

Southwest Bankruptcy Conference 2021

Complex Confirmation Issues

Jeffrey Bjork

Latham & Watkins; Los Angeles

Matt Foster

Sonoran Capital Advisors; Mesa, Ariz.

Jordan A. Kroop

Perkins Coie LLP; Phoenix

Hon. David T. Thuma

U.S. Bankruptcy Court (D. N.M.); Albuquerque

THIRD PARTY RELEASES IN PLANS OF REORGANIZATION

Hon. David T. Thuma United States Bankruptcy Judge District of New Mexico

These materials discuss whether a bankruptcy court may approve a plan of reorganization that releases claims held by nondebtors against third parties and, if so, when it is appropriate to do so.

A. <u>Applicable Bankruptcy Code Sections</u>.

- § 105(a). The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.
- § 524(e). Except as provided in subsection (a)(3)¹ of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.
- § 1123(b). Subject to subsection (a) of this section, a plan may

. . .

- (3) provide for
- (A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate;

. .

(6) include any other appropriate provision not inconsistent with the applicable provisions of this title.

B. Debtor Releases.

Not all releases in plans of reorganization are controversial. Plans often release claims debtors hold against creditors. For example: "On confirmation, all claims of the debtor against XYZ corporation are released." § 1123(b)(3)(A) expressly allows these types of releases. *See, e.g., In re Arden*, 176 F.3d 1226, 1228 (9th Cir. 1999) (citing the section).

¹ § 524(a)(3) protects after-acquired community property of the discharged spouse from the other spouse's creditors.

C. <u>Exculpation Releases</u>.

Releases that exculpate the debtor in possession, officers, directors, and professionals from claims arising during the bankruptcy case are also common and generally approved. An example is:

None of the Debtors, the Reorganized Debtors, . . . the Creditor Representative, the Committee or any of their respective members, officers, directors, employees, advisors, professionals or agents shall have or incur any liability to any holder of a Claim or Equity Interest for any act or omission in connection with, related to, or arising out of, the Chapter 11 Cases, the pursuit of confirmation of the Plan, the consummation of the Plan or the Administration of the Plan or the property to be distributed under the Plan, except for willful misconduct or gross negligence

In re PWS Holding Corp., 228 F.3d 224, 246 (3d Cir. 2000). Exculpation releases are a species of third party release, as they release claims that third parties may have against non-debtors such as professionals and officers. These releases generally have been upheld. The rationale is that the Bankruptcy Code provides limited immunity against negligence claims for estate fiduciaries, so exculpation clauses essentially restate the law. For that reason, acceptable exculpation releases clauses must "carve out" claims based on willful misconduct or gross negligence, for which estate fiduciaries are not immune. See, e.g., PWS Holding, 228 F.3d at 246 (exculpation clause is appropriate because it affects no change in liability); Blixseth v. Credit Suisse, 961 F.3d 1074 (9th Cir. 2020) (approved exculpation clause and found that it did not violate § 524(e)); In re Murray Metallurgical Coal Holdings, LLC, 623 B.R. 444, 500 (Bankr S.D. Ohio 2021) (exculpation clauses are common); In re Midway Gold US, Inc., 575 B.R. 475, 512-13 (Bankr. D. Colo. 2017) (clause restates the fiduciary standard); In re South Edge LLC, 478 B.R. 403, 415 (D. Nev. 2012) (to the same effect); In re Alpha Natural Resources, Inc., 556 B.R. 249, 260 (Bankr. E.D. Va. 2016) (exculpation provisions are not unusual and generally are permissible if properly limited);

In re Enron Corp., 326 B.R. 497, 503-04 (S.D.N.Y. 2005); In re Washington Mutual, 442 B.R. 314, 350-51 (Bankr. D. Del. 2011);

D. Third Party Releases.

The most problematic release is the third party release, often combined with a "channeling injunction." For example:

Channeling Injunction. In consideration of the undertakings . . . hereunder and other consideration . . . :

- (a) Any and all Channeled Claims are channeled into the Trust and shall be treated, administered, determined, and resolved under the procedures and protocols and in the amounts as established under the Plan as the sole and exclusive remedy for all holders of Channeled Claims; and
- (b) All Entities who . . . hold or assert . . . any Channeled Claim are hereby permanently stayed, enjoined, barred and restrained from taking any action, directly or indirectly, for the purposes of asserting, enforcing, or attempting to assert or enforce any Channeled Claim against any of the Protected Parties

The provisions of this Section will further operate, as between all Protected Parties, as a mutual release of all Claims relating to the Debtors, the Claims against the Debtor and the Insurance Policies, which any Protected Party may have against another Protected Party except as may specifically be reserved or set forth in a Participating Party Agreement, an Insurance Settlement Agreement or the Plan. The foregoing channeling provisions are an integral part of the Plan and are essential to its implementation.²

1. <u>Potential Problems With Third Party Releases</u>. Courts have identified two main issues that must be resolved when ruling on challenged third party releases. First, do the releases

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² From the First Amended and Restated Plan of Reorganization confirmed in the Roman Catholic Church of the Diocese of Gallup, case No. 13-13676, United States Bankruptcy Court, District of New Mexico.

run afoul of § 524(e)? Second, if not, does the bankruptcy court have the jurisdiction and authority to approve the releases?

2. Circuits That Don't Allow Third Party Releases.

a. <u>Ninth Circuit</u>. The Ninth Circuit has held that third party releases/channeling injunctions are contrary to § 524(e) and cannot be permitted. The first case to address the issue was *Underhill v. Royal*, 769 F.2d 1426 (9th Cir. 1985), which held:

the bankruptcy court has no power to discharge the liabilities of a nondebtor pursuant to the consent of creditors as part of a reorganization plan. The broad language of § 524(e), limiting the scope of a discharge so that it "does not affect the liability of any other entity," encompasses this result.

769 F.2d at 1432. Next came *American Hardwood, Inc. v. Deutsche Credit Corp.*, 885 F.2d 621 (9th Cir. 1989), which quoted and followed *Underhill*. Most recently, in *Resorts International v. Lawenschuss (In re Lowenschuss)*, 67 F.3d 1394 (9th Cir. 1995), the Ninth Circuit held:

The bankruptcy court lacks the power to confirm plans of reorganization which do not comply with applicable provisions of the Bankruptcy Code. 11 U.S.C. § 1129(a)(1). Pursuant to 11 U.S.C. § 524(a), a discharge under Chapter 11 releases the debtor from personal liability for any debts. Section 524 does not, however, provide for the release of *third parties* from liability; to the contrary, § 524(e) specifically states that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e).

This court has repeatedly held, without exception, that § 524(e) precludes bankruptcy courts from discharging the liabilities of non-debtors. [citations omitted].

See also Deocampo v. Potts, 836 F.3d 1134, 1143 (9th Cir. 2016) (citing Lowenschuss approvingly in dicta); In re Maxitile, Inc. 237 Fed. App'x 274 (9th Cir. 2007) (unpublished) (following the case law discussed above). However, the recent case of Blixseth v. Credit Suisse, 961 F.3d 1074 (9th Cir. 2020), clarified that the prohibition against third party releases only applies to releases of claims of non-debtors for which the debtor and the third party are jointly liable, such as guarantors

and co-debtors. The court held that § 524(e) does not apply to debts for which the debtor is not jointly liable, such as exculpation releases. 961 F.3d at 1083-84.

- b. <u>D.C.</u>, Fifth, and Tenth Circuits. These three circuits have sided with the Ninth and prohibited third party releases. Their rationale is the same, i.e., third party releases cannot be reconciled with § 524(e). *See In re AOV Industries, Inc.*, 792 F.2d 1140, 1152 (D.C. Cir. 1986); *Bank of N.Y. Trust Co. Official Unsecured Creditors' Committee (In re Pacific Lumber)*, 584 F.3d 229, 251-52 (5th Cir. 2009); and *In re Western Real Estate Fund*, 922 F.2d 592, 600-02 (10th Cir. 1990).
- 3. <u>Circuits That Allow Third Party Releases</u>. The First (bankruptcy court only), Second, Third, Fourth, Sixth, Seventh, Eighth (bankruptcy court only), and Eleventh circuits have ruled that third party releases can be approved in limited circumstances as part of plan confirmation. *See In re Charles St. African Methodist Episcopal Church of* Boston, 499 B.R. 66, 98-103 (Bankr. D. Mass. 2013); *In re Metromedia Fiber Network Inc.*, 416 F.3d 136, 141-43 (2d Cir. 2005); *In re Lower Bucks Hospital*, 571 Fed. App'x 139, 144 (3d Cir. 2014); *Nat'l Heritage Foundation, Inc. v. Highbourne Foundation*, 760 F.3d 344, 347-50 (4th Cir. 2014); *Class Five Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 657-58 (6th Cir. 2002); *Airadigm Communications, Inc. v. FCC (In re Airadigm Communications Inc.)*, 519 F.3d 640, 655-57 (7th Cir. 2008); *In re Master Mortgage, Investment Fund Inc.*, 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994); *SE Prop. Holdings LLC v. Seaside Engineering & Surveying Inc. (In re Seaside Engineering & Surveying Inc.)*, 780 F.3d 1070, 1077-78 (11th Cir. 2015).
- 4. <u>How the Courts Deal With § 524(e)</u>. Courts allowing third party releases have concluded that § 524(e) does not apply to the issue. For example, the Seventh Circuit held in *Airadigm Communication*:

Section 524(e) provides that the "discharge of a debt of the debtor does not affect the liability of another entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). The natural reading of this provision does not foreclose a third-party release from a creditor's claims. *Specialty Equipment*, 3 F.3d at 1047. Section 524(e) is a saving clause; it limits the operation of other parts of the bankruptcy code and preserves rights that might otherwise be construed as lost after the reorganization. *Id.*; *see also In re Hunter*, 970 F.2d 299, 311 (7th Cir. 1992). Thus, for example, because of § 524, a creditor can still seek to collect a debt from a codebtor who did not participate in the reorganization-even if that debt was discharged as to the debtor in the plan. *Compare* 11 U.S.C. § 524(a)(2) *with* 11 U.S.C. § 524(e). Or a third party could proceed against the debtor's insurer or guarantor for liabilities incurred by the debtor even if the debtor cannot be held liable. *See In re Shondel*, 950 F.2d 1301, 1306-07 (7th Cir. 1991); *see also In re Hendrix*, 986 F.2d 195, 197 (7th Cir. 1993).

In any event, § 524(e) does not purport to limit the bankruptcy court's powers to release a non-debtor from a creditor's claims. If Congress meant to include such a limit, it would have used the mandatory terms "shall" or "will" rather than the definitional term "does." And it would have omitted the prepositional phrase "on, or ... for, such debt," ensuring that the "discharge of a debt of the debtor shall not affect the liability of another entity"-whether related to a debt or not. See 11 U.S.C. § 34 (repealed Oct. 1, 1979) ("The liability of a person who is a co-debtor with, or guarantor or in any manner a surety for, a bankrupt shall not be altered by the discharge of such bankrupt.") (prior version of § 524(e)). Also, where Congress has limited the powers of the bankruptcy court, it has done so clearly-for example, by expressly limiting the court's power, see 11 U.S.C. § 105(b) ("[A] court may not appoint a receiver in a case under this title"), or by creating requirements for plan confirmation, see, e.g., 11 U.S.C. § 1129(a) ("The court shall confirm a plan only if the following requirements are met...."). As a result, for the reasons set out in Specialty Equipment, § 524(e) does not bar a non-consensual third-party release from liability.

519 F.3d at 657.

The discussion in *In re Archdiocese of St Paul and Minneapolis*, 578 B.R. 823 (Bankr. D.

Minn. 2017), also is instructive:

.... can a creditor, as part of a chapter 11 plan, be forced to give up its claim against a non-debtor? If so, under what circumstances?

.... a confirmed plan with such a provision does not violate the Bankruptcy Code as some courts have suggested. Clearly, § 524(a) creates an injunction only as to debts owed by the debtor and § 524(e) makes it clearer that the "discharge of the debt of the debtor does not affect the liability of any other entity, or the property of

any other entity for, such debts." From that, it is clear that the debts, if any, of the Catholic entities to the sexual abuse victim would not be discharged by §§ 1141 or 524. But neither of those sections or any other sections prohibit such a provision in a plan nor make a plan containing such provision, per se, unconfirmable. I agree with the Sixth Circuit when it said:

The Bankruptcy Codes does not explicitly prohibit or authorize a bankruptcy court to enjoin a non-consenting creditor's claims against a non-debtor to facilitate a reorganization plan. *In re Continental Airlines*, 203 F.3d 203, 211 (3d. Cir. 2000). However, bankruptcy courts, "as courts of equity, have broad authority to modify creditor-debtor relationships." *United States v. Energy Resources Co.*, 495 U.S. 545, 549, 110 S.Ct. 2139, 109 L.Ed.2d 580 (1990). For example, section 105(a) of the Bankruptcy Code grants a bankruptcy court the broad authority to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). This section grants the bankruptcy court the power to take appropriate equitable measures needed to implement other sections of the Code. *See In re Granger Garage, Inc.*, 921 F.2d 74, 77 (6th Cir. 1990).

In re Dow Corning Corp., *supra*, at 656. I conclude, therefore, that such provisions are permissible and that plans containing third party releases can be confirmed under appropriate circumstances.

578 B.R. at 833.

5. <u>Jurisdiction and Constitutional Authority</u>. A second issue is whether bankruptcy courts have the jurisdiction and authority to approve the third party releases. Two recent cases have discussed the question and have held that they do.

The first is *In re Millennium Lab Holdings II, LLC*, a Delaware bankruptcy case. Ruling from the bench, the bankruptcy court confirmed a plan of reorganization that contained third party releases. On appeal, the district court remanded the case so the bankruptcy court could address the appellant's argument that releasing the third party claims was beyond the bankruptcy's court's constitutional authority outlined in *Stern v. Marshall*, 564 U.S. 462 (2011). *In re Millennium Lab Holdings II, LLC*, 242 F. Supp. 3d 322 (D. Del. 2017).

On remand, the bankruptcy court analyzed the subject matter jurisdiction and constitutional authority issues in detail. First, the court held that it had "core" subject matter jurisdiction to consider confirmation of the debtor's plan under 28 U.S.C. § 157(b)(2)(L) ("Core proceedings include . . . confirmations of plans"). Thus, any problem with approving third party release did not include lack of subject matter jurisdiction.

Next, the bankruptcy court addressed whether it had the constitutional authority to confirm a plan of reorganization with a third party release. The court ruled that it did. It held that *Stern* did not require a different result because *Stern* only addressed state law counterclaims owned by the estate, not plan confirmation. In its ruling, the court held that it was not necessary to have authority to determine the released claims, so long as it had authority to confirm the plan. *In re Millennium Lab Holdings II, LLC*, 575 B.R. 252, 271(Bankr. D. Del. 2017). The bankruptcy court's ruling on the jurisdiction and constitutional authority issues was affirmed on appeal. *In re Millennium Lab Holdings II, LLC*, 591 B.R. 559 (D. Del. 2018).

The other recent case is *In re Kirwan Offices S.A.R.I.*, 592 B.R. 489 (S.D.N.Y. 2018). Addressing issues very similar to *Millennium Lab*, the district court reached the same conclusions on the bankruptcy court's jurisdiction 592 B.R. at 503-509, and the bankruptcy court's constitutional authority, 592 B.R. at 509-512.

6. When Third Party Releases are Appropriate. In the circuits that allow bankruptcy courts to confirm plans with third party releases, the question remains when they should do so. The usual response is to say that it is rarely appropriate, and then analyze a number of factors relevant to the decision. *In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930 (Bankr. W.D. Mo. 1994), for example, lists five factors:

- (1) There is an identity of interest between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete assets of the estate.
- (2) The non-debtor has contributed substantial assets to the reorganization.
- (3) The injunction is essential to reorganization. Without the it, there is little likelihood of success.
- (4) A substantial majority of the creditors agree to such injunction, specifically, the impacted class, or classes, has "overwhelmingly" voted to accept the proposed plan treatment.
- (5) The plan provides a mechanism for the payment of all, or substantially all, of the claims of the class or classes affected by the injunction.

168 B.R. at 935 (footnotes omitted); see also Millennium Lab, 591 B.R. at 566; Kirwan Offices, 592 B.R. at 511, citing In re Metromedia Fiber Network, Inc., 416 F.3d 136, 141 (2d Cir. 2005) (third party releases should be approved only in "rare cases"); In re Charter Communications, 419 B.R. 221, 258 (Bankr. S.D.N.Y. 2009) ("unusual circumstances" meant that the third party releases were permissible); In re SunEdison, Inc., 576 B.R. 453, 461-62 (Bankr. S.D.N.Y. 2017) (third party releases appropriate only in "rare and unusual circumstances"); In re SL Liquidating, Inc., 428 B.R. 799, 801 (Bankr. S.D. Ohio 2010) (third party releases are a "drastic measure to be used cautiously" and are "only appropriate in 'unusual circumstances"), citing In re Dow Corning Corp., 280 F.3d 648, 658 (6th Cir. 2002).

Of course, the analysis is much easier if the third parties consent to the release. *See, e.g., In re PG&E Corp.*, 617 B.R. 671, 683-84 (Bankr. N.D. Cal. 2020) (voluntary "opt-in" releases are OK); *In re Zenith Elecs. Corp.*, 241 B.R. 92 (Bankr. D. Del. 1999); *In re Genco Shipping & Trading Limited*, 513 B.R. 233 (Bankr. S.D.N.Y. 2014) (U.S. Trustee objected to third party releases to the extent the claim holders did not consent).

In re Debbie Reynolds Hotel & Casino, Inc., 255 F.3d 1061 (2001)

38 Bankr.Ct.Dec. 22, Bankr. L. Rep. P 78,475, 01 Cal. Daily Op. Serv. 5698...

KeyCite Yellow Flag - Negative Treatment

Rejected by In re NETtel Corporation, Bankr.D.Dist.Col., April 28, 2020

255 F.3d 1061 United States Court of Appeals, Ninth Circuit.

In re: DEBBIE REYNOLDS
HOTEL & CASINO, INC. Debtor.
In re: Debbie Reynolds
Management Company, Inc. Debtor.
In re: Debbie Reynolds Resorts, Inc. Debtor.
Debbie Reynolds Hotel & Casino, Inc.,
a Nevada corporation; Debbie Reynolds
Management Company, Inc., a Nevada
corporation; Debbie Reynolds Resorts,
Inc., a Nevada corporation, Appellants,

Calstar Corporation, Inc., Appellee. Resort Funding, Inc., Appellant,

Calstar Corporation, Inc., Appellee.

Nos. 99–17240, 99–17392. | Argued and Submitted March 13, 2001 | Filed July 6, 2001

Synopsis

Order was entered by the United States Bankruptcy Court for the District of Nevada, Robert Clive Jones, J., approving compromise agreement between Chapter 11 debtor and oversecured creditor, pursuant to which creditor agreed to surcharge of its collateral for benefit of debtor's attorney, on condition that no other surcharges would be allowed. Other creditors appealed. The Bankruptcy Appellate Panel, J.E.

Ryan, J., 238 B.R. 831, reversed. On further appeal, the Court of Appeals, Sneed, Circuit Judge, held that: (1) lender which extended postpetition financing to Chapter 11 debtor on superpriority basis had no standing to appeal bankruptcy court order approving compromise; and (2) surcharge had to be paid directly to debtor's counsel, as party that provided benefit to secured creditor.

Reversed and remanded.

Procedural Posture(s): On Appeal.

West Headnotes (14)

[1] Bankruptcy Discretion

Court of Appeals reviews, for abuse of discretion, bankruptcy court's approval of proposed compromise.

- 21 Cases that cite this headnote
- [2] Bankruptcy Conclusions of Law; De Novo Review

Bankruptcy Review of Appellate Panel

On appeal in bankruptcy case, both the bankruptcy court's and the Bankruptcy Appellate Panel's (BAP's) interpretation of Bankruptcy Code is reviewed de novo.

- 9 Cases that cite this headnote
- [3] Bankruptcy 🕪 Discretion

To extent that bankruptcy court's approval of settlement agreement rests on erroneous interpretation of law, it is abuse of discretion per se.

- 8 Cases that cite this headnote
- [4] Bankruptcy ← Conclusions of Law; De Novo Review

Whether the Bankruptcy Code permitted superpriority lender to surcharge secured creditor's collateral was question of law, which Court of Appeals would review de novo.

Bankr.Code, 11 U.S.C.A. § 506(c).

- 5 Cases that cite this headnote
- [5] Bankruptcy Proceedings and Determination; Persons Entitled

Bankruptcy Right of Review and Persons Entitled; Parties; Waiver or Estoppel

In re Debbie Reynolds Hotel & Casino, Inc., 255 F.3d 1061 (2001)

38 Bankr.Ct.Dec. 22, Bankr. L. Rep. P 78,475, 01 Cal. Daily Op. Serv. 5698...

Lender which extended postpetition financing to Chapter 11 debtor on superpriority basis had no standing to appeal bankruptcy court order that approved compromise between debtor and secured creditor, which purported to cut off whatever right of surcharge lender otherwise had against secured creditor's collateral; lender had no right of surcharge and thus could not show that it had suffered any direct and adverse harm from bankruptcy court's order. Bankr.Code,

11 U.S.C.A. § 506(c).

5 Cases that cite this headnote

[6] Bankruptcy Proceedings and Determination; Persons Entitled

Only parties that have standing to seek surcharge against secured creditor's collateral are bankruptcy trustee or, if proceeding is held pursuant to Chapter 11, the debtor-in-possession.

Bankr.Code, 11 U.S.C.A. § 506(c).

16 Cases that cite this headnote

[7] **Bankruptcy** Proceedings and Determination; Persons Entitled

Unsecured creditors may not seek payment for monies expended on behalf of estate from the collateral of secured creditor. Bankr.Code, 11 U.S.C.A. § 506(c).

4 Cases that cite this headnote

[8] Bankruptcy → Right of Review and Persons Entitled; Parties; Waiver or Estoppel

Only party who is directly and adversely affected pecuniarily by bankruptcy court's order may appeal therefrom; order must diminish appellant's property, increase its burdens, or detrimentally affect its rights.

5 Cases that cite this headnote

[9] Courts • In General; Retroactive or Prospective Operation

Rule of federal law, once announced and applied to parties to controversy, must be given full retroactive effect by all courts adjudicating federal law.

[10] Courts • In General; Retroactive or Prospective Operation

Retroactive application of Supreme Court precedent to all cases on direct review is the general rule, and it is only when Supreme Court reserves question of whether its holding should be applied to parties before it that other parties can also avoid retroactive application.

[11] **Bankruptcy** • Liability of Security for Expense of Preservation or Disposition

Surcharge must be paid directly to party that provided benefit to secured creditor, regardless of their priority status. Bankr.Code, 11 U.S.C.A. §§ 506(c), 507.

16 Cases that cite this headnote

[12] Bankruptcy • Liability of Security for Expense of Preservation or Disposition

Surcharge is not administrative claim, but assessment against secured party's collateral, which does not come out of debtor's estate, but directly from secured party's recovery.

Bankr.Code, 11 U.S.C.A. § 506(c).

5 Cases that cite this headnote

[13] Bankruptcy • Liability of Security for Expense of Preservation or Disposition

Bankruptcy ← Benefit to Creditor, in General

Bankruptcy Proceedings and Determination; Persons Entitled

Party seeking surcharge must prove that its expenses were reasonable and necessary, and provided quantifiable benefit to secured creditor.

Bankr.Code, 11 U.S.C.A. § 506(c).

In re Debbie Reynolds Hotel & Casino, Inc., 255 F.3d 1061 (2001)

38 Bankr.Ct.Dec. 22, Bankr. L. Rep. P 78,475, 01 Cal. Daily Op. Serv. 5698...

12 Cases that cite this headnote

[14] Bankruptcy • Benefit to Creditor, in General

Bankruptcy Proceedings and Determination; Persons Entitled

It is party seeking surcharge that has burden of showing "concrete" and "quantifiable" benefit, and party's recovery is limited to amount of the benefit actually proven. Bankr.Code, 11 U.S.C.A. § 506(c).

11 Cases that cite this headnote

Attorneys and Law Firms

*1063 Bob L. Olson, Shea & Carlton, Las Vegas, Nevada, for appellant Resort Funding, Inc.

Lenard Schwartzer, Mangels, Butler, Marmaro & O'Reilly, Las Vegas, Nevada, for appellant Debbie Reynolds Hotel & Casino, Inc.; Debbie Reynolds Management Company; Debbie Reynolds Resorts, Inc.

James R. Alsup, Law Office of Federico Sayre, Newport Beach, California, for appellee Calstar Corporation.

Appeal from the United States Bankruptcy Appellate Panel for the Ninth Circuit; J.E. Ryan, Bankruptcy Judge; Christopher M. Klein, Bankruptcy Judge; Samuel L. Bufford, Bankruptcy Judge, Presiding. BAP No. 98–1862 RYKBu.

Before: SNEED, FERNANDEZ, and KLEINFELD, Circuit Judges.

Opinion

SNEED, Circuit Judge:

Debtor Debbie Reynolds Hotel and Casino ("Debtor") and secured creditor Resort Funding, Inc. ("RFI") entered into a settlement agreement that provided for a \$50,000 payment

from RFI to Debtor's counsel pursuant to 11 U.S.C. § 506(c). The bankruptcy court approved the agreement. The Bankruptcy Appellate Panel ("BAP") reversed the bankruptcy court. Debtor and RFI jointly appeal the judgment

of the BAP and ask this court to enforce the settlement agreement.

The BAP reversed the bankruptcy court on two grounds. First, the BAP held that Appellants' settlement agreement impermissibly abrogated the right of Appellee Calstar Corporation ("Calstar") to surcharge the secured collateral of RFI. Second, the BAP held that the bankruptcy court abused its discretion by permitting the payment of the surcharge directly to Debtor's counsel rather than into Debtor's estate to be distributed according to the priority schedule codified in

We reverse the BAP and hold that the settlement agreement is valid and enforceable. Applying the recent Supreme Court decision of **Hartford Underwriters Ins. Co. v. Union Planters Bank, 530 U.S. 1, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000), we hold that Calstar has no standing to challenge the terms of the settlement agreement. We also hold that a surcharge secured pursuant to **11 U.S.C. § 506(c) should be distributed directly to the Debtor's counsel, whose services to the estate underlie the surcharge request.

BACKGROUND

A. The Sale of the Debbie Reynolds Hotel and Casino

In February 1998, Debtor proposed a liquidating plan of reorganization that provided for the sale of substantially all of its assets to Central Florida Investments ("CFI") for \$14,000,000. RFI supported the sale, but a committee of Debtor's unsecured creditors opposed it. Rather than approve the sale as negotiated, the bankruptcy court agreed to permit interested parties to appear at a hearing to bid to purchase Debtor's property for a sum in excess of the price negotiated with CFI.

At the close of bidding, the court awarded CFI the right to purchase the property for \$15,600,000. The order accepting CFI's bid also gave CFI the right to withdraw from the transaction without penalty by May 10, 1998. After completing its due *1064 diligence, CFI exercised this right and terminated the transaction. The right to purchase the hotel then fell to Appellee Calstar for \$15,500,000.

In re Debbie Reynolds Hotel & Casino, Inc., 255 F.3d 1061 (2001)

38 Bankr.Ct.Dec. 22, Bankr. L. Rep. P 78,475, 01 Cal. Daily Op. Serv. 5698...

Calstar agreed to loan Debtor \$150,000 to keep the hotel open while Calstar completed its due diligence prior to closing the sale. This postpetition financing was approved by the bankruptcy court on a "superpriority" basis under 11 U.S.C. § 364(c)(1). Calstar's superpriority loan did not alter the rights of secured creditors, but it gave Calstar the right to repayment ahead of all administrative and unsecured claims. ¹ Calstar subsequently decided not to purchase the hotel. It withdrew from the transaction without penalty.

Finding itself without any prospective purchasers of the hotel, the bankruptcy court entered an order permitting the sale of Debtor's assets through public auction. In August 1998, the hotel and all related personal property were sold through public auction for \$10,650,000.

B. The Settlement Agreement Between Debtor and RFI

After the sale of the hotel, but before final approval by the bankruptcy court, Debtor's counsel sought a payment out of RFI's secured collateral under the authority of 11 U.S.C. \$506(c). Section 506(c) provides that the "trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim." The payment of these "reasonable and necessary" expenses out of the secured property of a creditor is known as a surcharge.

