AMERICAN BANKRUPTCY INSTITUTE

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CONCURRENT SESSION

Momentive Aftermath

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U.S. Bankruptcy Court (D. Del.)

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Momentive Aftermath:
A Detailed Analysis of Bankruptcy Court and Second Circuit Decisions

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Agenda

Background

Prepetition Capital Structure & DIP Financing

➢ ***Outstanding Indebtedness***

- As of YE 2013, Momentive Performance Materials Holdings ("MPM Holdings"), Momentive Performance Materials Inc. ("MPM") and certain of MPM's subsidiaries (collectively, the "Debtors") had $4.114 billion of consolidated outstanding indebtedness, including:
  - $270 million revolving ABL credit facility;
  - $75 million revolving credit cash flow facility;
  - $1.1 billion of 8.875% First-Priority Senior Secured Notes due 2020 (the "First Lien Notes");
  - $250 million of 10% Senior Secured Notes due 2020 (the "1.5 Lien Notes" and, together with the First Lien Notes, the "Senior Lien Notes");
  - $1.161 billion of 9% Second-Priority Springing Lien Notes due 2021 and €133 million 9.5% Second-Priority Springing Lien Notes due 2021 (together, the "Second Lien Notes");
  - $382 million in 11.5% Senior Subordinated Notes due 2016 (the "Subordinated Notes"); and
  - $400 million PIK unsecured 11% Senior Discount Note due 2016 ("Holdings PIK Note").
- The First Lien Notes, 1.5 Lien Notes, Second Lien Notes and Subordinated Notes were each issued by MPM, guaranteed by the same Debtor subsidiaries of MPM and, in the case of the secured notes, secured by substantially the same pool of collateral.

Prepetition Capital Structure & DIP Financing (cont'd)

➢ ***DIP Financing***

- The Debtors secured prepetition commitments for DIP financing (the "DIP Facilities") that included a $270 million asset-based revolving loan and a $300 million term loan.
- The lenders under the DIP Facilities also committed, subject to certain conditions, to provide exit financing that included a $270 million asset-based revolving credit facility and a $1 billion term loan (the "Exit Financing"), the term loan portion of which would only be needed if the holders of the Senior Lien Notes voted to accept the Plan (as explained later).

RSA, BCA & Plan

➢ ***Chapter 11 Filing and Restructuring Support Agreement***

- The Debtors filed voluntary chapter 11 petitions on April 13, 2014 (the "Petition Date").
- The Debtors had, prior to the Petition Date, entered into a Restructuring Support Agreement ("RSA") with Apollo Global Management LLC and certain affiliated funds ("Apollo") and the members of an *ad hoc* committee of holders of Second Lien Notes (the "Ad Hoc Committee" and, collectively with Apollo, the "Consenting Noteholders"), which were the fulcrum security.
  - Apollo was also Momentive's prepetition controlling shareholder.

➢ ***Backstop Commitment Agreement***

- The Consenting Noteholders agreed to backstop a $600 million rights offering (the "Rights Offering") pursuant to a Backstop Commitment Agreement (the "BCA") for a $30 million backstop fee.

RSA, BCA & Plan (cont'd)

➢ ***Plan Treatment (Key Classes)***

- First Lien Notes and 1.5 Lien Notes (classified separately)
  - if class voted to accept the Plan (waiving any right to seek allowance of any "make-whole" or other premium), payment in full (including accrued interest) in cash.
  - if class voted to reject the Plan, payment in full (including accrued interest and any "make-whole" or other premium to the extent allowed) in new notes (the "Replacement Notes") with a present value equal to the allowed amount of the claims.
    - these toggle provisions were designed to encourage Senior Lien Noteholders to accept the Plan without pressing for payment of make-whole premiums and to enable the Debtors to avoid the expense and uncertainty of a cramdown fight.
- Second Lien Notes
  - direct distribution of new equity of reorganized MPM (the "New Equity").
  - subscription rights to participate at a discount in a rights offering for additional New Equity.
- Subordinated Notes
  - no distribution on account of subordination to Second Lien Notes.

