

Momentive Ruling May Pave the Road for Below-Market “Takeback Paper” Cramdowns of Secured Creditors

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In a lengthy bench ruling delivered on August 26, 2014, Judge Robert D. Drain of the United States Bankruptcy Court for the Southern District of New York held that Momentive Performance Materials could satisfy the cramdown standard of Section 1129(b) of the Bankruptcy Code as to its oversecured creditors by distributing to them replacement notes paying a below-market interest rate. Rejecting arguments made by the objecting creditors that a market rate of interest was required, Judge Drain approved the use of a rate computed by reference to the prime rate, with an additional margin to compensate the creditors for the risk of non-payment, reasoning that the Bankruptcy Code does not require an interest rate that covers creditors' costs or provides them with a profit. If followed, Judge Drain's ruling may shift the leverage in future cases in favor of debtors and unsecured creditors, potentially enabling them to satisfy secured creditors with long-term replacement notes at below-market rates, thus obviating the need for some debtors to secure takeout exit financing and potentially providing additional value for unsecured creditors at the expense of the secured creditors.

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