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First Lien/Second Lien Intercreditor Agreements

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Summary of Key Cases

TABLE OF CASES

***Beatrice Foods Co. v. Hart Ski Mfg. Co., Inc. (In re Hart Ski Mfg. Co., Inc.)*, 5 B.R. 734 (Bankr. D. Minn. 1980):**

In re Hart Ski was the first published case addressing the enforceability of an intercreditor agreement under § 510(a) of the Bankruptcy Code.

FACTS: Several years before Hart Ski filed for bankruptcy, the debtor's former owner sold its business and agreed to provide certain purchase-money financing. The purchaser simultaneously entered into a working capital facility to allow it to operate the business. An intercreditor agreement between the seller and new lender expressly subordinated the purchase-money financing to the working-capital facility.

- The intercreditor agreement provided that the subordinated lender could not "assert, collect or release . . . any collateral securing the indebtedness or enforce any security agreements, real estate mortgages, lien instruments, or other encumbrances securing said indebtedness except that it may collect regularly scheduled payments when and as due" without the senior lender's consent.

- The agreement also contained a provision requiring that any money received by the subordinated lender be turned over to the working-capital lender until the working-capital facility was paid in full.

- The agreement did not contain provisions waiving certain of the subordinated lender's rights in the event of the borrower's insolvency.

Following the bankruptcy filing, the subordinated lender filed a motion for adequate protection. The working-capital lender opposed the motion, arguing that the intercreditor agreement prohibited the subordinated lender from enforcing its rights before the working capital facility was paid in full and therefore prohibited the filing of the adequate protection motion.

HOLDING:

- The Bankruptcy Court refused to grant summary judgment, holding that although Congress clearly intended § 510(a) to allow creditors to contractually alter priority of payment among themselves, "[t]here is no indication that Congress intended to allow creditors to alter, by a subordination agreement, the bankruptcy laws unrelated to distribution of assets."

- "The intent of § 510(a) (subordination) is to allow the consensual and contractual priority of payment to be maintained between creditors among themselves in a bankruptcy proceedings."

- "The Bankruptcy Code guarantees each secured creditor certain rights, regardless of subordination. These rights include the right to assert and prove its claim, the right to seek Court ordered protection for its security, the right to have a stay lifted under proper circumstances, the right to participate in the voting for confirmation or rejection of any

plan of reorganization, the right to object to confirmation, and the right to file a plan where applicable. The above rights and others not related to contract priority of distribution pursuant to Section 510(a) cannot be affected by the actions of the parties prior to the commencement of a bankruptcy case when such rights did not even exist. To hold that, as a result of a subordination agreement, the 'subordinor' gives up all its rights to the 'subordinee' would be totally inequitable."

- The court explained that no prejudice is shown the senior lender if the subordinated lender is allowed to assert its claim because any money collected by the subordinated lender must be held in trust by the subordinated lender and paid to the senior lender until the senior lender is paid in full.

Title search: First Lien/Second Lien Intercreditor Agreements

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