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Topics in Distressed Debt

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Agenda [ANA]

- Part I: Introduction
- Part II: Modification of Debt Instruments
- Part III: Issue Price and Cancellation of Debt Income
- Part IV: Worthless Securities and Debt
- Part V: Market Discount, Payment Ordering and NYSBA Recommendations

Introduction [ANA]

- This discussion will provide an overview of several issues related to investments in distressed debt, including:
  - Modification of debt instruments
  - Determination of the issue price
  - Discharge of debt and cancellation of indebtedness income (CODI)
  - Significance of treatment of debt as recourse or nonrecourse
  - Section 108* bankruptcy and insolvency exceptions
  - Section 108 related party acquisitions
  - Deductions related to worthless securities and debts
  - Special considerations related to market discount
  - Payment ordering
  - Special issues and solutions for distressed debt

* Section references are to the Internal Revenue Code of 1986, as amended (the “Code”).

Part II: Modification of Debt Instruments [SAM]

- Definition of “Modification” and “Significant Modification”
- Examples
- Debt/Equity Considerations
- Consequences of an Exchange

Modification of Debt Instruments [SAM]

- An exchange of property constitutes a potentially taxable disposition if the property received differs “materially either in kind or extent” from the property relinquished (*i.e.*, the new property is materially different from the old property). A change in the terms of a debt instrument pursuant to a debt restructuring or modification produces an exchange if the new terms are materially different from the old terms.

- Treas. Reg. §1.1001-3 provides a two-tier structure to determine if a modification of a debt instrument (whether or not effected through an actual exchange) constitutes an exchange.
  - An alteration to the terms of an instrument is first tested to determine if it constitutes a “modification.”
  - If the alteration is a modification, the modification is then tested to determine whether it is a “significant modification.” A significant modification results in an exchange of the original debt instrument for the modified instrument for tax purposes. A modification that is not significant does not trigger an exchange.

Definition of “Modification” [SAM]

- A modification is an alteration of a legal right or obligation of the issuer or a holder of a debt instrument, whether the alteration is evidenced by an express agreement (oral or written), the conduct of the parties, or other means.
- Common examples of modifications include:
  - Permitting the borrower to consummate an extraordinary acquisition or disposition
  - Loosening financial covenants under an indenture
  - Covenant strips (*i.e.,* exit consents)
  - Change in security or credit enhancement
  - Addition of a co-obligor
  - Deferral of scheduled payments of principal or interest
  - Elimination of guarantee provisions

Alterations Under the Terms of Debt Instrument [SAM]

- An alteration that occurs by operation of the terms of a debt instrument is generally not a modification. For example, an annual resetting of the interest rate of a debt instrument based on the value of an index would not be a modification, nor would a specified increase in the interest rate that occurs under the terms of the instrument because the value of the collateral declines from a specified level.

- Certain alterations are considered modifications even if they occur by operation of the instrument's terms, including:
  - an alteration that results in the substitution of a new obligor,
  - the addition or deletion of a co-obligor, or
  - a change in the recourse nature (from recourse to nonrecourse or from nonrecourse to recourse) of the instrument.

Definition of "Significant Modification" [SAM]

- Generally, a modification is a significant modification if, based on all the facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are economically significant.

- The regulations set forth a number of specific circumstances under which significant modifications will be presumed to have occurred. These circumstances are generally described on the following slides.

- The regulations further provide that if a modification is significant, it will result in a deemed exchange of the original debt instrument for a modified instrument, and holder will realize gain or loss under Treas. Reg. §1.1001-1(a) (although any gain realized may not be recognized if the exchange qualifies under a nonrecognition provision of the Code).

