BANKRUPTCY PRACTICE IN TENNESSEE: A COLLECTION OF ESSAYS

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EDITOR'S INTRODUCTION

Transactions: The Tennessee Journal of Business Law is pleased to publish the following essays regarding bankruptcy law in Tennessee: *Cramming Down in a Credit Crunch*, *Is Deepening Insolvency a Recognized Tort in Tennessee?*, and *The Supreme Court's* Till *Decision and Its Impact on Chapter 11.* Given the current economic climate, we believe that the subject of bankruptcy law is particularly relevant to practitioners in Tennessee and around the country. We hope that these essays, authored by Nashville bankruptcy attorney Robert J. Mendes, will provide Tennessee practitioners—many of whom may be unfamiliar with bankruptcy-related topics—a valuable introduction to the subject.

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CRAMMING DOWN IN A CREDIT CRUNCH

INTRODUCTION

Cramdown interest rates in Chapter 11 bankruptcy cases are often speculative, hypothetical, and inexact. Calculation of a suitable rate consistently poses challenges for bankruptcy courts. The task becomes even more daunting against the backdrop of an economic recession and a credit crunch. Thus, bankruptcy courts will have their work cut out for them in determining the appropriate cramdown interest rates for the bankruptcy cases headed their way in the current economic crisis. This article examines how courts have applied *Till v. SCS Credit Corp.*[1] to Chapter 11 cases and how current economic conditions may affect the analysis moving forward.

I. REMEMBERING *TILL*

Since 2004, bankruptcy professionals have hotly debated the applicability of the Supreme Court's plurality holding in *Till* to Chapter 11 cramdown cases.[2] *Till* was a Chapter 13 case in which the Court evaluated four of the most widely-used approaches for calculating a cramdown interest rate: the coerced loan approach, the presumptive contract rate approach, the formula rate approach, and the cost of funds approach.[3]

The Court concluded that all but the formula rate approach suffer serious flaws.[4] The formula approach, also referred to as the prime-plus approach, uses the relatively risk-free national prime interest rate as the starting point and adjusts upward based on certain factors, such as the debtor's creditworthiness.[5] According to the Court, the formula approach "entails a straightforward, familiar, and objective inquiry, and minimizes the need for potentially costly additional evidentiary proceedings,"[6] while the other approaches "[are] complicated, impose[] significant

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[1] Till v. SCS Credit Corp., 541 U.S. 465 (2004). For an in-depth discussion of the *Till* case, see *infra The Supreme Court's* Till *Decision and Its Impact on Chapter 11.*

[2] Thomas R. Fawkes & Steven M. Hartmann, *Revisiting Till: Has a Consensus Emerged in Chapter 11s?*, AM. BANKR. INST. J., July-Aug. 2008, at 28, 28.

[3] *Till*, 541 U.S. at 477-81.

[4] *Id.* at 478-80.

[5] *Id.* at 478-79.

[6] *Id.* at 479.

evidentiary costs, and aim[] to make each individual creditor whole rather than to ensure the debtor's payments have the required present value."[7] Accordingly, the Court adopted the formula rate as the sole method for determining Chapter 13 cramdown interest rates.[8]

After *Till*, some commentators doubted whether the holding would apply in Chapter 11 cases. Skeptics pointed to *Till's* footnote 14, in which the Court noted that while there is no readily apparent market interest rate in Chapter 13 cramdowns, "the same is *not* true in the Chapter 11 context, as numerous lenders advertise financing for Chapter 11 debtors in possession."[9] The footnote contains internet links to market sources of interim financing,[10] also known as DIP financing (as opposed to sources of long term exit financing). The Court did not clarify, however, whether the appropriate market rate should assume the feasibility of the debtor's long term financial plan. The Court's point seemed to be that if there were an "efficient market" by which a rate could be determined, that market rate should be used.[11]

This led some to conclude that Chapter 11 cases call for an efficient market rate of interest rather than a formula rate. Others argued that the *Till* formula rate should apply to Chapter 11 cases. They based their argument on the identical nature of the cramdown provisions and the fact that the underlying purpose of efficiency exists in both Chapters. They also argued that there is no more of a free market of willing cramdown lenders in Chapter 11 than Chapter 13 cases.

II. THE "HYBRID" APPROACH

A review of post-*Till* case law reveals that both sides of the debate were right. That is, most courts currently apply—or claim to apply—a hybrid approach in which they use *Till's* formula rate in Chapter 11 cramdowns, but only if no efficient market exists.[12]

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[7] *Id.* at 477.

[8] *Id.* at 480.

[9] *Id.* at 477 n. 14.

