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CHAPTER 11 BANKRUPTCY AND CRAMDOWNS: ADOPTING A CONTRACT RATE APPROACH

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ABSTRACT—One of the key issues in many Chapter 11 bankruptcy proceedings is the determination of a proper interest rate that debtors must pay on secured claims existing at the time of a bankruptcy reorganization. For decades, the courts of appeals have debated the proper cramdown determination approach. In *Till v. SCS Credit Corp.*, the Supreme Court addressed the issue in a Chapter 13 context and produced a plurality opinion endorsing a formula approach. However, there is not yet a consensus for Chapter 11 cases. This Comment argues for the adoption of a "contract rate" approach whereby courts will default to the prepetition contract rate of the secured claim. I believe this method adequately protects the creditor's lending expectations while also helping to limit the debtor-in-possession's evidentiary costs. Unlike the other approaches, the contract rate approach is more objective; courts will no longer have to consider evidential material to make a determination of the appropriate risk premiums or the existence of an "efficient market." More importantly, the contract rate approach will provide predictability and greater fairness by ensuring that similar cases are treated alike. Overall, the ease, simplicity, and fairness of the contract rate approach make it a better option.

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INTRODUCTION

Bankruptcy law in the United States offers benefits to both debtors and creditors. Debtors are able to exit bankruptcy with a fresh start, while creditors generally get at least a portion of their money back.[1] Ideally, bankruptcy provides a quick and orderly forum for debtors to pay creditors

[1] *See* Saul P. Levmore, *Fables, Sagas, and Laws*, 33 WILLAMETTE L. REV. 485, 488–89 (1997) (describing the "fresh start" policy behind bankruptcy law); *see also* Williams v. U.S. Fid. & Guar. Co., 236 U.S. 549, 554–55 (1915) (contending that the purpose of bankruptcy law is to provide the debtor with a fresh start); *In re* Sullivan, 195 B.R. 649, 654 (Bankr. W.D. Tex. 1996) (asserting that a "fresh start" for the debtor is "the essence of modern bankruptcy law" and one of its "primary purposes" (quoting *In re* Willis, 189 B.R. 203, 205 (Bankr. N.D. Okla. 1995))). Of course, this debtor-focused purpose is balanced against another important interest advanced by the bankruptcy system: providing recovery for creditors. *See* Michael Bentley Guss, Comment, Ohio v. Kovacs*: The Conflict Between Federal Bankruptcy Laws and State Environmental Regulations*, 34 AM. U. L. REV. 1263, 1269 (1985) ("[T]he creditors will receive at least part of the debt owed to them.").

So who can be a debtor in bankruptcy? Precedents reveal that debtors in bankruptcy include "mom and pop" businesses, movie and pop stars, politicians, airlines, large investment banks, car manufacturers, etc.—the list is endless. *See, e.g.*, *In re* Tex. Rangers Baseball Partners, 434 B.R. 393 (Bankr. N.D. Tex. 2010) (describing the bankruptcy filing of the owners of the Texas Rangers).

and resolve their debts. Yet, in reality, many bankruptcies are drawn into long and expensive litigation. One of the most frequently argued economic issues in bankruptcy court is the proper interest rate that debtors must pay on secured claims existing at the time of a bankruptcy reorganization.[2] When the parties to the bankruptcy proceeding fail to settle upon an interest rate, the bankruptcy judge must determine and calculate an appropriate cramdown interest rate.

Due to the tremendous financial impact a cramdown can have on all parties, cramdown interest rates have become "one of the most litigated, contentious and costly squabbles in the bankruptcy arena."[3] The existence of cramdown interest rates stems from the bankruptcy court's "cramdown" power, which is the court's ability to confirm the reorganization plan proposed by a debtor-in-possession[4] despite the objections of creditors.[5] The judicial determination of this cramdown interest rate is often a decision that has significant financial ramifications both for the debtor-in-possession and for creditors.[6] The cramdown interest rate may determine whether a reorganization plan is feasible, and it is certainly a key factor that secured creditors consider when deciding whether or not to accept a proposed reorganization plan. Yet, oddly enough, despite the large number of Chapter 11 bankruptcies each year[7] and the need for predictability and certainty,

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[2] *See* Chaim J. Fortgang & Thomas Moers Mayer, *Valuation in Bankruptcy*, 32 UCLA L. REV. 1061, 1119 (1985) ("Few bankruptcy issues have met with as much confusion as the determination of a proper discount rate.").

"[A] 'secured claim' is a right to payment that can be enforced either against property in which the debtor has an interest or against a claim of the debtor that is subject to setoff." Eugene R. Wedoff, The Treatment of Claims in Consumer Bankruptcies 3 (1999), http://www.ilnb.uscourts.gov/Judge/Wedoff/Outlines/Treatment_of_Claims.pdf.

[3] C.B. Reehl & Stephen P. Milner, *Cram-Down Interest Rates: The Quest Continues*, 30 CAL. BANKR. J. 15, 19 (2009); *see* Jason A. Pill, *Un*Till *the Footnote Was Written: The Effect of* Till v. SCS Credit Corporation *on 11 U.S.C. § 1129(B)(2)*, 26 EMORY BANKR. DEV. J. 267, 268 (2010).

[4] Upon the filing of a voluntary petition for relief under Chapter 11 or, in the context of an involuntary case, upon the entry of an order for relief, the debtor automatically assumes an identity as "debtor in possession." 11 U.S.C. § 1101(1) (2006).

The debtor-in-possession keeps possession and control of its assets while undergoing reorganization under Chapter 11. Debtor-in-possession status ends when a plan of reorganization is confirmed, the bankruptcy case is dismissed or converted, or a Chapter 11 trustee is appointed. *See* § 1104(a) (describing the relatively limited circumstances in which a trustee may be appointed to manage the debtor's affairs); §§ 1107–1108 (describing the rights and powers of the debtor-in-possession).

[5] Chapter 11 grants "cramdown" powers to the bankruptcy court. *See* § 1129(b)(1).

[6] *See* Monica Hartman, Comment, *Selecting the Correct Cramdown Interest Rate in Chapter 11 and Chapter 13 Bankruptcies*, 47 UCLA L. REV. 521, 522 (1999) ("The interest rate that debtors must pay on claims existing at the time of a bankruptcy reorganization is arguably the most debated economic issue in bankruptcy litigation.").

[7] *See Annual Business and Non-Business Filings by Year (1980-2011)*, AM. BANKR. INST., http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&CONTENTID=65139&TEMPLATE=/CM/ContentDisplay.cfm (last visited May 5, 2012) (presenting bankruptcy filing statistics from 1980 to 2011).

bankruptcy courts continue to struggle with the proper determination of the cramdown interest rate a debtor-in-possession must pay on secured claims.

For decades, the courts of appeals have debated the proper approach to determining cramdown rates.[8] In *Till v. SCS Credit Corp.*,[9] a 2004 case, the Supreme Court addressed the issue and produced a plurality opinion endorsing a formula approach.[10] Yet because *Till* failed to produce a majority opinion and involved cramdown rates in the Chapter 13 context,[11] the extent of its precedential value in Chapter 11 cases is limited. Ultimately, *Till* has left practitioners and courts with little guidance as to the proper method of determining Chapter 11 cramdown interest rates.[12] Recent developments suggest several cramdown approaches are being applied to Chapter 11 cases, such as the efficient market and formula approaches; however, none yet commands a clear consensus.

After reviewing the various methods for determining cramdown rates, this Comment argues for the adoption of a contract rate approach. Under the contract rate approach, courts will default to the contract rate of the secured claim. This method will serve the interests of both the debtor-in-possession and the creditor better than the approaches that are currently being used because it adequately protects the creditor's lending expectations while also helping to limit the debtor-in-possession's evidentiary costs. Unlike the other approaches, the contract rate approach is objective; courts will no longer have to consider evidentiary material to make a determination of the appropriate risk premiums or the existence of an efficient market.[13] More importantly, the contract rate approach will provide predictability and greater fairness by ensuring that similar cases are treated alike. Overall, the ease, simplicity, and fairness of the contract rate approach make it a better option.

Part I reviews the legal background of the bankruptcy court and Chapter 11 bankruptcies. Part II discusses the importance of cramdown interest rates and examines the judicial approaches employed prior to *Till*.

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[8] *See* April E. Kight, Recent Development, *Balancing the Till: Finding the Appropriate Cram Down Rate in Bankruptcy Reorganizations After* Till v. SCS Credit Corporation, 83 N.C. L. REV. 1015, 1015 (2005).

[9] 541 U.S. 465 (2004).

[10] *See infra* Part III.

[11] Unless otherwise indicated, all code, chapter, section, and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101–1532 (2006), and the FED. R. BANKR. P. 1001–9037.

[12] A Chapter 11 debtor may also be an individual and not necessarily a corporation. However, for the purposes of this Comment, I will narrow the scope of Chapter 11 debtors to corporations or other business entities. In the Chapter 11 individual-debtor context, it may make sense for the courts to follow the approach adopted by *Till*'s plurality. The rationale for this lies in the inherent differences between individuals and corporations.

[13] For examples of the efficient market approach (and its concomitant interpretive difficulties), see Bank of Montreal v. Official Comm. Of Unsecured Creditors (*In re* Am. Homepatient, Inc.), 420 F.3d 559 (6th Cir. 2005), and *In re* Nw. Timberline Enters., Inc., 348 B.R. 412 (Bankr. N.D. Tex. 2006).

Part III analyzes the cramdown controversy and the impact of *Till* on Chapter 11 cases. It also discusses the precedential value of *Till* and concludes that it is instructive for Chapter 11 bankruptcies but not binding on lower courts. Part IV examines the efficient market approach and its connection with debtor-in-possession financing. It explains why and concludes that debtor-in-possession financing cannot equate to an "efficient market" for cramdown purposes. Finally, Part V proposes the contract rate approach for determining cramdown interest rates in Chapter 11 bankruptcies. It explains why a contract rate approach is preferable to other approaches that courts have adopted.

I. LEGAL BACKGROUND OF CHAPTER 11 BANKRUPTCY

Pursuant to its constitutional power "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States," Congress has established a federal bankruptcy system.[14] Although a negative stigma has been attached to bankruptcy, the current American bankruptcy system offers benefits to both debtors and creditors by offering relief to debtors while protecting the interest of creditors.

In 1978, Congress passed the Bankruptcy Reform Act,[15] a comprehensive piece of bankruptcy legislation that continues to serve as the uniform federal law governing all bankruptcy cases in the United States. One of the most notable features of the 1978 Bankruptcy Reform Act was the creation of a strong business reorganization section in Chapter 11 that dealt with how businesses file a bankruptcy petition and reorganize.

The goal of any Chapter 11 bankruptcy is to "strike a balance between the need of a corporate debtor in financial hardship to be made economically sound and the desire to preserve creditors' and stockholders' existing legal rights to the greatest extent possible."[16] In effect, a Chapter 11 bankruptcy embodies a policy that favors enabling "a debtor to continue to operate and to reorganize or sell its business as a going concern rather than simply to liquidate a troubled business."[17] It is thought that continuing to

[14] U.S. CONST. art. I, § 8, cl. 4.

[15] Pub. L. No. 95-598, § 402, 92 Stat. 2549, 2682 (codified as amended in scattered sections of 11 and 28 U.S.C.).

