

FALSE ALARM? CONVERTIBLE BONDS UNLIKELY TO BE REDUCED BY THE VALUE OF THEIR CONVERSION RIGHTS IN BANKRUPTCY

The author debunks the purported risk that convertible bond claims will be reduced by the value of their conversion rights in bankruptcy.

Timothy J. Durken is a bankruptcy and litigation attorney at Jager Smith P.C. in Boston, MA. The author may be reached at tdurken@jagersmith.com.¹

A 2010 article [Are the Claims of Convertible Debt Holders at Risk in Bankruptcy?](#) (the “Pratt’s Article”) sounded the alarm warning holders that their convertible bonds may not be allowed in full in bankruptcy.² The authors cautioned that the issue price of a convertible bond may be discounted by the value of its embedded conversion right creating original issue discount (“OID”) which, if unamortized at the time of the bankruptcy filing, would be disallowed as “unmatured interest” pursuant to Bankruptcy Code § 502(b)(2).³ The purported danger to holders of convertible bonds was substantial in light of the billions of dollars of convertible bonds outstanding and the significant value that can be attributed to their conversion rights.

This article explains that such risk is overstated and that convertible bonds are unlikely to be reduced by the value of their conversion rights in bankruptcy. Importantly, this article explains how the Pratt’s Article failed to recognize the *economic difference* between a convertible bond and an “investment unit” consisting of both notes and warrants to purchase equity, and how such economic difference results in original issue discount for investment units and no original issue discount for convertible bonds.⁴

A bond-warrant investment unit consists of both (1) a bond obligation that must be repaid at maturity or when redeemed and (2) an option or warrant to purchase stock—*two independent obligations both of which may be required to be satisfied*. The issue price of a bond-warrant investment unit, therefore, is allocated between the bond and warrant according to their fair market values with the market value of the bond being accepted as its issue price. If the bond-warrant investment unit is issued at par, the issue price of the bond is its face value less the value of the warrant resulting in OID for tax purposes and disallowance of any unamortized OID in bankruptcy.

In contrast, a convertible bond is an “indivisible unit” meaning the holder can *either* convert the debt to equity *or* be paid the face value of the debt at maturity—*only one alternative obligation must be satisfied*. Courts uniformly recognize that the economics of a convertible bond do not create OID for tax purposes because the holder will be repaid the issue price at maturity (with interest) only if the bond has not been converted. In such circumstances, the issue price *equals* the face amount of the bond repaid at maturity, the conversion right is extinguished, and the value of the conversion feature is not a cost of borrowing money that must be paid.

Courts are likely to recognize this economic distinction in the bankruptcy context and not disallow the unamortized value of the conversion feature of a convertible bond claim.

Therefore, holders should be confident that the issue price paid for convertible bonds will be allowed in full (plus accrued interest) in bankruptcy, however, holders of bond-warrant investment units face the likelihood that the portion of the issue price allocable to the value of the warrants, options or other property issued along with the notes will be disallowed to the extent unamortized as of the bankruptcy filing.

OID DISALLOWED IN BANKRUPTCY AS “UNMATURED INTEREST”

Original issue discount results when a bond is issued for less than its face value.⁵ The discount, which compensates for a below-market stated interest rate, equals the difference between a bond’s face amount and the proceeds received by the issuer.⁶ OID is amortized over the life of the bond for tax and accounting purposes with the face value generally paid back to bondholders on the maturity date.⁷ For example, when bonds of face amount of \$1,000 are issued for \$900, the difference of \$100 is the original issue discount. As the \$100 amortizes over the life of the bond, the creditor is deemed to receive interest—*not a return on capital*—that is taxable, and the debtor is deemed to be paying interest which is deductible.

