Washington and Lee Law Review

Volume 68 | Issue 1 Article 4

Winter 1-1-2011

Reconceptualizing Present-Value Analysis in Consumer Bankruptcy

Rafael I. Pardo

Reconceptualizing Present-Value Analysis in Consumer Bankruptcy

Rafael I. Pardo*

Abstract

During the three decades following the enactment of the Bankruptcy Code, courts and commentators have been vexed by the problem of determining the present value of future payments to creditors proposed in a debtor's repayment plan. The issue central to this problem has been the discount rate to be applied when conducting present-value analysis. While the Code unmistakably requires the discounting of future payments as part of the process for confirming a repayment plan, the Code does not explicitly specify the rate itself or the manner in which the rate should be calculated.

No uniform rule of decision has emerged on this issue. Instead, a multitude of approaches has proliferated within and across circuits. Not even the Supreme Court has been able to bring uniformity to bear on the issue. When given the opportunity to do so in 2004, the Court in Till v. SCS Credit Corp.[1] *could muster only a plurality opinion. In the wake of* Till, *disarray over the discount-rate calculus continues to abound.*

The main goal of this Article is to reconceptualize present-value analysis in consumer bankruptcy. It argues that, as a positive matter, the Bankruptcy Code compels use of a discount rate that solely accounts for expected inflation, but that does not take into account opportunity cost or the risk of nonpayment. The Article also examines whether the

---

* Professor of Law, University of Washington. For helpful comments and suggestions, I am grateful to Robert Ahdieh, Joanna Shepherd Bailey, William Buzbee, William Carney, David Epstein, David Hoffman, Timothy Holbrook, Michael Kang, Margaret Lemos, Jonathan Nash, Charles O'Kelley, the Honorable Pamela Pepper, Lawrence Ponoroff, Frederick Tung, and Kathryn Watts. This Article has also benefited greatly from the commentary of participants at the 2010 Annual Meeting of the Canadian Law and Economics Association and at faculty workshops at Emory University School of Law; the University of California, Irvine School of Law; and the University of Washington School of Law.

1. Till v. SCS Credit Corp., 541 U.S. 465 (2004).

doctrinal prescription for the application of an inflation discount rate is normatively desirable. The Article concludes that, not only does an inflation rate comport with generally held theory of bankruptcy law's procedural and substantive goals, it also optimizes the statutory design of the Bankruptcy Code and the institutional design of the bankruptcy courts.

Table of Contents

I. Introduction

During the three decades following the enactment of the Bankruptcy Code,[2] courts and commentators have been vexed by the problem of determining the present value of future payments to creditors proposed in a debtor's repayment plan. The issue central to this problem has been the discount rate to be applied when conducting present-value analysis. While the Code unmistakably requires the discounting of future payments as part of the process for confirming a repayment plan, the Code does not explicitly specify the rate itself or the manner in which the rate should be calculated.

No uniform rule of decision has emerged on this issue. Instead, a multitude of approaches has proliferated within and across circuits.[3] The lack of uniformity has generated a great deal of criticism, including that from the National Bankruptcy Review Commission (NBRC), which Congress authorized in 1994 to evaluate and recommend revisions to the Bankruptcy Code.[4] In its final report in 1997, the NBRC recommended that the discount rate for present-value analysis "should be determined using a

2. This Article uses the terms "Bankruptcy Code" and "Code" to refer to the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended primarily at 11 U.S.C. §§ 101-1532 (2006)).

3. *See infra* notes 22–24 and accompanying text (discussing the manner in which intercircuit and intracircuit splits culminated in the *Till* decision).

4. *See* Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 603, 108 Stat. 4106, 4147 (listing the duties of the NBRC).

nationally recognized rate to promote the equal treatment of similarly situated debtors and creditors,"[5] but it failed to specify a particular rate.[6]

Not even the Supreme Court has been able to bring uniformity to bear on the issue. When given the opportunity to do so in 2004, the Court in *Till v. SCS Credit Corp.* could muster only a plurality opinion.[7] In the wake of *Till*, disarray over the discount-rate calculus continues to abound. Pursuant to the test for determining the holding of a fragmented Court as articulated in *Marks v. United States*,[8] one court has concluded that no single standard exists that legitimately constitutes the narrowest ground for the plurality and concurring opinions in *Till*, such that no binding precedent resulted.[9] In contrast, another court applying the *Marks* test has reached the opposite conclusion.[10] And, making matters more interesting, the Fifth Circuit has held that, for a case involving a factual scenario identical to that presented in *Till*, the plurality opinion in *Till* constitutes binding authority (thus rendering the *Marks* test inapplicable).[11] Clearly, the issue of how to conduct present-value analysis in bankruptcy remains unsettled.

To be sure, some of the blame for this doctrinal mess falls on Congress for its repeated failure to specify the discount rate that a court ought to use in its present-value analysis.[12] But the rest of the blame falls on courts and

5. 1 NAT'L BANKR. REV. COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 261 (1997).

6. *Id.*

7. Till v. SCS Credit Corp., 541 U.S. 465 (2004) (Stevens, J., plurality opinion).

8. Marks v. United States, 430 U.S. 188, 193 (1977) ("When a fragmented Court decides a case and no single rationale explaining the result enjoys the assent of five Justices, 'the holding of the Court may be viewed as that position taken by those Members who concurred in the judgments on the narrowest grounds . . . .'" (omission in original) (quoting Gregg v. Georgia, 428 U.S. 153, 169 n.15 (1976))).

9. *See In re* Cook, 322 B.R. 336, 341 (Bankr. N.D. Ohio 2005) ("The lack of a legal rationale shared by five Justices leads to the inescapable conclusion that *Till* does not produce binding precedent."). For commentary arguing that, under the *Marks* narrowest-ground test, *Till* did not produce binding precedent, see April E. Knight, Recent Development, *Balancing the Till: Finding the Appropriate Cram Down Rate in Bankruptcy Reorganizations After* Till v. SCS Credit Corporation, 83 N.C. L. REV. 1015, 1026–27 (2005).

10. *See In re* Flores, No. 05-38630/JWH, 2006 WL 4452973, at *7 (Bankr. D.N.J. Mar. 29, 2006) (observing that, pursuant to the *Marks* test, the legal standard for calculating present value can be ascertained from the plurality and concurring opinions in *Till*).

11. *See* Drive Fin. Servs., L.P. v. Jordan, 521 F.3d 343, 349 (5th Cir. 2008) ("Drive Financial's reliance on *Marks* is misplaced in this case because we are presented with essentially the same facts that the Supreme Court was presented with in *Till*.").

12. In its most recent overhaul of the Bankruptcy Code in 2005, Congress did nothing to address the discount-rate calculus, with the exception of instructing a court to defer to nonbankruptcy law in determining the rate when conducting present-value analysis for the

commentators, who have failed to follow existing signposts throughout the Code that ultimately reveal the appropriate discount rate. As a result of this failure, a great deal of the debate over discounting in consumer bankruptcy cases has been inappropriately couched in terms of adequately compensating creditors for the opportunity cost and the default risk that arise from deferred repayment by a debtor. Because these considerations overlook, and sometimes even contravene, relevant Code provisions, the discount-rate calculus has been analytically unsound. Moreover, no comprehensive effort has been made to determine whether, and if so the extent to which, the Code's approach to present-value analysis squares with the normative principles underlying bankruptcy law.

Beyond these matters of legal consequence, however, present-value analysis is ultimately about money, plain and simple. In his critique of *Till*, Robert Rasmussen has observed that the competing discount rates offered by the debtor and the creditor translated into a mere $807.44 difference over a three-year period, an amount "seemingly not much over which to make a federal case."[13] But if one recognizes that this type of controversy is highly repetitious, then, Rasmussen observes, the significant economic consequence of such litigation quickly becomes apparent:

> What mattered, of course, was not the money at stake in [*Till*], but rather what legal rule would govern future cases of this type. The lender is a repeat player in bankruptcy, and how courts determine the applicable rate of interest in a Chapter 13 plan is an issue that matters a lot to it. In 2004, there were approximately 450,000 Chapter 13 cases. To be sure, not every Chapter 13 debtor has a car, but it is probably a safe bet that at least half of them do. . . . [I]f we take half of the Chapter 13 cases and assume that the amount at stake in *Till* represented an average in these cases, that comes out to $180 million at stake for 2004 alone.[14]

Rasmussen's estimate clearly does not account for the amounts at stake in *all* consumer bankruptcy cases involving present-value analysis. Individual debtors use Chapter 13 not only to retain cars, but also to retain other types of property (both real and personal).[15] If that property is subject

payment of tax claims. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 704(a), 119 Stat. 23, 125 (codified at 11 U.S.C. § 511(a) (2006)).

13. Robert K. Rasmussen, *Creating a Calamity*, 68 OHIO ST. L.J. 319, 323 (2007).

14. *Id.* at 324.

15. During the 2009 calendar year, the total amount of assets reported by individual debtors who filed for Chapter 13 relief exceeded $66.1 billion (with approximately $52.3 billion constituting real property and $13.8 billion constituting personal property). ADMIN. OFFICE OF THE U.S. COURTS, 2009 REPORT OF STATISTICS REQUIRED BY THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005, at 28 tbl.1D (2009),

to a creditor's lien, or if the property is owned free and clear but cannot be claimed by the debtor as exempt property, the Code's provision for present-value analysis will be triggered,[16] thereby opening the door for a potential dispute over the appropriate discount rate. When the disputes that materialize are considered in conjunction with Rasmussen's $180 million estimate, it seems reasonable to hypothesize that the amount at stake on an annual basis is at least a quarter of a billion dollars.[17]

The main goal of this Article is to reconceptualize present-value analysis in consumer bankruptcy. It argues that, as a positive matter, the Bankruptcy Code compels the use of a discount rate that accounts solely for expected inflation, but that does not take into account opportunity cost or the risk of nonpayment.

Part II.A describes the Code provisions that require a court to conduct present-value analysis as a condition to Chapter 13 plan confirmation. Part II.B discusses the Supreme Court's decision in *Till v. SCS Credit Corp.* in which a fractured Court arguably failed to provide a binding rule for present-value analysis as applied to the payment of secured claims in Chapter 13. Part III critiques the plurality and dissenting opinions in *Till*—both of which advocated a risk-adjusted discount rate—for their failure to interpret the Code properly. Part III also builds on Justice Thomas's concurring opinion, which advocated a risk-free discount rate, to

---

available at http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BAPCPA/2009/Table1D.pdf. It is the case, of course, that some debtors will choose not to retain their assets in their Chapter 13 cases. *See* 11 U.S.C. § 1325(a)(5)(C) (2006) (providing that a debtor may satisfy the claim of a creditor that is secured by property by surrendering the property to the creditor). But even if only a quarter of the amounts from 2009 represented the property sought to be retained by Chapter 13 debtors, the amounts involved are still quite substantial.

16. *See infra* Part III.A (discussing when the Chapter 13 provisions for present-value analysis apply).

17. In support of this conservative estimate, consider that total disbursements during the 2009 fiscal year by Chapter 13 trustees to secured creditors that were owed nonmortgage debt *exceeded* $1.3 billion. *See* U.S. Trustee Program, *Chapter 13 Handbooks & Reference Materials*, http://www.justice.gov/ust/eo/private_trustee/library/chapter13/index.htm (last visited Feb. 16, 2011) (providing Chapter 13 statistics by fiscal year) (on file with the Washington and Lee Law Review). Present-value analysis is usually not implicated in the context of mortgage debt because the Bankruptcy Code generally prohibits a debtor from modifying the rights of a creditor whose claim is secured only by a security interest in real property that is the debtor's principal residence. 11 U.S.C. § 1332(b)(2). There are exceptions, however, such as when the mortgage is *not* on the debtor's principal residence (in which case the Code's anti-modification provision does not apply in the first instance). Another exception is when the mortgage is on the debtor's principal residence, but the last payment on the mortgage is contractually due prior to the final payment scheduled in the debtor's Chapter 13 plan. *Id.* § 1322(c)(2).

demonstrate the propriety of using an inflation rate for discounting payments in consumer bankruptcy. Part IV describes the limited circumstances pursuant to which the Code allows the recovery of interest (i.e., amounts relating to opportunity cost, expected inflation, and risk of nonpayment) that matures subsequent to a debtor's bankruptcy filing. This descriptive account further bolsters the Article's positive theory of present-value analysis in consumer bankruptcy. Finally, Part V sets forth the normative arguments that justify the Article's positive theory of present-value analysis.

II. The Problem and the Court's Solution

An individual who files for bankruptcy generally faces the decision of filing under Chapter 7 or Chapter 13 of the Code.[18] One of the most significant functional differences between the two chapters relates to the manner in which creditor claims are paid. Claim repayment in Chapter 7 involves the distribution of proceeds from the sale of the debtor's pre-bankruptcy, nonexempt assets.[19] On the other hand, claim repayment in Chapter 13 involves the distribution of the debtor's post-bankruptcy income.[20] Because claim repayment in Chapter 13 constitutes a deferred

---

18. A debtor may voluntarily commence a bankruptcy case by filing with the bankruptcy court a petition under the particular operative chapter of the Bankruptcy Code pursuant to which he or she seeks relief. 11 U.S.C. § 301(a). Individual debtors may file for relief under Chapter 11 of the Bankruptcy Code. *Id.* § 109(b), (d); Toibb v. Radloff, 501 U.S. 157, 160–61, 166 (1991). However, Chapter 11 filings by individual debtors constitute a small percentage of total consumer filings. *See, e.g.*, JAMES C. DUFF, ADMIN. OFFICE OF THE U.S. COURTS, JUDICIAL BUSINESS OF THE UNITED STATES COURTS: 2009 ANNUAL REPORT OF THE DIRECTOR app. at 291 tbl.F-2 (2010), *available at* http://www.uscourts.gov/Statistics/JudicialBusiness/JudicialBusiness.aspx?doc=/uscourts/Statistics/JudicialBusiness/2009/JudicialBusinespdfversion.pdf (indicating that there were 1,306 nonbusiness Chapter 11 filings of a total 1,344,095 nonbusiness filings during the twelve-month period ending September 30, 2009). Individuals who are family farmers with regular income are eligible to file for relief under Chapter 12 of the Bankruptcy Code. 11 U.S.C. § 109(f). Chapter 12 filings likewise constitute a very small percentage of bankruptcy filings by individuals. *See, e.g.*, DUFF, *supra*, app. at 291 tbl.F-2 (indicating that there were 487 Chapter 12 filings during the twelve-month period ending September 30, 2009).

19. *See* 11 U.S.C. § 541(a)(1) (providing that commencement of a case creates an estate consisting of "all legal or equitable interests of the debtor in property as of the commencement of the case"); *id.* § 704(a)(1) (requiring the trustee to "collect and reduce to money the property of the estate"); *id.* § 726(a) (providing for distribution of property of the estate); *id.* § 522(b) (allowing debtor to claim as exempt certain property from property of the estate).

20. *See id.* § 1322(a)(1) (requiring that the plan "provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and

stream of future payments, the Code requires that, as a condition to confirmation of the debtor's repayment plan, the payments to the creditor be discounted to their present value.[21] Unfortunately, the Code does not expressly set forth how to calculate the appropriate discount rate to confirm that creditors in Chapter 13 will be properly compensated.

From the time that Congress enacted the Code in 1978,[22] courts developed different approaches to address this issue.[23] The diverging results across and within circuits eventually led the Supreme Court in 2004, in *Till v. SCS Credit Corp.*, to consider the issue as applied to the repayment of secured claims in Chapter 13.[24] Although the plurality and the dissent disagreed on the methodology for calculating the discount rate, they ultimately agreed that the rate must incorporate a premium for risk.[25] In stark contrast, Justice Thomas, who concurred in the judgment to reverse and remand the case to the bankruptcy court, disagreed with the consensus underlying the plurality and dissenting opinions.[26] In his view, the Code's discount-rate calculus does not call for any risk adjustment.[27]

---

control of the trustee as is necessary for the execution of the plan"). A Chapter 7 debtor's post-bankruptcy income is excluded from the debtor's estate. *Id.* § 541(a)(6). Thus, such income is not available as a source of property for the repayment of creditor claims in Chapter 7. *Id.* § 726(a). In contrast, a Chapter 13 debtor's post-bankruptcy income is included in the debtor's estate. *Id.* § 1306(a)(2). The Code permits a Chapter 13 debtor to retain all property of the estate not used to repay creditor claims. *Id.* §§ 1306(b), 1327(b). That said, the Code does authorize a debtor to use pre-bankruptcy assets, in addition to post-bankruptcy income, to repay creditor claims. *Id.* § 1322(a)(8). The functional difference in claim repayment under the two chapters has been described as "the basic chapter 13 bargain." David Gray Carlson, *Modified Plans of Reorganization and the Basic Chapter 13 Bargain*, 83 AM. BANKR. L.J. 585, 585–86 (2009).

21. *See* 11 U.S.C. § 1325(a)(4) (setting forth requirement for discounting property distributed on account of allowed nonpriority unsecured claims); *id.* § 1325(a)(5)(B)(ii) (setting forth requirement for discounting property distributed on account of allowed secured claims). *But see id.* § 1322(a)(2) (omitting any requirement that deferred cash payments to priority unsecured claims be discounted to present value).

22. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended primarily at 11 U.S.C. §§ 101–1532 (2006)).

23. *See* 1 NAT'L BANKR. REV. COMM'N, *supra* note 5, at 259 ("The absence of a statutory authority has led courts to employ different methods to determine the appropriate rate of interest."); David G. Epstein, *Don't Go and Do Something Rash About Cram Down Interest Rates*, 49 ALA. L. REV. 435, 443–59 (1998) (summarizing the various approaches to present-value analysis adopted by courts of appeals prior to the Supreme Court's decision in *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997)).

24. Till v. SCS Credit Corp., 541 U.S. 465 (2004) (Stevens, J., plurality opinion).

25. *Id.* at 491–92, 508 (Scalia, J., dissenting).

26. *Id.* at 486 (Thomas, J., concurring).

27. *Id.*

Part II.A sets forth a brief overview of the general principles governing present-value analysis of claim repayment in Chapter 13. Against this backdrop, Part II.B discusses the Court's decision in *Till*.

A. Present-Value Analysis in Chapter 13

A debtor's Chapter 13 plan must satisfy various standards in order to be confirmed.[28] Among those standards are two key provisions regarding the amount of property, usually income,[29] that a debtor must distribute to allowed claims, both secured and unsecured. The confirmation standard for payment of allowed unsecured claims, commonly referred to as the "best interest of creditors test,"[30] will be satisfied if "the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of [the Bankruptcy Code] on such date."[31] In those instances where the debtor proposes to retain the property securing a holder's claim and where the holder of the allowed secured claim has not accepted the debtor's Chapter 13 plan,[32] a process commonly referred to

28. 11 U.S.C. § 1325(a) (2006). The Supreme Court's recent decision in *United Student Aid Funds, Inc. v. Espinosa* indicates that the confirmation standards for a Chapter 13 plan are mandatory and that bankruptcy courts have an independent obligation to ensure compliance with those standards. *See* United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367, 1381 (2010) (stating that "§ 1325(a) instructs a bankruptcy court to confirm a plan only if the court finds, *inter alia*, that the plan complies with the 'applicable provisions' of the Code"); *id.* at 1381 n.14 (stating that Code § 1325(a) "*requires* bankruptcy courts to address and correct a defect in a debtor's proposed plan even if no creditor raises the issue"); Shaw v. Aurgroup Fin. Credit Union, 552 F.3d 447, 462 (6th Cir. 2009) (holding that confirmation standards for a Chapter 13 plan are mandatory); Wachovia Dealer Servs. v. Jones (*In re* Jones), 530 F.3d 1284, 1290 (10th Cir. 2008) (same); Barnes v. Barnes (*In re* Barnes), 32 F.3d 405, 407 (9th Cir. 1994) (concluding that Code § 1325(a)(5)(B)(ii) is a mandatory requirement for plan confirmation). *But see In re* Szostek, 886 F.2d 1405, 1412 (3d Cir. 1989) (concluding that Code § 1325(a) is a nonmandatory provision that "leaves an area of discretion for the court to confirm a plan which comports with the mandatory provisions of § 1322, but does not meet the conditions of § 1325(a)(5)(B)(i)–(iii)"). Additional standards must be satisfied if the trustee or the holder of an allowed unsecured claim objects to plan confirmation. 11 U.S.C. § 1325(b)(1).

29. *See supra* note 20 and accompanying text (discussing differences in claim repayment in Chapters 7 and 13).

30. H.R. REP. NO. 95-595, at 430 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6385.

31. 11 U.S.C. § 1325(a)(4).

32. If the holder of an allowed secured claim has accepted the plan, the confirmation standard for the payment of the allowed secured claim will be satisfied. 11 U.S.C.

as "cramdown,"[33] the confirmation standard for payment of allowed secured claims will be satisfied if, among other things, "the value, as of the effective date of the plan, of property to be distributed under the plan on account of [each allowed secured] claim is not less than the allowed amount of such claim."[34]

The language of the two confirmation standards is quite similar and worth noting. Consider a side-by-side comparison of the two statutory provisions, broken down into their constituent parts, as set forth in Table 1.

Table 1: Chapter 13 Confirmation Standards for Claim Repayment

Code § 1325(a)(4): Allowed Unsecured Claims	Code § 1325(a)(5)(B)(ii): Allowed Secured Claims
(A1) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than **(A2)** the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of [the Bankruptcy Code] on such date	**(B1)** the value, as of the effective date of the plan, of property to be distributed under the plan on account of [each allowed secured] claim is not less than **(B2)** the allowed amount of such claim

Both provisions establish inequalities that, if not satisfied, will preclude plan confirmation.[35] In the case of payment of an allowed unsecured claim, the Code requires a comparison of (1) the discounted present value of property to be distributed to the holder of the claim (i.e., the amount denominated A1 in Table 1)[36] to (2) the payment the holder

§ 1325(a)(5)(A). Alternatively, if the debtor surrenders the property securing an allowed secured claim, the confirmation standard will likewise be satisfied. *Id.* § 1325(a)(5)(C).

33. *See* Epstein, supra note 23, at 436–38 (discussing cramdown process). For the origins of the phrase "cramdown," see William Safire, *On Language: Cramdown*, N.Y. TIMES, Jan. 25, 2009, § 6 (Magazine), at 12.

34. 11 U.S.C. § 1325(a)(5)(B)(ii).

35. *See supra* note 28 and accompanying text (discussing mandatory nature of Chapter 13 plan confirmation requirements).

36. The amount denominated A1 in Table 1 requires a court (a) to ascertain the nominal amount of property that will be distributed to the holder of the allowed unsecured claim under the plan and (b) to then calculate the value of such property as of the effective date of the plan. It is the latter step that entails discounting the stream of income payments that will be received by the claim holder over a period that could possibly extend up to five years. *See* 11 U.S.C. § 1322(d) (setting forth limits on the duration of a Chapter 13 plan). Specifically, the future stream of income payments (and/or other property distributed) will

would receive in an immediate Chapter 7 liquidation of the debtor's estate (i.e., the amount denominated A2 in Table 1).[37] The plan can be confirmed only if the former equals or exceeds the latter (i.e., $A1 \geq A2$). In the case of cramdown payment of an allowed secured claim, the Code requires a comparison of (1) the discounted present value of property to be distributed to the holder of the claim (i.e., the amount denominated B1 in Table 1) to (2) the allowed amount of the secured claim (i.e., the amount denominated B2 in Table 1), an amount that entails a valuation of the property securing the claim.[38] Again, the plan can be confirmed only if the former equals or exceeds the latter (i.e., $B1 \geq B2$).