[16] *See* 7 COLLIER ON BANKRUPTCY ¶ 1100.01, at 1100-4 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009); *see also* Edward H. Levi & James Wm. Moore, *Bankruptcy and Reorganization: A Survey of Changes. III*, 5 U. CHI. L. REV. 398, 405 (1938) ("The problem of reorganization is primarily a problem of how a failing debtor may be made economically sound and at the same time the rights, insofar as they exist, of the creditors and stockholders be preserved under a fair arrangement.").

[17] 7 COLLIER, *supra* note 16. By comparison, in Chapter 7 bankruptcy, the business ceases operations and a trustee is appointed to sell all of its assets. The proceeds are then distributed to its creditors with any residual amount returned to shareholders and owners. *See* 6 COLLIER, *supra* note 16, ¶ 700.01 (2010).

Under Chapter 11 bankruptcy, the debtor remains in control of day-to-day business operations as a debtor-in-possession and files a repayment plan with the bankruptcy court. A debtor-in-possession is

operate can generate greater value than liquidating the company.[18] The bankrupt company hopes to emerge from bankruptcy with a new capital structure that will put behind it the economic woes that brought the company into bankruptcy in the first place.

Under Chapter 11, a debtor-in-possession must file a repayment plan with the bankruptcy court and solicit creditors for acceptance and confirmation.[19] If the court accepts and confirms the plan, the debtor will continue to operate and pay its debts under the terms of the repayment plan. In many instances, however, reorganizations will not proceed so smoothly due to creditors' refusal to assent to the repayment plan. Congress, in drafting the Bankruptcy Code, anticipated this issue and created § 1129(b) to allow nonconsensual confirmation of a repayment plan. If the requirements of § 1129(b) are met, the court can confirm the plan despite creditors' objections; essentially, the repayment plan is "crammed down" upon the nonassenting creditors.[20]

II. CRAMDOWN INTEREST RATE AND METHODS OF CRAMDOWN DETERMINATION

"Cramdown" is a bankruptcy term used to describe the judicial power to confirm or modify a plan against the wishes of certain classes of interest or claim holders.[21] It is a powerful tool that allows the bankruptcy court to force dissenting classes of creditors, including those with both secured and unsecured claims, to accept the plan. Under a cramdown, the "dissenting classes are compelled to rely on difficult judicial valuations, judgments, and

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offered considerable discretion regarding the business' operation, constrained generally only by the business judgment rule. *See* 11 U.S.C. § 1107–1108 (2006) (establishing that a debtor is given the rights and powers of a Chapter 11 trustee). In the plan process, creditors may propose their own bankruptcy plan once the debtor's exclusivity period has expired. *See* § 1121(c); discussion *infra* Part II.

[18] 7 COLLIER, *supra* note 16 ("Continued operation may enable the debtor to preserve any positive difference between the going concern value of the business and the liquidation value.").

[19] *See* § 1129(a). The debtor-in-possession must also satisfy certain requirements regarding the repayment plan itself (e.g., priority of certain creditors).

[20] Courts use "cramdown," "cram down" and "cram-down" interchangeably. *See In re* Shat, 424 B.R. 854, 858 n.7 (Bankr. D. Nev. 2010). Although this section discusses the cramdown provision of Chapter 11, the language of other cramdown provisions, such as the cramdown provision in Chapter 13 scenarios, are essentially the same. Some courts have held that the reasoning regarding the determination of cramdown interest rates in one Chapter's cramdown is applicable to other Chapters as well. Nonetheless, the Supreme Court has been silent on this issue. *See* Till v. SCS Credit Corp., 541 U.S. 465 (2004).

[21] *See* David G. Epstein, *Don't Go and Do Something* Rash *About Cram Down Interest Rates*, 49 ALA. L. REV. 435, 438 (1998); Bruce A. Markell, *Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claim Classification*, 11 BANKR. DEV. J. 1, 2 (1995).

Note that certain provisions must be satisfied before a bankruptcy judge is allowed to apply a cramdown.

determinations."[22] However, to protect the interests of dissenting classes, § 1129(b) provides that the bankruptcy court must determine that the repayment plan is "fair and equitable" and not unfairly discriminatory to dissenting classes of creditors.[23]

To find a repayment plan fair and equitable, the bankruptcy court must ensure that the repayment plan accommodates secured creditors in one of three ways under § 1129(b)(2)(A).[24] The first possibility is that the plan proponent, usually the debtor-in-possession, may surrender the secured property by selling the property free of the lien and transferring the proceeds of the sale to the lien holder.[25] Another way to satisfy the fair-and-equitable requirement is by allowing the debtor-in-possession or plan proponent to give the creditor an "indubitable equivalent" of its claim.[26] Finally, under § 1129(b)(2)(A)(i), the plan proponent may seek to satisfy the claim in full by issuing the secured creditor a new secured note payable over a period of years, with interest, rather than a single payment on the effective date of the plan.[27] Unlike the other two options, this last option is the only one that results in the creditor's continued involvement with the company throughout the reorganization plan. And it has been the subject of much litigation and debate.

Under § 1129(b)(2)(A)(i), the plan proponent has the ability to essentially write a new loan for its secured creditors. According to the statute, the holder of a claim retains the lien on the property, but must receive "deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property."[28] In other words, the bankruptcy plan must provide for the creditor to receive interest, as well as cash equivalent to the value of the collateral securing the creditor's interest, as part of the future stream of payments. In 1988, the Supreme Court noted in *United Savings Ass'n v. Timbers of Inwood Forest*

[22] *In re* 500 Fifth Ave. Assocs., 148 B.R. 1010, 1020 (Bankr. S.D.N.Y. 1993) (quoting *In re* 266 Wash. Assocs., 141 B.R. 275, 287 (Bankr. E.D.N.Y. 1992)). Bankruptcy valuation disputes generally occur over the valuation of debtor's assets or the secured creditor's collateral, which determines what portion of a creditor's claim will be secured rather than unsecured. *See* § 506 (discussing the role of valuation in bankruptcy).

[23] The primary focus under § 1129(b) is a repayment plan that embodies fairness and equity for dissenting secured creditors. *See* § 1129(b)(1). The bankruptcy judge is given discretion in evaluating the debtor's proposed use of the property, offer of adequate protection of the creditors, proposed borrowing, and any other business decisions under the business judgment rule. *See* § 363.

[24] Any one of the three methods will satisfy the fair-and-equitable requirement for secured creditors. *See* Arnold & Baker Farms v. United States (*In re* Arnold & Baker Farms), 85 F.3d 1415, 1420 (9th Cir. 1996); Wade v. Bradford, 39 F.3d 1126, 1129 (10th Cir. 1994).

[25] *See* 7 COLLIER, *supra* note 16, ¶ 1129.04[2][b], at 1129-125 to -127 (2012).

[26] *See id.* ¶ 1129.04[2][c], at 1129-127 to -138.1.

[27] *See id.* ¶ 1129.04[2], at 1129-120 (stating that the debtor "may satisfy the claim in full by giving the creditor a note in the amount of the secured claim secured by the same collateral").

[28] § 1129(b)(2)(A)(i)(II).

Associates, Ltd. that the "value, as of the effective date of the plan" language in the cramdown provision requires a present value analysis.[29]

Under a present value analysis, the bankruptcy court must ensure that the total stream of payments—or "deferred cash payments," in the words of the statute[30]—is set at a level sufficient to ensure the creditor receives the present value of its secured claim, even though it will receive that value over time. The deferred cash payments are discounted back to the present value of the claim at confirmation to ensure that the creditor receives disbursements of which the total present value equals or exceeds the amount of the secured claim.[31] To accomplish this, the deferred cash payments must include an interest rate, or "discount rate," which appropriately compensates the secured creditor for the fact that the value of its claim will be received over time rather than immediately.

For example, a creditor may have a claim of $50 secured by collateral of equal value. Common sense dictates that $50 today is worth more than $50 paid over a span of seven years; this is the reason why loans often require interest payments in addition to payments of principal. In sum, the $50 is reduced by inflation, risk, and the loss of opportunity to invest the money elsewhere.[32]

To compensate the creditor for the time value of money that is lost by the deferred repayment process, the bankruptcy courts apply an interest rate to the debtor-in-possession's deferred payments to creditors. However, the proper way to determine an appropriate interest rate has been the subject of much debate.

Although the Supreme Court has acknowledged the need to apply an interest rate to deferred payments to cramdown creditors,[33] it has not yet ruled on an appropriate method of determining an interest rate for Chapter 11 cramdown situations. The Bankruptcy Code is also silent on this issue. As a result, courts have endorsed a variety of approaches to determining the appropriate interest rate in Chapter 11 cramdowns.[34] Courts have used many different types of rates and methods to obtain rates, but there is not yet a definitive answer. The next section discusses four different approaches that have emerged over the years. These four approaches—each with its own

[29] 484 U.S. 365, 377 (1988). The present value analysis ensures that the creditor receives an amount that equals or is greater than the present value of the collateral at the confirmation date.

[30] § 1129(b)(2)(A)(i)(II).

[31] Rake v. Wade, 508 U.S. 464, 472 n.8 (1993).

[32] *See* 2 GRANT GILMORE & DAVID GRAY CARLSON, GILMORE AND CARLSON ON SECURED LENDING: CLAIMS IN BANKRUPTCY § 31.03 (2d ed. 2000).

[33] *See* Till v. SCS Credit Corp., 541 U.S. 465, 469 (2004); *Rake*, 508 U.S. at 465–66.

[34] *See* Bruce H. White & William L. Medford, *Finding the Proper Chapter 11 Cramdown Rate of Interest: Pick Your Experts Carefully*, AM. BANKR. INST. J., Dec./Jan. 2000, at 20 (discussing various methods used by the courts to establish an appropriate Chapter 11 cramdown interest rate or discount rate); *see also* 2 GILMORE & CARLSON, *supra* note 32 (noting there are at least forty-eight different approaches taken by courts).

advantages and weaknesses—are: (1) the formula approach, (2) the coerced loan approach, (3) the presumptive contract approach, and (4) the cost-of-funds approach.[35]

A. Formula Approach

The formula approach requires a court to start with a base rate, such as the national prime rate,[36] and then to increase it to account for any borrower-specific (or situation-specific) risk of nonpayment or default, typically between 1% and 3%.[37] For example, a court applying the formula approach may accept a proposed cramdown interest rate of 8% if the plan proponent can establish a national prime rate of 6.2% and a reasonable risk-adjustment rate of 1.8%. Most courts peg the base rate to the national prime rate of return.[38]

Although supporters of the formula approach emphasize its objectivity and ease of use,[39] many courts and commentators still question whether it adequately compensates creditors. Given the recent economic downturn, U.S. banks are tightening standards for lending.[40] Borrowing has become more costly for both consumers and companies that are hoping to make it out of the recession.[41] Under the formula approach, a debtor-in-possession has the opportunity "to refinance at a rate generally unobtainable by any like situated borrower."[42] Common borrowing practices dictate that a prime or risk-free rate is typically given only to the best borrowers; it does not

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[35] *See* Bank of Montreal v. Official Comm. of Unsecured Creditors (*In re* Am. Homepatient, Inc.), 420 F.3d 559, 566 (6th Cir. 2005); *In re* Till, 301 F.3d 583, 589–93 (7th Cir. 2002).