If the debtor files for bankruptcy protection, the unamortized OID constitutes “unmatured interest” within the meaning of § 502(b)(2) and must be excluded when determining the amount of the bondholder’s allowed claim.⁸ A claim on a \$1,000 bond issued the day before bankruptcy at a price of \$900 would result in an allowed claim of only \$900.⁹ If the same bond was issued some time before bankruptcy, the original issue discount would have to be pro-rated over the life of the bond and any unamortized portion at the time of the commencement of the case would be disallowed under § 502(b)(2).¹⁰

BOND-WARRANT INVESTMENT UNITS CREATE OID DISALLOWED IN BANKRUPTCY

Courts recognize that, in the case of investment units consisting of both notes and warrants, the value of the warrants must be deducted from the issue price of the investment unit to determine whether the notes were issued at a discount, and any original issue discount must be recognized by the creditor as ordinary income and may be deducted by the debtor over the life of the loan.¹¹

In In re Solutia, Inc., the Bankruptcy Court for the Southern District of New York held that a financing package consisting of both notes and warrants created original issue discount and disallowed the unamortized portion of the OID under § 502(b)(2).¹² The issuer received proceeds of approximately \$200.7 million in exchange for notes in the face amount of \$223 million and warrants to purchase the issuer’s common stock.¹³ Accounting for the value of the warrants and the discount, the Court determined that \$182 million represented the issue price of

the notes.¹⁴ The court held that the allowed amount of the noteholders' claims under § 502(b)(2) was the amount of proceeds allocated to the notes plus accrued OID as of the petition date, as well as OID that accrued during the cases as pendency interest under § 506(b).¹⁵

Following Solutia and tax law cases as precedent, courts are likely to hold that bond-warrant investment units create OID that will be disallowed in bankruptcy to the extent unamortized.

CONVERSION RIGHTS DO NOT CREATE OID FOR TAX PURPOSES

In contrast to the treatment of investment units, courts uniformly hold that the value allocable to the conversion feature of a convertible debenture cannot be treated as original issue discount for tax purposes.¹⁶

In Chock Full O'Nuts, the Second Circuit held that the value allocable to the conversion feature did not represent *the cost of borrowing money that without qualification must be paid* because the convertible bond provides for "two mutually exclusive modes of satisfaction."¹⁷ If the holder exercises its conversion right, it surrenders the debenture and will not be repaid at maturity, thus, it fails to meet the condition precedent to the allowance of discount as a cost of borrowing that must be paid.¹⁸ Alternatively, the debenture will be redeemed or paid at maturity, in which event the conversion right will be terminated and the debenture will pay out no more than was received at the time of issuance, thus, precluding the existence of any OID.¹⁹ In no event will the "two alternative modes of satisfaction" be met.²⁰ OID cannot be "based on two inconsistent assumptions, first that the debentures will be redeemed and second that they will be converted into stock."²¹ Furthermore, the Second Circuit explained that logic dictates that if the value of the conversion feature was deducted when determining the issue price, that same figure must be deducted when arriving at the redemption price, which would result in no original issue discount—the issue price would *equal* the redemption price *notwithstanding any value associated with the conversion feature*.²²

The Second Circuit also explained the "essential economic differences" between a bond-warrant investment unit, which consists of both (1) a bond obligation to be repaid at maturity *and* (2) an option or warrant to purchase stock, and a convertible debenture, which consists of *alternative* conversion *or* debt obligations, that result in differing OID treatment:

The convertible debenture is an indivisible unit; the issuer has but one obligation to meet, either redemption or conversion. It can never be required to do both. With the bond-warrant investment unit, however, the holder receives and the issuer incurs two separate and independent obligations, and both may have to be fulfilled. Indeed, while the warrant and debt obligations are often issued as a package, since they are far more attractive to investors in unison than they would

be separately, they are totally independent and separable obligations, and the warrant, unlike the conversion privilege, should be independently valued.²³

The Second Circuit further recognized that the conversion feature of a convertible bond is not assignable apart from the bond, while warrants are tradable in the markets.²⁴ Based on all of the foregoing, the Second Circuit held that convertible bonds do not create OID as a result of the value of the embedded conversion privilege.²⁵

Internal Revenue Service regulations also distinguish between convertible bonds and investment units for OID treatment as set forth in the definition of “issue price.” See Treas. Reg. § 1.1232-3(b)(2)(i)-(ii).

... In the case of an obligation which is *convertible* into stock or another obligation, ***the issue price includes any amount paid in respect of the conversion privilege.*** However, in the case of an obligation issued as part of an *investment unit* (as defined in subdivision (ii)(a) of this subparagraph), the *issue price* of the obligation includes *only that portion* of the initial offering price or price paid by the first buyer properly *allocable to the obligation* under the rules prescribed in subdivision (ii) of this subparagraph....