There are critical points regarding the basic framework for claim repayment in Chapter 13 that should not be overlooked. First, the

---

be discounted back to the effective date of the plan. *See* H.R. REP. NO. 95-595, at 414 (1977) (noting that valuation as of the effective date of the plan "contemplates a present value analysis that will discount value to be received in the future"), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6370. The Bankruptcy Code does not define the term "effective date of the plan." *See* 11 U.S.C. § 101 (failing to include "effective date of the plan" among the definitions applicable throughout the Bankruptcy Code). A debtor may set forth a provision in his or her Chapter 13 plan that specifies a particular date as the "effective date" of the plan. *E.g.*, *In re* Gibson, 415 B.R. 735, 738 (Bankr. D. Ariz. 2009); *In re* Cook, 38 B.R. 870, 872 (Bankr. D. Utah 1984). For further discussion regarding the effective date of a plan, see Carlson, *supra* note 20, at 601.

37. The statutory language relating to the amount denominated A2 in Table 1 refers to a hypothetical Chapter 7 liquidation on the effective date of the Chapter 13 plan—in other words, an *immediate* Chapter 7 liquidation that does not involve delay. It has been argued, however, that the amount distributed in a hypothetical Chapter 7 liquidation should be discounted to present value in order to reflect the reality that liquidation of a debtor's estate is a process that takes time. *See* 1 HENRY J. SOMMER ET AL., CONSUMER BANKRUPTCY LAW AND PRACTICE § 12.3.2, at 292 n.62 (John Rao ed., 8th ed. 2006) (stating that, in conducting the "best interests of creditors test" under Code § 1325(a)(4), "the court should also take into account the delay which occurs before creditors receive dividends in a chapter 7 case"); *cf.* Kenneth N. Klee, *Adjusting Chapter 11: Fine Tuning the Plan Process*, 69 AM. BANKR. L.J. 551, 567–68 (1995) (arguing that the "best interests of creditors test" under Code § 1129(a)(7) should be amended "so that it looks at present-value dollars that would be distributed from the estate in a hypothetical Chapter 7 case where conversion *commences* on the effective date of the plan and *not* at a distribution that assumes an instantaneous liquidation"). In some instances, the process can take years. *See In re* Smith, 431 B.R. 607, 611 (Bankr. E.D.N.C. 2010) (noting that, in one Chapter 7 case, "distribution to unsecured creditors did not occur for over two years after the petition date" and that "[t]his amount of time is not unusual for administration of an average chapter 7 estate").

38. *See infra* note 269 and accompanying text (discussing the manner in which the Bankruptcy Code defines the secured status of an allowed claim); *see also* Epstein, *supra* note 23, at 438 (noting that cramdown first requires a court to "determine the value of the creditor's collateral" and subsequently to "determine the value of the deferred payments proposed by the plan to determine whether the present value of such payments at least equals the value of the collateral").

confirmation threshold for claim repayment is keyed to substantive entitlements specified elsewhere in the Bankruptcy Code. The entitlements are represented by the amount denominated A2 (in the case of allowed unsecured claims) and the amount denominated B2 (in the case of allowed secured claims). Second, once the threshold has been established, the question becomes whether the property that the debtor plans to distribute over the life of the plan has a discounted present value that, at a minimum, equals the threshold. In other words, the discounting process seeks to verify that, notwithstanding the delay in payment, the claim holder is scheduled to receive the equivalent of its present-day substantive entitlement.[39] As a matter of statutory design, that process is articulated in a content-neutral manner. A comparison of the discounting process for unsecured claims (denominated A1 in Table 1) and for secured claims (denominated B1 in Table 1) reveals nearly identical language such that the discounting process should be the same for both classes of claims.[40] With

39. *See* Rake v. Wade, 508 U.S. 464, 472 n.8 (1993) ("[A] creditor receives the 'present value' of its claim only if the total amount of the deferred payments includes the amount of the underlying claim plus an appropriate amount of interest to compensate the creditor for the decreased value of the claim caused by the delayed payments."); H.R. REP. NO. 95-595, at 413 (1977) (noting that "property is to be valued as of the effective date of the plan, thus recognizing the time-value of money"), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6369; Dean Pawlowic, *Entitlement to Interest Under the Bankruptcy Code*, 12 BANKR. DEV. J. 149, 173 (1995) (noting that "the entitlement to receive plan interest is merely a means to provide for present value").

40. *See, e.g.*, Till v. SCS Credit Corp., 541 U.S. 465, 474 (2004) (Stevens, J., plurality opinion) ("We think it likely that Congress intended bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under any of these provisions."); *In re* Cook, 322 B.R. 336, 345 (Bankr. N.D. Ohio 2005) (considering the language of Code §§ 1325(a)(4) and 1325(a)(5)(B)(ii) and concluding "that Congress would intend identical language to have identical meaning when it is used twice in the same section of the Code"); *In re* Collins, 167 B.R. 842, 845 n.2 (Bankr. E.D. Tex. 1994) ("[A]lmost all courts which have examined the concept of present value in Chapters 11, 12, and 13 treat present value as a universal concept throughout the Code. . . . This Court's analysis will proceed accordingly."), *abrogated by* Green Tree Fin. Servicing Corp. v. Smithwick (*In re* Smithwick), 121 F.3d 211 (5th Cir. 1997); Pawlowic, *supra* note 39, at 169 ("For purposes of present value analysis, bankruptcy cases have not been distinguished on the basis of the chapters under which they were filed, and the concept of present value has been construed to have a single meaning wherever it is used in the Code."); *cf.* Dewsnup v. Timm, 502 U.S. 410, 422 (1992) (Scalia, J., dissenting) ("We have often invoked the normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning. That rule must surely apply, *a fortiori*, to the use of identical words *in the same section of the same enactment*." (internal quotation marks and citations omitted)). For an extended discussion on the applicability of case law and concepts from Chapter 13 cases when similar issues arise in Chapter 11 cases, and vice versa, see generally David G. Epstein & Christopher Fuller, *Chapters 11 and 13 of the Bankruptcy Code—Observations on Using Case Authority from One of the Chapters in Proceedings*

these considerations in mind, the discussion now turns to the Court's interpretation of present-value analysis as applied to cramdown payments in Chapter 13.

B. Till v. SCS Credit Corp.

Till involved a dispute between the Tills, a married couple who jointly filed for bankruptcy under Chapter 13 of the Code, and SCS Credit Corporation (SCS), the creditor to whom the Tills were indebted on account of a retail installment contract for a used truck that was subject to SCS's purchase-money security interest.[41] The Tills sought to retain the used truck and, in so doing, proposed to make cramdown payments to SCS,[42] whose $4,894.89 claim was undersecured due to the $4,000 value of the truck securing the claim.[43] Consequently, SCS's claim was bifurcated into an allowed secured claim of $4,000 and an allowed unsecured claim of $894.89.[44] The Chapter 13 plan provided that the Tills would pay interest on SCS's allowed secured claim at the rate of 9.5%, one-and-a-half percentage points above the national prime rate.[45] SCS objected to the plan, arguing that the Tills would have to pay interest at the rate of 21% in order to compensate SCS adequately.[46] The interest rate suggested by SCS happened to be the interest rate set forth in the contract between the Tills and SCS.[47] Thus, the task for the Court was to ascertain whether the Tills' proposed cramdown payments adequately compensated SCS.[48] The remainder of this Section will begin by considering how the plurality and

---

Under the Other, 38 VAND. L. REV. 901 (1985). In that discussion, Epstein and Fuller offer arguments for why a valid approach to present-value analysis in Chapter 13 may be equally applicable in Chapter 11. *Id.* at 905–10; *see also* Epstein, *supra* note 23, at 469 ("The present Congressional language, 'value, as of the effect[ive] date of the plan,' does not support a fixed cram down interest rate or support handling Chapter 13 cram down interest rate proceedings different from Chapter 11 cram down interest rate proceedings.").

41. *Till*, 541 U.S. at 469–70 (Stevens, J., plurality opinion).

42. *Id.* at 471.

43. *Id.* at 470.

44. *Id.*

45. *Id.* at 471.

46. *Id.*

47. *Id.* at 470.

48. *See id.* at 474 (stating that Chapter 13 cramdown provision ensures that "property to be distributed to a particular secured creditor over the life of a bankruptcy plan has a total 'value, as of the effective date of the plan,' that equals or exceeds the value of the creditor's allowed secured claim—in this case, $4,000").

dissenting opinions conceived of the underlying substance of the discounting process and will then contrast those opinions to Justice Thomas's concurring opinion.

1. The Plurality and Dissenting Opinions

Justice Stevens's plurality opinion begins by framing present-value analysis as the function of an interest rate that consists of the three components traditionally included in an interest rate—opportunity cost, a premium for expected inflation, and a premium for the risk of default:[49]

> 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. *The challenge for bankruptcy courts reviewing such repayment schemes, therefore, is to choose an interest rate sufficient to compensate the creditor for these concerns.*[50]

Further entrenching the concept of present-value analysis as a function of garden-variety interest-rate payments, Justice Stevens repeatedly invoked a loan metaphor—specifically, that the creditor to whom the debtor makes cramdown payments essentially makes a forced loan, or "cramdown loan," to the debtor.[51] This metaphor unfortunately obfuscates matters insofar as cramdown, a statutory directive involving a pre-existing secured-credit relationship in which the debtor had likely already defaulted, is far removed

---

49. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 194 (7th ed. 2007) (identifying the "three main components" of an interest rate as the opportunity cost, the risk premium, and the anticipated inflation rate); Pawlowic, *supra* note 39, at 173–74 ("This compensation includes three components: (1) the real rate . . . (2) an expected inflation rate . . . and (3) a risk premium . . . ."); *cf.* Edward R. Morrison, Timbers of Inwood Forest, *the Economics of Rent, and the Evolving Dynamics of Chapter 11*, *in* BANKRUPTCY LAW STORIES 21, 29 (Robert K. Rasmussen ed., 2007) (noting that rate of return "compensates investor for the time value of money . . . and risk"); Alan Schwartz, *Valuation of Collateral*, *in* BANKRUPTCY LAW STORIES, *supra*, at 103, 108 ("Two elements constitute an interest rate[:] the rate must compensate the lender for the time value of money, and the rate must compensate the lender for bearing the risk of nonpayment.").

50. Till v. SCS Credit Corp., 541 U.S. 465, 474 (2004) (Stevens, J., plurality opinion) (emphasis added); *see also id.* at 477 (stating that a "court should aim . . . to ensure that an objective economic analysis would suggest the debtor's interest payments will adequately compensate all such creditors for the time value of their money and the risk of default").

51. *See id.* at 475 n.12, 476 & n.14, 477 (using repeatedly the term "cramdown loan").

from the concept of a market-based transaction involving a new extension of credit by a creditor to a debtor.[52]

With the loan metaphor as a backdrop, Justice Stevens set forth a present-value analysis that presumptively establishes the national prime rate as the appropriate discount rate.[53] For the plurality, one of the hallmarks of the prime rate that makes it an appropriate discount rate is that it "compensate[s] for the opportunity costs of the loan, the risk of inflation, and the relatively slight risk of default."[54] The plurality, however, allowed for the possibility of an upward adjustment of the prime rate in order to account for the risk of nonpayment by a debtor in bankruptcy (as opposed to a solvent and creditworthy commercial borrower).[55] While the plurality

52. One need look no further than Code § 364, which governs the obtaining of post-petition credit and incurring of debt by a debtor's estate to confirm that the distribution provided to a creditor on account of its pre-petition claim is conceptually distinct from the post-petition extension of credit to a debtor's estate, which gives rise to a post-petition claim against the estate. 11 U.S.C. § 364 (2006); Shapiro v. Saybrook Mfg. Co. (*In re* Saybrook Mfg. Co.), 963 F.2d 1490, 1495 (11th Cir. 1992); *cf.* Ford Motor Credit Co. v. Dobbins, 35 F.3d 860, 867 n.7 (4th Cir. 1994) (observing in the context of the allowance of administrative expense claims how post-petition use of collateral by a debtor without creditor consent does not actually entail an extension of credit to the debtor's estate). The *Till* plurality, however, failed to appreciate this distinction. Instead, it improperly conflated the concepts of Chapter 11 cramdown under Code § 1129(b)(2)(A)(i) and post-petition financing for Chapter 11 debtors under Code § 364. *See Till*, 541 U.S. at 476 n.14 (Stevens, J., plurality opinion) (discussing the manner in which the market for debtor-in-possession financing might inform the cramdown rate in a Chapter 11 case).

Moreover, use of the loan metaphor seems inconsistent in light of Justice Stevens's rejection of the "coerced loan approach" to present-value analysis. *Id.* at 477. The descriptive account of that approach turns on the concept of a creditor required to lend against its will to the debtor post-bankruptcy. *In re* Collins, 167 B.R. 842, 845 (Bankr. E.D. Tex. 1994), *abrogated by* Green Tree Fin. Servicing Corp. v. Smithwick (*In re* Smithwick), 121 F.3d 211 (5th Cir. 1997). One would think that rejection of the approach would reasonably entail distancing oneself from the rationale's rhetoric. *In re* Till, 301 F.3d 583, 596–97 (7th Cir. 2002) (Rovner, J., dissenting), *rev'd and remanded sub nom.* Till v. SCS Credit Corp., 541 U.S. 465 (2004); Gen. Motors Acceptance Corp. v. Valenti (*In re* Valenti), 105 F.3d 55, 63–64 (2d Cir. 1997), *abrogated by* Assocs. Commercial Corp. v. Rash, 520 U.S. 953 (1997). Justice Stevens obviously conceptualized the cramdown loan as something different than what the coerced loan approach requires. *Till*, 541 U.S. at 476 (Stevens, J., plurality opinion). But, by relying on the loan metaphor, the plurality improperly framed the issue, which in turn resulted in imprecise analysis. *See infra* Part III.B (arguing that the plurality and dissenting opinions in *Till* failed to interpret the Code properly).

53. *Till*, 541 U.S. at 478–79 (Stevens, J., plurality opinion); *see also id.* at 484 (referring to prime rate as a "presumptive rate" that can be rebutted).

54. *Id.* at 479.

55. *See id.* ("Because bankrupt debtors typically pose a greater risk of nonpayment than solvent commercial borrowers, the approach then requires a bankruptcy court to adjust the prime rate accordingly.").

did not set forth a scale that would be appropriate for risk adjustment,[56] it specified that "the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan" would be appropriate factors to consider in making an upward risk adjustment.[57] Finally, pursuant to the plurality's "formula" or "prime-plus" approach for calculating the discount rate,[58] the burden of proof falls on the creditor, whom the plurality viewed as the better informed party, to justify the risk adjustment.[59]

Like the plurality, the dissent in *Till* interpreted the Code as requiring that the discount rate used in present-value analysis incorporate a risk premium for nonpayment by the debtor.[60] Justice Scalia's dissenting opinion argues, however, for a present-value analysis that presumptively establishes the contract interest rate as the appropriate discount rate,[61] with the possibility that either upward or downward adjustments of the rate could be sought by either the debtor or the creditor.[62] From the dissent's perspective, the initial estimate provided by the contract rate is likely to be more accurate than the prime rate, thereby resulting in less litigation and its concomitant costs.[63] Finally, like the plurality, Justice Scalia identified

56. *Id.* at 480.

57. *Id.* at 479.

58. *Id.* at 480.

59. *See id.* at 479 ("[S]tarting from a concededly *low* estimate and adjusting *upward* places the evidentiary burden squarely on the creditors, who are likely to have readier access to any information from the debtor's filing . . . ."); *id.* at 484–85 ("[T]he formula approach, which begins with a concededly low estimate of the appropriate interest rate and requires the creditor to present evidence supporting a higher rate, places the evidentiary burden on the more knowledgeable party, thereby facilitating more accurate calculation of the appropriate interest rate.").

60. *See id.* at 491 (Scalia, J., dissenting) (noting that the plurality and dissent "agree that any deferred payments to a secured creditor must fully compensate it for the risk that [Chapter 13 plan] failure will occur"); *id.* at 508 ("Eight Justices are in agreement that the rate of interest set forth in the debtor's approved plan must include a premium for risk.").

61. *See id.* at 494 (stating that "the contract rate is a decent estimate, or at least the lower bound, for the appropriate rate in cramdown").

62. *See id.* at 494 n.2 ("The contract rate is only a presumption, however, and either party remains free to prove that a higher or lower rate is appropriate in a particular case.").

63. *See id.* at 500 ("[I]t is far more important that the initial estimate be accurate than that the burden of proving inaccuracy fall on the better informed party."). Perhaps not surprisingly, the plurality argued that the formula approach yields the more accurate risk estimate and minimizes litigation costs. *See id.* at 484–85 (Stevens, J., plurality opinion) (arguing that the formula approach "places the evidentiary burden on the more knowledgeable party, thereby facilitating more accurate calculation of the appropriate interest rate"); *id.* at 479 ("[T]he formula approach entails a straightforward, familiar, and objective inquiry, and minimizes the need for potentially costly additional evidentiary

those factors that should inform a risk premium adjustment, noting that "the most relevant factors bearing on risk premium are (1) the probability of plan failure; (2) the rate of collateral depreciation; (3) the liquidity of the collateral market; and (4) the administrative expenses of enforcement."[64] He further noted that the contract rate had the advantage of already having incorporated such factors.[65]

Based on the foregoing discussion, one sees that the plurality and dissenting opinions in *Till* disagreed over the manner in which risk assessment should be incorporated into present-value analysis, rather than whether such analysis should adjust for risk in the first instance.[66] It is this latter point, however, on which Justice Thomas's concurring opinion is diametrically opposed to both the plurality and the dissent.

2. *Justice Thomas's Concurring Opinion*

Justice Thomas's concurring opinion, which embraces a plain-meaning approach to interpreting the Chapter 13 cramdown provision,[67] begins by shifting present-value analysis away from the loan metaphor, which in turn facilitates reconceptualizing the discount rate as a rate that should not account for risk of default:

> Both the plurality and the dissent ignore the clear text of the statute [Code § 1325(a)(5)(B)(ii)] in an apparent rush to ensure that secured creditors are not undercompensated in bankruptcy proceedings. But the statute that Congress enacted does not require a debtor-specific risk adjustment that would put secured creditors in the same position as if they had made another loan.[68]

---

proceedings.").

64. *Id.* at 499 (Scalia, J., dissenting); *see also id.* at 484 (Stevens, J., plurality opinion) (discussing risk-premium factors identified by Justice Scalia in his dissenting opinion).

65. *Id.* at 499 (Scalia, J., dissenting).

66. *See id.* at 485 (Thomas, J., concurring) ("[T]he plurality and 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."); *id.* at 491 (Scalia, J., dissenting) ("My areas of agreement with the plurality are substantial. . . . Our only disagreement is over what procedure will more often produce accurate estimates of the appropriate interest rate.").

67. *See id.* at 486, 489 (Thomas, J., concurring) (making references to "the clear text of the statute" and "the plain language of the statute").

68. *Id.* at 486.

With this frame, Justice Thomas proceeded to explain why the Code compels the use of a risk-free discount rate for present-value analysis.

The linchpin for Justice Thomas's argument is that the language of the Chapter 13 cramdown provision focuses solely on the value of the property the debtor proposes to distribute to a claim holder rather than the value of a promise to distribute property.[69] In other words, when the Code uses the language "property to be distributed under the plan,"[70] Justice Thomas would read the Code as instructing the court (1) to identify the property that the debtor proposes to distribute to the claim holder over the life of the Chapter 13 plan,[71] and then (2) to conduct a present-value analysis of that property with the assumption that such property will in fact be distributed.[72] On this reading, one assumes away risk of default when ascertaining the appropriate discount rate, thereby yielding a risk-free rate.[73] Further justifying the use of a risk-free rate, Justice Thomas pointed to other Chapter 13 confirmation standards that serve a protective function for creditors—namely, the requirements that (1) a Chapter 13 plan must be proposed in good faith,[74] (2) a creditor whose claim is crammed down must retain the lien securing the claim,[75] and (3) a Chapter 13 plan must be financially feasible (including that the debtor must be able to make all payments under the plan)[76]—all of which mitigate risk of default.[77]

---

69. *See id.* at 486 (stating that Chapter 13 cramdown provision "requires only that 'the value . . . of *property* to be distributed under the plan,' at the time of the effective date of the plan, be no less than the amount of the secured creditor's claim" (omission in original) (quoting 11 U.S.C. § 1325(a)(5)(B)(ii))); *id.* at 487 ("The statute only requires the valuation of the 'property to be distributed,' not the valuation of the plan (i.e., the promise to make the payments itself).").

70. 11 U.S.C. § 1325(a)(5)(B)(ii) (2006).

71. *See Till*, 541 U.S. at 486 (Thomas, J., concurring) ("Second, a court must determine what is the 'property to be distributed under the plan.'").

72. *See id.* ("Third, a court must determine the 'value, as of the effective date of the plan,' of the property to be distributed."); *id.* at 505 (Scalia, J., dissenting) (observing that Justice Thomas "reads the statutory phrase 'property to be distributed under the plan' to mean the proposed payments *if made as the plan contemplates*" (citations omitted)); *see also* Rasmussen, *supra* note 13, at 329–30 ("Justice Thomas, in essence, assumes that all promised payments will be made.").

73. *See Till*, 541 U.S. at 488 (Thomas, J., concurring) ("[A]lthough there is always some risk of nonpayment when A promises to repay a debt to B through a stream of payments over time rather than through an immediate lump sum payment, § 1325(a)(5)(B)(ii) does not take this risk into account.").

74. 11 U.S.C. § 1325(a)(3).

75. *Id.* § 1325(a)(5)(B)(i)(I).

76. *Id.* § 1325(a)(6).

77. *See Till*, 541 U.S. at 490 (Thomas, J., concurring) ("Given the presence of multiple

Having rejected risk adjustment as part of present-value analysis, two questions remain to be answered: first, whether the Thomas concurrence specifies what factors ought to be considered in calculating the discount rate; and second, whether a particular metric exists that accurately estimates the rate. In answer to the first question, Thomas focused on the time value of money as the sole factor that ought to inform the discount-rate calculus:

> The requirement that the 'value' of the property to be distributed be determined 'as of the effective date of the plan' incorporates the principle of the time value of money. To put it simply, $4,000 today is worth more than $4,000 to be received seventeen months from today because if received today, the $4,000 can be invested to start earning interest immediately.[78]

If time value of money is a function of a risk-free interest rate, then Justice Thomas's approach to present-value analysis would account only for (1) opportunity cost and (2) expected inflation.[79] To best approximate this, Justice Thomas suggested that courts ought to rely on the prime rate as the appropriate discount rate in present-value analysis.[80] Ultimately, Justice Thomas concurred in the judgment of the plurality on the ground that the interest rate proposed by the Tills exceeded the risk-free prime rate and thus adequately compensated SCS.[81]

3. Till*'s Postmortem*

In his dissenting opinion, Justice Scalia pointed out that all circuits had either explicitly or implicitly rejected the concept of a "risk-free" discount rate, and he further noted that Justice Thomas had failed to cite any decisional law supporting his position.[82] The Court's failure to reach consensus troubled Justice Scalia, who concluded his dissenting opinion by

---

creditor-specific protections, it is by no means irrational to assume that Congress opted not to provide further protection for creditors by requiring a debtor-specific risk adjustment under § 1325(a)(5).").

