AMERICAN BANKRUPTCY INSTITUTE

2018 Mid-Atlantic Bankruptcy Workshop

PLENARY SESSION

Judicial Debates

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Hon. Vincent F. Papalia
U.S. Bankruptcy Court (D. N.J.); Newark

Hon. Frank J. Santoro
U.S. Bankruptcy Court (E.D. Va.); Norfolk

Hon. Christopher S. Sontchi
U.S. Bankruptcy Court (D. Del.); Wilmington

2018

JUDICIAL DEBATES

ARE MAKE-WHOLE PREPAYMENT PREMIUMS PAYABLE IF THE DEBT WAS ACCELERATED DUE TO THE ISSUER'S BANKRUPTCY FILING?

OR

WHY U.S.B.J. SONTCHI (D.DEL.) WAS RIGHT IN *ENERGY FUTURE HOLDINGS* AND WAS "AFFIRMED" BY THE SECOND CIRCUIT IN *MPM SILICONES*

(ARGUED, NOT SURPRISINGLY, BY
HON. CHRISTOPHER S. SONTCHI)

V.

THE THIRD CIRCUIT'S REVERSAL OF HIS DECISION IN ENERGY FUTURE HOLDINGS (NO, JUDGE, IT DOESN'T WORK THAT WAY)

(ARGUED BY PROF. BRUCE GROHSGAL)

ABI MID ATLANTIC CONFERENCE

AUGUST 4, 2018

HERSHEY, PA

ARE MAKE-WHOLE PREPAYMENT PREMIUMS PAYABLE IF THE DEBT WAS ACCELERATED DUE TO THE ISSUER'S BANKRUPTCY FILING?

Make-Whole Prepayment Premiums Under the Bankruptcy Code and State Law

1. What is a make-whole provision and what are the disputes about?

   Given today's low interest rate environment, the enforceability of make-whole provisions has been the subject of intense litigation as debtors seek to redeem and refinance debt entered into during periods of higher interest rates, and investors seek to maintain their contractual rates of return. ...

   Credit documents often contain express make-whole provisions to offer yield protection to investors in the event of a repayment of a loan prior to the agreed upon maturity. Such provisions allow parties to agree in advance on a measure of damages for such prepayment. Lenders use make-wholes to lock in a guaranteed rate of return on their investment at the time they agree to provide the financing. Borrowers typically benefit from such provisions by obtaining lower interest rates or fees than they would otherwise absent such protections. ...

   For the most part, disputes regarding the enforceability of a make-whole provision center around the following arguments: (i) does the contractual language of the relevant credit agreement provide for payment of the make-whole; and, if so, (ii) has a bankruptcy filing or other default accelerated the debt, causing it to be already due and payable, thereby negating the requirement to pay a make-whole payment. Other lesser arguments that may be raised include: (i) whether the make-whole represents an unenforceable penalty under applicable state law, (ii) does the make-whole represent a claim for unenforceable unmatured interest under § 502(b)(2) of the Bankruptcy Code, (iii) whether the make-whole represents a secured or unsecured claim, and (iv) whether the make-whole amount is unreasonable.

Michael Freidman, *Make-Whole Provisions Continue to Cause Controversy*, Harvard Law School Forum on Corporate Governance and Finance Regulation, August 3, 2014, available https://corpgov.law.harvard.edu/2014/08/03/make-whole-provisions-continue-to-cause-controversy/

The contractual provisions regarding make-whole provisions can be dense. The make-whole provisions that might be triggered on a bankruptcy filing often are comprised of several interrelated sections of the indenture and/or other loan documents, and can be convoluted and, sometimes, ambiguous. Moreover, make-whole litigation – much of which is a matter of contract interpretation under the state law applicable to the debt transaction – can involve several tranches of senior and junior secured debt, each with a different indenture containing different contractual provisions for the make-whole.

For example, the material clauses in the *Energy Future Holdings* first lien indenture included an "Optional Redemption" provision that permitted the borrower to prepay or redeem all or part of the notes at a redemption price equal to 100% of the principal amount plus the "Applicable Premium." The "Applicable Premium" was the make-whole that provided yield-protection to the noteholders, for the interest that they lost because of the redemption of the notes prior to the maturity date.[1] The indenture also provided for the automatic acceleration of all indebtedness under the notes if the borrower filed a bankruptcy petition, but also gave the noteholders the right to rescind any acceleration of the notes "and its consequences." And the second lien indenture contained similar – but not identical – make-whole provisions.[2]

A lot can be at stake. The make-whole prepayment premium in *In re Energy Future Holdings Corp.* was more than $430 million on $4 billion of debt.[3] The make-whole prepayment premium in *Matter of MPM Silicones, L.L.C.* was $200 million.[4]

2. The Circuit Split on Whether a Voluntary Bankruptcy Filing that Accelerates the Debt under the Indenture is a Voluntary Redemption that Triggers the Make-Whole Payment: *In re Energy Future Holdings Corp.* (3rd Cir.) (Make-Whole Payable) v. *Matter of MPM Silicones, L.L.C.* (2nd Cir.) (Make-Whole Not Payable)

There is a Circuit split on the issue. The Third Circuit in *In re Energy Future Holdings Corp.*, construing the indenture provisions set forth above under New York which applied to the transaction, ruled that the noteholders were entitled to the make-whole premium. The Second Circuit in *Matter of MPM Silicones, L.L.C.*, construing similar indenture provisions, also under New York law, held that they were not.

[1] *In re Energy Future Holdings Corp.*, 842 F.3d 247, 251 (3rd Cir. 2016).
[2] *Id.*
[3] *Id.* at 251-252.
[4] *Matter of MPM Silicones, L.L.C.*, 874 F.3d 787, 805 (2nd Cir. 2017).

3. Make-Whole Payable: *In re Energy Future Holdings Corp.* (3rd Cir.), reversing *In re Energy Future Holdings Corp.* (Bankr.D.Del.)

The bankruptcy court in *Energy Future Holdings* held that the clause in the first lien indenture that provided for the acceleration of the notes on a bankruptcy filing made no mention of the make-whole and thus was not an "Optional Redemption" of voluntary prepayment that triggered the make-whole payment.[5] Moreover, the attempt by the trustee for the noteholders to rescind the acceleration and decelerate was barred by the automatic stay, as an act to obtain possession of property of the estate and to recover a claim that arose prepetition.[6] And a genuine issue of material fact existed that required a trial on the merits to determine whether the trustee for the noteholders could establish cause to lift the automatic stay and then decelerate the notes.[7] Accordingly, the trustee for the noteholders was not entitled to the "Applicable Premium," i.e., the make-whole payment.[8] In a later decision, the bankruptcy court reached the same conclusions with respect to the provisions of the second lien indenture.[9] The debtor thus did not, by redeeming the notes postpetition, incur any obligation to pay the make-whole premiums. The first and second lienholders appealed. The district courts affirmed, and the lienholders appealed again.[10]

The Third Circuit characterized the bankruptcy court's rulings as putting the first lienholders in a "Catch-22." The bankruptcy filing accelerated the debt and cut off the lienholders' right to yield-protection. "Rescission of the acceleration would have restored that right. But rescission was blocked by the automatic stay, which the Court refused to lift." The second lienholders "fared no better" than the first.[11]

In final analysis, though, the Third Circuit just interpreted the provisions of the indenture differently. The court knew of "no reason" why it should choose between the make-whole clause and the acceleration clause, when in its view "both plainly appl[ied]." By its own terms, the make-whole clause required payment of the make-whole premium on a voluntary redemption of the notes. And the court thought that it "surpasse[d] strange" to hold that the silence regarding the make-whole in the acceleration clause superseded the "simple script" of the make-whole provision.[12] The debtor had redeemed the first lien notes at its option, and subsequently redeemed part of the second lien notes. In the Third Circuit's view, the debtor's voluntary redemptions of the notes, before their maturity dates, had triggered the debtor's obligation to pay the make-whole premiums.[13]

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[5] *In re Energy Future Holdings Corp.*, 527 B.R. 178, 183 (Bankr.D.Del. 2015).
[6] *Id.* at 183-184, citing 11 U.S.C. §362(a)(3), (6).
[7] *Id.*
[8] *Id.* at 195.
[9] *In re Energy Future Holdings Corp.*, 539 B.R. 723, 729 (Bankr.D.Del. 2015).
[10] *In re Energy Future Holdings Corp.*, 842 F.3d at 253.
[11] *Id.*
[12] *Id.* at 257.
[13] *Id.* at 261.

4. Make-Whole Not Payable: *In re MPM Silicones, L.L.C.* (2nd Cir.), reversing *In re MPM Silicones, L.L.C.* (Bankr.S.D.N.Y.)

The bankruptcy court in *MPM Silicones* needed to construe similar provisions in an indenture. The debtor's reorganization plan in *MPM Silicones* issued replacement notes to its senior lien noteholders, which did not account for the make-whole premium. The noteholders contended that the debtor's failure to pay the make-whole premium violated the indentures. The bankruptcy determined that "the make-whole premium would be due only in the case of an 'optional redemption'" and not in the case of an acceleration brought about by a bankruptcy filing and confirmed the plan.[14]

The noteholders appealed, and the district court agreed with the bankruptcy court and affirmed. The noteholders appealed to the Second Circuit, which ruled: "We too agree."[15]

The Second Circuit in *MPM Silicones* reasoned that, because the bankruptcy filing resulted in the acceleration of the debt, "any payment on the accelerated notes following a bankruptcy filing would be a *post*-maturity payment." Moreover, a "payment made mandatory by operation of an automatic acceleration clause [was] not one made at MPM's option."[16] The court also held that the noteholders' attempt to rescind acceleration was barred "because it would be "an attempt to modify contract rights and would therefore be subject to the automatic stay."[17] So much for Catch-22s in the Second Circuit.

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[14] *Matter of MPM Silicones, L.L.C.*, 874 F.3d at 802, citing the bankruptcy court's opinion, *Matter of MPM Silicones, L.L.C.*, 2014 WL 4436335 *11-15 (Bankr.S.D.N.Y. 2014).
[15] *Id.*
[16] *Id.* at 802-803, citing *In re AMR Corp.*, 730 F.3d 88 (2nd Cir. 2013).
[17] *Id.* at 803-804, quoting *In re AMR Corp.*, 730 F.3d at 102.

CASES

1. *In re Energy Future Holdings Corp.*, 527 B.R. 178 (Bankr.D.Del. 2015)
2. *In re Energy Future Holdings Corp.*, 539 B.R. 723 (Bankr.D.Del. 2015)
3. *In re Energy Future Holdings Corp.*, 842 F.3d 247 (3rd Cir. 2016)
4. *Matter of MPM Silicones, LLC*, 874 F.3d 787 (2nd Cir. 2017)

1. *In re Energy Future Holdings Corp.*,
527 B.R. 178 (Bankr.D.Del. 2015)

KeyCite Red Flag - Severe Negative Treatment
Reversed and Remanded by In re Energy Future Holdings Corp., 3rd Cir.(Del.), November 17, 2016

527 B.R. 178
United States Bankruptcy Court,
D. Delaware.

In re Energy Future Holdings Corp., et al., Debtors.
Delaware Trust Company as Indenture Trustee, Plaintiff,
v.
Energy Future Intermediate Holding Company LLC and EFIH Finance Inc., Defendants.

Bankruptcy Case No. 14–10979 (CSS) (Jointly Administered)
|
Adversary Proceeding No. 14–50363 (CSS)
|
Signed March 26, 2015

Synopsis

Background: Indenture trustee objected to motion by debtor for leave to obtain debtor-in-possession financing to pay off notes that had been accelerated upon its bankruptcy filing, on ground that noteholders were entitled to prepayment premium.

Holdings: The Bankruptcy Court, Sontchi, J., held that:

[1] trust indenture did not require payment of applicable prepayment premium upon satisfaction of notes that had been accelerated due to the issuer's bankruptcy filing;

[2] that debtors, prior to filing for bankruptcy, may have planned to use automatic default created by their bankruptcy filing, and the automatic acceleration of their notes, to avoid paying prepayment premium to noteholders was insufficient to raise genuine issue of material fact as to whether debtors had intentionally created event of default solely for purpose of avoiding payment of prepayment penalty;

[3] rescission notice that indenture trustee attempted to send was in nature of attempt to "collect, assess or recover" on a claim, and was void ab initio as violative of automatic stay;

[4] genuine issue of material fact as to whether indenture trustee could establish cause to retroactively lift automatic stay nunc pro tunc to allow trustee to waive automatic default and to decelerate notes precluded entry of summary judgment in dispute regarding noteholders' right to contractual prepayment premium

[5] New York "perfect tender" rule did not apply; and

So ordered.

West Headnotes (25)

[1] Contracts
Language of contract

Under New York law, court need not look outside the four corners of a complete contract to determine what the parties intended.

Cases that cite this headnote

[2] Contracts
Existence of ambiguity

Under New York law, contract is not ambiguous merely because the parties offer different constructions of same term.

Cases that cite this headnote

[3] Contracts
Language of contract

Under New York law, best evidence of what parties to written agreement intend is what they say in their writing.

Cases that cite this headnote

[4] Contracts
Conflicting clauses in general

Under New York law, should there be any inconsistency between specific and general provision of contract, the specific controls.

Cases that cite this headnote

[5] Contracts
Construction to give validity and effect to contract

Under New York law, court's reading of contract should not render any portion meaningless.

[6] **Corporations and Business Organizations**
Construction, operation, and effect in general

Under New York law, trust indenture did not require payment of applicable prepayment premium upon satisfaction of notes that had been accelerated due to the issuer's bankruptcy filing, where trust indenture, by its plain terms, required payment of prepayment penalty only upon optional redemption of notes prior to maturity, and further specified that notes would be accelerated automatically in event that issuer filed for bankruptcy with no indication that such acceleration would trigger issuer's obligation for prepayment penalty.

4 Cases that cite this headnote

[7] **Corporations and Business Organizations**
Construction, operation, and effect in general

Under New York law, trust indenture must contain express language requiring the payment of prepayment premium upon acceleration; otherwise, it is not owed.

4 Cases that cite this headnote

[8] **Contracts**
Rewriting, remaking, or revising contract

Under New York law, courts will not read into agreements between sophisticated parties provisions that are not there.

1 Cases that cite this headnote

[9] **Contracts**
General and specific words and clauses

Under New York law, specific provision in contract governs the circumstance to which it is directed, even in the face of a more general provision.

Cases that cite this headnote

[10] **Bills and Notes**

Under New York law, borrower's repayment after acceleration is not considered voluntary, and will not trigger borrower's obligation for prepayment penalty under contract requiring payment of such a penalty upon voluntary repayment of loan prior to maturity.

Cases that cite this headnote

[11] **Bills and Notes**
Time of Maturity

Under New York law, acceleration of note moves maturity date from the original maturity date to the acceleration date, and that date becomes the new maturity date.

Cases that cite this headnote

[12] **Bills and Notes**
Time of Maturity
Bills and Notes
Mode and Sufficiency of Payment

Under New York law, prepayment of note, of kind triggering borrower's obligation for prepayment penalty, can only occur prior to the maturity date, and acceleration, by definition, advances the maturity date of the debt so that payment thereafter is not prepayment but instead is payment made after maturity.

1 Cases that cite this headnote

[13] **Bankruptcy**
Judgment or Order

That debtors, prior to filing for bankruptcy, may have planned to use the automatic default created by their bankruptcy filing, and the automatic acceleration of their notes, to avoid paying prepayment premium to noteholders was insufficient, in light of financial difficulties that debtors were facing and their obvious liquidity crisis, to raise genuine issue of material fact as to whether debtors had intentionally created event of default by filing for bankruptcy solely for purpose of avoiding payment of prepayment penalty, and did not foreclose entry of summary judgment for debtors on whether they became obligated for prepayment penalty due to their alleged bad faith in filing for bankruptcy, especially where trust indenture did not contain a avoid paying prepayment premium.

Cases that cite this headnote

[14] **Bankruptcy**
Notice to creditors; commencement
Corporations and Business Organizations
Construction, operation, and effect in general

Limitation on indenture trustee's ability to waive automatic default and to rescind automatic acceleration of notes occurring if notes' issuer filed for bankruptcy, due to language in trust indenture that precluded trustee from exercising such rights if it would conflict with "any judgment of a court of competent jurisdiction," was not triggered by automatic stay that arose as of commencement of bankruptcy case; stay was not itself an "order of court," within meaning of this language in trust indenture, but arose automatically pursuant to statute. 11 U.S.C.A. § 362(a).

1 Cases that cite this headnote

[15] **Bankruptcy**
Notice to creditors; commencement

Automatic stay arises pursuant to statute, and applies in every bankruptcy case automatically without any court order. 11 U.S.C.A. § 362(a).

1 Cases that cite this headnote

[16] **Bankruptcy**
Mortgages or Liens
Bankruptcy
Validity of acts in violation of injunction or stay

Rescission notice that indenture trustee attempted to send following commencement of bankruptcy case by corporation that had issued $2.18 billion in first lien notes, in attempt to rescind automatic acceleration that occurred because corporation's bankruptcy filing was event of default, and to preserve noteholders' right to prepayment premium, was in nature of attempt to "collect, assess or recover" on a claim, and was void ab initio as violative of automatic stay. 11 U.S.C.A. § 362(a).

2 Cases that cite this headnote

[17] **Bankruptcy**
Judgment or Order

Genuine issue of material fact as to whether indenture trustee could establish cause to retroactively lift the automatic stay nunc pro tunc to allow trustee to waive automatic default resulting when issuer of notes filed for bankruptcy and to decelerate notes precluded entry of summary judgment in dispute regarding noteholders' right to contractual prepayment premium based on issuer's payment of notes, with proceeds of debtor-in-possession financing, prior to their originally specified maturity date.

Cases that cite this headnote

[18] **Bankruptcy**
Cause; Grounds and Objections

Whether "cause" exists for relief from automatic stay must be determined based on totality of the circumstances in each particular case. 11 U.S.C.A. § 362(d)(1).

Cases that cite this headnote

[19] **Bankruptcy**
Cause; Grounds and Objections
Bankruptcy
Balancing hardships

Factors that bankruptcy courts consider in determining whether "cause" exists to lift stay are (1) whether any great prejudice to either the bankruptcy estate or debtor will result from lifting of stay, (2) whether hardship to movant from maintenance of stay considerably outweighs hardship to debtor, and (3) probability of movant prevailing on the merits. 11 U.S.C.A. § 362(d)(1).

Cases that cite this headnote

[20] **Bankruptcy**
Cause; Grounds and Objections

While debtor's solvency may, in certain cases, be relevant consideration for court in determining whether "cause" exists to lift automatic stay, it is not the sole factor to be considered by court. 11 U.S.C.A. § 362(d)(1).

[21] **Corporations and Business Organizations**
Construction, operation, and effect in general

Provision in trust indenture, requiring payment of prepayment premium if notes were redeemed prior to their maturity date, applied only to optional redemptions of notes whose maturity date had not automatically been accelerated due to event of default occurring on the issuer's bankruptcy filing, and was not in nature of no-call provision.

2 Cases that cite this headnote

[22] **Bills and Notes**
Mode and Sufficiency of Payment

Under New York's "perfect tender" rule, borrower has no right to pay off his obligation prior to its stated maturity date, in the absence of prepayment clause.

Cases that cite this headnote

[23] **Corporations and Business Organizations**
Construction, operation, and effect in general

New York "perfect tender" rule, pursuant to which borrower generally has no right to pay off his obligation prior to its stated maturity date, was inapplicable where trust indenture modified this common law rule by providing that notes were automatically accelerated and payable in full in event that issuer filed for bankruptcy relief.

Cases that cite this headnote

[24] **Bankruptcy**
Claims allowable; what constitutes 'claim.'
Corporations and Business Organizations
Construction, operation, and effect in general

While, pursuant to terms of trust indenture, trustee could waive automatic default occurring upon filing of bankruptcy petition by issuer of notes and rescind any acceleration of notes, in order to preserve noteholders' right to prepayment premium, trustee had no claim for damages for denial of this purported right to rescind solely as result of operation of automatic purported right to rescind. 11 U.S.C.A. §§ 362(a), 506(b).

Cases that cite this headnote

[25] **Bankruptcy**
Secured Claims

Secured claims are not allowed for breach of contract damages, unless those damages are specifically provided for in contract.

Cases that cite this headnote

Attorneys and Law Firms

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FINDINGS OF FACT AND CONCLUSIONS OF LAW REGARDING CROSS–MOTIONS FOR SUMMARY JUDGMENT[1]

Sontchi, J.

I. INTRODUCTION & PROCEDURAL HISTORY[2]

1. This adversary proceeding relates to a series of 10% First Lien Notes issued by Energy Future Intermediate Holding Company LLC and EFIH Finance Inc., with original maturity of 2020, pursuant to an Indenture dated August 17, 2010. The original indenture was supplemented as of January 29, 2013.

2. On April 29, 2014, the EFIH Debtors filed petitions for relief under chapter 11 of the Bankruptcy Code. The EFIH Debtors sought approval of debtor-in-possession financing, in part, to repay all of the outstanding Notes and settle certain Noteholders' claims (the "*DIP Motion*"). (No. 14–10979, D.I. 74, 858, 859.) The non-settling Noteholders are represented by the Trustee, the Plaintiff in this adversary proceeding.

3. On May 13, 2014, the Trustee objected to the DIP Motion, arguing that the Noteholders were entitled to a secured claim for an amount described in the Indenture as the "Applicable Premium" because: (i) an Optional Redemption would occur when the Notes were repaid; (ii) the EFIH Debtors intentionally defaulted by filing bankruptcy to avoid paying the Applicable Premium, and (iii) the repayment would be a breach of the Noteholders' purported right to rescind the Notes' acceleration. (No. 14–10979, D.I. 421.)

4. On May 15, 2014, the Trustee initiated this adversary proceeding. (No. 14–10979, D.I. 470; No. 14–50363, D.I. 1.) The Complaint contained the claims from the May 13 objection, plus (a) an unsecured claim for breach of a purported "no-call" covenant in the Indenture; and (b) three unsecured claims, one for each of the three counts raised in its May 13 objection. (Compl.¶ 76.) The Trustee also simultaneously filed a motion seeking a declaration that it could decelerate the Notes without violating the automatic stay. (No. 14–10979, D.I. 473 ("*Stay–Applicability Motion*").) On June 4, 2014, the Trustee sent a purported notice of deceleration to the EFIH Debtors.

5. On June 6, 2014, the Court approved the DIP financing, the EFIH Debtors' use of the DIP financing to pay the outstanding EFIH First Lien Noteholders, and the settlement resolving certain Noteholders' claims for the Applicable Premium. (No. 14–10979, D.I. 858 (Order Approving EFIH First Lien Settlement),[3] 859 (Order approving use of DIP financing).) The

financing, which was funded on June 19, 2014.

6. On September 12, 2014, the Court bifurcated this adversary proceeding. (D.I.128)[3] This is Phase One of the litigation in which the Court will determine (1) whether EFIH is "liable under applicable non-bankruptcy law for ... a Redemption Claim," including the "make-whole" or other "damages ... under any 'no-call' covenant, 'right to de-accelerate,' " or applicable law, and (2) "whether the Debtors intentionally defaulted in order to avoid paying an alleged make-whole premium or other damages." (Id. at 2–3.) Except with respect to the Trustee's claim that EFIH intentionally defaulted to evade payment of the make-whole, "the Court will assume solely for the purposes of Phase One that the EFIH Debtors are solvent and able to pay all allowed claims of their creditors in full." (*Id.*) If the Court finds EFIH liable for a Redemption Claim, and if EFIH contests that it is, in fact, solvent, Phase Two will determine "(a) whether the EFIH Debtors are insolvent, and, if so, whether that insolvency gives rise to any defenses arising under the Bankruptcy Code in favor of the EFIH Debtors that bar or limit the amount of the Redemption Claim, and (b) the dollar amount of ... any Redemption Claim." (*Id.*)

7. The parties conducted full discovery on the Phase One issues, including the production of documents, multiple fact witness depositions, production of expert reports, and multiple expert witness depositions. Thereafter, the EFIH Debtors and the Trustee submitted cross-motions for summary judgment, seeking to resolve all of the claims raised in the contested matter, the adversary complaint, and the Stay–Applicability Motion. (D.I.175, 176, 178, 179.)

8. As set forth below, the Court will grant, in part, and deny, in part, the EFIH Debtors' motion for summary judgment, and deny in its entirety the Trustee's motion for summary judgment. More specifically, the Court holds as follows:

a. The plain language of the Indenture does not require payment of an Applicable Premium upon a repayment of the Notes, following an acceleration under section 6.02 of the Indenture, arising from a default for the commencement of "proceeding to be adjudicated bankrupt or insolvent" under section 6.01(a)(6)(i) of the Indenture.

b. The EFIH Debtors' filing of bankruptcy, which gave rise to the default at issue, was not an intentional default under the Indenture.

c. The Trustee's right under Section 6.02 of the Indenture to waive the automatic default arising from the EFIH Debtors' bankruptcy filing and rescind the acceleration of the Notes is not barred by the language in the Indenture extinguishing that right if rescission would "conflict with any judgment of a court of competent jurisdiction" because the automatic stay under section 362 of the Bankruptcy Code is not a "judgment of a court."

d. The Trustee's attempt to waive the default and decelerate the Notes by sending notice of same on June 4, 2014, was barred by the automatic *184 stay under section 362(a)(3) and (6) of the Bankruptcy Code.

e. If the Court were to lift the automatic stay, *nunc pro tunc* to a date on or before the repayment of the Notes on June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes than EFIH's refinancing would be an Optional Redemption under section 3.07 of the Indenture and the Applicable Premium (also referred to as Redemption Claim) would be due and owing to the non-settling Noteholders.

f. A genuine issue of material fact exists that requires a trial on the merits as to whether the Trustee can establish cause to lift the automatic stay, *nunc pro tunc* to a date on or before June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes.

g. The Trustee has no claim for (i) breach of the "no-call" provision of section 3.07(c) of the Indenture; (ii) violation of the "perfect tender" rule under New York law; nor (iii) breach of the right to waive the default and decelerate the Notes.

II. FINDINGS OF FACT

9. The parties' cross-motions for summary judgment implicate various provisions in the Indenture dated August 17, 2010 governing the EFIH 10.000% Senior Secured Notes Due 2020 ("*Indenture*"). (March 2, 2015 Romanowicz Am. Decl. in Support of Defs.' Mot. for SJ (D.I. 197) ("*Romanowicz Am. Decl.*"), Ex. 1) (execution version of Indenture).) That Indenture was supplemented, as of January 29, 2013, but the parties agree that the provisions of that supplement are not relevant here. Additionally, EFIH issued certain 6.875% Senior Secured Notes Due 2012, pursuant to a separate 2012 indenture. That 2012 indenture is substantially identical in all relevant aspects to the Indenture.

A. The Parties

10. Plaintiff is the indenture trustee (the "*Trustee*" or "*Indenture Trustee*") for the 10.000% Senior Secured Notes due 2020 ("*Notes*"), representing Noteholders who did not accept a settlement offer in connection with the repayment of the Notes at the

11. In addition, the following parties are intervenors in this adversary proceeding: UMB, N.A., as indenture trustee for certain senior unsecured notes issued by EFIH (D.I. 13); Fidelity Management & Research Company (D.I. 14); the ad hoc committee of holders of certain unsecured EFIH toggle notes (D.I. 15); Pacific Investment Management Company LLC, investment manager for certain holders of the Notes (D.I. 16); Computershare Trust Company, N.A., and Computershare Trust Company of Canada, the indenture trustee for certain EFIH senior secured second lien notes (D.I. 19); the ad hoc group of holders of the so-called "Legacy Notes" issued by EFH Corp. (D.I. 18); the Official Committee of Unsecured Creditors of EFH Corp. and EFIH (D.I. 207); and the Official Committee of Unsecured Creditors of Energy Future Competitive Holdings Company LLC, Texas Competitive Electric Holdings Company LLC and their direct and indirect subsidiaries, and EFH Corporate Services Company (D.I. 227).

B. Negotiation of the EFIH Notes

12. In the summer of 2010, EFIH negotiated and ultimately executed a debt ***185** exchange that involved the issuance of $2.18 billion of Notes. EFIH and the so-called "Dealer Manager" investment banks, who represented the interests of the lenders who would be accepting the new Notes, were the principal negotiators of the offering and execution documents, including the governing Indenture that is at the center of the parties' cross-motions for summary judgment. (Moldovan Tr. 40:22–41:20, 47:17–21.)[2] The Indenture Trustee for the Notes was involved in this process as well; the lead negotiating parties sent the Trustee (and its counsel) drafts of key issuing documents, such as the description of the Notes and the actual global note certificate representing the 10% Note, and solicited (and accepted many of) the Trustee's proposed changes. (Moldovan Tr. 41:16–20; March 2, 2015 Madron Decl. in Support of Defs.' Memo. in Opposition to Pl.'s Mot. for SJ (D.I. 205) ("*Madron Decl.*"), Exs. 19–21 (email communications transmitting draft documents to Indenture Trustee).)

13. Many terms and conditions of the Indenture were modeled on other indentures governing previous debt issuances by EFIH and EFH Corp. in 2009 and 2007, respectively. (Moldovan Tr. 143:11–20.) Like the Indenture, these previous agreements included an "Optional Redemption" provision providing for the payment of an "Applicable Premium" under certain circumstances upon an early, voluntary repayment of the Notes. (Indenture § 3.07.) Such "call protections" are common features in the indentures governing the type of high-yield debt issued by the EFH corporate family.

C. The August 2010 EFIH Debt Exchange

14. The "August 2010 Exchange" called for exchanging outstanding 11.250%/12.000% Senior Toggle Notes due 2017 and 10.875% Senior Notes due 2017 issued by EFH Corp. in 2007 and guaranteed by EFIH (the "*Old Notes*") for up to $2.18 billion aggregate principal amount of Notes, as well as an aggregate of $500 million in cash. (Press Release (July 30, 2010), http:// www.sec.gov/Archives/edgar/data/1023291/000119312510171555/dex992.htm.) The EFIH Debtors also announced plans to amend the indenture governing any Old Notes that would remain outstanding after the August 2010 Exchange was executed. These amendments called for eliminating substantially all of the restrictive covenants contained in the existing indenture and the Old Notes, eliminating certain events of default, and modifying covenants regarding mergers and consolidations, in addition to other changes. (*Id.*) 99.51% of the Old Notes agreed to participate in the exchange, and the requisite number of holders also agreed to the proposed amendments. (*Id.*)

15. Therefore, the EFIH Debtors issued the new EFIH Notes pursuant to the Indenture dated August 17, 2010 between EFIH and the Bank of New York Mellon Trust Company, N.A., as trustee. (Press Release (August 18, 2010), http:// www.sec.gov/Archives/edgar/ data/1023291/000119312510191917/d8k.htm.) The Indenture is governed by New York Law. (Indenture § 13.08.) Plaintiff later succeeded Bank of New York Mellon Trust Company, N.A., as the indenture trustee.

D. Key Provisions of the Notes Indenture

16. These cross motions for summary judgment call for the Court to interpret the meaning of the Indenture, including section 3.07 ("*Optional Redemption*"), section ***186** 6.01 ("*Events of Default*"), section 6.02 ("*Acceleration*"), and the definition of "Applicable Premium" in section 1.01 ("*Definitions*"). Each is discussed below:

17. In section 3.07, the Indenture specifies what constitutes an Optional Redemption. Section 3.07(a) states:

> At any time prior to December 1, 2015, the Issuer may redeem all or a part of the Notes 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 to, the date of redemption (the "Redemption Date")....

(Indenture § 3.07(a).)

> "Applicable Premium" means, with respect to any Note on any Redemption Date, the greater of: (1) 1.0% of the principal amount of such Note; and (2) the excess, if any, of (a) the present value at such Redemption Date of (i) the redemption price of such Note at December 1, 2015 (such redemption price as set forth in the table appearing under Section 3.07(d) hereof), plus (ii) all required interest payments due on such Note through December 1, 2015 (excluding accrued but unpaid interest to the Redemption Date), computed using a discount rate equal to the Treasury Rate as of such Redemption Date plus 50 basis points; over (b) the principal amount of such Note.

(*Id.* § 1.01.)

19. The Indenture also specifies certain Events of Default as well as the consequences of such Events of Default. Section 6.01 defines the various Events of Default and, relevant here, sections 6.01(a)(6) and (a)(7) specify Events of Default related to bankruptcy. In particular, section 6.01(a)(6)(i) states that an Event of Default occurs when EFIH "commences proceedings to be adjudicated bankrupt or insolvent." (*Id.* § 6.01(a)(6)(i).)

20. The acceleration clause in section 6.02 explains the consequences of this bankruptcy-caused Event of Default:

> [I]n the case of an Event of Default arising under clause (6) or (7) of Section 6.01(a) hereof [including EFIH's bankruptcy filing], all outstanding Notes shall be due and payable immediately without further action or notice.

(*Id.* § 6.02, ¶ 2.)

21. By contrast, for an Event of Default unrelated to a bankruptcy filing, the Indenture provides an option to accelerate the Notes. (*Id.* § 6.02, ¶ 1.) Specifically, for non-bankruptcy defaults, the Trustee or holders of at least 30% of the Notes "may declare the principal, premium, if any, interest and any other monetary obligations on all the then outstanding Notes to be due and payable immediately." (*Id.*) This optional right to accelerate the Notes, however, does not apply to a bankruptcy default; instead, acceleration upon a bankruptcy default is automatic. (*Id.*)

22. Finally, in the event of an acceleration of the Notes, the Trustee possesses a qualified right effectively to decelerate the Notes through the act of rescission:

> The Holders of at least a majority in aggregate principal amount of the Notes by written notice to the Trustee may on behalf of all the Holders waive any existing Default and its consequences under the Indenture except a continuing Default in the payment of interest on, premium, if any, or the principal of any Note (held by a non consenting Holder) and rescind any acceleration with respect to the Notes and its consequences (so long as such rescission would not ***187** conflict with any judgment of a court of competent jurisdiction).

(*Id.* § 6.02, ¶ 3.)

E. EFIH's Decision to File for Chapter 11 Protection

23. One of the issues before the Court is whether the Debtors intentionally defaulted in order to avoid paying an alleged make-whole premium or other damages. Both sides assert that there is no genuine issue of material fact as to why EFIH filed bankruptcy, which gave rise to the default. As discussed below, the Court agrees; thus, this issue is appropriate for summary judgment.

i. The EFIH Debtors' Position

24. The EFIH Debtors argue that there is no genuine issue of material fact as to why EFIH filed for bankruptcy—they were running out of cash. For many months before EFIH ultimately filed for chapter 11 protection, the EFH corporate family pursued restructuring strategies that would involve seeking bankruptcy protection for TCEH but keeping EFIH out of bankruptcy. (*See, e.g.,* Pl. App'x, A–112 (May 29, 2013 EFIH Unsecured Creditors Advisor Presentation calling for recapitalizing EFIH "out-of-court"); Horton Tr. 94:17–24.) This strategy, known as "Project Olympus," was an effort to obtain the consent of key creditor constituencies to a consensual, prepackaged transaction that would minimize the amount of time spent in a restructuring, avoid potentially significant tax impacts, and maintain the EFH corporate family in one consolidated group. (8–K Filing of EFH (October 15, 2013).) This effort was ultimately unsuccessful, and all of the Debtors, including the

25. After the company's attempts to pursue Project Olympus failed on November 1, 2013, it was clear that EFIH would have to join the rest of the EFH corporate family in filing for bankruptcy. As the company's Treasurer stated at his deposition, "We're going to have to file EFIH now regardless of what ... anyone else is saying because we're running out of cash.... Project Olympus isn't happening, ... EFIH is going to have to file...." (Horton Tr. 190:19–191:2.) EFIH's Executive Vice President and CFO further explained that by April 28, 2014, the day before EFIH filed for bankruptcy, the company had run out of cash to satisfy its interest obligations coming due on June 1 of that year. (Keglevic Tr. 52:25–53:14.) Mr. Keglevic also testified at the June 5, 2014 hearing that the DIP was needed, in part, to provide liquidity to fund operations. (Hr'g Tr. 96:14–20, 100:12–101:3 (June 5, 2014)) The EFIH Debtors did not see "any ability to issue debt or get equity to increase the amount of cash" needed to meet those interest obligations. (*Id.* 172:14–173:4.)

ii. The Trustee's Position

26. The Trustee counters at length that there is no genuine issue of material fact as to why the EFIH Debtors filed bankruptcy —it was to avoid having to pay the Applicable Premium. First, the Trustee asserts that foregoing liability on the Applicable Premium was a reason for the bankruptcy filing. Second, the Trustee counters EFIH's position that liquidity issues ultimately required EFIH to file for bankruptcy. The Trustee asserts that EFIH avoided the most obvious potential source of liquidity for EFIH outside of bankruptcy, a sale of EFIH's equity stake in its principal assets, including its interest in Oncor Holdings.

