Financial Restructuring & Reorganization ADVISORY ■

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Bankruptcy Court Finds Federal Judgment Rate Applies to Postpetition Interest

by David Wender *and* Geoffrey C. Williams

On December 30, 2019, U.S. Bankruptcy Judge Dennis Montali of the Northern District of California resolved a significant dispute between PG&E and its bondholders, holding that the federal judgment rate controlled over the postpetition interest at the default rate called for under their contracts.

Case Background

The dispute arose in PG&E's bankruptcy case when PG&E proposed a "solvent" plan pursuant to which four classes of unsecured creditors (including priority non-tax claims, prepetition unsecured funded debt claims, and prepetition general unsecured claims (other than wildfire-related claims)) would be unimpaired and would receive payment "in full" by receiving payment for their claims in cash, plus interest accrued from the commencement of the Chapter 11 cases at the federal interest rate.[1]

In response to PG&E's proposed treatment, the Official Committee of Unsecured Creditors, Ad Hoc Committee of Senior Unsecured Noteholders, Ad Hoc Committee of Holders of Trade Claims, and others contended that the applicable interest rate should be determined by otherwise applicable nonbankruptcy law and, thus, would result in their claims bearing interest at either their contractually determined rates (if their contracts contained an applicable interest rate) or the rate determined under state law.

The court's ruling would have a significant impact on PG&E's plan/exit from bankruptcy because if the parties' contractual interest rate applied, PG&E would have been obligated to pay its senior noteholders approximately $500 million in additional cash to render the notes unimpaired.

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1 The federal judgment rate is calculated under 28 U.S.C. § 1961(a) as "a rate equal to the weekly average 1-year constant maturity Treasury yield, as published by the Board of Governors of the Federal Reserve System, for the calendar week preceding the date of the judgment." For purposes of postpetition interest on an allowed unsecured claim, "the date of the judgment" is the bankruptcy petition date. Of note, the federal judgment rate is currently 2.59 percent.

Applying Federal Interest Rate Does Not Impair Creditors

Under U.S. bankruptcy law, impaired creditors have the right to vote on a debtor's plan of reorganization. However, if the plan leaves creditors "unimpaired," those creditors are deemed to have accepted the plan. To the contrary, if impaired, creditors would have the ability to "reject" the plan. Thus, a finding of impairment would allow unsecured creditors the power to potentially block confirmation of the proposed restructuring plan.

Recent circuit court decisions have held that impairment is defined by the plain language of Section 1124(1) of the Bankruptcy Code. Specifically, a creditor is impaired only if *the plan itself* alters a claimant's legal, equitable, or contractual rights.

Treating the Ninth Circuit's milestone decision in *In re Cardelucci* as dispositive and "unequivocal," the bankruptcy court found that the application of the federal interest rate does not impair the unsecured creditor's claims. Thus, PG&E's proposed treatment in its plan—to pay unsecured creditors interest at the federal judgment rate—did not "impair" those creditors "under the plan." Notably, the court emphasized that under *Cardelucci*, the federal interest rate would apply uniformly to both impaired and unimpaired claims in a surplus estate.

While it is unclear whether the decision in *PG&E* will affect decisions in other districts, since bankruptcy courts in other jurisdictions have held that unsecured creditors should, presumptively, be entitled to postpetition interest provided in the creditor's respective contracts, the issue will continue to be debated in bankruptcy cases. Nonetheless, the *PG&E* decision reflects a broader trend of courts distinguishing between impairment resulting from a plan of reorganization as opposed to enforcement of the statutory rights of a claimant under the Bankruptcy Code and a trend of courts seeking to limit lender recoveries.

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