Senior Lien Noteholder Voting

- The holders of the Senior Lien Notes (the "Senior Lien Noteholders") voted to reject the Plan, thus triggering the Plan's Replacement Note provisions. The terms of the proposed Replacement Notes were:
  - *First Lien Replacement Notes:* Seven-year Treasury note rate plus 1.5% (equaling 3.6% as of August 26, 2014).
  - *1.5 Lien Replacement Notes:* Imputed seven-and-a-half year Treasury note rate (based on weighted averaging of the rates for the seven-year and ten-year Treasury notes) plus 2.0% (equaling 4.09% as of August 26, 2014).
- The Debtors sought to "cram down" the Plan over the objection of the trustees for the Senior Lien Notes (the "Senior Lien Trustees").

Objections to Confirmation

- The Senior Lien Trustees argued, among other things, that the Plan was not "fair and equitable" because the interest rates under the Replacement Notes were insufficient to satisfy the Bankruptcy Code's cramdown requirements.
- The Senior Lien Trustees also argued that their claims should include make-whole premiums (approximately $200 million for the First Lien Notes and $50 million for the 1.5 Lien Notes), which they maintained were payable notwithstanding automatic acceleration of the First and 1.5 Lien Notes.

Confirmation of Plan

- Judge Drain held a week-long confirmation trial in August 2014 and entered an order confirming the Plan on September 11, 2014.
  - The Plan went effective on October 24, 2014.
- In connection with confirmation, Judge Drain ruled in favor of the Debtors with respect to, among other things, the make-whole and cramdown issues.

Make-Whole Dispute

"Make-Whole" Premiums

- Bond indentures and credit agreements often restrict a borrower's ability to prepay secured debt obligations.
  - "No-call" provisions prohibit a borrower from prepaying a loan.
  - "Make-whole" provisions require the borrower to pay a fee upon early repayment of a loan to compensate the lender for the loss of future coupon payments that the lender would have received absent early redemption.
- A borrower's bankruptcy filing generally triggers an event of default and automatic acceleration of the debt under the loan documents.
- However, loan documents often do not specify whether "make-whole" amounts become immediately due upon a bankruptcy default or after automatic acceleration.
- Parties frequently litigate the issue of whether "make-whole" amounts (or damages for breach of a no-call provision) are payable when a debt is repaid in bankruptcy.
  - Courts address a variety of state and bankruptcy law issues in connection with the make-whole premium analysis.

Commonly Litigated "Make-Whole" Issues

- Recent cases have emphasized that a lender's entitlement to a make-whole premium depends primarily on the plain language of the credit documents.
  - A number of courts have held that if parties intend for a lender to receive a make-whole premium in the event of a post-acceleration *repayment,* they must explicitly so provide in their agreement.
  - Absent such a provision, these courts will not find that a premium is payable following acceleration (a lender's ability to exercise its contractual right to decelerate the debt will likely be constrained by the automatic stay).
  - However, the Third Circuit Court of Appeals recently reached a different conclusion in the *Energy Future Holdings* case, holding that, if parties intend for a make-whole premium obligation triggered by optional redemption to terminate upon acceleration, they must explicitly so provide in their agreement. Absent such a provision, the premium will be payable in the event of acceleration.
  - Efforts to recast a post-acceleration make-whole claim as a breach of contract claim (typically for breach of a "no-call" provision) generally do not prevail, although some courts have suggested that noteholders may assert such a claim against *solvent* debtors.
- A majority of courts now reject the proposition that make-whole premiums constitute unmatured interest, which may not be recoverable under section 502(b) of the Bankruptcy Code.

Commonly Litigated "Make-Whole" Issues (cont'd)

- Courts often hold that make-whole premiums constitute liquidated damages. Courts may analyze whether the premium amounts to an impermissible penalty under state law.
- Courts also may analyze whether a prepayment premium constitutes a reasonable charge under section 506(b), which permits an oversecured creditor to recover only *reasonable* fees, costs, or charges provided for under the relevant agreement.

