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DON'T GO AND DO SOMETHING RASH ABOUT CRAM DOWN INTEREST RATES

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At the time I wrote this Article (October 1997), I was a partner with King & Spalding. I am also proud of that. And, I am grateful to King & Spalding for the many opportunities it affords me.

One of my opportunities as a King & Spalding lawyer was making the oral argument for the General Motors Acceptance Corporation to the United States Court of Appeals for the Second Circuit in *General Motors Acceptance Corp. v. Valenti*, a Chapter 13 cram down interest rate case subjectively discussed herein. I am not proud that I lost the case and, of course, I am not grateful to the Second Circuit. I am a real bad loser.

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I. EXPLANATION OF "CRAM DOWN" OF HOLDER OF SECURED CLAIM

In many cases filed under Chapter 13¹ of the Bankruptcy Code,² the debtor wants to keep her car or truck and modify the

1. It can be said that Chapter 13 began in Alabama in the 1920s; an Alabama bankruptcy referee, Valentine Nesbit, developed an informal process for the resolution of bankruptcy cases through a negotiated plan of periodic repayments by the bankrupt, instead of the liquidation of the bankrupt's property. This became the precursor to Chapter XIII, which in turn was the precursor to Chapter 13. See NATIONAL BANKRUPTCY REVIEW COMMISSION FINAL REPORT, BANKRUPTCY: THE NEXT TWENTY YEARS 233 (Oct. 20, 1997) [hereinafter NATIONAL BANKRUPTCY REVIEW COMMISSION]; H.R. 12889, 74th Cong. 2d Sess., iv (Comm. Print 1936); *Bankruptcy Act: Hearings on H.R. 8046 Before the Senate Judiciary Committee*, 75th Cong., 2d Sess. 61-62 (1937); 81 CONG. REC. 8646-47 (1937); see generally W. HOMER DRAKE & JEFFREY MORRIS, CHAPTER 13 PRACTICE AND PROCEDURE 1.04 (1983) (discussing the origins of Chapter 13); Harry H. Haden, *Chapter XIII Wage Earner Plans-Forgotten Man Bankruptcy*, 55 KY. L.J. 564 (1966) (discussing the history and use of Chapter XIII). Nesbit's successor, Clarence Allgood, played a significant role in the implementation of Chapter XIII. See STEPHEN B. COLEMAN, JR. & JUDGE STEPHEN B. COLEMAN, SR., JUDGE CLARENCE ALLGOOD 19-23, 27-28 (1991); Clarence W. Allgood, *Operation of the Wage Earners' Plan in the Northern District of Alabama*, 14 RUTGERS L. REV. 578 (1960) (examining briefly the operation of Chapter XIII of the Bankruptcy Act).

2. 11 U.S.C. §§ 101-1330 (1995). All Chapters and sections referred to herein are Chapters and sections of the Bankruptcy Code.

terms of her car note in a manner that is not acceptable to the lender. And, in many Chapter 11 business cases, the debtor wants to keep its equipment or building and modify the terms of its secured loan in a manner that is not acceptable to the lender. A bankruptcy court can confirm a Chapter 11, 12, or 13 plan that modifies the rights of a secured creditor without the consent of that creditor. In other words, the plan can be "crammed down" over the objection of the secured creditor.³

Neither Chapter 11, Chapter 12, or Chapter 13 uses the words "cram down."⁴ Nonetheless, cram down has been described by Judge Robert J. Kressel, a bankruptcy judge in Minnesota, as the "centerpiece of the reorganization chapters."⁵ As Judge Kressel explains, the cram down of a secured creditor⁶ in

3. While Alabama can claim credit for Chapter 13, it escapes the blame for the cram down. In Nesbit's wage earner proceedings in Birmingham, repayment plans were consensual—acceptable to both the bankrupt and to creditors. Similarly, Chapter XIII under the prior Bankruptcy Act, did not provide for a cram down. The assent of each secured creditor whose debt was "dealt with by the plan" was required. See Bankruptcy Act Section 652(1) (1995) (original version at 11 U.S.C. 1052(1)).

4. Nor do these sections use the term "cramdown," although reported cases use both "cram down" and "cramdown." Compare *Associates Commercial Corp. v. Rash*, 117 S. Ct. 1879, 1882 (1997) (using the words "cram down") with *In re Rash*, 90 F.3d 1036, 1052 (5th Cir. 1996) (using the term "cramdown"). In 1997, the Ninth Circuit used both "cramdown" and "cram down." (This is not the reason that Congress is considering a split of the Ninth Circuit into two judicial circuits.) Compare *In re Ambanc La Mesa Ltd. Partnership*, 115 F.3d 650, 652 (9th Cir. 1997) (using the term "cramdown"), with *In re Figter Ltd.*, 118 F.3d 635, 637 (9th Cir. 1997) (using the term "cram down"). Both "cram down" and "cramdown" can be found in the opinions of Alabama bankruptcy judges. Compare *In re Equitable Dev. Corp.*, 196 B.R. 889, 892 (Bankr. S.D. Ala. 1996) (using the term "cramdown"), with *In re Hardy Machinery*, 1994 WL 722084, at *1 (Bankr. N.D. Ala. 1994) (using the term "cram down"). Chandler Watson, who served as bankruptcy judge in Anniston, Alabama for twenty-nine years, used the phrase "smooth down" instead of cram down. See 2 KEITH LUNDIN, CHAPTER 13 BANKRUPTCY § 5.42 n.519 (2d ed. 1994).

5. *In re Mattson*, 210 B.R. 157, 159 (Bankr. D. Minn. 1997); see generally Kenneth Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133 (1979) (describing the requirements for cramdown under the Bankruptcy Code).

6. Just as reported cases, but not the Bankruptcy Code, use the term "cram down," reported cases, but not the Bankruptcy Code, use the term "secured creditor." E.g., *Associates Commercial Corp. v. Rash*, 117 S. Ct. 1879, 1880 (1997); *In re Hoskins*, 102 F.3d 311, 317 (7th Cir. 1996). Section 506 "abolishes the use of the terms 'secured creditor' and 'unsecured creditor' and substitutes in their places the terms [holder of] 'secured claim' and [holder of] 'unsecured claim.'" S. REP. NO. 95-989 at 68 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5854; H.R. REP. NO. 75-595,

a Chapter 11, 12, or 13 case

starts with § 506(a) which basically provides that a creditor holding a security interest in property has a secured claim only to the extent that there is value in that property to provide actual security for its claim. . . . The basic rule of cramdown is that, under a plan, a debtor must make payments to a secured creditor which have a value equal to the debtor's allowed secured claim, which is not necessarily its entire claim.⁷

As Judge Kressel's description indicates, there are two separate valuations involved in the cram down of a secured claim.⁸ First, the court must determine the value of the creditor's collateral. Second, the court must determine the value of the deferred payments proposed by the plan to determine whether the present value of such payments at least equals the value of the collateral.

Assume, for example, that *D*, a Chapter 13 debtor, still owes \$10,000 on her GMAC car loan. To approve a Chapter 13 plan, over GMAC's objection, that provided for *D*'s retaining the car and making periodic payments to GMAC, a bankruptcy court would first have to determine the value of the car. If the court valued the car at \$7,000, GMAC would have a \$7,000 secured claim, even though the amount owing on the car loan was more than \$7,000. *D*'s plan could satisfy GMAC's secured claim by paying GMAC \$7,000 in cash on the date of plan confirmation. Most Chapter 13 plans (and Chapter 11 plans), however, provide for paying secured claims in installments. If *D*'s plan provides for such installment payments, the court would then have to address the second valuation involved in a cram down of a secured claim and determine whether the present value of the proposed payments under *D*'s plan was at least \$7,000.

Recently, the Supreme Court in *Associates Commercial Corp. v. Rash*,⁹ considered the first question of how to value a creditor's security interest in property.¹⁰ Interpreting section

at 356 (1977) reprinted in 1978 U.S.C.C.A.N. 5963, 6312.

7. *Mattson*, 210 B.R. at 159.

8. See CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* 866 (1997); see generally Chaim Fortgang & Thomas Moers Mayer, *Valuation in Bankruptcy*, 32 UCLA L. REV. 1061 (1985) (discussing principles of valuation in bankruptcy).

9. 117 S. Ct. 1879 (1997).

10. *Rash*, 117 S. Ct. at 1885; see generally Jon Yard Arnason, *Although The Su-*

506(a),¹¹ *Rash* held that in a cram down, valuation of retained encumbered property must be based on a "replacement-value standard."¹²

This Article considers the second and different question of how to value the proposed payments under the plan. While the question of how to value the proposed payments under the plan is different from the question of how to value the creditor's security interest in property, there is a connection between the answers to the questions. The value of the payments must at least equal the value of the security interest.

II. BANKRUPTCY CODE PROVISIONS ON CRAM DOWN OF SECURED CLAIMS

The cram down of a secured claim involves not only section 506, but also section 1129(b)(1), section 1222(b)(2), or section 1322(b)(2), which permit a Chapter 11, 12, or 13 plan to "impair" or "modify" the rights of holders of secured claims. Any plan impairment or modification must be confirmed by the bankruptcy judge. In approving such a change over the objection of the affected secured creditor, the court must find that the requirements of sections 1129(b)(2)(A), 1225(a)(5)(B)(ii), or 1325(a)(5)(B)(ii), generally referred to as the cram down provisions, have been satisfied.

preme Court Tried to Clarify How to Value Secured Claims When Bankruptcy "Cram Down" Provisions Are Invoked, The Standards Remain Unclear, NAT'L L.J., July 14, 1997, at B6 (discussing the impact of the *Rash* case and highlighting unanswered questions that must still be addressed by the lower courts); Alan Ostrowitz, *Valuation of Personal Property in Chapter 13 Cramdowns*, N.Y. L.J., Aug. 12, 1997, at 1 (noting that the *Rash* decision was a clear victory for secured lenders).

11. 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, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, 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.

11 U.S.C. § 506(a) (1995).

12. *Rash*, 117 S. Ct. at 1882.

Section 1129(b)(2)(A) provides in pertinent part:

With respect to a class of secured claims, the plan provides—

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a *value, as of the effective date of the plan*, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.¹³

Sections 1225(a)(5) and 1325(a)(5) provide:

with respect to each allowed secured claim provided for by the plan . . .

