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Allen Matkins

Bankruptcy & Creditors' Rights Alert

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The Ninth Circuit allows oversecured creditors in bankruptcy court to recover default interest

This alert pertains to **loan enforcement** and **entitlement to interest** and affects any party to a secured debt obligation that provides for default interest.

In *General Electric Capital Corporation v. Future Media Productions, Inc.* 2008 WL3091471 (9th Cir. 2008), the United States Court of Appeals for the Ninth Circuit recently ruled that oversecured creditors whose claims are paid outside of a plan of reorganization in bankruptcy are entitled to default interest pursuant to their state law contractual rights. In doing so, the Ninth Circuit clarified a misapplication of the rule it announced in *Entz-White Lumber & Supply, Inc. v. Great Western Bank & Trust,* (850 F.2d 1338 (9th Cir. 1988)) and joined the approach in many bankruptcy courts and two other circuit courts of appeals.

In *Entz-White*, the Ninth Circuit had earlier announced the rule that an oversecured creditor was not entitled to default interest *where its claim was paid in full under the terms of a confirmed Chapter 11 plan*. There, the Ninth Circuit found that the Bankruptcy Code specifically authorizes a plan reorganization to cure the consequences of a default.

In *Future Media*, the bankruptcy court extended *Entz-White's* rule outside the context of a Chapter 11 plan and denied GECC default interest (which amounted to an additional 2% per annum), when its claim was paid as a result of asset sales.

The Ninth Circuit reversed the bankruptcy court

The Ninth Circuit pointed to the general premise recently emphasized by the Supreme Court in *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.* (127 S.Ct. 1199 (2007)) that a creditor's entitlement in bankruptcy arises in the first instance from the underlying substantive law creating the debtor's obligations, subject only to any qualifying or contrary provisions of the Bankruptcy Code. As such, the Ninth Circuit found that the default rate should be enforced, subject only to the substantive law governing the loan agreement or an express provision of the Bankruptcy Code to the contrary. Outside the context of a plan of

reorganization, the Ninth Circuit found no qualifying or contrary provision of the Bankruptcy Code barring the recovery of default interest. Thus, under the rule announced by Ninth Circuit in *Future Media*, outside the context of a plan of reorganization, "the bankruptcy court should apply a presumption of allowability for the contracted for default rate, provided that the rate is not unenforceable under applicable nonbankruptcy law."

Notably, not only does the decision in *Future Media* clarify an oversecured creditor's right to recover default interest in bankruptcy, but, in light of the Supreme Court's instruction in *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*, it reflects an increasing acknowledgement by the courts of the inherent limitations of the Bankruptcy Code and growing deference by the courts to nonbankruptcy substantive law in the absence of express contrary provisions of the Bankruptcy Code.

If you are trying to claim or oppose default interest in bankruptcy, the Bankruptcy and Creditors' Rights attorneys at Allen Matkins are available to answer any questions you might have.

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