78. *Id.* at 486–87.

79. *See supra* note 49 and accompanying text (noting that the three basic components of an interest rate are (1) opportunity cost, (2) a premium for expected inflation, and (3) a premium for risk of default).

80. *Till*, 541 U.S. at 488 n.2 (Thomas, J., concurring).

81. *Id.* at 491.

82. *Id.* at 506 (Scalia, J., dissenting).

writing that "[t]oday's judgment is unlikely to burnish the Court's reputation for reasoned decisionmaking."[83]

Commentators have been equally critical of the Court's failure to provide a definitive answer.[84] Robert Rasmussen places the blame predominantly on Justice Thomas, whom he accuses of having been the most "tone-deaf to the situation."[85] And even though Rasmussen lodges the same accusation at Justice Stevens,[86] Rasmussen partially absolves him, observing that "[o]ne can . . . offer an *intelligible* defense of the result that Justice Stevens reaches."[87] The implication of that statement is quite clear: Rasmussen believes that no intelligible defense exists for the Thomas concurrence. This belief, in turn, leads Rasmussen to conclude that Justice Thomas failed as a judge: Rather than compromise and cast his vote in a way that would produce a majority opinion, thereby restoring some functionality to the bankruptcy system, Justice Thomas heedlessly ventured out on his own and left the doctrine of present-value analysis in a state of disorder.[88]

The remainder of this Article takes a contrary view. It argues that, as a descriptive matter, present-value analysis in consumer bankruptcy cases requires use of a discount rate that accounts only for expected inflation, but not default risk (as argued by Justice Thomas) or opportunity cost;[89] and that, moreover, such a rate is desirable from both a normative perspective and an institutional-design perspective. But for Justice Thomas standing his ground and voting his conviction, the Court would have issued a precedential decision at odds with the text of and doctrine interpreting the Bankruptcy Code. Admittedly, an unsettled state of the law is undesirable. Worse yet, however, would have been an erroneously settled rule of decision that would have bound all lower courts and could only be

83. *Id.* at 508.

84. *See, e.g.*, Rasmussen, *supra* note 13, at 321–22 ("The Supreme Court's fundamental task [in *Till*] was not so much to get it right as it was to get it done. On this score, it failed."); Schwartz, *supra* note 49, at 114 n.18 (noting that, in light of the lack of a majority for the plurality's view in *Till*, the decision "has little practical value").

85. Rasmussen, *supra* note 13, at 331.

86. *See id.* ("Justice Scalia, in his opinion, is not as tone-deaf to the situation as is either Justice Thomas, or, as we shall see, Justice Stevens.").

87. *Id.* at 332.

88. *See id.* at 328 ("Justice Thomas was content to issue an opinion that left the issue before the Court in an inconclusive draw.").

89. Such a rate would be even less compensatory than the one advocated by Justice Thomas in *Till*.

remedied either by the Court subsequently reversing itself or through legislative override.

III. Textual and Contextual Arguments for an Inflationary Discount Rate

This Part challenges the long-standing notion that the discount rate in Chapter 13 cases must be adjusted for default risk and does so by examining closely other Code provisions relating to claim compensation as well as Supreme Court doctrine interpreting some of those provisions. It critiques the plurality and dissenting opinions in *Till* by marshalling the statutory arguments missing from Justice Thomas's concurring opinion. These arguments not only bolster his conclusion, but also extend it.

Part III.A focuses on the competing plain-meaning arguments offered by Justices Thomas and Scalia regarding the statutory phrase "property to be distributed under the plan"[90] and demonstrates that such language cannot be interpreted to require a Chapter 13 debtor to compensate a creditor for default risk. Part III.B then argues that, when interpreting the phrase "as of the effective date of the plan,"[91] context similarly justifies omitting a risk adjustment for default into the discount rate used in present-value analysis. It examines each of the factors identified by the plurality and the dissent as relevant to risk compensation and demonstrates why a contextual reading of the Bankruptcy Code compels the opposite conclusion—namely, that present-value analysis requires a risk-free discount rate.[92]

Part III.C concludes by arguing that a contextual interpretation also compels a discount rate that does not take into account opportunity cost. Pursuant to this view, even Justice Thomas's approach to present-value analysis overcompensates creditors. More precisely, the discount rate ought to compensate solely for expected inflation and nothing more. Accordingly, instead of using the prime rate to estimate the discount rate, which would systematically overcompensate creditors for purposes of present-value analysis, the Chapter 13 discount rate should be estimated using the interest rate on short-term Treasury notes with a downward adjustment that subtracts the real rate for the riskless cost of capital.

---

90. 11 U.S.C. § 1325(a)(5)(B)(ii) (2006).

91. *Id.*

92. Robert Rasmussen adamantly thinks otherwise. Rasmussen, *supra* note 13, at 328–30.

A. "Property to Be Distributed"

In order to understand why Justices Thomas and Scalia reached divergent conclusions regarding whether the discount rate must account for the risk of nonpayment, it is critical to focus on the statutory language of the cramdown provision, which both Justices interpreted pursuant to a plain-meaning approach.[93] The language at issue is that which instructs a court to conduct present-value analysis—"the value, as of the effective date of the plan, of property to be distributed."[94] Justice Thomas deconstructed this phrase into two main components: (1) "as of the effective date of the plan" and (2) "property to be distributed."[95] Justice Thomas viewed the former phrase as encapsulating "the principle of the time value of money."[96] Accordingly, whether or not the Bankruptcy Code requires compensation for default risk depends on the meaning of the phrase "property to be distributed."[97]

Justice Scalia accepted Justice Thomas's analytical frame and, in doing so, acknowledged that their competing interpretations of the phrase "property to be distributed under the plan" would each be equally plausible when considered in isolation.[98] Justice Scalia, however, argued that a contextual interpretation better supports his reading of the phrase,[99] one that accounts for the risk of nonpayment.[100]

---

93. *See id.* at 329–30 (observing that Justice Thomas "accuse[d] his brethren of textual infidelity" and that Justice Scalia "focuse[d] squarely on the text of the Bankruptcy Code").

94. 11 U.S.C. § 1325(a)(5)(B)(ii).

95. *See* Till v. SCS Credit Corp., 541 U.S. 465, 487 (2004) (Thomas, J., concurring) (discussing separately the meaning of the phrases "as of the effective date of the plan" and "property to be distributed").

96. *Id.*

97. *See id.* at 487–88 (stating that "it is nonsensical to speak of a debtor's risk of default being inherent in the value of 'property' unless that property is a promise or a debt"). Without deconstructing the relevant text, Justice Stevens argued "that § 1325(a)(5)(B)(ii)'s reference to 'value, as of the effective date of the plan, of property to be distributed under the plan' is better read to incorporate all of the commonly understood components of 'present value,' including any risk of nonpayment." *Id.* at 483 (Stevens, J., plurality opinion).

98. *Id.* at 505 (Scalia, J., dissenting). Justice Stevens also conceded that Justice Thomas's interpretation that the Code mandates a risk-free discount rate is plausible, but ultimately rejected the interpretation for precedential and practical concerns. *Id.* at 483 n.25 (Stevens, J., plurality opinion). In other words, the plurality took the view that it was confronted with an egg that could not be unscrambled.

99. *Id.* at 505 (Scalia, J., dissenting).

100. *See id.* ("I would instead read this phrase to mean the right to receive payments that the plan vests in the creditor upon confirmation. Because there is no guarantee that the

An amendment to the Bankruptcy Code in 2005 (subsequent to the *Till* decision), while not necessarily determinative, strongly suggests that the phrase "property to be distributed under the plan" cannot be interpreted to signify that the value of that property must be discounted to account for risk of default. Pursuant to that amendment, Congress added a requirement that individual debtors who file for Chapter 11 relief devote all of their disposable income (or its equivalent) to repaying creditor claims in the event that an unsecured creditor objects to plan confirmation and the plan does not propose to pay that creditor in full.[101] The specific language of the requirement, set forth in Code § 1129(a)(15), provides that the court cannot confirm the debtor's plan unless one of the following conditions is satisfied:

> (15) In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to confirmation of the plan—
>
> (A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.[102]

Because subparagraphs (A) and (B) are set forth in the alternative, a debtor's Chapter 11 plan may be confirmed over the objection of an unsecured creditor so long as either subparagraph is satisfied.[103] Notably, subparagraph (A) includes the phrase "as of the effective date of the plan," whereas subparagraph (B) does not.[104] Recall that, pursuant to the

---

promised payments will in fact be made, the value of this property right must account for the risk of nonpayment.").

101. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 321(c)(1), 119 Stat. 23, 95 (codified at 11 U.S.C. § 1129(a)(15) (2006)). The amendment had the effect of bringing Chapter 11 plans filed by individual debtors more in line with Chapter 13 plans, which were subject to a disposable income requirement prior to the 2005 amendments. 11 U.S.C. § 1325(b)(1) (2000) (amended 2005); *see also* Bruce A. Markell, *The Sub Rosa Subchapter: Individual Debtors in Chapter 11 After BAPCPA,* 2007 U. ILL. L. REV. 67, 77 ("'Disposable income' is a concept borrowed from chapter 13. Indeed, § 1129(a)(15) refers to § 1325(b)(2) for a definition of the concept." (footnote omitted)).

102. 11 U.S.C. § 1129(a)(15) (2006).

103. *Id.*

104. *Id.*

analytical frame followed by Justices Thomas and Scalia, the phrase "as of the effective date of the plan" prompts discounting that accounts for the time value of money.[105] On this account, subparagraph (A) requires that the unsecured creditor be compensated for opportunity cost and the risk of inflation, but subparagraph (B) does not.[106]

If Justice Scalia is correct that "property to be distributed" must be interpreted to prompt discounting that accounts for risk of default, then subparagraph (B) requires that the debtor distribute to the objecting unsecured creditor a nominal amount of property that *exceeds* the projected disposable income of the debtor to be received during the longer of five years or the plan's term.[107] If the nominal amount of property is equal to or less than the relevant amount of projected disposable income, subparagraph (B) will not be satisfied by virtue of the fact that discounting the nominal amount of property for default risk will result in property with a present value that is *less* than the confirmation threshold.[108]

When one considers that Congress intended individual debtors to fund their Chapter 11 plans predominantly (if not exclusively) with the income

---

105. *See supra* notes 94–98 and accompanying text (deconstructing competing interpretations by Justices Thomas and Scalia of the phrase "value, as of the effective date of the plan, of property to be distributed").

106. *See supra* note 49 and accompanying text (indicating that the time value of money consists of opportunity cost and the anticipated inflation rate).

107. 11 U.S.C. § 1129(a)(15)(B). The Honorable Bruce Markell, U.S. Bankruptcy Judge for the District of Nevada, has interpreted Code § 1129(a)(15)(B)'s projected-disposable-income confirmation threshold as "requir[ing] the debtor to devote an amount equal to five years' worth of projected disposable income to the plan, with the five years measured from the date the plan is confirmed or plan payments start, whichever is later." Markell, *supra* note 101, at 87. That interpretation, however, cannot be squared with the provision's language. Subparagraph (B) sets the confirmation threshold according to the projected disposable income that the debtor will receive during the longer of two time periods: either (1) "during the 5-year period beginning on the date that that the first payment is due under the plan" or (2) "during the period for which the plan provides payments." 11 U.S.C. § 1129(a)(15)(B). The statutory language clearly contemplates that the latter time period (i.e., the plan's term) could be less than, equal to, or greater than "the 5-year period beginning on the date that the first payment is due under the plan." *Id.* Thus, when the plan term *exceeds* five years, Code § 1129(a)(15)(B), by virtue of its phrase "whichever is longer," instructs a court to calculate the debtor's projected disposable income during the plan's term and to use that estimate as the confirmation threshold (i.e., the value of the property to be distributed under the plan must be greater than or equal to the projected-disposable-income estimate). *See, e.g.*, *In re* Washington, No. 09-3013-BJH-11, 2010 WL 1417708, at *1 (Bankr. N.D. Tex. Apr. 2, 2010).

108. *See infra* note 144 and accompanying text (discussing the manner in which discounting reduces the present value of property to be distributed in the future).

they generate subsequent to filing for bankruptcy,[109] it becomes apparent that interpreting the phrase "property to be distributed" to require discounting for default risk could frequently lead to an absurd result. It is reasonable to assume that most individual debtors who file for Chapter 11 will not have sufficient pre-bankruptcy assets and post-bankruptcy income to fully repay their unsecured creditors. As such, if an unsecured creditor objects to plan confirmation, the debtor will be able to overcome the objection only by satisfying subparagraph (B). Assuming that subparagraph (B) requires discounting for default risk, then no debtor could ever satisfy subparagraph (B) with income alone. If a debtor's plan solely proposed to distribute all of the debtor's disposable income, the value of the income, once discounted, would be less than the nominal amount of disposable income generated by the debtor. Accordingly, the only way to satisfy subparagraph (B) would be for the debtor to liquidate pre-bankruptcy assets to make up the difference.

The Code certainly contemplates the possibility of the sale of assets by a Chapter 11 debtor.[110] That said, it seems highly illogical that Congress would have devised a statutory scheme like the one just described. Consider the example of an individual debtor who has initially proposed to devote all of his projected disposable income to fund his Chapter 11 plan. Further suppose that the proposed payments will be solely devoted to fully repaying (as required by the Code): (1) objecting creditors with secured claims that have been subjected to cramdown,[111] and (2) creditors whose unsecured claims are entitled to priority.[112] Pursuant to this scenario, the debtor does not have surplus disposable income to make any payment to

---

109. *See* 11 U.S.C. § 1123(a)(8) (providing that a plan shall, "in a case in which the debtor is an individual, provide for payment to creditors under the plan of all or such portions of earnings . . . or other future income of the debtor as is necessary for the execution of the plan").

110. *See id.* § 1123(a)(5) (providing that a Chapter 11 plan shall "provide adequate means for the plan's implementation, such as . . . sale of all or any part of the property of the estate"); *id.* § 1123(b)(4) (providing that a Chapter 11 plan may "provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests"); *see also* Markell, *supra* note 101, at 77 (noting that, "if property from any other source—such as loans or gifts, or from exempt property—is used to supplement the payments to unsecured creditors, the [Chapter 11] plan may be shorter than five years"). For the argument theorizing that a Chapter 13 debtor cannot be forced to liquidate assets for the benefit of creditors, see Carlson, *supra* note 20, *passim*.

111. *See* 11 U.S.C. § 1129(b)(2)(A)(i)(II) (requiring that a holder of a secured claim receive deferred cash payments whose present value is equal to the allowed secured claim).

112. *See id.* § 1129(a)(9) (requiring that holders of priority unsecured claims be fully repaid in cash).

creditors with allowed nonpriority unsecured claims (i.e., general unsecured creditors). Nonetheless, one of those creditors objects to plan confirmation under Code § 1129(a)(15).[113]

As things currently stand in this hypothetical, the creditor will prevail in its objection. Because the debtor's plan does not propose to distribute *any* property to the creditor, the plan does not satisfy Code § 1129(a)(15)(A), which requires the creditor's claim to be fully repaid (taking into account present-value considerations).[114] Moreover, even though the plan commits all of the debtor's projected disposable income to repaying creditor claims, the plan does not satisfy Code § 1129(a)(15)(B).[115] As set forth above, if subparagraph (B) is interpreted to require discounting for default risk, then the value of the income, once discounted, will be less than the nominal amount of disposable income generated by the debtor. Thus, to overcome the creditor's objection, the hypothetical debtor will have to modify the Chapter 11 plan to provide for the sale of a sufficient amount of estate property that will make up the difference between the nominal value and present value of the debtor's disposable income.[116] That difference will represent the premium for risk of default under the plan.[117]

Simply put, this would be an absurd result. If the debtor were to modify his plan to overcome the creditor's objection, the proceeds would not be distributed to the other creditors whose claims were proposed to be fully repaid. Instead, the proceeds would go to the class of creditors with allowed nonpriority unsecured claims. It seems ludicrous that, in a scenario such as this, Congress would have intended such creditors to receive risk-default premiums when the debtor's plan did not originally propose to make *any* payments to them (i.e., a situation in which default risk would be irrelevant to the creditor class). One might counter that Congress's intent in enacting Code § 1129(a)(15)(B) was to provide a mechanism ensuring some distribution to general unsecured creditors, but the language of subparagraph (B) does not support that argument. Whereas the Chapter 13 disposable-income requirement is expressly tailored solely for the benefit of

113. *Id.* § 1129(a)(15).

114. *Id.* § 1129(a)(15)(A).

115. *Id.* § 1129(a)(15)(B).

116. *See id.* § 1127(a) (providing for preconfirmation modification of a Chapter 11 plan).

117. Recall that, pursuant to Justice Scalia's interpretation, the phrase "property to be distributed" signals discounting for default risk. *Supra* notes 99–100 and accompanying text.

unsecured creditors,[118] the Chapter 11 disposable-income requirement does not identify any specific class of beneficiary.[119]

This absurd result can be avoided by interpreting the phrase "property to be distributed under the plan" in the manner suggested by Justice Thomas—that is, that the phrase does not mandate adjusting the present-value discount rate for risk of default. This analysis, however, merely demonstrates that Justice Scalia was incorrect to interpret the phrase as signifying the need for risk adjustment to the discount rate. Justice Thomas's analytical frame centers on the notion that it is the phrase "value, as of the effective date of the plan" that signifies the need for discounting, a frame that is consistent with the Code's legislative history.[120] The language of the phrase is broad enough to allow for the possibility that the discount rate must be adjusted for risk of default. The question thus becomes whether the phrase can be justifiably interpreted in this way. Because of the Code's express silence on this issue, one must look elsewhere within the Code's structure for the answer.

B. Contextualizing the Propriety of a Risk-Free Discount Rate

As discussed above, both the plurality and dissenting opinions in *Till* identify various factors that ought to be used to calculate the risk adjustment to the discount rate used in present-value analysis.[121] There are a total of five factors identified in the two opinions, with some overlap between the two opinions.[122] Descriptively, one might recast these factors as an equation that yields the creditor's expected losses in the event of

---

118. *See* 11 U.S.C. § 1325(b)(1)(B) (requiring plan to provide "that all of the debtor's projected disposable income . . . will be applied to make payments to unsecured creditors under the plan").

119. *See* Markell, *supra* note 101, at 80 (noting that "[d]isposable income under chapter 11 need only be part of the 'property to be distributed under the plan,' which presumably means some of it may be devoted to secured creditors and postpetition administrative claimants" (footnote omitted)).

120. *See supra* notes 36, 39 (citing relevant legislative history).

121. *Supra* notes 57, 64 and accompanying text.

122. *See* Till v. SCS Credit Corp., 541 U.S. 465, 479 (2004) (Stevens, J., plurality opinion) ("The appropriate size of that risk adjustment depends, of course, on such factors as the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan."); *id.* at 499 (Scalia, J., dissenting) ("[T]he most relevant factors bearing on risk premium are (1) the probability of plan failure; (2) the rate of collateral depreciation; (3) the liquidity of the collateral market; and (4) the administrative expenses of enforcement.").

default by the debtor (i.e., failure to complete the proposed payments), where P_d represents the probability of default, C_a represents the costs that would actually be incurred by the creditor in the event of default, and C_e represents the expected default costs: $C_a \times P_d = C_e$.[123] The amount C_e is an amount that, according to the plurality and dissent, should be reflected in the total amount of property that the debtor's plan proposes to distribute to a creditor when he or she implements the cramdown option.[124] A contextual reading of the Code reveals that the amounts represented by both C_a and P_d are irrelevant considerations in conducting present-value analysis because the Code takes these amounts into account elsewhere, either for purposes of plan confirmation or for purposes of creditor recovery.

1. *Probability of Default (P_d)*

To begin, consider the value represented by P_d—the probability of default by the debtor under the plan. Both the plurality and the dissent identified P_d as a central component of risk adjustment for present-value analysis. While the dissent referred to "the probability of plan failure,"[125] the plurality elaborated on the concept by referring to "the duration and feasibility of the reorganization plan."[126] In light of the plurality's elaboration, one might conceive of P_d as a function of both (1) plan length (i.e., duration) and (2) the debt burden the proposed plan imposes on the debtor (i.e., feasibility). It seems perfectly reasonable to conclude that plan length and debt burden should inform the likelihood of successfully completing a Chapter 13 plan. A recent empirical study of case outcomes in Chapter 13,[127] however, suggests that only the former may be relevant. That study found that plans of shorter duration were statistically significantly associated with higher rates of completion.[128] On the other

123. *Cf. id.* at 503 (Scalia, J., dissenting) (providing an example of how a creditor's expected default costs would be calculated).

124. *See id.* at 479 (Stevens, J., plurality opinion) ("Because bankrupt debtors typically pose a greater risk of nonpayment than solvent commercial borrowers, the [formula] approach then requires a bankruptcy court to adjust the prime rate accordingly."); *id.* at 491 (Scalia, J., dissenting) ("[A]ny deferred payments to a secured creditor must fully compensate it for the risk that . . . [plan] failure will occur.").

125. *Id.* at 499 (Scalia, J., dissenting).

126. *Id.* at 479 (Stevens, J., plurality opinion).

127. Scott F. Norberg & Nadja Schreiber Compo, *Report on an Empirical Study of District Variations, and the Roles of Judges, Trustees and Debtors' Attorneys in Chapter 13 Bankruptcy Cases*, 81 AM. BANKR. L.J. 431 (2007).

128. *Id.* at 454; *see also In re* Wirth, No. 09-12428-13, 2010 WL 2639873, at *2

hand, the study did not find any statistically significant association between the percentage of unsecured debt sought to be repaid and plan completion.[129] Of course, it may be that, if one were to look at other measures of debt burden, such as the amount of secured debt sought to be repaid or debt-to-income ratios, a statistically significant association would be unearthed. Nevertheless, no one would dispute that a plan's terms, when considered on a case-by-case basis, ought to provide some picture of the risk of default under the plan.[130]

The relevant question, however, is whether risk of default is a relevant factor for purposes of present-value analysis. A contextual reading of the Code suggests that risk of default should not be relevant in calculating the discount rate given that financial feasibility is a confirmation standard distinct from the cramdown confirmation standard. Code § 1325(a)(6) provides that a Chapter 13 plan can be confirmed only if "the debtor will be able to make *all* payments under the plan and to comply with the plan."[131] Both the plurality and the dissent took note of this provision in their respective opinions,[132] but neither reached the conclusion that the provision

---

(Bankr. W.D. Wis. June 28, 2010) (noting a higher dismissal rate for five-year plans than for three- or four-year repayment plans in the Western District of Wisconsin during the ten-year period beginning on January 1, 1995 and ending on December 31, 2004). The statistically significant association did not persist, however, when separating the dismissed cases into pre-confirmation and post-confirmation cases and comparing the plan length of each category to the plan length of successfully completed cases. Norberg & Compo, *supra* note 127, at 454 n.64. Even with this alternate grouping, though, the association between plan length and plan completion approached the conventional standard of statistical significance ($p \leq 0.05$), as indicated by the p-value of 0.093. *Id.*

129. Norberg & Compo, *supra* note 127, at 456.

130. For a summary of the various theories explaining the high failure rate of Chapter 13 plans, see 1 NAT'L BANKR. REV. COMM'N, *supra* note 5, at 234.