RFI did not concede that Debtor's counsel had provided any measurable benefit to its secured collateral. Nevertheless, it entered into an agreement allowing Debtor's counsel to collect a \$50,000 surcharge from its secured property. The surcharge agreement also provided that "RFI's secured and unsecured claims shall be irrevocably allowed and no debtor, administrative claimant or party in interest may: ... (5) seek to surcharge any of RFI's collateral pursuant to 11 U.S.C. \$506(c)." In effect, RFI attempted to buy "closure" by agreeing to a \$50,000 surcharge in exchange for assurance that there would be no further challenges to collection of its secured debt.

Calstar objected to the Settlement Agreement on two grounds. First, Calstar itself sought to surcharge RFI's secured property as repayment for the benefit provided by Calstar's \$150,000 loan to Debtor in May 1998. Calstar

argued that the immunizing language of the Settlement Agreement improperly foreclosed Calstar's right to seek a surcharge under 11 U.S.C. § 506(c). In addition, Calstar argued that because its loan to Debtor was made pursuant to 11 U.S.C. § 364(c)(1), it should collect ahead of Debtor's counsel. Therefore, the surcharge agreement between RFI and Debtor, whereby Debtor's counsel would collect the \$50,000 payment, violated Calstar's rights as a "superpriority" creditor.

The bankruptcy court approved the surcharge/settlement agreement in its entirety. The BAP, reversing the bankruptcy court, held that the lower court abused its discretion when it approved the immunizing language of the settlement agreement *1065 without first determining whether RFI benefitted from the actions of other claimants. In addition, the BAP held that the bankruptcy court erred in permitting the distribution of the surcharge directly to Debtor's attorneys rather than to the estate. This distribution "enabled [Debtor's attorneys] to get paid on a mere administrative claim ahead of Calstar, the holder of a superpriority claim under \$364(c)."

Both RFI and Debtor appealed from the BAP's reversal of the bankruptcy court's approval of the settlement agreement.

STANDARD OF REVIEW

[1] [2] [3] This court reviews the bankruptcy court's approval of a proposed compromise for an abuse of discretion.

Burton v. Ulrich (In re Schmitt), 215 B.R. 417, 420 (9th Cir.BAP1997). However, both the bankruptcy court's and the BAP's interpretation of the Bankruptcy Code is reviewed de novo. In re Celebrity Home Entertainment, Inc., 210 F.3d 995, 997 (9th Cir.2000); In re Los Angeles Int'l Airport Hotel Assocs., 106 F.3d 1479, 1480 (9th Cir.1997). To the extent that the bankruptcy court's approval of the settlement agreement rested on an erroneous interpretation of law, it was, per se, an abuse of discretion. Koon v. United States, 518 U.S. 81, 100, 116 S.Ct. 2035, 135 L.Ed.2d 392 (1996) ("A district court by definition abuses its discretion when it makes an error of law.").

[4] The bankruptcy court concluded that RFI could not, as a matter of law, be surcharged under 11 U.S.C. § 506(c).

In re Debbie Reynolds Hotel & Casino, Inc., 255 F.3d 1061 (2001)

38 Bankr.Ct.Dec. 22, Bankr. L. Rep. P 78,475, 01 Cal. Daily Op. Serv. 5698...

It approved the settlement agreement on this basis. The BAP reached the opposite conclusion. Whether section 506(c) permits Calstar to surcharge RFI is a question of law subject to de novo review.

DISCUSSION

This case presents two distinct questions arising under Section 506(c) of the Bankruptcy Code. First, we must determine whether Calstar has standing to object to the secured creditor's settlement agreement with the debtor-in-possession. The agreement foreclosed Calstar from seeking to surcharge the secured collateral of RFI. Following *Hartford Underwriters*, we hold that Calstar had no standing to seek a surcharge pursuant to \$506(c). Therefore, Calstar cannot object to the agreement which prevented it from bringing a surcharge action. We reverse the BAP decision holding otherwise

In addition, we must determine how the \$50,000 in proceeds from the \$506(c) surcharge should be distributed. We hold that under \$506(c), the party that has rendered a benefit to a secured creditor is properly reimbursed for that benefit from secured collateral. We reverse the BAP on this issue as well and hold that Debtor's counsel is entitled to the \$50,000 surcharge consistent with the terms of the settlement agreement.

- I. Immunizing Language of the Settlement Agreement
 - A. Under Hartford Underwriters, Calstar lacks standing to object to the settlement agreement.
- [5] The only objection to enforcement of the settlement agreement—and the point on which the bankruptcy court and the BAP disagreed—was whether the immunizing provision of the agreement improperly abrogated Calstar's right to seek a surcharge from RFI pursuant to \$\int_{\text{such}} \\$506(c)\$. *Hartford Underwriters* makes clear that Calstar cannot, under any circumstances, *1066 seek such a surcharge because Calstar, as a superpriority claimant, has no standing to do so. Under *Hartford Underwriters*, therefore, the immunizing language of the settlement agreement had no legal effect. Since Calstar's objection to the agreement was based on this language, that objection cannot succeed.

[6] [7] In Hartford Underwriters, the Supreme Court limited standing under 11 U.S.C. § 506(c) to the trustee of a bankruptcy estate or—if the proceeding is held pursuant to Chapter 11 of the Bankruptcy Code—a debtor-in-possession.

Id., 530 U.S. at 6 n. 3, 120 S.Ct. 1942; 11 U.S.C. § 1107(a) (in a proceeding under Chapter 11, a debtor-in-possession shall have the rights and powers of a trustee). Unsecured creditors (such as Calstar) may not seek payment for monies expended on behalf of the estate from the collateral of a secured creditor.

Hartford Underwriters, 530 U.S. at 13, 120 S.Ct. 1942.

Hartford Underwriters overruled North County Jeep and Renault, Inc. v. Gen. Electric Capital Corp. (Eln re Palomar Truck Corp.), 951 F.2d 229 (9th Cir.1991). In In re Palomar Truck Corp., this court held that when a trustee has "no economic incentive to seek recovery under \(\bigcup_{\{\circ}} \) 506(c)," other parties who provided a benefit to secured creditors may seek a surcharge under [8] 506(c). Id., 951 F.2d at 232. Because the present controversy arose prior to the Supreme Court's decision in Hartford Underwriters, both the bankruptcy court and the BAP relied on the holding in In re Palomar Truck Corp. Consequently, neither of the lower courts analyzed how Hartford Underwriters ' standing requirement affects the disposition of this appeal. The holding of Hartford Underwriters, however, is clear and unambiguous. "The statute appears quite plain in specifying who may use [8] 506(c)—the trustee." Hartford Underwriters, 530 U.S. at 6, 120 S.Ct. 1942. Because Calstar was not the trustee (or the debtor-in-possession) it could not seek a [8 506(c)] surcharge. The settlement agreement, in effect, abrogated a legal right that no longer exists. Id.

[8] Only a party who is "directly and adversely affected pecuniarily" by an order of the bankruptcy court may appeal. To provide standing, "the order must diminish the appellant's property, increase its burdens, or detrimentally affect its rights."

**In re P.R.T.C. Inc., 177 F.3d 774, 777 (9th Cir.1999). Calstar cannot show "direct and adverse" harm from the bankruptcy court's approval of the immunizing language in the settlement agreement. Consequently, Calstar has no standing to appeal this aspect of the bankruptcy court's

In re Debbie Reynolds Hotel & Casino, Inc., 255 F.3d 1061 (2001)

38 Bankr.Ct.Dec. 22, Bankr. L. Rep. P 78,475, 01 Cal. Daily Op. Serv. 5698...

order. Application of *Hartford Underwriters* to the facts of this case requires reversal of the BAP ruling.

B. Hartford Underwriters Applies Retroactively

[9] [10] In Harper v. Va. Dep't. of Taxation, 509 U.S. 86, 113 S.Ct. 2510, 125 L.Ed.2d 74 (1993), the Supreme Court simplified the doctrine of retroactivity. Under Harper, "a rule of federal law, once announced and applied to the parties to the controversy, must be given full retroactive effect by all courts adjudicating federal law." 509 U.S. at 96, 113 S.Ct. 2510 (citing James B. Beam Distilling Co. v. Georgia, 501 U.S. 529, 111 S.Ct. 2439, 115 L.Ed.2d 481 (1991)). Retroactive application of Supreme Court precedent to all cases on direct review is, therefore, the general rule. The exception to this rule is quite limited. Only when the Supreme Court "reserve [s] the question whether its holding should be applied to the parties before it" can other parties also avoid retroactive application. Id. at 97, 113 S.Ct. 2510.

In *Hartford Underwriters*, the Supreme Court applied its interpretation of \$\sum_{\}\$ 506(c) *1067 to the parties then before the court. The Court affirmed the dismissal of an administrative claimant's surcharge petition because the claimant lacked standing. This holding must also apply to Calstar's appeal on direct review. ** *Harper*, 509 U.S. at 97, 113 S.Ct. 2510 (Court's interpretation of federal law given full retroactive effect to all cases open on direct review); ** United States v. Newman, 203 F.3d 700, 701–702 (9th Cir.2000) (civil appeal governed by retroactivity analysis of *Harper*).

II. Distribution of the Surcharge

[11] Under the priority schedule codified in 11 U.S.C. § 507, Calstar's loan to Debtor had priority over Debtor's counsel's claim for fees. The question presented is whether a surcharge under 11 U.S.C. § 506(c) falls within the priority schedule of \$507. Appellee Calstar argues that the surcharge became part of the general assets of the estate and should be distributed according to the statutory priority schedule. Appellants, alternatively, argue that \$506(c) authorizes the party that provided the benefit to the

secured creditor to directly receive the reimbursement from the secured collateral regardless of their priority under \$507.

[12] We agree with Appellants and hold that a \$ 506(c) surcharge is not an administrative claim, but an assessment against a secured party's collateral. *In re Mall at One Assoc., L.P.,* 187 B.R. 476, 480 (E.D.Penn.1995). As such, it does not come out of the debtor's estate, but rather comes directly from the secured party's recovery. Consequently, \$ 506(c) expenses do not fall within the priority scheme of the Bankruptcy Code at all. These expenses "are paid first out of the proceeds of the sale, before a secured creditor is paid." *United States v. Federal Deposit Insurance Corporation,* 899 F.Supp. 50, 55 (D.R.I.1995); In re Anderson, 66 B.R. 97, 99 (9th Cir.BAP1986) ("We read the Code to provide for payment of the trustee's direct costs of sale out of the proceeds of the sale before distribution to the secured creditors.").

In *In re Palomar Truck Corp.*, this court held that the proceeds of a \$ 506(c) surcharge pass directly "to the claimant with no gain to the estate." 951 F.2d at 232. As noted above, the Supreme Court overruled *In re Palomar Truck Corp.* on the issue of who has standing to pursue a \$ 506(c) surcharge. The Court, however, specifically refused to decide how a surcharge recovered by the trustee should be distributed. *Hartford Underwriters*, 530 U.S. at 11 n. 4, 120 S.Ct. 1942. Consequently, we hold that this aspect of *In re Palomar Truck Corp.* survived *Hartford Underwriters* and remains the binding precedent of this Circuit.

The \$50,000 surcharge secured by the debtor-in-possession through the settlement agreement should therefore be distributed directly to Debtor's counsel. The basis of the surcharge was, after all, the work of the attorneys. Had the trustee paid its counsel's legal fees prior to seeking a surcharge, the effect would be the same as if the proceeds from the surcharge were distributed directly to Debtor's counsel. Once the trustee has incurred expenses, it may be reimbursed out of secured collateral upon a showing that the expenses incurred were reasonable, necessary and beneficial to the secured creditor.

**In re Compton Impressions Ltd., 217 F.3d 1256, 1262 (9th Cir.2000). Counsel's right to the proceeds of the surcharge should not depend on a formalistic distinction between whether the debtor expended *1068 money or

In re Debbie Reynolds Hotel & Casino, Inc., 255 F.3d 1061 (2001)

38 Bankr.Ct.Dec. 22, Bankr. L. Rep. P 78,475, 01 Cal. Daily Op. Serv. 5698...

simply incurred debt prior to seeking the surcharge. Debtor's counsel should receive the payment to the extent of the benefit provided or, in this case, to the extent agreed to by the secured creditor.

We reject the BAP's conclusion that direct distribution of the surcharge will result in a reordering of the Bankruptcy Code's priority schedule. In re Debbie Reynolds Hotel & Casino, Inc., 238 B.R. 831, 840 (9th Cir.BAP 1999); See also In re JKJ Chevrolet, Inc., 26 F.3d 481, 484 (4th Cir.1994) ("We are of the opinion that if Congress had intended to alter so fundamentally the structure and principles underlying bankruptcy proceedings, it would have done so expressly.").

First, under *Hartford Underwriters*, only the trustee or debtorin-possession may seek a surcharge. Therefore, in order for a party that provided a benefit to a secured creditor to receive payment for that benefit, the party must convince the trustee to seek a \$\int_{\circ}\$ 506(c) surcharge or get leave from the Bankruptcy Court to do so. ** *Hartford Underwriters*, 530 U.S. at 13 n. 5, 120 S.Ct. 1942. In many circumstances, this requirement alone will prevent unpaid administrative claimants from seeking refuge in \$\int_{\circ}\$\$ 506.

must prove that its expenses were reasonable, necessary and provided a quantifiable benefit to the secured creditor.

*In re Cascade Hydraulics and Utility Service, Inc., 815

F.2d 546, 548 (9th Cir.1987). This is not an easy standard to meet. It is the party seeking the surcharge that has the burden of showing a "concrete" and "quantifiable" benefit.

The \$506 recovery is limited to the amount of the benefit actually proven. *In re Compton Impressions, 217 F.3d at 1261. Because a party seeking a surcharge faces an onerous burden of proof, it is unlikely that creditors will use this provision when any other provision of the Code is available. Furthermore, because the amount of a surcharge is limited to the amount of the benefit and must be proven with specificity, the deserving party is easily ascertainable.

Debtor's counsel avoided these hurdles in the present case by procuring the agreement of the secured creditor to pay the surcharge. ⁴ In return for the surcharge, RFI received contractual assurances that no other party would seek payment from its secured collateral. After *Hartford Underwriters*, it is unlikely that a secured creditor would be willing to enter into such an agreement. The assurances that constituted Debtor's consideration have no legal effect. RFI agreed to pay \$50,000 and received nothing in return. Consequently, the underlying facts of this controversy are unlikely to repeat. There is, therefore, little concern that unsecured creditors can avoid the dictates of the Bankruptcy Code by colluding with secured creditors for the payment of a \$506 surcharge. There is no incentive for secured creditors to enter into such agreements.

CONCLUSION

Hartford Underwriters applies retroactively to this appeal. Under Hartford Underwriters, Calstar has no standing to seek a surcharge from RFI. Consequently, the *1069 immunizing language of the settlement agreement did not alter the legal rights of Calstar and was properly approved by the bankruptcy court. The BAP decision disapproving the settlement agreement is reversed. In addition, 11 U.S.C. § 506(c) authorizes the payment of the proceeds from a surcharge directly to the party who provided the quantifiable benefit to the secured collateral. The BAP's order directing these proceeds to be distributed according to the priority schedule of 11 U.S.C. § 507 is also reversed.

REVERSED and REMANDED.

All Citations

255 F.3d 1061, 38 Bankr.Ct.Dec. 22, Bankr. L. Rep. P 78,475, 01 Cal. Daily Op. Serv. 5698, 2001 Daily Journal D.A.R. 6997

Footnotes

1 U.S.C. § 364 provides in pertinent part:

In re Debbie Reynolds Hotel & Casino, Inc., 255 F.3d 1061 (2001)

38 Bankr.Ct.Dec. 22, Bankr. L. Rep. P 78,475, 01 Cal. Daily Op. Serv. 5698...

- (c) If the trustee is unable to obtain unsecured credit allowable under section 503(b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt—
- (1) with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title.
- 2 11 U.S.C. § 506(c) provides:

The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.

- Compensation for professionals is an administrative expense as defined in 11 U.S.C. § 503(b)(2). Calstar's loan was made "with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title." 11 U.S.C. § 364(c)(1).
- The fact that RFI consented to a surcharge in favor of Debtor's counsel supports a finding that the surcharge was properly distributed. William Collier, *Collier on Bankruptcy* ¶ 506.05[6] (15th Ed. Revised 2001) ("If the holder of a secured claim expressly consents to the payment of a specific administrative claim from its collateral, then the secured creditor's consent may be enforceable to ensure payment of the claim of the administrative claimant from the collateral.").

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In re Nuverra Environmental Solutions, Inc., 590 B.R. 75 (2018)

590 B.R. 75 United States District Court, D. Delaware.

IN RE: NUVERRA ENVIRONMENTAL SOLUTIONS, INC., et al., Debtors. David Hargreaves, Appellant,

v.

Nuverra Environmental Solutions, Inc., et al., Appellees.

Case No. 17-10949-KJC (Jointly Administered)

|
Civ. No. 17-1024-RGA

|
Signed 08/21/2018

Synopsis

Background: General unsecured creditor objected to debtors' proposed Chapter 11 plan. The Bankruptcy Court entered order cramming the plan down over creditor's objection, and creditor appealed.

Holdings: The District Court, Andrews, J., held that:

- [1] creditor's appeal was equitably moot;
- [2] debtors' proposed plan did not "unfairly discriminate" in favor of unsecured creditors holding trade and business-related claims and against creditors holding other general unsecured claims; and
- [3] debtors had rational basis for placing, in separate class from other general unsecured creditors, unsecured creditors which held trade and business-related claims.

Dismissed or, alternatively, affirmed.

Procedural Posture(s): On Appeal; Objection to Confirmation of Plan.

West Headnotes (20)

[1] Bankruptcy Conclusions of law; de novo review

Bankruptcy Discretion Bankruptcy Clear error

On appeal, district court reviews bankruptcy court's legal determinations de novo, its factual findings for clear error, and its exercise of discretion for abuse thereof. Fed. R. Bankr. P. 8013.

[2] Bankruptcy Moot questions

Equitable mootness is narrow doctrine by which a bankruptcy appellate court deems it prudent, for practical reasons, to forbear deciding an appeal when to grant the relief requested will undermine the finality and reliability of consummated plan of reorganization.

[3] Bankruptcy • Moot questions

Court assesses equitable mootness through the application of prudential considerations that address concerns unique to bankruptcy proceedings.

[4] Bankruptcy • Moot questions

In deciding whether bankruptcy appeal is equitably moot, court proceeds in two analytical steps by considering, first, whether a confirmed plan has been substantially consummated, and if so, whether granting the relief requested on appeal will fatally scramble the plan and/ or significantly harm third parties who have justifiably relied on plan confirmation.

[5] Bankruptcy Presumptions and burdens of proof

Reorganized Chapter 11 debtors, as parties asserting that appeal from order confirming their prepackaged reorganization plan was equitably moot, bore burden of overcoming strong presumption that appeals from plan confirmation orders, even those not only approved by confirmation but implemented thereafter, need to be decided.

[6] Bankruptcy • Moot questions

Appeal from unstayed order of bankruptcy court confirming proposed Chapter 11 plan, pursuant to which, due to contributions voluntarily made by secured creditors, unsecured trade and business creditors that otherwise would have received no distribution on their claims would be paid in full, while other general unsecured creditors would receive a lesser benefit of distribution of 4 to 6%, was equitably moot once plan was substantially consummated, despite objecting unsecured creditor's contention that district court, without unwinding plan, could simply order that he receive same treatment as trade and business creditors; court could not direct that objecting unsecured creditor receive treatment different from each other creditor in his class, and even if it could, it was unclear from where any additional distribution to him would come, as court could not compel secured creditors to increase their contributions.

[7] Bankruptcy • Moot questions

Even when a court applies doctrine of equitable mootness, it does so with a scalpel rather than an axe, and may fashion whatever relief is practicable instead of declining review simply because full relief is unavailable.

[8] Bankruptcy ← Fairness and Equity; "Cram Down."

Pertinent inquiry for court, in deciding whether Chapter 11 plan may be "crammed down" over objection of impaired dissenting class, is not whether the plan discriminates, but whether any proposed discrimination is "unfair." 11 U.S.C.A. § 1129(b)(1).

1 Cases that cite this headnote

[9] Bankruptcy • Fairness and Equity; "Cram Down."

Courts generally examine the facts and circumstances of the particular case in deciding whether any "unfair discrimination" exists,

such as will preclude "cramdown" of proposed Chapter 11 plan. 11 U.S.C.A. § 1129(b)(1).

1 Cases that cite this headnote

[10] Bankruptcy Fairness and Equity; "Cram Down."

In deciding whether proposed Chapter 11 plan "unfairly discriminates" against impaired dissenting class, so as to preclude its "cramdown," courts are concerned with whether there is a reasonable basis for the discrimination, and whether the debtor can confirm and consummate a plan without the proposed discrimination.

[11] Bankruptcy 🕪 Confirmation; Objections

Rebuttable presumption of "unfair discrimination," such as may prevent court from "cramming down" a proposed Chapter 11 plan, arises when there is (1) a dissenting class,(2) another class of the same priority, and (3) a difference in the plan's treatment of the two classes that results in either a materially lower percentage recovery for the dissenting class, measured in terms of the net present value of all payments, or regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution.

(1).

1 Cases that cite this headnote

[12] Bankruptcy Fairness and Equity; "Cram Down."

Whether the discriminatory treatment in proposed Chapter 11 plan should be deemed "unfair," so as to prevent court from "cramming down" the plan over the objection of impaired dissenting class, is to be viewed based on its effect on the dissenting class. — 11 U.S.C.A. § 1129(b)(1).

In re Nuverra Environmental Solutions, Inc., 590 B.R. 75 (2018)

[13] **Bankruptcy** • Unsecured creditors and equity holders, protection of

Debtors' proposed Chapter 11 plan did not "unfairly discriminate" in favor of unsecured creditors holding trade and business-related claims and against creditors holding other general unsecured claims, and could be "crammed down" over objection of an impaired dissenting unsecured creditor, though trade creditors, as result of contributions voluntarily made by secured creditors, would receive a 100% distribution on their claims while other general unsecured creditors would receive a distribution of only 4 to 6%, where unsecured creditors as whole were out of money, and neither the trade nor other general unsecured creditors would have received any distribution at all but for contributions of secured creditors in making funds available for distribution, predominantly, to creditors important to debtors' business. 11 U.S.C.A. § 1129(b)(1).

[14] Bankruptcy — Confirmation; Objections

Congress intended to afford bankruptcy judges broad discretion to decide the propriety of proposed Chapter 11 plans in light of the facts of each case.

[15] Bankruptcy → Provisions for satisfaction of claims; relation to recovery in liquidation Bankruptcy → Preservation of priority

While vertical gifting that funds distribution to holder of claim or interest that is junior to the claims of impaired dissenting class may be improper, as violative of absolute priority rule, there is no per se prohibition against all gifting in plan, whereby one class, by carveout or contribution, makes funds available for distribution to other creditors.

[16] Bankruptcy — Classification of claims

Plan proponent has significant flexibility in classifying claims and interests into different

classes in proposed Chapter 11 plan, as long as a rational legal or factual basis for separate classification exists, and as long as all claims or interests within a particular class are substantially similar. 11 U.S.C.A. § 1122(a).

[17] Bankruptcy - Classification of claims

Bankruptcy court's focus, when analyzing whether the claims within a given class are substantially similar, such that they may be classified together, should be on the legal character of the claims as they relate to the assets of the Chapter 11 debtor. 11 U.S.C.A. § 1122(a).

[18] Bankruptcy Classification of claims

Bankruptcy court's focus, when analyzing whether the claims within a given class are substantially similar, such that they may be classified together, should be on the legal attributes of the claims and not upon the status or circumstances of the claimant; emphasis is not upon the holder so much as it is upon that which is held. 11 U.S.C.A. § 1122(a).

[19] Bankruptcy Parking Classification of claims

Classification of claims or interests in proposed Chapter 11 plan must be reasonable, and claims or interests cannot be grouped together for arbitrary or fraudulent purposes. 11 U.S.C.A. § 1122(a).

[20] Bankruptcy — Classification of claims

Chapter 11 debtors had rational basis for placing, in separate class from other general unsecured creditors, unsecured creditors which held trade and business-related claims, and with which it was important for debtors to maintain business relationships, and such separate classification, with trade creditors to receive a 100% distribution using funds voluntarily contributed by secured creditors, did not prevent bankruptcy court from confirming debtors' proposed reorganization plan. 11 U.S.C.A. § 1122(a).

Attorneys and Law Firms

*78 Steven K. Kortanek, Esq., Drinker Biddle & Reath LLP, Wilmington, DE; James H. Millar, Esq. (argued), Clay J. Pierce, Esq., and Stacy A. Lutkus, Esq., Drinker Biddle & Reath LLP, New York, NY, attorneys for Appellant David Hargreaves.

Pauline K. Morgan, Esq., Kenneth J. Enos, Esq., and Jaime Luton Chapman, Esq., Young Conaway Stargatt & Taylor, LLP, Wilmington, DE; Frederic Sosnick, Esq. (argued), and Sara Coelho, Esq., Shearman & Sterling LLP, New York, NY, attorneys for Appellees, Reorganized Debtors.

MEMORANDUM

ANDREWS, UNITED STATES DISTRICT JUDGE:

Presently before the Court is the appeal (D.I. 1) of David Hargreaves with respect to the Bankruptcy Court's Order Confirming the Amended Prepackaged Plans of Reorganization of Nuverra Environmental Solutions, Inc. and its Affiliated Debtors, dated July 25, 2017 (B.D.I. 366) ("Confirmation Order"). The merits of the appeal are fully briefed. Also before the Court is *79 the Reorganized Debtors' motion to dismiss the appeal (D.I. 31) ("Motion to Dismiss") on the basis of equitable mootness. For the reasons set forth below, the appeal meets the criteria for equitable mootness, and the Court rules in the alternative that the Confirmation Order is affirmed.

I. BACKGROUND

The appeal arises from Debtors' plan of reorganization, pursuant to which secured creditors, who would not receive 100% recovery on their secured claims, made a gift to general unsecured creditors, who would otherwise receive no distribution under the Bankruptcy Code's priority scheme, in order to enable the Debtors to reorganize. Even though unsecured creditors would receive no distribution absent the gift, Appellant has appealed the Confirmation Order based on the fact that the plan placed general unsecured claims of the same priority into separate classes and provided disparate treatment.

The relevant facts are uncontested. In the months leading up to the bankruptcy filing, Debtors struggled with liquidity and negotiated with certain creditors toward a prepackaged plan of reorganization. On April 28, 2017, Debtors commenced a prepetition solicitation of votes on the negotiated plan. (See B.D.I. 14). On May 1, 2017, Debtors commenced their chapter 11 cases ("Petition Date"), at which time Debtors had approximately \$500 million in secured debt and an uncontroverted value of approximately \$302.5 million. (See B.D.I. 14 at Art. VIII). On the Petition Date, Debtors filed an initial plan of reorganization, which was amended on June 21, 2017 (B.D.I. 366) ("Plan").

According to Reorganized Debtors, to ensure that the Debtors' businesses remain viable and positioned for growth, the Plan eliminated approximately \$500 million of funded debt through the conversion to equity of certain 12.5%/10% senior secured second lien notes due 2021 (the "2021 Notes"), the Debtors' 9.875% unsecured senior notes due 2018 ("2018 Notes"), a term loan facility provided for under the term loan agreement dated April 15, 2016 (the "Term Loan Facility"), and a \$12.5 million senior secured, super-priority debtor in possession term credit facility (the "DIP Term Loan Facility"). Significant concessions by senior creditors ² funded gifted distributions to holders of out-of-the-money general unsecured claims under the Plan.

The Reorganized Debtors argue that the Plan treated unsecured creditors in distinct ways based upon their respective legal rights, their importance to the ongoing operation and the profitability of the Debtors' businesses, and the practical limitations impeding the Debtors' ability to provide such creditors with a recovery. (See D.I. 37 at 8; 7/21/17 Hr'g Tr. 60:1-62:5). Creditors holding claims derived from the purchase of 2018 Notes, which were classified in Class A6, received a combination of stock and cash by virtue of the gifted distributions from senior creditors, with an aggregate recovery to holders in Class A6 valued at approximately 4-6%. (See 7/21/17 *80 Hr'g Tr. at 30:23-25). In contrast, trade and certain other creditors related to the Debtors' business and operations ("Trade and Business-Related Claims"), classified in Class A7, B7, and C7, were reinstated under the Plan, and, therefore, holders of such claims were entitled to receive a 100% recovery by virtue of the gifted distributions. (See B.D.I. 14 at 12).

