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Corporate Panel—Chapter 11 Cramdown Interest Rates: Till, Momentive, and the Proper Valuation Method

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CORPORATE BANKRUPTCY PANEL

CHAPTER 11 CRAMDOWN INTEREST RATES: *TILL*, *MOMENTIVE*, AND THE PROPER VALUATION METHOD

Professor Ralph Brubaker (Moderator)[*]
Professor Anthony J. Casey[**]
Ms. Susan M. Freeman[***]
Professor Bruce A. Markell[****]

MR. JUMBECK: We're going to get started while people keep trickling in. Don't want to eat up too much time. Thank you to the Consumer Panel for presenting those insights and presenting here today. I'm sure everybody here learned a lot.

I have the honor of introducing our Corporate Panel here today which will be discussing the issue of Chapter 11 Cramdown Interest Rates and the Proper Valuation Method.

One quick procedural matter to note, per the request of the panel, questions will be permitted throughout. So if you have a question at any point, just simply walk up to one of the two microphones. Professor Brubaker will pause the discussion when appropriate and take your question.

I'm going to provide a brief introduction of each of the panelists and then let our moderator, Professor Brubaker, take it away.

Professor Brubaker is the Carl L. Vacketta Professor of Law at the University of Illinois College of Law. He rejoined the Illinois faculty in 2004, after serving here at Emory for over ten years. While he was here he was the faculty advisor for what was then known as the *Bankruptcy Developments Journal*. He also graduated law school from the University of Illinois where he graduated *summa cum laude*. It's a pleasure to welcome him back here to Emory Law today.

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**** Bruce A. Markell is Professor of Bankruptcy Law and Practice at Northwestern University's Pritzker School of Law.

To his right is Professor Tony Casey. Professor Casey is Professor of Law and Mark Claster Mamolen Teaching Scholar at the University of Chicago Law School. He graduated from the University of Chicago Law School with high honors. His research involves the intersection of finance and law, and his pieces have appeared in *The Yale Law Journal*, *The Columbia Law Review*, *The Supreme Court Review*, and *The University of Chicago Law Review*. His piece, *Bankruptcy's Endowment Effects*, which we had the privilege of publishing in our first issue, is in your CLE materials and contains the portion he will be discussing today.

To his right is Ms. Susan Freeman. Ms. Freeman is a partner at the Phoenix office of Lewis Roca Rothgerber Cristie, so she gets the silver medal for farthest travel to Emory Law here today. We're grateful to her for being here. Her practice focuses on business bankruptcy and appeals of all kinds. She regularly appears in front of federal circuit courts. For instance, in January she argued in front of a Ninth Circuit *en banc* appeal in *In re Sunnyslope Housing Partnership*.[1] In 2012 she also argued in front of the Supreme Court.[2]

To her right is Professor Bruce Markell. Professor Markell is the Professor of Bankruptcy Law and Practice at Northwestern University's Pritzker School of Law. Those here taking Professor Pardo's bankruptcy course should recognize the name from what's arguably the wittiest jokiest casebook on the market. If there is, I'd be really interested to see what it is. He graduated law school from King Hall School of Law at UC-Davis. He was in private practice for nine years before entering academia, including one of his earliest appointments, a brief stint here at Emory. He took a break from academia when he was appointed a bankruptcy judge for the District of Nevada.

It's our pleasure to welcome them all here today. I could go on at length, but I fear I've probably already spoken for too long. With that, it's all yours, Professor Brubaker.

PROFESSOR BRUBAKER: It's a pleasure to be here, a pleasure to be back at my old stomping grounds at Emory Law School and see a lot of my friends here in Atlanta. I want to give a special thanks to Jake and the other members of the editorial staff of the *Emory Bankruptcy Developments Journal*. It's been a pleasure to work with them. I congratulate them on putting together such a successful symposium.

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1 *In re* Sunnyslope Hous. Ltd. P'ship, 818 F.3d 937 (9th Cir. 2016), *as amended on denial of reh'g* (Apr. 21, 2016), *reh'g en banc granted*, 838 F.3d 975 (9th Cir. 2016).

2 Hall v. United States, 566 U.S. 506 (2012).

As Jake mentioned, we will take questions throughout. The microphones are behind the seats, so just queue up at the mic if you want to ask a question. The only modification I'd give to the ground rules that Jake issued is that you should just feel free to interrupt Professor Markell at will. Everyone else, please wait for me to acknowledge your questions so we don't interrupt the presentations.

It's my honor and pleasure to be moderating such a distinguished panel. We are going to talk today about one of my favorite terms in bankruptcy vernacular which is cramdown. We're going to talk about interest rates and the way interest rates play into the cramdown value that a dissenting secured creditor is entitled to. The *Emory Bankruptcy Developments Journal* published two articles on this issue in the most recent issue of the *Journal*, an article by Professor Markell to which Professor Casey responded, so much of the panel discussion will center around the points raised by them in their back-and-forth in the *Emory Bankruptcy Developments Journal*.[3]

The way we will proceed is that Professor Markell will open, will lay out his case. And much of this discussion has been prompted by the recent decision by Judge Drain in the *Momentive* case which is currently on appeal in the Second Circuit in which he approved a cramdown interest rate that some regarded as shockingly low. Bruce is going to defend that decision. Then Tony will give his response, and after that, Susan who is debtor's counsel in the *Sunnyslope* case just mentioned, will give sort of practical perspective on the arguments that have been set forth by Professors Markell and Casey.

If we have time for more questions at the end we'll do that, but again, we're going to try and do this as an open discussion throughout so please feel free to ask your questions throughout. If you're more comfortable asking questions at the end, we'll also do question-and-discussion at the end of the presentations.

So with that, I will turn the floor over to Professor Markell who will give us his view on cramdown interest rates and providing secured creditors the present value of their allowed secured claim. And from reading his paper, I take it he's going to explain to us that the requirement is not to give the

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[3] *Compare* Bruce A. Markell, *Fair Equivalents and Market Prices: Bankruptcy Cramdown Interest Rates*, 33 EMORY BANKR. DEV. J. 91 (2016) (arguing that *Till* is the appropriate way to determine the cramdown interest rate in chapter 11), *with* Anthony J. Casey, *Bankruptcy's Endowment Effect*, EMORY BANKR. DEV. J. 141 (2016) (responding to Professor Markell and arguing that courts should look to prevailing market rates in chapter 11 cramdown scenarios).

secured creditor the indubitable equivalent of their allowed secured claim which is I think the term that's used in the statute, but rather it is to give the secured creditor an equitable equivalent and again from reading his paper—

PROFESSOR MARKELL: Do you want me to describe my article or are you going to do it?

PROFESSOR BRUBAKER: By equitable equivalent he evidently means not equivalent. Go ahead, now explain that.

PROFESSOR MARKELL: You did. All right. First of all, I want to thank also Jake and his staff and Emory generally. Jake went to the point of actually tracking me down in Chicago and coercing me out for coffee to try and get me to do the article. I understand he did the same thing to Tony. It's that kind of work and effort that gets otherwise slow-moving academics to actually publish stuff, and I thank him for that.

I also, though it pains me greatly, want to thank Ralph for moderating. Because Ralph, as many of you may know, is the Editor-in-Chief of the *Bankruptcy Law Letter*, which he works, and again this hurts me to say, hard in terms of producing some quality stuff, and actually writes some of it. The article that appeared in the *Emory Bankruptcy Developments Journal* was an outgrowth of something that I had written in that, and I appreciate the opportunity to have that kind of vehicle around to kind of talk about the intersection, if you will, of bankruptcy law and bankruptcy practice which sometimes goes unexplored.

What I want to talk about is basically, and we have materials at the end. There's no pagination in the materials, but something from each of us is at the end of it and you can take a look at that for running down what we have said.