An *investment unit*, within the meaning of this subdivision (ii) and for purposes of section 1232, consists of an *obligation and an option*, security, or other property. For purposes of this subparagraph, the *initial offering price of an investment unit* shall be *allocated to the individual elements of the unit on the basis of their respective fair market values.* ...²⁶

CHOCK FULL O’NUTS ADOPTED FOR ALLOWANCE OF CONVERTIBLE BOND CLAIMS

The Bankruptcy Court and the District Court for the Southern District of New York in the In re Calpine Corp. cases ruled on the treatment of conversion rights and convertible bonds under § 502(b) and allowed for the payment of principal plus accrued interest, but rejected bondholders’ supplemental claim asserting damages for the loss of the conversion rights.²⁷

The Bankruptcy Court approved a stipulation between the debtors and bondholders to allow the convertible bond claims in the amount of the principal and pre-petition accrued interest.²⁸ The parties reserved the right for a later determination of the appropriate rate of post-petition interest.²⁹ Subsequent to the approved stipulation, bondholders filed “supplemental” proofs of claims seeking damages for loss of the conversion rights in addition to the repayment of outstanding principal and accrued interest.³⁰ Debtors objected to the conversion damages claims arguing that the conversion rights are *not independent* from the bond repayment obligation and are extinguished upon repayment of the principal relying on Chock Full O’Nuts

and distinguishing bond-warrant investment units.³¹ The Debtors argued further that *if* the conversion rights had value separate from the obligation to repay principal that “the value of any conversion right would be equivalent to the original issue discount (“OID”) and, therefore, any claim for such value would be treated as unmatured interest which must be disallowed pursuant to section 502(b)(2) of the Bankruptcy Code.”³²

In rejecting the claim for loss of conversion rights, the Bankruptcy Court relying on Chock Full O’Nuts recognized that convertible bonds are “indivisible units” subject to “two mutually [exclusive] modes of satisfaction.”³³ The Court held that by repaying the bondholders’ principal and accrued interest in full that the conversion feature was terminated and there was no merit to the bondholders’ conversion damages claim.³⁴

A convertible debenture is an indivisible unit. The issuer has but one obligation to meet either redemption or conversion, it can never be required to do both. *See Chock Full O’Nuts v. U.S.*, 453 F.2d, 300 (2d Cir. 1971)[.] [L]ikewise the convertible notes debentures do not provide for recovery on account of both debt and equity interest. Instead like all convertible debentures the convertible notes provide the security of a debt instrument but allow the noteholders to benefit from any future upside by converting their notes to cash and common stock. Once the noteholders have converted their notes, however, they no longer hold debt interest to the notes that have been converted. Accordingly, the convertible noteholders cannot possibly be entitled to receive payment of their debt and damages on the account of a conversion right. *See* 11 U.S.C. 1129(B)(1)(b). *See also Chock Full O’Nuts*, 453 F.2d at 304, “convertible debentures provide for two mutually [exclusive] modes of satisfaction.” By repaying the noteholders principal [and] accrued interest in full the debtors are rendering the alternative performance as provided in the indenture. *See Chock Full O’Nuts*, 453 F.2d at 304, “the alternative to conversion is that the issuer will redeem the debenture or pay it at maturity [i]n which event the conversion privilege will be terminated.”³⁵

The District Court affirmed this part of the Bankruptcy Court’s bench ruling.³⁶ The District Court held that the notes became “due and payable” as a result of automatic acceleration upon the debtors’ bankruptcy filing and the conversion rights expired as a result of the notes reaching maturity.³⁷

Although not directly addressing the OID issue, the Calpine decisions stand for the proposition that convertible bondholders are entitled to allowance of claims for principal and interest in full. Moreover, the Bankruptcy Court’s adoption of Chock Full O’Nuts reinforces the principle that the conversion privilege is not a separate, independent obligation. By so ruling, the Bankruptcy Court implicitly rejected the debtors’ alternative argument that if the convertible feature must be valued separately, such value constitutes OID that should be disallowed under § 502(b)(2) to the extent unamortized as of the petition date.

