

Chapter 11 confirmation
"Cramdown" interest rate

Fredric and Vonis Waugh, Case No. 03-67809-fra11

10/19/2004 FRA

Unpublished

Debtors' proposed chapter 11 plan of reorganization was approved by all creditors, except for Pacific Continental Bank (PCB), the principal secured creditor. In order to determine whether the plan should be confirmed over the objection of PCB, the court was required to determine the appropriate interest rate to be paid on PCB's secured claim and whether the plan was feasible given that and other claims required to be paid.

While the recent U.S. Supreme Court opinion in Till v. SCS Credit Corp, 124 S.Ct. 1951 (2004) did not involve a chapter 11 case, the bankruptcy court found that it is equally applicable in the context of chapter 11. The Supreme Court held that a formula approach should be used to determine the applicable cramdown interest rate. Starting with the current prime rate, the creditor must establish what additional interest should be charged in light of the risks of inflation and of default. Given the circumstances of the present case, the bankruptcy court determined that an interest rate of 7% is appropriate. The court confirmed the plan of reorganization, finding that the debtors had sufficient income to make required payments.

E04-17(6)

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:) Bankruptcy Case No.
) 03-67809-fra11
FREDRIC R. WAUGH and)
VONIS L. WAUGH,)
) MEMORANDUM OPINION
_____ Debtors.)

A hearing was held on September 14, 2004 to consider whether the Debtor-in-Possession's proposed plan should be confirmed over the objection of a dissenting creditor. The Court finds that the plan satisfies the requirements of Code § 1129, and that the plan should be confirmed.

Debtors-in-Possession are the operators of a gasoline service station in Jackson County. Their proposed plan of reorganization has been approved by all creditors except Pacific Continental Bank (PCB), the principal secured lender. PCB cast a ballot rejecting the proposed plan, and a written objection to confirmation on the grounds that (1) the plan is not feasible,

Code § 1129(a)(11), (2) PCB's claim, which is impaired, is not accorded the "fair and equitable" treatment required by § 1129(b)(2)(A), the so-called "cramdown" provision, and (3) the DIP is unable to pay administrative claims as of the effective date of the plan.

PCB is the holder of an allowed secured claim (No. 6) in the sum of \$1,486,434.33. The claim is secured by the DIP's real property. At trial, PCB asserted that its claim, as of August 26, 2004, totals \$1,539,248.41, including principal of \$1,303,832.36, accrued interest, fees and costs. This figure was not disputed, and will be accepted for the purposes of confirmation.

The Plan makes this provision for PCB's claim:

The Class 2 Claim will be paid in full together with interest at the contract rate, in monthly installments equal to the rent received at [the DIP's premises], for the months up to and including June 2004; and thereafter in monthly installments of \$10,160 beginning on July 1, 2004.

The contract rate in the original loan was Prime (per the Wall Street Journal) plus 1%, adjusted periodically. The loans were entered into in August, 1998, and were to mature in August, 2023. On the date of the hearing, the Prime Rate was 4.5%, and the contract rate 5.5%. At that rate, the proposed monthly payment would amortize and pay the claim in full in 21.5 years.

Assuming all other elements of § 1129 have been satisfied, three questions remain, to be answered in this opinion:

First, the interest rate required in order to assure that the payments to be made to PCB have a present value equal to its claim;

Second, whether the reorganized debtor will be able to make the monthly payments required in light of the appropriate interest rate; and

Third, whether there are sufficient funds available to pay administrative expenses payable on the effective date of the plan.

The Supreme Court resolved the long-standing debate over cramdown interest rates in its recent decision in *Till v. SCS Credit Corp.*, __ U.S. __, 124 S.Ct. 1951 (2004). Rejecting competing theories such as a presumed rate based on the contract, or a "coerced loan" rate, the Court held that the appropriate rate should be calculated by a "formula" approach. Taking the current prime rate as a starting point, the Court's approach requires the creditor to establish what additional interest should be charged in light of risks of inflation and default.

