POSTPETITION INTEREST ISSUES UNDER § 506(b)[1]

By: Hon. Cynthia A. Norton
U.S. Bankruptcy Judge
Western District of Missouri, Kansas City
Presented to the American College of Bankruptcy Judges' Roundtable
March 14, 2020

I. Equitable/Penalty Limitations on Oversecured Creditors' Entitlement to Postpetition Default Interest Under § 506(b)

<u>*Introduction*</u>

As a general rule, interest ceases to accrue on prepetition debts once the debtor files bankruptcy.[2] The reasons for this general rule include (1) the preservation of protection of the estate for the benefit of all interests; (2) avoidance of the administrative inconvenience of continuously recomputing claims; and (3) avoidance of the gain or loss as between creditors whose obligations bear different interest rates or who receive payment at different times.[3] The rule has been described as "a rule of administrative convenience and fairness to all creditors," which "makes it possible to calculate the amount of claims easily and assures that creditors at the bottom rungs of the priority ladder are not prejudiced by the delays inherent in liquidation and distribution of the estate."[4]

Section 506(b) of the Bankruptcy Code provides an exception to the general rule for oversecured creditors:

> To the extent that an allowed secured claim is secured by property the value of which after recovery under subsection (c) of this section, is greater than the amount

[1] Materials prepared by Erica Garrett, Career Law Clerk to the Hon. Cynthia A. Norton.
[2] This rule is codified in 11 U.S.C. § 502(b)(2), which disallows claims for "unmatured interest." *See 1111 Myrtle Ave. Group, LLC*, 598 B.R. 729, 735 (Bankr. S.D. N.Y. 2019).
[3] *1111 Myrtle Ave.* 598 B.R. at 735 (citing *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 163, 67 S.Ct. 237, 91 L.Ed. 162 (1946)).
[4] *In re Hanna*, 872 F.2d 829, 830 (8th Cir. 1989).

> of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided under the agreement or State statute under which such claim arose.[5]

This section allows an oversecured creditor to recover postpetition interest and reasonable attorney fees on its claims.

In *United States v. Ron Pair Enterprises, Inc.*, the Supreme Court held that § 506(b) allows oversecured creditors to recover "fees, costs and charges" – such as attorney fees – only if provided for in the parties' agreement and only if the court determines they are reasonable.[6] In contrast, recovery of postpetition interest by oversecured creditors is "unqualified"[7] and thus generally not subject to a reasonableness standard. However, although the Supreme Court said the right of oversecured creditors to interest is "unqualified,' the Court did not set the rate at which an oversecured creditor is entitled to recover postpetition interest.[8] When the debtor-creditor relationship is governed by contract, courts presumptively apply the contract rate of interest under § 506(b) – both as to non-default and default interest – although courts generally hold that the contract rate must be enforceable under nonbankruptcy law. Often, this question turns on whether the default rate is considered to be a penalty under applicable state law, as opposed to an estimate of liquidated damages resulting from a future breach.

In addition, many courts, including all of the circuit courts which have addressed the issue (*i.e.,* the First, Second, Third, Fifth, and Ninth Circuits), have either held outright, or at least suggested, that equitable factors can be considered in a § 506(b) analysis, although the equities

---

[5] 11 U.S.C. § 506(b).
[6] *In re Family Pharmacy, Inc.*, 605 B.R. 900, 905 (Bankr. W.D. Mo. 2019).
[7] *Id.* (citing *Ron Pair*, 489 U.S. at 241, 109 S.Ct. at 1030 (1989); *Rake v. Wade*, 508 U.S. 464, 113 S.Ct. 2187, 124 L.Ed.2d 424 (1993) (holding that § 506(b) requires allowance of postpetition interest with respect to the entire claim of an oversecured creditor, including arrearages, if the contract provides for it)).
[8] *Id.* (citing *In re White*, 260 B.R. 870, 879 (B.A.P. 8th Cir. 2001)).

will compel denial of the presumptive contract rate only in rare circumstances.[9] The party objecting to default interest bears the burden of rebutting the presumption that the contract rate of interest applies postpetition.[10]

Recent Case Law Summaries

1. Court Recognizes Equitable Exception to Entitlement to Default Interest under § 506(b), but Holds Debtor Failed to Rebut Presumption of Such Entitlement. *In re 1111 Myrtle Avenue Group, LLC*, 598 B.R. 729 (Bankr. S.D. N.Y. 2019)

> The confirmed plan in this case provided for payment of the oversecured lender in full, with interest at the non-default rate. It also provided for unsecured creditors to be paid in full, and provided for equity holders to retain their equity interests and to receive any excess cash after payment of creditors *pro rata*. The plan also provided, however, for any such excess cash after payment of creditors to be escrowed in anticipation of litigation regarding whether the oversecured lender would be entitled to default interest. As week after the plan was confirmed, the oversecured lender filed a motion for payment of default interest totaling $1 million.
>
> Despite the fact that interest is "plainly allowed" under § 506(b), the court held that, "in the case of default interest, the contract rate can be subject to adjustment based on equitable considerations." At the same time, however, the power to modify the contract rate based on notions of equity should, according to the court, be

---

[9] *See SW Boston Hotel Venture, LLC*, 748 F.3d 393, 413 (1st Cir. 2014) ("[C]ourts are largely in agreement that, although the appropriate rate of pendency interest is . . . within the limited discretion of the court, . . . where the parties have contractually agreed to interest terms, those terms should presumptively apply so long as they are enforceable under state law and equitable considerations do not dictate otherwise.") (internal quotation marks omitted); *In re Milham*, 141 F.3d 420, 423 (2d Cir. 1998) ("The appropriate rate of pendency interest is therefore within the limited discretion of the court.... Most courts have awarded pendency interest at the contractual rate; but nevertheless, however widespread this practice may be, it does not reflect an entitlement to interest at the contractual rate.") (citation omitted); *In re Nixon*, 404 Fed. Appx. 575, 578-79 (3d Cir. 2010) (acknowledging that entitlement to postpetition interest under § 506(b) is unqualified, but holding that "the Bankruptcy Code does not specify, however, that an oversecured creditor must receive interest indefinitely or at the contract rate"; rather, "[i]n several instances, courts have used equitable considerations to modify the interest awarded oversecured creditors within the parameters of the code.") (citations omitted); *In re Laymon*, 958 F.2d 72, 75 (5th Cir. 1992) (adopting a "flexible approach," allowing a determination of whether the higher default rate "would produce an inequitable or unconscionable result...") (citations omitted); *In re Southland Corp.*, 160 F.3d 1054, 1059-60 (5th Cir. 1998) ("The cases find that a default interest rate is generally allowed, unless the higher rate would produce an inequitable ... result.") (citation and internal quotations omitted); *Gen. Elec. Cap. Corp. v. Future Media Prods, Inc.*, 536 F.3d 969, 974 (9th Cir. 2008) (adopting the rule "adopted by the majority of federal courts" that the "bankruptcy court should apply a presumption of allowability for the contracted for default rate, provided that the rate is not unenforceable under applicable nonbankruptcy law") (citation and internal quotations omitted), *amended on other grounds*, *Gen. Elec. Cap. Corp. v. Future Media Prods, Inc.*, 547 F.3d 956, 961 (9th Cir. 2008).

[10] *In re John Q. Hammons Fall 2006, LLC*, ___ B.R. ____, 2020 WL 211466 (Bankr. D. Kan. Jan. 3, 2020).

"exercised sparingly" and "limited to situations where the secured creditor is guilty of misconduct, the application of the contractual rate of interest would harm the unsecured creditors or impair the debtor's fresh start or the contractual interest rate constitutes a penalty."

The court held that the debtor failed to rebut the presumption of entitlement to the contractual default rate in this case because: (i) the 7% differential between the non-default rate and the default rate fell well within the range of reasonableness and was not a penalty under New York law; (ii) allowing the default interest would not impair the debtor's fresh start because the equity in the property which the reorganized debtor retained exceeded the amount of the mortgage on it by a ratio of more than 3:1; (iii) unsecured creditors were being paid in full under the plan; and (iv) there had been no misconduct by the creditor.

2. Court Held Default Interest Was Penalty Under Missouri Law and, Alternatively, Equitable Considerations Warranted Denial of Default Interest. *In re Family Pharmacy, Inc.*, 605 B.R. 900 (Bankr. W.D. Mo. 2019)

At the time of filing, the debtor's assets were encumbered by three secured lenders, in order of priority: The Bank of Missouri, owed \$11 million; Cardinal Health, owed \$1 million, and J M Smith Corp. (Smith), owed \$18 million. The debtor was current on its obligations to Bank of Missouri at the time of filing. In a § 363 sale, the stalking horse bidder (Smith, who was also the DIP lender) made an initial offer of \$8 million, which at the time, was not enough to pay Bank of Missouri in full. The auction was an unexpected success, however, with Smith submitting the winning bid of \$14 million, meaning both the first and second lienholders were oversecured and both would be paid in full. Shortly before the auction – when it became apparent Bank of Missouri would likely be paid in full – Bank of Missouri, for the first time, claimed postpetition interest at the default rate, not relying on an *ipso facto* clause, but instead asserting that the first missed postpetition payment was the triggering default (despite the fact that it had not declared the loans in default at the time of the missed payment, or objected to the lack of postpetition debt service under the cash collateral and DIP financing orders). If default interest were not allowed, Smith would have received a small payment on its third priority secured claim; if the additional \$440,000 in claimed default interest were paid to the Bank of Missouri, Smith would be mostly out of the money. Both the debtor and Smith objected to the claim for default interest.

In deciding whether the bank was entitled to the default rate of interest, the court followed the many cases presumptively applying the contract rate of interest, subject to the rate being enforceable under state law. Under Missouri law, that question turned on whether the default interest could be considered a penalty, as opposed to anticipated liquidated damages as a result of a breach. The court suggested that the default rate – 18% versus the nondefault rate of 4-7% on the various loans – was likely an unenforceable penalty under Missouri law because there was no notice requirement, no right to cure, no acceleration requirement, and, because of the cross-default provisions of the multiple loans, one missed $500 payment on a car loan would trigger the default rate as to the entire $11 million indebtedness. Moreover, the Bank produced no evidence showing that the spreads between the contract and default rates were intended as a reasonable prediction for any harm caused by a presumed default (as in*,* a liquidated damages provision).

But even if the rate was enforceable under Missouri law, and despite the presumptive application of the contract rate, the court pointed out that all circuits that have decided the issue either hold outright or at least suggest that courts may consider equitable factors in their § 506(b) analysis.

Considering a number of equitable factors, including: (i) the large spread between the non-default and default interest rates; (ii) the Bank's waiting until the eve of the auction to claim default interest; and (iii) that allowing the default rate would result in a windfall to the bank at the expense of Smith (who had acted DIP financer, stalking horse, and successful bidder without notice that the Bank was going to claim an additional $440,000 in interest after the sale), the court concluded that allowance of default interest would be inequitable.

3. Court Held Objecting Party Failed to Rebut Presumption of Allowability of Default Interest on State Law or Equitable Grounds. *In re John Q. Hammons Fall 2006, LLC*, ___ B.R. ____, 2020 WL 211466 (Bankr. D. Kan. Jan. 3, 2020)

The court summarized the situation in this case as involving "a default interest provision in a sophisticated business contract supported by a securitized real estate mortgage conduit, itself with certificate holders and tax implications." The default interest rate was 5% in excess of the standard note rate.

As most courts have done, this court recognized the presumption in favor of the default rate, subject to permissibility under state law. Here, the creditor produced evidence that the default rate was a liquidated damages clause under applicable state law (Missouri), and not a penalty. The court also acknowledged that the presumption of validity is rebuttable by evidence that the equities of the case require a different result – such as where the secured creditor is guilty of misconduct, the application of the contractual interest rate would harm the unsecured creditors or impair the debtor's fresh start, or the contractual rate constitutes a penalty.

> Because (i) there was no "actual evidence" of misconduct or bad faith on the part of the creditor; (ii) the estate was solvent and the plan was a "full payment plan"; and (iii) the default interest was a reasonable estimation of risk when it was negotiated (and not with the benefit of hindsight), the court held the default rate was allowable.

For interesting discussions of the issue of allowability of postpetition default interest, *see* David M. Neff, *Default Interest Claims Make Gains*, 38 Amer. Bankr. Inst. J. 12, 64-65 (June 2019); Megan W. Murray, *Carrot or a Stick: When is Default Interest Not Equitable?*, 15 Amer. Bankr. Inst. J. 5, 26-27 (May 2019).

Unsecured Creditors' Entitlement to Interest in Solvent Debtor Cases

1. Court Holds Unsecured Creditors in Solvent Chapter 11 Case Entitled to Interest at the Federal Judgment Rate, Not at Contractual or State Statutory Rate. *In re PG&E Corp.*, 2019 7476648 (Bankr. N.D. Cal. Dec. 30, 2019)

> Although everyone in this solvent-debtor chapter 11 case agreed that unsecured creditors were entitled to some interest on their claims under a plan, they disputed what interest rate should apply. The unsecured creditors (including the Official Committee of Unsecured Creditors) asserted they were entitled to interest at the contract rates or judgment rates. The debtors and equity holders argued that under binding Ninth Circuit precedent, they were entitled to interest at the federal interest rate under 28 U.S.C. § 1961(a), which was 2.59% at the time.
>
> According to the court, the Ninth Circuit's decision in *In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002), was clear: "unsecured creditors of a solvent debtor will be paid the Federal Interest Rate whether their prepetition contracts call for higher or lower rates, or applicable state law judgment rates are higher, or there are no other applicable rates to consider. Nor is that rule limited to impaired classes." Under principles of *stare decisis*, the court was bound by *Cardelucci* unless it could be distinguished or overruled.
>
> On that point, and in light of § 502(b)(2)'s seeming disallowance of "unmatured interest," the court concluded that *Cardelucci*'s reliance on § 726(a)(5) "was critical." Section 726(a)(5) allows for fifth-priority payment of "interest at the legal rate" on unsecured claims. *Cardelucci* was clear that the "legal rate" was the federal

interest rate. Moreover, the fact that this rate was different than the contract rate did not render the creditors "impaired" under the plan because it was not the plan which mandated the interest rate; it was the Bankruptcy Code which required it. Therefore, if the plan proposed to pay the federal interest rate, the creditors would be presumed to accept the plan under § 1126(f).

2. Court Holds Unsecured Noteholders' Claim Not Entitled to Postpetition Interest. *In re Energy Future Holdings Corp.*, 540 B.R. 109 (Bankr. D. Del. 2015)

The debtors filed an objection to the unsecured noteholders' proof of claim to the extent it asserted postpetition interest. The court held sustained the objection because § 502(b)(2) expressly disallows "unmatured interest" on unsecured claims. Although § 726(a)(5), made applicable in chapter 11 by § 1129(7)(A)(ii) (which requires claimholders to be paid as much as they would in a chapter 7 liquidation), provides for payment of interest on claims, that is a plan confirmation issue, not a claims allowance issue, the court held.

The court further held that the "legal rate of interest" under § 726(a) was the federal judgment rate, but the applicability of that section is limited to its incorporation in § 1129(a)(7) and "does not create a general rule establishing the appropriate rate of postpetition interest." Moreover, the court held, "the plain meaning of section 1129(b)(2) does not require payment to unsecured creditors of post-petition interest when a junior class is receiving a distribution for a plan to be fair and equitable." Rather, the court has discretion to exercise its equitable power to require payment of postpetition interest which may be any rate the court deems appropriate. However, proposing a plan which did not pay the unsecured noteholders interest rendered them impaired and "in order for the [noteholders] to be unimpaired the plan must provide that the Court may award post-petition interest at an appropriate rate if it determines to do so under its equitable power."

