ALERTS

# Eleventh Circuit Reverses Denial of Lenders' Claim for Default-Rate Interest

**September 9, 2015**

A Chapter 11 debtor's reorganization plan purporting to cure a default under a pre-bankruptcy loan agreement must pay "the agreed-upon default rate interest," consistent with "the underlying agreement" and the "applicable nonbankruptcy law," held the U.S. Court of Appeals for the Eleventh Circuit on Aug. 31, 2015. *In re Sagamore Partners, Ltd.*, 2015 WL 5091909, at *4 (11th Cir. Aug. 31, 2015). Reversing the district and bankruptcy courts, the Eleventh Circuit found they had "erred in [holding] that [the lenders] waived their rights to default-rate interest." *Id.* at *1. Moreover, it explained, the "bankruptcy court … clearly erred in finding that [the lenders] 'consistently assessed late fees and not default interest.'" *Id.* at *5. Agreeing with the district court's reversal of the bankruptcy court on this second related issue, the Eleventh Circuit held the lenders' purported "faulty notice of default was legally irrelevant, because no notice of default was required." *Id.* at *6.

## Relevance

Bankruptcy Code ("Code") Section 1123(a)(5)(G) provides that "[n]otwithstanding any otherwise applicable nonbankruptcy law, a [reorganization] plan *shall … provide adequate means for the plan*'s implementation, *such as … curing or waiving of any default*." Section 1123(d) further provides that "if it is proposed in a plan *to cure a default the amount necessary to cure the default shall* be determined in accordance *with the underlying agreement and applicable nonbankruptcy law*." (emphasis added).

According to the Eleventh Circuit in *Sagamore*, when "the underlying agreement calls for default-rate interest and the applicable nonbankruptcy law permits it, a party cannot cure its default [and reinstate the loan] without paying the agreed-upon default-rate interest." *Id.* at *4. To hold otherwise, the court concluded, would run afoul of the "clear mandate of [Code] § 1123 that allows a creditor to demand default-rate interest as a condition for reinstating the loan." *Id.* at *4.

The lower courts in S*agamore* both denied the lenders' claim for default-rate interest based on their purported waiver of default interest. In challenging the lenders' claim, the debtor had "relied primarily on opinions issued by [other] circuits and … courts prior to … 1994 amendments to the … Code" plus "legislative history." *Id.* at *3. Earlier case law held that creditors lost any right to recover default-rate interest despite contractual provisions to the contrary. *See, e.g.*, *In re Entz-White Lumber & Supply, Inc.*, 850 F.2d 1338, 1340 (9th Cir. 1988) (noting that before 1994, "[t]he Code d[id] not define 'cure'" so courts typically looked for guidance to Section 1124's discussion of what constitutes an impaired claim)*; In re Madison Hotel Assocs.*, 749 F.2d 410 (7th Cir. 1984) (*held*,debtor's cure of its default returned the parties to the "*status quo ante*," meaning that creditors lost any contractual right to recover default-rate interest).

## Facts

The debtor had borrowed $31.5 million from the lenders, securing the loan with its hotel property. The loan bore a non-default 6.54-percent interest rate, but the default-rate was 11.54 percent. Although the lenders were not required to send a notice of default under the loan agreement for the default interest to begin to accrue in 2009, when the debtor had defaulted, the lenders did send a notice of default to the debtor, but not to the debtor's New York counsel (which, under the loan agreement, was to receive a copy of any "required or permitted" notice to the debtor).

The debtor later filed a Chapter 11 petition, and proposed a reorganization plan that would reinstate the secured loan and only pay accrued pre-default-rate interest to cure its default. When the lenders objected, the debtor amended the plan, proposing to set aside all of the funds required to cure the default in any amount deemed appropriate by the court. The debtor argued, though, that it did not owe default interest because the lenders had waived their right to default-rate interest of $5.5 million by accepting, under protest, late fees of $250,000. According to the debtor,

the lenders chose to accept late fees instead of default-rate interest. The debtor also argued that the lenders' notice of default was defective because the lenders had failed to send it to the debtor's New York counsel.

## The Lower Courts

The bankruptcy court held the lenders' notice of default "defective," invalidating the lenders' acceleration letter, foreclosure efforts and their claim to default-rate interest. Alternatively, it found that the lenders had "failed to demand default-rate interest" and were now precluded from doing so because they "asserted [their] entitlement to late fees." *Id.* at *3.