Class A6 voted to reject the Plan. 4 Because the Plan was nonconsensual, Debtors had the burden of "show[ing] that the plan meets the additional requirements of § 1129(b), including

against dissenting classes and the treatment of the dissenting classes is fair and equitable." In re Exide Techs., 303 B.R. 48, 58 (Bankr. D. Del. 2003). These requirements were

the requirements that the plan does not unfairly discriminate

addressed in the Debtors' confirmation brief and declaration in support. (See B.D.I. 302, 338).

Appellant, who held approximately \$450,000 of the 2018 Notes that had been classified in Class A6, objected to confirmation of the Plan (B.D.I. 290) on the grounds that (i) Appellant would receive a distribution of less value than certain of the Debtors' other unsecured creditors who also held unsecured claims (i.e., Trade and Business-Related Claims); and (ii) the classification scheme contemplated in the Plan was improper. Appellant was the sole objector to confirmation of the Plan. (7/24/17 Hr'g Tr. at 3:24-4:3). At the confirmation hearing on July 21, 2017, Appellant made arguments and examined and presented witnesses. (See 7/21/17 Hr'g Tr.). Appellant offered no evidence to controvert assertions with respect to the existing debt and value of Debtors' businesses. (See id.) Following the evidentiary hearing and argument on July 21, 2017, the Bankruptcy Court took the matter under advisement and made a bench ruling via telephonic hearing on July 24, 2017, overruling Appellant's objection and confirming the Plan. (See 7/24/17 Hr'g Tr.).

The Bankruptcy Court made the specific finding that "[u]nsecured creditors, including among others, trade creditors and holders of 2018 [N]otes are out of the money because they sit behind over \$500 million dollars of secured debt in the company that has an uncontroverted value of approximately \$300 million dollars." (7/24/17 Hr'g Tr. at 4:4-10). Addressing Appellant's classification objection, the Bankruptcy Court determined that separate classification of trade creditors and noteholders was reasonable on the basis that trade creditors were critical to the success of the reorganized debtors. (See id. at 5:5-6:24). Addressing Appellant's unfair discrimination objection, the Bankruptcy Court determined that, while the disparate treatment of Class A6 gave rise to a rebuttable presumption of unfair discrimination (id. at 9:12-14), that presumption was rebutted because Class A6 is "indisputably out of the money and not, otherwise, entitled to any distribution under the bankruptcy *81 code's priority scheme and provided further that the proposed classification and treatment of the unsecured creditors fosters a reorganization of these debtors." (Id. at 8:24-9:3). The Bankruptcy Court determined that its decision was consistent with leading cases governing the issue of gifting (9:14-12:12) and rejected Appellant's argument that the gift was from estate property, violated the absolute priority rule, and thus the Plan was not "fair and equitable." (See id.) The Bankruptcy Court overruled the objection, confirmed the Plan (id. at 13:24-14:5), and further held that any request for a stay of the Confirmation Order beyond the 10-day period included therein "would serve no purpose" as a stay was not warranted. (See id. at 14:19-15:3).

Appellant filed a timely notice of appeal on July 25, 2017. (D.I. 1). Contemporaneously, Appellant filed an emergency motion for stay of the Confirmation Order pending appeal (D.I. 3) ("Stay Motion") and a related motion for expedited consideration (D.I. 4). On August 3, 2017, the Court denied the Stay Motion on the basis that Appellant was unlikely to succeed on the merits of the appeal and had failed to establish irreparable harm absent a stay. (D.I. 20). On October 16, 2017, Debtors filed the Motion to Dismiss. (D.I. 31). The parties have fully briefed the Motion to Dismiss (D.I. 31, 32, 36, 40) and the merits of the appeal (D.I. 29, 37, 41). On May 14, 2018, the Court held oral argument on both the Motion to Dismiss and the merits of the appeal. (D.I. 44).

II. CONTENTIONS

Appellant raises the following issues on appeal: (i) whether the Bankruptcy Court erred by concluding that the Plan did not discriminate unfairly in finding that the "gift" under the Plan made by secured creditors to unsecured creditors providing varying levels of claim recovery did not constitute unfair discrimination under \[\bigsec{8}{2} \bigsec{1129(b)(1)}{2} \] of the Bankruptcy Code; and (ii) whether the Bankruptcy Court erred by concluding that the Plan properly classified 2018 Note claims separately from other general unsecured claims. (See D.I. 22 at ¶ 1-3). 5

With respect to equitable mootness, Reorganized Debtors argue that the Plan has been substantially consummated. Reorganized Debtors assert that, if I agree with Appellant that the Plan unfairly discriminated against and/or improperly classified Class A6 claims, correcting those errors would require a wholesale reversal of the Plan, restoration of the Reorganized Debtors' estates to the *status quo ante* prior to the Effective Date, and disgorgement of the gifted distributions, which is not possible as a practical matter and which would necessarily harm third parties who reasonably relied on plan confirmation. (See D.I. 31 at 3).

According to Appellant, this argument fails, as "[t]he Debtors can easily pay [him] the full amount of his claim if his appeal

is successful" as such "additional recovery by [Appellant] does not present a risk of fatally scrambling the Plan; nor does it present a risk of significant harm to third parties." (See D.I. 36 at 1, 12). Appellant urges the Court to use its remedial powers to fashion the relief he proposes: an order directing Reorganized Debtors *82 to pay 100% of Appellant's claim, plus several months' interest, so he may "receive the same treatment of holders of general unsecured creditors in Class A7." (See id. at 12-13).

With respect to the merits, Appellant argues that the Bankruptcy Court erred in concluding that the Plan did not improperly classify Class A6 Claims separately from other general unsecured claims. Appellant argues the separate classification was motivated "solely for the discriminatory purpose of not having to pay holders of the 2018 Notes Claims in full." (See D.I. 29 at 14; 31-35). Appellant argues that even if the Plan's separate classification of general unsecured claims was proper, the Plan unfairly discriminates in its treatment of 2018 Note claims, and that the Bankruptcy Court erred in its application of the Markell test (discussed below). (See id. at 15-18). Appellant argues that the Bankruptcy Court failed to properly consider whether Debtors had rebutted the presumption of unfair discrimination and relied instead merely on gifting. (See id. at 16-18). Appellant argues that such a gift cannot rebut the presumption of unfair discrimination under the Markell test, and that the entire concept of gifting has been flatly rejected by the Third Circuit. (See id. at 28-29).

Conversely, Reorganized Debtors argue that Appellant relies on cases that prohibit the use of gifts in contravention of the absolute priority rule, which is not at issue in this appeal. (See D.I. 37 at 14). "That body of law prohibits the gifting of a distribution from a senior class of creditors in a manner that skips over an intermediary junior class of dissenting creditors - "vertical gifting" - because it violates the strict requirements of the absolute priority rule." (Id.) The distribution in this case concerns unequal gifts by a secured creditor to two classes of junior creditors - horizontal gifting - which is not foreclosed under Third Circuit law. (See id. at 25). According to Reorganized Debtors, courts in this circuit have held that such a horizontal gift is not unfair discrimination against the class that does not receive the larger gift when (i) the creditor that does not receive the larger gift is not entitled to a distribution under a plan, and (ii) no class junior to the creditor receives a distribution under the plan. (See id. at 12-13). Debtors argue that confirmation of the Plan is consistent with controlling caselaw on the issue as well as the legislative history of \$\ \bigcessup \square \text{\text{\$}} \ \text{\$} \ \te

III. JURISDICTION

[1] The Court has jurisdiction to hear an appeal from a final judgment of the Bankruptcy Court pursuant to 28 U.S.C. § 158(a)(1). In reviewing the bankruptcy court's determinations, this Court "review[s] the bankruptcy court's legal determinations *de novo*, its factual findings for clear error and its exercise of discretion for abuse thereof." *See* In re Trans World Airlines, Inc., 145 F.3d 124, 130 (3d Cir. 1998) (noting that both the Third Circuit and the district court "exercise the same standard of review") (internal quotations and citations omitted).

*83 IV. DISCUSSION

A. The Appeal Meets the Criteria for Equitable Mootness

[4] [5] "'Equitable mootness' is a narrow doctrine by which an appellate court deems it prudent for practical reasons to forbear deciding an appeal when to grant the relief requested will undermine the finality and reliability of consummated plans of reorganization." Tribune, 799 F.3d at 277. A court assesses equitable mootness through the application of "prudential" considerations that address "concerns unique to bankruptcy proceedings."

In re Philadelphia Newspapers, LLC, 690 F.3d 161, 168 (3d Cir. 2012). The Third Circuit's recent decisions have synthesized the test for equitable mootness as "proceed[ing] in two analytical steps: (1) whether a confirmed plan has been substantially consummated; and (2) if so, whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation." In re Tribune

Media Co., 799 F.3d 272, 278 (3d Cir. 2015) (quoting In re SemCrude, 728 F.3d 314, 321 (3d Cir. 2013)). Reorganized Debtors, as the proponents of an equitable mootness dismissal, "bear[] the burden of overcoming the strong presumption that appeals from confirmation orders of reorganization plans – even those not only approved by confirmation but implemented thereafter (called 'substantial consummation' or simply 'consummation') – need to be decided." Id. at 278.

1. Whether the Plan Has Been Substantially Consummated

The Bankruptcy Code defines "substantial consummation" to mean:

- (A) transfer of all or substantially all of the property proposed by the plan to be transferred;
- (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and
- (C) commencement of distribution under the plan.

11 U.S.C. § 1101(2). Appellant concedes that the Plan has been substantially consummated. (*See* D.I. 36 at 12 (conceding that "the Plan has been substantially consummated"); *see also* D.I. 44 at 17:20-18:2). The record supports this conclusion. ⁶

If it is established that substantial consummation has occurred, the next step for a court considering equitable mootness is to "look to whether granting relief will require undoing the plan as opposed to modifying it in a manner that does not cause its collapse." *84 SemCrude, 728 F.3d at 321. A court "should also consider the extent that a successful appeal, by altering the plan or otherwise, will harm third parties who have acted reasonably in reliance on the finality of plan confirmation." **Id.

2. Granting Appellant Higher Individual Recovery than Class A6

[6] Appellant apparently does not seek revocation of the Plan and the imposition of a new chapter 11 plan in its place. (D.I. 44 at 17:19-18:2). Although Appellant's confirmation objection sought denial of Plan confirmation only, Appellant argues "that does not mean that the only relief available after the substantial consummation of the Plan is a complete unwinding of the Plan and a return to bankruptcy for the Debtors." (D.I. 36 at 13). Rather than apply equitable mootness and dismiss his appeal, however, Appellant contends that the Court should exercise its remedial powers and fashion relief in a way that would not upset the Plan -i.e., "by ordering payment of his claim in full" so Appellant may "receive the same treatment as the holders of general unsecured creditors in Class A7." (See id. at 12-13).

The Third Circuit instructs that the "starting point is the relief an appellant specifically asks for." Tribune, 799 F.3d at 278 (citations omitted). The only specific relief Appellant proposes is "full recovery" which is a much higher individual recovery than other holders of claims in Class A6. (See D.I. 44 at 23:22-24:9) Thus, in considering available relief to cure unfair discrimination, the Court's "starting point" is an order directing Reorganized Debtors to "provide [Appellant] with the same treatment as general unsecured creditors – payment of 100 cents on the dollar plus interest" - as compared with the 4-6% recovery provided to other members of Class A6. (Id.) According to Appellant, "because no bondholder other than Mr. Hargreaves filed a timely objection to the Plan, there is no danger that paying Mr. Hargreaves would require additional payments to any other bondholder." (See id.) That such relief would result in disparate treatment of Appellant's claim as compared with all other bondholder claims in Class A6 – precisely the issue that predicates the appeal – is of little concern to Appellant and of much concern to the Court. Appellant offers no support for his position that a remedy exists that allows him to receive, on appeal, treatment better than other creditors in the same class. (See D.I. 44 at 20:23-21:1).

However, it is not Appellant's burden to show that his success on appeal will not require undoing the plan; rather, it is the burden of the Reorganized Debtors, as the moving party, to demonstrate that the prudential factors weigh in favor of dismissal. — In re One2One Commc'ns, LLC, 805 F.3d 428, 436 (3d Cir. 2015). Reorganized Debtors argue that the higher individual relief proposed by Appellant would necessarily upset the Plan. As Reorganized Debtors argue, there is no mechanism under the *85 Bankruptcy Code by

which Appellant's claim can be paid in full outside of the confirmed Plan without paying in full the other members of Class A6. (See D.I. 31 at 16-17). Having placed the 2018 Noteholders in the same class, Reorganized Debtors argue, it would violate § 1123(a)(4) of the Bankruptcy Court to provide Appellant alone with a full recovery. Section 1123(a)(4) requires that "a plan shall ... provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment" 11 U.S.C. § 1123(a)(4). This section prohibits preferential treatment of a single bondholder who holds the exact same claims based upon the exact same instrument as other bondholders. Appellant's argument that § 1123(a)(4) of the Bankruptcy Code does not prohibit

disparate treatment, so long as creditors "ha[d] an equal

opportunity to recover on their claims" is unpersuasive and

not supported by the cases cited. (See D.I. 36 at 15, n.5).

The Court agrees with the conclusion reached in [In re Genesis Health Ventures, Inc., 280 B.R. 339 (D. Del. 2002) ("Genesis II"). There, appellant was a bondholder who appealed plan confirmation on the basis that his small percentage recovery, in the form of new common shares and warrants, was the result of the debtors' incorrect application of valuation methodologies which understated the enterprise value of the reorganized entity and the securities issued to senior secured lenders under the plan. See __id. at 342. Debtors moved to dismiss the appeal as equitably moot, and the Court granted the dismissal, finding, inter alia:

> [T]he Plan in this case was consented to by all of the creditors except for Class G5 bondholders like Appellant. Class G5 creditors have allowed claims in the amount of \$387 million. Appellant is a creditor holding \$20 million of Genesis bonds. Under the Bankruptcy Code, creditors of the same class are to be treated in the same manner unless they consent to receive less favorable treatment. 11 U.S.C. § 1123(a)(3)-(4); 11 U.S.C. \S 1129(b)(1) (prohibiting unfair discrimination among creditors

> when plan is confirmed over objection

of non-consenting creditors). The

relief Appellant proposes, i.e., the issuance of additional shares to him, would be unfair to the other creditors in Appellant's own class, and thus, prohibited under the Bankruptcy Code.

Id. at 346. Moreover, even assuming the Court could grant the higher individual recovery to Appellant without violating the Bankruptcy Code, it is unclear which party the Court may order to fund such a recovery. Appellant clearly seeks payment from the Reorganized Debtors' business. (See D.I. 44 at 23:18-21). However, the gifted distributions were funded by the collective, agreed concessions of various senior lenders, and the Court cannot order those creditors to supplement a gift made voluntarily. The only way to accomplish this would include a regifting by the former holders of 2021 Notes, which would require their vote in chapter 11.

Appellant argues that a higher individual recovery may be granted, but the cases cited by Appellant do not support such relief. Appellant argues, "The Third Circuit has repeatedly found that payments of small percentage amounts of a reorganized debtors' enterprise value would not fatally scramble a plan." (See D.I. 36 at 13-14). Appellant argues that in Philadelphia Newspapers, the court found that appellants' claim would not unravel plan as it accounted for only 1.7% of amount buyer paid to acquire debtors' assets. See In re Philadelphia Newspapers, LLC, 690 F.3d 161,

170-71 (3d Cir. 2012). In that case, appellant sought payment of administrative *86 expense claims, which, if ultimately allowed in a successful appeal, would be paid from an account established under the plan for the payment of such claims and the payment would represent only a small percentage of the money coming into the estate by virtue of the asset sale consummated under the plan. See *id.* at 167. As that appeal concerned the allowance of administrative expenses, however, success on appeal would not entitle appellant to a greater recovery than other holders of administrative expense claims.

Appellant also cites **Zenith**, where the court similarly noted that appellant sought "the disgorgement of \$76,500 in professional fees, a tiny sum in the context of the reorganization of a company valued at \$300 million." See

United States Tr. v. Official Comm. of Equity Sec. Holders

(In re Zenith Elecs. Corp.), 329 F.3d 338, 346 (3d Cir. 2003).

In Zenith, the United States Trustee appealed the award, and sought the disgorgement of \$76,500 in professional fees awarded to counsel to an unofficial committee. The District Court dismissed the Trustee's appeal as equitably moot, and the Third Circuit reversed, observing that "far from causing the reorganization plan to unravel, the Trustee's appeal, if successful, would return money to the estate."

Id. at 346. As Reorganized Debtors correctly observe, the appeals in both Philadelphia Newspapers and Zenith each concerned whether appellant's claim should have been allowed. Here, there is no dispute over the allowance of Appellant's claim – all of the claims of holders of 2018 Notes, including Appellant's, were allowed, but received limited recoveries under the Plan. These cases do not support a higher individual recovery by Appellant than other members of Class A6.

At oral argument, Tribune was cited as Appellant's "best case" in support of his request for full recovery. (See D.I. 44 at 20:4-18). The *Tribune* court declined to dismiss one of two appeals as equitably moot and suggested that disgorgement to satisfy appellant-trustee's claim was an available remedy. See Tribune, 799 F.3d at 283. The court observed that there was no chance the plan modification would unravel the plan, as the dispute concerned class entitlement to a \$30 million recovery in the context of a \$7.5 billion reorganization. See __id. However, the appeal in that case concerned an intercreditor dispute over whether one of two classes of creditors was entitled to funds under the relevant contract. 8 Tribune was not a case where one member of a class sought relief on appeal in the form of a higher individual recovery than the recovery provided to other members of the same class, as here. If successful on appeal, the relief sought in *Tribune* would have gone to the entire class: "disgorgement could be ordered against those Class 1F holders who have received more than their fair share, and the Litigation Trust's waterfall can be restructured to make sure that [Class] 1E gets its recovery to the exclusion of Class 1F." Id. at 282-83.

These decisions do not support the higher individual relief Appellant requests. While the cases support the notion that granting relief on a successful appeal is unlikely to unravel the plan where the relief would represent only a small percentage of the overall reorganization, those cases say nothing about a case like this *87 one, where granting appellant relief that is a small percentage of the overall reorganization would violate

§ 1123(a)(4) of the Bankruptcy Code.

Finally, Appellant cites SemCrude in support of his argument that he is entitled to higher individual recovery than the rest of Class A6 because he alone objected to the plan and appealed. (See D.I. 36 at 16; D.I. 44 at 16:22-17:8). In SemCrude, appellants argued that the plan improperly discharged their claims arising from statutory liens and property rights and sought an opportunity to assert those claims in an adversary proceeding. See SemCrude, 728 F.3d at 320. The court found no reason to believe that granting relief would cause the plan to collapse. See __id. at 324. "Even if Appellants are successful on their claims, ... the amounts involved will not require a sufficient redistribution of assets to destabilize the financial basis of the settlement." *Id.* Although *SemCrude* did draw a distinction between granting individual relief to appellant (versus parties who failed to appeal), that distinction is inapposite under these facts. As Reorganized Debtors correctly argue, any creditor may elect to consent to a release of its claims, which is effectively what the Third Circuit concluded the nonappealing creditors did in SemCrude. There is no analogue in the Bankruptcy Code for an individual creditor to withhold consent to a distribution in order to get a higher distribution under a plan than other creditors in the same class.

3. Other Practicable Relief

[7] The Third Circuit instructs that "even when a court applies the doctrine of equitable mootness, it does so with a scalpel rather than an axe. To that end, a court may fashion whatever relief is practicable instead of declining review simply because full relief is not available." Tribune, 799 F.3d at 278 (internal citations and quotations omitted). Assuming Appellant is successful on appeal, however, it is unclear what other practicable relief I may grant at this point. To meet their burden, the Reorganized Debtors assert that there is no practicable relief that can be granted with respect to the unfair discrimination and improper classification arguments at issue in this appeal that would not collapse the Plan and harm third parties who justifiably relied on plan confirmation. (See D.I. 31 at 12-18; D.I. 32).

Debtors argue that to address the unfair discrimination issue, the only possible remedy would be to provide equal recoveries to all unsecured creditors. (See D.I. 31 at 13). Reorganized Debtors argue that they do not have \$40 million in cash that would be required to pay claims of former holders of the 2018 Notes in full. (See id.) Even if sufficient cash were available, there would be no practical way to distribute it, according to Reorganized Debtors, as the 2018 Notes were cancelled under the Plan, and the indenture trustee for the 2018 Notes discharged of its duties and obligations under the governing indenture. (See id. at 14). As Reorganized Debtors lack sufficient cash to pay bondholders in *88 full, the only other relief would be to recover funds and balance recoveries among general unsecured creditors. In *Tribune*, the Third Circuit noted that "if funds can be recovered from third parties without a plan coming apart, it weighs heavily against barring an appeal as equitably moot, both in our Court and other circuits." Tribune, 799 F.3d at 279. Reorganized Debtors argue that this is not such a case. According to Reorganized Debtors, ordering disgorgement and recovery of the gifted distributions, and redistributing those distributions evenly among Classes A6 and A7, "would involve a massive, and likely impossible, disgorgement exercise:"

Although it is possible to conceive of a disgorgement scenario to recover all Gifted Distributions that had been provided to all unsecured creditors in order to redistribute them among former holders of Class A6 Claims and General Unsecured Claims, such a recovery effort would be virtually (if not actually) impossible to accomplish. The exercise would involve seeking the disgorgement of Reorganized Nuverra Common Stock, which is freely trading on NYSE American. Courts in this Circuit have recognized that there is no practical way to retrieve distributions from public security holders ... It is for that reason that the Third Circuit has "most frequently found that a plan could not be retracted when the reorganized debtor issued [publicly] traded debt or securities."

(D.I. 31 at 14 (quoting One2One, 805 F.3d at 436)). Additionally, Reorganized Debtors assert that a disgorgement of payments from customers and vendors who have continued doing business with the Reorganized Debtors "would irreparably damage [those] relationships ... and disrupt ongoing operations, jeopardizing stakeholder recoveries:"

The Reorganized Debtors operate in a variety of remote areas where the vendor base is limited, and many are small businesses. [F]ailing to pay vendors in some of these locations would have led those vendors to refuse to do business with the Reorganized Debtors, creating significant operational problems in areas where those vendors are not replaceable. [A] disgorgement exercise that involves the clawback of payments to vendors and suppliers would in turn lead to the loss of credit, vendors, and suppliers, which would cause significant harm to all stakeholders, especially senior creditors who own the Reorganized Debtors' equity and depend on the success of the Reorganized Debtors' businesses to achieve a recovery in these cases.

(See D.I. 32 at 8, ¶ 14 (affidavit of CRO)). Thus, disgorgement would require the claw back, not only of cash payments made to hundreds of individual creditors, but also the claw back of stock that is trading on the national stock exchange, and which now may be held by third parties who purchased those securities in the ordinary course. (See id).

This case is therefore unlike the *Tribune* case in which the Third Circuit suggested disgorgement as a possible remedy.

Tribune, 799 F.3d at 282. There, the court notably observed that the money at issue "has gone to a readily identifiable set of creditors against whom disgorgement can be ordered."

Id. Unlike *Tribune*, the disgorgement required in this case to grant equal recovery to Class A6 will require undoing the Plan and necessarily result in harm to third parties.

With respect to the second issue on appeal, as the Bankruptcy Court observed, Appellant "objects to the debtors' classification scheme for the same reason [as his unfair discrimination objection] arguing that classification of unsecured claims in more than one class is improper and calls for disparate treatment." (7/24/17 Hr'g Tr. *89 at 5:1-4). To address the improper classification issue, Reorganized

Debtors argue that the only possible remedy would require "having the Reorganized Debtors go back into chapter 11 in order to develop an amended plan that classifies all unsecured claims in the same class and provides all creditors in the single class with the same treatment." (See D.I. 31 at 16-17). Reorganized Debtors argue that, having repaid the DIP Loans on the Effective Date, they no longer have access to liquidity to fund a second trip through chapter 11, which makes a forced liquidation through chapter 7 a likely outcome. (See id. at 4). "If the Reorganized Debtors were forced to re-enter bankruptcy to revise their plan, I believe liquidation is a likely possibility, given that the Reorganized Debtors lack financing for a second Chapter 11 case, and had an extremely difficult time obtaining financing for the case they just emerged from." (D.I. 32 at 8, ¶ 15 (affidavit of CRO)). As with the remedy of providing equal recovery to general unsecured creditors, reclassifying the claims to balance distributions and to achieve the same result would "require undoing the plan as opposed to modifying it in a manner that does not cause its collapse," and would result in harm to third parties who have justifiably relied on the Plan. SemCrude, 728 F.3d at 321.

The Bankruptcy Court recognized the overall harm to the Debtors and other third parties that may result on appeal: "the consequences of an adverse ruling on appeal of a reversal of this confirmation order on appeal, frankly, the risks lie with the other constituents in this case, not with [Appellant] ..." (7/24/17 Hr'g Tr. at 14:24-15:3). The Court is unable grant Appellant higher individual recovery than other members of his class within the confines of the Bankruptcy Code. Because correcting unfair discrimination and improper classification issues would require undoing the Plan and would necessarily harm third parties, and because it is unclear what other practicable relief the Court may grant, the appeal meets the criteria for equitable mootness.

B. The Confirmation Order Is Affirmed

Although I find the appeal meets the criteria for equitable mootness, the Court can "readily resolve the merits of [the] appeal against the appealing party," so I hold, in the alternative, that the Confirmation Order is affirmed. See

Tribune, 799 F.3d at 278.

[8] Under \$\frac{1129(b)(1)}{\}\$ of the Bankruptcy Code, a plan may be "crammed down" on a dissenting impaired class only if it "does not discriminate unfairly" and is "fair and equitable" with respect to the non-accepting impaired

class. See 11 U.S.C. § 1129(b)(1); see also In re Armstrong World Indus., Inc., 320 B.R. 523 (D. Del. 2005) ("Armstrong IP"), aff'd, 432 F.3d 507 (3d Cir. 2005) ("Armstrong IP"). "[T]he pertinent inquiry is not whether the plan discriminates but whether the proposed discrimination is 'unfair.' "In re Tribune Co., 472 B.R. 223, 242 (Bankr. D. Del. 2012) (quoting In re Armstrong World Indus., Inc., 348 B.R. 111, 121 (D. Del. 2006) ("Armstrong III")). The main issue on appeal is whether the Plan "discriminates unfairly" in a manner that would prevent the Plan from being confirmed in accordance with § 1129(b)(1).

[10][11] [12] The concept of unfair discrimination is not defined in the Bankruptcy Code. See Armstrong III, 348 B.R. at 121. Courts typically examine the facts and circumstances of the particular case to determine whether unfair discrimination exists. *90 10 Various tests have emerged in the caselaw, with the hallmarks being "whether there is a reasonable basis for the discrimination, and whether the debtor can confirm and consummate a plan without the proposed discrimination." Ltd. at 121 (internal quotation omitted). The Third Circuit has not yet discussed the standard that should apply when assessing unfair discrimination, but courts within this jurisdiction have applied the test set forth by Bruce A. Markell, A New Perspective on Unfair Discrimination in Chapter 11, 72 Am. Bankr. L.J. 227, 249 (1998). Under the Markell test, a rebuttable presumption of unfair discrimination arises when there is:

(1) a dissenting class; (2) another class of the same priority; and (3) a difference in the plan's treatment of the two classes that results in either (a) a materially lower percentage recovery for the dissenting class (measured in terms of the net present value of all payments), or (b) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution.

See, e.g., Tribune, 472 B.R. at 241 (adopting and applying Markell test); In re Genesis Health Ventures, Inc., 266 B.R. 591, 612 (Bankr. D. Del. 2001) ("Genesis P") (applying Markell test). As Reorganized Debtors correctly point out, in applying the Markell test, "the analysis for determining whether the discriminatory treatment is unfair should be viewed by its effect on the dissenting class." Tribune, 472 B.R. at 244. This is consistent with the legislative history of \$1129(b)(1), which makes clear that "[t]he criterion of unfair discrimination is not derived from the fair and equitable rule or from the best interest of creditors test. Rather it preserves just treatment of a dissenting class from the class's own perspective." H.R. Rep. No. 595, 1 st Sess. 417 (1977).

