



Financial Restructuring & Reorganization ADVISORY ■

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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.

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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](#).

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