[36] *Till*, 541 U.S. at 479 ("[T]he national prime rate . . . reflects the financial market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower . . . ."). Other possible base rates courts could choose—depending on the type of loan, its duration, and lender circumstances—include LIBOR (London Interbank Offering Rate), Federal Home Loan Bank District Cost of Funds Index (COFI), and U.S. Treasuries. "Financial markets generally consider these to be 'risk-free' or nearly risk-free rates." Ronald F. Greenspan & Cynthia Nelson, *"Un*Till*" We Meet Again: Why the* Till *Decision Might Not Be the Last Word on Cramdown Interest Rates*, AM. BANKR. INST. J., Dec./Jan. 2005, at 48, 49.

[37] *Till*, 541 U.S. at 480.

[38] A prime rate of return is usually a reference to the interest rate used by banks. It is usually the rate of interest at which banks lend to preferred customers, such as those with strong credit histories. *See* Greenspan & Nelson, *supra* note 36, at 49 (defining the "national" prime rate, published by the *Wall Street Journal*, "as the base rate on corporate loans posted by at least 75 percent of the nation's 30 largest banks").

[39] Courts can readily and objectively ascertain the national prime rate. *See Till*, 541 U.S. at 479. Beyond objectivity and simplicity, some supporters have argued that the formula approach instills predictability because risk-free interest rates tend not to fluctuate drastically and thus allow creditors to better establish contract rates and hedge any lending risks.

[40] *See* Dan Wilchins & Emily Kaiser, *U.S. Banks Tighten Lending Standards*, N.Y. TIMES, Jan. 7, 2008, http://www.nytimes.com/2008/01/17/business/worldbusiness/17iht-lend.4.9295180.html.

[41] *See id.*

[42] Michael Elson, Note, *Say "Ahhh!": A New Approach for Determining the Cram Down Interest Rate After* Till v. SCS Credit, 27 CARDOZO L. REV. 1921, 1927 (2006).

follow that a bankrupt debtor-in-possession would (or should) be given that same rate. It is one thing for a bank that is in the business of lending to determine the interest rate, but it is another for a court to unsystematically establish one. Another concern that arises involves the determination of a risk premium. The formula approach takes into account the risk specific to each debtor-in-possession's reorganization plan, but translating these risks into nominal percentages is certainly more of a subjective challenge than an objective one.

B. Coerced Loan Approach

Another approach endorsed by a number of courts is the coerced loan approach.[43] Under this approach, the court sets the cramdown interest rate at the level the creditor would have obtained if it had "foreclosed [on the loan] and reinvested the proceeds in loans of equivalent duration and risk."[44] The bankruptcy court considers such factors as the payout period, the quality of the security, and the risk of future default.[45] In addition, the coerced loan approach relies on evidence from actual credit markets. This approach attempts to put the creditors in the place they would have been in had they received the value of their claim and reloaned the funds in the open market.[46] It assumes that the best way to determine the appropriate stream of future payments is by comparison to what the lender would charge in the open market for a loan of similar duration and risk as to the "new" post-cramdown loan.[47]

For example, assume that the debtor-in-possession borrows $1 million to buy an office building, with the building itself as collateral. Under the terms of the loan, the prepetition contract interest rate is 10%, whereas the postpetition comparable market rate is 14%. Subsequently, the debtor-in-possession fails to make its loan payments and files for bankruptcy. Under a coerced loan approach, the bankruptcy court will force the debtor-in-possession into a new loan of $1 million at a cramdown interest rate of 14%, which is the rate for a comparable loan in the market.

The coerced loan approach has several limited advantages. First, the coerced loan prevents the debtor-in-possession from obtaining the windfall

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[43] *See, e.g.*, GMAC v. Jones, 999 F.2d 63, 67 (3rd Cir. 1993); United States v. Arnold, 878 F.2d 925, 930 (6th Cir. 1989); United States v. Neal Pharmacal Co., 789 F.2d 1283, 1289 (8th Cir. 1986); United States v. S. States Motor Inns, Inc. (*In re* S. States Motor Inns, Inc.), 709 F.2d 647, 653 (11th Cir. 1983); Memphis Bank & Trust Co. v. Whitman, 692 F.2d 427, 431 (6th Cir. 1982).

[44] Koopmans v. Farm Credit Servs. of Mid-Am., ACA, 102 F.3d 874, 875 (7th Cir. 1996) (discussing the coerced loan approach as one of multiple approaches to the cramdown subject).

[45] *See* Travelers Ins. Co. v. Bryson Props., XVIII (*In re* Bryson Props., XVIII), 961 F.2d 496, 500 n.4 (4th Cir. 1992).

[46] *See* Thomas R. Fawkes & Steven M. Hartmann, *Revisiting* Till*: Has a Consensus Emerged in Chapter 11s?*, AM. BANKR. INST. J., Jul./Aug. 2008, at 28, 28.

[47] *See id.*

opportunities that the formula rate might give. The most obvious windfall is allowing the debtor-in-possession potentially to refinance at a lower interest rate than the current market or original contract rate, essentially rewarding him for entering bankruptcy. Second, the coerced loan approach protects the creditor's expectations of lending in the open market.

Yet the coerced loan approach is open to the criticism that no actual market exists for either the cramdown loan or a similar loan to a debtor-in-possession. Several other concerns are raised in the criticism of the coerced loan approach.[48] One is the lack of an equity cushion for the expected depreciation of the collateral. Lenders, when lending to a borrower, almost universally require some sort of equity cushion.[49] However, in most cramdown situations, there is no equity cushion because the bankruptcy court forces the lender to make a new loan equal to the value of the collateral plus interest.[50] The lack of any equity cushion exposes the creditor to an additional default risk.

Even though there are primary and secondary lending markets for debt instruments created in Chapter 11 reorganizations that may yield reasonably accurate interest rates,[51] there is also concern about whether an actual market can be replicated under the unique features of a Chapter 11 bankruptcy.[52] Certain costs, such as monitoring costs, are not incorporated into the actual markets the bankruptcy courts look to when determining an appropriate cramdown interest rate under the coerced loan theory.[53] If a market does not exist for a particular loan, then "the policies behind reorganization are significantly impacted."[54] Critics of the coerced loan approach also argue that any market rate will include a lender's profit margin, which is not part of the Bankruptcy Code's definition of a

[48] *See* John K. Pearson et al., *Ending the Judicial Snipe Hunt: The Search for the Cramdown Interest Rate*, 4 AM. BANKR. INST. L. REV. 35, 44–47 (1996); *see also* Fleet Fin., Inc. v. Ivey (*In re* Ivey), 147 B.R. 109, 114–16 (discussing the problems with the coerced loan approach).

[49] The debtor's "equity" in property securing a debt is the amount by which the market value of the property exceeds the amount of the debt. An equity cushion exists when the debtor has sufficient equity in the collateral to protect against its depreciation and the accrual of interest and charges. For example, a debtor may place as collateral real property worth $55,000 for a $50,000 loan. However, secured claims in bankruptcy proceedings are often valued at a similar or the same value as the collateral and therefore lack an equity cushion. *See* 11 U.S.C. § 506(a) (2006); GMAC v. Jones, 999 F.2d 63, 68 (3rd Cir. 1993).

[50] *See* § 506(a). As under § 506(a), if a creditor's claim is treated as a secured claim to the extent of the value of the estate's interest in the property, by definition there is no equity cushion because no excess of the value of the property over the amount of the debt exists.

[51] *Cf.* Till v. SCS Credit Corp., 541 U.S. 465, 476 n.14 (2004) (noting that there are a number of commercial lenders' websites that offer to loan to companies in Chapter 11 proceedings).

[52] For example, the loan may be too large and the market may have shrunk for loans of the type proposed. *See* 7 COLLIER, *supra* note 16, ¶ 1129.05[2][c][ii][B], at 1129-152.

[53] Other expenses can include U.S. Trustee expenses and Creditor of Committee expenses. *See, e.g.*, 8 *id.* ¶ 1302.05, at 1302-29 (2010). Chapter 13 reorganizations do typically require a trustee that monitors and controls the debtor's assets. *See id.* ¶ 1302.03, at 1302-8 (2011).

[54] 7 *id.* ¶ 1129.05[2][c][ii][B], at 1129-152 (2009).

creditor's claim.[55] This may overcompensate the lender at the expense of the debtor-in-possession.[56]

C. Presumptive Contract Approach

Rather than looking at the market rate, the presumptive contract approach requires a court to begin with the prepetition contract rate on the presumption that the prebankruptcy interest rate on the loan is an accurate reflection of the lending market.[57] However, this presumption is rebuttable by either the secured creditor or the debtor-in-possession—who is unlikely to so rebut, given the likelihood that the cramdown is a product of the proposed plan—with persuasive evidence that a lower cramdown interest rate should apply based upon current market conditions or changes in the debtor-in-possession's risk profile.[58] However, the right to rebut the presumptive contract may be costly. "The debtor must obtain information about the creditor's costs of overhead, financial circumstances, and lending practices to rebut the presumptive contract rate."[59]

For example, similar to the hypothetical in the coerced-loan-approach scenario, assume that the debtor-in-possession borrows $1 million to buy an office building, which will serve as collateral. Prebankruptcy, the parties agree to a long-term loan with a contract interest rate of 10%. Subsequently, the debtor-in-possession fails to make its loan payments and files for bankruptcy. Under the presumptive contract approach, the bankruptcy court will force the creditor into a new loan with a cramdown interest rate of 10%, which is the original negotiated contract rate.

The presumptive contract approach possesses certain advantages. The most obvious benefit is that the cramdown interest rate is predetermined by the contract creating the original loan. Courts find this cost-effective method for determining the cramdown interest rate particularly attractive in

[55] *See* Elson, *supra* note 42, at 1930. However, presumably, the original contract rate between the parties included a lender's profit margin. Thus, one can argue that a creditor is not paid in full under a bankruptcy proceeding unless a lender's profit margin is included.

[56] Reorganization plans are approved by the bankruptcy judge, who must consider the feasibility of the plan.

[57] *See* Official Comm. of Unsecured Creditors v. Dow Corning Corp. (*In re* Dow Corning Corp.), 456 F.3d 668, 679 (6th Cir. 2006) ("When a debtor is solvent, . . . the presumption is that a bankruptcy court's role is merely to enforce the contractual rights of the parties, and the role that equitable principles play in the allocation of competing interest is significantly reduced.").

[58] *See* Till v. SCS Credit Corp., 541 U.S. 465, 473 (2004) ("[T]he court remanded the case to the Bankruptcy Court to afford petitioners and respondent an opportunity to rebut the presumptive 21% rate."); GMAC v. Jones, 999 F.2d 63, 71 (3rd Cir. 1993) ("[I]f a debtor proposes a plan with a rate less than the contract rate, it would be appropriate, in the absence of a stipulation, for a bankruptcy court to require the debtor to come forward with some evidence that the creditor's current rate is less than the contract rate.").

