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An Agricultural Law Research Article

Determining the Proper “Cramdown” Rate of Interest in Agricultural Bankruptcies Post-*Till v. SCS Credit Corp.*

by

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October 2004

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Introduction

On October 2, 1998, Lee and Amy Till purchased a used vehicle from Instant Auto Finance in Kokomo, Indiana. Little did they know that the events of that day would evolve into legal battles before a bankruptcy court, a federal district court, a circuit court of appeal, and the United States Supreme Court. Nor could they have known that those events would culminate in a legal precedent that helped resolve one of the most significant issues in Chapter 11, 12, and 13 bankruptcies: how to calculate the appropriate “cramdown” interest rate.¹ In *Till v. SCS Credit Corp.*,² the United States Supreme Court held in a plurality decision that the so-called “formula approach” is the appropriate method for determining the adequate rate of interest in a Chapter 13 cramdown. The “formula approach” requires that the prime national interest rate³ serve as a baseline for determining the appropriate cramdown interest rate and that the rate be adjusted, if necessary, based on the risk of nonpayment.

The Tills filed a Chapter 13 bankruptcy petition in October of 1999.⁴ Although they owed approximately \$5,000.00 on their vehicle, the parties agreed that the value of the vehicle was \$4,000.00.⁵ The Tills proposed to pay their debt in 36 monthly principal payments along with an annual rate of interest of 9.5%, which represented a 1.5% modification of the national prime rate to compensate for the risk of nonpayment. Respondent SCS Credit Corp.⁶ objected to the Tills’ proposed rate of interest, arguing that it was “entitled to interest at the rate of 21%, which is the rate . . . it would obtain if it could foreclose on the vehicle and reinvest the proceeds in loans of equivalent duration and risk as the loan’ originally made to the [Tills].”⁷ The bankruptcy court accepted the Tills’

¹ See *In re Mattson*, 210 B.R. 157, 159 (Bankr. D. Minn. 1997) (“Cramdown is the centerpiece of the reorganization chapters.”).

² 124 S.Ct. 1951 (2004).

³ See *Till*, 124 S.Ct. at 1961 (stating that “the national prime rate, reported daily in the press, which reflects the financial market’s estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate for the opportunity costs of the loan, the risk of inflation, and relatively slight risk of default.”). See also *Encyclopedia of Banking & Finance* 830 (9th ed. 1991) (defining “prime rate” as the “interest rate most closely approximating the riskless or pure rate for money.”).

⁴ See *id.* at 1956.

⁵ See *id.*

⁶ Instant Auto Finance assigned its contract with the Tills to SCS Credit Corp. immediately after it entered into the contract. See *id.*

⁷ See *id.*

argument and confirmed their proposed bankruptcy plan.⁸ On appeal, the district court adopted the respondent's argument and reversed the bankruptcy court, holding that the appropriate rate of interest was 21%.⁹ The United States Court of Appeals for the Seventh Circuit upheld the district court's determination that 21% was the appropriate interest rate but based its determination on the parties' pre-bankruptcy contract that set the interest rate at 21%.¹⁰ The Seventh Circuit held that the contract rate should "serve as a presumptive [cram down] rate" that either party could challenge with evidence that necessitated modification of that rate.¹¹ The United States Supreme Court subsequently granted certiorari and reversed the Seventh Circuit.¹²

Till involved a Chapter 13 bankruptcy filing and did not arise in an agricultural bankruptcy context. Thus, attorneys who represent clients involved in agricultural bankruptcies brought under Chapters 11, 12, and 13 of the Bankruptcy Code may not be aware of *Till* and its implications.¹³ This article is not intended to serve as an exhaustive discussion of the *Till* decision but rather to bring *Till* to the attention of attorneys and trustees involved in agricultural bankruptcies and to highlight the important role it will play in agricultural bankruptcy litigation.