(B)(ii) the *value, as of the effective date of the plan*, of property to be distributed [by the trustee or the debtor] (only in § 1225(a)(5)) 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 (emphasis added).¹⁴

Obviously, the language of the provision for cram down of secured creditors in Chapter 11 cases differs from the provisions for cram down in Chapters 12 and 13 cases. Section 1129(a) refers to "deferred cash payments," while sections 1225(a)(5) and 1325(a)(5) refer to "property to be distributed . . . under the plan," which, at least in theory, could be "property" other than "cash payments." And, in Chapter 11 the alternative to such deferred cash payments is "realization . . . of the indubitable equivalent,"¹⁵ while in Chapters 12 and 13 the alternative to

13. 11 U.S.C. § 1129(b)(2)(A) (1995) (emphasis added).

14. 11 U.S.C. §§ 1225(a)(5) and 1325(a)(5) (1995) (emphasis added).

15. 11 U.S.C. § 1129 (1995); see also *In re Murel Holding Corp.*, 75 F.2d 941,

the plan property distributions is the debtor's surrender of the encumbered property.¹⁶

And there are other differences among the Chapters that affect the operation of these provisions.¹⁷ For example, Chapters 12 and 13 require that all of the debtor's projected disposable income be used to make payments under the plan.¹⁸ Accordingly, in Chapter 12 and Chapter 13 cases, contests over the cram down interest rate for secured creditors affect the relative distributions among creditors, but do not affect what the debtor retains. In Chapter 11 cases, on the other hand, contests over the cram down interest rate for secured creditors may affect not only relative distributions among creditors but also the relative allocation between debt and equity.

Notwithstanding these differences, the courts and commentators have generally treated the question of how the cram down interest rate should be determined as a question that is answered the same in Chapter 11, 12, and 13 cases.¹⁹ Note the italicized phrase, "value, as of the effective date of the plan," in each of these sections.²⁰ Each of these provisions requires that a

942 (2d Cir. 1935) (stating "he [a secured creditor] wishes to get his money or at least the property. We see no reason to . . . deprive him of that . . . unless by a substitute of the most indubitable equivalence.").

16. "Structurally, it appears that these two alternatives are set forth as equivalent methods of protecting the creditor's security interest where it does not accept the debtor's treatment of that interest under the plan. Accordingly, one would expect that these alternatives would yield the same result." *Associates Commercial Corp. v. Rash*, 90 F.3d 1036, 1046 (5th Cir. 1996), *rev'd*, 117 S. Ct. 1879 (1997).

17. See generally David Epstein & Christopher Fuller, *Chapters 11 and 13 of the Bankruptcy Code: Observations on Using Case Authority From One of the Chapters in Proceedings Under the Other*, 38 VAND. L. REV. 901 (1985) (focusing on the relationship between Chapter 11 and Chapter 13).

18. See 11 U.S.C. §§ 1225(b)(1)(B) and 1325(b)(1)(B) (1994).

19. *E.g.*, *Koopmans v. Farm Credit Services of Mid-America, ACA*, 102 F.3d 874 (7th Cir. 1996) (Chapter 12 case which cited to Chapter 13 cases and uses the "indubitable equivalent" language of Chapter 11); *In re River Village Associates*, 161 B.R. 127, 135 (Bankr. E.D. Pa. 1993) ("cases analyzing the appropriate interest rate in a present value analysis under any of these sections are instructive"); Dean Pawlowic, *Entitlement to Interest Under the Bankruptcy Code*, 12 BANKR. DEV. J. 149, 173-78 (1995); Hon. John Pearson et al., *Ending the Judicial Snipe Hunt: The Search for the Cramdown Interest Rate*, 4 ABI L. REV. 35 (1996); but see *In re 222 Liberty Associates*, 108 B.R. 971, 995 n.16 (Bankr. E.D. Pa. 1990) (suggesting a more "consumer oriented" approach in Chapter 13 cases).

20. This phrase also appears in section 1129(a)(9)(C) (Chapter 11 priority tax claims). See *supra* text accompanying notes 13 & 14.

secured creditor who is not either paid in full or permitted to repossess must receive the present equivalent value of its secured claim.²¹ If the Chapter 11, 12 or 13 plan proposes periodic payments, the court must determine the "value, as of the effective date of the plan," of the plan's promised stream of payments.

For example, if a creditor has a secured claim of \$36,000, a Chapter 13 plan provision for 36 monthly payments of \$1,000 will not have a "value, as of the effective date of the plan" of \$36,000. Obviously, a creditor would rather have \$36,000 in cash than a Chapter 13 debtor's promise to pay \$36,000 over thirty-six months—obviously, such a promise does not have a present value of \$36,000. What is not obvious is how large the promised stream of payments has to be in order to have a present value of \$36,000—what is not obvious is the interest rate that will fully compensate the secured creditor for the delay in receiving payment in full of the secured claim immediately on confirmation of the plan.²²

Notice that the words "interest rate," like the words "cram down," do not appear in sections 1129(b)(2)(A), 1125(a)(5)(B)(ii), or 1325(a)(5)(B)(ii).²³ The words do, however, regularly appear in

21. *Associates Commercial Corp. v. Rash*, 117 S. Ct. 1879, 1883 (1997) ("payments over the life of the plan, that will total the present value of the allowed secured claim . . .").

22. Cf. Walter J. Blum, *Treatment of Interest on Debtor Obligations in Reorganizations Under the Bankruptcy Code*, 50 U. CHI. L. REV. 430, 439 (1983) ("To determine its present value, a sum due in the future must, of course, be discounted to reflect the interest foregone by the creditor during the period the debtor has use of the funds."); LUNDIN, *supra* note 4, at 5-139, 5-140 ("The phrase 'value, as of the effective date of the plan' means that a stream of future payments must be discounted to present value. . . . The payment of interest is just a mathematical technique for ensuring that secured claim holder gets the present value of its claim while it waits for payments under the plan.").

23. The words "interest at the current fair market rate" do appear in section 362(d)(3). It has been argued that since Congress used that phrase in section 362(d)(3), but not in section 1129(b)(2)(A), section 1225(a)(5)(B)(ii), or section 1325(a)(5)(B)(ii), that Congress intended for "value, as of the effective date of the plan" to be different from the current fair market rate. See Robert Quila, *Cramdown Interest Rate: Second Circuit Court of Appeals Addresses What It Is and What It Is Not*, 6 J. BANKR. L. & PRAC. 549, 555 (1997). "Expressio unius, exclusio alterius" is a recognized statutory construction argument. See, e.g., *Burgo v. General Dynamics Corp.*, 122 F.3d 140 (2d Cir. 1997); *Ex parte Dunlop Tire Corp.*, Nos. 1951184, 1960105, 1997 WL 531095 (Ala. Aug. 29, 1997). In this instance, however, the argument is weakened by the fact that section 362(d)(3) was added to the Bankruptcy

the judicial opinions that apply these sections to cram down secured creditors.

III. UNITED STATES COURTS OF APPEALS DECISIONS ON CRAM DOWN INTEREST PRIOR TO *RASH*

One bankruptcy judge describes his colleagues' opinions setting the cram down interest rate as a "many-colored splendor of conflicting and sometimes indecipherable formulas."²⁴ And, there are reported bankruptcy court opinions to support almost any conceivable cram down interest rate.²⁵

There is much less diversity in the opinions from the ten courts of appeals that have issued opinions on cram down interest rates. None of the circuit court decisions has taken the position that "value, as of the effective date of the plan" should have a different meaning in Chapter 11 cases from its meaning in Chapter 12 and 13 cases.²⁶ And all of the circuit court decisions agree that the cram down interest rate should be a "market" rate. The disagreement is limited to the approach and methodology for determining what the market rate is.

Seven of the circuits—the Third, Fourth, Fifth, Sixth, Seventh, Tenth and Eleventh Circuits—have approved the calculation of cram down interest by looking to the rate that the debtor would pay outside of bankruptcy to obtain a loan on terms comparable to the terms proposed in the plan. This approach has been labeled the "coerced loan" approach.

Three of the circuits—the Second, Eighth and Tenth—have

Code in 1994 as a result of special interest lobbying efforts. See generally Dan Willenburg & Baxter Dunaway, *Single Asset Real Estate Cases after the Bankruptcy Reform Act of 1994*, 5 BANKR. DEV. J. 107 (1996) (reviewing treatment of single asset real estate cases under the 1994 amendments).

24. *In re Computer Optics, Inc.*, 126 B.R. 664, 671 (Bankr. N.H. 1991).

25. Compare, e.g., *In re Hardware*, 189 B.R. 273 (Bankr. E.D.N.Y. 1989) (New York judgment rate of 9%); and *In re Reinhardt*, 187 B.R. 433 (Bankr. N.D.N.Y. 1995) (contract rate of 17.99%); and *In re Miller*, 13 B.R. 110 (Bankr. S.D. Ind. 1981) (average of contract rate and market rate); and *In re Klein*, 10 B.R. 657 (Bankr. E.D.N.Y. 1981) (average of legal rate and contract rate); and *In re Hyden*, 10 B.R. 21 (Bankr. S.D. Ohio 1980) (average of 6% and the Ohio installments sales rate and the contract rate).

26. *But cf. Matter of Smithwick*, 121 F.3d 211 (5th Cir. 1997) (stating that expert testimony on valuation presented in certain Chapter 11 cases is not practice for the regular Chapter 13 case).

approved the calculation of cram down interest by looking to the sum of a base "risk-free" rate, such as the rate for treasury securities, for a duration comparable to the payout period under the plan plus an adjustment for risk. This approach has been labeled the "formula approach."

A. *Origins of the Coerced Loan Approach*

1. *Collier*.—The "coerced loan" approach is generally attributed to the Collier bankruptcy treatise.²⁷ As early as 1980, *Collier*²⁸ advocated a coerced loan approach to determining the secured creditor cram down interest rate in its discussion of section 1129(b)(2)(A):

It is submitted that deferred payment of an obligation under a plan is like a coerced loan and the rate of return with respect to such loan must correspond to the rate which would be charged or

27. 7 COLLIER ON BANKRUPTCY 81129.06(1)(c)(ii) (Rev. 15th ed. 1996); see also *In re Computer Optics, Inc.*, 126 B.R. 664, 671 (Bankr. N.H. 1991) ("[M]uch of the confusion in my judgment stems from additional reference in Collier to a 'coerced loan', in this context which has skewed analysis ever since."); C. Frank Carbiener, *Present Value in Bankruptcy: The Search for An Appropriate Cramdown Discount Rate*, 32 S.D. L. REV. 42, 51 (1987) ("The origin of this theory is not found in the case law but in the treatise, Collier on Bankruptcy.").