What I want to take a look at is approaches to what I'll call cramdown valuation, really through the lens of the *Momentive Performance* case.[4] I want to do that in a couple of stages. The first stage is I want to take a look at, not necessarily the theory but the history and the precedence behind involuntary valuation in bankruptcy which we might otherwise call cramdown, and then to take a look at how Judge Drain handled this in *Momentive*. He wasn't the first person to adopt kind of a formula approach with respect to chapter 11

[4] *In re* MPM Silicones, LLC (*Momentive*), No. 14-22503-rdd, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd*, 531 B.R. 321 (S.D.N.Y. 2015), *appeal docketed*, No. 15-1771 (2d Cir. filed June 1, 2015).

cramdown valuation, but certain in a case that had lots of zeroes in it and it focused the attention of many including myself, so kind of take a look at it from that point of view.

Just some background. Since this is a bankruptcy audience, I don't have to go through too much of the background. It's possible, in bankruptcy the idea, especially in chapter 11, is if you're going to reorganize the idea is to get everybody together to get a feasible plan to go forward, and reorganize by what it takes. If all it takes is a reduction in interest rate or an extension of maturity, that's what you do. But in many cases the change in economics or the drop in value is such that there has to be a reckoning, if you will, with respect to what creditors have and what they could reasonably expect either in liquidation or in reorganization.

So when we talk about cramdown, we are talking about, and tend to throw out Code sections, I want to say § 1129(b)(1), not (b)(2), (b)(1). Because (b)(1) says if you're going to do that, if you're going to cramdown, if you're going to confirm over the dissent of a class, then the plan that does so has to be fair and equitable as to that dissenting class, period. We get to (b)(2) because (b)(2) then talks about being conditions of fair and equitable include the list then of subparagraphs (a), (b) and (c) for secured creditors, unsecured creditors and equity interest holders.

If you go through as I do in my article, that's not unintentional. There's a lot of drafting about how to incorporate and how to preserve much of the learning that had occurred before the 1978 Code. So I went back to some of those cases to take a look at what the Supreme Court thought fair and equitable meant with respect to cramdown provisions in plans after, if you will, basically 1938.

The history is interesting if you take a look at the evolution of the statutory terms of fair and equitable, it actually started out in 1933 as just equitable, and it was only for railroad reorganizations. When we have revision the next year, then Congress decides to add in fair and equitable. If you take a look at the terms fair and equitable and unfair discrimination and feasibility, if you compare that to how Congress kind of mixes and matches those terms as we come from 1933 through the 1978 Act, you get a very interesting kind of view as to how they actually viewed it. And most of the opinions of the court with respect to fair and equitable, at least for the first decade after the Chandler Act of 1938, they're written by Justice Douglas, former chair of the SEC, former Yale law professor, actually probably the last Supreme Court justice who

really cared deeply about bankruptcy. And you take a look at some of his opinions in terms of what he believed was the proper role of valuation, because when we talk about cramdown valuation, what are we talking about?

Well, at some level someone is giving up a prepetition entitlement, either be it a promise or be it collateral for that promise, and they're getting in return something that makes sense in the context of reorganization. That is to say makes sense in the context of a vehicle of trying to preserve a business that's worth preserving. It may very well be that it just produces more cash that it consumes and we have to kind of produce a capital structure that reflects that.

But if you take a look at these cases primarily *Consolidated Rock Products*,[5] *Group of Institutional Investors*,[6] a bunch of other cases,[7] you come up with what I call in the article three basic principles with respect to cramdown valuation. One, don't pay too little; two, don't pay too much; and three, don't expect precision.[8]

Let me explain a little bit about each of those, because I think most of the focus from the practice side these days is on the first one, don't pay too little. Most of the complaints and the objections with respect to what *Momentive* has used as valuation is that although to undercompensate secured creditors they're giving up a collateral entitlement to the obligation, they're getting less than they would get if they had extended the loan on initial terms. I'll accept that some of that actually may be true, that in fact what may be happening in some cases is under-compensation. But that leads me to my second point, don't pay too much, and also leads to my purpose in focusing on § 1129(a)(1) rather than (a)(2).

I think, and I will assert it's an uncodified component of the fair and equitable rule that you shouldn't pay too much, that you don't pay a class anything more than what it's entitled to under pre-bankruptcy rules. That's in essence part of the genesis of the absolute priority rule, that we pay creditors first before we pay a dime to equity. We make sure that the reverse, however, also ought to be true. That is to say, we don't pay the secured creditors too much and leave nothing for junior creditors. And so the valuation comes at it from both sides, not just the side of the creditor in terms of being paid too

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[5] Consol. Rock Prods. Co. v. Du Bois, 312 U.S. 510 (1941).

[6] Grp. Of Inst. Inv'rs v. Chi., Milwaukee, Saint Paul & Pac. R.R., 318 U.S. 523 (1943).

[7] *See, e.g.*, Marine Harbor Props., Inc. v. Mfr.'s Tr. Co., 317 U.S. 78 (1942); Case v. L.A. Lumber Prods. Co., 308 U.S. 106, 117 (1939).

[8] Markell, *supra* note 3, at 103–05.

little, but insuring that whatever valuation you come up with doesn't pay too much to the creditor class. This even can be applied to intercreditor classes where you have senior and junior creditors.

Finally, I spent a fair amount of time in the article talking about don't expect precision. If you take a look at Justice Douglas' writings, either in *Consolidated Rock* or *Group of Institutional Investors* and other cases, you see a healthy skepticism with respect to mathematical certitude. Indeed, the test that you can extract from these cases is that what creditors can expect is the equitable equivalent of what they're giving up; not dollar-for-dollar precision but an equitable equivalent, with certain exhortations that you can't decide this with mathematical certainty, that basically educated guesses rather than precision are to be expected. And that is actually very contrary to what I perceive to be the culture at many hedge funds or many lenders that are in these types of situations who are captured to some extent by what the current—I'll go out on a limb here—current craze in valuation is.

If you take a look at the old, remember under chapter X, that any plan that was proposed had to also go to the SEC first to be assessed for feasibility and then come back to the court for confirmation. So there was a lot more formal evaluation of value at that time, by a staff, an agency that doesn't have the luster it once did, but an agency that at the time was considered one of the best in the government for doing it. And still against this background, Justice Douglas is saying, well, you know, we're going to take a look at capitalized earnings.

Now, if you talk capitalized earnings to most hedge funds or investment bankers they laugh at you these days. It was the current thing then; it's too simple now. They're now talking about getting rid of what we use now in terms of beta analysis and maybe replacing it with some form of analysis based on derivatives trading. Although that point later on as I'll say kind of feeds into what I'm saying, valuation is not necessarily a science. It's not as clear as the sun will rise in the east that you can value a company down to a penny or even to $100 or $1,000 or maybe even a million, depending on what that you are doing, and I think Douglas understood this. Because one of the things that also comes out of these cases is he's saying, well, listen, one of the things you should be doing in bankruptcy is looking to the future. I mean, bankruptcy should shed the taint of the past. And what we have is a very strong indication that valuation in bankruptcy should be based on forward-looking, earnings-based projections and not what has gone in the past.

Indeed, although many people will cite *TMT Trailer Ferry*[9] for the standards for settlements, ultimately that case had another aspect where it reversed the valuation of a company that was based solely on past offers. The Court said, you can't value a company, it's improper valuation of a company to take a look at the past, you have to look at the future. If you don't take into account what the earnings and what the prospects of the company are, that's not a fair valuation. That's not an equitable equivalence going forward. That's simply, to borrow a phrase, using the dead hand of the past to hold down the earnings. And there are from time to time cited in the article lower court opinions who basically say, listen, we think that the markets will undervalue bankruptcy debtors because of this taint. It's hard in essence to value the promise of a company that has just broken every single one of its promises to its creditors. It's kind of like saying, don't think of a pink elephant. You can't get rid of the fact that at some point this is a company that hasn't been true to its word and hasn't honored what it's supposed to do.