The Bankruptcy Code also recognizes the fact that convertible bonds are an “indivisible unit” and that the conversion rights do not constitute an “equity security.” Bankruptcy Code § 101(16) defines the term “equity security” to include a “warrant or right, *other than a right to convert*, to purchase, sell, or subscribe to” a share in a corporation or interest in a limited partnership.³⁸ Moreover, the legislative history reveals that Congress did not intend the definition of “equity security” to include “a security, such as a convertible debenture, that is convertible into an equity security, but has not been converted.”³⁹ As conversion rights are not recognized as a separate and independent instrument under the Bankruptcy Code, such rights should not be allocated value for purposes of finding disallowable unamortized original issue discount under § 502(b)(2). In contrast, the Bankruptcy Code recognizes warrants and options as equity securities which support the original issue discount treatment of bond-warrant investment units.

While the Fifth Circuit Court of Appeals considered the disallowance of OID in the context of convertible bonds in In re Pengo, the issue of whether the value of the embedded convertible right resulted in OID was not raised by the parties or addressed by the Court.⁴⁰ In Pengo, the borrower issued \$22.5 million of 8 ½% convertible debentures for the full face amount of \$1,000 each.⁴¹ Several years later, as part of an out-of-court workout, the issuer exchanged two new 0% convertible debentures with a total face value of \$1,000 for the old convertible debentures with a face value of \$1,000.⁴² The Fifth Circuit agreed that any unamortized OID created in the exchange would be disallowable under § 502(b)(2).⁴³ The Fifth Circuit, however, rejected the argument that the *market value* of the old debentures *as of the exchange date* created OID for the new debentures in the debt-for-debt face value exchange that would be disallowed under § 502(b)(2).⁴⁴ The fact that the Fifth Circuit did not find the creation of any OID for the convertible bonds provides additional support that the unamortized value of the conversion feature will not be disallowed under § 502(b)(2).

PRATT’S ARTICLE FAILS TO DISTINGUISH CONVERTIBLE NOTES FROM INVESTMENT UNITS

The Pratt’s Article failed to distinguish between the economic differences of convertible bonds and bond-warrant investment units and their differing OID treatment, and the case law it relied upon does not support a finding that the value of the conversion right in a convertible bond should be disallowed as unamortized OID under § 502(b)(2).⁴⁵

While the Trustee in the SONICblue case argued that conversion rights could create disallowable unamortized OID, the bankruptcy court never had to decide the issue as the parties resolved the claim objection as part of a comprehensive settlement in the plan.⁴⁶ In that case, noteholders purchased an “investment unit” consisting of (1) convertible bonds, (2) warrants, and (3) options in exchange for *total consideration less than the face value of the convertible bonds*.⁴⁷ The Trustee valued the warrants, options and conversion rights at the time of issuance and sought to disallow unamortized OID with respect to each under § 502(b)(2).⁴⁸ In response,

the noteholders conceded that some portion of the claims constituted unamortized OID but disputed the Trustee's amount and methodology.⁴⁹ While the noteholders may have conceded that the discounted issue price, warrants and options resulted in some unamortized OID, the noteholders devoted five pages of their brief arguing that the conversion rights could not be separately valued for OID purposes relying on Calpine and Chock Full O'Nuts.⁵⁰ Therefore, SONICblue does not provide any additional support for a finding that the value of the conversion feature in a convertible bond creates OID that can be disallowed under § 502(b)(2).

The In re Bridge Information Systems, Inc. case relied on in the Pratt's Article is based on a misunderstanding of the economic nature of convertible bonds.⁵¹ In that case, the bankruptcy court held that the conversion rights embedded in the convertible bonds at issue constituted a transfer provided from the debtor to the bondholders for the purpose of the "new value" preference defense under Bankruptcy Code § 547(c)(4).⁵² In doing so, the court erroneously applied the "investment unit" OID decision in Custom Chrome and the "investment unit" OID provision of I.R.C. § 1273(c)(2) to the convertible bonds at issue in its case and concluded that the unsecured debt and option components are "discrete" and "must be valued separately."⁵³ For this reason, the case does not support the argument that conversion rights give rise to unamortized OID for purposes of reducing convertible bond claims.