Background

An agricultural producer may file a Chapter 7, 11, 12, or 13 bankruptcy petition. Chapter 7 is considered a "liquidation" bankruptcy because the debtor's assets are sold, or "liquidated," and the proceeds distributed to creditors.¹⁴ Thus, a farmer who wants to retain assets essential to its farming operation post-bankruptcy usually will not seek Chapter 7 protection. Chapters 11, 12, and 13 have important differences, but are considered "reorganization" bankruptcies.¹⁵ In a reorganization bankruptcy, debtors can retain, or at least attempt to retain, assets that are subject to an allowed, secured interest, rather than relinquishing those assets for the benefit of creditors. Thus, a reorganization bankruptcy is particularly desirable to agricultural producers who intend to continue farming post-bankruptcy. *Till* applies to Chapters 11, 12, and 13 bankruptcies; it does not apply to Chapter 7 bankruptcy proceedings.

A debtor in a reorganization bankruptcy must propose a bankruptcy plan of reorganization that satisfies each allowed, secured creditor, and, if certain conditions are satisfied, the plan must be confirmed by the bankruptcy court.¹⁶ The Code expressly provides Chapter 12 and Chapter 13 debtors three options with which they can satisfy creditors holding an allowed, secured claim. They may obtain the creditor's acceptance of the plan, surrender the property to the creditor, or provide the

⁸ See *id.* at 1957.

⁹ See *id.*

¹⁰ See *id.* (citing *In re Till*, 301 F.3d 583, 591 (7th Cir. 2002)).

¹¹ *Id.* at 1957-58.

¹² See *id.* at 1958.

¹³ Chapter 12 currently is not in effect.

¹⁴ See CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* § 1.1, at 2 (1997).

¹⁵ Reorganization bankruptcies are also referred to as "rehabilitation" bankruptcies. For purposes of simplicity, only the term reorganization is used in this article.

¹⁶ See 11 U.S.C. § 1129 (Chapter 11), 11 U.S.C. § 1225 (Chapter 12), and 11 U.S.C. § 1325 (Chapter 13) (setting forth plan confirmation requirements).

creditor both a lien in the property and “the value, as of the effective date of the plan, of property to be distributed under the plan”¹⁷ Similar to Chapters 12 and 13, a Chapter 11 debtor may propose to provide the secured creditor a lien in the property along with “deferred cash payments totalling [sic] at least the amount” of the secured claim.¹⁸ The option of providing the creditor a lien in the property along with the value of the property is commonly referred to as the cramdown option because it can be confirmed, or “crammed down,” over the creditor’s objections.¹⁹ Although separate provisions govern cramdown for Chapters 11, 12, and 13, it has been noted that “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.”²⁰

To exercise the cramdown option, the debtor will typically propose that installment payments, along with an appropriate rate of interest, be made to the creditor over a period of time. Whatever form the payments take, however, the proposed payments must provide the creditor with a total present value that equals or exceeds the amount of the creditor’s allowed secured claim.²¹ In *Till*, the Court described the difficulty presented by this requirement:

That command is easily satisfied when the plan provides for a lump-sum payment to the creditor. Matters are not so simple, however, when the debt is to be discharged by a series of payments over time. A debtor’s promise of future payments is worth less than an immediate payment of the same total amount because the creditor cannot use the money right away, inflation may cause the value of the dollar to decline before the debtor pays, and there is always some risk of nonpayment. *The challenge for bankruptcy courts reviewing such repayment schemes, therefore, is to choose an interest rate sufficient to compensate the creditor for these concerns.*²²

¹⁷ See 11 U.S.C. § 1325(a)(5) (Chapter 13) and 11 U.S.C. § 1225(a)(5) (Chapter 12). The statutory language set forth in §§ 1325(a)(5) and 1225(a)(5) are nearly identical.

¹⁸ 11 U.S.C. § 1129(b)(2)(A)(i). A Chapter 11 debtor may also propose a sale of the property to which the liens in the property attach to the proceeds of the sale, or provide for the realization by secured claimholders “the indubitable equivalent of such claims.” 11 U.S.C. § 1129(b)(2)(A)(ii)-(iii).