So we have this kind of conception, and then in 2004, and I really commend you, Ralph's article from 2004 which is in the materials,[10] a chapter 13 case called *Till v. SCS Credit*.[11] *Till* is a chapter 13 case, no doubt about that. *Till* is a case involving not that much money, about a $6,000, $7,000 loan at 21% interest, and the fight there was, well, what interest rate do you use in chapter 13? Because not surprisingly § 1325(a)(5)(B) uses more or less the same language that § 1129(b)(2)(A) uses with respect to secured creditors, that you have to in fact cramdown somebody, give them property of a value as of date of confirmation which Congress indicated in legislative history would be employing a present value analysis.

Well, herein we come kind of where the issue has arise, to do a present value analysis you need a discount rate. A discount rate is the rate by which you in essence estimate the future will unfold as to what rate will compensate you for the notion that a dollar today is not worth a dollar a year from now or two years from now, and how to get to that number we kind of insert present value, we insert a discount rate, then people take the step from discount rate to the interest rate on any loan or any note or any promise to pay that's incorporated in the bankruptcy reorganization plan.

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9 TMT Trailer Ferry v. Anderson, 390 U.S. 414, 424 (1968).

10 *Cramdown Interest Rates: Disarray Dominates* Till *. . .?*, 24 BANKR. L. LETTER No. 8, Aug. 2004, at 1–12.

11 541 U.S. 465 (2003).

Till said, listen chapter 13, we think that a formula rate, we'll start with the prime rate and we'll add one to three percent for some risk factors that may do it, but primarily this is a market based thing, there are millions literally in car contracts like this written most of the time. And so that's what we'll take a look at. They drop a footnote here and there kind of indicating that they understand that chapter 11 has a different number than chapter 13, but not much more understanding about chapter 11 than from chapter 13. Basically making an equivalency in a footnote between DIP financing and exit financing, which most people have kind of seized on to say, well, they don't really know what they're talking about. But it's there. You have a case interpreting language from chapter 13 that's almost mirrored word-for-word in chapter 11. The courts then go into this kind of fitted, well, do we apply *Till*? Do we apply something else? This rolls along with all sorts of cases from the circuit level on down until we get to *Momentive*.

Now *Momentive* is an interesting case.[12] Momentive was in the silicone and plastics area. It had a little over 2 billion in sales, employed about 4500 people. It also had $288 million a year of debt service on $88 million of revenue. Classic candidate for chapter 11.

The reason it had so much debt, it had been subject to a leveraged buyout by a hedge fund earlier, had been refinanced several times, and it came into bankruptcy with two things: One, it had a business plan but it also came into bankruptcy at a time in which interest rates had dropped from the time that it had refinanced. Its lenders had also very cleverly put into their loan arrangements, and there was no doubt by the way that these lenders were oversecured.

Just to take a step back, the plan that *Momentive* said was, okay, the hedge fund sponsor who is undersecured and who has equity will cancel their interest, put in some new money, issue new stock and we'll then unimpair the unsecured creditors and we'll pay the secured creditors what they're due under the Code. Kind of a plain vanilla approach. The trouble is that no one could agree what the secured creditors were owed. The secured creditors had a provision in their documents that said, a so-called make-whole provision, said if you ever pay us off early, by the way, we want the difference between what

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[12] *See In re* MPM Silicones, LLC (*Momentive*), No. 14-22503-rdd, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd*, 531 B.R. 321 (S.D.N.Y. 2015), *appeal docketed*, No. 15-1771 (2d Cir. filed June 1, 2015). *See generally* Markell, *supra* note 3, at 121–30 (discussing *Momentive* in greater depth and outlining the court's reasoning).

the interest we would've earned had you not paid us off early and what we're going to earn on the money if we have to turn around and reinvest it now. I've written elsewhere I think that's blatantly objectionable under 502(b)(2) as unmatured interest. And that's the core of the fight. Momentive says this is how we're going to treat you. We'll pay you off in cash your multibillion dollar loans. We'll pay you in cash but we won't include the make-whole premium; alternatively, we'll cram you down, and here's the interest rate. We're going to use *Till*.

And so the secured creditors rejected the cash option and said we'll fight you on make-whole, we'll fight you on *Till*, because they thought they had a great case that *Till* didn't apply. Well, the court says, sorry, I think *Till* applies. I think the terms of the reorganization debt are such that I would use a T bill rate rather than the prime rate that the Supreme Court uses. By the way, the rates vary between 3.6% and 4.1%, which, and this is what I love about the case, we know that they had take-out financing arranged if the lenders had opted for the cash option. The interest rate on that financing was 6%. We also know because they filed a 10-K later on about a year later that said they believed that the interest rate they got in this plan was about 87% of market value and even though they were getting a 3½ to 4% rate under the cramdown plan, their weighted average cost of capital was about 10%. So by all measures this was a "good deal."

So how can I support it? I can support it for a couple of reasons: One, let's go back to the original rules. Don't pay too much, don't pay too little, don't expect precision. One of the things that happens when you focus on the don't pay too little is that you kind of forget the don't pay too much. Every dollar of error in favor of the secured creditor takes money away either from equity or from junior creditors. So there's a balance there that isn't really captured by the fact that and insistence that at all costs and even if it was some error, that we're going to make sure we compensate secured creditors in full.

I also think it overlooks the general notion in terms of reorganization that this type of mathematical precision doesn't work and that we're not really supposed to look at the past attributes. It's hard, as I said, to use my pink elephant example, it's hard to think of what would we do because this is somebody who just broke all their promises? How can we value the promise that they're going to make now any differently? How can we value that promise without thinking about that? That's what Justice Douglas and the Supreme Court precedent says you should do. And that's unfortunately when

you bring into a market rate analysis that's what happens because you have to say, okay, market rate for what? Because there's no market almost by definition no market for cramdown loans because cramdown loans are nonconsensual loans to begin with, so how can you have a market for something that's nonconsensual? So you're starting with a kind of constructed base. That gets us to *Till*, and that gets to my final point, which is I think valuation is a question of fact.

What that means is when a court sits down and tries to figure out a value, it's not bound the same way that a student in an introductory class in Finance at an MBA school is limited to kind of there's a long range of things and as I said earlier, we've kind of gone from just kind of earnings to just kind of cash flow to beta to derivatives. You've got to give a little leeway to bankruptcy courts in terms of making the valuation which means the valuation they make can, as long as it's not I'll flip a coin to get a value, as long as it's not irrational it's something that should be given deference. So that's all that Judge Drain did in *Momentive*. He took an accepted valuation that was based on language almost identical to the language that govern in this case and took it through.

Now, do I say that market values are never important? No. I mean they obviously kind of factor in. But the fact that he picked this I think is something that should be upheld because if nothing else it's not an irrational finding of fact that under the rules should only be reversed if it's clearly erroneous.

That's, in a nutshell, my argument.

PROFESSOR BRUBAKER: I'll exercise the prerogative of the moderator to ask the first question. So when you say we should apply *Till*, what does that mean, since *Till* didn't actually have a majority opinion and it's hard to see that it even had a holding?

PROFESSOR MARKELL: *Till* was a four-one-four opinion, with the one who knows what that went with. So I think you apply the plurality, which got Justice Thomas to kind of at least not dissent from it. The way in which I read *Till* is an acceptable way of valuation in cramdown situations using the language you find in §§ 1325(a)(5)(B) and 1129(b)(2) is a formula method based on a base point of either prime rate or as *Momentive* used *Till*, plus some factors that in my mind can maybe verge on feasibility.