28. It is inaccurate and misleading to refer to *Collier* as if Collier is a person and the Collier bankruptcy treatise reflected the views of that person. In 1898, Collier was a person, William Miller Collier, a thirty-year old bankruptcy referee in Auburn, New York who wrote a treatise setting out his views on the Bankruptcy Act of 1898. See generally Honorable Prudence Beatty Abram & Andrew DeNatale, *From Referee to Bankruptcy Judge: A Century of Change in the Second Circuit, in THE DEVELOPMENT OF BANKRUPTCY AND REORGANIZATION LAW IN THE COURTS OF THE SECOND CIRCUIT OF THE UNITED STATES* 59, 67 (1995). Today, the Collier treatise has multiple editors and authors who work largely independent of each other. Accordingly, it is neither surprising nor significant that the author of the portion of Collier dealing with cram down interest in Chapter 13 was critical of the coerced loan approach while the author of the portion of Collier dealing with cram down interest rate in Chapter 11 was advocating the coerced loan approach and neither even acknowledged the position of the other. 5 COLLIER, *supra* note 27, at 81129.03. Cf. *In re Ivey*, 147 B.R. 109, 115 (Bankr. MD. N.C. 1992) (stating that Collier criticizes the coerced loan approach but has also caused much confusion surrounding the interest rate issue by reference to the coerced load theory). *But cf.* Quila, *supra* note 23, at 551 n.12 ("Without explanation, Collier advances a 'coerced loan' theory under Chapter 11 and a 'cost of funds' approach under Chapter 13. Both theories obviously cannot be correct. Therefore, courts that have relied on Collier regarding the coerced loan theory [but not courts that have relied on Collier regarding the cost of funds theory?] should be cited cautiously.") (citations omitted).

obtained by the creditor making a loan to a third party with similar terms, duration, collateral and risk. It is therefore submitted that the appropriate discount rate must be determined by reference to the "market" interest rate.²⁹

No cases were cited to support this statement. In 1980, no reported cases had considered this approach to fixing the cram down interest rate.

2. *Memphis Bank (Sixth Circuit)*.—In 1982, *Memphis Bank & Trust Co. v. Whitman*³⁰ was the initial circuit court opinion on the secured creditor cram down interest rate. Two months after obtaining a car loan at 21% interest, Ms. Whitman filed a Chapter 13 plan which provided that Ms. Whitman would retain the car and make monthly payments on Memphis Bank's secured claim at ten percent interest. Over the objection of the secured creditor, the Bankruptcy Court confirmed the plan. The district court affirmed. The Sixth Circuit reversed and remanded. The court's brief, two-paragraph discussion of the interest rate to be allowed on a secured claim in a cram down does not refer to legislative history, the *Collier* discussion of section 1129, or any other secondary authority.

Rather than tying the interest rate to an arbitrary ten per cent rate, the Bankruptcy Court's solution, or some other arbitrary rate, we hold that in the absence of special circumstances bankruptcy courts should use the current market rate of interest used for similar loans in the region. Bankruptcy courts are generally familiar with the current conventional rates on various types of consumer loans. And where parties dispute the question, proof can easily be adduced.

The reason we do not use an arbitrary rate is that such a rate may vary widely from the current market rate. The theory of the statute is that the creditor is making a new loan to the debtor in the amount of the current value of the collateral. Under this

29. 5 COLLIER ON BANKRUPTCY ¶ 1129.03(4)(f)(i) (15th ed. 1980). The authors of the current edition of *Collier* discuss, but do not advocate, the coerced loan approach. See 7 COLLIER ON BANKRUPTCY ¶ 1129.06(1)(c) (Rev. 15th ed. 1996). See also Walter J. Blum, *Treatment of Interest on Debtor Obligations in Reorganizations Under the Bankruptcy Code*, 50 U. CHI. L. REV. 430, 439 (1983) ("As an aid to analysis, one can think of impaired creditor classes in a reorganization as making new forced loans to the debtor entity.").

30. 692 F.2d 427 (6th Cir. 1982).

theory, the most appropriate interest rate is the current market rate for similar loans at the time the new loan is made, not some other unrelated arbitrary rate.³¹

3. *Southern States (Eleventh Circuit)*.—The next year, the Eleventh Circuit issued an opinion with a similar interpretation of “value, as of the effective date,” in *In re Southern States Motor Inns*.³² The bankruptcy court and the district courts confirmed a Chapter 11 plan which calculated the interest rate to be paid on unsecured priority federal taxes under section 1129(a)(9)(C)³³ at the statutory rate of interest for unpaid federal taxes less a one per cent reduction for “rehabilitation aspects” of Chapter 11. Reversing and remanding, the Eleventh Circuit stated:

We believe that Congress intended that creditors required to accept deferred payments pursuant to section 1129(a)(9)(C) should be placed in as good a position as they would have been had the present value of their claims been paid immediately. Consequently we hold that the interest rate to be used in computing present value of a claim pursuant to section 1129(a)(9)(C) should be the current market rate without any reduction for the “rehabilitation aspects” of the plan.³⁴

While *Southern States* involved the same statutory phrase as *Memphis Bank*, the issues were different. The objecting creditor in *Southern States* held a priority, unsecured tax claim against a Chapter 11 debtor, not a secured claim against a Chapter 13 debtor.

As a matter of bankruptcy policy, it would be hard to argue that the holder of an unsecured claim, even an unsecured priority claim, should receive a more favorable interest rate than the

31. *Memphis Bank*, 692 F.2d at 431.

32. 709 F.2d 647 (11th Cir. 1983).

33. 11 U.S.C. § 1129(a)(9)(C) states:

Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that . . .

(C) with respect to a claim of a kind specified in section 507(a)(8) [tax priority claims] of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.

11 U.S.C. § 1129(a)(9)(C) (1978) (emphasis added).

34. *In re Southern States Motor Inns*, 709 F.2d at 652.

holder of a secured claim. And, as a matter of bankruptcy law, it would be hard to argue that the phrase "value, as of the effective date of the plan" should have a different meaning in section 1129(a)(9)(C) from its meaning in section 1129(b)(2)(A)(i)(II) or in section 1325(a)(5)(B)(ii).³⁵ The *Southern States* opinion recognizes this commonality and relies on *Collier's* "coerced loan" analysis of section 1129(b)(2)(A)(i)(II) to support its holding.³⁶

*B. Circuit Court Decisions Prior to 1997 Approving a Formula Approach*³⁷

1. *Doud (Eighth Circuit)*.—The Eighth Circuit was the first of the circuits to approve a bankruptcy court's use of a formula approach to determining the cram down interest rate in *United States v. Doud*.³⁸ The Douds' Chapter 12 plan provided for installment payments on the Farmers Home Administration's (FmHA) secured claim, with an interest rate based on the

35. *But cf.* *Confederation Life Ins. v. Beau Rivage Ltd.*, 126 B.R. 632 (N.D. Ga. 1991). *Confederation Life* affirmed confirmation of a Chapter 11 plan that provided a cram down interest rate to a secured claim measured by the contract rate, rather than the higher market rate. In so holding, the district court distinguished *Southern States*: "The Eleventh Circuit in *Southern States* addressed section 1129(a)(9)(C) pertaining to delinquent federal tax claims rather than the type of secured creditor situation presented here." *Confederation Life*, 126 B.R. at 638.

36. *Southern States*, 709 F.2d at 652 n.7. The Eighth Circuit also recognized the commonality in relying on both *Southern States* and the *Collier* coerced loan analysis of section 1129(b)(2)(A)(i)(II) in its initial opinion on secured creditor cram down interest. *In re Monnier Bros.*, 755 F.2d 1336, 1338-39 (8th Cir. 1985). The case involved the cram down of a creditor who had made a secured loan with a 13% interest rate to the debtor prior to its bankruptcy filing. The debtor's Chapter 11 plan in effect reduced that interest rate to 10.5%, a rate based on United States treasury bill yields. Over the secured creditor's objection, the Bankruptcy Court confirmed the Chapter 11 plan. The district court reversed and ordered that the interest rate under the plan be the contract rate of 13%. The Eighth Circuit in its *Monnier Bros.* opinion affirmed the district court decision and stated: "Lacking any evidence correlating other rates with the 'coerced loan' approach contemplated by the plan, the district court did not err in reinstating the contract rate." *Monnier Bros.*, 755 F.2d at 1339. The Eighth Circuit also later affirmed that "value, as of the effective date of the plan," has the same meaning throughout the Bankruptcy Code. *See United States v. Neal Pharmacal Co.*, 789 F.2d 1283, 1285 (8th Cir. 1986) (relying on *Monnier Bros.* in a section 1129(a)(9)(C) case).

37. *In re Valenti*, 105 F.3d 55 (2d Cir. 1997), also approved the formula approach. It is considered separately, *infra* at text accompanying notes 82-94.

38. 869 F.2d 1144 (8th Cir. 1989).

treasury bill rate plus a one percent risk factor. The FmHA objected, and the bankruptcy court held that the cram down interest rate in the plan should be based on the "yield on a treasury bond with a remaining maturity matched to the average amount outstanding during the term of the allowed claim plus a two percent adjustment for risk."³⁹ The debtors appealed, and both the district court and the Eighth Circuit affirmed.

In approving the formula approach to cram down interest rate, *Doud* discusses several bankruptcy court decisions that take this approach but relies primarily on an earlier Eighth Circuit decision, *In re Monnier Brothers*.⁴⁰ In that case, the Eighth Circuit affirmed the bankruptcy court's confirmation of a Chapter 11 plan that provided for cram down interest at the pre-bankruptcy contract rate. The *Monnier Brothers* opinion, however, uses the language and the reasoning of the formula approach: the court found that the contract rate is the appropriate base rate and that there were no new risks to merit an additional risk premium.⁴¹

The *Doud* opinion does not refer to the *Memphis Bank* or *Southern States* decisions. It does not reject or even discuss the coerced loan approach.

