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Till v. SCS Credit Corp. – U.S. Supreme Court Rejects Application of Contract Rate to Deferred Cram Down Payments

Last week, in *Till v. SCS Credit Corp.*, 541 U.S. ___ (2004), the Supreme Court gave substance to the phrase, "*value, as of the effective date of the plan*" in section 1325(a)(5) of the Bankruptcy Code, 11 U.S.C. § 1325(a)(5). This section of the Code governs confirmation of plans over the objection of secured creditors (more descriptively known as "cram down") in individual reorganizations under chapter 13 of the Bankruptcy Code. Due to the fact that the same words, "value, as of the effective date of the plan", are used in the sections of the Bankruptcy Code governing cram down under chapter 11, bankruptcy courts should apply *Till* to establish the rate of interest paid on claims owed to classes of non-consenting secured creditors under a chapter 11 plan of reorganization.

In *Till*, the Court sought to resolve a seemingly simple legal issue: the rate of interest necessary to ensure that SCS would receive over a period of time the "*value*" of its claim "*as of the effective date of the plan*". Five members of the Court, utilizing different rationales, rejected the argument of a secured creditor that it was entitled to receive interest at the rate set forth in the pre-petition credit agreement. Four members of the Court ruled that a "formula" rate, also known as a "prime-plus" rate (i.e., the national prime rate plus some compensation for risk of default)—rather than the credit agreement rate of 21%—was the appropriate method to provide the secured creditor with the value of its claim while it received monthly payments over the three-year course of the chapter 13 plan. Justice Thomas, in a separate concurrence, argued that the language of the statute precluded any consideration of non-payment risk, and required only an "appropriate risk-free rate".

Facts

Lee and Amy Till wished to maintain possession of their truck, which they had financed one year earlier, as part of their individual reorganization plan under chapter 13 of the U.S. Bankruptcy Code. The parties agreed that the value of the truck did not exceed $4,000.00. The Tills' chapter 13 plan of reorganization proposed to pay SCS Credit Corp., the holder of the purchase money security interest on the truck, the amount of its secured claim over a thirty-six month period plus interest at 9.5%, based on the national prime rate (i.e., 8%) in effect in October 1999 plus a risk factor amount. SCS objected, contending that it was entitled to the 21% rate set forth in the financing agreement for purposes of section 1325(a)(5).

Four Different Methods Considered by the Court

The procedural history of the *Till* case produced four different methods for providing SCS with the present value of its $4,000 secured claim over thirty-six months. The Bankruptcy Court accepted the Tills' argument that the "formula" rate was appropriate. The District Court reversed, holding that because SCS effectively was being "coerced" into extending a $4,000 loan to the Tills, the "value" of its claim "as of the effective date of the plan" should have been based on the rate set forth in the Tills' financing agreement, i.e., the rate that SCS could have realized had it been able to realize immediately on the value of its collateral and reinvest the proceeds in a loan of equivalent duration and risk. The Seventh Circuit Court of Appeals majority opinion slightly modified the "coerced loan" approach of the District Court, holding that the contract rate should serve as the "presumptive" cram down rate, but that a debtor should have the opportunity to seek a downward adjustment (and the creditor an upward adjustment) based on evidence that the prevailing contract rate would overcompensate (or undercompensate) the secured creditor. The dissenting opinion, on the other hand, would have reversed the District Court, arguing that the "cost of funds" to SCS, i.e., the rate necessary for SCS to obtain the cash equivalent of its secured claim from an alternative source, was all that was necessary to provide SCS with the "value" of its claim "as of the effective date of the plan".

The plurality opinion of Justice Stevens notes that nothing in the Bankruptcy Code itself provides any

guidance as to which of the four methods—the formula rate, the coerced loan rate, the presumptive contract rate, or the cost of funds rate—is appropriate. Section 1325(a)(5), he states, simply requires that SCS be compensated for its inability to use the value of its claim right away, the threat of inflation, and the risk of non-payment. Based on its view of the major considerations it believes Congress had in mind in order to provide such compensation, including the need for a "familiar" approach that would "minimize[] the need for expensive evidentiary proceedings", and what it terms as the need for "an objective rather than a subjective inquiry", the Court rejects the coerced loan, presumptive contract, and cost of funds rates in favor of the formula rate.

The coerced loan rate, according to the Supreme Court, improperly seeks to make a secured creditor whole, rather than simply providing it with the present value of its claim, and as a result would overcompensate such creditors because the contract rate presumably factors in a profit margin and origination and administrative costs which are no longer relevant. The Court also rejects the presumptive contract rate as improperly placing the burden on the debtor to present evidence regarding the creditor's costs and lending practices. Lastly, the Court views the cost of funds rate as improperly focusing on the creditworthiness of the creditor rather than the debtor.

The formula rate, in the Court's opinion, properly takes an objective, market rate of interest, and adjusts it upward based on the extent of the risk of non-payment presented by the debtor's plan. The Court makes clear that creditors, not debtors, should bear the evidentiary burden of presenting relevant information to the bankruptcy court. "[T]he formula approach entails a straightforward, familiar and objective inquiry . . . [and] 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."

Impact on Chapter 11 Cases

As the Supreme Court points out, the same words, "*value, as of the effective date of the plan*", are utilized in the chapter 11 cram down sections. Moreover, as the Court's main opinion states, "[w]e think it likely that Congress intended bankruptcy judges . . . to follow essentially the same approach when choosing an appropriate interest rate under any of these provisions." It is therefore probable that the *Till* decision will control the setting of interest rates in cram down plans under chapter 11.

Nevertheless, it is possible that a different approach could develop in chapter 11 cases. In a footnote, the opinion in *Till* recognizes a significant difference between chapter 11 and chapter 13 cases: the existence of a well-established market for the making of loans to debtors in chapter 11 cases, and suggests that a cram down rate in a chapter 11 case could be based on the rate that "an efficient market might produce". If a debtor emerging from chapter 11 has debtor-in-possession financing or has obtained exit financing, and the interest rate in such facilities closely approximates (or exceeds) the pre-petition contract rate, a crammed down secured creditor would at least have some plausible basis for seeking the utilization of its contract rate (or higher) as the cram down rate of interest. It is safe to say, however, that any such creditor will face an uphill battle in opposing confirmation of a plan that utilizes the formula rate in a chapter 11 case.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired. For more information on the topics covered in this issue, please contact:

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