15-1682-bk(L)

15-1824-bk(CON)

United States Court of Appeals

FOR THE SECOND CIRCUIT

IN RE: MPM SILICONES, L.L.C.,

Debtor,

MOMENTIVE PERFORMANCE MATERIALS INCORPORATED,
APOLLO GLOBAL MANAGEMENT, LLC,
AD HOC COMMITTEE OF SECOND LIEN HOLDERS,

Plaintiffs-Appellees,

—against—

BOKF, NA, as First Lien Trustee,
WILMINGTON TRUST, N.A., as 1.5 Lien Trustee,

Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR *AMICI CURIAE* LOAN SYNDICATIONS AND TRADING ASSOCIATION, THE MANAGED FUNDS ASSOCIATION, AND THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF DEFENDANTS-APPELLANTS BOKF, NA, *ET AL.*

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QUESTION PRESENTED

Whether a plan of reorganization in bankruptcy that obligates an oversecured creditor to accept property of a type traded in public markets at a value markedly less than the amount of the creditor's secured claim provides property "of at least the value" of that claim for purposes of 11 U.S.C. § 1129(b)(2)(A)(i)(II).

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INTEREST OF *AMICI CURIAE*[1]

The Loan Syndications and Trading Association (the "LSTA") is a financial trade association with a mission to promote a fair, orderly, efficient, and growing corporate loan market and to provide leadership in advancing and balancing the interests of all market participants. Because its members frequently purchase secured debt in the secondary market, they have a strong interest in a reasoned resolution of the core problem presented by the appeal. Moreover, as a nationwide group with members engaging in commercial behavior under the jurisdiction of every federal court of appeals, the LSTA has a unique interest in ensuring regularity and predictability throughout the circuits, and especially in uniform rules that promote efficient bankruptcy administration.

The Managed Funds Association (the "MFA") represents the global alternative investment industry, including hedge funds, funds of funds, their investors, and service providers, by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. Importantly, numerous MFA members are active participants in the financial markets that allocate capital to companies in distress or in bankruptcy, and often find themselves in the position of creditors and customers holding

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[1] This brief was not authored in whole or in part by counsel for a party. No person other than the *amicus* made a monetary contribution intended to fund the preparation or submission of this brief.

significant amounts of debt in bankruptcy cases. As of January 1, 2015, MFA member firms with $1 billion or greater under management account for approximately $1.1 trillion in assets under management.

The Securities Industry and Financial Markets Association ("SIFMA") is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving retail clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans.

The courts below held that a plan affords a secured creditor property "of at least the value" of the creditor's secured claim (for purposes of 11 U.S.C. § 1129(b)(2)(A)(i)(II)) even if the plan obligates the creditor to accept property of a type traded in public markets at a value markedly less than the amount of that claim. The impact of the decision on settled expectations of the affected market participants is evident from the breadth and strength of the reactions. The decision struck informed observers as "momentous"[2] and "spooked the bond world"[3] with

[2] David Griffiths, Momentous Decision in Momentive Performance Materials (Sept. 9, 2014), *available at* http://business-finance-restructuring.weil.com/chapter-11-plans/momentous-decision-in-momentive-performance-materials-cramdown-of-secured-creditors-part-i/ (last visited Aug. 5, 2015).

its promise of "more risk on the horizon in bankruptcy cases,"[4] primarily because the decision would "dramatically alter the playing field for debtors and even junior creditors,"[5] which would lead in turn to "increasing interest rates generally to reflect the risk of receiving below-market replacement notes in a bankruptcy."[6]

The appeal directly affects the rights of all secured creditors in Chapter 11 bankruptcies in this Circuit. If this Court allows the ruling to stand, the adverse effects would shrink the market for origination of high-yield bonds by increasing the cost of lending. Perversely, the hindrance of capital-raising would strike most directly at the financially troubled companies that need funding most urgently. The broad experience of the amici in the financial markets gives them a

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[3] Nathan Vardi, Leon Black's Apollo Global Management Keeps Winning Battles and Outmaneuvering Creditors, Forbes (Aug. 28, 2014), *available at* http://www.forbes.com/sites/nathanvardi/2014/08/28/leon-blacks-apollo-global-management-keeps-winning-battles-and-outmaneuvering-creditors/ (last visited Aug. 6, 2015).

[4] Timothy S. McFadden, Cramdown: A Dirty Word Getting Dirtier for Secured Lenders, ABL Advisor (Oct. 29, 2014), *available at* http://www.abladvisor.com/articles/5736/cramdown-a-dirty-word-getting-dirtier-for-secured-lenders (last visited Aug. 6, 2015).