The In re ICH Corp. case cited in the Pratt's Article is entirely inapposite as the issue in that case was whether *stock* purchased with \$30 million face value in non-convertible debentures and \$15 million in cash *was worth \$45 million* to determine whether the debentures were issued at OID.⁵⁴

CONCLUSION

Convertible bondholders should be confident that their capital invested in convertible bonds will be allowed in full as claims in bankruptcy. Case law and tax rules recognize the "indivisible" economic nature of the conversion rights and debt obligations embedded in convertible bonds which provide "two mutually exclusive modes of satisfaction" and are not valued separately for purposes of determining original issue discount. The Bankruptcy Code's exclusion of conversion rights from the definition of "equity security" similarly recognizes that the conversion feature should not be separately valued. The Bankruptcy Court in Calpine adopted Chock Full O'Nuts' "indivisible" view of convertible bonds and implicitly rejected the debtors' alternative argument that, if the conversion feature must be valued separately, it would result in disallowed OID under § 502(b)(2). In light of the foregoing, it is unlikely that a court would disallow the value of a conversion feature as unamortized OID in a bankruptcy claim to recover a convertible bond's principal and accrued interest. While the issue price of convertible bonds should be safe in bankruptcy, holders of investment units face the strong likelihood of bankruptcy claims reduced by the unamortized value of warrants or other property issued along with the notes.

Each investment instrument is different and the characteristics of the investment must be carefully considered to determine whether it will result in disallowed unamortized OID in bankruptcy. If a convertible bond was issued at a discount to its face amount, it will have OID that will be disallowed to the extent unamortized. Similarly, if a convertible bond is issued as part of an investment unit with independent options or warrants to purchase stock, the value of such warrants and/or options will be discounted to determine the issue price and disallowed in bankruptcy to the extent unamortized.

¹ This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to the author.

² See B. Erens and T. Hoffman, Are the Claims of Convertible Debt Holders at Risk in Bankruptcy?, 6 PRATT'S JOURNAL OF BANKRUPTCY LAW 575 (Oct. 2010).

³ See generally id.

⁴ See Chock Full O'Nuts Corp. v. U.S., 453 F.2d 300, 303-06 (2d Cir. 1971); Tr. of Hearing and Bench Ruling, In re Calpine Corp., No. 05-60200-BRL (Bankr. S.D.N.Y. Aug. 8, 2007) [Doc. No. 5599], at pp. 93-101.

⁵ In re Chateaugay Corp., 961 F.2d 378, 380 (2d Cir. 1992).

⁶ Id.

⁷ Id.

⁸ See 11 U.S.C. § 502(b)(2); In re Chateaugay Corp., 961 F.2d 378, 380-81 (2d Cir. 1992) (holding that unamortized OID shall be disallowed as "unmatured interest" under § 502(b)(2)); In re Pengo Indus., Inc., 962 F.2d 543, 546 (5th Cir. 1992) (same); In re Allegheny Int'l, Inc., 100 B.R. 247, 250, 255 (Bankr. W.D. Pa. 1989) (same).

⁹ In re Chateaugay Corp., 961 F.2d 378, 381 (2d Cir. 1992) (citing the legislative history of § 502(b)(2)); see also H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 352-353 (1977); S.Rep. No. 95-989, 95th Cong., 2d Sess. 62 (1978), U.S. Code Cong. & Admin News 1978, pp. 5848, 6308-6309.

¹⁰ Id.

¹¹ See Custom Chrome, Inc. v. IRS, 217 F.3d 1117, 1120-21 (9th Cir. 2000); Monarch Cement Co. v. U.S., 634 F.2d 484, 485 (10th Cir. 1980).

¹² 379 B.R. 473, 476-77, 486-87 (Bankr. S.D.N.Y. 2007).

¹³ Id. at 476.

¹⁴ Id. at 477.

¹⁵ Id. at 476-77, 486-87.