PROFESSOR BRUBAKER: My problem with that is that you didn't have a majority of the Court sign off on the formula method, and Justice Thomas, who concurred, said there should be no compensation for risk at all. You should use

a risk-free rate and the only reason he concurred is because he said there was no reason for the creditors to complain.

PROFESSOR MARKELL: But I would go the other way. The fact that he didn't dissent means—

PROFESSOR BRUBAKER: It's just an oddity of the posture of the case.

PROFESSOR MARKELL: I would agree but at the same time, they didn't reverse it. If they didn't reverse it, it's almost per se an acceptable way at least in 13's and the question whether—and I don't think it's much of a question to say you extend that beyond. If it was unacceptable they would've reversed. They didn't.

PROFESSOR BRUBAKER: Isn't a more rational way to read the voting alignments is that eight justices, it was an eight-one decision. Eight justices agreed that there has to be compensation for risk. One justice said there doesn't have to be compensation for risk. And with respect to the methodology for coming up with what is the compensation for risk, there's no holding of the Court because a majority did not agree. So doesn't that just leave things wide open for bankruptcy judges? And it's in alignment with your view that it's just a question of fact that as long as the bankruptcy judge is adopting a reasonable basis for giving compensation for the risk that's inherent in the promised stream of payments then the bankruptcy judge has to be upheld.

PROFESSOR MARKELL: That's half of my argument. The other half is, and it's not part of *Till*; it's part of the older cases is you have to be careful that the factors, the inputs aren't tainted, if you will, by the fact that the debtor is in fact a debtor or by the past bad associations with the debtor. In essence, I mean I think you have to take a look at the economics, if you will, or at least the business model as well, and that has to justify it. I mean that is, as I think you're hinting, more a feasibility issue than anything else, but at the same time, and again I go back to the *TNT* case. There's a case in which the valuation was based on offers that they had prebankruptcy. They didn't even look at the current cash flow projections of the company. And the Court said, sorry, that's just improper valuation under bankruptcy. Under bankruptcy we don't look at the past, we look at the future. So the other half of that has to I think include—I mean, I think you're right as to half of it, but you're fast but you're not half fast in terms of that way in which it goes and that's half kind of where we want to go.

PROFESSOR BRUBAKER: And the other thing to think about is the justices and the lower courts were very concerned about the particular methodology in chapter 13 because you're not going to have evidentiary hearings in a chapter 13 cramdown case the way you will in a chapter 11 case, so the baseline that you're adjusting from is all important in chapter 13, perhaps less so in chapter 11.

PROFESSOR MARKELL: I mean, I understand that argument, and the trouble is, is that I don't see that anywhere in the statute. I mean I think that's what the Court tried to kind of get, because it drops a whole footnote in terms of where all this similar language is used in all the Code, even in chapter 12.[13] And I think what they were looking for which you can say from the text of *Till* is that they want you to start from a generalized common starting point when interpreting similar language.

MS. FREEMAN: And there are a lot of—there is a market for used car loans. You can get that. There was evidence that the Court could've considered. So they rejected that. They said, don't look at that, even though it's very much there.

PROFESSOR BRUBAKER: We'll keep this moving and we'll go to Tony. So Tony, we know Bruce is wrong, but how wrong is he and exactly why is he wrong?

PROFESSOR CASEY: Thank you very much. So I kind of agree, just to touch on the argument that just happened, I don't think *Till* gets us very far. So to defend Drain in *Momentive* against the four-four-one problem, the Second Circuit had adopted *Till* in chapter 13s, so to the extent that that applies in chapter 11, the lower court was bound.[14] In chapter 13 Drain would've certainly been bound by *Till*. I don't think you can extract from *Till* that you would have a majority in a chapter 11 because as Professor Brubaker suggested, Thomas had this weird concurrence and he actually focused on the one word that was different in 13 than 11, and he talks about the property to be distributed where in 11 we're talking about deferred cash payments. And his analysis there I think flips his vote in a chapter 11 so the dissent becomes five-four.

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13 *See* 11 U.S.C. § 1225(a)(5)(B) (2012).

14 *See* GMAC v. Valenti (*In re* Valenti), 105 F.3d 55, 64 (2d Cir. 1997) ("Therefore, we hold that the market rate of interest under § 1325(a)(5)(B)(ii) should be fixed at the rate on a United States Treasury instrument with a maturity equivalent to the repayment schedule under the debtor's reorganization plan.").

Now legal realist in me says so what. Like the Court looks totally different now. I know how Thomas is going to vote. I kind of don't know how anyone else is going to vote in a chapter 11 case. But all this then says well what should we be doing with the statute with the history in chapter 11, and there's lots of reasons to think that the context is very different from chapter 13, both because of markets but also because of if we tank a company because they can't get a loan exiting bankruptcy, that might be the right outcome. If we tank an individual human because of that, that might be the wrong outcome. So we might want to use a non-market rate in chapter 13 and we might use market rate in chapter 11.

With that, let's look at the history and the principles. I agree with a lot of what Professor Markell says except his ultimate conclusion. So what's the purpose of chapter 11 reorganization? We have this collective action bargaining problem that we fear will cause stakeholders in a company to let it fail when it goes into distress. So we create a statute to try to force them to do things that are in their collective best interest. One of those things is we allow cramdown. Cramdown keeps creditors from acting opportunistically. So let's say a creditor is the best new lender to a corporation and they're like, I'm willing to loan to you at the market rate of 10%, but I know that it would cost you 2% in transaction costs and this asymmetric information, I know it would be 12% on the market even though the real risk rate makes it 10%, so I'm going to say I want 11.5%. And let's say that it's only worth it to the debtor at 11%, we're now destroying the company when everyone who knows, knows that 10% is the right rate. Hard bargaining like that could lead the debtor not to reorganize when it should. So the Code says you can cram the lender down. You can force them to essentially continue to provide financing, provide a new exit financing at a rate, the market rate.

Now I think of that as the don't pay too much. You can't as a creditor ask for too much, and too much in my mind here is defined as so much that it would destroy the value in the debtor. And that, we have a statutory provision that gets us there. That's § 1129(b)(1). I think Professor Markell's article is great in focusing people's attention on § 1129(b)(1), which so many courts and lawyers forget about and they skip straight to (b)(2). And Frank Easterbrook has some nice opinions saying fair and equitable is more than just § 1129(b)(2). It includes whatever is implied by the history of fair and equitable. Don't pay too much.

Now there's also a worry, though, that if a debtor can take advantage of the bankruptcy process, they will incur costs and cause creditors to incur costs in this game to extract value that doesn't create it in for the estate. So for example, if the market rate is 10% but I can get 8% in a bankruptcy, I'll file, I'll make everyone incur all the costs of bankruptcy, and now I the debtor have a new loan at 8% where it used to be 10%, and all these costs incurred, I don't care; they go to the other stakeholders. So the Code does not want that. That's a collective action bargaining problem. It doesn't want the debtor to act opportunistically that way.

So to prevent that, the Code has to say, don't pay too little. You the debtor are not allowed to pay too little. But where does that come from? That comes from § 1129(b)(2) which, Professor Markell left out the word in the statute that I think is important, they're called requirements and the courts have said these are requirements. *RadLAX* is very clear, the Supreme Court opinion in *RadLAX* that you have to meet § 1129(b)(2).[15] You have to give the creditor one of three things. You have to give them the stream of payments equal to the value of the collateral, with some weird nuances about § 1111 and maybe more than value required in certain instances. Or you have to give them the right to buy the asset in a market sale through a credit bid. Or you have to give them the indubitable equivalent. And every case that I've ever seen indubitable equivalent suggests that last one is a really high metric, and the reason it's a really high metric and Judge Posner had a great opinion in *River East* where he says because we should be skeptical when the debtor is choosing something other than a market sale or giving them a stream of payments equal to the value of the collateral. Because if the things really were all equal, the debtor should be indifferent to the three. So what's this third thing they're trying to give?