131. 11 U.S.C. § 1325(a)(6) (2006) (emphasis added). Courts use the term "feasibility" to describe the confirmation requirement set forth in Code § 1325(a)(6). *See, e.g.*, *In re* St. Cloud and Jeudi, 209 B.R. 801, 809 (Bankr. D. Mass. 1997). The influence for doing so likely stems from the Code's legislative history, which states that "[t]he bankruptcy court must confirm a [Chapter 13] plan if . . . the plan is feasible," among other things. S. REP. NO. 95-989, at 142 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5928. The legislative history's reference to feasibility, in turn, likely derives from the pre-Code confirmation standard for Chapter XIII plans that required a court to find that the plan was "feasible." *Infra* note 135.

132. Justice Thomas's concurring opinion directly quotes the provision as one example of the "multiple creditor-specific protections" that evidence Congress's intent "not to provide further protection for creditors by requiring a debtor-specific risk adjustment under § 1325(a)(5)." Till v. SCS Credit Corp., 541 U.S. 465, 490 (2004) (Thomas, J., concurring); *see also* Rasmussen, *supra* note 13, at 329–30 ("Justice Thomas, in essence, assumes that all promised payments will be made.").

precludes taking account of the risk of nonpayment when discounting to present value the debtor's proposed payments. The plurality merely observed that the financial-feasibility requirement serves to reduce the amount of default risk, but does not completely eliminate such risk.[133] On the other hand, the dissent took the view that the requirement generally does not reduce the risk of default.[134] In their discussions of the financial-feasibility requirement, both the plurality and dissent referred to empirical evidence indicating a high rate of Chapter 13 plan failure,[135] a phenomenon that continues to be empirically documented.[136] Both the plurality and

133. *Till*, 541 U.S. at 475 & n.12, 480 (Stevens, J., plurality opinion).

134. *See id.* at 493 (Scalia, J., dissenting) (noting that many confirmed Chapter 13 plans fail and concluding that the high failure rate "proves that bankruptcy judges are not oracles and that trustees cannot draw blood from a stone").

135. *Id.* at 480 (Stevens, J., plurality opinion); *id.* at 493 & n.1 (Scalia, J., dissenting). The Bankruptcy Act of 1898 was the Bankruptcy Code's predecessor. Act of July 1, 1898, ch. 541, 30 Stat. 544 (repealed 1978). The 1898 Act allowed individual debtors to repay their creditors through a court-supervised repayment plan under Chapter XIII of the Act, which was enacted in 1938. Act of June 22, 1938, ch. 575, 52 Stat. 840, 930–38. The historical record suggests that Chapter XIII wage-earner plans had a low rate of completion. *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the H. Comm. on the Judiciary*, 94th Cong. 1327–28 (1976) (testimony of Hon. Conrad K. Cyr, U.S. Bankruptcy Judge, District of Maine). This occurred despite the financial-feasibility requirement for plan confirmation. *See* 11 U.S.C. § 1056(a)(3) (1976) (requiring court to confirm Chapter XIII plan "if satisfied that . . . [the plan] is feasible," among other requirements) (repealed 1978). The low success rate may have been partly attributable to an excess of repayment optimism by debtors. COMM'N ON THE BANKR. LAWS OF THE U.S., REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93–137, pt. 1, at 160 (1973); Henry A. Bundschu, *Administration of Wage Earners' Plans in the Bankruptcy Court*, 18 J. NAT'L ASS'N REF. BANKR. 55, 56 (1944). For an empirical account of outcomes in Chapter XIII cases filed in five cities during the three years following Chapter XIII's enactment, see Frederick Woodbridge, *Wage Earners' Plans in the Federal Courts*, 26 MINN. L. REV. 775, 818–19 (1942). For a historical discussion on the origins of Chapter XIII, see Timothy W. Dixon & David G. Epstein, *Where Did Chapter 13 Come from and Where Should It Go?*, 10 AM. BANKR. INST. L. REV. 741 (2002).

136. According to an empirical study of Chapter 13 cases that were filed in 1994 in seven federal judicial districts, 351 of the 613 *confirmed* cases in the study's sample were either dismissed or converted to Chapter 7. Scott F. Norberg & Andrew J. Velkey, *Debtor Discharge and Creditor Repayment in Chapter 13*, 39 CREIGHTON L. REV. 473, 479, 506 tbl.19 (2006); *see also* 1 NAT'L BANKR. REV. COMM'N, *supra* note 5, at 233 ("For more than a decade, two-thirds of all Chapter 13 plans have failed before the debtor completes payments, and sometimes before unsecured creditors have received anything at all."); *cf.* ADMIN. OFFICE OF THE U.S. COURTS, *supra* note 15, at 64 tbl.6 (reporting that, of the 145,940 Chapter 13 cases dismissed during the 2009 calendar year, 71,114 cases (approximately 49%) were dismissed because of the debtor's failure to make payments under the plan). Put another way, the bankruptcy courts in the study erroneously determined the financial feasibility of plan success in 57% of the confirmed cases.

dissent chided bankruptcy courts for the high incidence of plan failure,[137] but they diverged in their assessment of the implications of such failure in conducting present-value analysis: The dissent took the view that the status quo will continue, such that the risk adjustment should not be offset by the financial-feasibility requirement;[138] whereas the plurality took the view that there should be some offset.[139]

What both the plurality and dissent fail to appreciate is that the financial-feasibility requirement is framed as an all-or-nothing proposition: The debtor will either be able or unable to make all payments.[140] There is no middle ground. Section 1325(a)(6) does not permit a court to confirm a plan if it believes that the debtor will be able to make only *some* of the payments under the plan. The court may only confirm if it is convinced that the debtor will make *all* payments under the plan.[141] In other words, the court must be convinced that $P_d = 0$ for all confirmed plans.

If $P_d = 0$ for a confirmed plan, then there are no expected default costs at the time of plan confirmation (i.e., $C_e = 0$). Accordingly, when a court factors in any expected default cost into its present-value analysis, it does so in contravention of the statutory scheme for plan confirmation. Any time a court adjusts the discount rate for risk of nonpayment, it essentially

---

137. *See Till*, 541 U.S. at 482–83 (Stevens, J., plurality opinion) ("Perhaps bankruptcy judges currently confirm too many risky plans, but the solution is to confirm fewer such plans, not to set default cramdown rates at absurdly high levels, thereby increasing the risk of default."); *id.* at 493 (Scalia, J., dissenting) ("That so many nonetheless failed proves that bankruptcy judges are not oracles and that trustees cannot draw blood from a stone."). Admittedly, a focus on plan failure as a metric for the effectiveness of Chapter 13 relief may be too narrow. Norberg & Velkey, *supra* note 136, at 504; Woodbridge, *supra* note 135, at 819–20.

138. *See* Till v. SCS Credit Corp., 541 U.S. 465, 497 (2004) (Scalia, J., dissenting) (noting that full compensation "cannot be attained by *high*-risk-plans and *low* interest rates, which, absent cause to anticipate a change in confirmation practices, is precisely what the formula approach would yield").

139. *See id.* at 482–83 (Stevens, J., plurality opinion) ("Perhaps bankruptcy judges currently confirm too many risky plans, but the solution is to confirm fewer such plans, not to set default cramdown rates at absurdly high levels, thereby increasing the risk of default.").

140. *See* 11 U.S.C. 1325(a)(6) (2006) (stating that a court shall confirm a plan if "the debtor will be able to make *all* payments under the plan and to comply with the plan" (emphasis added)).

141. *See Till*, 541 U.S. at 490 (Thomas, J., concurring) (noting that "a bankruptcy court must *ensure* that 'the debtor will be able to make all payments under the plan and to comply with the plan'" (emphasis added) (quoting 11 U.S.C. § 1325(a)(6)); *cf.* United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367, 1381 n.14 (2010) (stating that Code § 1325(a) "*requires* bankruptcy courts to address and correct a defect in a debtor's proposed plan even if no creditor raises the issue").

admits that $P_d > 0$. A court, however, must deny plan confirmation when that condition arises. To make matters worse, allowing such a risk premium essentially allows a creditor in certain circumstances (e.g., a no-asset case)[142] to insure against plan default through the equivalent of an unearned lien on the debtor's postbankruptcy income—at the expense of unsecured creditors.[143] Any increase in the discount rate will reduce the present value of the proposed cash flows under the debtor's plan,[144] with the result that the debtor will have to increase the amount of payments so that their present value is equal to the allowed amount of the creditor's claim. The portion of the income stream that correlates to the default risk represents payments that, in the absence of the risk premium, would likely have been distributed to unsecured creditors.[145]

142. A no-asset case is one in which the debtor does not have nonexempt assets available for distribution to unsecured creditors. Steven W. Rhodes, *An Empirical Study of Consumer Bankruptcy Papers*, 73 AM. BANKR. L.J. 653, 664 (1999). If such a case were administered under Chapter 7, no payment would be made to holders of allowed nonpriority, unsecured claims. 11 U.S.C. § 726(a). Accordingly, if a no-asset case is administered under Chapter 13, the debtor's repayment plan will satisfy the best-interest test, even though it proposes not to make any payments to the class of general unsecured creditors. 11 U.S.C. § 1325(a)(4); *supra* notes 28–31 and accompanying text. A similar situation would arise if the debtor did have nonexempt assets available for distribution, but those assets did not have sufficient value—if the case were administered under Chapter 7—to exceed the amount of allowed priority unsecured claims. In such a case, no payment would be made to holders of allowed nonpriority unsecured claims. 11 U.S.C. § 726(a).

143. *See In re* Scott, 248 B.R. 786, 789 (Bankr. N.D. Ill. 2000) ("[U]nless the debtor has sufficient disposable income to pay all claims in full during a Chapter 13 case, the rules for cramdown determine how the debtor's plan payments are divided between secured and unsecured creditors—the higher the cramdown payments, the lower the payments to unsecured creditors."). I borrow the concept of a creditor acquiring an unearned lien through the bankruptcy process from Lawrence Ponoroff and F. Stephen Knippenberg. Lawrence Ponoroff & F. Stephen Knippenberg, *Debtors Who Convert Their Assets on the Eve of Bankruptcy: Villains or Victims of the Fresh Start?*, 70 N.Y.U. L. REV. 235, 318–19 (1995).

144. Consider the following present-value formula, where pv is present value, f is the income flow, i is the discount rate per compounding period, and n is the number of compounding periods: $pv = f/(1 + i)^n$. C. Frank Carbiener, *Present Value in Bankruptcy: The Search for an Appropriate Cramdown Discount Rate*, 32 S.D. L. REV. 42, 44 (1987). When all other variables are held constant, pv decreases as i increases.

145. *See* 11 U.S.C. § 1325(b)(1)(B) (providing that, upon objection by the trustee or an unsecured creditor, a court may not approve a plan unless "the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due . . . will be applied to make payments to unsecured creditors"); *see also* 1 NAT'L BANKR. REV. COMM'N, *supra* note 5, at 261 ("[I]n the current Chapter 13 system, the amount of money allocated to interest payments on secured debt is deducted directly from the amount that otherwise would be available for distribution to unsecured creditors."). The possibility exists, of course, that the surplus disposable income in the absence of a risk premium could be sufficient to permit the debtor

It may be argued that, when a court concludes that a debtor will be able to make all payments under the plan, setting P_d at zero in the formula for expected default costs results in an inappropriately narrow construction of the Code's financial-feasibility requirement for Chapter 13 plans. The premise for this argument would be that the standard of proof associated with a finding of financial feasibility does not require a court to predict with absolute certainty successful completion of the repayment plan. Assuming that the correct standard of proof for confirmation of a Chapter 13 plan is preponderance of the evidence (the POE standard),[146] a court need only find that it is more likely than not that the debtor will be able to make all payments under the plan.[147] In quantitative terms, the court can make such a finding if it is convinced that there is at least a 0.501 probability (rounding to the nearest thousandth) of all proposed payments being made.[148] From this probability assessment, one could calculate for purposes of present-value analysis a corresponding probability of default under the plan and incorporate the figure as P_d in the formula for expected default costs.[149]

---

to retain additional property through cramdown. In this case, the beneficiary of a risk-free discount rate would be the holder of the crammed-down claim, rather than the general unsecured creditors. Also, in those instances where the debtor proposes to pay 100% of the unsecured claims, a risk-adjusted discount rate would not present the problem of the unearned lien.

146. *See In re* Santiago, 404 B.R. 564, 570 n.8 (Bankr. S.D. Fla. 2009) ("While the standard of proof [for Chapter 13 plan confirmation] seems generally recognized as 'preponderance of the evidence,' there are some courts that require proof by clear and convincing evidence." (citations omitted)); *cf.* Fin. Sec. Assurance Inc. v. T-H New Orleans Ltd. P'ship (*In re* T-H New Orleans Ltd. P'ship), 116 F.3d 790, 801 (5th Cir. 1997) (applying the preponderance-of-the-evidence standard in the context of Chapter 11 plan confirmation); Heartland Fed. Sav. & Loan Ass'n v. Briscoe Enter., Ltd., II (*In re* Briscoe Enter., Ltd., II), 994 F.2d 1160, 1165 (5th Cir. 1993) (same); United States v. Arnold & Baker Farms (*In re* Arnold & Baker Farms), 177 B.R. 648, 655 (B.A.P. 9th Cir. 1994) (same); *In re* Charles, 334 B.R. 207, 216 (Bankr. S.D. Tex. 2005) ("Absent a statute or rule to the contrary, the burden of proof in a bankruptcy case is by a preponderance of the evidence."). I borrow the phrase "POE standard" from Saul Levmore. Saul Levmore, *Conjunction and Aggregation*, 99 MICH. L. REV. 723, 726 (2001).

147. *See In re Arnold & Baker Farms*, 177 B.R. at 654 ("Proof by the preponderance of the evidence means that it is sufficient to persuade the finder of fact that the proposition is more likely true than not.").

148. *See, e.g.*, Neil Cohen, *Confidence in Probability: Burdens of Persuasion in a World of Imperfect Knowledge*, 60 N.Y.U. L. REV. 385, 399 (1985) (stating that the POE standard is satisfied if the probability exceeds 0.5); Levmore, *supra* note 146, at 725–26 (same).

149. Any skepticism regarding the inclination of courts to conduct likelihood assessments in resolving disputes that arise under the Bankruptcy Code can be dismissed. Courts have calculated such probabilities, for example, when valuing a debtor's contingent

Imagine, for example, that a court finds it more likely than not that the debtor will be able to make all payments under the plan. This represents an affirmative answer to the binary question of whether the financial-feasibility requirement—that is, 100% payment by the Chapter 13 debtor—has been met by the POE standard, which is the equivalent of saying that there is more than a 0.5 chance of a successful repayment plan. The extent to which the quantum of proof offered by the debtor exceeds the POE standard will surely vary across different cases. The court's assessment, for example, may be that the evidence presented suggests a 0.8 likelihood of a successful repayment plan.[150] In this example, the court can hold that the financial-feasibility requirement has been satisfied and then proceed to use this information in calculating risk of default for purposes of present-value analysis. The court's assessment of a 0.8 chance of successful plan is similarly an assessment of a 0.2 chance of the debtor not making all payments under the plan—in other words, plan default. Thus, the court could set P_d in the formula for expected default costs to 0.2.

On this account, one can reconcile a finding of financial feasibility with the incorporation of a premium for risk of default into the discount rate used for present-value analysis. The risk factor merely represents the degree of uncertainty of plan completion perceived by the court, even though the court ultimately concludes that the debtor, more likely than not, will succeed.[151] To calculate P_d in the formula for expected default costs, one merely subtracts the court's likelihood assessment of financial feasibility—that is, the probability of successful repayment (represented by P_s)—from 1. Thus, $P_d = 1 - P_s$. Because the POE standard requires that P_s

---

liabilities for purposes of determining the debtor's insolvency. *See, e.g.*, Covey v. Commercial Nat'l Bank of Peoria, 960 F.2d 657, 660 (7th Cir. 1992) ("Discounting a contingent liability by the probability of its occurrence is good economics and therefore good law, for solvency, the key to § 548(a)(2), is an economic term.").

150. Put another way, the court would reason that, if it were to observe the proffered evidence ten times, the court would conclude eight times that the debtor would make all payments under the plan and would conclude two times that the debtor would fail to make all payments under the plan.

151. Epstein & Fuller, *supra* note 40, at 909. In further support of this point by way of analogy, it has been stated that, in conducting present-value analysis under the best-interests test in Chapter 11, a court must account for the probability of success of the reorganization plan in addition to the discount rate. Timothy C.G. Fisher & Jocelyn Martel, *Does It Matter How Bankruptcy Judges Evaluate the Creditors' Best-Interests Test?*, 81 AM. BANKR. L.J. 497, 498, 500–01 (2007). Interestingly, however, because this prescription separates the discount rate and the likelihood of successful reorganization into distinct analytical concepts, it suggests that the discount rate ought to be a risk-free rate that accounts only for the time value of money (i.e., opportunity cost and expected inflation).

exceed 0.5, it follows that, when rounding to the nearest thousandth, P_s will have a lower bound of 0.501 and an upper bound of 1.000 (i.e., $0.501 \leq P_s \leq 1.000$). Consequently, the value for P_d in the formula for expected default costs could range from 0.000 to 0.499, notwithstanding the court's finding of financial feasibility.

This "flexible approach" undoubtedly has pragmatic appeal. It gives a court the flexibility of confirming a plan not guaranteed to succeed, but nonetheless having reasonable prospects for success. Moreover, the approach allows a court to mitigate its prediction error by compensating creditors through the incorporation of a risk factor into the discount rate for present-value analysis.[152] Were courts required to predict with certainty the successful completion of a Chapter 13 plan, they would likely confirm fewer Chapter 13 plans, which would result in a higher incidence of dismissed or converted Chapter 13 cases.[153] This would likely deter debtors from filing for bankruptcy under Chapter 13, thus undermining Congress's intent to encourage greater use of the chapter by individual debtors.[154]

The flexible approach fails to account, however, for a key difference between the financial-feasibility standards for the confirmation of Chapter 11 and Chapter 13 plans. That difference suggests that a finding of financial feasibility ought to result in distinct approaches for incorporating risk of default when conducting present-value analysis under the two chapters. Whereas the financial-feasibility requirement for confirmation of a Chapter 13 plan requires a court to find that "the debtor will be able to make all payments under the plan,"[155] the Chapter 11 analogue only requires a court to find that "[c]onfirmation of the plan is *not likely* to be followed by the liquidation, or the need for further financial reorganization, of the debtor . . . , unless such liquidation or reorganization is proposed in

152. Even under this approach, there will be instances in which the prediction error is not completely mitigated—specifically, those cases where it is more likely than not that the debtor's plan will fail, but the court concludes otherwise. In such cases, the probability of plan default will be greater than or equal to 0.501. By virtue of its erroneous finding of financial feasibility, however, the court will not be able to set P_d in the formula for expected default costs any higher than the upper bound of 0.499. Accordingly, in such cases, the prediction error will not be mitigated to the extent that the actual probability of plan default exceeds the predicted probability of plan default.

153. *See* 11 U.S.C. § 1307(c)(5) (2006) (providing that a court may convert or dismiss a Chapter 13 case for cause, including "denial of confirmation of a plan . . . and denial of a request made for additional time for filing another plan or a modification of a plan").

154. *See* 1 NAT'L BANKR. REV. COMM'N, *supra* note 5, at 233 ("The legislative history of the Bankruptcy Reform Act of 1978 establishes that Congress sought to promote the use of Chapter 13 in appropriate cases.").

155. 11 U.S.C. § 1325(a)(6).

the plan."[156] Because the standard of proof for Chapter 11 plan confirmation is a preponderance of the evidence, a court need only find that it is more likely than not that the Chapter 11 plan is not likely to fail.[157] A court required to make a finding of the financial feasibility of a Chapter 11 plan thus faces what can be described as "two more-likely-than-not assessments,"[158] which has significant implications when importing the flexible approach into the Chapter 11 context.[159]

As in Chapter 13,[160] confirmation of a Chapter 11 plan will generally require a court to conduct present-value analysis, which is indicated by the identical language "value, as of the effective date of the plan."[161] Assuming that it is appropriate in Chapter 11 cases to implement the Chapter 13 framework for conducting present-value analysis,[162] one would conduct the analysis by calculating expected default costs. To ascertain expected default costs, one would have to estimate the probability of default (P_d) under the Chapter 11 plan. Under the flexible approach, $P_d = 1 - P_s$, with P_s representing the probability of a successful Chapter 11 reorganization. In turn, P_s is derived from the court's financial-feasibility determination. As mentioned before, such a determination involves two probability estimates—specifically, (1) whether it is more likely than not that (2) the plan is likely to succeed. The first estimate represents the POE standard,

156. *Id.* § 1129(a)(11) (emphasis added). Similar to the Chapter 13 context, the Code's legislative history uses the term "feasibility" to describe the confirmation requirement set forth in Code § 1129(a)(11). *See* S. REP. NO. 95-989, at 128 (1978) ("Paragraph (11) requires a determination regarding feasibility of the plan."), *reprinted* in 1978 U.S.C.C.A.N. 5787, 5914; H.R. REP. NO. 95-595, at 413 (1977) ("Paragraph (11) contains the feasibility standards."), *reprinted* in 1978 U.S.C.C.A.N. 5963, 6369. For further discussion regarding the Chapter 11 feasibility standards, see, for example, *Financial Security Assurance Inc. v. T-H New Orleans Ltd. Partnership (In re T-H New Orleans Ltd. Partnership)*, 116 F.3d 790, 801 (5th Cir. 1997); *In re Arts Dairy, LLC*, 432 B.R. 712, 716–17 (Bankr. N.D. Ohio 2010).

157. *See supra* note 146 (citing case law supporting the proposition that the standard of proof for Chapter 11 plan confirmation is preponderance of the evidence).

158. Levmore, *supra* note 146, at 742.

159. *See supra* note 40 (citing authorities in support of the proposition that the present-value provisions should be consistently interpreted throughout the Code).

160. *See supra* notes 31, 34 and accompanying text (quoting Chapter 13 present-value provisions).

161. 11 U.S.C. § 1129(a)(7), (a)(9), (a)(15)(A), (b)(2)(A)(i)(II), (b)(2)(B)(i), (b)(2)(C)(i); *cf.* Epstein & Fuller, *supra* note 40, at 905 ("[B]oth section 1129 of Chapter 11 and section 1325 of Chapter 13 test the adequacy of a plan's deferred cash payments to the holder of a secured claim by looking to the 'value, as of the effective date of the plan' of the deferred cash payments.").

162. *See supra* note 40 (citing authorities in support of the proposition that the present-value provisions should be consistently interpreted throughout the Bankruptcy Code).

and the second estimate represents the financial-feasibility requirement. Unlike the Chapter 13 feasibility requirement, which is framed as a binary assessment (i.e., whether the debtor will make all payments), the Chapter 11 feasibility requirement is framed as an interval assessment (i.e., the likelihood of the plan succeeding). Calculating P_s thus presents the issue of conjunctive probability and implicates use of the "product rule," whereby the probability associated with the POE standard and the probability associated with the feasibility standard will be multiplied in order to calculate the combined likelihood that yields P_s.[163]

In quantitative terms, the court can make a Chapter 11 feasibility finding if it is convinced that there is at least a 0.501 probability (again, rounding to the nearest thousandth) that plan confirmation will not likely be followed by liquidation or further financial reorganization. The latter condition can be reclassified and quantified as a finding that, at a minimum, there exists a 0.501 probability of successful reorganization. Accordingly, when multiplying the quantified confirmation standard (which could range from 0.501 to 1.000) by the quantum of proof (which could range from 0.501 to 1.000), a court could make a finding of financial feasibility in the Chapter 11 context where the predicted probability of plan success ranges from a lower bound of 0.251 (i.e., a finding of a 0.501 probability of successful reorganization multiplied by the 0.501 quantum of proof) to an upper bound of 1.000 (i.e., a finding of a 1.000 probability of successful reorganization multiplied by a 1.000 quantum of proof). In other words, $0.251 \leq P_s \leq 1.000$.