27. As discussed above, from late 2012 until November 2013, the Debtors pursued a plan known as "Project Olympus." (Horton Tr. 124:8–20.) The goal was to put TCEH into bankruptcy and convert its ***188** first-lien debt into EFH equity, but to "keep EFH and EFIH out of bankruptcy." (Horton Tr. 94:6–95:3, 122:9–124:7; Keglevic Tr. 39:10–14.) EFIH's senior executives believed this approach made sense because they were convinced that EFIH was solvent. (Horton Tr. 125:4–13; Keglevic Affidavit at 26–28.)

28. In stage 1 of Project Olympus, EFH would raise $2 billion of equity and use it to refinance EFIH first lien, second lien and unsecured notes (the so-called "*PIK Notes*") while TCEH was in bankruptcy. (Horton Tr. 166:14–22; Horton Ex. 14 at -2605, -2606; Horton Ex. 15 at 5648.) In stage 2, after TCEH emerged from bankruptcy, all remaining EFIH first-lien and second-lien debt would be refinanced. (Horton Tr. 166:23–167:11; Horton Ex. 15 at 5648.) In both stages, EFIH would use the optional redemption provisions of the Indenture for the Notes and pay the required make-whole. (Horton Tr. 153:19–154:3, 162:25–163:22; Horton Ex. 14 at 2605, 2606; Horton Ex. 15 at 5648; Keglevic Tr. 84:22–86:25 ("To the extent we called it, we would of course follow the indenture which said a call premium was due.").) During this period, the Debtors "were continuously looking for opportunities" to "refinance the first lien debt" through an optional redemption that EFIH admits would have triggered the make-whole. (Horton Tr. 70:18–71:23, 122:12–20; Horton Ex. 9; Horton Ex. 10.) But, in the Debtors' view, any restructuring "require[d]" the "agreement" of two creditor groups: the "TCEH 1st lien creditors" and the "EFIH/EFH unsecured creditors," i.e., the holders of the PIK Notes. (Horton Ex. 16 at 2696.)

29. In March 2013, the TCEH first-lien noteholders presented the Debtors with proposals that would put EFIH into bankruptcy. (Keglevic Tr. 87:9–88:25.) They proposed an "alternative refinancing case," in which "significant value could be unlocked" if EFIH did not pay the make-whole after it filed for bankruptcy. (Keglevic Ex. 6 at 0825); *see also* (Millstein & Co., Project Olympus Preliminary Discussion Materials May 2013, SP_MW_000000741 ("If EFIH and EFH file for bankruptcy, thereby accelerating the maturity of the EFIH debt, the Company may be able to refinance EFIH without paying make-whole premiums, resulting in substantial savings compared to the Company's forecast.").) In the view of these creditors, there was "more value through potentially going into bankruptcy and either negotiating or winning make-wholes than a settlement outside of bankruptcy." (Keglevic Tr. 90:7–17.)

30. In addition, the Debtors had proposed that the PIK noteholders convert their debt to equity. (Horton Tr. 186:9–187:25.) Those PIK noteholders evidently viewed that equity as valuable. (Ying Tr. (6/23) 120:24–123:18; Horton Tr. 188:4–189:22.) Because that equity would be more valuable if EFIH could refinance its debt without paying a make-whole, they too pushed the Debtors to contest the Noteholders' right to a make-whole. (Horton Tr. 189:11–22.)

31. On October 15, 2013, EFIH filed an 8–K with the SEC disclosing a restructuring proposal from the TCEH first-lien noteholders, in which, among other things, EFIH would file for bankruptcy and "refinance" the EFIH Notes without paying "any make-whole amount." (Horton Ex. 19 at 2–3 & Ex. 99.2; *id.* Ex. 99.2 at 1 (proposing that TCEH first-lien noteholders receive 100% of EFH equity); Horton Tr. 206:3–208:17.)

32. On October 24, 2013, the EFIH PIK noteholders sent the Debtors a restructuring proposal that likewise provided, among other things, for EFIH to file bankruptcy, refinance the Notes and "disallow ***189** ... any make-whole fee." (Horton Ex. 17 at 6084, 6088; *id.* at 6086, 6088 (proposing that PIK noteholders receive up to 94.9% of EFIH equity); Horton Tr. 191:20–197:25.)

96:12–22; *see id.* 97:21–98:2.) On November 1, 2013, the Debtors filed an 8–K with the SEC disclosing their own proposal whereby, among other things, EFIH would file for bankruptcy and refinance the Notes without paying "any make-whole amount." (Horton Ex. 20 (EFIH 8–K) at 4, Ex. 99.1 at 2; Horton Tr. 184:9–23, 213:13–219:13.) This was the first time EFIH had publicly suggested that it would, or could, refinance the Notes in bankruptcy without paying a make-whole. The Debtors ultimately memorialized this plan in a Restructuring Support Agreement (the "*RSA*") with certain creditors, including the PIK noteholders, who were to receive most of the EFH equity. (Keglevic Affidavit at 71–72, 75–76; No. 14–10979, D.I. 98 (RSA term sheet) at 2–4.)

34. In the October 2012 and December 2012 dealer manager agreements for the EFIH 6.875% Notes and in the January 2013 exchange for the Notes, EFIH's executives represented to the Dealer Managers that EFIH was "solvent."[2] At no point did the Debtors conclude that EFIH's assets were worth less than its liabilities. (Horton Tr. 270:9–271:24; Keglevic Tr. 158:4–15, 169:24–170:11.) EFIH had not missed any payment on the Notes or otherwise defaulted. (Horton Tr. 80:23–81:16; Keglevic Tr. 52:17–53:14, 189:15–190:2.)

35. Before filing for bankruptcy, EFIH solicited, negotiated, and obtained commitments for, and obligated itself to pay commitment and other fees on, $5.4 billion in DIP financing. (No.14–50363, D.I. 27 ¶¶ 3, 15, 31–34.) On the Petition Date, EFIH filed and served the EFIH First Lien DIP Motion seeking authority for the DIP financing. Ultimately, EFIH obtained $5.4 billion in DIP financing, most of which it used to pay off the outstanding principal and interest (other than disputed interest) on the Notes.

36. EFIH sought authority to, and did, redeem the Notes because it had "the opportunity to pay [them] off and ... replac[e] [them] with DIP financing, ... lower[ing] the interest costs." (Keglevic Tr. 182:22–183:23.) The DIP financing bore an interest rate of 4.25% (Horton Tr. 37:1820; Keglevic Tr. 184:15–20), substantially less than the interest rate that EFIH was paying on the Notes (10% for most of the Notes; 6.875% for the rest). (Horton Tr. 37:21–25; Keglevic Tr. 184:2125). Mr. Keglevic testified that "by paying it sooner we could replace it with cheaper cost of money." (Keglevic Tr. 186:10–187:1.) The refinancing's purpose, as EFIH explained, was "to take advantage of highly favorable debt market conditions to refinance the EFIH First Lien Notes," "saving an estimated $13 million in interest per month." (No. 14–10979, D.I. 74 at 4 ¶ 4; Horton Tr. 40:9–41:13, 44:15–20, 89:11–24; Horton Ex. 5 (Goldstein Decl.) at 5 ¶ 9.)

37. On June 19, 2014, EFIH paid all outstanding principal and accrued interest *190 (other than disputed amounts of interest and any make-whole or comparable damages) on the First Lien Notes, and the Notes were then cancelled.[3]

38. Prior to filing bankruptcy, EFIH did not market its assets to avoid bankruptcy. (Horton Tr. 226:13–228:1; Keglevic Tr. 54:16–55:21, 57:2–58:5, 60:8–61:12.) EFIH did not pursue a possible sale of its interest in Oncor because it wanted to limit the tax liabilities of a separate entity, its parent EFH. *See, e.g.,* Omnibus Tax Memorandum (No. 14–10979, D.I. 2296 at 12 ("The principal goal of all the Debtors ... was to keep EFH, TCEH, and EFIH together as a single consolidated group for federal income tax purposes and to *avoid* a taxable separation ... [that] would trigger a tax liability of potentially $7 *billion* or more for EFH.")); Ruling on Bid Procedures, Nov. 3, 2014 Tr. at 13:1–6 ("There can be no question that the debtors' proposed tax structure that calls for a complicated tax-free deconsolidation of the E side and T side of the balance sheet was the fundamental element of the RSA, and is the debtors' preferred structure for the sale of the Oncor business....".)

III. CONCLUSIONS OF LAW

A. Jurisdiction and Venue

39. The Debtors commenced these chapter 11 cases on April 29, 2014 (the "*Petition Date*"). Venue in the United States Bankruptcy Court for the District of Delaware was proper as of the Petition Date pursuant to 28 U.S.C. §§ 1408 and 1409 and continues to be so in the context of this adversary proceeding. This Court has subject matter jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 11 U.S.C. § 157(b).

B. Standard for Summary Judgment

40. Federal Rule of Civil Procedure 56, made applicable to adversary proceedings by Federal Rule of Bankruptcy Procedure 7056, directs that summary judgment should be rendered if the pleadings, the discovery and disclosure materials on file, and any affidavits "show that there is no genuine issue as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a); *see also In re Delta Mills, Inc.,* 404 B.R. 95, 103 (Bankr.D.Del.2009). Summary judgment is designed "to avoid trial or extensive discovery if facts are settled and the dispute turns on an issue of law." *Delta Mills,* 404 B.R. at 104.

41. Here, the parties agree that there are no material facts in dispute, and that the questions necessary to resolve this proceeding

decelerate the Notes. Otherwise, summary judgment is appropriate at this stage. Niagara Frontier Transit Metro Sys., Inc. v. Cnty. of Erie, 212 A.D.2d 1027, 623 N.Y.S.2d 33 (1995) (citing W.W.W. Assoc., Inc. v. Giancontieri, 77 N.Y.2d 157, 565 N.Y.S.2d 440, 566 N.E.2d 639, 642 (1990) ("Where the contract is unambiguous on its face, it should be construed as a matter of law and summary judgment is appropriate.")); Green Mach. Corp. v. Zurich Am. Ins. Grp., No. CIV. A. 99-3048, 2001 WL 1003217, at *6 (E.D.Pa. Aug. 24, 2001) ("Whether a contract provision ***191** is ambiguous is a question of law for the court."), *aff'd sub nom.* Green Mach. Corp. v. Zurich–Am. Ins. Grp., 313 F.3d 837 (3d Cir.2002).

C. Contract Interpretation Under New York Law

[1] [2] 42. Under New York law, which governs the Indenture, the Court need not look "outside the four corners" of a complete document to determine what the parties intended. W.W.W., 565 N.Y.S.2d 440, 566 N.E.2d at 642; *see also* R/S Assocs. v. N.Y. Job Dev. Auth., 98 N.Y.2d 29, 744 N.Y.S.2d 358, 771 N.E.2d 240, 242 (2002) (applying same principle). Here, neither party has alleged that the Indenture is an incomplete document, so it is not necessary to resort to extrinsic evidence to interpret it. Moreover, neither party contends that any term in the Indenture is ambiguous—instead, each party relies on its own "plain reading" of the indenture in reaching competing results. A contract is not ambiguous merely because the parties offer different constructions of the same term. Sayers v. Rochester Tel. Corp. Supp. Mgmt. Pension Plan, 7 F.3d 1091, 1095 (2d Cir.1993). The Court finds that the Indenture is not ambiguous.

[3] [4] [5] 43. Having reached the conclusion that the Indenture is unambiguous, the Court relies on long-recognized canons of interpretation to determine its meaning. First, "[t]he best evidence of what parties to a written agreement intend is what they say in their writing." Schron v. Troutman Sanders LLP, 20 N.Y.3d 430, 963 N.Y.S.2d 613, 986 N.E.2d 430, 433 (2013) (internal quotation marks and citation omitted). Second, should there be an inconsistency between a specific and general provision of a contract, the specific controls. Muzak Corp. v. Hotel Taft Corp., 1 N.Y.2d 42, 150 N.Y.S.2d 171, 133 N.E.2d 688, 690 (1956); Waldman v. New Phone Dimensions, Inc., 109 A.D.2d 702, 487 N.Y.S.2d 29, 31 (N.Y.1985). Third, "[a] reading of the contract should not render any portion meaningless." *See* Beal Sav. Bank v. Sommer, 8 N.Y.3d 318, 834 N.Y.S.2d 44, 865 N.E.2d 1210, 1213 (2007) (quotation marks and citations omitted); Barrow v. Lawrence United Corp., 146 A.D.2d 15, 538 N.Y.S.2d 363, 365 (N.Y.1989) ("Contracts are also to be interpreted to avoid inconsistencies and to give meaning to all of its terms.").

D. The Plain Language Of The Indenture Does Not Require Payment Of The Applicable Premium

[6] 44. The Trustee seeks a declaratory judgment that EFIH's refinancing of the Notes constituted a redemption requiring payment of the Applicable Premium as a secured claim. (Compl.¶¶ 51–57, 74–76.)[5]

45. The Court begins its analysis with the most relevant provision, the acceleration provision of section 6.02 of the Indenture. Under section 6.02, "in the case of an Event of Default arising under clause (6) or (7) of Section 6.01(a) hereof, all outstanding Notes shall be due and payable immediately without further action or notice." Here, EFIH's filing for bankruptcy was an Event of Default arising under clause (6) of Section 6.01(a). Thus, the Notes were automatically accelerated on the Petition Date and became due and payable immediately without further action ***192** or notice of the Trustee or any Noteholder. (Indenture § 6.02, ¶ 2.)

46. There is no reference in Section 6.02 to the payment of the "Applicable Premium" upon an automatic acceleration, nor is section 3.07 incorporated into section 6.02. The parties included the concept of an Applicable Premium in only one instance (an optional redemption under section 3.07). It is not mentioned in section 6.02 or anywhere else in the Indenture.

[7] 47. Under New York law, an indenture must contain express language requiring payment of a prepayment premium upon acceleration; otherwise, it is not owed. *See* Northwestern Mut. Life Ins. Co. v. Uniondale Realty Assocs., 11 Misc.3d 980, 816 N.Y.S.2d 831, 836 (N.Y.Sup.Ct.2006) ("A prepayment premium will not be enforced under default circumstances in the absence of a clause which so states."); In re South Side House, LLC, 451 B.R. 248, 268 (Bankr.E.D.N.Y.2011) ("[A] lender is not entitled to prepayment consideration after a default unless the parties' agreement expressly requires it."), *aff'd* U.S. Bank Nat'l Ass'n v. South Side House, LLC, No. 11–4135, 2012 WL 273119 (E.D.N.Y. Jan. 30, 2012); In re Premier Entm't Biloxi LLC, 445 B.R. 582, 626; Hr'g Tr. 36:9–14, In MPM Silicones, LLC, et al., No. 14–22503, 2014 WL 4436335, at *13–14 (Bankr.S.D.N.Y. Sept. 9, 2014) ("*Momentive*").

[8] 48. The parties certainly could have bargained for such a provision. In many other cases—including cases decided before August of 2010, when this Indenture was negotiated—clauses specifically requiring post-acceleration payment of a make-whole, prepayment premium, or certain costs were upheld. *See, e.g.,* United Merchs. & Mfgrs., Inc. v. Equitable Life Assurance Soc'y of the United States (In re United Merchs. & Mfrs., Inc.), 674 F.2d 134, 141–43 (2d Cir.1982); Parker Plaza W. Partners v. UNUM Pension & Ins. Co., 941 F.2d 349, 355–56 (5th Cir.1991); Teachers Ins. & Annuity Ass'n of Am. v. Butler, 626

834–35 (Bankr.E.D.N.Y.1992); *In re Schaumburg Hotel Owner*, 97 B.R. 943, 952–54 (Bankr.N.D.Ill.1989). The Indenture here was negotiated at arm's length between sophisticated parties who were represented by counsel. The Court is unwilling to "read[ ] into agreements between sophisticated parties provisions that are not there." *In re Solutia*, 379 B.R. 473, 485 n.7 (Bankr.S.D.N.Y.2007).[2]

[9] 49. The EFIH Debtors' reading is also correct based on well-accepted canons of contract interpretation. Under established principles of New York law, "a specific provision ... governs the circumstance to which it is directed, even in the face of a more general provision." *In re AMR Corp.*, 730 F.3d 88, 99 (2d Cir.2013) (citation omitted), *cert denied*, — U.S. —, 134 S.Ct. 1888, 188 L.Ed.2d 913 (2014); *Muzak Corp.*, 150 N.Y.S.2d 171, 133 N.E.2d at 690 ("Even if there was an inconsistency between a specific provision and a general provision of a contract (we find none), the specific provision controls." *193). As the Second Circuit has reasoned, "[i]n analyzing whether a Make–Whole Amount is due, the Court turns first to the provision of the Indentures that most specifically addresses the circumstances before the Court. That provision is Section 4.01(g), which provides that the filing of a voluntary bankruptcy constitutes an event of default." *In re AMR Corp.*, 485 B.R. 279, 289 (Bankr.S.D.N.Y.2013), *aff'd* 730 F.3d 88 (2d Cir.2013). Here, that specific provision is section 6.02. Nowhere in section 6.02 is there a reference to Applicable Premium, to Optional Redemption, section 3.07, or anything that would support the Trustee's position that the Applicable Premium is owed upon a bankruptcy event of default and acceleration.

50. Comparing the relevant language in the governing Indenture with language from other cases compels the conclusion that the Indenture does not provide for a make-whole premium following a bankruptcy acceleration.

- ***Calpine***: "In the case of an Event of Default specified in clause (10) or (11) of Section 6.01 [which includes a bankruptcy filing], ***all outstanding Notes will become due and payable immediately without further action or notice.***" (Romanowicz Decl., Ex. 2 § 6.02 ¶ 1, *In re Calpine Corp.*, No. 05–60200, 2007 WL 950090 (Bankr.S.D.N.Y.2007) (Dkt. No. 3481–4), overruled by *HSBC Bank USA, N.A. v. Calpine Corp.*, No. 07–3088, 2010 WL 3835200 (S.D.N.Y. Sept. 15, 2010) (emphasis added)); *HSBC Bank USA, N.A. v. Calpine Corp.*, No. 07–3088, 2010 WL 3835200, at *4–*5 (S.D.N.Y. Sept. 15, 2010) ("Calpine II").

- ***Premier***: "In the case of an Event of Default specified in clause (j) [commencement of a voluntary bankruptcy case] ... of § 6.01 hereof, with respect to Premier ... *all outstanding Notes will become due and payable immediately without further action or notice.*" (Romanowicz Decl., Ex. 3, at 73 (§ 6.02 ¶ 2), *In re Premier Entm't Biloxi LLC*, 445 B.R. 582 (Bankr.S.D.Miss.) (Dkt. No. 6–1 to –3) (emphasis added)); *In re Premier Entm't Biloxi LLC*, 445 B.R. at 626–632.

- ***Momentive***: "If an Event of Default specified in Section 6.01(f) or (g) [which includes a bankruptcy filing] with respect to the Company occurs, *the principal of, premium, if any, and interest on all the Notes shall ipso facto become and be immediately due and payable without any declaration or other act* on the part of the Trustee or any Holders." (Romanowicz Decl., Ex. 5, at 92, *In re MPM Silicones, LLC*, et al., No. 14–22503 (Bankr.S.D.N.Y. June 18, 2014) (Dkt. No. 464–1) (emphasis added)); *Momentive*, 2014 WL 443635, at *13–14.

- ***Solutia***: "If an Event of default specified in 6.01(7) occurs with respect to the Company or any Subsidiary Guarantor [which includes filing a bankruptcy petition] *the principal of and premium, if any, and accrued interest, if any, on the Notes then outstanding shall become and be immediately due and payable without any declaration or other act* on the part of the Trustee or any Holder.' " (Romanowicz Decl., Ex. 4, at 11/70 (§ 6.02 ¶ 1), *In re Solutia*, 379 B.R. 473 (Bankr.S.D.N.Y.2007) (Dkt. No. 4211–1 to –2) (emphasis added)); *In re Solutia Inc.*, 379 B.R. at 488.

51. In each of these cases, the court found no make-whole obligation was created by acceleration provisions substantially similar to the language before the Court. The Court agrees with the holdings in these cases and finds that the acceleration provision in the Indenture does not include *194 clear and unambiguous language that a make-whole premium (here the "Applicable Premium") is due upon the repayment of the Notes following a bankruptcy acceleration. Because the Indenture does not specify that the Applicable Premium is owed after automatic acceleration, the Applicable Premium is not owed.

52. In contrast, the Trustee's reading of the Indenture does not give meaning to each provision. Both parties have argued that the Indenture must be read as a whole giving meaning to each provision. The Court agrees. *See Beal Sav. Bank v. Sommer*, 8 N.Y.3d 318, 834 N.Y.S.2d 44, 865 N.E.2d 1210, 1213 (2007) (A reading of the contract should not render any portion meaningless.") (citations omitted); *Barrow v. Lawrence United Corp.*, 146 A.D.2d 15, 538 N.Y.S.2d 363, 365 (N.Y.1989) ("Contracts are also to be interpreted to avoid inconsistencies and to give meaning to all its terms."). A review of section 3.07, one of the sections upon which the Trustee heavily relies, does not change the Court's reading of section 6.02. The Trustee argues that section 3.07, the "Optional Redemption" provision, is a wholesale bar to any repayment before December 1, 2015. This reading is strained for a number of reasons.

53. As an initial matter, the Trustee looks to Article 3, "Redemption," instead of Article 6, "Defaults and Remedies," to determine the Debtors' obligations and the Trustee's remedies upon a default. This defies the canons of contract interpretation. Further, the Trustee asks this Court to conclude, contrary to New York law, that because section 3.07 does not include

54. "Optional Redemption" under section 3.07 is an act separate and apart from automatic acceleration. This is evident in part from the noticing scheme outlined in Article 3, "Redemption." (*See* Indenture §§ 3.01–3.06 (requiring written notice prior to redemption and outlining procedures for same).) This noticing scheme specifies a detailed process for advance notice of redemption, including the "Redemption Date," the Notes to be redeemed, and more. No part of this notice process is required to be followed when the Notes become "due and payable immediately without further action or notice" under section 6.02.

55. In other words, under the Indenture, redemption and acceleration are not the same thing. The Indenture in various places distinguishes between the two concepts:

• "(a) An 'Event of Default' ... means ... (1) default in payment when due and payable, upon *redemption, acceleration* or otherwise, of principal, or premium, if any, on the Notes...." (Indenture § 6.01(a)(1) (emphasis added).)

• "The due and punctual payment of the principal, premium, if any, and interest on the Notes when and as the same shall be due and payable, whether on an Interest Payment Date, at maturity, by *acceleration*, repurchase, *re* ***195** *demption* or otherwise...." (*Id.* § 10.04 (emphasis added).)

• "[T]he principal, premium, if any, and interest on the Notes shall be promptly paid in full when due, whether at maturity, by *acceleration, redemption* or otherwise...." (*Id.* § 11.01 (emphasis added).)

[10] [11]56. When the EFIH Debtors filed for bankruptcy, the Notes automatically accelerated and became due and payable immediately. Under New York law, "a borrower's repayment after acceleration is not considered voluntary." South Side, 451 B.R. at 268; *see also* AMR, 730 F.3d at 103 (rejecting the claim that an accelerated repayment was a "voluntary redemption"). This is because "[a]cceleration moves the maturity date from the original maturity date to the acceleration date and that date becomes the new maturity date." Solutia, 379 B.R. at 484.

[12]57. "Prepayment can only occur prior to the maturity date," *Id.* at 488 (emphasis omitted), and "acceleration, by definition, advances the maturity date of the debt so that payment thereafter is not prepayment but instead is payment made after maturity." *In re LHD Realty Corp.*, 726 F.2d 327, 330–31 (7th Cir.1984). "Once the maturity date is accelerated to the present, it is no longer possible to prepay the debt before maturity." Northwestern Mutual, 816 N.Y.S.2d at 834 (quoting *Rodgers v. Rainier Nat'l Bank*, 111 Wash.2d 232, 757 P.2d 976 (1988)); *see also* Solutia, 379 B.R. at 488 ("Because the 2009 Notes were automatically accelerated, any payment at this time would not be a prepayment."). Acceleration therefore "does not trigger the [Trustee's] right to prepayment consideration" under the Optional Redemption provision. South Side, 451 B.R. at 268. Thus, the Trustee's claim that the EFIH Debtors' repayment was an optional redemption must fail. For these reasons, the Trustee is not entitled to an Applicable Premium.

E. The EFIH Debtors' Bankruptcy Filing Was Not An Intentional Default Under The Indenture

[13]58. The Trustee also seeks judgment for an allowed secured claim arguing that EFIH's default was done with intent to deny the Trustee the Applicable Premium. (Compl.¶¶ 58–65, 74–76.) The Court disagrees with the Trustee that it would be entitled to any relief.

59. First, unlike in some cases, the Indenture does not contain a provision stating that a premium will be owed if EFIH intentionally causes an event of default to avoid paying the Applicable Premium. *Compare with* Premier, 445 B.R. at 591 ("If an Event of Default occurs ... by reason of any willful action ... with the intention of avoiding the prohibition on redemption of the Notes ... an additional premium shall also become due."); and South Side, 451 B.R. at 269–70 ("[P]arties may agree that a borrower's repayment of the debt after acceleration ... will be deemed an evasion of the parties' prepayment agreement.")

60. Second, the Trustee has the burden of supplying "sufficient evidence (not mere allegations)" for a reasonable factfinder to conclude that the EFIH Debtors intentionally defaulted. *United States v. Jamas Day Care Ctr. Corp.*, 152 Fed.Appx. 171, 173 (3d Cir.2005) (quoting *Olson v. General Elec. Astrospace*, 101 F.3d 947, 950 (3d Cir.1996)). A material fact is one that could "alter the outcome of the case." *Argus Mgmt. Group v. GAB Robins, Inc. (In re CVEO Corp.)*, 327 B.R. 210, 214 (Bankr.D.Del.2005) (quoting *Horowitz v. Fed. Kemper Life Assurance Co.*, 57 F.3d 300, 302 n. 1 (3d Cir.1995)). It is genuine when it is "triable," that is, when reasonable minds could disagree on the result. ***196** *Id.* at 210 (quoting *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986)).

61. Viewing all factual inferences in a light most favorable to the Trustee, its argument is nonetheless insufficient to create a genuine issue of material fact as to why the EFIH Debtors filed bankruptcy. While it is certainly the case that the EFIH Debtors planned pre-petition and followed through after filing bankruptcy to use the default created by that filing to refinance the Notes without having to pay the Applicable Premium, that is not enough to counter the overwhelming evidence that the Debtors filed bankruptcy because they were facing a severe liquidity crisis. The collapse of Project Olympus doomed a T-side only bankruptcy and to suggest that the Debtors refused to market and sell Oncor, which may be worth $18 billion, to avoid having

bankruptcy, such as the power to reject unprofitable leases, for business reasons. The Trustee has presented insufficient evidence to rebut that put forth by the EFIH Debtors. There is no genuine issue of material fact—the EFIH Debtors did not file bankruptcy in an intentional effort to default under the Indenture so that the Applicable Premium would not be due.

F. The Trustee's Right To Rescind Acceleration

62. The Trustee asserts that the Noteholders had an "absolute right" to rescind the automatic acceleration of the Notes. Based on this theory, the Trustee also seeks a declaratory judgment that it is entitled to an allowed secured claim in the amount of the Applicable Premium, for breach of the alleged right to rescind. (Compl. 11 69, 73.) The Trustee's qualified right of rescission raises a number of issues.

i. The Trustee's right to rescind the acceleration of the Notes is not barred because the automatic stay under section 362 of the Bankruptcy Code is not a "judgment of a court."

[14]62. First, while the Trustee has the right under Section 6.02 of the Indenture to waive the automatic default arising from the EFIH Debtors' bankruptcy filing and rescind the acceleration of the Notes, that right is not absolute. Section 6.02 of the Indenture, the relevant provision, reads:

> The Holders of at least a majority in aggregate principal amount of the Notes by written notice to the Trustee may on behalf of all the Holders waive any existing Default and its consequences under the Indenture except a continuing Default in the payment of interest on, premium, if any, or the principal of any Note (held by a non consenting Holder) and rescind any acceleration with respect to the Notes and its consequences (*so long as such rescission would not conflict with any judgment of a court of competent jurisdiction*).

(Indenture § 6.02, ¶ 3 (emphasis added).)

64. Thus, the Trustee may not rescind acceleration of the Notes if so doing would "conflict with any judgment of a court of competent jurisdiction." The EFIH Debtors argue that the right to rescind incorporates and is expressly limited by judicial orders, including the automatic stay. *In re Gruntz*, 202 F.3d 1074, 1082 (9th Cir.2000) ("The automatic stay is an injunction issuing from the authority of the bankruptcy court, and bankruptcy court orders are not subject to collateral attack in other courts."); *197 *In re San Angelo Pro Hockey Club, Inc.*, 292 B.R. 118, 124 (Bankr.N.D.Tex.2003) ("The automatic stay is self-executing injunction, and therefore, for contempt purposes, constitutes an order issuing from the bankruptcy court,").

[15]65. The Court disagrees. The automatic stay is not a "judgment of a court of competent jurisdiction." It is prescribed by statute, not by any court, and applies in every bankruptcy case automatically without any court order. *See* 11 U.S.C. § 362(a); *In re James*, 257 B.R. 673, 678 (8th Cir. BAP 2001) ("[T]he stay is a statutory provision and not a court order [.]"); *In re Alberts*, 381 B.R. 171, 176 (Bankr.W.D.Pa.2008) ("The 'automatic stay' is a statutory injunction ... that ... arises without ... court order."). Nor is the automatic stay a "judgment" under New York law, which provides that a judgment is "the determination of the rights of the parties in an action or special proceeding," N.Y. CPLR § 5011, and is appealable as of right.[1] N.Y. CPLR § 5701(a)(1). The fact that a bankruptcy filing gives rise to an automatic stay, by contrast, cannot be appealed.

Thus, the Trustee's right to rescission is not barred by section 6.02 of the Indenture as a result of the imposition of the automatic stay.[2]

ii. The automatic stay bars the Trustee's rescission notice.

[16]67. Second, the automatic stay bars the Trustee's rescission notice of June 4, 2014. Upon filing its voluntary chapter 11 petition, EFIH's assets, including its rights under the Indenture, became subject to the automatic stay. 11 U.S.C. § 362(a). Sending a notice of rescission is an act to "collect, assess or recover" on a claim, especially when the Noteholders have already been paid their full principal and accrued interest. *Id.* § 362(a)(6); *see also Momentive*, 2014 WL 4436335, at *19 ("[T]he automatic stay does, in fact, apply to the sending of a rescission notice."); *AMR Corp.*, 485 B.R. at 294 ("Any deceleration of these notes, however, is barred by the automatic stay imposed by the filing of this bankruptcy."), *aff'd* 730 F.3d 88 (2d Cir.2013); *Solutia*, 379 B.R. at 485 ("[W]here the indenture provides for an automatic acceleration any attempt at deceleration would violate the automatic stay.").

iii. If the Court were to lift the automatic stay the Applicable Premium would be due.

68. Third, if the Court were to lift the automatic stay, *nunc pro tunc* to a date on or before the repayment of the Notes on June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes than EFIH's refinancing would be an Optional Redemption under section 3.07 of the Indenture and the Applicable Premium would be due and owing to the non-settling Noteholders.

69. Had EFIH refinanced the debt on the same day (June 19, 2014), on the same terms, outside of bankruptcy, on which it redeemed the Notes in bankruptcy, it would have owed the Applicable Premium. ***198** The only thing that stands in the way of owing the Applicable Premium is that the bankruptcy caused an automatic default that accelerated the debt. The Trustee, however, had the right to waive that default and decelerate the Notes, which it attempted to do by sending a rescission notice on June 4, 2014. That notice, however, was void *ab initio* as a result of the automatic stay. Were the Court, however, to lift the automatic stay, *nunc pro tunc* to a date on or before June 19, 2014, to allow the Trustee's rescission notice to take effect then the automatic default would be waived, the Notes would no longer be immediately due and the refinancing would require payment of the Applicable Premium.

70. Were the Court, however, either not lift the stay or do so, but not *nunc pro tunc* to a date on or before June 19, 2014, the date the Notes were paid, then the Applicable Premium would not have been owed at the time the Notes were paid in full. At most, the Trustee and the Noteholders would have a damages claim for denial of the rescission right. Whether such a claim exists is discussed below.

iv. A genuine issue of material fact exists as to whether the Trustee can establish cause to lift the automatic stay.

[17]71. Fourth, a genuine issue of material fact exists as to whether the Trustee can establish cause to lift the automatic stay, *nunc pro tunc* to a date on or before June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes, i.e., to give effect to the June 4, 2014 notice.

72. The Stay–Applicability Motion requests a determination that the automatic stay would not bar the Noteholders from rescinding acceleration or, in the alternative, that the stay should be lifted. The Court has already held that the automatic stay applies to the June 4 rescission notice. There is a genuine issue of material fact precluding summary judgment as to whether cause exists to lift the automatic stay.

[18] [19]73. The Bankruptcy Code authorizes bankruptcy courts to grant relief from the stay for "cause." 11 U.S.C. § 362(d)(1). Courts are to determine "cause" based on the totality of the circumstances in each particular case. *In re Wilson*, 116 F.3d 87, 90 (3d Cir.1997). The factors courts generally use in determining whether cause exists are (1) whether any great prejudice to either the bankrupt estate or the debtor will result from a lifting of the stay; (2) whether the hardship to the non-bankrupt party by maintenance of the stay considerably outweighs the hardship to the debtor; and (3) the probability of the creditor prevailing on the merits. *In re Downey Fin. Corp.*, 428 B.R. 595, 609 (Bankr.D.Del.2010).

[20]74. The Trustee argues that, as a matter of law, cause exists to lift the automatic stay because at this stage of the proceedings the EFIH Debtors are presumed to be solvent. The Trustee cites to a number of cases in support of its argument. *See, e.g.*, *Claughton v. Mixson*, 33 F.3d 4 (4th Cir.1994); and *In re Texaco, Inc.*, 81 B.R. 804 (Bankr.S.D.N.Y.1988). These cases do not stand for the proposition that a debtor's solvency is, as a matter of law, cause to lift the automatic stay. While a debtor's solvency may, in certain cases, be a relevant consideration in determining whether cause exists to lift the automatic stay it is not the sole factor to be considered by the Court.