[5] Bryan W. Stone, Case Could Reshape How, Where Companies Restructure Debts of Senior Lien Holders, Charlotte Bankruptcy (Jan. 22, 2015), *available at* http://www.charlottebankruptcylawyer-blog.com/2015/01/22/case-reshape-companies-restructure-debts-senior-lien-holders/ (last visited Aug. 6, 2015).

[6] In re MPM Silicones: SDNY Bankruptcy Court Denies Make-whole Claim and Approves Cramdown of Secured Creditors with Below-market Replacement Notes, Practical Law (Sept. 18, 2014), *available at* http://us.practicallaw.com/1-580-3268 (last visited Aug. 6, 2015) [hereinafter Practical Law].

particularized awareness of the distortions that the decision brings to the ongoing operations of those markets. We believe that the perspective of the amici will help the Court put this matter in the proper context.

SUMMARY OF ARGUMENT

The decisions of the bankruptcy court and the district court treated this Chapter 11 case as governed by the plurality opinion of the Supreme Court in *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), and the pre-*Till* comments of this Court in *GMAC v. Valenti* (*In re Valenti*), 105 F.3d 55 (2nd Cir. 1997), two Chapter 13 consumer bankruptcy cases in which there was no competitive market for loans to bankrupt individuals. *See* App. 68-92 (analysis of bankruptcy court), 240-45 (analysis of district court). As appellants explain, however, neither *Till* nor *Valenti* supports, much less compels, the decisions below. This is a Chapter 11 case, distinguished from those cases by its statutory framework and the uncontroverted evidence of a competitive market for the types of loans at issue. *See* Brief for Defendant-Appellant BOKF, NA 26-36 (detailed explanation of why the reasoning of those cases compels reversal); Brief for Appellant Wilmington Trust, Nat'l Ass'n 23-39 (same).

Amici submit this brief not to repeat that discussion, but to address the basic principles that should inform this Court's interpretation of the relevant statutory provisions. As we explain below, the most straightforward reading of the statute

and its history, considered in the light of the applicable financial principles, makes it clear that secured creditors do not receive the "value" of their claim when they are compelled to accept assets worth less than that claim.

1. The lower courts' analysis of present value is fundamentally flawed. The reference in Section 1129 to value "as of the effective date of the plan" calls on its face for a determination of the "value" on that date. When assets trade regularly in public markets, the observable price at which they trade in those markets is by definition their "value" on that date. It follows as a matter of logic that the interest rate necessary for an obligation to trade at par in those markets is the only interest rate that can give those obligations a value that matches their face amount. Here, the bankruptcy court acknowledged that the interest rate on the notes that the plan compelled appellants to accept was markedly below the market interest rate, and it is conceded that the notes in fact trade at a price far below the value that the plan assigns to them. Neither *Till* nor *Valenti* – much less the Code itself permits a bankruptcy court to assign a value to an asset that so plainly and indisputably departs from the asset's value in fact.

The lower courts demonstrably erred when they assigned an interest rate to those notes based on a "formula" approach – a subjective, predictive, and inherently indirect framework – in the face of undisputed contradictory evidence of the valuations that the assets would have in open public markets. The point

missing from their analysis was the direct link between the market price of a publicly traded financial obligation and the market interest rate on which that price depends. As a matter of logic, the trial court's view of the propriety of that rate – too pessimistic, too optimistic, about right – can have no relevance. The interest rate that establishes the current market price is accordingly the only rate relevant to the current value of the obligation itself. Because the current value of the obligation is the question committed to judicial determination, it follows that the market interest rate is the ***only*** rate that can inform a coherent determination of the present "value" of the obligation. It just as surely follows in turn that the lower courts' intentional approval of an interest rate markedly below that rate compelled appellants to accept property with a value, "as of the effective date of the plan," less than the face amount of their claim.

2. It is inconceivable that those who crafted the Bankruptcy Code contemplated confirmation of a plan that strips creditors of claims wholly secured by collateral by compelling them to accept property with a market value self-evidently less than the value of those claims. The Code was drafted against the backdrop of a preexisting recognition of the entitlement of secured creditors to retain the value of such claims. Among other things, the relevant practice under the old Bankruptcy Act (as it existed until adoption of the Code in 1978) started from an uncontroversial premise that excluded inferior creditors and equityholders

from participation in a reorganization unless senior creditors received "full compensation" for the "value" of their secured claims.

The foundational revisions to the law of corporate reorganizations included in the Bankruptcy Code were designed to strengthen that principle, not sweep it away. Congressional leaders involved in the adoption of the Code repeatedly described the new system as one that would provide "full compensation" to senior creditors, measured by the "value" afforded those creditors under the plan. Indeed, with a prescience that seems remarkable in hindsight, the contemporaneous explanations of the cramdown provisions document the understanding of the financial reality: a below-market interest rate ***by definition*** results in an obligation with a present value less than the face amount of the obligation. In sum, the relevant history establishes beyond peradventure the impropriety of attributing to the Code the claim-stripping rule approved by the lower courts.

