ALERT MEMORANDUM

Fifth Circuit Issues New Opinion in *Ultra Petroleum*, Withdrawing Guidance on Make-Whole Claims

December 12, 2019

On November 26, 2019, the U.S. Fifth Circuit Court of Appeals (the "Fifth Circuit" or the "Court") granted a petition for rehearing in the In re Ultra Petroleum Corporation bankruptcy case. The Court issued a new opinion (the "New Opinion"), [1] which withdrew the Court's January 17, 2019 opinion (the "Prior Opinion"). This Alert Memorandum updates our previous memorandum discussing the Court's Prior Opinion.[2]

In the New Opinion, the Fifth Circuit retained its prior holding that the alteration of a claim by the Bankruptcy Code does not render a claim impaired under section 1124(1). Unlike in the Prior Opinion, however, the Fifth Circuit only briefly commented on the questions of whether the Bankruptcy Code disallows certain claims for make-whole amounts and post-petition interest. The Court remanded both questions to the Bankruptcy Court, stating that "absent compelling equitable considerations, when a debtor is solvent, it is the role of the bankruptcy court to enforce the creditors' contractual rights."

In so doing, the Fifth Circuit eliminated guidance initially provided in dicta in its Prior Opinion asserting that the Make-Whole Amount was the "economic equivalent of 'interest.'" The Court also withdrew language from the Prior Opinion that (i) suggested the appropriate post-petition interest rate could be set by either the general post-judgment interest statute or a bankruptcy court acting pursuant to its equitable powers, and (ii) cast doubt on the vitality of the pre-Bankruptcy Code solvent-debtor exception.

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[1] *In re Ultra Petroleum Corp.*, No. 17-20793 (5th Cir., Nov. 26, 2019).
[2] *See* *Fifth Circuit Distinguishes Code Impairment from Plan Impairment, Casts Doubt on Make-Whole Claims* (Feb. 26, 2019).

Background and Procedural History

Ultra Petroleum Corporation (the "Holding Corporation") and its affiliated debtors (collectively, the "Debtors") filed voluntary petitions for relief under Chapter 11 on April 29, 2016. The Debtors had significant prepetition debt obligations, including approximately $1.46 billion of unsecured notes issued pursuant to a Master Note Purchase Agreement (the "Note Agreement") governed by New York law.

Despite this debt burden, the Debtors became solvent during the course of their bankruptcy proceedings as rising oil prices buoyed the Debtors' oil and gas exploration and production businesses. In the U.S. Bankruptcy Court for the Southern District of Texas (the "Bankruptcy Court"), the Debtors sought confirmation of a plan of reorganization that they alleged would pay creditors in full—such creditors would have "unimpaired" claims and lack the ability to object to the plan.

Creditors with claims under the Note Agreement (the "Noteholders") objected and argued that their claims were, in fact, impaired. The Noteholders argued that the plan did not preserve their rights under provisions of the Note Agreement requiring the Debtors to pay (i) a make-whole amount (the "Make-Whole Amount") and (ii) additional post-petition interest at contractual default rates.[3] The Debtors countered that whether a plan impairs state law claims should be determined only after incorporating the Bankruptcy Code's provisions, arguing that make-whole amounts are disallowed as "unmatured interest" under 11 U.S.C. § 502(b)(2) and post-petition interest is limited to the "legal rate" under 11 U.S.C. § 726(a)(5).

The Bankruptcy Court agreed with the Noteholders, holding that valid state law claims must be paid in full to be classified as unimpaired even if the Bankruptcy Code would disallow such claims.[4] The Bankruptcy Court emphasized that it is the effectiveness of the plan pursuant to 11 U.S.C. § 1141(d), rather than the disallowance provision in 11 U.S.C. § 502(b)(2), that discharges the state law claims and determines their impairment.[5] In reaching this conclusion, the Bankruptcy Court rejected the Third Circuit's reasoning in *In re PPI Enterprises (U.S.), Inc.*[6]

Having found that the Noteholders were impaired, the Bankruptcy Court concluded that the Make-Whole Amount was permitted under New York law and the Bankruptcy Code did not limit the enforcement of the Note Agreement's contractual post-petition interest rates. Accordingly, the Bankruptcy Court ordered the Debtors to pay the Noteholders the Make-Whole Amount and post-petition interest at the contractual default rates. The Debtors appealed and were granted a direct appeal to the Fifth Circuit.

In its Prior Opinion, the Fifth Circuit vacated and remanded the Bankruptcy Court's order for reconsideration. The Court rejected the Bankruptcy Court's impairment analysis, holding that the alteration of a claim by the Bankruptcy Code does not render a claim impaired under 11 U.S.C. § 1124(1). The Court declined to rule on the questions of whether the Bankruptcy Code allows the asserted make-whole and post-petition interest claims, but offered significant guidance on how it might rule on each issue. The Prior Opinion is discussed in further detail in our previous memorandum.[7]

The Noteholders filed a joint petition for rehearing *en banc*.[8] In that petition, the Noteholders challenged, *inter alia*, the Court's impairment analysis under section 1124(1). The Noteholders also challenged the

[3] Lenders under a $999 million revolving credit facility similarly objected that their claims were impaired because the plan did not pay post-petition interest at the contractual default rate. *See* Prior Opinion, at 4.

