

## Alert

### Seventh Circuit Affirms Lessor's Priming of DIP Lender's Lien

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A super-priority debtor-in-possession (“DIP”) lender with a lien on all of the debtor’s assets has no “better claim” to a Chapter 11’s debtor’s leased property than the lessor, held the U.S. Court of Appeals for the Seventh Circuit on Jan. 11, 2018. *Banco Panamericano, Inc. v. City of Peoria*, 2018 U.S. App. LEXIS 738, \*12 (7th Cir. Jan. 11, 2018). According to the court, the “lease between [the debtor] and [the lessor] gave [the debtor] no post-termination property interest” in “installations or structures” on the debtor’s property. *Id.* Affirming the dismissal of the lender’s complaint, the Seventh Circuit reasoned that “[n]o matter the priority of the bank’s claim to [the debtor’s] assets, . . . the bank has no claim to the [lessor’s] assets.” *Id.*, at \*3.

#### Facts

The debtor and a city had signed a lease on the city’s landfill, allowing the debtor to construct and operate a gas conversion project. Under the terms of the lease, when it ended, “the city had an absolute right to retain, at no cost, the ‘structures’ and ‘below-grade installations and/or improvements’ that [the debtor] installed” on the property. The debtor filed a Chapter 11 petition several years later and obtained DIP financing from a bank (“Bank”) secured by liens on all of the debtor’s assets. *Id.* at \*2. When the debtor defaulted on its loan from the Bank, the city terminated its lease, electing to “retain the structures and installations as provided in the lease.” *Id.* The city also continued to use the underlying property when the Bank sued it for “unjust enrichment.” *Id.* at \*3. According to the Bank, it had a better claim to the property because it had a lien on all of the debtor’s assets with a “super-priority” bankruptcy court order. The district court granted the city’s motion for summary judgment dismissing the complaint.

#### The Seventh Circuit

The Seventh Circuit stressed that the Bank had “no claim” to the city’s assets. The terms of the lease made the “disputed structures and installations” the city’s property, with “no post-termination property interest” retained by the debtor.

The court conceded the Bank’s “super-priority” claim under Bankruptcy Code § 364(c)(1), which conferred a “priority in right of payment over any and all other unsecured obligations, liabilities and indebtedness of the Debtor” plus “administrative expenses and certain priority claims.” *Id.* at \*5. Still, the court stressed, the Bank “could not have obtained any rights greater than those held by [the debtor] even with a super-priority interest” in the debtor’s assets. *Id.* at \*7.

The Bank’s sole claim was one for unjust enrichment under applicable Illinois law. In essence, it argued that it had a “better claim to the gas collection system” on the debtor’s property than the one asserted by the defendant city. *Id.* at \*8-9. But “the lease gave [the debtor] no post-termination interest in the disputed property at all, only obligations,” reasoned the Court of Appeals. *Id.*, at \*9. “[T]he property in question — pipes, pumps, electrical lines, etc. — was . . . installed on public property, the city landfill

and removal would pose obvious practical problems, at least without the city’s consent.” *Id.* Most important, “the lease gave the [lessor city] the right to retain the structures and installations at no cost no matter how the lease terminated.” *Id.*, at \*11. That “property automatically passed to [the lessor city] 90 days after termination of the lease ..., which happened years before” the Bank sued. *Id.*, at \*12. Upon termination of the lease, it “allowed for no situation in which [the debtor] could have kept the structures and installations,” meaning that the Bank’s “security interest could not reach” them. *Id.*

### **Comment**

This case confirms the need for effective diligence by a lender before making a DIP loan. A priority lien on a debtor’s property turns on the nature of the debtor’s property interest. Is it terminable? If so, by whom? If so, when? The lender here apparently failed to analyze the debtor’s lease. It learned of the nature of its collateral only during later litigation.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or the author.

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