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Client Alert

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PG&E Bankruptcy Court Finds that Postpetition Interest for Unsecured Creditors Must be Calculated at the Federal Judgement Rate

In a decision entered just before the end of the year in the PG&E bankruptcy cases,[1] Judge Montali issued an opinion (the "**Opinion**")[2] finding that unsecured creditors in a solvent bankruptcy case are entitled under the Bankruptcy Code to postpetition interest calculated pursuant to 28 U.S.C. § 1961(a) (the "**Federal Interest Rate**"), rather than using other (generally higher) contractual or state law statutory rates. The Opinion reviews certain approaches taken by other courts, but ultimately follows the holding and rationale of the Ninth Circuit decision in *Onink v. Cardelucci (In re Cardelucci)*.[3] Also presently before Judge Montali is a dispute over the amount of asserted make-whole claims.[4] Given the "close relationship" between the postpetition interest question and the issues presented in the pending make-whole dispute,[5] Judge Montali stated that he will not enter an order on the Opinion until he decides the make-whole issue, which is scheduled to be heard on January 14, 2020. From the perspective of distressed investors, this Opinion highlights the concerns and risks that a distressed investor must consider when evaluating unsecured investment opportunities.[6]

BACKGROUND

The issue before the Court was whether the applicable postpetition interest rate to be paid to four classes of allowed unsecured (and asserted unimpaired) claims under a proposed Chapter 11 reorganization plan for the solvent Debtors should be at the Federal Interest Rate in effect as of the filing of the Debtors' bankruptcy cases (2.59%), or other (generally higher) contractual or state law interest rates. The Debtors proposed to pay certain unsecured creditors postpetition interest at the Federal Interest Rate; other parties (the official committee of unsecured creditors, an ad hoc committee of senior unsecured noteholders, an ad hoc committee of

holders of trade claims and others, collectively, the "**Unsecured Creditors**") objected to such treatment, contending that postpetition interest on their unsecured claims should be calculated based on contractual, applicable statutory, or other interest rates. At stake was approximately $480 million that the Debtors would save by utilizing the otherwise lower Federal Interest Rate.

DECISION

Ultimately, the Court found for the Debtors, ruling that "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".[7] The Court based its ruling on two grounds: (i) binding precedent, namely *Cardelucci*, and (ii) a finding that application of the Federal Interest Rate is consistent with the controlling provisions of the Bankruptcy Code and would not otherwise "impair" the claims of the unsecured creditors.[8]

First, the Court found that the Ninth Circuit's *Cardelucci* decision was applicable and binding precedent. In *Cardelucci*, the Ninth Circuit found that unsecured creditors are entitled to postpetition interest at the Federal Interest Rate, "not at contractual or state statutory rates."[9] In discussing the precedential impact of *Cardelucci*, Judge Montali noted that although the Ninth Circuit in *Cardelucci* pinpointed a "narrow but important issue," it "did not narrow the application of its holding, which must be applied broadly".[10] Judge Monatali agreed with the *Cardelucci* rationale that having a uniform rate (the Federal Interest Rate) made for sound bankruptcy policy. He went on to state that, "[t]he 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 . . . ."[11]

Second, the Court addressed the Unsecured Creditors' contention that the applicable plan, by paying Unsecured Creditors at the Federal Interest Rate, impaired their claims. The Court made clear that it is not the plan in question that compels the payment of the Federal Interest Rate, rather it is the Bankruptcy Code and the limited exception[12] to the general rule under Section 502(b)(2) of the Bankrupty Code that unsecured creditors are not entitled to postpetition interest. In support thereof, the Court referenced decisions from, among others, the Fifth Circuit (*In re Ultra Petroleum Corporation*, 943 F.3d 758 (5th Cir. 2019)) and the Third Circuit (*In Solow v. PPI Enterprises (U.S.) Inc. (In re PPI Enterprises (U.S.) Inc.)*, 324 F.3d. 197 (3d Cir. 2003)) for the proposition that impairment results from what a plan does, not from what a statute like the Bankruptcy Code otherwise provides.[13]