1. The Bankruptcy Court Correctly Determined that the Plan Did Not Unfairly Discriminate

[13] Appellant argues that the Bankruptcy Court improperly applied the Markell test and blindly relied on the gifting doctrine in determining that the presumption of unfair discrimination was rebutted in this case. (See D.I. 29 at 15-18). I note that the Markell test did not address a situation in which the classes in which disparate treatment was occurring both were receiving their recoveries solely on account of a gift from a senior class. ¹¹ Indeed, Markell says nothing about gifting. Notwithstanding this distinction, the Court finds no error in the Bankruptcy Court's application of the Markell test. Its application is consistent with the decisions of other courts in this circuit which have examined gifted distributions.

Looking to percentage recovery between Classes A6 and A7, the Bankruptcy Court determined that the Plan's treatment "gives rise to a rebuttable presumption of unfair discrimination that the [D]ebtors must overcome." (7/24/17 Hr'g Tr. at 9:12-14). *91 The Bankruptcy Court found the presumption rebutted. Specifically, the Bankruptcy Court found that the gift here "constitute[d] no unfair discrimination" (id. at 8:23-24) because "class A6 was indisputably out of the money and not, otherwise, entitled to any distribution under the Bankruptcy Code's priority scheme and provided further that the proposed classification and treatment of other unsecured creditors fosters a reorganization of these debtors." (Id. at 8:24-9:9). As noted above, in applying the Markell test, and identifying unfair

discrimination, the analysis for determining whether the discriminatory treatment is unfair should be viewed by its effect on the dissenting class. See H.R. Rep. No. 595, 1 st Sess. 417 (1977). For example, in *Tribune*, the bankruptcy court applied the Markell test to a plan that involved classes that benefitted from differing treatment, receiving an increase in their recovery of between 47.8% and 53% on a dollar basis, which was caused by the forced sharing of a "Disputed Allocation." See Tribune, 472 B.R. at 244. The Bankruptcy Court held that, in applying the Markell test, "the analysis for determining whether the discriminatory treatment is unfair should be viewed by its effect on the dissenting class." *Id.* In reaching its conclusion that there was no unfair discrimination, the *Tribune* court only focused on the amount that the reallocation decreased the recovery to the dissenting class, and did not consider the large increase in recoveries to the other similarly-situated classes. See *id.* at 244. 12

Similarly, here, distributions to holders of Trade and Business-Related Claims have no impact on the distributions to holders of unsecured claims in Class A6. The record is clear that unsecured creditors are entitled to nothing under the Bankruptcy Code's priority scheme, and an increased distribution to unsecured creditors holding Trade and Business-Related Claims does not diminish the distribution to holders of claims in Class A6. If holders of Trade and Business-Related Claims did not receive this increased recovery, the surplus distribution would revert to secured creditors, not holders of claims in Class A6. As Appellant and his class were not entitled to a distribution in the first place, providing a greater distribution to a different class of unsecured creditors does not alter the distribution to which Appellant is entitled.

Appellant argues that the Bankruptcy Court erred by failing to address whether the two bases for rebuttal specifically mentioned by Markell were satisfied. Rebuttal of the presumption is discussed briefly by Markell:

The unfair discrimination in these situations is only presumptive. The plan proponent may overcome the presumption based on different percentage recoveries by showing that

a lower recovery for the dissenting class is consistent with the results that would obtain outside of bankruptcy, or that a greater recovery for the other class is offset by contributions from that class to the reorganization. The presumption of unfairness based on differing risks may be overcome by a showing that the risks are allocated in a manner consistent with the prebankruptcy expectations of the parties.

Markell, 72 Am. Bankr. L.J. at 228.

In either case—disparity of recovery disparity of risk—the plan proponent *92 can rebut the presumption of unfairness by proving that the difference in treatment is attributable to differences in the prepetition status of the creditors. In the case of a difference in the present value of the recovery, the presumption may also be overcome by a demonstration that contributions will be made by the assenting classes to the reorganization, and that these contributions are commensurate with the different treatment. In such cases, while discrimination exists, it is not unfair.

Id. at 250. Appellant argues that if the Bankruptcy Court had considered Markell's bases for rebuttal, neither prong would have been met here, as (i) ad unsecured creditors would be entitled to exactly the same percentage recovery outside of the Plan, and (ii) there is no proof that the holders of [Trade and Business-Related Claims] will infuse any new value into the reorganization.") (*See* D.I. 29 at 17).

[14] While Appellant argues these are the "only" bases for rebutting the presumption of unfair discrimination (*see id.* at 16), neither Markell nor any of the cases cited by Appellant suggest any limitations on the case-specific facts and circumstances which might rebut the presumption of unfair

discrimination. As Reorganized Debtors correctly argue, "the Markell test is not the only basis for rebutting a presumption of unfair discrimination, and the Bankruptcy Court was not required to evaluate these bases for rebuttal" (*See* D.I. 37 at 23). As noted above, Markell did not address a situation where, as here, the classes in which disparate treatment was occurring both were receiving their recoveries solely on account of a gift from a senior class. A reading of Markell does not support the limitations on the Bankruptcy Court's analysis that Appellant asserts, nor would such limitations be consistent with the Bankruptcy Court's broad discretion to consider case-specific facts in the context of plan confirmation. ¹³

In Genesis I, a case with virtually identical facts, the court found the presumption of unfair discrimination was rebutted in the horizontal gifting context. See Genesis I, 266 B.R. at 612. As in this case, the plan in Genesis I provided a gift to certain, but not ad, classes of unsecured creditors out of the recoveries of secured creditors. See *id.* at 600-01. In that case, the unsecured creditors holding punitive damage litigation claims classified in classes G7 and M7 were to receive no recovery, while the other classes of general unsecured creditors (classes G4 and M4) received the gift. **Id.** Holders of claims in classes G7 and M7 objected, arguing, among other things, that the plan unfairly discriminated against them in light of the recovery to unsecured creditors in classes G4 and M4. In assessing unfair discrimination, the court in Genesis I applied the Markell test and concluded that, while the disparate treatment gave rise to the presumption of unfair discrimination, the presumption was rebutted:

[T]he recovery by Classes G4 and M4 of a dividend in the form of New Common Stock and Warrants is based on the agreement of the Senior Lenders to allocate a portion of the value they would have otherwise received to Classes G4 and G5. The disparate treatment ... is a permissible allocation by the secured creditors of a portion of the distribution to which they would otherwise be entitled, rather than unfair discrimination *93

against Classes G7 and M7 by the proponents of the plan.

Id. at 612. Thus, Genesis I found that the presumption of unfair discrimination was rebutted where the distribution was based on the agreement of senior lenders to allocate a portion of the value to which they would have otherwise been entitled under the Bankruptcy Code. See id. Although gifting is not a basis for rebuttal specifically mentioned by Markell, the Genesis I court found this permissible allocation sufficient to rebut the presumption of unfair discrimination. The Bankruptcy Court's ruling here is consistent with Genesis I. 14

As unfair discrimination is not defined in the Bankruptcy Code, courts must examine the facts and circumstances of the particular case to determine whether unfair discrimination exists. The Third Circuit has yet to mandate application of the Markell test in determining whether a plan discriminates unfairly, and Markell's useful analysis is not exhaustive of the facts and circumstances that may rebut a presumption of unfair discrimination. Under the facts of this case, the holders of Class A6 were not harmed by the disparate recovery provided to Trade and Business-Related Claims, and ad unsecured creditors did significantly better than they would have outside of chapter 11 or under a plan of liquidation. To the extent the Bankruptcy Court did not specifically address the Markell bases for rebuttal in its bench ruling, Appellant cites no case law in support of such a limited, formulaic application. The Bankruptcy Court's analysis is consistent with the Markell analysis undertaken in *Genesis I*. I find no error in the Bankruptcy Court's conclusion that the Plan did not unfairly discriminate, which is based on uncontroverted, case-specific facts and consistent with applicable case law and legislative history concerning unfair discrimination.

2. The Third Circuit Has Not Foreclosed Horizontal Gifting, and the Vertical Gifting Cases Cited by Appellant Are Inapposite

[15] In determining that the Plan did not unfairly discriminate, the Bankruptcy Court relied on Genesis I, a case with virtually identical facts, which examined whether a horizontal gift – like the one at issue in this

case – unfairly discriminated against other classes. (7/24/17 Hr'g Tr. at 10:12-12:12). As noted above, in Genesis I, senior creditors who were not being paid in full shared a portion of their distributions with junior classes (Classes G4 and M4) but not with creditors holding punitive *94 damages claims (Classes G7 and M7). See Genesis I. 266 B.R. at 612. There, the Bankruptcy Court held that "the disparate treatment between Classes G4 and G7 and Classes M4 and M7 is a permissible allocation by the secured creditors of a portion of the distribution to which they would otherwise be entitled, rather than unfair discrimination against [dissenting classes] by the proponents of the plan." -Id. Here, the Bankruptcy Court found "this situation [i.e., the Plan] to be consistent with the gift contained in the plan proposed in *Genesis*, which the *Armstrong* court viewed favorably." (7/24/17 Hr'g Tr. at 10:16-19).

Appellant argues that the Bankruptcy Court's approval of the Plan was erroneous, as "multiple appellate courts have held that a plan may not use gifting to circumvent [] § 1129(b)'s express provisions" in rulings following *Genesis* I, including the Armstrong decisions in this circuit. (See D.I. 29 at 22-30). Reorganized Debtors distinguish "vertical gifting" from "horizontal gifting." They argue that any "[n]egative treatment of gifting in the caselaw applies [only] to vertical gifting, which violates the absolute priority rule, a different provision of the Bankruptcy Code implicating different concerns." (D.I. 37 at 25-28). "The absolute priority rule, as codified, ensures that 'the holder of any claim or interest that is junior to the claims of [an impaired dissenting] class will not receive or retain under the plan on account of such junior claim or interest any property.' "

Armstrong II, 432 F.3d at 513 (quoting 11 U.S.C. § 1129(b)(2)(B) (ii)). Reorganized Debtors argue that the absolute priority rule is not implicated here, as "there is no higher priority dissenting creditor being deprived of a gift (i.e., no class skipping) because equity, which is the class junior to Class A6, received no distribution under the Plan." (D.I. 37 at 25). Contrary to Appellant's contention that gifting has been "flatly rejected" in this circuit, Reorganized Debtors argue that the Third Circuit in Armstrong II purposefully carved out Genesis I's horizontal gift ruling from its decision prohibiting vertical gifting in violation of the absolute priority rule. (See id.)

The Court agrees with Reorganized Debtors that Armstrong II did not "flatly reject" the concept of gifting. Armstrong II considered whether vertical gifting violated the "fair and equitable" requirement for cram-down, which invokes the absolute priority rule of 11 U.S.C. § 1129(b)(2)(B)(ii). The Third Circuit concluded – based upon its consideration of the absolute priority rule, not any consideration of whether there was "unfair discrimination" - that the distribution of warrants to equity holders, which skipped over an objecting class of unsecured creditors, violated the absolute priority rule. See Armstrong II, 432 F.3d at 513. "Under the statute, a plan is fair and equitable with respect to an impaired, dissenting class of unsecured claims if (1) it pays the class's claims in full, or if (2) it does not allow holders of any junior claims or interests to receive or retain any property under the plan 'on account of' such claims or interests." Id. at 512 (citing 11 U.S.C. § 1129(b)(2)(B)(i)-(ii)). The Third Circuit concluded that the plain language of the statute makes clear that a plan cannot give property to junior claimants over the objection of a more senior class that is impaired, and noted that "section 1129 was at least designed to address 'give-up' situations where a senior class gave property to a class junior to the dissenting class." Id. at 513.

Unlike that case, the gift at issue here does not involve vertical class skipping as it does not provide a distribution to a class junior to the dissenting Class A6. As the *95 Bankruptcy Court noted, ¹⁵ Armstrong I also distinguished Genesis I on the facts as involving a distribution of property subject to the senior creditor's liens that was "carved out" voluntarily for junior claimants. See Armstrong 1, 320 B.R. at 539. The Third Circuit adopted this reading of that case in Armstrong II. characterizing the Genesis I decision as having allowed a secured creditor to "(1) give up their proceeds under the reorganization plan to holders of unsecured and subordinated claims, without including the holders of punitive damages in the arrangement, and (2) allocate part of their value under the plan to the debtor's officers and directors as an employment incentive package." Armstrong II, 432 F.3d at 513-14; see also In re World Health Alternatives, Inc., 344 B.R. 291, 298-99 (Bankr. D. Del. 2006) (discussing Armstrong II and Genesis I and concluding that Armstrong II distinguished, but did not

disapprove of, Genesis I, and that secured creditors may give up a portion of their lien for the benefit of junior creditors without violating the Bankruptcy Code). Armstrong I reviewed relevant case law, including Genesis I, In re MCorp. Financial, Inc., 160 B.R. 941 (S.D. Tex. 1993), and In re SPM Mfg. Corp., 984 F.2d 1305 (1st Cir. 1993), and rejected a blanket rule that all gifting is permissible.

Armstrong I, 320 B.R. at 539-40. The Third Circuit agreed:

We adopt the District Court's reading of [the MCorp-Genesis I line of] cases, and agree that they do not stand for the unconditional proposition that creditors are generally free to do whatever they wish with the bankruptcy proceeds they receive. Creditors must also be guided by the statutory prohibitions of the absolute priority rule, as codified in U.S.C. § 1129(b)(2)(B).

Armstrong II, 432 F.3d at 514. Reorganized Debtors do not advance a blanket rule that all gifting is permissible. Reorganized Debtors' position is merely that "courts in this circuit have held that such a horizontal gift is not unfair discrimination against the class that does not receive the larger gift when (i) the creditor that does not receive the larger gift is not entitled to a distribution under a plan, and (ii) no class junior to the creditor receives a distribution under the plan." (D.I. 37 at 12-13). The horizontal gifting in Genesis I does not violate the absolute priority rule and remains good law.

Appellant cites several cases in support of his argument, but because they are vertical gifting cases, they do not change the outcome here. Appellant cites In re ICL Holding Co., Inc., 802 F.3d 547 (3d Cir. 2015), but that case addressed priority skipping payments in violation of the absolute priority rule and did not address issues of unfair discrimination. (See D.I. 29 at 24). Appellant also relies on the DBSD case from the Second Circuit. See Dish Network Corp. v. DBSD N. Am., Inc. (In re DBSD), 634 F.3d 79, 86-87 (2d Cir. 2011).

That case also involved a class-skipping gift to a class junior to the dissenting creditor in violation of the absolute priority rule. The Second Circuit held that the gifting of shares and warrants by second lien secured creditors to the debtor's sole shareholder was impermissible where the company's general unsecured creditors did not receive full satisfaction of their claims. See id. at 87. In short, these decisions focus on vertical class skipping in violation of the absolute priority rule and do not support Appellant's argument that the gifted distributions in this case are impermissible.

*96 Appellant cites just one case addressing horizontal gifting, In re Sentry Operating Co. of Texas, 264 B.R. 850 (Bankr. S.D. Tex. 2001), which as Reorganized Debtors correctly argue, is nonbinding and factually distinguishable. There, the plan sought to pay trade claims in full, while providing only a de minimis distribution to other general unsecured creditors. See Lid. at 851. In finding unfair discrimination, the Sentry court also emphasized that the secured lender was controlled by a competitor of the debtors, and that a large portion of the trade claims to be paid were to parties with "whom [the secured lender's] parent does substantial business." — *Id.* at 856. Although the — *Sentry* court concluded that there was a presumption of unfair discrimination, and stated that a secured creditor should not be permitted to "decide which creditors get paid and how much those creditors get paid" (id. at 865), the presence of a possible conflict of interest was evident. The Sentry court noted that the class of trade claims to be paid included creditors who "appear to be paid for reasons other than preservation of value." Id. at 864.

3. The Bankruptcy Court Did Not Err in Finding a Rational Basis for Separate Classification of Class A6 Claims

[16] [17] [18] [19] Section 1122(a) of the Bankruptcy Code provides that, except as otherwise provided in § 1122(b) of the Bankruptcy Code, "a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class." 11 U.S.C. § 1122(a). "Section 1122 of the Code provides that claims that are not 'substantially similar' may not be placed in the same class; it does not expressly prohibit placing 'substantially similar' claims in separate

classes." In re Coram Healthcare Corp., 315 B.R. 321, 348 (Bankr. D. Del. 2004). Courts have held that there is significant flexibility in classifying claims and interests into different classes as long as a rational legal or factual basis for separate classification exists and all claims or interests within a particular class are substantially similar. See, e.g., Jersey City, 817 F.2d at 1060-61 (approving classification of general unsecured creditors into separate classes of doctors' indemnification claims, medical malpractice claims, employee benefit claims, and trade claims). "[I]n analyzing whether claims within a given class are substantially similar, the focus of the classification should be on the legal character of the claim as it relates to the assets of the debtor." re W.R. Grace & Co., 475 B.R. 34, 109-10 (D. Del. 2012), aff'd, 729 F.3d 332 (3d Cir. 2013) (internal citations and quotation marks omitted). The "primary analysis centers upon the legal attributes of the claims and not upon the status or circumstances of the claimant. Emphasis is not upon the holder so much as it is upon that which is held." In re FF Holdings Corp., 1998 U.S. Dist. LEXIS 10741, *13 (D. Del. Feb. 17, 1998) (quoting In re Northeast Dairy Cooperative Fed., Inc., 73 B.R. 239, 250 (Bankr. N.D.N.Y. 1987)). In determining whether the separate classification of substantially similar claims is permissible. "[i]t is a wellrecognized principle that the classification of claims or interests must be 'reasonable' and cannot be grouped together for arbitrary or fraudulent purposes." W.R. Grace, 475 B.R. at 110.

[20] Addressing Appellant's argument that the Plan improperly classified his claims separately from other general unsecured claims, the Bankruptcy Court noted that the proper analysis "focused on how the legal character of the claim relates to the assets of the debtor and whether the claims exhibit a similar effect on the bankruptcy estate." (7/24/17 Hr'g Tr. at 5:23-25). Based on the character and effect of *97 the claims, the Bankruptcy Court found the Plan's separate classification of those claims to be reasonable and based on

[T]he debtors are entitled to flexibility in classifying claims [and] interests into different classes so long as a rational[], legal, or factual basis for separate classifications exists and all claims or interest[s] within a particular class are substantially similar.

a "justifiable rationale:"

On[e] such justifiable rationale for separately classifying certain trade creditors from others is the debtors' intention

of a continuing business relationship with such trade creditors as here. In its submissions, the debtors clearly explain that separate classification is necessary to maintain ongoing business relationships that [t]he debtors need to ensure the continuance of operations.

In *Coram*, the Bankruptcy Court determined that separate classification of unsecured noteholders and trade creditors was reasonable because each group represented a voting interest that was sufficiently distinct from one another to merit a separate voice in the reorganization.

Here, I similarly find that the plan reasonably classifies the 2018 noteholders separately from the other unsecured claims including intercompany claims, other general unsecured claims, and [what] I'll refer to as litigation claims including tort and disputed contract claims, all related to activities arising out of day-to-day operations of the companies.

(Id. at 6:1-24).

Appellant argues on appeal that "[t]he purported justification for separate classification [of those substantially similar claims] - that is, note claims on the one hand versus claims 'arising out of day-to-day operations,' on the other - does not pass muster under the law." (D.I. 29 at 31-32). Appellant argues that litigation claims being paid in full include liabilities arising out of "negative outcomes," including "lawsuits involving employment, commercial, and environmental issues, other claims for injuries and damages, and various shareholder and class action litigation, among other matters." (See D.I. 29 at 34 (citing 7/21/17 Hr'g Tr. 40:1-42:6)). "Other than saying that those claims arose from 'day-to-day operations,' the Bankruptcy Court failed to identify any business reason for paying those litigation claims in full, while simultaneously paying holders of the 2018 Notes Claims received less than 10 cents on the dollar." (Id.) According to Appellant, "It is difficult to fathom what possible business reason could exist." (Id). Conversely, Reorganized Debtors argue that the Bankruptcy Court correctly found that fostering the Debtors' reorganization formed a rational basis for separate classification of the Trade and Business-Related Claims. (See D.I. 37 at 14-15). "Creditors holding Trade and Business-Related Claims were paid in full in recognition of the impossibility of partially impairing them during an expedited case, the relatively small amount that this body of creditors represents, and their importance to the smooth operation and success of the Debtors' business." (Id. at 36-37).

Numerous cases permit separate classification of trade claims from noteholder claims on the grounds that such claims have different legal attributes. In Coram, the chapter 11 plan separately classified trade creditors from other unsecured claims, including noteholder claims, and the noteholders argued that such separate classification of substantially similar claims was improper. See Coram, 315 B.R. at 348-49. The court found that the legal attributes of the noteholder claims were different from the trade claims because the *98 noteholder claims "arose from the purchase of notes, not the provision of services to the [d]ebtors" like the trade claims. See __id. at 349. Accordingly, the court concluded that the claims were not substantially similar and that separate classification was proper. Id. at 351 ("[W]e are convinced that the Noteholders do represent a voting interest that is sufficiently distinct from the trade creditors to merit a separate voice in this reorganization case."). As in Coram, the Plan here permissibly classified claims arising

from the purchase of the 2018 Notes separately from claims arising from the Debtors' operations and businesses, Classes A7, B7, and C7. Claims in Class A6 (2018 Note Claims) are legally distinct in nature from claims in the other classes of general unsecured claims. Creditors in Class A6 derive their claims from the 2018 Note indenture, a single debt instrument governing the 2018 Notes. In contrast, the holders of claims in Classes A7, B7 and C7, containing Trade and Business-Related Claims, all have claims that arose in connection with the Debtors' business operations, not indentures or similar financial instruments, including certain contingent litigation claims related to the Debtors' operations and businesses.

Reorganized Debtors further cite decisions by "[n]umerous courts [that] have held that separate classification and treatment of trade claims is acceptable if the separate classification is justified because they are essential to a reorganized debtor's ongoing business." Appellant disputes this argument, arguing that the separate classification was motivated "solely for the discriminatory purpose of not having to pay holders of the 2018 Notes Claims in full." (D.I. 29 at 14). However, Appellant's only argument in support of discriminatory purpose is circular: essentially, that the separate classification otherwise "makes no sense." (See id. at 33). "The origin of a given unsecured claim has nothing to do with whether a business reason exists for providing that claim with better treatment going forward." (Id.). Appellant's argument regarding discriminatory purpose is unavailing. The

In re Nuverra Environmental Solutions, Inc., 590 B.R. 75 (2018)

Bankruptcy Court's decision rested on its finding that the separate classification of trade creditors from noteholders fosters the reorganization. This finding is supported by the record, including Debtors' CRO's confirmation hearing testimony that the separate classification and treatment of the Trade and Business-Related Claims was necessary (i) to "preserve what little trade credit the company did have remaining," (ii) because the businesses are typically operated in smaller towns with limited vendors, and (iii) because not paying any particular vendor would likely tarnish the reputation of the Debtors and harm relationships with other current or future potential *99 vendors. (7/21/17 Hr'g Tr. 60:24-62:5; see also B.D.I. 338 at ¶ 37). Nothing in the record indicates that Appellant's claims were placed in Class A6 for arbitrary or fraudulent purposes, which is also belied by the Class A6 vote. ¹⁷ The Court finds no error in the Bankruptcy Court's determination that a rational basis for separate classification exists and that the classification was reasonable.

V. CONCLUSION

The Plan has been substantially consummated, and there is no practical relief that could be granted to Appellant that would not violate express provisions of the Bankruptcy

Code, fatally scramble the Plan, and significantly harm third parties who have justifiably relied on plan confirmation. Therefore, the appeal meets the criteria for equitable mootness. Alternatively, the Bankruptcy Court's ruling is consistent with existing precedent, and the Confirmation Order is affirmed.

A separate order will be entered.

ORDER

For the reasons set forth in the accompanying Memorandum, this <u>21</u> day of August, 2018, IT IS HEREBY ORDERED that:

- 1. The Motion to Dismiss (D.I. 31) is GRANTED.
- 2. Alternatively, the Confirmation Order (B.D.I. 366) is AFFIRMED.
- 3. The Clerk is directed to CLOSE Civ. No. 17-1024-RGA.

All Citations

590 B.R. 75

Footnotes

- The docket of the Chapter 11 cases, captioned *In re Nuverra Environmental Solutions, Inc.*, No. 17-10949 (KJC) (Bankr. D. Del.), is cited herein as "B.D.I. ____." The transcript of the confirmation hearing, at B.D.I. 362, is cited herein as "7/21/17 Hr'g Tr. at ____," and the transcript of the Bankruptcy Court's oral decision, at B.D.I. 363, is cited herein as "7/24/17 Hr'g Tr. at ____." The *Appendix of Appellant David Hargreaves* (D.I. 33-35) is cited herein as "A ___."
- Specifically, holders of 2021 Notes and lenders under the Term Loan Facility and DIP Term Loan Facility voluntarily agreed to accept a lower recovery on their secured claims than they were entitled to receive. The DIP Term Loan Facility and Term Loan Facility converted to equity at a discount, receiving distributions of equity worth less than the face value of the debt converted. (See 7/21/17 Hr'g Tr. 7:21-8:13). The 2021 Notes also converted into equity, receiving recoveries of less than 54.5% of their claims, and voluntarily agreeing to forgo any Plan distributions on account of approximately \$190 million in unsecured deficiency claims relating to the 2021 Notes, claims that otherwise would have ranked equally with all other unsecured claims. (See B.D.I. 338 at ¶ 37).
- Included among the Trade and Business-Related Claims were certain contingent litigation claims related to the Debtors' business operations, including tort and personal injury suits that the Debtors believed would be covered under insurance as well as litigation claims to which the Debtors had counterclaims. (See 7/21/17 Hr'g Tr. at 59:14-17; 57:23-58:9).
- Despite having approximately 80% in number of holders vote to accept the plan, the plan failed to gain the support of 50% in dollar amount. (See B.D.I. 154, A746 (voting declaration)). Under § 1126(c) of the

In re Nuverra Environmental Solutions, Inc., 590 B.R. 75 (2018)

- Bankruptcy Code, "[a] class of claims has accepted a plan if such plan has been accepted by creditors that hold ... at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors ... that have accepted or rejected such plan." 11 U.S.C. § 1126(c).
- Appellant identified the following additional issue on appeal but failed to address it in merits briefing: "whether the Bankruptcy Court erred by concluding that the Plan was fair and equitable even though it allows the Debtors to retain equity interests in their subsidiaries despite all unsecured creditors not being paid in full." (Compare D.I. 22 & 29). Accordingly, I do not consider this issue.
- The Reorganized Debtors filed a declaration of their Chief Restructuring Officer ("CRO") Robert Albergotti (D.I. 32) ("Albergotti Decl."), in which he attests, *inter alia*, that, beginning on the Effective Date, Reorganized Debtors entered into certain financing exit facilities and security agreements in order to repay obligations under the Debtors' pre-Effective Date asset based lending facility and debtor-in possession lending facility; make certain required payments under the Plan; pay costs and expenses incurred in connection with the Plan; and for working capital, transaction expenses, and other general corporate expenses. (*See* Albergotti Decl. at ¶¶ 6-9). Additionally, on the Effective Date, (i) Reorganized Debtors issued approximately 12 million shares of reorganized Nuverra common stock (that is freely tradable on a national stock market) and 118,137 warrants to purchase shares, with an exercise term expiring 5 years from the Effective Date, or, in certain instances, as specified in the Plan; and (ii) all shares of the Debtors pre-Effective Date common stock and outstanding equity interests in the Debtors were cancelled and discharged. (*See id.* at ¶ 10). Additionally, cash distributions were made under the Plan and all prepetition debt was either repaid or cancelled. (*See id.* at ¶ 11)
- 7 Reorganized Debtors argue that Appellant never sought full payment of his claim below, and only sought denial of plan confirmation, and cannot be heard to make such a request now:
 - Appellant takes a 180-degree turn from the substantive position that he raises in the Appeal by suggesting that a claim of unfair discrimination could be satisfied by discriminating in favor of him relative to other holders of claims in his class. Appellant now identifies the sole remedy he seeks on appeal as the payment in full of his claims, and only his claims... By re-casting the issue in that manner, Appellant has abandoned his contention that the Plan's distribution scheme could be changed to address his unfair discrimination and classification arguments, effectively conceding that doing so would fatally scramble the Plan. (See D.I. 40 at 1-2).
- "[T]he Trustees contend that they are beneficiaries of a subordination agreement that guarantees that they will receive any recovery that goes to the holders of the PHONES and EGI Notes ahead of a class of trade and other creditors (Class 1F) ... The merits question presented by the Trustees' appeal is straightforward: does the Plan unfairly allocate Class 1E's recovery to 1F?" Tribune, 799 F.3d at 282-83.
- As the SemCrude court observed: "We also fail to see any indication that allowing Appellants to proceed with their claims would result in a deluge of other Producers filing their own adversary proceedings. Unlike with Appellants, we are unaware of any evidence in the record showing that other Producers objected to the discharge of their claims or asserted the right to an adversary proceeding. In return for the distributions they received under the plan, other Producers were required to dismiss with prejudice any adversary proceedings they had filed. Absent their objecting at the time of plan confirmation to this dismissal requirement (as well as to the discharge of their claims), they cannot now attempt to restart those actions." SemCrude, 728 F.3d at 324.
- See In re 203 N. LaSalle St. Ltd. P'ship, 190 B.R. 567, 585 (Bankr. N.D. III. 1995) (noting "the lack of any clear standard for determining the fairness of a discrimination in the treatment of classes under a Chapter 11 plan," and that "the limits of fairness in this context have not been established"), aff'd, 195 B.R. 692 (N.D. III. 1996), aff'd, 126 F.3d 955 (7th Cir. 1997), rev'd on other grounds, 526 U.S. 434, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999).