75. The Trustee further argues that lifting the automatic stay would not prejudice either the bankruptcy estate or the debtor because doing so would simply hold the EFIH Debtors to their bargain and ***199** there can be no harm to a solvent estate. The Court disagrees. Several courts have held that lifting the automatic stay to trigger liability under a make-whole claim may harm a debtor or its estate and that analysis does not depend solely on whether that estate is insolvent. *See, e.g.*, *In re AMR Corp.*, 485 B.R. 279, 295 (Bankr.S.D.N.Y.2013); *In re AMR Corp.*, 730 F.3d 88, 112 (2d Cir.2013), and *Momentive*, 2014 WL 4436335, at *23. Moreover, "denial" of the Noteholders' contractual right to rescission does not, in and of itself, establish cause to lift the automatic stay.

76. While the Trustee cannot meet its burden on summary judgment that cause exists to lift the stay, the Court cannot hold on summary judgment, as urged by the EFIH Debtors, that cause does not exist. In short, there is a genuine dispute of material fact as to whether cause exists to lift the automatic stay.

C. The Trustee has no claim for (i) breach of the "no-call" provision of section 3.07(c) of the Indenture; (ii) violation of the "perfect tender" rule under New York law; nor (iii) breach of the right to waive the default and decelerate the Notes.

77. The Trustee asserts claims for various breaches of the Indenture. No such claims exist.

i. Breach of no-call provision

[21]78. The Trustee argues it should be entitled to a claim for damages arising from the Debtors' breach of section 3.07(c) of the Indenture's No–Call Provision. (Compl.¶¶ 74–76.) The Court disagrees.

79. As an initial matter, the Trustee appears to concede that section 3.07(c) is *not* a "no-call" provision prohibiting repayment. (Pl.'s Memo. in Support of Mot. for SJ 66. ("*Pl. Br.*").) The Trustee characterizes 3.07(c) as requiring payment of a make-whole premium if the Notes are repaid (under any circumstances) before December 1, 2015. But Section 3.07(c) provides only that redemptions at the EFIH Debtors' option, as defined by that section, require paying the Applicable Premium.

80. The court in *Momentive* analyzed a nearly identical provision. The indenture there provided: "the Note shall not be redeemable at the option of MPM prior to October 15, 2015," which language, the court found, was "no more than an introduction or framing device for the notes' elective redemption provisions." *Momentive*, 2014 WL 4436335, at *16. The same is true here.

81. Because the Notes were not optionally redeemed, section 3.07(c) does not apply, and the Court finds that the Trustee is not entitled to damages based on a breach of "no-call" theory.

ii. "Perfect Tender" claim

82. The Trustee also asserts that repayment pursuant to section 6.02 of the Indenture breached New York's common-law "perfect tender" rule. (Pl.Br.66–67.) The Court disagrees.

[22]83. Under the perfect tender" rule, "a [borrower] has no right to pay off his obligation prior to its stated maturity date in the absence of a prepayment clause." *Arthur v. Burkich*, 131 A.D.2d 105, 106, 520 N.Y.S.2d 638 (N.Y.1987). The Trustee claims that section 6.10 of the Indenture ("Rights and Remedies Cumulative"), which states that "every right and remedy shall, to the extent permitted by law, be cumulative and in addition to every other right and remedy," requires this Court to find the EFIH Debtors liable for damages under the rule of perfect tender.

[23]84. In a subsequent opinion, the *Momentive* court explained that the perfect tender rule does not apply if, as was *200 the case there, the indenture modified the common-law rule. Bench Ruling Tr. 16:19–17:9, *In re MPM Silicones, LLC, et al.*, 518 B.R. 740 (Bankr.S.D.N.Y.2014) (Dkt. No. 60).) The Court agrees. Section 6.02 of the Indenture makes payment of the Notes automatic and mandatory before the Notes' stated maturity. This provision directly modifies the common-law "perfect tender" rule, and the Trustee therefore is not entitled to damages.

iii. Claim for denial of right of rescission

[24]85. The Trustee also argues that it is entitled to a claim for the denial of the right to rescind acceleration, which constituted a breach of the Indenture giving rise to damages in the amount of the make-whole that the Noteholders would have been entitled to receive if their contractual right to rescind had been honored. The Court disagrees.

86. Oversecured creditors have allowed claims for "reasonable fees, costs, or charges" when those amounts are "provided for under the agreement ... under which such claim arose." *See* 11 U.S.C. § 506(b). The Indenture here does not provide for any fee, cost, or charge for breach of the purported right to rescind. The Trustee merely asserts a vague claim for damages arising out of its inability to decelerate the Notes.

[25]87. As several courts have explained, secured claims are not allowed for breach of contract damages unless those damages are specifically provided for in the Indenture. For example, in *Continental Securities* the lender sought damages for the alleged breach of a no-call provision. *Cont'l Secs. Corp. v. Shenandoah Nursing Home P'ship*, 188 B.R. 205, 215 (W.D.Va.1995),

the note at issue did not provide for a make-whole premium upon post-acceleration repayment, but the lender nonetheless asserted a secured claim for the adverse tax consequences allegedly caused by the prepayment. *In re Vest Assocs.*, 217 B.R. 696, 699 (Bankr.S.D.N.Y.1998). The court denied the claim because the damages sought were not provided for in the loan agreement. *Id.* Here, as in *Continental* and in *Vest*, the damages sought for the asserted breach of the alleged right to rescind are not set forth in the Indenture, and they cannot therefore be allowed as a secured claim.

88. The cases the Trustee cites are inapposite. *See In re Rodriguez*, 629 F.3d 136, 141–42 (3d Cir.2010) (finding that underlying agreement provided for an enforceable state law claim); *In re Chemtura Corp.*, 439 B.R. 561, 603 (Bankr.S.D.N.Y.2010) (noting first the requirement that a claim must be valid under applicable non-bankruptcy law).

H. Counts I–IV of the Complaint

89. Before the Court are cross motions for summary judgment on the Complaint filed by the Trustee. Having addressed the relevant factual and legal issues raised by the parties, the Court now turns to the Complaint.

i. Count I

90. Count I of the Complaint seeks a declaratory judgment that the EFIH Debtors' refinancing of the Notes constitutes a redemption under section 3.07 of the Indenture requiring payment of the Applicable Premium as an allowed secured claim. (Compl.¶¶ 51–57.) The Court has held that where, as here, the Notes were paid following an acceleration under section ***201** 6.02 of the Indenture arising from a default for the commencement of "proceeding to be adjudicated bankrupt or insolvent" under section 6.01(a)(6)(i) of the Indenture, the plain language of the Indenture does not require payment of an Applicable Premium. The Court has also held that if it were to lift the automatic stay, *nunc pro tunc* to a date on or before the repayment of the Notes on June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes than EFIH's refinancing would be an Optional Redemption under section 3.07 of the Indenture and the Applicable Premium would be due and owing to the non-settling Noteholders. As a result, were the Court to grant relief from the automatic stay as outlined above, it could enter judgment in favor of the Trustee on Count I. Thus, the Court will grant summary judgment in favor of the EFIH Debtors on Count I of the Complaint without prejudice to the Court's right to reinstate Count I and enter judgment in favor of the Trustee if, and only if, the Court deems it appropriate upon entry of an order lifting the automatic stay, *nunc pro tunc* to a date on or before the repayment of the Notes on June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes.

ii. Count II

91. Count II of the Complaint seeks a declaratory judgment that the EFIH Debtors' default under the Notes with an intent to deny payment of the Applicable Premium requires payment of the Applicable Premium as an allowed secured claim. (Compl.¶¶ 58–65.) The Court has held that the EFIH Debtors did not file bankruptcy in an intentional effort to default under the Indenture so that the Applicable Premium would not be due. Thus, the Court will enter summary judgment in favor of the EFIH Debtors on Count II of the Complaint.

iii. Count III

92. Count III of the Complaint seeks a declaratory judgment that the EFIH's Debtors' denial of the Noteholders' right to rescind acceleration of the Notes under section 6.02 of the Indenture gives rise to an allowed secured claim. (Compl.¶¶ 66–73.) The Court has held that while the Noteholders have a right of rescission under section 6.02 of the Indenture their attempt to exercise that right was a violation of the automatic stay. As such, there can be no claim for breach of contract arising from operation of the automatic stay. Moreover, secured claims are not allowed for breach of contract damages unless those damages are specifically provided for in the Indenture, which is not the case here. Thus, the Court will enter summary judgment in favor of the EFIH Debtors on Count III of the Complaint

iv. Count IV

of New York's "perfect tender rule" and denial of the right to rescission. (Compl.¶¶ 74–76.) The Court has ruled that the EFIH Debtors' are entitled to summary judgment on Counts I–III (although without prejudice as to Count I) and there is no claim for breach of section 3.07(c) of the Indenture's "no-call" provision, violation of New York's "perfect tender rule" and denial of the right to rescission. The sole avenue for relief in connection with the denial of the right to rescission is to seek relief from the automatic stay, which, if granted, might give rise to a claim under Count I. Thus, the Court will grant summary judgment in favor of the EFIH Debtors on Count IV of the Complaint.

***202 I. The Stay–Applicability Motion**

94. The parties have also sought summary judgment on the Stay–Applicability Motion, which requests a determination that the automatic stay would not bar the Noteholders from rescinding acceleration or, in the alternative, that the stay should be lifted to give effect of the rescission. The Court has held that the right of rescission is not barred by the automatic stay but the issuance of the notice of rescission was a stay violation and void *ab initio*. The Court has further held that if it were to lift the automatic stay, *nunc pro tunc* to a date on or before the repayment of the Notes on June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes than EFIH's refinancing would be an Optional Redemption under section 3.07 of the Indenture and the Applicable Premium would be due and owing to the non-settling Noteholders. In that instance, the Court could reinstate Count I of the Complaint, which is why summary judgment on Count I is being granted in favor of the EFIH Debtors without prejudice. Finally, the Court has held that a genuine issue of material fact exists as to whether the Trustee can establish cause to lift the automatic stay. Thus, the Court will grant summary judgment, in part, in favor of the EFIH Debtors on the Stay–Applicability Motion in that the automatic stay is applicable and the issuance of the notice of rescission was a stay violation. The Court will not grant summary judgment in favor of either party on the Stay–Applicability Motion on the issue of whether the Trustee can establish cause exists to lift the automatic stay.

IV. CONCLUSION

95. For the reasons and to the extent set forth above, the EFIH Debtors' motion for summary judgment is granted, in part, and denied, in part, and the Trustee's motion for summary judgment is denied in its entirety. Summary judgment is entered in favor of the EFIH Debtors on Counts I–IV of the Complaint, provided, however, that entry of summary judgment on Count I of the Complaint is without prejudice, summary judgment is entered, in part, in favor of the EFIH Debtors on the Stay–Applicability Motion, and summary judgment is not entered on the Stay–Applicability Motion solely to the issue of whether cause exists to lift the automatic stay.

96. An order will be issued.

All Citations

527 B.R. 178

Footnotes

1 The Court hereby makes the following findings of fact and conclusions of law pursuant to Fed. R. Bank. P. 7052, which is applicable to this matter by virtue of Fed. R. Bankr. P. 9014. To the extent any findings of fact constitute conclusions of law, they are adopted as such. To the extent any conclusions or law constitute findings of fact, they are adopted as such.

2 Capitalized terms in the Introduction and Procedural History section not otherwise defined in this section are defined below.

(No. 14–00723, D.I. 50 (D.Del. 2015).)

4 References in this opinion to "D.I.," without further description, shall refer to docket entries in this adversary proceeding, No. 14–50363.

5 Deposition transcripts referenced herein are cited as "Deponent Tr. Page:line"

6 *See* Horton Tr. 129:12–135:23, 151:23–152:22, 162:15–24, 176:12–177:15, 181:6–17; Keglevic Tr. 153:3–8, 162:23163:18, 174:22–175:6, 207:13–208:1; Horton Ex. 13 (Oct. 18, 2012 dealer manager agreement) at 0018, 0030 (EFIH representation that it is solvent); Keglevic Ex. 9 (EFIH Dec. 21, 2012 dealer manager agreement) at 9706 (EFIH representation that it is solvent); Horton Ex. 14 (Feb.2013 presentation) at 2554 (referring to a "solvent" EFIH); Horton Ex. 15 (March 2013 presentation) at 5602 (same).

7 No. 14–10979, D.I. 859 (DIP Financing Order) ¶ 12 (directing Trustee to reduce Notes in customary manner following payment).

8 A secured claim is allowable only if, in the first instance, it is "provided for under the agreement ... under which such claim arose." 11 U.S.C. § 506(b); *see id.* § 502(b); *HSBC Bank USA, N.A. v. Calpine Corp.*, No. 07–3088, 2010 WL 3835200, at *5 (S.D.N.Y. Sept. 15, 2010) (citing *Travelers Cas. & Sur. Co. of Am.*, 549 U.S. 443, 450, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007)).

9 Because this Court does not find that an ambiguity exists, it is not necessary to consider the question whether the Indenture need to be construed against the EFIH Debtors. *Wallace v. 600 Partners Co.*, 86 N.Y.2d 543, 634 N.Y.S.2d 669, 658 N.E.2d 715, 717 (1995) ("The rules governing the construction of ambiguous contracts are not triggered unless the court first finds an ambiguity.").

10 The Trustee cites to *NML Capital v. Republic of Argentina*, 17 N.Y.3d 250, 928 N.Y.S.2d 666, 952 N.E.2d 482, 492 (2011) for the proposition that absent specific language indicating that the parties intended for 3.07(c) to terminate upon acceleration, section 3.07(c) still applies after acceleration. This is not the law. In *NML Capital*, the Second Circuit stated that Argentina had not pointed to any language indicating that the biannual interest payment terminated upon acceleration of the debt. *Id.* at 263. It did not state that there must be specific language indicating that the parties intended for a provision to terminate upon acceleration.

11 *See also* Fed. R. Civ. P. 54(a) ("Definition; Form. 'Judgment' as used in these rules includes a decree and any order from which an appeal lies."); Black's Law Dictionary 970 (10th ed.2014) ('judgment" means "[a] court's final determination of the rights and obligations of the parties in a case. The term judgment includes an equitable decree and any order from which an appeal lies.").

12 Moreover, even were the automatic stay a judgment under section 6.02 of the Indenture, the automatic stay can always be lifted. In that case, rescission would no longer conflict with a judgment of the Court because the stay/judgment would simply cease to exist.

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In re Energy Future Holdings Corp., 527 B.R. 178 (2015)

2. *In re Energy Future Holdings Corp.*, 539 B.R. 723 (Bankr.D.Del. 2015)

In re Energy Future Holdings Corp., 539 B.R. 723 (2015)
61 Bankr.Ct.Dec. 200

KeyCite Red Flag - Severe Negative Treatment
Reversed and Remanded by In re Energy Future Holdings Corp., 3rd Cir.(Del.), November 17, 2016

539 B.R. 723
United States Bankruptcy Court,
D. Delaware.

In re Energy Future Holdings Corp., et al., Debtors.
Computershare Trust Company, N.A. and Computershare Trust Company of Canada, as Indenture Trustee, Plaintiff,
v.
Energy Future Intermediate Holding Company LLC and EFIH Finance Inc., Defendants.

Bankruptcy Case No. 14–10979 (CSS) (Jointly Administered)
|
Adversary Proceeding No. 14–50405 (CSS)
|
Signed October 28, 2015
|
As Amended October 29, 2015

Synopsis
Background: Trustee for second lien noteholders sought determination that, due to debtor's partial payment of notes that had been accelerated due to its bankruptcy filing, noteholders' right to make-whole or prepayment premium had been triggered. Parties cross-moved for summary judgment.

[Holding:] The Bankruptcy Court, Christopher S. Sontchi, J., held that, under New York law, trust indenture did not clearly and explicitly require payment of applicable prepayment premium upon partial payment of notes which had been accelerated due to issuer's bankruptcy filing.

Debtor's motion granted; trustee's motion denied.

West Headnotes (10)

[1] Contracts
Language of contract

to determine what the parties intended.

Cases that cite this headnote

[2] **Contracts**
Existence of ambiguity

Under New York law, contract is not ambiguous merely because the parties offer different constructions of same term.

Cases that cite this headnote

[3] **Contracts**
Language of contract

Under New York law, best evidence of what parties to written agreement intend is what they say in their writing.

Cases that cite this headnote

[4] **Contracts**
General and specific words and clauses

Under New York law, to extent that there is inconsistency between a specific and general provision of contract, the specific controls.

1 Cases that cite this headnote

[5] **Contracts**
Construction as a whole

Under New York law, court's reading of contract should not render any portion meaningless.

Cases that cite this headnote

[6] **Damages**
Express declaration as to nature of provision

Under New York law, language in loan agreement requiring a make-whole or prepayment premium generally should not be interpreted as entitling lender to prepayment consideration following borrower's default, unless loan agreement expressly so requires.

[7] **Damages**
Express declaration as to nature of provision

Under New York law, while language in loan agreement requiring a make-whole or prepayment premium generally should not be interpreted as entitling lender to prepayment consideration following borrower's default, parties may agree that even after default and acceleration, or when borrower's prepayment is otherwise involuntary, an amount equivalent to prepayment consideration may nevertheless be due; however, parties' agreement must be express and must define the parameters of borrower's obligation to pay a make-whole or prepayment premium in event of default and/or acceleration.

1 Cases that cite this headnote

[8] **Damages**
Construction of Stipulations

Under New York law, if loan agreement explicitly requires payment of make-whole or prepayment premium even after borrower's default and/or acceleration of loan, then court will review contract's terms to determine whether the amount due is unenforceable penalty.

Cases that cite this headnote

[9] **Damages**
Certainty as to Amount of Actual Damage
Damages
Proportion of Sum Stipulated to Actual Debt or Damage

Under New York law, prepayment premium is enforceable when: (1) actual damages may be difficult to determine, and (2) the sum stipulated is not plainly disproportionate to the possible loss.

Cases that cite this headnote

[10] **Damages**
Express declaration as to nature of provision

Under New York law, trust indenture did not require payment of applicable prepayment filing, where trust indenture, by its terms, did not clearly and expressly require payment of such a premium except upon optional redemption of notes prior to maturity, and further specified that notes would be accelerated automatically in event that issuer filed for bankruptcy with no indication that such acceleration would trigger issuer's obligation for prepayment premium; while provision of trust indenture dealing with default specified that, in the event thereof, all principal and premium, if any, interest would be immediately due and payable, this was not sufficiently clear to require payment of prepayment premium upon partial payment of notes that had been accelerated and could no longer be prepaid.

1 Cases that cite this headnote

Attorneys and Law Firms

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MEMORANDUM OPINION[1]

Christopher S. Sontchi, United States Bankruptcy Court

Computershare Trust Company N.A. and Computershare Trust Company of Canada are the indenture trustee (together, the "Second Lien Trustee") for the 11% Senior Secured Second Lien Notes due 2021 and 11.75% Senior Secured Second Lien Notes due 2022.[2] Pursuant to the Indenture dated April 25, 2011 and the ***725** First Supplemental Indenture dated February 6, 2012,[3] Energy Future Intermediate Holding Company LLC and EFIH Finance Inc. (together, "EFIH") issued $406,392,000 of 2021 Second Lien Notes and $1.750 billion of 2022 Second Lien Notes. Pursuant to the Second Lien Indenture and the Bankruptcy Code, the Second Lien Trustee timely filed Proofs of Claim No. 7486 and 7487.

On April 29, 2014,[4] Energy Future Holdings Corp. and a number of its affiliates and subsidiaries, including EFIH,[5] filed for bankruptcy in the District of Delaware. Nine months after filing, EFIH sought Court approval to use its remaining DIP financing to pay $750 million of principal and accrued interest under the Second Lien Notes.[6] The Court approved the Partial Paydown, and the Second Lien Notes were partially paid on March 11, 2015. Through the Amended Complaint, the Second Lien Trustee asserts a claim on behalf of the holders of the Second Lien Notes against EFIH for EFIH's failure to pay the "Applicable Premium," which the Second Lien Trustee claims became due when EFIH made the Partial Paydown. The Second Lien Trustee also seeks a number of declarations; in particular, the Second Lien Trustee asks the Court to rule that any future paydown of the Second Lien Notes prior to their Call Dates will give rise to a secured claim for the Applicable Premium.

BACKGROUND

The Debtors filed for bankruptcy on the Petition Date, citing both liquidity concerns and a need to restructure their ongoing operations. EFIH is a subsidiary holding company of the lead debtor, Energy Future Holdings Corp. EFIH's primary asset is its equity interests in Oncor Electric Delivery Holdings Company, LLC,[7] which, through its subsidiaries, operates the largest electrical distribution and transmission system in Texas. The equity in Oncor is also the sole source of collateral for the Second Lien Notes.

Before filing, EFIH had already sought and begun negotiations with a DIP lender and sought approval for DIP financing in its

First Lien Trustee filed an objection to the DIP Motion and on May 14, 2015, filed an adversary proceeding in this Court. The First Lien Trustee argued, in part, that "(i) an Optional Redemption would occur when the Notes were repaid, (ii) the EFIH intentionally defaulted by filing bankruptcy in order to avoid paying the Applicable Premium and (iii) the repayment would be a breach of the Noteholders' right to rescind the Notes' acceleration."[9] On June 16, 2014, the Second Lien Trustee filed this adversary action, seeking declaratory judgment on the same issues in regards to the Second Lien Notes. After the parties entered into certain agreements preserving their rights for judicial relief, the Court approved both the DIP Motion and the paydown of the First Lien Notes.

***726** EFIH later decided not to pursue a second round of DIP Financing. Instead, EFIH filed a motion on February 12, 2015, requesting the Court's approval to use a substantial portion of the remaining DIP financing to pay down the Second Lien Notes. The Second Lien Trustee timely objected and, after the parties agreed to certain reservations of rights and remedies, the Court approved the Partial Paydown on March 10, 2015. On April 13, 2015, the Second Lien Trustee filed its Amended Complaint in this adversary proceeding. On July 17, 2015, EFIH filed a motion seeking summary judgment on Counts I–VII and IX–X of the Amended Complaint. On August 13, 2015, the Second Lien Trustee filed its opposition to EFIH's motion and a cross-motion seeking summary judgment on Counts I–VII, IX–X and XII of the Amended Complaint.

THE FIRST LIEN MAKE–WHOLE PROCEEDINGS

Meanwhile, the First Lien Trustee's adversary action against EFIH proceeded at full steam. EFIH and the First Lien Trustee filed cross-motions for summary judgment on February 13, 2015. After a hearing on March 16, 2015—and review of the First Lien Indenture and governing law—the Court issued its findings of fact and conclusions of law on March 26, 2015 and denied the First Lien Trustee's motion for summary judgment while granting, in part, EFIH's cross-motion for summary judgment.[10]

In so doing, the Court found that (i) EFIH's bankruptcy filing was not an intentional default under the First Lien Indenture, (ii) EFIH's bankruptcy filing caused an automatic acceleration of its Obligations under the First Lien Indenture and (iii) under the plain language of the First Lien Indenture, EFIH's repayment of the First Lien Notes did not meet the conditions necessary for an Applicable Premium to become due.[11] The Court further held that the First Lien Trustee's attempt to waive EFIH's default and rescind the acceleration of the First Lien Notes would violate the automatic stay.[12] After additional briefing and a hearing, the Court found that cause did not exist to lift the automatic stay *nunc pro tunc* to allow the First Lien Trustee to waive EFIH's default and decelerate the First Lien Notes.[13]

Except as noted below, the relevant provisions of the Second Lien Indenture and the First Lien Indenture are substantially identical. Under New York law, if a document or writing is complete, the Court need not look "outside the four corners" of the document in determining the parties' intent.[14] The Court therefore incorporates its prior interpretation of the First Lien Indenture[15] to the Second Lien Indenture under examination here, except as to § 6.02 of the Indenture, in which the Second Lien Trustee has identified a textual difference between the First Lien Indenture and the Second Lien Indenture.

*727 DISCUSSION

A. Standard for Summary Judgment

Federal Rule of Civil Procedure 56 is made applicable to these adversary proceedings by Federal Rule of Bankruptcy Procedure 7056 and directs that summary judgment should be rendered if the pleadings, the discovery and disclosure materials on file, and any affidavits "show that there is no genuine issue as to any material fact and the movant is entitled to judgment as a matter of law."[16] Summary judgment is designed "to avoid trial or extensive discovery if facts are settled and the dispute turns on an issue of law."[17]

Neither party before the Court has raised a genuine dispute of a material fact or expressed a need for more discovery. The questions before the Court are purely legal in nature. Summary judgment is therefore appropriate at this stage.[18]

B. Contract Interpretation Under New York Law

[1] [2]Under New York law, which governs the Second Lien Indenture,[19] the Court need not look "outside the four corners" of a complete document to determine what the parties intended.[20] Here, neither party has alleged that the Second Lien Indenture is an incomplete document, so it is not necessary to resort to extrinsic evidence to interpret it. Moreover, neither party contends that any term in the Second Lien Indenture is ambiguous—instead, each party relies on its own "plain reading" in reaching competing results. A contract is not ambiguous merely because the parties offer different constructions of the same term.[21] The

[3] [4] [5]Having reached the conclusion that the Second Lien Indenture is unambiguous, the Court relies on long-recognized canons of interpretation to determine its meaning. First, "[t]he best evidence of what parties to a written agreement intend is what they say in their writing."[22] Second, should there be an inconsistency between a specific and general provision of a contract, the specific controls.[23] Third, "[a] reading of the contract should not render any portion meaningless."[24]

*728 C. The Parties' Positions

The Second Lien Trustee argues that the inclusion of the phrase "premium, if any," in § 6.02 of the Second Lien Indenture can only be interpreted as requiring the payment of a make-whole premium upon acceleration. Because this phrase was not in § 6.02 of the First Lien Indenture, the Second Lien Trustee argues, the Court's interpretation of the First Lien Indenture is not applicable here.

In response, EFIH argues that the "premium, if any" language cannot reasonably be read as requiring a make-whole upon acceleration. EFIH further asserts that even if this were a reasonable interpretation, New York law and precedent both require a provision providing for a make-whole payment be in express, specific language and that the phrase "premium, if any" cannot be considered express and specific enough to meet this burden.

D. Make–Whole and Prepayment Premiums

[6] [7] [8] [9]As a general rule regarding make-whole or prepayment premiums, "a lender is not entitled to prepayment consideration after a default unless the parties' agreement expressly requires it. This is because prepayment provisions generally address the consideration to be paid when the borrower voluntarily prepays the debt, but after a default the borrower's repayment is neither voluntary nor in the nature of a prepayment."[25] However, parties may agree that "even after default and acceleration, or where the borrower's prepayment is otherwise involuntary, an amount that is equivalent to prepayment consideration may nevertheless be due."[26] However, the parties' agreement *must* be express and the terms of their agreement *must* define the parameters of the borrower's obligation to make a make-whole or prepayment premium in the event of default and/or acceleration.[27] If the language is explicit,

> [c]ourts review prepayment consideration terms that are triggered by default and acceleration under the standards applicable to liquidated damages. That is, courts consider whether the amount due is an unenforceable penalty.[28]

***729** As the Second Circuit has explained, a prepayment premium is enforceable "where (1) actual damages may be difficult to determine and (2) the sum stipulated is not 'plainly disproportionate' to the possible loss."[29]

E. The Applicable Premium is Not Due Under the Terms of the Second Lien Indenture.

[10]Pursuant to the terms of the Second Lien Indenture, the Court must determine whether an Applicable Premium is due. As the Second Lien Notes were automatically accelerated as a result of the Debtors' bankruptcy filings, the Partial Payment of the Second Lien Notes was not an optional redemption nor will any future payment be an optional redemption. As this Court stated in relation to the First Lien Notes, which is also applicable herein:

> When the EFIH Debtors filed for bankruptcy, the Notes automatically accelerated and became due and payable immediately. Under New York law, a borrower's repayment after acceleration is not considered voluntary. This is because acceleration moves the maturity date from the original maturity date to the acceleration date and that date becomes the new maturity date. Prepayment can only occur prior to the maturity date, and acceleration, by definition, advances the maturity date of the debt so that payment thereafter is not prepayment but instead is payment made after maturity. Once the maturity date is accelerated to the present, it is no longer possible to prepay the debt before maturity. Acceleration therefore does not trigger the Trustee's right to prepayment consideration under the Optional Redemption provision. Thus, the Trustee's claim that the EFIH Debtors' repayment was an optional redemption must fail.[30]

There is nothing in the Second Lien Indenture that would lead the Court to a different conclusion. The Partial Paydown was not "optional" as the Second Lien Notes were accelerated under the terms of section 6.02 of the Second Lien Indenture. According to the terms of the Second Lien Indenture, the Applicable Premium is not due. Thus, even if the Court found that the language "if any" (as discussed *infra*) refers back to sections 3.07(a) and 3.07(d) of the Second Lien Indenture, there would be no premium due pursuant to the terms of the Second Lien Indenture.[31]

Second Lien Trustee asserts that language in the acceleration provision provides for payment of a make-whole premium (in addition to principal, interest, etc.) upon automatic acceleration. The Second Lien Trustee asserts that the acceleration clause language in the Second Lien Indenture differs from the First Lien Indenture—and these additional 9 words create the obligation to pay the make-whole upon acceleration. As compared to the acceleration clause in the First Lien Indenture, the Second Lien Indenture states, in part (differing language is bolded):

> [I]n the case of an Event of Default arising under clause (6) or (7) of Section 6.01(a) hereof, all principal of *and premium, if any,* interest (including Additional Interest, if any) *and any other monetary obligations* on the outstanding Notes shall be due and payable immediately without further action or notice.[32]

Thus, the Court must determine whether these additional 9 words create the obligation to pay a make-whole premium after acceleration.

The Bankruptcy Court for the Southern District of New York examined virtually identical language in *Momentive*.[33] The language in the *Momentive's* indenture was as follows: " 'If an Event of Default specified in Section 6.01(f) or (g) with respect to MPM [which includes the debtors' bankruptcy] occurs, the principal of, premium, if any, and interest on all the Notes shall ipso facto become and be immediately due and payable without any declaration or other act on the part of the Trustee or any Holders.' "[34] In *Momentive*, Judge Drain held:

> [I]t is "well-settled law," that, unless the parties have clearly and specifically provided for payment of a make-whole (in this case the Applicable Premium), notwithstanding the acceleration or advancement of the original maturity date of the notes, a make-whole will not be owed. Such language is lacking in the relevant sections of the first and 1.5 lien indentures and notes; therefore, they do not create a claim for Applicable Premium following the automatic acceleration of the debt pursuant to Section 6.02 of the indentures.[35]

Thus, the *Momentive* court held that the "premium, if any" to be paid upon prepayment was not specific enough to meet the specificity requirement of New York law in order for the make-whole or prepayment claim to be payable post-acceleration.[36] Judge Drain continued to state that even if the "if any" language referred back to the actual provisions of the indenture that provides for a specific premium, those premium provisions do not sufficiently provide for payment after acceleration under New York law.[37]

The *Momentive* court stated that there are only two ways to receive a make-whole upon acceleration under New York law: (i) explicit recognition that the make-whole would be payable notwithstanding the acceleration, or (ii) a provision that requires *731 the borrower to pay a make-whole whenever debt is repaid prior to the *original* maturity.[38] As discussed *infra*, the relevant language in this case is identical to that in *Momentive* and does not explicitly provide for payment of the premiums notwithstanding acceleration nor does it provide for payment of the make-whole any time prior to the original due date.

The District Court for the Southern District of New York affirmed the bankruptcy court's holding in *Momentive* holding that the language "premium, if any" was not sufficient to create an "unambiguous right to a make-whole payment."[39] This Court fully endorses and adopts the holding in the *Momentive* cases.

The Second Lien Trustee attempts to distinguish *Momentive* because Judge Drain likened "if any" to other belt-and-suspenders catch-all provisions in other New York cases, where the role of "catch-all" in the Second Lien Indenture is played by the "and any other monetary obligations" provision – thus, according to the Second Lien Trustee, the phrase "premium, if any" in this case refers to the applicability of the call premium for payments made after the maturity date. This distinction fails for several reasons: (i) the Second Lien Indenture is not specific or explicit about the payment of any premium upon automatic acceleration; and (ii) "if any" means that the premium may not be due at all.

The Second Lien Trustee also advances the argument that "premium, if any" must be "specific" because the Second Lien Indenture would not contain two "catch all" provisions. However, legal documents such as the Second Lien Indenture often contain redundant language and "mere redundancy of words is not so unusual as to justify the court in giving an interpretation to the contract which its words do not import."[40]

In another example similar to *Momentive*, in *In re Solutia Inc.*, the bankruptcy court found the language of "premium, if any" insufficient and lacking in "explicitness that would be expected in a typical post-acceleration yield-maintenance clause."[41] Similarly, in *In re AMR Corp.*, the bankruptcy court held that it "reads 'if any' to mean that payment of the Make–Whole Amount is not automatic and there are some circumstances under which a Make–Whole Amount will not be payable."[42]

These cases should be compared to *Northwestern Mutual* and *United Merchants*, wherein the courts held that the contractual language was explicit. In *Northwestern Mutual Life Ins. Co. v. Uniondale Realty Associates*, the court reviewed the following language in the loan agreement (referred to below as the "Note"):

"Borrower shall have the right, upon thirty (30) days advance written notice, beginning December 15, 2003 of paying this

> prepayment. In the event of a prepayment of this note following (i) the occurrence of an Event of Default ... followed by the acceleration of the whole indebtedness evidenced by this note ... such prepayment will constitute an evasion of the prepayment terms ... and be deemed to be a voluntary prepayment ... and such payment will, therefore,... include the prepayment fee required under the prepayment in full privilege recited above ..."[43]

The *Northwestern Mutual* court held: "When a clear and unambiguous clause which calls for payment of the prepayment premium or a sum equal thereto, at any time after default and acceleration is included in the loan agreement, such clause is analyzed as liquidated damages and is generally enforceable."[44] The *Northwestern Mutual* court found that the critical language in the subject clause is "in the event of prepayment" and "evasion."[45] The *Northwestern Mutual* court held:

> the subject clause eliminates the need to prove that prepayment after acceleration is an intentional avoidance of the premium, as prepayment after acceleration is "deemed" voluntary and an avoidance. *The clause does not, however, contain language indicating prepayment application in foreclosure, redemption or any other payment.* If the word "prepayment" in the subject clause was intended to include "redemption" in the context of foreclosure, it would be expressly included, as was done in the aforementioned examples.[46]

Thus, the court ultimately found that the prepayment premium was only relevant after an attempt at prepayment after a default and acceleration but prior to commencement of a foreclosure action; thus in *Northwestern Mutual,* as it was a foreclosure action, the prepayment premium was not recoverable.[47] Thus, even though the language in *Northwestern Mutual* was more specific than the Second Lien Indenture language, the *Northwestern Mutual* court ultimately held that the language lack specificity in a foreclosure context and, therefore, did not allow the premium.

Similarly, in *In re United Merchants and Manufacturers, Inc.,* the default provision in the note at issue stated:

> then, at the option of the holder of any Note, exercised by written notice to (UM & M), the principal of such Note shall forthwith become due and payable, together with the interest accrued thereon, and, to the extent permitted by law, an *amount equal to the pre-payment charge that would be payable if (UM & M) were pre-paying such Note at the time pursuant to P 8.2 hereof.*[48]

The Second Circuit held that this liquidated damages provision in the agreement was valid under New York law as it was a loan agreement between sophisticated parties for a large sum of money and the amount stipulated was "not plainly disproportionate to the possible loss."[49] Again, however, as distinguished from this case, the contractual language was specific regarding the amount of the pre-payment ***733** charge and specifically referring to the calculation thereof in the note. Here, the Second Lien Indenture states "premium, if any" without any additional language referring to the amount of such premium or what type of premium being sought.

