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Delaware Joins Growing Consensus on Calculation of Postpetition Interest in Solvent Debtor Cases

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Key Takeaways

- The recent decision by Judge Mary Walrath in *In re Hertz* is consistent with the growing trend among bankruptcy courts to apply the federal judgment rate to the calculation of postpetition interest on unsecured claims in solvent debtor cases.
- The *Hertz* opinion departs from Judge Walrath's previous reasoning in *In re Coram*, where she determined the decision to apply the federal judgment or contract rate should be based on what is "fair and equitable" in each specific case.
- Courts justify application of the federal judgment rate on uniformity principles without considering its consequence of forcing creditors to subsidize the debtor's shareholders.

The Issue

In a previous article, we highlighted what we observed to be a "growing consensus" among bankruptcy courts that in cases where the debtor is solvent, postpetition interest on general unsecured claims should be calculated at the federal judgment rate rather than the contract rate. The recent *Hertz* decision adds Delaware to the emerging majority of courts in this ongoing debate and demonstrates Judge Mary Walrath's evolution in reasoning on the topic since her 2004 decision in *In re Coram*.[1]

In *Hertz*, certain unsecured noteholders argued they were entitled to postpetition interest on their claims at the rate specified in their contract rather than the federal judgment rate. The court reviewed two discrete arguments: (1) whether the noteholder's claims must receive postpetition interest at the contract rate since the debtor's plan treats the claims as unimpaired, and (2) whether the "solvent debtor exception" warranted postpetition interest at the contract rate instead of the federal judgment rate.

***In re Coram* and Judge Walrath's Previous Holding on Postpetition Interest**

Hertz was not the first time Judge Walrath confronted the question of what interest rate should be applied to unsecured claims where the debtors' estate is solvent. In the 2004 case of *In re Coram*, the issue of providing postpetition interest at the contract rate versus the federal judgment rate arose through two competing chapter 11 plans of reorganization.[2] First, Judge Walrath determined the best interests test of section 1129(a)(7) requires a plan to provide nonconsenting impaired creditors with at least as much as they would receive if the debtor liquidated in chapter 7.[3] Bankruptcy Code section 726(a)(5), in turn, sets the floor for unsecured claimholder recoveries by providing an unsecured claimholder with "interest at the legal rate" for its claim.[4]

The Bankruptcy Code, however, does not define or specify the "legal rate." The court observed that most courts deem the federal judgment rate appropriate because (1) an allowed claim is equivalent to a monetary judgment, and (2) postpetition and post-judgment interest both compensate a party for the delay between the judgment/petition date and the date of payment.[5]

In *Coram*, Judge Walrath declined to follow this approach, as she was "not convinced that Congress intended to supplant a party's contractual right to interest in all circumstances under chapter 11."[6] The court found nothing in the Bankruptcy Code *required* using the federal judgment rate for calculating postpetition interest.[7] Instead, Judge Walrath said she believed courts should use the "specific facts of each case" to determine what is "fair and equitable."[8] Because the debtors' chief executive officer in *Coram* was also employed as a consultant for the largest noteholder, Judge Walrath held the noteholders' bad faith warranted providing the lower federal judgment rate of postpetition interest.[9]

In re Hertz Diverts from "Equitable" Test, Opts for Uniformity

The same issue would arise almost 18 years later in *Hertz.* Without mentioning her opinion in *Coram*, Judge Walrath departed from the subjective "fair and equitable test" adopted there and instead held that postpetition interest must be calculated at the federal judgment rate.

The court first addressed the noteholders' argument that the plan would impair their claims if they did not receive interest at the contract rate. The court held, consistent with Third Circuit precedent,[10] that there was no impairment of noteholder claims because it was the Bankruptcy Code - not the debtor's plan - that disallowed unmatured interest on claims through 11 U.S.C. § 502(b)(2).[11]

Next, the court assessed whether the "solvent debtor exception," an equitable doctrine recognized under the former Bankruptcy Act, was incorporated into the Bankruptcy Code, and thus would require creditors to receive their full contract rights.[12] Notably, the solvent debtor exception was not raised in *Coram.* Opponents of the contract rate instead argued the equitable doctrine would inappropriately override 11 U.S.C. §§ 726(a)(5) and 1129(a)(7).[13]