In re Nuverra Environmental Solutions, Inc., 590 B.R. 75 (2018)

- Reorganized Debtors argue that the Markell test was intended to fill in the blanks on how a court should assess disparate treatment of claims outside of a scenario where distributions are based solely on gifts. (See D.I. 44 at 38:20-25). The Court expresses no opinion on this argument.
- See also LaSalle, 126 F.3d at 969 (factually predating Markell, and finding, in part, that, "the disparity between [the trade claims and the nonrecourse deficiency claims], with the trade creditors receiving 100 percent and Bank America receiving sixteen percent, is not unfair [because] Bank America does better than it would have under chapter 7, and the trade creditors do no worse.")
- "[I]t remains clear that Congress intended to afford bankruptcy judges broad discretion to decide the propriety of plans in light of the facts of each case." In re Jersey City Med. Ctr., 817 F.2d 1055, 1060-61 (3d Cir. 1987).
- 14 Reorganized Debtors further argue that, despite not being required to evaluate Markell's specific bases for rebuttal, the Bankruptcy Court's ruling does address them, including "factual findings that support rebuttal of any presumption of unfair discrimination under the Markell framework." (See D.I. 37 at 23). Reorganized Debtors argue that Markell's first basis for rebuttal - that a lower recovery for the dissenting class is consistent with the results that would obtain outside of bankruptcy - is present here, as there was no value in the Debtors' businesses to make any payment to unsecured creditors. The Bankruptcy Court found as much when it concluded that unsecured creditors "sit behind over \$500 million dollars of secured debt in the company that has an uncontroverted value of approximately \$300 million dollars." (7/24/17 Hr'g Tr. at 4:4-8). Appellant does not challenge the Bankruptcy Court's factual determination regarding the Appellant's entitlements to proceeds of the Debtors' estates, nor does he offer any explanation of how, from the perspective of the 2018 Notes, recoveries could be any better outside of bankruptcy. Reorganized Debtors argue that Markell's second basis for rebuttal - that a greater recovery for the other class is offset by contributions from that class to the reorganization – is also present here. The Bankruptcy Court made findings indicating that the ongoing business relationships provided by business creditors created value which justified the Plan's classification and treatment of unsecured creditors. (Id. at 6:6-24).
- The Bankruptcy Court noted in its bench ruling that *Armstrong* had distinguished the very similar "arrangement in *Genesis* [I] as an ordinary carve-out of the senior creditor's lien for the junior claimant's benefit" but did not reject it. (*See* 7/27/17 Hr'g Tr. at 11:8-12:9).
- See, e.g., Coram, 315 B.R. at 349 (approving separate classification of trade creditors from other unsecured claims, including noteholder claims); Jersey City Med. Ctr., 817 F.2d at 1061 (upholding separate classification of trade creditors as reasonable because of the differences between physician claims, medical malpractice claims, employee benefit claims, and trade creditor claims); FF Holdings, 1998 U.S. Dist. LEXIS 10741, at *16 (finding that separate classification of trade claims is permitted "if the separate classification is justified by a 'reasonable purpose,' legitimate basis, or necessary business objective."); In re Adelphia Commc'ns Corp., 368 B.R. 140, 247 (Bankr. S.D.N.Y. 2007) (finding it was within the debtor's discretion to separately classify the trade claims from other unsecured claims because the trade claims reserves would be shielded from the risk of certain of the unliquidated claims in the other unsecured claims class); In re Richard Buick, Inc., 126 B.R. 840, 852 (Bankr. E.D. Pa. 1991) (upholding full payment of trade claims but only 5% recovery for other unsecured claims because full payment of the trade claims was necessary to the future success of the debtor's business).
- 17 The record reflects that, of the holders of Class A6 claims who voted on the Plan, approximately 80% in number voted to accept the Plan. (See B.D.I. 154, A746 (voting declaration)).

End of Document

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In re: Transwest Resort Properties, Inc., 554 B.R. 894 (2016)

2016 WL 4087111, 62 Bankr.Ct.Dec. 254

554 B.R. 894 United States District Court, D. Arizona.

IN RE: TRANSWEST RESORT
PROPERTIES, INC., Debtor.

Joint Administration with: Transwest Tucson
Property, L.L.C., Transwest Hilton Head
Property, L.L.C., Transwest Tucson II, L.L.C.
JPMCC 2007-C1 Grasslawn
Lodging, LLC, Appellant,

Transwest Resort Properties, Inc., Transwest Tucson Property, L.L.C., Transwest Hilton Head Property, L.L.C., Transwest Tucson II, L.L.C., Transwest Hilton Head II, L.L.C., Appellees.

Case No. 4:12-cv-00024-RCC (Lead Case)

Consolidated with Appeal
Case No. 4:12-cv-00121-RCC

On appeal from Chapter 11
Case No. 4:10-bk-37134-EWH

Jointly Administered With Case Nos.: 4:10-bk-37160-EWH, 4:10-bk-37170-EWH,
4:10-bk-37151-EWH, 4:10-bk-37145-EWH

Signed June 21, 2016

Filed June 22, 2016

Synopsis

and remanded.

Background: Lender objected to debtors' Chapter 11 reorganization plan. The United States Bankruptcy Court for the District of Arizona overruled lender's objections and confirmed the plan, and then denied lender's motion for stay pending appeal. Lender appealed and moved for a stay. The District Court, Raner C. Collins, Chief Judge, denied the motion for a stay and held that the appeal was equitably moot. Lender appealed. The Court of Appeals for the Ninth Circuit, Friedland, Circuit Judge, 801 F.3d 1161, reversed

Holdings: On remand, the District Court, Collins, Chief Judge, held that:

- [1] proposed Chapter 11 plan did not have to contain dueon-sale clause, to prevent Chapter 11 debtors from cashing out their investments following renovation of commercial property that secured the allegedly undersecured claim of lender that had made statutory election, in order to be fair and equitable to this lender and to respect rights that it obtained by making statutory election, and
- [2] statutory requirement that, in order to be confirmed, proposed Chapter 11 plan had to be accepted by at least one impaired class applied, in jointly administered case filed by debtors whose estates had not been substantively consolidated, on per-plan, rather than on per-debtor, basis.

Affirmed.

West Headnotes (7)

[1] Bankruptcy Conclusions of law; de novo review

Bankruptcy 🤛 Clear error

On appeal, bankruptcy court's findings of fact are reviewed for clear error, and its conclusions of law are reviewed de novo. Fed. R. Bankr. P. 8013.

[2] Bankruptcy Secured creditors, protection of

Proposed Chapter 11 plan did not have to contain due-on-sale clause, to prevent Chapter 11 debtors from cashing out their investments following renovation of commercial property that secured the allegedly undersecured claim of lender that had made statutory election, in order to be fair and equitable to this lender and to respect rights that it obtained by making statutory election; original loan did not contain due-on-sale clause, and plan in fact provided due-on-sale protection except over ten-year window in 21-year loan repayment period. 11 U.S.C.A. §§ 1111(b)(2),

1129(b).

In re: Transwest Resort Properties, Inc., 554 B.R. 894 (2016)

2016 WL 4087111, 62 Bankr.Ct.Dec. 254

[3] Bankruptcy • Liens securing claims not allowed

Generally, total claim of undersecured creditor is bifurcated into two claims: (1) a secured claim equal to value of creditor's collateral and (2) an unsecured claim equal to the remainder of the obligation owning to creditor as of petition date.

11 U.S.C.A. § 506(a).

[4] Bankruptcy Amount secured; partial security

By making statutory election, allegedly undersecured creditor obtains right to have its entire claim treated as secured claim, rather than being bifurcated, and secures right to avail itself of protections provided for secured claims. 11 U.S.C.A. §§ 506(a), 1111(b).

[5] Bankruptcy Particular cases and issues

Determination that proposed Chapter 11 plan is "fair and equitable," as required for "cramdown" of plan over objection of dissenting class, is finding of fact, which the district court reviews for clear error on appeal from bankruptcy court.

11 U.S.C.A. § 1129(b); Fed. R. Bankr. P.

8013.

[6] Bankruptcy Psy one class

Statutory requirement that, in order to be confirmed, proposed Chapter 11 plan had to be accepted by at least one impaired class applied, in jointly administered case filed by debtors whose estates had not been substantively consolidated, on per-plan, rather than on per-debtor, basis, such that as long as one impaired class accepted plan, this was sufficient to satisfy this confirmation requirement for all of the debtors that joined in submitting this joint plan. 11 U.S.C.A. § 1129(a)(10).

1 Cases that cite this headnote

[7] Bankruptcy Secured creditors, protection of

Bankruptcy court did not clearly err in finding that proposed Chapter 11 plan of debtors whose cases were being jointly administered was fair and equitable to mezzanine lender whose equity interest in the operating debtors would be cancelled; repayment of mezzanine loan was always dependent on whether or not the operating debtors were profitable, and because operating debtors were insolvent, lender's equity in those debtors was also valueless.

11
U.S.C.A. § 1129(b)(2)(A).

1 Cases that cite this headnote

Attorneys and Law Firms

*896 Andrew Anthony Harnisch, Dean Christian Waldt, Ethan Bennett Minkin, Michael Anthony DiGiacomo, Ballard Spahr LLP, Phoenix, AZ, David M. Neff, Eric E. Walker, Perkins Coie LLP, Chicago, IL, Jon T. Pearson, Ballard Spahr LLP, Las Vegas, NV, for Appellant.

Southwest Value Partners Fund XV LLP, pro se.

Adrian Evans O'Brien, Donald L. Gaffney, Snell & Wilmer LLP, Phoenix, AZ, Kasey Cameron Nye, Susan G. Boswell, Quarles & Brady LLP, Tucson, AZ, Christy I. Yee, Donald A. English, English & Gloven APC, San Diego, CA, for Appellees.

ORDER

Raner C. Collins, Chief United States District Judge

**1 Pending before this Court is Appellant JPMCC 2007-C1 Grasslawn Lodging, LLC's ("Lender") appeal of the Bankruptcy Court for the District of Arizona's holding that 11 U.S.C. § 1111(b) allows a due-on-sale clause to have a ten year exception and that 11 U.S.C. § 1129(a)(10) applies on a "per-plan" basis before confirming the plan. Previously, this Court held that Lender's contentions were equitably moot. The Ninth Circuit held that Lender's contentions were not equitably moot then reversed and remanded the case for further proceedings. For the foregoing reasons, this Court

In re: Transwest Resort Properties, Inc., 554 B.R. 894 (2016)

2016 WL 4087111, 62 Bankr.Ct.Dec. 254

holds that 11 U.S.C. § 1111(b) does not require a due-on-sale clause and that 11 U.S.C. § 1129(a)(10) applies on a perplan basis.

I.

A. Background

In 2007, five related entities acquired the Westin Hilton Head Resort and Spa and the Westin La Paloma Resort and Country Club. The five entities (collectively "Debtors") were: Transwest Hilton Head Property, LLC, and Transwest Tucson Property, LLC (collectively "Operating Debtors"); Transwest Hilton Head II, LLC, and Transwest Tucson II, LLC (collectively "Mezzanine Debtors"); and Transwest Resort Properties, Inc. ("Holding Company Debtor"). The Holding Company Debtor was the sole owner of the Mezzanine Debtors. The Mezzanine Debtors, in turn, were each the sole owners of the Operating Debtors, which owned and operated the respective resorts.

The hotel acquisitions were financed by a \$209 million mortgage loan to the Operating Debtors that was secured by liens on the two hotels and a \$21.5 million loan to the Mezzanine Debtors secured by liens on the ownership interests in the Operating Debtors.

In 2010, Debtors filed Chapter 11 petitions and the five cases were jointly administered but not substantively consolidated. Lender, who acquired the mortgage loan before Debtors filed for bankruptcy, filed a proof of claim in the bankruptcy proceeding for \$209 million. PIM Ashford Subsidiary I LLC, who acquired the mezzanine loan in 2008, filed two proofs of *897 claim totaling \$39 million. Debtors and Lender stipulated that the value of the two resorts was \$92 million.

B. Reorganization Plans

Debtor's joint plan of reorganization proposed to cancel the Mezzanine Debtors' equity interest in the Operating Debtors and to dissolve the Mezzanine Debtors. Southwest Value Partners Fund XV, LP ("SWVP") would then invest no less than \$30 million and would also become the sole owner of the Operating Debtors.

Pursuant to 11 U.S.C. § 1111(b)(2), Lender elected to have its entire allowed claim, \$247 million, treated as a secured claim. Under the proposed plan, Lender's loan would be reinstated but the repayment requirements would be restructured. The repayment schedule would be comprised of monthly interestonly payments and then a balloon payment of the remaining loan amount after 21 years.

The restricted loan would also include a due-on-sale clause. Pursuant to the clause, any sale or refinancing of the resorts would make the entire remainder of the \$247 million loan due immediately. However, the clause contained an exception: between years five and fifteen of the loan, the resorts could be sold or refinanced subject to the restricted loan. That is, a new buyer could take on the loan obligation without the full amount of the loan coming due on sale, as long as certain conditions were met.

**2 PIM Ashford's treatment under the plan depended on how it voted for the plan. If it voted against the plan, it would not receive any distributions; if it voted for the plan, the entity would be entitled to a small percentage of surplus cash flow in the future. The plan extinguished the mezzanine loan's collateral, which was the Mezzanine Debtors' equity interest in the Operating Debtors.

The plan had ten classes of claims with the mortgage loan and the mezzanine loan in a class by themselves. After the plan was proposed. Lender acquired the mezzanine loan from PIM Ashford. Lender then voted both its positions, its original claim and the claim it obtained from PIM Ashford, against the plan.

The bankruptcy court confirmed the plan despite Lender's two dissenting classes because the plan satisfied the "cram down" requirements of \(\bigcirc \) \(\) \(\) 1129(b). Pursuant to the plan, the restructured mortgage loan entitled the Lender to deferred cash payments (1) totaling at least the amount of the allowed claim (\$247 million, or the "total loan amount"), and (2) having a net present value equal to the value of the collateral.

(\$92 million). 11 U.S.C. § 1129(b)(2)(A)(i)(II). Lender also retained a lien on the resorts for the total loan amount. *Id.* § 1129(b)(2)(A)(i)(I).

The Operating Debtors were renamed SWVP La Paloma, LLC and SWVP Hilton Head Property, LLC (collectively "Reorganized Debtors") and continued to be wholly owned by SWVP through an intermediary entity. The Reorganized Debtors became the borrowers under the restructured mortgage loan.

In re: Transwest Resort Properties, Inc., 554 B.R. 894 (2016)

2016 WL 4087111, 62 Bankr.Ct.Dec. 254

C. Lender's Objections

Previously, Lender objected to two aspects of the plan. First, Lender argued that the ten-year exception to the due on sale clause should be removed because it negated Lender's § 1111(b) election. Lender contends that the option to keep the entire loan amount as a secured claim, codified in § 1111(b), was intended by Congress to protect secured creditors against the undervaluation of their collateral. According to Lender, if the collateral for a loan were undervalued, the due-on-sale clause would protect Lender's interest *898 by preventing Debtor from immediately selling the collateral subject to the restructured loan and capturing the true value of the collateral. Lender claimed that the exception to the due-on-sale clause between years five and fifteen would allow Reorganized Debtors to unfairly negate at least part of the benefit of Lenders § 1111(b) election.

Second, Lender argued that the bankruptcy court misapplied one of the plan confirmation requirements. Section 1129(a)(10) states that "[i]f a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan [must have] accepted the plan" for it to be confirmed. Lender noted that in cases involving multiple debtors, courts have split on whether $\frac{1}{2}$ § 1129(a)(10)'s requirement applies on a "per-plan" or "per-debtor" basis. Compare In re Tribune Co., 464 B.R. 126, 180-84 (Bankr.D.Del.2011) (perdebtor) with IPMorgan Chase Bank, N.A. v. Charter Commc'ns Operating, LLC (In re Charter Commc'ns), 419 B.R. 221, 264-66 (Bankr.S.D.N.Y.2009) (per-plan). Lender Because Lender is the only impaired class of creditors for the Mezzanine Debtors and Lender did not vote for the plan, Lender argues that the plan violated § 1129(a)(10) under the per-debtor interpretation.

**3 The bankruptcy court overruled Lender's two objections and confirmed the plan. Lender appealed to this Court. This Court dismissed Lender's appeal, which advanced Lender's two objections to the plan, and held that the appeal was equitably moot. The Ninth Circuit reversed and remanded for further proceedings. Here, Lender again advances the previous two objections.

II. Standard of Review

[1] The bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law are reviewed *de novo*.

In re Candland, 90 F.3d 1466, 1469 (9th Cir. 1996)(citation omitted).

III. Analysis

A. 11 U.S.C. § 1111(b)(2) Requirements

[2] Section 1111(b)(2) allows an undersecured creditor to elect to have its entire claim treated as a nonrecourse secured claim, thereby foregoing any unsecured deficiency claim. Here, Lender made a § 1111(b) election and the bankruptcy court added a due-on-sale clause to the plan. However, the plan also permits the sale of the resorts subject to Lender's restricted loan in years five through fifteen. That is, Debtors may sell the resorts at any time during the ten year window without accelerating the restricted loan or paying Lender in full, rather, the loan transfers to the new buyer under the same terms set forth in the plan. Additionally, the plan stretches the term of the loan from ten to twenty-one years.

[3] First, it is important to consider the effects of [11] U.S.C. § 506(a) on the claim of a creditor not making the an undersecured creditor is bifurcated into two claims: (1) a secured claim equal to the value of the collateral and (2) an unsecured claim equal to the remainder of the obligation owning to the creditor as of the petition date. In re Weinstein, 227 B.R. 284, 291 (9th Cir. BAP 1998). Regarding the unsecured portion of the undersecured creditor's claim, the treatment of that claim in bankruptcy depends on whether the creditor did or did not have recourse. A nonrecourse creditor is one who can "look only to its collateral for satisfaction of its debt and does not have any right to seek payment of any deficiency from a debtor's other assets." Ltd. A recourse creditor "has the right to *899 seek payment of a deficiency in the value of its collateral from the debtor's other assets." *Id.* at 292.

[4] Section 1111(b)(2) states: "[i]f such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed." 11 U.S.C. § 1111(b)(2). A § 1111(b)2 election treats the electing creditor's total claim as a secured claim rather than having both a secured and an unsecured deficiency

In re: Transwest Resort Properties, Inc., 554 B.R. 894 (2016)

2016 WL 4087111, 62 Bankr.Ct.Dec. 254

claim for Chapter 11 purposes. This allows a technically undersecured creditor to avail itself of the protections provided for secured claims, including those detailed in \$\bigcup_{\bigsele}\{\bigsele}\$ \text{1129(b)(2)(A).}

Here, Lender argues that a § 1111(b)(2) election requires the inclusion of a due-on-sale clause without a ten year exception. Lender contends that the plan currently allows Debtors "to cash out of its investment after the resorts are renovated and at their peak value, while requiring Lender to remain holding the secured debt with a new borrower until the restricted loan matures in 2033." Doc. 110 at 10. However, the plain language of the statute does not indicate that a due-on-sale clause is an absolute right. Section 1129(b)(2)(A) also makes no reference to any such requirement. Further, the authority that Lender has cited does not compel this Court to read such a requirement into the text of the statute. The Court also notes that the confirmed loan provides the Lender with additional protections compared to the original loan. For example, the original loan did not have a due-on-sale clause. Lender also retains strikingly similar approval rights of a potential buyer, the new plan provides for the payment of an assumption fee and Lender's principal has increased from \$209 million to \$247 million. SER 5-7, 10, 30, 1583-1586, 2269.

**4 [5] Pursuant to Lender's § 1111(b) election, the bankruptcy court found the plan to be fair and equitable to Lender as defined by § 1129(b). Because the fair and equitable determination is a finding of fact, this Court reviews the determination for clear error. In re Dynamic Brokers, Inc., 293 B.R. 489, 493 (9th Cir. BAP 2003) ("Whether a chapter 11 plan ... is fair and equitable [this court] review[s] for clear error."). The Court finds no error in the Bankruptcy Court's failure to impose a due-on-sale clause that is not required by the plain language of the statute.

B. 11 U.S.C. § 1129(a)(10) Requirements

[6] Section 1129(a)(10) of the Bankruptcy Code governs confirmation of a reorganization plan. It states:

(a) The court shall confirm a plan only if all of the following requirements are met: ... (10) If a class of claims is impaired under the plan, at least

one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

11 U.S.C. § 1129(a)(10).

Here, Debtors filed a joint plan of reorganization for all five Debtors and there are ten classes of claims under the plan. Five impaired classes under the plan voted in favor of it. SER 1213. Section 1129(a)(10) poses a conundrum for courts in cases where there are multiple debtors and creditors when satisfying the "impaired class" requirement: Should the court interpret the statute as mandating what is known as a "per-plan" requirement, which is satisfied by the acceptance of one impaired class for any debtor involved in the proceedings, or does \[\frac{1}{8} \] \[\frac{1129(a)(10)}{8} \] contemplate a "perdebtor" requirement, meaning the plan must be approved by at least one impaired class for each debtor involved? Applying that question here, does the fact that Lender is Mezzanine Debtor's only creditor and *900 Lender did not vote for the plan, prevent the plan from going forward?

Few courts have discussed this issue directly and the courts that have done so have reached different conclusions.

Lenders rely heavily on In re Tribune, 464 B.R. 126 (Bankr.D.Del.2011), and In re JER/Jameson Mezz Borrower II, LLC, 461 B.R. 293 (Bankr. D. Del. 2011) for the proposition that \$1129(a)(10) applies on a per-debtor basis. Because Lender is the only creditor for the Mezzanine Debtors and Debtors have not substantively consolidated, Lender argues that \$1129(a)(10) can only be satisfied if Lender approves the plan. Lender has not done either, thus \$1129(a)(10) is not satisfied.

In re: Transwest Resort Properties, Inc., 554 B.R. 894 (2016)

2016 WL 4087111, 62 Bankr.Ct.Dec. 254

U.S.C. § 102(7). Second, the court relied on the doctrine of corporate separateness to conclude that \$\sum_{\circ}\$ 1129(a)(10) applies on a per-debtor basis.

In **Jameson*, the court dismissed a Chapter 11 filing by several related debtors as a "bad faith" filing. In reaching its opinion, the court noted there was no substantive consolidation of the debtors and relied on **Tribune* to hold that each debtor with impaired creditors would need at least one accepting class. However, because one of the debtors has only one creditor and one asset, it could not confirm a plan over that lender's objections because it could not get an accepting class.

**5 In response, Debtors primarily rely on *In re SPGA*, *Inc.*, 2001 WL 34750646 (Bankr.M.D.Pa.2001), *In re Enron Corp.*, 2004 WL 6075307, 2004 Bankr. LEXIS 2549 (Bankr.S.D.N.Y.2004), and *In re Charter Communications*, 419 B.R. 221, 266 (Bankr.S.D.N.Y.2009) for the proposition that the plain language of \$1129(a)(10) supports the view that the affirmative vote of one impaired class under the joint plan of multiple debtors is sufficient to satisfy \$1129(a)(10). Debtors also argue that \$1129(a)(10) confers no substantive rights on the Lender because it is only a technical requirement.

In *SPGA*, the debtors had a multi-million dollar syndicated secured credit facility with a certain "Bank Group" and senior unsecured debt held by a group of bondholders referred to as the "Subordinated Bondholders." The debtors negotiated a workout with the Bank Group but not the Subordinated Bondholders. The debtors proposed a joint plan based on the workout with Bank Group that contained fifty-seven classes of creditors. Subordinated Bondholders objected, arguing that the debtors failed to establish an impaired accepting class as to each debtor. Subordinated Bondholders also argued that the only way the debtors could have satisfied \$1129(a)(10) was if the court had ordered substantive consolidation.

The *SPGA* court, after explaining that it did not truly understand the corporate structure prepetition and post-confirmation, held that in order to confirm the plan, the multi-debtor plan only needed one impaired accepting class to satisfy \$\frac{1129(a)(10)}{2}\$. However, the court appears to have been swayed primarily by the equities of the case. Specifically, the court noted that under a per-debtor

reading, "ten of the 11 debtors cannot satisfy 1129(a) (10)" because the impaired classes were to receive no distribution, each of those classes are deemed to reject the plan and the deemed rejections eliminate the possibility of a consenting class for the ten debtors on a stand-alone basis. Further, the court notes that whether the *901 debtors "were substantively consolidated or jointly administered would have no adverse affect [sic] on the Subordinated Bondholders."

In *Enron*, the court also measured the legal standard under \$ 1129(a)(10) on a per-plan basis. However, *Enron* is distinguishable from the case at hand because the debtors were substantively consolidated.

In *Charter*, the court relies on both the *SPGA* and *Enron* holdings to reach the per-plan conclusion. 419 B.R. at 266.

Here, the Court finds that \$1129(a)(10) applies on a per-plan basis. First, unlike the *Tribune* court, this Court finds the plain language of the statute to be dispositive. The statute states that "[i]f a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan" then the court shall confirm the plan if additional requirements are met. 11 U.S.C. § 1129(a)(10) (emphasis added). Thus, once an impaired class has accepted the plan, \$1129(a)(10) is satisfied as to all debtors because all debtors are being reorganized under a joint plan of reorganization. It is not clear to this Court as to how § 102(7) alters the plain language of \$1129(a)(10) to be read as applying on a per-debtor basis.

[7] Second, the bankruptcy judge's decision to cancel Lender's equity in the mezzanine loan was not a clear error. The mezzanine loan was solely on the equity of the Operating Debtors. SER 1864. That is, the repayment of the mezzanine loan was always dependent on whether or not the Operating Debtors were profitable. Because the Operating Debtors are insolvent, Lender's equity in those debtors is also valueless. The bankruptcy judge found the cancellation of Lender's equity to be fair and equitable pursuant to 11 U.S.C. § 1129(b)(2)(A) because the equity was valueless. This Court reviews the bankruptcy court decision for clear error because the fair and equitable determination is a finding of fact. In re Dynamic Brokers, Inc., 293 B.R. at 493 (9th Cir. BAP)

In re: Transwest Resort Properties, Inc., 554 B.R. 894 (2016)

2016 WL 4087111, 62 Bankr.Ct.Dec. 254

2003). Because no clear error is present, this Court declines to alter the bankruptcy court finding.

does not require a due-on-sale clause and that 11 U.S.C. § 1129(a)(10) applies on a per-plan basis.

IV. Conclusion

**6 For the above reasons, the Court will affirm the bankruptcy court decision and hold that 11 U.S.C. § 1111(b)

All Citations

554 B.R. 894, 2016 WL 4087111, 62 Bankr.Ct.Dec. 254

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Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

KeyCite Yellow Flag - Negative Treatment
Superseded by Statute as Stated in In re Jones, Bankr.S.D.Tex., April
18, 2007

124 S.Ct. 1951 Supreme Court of the United States

Lee M. TILL, et ux., Petitioners,
v.
SCS CREDIT CORPORATION.

No. 02–1016. | Argued Dec. 2, 2003. | Decided May 17, 2004.

Synopsis

Background: Secured creditor objected to interest rate on payments to creditor on cram down loan under debtors' proposed Chapter 13 payment plan. The United States Bankruptcy Court for the Southern District of Indiana overruled objection, and creditor appealed. The District Court, Larry J. McKinney, Chief Judge, reversed. Debtors appealed, and the United States Court of Appeals for the Seventh Circuit, Ripple, Circuit Judge, 301 F.3d 583, vacated and remanded. Certiorari was granted.