ARGUMENT

I. The Lower Courts Misapplied Basic Precepts of Financial Valuation.

The central problem with the decisions below is their conclusion that the best way to assess the "value" of property of a type publicly traded in open markets is to ignore the pricing in those markets and rely instead on a judicially crafted "formula." App. 240-44. The language of Section 1129 does not condition confirmation on the proponent's selection of an interest rate the court finds

"appropriate."[7] Rather, it describes the objecting creditors' entitlement by reference to the "value" of the property the creditors receive.

As a matter of judicial competency, it is simpler and more reliable to observe the price at which willing participants buy and sell assets in active public markets than it is to proceed indirectly through the vagaries of interest-rate formulae. This case illustrates the perils of the formula approach: acknowledging uncontroverted evidence of market valuations, the courts used a predictive and policy-laden inquiry to justify an interest rate designedly set below the comparable market rate. *See* App. 90-91 (discussing the pros and cons of Treasury rates as compared to the prime rate), 90 (concluding that a risk premium should exceed 3 percent only for "extreme risks"), 255 (approving that conclusion)].[8] The central

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[7] *But see* App. 84-90 (analysis of "appropriate" interest rate), 240-45 (same).

[8] Although the courts below consciously rejected the relevance of market information in assessing appropriate risk premia, it bears noting that the upper bound of the risk premium that they characterized as appropriate for obligations issued by bankrupt firms was at the low end of the yields that are typical for high-yield bonds. *See* Frank K. Reilly et al., *Historic Changes in the High Yield Bond Market*, 21 J. Applied Corp. Fin. 65, 73 (2009) (data illustrating that the average credit risk spread on high-yield bonds from 1985-2009 never fell below 2% and was above 6% for more than one-third of the period in question); Conrad de Aenlle, *The Signals from the High-Yield Bond Market*, Dealbook, Aug. 14, 2014, *available at* http://mobile.nytimes.com/blogs/dealbook/2014/08/14/the-signals-from-the-high-yield-bond-market/ (last visited Aug. 17, 2015) (reporting that the yield spread on high-yield bonds from 2008 through 2014 never fell below 2.5% and remained above 5% for most of that period); Michael Aneiro, *Junk Bond Spread Drops Below 400 Basis Points*, Barron's (Dec. 21, 2013) (suggesting that the historic average credit risk on junk bonds is "a bit below 500 basis points" and that the credit risk spread "bottomed at an all-time low of 240 basis points" during

point is not that the courts erred in application of the formula (though the radical departure of the court's valuations from the market's makes the error all but indisputable).[9] Rather, the key takeaway is that only an ill-designed system would use judicial answers to such questions as a method for determining the value (and appropriate interest rate) of assets of a type traded in public markets.[10]

The problem with the decisions below rests on a failure to appreciate the direct links among the value of a note or obligation, the interest rate that the obligation bears, and the discount rate that the market ***in fact*** attributes to the obligation. Because the market price of a publicly traded obligation directly reflects the market interest rate for that obligation, the selection of any other interest rate necessarily drives the value of the obligation away from its face amount.[11] This has nothing to do with "profit," however likely or unlikely it may

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2007), *available at* http://blogs.barrons.com/incomeinvesting/2013/12/31/junk-bond-spread-drops-below-400-basis-points/ (last visited Aug. 17, 2015).

[9] "The cramdown rate analysis, therefore, should focus on a rate that does not take market factors into account * * * ." App. 72.

[10] *Compare Bank of Am. Nat'l Trust & Savings Ass'n v. 203 N. LaSalle Street Partnership*, 526 U.S. 434, 457-58 (1999) (explaining that "the best way to determine value is exposure to a market" and discussing the "disfavor for decisions untested by competitive choice").

[11] *See Insurance Group Committee v. Denver & Rio Grande Western R.R.*, 329 U.S. 607, 615 & n.6, 618 (1947) (explaining that where "none of the authorized securities * * * have shown values much above par," objecting creditors failed to "conten[d] with some show of reasonableness that the [holders] * * * have received more in value than the face of their claims").

be.[12] Whatever the expectations of the asset's buyers, the value of a publicly traded financial obligation is almost definitionally the price at which it commonly trades.[13]

The lower courts' market-rejecting approach seems to assume that the interest rate an obligation bears is only marginally relevant to the obligation's current value. On the contrary, the value of a financial obligation flows inevitably from the interest rate that it bears. Elementary precepts of finance show that any

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[12] *Cf. Koopmans v. Farm Credit Servs. Of Mid-Am.*, 102 F.3d 874, 876 (7th Cir. 1996) (per Easterbrook, J.) ("[I]n competition, a financial intermediary does not make a 'profit.' * * * * [T]he market rate of interest * * * is * * * [the lender's] cost of capital * * * : the price it must pay to its own lenders, plus the costs of making and administering loans, plus reserves for bad debts."). *But see* App. 73 ("Therefore, as a first principle, the cramdown interest rate * * * should not contain any profit or cost element."), 242 (rejecting relevance of market rates because the "profit" included in a market rate would bring the holder "more than the present value" of its claim).

