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Financial Statements

By Geraldine Ponto and Ferve E. Ozturk

Getting the Whole Make-Whole

Momentive *and* Energy Future Holdings *Consider Equity*

Editor's Note: *ABI's Secured Credit Committee hosted an ABILive webinar in Sepember 2014 that discussed points presented in this article. Recordings are available for purchase at cle.abi.org.*

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A make-whole premium is a lump-sum payment that becomes due under a financing agreement when repayment occurs before the stated maturity date, thereby depriving the lender of all future interest payments bargained for under the agreement.[1] As bond-financing arrangements increasingly use make-whole premiums, the question of whether and when claims for make-whole premiums are allowable in bankruptcy has become more prominent. Two recent decisions shed light on this issue.

On Sept. 9, 2014, Hon. **Robert D. Drain** of the U.S. Bankruptcy Court for the Southern District of New York entered a bench ruling denying the noteholders' claims against the debtors, Momentive Performance Materials Inc. and its affiliates, for the payment of make-whole premiums.[2] The ruling followed on the heels of the Aug. 5, 2014, decision by Hon. **Christopher S. Sontchi** of the U.S. Bankruptcy Court for the District of Delaware granting an indenture trustee discovery on the debtors' solvency in connection with the noteholders' claims to a make-whole premium in the reorganization case of *Energy Future Holdings Corp.*(*EHF*).[3]

Case law precedent prior to *Momentive* and *EHF* instructed that courts look strictly to the language of the parties' contract in determining whether a make-whole premium is allowable.[4] However, both of these rulings make it clear that the court will look beyond the four corners of the contract and consider equitable factors when the debtor's solvency is at issue. Going forward, these decisions could affect how the holders of bond debt and lenders litigate the right to make-whole premiums, and they could reshape how conventional language in bond indentures is drafted. All parties involved in bond-debt transactions would be wise to review these rulings and watch for further guidance from the expected-merits decision in *EHF*.

Momentive Decision Summary

In *Momentive*, the indenture trustees of certain "first and 1.5 lien notes" (the "notes") sought payment of a contractual "make-whole" premium and, alternatively, asserted a common-law claim for damages based on the debtors' payment of their notes before the stated maturity date.[5] Judge Drain began his analysis with the language of the indentures and form of the notes. Paragraph 5 of the form dealt with voluntary redemption and provided that "prior to October 15, 2014, the Issuer may redeem the Notes at its option ... at a redemption price equal to 100% of the principal amount of the Notes redeemed, plus the Applicable Premium as of, and accrued and unpaid interest."[6] The indenture trustees argued that the debtors' proposed treatment of the notes under the chapter 11 plan, providing for a payoff by issuing replacement notes, entitled the trustees to the "applicable premium" as defined in the indentures, which was equal to the make-whole amount.

The court rejected the indenture trustees' argument, finding that the indentures required the lender to forfeit its right to make-whole consideration resulting from the debtor's acceleration of the balance of the loan.[7] The court noted there was no "clear and unambiguous clause ... with sufficient clarity" that provided for a make-whole payment after acceleration in section 6.02 of the indenture.[8] Section 6.02 stated that upon the debtors' bankruptcy, "the principal of, *premium, if any*, and interest on all Notes shall *ipso facto* become and be immediately due and payable."[9] The court held that the language did not entitle the noteholders to a claim for the applicable premium (the make-whole amount) following automatic acceleration of the debt.[10] Reference to the "premium, if any," to be paid on prepayment was "not specific enough" to require payment of a make-whole premium post-acceleration.[11]

Next, the court turned to the trustees' alternative argument that in lieu of a make-whole premium, they were entitled to a claim for damages for the debtors' violation of the indentures' no-call provisions. However, the court held that such a claim would be disallowed as unmatured interest under § 502(b)(2) of the Bankruptcy Code.[12] The court

1 *See* Geraldine Ponto and Ferve Ozturk, "Make-Whole Premiums Get to 'Pass Go' in Bankruptcy Court," BakerHostetler Executive Alert (Sept. 27, 2013) (defining make-whole premiums).
2 *See In re MPM Silicones LLC*, No. 14-22503, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014) ("*Momentive*").
3 *See CSC Trust Co. of Delaware v. Energy Future Intermediate Holdings Co. LLC, et al. (In re Energy Future Holdings Corp.)*, 513 B.R. 651 (Bankr. D. Del. Aug. 5, 2014).
4 *See, e.g., In re School Specialty Inc.*, No. 13-10125, 2013 WL 1838513 (Bankr. D. Del. April 22, 2013); *In re AMR Corp.*, 485 B.R. 279 (Bankr. S.D.N.Y. 2013); *aff'd*, 730 F.3d 88 (2d Cir. 2013).
5 2014 WL 4436335 at *11.
6 *Id.*
7 *Id.* at *12.
8 *Id.* at *13.
9 *Id.* (emphasis added).
10 *Id.* at *14.
11 *Id.* at *15.
12 *Id.* at *17. This ruling parts ways with *In re Trico Marine Servs. Inc.*, 450 B.R. 474, 480-82 (Bankr. D. Del. 2011), which provides that liquidated-damages clauses, like clauses providing for make-whole premiums, necessarily cannot be unmatured interest.

