

St. John's University School of Law

St. John's Law Scholarship Repository

Bankruptcy Research Library

Center for Bankruptcy Studies

2023

Solvent Debtors Must Pay the Contractual Post-Petition Interest Rate on Unimpaired Claims

Rayla Aberman

Follow this and additional works at: https://scholarship.law.stjohns.edu/bankruptcy_research_library



Part of the [Bankruptcy Law Commons](#)



Solvent Debtors Must Pay the Contractual Post-Petition Interest Rate on Unimpaired Claims

Rayla Aberman, J.D. Candidate 2024

Cite as: *Solvent Debtors Must pay the Contractual Post-Petition Interest Rate on Unimpaired Claims*, 15 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 1 (2023).

Introduction

The default rule in bankruptcy law is that when a debtor files for bankruptcy, interest ceases to accrue on their unsecured claims. This general principle is subject to an exception known as the solvent debtor exception.¹ Under this exception, solvent debtors are required to pay post-petition interest on their outstanding claims, even after filing for bankruptcy.² Section 726(a)(5) of the Bankruptcy Code states that solvent debtors must pay interest at “the legal rate.”³ However, the Bankruptcy Code does not define what the legal rate is, and courts have disagreed over whether it applies to both impaired and unimpaired claimants.⁴

¹ Ad Hoc Comm. of Holders of Trade Claims v. PG&E (*In re* PG&E Corp.), No. 21-16043, 2022 U.S. App. LEXIS 24269, at *12 (9th Cir. Aug. 29, 2022).

² *Id.*

³ 11 U.S.C. § 726(a)(5).

⁴ See *In re* PG&E Corp., 2022 U.S. App. LEXIS 24269, at *19 (holding that the federal judgment rate is the legal rate, but that it only applies to unimpaired claims); *Ultra Petroleum Corp. v. Ad Hoc Comm. of OpCo Unsecured Creditors (In re* Ultra Petroleum Corp.), 51 F.4th 138, 159 (5th Cir. 2022) (holding that the legal rate provided by Section 726(a)(5) of the Bankruptcy Code is merely a minimum threshold and that bankruptcy courts have the discretion to require a higher rate than the federal rate when calculating post-petition interest); *In re* Hertz Corp., 637 B.R. 781, 801 (Bankr. D. Del. 2021) (holding that the federal judgment rate is the legal rate, and that it applies to both impaired and unimpaired claims).

This article analyzes the post-petition interest rate that solvent debtors must pay to unimpaired claimants. Part I analyzes whether the solvent debtor exception survived the passing of the Bankruptcy Code. Part II analyzes the definition of the legal rate and its potential application to unimpaired claimants.

I. The Solvent Debtor Exception Survived the Passing of the Bankruptcy Code

Generally, when a debtor files for bankruptcy interest ceases to accrue on all claims because “the debtor cannot pay all its creditors, and therefore payment of interest accruing after filing would diminish the value of the estate and result in disparate treatment of creditors.”⁵ However, the default rule was not intended to apply to solvent debtors since the rationale behind halting interest in bankruptcy cases does not apply when a debtor has sufficient funds to pay all outstanding debts.⁶ The solvent debtor exception is a common-law exception.

There has been debate among the courts over the extent to which the solvent debtor exception survived the passing of the Bankruptcy Code.⁷ This section of the Bankruptcy Code can be interpreted as “expressly disallow[ing] claims of unsecured creditors for unmatured interest.”⁸ Courts interpreting the statute in this way have held that the solvent debtor exception only survived the passing of the Bankruptcy Code to the limited extent of it being codified “in section 506(b) as to oversecured creditors and in section 1129(a)(7) and 726(a)(5) as to unsecured creditors.”⁹

However, “[t]he Senate Report accompanying the passage of the Bankruptcy Code emphasized that § 502(b) simply restated ‘principles of [then] present law,’” under which the

⁵ *In re PG&E Corp.*, 2022 U.S. App. LEXIS 24269, at *12.

⁶ *Id.*

⁷ See *In re Hertz Corp.*, 637 B.R. at 800 (holding that the solvent debtor exception only survived to a limited extent); *In re PG&E Corp.*, 2022 U.S. App. LEXIS 24269, at *24 (holding that the solvent debtor exception fully survived); *In re Ultra Petroleum Corp.*, 51 F.4th at 154. Under Section 502(b)(2) of the Bankruptcy Code, a claim will only be allowed “to the extent that . . . such claim is for unmatured interest” 11 U.S.C. § 502(b)(2).

⁸ *In re Hertz Corp.*, 637 B.R. at 799.