[59] *Till*, 541 U.S. at 478. A debtor seeking to rebut the presumptive contract rate may need to introduce expert testimony about the creditor's financial condition, increasing the evidentiary burden on the debtor.

bankruptcy proceedings, where the debtor-in-possession has limited resources.[60] Assuming there is no attempt to rebut the prepetition rate, the debtor-in-possession is able to save resources by avoiding the expense of discovery and evidentiary hearings.[61] Second, the presumptive contract approach protects the justified expectations of both the creditor and the debtor-in-possession. By entering into the initial creditor–debtor relationship, both parties are given proper notice of their duties and obligations. It eliminates the subjective dimensions found in other approaches.

However, like the other approaches, the presumptive contract approach has its deficiencies. For example, many courts face the question of whether they should cram down contractual subprime mortgage rates that are characterized as being higher than standard market interest rates.[62] The interest rates charged on these subprime mortgages are so outrageously high that more often than not the debtor-in-possession is unable to satisfy its obligations.[63] Critics also stress that the approach does not adequately take into consideration important differences between the actual lending market and the cramdown situation.[64]

D. Cost-of-Funds Approach

The cost-of-funds approach requires the court to set the cramdown interest rate at the rate another lender would charge the debtor to borrow an amount equal to the value of the secured claim.[65] It is based on the

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[60] *See In re* Till, 301 F.3d 583, 592 (7th Cir. 2002) ("The continuation of the old contract rate to the bankrupt debtor under the supervision of the bankruptcy court will . . . also result in some economies."); Green Tree Fin. Servicing Corp. v. Smithwick (*In re* Smithwick), 121 F.3d 211, 214–15 (5th Cir. 1997) ("Chapter 13 cases, because of the greater need to reduce litigation expenses associated with an individualized discount rate determination, call for particular guidance in the selection of the appropriate post-confirmation interest rate.").

[61] *See Smithwick*, 121 F.3d at 214–15 (noting that in Chapter 11 proceedings the interest rate determination requires expert testimony on valuation).

[62] *See* Household Auto. Fin. Corp. v. Burden (*In re* Kidd), 315 F.3d 671, 673–74 (6th Cir. 2003).

[63] *See* Raymond H. Brescia, *Subprime Communities: Reverse Redlining, the Fair Housing Act and Emerging Issues in Litigation Regarding the Subprime Mortgage Crisis*, 2 ALB. GOV'T L. REV. 164, 166 (2009) ("[M]any subprime borrowers fall into delinquency and foreclosure, [and] since a disproportionate share of such loans were made in communities of color, a disproportionate share of the foreclosures will also fall on such communities."). Subprime interest rates can be as high as 20.95%. *See Kidd*, 315 F.3d at 673 ("[S]ub-prime lenders generally charged higher rates of interest on their loans, ranging from 20.95% to 24.95% for automobile loans."). Payday loans provide another example of high contractual interest rates. Payday loans are short-term cash advances secured by future paychecks. Typical rates for these loans range from 200% to 300%. Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518, 581 n.300 (2004).

[64] *See* Hartman, *supra* note 6, at 536–38.

[65] 8 COLLIER, *supra* note 16, ¶ 1325.06[4]; Michael G. Williamson, *Determining Cram Down Interest Rates Post*-Till (Am. Bankr. Inst. 10th Annual Se. Bankr. Workshop, Kiawah Island Resort, S.C.), July 27–30, 2005, at 2, *available at* http://www.abiworld.org/committees/newsletters/financebank/

assumption that the secured creditor will borrow new funds to replace the money tied up in the bankruptcy and that secured creditors have access to additional funding.[66] A number of bankruptcy courts have adopted the cost–of-funds approach,[67] but no circuit court has yet implemented it.[68]

The major difficulty associated with the cost-of-funds approach is its underlying assumption that the secured creditor has access to an unlimited supply of credit.[69] With a limited amount of credit to draw on, "utilizing [the secured creditor's] borrowing capacity without providing . . . the usual return on its capital produces a loss for the secured creditor."[70] The approach does not consider the administrative costs and normal profits from lending.[71]

Another difficulty associated with the cost-of-funds approach is its failure to account for the risk of default.[72] "[T]he focus is on the creditworthiness of the creditor, not the creditworthiness of the debtor."[73] In determining the proper cost-of-funds interest rate, the court will assess the creditor's business structure, capital, operational efficiency, and credit history.[74] An inefficient or poorly capitalized lender will generate a different cost-of-funds interest rate than a more efficient and better capitalized lender.[75] This approach fails to reflect the debtor-in-possession's status as a borrower; it further fails to consider the likelihood of a Chapter 11 debtor-in-possession being more creditworthy—and therefore able to access money more cheaply—than the creditor is. For example, a lender with operational inefficiencies may charge higher interest to cover its losses.

III. *TILL* AND THE CRAMDOWN CONTROVERSY

Prior to 2004, courts applied a variety of methods in establishing the proper cramdown interest rate, including the four methods discussed

vol2num1/cramdown.pdf; *see* GMAC v. Valenti (*In re* Valenti), 105 F.3d 55, 63 (2d Cir. 1997) ("[T]he 'cost of funds' approach[] bases the market rate on the rate that the creditor itself pays when it borrows funds.").

66 *See* United Carolina Bank v. Hall, 993 F.2d 1126, 1130 (4th Cir. 1993). The formula approved in these cases can better be described as approximating the debtor's cost of funds than as the secured creditor's cost of funds. *See* GMAC v. Jones, 999 F.2d 63, 69 n.9 (3d Cir. 1993).

67 *See In re* Jordan, 130 B.R. 185, 190 (Bankr. D.N.J. 1991); Elson, *supra* note 42, at 1933.

68 Elson, *supra* note 42, at 1933; Williamson, *supra* note 65, at 2.

69 *See* Epstein, *supra* note 21, at 450.

70 *United Carolina Bank*, 993 F.2d at 1130; *see* Epstein, *supra* note 21, at 450.

71 *See* Elson, *supra* note 42, at 1934.

72 Epstein, *supra* note 21, at 450–51; *see United Carolina Bank*, 993 F.2d at 1130.

73 Epstein, *supra* note 21, at 451.

74 *Id.*

75 *Id.* ("[A] cram down interest rate based on the cost of funds approach in essence rewards a lender for being inefficient or poorly capitalized. More efficient and better capitalized lenders will have lower costs of funds.").

above.[76] Consensus on which of these approaches should apply in a Chapter 11 proceeding was a "distant reality."[77] However, in 2004, the Supreme Court addressed the important question of how to select an appropriate interest rate for cramdown situations in *Till v. SCS Credit Corp.*[78]

In the case, Lee and Amy Till owned and operated a used pickup truck worth $4000 that was subject to a debt to SCS Credit Corporation (SCS).[79] The Tills had bought the truck just one year earlier, financing the purchase with a loan that had a "subprime" interest rate of 21% for 136 weeks. Under the contract, the Tills agreed to make 68 biweekly payments to cover the debt; if the Tills defaulted, SCS retained the right to repossess the truck.[80] Subsequently, the Tills filed for Chapter 13 bankruptcy and elected to pursue a "cramdown option." Under the proposed Chapter 13 plan, the Tills would pay 9.5% interest on the secured portion of SCS's claim, representing a 1.5% "risk adjustment" to the 8% national prime rate at the time.[81] The bankruptcy court confirmed the plan's 9.5% cramdown interest rate. On appeal, the district court reversed and held that the 21% "subprime" interest rate per the original contract was the proper rate. On a subsequent appeal, the Seventh Circuit Court of Appeals vacated the district court's judgment and remanded, expressing the view that the contract's 21% interest ought to serve as the "presumptive" cramdown rate.[82] The Supreme Court granted certiorari, reversed, and remanded the case back to the bankruptcy court.[83]

A. *The Value of* Till

In *Till*, the issue was how to establish a proper cramdown rate on a used truck in a Chapter 13 case.[84] The decision in *Till* consisted of a four-Justice plurality opinion,[85] a concurring opinion,[86] and a four-Justice dissenting opinion. Although there was no approach endorsed by a clear

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76 *See* Fawkes & Hartmann, *supra* note 46, at 28.

77 *Id.*

78 541 U.S. 465 (2004).

79 *Id.* at 470. The Tills' outstanding claim at the time of filing was $4894.89, but as agreed by the parties, the value of the truck securing the claim was only $4000. *Id.*

80 *Id.*

81 *Id.* at 471.

82 *Id.* at 472–73.

83 *Id.* at 473, 485.

84 *Id.* at 474–75.

85 *Id.* at 468. A plurality opinion is the controlling opinion when no majority opinion exists. It is written when a majority of judges agree on the outcome, but not on the reasoning behind that outcome. For example, in a twelve-member court, seven judges believe that the plaintiff should win a given case, but only four of them agree on the reasoning behind that decision. *See* Marks v. United States, 430 U.S. 188 (1977) (explaining how the holding of a case should be interpreted when there is only a plurality).

86 Justice Thomas authored the lone concurrence. *Till*, 541 U.S. at 485 (Thomas, J., concurring).

majority of the Justices, five Justices rejected the presumptive contract approach for the Chapter 13 case.[87]

In *Till*, Justice Stevens, announcing the judgment of the Court and the plurality opinion, accepted the formula approach as the ideal method of calculating an appropriate interest rate in Chapter 13 contexts.[88] The plurality found the formula approach—in comparison to the other approaches—a "straightforward, familiar, and objective inquiry, [which] minimizes the need for potentially costly additional evidentiary proceedings."[89] Justice Thomas, concurring, agreed with the plurality that the use of the presumptive contract rate was inappropriate,[90] but opted for a "risk-free" rate that did not include the risk-factor adjustment found in the plurality's formula approach.[91] He reasoned that the Bankruptcy Code only required a valuation of the property to be distributed under the plan, not the promise to pay pursuant to the plan.[92] Thus, because the risk of default was not relevant in valuing the underlying property, the risk-free rate itself was enough to satisfy the Bankruptcy Code.

The dissent, in an opinion by Justice Scalia, endorsed using the contract rate of the original agreement as a rebuttable presumption of (and proxy for) the market rate when determining the appropriate interest rate in cramdown situations in the absence of other evidence.[93] The dissent favored using a contract rate based on the view that "lending markets are competitive"[94] and that the contract rate yields the most accurate estimate of a market interest rate.[95] In addition, the dissent agreed with the plurality on the need to compensate creditors for the increased risk of nonpayment and default once the debtor has entered bankruptcy. According to the dissent, relevant factors in determining the risk premium include: "(1) the

[87] Four Justices joined the plurality reasoning (formula approach), *see id.* at 468 (plurality opinion), and Justice Thomas endorsed a variant of the formula approach, *id.* at 491 (Thomas, J., concurring) (noting that the risk-free rate alone satisfies the statute's textual requirement that the creditor receive the value of its claim, and that therefore the judgment of the circuit court should be reversed).

[88] *Id.* at 468, 479–80 (plurality opinion). The plurality also found that debtors and creditors should be allowed to present evidence about the appropriate risk adjustments, with the evidentiary burden on the creditors (as information will be far more accessible to creditors than to individual debtors). *Id.* at 484–85.

[89] *Id.* at 479.

[90] *Id.* at 487 (Thomas, J., concurring).

[91] *See id.* at 486–91.

[92] *Id.* at 486.