[13] *See, e.g.*, *United States v. 50 Acres of Land*, 469 U.S. 24, 25 n.1 (1984) (defining fair market value as "'what a willing buyer would pay in cash to a willing seller'") (quoting *United States v. Miller*, 317 U.S. 369, 374 (1943)); *Scheidelman v. Commissioner*, 755 F.3d 148, 151-52 (2nd Cir. 2014) ("Fair market value is based on a hypothetical transaction between a willing buyer and a willing seller * * * ." (citation and internal quotation marks omitted)); 26 C.F.R. § 20.2031-2(b)(1) ("[I]f there is a market for stocks or bonds, * * * the mean between the highest and lowest quoted prices on the valuation date is the fair market value per share or bond."). *See also Associates Comm'l Corp. v. Rash*, 520 U.S. 953 (1997) (defining "value" for purposes of 11 U.S.C. § 506 as "the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller") (quoted with approval in *Till v. SCS Credit Corp.*, 541 U.S. 465, 481 n. 20 (2004)).

difference between the interest rate on the obligation and the market rate will lead to a value that differs from the face amount of the obligation:

> Bonds can be priced at a premium, discount, or at par. If the bond's price is higher than its par value, it will sell at a premium because its interest rate is higher than current prevailing rates. If the bond's price is lower than its par value, the bond will sell at a discount because its interest rate is lower than current prevailing interest rates.

Investopedia.com, "Advanced Bond Concepts: Bond Pricing," *available at* http://www.investopedia.com/university/advancedbond/advancedbond2.asp (last visited Aug. 11, 2015).[14]

The facts of this case demonstrate the point well. The bankruptcy court selected an interest rate markedly below the market rate; the consequent value of the obligations predictably fell below their face amount. The only thing surprising is the conclusion of the courts below that those obligations – despite an interest rate concededly below market[15] and a market value concededly below their face

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[14]"A fundamental principle of bond investing is that market interest rates and bond prices generally move in opposite directions. When market interest rates rise, prices of fixed-rate bonds fall." Securities and Exchange Commission, Office of Investor Education and Advocacy, "Interest Rate Risk—When Interest Rates Go Up, Prices of Fixed-Rate Bonds Fall" (SEC Pub. No. 151 (6/13)), *available at* https://www.sec.gov/investor/alerts/ib_interestraterisk.pdf (last visited Aug. 11, 2015).

[15] Contemporaneous reactions to the rate selected by the court regarded it as "below-market" (Griffiths, *supra*; Practical Law, *supra*; Stone, *supra*; Andrew Scurria, "Momentive Win Shifts Balance of Power in Ch. 11 Process, Law 360 (May 6, 2015), *available at* http://www.law360.com/articles/651937/momentive-

amount – have a "value" for purposes of confirmation that equals their face amount. Both courts rested their rejection of the asset's market value on the incorrect premise that "market" values necessarily exceed "present value." *See* App. 242 (rejecting market evidence lest creditors "receive more than the present value of their allowed claim" (brackets, citation, and internal quotation marks omitted)), 81 (explaining that market valuations are necessarily incorrect because "capturing profit * * * is the marketplace lender's reason for being"). Indeed, the bankruptcy court acknowledged that its formula produced a ***lower*** interest rate for an obligation issued by a bankrupt company than the rate a "healthy" borrower would pay for a "comparable loan." App. 81.

As a matter of financial logic, the error of the courts below is simple: if a court consciously approves a below-market interest rate for a financial obligation, the court necessarily has created an asset with a value that is less than the face amount of the obligation. That is what it means to issue an instrument with a below-market interest rate. No coherent conception of "value" can support the holding that the "value" of such an obligation equals its face amount rather than its actual market value. Forcing a creditor to exchange a wholly secured claim for

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win-shifts-balance-of-power-in-ch-11-process (last visited Aug. 14, 2015)), "below the prevailing market" (Garry M. Graber and Craig T. Lutterbein, *Southern District Disallows Make Whole Payments and Market Interest Rates in* Momentive *Bankruptcy Proceedings*, 43 N.Y. Real Prop. L.J. 24, 24 (2015)), or "rock-bottom" (Vardi, *supra*).

such an obligation necessarily strips from the creditor much of the value of its claim.

II. Adoption of the Bankruptcy Code Did Not Alter the Preexisting Entitlement of Secured Creditors to the Full Value of Wholly Secured Claims.