Celine DeSantis, Judicial Law Clerk for Hon. Catherine J. Furay
January 26th, 2022

American College of Bankruptcy
2022 Induction Education Sessions
Judges' Roundtable Materials

Postpetition Interest Case Check

1. **Postpetition Interest**
    a. ***In re Family Pharmacy, Inc.*****, 605 B.R. 900 (Bankr. W.D. Mo. 2019)**
        i. Procedural Developments: Reversed and remanded by *In re Family Pharmacy, Inc.*, 614 B.R. 58 (B.A.P. 8th. Cir. 2020)
        ii. The Bankruptcy Appellate Panel reversed and remanded the bankruptcy court's decision, holding that:

            1. The bankruptcy court, in deciding whether the default interest provision of a loan agreement was enforceable under Missouri Law, should not have applied a liquidated damages vs. penalty analysis. The BAP panel based this conclusion on two things. First, it found that there were no cases under Missouri law which applied a liquidated damages analysis to a contractual interest rate set forth in a promissory note, and that because the default interest rate in the loan agreement was a lawful interest rate under Missouri law, there was no support for the proposition that an otherwise lawful interest rate can or should be denied or reduced under such a liquidated damages analysis. Further, the BAP Panel found that applying the liquidated damages analysis to a contractual interest rate brings into play "reasonableness" factors that are not applicable to interest rates under 11 U.S.C. § 506(b). Citing to *Ron Pair*, the BAP Panel found the Supreme Court was clear that the right to interest is "unqualified" by the reasonableness language that qualifies a creditor's right to fees, costs and charges. 489 U.S. at 241, 109 S.Ct. 1026.

2. In deciding whether to allow an oversecured lender's claim for postpetition interest at a default rate, as specified in loan agreement between parties, it was inappropriate for the bankruptcy court to consider equitable factors. In holding as such, the BAP Panel voiced concern that even though the Missouri statute at issue in the case did not define an applicable interest rate, "the affinity for weighing equitable concerns in determining claims has strayed beyond the circumstances in which it is most useful and into situations where the statute itself provides the answer in a more straightforward and less time-consuming manner." *In re Family Pharmacy, Inc.*, 614 B.R. at 66. The BAP Panel then reasoned that because "no section of the Bankruptcy Code gives the bankruptcy court authority, equitable or otherwise, to modify a contractual interest rate prior to plan confirmation…the bankruptcy court need not have considered equitable factors in deciding the matter at hand." *Id.*

b. *In re PG&E Corporation*, 610 B.R. 308 (Bankr. N.D. Cal. 2019):

i. Procedural Developments: Declined to extend by *In re Matthews*, 623 B.R. 818 (Bankr. S.D. Ga. 2020) (finding that the *Till* rate, not the federal judgment interest rate, was proper interest for debtor to pay on unsecured claims in order to obtain confirmation, over objection of trustee, of a plan that did not commit all of debtor's projected disposable income to payment of unsecured creditors).

c. *In re Energy Future Holdings Corp.*, 540 B.R. 109 (Bankr. D. Del. 2015):

i. Procedural Developments: No significant procedural developments.

605 B.R. 900
United States Bankruptcy Court, W.D. Missouri.

IN RE: FAMILY PHARMACY, INC., et al., Debtors.

Case No. 18-60521
|
Signed August 5, 2019

Synopsis
Background: Bank, in its capacity as oversecured creditor, filed motion for allowance of postpetition attorney fees and cost and interest at default rate, and Chapter 11 debtor and junior lender objected.

Holdings: The Bankruptcy Court, Cynthia A. Norton, Chief Judge, held that:

provision in loan documents authorizing recovery of default interest was in nature of an unenforceable penalty under Missouri law;

bankruptcy court had authority to disallow such bargained-for default interest on equitable grounds, regardless of whether it was enforceable under state law; and

bankruptcy court would exercise its discretion to disallow such interest on equitable grounds.

Motion granted in part and denied in part.

Attorneys and Law Firms

***902** Mark T. Benedict, John Joseph Cruciani, Michael D. Fielding, Christopher C. Miles, Husch Blackwell Sanders LLP, Kansas City, MO, for Debtors.

MEMORANDUM OPINION (Amended Nunc Pro Tunc to Correct Amount of Attorney Fees)

Cynthia A. Norton, Chief Judge

The issue in this case is whether the debtors and a junior lender have met their burden of rebutting a senior lender's claim to postpetition default interest[1] under its loan documents and applicable Missouri and federal bankruptcy law. For the reasons set forth below, the court finds and concludes they have.[2]

JURISDICTION
This matter concerns the allowance or disallowance of The Bank of Missouri's claims against the bankruptcy estate and is therefore a statutorily core proceeding under 28 U.S.C. § 157(b)(2)(B). Specifically, because this proceeding involves a determination of the Bank's entitlement to default interest on claims to be paid from estate assets, it "falls squarely into the category of matters that 'necessarily be ***903** resolved in the claims allowance process.' "[3] Therefore, this court has the authority to enter a final judgment or order in this matter.[4]

FINDINGS OF FACT
The facts are not disputed.[5]

Debtor Family Pharmacy, Inc. and four related entities[6] (collectively, the "Debtors") filed voluntary petitions for chapter 11 relief on April 30, 2018. Debtors' assets, consisting primarily of inventory, equipment and real estate used in operating pharmacies in southwest Missouri, were encumbered by three secured creditors, in order of priority: The Bank of Missouri, owed approximately $11 million; Cardinal Health, $1 million, and J M Smith Corp., $18 million. From the inception, all parties[7] agreed that the assets needed to be sold at a § 363[8] auction sale. Smith, the Debtors' primary supplier, agreed to advance debtor-in-possession ("DIP") financing[9] and to serve as the so-called stalking horse bidder for the sale with an $8 million opening bid.

The court entered orders authorizing the DIP financing with Smith, approving Debtors' interim and final motions for use of DIP financing and use of cash collateral, and approving bid procedures for the sale.[10] After a robust auction, the court in early August 2018 – some three months after the case was filed – approved Smith as the final bidder with a cash bid of $13,975,000.[11] Under the terms of the order approving the sale, the principal claims of the Bank[12] and Cardinal Health and other fees and closing costs were paid at closing, leaving sales proceeds of approximately $556,040.59.[13]

***904** The Bank, as an oversecured creditor, then filed its motion under § 506(b) seeking allowance of $18,271.19 in postpetition attorneys fees plus $442,843.51 in interest calculated at an 18% default rate.[14] The Debtors and Smith[15] jointly objected to the Bank's motion. The parties stipulated that Smith is owed approximately $16 million on account of its undersecured secured claim.[16]

At the hearing on the Bank's motion, the Debtors and Smith agreed to allowance of the Bank's attorney fees, leaving only the default interest at issue. Additional findings of fact will be made below.

DISCUSSION

Postpetition Interest Under the Bankruptcy Code, Generally

As a general rule, interest ceases to accrue on prepetition debts once a bankruptcy filing occurs.[17] This rule is codified in § 502(b)(2) of the Bankruptcy Code, which disallows a claim for "unmatured interest."[18] As the Eighth Circuit has explained, "[t]he general rule 'disallowing' the payment of unmatured interest out of the assets of the bankruptcy estate is a rule of administrative convenience and fairness to all creditors. The rule makes it possible to calculate the amount of claims easily and assures that creditors at the bottom rungs of the priority ladder are not prejudiced by the delays inherent in liquidation and distribution of the estate."[19]

The Bankruptcy Code provides, however, an exception to the general rule for oversecured creditors. Section 506(b) provides:

> To the extent that an allowed secured claim is secured by property the value of which after recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided under the agreement or State statute under which such claim arose.[20]

This section authorizes an oversecured creditor, such as The Bank of Missouri ***905** here, to recover postpetition interest and reasonable attorney fees on its claims.[21]

In *United States v. Ron Pair Enterprises, Inc.*, the Supreme Court held that § 506(b) allows oversecured creditors to recover "fees, costs and charges" – such as attorney fees – only if provided for in the parties' agreement and only if the court determines they are reasonable. In contrast, recovery of postpetition interest by oversecured creditors is "unqualified."[22] Although the right of oversecured creditors to postpetition interest is "unqualified," the Supreme Court did not set the rate at which an oversecured creditor is entitled to recover postpetition interest.[23] When the debtor-creditor relationship is governed by contract, as is the case here, most courts presumptively apply the contract rate of interest under § 506(b),[24] although – as discussed more fully below – the contract rate must be enforceable under state law, and many courts also consider equitable factors in their § 506(b) analysis.[25] In addition, most courts have at least recognized a presumption of allowability of default rates of interest, provided, again, that the rate is enforceable under applicable nonbankruptcy law.[26]

Summary of the Parties' Arguments

The parties agree that the Bank is an oversecured creditor to the extent of the remaining sales proceeds pursuant to ***906** § 506(b). The parties also agree that the Bank's various loan documents provide for nondefault contract interest of between 3.65 – 7.5%[27] and a default rate of 18% and are subject to applicable Missouri law. The parties even agree that the Debtors were current on all loans to the Bank as of the date of filing.[28] Where the parties disagree, however, is (1) whether the Debtors were in default postpetition; and (2) if so, whether application of an 18% default rate under the circumstances of this case should be disallowed as either a penalty or for equitable reasons under Missouri or federal bankruptcy law. There are no Eighth Circuit cases on point.[29]

I. Was the Default Rate Triggered Under the Terms of the Bank's Loan Documents?

The court makes additional findings with respect to whether the Debtors were in default as follows:

Between July 21, 2014 and March 1, 2018, the Bank of Missouri made eight loans to the Debtors.[30] The individual promissory notes have non-default interest rates ranging between 3.65 – 7.5%.[31] Other than these non-default interest rates and the maturity dates which vary from loan to loan, the relevant terms of the notes are, for all practical purposes, identical. They provide that "[u]pon default, including failure to pay upon final maturity, the interest rate on this Note shall be increased to 18.000% per annum based on a year of 360 days...." A "default" as relevant here is in turn triggered when the "Borrower fails to make any payment when due under this Note." Importantly, the notes contain no right to cure for a payment default.

The notes also contain a standard acceleration clause providing that the Bank "may" declare the entire unpaid principal balance due "upon default," in addition to a so-called ipso facto clause under which insolvency or bankruptcy constitutes an event of default. The notes provide that they are to be construed in accordance with Missouri law and contain cross-default and cross-collateralization provisions. Payments on each of the notes were due on the first of each month.

As noted previously, the Debtors were current on all the Bank's loans when they filed bankruptcy on April 30, 2018. The loan payments on most of the loans were due under the terms of the various notes the next day, May 1.[32] Except for a payment on one small vehicle loan (which the Debtor's chief reorganizing officer testified was made to the Bank in error), the Debtors ***907** did not make the May 1 or subsequent regular monthly payments. The Bank did not, however, send a notice of default or otherwise send notice of acceleration when the Debtors failed to make the postpetition payments, and otherwise made no claim for default interest until just before the auction sale was set to occur, several months later.

Discussion Concerning Whether the Debtors Defaulted

The Bank argues that under the plain terms of its loan documents, the Debtors defaulted when they failed to make loan payments, even when those payments became due postpetition. The Debtors and Smith vehemently disagree; they argue that the Debtors were prevented by the filing from making loan payments such that any payment default should be excused and that the ipso facto clause is not enforceable.[33] They point out that the Bank did not send a notice of payment default or even accelerate. The Bank retorts that nothing in the Bankruptcy Code or case authorities prevents a debtor in bankruptcy from continuing to make payments to creditors; that it did not have to affirmatively accelerate to trigger default; and that the cases so requiring[34] are distinguishable based on the terms of the loan documents in those cases.

Surprisingly, the case law is murky. The court found cases for the broad proposition that some (but not all) ipso facto clauses are not enforceable in bankruptcy[35] as well as for the proposition that bankruptcy effectuates an acceleration (and perhaps a default).[36] Many of the cases are distinguishable based on differences in the terms of the loan documents, the applicable state law, or precedential circuit decisions, and whether the debtor was already in default before the bankruptcy was filed. Although common sense might dictate that a debtor should not continue to make regular payments to secured creditors absent court order in a bankruptcy case (otherwise, what is the point of filing bankruptcy?) the parties did not cite and the court did not find any cases quite on point.

One thing is clear (and is a fact that the Bank conveniently ignores): the court's interim and final cash collateral orders authorized the Debtors only to make such payments as were listed in the budget, and regular loan payments to the Bank were simply not there. The Bank, despite having participated in both the interim and final cash collateral hearings, did not object to the Debtors' motions nor to the court's ***908** orders. The existence of a valid, final court order barring the Debtors from making loan payments to the Bank would seem to be a valid legal defense to the Bank's argument that the Debtors defaulted by failing to make payments (but, again, the parties cited the court no authority one way or the other).

Given, however, that the court ultimately concludes default interest is not allowable under the circumstances of this case, the court need not decide the issue. The court will presume for purposes of this opinion that the Bank became entitled to default interest when the Debtors did not pay the loan payments when they came due on May 1, the day after the bankruptcy was filed.[37]

II. Should the Default Rate of Interest be Disallowed as a Penalty?

The Bank argues that Missouri law governs, such that this court has no power or authority to disallow default interest to which it is entitled under the terms of its loan documents. The Bank argues that the Eighth Circuit has not found such power or authority to exist in the bankruptcy court or in the Bankruptcy Code and that the other Circuits that have found so – including the Second, Third, Fifth, and Ninth, among others – are wrong. The Bank misconstrues both Missouri and federal bankruptcy law. But, taking Missouri law first.

It is true that Missouri law generally authorizes parties to a business loan to "agree in writing to any rate of interest, fees, and other terms and conditions in connection with" the loan.[38] Thus, an 18% interest rate (whether default or otherwise) in connection with a business loan, such as the one here, is not *per se* illegal under Missouri law.

Missouri law distinguishes, however, between liquidated damages clauses, which are valid, and penalty clauses, which are not:[39]

> A penalty provision specifies a punishment for default, while liquidated damages are provided as a measure of compensation that, at

> the time of contracting, the parties agree will represent damages in the event of a breach. For a damage clause to be valid as setting liquidated damages, the amount fixed as damages must be a reasonable prediction for the harm caused by the breach and the harms must be of a kind difficult to estimate accurately. In determining whether an agreement sets forth liquidated damages or a penalty, this Court looks to the intent of the parties as determined from the contract as a whole.[40]

While it is not necessary to actually prove damages in the same amount as stated in a liquidated damages provision, without evidence of damages, a liquidated damages clause actually becomes a penalty and is ***909** unenforceable.[41] "For the amount to be a reasonable forecast of damages, it must not be unreasonably disproportionate to the amount of harm anticipated when the contract was made."[42]

The evidence in this case convincingly proved that the Bank's 18% default rate constituted an unenforceable penalty under Missouri law. The Bank's loan documents provided that a default occurs upon a failure to make a payment; that such default is not curable; and that default interest automatically is triggered without notice or acceleration. The court would be speculating if it concluded that this language was written to avoid the highly publicized result in two cases, *Tarkio College* and *Payless Cashways*, in which the bankruptcy court held (and in *Tarkio*, the Eighth Circuit affirmed) that a bank was not entitled to default interest when it failed to give notice of default and acceleration.

But no matter. The effect is stark: if the Debtors were one day late or missed one payment – say the $765.45 payment due on Loan # 3291, a $26,000 car loan bearing 3.650% interest – then 18% default interest would be triggered not only on that loan but on the entire $11 million of debt, and without notice or opportunity to cure.