Examples of Significant Modifications [ANA]

- A change in the annual yield by more than the greater of 1/4 of 1% (*i.e*., 25 basis points) or 5% of the annual yield to maturity (YTM) of the unmodified instrument. For this purpose, a forgiveness of a portion of the principal of a debt that changes the annual yield by more than the greater of 1/4 of 1% or 5% of the annual YTM of the unmodified instrument based on the original issue price of the instrument is treated as a significant modification.
  - Consent Fees – Change in Yield Analysis Applies - The payment of a consent fee reduces the issue price of an instrument and results in OID over the remaining term of the debt. Thus, the change in yield test described above applies to determine whether the payment of a consent fee constitutes a significant modification. Treas. Reg. §1.1273-2(g)(2); see also PLR 201105016 (consent fees paid to note holders treated first as payments of accrued interest, to the extent of any accrued and unpaid interest, and second as payments of principal on the note which in turn decreases the adjusted issue price of the relevant note).
- An extension of the maturity date of a debt instrument is significant if such change results in a material deferral of scheduled payments.
  - Safe Harbor Deferrals. An extension of the maturity date that is not greater than the lesser of five years or 50% of the original term of the instrument does not constitute a material deferral. Treas. Reg. §1.1001-3(e)(3)(ii).
  - Consider whether the extension of the maturity date effectuates a change in yield greater than 25 basis points / 5% of YTM.

Examples of Significant Modifications (Cont.) [ANA]

- A substitution of a new obligor on a recourse debt instrument, except for certain transactions (i) described in Section 381(a), (ii) where the new obligor acquires substantially all of the assets of the original obligor, or (iii) where the debt is a tax-exempt obligation.
- The alteration of the collateral for, a guarantee on or other form of credit enhancement for, a recourse debt, if the modification results in a change in payment expectations.
- A substantial change in the collateral for, a guarantee on or other form of credit enhancement for, a nonrecourse debt instrument, subject to exceptions where the collateral is fungible or a similar commercially available credit enhancement contract is substituted.
- A change in the priority of a debt instrument relative to other debt of the issuer if it results in a change in payment expectations.

Debt/Equity Considerations [ANA]

- Does modified debt need to be tested under traditional debt/equity principles?
  - Treas. Reg. §1.1001-3(f)(7) provides that in determining whether an altered or modified debt instrument will cease to be treated as debt for tax purposes, deterioration in the financial condition of the borrower between the issue date and date of alteration or modification of the debt instrument generally will be disregarded.
  - However, this rule does not apply if there is a substitution of a new obligor or the addition or deletion of a co-obligor.
  - The regulations are effective for alterations of debt instruments after the publication of the final regulations on January 7, 2011, with an elective retroactive application by taxpayers.

Consequences of an Exchange [ANA]

- Holder of a debt instrument generally will recognize gain or loss equal to the difference between the issue price of the new debt and the holder's tax basis in the old debt, unless the exchange qualifies as a tax-free recapitalization. See Sections 368(a)(1)(E) and 1001.

- The borrower may realize CODI to the extent of the difference between the adjusted issue price of the old debt and the issue price of the new debt. See Section 108(e)(10); Treas. Reg. §1.61-12(c)(2)(ii).

- New debt treated as exchanged for old debt may also be issued with original issue discount (OID). Generally, OID is the excess of stated redemption price at maturity over issue price. OID is generally includible in taxable income by holders on a constant yield basis over the life of the debt, and is generally deductible by the issuer over the life of the instrument on the same basis as such OID is required to be taken into income by the holder. See generally Sections 1272 and 1273.

Part III: Issue Price and CODI [SAM]

- Determining Issue Price
- Public Trading
- Discharge of Debt
- CODI Rules under Section 108

Determining Issue Price [SAM]

- If debt is issued for money, the issue price is the first price at which a substantial amount of the debt instruments is sold, excluding sales to bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers.

- If debt is issued for property:
  - If it is part of an issue a substantial amount of which is traded on an established securities market, the issue price is the fair market value (FMV) on the issue date.
  - If it is not publicly traded but a substantial amount of the issue is issued for property that is traded on an established market, the issue price is the FMV of the property on the issue date.
  - Otherwise, the issue price generally is determined under Section 1274 or Section 483.

Determining Issue Price - Public Trading [SAM]

- Under current law, debt is "publicly traded" for federal income tax purposes if, within the 60-day period commencing 30 days prior to the consummation of the exchange offer:
  - The debt is listed on a major U.S. or specified foreign exchange,
  - The debt appears on a quotation medium of general circulation that provides a **"reasonable basis"** to determine FMV by disseminating either (i) recent price quotations or (ii) actual prices of recent sales transactions, or
  - Price quotations are readily available from dealers, there is other outstanding debt of the borrower that is described above and certain other requirements are met. Treas. Reg. §1.1273-2(f).