[10] *Id.*

[11] *Id.*

[12] *See* Bank of Montreal v. Official Comm. of Unsecured Creditors (*In re* American Homepatient, Inc.), 420 F.3d 559, 568 (6th Cir. 2005); Gen. Elec. Credit Equities, Inc. v. Brice Road Dev., L.L.C. (*In re* Brice Road Dev., L.L.C.), 392 B.R. 274, 280 (B.A.P. 6th Cir. 2008); Mercury Capital Corp. v.

A. An "Efficient Market"

The hybrid approach has led to a whole new wave of questions, including one that becomes increasingly important with the worsening of the nation's economy and credit markets: What is an efficient market? Unfortunately, courts have yet to fully answer this question. Even when courts hold that an efficient market does or does not exist in a particular case, they rarely provide reasoning. Courts have taken a variety of approaches.

For example, in *Mercury Capital Corp. v. Milford Connecticut Assoc.*, the district court reviewed a bankruptcy court's decision to apply the formula rate after it had determined that no efficient market existed.[13] The bankruptcy court had considered the original contract rate of interest, as well as testimony that the debtor would have trouble finding a loan under current conditions from a third party at less than double the rate proposed by the debtor.[14] The district court held that the bankruptcy court "did not necessarily err as a matter of law" in applying the *Till* formula rate approach to a Chapter 11 plan,[15] but nevertheless remanded because there was not enough evidence in the record to determine if an efficient market rate existed.[16]

According to the district court, "[n]either piece of evidence [offered] . . . [wa]s sufficient to establish whether or not an efficient market rate exist[ed] for the type of loan [the creditor] must give the debtor under the debtor's plan, and if so, what that interest rate [wa]s."[17] On remand, the bankruptcy court denied confirmation of the plan for lack of feasibility and never discussed the efficient market issue.[18] What evidence would have been sufficient in order to determine if an efficient market existed? The court left this question unanswered.

Milford Conn. Assoc., L.P., 354 B.R. 1, 13 (D. Conn. 2006); Interim Capital, LLC v. Hank's Dock, Inc. (*In re* Seaspan Dev. Corp.), No. 04-21339, 2006 WL 2672298, at *3 (E.D. Tenn. Sept. 18, 2006); *In re* Winn-Dixie Stores, Inc., 356 B.R. 239, 255 (Bankr. M.D. Fla. 2006); *In re* Northwest Timberline Enter., Inc., 348 B.R. 412, 434 (Bankr. N.D. Tex. 2006).

[13] *Mercury Capital Corp.*, 354 B.R. at 12.

[14] *Id.*

[15] *Id.*

[16] *Id.* at 12-13.

[17] *Id.* at 12.

[18] *In re* Milford CT Assoc., L.P., No. 04-30511, 2008 WL 687266, at *2 (Bankr. D. Conn. Mar. 10, 2008).

Some courts, however, claim to follow the hybrid approach while actually applying other already-rejected approaches, such as the presumptive contract rate approach.[19] For example, at least two courts since *Till* have deemed the original loan between the debtor and creditor evidence of the existence of an "efficient market" and then used that rate as the cramdown rate.[20]

In 2008, the Bankruptcy Court for the Southern District of Ohio put forth the following criteria for evaluating a proposed efficient market rate:

> [T]he priority of the lien securing the loan; whether there exists an open, well-developed market for loans of the kind between the debtor and secured creditor; the type of collateral involved; the quality, age, and life expectancy of the collateral; short or long term nature of the proposed term of the loan; and the amount financed.[21]

The second factor looks objectively to the existence of a market, while the other five seem to focus on a subjective evaluation of the rate's reasonableness. The Bankruptcy Appellate Panel for the Sixth Circuit upheld the bankruptcy court's finding under these criteria that the interest rate proposed by the debtor's plan was appropriate.[22] It remains to be seen whether these criteria will be used by other courts. However, courts that wish to use these criteria still must determine whether an "open, well-developed market for loans of the kind between the debtor and secured creditor" exists.[23]

At least one court has focused on the difficulties with the term "efficient" to support using the formula or prime-plus approach.[24] In *Timberline*, the court held that even if "there were a ready market of lenders willing to make an exit loan to

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[19] *See infra* note 20 and accompanying text; *see also infra* note 81 and accompanying text.

[20] *See e.g.*, *In re* Seaspan Dev. Corp. and Hank's Dock, Inc., Ch. 11 Case No. 04-21339 & 04-21340, Adv. No. 2:05-CV-315, 2006 WL 2672298, at *3 (affirming a bankruptcy court decision to use the four percent contract interest rate because the contract rate between the parties established "the market" and therefore should be applied to the secured creditor's claim); *see also In re* Sylvan I-30 Enter., No. 05-86708-HDH-11, 2006 WL 2539718, at *7 (Bankr. N.D. Tex. Sept. 1, 2006) (applying the variable rate set forth in the original loan to the cramdown loan).