2. *Fowler (Ninth Circuit)*.—The Ninth Circuit has also approved a bankruptcy court's formula approach to determination of the cram down interest rate in a Chapter 12 case, in *In re Fowler*.⁴² While *Fowler* mentions the *Memphis Bank* decision and acknowledges two methods of determining a market cram down rate,⁴³ the opinion does not give reasons for its approval of the formula approach and does not preclude a bankruptcy court's use of the coerced loan approach in other cases. *Fowler's* holding is simply that in this case the bankruptcy court "did not

39. *In re Dowd*, 4 B.R. 865, 870 (Bankr. S.D. Iowa 1987), *aff'd*, 869 F.2d 1144 (8th Cir. 1989).

40. 755 F.2d 1336 (8th Cir. 1985).

41. *Monnier Bros.*, 755 F.2d at 1339.

42. 903 F.2d 694 (9th Cir. 1990). The court in *Fowler* reads an earlier Ninth Circuit case on section 1129(a)(9)(C) interest on deferred payment of priority tax claims, *United States v. Camino Real Landscape Maintenance Contractors, Inc.*, 818 F.2d 1503 (9th Cir. 1987), as approving the use of the formula approach. *Fowler*, 903 F.2d at 696.

43. *Id.*

err in using this [the formula] approach to determine the cramdown interest rate."⁴⁴

C. Circuit Court Decisions Comparing Approaches

1. *Hardzog (Tenth Circuit)*.—The Tenth Circuit decision, *In re Hardzog*,⁴⁵ was the first opinion by a circuit court that discusses both the coerced loan and formula methods of determining the cram down interest rate. The Chapter 12 debtor in *Hardzog* had a farm mortgage that provided for interest at a rate of 12.5%. The original Chapter 12 plan provided for deferred payments of the secured claim with an interest rate of 7.5%.

Over the objection of the secured creditor, the Bankruptcy Court confirmed a modified plan which called for an interest rate of 10%. In establishing the cram down interest rate at 10%, the Bankruptcy Court determined the secured creditor's cost of funds at 9.3% and added .7% as a risk factor.⁴⁶ The district court affirmed.⁴⁷

In reversing and remanding, the Tenth Circuit expressly rejected the "cost of funds" approach in *United States v. Doud* and expressly mandated that bankruptcy courts use the "current market rate of interest used for similar loans in the region" in fixing the secured creditor cram down interest rate.⁴⁸ *Hardzog* gave a number of reasons for so ruling: (1) "A 'cost of funds' approach is not susceptible of accurate determination without complex problems of proof and may not result in fairness;"⁴⁹ (2) "Bankruptcy Courts, counsel, lenders and borrowers should have a familiarity with current interest rates on like-type loans and when a dispute arises, the market rate should be easily susceptible of determination . . .";⁵⁰ and (3) "Chapter 12 is predicated

44. *Id.* at 698.

45. 901 F.2d 858 (10th Cir. 1990).

46. There is a list of ten items that the Bankruptcy Court considered in fixing the risk factor of .7%. *Hardzog v. Federal Land Bank*, 113 B.R. 718, 722 (W.D. Okla. 1989). Finding a "plug" number that would result in an interest rate midway between the 7.5% prepared by the debtor, and the 12.5% demanded by the secured creditor, was not on the list.

47. *Hardzog*, 113 B.R. at 718.

48. *Hardzog*, 901 F.2d at 860.

49. *Id.*

50. *Id.*

upon the theory that the lender is making a new loan to the debtor. It therefore follows that the most appropriate rate is the current market rate for similar loans⁵¹

2. *United Carolina (Fourth Circuit)*.—In *United Carolina Bank v. Hall*,⁵² the Fourth Circuit expressly adopted the coerced loan approach taken by the Tenth Circuit in *Hardzog* and by the Sixth Circuit in *Memphis*, expressly rejected the approach taken by the Eighth Circuit in *Doud* and the Ninth Circuit in *Fowler*, and evaluated the two approaches. *United Carolina*, however, “reads” *Doud* and *Fowler* as basing cram down interest on what the secured creditor has to pay to borrow funds on the assumption that the secured creditor will borrow new funds to replace the money tied up in the bankruptcy by the plan.⁵³ According to *United Carolina*:

A major difficulty with this approach, often referred to as the cost of funds approach, however, is its underlying assumption that the secured creditor has an unlimited supply of credit. When it is recognized that every secured creditor has a limited amount of credit on which to draw, then it follows that utilizing some of that borrowing capacity without providing the secured creditor with the usual return on its capital produces a loss for the secured creditor.⁵⁴

There are other difficulties with the cost of funds approach. A cram down interest rate measured by the costs of funds ignores the risks that the debtor will not make the payments proposed in the plan.⁵⁵ In measuring the cram down interest

51. *Id.*

52. 993 F.2d 1126 (4th Cir. 1993).

53. *United Carolina Bank*, 993 F.2d at 1130. I disagree with this characterization of *Doud* and *Fowler*. The formula approved in these cases can better be described as approximating the debtor's cost of funds than the secured creditor's cost of funds. See *General Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 68 n.9 (3d Cir. 1993).

54. *United Carolina Bank*, 993 F.2d at 1130.

55. In theory, if a lender had a substantial portion of its assets invested in a secured loan to the debtor, then its costs of credit would reflect the debtor's creditworthiness and the risks of nonpayment by the debtor. See Michael E.S. Frankel, *The Emerging Fixed Cramdown Rate Regime: A Market-Driven Argument for Effective Fixed Rates in Bankruptcy Cramdown*, 2 U. CHI. L. SCH. ROUNDTABLE 643, 647 (1995).

rate on the costs of funds to the creditor, the focus is on the creditworthiness of the creditor, not the creditworthiness of the debtor. The cost of funds to United Carolina Bank turns on factors such as its capital, the efficiency of its operation, and its credit history. United Carolina Bank's cost of funds does not reflect Loretta A. Degolier Hall's capital, her efficiency, or her credit history.

Moreover, by focusing on the creditworthiness of the creditor, a cram down interest rate based on the cost of funds approach in essence rewards a lender for being inefficient or poorly capitalized. More efficient and better capitalized lenders will have lower costs of funds. Under the cost of funds approach, if Ms. Hall not only financed her mobile home purchase with United Carolina Bank but also financed her car purchase with Friendly Finance Company and proposed to cram down both United Carolina's and Friendly Finance's secured claim in her Chapter 13 plan, the cost of funds approach might result in Friendly Finance receiving a higher cram down interest rate on its secured claim than United Carolina for reasons unrelated to the rates of interest in their prebankruptcy contracts and unrelated to the risks presented by their postbankruptcy cram downs.

3. *Jones (Third Circuit)*.—*General Motors Acceptance Corp. v. Jones*⁵⁶ is the most-cited circuit court decision on cram down interest rates. Mr. Jones purchased a truck pursuant to a financing agreement with GMAC providing for 11.98% interest. His Chapter 13 plan proposed that Mr. Jones would retain the truck and make periodic payments to GMAC on its secured claim at 10% interest. The bankruptcy court confirmed the plan, over GMAC's objection, using a cost of funds approach to cram down interest rates, with the prime rate as the presumptive cost of funds.⁵⁷ The district court affirmed without opinion. The Third Circuit reversed and remanded, adopting a coerced loan approach to cram down interest rates, with the contract rate as the presumptive coerced loan rate.⁵⁸

56. 999 F.2d 63 (3d Cir. 1993).

57. See *In re Jordan*, 130 B.R. 185, 190-192 (Bankr. N.J. 1991).

58. *Jones*, 999 F.2d at 67-68.

In so ruling, the Third Circuit compares the formula approach, the cost of funds approach, and the coerced loan approach. According to *Jones*, the "coerced loan [approach] presents a more complete picture of what happens in a cramdown"⁵⁹ because:

(i) present value requires that the secured creditor be put in an economic position equivalent to receiving the amount of its secured claim immediately;

(ii) present value should thus include the additional amounts that the secured creditor could generate in its business if the plan provided for immediate rather than deferred payment of its secured claim;

(iii) if the secured creditor received immediate payment and made a new loan, it would anticipate that over the course of the loan it would recover not only its costs of capital but also its costs of servicing the loan and a profit.⁶⁰

In so ruling, the Third Circuit acknowledges that a coerced loan in a bankruptcy cram down is not the "precise equivalent" of a new loan outside of bankruptcy.⁶¹ Arguably, the coerced loan is *less* costly because of the absence of any loan marketing costs and lower loan monitoring costs.⁶² And arguably, the coerced loan is *more* costly because cram down coerced loans, unlike the typical new loan, are loans without an "equity cushion" and because a Chapter 11, 12, or 13 debtor has a more problematic credit history than the borrower in a new loan.⁶³ *Jones* concludes that "the elements that would tend to make 'coerced loans' more costly to the secured creditor than new loans, and the elements that would tend to make 'coerced loans' less costly to the secured creditor than new loans will generally balance out"⁶⁴

The *Jones* opinion also acknowledges the bankruptcy court's objection to profit as a component of the cram down interest rate: "[P]rofit is not an appropriate factor to consider in determining present value in a Chapter 13 case."⁶⁵ The Third

59. *Id.* at 67.

60. *Id.* at 66-67.

61. *Id.* at 68.

62. *Id.*

63. *Jones*, 999 F.2d at 68.

64. *Id.* at 69.

