FUNDAMENTALS OF VALUATION ANALYSIS, PART II: APPLYING THE MODELS TO RESTRUCTURING AND REORGANIZATION STAGES

Moderator:
William L. Wallander, Vinson & Elkins LLP, Dallas, TX

Panelists:
R. Seth Bullock, Conway MacKenzie, Inc., Houston TX
Brian Cejka, Alvarez & Marsal, Dallas, TX
Adam Dunayer, Houlihan Lokey, Dallas TX
Tonya Moffat Ramsey, Vinson & Elkins LLP, Dallas TX
I. **Introduction**¹

Valuation is very important in almost every stage of a bankruptcy proceeding, especially where a secured creditor is involved. Valuation often consists of valuing opaque, niche, and complex assets with a situation of no willing buyer or seller, and is decided by judges trained under the law and not in finance. An advocate, expert, or any other participant in a valuation hearing must understand the fundamentals of a valuation battle under different provisions of the Bankruptcy Code as well as what kind of problems may arise in proving valuation within the paradigm of these fundamentals.

There is only one statute, 11 U.S.C. § 506(a), that directs a court on how to value assets under the Code, and it is written deceptively simple,

“[V]alue shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such [secured] creditor’s interests.”²

Accordingly, valuation is highly situational and is an inexact science.³ This paper will first discuss the basic valuation methods and then apply those methods to specific bankruptcy case situations.

II. **Basic Valuation Methods**

When valuing a complex debtor or asset, a court will probably use one or more of the four most common valuation methods: Discount Cash Flow, Comparable Companies, and Comparable Transactions, and Market Approach.⁴ A summary of the methods is below.

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¹ Thanks to Casey Doherty and John Napier, Associates of Vinson & Elkins LLP for their research and writing contributions to this article.
³ See In re Sherman, 157 B.R. 987, 989 (Bankr. E.D. Tex. 1993) (“No other area is more central to the bankruptcy process, yet more perplexing to those practitioners and courts presented with its permutations than the question of valuation of assets.”).
⁴ All four are explained in detail in Part III of this series, available in the course materials and presented later during the conference. See also, Hon. Christopher Sontchi, Valuation Methodologies: A Judges View, 20
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<td>Discount Cash Flow</td>
<td>Can be used for “peerless” debtors. Numbers will be available from the debtor. Possible to adjust numbers through projections.</td>
<td>Courts are sometimes wary to speculate too much, especially in young and/or volatile industries. Court has lots of leeway to diverge from an advocate’s analysis.</td>
<td>Average out multiple forecasts. Use concrete evidence whenever possible Account fairly for competitive pressures Normalize’ figures for a cyclical industry.</td>
<td>“Naked” speculations Speculations which diverge greatly from others in the case. Cherry-picking stats and estimates only when favorable or a favorable run of years in a cyclical industry.</td>
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<td>Comparable Company</td>
<td>If right match-up is found, strong evidence of value. Court can be handed a valuation derived largely from hard, tested numbers instead of subjective analysis.</td>
<td>Contains difficulty of finding a peer comparable Transactions are often not clear and a court may have to undertake a valuation within a valuation, only the latter will not have accessible data.</td>
<td>Look for situations with company peers. Include multiple transactions if possible If there are no plausible comparable transactions, don’t waste the court’s time.</td>
<td>Don’t just focus on transactions which reflect favorable for client, account for all plausible comparables. Don’t use transactions that took place in a significantly different market context.</td>
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<td>Comparable Transactions</td>
<td>Combination of hard evidence of a competitor with ability to advocate for a favorable adjustment through a subjective multiple</td>
<td>Courts strict on what is actually comparable. Combines double risk of court not finding a competitor is suitable with not finding that a multiple is suitable. Might be difficult to access information from an outside source, especially a competitor.</td>
<td>Find almost exact replica within industry. Find multiples if possible. Have a range of multiples to give the court discretion.</td>
<td>Avoid companies that are significantly older or younger than debtor. Adding any other subjective multiples besides those permitted by analysis.</td>
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<td>Market Approach</td>
<td>Can provide clarity through concrete evidence. Easier for court to understand.</td>
<td>Courts believe that the market is distorted during a bankruptcy. Market with a complex debtor is often opaque. Potential buyers are often restricted during a case.</td>
<td>Supplement market evidence with other valuation analysis. Using market for prepetition valuations.</td>
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A. Discount Cash Flow

Under a Discount Cash Flow (DCF) analysis, the court calculates a company’s future cash flow and then discounts it by the projected weighted cost of capital. A DCF analysis should be used in most every case. Courts prefer more data than less, and, unlike its peer methods, DCF is most always possible to use because it focuses on the company’s own internal numbers and projections and is not dependent on data from competitors.

The heart of a DCF valuation battle will take place within the projection of a company’s future cash-flows. Courts realize that projections are speculative and, therefore, insist that the projections be backed by realistic, concrete evidence that takes into account limitations on future growth and success as well as likely pitfalls.\(^5\) In considering a company’s projections, courts consider the past performance of a company as a barometer in which to judge optimistic future estimates.\(^6\) As elapsed time opens up exponential contingencies and sub-contingencies, the further into the future the projections extend the more suspicious courts will be of such projections. Thus, it is generally acceptable to project three to five years into the future.\(^7\) If the industry is volatile, complex, and/or specialized, then courts will be suspicious of aggressive valuations, especially those that appear to “cherry-pick” certain contingencies or figures without applying the possible negative implication of these to the entirety of a report.\(^8\) Overall, given the fragility of projections, it is prudent to use multiple sources of projections for a court to either

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\(^8\) *In re Tribune Co.*, 464 B.R. 126, 151 (Bankr. D. Del. 2011) (“The Rebuttal Report sets forth proposed revisions, but does not indicate how ‘cherry-picked’ changes would impact the report as a whole.”).
average out, or to have back-up analysis that anticipates a court’s rejection of certain, more aggressive conclusions.\(^9\)

One of the most subjective aspects of a DCF analysis is choosing the discount rate under which a company will be able to raise capital in the future. Due to the subjective nature of picking a discount rate, discount rates which appear to stray too far from others in the case, as well as those that are not meticulously explained, face the risk of being discarded by the court.\(^10\)

As the United States Bankruptcy Court for the Northern District of Texas in \textit{In re Mirant Corp.}\(^9\) demonstrated, the relationship of the selection of a discount rate within a bankruptcy can resemble a chicken and the egg type dilemma.\(^11\) This is because the court might lower the rate if it finds the plan to be feasible; but, of course, in undertaking the analysis the court is actually deciding whether the plan can go forward.\(^12\) Discount rates are often a dispositive part of a plan confirmation analysis, but at their core, are subjective figures. Accordingly, courts often spend a significant amount of time analyzing and determining the discount rate in opinions.