The Second Lien Indenture does not provide specifically for a payment of a premium upon acceleration, nor does it refer back to specific sections of the Second Lien Indenture. As such, and for the reasons set forth in *Momentive,* the Court finds that the Second Lien Indenture's acceleration clause is unambiguous, insufficient and lacking in explicitness regarding whether a make-whole premium is due upon an event of default. Thus, after acceleration, the Second Lien Trustee does not have a valid claim for the Applicable Premium.

G. Conclusion

For the reasons set forth above the Court will grant summary judgment for EFIH on Counts I–IV and IX–X of the Amended Complaint. Counts V–VII of the Amended Complaint are identical in form and substance to claims brought by the First Lien Trustee on which the Court found summary judgment for EFIH.[50] Because the Second Lien Trustee has failed to raise any material disputes of fact that would differentiate its claims from the First Lien Trustee's claims, the Court hereby incorporates and applies its previous ruling[51] and will grant summary judgment in favor of EFIH on Counts V–VII of the Amended Complaint. The question of the Trustee's fees and expenses and "interest on interest" were not the subject of EFIH's motion and therefore Counts VIII, XI and XII of the Amended Complaint survive summary judgment. The Court will deny the Second Lien Trustee's motion for summary judgment in its entirety.

An order will be issued.

All Citations

539 B.R. 723, 61 Bankr.Ct.Dec. 200

In re Energy Future Holdings Corp., 539 B.R. 723 (2015)
61 Bankr.Ct.Dec. 200

Footnotes

1 This Memorandum Opinion constitutes the Court's findings of fact and conclusions of law pursuant to Fed. R. Bank. P. 7052. The Court has subject matter jurisdiction over this contested matter pursuant to 28 U.S.C. § 157 and 1334. This is a core proceeding pursuant to 11 U.S.C. 157(b)(2). Venue is proper pursuant to 28 U.S.C. § 1408 and 1409. This Court has the judicial power to enter a final order.

2 Respectively, the "2021 Notes" and "2022 Notes." Together, the "Second Lien Notes."

3 Together and with all supplements, amendments, and exhibits, the "Second Lien Indenture."

4 The "Petition Date."

5 Collectively, the "Debtors."

6 The "Partial Paydown."

7 Together, with its direct and indirect subsidiaries, "Oncor."

8 The "DIP Motion."

9 *Delaware Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 527 B.R. 178, 182 (Bankr.D.Del.2015) ("*EFH I* ").

10 *Id.* at 202.

11 *Id.* at 183–84.

12 *Id.*

13 *Delaware Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 533 B.R. 106, 110–11 (Bankr.D.Del.2015) ("*EFH II* ").

14 *W.W.W. Assoc., Inc. v. Giancontieri*, 77 N.Y.2d 157, 565 N.Y.S.2d 440, 566 N.E.2d 639, 642 (1990); *see also R/S Assocs. v. N.Y. Job Dev. Auth.*, 98 N.Y.2d 29, 744 N.Y.S.2d 358, 771 N.E.2d 240, 242 (2002) (applying same principle).

15 *EFH I* at 186–87.

16 Fed. R. Civ. P. 56(a); *see also In re Delta Mills, Inc.*, 404 B.R. 95, 103 (Bankr.D.Del.2009).

17 *Delta Mills*, 404 B.R. at 104.

18 *Niagara Frontier Transit Metro Sys., Inc. v. Cnty. of Erie*, 212 A.D.2d 1027, 623 N.Y.S.2d 33 (1995) ("Where the contract is unambiguous on its face, it should be construed as a matter of law and summary judgment is appropriate.")); *Green Mach. Corp. v. Zurich Am. Ins. Grp.*, No. CIV. A. 99–3048, 2001 WL 1003217, at *6 (E.D.Pa. Aug. 24, 2001) ("Whether a contract provision is ambiguous is a question of law for the court."), *aff'd sub nom. Green Mach. Corp. v. Zurich–Am. Ins. Grp.*, 313 F.3d 837 (3d Cir.2002).

19 Second Lien Indenture at § 13.08 "Governing Law," attached as Exhibit A to the Amended Complaint.

20 *W.W.W. Assoc.*, 565 N.Y.S.2d 440, 566 N.E.2d at 642.

21 *Sayers v. Rochester Tel. Corp. Supp. Mgmt. Pension Plan*, 7 F.3d 1091, 1095 (2d Cir.1993).

23 Muzak Corp. v. Hotel Taft Corp., 1 N.Y.2d 42, 150 N.Y.S.2d 171, 133 N.E.2d 688, 690 (1956); Waldman v. New Phone Dimensions, Inc., 109 A.D.2d 702, 487 N.Y.S.2d 29, 31 (N.Y.App.Div.1985).

24 See Beal Sav. Bank v. Sommer, 8 N.Y.3d 318, 834 N.Y.S.2d 44, 865 N.E.2d 1210, 1213 (2007) (quotation marks and citations omitted); Barrow v. Lawrence United Corp., 146 A.D.2d 15, 538 N.Y.S.2d 363, 365 (N.Y.App.Div.1989) ("Contracts are also to be interpreted to avoid inconsistencies and to give meaning to all of its terms.").

25 In re S. Side House, LLC, 451 B.R. 248, 268 (Bankr.E.D.N.Y.2011) *aff'd sub nom.* U.S. Bank Nat. Ass'n v. S. Side House, LLC, No. 11–CV–4135 ARR, 2012 WL 273119 (E.D.N.Y. Jan. 30, 2012) (citations omitted). *See also* Energy Future Holdings Corp., 527 B.R. at 192 ("Under New York law, an indenture must contain express language requiring payment of a prepayment premium upon acceleration; otherwise, it is not owed."); and MSCI 2007–IQ16 Retail 9654, LLC v. Dragul, No. 1:14–CV–287, 2015 WL 1468435, at *3 (S.D.Ohio Mar. 30, 2015) ("Upon default and the acceleration of the loan, the maturity date advances and any subsequent payment is no longer considered a voluntary prepayment. The lender forfeits the collection of a prepayment premium in such a scenario unless the parties' agreement contains a 'clear and unambiguous' clause requiring payment of the prepayment premium upon default and acceleration. This general rule created the problem that a borrower might actually intentionally default to acquire the right to prepay without penalty, so lenders began including provisions in loan documents to ensure the prepayment penalty would be enforceable after default.") (citations omitted)).

26 S. Side House, 451 B.R. at 269 (citations omitted).

27 Id. at 270.

28 Id. (holding mortgage lender's claim for a post-default, post-acceleration prepayment premium, pursuant to "escape" clause in mortgage documents that prohibited debtor from evading prepayment fee by tendering full amount of debt post-foreclosure, had to be disallowed; because the debtor, in proposing to pay mortgage debt over time in plan of reorganization, was not tendering full amount of debt, and was not attempting to prepay this accelerated debt.).

29 United Merchants and Mfrs., Inc. v. Equitable Life Assurance Society of the U.S. (In re United Merchants & Mfrs., Inc.), 674 F.2d 134, 142 (2d Cir.1982).

30 EFH I at 195 (citations and quotations marks omitted).

31 See In re MPM Silicones, LLC, No. 14–22503–RDD, 2014 WL 4436335, at *3 (Bankr.S.D.N.Y. Sept. 9, 2014) *aff'd*, 531 B.R. 321 (S.D.N.Y.2015) (hereinafter, "*Momentive*").

At oral argument, the Second Lien Trustee presented an argument that appears to differ subtly but significantly from its primary argument in the briefing. Rather than assert that § 6.02 causes the make-whole premium to become due upon acceleration, the Second Lien Trustee appears to be rehashing the primary argument made by the First Lien Lenders in their attempt to receive a make-whole premium: namely, that even though § 6.02 accelerated the First Lien Notes, the Partial Paydown still constituted a "redemption" under § 3.07. The Second Lien Trustee argues that the change of language in § 6.02, namely the presence of the phrase "premium, if any," makes this argument more credible than it was when the Court considered and rejected it during the First Lien proceedings.

The Second Lien Trustee's assertion is incorrect. As EFIH's counsel summarized, it appears the Second Lien Trustee is asking the Court to embrace a new principle of law: that "unless acceleration clearly extinguishes the prepayment provision, that provision continues in full force post-acceleration." As the Court found in the previous preceding, however, the plain language of § 3.07 is that only prepayment creates an obligation in EFIH to pay an "Applicable Premium." Because § 6.02 accelerated the Second Lien Notes when EFIH declared bankruptcy, therefore, the Partial Paydown did not constitute a prepayment.

32 Second Lien Indenture § 6.02 (emphasis added).

33 2014 WL 4436335, *supra*.

34 Id. at *13.

35 Id. at *14 (citations omitted).

36 Id. at *15.

37 Id.

38 Id.

39 U.S Bank N.A. v. Wilmington Savings Fund Society (In re MPM Silicones, LLC), 531 B.R. 321, 336 (S.D.N.Y.2015).

40 Casler v. Connecticut Mut. Life Ins. Co., 22 N.Y. 427, 432 (1860).

42 U.S. Bank Trust N.A. v. American Airlines, Inc. (In re AMR Corp.), 485 B.R. 279, 303 (Bankr.S.D.N.Y.) *aff'd*, 730 F.3d 88 (2d Cir.2013) *cert. denied sub nom.* U.S. Bank Trust Nat. Ass'n v. AMR Corp., — U.S. —, 134 S.Ct. 1888, 188 L.Ed.2d 913 (2014).

43 Nw. Mut. Life Ins. Co. v. Uniondale Realty Associates, 11 Misc.3d 980, 816 N.Y.S.2d 831, 833–34 (Sup.Ct.2006) (*quoting* the Note at issue in the case; emphasis supplied in Note).

44 *Id.* at 836 (citations omitted).

45 *Id.* at 839.

46 *Id.* (emphasis added).

47 *Id.* at 839–40.

48 *United Merchants and Mfrs.* 674 F.2d at 140 (emphasis added; footnote and citations omitted).

49 *Id.* at 143 (internal quotation marked omitted).

50 *EFH I* at 196–200.

51 *Id.*

In re Energy Future Holdings Corp., 539 B.R. 723 (2015)
61 Bankr.Ct.Dec. 200

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In re Energy Future Holdings Corp., 539 B.R. 723 (2015)
61 Bankr.Ct.Dec. 200

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3. *In re Energy Future Holdings Corp.*,
842 F.3d 247 (3rd Cir. 2016)

In re Energy Future Holdings Corp., 842 F.3d 247 (2016)
63 Bankr.Ct.Dec. 95

842 F.3d 247
United States Court of Appeals,
Third Circuit.

IN RE: ENERGY FUTURE HOLDINGS CORP., a/k/a TXU Corp. a/k/a TXU Corp a/k/a/ Texas Utilities, et al., Debtors
Delaware Trust Company, f/k/a CSC Trust Company of Delaware, as Indenture Trustee, Appellant
v.
Energy Future Intermediate Holding Company LLC; EFIH Finance Inc.; Ad Hoc Committee of EFIH Unsecured Noteholders
In re: Energy Future Holdings Corp., a/k/a TXU Corp. a/k/a TXU Corp a/k/a Texas Utilities, et al., Debtors
Computer Trust Company, NA & Computershare Trust Company of Canada, Appellants
v.
Energy Future Intermediate Holding Company LLC; EFIH Finance Inc.
No. 16-1351
|
Nos. 16-1926, 16-1927 & 16-1928
|
Argued September 27, 2016
|
(Opinion filed November 17, 2016)

Synopsis

Background: Indenture trustee objected to motion by Chapter 11 debtor for leave to obtain debtor-in-possession financing to pay off notes that had been accelerated upon its bankruptcy filing, on ground that noteholders were entitled to early redemption premium. The United States Bankruptcy Court for the District of Delaware, Christopher S. Sontchi, J., 527 B.R. 178, concluded that noteholders were not entitled to premium, and later denied motion for relief from stay to decelerate notes, 533 B.R. 106, and reached same conclusion with regard to second lien noteholders' right to early redemption premium, 539 B.R. 723. Indenture trustee appealed, and the District Court, Richard G. Andrews, J., 2016 WL 1451045 and 2016 WL 627343, affirmed. Indenture trustee appealed.

Holdings: The Court of Appeals, Ambro, Circuit Judge, held that:

[1] "redemption," of kind required to trigger debtor-borrower's obligation for early redemption premium, could include both pre- and post-maturity repayments of note;

[2] debtor-borrower's redemption of notes that had been accelerated automatically as result of its bankruptcy filing, over objection of noteholders that did not want to be repaid early, but that had been blocked by automatic stay from decelerating the notes, had to be regarded as "voluntary";

[3] redemption, coming before date specified in parties' agreement, triggered debtor's obligation for early redemption premium;

[4] mere fact that promissory notes had been automatically accelerated as result of debtor-borrower's Chapter 11 filing, pursuant to one provision of trust indenture, did not render another provision requiring payment of early redemption premium inapplicable.

Reversed and remanded.

West Headnotes (20)

[1] **Bankruptcy**
Conclusions of law; de novo review

Bankruptcy court's determinations on questions of statutory construction and contract interpretation are legal determinations reviewable de novo.

Cases that cite this headnote

[2] **Federal Courts**
Highest court
Federal Courts
Anticipating or predicting state decision

When interpreting state law, federal court must follow the state's highest court, and if state's highest court has not provided guidance, federal court is charged with predicting how that court would resolve the issue.

2 Cases that cite this headnote

[3] **Federal Courts**
Highest court
Federal Courts
Inferior courts
Federal Courts
Sources of authority; assumptions permissible

To predict how state's highest court would resolve an unsettled question of state law, federal court must take into consideration: (1) what that court has said in related areas; (2) the decisional law of state's intermediate courts; (3) federal cases interpreting state law; and (4) decisions from other jurisdictions that have discussed the issue.

2 Cases that cite this headnote

Intention of Parties

Under New York law, fundamental, neutral precept of contract interpretation is that agreements are construed in accordance with parties' intent.

Cases that cite this headnote

[5] **Contracts**
Language of contract

Under New York law, best evidence of what parties to written agreement intend is what they say in their writing.

Cases that cite this headnote

[6] **Contracts**
Application to Contracts in General
Contracts
Rewriting, remaking, or revising contract

Under New York law, it is role of courts to enforce agreement made by the parties, not to add, excise or distort the meaning of terms that they chose to include, thereby creating a new contract under the guise of construction.

Cases that cite this headnote

[7] **Contracts**
Rewriting, remaking, or revising contract
Contracts
Language of contract

Under New York law, adherence to traditional principles of contract construction, that best evidence of what parties to written agreement intend is what they say in their writing, and that court may not add to, excise or distort the meaning of the terms that parties chose to employ under the guise of contract construction, is particularly appropriate when interpreting documents drafted by sophisticated, counseled parties, that involve the loan of substantial sums of money.

Cases that cite this headnote

[8] **Bills and Notes**

Under New York law, "redemption," of kind required to trigger borrower's obligation for early redemption premium, may include both pre- and post-maturity repayments of note.

Cases that cite this headnote

[9] Bills and Notes
Mode and Sufficiency of Payment

Chapter 11 debtor-borrower's redemption of notes that had been accelerated automatically as result of its bankruptcy filing, over objection of noteholders that did not want to be repaid early, but that had been blocked by automatic stay from decelerating the notes, had to be regarded as "voluntary," as required to trigger debtor-borrower's obligation for early redemption premium, where debtor had the option, pursuant to its reorganization plan, to reinstate the accelerated notes' original maturity date but chose not to do so, and had in fact filed for bankruptcy in attempt to repay notes early while avoiding obligation for early redemption premium.

1 Cases that cite this headnote

[10] Bills and Notes
Mode and Sufficiency of Payment

Chapter 11 debtor-borrower's voluntary redemption of notes that had been accelerated automatically as result of its bankruptcy filing was in nature of early redemption, of kind triggering its obligation for early redemption premium; while redemption occurred after notes had matured as result of being automatically accelerated, it occurred prior to due date specified in agreement between parties.

Cases that cite this headnote

[11] Bills and Notes
Mode and Sufficiency of Payment

Mere fact that promissory notes had been automatically accelerated as result of debtor-borrower's Chapter 11 filing, pursuant to one provision of trust indenture, did not render another provision requiring payment of early redemption premium inapplicable; provisions had to be construed together in order to give effect to

Cases that cite this headnote

[12] Contracts
Construction as a whole

Under New York law, contracts are to be interpreted to avoid inconsistencies and to give meaning to all of their terms.

1 Cases that cite this headnote

[13] Bills and Notes
Mode and Sufficiency of Payment

Language in second lien trust indenture, providing that, upon acceleration of notes, it was not only the principal, but "premium, if any," that would become immediately due and payable, was most naturally interpreted as referring to early redemption premium, the only "premium" referred to in trust indenture, and clarified that lender was entitled to this early redemption premium even after notes had been accelerated, without need for any greater level of exactness by parties.

1 Cases that cite this headnote

[14] Bills and Notes
Time of Maturity
Bills and Notes
Mode and Sufficiency of Payment

Under New York law, while agreement must clearly provide for payment of prepayment penalty even after note has been accelerated, in order for lender to obtain such a premium in connection with borrower's payment of accelerated note, that is not the rule with regard to yield-protection payments not styled as prepayment premiums; rather, if borrowers want their contractual obligation for yield protection payment not tied to any "prepayment" to terminate upon acceleration of debt, they must make that intent clear.

1 Cases that cite this headnote

[15] Federal Courts
State Courts and Their Decisions in General

1 Cases that cite this headnote

[16] **Bills and Notes**
Time of Maturity

Under New York law, while acceleration advances the maturity date of debt, other terms of contract that are not necessarily impacted by acceleration do not automatically cease to be enforceable after acceleration.

Cases that cite this headnote

[17] **Bills and Notes**
Time of Maturity
Bills and Notes
Mode and Sufficiency of Payment

Acceleration, by definition, advances the maturity date of debt, so that any payment thereafter is not prepayment, but is instead payment made after maturity; after maturity, any option to prepay can no longer be exercised.

1 Cases that cite this headnote

[18] **Bills and Notes**
Mode and Sufficiency of Payment

Unlike prepayment, redemption of debt security may occur at or before maturity.

Cases that cite this headnote

[19] **Bills and Notes**
Mode and Sufficiency of Payment

Under New York law, while a premium contingent on "prepayment" cannot take effect after a debt's maturity, a premium tied to a "redemption" is unaffected by acceleration of debt's maturity.

Cases that cite this headnote

[20] **Contracts**
Application to Contracts in General

court must give effect to the words and phrases that the parties chose.

1 Cases that cite this headnote

*250 Appeal from the United States District Court for the District of Delaware (D.C. Civil Action Nos. 1–15–cv–00620, 1–15–cv–01011, 1–15–cv–01014 & 1–15–cv–01015), District Judge: Honorable Richard G. Andrews

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Before: AMBRO, SMITH,* and FISHER, Circuit Judges

OPINION OF THE COURT

Ambro, Circuit Judge

We address what happens when one provision of an indenture for money loaned provides that the debt is accelerated if the debtor files for bankruptcy and while in bankruptcy it opts to redeem that debt when another indenture provision provides for a redemption premium. Does the premium, *251 meant to give the lenders the interest yield they expect, fall away because the full principal amount is now due and the noteholders are barred from rescinding the acceleration of debt? We hold no.

I. BACKGROUND

A. The Notes

Energy Future Intermediate Holding Company LLC and EFIH Finance Inc. (collectively, "EFIH") borrowed in 2010 approximately $4 billion at a 10% interest rate by issuing Notes due in 2020 and secured by a first-priority lien on their assets (the "First Lien Notes"). To protect (at least in part) the lenders' anticipated interest-rate yield, the Indenture governing the loan (the "First Lien Indenture") provides in § 3.07, captioned "Optional Redemption," that "[a]t any time prior to December 1, 2015, [EFIH] may redeem all or a part of the Notes at a redemption price equal to 100% of the principal amount of the Notes redeemed plus the Applicable Premium ... and accrued and unpaid interest" (emphasis in original). "Applicable Premium" is what we shall call the make-whole, or yield-protection, contractual substitute for interest lost on Notes redeemed before their

The First Lien Indenture contains an acceleration provision in § 6.02 that makes "all outstanding Notes ... due and payable immediately" if EFIH files a bankruptcy petition. The same provision also gives the First Lien Noteholders the right to "rescind any acceleration [of] the Notes and its consequences[.]"

EFIH borrowed funds again in 2011 and 2012 by issuing two sets of Notes secured by a second-priority lien on its assets (the "Second Lien Notes"). As with the First Lien Noteholders, EFIH promised to pay holders of the Second Lien Notes (the "Second Lien Noteholders") a make-whole premium—in a provision essentially identical to the one quoted above—if it chose to redeem the Second Lien Notes, at its option, on or before a date certain (May 15, 2016 for Second Lien Notes set to mature in 2021 and March 1, 2017 for those maturing in 2022).

The Indenture for the Second Lien Notes (the "Second Lien Indenture") contains an acceleration provision different from § 6.02 of the First Lien Indenture: if EFIH files a bankruptcy petition, "all principal of *and premium, if any*, interest ...[,] and *any other monetary obligations* on the outstanding Notes shall be due and payable immediately[.]" Second Lien Indenture § 6.02 (emphases added). Like the First Lien Noteholders, the Second Lien Noteholders have the right to "rescind any acceleration [of] the Notes and its consequences" under § 6.02.

B. Refinancing the First Lien Notes

When market interest rates went down, EFIH considered refinancing the Notes. Refinancing outside of bankruptcy would have required it to pay the make-whole premium. *See In re Energy Future Holdings Corp.*, 527 B.R. 178, 188 (Bankr. D. Del. 2015). By filing for bankruptcy, however, EFIH believed it might avoid the premium. So on November 1, 2013, it filed an 8–K form with the Securities and Exchange Commission "disclosing [its] proposal [whereby] ... EFIH would file for bankruptcy and refinance the Notes without paying any make-whole amount." *Id.* (internal quotation marks omitted).

Six months later, on April 29, 2014, EFIH and other members of its corporate family filed Chapter 11 bankruptcy petitions in the Bankruptcy Court for the District of Delaware. Once in bankruptcy, EFIH sought to "take advantage of highly favorable debt market conditions to refinance," ***252** beginning with the First Lien Notes. *Id.* at 189. It asked the Bankruptcy Court for leave to borrow funds to pay them off and to offer a settlement to any of its First Lien Noteholders who agreed to waive their right to the make-whole. *Id.* at 182, 189.

Fearing loss of the income stream EFIH had promised, the Trustee for the First Lien Noteholders—Delaware Trust Company —filed an adversary proceeding on May 15, 2014. It sought a declaration that refinancing the First Lien Notes would trigger the make-whole premium.

EFIH's bankruptcy filing caused the "[First Lien] Notes [to] be[come] due and payable immediately" under Indenture § 6.02, subject to the right of their holders to rescind acceleration. So the Trustee also requested a declaration that it could rescind the First Lien Notes' acceleration without violating the automatic stay of creditors' acts to enforce their remedies once bankruptcy occurs, 11 U.S.C. § 362. However, should the stay apply, the Trustee asked the Court to lift it.

When the Bankruptcy Court did not act, on June 4, 2014, the holders of a majority of the principal amount of the First Lien Notes sent a notice to EFIH rescinding acceleration, contingent on relief from the automatic stay. Two days later, the Bankruptcy Court granted EFIH's motion to refinance. It ruled, however, that the refinancing would not prejudice the First Lien Noteholders' rights in the pending adversary proceeding.

On June 19, 2014, EFIH paid off the First Lien Notes and refinanced the debt at a much lower interest rate of 4.25%, saving "an estimated $13 million in interest per month." *In re Energy Future Holdings Corp.*, 527 B.R. at 189. This of course disadvantaged the First Lien Noteholders, who had contracted to receive interest at 10% until the Notes' full maturity in 2020. EFIH did not compensate the loss set by contract by paying the make-whole, which would have been approximately $431 million.

C. Refinancing the Second Lien Notes

Shortly after entering bankruptcy, EFIH declared in an SEC 8–K filing that it "reserve[d] the right to ... redeem ... some or all of the outstanding ... Second Lien Notes" but asserted that it "[wa]s under no obligation to do so." *See In Re Energy Future Holdings Corp.*, No. 14–50363 (Bankr. D. Del.), Docket Entry 181, A–222. Aware of this, as well as the First Lien Noteholders' predicament, the Trustees for the Second Lien Noteholders—Computershare Trust Company, N.A. and Computershare Trust Company of Canada—filed their own adversary proceeding on June 16, 2014.

Like the First Lien Trustee, the Second Lien Trustees sought a declaration that EFIH would have to pay the make-whole if it chose to refinance the Second Lien Notes. The Second Lien Noteholders also issued a notice rescinding acceleration of that

With the Bankruptcy Court's permission, EFIH refinanced a portion of the Second Lien Notes on March 10, 2015—again without paying the yield-protection amount.

D. First Lien Make–Whole Litigation

Nine months after granting leave to refinance the First Lien Notes, the Bankruptcy Court considered whether EFIH had to pay the make-whole. *In re Energy Future Holdings Corp.*, 527 B.R. at 191–95. The holding was that it did not. *Id.*

*253 Although EFIH's obligation to pay the make-whole appears in § 3.07 of the First Lien Indenture, the Court focused its reasoning on the acceleration provision in § 6.02. Because it took effect when EFIH entered bankruptcy but made no mention of the make-whole, the Court concluded that none was due.[2]

It further held that the automatic stay prevented the First Lien Noteholders' attempt to rescind the Notes' acceleration. *Id.* at 197. Finally, after trial in 2015, it denied the Trustee's motion to lift the stay retroactively "to a date on or before June 19, 2014, to allow the Trustee to ... decelerate the Notes." *In re Energy Future Holdings Corp.*, 533 B.R. 106, 116 (Bankr. D. Del. 2015).

These rulings put the First Lien Noteholders in a Catch–22. When EFIH filed for bankruptcy, the maturity of its debt accelerated. This, according to the Bankruptcy Court, cut off the First Lien Noteholders' right to yield-protection. Rescission of the acceleration would have restored that right. But rescission was blocked by the automatic stay, which the Court refused to lift.

The District Court for the District of Delaware affirmed the Bankruptcy Court's rulings in February 2016. *In re Energy Future Holdings Corp.*, No. CV 15–620 RGA, 2016 WL 627343, at *1–3 (D. Del. Feb. 16, 2016).

E. Second Lien Make–Whole Litigation

The Second Lien Noteholders fared no better than the First Lien Noteholders. Six months after EFIH refinanced a portion of the Second Lien Notes, the Court considered the Second Lien Noteholders' entitlement to the make-whole. In construing the Second Lien Indenture's provisions, the Court adopted its findings and conclusions from the make-whole litigation for the First Lien Noteholders. After rejecting arguments based on the few differences between the First and Second Lien Indentures' texts, the Court held that the Second Lien Noteholders also were not entitled to yield-protection. *In re Energy Future Holdings Corp.*, 539 B.R. 723, 733 (Bankr. D. Del. 2015). The District Court again affirmed. *In re: Energy Future Holdings Corp.*, No. CV 15–1011–RGA, 2016 WL 1451045, at *4 (D. Del. Apr. 12, 2016).

* * * * *

The First and Second Lien Trustees brought appeals on behalf of their respective Noteholders, which we consolidated. They argue the Bankruptcy and District Courts erred by holding that the Indentures did not require payment of the make-whole when EFIH redeemed the Notes after their maturity had accelerated.

II. JURISDICTION AND GOVERNING LAW

[1]We have jurisdiction to hear appeals from the Bankruptcy and District Courts in this Circuit under 28 U.S.C. §§ 158 and 1291. Statutory construction and contract interpretation are legal questions reviewed anew by us. The contracts at issue—the Indentures that control the Notes—are governed by New York law. First Lien Indenture § 13.08; Second Lien Indenture § 13.08.

[2] [3]"When interpreting state law, we follow a state's highest court; if that state's *254 highest court has not provided guidance, we are charged with predicting how that court would resolve the issue." *Illinois Nat. Ins. Co. v. Wyndham Worldwide Operations, Inc.*, 653 F.3d 225, 231 (3d Cir. 2011). "To do so, we must take into consideration: (1) what that court has said in related areas; (2) the decisional law of the state intermediate courts; (3) federal cases interpreting state law; and (4) decisions from other jurisdictions that have discussed the issue." *Id.*

[4] [5] [6] [7]Here we look to the New York Court of Appeals, which has held that "[t]he fundamental, neutral precept of contract interpretation is that agreements are construed in accord with the parties' intent." *Greenfield v. Philles Records, Inc.*, 98 N.Y.2d 562, 750 N.Y.S.2d 565, 780 N.E.2d 166, 170 (2002) (internal citations and quotation marks omitted). "The best

thereby creating a new contract under the guise of construction." NML Capital v. Republic of Argentina, 17 N.Y.3d 250, 928 N.Y.S.2d 666, 952 N.E.2d 482, 489–90 (2011). "Adherence to these principles is particularly appropriate in a case like this involving interpretation of documents drafted by sophisticated, counseled parties and involving the loan of substantial sums of money." *Id.*

III. ANALYSIS

A. The First Lien Indenture

Although both Indentures contain many provisions, this case centers on the words of but two: §§ 3.07 and 6.02.[2] The former, noted earlier as titled "Optional Redemption," states when the make-whole is due: "At any time prior to December 1, 2015, the Issuer may redeem all or a part of the Notes at a redemption price equal to 100% of the principal amount of the Notes redeemed plus the Applicable Premium [*i.e.*, the make-whole] ... and accrued and unpaid interest" (emphasis in original). Indenture § 3.07. The premium decreases annually on a sliding scale between December 1, 2015 and November 30, 2018. From December 1, 2018 until the Notes' maturity date in 2020, the Notes may be optionally redeemed without payment of a premium. *See* Indenture §§ 1.01 (defining "Applicable Premium" and providing formula for its application) & 3.07(d) (setting premium amount for redemptions after December 1, 2015).

Section 6.02 provides that on the filing of a bankruptcy petition by EFIH "all outstanding Notes shall be due and payable immediately without further action or notice." Indenture § 6.02; *see also id.* § 6.01 (defining bankruptcy as an event of default).

Any duty to pay the make-whole comes from § 3.07. It leaves us with three questions: was there a redemption; was it optional; and if yes to both, did it occur before December 1, 2015?

Section 3.07 does not define "redemption." As a redemption "usu[ally] refers to the repurchase of a bond before maturity," Black's Law Dictionary 1390 (9th ed. 2009), EFIH contends that we should limit the term to mean only repayments of debt ***255** that pre-date the debt's maturity. Section 6.02 accelerated the Notes' maturity to the date EFIH entered bankruptcy —April 29, 2014. It refinanced the Notes several weeks later. Thus it argues that its post-maturity refinancing was not a redemption.

[8]But contrary to that position, New York and federal courts deem "redemption" to include both pre- and post-maturity repayments of debt. *See e.g.*, Chesapeake Energy Corp. v. Bank of N.Y. Mellon, 773 F.3d 110, 116 (2d Cir. 2014) (in interpreting New York law, to "redeem" is to "repay[ ] ... a debt security ... at or before maturity" (quoting *Barron's Dictionary of Finance and Investment Terms* 587 (8th ed. 2010))); *Treasurer of New Jersey v. U.S. Dep't of Treasury*, 684 F.3d 382, 388 (3d Cir. 2012) (discussing regulations permitting bondholders to "present ... long-matured savings bond[s] for redemption"); *Fed. Nat'l Mortg. Ass'n v. Miller*, 123 Misc.2d 431, 473 N.Y.S.2d 743, 744 (N.Y. Sup. Ct. 1984) ("debtor may redeem" mortgage by "pay [ing] ... accelerated debt"); *see also* N.Y. U.C.C. § 9-623, Official Comment No. 2 ("To redeem the collateral ... of a secured obligation [that] has been accelerated, it would be necessary to tender the entire balance."). Accordingly, EFIH's June 19, 2014 refinancing was a "redemption" within the meaning of § 3.07.

[9]Whether the redemption was "[o]ptional" is next up. EFIH argues that refinancing the Notes was not optional because § 6.02 made them "due and payable immediately without further action or notice" once it was in bankruptcy. EFIH, however, filed for Chapter 11 protection voluntarily. Once there, it had the option, per its plan of reorganization, to reinstate the accelerated Notes' original maturity date under Bankruptcy Code § 1124(2) rather than paying them off immediately. It chose not to do so, and instead followed the path laid out six months before in its SEC 8–K filing.

EFIH contends nonetheless that any redemption was mandatory rather than optional. But this contention does not match the facts. Indeed "a chapter 11 debtor that has the capacity to refinance secured debt on better terms ... is in the same position within bankruptcy as it would be outside bankruptcy, and cannot reasonably assert that its repayment of debt is not 'voluntary.' " Scott K. Charles & Emil A. Kleinhaus, *Prepayment Clauses in Bankruptcy*, 15 Am. Bankr. Inst. L. Rev. 537, 552 (2007).

Events leading up to the post-petition financing on June 19, 2014 demonstrate that the redemption was very much at EFIH's option. To repeat, months before its Chapter 11 filing EFIH announced its plan to redeem the Notes before their stated maturity date. *In re Energy Future Holdings Corp.*, 527 B.R. at 189. And after filing for bankruptcy, it produced another 8–K stating that it may, "but [wa]s under no obligation" to, redeem the similarly situated Second Lien Notes. *In Re Energy Future Holdings Corp.*, No. 14–50363 (Bankr. D. Del.), Docket Entry 181, A–222.

The irony is that the Noteholders did not want to be paid back on June 19, 2014. They attempted to rescind the Notes' acceleration on June 4, 2014, but were blocked by the automatic stay. *In re Energy Future Holdings Corp.*, 533 B.R. at 108. When EFIH redeemed the Notes, it did so "on a non-consensual basis," that is, over the Noteholders' objection. J.A. 1214.

[10]And, only to close the loop, all this occurred before December 1, 2015. Hence § 3.07 on its face requires that EFIH pay *256 the Noteholders the yield-protection payment.

B. The Relationship Between §§ 3.07 And 6.02 (Or Whether § 6.02, Once Triggered, Annuls § 3.07)

[11]At oral argument, EFIH's counsel described §§ 3.07 and 6.02 as "different pathways" that we must choose between. Only the latter is relevant, the argument goes, because it addresses post-maturity payment more specifically than § 3.07, and specific contract provisions govern over more general ones. *See* Muzak Corp. v. Hotel Taft Corp., 1 N.Y.2d 42, 150 N.Y.S.2d 171, 133 N.E.2d 688, 690 (1956).

It is not obvious why EFIH believes § 6.02 addresses the consequences of the June 2014 redemption more specifically than § 3.07 or why we must choose between them. The two sections simply address different things: § 6.02 causes the maturity of EFIH's debt to accelerate on its bankruptcy, and § 3.07 causes a make-whole to become due when there is an optional redemption before December 1, 2015. Rather than "different pathways," together they form the map to guide the parties through a post-acceleration redemption. In any event, § 3.07 is the only provision that specifically addresses redemptions.

To support its position, EFIH looks primarily to *In re AMR Corp.*, 730 F.3d 88 (2d Cir. 2013). It focused on an indenture's acceleration provision to determine whether a make-whole was due. Crucially, however, that provision addressed outright whether a make-whole would be due following acceleration.

> "[I]f an Event of Default referred to in ... Section 4.01(g) [*i.e.*, the voluntary filing of a bankruptcy petition] ... shall have occurred and be continuing, then and in every such case the unpaid principal amount of the Equipment Notes then outstanding, together with accrued but unpaid interest thereon and all other amounts due thereunder **(but for the avoidance of doubt, without Make–Whole Amount)**, shall immediately and without further act become due and payable without presentment, demand, protest or notice, all of which are hereby waived."