The Bank adduced no evidence showing that a spread of between 10.5 and 14.35 between contract and default rate was either intended or a reasonable prediction for any harm caused by a presumed default, and in fact adduced no evidence of any harm. Although the Bank's counsel argued the Bank was "harmed" because it paid a portion of the broker's fee, the Bank agreed to do so. The Bank also benefitted from the broker's services, in that those services resulted in a successful auction turning the Bank from an undersecured creditor (with the $8 million opening bid) to an oversecured creditor[43] paid in full, including postpetition non-default interest and all attorney fees, expenses and costs.[44]

If acceleration without clear and unequivocal notice is considered by Missouri courts to be "a harsh remedy" as the Eighth Circuit said in *Tarkio*,[45] default interest on an entire $11 million obligation, without notice and opportunity to cure, for missing a small car loan payment most certainly is. More importantly, such a result has no correlation to damages the Bank would incur as the result of missing such a payment. Taken together, the court concludes that, under Missouri law, these provisions would be deemed an unenforceable penalty. The Bank's argument that Missouri law gives it unfettered rights to charge what interest it wants is simply not an accurate portrayal of Missouri law.

910** ***III. Should the Default Rate of Interest be Disallowed for Equitable Reasons?

Even if the cumulative effect of the notes' terms do not amount to an unenforceable penalty under Missouri law, the court finds that the equities of this case under applicable federal bankruptcy law mandate disallowance of default interest on the Bank's claim.

In the bankruptcy court's opinion in *In re Tarkio College*, Judge Federman did not ultimately decide whether default interest was permitted because his decision rested on the conclusion that the lender had not properly accelerated and thus did not trigger the default interest pursuant to the particular loan documents in that case.[46] He stated in dicta, however, that "the language of section 506(b) may give courts flexibility to adjust a default interest rate based on the equities of the case."[47]

The Eighth Circuit affirmed Judge Federman's decision, but did not have to decide the equities issue because, one, it agreed with Judge Federman that the default rate had not been triggered by the payment default without acceleration and, two, the lender had not raised the application of default interest upon maturity (which had occurred postpetition) below.[48] The Eighth Circuit hinted, however, that if that issue had been properly raised and developed in the record below, Judge Federman may have properly considered the reasonableness of the default rate.[49]

The Eighth Circuit has not definitively answered that question post-*Tarkio*. All circuits that have decided the issue either hold outright or at least suggest that courts may consider equitable factors in allowing postpetition interest at the contract rate under § 506(b). According to the Seventh Circuit, although creditors have a right to bargained-for postpetition interest, "[w]hat emerges from the post-*Ron Pair* decisions is a presumption in favor of the contract rate subject to rebuttal based upon equitable considerations."[50]

The Second, Third, Fifth, and Ninth Circuits all likewise hold that equitable factors may be considered.[51] Most recently, ***911** the First Circuit held, interpreting *Ron Pair*, that "the statutory language does not dictate that bankruptcy courts look to the applicable contract provisions, if any, when computing postpetition interest."[52] Rather, the First Circuit said, "courts are largely in agreement that, although the appropriate rate of pendency interest is within the limited discretion of the court, where the parties have contractually agreed to interest terms, those terms should presumptively apply *so long as they are enforceable under state law and equitable considerations do not dictate otherwise*."[53]

Although courts may disagree on who has the burden of proof and what factors to consider, the overwhelming majority of courts – including all circuits to have addressed it – recognize the bankruptcy courts' equitable power to disallow interest under certain circumstances. The Bank makes no persuasive argument why the Eighth Circuit would likely buck this consensus; in fact, the Eighth Circuit often observes that federal bankruptcy law supersedes parties' state law rights and has stated so in a similar context involving postpetition interest.[54]

The Supreme Court reasoned in *Ron Pair* that § 506(b)'s phrase "interest on such claim" is not limited by the subsequent language "provided for under the agreement under which claim arose."[55] "As such, the Court concluded that, unlike an award of fees, costs or charges, the grant of interest is not dictated by the loan agreement,"[56] which is why many courts only presume the contract rate applies, subject to other considerations. The court ***912** therefore concludes that although a party's contract default rate of interest is presumed enforceable, the presumption may be rebutted and default interest disallowed when allowance would be inequitable.

Consideration of Equitable Factors

The balancing of the equities does not require resort to a particular list of factors; rather, "[t]he very purpose of equity is to exalt the individual circumstances of a case of law's hard and fast rules."[57] Courts nonetheless have considered several factors when deciding whether to enforce a contractual default rate as opposed to the nondefault rate, including:

(1) The difference between the default and nondefault rates;

(2) The reasonableness of the differential between the rates;

(3) The relative distribution rights of other creditors and whether enforcement of the higher rate will do injustice to the concept of equitable distribution of the estate's assets; and

(4) The purpose of the higher interest rate. Specifically, does the default rate merely compensate the creditor for any loss resulting from the nonpayment of the principal at maturity, or is it a disguised penalty?[58]

The debtor (or objecting party) bears the burden of rebutting the presumption that the contract rate of interest applies post-petition.[59]

Here, for the same reasons discussed above, the spread between the nondefault and default rates of interest are between 10.5 and 14.35, which is a significant spread and not within a range other courts have found reasonable,[60] and there was no evidence regarding the purpose of such a difference.

More importantly, allowing the Bank default interest in effect gives it a windfall at the expense of Smith. At the default rate, the Bank claims $755,389.88 in postpetition interest for four months, compared to $312,546.37 at the nondefault rate – a difference of almost $443,000.[61] Yet it was through Smith's efforts as DIP financer and stalking horse bidder that the Bank went from being an undersecured creditor as of filing to an oversecured creditor paid in full. Despite many hearings on cash collateral and sale matters, the Bank did not assert that its loans were in default or that it was claiming default interest, until just before the auction sale occurred. The Bank's attorney fees invoices reveal that the Bank's attorneys did not begin to research or discuss entitlement to default rate interest until August 9, 2018, the day ***913** after the court entered its order approving the auction and when it then became clear that there were a number of other interested bidders.[62]

Without question, Smith is a sophisticated creditor who made loans to the Debtors that were lower in priority to the Bank's liens, and "[t]he general rule of freedom of contract includes the freedom to make a bad bargain."[63] But the Bank's loan provisions allowing default interest without notice greatly compounds the injustice to the concept of equitable distribution of the estate's assets in this particular bankruptcy case; neither the Debtors nor the court – and certainly not Smith or the other bidders –were aware that the Bank intended to claim default interest at the time the court approved the bid procedures and granted the motion to sell. The Debtors and Smith assert that the Bank's failure to notify the court and parties earlier of its intent to assert default interest amounts to a "waiver" of its rights to do so. Regardless of whether a lender may waive default interest under Missouri law, the court concludes the Bank's delay in making known to the court and the parties that it intended to claim more than $400,000 of default interest in lieu of nondefault interest weighs heavily against the Bank.

The Fifth Circuit has held that when a bank ambushes other parties by claiming default interest, this may be a factor to be considered.[64] The court does not mean to suggest that ambush was on the Bank's mind, but it was clear at the hearing that at least the Debtors and Smith had been surprised by the late claim to more than $400,000 in additional interest.[65] And it appears to the court that the Bank's claiming of default interest came only as an afterthought, once it became apparent that the auction might be more of a success than anyone anticipated.

CONCLUSION

The court concludes that The Bank of Missouri's claim for default interest constitutes an unenforceable penalty under Missouri law. In the alternative, the court concludes that allowance of default interest would be inequitable under federal bankruptcy law. The Bank's motion to allow postpetition attorney fees and interest at the contract rate is allowed; the request to allow default interest is denied. All other arguments and requests for relief are rejected.

A separate order will issue.

All Citations

605 B.R. 900

Footnotes

1 Sometimes referred in the case law as "pendency interest." *See In re Consumers Realty & Development Company, Inc.*, 238 B.R. 418, 425 (8th Cir. BAP 1999). For a general overview, *see* David M. Neff, *Default Interest Claims Make Gains*, 38 AMER. BANKR. INST. J. 12, 64-65 (June 2019); Megan W. Murray, *Carrot or a Stick: When is Default Interest Not Equitable?*, 15 AMER. BANKR. INST. J. 5, 26-27 (May 2019).

2 Fed. R. Civ. Proc. 52, as incorporated by Fed. R. Bankr. Proc. 7052.

3 *In re 1111 Myrtle Ave. Group, LLC*, 598 B.R. 729, 735 n. 2 (Bankr. S.D. N.Y. 2019) (quoting *Stern v. Marshall*, 564 U.S. 462, 499, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011)).

4 *Id.* (citations omitted). No party has contested jurisdiction or the court's authority to make a final decision.

5 The parties agreed to submit this matter to the court based on a joint stipulation of fact and agreed admissibility of certain documents in addition to live testimony from the Bank's loan officer. *Joint Stipulation of Facts and Agreement Related to the Admissibility of Certain Exhibits By and Between Debtors, JM Smith Corporation, Smith Management Services, LLC, and the Bank of Missouri* (ECF No. 328) ("Joint Stipulation"). The court hereby incorporates the parties' Joint Stipulation as part of its findings of fact.

6 Family Pharmacy, Inc. (Case No. 18-60521); Family Pharmacy of Missouri, LLC (Case No. 18-60523); HealthTAC Logistics, LLC (Case No. 18-60526); Family Property Management, LLC (Case No. 18-60525); and Family Pharmacy of Strafford, Inc. (Case No. 18-60524).

7 There were only two unsecured creditors in the first filed Schedule E/F: a $101,000 intercompany claim and a small utility bill. The parties stipulated that unsecured claims are now in excess of $300,000. *Joint Stipulation* (ECF No. 328) at ¶ 28.

8 11 U.S.C. § 363. Unless otherwise indicated, all future statutory references will be to title 11, 11 U.S.C. §§ 101 *et seq.*

9 11 U.S.C. § 364.

10 ECF Nos. 37, 90 and 111. The Bank did object to certain provisions in the bidding procedures, but did not object to the assets being sold. ECF No. 84.

11 ECF No. 215.

12 The parties stipulate that that the Bank was paid $11,300,477.87, consisting of principal, estimated nondefault interest, attorneys fees and other charges, less a pro-rated portion of the broker fee.

13 *Joint Stipulation* (ECF No. 328) at ¶¶ 26-27.

14 *Motion for Order Allowing Secured Claims* (ECF No. 281). The court notes that the Motion requested $513,761 in interest but, at the hearing, the parties clarified that the Debtors had since paid the Bank $70,756.20 in outstanding postpetition nondefault contract interest and that the Bank was only seeking the $442,843.51 of default interest. With respect to attorney fees, the Motion was orally amended at the hearing to increase the request for attorney fees from $12,511.89 to $18,271.19.

15 Smith transferred its claims to Smith Management Services, LLC after the sale, but for the sake of convenience, the court will continue to refer to this party as "Smith."

16 *Joint Stipulation* (ECF No. 328) at ¶ 28.

17 *In re 1111 Myrtle Ave. Group, LLC*, 598 B.R. 729, 735 (Bankr. S.D. N.Y. 2019) (citing *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 163, 67 S.Ct. 237, 91 L.Ed. 162 (1946)). The reasons for this general rule include (1) the preservation and protection of the estate for the benefit of all interests; (2) avoidance of the administrative inconvenience of continuously recomputing claims; and (3) avoidance of the gain or loss as between creditors whose obligations bear different interest rates or who receive payment at different times. *Id.*

18 11 U.S.C. § 502(b)(2); *see also 1111 Myrtle Ave.*, 598 B.R. at 735.

19 *In re Hanna*, 872 F.2d 829, 830 (8th Cir. 1989).

20 11 U.S.C. § 506(b).

21 *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989); *In re Payless Cashways, Inc.*, 287 B.R. 482, 484-85 (Bankr. W.D. Mo. 2002).

22 *Ron Pair*, 489 U.S. at 241, 109 S.Ct. at 1030 (1989). *See also Rake v. Wade*, 508 U.S. 464, 113 S.Ct. 2187, 124 L.Ed.2d 424 (1993) (holding that § 506(b) requires allowance of postpetition interest with respect to the entire claim of an oversecured creditor, including arrearages, if the contract provides for it).

23 *In re White*, 260 B.R. 870, 879 (8th Cir. BAP 2001).

24 *See White*, 260 B.R. at 879 ("[M]ost courts have concluded that postpetition interest should be computed at the rate provided in the agreement, or other applicable law, under which the claim arose – the so-called contract rate of interest.") (quoting 3 Lawrence P. King, Collier on Bankruptcy ¶ 506.04[2][b][i] (15th ed. rev. 2000)). *See also KCC-Leawood Corp. Manor I v. Travelers Ins. Co.*, 117 B.R. 969, 973 (W.D. Mo. 1989) ("It is well established that, pursuant to section 506(b) of the Bankruptcy Code, an oversecured creditor is entitled to the contract rate of interest, 'up to the point where it, when added to total principal to be paid and allowable costs, equals the value of the collateral.' ") (citation omitted); *In re Bryant*, 439 B.R. 724, 739 (Bankr. E.D. Ark. 2010) ("The rate of interest to be paid is the contract rate") (citations omitted); *In re Johnston*, 44 B.R. 667, 669 (Bankr. W.D. Mo. 1984) ("As the statute makes clear, if the creditor is oversecured, the rate of interest to be paid is the contract rate."). *See also In re Lockard*, 234 B.R. 484, 494 (Bankr. W.D. Mo. 1999) ("The Bank is entitled to its contract rate of interest through the date of confirmation ....").

25 *See, e.g.*, *In re Northern Beef Packers L.P.*, 2015 WL 2236185 at *11 (Bankr. D. S.D. April 10, 2015) ("Many courts presumptively apply the rate set forth in the parties' agreement or applicable nonbankruptcy law. Others apply the rate set forth in the parties' agreement or applicable nonbankruptcy law *unless* the court finds equity dictates a different rate.") (emphasis in original; citations

omitted).

26 *See* 4 Collier on Bankruptcy ¶ 506.04[2][b][ii] (Richard Levin & Henry J. Sommer eds., 16th ed.) ("In general, just as there is no express mechanism in section 506(b) for adjusting basic interest rates, courts should be reluctant to infer a mechanism for disallowing default rates of interest under federal law. Rather, the allowability of the rate should turn instead on applicable nonbankruptcy law.").

27 *Motion for Allowance of Secured Claims* (ECF No. 281) at ¶ 13.

28 Prior to the filing of the bankruptcy cases, on October 27, 2017 and March 14, 2018, the Bank sent the Debtors four notices of certain non-monetary defaults. These notices did not invoke the default interest rate and the Bank concedes that it does not rely on these prepetition non-monetary defaults or notices as triggering events for default interest.

29 The Eighth Circuit, in discussing whether interest accrued postpetition on a state court judgment provided for under a chapter 13 plan, states generally that federal law determines creditor's rights after filing of a bankruptcy petition. *In re Brooks*, 323 F.3d 675, 678 (8th Cir. 2003), citing *Bursch v. Beardsley & Piper*, 971 F.2d 108, 114 (8th Cir. 1992).

30 *Joint Stipulation* (ECF No. 328) at ¶ 1.

31 *Motion for Allowance of Secured Claims* (ECF No. 281) at ¶ 13.

32 On several of the loans, the next payment was not due until June 1, 2018. *See* Exhibit 1, § 506(b) Motion (ECF No. 281).

33 It is not clear to the court that the Bank is actually relying on the ipso facto clause as a basis for triggering a default since it was not raised in the motion or in the Bank's briefing.

34 *See First Bank Investors' Trust v. Tarkio College*, 129 F.3d 471, 475 (8th Cir. 1997), affirming *In re Tarkio College*, 195 B.R. 424, 429 (Bankr. W.D. Mo. 1996); *In re Payless Cashways, Inc.*, 287 B.R. 482, 484-85 (Bankr. W.D. Mo. 2002).

35 *See generally* Paul Rubin, *Not Every Ipso Facto Clause is Unenforceable in Bankruptcy*, 32 AMER. BANKR. INST. J. 12 (Aug. 2013).

