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Conflicting Rulings on Applicable Rate of Postpetition Interest Set the Stage for Hertz Post-Confirmation Interest Rate Litigation

On June 10, 2021, Bankruptcy Judge Mary Walrath of the District of Delaware confirmed the chapter 11 plan filed by The Hertz Corporation debtors. In the days just prior to confirmation, the debtors filed a revised plan that proposed to pay unimpaired unsecured creditors postpetition interest at the federal judgment rate. However, the plan reserved to those unsecured creditors the right to later assert entitlement to postpetition interest at higher contractual rates, while also reserving to the debtors the right to argue that no postpetition interest is payable at all.

The question of entitlement to, and appropriate rate of, postpetition interest payable to unimpaired unsecured creditors in solvent debtor cases has been addressed by several courts across the country, which have come to varying conclusions including payment of interest at the contractual rate (if applicable) and payment of interest at the federal judgment rate.¹ The District Court for the Northern District of California recently affirmed a bankruptcy court ruling in the PG&E Corporation chapter 11 cases that a solvent debtor need only pay its unsecured creditors postpetition interest at the federal statutory rate for judgments (not at the underlying contract rate) for such creditors to be deemed unimpaired. In so ruling, the District Court adhered to the Ninth Circuit's decision in *In re Cardelucci* granting postpetition interest at the federal judgment rate to unsecured creditors in a solvent debtor bankruptcy case.² In stark contrast, the Bankruptcy Court for the Southern District of Texas recently held in the Ultra Petroleum chapter 11 cases that unimpaired unsecured creditors in a solvent debtor case are entitled to their contractual default rate of interest.^{3 4}

¹ Generally, federal statutory judgment rates are lower than contractual interest rates.

² See *In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002).

³ *In re Ultra Petroleum Corp.*, 624 B.R. 178 (Bankr. S.D. Tex. 2020).

⁴ In the PG&E chapter 11 cases, Paul, Weiss represented the California Public Utilities Commission. In the 2016 Ultra Petroleum chapter 11 cases, Paul, Weiss represented an ad hoc committee of holding company noteholders. In the Hertz chapter 11 cases, Paul, Weiss represented Apollo Capital Management, L.P. on behalf of one or more investment funds, separate accounts, and other entities owned (in whole or in part), controlled, managed and/or advised by it or its affiliates.

Background

Under U.S. bankruptcy law, interest ceases to accrue on claims as of the petition date.⁵ Two exceptions exist: First, over-secured creditors are entitled to postpetition interest up to the value of their collateral.⁶ Second, some courts have found that unsecured creditors of a solvent debtor may receive postpetition interest on their claims under the so-called “solvent-debtor exception.” While section 506(b) of the Bankruptcy Code provides over-secured creditors a statutory right to postpetition interest, unsecured creditors enjoy no such express entitlement. Courts applying the solvent-debtor exception have ruled, however, that where a debtor in bankruptcy is solvent, unimpaired unsecured creditors are entitled to receive postpetition interest.

The courts in both PG&E and Ultra Petroleum recognized the solvent-debtor exception and applied the doctrine under the Bankruptcy Code to grant unimpaired unsecured creditors postpetition interest. However, the courts diverged on the applicable rate of postpetition interest owed to such unsecured creditors.

The PG&E and Ultra Petroleum Decisions

On December 30, 2019, Bankruptcy Judge Dennis Montali issued an opinion in the PG&E chapter 11 cases finding that the Ninth Circuit’s ruling in *Cardelucci* constituted controlling precedent, and that *Cardelucci* requires application of the federal judgment rate—not contractual or state law judgment rates—to calculate postpetition interest on unsecured claims. Judge Montali ruled that *Cardelucci* applies to all unsecured and undersecured claims in a solvent estate. The judge noted that there is no specific provision in chapter 11 that allows any interest on unsecured claims and that, in fact, section 502(b)(2) of the Bankruptcy Code specifically disallows all claims for unmatured interest. Without the Ninth Circuit’s citation in *Cardelucci* to section 726(a)(5) of the Bankruptcy Code (which permits the recovery of postpetition interest at “the legal rate”), the opinion pointed out, the unsecured creditors would be left with no allowed postpetition interest at all.

On May 20, 2021, District Judge Haywood Gilliam entered an order affirming Judge Montali’s ruling. In that opinion, the judge pointed out that *Cardelucci* reasoned that “applying a single, easily determined interest rate to all claims for post-petition interest ensures equitable treatment of creditors.” Judge Gilliam found persuasive the Ninth Circuit’s reasoning that a bankruptcy “claim” held by a creditor against the estate is “similar to a federal judgment” payable upon completion of the bankruptcy process, thereby making an award of postpetition interest analogous to an award of post-judgment interest. Finally, Judge Gilliam agreed with Judge Montali that there can be no impairment of a creditor’s claim under section 1124 of the Bankruptcy Code where, as in *PG&E*, the modification of non-bankruptcy contractual rights is effected by the Bankruptcy Code, rather than a chapter 11 plan.

Bankruptcy Judge Marvin Isgur of the Bankruptcy Court for the Southern District of Texas followed a different line of reasoning in arriving at the opposite conclusion. According to Judge Isgur, section 1124 of the Bankruptcy Code requires that in a solvent debtor case, a chapter 11 plan leave the “legal, equitable, and contractual rights” of unimpaired unsecured creditors unaltered. Judge Isgur acknowledged that section 502(b)(2) of the Bankruptcy Code restricts such creditors’ legal right to receive unmatured interest. However, said the judge, such creditors have an equitable right to be treated better than similarly situated impaired creditors, who would receive “at least their full allowed claim plus interest at the legal rate.” Moreover, the judge said, unimpaired unsecured creditors have an equitable right to be paid the full amount they are validly owed before the debtors’ equityholders receive any recovery.

Based on these equitable rights, Judge Isgur ruled that unsecured creditors in a solvent debtor case must be permitted to recover postpetition interest at contractual default rates to be considered unimpaired. The judge pointed out that even if such creditors were to receive postpetition interest at the federal judgment rate, those creditors would be “worse off” than impaired creditors, because they would have been deprived of the right to vote on the plan. Judge Isgur further held that the underlying

⁵ 11 U.S.C. § 502(b)(2).

⁶ 11 U.S.C. § 506(b).

purpose of the solvent-debtor exception would not be met by limiting postpetition interest to the federal judgment rate, because it would allow the debtor and its equityholders to escape bankruptcy with a windfall.

Conclusion

Case law regarding the postpetition interest entitlement of unimpaired unsecured creditors is not uniform, and courts have come to conflicting conclusions by emphasizing different provisions of the Bankruptcy Code. While the courts in the PG&E chapter 11 cases have reaffirmed that such unsecured creditors can be deemed unimpaired under section 1124 by receiving interest only at the federal judgment rate, Judge Isgur has ruled that the equitable rights of such creditors demand payment of postpetition interest at contractual default rates. The ongoing uncertainty surrounding these issues is evidenced by the fact that both Judge Gilliam's and Judge Isgur's decisions have been appealed to the respective Courts of Appeals, creating the possibility of a circuit split, which may only be resolved by the Supreme Court or by statute. It remains to be seen whether, in the Hertz chapter 11 cases, Judge Walrath will follow the lead of Judge Isgur or the Ninth Circuit courts, or rule in a different manner entirely.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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