Determining the terminal value of a company also presents issues in valuation cases due to the “snapshot” nature of determining value for a complex business. “A terminal value is a shortcut for determining the debtors’ ability to generate cash flow between the end of the projection period and perpetuity,”\(^13\) and it is calculated at one point in the company’s future. A common issue that emerges in complex chapter 11 cases is how to compute the terminal value for a cyclical business.\(^14\) In a cyclical business, using one point for a terminal value could prove to be

\(^10\) \textit{In re Exide Techs.}, 303 B.R. at 64 (“Newman’s numerous subjective adjustments to the analysis stray too far from the generally accepted method of determining the discount rate. Therefore, I will rely on Derrough’s more straightforward determination of the discount rate.”).
\(^11\) \textit{In re Mirant Corp.}, 334 B.R. at 840.
\(^12\) \textit{Id.}
\(^14\) In bankruptcies in which an entire cycle has not yet passed, this provides a unique problem. See \textit{In re Mirant Corp.}, 334 B.R. at 819.
grossly misrepresentative of a company’s health and potential.\textsuperscript{15} Therefore, it is recommended to “normalize” the projections by averaging out figures across an entire cycle.\textsuperscript{16} Here, the substance of the litigation dispute will be in defining what exactly is the correct business cycle to normalize, and courts will be wary of litigants gaming their definition by either excluding positive or negative years from the cycle.\textsuperscript{17}

\textbf{B. Comparable Company}

The comparable company method derives a debtor’s value from the value relative to the value of its peers. This is a two-part process. First the court calculates a financial indicator of the debtor’s health called an EBITDA (earnings before interest taxes, depreciation, and amortization). Next a multiple of a “healthy” comparable company is applied to the EBITDA to determine the debtor’s value.\textsuperscript{18}

Courts have been quite strict in finding that a company is actually ‘comparable’ enough to be relevant under this analysis. Accordingly, most of the disputes under this analysis turn upon the question of how “comparable” is comparable enough. This is important practically because proving up this method is incredibly complex and time intensive even once a comparable company is chosen. So, ample resources can be wasted if a court finds that a company is not comparable enough to be used to value a debtor. Therefore, when selecting a peer company, one needs to go beyond selecting a mere competitor in the debtor’s industry, to one that essentially is susceptible to the nearly exact same risks and rewards that the debtor is. Thus, a competitor selected for a debtor in the semi-conductor business may not be considered a true “comparable,” even if they also manufacture semi-conductors, if it does not manufacture

\textsuperscript{15} \textit{In re Chemtura Corp.}, 439 B.R. at 582 (Bankr. S.D.N.Y. 2010).
\textsuperscript{16} \textit{Id.}
\textsuperscript{17} \textit{Id.}, at 583
semi-conductors in the same niche of the semi-conductor industry as the debtor, and a relatively young cell phone company may not be considered a comparable to their more mature rivals.

The requirements of actually valuing a comparable company are also complicated. The court is in no way bound to accept an advocate’s suggested multiple to apply to the EBITDA, even if the court is convinced by the veracity of the rest of their analysis, so it is prudent to sever the analysis between subjective and objective equations to avoid the risk of having all of one’s analysis eliminated. Additionally, the multiple selected does not need to be a single number, a range of multiples is acceptable, and in presenting such a range, an advocate will allow a court to be more flexible in accepting their general analysis.

C. Comparable Transactions

The comparable transaction analysis identifies a recent transaction of a comparable peer of a debtor and then scales the price to identify the value of the debtor. The application of the comparable transactions approach is similar to that of the comparable companies’ approach, but more complex, because the comparable entity must be not only comparable enough, but the transaction itself must have been fair and fairly transparent. As a threshold matter in young and/or niche industries, there are no realistic transactions that can be used as a guide under this analysis. So, though more information is generally always better in valuations, a court will bless agreed pragmatism on both sides in forgoing a comparable transactions analysis if it is simply a waste of time. If using this method, though, a court will prefer that the transaction involve a near identical match of the debtor, which, as discussed above in the comparable companies

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21 See In re Exide Techs., 303 B.R. at 62.
22 Id., at 62.
23 See In re Mirant Corp., 334 B.R. at 816.
section, is no easy task.\textsuperscript{24} The transaction itself should be recent\textsuperscript{25} (especially in volatile, cyclical industries), and the details of the transaction should be straightforward and accessible, i.e. the court should not be asked to make a complex valuation (of the consideration exchanged in the transaction) within a complex valuation.\textsuperscript{26} Given that the information might only be available through the cooperation of competitors who are probably not eager to aid a debtor towards rehabilitation, this latter step can prove very difficult.

Additionally, the transactions not included in an analysis might become the main focus of an opponent’s or the court’s attention, especially if these transactions prove prejudicial towards a desired valuation. So, an advocate should be prepared to comment on these outliers with the same familiarity as those included in a valuation report.\textsuperscript{27} Indeed, given that the number of transactions that are arguably relevant will most likely be small, advocates will most likely need to include transactions that might harm their position to maintain credibility with the court.\textsuperscript{28} Given the following limitations, courts want to examine multiple transactions in their analysis, though, if there is a dearth of transactions, the one or two available can still more probative if not dispositive of a debtor’s value.\textsuperscript{29}

\textbf{D. Market Approach}

The market based approach examines the value the market assigns to a debtor or an asset, often by using market evidence to ascertain the total capital value of the debtor or asset. This can be achieved by using the market price assigned to the debtor whether in stock or bond

\textsuperscript{24} See \textit{In re Spansion, Inc.}, 426 B.R. at 135; \textit{supra} “Comparable Company Analysis”.
\textsuperscript{25} \textit{In re Exide Techs.}, 303 B.R. at 62-63 (rejecting transactions in industry where market changed considerably from 1998-2002.).
\textsuperscript{26} See \textit{In re Cellular Information Sys.}, 171 B.R. at 936 (Bankr. S.D.N.Y. 1994) (rejecting a sale where sale terms were too contingent and complicated to discern an actual value paid.); \textit{In re Chemtura Corp.}, 439 B.R. at 585-586 (Transaction does not need to be closed to be considered under analysis if sufficient documentation is available.).
\textsuperscript{27} See \textit{In re Tribune Co.}, 464 B.R. 126, 151 (Bankr. D. Del. 2011).
\textsuperscript{28} \textit{In re Chemtura Corp.}, 439 B.R. at 585-586 (“But to its credit, Lazard used [a transaction which might have hurt its client] in its analysis.”).
\textsuperscript{29} \textit{Id.}, at 586 (Bankr. S.D.N.Y. 2010).
markets. It makes sense that the market should provide the ideal vehicle for determining value. After all, if value is meant to capture the amount of how much consideration that could be brought into the estate after the disposition of the asset, the price an actual buyer is willing to pay seems like perfect evidence. Indeed, the Third Circuit has written “[a]bsent some reason to distrust it, the market price is a more reliable measure of . . . value than the subjective estimates of . . . expert witnesses,” and the United States Supreme Court has expressed its view that market evidence should be used in bankruptcy proceedings when possible. However, the court may be reluctant to only use the market value because of (i) the “taint” of bankruptcy on an asset’s price due to third parties not giving the chapter 11 process enough credit, and (ii) the cloudiness a bankruptcy case may create in valuing an already complex asset.

Therefore, the ideal place for market valuations is to value assets before the bankruptcy took place. For example, while a court may distrust what a buyer is willing to pay for a company engulfed in a bankruptcy proceeding, it will more likely consider the market capitalization value of a debtor as probative, and possibly as a final indicator of value, if this valuation took place while the debtor was healthy. This is particularly so if an exact value does not need to be arrived at and the only question is whether the debtor was not insolvent.

E. Combination of Methods

It is risky, given the intrinsic fragility of valuations combined with the variation of courts’ approaches and preferred methods, to count on a court accepting that only one method in

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30 VFB LLC v. Campbell Soup Co., 482 F.3d 624, 632-33 (3d Cir. 2007).
33 Kenny O’Rourke, Survey: Valuation Uncertainty In Chapter 11 Reorganizations, 2005 COLUM. BUS. L. REV. 403, 417-18 (2005) (discussing Adelphia Communications bankruptcy where thin market existed for such a complex company); Id., at 416 (Potential buyers are often connected to the case, and thus privy to confidential information and restricted by the government); infra, (discussing limitations of a sale indicating value).
34 See In re VFB LLC, 482 F.3d at 624; In re Iridium Operating LLC, 373 B.R. 283 (Bankr. S.D.N.Y. 2007).
valuation proceedings. Therefore, it is advisable to undertake multiple methods, and, possibly, to weigh the valuations out proportionally if one method appears to be less reliable than others. While advocates generally do not, courts have the flexibility of picking bits and pieces of analysis or using different valuations as supporting a finding instead of demanding it. So, as a general rule, the more information, and the more detachable individual pieces of information are from the overall valuation analysis, the better.