36 *See, e.g.*, *In re Premier Entertainment Biloxi LLC*, 445 B.R. 582, 630 (Bankr. S.D. Miss. 2010) (noting a distinction between the automatic acceleration effectuated by the Bankruptcy Code and an automatic acceleration effectuated by a contractual provision; the automatic acceleration by the Code allows a lender to file a proof of claim for the unmatured principal amount of the debt under § 502 without violating the stay, but such acceleration is "relatively limited" and does not change the maturity date of the debt); *In re AMR Corporation*, 485 B.R. 279 (Bankr. S.D.N.Y. 2013) (discussion of acceleration in context of lender's entitlement to make-whole premiums).

37 The court is mindful that determining a default was triggered under these circumstances may have ramifications in other contexts, such as a lender's entitlement to make-whole premiums. In the absence of clear authority cited by the parties or guidance by the Eighth Circuit, the court believes it is not necessary to reach this determination.

38 Mo. Rev. Stat. § 408.035.

39 *Phillips v. Missouri TLC, LLC*, 468 S.W.3d 398, 407 (Mo. Ct. App. S.D. 2015) (citation and internal quotation marks omitted).

40 *Id.* (quoting *City of Richmond Heights v. Waite*, 280 S.W.3d 770, 776 (Mo. Ct. App. E.D. 2009)).

41 *Id.*

42 *Paragon Group, Inc. v. Ampleman*, 878 S.W.2d 878, 881 (Mo. Ct. App. E.D. 1994) (citation and internal quotations omitted). *See*

also Kansas City Live Block 139 Retail, LLC v. Fran's K.C., Ltd, 504 S.W.3d 725, 731 (Mo. Ct. App. W.D. 2016).

43 *See* § 506(a)(1) (value determined in light of the purpose of the valuation and of the proposed use or disposition of the collateral).

44 According to the Bank's Exhibit 2, the Bank was paid $241,790.17 in estimated nondefault interest on August 31, 2018, the date of closing, plus $38,154.65 in attorney fees. With the addition of the $70,756.20 in nondefault interest the Debtors paid after this Motion was filed, the Bank's total postpetition nondefault interest was $312,546.37 for the approximately four months from filing to closing, compared to a total of $755,389.88 the Bank would have been paid if the court allowed default interest.

45 *Tarkio College*, 129 F.3d at 475.

46 *Tarkio College*, 195 B.R. at 428-29.

47 *Id.* at 428.

48 *Tarkio College*, 129 F.3d at 477.

49 *Id.* at 477-78 ("Similarly, the record has not been developed with respect to the reasonableness of the post-maturity interest rate of sixteen percent under 11 U.S.C. § 506(b)."). *See also In re Payless*, 287 B.R. at 489 (stating, without deciding, that "cases hold that section 506(b) contemplates the award of interest to an oversecured creditor at the contract rate *barring equitable considerations or restrictions under state law.*") (emphasis added). *Compare*, *In re Smith*, 2008 WL 185784 at *8 (Bankr. W.D. Mo. Jan. 19, 2008) (Judge Federman holding, in the context of a loan that had been accelerated prepetition, that "the plain language of § 506(b) allows oversecured creditors to receive their contract rate of postpetition interest, regardless of any reasonableness or equitable considerations" but holding that the 4% default rate there was nevertheless reasonable and equitable).

50 *In re Terry Ltd. Partnership*, 27 F.3d 241, 243 (7th Cir. 1994) (citations omitted).

51 *See In re Milham*, 141 F.3d 420, 423 (2d Cir. 1998) ("The appropriate rate of pendency interest is therefore within the limited discretion of the court.... Most courts have awarded pendency interest at the contractual rate; but nevertheless, however widespread this practice may be, it does not reflect an entitlement to interest at the contractual rate.") (citation omitted); *In re Nixon*, 404 Fed. Appx. 575, 578-79 (3d Cir. 2010) (acknowledging that entitlement to postpetition interest under § 506(b) is unqualified, but holding that "the Bankruptcy Code does not specify, however, that an oversecured creditor must receive interest indefinitely or at the contract rate"; rather, "[i]n several instances, courts have used equitable considerations to modify the interest awarded oversecured creditors within the parameters of the code.") (citations omitted); *In re Laymon*, 958 F.2d 72, 75 (5th Cir. 1992) (adopting a "flexible approach," allowing a determination of whether the higher default rate "would produce an inequitable or unconscionable result...") (citations omitted); *In re Southland Corp.*, 160 F.3d 1054, 1059-60 (5th Cir. 1998) ("The cases find that a default interest rate is generally allowed, unless the higher rate would produce an inequitable ... result.") (citation and internal quotations omitted); *Gen. Elec. Cap. Corp. v. Future Media Prods, Inc.*, 536 F.3d 969, 974 (9th Cir. 2008) (adopting the rule "adopted by the majority of federal courts" that the "bankruptcy court should apply a presumption of allowability for the contracted for default rate, provided that the rate is not unenforceable under applicable nonbankruptcy law") (citation and internal quotations omitted), *amended on other grounds*, *Gen. Elec. Cap. Corp. v. Future Media Prods, Inc.*, 547 F.3d 956, 961 (9th Cir. 2008).

52 *In re SW Boston Hotel Venture, LLC*, 748 F.3d 393, 413 (1st Cir. 2014).

53 *Id.* (emphasis added; internal quotation marks and ellipses omitted) (citing *Gen. Elec. Cap. Corp. v. Future Media Prods, Inc.*, 536 F.3d 969, 974 (9th Cir. 2008); *In re Terry L.P.*, 27 F.3d 241, 243 (7th Cir 1994) (additional citations omitted)).

54 *In re Brooks*, 323 F.3d at 678 (federal law determines creditor's rights after filing of petition). *In re Black Ranches, Inc.*, 362 F.2d 8, 16 (8th Cir. 1966) (allowance of postpetition interest under the Bankruptcy Act, observing "that there may be situations where the higher rate would produce an inequitable or unconscionable result, so as to require disallowance thereof"); *see also Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed. 162 (1946) (under the Act; whether interest allowed on claims has long been decided by federal law).

55 *In re Johnson*, 184 B.R. 570, 572 (Bankr. D. Minn. 1995).

56 *Id.*

57 *In re Southland Corp.*, 160 F.3d at 1060.

58 *In re Johnson*, 184 B.R. at 573 (citations omitted).

59 *1111 Myrtle Ave.* 598 B.R. at 736. *But see In re Jack Kline Co., Inc.*, 440 B.R. 712, 732-33 (Bankr. S.D. Tex. 2010) (oversecured creditors have the ultimate burden of showing they are entitled to postpetition fees).

60 *E.g.*, *In the Matter of Bowles Sub Parcel C, LLC v. Wells Fargo Bank, N.A.*, 2015 WL 7573189 (D. Minn. 2015) (5% spread not so high as to raise equitable concerns), citing *In re 785 Partners LLC*, 470 B.R. 126, 134 (Bankr. S.D.N.Y. 2012) (upholding default rate of 10% where the non-default rate was 5%); *In re Cliftondale Oaks, LLC*, 357 B.R. 883 (Bankr. N.D. Ga. 2006) (5% spread reasonable); *In re Route One West Windsor LP*, 225 B.R. 76, 92 (Bankr. D.N.J. 1998) (upholding 8% spread); *In re White*, 88 B.R. 494, 498 (Bankr. D. Mass. 1988) (affirming default rate of 19.25% where non-default rate was 14.25%).

61 See fn. 44, *infra.*

62 Bank Exhibit1 Itemized Fee Statements. The statements also show that the Bank's attorneys spent $8,702 in fees researching the issue, which is being paid out of the estate.

63 *R & R Land Dev., L.L.C v. Am. Freightways, Inc*, 389 S.W.3d 234, 243-44 (Mo. Ct. App. 2012) (citing *Byrd v. Liesman*, 825 S.W.2d 38, 41 (Mo. Ct. App. 1992)).

64 *In re Southland Corp.*, 160 F.3d at 1060.

65 The court is aware that in *1111 Myrtle Ave.*, 598 B.R. at 736-37, the court held that notice was not required and that the equities did not mandate disallowance of the claim. That case is distinguishable because the debtor there knew from the beginning – even without notice – that the bank was going to claim default interest, and that case did not involve an auction with bidders relying on the bank's claims.

End of Document

2019 WL 7476648
Only the Westlaw citation is currently available.
United States Bankruptcy Court, N.D. California.

IN RE: PG&E CORPORATION,
and
Pacific Gas and Electric Company, Debtors.
Affects both Debtors
* All papers shall be filed in the Lead Case, No. 19-30088 (DM).

Bankruptcy Case No. 19-30088-DM Jointly Administered
|
Date: December 11, 2019, Time: 10:00 AM, Place: Courtroom 17, 450 Golden Gate Ave., 16th Floor, San Francisco, CA
|
Signed December 30, 2019

Synopsis
Background: Parties sought to determine applicable postpetition interest to be paid to four classes of allowed unsecured and unimpaired claims under any Chapter 11 reorganization plan for solvent corporate debtors.

The Bankruptcy Court, Dennis Montali, J., held that unsecured creditors were entitled to postpetition interest at the federal judgment rate, not at contractual or state statutory rates.

Ordered accordingly.

Attorneys and Law Firms

Peter J. Benvenutti, Tobias S. Keller, Jane Kim, Dara Levinson Silveira, Thomas B. Rupp, Keller & Benvenutti LLP, San Francisco, CA, Kevin Bostel, Jared R. Friedmann, Andriana Georgallas, Stuart J. Goldring, Matthew Goren, Stephen Karotkin, Kevin Kramer, Jessica Liou, John Nolan, Ray C. Schrock, Richard W. Slack, Theodore Tsekerides, Weil, Gotshal & Manges LLP, Timothy G. Cameron, David A. Herman, Omid H. Nasab, Kevin J. Orsini, Paul H. Zumbro, Cravath, Swaine & Moore LLP, New York, NY, Katherine Kohn, David Levine, Groom Law Group, Chartered, Washington, DC, Bradley R. Schneider, Munger Tolles and Olson LLP, Los Angeles, CA, for Debtors.

MEMORANDUM DECISION REGARDING POSTPETITION INTEREST

DENNIS MONTALI, U.S. Bankruptcy Judge

I. INTRODUCTION

***1** On December 11, 2019, the court heard oral argument on the discrete legal issue of the applicable postpetition interest to be paid to four classes of allowed unsecured and unimpaired claims, under any chapter 11 reorganization plan for solvent debtors PG&E Corporation and Pacific Gas and Electric Company ("Debtors"). The Debtors, joined by certain Shareholders, argue that creditors in all four classes should receive interest calculated pursuant to 28 U.S.C. § 1961(a) (the "Federal Interest Rate") in effect as of the petition date (January 29, 2019) these chapter 11 cases. That rate for these jointly administered cases is 2.59 percent. Debtors contend that use of the Federal Interest Rate is consistent with *In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002) ("*Cardelucci*"), which holds that unsecured creditors in a solvent case should receive postpetition interest calculated at the Federal Interest Rate.

Several parties, including the Official Committee of Unsecured Creditors, the Ad Hoc Committee of Senior Unsecured Noteholders, the Ad Hoc Committee of Holders of Trade Claims and others (collectively "Unsecured Creditors") oppose the motion. They urge application of various rates, generally determined by applicable contracts between the Debtors and the respective claimants, judgment rates or some other rate.

For the following reasons, the court concludes that the Debtors are correct, that *Cardelucci* controls and that the Federal Interest Rate applies to any Plan.

II. APPLICABLE LAW

Statutory construction of the Bankruptcy Code[1] is "a holistic endeavor" requiring consideration of the entire statutory scheme. *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.,* 484 U.S. 365, 371, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988), cited by *In re BCE West, L.P.*, 319 F.3d 1166, 1171 (9th Cir. 2003).

In *Timbers*, the Supreme Court utilized this holistic approach to analyze five seemingly unconnected provisions of Title 11 in determining that oversecured creditors are entitled to receive postpetition interest. Applying a similar holistic approach, this court has looked to the structure of the Bankruptcy Code and the purposes behind its many parts to conclude while unsecured creditors are entitled to postpetition interest in a solvent estate, the Bankruptcy Code requires application of the Federal Interest Rate to those claims and that such an application does not impair these claims. Even if *Cardelucci* were not binding, the court would reach the same conclusion.

Chapter 5, subchapter I ("Creditors and Claims") of the Bankruptcy Code sets forth the guiding principles for filing and allowance of claims or interests, administrative expenses, determination of secured status and other provisions not important to the current analysis. In contrast, the court must apply the critical provisions of chapter 11, subchapter II ("The Plan"). Section 1123(a) states what a plan "shall" do or include. Section 1123(b) states what a plan "may" do or include. As a definitional matter, section 1124 explains that a class of claims or interest is impaired <u>unless</u> the plan leaves certain legal, equitable and contractual rights unaltered (§ 1124(1)), or cures, restates, or compensates the rights of class or interest members (§ 1124(2)(A)-(E)).

***2** The structure of the Bankruptcy Code and the applicability of these definitional and empowering sections, therefore, dictate rights that are fixed as of the petition date and what rules apply after that. Nothing suggests that, absent specific rules, provisions dealing with prepetition entitlements carry over postpetition. For example, section 502(b)(2) clearly provides that a claim for "unmatured interest"[2] may not be allowed. An exception to the rule is found in section 506(b) that permits accrued interest to be allowed as long as the security is "greater than the amount of such claim."

The Unsecured Creditors' argument that somehow the definitions and remedies found in section 1124 override the plain impact of section 502(b)(2) is simply not persuasive and would require the court to ignore not only the plain words of the statute but also the holistic notion of treating them as part of a combined comprehensive instrument of definitions, applicability and implementation. Section 1124(1) describes what claims are unimpaired and section 1124(2) describes what is necessary for a plan to "unimpair" impaired claims. In contrast, chapter 5 ("Creditors and Claims") dictates how claims and interests are dealt with in the substantive chapters: 7, 11, 12 and 13. The subparts of section 502(b) list nine specific rules for affecting allowed claims.

An example not directly related to this case proves the point. Section 502(b)(4) disallows the claim of an insider or an attorney to the extent it exceeds the reasonable value of the services. Unsecured Creditors could not persuade the court or even make a convincing argument that somehow an insider or an attorney whose asserted claim exceeds a reasonable value could take refuge in section 1124((1)'s definitional provision and escape the clear intention of Congress to limit unreasonable claims for services in the same manner it has limited postpetition unsecured claims for unmatured interest. For the same reason, underlying non-bankruptcy law must give way to contrary provisions of the Bankruptcy Code. *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.,* 549 U.S. 443, 444, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007) (quoting *Raleigh v. Illinois Dept. of Revenue*, 530 U.S. 15, 20, 120 S.Ct. 1951, 147 L.Ed.2d 13 (2000).

With that background, the court turns to the applicability of *Cardelucci* and its clear message.

III. <u>THIS COURT'S RESPONSIBILITY UNDER *STARE DECISIS*</u>

This court is bound by the Ninth Circuit's *Cardelucci* decision unless it can be distinguished or overruled:

> Courts are bound by the decisions of higher courts under the principle of *stare decisis*. The doctrine derives from the maxim of the common law, "Stare decisis et non quieta movere," which literally means, "Let stand what is decided, and do not disturb what is settled." See 1B Jeremy C. Moore et al., Moore's Federal Practice ¶ 0.402[1] (2d ed. 1992). Moore's treatise describes the rule as follows:
>
> > The rule, as developed in the English law, is that a decision on an issue of law embodied in a final judgment is binding on the court that decided it and such other courts as owe obedience to its decisions, in all future cases. *Id.*
>
> Under this principle a decision of a circuit court of appeal is binding on all lower courts in the circuit, including district courts and bankruptcy courts (absent a contrary United States Supreme Court decision). *Zuniga v. United Can Co.*, 812 F.2d 443, 450 (9th Cir. 1987).
>
> This is true even if there is a split of opinion between the controlling circuit and another circuit court of appeals, and the lower court believes that the controlling circuit court is in error. *Zuniga*, 812 F.2d at 450; *Hasbrouck v.*

Texaco, Inc., 663 F.2d 930, 933 (9th Cir. 1981)[.]