Momentive Make-Whole Dispute

- ***Adversary Proceeding***
  - On May 9, 2014, the Debtors initiated adversary proceedings against (i) The Bank of New York Mellon Trust Co. (subsequently replaced by BOKF, N.A.), as Indenture Trustee for the First Lien Notes (the "First Lien Trustee") and (ii) Wilmington Trust, N.A., as Indenture Trustee for the 1.5 Lien Notes (the "1.5 Lien Trustee" and together with the First Lien Trustee, as previously defined, the "Senior Lien Trustees").
  - In both adversary proceedings, the Debtors sought declarations from the Bankruptcy Court that the terms of the indentures under which the Senior Lien Notes were issued (the "Senior Indentures") did not require the payment of a "make-whole amount" (the "Applicable Premium") upon the Debtors' filing for bankruptcy.
    - The Applicable Premiums under the Senior Indentures were estimated to be in excess of $200 million in the aggregate.
- ***Plan Objection***
  - The Senior Lien Trustees each objected to the confirmation of the Plan on the grounds that the Plan did not provide for the payment of the Applicable Premium.

Senior Indentures and Notes—Applicable Provisions

- ***Senior Lien Notes Section 5 – Optional Redemption***
  - "Except as set forth in the following . . . paragraphs, the Notes shall not be redeemable at the option of MPM prior to October 15, 2015."
  - "[P]rior to October 15, 2015, [MPM] may redeem the Notes at its option, in whole at any time or in part from time to time, upon not less than 30 nor more than 60 days' prior notice . . . , 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 and Additional Interest, if any, to, the applicable redemption date . . . ."
- ***Senior Indenture Section 6.2 – Acceleration***
  - "If an Event of Default specified in Section 6.01(f) or (g) [bankruptcy events of default] 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. The 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."

Debtors' Arguments

- ***Debtors' Arguments – Senior Indentures' Text***
  - The Debtors' arguments against payment of the Applicable Premium were based on the text of the Senior Indentures:
    - The Senior Indentures required payment of the Applicable Premium upon an "Optional Redemption," and no Optional Redemption could occur following the automatic acceleration of the Senior Lien Notes upon the Debtors' bankruptcy filing.
    - Under the Second Circuit's decision *In re AMR Corp.*, any payment made on the Senior Lien Notes after automatic acceleration constituted a post-maturity repayment, not a voluntary "prepayment" that would have triggered the Debtors' obligation to pay the Applicable Premium.
      - Under *AMR*, an indenture must explicitly provide for a prepayment premium following an acceleration of maturity for such a premium to be recoverable.

Senior Lien Trustees' Arguments

- ***Senior Lien Trustees' Arguments – Voluntary Prepayment***
  - The Senior Lien Trustees argued that the Debtors' *voluntary* bankruptcy filing and proposed payment of the Senior Lien Notes under the Plan was a *voluntary* repayment prior to October 15, 2015, which triggered the obligation to pay the Applicable Premiums.
    - The *AMR* decision was inapplicable because the indenture at issue in that case had language that **expressly excluded** a make-whole payment post-bankruptcy default.
- ***Senior Lien Trustees' Arguments – Damages Claim***
  - The Senior Lien Trustees asserted, in the alternative, a claim for damages under state law as a result of a breach of a purported "no call" provision in Section 5 of the Senior Lien Notes and an alleged common law entitlement to repayment only on the agreed-upon maturity date (the "perfect tender" rule).
  - The Senior Lien Trustees also argued that they were entitled to a claim for damages for losing their ability to rescind the automatic acceleration of the Senior Lien Notes.

Bankruptcy Court Ruling

- The Bankruptcy Court rejected the Senior Lien Trustees' arguments and found that the Senior Lien Noteholders were not entitled to either payment of the Applicable Premium or a damages claim.
- ***Bankruptcy Court Ruling – Prepayment***
  - The Bankruptcy Court made several findings in reaching the conclusion that the Plan did not constitute a voluntary prepayment of the Senior Lien Notes:
    - Under "well-settled" New York law, the acceleration of a debt advances the maturity date and any payment made thereafter cannot be considered a "prepayment" unless an exception to this rule applies.
      - "The rationale for this rule is logical and clear: by accelerating the debt, the lender advances the maturity of the loan and any subsequent payment . . . cannot be a prepayment. . . . [R]ather than being compensated . . . for the frustration of its desire to be paid interest over the life of the loan, the lender has, . . . instead chosen to be paid early." (Bench Ruling at 34:18-25.)
    - Neither of the two recognized exceptions to this rule applied:
      - The Debtors' bankruptcy filing was not an intentional default intended to evade payment of a make-whole premium.
      - The Senior Indentures lacked a "clear and unambiguous clause [that] calls for the payment of a prepayment premium or make-whole even in the event of acceleration of . . . the debt."