The Supreme Court consistently has respected Congress's general intention to maintain continuity of practice under the Bankruptcy Code with practice under the Bankruptcy Act that preceded it. To that end, the Court has taken "particular care" in applying the view that Congress makes its "intent specific" when it "intends for legislation to change" the application of rules well-settled under the Bankruptcy Act. *Midlantic Nat'l Bank v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494, 501 (1986). Even those most skeptical of legislative history have acknowledged that "a major change in the existing rules would not likely have been made without specific provision in the text of the statute; it is most improbable that it would have been made without even any mention in the legislative history." *United Savings Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 380 (1988); *see BFP v. Resolution Trust Corp.*, 511 U.S. 531, 540 (1994) (noting that a "sense of history is needed to appreciate" the context of the Bankruptcy Code). As the sections that follow demonstrate, the baseline entitlement of secured creditors to the value of claims wholly secured by collateral was well-settled under the Act, and the legislative history shows an intent to

reinforce that protection, not undermine it. The common course of the Court's interpretive practice weighs strongly against the claim-stripping doctrine of the courts below.

A. The Entitlement of Secured Creditors to the Full Value of Wholly Secured Claims Under the Bankruptcy Act Was Well-Settled.

The Bankruptcy Act recognized in plain terms the entitlement of secured creditors to the full value of their secured claims. As for the problem at hand, courts under the Act readily recognized the importance of appropriate compensation for a delay in payment. Indeed, the most famous explanation of that baseline understanding comes from the opinion of Learned Hand for this Court in *Metropolitan Life Ins. Co. v. Murel Holding Corp.* (*In re Murel Holding Corp.*), 75 F.2d 941 (1935) [hereinafter *Murel*]. In that case, the trial court stayed a foreclosure action by a lender with a debt of $500,000 against a property with a value of $540,000. The trial court then approved a plan that obligated the creditor to accept interest-only payments for a term of ten years, at the conclusion of which the entire loan would come due. This Court found the plan unacceptable because it failed to accord appropriate protection to the secured creditors. When a court compels a secured creditor to changes the terms of its loan (the equivalent of a modern cramdown), Judge Hand explained, "it is plain that [the new obligation] must be completely compensatory; and that payment ten years is not generally the equivalent of payment now." 75 F.2d at 942.

A few years later, the Supreme Court pressed the same idea even more explicitly. The trial court in that case confirmed a plan of reorganization in which the bondholders received 5% bonds and preferred stock in return for their existing 6% bonds – trimming down their rights even though lower priority claimants were participating in the reorganization. *Consolidated Rock Prods. Co. v. DuBois*, 312 U.S. 510 (1941). The Supreme Court rejected that action out of hand, explaining:

> [T]he bondholders have not been made whole. They have received an inferior grade of securities, inferior in the sense that the interest rate has been reduced, a contingent return has been substituted for a fixed one, the maturities have been in part extended and in part eliminated by the substitution of preferred stock, and their former strategic position has been weakened. Those lost rights are of value. Full compensatory provision must be made for the entire bundle of rights which the creditors surrender.

312 U.S. at 527-28. Indeed, some thought that a contrary result would raise constitutional questions. *Wright v. Vinton Branch of Mountain Trust Bank*, 300 U.S. 440, 458 n.2 (1937) (per Brandeis, J.) (noting such concerns).

In sum, the regime against which Congress enacted the Code had no place for a proceeding stripping a secured creditor of any part of the value of a wholly secured claim by a compelled exchange for property traded in public markets at prices markedly below the value of the wholly secured obligation.

B. Congress Designed the Code to Extend the Protection of Secured Creditors.

The introduction of Chapter 11 in the 1978 Bankruptcy Code brought with it a major revision of the procedures for addressing secured claims in the bankruptcy process. No aspect of the Code, however, contemplated a process that forcibly deprived creditors of wholly secured obligations without providing property of equivalent value.

That point appears again and again throughout the course of the legislative history, with the designers of the bill emphasizing two closely related points. First, those holding a claim of lower priority (inferior debt or equity) should participate in a reorganization ***only*** if senior claimants are "fully compensated." Second, what full compensation means is payments that provide the secured creditors the "value" of their secured claims. A brief summary of the relevant history documents the pervasiveness of that understanding.

1. *The Commission's Bill and Report.*—The text of the Bankruptcy Code has its roots in the July 1973 Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137.[16] Part I of that document was a lengthy

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[16]The Commission on the Bankruptcy Laws of the United States was a bipartisan effort to produce a comprehensive reframing of the bankruptcy laws and included, among others, leading bankruptcy scholars, experienced federal judges, and key legislators. Its work was highly influential in the design and drafting of the Bankruptcy Code of 1978. *See generally* Charles Jordan Tabb, *The History of the Bankruptcy Laws of the United States*, 3 ABI L. Rev. 5, 32-34 (1995).

report explaining the deliberations of the Commission and the choices that the Commission had made in formulating a new bankruptcy law. Part II provided a draft statute, with detailed comments (much like the comments that accompany the Uniform Commercial Code).