¹⁹ David G. Epstein, *Don’t Go and Do Something Rash about Cram Down Interest Rates*, 49 ALA. L. REV. 435, 436-437 (1998) (“A bankruptcy court can confirm a Chapter 11, 12, or 13 plan that modifies the rights of a secured lender without the consent of that creditor. In other words, the plan can be “crammed down” over the objection of the secured creditor.”).

²⁰ See *id.* at 441-42. See also *In re Till*, 301 F.3d 583, 586-87 (7th Cir. 2002), *rev’d on other grounds*, 124 S. Ct. 1951 (2004) (stating that Chapter 11 and 12 contain analogous cramdown provisions); *Koopmans v. Farm Credit Services of Mid-America*, ACA, 102 F.3d 874, 875 (7th Cir. 1996) (Chapter 12 case citing Chapter 13 cramdown provision); *In re Smithwick*, 121 F.3d 211, 213-14 (5th Cir. 1997) (Chapter 13 case stating that Chapter 11 cramdown provisions are analogous to Chapter 13 provisions, and relying on Chapter 12 case considering cramdown); *In re Fowler*, 903 F.2d 694, 697 (9th Cir. 1990) (Chapter 12 case stating that Chapter 11 cramdown analysis applies to Chapter 12); *United States v. Arnold*, 878 F.2d 925, 928 (6th Cir. 1989) (stating that Chapter 12 and 13 cramdown provisions are identical and should be similarly construed). *But see, Till*, 124 S.Ct. at 1960 n.14 (“Thus, when picking a cram down rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce. In the Chapter 13 context, by contrast, the absence of any such market obligates courts to look to first principles and ask only what rate will fairly compensate a creditor for its exposure.”).

²¹ See *Till*, 124 S.Ct. at 1955-56. The statutory bases for this requirement are found at 11 U.S.C. § 1129(b)(2)(A)(i) (Chapter 11), 11 U.S.C. § 1225(a)(5)(B) (Chapter 12), and 11 U.S.C. § 1325(a)(5)(B) (Chapter 13). See also *Rake v. Wade*, 508 U.S. 464, 472 (1993) (describing concept of present value).

²² *Id.* at 1958 (emphasis added).

The challenge of determining the proper interest rate has been answered in different ways by different courts. In *Till*, the plurality identified four methods that have been used to determine the appropriate cramdown interest rate: (1) the “formula rate” or “prime-plus” rate, (2) the “coerced loan rate” or “forced loan rate,” (3) the “presumptive contract rate,” and (4) the “cost of funds rate.”²³ The “formula rate” requires that the national prime rate serve as a baseline amount, which can be augmented, if necessary, based on the risk of nonpayment.²⁴ The “coerced loan rate” requires the interest rate to be set at “the level the creditor could have obtained if it had foreclosed on the loan, sold the collateral, and reinvested the proceeds in loans of equivalent duration and risk.”²⁵ The “presumptive contract rate”—a “slightly modified version” of the “coerced loan rate” approach—allows the interest rate in the parties’ contract to “serve as a presumptive [cram down] rate,’ which either the creditor or the debtor could challenge with evidence that a higher or lower rate should apply.”²⁶ The “cost of funds” approach inquires “what it would cost the creditor to obtain the cash equivalent of the collateral from an alternative source.”²⁷

Discussion

Plurality Decision

Justice Stevens, joined by Justices Souter, Ginsberg, and Breyer, adopted the formula rate approach and rejected the coerced loan, presumptive contract rate, and cost of funds approaches. The plurality recognized that although Congress’ intent for determining the cramdown interest rate could not be discerned from the Chapter 13 cramdown provision, three factors governed courts’ and trustees’ consideration of the issue.²⁸

The first factor is that several Code provisions mirror the Chapter 13 cramdown provision by requiring courts to “discoun[t] . . . [a] stream of deferred payments back to the[ir] present dollar value’ . . . to ensure that a creditor receives at least the value of its claim.”²⁹ The plurality reasoned that Congress

²³ See *id.* at 1956-58.

²⁴ See *id.* at 1957.

²⁵ *Id.*

²⁶ *Id.* at 1957-58 (citation omitted).