suggested that the result could be different in the case of a solvent debtor.[13]

Finally, the court denied the trustees' effort to lift the automatic stay so that the debtors could rescind the automatic acceleration of the notes, and thus revive the make-whole premium. Relying on the Second Circuit's decision in *AMR*,[14] which squarely addressed that issue, Judge Drain ruled that post-acceleration rescission is not permitted absent clear language in the indenture.[15]

EFH Decision Summary

Momentive determined issues that are presently in dispute before the Delaware bankruptcy court in the *EFH*. In *EFH*, the indenture trustee for senior secured notes issued by the debtors sought payment of a $665 million make-whole premium in connection with a proposed refinancing of the notes.[16] The language of the applicable provisions of the indentures closely tracks the language in the *Momentive* indentures. As was the case in *Momentive*, the *EFH* indentures had an applicable premium due on voluntary redemption, along with a clause providing that automatic acceleration entitled the noteholders to principal and accrued but unpaid interest, and a "premium, if any."[17] Hence, commentators view *Momentive* as a trailblazer for Judge Sontchi's decision in the *EFH* make-whole litigation.

In the Aug. 5, 2014, discovery ruling,[18] Judge Sontchi ruled that the question of the debtors' solvency or insolvency was relevant to the make-whole dispute and granted the indenture trustee discovery on the debtors' solvency. He reasoned that the debtors' solvency had a bearing on whether the court would strictly enforce the terms of the contract or apply equitable principles to adjust the parties' obligations,[19] stating that "even in bankruptcy, a solvent debtor cannot escape its contractual obligations, but an insolvent debtor may rely on equitable principles to argue [that] the premium should be reduced or not paid."[20]

The first step in the court's analysis as to whether the trustee was entitled to a make-whole premium was a review of the language of the indenture. The court could only allow the trustee a make-whole amount if the right to such a claim were clear under the indenture. If it was clear, the court would then consider the debtors' solvency as bearing on the amount of the premium that would have to be paid.[21] If the debtors were solvent, the court would "enforce the terms of the contract under state law." If the debtors were insolvent, however, the court reasoned that "the equities of the case may require the Court to distribute the limited pie in a different fashion."[22]

Discussion

Momentive and *EFH* taken together further lay the groundwork to guide clients on whether and when make-whole premiums are allowable in bankruptcy. In particular, *Momentive* clarifies the issue of whether automatic acceleration can ever constitute a voluntary redemption. Following *AMR* and *In re Solutia Inc.*,[23] the court answered this question with a resounding "no." That result will likely influence the outcome in *EFH*, which involves similar automatic-acceleration provisions, and may shut the tap on arguments in favor of treating automatic acceleration as voluntary redemption.

The *Momentive* decision also adds to the precedents, including *AMR*, that held that a party cannot lift the automatic stay to rescind an acceleration provision to salvage a claim to a make-whole premium when the contract does not clearly provide for a make-whole premium post-acceleration. These decisions also reaffirm the importance of drafting indenture language that will hold up to strict scrutiny of the contractual terms and give effect to the parties' deal. *Momentive* and the *EFH* discovery ruling follow the analysis set by the Delaware bankruptcy court in the *School Specialty* reorganization case[24] and the Second Circuit in the *AMR* reorganization case,[25] which narrowly interpreted the plain language of the indentures.[26] Judge Sontchi indicated that his review would start with the plain language of the indentures. In light of *Momentive*, the prognosticators are buzzing that this will result in a favorable ruling for the debtors in *EFH* in denying the payment of the make-whole premium.