***3** In re Globe Illumination Co., 149 B.R. 614, 617 (Bankr. C.D. Cal. 1993) (multiple internal citations omitted).

Cardelucci is a published panel opinion by the Court of Appeals for the Ninth Circuit. It is binding on this court. *State Farm Fire & Cas. Ins. Co. v. GP West, Inc.,* 190 F. Supp.3d 1003, 1018 (D. Haw. 2016) (citation and internal quotation marks omitted). *See Lair v. Bullock*, 798 F.3d 736, 747 (9th Cir. 2015) ("[W]e are bound by a prior three-judge panel's published opinions, ...") (citing *Miller v. Gammie*, 335 F.3d 889, 892–93 (9th Cir. 2003) (en banc)).

IV. THE HOLDING OF *CARDELUCCI*

In *Cardelucci*, the Ninth Circuit framed the issue before it as follows:

> This appeal presents the narrow but important issue of whether such post-petition interest is to be calculated using the (federal judgment rate) or is determined by the parties' contract or state law.

Cardelucci, 285 F.3d at 1231.

The Ninth Circuit held that in chapter 11 cases involving solvent debtors, unsecured creditors are entitled to postpetition interest at the federal judgment rate, not at not at contractual or state statutory rates. *Id.* at 1234. In so holding, the Ninth Circuit observed that application of the lower federal judgment rate did not violate an unsecured creditor's substantive due process rights (*id.* at 1236) and that utilization of federal judgment rate for all claims was rationally related to legitimate interests in efficiency, fairness, predictability, and uniformity within bankruptcy system. *Id.*

While the court pinpointed a "narrow but important issue," it did not narrow the application of its holding, which must be applied broadly given the structure of the Bankruptcy Code and the clear and plain meaning of its applicable provisions, as noted above.

In *Cardelucci*, the debtor and his opponents, holders of a state court judgment, set aside various differences and thereby permitted confirmation to proceed subject to a reservation of rights concerning the applicable postpetition interest rate.[3] The Ninth Circuit concluded that the reference by Congress to "the legal rate" in section 726(a)(5) was intentional, in that Congress had rejected proposed language of "interest on claims allowed." *Cardelucci,* 285 F.3d at 1234. The court also emphasized that a single, easily determined rate for all postpetition interest ensures equitable treatment of creditors.[4] Although *Cardelucci* was a chapter 11 case, the reference to section 726(a)(5) was critical. Without that reference, the court would be compelled by section 502(b)(2) to allow claims "except to the extent that ... (2) such claim is for unmatured interest."[5] There is no specific provision in chapter 11 that allows any interest on unsecured claims.[6] Without that reference, Unsecured Creditors would be left with no allowed postpetition interest.

***4** The rule in the seventeen years since *Cardelucci* is clear: unsecured creditors of a solvent debtor will be paid the Federal Interest Rate whether their prepetition contracts call for higher or lower rates, or applicable state law judgment rates are higher, or there are no other applicable rates to consider. Nor is that rule limited to impaired claims. *Cardelucci* is unequivocal and articulates several reasons for broad application of its holding despite the recognition of the narrow issue presented:

> 1. The use of the term "legal rate" indicates the Congress intended the single source to be statutory because of the common use of the term when the Bankruptcy Code was enacted.
>
> 2. Using the federal rate promotes uniformity within federal law.
>
> 3. The analogous post-judgment interest entitlement compensates for being deprived of compensation for the loss of time between ascertainment of damages and payment.
>
> 4. Application of a single, easily determined rate ensures equitable treatment of creditors.
>
> 5. With a uniform rate, no single creditor will be eligible for a disproportionate share of the remaining assets.

Cardelucci, 285 F.3d at 1235-1236.

The Unsecured Creditors refer to the opinion's "parting note" to support their cause. The actual conclusion rejects a substantive due process argument that has not been developed here for good reasons. To this court, the "parting note" that dooms their cause is in the penultimate paragraph, and bears repeating:

> The Court recognizes that these two interests, fairness among creditors and administrative efficiency, may be of limited relevance in certain bankruptcy proceedings. Where there are only a few unsecured creditors seeking post-petition interest and there are sufficient assets to pay all claims for all interest (sic), there will be no concerns regarding equity among creditors or practicality. In those instances, a debtor may receive a windfall from the application of a lower federal interest rate to an award of post-petition interest. Nonetheless 'interest at the legal rate' is a statutory term with a definitive meaning that cannot shift depending on the interests invoked by the specific factual circumstances before the court. *See In re Thompson,* 16 F.3d 576, 581 (4th Cir. 1994).

Cardelucci, 285 F.3d at 1236.

Unsecured Creditors' reliance on older cases invoking the "absolute priority" rule in defense of postpetition interest at the contract rate are unavailing. *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510, 61 S.Ct. 675, 85 L.Ed. 982 (1941), was decided under the former Bankruptcy Act and is of questionable viability now that the Bankruptcy Code includes sections 726(a)(5) and 502(b)(2). Similarly, *Debentureholders Protective Committee of Continental Inv. Corp. v. Continental Inv. Corp.*, 679 F.2d 264 (1st Cir. 1982), was decided under Chapter X of the former Bankruptcy Act and thus offers no guidance here.

The Ninth Circuit's decision in *L&J Anaheim Associates v. Kawasaki Leasing International, Inc.* (*In re L&J Anaheim Associates*), 995 F.2d 940 (9th Cir. 1993) does not change the outcome. *L&J Anaheim* was decided only a few months after *Cardelucci* and did not cite it, as it addressed an altogether different issue.

In *L&J Anaheim*, a secured creditor filed a chapter 11 plan that was opposed by the debtor. In order to achieve the statutory requirement for at least one impaired class, the creditor, Kawasaki, proposed changing its own state law remedies following debtor's breach. It eliminated its right to exercise various remedies under the California Uniform Commercial Code, replacing those entitlements under its proposed plan with a requirement that its collateral and a related lawsuit be sold at public auction under procedures mandated by the Bankruptcy Code.

***5** In determining that Kawasaki's rights were altered, and thus its claim was impaired, the court stated:

> At first blush the idea that an improvement in ones' position as a creditor might constitute 'impairment' seems nonsensical."

L & J Anaheim, 995 F.2d at 942.

The court examined the term of art adopted by Congress to replace language in the prior Bankruptcy Act and concluded that section 1124 created certainty in determining whether or not a creditor was impaired. Once again, section 1124 is definitional, describing improvement in the context of the plan presented as impairment. The court had no occasion to address whether, for an impaired class, postpetition interest was even relevant.

Of importance here is that the plan's own language altered Kawasaki's rights; in the present case, the Bankruptcy Code, and not the Plan, is what causes Unsecured Creditors to have their postpetition interest limited to the Federal Judgment Rate. The Plan is not the culprit.

A few months after *Cardelucci*, the Ninth Circuit *decided Platinum Capital, Inc. v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.*, 314 F.3d 1070 (9th Cir. 2002). There, the court addressed whether or not a plan proponent had proposed the plan in good faith under section 1129(a)(3) when its sole purpose was to enable the debtors to cure and reinstate an obligation. At that time, *Great W. Bank & Trust v. Entz-White Lumber and Supply, Inc. (In re Entz-White Lumber and Supply, Inc.)*, 850 F.2d 1338 (9th Cir. 1988), was good law. Under *Entz-White*, plan proponents were permitted to cure defaults under former section 1124(3), leaving the objecting creditor not impaired under section 1124. Perhaps predicting the crucial distinction between what a plan does and what the Bankruptcy Code does, the *Sylmar Plaza* court rejected the argument that a plan lacks good faith when it permits owners of a solvent debtor to avoid paying postpetition interest at the default interest rate. The fact that a creditor's contractual rights are adversely affected does not by itself warrant a bad faith finding. Quoting the bankruptcy court in *In re PPI Enters. (US), Inc.*, 228 B.R. 339 (Bankr. D. Del. 1998), the court stated:

> In enacting the Bankruptcy Code, Congress made a determination that an eligible debtor should have the opportunity to avail itself of a number of Code provisions which adversely altered creditors' contractual and non bankruptcy rights ....
>
> The fact that a debtor proposes a plan which it avails itself of an applicable Code provision does not constitute evidence of bad faith.

Sylmar Plaza, 314 F.3d at 1075 (citations omitted).

Cases cited by the *Sylmar Plaza* creditor to support a per se rule were distinguishable in that neither adopted or approved such a rule and, moreover, "... because none involved an objection to a plan by an unimpaired creditor." *Id.*

At oral argument counsel for one of the Unsecured Creditors argued that *Cardelucci* has been superseded by *In re New Investments, Inc.*, 840 F.3d 1137 (9th Cir. 2016). That argument is unavailing. The *New Investments* decision concludes that the 1994 amendments to section 1124 abrogated the holding of *Entz-White* that default interest rates could be eliminated by curing defaults under a plan. The decision does not even mention postpetition interest or *Cardelucci* and does not deal with unimpaired claims under section 1124(1) and thus is of no bearing on the issue presented or the outcome here.

V. IMPAIRED OR UNIMPAIRED CLAIMS ARE TREATED ALIKE

***6** Unsecured Creditors attempt in vain to escape *Cardelucci's* impact by arguing that, unlike the impaired claim there, their claims will be unimpaired under a plan. The court rejects Unsecured Creditors' argument.

First, *Cardelucci*, in answering the narrow question, drew no distinction as to whether the rule it announced was confined only to impaired claims. The clear and unequivocal analysis based on section 726(b)(5) is obvious: it applies to all unsecured and undersecured claims in a surplus estate.

Second, no plan compels the payment of the Federal Interest Rate. Rather, the Bankruptcy Code does. A similar analysis was applied very recently by the Fifth Circuit in *In re Ultra Petroleum Corporation*, 943 F.3d 758 (5th Cir. 2019). There, the court contrasted the treatment of creditors' claims outside of bankruptcy and whether the plan itself was a source of limitation on their legal, equitable and contractual rights, or rather the Bankruptcy Code. The court looked to the language of section 1124(1), defining not impaired when the plan "... leaves unaltered [the claimant's] legal, equitable and contractual rights." The court ruled that a claim is impaired only if the plan itself does the altering, not what the Bankruptcy Code does.

Ultra Petroleum agreed with the only other court of appeals decision to draw the distinction between what a plan might do and what the Bankruptcy Code does do. *In Solow v. PPI Enterprises (U.S.) Inc. (In re PPI Enterprises (U.S.) Inc.),* 324 F.3d 197 (3d Cir. 2003) the court upheld confirmation of a plan notwithstanding a limitation on an objecting landlord's statutorily capped damages under section 502(b)(6). It held that where section 502(b)(6) alters a creditor's non-bankruptcy claim, there is no alteration of the claimant's "legal, equitable and contractual rights" for purposes of impairment under section 1124(1). *Id.* at 203.

The *PPI Enterprises* court agreed with the bankruptcy court's analysis in *In re American Solar King Corp.*, 90 B.R. 808 (Bankr. W.D. Tex. 1988) where the bankruptcy court made the following very thoughtful observation:

> A closer inspection of the language employed in [s]ection 1124(1) reveals 'impairment by statute to be an oxymoron.' Impairment results from what the <u>plan</u> does, not what the statute does. A plan which 'leaves unaltered' the legal rights of a claimant is one which by definition, does not impair the creditor. A plan which leaves a claimant subject to other applicable provisions of Bankruptcy Code does no more to alter a claimant's legal rights than does a plan which leaves a claimant vulnerable to a given state's usury laws or to federal environmental laws. The Bankruptcy Code itself is a statute which, like other statutes, helps to define the legal rights of person's, just as surely as it limits contractual rights. Any alteration of legal rights is a consequence not of the plan but of the bankruptcy filing itself.

American Solar, 90 B.R. at 819-20.

The *Ultra Petroleum* court noted that decisions from bankruptcy courts across the country have reached the same conclusion, agreeing that impairment results from what a plan does, not from what a statute does. Its conclusion reinforces the point:

> ***7** We agree with *PPI*, every reported decision identified by either party, and Collier's treatise. Where a plan refuses to pay funds disallowed by the Code, the Code - not the Plan – is doing the impairing.

Ultra Petroleum, 943 F.3d at 765.

Like the creditors in *Ultra Petroleum*, the Unsecured Creditors' complaint is with Congress and the Bankruptcy Code, not the drafters of a Plan. The Bankruptcy Code, not the Plan, limits them to the Federal Interest Rate.[7] The cases cited by Unsecured Creditors do not apply here, as the rights in those cases were impaired by the plan and not by operation of law. *See Acequia, Inc. v. Clinton (In re Acequia)*, 787 F.2d 1352, 1363 (9th Cir. 1986) (shareholder voting rights altered by plan); *In re Rexford Properties, LLC*, 558 B.R. 352, 368 (Bankr. C.D. Cal 2016) (creditor's rights regarding ongoing business altered by plan).

There is no point in discussing section 1124(2), as that subsection is not relevant to the treatment of the four not impaired classes. Were Debtors to have proposed a treatment of the Unsecured Creditors' claims that cured, reinstated, or reversed any acceleration, then the analysis might be helpful. But because section 1124(1) is the operative section here, that ends the discussion.

Because the Plan leaves the Unsecured Creditors' claims not impaired, there is also no need to dwell on whether or not "fair and equitable" principles apply. They do not. Unimpaired Creditors, when treated as dictated by the Bankruptcy Code, are not impaired by the Plan. They are conclusively presumed to have accepted the Plan. Section 1126(f). Section 1129(b) is not available to them.[8]

VI. CONCLUSION

As a trial court in the Ninth Circuit, this court is bound to follow *Cardelucci* unless, as a matter of principled reasoning, it can be distinguished. No such grounds exist. The 1994 amendments to section 1124 predated *Cardelucci*. Thus, whether or not *Cardelucci* addressed the issue is not the point. Its rule is the law of this circuit until altered either by an *en banc* panel, the United States Supreme Court, legislation or some other controlling change in the law.

Even were *Cardelucci* not controlling, this court would follow the lead of *PPI* and *Ultra Petroleum* (and the lower court decisions cited by *Ultra Petroleum)*, and reject the contention of Objecting Creditors that imposition of the Federal Interest Rate impairs them. It is the Bankruptcy Code itself, not any plan provision, that imposes that rate.[9]

***8** The court is not concurrently entering an order consistent with this Memorandum Decision as was the case with its recent decision in the Inverse Condemnation action (Dkt. No. 4895). Because of the close relationship between the postpetition interest question and the issues presented in the forthcoming Make-Whole dispute, orders disposing of them both at the same time seems appropriate and efficient. Whether either or both questions should be certified for direct appeal or to treated as final for purposes of Fed. R. Bankr. P. 7054, can be visited later.

All Citations

--- B.R. ----, 2019 WL 7476648

Footnotes

1 Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532.

2 No one has suggested that "unmatured interest" means anything other than "postpetition interest."

3 While the opinion is silent on the specifics of that debtor's plan, the opponents' claim was impaired for reasons not relevant to this analysis. In the present case the Unsecured Creditors' claims are unimpaired. The Unsecured Creditors put the cart before the horse when they contend that the application of the "fair and equitable" test of section 1129(b) determines that their claims are impaired under section 1124.

4 In this case, given the vast array of creditors' claims, the equal application of such uniform policy is all the more compelling.