²⁷ *Id.* at 1958 (citation omitted). One scholar explained that “[b]y the time the issue had found its way to the Supreme Court, some form of the ‘coerced loan method had been adopted by seven of the ten circuits to have considered the issue, whereas three circuits had adopted some form of the ‘formula method.’” See Rebecca Harper, *Supreme Court Issues Landmark Decision on Chapter 13 Cramdown Interest Rates*, NATIONAL CONSUMER LAW CENTER, May/June 2004, Vol. 22, available at http://www.consumerlaw.org/publications/reports/content/nclc_rept_bankr.pdf (subscription required to view entire document) (citing *Matter of Southern States Motor Inns, Inc.*, 709 F.2d 647 (11th Cir. 1983) (coerced loan approach), *In re Smithwick*, 121 F.3d 211 (5th Cir. 1997) (same), *United Carolina Bank v. Hall*, 993 F.2d 1126 (4th Cir. 1993) (same), *In re Hardzog*, 901 F.2d 858 (10th Cir. 1990) (same), *GMAC v. Jones* 999 F.2d 63 (3d Cir. 1993) (same), *United States v. Arnold*, 878 F.2d 925 (6th Cir. 1989) (same), and *In re Kidd*, 315 F.3d 671 (6th Cir. 2003) (variation on coerced loan approach), *United States v. Doud*, 869 F.2d 1144 (8th Cir. 1989) (formula method), *In re Fowler*, 903 F.2d 694 (9th Cir. 1990) (same), and *In re Valenti*, 105 F.3d 55 (2d Cir. 1997) (same)). Rebecca Harper represented the *Tills* throughout their legal proceedings, including the arguing of their case before the Supreme Court.

²⁸ See *Till*, 124 S.Ct. 1951, 1958 (2004).

²⁹ *Id.* (quoting *Rake v. Wade*, 508 U.S. 464, 472 n.8 (1993) (footnote citations omitted)).

likely intended courts and trustees to apply an essentially uniform approach for determining the appropriate interest rate under the several provisions, particularly an approach generally known to the financial community and one that alleviated “the need for expensive evidentiary proceedings.”³⁰

The second factor is that courts have express authority under Chapter 13 “to modify the rights of any creditor whose claim is secured by an interest in anything other than ‘real property that is the debtor’s principal residence.’”³¹ Thus, courts and trustees have complete authority to disavow any contractual terms regarding any interest rates previously agreed to between the debtor and the creditor, as long as the terms are not a part of the contract for the debtor’s principal residence.

The third factor is that from the creditors’ point of view the Chapter 13 cramdown provision mandates “an objective rather than a subjective inquiry.”³² Courts considering a proper cramdown interest rate can therefore ignore the creditor’s individual circumstances and should attempt “to treat similarly situated creditors similarly, and to ensure that an objective economic analysis would suggest the debtor’s interest payments will adequately compensate all such creditors for the time value of their money and the risk of default.”³³

The plurality concluded that these factors warranted rejection of the coerced loan, presumptive contract rate, and cost of funds approaches.³⁴ The formula approach, according to the plurality, had none of the defects associated with the other approaches. It explained that

unlike the coerced loan, presumptive contract rate, and cost of funds approaches, the formula approach entails a straightforward, familiar, and objective inquiry, and minimizes the need for potentially costly additional evidentiary proceedings. Moreover, the resulting “prime-plus” rate of interest depends only on the state of financial markets, the circumstances of the bankruptcy estate, and the characteristics of the loan, not on the creditor’s circumstances or its prior interactions with the debtor. For these reasons, the prime-plus or formula rate best comports with the purposes of the Bankruptcy Code.³⁵

Concurring Opinion

The concurring opinion, written by Justice Thomas, advanced the view that, in light of the “clear text” of the Chapter 13 cramdown provision, the risk of nonpayment was not a factor in determining the proper cramdown interest rate. It stated that the Chapter 13 cramdown provision “only requires the

³⁰ See *id.* at 1958-59.