[21] *See* Gen. Elec. Credit Equities, Inc. v. Brice Road Dev., L.L.C. (*In re* Brice Road Dev., L.L.C.), 392 B.R. 274, 280-81 (B.A.P. 6th Cir. 2008).

[22] *Id.* at 281.

[23] *Id.* at 280.

[24] *In re* Northwest Timberline Enter., Inc., 348 B.R. 412, 434 (Bankr. N.D. Tex. 2006).

the[] [d]ebtors similar to what [was] proposed" under the plan, the "market would have to be *efficient* for it to be all controlling."[25] The court recognized that "[t]he market might, in fact, too highly assess the risk of (or unfairly put a taint on) the debtors coming out of bankruptcy."[26] After holding that no efficient market existed because there were no lenders willing to provide an exit loan "identical" to what was being offered under the plan, "other than perhaps a [wealthy] individual lender," the court applied the formula rate.[27]

It appears then that *Till* has left room for courts to readily stake out both ends of the spectrum—that an efficient market exists or that one does not. With the current credit crunch, it stands to reason that frequency of decisions determining that there is not an efficient market may increase.

B. Risk Adjustments

To the extent that a court may determine that there is no efficient market on which to base a rate, the risk adjustment process (or calculation of the "plus" in the prime-plus approach) may become the real battleground in the cramdown fight. This is important because small changes in risk adjustments can mean the difference between a successful plan and a failing one.

Till did not specify the proper level of upward adjustment, but noted that courts have generally approved adjustments in the range of one to three percent.[28] The rate should be "high enough to compensate the creditor for its risk but not so high as to doom the plan."[29] Many courts have stayed within the one to three percent range, but some courts have awarded risk adjustments well over three percent. The court in *Timberline*, for example, held that the prime rate with an upward adjustment of 5.75 percent was appropriate.[30] The primary factors courts consider in this process are: (1) the estate's circumstances, (2) the security's nature, and (3) "the duration and feasibility of the reorganization plan."[31] Of these factors, the nature of the security and the plan's feasibility will probably provide the biggest

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[25] *Id.*

[26] *Id.*

[27] *Id.*

[28] Till v. SCS Credit Corp., 541 U.S. 465, 480 (2004).

[29] *Id.*

[30] *Timberline*, 348 B.R. at 434.

[31] *Till*, 541 U.S. at 479.

challenges ahead for debtors because these are the factors most dependent upon the economy.

Evaluating the nature of the security, for example, entails appraising the value and assessing the liquidity of the collateral and considering the uncertainty of the collateral's estimated value. Each of these considerations is intertwined with economic conditions. Instability in the economy creates uncertainty about the nature of the security, which translates to higher risk.

The economy also has an impact on the feasibility factor. The Bankruptcy Code defines "feasibility" as the likelihood that a plan will not result in the need for further reorganization.[32] Bankruptcy courts must determine whether a plan will likely generate sufficient cash flow to meet payment obligations. Ordinarily, the court can rely on financial ratios, proxies, and other financial indicators in making this determination. However, a credit crunch introduces new variables into the equation. Businesses may be unable to take out loans in order to purchase the equipment, property, or services they need for daily operations; revenues may plummet due to consumer spending cuts; or a company on which the debtor's business relies may shut down. For these reasons and more, a credit crunch creates additional questions about the feasibility of a reorganization plan.

A declining economy puts all businesses at a higher risk for failure, and the debtor in a Chapter 11 case is no different. During this downturn, risk adjustments may reflect this higher uncertainty.

III. CONCLUSION

With the economy in disarray, it may be more likely for courts to conclude that there is no efficient market for loans in question. This may result in greater reliance on the formula approach. Under the formula approach, creditors will undoubtedly urge courts to make large upward risk adjustments, citing high uncertainty about the value of the security and low likelihood of the feasibility of a proposed plan. Whether courts will apply a consistent analysis remains to be seen.

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[32] *See* 11 U.S.C. § 1129(a)(11) (2008); *see also* GEORGE W. KUNEY, MASTERING BANKRUPTCY 167 (2008) (discussing the feasibility test).

IS DEEPENING INSOLVENCY A RECOGNIZED TORT IN TENNESSEE?