65. *In re Jordan*, 130 B.R. 145, 189 (Bankr. N.J. 1991); see also *In re Valenti*,

Circuit's *Jones* opinion does not contain the bankruptcy court's one-sentence "explanation" for its "no profit" statement: "The Bankruptcy Code protects the creditor's interest in the property, not the creditor's interest in the profit it had hoped to make on the loan."⁶⁶

While this sentence might be relevant and helpful to an understanding of some provisions of the Bankruptcy Code, such as section 362(d), which deal with "adequate protection" of interest in property, it is neither relevant nor helpful to an understanding of the Bankruptcy Code's cram down provisions which deal with present value of payments under a plan. In a cram down, the secured creditor is seeking payment, not "protection." And in a cram down, the secured creditor is not asking for payment of the "profit it had hoped to make on the [pre-bankruptcy] loan." Rather, the secured creditor is asking for payment of the profits that it would have made from its postbankruptcy use of the amount of its secured claim if the debtor had paid its secured claim in cash instead of using the Bankruptcy Code's cram down power to defer payment of the secured claim.⁶⁷

As the Third Circuit explains in *Jones*, recognition of profit is consistent with the objective of section 1325(a)(5)(B)(ii) of putting "the creditor in the same position it would have been in if it had been allowed to end the lending relationship at the point of the bankruptcy filing by repossessing the collateral"⁶⁸ The creditor would have reinvested the proceeds in a

105 F.3d 55, 63 (2d Cir. 1997) ("There is no reason, therefore, that the interest rate should account for profit."); *In re Hudock*, 124 B.R. 532, 534 (Bankr. N.D. Ill. 1991) ("[T]he Bankruptcy Code protects the creditor's interest in the property, not the creditor's interest in the profit it had hoped to make on the loan."); LUNDIN, *supra* note 4, at 5-149; C. Frank Carbiener, *Present Value in Bankruptcy: The Search for An Appropriate Cramdown Discount Rate*, 32 S.D. L. REV. 42, 60 (1986) ("[A]llowing creditors to collect profit clearly violates the Code objective of treating all creditors fairly, and it should not be allowed."); Todd J. Zywicki, *Cramdown and the Code, Calculating Cramdown Interest Rates Under The Bankruptcy Code*, T. MARSHALL L. REV. 241, 255-56 (1994) ("Profit' from the loan is also impermissible."). *But see In re Arnold*, 80 B.R. 806, 810 (Bankr. M.D. La. 1987) ("While the author [Carbiener] of the law review article may have some personal objection to a lender making a profit, I am under a duty to interpret a statute rather than to indulge my preference, and I find no authority for such a proposition in the Bankruptcy Code. . . .").

66. *Jordan*, 130 B.R. at 189.

67. *Id.*

68. *Jones*, 999 F.2d at 69.

new loan with a profit component.

4. *Koopmans (Seventh Circuit)*.—*Koopmans v. Farm Credit Services of Mid-America, ACA*⁶⁹ has been described as an opinion that “adopted a ‘cost funds’ approach”⁷⁰ and has also been described as one of “[t]he leading cases articulating the ‘coerced loan’ view. . . .”⁷¹ It can better be described as a case that approves a bankruptcy court’s use of the formula approach but that does not require bankruptcy courts to use any particular approach to determine the market rate.⁷²

The *Koopmans* filed a Chapter 12 plan that proposed to retain their family farm worth more than \$200,000 and make periodic payments to Farm Credit Services which held a \$110,000 first mortgage on the farm. Farm Credit Services objected to the plan’s interest rate on the periodic payments of 6.9%, based on the treasury bill rate. In an unreported opinion, the bankruptcy court held that the appropriate cram down interest rate was 10.5%, based on the prime rate of interest of 9% which the court found was the prevailing market rate for well-secured farm loans, plus a 1.5% additional risk factor because of the *Koopmans*’ credit history.

The district court and Seventh Circuit affirmed. While the bankruptcy court’s decision could be classified as a “formula approach” decision, both the district court⁷³ and the Seventh Circuit⁷⁴ use the phrase “coerced loan” to describe the bankruptcy court’s methodology. More important than commentators’ classification of the Seventh Circuit’s *Koopmans* decision or the Seventh Circuit’s classification of the bankruptcy court’s *Koopmans* decision are (i) the Seventh Circuit’s discussion of profit, (ii) the Seventh Circuit’s view of the critical cram down interest rate question, and (iii) its answer to that question.

Koopmans addresses the objection to a cram down interest

69. 102 F.3d 874 (7th Cir. 1996).

70. Timothy D. Moratzka, *Chapter 13 Interest Rate Pegged to Treasury Rate in Second Circuit*, 14 AM. BANKR. INST. J. 16 (Apr. 1997).

71. Qulia, *supra* note 23, at 551 n.11.

72. Cf. Robert M. Fishman & Brian L. Shaw, *Koopmans: The End Justifies the Means*, NORTON BANKR. L. ADVISER, Apr. 1997, at 15-17.

73. *Koopmans v. Farm Credit Serv.*, 196 B.R. 425, 428 (N.D. Ind. 1996).

74. *Koopmans*, 102 F.3d at 875.

rate that includes profit by analogizing a secured creditor subjected to a Chapter 12 cram down to other suppliers.⁷⁵ The Seventh Circuit notes that a seed supplier or other supplier to a Chapter 12 debtor post-petition can receive its market price, including profit; there is no bankruptcy rule prohibiting suppliers to Chapter 12 debtors from receiving a profit.⁷⁶ Similarly, a secured creditor subjected to a cram down, who in essence is an involuntary supplier of capital to a Chapter 12 debtor, can receive its market rate, including a profit.⁷⁷

According to *Koopmans*, the question that a court must answer in determining the cram down interest rate is: "At what rate of interest, will Farm Credit Services be as well off in the reorganization as if it had been allowed to foreclose on and sell the farm?"⁷⁸ Under the *Koopmans* facts, a \$110,000 claim secured by property worth more than \$200,000, Farm Credit Services would have received the full amount of its secured claim of \$110,000 if it had been allowed to foreclose. Thus, the *Koopmans* question asks what rate of interest will result in the secured creditor being as well off as if it had received the immediate, full cash payment of its secured claim.⁷⁹ The Seventh Circuit then

75. *Id.* at 876.

76. *Id.*

77. *Id.* Judge Easterbrook also provides an economic analysis of the profit issue: "[I]n competition, a financial intermediary does not make a 'profit.' True, there may be accounting profits, but there are no economic profits in vigorous competition, one of Adam Smith's principal points in *The Wealth of Nations* (1776). See generally GEORGE J. STIGLER, *THE THEORY OF PRICE* 178-92 (4th ed. 1987). Normal returns to entrepreneurial and managerial skills may keep the wolf from the door, but they are not economic 'profit.'" *Id.*

78. *Koopmans*, 102 F.3d at 874.

79. The wording of this question (and the wording of the Seventh Circuit's answer to its question) becomes problematic in the more typical cases in which the creditor is undersecured. For example, consider again the facts of *Rash*, discussed in the text, *infra* at at 459-60. There, a truck with a foreclosure value of less than \$32,000 secured a debt of more than \$41,000. Because the debtor's Chapter 11 plan proposed to retain the truck, the Court found that Associates' secured claim is measured by the truck's replacement value of \$41,000 and not its foreclosure value of \$32,000. Reading and applying the words of the *Koopmans* question ("as if it had been allowed to foreclose on and sell") would mean that the cram down interest rate in the *Rashes*' Chapter 13 plan would have to produce the same amount that Associates would have realized had it received the \$32,000 foreclosure value in cash at the time of plan confirmation. Reading and applying the words of section 1325(a)(5)(B)(ii) and the *Rash* decision literally would mean that the cram down interest rate in the *Rashes*' Chapter 13 plan would produce the same amount that

answers this question in general terms: "[T]he creditor [in a cram down] is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk."⁸⁰ The Seventh Circuit prefaces this answer by expressly noting that it is not even "implying [that the method used by the bankruptcy court] is the only way to approximate the market rate of interest"⁸¹

5. *Valenti (Second Circuit)*.—*General Motors Acceptance Corp. v. Valenti*⁸² is the last circuit court decision to consider the various approaches for determining the cram down interest rate prior to the Supreme Court's decision in *Rash*. *Valenti* is also the only circuit court decision on cram down interest rate that directly and expressly rejects the coerced loan approach as a possible measure of the cram down interest rate.⁸³

The Valentis had purchased a car in 1993 and financed the purchase with General Motors Acceptance Corporation (GMAC) on an installment sales contract with an interest rate of 12.95%. In 1994, they filed a Chapter 13 petition and a plan proposing to

Associates would have realized had it received its \$41,000 secured claim in cash at the time of the plan confirmation. Accordingly, the Seventh Circuit's question should be reframed: "At what rate of interest will a secured creditor be as well off as if it had been paid the full amount of its secured claim in cash?"

80. *Koopmans*, 102 F.3d at 875.

81. *Id.*

82. 105 F.3d 55 (2d Cir. 1997); see generally Qulia, *supra* note 23, at 549 (asserting that while many courts have adopted the ambiguous statutory language of the coerced law theory to reach perceived "fair" results that are unsupported by the Bankruptcy Code, the *Valenti* decision was faithful to the Code and was economical for debtors, creditors and the judiciary); John J. Rapisardi, *Cramdown Interest Rates: Should Lender's Profits Be Included?* N.Y. L.J., June 5, 1997 at 1 (comparing the *Valenti* decision to the *Koopmans* decision).

83. The Eighth Circuit in *Doud* and the Ninth Circuit in *Fowler* approve a bankruptcy court's use of a formula approach. *Supra* notes 38-44 and accompanying text. Neither requires a bankruptcy court to use the formula approach in all cases. Neither expressly precludes bankruptcy courts from using the coerced loan approach. Three other reported cases from the Eighth Circuit look to comparable loans in fixing "present value." See *United States v. Roso*, 76 F.3d 179 (8th Cir. 1996); *United States v. Neal Pharmacal Co.*, 789 F.2d 1283 (8th Cir. 1986); *United States Dept of Agric. v. Fisher*, 930 F.2d 1361, 1363 (8th Cir. 1991). There is an arguably somewhat similar division in Ninth Circuit cases. See *In re Camino Real Landscape Maintenance Contractors*, 818 F.2d 1503, 1508 (9th Cir. 1987) (Chapter 11 case under section 1129(a)(9)(C) (deferral of federal taxes), requiring the bankruptcy court to look to the rate on similar loans in the open market).

retain the car and make installment payments to GMAC at 8% interest. GMAC objected; the bankruptcy court fixed the cram down interest rate at 9% and confirmed the plan without issuing an opinion. In affirming, the district court concluded that section 1325 contemplates "market rate interest," and "the relevant market rate . . . is the rate paid by GMAC for the funds it borrows."⁸⁴

The Second Circuit vacated the district court's holding on interest and remanded for a recalculation based on (i) the rate of United States treasury instrument with a maturity similar to the plan repayment schedule and (ii) a risk premium.⁸⁵ *Valenti* described the district court's "cost of funds," approach as the approach that "more appropriately reflects the present value of a creditor's allowed claim" but rejected the costs of funds approach because of problems in its application.⁸⁶ Because each lender has a different costs of funds, Chapter 13 debtors would pay different interest rates for reasons unrelated to the debtors' creditworthiness and each proceeding would require an evidentiary hearing on the creditor's costs of funds.⁸⁷

Valenti also expressly rejected the coerced loan approach:

We believe that courts adopting the "forced loan" approach misapprehend the "present value" function of the interest rate. The objective of section 1325(a)(5)(B)(ii) is to put the creditor in the same economic position that it would have been in had it received the value of its allowed [sic] claim immediately. The purpose is not to put the creditor in the same position that it would have been in had it arranged a "new" loan.⁸⁸

The second and third sentences from the above excerpt seem inconsistent. In *Valenti*, if GMAC had "received the value of its allowed claim"⁸⁹ immediately, it would have used the funds it

84. *General Motors Acceptance Corp. v. Valenti*, 191 B.R. 521, 522 (N.D.N.Y. 1995), *aff'd*, 105 F.3d 55 (2d Cir. 1997).

