Creditors Can Recover Post-Petition Interest by Incorporating Original Agreement into the Plan of Reorganization by Referencing a Specific Clause in the Original Agreement

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Cite as: Creditors Can Recover Post-Petition Interest by Incorporating Original Agreement into the Plan of Reorganization by Referencing a Specific Clause in the Original Agreement, 12 ST. JOHN’S BANKR. RESEARCH LIBR. NO. 28 (2020).

INTRODUCTION

Courts will generally interpret a contract according to its plain language, and any intent to incorporate a separate document must be clearly manifested with sufficient specificity. The parties’ intent will be inferred from the express language of the contract. Under section 506(b) of title 11 of the United States Code (the “Bankruptcy Code”), an oversecured creditor is entitled to post-petition interest on its secured claim up to the value of the collateral securing its claim. Additionally, most courts have ruled that a secured creditor is entitled to post-petition interest according to the rate specified in the contract or a rate established by applicable non-bankruptcy law. However, creditors may reserve the right to recover post-petition interest at the contractual rate so long as (1) they expressly manifest their intent to do so in the plan of reorganization, and (2) the interest serves no purpose that violates equitable considerations.

DISCUSSION

I. Creditors can Recover Post-Petition Interest at the Contractual Rate

Under general equitable principles of insolvency law, interest ceases to accrue at the beginning of the proceedings.¹ Specifically, section 502(b)(2) of the Bankruptcy Code, denies and

does not allow claims for unmatured interest. However, pursuant to section 506(b), this rule does not apply to an oversecured creditor who is entitled to post-petition interest up to the value of its collateral.²

Although post-petition default interest is typically analyzed under section 506(b), this section does not specify that the creditor is entitled to collect post-petition interest at the contract rate.³ Nevertheless, bankruptcy courts generally apply a presumption in favor of post-petition default interest subject to rebuttal or adjustment based on the equities.⁴

The presumption can be rebutted, and the interest rate will not be enforced if the court determines the specified default interest rate is unconscionable or violates equitable principles. But the courts’ powers to “modify the contract rate based on notions of equity should be exercised sparingly” and “limited to situations where the secured creditor is guilty of misconduct, the application of the contractual interest rate would harm the unsecured creditors or impair the debtor’s fresh start or the contractual interest rate constitutes a penalty.”⁵ Where the default interest served instead as a penalty, courts are unlikely to award them. For example, in In re Tampa Chain Co.⁶, the court held “[s]ince interest had already been factored into the face amount of the loan, the interest now sought by Fundex is for late charges. They are thus a penalty.” Similarly, in In re

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² See also Vanston, 329 U.S. at 164.
³ In re Milham, 141 F.3d 420, 423 (2d Cir. 1998).
⁴ See, e.g., In re 785 Partners LLC, 470 B.R. 126, 134 (Bankr. S.D. N.Y. 2012) (“There is nevertheless a rebuttable presumption that the oversecured creditor is entitled to default interest at the contract rate subject to adjustment based on equitable considerations.”); In re Terry Ltd. P’ship, 27 F.3d 241, 243 (7th Cir. 1994), cert. denied sub nom., In re Tampa Chain Co. v. Equitable Life Ins. Co. of Iowa, 513 U.S. 948 (1994) (“What emerges from the post-Ron Pair decisions is a presumption in favor of the contract rate subject to rebuttal based upon equitable considerations.”); 4 COLLIER ON BANKRUPTCY ¶ 506.04[2][b], at 506–102 (collecting cases); But see In re Sundale, Ltd., 410 B.R. 101, 106 (Bankr. S.D. Fla. 2009) (“this Court may not use its equitable powers to alter Ocean Bank's state law contract right either under Florida or federal law”).
⁶ 53 B.R. 772, 781 (Bankr. S.D.N.Y. 1985)
Vest Assocs., the court explained that “oversecured creditors may receive payment of 
either default interest or late charges, but not both.”