The prospect of the courts applying equitable principles to adjust contractual terms where a debtor is insolvent adds a new layer to the discussion. The *Momentive* court's consideration of the debtor's solvency in determining that damages for breach of no-call provisions might be available, despite the Bankruptcy Code's bar of allowing unmatured interest, might affect the court's analysis in *EFH*, which appears to involve a solvent debtor. Likewise, Judge Sontchi's ruling in the discovery dispute that equitable principles may pertain to determine the amount of an allowed make-whole claim if the debtor is insolvent takes a different approach from *School Specialty*, which contained no discussion whatsoever on the role of equity.[27]

These rulings suggest that in cases with insolvent debtors (which are more common than solvent debtors), even clearly drafted language that provides for the make-whole premium regardless of the debtor's solvency may nonetheless be adjusted by courts applying equitable principles. This may complicate the process of negotiating the language of note indentures, the cost of the transactions to the issuers and the consideration that will be required to do a deal, and the strategy in attempting to enforce make-whole premiums. Judge Sontchi's ruling on the merits of the *EFH* dispute, and future cases involving insolvent debtors facing make-whole claims, will add to the discussion. abi

13 *Id.*
14 *Id.* at *23 (citing *AMR*, 730 F.3d 88).
15 *Id.* at *23.
16 *See* Complaint, *CSC Trust Co. of Delaware v. Energy Future Intermediate Holdings Co. LLC, et al. (In re Energy Future Holdings Corp.)*, Adv. Pro. No. 14-50363, ECF No. 1 (Bankr. D. Del. filed May 15, 2014).
17 *See* Energy Future Intermediate Holding Co. LLC and EFIH Finance Inc. 6.875 Percent Senior Secured Notes Due 2017 (First Lien) Indenture dated as of Aug. 14, 2012, section 6.02 ("If any Event of Default (other than an Event of Default specified in clause (6) or (7) of Section 6.01(a) hereof) occurs and is continuing under this Indenture, the Trustee or the Required Holders of at least 30% in aggregate principal amount of the outstanding Required Debt may declare the principal of, and premium, if any, interest, Additional Interest, if any, and any other monetary obligations on all the then outstanding Notes to be due and payable immediately.); Energy Future Intermediate Holding Co. LLC and EFIH Finance Inc. 11 Percent Senior Secured Second-Lien Notes Due 2021 (Second Lien) Indenture dated as of April 25, 2011, section 6.02 (substantively identical).
18 *In re Energy Future Holdings Corp.*, 513 B.R. 651.
19 513 B.R. at 657-62.
20 *Id.* at 658 (collecting cases and citing Scott K. Charles and Emil A. Kleinhaus, "Prepayment Clauses in Bankruptcy," 15 *ABI Law Review* 537, 582-83 (2007), *available at* http://lawreview.abi.org/sites/default/files/Articles/2007/charles.pdf).
21 513 B.R. at 660-61.
22 *Id.* at 660.
23 379 B.R. 473 (Bankr. S.D.N.Y. 2007).
24 *See School Specialty*, 2013 WL 1838513.
25 *See AMR*, 730 F.3d 88.
26 *See School Specialty*, 2013 WL 1838513, at *2-*3 (allowing make-whole premium when indenture unambiguously provided for premium); *AMR*, 730 F.3d at 100-02 (denying make-whole premium when "plain language" of indenture provided that bankruptcy filing triggered acceleration of debt but did not require payment of make-whole amount).
27 However, *School Specialty* appeared to involve a solvent debtor, which might explain why the court did not find it necessary to determine the application of equitable principles. *See School Specialty Inc.*, Form 10-K (Annual Report), filed July 9, 2014, for the period ending April 26, 2014, *available at* www.edgar-online.com, at 22 (suggesting that company is solvent as of date of filing of form).

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In re MPM Silicones, LLC
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In re MPM Silicones, LLC

11 U.S.C. § 510
§ 510(c)
Number: 1014-011
Decided: September 9th, 2014
Filing type: Commercial [1]
Ruling: Claims of senior note-holders properly subordinated to claims of second lien holders.
Issue: What was proper treatment of claims of senior note holders and second lien holders in debtor's plan?
Holdings: [1]-Claims of senior note-holders were properly subordinated to claims of second lien holders in bankruptcy debtors' plan since the lien holders' notes constituted senior indebtedness under the terms of indentures;
[2]-First lien holders were not entitled to prepayment premiums based on the debtors' payment of their notes before the stated maturity of the notes, since the lien holders bargained for acceleration and prepayment of the notes upon the event of the debtors' bankruptcy without clearly reserving a right to the premiums in the indentures;
[3]-The first lienholders were precluded from exercising their contractual right to rescind the automatic acceleration under the indentures since the indentures were property of the debtors' estates subject to the automatic bankruptcy stay, and relief from the stay was not warranted to allow rescission and effect a material change.
Court: Southern District of New York [2] (Drain [3])

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