85. *Valenti*, 105 F.3d at 64.

86. *Id.*

87. *Id.* at 63.

88. *Id.* at 63-64.

89. The Second Circuit's use of the phrase "allowed claim" in *Valenti* is somewhat imprecise. Section 1325(a)(5)(B)(ii) refers to "such claim", i.e., the secured claim. A creditor's secured claim can be different from its "allowed claim." Often a creditor has both an allowed secured claim and an allowed unsecured claim. Section 506(a) limits a secured claim to the value of the collateral which secures it and the balance

received to arrange a new loan to some third party. GMAC's return from that new loan would reflect not only GMAC's costs of funds but also its other costs and risks and a profit.

Bankruptcy courts in the Second Circuit cannot follow the mandate of the second sentence from *Valenti* without violating the mandate of the third sentence from *Valenti*. Bankruptcy courts cannot put a creditor like GMAC "in the same economic position that it would have been in had it received the value of its allowed [sic] claim immediately" without putting it "in the same position that it would have been in had it arranged a 'new' loan."⁹⁰

The above excerpt from the *Valenti* opinion is not only internally inconsistent but is also inconsistent with the opinion of the Seventh Circuit in *Koopmans*. A comparison of *Valenti* with *Koopmans* illustrates the diversity in the rhetoric, if not reasoning, of the circuit courts' opinions on cram down interest rates prior to the Supreme Court's *Rash* decision.

Valenti condemns any "profit" component in a cram down interest rate.⁹¹ *Koopmans* alternatively approves a profit component and questions whether there can even be an economic profit in any interest rate.⁹² *Valenti* mandates bankruptcy courts' use of the "formula approach" in determining the appropriate cram down interest rate.⁹³ *Koopmans* expressly refrains from even implying which bankruptcy approach courts should use in determining the appropriate cram down interest rate in other cases.⁹⁴ And yet arguably, the Second Circuit, like the Seventh Circuit, would have approved the bankruptcy court's use of the prime plus 1.5% formula under the facts of *Koopmans*,

of the debt is an unsecured claim. See generally David Gray Carlson, *Bifurcation of Undersecured Claims in Bankruptcy*, 70 AM. BANKR. L.J. 1 (1996) (describing consequences of Section 596 bifurcation). In *Valenti*, the bankruptcy court valued GMAC's collateral at \$6,700, the average of its wholesale and retail prices so that GMAC had an allowed secured claim of \$6,700 and an allowed unsecured claim for the balance owed by the Valentis. Section 1325(a)(5)(B)(ii) and the *Valenti* opinion address only the present value of the debtors' proposed deferred payments of the \$6,700 secured claim.

90. *Valenti*, 105 F.3d at 63-64.

91. *Id.* at 64.

92. *Koopmans*, 102 F.3d at 876.

93. *Valenti*, 105 F.3d at 64.

94. *Koopmans*, 102 F.3d at 875.

and the Seventh Circuit, like the Second Circuit, would have reversed and remanded the lower courts' cost of funds approach to cram down interest rates in *Valenti*.

IV. SUPREME COURT *RASH* DECISION ON CRAM DOWN OF SECURED CREDITORS

On July 6, 1997, the Supreme Court addressed the issue of how to measure the value of collateral in the context of a Chapter 13 cram down plan in *Associates Commercial Corp. v. Rash*.⁹⁵ The petition for certiorari in *Rash* presented the question:

Whether, when a debtor proposes to retain a secured creditor's collateral under the cramdown powers of Chapter 13 of the Bankruptcy Code, the amount required to be paid on account of the creditor's secured claim is limited to the value that the secured creditor could have obtained if it had sold the collateral at foreclosure.⁹⁶

In *Rash*, the Chapter 13 debtors wanted to retain their tractor truck. Associates held a lien on the truck. The Rashes filed a Chapter 13 plan that proposed deferred payments to Associates at 9% interest based on the net foreclosure value of the truck, \$31,875. Associates objected and argued that its secured claim should be based on the replacement value of the truck, \$41,000.

The Bankruptcy Court agreed with the Rashes and fixed the amount of Associates' secured claim at \$31,875, the net amount Associates would realize on foreclosure.⁹⁷ The district court affirmed in an unreported decision. A panel of the Court of Appeals for the Fifth Circuit reversed,⁹⁸ holding "the replacement cost approach is the only one that gives full effect to the language of section 506(a)."⁹⁹ Initially, the Fifth Circuit in a 2-1

95. 117 S. Ct. 1879 (1997).

96. Brief of Petitioner at i, *Associates Commercial Corp. v. Rash*, 117 S. Ct. 1879 (1997) (No. 96-454).

97. *In re Rash*, 149 B.R. 430 (Bankr. E.D. Tex. 1993).

98. *Associates Commercial Corp. v. Rash (In re Rash)*, 31 F.3d 325 (5th Cir. 1994).

99. *Rash*, 31 F.3d at 329.

decision denied a petition for panel rehearing.¹⁰⁰ Then, the court granted such a petition,¹⁰¹ and on rehearing *en banc*, the Fifth Circuit affirmed the bankruptcy court and the district court, holding that Associates' secured claim was limited to the \$31,875 net foreclosure value.¹⁰² The Supreme Court reversed the Fifth Circuit panel and held that the replacement value standard and not the foreclosure value standard governs in cram down cases.¹⁰³ The Court based its holding on the language of section 506.¹⁰⁴

In the *Rash* case, Associates did not object to the proposed 9% cram down interest rate. The question of the proper method for determining "value, as of the effective date of the plan" was not raised by Associates nor considered by the Court. The *Rash* decision addresses solely the question of valuation of collateral under section 506, not the question of valuation of deferred payments under section 1325.

Even though the Court addressed a different question under a different section of the Bankruptcy Code, attorneys for debtors, attorneys for secured creditors, and bankruptcy judges, will creatively use the *Rash* decision to support their positions on questions of cram down interest rates.¹⁰⁵ The policy choice made by the Court in *Rash* and the Court's choice of particulars in a footnote in *Rash* provide two examples of possible arguments.

First, the policy question resolved in *Rash* is the same as the policy question raised in litigation over cram down interest rates: should a debtor in bankruptcy be able to obtain better than market terms because of bankruptcy? In *Rash*, the debtors

100. *In re Rash*, 62 F.3d 685 (5th Cir. 1995).

101. *In re Rash*, 68 F.3d 113 (5th Cir. 1995).

102. *In re Rash*, 90 F.3d 1036 (5th Cir. 1996).

103. *Rash*, 117 S. Ct. 1879 (1997).

104. *Id.* at 1884-86.

105. Compare *In re Segura*, No. 97-03289-R, 1998 WL 97812, *8 (Bankr. N.D. Okla. Mar. 5, 1998) (Judge Rasure finds that *Rash* supports a coerced loan approach stating: "This 'replacement lender' theory is consistent with the policy articulated in *Hardzog* . . . and is also complimentary to *Rash* in that the 'new' transaction is viewed from the debtor's perspective for both valuation and interest rate determinations."), and *In re Goodyear*, No. 94-10645, 96-10014, 1998 WL 58528, *3 (Bankr. Vt. Feb. 3, 1998) (Judge Conrad finds that *Rash* supports a formula approach stating: "*Rash* shifted compensation for the risk to default from the 'interest' component of 'value' to the valuation component.").

it would cost them to obtain a similar truck on the open market. In *Valenti* and the other cram down interest rate cases, the debtors were seeking to retain the use of a creditor's funds by paying less than what it would cost them to obtain similar funds on the open market. Secured creditors may argue that since *Rash* looks to the replacement costs of the truck in determining the amount of the secured claim, courts should now look to the replacement costs of new funds in determining "value, as of the effective date of the plan."

There are at least two flaws in any such argument. First, the *Rash* decision is based on statutory interpretation, not policy.¹⁰⁶ The *Rash* opinion focuses on and is largely limited to the meaning of language in the Bankruptcy Code. Second, the statute interpreted in *Rash*, section 506, provides that valuation of the collateral turns on "the proposed disposition or use of such property," and the Court relied on that language in concluding that "the replacement-value standard accurately gauges the debtor's 'use' of the property."¹⁰⁷ Section 506 refers to the debtor's use. Section 506 views the issue of valuation of the collateral for purposes of determining the amount of the secured claim from the debtor's perspective. Section 1325(a)(5)(B)(ii) does not contain comparable language. Section 1325(a)(5)(B)(ii) does not suggest a debtor perspective.

Language contained and not contained in footnote 6 of the *Rash* opinion can be the basis of other arguments on cram down interest rates. That footnote states in relevant part:

For example, where the proper measure of the replacement value of a vehicle is its retail value, an adjustment to that value may be necessary: A creditor should not receive portions of the retail price, if any, that reflect the value of items the debtor does not receive when he retains his vehicle, items such as warranties, inventory, storage and reconditioning.¹⁰⁸

106. *Rash*, 117 S. Ct. at 1884 ("[t]he Bankruptcy Code provision central to the resolution of this case is § 506(a)"). *Id.* at 1886 ("Whatever the attractiveness of a standard that picks the midpoint between foreclosure and replacement values, there is no warrant for it in the Code."). See also Brief for the United States as Amicus Curiae Supporting Petitioner, *Associates Commercial Corp. v. Rash*, No. 96-454, 1997 WL 82686, at *12 (referring to case law interpreting section 506(a)).