CONCLUSION

The law remains unsettled as to whether postpetition interest for unsecured creditors is to be calculated at the Federal Interest Rate or a different (and potentially higher) rate. The Opinion, which lands squarely on the Federal Interest Rate side of the issue, is noteworthy since the PG&E bankruptcy cases are high profile and the amount at stake is significant. How this ultimately plays out and whether the Opinion foreshadows the result in the pending make-whole dispute remains to be seen. The Court has yet to enter an order consistent with its Opinion because of the pending make-whole issue. Also, Judge Montali has also not decided whether to certify a direct appeal of the Opinion to the Ninth Circuit (which could be certified together with a future opinion on the make-whole issue).

It is not often that solvent debtors file for bankruptcy and thus the postpetition interest issue for unsecured creditors is not often litigated. However, the issue is related to disputes over make-whole provisions, which are more commonly litigated (*see, e.g.*, *Ultra Petroleum*[14] and *Momentive*[15]). It will be interesting to see, and we will subsequently report on, how Judge Montali approaches the make-whole issue in light of the Opinion.

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[1] The bankruptcy cases are PG&E Corporation and Pacific Gas and Electric Company (the "**Debtors**"), *In re PG&E Corp.*, et al., Case No. 19-30088-DM (jointly administered) (Bankr. N.D. Ca. Dec. 30, 2019) (the "**PG&E bankruptcy cases**").
[2] *Id*.
[3] 285 F.3d 1231 (9th Cir. 2002).
[4] At issue before the Court with respect to the make-whole dispute is whether senior noteholders are entitled to a make-whole premium if they are to be "unimpaired" and not reinstated as contemplated by the Debtors' proposed Chapter 11 plan. The Debtors contend that a make-whole payment is not provided for by the indenture and, in any event, should be disallowed as unmatured interest. The opposing creditor groups argue that the Debtors' decision to satisfy the notes early, despite their ability to pay the notes when due, is an "optional redemption" that entitles them to a make-whole premium.
[5] Opinion, at 17.
[6] Postpetition interest for secured creditors at the contractual rate, or the state statute which is the basis for the claim, is expressly provided for by Section 506(b) of the Bankruptcy Code.
[7] Opinion, at 3.
[8] In the bankruptcy context, a creditor is impaired under a Chapter 11 plan if its legal, equitable or contractual rights are altered. An unimpaired creditor is one whose rights are unaltered by the Chapter 11 plan or whose interests are otherwise cured, restated or compensated. 11 U.S.C. § 1124. An unimpaired creditor is deemed to have accepted a Chapter 11 plan. *Id.* §1126.
[9] Opinion, at 7 (citation omitted).
[10] *Id*.
[11] *Id.* at 7–8. Since the PG&E bankruptcy cases are pending in the Ninth Circuit, Judge Montali ruled that he was bound to follow *Cardelucci*.
[12] Under the "best interests of creditors" test, creditors are entitled to receive under a Chapter 11 plan at least what they would get in a Chapter 7 liquidation. 11 U.S.C. § 1129(a)(7). Under the Chapter 7 priority distribution scheme, unsecured creditors are entitled to interest at the "legal rate" before equity receives a distribution. *Id.* § 726(a)(5). The dispute over the applicable postpetition interest rate centers on the extent to which the best interests test incorporates the Chapter 7 distribution scheme and what is meant by the undefined term "legal rate."
[13] Opinion, at 15 (citations omitted).
[14] 575 B.R. 361 (Bankr. S.D. Tex. 2017), *rev'd in part, vacated in part*, 913 F.3d 533 (5th Cir. 2019), *opinion withdrawn and superseded on reh'g*, 943 F.3d 758 (5th Cir. 2019), *and rev'd in part, vacated in part*, 943 F.3d 758 (5th Cir. 2019).
[15] No. 14-22503-RDD, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd*, 531 B.R. 321 (S.D.N.Y. 2015), *aff'd in part, rev'd in part and remanded sub nom. In re MPM Silicones, L.L.C.*, 874 F.3d 787 (2d Cir. 2017).