Developments in Business Bankruptcy Cases

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Synopsis

Recent bankruptcy opinions may alter the business lending landscape and add to the list of issues to be considered prior to extending loans.

Court Opinions That May Make the Decision to Lend **More Difficult**

In re TOUSA, INC.

Case Brief

- **Facts**:
  - TOUSA ("Debtor") owed money to its Original Lenders.
  - TOUSA paid off this debt with proceeds of a loan provided by its New Lenders.
  - The New Lenders' loan was secured by all of TOUSA's subsidiaries' ("Conveying Subsidiaries") assets.
  - After TOUSA and its subsidiaries declared bankruptcy, the bankruptcy court avoided the liens as fraudulent transfers, and ordered the Original Lenders to disgorge most of the money received from Debtor's because the transfer of the liens was for the benefit of the Original Lenders.

  Issues Considered By The Eleventh Circuit:
  - Did the bankruptcy court error when it held that the Conveying Subsidiaries did not receive reasonably equivalent value in exchange for the liens?
  - Were the Original Lenders entities "for whose benefit" the Conveying Subsidiaries transferred the liens?
- **The Eleventh Circuit's Holding**:
  - The Conveying Subsidiaries did not receive reasonably equivalent value in exchange for the liens to secure loans used to pay a debt owned only by TOUSA.
  - The Original Lenders constituted entities "for whose benefit" the liens were transferred because under the loan agreement, the proceeds of the loans secured by the liens were to be transferred to the Original Lenders as payment of the Original Lenders' settlement.

Rule

- **Lenders should exercise caution when accepting re-payment of a loan with proceeds of a new loan, when the new loan is secured by a lien on the borrower's subsidiaries' assets.**

In re Mirant Corp.

Case Brief

- **Facts**:
  - Lender financed the Debtor's acquisition of nine power islands to expand its European operations.
  - As part of the financing arrangement Debtor's parent company ("Guarantor") guaranteed the amounts owned by Debtor.
  - After the power island deal fell through, the Guarantor begin making payments pursuant to the Guaranty. Soon after, the Guarantor sought bankruptcy protection.
  - Guarantor sued the bank to avoid the Guaranty and to recover the funds Guarantor paid pursuant to the Guaranty.
  - Lender moved for Summary Judgment arguing that because all unsecured creditors were paid in full, the trustee lacked standing.
- **Issue**:
  - Does a trustee have standing to avoid a fraudulent transfer when the unsecured creditors are satisfied in full?
- **Holding**:
  - Yes; to the extent that a trustee's successful avoidance of fraudulent transfers will benefit the bankruptcy estate, the trustee has standing to avoid transfers that injured the estate.
- **Reasoning**:
  - A trustee's avoidance rights are triggered at the time of filing. The rights persist until avoidance will no longer benefit the estate under § 550.
  - Avoiding a fraudulent transfer may benefit the estate even though the assets gathered are not for the sole benefit of unsecured creditors (e.g., if the assets are to be used to pay administrative claims out of the bankruptcy estate, then avoiding the fraudulent transfer will benefit the estate).

Rule

- **A transfer may be avoided even if the Debtor's unsecured creditors have been paid in full.**

Court Opinion That May Make the Decision to Lend **Easier**

RadLAX Gateway Hotel, LLC

v.

Amalgamated Bank

Case Brief

- **Facts**:
  - Debtors obtained a secured loan from an investment fund ("Lender").
  - After becoming insolvent, the Debtors filed for Chapter 11 bankruptcy and sought to confirm a "cramdown" bankruptcy plan over the Lender's objections.
  - The plan proposed to auction substantially all of the Debtors' property, and use the proceeds to repay the Lender.
  - Under the proposed auction procedures, the Lender would not be permitted to bid for the property using the debt it was owed to offset the purchase price (known as "credit-bidding").
  - The Bankruptcy Court denied the Debtors' bid procedures motion and the Seventh Circuit court affirmed.
    - (Note: there was a split in US circuit courts of appeals decisions relating to the ability of a secured creditor to credit bid in connection with sales of encumbered assets under a plan of reorganization or liquidation. One line of courts held that secured creditors were allowed to credit-bid in connection with sales of encumbered assets under a plan of reorganization or liquidation while another line of courts held that secured creditors were not allowed to credit-bid in connection with sales of encumbered assets under a plan of reorganization or liquidation).
- **Issue**:
  - Can a Chapter 11 bankruptcy plan be confirmed over the objection of a secured creditor if the plan provides for the sale of collateral free and clear of the creditor's lien, but does not permit the creditor to "credit-bid" at the sale?
- **The Supreme Court's Holding**:
  - No; Secured creditors are permitted to credit-bid if the plan provided for the sale of the creditors' collateral free and clear of liens.

Rule

- **Lenders are permitted to "credit-bid" if the Debtor's plan provides for the sale of the collateral free and clear of the lender's lien.**