[Holding:] The Supreme Court, Justice Stevens, held that formula approach, requiring adjustment of prime national interest rate based on risk of nonpayment, was appropriate method for determining adequate rate of interest on cram down loan.

Reversed and remanded.

Justice Thomas filed opinion concurring in judgment.

Justice Scalia filed dissenting opinion, in which Chief Justice Rehnquist, Justice O'Connor, and Justice Kennedy joined.

Procedural Posture(s): On Appeal.

West Headnotes (4)

[1] Interest P Computation of Rate in General

Coerced loan approach was not appropriate method for determining adequate rate of interest on cram down loan pursuant to Chapter 13 payment plan; method required bankruptcy court to consider evidence about market for comparable loans to similar debtors, an inquiry far removed from court's usual task of evaluating debtors' financial circumstances and feasibility of their debt adjustment plan, and it overcompensated creditor. (Per Justice Stevens, with three Justices concurring, and one Justice concurring in judgment). Bankr.Code,

11 U.S.C.A. § 1325(a)(5)(B).

253 Cases that cite this headnote

[2] Interest • Computation of Rate in General

Presumptive contract rate approach was not appropriate method for determining adequate rate of interest on cram down loan pursuant to Chapter 13 payment plan; approach improperly focused on creditor's potential use of proceeds of foreclosure sale, it required debtor to obtain information about creditor's costs of overhead, financial circumstances, and lending practices to rebut presumptive contract rate, it could have produced absurd results, entitling inefficient, poorly managed lenders with lower profit margins to obtain higher cram down rates than well managed, better capitalized lenders, and similarly situated creditors could have ended up with vastly different cram down rates. (Per Justice Stevens, with three Justices concurring, and one Justice concurring in judgment). Bankr,Code, 11 U.S.C.A. §

1325(a)(5)(B).

113 Cases that cite this headnote

[3] Interest Page Computation of Rate in General

Cost of funds approach was not appropriate method for determining adequate rate of interest

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

on cram down loan pursuant to Chapter 13 payment plan; approach mistakenly focused on creditworthiness of creditor rather than debtor, it imposed significant evidentiary burden, as debtor seeking to rebut creditor's asserted cost of borrowing had to introduce expert testimony about creditor's financial condition, and creditworthy lender with low cost of borrowing could have obtained lower cram down rate than financially unsound lender. (Per Justice Stevens, with three Justices concurring, and one Justice concurring in judgment). Bankr.Code,

11 U.S.C.A. § 1325(a)(5)(B).

139 Cases that cite this headnote

[4] Interest • Computation of Rate in General

Formula approach, requiring adjustment of prime national interest rate based on risk of nonpayment, was appropriate method for determining adequate rate of interest on cram down loan pursuant to Chapter 13 payment plan; approach entailed straightforward, familiar, and objective inquiry, and minimized need for potentially costly additional evidentiary proceedings, and resulting "prime-plus" rate of interest depended only on state of financial markets, circumstances of bankruptcy estate, and characteristics of loan, not on creditor's circumstances or its prior interactions with debtor. (Per Justice Stevens, with three Justices concurring, and one Justice concurring in judgment). Bankr.Code, 11 U.S.C.A. § 1325(a)(5)(B).

375 Cases that cite this headnote

**1952 Syllabus *

Under the so-called "cramdown option" permitted by the Bankruptcy Code, a Chapter 13 debtor's proposed debt adjustment plan must provide each allowed, secured creditor both a lien securing the claim and a promise of future property disbursements whose total value, as of the plan's date, "is not less than the [claim's] allowed amount,"

U.S.C. § 1325(a)(5)(B)(ii). When such plans provide for installment payments, each installment must be calibrated to ensure that the **1953 creditor receives disbursements whose total present value equals or exceeds that of the allowed claim. Respondent's retail installment contract on petitioners' truck had a secured value of \$4,000 at the time petitioners filed a Chapter 13 petition. Petitioners' proposed debt adjustment plan provided the amount that would be distributed to creditors each month and that petitioners would pay an annual 9.5% interest rate on respondent's secured claim. This "prime-plus" or "formula rate" was reached by augmenting the national prime rate of 8% to account for the nonpayment risk posed by borrowers in petitioners' financial position. In confirming the plan, the Bankruptcy Court overruled respondent's objection that it was entitled to its contract interest rate of 21%. The District Court reversed, ruling that the 21% "coerced loan rate" was appropriate because cramdown rates must be set at the level the creditor could have obtained had it foreclosed on the loan, sold the collateral, and reinvested the proceeds in equivalent loans. The Seventh Circuit modified that approach, holding that the original contract rate was a "presumptive rate" that could be challenged with evidence that a higher or lower rate should apply, and remanding the case to the Bankruptcy Court to afford the parties an opportunity to rebut the presumptive 21% rate. The dissent proposed adoption of the formula approach rejecting a "cost of funds rate" that would simply ask what it would cost the creditor to obtain the cash equivalent of the collateral from another source.

Held: The judgment is reversed, and the case is remanded.

301 F.3d 583, reversed and remanded.

Justice STEVENS, joined by Justice SOUTER, Justice GINSBURG, and Justice BREYER, concluded that the prime-plus or formula rate best meets the purposes of the Bankruptcy Code. Pp. 1958–1964.

*466 a) The Code gives little guidance as to which of the four interest rates advocated by opinions in this case Congress intended when it adopted the cramdown provision. A debtor's promise of future payments is worth less than an immediate lump-sum payment because the creditor cannot use the money right away, inflation may cause the dollar's value to decline before the debtor pays, and there is a nonpayment risk. In choosing an interest rate sufficient to compensate the creditor for such concerns, bankruptcy courts must consider that: (1) Congress likely intended bankruptcy

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under any of the many Code provisions requiring a court to discount a stream of deferred payments back to their present dollar value; (2) Chapter 13 expressly authorizes a bankruptcy court to modify the rights of a creditor whose claim is secured by an interest in anything other than the debtor's principal residence; and (3) from a creditor's point of view, the cramdown provision mandates an objective rather than a subjective inquiry. Pp. 1958-1960.

- (b) These considerations lead to the conclusion that the coerced loan, presumptive contract rate, and cost of funds approaches should be rejected, since they are complicated, impose significant evidentiary costs, and aim to make each individual creditor whole rather than to ensure that a debtor's payments have the required present value. Pp. 1960–1961.
- (c) The formula approach has none of these defects. Taking its cue from ordinary lending practices, it looks to the national prime rate, which reflects the financial market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate **1954 for the loan's opportunity costs, the inflation risk, and the relatively slight default risk. A bankruptcy court is then required to adjust the prime rate to account for the greater nonpayment risk that bankrupt debtors typically pose. Because that adjustment depends on such factors as the estate's circumstances, the security's nature, and the reorganization plan's duration and feasibility, the court must hold a hearing to permit the debtor and creditors to present evidence about the appropriate risk adjustment. Unlike the other approaches proposed in this case, the formula approach entails a straightforward, familiar, and objective inquiry, and minimizes the need for potentially costly additional evidentiary hearings. The resulting prime-plus rate also depends only on the state of financial markets, the bankruptcy estate's circumstances, and the loan's characteristics, not on the creditor's circumstances or its prior interactions with the debtor. The risk adjustment's proper scale is not before this Court. The Bankruptcy Court approved 1.5% in this case, and other courts have generally approved 1% to 3%, but respondent claims a risk adjustment in this range is inadequate. The issue *467 need not be resolved here; it is sufficient to note that courts must choose a rate high enough to compensate a creditor for its risk but not so high as to doom the bankruptcy plan. Pp. 1961–1962.

Justice THOMAS concluded that the proposed 9.5% rate will sufficiently compensate respondent for the fact that it is

receiving monthly payments rather than a lump sum payment, but that 11 U.S.C. § 1325(a)(5)(B)(ii) does not require that the proper interest rate reflect the risk of nonpayment. Pp. 1965-1968.

- (a) The plain language of \[\sum_{\quad \text{1325(a)(5)(B)(ii)}} \] requires a court to determine, first, the allowed amount of the claim; second, what is the property to be distributed under the plan; and third, the "value, as of the effective date of the plan," of the property to be distributed. This third requirement, which is at issue here, incorporates the principle of the time value of money. Section 1325(a)(5)(B)(ii) requires valuation of the property, not valuation of the plan. Thus, a plan need only propose an interest rate that will compensate a creditor for the fact that had he received the property immediately rather than at a future date, he could have immediately made use of the property. In most, if not all, cases, where the plan proposes simply a stream of cash payments, the appropriate risk-free rate should suffice. There may be some risk of nonpayment, but [8] 1325(a)(5)(B)(ii) does not take this risk into account. Respondent's argument that \(\bigcirc \) \(\) (5)(B)(ii) was crafted to protect creditors rather than debtors ignores the statute's plain language and overlooks the fact that secured creditors are compensated in part for the nonpayment risk through the valuation of the secured claim. Further, the statute's plain language is by no means debtor protective. Given the presence of multiple creditor-specific protections, it is not irrational to assume that Congress opted not to provide further protection for creditors by requiring a debtor-specific risk adjustment under \(\bigsigma \) \(\
- (b) Here, the allowed amount of the secured claim is \$4,000. and the property to be distributed under the plan is cash payments. Because the proposed 9.5% interest rate is higher than the risk-free rate, it is sufficient to account for the time value of money, which is all the statute requires. Pp. 1967– 1968.

STEVENS, J., announced the judgment of the Court and delivered an opinion, in which SOUTER, GINSBURG, and BREYER, JJ., joined. THOMAS, J., filed an opinion concurring in the **1955 judgment, post, p. 1965. SCALIA, J., filed a dissenting opinion, in which REHNQUIST, C.J., and O'CONNOR and KENNEDY, JJ., joined, post, p. 1968.

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

Attorneys and Law Firms

Rebecca J. Harper for the petitioners, by David B. Salmons, pro hac vice, by special leave of the Court, for the United States as amicus curiae, supporting the petitioners.

Rebecca J. Harper, Counsel of Record, UAW–DaimlerChrysler Legal Services Plan, Marion, IN, Annette F. Rush, UAW–DaimlerChrysler Legal Services Plan, Kokomo, IN, for Petitioners Lee M. Till and Amy M. Till.

John M. Smith, Mishawaka, Indiana, Roger P. Ralph, Indianapolis, Indiana, G. Eric Brunstad, Jr., Counsel of Record, Patrick J. Trostle Robert A. Brundage, Rheba Rutkowski, Susan Kim Nicole Anker, Renee M. Dailey, Bryan Short, Alexis Freeman, Timothy Watson, Lawrence P. Baxler, Eleanor H. Gilbane, Rebecca L. Bouchard, Bingham McCutchen LLP, Hartford, Connecticut, for Respondent.

Opinion

Justice STEVENS announced the judgment of the Court and delivered an opinion, in which Justice SOUTER, Justice GINSBURG, and Justice BREYER join.

*468 To qualify for court approval under Chapter 13 of the Bankruptcy Code, an individual debtor's proposed debt adjustment plan must accommodate each allowed, secured creditor in one of three ways: (1) by obtaining the creditor's acceptance of the plan; (2) by surrendering the property securing the claim; or (3) by providing the creditor both a lien securing the claim and a promise of future property distributions (such as deferred cash payments) whose total "value, as of the effective date of the plan, ... is not less than the allowed amount of such claim." ¹ The third alternative is *469 commonly known as the "cram down option" because it may be enforced over a claim holder's objection. ²

Associates Commercial Corp. v. Rash, 520 U.S. 953, 957, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997).

Plans that invoke the cramdown power often provide for installment payments over a period of years rather than a single payment. In such circumstances, the amount of each installment must be calibrated **1956 to ensure that, over time, the creditor receives disbursements whose total present value equals or exceeds that of the allowed claim. The proceedings in this case that led to our grant of certiorari identified four different methods of determining the appropriate method with which to perform that calibration.

Indeed, the Bankruptcy Judge, the District Court, the Court of Appeals majority, and the dissenting judge each endorsed a different approach. We detail the underlying facts and describe each of those approaches before setting forth our judgment as to which approach best meets the purposes of the Bankruptcy Code.

I

On October 2, 1998, petitioners Lee and Amy Till, residents of Kokomo, Indiana, purchased a used truck from Instant Auto Finance for \$6,395 plus \$330.75 in fees and taxes. *470 They made a \$300 downpayment and financed the balance of the purchase price by entering into a retail installment contract that Instant Auto immediately assigned to respondent, SCS Credit Corporation. Petitioners' initial indebtedness amounted to \$8,285.24—the \$6,425.75 balance of the truck purchase plus a finance charge of 21% per year for 136 weeks, or \$1,859.49. Under the contract, petitioners agreed to make 68 biweekly payments to cover this debt; Instant Auto—and subsequently respondent—retained a purchase money security interest that gave it the right to repossess the truck if petitioners defaulted under the contract.

On October 25, 1999, petitioners, by then in default on their payments to respondent, filed a joint petition for relief under Chapter 13 of the Bankruptcy Code. At the time of the filing, respondent's outstanding claim amounted to \$4,894.89, but the parties agreed that the truck securing the claim was worth only \$4,000. App. 16–17. In accordance with the Bankruptcy Code, therefore, respondent's secured claim was limited to \$4,000, and the \$894.89 balance was unsecured. ⁵ Petitioners' filing automatically stayed debt-collection activity by their various creditors, including the Internal Revenue Service (IRS), respondent, three other holders of secured claims, and unidentified unsecured creditors. In addition, the filing created a bankruptcy estate, administered by a trustee, which consisted of petitioners' property, including the truck. ⁶

*471 Petitioners' proposed debt adjustment plan called for them to submit their future earnings to the supervision and control of the Bankruptcy Court for three years, and to assign \$740 of their wages to the trustee each month. ⁷ App. to Pet. for Cert. 76a–81a. The plan charged the trustee with distributing these monthly wage assignments to pay, in order of priority: (1) **1957 administrative costs; (2) the IRS's

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

priority tax claim; (3) secured creditors' claims; and finally, (4) unsecured creditors' claims. Id., at 77a-79a.

The proposed plan also provided that petitioners would pay interest on the secured portion of respondent's claim at a rate of 9.5% per year. Petitioners arrived at this "primeplus" or "formula rate" by augmenting the national prime rate of approximately 8% (applied by banks when making lowrisk loans) to account for the risk of nonpayment posed by borrowers in their financial position. Respondent objected to the proposed rate, contending that the company was "entitled to interest at the rate of 21%, which is the rate ... it would obtain if it could foreclose on the vehicle and reinvest the proceeds in loans of equivalent duration and risk as the loan" originally made to petitioners. App. 19–20.

At the hearing on its objection, respondent presented expert testimony establishing that it uniformly charges 21% interest on so-called "subprime" loans, or loans to borrowers with poor credit ratings, and that other lenders in the subprime market also charge that rate. Petitioners countered with the testimony of an Indiana University-Purdue University Indianapolis economics professor, who acknowledged that he had only limited familiarity with the subprime auto lending market, but described the 9.5% formula rate as "very reasonable" given that Chapter 13 plans are "supposed to be *472 financially feasible." 8 Id., at 43–44. Moreover, the professor noted that respondent's exposure was "fairly limited because [petitioners] are under the supervision of the court." Id., at 43. The bankruptcy trustee also filed comments supporting the formula rate as, among other things, easily ascertainable, closely tied to the "condition of the financial market," and independent of the financial circumstances of any particular lender. App. to Pet. for Cert. 41a-42a. Accepting petitioners' evidence, the Bankruptcy Court overruled respondent's objection and confirmed the proposed plan.

The District Court reversed. It understood Seventh Circuit precedent to require that bankruptcy courts set cramdown interest rates at the level the creditor could have obtained if it had foreclosed on the loan, sold the collateral, and reinvested the proceeds in loans of equivalent duration and risk. Citing respondent's unrebutted testimony about the market for subprime loans, the court concluded that 21% was the appropriate rate. Id., at 38a.

On appeal, the Seventh Circuit endorsed a slightly modified version of the District Court's "coerced" or "forced loan" approach. In re Till, 301 F.3d 583, 591 (C.A.7 2002). Specifically, the majority agreed with the District Court that, in a cramdown proceeding, the inquiry should focus on the interest rate "that the creditor in question would obtain in making a new loan in the same industry to a debtor who is similarly situated, although not in bankruptcy." - Id., at 592. To approximate that new loan rate, the majority looked to the parties' prebankruptcy contract rate (21%). The court recognized, however, that using the contract rate would not "duplicat[e] precisely ... the present value of the collateral to the creditor" because loans to bankrupt, court-supervised debtors "involve some risks that would not be incurred in a *473 new loan to a debtor not in default" and also produce "some economies." *Ibid.* To correct for these inaccuracies, the majority held that the original **1958 contract rate should "serve as a presumptive [cramdown] rate," which either the creditor or the debtor could challenge with evidence that a higher or lower rate should apply. *Ibid.* Accordingly, the court remanded the case to the Bankruptcy Court to afford petitioners and respondent an opportunity to rebut the presumptive 21% rate. 9

Dissenting, Judge Rovner argued that the majority's presumptive contract rate approach overcompensates secured creditors because it fails to account for costs a creditor would have to incur in issuing a new loan. Rather than focusing on the market for comparable loans, Judge Rovner advocated the Bankruptcy Court's formula approach.
-- Id., at 596. Although Judge Rovner noted that the rates produced by either the formula or the cost of funds approach might be "piddling" relative to the coerced loan rate, she suggested courts should "consider the extent to which the creditor has already been compensated for ... the risk that the debtor will be unable to discharge his obligations under the reorganization plan ... in the rate of interest that it charged to the debtor in return for the original loan." *Ibid.* We granted certiorari and now reverse. 539 U.S. 925, 123 S.Ct. 2572, 156 L.Ed.2d 601 (2003).

II

The Bankruptcy Code provides little guidance as to which of the rates of interest advocated by the four opinions in this case—the formula rate, the coerced loan rate, the presumptive contract rate, or the cost of funds rate—Congress had in mind

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

when it adopted the cramdown provision. That provision, 11 U.S.C. § 1325(a)(5)(B), does not mention the term "discount rate" or the word "interest." Rather, it simply *474 requires bankruptcy courts to ensure that the property to be distributed to a particular secured creditor over the life of a bankruptcy plan has a total "value, as of the effective date of the plan," that equals or exceeds the value of the creditor's allowed secured claim—in this case, \$4,000. [8] § 1325(a)(5) (B)(ii).

That command is easily satisfied when the plan provides for a lump-sum payment to the creditor. Matters are not so simple, however, when the debt is to be discharged by a series of payments over time. A debtor's promise of future payments is worth less than an immediate payment of the same total amount because the creditor cannot use the money right away, inflation may cause the value of the dollar to decline before the debtor pays, and there is always some risk of nonpayment. The challenge for bankruptcy courts reviewing such repayment schemes, therefore, is to choose an interest rate sufficient to compensate the creditor for these concerns.

Three important considerations govern that choice. First, the Bankruptcy Code includes numerous provisions that, like the cramdown provision, require a court to "discoun[t] ... [a] stream of deferred payments back to the[ir] present dollar value," **Rake v. Wade, 508 U.S. 464, 472, n. 8, 113 S.Ct. 2187, 124 L.Ed.2d 424 (1993), to ensure that a creditor receives at least the value of its claim. 10 We think it likely that **1959 Congress intended bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under any of these provisions. Moreover, we think Congress would favor an approach that is familiar in the financial *475 community and that minimizes the need for expensive evidentiary proceedings.

Second, Chapter 13 expressly authorizes a bankruptcy court to modify the rights of any creditor whose claim is secured by an interest in anything other than "real property that is the debtor's principal residence." 11 U.S.C. § 1322(b)(2). 11 Thus, in cases like this involving secured interests in personal property, the court's authority to modify the number, timing, or amount of the installment payments from those set forth in the debtor's original contract is perfectly clear. Further, the potential need to modify the loan terms to account for intervening changes in circumstances is also clear: On the one hand, the fact of the bankruptcy establishes that the debtor is

overextended and thus poses a significant risk of default; on the other hand, the postbankruptcy obligor is no longer the individual debtor but the court-supervised estate, and the risk of default is thus somewhat reduced. ¹²

*476 Third, from the point of view of a creditor, the cramdown provision mandates an objective rather than a subjective inquiry. ¹³ That is, although [8] 1325(a)(5) (B) entitles the creditor to property whose present value objectively equals or exceeds the value of the collateral, it does not require that the terms of the cramdown loan match the terms to which the debtor and creditor agreed prebankruptcy, nor does it require that the cramdown terms make the creditor subjectively indifferent between present foreclosure and future payment. Indeed, the very idea of a "cramdown" loan precludes the latter result: By definition, a creditor forced to accept such a loan would prefer instead to foreclose. 14 Thus, a court **1960 choosing a cramdown interest rate need not consider the creditor's individual circumstances, such as its prebankruptcy dealings with the debtor or the alternative loans it *477 could make if permitted to foreclose. 15 Rather, the court should aim to treat similarly situated creditors similarly, ¹⁶ and to ensure that an objective economic analysis would suggest the debtor's interest payments will adequately compensate all such creditors for the time value of their money and the risk

Ш

[1] These considerations lead us to reject the coerced loan, presumptive contract rate, and cost of funds approaches. Each of these approaches is complicated, imposes significant evidentiary costs, and aims to make each individual creditor whole rather than to ensure the debtor's payments have the required present value. For example, the coerced loan approach requires bankruptcy courts to consider evidence about the market for comparable loans to similar (though nonbankrupt) debtors—an inquiry far removed from such courts' usual task of evaluating debtors' financial circumstances and the feasibility of their debt adjustment plans. In addition, the approach overcompensates creditors because the market lending rate must be high enough to cover factors, like lenders' transaction costs and overall profits, that are no longer relevant in the context of court-administered and court—supervised cramdown loans.

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

[2] Like the coerced loan approach, the presumptive contract rate approach improperly focuses on the creditor's potential use of the proceeds of a foreclosure sale. In addition, although the approach permits a debtor to introduce some evidence about each creditor, thereby enabling the court to tailor the interest rate more closely to the creditor's financial circumstances and reducing the likelihood that the creditor *478 will be substantially overcompensated, that right comes at a cost: The debtor must obtain information about the creditor's costs of overhead, financial circumstances, and lending practices to rebut the presumptive contract rate. Also, the approach produces absurd results, entitling "inefficient, poorly managed lenders" with lower profit margins to obtain higher cramdown rates than "well managed, better capitalized lenders." 2 K. Lundin, Chapter 13 Bankruptcy § 112.1, p. 112-8 (3d ed.2000). Finally, because the approach relies heavily on a creditor's prior dealings with the debtor, similarly situated creditors may end up with vastly different cramdown rates. 17

**1961 [3] The cost of funds approach, too, is improperly aimed. Although it rightly disregards the now-irrelevant terms of the parties' original contract, it mistakenly focuses on the creditworthiness of the *creditor* rather than the debtor. In addition, the approach has many of the other flaws of the coerced loan and presumptive contract rate approaches. For example, like the presumptive contract rate approach, the cost of funds approach imposes a significant evidentiary burden, as a debtor seeking to rebut a creditor's asserted cost of borrowing must introduce expert testimony about the creditor's financial condition. Also, under this approach, a creditworthy lender with a low cost of borrowing may obtain a lower cramdown rate than a financially unsound, fly-by-night lender.

IV

[4] The formula approach has none of these defects. Taking its cue from ordinary lending practices, the approach begins *479 by looking to the national prime rate, reported daily in the press, which reflects the financial market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate for the opportunity costs of the loan, the risk of inflation, and the relatively slight risk of default. ¹⁸ Because bankrupt debtors typically pose a greater risk of nonpayment than solvent commercial borrowers, the approach then requires a bankruptcy court to adjust the prime rate accordingly. The appropriate size of that risk adjustment

depends, of course, on such factors as the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan. The court must therefore hold a hearing at which the debtor and any creditors may present evidence about the appropriate risk adjustment. Some of this evidence will be included in the debtor's bankruptcy filings, however, so the debtor and creditors may not incur significant additional expense. Moreover, starting from a concededly *low* estimate and adjusting *upward* places the evidentiary burden squarely on the creditors, who are likely to have readier access to any information absent from the debtor's filing (such as evidence about the "liquidity of the collateral market," *post*, at 1973 (SCALIA, J., dissenting)). Finally, many of the factors relevant to the adjustment fall squarely within the bankruptcy court's area of expertise.

Thus, unlike the coerced loan, presumptive contract rate, and cost of funds approaches, the formula approach entails a straightforward, familiar, and objective inquiry, and minimizes the need for potentially costly additional evidentiary proceedings. Moreover, the resulting "primeplus" rate of interest depends only on the state of financial markets, the circumstances of the bankruptcy estate, and the characteristics of the loan, not on the creditor's circumstances or its prior interactions with the debtor. For these reasons, **1962 the *480 prime-plus or formula rate best comports with the purposes of the Bankruptcy Code. ¹⁹

We do not decide the proper scale for the risk adjustment, as the issue is not before us. The Bankruptcy Court in this case approved a risk adjustment of 1.5%, App. to Pet. for Cert. 44a-73a, and other courts have generally approved adjustments of 1% to 3%, see In re Valenti, 105 F.3d 55, 64 (C.A.2) (collecting cases), abrogated on other grounds by Associates Commercial Corp. v. Rash, 520 U.S. 953, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997). Respondent's core argument is that a risk adjustment in this range is entirely inadequate to compensate a creditor for the real risk that the plan will fail. There is some dispute about the true scale of that risk—respondent claims that more than 60% of Chapter 13 plans fail, Brief for Respondent 25, but petitioners argue that the failure rate for approved Chapter 13 plans is much lower, Tr. of Oral Arg. 9. We need not resolve that dispute. It is sufficient for our purposes to note that, under 11 U.S.C. § 1325(a)(6), a court may not approve a plan unless, after considering all creditors' objections and receiving the advice of the trustee, the judge is persuaded that "the debtor will be able to make all payments under the plan and to comply with

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

the plan." *Ibid.* Together with the cramdown provision, this requirement obligates the court to select a rate high enough to compensate the creditor for its risk but not so high as to doom the plan. If the court determines that the likelihood of default is so high as to necessitatean *481 "eye-popping" interest rate, 301 F.3d, at 593 (Rovner, J., dissenting), the plan probably should not be confirmed.

V

The dissent's endorsement of the presumptive contract rate approach rests on two assumptions: (1) "subprime lending markets are competitive and therefore largely efficient"; and (2) the risk of default in Chapter 13 is normally no less than the risk of default at the time of the original loan. *Post*, at 1969. Although the Bankruptcy Code provides little guidance on the question, we think it highly unlikely that Congress would endorse either premise.

First, the dissent assumes that subprime loans are negotiated between fully informed buyers and sellers in a classic free market. But there is no basis for concluding that Congress relied on this assumption when it enacted Chapter 13. Moreover, several considerations suggest that the subprime market is not, in fact, perfectly competitive. To begin with, used vehicles are regularly sold by means of tie-in transactions, in which the price of the vehicle is the subject of negotiation, while the terms of the financing are dictated by the seller. ²⁰ In addition, there is extensive **1963 federal *482 ²¹ and state ²² regulation of subprime lending. which not only itself distorts the market, but also evinces regulators' belief that unregulated subprime lenders would exploit borrowers' ignorance and charge rates above what a competitive market would allow. 23 Indeed, Congress enacted the Truth in Lending Act in part because it believed "consumers would individually benefit not only from the more informed use of credit, but also from heightened competition which would result from more knowledgeable credit shopping." S.Rep. No. 96–368, p. 16 (1979). ²⁴

Second, the dissent apparently believes that the debtor's prebankruptcy default—on a loan made in a market in which creditors commonly charge the maximum rate of interest allowed by law, Brief for Respondent 16, and in which neither creditors nor debtors have the protections afforded by Chapter 13—translates into a high probability that the same debtor's confirmed Chapter 13 plan will fail. In our view,

however, Congress intended to create a program under which plans that qualify for confirmation have a high probability of success. Perhaps bankruptcy judges currently confirm too *483 many risky plans, but the solution is to confirm fewer such plans, not to set default cramdown rates at absurdly high levels, thereby increasing the risk of default.