107. *Id.* at 1885.

108. *Id.* at 1886-87 n.6 (citations omitted).

inventory, storage and reconditioning.¹⁰⁸

The debtor or Chapter 13 trustee can argue from footnote 6 that if the present value of deferred payments under a plan are based on the coerced loan approach, then the creditor should not receive portions of the interest rate on such a loan that reflect costs that the creditor does not incur such as marketing costs. And, the secured creditor can argue from footnote 6 that exclusion of "profits" from the list of excluded items means that present value can include profit.

While the *Rash* opinion will be a source to lawyers for arguments in proceedings challenging the cram down interest rate in Chapter 11, 12, and 13 cases, it does not provide a basis for judges to determine the appropriate cram down interest rate. At most, *Rash* will affect the explanations judges offer for their cram down interest rate determinations. Because of the Supreme Court's emphasis on construction of statutory language and disregard of considerations of efficient case administration,¹⁰⁹ it would seem that future opinions will not explain their holdings on cram down interest rates in terms such as "because it is easy to apply, it is objective, and it will lead to uniform results."¹¹⁰

V. CALCULATING¹¹¹ CRAM DOWN INTEREST RATE AFTER *RASH*

A. *The Fifth Circuit's Approach(es?)*

Since the *Rash* decision, the United States Court of Appeals for the Fifth Circuit has issued two opinions on the cram down interest rate, *Financial Security Assurance, Inc. v. T-H New*

108. *Id.* at 1886-87 n.6 (citations omitted).

109. *Id.* at 1886.

110. This is the language of the *Valenti* decision. 105 F.3d at 64. See also the "real bad loser" language in the introductory note. The language of the Fifth Circuit in *In re Smithwick*, 121 F.3d 211, 214 (5th Cir. 1997) ("greater need to reduce litigation expenses associated with an individualized discount rate determination") suggests that I am also a real bad predictor of what judges will do.

111. Cf. WEBSTER'S DICTIONARY OF SYNONYMS 675 (1951) ("*rash*, daring, daredevil, reckless, temerarious, fool-hardy, adventurous, venturous, venturesome. *Ana.* Precipitate, abrupt, impetuous, sudden, hasty, desperate, forlorn. Ant. Calculating.") (emphasis added).

Orleans Limited Partnership,¹¹² a Chapter 11 case, and *In re Smithwick*,¹¹³ a Chapter 13 case. Both cases cited to the *Rash* decision; neither case relied on *Rash* in affirming bankruptcy court rulings that the rate of interest in the debtor's prepetition contract with the lender was an appropriate cramdown interest rate; and each case provides helpful insights for calculating the cram down interest rate.

In *T-H New Orleans*, the debtor's Chapter 11 plan proposed a cram down interest rate of 8.45%, based on a formula approach. The debtor's expert witness came up with the 8.45% interest rate by adding 210 basis points to the rate for two-year treasury instruments. While the debtor's hotel financing expert in *T-H New Orleans* somehow came up with the number 210, he could not on cross-examination come up with the name of a lender to whom he would recommend making such an 8.45% loan to the debtor. The Fifth Circuit agreed with the court that "this interest rate would not adequately compensate FSA for not receiving its money on the Plan's effective date."¹¹⁴

The add-on factors in *T-H New Orleans* and in most of the cases discussing the formula approach seem arbitrary. A reviewer of the Chapter 11 formula approach cases concluded:

Not one of the reported decisions, discussing what 'risk factor' should be added to a base rate, has even analyzed the probability and magnitude of actual risk. Decisions may generally discuss the condition of the debtor or the collateral, especially whether there is an equity cushion, but an objective basis for quantifying the risk factor is rarely developed.¹¹⁵

Judge Lundin reached a similar conclusion as to the Chapter 13 cases that use the formula approach: "The add-on factors used by many courts seem to be arbitrary and certainly do not represent the financial market's true evaluation of the risk involved in the various kinds of loans that are forced on lenders in Chapter 13 cases."¹¹⁶

112. 116 F.3d 790 (5th Cir. 1997).

113. 121 F.3d 211 (5th Cir. 1997).

114. *T-H New Orleans*, 116 F.3d at 800.

115. Jack Friedman, *What Courts Do to Secured Creditors in Chapter 11 Cram Down*, 14 CARDOZO L. REV. 1495, 1521 (1993).

116. 2 LUNDIN, *supra* note 4, at 5-147.

Commentators have also been critical of the accuracy and validity of the coerced loan approach. According to a recent article on cram down interest rates in Chapter 11 cases co-authored by Judge Pearson, Dillon Jackson and Tim Nohr:

Indeed, in no reported case has a court concluded, based on evidence presented, that any actual market exists in which a lender makes loans to debtors under the circumstances which generally prevail in reorganization. "[I]t is difficult to arrive at a current market rate of interest for a hypothetical new loan when there is no market for the loan proposed, no equity in the property and limited opportunity on the part of the debtor to obtain financing outside of the Bankruptcy Code framework." Bankruptcy courts, notwithstanding the faith of the circuit courts that bankruptcy judges are familiar with "market" conditions, have been unable to observe this "market" directly and therefore have been forced to rely on expert testimony provided by the parties. In fact, no case has affirmatively linked the terms of the reorganization plans at issue with a specific market in which rates are widely and timely reported and in which the terms of the instruments negotiated or traded mirror the characteristics of emerging Chapter 11 debtors. The reason is simple: No similar loans are being made.¹¹⁷

A bankruptcy cram down of a secured creditor is dissimilar to loans being made outside of bankruptcy in that a cram down forces the secured creditor to make a 100% loan to value. If the amount owed the secured creditor is 100 and the collateral has a value of 70, then a Chapter 11, 12, or 13 who proposes to retain the encumbered property and pay the creditor over time is in essence forcing the secured creditor to make a loan of 70 secured by collateral worth 70. Outside of bankruptcy, a lender does not generally make a 100% loan to value.

Because of the absence of a market for 100% loans, an "investment band" technique can be employed to hypothesize the loans that the debtor could obtain in the market place. The band of investment technique typically divides the cram down loan into two or more loans: (1) a senior band or loan in an amount equal to the loan-to-value ratio for which there is an actual market for secured loans and (2) one or more junior bands or

117. Pearson et al., *supra* note 19, at 47 (1996). See also Zywicki, *supra* note 65, at 257-58 (criticizing the Locke loan approach as unrealistic).

loans for the remaining amount of the secured claim. The interest rate required to be paid under the plan as the market rate is then derived as a blended rate taking into account the amounts and interest rates of these hypothetical loans.¹¹⁸

In the *T-H New Orleans* Chapter 11 case, the secured creditor's interest rate expert used investment band methodology in arguing for a cram down interest rate of 13.6%.¹¹⁹ In an unreported decision, the bankruptcy court in *T-H New Orleans* found that this rate was too high because of testimony that the collateral would increase in value over the life of the plan and testimony that the debtor would be able to make plan payments. The bankruptcy court also found that the 8.45% formula approach interest rate urged by the debtor was too low and so determined that the contract rate of 11.5% was the appropriate rate for this case.

The district court affirmed.¹²⁰ The Fifth Circuit also affirmed, holding simply that the "bankruptcy court was not clearly erroneous in its determination of the appropriate cramdown interest rate."¹²¹

In so holding, the court quoted from its earlier decision in *In re Briscoe Enter. Ltd.*,¹²² stating that "[o]ften the contract rate will be an appropriate rate,"¹²³ but neither *Briscoe* nor *T-H New Orleans* should be read as requiring bankruptcy courts to use the contract rate as the cram down interest rate or to use any particular approach to determining the cram down interest rate. While the court in *T-H New Orleans* affirmed the bankruptcy court's use of the contract rate for cram down interest, the Fifth Circuit expressly declined to establish a particular formula for determining the cram down interest rate.¹²⁴

Less than two months later, the Fifth Circuit took a seem-

118. See, e.g., *In re SM 104 Limited*, 160 B.R. 202, 233 *et seq.* (Bankr. M.D. Fla. 1993); *In re Cellular Information Sys., Inc.*, 171 B.R. 926, 943-44 (Bankr. S.D.N.Y. 1994) (applying investment band approach); see also Pawlowic, *supra* note 19, at 177-78 (describing the determination of a weighted blended rate).

119. *T-H New Orleans*, 116 F.3d at 800.

120. *In re T-H New Orleans Ltd. Partnership*, 188 B.R. 799, 810 (Bankr. E.D. La. 1996).

121. *T-H New Orleans*, 16 F.3d at 801.

122. 994 F.2d 1160 (5th Cir. 1993).

123. *T-H New Orleans*, 116 F.3d at 801.

124. *Id.* at 800.

ingly different approach to cram down interest rates in Chapter 13 cases in *In re Smithwick*.¹²⁵ In *Smithwick*, Chapter 13 debtors filed a plan that provided for a cram down interest rate of 11%, based on a local rule which required a formula approach to Chapter 13 cram down interest—two percent plus the *Wall Street Journal* prime rate.¹²⁶ The secured creditor objected and argued for the 12.75% rate in its prebankruptcy contract with the debtors.¹²⁷ The bankruptcy court confirmed the plan. The district court affirmed, noting that “in making ‘cramdown’ interest rate determinations, a bankruptcy court should be accorded substantial deference”¹²⁸ and holding that the Appellant failed to satisfy its burden of showing that the bankruptcy court’s findings of fact are clearly erroneous.¹²⁹ In reversing and remanding, the Fifth Circuit stressed the findings of law from the Third Circuit’s *Jones*¹³⁰ decision rather than the findings of facts from the bankruptcy court’s *Smithwick* decision.¹³¹

Smithwick adopts *Jones*’ “coerced loan” approach.¹³² It agrees with *Jones*’ inclusion of profit as part of the cram down interest rate and quotes from the Seventh Circuit decision in *Koopmans* to further support this position.¹³³ The Fifth Circuit further adopts the *Jones*’ rebuttable presumption that the contract rate is the appropriate cram down interest rate in Chapter 13 cases.¹³⁴ In so ruling, *Smithwick* refers to the *T-H New Orleans* Chapter 11 cram down interest rate decision, states that the *Smithwick* decision “is consistent with the approach we have

125. 121 F.3d 211 (5th Cir. 1997).