III. Applying Models to Bankruptcy Case Situations

When undertaking a valuation, the court will need to select (i) a time to value the collateral, i.e. before the case, the filing date, the hearing date etc., (ii) which party bears the burden of proof, and (iii) at what price to value the property, i.e. fair market or liquidation. There are therefore many permutations of valuation methods. However, individual valuation permutations are typically locked in categorically depending on what Code section applies and what purpose the court is valuing assets.

A. Adequate Protection

“Adequate protection” in bankruptcy proceedings is meant to protect secured creditors from the depreciation of the value of their collateral during a bankruptcy case. Different code provisions work together to mandate that a secured creditor, whose lifeblood in a bankruptcy case is contingent on the collateral on which his claim attaches to, will be protected from losing that value through the depreciation of that collateral during a case. 11 U.S.C. § 361 provides

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35 In re Exide Techs., 303 B.R. 48, 65; In re Chemtura Corp., 439 B.R. at 580-581 (“the difference in technique [of including multiple methods other than DCF] makes the Lazard analysis superior [to one that just used DCF].”); In re Spansion, Inc., 426 B.R. 114, 133 (Expert weighted different methods and multiplied them by a percentile).
three possibilities that a creditor can receive as protection: (i) cash, (ii) alternative liens, or (iii) an otherwise “indubitable equivalent” of value.\textsuperscript{38}

\textbf{1. Section 363: Use Sale, or Lease of Property}

Section 363 concerns adequate protection when a debtor is proposing to or is actually using a secured creditor’s collateral during the case and this collateral is depreciating. The most common situation encountered under § 363 is the use of a creditor’s cash collateral, which obviously depreciates when the debtor spends it, though it can also concern use of assets such as vehicles or equipment.

Valuation takes a central role in § 363 adequate protection, because a court must decide how much the collateral is worth at the time relief is sought\textsuperscript{39} compared to the value of the collateral at the filing date. The burden of proof for valuation is on the debtor in any hearing under § 363.\textsuperscript{40} The court will use a fair market valuation\textsuperscript{41} of the collateral. This is because using a ‘liquidation value’ of the collateral would almost always permit a debtor to reap a ‘windfall’ by, after paying minimum adequate protection, selling collateral at the fair market price and “pocketing equity that would have been completely beyond reach save for the filing of the bankruptcy petition.”\textsuperscript{42}

If adequate protection is needed, the court will also value what is offered to replace the depreciation in collateral. Cash is the best and most easily valued asset, but, during a

\textsuperscript{38} 11 U.S.C. § 361.
\textsuperscript{39} In re Waverly Textile Processing, 214 B.R. 476, 479 (Bankr. E.D. Va. 1997) (holding that the date the creditor filed the motion for adequate protection is the proper date for valuing the collateral for adequate protection purposes).
\textsuperscript{40} 11 U.S.C. § 363(p)(1).
\textsuperscript{42} In re Winthrop Old Farm Nurseries, 50 F.3d at 76.
bankruptcy, of course, cash can be scarce. Still, some real value needs to be given and, though the debtor may offer “replacement liens,” these liens need to actually and meaningfully protect the creditor’s secured position. Likewise the proposition of brighter days ahead for the debtor cannot provide adequate protection absent some other insuring transfer to the creditor. Examples of courts valuing offered adequate protection include:

- In *In re O’Connor*, the court upheld a decision by the bankruptcy court that valued replacement liens on the proceeds of promising oil and gas properties as adequately protecting lienholders who held liens on the cash to be used to build these properties.

- In *In re Smithville Crossing*, the court found that the debtor, proposing to use cash from rents, offered no new value to a creditor who held a lien on these rents, when the debtor only offered to allow the creditor to retain its lien on these rents in the future.

An interesting, recurring issue arises when adequate protection payments, often agreed to ahead of time, turn out to be not needed in a case, *i.e.* the collateral did not depreciate to the extent contemplated. Normally, a court will value this amount as credited against the creditor’s secured debt, as the payments were meant to stand in for the security. However, if a creditor holds a Bankruptcy Code § 552(b) claim that entitles that creditor to a security interest in the continued, postpetition cash collateral or rent proceeds of the debtor, than the adequate protection payments are to be paid out of this continuing accumulation of collateral, and, therefore, should be applied against the principal amount of debt held by a creditor.

2. **Section 364(d): DIP Financing & Priming Liens**

A debtor in possession (DIP) that needs and is otherwise unable to secure funding postpetition may obtain funding by offering “priming liens” in exchange for financing under

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44 *See In re O’Connor*, 808 F.2d 1393, 1396 (10th Cir. 1987).
46 *See e.g., In re Geijsel*, 480 B.R. at 266-68 (citing 3 Collier on Bankruptcy ¶ 361.03 [2] [a] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed. 2011).
§ 364(d)(1). These liens are “prime” because they are superpriority liens and move ahead of previous first liens on specific estate property.\textsuperscript{47} Valuation is necessary under § 364(d)(1) because a court must be assured that previous senior lien holders will be adequately protected. Thus, a court must value the extent of the existing lien compared to the offered adequate protection. The court values the current senior lien holder’s secured interest at the time of the filing,\textsuperscript{48} and the burden of proving adequate protection is on the debtor seeking the financing.\textsuperscript{49} This is a heavy burden as courts are understandably reluctant to potentially sweep away the bargained for lien of a secured creditor.\textsuperscript{50} Therefore, like under § 363, the debtor must offer something other than the ability to bring in more cash as adequate protection to the estate, and instead needs to offer tangible assurance. For example, in In re YL West 87\textsuperscript{th} Holdings I LLC, the court found that the continued construction of a real estate project, to be funded by “primed” DIP financing, would not provide sufficient value to protect the creditor that held a lien on the real property that was to become subservient to the DIP lien.\textsuperscript{51}

3. Section 362: Automatic Stay

The automatic stay gives numerous protections to the debtor, including keeping creditors from foreclosing on or repossessing the estate’s property during the bankruptcy case. Valuation plays a double factor in these motions because the creditor can lift the stay if it is not adequately protected and also can lift the stay in some circumstances where the debtor does not have equity in the pertinent property.\textsuperscript{52} As discussed above, valuation is integral in determining adequate

\textsuperscript{47} See In re Levitt & Sons, LLC, 384 B.R. 630, 640-641 (Bankr. S.D. Fla. 2008).
\textsuperscript{48} Id., at 643-644.
\textsuperscript{49} In re YL West 87\textsuperscript{th} Holdings I LLC, 423 B.R. 421, 431 n. 44 (Bankr. S.D.N.Y. 2010); 11 U.S.C. § 364(d)(2).
\textsuperscript{50} Id., at 431 (citing In re Seth, 281 B.R. 150, 153 (Bankr. D. Conn. 2002)).
\textsuperscript{51} In re YL West 87\textsuperscript{th} Holdings I LLC, 423 B.R. at 431 (quoting Suntrust Bank v. Den-Mark Constr., Inc (In re Den-Mark Constr., Inc.), 406 B.R. 683, 689 (E.D.N.C. 2009) (citing Resolution Trust Corp. v. Swedeland Dev. Group, Inc. (In re Swedeland Dev. Group, Inc.), 16 F.3d 552, 564 (3rd Cir. 1994)).
\textsuperscript{52} 11 U.S.C. 362(d)(2)(A). The other factor for this prong is whether the property is not needed for an effective reorganization which, though will depend on some valuation, is a more holistic, opinion-based inquiry.
Further, in order to determine whether a debtor has equity in the property the court will have to value the collateral to offset against the creditor’s claim. For example, in *In re Davenport*, the court found that the creditor could lift the automatic stay and liquidate stock it held a lien on where the debtor had no equity in stock of a corporation when the court found the price for the stock wholesale was less than the market rate for an individual share.  