The Commission's proposed bill included a predecessor to Section 1129, which (at least for present purposes) provided substantially the same protections to secured creditors as the present law. Thus, among other things Section 7-310 permitted confirmation of a plan that impaired a class of objecting secured creditors only if "the plan is fair and equitable in that there is a reasonable probability that the securities issued and other consideration distributed under the plan will fully compensate the respective classes of creditors * * * for their respective interests in the debtor or his property." Commission Bill § 7-310(d)(2)(B), H.R. Doc. No. 93-137, Part II, at 252 [hereinafter Comm'n Bill]. Related comments emphasized that "[t]he changes [from existing law] are not intended to affect in any way the holding in *In re Murel Holding Corp.*" Comm'n Bill, *supra*, § 7-303 cmt. 8, at 245. As relevant to this dispute, the language suggests, if anything, an emphasis on the real-world likelihood that the consideration issued under the plan in fact would "fully compensate" creditors for their collateral.

The Commission's narrative report provided an expansive explanation of the Commission's deliberations on this point, which had motivated the Commission to recommend across-the-board application of the familiar "absolute priority" rule. Of importance for the present dispute are the Report's repeated descriptions of the rule as one designed to provide "full compensation." So, for example, in its general discussion of the structure of the reforms to business reorganization that the Commission recommended, the report summarized the absolute priority rule as follows: "Basically, this rule merely recognizes the priorities already existing among various classes of security holders and requires that a senior class of security holders be ***fully compensated for their interest*** before any class junior to them may participate." H.R. Doc. No. 93-137, Part I, at 26 [hereinafter Comm'n Report] (emphasis added); *see also id.* at 245 ("In very general terms, [the absolute priority rule] means that a junior interest may not be retained unless claims of senior interests are ***fully satisfied***.") (emphasis added). Even more firmly, the Report took the position that in the absence of any contribution of new value "[t]here is ***no justification for*** equity security holders, partners, or an individual debtor to receive an interest in the reorganized business when creditors receive ***less than full compensation***." Comm'n Report, *supra*, at 254 (emphasis added).

The point is made most firmly in the Commission's extended discussion of its understanding of how the absolute priority rule should work in practice:

> The absolute priority rule ***condemns*** any plan of reorganization unless it provides participation for claims and interests in ***complete recognition of their strict priorities*** * * * . Any arrangements by which a junior class receives values allocable to a senior class comes within ***judicial denunciation***. Beginning with the topmost class of claims against the debtor, each class in descending rank must receive ***full and complete compensation*** for the rights surrendered before the next class below may properly participate.

Comm'n Report, *supra*, at 254 (emphasis added; citation, ellipsis, and internal quotation marks omitted).[17]

As those comments make clear, the Commission's most strongly held conception in this area of the law was a "strict" application of the absolute priority rule, with analysis of adequacy of creditor compensation to start from the baseline that objecting senior creditors must receive "full" and "complete" compensation before junior creditors properly can receive anything at all. It is impossible to reconcile that intention with the plan approved here, which permits lower creditors to participate in the capital structure of the reorganized debtors, while obligating

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[17]In assessing the likely reaction of the Commission if it had considered the rule adopted below, compare the passage quoted in the text to the description of the decision below by Vardi, *supra*:

> [T]he frustration of the company's highest-ranking creditors stems from the fact that they were fully covered going into the bankruptcy case * * * . Now, they are wondering how Apollo and Oaktree, financial players who stand below them in Momentive's capital structure, can be getting such a sweet recovery while the first lien debt holders look to receive less than par.

senior secured creditors to accept securities self-evidently worth over one hundred million dollars less than the secured claims for which they afford payment.

2. *H.R. 8200 and the House Report.*—To be sure, although Congress accepted many of the Commission's recommendations for reform of the bankruptcy system, much of the text and structure of the Code itself shifted during the course of congressional deliberations. The particular language at issue here, though, was finalized early in the process, with the July 1977 introduction of H.R. 8200, 95th Cong., 1st Sess. (July 1, 1977). Thus, Section 1129(b)(1)(B)(iii) of H.R. 8200 prohibited confirmation of a plan over the objection of impaired objecting secured creditors unless the plan provided "property of a value, as of the effective date of the plan, equal to the allowed amount of such claim." H.R. 8200 (July 1, 1977), *supra*, p. 205.[18] Notably, that bill included the specific phrase – "value as of the effective date of the plan" – that the courts below used to justify the rejection of empirically derived market valuations in favor of valuations based on policy-laden judicial norms of appropriate profit.

