

Legislation/Secured Credit

Secured Credit Under the Code and Commission Report

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COMMISSION TO
STUDY THE REFORM OF CHAPTER 11
2012-2014
FINAL REPORT AND RECOMMENDATIONS
SPONSORED BY THE ARTHUR H. SCHALLING ENDOWMENT FUND

ABI Commission to Study the Reform of Chapter 11

Overview of
Recommendations and Findings

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Key Themes of Recommendations

- Reduce barriers to entry
- Facilitate certainty and more timely resolution of disputed matters
- Enhance exit strategies for debtors
- Create an effective alternative restructuring scheme for small and medium-sized firms

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General Approach to Valuation

“[T]he Commission’s decision to use foreclosure value is an integral part of the delicate balance the Commission struck between the rights of secured creditors, on the one hand, and the reorganizational objectives of the estate, on the other hand. *Specifically, the Commission agreed that the foreclosure value of an interest should be used early in the case when determining adequate protection issues, but that the secured creditor should be entitled to receive the reorganization value of its interest in the debtor’s property through the claims allowance and distribution process later in the case.*”

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Foreclosure Value

“[T]he term ‘**foreclosure value**’ means the net value that a secured creditor would realize upon a hypothetical, commercially reasonable foreclosure sale of the secured creditor’s collateral under applicable nonbankruptcy law.”

– ABI Report Section IV.B.1.

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Adequate Protection

“The amount of adequate protection required under section 361 of the Bankruptcy Code to protect a secured creditor’s interest in a debtor’s property should be determined based on the foreclosure value of the secured creditor’s collateral.”

- ABI Report Section IV.B.

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Adequate Protection

- Secured creditor could challenge adequate protection determination if circumstances or valuations change
- Even though based on foreclosure value, the secured creditor’s distributions would be based on reorganization value (essentially an enterprise value concept)
- If adequate protection fails, secured creditor has right to request that collateral be sold under section 363 of Code and its section 507(b) rights, including to proceeds of avoidance actions, are preserved

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Reorganization Value

“[T]he term ‘**reorganization value**’ means (i) if the debtor is reorganizing under the plan, the enterprise value attributable to the reorganized business entity, plus the net realizable value of its assets that are not included in determining the enterprise value and are subject to subsequent disposition as provided in the confirmed plan; or (ii) if the debtor is selling all or substantially all of its assets under section 363x or a chapter 11 plan, the net sale price for the enterprise plus the net realizable value of its assets that are not included in such sale and are subject to subsequent disposition as provided in the confirmed plan or as contemplated at the time of the section 363x sale.”

- ABI Report Section IV.B.

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Redemption Option Value

- In general, “*redemption option value*” (ROV), if any, is value available to the class of creditors immediately junior to the fulcrum security based on a valuation formula that considers, among other things, the recovery by the senior (i.e., fulcrum) class and the value of the debtor during the redemption period (i.e., three years from the petition date).
- In calculating ROV, the senior class must receive the full face amount of its claims, including any unsecured deficiency claim, plus any interest at the non-default contract rate plus allowable fees and expenses unpaid by the debtor.
- Basic concept is to account for value fluctuations based solely on the timing of the valuation-realization event in the case.

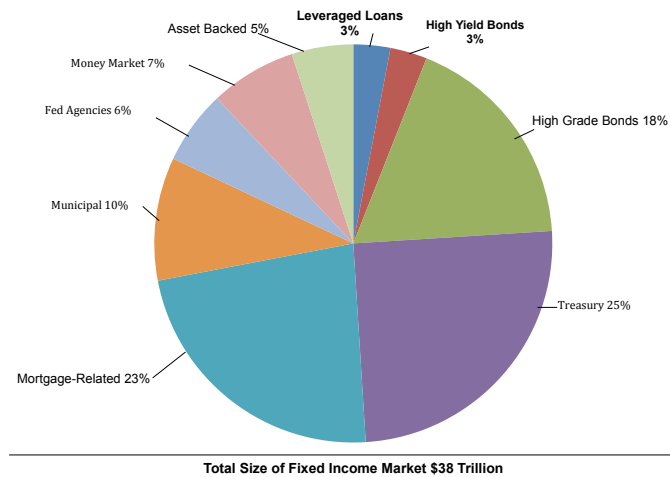
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Conclusion

- Principles intended to, among other things, create certainty and efficiencies in process
- Commission hopes that the Report will facilitate debate and meaningful dialogue concerning necessary and beneficial reforms to chapter 11

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Leverage Loans and High Yield Bonds Represent More than 6% of U.S. Fixed Income Asset Classes

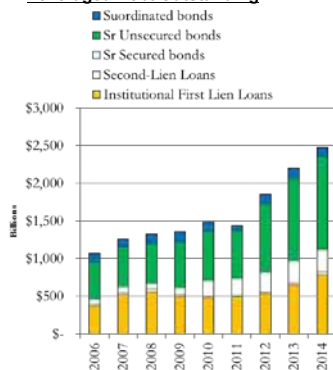


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There is Almost \$2.5 Trillion in Total Leveraged Debt Outstanding

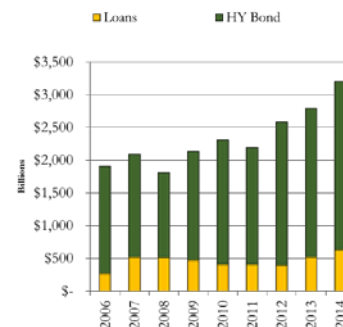
With \$3.2 Trillion Traded Annually by Year-End 2014

Leveraged Debt Outstanding



Source: S&P Capital IQ LCD

Leveraged Debt Secondary Trading Volume



Source: Thomson Reuters & LSTA Trade Data Study

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