INTRODUCTION

There is remarkably little law in Tennessee about the tort theory of "deepening insolvency." The only case applying Tennessee law that addresses the tort is partially based on cases applying Delaware law.[33] However, on August 14, 2007, the Delaware Supreme Court ruled that there is no cause of action under Delaware law for deepening insolvency.[34] This article explores the impact of this decision on whether deepening insolvency is an actionable tort under Tennessee law.[35]

I. WHAT IS DEEPENING INSOLVENCY?

The answer to this question depends largely on one's perspective. Proponents argue that deepening insolvency is an independent tort theory by which creditors should be able to recover from officers, directors, or outside professionals for causing an entity to become more insolvent than it otherwise would have been absent the defendants' actions or inactions. The theory is that by deepening the insolvency, the control persons or advisors reduced or eliminated the return to creditors that would have been available if the defendants had acted more prudently. Others argue that there is no point to having an independent tort of deepening insolvency because the existing universe of fiduciary duties owed by officers, directors, and outside professionals are adequate to address any harm worth remedying.

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[33] Limor v. Buerger (*In re* Del-Met Corp.), 322 B.R. 781 (Bankr. M.D. Tenn. 2005). *But see infra* note 35 (explaining that immediately prior to publication of this Article, the United States Bankruptcy Court for the Eastern District of Tennessee held that the State of Tennessee would not recognize deepening insolvency as a tort).

[34] *See* Trenwick Am. Litigation Trust v. Billett, 931 A.2d 438 (Del. 2007) (stating simply that "the final judgment of the Court of Chancery should be affirmed on the basis of and for the reasons assigned by the Court of Chancery in its opinion"); *see also* Trenwick Am. Litigation Trust v. Ernst & Young, L.L.P., 906 A.2d 168 (Del. Ch. 2006).

[35] Editor's note: As predicted in this Article, the United States Bankruptcy Court for the Eastern District of Tennessee held on March 5, 2009 that the State of Tennessee would not recognize deepening insolvency as a tort. Official Comm. of Unsecured Creditors of Propex Inc. v. BNP Paribas (*In re* Propex Inc.), Ch. 11 Case No. 08-10249, Adv. No. 08-1136, 2009 WL 562595 (Bankr. E.D. Tenn. Mar. 5, 2009).

Whichever side of this debate one is on, it is clear that for much of the last quarter century, momentum has built to recognize an independent tort for deepening insolvency. That is, until the Delaware Supreme Court issued *Trenwick*.[36] The result is that Delaware law is now clear; that state has come down firmly on the side that deepening insolvency is not an independent tort.[37] Instead, Delaware "remits plaintiffs to the contents of their traditional toolkit, which contains, among other things, causes of action for breach of fiduciary duty and for fraud."[38]

II. EXISTING TENNESSEE LAW

There is only one case applying Tennessee law that directly discusses deepening insolvency.[39] In that case, Del-Met was an automotive parts supplier.[40] Its three largest customers were General Motors, Johnson Controls, and Lear.[41] The trustee in Del-Met's Chapter 7 bankruptcy sued these three customers as well as outside management and accounting professionals.[42] Among other theories, the trustee argued for breach of fiduciary duty in connection with an alleged deepening of insolvency.[43] In summary, the trustee alleged that these parties essentially seized management and control of the debtor corporations, manipulated the debt structure of the companies, and required the companies to continue to service unprofitable contracts.[44]

In considering the defendants' motion to dismiss, the bankruptcy court's initial inquiry was whether the trustee was asserting an independent cause of action for deepening insolvency or alleging a traditional breach of fiduciary duty.[45] In the trustee's brief and "[a]t oral argument, counsel for the trustee reiterated that deepening insolvency was alleged as a breach of fiduciary duty by the Defendants,

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[36] *See supra* note 34 and accompanying text.

[37] *Trenwick*, 906 A.2d at 205.

[38] *Id.*

[39] Limor v. Buerger (*In re* Del-Met Corp.), 322 B.R. 781 (Bankr. M.D. Tenn. 2005). *But see supra* note 35.

[40] *Id.* at 790-91.

[41] *Id.* at 791.

[42] *Id.* at 789.

[43] *Id.* at 807.

[44] *Id.* at 806-07.