Accordingly, it is generally accepted that the valuation should take place at or close to the time the relief is sought, in order to be “consistent with the Code” of maintaining the fluidity of § 362. Determining whether to value the collateral at fair market or liquidation value turns to how the debtor proposes to use the property, which in the context of a chapter 11 in which the debtor is trying to reorganize will most likely be fair market value. Recent cases have incorporated this fluid, pragmatic approach:

- In *In re Deep River Warehouse Inc.*, the court found that, because it was valuing a debtor in chapter 11, that fair market valuation should be used, and valued the property on the date of the lift-stay hearing.  
- In *In re Global Ship Sys.*, the court found that a creditor could lift the stay when the most recent appraisal of the property valued it at $16 million at fair market value, and the creditor’s debt was $37 million.

### 4. Section 507(b): Superpriority Claims for Failure of Adequate Protection

Section 507(b) of the Bankruptcy Code grants a superpriority expense claim under § 503(b) where adequate protection payments prove insufficient to compensate a secured creditor for the diminution in the value of its collateral. “It is an attempt to codify a statutory fail-safe system in recognition of the ultimate reality that protection previously determined the

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53 *See supra* pp. 9-11.  
'indubitable equivalent’ . . . may later prove inadequate.” Under § 507(b), valuation will be important because the court must decide (i) how much protection the creditor received and (ii) how much the creditor deserved based on the value of its collateral at the time of the filing.

It is unclear who bears the burden regarding valuation under § 507(b). Though, the Fourth and Fifth Circuits have held that creditors “have the burden to prove their entitlement to § 507(b) [claims],” the Circuits were discussing the burden of proving that the diminution of the value occurred in order to benefit the estate. This does not concern the burden of proving value, and under §363, the creditor has the burden on proving everything besides the value of the collateral, with the burden on the debtor to prove adequate protection vis-a-vis valuation.

Conversely, under § 362, the creditor has the burden of proving lack of adequate protection in order to foreclose or repossess the property. Given these conflicting and limiting influences, the question of who has the burden in valuing collateral under § 507(b) is therefore part of what the Southern District of New York and the First Circuit deemed the “complex maze of ambiguous statutory provisions and opaque, inconsistent case law” under the vaguely worded but immensely complex § 507(b). Perhaps the best way to view the issue, is that, unlike under § 363, in which adequate protection can be denied simply in principle, in a § 507(b) hearing two valuations will have to be determined, and thus the court will simply decide the matter via a preponderance of the evidence on an even playing field.

Adding to the confusion of valuation issues under § 507(b) is the question of whether the valuation of the creditor’s interests should take place under fair market or liquidation value.

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58 (In re Scopac), 624 F.3d at 282 (5th Cir. 2010) (citing In re Carpet Ctr. Leasing Co., Inc., 4 F.3d 940, 941 (11th Cir. 1993)).
59 In re Scopac, 624 F.3d at 284 (quoting Ford Motor Credit Co. v. Dobbins, 35 F.3d 860, 866 (4th Cir. 1994)).
Section 507(b) often follows a failed plan and/or a liquidation or hurried disposition of a creditor’s collateral, so it seems logical that the creditor’s interests should be valued at liquidation value at the time of the plan. However, courts have split on the issue:

- In *In re Scopac*, the Fifth Circuit affirmed the bankruptcy court’s use of fair market value in valuing the creditor’s collateral when it took into account the long-term benefit of improvements to a lumber property, such as roads and watershed analysis.\(^{62}\)

- In *In re Modern Warehouse, Inc.*, the court found that liquidation value was appropriate because a creditor is only entitled to be protected from a worst-case scenario. As the property ultimately was liquidated, the court used this price.\(^{63}\)

Therefore, it appears as though the facts and circumstances of an individual case might dictate which valuation is selected by a court.\(^{64}\)

### B. Postpetition Interest and Fees

Under § 506(b) a secured creditor, if it is oversecured, may recover fees and interests to the extent it is oversecured. Thus, if a secured creditor has a claim worth $800 on collateral worth $1000, but has accrued interest during the course of the case, it can collect that interest up to $200. The modern view holds that the right to accrue interest begins immediately when a creditor is oversecured and ceases when the creditor becomes undersecured\(^{65}\) and the creditor’s right to be paid is at the time of confirmation or dismissal of the case.\(^{66}\) A creditor can become over or under secured at any point during the case. Thus, a hearing can be held at any time under § 506(b). At that hearing, the creditor will bear the burden “to prove by a preponderance of

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\(^{62}\) See *In re Scopac*, 624 F.3d at 285.

\(^{63}\) See *In re Modern Warehouse, Inc.*, 74 B.R. 173, 177 (Bankr. W.D. Mo. 1987) (citing *In re American Mariner Indus.*, 734 F.2d 426, 435 (9th Cir. Cal. 1984)).

\(^{64}\) Cf. *In re Winthrop Old Farm Nurseries*, 50 F.3d at 73-74 (“In any particular case, especially a reorganization case, the determination of which entity should be entitled to the difference between the going concern value and the liquidation value must be based on equitable considerations arising from the facts of the case.”).


\(^{66}\) In re T-H New Orleans Ltd. P’shp., 116 F.3d at 799.
evidence its entitlement to postpetition interest, that is, that its claim was oversecured, to what extent, and for what period of time.\textsuperscript{67}

Therefore, especially in elongated cases with perishable or fickly priced collateral, practitioners will need to stay attuned to the status of collateral. For example, in \textit{In re Geijsel}, the court found that the creditor was undersecured at the time of the petition date, but became oversecured as its collateral appreciated during the case and became entitled to interest and fees.\textsuperscript{68}

\textbf{C. Section 1129: Plan Confirmation}

Any Bankruptcy Code § 1129 ‘cramdown’ hearing, in which a court confirms a bankruptcy reorganization plan against the wishes of at least one dissenting creditor group, will contain important valuation issues. This is because § 1129 contains numerous requirements that a plan must pass before a court can approve it, notably that the plan be fair and equitable,\textsuperscript{69} and that the plan not pay off any junior creditors ahead of senior ones under the ‘absolute priority rule.’\textsuperscript{70} Thus, valuation within a § 1129 confirmation hearing is essentially the determination of two things: (i) how much “pie” there is in the form of the value of the debtor and (ii) how big everyone’s respective piece is.\textsuperscript{71} Therefore, a court must find that a debtor, who has not convinced at least one group of creditors that the plan is fair, really is paying off all claims fairly \textit{vis-a-vis} the value of the debtor, the value of that claim, and the value of other claims; and this must be done through valuation.

\textsuperscript{67} \textit{In re T-H New Orleans Ltd. P'shp.}, 116 F.3d at 798 (citing \textit{In re Grabill Corp.}, 121 B.R. 983, 991-92 (Bankr.N.D.III.1990)).
\textsuperscript{68} \textit{See In re Geijsel}, 480 B.R. at 262-264.
\textsuperscript{69} 11 U.S.C. § 1129(b)(2).
\textsuperscript{70} \textit{In re Exide Techs.}, 303 B.R. at 60-61; \textit{In re Spansion, Inc.}, 426 B.R. at 130 (determining whether a plan is fair or equitable requires the valuation of a debtor.).
\textsuperscript{71} O’Rourke, 2005 \textit{COLUM. BUS. L. REV.}, at 407-408.; \textit{See also In re Johns-Manville Corp.}, 68 B.R. 618, 636 (Bankr. S.D.N.Y. 1986) This is particularly important to equity holders, as, if the court finds that, upon confirmation the amount of debt exceeds the value of a debtor, than equity is not only not entitled to, but is forbidden from receiving returns under the Plan.
Under § 1129, collateral is valued at the time of confirmation as a going concern, because the debtor is presumably proposing to use creditors’ collateral to effectuate a successful reorganization. Thus, secured creditors will enjoy the benefit of having their collateral valued at a fair market rate, while also potentially being prejudiced in that their collateral may not be being used for its most valuable purpose. Courts value the collateral at the time of confirmation, because to value it at another time, such as the filing date, would eviscerate the purpose of adequate protection under the Bankruptcy Code. This is because a creditor must take specific, affirmative actions to recover the loss in value of their collateral during the pendency of a bankruptcy case.

