



Financial Restructuring & Reorganization ADVISORY ■

JANUARY 28, 2019

Fifth Circuit Rules on Payment of a Make-Whole Premium and Post-Petition Default Interest

On January 17, 2019, the Fifth Circuit Court of Appeals issued another significant opinion concerning the viability/enforceability of a contractual “make-whole” provision. Specifically, the Fifth Circuit yet again addressed the treatment of make-whole premiums and post-petition interest in bankruptcy and provided meaningful analysis and guidance for the bankruptcy court to consider on remand.

In the underlying *Ultra Petroleum Corp.* bankruptcy case (Bankr. S.D. Tex., No. 16-32202), the debtors proposed a plan where certain noteholder claimants would be “unimpaired” because they would receive the outstanding principal amount on their notes plus pre-petition interest at a rate of 0.1% plus post-petition interest at the federal judgment rate. The noteholders objected to being classified as “unimpaired” because the plan did not provide for payment of a contractual make-whole premium (totaling \$201 million) and post-petition interest at the default rate (totaling \$186 million). Importantly, under the debtors’ plan, they were solvent.

After considering the noteholders’ objection, the bankruptcy court agreed, holding that they were entitled to recover the make-whole amount and that the Bankruptcy Code did not limit their contractual right to receive post-petition interest at the default rate. The bankruptcy court concluded that, to be considered unimpaired, the noteholders were required to receive such amounts in full. The debtors appealed the bankruptcy court’s ruling directly to the Fifth Circuit Court of Appeals.

Fifth Circuit Reversal and Remand

In vacating the bankruptcy court’s decision, the Fifth Circuit addressed three important issues. Preliminarily, the Fifth Circuit addressed the bankruptcy court’s analysis of what constitutes impairment under a Chapter 11 plan.

This advisory is published by Alston & Bird LLP to provide a summary of significant developments to our clients and friends. It is intended to be informational and does not constitute legal advice regarding any specific situation. This material may also be considered attorney advertising under court rules of certain jurisdictions.

Impaired claims

The Bankruptcy Code generally requires a debtor to gain a creditor's vote to confirm a plan. Nevertheless, a creditor is not entitled to vote if the plan does not affect the creditor's rights. Simply, if the plan does not impair the creditor's rights, the creditor is deemed to have accepted the plan.

In determining what constitutes impairment, the Fifth Circuit first turned to the plain language of Section 1124(1) of the Bankruptcy Code, which provides that "a class of claims or interests" is not impaired if "the plan ... leaves unaltered [the claimant's] legal, equitable, and contractual rights." The court held that the plain text of, and existing authority on, Section 1124(1) provides that a creditor is impaired under Section 1124(1) only if *the plan itself* alters a claimant's legal, equitable, or contractual rights.

The court next noted that the bankruptcy court never addressed issues of whether the *Bankruptcy Code* disallows the make-whole amount and/or post-petition interest at the contractual default rate. As a result, the Fifth Circuit vacated the bankruptcy court's decision and remanded the case back to the bankruptcy court for it to determine whether the Bankruptcy Code disallows or limits such payments, for example as "unmatured" interest under Section 502(b)(2) or pursuant to Section 726(a)(5)'s legal rate of interest. Importantly, although the Fifth Circuit remanded on the issues of whether the make-whole amount and post-petition interest at the default rate are payable under the Bankruptcy Code, it nevertheless provided significant "guidance" to the bankruptcy court.

Treatment of the Make-Whole Amount and Post-Petition Interest Under the Bankruptcy Code

Disallowance of make-whole amount

Next, although the Fifth Circuit did not "rule" on the issue, the court indicated that it thought that the make-whole amount could be disallowed under Section 502(b)(2) of the Bankruptcy Code, which disallows claims to the extent they seek "unmatured" interest, on three grounds.

First, the court indicated its belief that a make-whole amount could be considered unmatured interest because it is the "economic equivalent" of interest and because the purpose of a make-whole provision is to compensate the lender for lost interest.