A brief discussion of the progress of H.R. 8200 illustrates that the approach of the courts below is just as inconsistent with the expectations of those involved

[18] H.R. 8200 included the provision in existing law that bifurcated claims secured by collateral into a secured claim, to the extent of the collateral, and an unsecured claim, to the extent of any excess. § 506(a), p. 79. Thus, the allowed secured claim discussed in that version of Section 1129(b) was by definition a claim wholly secured by collateral.

with H.R. 8200 as it with the understanding of the Commission. The language quoted above was retained without alteration in the version of H.R. 8200 that was reported out of the Judiciary Committee. Proposed Section 1129(b)(1)(B)(iii), H.R. 8200, 95th Cong., 1st Sess., at 511 (Sept. 8, 1977). Among other things, the report accompanying that version of H.R. 8200 made clear that those involved with H.R. 8200 would have rejected any idea that judicial assessment of non-market considerations could justify depriving a creditor of the value of a wholly secured claim. Two points are salient.

First, like the Commission Report, the House Report repeatedly characterizes the absolute priority rule as ensuring that creditors receive "value" that provides "full payment" for their interest in collateral. So, the section-by-section analysis of Section 1129(b) explained that "the so-called cramdown * * * requires simply that [among other things] [t]he dissenting class must be ***paid in full*** before any junior class may share under the plan," and that payment in full required "***property of a value*** equal to the allowed amount of their secured claims." H.R. Rep. No. 95-595, at 413 [hereinafter House Report] (emphasis added). Indeed, the report directly considered the situation presented here, in which a creditor is compelled to accept a new class of security in substitution for its original holdings; the touchstone was to be the "value" of the securities under actual market conditions:

> The partial codification of the absolute priority rule here is not intended to deprive senior creditor[s] of compensation for being required to take securities in the reorganized debtor that are of an equal priority with the securities offered to a junior class. Under current law, seniors are entitled to compensation for their loss of priority, and the increased risk put upon them by being required to give up their priority will be reflected in a lower value of the securities given to them than the value of comparable securities given to juniors that have not lost a priority position.

House Report, *supra*, at 414. Nothing in that passage suggests any sympathy for the concern of the court below that a plan assessing publicly traded securities at their market value might err by providing "more than the present value" of the claim.

The House Report also includes an extended discussion of the statutory reference to value "as of the effective date of the plan." Unlike the courts below, though, the House Report's analysis starts with recognition of the direct link between the value of an asset and the interest rate that the obligation bears. So, for example, the discussion started by acknowledging that the statute

> requires a valuation of the consideration "as of the effective date of the plan." This contemplates a present value analysis that will discount value to be received in the future; of course, if the interest rate paid is equivalent to the discount rate used, the present value and face future value will be identical.

House Report, *supra*, at 414. In the plan at issue here, of course, the interest rate paid is ***not*** equivalent to the discount rate, which means that the present value of the asset is ***not*** identical to the face future value.

As if that were not clear enough, the House Report continued with several hypotheticals providing even more specific guidance about the "value" of payments received over time. The last of those hypotheticals involved a plan that would obligate the holder of a $1,000 allowed secured claim to accept "a note in a face amount of $1,000 due five years from the effective date of the plan plus six percent annual interest commencing on the effective date of the plan." House Report, *supra*, at 415. Noting that "the higher the discount rate, the less present value the note will have," the report explained that assessment of that hypothetical "depends on whether the discount rate is less than six percent." *Id.*

Considering alternate possibilities, finding "the discount rate to be greater than or equal to the interest rate used in the plan" would prove that "the value of the note as of the effective date of the plan would not exceed the allowed amount of the secured claim."[19] *Id.* The report went on to emphasize the specific point

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[19] The report referred to the (largely superfluous) prohibition in the bill then under consideration of any order cramming down a plan that paid the holder of a secured claim "property of a value, as of the effective date of the plan, ***greater than*** the allowed amount of such claim." H.R. 8200 (Sept. 8, 1977), § 1129(b)(1)(A), p. 511 (emphasis added). With regard to the deletion of that provision, comments on the floor of Congress explained: "While that provision was explicitly included in the House bill, the deletion is intended to be one of style

missed by the courts below: "[I]t is important to recognize that the future principal amount of a note * * * may have a present value less than such * * * amount, if the interest rate under the plan is correspondingly less than the discount rate." *Id.*

The logic of that discussion is crucial. The House Report focuses on the statutory reference to the "value" of the note. Nowhere does the report consider whether an interest rate does or does not provide an appropriate "profit" to the lender. From the perspective of the House Report, the interest rate is but a tool for assessing the value of the underlying note. The House Report emphasized ***exactly*** the point of which the lower courts lost track: that a note with an interest rate less than the market discount rate will have a present value less than the face amount of the note. Indeed, to read the House Report, one would think (exactly contrary to the analysis of the courts below) that the "discount rate" is an external fact about the marketplace for the court to find; there is no hint that court should use calculation of the rate as a tool for the implementation of a court's view that market rates are unacceptably high.

