Significant Ruling Gives Chapter 11 Debtors New Leverage Over Secured Creditors

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The Bankruptcy Code's so-called "cramdown" statute provides debtors with a significant tool that can be used to impose a reorganization plan upon recalcitrant secured lenders, subject to fulfillment of certain requirements. In particular, Section 1129(b) of the Bankruptcy Code allows a bankruptcy court to approve a debtor's reorganization plan over the objections of a secured creditor so long as the plan is "fair and equitable" to the creditor. A debtor can meet the "fair and equitable" requirement if the plan allows a secured creditor to retain its lien on the assets securing its allowed claim and affords the creditor deferred cash payments with a present value totaling at least the value of those assets. The relevant inquiry is what present value interest rate should be applied to the deferred stream of payments in order to ensure that the creditor's claim will be satisfied in full.

A hotly contested Chapter 11 case in the Bankruptcy Court for the Southern District of New York, *In re MPM Silicones LLC*, *et al*., Case No. 14-22503-rdd (Bankr. S.D.N.Y. Aug. 26, 2014), has the potential to change the dynamics between debtors and secured creditors in cramdown situations, with the court's decision on the relevant interest rate lessening the burden debtors must meet to restructure secured obligations.

Calculating Cramdown Rate of Interest Under *Till*

Prior to the Supreme Court decision in *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), courts varied in their approaches to determining the appropriate rate of interest for a cramdown loan. Some applied the market rate of interest that would provide the secured lender with the interest rate that it could have obtained had it foreclosed on the collateral and reinvested the proceeds. Others considered either the contract rate in existence between the parties, the cost the lender would incur to obtain the cash equivalent of the collateral or the prevailing rate of interest if an efficient market existed.

The Supreme Court rejected these varied approaches in *Till* and held that a "formula" approach was the appropriate metric. Under this approach, the interest rate is calculated using a riskless base rate plus a percentage risk adjustment to reflect the risk of the debtor's nonpayment of its obligation. According to the *Till* court, this risk adjustment will usually be 1-3 percent, depending on the debtor's circumstances, the nature of the security and the length of the payment. However, because *Till* was decided under Chapter 13 of the Bankruptcy Code, which applies only to individuals and not corporations, the Supreme Court noted in a footnote that "when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce." By distinguishing a Chapter 13 cramdown situation from one in Chapter 11, the Supreme Court seemingly left the door open for courts to adopt other approaches in the Chapter 11 context, if they found that an efficient market existed.

Following the *Till* decision, many courts have adopted a two-step approach to determining whether proposed cramdown treatments meet the fair and equitable test in the Chapter 11 context. The first step considers whether an efficient market for the loan exists, and if so, what interest rate would apply. If no efficient market exists, most courts apply the *Till* formula. As a practical matter, however, regardless of whether one or two steps are required in any given case, and with few exceptions, most post-*Till* courts approve Chapter 11 cramdown rates that do not stray far from the *Till* model of the prime rate plus a risk adjustment of 1-3 percent.

MPM Silicones: A Variation of *Till*'s Formula Approach in Chapter 11

In the *MPM Silicones* case, the Bankruptcy Court for the Southern District of New York ruled that the *Till* formula approach applies in Chapter 11 cases, without the need to first answer whether an efficient market exists. Judge Robert D. Drain allowed the debtors to use the Treasury rate, rather than prime, as the base rate for the reorganized notes issued under the plan, noting that the Treasury rate is often used as the base rate for longer-term corporate debt instruments such as the reorganized notes. In recognition of the lack of risk and profit found in the Treasury rate given that the United States government is the obligor, he required the debtors to factor in a modest incremental increase to the risk premium. Judge Drain found that the risk premiums on the replacement notes under the debtors' plan, which fell within the 1-3 percent range, were adequate, based in significant part on the likely prospect of repayment given the significant deleveraging, equity infusion and equity cushion.

Depending on the jurisdiction, the applicability of the *Till* formula in Chapter 11 cases may still be unsettled. As noted, however, regardless of the method employed for calculating cramdown interest rates, courts typically approve cramdown payments that fall within the same range as prime plus 1-3 percent. At least in Judge Drain's courtroom, and likely in the Second Circuit generally, the formula approach seems to be the standard. In the wake of *MPM Silicones*, it appears that debtors can comply with the *Till* formula by using not only the prime rate but the Treasury rate as well. The net result is a lessening of the burden Chapter 11 debtors need to meet to cram down their secured objecting creditors.