Id. at 99 (emphasis added).

AMR is the easy case; just follow the text. The litigants took a route suggested by the New York Court of Appeals in *NML Capital v. Republic of Argentina*: parties that want obligations to cease when accelerated should say so in their agreement. 928 N.Y.S.2d 666, 952 N.E.2d at 490 ("Had Argentina intended that its responsibility to pay interest twice a year cease upon maturity, it could easily have clarified that intent in any number of ways.").

[12]In our case, § 6.02 makes no mention of the make-whole. EFIH argues that this silence saps § 3.07's effect. On a general note, that reading would cross cords with our duty to "give full meaning and effect to all of [the Indenture's] provisions." *Chesapeake Energy Corp.*, 773 F.3d at 113–14 (internal quotation marks omitted). "Contracts are ... to be interpreted to avoid inconsistencies and to give meaning to all [their] terms." *Barrow v. Lawrence United Corp.*, 146 A.D.2d 15, 18, 538 N.Y.S.2d 363 (N.Y. App. Div. 1989). More specifically, EFIH's interpretation conflicts with the New York Court of Appeals' statement that "[w]hile it is understood that acceleration advances the maturity date of the debt," there is no "rule of New York law declaring that other terms of the contract not necessarily impacted by acceleration ... automatically cease to be enforceable after acceleration." *NML Capital*, 928 N.Y.S.2d 666, 952 N.E.2d at 492. *257 Accordingly, § 3.07 stands on its own, unswayed by the Indenture's other provisions.

EFIH alternatively argues that §§ 6.02 and 3.07 are in conflict, so that only one may apply to the June 2014 redemption. Subsection 3.07(e) prescribes detailed notice procedures for EFIH to follow before redeeming the Notes, while § 6.02 makes the Notes "due and payable immediately without further action or notice." If the notice procedures were not followed, no redemption could follow. Yet EFIH offers no reason why it could not have complied with § 3.07(e)'s notice procedures. In any event, it cannot use its own failure to notify to absolve its duty to pay the make-whole. Any conflict between the two provisions in this instance is illusory.

We know no reason why we should choose between §§ 3.07 and 6.02 when both plainly apply. By its own terms, § 3.07 governs the optional redemption embedded in the refinancing and requires payment of the make-whole. It surpasses strange to hold that silence in § 6.02 supersedes § 3.07's simple script.

C. The Second Lien Indenture's Additional Language

[13]As mentioned above, the Second Lien Indenture's acceleration provision contains words not present in the First Lien Indenture. These additions make explicit in the Second Lien Indenture the link between acceleration under § 6.02 and the make-whole for an optional redemption per § 3.07. While for the First Lien Indenture these concepts are without cross-

certain, thereby triggering make-whole premiums.

When EFIH filed its bankruptcy petition, Second Lien Indenture § 6.02 caused "all principal of and *premium, if any*, interest ... [,] and any other monetary obligations on the outstanding [Second Lien] Notes [to] be[come] due and payable immediately" (emphasis added). Compare First Lien Indenture § 6.02 ("all outstanding Notes shall be due and payable immediately"). The words "premium, if any," are most naturally read to reference § 3.07's "Applicable Premium"—that is, the make-whole.

The most EFIH musters is that the Second Lien Indenture could have been even more specific by replacing "premium, if any," with "a premium owed under section 3.07" or "Applicable Premium or other premium owed as if repayment under this section were an Optional Redemption under section 3.07." EFIH's Br. at 24–25. But we see no reason to demand such exactness. Indeed, EFIH has not suggested any other "premium" the drafters could have had in mind.

True, in a case called *Momentive*, the Bankruptcy Court for the Southern District of New York held the words "premium, if any," were not specific enough to require payment of a make-whole in similar circumstances. *In re MPM Silicones, LLC*, No. 14–22503–RDD, 2014 WL 4436335, at *13 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd*, 531 B.R. 321 (S.D.N.Y. 2015) ("*Momentive*"). We believe, however, the result in *Momentive* conflicts with that indenture's text and fails to honor the parties' bargain. For these and additional reasons discussed below, we find it unpersuasive.

By including the words "premium, if any," in its acceleration provision, the Second Lien Indenture leaves no doubt that §§ 3.07 and 6.02 work together. The latter is explicit that a premium is in play, and ***258** the only relevant premium provision is the former. Thus both remained applicable following bankruptcy, and, pursuant to the agreement struck with the Second Lien Noteholders, they are entitled to the make-whole.

D. The Effect of Acceleration on Make–Whole Provisions

[14]Notwithstanding the result dictated by § 3.07's text in both Indentures, EFIH asserts that it should not have to pay the make-whole because § 6.02 caused the Notes' maturity to accelerate before it paid them off. Citing a New York trial court opinion, *Nw. Mut. Life Ins. Co. v. Uniondale Realty Assocs.*, 11 Misc.3d 980, 816 N.Y.S.2d 831, 836 (N.Y. Sup. Ct. 2006) ("*Northwestern*"), it argues that courts must close their eyes to make-whole provisions once a debt's maturity has accelerated.

[15]In interpreting laws of a state, we need not follow the judgments of its trial courts. *See MRL Dev. I, LLC v. Whitecap Inv. Corp.*, 823 F.3d 195, 203 (3d Cir. 2016) ("The Superior Court of the Virgin Islands ... is not the highest court of the Territory or even an intermediate appellate court, but rather a trial court. Accordingly, we are not bound by Superior Court decisions" (internal brackets, citations, and quotation marks omitted)). But even if we were inclined to do so here, EFIH's interpretation of *Northwestern* conflicts with the pronouncements of New York's highest court, which we follow on questions of New York law. *See Illinois Nat. Ins. Co.*, 653 F.3d at 231.

[16]As we noted above, the New York Court of Appeals stated unequivocally in *NML Capital v. Republic of Argentina* that "[w]hile it is understood that acceleration advances the maturity date of the debt, [it was] unaware of any rule of New York law declaring that other terms of the contract not necessarily impacted by acceleration ... automatically cease to be enforceable after acceleration." 928 N.Y.S.2d 666, 952 N.E.2d at 492. Put differently, contract terms like § 3.07 that are applicable before acceleration remain so afterward.

In *NML Capital*, New York's highest Court answered several questions certified to it by the U.S. Court of Appeals for the Second Circuit. *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 486. Among them was "whether Argentina's obligation to make [certain contractually established interest] payments to bondholders continued after maturity or acceleration of the indebtedness [.]" *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 486. Argentina contended that, after the maturity of its debt had accelerated, bondholders were entitled only to their principal and any accrued interest. *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 490. Acceleration, it argued, terminated its duty to make biannual interest payments mandated by the bond documents. *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 487.

In rejecting those assertions, the New York Court of Appeals held that "in New York the consequences of acceleration of the debt depend on the language chosen by the parties in the pertinent loan agreement." *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 492. "Had Argentina ... intended that its responsibility to pay interest twice a year cease upon maturity, it could easily have clarified that intent in any number of ways." *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 490. For example, the bond documents could have specified that the payment "obligation continued 'until' the maturity date" or could have provided "that interest payments were to be made until the principal was due, thereby referring back to the loan maturity date." *Id.* However, because the bond language that Argentina pay biannual interest payments made no reference ***259** to acceleration or maturity, it remained effective following the bonds' acceleration. *Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 493. The takeaway for us is that § 3.07 applies no less following acceleration of the Notes' maturity than it would to a pre-acceleration redemption.

we should decline to require payment of the make-whole because the trial court declared that a "prepayment premium will not be enforced under default circumstances in the absence of a clause which so states[.]" Northwestern, 816 N.Y.S.2d at 836. It held that a mortgage lender who chose to foreclose following default was not entitled to a "prepayment premium" because foreclosure had advanced the debt's maturity date. Id. "[P]repayment is a payment *before* maturity[,]" but after foreclosure prepayment is impossible as the debt has become due and payable immediately. Id. at 837 (emphasis in original). According to EFIH, Northwestern sets a rule that, unless an agreement clearly provides for it, no make-whole payment is due after a note's acceleration.

[17]No doubt prepayment premiums are the price of "an option voluntarily to prepay the loan and terminate the mortgage before the maturity." In re S. Side House, LLC, 451 B.R. 248, 267 (Bankr. E.D.N.Y. 2011), *aff'd sub nom.*, U.S. Bank Nat. Ass'n v. S. Side House, LLC, No. 11–CV–4135 ARR, 2012 WL 273119 (E.D.N.Y. Jan. 30, 2012); *accord* Northwestern, 816 N.Y.S.2d at 836. "[A]cceleration, by definition, advances the maturity date of the debt so that payment thereafter is not prepayment but instead is payment made after maturity [,]" and logically the option to prepay can no longer be exercised after maturity. Matter of LHD Realty Corp., 726 F.2d 327, 330–31 (7th Cir. 1984); D.I.S., LLC v. Sagos, 38 A.D.3d 543, 832 N.Y.S.2d 581, 582 (2007) ("prepayment" penalty did not apply to tender of mortgage principal and interest following acceleration because post-acceleration payments are not "prepayments").

[18] [19]Unlike prepayment, however, "redemption" of "a debt security" may occur "*at* or before maturity." Chesapeake Energy Corp., 773 F.3d at 116 (emphasis added). Thus, while a premium contingent on "prepayment" could not take effect after the debt's maturity,[4] a premium tied to a "redemption" would be unaffected by acceleration of a debt's maturity.

Our understanding of New York law is that it follows a logical path: prepayments cannot occur when payment is now due by acceleration of the debt's maturity. If parties want to mandate a "prepayment" premium following acceleration, they must clearly state it in their agreement. This is the Northwestern rule.

Recently, however, bankruptcy courts, including the Bankruptcy Court here, have stretched Northwestern beyond its language and applied its clear-statement rule to yield-protection payments not styled as prepayment premiums. In the Momentive case we mentioned in our discussion of the Second Lien Indenture, a Bankruptcy Court considered language similar to that of both Indentures and nearly identical to the text of the Second Lien Indenture. Like the Indentures here, the Momentive indenture required payment of a make-whole on optional redemptions occurring ***260** before a particular date. Momentive, 2014 WL 4436335, at *13. The Court, however, disallowed the lenders' claim for a make-whole, declaring it "well-settled law in New York" that a make-whole, like a prepayment premium, will only be due on a default and acceleration "when a clear and unambiguous clause calls" for it. Momentive, 2014 WL 4436335, at *12–*13 (citing Northwestern). The Delaware Bankruptcy Court followed the same line, declining to enforce the make-whole provision because "an indenture must contain express language requiring payment of a prepayment premium upon acceleration; otherwise, it is not owed." In re Energy Future Holdings Corp., 527 B.R. at 192 (construing First Lien Indenture); *accord* In re Energy Future Holdings Corp., 539 B.R. at 733 (construing Second Lien Indenture).

By denying the make-whole after the Notes' acceleration, the Bankruptcy Court pushed the Northwestern rule beyond its language and underlying policy concerns. First, its application of the rule is off point because § 3.07 in the Indentures does not use the word "prepayment." Northwestern responds, in part, to the linguistic paradox created by the idea of a *prepayment* following acceleration. "Once the maturity date is accelerated to the present, it is no longer possible to prepay the debt before maturity." Northwestern, 816 N.Y.S.2d at 834. That is why, if parties want a "prepayment" premium to survive acceleration and maturity, they must clearly state it.

The Indentures here present no linguistic tension to resolve. Nothing in § 6.02 negates the premium § 3.07 requires if an optional redemption occurs before a stated date. Acceleration here has no bearing on whether and when the make-whole is due.

[20]EFIH argues that, even though § 3.07 does not use the word "prepayment," the make-whole is in substance a prepayment premium, and thus the Northwestern rule should apply. But we must give effect to the "words and phrases" the parties chose. Chesapeake Energy Corp., 773 F.3d at 113–14; NML Capital, 928 N.Y.S.2d 666, 952 N.E.2d at 489–90. By avoiding the word "prepayment" and using the term "redemption," they decided that the make-whole would apply without regard to the Notes' maturity.

Moreover, beneath the Northwestern holding was a policy concern that lenders should not be permitted "to recover prepayment premiums after default and acceleration in order to preserve an income stream ... absent any 'voluntary' prepayment." Northwestern, 816 N.Y.S.2d at 836. There the mortgagee seeking the prepayment premium had elected to foreclose in order to recoup its investment immediately. Id. at 833. Ordinarily, by electing to accelerate the debt, a lender forgoes its right to a stream of payments in favor of immediate repayment. Matter of LHD Realty Corp., 726 F.2d at 331 & n.4. The Northwestern Judge was concerned that lenders should not be able to seek immediate repayment and pile on by also receiving a premium. Here, by contrast, the Noteholders did not seek immediate payment. EFIH voluntarily redeemed the Notes over the

Finally, to repeat what we said at the outset, by declining to enforce § 3.07 after acceleration, the Bankruptcy Court ran afoul of New York authority by failing to enforce a contract provision—§ 3.07—not affected by acceleration. NML Capital, 928 N.Y.S.2d 666, 952 N.E.2d at 492. To reach its conclusion, it followed Momentive, which described "automatic acceleration clauses" as "negating" the effect of make-whole redemption provisions. Momentive, 2014 WL 4436335, at *14. That is not what NML Capital tells us.

***261** EFIH answers that the Noteholders should have taken note of bankruptcy courts' novel application of Northwestern and insisted on clearer language in the Indenture. *See e.g., In re Anchor Resolution Corp.*, 221 B.R. 330, 334 (Bankr. D. Del. 1998) ("If the maturity of any Series B Note shall be accelerated ... [,] there shall become due and payable ... as compensation to the holders ... a premium equal to the Make-Whole Amount."). But this puts the burden backward; if EFIH wanted its duty to pay the make-whole on optional redemption to terminate on acceleration of its debt, it needed to make clear that § 6.02 trumps § 3.07. *See* NML Capital, 928 N.Y.S.2d 666, 952 N.E.2d at 490. The burden to make that showing is with EFIH. To place it on the Noteholders for EFIH's decision to redeem the Notes is a bridge too far.

* * * * *

Our "primary objective ... is to give effect to the intent of the parties as revealed by the language of their agreement." Chesapeake Energy Corp., 773 F.3d at 113–14. The language of the First Lien Indenture requires EFIH to pay a make-whole if it redeems the First Lien Notes at its option before December 1, 2015, and the Second Lien Indenture requires the same for redemptions of Second Lien Notes before May 15, 2016 or March 1, 2017 (depending on the initial maturity date of the particular debt instruments). EFIH redeemed the First Lien Notes at its option on June 19, 2014 and redeemed a portion of the Second Lien Notes on March 10, 2015. Redemptions, not prepayments, occurred here, they were at the election of EFIH, and they occurred before the respective dates noted. Statements of New York law by its highest Court and the federal Circuit Court in New York reinforce our conclusion that EFIH must pay the make-whole per the Indenture language before us.[3]

The judgments of the District Court are reversed with instructions to remand to the Bankruptcy Court for further proceedings consistent with this opinion. Any future appeals shall return to this panel.

All Citations

842 F.3d 247, 63 Bankr.Ct.Dec. 95

Footnotes

* Honorable D. Brooks Smith, United States Circuit Judge for the Third Circuit, assumed Chief Judge status on October 1, 2016.

1 For the purpose of determining EFIH's duty to pay any make-whole, the Bankruptcy Court assumed that it was "solvent and able to pay all allowed claims of [its] creditors in full." In re Energy Future Holdings Corp., 527 B.R. at 183. We do the same. Because we do not have any briefing on the matter even without that assumption, we do not consider whether insolvency might have affected EFIH's obligations.

2 In Sections A and B, we refer for convenience to the First Lien Indenture simply as the "Indenture." Likewise, we mean the First Lien Notes and First Lien Noteholders when we refer to "the Notes" or "the Noteholders" in these Sections. Thereafter the two terms mean all debt instruments and their holders under both the First Lien and Second Lien Indentures, which themselves may be referred to collectively as the "Indentures."

3 Even though a debtor cannot prepay what is already due, courts have enforced prepayment premiums after acceleration when the debtor has intentionally defaulted in order to avoid the premium. *See e.g.*, In re S. Side House, LLC, 451 B.R. at 269; Northwestern, 816 N.Y.S.2d at 836.

arguments that the Bankruptcy Court should have lifted the automatic stay to permit rescission of the Notes acceleration or that the Court should have allowed the Noteholders a contingent claim for the make-whole or a claim for contract damages.

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In re Energy Future Holdings Corp., 842 F.3d 247 (2016)
63 Bankr.Ct.Dec. 95

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4. *Matter of MPM Silicones, LLC*, 874 F.3d 787 (2nd Cir. 2017)

Matter of MPM Silicones, L.L.C., 874 F.3d 787 (2017)
Bankr. L. Rep. P 83,176

KeyCite Blue Flag – Appeal Notification
Petition for Certiorari Docketed by BOKF, N.A., AS FIRST LOAN TRUSTEE v. MOMENTIVE PERFORMANCE MATERIALS, INC., ET AL., U.S., March 14, 2018

874 F.3d 787
United States Court of Appeals,
Second Circuit.

In the MATTER OF: MPM SILICONES, L.L.C.
Momentive Performance Materials Incorporated, Apollo Global ManagemenT, LLC, Ad Hoc Committee of Second Lien Holders, Plaintiffs-Appellees,
v.
BOKF, NA, as First Lien Trustee, Wilmington Trust, N.A., as 1.5 Lien Trustee, Defendants-Appellants.
U.S. Bank National Association, as Indenture Trustee, Plaintiff-Appellant,
v.
Wilmington Savings Fund Society, FSB, as Successor Indenture Trustee, Momentive Performance Materials Incorporated, Ad Hoc Committee of Second Lien Noteholders, Apollo Management, LLC, and Certain of its Affiliated Funds, Defendants-Appellees.

Nos. 15-1682 (L)
|
15-1824 (CON)
|
No. 15-1771
|
August Term, 2016
|
Submitted: November 9, 2016
|
Decided: October 20, 2017

Synopsis
Background: Order was entered by the United States Bankruptcy Court for the Southern District of New York, Robert D. Drain, J., 2014 WL 4436335, confirming debtor's proposed Chapter 11 plan, and noteholders appealed on theory that the plan violated the "absolute priority" rule, that Chapter 11 "cramdown" interest rate was inadequate, and that the lower court had erroneously denied their request for make-whole premium. The District Court, Briccetti, J., 531 B.R. 321, affirmed, and noteholders appealed.

Holdings: The Court of Appeals, Barrington D. Parker, Circuit Judge, held that:

[1] proposed Chapter 11 plan did not violate "absolute priority" rule, by providing a partial distribution to second lien noteholders on their claims but none to holders of subordinated notes;

process and first determined whether there existed an efficient market for loans of type that secured creditors would be required to make under plan;

[3] senior lien noteholders were not entitled to make-whole premium on notes which had been accelerated automatically upon debtors' Chapter 11 filing; and

[4] appeal from district court's affirmance of bankruptcy court's Chapter 11 plan confirmation order was not equitably moot.

Affirmed in part, reversed in part, and remanded.

West Headnotes (16)

[1] Bankruptcy
Conclusions of law; de novo review
Bankruptcy
Clear error

Court of Appeals exercises plenary review over district court's affirmance of bankruptcy court's decision, reviewing de novo the bankruptcy court's conclusions of law, and reviewing its findings of facts for clear error. Fed. R. Bankr. P. 8013.

Cases that cite this headnote

[2] Contracts
Intention of Parties

Under New York law, fundamental objective of contract interpretation is to give effect to the expressed intention of the parties.

Cases that cite this headnote

[3] Contracts
Existence of ambiguity

Under New York law, contract language is "ambiguous" if it is capable of more than one meaning.

Cases that cite this headnote

[4] Bankruptcy
Preservation of priority

Proposed Chapter 11 plan did not violate "absolute priority" rule, by providing a partial ambiguity in trust indenture as to whether second lien notes were "senior indebtedness," to which these subordinated notes had been subordinated, had to be resolved in favor of finding such subordination, not only because this was consistent with debtors' repeated representations to the Securities and Exchange Commission (SEC) and to financial community, but because contrary interpretation led to irrational results. 11 U.S.C.A. § 1129(b)(2)(B)(ii).

Cases that cite this headnote

[5] **Contracts**
Application to Contracts in General
Evidence
Showing Intent of Parties as to Subject-Matter

When contract term is ambiguous, New York courts look to extrinsic evidence to determine the intention of the parties, including evidence of parties' apparent intention, evidence of what would be commercially reasonable, and the parties' interpretation of the contract in practice, prior to litigation.

Cases that cite this headnote

[6] **Bankruptcy**
Secured creditors, protection of

To determine appropriate Chapter 11 "cramdown" rate of interest to ensure that objecting secured class receives stream of payments under proposed plan with present value that is at least equal to amount of class members' allowed secured claims, bankruptcy court should engage in two-stage process and first determine whether there exists efficient market for loans of type that secured creditors will be required to make under plan; only if there is no efficient market for such loans should courts proceed to second stage of process and use "formula" or prime-plus approach to calculate appropriate "cramdown" rate by starting with largely risk-free interest rate and applying appropriate risk adjustments. 11 U.S.C.A. § 1129(b)(2)(A)(i)(II).

Cases that cite this headnote

[7] **Bankruptcy**
Secured creditors, protection of

To determine appropriate Chapter 11

payments under proposed plan with present value that was at least equal to amount of class members' allowed secured claims, bankruptcy court should not have categorically rejected the probative value of evidence as to market rates of interest, but should have considered such evidence to determine whether an efficient market existed for loans of type that objecting secured creditors would be required to make under proposed plan. 11 U.S.C.A. § 1129(b)(2)(A)(i)(II).

Cases that cite this headnote

[8] Bills and Notes
Mode and Sufficiency of Payment

"Make-whole premium" is a contractual substitute for interest lost on promissory notes redeemed before their expected due date, and is meant to ensure that lender is compensated, if paid earlier than the original maturity of loan, for the interest that it will not receive.

Cases that cite this headnote

[9] Bills and Notes
Mode and Sufficiency of Payment

Senior lien noteholders were not entitled to make-whole premium on notes which had been accelerated automatically upon debtors' Chapter 11 filing, an event of default under senior notes; while notes required payment of make-whole premium in event that they were redeemed early, repayment of notes that had been accelerated automatically due to debtors' bankruptcy filing was not a voluntary early "redemption" of notes prior to their due date, but a repayment contractually required on notes that had become due, pursuant to their terms, due to commencement of jointly administered bankruptcy cases.

Cases that cite this headnote

[10] Bankruptcy
Proceedings, Acts, or Persons Affected

Any attempt by senior noteholders to rescind the automatic acceleration of their notes that occurred due to debtors' Chapter 11 filing, in attempt to preserve their right to make-whole premium, would be a postpetition attempt to

Cases that cite this headnote

[11] Bankruptcy
—Moot questions

Equitable mootness is a prudential doctrine that is invoked to avoid disturbing a reorganization plan once implemented.

Cases that cite this headnote

[12] Bankruptcy
—Moot questions

Equitable mootness doctrine allows appellate courts to dismiss bankruptcy appeals when, during pendency of appeal, events occur such that, while appellate court may conceivably be able to fashion effective relief, implementation of that relief would be inequitable.

Cases that cite this headnote

[13] Bankruptcy
—Moot questions

Equitable mootness doctrine requires a bankruptcy appellate court to carefully balance importance of finality in bankruptcy proceedings against appellant's right to review and relief.

Cases that cite this headnote

[14] Bankruptcy
—Moot questions

When reorganization plan has been substantially consummated, bankruptcy appellate court presumes that appeal from plan confirmation order is equitably moot; that presumption, however, will give way upon showing of presence of the five *Chateaugay* factors: (1) that effective relief can be ordered; (2) that such relief will not affect debtor's re-emergence from bankruptcy; (3) that such relief will not unravel intricate transactions; (4) that affected third parties were notified and able to participate in appeal; and (5) that appellant diligently sought stay of reorganization plan.

[15] **Bankruptcy**
Moot questions

While each of the five *Chateaugay* factors must be satisfied in order to overcome presumption that substantial consummation of Chapter 11 reorganization plan will equitably moot an appeal from plan confirmation order, bankruptcy appellate courts place significant weight on fifth factor, i.e., on whether appellant diligently sought a stay of reorganization plan; if stay was sought, then courts will provide relief if it is at all feasible, that is, unless relief would knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for bankruptcy court.

Cases that cite this headnote

[16] **Bankruptcy**
Moot questions

Appeal from district court's affirmance of bankruptcy court's Chapter 11 plan confirmation order, on ground that bankruptcy court had improperly relied solely on a "formula," or prime-plus approach, to calculate appropriate "cramdown" interest rate and had not considered whether there was efficient market for loans of type that objecting secured creditors would be required to make under proposed plan, was not rendered equitably moot by substantial consummation of plan, where creditors had diligently sought stay pending appeal from multiple courts, and where requiring debtors to pay additional interest to objecting secured creditors would not unravel the plan, threaten debtors' re-emergence from bankruptcy, or otherwise materially implicate *Chateaugay* concerns. 11 U.S.C.A. § 1129(b)(2)(A)(i)(II).

Cases that cite this headnote

***790** Appeals from the United States District Court for the Southern District of New York. Vincent L. Briccetti, *Judge*.

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Before: Cabranes, Pooler, and Parker, Circuit Judges.

Opinion

Barrington D. Parker, Circuit Judge:

Three groups of creditors separately appeal a judgment of the United States District Court of the Southern District of New *791 York (Briccetti, *J.*) affirming the confirmation of Debtors' Chapter 11 reorganization plan by the U.S. Bankruptcy Court (Drain, *J.*). The creditors argue that the plan improperly eliminated or reduced the value of notes they held. Debtors argue that the plan was properly confirmed and that these appeals should be dismissed as equitably moot. With one exception, we conclude that the plan confirmed by the bankruptcy court and affirmed by the district court comports with the provisions of Chapter 11. We remand so that the bankruptcy court can address the single deficiency we identify with the proceedings below which is the process for determining the proper interest rate under the cramdown provision of Chapter 11. We decline to dismiss these appeals as equitably moot.

These appeals by three groups of creditors challenge various aspects of Appellee Momentive Performance Materials, Inc.'s ("MPM,") substantially consummated plan of reorganization under Chapter 11 of the U.S. Bankruptcy Code.[1] With one exception, we conclude that the reorganization plan (the "Plan") confirmed by the bankruptcy court and affirmed by the district court comports with Chapter 11. We remand so that the bankruptcy court can address the single deficiency we identify in the proceedings below, which is the process for determining the proper interest rate under the cramdown provision of Chapter 11.

I

MPM, a leading producer of silicone, faced serious financial problems after it took on significant new debt obligations beginning in the mid-2000s.[2] *See* 15-1771 JA 286-88; 15-1682 JA 1605-06.[3] Following these debt issuances, MPM was substantially overleveraged, and ultimately filed a petition under Chapter 11. The four relevant classes of notes issued by MPM are as follows:

Subordinated Notes. In 2006, MPM issued $500 million in subordinated unsecured notes (the "Subordinated Notes") pursuant to an indenture (the "2006 Indenture"). 15-1771 JA 303. Appellant U.S. Bank is the indenture trustee for the Subordinated Notes. In 2009 MPM issued secured second-lien notes and offered the Subordinated Notes holders the option of exchanging their notes for the newly-issued second-lien notes. The second-lien notes were offered at a 60% discount but were secured. 15-1771 JA 2241. Holders of $118 million of the Subordinated Notes accepted the offer, leaving $382 million in unsecured Subordinated Notes outstanding. 15-1771 JA 2241.

Second-Lien Notes. In 2010, MPM issued approximately $1 billion in "springing" *792 second-lien notes (the "Second-Lien Notes"). 15-1682 JA 1616; 15-1771 JA 476. The Second-Lien Notes were to be unsecured until the $118 million of previously exchanged Subordinated Notes were redeemed, at which point the "spring" in the lien would be triggered. 15-1771 JA 517, 580-81. Once triggered, the Second-Lien Notes would then (but only then) obtain a security interest in the Debtor's collateral.

collateral. A primary issue on this appeal is whether the Second-Lien Notes have priority over the Subordinated Notes.

Senior-Lien Notes. In 2012, MPM again issued more debt, this time in the form of two classes of senior secured notes. Specifically, MPM issued $1.1 billion in first-lien secured notes (the "First-Lien Notes"), and $250 million in 1.5-lien secured notes (the "1.5-Lien Notes," and, with the First-Lien Notes, the "Senior-Lien Notes"). 15-1682 JA 1615. Appellants BOKF and Wilmington Trust are the indenture trustees for the First-Lien Notes and 1.5-Lien Notes, respectively. Pursuant to the governing indentures (the "2012 Indentures"), the Senior-Lien Notes were to be repaid in full by their maturity date of October 15, 2020. They carried fixed interest rates of 8.875% and 10%, respectively. The 2012 Indentures also called for the recovery of a "make-whole" premium if MPM opted to redeem the notes prior to maturity. Because the Second-Lien Notes and the Senior-Lien Notes are secured by the same collateral, the holders of those notes executed an intercreditor agreement (the "Intercreditor Agreement"), which provided that the Senior-Lien Notes stood in priority to the Second-Lien Notes as to their respective liens, but that each was junior to pre-existing liens on MPM's collateral. 15-1771 JA 691-718. Other primary issues on this appeal are whether the Senior-Lien Note holders are entitled to the make-whole adjustment and the cramdown interest rate they are entitled to if their Notes are replaced under the Plan.

II

After these notes were issued, MPM experienced significant financial problems. *See* 15-1771 JA 284-88. In April 2014, MPM filed a petition under Chapter 11 and ultimately submitted a reorganization plan to the bankruptcy court. 15-1682 JA 3841-912. Several elements of that Plan are at issue on these appeals. The Plan provided for (i) a 100% cash recovery of the principal balance and accrued interest on the Senior-Lien Notes; (ii) an estimated 12.8%-28.1% recovery on the Second-Lien Notes in the form of equity in the reorganized Debtors; but (iii) no recovery on the Subordinated Notes. 15-1771 JA 271-74.

The Plan also gave the Senior-Lien Notes holders the option of (i) accepting the Plan and immediately receiving a cash payment of the outstanding principal and interest due on their Notes (without a make-whole premium), or (ii) rejecting the Plan, receiving replacement notes "with a present value equal to the Allowed amount of such holder's [claim]," and then litigating in the bankruptcy court issues including whether they were entitled to the make-whole premium and the interest rate on the replacement notes. 15-1771 JA 271-72; 15-1682 JA 3873-75. The Senior-Lien Notes holders rejected the Plan, and, thus, elected the latter option.

The appellants here—the Subordinated Notes holders and the Senior-Lien Notes holders—opposed the Plan. (The Second-Lien Notes holders unanimously accepted *793 it.) The Subordinated Notes holders, who were to receive nothing, contended that, under relevant indenture provisions, their Notes were not subordinate to the Second-Lien Notes holders and, consequently, they were entitled to some recovery. The Senior-Lien Notes holders opposed the Plan on the ground that the replacement notes they received did not provide for the make-whole premium, and carried a largely risk-free interest rate that failed to comply with the Code because it was well below ascertainable market rates for similar debt obligations and thus was not fair and equitable because it failed to give them the present value of their claim.

Despite these objections, the bankruptcy court confirmed the Plan following a four-day hearing. *In re MPM Silicones, LLC*, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd*, 531 B.R. 321 (S.D.N.Y. 2015). Confirmation was facilitated by Chapter 11's "cramdown" provision, which allows a bankruptcy court to confirm a reorganization plan notwithstanding non-accepting classes if the plan "does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1).

The bankruptcy court concluded that the Plan was fair to the Subordinated Notes holders, despite no recovery, because the 2006 Indenture called for their subordination to the Second-Lien Notes. *In re MPM Silicones, LLC*, 2014 WL 4436335, at *2-*11. It held the plan was fair to the Senior-Lien Notes holders because the 2012 Indentures did not require payment of the make-whole premium in the bankruptcy context and because the interest rate on the proposed replacement notes, even though well below a "market" rate, was determined by a formula that complied with the Code's cramdown provision. *Id.* at *11-*32.

The bankruptcy court's confirmation order triggered an automatic 14-day stay during which Debtors could not consummate the Plan. *See* Fed. R. Bankr. P. 3020(e). Appellants aggressively took advantage of this period and attempted to block the implementation of the Plan. Specifically, prior to the expiration of the automatic stay, appellants moved in the bankruptcy court to extend the stay pending their appeal of the confirmation order, which the court denied. *See* 15-1682 JA 4099, 4173. They then promptly moved the district court for a stay, which was also denied. *See* 15-1682 JA 183, 185. Appellants then appealed the denial of the stay to this Court, and we dismissed the appeal for lack of jurisdiction. 15-1682 JA 4872-73. Despite these efforts, the Debtors contend this appeal is equitably moot, a contention with which we do not agree.

The appellants appealed the confirmation order to the district court which affirmed the bankruptcy court's confirmation order.

selected by the bankruptcy court complied with the Code, id. at 331-34; and (iii) under their indentures, the Senior-Lien Notes holders are not entitled to the make-whole premium in the context of a bankruptcy, id. at 335-38. The Subordinated Notes holders, the First-Lien Notes holders, and the 1.5-Lien Notes holders separately appealed.[4]

***794 III**

[1] "We exercise plenary review over a district court's affirmance of a bankruptcy court's decisions, reviewing *de novo* the bankruptcy court's conclusions of law, and reviewing its findings of facts for clear error." In re Lehman Bros., Inc., 808 F.3d 942, 946 (2d Cir. 2015) (internal quotation marks omitted).

IV

These appeals raise four issues. First, the Subordinated Notes holders challenge the lower courts' conclusions that their claims are subordinate to the Second-Lien Notes holders' claims. Second, the Senior-Lien Notes holders contend that the lower courts erroneously applied a below-market interest rate to their replacement notes. Third, the Senior-Lien Notes holders challenge the lower courts' rulings that they are not entitled to a make-whole premium. Finally, Debtors argue that we should dismiss these appeals as equitably moot. We find merit only in the Senior-Lien Notes holders' contention with respect to the method of calculating the appropriate interest rate for the replacement notes. We reject the others.

A

The lower courts concluded that the Plan, which provided no distribution to the Subordinated Notes holders, complied with the governing 2006 Indenture. The Subordinated Notes holders argue this conclusion was erroneous because, under the terms of the 2006 Indenture, their claims are not subordinate to the Second-Lien Notes, whose holders recovered under the plan. The Debtors, on the other hand, contend that the 2006 Indenture gives the Second-Lien Notes priority over the Subordinated Notes. We agree with the Debtors, although for somewhat different reasons from the lower courts which found the relevant indenture provisions unambiguous. We find them to be ambiguous, but resolve the ambiguities in favor of the Debtors.

The Subordinated Notes holders' argument begins with Section 10.01 of the 2006 Indenture, which states that the Subordinated Notes are "subordinated in right of payment ... to the prior payment in full of all existing and future Senior Indebtedness of the Company," and that "only Indebtedness of the Company that is Senior Indebtedness of the Company shall rank senior to the Securities in accordance with the provisions set forth herein." 15-1771 JA 404. Accordingly, the Second-Lien Notes stand in priority to the Subordinated Notes only if they constitute "Senior Indebtedness."

"Senior Indebtedness" in the 2006 Indenture begins with what the parties refer to as the "Baseline Definition," which defines Senior Indebtedness as:

> all Indebtedness ... unless the instrument creating or evidencing the same or pursuant to which the same is outstanding expressly provides that such obligations are subordinated in right of payment to any other Indebtedness of the Company ...

15-1771 JA 341.

