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By: Michael S. Amato, Esq.  
Christopher Bluethgen, Esq.



## Second Circuit Holds that Failure to Pay Interest on Unsecured Claim under Confirmed Plan does not Render Claim Impaired

In a recent decision, the Second Circuit joined the Third, Fifth, and Ninth Circuits in holding that a claim is impaired under Section 1124(1) of the Bankruptcy Code only where the plan of reorganization itself alters the creditor's rights. [1]

The debtor, Tam Linhas Aéreas S.A. ("TLA"), is an affiliate of LATAM Airlines Group S.A., a South American airline holding company. The creditors in this case are TLA Claimholders, who were unsecured creditors of LATAM. LATAM's plan of reorganization provided that the TLA Claimholders would receive the full allowed amount of their unsecured claims recoverable under the Bankruptcy Code and designated them as "unimpaired." The plan did not provide for payment of post-petition interest on the TLA Claimholders' claims, which totaled approximately \$150 million.

The TLA Claimholders argued that: (1) non-payment of post-petition interest on their claims rendered them "impaired" under the Bankruptcy Code, regardless of the debtor's solvency; and (2) the debtor actually was solvent, and therefore the TLA Claimholders were entitled to receive post-petition interest on their claims under the "solvent-debtor" exception to the Bankruptcy Code's moratorium on post-petition interest under §502(b)(2).

The Bankruptcy Court determined that the debtor was insolvent and confirmed the plan of reorganization, holding that the TLA Claimholders' claims were unimpaired despite the exclusion of post-petition interest under the plan. The District Court affirmed, and the TLA Claimholders appealed to the Second Circuit.

The Second Circuit, citing decisions by the Third, Fifth and Ninth Circuits, held that Section 502(b)(2) of the Bankruptcy Code precluded payment of post-petition interest, stating "that a claim is impaired under Section 1124(1) only when the plan of reorganization, rather than the Code, alters the creditor's legal, equitable, or contractual rights."

The Court held that a creditor's right to payment outside of bankruptcy is not the relevant "barometer for impairment", and that the contractual right to receive post-petition interest on the claims was superseded by § 502(b)(2) of the Bankruptcy Code.

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[1] LTA Claimholders Group v. LATAM Airlines Group S.A. (In re LATAM Airlines Group S.A.), 22-1940 (2d Cir. Dec. 14, 2022).

The Court then considered whether the TLA Claimholders had an “equitable” right to post-petition interest on their claims under the “solvent-debtor” exception. The TLA Claimholders argued that: (i) the solvent debtor exception arose from the absolute priority rule, which precludes a debtor’s equity holders from recovering value from the estate unless and until all creditors are paid the full value of their allowed claims, and (ii) the Bankruptcy Court incorrectly calculated the earning capacity of the debtor.

The Court held that the absolute priority rule applies only when a class of impaired creditors votes to reject a plan, and the debtor resorts to the “cram down” procedure and that the TLA Claimholders — who would be paid the full allowed amount of their allowed claims — were not entitled to the benefit of the absolute priority rule.

The Second Circuit’s decision in *In re LATAM* brings each of the major Circuits in line in holding that unimpaired, unsecured creditors are not entitled to receive post-petition interest on their claims where their legal, equitable or contractual rights are modified under a plan of reorganization.

**For more information, please contact:**

**Michael S. Amato, Esq.**  
**(516) 663-6517**  
**mamato@rmfpc.com**

**Christopher Bluethgen, Esq.**  
**(516) 663-6671**  
**cbluethgen@rmfpc.com**