UNITED STATES BANKRUPTCY COURT
DISTRICT OF VERMONT

In re:

Pasquale Vescio and Vatsala Vescio
Debtors-in-Possession

Chapter 11
Case # 96-10153

#453-1

Memorandum of Decision
Determining Valuation And Setting Interest Rate
For Purposes of The Third Amended Chapter 11 Plan

This cause has come before the Bankruptcy Court on remand from the United States District Court for the District of Vermont to determine the value of collateral securing a claim, and interest rate to be paid on that secured claim, within the criteria set by this circuit in In re Valenti, 105 F.3d 55 (2nd Cir. 1997). In response to this Court's Orders dated September 13 and 28, 2000, the Debtors, Pasquale Vescio and Vatsala Vescio, (hereafter referred to jointly as "Vescio")and the Creditor, Amresco New England II, L.P. ("Amresco") have filed affidavits and supplemental memorandum of law, respectively, in support of their opinions as to valuation and interest rate. For the reasons set forth below, this Court holds that the value of Vescio's subject real property is $850,000 and that the interest rate to be paid to Amresco is 8.235%.

JURISDICTION

This Court has subject matter jurisdiction over this controversy pursuant to 28 USC §§ 157 and 1334(b). This is a core matter under 28 USC § 157(b)(2)(A), (B), (K), (L) and (O). This Memorandum of Decision constitutes the findings of fact and conclusions of law of this Bankruptcy Court regarding the issues of collateral valuation and applicable interest rate under the Debtors' chapter 11 plan.

US BANKRUPTCY COURT
DISTRICT OF VERMONT
NOV - 2 2000
FILED & ENTERED ON DOCKET
BY: KATHLEEN A. FORD

ISSUES

The issues presented are (1) whether the undisputed replacement value of the subject property includes a risk premium and (2) what risk premium should be added to the risk free interest rate in order to compensate Amresco for the risk of receiving deferred payments, pursuant to In re Valenti, *supra.*

BACKGROUND

The Vescio chapter 11 case was filed on February 19, 1996 and an Order Confirming the Third Amended Chapter 11 Plan was entered on August 19, 1996. An initial appeal was filed with the U.S. District Court on November 18, 1996 ("the first appeal") which resulted in a remand of the case to this Court ("the first remand") and this Court (Conrad, J.) entered a decision reaffirming its prior ruling on November 20, 1998. Thereafter, an appeal of the November 20, 1998 decision was filed with the U.S. District Court on December 1, 1998 ("the second appeal") which resulted in a remand of the case to this Court ("the second remand") on October 6, 1999. In its remand decision, the U.S. District Court (Sessions, J.) very clearly and narrowly defined the two issues on remand as follows:

> . . . reimposing the risk free interest rate by the Bankruptcy Court is not in conformity with binding Second Circuit precedent. This matter is therefore remanded for a determination of a risk premium which reflects Amresco's risk of receiving deferred payments. Valenti, 105 F.3d at 64 Moreover, since it is unclear whether the valuation of the property is based in part upon the risk of default, the Court remands the issue regarding the valuation of the property to insure there is not double counting of a risk premium.

In re Vescio, 2:99-CV-053 (October 4, 1999) at 8.

In the earlier valuation determination, this Court (Conrad, J.) credited the testimony of Mr. Pasquale Vescio as the most credible testimony as to value, and that finding has not been brought into

question in the second remand, See Id. at 6, footnote 2. Moreover, this Court (Conrad, J.) previously held, consistent with Valenti, that the proper risk free interest rate is a United States Treasury note, and found that this instrument has an interest rate of 6.36% per annum, In Re Vescio case # 96-10153 Docket # 230-1 at 3. Thus, the only two questions presented on remand are (1) whether the undisputed replacement valuation of the property includes a risk premium and (2) what risk premium should be added to the risk free interest rate in order to compensate Amresco for the risk of receiving deferred payments, as required by In Re Valenti 105 F.3d 55 (2nd Cir. 1997). As noted in this Court's directives to the parties, counsel for Amresco and counsel for the Debtor have each already submitted a comprehensive Memorandum of Law in response to the second remand and the two issues set forth in the second remand do not raise any issues of witness credibility. Therefore, the reopening of the hearing would be likely to increase both the expense and duration of this already long-lived litigation. The parties were directed by Order dated September 13, 2000, therefore, to supplement their previously filed legal memoranda and to present affidavits of their respective experts specifically addressing the foregoing two issues, in light of the law in this Second Circuit as articulated in In re Valenti, *supra.*