¹⁶ See Chock Full O'Nuts Corp. v. U.S., 453 F.2d 300, 303-06 (2d Cir. 1971) (holding that no original issue discount created notwithstanding that \$100 par value convertible debentures would have been issued at \$89.625 without the conversion feature); see also Honeywell Inc. v. C.I.R., 87 T.C. 624, 636-40 (1986); National Can Corp. v. U.S., 520 F.Supp. 567, 572-76 (N.D. Ill. 1981), aff'd on other issues, 687 F.2d 1107 (7th Cir. 1982); Hunt Foods & Indus., Inc. v. Commissioner, 57 T.C. 633, 636-43 (1972), aff'd per curiam, 496 F.2d 532 (9th Cir. 1974); AMF, Inc. v. U.S., 476 F.2d 1351, 1352-54 (Ct. Cl. 1973), cert. denied, 417 U.S. 930, 94 S.Ct. 2639 (1974).

¹⁷ 453 F.2d at 304.

¹⁸ Id.

¹⁹ Id.

²⁰ Id.

²¹ Id.

²² Id.; see also Hunt Foods, 57 T.C. at 640-41 ("The petitioner's contention that the convertible debentures were issued at a discount rests on the proposition that a part of the proceeds of the debentures should be allocated to the conversion privilege and that only the remainder was paid for the debt. Thus, it asks us to treat the convertible debenture as including two separate obligations. However, such proposition is contrary to the practice that has apparently generally been followed throughout the years and ignores the realities of a convertible debenture. Such a security does not consist of two separate and independent obligations; the obligations are in the alternative. If the debt is repaid, the lender will be repaid all that he has advanced; but if the conversion privilege is exercised, no cash

will be paid. Under these circumstances, there is no basis for assuming that the issuing corporation will be obligated to repay more than it received; to make the suggested allocation, with the resulting deduction for discount, would ignore the substance of the transaction.”).

²³ Id. at 304-05.

²⁴ Id. at 305; see also Hunt Foods, 57 T.C. at 642 (distinguishing the economic characteristics of an “investment unit” which is composed of “two separate securities” and a convertible obligation which consists of “a single security”); AMF Inc., 201 Ct. Cl. at 341-42 (“Taxpayer draws an analogy between the [convertible debenture] in question and the case of a bond issued with a detachable warrant and points out that in the latter case a discount for the value of the warrant is permitted. Taxpayer’s contention fails and a comparison to the case of the bond issued with a warrant demonstrates why it must. In the case of the debenture issued with a conversion feature the holder may *either* convert his debenture into stock *or* redeem the debenture at the end of the prescribed period, one or the other but not both. The issuer will not in any event incur costs over and above the face value of the debenture plus the stated interest. If the holder elects to convert, the issuer pays nothing. On the other hand, in the case of the bond issued with a warrant, the holder may exercise either or both of his options. He may for example, exercise his warrant or sell it and still redeem his bond at the end of the period. The issuer of the bond issued at par with a warrant is faced with the possibility of incurring an economic detriment over and above the stated interest. The difference involved when a debenture is issued with a conversion feature is how the issuer will pay for the capital received.”)

²⁵ Id. at 303-06.

²⁶ Id. (emphasis added). Treas. Reg. § 1.1232-3(b)(2) was promulgated on December 23, 1968 to apply to obligations issued after December 31, 1954.

²⁷ See Tr. of Hearing and Bench Ruling, In re Calpine Corp., No. 05-60200-BRL (Bankr. S.D.N.Y. Aug. 8, 2007) [Doc. No. 5599] (the “Calpine Bankruptcy Court Bench Ruling”); Opinion and Order, In re Calpine Corp., 07-Civ-8493-JGK (S.D.N.Y. Nov. 21, 2007) [Doc. No. 17] (the “Calpine District Court Opinion”).

²⁸ See Calpine Bankruptcy Court Bench Ruling, pp. 95-96; see also Stipulation and Order Resolving Claim Numbers 2820, 2821, 2822, 2823, 2824 and 2825, No. 05-60200-BRL (Bankr. S.D.N.Y. Jan. 30, 2007) [Doc. No. 3501] (the “Calpine Stipulation”). The notes had original issue discount because they were issued at a discount to the face principal amount and the Calpine Stipulation determined the amounts owed by the debtors on account of principal outstanding and accrued unpaid interest at the time of the petition date.