Determining Issue Price - Public Trading (Cont.) [SAM]

- Because public trading may occur before or after an exchange or modification, the status of an instrument as publicly traded may not be known with confidence on the date of the exchange or modification.

- Is there a minimum volume of trading that must occur, by dollar amount, percentage of the issue, or number of trades, for an instrument to be publicly-traded?

- Can an instrument be publicly-traded even if there is no trading in the relevant 60-day period?

Determining Issue Price - Public Trading (Cont.) [SAM]

- On January 6, 2011, proposed Treasury regulations were issued that would generally expand the scope of public trading.

- The proposed Treasury regulations generally provide that a debt instrument will generally be treated as publicly traded if:
  - It is listed on a securities exchange,
  - Executed sales prices are available,
  - Firm quotes are available, or
  - Indicative quotes are available.
- Nevertheless, an instrument will not be publicly traded if:
  - No trade is larger than $1 million and no more than $5 million in trades occur in the tested 31-day window, or
  - It is part of an issue of no more than $50 million original principal amount.

Determining Issue Price - Public Trading (Cont.) [SAM]

- The proposed Treasury regulations would expand the definition of public trading and the use of FMV as issue price.
- It would no longer be necessary to determine whether quotes or prices may be reasonably relied upon for the FMV determination to apply.
- CODI and "applicable high yield discount obligation" (AHYDO) concerns could be exacerbated for distressed debt modifications and exchanges due to the increased use of FMV to determine issue price.

Discharge of Debt - Recourse v. Nonrecourse Liabilities [ANA]

- The treatment for CODI depends, in part, on whether the discharged debt is recourse or nonrecourse.

- Nonrecourse debt is generally defined as debt where the creditor can look only to the identified property as securitized collateral as security for payment of the principal and interest on the loan and, thus, cannot look to any other property, the borrower, or any third party for repayment.

- Recourse debt, on the other hand, is generally debt where the borrower is personally liable for payment and the creditor may look to the borrower and any guarantor's assets for satisfaction of the debt.

Discharge of Debt – Nonrecourse Liabilities [ANA]

- If property is subject to nonrecourse debt, the amount realized upon any disposition of the property is not less than the amount of the nonrecourse debt (*i.e.,* the full amount of debt from which the transferor is discharged as a result of the disposition). See Section 7701(g); Treas. Reg. §1.1001-2(a)(1).

- Thus, if property is subject to nonrecourse debt, the borrower's gain or loss upon a transfer of the property to the creditor in satisfaction of the debt will be the difference between the amount of the nonrecourse debt (plus the amount of any cash and the FMV of any other property paid to the borrower) and the borrower's tax basis in the property at that time.

- The borrower will not realize any CODI as a result of the transfer of the property.

- A sale of property subject to nonrecourse debt will have similar consequences.

Discharge of Debt – Recourse Liabilities [ANA]

- A borrower will generally recognize CODI upon the discharge of a recourse liability equal to the adjusted issue price of the debt before discharge, *reduced by* the sum of the following (see Treas. Reg. §1.61-12(c)(2) and Section 108(e)(10)):
  - the amount of cash paid to the creditor as part of the discharge transaction;
  - the issue price of any new debt issued to the creditor as part of the discharge transaction;
  - the fair market value of any other property transferred to the creditor as part of the discharge transaction (including the value of any of the borrower's stock being issued, regardless of whether the borrower is bankrupt or insolvent); *and*
  - the amount of any old debt that remains outstanding after the discharge transaction.

Discharge of Debt – Recourse Liabilities (Cont.) [ANA]

- If the borrower transfers cash, its own stock or debt, or a combination thereof, or transfers no consideration at all, in satisfaction of a recourse liability, the total amount realized will be ordinary CODI. See, *e.g.*, Sections 1032, 108(e)(8) and 108(e)(10).

- However, if the borrower transfers properties to the creditor other those described above, it may also recognize gain or loss under Section 1001, the character of which will depend on the type of property transferred. See Treas. Reg. §1.1001-2(a)(2); Treas. Reg. §1.1001-2(c), Example 8.

- If the borrower transfers a combination of assets, the transaction will be bifurcated. See, *e.g.*, FSA 200135002.

