

ALERTS

Ninth Circuit Holds Unimpaired Unsecured Creditors Entitled to Post-Bankruptcy Interest on Claims at Contractual Default Rate

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“Under the long-standing ‘solvent-debtor exception,’ plaintiffs [unsecured trade creditors] possess an equitable right to receive post-petition interest at the contractual or default state law rate, subject to any other equitable considerations, before [the debtor] collects surplus value from the bankruptcy estate,” held the Ninth Circuit on Aug. 29, 2022. *In re PG&E Corporation*, 2022 WL 3712498, *4 (9th Cir. Aug. 29, 2022) (2-1). “No circuit court [had] addressed the issue [i.e., rate of post-petition interest to unimpaired unsecured creditors], and bankruptcy courts have reached different conclusions.” *Id.*, at *4. In this case, additional post-petition interest to unsecured creditors at contractual rates or the California statutory interest rate, rather than the then-applicable “much lower” 2.59 percent federal judgment rate, could total an additional \$200 million. *Id.*, at *3. The court did not impose either the contractual default rate or the California judgment rate, but instead remanded the case back to the bankruptcy court “to weigh the equities and determine what rate of interest plaintiffs are entitled to....” *Id.*, at *13. But the Ninth Circuit warned the bankruptcy judge that “the solvent-debtor exception, though equitable in nature, does not give bankruptcy judges ‘free-floating discretion to redistribute rights in accordance with [their] personal views of justice and fairness.’” *Id.* at *14. According to the court, “the record before us is limited,” causing the remand, but it saw nothing that would “defeat the presumption that plaintiffs are entitled to contractual or default post-petition interest.” *Id.*

Relevance

The Fifth Circuit heard argument in another similar case during October 2021 on a direct appeal from a Texas bankruptcy court's holding that the "Bankruptcy Code [does not allow]... a solvent debtor to avoid paying unimpaired unsecured creditors a contractual liquidated damages claim and to avoid paying postpetition interest at contractual default rates." *In re Ultra Petroleum Corp.*, 624 B.R. 178, 181 (Bankr. S.D. Tex. 2020) (appeal pending in Fifth Circuit) ("*Ultra*"). A decision in *Ultra* is expected soon.

The *PG&E* decision is therefore important. In *Ultra*, the debtor argued, among other things, that the federal judgment rate is the "legal" rate of post-petition interest. The bankruptcy court in *Ultra* rejected that argument. Although the dissent in *PG&E* argued that "unsecured creditors are not entitled to *any* post-petition interest from a solvent debtor... not even *PG&E* advocated this position, instead conceding that the Code entitled plaintiffs... to post-petition interest... at the federal judgment rate." *PG&E*, at *12.

The former Bankruptcy Act § 63(a) cut off interest at the petition date -- the "default rule in bankruptcy law," said the Ninth Circuit, 2022 WL 3712478, at *4. *Sexton v. Dreyfus*, 219 U.S. 339, 344 (1911). But the Supreme Court later noted that the solvent debtor exception under English law "carried over into our system." *City of New York v. Saper*, 336 U.S. 328, 330 n. (7) (1949). And the Second Circuit also held that it was the "opposite of equity to allow [a solvent debtor] to escape the expressly bargained-for" contractual interest provision. *Ruskin v. Griffiths*, 269 F.2d 827, 832 (2d Cir. 1959). Another bankruptcy court recently held in a Bankruptcy Code case, however, that post-petition interest should be calculated at the lower federal judgment rate, not the contractual or default rate. *Wells Fargo Bank, N.A. v. The Hertz Corp.*, 637 B.R. 781, 800-01 (Bankr. Del. Dec. 22, 2021). *See also In re Energy Future Holdings Corp.*, 540 B.R. 109, 124 (Bankr. D. Del. 2015) (interest based on "equitable principles," at rate court "deems appropriate.").

Comment

The Ninth Circuit's sensible decision should be followed by the Fifth Circuit in *Ultra*. A circuit split would probably have to be resolved by the Supreme Court, a development that would only cause further uncertainty, delay and expense in the lower courts. The unsecured creditor interest-

rate controversy should end. Appellate courts generally agree that oversecured creditors are entitled to contractual or default interest. See, e.g., *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 240-42 (1989) (“Recovery of postpetition interest is unqualified” for “oversecured” creditor); *In re Future Media Prod.*, 547 F.3d 956 (9th Cir. 2008) (oversecured lender awarded post-petition interest at prepetition default rate); *In re Gencarelli*, 501 F.3d 1 (1st Cir. 2007) (same).

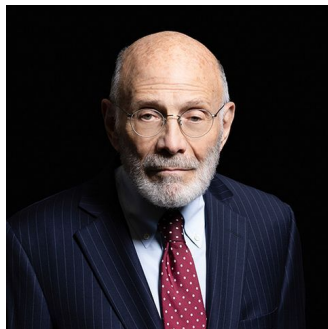
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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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