[45] *Id.* at 807.

not as an independent tort."[46] Despite this disclaimer, when questioned by the court about the source of the duty owed by Del-Met's customers and professionals to Del-Met, the trustee argued that the court should acknowledge the viability of the deepening insolvency theory under Tennessee law.[47] In a nutshell, the trustee said that she sought to pursue a traditional fiduciary duty claim where the duty related to obligations arising in connection with the independent tort of deepening insolvency.[48] The court stated that "[t]hese circular positions by the trustee speak volumes to the lack of definition of the developing theory of deepening insolvency."[49]

The next step in the court's analysis was to observe that, whether the cause of action was characterized as a separate tort or a type of a breach of fiduciary duty, there must be a duty that was violated.[50] Specifically, the court explained:

> [T]he Trustee's deepening insolvency claim is cognizable only if the Defendants owed duties to the debtor corporations under nonbankruptcy law by virtue of their domination and control such that the run up of debt, the performance of unprofitable contracts, the selective payment of vendors and other allegations in the complaint are actionable breaches.[51]

After framing the issue this way, the court separately analyzed whether the behavior alleged in the complaint was actionable under Tennessee law as a breach of fiduciary duty or as an independent tort.[52]

A. Actionable as a Breach of Fiduciary Duty?

In thinking about the trustee's complaint against customers and outside professionals as a breach of fiduciary duty, the court examined a variety of situations where duties were found to be owed.[53] For example, Tennessee law is clear that a

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[46] *Id.*

[47] *Id.*

[48] *Id.*

[49] *Id.*

[50] *Id.* at 808.

[51] *Id.*

[52] *Id.*

[53] *Id.* at 809-11.

shareholder can become a fiduciary by exercising dominion and control over the affairs of a corporation.[54]

In *Del-Met*, the court also looked "beyond the immediate corporate family" in noting that "the Court of Appeals of Tennessee has acknowledged the possibility that breachable duties can arise in the context of a lending relationship when special facts or circumstances are present."[55] After examining a range of Tennessee cases addressing fiduciary duties, the court concluded that the "extreme" facts alleged about the defendants exercising control over the debtor corporations "would support a cause of action for breach of fiduciary duties under Tennessee law."[56]

B. Actionable as an Independent Tort of Deepening Insolvency?

The court next considered whether the alleged facts constituted the independent tort of deepening insolvency.[57] Because there were no applicable decisions by Tennessee courts, the court was required to predict "whether the Tennessee Supreme Court would recognize deepening insolvency as an actionable breach of duty."[58]

In analyzing how the Tennessee Supreme Court would resolve this issue, the *Del-Met* court was guided by a series of federal court cases interpreting Delaware, New York, and Pennsylvania law.[59] For each of these states, a federal court had interpreted applicable law to conclude that the state would recognize an independent deepening insolvency tort.[60] Due to the developing nature of the subject, this constituted a comprehensive review of the case law at that time.

The court took particular guidance from *Official Committee of Unsecured Creditors v. R.F. Lafferty & Co.*, which construed Pennsylvania law.[61] To determine whether

[54] *Id.* at 810 (citing Intertherm, Inc. v. Olympic Homes Sys., Inc., 569 S.W.2d 467 (Tenn. Ct. App. 1978)).

[55] *Id.* at 811 (citing Oak Ridge Precision Indus., Inc. v. First Tenn. Bank N.A., 835 S.W.2d 25 (Tenn. Ct. App. 1992)).

[56] *Id.*

[57] *Id.* at 811-15.

[58] *Id.* at 813.

[59] *Id.* at 811-15.

[60] *Id.*

[61] Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340 (3d Cir. 2001).

Pennsylvania would recognize the independent tort, the Third Circuit considered: "(1) [the] soundness of the theory; (2) the growing acceptance of the theory; and (3) the remedial theme [of the state's] law."[62] In short, the Third Circuit concluded that the theory was sound, that it was indeed growing in acceptance, and that it was consistent with the concept in Pennsylvania jurisprudence that the law provides a remedy where there is an injury.[63]

In *Del-Met*, the court agreed with the Third Circuit's reasoning and added that "the Tennessee Supreme Court has adopted the same jurisprudential principle as the Pennsylvania high court: where there is a tortious injury, the law will provide a remedy."[64] Thus, the court held "that if presented with compelling facts, the Tennessee Supreme Court would recognize deepening insolvency as an actionable breach of duty to a corporation."[65]

In summary, the only case applying Tennessee law that directly addresses the deepening insolvency theory held that the "extreme" facts in that case successfully pled a cause of action whether construed as a traditional breach of fiduciary duty or an independent deepening insolvency tort.[66]

III. HOW DOES *TRENWICK* IMPACT THE ANALYSIS?

As described above, regarding "deepening insolvency," it is now clear that "Delaware law does not recognize this catchy term as a cause of action[] because[,] catchy though the term may be, it does not express a coherent concept."[67] The Delaware Chancery Court elaborated:

> Even when a firm is insolvent, its directors may, in the appropriate exercise of their business judgment, take action that might, if it does not pan out, result in the firm being painted in a deeper hue of red. The fact that the residual claimants of the firm at that time are

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[62] *In re Del-Met Corp.*, 322 B.R. at 813 (explaining the factors considered in the Official Comm. of Unsecured Creditors case).

