

## The Cram Down Debate *In re: MPM Silicones, LLC*

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Experts are frequently asked to provide analyses and calculations of interest rates in litigation, whether for purposes of calculating the present value of lost profits, for example, or prejudgment interest thereon. In Chapter 11 proceedings, it is common for experts to testify regarding the calculation of the interest rate to be applied in the repayment of a secured claim, which when associated with the involuntary imposition of a plan of reorganization on a class of creditors that have voted to reject the plan, is referred to as a cram down interest rate. On August 26, 2014, in concluding the plan of reorganization confirmation hearing for *In re: MPM Silicones, LLC*, (Momentive), Judge Robert Drain of the Bankruptcy Court for the Southern District of New York issued a bench ruling significant in concluding that the allowed claim of a secured creditor may be satisfied by a long-term note with a below-market interest rate.

The dispute over the appropriate cram down rate of interest in the Momentive confirmation proceedings arose from certain note holders who argued for interest rates higher than that proposed in Momentive's plan of reorganization based on their views of what market-based lenders would expect for new, replacement notes. Given that Momentive had secured a \$1 billion exit financing facility for a term of seven years, however, senior secured creditors argued that this was evidence of a market rate, and that this rate should be used as a proxy for the cram down interest rate.

Judge Drain considered two methods for purposes of calculating interest: the coerced loan approach and the formula approach. Under the coerced loan approach, a cram down interest rate is determined from the rate of interest a secured creditor would achieve if it foreclosed on the collateral underlying its allowed claim, and reinvested the proceeds in assets similar to that of the debtor, for a period of time comparable to that proposed in the debtor's plan of reorganization. By comparison, as decided by the Supreme Court in *Till v. SCS Credit Corp.*, using the formula approach, a cram down interest rate is determined from the sum of a risk-free rate and a premium for risk. In practice this is usually accomplished by adding to the prime rate, which is the rate offered by financial institutions to the most credit-worthy borrowers, a risk premium of between 1 and 3 percent. In *Till*, the Court added also that "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 arriving at his conclusions, Judge Drain followed the analytical guidance provided in the Supreme Court's decision in *Till v. SCS Credit Corp.*, and in the Second Circuit's decision in *In re Valenti*. In both cases, the Court rejected the coerced loan approach proposed by the senior secured lenders in Momentive. Judge Drain rejected the coerced loan approach for much the same reasons, and in choosing the formula approach,

decided that it was not appropriate to consider an analysis of market-based interest rates for similar loans to determine an appropriate cram down interest rate.

Explaining his findings, Judge Drain noted that the objective of a cram down interest rate is to place a creditor in the same position it would have been in economically if it had received the value of its allowed claim immediately, not as if it had arranged a new loan. Further, the rate should not include any element of profit, cost or fees since such a rate would not be appropriate for purposes of calculating the present value of a secured creditor's deferred distributions in a cram down calculation. In addition, it is not appropriate to consider market-based evidence, except secondarily for purposes of determining an appropriate risk premium, in which case factors including the circumstances of the debtor's estate, the underlying collateral, the terms of the new debt, and the feasibility and duration of the plan of reorganization should be taken into account. The risk adjustment, however, should not be used as a means of backing into a market rate.

**Keywords:** expert witnesses, litigation, cram down interest rate, coerced loan approach, formula approach, Momentive, MPM Silicones

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