Section 108 – Generally [SAM]

- In general, when a borrower is discharged of an obligation to repay a debt for consideration less than the amount of the obligation, the borrower recognizes CODI.
- Section 108(a) provides various exceptions from the inclusion of CODI in taxable income.
- Section 108(b) provides rules to reduce certain tax attributes of borrowers whose CODI qualifies for certain Section 108(a) exceptions.
- Section 108(e) provides additional rules and exceptions regarding CODI.
- Additional considerations apply to CODI within partnerships and consolidated groups.

Section 108 - Bankruptcy & Insolvency Exceptions [SAM]

- Section 108 provides rules regarding the treatment of CODI, including when such income will be excluded from a taxpayer's gross income.

- If a borrower recognizes CODI while the borrower is under the jurisdiction of the bankruptcy court, CODI will be excluded from the taxable income of the borrower.
  - Includes Federal bankruptcy only, *not* the broader "title 11 or similar case" definition applicable for G reorganizations and special limitations on losses.

- If a borrower recognizes CODI in the context of an out-of-court restructuring, CODI will be excluded from taxable income to the extent that the borrower is insolvent.
  - Aggregate Liabilities – FMV of Assets = Insolvency Amount
  - Where there is continuing uncertainty as to treatment of a contingent liability, the amount may not be deductible in whole or in part in the insolvency calculation.

Section 108 – Attribute Reduction [SAM]

- To the extent CODI is excluded from gross income under the bankruptcy or insolvency exceptions of Section 108(a), the borrower's tax attributes generally are reduced as follows:

Tax Attribute	Attribute Reduction: $ of Excluded CODI
NOLs	1:1
Section 38 general business credits	0.333:1
Section 53(b) minimum tax credits	0.333:1
Capital loss carryovers	1:1
Reduction of tax basis in property	1:1
Section 469(b) passive activity loss/credit carryovers	0.333:1
Section 27 foreign tax credit carryovers	0.333:1

Section 108 – Attribute Reduction (Cont.) [SAM]

- The total amount of tax basis reduction generally is limited to the amount by which the aggregate adjusted basis of the borrower's property immediately after the debt discharge exceeds the aggregate of the borrower's liabilities immediately after the debt discharge. Treas. Reg. §1.1017-1(a).

- Attributes are reduced after the determination of tax for the year during which the restructuring is consummated.

- In lieu of attribute reduction, the taxpayer may instead elect to first reduce the basis of its depreciable property under Section 108(b)(5).

Section 108(b)(5) Election [ANA]

- Instead of the attribute reduction scheme described above, the borrower may elect to apply any portion of excluded CODI to reduce the basis of the borrower's depreciable property under Section 1017, up to the aggregate adjusted bases of the borrower's depreciable property as of the beginning of the taxable year following the year the debt discharge occurs.

- If the borrower makes this election, tax basis reduction will not be limited by the excess of the aggregate bases of the borrower's property over its remaining liabilities.

- If the borrower makes this election, no other tax attributes will be reduced by the amount of CODI subject to the election. Excess CODI will reduce attributes in the order described in Section 1017.

- Depending on the specific facts, this election may be useful if the borrower has NOLs that will expire soon and a large amount of basis in long-lived depreciable assets.

Section 108(b)(5) Election [ANA]

- Under Section 1017, the term "depreciable property" includes:
  - Property subject to the allowance for depreciation, but only if a basis reduction would reduce the amount of depreciation or amortization otherwise allowable for the period following the reduction;
  - Interests in a partnership to the extent the partnership reduces its basis in the partner's proportionate share of the partnership's depreciable property;
  - Stock of subsidiaries in an affiliated group to the extent the subsidiary makes a corresponding reduction in the basis of its depreciable property; and
  - Real property held for sale to customers in the ordinary course of business.

Section 108 - Planning Considerations for Attribute Reduction [ANA]

- Will tax attribute reduction reduce NOLs that have already become substantially limited by a Section 382 ownership change? (Potentially not very burdensome.)
- Will the Borrower’s ability to claim future depreciation or amortization deductions become substantially impaired?
- Will the assets subject to basis reduction be retained?

