Committees: Financial Advisors and Investment Banking

Why Till Works

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Many have reviewed the U.S. Supreme Cour
and walked away shaking their heads in confusion. The underlying case invc
purchased a used truck and shortly thereafter filed for bankruptcy under cha
choose the best method to determine a cramdown interest rate. It is importa
addressing an all-inclusive list of methodologies available to financial practiti
methodologies previously used by various bankruptcy courts. The case and
of the mathematics of a particular interest rate methodology, but rather selec
bankruptcy courts might best apply to return the present value of a creditor's
(Bankruptcy Code § 1129(b)(2)(A)(II)).

From a financial perspective, there are often multiple ways to determine the
simplest, at least from an intuitive perspective, is the formula approach (a/k/a
the Supreme Court involved a relatively straightforward consumer case. For various reasons, the Cour
better position to determine and support their view of the correct interest rate and so moved the burde
13 cases, this makes good sense. Since chapter 13 cases are consumer cases and in some manner n
as the formula approach, was a good result.

However, there is some disagreement over whether *Till* should apply to more complex chapter 11 case
balanced. Borrowers tend to be far more sophisticated and better able to provide evidence to prove the

however, and the formula approach suggested in *Till* continues to work. The question now for many re
mean that bankruptcy courts should only use the formula approach in chapter 11 cases, and is simples

Many sophisticated financial professionals and some courts have reasoned that other methodologies r
the appropriate interest rate. Financial professionals have routinely used methods such as the weighte
asset pricing model for several decades. In fact, in many investment scenarios, the presentation of a fo
too simple and less reliable than one of these other methodologies. When an investment committee at
determines the appropriate return for its investment, it does not rely solely (if at all) on the formula appr

That said, in making its decision, the committee absolutely considers the same concept that the formul
investment committee compares the risk and potential return of the new investment to the risk and retu
knows its cost of funds (its unique base rate), and that as it incurs more risk, it must add to its rate. So
compares the rate to the Prime rate, U.S. Treasuries or some other rate, the same underlying concept
risk remains.

So if the formula approach works, why are so many financial professionals reluctant to use it? The ans
earliest finance and economics classes, we learned that the markets move to account for supply and d
of a good or service to balance the supply and demand, and those markets are generally economically
existence of an active market as the Supreme Court seemed to imply, but rather that investors in the m
information in the market. Ultimately, for less risk, investors demand less; for more risk, investors dema
training and market theory lies the punch line: "all the pieces of information."

To complete the formula approach, the financial professional must determine all of the risk factors and
price the risk. The Court in *Till* gave us four broad categories to use in this evaluation, but the list of mo
chapter 11 case is usually very long. In many cases, risk factors can be continually broken down into a
each of these risk "sub-factors" is unrealistic, if not impossible. More importantly, the individual pieces
price for each of these risk factors is often not available.

So how does someone determine the rate of interest for a loan? The answer is to analyze the risk and
those pieces have very definable market-driven data. In an interest rate scenario, the financial professi
average loan for unanchored retail shopping centers is Prime plus 2%. This is a definable and accurate
risk and reward. The analyst can continue to examine other variables and make adjustments, such as
etc., to include all of the risk factors of the debtor's plan.

Financial professionals are trained to look toward known market data, so the idea of introducing error w
hard market data should be a source of discomfort. In many cases, the risk factors may be easy to ider
factor from the market may be too expensive or time-consuming, or the data simply might not exist. Th
force the analyst to consider the aspects of each subjective adjustment. In these cases, analysts must
estimate the necessary reward for the risk. Financial professionals who use methods other than the for
average cost of capital, often must make subjective adjustments into the calculation's inputs in order to

In the context of chapter 13, case efficiency prevails with the formula approach. Judges routinely see t
that come before them. They make judgments and move on. It is simple, logical and efficient, and it wo
make decisions on a number of wide-ranging business types, debt structures and plan designs. Few ju
deal with such wide-ranging data and issues. As a result, experts are called upon to help the judge ide
interpret data, and to give opinions on subjective matters.

And this is why *Till* works: Using *Till* forces the financial professional to break their opinion down into "b
then be considered by the trier of fact.

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