²⁹ See id.

³⁰ See Calpine Bankruptcy Court Bench Ruling, pp. 96.

³¹ See Debtors’ Omnibus Reply in Support of Limited Objection to Convertible Noteholder Claim Nos. 2404, 2821, 2823, 6247, 6249, 6280, 6299 and 6300, No. 05-60200-BRL (Bankr. S.D.N.Y. Aug. 6, 2007) [Doc. No. 5540], pp. 11-13.

³² See id., pp. 17-18.

³³ See Calpine Bankruptcy Court Bench Ruling, p. 100.

³⁴ See id.

³⁵ See id.

³⁶ See Calpine District Court Opinion, pp. 18-30.

³⁷ See id., p. 22.

³⁸ 11 U.S.C. § 101(16)(C) (emphasis added).

³⁹ S. Rep. No. 989, 95th Cong. (2d Sess. 1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5810.

⁴⁰ See 962 F.2d 543 (5th Cir. 1992).

⁴¹ Id. at 544-45.

⁴² Id. at 545.

⁴³ Id. at 546.

⁴⁴ Id. at 547-49.

⁴⁵ See Custom Chrome, 217 F.3d at 1121-22 (addressing the value of warrants as part of an investment unit for purposes of determining OID and tax treatment not a convertible bond); Monarch Cement Co., 634 F.2d at 485 (same); In re SONICblue, Inc., No. 03-51775 (Bankr. N.D. Cal.).

⁴⁶ See First Amended Disclosure Statement Describing the First Amended Joint Chapter 11 Plan of Liquidation Proposed by Dennis J. Connolly, Chapter 11 Trustee and the Reconstituted Creditors' Committee (as Modified as of August 22, 2008), No. 03-51775-MM (Bankr. N.D. Cal. Aug. 22, 2008) [Doc. No. 3253], at pp. 75-103. The First Amended Joint Chapter 11 Plan of Liquidation Proposed by Dennis J. Connolly, Chapter 11 Trustee and the Reconstituted Creditors' Committee (as Modified as of August 22, 2008) [Doc. No. 3251] was confirmed on October 24, 2008. See Order Confirming Modified Chapter 11 Plan as of August 22, 2008 [Doc. No. 3358].

⁴⁷ See Objection of the Chapter 11 Trustee to the Claims of Portside Growth and Opportunity Fund, Ltd., Smithfield Fiduciary LLC and Citadel Equity Fund, Ltd., No. 03-51775-MM (Bankr. N.D. Cal. Nov. 14, 2007) [Doc. No. 2559], at pp. 3-4.

⁴⁸ See id., pp. 4-18.

⁴⁹ See Senior Noteholders' Preliminary Response to Objection of the Chapter 11 Trustee to the Claims of Portside Growth and Opportunity Fund, Ltd., Smithfield Fiduciary LLC and Citadel Equity Fund, Ltd., No. 03-51775-MM (Bankr. N.D. Cal. Dec. 10, 2007) [Doc. No. 2638], at p. 15.

⁵⁰ See id., at pp. 11-15.

⁵¹ 311 B.R. 781 (Bankr. E.D. Mo. 2004).

⁵² Id. at 791.

⁵³ Id. at 792. I.R.C. § 1273(c)(2) provides for the "treatment of investment units" to determine the amount of original issue discount:

In the case of any debt instrument and an option, security, or other property issued together as an investment unit—

(A) the issue price for such unit shall be determined in accordance with the rules of this subsection and subsection (b) as if it were a debt instrument,

(B) the issue price determined for such unit shall be allocated to each element of such unit on the basis of the relationship of the fair market value of such element to the fair market value of all elements in such unit, and

(C) the issue price of any debt instrument included in such unit shall be the portion of the issue price of the unit allocated to the debt instrument under subparagraph (B).

26 U.S.C. § 1273(c)(2).

⁵⁴ 230 B.R. 88, 95-96 (N.D. Tex. 1999) ("[T]he determination whether OID exists depends on whether the stock was worth \$45 million at the time of the transaction.").