In response to this court's order, the Debtors filed the *Affidavit of James B. Lurie* ("the Lurie Affidavit"), the *Affidavit of Pasquale Vescio* ("the Vescio Affidavit"), the *Affidavit of James B. Lurie in Response to Affidavit of Jeffrey Carr dated October 2, 2000* ("the Supplemental Lurie Affidavit"), and *Pasquale and Vatsala Vescios' Supplemental Memorandum of Law* ("Vescios' Supplemental Memorandum of Law"). In support of its contentions regarding valuation and the applicable interest rate, Amresco filed its *Affidavit of Jeffrey B. Carr* dated October 2, 2000 ("the Carr Affidavit"), the *Affidavit of Jeffrey B. Carr* dated October 16, 2000 ("the Supplemental Carr Affidavit"), and *Amresco's Supplemental Memorandum of Law in Support of a 10.1% Interest Rate and Request for an Evidentiary Hearing* ("Amresco's Supplemental Memorandum of Law"). This Court has carefully considered all

pleadings filed of record and the case of In re Valenti, *supra*, in resolving the issues presented.

DISCUSSION

As noted by the District Court in its most recent remand of this matter, a determination of the valuation of the subject real property and a risk premium which reflects Amresco's risk of receiving deferred payments on its related interest in the property is governed by In re Valenti, *supra*.

In the Valenti case, the debtors had purchased a car in 1993 and financed the purchase with General Motors Acceptance Corporation (GMAC) on an installment sales contract with an interest rate of 12.95%. In 1994, the Valentis filed a chapter 13 petition and a plan proposing to retain their undersecured car and make installment payments to GMAC at 8% interest. In response to GMAC's objection to the proposed plan, the Bankruptcy Court fixed the cram down interest rate at 9% and confirmed the plan without issuing an opinion. In affirming, the District Court concluded that 11 U.S.C. section 1325 requires "market rate interest" and that the applicable interest rate would be the rate paid by GMAC for the funds it borrows. *See* General Motors Acceptance Corp. v. Valenti, 191 B.R. 521, 522 (N.D.N.Y. 1995), *aff'd.*, 105 F.3d 55 (2d Cir. 1997). In determining the appropriate cram down interest rate, the Valenti court reviewed the different approaches utilized by the various Bankruptcy and Circuit Courts, and ruled that the following criteria must be followed in fixing the interest rate:

> . . . we hold that the market rate of interest . . . 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. This method of calculating interest is preferable to either the "cost of funds" approach or the "forced loan" approach because it is easy to apply, it is objective, and it will lead to uniform results. In addition, the treasury rate is responsive to market conditions.
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> Because the rate on a treasury bond is virtually risk-free, the . . . interest rate should also include a premium to reflect the risk to the creditor in receiving deferred payments under the reorganization plan. ... A review of the case law in those jurisdictions that use this approach to determine a fair rate of interest suggests that the risk premium has been set

> by bankruptcy courts at from one to three percent. ... The actual rate will depend upon the circumstances of the debtor, including prior credit history as well as the viability of the reorganization plan. ***We hold that a range of one to three percent is reasonable in this Circuit but leave it to the bankruptcy court in the first instance to make a specific determination. If the parties are unable to stipulate as to the applicable risk premium, then the bankruptcy court may conduct a hearing limited solely to a determination of that premium.*** [citations omitted] [emphasis added]

In re Valenti, 105 F.3d at 64.

Furthermore, the Valenti case admonishes the Bankruptcy Courts to consider the following factors in setting the "risk premium": (1) the circumstances of the debtor; (2) the debtor's prior credit history; and (3) the viability of the debtor's plan. In re Valenti, 105 F.3d at 64. Accordingly, the parties were specifically directed by this Court's Order to submit and support their respective opinions regarding the appropriate cram down interest rate applicable to the subject real property in accordance with the remand order of the District Court and the foregoing ruling in Valenti.

The party objecting to confirmation of a proposed chapter 11 plan has the burden of persuasion. *See* In re Mendenhall, 54 B.R. 44 (Bankr. W.D.Ark. 1985)(cases cited therein); In re Flick, 14 B.R. 912 (Bankr. E.D.Penn. 1981); *see also* Education Assistance Corp. v. Zellner, 827 F.2d 1222 (8th Cir. 1987)(objecting party has at a minimum the burden of producing satisfactory evidence on issue raised by the objection); In re Blevins, 150 B.R. 444 (Bankr. W.D. Ark. 1992)(generally, the burden of going forward with evidence and the ultimate burden of proof is borne by the party objecting to confirmation); 8 Collier on Bankruptcy, §1324.03. If a party fails to prosecute its objection or otherwise support its position with credible evidence, the objection should be overruled or dismissed. *See* In re Blevins, 150 B.R. at 446; In re Mendenhall, 54 B.R. at 47; In re Hugee, 54 B.R. 676, 679 (Bankr. D.So.Car. 1985); In re Parker, 49 B.R. 61 (Bankr. E.D.Va. 1985); In re Powell, 15 B.R. 465 (Bankr. N.D.Ga. 1981); *see also* 8 Collier on Bankruptcy, §1324.03. Therefore, Amresco has the initial burden of persuasion on its objection to the proposed cram down interest rate.