Section 108(e)(4) [SAM]

- CODI is triggered when a borrower's indebtedness is forgiven or repurchased by the borrower at a discount.
- Under Section 108(e)(4), CODI is also triggered when certain entities acquire debt of a related borrower at a discount from an unrelated party. Whether parties are related is generally determined under Sections 267(b) and 707(b)(1).
- Indirect Acquisitions - If an unrelated person acquires debt in anticipation of becoming related to the borrower, that acquisition will fall within the scope of these rules.
  - Generally a facts-and-circumstances test is used to determine if an unrelated person acquires debt in anticipation of becoming related to the borrower.
  - If the acquiror becomes related to the borrower within six months of acquiring the borrower's debt, the acquiror will be treated as related to the borrower.

Section 108(e)(4) – Exceptions [SAM]

- No CODI results from the direct or indirect acquisition of indebtedness by a related party if the debt has a stated maturity date that is not more than one year after the date of the debt's acquisition, but only if the debt is actually retired on or before its stated maturity date.

- No CODI results from the direct or indirect acquisition of indebtedness by a related party that is a dealer that acquires and disposes of debt in the ordinary course of business and certain other requirements are met.

Section 108(e)(4) – Amount of CODI [SAM]

- If a debt is discharged through the acquisition of such debt by a related party, rules similar to the recourse liability discharge will apply, subject to a few differences.
- Depending on the timing and nature of the acquisition, the amount realized by the borrower will either be determined by reference to:
  - (1) the related holder's adjusted basis in the debt if the holder acquired the indebtedness by purchase on or less than six months before the acquisition date, or
  - (2) if acquired by the holder earlier than six months before the acquisition date, the debt's fair market value on the acquisition date. See Treas. Reg. §1.108-2(f).
- No Section 1001 gain or loss is realized to the borrower, but the acquiring holder may have Section 1001 gain depending on the type of consideration it transfers (*i.e.*, if it transfers appreciated property to acquire the debt).

Part IV: Worthless Securities and Debts [ANA]

- Worthless Securities

- Worthless Debts

Worthless Securities [ANA]

- Creditors may be entitled to a deduction if they own "securities" or debts which become worthless during the taxable year.

- For purposes of the worthless securities deduction, the term "security" means stock, stock rights, or "a bond, debenture, note, or other evidence of indebtedness to pay a fixed or determinable sum of money, *which has been issued with interest coupons or in registered form*."

- If a "security" becomes worthless during the creditor's taxable year, then the creditor may be entitled to a capital loss if the security is a "capital asset" or an ordinary loss if the security is not a "capital asset."

- Note: Special rules apply to the stock of an "affiliated corporation" which becomes worthless during the taxable year.

Worthless Securities (Cont.) [ANA]

- No deduction is allowed unless the security is completely worthless.
- The basic test of worthlessness: (i) the security has no current liquidating value; and (ii) the security has no future value.
  - *No current value*: The borrower's liabilities exceed the value of its assets.
  - *No future value*: May be established by (i) pointing to an identifiable event (*e.g.*, bankruptcy, cessation of business, liquidation, etc.); or (ii) showing that liabilities are so greatly in excess of assets plus the nature of the assets and business are such that there is no reasonable hope that continuation will result in any profits for shareholder.

Worthless Debts [SAM]

- The worthless debt deduction may be available for debt instruments that do not meet the definition of “security” above.
  - Note, if the debt instrument is a “security,” it cannot be deducted under the worthless debt rules.
- Depending on the circumstances, a deduction may even be available for debt that is only “partially worthless.”
- However, the debt must be “*bona fide*” debt (*i.e.*, arise from a borrower-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money).

Worthless Debts (Cont.) [SAM]

- For *non-corporate creditors*, deductibility depends on whether the debt is business or nonbusiness debt (all debts owed to corporate creditors are "business debts").
  - *Business debts*: Ordinary deduction
  - *Nonbusiness debts*: Short-term capital loss
- Nonbusiness debt is any debt other than:
  - Debt created or acquired by the creditor in connection with the creditor's trade or business; or
  - Debt the loss from the worthlessness of which was incurred during the operation of the creditor's trade or business.
    - For this test, the debt must, at the time of the worthlessness, be "proximately related" to the creditor's trade or business, as determined by the "dominant motivation" of the creditor.