Accordingly, courts will enforce the default interest rate contracted upon by the parties so 
long as the interest rate does not violate rules of equity.

II. Interpreting the Plan of Reorganization to Determine Whether Creditors 
Successfully Reserved the Right to Post-Petition Interest

Plans of reorganization are generally construed as contracts and, therefore, traditional 
principles of contract interpretation apply. 

A. Plans of Reorganization should be unambiguous and clearly express the creditors’ 
intent to recover post-petition default interest.

Under New York law, in the absence of ambiguity, a contract should be interpreted 
according to its “express” terms. Additionally, in contract disputes between two sophisticated 
parties, New York courts do not construe the contract against the drafter.

Ambiguity in contract exists when the language is “capable of more than one meaning 
when viewed objectively by a reasonably intelligent person who has examined the context of the 
entire integrated agreement and who is cognizant of the customs, practices, usages and terminology 
as generally understood in the particular trade or business.” Conversely, an agreement is

8 See also, e.g., In re Tampa Chain Co., 53 B.R. 772, 781 (Bankr. S.D.N.Y. 1985) (“Since interest had already 
been factored into the face amount of the loan, the interest now sought by Fundex is for late charges. They are 
thus a penalty.”); In re Vest Assocs., 217 B.R. 696, 701 (Bankr. S.D.N.Y. 1998) (“oversecured creditors may 
receive payment of either default interest or late charges, but not both”); In re 1095 Commonwealth Ave. 
Corp., 204 B.R. 284, 304-05 (Bankr. D. Mass. 1997) (allowing recovery at default rate of interest but 
precluding recovery of late fees because “[b]oth the late charge and the default rate of interest are intended to 
compensate the lender for the increased costs of administration caused by the borrower's failure to make 
payment as and when it is due”); In re White, 88 B.R. 498, 511 (Bankr. D. Mass. 1988) (finding that a 
48% default rate of interest was unreasonable, and therefore a penalty, where the non-default rate was 16.5% 
and grossly disproportionate to the damages resulting from the breach).
9 In re Stratford of Tex., Inc., 635 F.2d 365, 368 (5th Cir. 1981).
doctrine of contra proferentem because the plaintiff was sophisticated and had “equal bargaining power”)
unambiguous if the language used in the contract has “a definite and precise meaning, unattended by danger of misconception in the purport of the [agreement] itself, and concerning which there is no reasonable basis for a difference of opinion.” Notably, when determining ambiguity, the contract should be read “as a whole to ensure that undue influence is not placed upon particular words and phrases.”

Furthermore, a cardinal rule of construction is that interpretations that “render[] at least one clause superfluous or meaningless” should be avoided. For example, in In re Linn Energy, LLC, one clause of the plan of reorganization purported to incorporate the original agreement, which allowed creditors to recover post-petition default interests, but the clause made no mention to default-interest. However, a separate clause in the plan, entitled “No Postpetition or Default Interest on Claims,” specifically and “expressly” forbade recovery of post-petition default interest. The Fifth Circuit held that while no specific provision of the plan specifically provided for payment of default interest to provision, one provision’s language was specific, “simple and to the point” in its denial of such payment. Any other interpretation would have rendered the latter section meaningless. As such, the clearer language, barring interest, was enforced.

Thus, the plan of reorganization should clearly and unambiguously express the intent for creditors to recover post-petition default interest. Similarly, as discussed below, they must also unambiguously express the intent to incorporate the original agreement into the plan of reorganization if that is the document permitting the interest recovery.

16 927 F.3d 350 (5th Cir. 2019).
17 Id. at 352.
18 Id at 354.
B. Creditors and Debtors Should Clearly Express their Intent to Incorporate by Reference the Original Agreement into the Plan of Reorganization.