The solicitation or continuing negotiation of a sale of a debtor during valuation hearings has become a recent, overall welcome trend. Courts are becoming somewhat more market-friendly in their valuation approach, and the presence of actual bidders putting their money where their valuation mouth acts as a useful tool for courts to gauge valuation. Still, not all sale discussions are created equal. For example,

- In *Beal Bank S.S.B. v. Waters Edge Ltd. P’shp.*, the court found that a sale price offered to insiders of the debtor entitled much scrutiny to determine whether it was fair and equitable.
- In *In re Scopac*, the court found that a sale offer offered as evidence during a § 1129 hearing was not particularly probative where the buyers did not appear to be serious in their negotiations.

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72 Indeed, even if a sale is proposed by the debtor, this same valuation will apply. See *Heritage Highgate, Inc. v. Scaglotti*, 679 F.3d 132, 144-145 (3d Cir. 2012).
73 Cf. *In re Nice*, 355 B.R. 554, 563 (Bankr. N.D. W. Va. 2006); supra “Adequate Protection”.
75 *Beal Bank, S.S.B. v. Waters Edge Ltd. P’shp.*, 248 B.R. 668, 680 (D. Mass. 2000) (“To be sure, insider private transactions, which are not at arms’ length, raise the very real spectre that insiders might receive favorable terms at the expense of impaired creditors. Because of the lack of market valuation or competitive bidding, such insider transactions require greater scrutiny by the bankruptcy court to ensure fairness.”).
So, courts will look more favorably on sales that are arms’ length, supplemented by current valuation testimony\textsuperscript{77} and that are preferably offered seriously by the buyer instead of resulting from superficial solicitation by the debtor. Nevertheless, it is almost always a good idea to complement a § 1129 valuation analysis with any sale data, because, at the very least, “[r]eorganization practice illustrates that the presence of competing bidders for a debtor, whether they are owners or not, tends to increase creditor dividends.”\textsuperscript{78}

### D. Fee Enhancement

In bankruptcy cases, a series of decisions have permitted professionals compensated by the bankruptcy estate to receive an enhanced fee “in rare and exceptional circumstances.”\textsuperscript{79} In determining the reasonableness of fees paid by the bankruptcy estate, bankruptcy courts have a number of factors to consider. First, courts are to calculate the “lodestar,” which calculates a “reasonable” fee for similar work. \textsuperscript{80} Second, twelve factors are generally considered in determining the reasonableness of professional fees, in and outside of the bankruptcy context. In the Fifth Circuit, these factors are set forth in the touchstone case of \textit{Johnson v. Ga. Highway Express, Inc.}\textsuperscript{81} which are utilized by the courts in the Fifth Circuit and other courts. \textsuperscript{82} Third, Bankruptcy Code § 330 also sets forth certain factors for determining the reasonableness of fees. \textsuperscript{83} From there, bankruptcy courts have “discretion to adjust the lodestar upwards or downwards” in consideration of the \textit{Johnson} factors and Bankruptcy Code § 330.

\textsuperscript{77} \textit{In re Exide Techs.}, 303 B.R. at 59.
\textsuperscript{78} \textit{Bank of Am. Nat’l Trust & Sav. Ass’n}, 526 U.S. at 457-58.
\textsuperscript{79} \textit{In re Pilgrim’s Pride Corp.}, 690 F.3d 650, 660 (5th Cir. 2012); see also \textit{In re Market Center East Retail Property, Inc.}, 469 B.R. 44, 52 (B.A.P. 10th Cir. 2012); \textit{In re Trailer Source, Inc.}, 474 B.R. 846, 850 (Bankr. M.D. Tenn. 2012).
\textsuperscript{80} \textit{In re Pilgrim’s Pride Corp.}, 690 F.3d 650, 655 (5th Cir. 2012).
\textsuperscript{81} 488 F.2d 714 (5th Cir. 1974).
\textsuperscript{82} See, e.g., \textit{In re Market Center East Retail Property, Inc.}, 469 B.R. 44, 52 (B.A.P. 10th Cir. 2012); \textit{In re Ohio Indus., Inc.}, 299 B.R. 853, 858 (Bankr. N.D. Ohio 2003).
In analyzing the reasonableness of a fee enhancement, courts do not engage in a separate valuation analysis, outside determining the lodestar, and instead consider the facts and circumstances of the case, which may involve valuations made in the bankruptcy case. For example,

- **In In re Lawler**, the court found that a fee enhancement justified where valueless estate was transformed into one worth “approximately $29 million.”

- **In In re Market Center East Retail Property, Inc.**, the court generally considered facts from the bankruptcy case in determining a fee enhancement was warranted.

- **In In re Mirant Corp.**, the court allowed a fee enhancement for counsel to an equity committee, pointing specifically to the fact that only two lawyers were present for a key hearing on valuation.

- **In In re Janata**, the court noted that the efficiency of the professionals “yielded a generous creditor payout” and awarded a fee enhancement.

Thus, valuations made in a bankruptcy case may provide helpful benchmarks for the court to consider in a fee enhancement analysis, but valuation is not a necessary part of this analysis.

**E. Avoidance Actions**

Chapter 5 of the Bankruptcy Code provides a bankruptcy trustee, or debtor in possession, several tools to avoid certain transfers, occurring both prior to the bankruptcy and during, assuming certain requirements are met. Several of these requirements necessitate valuation of the debtor and/or property of the debtor.

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84 The lodestar is “is equal to the number of hours reasonably expended multiplied by the prevailing hourly rate in the community for similar work.” In re Pilgrim’s Pride Corp., 690 F.3d 650, 655 (5th Cir. 2012).

85 807 F.2d 1207, 1209 (5th Cir. 1987).

86 469 B.R. 44, 55 (B.A.P. 10th Cir. 2012).

There are two primary avoidance actions that arise due to transfers occurring prior to the bankruptcy. The first is preferential transfers under Bankruptcy Code § 547, and the second is fraudulent transfers under Bankruptcy Code § 548.

1. Preferential Transfers

   a. Solvency of the Debtor

   In order to prove a transfer is preferential, valuation of the debtor pre-bankruptcy is a critical requirement. Bankruptcy Code § 547(b)(3) requires that the transfer be made while the debtor was insolvent. Reducing valuation issues in preference litigation, Bankruptcy Code § 547(f) provides that “[f]or the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition,” the same time frame where transfers are subject to avoidance under this statute. However, this presumption may be rebutted by evidence of solvency, thereby shifting the burden to the trustee to prove insolvency.

   The term “insolvent” is actually defined in the Bankruptcy Code, where insolvency exists if the sum of [an] entity’s debts is greater than all of such entity’s property, at a fair valuation. This definition generally requires a “balance sheet test,” where courts look at whether the debtor’s assets were exceeded by its liabilities at the time of the transfer.