In the *Carr Affidavit* and *Supplemental Carr Affidavit*, Amresco seeks to substantiate its request for the imposition of a "10.0% total interest rate that would correspond to a rate of return on Amresco's investment in this proceeding that is consistent with the risk inherent in all of Amresco's business activities."[1] Mr. Carr utilizes a "cost of capital" based approach in determining Amresco's risk premium that would "at least be equal to the cost of capital experienced by Amresco in the normal course of its business." While Mr. Carr indicates that he has considered the debtors' circumstances, his opinion nonetheless emphasizes factors related to "the total return a prudent investor would demand from the purchase of a comparable asset or from an ownership interest in an asset of comparable risk." This asset-based and creditor oriented "cost of capital" approach resembles the "forced loan" and "cost of funds" approaches that were expressly considered and rejected by Valenti. Instead, the Second Circuit requires that a secured creditor receive a market rate of interest that is fixed by the U.S. Treasury rate and supplemented by a risk premium. The Valenti Treasury rate approach is adopted because "it is easy to apply, it is objective, and it will lead to uniform results" and is "responsive to market conditions." In re Valenti, 105 F.3 at 64. Amresco's approach to determining the method for determining the appropriate cram down interest rate is erroneous and ignores the specific directive of this Court that the parties submit expert opinions within the parameters of Valenti.

Furthermore, in order to avoid the sanctioning of a risk free interest rate, Valenti directed the Bankruptcy Courts to apply a one to three percent premium to the treasury rate to correspond to the risk inherent in the proposed payment schedule. As noted above, the Valenti court states that "a range of one to three percent is reasonable in this Circuit but leave it to the Bankruptcy Court in the first instance to make a specific determination." Id. at 64. The range of one to three percent risk premium established by

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[1] While Amresco's *Supplemental Memorandum of Law* supports a risk premium of 10.1% based upon the *Carr Affidavits*, it appears that Mr. Carr is proposing a total rate of 10.0% based upon a 3.64% risk premium added to an undisputed risk free premium of 6.36%.

Valenti establishes a rebuttable presumption regarding the parameters by which a court can adequately protect the economic interest of a creditor above the risk free rate. In this instance, Amresco fails to propose a risk premium within the one to three percent range that is presumed to be reasonable within this Circuit or to otherwise provide adequate evidence of unique factors or circumstances pertaining to these Debtors that would warrant a risk premium beyond the prescribed range. Amresco is proposing a 3.64% risk premium without evidence or persuasive argument[2]. Moreover, the *Carr Affidavits* fail to address adequately the three factors that Valenti and this Court presented for determining an appropriate risk premium[3]. Therefore, the proposed total interest rate of 10.0% based upon a 3.64% risk premium added to an undisputed risk free premium of 6.36% is rejected and I find that Amresco has failed to meet its burden of persuasion regarding the cram down interest rate issue.

In response to the directive of this Court and the District Court, the Debtors submitted the *Vescio and Lurie Affidavits*, respectively, that indicate that the undisputed replacement valuation of the subject property does not include a risk premium and propose a total applicable interest rate of 8.235% , based upon a risk premium of 1.875% coupled with the undisputed Treasury rate of 6.36%. Because Amresco has not met its burden of persuasion, the Debtors' proposed total interest rate of 8.235% is accepted by this Court.

Furthermore, in reviewing the *Lurie Affidavits*, I find that the Debtors have adequately supported their proposed 1.875% risk premium. Mr. Lurie has considered BAA securities corresponding to medium-

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[2] It should be noted that the norm throughout the country appears to be 1-3%, *see* In re Carson, 227 B.R. 719, 724 (Bankr. S.D.Ind. 1998), with a 3.85% rate above the risk free rate (or 50% greater than the riskless rate) considered a risk premium rate comparable with many "junk bonds." *See* In re Briscoe, 994 F.2d 1160, 1169 (5th Cir. 1993). It has been noted that the risk factor typically need not be large in most instances due to the several protections creditors generally receive in bankruptcy plans. *See* In re Carson, 227 B.R. at 723-24; In re Dingley, 189 B.R. 264, 272 (Bankr. N.D.N.Y. 1995); *see also* 8 Collier on Bankruptcy, §1325.06[3][b].