³¹ *Id.* at 1959 (quoting 11 U.S.C. § 1322(b)(2)). Note that the Court referred specifically to authority available under Chapter 13. Chapters 11 and 12 contain provisions that authorize courts to modify claims. See 11 U.S.C. § 1123(b)(5) (same language as used in Chapter 13) and 11 U.S.C. § 1222(b)(2) (governing Chapter 12). Note also that unlike §§ 1322(b)(2) and 1123(b)(5), § 1222(b)(2) does not distinguish between courts’ authority to modify creditors’ rights in real property and personal property.

³² *Id.* See also *id.* n. 13 (“We reached a similar conclusion in *Associates Commercial Corp. v. Rash*, . . . when we held that a creditor’s secured interest should be valued from the debtor’s, rather than the creditor’s, perspective.”) (internal footnote citation and quotation omitted).

³³ *Id.* at 1960.

³⁴ See *id.* at 1960-61 (elaborating briefly on defects of each the three approaches as they relate to the Court’s three factors for determining cramdown interest rates).

³⁵ *Id.* at 1961-62 (footnote citation omitted).

valuation of the 'property to be distributed,' not the valuation of the plan (*i.e.*, the promise to make the payments itself.).³⁶ The concurrence continued, "[t]hus, in order for a plan to satisfy § 1325(a)(5)(B)(ii), the plan need only propose an interest rate that will compensate a creditor for the fact that if he had received the property immediately rather than at a future date, he could have immediately made use of the property."³⁷ The concurrence forwarded this view in light of its belief that "there is always a risk of nonpayment" when a debtor proposes to pay a debt to a creditor through a series of payments and that the "'promise of future payments is worth less than an immediate payment' of the same amount, in part because of the risk of nonpayment."³⁸

The concurring opinion qualified its view in two respects. First, it stated that "[i]n most, if not all, cases, where the plan proposes simply a stream of cash payments, the appropriate risk-free rate should suffice."³⁹ This statement supposes that it may be appropriate to consider the risk of nonpayment in a relatively small number of instances. The concurrence limited these instances to those in which the property to be valued is a promise or a debt: "It is nonsensical to speak of a debtor's risk of default being inherent in the value of 'property' *unless that property is a promise or a debt.*"⁴⁰

Second, the concurrence stated that the risk of nonpayment could be a factor in determining the value of the property to be distributed in the debtor's bankruptcy plan. It reasoned that

Although "property" is not defined in the Bankruptcy Code, nothing in § 1325 suggests that "property" is limited to cash. Rather, "property can be cash, notes, stock, personal property or real property; in short, anything of value. And if the "property to be distributed" under a Chapter 13 plan is a note (*i.e.*, a promise to pay), for instance, the value of that note necessarily includes the risk that the debtor will not make good on that promise. Still, accounting for the risk of nonpayment in that case is not equivalent to reading a risk adjustment requirement into the statute, as in the case of a note, the risk of nonpayment is part of the value of the note itself."⁴¹

Dissenting Opinion

Justice Scalia, joined by Chief Justice William Rehnquist and Justices O'Connor and Kennedy, rejected the formula approach and expressly adopted the presumptive contract rate approach because, despite its defects, the contract rate approach was the best estimate for determining the appropriate rate of interest in cramdown. The dissent identified several "imponderable" risk factors, such as the probability of plan failure and the rate of collateral depreciation, that courts must consider when determining an appropriate cramdown rate of interest. It stated that under the formula approach a risk premium would have to be determined in every case, whereas under the contract rate approach

³⁶ *Id.* at 1966.

³⁷ *Id.*

³⁸ *Id.* at 1965.

³⁹ *Id.* at 1966 (emphasis added).

⁴⁰ *Id.*

⁴¹ *Id.* at 1967.