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88 In certain circumstances, insolvency may be difficult to determine on the exact date of transfer. To solve this issue, courts often use “retrojection” and “projection” which “provide for the use of evidence of insolvency on a date before and after the preference date as competent evidence of the debtor’s insolvency on the preference date.” In re Bruno Machinery Corp., 435 B.R. 819, 838 (Bankr. N.D.N.Y. 2010) (citing Coated Sales, Inc. v. Glantz (In re Coated Sales, Inc.), 144 B.R. 663, 666 (Bankr. S.D.N.Y.1992)).


90 Jones Truck Lines, Inc. v. Full Service Leasing Corp., 83 F.3d 253, 258 (8th Cir. 1996). In fact, the trustee bears the burden of proving each of the required elements of Bankruptcy Code § 547(b) by a preponderance of the evidence. Cadle Co. v. Mangan (In re Flanagan), 503 F.3d 171, 180 (2d Cir. 2007) (citing Lawson v. Ford Motor Co. (In re Roblin Indus., Inc.), 78 F.3d 30, 34 (2d Cir. 1996)).


While liabilities may be easily established by the debtor’s books and records, the value of the debtor’s property requires valuation at “fair valuation.” Generally, courts adopt a “fair market” approach to valuating the debtor’s assets.\textsuperscript{93} Fair market, however, depends on whether the property should be valued on a going-concern basis or liquidation value.\textsuperscript{94} Additionally, when valuating a publicly traded company, market value of the entire enterprise is also a proper and preferred metric for valuation. For example, in \textit{In re TOUSA, Inc.}, the bankruptcy court found that the “observable market approach,” which looks at the sum of the market values of a company’s debt and equity” to determine enterprise, was “a reliable and credible test for determining the solvency” of the applicable debtors.\textsuperscript{95}

\begin{itemize}
\item[b.] \textbf{Transfer Results in Creditor Getting More Than it Would in a Hypothetical Chapter 7 Liquidation}
\end{itemize}

Yet another valuation issue in the avoidance of preferential transfers is the requirement that the transfer must also result in the creditor getting more than it would in a hypothetical chapter 7 liquidation. This analysis is at its simplest when dealing with payments to unsecured creditors in the 90 days preceding the bankruptcy case. If the distribution in a hypothetical chapter 7 liquidation to unsecured creditors is less than 100%, then any payment to an unsecured creditor would result in that creditor getting more.\textsuperscript{96} On the contrary, generally, transfers to fully secured creditors are not preferential because secured creditors are entitled to payment of 100%

\begin{footnotesize}
\textsuperscript{93} \textit{Briden v. Foley}, 776 F.2d 379, 382 (1st Cir. 1985); see also \textit{In re TOUSA, Inc.}, 422 B.R. 783, 806 (Bankr. S.D. Fla. 2009) (court found it was reasonable for expert to value homebuilding assets by “assessing the price that a hypothetical willing buyer would have paid a hypothetical willing seller for the assets on or about that date, assuming no undue pressure on either party, and with a reasonable period of time to consummate a transaction”).

\textsuperscript{94} \textit{Briden v. Foley}, 776 F.2d 379, 382 (1st Cir. 1985); \textit{Wolkowitz v. American Research Corp. (In re DAK Indus.)}, 170 F.3d 1197, 1200 (9th Cir. 1999); \textit{Gillman v. Scientific Research Prods. Inc. of Del. (In re Mama D’Angelo, Inc.)}, 55 F.3d 552, 555-56 (10th Cir. 1995); \textit{In re TOUSA, Inc.}, 422 B.R. 783, 860 (Bankr. S.D. Fla. 2009).

\textsuperscript{95} \textit{In re TOUSA, Inc.}, 422 B.R. 783, 825-26; see also \textit{In re Iridium Operating LLC}, 373 B.R. 283, 303-04 (Bankr. S.D.N.Y. 2007) (where court was presented with competing valuations for the total enterprise value of the debtor, court preferred “standard” of market price versus discounted cash flow model).

\textsuperscript{96} \textit{In re Lewis W. Shurtleff, Inc.}, 778 F.2d 1416, 1421 (9th Cir. 1985).
\end{footnotesize}
of their claims in a chapter 7. Thus, when dealing with secured creditors, the valuation of collateral under Bankruptcy Code § 506 is critical to determining whether the creditor is fully secured (transfer not preferential) or undersecured (transfer may be preferential).

c. Defenses to Preference Actions and Related Valuation Issues

(i) Contemporaneous Exchange of New Value Defense

Even if a transfer otherwise meets all of the requirements of Bankruptcy Code § 547(b) to be a preferential transfer, the transfer may not be avoided if certain defenses apply. One such defense exists if the transfer was made as a part of a contemporaneous exchange of new value under Bankruptcy Code § 547(c)(1).

The term “new value” is defined in Bankruptcy Code § 547(a)(2) to mean money or money’s worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation. Ultimately, new value is given if the estate was not diminished or depleted due to the transfer. However, like valuation of the debtor’s assets in a solvency analysis, fair market is typically the proper standard for assigning an amount of new value given. In establishing that new value was given, the burden rests on the creditor to prove new value, as well as for every other defense under Bankruptcy Code § 547(c).

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97 In re Smith’s Home Furnishings, Inc., 265 F.3d 959, 964 (9th Cir. 2001).
98 There is a split as to how to determine whether the transfer was in fact substantially contemporaneous. Some courts utilize the ten-day period specified in the relation-back provision of § 547(e)(2)(A) while other courts make the determination on a case-by-case basis. In re Hedrick, 524 F.3d 1175, 1186 (11th Cir. 2008). It is this date where the determination is made whether new value was in fact given.
100 Velde v. Kirsch, 543 F.3d 469, 47273 (8th Cir. 2008) (citing Endo Steel, Inc. v. Jonas (In re JWJ Contracting Co. Inc.), 371 F.3d 1079, 1081 (9th Cir.2004)).
101 See e.g., In re Adelphia Automatic Sprinkler Co., 184 B.R. 224, 228 (E.D. Pa. 1995) (rejecting bankruptcy court valuation of new value where, inter alia, the record did not contain any indication of fair market value of alleged new value).
102 United Rentals, Inc. v. Angell, 592 F.3d 525, 531 (4th Cir. 2010).
(ii) Subsequent New Value Defense

Another exception which hinges on valuation is the subsequent new value defense of Bankruptcy Code § 547(c)(4). Under this exception, if a creditor gives new value after the transfer, and that new value is not secured by an otherwise unavoidable security interest and is not an otherwise avoidable transfer to such creditor, the transfer is not avoidable.

New value under this defense means the same as for the contemporaneous exchange defense—value at fair market value. Thus, the creditor must prove that the new value given caused the debtor’s estate to be depleted or diminished as a result of the transfer. Additionally, for timing purposes, the new value must be made on, and consequently its valuation based upon, a date after the preferential transfer.

(iii) Security Interests in Inventory or Receivables Exception

A third defense to preferential transfers where valuation plays a key role is the exception under Bankruptcy Code § 547(c)(5). Under this defense, a voidable preferential transfer does not occur if a secured creditor, holding a security interest in the debtor’s inventory or receivables, did not improve its position over the ninety-day period preceding the bankruptcy. To determine if a secured creditor improved its position, the “two-point net improvement” test is utilized. This test requires the computation of:

a. the loan balance outstanding ninety days prior to the bankruptcy;

b. the value of the collateral on that day;

c. the loan balance outstanding on the day the bankruptcy petition was filed; and

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104 In re IRFM, Inc., 52 F.3d 228, 231 (9th Cir. 1995).
d. the value of the collateral on that day.\textsuperscript{105}

Thus, valuation of the collateral is critical to determining whether the secured creditor’s position was improved as a result of the transfer. Valuation of collateral depends on the facts and circumstances, but generally, in a chapter 7 case, market value at liquidation is used,\textsuperscript{106} while in a reorganization, market value of a going concern is the proper metric.\textsuperscript{107} Additionally, when making this determination, valuation should be from the perspective of the creditor.\textsuperscript{108} Ultimately, however, principles of valuing collateral in this context should be no different than valuation of collateral under Bankruptcy Code § 506.