Consider the implication of implementing the flexible approach in the Chapter 11 context. Under that approach, $P_d = 1 - P_s$. Given the range of P_s, the value for P_d in the formula for expected default costs could range from 0.000 to 0.749. The conjunction issue presented by the Chapter 11 feasibility standard gives rise to the possibility that, if one were to implement the flexible approach, P_d could exceed 0.500 for purposes of Chapter 11 present-value analysis. More specifically, there would be a range of cases where $0.501 \leq P_d \leq 0.749$. For such cases, implementing the flexible approach would entail use of a discount rate that would compensate creditors (under a confirmed plan) at a level reflecting plan failure rather than plan success. Such a result would be demonstrably at odds with the notion of a confirmed plan as being one that "is not likely to be followed by

163. *See* Levmore, *supra* note 146, at 723 (describing application of the "product rule").

the liquidation, or the need for further financial reorganization, of the debtor."[164]

To avoid this absurd result, a court would have to dispense with application of the product rule. Once a court was satisfied that the POE threshold of 0.501 had been met or exceeded, the court would take what had been proven as a given—specifically, that successful reorganization was more likely than not (i.e., $P_s \geq 0.501$). A finding of financial feasibility in the Chapter 11 context would thus entail an estimate within the range of $0.501 \leq P_s \leq 1.000$. This, in turn, would allow for a sensible application of the flexible approach in Chapter 11 pursuant to which creditors would be compensated according to a discount rate reflecting successful reorganization (as a result of $0.000 \leq P_d \leq 0.499$).

If the flexible approach can be sensibly applied only by taking what has been proven as a given, then a court that makes a finding of financial feasibility in the Chapter 13 context must calculate the discount rate for present-value analysis on the assumption that the "debtor will be able to make all payments under the plan."[165] Under the assumption $P_d = 0$, there are no expected default costs (i.e., $C_e = 0$). It is important to note that this line of argument does not contradict the proposition that present-value analysis should be applied consistently across the different Code chapters.[166] The argument offered here began with the idea that the discount rate can be reframed as a formula for expected default costs. Although the formula remains constant across Code chapters, P_d is calculated differently in Chapter 13 than in Chapter 11 by virtue of the distinct financial-feasibility requirements of the two chapters. Thus, the expected-default-costs framework can be applied equally in both chapters while simultaneously recognizing and giving effect to their substantive differences in confirmation standards.

2. *Actual Default Costs (C_a)*

Solely on the basis of this contextualized reading of the Code, one could conclude that the discount rate must be a risk-free rate. For the sake of argument, however, assume that taking account of the likelihood of plan failure *is* appropriate—that is, that a court may confirm a plan

164. 11 U.S.C. § 1129(a)(11).

165. *Id.* § 1325(a)(6).

166. *See supra* note 40 (citing authorities in support of the proposition that the present-value provisions should be consistently interpreted throughout the Bankruptcy Code).

notwithstanding that $P_d > 0$ and that the court may factor this into its present-value analysis. One must still answer whether the amounts represented by C_a should be factored into present-value analysis. If none of those factors may be taken into account when calculating the risk-adjusted discount rate, this would be the equivalent of saying that $C_a = 0$ in calculating expected default costs. Under that condition, C_e also equals zero, thereby yielding a riskless discount rate.

The factors identified by the plurality as producing default costs relate to (1) the value of the collateral securing the creditor's allowed secured claim and (2) presumably the degree of insolvency of the debtor's estate (i.e., the degree to which the sum of the claims against the estate exceed estate property available for distribution).[167] The factors identified by the dissent as producing default costs relate to (1) the value of the collateral securing the creditor's allowed secured claim, (2) the illiquidity of foreclosed or repossessed collateral, and (3) the enforcement of security rights in the bankruptcy forum.[168] Each of these factors will be considered in turn, and it will be shown that the Code allows recovery for some of these costs pursuant to procedures outside the confirmation process and precludes recovery of the remaining costs.

a. Default Costs Relating to Collateral Value

First, consider default costs relating to the value of the collateral securing the creditor's allowed secured claim, a factor identified by both the plurality and the dissent. According to the plurality opinion, risk adjustment should be dictated partly by "the nature of the security."[169] The dissenting opinion is more specific than the plurality, identifying "the rate of collateral depreciation" as a "relevant factor[] bearing on risk premium."[170] Given the plurality's broader statement, one might reasonably conclude that concern over the nature of the security includes not only depreciation, but also destruction or loss of the collateral. When a debtor

167. *See* Till v. SCS Credit Corp., 541 U.S. 465, 479 (2004) (Stevens, J., plurality opinion) ("The appropriate size of th[e] risk adjustment depends . . . on such factors as the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan.").

168. *See id.* at 499 (Scalia, J., dissenting) ("[T]he most relevant factors bearing on risk premium are (1) the probability of plan failure; (2) the rate of collateral depreciation; (3) the liquidity of the collateral market; and (4) the administrative expenses of enforcement.").

169. *Id.* at 479 (Stevens, J., plurality opinion).

170. *Id.* at 499 (Scalia, J., dissenting).

retains property subject to a creditor's security interest and does so over the objection of the creditor, the concern arises that, in the event of default, if the collateral has depreciated or has been destroyed, then the creditor will be left with a loss that it would not have suffered if it had been allowed to foreclose on the collateral in the first instance.[171] Under such circumstances, the retention of the lien by the creditor—which the plan must provide when the debtor exercises the cramdown option[172]—will be of little comfort.

Congress, however, well aware of this problem when it drafted the Code, created a process by which a secured creditor can seek protection from the loss or declining value of its collateral. Before discussing this process, it is worth noting how and why the Code interferes with a creditor's ability to enforce its security rights. When a debtor files for bankruptcy, a stay goes into effect automatically (without requiring court action) that prevents creditors from taking certain actions against the debtor and its estate.[173] The automatic stay plays a fundamental role in protecting both debtors and creditors: It gives a debtor breathing room,[174] and it "accords procedural relief to creditors in the form of an orderly, collective process that administers the assets of a debtor to its creditors as a response to the common pool problem that arises when a debtor has insufficient assets to repay his or her debts."[175] The automatic stay therefore prohibits, among other acts, any act to obtain possession of estate property and any act to enforce a lien against estate property.[176]

171. *See id.* at 502 ("The first cost of default involves depreciation. If the debtor defaults, the creditor can eventually repossess and sell the collateral, but by then it may be substantially less valuable than the remaining balance due—and the debtor may stop paying long before the creditor receives permission to repossess.").

172. 11 U.S.C. § 1325(a)(5)(B)(i)(I) (2006).

173. *See id.* § 362(a) (listing acts that are stayed); Sunshine Dev., Inc. v. FDIC, 33 F.3d 106, 113 (1st Cir. 1994) ("Because the automatic stay is exactly what the name implies—'automatic'—it operates without the necessity for judicial intervention."); FDIC v. Hirsch (*In re* Colonial Realty Co.), 980 F.2d 125, 137 (2d Cir. 1992) ("[T]he automatic stay is imposed by Congressional mandate and not by court order. By its very terms, no action by any court is necessary for the stay to take effect." (citations omitted)).

174. H.R. REP. NO. 95-595, at 340 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6297.

175. Rafael I. Pardo & Michelle R. Lacey, *Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt*, 74 U. CIN. L. REV. 405, 414 (2005); *see also* S. REP. NO. 95-989, at 49 (1978) (discussing how the automatic stay protects creditors), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5835; H.R. REP. NO. 95-595, at 340 (same), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6297.

176. 11 U.S.C. § 362(a)(3), (5).

A creditor may seek relief from the automatic stay, however, if its interest in estate property is not adequately protected.[177] The concept of adequate protection can be located within the Fifth Amendment and its protection of property interests, the idea being that a procedure should exist to ensure that the automatic stay does not unconstitutionally deprive a creditor's nonbankruptcy property right to seize collateral pursuant to its security agreement with the debtor.[178] As a matter of policy, the concept of adequate protection recognizes that giving a secured creditor the absolute right to its nonbankruptcy entitlement may undermine bankruptcy's collective process; accordingly, adequate protection provides a secured creditor with the equivalent value of its nonbankruptcy entitlement rather than the entitlement itself.[179] The Code provides three methods for adequately protecting a secured creditor's interest in collateral that the debtor retains: (1) providing periodic cash payments to the creditor equal to the decrease in the value of the creditor's interest in the collateral;[180] (2) granting the creditor an additional lien or substitute lien on other property equal to the decrease in the value of the creditor's interest in the collateral;[181] or (3) other protection, other than providing an administrative expense claim to the creditor, that will result in the creditor realizing the indubitable equivalent of the value of its interest in the collateral.[182]

In general terms, a creditor's interest will be adequately protected only if the creditor's allowed secured claim, which is determined by reference to the value of the collateral securing the claim,[183] remains fully secured throughout the life of the debtor's repayment plan.[184] If this condition obtains, then the creditor will, at a minimum, be able to realize the amount it would have received had the creditor been allowed to seize the collateral and liquidate it on the petition date.[185] To see why this is the case, consider

177. *Id.* § 362(d)(1).

178. H.R. REP. NO. 95-595, at 339, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6295.

179. *Id.*

180. 11 U.S.C. § 361(1).

181. *Id.* § 361(2).

182. *Id.* § 361(3).

183. *See id.* § 506(a) ("An allowed claim of a creditor secured by a lien on property in which the estate has interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . .").

184. Americredit Fin. Servs., Inc. v. Nichols (*In re* Nichols), 440 F.3d 850, 857 n.6 (6th Cir. 2006).

185. In Chapter 7 and Chapter 13 cases involving an individual debtor, the standard for valuing collateral that consists of personal property is replacement value. 11 U.S.C. § 506(a)(2). This value is obviously higher than liquidation value. Accordingly, when

the simple dynamic of repayment under the cramdown option. Recall that, when a debtor invokes the cramdown option, the debtor's plan must propose that the creditor retain the lien securing its claim.[186] Payments to the creditor have the effect of reducing the amount of debt outstanding. The only way that a creditor's allowed secured claim will become undersecured is if the rate of decline in the value of the collateral (whether because of depreciation or loss) exceeds the rate of repayment. Thus, so long as the rate of repayment exceeds the rate of decline in value, the creditor's interest will be adequately protected.[187] In the event that the debtor's plan fails, and the case is either converted to Chapter 7 or dismissed, the outstanding debt owed on the allowed secured claim will be fully covered by the value of the collateral as a result of the retained lien,[188] thereby permitting complete recovery by the creditor.

Given that the Code has an independent process for adequately protecting a creditor's interest in collateral, any discount rate that compensates for expected default costs related to a decline in collateral value is inappropriate. An amendment in 2005 to the Chapter 13 confirmation standards further confirms this.[189] Pursuant to that

determining whether the present value of the proposed income payments under the Chapter 13 cramdown option is equal to the allowed amount of a claim secured by personal property, the latter amount will be greater than what the creditor would have received through liquidation of the collateral at a foreclosure sale, since the allowed amount of the secured claim will be determined by reference to the replacement value of the collateral. *Infra* note 269 and accompanying text. Thus, if the allowed secured claim has remained fully secured and the debtor has made some payments under the plan prior to default, it is highly likely that the creditor will have received more than it would have received upon immediate foreclosure (i.e., the surplus represented by the difference between the plan payments actually made under a replacement-value standard and what those payments would have been under a liquidation-value standard).

186. 11 U.S.C. § 1325(a)(5)(i).

187. If the rate of decline in collateral value exceeds the rate of repayment required by the cramdown option, a debtor would be able to use the options provided in the Code's adequate protection provision to rectify the situation. For example, the debtor could increase the amount of periodic payments in order to offset the rate of depreciation. *Id.* § 361(1). Alternatively, the debtor could give the creditor an additional or substitute lien on property whose value is determined not to decline during the life of the plan. *Id.* § 362(2).

188. *See id.* § 1325(a)(5)(B)(i)(II) (requiring Chapter 13 plan to provide that, upon dismissal or conversion of the case prior to completion of the plan, the secured creditor will retain its lien to the extent recognized by applicable nonbankruptcy law). A lien generally passes through bankruptcy unaffected. *Id.* § 506(d); Dewsnup v. Timm, 502 U.S. 410, 417 (1992); H.R. REP. NO. 95-595, at 357 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6313. The Bankruptcy Code does provide mechanisms for lien avoidance, none of which is relevant to discussion here. *E.g.*, 11 U.S.C. §§ 506(d), 544–548.

189. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No.

amendment, when a debtor invokes the cramdown option with respect to a creditor whose claim is secured by personal property and to whom the debtor proposes to make periodic payments, the Code now provides that "the amount of such payments shall not be less than an amount sufficient to provide to the holder of such claim adequate protection during the period of the plan."[190] The amendment makes it quite clear that adequate-protection concerns are to be addressed distinctly from present-value analysis.[191] Thus, expected default costs related to declining collateral value should not be incorporated into the discount rate used for such analysis.[192]

b. Default Costs Relating to Estate Insolvency

Second, consider default costs relating to the degree of insolvency of the debtor's estate (i.e., the degree to which the sum of the claims against the estate exceeds estate property available for distribution). Presumably, this is what the plurality opinion refers to when it states that "the circumstances of the estate" are a relevant factor in making an upward adjustment to the discount rate used in present-value analysis.[193] This should not be a concern for creditors who have allowed secured claims. By virtue of their liens on property of the estate, that property (i.e., the collateral securing the claim) serves as a form of insurance against nonpayment.[194] To the extent such creditors are concerned about the declining value of their collateral, they can demand adequate protection of their interests in the property. Because secured creditors have first claim to

109-8, § 309(c)(1)(C), 119 Stat. 23, 83 (codified at 11 U.S.C. § 1325(a)(5)(B)(iii) (2006)).

190. 11 U.S.C. § 1325(a)(5)(B)(iii)(II).

191. Indeed, Justice Stevens argued in his dissenting opinion in *Associates Commercial Corp. v. Rash* that the loss of collateral value in a Chapter 13 case ought to be mitigated by adequate-protection payments and not present-value-interest payments. Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 966 n.* (1997) (Stevens, J., dissenting). This makes all the more perplexing his reference in *Till* to the "nature of the security" as a relevant consideration in determining the risk adjustment to the discount rate used for present-value analysis. *Supra* note 169 and accompanying text.

192. On this account, Justice Scalia's focus on the expected default cost resulting from the depreciation in the value of collateral is misguided. Till v. SCS Credit Corp., 541 U.S. 465, 502 (2004) (Scalia, J., dissenting).

193. *Id.* at 479 (Stevens, J., plurality opinion).

194. *See In re* Collins, 167 B.R. 842, 847 n.7 (Bankr. E.D. Tex. 1994) ("[I]n case of default, the creditor can recover the remaining value of his claim by securing and disposing of the collateral."), *abrogated by* Green Tree Fin. Servicing Corp. v. Smithwick (*In re* Smithwick), 121 F.3d 211 (5th Cir. 1997).

the estate assets in which they have an interest, they theoretically need not be concerned with the degree of insolvency of the debtor's estate.[195]

Unsecured creditors, on the other hand, would rightfully be concerned about the estate's insolvency in the event of plan default. Recall, however, that the Chapter 13 confirmation standard for allowed unsecured claims focuses on whether the proposed distributions on account of such claims have a present value equal to the amount of property that would be distributed to such claims in a hypothetical Chapter 7 liquidation.[196] Given that general unsecured claims in Chapter 7 receive a pro-rata distribution of nonexempt estate property remaining after payment to priority unsecured claims,[197] it would be quite misguided to compensate general unsecured creditors in Chapter 13 for the loss which they would otherwise experience in Chapter 7.[198] In light of these considerations, default costs relating to the degree of insolvency of the debtor's estate should not be incorporated if calculating a risk-adjusted discount rate.

c. *Default Costs Relating to Collateral Illiquidity*

Third, consider default costs relating to the illiquidity of foreclosed or repossessed collateral. In his dissent, Justice Scalia observed that, in the event of default, a creditor would not be able to recover the replacement

195. I say theoretically because of the possibility that, in the event the court determines that a creditor is entitled to adequate protection, that protection could prove to be inadequate—that is, the creditor's allowed secured claim may end up undersecured because of a deficiency in the protection given to the creditor. When this occurs, the Code provides that the creditor will be allowed an administrative expense claim against the estate with priority over all other administrative expense claims. 11 U.S.C. § 507(b). If the debtor's plan fails and the case is converted to Chapter 7, the Chapter 7 administrative expense claims will be paid before the Chapter 13 administrative expense claims. *Id.* § 726(b). If the debtor's Chapter 7 estate is administratively insolvent, or if there are insufficient assets to pay the Chapter 13 administrative expense claims in full, the creditor will suffer a loss that it would not have suffered had the creditor been able to foreclose on its collateral when the debtor filed for bankruptcy. Under this limited set of circumstances, a creditor would be concerned over the degree of insolvency of the debtor's estate. Nonetheless, this is an adequate-protection issue and thus not properly considered in the vein of present-value analysis. *Supra* Part III.B.2.a.

196. *See supra* notes 36–37 and accompanying text (discussing application of present-value analysis with respect to allowed unsecured claims).

197. *See* 11 U.S.C. § 726(a), (b) (specifying the order in which claims will be paid in Chapter 7 and requiring that payment be made on a pro rata basis).

198. In fact, when Congress has desired to increase the distributions to general unsecured creditors in Chapter 13 over and above the amounts they would receive in Chapter 7, it has expressly drafted Code provisions to this effect. 11 U.S.C. § 1325(b)(1)(B).

value to which it is entitled in Chapter 13 when a debtor invokes the cramdown option.[199] Instead, the creditor would receive "only a lesser *foreclosure* value because collateral markets are not perfectly liquid, and there is thus a spread between what a buyer will pay and what a seller will demand."[200] In the 2005 amendments to the Bankruptcy Code,[201] Congress clearly expressed its view that this is an expected default cost for which a secured creditor should not be compensated in bankruptcy. Pursuant to those amendments, in an individual debtor's Chapter 7 or Chapter 13 case, the current standard for valuing collateral that consists of personal property is replacement value,[202] a value that is obviously higher than liquidation value. Consider the implications of this valuation standard for creditor repayment in Chapter 7.

Imagine a creditor has an allowed claim of $10,000 that is secured by property with a replacement value of $10,000 and a foreclosure value of $8,000. The trustee will abandon such property given both its burden to the estate as well as its inconsequential value and benefit to the estate.[203] Once such property is abandoned and is no longer part of the estate, the automatic stay will no longer prohibit the creditor from enforcing its lien against the property.[204] When the creditor forecloses, it will realize only $8,000, thereby suffering a loss of $2,000. The Code, however, will not entitle the creditor to recover this loss. Because the creditor will have been deemed to

---

199. Till v. SCS Credit Corp., 541 U.S. 465, 502 (2004) (Scalia, J., dissenting).

200. *Id.* at 502–03.

201. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 327, 119 Stat. 23, 99–100 (providing that, in an individual debtor's Chapter 7 or Chatper 13 case, "value with respect to personal property securing an allowed claim shall be determined based on the replacement value of such property") (codified at 11 U.S.C. § 506(a)(2) (2006)).

202. 11 U.S.C. § 506(a)(2).

203. *See id.* § 554(a) (authorizing a trustee to abandon any property that is burdensome or of inconsequential value and benefit to the estate). A Chapter 7 trustee is accountable for all property received. *Id.* § 704(a)(2). As such, the estate will incur administrative costs in preserving the property (i.e., a burden). *See id.* § 330(a)(1)(B) (providing that a court may award to a trustee "reimbursement for actual, necessary expenses"); *id.* § 503(b)(2) (providing that reimbursement awarded under Code § 330(a) constitutes an administrative expense). The property, however, will generally not provide any value or benefit to the estate because the allowed amount of the creditor's claim consumes the entire value of the property to which the creditor has first claim. *Id.* §§ 506(a)(1), 725. In other words, the property will not provide any value for distribution to the unsecured creditors. Under these circumstances, the trustee will abandon the property.

204. *See id.* § 362(c)(1) ("[T]he stay of an act against property of the estate . . . continues until such property is no longer property of the estate.").

have had an allowed claim that was fully secured,[205] the creditor will not have an unsecured claim entitling it to participate in distribution of nonexempt estate property to the holders of allowed unsecured claims.[206] Accordingly, if the Code precludes in Chapter 7 cases the recovery of expected default costs relating to the illiquidity of foreclosed or repossessed collateral, there is no principled reason to account for such costs were one to calculate a risk-adjusted discount rate.

d. Default Costs Relating to Enforcement Actions

Finally, consider default costs relating to the enforcement of a creditor's security rights in the bankruptcy forum. Justice Scalia described the problem as follows:

> The third cost of default consists of the administrative expenses of foreclosure. While a Chapter 13 plan is in effect, the automatic stay prevents secured creditors from repossessing their collateral, even if the debtor fails to pay. The creditor's attorney must move the bankruptcy court to lift the stay. . . . Moreover, bankruptcy judges will often excuse first offenses, so foreclosure may require multiple trips to court. The total expected administrative expenses in the event of default could reasonably be estimated at $600 or more.[207]

Yet again, here is another instance in which the Code allows recovery for this type of expected default cost pursuant to a procedure outside of the confirmation process—specifically, the claim-allowance process. The definition of claim includes a contingent right to payment,[208] and only creditors (i.e., entities with a pre-petition claim against the debtor)[209] may file proofs of claim.[210] Moreover, a claim cannot be disallowed merely because it is contingent.[211] Finally, the Code authorizes a court to estimate

205. *See infra* note 269 and accompanying text (explaining the manner in which the secured status of an allowed claim is determined).

206. *See* 11 U.S.C. § 726(a) (establishing the order of distribution of estate property to unsecured creditors in Chapter 7 cases).

207. Till v. SCS Credit Corp., 541 U.S. 465, 503 (2004) (Scalia, J., dissenting).

208. 11 U.S.C. § 101(5)(A).

209. *See id.* § 101(10)(A) (defining creditor as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor"). For a discussion of the terms "pre-petition" and "post-petition," see *infra* note 245.

210. 11 U.S.C. § 501(a).

211. *Id.* § 502(b)(1).

for claim-allowance purposes "any contingent . . . claim, the fixing . . . of which . . . would unduly delay the administration of the case."[212]

With these principles in mind, it should become clear that a creditor ought to be able to recover expected default costs relating to the administrative expenses of foreclosure through the claim-allowance process. Security agreements routinely provide that a creditor may recover collection costs incurred in enforcing the agreement.[213] If carefully drafted, such a provision could include collection costs incurred while enforcing the agreement in the bankruptcy forum. Pursuant to that agreement, the creditor would have a pre-petition contingent right to recover collection costs in the bankruptcy forum.[214] Accordingly, expected default costs arising from the administrative expenses of foreclosure should be recovered as part of a creditor's allowed claim (i.e., the confirmation threshold for evaluating present-value analysis)[215] rather than being incorporated into a risk-adjusted discount calculus.[216]

As the foregoing reveals, none of the factors identified by the plurality and dissent as producing expected default costs should be incorporated into the discount rate used for present-value analysis.[217] In other words, a

---

212. *Id.* § 502(c)(1).

213. LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT: A SYSTEMS APPROACH 159 (6th ed. 2009).

214. *See* Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co., 549 U.S. 443, 453–54 (2006) (stating that the Bankruptcy Code provision governing the allowance of claims does not prohibit an unsecured creditor from recovering attorneys' fees authorized by a pre-petition contract and incurred in post-petition litigation).

215. *See supra* Part II.A (explaining the Chapter 13 confirmation threshold for secured and unsecured claims).

216. The Court in *Travelers* did not address whether Code § 506(b) categorically disallows unsecured claims for contractual attorneys' fees that arise under a pre-petition contract but are incurred post-petition. *Travelers*, 549 U.S. at 454–56; *see also infra* Part IV.B.1 (discussing Code § 506(b)). For the argument that Code § 506(b) does not disallow such claims, see, for example, *Insurance Administrators, Inc. v. SNTL Corp. (In re SNTL Corp.)*, 380 B.R. 204, 218–20 (B.A.P. 9th Cir. 2007), *aff'd sub nom. SNTL Corp. v. Centre Insurance Co.*, 571 F.3d 826 (9th Cir. 2009); *Qmect, Inc. v. Burlingame Capital Partners (In re Qmect, Inc.)*, 368 B.R. 882, 885–86 (Bankr. N.D. Cal. 2007). For the argument that Code § 506(b) does disallow such claims, see, for example, Mark S. Scarberry, *Interpreting Bankruptcy Code Sections 502 and 506: Post-Petition Attorneys' Fees in a Post-*Travelers *World*, 15 AM. BANKR. INST. L. REV. 611, 615 (2007). If the argument that such claims are disallowed is correct, then this further bolsters the conclusion that expected default costs relating to the enforcement of security rights in the bankruptcy court should not be incorporated into a risk-adjusted discount-rate calculus. If the Code generally precludes the recovery of such costs from the estate, there is no principled reason to allow their recovery in Chapter 13.

217. *See supra* notes 121–23 and accompanying text (discussing factors identified by

contextual reading of the Code reveals that none of the amounts represented by C_a should be taken into account when calculating a risk premium for the present-value discount rate. This is the equivalent of $C_a = 0$. Thus, even if risk of default is a relevant factor such that one may account for the possibility that $P_d > 0$, the expected costs of default will nonetheless equal zero for purposes of calculating an appropriate discount rate. Under either view (i.e., $P_d = 0$ or $C_a = 0$), the discount rate should be risk free rather than risk adjusted.

C. A Discount Rate That Accounts Only for Expected Inflation

Given that the Code compels use of a risk-free discount rate for present-value analysis, what about the Code further requires that the rate not include compensation for opportunity cost? Here, the answer lies in the Supreme Court's interpretation of the scope of a secured creditor's interest in collateral that must be adequately protected. Recall that a creditor may seek relief from the automatic stay on the basis of "lack of adequate protection of [the creditor's] interest in property."[218] In *United Savings Bank Ass'n of Texas v. Timbers of Inwood Forest Associates*,[219] the Court unanimously held that the term "interest in property" does not include the foregone investment opportunity that results when the automatic stay prohibits immediate foreclosure and sale of the collateral securing the creditor's claim.[220] In other words, the Code prohibits compensation for opportunity cost. On this account, a discount rate for purposes of present-value analysis should not seek to compensate the creditor for such cost.

Prior to *Till*, at least one bankruptcy court, relying upon the Court's decision in *Timbers*, took the view that the discount rate used for present-value analysis should not compensate a creditor for opportunity cost. In *In re Collins*,[221] which involved a dispute over the appropriate discount rate to be applied in a Chapter 13 cramdown,[222] the U.S. Bankruptcy Court for the Eastern District of Texas made the following observation:

---

the plurality and dissent in *Till* that would produce expected default costs).

218. 11 U.S.C. § 362(d)(1) (2006). For further discussion on the topic of adequate protection, see *supra* Part III.B.2.a.

219. United Savings Bank Ass'n of Tex. v. Timbers of Inwood Forest Assocs., 484 U.S. 365 (1988).

220. *Id.* at 370–71, 82.

221. *In re* Collins, 167 B.R. 842 (Bankr. E.D. Tex. 1994), *abrogated by* Green Tree Fin. Servicing Corp. v. Smithwick (*In re* Smithwick), 121 F.3d 211 (5th Cir. 1997).

222. *Id.* at 843–44.

> The *Timbers* case is significant because the concept of adequate protection is closely analogous to the present value debate. In *Timbers*, adequate protection was held not to encompass the prevention of lost opportunity costs on behalf of a creditor. This Court views present value analysis in much the same way. What § 1325(a)(5)(B)(ii) attempts to remedy is the loss in value of money due solely to the passage of time much as a cost of living adjustment to an employee's wage protects against inflation. Put simply, the concepts of present value and adequate protection are the same, they serve to protect the status quo.[223]

In this statement, one witnesses that the *Collins* court conceptualized the time-value-of-money component of the discount rate merely as a function of expected inflation rather than expected inflation and opportunity cost. With an inflationary risk-free rate as a base rate, the *Collins* court adopted a methodology similar to the *Till* plurality's formula approach—specifically, an upward adjustment to the base rate, which the *Collins* court described as "an additional risk factor of interest . . . based on the relevant considerations of the case."[224] Although the *Collins* court acknowledged the inherent risk of plan failure in its discussion of the adjustment to the inflationary base rate,[225] the court clearly conceived of the adjustment as one intended to compensate a creditor for administrative and transaction costs rather than for the risk of nonpayment.[226] Thus, in describing the proper methodology for calculating the present-value discount rate, "risk factor" appears to have been a misnomer, making the *Collins* court's repeated references to the term unfortunately misleading.[227]

At bottom, *Collins* stands for the proposition that the present-value discount rate ought to be an inflation rate that can potentially be adjusted to compensate for administrative costs. Here, then, is an example of a pre-*Till* decision that conceptualized the discount rate as one that ought to

223. *Id.* at 845–46.

224. *Id.* at 846.

225. *Id.* at 847.

226. *See id.* at 847 n.7 ("[T]he enhancement above a risk-free discount factor is more in the nature of an extra payment to compensate the creditor for administration and transaction costs rather than to compensate him for the possibility of default in the scheduled plan payments."). In rejecting the coerced-loan approach, the *Till* plurality deemed the recovery of transaction costs through the present-value discount rate to be inappropriate. Till v. SCS Credit Corp., 541 U.S. 465, 477 (2004) (Stevens, J., plurality opinion). And, as argued above, compensation for such costs should occur pursuant to other Code procedures. *Supra* notes 207–16 and accompanying text.

227. *See, e.g.*, *In re* Collins, 167 B.R. 842, 846, 847 & nn.7–8 (Bankr. E.D. Tex. 1994) (making repeated references to the term "risk factor"), *abrogated by* Green Tree Fin. Servicing Corp. v. Smithwick (*In re* Smithwick), 121 F.3d 211 (5th Cir. 1997).

compensate for the risk of inflation, but not risk of nonpayment or opportunity cost.[228] Granted, the *Collins* decision was subsequently abrogated by the Fifth Circuit.[229] But the important takeaway is that a bankruptcy court recognized the relevance of the Court's precedent in *Timbers* for purposes of conducting present-value analysis, a precedent whose implications the Court failed to appreciate when deciding *Till*.[230]

It may be argued that reliance on *Timbers* is an insufficient basis to exclude compensation for opportunity cost from the present-value calculus. After all, that opportunity cost is not an "interest in property" that must be protected does not mean that opportunity cost should not be recovered in another context. In other words, it could plausibly constitute a component of the discount rate notwithstanding the Court's views on adequate-protection compensation. But even if one accepts the argument that *Timbers* is inapposite for purposes of present-value analysis, courts have repeatedly declined to compensate creditors for opportunity cost when they have asserted their entitlement thereto on the basis that such cost should be allowed as an administrative expense constituting an actual, necessary cost and expense of preserving the debtor's estate.[231] Accordingly, using the

---

228. In this regard, Rasmussen goes too far in his assertion that "Justice Thomas came up with an argument . . . adopted by no court." Rasmussen, *supra* note 13, at 326.

229. Green Tree Fin. Servicing Corp. v. Smithwick (*In re* Smithwick), 121 F.3d 211 (5th Cir. 1997), *overruled by* Drive Fin. Servs., L.P. v. Jordan, 521 F.3d 343 (5th Cir. 2008). Nonetheless, it is clear that, prior to *Till*, at least one court had concluded that the present-value discount rate should not compensate for default risk.

230. This failure is perhaps not that surprising. The Court is generally viewed to lack competence in deciding bankruptcy cases. Schwartz, *supra* note 49, at 105, 116. The lack of competence may flow from "the tendency of the Supreme Court to use the Bankruptcy Code as a laboratory for strict statutory construction." Lawrence Ponoroff, *The Dubious Role of Precedent in the Quest for First Principles in the Reform of the Bankruptcy Code: Some Lessons from the Civil Law and Realist Traditions*, 74 AM. BANKR. L.J. 173, 215 (2000). This tendency has had the effect of foreclosing a "pragmatic and contextual approach to interpretation of the Code." *Id.* at 214. And, of course, the Justices generally lack expertise in bankruptcy. For evidence that specialization (among other factors) produces better decision-making in the bankruptcy context, see Jonathan R. Nash & Rafael I. Pardo, *An Empirical Investigation into Appellate Structure and the Perceived Quality of Appellate Review*, 61 VAND. L. REV. 1745, 1803–06 (2008).

231. *E.g.*, Ford Motor Credit Co. v. Dobbins, 35 F.3d 860, 868 (4th Cir. 1994); *In re* Plunkett, 191 B.R. 768, 780–81 (Bankr. E.D. Wis. 1995). The Code permits an entity to file a request for payment of an administrative expense. 11 U.S.C. § 503(a) (2006). An administrative expense can include "the actual, necessary costs and expenses of preserving the estate." *Id.* § 503(b)(1)(A). Pursuant to the benefit-to-the-estate test, a debt will qualify as an actual, necessary cost and expense of preserving the estate "if (1) it arose from a transaction with the bankruptcy estate and (2) directly and substantially benefitted the estate." Pension Benefit Guar. Corp. v. Sunarhauserman, Inc. (*In re* Sunarhauserman, Inc.), 126 F.3d 811, 816 (6th Cir. 1997). Accordingly, such administrative expenses are limited to

discount rate as a *sub-rosa* mechanism for the recovery of opportunity cost would impermissibly end-run the Code's primary procedure governing creditor compensation for postbankruptcy liabilities.

Once one eliminates the components of opportunity cost and risk of nonpayment from an interest rate, all that remains is the component that accounts for expected inflation.[232] Accordingly, the discount rate used for present-value analysis should be the equivalent of an inflation rate.[233] Pursuant to this interpretation of the Code, Justice Thomas's concurring opinion did not go far enough. Using the prime rate as the discount rate, as Justice Thomas suggested,[234] would overcompensate creditors in Chapter 13. Even the most creditworthy borrowers default and get charged accordingly when borrowing. In other words, the prime rate is not a riskless rate.[235] It is also a rate that takes into account opportunity cost.[236]

How, then, should a court estimate expected inflation so as to arrive at the appropriate discount rate for calculating present value in Chapter 13? One approach would be (1) to start with the current interest rate on a Treasury note with a maturity date roughly equivalent to the Chapter 13

---

debts for which the acts giving rise to the liability occurred subsequent to the debtor's bankruptcy filing. *Id.* at 817–19.

232. *See supra* note 49 and accompanying text (discussing the three primary components of a traditional interest rate).

233. It is beyond the scope of this Article to consider whether its positive theory of present-value analysis in Chapter 13 ought to be equally applicable in Chapter 11. On the one hand, the language of various Code provisions that require present-value analysis is similar. *Compare, e.g.*, 11 U.S.C. § 1129(a)(7)(A)(ii) (requiring that a nonconsenting holder of an impaired claim "receive or retain under the plan . . . property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 . . . on such date"), *with id.* § 1325(a)(4) (requiring for Chapter 13 plan confirmation that, with respect to the holder of an allowed unsecured claim, the value, as of the effective date of the plan, of property to be distributed . . . is not less than the amount that would be paid . . . if the estate of the debtor were liquidated under chapter 7"). This may justify a uniform approach. *Supra* note 40. If, however, one takes into account contextual differences, such as the differences in the financial-feasibility provisions of Chapters 11 and 13, such differences may justify incorporating an adjustment for default risk when conducting present-value analysis in Chapter 11 cases. *Supra* Part III.B.1. For a discussion of the applicability of *Till* in Chapter 11 cases see, for example, Gary W. Marsh & Matthew M. Weiss, *Chapter 11 Interest Rates After* Till, 84 AM. BANKR. L.J. 209, 212–30 (2010).

234. *Supra* note 80 and accompanying text.

235. *E.g.*, Till v. SCS Credit Corp., 541 U.S. 465, 479 (2004) (Stevens, J., plurality opinion); *see also* Koopmans v. Farm Credit Servs. of Mid-America, ACA, 102 F.3d 874, 875 (7th Cir. 1996).

236. *See supra* note 49 and accompanying text (discussing the three primary components of a traditional interest rate).

plan's duration (a period that cannot exceed five years[237]),[238] and (2) to subtract from the interest rate the real rate for the riskless cost of capital,[239] which has been estimated to be two percent.[240] This figure will produce an estimated inflation rate that can be used as a riskless discount rate that does not account for opportunity cost.

IV. The Recovery of Interest in Bankruptcy

In further support of the argument for an inflationary discount rate, this Part illuminates a critical dimension to the present-value debate that has heretofore been ignored in the literature. In debating what discount rate ought to be applied in bankruptcy, courts and commentators on all sides of the debate have assumed that, as a descriptive matter, the core components of a discount rate applied in bankruptcy do not substantively differ from discount rates that are applied to financial flows outside of bankruptcy. Mechanically importing nonbankruptcy discount rates into the bankruptcy context, however, overlooks the fact that bankruptcy law's response to a common-pool problem[241] presents a set of analytically distinct

237. *See* 11 U.S.C. §§ 1322(d), 1329(c) (providing that a Chapter 13 plan cannot exceed a repayment period of five years and that the five-year limitation applies to a post-confirmation modified plan).

238. The idea of using a Treasury-note rate as the starting point for the discount-rate calculus is not a novel one. For example, in a pre-*Till* decision, the U.S. Court of Appeals for the Second Circuit held that the discount rate used for present-value analysis in the Chapter 13 cramdown context "should be fixed at the rate on a United States Treasury instrument with a maturity equivalent to the repayment schedule under the debtor's reorganization plan" and further observed that, "[b]ecause the rate on a treasury bond is virtually risk free, the § 1325(a)(5)(B)(ii) interest rate should also include a premium to reflect the risk to the creditor in receiving deferred payments under the reorganization plan." Gen. Motors Acceptance Corp. v. Valenti (*In re* Valenti), 105 F.3d 55, 64 (2d Cir. 1997), *abrogated by* Assoc. Commercial Corp. v. Rash, 520 U.S. 953 (1997).

239. The current interest rate on a government bond is a nominal rate that "includes expected inflation and the real cost of capital." POSNER, *supra* note 49, at 195 & n.11; *see also In re* Till, 301 F.3d 583, 596 (7th Cir. 2002) (Rovner, J., dissenting) (noting that Treasury rate "reflects two of the three components of a market interest rate—expected inflation, and 'real' interest"), *rev'd and remanded sub nom.* Till v. SCS Credit Corp., 541 U.S. 465 (2004). Accordingly, the inflation rate is the nominal rate minus the real rate.

240. POSNER, *supra* note 49, at 195; *see also* Richard L. Revesz, *Environmental Regulation, Cost-Benefit Analysis, and the Discounting of Human Lives*, 99 COLUM. L. REV. 941, 979 (1999) ("In recent years, the economics literature has generally called for the use of a real discount rate of 2–3%.").

241. *See* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 16–17 (1986) ("The single most fruitful way to think about bankruptcy is to see it as ameliorating a common pool problem created by a system of individual creditor remedies.").

considerations that demands a unique discount-rate calculus. The standard approach has been to conceptualize the discounting process as the payment of a traditional interest rate—that is, a rate that compensates for opportunity cost, expected inflation, and risk of default.[242] While such compensation may be the appropriate treatment of discounting in the nonbankruptcy context, it does not follow, *a fortiori*, that a bankruptcy discount rate should be equally compensatory.

The Bankruptcy Code strictly limits the instances in which a creditor may recover interest as part of its claim against the debtor's estate.[243] Once one recognizes that the Code has been quite explicit where interest recovery is warranted, and that the discounting process mandated by the Code is not articulated as the recovery of interest, it follows that wholesale incorporation of interest-rate components into a bankruptcy discount rate cannot be justified without statutory directive. In order to support this claim, Part IV.A sets forth the manner in which the Code generally excludes the recovery of interest as part of a creditor's claim. Part IV.B then identifies the few instances in which the Code provides exceptions to this general rule. This Section thus bolsters the arguments in Part III for why discounting cash flows in consumer bankruptcy cases ought to be conceptually different from the discounting of nonbankruptcy cash flows.

A. The Nominal Amount of Allowed Claims

A creditor in bankruptcy faces two pressing questions: "How do I get paid?" and "How much will I get paid?" The answer to the first question addresses the process by which a creditor may establish a claim for repayment from the debtor's estate. The answer to the second question is a function of (1) the amount of property available for distribution to creditors on account of their claims, and (2) the order of claim repayment based on the priority of the competing claims against the debtor's estate. Thus, claim repayment generally involves determination of the debtor's liabilities and distribution of the debtor's property on account of those liabilities.

The Code broadly defines a claim as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable,

---

242. *See supra* note 49 and accompanying text (discussing the three primary components of a traditional interest rate).

243. *See* 11 U.S.C. § 502(b)(2) (2006) (providing general rule that a claim will be disallowed "to the extent that . . . such claim is for unmatured interest").

secured, or unsecured."[244] Notwithstanding this broad definition, the Code generally circumscribes repayment to those creditors whose right to payment arose pre-petition (i.e., prior to the debtor's bankruptcy filing).[245] Only a creditor may file a proof of claim,[246] and the Code defines a creditor as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor."[247] Given that the commencement of a voluntary case constitutes an order for relief,[248] and given that the filing of a petition commences a bankruptcy case,[249] claim repayment in bankruptcy primarily focuses on sorting out a debtor's prebankruptcy liabilities.[250]

Once a creditor has ascertained that it has a claim against the debtor, the allowance of the claim must be addressed given that distributions from a debtor's estate are made to *allowed* claims.[251] Absent objection by a party in interest, the filing of a proof of claim creates a presumption of its allowance—a presumption that extends both

244. *Id.* § 101(5)(A).

245. A debtor voluntarily commences a bankruptcy case by filing a petition. *Id.* § 301(a). Accordingly, it is common to describe the period of time leading up to the filing of a bankruptcy petition as "pre-petition" and the period of time following the filing of the petition as "post-petition."

246. *Id.* § 501(a). If a creditor fails to file a proof of claim, the possibility exists that others may file the claim on the creditor's behalf. *Id.* § 501(b), (c).

247. *Id.* § 101(10).

248. *Id.* § 301(b).

249. *Supra* note 245.

250. *See* JACKSON, *supra* note 241, at 34 ("Bankruptcy law should determine who are owners of the [debtor's] assets, in the sense of having rights against them, at the moment the bankruptcy petition is filed."). There are certain instances in which the Code treats a post-petition claim as a pre-petition claim. *E.g.*, 11 U.S.C. § 502(g), (h), (i); *id.* § 1305(a), (b). Additionally, entities who incur expenses in connection with the administration of a debtor's estate may seek repayment of their administrative expenses from the estate. *Id.* § 503(a). The court may allow such administrative expenses. *Id.* § 503(b). If they are allowed, the expenses will be granted priority status, and the entity will be allowed to obtain repayment from the debtor's estate on account of the priority status of the expense. *Id.* §§ 507(a)(2), 726(a)(1), 1322(a)(2). Interestingly, the Code provisions from Chapter 7 and Chapter 13 pursuant to which an entity with an administrative expense would seek repayment from the debtor's estate reference distribution only to *claims* entitled to priority under Code § 507. *Id.* §§ 726(a)(1), 1322(a)(2). Although a claim entitled to priority under Code § 507(a) is distinct from an expense entitled to priority under that section, administrative expense claimants routinely participate in distribution of property from the debtor's estate. The logical conclusion must be that Congress inadvertently failed to reference the term "expenses" in Code §§ 726 and 1322.

251. *See, e.g.*, 11 U.S.C. §§ 726(a), 1322(a)(2), 1325(a)(4), 1325(a)(5) (providing for distribution to various types of allowed claims).

to the validity and amount of the claim.[252] In the event of an objection, the court will be called upon to determine the amount of the claim as of the petition date.[253] Various grounds exist for lodging an objection to a creditor's claim for repayment.[254] Critical for purposes of this Article's positive theory of present-value analysis is the extent to which the Bankruptcy Code allows repayment of *unmatured claims*.

As previously mentioned, the Code's definition of claim includes any unmatured right to payment.[255] Accordingly, unless the Code provides a basis for disallowing an unmatured right to payment, a creditor's claim for such an amount will be allowed. The Code generally does not allow objection to a claim on the basis that the claim is unmatured.[256] The stark exception to this rule is that, to the extent a claim is for unmatured interest, the claim will be disallowed.[257] From these two rules emerges the proposition that "bankruptcy operates as the acceleration of the principal amount of all claims against the debtor."[258] Accordingly, the Code establishes a simple baseline for the nominal amount a creditor may seek to recover in bankruptcy (the "nominal-amount baseline"): all principal amounts, whether matured or

252. *See id.* § 502(a) ("A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest . . . objects."); FED. R. BANKR. P. 3001(f) ("A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim."). For a discussion of how the Code's broad definition of "claim" and the presumption regarding claim allowance facilitate the expeditious and efficient resolution of creditor claims against the debtor, see Rafael I. Pardo & Michelle R. Lacey, *The Real Student-Loan Scandal: Undue Hardship Discharge Litigation*, 83 AM. BANKR. L.J. 179, 185–87 (2009).

253. *See* 11 U.S.C. § 502(b) (providing that, upon objection to a claim, "the court . . . shall determine the amount of such claim . . . as of the date of the filing of the petition").

254. *Id.* § 502(b)(1)–(9).

255. *See supra* note 244 and accompanying text (discussing the Code's definition of "claim").

256. *See* 11 U.S.C. § 502(b)(1) (providing for disallowance of a claim to the extent "such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason *other than because such claim is contingent or unmatured*" (emphasis added)); *see also* S. REP. NO. 95-989, at 62 (1978) (stating that "[a]ll . . . unmatured claims are to be liquidated by the bankruptcy court in order to afford the debtor complete bankruptcy relief"), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5848; H.R. REP. NO. 95-595, at 352 (1977) (same), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6308.

257. 11 U.S.C. § 502(b)(2).

