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July 30, 2015

The Precedential Value of Sagamore Partners

On July 13, 2015, the United States Court of Appeals for the Eleventh Circuit reversed lower court orders that had precluded a lender from collecting accrued default interest from a debtor as a condition for reinstatement of the loan under a confirmed plan of reorganization.[1] While the particular point upon which the reversal was based was the appellate court's disagreement with the notion that the lender had effectively waived its entitlement to default interest in the course of attempting to enforce its rights, the decision, more broadly, affirms that the nonconsensual reinstatement of a loan by a debtor through a Chapter 11 plan requires that any default interest requirements be satisfied in full.

Background

The debtor, Sagamore Partners Ltd., owned a hotel on Collins Avenue in Miami Beach (the "property"). JPMCC 2006-LDP7 Miami Beach Lodging LLC (the "lender") had a principal claim of $31.5 million secured by a mortgage against the property, based on a loan that the debtor received in 2006 when it refinanced the property (the "loan"). Because the debtor had stopped making required interest payments on the loan as of August 2009, the lender's claim against the debtor included a claim for default-rate interest of 11.54 percent, substantially higher than the contractual nondefault rate of 6.54 percent, and resulting in a claim for default interest that exceeded $5 million by the time the debtor was prepared to reinstate the loan in connection with confirmation of its reorganization plan late in 2012.

However, while the debtor sought to reinstate the loan on its original terms, it contended that it was not required to pay accrued default interest in connection with that reinstatement. The bankruptcy court ruled in favor of the debtor. Although the loan agreement, by its terms, did not condition the triggering of default interest upon any obligation to provide notice of default, the bankruptcy court nevertheless held that notice was required, and that the notice that the lender had purportedly provided was "defective." Alternatively, the bankruptcy court held that by asserting late fees in addition to default interest, the lender had waived its right to late fees. The principal basis for this holding appears to have been a 2005 case issued by an Illinois bankruptcy court suggesting that a lender may assert late fees, or default interest, but not both.[2]

On appeal, the district court disagreed with the bankruptcy court's conclusion that notice was required in order to trigger the loan agreement's default provisions (including default interest), but nonetheless arrived at the same outcome, on the grounds that the lender had waived its entitlement to default interest by asserting a claim for late fees too. The lender appealed to the Eleventh Circuit.

The Eleventh Circuit Appeal

On appeal to the Eleventh Circuit, the debtor made at least two threshold arguments that had not been addressed by the lower courts. First, the debtor argued that as a matter of bankruptcy law, reinstatement under Section 1124 of the Bankruptcy Code does not require the debtor to pay accrued default rate interest. The court held that while this may have been a historically valid argument adopted in several older cases, it was no longer tenable since the enactment of the 1994 amendments to the Bankruptcy Code and, in particular, Section 1123(d), which provides that cure obligations under a plan or reorganization must be determined "in accordance with the underlying agreement and applicable law." Thus, according to the court, if an otherwise enforceable agreement provides for default interest, that obligation becomes part of the cure obligation associated with reinstatement under Section 1124.

The debtor also argued that, because the plan of reorganization had been consummated in the interim, the

lender's appeal had been rendered equitably moot. The court rejected this argument as well, given that the plan expressly provided for payment to the lender of "funds required to reinstate the indebtedness, whatever that amount is, as determined by the Court ...."

As to the arguments that had been considered by the lower courts, the circuit court of appeals held that the district court had correctly reversed the bankruptcy court's holding that the notice of default issued by the lender had been insufficient, "because no notice of default" was required under the loan documents.

With regard to the lower courts' conclusion that the lender's demand for late fees constituted a waiver of a right to default interest, the court disagreed, for a number of reasons. First, as a matter of fact, it concluded that, contrary to the lower courts' findings, the lender had demanded default interest from the outset of the event of default, and only accepted payment of a late fee under protest. Second, the court held that as a matter of Florida law, late fees and default interest are "consistent remedies" that could be pursued concurrently in any event.

For all these reasons, the Eleventh Circuit court found that the lender was entitled to default interest under the debtor's plan of reorganization, and remanded the case to the district court for a determination regarding other fees and costs that had not otherwise been addressed on appeal.[3]

Analysis

While the Eleventh Circuit issued its reversal on the basis of one narrow issue, i.e., whether the lender had waived its right to default interest, Sagamore Partners emerges as a far more notable and precedential decision than that.

First, on the waiver issue itself, in addition to finding that the facts did not support the notion that there had been a waiver by the lender, the court also expressly rejected the notion that under Florida law, and implicitly the argument that under federal bankruptcy law, late fees and default interest are somehow inconsistent remedies or that collection of both would constitute a "double recovery."[4]

Second, with regard to "reinstatement" of a loan under a Chapter 11 plan, it is now clear that in the Eleventh Circuit, at least, reinstatement includes a requirement that the debtor pay accrued default interest, based on what the court in Sagamore Partners describes as the "straightforward statutory command" of Section 1123(d), as enacted as part of the 1994 Bankruptcy Code amendments.[5] This is important because, however straightforward the statute may be, other courts remain of the view that even post-1994, the law remains that a debtor may reinstate a loan under a Chapter 11 plan without paying accrued default interest,[6] potentially even where the benefit of the savings inures to the debtor personally, rather than to unsecured creditors.[7]

Finally, although in Sagamore Partners it really was not that hard a call, the decision is another in a string of cases that confirms an increasing reluctance on the part of appellate courts to dismiss appeals of consummated, confirmed plans based on the doctrine of equitable mootness.[8] This is important because the ability of unsuccessful Chapter 11 plan objectors to secure stays pending appeal are typically very limited. Therefore, the availability of post-consummation appeals are often the only way that the objector can exercise its right to test the conclusions of the bankruptcy court in an appellate forum.

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1 JPMCC 2006-LDP7 Miami Beach Lodging LLC et al. v. Sagamore Partners, LTD., No. 14-11106 (11th Cir. July 13, 2015) ("opinion").

2 See In re AE Hotel Venture, 321 B.R. 209, 216 (Bankr. N.D. Ill. 2005). The court there held that the recovery of both default interest and late fees would amount to a "double recovery" for the incremental costs of collection associated with defaults.

3 The court also rejected an argument that had been made by the lender that the debtor's plan of reorganization was not feasible, and that the confirmation order should therefore be vacated.

4 Arguably, part of the court's ruling on this point may be dicta, because the lender, in an apparent effort to bolster its much larger claim for default interest, deliberately avoided pursuing a claim for the much smaller late fee.

5 Opinion at 10.

6 See, e.g., Brody v. Geared Equity LLC, No. 13-2090, 2014 WL 4090549 (D. Ariz. Aug. 6, 2014)

7 See Platinum Capital Inc. v. Sylmar Plaza LP (In re Sylmar Plaza LP), 314 F.3d 1070 (9th Cir. 2002)

8 Indeed, in a decision issued just this week, one judge on the Third Circuit Court of Appeals has called for the abrogation of the doctrine altogether. See In re One2One Communications LLC, 2015 U.S. App. LEXIS 12544 (3d Cir. July 21, 2015) (Krause, J. concurring). The other two judges on the panel applied the doctrine narrowly to permit an appeal under the facts of the case before it. Id. See also, e.g., JPMCC 2007-C1 Grasslawn Lodging LLC v. Transwest Resort Props. Inc. (In re Transwest Resort Props. Inc.), No. 12-17176, 2015 WL 3972917 (9th Cir. July 1, 2015); In re SCH Corp., 569 Fed. Appx. 119 (3d Cir. Apr. 8, 2014).

Originally published July 23, 2015 in Law360.

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