2. **Fraudulent Transfers**

Bankruptcy Code § 548 generally permits a trustee to avoid a transfer of an interest of the debtor in property, or any obligation incurred by the debtor, made on or within 2 years prior to the bankruptcy if the transfer was made with the actual intent to hinder, delay, or defraud a creditor.\textsuperscript{109} Such a transfer is also avoidable, even if there was no actual fraud, if certain requirements, amounting to constructive fraud, are met.\textsuperscript{110} To satisfy these requirements, valuation plays a critical role.

The constructive fraud necessary to avoid a transfer is two part in nature. The first part requires determination of whether the debtor received “less than a reasonably equivalent value in

\textsuperscript{105} In re Clark Pipe and Supply Co., Inc., 893 F.2d 693, 697 (5th Cir. 1990) (quoting In re Missionary Baptist Found. of Am., Inc., 796 F.2d 752, 760 (5th Cir. 1986)).

\textsuperscript{106} See, e.g., In re Ebbler Furniture and Appliances, Inc., 804 F.2d 87, 91 (7th Cir. 1986).

\textsuperscript{107} See, e.g., In re Lackow Bros., Inc., 752 F.2d 1529, 1532 (11th Cir. 1985).

\textsuperscript{108} In re Clark Pipe and Supply Co., Inc., 893 F.2d 693, 698 (5th Cir. 1990).

\textsuperscript{109} Bankruptcy Code § 548 is not the only method by which a trustee may avoid a fraudulent transfer. Pursuant to Bankruptcy Code § 544, a trustee can avoid certain transfers that are voidable under “applicable law.” 11 U.S.C. § 544(b). There are two uniform acts which are broadly adopted in the United States, including the Uniform Fraudulent Transfer Act and the Uniform Fraudulent Conveyance Act. These statutes utilize similar terminology to Bankruptcy Code § 548, and, in fact, courts often consider cases interpreting such similar terminology to their analysis of the applied statute.

\textsuperscript{110} To prove a fraudulent transfer, whether by actual fraud or otherwise, the trustee bears ultimate burden of proof. See In re Hannover Corp., 310 F.3d 796, 802.
Courts often wrestle with the term of “reasonably equivalent value,” but certain principles, by statute and by case law, have emerged.

Value itself is defined in Bankruptcy Code § 548(d)(2)(A) to mean “property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor.” Courts construe this definition broadly, where value can include any benefit, whether direct or indirect, even including an opportunity to receive an economic benefit in the future.”

Furthermore, for timing purposes, value should be determined at the time of the transfer.

To determine whether the value furnished is “reasonably equivalent,” courts typically consider the fair market value or what would be the fairly equivalent value of the property, taking into consideration all of the specific circumstances of each case affecting the value of the asset. However, it should be noted that if the property is ultimately sold at a foreclosure sale, that price is “reasonably equivalent value” so long as all the requirements of the applicable state foreclosure law have been complied with.

The second part of the constructive fraud analysis is itself multipart. First, the debtor must be found insolvent on the date of the allegedly fraudulent transfer, or became insolvent as a
result of the transfer. This insolvency analysis is no different than with respect to preferences and Bankruptcy Code § 547(b)(3).

Second, the debtor must have been engaged in business or a transaction, or about to have engaged in business or a transaction, for which any property remaining with the debtor was an “unreasonably small capital.” Like “reasonably equivalent value,” this phrase is not defined by the Bankruptcy Code. This terminology has been interpreted to generally denote a “financial condition short of equitable insolvency.”

Further explained,

[A]n ‘unreasonably small capital’ refer[s] to the inability to generate sufficient profits to sustain operations. Because an inability to generate enough cash flow to sustain operations must precede an inability to pay obligations as they become due, unreasonably small capital would seem to encompass financial difficulties short of equitable solvency.

Additionally, the analysis should be broad, considering all reasonably anticipated sources of operating funds (including, but not limited to, new equity infusions, cash from operations, or cash from secured or unsecured loans), as well as the objective reasonableness of the debtor’s financial projections.

3. Liability of Transferee for Avoided Transfers

After a transfer is avoided pursuant to, inter alia, Bankruptcy Code §§ 547 or 548, the trustee can either have the property returned, or the trustee may recover “the value of such property.” To determine the value of the property, consistent with the valuation principles in other contexts, courts should consider the fair market price. The valuation should be

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117 Id.
120 See, e.g., Active Wear, Inc. v. Parkdale Mills, Inc., 331 B.R. 669, 673 (W.D. Va. 2005) (“Case law and statutory law demand that the value which must be assigned to the yarn in this case is the fair market value that could be obtained for the yarn in a liquidation sale held by Active Wear.”); Hirsch v. Steinberg (In re Colonial Realty Co.), 226 B.R. 513, 525 (Bankr. D. Conn. 1998) (“Courts generally agree that the market value of the property at the time of transfer, less the consideration received, is the proper measure of recovery under § 550.”) (citations omitted);
determined at the time of the transfer;\textsuperscript{121} however, this is not an iron-clad rule, as courts should consider the individual circumstances of the case.\textsuperscript{122}


\textit{USAA Fed. Savings Bank v. Thacker (In re Taylor)}, 599 F.3d 880, 890 (9th Cir. 2010).