Bankruptcy Court Ruling (cont'd)

- ***Bankruptcy Court Ruling – Indenture Language***
  - To overcome New York law that prepayment premiums are generally not enforceable after acceleration, an indenture must use clear and specific language.
    - Contrary to the Senior Lien Trustees' contention, the words "***premium, if any***" used in the Acceleration Provisions of the Senior Lien Indentures was not sufficient to require payment of the Applicable Premium following acceleration of the debt.
  - Citing the *AMR* decision and other case law, the Bankruptcy Court noted that automatic acceleration provisions are bargained-for covenants by which the noteholders elect in advance to accelerate in exchange for forfeiture of any post-acceleration prepayment premium.
- ***Bankruptcy Court Ruling – Damages Claim***
  - The Bankruptcy Court also rejected the Senior Lien Trustees' claims for damages on the grounds that (i) the Senior Indentures did not have a no-call provision; (ii) New York's rule of perfect tender had not been violated; and (iii) any damages claim, even if it existed under state law, would be effectively an unsecured claim for unmatured interest not permitted under the Bankruptcy Code, whether based on breach of a no-call provision or denial of a rescission right.

Bankruptcy Court Ruling (cont'd)

- ***No-Call***
  - Judge Drain concluded that the indentures did not contain a strict "no-call" covenant.
- ***Perfect Tender Rule***
  - ***Overview of Rule***
    - New York's rule of perfect tender bars an issuer from paying debt before its maturity.
    - However, parties can amend the general rule to allow an issuer to prepay debt in exchange for agreed consideration that compensates the lender for the cessation of the stream of interest payments running to the original maturity date of the loan.
  - ***Noteholders' Argument***
    - The noteholders argued that New York's common law rule of perfect tender would apply even if their agreements were silent regarding the consequences of such prepayment—*i.e.*, that a claim for a prepayment premium exists based solely on the fact that the notes were prepaid.

Bankruptcy Court Ruling (cont'd)

- ***Perfect Tender Holding***

  - Although Judge Drain stated that a lender may have a claim under New York law for a violation of the perfect tender rule (at least for specific performance), he held that any such claim would be disallowed under section 502(b)(2) of the Bankruptcy Code as unmatured interest.
    - In a separate ruling, Judge Drain held that the existence of a make-whole provision in the notes modified the perfect tender rule and, thus, the senior lenders did not have a claim for breach of perfect tender.

  - Judge Drain acknowledged that it is unclear whether a breach of a make-whole provision should be viewed as unmatured interest; however, the measure of a claim based on New York's perfect tender rule or breach of a no-call covenant (assuming no liquidated damages provision) would be the difference between the present value of interest to be paid under the First and 1.5 Lien Notes through their stated maturity and the present value of interest under the replacement notes to be provided such noteholders, which equates to unmatured interest.
    - Damages for breach of the right to rescind acceleration would equate to the same lost unmatured interest and, thus, would also be disallowed.

Bankruptcy Court Ruling (cont'd)

- ***Rescission of Acceleration Holding***
  - Judge Drain also rejected the Senior Lien Trustees' efforts to resurrect the make-whole claims by rescinding the automatic acceleration of the notes.
    - Following the Second Circuit's decision in *In re AMR Corp.*, Judge Drain found that the automatic stay applied because sending a rescission notice constituted an act to exercise control over estate property and recover a claim against the debtor in violation of sections 362(a)(3) and (6) of the Bankruptcy Code.
    - Judge Drain declined to grant relief from the stay to allow the noteholders to send the rescission notice because deceleration would, among other things, significantly increase claims against the estate.
    - Judge Drain also rejected the argument that sending a rescission notice was safe-harbored under section 555 of the Bankruptcy Code, which excepts from the automatic stay "the exercise of a contractual right of a stockbroker, financial institution, financial participant or securities clearing agency to cause the liquidation, termination or acceleration of a securities contract . . . ."

