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Fifth Circuit Denies Post-Petition Default Interest to Fully Secured Creditors

*Jeffrey R. Dutson, Sarah L. Primrose, and Nadia B. Saleem**

The U.S. Court of Appeals for the Fifth Circuit recently issued an opinion finding that, under the terms of the confirmed Chapter 11 bankruptcy plan, the debtors' lenders were not entitled to receive over 30 million dollars of post-petition default interest even though the lenders were fully secured. The authors of this article discuss the decision.

Recently, the U.S. Court of Appeals for the Fifth Circuit issued an opinion¹ affirming bankruptcy and district court decisions finding that, under the terms of the confirmed Chapter 11 bankruptcy plan, the debtors' lenders were not entitled to receive over 30 million dollars of post-petition default interest even though the lenders were fully secured. Despite the fact that the plan provided that the lenders were fully secured on "account of unpaid principal, plus unpaid interest . . . and other obligations arising under" the applicable loan documents, this provision was deemed not sufficiently specific to override the plan's general prohibition on post-petition default interest.

BACKGROUND

In 2016, Linn Energy and 12 of its affiliates (the "Debtors") filed for Chapter 11 bankruptcy relief in the U.S. Bankruptcy Court for the Southern District of Texas. Prior to filing for bankruptcy, the Debtors had entered into a credit agreement (the "Credit Agreement") with over 40 lenders (collectively, the "Lenders") for loans in excess of a billion dollars. The Credit Agreement provided that in the event of a bankruptcy filing, interest would automatically accrue at a default rate of two percent above the otherwise applicable base rate. The Lenders filed proofs of claim that included claims for almost \$31.2 million in post-petition default interest.

The Debtors' bankruptcy plan (the "Plan") contained two relevant (and potentially contradictory) provisions. On one hand, Article III provided for the

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¹ *In re Linn Energy, L.L.C.*, Case No. 18-40443, 2019 U.S. App. LEXIS 17934 (5th Cir. June 14, 2019).

payment of “unpaid interest, fees . . . and other obligations arising under or in connection with” the Credit Agreement, “notwithstanding any other provision of this Plan to the contrary.”² On the other hand, Article VI expressly prohibited post-petition default interest unless “*specifically* provided for in the Plan or the Confirmation Order.”³

The bankruptcy court concluded that since there was no specific reference to “default interest” in Article III, that section was insufficient to overcome the express prohibition against the payment of default interest included in Article VI. The Lenders appealed the decision to the district court, which affirmed the bankruptcy court.

FIFTH CIRCUIT’S DECISION

On appeal, the Fifth Circuit noted that the language of Article VI prohibited payment of default or post-petition interest unless “specifically provided for in the Plan or the Confirmation Order,” and concluded that the Lender’s claims for default interest should be disallowed because Article III of the Plan did not specifically reference “default interest.”

CONCLUSIONS AND LESSONS LEARNED

Provisions generally disallowing post-petition and default interest, like Article VI of the *Linn* plan, are common. Chapter 11 debtors include these provisions to cut off claims for default and post-petition interest that may be asserted by a wide variety of creditors, including equipment lessors, contract counter-parties and trade creditors. Under the Fifth Circuit’s opinion in this case, over-secured creditors that want to preserve and assert claims for

² Article III.B.3(b) of the Plan provided “[n]otwithstanding any other provision of this Plan to the contrary, on the Effective Date, the LINN Lender Claims are Allowed as fully Secured Claims under section 506(b) of the Bankruptcy Code having first lien priority in the amount of \$1.939 billion on account of unpaid principal, plus interest, fees, other expenses, and other obligations arising under or in connection with the LINN Lender Claims, or as set forth in the LINN Credit Agreement other Loan Documents (as defined in the LINN Credit Agreement), in each case, not subject either in whole or in part to off-set, disallowance or avoidance under chapter 5 of the Bankruptcy Code or otherwise, or any legal, contractual, or equitable theory for claims”

³ Article VI.F provided “[u]nless otherwise specifically provided for in the Plan or the Confirmation Order, and notwithstanding any documents that govern the LINN Debtors’ prepetition funded indebtedness to the contrary, (a) postpetition and/or default interest shall not accrue or be paid on any Claims and (b) no Holder of a Claim shall be entitled to: (i) interest accruing on or after the Petition Date on any such Claim; or (ii) interest at the contract default rate, as applicable.”

post-petition default interest should ensure that the plan provisions regarding the treatment of their claims expressly and specifically provide for the payment of post-petition default interest.