So giving the indubitable equivalent should be pretty rare. And the language in *RadLAX* suggests as much. I buy fully into Judge Posner's view in the Seventh Circuit and *River East* about we should be very skeptical when we use that.[16] So then the question is, okay, so we have this too much (b)(1), too little (b)(2), and Markell gives us this new idea of don't expect too much precision. It's not in the Code, but I think it is in the history and I agree completely with it.

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[15] RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 132 S. Ct. 2065, 2069–70 (2012) ("A Chapter 11 plan confirmed over the objection of a 'class of secured claims' must meet one of three requirements in order to be deemed 'fair and equitable' with respect to the nonconsenting creditor's claim.").

[16] River East Plaza, LLC v. Geneva Leasing Ass'n (*In re* River East Plaza, LLC), 669 F.3d 826, 828–29 (7th Cir. 2012).

But to implement that we need to know too little with regard to what, too much with regard to what. His analysis suggests with regard to the pre-bankruptcy entitlements. That is consistent with I think the way most people talk about the Bankruptcy Code, although most people who do use that entitlement think *Momentive* was wrong. I think that's the wrong baseline. It's not about the pre-bankruptcy entitlements because we overpay and underpay on pre-bankruptcy entitlements all the time to solve the collective action problem. Too little and too much should be about too little being too little such that the debtor is allowed to act opportunistically or so much, too much, so that the creditor is allowed to act opportunistically. When you do that and you say, okay, well, if we set a below market interest rate, the debtor will do all the things I talked about earlier. It will take advantage of bankruptcy to change its loan, and that's not helping anyone. It'll do things like it did in *Momentive*. So it proposes a plan and says I'll pay you cash, what you're entitled to, as long as you give up your procedural objection to the make-whole payment.

Now I think I agree, although it's really complicated. I think I agree with Professor Markell that make-wholes are probably not allowed in bankruptcy in the court in that in the end they weren't allowed here.[17] But your objection about the make-whole is absolutely allowed in bankruptcy. And so if the debtor is using this threat of I'll give you cash, which with the current value, or I'll give you this below market value, if you exercise your procedural rights. You see that the debtor is misbehaving. They're saying, I want to force you to give up your rights to object. Now whether or not you're entitled to make-whole I don't care, you're allowed to make motions in bankruptcy court. So the debtor uses this delta between market and non-market to extort procedural rights from the creditors. And we shouldn't think if *Momentive* is affirmed that it should be limited to procedural rights where the creditor will lose. It might be like you're violating the absolute priority rule. You're giving all kinds of shares to the CEO's husband or wife. Well, you can't object to that or I'll cram you down with a low market interest rate. That we should really worry about. And so for me the too little, too much, should be all about that.

Then the precision comes in. What I find odd about using the precision to support *Momentive* is *Momentive* gives us a pretty precise answer and it gives us the *Till* formula, prime or T bills plus one to three. In the world of bankruptcy valuation, that's pretty precise. And Professor Markell and Judge

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[17] See Bruce A. Markell, *"Shoot the ...": Holes in Make Whole Premiums*, 36 BANKR. L. LETTER NO. 5 (Thomson Reuters, St. Paul, Minn.), May 2016, at 1, 2–3, 4, for a discussion of the make-whole premiums issues in *Momentive*.

Drain tell us, yeah, but you want us to give valuation and valuation is really hard and we don't like mathematical certainty. I was like yeah, we don't care about mathematical certainty. So it's okay to do a valuation that's kind of back of the envelope. And so in most cases you can say what's the general market for exit financing, and I'm going to give you a rate that's equivalent to that. I'm not going to get it right because a valuation is messy, but we don't need to be that precise. And it's not going to be exactly your pre-bankruptcy entitlement, but we don't need to be that precise either. We just need to be kind of within the range of fairness and not too high so that we get opportunistic behavior, and not so low that we get opportunistic behavior.

And then *Momentive* is particularly funny because we actually knew what the market rate was and we didn't have to do a back of the envelope. It's one weird case where we knew exactly what the rate was, and so we could be both not too high, not too low, and precise. In most cases we won't be, but that doesn't mean we should throw out information. The way I look at *Till* is, it's a very precise rate that is always too low. And so you're sacrificing not too high, not too low for precision and you should be doing the opposite. You should be sacrificing some precision to get something within the range that avoids the opportunistic behavior that the whole point of bankruptcy is to prohibit, which is ultimately why I think *Momentive* went the wrong way. *Till* might have been right in chapter 13 because I don't think there we're only worried about opportunistic behavior. We're also worried about fresh start and people having a livelihood. Companies are different. We don't worry about those last ones.

PROFESSOR BRUBAKER: I'll exercise the moderator's prerogative again to ask the first question of Tony. So I think a lot of people agree with you that using *Till* systematically undercompensates secured creditors for risk. And after reading *Till,* do you get the sense that's what it's intended to do is to systematically undercompensate secured creditors for the risk? Scalia's phrase was a memorable one. Picking a smallish number out of a hat.[18] There's actually some flavor of that in Professor Markell's article where he says you have to keep in mind that we have a reorganization purpose here, and preserving viable companies. That also seems to be putting a thumb on the scale of don't pay too much and going towards pay too little.

PROFESSOR MARKELL: Is there a question there, Ralph?

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[18] Till v. SCS Credit Corp., 541 U.S. 465, 501 (2004) (Scalia, J., dissenting) ("[I]t is impossible to view the 1.5% figure as anything other than a smallish number picked out of a hat.").

PROFESSOR BRUBAKER: This is the setup for my question. As an explanation for that instinct to systematically undercompensate secured creditors and that people would sign onto that, I proffer a couple of explanations that I would like your reaction to. So of course in giving in this equivalency calculus, it's an equivalency to the allowed secured claim, the allowed secured claim turns on the value of the collateral, especially when the secured creditor is undersecured which are in some ways the more significant cases to be thinking about in that regard. So it may be a reaction to the fact that there's a sense that, with respect to collateral valuation, secured creditors are being systematically overcompensated and that can be attributable to a couple of different things. One is that it's just baked into the cake with *Rash,* that *Rash,* by choosing something other than foreclosure value for the collateral is systematically overcompensating secured creditors, and this is just a fudge factor on the interest rate side to make sure that secured creditors are not overcompensated.

The other way in which especially in the new world of capital structures being dominated by secured credit and sort of vastly undersecured and secured creditors coming in, secured creditors are also capturing a lot of the going concern value of the company in reorganization in all sorts of ways which may not necessarily be appropriate, depending upon how you view their baseline entitlement. They may be entitled as a baseline matter to none of the going concern value that bankruptcy—what bankruptcy is all about is how to allocate that going concern value. So maybe the instinct that we should be systematically undercompensating for risk in the interest rate is to sort of correct for these valuation issues.

PROFESSOR CASEY: I'm sympathetic to the instinct but not the solutions. I've written elsewhere about we don't know how we should divide the going concern surplus and certainly secured creditors do under the current system capture most of it in most cases. I'm not sure that's the right outcome. There are ways to solve that, proposing changing absolute priority and making it relative priority, tweaking it other places. Secured creditors might be overcompensated elsewhere. And Drain talks about two things in the *Momentive* rate. Like there's the transaction cost and I think he's right that we should net those out of the cramdown interest rate but not the profit because the profit, we should be comparing to a market rate.