Cramdown Dispute

Cramdown in the Secured Creditor Context

- Under section 1129(b)(2)(A) of the Bankruptcy Code, if the impaired, non-accepting class constitutes a class of *secured* claims, the plan is "fair and equitable" with respect to this class only if the claimants either (a) retain their liens and receive deferred cash payments under the plan with a present value at least equal to the value of their collateral (or the collateral's proceeds, if it is sold), or (b) otherwise receive the "indubitable equivalent" of their secured claims.
- Such deferred cash payments must "total[] at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of [the creditor's] interest in the estate's interest in [the collateral]."
- To compensate a secured creditor for the delay, any deferred cash payments must therefore include interest on the secured claim.

Cramdown in Secured Creditor Context (cont.)

- The proper rate of such "cramdown" interest, however, is unsettled. Courts have adopted varying approaches to calculate the cramdown rate of interest.
  - *Formula Rate:* The risk-free rate (Treasury or prime) plus a risk premium (generally 1-3%).
  - *Coerced Loan Approach*: The rate of interest the lender could obtain if it foreclosed on its collateral and reinvested the proceeds in loans of equivalent duration and risk.
  - *Cost of Funds Approach*: The rate the lender would have to pay to borrow funds.
  - *Presumptive Contract Rate Approach*: A rebuttable presumption that the prepetition contract rate applies unless either the creditor or the debtor can counter with persuasive evidence that the cramdown rate should differ.

Momentive Cramdown Dispute

➢ ***Cramdown Plan Terms***

- In the event that the holders of Senior Lien Notes voted to reject the Plan — which, in fact, occurred — the Plan in the *Momentive* case provided that they would receive Replacement Notes "with a present value equal to the Allowed amount of [each] holder's [Senior] Note Claim."

- The respective rates of interest on the Replacement First Lien Notes and the Replacement 1.5 Lien Notes provided in the Plan were: (i) a 7-year Treasury Rate plus 1.50% (approximately 3.6%) and (ii) a 7.5-year Treasury Rate plus 2.00% (approximately 4.1%), respectively.

  - These rates were lower than the rates the Debtors secured for Exit Financing obtained in connection with confirmation of the *Momentive* chapter 11 plan.

Observable Fair Market Value Considerations

- The present value of the Replacement Notes for the First Lien and 1.5 Lien Notes would be below face value when applying discount rates based on observable terms that the Debtors obtained from financing sources for the Exit Financing.
  - The First Lien Notes discounted by L + 4.0% (5.00%) or Prime + 3.0% (6.25%) vs. the Exit Financing terms of T + 1.5% (3.6%) results in a present value of 85.8% to 92.3% of face value. The 1.5L Notes discounted by the same 5.0%-6.25% vs. the Exit Financing terms of T + 2.0% (4.1%) results in a present value of 88.0% to 95.0% of face value.
- In both cases, if the observable Exit Financing terms were found to be the appropriate standard to be applied, the Noteholders would not be receiving the present value of deferred cash payments equal to the value of its collateral or the indubitable equivalent.

($mm)	Face Value			Interest Rate	Term	Cash Payments
Replacement First Lien Notes	$ 1,100.0			T + 1.5% [3.6%]	7 years	$ 1,377.2

($mm) Market Comparables	Face Value	Term	Interest Rate	Discount Rate	Present Value	% of Face
Replacement First Lien Notes	$ 1,100.0	7 years	T + 1.5% [3.6%]	T + 1.5% [3.6%]	$ 1,103.2	100.3%
Exit Term Loan Financing [1]				L + 4.0% [5%]	1,015.1	92.3%
Exit Term Loan Financing [1]				Prime + 3.0% [6.25%]	943.8	85.8%

($mm)	Face Value			Interest Rate	Term	Cash Payments
1.5 Lien Replacement First Lien Notes	$ 250.0			T + 2.0% [4.1%]	7.5 years	$ 326.9

($mm) Market Comparables	Face Value	Term	Interest Rate	Discount Rate	Present Value	% of Face
1.5 Lien Replacement First Lien Notes	$ 250.0	7.5 years	T + 2.0% [4.1%]	T + 2.0% [4.1%]	$ 251.0	100.4%
Exit Term Loan Financing [1]				L + 4.0% [5%]	237.4	95.0%
Exit Term Loan Financing [1]				Prime + 3.0% [6.25%]	220.0	88.0%

[1]: Borrower can elect to receive L+4.0% or Prime + 3.0%. Assumed LIBOR floor of 1.0% and Prime Rate of 3.25%.