126. *Smithwick*, 121 F.3d at 211 n.1.

127. *Id.* at 212-213.

128. *Green Tree Fin. Serv. Corp. v. Smithwick*, 202 B.R. 420, 422 (S.D. Tex. 1996) (footnote omitted).

129. *Green Tree*, 202 B.R. at 424.

130. *General Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 65 (3d Cir. 1993), discussed *supra* at notes 56-68 and accompanying text. In her *Smithwick* opinion, Judge Jones refers to the case as “*General Motors Acceptance Corp.*” not “*Jones.*”

131. *Smithwick*, 121 F.3d at 214.

132. *Id.*

133. *Id.*

134. *Id.* The district court’s decision in *Smithwick* noted that Congress considered and rejected an amendment to section 1325(a)(5)(B)(ii) that would have required use of the contract rate. *Green Tree*, 202 B.R. at 423; see also *Key Bank of N.Y. v. Harko (In re Harko)*, 211 B.R. 116, 120 n.7 (B.A.P. 2d Cir. 1997) (noting that Congress specifically considered and rejected an amendment requiring the contract rate to be paid).

taken in Chapter 11 cases.¹³⁵ *Smithwick* then uses a quotation from the Seventh Circuit *Koopmans* decision,¹³⁶ rather than a quotation from *T-H New Orleans* or some other Fifth Circuit case to explain the position that the Fifth Circuit has taken in Chapter 11 cram down interest rate cases.¹³⁷

B. A Suggested Approach for Courts

The question of cram down interest rate is a question of statutory application, a question of application of the phrase "value, as of the effective date of the plan." The need to apply the phrase "value, as of the effective date of the plan" only arises because a Chapter 11, 12, or 13 plan proposes to defer payment of a creditor's secured claim and the secured creditor objects to the proposed terms of deferred payment. To state the obvious, a Chapter 11, 12, or 13 plan that provides for full cash payment to holders of secured claims does not raise any question of cram down interest: a secured creditor who receives a cash payment equal to the value of its secured claim on the effective date of the plan has received the value of such claim.

135. *Smithwick*, 121 F.3d at 214. Judge Parker who was a part of the three-judge panel that decided *Smithwick*, wrote the opinion in *T-H New Orleans*.

136. "[T]he creditor is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk." *Koopmans*, 102 F.3d at 214.

137. *Smithwick*, 121 F.3d at 214. In so ruling, the Fifth Circuit does not address the question of whether a local bankruptcy rule can fix the cram down interest rate for all Chapter 13 cases in that district. Local Rule 3020(d) of the United States Bankruptcy Court for the Southern District of Texas states: "The interest or discount rate on deferred payments made through a confirmed Chapter 13 plan must equal two percent plus the prime rate set in the Money Rate Section of the *Wall Street Journal* on the date the petition initiating the Chapter 13 case was filed." *Id.* at 213 n.1. It can be argued that such a rule goes beyond "rules governing practice and procedure" as contemplated by Federal Rule of Bankruptcy Procedure 9029. See generally Mary Josephine Newborn Wiggins, *Globalism, Parochialism and Procedure: A Critical Assessment of Local Rulemaking in Bankruptcy Court*, 46 S.C. L. REV. 1245 (1995) (considering the problems presented by the proliferation of local bankruptcy rules in light of F.R.B.P. 9029). But see *In re Wilmsmeyer*, 171 B.R. 61 (Bankr. E.D. Mo. 1994). *Wilmsmeyer* confirmed a Chapter 13 plan with a cram down rate based on a local rule of 3.5% plus the *Wall Street Journal* rate. *Wilmsmeyer*, 171 B.R. at 64. The local rule for the Eastern District of Missouri, unlike the local rule for the Southern District of Texas, included the introductory phrase, "[a]bsent proof to the contrary." *Id.* at 63 (discussing the efficacy of local rules under F.R.B. 9029).

Accordingly, in applying the phrase "value, as of the effective date of the plan," bankruptcy courts should endeavor to leave the secured creditor as well off as if it had been paid the amount of its secured claim in cash. The cram down interest rate should reflect what the secured creditor would have earned had it taken that cash and reinvested it in loans with terms comparable to the terms proposed by the debtor's plan and with risks comparable to the risks presented by the debtor's nonpayment.

In most cases, there will be evidence of *relatively comparable* transactions. In other cases, the plan's extreme terms or the debtor's extreme credit history will require that the bankruptcy court derive an interest rate from a combination of some base rate and an additional risk factor.¹³⁸ And, in still other cases, bankruptcy courts may conclude that the rate in the contract is the most credible evidence of what the secured creditor would have earned had it been paid a cash amount equal to the value of its secured claim and reinvested that cash in a loan comparable to the terms and risks presented by the debtor's plan.¹³⁹

A bankruptcy court's determination of "value, as of the effective date of the plan" should be difficult to overturn on appeal. The appellate court's focus should be on the bankruptcy court's factual decisions regarding the relevant market rate rather than on the bankruptcy court's methodology in making these factual determinations.¹⁴⁰ If the cram down interest rate approved by the bankruptcy court is not a "clearly erroneous" determination

138. Cf. *In re St. Cloud*, 209 B.R. 801, 808 (Bankr. Mass. 1997) (setting an interest rate based on the current market rate plus a one point premium for risk).

139. Cf. *In re Kennedy*, 177 B.R. 967, 974 (Bankr. S.D. Ala. 1995) (noting that an "appropriate interest rate provides the creditor with the present value over time" and should be determined based on evidence of the contract rate, prevailing market rates, creditor's cost of capital and service, creditor's profit, debtor's situation, the type and condition of collateral, etc.). As noted in *supra* note 134, Congress considered and rejected an amendment to section 1325(a)(5)(B)(ii) that would have required that interest be paid at the contract rate. See H.R. 1085, 98th Cong., 1st Sess. § 19(2)(a)(1983) (amending § 1325 to make the interest rate the contract rate). The fact that Congress fifteen years ago refused to require contract rate interest in *all* cram down cases is not an argument against a bankruptcy court today looking to the contract interest rate in *some* cram down cases.

140. Professor Carlson made a similar (but unsuccessful) argument regarding valuation of collateral under section 506. See David Gray Carlson, *Car Wars: Valuation Standards in Chapter 13 Bankruptcy Cases*, 13 BANKR. DEV. J. 1, 7, 25, 58 (1996).

of what the secured creditor would have realized on its secured claim had it been paid the amount of the secured claim in cash at the time of the court's confirmation of the plan, then the bankruptcy court's application of section 1129(b)(2)(A)(i)(II), 1225(a)(5)(B)(ii), or section 1325(a)(B)(ii) should be affirmed.

While this suggested approach will reduce appeals from bankruptcy court cram down interest rate proceedings, it will not eliminate bankruptcy court litigation. The relevant statutory language, "value, as of the effective date of the plan" invites such litigation, and invites the exercise of judicial discretion.

There are obvious market efficiency arguments supporting proposals for a fixed cram down interest rate such as simply the prime rate. And, there are obvious judicial efficiency arguments supporting proposals for handling Chapter 13 cram down interest rate proceedings differently from Chapter 11 cram down interest rate proceedings.

Such arguments and proposals should be addressed to Congress and not the courts.¹⁴¹ The present Congressional language, "value, as of the effect date of the plan," does not support a fixed cram down interest rate or support handling Chapter 13 cram down interest rate proceedings different from Chapter 11 cram down interest rate proceedings.

VI. (NOT A *RASH*) CONCLUSION

This Article has considered the Chapter 11, 12, or 13 plan confirmation question of how to value deferred payments to a holder of a secured claim. Different courts of appeals have debated over different answers to this question. Because of these differences, it is probable that the United States Supreme Court will provide a conclusion to this debate over valuing proposed cram down payments to holders of secured claims.¹⁴²

141. A divided National Bankruptcy Review Commission has addressed such arguments and addressed a proposal to Congress. NATIONAL BANKRUPTCY REVIEW COMMISSION, *supra* note 1, at 258-62.

142. See Qulia, *supra* note 23, at 558; Timothy D. Moratzka, *Chapter 13 Interest Rate Pegged to Treasury Rate in Second Circuit*, 14 AM. BANKR. INST. J. 16 (Apr. 1997) (concluding that the difference in rate formulas among the circuits must be resolved by the United States Supreme Court); see generally Robert M. Lawless & Dylan Lager Murphy, *An Empirical Analysis of Bankruptcy Certiorari*, 62 MO. L.

In the recent *Rash* decision, the United States Supreme Court endeavored to provide a conclusion to the differences among the courts of appeals over valuation of secured claims in a cram down. The Court focused on section 506(a) and concluded that words in the second sentence of section 506(a)—“proposed disposition or use”—“speak to the how question,”¹⁴³ i.e., the question of how secured claims in a cram down should be valued. *Rash* held that a replacement value standard “renders meaningful the key words ‘disposition or use.’”¹⁴⁴

Neither *Rash* nor section 506(a) addresses the standard for determining the present value of deferred plan payments to holders of secured claims. If the Supreme Court endeavors to provide a conclusion to the differences among the courts of appeals over valuation of cram down payments, the Court will focus on section 1129(b)(2)(A), 1225(a)(5)(B)(ii), or section 1325(a)(5)(B)(ii). The Court should conclude that there are no words in any of these provisions that “speak to the how question”, i.e., the question of how plan payments to a holder of a secured claim in a cram down should be valued. There is no statutorily mandated “right” approach for this factual determination, no statutory basis for a “*Rash*” review of bankruptcy court valuation methodology. The Court should hold that any value standard that reflects what the secured creditor would have earned had it been paid in cash “renders meaningful” the key words “value, as of the effective date of the plan.”

REV. 101, 134 (1997) (“the Court approaches bankruptcy cases in more or less the manner as it approaches any federal law issue. Our study shows that circuit splits and percolation are important for bankruptcy law, as they are for any other federal law.”).

143. *Rash*, 117 S. Ct. at 1885.

144. *Id.*