The court rejected this argument on the basis that those sections only apply to *impaired* creditors: §1129(a)(7) by its express terms and § 726(a)(5) through its incorporation into chapter 11 in the best interests test.[14] The Bankruptcy Code, however, "is silent on what treatment *unimpaired* creditors must receive in a solvent chapter 11 debtor case." [15]

The court ruled that the solvent debtor exception survived passage of the Bankruptcy Code to the "limited extent" it was "expressly codified" in particular sections of the Bankruptcy Code, such as those relating to impaired unsecured claimholders in a solvent debtor situation.[16] Neither those sections, nor the Code's legislative history, however, suggests "unimpaired creditors are entitled to their contract rate of interest or even to *more* than impaired creditors in the case of a solvent debtor."[17] Instead, the court concluded that the legislative history "provides strong evidence Congress intended that unimpaired creditors in a solvent chapter 11 debtor case should receive post-petition interest only in accordance with sections 1129(a)(7) and 726(a)(5)."[18]

In accordance with those sections, the court determined that the appropriate rate for unimpaired, unsecured claimholders in a solvent debtor case is the federal judgment rate, not the contract rate.[19] Using the federal judgment rate promotes two Bankruptcy Code policies. First, applying the same interest rate to both impaired and unimpaired unsecured creditors where the debtor is solvent promotes the basic policy of assuring that similarly situated creditors receive equitable treatment.[20] Second, doing so promotes predictability and the efficient administration of the bankruptcy estate.[21]

In coming to this conclusion, Judge Walrath rejected the rule espoused in *In re Energy Future Holding (“EFH”)*, which like *Coram* provided courts with equitable discretion to impose postpetition interest rates “at the contract rate or such other rate as the [c]ourt deems appropriate.”[22] The court declined to follow *EFH* because such a rule (1) “provides no guidance” to litigants as to the appropriate treatment for an unimpaired creditor, therefore causing “endless litigation,” and (2) goes against “recent Supreme Court jurisprudence” seeking to “curb the bankruptcy court’s exercise of equitable discretion.”[23] The evolution in case law on this issue, combined with recent Supreme Court guidance limiting a bankruptcy court’s equitable discretion, may account for Judge Walrath’s divergence from the equitable rules articulated in *EFH* and *Coram.*

Contextualizing *In re Hertz* and *In re Coram* in Larger Debate on Postpetition Interest

Judge Walrath’s shift from embracing the equitable test for applying postpetition interest rates in *Coram* to uniformly extending application of the federal judgment rate to all claims within a specific category in *Hertz* is consistent with the growing trend among bankruptcy courts overall. For example, the court in the 2019 case *In re PG&E Corp.* reached an identical conclusion, applying the federal judgment rate uniformly to both impaired and unimpaired creditors in a solvent debtor case.[24]

While Delaware’s embrace of this rule provides more certainty to parties as to how their claims may be treated in solvent debtor cases, it takes away the equitable discretion Delaware courts had under *Coram* and *EFH* to determine if the contract rate would be more appropriate, particularly where elimination of the contract rate would force noteholders to effectively subsidize shareholder recoveries.

[1] *In re Hertz Corp.,* No. 20-11218, 2021 WL 6068390 (Bankr. D. Del. Dec. 22, 2021).

[2] *In re Coram*, 315 B.R. 321 (Bankr. D. Del. 2004).

[3] *In re Coram*, 315 B.R. at 346.

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.* at 347.

[10] *In re PPI Enters.*, Inc. 324 F.3d 197, 204 (3d Cir. 2003).

[11] *In re Hertz*, 2021 WL 6068390, at *10.

[12] *In re Hertz*, 2021 WL 6068390, at *11.

[13] *Id.*

[14] *Id.*

[15] *Id.* (emphasis added).

[16] *Id.* at *16.

[17] *Id.* (emphasis in original).

[18] *Id.*

[19] *Id.*

[20] *Id.* at *17.

[21] *Id.*

[22] *In re Energy Future Holdings Corp.,* 540 B.R. 109, 124 (Bankr. D. Del. 2015).

[23] *In re Hertz*, 2021 WL 6068390, at *15.

[24] *In re PG&E Corp.*, 610 B.R. 308 (Bankr. N.D. Cal. 2019).

Related Professionals

- **Vincent Indelicato**

Partner

- **Daniel Desatnik**
  Partner
- **Maximilian A. Greenberg**
  Associate