New York law prohibits incorporating extrinsic documents into an agreement unless they are specifically incorporated by reference.\(^{19}\) The incorporation by reference doctrine is “grounded on the premise that the material to be incorporated into a contract is so well known to the contracting parties that a mere reference to it is sufficient.”\(^{20}\) For this doctrine to apply, courts require that the document to be incorporated by reference is “described in the contract such that it is identifiable beyond all reasonable doubt.”\(^{21}\)

Under New York law, incorporation by reference is an exacting standard that requires “a clear manifestation of an intent” to be bound by specific terms of an incorporated document.\(^{22}\) The courts will use an objective standard to determine whether a document has been incorporated by reference, evaluating whether a “reasonable person would understand the specific document to be incorporated by reference.”\(^{23}\) An extrinsic document is successfully incorporated when interpreting a contract if: (1) the document is clearly and expressly identified and described in the contract such that the extrinsic document “may be identified beyond all reasonable doubt”, and (2) the contract contains language that clearly communicates that the purpose of the reference is to incorporate the referenced material into the contract, rather than merely to acknowledge that the referenced material is relevant to the contract.”\(^{24}\) Additionally, successful incorporation by reference is “limited to the section and purpose for which the incorporated document is identified.”\(^{25}\)

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\(^{19}\) See *PaineWebber Inc. v. Bybyk*, 81 F.3d 1193, 1201 (2d Cir. 1996).


\(^{21}\) *Id.* (quoting *Bd. Of Comm’rs. Of Washington Park of City of Albany, 52 N.Y. 131, 134 (1873)*).


\(^{25}\) *Miller*, 291 F. Supp. 3d at 517.
Under the first prong, “the document to be incorporated must be identified with sufficient specificity.” It is insufficient for a contract to make a vague reference to a voluminous outside document. In such situations where the reference is general and fails to identify precisely what terms within the other document apply, the outside document will not be considered incorporated. For example, in In re Linn Energy, the clause in the reorganization plan purporting to incorporate the original agreement merely stated the lenders were entitled to “principal, plus unpaid interest, fees, other expenses, and other obligations arising under or in connection with the LINN Lender Claims, or as set forth in the [original agreement].” The court held this was not a sufficient reference to any specific clause in the original agreement. The clause purporting to incorporate made no specific mention to the “default interests,” identified in the original agreement and proof of claims. It was therefore not specific enough. Thus, when the reference is vague and too general, the extrinsic document is not clearly identified beyond all reasonable doubt.

CONCLUSION

Oversecured creditors are entitled under the Bankruptcy Code and New York Law to recover post-petition interest at a rate contractually agreed upon between the parties. However, if creditors intend to recover such interest, they must contract around the interest and ensure the original agreement and the plan of reorganization explicitly clarifies the intent. When parties set down their contract in a clear, complete document, their writing should be enforced according to its terms. The least problematic way to ensure recovery is to have a clause in the plan of reorganization dedicated to post-petition default interest recovery. Alternatively, if the interest is

26 Woodstock ’99, 140 F. Supp. 2d at 228-29.
27 927 F.3d at 352.
28 Id. at 354.
29 See also Woodstock ’99, 140 F. Supp. 2d at 228-29 (waiver of subrogation term in extrinsic contract was not successfully incorporated into letter agreement where, although extrinsic contract was specifically referenced, the waiver term was not); Weiner v. Mercury Artists Corp., 130 N.Y.S.2d 570, 571 (N.Y. App. Div. 1954) (provision buried in lengthy booklet was not incorporated despite reference to booklet in contract).
30 PaineWebber Inc, 81 F.3d at 1193.
reserved and specified in the original or a separate document, the extrinsic document may be incorporated into the new plan or agreement. However, it is crucial that the new plan not only refers to the extrinsic document but to the specific section dealing with post-petition default interest. Not doing so is likely to result in unsuccessful incorporation by reference, and, therefore, an inability to recover the interests. Courts require a clear manifestation of an intent to incorporate a separate document. Absent such showing, courts will enforce the new plan according to its terms and bar creditors from recovering their interests at the contracted rate, or possibly at all.