“the task of assessing . . . these risk factors is entrusted to the entity most capable of undertaking it: the market.”⁴² It added that

[a]ll the risk factors are reflected (assuming market efficiency) in the debtor’s contract rate—a number easily found in the loan document. If neither party disputes it, the bankruptcy judge’s task is at an end. There are straightforward ways a debtor *could* dispute it—for example, by showing that the creditor is now substantially oversecured, or that some other lender is willing to extend credit at a lower rate. But unlike the formula approach, which requires difficult estimation in every case, the contract-rate approach requires it only when the parties choose to contest the issue.⁴³

Conclusion

The dissenting opinion’s opening statement that “[m]y areas of agreement with the plurality are substantial” belies the effect that *Till* may have on debtors and creditors involved in agricultural bankruptcies brought under Chapters 11, 12, and 13. In short, *Till* presents creditors with an uphill battle in having bankruptcy courts establish a cramdown rate of interest that is substantially higher than the prime national rate of interest and strengthens the hands of debtors who desire the cramdown interest rate be established at or near the national prime rate.

Attorneys should be aware that bankruptcy courts and trustees could reasonably interpret *Till* to suggest that a relatively low adjustment should be used to compensate for the risk of nonpayment, even though the plurality expressly declined to determine the proper scale for the risk adjustment and stated that bankruptcy courts must establish an interest rate “high enough to compensate the creditor for its risk, but not so high as to doom the plan.”⁴⁴ In remanding the matter back to the bankruptcy court for proceedings consistent with its opinion, the plurality noted that the bankruptcy court approved a risk adjustment of 1.5% and that “courts have generally approved adjustments of 1% to 3%.”⁴⁵ This statement by itself could be interpreted as a tacit endorsement by the Court of a risk adjustment in the 1% to 3% range. In addition, the plurality stated that rather than adjusting the rate for the risk of nonpayment, bankruptcy courts may establish the cramdown rate without adjusting for risk of nonpayment: “We note that, if the court could somehow be certain a debtor would complete his plan, the prime rate would be adequate to compensate any secured creditors forced to accept the cram down loans.”⁴⁶ Moreover, a court inclined to adopt this interpretation of *Till* would be encouraged by the concurring opinion’s view that the risk of nonpayment should not be—at least in most bankruptcies—a factor in determining the appropriate cramdown interest rate.

Attorneys and trustees should also be aware that the potential impact in agricultural bankruptcies brought under Chapters 11, 12, and 13 is significant. For example, consider that the Tills proposed to make 36 monthly payments along with an interest rate payment of 9.5%. Because the secured value of the vehicle was \$4,000.00, the Tills’ monthly payments averaged \$111.11 per month (\$1,333.33 annually). An annual interest rate of 9.5% on this amount equals \$126.66. Thus, the Tills’ monthly

⁴² *Id.* at 1973.

⁴³ *Id.*

⁴⁴ *Id.* at 1962.

⁴⁵ *Id.* at 1962 (citing *In re Valenti*, 105 F.3d 55, 64 (2d Cir. 1997) (collecting cases), *abrogated on other grounds by Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997)).

⁴⁶ *Id.* at 1961 n.18.

payments, along with the annual interest rate, equaled \$1,459.99 each year. Had the 21% interest rate been applied, however, the Tills would have paid \$280.00, for a total of \$ 1,613.33 per year in interest payments. Under these facts, the difference in the amounts seems insignificant. Applying the same basic calculation in a situation where a farmer owes \$40,000.00 for farm equipment—an amount that is modest in some situations—creates a significant difference. For example, suppose that Farmer A proposes to pay the \$40,000.00 secured claim in 72 monthly installment payments, totaling \$555.55 per month, or \$6,666.66 per year. An annual interest rate of 9.5% would equal \$633.33 per year (\$3,799.98 over a six-year period), and an annual rate of 21% would equal \$1,400.00 (\$8,400.00 over a six-year period). These two examples illustrate clearly the practical impact that *Till* could have on debtors and creditors involved in agricultural reorganization bankruptcies.

Finally, attorneys should be aware that bankruptcy courts and trustees may be less inclined to confirm a bankruptcy plan if the risk of nonpayment necessitates the establishment of too high an interest rate. In particular, the plurality stated that a bankruptcy court should probably not confirm a bankruptcy plan if “the likelihood of default is so high as to necessitate an ‘eye-popping’ interest rate .

. . . ⁴⁷

⁴⁷ *Id.* at 1963 (citing *Till v. SCS Credit Corp.*, 301 F.3d 583, 593 (7th Cir. 2002) (Rovner, J., dissenting)).