5 The exception found in section 506(b) for secured claims has no bearing here.

6 The court rejects the argument by the Ad Hoc Committee of Holders of Trade Claims that section 103(b) precludes consideration of section 726(a)(5). *Cardelucci* merely compared the chapter 7 outcome (apply the Federal Interest Rate) as part of the "best interest" test of Section 1129(a)(9) to compare whether creditors do better in chapter 7 or chapter 11.

7 For the same reason, creditors who hold contractual claims calling for interest lower than 2.59% will fare better under the Plan.

8 For this reason, the court rejects as incorrect the bankruptcy court's reliance *In re Energy Future Holdings*, 540 B.R. 109 (Bankr. D. Del. 2015) on "equitable principles" to permit unsecured creditors in a solvent case to recover a contract rate or such other rate as it deemed appropriate.

9 *Ultra Petroleum* remanded the case to the bankruptcy court to decide the appropriate Make-Whole amounts, the appropriate postpetition interest rate, and the applicability of the solvent-debtor exception. If the three judges on the Fifth Circuit panel had been members of the Ninth Circuit, there is no doubt they would have been bound by *Cardelucci*, thus limiting the remand to the Make-Whole issue.

End of Document

540 B.R. 109
United States Bankruptcy Court, D. Delaware.

IN RE: ENERGY FUTURE HOLDINGS CORP., et al., Debtors.

Case No. 14–10979 (CSS) (Jointly Administered)
|
Signed October 30, 2015

Synopsis
Background: Debtors filed partial objection to proof of claim filed by indenture trustee for unsecured notes relating to postpetition interest.

The Bankruptcy Court, Christopher S. Sontchi, J., held that unsecured noteholders' allowed claim was limited to the principal and accrued fees and interest due under the notes as of the petition date and excluded unmatured, i.e., postpetition, interest.

Partial objection sustained.

Attorneys and Law Firms

Joseph Charles Barsalona II, Mark D. Collins, Daniel J. Defranceschi, Tyler D. Semmelman, Richards, Layton & Finger, P.A., Thomas F. Driscoll, III, Bifferato LLC, David M. Klauder, Bielli & Klauder, LLC, Wilmington, DE, Iskender H. Catto, McDermott Will & Emery LLP, Michael A. Rosenthal, Gibson Dunn & Crutcher LLP, Richard M. Cieri, Stephen E. Hessler, Edward O. Sassower, James H.M. Sprayregen, Aparna Yenamandra, Kirkland & Ellis LLP, Brian Schartz, c/o Kirkland & Ellis LLP, New York, NY, William Guerrieri, Richard U.S. Howell, Chad J. Husnick, Natalie Hoyer Keller, Marc Kieselstein, Todd F. Maynes, Andrew Mcgaan, William T. Pruitt, Brenton Rogers, Steven N. Serajeddini, Anthony V. Sexton, Michael B. Slade, Kirkland & Ellis, LLP, Jeff J. Marwil, Peter Jonathon Young, Mark K. Thomas, Proskauer Rose LLP, Chicago, ***110** IL, Christopher W. Keegan, Anna Terteryan, Justin Sowa, Mark E. McKane, Esq, Michael P. Esser, Kevin Chang, Kirkland & Ellis LLP, San Francisco, CA, Bridget K. O'Connor, Matthew E. Papez, Michael A. Petrino, Bryan M. Stephany, Cormac T. Connor, Jonathan F. Ganter, Kirkland & Ellis LLP, Washington, DC, Michael A. Firestein, Lary Alan Rappaport, Proskauer Rose LLP, Los Angeles, CA, Jeremy L. Retherford, W. Clark Watson, P. Stephen Gidiere, III, Balch & Bingham LLP, Birmingham, AL, Jeremy L. Graves, Gibson Dunn & Crutcher LLP, Denver, CO, Michael L. Raiff, Gibson Dunn & Crutcher LLP, Dallas, TX, Shannon J. Dougherty, O'Kelly Ernst & Bielli, LLC, William A. Romanowicz, for Debtor, Energy Future Holdings Corp.

MEMORANDUM OPINION[1]

Christopher S. Sontchi, United States Bankruptcy Court

UMB Bank, N.A. ("UMB") is the Indenture Trustee for the unsecured 11.25%/12.25% Senior Toggle Notes Due 2018 (the "PIK Notes" and such holders the "PIK Noteholders"). Pursuant to an indenture dated December 5, 2012 (the "PIK Indenture"), Energy Future Intermediate Holding Company LLC and EFIH Finance Inc. (the "EFIH Debtors" and, collectively with its affiliated debtors, the "Debtors") issued approximately $1.4 billion in aggregate principal amount of PIK Notes. The PIK Indenture provides for, among other things, the payment of post-petition interest on overdue principal at the contract rate. Pursuant to the PIK Indenture, UMB timely filed Proof of Claim No. 6347 with an accompanying addendum on behalf of the PIK Noteholders (the "PIK Claim"). The PIK Claim seeks a minimum of approximately $1.57 billion in principal "plus interest, fees and other amounts arising in connection with the [PIK] Indenture ..."[2] The addendum to the PIK Claim states:

> This Master Proof of Claim makes claim to all amounts—whether liquidated or unliquidated—due under or relating to the [PIK Notes] or arising under the [PIK] Indenture on behalf of the Claimant and the [PIK] Noteholders, including, but not limited to, principal, ***premiums, the Applicable Premium, pre-payment penalties, make-whole premiums, call premiums, interest,*** fees, costs, and expenses outstanding as of, and arising from and after, April 29, 2014. (emphasis added)

On July 9, 2015, the Debtors filed the EFIH Debtors' Partial Objection to Proof of Claim No. 6347 Filed by the Indenture Trustee for the EFIH Unsecured Notes (the "Partial Objection") in which the Debtors objected to the portion of UMB's claim seeking post-petition interest and payment of a make-whole claim. This memorandum opinion addresses that portion ***111** of the Partial Objection relating to post-petition interest. The Court will render a separate decision related to the make-whole claim.

In the Partial Objection, the Debtors argue that, under section 502(b)(2) of the Bankruptcy Code, UMB's claim for post-petition interest must be disallowed as "unmatured interest." At most, the Debtors argue, UMB's claim for post-petition interest is limited under section 726(a)(5), made applicable by section 1129(a)(7)(A)(ii), to "payment of interest at the legal rate," which the Debtors claim is the Federal judgment rate. UMB argues that it is entitled to post-petition interest at its contract rate as part the PIK Claim.

The Debtors are correct that UMB's allowed claim cannot include post-petition interest, i.e., "unmatured interest," because to hold otherwise would violate the plain meaning of section 502(b)(2). Furthermore, sections 726(a)(5) and 1129(a)(7)(A)(ii) do not alter the allowed amount of UMB's claim. UMB's allowed unsecured claim is limited to the amount of principal and accrued fees and interest due under the unsecured notes "as of the date of the filing of the petition" and does not include any post-petition interest, regardless of whether such interest would be calculated at the contract rate, the Federal judgment rate or otherwise. *See In re W.R. Grace & Co.,* 475 B.R. 34, 159 (D.Del.2012) (Section 502(b)(2) "prohibits the allowance of unmatured interest as part of an allowed unsecured claim. It is well-established that when a debtor files for bankruptcy, the accrual of interest on its loans is suspended, and any subsequent claims brought by unsecured creditors for the amount of this "unmatured interest" is prohibited under § 502(b) of the Bankruptcy Code.").

The parties' arguments, however, miss the mark. To say that UMB's allowed claim excludes post-petition interest is the beginning of the analysis not the end. As one court has noted, there is a distinction between the payment of interest ***on an allowed claim*** as opposed to ***as an allowed claim***. Ultimately, the Debtors must confirm a plan of reorganization. The provisions governing confirmation will determine what the holders of claims must receive in order for the plan to be confirmed. In some instances the holders of unsecured claims such as the PIK Notes at issue here will be entitled to just the allowed amount of the claim excluding post-petition interest while in other instances the holders will be entitled to the allowed amount of the claim plus additional consideration, which may include post-petition interest. The receipt of post-petition interest, thus, does not arise as part of the allowed amount of the claim but, rather, as a requirement of confirmation. That is a critical distinction. Section 502 defines the amount of the claim while section 1129 and its other related provisions govern confirmation of a plan. They are different sections of the Code with very different purposes. The claim itself does not change. What may change is what the holder of a claim is entitled to receive under a confirmed plan.

To illustrate this distinction, let's explore how this plays out.

Section 1123(a)(1) of the Code requires that a plan designate classes of claims. Under section 1123(a)(2) and (3) a plan must specify any class of claims that is impaired under the plan and the treatment of any impaired class of claims, respectively. Section 1123(b)(1) provides that a plan may impair or leave unimpaired any class of claims. Section 1124 provides that a "class of claims ... is impaired under a plan unless, with respect to each claim ... of such class the treatment satisfies either subsection (1) or (2). Section 1124(1) provides ***112** that a class of claims is unimpaired if a plan "leaves unaltered the legal, equitable, and contractual rights to which such claim ... entitles the holder of such claim" while section 1124(2) provides that a class of claims is unimpaired if the plan provides for the holder of such claim to receive what is generally referred to as reinstatement of the claim.

Section 1126 contains a number of provisions governing acceptance or rejection of a plan. More specifically, section 1126(a) provides that the holder of a claim may accept or reject a plan. Section 1126(c) provides that "a class of claims has accepted a plan if such plan has been accepted by creditors ... that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors ... that have accepted or rejected such plan." Section 1126(f) provides that "a class that is not impaired under a plan, and each holder of a claim ... of such class, are conclusively presumed to have accepted the plan." And, section 1126(g) provides that "a class is deemed not to have accepted a plan if such plan provides that the claims ... of such class do not entitle the holders of such claims ... to receive or retain any property under the plan on account of such claims."

Section 1129 governs confirmation of a plan. It creates a number of requirements for confirmation, including sections 1129(a)(7), (a)(8), (a)(10) and (b). Section 1129(a)(7) provides that in order for a plan to be confirmed, with respect to each impaired class, each holder of a claim that has not accepted the plan "will receive or retain under the plan on account of such claim ... property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date." This is known as the "best interest of creditors" test.

Section 1129(a)(8) requires that in order for a plan to be confirmed with respect to each class of claims such class has either accepted the plan or is not impaired under the plan.

Section 1129(b)(1) provides that a plan may be confirmed even if each impaired class has not accepted the plan "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims that is impaired under, and has not accepted, the plan." This is, of course, known as cramdown. With respect to unsecured creditors, section 1129(b)(2)(B) provides that a plan is fair and equitable with respect to a class if "(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property."

Finally, section 1129(a)(10) provides that if a class of claims is impaired under the plan, it can only be confirmed if "at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider."

Thus, there a limited number of scenarios under which a plan can be confirmed and the consideration paid to the holder of an allowed unsecured claim in a class will vary from scenario to scenario.

A plan can provide that a class of claims is impaired or unimpaired. Looking first to impaired classes, a plan that impairs a class of unsecured claims can be confirmed a number of ways.

***113** An impaired class can vote to accept a plan. Creditors are free to agree to virtually any treatment of claims in a class by voting, as a class, to accept a plan. This would include a plan that pays holders of unsecured claims in the class any unpaid principal and accrued fees and interest owed as of the petition date but excluding post-petition interest.

But there is a caveat. Under the best interests of creditors test, the holder of an impaired claim that votes to reject a plan (even if the class votes to accept the plan) must "receive or retain under the plan on account of such claim ... property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date." Section 726 of the Code governs the distribution of property of the estate to the holders of claims in Chapter 7 cases. Under section 726, property is distributed in a waterfall until the estate is depleted. If holders of claims under the first priority are paid in full then the holders of claims under the second priority receive a distribution, etc. If the holders of claims under a priority are not paid in full, holders of claims under lower priorities do not receive a distribution. Under section 726(a)(2), the second priority of distribution is for "payment of any allowed unsecured claim." Under section 726(a)(5), the fifth priority of distribution includes "payment of interest at the legal rate from the date of the filing of the petition" on any allowed unsecured claim paid under the second priority.

This is significant for two reasons. First, section 726(a)(2) governs payment of allowed unsecured claims and 726(a)(5) provides for the payment of post-petition interest on allowed unsecured claims. The distinction in section 726(a)(2) and (a)(5) between the allowed amount of the claim and post-petition interest on the allowed claim, respectively, supports the plain meaning interpretation of section 502(b)(2), i.e., an allowed unsecured claim cannot include post-petition interest. Otherwise, the distinction between payment under the 2nd and 5th priorities of the allowed claim and interest on the allowed claim, respectively, would be meaningless. Second, and nonetheless, in order to satisfy section 1129(a)(7), which is necessary to confirm a plan where the holder of a claim in an impaired class has voted to reject the plan, the holder of an allowed claim in the class must receive payment of its allowed claim plus post-petition interest at the legal rate, if and only if, the holder of that claim would receive payment under the 5th priority of distribution under section 726(a) in a hypothetical Chapter 7 liquidation of the debtor's estate. The inquiry is not into the value of the property of the estate and the distributions under the plan before the court but, rather, what would occur in the hypothetical scenario of a Chapter 7 liquidation of the debtor. The point is that nothing in sections 1129(a)(7) nor 726(a) alters the allowed amount of the unsecured claim, which excludes unmatured, i.e., post-petition, interest. Neither do these sections either singularly or in tandem serve to create a universal limitation on the payment of post-petition interest on unsecured debt. Rather, they merely provide that in a certain scenario, in order for a plan to be confirmed, the holders of claims in a class must receive payment in full of the allowed amount of the claim, i.e., unpaid principal and accrued fees and interest due at the petition date, plus the additional consideration of post-petition interest on the claim at the legal rate—however defined.

So, what is the legal rate of interest? This Court adopts that portion of Judge Walrath's ruling in *In re Washington Mutual, Inc.,* 461 B.R. 200 (Bankr.D.Del.2011) in which she held that the legal rate of ***114** interest under sections 726(a) and 1129(a)(7) is the Federal judgment rate.

> Now that all issues have been presented to the Court, the Court concludes that the better view is that the federal judgment rate is the appropriate rate to be applied under section 726(a)(5), rather than the contract rate. The Court's conclusion is supported by many factors.
>
> First, section 726(a)(5) states that interest on unsecured claims shall be paid at "the legal rate" as opposed to "a" legal rate or the contract rate. As the LTW Holders note, where Congress intended that the contract rate of interest apply, it so stated.
>
> Second, the payment of post-judgment interest is procedural by nature and dictated by federal law rather than state law, further supporting use of the federal judgment rate.
>
> Third, the use of the federal judgment rate promotes two important bankruptcy goals: "fairness among creditors and administrative efficiency."
>
> *Id.* at 242–43 (citations omitted). *See also In re Dow Corning Corp. ("Dow I")*, 237 B.R. 380, 412 (Bankr.E.D.Mich.1999) ("the Court concludes that, within the context of § 726(a)(5), 'interest at the legal rate' means the federal judgment rate.").

An impaired class can also vote to reject a plan. As a preliminary matter, section 1129(a)(7) also applies if a class votes to reject a plan. So, in order for the plan to be confirmed, the holder of an allowed claim in the class must receive payment of its allowed claim plus post-petition interest at the Federal judgement rate, if and only if, the holder of that claim would receive payment under the 5th priority of distribution under section 726(a) in a hypothetical Chapter 7 liquidation of the debtor's estate

Regardless of the application of the best interest of creditors test, under section 1129(a)(8), all impaired classes must vote to accept the plan for it to be confirmed. Notwithstanding that provision, under section 1129(b)(1), a plan may be crammed down on a rejecting impaired class and confirmed "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims that is impaired under, and has not accepted, the plan." As stated earlier, with respect to unsecured creditors, section 1129(b)(2)(B) provides that a plan is fair and equitable with respect to a class if "(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property." Importantly, section 1129(b)(2)(B) is written in the disjunctive and satisfaction of either prong is sufficient to cram down the plan on the rejecting class.