It is undisputed that the Second-Lien Notes are not subordinated in right of payment to any other indebtedness and that therefore they satisfy the Baseline Definition of Senior Indebtedness. However, the Baseline Definition is then subject to six enumerated exceptions, the fourth of which (the "Fourth Proviso") excepts from Senior Indebtedness:

> *795 any Indebtedness or obligation of the Company ... that by its terms is subordinate or junior *in any respect* to any other Indebtedness or obligation of the Company ... including any Pari Passu Indebtedness.

15-1771 JA 342 (emphasis added).

The Subordinated Notes holders argue that the Fourth Proviso carves out the Second-Lien Notes from the Baseline Definition, respect" language. They argue that the Second-Lien Notes are subordinate to, for example, the First-Lien Notes—because, pursuant to the Intercreditor Agreement, the liens supporting the Second-Lien Notes are junior to the liens supporting the First-Lien Notes—and that they are therefore subordinate to other Indebtedness of the company.

The lower courts rejected this argument, and concluded that the Second-Lien Notes unambiguously constitute Senior Indebtedness despite the Fourth Proviso. They did so in reliance on a distinction between "lien subordination" and "payment (or debt) subordination," concluding that the Fourth Proviso unambiguously carves out from the Baseline Definition only the latter and not the former.[2] Because the Second-Lien Notes are not subordinate in *payment* to other note classes—but rather, the *liens* supporting their notes are subordinate—the lower courts concluded that the Second-Lien Notes are not covered by the Fourth Proviso.

We do not agree with the lower courts that the Fourth Proviso unambiguously incorporates a distinction between lien subordination and payment subordination. Rather, we conclude that the Fourth Proviso renders the definition of Senior Indebtedness ambiguous as to whether it includes the Second-Lien Notes. Nevertheless, we conclude that this ambiguity should be resolved in Debtors' favor given the plethora of evidence in the record that the parties intended the Second-Lien Notes to be Senior Indebtedness.

I

[2] [3]As discussed, the lower courts concluded that the Second-Lien Notes are unambiguously Senior Indebtedness. Under New York law, which governs the Indenture, a fundamental objective of contract interpretation is to give effect to the expressed intention of the parties. The initial inquiry is whether the contractual language, without reference to sources outside the text of the contract, is ambiguous. Contract language is ambiguous if it is capable of more than one meaning.

[4]We are not persuaded by the Debtors' (and lower courts') conclusion that the Fourth Proviso's reference to "subordinate ... in any respect" unambiguously refers only to payment subordination and not to lien subordination. The Debtors read the Fourth Proviso as if it states "subordinate ... *in right of payment*," which of course it does not. In so doing, the Debtors disregard the breadth of the term "in any respect," a term which is generally thought *796 to be as broadly encompassing as possible.[3] And, as a practical matter, it seems to us illogical to believe that a second-lien holder does not possess an obligation that is meaningfully subordinate in some respect to a first-lien holder. These sophisticated parties knew how to cabin the type of subordination to which they refer; the indenture uses the term "subordinate ... in right of payment" many times, including in the Baseline Definition itself.

Moreover, the Debtors' interpretation renders language in the indenture superfluous, which is a common sign of ambiguity. *See RJE Corp. v. Northville Indus. Corp.*, 329 F.3d 310, 314 (2d Cir. 2003) (in assessing ambiguity, courts consider the entire contract "to safeguard against adopting an interpretation that would render any individual provision superfluous" (internal quotation marks omitted)); *see also Lawyers' Fund for Client Protection of State of N.Y. v. Bank Leumi Trust Co. of New York*, 94 N.Y.2d 398, 404, 706 N.Y.S.2d 66, 727 N.E.2d 563 (N.Y. 2000) (concluding that an interpretation that renders a portion of a contract superfluous is "unsupportable: under standard principles of contract interpretation"). Specifically, if the Fourth Proviso only excepts debt subordinate in right of payment, there is no purpose for the "in right of payment" carve-out in the Baseline Definition. We disagree with the lower courts' attempts to interpret away this superfluity by finding a distinction between "expressly" (in the Baseline Definition) and "by its terms" (in the Fourth Proviso). We see no meaningful distinction between those terms.

Nevertheless, we also conclude that the Subordinated Notes holders' interpretation, that the Fourth Proviso unambiguously excludes the Second-Line Notes from the definition of Senior Indebtedness, is incorrect. As the lower courts correctly concluded, the Subordinated Notes holders' interpretation renders key parts of the Baseline Definition superfluous. Under their reading, that definition excludes from Senior Indebtedness only obligations subordinate "in right of payment," but the Fourth Proviso excludes all obligations that stand behind any type of other obligation. If so, the Baseline Definition's more limited carve-out for debt subordinate "in right of payment" would be unnecessary, because all such debt would be carved out from the definition of Senior Indebtedness by the Fourth Proviso.

As the Subordinated Notes holders correctly acknowledge, "[f]or this indenture, it simply is *not* possible to avoid superfluity." 15-1771 Br. of Appellant 54 (internal quotation marks omitted). Where, as here, varying interpretations render contractual language superfluous, we are not obligated to arbitrarily select one as opposed to another. Because the 2006 Indenture is open to differing reasonable interpretations as to whether the Second-Lien Notes constitute Senior Indebtedness, we conclude that it is ambiguous as a matter of law.

[10] Where a contract term is ambiguous, we look to extrinsic evidence to determine the intention of the parties. That evidence can include the parties' apparent intention, *Walk-In Medical Centers, Inc. v. Breuer Capital Corp.*, 818 F.2d 260, 264 (2d Cir. 1987), what would be commercially reasonable, *Fundamental Long Term Care Holdings, LLC v. Cammeby's Funding LLC*, 20 N.Y.3d 438, 445, 962 N.Y.S.2d 583, 985 N.E.2d 893 (2013), and the "parties' *797 interpretation of the contract in practice, prior to litigation," *Ocean Transp., Inc. v. American Philippine Fiber Indus., Inc.*, 743 F.2d 85, 91 (2d Cir. 1984). Applying these tools, we conclude, as did the district court, that the parties understood that the Second-Lien Notes constituted Senior Indebtedness. *See* 531 B.R. at 331 n.7.

First, MPM repeatedly represented to the Securities Exchange Commission and to the financial community that the Second-Lien Notes were Senior Indebtedness. It did so in its prospectuses, 8-Ks and 10-Ks. For example, it disclosed in a November 2010 8-K that the Second-Lien Notes are "senior indebtedness of the Company ... and will rank ... senior in right of payment to all existing and future subordinated indebtedness." 15-1771 JA 3057; *see also* 15-1771 JA 2231. It went further when it subsequently resold certain Subordinated Notes. In a May 2013 prospectus, MPM restated that the Subordinated Notes "are subordinated to all our existing and future senior debt, including the ... Second-Priority Springing-Lien Notes." MPM also specifically identified as the first risk related to the Subordinated Notes that those holders' "right to receive payments on the Notes is junior to those lenders who have a security interest in our assets." 15-1771 JA 3007, 3010. MPM further asserted that in the event it were to file for bankruptcy and were unable to repay its secured debt, "it is possible that there would be no assets remaining from which your claims could be satisfied." 15-1771 JA 3010. The Subordinated Note holders knew all of this because the Debtors were contractually obligated, pursuant to Section 4.02 of the 2006 Indenture, to provide copies of its 10-Ks, 10-Qs, 8-Ks, and all other required disclosures both to the Subordinated Note holders as well as to their Trustee—a highly sophisticated group of investors. 15-1771 JA 357. There is no dispute that these disclosures occurred. Consequently, it was widely understood in the investment community that the Second-Lien Notes had priority.

Second, the Subordinated Notes holders' interpretation generates the irrational outcome that the springing of the Second-Lien Notes' security interest, which was meant to enhance the note holders' protection, would actually strip those notes of their status as Senior Indebtedness and therefore their priority over the Subordinated Notes. As the bankruptcy court concluded, "[t]here is no logical reason for such a distinction, notwithstanding the subordinated noteholders' attempt to find one." 2014 WL 4436335, at *9.

Third, the Subordinated Notes holders' proposed interpretation that "in any respect" covers all junior liens would mean that no senior note classes would qualify as Senior Indebtedness because each was secured in some respect by a junior lien. For example, the First-Lien Notes were secured in part by a second priority lien on collateral securing a prepetition revolving credit facility. *See* 15-1771 JA 2425-26. We think it highly improbable that anyone understood this interpretation to be correct. Certainly MPM did not. For example, in a December 2012 prospectus MPM represented to the SEC that the Senior-Lien Notes were Senior Indebtedness. 15-1771 JA 3725. Because those note classes are subordinate to pre-existing liens as to the Debtors' collateral, they, too, would seemingly not qualify as Senior Indebtedness under the Subordinated Notes holders' interpretation. In light of these factors, we have little trouble concluding that the extrinsic evidence establishes that the most reasonable interpretation of the Indenture is that the Second-Lien Notes are Senior Indebtedness. The judgment of the district court on that issue is, therefore, affirmed.

***798 B**

As a consequence of rejecting the Plan, the Senior-Lien Notes holders received replacement notes which pay out their claim over time. The Code permits debtors to make such "deferred cash payments" to secured creditors (*i.e.*, to "cramdown"). 11 U.S.C. § 1129(b)(2)(A)(i)(II). However, those payments must ultimately amount to the full value of the secured creditors' claims. *Id.* To ensure the creditor receives the full present value of its secured claim, the deferred payments must carry an appropriate rate of interest. *See* *Rake v. Wade*, 508 U.S. 464, 472 n.8, 113 S.Ct. 2187, 124 L.Ed.2d 424 (1993).

The rate selected by the lower courts for the Senior-Lien Note holders' replacement notes was based on the "formula" rate. The bankruptcy court selected interest rates of 4.1% and 4.85%, respectively, which were largely risk-free rates slightly adjusted for appropriate risk factors. It is not disputed that this rate is below market in comparison with rates associated with comparable debt obligations. The Debtors defend the application of the "formula" method on the ground that it is required by the plurality opinion in the Chapter 13 case of *Till v. SCS Credit Corp.*, 541 U.S. 465, 124 S.Ct. 1951, 158 L.Ed.2d 787 (2004).

The Senior-Lien Notes holders contend that because this rate is too low, the Plan is not "fair and equitable" as required by § 1129(b). They argue that the lower courts should have applied a market rate of interest which is the rate MPM would pay to a contemporaneous sophisticated arms-length lender in the open market. The Senior-Lien Notes holders argued in the bankruptcy court that such a market exists and would generate interest in the 5-6+% range. *See* 15-1682 JA 464, 1941.[2]

in *Till v. SCS Credit Corp.*, 541 U.S. 465, 124 S.Ct. 1951, 158 L.Ed.2d 787 (2004)," it concluded that the proper rate was what the plurality in *Till* referred to as the "formula" or "prime-plus" rate (discussed more fully below). *Id.* at *24, *26. The district court agreed. 531 B.R. at 332-34. The Senior-Lien Notes holders argue on appeal that the lower courts erred in concluding that the *Till* plurality opinion is wholly applicable to this Chapter 11 proceeding. In substantial part, we agree.

At issue in *Till* was a Chapter 13 debtor's sub-prime auto loan, carrying an interest rate of 21% and providing the creditor with a $4,000 secured claim. As with Chapter 11, Chapter 13 allows debtors to provide secured creditors with future property distributions (such as deferred cash payments) whose total "value, as of the effective date of the plan, ... is not less than the allowed amount of such claim." 11 U.S.C. § 1325(a)(5)(B)(ii). The question became, as here, how to calculate the interest on the deferred payments such that the creditor would receive the full value of its claim. No single interest-calculation method secured a majority vote on the Court, *799 resulting in a plurality opinion endorsing the "formula" method.

The "formula" approach endorsed by the *Till* plurality instructs the bankruptcy court to begin with a largely risk-free interest rate, specifically, the "national prime rate ... which reflects the financial market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate for the opportunity costs of the loan, the risk of inflation, and the relatively slight risk of default." 541 U.S. at 479, 124 S.Ct. 1951. The bankruptcy court should then hold a hearing to determine a proper plan-specific risk adjustment to that prime rate "at which the debtor and any creditors may present evidence." *Id.* Using this approach, "courts have generally approved adjustments [above the prime rate] of 1% to 3%." *Id.* at 480, 124 S.Ct. 1951.[8]

The *Till* plurality arrived at the "formula" rate after rejecting a number of alternative methods relied on by the lower courts. Significantly, it rejected methods relying on purported "market" rates of interest because those rates "must be high enough to cover factors, like lenders' transactions costs and overall profits, that are no longer relevant in the context of court-administered and court-supervised cramdown loans." 541 U.S. at 477, 124 S.Ct. 1951. The plurality then identified the only factors it viewed as relevant in properly ensuring that the sum of deferred payments equals present value: (i) the time-value of money; (ii) inflation; and (iii) the risk of non-payment. *Id.* at 474, 124 S.Ct. 1951. The plurality concluded that the "formula" or "prime-plus" method best reflects those considerations.

Although *Till* involved a Chapter 13 petition, the plurality intimated that the "formula" method might be applicable to rate calculations made pursuant to other similarly worded Code provisions. In fact, it cited the Chapter 11 cramdown provision, 11 U.S.C. § 1129(b)(2)(A)(i)(II), among many other provisions, when it noted that "[w]e think it likely that Congress intended bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under any of these [Code] provisions." *Id.* at 474 & n.10, 124 S.Ct. 1951.

Despite that language, however, the plurality made no conclusive statement as to whether the "formula" rate was generally required in Chapter 11 cases. And, notably, the plurality went on to state, in the opinion's much-discussed footnote 14, that the approach it felt best applied in the Chapter 13 context may *not* be suited to Chapter 11. Specifically, in that footnote, the Court stated that in Chapter 13 cramdowns "there is no free market of willing cramdown lenders." 541 U.S. at 476 n.14, 124 S.Ct. 1951. It continued: "[i]nterestingly, the same is *not* true in the Chapter 11 context, as numerous lenders advertise financing for Chapter 11 debtors in possession. Thus, when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce." *Id.* (internal citations omitted) (emphasis in original).[9]

[6] *800 Many courts have relied on footnote 14 to conclude that efficient market rates for cramdown loans cannot be ignored in Chapter 11 cases. Most notably, the Sixth Circuit, "tak[ing] [its] cue from Footnote 14" of the *Till* plurality, adopted a two-part process for selecting an interest rate in Chapter 11 cramdowns:

> [T]he market rate should be applied in Chapter 11 cases where there exists an efficient market. But where no efficient market exists for a Chapter 11 debtor, then the bankruptcy court should employ the formula approach endorsed by the *Till* plurality.

In re American HomePatient, Inc., 420 F.3d 559, 568 (6th Cir. 2005). In applying this rule, courts have held that markets for financing are 'efficient' where, for example, "they offer a loan with a term, size, and collateral comparable to the forced loan contemplated under the cramdown plan." *In re Texas Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d 324, 337 (5th Cir. 2013).[10]

We adopt the Sixth Circuit's two-step approach, which, in our view, best aligns with the Code and relevant precedent. We do not read the *Till* plurality as stating that efficient market rates are irrelevant in determining value in the Chapter 11 cramdown context. And, disregarding available efficient market rates would be a major departure from long-standing precedent dictating that "the best way to determine value is exposure to a market." *Bank of Am. Nat'l Trust and Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 457, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999) (assessing a Chapter 11 cramdown); *see also United States v. 50 Acres of Land*, 469 U.S. 24, 25 & n.1, 105 S.Ct. 451, 83 L.Ed.2d 376 (1984) ("fair market value" is "what a willing buyer would pay in cash to a willing seller" (internal quotation marks omitted)). In *Bank of America*, the Court noted that "one of the Code's innovations [was] to narrow the occasions for courts to make valuation judgments," and expressed a "disfavor for

The Senior-Lien Notes holders presented expert testimony in the bankruptcy court that, if credited, would have established a market rate. This evidence showed that if the Senior-Lien Noteholders were to have approved the Plan and accepted a cash-out payment for their notes, MPM would have had to secure exit financing to cover the lump-sum payment. In preparation for that possible eventuality (which did not come to pass in light of the Senior-Lien Notes holders' rejection of the Plan), MPM went out into the market seeking lenders to provide that financing. Those lenders quoted MPM rates of interest ranging between 5 and 6+%. *See In re MPM Silicones, LLC*, 2014 WL 4436335, at *29.

At these rates, the First-Lien Note holders contend that they would have received around $150 million more than the Plan offered, Br. of First-Lien Appellant 25, 33. The 1.5-Lien Note holders claim that the interest rate chosen by the lower courts led them to receive notes "valued by the market at *less than 93 cents* on the value of the secured claims," Br. of 1.5-Lien Appellant 20.[11] The Plan was objectionable ***801** to the Senior-Lien Notes holders because, in essence, it required them to lend Debtors a significant sum of money and receive a much lower rate of interest than any other lender would have received for offering the same loan to MPM on the open market.

When dealing with a sub-prime loan in the Chapter 13 context, "value" can be elusive because the market is not necessarily efficient and the borrower is typically unsophisticated. However, where, as here, an efficient market may exist that generates an interest rate that is apparently acceptable to sophisticated parties dealing at arms-length, we conclude, consistent with footnote 14, that such a rate is preferable to a formula improvised by a court. *See Bank of America*, 526 U.S. at 457, 119 S.Ct. 1411; *see also In re Valenti*, 105 F.3d 55, 63 (2d Cir. 1997) (the goal of the cramdown rate "is to put the creditor in the same economic position that it would have been in had it received the value of its allowed claim immediately"); *see also* 15-1682 JA 3428 (First-Lien Notes holders' expert testifying that because the First-Lien Notes holders "are pricing it at the market ... they're being compensated for the underlying risk that they are taking," and not for any "imbedded profit").

We understand that the complexity of the task of determining an appropriate market rate will vary from case to case. In some cases the task will be straightforward, in others it will be more complex. But, at the end of the day, we have no reason to believe the task varies materially in difficulty from the myriad tasks which we regularly rely on the expertise of our bankruptcy courts to resolve.

[7]We therefore conclude that the lower courts erred in categorically dismissing the probative value of market rates of interest. We remand so that the bankruptcy court can ascertain if an efficient market rate exists and, if so, apply that rate, instead of the formula rate.[12] We arrive at no conclusion with regard to the outcome of this inquiry.

C

[8]The 2012 Indentures governing the Senior-Lien Notes contain Optional Redemption Clauses, which provide for the payment of a make-whole premium[13] (referred to as the "Applicable Premium" in the indentures) if MPM were to "redeem the Notes at its option" prior to October 15, 2015. 15-1682 JA 2322.[14] The make- ***802** whole premium was intended to ensure that the Senior-Lien Notes holders received additional compensation to make up for the interest they would not receive if the Notes were redeemed prior to their maturity date.

[9]In October 2014, the Debtors, pursuant to the Plan, issued replacement notes to the Senior-Lien Notes holders, which did not account for the make-whole premium. These holders contended that the failure to include that premium violated the 2012 Indentures. The bankruptcy court concluded that the Senior-Lien Notes holders were not entitled to the premium. It reasoned that under the 2012 Indentures the make-whole premium would be due only in the case of an "optional redemption" and not in the case of an acceleration brought about by a bankruptcy filing. 2014 WL 4436335, at *11-*15. The district court agreed. 531 B.R. at 335-38. We too agree.

The Senior-Lien Notes holders claim entitlement to the make-whole premium for essentially three reasons: (i) they are entitled to the make-whole under the 2012 Indentures' Optional Redemption Clauses; (ii) they are entitled to it under the 2012 Indentures' Acceleration Clauses; and (iii) even if the indentures did not allow for a make-whole premium upon acceleration, they should not have been permanently barred from exercising their contractual right to rescind acceleration and thereby obtain the make-whole premium.

1

the same reasons we rejected nearly identical arguments in *In re AMR Corp.*, 730 F.3d 88 (2d Cir. 2013). There we rejected the note holders' argument that they were entitled to a make-whole premium following a debtor's bankruptcy filing. We concluded that:

> American's bankruptcy petition triggered a default, and this default automatically accelerated the debt. That acceleration changed the date of maturity from some point in the future ... to an earlier date based on the debtor's default under the contract. ... When the event of default occurred and the debt accelerated, the new maturity for the debt was November 29, 2011 [the date of the bankruptcy petition]. Consequently, American's attempt to repay the debt in October 2012 was not a voluntary prepayment because [p]repayment can only occur *prior* to the maturity date.

Id. at 103 (internal citations and quotation marks omitted).

The Senior-Lien Notes holders argue *AMR* is inapplicable because it spoke only to "prepayment" rather than "redemption." As the district court noted, the principle of *AMR* does not turn on the distinction between "prepayment" and "redemption." 531 B.R. at 336-37. In fact, in *AMR* we stated that because "American's debt was accelerated ... upon its bankruptcy filing [it] is not now voluntarily redeeming the notes." *AMR*, 730 F.3d at 109.

We also held in *AMR* that acceleration brought about by a bankruptcy filing changes the date of maturity of the accelerated notes to the date of the petition. 730 F.3d at 103. Therefore, any payment on the accelerated notes following a bankruptcy filing would be a *post*-maturity payment. And, as the First-Lien Notes holders ***803** concede, the "plain meaning of the term 'redeem' is to 'repay[ ] ... a debt security ... *at or before* maturity.' " 15-1682 Br. of First-Lien Appellant 39 (emphasis added). Here, Debtors' payment was *post*-maturity, not "at or before" maturity. *But see In re Energy Future Holdings Corp.*, 842 F.3d 247, 255 (3d Cir. 2016). Moreover, even assuming MPM's issuance of the replacement notes was a "redemption," it would not have been "at [*MPM's*] option," as required to trigger the Optional Redemption Clauses. Rather, the obligation to issue the replacement notes came about automatically by operation of separate indenture provisions, the Automatic Acceleration Clauses. A payment made mandatory by operation of an automatic acceleration clause is not one made at MPM's option. *See AMR*, 730 F.3d at 100B01.

2

As discussed, the 2012 Indentures each contain an Acceleration Clause, which calls for the acceleration of payment of the Senior-Lien Notes under certain conditions constituting an Event of Default. Pursuant to Section 6.01(g), one such event is MPM's filing of a voluntary bankruptcy petition. Although most Events of Default allow the Senior-Lien Notes holders the *option* of accelerating payment, a default brought about by MPM's voluntary bankruptcy petition leads to an *automatic* acceleration under Section 6.02.[13]

The Senior-Lien Notes holders argue that the term "premium, if any" in the Acceleration Clauses requires that the make-whole premium is due upon an automatic acceleration. This argument fails in light of our conclusion that the Senior-Lien Notes holders are not entitled to the make-whole premium under the Optional Redemption Clauses. In other words, the make-whole premium is not due pursuant to the Acceleration Clauses' reference to "premium, if any," for the simple reason that the more specific Optional Redemption Clauses which grant the make-whole are not triggered and thus no premium has been generated. *See Aramony v. United Way of Am.*, 254 F.3d 403, 413 (2d Cir. 2001) (noting that "it is a fundamental rule of contract construction that specific terms and exact terms are given greater weight than general language" (internal quotation marks omitted)).

3

[10]Finally, the Senior-Lien Notes holders argue that the lower courts erred in disregarding their contractual right to rescind acceleration,[14] a right that if invoked would have reinstated the original maturity date and thereby kept the Optional Redemption Clauses (and therefore the make-whole premium) in effect.

AMR forecloses this argument as well. There, considering nearly identical indenture language, we concluded that a creditor's post-petition invocation of a contractual right to rescind an acceleration triggered automatically by a bankruptcy filing is barred because it would be "an attempt to modify contract rights and would therefore be subject to the automatic ***804** stay." 730 F.3d at 102; *see also id.* at 102-03 ("any attempt by U.S. Bank to rescind acceleration now—after the automatic stay has taken effect —is an effort to affect American's contract rights, and thus the property of the estate").

unlike the one here, expressly disavowed the make-whole premium. According to the 1.5-Lien Notes holders, our concern in AMR was therefore with not allowing the creditors "an end-run around their bargain by rescission." 15-1682 Br. of 1.5-Lien Appellant 45. This argument fails because, although the provisions at issue here do not expressly disallow the make-whole premium, the Optional Redemption Clauses, as we have seen, achieve this result. Therefore, just as in AMR, because the right to rescind acceleration here would serve as "an end-run around their bargain by rescission," the lower courts correctly concluded that the automatic stay barred rescission of the acceleration of the Notes.

V

[11] [12] [13]Debtors seek dismissal of these appeals under the principle of equitable mootness, a "prudential doctrine that is invoked to avoid disturbing a reorganization plan once implemented." In re Metromedia Fiber Network, Inc., 416 F.3d 136, 144 (2d Cir. 2005).[17] The doctrine "allows appellate courts to dismiss bankruptcy appeals 'when, during the pendency of an appeal, events occur' such that 'even though effective relief could conceivably be fashioned, implementation of that relief would be inequitable.' " In re Motors Liquidation Co., 829 F.3d 135, 167 (2d Cir. 2016) (quoting In re Chateaugay Corp., 988 F.2d 322, 325 (2d Cir. 1993) ("Chateaugay II")). The doctrine requires us to "carefully balance the importance of finality in bankruptcy proceedings against the appellant's right to review and relief." In re Charter Commc'ns, Inc., 691 F.3d 476, 481 (2d Cir. 2012). With these principles in mind, we decline to dismiss any of these appeals as equitably moot.

[14]Where, as here, a reorganization plan has been substantially consummated, we presume that an appeal of that plan is equitably moot. In re BGI, Inc., 772 F.3d 102, 104 (2d Cir. 2014). That presumption, however, gives way where five factors first identified in Chateaugay II are met. They are, where: (i) effective relief can be ordered; (ii) relief will not affect the debtor's re-emergence; (iii) relief "will not unravel intricate transactions"; (iv) affected third-parties are notified and able to participate in the appeal; and (v) appellant diligently sought a stay of the reorganization plan. In re Charter, 691 F.3d at 482.

[15]Although we require satisfaction of each Chateaugay II factor to overcome a mootness presumption, we have placed significant reliance on the fifth factor, concluding that a "chief consideration under Chateaugay II is whether the appellant sought a stay of confirmation." In re Metromedia, 416 F.3d at 144. Along these lines, we concluded that "[i]f a stay was sought, we will provide relief if it is at all ***805** feasible, that is, unless relief would 'knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the Bankruptcy Court.' " Id. (quoting Chateaugay II, 10 F.3d 944, 953 (2d Cir. 1993)).

A special emphasis on this factor is sound. Equitable mootness issues only arise in earnest following a judicial determination that some facet of a reorganization plan violates the Code. It is generally considered inappropriately harsh to deny relief to which one is entitled on the purportedly equitable ground that the unfair (or illegal) plan has been put into effect, especially where a creditor took all appropriate steps to secure judicial relief. In such a case, we have held that it is proper to "provide relief if it is at all feasible." Id.

[16]Here, the appellants immediately objected to various provisions of the Plan and promptly and consistently sought a stay in three different courts. Thus their diligence is not in question. Debtors nevertheless argue that these appeals should be dismissed as moot because of the cascading effects of rewriting the plan were the appellants to prevail. Specifically, they argue that "granting the Noteholders' relief would alter a critical piece of the Plan resulting from the intense-multi-party negotiation, thereby impact[ing] other terms of the agreement and throw[ing] into doubt the viability of the Plan," and that according such relief "would cause debilitating financial uncertainty" to the emergent Debtor. 15-1682 Br. of Appellees 69, 71 (internal quotation marks omitted).

In light of the limited nature of the remand we order, we do not believe these concerns will materialize. On remand, the bankruptcy court will only be called on to re-evaluate the interest to be received on the replacement notes held by the Senior-Lien Notes holders. The Debtors acknowledge that this might require, at most, $32 million of additional annual payments over seven years. 15-1682 Br. of Appellees 69. The Debtors will not have to pay out the nearly $200 million they assert would be required to pay the Senior-Lien Notes holders' make-whole premium, nor will any redistribution be required to the Subordinated Notes holders, as to which the plan is fair. In fact, our judgment allows for no redistribution other than that from the Debtors to the Senior-Lien Notes holders.

Given the scale of Debtors' reorganization, we are not persuaded that a payment of, perhaps, $32 million in annual payments over seven years, with no other redistribution from other creditors or third parties, would unravel the plan, threaten Debtors' emergence, or otherwise materially implicate the concerns identified in Chateaugay II.

Our conclusion is supported by the findings of the lower courts, which had intimate familiarity with the Debtors' financial condition and the transactions that will arise from the reorganization. Although it made no determinative ruling as to equitable

The district court agreed. 15-1682 JA 4837 ("I agree with Judge Drain that the risk of equitable mootness here is not very great ..."). Debtors' request that we dismiss these appeals as equitably moot is denied.

VI

To summarize, we conclude as follows:

1. The Second-Lien Notes stand in priority to the Subordinated Notes.

***806** 2. The Senior-Lien Notes holders are not entitled to the make-whole premium.

3. The lower court erred in the process it used to calculate the interest rate applicable to the replacement notes received by the Senior-Lien Notes holders. On remand, the bankruptcy court should assess whether an efficient market rate can be ascertained, and, if so, apply it to the replacement notes.

4. We decline to dismiss any of these appeals as equitably moot.

For the foregoing reasons, we **AFFIRM** the District Court's order in part, with respect to the priority of the Subordinated Notes and the Senior-Lien Notes holders' entitlement to a make-whole premium; **REVERSE** the order in part, with respect to the method of calculating the interest rate on the Senior-Lien Notes holders' replacement notes; and **REMAND** the matter for further proceedings consistent with this opinion.

All Citations

874 F.3d 787, Bankr. L. Rep. P 83,176

Footnotes

1 Momentive Performance Materials, Inc.'s "MPM," and with affiliated debtors, "Debtors".

2 The facts recounted herein derive principally from the bankruptcy court's decision confirming Debtors' reorganization plan, *In re MPM Silicones, LLC*, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd* 531 B.R. 321 (S.D.N.Y. 2015), as well as the public disclosures made part of the record. We rely on the facts recounted in the bankruptcy court's ruling in light of our "oblig[ation] to accept the bankruptcy court's undisturbed findings of fact unless they are clearly erroneous." *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F.2d 395, 396 (2d Cir. 1987).

3 As discussed, *infra* note 4, we resolve with this opinion three separate appeals. Our citations to the respective records will begin with the relevant docket number on appeal, and references to "JA" are to the respective joint appendices filed with that appeal. For example, our citation to "15-1771 JA 286-88" is to pages 286-88 of the joint appendix filed in the appeal brought by U.S. Bank, docketed No. 15-1771.

4 The appeals by the First-Lien Notes holders (No. 15-1682) and 1.5-Lien Notes holders (No. 15-1824) were consolidated and heard in tandem with the appeal by the Subordinated Notes holders (No. 15-1771).

5 The district court discussed in some detail the distinction between lien subordination and payment/debt subordination. 531 B.R. at 328. In short, "[l]ien subordination involves two senior creditors with security interests in the same collateral, one of which has lien priority over the other. ... By contrast, in payment subordination, the senior lender enjoys the right to be paid first from all assets of the borrower or any applicable guarantor, whether or not constituting collateral security for the senior or subordinated lenders." *Id.*

term appears nowhere else in the indenture other than in the Fourth Proviso.

7 Debtors' reorganization plan proposed interest rates of 3.6% and 4.09%. *See* 2014 WL 4436335, at *24. However, the bankruptcy court concluded that those rates should be increased by 0.5% and 0.75%, respectively, in light of the fact that the base interest rate was pegged to the Treasury rate, rather than the prime rate (which reflects additional risk). *Id.* at *32. On appeal to the district court, the Senior-Lien Notes holders argued the bankruptcy court erred in not requiring the prime rate, an argument the district court rejected. 531 B.R. at 334-35. The Senior-Lien Notes holders do not press this argument here.

8 Here, the bankruptcy court applied risk adjustments of 2.0% and 2.75%, which it added to the Treasury rate of 2.1% to arrive at interest rates of 4.1% and 4.85%, respectively. 2014 WL 4436335, at *32. Debtors assert in their briefing that the Treasury rate dropped by approximately 0.2% between the confirmation date and the plan's effective date, which thereby further lowered their notes' interest rate. 15-1682 Br. of Appellee at 11 n.3.

9 The Supreme Court has not subsequently spoken about the interest-calculation method to be applied in a Chapter 11 case. Nor have we.

10 Numerous courts, included in this Circuit, have followed the *American HomePatient* approach. *See, e.g., In re 20 Bayard Views, LLC*, 445 B.R. 83, 108-09 (E.D.N.Y. 2011) (collecting cases and deciding to "follow the majority approach" first outlined in *American HomePatient*).

11 The Senior-Lien Notes holders offered evidence that the market price for their notes dropped, respectively, from 101.375% and 104.000% six days prior to the bankruptcy court's oral decision, to 94.375% and 92.563% nine days after that decision. 15-1682 JA 3991 ¶¶ 5-6, 8-9.

12 We acknowledge that the lower courts grappled with the Senior-Lien Notes holders' evidence regarding MPM's quoted exit financing, and made express their view that the rate produced by that process may not in fact have been produced by an efficient market. 2014 WL 4436335, at *26, *29; 531 B.R. at 334 n.9. Nevertheless, Judge Drain left no ambiguity that he applied the "formula" approach for Chapter 13 individual bankruptcy cases as dictated by the *Till* plurality and, in so doing, explicitly declined to consider market forces. *See* 2014 WL 4436335, at *25-*26; *see also id.* at *28 ("I conclude that [the *American HomePatient*] two-step method, generally speaking, misinterprets *Till*"). Judge Briccetti agreed with this approach. 531 B.R. at 334. As discussed, this was in error. The bankruptcy court should have the opportunity to engage the *American HomePatient* analysis in earnest.

13 A make-whole premium is a "contractual substitute for interest lost on Notes redeemed before their expected due date." *In re Energy Future Holdings Corp.*, 842 F.3d 247, 251 (3d Cir. 2016) ("*EFH*"). As stated by the bankruptcy court, its purpose "is to ensure that the lender is compensated for being paid earlier than the original maturity of the loan for the interest it will not receive ...." 2014 WL 4436335, at *15.

14 We cite in this section to the indenture for the First-Lien Notes; the indenture for the 1.5-Lien Notes is identical for relevant purposes.

15 Section 6.02 provides: "If an Event of Default specified in Section 6.01(f) or (g) with respect to MPM occurs, the principal of, premium, if any, and interest on all the Notes shall ipso facto become and be immediately due and payable without any declaration or other act on the part of the Trustee or any Holders." 15-1682 JA 2260.

16 "Holders of a majority in principal amount of outstanding Notes by notice to the Trustee may rescind any such acceleration with respect to the Notes and its consequences." 15-1682 JA 2260.

17 Debtors filed with the district court a motion to dismiss the appeal of the bankruptcy court's confirmation order on the basis of equitable mootness. 15-1771 JA 4570-88. The district court made no ruling on the motion, concluding it was "mooted by this Court's decision to affirm the Orders of the Bankruptcy Court." 531 B.R. at 338 n.14. Debtors then filed motions to dismiss on equitable mootness grounds with this Court, 15-1682 Doc. 58; 15-1771 Doc. 62, which we summarily denied without prejudice to Debtors "rais[ing] the issue ... in their merits brief," 15-1682 Doc. 159; 15-1771 Doc. 102.

Matter of MPM Silicones, L.L.C., 874 F.3d 787 (2017)

Bankr. L. Rep. P 83,176

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U.S. BANKRUPTCY COURT
NEWARK, N.J.
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UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In Re: **SARAH HUNTER,** Debtor.	Case No.: 15-17329-JKS Adv. Pro. No.: 15-02052-JKS Judge: Hon. John K. Sherwood
SARAH HUNTER, Plaintiff, vs. **NEW JERSEY HIGHER EDUCATION STUDENT ASSISTANCE AUTHORITY,** Defendant.	