Indeed, as Justice THOMAS demonstrates, post, at 1966 (opinion concurring in judgment), the text of \(\bigsim \) \(\) (B)(ii) may be read to support the conclusion that Congress did not intend the cramdown rate to include any compensation for the risk of default. 25 That reading is consistent with a view that Congress believed Chapter 13's protections to be so effective **1964 as to make the risk of default negligible. Because our decision in Rash assumes that cramdown interest rates are adjusted to "offset," to the extent possible, the risk of default, 520 U.S., at 962–963, 117 S.Ct. 1879, and because so many judges who have considered the issue (including the authors of the four earlier opinions in this case) have rejected the risk-free approach, we think it too late in the day to endorse that approach now. Of course, if the text of the statute required such an approach, that would be the end of the matter. We think, however, effective date of the plan, of property to be distributed under the plan" is better read to incorporate all of the commonly understood components of "present value," including any risk of nonpayment. Justice THOMAS' reading does emphasize, though, that a presumption that bankruptcy plans will succeed is more consistent with Congress' statutory scheme than the dissent's more cynical focus on bankrupt debtors' "financial instability and ... proclivity to seek legal protection," post, at 1969.

Furthermore, the dissent's two assumptions do not necessarily favor the presumptive contract rate approach. For one thing, the cramdown provision applies not only to subprime *484 loans but also to prime loans negotiated prior to the change in circumstance (job loss, for example) that rendered the debtor insolvent. Relatedly, the provision also applies in instances in which national or local economic conditions drastically improved or declined after the original loan was issued but before the debtor filed for bankruptcy. In either case, there is every reason to think that a properly risk-adjusted prime rate will provide a better estimate of the creditor's current costs and exposure than a contract rate set in different times.

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

Even more important, if all relevant information about the debtor's circumstances, the creditor's circumstances, the nature of the collateral, and the market for comparable loans were equally available to both debtor and creditor, then in theory the formula and presumptive contract rate approaches would yield the same final interest rate. Thus, we principally differ with the dissent not over what final rate courts should adopt but over which party (creditor or debtor) should bear the burden of rebutting the presumptive rate (prime or contract, respectively).

Justice SCALIA identifies four "relevant factors bearing on risk premium[:] (1) the probability of plan failure; (2) the rate of collateral depreciation; (3) the liquidity of the collateral market; and (4) the administrative expenses of enforcement." Post, at 1973. In our view, any information debtors have about any of these factors is likely to be included in their bankruptcy filings, while the remaining information will be far more accessible to creditors (who must collect information about their lending markets to remain competitive) than to individual debtors (whose only experience with those markets might be the single loan at issue in the case). Thus, the formula approach, which begins with a concededly low estimate of the appropriate interest rate and requires the creditor to present evidence supporting a higher rate, places the evidentiary burden on the more knowledgeable *485 party, thereby facilitating more accurate calculation of the appropriate interest rate.

If the rather sketchy data uncovered by the dissent support an argument that Chapter 13 of the Bankruptcy Code should mandate application of the presumptive contract rate approach (rather than merely an argument that bankruptcy judges should exercise greater caution before approving debt adjustment plans), those data **1965 should be forwarded to Congress. We are not persuaded, however, that the data undermine our interpretation of the statutory scheme Congress has enacted.

The judgment of the Court of Appeals is reversed, and the case is remanded with instructions to remand the case to the Bankruptcy Court for further proceedings consistent with this opinion.

It is so ordered.

Justice THOMAS, concurring in the judgment.

This case presents the issue of what the proper method is for discounting deferred payments to present value and what compensation the creditor is entitled to in calculating the appropriate discount rate of interest. Both the plurality and the dissent agree that "[a] debtor's promise of future payments is worth less than an immediate payment of the same total amount because the creditor cannot use the money right away, inflation may cause the value of the dollar to decline before the debtor pays, and there is always some risk of nonpayment." Ante, at 1958; post, at 1968. Thus, the plurality and the dissent agree that the proper method for discounting deferred payments to present value should take into account each of these factors, but disagree over the proper starting point for calculating the risk of nonpayment.

I agree that a "promise of future payments is worth less than an immediate payment" of the same amount, in part because of the risk of nonpayment. But this fact is irrelevant. The statute does not require that the value of the *486 promise to distribute property under the plan be no less than the allowed amount of the secured creditor's claim. It requires only that "the value ... of property to be distributed under the plan," at the time of the effective date of the plan, be no less than the amount of the secured creditor's claim. 11 U.S.C. § 1325(a)(5)(B)(ii) (emphasis added). Both the plurality and the dissent ignore the clear text of the statute in an apparent rush to ensure that secured creditors are not undercompensated in bankruptcy proceedings. But the statute that Congress enacted does not require a debtor-specific risk adjustment that would put secured creditors in the same position as if they had made another loan. It is for this reason that I write separately.

"It is well established that 'when the statute's language is plain, the sole function of the courts-at least where the disposition required by the text is not absurd—is to enforce it according to its terms.' "Lamie v. United States Trustee, 540 U.S. 526, 534, 124 S.Ct. 1023, 1030, 157 L.Ed.2d 1024 (2004) (quoting Hartford Underwriters Ins. Co. v. Union Planters Bank, N. A., 530 U.S. 1, 6, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000)). Section 1325(a)(5)(B) provides that "with respect to each allowed secured claim provided for by the plan," "the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim [must] not [be] less than the allowed amount of such claim." Thus, the statute requires a bankruptcy court to make at least three separate determinations. First, a court must

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

determine the allowed amount of the claim. Second, a court must determine what is the "property to be distributed under the plan." Third, a court must determine the "value, as of the effective date of the plan," of the property to be distributed.

The dispute in this case centers on the proper method to determine the "value, as of the effective date of the plan, of property to be distributed under the plan." The requirement that the "value" of the property **1966 to be distributed be *487 determined "as of the effective date of the plan" incorporates the principle of the time value of money. To put it simply, \$4,000 today is worth more than \$4,000 to be received 17 months from today because if received today, the \$4,000 can be invested to start earning interest immediately. See G. Munn, F. Garcia, & C. Woelfel, Encyclopedia of Banking & Finance 1015 (rev. 9th ed.1991). Thus, as we explained in Rake v. Wade, 508 U.S. 464, 113 S.Ct. 2187, 124 L.Ed.2d 424 (1993), "[w]hen a claim is paid off pursuant to a stream of future payments, a creditor receives the 'present value' of its claim only if the total amount of the deferred payments includes the amount of the underlying claim plus an appropriate amount of interest to compensate the creditor for the decreased value of the claim caused by the delayed payments." Id., at 472, n. 8, 113 S.Ct. 2187.

Respondent argues, and the plurality and the dissent agree, that the proper interest rate must also reflect the risk of nonpayment. But the statute contains no such requirement. The statute only requires the valuation of the "property to be distributed," not the valuation of the plan (*i.e.*, the promise to make the payments itself). Thus, in order for a plan to satisfy

§ 1325(a)(5)(B)(ii), the plan need only propose an interest rate that will compensate a creditor for the fact that if he had received the property immediately rather than at a future date, he could have immediately made use of the property. In most, if not all, cases, where the plan proposes simply a stream of cash payments, the appropriate risk-free rate should suffice.

Respondent here would certainly be acutely aware of any risk of default inherent in a Chapter 13 plan, but it is nonsensical to speak of a debtor's risk of default being inherent in the value of "property" unless that property is a promise or *488 a debt. Suppose, for instance, that it is currently time A, the property to be distributed is a house, and it will be distributed at time B. Although market conditions might cause the value of the house to fluctuate between time A and time B, the fluctuating value of the house itself has nothing to do with the risk that the debtor will not deliver the house at time B. The value

of the house, then, can be and is determined entirely without any reference to any possibility that a promise to transfer the house would not be honored. So too, then, with cash: the value of the cash can be and is determined without any inclusion of any risk that the debtor will fail to transfer the cash at the appropriate time.

The dissent might be correct that the use of the prime rate, ² even with a small risk adjustment, "will systematically undercompensate secured creditors for the true risks of default." *Post*, at 1968. ³ This systematic undercompensation might seem problematic as a matter of policy. But, it raises no problem as a matter of statutory interpretation. Thus, although there is always some risk of nonpayment when A promises to repay a debt to B through a stream of payments over time rather than through an immediate lump-sum payment,

This is not to say that a debtor's risk of nonpayment can never be a factor in determining the value of the property to be distributed. Although "property" is not defined in the Bankruptcy Code, nothing in 8 1325 suggests that "property" is limited to cash. Rather, " 'property' can be cash, notes, stock, personal property or real property; in short, anything of value." 7 Collier on Bankruptcy ¶ 1129.03[7][b] [i], p. 1129-44 (rev. 15th ed.2003) (discussing Chapter 11's cramdown provision). And if the "property to be distributed" *489 under a Chapter 13 plan is a note (i.e., a promise to pay), for instance, the value of that note necessarily includes the risk that the debtor will not make good on that promise. Still, accounting for the risk of nonpayment in that case is not equivalent to reading a risk adjustment requirement into the statute, as in the case of a note, the risk of nonpayment is part of the value of the note itself.

Respondent argues that "Congress crafted the requirements of section 1325(a)(5)(B)(ii) for the protection of *creditors*, not debtors," and thus that the relevant interest rate must account for the true risks and costs associated with a Chapter 13 debtor's promise of future payment. Brief for Respondent 24 (citing Johnson v. Home State Bank, 501 U.S. 78, 87–88, 111 S.Ct. 2150, 115 L.Ed.2d 66 (1991)). In addition to ignoring the plain language of the statute, which requires no such risk adjustment, respondent overlooks the fact that secured creditors are already compensated in part for the risk of nonpayment through the valuation of the secured claim. In

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

Associates Commercial Corp. v. Rash, 520 U.S. 953, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997), we utilized a secured-creditor-friendly replacement-value standard rather than the lower foreclosure-value standard for valuing secured claims when a debtor has exercised Chapter 13's cramdown option. We did so because the statute at issue in that case reflected Congress' recognition that "[i]f a debtor keeps the property and continues to use it, the creditor obtains at once neither the property nor its value and is exposed to double risks: The debtor may again default and the property may deteriorate from extended use."

Id., at 962, 117 S.Ct. 1879.

Further, the plain language of the statute is by no means specifically debtor protective. As the Court pointed out in Johnson, supra, at 87–88, 111 S.Ct. 2150, 8 1325 contains a number of provisions to protect creditors: A bankruptcy court can only authorize a plan that "has been proposed in good faith," [8 1325(a)(3); secured creditors must accept the plan, obtain the property securing the claim, or "retain the[ir] lien[s]" and receive under the plan distributions of property which equal *490 "not less than the allowed amount of such claim," [8 1325(a)(5); and a bankruptcy court must ensure that "the debtor will be able to make all payments under the plan and to comply with the plan," [8] 1325(a)(6). Given the presence of multiple creditor-specific protections, it is by no means irrational to assume that Congress opted not to provide further protection for creditors by requiring a debtor-specific risk adjustment under \(\bigsize \) \(is insufficient compensation for secured creditors, given the apparent rate at which debtors fail to complete their Chapter 13 plans, see *post*, at 1969, and n. 1, this is a matter that should be brought to the attention of Congress rather than resolved by this Court.

II

The allowed amount of the secured claim is \$4,000. App. 57. The statute then requires **1968 a bankruptcy court to identify the "property to be distributed" under the plan. Petitioners' Amended Chapter 13 Plan (Plan) provided:

"The future earnings of DEBTOR(S) are submitted to the supervision and control of this Court, and DEBTOR(S) shall pay to the TRUSTEE a sum of \$740 ... per month

in weekly installments by voluntary wage assignment by separate ORDER of the Court in an estimated amount of \$170.77 and continuing for a total plan term of 36 months unless this Court approves an extension of the term not beyond 60 months from the date of filing the Petition herein." App. to Pet. for Cert. 77a.

From the payments received, the trustee would then make disbursements to petitioners' creditors, pro rata among each class of creditors. The Plan listed one priority claim and four secured claims. For respondent's secured claim, petitioners proposed an interest rate of 9.5%. App. 57. Thus, petitioners proposed to distribute to respondent a stream of cash payments equaling respondent's pro rata share of \$740 per month for a period of up to 36 months. *Id.*, at 12.

*491 Although the Plan does not specifically state that "the property to be distributed" under the Plan is cash payments, the cash payments are the only "property" specifically listed for distribution under the Plan. Thus, although the plurality and the dissent imply that the "property to be distributed" under the Plan is the mere *promise* to make cash payments, the plain language of the Plan indicates that the "property to be distributed" to respondent is up to 36 monthly cash payments, consisting of a pro rata share of \$740 per month.

The final task, then, is to determine whether petitioners' proposed 9.5% interest rate will sufficiently compensate respondent for the fact that instead of receiving \$4,000 today, it will receive \$4,000 plus 9.5% interest over a period of up to 36 months. Because the 9.5% rate is higher than the risk-free rate, I conclude that it will. I would therefore reverse the judgment of the Court of Appeals.

Justice SCALIA, with whom THE CHIEF JUSTICE, Justice O'CONNOR, and Justice KENNEDY join, dissenting. My areas of agreement with the plurality are substantial. We agree that, although all confirmed Chapter 13 plans have been deemed feasible by a bankruptcy judge, some nevertheless fail. See *ante*, at 1962. We agree that any deferred payments to a secured creditor must fully compensate it for the risk that such a failure will occur. See *ante*, at 1958. Finally, we agree that adequate compensation may sometimes require an "'eyepopping'" interest rate, and that, if the rate is too high for the plan to succeed, the appropriate course is not to reduce it to a more palatable level, but to refuse to confirm the plan. See *ante*, at 1962.

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

Our only disagreement is over what procedure will more often produce accurate estimates of the appropriate interest rate. The plurality would use the prime lending rate—a rate we *know* is too low—and require the judge in every case to determine an amount by which to increase it. I believe *492 that, in practice, this approach will systematically undercompensate secured creditors for the true risks of default. I would instead adopt the contract rate—*i.e.*, the rate at which the creditor actually loaned funds to the debtor—as a presumption that the bankruptcy judge could revise on motion of either party. Since that rate is generally a good indicator of actual risk, disputes should be infrequent, and it will provide a quick and reasonably accurate standard.

**1969 I

The contract-rate approach makes two assumptions, both of which are reasonable. First, it assumes that subprime lending markets are competitive and therefore largely efficient. If so, the high interest rates lenders charge reflect not extortionate profits or excessive costs, but the actual risks of default that subprime borrowers present. Lenders with excessive rates would be undercut by their competitors, and inefficient ones would be priced out of the market. We have implicitly assumed market competitiveness in other

bankruptcy contexts. See Bank of America Nat. Trust and Sav. Assn. v. 203 North LaSalle Street Partnership, 526 U.S. 434, 456-458, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999). Here the assumption is borne out by empirical evidence: One study reports that subprime lenders are nearly twice as likely to be unprofitable as banks, suggesting a fiercely competitive environment. See J. Lane, Associate Director, Division of Supervision, Federal Deposit Insurance Corporation, A Regulator's View of Subprime Lending: Address at the National Automotive Finance Association Non-Prime Auto Lending Conference 6 (June 18-19, 2002) (available in Clerk of Court's case file). By relying on the prime rate, the plurality implicitly assumes that the prime lending market is efficient, see ante, at 1961; I see no reason not to make a similar assumption about the *sub* prime lending market.

The second assumption is that the expected costs of default in Chapter 13 are normally no less than those at the *493 time of lending. This assumption is also reasonable. Chapter 13 plans often fail. I agree with petitioners that the relevant statistic is the percentage of *confirmed* plans that fail, but even resolving that issue in their favor, the risk is still substantial.

The failure rate they offer—which we may take to be a conservative estimate, as it is doubtless the lowest one they could find—is 37%. See Girth, The Role of Empirical Data in Developing Bankruptcy Legislation for Individuals, 65 Ind. L.J. 17, 40–42 (1989) (reporting a 63.1% success rate). In every one of the failed plans making up that 37%, a bankruptcy judge had found that "the debtor will be able to make all payments under the plan," 11 U.S.C. § 1325(a) (6), and a trustee had supervised the debtor's compliance, § 1302. That so many nonetheless failed proves that bankruptcy judges are not oracles and that trustees cannot draw blood from a stone.

While court and trustee oversight may provide some marginal benefit to the creditor, it seems obviously outweighed by the fact that (1) an already-bankrupt borrower has demonstrated a financial instability and a proclivity to seek legal protection that other subprime borrowers have not, **1970 and *494 (2) the costs of foreclosure are substantially higher in bankruptcy because the automatic stay bars repossession without judicial permission. See § 362. It does not strike me as plausible that creditors would prefer to lend to individuals already in bankruptcy than to those for whom bankruptcy is merely a possibility—as if Chapter 13 were widely viewed by secured creditors as some sort of godsend. Cf. Dunagan, Enforcement of Security Interests in Motor Vehicles in Bankruptcy, 52 Consumer Fin. L.Q. Rep. 191, 197 (1998). Certainly the record in this case contradicts that implausible proposition. See App. 48 (testimony of Craig Cook, sales manager of Instant Auto Finance) ("Q. Are you aware of how other lenders similar to Instant Auto Finance view credit applicants who appear to be candidates for Chapter 13 bankruptcy?" "A. Negative[ly] as well"). The better assumption is that bankrupt debtors are riskier than other subprime debtors—or, at the very least, not systematically less risky.

The first of the two assumptions means that the contract rate reasonably reflects actual risk at the time of borrowing. The second means that this risk persists when the debtor files for Chapter 13. It follows that the contract rate is a decent estimate, or at least the lower bound, for the appropriate interest rate in cramdown. ²

The plurality disputes these two assumptions. It argues that subprime lending markets are not competitive because "vehicles are regularly sold by means of tie-in transactions, in which the price of the vehicle is the subject of negotiation,

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

while the terms of the financing are dictated by the seller."

*495 Ante, at 1962. Tie-ins do not alone make financing markets noncompetitive; they only cause prices and interest rates to be considered in tandem rather than separately. The force of the plurality's argument depends entirely on its claim that "the terms of the financing are dictated by the seller." Ibid. This unsubstantiated assertion is contrary to common experience. Car sellers routinely advertise their interest rates, offer promotions like "zero-percent financing," and engage in other behavior that plainly assumes customers are sensitive to interest rates and not just price. 4

**1971 *496 The plurality also points to state and federal regulation of lending markets. Ante, at 1962–1963. It claims that state usury laws evince a belief that subprime lending markets are noncompetitive. While that is one conceivable explanation for such laws, there are countless others. One statistical and historical study suggests that usury laws are a "primitive means of social insurance" meant to ensure "low interest rates" for those who suffer financial adversity. Glaeser & Scheinkman, Neither a Borrower Nor a Lender Be: An Economic Analysis of Interest Restrictions and Usury Laws, 41 J. Law & Econ. 1, 26 (1998). Such a rationale does not reflect a belief that lending markets are inefficient, any more than rent controls reflect a belief that real estate markets are inefficient. Other historical rationales likewise shed no light on the point at issue here. See id., at 27. The mere existence of usury laws is therefore weak support for any position.

The federal Truth in Lending Act, 15 U.S.C. § 1601U.S.C. § 1601 et seq., not only fails to support the plurality's position; it positively refutes it. The plurality claims the Act reflects a belief that full disclosure promotes competition, see ante, at 1963, and n. 24; the Act itself says as much, see 15 U.S.C. § 1601(a). But that belief obviously presumes markets are competitive (or, at least, that they were noncompetitive only because of the absence of the disclosures the Act now requires). If lending markets were not competitive—if the terms of financing were indeed "dictated by the seller," ante, at 1962—disclosure requirements would be pointless, since consumers would have no use for the information. ⁵

As to the second assumption (that the expected costs of default in Chapter 13 are normally no less than those at the *497 time of lending), the plurality responds, not that Chapter 13 as currently administered is less risky than subprime lending generally, but that it would be less risky, if only bankruptcy courts would confirm fewer risky

plans. *Ante*, at 1963. Of course, it is often quite difficult to predict which plans will fail. See Norberg, Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13, 7 Am. Bankr.Inst. L.Rev. 415, 462 (1999). But even assuming the high failure rate primarily reflects judicial dereliction rather than unavoidable uncertainty, the plurality's argument fails for want of any reason to believe the dereliction will abate. While full compensation can be attained either by low-risk plans and low interest rates, or by high-risk plans and high interest rates, it cannot be attained by *high*-risk plans and *low* interest rates, which, absent cause to anticipate a change in confirmation practices, is precisely what the formula approach would yield.

The plurality also claims that the contract rate overcompensates creditors because it includes "transaction costs and **1972 overall profits." *Ante,* at 1960. But the same is true of the rate the plurality prescribes: The prime lending rate includes banks' overhead and profits. These are necessary components of *any* commercial lending rate, since creditors will not lend money if they cannot cover their costs and return a level of profit sufficient to prevent their investors

from going elsewhere. See Koopmans v. Farm Credit Services of Mid-America, ACA, 102 F.3d 874, 876 (C.A.7 1996). The plurality's criticism might have force if there were reason to believe subprime lenders made exorbitant profits while banks did not—but, again, the data suggest otherwise. See Lane, Regulator's View of Subprime Lending, at 6. 6

*498 Finally, the plurality objects that similarly situated creditors might not be treated alike. *Ante*, at 1960–1961, and n. 17. But the contract rate is only a presumption. If a judge thinks it necessary to modify the rate to avoid unjustified disparity, he can do so. For example, if two creditors charged different rates solely because they lent to the debtor at different times, the judge could average the rates or use the more recent one. The plurality's argument might be valid against an approach that *irrebuttably* presumes the contract rate, but that is not what I propose. ⁷

II

The defects of the formula approach far outweigh those of the contract-rate approach. The formula approach starts with the prime lending rate—a number that, while objective and easily ascertainable, is indisputably too low. It then adjusts *499 by adding a risk premium that, unlike the prime rate, is

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

neither objective nor easily ascertainable. If the risk premium is typically small relative to the prime rate—as the 1.5% premium added to the 8% prime rate by the court below would lead one to believe—then this subjective element of the computation might be forgiven. But in fact risk premiums, if properly computed, would typically be substantial. For example, if the 21% contract rate is an accurate reflection of risk in this case, the risk **1973 premium would be 13%—nearly two-thirds of the total interest rate. When the risk premium is the greater part of the overall rate, the formula approach no longer depends on objective and easily ascertainable numbers. The prime rate becomes the objective tail wagging a dog of unknown size.

As I explain below, the most relevant factors bearing on risk premium are (1) the probability of plan failure; (2) the rate of collateral depreciation; (3) the liquidity of the collateral market; and (4) the administrative expenses of enforcement. Under the formula approach, a risk premium must be computed in every case, so judges will invariably grapple with these imponderables. Under the contract-rate approach, by contrast, the task of assessing all these risk factors is entrusted to the entity most capable of undertaking

it: the market. See Bank of America, 526 U.S., at 457, 119 S.Ct. 1411 ("[T]he best way to determine value is exposure to a market"). All the risk factors are reflected (assuming market efficiency) in the debtor's contract rate—a number readily found in the loan document. If neither party disputes it, the bankruptcy judge's task is at an end. There are straightforward ways a debtor *could* dispute it—for example, by showing that the creditor is now substantially oversecured, or that some other lender is willing to extend credit at a lower rate. But unlike the formula approach, which requires difficult estimation in every case, the contract-rate approach requires it only when the parties choose to contest the issue.

*500 The plurality defends the formula approach on the ground that creditors have better access to the relevant information. *Ante*, at 1964–1965. But this is not a case where we must choose between one initial estimate that is too low and another that is too high. Rather, the choice is between one that is far too low and another that is generally reasonably accurate (or, if anything, a bit too low). In these circumstances, consciously choosing the less accurate estimate merely because creditors have better information smacks more of policymaking than of faithful adherence to the statutory command that the secured creditor receive property worth "not less than the allowed amount" of its

claim, —11 U.S.C. § 1325(a)(5)(B)(ii) (emphasis added). Moreover, the plurality's argument assumes it is plausible—and desirable—that the issue will be litigated in most cases. But the costs of conducting a detailed risk analysis and defending it in court are prohibitively high in relation to the amount at stake in most consumer loan cases. Whatever approach we prescribe, the norm should be—and undoubtedly will be—that the issue is not litigated because it is not worth litigating. Given this reality, it is far more important that the initial estimate be accurate than that the burden of proving inaccuracy fall on the better informed party.

There is no better demonstration of the inadequacies of the formula approach than the proceedings in this case. Petitioners' economics expert testified that the 1.5% risk premium was "very reasonable" because Chapter 13 plans are "supposed to be financially feasible" and "the borrowers are under the supervision of the court." App. 43. Nothing in the record shows how these two platitudes were somehow manipulated to arrive at a figure of 1.5%. It bears repeating that feasibility determinations and trustee oversight do not prevent at least 37% of confirmed Chapter 13 plans from failing. On cross-examination, the expert admitted that he had only limited familiarity with the subprime auto lending market and that he was not familiar with the default rates or the *501 costs of collection in that market. Id., at 44-45. In light of these devastating concessions, it is **1974 impossible to view the 1.5% figure as anything other than a smallish number picked out of a hat.

Based on even a rudimentary financial analysis of the facts of this case, the 1.5% figure is obviously wrong—not just off by a couple percent, but probably by roughly an order of magnitude. For a risk premium to be adequate, a hypothetical, rational creditor must be indifferent between accepting (1) the proposed risky stream of payments over time and (2) immediate payment of its present value in a lump sum. Whether he is indifferent—*i.e.*, whether the risk premium added to the prime rate is adequate—can be gauged by comparing benefits and costs: on the one hand, the expected value of the extra interest, and on the other, the expected costs of default.

Respondent was offered a risk premium of 1.5% on top of the prime rate of 8%. If that premium were fully paid as the plan contemplated, it would yield about \$60. If the debtor defaulted, all or part of that interest would not be paid, so the expected value is only about \$50. The prime rate

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

itself already includes some compensation for risk; as it turns out, about the same amount, yielding another \$50. 10 *502 Given the 1.5% risk premium, then, the total expected benefit to respondent was about \$100. Against this we must weigh the expected costs of default. While precise calculations are impossible, rough estimates convey a sense of their scale.

The first cost of default involves depreciation. If the debtor defaults, the creditor can eventually repossess and sell the collateral, but by then it may be substantially less valuable than the remaining balance due—and the debtor may stop paying long before the creditor receives permission to repossess. When petitioners purchased their truck in this case, its value was almost equal to the principal balance on the loan. ¹¹ By the time the plan was confirmed, however, the truck was worth only \$4,000, while the balance on the loan was \$4,895. If petitioners were to default on their Chapter 13 payments and if respondent suffered the same relative loss from depreciation, it would amount to about \$550. ¹²

**1975 The second cost of default involves liquidation. The \$4,000 to which respondent would be entitled if paid in a lump sum reflects the *replacement* value of the vehicle, *i.e.*, the amount it would cost the debtor to purchase a similar

used truck. See Associates Commercial Corp. v. Rash, 520 U.S. 953, 965, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997). If the debtor defaults, the creditor cannot sell the truck for that amount; it receives only a lesser *503 foreclosure value because collateral markets are not perfectly liquid and there is thus a spread between what a buyer will pay and what a seller will demand. The foreclosure value of petitioners' truck is not in the record, but, using the relative liquidity figures in

Rash as a rough guide, respondent would suffer a further loss of about \$450. 13

The third cost of default consists of the administrative expenses of foreclosure. While a Chapter 13 plan is in effect, the automatic stay prevents secured creditors from repossessing their collateral, even if the debtor fails to pay. See 11 U.S.C. § 362. The creditor's attorney must move the bankruptcy court to lift the stay. § 362(d). In the District where this case arose, the filing fee for such motions is now \$150. See United States Bankruptcy Court for the Southern District of Indiana, Schedule of Bankruptcy Fees (Nov. 1, 2003) (available in Clerk of Court's case file). And the standard attorney's fee for such motions, according to one survey, is \$350 in Indiana and as high as

\$875 in other States. See J. Cossitt, Chapter 13 Attorney Fee Survey, American Bankruptcy Institute Annual Spring Meeting (Apr. 10–13, 2003) (available in Clerk of Court's case file). Moreover, bankruptcy judges will often excuse first offenses, so foreclosure may require multiple trips to court. The total expected administrative expenses in the event of default could reasonably be estimated at \$600 or more.