[3] As indicated above, the following factors in setting the "risk premium": (1) the circumstances of the debtor; (2) the debtor's prior credit history; and (3) the viability of the debtor's plan. In re Valenti, 105 F.3d at 64.

grade obligations with interest payments and principal security appearing adequate for the present, but with certain protective elements potentially lacking or uncharacteristically unreliable over any length of time. Additionally, Mr. Lurie considered the extent of security provided by the subject collateral and the tenant circumstances at the property. In determining the adequacy of the Debtors' proposed cram down interest rate, this Court has also considered the Debtors' circumstances, their prior credit history as reflected by the bankruptcy petition and related filings, and the viability of the proposed chapter 11 plan. In evaluating the criteria applicable to these Debtors, this Court determines that the Debtors' proposed chapter 11 plan is viable and that the Debtors' credit history and related circumstances adequately relate to a mid range risk premium of 1.875%. I find that this proposed rate is not only well within the reasonable range established in this Circuit by Valenti, but it is consistent with the overall circumstances of these parties and the chapter 11 plan.

Lastly, this Court determines that the record is sufficient to resolve the cram down interest rate issue and therefore denies Amresco's request for an evidentiary hearing. As noted above, the parties have already submitted comprehensive legal memoranda in response to the second remand and the two issues set forth in the second remand do not raise any issues of witness credibility. The parties have further supplemented the record with supplemental memoranda and affidavits. The reopening of the hearing is not only unnecessary, but would be contrary to this Court's obligation to promote judicial economy. [4] Moreover, Amresco does not demonstrate why a further evidentiary hearing is warranted or that its expert has information or opinions that are not or could not be adequately presented in the affidavits filed of record. Neither Valenti nor the Bankruptcy rules mandate that this Court undertake a further evidentiary hearing under these circumstances, especially where the parties have been provided an adequate opportunity to present supporting evidence and the movant has failed to meet its burden of persuasion

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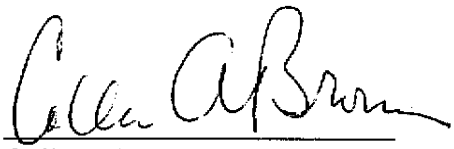
[4] *See* In re Yrlas, 183 B.R. 119, 121 (Bankr. N.D.Tex. 1995).

regarding the subject of its objection.[5]

Accordingly, this Court determines that the undisputed replacement valuation of the subject property did not include a risk premium and that a total cram down interest rate of 8.235% , comprised of a risk premium of 1.875% coupled with the undisputed Treasury rate of 6.36%, is consistent with In re Valenti and the circumstances of this chapter 11 plan. The Amresco collateral is therefore valued at $850,000 and the Debtors are directed to pay interest on the Amresco secured claim at a rate of 8.235% per annum.

November 2, 2000
Rutland, Vermont



Colleen A. Brown
U.S. Bankruptcy Judge

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[5] While Valenti indicates that the bankruptcy court *may* conduct a hearing limited solely to a determination of the risk premium when the parties are unable to stipulate, a hearing is not mandated and the Bankruptcy Court has discretion to render its determination without the necessity of further hearings and delay. The verb "may" merely confers discretion upon a court. *See* Noreen v. Slattengren, 974 F.2d 7576 (8th Cir. 1992)(Bankruptcy Court not required to hold evidentiary hearing on issue of good faith filing); In re Linkous, 141 B.R. 890, 894 (W.D.Va. 1992).

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DISTRICT OF VERMONT

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Debtors-in-Possession

Chapter 11
Case # 96-10153

#454-1

Order Determining Valuation And Setting Interest Rate
For Purposes of The Third Amended Chapter 11 Plan

This cause has come before the Bankruptcy Court on remand from the United States District Court for the District of Vermont to determine the value of collateral securing a claim, and interest rate to be paid on that secured claim, within the criteria set by this circuit in In re Valenti, 105 F.3d 55 (2nd Cir. 1997), and this Court having considered the matters filed of record and based upon the reasons set forth in the Memorandum of Decision Determining Valuation and Setting Interest Rate for Purposes of the Third Amended Chapter 11 Plan, it is

ORDERED AND ADJUDGED that this Court determines that the Amresco collateral is valued at $850,000 and the Debtors are directed to pay interest on the Amresco secured claim at a rate of 8.235% per annum.

November 2, 2000
Rutland, Vermont

Colleen A. Brown
U.S. Bankruptcy Judge

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US BANKRUPTCY COURT
DISTRICT OF VERMONT
NOV - 2 2000
FILED & ENTERED ON DOCKET
BY: KATHLEEN A. FORD