DECISION AND ORDER GRANTING PARTIAL DISCHARGE OF DEBTOR'S STUDENT LOAN DEBT PURSUANT TO 11 U.S.C. § 523(a)(8)

The relief set forth on the following pages, numbered two (2) through nineteen (19), is hereby **ORDERED.**

HONORABLE JOHN K. SHERWOOD
UNITED STATES BANKRUPTCY JUDGE

Dated: April 27, 2018

APPEARANCES:

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INTRODUCTION

Debtor Sarah Hunter ("Debtor") filed an adversary complaint against the New Jersey Higher Education Student Assistance Authority ("NJHESAA") seeking to discharge student loan debt in the amount of $288,911.15 at the time she filed her bankruptcy petition.[1] Ms. Hunter has a master's degree and works in the public interest sector, where she earns $50,000 per year. She is married with a young daughter and has a second child due later this year. Her husband earns approximately $74,000 per year. Ms. Hunter asserts that repayment of her student loans would cause undue hardship because their joint income is not enough to make her combined monthly student loan payments of $2,609.24 after deducting expenses necessary to maintain a minimum standard of living for her family.[2] Based on the evidence in the record and Ms. Hunter's trial testimony, the Court concludes that requiring Ms. Hunter to repay all of her student loans would cause undue hardship and grants a partial discharge of her student loans as detailed below.

PROCEDURAL HISTORY

On April 22, 2015, the Debtor filed a voluntary petition for relief under chapter 13 of the Bankruptcy Code.[3] On July 23, 2015, Ms. Hunter filed an adversary complaint against NJHESAA.[4] On January 25, 2017, Ms. Hunter filed an amended complaint which contained

[1] Debtor's Am. Compl., ECF No. 13; Debtor's Ex. C-O.
[2] Test. of Sarah Hunter; Debtor's Ex. Q and O; Although Ex. Q states that Ms. Hunter's monthly student loan payment would be $2,609.24 as of February 2015, this amount does not include the Navient loan, which is included in the total amount of Ms. Hunter's debt with NJHESAA and for which a proof of claim was filed. The monthly amount of $2,609.24 is what the Debtor owed as of February 2015 and does not reflect compounding interest or other fees which have since accrued.
[3] Chapter 13 Voluntary Pet., *In re Sarah Hunter*, No. 15-17329 (JKS), ECF No. 1.
[4] Debtor's Adversary Compl., ECF No. 1.

among its five counts an assertion that repayment of her student loan debt is dischargeable based on undue hardship.[5] NJHESAA filed an answer to the amended complaint on March 10, 2017.[6] On January 5, 2018, after oral argument on summary judgment, the Court found that undue hardship was a triable issue of material fact.[7] Trial took place on February 28, 2018. The Debtor was the only witness.

JURISDICTION

The Court has jurisdiction over this proceeding pursuant to 28 U.S.C. §§ 1334(b), 157(a) and the Standing Order of Reference from the United States District Court for the District of New Jersey dated July 23, 1984, as amended September 18, 2012. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (I). Venue is proper under 28 U.S.C. §§ 1408 and 1409(a).

STATEMENT OF FACTS

Sarah Hunter was a student at Seton Hall University from 2007 through 2013. She graduated with a Bachelor of Science degree in Diplomacy and International Relations and Russian Suburban Studies as well as a Master's in Diplomacy and International Relations. She financed her education with various forms of financial aid, including loan proceeds from NJHESAA.[8] In addition to her loans with NJHESAA, Ms. Hunter has $66,000 in federal student loan debt which

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[5] Debtor's Am. Compl., ECF No. 13.
[6] NJHESAA's Answer to the Am. Compl., ECF No. 16.
[7] Decision and Order Regarding Pl.'s Mot. for Summ. J. to Discharge Student Loan Debt Pursuant to 11 U.S.C. § 523(a)(8) and Def.'s Cross-Mot. for Summ. J., ECF No. 31.
[8] Test. of Sarah Hunter.

may be eligible for income-based and income-contingent repayment plans.[9] Ms. Hunter's employment with the Global Center for Responsibility may also qualify her student loans for forgiveness under the federal Public Service Loan Forgiveness Program ("PSLF").[10] The Debtor's federal loans are not at issue in this proceeding but are relevant to the discussion of her ability to pay NJHESAA.

On April 22, 2015, Ms. Hunter filed a voluntary petition for relief under chapter 13 of the Bankruptcy Code.[11] Between May 14, 2015 and May 28, 2015, NJHESAA filed thirteen claims totaling $288,911.15, twelve under New Jersey College Loans to Assist State Students ("NJCLASS"), a loan program administered by NJHESAA,[12] and the last through Navient Solutions, Inc. on behalf of NJHESAA.[13] Ms. Hunter's chapter 13 plan was confirmed by Order dated July 27, 2015 and amended on August 5, 2015.[14] As part of the confirmed plan, Ms. Hunter made payments of $400 per month for the first five months and is making ongoing payments for the remaining 55 months of $100 per month to the chapter 13 trustee through May 1, 2020.

[9] *Id.*; *see* 34 C.F.R. §§ 685.221 (LEXIS through the Apr. 25, 2018 issue of the Fed. Reg. Title 3 is current through Apr. 6, 2018) (Income-based Repayment Plan) and 685.209 (LEXIS through the Apr. 25, 2018 issue of the Fed. Reg. Title 3 is current through Apr. 6, 2018) (Income-contingent Repayment Plan).
[10] Test. of Sarah Hunter; Pub. Serv. Loan Forgiveness Program, 34 C.F.R. § 685.219 (LEXIS through the Apr. 25, 2018 issue of the Fed. Reg. Title 3 is current through Apr. 6, 2018). A qualifying employer under the PSLF includes governmental entities at any level and not-for-profits that are tax-exempt under § 501(c)(3) of the Internal Revenue Code. The PSLF allows for loan forgiveness if the borrower makes 120 qualifying payments and is not in default on her loans, in addition to other requirements. *See id*. at (c).
[11] Chapter 13 Voluntary Pet., *In re Sarah Hunter*, No. 15-17329 (JKS), ECF No. 1.
[12] N.J.S.A. § 18A:71C-21 (LEXIS through N.J. 218th First Ann. Sess., L. 2018, c. 4 and J.R. 4).
[13] Debtor's Ex. C-O.
[14] Order Confirming Plan, *In re Sarah Hunter*, No. 15-17329 (JKS), ECF No. 31; Am. Order Confirming Plan, *In re Sarah Hunter*, No. 15-17329 (JKS), ECF No. 33.

Through the end of 2017, $1,368.85 of the plan payments have been disbursed to NJCLASS and NJHESAA.[15]

Ms. Hunter is employed as a research analyst in New York City at the City University of New York (CUNY) Global Center for Responsibility and earns approximately $50,000 a year.[16] At the time she filed her bankruptcy petition, she lived with her boyfriend and daughter in a rented townhouse in Jamesburg, New Jersey. She and her boyfriend have since married. They continue to live in the Jamesburg townhouse and are expecting a second child in September 2018.[17] Ms. Hunter testified at trial that her husband works full time as a project manager at an audio-visual installation company and once a week as a bartender. His gross income is about $74,000 per year.[18] Although both contribute toward their living expenses, Ms. Hunter and her husband maintain separate checking accounts from which they pay their household expenses. Ms. Hunter estimated that she takes home $2,000 per month.[19] She testified that she spends $900 for groceries, $293 for clothing, $77 for personal care items, and $385 for her New Jersey Transit train pass. The Debtor also pays $100 per month to the Chapter 13 trustee. Comparing these expenses to Ms. Hunter's take-home pay of $2,000 per month, she has about $245 of discretionary income at the end of each month. Her husband pays for all other expenses, including rent of $1,500 per month, condominium fees of $185 per month, car payment of $440 per month, car insurance of $85 per

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[15] Chapter 13 Trustee Ann. Rep., No. 15-17329 (JKS), ECF No. 48.
[16] Debtor's Ex. B.
[17] Test. of Sarah Hunter.
[18] *Id.*
[19] *Id.*

month, gas at $200 per month and day care of $507 per month.[20] The sum of these monthly expenses is $2,917. Assuming her husband's take-home pay is approximately $3,500 per month, he would have about $583 remaining per month. Ms. Hunter also testified that her husband has $2,500 in credit card debt as well as $4,000 in medical debt of which he pays about $400 a month as part of a repayment plan.

Ms. Hunter has been employed with the Global Center for five years. The Center is a non-profit organization with approximately eight to ten employees. Ms. Hunter currently receives an annual 2% salary increase but believes that any pay increase resulting from a promotion would be insignificant with respect to her ability to repay her loans. She testified that the individuals in the next two senior positions earn an estimated $58,000 to $75,000 per year. However, due to the small size of the organization, someone of seniority must leave the organization for a junior employee to be able to advance. At the top of the non-profit organization, the director makes "above six figures," but also has at least 30 years' experience in the field according to Ms. Hunter's testimony. Ms. Hunter testified that she feels unqualified to advance into a director position and, in general, that higher paying positions and job openings within this specialized field are scarce.[21]

For about six months during 2014, Ms. Hunter looked for work outside of the field of international relations and applied for four general administrative positions near her home with the goal of cutting back on transportation costs, but did not receive any offers of employment.[22]

[20] *Id.*
[21] *Id.* Ms. Hunter gave Human Rights Watch and Amnesty International as examples of other organizations that might consider her for employment given her experience and education.
[22] *Id.*

Ms. Hunter has not sought full-time employment outside the field of international relations since 2014 but bartended once a week in addition to her full-time job at the Center until six months into her pregnancy with her first child.[23]

Ms. Hunter has $288,911.15 in student loan debt with NJHESAA,[24] $285,461.63 of which is attributable to NJCLASS loans.[25] The remaining $3,449.52 stems from a Federal Stafford Loan disbursed by NJHESAA and now held by Navient Solutions, Inc. Since the Navient loan is a Federal loan, it would provide for income-based repayment options.[26]

The table below was prepared based on the proofs of claim filed by NJCLASS and reflects the Debtor's monthly student loan payments due as of February 2015.[27]

Outstanding Balance[28]	Origination Date	Monthly Payment	Maturation Date
$37,966.05	09/04/2007	$365.66	09/04/2027
$57,961.83	09/11/2008	$571.31	09/11/2028
$16,258.07	10/06/2008	$159.72	10/06/2028
$15,086.96	01/20/2009	$146.79	01/20/2029
$43,972.70	09/10/2009	$417.55	09/10/2029
$11,428.28	05/21/2010	$106.09	05/21/2030
$37,656.57	10/14/2010	$343.08	10/14/2030
$10,690.58	01/26/2012	$84.78	01/26/2037
$9,283.77	06/22/2012	$71.57	06/22/2037
$24,725.05	09/06/2012	$185.44	09/06/2037
$10,264.41	05/30/2013	$76.05	05/30/2038
$10,167.36	09/04/2013	$81.20	09/04/2038
$285,461.63		$2,609.24	

[23] Test. of Sarah Hunter.
[24] *See* Debtor's Ex. C-O.
[25] *See* Debtor's Ex. C-N.
[26] Debtor's Ex. O.
[27] Debtor's Ex. C-N; Q.
[28] Outstanding balance includes outstanding principal and interest at the time the bankruptcy petition was filed.

The maturity dates for the NJCLASS loans range from 2027 to 2038. NJHESAA granted the Debtor a post-undergraduate deferment on her loans from May 2011 through December 2011. Deferment was extended throughout her graduate studies and six months immediately thereafter, from January 2012 through July 2014. Interest continued to accrue on the loans during the deferment period.[29] Although no payments were due during this period, Ms. Hunter did make payments on her NJCLASS loans totaling $21,690.06.[30] In July 2014, at the end of her deferment period, Ms. Hunter was granted forbearance on her student loans. The terms of the forbearance still obligated Ms. Hunter to make interest-only payments on her loans through January 2015 that totaled $3,983.82, of which Ms. Hunter paid $1,218.80.[31] NJHESAA also warned that "the monthly principal and interest payment will increase after the expiration of the deferment or forbearance period."[32] In other words, although forbearance would provide short-term relief from payment, it would result in higher future monthly payments due to the accumulation of deferred principal against a maturity date that cannot be extended.

The provisions of N.J.A.C. § 9A:10-6.11 restrict NJHESAA's ability to provide flexible repayment options, as the regulation requires that student loans "be paid in full within the amount of years from the date of disbursement as specified in the NJCLASS Application, Promissory Note, and disclosures."[33] In response to Ms. Hunter's inquiry into any long-term lower monthly payment options, NJHESAA informed the Debtor that "the only long term option HESAA has for lowering

[29] Debtor's Ex. Q.
[30] Debtor's Ex. C-N.
[31] Debtor's Ex. Q.
[32] *Id*.
[33] N.J.A.C. § 9A:10-6.11(e) (LEXIS through the N.J. Reg., Vol. 50 No. 8, Apr. 16, 2018).

monthly payments is through the NJCLASS Consolidation program" and advised that she could also seek consolidation through a private lender. Furthermore, due to NJHESAA's inability to modify the loans, one representative advised Ms. Hunter that her options were to make more money and reduce her expenses.[34]

Ultimately, Ms. Hunter chose not to seek an additional forbearance because she could not afford to make the resulting interest payment. She also decided not to consolidate because it would not have resulted in an affordable payment.[35] Without any other options, Ms. Hunter seeks to discharge these loans in bankruptcy.

DISCUSSION

The Third Circuit has adopted the *Brunner* test to measure whether a debtor has suffered "undue hardship" and may be eligible for a discharge of student loan debt.[36] Under the *Brunner* test, the debtor must prove by a preponderance of the evidence: "(1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period for student loans; and (3) that the debtor has made good faith efforts to repay the loans."[37] The debtor must satisfy all three elements. If one element is not sufficiently proven the inquiry cannot continue

[34] Test. of Sarah Hunter.
[35] *Id*.
[36] *Pa. Higher Educ. Assistance Agency v. Faish* (*In re Faish*), 72 F.3d 298, 306 (3d Cir. 1995).
[37] *Id*. at 304-05.

and discharge shall be denied without consideration of "equitable concerns or other extraneous factors."[38]

A. UNDUE HARDSHIP UNDER THE *BRUNNER* TEST

1. The Debtor Cannot Maintain a Minimal Standard of Living Based on Current Income and Expenses

The first prong of the *Brunner* test requires that a debtor prove, based on her current income and expenses, that she cannot "maintain a 'minimal' standard of living for herself and her dependents if forced to repay the loans."[39] Although the Third Circuit has not defined the term "minimal standard," it has established that a debtor seeking to prove undue hardship must show that undue hardship would mean more than a mere tightening of finances.[40] However, a debtor is not required to live in poverty to satisfy the first prong.[41] Rather, "the proper inquiry is whether it would be 'unconscionable' to require [the debtor] to take any available steps to earn more income or to reduce her expenses."[42]

Based on the Debtor's testimony, and without considering adjustments, she has $245 available monthly after payment of expenses and her husband has $583. The Debtor's total monthly student loan bill was $2,609.24 as of February 2015.[43] Based on these numbers, the Debtor and her husband are (and were) operating at a deficit of almost $2,000 per month. The

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[38] *Id*. at 306.
[39] *Id*. at 304-05.
[40] *Id*. at 306.
[41] *Hoyle v. Pa. Higher Educ. Assistance Agency* (*In re Hoyle*), 199 B.R. 518, 523 (Bankr. E.D. Pa. 1996); *McCormack v. Educ. Credit Mgmt. Corp.* (*In re McCormack*), 2000 WL 33710278, at *4 (Bankr. D.S.C. July 3, 2000); *In re Vasilyeva*, 2008 WL 5954678 at *3 (Bankr. D.N.J. Dec. 12, 2008).
[42] *In re Faish*, 72 F.3d at 307; *Rumer v. Am. Educ. Servs.* (*In re Rumer*), 469 B.R. 553, 564 (Bankr. M.D. Pa. 2012).
[43] Debtor's Ex. Q.

evidence indicates that this substantial deficit cannot be made up entirely by cost cutting or that the Debtor and her husband have the capacity to earn enough to cover it.

But certain adjustments to the numbers are warranted. First, Ms. Hunter's itemized monthly expenses include $900 for groceries, $293 for clothing and $77 for personal care products. The Court finds that the Debtor's expenses may be reasonably reduced by $200 for these items collectively, bringing her available funds up from $245 to $445. Otherwise, her budget does not appear to contain any unnecessary or frivolous expenses.[44] As to the husband's "free funds" after expenses in the amount of $583, this amount seems overstated. It does not include utilities or payment of his own credit card and medical debt of approximately $400 per month. And, in September of 2018, the child care expense will probably increase by $500. These items alone turn the husband's "surplus" into a deficit.

Based on these figures and adjustments, the Court concludes that the Debtor could reasonably afford to pay approximately $450 per month on her student loan debt. Payment of this reduced amount will require personal sacrifice and strict financial discipline on the part of Ms. Hunter and her husband.[45]

The Debtor's realistic surplus of approximately $450 per month does not come close to being enough to satisfy her monthly obligation to NJHESAA. Again, the monthly payment was $2,609 in February 2015 and is probably close to $3,000 now. The Debtor works in New York

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[44] *In re Hoyle*, 199 B.R. at 523 ("[W]here a family earns a modest income and the family budget, which shows no unnecessary or frivolous expenditures, is still unbalanced, a hardship exists from which a debtor may be discharged of his student loan obligations" (quoting *Correll v. Union Nat'l Bank of Pittsburgh* (*In re Correll*), 105 B.R. 302, 306 (Bankr. W.D. Pa. 1989))).
[45] *See Sperrazza v. Univ. of Md.*, 2008 WL 818616 at *2 (E.D. Pa. Mar. 24, 2008).

City and lives in New Jersey where the cost of living is high. Ms. Hunter and her husband both already work full time and her husband also works an additional part-time job. They have one child and one on the way. Given the overall reasonableness of their household budget, it would be unrealistic to require Ms. Hunter to further minimize her household expenses or increase her income beyond what has been suggested above. Thus, Ms. Hunter has satisfied the first prong of the *Brunner* test because she cannot maintain a minimal standard of living if required to repay her student loans in full.

2. The Debtor Has Shown that Additional Circumstances Exist Indicating the State of Affairs is Likely to Persist for a Significant Portion of the Repayment Period

To satisfy the second prong of the *Brunner* test, a debtor must prove that additional circumstances exist beyond her control that will prevent her situation from improving for a significant portion of the loan repayment period.[46] Dischargeability is based on the certainty of hopelessness of repayment, not merely on current inability to repay.[47] "The second prong of the *Brunner* test recognizes that the borrower's education should, in most cases, provide increased income that will allow the loan to be repaid, even though immediately after graduation a student borrower's assets may be dwarfed by the size of the loan."[48]

Here, Ms. Hunter is in a unique situation where her education is unlikely to materially improve her financial situation over the lifetime of the loan. Ms. Hunter testified at trial that a master's degree is a minimum qualification to enter the field of international relations. As

[46] *In re Faish*, 72 F.3d at 305.
[47] *In re Williams*, 296 B.R. 128, 134 (Bankr. D.N.J. 2003).
[48] *In re Hoyle*, 199 B.R. at 523 (quoting *Elebrashy v. Student Loan Corp.*, 189 B.R. 922, 927 (Bankr. N.D. Ohio 1995)).

previously noted, she earns about $50,000 per year and the two senior staffers directly above her at the Global Center earn approximately $58,000 and $75,000. Her employer is a non-profit institution that relies on outside funding for its operations. There are few positions in the field or at the Center that Ms. Hunter may seek to earn more money. A senior employee would have to leave for a junior employee to advance. Her annual 2% salary increase is insufficient to materially improve her financial situation. Even if Ms. Hunter sought and gained employment outside the field of international relations, it is unlikely that the administrative positions that she applied for in 2014 would provide enough of a pay increase to enable her to make her full monthly student loan payment. The work for which Ms. Hunter's advanced degree qualifies her is so specialized that she is unlikely to leverage her education and experience into a higher-paying job outside of the field of international relations.

As discussed above, the Debtor also has $66,000 in federal student loan debt, which may be eligible for income-based and income-contingent repayment plans.[49] Under these federal programs, as the Debtor earns more money, more of her income will be directed toward repayment of her federal loans, leaving her in no better financial position. Also, requiring the Debtor to leave the public sector might leave her worse off financially because it may disqualify her from the PSLF, potentially causing her to have to repay her federal loans over a longer period.[50]

In addition, each NJCLASS loan balance and monthly payment will increase every month a full payment is not made, which will further eat into Ms. Hunter's net household income.

[49] 34 C.F.R. §§ 685.221 (Income-based Repayment Plan) and 685.209 (Income-contingent Repayment Plan).
[50] Pub. Serv. Loan Forgiveness Program, 34 C.F.R. § 685.219.

Ms. Hunter has shown that her net household income is unlikely to substantially improve during the 10- to 20-year repayment periods due to circumstances beyond her control and has satisfied the second prong of the *Brunner* test.

3. The Debtor Made a Good Faith Effort to Repay NJHESAA

The final prong of the *Brunner* test requires a debtor to have made a good faith effort to repay her loans. "Undue hardship encompasses a notion that the debtor may not willfully or negligently cause [her] own default, but rather [her] condition must result from 'factors beyond [her] reasonable control.'"[51] Ms. Hunter applied for administrative positions outside of her chosen field of work and worked a second, part-time job as a bartender until several months into her first pregnancy. Although Ms. Hunter did not apply for many positions outside of her chosen field, her degree is sufficiently specialized that the Court has found it unlikely to lead to higher paying positions outside of the field of international relations. Ms. Hunter made $21,690.06 in payments on her loans during the deferment period, not an insignificant sum.[52] She also borrowed money from other people to repay the interest due at the end of her forbearance and asked NJHESAA for repayment assistance.[53] However, as stated above, NJHESAA is limited by state regulation to the repayment options available under N.J.A.C. § 9A:10-6.11. Instead of offering payment assistance or an opportunity to modify the loans beyond general consolidation, NJHESAA suggested that Ms. Hunter must lower her expenses or increase her income.[54]

[51] *In re Faish*, 72 F.3d at 304.
[52] Debtor's Ex. C-N.
[53] Test. of Sarah Hunter.
[54] *Id.*; Debtor's Ex. Q.

N.J.A.C. § 9A:10-6.11 provides that a borrower may choose from three repayment options when applying for an NJCLASS loan. Ms. Hunter chose to defer payment of the principal and interest until after she graduated.[55] After the deferment period ended, she was prohibited from making lower monthly payments over a longer period. The regulation provides that the borrower's minimum payment must be "the amount required to fully repay an NJCLASS Loan Program loan in the maximum repayment period," and, as noted above, that "[n]otwithstanding any periods of deferment or forbearance, NJCLASS Loan Program loans shall be paid in full within the amount of years from the date of first disbursement as specified in the NJCLASS Application, Promissory Note, and disclosures. The amount of years in which a loan is to be repaid is determined by the indentures for the bonds or notes whose proceeds are funding the loan."[56] The regulatory requirement that NJCLASS loans be repaid by the maturation date is a "factor beyond [the Debtor's] reasonable control,"[57] which works against her efforts to negotiate a way to repay her loans. That Ms. Hunter filed for bankruptcy within two years of completing her master's degree program is not a sign of lack of good faith considering the significant disparity between her income and expenses, her attempts to maximize her income and repay her loans, and NJHESAA's inability to negotiate more affordable repayment terms. The Court finds Ms. Hunter made a good faith effort to repay her loans and has satisfied the third prong of the *Brunner* test.

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[55] Test. of Sarah Hunter.
[56] N.J.A.C. § 9A:10-6.11(d) and (e).
[57] *In re Faish*, 72 F.3d at 304.

B. DISCHARGEABILITY

Having determined that Ms. Hunter has proven that repayment of all her loans would constitute an undue hardship, the Court now turns to the dischargeability of the debt. The Third Circuit has not addressed whether section 523(a)(8) requires complete discharge of student loan debt or permits partial discharge. Other circuits are divided on this issue. Some courts hold that section 523(a)(8) requires either a complete discharge or no discharge at all. Others justify partial discharge of either the aggregate debt or of individual loans on various grounds.[58] Courts adhering to the so-called "hybrid approach" construe section 523(a)(8) as allowing the discharge of individual student loans on a loan-by-loan basis, thereby harmonizing the statute's language with its intent to relieve hardship and the Code's objective of providing a fresh start.[59] "Partial dischargeability or other modification of a student loan debt accomplishes Congress' purpose of providing debtors with a 'fresh start' while maximizing the repayment of the debt . . . . Financial hardship is not all-or-nothing, but is more or less. The load may be made more bearable by reducing, rather than eliminating it."[60] At least one court within the Third Circuit has adopted this approach and this Court agrees.[61] Ms. Hunter incurred a massive amount of student loan debt to finance her education. It is fair to request her to repay this debt to the fullest extent possible, even if it means that she will have to endure financial hardship.

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[58] See *In re Lamanna*, 285 B.R. 347, 350-52 (Bankr. D.R.I. 2002) for a discussion of the three approaches to discharge of student loan debt.
[59] *Grigas v. Sallie Mae Servicing Corp.* (*In re Grigas*), 252 B.R. 866, 873-74 (Bankr. D.N.H. 2000).
[60] *Mosko v. Am. Educ. Servs.*, 2005 WL 2413582 at *9 (Bankr. M.D.N.C. Sept. 29, 2005) (quoting *Educ. Credit Mgmt. Corp. v. Jones*, 1999 WL 1211797 at *3 (E.D. Va. July 14, 1999)).
[61] *See Allen v. Am. Educ. Servs.* (*In re Allen*), 329 B.R. 544, 549-50 (Bankr. W.D. Pa. 2005).

The Debtor unequivocally cannot afford to pay her full monthly student loan bill of $2,609.24, but she has a monthly surplus of about $450 and can afford to pay a portion of it. She will also be better able to pay over time, assuming she continues to receive annual pay increases and her husband's earning capacity grows.

Therefore, based on the Debtor's showing of undue hardship, the Court applies the undue hardship test to each loan held by NJHESAA and orders the discharge of loans maturing before June 2037.[62] The Debtor must repay the last four loans listed in the chart below. This would leave the Debtor with a monthly student loan payment of $414.26 as of February 2015 plus accrued and unpaid interest on those loans.

Outstanding Balance[63]	Origination Date	Monthly Payment	Maturation Date
$37,966.05	09/04/2007	$365.66	09/04/2027
$57,961.83	09/11/2008	$571.31	09/11/2028
$16,258.07	10/06/2008	$159.72	10/06/2028
$15,086.96	01/20/2009	$146.79	01/20/2029
$43,972.70	09/10/2009	$417.55	09/10/2029
$11,428.28	05/21/2010	$106.09	05/21/2030
$37,656.57	10/14/2010	$343.08	10/14/2030
$10,690.58	01/26/2012	$84.78	01/26/2037
$9,283.77	06/22/2012	$71.57	06/22/2037
$24,725.05	09/06/2012	$185.44	09/06/2037
$10,264.41	05/30/2013	$76.05	05/30/2038
$10,167.36	09/04/2013	$81.20	09/04/2038
$285,461.63		$2,609.24	

NJHESAA shall provide the Debtor with updated monthly payment amounts for these four loans and repayment shall commence immediately.

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[62] Debtor's Ex. C-N; Q.
[63] Outstanding balance includes outstanding principal and interest at the time the bankruptcy petition was filed.

C. DEBTOR'S REQUEST FOR RELIEF UNDER 11 U.S.C. § 524(m)

Ms. Hunter has also asked this Court to adopt an alternative test for undue hardship set forth under section 524(m). This request is denied as the Court believes that the *Brunner* test is applicable.

CONCLUSION

The Court hereby orders the discharge of loans maturing before June 2037 as set forth above.

ABI Mid-Atlantic Bankruptcy Workshop 2018
Judicial Debates, August 4, 2018

The Treatment of Student Loans in Bankruptcy: A Certainty of Hopelessness, or Is There Room for Hope?

The Honorable Vincent F. Papalia, U.S.B.J., D.N.J.
The Honorable Frank J. Santoro, U.S.B.J., E.D. Va.

I. INTRODUCTION

Whether a Chapter 13 Plan may separately classify student loans and afford them treatment different from that of other general unsecured creditors sharply divides bankruptcy courts. *In re Edmonds*, 444 B.R 898, 900 (Bankr. E.D. Wis. 2010). The majority view finds no legally permissible justification to classify student loans separately from other general unsecured claims and emphasizes Congressional intent to harmonize 11 U.S.C. §§ 1322(b)(1) and 1322(b)(5). *Id.* at 900-901. The minority view (i) applies 11 U.S.C. § 1322(b)(5), free from the general anti-discrimination language of § 1322(b)(1); or (ii) allows discrimination under 11 U.S.C. § 1322(b)(1), provided that it is not *unfair*, so as to allow for plan confirmation and a fresh start. *Id.* at 901-902.

Courts employ different tests to determine whether discrimination is fair. The *Leser* test analyzes:

(1) whether the discrimination has a reasonable basis;
(2) whether the debtor can carry out a plan without the discrimination;
(3) whether the discrimination is proposed in good faith; and
(4) whether the degree of discrimination is directly related to the basis or rationale for the discrimination.

In re Leser, 939 F.2d 669, 672 (8th Cir. 1991) (a case addressing the classification of domestic support obligations) (paragraphing added). The *King/Simmons* test "requires that the discrimination serve a rational purpose of the debtor" and that "the class discriminated against receives no less than the amount it would have been entitled to receive" without discrimination, under the applicable commitment period. *In re King*, 460 B.R. 708, 711 (Bankr. N.D. Tex 2009); *In re Simmons*, 288 B.R. 737, 751-52 (Bankr. N.D. Tex. 2003) (the court in *In re King* adjusted the *Simmons* test to account for BAPCPA). In *In re King*, the court overruled the Trustee's objection and confirmed the debtors' Chapter 13 plan finding the discrimination rational because any excess funds may be used at the discretion of the debtor, and the unsecured creditors received their expected plan payments. *In re King*, 460 B.R. at 714.

Following are summaries of the cases that: (i) follow the majority rule and disallow separate classification of student loans; (ii) adopt the minority rule and allow separate classification based on a finding that there is no unfair discrimination; (iii) allow separate classification based on the payment of student loan obligations from discretionary income in excess of the debtor's Projected Disposable Income under 11 U.S.C. § 1325(b); and (iv) allow separate classification based on cure-and-maintain payments of debts that extend beyond the life of the plan.

II. CASES DISALLOWING SEPARATE CLASSIFICATION

In re Edmonds, 444 B.R. 898 (Bankr. E.D. Wis. 2010). The court reasoned that separate classification of student loans may be possible in *some* cases, and applied a four-part test: (1) whether the discrimination had a reasonable basis, (2) whether the debtor can carry out a plan without such discrimination, (3) whether such classification is proposed in good faith, and (4) whether the degree of discrimination is related to the basis for the discrimination. Based on the Debtors' employment history and combined annual income of $130,000.00, they could fund a plan providing for equal treatment of all unsecured creditors, and therefore separate classification of their student loans was prohibited.

In re Bentley, 266 B.R. 229 (B.A.P. 1st Cir. 2001). The court affirmed denial of confirmation based on factors drawn from the principles and structure of Chapter 13 itself: (1) the student loan debt was not accorded statutory priority; (2) there was no equality of distribution, as unsecured creditors would have received less than they would have absent discrimination; (3) the debtors did not make any voluntary contributions to "square up" the unequal distribution; (4) preferential treatment of the student loan creditors was not required for the debtors' fresh start, as Chapter 13 specifically excepts student loan debt from discharge and a fresh start does not require being totally debt-free.

In re Renteria, 2012 WL 1439104 (Bankr. D. Colo. Apr. 26, 2012). The court denied confirmation because, though there was a rational basis for the discrimination in favor of student loan creditors, it was unfair to other unsecured creditors, who would receive a 1% return on their claims under the proposed plan but would receive 12% absent any discrimination.

In re Zeigafuse, 2012 WL 1155680 (Bankr. D. Wyo. Apr. 5, 2012). The court analyzed the facts before it under several different tests, ultimately adopting the *Bentley* "baseline test." It denied confirmation because the plan proposed to pay unsecured creditors only 1.2% (versus 19% absent discrimination), and because even under the discriminatory plan, roughly 80% of the student loan debt would survive bankruptcy, thus not furthering the debtors' fresh start.

III. CASES ALLOWING SEPARATE CLASSIFICATION OF STUDENT LOANS ON THE BASIS OF NO UNFAIR DISCRIMINATION

In re Pracht, 464 B.R. 486 (Bankr. M.D. Ga. 2012). Over the objection of the Chapter 13 Standing Trustee, the bankruptcy court confirmed a Chapter 13 plan that (i) separately classified \$115,934 in student loans from \$102,000 in other general unsecured claims; and (ii) allowed the Debtor to continue to pay her negotiated prepetition debt service of \$532 to the Department of Education (under an agreement which also forgave \$50,000 of student loan debt) and the balance of her projected disposable income into the plan for *pro rata* distribution to other general unsecured creditors. The plan satisfied both (i) 11 U.S.C. § 1325(b)(1) because the Debtor was committing all her projected disposable income to the plan; and (ii) 11 U.S.C. §§ 1322(b)(1) and (5) because, although the Plan discriminated between two classes of general unsecured creditor, it did not do so *unfairly*, citing *In re Harding*, 423 B.R. 568, 575 (Bankr. S.D. Fla. 2010). *In re Pracht*, 464 B.R. at 490.

In re Birts, 2012 WL 631875, at *1 (Bankr. E.D. Va. 2012), *rev'd on other grounds*, 2012 WL 3150384 (Aug. 1, 2012). The bankruptcy court confirmed the Debtor's Chapter 13 plan that separately classified student loans and allowed the debtor to pay the agreed contractual payment of $271 while paying approximately 7% to her other unsecured creditors. *See id*. at *1. The court created a "variant" four-factor testing using three factors from the *Leser* test and the fifth factor used in *In re Husted*, 142 B.R. 72, 74 (Bankr. W.D.N.Y. 1992). *In re Birts*, 2012 WL 631875, at *1-*2. The Court held that the plan did not unfairly discriminate because (i) there was a reasonable basis for discrimination; (ii) the plan *could* be successful without the discrimination, but the burden of the student loan debt might serve as a disincentive to complete plan payments; (iii) the plan was proposed in good faith; and (iv) the difference between what unsecured creditors would receive with and without the separation was not enough to deny confirmation. *Id*. at *2-*3. The district court agreed in principle with separate classification but found clear error in the bankruptcy court's application of the test and reversed. *In re Birts*, 2012 WL 3150384 at *3 (E.D. Va. Aug. 1, 2012).

In re Machado, 378 B.R. 14 (Bankr. D. Mass. 2007). The bankruptcy court found that the proposed Chapter 13 plan that separately classified student loans did not discriminate unfairly. In providing for payment of $250 per month directly to student loan lenders to "cure and maintain" those loans and $276.20 per month directly into the plan to "cure" debts to other general unsecured creditors, the plan provided a rational basis for separate classification (as well as for assessing Trustee commissions on the plan payments but not on the student loan payments). *Id.* at 18. The court also found that the separate classification created a negligible difference in the payout to the general unsecured creditors. *Id.* at 17.