The district court affirmed the bankruptcy court's conclusion that [the lenders] waived default-rate interest. But it reversed the bankruptcy court's invalidating of the lenders' notice of default and remanded to the bankruptcy court the lenders' claim for legal fees and costs. *Id.*

## Default Rate Interest Not Waived

The Eleventh Circuit reversed the lower courts' finding that the lenders had waived their rights to default-rate interest by accepting late fees. Under applicable Florida law, claims for default-rate interest and late fees are consistent remedies that can be asserted together so long as the party does not receive payment of both. *Id.* at *5 (quoting *Princeton Homes, Inc. v. Virone*, 612 F.3d 1324, 1334 n.6 (11th Cir. 2010) ("'Under Florida law, all consistent remedies may in general be pursued concurrently even to final adjudication,' so long as a party does not receive 'satisfaction of the claim by one remedy'")). The lenders here had properly demanded both default-rate interest and late fees but later waived their claim to late fees for any time period for which they received default-rate interest. Although they accepted payment of late fees, under protest, reasoned the court, "[p]ayment accepted under protest cannot be the basis of waiver." *Id.* at *6.

## Defective Notice of Default Irrelevant

The lenders were not required by the loan documents to provide notice of default in order for default-rate interest to begin to accrue. Moreover, the debtor expressly waived in those documents any right to receive such notice. The Eleventh Circuit affirmed the district court's holding "that the

faulty notice of default was legally irrelevant, because no notice of default was required." *Id.*

## Default Interest Issue Not Equitably Moot

Despite the substantial consummation of the debtor's plan, the Eleventh Circuit rejected the debtors' reliance on the equitable mootness doctrine to preclude appellate review. According to the court, it could grant effective relief because the plan specifically provided for the payment of any cure amount, as later determined by the lower court on remand. *Id.* The debtor apparently had funds on deposit or available to pay the default-rate interest. Thus, there was no need to unravel the consummated plan.

## Remand

Aside from awarding the lenders their default-rate interest, the Eleventh Circuit affirmed the lower court's finding that the debtor's plan was "feasible" (i.e., that the debtor would be able to make all required payments). 2015 WL 5091909, at *7. But the court remanded "the question of [the Lenders'] costs and fees … , the timing of payment of the default-rate interest, and any other remaining [unresolved] issues" to the lower court for "resolution." *Id.*

## Comments

The Eleventh Circuit's analysis in *Sagamore* is consistent with other court rulings since the Code's 1994 amendment. *See, e.g., In re 139-141 Owners Corp*, 306 B.R. 763, 768 (Bankr. S.D.N.Y 2004) (debtor may not "avoid or vitiate a secured creditor's contractual right to default interest by complying with" Code Section 1124), *aff'd in part and vacated on different grounds*, 313 B.R. 364 (S.D.N.Y. 2004); *In re Moody Nat'l SHS Houston H, LLC*, 426 B.R. 667, 676 (Bankr. S.D. Tex. 2010) (*held*, the plan must provide for payment of default interest pursuant to Section 1123(d)); *In re Sweet*, 369 B.R. 644, 648-51 (Bankr. D. Colo. 2007) (*held*, where the default interest rate was not considered a penalty, default interest was appropriate to effectuate a Section 1124(2)(A) cure).

The court's equitable mootness ruling, enabling it to review the lenders' appeal on the merits, is consistent with other recent appellate rulings. *See In re Transwest Resort Properties, Inc.*, 791 F.3d 1140, 1142 1 (9th Cir. 2015)

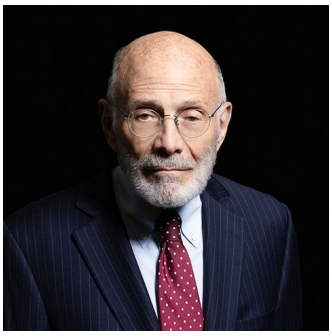
(2-1) (appellate review would not unfairly affect "third parties or entirely unravel the plan"); *In re One2One Communications LLC*, 2015 WL 4430302, at *6 (3d Cir. July 21, 2015) (reversed district court's dismissal of confirmation order appeal on equitable mootness grounds; "[confirmed] Plan did not involve the issuance of any publicly traded securities, bonds or other circumstances that would make it difficult to retract the plan"; "limited evidence of potential third-party injury"); *In re Tribune Media Co.*, 2015 WL 4925923, at *9-*10 (3d Cir. Aug. 19, 2015) (finding one of the two appeals before it, where the appellant had challenged the plan's allocation of funds among two classes of creditors, *not* to be equitably moot because relief could be granted to the appellant; third parties would not be harmed; and because the plan would not be fatally scrambled); *but seeid.* at *11 (finding second appeal before it *was* equitably moot because (1) the plan had been "consummated"; (2) the appellant had "spurned the offer of a stay accompanied by a bond"; and (3) "it would be unfair" to unravel "the most important aspect of the overwhelmingly approved Plan").

*Authored by Michael L. Cook and Brian C. Tong.*

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

---

## Related People



### Michael Cook

Of Counsel

New York

## Practices

**BUSINESS REORGANIZATION**

## Attachments

Download Alert