If you decide to solve this going concern surplus problem and overpayment of secured creditors through the cramdown rate, you're creating a weird

distortion because you're only solving it when you're cramming down a secured creditor. You're not solving it when you don't need to cramdown when you pay them off, when you reorganize and give them consensual reorganization where they get equity. It's just solving this big problem with this tiny little thing that creates these other big problems of distorting behavior. And so again I think the way we should divide the going concern surplus is the way that minimizes opportunistic behavior. The way we should set the cramdown rate is the way that minimizes opportunistic behavior. We shouldn't maximize opportunistic behavior here to solve the problem that we're maximizing opportunistic behavior here, because then we're just transferring value with lots of opportunistic behavior. So again I agree with the problem but not the solution.

PROFESSOR MARKELL: I just want to point one thing out, and that is our model in our minds may not be accurate. Last year there were about 7500 chapter 11 cases filed; only 99 of those were public companies. Approximately 25 to 30%, a quarter to a third of all cases are individuals. And I'm not sure how much that when we start talking about going concern value and the like, it's the same statute for individuals. I'm not so much how much of that learning will transfer to the vast bulk of chapter 11 cases which is I think a strength actually of *Momentive* in terms of looking at it as an if you will approved or not disapproved method of valuation.

MS. FREEMAN: That kind of feeds into mine because let me come at it from a practical perspective of the litigator and from the perspective of somebody who practices in Arizona and Nevada and Colorado for the most part, which is probably not all that much unlike practicing in Georgia, in that you don't have cases like *Momentive* with $17 billion of debt. Most of the chapter 11 cases that you have are small businesses. You've got some individuals and you've got a lot of small businesses, and those are the ones you're dealing with. And in terms of how to prove your cramdown rate, *Till* is great. It's really nice to have a formula where you're focusing on a number that you can start with, whether it's the T bill rate or whether it is the prime rate, and then figuring out what the risk is because you're dealing with evidence about risk in terms of feasibility in any event, and that's what the creditors are focused on and that's what the debtor is focused on. But to try and come up with what hypothetically you could get with a combination of a senior loan and a mezzanine loan and an equity infusion and try to hypothetically come up with some dollar amount, I mean, people may be willing to pay for that evidence in a $17 billion company, but most companies, you're not going to be able to do that. And even having

the Court, I think *Till* also rejected having the Court determine what a creditor could have obtained if it foreclosed and then it reinvested the money and then it was able to make something else. That's not the point. The point is to figure out the discount rate, how much does it take in order to pay this creditor over time and get the equivalent of what he would've had if he were paid in cash today the amount of the secured loan.

So I think that's important. I think that the relative ease of implementing it is really important. I think that, especially Judge Drain in *Momentive* was right that *Till* does, that the four-judge opinion that is really treated as the plurality opinion as a practical matter in cases going forward, does meet the underlying principles of chapter 11 and chapter 13. It meets the underlying principles of § 1129 because the other approaches are trying to put the creditor in the position that the creditor would've been in if the creditor arranged a new loan, and the point is to figure out what does it take to pay to get the equivalent of getting this secured component portion of your loan in cash today but spread out over time. And that doesn't include profit, and that doesn't include what kind of transaction costs you would have if you were obtaining a new loan.

It also results in a number that is not back-breaking which is very important for being able to confirm plans especially in my mid-market kinds of cases that most of you all will be dealing with. *Till* is implicitly sanctioning the 1% to 3% number. It said that, and it said it's approving this risk adjustment of 1.5%. I like what *Momentive* did in terms of chapter 11 as saying a T-bill rate makes a lot more sense than a prime rate because a T-bill rate is really paying a company over a period of time as opposed to what banks are loaning each other right now. That may make more sense for a consumer loan, but in terms of a business loan the T-bill rate makes more sense. I think Judge Drain was great in pointing out that a T-bill rate assumes that there is no risk at all, as opposed to a prime rate which assumes some risk for the banks loaning each other. And so you have to add a little bit more. And, all right, it was .5% for one and .75% for the other, given the respective risks of the amount. But that makes sense.

So how do courts use it? Other circuits since then, they say that they're not using it but they really are. So *American Home Patient* says, well, we're taking our cue from the *Till* footnote which says it makes sense to ask what an efficient rate would produce.[19] But then the court, although it says it's a coerced loan approach it's really not. Instead it takes the debtor's expert's six-

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[19] *In re* Am. HomePatient, Inc., 420 F.3d 559 (6th Cir. 2005).

year T-bill rate and adds .35%. Okay. That really is the equivalent of the *Till* plurality. The end result is actually lower than the *Momentive* rate of 4.1% above the seven-year rate. And then you have the other circuit court case which is the Fifth Circuit in Texas, *Grand Prairie Hotel*, and it says it's not going to tie the hands of bankruptcy courts in terms of figuring out how you come up with a rate.[20] But it's not going to take this coerced loan formula of figuring out what the combination of equity and mezz and forced loan for a senior debt would be, a hypothesized package of rates, and instead accepts the *Till* rate of 5%, says that's not clearly erroneous, and the court says that's fine. It rejects the bank's expert computation.

So in practice, in the kinds of cases that we have, how can you try to figure out what a market rate might be? Can you really test the formula rate against the market? Well, my initial understanding of an efficient market was, is there a market out there, and that comes back to things like you've got a big market for used car loans, and yet the court is rejecting that and is not turning to that and it's rejecting the coerced loan approach as well.

I appreciated what Professor Markell said in his paper about efficient market is efficient as understood by economists of really prices that are reflecting all the known information, all the information that you really need in order to make a determination of what the asset being traded is in the efficient market context, and it's really here the equivalent of what the rate would be as an alternative in this particular context. I don't think that the thing that you would look to would be the DIP loan context, even though that's what the Court referenced in its footnote because DIP loans really are loans to a company that is in bankruptcy under the supervision of a bankruptcy judge with all of the creditors looking over their necks, and it's the context of a company that is very much in distress as opposed to you get to the reorganization and you should have a reorganized company that can go forward and fend for itself, that is now de-leveraged and is in a much better position going forward. So they're really different.

Judge Drain in *Momentive* said there aren't any cases anywhere that have accepted a DIP loan rate as a proxy for a cramdown rate, and that makes sense. You just wouldn't do that.

So then you have ones like exit financing, it's generally by a third-party lender or it's often by a rights offering. You have a combination of the existing

[20] *In re* Texas Grand Prairie Hotel Realty, L.L.C., 710 F.3d 324 (5th Cir. 2013).

lender that's putting in new money and giving an opportunity for some of the other creditors to put in new money on a rights offering.

One of the cases that's a post-*Till* case is *DBSD*, and the court points out, no, we're not going to look to the reorganized debt possibilities and what's being done here because it's a rights offering and there's equity attached to it to encourage participation. It's junior to the exit facility that we're trying to come up with an interest rate for. It's just different. It's not something that you could have as an equivalent even in an efficient market kind of a comparative sense. *Momentive* you've got your billion-dollar exit facility and your seven-year term and 5% interest rate, but the court points out that there were three potential exit financers and they all combined to come up with something and they kept confidential their fees, and they kept confidential their rate flex provisions. You don't know what all of this was. So it's not really something you can look to and say, all right, there's my efficient market.

You do have some cases, I think one of them where you had actually 14 different lenders that they said, and I'm not finding my note here as to which case it was, so you may be able to come up with some evidence as to what's different. I also agree with the point in Professor Markell's paper about reorganization debt often being the subject of negotiation and therefore it being unusual, not really a market in the sense that it would take into account I'm going to negotiate out your objection to my receipt of funds on an avoidance action basis. I'm going to kind of settle my fraudulent conveyance claims as part of this, or I'm going to settle my make-whole value. Those kinds of things mean that it really is not the equivalent. So what you're really talking about is a third party, and in most cases you don't have a whole market full of third parties like you do for used car loans, but yet the Supreme Court is rejecting that as a basis.