Worthless Debts (Cont.) [SAM]

- Unlike the rules for worthless securities, a deduction may be available for partially worthless debts (*i.e.*, to the extent the IRS is satisfied the debt is "recoverable only in part").
  - *Business debts*: Deduction available
  - *Nonbusiness debts*: No deduction available
- Establishing Worthlessness: creditor must demonstrate that the debt had value at the beginning of the tax year and became worthless during that year. Factors to consider include:
  - Subordinated status of the debt
  - Decline in borrower's business
  - Decline in value of all property secured by the debt
  - Claims of prior creditors far in excess of the fair market value of all assets available for payment
  - Overall business climate
  - Borrower's earning capacity
  - Borrower's serious financial reserves
  - Guarantees on the debt
  - Events of default (major or minor)
  - Insolvency of the borrower
  - Borrower's refusal to pay
  - Abandonment of assets or businesses
  - Ill health, death or disappearance of the principals
  - Bankruptcy or receivership
  - Actions of the creditors in pursuing collection (*i.e.*, whether a creditor unreasonably failed to take action then claimed a deduction)
  - Subsequent dealings between the creditor and Borrower
  - Lack of assets of the borrower

Part V: Market Discount and Payment Ordering [ANA]

- Accrual of Market Discount
- Treatment of Payments on Distressed Debt Instruments
- NYSBA Proposal

- Market discount generally equals the excess of the principal amount (or adjusted basis, in the case of an OID instrument) of a debt instrument over the holder's basis in the obligation.

- Market discount is computed on a ratable basis unless taxpayer elects to use constant yield principles.
  - *Loans with a single principal payment at maturity*: Use straight-line accrual method.
  - *Loans with multiple principal payments*: Regulations are yet to be issued, but legislative history prescribes an "interest-over-interest" method:
    - Amount of market discount accrued in each period = total remaining market discount on the loan x [(interest accrued in that period)/(interest for period + total amount of interest for all remaining periods)]

- These rules were not enacted with distressed debt in mind, and contain no exceptions or special rules for distressed debt.

  - No adjustment is permitted for the risk of default on the obligation, even if it is reasonably certain that there will be nonpayment of some or all of the principal.

  - Any payment received and any gain on sale is treated as ordinary income to the extent of accrued market discount not previously taken into account.

- Should rules apply in a different manner to distressed debt?

- Scheduled Payments**:** Generally, under Treas. Reg. §§1.446-2(e) and 1.1275-2, any payment under a debt instrument is treated first as interest or OID to the extent accrued and then as a payment of principal.
  - Commentators have noted that while rule is sensible when applied to scheduled payments on debt, it does not make sense when applied to a debt that is settled for less than its principal amount plus accrued interest. Interest is a return on the lender's investment, so a lender should not be charged with interest income if it has not fully recovered its investment.
- Final Settlements: In the event that a lender receives less than unpaid principal and interest upon final settlement, should the ordering rules above apply?
  - The Treasury regulations above suggest that the ordering rules may apply, although case law has held that such a payment may be allocated to principal.
  - It is also possible to argue that such a payment is outside the scope of the regulations since it is not a payment under the loan itself.

- In its recent report, the NYSBA recommends the establishment of specific rules that would apply when an instrument is considered "distressed debt." Under this approach, the Treasury could then issue regulations that would either turn off or modify the application of certain rules, including (i) the accrual of interest, OID, and market discount; (ii) the payment ordering rule; and (iii) the determination of issue price.
  - The standard generally suggested is that debt is distressed if there is "no reasonable expectation that the issuer will make total payments on the debt instrument equal to the debt instrument's 'Tax Principal Amount'."
    - *Timing*: This would be tested on the last day of a calendar year to determine a debt instrument's status for the following calendar year.
    - *Safe harbors*: Two safe harbors would supplement this definition, a "valuation" safe harbor (and accompanying presumption for certain instruments) and a "yield" safe harbor.

- If a debt instrument qualifies as a “distressed debt” under the provided definition, then the following modified rules generally would apply:
  - Stated interest, OID and market discount income would no longer accrue.
  - For significant modifications, the amount realized in such an exchange under Treas. Reg. §1.1001-3 is FMV even if the debt instrument received is not publicly traded, and recapitalization rules would be expanded in this context.
  - Certain reporting and withholding rules would apply to holders that treat debt instruments as distressed.
  - The proposed distressed debt rules would not affect the treatment of the issuer, including deductibility of interest and OID, and payment ordering rules.

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