Assume that a plan provides that holders of claims in the unsecured class receive payment on the effective date in cash in the amount of any unpaid principal and accrued fees and interest owed as of the petition date but excluding post-petition interest and that no claims or interests junior to the unsecured class receive any distribution. The plan can be crammed down on the rejecting unsecured class under section 1129(b)(2)(B)(ii) because "the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property."

Now assume that a plan provides that holders of claims in the unsecured class receive payment on the effective date in cash in the amount of any unpaid principal ***115** and accrued fees and interest owed as of the petition date but excluding post-petition interest and that one or more classes of claims or interests junior to the unsecured class receives a distribution. The plan cannot be crammed down on the rejecting unsecured class under section 1129(b)(2)(B)(ii) because the holder of a junior claim or interest is receiving a distribution under the plan on account of such junior claim or interest.

That leaves section 1129(b)(2)(B)(i). Under the plain meaning of the statute, the plan can be crammed down on the rejecting class even though junior claims or interests are receiving a distribution because each holder of an unsecured claim is receiving on account of such claim cash, as of the effective date of the plan, equal to the allowed amount of such claim, i.e., unpaid principal and accrued fees and interest owed as of the petition date, excluding unmatured, i.e., post-petition interest.

But there is a complication. Section 1129(b)(2) actually provides that "[f]or purposes of this subsection, the condition that a plan be fair and equitable with respect to a class ***includes***" the requirements of subsections (b)(2)(A) through (C). UMB argues that the use of the words "includes" means that for a plan to be fair and equitable with respect to unsecured claims, the plan must satisfy

either clause (i) or clause (ii) of section 1129(b)(2)(B), ***plus*** any other unenumerated requirements that may be applicable. UMB goes on to argue that in the context of solvent debtor reorganizations, i.e., when equity holders are receiving a distribution, payment to unsecured creditors of post-petition interest at the contract rate is one of the additional requirements that must be satisfied for a plan to be fair and equitable. In support of this proposition UMB cites to pre-Code and post-Code case law.

The Court disagrees with UMB's argument. The use of the word "includes" in section 1129(b)(2) does not create a requirement that unsecured claims must receive post-petition interest at the contract rate in order to cramdown a plan on a class of unsecured creditors that are receiving payment in full of their allowed claims under section 502(b) when a junior class is receiving a distribution.

First, as a textual matter, the word "includes" applies to all three types of claims and interests in section 1129(b)(2)—secured claims, unsecured claims and interests. As such, one would expect the unenumerated requirements under the fair and equitable test to apply to all three categories of claims and interest. But UMB does not argue that post-petition interest is required as an unenumerated requirement in all three cases. Nor could it. 1129(b)(2)(A) provides for the payment of allowed secured claims, which specifically includes post-petition interest at the contract rate; and post-petition interest is something that would never be applicable to interests under section 1129(b)(2)(C). What then are the unenumerated requirements for secured claims and interests? If the use of the word "includes" is important for unsecured creditors it must also be important for secured creditors and interests. But UMB does not specify what significance it holds for those other categories.

Second, UMB's reliance on pre-Code case law, which it argues has not been abrogated by adoption of the Bankruptcy Code, is inapposite. UMB relies on the Supreme Court's holding in *Consolidated Rock Products Co. v. Du Bois,* 312 U.S. 510, 61 S.Ct. 675, 85 L.Ed. 982 (1941), stating that the court held that a plan of reorganization runs afoul of the absolute priority rule if equity holders receive value before bondholders are paid their full contract ***116** rate of interest. What UMB conveniently fails to note, however, is that the bondholders in *Consolidated Rock* were secured creditors. The treatment of unsecured claims was not before the court because under the plan "the claims of general creditors will be paid in full or assumed by the new company." *Id*. at 515, 61 S.Ct. 675 n. 9.

Moreover, the holding of that case was codified in sections 506(b) and 1129(b)(2)(A), which in combination provide that in order for a plan to be fair and equitable to a class of secured creditors when a junior class is receiving a distribution the secured class must receive post-petition interest at the contract rate. Thus, UMB's argument that the holding in *Consolidated Rock* was not abrogated by passage of the Bankruptcy Code is incorrect. Importantly, however, the holding in *Consolidated Rock* was not incorporated in section 1129(b)(2)(B) governing the treatment of unsecured creditors. At most, *Consolidated Rock* stands for the proposition articulated by the Supreme Court in *Vanston Bondholders Protective Committee v. Green,* 329 U.S. 156, 165, 67 S.Ct. 237, 91 L.Ed. 162 (1946) that it is "manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtors." *But see In re Manchester Gas Storage, Inc.,* 309 B.R. 354, 385 (Bankr.N.D.Okla.2004) ("The Court is not comfortable with the notion that the *Vanson* case gives permission to present-day bankruptcy courts bound by the bankruptcy Code to override section 502(b) of the Code by invoking equity ... The concept that post-petition interest is a matter of the bankruptcy court's equitable jurisdiction has been superseded by statute.").

The only other pre-Code cases identified by UMB are *In re Realty Associates Securities Corp*., 163 F.2d 387 (2d Cir.1947) and *Empire Trust Co. v. Equitable Office Building Corp*., 167 F.2d 346 (2d Cir.1948), which are cited for the proposition that contract rate is the proper rate for calculation of post-petition interest. But whether to use contract rate is not the issue. The issue is whether ***any*** post-petition interest must be paid to unsecured creditors under the absolute priority rule and neither of those cases stand for that proposition.

Third, UMB's reliance on post-Code case law is not persuasive. In making this argument UMB relies on the *Dow Corning* line of cases out of the Sixth Circuit, specifically *In re Dow Corning Corp. ("Dow II"),* 244 B.R. 678 (Bankr.E.D.Mich.1999); and *In re Dow Corning Corp. ("Dow III"),* 456 F.3d 668 (6th Cir.2006). But those cases do not stand for the proposition that payment to unsecured creditors of post-petition interest at the contract rate when a junior class is receiving a distribution is required for a plan to be fair and equitable. The court in *Dow II* went through an exhaustive and scholarly recitation of the origins of section 502(b)(2), 726(a) and 1129(b) of the Bankruptcy Code. The court concluded that post-petition interest is not part of an allowed claim under section 502(b) and that the legal rate under section 726(a) is the Federal judgment rate but does not serve as a cap on post-petition interest that applies throughout the Code. In addition, the court concluded that in applying the fair and equitable test under section 1129(b)(2) it has the discretion to exercise its equitable power to require, among other things, the payment of post-petition interest. Specifically, the court held that "[t]he wide parameters associated with the fairness inquiry, in conjunction with the discretion which we are generally accorded in matters concerning post-petition interest, lead us to conclude that a ***117** plan which would pay the dissenting class [post-petition] interest at the minimum rate pursuant to sections 1129(a)(7)(ii)/726(a)(5) is ***not necessarily*** 'fair and equitable' for purposes of section 1129(b)." *Dow II* at 695, (emphasis added). The court then went on to determine, based on the evidence, whether the plan before it was, in fact, "fair and equitable." The court found that, in its case, the plan proponents offered no persuasive evidence in support of paying less than the contract interest and that to do otherwise would not be fair and equitable. Nonetheless, the unsecured creditors were not fully vindicated as the court declined to award default interest due under the contract.

For the next five years the parties litigated the validity of the claims that would be paid under the plan. The bankruptcy court ultimately determined on summary judgment that it could not award default interest because there was no evidence that it would be fair and equitable to do so and because the debtor had not been in default on the date of the bankruptcy filing. The unsecured creditors appealed and the district court affirmed the bankruptcy court's ruling on default interest. The 6th Circuit reversed. The court noted that where debtors are insolvent, bankruptcy courts have concluded that whether to award default interest under 1129(b) is determined on a case-by-case basis based on the facts and equities of each specific case. The court went on to note, however, that, "in solvent debtor cases, rather than considering equitable principles, courts have generally confided themselves to determining and enforcing whatever pre-petition rights a given creditor has against the debtor." *Dow III,* 456 F.3d at 679. The court went on to state that "[w]hen a debtor is solvent, the presumption is that a bankruptcy court's role is merely to enforce the contractual rights of the parties, and the role that equitable principles play in the allocation of competing interest is significantly reduced." *Id*. Note that the court stated that the role of equitable principles is reduced—not eliminated. Thus, the 6th Circuit held that, in solvent debtor cases, there is a presumption that the default interest rate should be awarded. Nonetheless, the court held that the record before it was not sufficiently developed for it to determine whether the general rule calling for the payment of default interest in solvent debtor cases, when considered with other equitable factors, made the award of default interest in the case appropriate. Thus, the court remanded the case to bankruptcy court for proceedings consistent with its decision "including the consideration of any equitable factors affecting the interest rate." *Id.* at 680.

The import of the use of the word "includes" in section 1129(b)(2) is less than clear. What is clear, however, is that UMB is overreaching in arguing that the term somehow requires that, when a junior class is receiving a distribution, unsecured claims must receive post-petition interest at the contract rate in order to cramdown a plan on a class of unsecured creditors that are receiving payment in full of their allowed claims under section 502(b). At most, it allows a court to weigh equitable considerations in deciding whether to award post-petition interest. Whether to invoke that equitable power here would require an evidentiary record that is not before the Court. But it is not necessarily the case that equitable considerations require the payment of post-petition interest to unsecured creditors any time equity holders are receiving a distribution. For example, in a case such as this, the ultimate equity holders of the enterprise are not receiving a distribution. Rather, the equity is held by another debtor entity in an integrated capital structure. To require the payment of post-petition interest ***118** in a case such as this would reduce the consideration available to pay other creditors of the enterprise not the ultimate equity holders. It is not clear to the Court that it would be equitable in this situation to require the payment of post-petition interest. Indeed, the court in *Dow II* specifically noted that inherent in the court's discretion in applying its equitable powers is the ability not to require the payment of post-petition interest, especially when "such payments may mean a *pro tanto* reduction in the payment of *principal* owed to lower-priority creditors." *Dow II,* 244 B.R. at 691.

In any event, this Court holds that the plain meaning of section 1129(b)(2) does *not* require payment to unsecured creditors of post-petition interest when a junior class is receiving a distribution for a plan to be fair and equitable. Rather, the Court has the discretion to exercise its equitable power to require, among other things, the payment of post-petition interest. The rate of interest may be the contract rate or such other rate as the Court deems appropriate.[3] Exercise of the Court's discretion to award interest will vary on a case by case basis and must be based on an evidentiary record. There is no hard and fast rule and the Court has the full authority to decline to exercise its discretion at all and leave the fair and equitable requirement to the elements specified in the statute, which provide for the payment of allowed claims that exclude the payment of unmatured, i.e., post-petition interest.

So where does that leave unsecured creditors where its class has voted to reject a plan that does not provide for the payment of post-petition interest? Are they confined to a world where they will always be subject to cramdown and never receive post-petition interest? No. At the very least, section 1129(a)(7) might require that they receive post-petition interest at the Federal judgment rate. In addition, the court might exercise its equitable power under the fair and equitable requirement of 1129(b)(2) to award post-petition interest at an appropriate rate, which might be at that provided in the contract. But the unsecured creditors also have the protection of section 1129(a)(10), which provides that if a class of claims is impaired under the plan, it can only be confirmed if "at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider." Note that 1129(a)(10) requires acceptance by one class of claims—interests, i.e., equity, are excluded. Thus, a plan that fails to pay unsecured creditors post-petition interest at the contract rate will be unconfirmable unless a class of impaired creditors votes to accept the plan. In most cases where unsecured claims are being paid the full amount of their allowed claims plus post-petition interest at the Federal judgment rate and equity holders are receiving a distribution the only impaired class will be the unsecured creditors and they will control their own destiny—their rejection of the plan that does not pay them at the contract rate will render the plan unconfirmable. Only in the rare case where another class of impaired claims exists, such as a secured class, that has voted to accept the plan will the class of unsecured creditors be at risk of receiving, at most, post-petition interest at the Federal ***119** judgment rate. So how does a debtor confirm a plan where, as here, it lacks the support of any of its creditors and avoid the problem of section 1129(a)(10)? By unimpairing its creditors. That leads to the question of whether a class of unsecured creditors must receive post-petition interest at the contract rate in order to be unimpaired.

As just noted, a plan can provide that a class of claims is not impaired under the plan, which under section 1124(1) would mean that the plan "leaves unaltered the legal, equitable, and contractual rights to which such claim ... entitles the holder of such claim." A plan can also leave a class of creditors unimpaired by reinstating the claims under section 1124(2) but that is not relevant here. The proposed plan in this case purports to leave the PIK Noteholders unimpaired under section 1124(1). More specifically, the plan provides that each holder of general unsecured claims against the EFIH Debtors, which includes the PIK Noteholders, will receive "up to the Allowed amount of its Claim, payment in full in Cash or other treatment rendering such Claim unimpaired." The plan further provides that Allowed Claims will include accrued principal, fees and interest due as of the petition date plus "accrued postpetition interest at the Federal Judgment Rate." UMB argues that in addition to the payment of the principal, fees and interest due as of the petition date the PIK Noteholders' treatment under the plan must include the payment in cash of post-petition interest at the contract rate (rather than the Federal judgment rate) that has accrued as of the effective date of the plan in order for its class to be unimpaired.

The Third Circuit described impairment in *In re PPI Enterprises (U.S.), Inc.,* 324 F.3d 197, 202–203 (3d Cir.2003) ("*PPI II* ").

> "Impairment" is a term of art crafted by Congress to determine a creditor's standing in the confirmation phase of bankruptcy plans. Each creditor has a set of legal, equitable, and contractual rights that may or may not be affected by bankruptcy. If the debtor's Chapter 11 reorganization plan does not leave the creditor's rights entirely "unaltered," the creditor's claim will be labeled as impaired under section 1124(1) of the Bankruptcy Code. If the creditor's claim is impaired, the Code provides the creditor with a vote that, depending on the value of the creditor's claim, may be sufficient to defeat confirmation of the bankruptcy plan.
>
> The Bankruptcy Code creates a presumption of impairment "so as to enable a creditor to vote on acceptance of the plan." Under section 1124(1), the presumption of impairment is overcome only if the plan "leaves unaltered the [creditor's] legal, equitable, and contractual rights." The burden is placed on the debtor to demonstrate the plan leaves the creditor's rights unaltered.

Under section 502(b), the PIK Claim does not include post-petition interest. The question is whether a plan that does not provide for the payment of post-petition interest at the contract rate "leaves unaltered the legal, equitable, and contractual rights to which such claim ... entitles the holder of such claim." As UMB argues in its sur-reply, "[i]f the Plan does not leave 'unaltered the ... contractual rights,' then the PIK Noteholders are impaired. Because anything short of the contract rate would alter their contractual rights, *a fortiori* the PIK Noteholders must receive postpetition interest ***at the contract rate*** in order to be treated as unimpaired under the Plan." D.I. 6303, Exh. A at 3 (emphasis in original). But it is not that simple.

***120** Prior to 1994, section 1124 provided that "a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan ... (3) provides that, on the effective date of the plan, the holder of such claim or interest receives, on account of such claim or interest, cash equal to (A) with respect to a claim, the allowed amount of such claim." Because under section 502(b)(2) allowed unsecured claims do not include post-petition interest, under the plain meaning of section 1124(3)(A), a debtor could render an unsecured class unimpaired by paying the allowed claim in full without post-petition interest even if the debtor was solvent and providing a distribution to a junior class. Indeed, the New Jersey bankruptcy court so held in *In re New Valley Corp.,* 168 B.R. 73 (Bankr.D.N.J.1994). As described by Judge Walsh, "the result in *New Valley* stood in contrast with a line of cases holding that where a debtor is solvent, unsecured creditors must be paid in full, including postpetition interest, pursuant to the 'fair and equitable' test of section 1129(b)(2) when the debtor is cramming down that creditor's claim. Thus, solvent debtors could avoid paying 'unimpaired' unsecured creditors postpetition interest by paying them in full in cash, yet the same solvent debtor would be required to pay postpetition interest to an 'impaired' dissenting class of unsecured creditors." *In re PPI Enterprises (U.S.), Inc.,* 228 B.R. 339, 351 (Bankr.D.Del.1998) ("*PPI I* "). While this Court disagrees that there is a requirement to pay post-petition interest in a solvent debtor case, there was certainly the potential for an inconsistent result.