The other thing that I think is really important about *Momentive* and why I think it's a great decision is that the court's pointing out no private lender, no third party lender out there is going to come in and give you a loan without covering all of its costs and fees, and without making a profit. That's the whole point of their business. They don't go out and make loans without making a profit, and a profit component I think is not really part of figuring out a discount rate, which is what this whole thing is really a proxy for doing. *Winn Dixie* was the one where they had 14 exit financing proposals that they came up with.

So I do think that market testing matters in terms of collateral valuation which is a big component of figuring out cramdown, what is the amount of money that we're going to cramdown, and so you're figuring out the value there. It matters for valuation in terms of treatment whether you're going to sell it and figure out what the value is, and that's the *RadLAX* kind of an issue of should you have the market testing to figure out whether you're getting the right amount through your sale. It matters for testing new value, the amount of equity that you have to put in, that's the *203 North LaSalle*, it matters for the liquidation analysis, what are you going to sell this for and the liquidation value. But in terms of the interest rate, I really don't think it makes that much of a difference. I think that the real matter—sure.

[Inaudible question or comment from audience]

PROFESSOR MARKELL: Actually it's not actuaries; it's one of the biggest markets for Ph.D's in math. No, I'm serious, it is—

[Inaudible audience member talking at same time]

PROFESSOR MARKELL: - is the Wall Street firms in terms of calculating those rates.

[Inaudible question or comment from audience]

MS. FREEMAN: It does.

[Inaudible question or comment from audience]

MS. FREEMAN: But even in the bigger cases where you do have some evidence, where you do have efforts to try and get exit financing from a third party, which are not your consumer cases but a little bit bigger, that exit financing effort does have a bearing. It has a bearing on figuring out what the risk is. It has a bearing on feasibility. I mean, if you can't get a loan except at 25% interest, then this is not going to fly. It's not going to be feasible as a practical matter. So that kind of evidence matters.

In the *Momentive* case, the kind of evidence that the Court took was evidence from the CFO of the company, and then from the experts for the debtor and the expert for the creditor, and the kind of things that they were looking at included that the future shareholders were putting in $600 million of new equity, which shows that people believe in this, that they think that there's not that big of a risk because they're putting in this much equity. And so one of the things that you need to look at is how much is really being invested here by

whoever it is, because you're going to have some new investment to be able to go forward with your reorganization.

PROFESSOR MARKELL: My cynic's view is that the 600 million of equity just showed that they really got the equity for a really low price, because in *Momentive* you're not dealing with the original lenders; you're dealing primarily with hedge funds who bought and sold this, and the number you don't know is what they really paid for the debt they're trying now to get 100 cents on the dollar for.

MS. FREEMAN: That's true. So maybe you discount the 600 million and say it's the equivalent of 100—

PROFESSOR MARKELL: I mean, 600 million, I mean, listen, if you're going to offer me 600 million I'd take it. I'm not saying it's a small amount.

MS. FREEMAN: Okay. So let's talk about some unusual default cases, which is part of what my materials included, and talk about what that means for the overall.

One of the things that I discuss is affordable housing, and that's the *Sunnyslope* case that was mentioned at the beginning.[21] When you have affordable housing, you have reduced rental rates so that people who have very little money can afford to pay that. Well, as a practical matter, you're not going to have as much financing ability. You're not going to have the stream of rental income that you would have if you were operating at a market rate, and so you have to be able to under a plan stretch it out over a period of time. In affordable housing context, what you usually have is a secured loan that is guaranteed by HUD starting out, and then you have some additional financing, often from government entities, in my case from the State of Arizona and from the City of Phoenix. And then you have equity in the form of investors who are going to come in and they get tax credits as part of having this affordable housing, that's their compensation effectively for doing this. They get the ultimate value of the property after the debts have been paid off over a period of time. And when you're talking about affordable housing, under the Treasury regulations, you're usually talking about a 40-year period, 30 to 40 years. So this is a long period of time which is why the government is really involved in the first place.

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[21] *In re* Sunnyslope Hous. Ltd. P'ship, 818 F.3d 937 (9th Cir. 2016), *as amended on denial of reh'g* (Apr. 21, 2016), *reh'g en banc granted*, 838 F.3d 975 (9th Cir. 2016).

But then if the debtor defaults, HUD usually sells its loan so that the government gets whatever money it can get back, and so now you have a new private bank. And the new private banks don't want to get paid over time at a low interest rate which is what they acquired when they bought an affordable housing loan. And as a result, they want to try and foreclose, and foreclose out the covenants, conditions and restrictions, which are what require the property to be operated as affordable housing. That's fine if you foreclose it out. But if you don't foreclose it out, then you get stretched out over time under a plan of reorganization. The CC and R's continue to bind, and what *Rash*[22] says is you value the property based upon what the debtor is doing with the property and what the debtor even could do with the property, and when you're dealings with affordable housing, that means binding CC and R's, not foreclosing them out, and operating over a period of time to do so.

So what does this mean for interest rates? Well, in the *Sunnyslope* case, the court came up, used a *Till* formula, and looked at factors that bore on the risk that would take it above the prime rate, came up with a 1.15% risk premium, looked at the fact that at this point in time after it had been operating for a year in a bankruptcy, the debtor had a demonstrated post-petition ability to generate positive cash flow. It had new property managers who were very experienced in affordable housing. There was a significant cash cushion, $1.5 million, this is a pretty small project, that the investors were putting into this project, and so you have additional investment that is coming in, and that provides a cash cushion, and one of the things that the court did in terms of look at what a market rate would be, was to go back and look at what the original loan was. And the original loan had an interest rate that was .04% less than prime for a 40-year loan at a point in time that the project had not even been built yet, and but it did have a HUD guarantee.

Okay, so you compare that and say now we have a stabilized project that is built and does have continuing income, has quality management, stabilized occupancy, but it doesn't have a HUD guarantee, and so you look at it and see what the comparison is. And then you also in that situation had the market equivalent of looking to see what is the current market for affordable housing loans, because people are still building affordable housing, and they're still making loans for affordable housing, and so you had evidence of a 40-year low income housing tax credit properties that are continuing to be built, and they're being financed with rates that are 4.2% over—that's the median over the 10-

22 Assocs. Comm'l Corp. v. Rash, 520 U.S. 953 (1997).

year T-bill. And so the court says, all right, there's a market for it. I can look at it right now and see that these kinds of loans are being made for affordable housing.

And then you had one other unusual factor that bore on risk in this affordable housing kind of case, and that's the fact that once you do foreclose, then the covenants, conditions, and restrictions are foreclosed out, they're extinguished, and also at the end of the financing period, then the affordable housing restrictions go away, so that at the end of the 40-year period the restrictions will cease and you'll be able to increase the rents to market rate at that point in time. But that gives some assurance that, yes, you're going to be able to repay the loan in full or be able to refinance it. And in this particular case they exercised § 1111(b) rights, so you not only had the amount of the secured claim, but you also had that deficiency claim that is having to be paid as a balloon at the end. How can you make sure you're going to pay it? Well, by that time the affordable housing restrictions will end and the rates will go up. And we did put in evidence of 35 other apartment complexes in this same Phoenix metropolitan area that added over 40-year term, they were still, they'd been maintained well enough and they were operating just fine and still had income and so we had that kind of valuation as well.

But then also at the point in time that there might ever be a default under the plan, then again, the secured creditor could foreclose, market restrictions would end, the interest rates would pop up. The court called that springing value and said that's a credit enhancement. That's the equivalent of a guarantee from somebody with money or a standby letter of credit or mortgage insurance. You know, you have other kinds of things that help provide some assurance that something is going to get paid, so that reduces the risk. And the point is, look at your deals and see what might reduce the risk as well as the things that might increase the risk going forward, because that evidence of risk matters in terms of figuring out what the value should be. The evidence of market matters in the sense of a comparable when you do have something that's out there, but a lot of the time you just don't.