[63] *Id.* at 813-15 (quoting Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 349-51 (3d Cir. 2001)).

[64] *Id.* at 815.

[65] *Id.*

[66] *See id.* *But see supra* note 35.

[67] Trenwick Am. Litigation Trust v. Ernst & Young, L.L.P., 906 A.2d 168, 174 (Del. Ch. 2006).

> creditors does not mean that the directors cannot choose to continue the firm's operations in the hope that they can expand the inadequate pie such that the firm's creditors get a greater recovery. By doing so, the directors do not become a guarantor of success. Put simply, under Delaware law, "deepening insolvency" is no more of a cause of action when a firm is insolvent than a cause of action for "shallowing profitability" would be when a firm is solvent. Existing equitable causes of action for breach of fiduciary duty, and existing legal causes of action for fraud, fraudulent conveyance, and breach of contract are the appropriate means by which to challenge the actions of boards of insolvent corporations.[68]

The Delaware court criticized "those federal courts that became infatuated with the concept" of deepening insolvency for "not look[ing] closely enough at the object of their ardor."[69]

So, what does that mean for Tennessee law? Remember, *Del-Met* analyzed the facts alleged from two perspectives— as a traditional breach of fiduciary duty and as an independent tort.[70] It seems clear that *Trenwick* bears on the second of these. Because a federal court applying Tennessee law should consider the soundness of a new theory and whether the new theory is growing in acceptance, it should weigh heavily that Delaware, a state with a sophisticated body of commercial law, has rejected deepening insolvency as an independent tort.[71] Further, while not catalogued at length here, it is fair to say that the trend nationally has turned away from recognizing deepening insolvency as a separate tort.[72] Thus, it appears that the status of deepening insolvency as a cognizable tort is in serious doubt.

However, the *Del-Met* analysis about whether the trustee's allegations properly pled a traditional breach of fiduciary duty is consistent with *Trenwick*. If Tennessee law recognizes a breach of fiduciary duty claim against persons outside the corporate family when they exercise dominion and control over the corporation,

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[68] *Id.*

[69] *Id.* at 206.

[70] *In re Del-Met Corp.*, 322 B.R. at 808.

[71] *See id.* at 813.

[72] *See, e.g.*, *In re Amcast Industrial Corp.*, 365 B.R. 91, 116-19 (Bankr. S.D. Ohio 2007) (reviewing trend over previous twenty-four months in deciding that Ohio would not recognize the independent tort).

then the *Del-Met* trustee stated a cause of action. As *Del-Met* acknowledged, though, this requires an "extreme" set of facts.[73]

IV. CONCLUSION

There are no Tennessee decisions that directly address the deepening insolvency theory.[74] In the author's opinion, if a federal court were to predict Tennessee law today, it may well conclude that Tennessee would not recognize the independent tort of deepening insolvency.[75] However, it is clear that Tennessee courts will allow a party to assert a breach of fiduciary duty cause of action where the defendant is alleged to have exercised dominion and control over the corporation.[76]

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[73] *In re Del-Met Corp.*, 322 B.R. at 811.

[74] *But see supra* note 35.

[75] *See supra* note 35 (discussing that immediately prior to publication of this Article—as predicted by the author—the United States Bankruptcy Court for the Eastern District of Tennessee held that the State of Tennessee would not recognize deepening insolvency as a tort).

[76] *Id.*

THE SUPREME COURT'S *TILL* DECISION AND ITS IMPACT ON CHAPTER 11

INTRODUCTION

On May 17, 2004, the United States Supreme Court issued its decision in *Till v. SCS Credit Corp.*[77] *Till* resolved a split in authority regarding how bankruptcy courts should determine cramdown interest rates in Chapter 13 cases. The decision has generated significant commentary, some of which has suggested that *Till* might not apply to Chapter 11 cases. As discussed below, the better reading of *Till* is that it does apply.

I. WHAT HAPPENED IN *TILL*?

In order to understand why *Till* applies to Chapter 11 cases, one must first understand the holding and the logic behind it. *Till* was a typical Chapter 13 case. The parties disagreed about what the cramdown interest rate should be for the creditor who financed the debtor's purchase of a used truck.[78] The Supreme Court ruled that the "formula approach" should be used.[79] This approach starts with a relatively risk-free rate (such as the prime rate) and adds an appropriate risk adjustment to that rate.[80] In adopting the formula approach, the Court rejected three competing approaches: the presumptive contract rate approach, the coerced loan approach, and the cost of funds approach.[81]

In choosing the formula approach, the Court explained that it wanted to compensate creditors for the time value of money without providing any upward adjustment for profit, transaction costs, or any other factors that were creditor-specific.[82] The only upward adjustment above the prime rate allowed now is a "risk adjustment" based on "the circumstances of the estate, the nature of the security,

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

[78] *Id.* at 471.