⁹ *Id.* at 800.

solvent debtor exception was widely accepted.¹⁰ Additionally, the Supreme Court held that it “will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.”¹¹ It follows that courts which focus on congressional intent, rather than the plain language of the statute, have held that the solvent debtor exception survived the passing of the Bankruptcy Code in full.¹²

II. Interpreting the Applicable Post-Petition Interest Rate

Section 726(a)(5) of the Bankruptcy Code requires payment of interest at “the legal rate.”¹³ However, the Bankruptcy Code does not provide a definition of the legal rate. As a result, courts addressing the appropriate rate of post-petition interest for unimpaired claims in solvent debtor cases have applied either the contract rate or the federal judgment rate provided in 28 U.S.C. §1961.¹⁴ Further, the issue of whether the applicable interest rate applies to both impaired and unimpaired claims remains unsettled.¹⁵

The “legal rate” for post-petition interest referred to in section 726(a)(5) of the Bankruptcy Code means the federal judgment rate.¹⁶ However, section 726(a)(5) only applies to impaired claims.¹⁷ Because the Bankruptcy Code only explicitly refers to impaired claims, courts have diverged in resolving the issue of which authority governs the interest rate for unimpaired

¹⁰ See *In re PG&E Corp.*, 2022 U.S. App. LEXIS 24269, at *24.

¹¹ *Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998).

¹² See *In re PG&E Corp.*, 2022 U.S. App. LEXIS 24269, at *24; *In re Ultra Petroleum Corp.*, 51 F.4th 138 at 154 (“abrogation of a prior bankruptcy practice generally requires an ‘unmistakably clear’ statement on the part of Congress . . .”).

¹³ 11 U.S.C. § 726(a)(5).

¹⁴ See *In re Ultra Petroleum Corp.*, 51 F.4th at 159 (holding that the federal judgment rate is merely the floor); *In re Hertz Corp.*, 637 B.R. at 801 (holding that the federal judgment rate is the legal rate); *In re Energy Future Holdings Corp.*, 540 B.R. 109, 124 (Bankr. D. Del. 2015) (holding that the required rate of interest for unimpaired claims in solvent debtor cases “may be the contract rate or such other rate as the Court deems appropriate.”).

¹⁵ See *In re PG&E Corp.*, 2022 U.S. App. LEXIS 24269, at *19 (holding that this provision only applies to impaired claims). *But see In re Hertz Corp.*, 637 B.R. at 801 (holding that this provision applies to both impaired and unimpaired claims).

¹⁶ *In re PG&E Corp.* 2022 U.S. App. LEXIS 24269, at *19; *In re Hertz Corp.*, 637 B.R. at 801; *In re Ultra Petroleum Corp.*, 51 F.4th at 159 (holding that the “legal rate” may mean the federal judgment rate).

¹⁷ *In re PG&E Corp.* 2022 U.S. App. LEXIS 24269, at *19; *In re Hertz Corp.*, 637 B.R. at 800.

claims.¹⁸ In solvent debtor cases, courts have chosen not to distinguish between impaired and unimpaired claimants, even though section 726(a)(5) only explicitly refers to impaired claims.¹⁹ Conversely, courts have held that because section 726(a)(5) does not establish the applicable post-petition interest rate for unimpaired claimants, the applicable rate should be informed by the solvent debtor exception’s “core principle that creditors should be made whole when the bankruptcy estate is sufficient”²⁰ “Accordingly, under the Code, unsecured creditors of a solvent debtor retain an equitable right to post-petition interest pursuant to their contracts, subject to any other equities in a given case. A failure to compensate creditors according to this equitable right as part of a bankruptcy plan results in impairment.”²¹

Notably, the fifth and ninth circuits are among the courts which have held that unimpaired claimants are entitled to their contractual post-petition interest rates, whereas the authority for applying the federal judgment rate is limited to lower courts.

Conclusion

The solvent debtor exception survived the passing of the Bankruptcy Code. However, while a majority of the courts have held that the exception fully survived the passing of the Bankruptcy Code, there are some courts which have held that the exception only survived to a limited extent. In regards to the legal rate, the majority rule among the lower courts has been that solvent debtors must pay post-petition interest at the legal rate, which is the federal judgment

¹⁸ See *In re Hertz Corp.*, 637 B.R. at 801 (holding that section 726(a)(5) governs the interest rate for unimpaired claims); *In re PG&E Corp.* 2022 U.S. App. LEXIS 24269, at *29–30 (holding that principles of equity govern the interest rate for unimpaired claims); *In re Ultra Petroleum Corp.* 51 F.4th at 159 (holding that even if section 726(a)(5) governs the interest rate for unimpaired claims, it only sets a minimum rate).

¹⁹ *In re Hertz Corp.*, 637 B.R. at 801 (holding that section 726(a)(5) would cover unimpaired creditors in these instances).

²⁰ See *In re PG&E Corp.*, 2022 U.S. App. LEXIS 24269, at *29–30; *In re Ultra Petroleum Corp.*, 51 F.4th at 160 (holding that “[c]reditors are entitled to what they bargained for,” including their contractual interest rate).

²¹ *In re PG&E Corp.*, 2022 U.S. App. LEXIS 24269, at *29–30.

rate. However, the fifth and ninth circuits have held that solvent debtors must pay post-petition interest at the contractual rate.