[4] *See In re Ultra Petroleum Corp.*, 575 B.R. 361, 373 (Bankr. S.D. Tex. 2017) (quoting *In re Vill. at Camp Bowie I, L.P.*, 454 B.R. 702, 708 (Bankr. N.D. Tex. 2011), *aff'd*, 710 F.3d 239 (5th Cir. 2013) ("[E]ven the smallest impairment nonetheless entitles a creditor to participate in voting.")).

[5] *In re Ultra Petroleum Corp.*, 575 B.R. at 373.

[6] 324 F.3d 197 (3d Cir. 2003).

[7] *See Fifth Circuit Distinguishes Code Impairment from Plan Impairment, Casts Doubt on Make-Whole Claims*, *supra* note 2.

[8] Appellees' and Intervenors' Joint Petition for Rehearing En Banc (Jan. 31, 2019).

Court's holding in its Prior Opinion that the Make-Whole Amount was the economic equivalent of interest, arguing that the Court should not have reached the question and that the holding was inconsistent with Fifth Circuit precedent, and sought to have the Court strike the portion of the Prior Opinion addressing the solvent-debtor exception.

The Opinion

The Fifth Circuit granted the petition for rehearing *en banc* as a petition for panel rehearing, and on November 26, 2019, issued a New Opinion that withdrew is Prior Opinion.

The Fifth Circuit's New Opinion reaffirmed its holding from its Prior Opinion that the alteration of a claim by the Bankruptcy Code does not render a claim impaired under section 1124(1), but withdrew most of the guidance that it offered in its Prior Opinion regarding the treatment of make-whole claims under 11 U.S.C. § 502(b)(2), the vitality of the pre-Bankruptcy Code solvent-debtor exception and the appropriate interest rate to calculate the asserted post-petition interest.

The Court preserved in its entirety the portion of its Prior Opinion which held, "follow[ing] the monolithic mountain of authority," that the alteration of a claim by the Bankruptcy Code does not render a claim impaired under section 1124(1). The Court reiterated that "[w]here a plan refuses to pay funds disallowed by the Code, the Code—not the plan—is doing the impairing."

With respect to the allowance of the Make-Whole Amount, the Court's Prior Opinion noted that the Make-Whole Amount is the "economic equivalent of 'interest,'" suggesting that make-whole claims might be disallowed under 11 U.S.C. § 502(b)(2). This language was withdrawn in the New Opinion. Similarly, the Prior Opinion featured a lengthy discussion of the provenance and continued vitality of the so-called solvent-debtor exception, a pre-Bankruptcy Code exception to section 502(b)(2)'s general rule that applies to permit the payment of unmatured interest where the debtor is solvent. Although in its Prior Opinion the Court suggested that an argument relying on the solvent-debtor exception would be unlikely to prevail, in the New Opinion the Court concluded that its "review of the record reveals no reason why the solvent-debtor exception could not apply," remanding the question of the exception's applicability to the Bankruptcy Court. [9]

Finally, the Court's opinion also remanded to the Bankruptcy Court the question of the appropriate post-petition interest rate, withdrawing the language in its Prior Opinion on the lack of rate-setting guidance for unimpaired Chapter 11 claims, as well as its prior suggestion that the Bankruptcy Court could apply the general post-judgment interest rate set by 28 U.S.C. § 1961.

Implications of the Fifth Circuit's Decision

While the Fifth Circuit's Prior Opinion appeared to cast doubt on the enforceability of make-whole claims in bankruptcy, in its New Opinion the Court withdrew essentially all of the guidance it had offered in its Prior Opinion on whether the Bankruptcy Code disallows the claims for the Make-Whole Amount, as well as the appropriate calculation for post-petition interest. In so doing, the Court reiterated that the Bankruptcy Court did not properly reach either issue because it had erred in its impairment analysis.

The Court emphasized that the issue of make-whole premiums has become a common dispute in modern bankruptcy, and that the question of whether such premiums are effectively unmatured interest varies in difficulty depending on the specific facts of a given case. The Court concluded that "[t]he bankruptcy court is often best equipped to understand these individual dynamics—at least in the first instance."

The withdrawal of the Court's non-binding guidance in its New Opinion represents a deference to the bankruptcy court's initial determination on these fact-

[9] In a footnote, the Court suggested that that "it is possible a bankruptcy court's equitable power to enforce the solvent-debtor exception is moored in 11 U.S.C. § 1124's command that a 'plan leave[] unaltered . . . equitable . . . rights.'" *See* New Opinion at 12, n. 2.

intensive issues, and means that the questions of whether the Make-Whole Amount should be allowed under section 502(b)(2) or the solvent-debtor exception, along with the appropriate method of calculating post-petition interest, remain live issues for the Bankruptcy Court to consider.

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