Second, the court stated its belief that the make-whole amount could be considered compensation for interest that was unmatured when the debtors filed their Chapter 11 petitions. The court reasoned that since Section 502(b)'s disallowance provisions apply as of the date of the filing of the petition and the make-whole amount was only triggered under the agreement's acceleration clause upon the bankruptcy filing,

the amount was not matured as of the petition date. The Fifth Circuit further indicated that the agreement's acceleration was an unenforceable ipso facto clause in any event, which precluded the triggering of the make-whole amount.¹

Third, the Fifth Circuit distinguished other cases that found that a make-whole amount was not unmatured interest. In particular, while some courts have concluded that Section 502(b)(2) does not cover make-whole provisions because they are considered fully matured pursuant to the contract, the Fifth Circuit countered that ipso facto clauses do not factor into a determination of maturity under Section 502(b)(2). Additionally, the Fifth Circuit also specifically disagreed with courts that have held that make-whole provisions do not implicate Section 502(b)(2) because they serve as liquidated damages rather than unmatured interest, noting that the categories are not mutually exclusive.

Additionally, the Fifth Circuit noted that the noteholders could potentially prevail in this case because the debtors here were solvent and the arguments above may not apply under such facts. In particular, the court left open the question of whether the so-called "solvent debtor" exception survived the enactment of the Bankruptcy Code in 1978. The court noted that this exception dates back to eighteenth century English law, which was the groundwork for U.S. bankruptcy laws, and provided for the payment of contractual interest post-petition when the debtor was solvent. While the Fifth Circuit did not firmly take a position on the issue, it expressed some doubt that the exception survived enactment of the Bankruptcy Code.

Post-petition interest

Finally, turning to the question of post-petition interest, the Fifth Circuit acknowledged that while the noteholders may be entitled to some post-petition interest, Section 726(a)(5) does not apply to the noteholders here. The court did illuminate two potential paths for determining the rate of post-petition interest: (1) 28 U.S.C. Section 1961(a), the general federal post-judgment interest statute, which allows interest "on any money judgment in a civil case recovered in a district court" and sets a rate referencing certain Treasury yields; and (2) a bankruptcy court's power to set an "equitable" rate of interest. The Fifth Circuit left the bankruptcy court to choose the path on remand.

The *Ultra Petroleum* decision is an interesting development in the case law on make-whole payments and post-petition interest. It provides guidance on numerous issues and will most certainly be debated in future litigation on such issues, including on remand before the bankruptcy court.

But wait for more as we await the bankruptcy court's decision on remand. . . .

¹ *But see In re MPM Silicones LLC* (citing *In re AMR Corp.*, 730 F.3d, 88, 101 (2d Cir. 2013) (holding that contractual automatic acceleration is not voluntary on the issuer's part because it is an enforceable covenant, including not being subject to invalidation under any section of the Bankruptcy Code, such as Section 365(e), which would negate so-called ipso facto provisions triggered by a debtor's bankruptcy filing)). See our advisory on *MPM Silicones*: [Intercreditor Agreements in Bankruptcy](#).

You can subscribe to future **Financial Restructuring & Reorganization Group** advisories and other Alston & Bird publications by completing our [publications subscription form](#).

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

Gerard S. Catalanello
212.210.9509
gerard.catalanello@alston.com

Dennis J. Connolly
404.881.7269
212.905.9154
dennis.connolly@alston.com

Jonathan T. Edwards
404.881.4985
212.905.9126
jonathan.edwards@alston.com

William Hao
212.210.9417
william.hao@alston.com

Leib M. Lerner
213.576.1193
leib.lerner@alston.com

Diane C. Stanfield
213.576.1039
diane.stanfield@alston.com

Grant T. Stein
404.881.7285
grant.stein@alston.com

William S. Sugden
404.881.4778
will.sugden@alston.com

James J. Vincequerra
212.210.9503
james.vincequerra@alston.com

John W. Weiss
212.210.9412
john.weiss@alston.com

David A. Wender
404.881.7354
david.wender@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

© ALSTON & BIRD LLP 2019

ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777
BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghai Road ■ Chaoyang District ■ Beijing, 100004 CN ■ +86 10 8592 7500
BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111
DALLAS: Chase Tower ■ 2200 Ross Avenue ■ Suite 2300 ■ Dallas, TX 75201 ■ 214.922.3400 ■ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444
RALEIGH: 555 Fayetteville Street ■ Suite 600 ■ Raleigh, North Carolina, USA, 27601-3034 ■ 919.862.2200 ■ Fax: 919.862.2260
SAN FRANCISCO: 560 Mission Street ■ Suite 2100 ■ San Francisco, California, USA, 94105-0912 ■ 415.243.1000 ■ Fax: 415.243.1001
SILICON VALLEY: 1950 University Avenue ■ 5th Floor ■ East Palo Alto, California, USA, 94303-2282 ■ 650-838-2000 ■ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333