Congress agreed and, in 1994, removed section 1124(3) from the Bankruptcy Code. The legislative history makes clear Congress's intent.

> [t]he principal change in this section ... relates to the award of postpetition interest. In a recent Bankruptcy Court decision in *New Valley,* unsecured creditors were denied the right to receive postpetition interest on their allowed claims even though the debtor was liquidation and reorganization solvent. The *New Valley* decision applied section 1124(3) of the Bankruptcy Code literally by asserting, in a decision granting a declaratory judgment, that a class that is paid the allowed amount of its claims in cash on the effective date of a plan is unimpaired under section 1124(3), therefore is not entitled to vote, and is not entitled to receive postpetition interest. The Court left open whether the good faith plan proposal requirement of section 1129(a)(3) would require the payment of or provision for postpetition interest. In order to preclude this unfair result in the future, the Committee finds it appropriate to delete section 1124(3) from the Bankruptcy Code.
>
> H.R.Rep. No. 835, § 214 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340.

Judge Walsh summarized the effect of the deletion of section 1124(3) and the interplay with section 1124(1) as follows:

> Section 1124(3) created nonimpairment status by a cash payment equal to the allowed amount of the claim but without postpetition interest. Such treatment could not qualify for nonimpairment under § 1124(1) because the failure to pay postpetition interest does not leave unaltered the contractual or legal rights of the claim. If, in a nonbankruptcy context, the creditor would be entitled to interest on its claim to the date of payment, then in a bankruptcy context the claim is altered absent the interest payment. Section 1124(3) may be viewed as an exception to the test set forth in § 1124(1). Congress, of course, deleted the section for the reason discussed ***121** above. *Now the holder of a claim can only be deemed unimpaired if the cash payment is both equal to the claim and includes postpetition interest.*
>
> *PPI I*, 228 B.R. at 352–53 (emphasis added).

The Third Circuit specifically endorsed this view. *PPI II,* 324 F.3d at 207.

But that is not the end of the analysis. The Court must address the issue of statutory impairment versus plan impairment.

The issue in *PPI* was whether a landlord's lease rejection claim was impaired by the statutory cap on the claim under section 502(b)(6) of the Code. The plan in *PPI* purported to treat the landlord as unimpaired by paying him the entire amount of his section 502(b)(6) capped rent claim, plus pre- and post-petition interest. The landlord argued that the failure to pay him the full amount of his claim under state law for breach of his lease as opposed to the allowed amount of his claim capped under section 502(b)(6) altered "the legal, equitable, and contractual rights to which such claim ... entitles the holder of such claim" and, thus, his claim was impaired. Judge Walsh, however, disagreed, finding that the landlord was confusing "two distinct concepts: (i) plan impairment, under which the debtor alters the 'legal, equitable, and contractual rights to which [their] claim entitles the holder of such claim,' and (ii) statutory impairment, under which the operation of a provision of the Code alters the amount that the creditor is entitled to under nonbankruptcy law." *PPI I,* 228 B.R. at 353. Judge Walsh went on to state:

> By its very language, § 1124(1) embodies this distinction. It requires the plan to leave unaltered those rights to which the creditor's "claim or interest ***entitles*** the holder of such claim or interest." § 1124(1) (emphasis added). Note that the quoted provision does not say "entitles the holder under nonbankruptcy law"; it includes bankruptcy law and in this case § 502(b)(6) determines that entitlement. Thus, it is not PPI's Plan which proposes to alter [the landlord's] rent claim; PPI's

> Plan provides for payment in full of the capped rent claim plus interest. Instead, it is the operation of the Code itself that has altered the $4.7 million amount owed by PPI [under state law]. That $4.7 million is not a right of payment to which [the landlord] is entitled to as a result of his bankruptcy claim.
>
> *Id.* (emphasis in original).

As the plan was to pay the landlord exactly what he was entitled to receive, subject to the cap on the claim under section 502(b)(6), Judge Walsh found that the plan did not alter the landlord's rights and his claim was not impaired.

The Third Circuit affirmed Judge Walsh's ruling. Adopting the analysis of *In re American Solar King Corp.,* 90 B.R. 808 (Bankr.W.D.Tex.1988), upon which Judge Walsh also relied, the court held:

> The relevant impairment language requires bankruptcy plans to leave unaltered those rights to which the creditor's "claim or interest entitles the holder of such claim or interest." This language in section 1124(1) does not address a creditor's claim "under nonbankruptcy law." The use of a present-tense verb suggests a creditor's rights must be ascertained with regard to applicable statutes, including the section 502(b)(6) cap. In other words, a creditor's claim outside of bankruptcy is not the relevant barometer for impairment; we must examine whether the plan itself is a source of limitation on a creditor's legal, equitable, or contractual rights.
>
> *PPI II,* 324 F.3d at 204.

The court then went on to conclude:

> ***122** In sum, [PPI's plan] intends to pay [the landlord] his "legal entitlement" and provide him with "full and complete satisfaction" of his claim on the date the Plan becomes effective. [The landlord] is only "entitled" to his rights under the Bankruptcy Code, including the section 502(b)(6) cap. [The landlord] might have received considerably more if he had recovered on his leasehold claims before [PPI] filed for bankruptcy. But once [PPI] filed for Chapter 11 protection, that hypothetical recovery became irrelevant. [The landlord] is only entitled to his "legal, equitable, and contractual rights," as they now exist. Because the Bankruptcy Code, not the Plan, is the only source of limitation on those rights here, [the landlord's] claim is not impaired under section 1124(1).
> *Id.* at 205.[4]

But if the limit on rejection damages under section 502(b)(6) is statutory impairment not plan impairment then what about the exclusion of unmatured, i.e., post-petition, interest on unsecured claims under section 502(b)(2)? The same analysis should apply. *See W.R. Grace,* 475 B.R. at 161 ("It is unlikely that the Third Circuit meant to sift the statutory grains of sand here so finely—if it found no impairment on the basis of application of subsection (b)(6) to a creditor's claim, then it stands to reason that there likewise would be no impairment from the application of subsection (b)(2)."). Indeed, one can easily replace the reference to section 502(b)(6) in the Third Circuit's conclusory paragraph.

> In sum, [the Debtors' plan] intends to pay [the PIK Noteholders their] "legal entitlement" and provide [them] with "full and complete satisfaction" of [their] claim on the date the Plan becomes effective. [The PIK Noteholders are] only "entitled" to [their] rights under the Bankruptcy Code, including the [the exclusion of unmatured interest under section 502(b)(2)]. [The PIK Noteholders] might have received considerably more if [they] had recovered on [their] claims [under the PIK Notes] before [the Debtors] filed for bankruptcy. But once [the Debtors] filed for Chapter 11 protection, that hypothetical recovery became irrelevant. [The PIK Noteholders are] only entitled to [their] "legal, equitable, and contractual rights," as they now exist. Because the Bankruptcy Code, not the Plan, is the only source of limitation on those rights here, [the PIK Noteholders' claim is] not impaired under section 1124(1).

A finding that the exclusion of post-petition interest at the contract rate on the PIK Noteholders' claims under the plan in this case is a result of the statute, i.e., section 502(b)(2), and not the plan and, thus, the plan does not impair their claim is the logical and, indeed, unavoidable extension of the holding in both *PPI* cases that the limit on rejection damages under section 502(b)(6) is statutory impairment not plan impairment. Such a ruling, however, ***123** appears to create an irreconcilable conflict with the findings in both *PPI* cases that the holder of an unsecured claim against a solvent debtor can only be deemed unimpaired if the cash payment is both equal to the claim and includes post-petition interest. *See PPI I,* 228 B.R. at 353; and *PPI II,* 324 F.3d at 207. Indeed, Judge Walsh specifically found that the plan in *PPI* did not impair the landlord's claim because he was to receive pre- and post-petition interest. *PPI I, 228 B.R. at 354.*

The conflict is resolved by returning to the text of section 1124(1), which provides that a class is unimpaired if the plan does not alter "the legal, *equitable,* and contractual rights to which such claim ... entitles the holder of such claim." (emphasis added) Section 502(b)(2), like 502(b)(6), has altered by statute the terms of the parties' contract. The contractual right to post-petition interest has been trumped by the Bankruptcy Code. Nor is there a legal right to post-petition interest because no other provision of the Bankruptcy Code providing for payment of such interest, such as section 1129(a)(7), is applicable. But what of the claimant's equitable rights?

Although *Consolidated Rock* and *Vanston* are not directly applicable, allowing for the award of post-petition interest on an allowed claim to unimpaired unsecured creditors in a solvent debtor case as a matter of equity is consistent with the spirit and principles behind the Supreme Court's decisions.[5] It also resolves a conflict between the holdings in the *PPI* cases and the legislative history behind Congress's deletion of section 1124(3) in which Congress clearly expressed its disagreement with the decision in *New Valley* that a debtor could render an unsecured class unimpaired by paying the allowed claim in full without post-petition interest even if the debtor was solvent and providing a distribution to a junior class. To strictly apply the reasoning of the *PPI* cases as to statutory impairment to the facts of this case would result in exactly the same result that led Congress to delete section 1124(3) from the Bankruptcy Code.

Such a strict holding would also create a conflict between the treatment of impaired and unimpaired creditors in solvent reorganization cases such that unimpaired creditors might receive ***inferior*** treatment than that accorded impaired creditors. Recall that, under the fair and equitable requirement of section 1129(b)(2), the court has the equitable power to award post-petition interest to impaired unsecured creditors when a junior class is receiving a distribution. Granting unimpaired creditors the equitable right to seek post-petition interest puts them on the same footing as impaired creditors under the fair and equitable test.

Nonetheless, impaired creditors are potentially in a better position than unimpaired creditors in at least one instance. Separate from the application of equitable principles, impaired creditors have the protection of section 1129(a)(7) that might require such impaired creditors to receive post-petition interest at the Federal judgment rate. But neither sections 1129(b) nor 1129(a)(7) apply to unimpaired creditors.[6]

In the end, the only way to reconcile the Third Circuit's decision in *PPI II* is to hold ***124** that the plan in this case need not provide for the payment in cash on the effective date of post-petition interest at the contract rate in order for the PIK Noteholders to be unimpaired. Indeed, the plan need not provide for any payment of interest at all, even at the Federal judgement rate, as what would be the basis for the payment of post-petition interest other than the contract? But the plan must allow for the PIK Noteholders to be awarded post-petition interest at an appropriate rate under equitable principles. In effect, the Court holds that the fair and equitable test as applied to unsecured creditors in solvent debtor cases, *see* p. 17, *supra,* must also be met in solvent debtor cases for such creditors to be unimpaired. As with the fair and equitable test, the rate of interest may be the contract rate or such other rate as the Court deems appropriate.[7] Whether such interest would be awarded and at what rate in this case cannot be determined at this time, but the Court has already noted that it is less than clear that an award of post-petition interest under the facts of this case would be equitable.

Thus, the Court will sustain the Debtors' Partial Objection to UMB's claim. The PIK Claim is limited to the principal and accrued fees and interest due as of the petition date and excludes unmatured, i.e., post-petition interest. The Court further finds that the legal rate of interest under section 726(a) is the Federal judgment rate but the applicability of section 726(a) is limited to its incorporation in section 1129(a)(7) and does not create a general rule establishing the appropriate rate of post-petition interest. Moreover, the plain meaning of section 1129(b)(2) does not require payment to unsecured creditors of post-petition interest when a junior class is receiving a distribution for a plan to be fair and equitable. Rather, the Court has the discretion to exercise its equitable power to require, among other things, the payment of post-petition interest, which may be at the contract rate or such other rate as the Court deems appropriate. Finally, the plan in this case need not provide for the payment in cash on the effective date of post-petition interest at the contract rate for the PIK Noteholders to be unimpaired. Indeed, the plan need not provide for any payment of interest, even at the Federal judgement rate. But in order for the PIK Noteholders to be unimpaired the plan must provide that the Court may award post-petition interest at an appropriate rate if it determines to do so under its equitable power.

An order will be issued.

All Citations

540 B.R. 109

Footnotes

1 This Memorandum Opinion constitutes the Court's findings of fact and conclusions of law pursuant to Fed. R. Bank. P. 7052, which is applicable to this matter by virtue of Fed. R. Bankr.P. 9014. The Court has subject matter jurisdiction over this contested matter pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 11 U.S.C. § 157(b)(2). Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409. The Court has the judicial power to enter a final order.

2 The PIK Claim was filed in the amount of $1,647,374,288.21 plus interest, fees, expenses and other amounts "arising in connection with the [PIK] Indenture (see addendum)." PIK Claim (attached as Exh. 1 to the PIK Claim Objection. Based on the record in these proceedings it is the Court's understanding that there is approximately $1.57 billion in principal, $81 million in pre-petition accrued interest and $109,000 in pre-petition accrued fees and expenses owed under the PIK Notes.

3 The Court disagrees with the 6th Circuit's adoption of a presumption that interest should be awarded at a specific rate whether it be the contractual default rate or otherwise. *Dow III,* 456 F.3d at 679. The Court sees no reason to create a presumption one way or the other. Nor does the Court believe that its role in weighing equitable principles to determine an appropriate rate of interest is reduced in solvent debtor cases.

4 One could argue that section 1124(1)'s reference to "claim," which is defined in section 101(5) as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured," is broader than "allowed claim" under section 502(b) and, thus, any limitation on allowance is irrelevant for purposes of determining whether a claim is impaired under section 1124(1). Indeed, this was the landlord's argument in *PPI*. Judge Walsh, however, specifically rejected that argument in *PPI I,* 228 B.R. at 353, which the Third Circuit endorsed in *PPI II,* 324 F.3d at 204. *See also In re Smith,* 123 B.R. 863, 867 (Bankr.C.D.Cal.1991) ("[A] plan may limit payment of claims to 'the extent allowed,' without impairing them; for until claims are allowed, or deemed allowed, the holders thereof are not entitled to distribution from the bankruptcy estate.").

5 *See Vanston,* 329 U.S. at 165, 67 S.Ct. 237 (it is "manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtors.").

6 While the plan need not pay the PIK Noteholders any post-petition interest for the class to be unimpaired that is not to say it can't. The discussion here has focused on the minimum required. There is nothing to keep a plan from paying such interest at any rate, including at the Federal judgment rate. Indeed, this plan so provides. As such, it moots any argument that as unimpaired creditors the PIK Noteholders are being deprived of the benefit they would receive under section 1129(a)(7) as impaired creditors. Were section 1129(a)(7) applicable, the PIK Noteholders would be entitled under that section to receive, at most, post-petition interest at the Federal judgment rate, which is what they are receiving under the plan.

7 *See W.R. Grace,* 475 B.R. at 164 ("Therefore, [*PPI II*] at most stands for the proposition that a claim must receive *some* form of post-petition interest in a *solvent* debtor case to qualify as unimpaired ... [it] does not stand for the proposition that unsecured creditors must receive post-petition interest at the contractual default rate in order to render their claims unimpaired. Rather, [*PPI II*] can at most be applied here to require the [unsecured creditors] to receive some form of post-petition interest, regardless of whether or not that interest is at the contractual rate of interest.") (emphasis in original).

End of Document