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Secured Creditor's Loan Equitably Subordinated; Loan Found to Benefit Lender, Not Debtor

In a harshly worded decision, a federal bankruptcy judge concluded that a syndicated loan product was so one-sided in favor of the lender as to "shock the conscience" of the court. The judge therefore equitably subordinated the secured lender's claim. See *In re Yellowstone Mountain Club, LLC*, No. 08-61570, 2009 WL 1324950 (Bankr. D. Mont. May 12, 2009).

Yellowstone Mountain Club

The case arose out of the financing of the Yellowstone Mountain Club. A gentleman by the name of Mr. Blixseth traded some Montana timberland with the federal government and came to control at least 13,500 formerly federal acres adjacent to Yellowstone Park. His goal was to turn this land into a private ski resort.

Having found a few buyers for lots at "pre-development" prices, and some Class B equity investors, Yellowstone Mountain Club, LLC (the "Club") was in business but operating mostly at losses from 2002-2004. In 2005, a branch of Credit Suisse in the Cayman Islands sold Mr. Blixseth on a new syndicated loan product.

Bankruptcy Judge Ralph B. Kirscher described the transaction as follows:

In 2005, Credit Suisse was offering a new financial product for sale. It was offering the owners of luxury second-home developments the opportunity to take their profits up front by mortgaging their development projects to the hilt. Credit Suisse would loan the money on a non-recourse basis, earn a substantial fee, and sell off most of the credit to loan participants. The development owners would take most of the money out as a profit dividend, leaving their developments saddled with enormous debt. Credit Suisse and the development owners would benefit, while their developments – and especially the creditors of their developments – bore all the risk of loss. This newly developed syndicated loan product enriched Credit Suisse, its employees and more than one luxury development owner, but it left the developments too thinly capitalized to survive. Numerous entities that received Credit Suisse's syndicated loan product have failed financially

Credit Suisse ... and [those] on the Credit Suisse team only earned fees if they sold loans. Credit Suisse thus devised a loan scheme whereby it encouraged developers of high-end residential resorts, such as Blixseth, to take unnecessary loans. The higher the loan amount, the fatter the fee to Credit Suisse. This program essentially puts the fox in charge of the hen house and was clearly self-serving for Credit Suisse.

Mr. Blixseth caused the Club to loan \$209 million of the loan proceeds to another entity he controlled, thereby cashing out his developer's equity, phantom as it proved.

Bankruptcy Filing

Credit Suisse, having syndicated its loan "applying a new valuation methodology [relying] almost exclusively on ... future financial projections, even though such projections bore no relation to ... historical or present reality," proposed to increase the Club's debt load by at least six times and "could not have believed under any set of circumstances that [the Club] could service such an increased debt load."

The Club filed bankruptcy in 2008.

Bankruptcy Judge Kirscher found the following:

The only plausible explanation for Credit Suisse's actions is that it was simply driven by the fees it was extracting from the loans it was selling, and letting the chips fall where they may. Unfortunately for Credit Suisse, those chips fell in this Court with respect to the Yellowstone Club loan. The naked greed in this case combined with Credit Suisse's complete disregard for the Debtors or any other person or entity who was subordinated to Credit Suisse's first lien position, shocks the conscience of this Court. While Credit Suisse's new loan product resulted in enormous fees to Credit Suisse in 2005, it resulted in financial ruin for several residential resort communities. Credit Suisse lined its pockets on the backs of the unsecured creditors.

As a result, Bankruptcy Judge Kirscher equitably subordinated Credit Suisse's secured claim to most of the other debt in the Club's bankruptcy.

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