[93] *Id.* at 492 (Scalia, J., dissenting). For example, a presumptive contract rate can be rebutted by evidence from the debtor showing the creditor's rate on current lending is less than the contract rate. GMAC v. Jones, 999 F.2d 63, 70–71 (3d Cir. 1993).

As discussed above, rebutting a presumptive contract rate may be costly. The debtor must obtain evidence that includes, but may not be limited to, the creditor's overhead costs, financial circumstances, and lending practices. *See* discussion *supra* Part II.C.

[94] *Till*, 541 U.S. at 492 (Scalia, J., dissenting).

[95] *See id.* at 492–99.

probability of plan failure; (2) the rate of collateral depreciation; (3) the liquidity of the collateral market; and (4) the administrative expenses of enforcement."[96]

Although the case revolved around a Chapter 13 bankruptcy, much debate arose with respect to the application of *Till* outside of the Chapter 13 context.[97] Justice Stevens, speaking for the *Till* plurality, wrote, "We think it likely that Congress intended bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under any of these provisions."[98] A plain interpretation of the statement would suggest that the formula approach should be used in Chapter 11 scenarios too. However, in a later footnote, the Court appears to suggest that an "efficient market" approach would be preferred.[99] The Court noted:

> Because every cramdown loan is imposed by a court over the objection of the secured creditor, there is no free market of willing cramdown lenders. Interestingly, the same is *not* true in the Chapter 11 context, as numerous lenders advertise financing for Chapter 11 debtors in possession. . . . Thus, when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce.[100]

The argument against according precedential effect to *Till*'s plurality opinion outside the Chapter 13 context is in its "substantial inconsistency";[101] as shown above, the plurality itself seems internally conflicted over the preferred approach in Chapter 11 conditions.[102]

Another possible reason why *Till* is not binding on non-Chapter 13 situations is that there are inherent differences between Chapter 11 and Chapter 13 bankruptcies. Failing businesses are hardly the same as private individuals failing with their personal financial affairs. Just to survive, private individuals may need to incur daily expenses on food, housing, health care, and many other personal care products.[103] One might also worry over whether the individual is a sophisticated party who has the necessary resources to protect his or her bankruptcy rights.[104] Chapter 13 is meant to

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[96] *Id.* at 499.

[97] *See, e.g.*, Bank of Montreal v. Official Comm. of Unsecured Creditors (*In re* Am. Homepatient, Inc.), 420 F.3d 559, 566–67 (6th Cir. 2005) ("[E]ven though the [*Till*] plurality is clear that the formula approach is the preferable method for Chapter 13 cases, the opinion is less clear about cases in the Chapter 11 context."); *In re* Prussia Assocs., 322 B.R. 572, 585 (Bankr. E.D. Pa. 2005) (opining that whether *Till* applies to Chapter 11 cases is "an undecided question"); *see also* Fawkes & Hartmann, *supra* note 46, at 28–29, 66 (discussing the effects of *Till* on subsequent Chapter 11 cases).

[98] *Till*, 541 U.S. at 474.

[99] *Id.* at 476 n.14.

[100] *Id.*

[101] Fawkes & Hartmann, *supra* note 46, at 28.

[102] *See supra* notes 98–100 and accompanying text.

[103] *Cf.* 11 U.S.C. § 707(b)(2) (2006) (summarizing the potential monthly expenses of a debtor).

[104] *See* Donald R. Lassman, *Individual Chapter 11s Really Do Work: Practical Considerations for Small-Business Debtors*, AM. BANKR. INST. J., Mar. 2008, at 18, 18 ("Because chapter 11 can be much

only protect insolvent individuals, whereas Chapter 11 filers are generally businesses.[105] Both Chapter 13 and Chapter 11, like the Bankruptcy Code as a whole, advance the dual goals of providing debtor relief and satisfying creditors' claims.[106] The legislative history of Chapter 11 reveals no preference between the dual goals. However, the legislative history of Chapter 13 reveals "Congress's goal of increasing the efficacy of the fresh start that bankruptcy provides individuals," which suggests, in the context of Chapter 13 bankruptcies, that a debtor-in-possession's fresh start might be more important than the rights of creditors.[107]

It may also help to focus on the differences between individuals and businesses. Each are distinct legal entities and the Code itself acknowledges this through the creation of different bankruptcy provisions for each.[108] The distinction between individuals and businesses is important because the impact of bankruptcy on a corporation is bound to differ in many respects from its impact on individuals.[109] An approach that works for Chapter 13 bankruptcies, such as the formula approach, might not necessarily work for Chapter 11 bankruptcies. Thus, courts are left with an opportunity to consider new approaches in regards to Chapter 11 bankruptcies.

B. Plurality Opinion

It is also important that *Till*'s ruling was based on a plurality opinion.[110] The force of a plurality decision generally depends on the level of agreement or disagreement exhibited by the various opinions issued.[111] In

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more complex than chapter 13, assembling a team of professionals, particularly accounting professionals with chapter 11 experience, can be essential to success.").

[105] Individuals who engage in business may also file for bankruptcy under Chapter 11. *See* 2 COLLIER, *supra* note 16, ¶ 109.05[1], at 109-35 (2010). However, as noted above, the focus of this Comment is primarily on corporations and other business entities filing Chapter 11 bankruptcies.

[106] 7 *id.* ¶ 1100.01; *see also* Carpenter v. Fanaras (*In re* Fanaras), 263 B.R. 655, 671 (Bankr. D. Mass. 2001) ("The twin goals of bankruptcy law [are] debtor relief and equitable distribution . . . ."); C. Scott Pryor, *Revised Uniform Commercial Code Article 9: Impact in Bankruptcy*, 7 AM. BANKR. INST. L. REV. 465, 514 (1999) (stating that the two co-equal goals of bankruptcy "are the collective enforcement of claims recognized by state law and the rehabilitation of the debtor").

[107] Elson, *supra* note 42, at 1942. In the context of Chapter 13, there is legislative history to suggest a debtor-in-possession's fresh start is more important than the rights of creditors. *See* 8 COLLIER, *supra* note 16, ¶ 1300.02 (citing H.R. REP. NO. 95-595, at 117 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6077–78).

[108] *See* Richard H.W. Maloy, *Comparative Bankruptcy*, 24 SUFFOLK TRANSNAT'L L. REV. 1, 10 (2000) ("Although Chapter 11 is not restricted to business-debtors, business entities file under Chapter 11 far more frequently than individual debtors do. Adjustment of debts under Chapter 13 is limited to individuals."); Mark A. Davis, Comment, Toibb v. Radloff*: Chapter 11 Relief Now Available to Individual Debtors*, 27 NEW ENG. L. REV. 693, 710 (1993) ("Given the complexities associated with a Chapter 11 petition, most individual debtors will seek relief under Chapter 7 or 13.").

[109] *See, e.g.*, discussion *infra* Part V.B.

[110] *See* Till v. SCS Credit Corp., 541 U.S. 465, 468 (2004).

[111] A plurality opinion is the opinion that received more support than any other in a situation in which no opinion commanded a majority. Plurality opinions present a precedential quagmire for lower

Marks v. United States, the Supreme Court explained how the holding of a case should be viewed where there is no majority supporting the rationale of any opinion.[112] "When a fragmented Court decides a case and no single rationale explaining the result enjoys the assent of [the majority], 'the holding of the Court may be viewed as that position taken by those Members who concurred in the judgments on the narrowest grounds . . . .'"[113]

The lack of a majority rationale weakens the precedential effect of *Till* in non-Chapter 13 situations, especially because each opinion endorses a different method for determining interest rates. The narrowest interpretation is that the Supreme Court did not endorse the coerced loan approach for Chapter 13 debtors.[114] There is, however, no indication that a majority of the Justices would agree on the cramdown interest rate approach in non-Chapter 13 situations, such as a Chapter 11 bankruptcy.

Only the plurality opinion explicitly discusses the applicability of *Till* to other provisions of the Bankruptcy Code.[115] Justice Thomas's concurrence and the dissent in *Till* are silent on the issue.[116] Furthermore, Justice Thomas's concurring opinion only focuses on what is necessary in a plan to satisfy § 1325(a)(5)(B)(ii); there is no mention of § 1129(b)(2) or Chapter 11 plans at all.[117]

As such, *Till* leaves lower courts without any clear guidance as to which rule to apply in Chapter 11 cramdown cases.[118] As there is no uniform holding with regard to *Till*'s applicability to non-Chapter 13 provisions, *Till*, at most, is instructive. Lower courts are left free to reach their own conclusion as to the appropriate cramdown interest rate for Chapter 11 bankruptcies. Therefore, *Till* does not prevent courts from adopting the contract rate approach set forth in this Comment.

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federal courts. *See generally* Comment, *Supreme Court No-Clear-Majority Decisions: A Study in* Stare Decisis, 24 U. CHI. L. REV. 99 (1956) (analyzing the precedential problems posed by plurality opinions and classifying them based on their usefulness).

[112] 430 U.S. 188, 193–94 (1977).

[113] *Id.* at 193 (quoting Gregg v. Georgia, 428 U.S. 153, 169 n.15 (1976) (opinion of Stewart, Powell & Stevens, JJ.)).

[114] *Till*, 541 U.S. at 477. While no opinion commanded a majority of the Justices, neither the plurality nor the concurrence endorsed the coerced loan approach. *See also* Elson, *supra* note 42, at 1934–39 (discussing the precedential value of the court's holding in *Till*, and noting that "[t]he narrowest interpretation is that the Supreme Court did not endorse the Seventh Circuit's ruling [favoring the coerced loan approach]").

[115] *See Till*, 541 U.S. at 474–75.

[116] *See id.* at 485–508 (Thomas, J., concurring & Scalia, J., dissenting). Justice Scalia, in arguing for the coerced loan approach, noted that the Court has assumed market competitiveness in the Chapter 11 context. *Id.* at 492, 499 (Scalia, J., dissenting). However, the dissent makes no further mention of non-Chapter 13 bankruptcies.

[117] *Id.* at 485–91 (Thomas, J., concurring). Section 1325(a)(5)(B)(ii) is the Chapter 13 equivalent to Chapter 11's § 1129. *Compare* 11 U.S.C. § 1325 (a)(5)(B)(ii) (2006), *with id.* § 1129.

[118] *See* Elson, *supra* note 42, at 1936–39.

C. *Current Interpretation of* Till

Even with the evidentiary suggestion in *Till*'s footnote fourteen, courts continue to struggle with determining Chapter 11 cramdown interest rates and defining what constitutes an "efficient market."[119] Some courts purport to utilize an efficient market approach, while others continue to rely on *Till*'s formula approach.[120]

Although courts have yet to reach a Chapter 11 cramdown consensus,[121] several cases show that there is a growing trend toward the efficient market approach.[122] In *Bank of Montreal v. Official Committee of Unsecured Creditors* (*In re American Homepatient, Inc.*), the Sixth Circuit squarely addressed the issue of applying *Till* in the Chapter 11 context.[123] Recognizing what *Till*'s footnote suggested, the Sixth Circuit articulated an efficient market approach[124] and held that "the market rate should be applied in Chapter 11 cases where there exists an efficient market."[125] When no efficient market exists for a loan to a Chapter 11 debtor-in-possession, "the bankruptcy court should employ the formula approach endorsed by the *Till* plurality."[126]

In *Mercury Capital Corp. v. Milford Connecticut Associates, L.P.*, the district court held that "the [b]ankruptcy [c]ourt did not necessarily err as a matter of law" in applying the *Till* plurality's formula rate approach to a

[119] *See* Fawkes & Hartmann, *supra* note 46, at 28–29, 66. At least one court that has examined cramdown interest rates post-*Till* has concluded *Till* does not apply in a Chapter 11 context. *See In re* Prussia Assocs., 322 B.R. 572, 585 (Bankr. E.D. Pa. 2005) ("*Till* is instructive, but it is not controlling, insofar as mandating the use of the 'formula' approach described in *Till* in every Chapter 11 case."). However, several commentators have argued that Chapter 11 cases are not quite as dissimilar to Chapter 13 cases as the *Till* Court assumed, in which case the *Till* formula approach could also apply to Chapter 11 cases. *See* 7 COLLIER, *supra* note 16, ¶ 1129.05[2][c], at 1129-148 to -149.