3. S. 2266 and the Senate Report.—Although it phrased the matter a bit differently, the parallel Senate bill (S. 2266, 95th Cong., 2nd Sess. (July 14, 1978)) was no more intrusive on the rights of secured creditors. What was most important to the legislators was that the bill bifurcated treatment of secured creditors in

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and not one of substance." 124 Cong. Rec. 32,407 (Sept. 28, 1978) (comments of Rep. Edwards).

public companies from treatment of other companies. The treatment of other companies was substantially identical to the House bill – requiring plans to provide objecting impaired secured creditors "realization * * * of the value of their secured claims [by a method that] will * * * assure the realization by such class of the indubitable equivalent of the allowed amount of [their] claims." S. 2266 § 1130(a)(9)(A)(iii), at 519. With respect to public companies, by contrast, the Senate bill described the appropriate standard as one that would provide "adequate protection for the realization of the claims or interests." *Id.* § 1130(b), at 521. Lest there be any doubt about the intention of those provisions, the Senate Report explained that "[t]he indubitable equivalent language is intended to follow the strict approach taken by Judge Learned Hand in *In re Murel Holding Corp.*" S. Rep. No. 95-989, at 127.

4. The Final Bill.—When the managers of the statute brought the final bill to the floors of the House and Senate in September of 1978, they had to resolve the differences between the two approaches. The final solution was to extend the absolute priority rule across all companies, public and nonpublic. As Representative Edwards explained in extended remarks, conferees concluded that a unified approach for all companies (the modern Chapter 11) was superior. 124 Cong. Rec. 32,403-05 (Sept. 28, 1978). Although the final bill restructured many aspects of Section 1129, it retained the provisions included from the earliest

versions of that provision in H.R. 8200, requiring that the plan be "fair and equitable" and specifying the entitlement of secured creditors to the "value" of their collateral "as of the effective date of the plan." Section 1129(b)(2)(A)(i)(II), 124 Cong. Rec. 32,376 (Sept. 28, 1978). The explanations offered on the floor of the House and the Senate did not discuss those provisions in detail, stating only that they implemented the "fair and equitable" standard from prior law and that "secured creditors must receive present or deferred payments with a present value equal to the allowed secured claim." 124 Cong. Rec. 32,407 (Sept. 24, 1978) (remarks of Rep. Edwards). The final substantive discussion of the topic came when Senator DeConcini provided identical explanations a few weeks later, as the final bill reached the floor of the Senate just before its enactment into law. 124 Cong. Rec. 34,006-07 (Oct. 5, 1978) (comments of Sen. DeConcini).[20]

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The discussion above underscores the care with which Congress considered quite a few aspects of the cramdown provisions, revising them multiple times during the course of the process. It is inconceivable that legislators so repeatedly stressing the right of senior creditors to be paid in full intended to authorize free-

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[20] Like the Commission Report and the Senate Report, the extended remarks of Representative Edwards and Senator DeConcini both referred with approval to Judge Hand's opinion in *Murel*. 124 Cong. Rec. at 32,407 (Sept. 24, 1978) (comments of Rep. Edwards), 34,007 (Oct. 5, 1978) (comments of Sen. DeConcini).

wheeling judicial valuation as a tool for transferring values from senior creditors to junior creditors. Given the detailed consideration of much less momentous questions, and the repeated emphasis on preservation of time-honored notions of "full compensation," it seems clear that if any component of Congress ever "had intended, by [Section 1129] or any other provision," to authorize bankruptcy judges to use a consciously market-rejecting sense of "appropriate" pricing to strip secured creditors of the value of claims wholly secured by collateral, "'we can be certain that there would have been hearings, testimony, and debate concerning consequences so wasteful, so inimical to purposes previously deemed important, and so likely to arouse public outrage.'" *Kelly v. Robinson*, 479 U.S. 36, 51 (1986) (quoting *TVA v. Hill*, 437 U.S. 153, 209 (1978) (Powell, J., dissenting).

CONCLUSION

Because the decision of the bankruptcy court directly contradicts the scheme designed by Congress for cramdown bankruptcy plans, we respectfully submit that this Court should reverse.

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Rules 29(d) and 32(a)(7)(B) of the Federal Rules of Appellate Procedure because it contains 6,990 words, excluding the parts of the brief exempted by Rule 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Rule 32(a)(5) and the type style requirements of Rule 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word in Times Roman 14-point font.

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