[79] *Id.* at 484-85.

[80] *Id.* at 478-79.

[81] *Id.* at 477. The presumptive contract rate approach starts with the contract rate and lets parties argue for upward or downward adjustments. The coerced loan approach involves choosing a market rate for the loan. The cost of funds approach provides only a relatively risk-free rate like the prime rate.

[82] *Id.* at 483.

and the duration and feasibility of the reorganization plan."[83] The Court ruled that the "[bankruptcy] court must hold a hearing to permit the debtor and creditors to present evidence about the appropriate risk adjustment."[84] While the Court did not formally decide the issue, it stated in dicta that an appropriate risk adjustment would be one to three percent above the prime rate.[85] The Court acknowledged that this approach puts the evidentiary burden "squarely" on a creditor to provide evidence supporting any upward risk adjustment that it proposes.[86]

Because *Till* set the starting point for cramdown interest rates at the prime rate and placed the evidentiary burden on creditors to demonstrate the size of any upward risk adjustment, some institutional creditors are distressed about the decision. These creditors had been engaged in a long-term campaign to convince courts to adopt the more creditor-friendly presumptive contract rate approach. *Till* has now clearly ended that campaign with regard to Chapter 13 cases. However, since the Court did not expressly apply the holding to Chapter 11 cases, that debate continues.

II. PLURALITY, CONCURRENCE, AND DISSENT

To fully understand *Till*, one must be aware of the unusual alignment of the Justices. A plurality decision, comprised of Justices Stevens, Souter, Ginsberg, and Breyer, endorsed the formula approach.[87] Justice Thomas concurred in holding that the debtor should win the appeal, but argued for the cost of funds approach.[88] The dissent, comprised of Justices Scalia, Rehnquist, O'Conner, and Kennedy, preferred the presumptive contract rate.[89]

Despite the fact that there was no majority opinion, the plurality and the dissent shared substantial philosophical common ground.[90] Justice Thomas stated:

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[83] *Id.* at 479.

[84] *Id.*

[85] *Id.* at 480.

[86] *Id.* at 479.

[87] *Id.* at 465.

[88] *Id.* at 467.

[89] *Id.* at 492.

[90] *See id.* at 485.

> Both the plurality and the dissent agree that "[a] debtor's promise of future payments is worth less than an immediate payment of the same total amount because the creditor cannot use the money right away, inflation may cause the value of the dollar to decline before the debtor pays, and there is always some risk of nonpayment." Thus, the plurality and the dissent agree that the proper method for discounting deferred payments to present value should take into account each of these factors, but disagree over the proper starting point for calculating the risk of nonpayment.[91]

This common ground will likely shape the analysis regarding whether bankruptcy courts apply *Till* to Chapter 11 cases. It seems likely that, when discounting a stream of future payments in a Chapter 11 case, these eight Justices would decide that the proper discount method should take into account these same factors. It also seems likely that Justice Thomas's commitment to the cost of funds approach would not change in a Chapter 11 case.

III. THE COURT'S RATIONALE

The last building block to thinking about whether *Till* will apply to Chapter 11 cases is the rationale behind choosing the formula rate. The Court described three important considerations:[92]

First, the Court observed that the "Code includes numerous provisions that, like the cramdown provision, require a court to 'discoun[t] . . . [a] stream of deferred payments back to the[ir] present dollar value.'"[93] The Court explained that it believed Congress intended to have bankruptcy courts choose discount rates in the same manner despite which of the numerous provisions was at issue.[94]

The Court's list of "numerous provisions" included seven subsections of § 1129(a) and (b), including the Chapter 11 cramdown provisions analogous to the Chapter 13 cramdown provision being analyzed by the Court.[95] The implication is clear; to the extent that § 1129 requires discounting a stream of payments and to the

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[91] *Id.* (citations omitted).

[92] *Id.* at 474-76.

[93] *Id.* at 474.

[94] *Id.* at 474.

[95] *Id.* at 475 n.10.

extent that Congress intended bankruptcy courts to determine interest rates in a consistent manner, a case regarding a cramdown interest rate in a Chapter 13 case should apply in a Chapter 11 case.