[120] A number of post-*Till* Chapter 11 cases have relied on the formula approach to determine an appropriate cramdown. *See In re* Mendoza, No. 09-11678, 2010 WL 1610120, at *2 (Bankr. N.D. Cal. Apr. 20, 2010); *In re* Field, No. 04-00028-TLM, 2005 WL 3148287, at *4–6 (Bankr. D. Idaho Oct. 17, 2005); *In re* Deep River Warehouse, Inc., No. 04-52749, 2005 WL 2319201, at *9–11 (Bankr. M.D.N.C. Sept. 22, 2005). Other courts have simply assumed that the prepetition contract rate is also the efficient market rate, without evidence to support a conclusion that such an equation is fair and reasonable under the circumstances. *See* Interim Capital, LLC v. Hank's Dock, Inc. (*In re* Seaspan Dev. Corp.), Nos. 04-21339, 04-21340, 2:05-CV-315, 2006 WL 2672298, at *1–4 (E.D. Tenn. Sept. 18, 2006); *In re* Sylvan I-30 Enters., No. 05–86708–HDH–11, 2006 WL 2539718, at *7 (Bankr. N.D. Tex. Sept. 1, 2006).

[121] *See* 7 COLLIER, *supra* note 16, ¶ 1129.05[2][c], at 1129-149 to -151.

[122] *See id*. at 1129-150 to -151. The efficient market approach is also known as the hybrid formula approach and the two terms can be used interchangeably.

[123] 420 F.3d 559 (6th Cir. 2005).

[124] *See id.* at 567–68; *see also infra* Part IV.

[125] *Am. Homepatient*, 420 F.3d at 568. In an analysis of the *American Homepatient* decision, commentators have argued that the Sixth Circuit essentially relied on a coerced loan approach in setting the interest rate on a partially secured cramdown loan based on the type of loan at issue. *See* Robert Goodrich & Madison Martin, *Emptying the "*Till*": The Sixth Circuit Sequel*, NORTON BANKR. L. ADVISER, June 2006, *available at* 2006 No. 06 Norton Bankr. L. Adviser 1.

[126] *Am. Homepatient*, 420 F.3d at 568.

Chapter 11 context.[127] However, the district court vacated the decision and remanded the case due to insufficient evidence in the record to determine if an efficient market rate existed for the type of loan contemplated by the plan.[128] Additionally, the court noted that the debtor's plan did not apply the *Till* formula correctly because the record lacked any evidence as to the national prime rate, which is the baseline rate of *Till*'s formula approach.[129]

In another case concerning the proper Chapter 11 cramdown interest rate, the court in *In re Northwest Timberline Enterprises, Inc.*[130] adopted the *Till* formula approach after it found that there was no "efficient market" for loans identical to what was being offered by the secured creditor. The court approved a 13.75% discount rate, adding a 5.75% risk adjustment to the 8% prime rate.[131]

These decisions demonstrate that courts will focus on whether an efficient lending market exists before applying a formula rate to determine the proper Chapter 11 cramdown interest rate. Yet whether this is the most rational approach to the problem is debatable. The next Part will further explore the efficient market approach and methods of defining an "efficient market."

IV. THE EFFICIENT MARKET APPROACH

Under the efficient market approach as applied by *In re American Homepatient*, the courts will first conduct an "efficient market" analysis and determine whether there is an applicable market rate that can fairly compensate a creditor for its exposure.[132] An obvious possible advantage is that an efficient market rate of interest may accurately capture the present value of the secured claim, thus fulfilling the fair-and-equitable requirement of the cramdown provisions.[133] More importantly, the efficient market approach can adequately protect the lender from being undercompensated.[134] In the current economic downturn, it can be argued that greater emphasis should be placed on preserving the rights of creditors and ensuring their proper compensation. To provide adequate relief and

[127] 354 B.R. 1, 4 (D. Conn. 2006).

[128] *Id.* at 12–13.

[129] *Id.* at 13.

[130] 348 B.R. 412, 434 (Bankr. N.D. Tex. 2006).

[131] *Id.*

[132] *See* 420 F.3d 559 (6th Cir. 2005).

[133] *See* GMAC v. Jones, 999 F.2d 63, 69 (3d Cir. 1993). The efficient market rate of interest will also reduce concerns that the creditor is undercompensated during the bankruptcy proceeding. *Id.*

[134] *See In re* Smith, 178 B.R. 946, 955–56 (Bankr. D. Vt. 1995) ("In a perfect bankruptcy world, a debtor-in-possession and a creditor would come to agreement on the perfect discount rate for every creditor's claim in bankruptcy. That is, they would arrive at a claim position that allows a debtor to survive and a creditor to earn an *appropriate return* on the claim in any future interest rate environment." (emphasis added)).

prevent further impairment of lenders and the vulnerable lending market, courts, when possible, should apply a market rate approach for Chapter 11 cramdown situations.[135] However, what is an "efficient market" and when does one exist?

The remainder of this Part will explore the meaning of an efficient market. First, it will provide an overview of what constitutes an efficient market and its connection with debtor-in-possession financing. Then, it will provide a quick summary of debtor-in-possession financing before continuing with a discussion of why the availability of debtor-in-possession financing should not equate to the existence of an "efficient market."

A. Defining an Efficient Market

An efficient market should reveal what a debtor and a creditor, both having reasonable knowledge of relevant facts, are willing to agree upon. Although *Till* did not define the term "efficient market," the term has appeared quite frequently in other areas of law, especially securities litigation. In the context of securities fraud, "an efficient market is one in which market price fully reflects all publicly available information."[136] The efficient market is based on the assumptions that: "(1) all investors have costless access to currently available information about the future; (2) all investors are good analysts; and (3) all investors pay close attention to market prices and adjust their holdings appropriately."[137] One can infer that availability of material information is the key ingredient for defining an efficient market in securities litigation. However, whether bankruptcy courts will adopt this definition is yet to be determined.

[135] *See Lehman Brothers, Sharper Image, Bennigan's and Beyond: Is Chapter 11 Bankruptcy Working?: Hearing Before the Subcomm. on Commercial & Admin. Law of the H. Comm. on the Judiciary*, 110th Cong 10–17 (2008) (statement of Jay Lawrence Westbrook, Benno C. Schmidt Chair of Business Law, Univ. of Tex. Sch. of Law) (discussing recent bankruptcies and the lending market's exposure).

[136] Bowe v. PolyMedica Corp. (*In re* PolyMedica Corp. Sec. Litig.), 432 F.3d 1, 10 (1st Cir. 2005) (citing Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635, 639 (2003) ("[T]he common definition of market efficiency . . . is really a shorthand for the empirical claim that 'available information' does not support profitable trading strategies or arbitrage opportunities.")); *see also* Greenberg v. Crossroads Sys., Inc., 364 F.3d 657, 661 n.6 (5th Cir. 2004) ("[W]here securities are traded in an efficient market, it is assumed that all public information concerning a company is known to the market and reflected in the market price of the company's stock."); GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 208 (3d. Cir. 2001) (defining "efficient marketplace" as one "in which stock prices reflect all available relevant information about the stock's economic value"); Joseph v. Wiles, 223 F.3d 1155, 1163 n.2 (10th Cir. 2000) (stating that in an efficient market, "the investor must rely on the market to perform a valuation process which incorporates all publicly available information, including misinformation").

[137] Jonathan R. Macey et al., *Lessons from Financial Economics: Materiality, Reliance, and Extending the Reach of* Basic v. Levinson, 77 VA. L. REV. 1017, 1022 (1991) (quoting G. ALEXANDER & W. SHARPE, FUNDAMENTALS OF INVESTMENTS 67 (1989)).

Rather, we can look back at *Till* for some guidance on defining market efficiency in the bankruptcy context. In *Till*, the Court acknowledged that "there is no readily apparent Chapter 13 cramdown market rate of interest: Because every cramdown loan is imposed by a court over the objection of the secured creditor, there is no free market of willing cramdown lenders."[138] The Court then noted that this is not necessarily true for Chapter 11 debtors-in-possession seeking financing. As the plurality in *Till* recognized, "[N]umerous lenders advertise financing for Chapter 11 debtors in possession."[139] This suggests that the wide availability of debtor-in-possession financing may be sufficient to establish an efficient market for Chapter 11 situations. However, many believe "the *Till* plurality's footnote discussion of Chapter 11 [represents] a misunderstanding of the nature of [debtor-in-possession] financing."[140] To consider this contention, we must further explore the concept of debtor-in-possession financing.

B. Debtor-in-Possession Financing

Debtor-in-possession financing is typically "a relatively short-term, restrictive loan that contains more stringent covenants and features higher interest rates and fees."[141] More often than not, it is the existing lender that provides some of the loan or the entire loan to the debtor-in-possession.[142] This form of financing can be highly profitable for lenders such as financial

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[138] Till v. SCS Credit Corp., 541 U.S. 465, 476 n.14 (2004) (internal quotation marks omitted).

[139] *Id.*

[140] *The Great Debates Resolved: The* Till *Rate of Interest Is Applicable in Chapter 11 Cases* (Am. Bankr. Inst. 30th Annual Midwestern Bankr. Inst.), 2010, at 252, *available at* http://www.abiworld.org/committees/newsletters/busreorg/vol9num10/till.pdf; *see* 7 COLLIER, *supra* note 16, ¶ 1129.05[2][c][i], at 1129-148 to -149.

[141] George W. Kuney, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19, 50 (2004); *see also id.* at 50–56 (discussing the nature of, and common covenants that are associated with, debtor-in-possession (DIP) financing loans). Debtor-in-possession financing is generally used to fund operating activities during Chapter 11 bankruptcy. Lenders generally require "the debtor [to] use the proceeds specifically as working capital, for general corporate purposes, allowed operating expenses, or a specific real estate development or acquisition." *Id.* at 51–52 (footnotes omitted). Additionally, most debtor-in-possession financing loans are typically in the form of a revolving credit agreement utilizing inventory or accounts receivable as the primary collateral. *Id.* at 51. A revolving credit agreement is generally a type of loan in which the bank promises to lend the borrower up to a specific maximum amount during a specified time period. *See Glossary of Economic Terms*, FED. RESERVE BANK OF S.F., http://www.frbsf.org/tools/glossary/index.html (search "open-end credit") (last visited June 17, 2012).