I have omitted several other costs of default, but the point is already adequately made. The three figures above total \$1,600. Even accepting petitioners' low estimate of the plan failure rate, a creditor choosing the stream of future payments instead of the immediate lump sum would be selecting an alternative with an expected cost of about \$590 (\$1,600 multiplied by 37%, the chance of failure) and an expected *504 benefit of about \$100 (as computed above). No rational creditor would make such a choice. The risk premium over prime necessary to make these costs and benefits equal is in the neighborhood of 16%, for a total interest rate of 24%. ¹⁴

Of course, many of the estimates I have made can be disputed. Perhaps the truck will depreciate more slowly now than at first, perhaps the collateral market is more liquid than the one in *Rash*, perhaps respondent can economize on attorney's fees, and perhaps there is some reason (other than judicial optimism) to think the Tills were unlikely to default. I have made some liberal assumptions, ¹⁵ but also some **1976 conservative ones. ¹⁶ When a risk premium is off by an order of magnitude, one's estimates need not be very precise to show that it cannot possibly be correct.

In sum, the 1.5% premium adopted in this case is far below anything approaching fair compensation. That result is not unusual, see, e.g., In re Valenti, 105 F.3d 55, 64 (C.A.2 1997) (recommending a 1%–3% premium over the treasury rate—i.e., approximately a 0% premium over prime); it is the entirely predictable consequence of a methodology that tells bankruptcy judges to set interest rates based on highly imponderable factors. Given the inherent uncertainty of the enterprise, what heartless bankruptcy judge can be expected to demand that the unfortunate debtor pay triple the prime rate as a condition of keeping his sole means of transportation? It challenges human nature.

*505 III

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

Justice THOMAS rejects both the formula approach and the contract-rate approach. He reads the statutory phrase

"property to be distributed under the plan," 11 U.S.C. § 1325(a)(5)(B)(ii), to mean the proposed payments *if made as the plan contemplates*, so that the plan need only pay the risk-free rate of interest. *Ante*, at 1966 (opinion concurring in judgment). I would instead read this phrase to mean the right to receive payments that the plan vests in the creditor upon confirmation. Because there is no guarantee that the promised payments will in fact be made, the value of this property right must account for the risk of nonpayment.

Viewed in isolation, the phrase is susceptible of either meaning. Both the promise to make payments and the proposed payments themselves are property rights, the former "to be distributed under the plan" immediately upon confirmation, and the latter over the life of the plan. Context, however, supports my reading. The cramdown option which the debtors employed here is only one of three routes to confirmation. The other two—creditor acceptance and collateral surrender, \$\sqrt{\text{

The risk-free approach also leads to anomalous results. Justice THOMAS admits that, if a plan distributes a note rather than cash, the value of the "property to be distributed" must reflect the risk of default on the note. *Ante*, at 1966–1967. But there is no practical difference between obligating the debtor to make deferred payments under a plan and obligating the debtor to sign a note that requires those same payments. There is no conceivable reason why Congress *506 would give secured creditors risk compensation in one case but not the other.

Circuit authority uniformly rejects the risk-free approach. While Circuits addressing the issue are divided over *how* to calculate risk, to my knowledge all of them require some compensation for risk, either explicitly or implicitly. See **In re Valenti, supra*, at 64 (treasury rate plus 1%–3% risk premium); **GMAC v. Jones*, 999 F.2d 63, 71 (C.A.3 1993) (contract rate); **United Carolina Bank v. Hall, 993 F.2d 1126, 1131 (C.A.4 1993) (creditor's rate for similar **1977 loans, but not higher than contract rate); **In re*

Smithwick, 121 F.3d 211, 214 (C.A.5 1997) (contract rate);

In re Kidd, 315 F.3d 671, 678 (C.A.6 2003) (market rate for similar loans);

In re Till, 301 F.3d 583, 592–593 (C.A.7 2002) (case below) (contract rate);

In re Fisher, 930 F.2d 1361, 1364 (C.A.8 1991) (market rate for similar loans) (interpreting parallel Chapter 12 provision);

In re Fowler, 903 F.2d 694, 698 (C.A.9 1990) (prime rate plus risk premium);

In re Hardzog, 901 F.2d 858, 860 (C.A.10 1990) (market rate for similar loans, but not higher than contract rate) (Chapter 12);

In re Southern States Motor Inns, Inc., 709 F.2d 647, 652–653 (C.A.11 1983) (market rate for similar loans) (interpreting similar Chapter 11 provision); see also 8 Collier on Bankruptcy, ¶ 1325.06[3][b], p. 1325–37 (rev. 15th ed. 2004). Justice THOMAS identifies no decision adopting his view.

Nor does our decision in Rash, 520 U.S. 953, 117 S.Ct. 1879, 138 L.Ed.2d 148, support the risk-free approach. There we considered whether a secured creditor's claim should be valued at what the debtor would pay to replace the collateral or at the lower price the creditor would receive from a foreclosure sale. Justice THOMAS contends that Rash selected the former in order to compensate creditors for the risk of plan failure, and that, having compensated them once in that context, we need not do so again here. Ante, at 1967. I disagree with this reading of Rash. The Bankruptcy Code provides that "value shall be determined in light of the purpose of the valuation and of the *507 proposed disposition or use of [the] property." 11 U.S.C. § 506(a). Rash held that the foreclosure-value approach failed to give effect to this language, because it assigned the same value whether the debtor surrendered the collateral or was allowed to retain it in exchange for promised payments. 520 U.S., at 962, 117 S.Ct. 1879. "From the creditor's perspective as well as the debtor's, surrender and retention are not equivalent acts." *Ibid.* We did point out that retention entails risks for the creditor that surrender does not. Ld., at 962-963, 117 S.Ct. 1879. But we made no effort to correlate that increased risk with the difference between replacement and foreclosure value. And we also pointed out that retention benefits the debtor by allowing him to continue to use the property—a factor we considered "[o]f prime significance." *Id.*, at 963, 117 S.Ct. 1879. *Rash* stands for the

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

proposition that surrender and retention are fundamentally different sorts of "disposition or use," calling for different valuations. Nothing in the opinion suggests that we thought the valuation difference reflected the degree of increased risk, or that we adopted the replacement-value standard *in order to compensate* for increased risk. To the contrary, we said that the debtor's "actual use ... is the proper guide under a prescription hinged to the property's 'disposition or use.'"

- Ibid

If Congress wanted to compensate secured creditors for the risk of plan failure, it would not have done so by prescribing a particular method of valuing collateral. A plan may pose little risk even though the difference between foreclosure and replacement values is substantial, or great risk even though the valuation difference is small. For example, if a plan proposes immediate cash payment to the secured creditor, he

is entitled to the higher replacement value under Rash even though he faces no risk at all. If the plan calls for deferred payments but the collateral consists of listed securities, the valuation difference may be trivial, but the creditor still faces substantial risks. And a creditor oversecured in even the slightest degree at **1978 the time of bankruptcy *508 derives no benefit at all from Rash, but still faces some risk of collateral depreciation. 17

There are very good reasons for Congress to prescribe full risk compensation for creditors. Every action in the free market has a reaction somewhere. If subprime lenders are systematically undercompensated in bankruptcy, they will charge higher rates or, if they already charge the legal maximum under state law, lend to fewer of the riskiest borrowers. As a result, some marginal but deserving borrowers will be denied vehicle loans in the first place. Congress evidently concluded that widespread access to credit is worth preserving, even if it means being ungenerous to sympathetic debtors.

* * *

Today's judgment is unlikely to burnish the Court's reputation for reasoned decisionmaking. Eight Justices are in agreement that the rate of interest set forth in the debtor's approved plan must include a premium for risk. Of those eight, four are of the view that beginning with the contract rate would most accurately reflect the actual risk, and four are of the view that beginning with the prime lending rate would do so. The ninth Justice takes no position on the latter point, since he disagrees with the eight on the former point; he would reverse because the rate proposed here, being above the risk-free rate, gave respondent no cause for complaint. Because I read the statute to require full risk compensation, and because I would adopt a valuation method that has a realistic prospect of enforcing that directive, I respectfully dissent.

All Citations

541 U.S. 465, 124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2, Bankr. L. Rep. P 80,099, 04 Cal. Daily Op. Serv. 4224, 2004 Daily Journal D.A.R. 5841, 17 Fla. L. Weekly Fed. S 282

Footnotes

- * The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See United States v. Detroit Timber & Lumber Co., 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.
- 1 LI U.S.C. § 1325(a)(5). The text of the statute reads as follows:
 - " § 1325. Confirmation of plan
 - "(a) Except as provided in subsection (b), the court shall confirm a plan if—

.

- "(5) with respect to each allowed secured claim provided for by the plan-
- "(A) the holder of such claim has accepted the plan;
- "(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

- "(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
- "(C) the debtor surrenders the property securing such claim to such holder...."
- As we noted in Associates Commercial Corp. v. Rash, 520 U.S. 953, 962, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997), a debtor may also avail himself of the second option (surrender of the collateral) despite the creditor's objection.
- See Rake v. Wade, 508 U.S. 464, 472, n. 8, 113 S.Ct. 2187, 124 L.Ed.2d 424 (1993) (noting that property distributions under \[\frac{1}{2} \frac{1}{2}
- In the remainder of the opinion, we use the term "present value" to refer to the value as of the effective date of the bankruptcy plan.
- Title 11 U.S.C. § 506(a) provides:

"An allowed claim of a creditor secured by a lien on property in which the estate has an interest ... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, ... and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest."

- 6 See §§ 541(a), 1306(a).
- Petitioners submitted an initial plan that would have required them to assign \$1,089 of their wages to the trustee every month. App. 9. Their amended plan, however, reduced this monthly payment to \$740. App. to Pet. for Cert. 77a.
- The requirement of financial feasibility derives from 11 U.S.C. § 1325(a)(6), which provides that the bankruptcy court shall "confirm a plan if ... the debtor will be able to make all payments under the plan and to comply with the plan." See *infra*, at 1962.
- As 21% is the maximum interest rate creditors may charge for consumer loans under Indiana's usury statute, Ind.Code § 24–4.5–3–201 (1993), the remand presumably could not have benefited respondent.
- See 11 U.S.C. § 1129(a)(7)(A)(ii) (requiring payment of property whose "value, as of the effective date of the plan" equals or exceeds the value of the creditor's claim); §§ 1129(a)(7)(B), 1129(a)(9)(B)(i), 1129(a)(9)(C), 1129(b)(2)(A)(i)(II), 1129(b)(2)(B)(i), 1129(b)(2)(C)(i), 1173(a)(2), 1225(a)(4), 1225(a)(5)(B)(ii), 1228(b)(2), 1325(a)(4), 1228(b)(2) (same).
- 11 Section 1322(b)(2) provides:

"[T]he plan may ... modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, ... or leave unaffected the rights of holders of any class of claims."

Several factors contribute to this reduction in risk. First, as noted below, *infra*, at 1962, a court may only approve a cramdown loan (and the debt adjustment plan of which the loan is a part) if it believes the debtor will be able to make all of the required payments. \$\frac{1}{2}\$\$\frac

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

- We reached a similar conclusion in Associates Commercial Corp. v. Rash, 520 U.S. 953, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997), when we held that a creditor's secured interest should be valued from the debtor's, rather than the creditor's, perspective. Id., at 963, 117 S.Ct. 1879 ("[The debtor's] actual use, rather than a foreclosure sale that will not take place, is the proper guide ...").
- This fact helps to explain why there is no readily apparent Chapter 13 "cram down 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. Interestingly, the same is *not* true in the Chapter 11 context, as numerous lenders advertise financing for Chapter 11 debtors in possession. See, *e.g.*, Balmoral Financial Corporation, http://www.balmoral.com/bdip.htm (all Internet materials as visited Mar. 4, 2004, and available in Clerk of Court's case file) (advertising debtor in possession lending); Debtor in Possession Financing: 1st National Assistance Finance Association DIP Division, http://www.loanmallusa.com/dip.htm (offering "to tailor a financing program ... to your business' needs and ... to work closely with your bankruptcy counsel"). Thus, when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce. In the Chapter 13 context, by contrast, the absence of any such market obligates courts to look to first principles and ask only what rate will fairly compensate a creditor for its exposure.
- See *supra*, at 1957 (noting that the District Court's coerced loan approach aims to set the cramdown interest rate at the level the creditor could obtain from new loans of comparable duration and risk).
- Cf. 11 U.S.C. § 1322(a)(3) ("The plan shall ... provide the same treatment for each claim within a particular class").
- For example, suppose a debtor purchases two identical used cars, buying the first at a low purchase price from a lender who charges high interest, and buying the second at a much higher purchase price from a lender who charges zero-percent or nominal interest. Prebankruptcy, these two loans might well produce identical income streams for the two lenders. Postbankruptcy, however, the presumptive contract rate approach would entitle the first lender to a considerably higher cramdown interest rate, even though the two secured debts are objectively indistinguishable.
- We note that, if the court could somehow be certain a debtor would complete his plan, the prime rate would be adequate to compensate any secured creditors forced to accept cramdown loans.
- The fact that Congress considered but rejected legislation that would endorse the Seventh Circuit's presumptive contract rate approach, H.R. 1085, 98th Cong., 1st Sess., § 19(2)(A) (1983); H.R. 1169, 98th Cong., 1st Sess., § 19(2)(A) (1983); H.R. 4786, 97th Cong., 1st Sess., § 19(2)(A) (1981), lends some support to our conclusion. It is perhaps also relevant that our conclusion is endorsed by the Executive Branch of the Government and by the National Association of Chapter Thirteen Trustees. Brief for United States as Amicus Curiae; Brief for National Association of Chapter Thirteen Trustees as Amicus Curiae. If we have misinterpreted Congress' intended meaning of "value, as of the date of the plan," we are confident it will enact appropriate remedial legislation.
- The dissent notes that "[t]ie-ins do not *alone* make financing markets noncompetitive; they only cause prices and interest rates to be considered *in tandem* rather than separately." *Post*, at 1970. This statement, while true, is nonresponsive. If a market prices the cost of goods and the cost of financing together, then even if that market is perfectly competitive, all we can know is that the *combined* price of the goods and the financing is competitive and efficient. We have no way of determining whether the allocation of that price between goods and financing would be the same if the two components were separately negotiated. But the only

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

issue before us is the cramdown interest rate (the cost of financing); the value of respondent's truck (the cost of the goods) is fixed. See **Rash*, 520 U.S.*, at 960, 117 S.Ct. 1879 (setting the value of collateral in Chapter 13 proceedings at the "price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller"). The competitiveness of the market for cost-cum-financing is thus irrelevant to our analysis.

- For example, the Truth in Lending Act regulates credit transactions and credit advertising. 15 U.S.C. §§ 1604–1649, 1661–1665b.
- Usury laws provide the most obvious examples of state regulation of the subprime market. See, *e.g.*, Colo.Rev.Stat. § 5–2–201 (2003); Fla. Stat. Ann. § 537.011 (Supp.2004); Ind.Code § 24–4.5–3–201 (1993); Md. Com. Law Code Ann. § 12–404(d) (2000).
- Lending practices in Mississippi, "where there currently is no legal usury rate," support this conclusion: In that State, subprime lenders charge rates "as high as 30 to 40%"—well above the rates that apparently suffice to support the industry in States like Indiana. Norberg, Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13, 7 Am. Bankr.Inst. L.Rev. 415, 438–439 (1999).
- See also H.R.Rep. No. 1040, 90th Cong., 1st Sess., 17 (1967) ("The basic premise of the application of disclosure standards to credit advertising rests in the belief that a substantial portion of consumer purchases are induced by such advertising and that if full disclosure is not made in such advertising, the consumer will be deprived of the opportunity to effectively comparison shop for credit").
- The United States, too, notes that "[t]he text of Section 1325 is consistent with the view that the appropriate discount rate should reflect only the time value of money and not any risk premium." Brief for United States as *Amicus Curiae* 11, n. 4. The remainder of the United States' brief, however, advocates the formula approach. See, *e.g.*, *id.*, at 19–28.
- For example, if the relevant interest rate is 10%, receiving \$4,000 one year from now is the equivalent to receiving \$3,636.36 today. In other words, an investor would be indifferent to receiving \$3,636.36 today and receiving \$4,000 one year from now because each will equal \$4,000 one year from now.
- The prime rate is "[t]he interest rate most closely approximating the riskless or pure rate for money." G. Munn, F. Garcia, & C. Woelfel, Encyclopedia of Banking & Finance 830 (rev. 9th ed.1991).
- 3 Of course, in an efficient market, this risk has been (or will be) built into the interest rate of the original loan.
- The true rate of plan failure is almost certainly much higher. The Girth study that yielded the 37% figure was based on data for a single division (Buffalo, New York) from over 20 years ago (1980–1982). See 65 Ind. L. J., at 41. A later study concluded that "the Buffalo division ha [d] achieved extraordinary results, far from typical for the country as a whole." Whitford, The Ideal of Individualized Justice: Consumer Bankruptcy as Consumer Protection, and Consumer Protection in Consumer Bankruptcy, 68 Am. Bankr.L.J. 397, 411, n. 50 (1994). Although most of respondent's figures are based on studies that do not clearly exclude unconfirmed plans, one study includes enough detail to make the necessary correction: It finds 32% of filings successful, 18% dismissed without confirmation of a plan, and 49% dismissed after confirmation, for a postconfirmation failure rate of 60% (*i.e.*, 49% ÷ (32% + 49%)). See Norberg, Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13, 7 Am. Bankr.Inst. L.Rev. 415, 440–441 (1999). This 60% failure rate is far higher than the 37% reported by Girth.
- The contract rate is only a presumption, however, and either party remains free to prove that a higher or lower rate is appropriate in a particular case. For example, if market interest rates generally have risen or fallen since the contract was executed, the contract rate could be adjusted by the same amount in cases where the difference was substantial enough that a party chose to make an issue of it.
- To the extent the plurality argues that subprime lending markets are not "perfectly competitive," ante, at 1962 (emphasis added), I agree. But there is no reason to doubt they are reasonably competitive, so that pricing in those markets is reasonably efficient.
- I confess that this is "nonresponsive" to the argument made in the plurality's footnote (that the contract interest rate may not accurately reflect risk when set jointly with a car's sale price), see *ante*, at 1962, n. 20; it is in

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

response to the quite different argument made in the plurality's text (that joint pricing shows that the subprime lending market is not competitive), see *ante*, at 1962. As to the *former* issue, the plurality's footnote makes a fair point. When the seller provides financing itself, there is a possibility that the contract interest rate might not reflect actual risk because a higher contract interest rate can be traded off for a lower sale price and vice versa. Nonetheless, this fact is not likely to bias the contract-rate approach in favor of creditors to any significant degree. If a creditor offers a promotional interest rate—such as "zero-percent financing"—in return for a higher sale price, the creditor bears the burden of showing that the true interest rate is higher than the contract rate. The opposite tactic—inflating the interest rate and decreasing the sale price—is constrained at some level by the buyer's option to finance through a third party, thus taking advantage of the lower price while avoiding the higher interest rate. (If a seller were to condition a price discount on providing the financing itself, the debtor should be entitled to rely on that condition to rebut the presumption that the contract rate reflects actual risk.) Finally, the debtor remains free to rebut the contract rate with any other probative evidence. While joint pricing may introduce some inaccuracy, the contract rate is still a far better initial estimate than the prime rate.

- The plurality also argues that regulatory context is relevant because it "distorts the market." *Ante*, at 1963. Federal disclosure requirements do not distort the market in any meaningful sense. And while state usury laws do, that distortion works only to the benefit of debtors under the contract-rate approach, since it keeps contract rates artificially low.
- Some transaction costs are avoided by the creditor in bankruptcy—for example, loan-origination costs such as advertising. But these are likely only a minor component of the interest rate. According to the record in this case, for example, the average interest rate on new-car loans was roughly 8.5%—only about 0.5% higher than the prime rate and 2.5% higher than the risk-free treasury rate. App. 43 (testimony of Professor Steve Russell). And the 2% difference between prime and treasury rates represented "mostly ... risk [and] to some extent transaction costs." *Id.*, at 42. These figures suggest that loan-origination costs included in the new-car loan and prime rates but not in the treasury rate are likely only a fraction of a percent. There is no reason to think they are substantially higher in the subprime auto lending market. Any transaction costs the creditor avoids in bankruptcy are thus far less than the additional ones he incurs.
- The plurality's other, miscellaneous criticisms do not survive scrutiny either. That the cramdown provision applies to prime as well as subprime loans, *ante*, at 1964, proves nothing. Nor is there any substance to the argument that the formula approach will perform better where "national or local economic conditions drastically improved or declined after the original loan was issued." *Ibid*. To the extent such economic changes are reflected by changes in the prime rate, the contract rate can be adjusted by the same amount. See n. 2, *supra*. And to the extent they are not, they present the same problem under either approach: When a party disputes the presumption, the court must gauge the significance of the economic change and adjust accordingly. The difference, again, is that the contract-rate approach starts with a number that (but for the economic change) is reasonably accurate, while the formula approach starts with a number that (with or without the economic change) is not even close.
- Given its priority, and in light of the amended plan's reduced debtor contributions, the \$4,000 secured claim would be fully repaid by about the end of the second year of the plan. The average balance over that period would be about \$2,000, *i.e.*, half the initial balance. The total interest premium would therefore be 1.5% x 2 x \$2,000 = \$60. In this and all following calculations, I do not adjust for time value, as timing effects have no substantial effect on the conclusion.
- Assuming a 37% rate of default that results on average in only half the interest's being paid, the expected value is $60 \times (1 37\% \div 2)$, or about 50.
- According to the record in this case, the prime rate at the time of filing was 2% higher than the risk-free treasury rate, and the difference represented "mostly ... risk [and] to some extent transaction costs." App. 42 (testimony of Professor Steve Russell); see also Federal Reserve Board, Selected Interest Rates, http://www.federalreserve.gov/releases/ h15/data.htm (as visited Apr. 19, 2004) (available in Clerk of Court's case file) (historical data showing prime rate typically exceeding 3–month constant-maturity treasury rate by 2%–

Till v. SCS Credit Corp., 541 U.S. 465 (2004)

124 S.Ct. 1951, 158 L.Ed.2d 787, 51 Collier Bankr.Cas.2d 642, 43 Bankr.Ct.Dec. 2...

- 3.5%). If "mostly" means about three-quarters of 2%, then the risk compensation included in the prime rate is 1.5%. Because this figure happens to be the same as the risk premium over prime, the expected value is similarly \$50. See nn. 8–9, *supra*.
- 11 The truck was initially worth \$6,395; the principal balance on the loan was about \$6,426.
- On the original loan, depreciation (\$6,395 \$4,000, or \$2,395) exceeded loan repayment (\$6,426 \$4,895, or \$1,531) by \$864, *i.e.*, 14% of the original truck value of \$6,395. Applying the same percentage to the new \$4,000 truck value yields approximately \$550.
- The truck in **Rash* had a replacement value of \$41,000 and a foreclosure value of \$31,875, i.e., 22% less. **520 U.S., at 957, 117 S.Ct. 1879. If the market in this case had similar liquidity and the truck were repossessed after losing half its remaining value, the loss would be 22% of \$2,000, or about \$450.
- A 1.5% risk premium plus a 1.5% risk component in the prime rate yielded an expected benefit of about \$100, see *supra*, at 1973–1974, so, to yield \$590, the total risk compensation would have to be 5.9 times as high, *i.e.*, almost 18%, or a 16.5% risk premium over prime.
- For example, by ignoring the possibility that the creditor might recover some of its undersecurity as an unsecured claimant, that the plan might fail only after full repayment of secured claims, or that an oversecured creditor might recover some of its expenses under 11 U.S.C. § 506(b).
- For example, by assuming a failure rate of 37%, cf. n. 1, *supra*, and by ignoring all costs of default other than the three mentioned.
- 17 It is true that, if the debtor defaults, one of the costs the creditor suffers is the cost of liquidating the collateral. See *supra*, at 1975. But it is illogical to "compensate" for this risk by requiring all plans to pay the full cost of liquidation (replacement value minus foreclosure value), rather than an amount that reflects the possibility that liquidation will actually be necessary and that full payments will not be made.

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Faculty

Jeffrey Bjork is the global vice chair of the Restructuring and Special Situations Practice at Latham & Watkins in Los Angeles, where he represents public and private companies, creditors and investors in all aspects of restructuring. Widely recognized as a leading U.S. restructuring lawyer, he is a Fellow of the American College of Bankruptcy and was named one of the "Outstanding Restructuring Lawyers" for 2020 by Turnarounds & Workouts. With more than 20 years in practice, Mr. Bjork represents debtors, creditors, sponsors, boards of directors and investors in all aspects of restructuring distressed companies. He regularly advises companies on successful strategies to address masstort and legacy liabilities, including asbestos, environmental and product-related liabilities, and he has represented clients in numerous mass-tort bankruptcies. Mr. Bjork has been named a leading restructuring lawyer by IFLR1000 for Restructuring and Insolvency, and in the 2020 Lawdragon 500 Leading Lawyers in America, The Best Lawyers in America for Bankruptcy Insolvency, The International Who's Who for Restructuring & Insolvency Lawyers and The Legal 500 for Municipal Bankruptcy, among others. He is a member of the Pepperdine University Board and a frequent lecturer, speaker and writer on restructuring, bankruptcy and insolvency topics. Mr. Bjork received his B.A. magna cum laude in 1995 from Pepperdine University and his J.D. with distinction from Emory University School of Law in 1998.

Matt Foster is a managing director and founding partner of Sonoran Capital Advisors in Mesa, Ariz. Prior to founding Sonoran in 2017, he worked as a director for international insolvency firm KRYS Global, and before that he worked for another restructuring boutique, Odyssey Capital Group. Mr. Foster began his finance career in private equity working for Citizens Capital, Inc. (CCI), the private equity arm of RBS Citizens Bank. He oversaw CCI's interests in its private-equity portfolio consisting of investments in over a dozen private companies. Since that time, Mr. Foster has been involved in a wide range of restructuring engagements, including out-of-court restructurings, chapter 11 restructurings, litigation support and solvency. He has served in multiple CRO, CFO, financial advisor and investment banking positions across various industries. In the past 12 months, he's been engaged as the CRO of an oilfield services company, CRO of a cryptocurrency bank, and financial advisor to a land development and mining company. Mr. Foster received his B.S. in finance from the University of Utah and his M.B.A. from Northeastern University.

Jordan A. Kroop is a corporate bankruptcy, restructuring, and reorganization attorney with Perkins Coie LLP in Phoenix, where he represents debtors, official committees, acquirers and significant creditors in chapter 11 matters involving publicly traded and privately held companies throughout the U.S. He is a Fellow of the American College of Bankruptcy and represents clients in such diverse industries as manufacturing, real estate development, construction, hospitality, food and beverage, gaming, health care and technology. Mr. Kroop represented the Russian Tea Room, the iconic Manhattan restaurant, in its chapter 11 filing, as well as the NHL's Phoenix Coyotes as chapter 11 debtor's counsel, leading the team to its eventual sale. He has also represented the Boston Celtics and Milwaukee Bucks in reorganization matters. Mr. Kroop has represented debtor-sellers as well as strategic acquirers in chapter 11 asset sales throughout the country in transactions totaling several hundred million dollars. He teaches information privacy and bankruptcy topics as an adjunct professor of law at the Sandra Day O'Connor College of Law at Arizona State University. He also

instructs at ABI's Litigation Skills Symposium and has taught international commercial arbitration at the University of the Pacific's McGeorge School of Law in Salzburg, Austria. Since 1998, Mr. Kroop has co-authored and regularly updated the two-volume treatise *Bankruptcy Litigation and Practice: A Practitioner's Guide*, now in its fourth edition. He also co-authored a chapter on chapter 11 and sports franchises in the *Collier Guide to Chapter 11* (LexisNexis 2011, rev'd 2012, 2013) and co-authored *The Executive Guide to Corporate Bankruptcy* (Beard Books). In addition, he has authored dozens of articles in national publications and augments his writing with frequent panel and seminar presentations across the nation. He also co-chairs ABI's Southwest Bankruptcy Conference. Mr. Kroop has been recognized for more than 10 years in *Southwest Super Lawyers* and *The Best Lawyers in America*, including as Lawyer of the Year in 2017. He received his A.B. *magna cum laude* from Brown University and his J.D. from the University of Virginia.

Hon. David T. Thuma is a U.S. Bankruptcy Judge for the District of New Mexico in Albuquerque, sworn in on Aug. 14, 2012. He previously practiced law in a large Indianapolis firm for five years before moving to New Mexico, where he focused on bankruptcy law and commercial litigation between 1989 and 2012. Judge Thuma received his undergraduate degree from the University of Chicago in 1980 and his J.D. from Duke University in 1984; between college and law school, he worked briefly as a cowboy on a ranch near Mayer, Ariz.