\textit{In re Integra Realty Resources, Inc.}, 354 F.3d 1246, 1267 (10th Cir. 2004).
APPENDIX I: VALUATION GUIDE
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<td>Fee enhancements</td>
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<td>Lodestar is determined by calculating the number of hours reasonably expended multiplied by the prevailing hourly rate in the community for similar work. <em>In re Pilgrim’s Pride Corp.</em>, 690 F.3d 650, 655 (5th Cir. 2012). No separate valuation analysis.</td>
<td>The burden of proof to establish each of the elements of § 547(b) by a preponderance of the evidence rests on the trustee in bankruptcy. <em>Cadle Co. v. Mangan</em> (<em>In re Flanagan</em>), 503 F.3d 171, 180 (2d Cir. 2007) (citing <em>Lawson v. Ford Motor Co.</em> (<em>In re Roblin Indus., Inc.</em>), 78 F.3d 30, 34 (2d Cir. 1996)).</td>
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<td>547 Preference: Insolvency of the Debtor</td>
<td>Generally, on the date of the transfer, but courts often use “retrojection” and “projection” to determine insolvency of debtor. <em>In re Bruno Machinery Corp.</em>, 435 B.R. 819, 838 (Bankr. N.D.N.Y. 2010) (citing <em>Coated Sales, Inc. v. Glantz</em> (<em>In re Coated Sales, Inc.</em>), 144 B.R. 663, 666 (Bankr. S.D.N.Y. 1992)).</td>
<td>Generally, insolvency exists if “the sum of [an] entity’s debts is greater than all of such entity’s property.” 11 U.S.C. § 101(32)(A). Ultimately, courts use a “balance sheet test” to determine insolvency, which looks to whether the debtor’s assets were exceeded by its liabilities at the time of the transfer. <em>In re Bruno Machinery Corp.</em>, 435 B.R. 819, 838 (Bankr. N.D.N.Y. 2010). Generally, fair market value is the basis of the debtor’s assets. <em>Briden v. Foley</em>, 776 F.2d 379, 382 (1st Cir. 1985). If debtor is on its “deathbed” at time of transfer, liquidation value should be used rather than going concern or market value. <em>In re CXM, Inc.</em>, 336 B.R.757, 761 (Bankr. N.D. Ill. 2006) ((citing <em>In re Taxman Clothing Co., Inc.</em>, 905 F.2d 166, 170 (7th Cir. 1990); <em>Fryman v. Century Factors, Factor for New Wave</em> (<em>In re Art Shirt Ltd.</em>), 93 B.R. 333, 341 (E.D. Pa. 1988); <em>Neuger v. Casgar</em> (<em>In re Randall Construction</em>), 20 B.R. 179, 183-84 (N.D. Ohio 1981)).</td>
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<td>547 Preference: Hypothetical Chapter 7 Liquidation</td>
<td>Valuation typically as of the date of the bankruptcy filing. <em>In re Smith’s Home Furnishings, Inc.</em>, 265 F.3d 959, 964 (9th Cir. 2001).</td>
<td>If the distribution in bankruptcy to unsecured creditors is less than 100%, then any payment to an unsecured creditor would result in that creditor getting more than it would in a hypothetical chapter 7 liquidation. <em>In re Lewis W. Shurtleff, Inc.</em>, 778 F.2d 1416, 1421 (9th Cir. 1985). Transfers to fully secured creditors are typically not preferential because secured creditors are entitled to payment of 100% of their claims in a chapter 7. <em>In re Smith’s Home Furnishings, Inc.</em>, 265 F.3d 959, 964 (9th Cir. 2001). Valuation is typically the same as Bankruptcy Code § 506 valuation, since valuation is of a creditor’s collateral.</td>
<td>The burden of proof to establish each of the elements of § 547(b) by a preponderance of the evidence rests on the trustee in bankruptcy. <em>Cadle Co. v. Mangan</em> (<em>In re Flanagan</em>), 503 F.3d 171, 180 (2d Cir. 2007) (citing <em>Lawson v. Ford Motor Co.</em> (<em>In re Roblin Indus., Inc.</em>), 78 F.3d 30, 34 (2d Cir. 1996)).</td>
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<td>Generally, new value is given if the contemporaneous exchange does not diminish or deplete the estate. <em>Velde v. Kirsch</em>, 543 F.3d 469, 47273 (8th Cir. 2008) (citing <em>Endo Steel, Inc. v. Jonas (In re JWJ Contracting Co., Inc.)</em>, 371 F.3d 1079, 1081 (9th Cir. 2004)). Fair market value is typically the standard. See e.g., <em>In re Adelphia Automatic Sprinkler Co.,</em> 184 B.R. 224, 228 (E.D. Pa. 1995).</td>
<td>The party against whom recovery or avoidance is sought bears the burden of proving a § 547(c) defense. <em>United Rentals, Inc. v. Angell</em>, 592 F.3d 525, 531 (4th Cir. 2010).</td>
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<td>547 Preference: Subsequent New Value Defense</td>
<td>Determination of new value based on whether new value was given after the allegedly preferential transfer. <em>In re IRFM, Inc.</em>, 52 F.3d 228, 231 (9th Cir. 1995).</td>
<td>New value is value that “replenishes the estate.” <em>Southern Tech. College, Inc. v. Hood</em>, 89 F.3d 1381, 1384 (8th Cir. 1996) (citing <em>Kroh Bros. Dev. Co. v. Continental Const. Eng’rs, Inc. (In re Kroh Bros. Dev. Co.)</em>, 930 F.2d 648, 652 (8th Cir.1991)). Valuation is same as for Bankruptcy Code § 547(c)(1), contemporaneous new value exception.</td>
<td>The party against whom recovery or avoidance is sought bears the burden of proving a § 547(c) defense. <em>United Rentals, Inc. v. Angell</em>, 592 F.3d 525, 531 (4th Cir. 2010).</td>
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<td>547 Preference: Security Interests in Inventory or Receivables Defense</td>
<td>Valuation made on the date 90 days prior to bankruptcy, and then again on the day of the petition. <em>In re Clark Pipe and Supply Co., Inc.</em>, 893 F.2d 693, 697 (5th Cir. 1990).</td>
<td>To determine if a secured creditor improved his position, two-point net improvement test is used which evaluates (a) the loan balance outstanding ninety days prior to the bankruptcy; (b) the value of the collateral on that day; (c) the loan balance outstanding on the day the bankruptcy petition was filed; and (d) the value of the collateral on that day, <em>In re Clark Pipe and Supply Co., Inc.</em>, 893 F.2d 693, 697 (5th Cir. 1990).</td>
<td>The party against whom recovery or avoidance is sought bears the burden of proving a § 547(c) defense. <em>United Rentals, Inc. v. Angell</em>, 592 F.3d 525, 531 (4th Cir. 2010).</td>
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<td>548: Fraudulent Transfers</td>
<td>Value is to be determined at the time of the transfer. <em>Jimmy Swaggert Ministries v. Hayes (In re Hannover Corp.)</em>, 310 F.3d 796, 802-03 (5th Cir. 2002); <em>In re JTS Corp.</em>, 617 F.3d 1102, 1109 (9th Cir. 2010) (citing <em>In re Prejean</em>, 994 F.2d 706, 708 (9th Cir. 1993); <em>In re Fairchild Aircraft Corp.</em>, 6 F.3d 1119, 1125-26 n.5 (5th Cir. 1993)).</td>
<td>Courts typically consider the fair market value or what would be the fairly equivalent value of the property, taking into consideration all of the specific circumstances of each case affecting the value of the asset. <em>In re JTS Corp.</em>, 617 F.3d 1102, 1109 (9th Cir. 2010). If the property is ultimately sold at a foreclosure sale, that price is “reasonably equivalent value” so long as all the requirements of the applicable state foreclosure law have been complied with. <em>BFP v. Resolution Trust Corp.</em>, 511 U.S. 531, 545 (1994). “‘[U]nreasonably small capital’ refers to the inability to generate sufficient profits to sustain operations. Because an inability to generate enough cash flow to sustain operations must precede an inability to pay obligations as they become due, unreasonably small capital would seem to encompass financial difficulties short of equitable solvency.” <em>Moody v. Security Pacific Business Credit, Inc.</em>, 971 F.2d 1056, 1070 (3d. Cir. 1992).</td>
<td>Trustee bears burden of proof. <em>In re Hannover Corp.</em>, 310 F.3d 796, 802 (5th Cir. 2002).</td>
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<td>Situation</td>
<td>Valuation Date</td>
<td>Key Factors</td>
<td>Burden of Proof</td>
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<td>550: Liability of Transferee for Avoided Transfers</td>
<td>Value is ordinarily determined at time of transfer. <em>USAA Fed. Savings Bank v. Thacker (In re Taylor)</em>, 599 F.3d 880, 890 (9th Cir. 2010). However, timing of valuation should “depend[] upon the circumstances of each individual case.” <em>In re Integra Realty Resources, Inc.</em>, 354 F.3d 1246, 1267 (10th Cir. 2004).</td>
<td>Value for determining amount that may be recovered under Bankruptcy Code § 550 should be based upon fair market price. See, e.g., <em>Active Wear, Inc. v. Parkdale Mills, Inc.</em>, 331 B.R. 669, 673 (W.D. Va. 2005) (“Case law and statutory law demand that the value which must be assigned to the yarn in this case is the fair market value that could be obtained for the yarn in a liquidation sale held by Active Wear.”); <em>Hirsch v. Steinberg (In re Colonial Realty Co.)</em>, 226 B.R. 513, 525 (Bankr. D.Conn. 1998) (“Courts generally agree that the market value of the property at the time of transfer, less the consideration received, is the proper measure of recovery under § 550.”) (citations omitted); <em>Slutsky v. Michel Tire Co. (In re Vann)</em>, 26 B.R. 148, 149 (Bankr. S.D. Ohio 1983) (“The term “value” connotes market value . . .”).</td>
<td>N/a</td>
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