[142] U.S. statistics suggest that the existing lender provides some or all of the debtor-in-possession loan in 58% of Chapter 11 cases. Sandeep Dahiya et al., *Debtor-in-Possession Financing and Bankruptcy Resolution: Empirical Evidence*, 69 J. FIN. ECON. 259, 265 (2003). Additionally, DIP financing tends to increase a firm's chances of emerging successfully from Chapter 11 bankruptcy based on a sample taken from all Chapter 11 cases filed. *Id.* at 273; *see also* Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 524 (2009) (finding that 50% of firms in a sample of firms in Chapter 11 bankruptcy obtained DIP financing and that 54% of those obtained financing from a preexisting creditor).

institutions, hedge funds, and private equity firms.[143] Generally, the rates of interest and loan fees charged on debtor-in-possession financing are higher than traditional loans, presumably to offset the risk of lending to an insolvent company that may not emerge from bankruptcy.[144]

One important feature of debtor-in-possession financing is that the loan is almost always secured. Most of the time, it is secured by all of the corporation's assets.[145] Accordingly, it follows that a judge can look to the interest rate of the debtor-in-possession financing loan to determine the cramdown of the creditor's collateral.

In regard to lending practices for debtor-in-possession financing, it is clear that lenders are willing to lend to bankrupt corporations under Chapter 11.[146] In 2008, debtor-in-possession financing was at a five-year record high, totaling approximately $18.1 billion.[147] This marked a 33% increase from 2007, and the market is expected to continue to grow.[148] Moreover, a number of papers have acknowledged the ubiquity of debtor-in-possession financing during the 1990s.[149]

C. Concerns Regarding the Efficient Market Approach and Debtor-in-Possession Financing

Although it appears that there is indeed a readily available debtor-in-possession financing market, there are several reasons why it should not be used to determine a proper efficient market cramdown rate.

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[143] Mark Schrager, Financing the Insolvent Company—An Overview 14–16 (Aug. 2006), *available at* http://www.dwpv.com/images/Financing_the_Insolvent_Company_-_An_Overview.pdf.

[144] *Id.* The higher rates of interest and loan fees reflect a risk premium due to the nature of the debtor-in-possession. *Id.* at 14.

[145] *See* Ayotte & Morrison, *supra* note 142, at 522–24 (finding that 92% of DIP loans are secured by all of the debtor corporation's assets).

[146] *See* David W. Marston, *DIP Financing Issues and Alternatives*, GIBBONS (Apr. 7, 2009), http://www.gibbonslaw.com/news_publications/articles.php?action=display_publication&publication_id=2734 ("We never lost one penny in Chapter 11 financings in all of those years." (quoting Sterling Chairman Louis Cappelli)); *see also* Michelle J. White, *Economics of Corporate and Personal Bankruptcy Law*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS 4–9 (2d ed. 2008).

The efficient market approach is not likely to be applicable for Chapter 13 individual debtors. Presumably, individuals have significantly less nonexempt assets available as collateral to securitize new loans. This ultimately reduces the attractiveness of lending to individuals. While individuals can file bankruptcy under Chapter 11, that is beyond the scope of this paper. In this Comment, I primarily focus on corporations filing under Chapter 11.

[147] *See* Stephen A. Donato & Thomas L. Kennedy, *Trends in DIP Financing: Not as Bad as It Seems?*, J CORP. RENEWAL, Sept./Oct. 2009, at 4, 5, *available at* http://www.turnaround.org/Publications/Articles.aspx?objectId=11602 ("DIP loans traditionally were viewed as safe and profitable for lenders and were almost taken for granted by many potential debtors.").

[148] *Id.*

[149] *See* Ayotte & Morrison, *supra* note 142, at 515 (surveying research).

The first reason is associated with the idea that a relevant efficient market for Chapter 11 loans "may be just as illusory as in chapter 13."[150] This argument takes aim at what it suggests is an "inapt and unstated inference the Court makes with respect to the similarity between the interest rates applicable to [debtor-in-possession] financing and the interest rates applicable to loans imposed upon dissenting creditors at cramdown."[151] Debtor-in-possession financing generally occurs at the beginning of a bankruptcy case, whereas the determination of a Chapter 11 cramdown rate under § 1129(b)(2) occurs at confirmation.[152] Therefore, given the differences in timing, there are generally more risks associated with the lending when a debtor-in-possession seeks financing than when a debtor-in-possession seeks a cramdown confirmation.[153] An appropriate Chapter 11 cramdown rate should be less than the rate offered to a debtor-in-possession seeking financing.

The second reason is the fear that bankruptcy lenders may charge excessive rates in an efficient market. Bankruptcy lenders, such as debtor-in-possession financing lenders, can take advantage of the debtor-in-possession's need for interim financing, thus forcing the debtor-in-possession to "obtain credit in order to save [itself] from liquidation and often ha[s] little negotiating leverage."[154] One commentator has stated that while debtor-in-possession financing loans "may in fact be very low risk credits, . . . they are [in reality] priced as very high risk credits."[155] The argument is that debtor-in-possession financing markets present excessive rates, are unlike normal credit markets, and do not reflect an efficient market.[156]

Under these circumstances, it does not make sense for a court to look toward debtor-in-possession financing to establish an efficient market. "Equating the availability of [debtor-in-possession] financing with the existence of an 'efficient market' for secured *exit* financing seems quite a stretch. The 'market' for [debtor-in-possession] loans is not like regular credit markets and not like the markets for exit financing."[157]

[150] 7 COLLIER, *supra* note 16, ¶ 1129.05[2][c][i], at 1129-148.

[151] *Id.*

[152] *See id.*

[153] *Id.* at 1129-148 to -149 ("Thus, instead of the interim and inherently more uncertain risk present in debtor in possession financing, the court at confirmation is presented with a less risky, more stable and restructured debtor; the fact that the debtor is more stable is bound up in the court's necessary feasibility determination under section 1129(a)(11).").

[154] Adam Strochak, *A Cram Session on Cramdown Interest Rates*, WEIL BANKR. BLOG (June 22, 2011), http://business-finance-restructuring.weil.com/chapter-11-plans/a-cram-session-on-cramdown-interest-rates/#axzz1mReC6f54.

[155] *Id.*

[156] However, one could argue that the lending market is competitive, and presumably the economics of supply and demand will regulate any possibilities of excessive rates.

[157] Strochak, *supra* note 154.

If not the market for debtor-in-possession financing, then what should courts look to in establishing an efficient market rate? One possible alternative would be to equate an efficient market with any comparable market loan, as is done in the coerced loan approach. However, this approach is not without its own problems. There may not always be an actual efficient market for a particular cramdown loan.[158] A particular comparable loan may not be available for many reasons, including the tightening of the credit market or the lack of any comparable business structured in the same manner as the debtor.[159] One commentator believes "[t]here is no more of a 'free market of willing cramdown lenders' in a chapter 11 . . . than in a chapter 13."[160] If there is a lending market, then "there is no need to resort to a cramdown provision."[161] Other possible problems associated with this interpretation of an efficient market may be traced to the problems found in the coerced loan approach as discussed above, which include (1) the loan proposed is "so outrageous that no rational lender would make [a similar loan]"[162] or (2) "the market may have shrunk for loans of the type proposed."[163]

Ultimately, the problem with the efficient market approach is the elusive definition of an efficient market. There does not appear to be a clear answer. Regrettably, "[t]he definition of an efficient market has not been directly addressed by a post-*Till* case."[164] Several of the post-*Till* cases mentioned above exhibit instances of how difficult it is to find an applicable efficient market rate.[165] The party attempting to establish the efficient market rate "is left to speculate what evidentiary considerations will be required to establish an efficient market and what this evidentiary endeavor will cost."[166]

It is ultimately up to the bankruptcy judge to weigh the evidence and determine whether an efficient market exists. Where there is no actual efficient market, there is, of course, no applicable efficient market interest

[158] *See* Bank of Montreal v. Official Comm. of Unsecured Creditors (*In re* Am. Homepatient, Inc.), 420 F.3d 559, 567–68 (6th Cir. 2005).

[159] *See In re* Jordan, 130 B.R. 185, 189 (Bankr. D.N.J. 1991) ("[A]s Judge Lundin articulated in the chapter 11 context in *In re Aztec Company* . . . it is difficult to arrive at a current market rate of interest for a hypothetical new loan when there is no market for the loan proposed, no equity in the property and limited opportunity on the part of the debtor to obtain financing outside of the Bankruptcy Code framework.").

[160] Thomas J. Yerbich, *How Do You Count the Votes—Or Did* Till *Tilt the Game?*, AM. BANKR. INST. J., July/Aug. 2004, at 10, 59.

[161] *Id.*

[162] 7 COLLIER, *supra* note 16, ¶ 1129.05[2][c][ii][B], at 1129-152.

[163] *Id.*

[164] Pill, *supra* note 3, at 290.

[165] *See supra* Part III.C.

[166] Pill, *supra* note 3, at 288–89.

rate. It seems that courts and practitioners alike will continue to wrestle with the proper definition of efficient market.

V. THE CONTRACT RATE APPROACH—A BETTER WAY

This Comment argues that there is a better way to determine an appropriate Chapter 11 cramdown rate. Namely, the court should apply a contract rate approach by looking at the interest rate of the original agreement between the parties, rather than applying *Till*'s formula approach or the efficient market approach.

Under the contract rate approach, courts apply the prepetition contract rate on the presumption that the prebankruptcy contract interest rate on the loan is an accurate reflection of the lending market.[167] The contract rate "is generally a good indicator of actual risk, . . . and it will provide a quick and reasonably accurate standard"[168] for determining a cramdown rate. To be clear, the contract rate approach differs from the aforementioned presumptive contract approach in that it will not allow the parties to rebut the negotiated contract rate. One principal reason why the contract rate approach does not include a rebuttal element is the significant evidentiary burden (including discovery) and cost associated with rebuttal. As suggested by *Till*'s plurality, the debtor-in-possession must spend considerable resources to obtain sufficient information, such as the creditor's overhead costs and lending practices, to rebut the presumptive contract rate.[169] In addition, another difficulty is in establishing a clear standard for the rebuttal, which is beyond the scope of this Comment. Even then, I question how much information is needed to persuade the court to rebut the presumptive contract rate.

Applying a contract rate approach raises various obvious questions, namely, why not stick with *Till*'s formula approach or the efficient market approach? The Supreme Court adopted the formula approach, so is the contract rate approach inconsistent with the Court's mandate? Why should the courts apply the contract rate approach over the formula and efficient market approaches?

As I argued above, *Till*'s plurality opinion is not binding on lower courts in regard to Chapter 11 cramdown situations.[170] Other than the Justices who joined the plurality opinion, no Justice discussed the applicability of *Till* to Chapter 11 cramdown situations. The plurality did suggest that an efficient market analysis should apply to Chapter 11 cramdowns,[171] but it failed to provide a workable definition of efficient

[167] *See supra* Part II.C.
[168] Till v. SCS Credit Corp., 541 U.S. 465, 492 (2004) (Scalia, J., dissenting).
[169] *Id.* at 478 (plurality opinion).
[170] *See supra* Part III.B. There should be no doubt that *Till* is binding on Chapter 13 debtors.
[171] *See Till*, 541 U.S. at 476 n.14.

market. Justice Stevens, writing for the plurality, did point to the availability of debtor-in-possession financing as evidence of a "free market of willing cramdown lenders."[172] However, as discussed above, there are several reasons why the debtor-in-possession financing market is not necessarily an appropriate efficient market for cramdown purposes.[173] Consequently, the efficient market approach offers no solution to the Chapter 11 cramdown dilemma.

