

INSIGHTS

## The Fifth Circuit Holds Bankruptcy Code Can Impair Claims and Make-Whole Provision May Not Be Enforceable

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On January 17, 2019, the Fifth Circuit held that a creditor is not impaired for the purpose of voting on a plan if it is the Bankruptcy Code (as opposed to plan treatment) that impairs a creditor's claim. The court further held that a make-whole premium is a claim for unmatured interest which is not an allowable claim under Bankruptcy Code, absent application of the "solvent-debtor" exception which may or not apply—the issue was remanded to the bankruptcy court for decision. Finally, the court held that entitlement to, and the amount of, post-petition interest was not legally or contractually required, but may be granted under equity. Again, the issue was remanded to the bankruptcy court for decision.

Ultra Petroleum Corporation ("Ultra") is an oil and gas company that filed for Chapter 11 bankruptcy protection when crude oil dropped to \$30/barrel. Oil prices more than doubled during the bankruptcy proceedings, allowing Ultra to propose a reorganization plan that purported to compensate all creditors in full. However, plan distributions for certain unsecured creditors provided no make-whole premium (despite underlying contractual terms) and post-petition interest at the federal judgment rate (instead of the underlying contractual default rate).

A group of creditors deemed unimpaired, and thus unentitled to vote on the plan, objected and argued that they were impaired under section 1124(1) of the Bankruptcy Code. According to the creditors, the plan should have enforced the underlying contractual provisions calling for a make-whole premium upon acceleration and additional post-petition interest at contractual default rates, all of which totaled approximately \$387 million. Ultra countered that the make-whole premium should be disallowed under section 502(b)(2) of the Bankruptcy Code (barring claims for unmatured interest) or, alternatively, under New York contract law. Furthermore, Ultra argued, the Bankruptcy Code caps post-petition interest at the federal judgment rate under 11 U.S.C. § 726(a)(5) (mandating the payment of interest at the federal judgment rate for certain bankruptcy claims).

The parties agreed to proceed with confirmation of the plan and take up the impairment question at a later date. Meanwhile, Ultra agreed to set aside \$400 million to compensate the creditors if they prevailed.

The bankruptcy court ultimately held that, for a class of claims to be unimpaired under a plan, the class must receive all distributions to which it is entitled under state law. Thus, the unsecured creditors were entitled to the contractual make-whole premium and additional post-petition interest at contractual default rates. According to the bankruptcy court, the outcome complied with section 1124(1), which provides that a class of claims is not impaired if a plan “leaves unaltered the legal, equitable, and contractual rights to which such claim” entitles the holder. The bankruptcy court concluded that an alteration of the claimant’s rights by operation of the Bankruptcy Code would impair its claims (instead of excluding such alteration from the impairment analysis). In essence, the Bankruptcy Court held that it is the Plan—and not the Bankruptcy Code—that impairs a class.

On appeal, the Fifth Circuit disagreed, holding that a class is not impaired under a plan for purposes of section 1124(1) if the *Code* disallows a portion of its claims that would otherwise be preserved under *state* law. The Fifth Circuit held that a make-whole premium designed to compensate creditors for lost interest is “unmatured interest” under section 502(b)(2) of the *Code* and therefore disallowed absent an applicable exception. Such an exception, the court held, may be the “solvent-debtor exception.” Under the solvent-debtor exception (rooted in English law), if a debtor is solvent, then creditors should receive distributions on account of pre-petition claims to the full extent of their contractual rates and terms. The ruling directs the bankruptcy court to consider whether the exception applies here.

Turning to the federal judgment rate, the Fifth Circuit held that the unsecured creditors had no legal right to post-petition interest at the default rates under section 726(a)(5). However, the court recognized that the creditors may have an equitable right to post-petition interest and remanded the issue to the bankruptcy court.

The ruling highlights important issues concerning claim impairment, plan voting, and the enforceability of make-whole provisions. According to the Fifth Circuit, a class of creditors impaired by the *Code* may remain unimpaired under a plan of reorganization for purposes of section 1124(1). Creditors and debtors will be closely watching the case on remand to see whether the make-whole premium survives under the solvent-debtor exception and whether it is equitable to allow post-petition interest at the default rate, federal judgment rate, or some other rate.

For more information, click [here](#).