ALERTS

Fifth Circuit, Like Ninth Circuit, Allows Post-Bankruptcy Contract Rate Interest in Solvent Debtor Case

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"...[B]ecause Congress has not clearly abrogated the solvent-debtor exception," the U.S. Court of Appeals for the Fifth Circuit held that a reorganized solvent debtor had to "pay what it promised now that it is financially capable." *In re Ultra Petroleum Corp.*, 2022 WL 8025329, *1, (5th Cir. Oct. 14, 2022) (2-1). Moreover, "given [the debtor's] solvency, post-petition interest is to be calculated according to the agreed-upon ... contractual default rate ...," not the "much lower Federal Judgment Rate . . .," held the court. *Id.* This $387 million win for creditors follows the similar recent $200 million creditor victory in the Ninth Circuit. *In re PG&E Corporation*, 46 F. 4th 1047, 1053 (9th Cir. Aug. 29, 2022) (2-1) ("Under the long-standing 'solvent debtor' exception," unsecured creditors have "equitable right to receive post-petition interest at . . . contractual or default state law rate, subject to any other equitable consideration; "because of limited" record, case remanded to bankruptcy court with "presumption" of "contractual or default post-petition interest.").

Relevance

"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 in the rare solvent debtor case," noted the Ninth Circuit on Aug. 29, 2002, in the *PG&E* case, 46 F. 4th at 1052, a decision not mentioned by the Fifth Circuit in *Ultra*. And "this is not the ordinary case," said the Fifth Circuit. 22 WL 8025329, at *8. Some lower

courts, for example, had held that post-petition interest should be calculated at the lower federal judgment rate, not the contractual default rate. *In re The Hertz Corp.*, 647 B.R. 781, 800-01 (Bankr. D. Del. 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.").

Facts

The affiliated debtors in Ultra (collectively, "Ultra") were insolvent when they commenced their Chapter 11 cases but "became supremely solvent" during bankruptcy. *Id.*, at *1. "Ultra proposed a $2.5 billion [reorganization] plan" providing full cash payment to creditors plus pre-bankruptcy interest at the Federal Judgment Rate "for the duration of the bankruptcy [case]." But two groups of creditors claimed not only a "Make-Whole Amount," a lump sum "calculated to give them the present value of the interest … they would have received but for Ultra's bankruptcy," but also "post-petition interest" at the contractual default rate.

Make-Whole Amount Unmatured Interest and Liquidated Damages. The Fifth Circuit rejected the creditors' argument that the Make-Whole is not governed by Bankruptcy Code ("Code") § 502(b)'s bar on unmatured interest. "But the Make-Whole Amount… is both liquidated damages and the 'economic equivalent of unmatured interest' – indeed, that is its whole point." Id., at *7. Because the court also held that "solvent-debtor exception survived the … Code's enactment and applies to this case… Ultra must pay the Make-Whole Amount." [16] When a solvent debtor, like Ultra, "is able to pay its valid contractual debts, traditional doctrine says it should – bankruptcy rules notwithstanding." *Id.*, at *8.

Solvent-Debtor Exception. The Code "does not specifically address the solvent-debtor scenario," but "traditional bankruptcy practice has always provided an exception" to the Code's bar on unmatured interest claims. *Id.*, citing, *Am. Iron & Steel Mfg. Co. v. Seaboard Air Line Ry.,* 233 U.S. 261, 266 (1914) (if debtor solvent, "interest as well as principal should be paid."); *City of New York v. Saper*, 336 U.S. 328, 330 n. 7 (1949) (English solvent-debtor exception "carried over into our system."). Because the solvent-debtor exception existed under the Code's predecessor statute, Code § 502(b)(2) does not eliminate it. Here, "the exception operates …… to suspend § 502(b)(2) disallowance of [the] Make-Whole Amount." *Id.*

Make-Whole Enforceable As Liquidated Damages Under Applicable New York Law. The court further rejected Ultra's argument that the Make Whole was an unenforceable penalty under applicable New York Law. "Ultra fail[ed] to meet its burden" of showing that the Make-Whole Amount was "unreasonably disproportionate." *Id.*, at *14., citing *JMD Holding Corp. v. Congress Financial Corp.*, 4 N.Y.2d 373, 376 (borrower failed "to show that … early termination fee is an unenforceable penalty."). "The Make-Whole Amount serves as liquidated damages for Ultra's breach; the post-petition interest compensates for Ultra's lag in paying the accelerated principal (and the Make-Whole itself), which were already due and payable for the duration of the bankruptcy. Separate harms warrant separate recoveries." *Id.* Because the "Make-Whole Amount is enforceable under New York Law, … § 502(b)(1) does not stand in the way of the solvent-debtor exception." *Id.*

Post-Petition Interest at Contractual Default Rate. "[T]he Code does not preclude unimpaired creditors from receiving default-rate post-petition interest in excess of the Federal Judgment Rate in solvent-debtor Chapter 11 cases …. And as a matter of equity creditors are entitled to contractually specified rates of interest 'on' their claims when a solvent debtor is fully capable of paying up… As the bankruptcy court explained well, …'[w]hen the struggle is between creditors *and equity holders*, as opposed to creditor and creditors, [creditors'] equitable right [to contractual post-petition interest rates] is critical.'" *Id.*, at *16.

Dissent: Code Bars Make-Whole Amount. According to the dissent, because "the Make-Whole Amount is unmatured interest in disguise," barred by Code §502(b)(2), "the Code bars the Make-Whole Amount." *Id.*, at *17. Further, it said, "the solvent-debtor exception didn't survive adoption of the … Code," which "overrides the solvent-debtor exception." *Id.* It rejected "with deepest respect," the majority's legal analysis as "convoluted." *Id.*, at *20.

Comments

1. Two important Circuits are now in agreement, having rendered carefully reasoned, sensible and fair opinions. For the moment, the Supreme Court has no reason to review these decisions that can only arise in the rare solvent-debtor case.

2. The sophomoric dissents in *PG&E* and *Ultra* were overwrought. They were also unfair, unconvincing and unnecessary.

Authored by Michael L. Cook.

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

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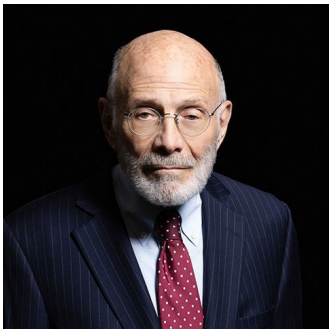

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