Accordingly, we must address the issue of why the contract rate approach is preferable to the formula and efficient market approaches. The proposed contract rate approach is superior for three reasons. First, the contract rate approach best protects the justified expectations of the parties. Second, the basic policies and interests underlying the laws of Chapter 11 and Chapter 13 bankruptcies are different. Bankrupt corporations (Chapter 11) are not the same as bankrupt individuals (Chapter 13). Considering the various interests of a Chapter 11 corporation, there are strong arguments why a contract rate approach is more suitable. Third, both the formula and the efficient market approaches are excessively complicated, requiring risk premium calculations and efficient market determinations. The contract rate approach is easier to manage and creates consistent, predictable outcomes.

A. Justified Expectations of the Parties

Applying a contract rate approach will protect the justified expectations of both the creditor and debtor-in-possession. Generally, "it would be unfair and improper" to hold the creditor to a new interest rate "when he had justifiably molded his conduct to conform" to the demands of a competitive lending market.[174] Parties enter a transaction with the expectation that each side will satisfy their duties and obligations, and creditors expect a certain amount of compensation from their loans.[175] A desire to protect justified expectations is one key factor underlying the relatively broad freedom the law gives contracting parties to choose what type of debt they wish to incur.[176]

Without protection of their justified expectations, parties are likely to change their borrowing and lending behaviors, which would create a ripple

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[172] *Id.*

[173] *See supra* Part IV.C.

[174] 1 RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6 cmt. g (1971) (noting that the "[p]rotection of justified expectations . . . is an important value in all fields of the law" (emphasis omitted)).

[175] Likewise, it can be argued that creditors know, or should know, that their loans may be rewritten in bankruptcy. However, whether the creditor accounts for this risk is uncertain.

[176] *Cf.* KERMIT ROOSEVELT, III, CONFLICT OF LAWS 82 (2010) (listing protection of the justified expectations of the parties as a relevant factor in the choice of law determination for contracts issues); *see also* Paul L. Regan, *Great Expectations? A Contract Law Analysis for Preclusive Corporate Lock-Ups*, 21 CARDOZO L. REV. 1, 33 (1999) ("The principal purpose of contract law is to protect the justified expectations that arise from promises underlying bargains.").

effect throughout the economy.[177] For example, if cramdown creditors are "systematically undercompensated," lenders will offset their losses with higher rates or simply decline to lend money to the riskiest debtors.[178] Such an arrangement would, of course, be suboptimal. The recent credit crunch serves as a concrete illustration of the importance of credit availability. Restricting access to credit ultimately decreases the amount of investment in business, education, and housing—all vital components of the greater public interest of economic growth. Protecting justified expectations and applying a contract rate approach would ensure that lenders are adequately protected, enhancing the lending market and potentially resulting in lower interest rates.[179]

B. Underlying Policies and Interests of Bankruptcy

An assessment of the policies and interests underlying Chapter 11 bankruptcy proceedings justifies choosing a contract rate approach. The fundamental goals of Chapter 11 bankruptcies are to provide a fresh start and to protect the rights of creditors.[180] However, in the Chapter 11 context, it is debatable whether a debtor-in-possession's fresh start is more important than the rights of creditors.[181]

In *Till*, the Court, in supporting the formula approach, focused on the debtor's fresh start and minimizing costs in Chapter 13 cases. Most Chapter 13 debtors or individuals can ill afford to handle costly disputes.[182] Individual debtors are also not as well versed in the legal and financial ramifications of bankruptcy.[183] These rationales, although still present in some Chapter 11 bankruptcies, are certainly not a main concern in larger Chapter 11 cases.[184] Corporations (filing under Chapter 11) tend to have more resources, such as legal and finance departments, that allow them to obtain better knowledge and an understanding of the potential risks

[177] *See Till*, 541 U.S. at 508 (Scalia, J., dissenting).

[178] *Id.*

[179] This section presents a strong argument against applying an efficient market rate, which may produce a new cramdown interest rate that neither party expected prepetition.

[180] *See* 7 COLLIER, *supra* note 16, ¶ 1100.01, at 1100-4.

[181] *See* Ralph Brubaker, *Taking Exception to the New Corporate Discharge Exceptions*, 13 AM. BANKR. INST. L. REV. 757, 760–61 (2005) (discussing why giving the corporate debtor a "fresh start" might not be the principal policy concern in Chapter 11 bankruptcies).

[182] *See* 7 COLLIER, *supra* note 16, ¶ 1129.05[2][c][i].

[183] Chapter 13 debtors are assigned a Chapter 13 trustee. The trustee is considered the representative of the Chapter 13 estate. In United States trustee districts, the United States trustee, rather than the court, makes the appointment of an individual to serve as standing Chapter 13 trustee, or as trustee in a particular case, or else the United States trustee may serve as the Chapter 13 trustee. *See* 11 U.S.C. § 323 (2006); 28 U.S.C. § 586 (2006).

[184] *See* 7 COLLIER, *supra* note 16, ¶ 1129.05[2][c][i], at 1129-148 ("[The cost-minimizing] rationale, while not absent from chapter 11 cases, is certainly minimized in larger chapter 11 cases.").

associated with debt.[185] For instance, a Chapter 11 corporation is arguably better at understanding the consequences of negotiating a subprime mortgage with high variable rates—and therefore needs less protection—than a Chapter 13 individual debtor.

It would be unjustified to treat Chapter 11 debtors-in-possession the same as Chapter 13 debtors. The contract rate approach does not, per se, tilt the balance in favor of the debtor or creditor. Rather, it seeks to preserve the equitable balance between debtors and creditors that existed prior to bankruptcy.

C. Ease of Management, Uniformity, and Predictability

Ease of management, uniformity, and predictability are values desirable across a wide range of legal fields.[186] Bankruptcy law is no exception. It is important that good rules be developed to reaffirm these values. A contract rate approach is simply more straightforward than the formula and efficient market approaches because it is easier to apply and more objective. As Justice Scalia stated in his *Till* dissent, a contract rate provides a good indication of the actual risk of default in the particular case.[187] The cramdown rate is already predetermined by the contract rate, "a number readily found in the loan document."[188] Moreover, a contract rate approach would make the cramdown process more objective and uniform by eliminating the subjective elements found in both the formula approach and the efficient market approach.[189] Courts will no longer have to ponder whether, for example, a 1% or 4% risk adjustment is adequate and feasible for the debtor.[190] The parties will also no longer have to wait and wonder how the bankruptcy court will rule concerning the existence of an efficient market. Additionally, the predictability afforded by the contract rate approach will lower lending risks and enable lenders to appropriately evaluate the debt market.

Finally, another potential benefit of using the contract rate approach is a reduction of the number and complexity of evidentiary hearings and

[185] I imagine corporate bankruptcies tend to implicate larger concerns of economic welfare, such as productivity and market stability, whereas individual bankruptcies often highlight social policies such as the prevention of homelessness and the protection of the common person.

[186] *See* ROOSEVELT, *supra* note 176, at 82.

[187] *See* Till v. SCS Credit Corp., 541 U.S. 465, 492 (2004) (Scalia, J., dissenting).

[188] *Id.* at 499.

[189] *See* Greenspan & Nelson, *supra* note 36, at 70 (arguing that although the factors the *Till* plurality used to find the appropriate formula approach risk adjustment are arguably objectively observable in the market, it nonetheless "takes subjective professional judgment to apply [them] to each debtor's circumstances").

[190] *See id.* ("[I]n noting that courts 'have generally approved 1–3 percent' as the proper risk adjustment, *Till* will inevitably, and perhaps inappropriately, frame discussions as to the range of this adjustment." (citations omitted) (quoting *Till*, 541 U.S. at 480 (plurality opinion))).

expensive discovery associated with the formula and efficient market approaches.[191]

CONCLUSION

This Comment has attempted to shed light on the difficulty of choosing an appropriate cramdown interest rate to apply to a creditor's claim in the Chapter 11 context. With the Supreme Court's decision in *Till v. SCS Credit Corp.* serving as a backdrop, courts are still struggling to reach a consensus in Chapter 11 cases. The *Till* Court described the many benefits and problems with each approach,[192] but ultimately decided on the formula approach as the appropriate method for determining the cramdown rate for secured claims in Chapter 13.

The import of *Till*'s holding to Chapter 11 cases is not yet clear. Although *Till*'s plurality hinted at a desire for uniformity among various chapters of the Bankruptcy Code,[193] footnote fourteen of the opinion has caused confusion for practitioners, litigants, and courts alike. Both because *Till*'s reasoning did not garner a majority and because of the peculiarities of footnote fourteen, one is left to wonder whether even a majority of the *Till* Court would apply its holding to Chapter 11.

Since *Till*, some courts have applied *Till*'s formula approach,[194] whereas other courts have found footnote fourteen persuasive and have created new approaches to take into account the possibility of an efficient market analysis.[195] To address the issue of which approach should be used in Chapter 11 cases, this Comment has advocated the implementation of neither the formula nor efficient market approaches, but, instead, a contract rate approach.

This Comment has established that the contract rate approach is superior for several reasons. First, the contract will allow the court to apply an objective approach that can eliminate the uncertainty involved in establishing a risk premium under the formula approach or an efficient market under the efficient market approach. Second, this Comment has showed that the contract rate approach protects the justified expectations of

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[191] *Cf. In re* Collins, 167 B.R. 842, 847 (Bankr. E.D. Tex. 1994) ("Determination of an appropriate rate is a difficult question because unlike a lending institution, this Court does not have a lending manual which mechanically guides this analysis."). Moreover, a debtor-in-possession attempting to establish an efficient market has the burden of obtaining information on the creditor's lending practice, costs of overhead, financial circumstances, and more. *See* Pill, *supra* note 3, at 188–89.

[192] *See Till*, 541 U.S. 465. A reading of *Till* suggests a lack of satisfactory reasoning for any of the many approaches suggested.

[193] *E.g.*, *id.* at 474 ("Congress intended bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under any of these provisions.").

[194] *See In re* Prussia Assocs., 322 B.R. 572, 590 (Bankr. E.D. Pa. 2005).

[195] *See* Bank of Montreal v. Official Comm. of Unsecured Creditors (*In re* Am. Homepatient, Inc.), 420 F.3d 559, 568 (6th Cir. 2005); Mercury Capital Corp. v. Milford Conn. Assocs., L.P., 354 B.R. 1, 13 (D. Conn. 2006); *In re* Nw. Timberline Enters., Inc., 348 B.R. 412, 432 (Bankr. N.D. Tex. 2006).

the parties and the underlying policies of the Bankruptcy Code. And finally, the contract rate approach is easier to manage and instills predictability and uniformity in an area of law that has generally lacked both. As a whole, the benefits of the contract rate approach outweigh those of all the other alternatives. For these reasons, courts should adopt the contract rate approach when dealing with Chapter 11 cramdowns.