So the other case that I talked about was the *River East Plaza*,[23] and I take this as a case that is really showing that in some instances while the creditors want safety, want to be sure that their loan is going to be paid, and the whole point of the risk and the interest rate is to help show you that, yes, in fact,

[23] River East Plaza, LLC v. Geneva Leasing Ass'n (*In re* River East Plaza, LLC), 669 F.3d 826 (7th Cir. 2012).

you're going to get paid over time, sometimes the secured creditor believes that the value is increasing, and so it's not a matter of concern that the value is going to go down and I'm not going to be able to foreclose and get my money back at that point in time and I need that risk assistance. Instead, I think that the value is increasing or may increase, and that's the kind of situation where if it's going to get sold, you're going to exercise your § 363(k) rights and credit bid so that you're the one who owns this property and can benefit when it goes up in value. And if it's going to be a cramdown, it's a stretch-out, that's when you're going to exercise your § 1111(b) rights so that the amount of your secured claim at the point you do foreclose because there might be a default is the whole debt as opposed to just your amount that was valued as the secured claim back on the confirmation date, and then the debtor gets the upside when it gets foreclosed and somebody comes in and buys it for a bazillion dollars. So, yes, you do want to exercise your § 1111(b) rights at that point in time.

So *River East Plaza* is one of those where there was an expected rise in value, and so there was an § 1111(b) exercised, and it was one where what the debtor was trying to do was to use indubitable equivalent and give the creditor T-bills. I'm going to give 30-year T-bills. Those are not risky. This is great. This is just what you want. This should be fine. Indubitable equivalent of this property is Treasury bills, you should be fine. And the court points out that if the debtor defaults and it has a lien on real estate, it can foreclose immediately. And if the debtor has a lien on T-bills, then it can't get the money back for the remainder of the entire 30 years. So there's a little bit of a difference there. And that if the value goes up, the value of the T-bills is not going to go up. It's right there. It is what it is. And so you don't get the benefit of that rise in value, and the court says the two types of collateral have to have the same risk profiles to be indubitably equivalent. So that's what it's focusing on.

But it also bears on interest because one of the things that the court said is, "The fewer rights that the creditors have in the event of default, the higher interest rates will be to compensate creditors for the increased risk of loss." You're really focusing on risk and what impact risk has on the interest rates. So safety isn't the only thing. It also includes your rights upon a default.

And that brings me to the nonbankruptcy endowments preservation. I think this risk upon defaults is the practical illustration of what I read in Professor Casey's materials. I disagree that the focus of cramdown should be on preserving those property rights. I think that that's an important part of determining what the value is of the collateral and whether or not the property

can be sold free and clear of those kinds of things. But for the most part your debt is not the property that you're cramming down. Your debt is the amount of money that you have to pay out and you're entitled to preserve your security interest in the property that under *Rash* is valued from the debtor's perspective. And then that amount is what's paid out with interest or result in an equivalent of the discount rate.

But the non-bankruptcy endowments can play an important right in evaluating risk, and that's what we saw in *River East* and part of what we see in *Sunnyslope*. More commonly from the kind of cases that you and I are dealing with on a day-to-day basis is when the debtor is trying to in its cramdown give you a new note without all of the bells and whistles that your client had put into its original deed of trust or its original UCC financing agreement, things like I can have my UCC foreclosure upon ten days' notice. Nope, they want to get rid of that; instead, they want to be able to come back to court and argue about preserving the value of it, and things like I want to have a rental lockbox, so all the money is going to come into my lockbox. No, of course, the debtor wants to get rid of those kinds of things, but those are the kinds of things that bear on risk, on your risk of the debtor not paying you. So practical note to self is look at the details on those kinds of things, and don't just look at the disclosure statement and the plan that say you're going to get X percent of interest, and you're going to keep your collateral. It's more than that, and you have to spend the time to go back and look at it.

So it does matter. I can say from a creditor standpoint I'm going to say that those relate to my collateral and my interest rate that I get and the amount of risk on when I'm representing the plan proponent, what I'm going to say is those provisions all go to the claim amount, so figure out what the—I'm liquidating your claim and paying you the amount of your claim, and your claim is now an amount that's in default and part of the defaults are that you're no longer getting your lockbox. So monetize that. What's your damages from no longer getting your lockbox, and that is part of the amount that you have, and that's what I'm going to pay you out over time with my interest rate.

In terms of incentivizing opportunistic behavior, I would say that because of the costs of chapter 11, because of the cost in professional fees and the cost in the impact on the debtor's business, its impact on its sales, its impact on the time that all the management has to spend on this thing, that really it's pretty rare to come in and say, I'm going to reduce my interest rate by a couple of points, and therefore I'm going to file bankruptcy. I think it's a real world

matter that doesn't really happen, and you also have the importance of the petition really has to be filed in good faith. And if what you're doing is just coming in to reduce your interest rate, it's not going to fly in I think a lot of cases in any event. There are cases like *Integrated Telecom* where you have a filing that's just to try and reduce the amount that the landlord gets paid to the amount of landlord's damages upon a default. That's not enough for a bankruptcy. You also have to have a real financial impact. You have to be in—you can be solvent, but you have to have financial distress.

With respect to the point about § 1129(b)(2) saying fair and equitable includes the following requirements, which implicitly requires you to include other historical requirements, I would say as a practical matter that I've never seen a court that's come in and said even though the Code says you have to meet 1, 2, or 3, you now also have to meet 4, 5, and 6 that aren't written into the Code. I've never seen that happen. As a lawyer arguing to a judge, I would look to *RadLAX* saying you must meet 1, 2, or 3 to be deemed fair and equitable. That 1, 2 and 3 establish the criteria for determining whether a cramdown plan is fair and equitable. That's what I have to meet and that's all I have to meet and I don't have to come back to something else. I don't think that this is a floor for anything and that you have to come up with some amount over and above that to try and get something better. And certainly there is a tragedy of the commons kind of situation where each individual creditor wants to get the best for himself, even though that's not the best for the debtor and for the reorganization and for the country as a whole, the economy as a whole. You want to have reorganizations that work and that go forward and not just what's in the individual creditor's best interest.

But I don't think it's a realistic matter that you're going to have creditors who are reduced willingness to make loans to healthy firms that don't have a bankruptcy risk or even that do have a low bankruptcy risk. You've got a credible lending market at least right now. We're not in the recession period anymore. And in terms of the debtor getting additional value out of the reorganization that are supposed to be getting the additional value out of the reorganization, the creditors get what the creditors are entitled to on the plan confirmation date.

So all in all, I applaud the *Till* formula. I think that it works and is very useful in most cases. I think even in the huge cases that it's a good starting point, although I agree that using the T bill rate is a good addition to be used in that instance. And then look at the real evidence in terms of what it bears on

risk and determining what the risk should be. And maybe in some instances you're going to have 5 or 10 or 15% above prime, but if you're dealing with that, then you probably don't have a feasible plan in any event.

PROFESSOR BRUBAKER: It's about time for lunch. We might be able to entertain one quick question if anybody has one that they just can't contain. Otherwise we'll leave it to you to—

JUDGE BONAPFEL (in the audience): Is it *en banc* or *en banc*?

PROFESSOR MARKELL: Are you in England or France?

[Inaudible response]

PROFESSOR MARKELL: It's *en banc* in France because it's French. It's *en banc* if you're in England, which is how they pronounced it.

MR. JUMBECK: Before we conclude, and I'll close out, please join me in thanking the Corporate Panel for their insights today.