258. S. REP. NO. 95-989, at 63, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5849; H.R. REP. NO. 95-595, at 353, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6309.

unmatured,[259] and all amounts for *matured* interest;[260] but not amounts for *unmatured* interest.[261]

B. *Deviations from the Nominal-Amount Baseline*

The nominal-amount baseline for claim repayment is critically important because it establishes the backdrop against which to evaluate the manner in which the Code may alter the baseline in specific contexts. The Code section regarding claim allowance is a section of general applicability, one that will have uniform application regardless of the operative Code chapter under which a debtor files for relief (e.g., Chapter 7 or Chapter 13).[262] Put another way, unless a contrary Code section supplements or displaces the principles encapsulated in the nominal-amount baseline, that baseline dictates the amount of repayment that may be demanded by a creditor in bankruptcy.[263]

---

259. For purposes of simplicity, the nominal-amount baseline set forth in this Article applies to garden-variety claims and ignores special instances in which particular claims for either matured or unmatured principal amounts will be disallowed. *See, e.g.*, 11 U.S.C. § 502(b)(3), (b)(5).

260. *See id.* (providing that the definition of claim includes a matured right to payment); *id.* § 502(b)(2) (listing grounds for disallowance of claim and making no reference to matured interest); *see also* 124 CONG. REC. 32,401 (1978) (statement of Rep. Edwards) ("The House amendment deletes a provision following Section 726(a)(6) of the Senate amendment providing that the term 'claim' includes interest due owed before the date of the filing of the petition as unnecessary since a right to payment for interest due is a right to payment which is within the definition of 'claim' . . . ."), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6459.

261. *See* United States v. Victor, 121 F.3d 1383, 1387 (10th Cir. 1997) ("Section 502(b) does not simply prohibit certain creditors from filing a proof of claim for post-petition interest; it prohibits those creditors from collecting the interest from the bankruptcy estate.").

262. Code § 502, which governs the allowance of claims, is set forth in Chapter 5 of the Bankruptcy Code, a chapter whose provisions apply throughout the Code. 11 U.S.C. § 103(a); S. REP. NO. 95-989, at 28, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5814; H.R. REP. NO. 95-595, at 316, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6273.

263. This approach in setting forth a positivist account of claim repayment in bankruptcy is consistent with the manner in which the Supreme Court has sought to interpret the Bankruptcy Code. United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Inc., 484 U.S. 365, 371 (1988). In *Timbers*, the Court stated the following:

> Statutory construction . . . is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme—because the same terminology is used elsewhere in a context that makes its meaning clear, or because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law.

Id. (citations omitted). The Court's opinion in *Timbers* was the first majority opinion in a

If deviations from the nominal-amount baseline are to be properly understood, it becomes necessary to deconstruct what disallowance of unmatured interest entails. The interest a creditor charges a debtor primarily consists of three components: (1) opportunity cost, (2) a premium for risk of default, and (3) a premium for expected inflation.[264] In light of this, disallowance of unmatured interest as part of a creditor's claim generally translates into exclusion from the nominal-amount baseline of unmatured amounts relating to opportunity cost, risk of default, and expected inflation. Without a Code section that states otherwise, these are liabilities for which estate property will not be held accountable.

The question arises as to when, if ever, the Code deviates from the nominal-amount baseline. Only five Code sections—Code §§ 506(b), 362(d)(3)(B)(ii), 726(a)(5), 1222(b)(11), and 1322(b)(10)—authorize, in a formalistic sense, the payment of unmatured interest to a creditor.[265] As a

bankruptcy case authored by Justice Scalia, an opinion that was unanimous. Morrison, *supra* note 49, at 41.

264. *See supra* note 49 (discussing the three primary components of a traditional interest rate).

265. While the Code's present-value-analysis provisions may be characterized as essentially authorizing the payment of interest, it will become clear from the discussion that follows that such a characterization is imprecise and obfuscates analysis of the nominal-amount baseline and clear deviations therefrom. *See supra* Part III.A (discussing Chapter 13 present-value-analysis provisions). For this reason, the Article excludes these additional provisions from the group of Code sections that formalistically authorize the recovery of interest by a creditor.

There is another provision that arguably should be included within the group of Code sections authorizing deviation from the nominal-amount baseline. Code § 101(14A) defines the term "domestic support obligation," in relevant part, as "a debt that accrues before, on, or after the date of the order for relief in a case under this title, *including interest that accrues on that debt as provided under applicable nonbankruptcy law notwithstanding any other provision of this title.*" 11 U.S.C. § 101(14A) (emphasis added). The phrase "notwithstanding any other provision of this title" possibly suggests that the specific definition of "domestic support obligation" ought to trump the rules for claim allowance set forth in Code § 502, a provision of general applicability. *See* Busic v. United States, 446 U.S. 398, 406 (1980) ("[A] more specific statute will be given precedence over a more general one, regardless of their temporal sequence."); *supra* note 262 (discussing the general applicability of Code § 502). On this view (the "primacy view"), the general rule that a claim will not be allowed to the extent it is for unmatured interest would be trumped by the directive that a debt constituting a domestic support obligation is to include unmatured interest. 11 U.S.C. § 502(b)(2). But if that is true, then one would have to accept that the definition also trumps the rule set forth in Code § 502(b)(5), which disallows a claim to the extent that it is an unmatured domestic support obligation. *Id.* §§ 502(b)(5), 523(a)(5). Accordingly, the primacy view would render Code § 502(b)(5) a nullity. If Congress had intended that result, however, the logical approach would have been to repeal Code § 502(b)(5). Because it did not, one might conclude that Congress did not intend the definition for domestic support obligation to supplant the rules governing claim allowance descriptive matter, these sections can be categorized according to two attributes (the "baseline-deviation attributes"): (1) whether the section has been expressly framed as one regarding the allowance of interest, and (2) whether the section is set forth in a chapter of general applicability. The first criterion signifies express recognition by the Code that a creditor's claim can be augmented to include unmatured interest, thereby increasing the nominal amount of the claim. This will have implications for the treatment that may be afforded to the claim by other Code sections centering on the allowed amount of a claim, such as the Chapter 13 confirmation thresholds for claim repayment.[266] The second criterion signifies the policy choice to allow recovery of interest regardless of context (e.g., liquidation under Chapter 7 or rehabilitation under Chapter 13).[267] When considered jointly, these criteria provide a metric against which to evaluate the Code's statutory design for the recovery of interest.

1. Allowance of Accrued Post-Petition Interest on Oversecured Pre-Petition Claims—Code § 506(b)

The first section authorizing payment of unmatured interest to a creditor satisfies both of the baseline-deviation attributes—that is, the section is expressly framed in terms of the allowance of interest and is set forth in a chapter of general applicability. Code § 506(b) provides that,

---

(the "nonprimacy view"). Instead, Congress may have included the phrase "notwithstanding any other provision of this title" to clarify that one must account for a debtor's accrued *and* unaccrued liability for a domestic support obligation when considering the scope of a debtor's substantive entitlements under the Code, even though such unaccrued liability is to be ignored for purposes of claim repayment through the bankruptcy process. *See, e.g., id.* § 362(b)(2)(B) (providing that the automatic stay does not prohibit collection of a domestic support obligation from the debtor's property); *id.* § 522(c)(1) (providing that a debtor's exempt property remains liable during or after the bankruptcy case for any debt that is a domestic support obligation).

This Article considers the nonprimacy view to produce a more coherent and pragmatic interpretation to the Code. As such, the definitional provision for domestic support obligation is not included within the group of Code sections authorizing deviation from the nominal-amount baseline. For a decision that directly supports the nonprimacy view, see *In re* Hernandez, No. 07-40470-R, 2007 WL 3998301, at *2–3 (Bankr. E.D. Tex. Nov. 15, 2007). For a decision that indirectly supports the primacy view, but fails to discuss the general rules for claim allowance, see *In re* Reid, No. 06-50147, 2006 WL 2077572, at *1–2 (Bankr. M.D.N.C. July 19, 2006).

266. *See supra* Part II.A (discussing Chapter 13 confirmation thresholds).

267. *See supra* notes 262–63 and accompanying text (discussing the circumstances under which deviation from the nominal-amount baseline for claim repayment is permitted).

"[t]o the extent that an allowed secured claim is secured by property the value of which, after any recovery under [§ 506(c)], is greater than the amount of such claim, *there shall be allowed to the holder of such claim, interest on such claim*."[268] The Code specifies that the nominal amount of an allowed secured claim is calculated by comparing (1) the amount of the allowed claim to (2) the value of the collateral securing the claim: The allowed secured claim will be equal to the lesser of the allowed claim or the value of the collateral.[269] Pursuant to Code § 506(b)'s directive, only holders of allowed *oversecured* claims (i.e., allowed claims secured by collateral whose value exceeds the amount of the claim) are entitled to augment the nominal amount of their allowed claims with unmatured interest.[270] This entitlement is an "unqualified" right that exists even in the absence of an agreement between the creditor and the debtor for the recovery of interest.[271] Accordingly, the estate's liability to holders of oversecured claims will include liability for amounts relating to opportunity cost, risk of default, and expected inflation.[272]

---

268. 11 U.S.C. § 506(b) (emphasis added). As a provision from Chapter 5 of the Bankruptcy Code, § 506(b) is a provision of general applicability. *Supra* note 262. Code § 506(c) authorizes the trustee to surcharge the property securing an allowed secured claim for certain expenses incurred in the preservation or disposition of such property, but only to the extent of the benefit provided to the holder of the claim. *Id.* § 506(c).

269. *See* 11 U.S.C. § 506(a) (providing rule for determining the secured status of an allowed claim). In those instances where the amount of the allowed claim exceeds the value of the collateral securing the claim, the creditor will have an allowed unsecured claim to the extent that the allowed claim exceeds the collateral. *Id.* Accordingly, the Code bifurcates an allowed undersecured claim into an allowed secured claim and an allowed unsecured claim. Barash v. Pub. Fin. Corp., 658 F.2d 504, 507 (7th Cir. 1981); S. REP. NO. 95-989, at 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854; H.R. REP. NO. 95-595, at 356 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6312.

270. Of course, the claim can be augmented only to the extent that the allowed claim is oversecured and only as the unmatured interest accrues. The rate at which post-petition interest allowed under Code § 506(b) accrues has been observed to fall within the discretion of the court. *In re* Southland Corp., 160 F.3d 1054, 1058–60 (5th Cir. 1998); *In re* Milham, 141 F.3d 420, 423 (2d Cir. 1998); *In re* Terry Ltd. P'ship, 27 F.3d 241, 243 (7th Cir. 1994). In Chapter 13, recovery of unmatured interest pursuant to Code § 506(b) is limited to the period of time beginning on the petition date and ending of the date of confirmation of the debtor's repayment plan. Telfair v. First Union Mortg. Corp., 216 F.3d 1333, 1338 (11th Cir. 2000).

271. United States v. Ron Pair Enters., 489 U.S. 235, 241 (1989).

272. In Chapter 13 cases, the Code arguably carves out an exception for the allowance of interest under Code § 506(b) for holders of allowed claims secured by certain types of purchase money security interests. 11 U.S.C. § 1325(a). Code § 1325(a) provides as follows:

> For purposes of [§ 1325(a)(5)], section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest

2. Monthly Interest Payments to Single-Asset-Real-Estate Creditors—Code § 362(d)(3)(B)(ii)

The second section satisfies only one of the baseline-deviation attributes: It is not expressly framed as authorizing the allowance of interest, but it is a generally applicable section. For a creditor of a debtor with a single asset real estate (SARE)[273] whose claim is secured by the real estate, Code § 362(d)(3)(B)(ii) authorizes a court to grant relief to the creditor from the automatic stay[274] if the debtor fails to commence monthly payments (within a specified time period) to the creditor that "are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate."[275] While the Code creates an entitlement for recovery of interest (i.e., amounts relating to opportunity cost, risk of default, and expected inflation) by a SARE creditor, it does not authorize such a creditor to augment the nominal amount of its allowed claim.

3. Payment of Post-Petition Interest Accrued on Chapter 7 Pre-Petition Claims—Code § 726(a)(5)

The third section satisfies neither of the baseline-deviation attributes—that is, it neither is expressly framed as authorizing the allowance of interest nor is it a generally applicable section. Code § 726(a)(5) specifies that, in a Chapter 7 case, allowed unsecured claims (in addition to certain allowed secured claims for nonpecuniary loss) that have been fully repaid from estate property will also receive payment of interest at the legal rate from

---

> securing the debt that is the subject of the claim, the debt was incurred within the 910-day [period] preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle . . . acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.

Id.; *see also, e.g.*, *In re* Leath, 389 B.R. 494, 499 (Bankr. E.D. Tex. 2008) (concluding that the language of Code § 1325(a)'s hanging paragraph is broad enough to preclude the recovery of post-petition interest by oversecured creditors under Code § 506(b)).

273. *See* 11 U.S.C. § 101(51B) (defining SARE, in relevant part, as "real property constituting a single property or project . . . which generates substantially all of the gross income of a debtor . . . and on which no substantial business is being conducted by a debtor other than the business of operating the real property").

274. *See supra* notes 173–76 and accompanying text (discussing the automatic stay).

275. 11 U.S.C. § 362(d)(3)(B)(ii).

the petition date,[276] provided that estate funds remain for distribution.[277] Like Code § 362(d)(3)(B)(ii), Code § 726(a)(5) creates an entitlement for recovery of interest but does not authorize augmentation of the nominal amount of the creditor's allowed claim.[278] Although Code § 726(a)(5) is a specific section that, as a formal matter, applies only in Chapter 7 cases,[279] the section is indirectly incorporated into cases under Chapters 11, 12, and 13 for purposes of ascertaining the amount of property that must be distributed to allowed unsecured claims in order for a court to confirm a debtor's repayment plan.[280] Specifically, if an allowed unsecured claim would have received payment of interest at the legal rate from the petition date in a hypothetical Chapter 7 liquidation, that amount must be taken into account in calculating whether a debtor's repayment plan makes a sufficient distribution to the allowed unsecured claim.[281]

---

276. *Id.* § 726(a)(5).

277. *See id.* § 726(a), (b) (establishing order of distribution of estate property in Chapter 7 cases to various classes of claimants and requiring distribution to be made within each class on a pro rata basis); *see also* S. REP. NO. 95-989, at 97 (1978), (stating that Code § 726(a)(5) interest "will be paid from the estate only if and to the extent that a surplus of assets would otherwise remain for return to the debtor at the close of the case"), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5883.

278. *See In re* Dow Corning Corp., 244 B.R. 678, 685 (Bankr. E.D. Mich. 1999) ("Properly understood, . . . interest under § 726(a)(5) is paid *on* an allowed claim . . . rather than *as* an allowed claim.").

279. *See* 11 U.S.C. § 103(b) ("Subchapters I and II of chapter 7 of this title apply only in a case under such chapter.").

280. Pawlowic, *supra* note 39, at 156.

281. *See* 11 U.S.C. §§ 1129(a)(7), 1225(a)(4), 1325(a)(4) (creating confirmation threshold focusing on the amount that would have been distributed in a hypothetical Chapter 7 liquidation); *see also, e.g.*, Rice v. Dunbar (*In re* Rice), 357 B.R. 514, 518 (B.A.P. 8th Cir. 2006) (applying Code § 726(a)(5) in a Chapter 12 case); Groundhog, Inc. v. San Joaquin Estates, Inc. (*In re* San Joaquin Estates, Inc.), 64 B.R. 534, 536 (B.A.P. 9th Cir. 1986) (applying Code § 726(a)(5) in a Chapter 11 case); *In re* Hoskins, 405 B.R. 576, 587–89 (Bankr. N.D.W. Va. 2009) (applying Code § 726(a)(5) in a Chapter 13 case). It has been suggested that reference to Code § 726(a)(5) in applying the "best interest test" would be inappropriate because the test envisions a hypothetical Chapter 7 liquidation that occurs *immediately* on the effective date of the plan, thus precluding the accrual of interest. *In re* Martin, 17 B.R. 924, 925 (N.D. Ill. 1982). But this view fails to consider that Code § 726(a)(5) provides for the payment of interest at the legal rate from the petition date and that the effective date of the plan can be subsequent to the petition date, thereby creating an opportunity for the accrual of interest prior to the hypothetical Chapter 7 liquidation. *Supra* note 36.

Interestingly, although certain allowed *secured* penalty claims for nonpecuniary loss are entitled to receive the payment of interest at the legal rate from the petition date, if sufficient funds exist, the Code does not take this into account in determining whether such claims receive adequate distribution in Chapters 12 and 13. 11 U.S.C. § 726(a)(4)–(5), (b). In those instances where the debtor proposes to retain the property securing a holder's claim

Importantly, it should be noted that use of the term "legal rate" in Code § 726(a)(5) has been interpreted to mandate application of the postjudgment interest rate for federal cases,[282] which does not compensate for risk of default.[283] If this view is correct, then one witnesses an instance in which Congress has expressed a preference for the recovery of interest at a risk-free rate. It should not be so hard to imagine, then, that Congress may similarly have intended that the discount rate for present-value analysis be risk free.

4. Payment of Post-Petition Interest Accrued on Chapter 12 and Chapter 13 Pre-Petition Nondischargeable Claims—Code §§ 1222(b)(11) and 1322(b)(10)

Like the third section, the fourth and fifth sections satisfy neither of the baseline-deviation attributes—that is, they are neither expressly framed as authorizing the allowance of interest nor are they generally applicable sections. Code §§ 1222(b)(11) and 1322(b)(10) relate to provisions that may, but need not be included, in Chapter 12 and Chapter 13 repayment plans.[284] Each provision permits a Chapter 12 or Chapter 13 plan, respectively, to provide for the payment of post-petition interest that accrues on debts that are not discharged upon completion of the plan, but only if the plan provides to pay in full all allowed claims and the debtor has sufficient disposable income to make the interest payments.[285] Prior to enactment of the Code, the Supreme Court had held that a debtor remains

---

and where the holder of the allowed secured claim has not accepted the debtor's Chapter 12 or Chapter 13 plan, a court must ascertain whether the plan makes a sufficient distribution of property to the holder of the allowed *secured* claim. In making the determination, the focus is on the allowed amount of the secured claim rather than the amount that the holder of the claim would have received in a hypothetical Chapter 7 liquidation. *Id.* §§ 1225(a)(5)(B)(ii), 1325(a)(5)(B)(ii). If the holder of the allowed secured penalty claim for nonpecuniary loss is not oversecured, it is not entitled to augment its allowed claim with amounts for unmatured interest. *Supra* notes 269–72 and accompanying text. Thus, the holder of the claim will not be compensated for the interest that it would have received in a Chapter 7 case. If the holder of such a claim is *undersecured*, however, the holder has both an allowed secured claim and an allowed unsecured claim. *Supra* note 269. Thus, the holder would be compensated for the interest that it would have received on account of its allowed unsecured claim in a Chapter 7 case.

282. Onink v. Cardelucci (*In re* Cardelucci), 285 F.3d 1231, 1233 (9th Cir. 2002).

283. Gorenstein Enters., Inc. v. Quality Care-USA, Inc., 874 F.2d 431, 436–37 (7th Cir. 1989).

284. 11 U.S.C. §§ 1222(b)(11), 1322(b)(10).

285. *Id.*

personally liable following a bankruptcy discharge for post-petition interest on nondischargeable tax debt.[286] Under the Code, courts have continued to follow the Court's pre-Code precedent, holding that interest on nondischargeable debts continues to accrue during bankruptcy and that the debtor will remain personally liable for such debt postbankruptcy.[287] Accordingly, in order to maximize the fresh start provided by discharge, a debtor will have an incentive to eliminate, to the extent possible, any nondischargeable debt (including nondischargeable accrued interest) prior to exiting bankruptcy.[288]

C. The Implications of the Nominal-Amount Baseline

With little rhyme or reason, the following picture emerges of the special instances in which the Code deviates from the nominal-amount baseline such that a creditor may recover unmatured interest:

- Holders of allowed oversecured claims will generally be allowed to augment the allowed amount of their claims to include unmatured interest, subject to the following exceptions:
    - Holders of allowed oversecured claims secured by certain purchase-money security interests will not be entitled to such recovery in Chapter 13.[289]
    - Holders of allowed oversecured penalty claims for nonpecuniary loss in Chapter 7 cases will be allowed to

286. Bruning v. United States, 376 U.S. 358, 363 (1964).

287. *See, e.g.*, Leeper v. Pa. Higher Educ. Assistance Agency (*In re* Leeper), 49 F.3d 98, 105 (3d Cir. 1995) (holding that, in a Chapter 13 case, post-petition interest can continue to accrue on a nondischargeable student loan); Fullmer v. United States (*In re* Fullmer), 962 F.2d 1463, 1468 (10th Cir. 1992) ("Interest that accrues postpetition on a nondischargeable prepetition tax debt survives bankruptcy as a personal liability."), *abrogated on other grounds by* Raleigh v. Ill. Dep't of Revenue, 530 U.S. 15 (2000); Burns v. United States (*In re* Burns), 887 F.2d 1541, 1543 (11th Cir. 1989) ("[W]e conclude that the post-petition interest on a nondischargeable tax debt is nondischargeable."); Hanna v. United States (*In re* Hanna), 872 F.2d 829, 831 (8th Cir. 1989) (same). It should be noted that this rule contradicts the manner in which the Code's legislative history generally characterizes the accrual of post-petition interest—specifically, that such interest does not accrue. S. REP. NO. 95-989, at 63 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5849; H.R. REP. NO. 95-595, at 353 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6309.

288. *See* Pardo & Lacey, *supra* note 175, at 417–18 ("Any exception to discharge, of course, encroaches upon the fresh start principle, and the threat looms that, when such incursion is overextensive, the debtor will fail to reintegrate into society as an economically productive individual." (footnote omitted)).

289. *Supra* note 272.

augment their claims to include unmatured interest but will be automatically subordinated to the claims of holders of priority and nonpriority unsecured claims, with the result that recovery of interest will occur only if there are sufficient proceeds from property of the estate to make distributions to the class of subordinated penalty claims (and even then, the distribution could be less than 100% of the claim).[290]

- Holders of claims secured by a single asset real estate will not be allowed to augment their allowed claims but will be allowed to recover monthly interest payments if the debtor desires to avoid having the court grant relief to the SARE creditor from the automatic stay.

- In Chapter 7 cases, holders of allowed unsecured claims and holders of allowed secured penalty claims for nonpecuniary loss will not be entitled to augment their claims to include unmatured interest but will be entitled to receive payment of interest at the legal rate from the petition date if there are sufficient estate funds,[291] which is highly unlikely.[292]

- In cases under Chapters 11, 12, and 13, distributions to holders of allowed unsecured claims must account for any payment of

---

290. In a Chapter 13 case, the Code has no such automatic subordination provision. As such, the possibility arises that the debtor will have to make distributions on account of a claim that otherwise may not have received a distribution in Chapter 7. This has the potential to create a hurdle to plan confirmation if the debtor does not have sufficient income to make the required distribution to the holder of an allowed nonpecuniary-loss penalty claim that is secured.

291. Note that nothing about the Code's automatic subordination provision in Chapter 7 for nonpecuniary-loss penalty claims prohibits a holder of such a claim that is oversecured from availing itself of the entitlement to augment the allowed claim to include unmatured interest. The subordination provision merely affects the order of distribution but does not affect the allowance of the creditor's claim. *Cf. In re* County of Orange, 219 B.R. 543, 559 (Bankr. C.D. Cal. 1997) (noting that the purpose of the doctrine of equitable subordination, codified in 11 U.S.C. § 510(c) (2006), is "to reprioritize the order of allowed claims based on the equities of the case, *rather than to allow or disallow the claim in the first instance*" (emphasis added)). Accordingly, the possibility exists that, with a Chapter 7 estate where sufficient funds exist for payment of interest at the legal rate, the holder of a nonpecuniary-loss penalty claim that is oversecured will recover Code § 726(a)(5) interest on Code § 506(b) interest—in effect, the recovery of compound interest. In other words, because Code § 506(b) interest becomes part of the creditor's allowed claim, it is essentially treated as "principal" upon which Code § 726(a)(5) interest can be earned.