Based on the evidence presented, I find that the rate applicable here is 7% per annum. At that rate, the monthly

payment required to pay \$1,539,248.41 in 228 months, the remaining term of the contract, is \$12,224.59 per month.

Total payments required under the plan (other than Classes 4 and 5, which are included in DIP's operating budget) are:

Jackson County	\$ 2,000.00
PCB	12,224.59
K. Anderson	625.00
Unsecured Creditors	<u>1,500.00</u>
TOTAL	\$16,349.59

The DIPs rely on their Rule 2015 financial statements as evidence of their ability to make plan payments. The last statement, for the month of July 2004, reveals (excluding details):

Total income [i.e., gross sales]	\$ 264,190.56
Less: cost of goods	<u>(214,388.93)</u>
Gross Profit	\$ 31,801.63
Total Expenses	(19,449.65)
Net Ordinary Income	12,351.00
Rental Income	7,160.00
Total income	<u>\$ 19,511.00</u>

The report does not appear to provide for any reserve for property taxes in the monthly budget. Presumably, the loans have provided for such reserves, and the funds were included in debt service. Moreover, there was evidence that, in the future, 75%

of the taxes would be paid by tenants according to the terms of their leases. In that case, the reorganized debtors will have to set aside an additional \$840.00 per month for their share of the real property taxes, reducing the income available for plan payments to \$18,671 per month.

This means that the Debtors will have about \$2,322 left each month for themselves, and to cover unexpected expenses. While this means a very tight budget, I do not find that it is so tight that Debtors cannot make necessary adjustments, and that they are likely to need further relief in the future.

PCB's remaining objection is that the claim of Jackson County for post-petition real property taxes must be paid as of the effective date of the plan. § 1129(a)(9)(A). Jackson County has an allowed secured claim (No. 1) of \$132,582.87. This includes taxes payable for the tax year 2003/04, which became a lien on the DIPs' property on July 1, 2003 (the petition for relief was filed on September 19, 2003). The claim is provided for in the plan, which the County has accepted.

Taxes for the 2004/05 tax year became a lien on July 1, 2004. ORS 311.405(2)¹. Property tax statements for this tax

¹ORS 311.405(2):

Taxes on real property shall be a lien thereon from and including July 1 of the year in which they are levied until paid...

(continued...)

year are not yet available, even though the tax is now a lien.² Assuming the tax is at least as much as last year's, the tax claim can be expected to be about \$22,630.97 for the two lots in question. PCB claims that this sum is an administrative expense that must be paid in full as of the effective date of the plan³, and that the DIPs lack the cash to do so. DIPs argue that the *payment* is not yet due, so the tax need not be paid in full on the effective date.

Under ORS 311.505, payment of the first one-third of property taxes levied for the tax year are due on November 15. The second third is due on the following February 15, and the remaining third on May 15. Discounts are allowed for earlier payment. The Code, as noted, requires payment in full of administrative claims as of the effective date. However, § 1129(a)(2)(A) cannot be construed, at least in this instance, as

¹(...continued)

ORS 311.410(1):

Real property or personal property which is subject to taxation on July 1 shall remain taxable and taxes levied thereon for the ensuing tax year shall become due and payable, notwithstanding any subsequent transfer of the property to an exempt ownership or use.

²Statements are issued by the County not later than October 25. ORS 311.250(1)

³The effective date of the plan is "the first business day of the first full calendar month after the tenth day following the Confirmation Date [the date an order confirming the plan is docketed] upon which no stay of the confirmation order is in effect." Plan ¶13.14

accelerating claims which may arise post- petition but are not yet due.

In conclusion: I find that the requirements of Code § 1129, including § 1129(b), have been satisfied, and that an order confirming the proposed plan of reorganization should be entered.

The Plan as submitted cannot be confirmed, however, because the payments provided for PCB are not sufficient. A plan may be confirmed if it is amended with respect to PCB, as discussed above. An order confirming the plan, as modified, may be submitted.

This opinion constitutes the Court's findings of fact and conclusions of law.

FRANK R. ALLEY, III
Bankruptcy Judge