The Court's second consideration was that Chapter 13 "expressly authorizes a bankruptcy court to modify the rights of any creditor whose claim is secured by an interest in anything other than 'real property that is the debtor's principal residence.'"[96] For this, the Court cited § 1322(b)(2) of the Code.[97] While not mentioned in *Till*, Chapter 11 has an identical provision at § 1123(b)(5). Therefore, this second consideration appears to apply to Chapter 11 cases as well.

The third consideration was that the cramdown provision should provide an objective inquiry—not a subjective one.[98] The Court meant that the Code simply provides that secured creditors are entitled to the present value of their collateral.[99] The Code does not require debtors to match the terms of the pre-bankruptcy loan, "nor does it require that the cramdown terms make the creditor subjectively indifferent between present foreclosure and future payment."[100] So, instead of considering a creditor's individual circumstances, the cramdown analysis should endeavor to "adequately compensate all such creditors for the time value of their money and the risk of default."[101] This consideration should also apply in Chapter 11 cases.

IV. FOOTNOTE 14: THE DOOR IS OPEN TO FURTHER DEBATE

In discussing the third consideration, that a creditor's specific circumstances are not relevant to determining the cramdown interest rate, the Court observed that Chapter 13 creditors subject to cramdown would, by definition, prefer to foreclose and get their collateral back.[102] Footnote 14 states in part:

> Interestingly, the same is not true in the Chapter 11 context, as numerous lenders advertise financing for Chapter 11 debtors in

[96] *Id.* at 475.

[97] *Id.*

[98] *Id.* at 476.

[99] *Id.* at 477.

[100] *Id.* at 476.

[101] *Id.* at 476-77.

[102] *Id.* at 476.

> possession . . . . Thus, when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce.[103]

This footnote, which describes in dicta one of the three considerations that led the Court to choose the formula approach, has been interpreted by some to mean that *Till* will not apply to Chapter 11 cases. This conclusion is premature and perhaps overstated.

V. CONCLUSION: *TILL* APPLIES TO CHAPTER 11 CASES

As an initial matter, the suggestion in footnote 14 that "it might make sense to ask what rate an efficient market would produce" is based on the premise that there are lenders that provide financing for Chapter 11 debtors.[104] In support of this premise, the Court referred to two web sites offering debtor-in-possession ("DIP") financing.[105] This premise is flawed. The two web sites cited by the Court refer to interim financing based on collateralizing receivables for the period while a case is pending.[106] This sort of DIP financing is governed by § 364 of the Code and requires consent between the debtor, the lender, and the bankruptcy court. It is fundamentally different than a cramdown loan over a creditor's objection. Except to the extent that a creditor can somehow show the existence of an efficient market for loans to debtors for the full value of collateral, the analytical crack in the door may be small.

Second, even assuming that there exists an efficient market for exit financing in Chapter 11 cases, then what? How would that fit in with the three considerations that led the Court to the formula approach? Remember that the Court held that creditors should be compensated only for the time value of money and a risk adjustment.[107] The plurality was clear that it is not appropriate to compensate for "lenders transaction costs and overall profits . . . that are no longer relevant in the context of court-administered and court-supervised cramdown loans."[108] Also,

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[103] *Id.* at 477 n.14.

[104] *Id.*

[105] *Id.*

[106] *Id.*

[107] *Id.* at 483.

[108] *Id.* at 477.

remember that Justice Thomas opposed providing any return greater than the relatively risk-free prime rate.[109]

Therefore, with at least five Justices opposing the inclusion of profit or transaction costs in the discount rate for cramdown, it would appear that a rate that our hypothetical efficient market might produce would be too high. It would have to be adjusted downward to eliminate profits and transaction costs. If faced with such a case, the Court would be right back to *Till*. Should it start with prime and adjust upward for the risk of default, or should it start with the supposedly efficient market's rate and adjust downward to eliminate profit and transaction costs? There is little reason to think that the Court would do anything differently than it did in *Till*.

Third, it is important to remember that footnote 14 introduces uncertainty regarding only one of three considerations that led the Court to adopt the formula approach. The other two considerations, that Congress intended bankruptcy courts to determine discount rates in a similar fashion regardless of the Code section involved and that the Code expressly grants the power to modify a creditor's rights, remain unchallenged by footnote 14.

Last, it seems unlikely that dicta in a footnote will be enough to derail the long-standing practice of courts applying Chapter 13 cramdown case law to Chapter 11 cases, especially in the context of the factors described above.

In conclusion, practitioners should expect creditors to explore the crack that the Court left open. However, the better analysis is that the Court's considerations described in *Till* will have a major impact on cramdown interest rate calculations in Chapter 11 cases.

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[109] *Id.* at 487.