292. *See* U.S. TR. PROGRAM, U.S. DEP'T OF JUSTICE, PRELIMINARY REPORT ON CHAPTER 7 ASSET CASES 1994 TO 2000, at 7 (2001), *available at* http://www.justice.gov/ust/eo/private_trustee/library/chapter07/docs/assetcases/Publicat.pdf (noting that, "[h]istorically, the vast majority (about 95 to 97 percent) of chapter 7 cases yield no assets").

interest at the legal rate that such holders would have received in a hypothetical Chapter 7 liquidation.

- In cases under Chapters 12 and 13, holders of allowed claims that are nondischargeable may receive interest payments if the debtor's repayment plan so provides.

Given the narrow set of circumstances in which the Code deviates from the nominal-amount baseline, it seems reasonable to conclude that the Code severely limits the recovery of unmatured interest—that is, amounts for opportunity costs, risk of default, and expected inflation—by creditors. It is equally important to note that the adequacy of the discount rate proposed in a debtor's repayment plan is generally a question of bankruptcy law.[293] When Congress has sought to defer to nonbankruptcy law in setting the appropriate discount rate, it has expressly indicated this desire.[294] Finally, the discounting process does not make any reference to the term "interest."[295]

As evident from the outline set forth above, Congress has expressly provided for the recovery of interest by creditors elsewhere throughout the Code,[296] including the payment of post-petition interest accrued on Chapter 13 pre-petition nondischargeable claims.[297] Had Congress intended present-value analysis to be tantamount to the recovery of garden-variety interest (i.e., interest that compensates for opportunity cost, expected

---

293. *See, e.g.*, Warehouse Home Furnishings Distribs., Inc. v. Richards (*In re* Richards), 106 B.R. 762, 766 (Bankr. M.D. Ga. 1989) (stating that the determination of present-value interest is determined by the Bankruptcy Code rather than by the contract between the debtor and the creditor).

294. *See* 11 U.S.C. § 511(a) (2006) ("If any provision of this title requires . . . the payment of interest to enable a creditor to receive the present value of the allowed amount of a tax claim, the rate of interest shall be the rate determined under applicable *nonbankruptcy law*." (emphasis added)).

295. *See* Till v. SCS Credit Corp., 541 U.S. 465, 473 (2004) (Stevens, J., plurality opinion) (noting that Code § 1325(a)(5)(B) "does not mention the term 'discount rate' or the word 'interest'"). Although this signpost did not go unnoticed by the plurality in *Till*, Justice Stevens nonetheless framed the issue of present-value analysis in terms of interest payments. *See id.* at 474 ("The challenge for bankruptcy courts reviewing such repayment schemes, therefore, is to choose an interest rate sufficient to compensate the creditor for these concerns.").

296. *See supra* Part IV.B (discussing the manner in which the Code provides for the recovery of interest); *see also* Pawlowic, *supra* note 39, at 173 ("[I]t is apparent that Congress described the obligation to pay plan interest under the reorganization chapters in very different terms from the obligations to pay pendency interest under section 506(b) or 726(a)(5)." (footnote omitted)).

297. *Supra* Part IV.B.4.

inflation, and risk of default), one would have expected Congress to have explicitly said so. But it did not and has not.

Although considerations of administrative convenience may prompt us to conceptualize the discounting process as nothing other than the payment of garden-variety interest,[298] doing so infuses the Code's statutory confirmation standards with a meaning that is not expressed in those provisions but is expressed elsewhere in the Code—namely, the recovery of interest (i.e., opportunity cost, expected inflation, and risk of default) pursuant to those Code sections permitting deviation from the nominal-amount baseline. Accordingly, courts and commentators have inappropriately assumed that the discount rate used for present-value analysis ought to be similarly compensatory.

V. A Normative Appraisal of an Inflationary Discount Rate in Consumer Bankruptcy

The remainder of this Article examines whether the doctrinal prescription for the application of an inflationary discount rate in bankruptcy is normatively desirable, ultimately concluding that it is. Drawing upon the work of Thomas Jackson, Part V.A examines the issue of whether failing to compensate creditors for opportunity cost and risk of default undermines bankruptcy law's goal to give effect to nonbankruptcy entitlements, unless doing so interferes with the law's attempt to overcome the collective-action problem of self-interested creditors acting counter to the interests of the creditors as a group.[299] Part V.B then considers the extent to which an inflationary discount rate comports with the fresh-start principle in bankruptcy, which "captures the notion that substantive relief should be afforded in the form of forgiveness of existing debt, with relinquishment by the debtor of either existing nonexempt assets or a portion of future income, in order to restore the debtor to economic

---

298. *See* Carbiener, *supra* note 144, at 45 ("Rather than discount the stream of payments to be received by the discount rate, the same result can be achieved by adding interest equal to the discount rate to scheduled principal payments."); Pawlowic, *supra* note 39, at 170 (noting that a present-value determination can be simplified if the debtor's plan proposes "the payment of a principal amount . . . plus interest at a rate equal to the rate that otherwise would be used to discount the payments to present value").

299. *See* JACKSON, *supra* note 241, at 28 ("Because the collective damage resulting from adhering to a right may sometimes exceed any benefit, a bankruptcy statute sometimes *must* replace nonbankruptcy rights with something else.").

productivity."[300] Finally, Part V.C identifies the manner in which present-value analysis implicates an administrative function that has the potential to undermine the optimal institutional design of bankruptcy courts, pursuant to which administrative and judicial functions are to be kept as separate as possible. The Article concludes that, not only does an inflation rate comport with generally held theory of bankruptcy law's procedural and substantive goals, it also optimizes the statutory design of the Bankruptcy Code and the institutional design of the bankruptcy courts.

A. Advancing Bankruptcy Law's Procedural Goal

Thomas Jackson has argued that bankruptcy law ought to respect and vindicate nonbankruptcy entitlements in order to avoid creating the very problem that bankruptcy law seeks to overcome—that is, individuals acting in self-interest counter to the group's interest, such as one creditor shopping for the bankruptcy forum merely to gain the advantage conferred by a bankruptcy rule that does not recognize a competing creditor's nonbankruptcy entitlement.[301] An exception to this rule exists, however, if vindicating the nonbankruptcy entitlement interferes with bankruptcy law's collectivizing goal.[302] In evaluating the normative desirability of an inflationary discount rate in bankruptcy, one might therefore frame the question in the following manner: If a creditor has a nonbankruptcy entitlement to be compensated for risk of default and opportunity cost, does bankruptcy procedural theory suggest that the entitlement should be vindicated or give way? Arguably, sound bankruptcy policy dictates a disregard for a creditor's nonbankruptcy right to be compensated for both.

First, in considering why a creditor's nonbankruptcy right to be compensated for default risk ought not to be vindicated, one should consider the issue from the perspective of both voluntary and involuntary

300. Pardo & Lacey, *supra* note 175, at 414; *see also, e.g.*, JACKSON, *supra* note 241, at 4 (noting that "[t]he policy relating to discharge and notions of a fresh start . . . addresses the question of whether limits should be established on what creditors can get from their debtor"); William O. Douglas, *Wage Earner Bankruptcies—State vs. Federal Control*, 42 YALE L.J. 591, 592–93 (1933) ("The bankruptcy power in general entails a determination of legislative policy on two problems[.] . . . The second problem entails primarily a determination of the debts from which a debtor may be discharged, the conditions if any for a discharge, and the grounds upon which it may be refused.").

301. *See* JACKSON, *supra* note 241, at 20–67 (examining the determination of liabilities in bankruptcy in relation to the role of bankruptcy law).

302. *Supra* note 299.

creditors. From the perspective of a voluntary creditor, that creditor's nonbankruptcy right to be compensated for default risk will generally terminate once the borrowing debtor defaults. Such a creditor will generally extend credit to many borrowers. Some of those borrowers will default and others will not. If the creditor has appropriately priced the cost of credit, it will be able to offset the losses from defaulting borrowers with the gains from nondefaulting borrowers.[303] Extending in bankruptcy a voluntary creditor's nonbankruptcy right that has terminated would have the effect of impermissibly overvaluing the right relative to those of competing claimants—that is, by allowing the recovery of profit from a debtor who has defaulted, which loss should be offset by the creditor's nondefaulting borrowers[304]—and would thus compromise the collectivizing goal of the bankruptcy process.[305]

From the perspective of an involuntary creditor, there is the initial question of whether that creditor has a nonbankruptcy entitlement to compensation for default risk. For example, the federal postjudgment rate is a risk-free rate.[306] For those instances where applicable nonbankruptcy law would entitle an involuntary creditor to recover for default risk,[307] it

303. *See In re* Collins, 167 B.R. 842, 847 n.7 (Bankr. E.D. Tex. 1994) (noting that, when a lending institution calculates a risk factor, "[t]hat calculation can simply be made by determining the expected rate of default and then factoring an enhanced interest rate charge so that the cost or risk of defaulting loans will be evenly spread among other loans"), *abrogated by* Green Tree Fin. Servicing Corp. v. Smithwick (*In re* Smithwick), 121 F.3d 211 (5th Cir. 1997).

304. *See In re* Till, 301 F.3d 583, 597 (7th Cir. 2002) (Rovner, J., dissenting) ("These lenders understand that a significant number of their borrowers . . . may, in fact, end up in bankruptcy. Yet, they continue to make high-risk loans because the money they receive from non-defaulting borrowers is enough to offset that risk; they would not remain in business otherwise."), *rev'd and remanded sub nom.* Till v. SCS Credit Corp., 541 U.S. 465 (2004); *see also* 1 NAT'L BANKR. REV. COMM'N, *supra* note 5, at 262 (noting that, if a creditor were entitled to recover present-value interest at the nondefault contract rate, "[s]uch an interest rate arguably includes a calculation for profit, potentially giving the creditor more than it would have received had the property been foreclosed").

305. *Cf. In re* Scott, 248 B.R. 786, 793 (Bankr. N.D. Ill. 2000) ("[A]pplying a rate of interest that fully reflects risk of nonpayment—like the contract rate in the present case—to a secured claim amount that already includes substantial 'risk protection' results in a windfall for the secured creditor, to the detriment of unsecured creditors.").

306. *See* 28 U.S.C. § 1961(a) (2006) (providing that postjudgment interest rate "shall be calculated from the date of the entry of the judgment, at a rate equal to the weekly average 1-year constant maturity Treasury yield").

307. *See, e.g.*, Gorenstein Enters., Inc. v. Quality Care-USA, Inc., 874 F.2d 431, 436 (7th Cir. 1989) ("[W]e suggest that district judges use the prime rate for fixing prejudgment interest where there is no statutory interest rate. That is a readily ascertainable figure which provides a reasonable . . . estimate for the interest rate necessary to compensate plaintiffs . . .

seems reasonable to conclude that the majority of such creditors will be general unsecured creditors. Because an individual debtor's risk of default under a Chapter 13 repayment plan will likely be uniform vis-à-vis all members within this class of claimants for a given case, the effect of vindicating the nonbankruptcy entitlement to default-risk compensation will be to increase the nominal amount of each creditor's claim. But because the income available for distribution is limited, there will be no increase in the creditor's pro-rata distribution. Accordingly, vindicating the right increases administrative costs without any real benefit, thus undermining the goal of maximizing a debtor's estate for the benefit of all creditors. As such, the nonbankruptcy entitlement ought to give way.

Second, in considering why a creditor's nonbankruptcy right to be compensated for opportunity cost ought not to be vindicated, the concern over administrative costs is equally present. Each creditor's opportunity cost will differ from that of other creditors in a given bankruptcy case. As such, opportunity cost will have to be calculated individually for each creditor. It is not difficult to imagine that, in some instances, the calculus will lead to litigation. The initial calculus and any subsequent litigation related thereto will produce administrative costs that could very well become intractable.[308] Once again, these costs will have the effect of undermining bankruptcy law's procedural goal of maximizing a debtor's estate for the benefit of all creditors. To avoid this result, a nonbankruptcy entitlement to be compensated for opportunity cost ought not to be vindicated in bankruptcy.[309]

---

for the risk of default.").

308. *See* Onink v. Cardelucci (*In re* Cardelucci), 285 F.3d 1231, 1236 (9th Cir. 2002) ("Calculating the appropriate rate and amount of interest to be paid to a myriad of investors has the potential to overwhelm what could otherwise be a relatively simple process pursuant to 11 U.S.C. § 726(a)(5)."); Gen. Motors Acceptance Corp. v. Valenti (*In re* Valenti), 105 F.3d 55, 64 (2d Cir. 1997) ("This ['cost of funds'] approach, however, is difficult for bankruptcy courts to apply efficiently and inexpensively. Because individual creditors borrow funds at different rates, bankruptcy courts would have to determine a creditor's cost of funds on a case-by-case basis."), *abrogated by* Assocs. Commercial Corp. v. Rash, 520 U.S. 953 (1997).

309. One might go a step further and ask whether bankruptcy law ought to compensate creditors for expected inflation. In any given case, the inflation rate ought to be the same for all creditors. Thus, compensating creditors for expected inflation will increase the nominal amount of their claims. Because the amount of estate property available for distribution is fixed, however, a creditor's pro-rata distribution will not be increased. Thus, there will be administrative costs with little benefit gained. This may suggest that bankruptcy law ought not to provide for discounting in the first instance. While this may sound unorthodox, it may be that the common-pool problem that bankruptcy law seeks to overcome makes bankruptcy a unique area of law requiring an unconventional approach. *Cf.* Revesz, *supra* note 240, at

B. Advancing Bankruptcy Law's Substantive Goal

One of the animating goals of bankruptcy law is to restore financially distressed debtors to economic productivity by forgiving their past debts. The litigation process in bankruptcy, depending on how it is structured, may potentially interfere with a debtor's fresh start.[310] If discounting in bankruptcy is structured so as to compensate a creditor for default risk and opportunity cost, any dispute over the appropriate rate will involve a calculation of these amounts. This information is more readily available to and more easily processed by commercially sophisticated creditors, who are repeat players in the system, rather than consumer debtors, who tend to be one-shot players. The informational asymmetry that results is one likely to favor creditors.[311] If, on the other hand, discounting in bankruptcy is structured solely to account for inflation, the playing field would be leveled insofar as the information regarding the inflation rate is readily ascertainable and processed by both parties. An inflation-rate regime thus reduces search costs for debtors, thereby opening access to Chapter 13 rehabilitation. Accordingly, the Article concludes that an inflation rate for present-value analysis enhances the prospects of debtor rehabilitation by eliminating undue advantages from informational asymmetries that

987–1016 (examining environmental regulation, cost-benefit analysis, and the discounting of human lives; and arguing that, in the case of harms to future generations, discounting is ethically unjustified and thus should not be part of the regulatory process).

As a functional matter, empirical evidence suggests that the focus in bankruptcy ought to be on the valuation of assets, rather than the discounting of payments. In a 2007 study, Timothy Fisher and Jocelyn Martel examined the sensitivity of the best-interests test to various assumptions about (1) discount rates, (2) probability of successful reorganization, (3) time required to liquidate assets, and (4) the liquidation value of assets. Fisher & Martel, *supra* note 151, at 498. The study looked at data on 180 firms that filed for reorganization under the Canadian Bankruptcy and Insolvency Act between 1992 and 1996, and they carried out best-interests tests on the data by varying the values for the aforementioned variables. They ultimately found that the best-interests test is sensitive only to assumptions about liquidation value; the test, however, is not sensitive to discount rates, the probability of successful reorganization, and the time required for liquidation. Fisher & Martel, *supra* note 151. The findings from the study thus suggest that it is the valuation threshold that matters most. If valuation drives recovery in bankruptcy, rather than a discount rate, bankruptcy law ought to focus on the former rather than the latter. Doing so will eliminate a layer of administrative costs and have the positive effect of maximizing returns to creditors.

310. *See, e.g.*, Pardo & Lacey, *supra* note 252, at 232 (stating that empirical evidence "suggests that undue hardship discharge litigation improperly curtails access to justice for student-loan debtors who legitimately need relief from their financial distress").

311. Justice Stevens's plurality opinion in *Till* recognizes the informational asymmetry inherent in a present-value-analysis dispute between a creditor and an individual debtor. Till v. SCS Credit Corp., 541 U.S. 465, 484–85 (2004) (Stevens, J., plurality opinion).

generally favor creditors and by reducing search costs for consumer debtors.[312] As such, the doctrinal prescription suggested in this Article comports with generally held notions of what bankruptcy law ought to do substantively.

C. Optimizing Statutory and Institutional Design

Nondelegation doctrine holds that Congress violates the constitutional principle of separation of powers when it delegates excessive authority to agencies.[313] The delegation is not excessive, however, if Congress supplies an "intelligible principle" that guides and constrains the delegated authority.[314] In other words, Congress must make the foundational decisions about statutory policy. Margaret Lemos has persuasively argued that Congress delegates to courts in the same fashion as it does to administrative agencies and that, as such, those delegations ought to be examined to see whether they run afoul of the nondelegation doctrine.[315] Moreover, even if the delegation is permissible, the question arises as to who is the more appropriate delegate—that is, a court or an agency.[316] In evaluating the normative desirability of an inflation rate for discounting in consumer bankruptcy, one might therefore examine Congress's decision to delegate (a question of statutory design) as well as Congress's choice of delegate (a question of institutional characteristics).

---

312. In the Seventh Circuit's decision in *Till*, Judge Rovner's dissenting opinion noted that an overcompensatory discount rate is "inconsistent with the fresh start that Chapter 13 was intended to provide to debtors." *In re* Till, 301 F.3d 583, 593 (7th Cir. 2002) (Rovner, J., dissenting), *rev'd and remanded sub nom.* Till v. SCS Credit Corp., 541 U.S. 465 (2004).

313. *See* Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 472 (2001) ("In a delegation challenge, the constitutional question is whether the statute has delegated legislative power to the agency.").

314. *Id.*

315. *See* Margaret H. Lemos, *The Other Delegate: Judicially Administered Statutes and the Nondelegation Doctrine*, 81 S. CAL. L. REV. 405, 408 (2008) ("Just as agencies exercise a lawmaking function when they fill in the gaps left by broad delegations of power, so too do courts. And, to the extent that lawmaking by agencies triggers constitutional anxieties about the proper allocation of power . . . , so too should delegated lawmaking by courts." (footnote omitted)); *see also* Scott Baker & Kimberly D. Krawiec, *The Penalty Default Canon*, 72 GEO. WASH. L. REV. 663, 665 (2004) (developing the "Penalty Default Canon [which] requires courts to declare responsibility-shifting statutory provisions unconstitutional delegations of legislative authority").

316. *See* Lemos, *supra* note 315, at 469–75 (analyzing the positive and negative effects of courts serving as delegates).

First, consider the question of statutory design. An open-ended instruction by Congress to the courts without more, as exists under the current arrangement, may constitute an impermissible delegation. The positive theory provided in Part III of this Article is one that may insulate the current statutory design from such an attack. One might argue that the guideposts throughout the Code provide the requisite "intelligible principle" that would make the delegation nonexcessive.

But even if a nondelegation challenge to the current arrangement is unlikely, open-ended statutory design in the discounting context raises implementation concerns as a result of anchoring effects. Research shows that, when individuals make estimates, they will often rely on an initial value to anchor their final estimate.[317] An anchor can influence judgment, even if the anchor does not convey useful information.[318] In an experimental study in 2004 involving 113 bankruptcy judges (after the Supreme Court had decided *Till*), the judges were asked to set the discount rate for cramdown payments to a secured creditor in a hypothetical Chapter 13 proceeding.[319] Judges were instructed to follow the *Till* plurality's "prime-plus" approach.[320] The control group was not told the contract interest rate, which was higher than the prime rate, whereas the experimental group was told the contract rate.[321] At the mean, the experimental group set a statistically significantly higher discount rate than the control group.[322]

As a matter of statutory design, asking courts to account solely for expected inflation provides a prophylactic approach toward overcoming anchoring effects. Recall that the doctrinal prescription set forth in this Article calls for a downward departure from the Treasury-note rate.[323] Assuming that knowledge of a contract rate has an anchoring effect, it will be to minimize the downward departure. Given that the Treasury-note rate is lower than the prime rate, the detrimental effect of anchoring will be mitigated.

317. Jeffrey J. Rachlinksi, Chris Guthrie & Andrew J. Wistrich, *Inside the Bankruptcy Judge's Mind*, 86 B.U. L. REV. 1227, 1233 (2006).

318. *Id.*

319. *Id.* at 1234.

320. *Id.* at 1234–35.

321. *Id.* at 1235.

322. *Id.* For further discussion regarding anchoring effects in the context of *Till*, see Schwartz, *supra* note 49, at 113.

323. *Supra* notes 238–40 and accompanying text.

Second, consider the question of institutional design. In order to get better administrability of present-value analysis in consumer bankruptcy, we ought to use a discount rate that solely accounts for expected inflation—particularly in light of the fact that, under the current bankruptcy system, there exists no administrative agency with rulemaking or adjudicatory authority. Anything beyond an inflationary discount rate may have the effect of making the bankruptcy court a bad delegate for administering the Code's present-value provision. If discounting in bankruptcy is required to account for risk of default and opportunity cost, in addition to expected inflation, the discount-rate calculus becomes an overly burdensome nonforensic determination—that is, a determination that involves prediction about the future course of events in administration of the bankruptcy case, which in turn requires the court to evaluate risks and balance competing risk-reward preferences among case participants.[324] A court, however, is not well equipped to make such a determination because (1) the court does not have an independent investigatory arm to conduct research about future risk, (2) the adversary system chills collaborative exchange between parties in solving a forward-looking problem, and (3) the indeterminacy of the future makes it difficult to establish an effective legal standard.[325] Furthermore, estimating default risk and opportunity cost increases the complexity and cost of acquiring information that will accurately predict present value. This will interfere with a court's ability to devote its resources to resolving disputed forensic matters, which are at the core of the judicial function.[326] Thus, concerns over institutional design provide normative support for a discount rate that solely accounts for expected inflation.[327]

---

324. Richard B. Levin, *Towards a Model of Bankruptcy Administration*, 44 S.C. L. REV. 963, 972 (1993).

325. *Id.* at 981–83.

326. *See id.* at 978 ("[A]uthoritative decisions about disputed forensic matters in bankruptcy cases should be made in the judicial system."). For further discussion regarding the manner in which the statutory design of the Bankruptcy Code erodes the judicial function, see Rafael I. Pardo, ***Eliminating the Judicial Function in Consumer Bankruptcy***, 81 AM. BANKR. L.J. 471, 488–93 (2007).

327. *Cf.* Rasmussen, *supra* note 13, at 328 ("[T]here is little to be said for any approach that places large information burdens on the bankruptcy court. . . . The system really is not designed to adjudicate the facts of each individual debtor."); Schwartz, *supra* note 49, at 115 n.18 (stating that *Till* "needlessly increase[s] the administrative costs of consumer bankruptcy . . . by increasing the number of interest rate hearings").

VI. Conclusion

This Article has attempted to bring some order to the chaos that has characterized the law's approach to present-value analysis in consumer bankruptcy. It has argued that, as a positive matter, the Bankruptcy Code compels application of an inflation rate when discounting future payments to present value. Adherence to this prescription will not only make the doctrine more sound, it will also further bankruptcy law's procedural and substantive goals and will optimize the statutory design of the Bankruptcy Code and the institutional design of the bankruptcy courts.