In re Kalfayan, 415 B.R. 907 (Bankr. S.D. Fla. 2009). Debtor sought to continue to make contract payments of $382.24 per month on her $157,040.34 student loans (either separately or through the trustee) while making plan payments of $673.51 to $901.93 per month to the other general unsecured creditors. *Id*. at 908. The Court held that discrimination which ultimately benefits the creditors discriminated against can be fair under 11 U.S.C. § 1322(b)(1). *Id*. at 910. In this case, the creditors discriminated against benefited from the debtor's making timely student loan payments to the reduce risk of her losing her optometrist license and income. *Id*. at 910-11.

In re Belton, 2016 WL 7011570, at *1 (Bankr. D.S.C. 2016). The bankruptcy court overruled the Trustee's objection to a Chapter 13 plan that allowed separate payments on a student loan debt. *Id*. at *1. The Court held that under 11 U.S.C. § 1322(b)(1) discrimination can be fair (i) if there is "a good faith, rational basis for the separate classification"; (ii) "the separate classification [is] necessary to the debtor's rehabilitation under Chapter 13"; and (iii) "meaningful payment [is] made to the discriminated class." *Id.* at *7.

IV. CASES ALLOWING SEPARATE CLASSIFICATION AND CONFIRMATION BASED ON USE OF DISCRETIONARY INCOME IN EXCESS OF PROJECTED DISPOSABLE INCOME ("PDI")

In re Abaunza, 452 B.R. 866, 876 (Bankr. S.D. Fla. 2011). Over the Trustee's objection, the court confirmed a plan that separately classified student loans to be paid outside the plan because the debtors had discretionary income in excess of their calculated, projected disposable income ("PDI"), defined under 11 U.S.C. § 1325(b), and were permitted to use that discretionary income as they wished. Under those circumstances, the separate classification did not discriminate unfairly against the other general unsecured creditors. *Id.*

In re Sharp, 415 B.R. 803 (Bankr. D. Colo. 2009). In three consolidated cases, the bankruptcy court overruled the Chapter 13 Standing Trustee's objection that paying student loan creditors both outside the plan and *pro rata* inside the plan created unfair discrimination, as the payments inside the plan reflected the debtors' projected disposable income ("PDI"). *Id.* at 811-13. The court ultimately rejected two of the three plans because the debtors had not correctly calculated their PDI. *Id.* at 814.

In re Orkawsky, 387 B.R. 128 (Bankr. E.D. Pa. 2008). Over the objection of the Chapter 13 Standing Trustee, the bankruptcy court confirmed a Chapter 13 plan into which the debtor paid $100 per month for *pro rata* distribution to non-student loan general unsecured creditors while paying $217 per month outside the plan to Sallie Mae for student loan debts. *Id.* at 148-49. Because the debtor's projected disposable income was calculated at $0.00 under 11 U.S.C. §§ 1325(b)(2) and (3), the Court deemed the debtor's $317 per month payments entirely discretionary and voluntary with respect to the plan. *Id.* at 154-55.

Hunter v. New Jersey Higher Education Student Assistance Authority, Adv. Pro. No. 15-02052 (JKS) (*In re Hunter*, Case NO. 15-17329) (JKS) (Bankr. D.N.J. Apr. 27, 2018). The debtor filed her petition on April 22, 2015, and the court on July 27, 2015 confirmed a sixty-month plan in which the student loan creditor shared a modest, *pro rata* distribution with other general unsecured creditors. On February 28, 2018, the court conducted a trial on the debtor's complaint under 11 U.S.C. § 523(a)(8) to discharge the aggregate $285,461.63 balance due under twelve (12) student loans, which generated a debt service payment of $2609.24 per month, as creating undue hardship under the *Brunner* test adopted by the Third Circuit in *In re Faish*, 72 F.3d 298, 306 (3d Cir. 1995); *In re Brunner*, 831 F.2d 395 (2d Cir. 1987). Without disturbing the confirmed plan, the court calculated that debtor had an additional monthly surplus of $450.00 to pay the student loans and required her to continue to make contract payments on the four (4) most recent loans, which had an outstanding balance of about $54,000 with combined debt service of $414.26 per month. The court discharged the remaining eight (8) loans on which there was an aggregate balance due of approximately $231,000.

V. CASES ALLOWING SEPARATE CLASSIFICATION ON THE GROUNDS OF CONTRACT TERMS THAT EXCEED THE FIVE-YEAR PLAN

In re Johnson, 446 B.R. 921 (Bankr. E.D. Wis. 2011). The court held that student loan payment obligations incurred by a debtor who left her RN position to attend law school for weight related reasons did not constitute "special circumstances," arising from a serious health condition or an unexpected event, under § 707(b)(2)(B) that would permit her to deduct the payment as an expense. However, the court also held that student loan debt could be separately classified pursuant to § 1322(b)(5), which authorizes a debtor to maintain regular payments on long-term debts when the last payment date post-dates the plan term.

In re Truss, 404 B.R. 329 (Bankr. E.D. Wis. 2011). The court held that § 1322(b)(5), which authorizes debtors to separately classify and maintain payments on long term debts, permitted the debtor to provide for the maintenance of regular student loan payments that extend beyond the term of the plan without running afoul of § 1322(b)(1), which addresses fair treatment among classes of unsecured creditors, because § 1322(b)(5) is more specific and operates independently from § 1322(b)(1).

In re Knight, 370 B.R. 429 (Bankr. N.D. Ga. 2007). The court held that pro rata allocation of the debtor's projected disposable income among the debtor's student loan obligations and other unsecured debts was not required as the long-term nature of student loans debt permits it to be separately classified and paid via § 1322(b)(5). However, the court further held that, even if pro rata distribution among all unsecured creditors was required, the debtor may be able to deduct the student loan payments as a "special circumstance" expense under § 707(b)(2)(B) because the repayment of the non-dischargeable obligation is an "economic and legal necessity" not a "lifestyle choice."

In re Hanson, 310 B.R. 131 (Bankr. W.D. Wis. 2004). The court held that to separately classify student loan payments as maintenance payments on long term debt under § 1322(b)(5), the plan cannot change the contracted interest rate or monthly payment amount and that payments cannot be made directly by the debtor absent proper justification. Accordingly, the court further held that the debtors' plan, which proposed a reduced payment on student loan obligations with the consent of the student loan lender and direct payments by the debtors without any justification, could not be confirmed.

In re Williams, 253 B.R. 220 (Bankr. W.D. Tenn. 2000). The court determined it must undertake a four-factor inquiry to determine if a discriminatory classification scheme is proper: "(1) whether the discrimination has a reasonable basis; (2) whether the debtor can carry out the plan without such discrimination; (3) whether the classification has been proposed in good faith; and (4) the nature of the treatment of the class discriminated against." In light of this, the court concluded that it would "not confirm Chapter 13 plans that provide for the payment of interest to student loan creditors, but not to other unsecured creditors; that accelerate the repayment of student loans at the expense of general unsecured creditors; that provide for repayment of 100% of student loan claims when other unsecured claims are not paid at least 70%; or that provide for the repayment of student loans before other unsecured claims are paid." The court also held that it would "permit arrearages on student loans to be paid in full, even though other unsecured claims will not be paid in full, if the student loan is treated as a long term debt pursuant to section 1325(b)(5)."

In re Chandler, 210 B.R. 898 (Bankr. D.N.H. 1997). The fact that student loan debt is nondischargeable cannot form the sole basis for a debtor to separately classify such debs from other unsecured debts, as that alone would be unfair discrimination in contravention of § 1322(b)(1). However, the court further held that if a student loan debt qualifies as long term unsecured debt that may be classified and separately paid under § 1322(b)(5), then maintenance of student loan payments at the full contract rate does not constitute unfair discrimination because the treatment is expressly authorized by the Bankruptcy Code.

FILED
JEANNE A. NAUGHTON, CLERK

APR 27 2018

U.S. BANKRUPTCY COURT
NEWARK, N.J.
BY ______ DEPUTY

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In Re: **SARAH HUNTER,** Debtor.	Case No.: 15-17329-JKS Adv. Pro. No.: 15-02052-JKS Judge: Hon. John K. Sherwood
SARAH HUNTER, Plaintiff, vs. **NEW JERSEY HIGHER EDUCATION STUDENT ASSISTANCE AUTHORITY,** Defendant.	

DECISION AND ORDER GRANTING PARTIAL DISCHARGE OF DEBTOR'S STUDENT LOAN DEBT PURSUANT TO 11 U.S.C. § 523(a)(8)

The relief set forth on the following pages, numbered two (2) through nineteen (19), is hereby **ORDERED.**

HONORABLE JOHN K. SHERWOOD
UNITED STATES BANKRUPTCY JUDGE

Dated: April 27, 2018

APPEARANCES:

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New Jersey Higher Education Student Assistance Authority

INTRODUCTION

Debtor Sarah Hunter ("Debtor") filed an adversary complaint against the New Jersey Higher Education Student Assistance Authority ("NJHESAA") seeking to discharge student loan debt in the amount of $288,911.15 at the time she filed her bankruptcy petition.[1] Ms. Hunter has a master's degree and works in the public interest sector, where she earns $50,000 per year. She is married with a young daughter and has a second child due later this year. Her husband earns approximately $74,000 per year. Ms. Hunter asserts that repayment of her student loans would cause undue hardship because their joint income is not enough to make her combined monthly student loan payments of $2,609.24 after deducting expenses necessary to maintain a minimum standard of living for her family.[2] Based on the evidence in the record and Ms. Hunter's trial testimony, the Court concludes that requiring Ms. Hunter to repay all of her student loans would cause undue hardship and grants a partial discharge of her student loans as detailed below.

PROCEDURAL HISTORY

On April 22, 2015, the Debtor filed a voluntary petition for relief under chapter 13 of the Bankruptcy Code.[3] On July 23, 2015, Ms. Hunter filed an adversary complaint against NJHESAA.[4] On January 25, 2017, Ms. Hunter filed an amended complaint which contained

[1] Debtor's Am. Compl., ECF No. 13; Debtor's Ex. C-O.
[2] Test. of Sarah Hunter; Debtor's Ex. Q and O; Although Ex. Q states that Ms. Hunter's monthly student loan payment would be $2,609.24 as of February 2015, this amount does not include the Navient loan, which is included in the total amount of Ms. Hunter's debt with NJHESAA and for which a proof of claim was filed. The monthly amount of $2,609.24 is what the Debtor owed as of February 2015 and does not reflect compounding interest or other fees which have since accrued.
[3] Chapter 13 Voluntary Pet., *In re Sarah Hunter*, No. 15-17329 (JKS), ECF No. 1.
[4] Debtor's Adversary Compl., ECF No. 1.

among its five counts an assertion that repayment of her student loan debt is dischargeable based on undue hardship.[5] NJHESAA filed an answer to the amended complaint on March 10, 2017.[6] On January 5, 2018, after oral argument on summary judgment, the Court found that undue hardship was a triable issue of material fact.[7] Trial took place on February 28, 2018. The Debtor was the only witness.

JURISDICTION

The Court has jurisdiction over this proceeding pursuant to 28 U.S.C. §§ 1334(b), 157(a) and the Standing Order of Reference from the United States District Court for the District of New Jersey dated July 23, 1984, as amended September 18, 2012. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (I). Venue is proper under 28 U.S.C. §§ 1408 and 1409(a).

STATEMENT OF FACTS

Sarah Hunter was a student at Seton Hall University from 2007 through 2013. She graduated with a Bachelor of Science degree in Diplomacy and International Relations and Russian Suburban Studies as well as a Master's in Diplomacy and International Relations. She financed her education with various forms of financial aid, including loan proceeds from NJHESAA.[8] In addition to her loans with NJHESAA, Ms. Hunter has $66,000 in federal student loan debt which

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[5] Debtor's Am. Compl., ECF No. 13.
[6] NJHESAA's Answer to the Am. Compl., ECF No. 16.
[7] Decision and Order Regarding Pl.'s Mot. for Summ. J. to Discharge Student Loan Debt Pursuant to 11 U.S.C. § 523(a)(8) and Def.'s Cross-Mot. for Summ. J., ECF No. 31.
[8] Test. of Sarah Hunter.

may be eligible for income-based and income-contingent repayment plans.[9] Ms. Hunter's employment with the Global Center for Responsibility may also qualify her student loans for forgiveness under the federal Public Service Loan Forgiveness Program ("PSLF").[10] The Debtor's federal loans are not at issue in this proceeding but are relevant to the discussion of her ability to pay NJHESAA.

On April 22, 2015, Ms. Hunter filed a voluntary petition for relief under chapter 13 of the Bankruptcy Code.[11] Between May 14, 2015 and May 28, 2015, NJHESAA filed thirteen claims totaling $288,911.15, twelve under New Jersey College Loans to Assist State Students ("NJCLASS"), a loan program administered by NJHESAA,[12] and the last through Navient Solutions, Inc. on behalf of NJHESAA.[13] Ms. Hunter's chapter 13 plan was confirmed by Order dated July 27, 2015 and amended on August 5, 2015.[14] As part of the confirmed plan, Ms. Hunter made payments of $400 per month for the first five months and is making ongoing payments for the remaining 55 months of $100 per month to the chapter 13 trustee through May 1, 2020.

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[9] *Id.*; *see* 34 C.F.R. §§ 685.221 (LEXIS through the Apr. 25, 2018 issue of the Fed. Reg. Title 3 is current through Apr. 6, 2018) (Income-based Repayment Plan) and 685.209 (LEXIS through the Apr. 25, 2018 issue of the Fed. Reg. Title 3 is current through Apr. 6, 2018) (Income-contingent Repayment Plan).

[10] Test. of Sarah Hunter; Pub. Serv. Loan Forgiveness Program, 34 C.F.R. § 685.219 (LEXIS through the Apr. 25, 2018 issue of the Fed. Reg. Title 3 is current through Apr. 6, 2018). A qualifying employer under the PSLF includes governmental entities at any level and not-for-profits that are tax-exempt under § 501(c)(3) of the Internal Revenue Code. The PSLF allows for loan forgiveness if the borrower makes 120 qualifying payments and is not in default on her loans, in addition to other requirements. *See id*. at (c).

[11] Chapter 13 Voluntary Pet., *In re Sarah Hunter*, No. 15-17329 (JKS), ECF No. 1.

[12] N.J.S.A. § 18A:71C-21 (LEXIS through N.J. 218th First Ann. Sess., L. 2018, c. 4 and J.R. 4).

[13] Debtor's Ex. C-O.

[14] Order Confirming Plan, *In re Sarah Hunter*, No. 15-17329 (JKS), ECF No. 31; Am. Order Confirming Plan, *In re Sarah Hunter*, No. 15-17329 (JKS), ECF No. 33.

Through the end of 2017, $1,368.85 of the plan payments have been disbursed to NJCLASS and NJHESAA.[15]

Ms. Hunter is employed as a research analyst in New York City at the City University of New York (CUNY) Global Center for Responsibility and earns approximately $50,000 a year.[16] At the time she filed her bankruptcy petition, she lived with her boyfriend and daughter in a rented townhouse in Jamesburg, New Jersey. She and her boyfriend have since married. They continue to live in the Jamesburg townhouse and are expecting a second child in September 2018.[17] Ms. Hunter testified at trial that her husband works full time as a project manager at an audio-visual installation company and once a week as a bartender. His gross income is about $74,000 per year.[18] Although both contribute toward their living expenses, Ms. Hunter and her husband maintain separate checking accounts from which they pay their household expenses. Ms. Hunter estimated that she takes home $2,000 per month.[19] She testified that she spends $900 for groceries, $293 for clothing, $77 for personal care items, and $385 for her New Jersey Transit train pass. The Debtor also pays $100 per month to the Chapter 13 trustee. Comparing these expenses to Ms. Hunter's take-home pay of $2,000 per month, she has about $245 of discretionary income at the end of each month. Her husband pays for all other expenses, including rent of $1,500 per month, condominium fees of $185 per month, car payment of $440 per month, car insurance of $85 per

[15] Chapter 13 Trustee Ann. Rep., No. 15-17329 (JKS), ECF No. 48.
[16] Debtor's Ex. B.
[17] Test. of Sarah Hunter.
[18] *Id.*
[19] *Id.*

month, gas at $200 per month and day care of $507 per month.[20] The sum of these monthly expenses is $2,917. Assuming her husband's take-home pay is approximately $3,500 per month, he would have about $583 remaining per month. Ms. Hunter also testified that her husband has $2,500 in credit card debt as well as $4,000 in medical debt of which he pays about $400 a month as part of a repayment plan.

Ms. Hunter has been employed with the Global Center for five years. The Center is a non-profit organization with approximately eight to ten employees. Ms. Hunter currently receives an annual 2% salary increase but believes that any pay increase resulting from a promotion would be insignificant with respect to her ability to repay her loans. She testified that the individuals in the next two senior positions earn an estimated $58,000 to $75,000 per year. However, due to the small size of the organization, someone of seniority must leave the organization for a junior employee to be able to advance. At the top of the non-profit organization, the director makes "above six figures," but also has at least 30 years' experience in the field according to Ms. Hunter's testimony. Ms. Hunter testified that she feels unqualified to advance into a director position and, in general, that higher paying positions and job openings within this specialized field are scarce.[21]

For about six months during 2014, Ms. Hunter looked for work outside of the field of international relations and applied for four general administrative positions near her home with the goal of cutting back on transportation costs, but did not receive any offers of employment.[22]

[20] *Id.*
[21] *Id.* Ms. Hunter gave Human Rights Watch and Amnesty International as examples of other organizations that might consider her for employment given her experience and education.
[22] *Id.*

Ms. Hunter has not sought full-time employment outside the field of international relations since 2014 but bartended once a week in addition to her full-time job at the Center until six months into her pregnancy with her first child.[23]

Ms. Hunter has $288,911.15 in student loan debt with NJHESAA,[24] $285,461.63 of which is attributable to NJCLASS loans.[25] The remaining $3,449.52 stems from a Federal Stafford Loan disbursed by NJHESAA and now held by Navient Solutions, Inc. Since the Navient loan is a Federal loan, it would provide for income-based repayment options.[26]

The table below was prepared based on the proofs of claim filed by NJCLASS and reflects the Debtor's monthly student loan payments due as of February 2015.[27]

Outstanding Balance[28]	Origination Date	Monthly Payment	Maturation Date
$37,966.05	09/04/2007	$365.66	09/04/2027
$57,961.83	09/11/2008	$571.31	09/11/2028
$16,258.07	10/06/2008	$159.72	10/06/2028
$15,086.96	01/20/2009	$146.79	01/20/2029
$43,972.70	09/10/2009	$417.55	09/10/2029
$11,428.28	05/21/2010	$106.09	05/21/2030
$37,656.57	10/14/2010	$343.08	10/14/2030
$10,690.58	01/26/2012	$84.78	01/26/2037
$9,283.77	06/22/2012	$71.57	06/22/2037
$24,725.05	09/06/2012	$185.44	09/06/2037
$10,264.41	05/30/2013	$76.05	05/30/2038
$10,167.36	09/04/2013	$81.20	09/04/2038
$285,461.63		$2,609.24	

[23] Test. of Sarah Hunter.
[24] *See* Debtor's Ex. C-O.
[25] *See* Debtor's Ex. C-N.
[26] Debtor's Ex. O.
[27] Debtor's Ex. C-N; Q.
[28] Outstanding balance includes outstanding principal and interest at the time the bankruptcy petition was filed.

The maturity dates for the NJCLASS loans range from 2027 to 2038. NJHESAA granted the Debtor a post-undergraduate deferment on her loans from May 2011 through December 2011. Deferment was extended throughout her graduate studies and six months immediately thereafter, from January 2012 through July 2014. Interest continued to accrue on the loans during the deferment period.[29] Although no payments were due during this period, Ms. Hunter did make payments on her NJCLASS loans totaling $21,690.06.[30] In July 2014, at the end of her deferment period, Ms. Hunter was granted forbearance on her student loans. The terms of the forbearance still obligated Ms. Hunter to make interest-only payments on her loans through January 2015 that totaled $3,983.82, of which Ms. Hunter paid $1,218.80.[31] NJHESAA also warned that "the monthly principal and interest payment will increase after the expiration of the deferment or forbearance period."[32] In other words, although forbearance would provide short-term relief from payment, it would result in higher future monthly payments due to the accumulation of deferred principal against a maturity date that cannot be extended.

The provisions of N.J.A.C. § 9A:10-6.11 restrict NJHESAA's ability to provide flexible repayment options, as the regulation requires that student loans "be paid in full within the amount of years from the date of disbursement as specified in the NJCLASS Application, Promissory Note, and disclosures."[33] In response to Ms. Hunter's inquiry into any long-term lower monthly payment options, NJHESAA informed the Debtor that "the only long term option HESAA has for lowering

[29] Debtor's Ex. Q.
[30] Debtor's Ex. C-N.
[31] Debtor's Ex. Q.
[32] *Id*.
[33] N.J.A.C. § 9A:10-6.11(e) (LEXIS through the N.J. Reg., Vol. 50 No. 8, Apr. 16, 2018).

monthly payments is through the NJCLASS Consolidation program" and advised that she could also seek consolidation through a private lender. Furthermore, due to NJHESAA's inability to modify the loans, one representative advised Ms. Hunter that her options were to make more money and reduce her expenses.[34]

Ultimately, Ms. Hunter chose not to seek an additional forbearance because she could not afford to make the resulting interest payment. She also decided not to consolidate because it would not have resulted in an affordable payment.[35] Without any other options, Ms. Hunter seeks to discharge these loans in bankruptcy.

DISCUSSION

The Third Circuit has adopted the *Brunner* test to measure whether a debtor has suffered "undue hardship" and may be eligible for a discharge of student loan debt.[36] Under the *Brunner* test, the debtor must prove by a preponderance of the evidence: "(1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period for student loans; and (3) that the debtor has made good faith efforts to repay the loans."[37] The debtor must satisfy all three elements. If one element is not sufficiently proven the inquiry cannot continue

[34] Test. of Sarah Hunter.
[35] *Id*.
[36] *Pa. Higher Educ. Assistance Agency v. Faish* (*In re Faish*), 72 F.3d 298, 306 (3d Cir. 1995).
[37] *Id*. at 304-05.

and discharge shall be denied without consideration of "equitable concerns or other extraneous factors."[38]

A. UNDUE HARDSHIP UNDER THE *BRUNNER* TEST

1. The Debtor Cannot Maintain a Minimal Standard of Living Based on Current Income and Expenses

The first prong of the *Brunner* test requires that a debtor prove, based on her current income and expenses, that she cannot "maintain a 'minimal' standard of living for herself and her dependents if forced to repay the loans."[39] Although the Third Circuit has not defined the term "minimal standard," it has established that a debtor seeking to prove undue hardship must show that undue hardship would mean more than a mere tightening of finances.[40] However, a debtor is not required to live in poverty to satisfy the first prong.[41] Rather, "the proper inquiry is whether it would be 'unconscionable' to require [the debtor] to take any available steps to earn more income or to reduce her expenses."[42]

Based on the Debtor's testimony, and without considering adjustments, she has $245 available monthly after payment of expenses and her husband has $583. The Debtor's total monthly student loan bill was $2,609.24 as of February 2015.[43] Based on these numbers, the Debtor and her husband are (and were) operating at a deficit of almost $2,000 per month. The

[38] *Id*. at 306.
[39] *Id*. at 304-05.
[40] *Id*. at 306.
[41] *Hoyle v. Pa. Higher Educ. Assistance Agency* (*In re Hoyle*), 199 B.R. 518, 523 (Bankr. E.D. Pa. 1996); *McCormack v. Educ. Credit Mgmt. Corp.* (*In re McCormack*), 2000 WL 33710278, at *4 (Bankr. D.S.C. July 3, 2000); *In re Vasilyeva*, 2008 WL 5954678 at *3 (Bankr. D.N.J. Dec. 12, 2008).
[42] *In re Faish*, 72 F.3d at 307; *Rumer v. Am. Educ. Servs.* (*In re Rumer*), 469 B.R. 553, 564 (Bankr. M.D. Pa. 2012).
[43] Debtor's Ex. Q.

evidence indicates that this substantial deficit cannot be made up entirely by cost cutting or that the Debtor and her husband have the capacity to earn enough to cover it.

But certain adjustments to the numbers are warranted. First, Ms. Hunter's itemized monthly expenses include $900 for groceries, $293 for clothing and $77 for personal care products. The Court finds that the Debtor's expenses may be reasonably reduced by $200 for these items collectively, bringing her available funds up from $245 to $445. Otherwise, her budget does not appear to contain any unnecessary or frivolous expenses.[44] As to the husband's "free funds" after expenses in the amount of $583, this amount seems overstated. It does not include utilities or payment of his own credit card and medical debt of approximately $400 per month. And, in September of 2018, the child care expense will probably increase by $500. These items alone turn the husband's "surplus" into a deficit.

Based on these figures and adjustments, the Court concludes that the Debtor could reasonably afford to pay approximately $450 per month on her student loan debt. Payment of this reduced amount will require personal sacrifice and strict financial discipline on the part of Ms. Hunter and her husband.[45]

The Debtor's realistic surplus of approximately $450 per month does not come close to being enough to satisfy her monthly obligation to NJHESAA. Again, the monthly payment was $2,609 in February 2015 and is probably close to $3,000 now. The Debtor works in New York

[44] *In re Hoyle*, 199 B.R. at 523 ("[W]here a family earns a modest income and the family budget, which shows no unnecessary or frivolous expenditures, is still unbalanced, a hardship exists from which a debtor may be discharged of his student loan obligations" (quoting *Correll v. Union Nat'l Bank of Pittsburgh* (*In re Correll*), 105 B.R. 302, 306 (Bankr. W.D. Pa. 1989))).
[45] *See Sperrazza v. Univ. of Md.*, 2008 WL 818616 at *2 (E.D. Pa. Mar. 24, 2008).

City and lives in New Jersey where the cost of living is high. Ms. Hunter and her husband both already work full time and her husband also works an additional part-time job. They have one child and one on the way. Given the overall reasonableness of their household budget, it would be unrealistic to require Ms. Hunter to further minimize her household expenses or increase her income beyond what has been suggested above. Thus, Ms. Hunter has satisfied the first prong of the *Brunner* test because she cannot maintain a minimal standard of living if required to repay her student loans in full.

2. The Debtor Has Shown that Additional Circumstances Exist Indicating the State of Affairs is Likely to Persist for a Significant Portion of the Repayment Period

To satisfy the second prong of the *Brunner* test, a debtor must prove that additional circumstances exist beyond her control that will prevent her situation from improving for a significant portion of the loan repayment period.[46] Dischargeability is based on the certainty of hopelessness of repayment, not merely on current inability to repay.[47] "The second prong of the *Brunner* test recognizes that the borrower's education should, in most cases, provide increased income that will allow the loan to be repaid, even though immediately after graduation a student borrower's assets may be dwarfed by the size of the loan."[48]

Here, Ms. Hunter is in a unique situation where her education is unlikely to materially improve her financial situation over the lifetime of the loan. Ms. Hunter testified at trial that a master's degree is a minimum qualification to enter the field of international relations. As

[46] *In re Faish*, 72 F.3d at 305.
[47] *In re Williams*, 296 B.R. 128, 134 (Bankr. D.N.J. 2003).
[48] *In re Hoyle*, 199 B.R. at 523 (quoting *Elebrashy v. Student Loan Corp.*, 189 B.R. 922, 927 (Bankr. N.D. Ohio 1995)).

previously noted, she earns about $50,000 per year and the two senior staffers directly above her at the Global Center earn approximately $58,000 and $75,000. Her employer is a non-profit institution that relies on outside funding for its operations. There are few positions in the field or at the Center that Ms. Hunter may seek to earn more money. A senior employee would have to leave for a junior employee to advance. Her annual 2% salary increase is insufficient to materially improve her financial situation. Even if Ms. Hunter sought and gained employment outside the field of international relations, it is unlikely that the administrative positions that she applied for in 2014 would provide enough of a pay increase to enable her to make her full monthly student loan payment. The work for which Ms. Hunter's advanced degree qualifies her is so specialized that she is unlikely to leverage her education and experience into a higher-paying job outside of the field of international relations.

As discussed above, the Debtor also has $66,000 in federal student loan debt, which may be eligible for income-based and income-contingent repayment plans.[49] Under these federal programs, as the Debtor earns more money, more of her income will be directed toward repayment of her federal loans, leaving her in no better financial position. Also, requiring the Debtor to leave the public sector might leave her worse off financially because it may disqualify her from the PSLF, potentially causing her to have to repay her federal loans over a longer period.[50]

In addition, each NJCLASS loan balance and monthly payment will increase every month a full payment is not made, which will further eat into Ms. Hunter's net household income.

[49] 34 C.F.R. §§ 685.221 (Income-based Repayment Plan) and 685.209 (Income-contingent Repayment Plan).
[50] Pub. Serv. Loan Forgiveness Program, 34 C.F.R. § 685.219.

Ms. Hunter has shown that her net household income is unlikely to substantially improve during the 10- to 20-year repayment periods due to circumstances beyond her control and has satisfied the second prong of the *Brunner* test.

3. The Debtor Made a Good Faith Effort to Repay NJHESAA

The final prong of the *Brunner* test requires a debtor to have made a good faith effort to repay her loans. "Undue hardship encompasses a notion that the debtor may not willfully or negligently cause [her] own default, but rather [her] condition must result from 'factors beyond [her] reasonable control.'"[51] Ms. Hunter applied for administrative positions outside of her chosen field of work and worked a second, part-time job as a bartender until several months into her first pregnancy. Although Ms. Hunter did not apply for many positions outside of her chosen field, her degree is sufficiently specialized that the Court has found it unlikely to lead to higher paying positions outside of the field of international relations. Ms. Hunter made $21,690.06 in payments on her loans during the deferment period, not an insignificant sum.[52] She also borrowed money from other people to repay the interest due at the end of her forbearance and asked NJHESAA for repayment assistance.[53] However, as stated above, NJHESAA is limited by state regulation to the repayment options available under N.J.A.C. § 9A:10-6.11. Instead of offering payment assistance or an opportunity to modify the loans beyond general consolidation, NJHESAA suggested that Ms. Hunter must lower her expenses or increase her income.[54]

[51] *In re Faish*, 72 F.3d at 304.
[52] Debtor's Ex. C-N.
[53] Test. of Sarah Hunter.
[54] *Id.*; Debtor's Ex. Q.

N.J.A.C. § 9A:10-6.11 provides that a borrower may choose from three repayment options when applying for an NJCLASS loan. Ms. Hunter chose to defer payment of the principal and interest until after she graduated.[55] After the deferment period ended, she was prohibited from making lower monthly payments over a longer period. The regulation provides that the borrower's minimum payment must be "the amount required to fully repay an NJCLASS Loan Program loan in the maximum repayment period," and, as noted above, that "[n]otwithstanding any periods of deferment or forbearance, NJCLASS Loan Program loans shall be paid in full within the amount of years from the date of first disbursement as specified in the NJCLASS Application, Promissory Note, and disclosures. The amount of years in which a loan is to be repaid is determined by the indentures for the bonds or notes whose proceeds are funding the loan."[56] The regulatory requirement that NJCLASS loans be repaid by the maturation date is a "factor beyond [the Debtor's] reasonable control,"[57] which works against her efforts to negotiate a way to repay her loans. That Ms. Hunter filed for bankruptcy within two years of completing her master's degree program is not a sign of lack of good faith considering the significant disparity between her income and expenses, her attempts to maximize her income and repay her loans, and NJHESAA's inability to negotiate more affordable repayment terms. The Court finds Ms. Hunter made a good faith effort to repay her loans and has satisfied the third prong of the *Brunner* test.

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[55] Test. of Sarah Hunter.
[56] N.J.A.C. § 9A:10-6.11(d) and (e).
[57] *In re Faish*, 72 F.3d at 304.

B. DISCHARGEABILITY

Having determined that Ms. Hunter has proven that repayment of all her loans would constitute an undue hardship, the Court now turns to the dischargeability of the debt. The Third Circuit has not addressed whether section 523(a)(8) requires complete discharge of student loan debt or permits partial discharge. Other circuits are divided on this issue. Some courts hold that section 523(a)(8) requires either a complete discharge or no discharge at all. Others justify partial discharge of either the aggregate debt or of individual loans on various grounds.[58] Courts adhering to the so-called "hybrid approach" construe section 523(a)(8) as allowing the discharge of individual student loans on a loan-by-loan basis, thereby harmonizing the statute's language with its intent to relieve hardship and the Code's objective of providing a fresh start.[59] "Partial dischargeability or other modification of a student loan debt accomplishes Congress' purpose of providing debtors with a 'fresh start' while maximizing the repayment of the debt . . . . Financial hardship is not all-or-nothing, but is more or less. The load may be made more bearable by reducing, rather than eliminating it."[60] At least one court within the Third Circuit has adopted this approach and this Court agrees.[61] Ms. Hunter incurred a massive amount of student loan debt to finance her education. It is fair to request her to repay this debt to the fullest extent possible, even if it means that she will have to endure financial hardship.

[58] See *In re Lamanna*, 285 B.R. 347, 350-52 (Bankr. D.R.I. 2002) for a discussion of the three approaches to discharge of student loan debt.
[59] *Grigas v. Sallie Mae Servicing Corp.* (*In re Grigas*), 252 B.R. 866, 873-74 (Bankr. D.N.H. 2000).
[60] *Mosko v. Am. Educ. Servs.*, 2005 WL 2413582 at *9 (Bankr. M.D.N.C. Sept. 29, 2005) (quoting *Educ. Credit Mgmt. Corp. v. Jones*, 1999 WL 1211797 at *3 (E.D. Va. July 14, 1999)).
[61] *See Allen v. Am. Educ. Servs.* (*In re Allen*), 329 B.R. 544, 549-50 (Bankr. W.D. Pa. 2005).

The Debtor unequivocally cannot afford to pay her full monthly student loan bill of $2,609.24, but she has a monthly surplus of about $450 and can afford to pay a portion of it. She will also be better able to pay over time, assuming she continues to receive annual pay increases and her husband's earning capacity grows.

Therefore, based on the Debtor's showing of undue hardship, the Court applies the undue hardship test to each loan held by NJHESAA and orders the discharge of loans maturing before June 2037.[62] The Debtor must repay the last four loans listed in the chart below. This would leave the Debtor with a monthly student loan payment of $414.26 as of February 2015 plus accrued and unpaid interest on those loans.

Outstanding Balance[63]	Origination Date	Monthly Payment	Maturation Date
$37,966.05	09/04/2007	$365.66	09/04/2027
$57,961.83	09/11/2008	$571.31	09/11/2028
$16,258.07	10/06/2008	$159.72	10/06/2028
$15,086.96	01/20/2009	$146.79	01/20/2029
$43,972.70	09/10/2009	$417.55	09/10/2029
$11,428.28	05/21/2010	$106.09	05/21/2030
$37,656.57	10/14/2010	$343.08	10/14/2030
$10,690.58	01/26/2012	$84.78	01/26/2037
$9,283.77	06/22/2012	$71.57	06/22/2037
$24,725.05	09/06/2012	$185.44	09/06/2037
$10,264.41	05/30/2013	$76.05	05/30/2038
$10,167.36	09/04/2013	$81.20	09/04/2038
$285,461.63		$2,609.24	

NJHESAA shall provide the Debtor with updated monthly payment amounts for these four loans and repayment shall commence immediately.

[62] Debtor's Ex. C-N; Q.
[63] Outstanding balance includes outstanding principal and interest at the time the bankruptcy petition was filed.

C. DEBTOR'S REQUEST FOR RELIEF UNDER 11 U.S.C. § 524(m)

Ms. Hunter has also asked this Court to adopt an alternative test for undue hardship set forth under section 524(m). This request is denied as the Court believes that the *Brunner* test is applicable.

CONCLUSION

The Court hereby orders the discharge of loans maturing before June 2037 as set forth above.