Applicable Law

- ***Applicable Law – Bankruptcy Code***
  - Section 1129(b)(2)(A) of the Bankruptcy Code permits confirmation of a chapter 11 plan when a class of secured creditors votes to reject the plan if:

    (i) (I) such creditors retain the liens securing their prepetition claims, and

    (II) such creditors receive "deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of" the secured claim;

    (ii) such creditors' collateral is sold, subject to the secured creditors' right to credit bid, and a lien attaches to the proceeds of the sale; or

    (iii) such creditors receive the "indubitable equivalent" of their secured claims.
  - Because the Plan did not contemplate the sale of the Senior Lien Noteholders' collateral or propose to provide the Senior Lien Noteholders with the indubitable equivalent of their secured claims through a means other than that provided under section 1129(b)(2)(A)(i), the latter two cramdown methods were not at issue.
  - Because the present value of the deferred payments under clause (i)(I) is achieved through the application of an appropriate interest rate, determining the correct interest rate is paramount.

Applicable Law (cont'd)

- ***Applicable Law – Case Law***
  - *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004) – In a chapter 13 cramdown interest rate dispute, a plurality of the Supreme Court held that a "formula approach" should be utilized to determine the appropriate rate by adding a "risk premium," generally between 1 and 3 percent, to the national prime rate.
    - Footnote 14 of the *Till* decision stated that "in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce," which differs from the chapter 13 context, in which the plurality said an efficient market did not exist.
    - The *Till* plurality also concluded that Congress likely intended courts to use a uniform approach whenever the Bankruptcy Code required them to choose an interest rate to discount a stream of deferred payments to present value, whether in a chapter 11 or 13 case.

Applicable Law (cont'd)

➢ ***Applicable Law – Case Law (cont'd)***

- *GMAC v. Valenti (In re Valenti)*, 105 F.3d 55 (2d Cir. 1997) – Prior to *Till*, the Second Circuit, in another chapter 13 case, held that an appropriate cramdown interest rate was the rate of interest on a U.S. Treasury instrument having a maturity equivalent to the repayment schedule under the plan, plus a premium of between 1 and 3 percent reflecting the risk to the creditor receiving deferred payments.
  - The Second Circuit noted that "the value of a creditor's allowed claim does not include any degree of profit. There is no reason, therefore, that the [cramdown] interest rate should account for profit."
  - The *Till* decision cited to *Valenti* with approval.
- *In re American HomePatient, Inc.*, 420 F.3d 559 (6th Cir. 2005) – The Sixth Circuit, citing FN 14 of *Till*, 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."

Senior Lien Trustees' Arguments

➢ ***Senior Lien Trustees' Arguments – Market Rate***

- The Senior Lien Trustees contended that the Plan was not "fair and equitable" under section 1129(b) of the Bankruptcy Code because (i) *Till*'s formula approach should not apply to chapter 11 cases and should be limited to chapter 13 cases; and (ii) the Replacement Notes' interest rates ignores the command in Footnote 14 of *Till* that the market rate of interest should be used if an efficient market is available.
- The Senior Lien Trustees contended that an efficient market existed in this case, as evidenced by the availability of the Exit Financing and the robust markets for leveraged loans and high-yield debt generally.
- The Senior Lien Trustees contended that the Replacement Notes would trade below par and as such would not provide their respective noteholders with the full value of the allowed amount of their claims.

Senior Lien Trustees' Arguments (cont'd)

➢ ***Senior Lien Trustees' Arguments – Formula Rate***

- The Senior Lien Trustees also argued that even if the *Till* formula approach were appropriate, the Replacement Notes' interest rates did not comply with *Till* for two reasons:
  - **Use of Treasury Rate** – The Replacement Notes should utilize the prime rate as a base rate, because a prime rate "reflects the financial market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower" (quoting *Till*) and was the rate specifically approved by the *Till* plurality.
  - **Inadequate Risk Premium** – The risk premium of 1.5% and 2% for the First and 1.5 Lien Replacement Notes, respectively, failed to adequately compensate the Senior Lien Noteholders for the risk of the Debtors' business and industry, as well as the specific features of the Replacement Notes (*e.g.*, extended maturity, relaxed covenants, and non-availability of certain premiums).

Debtors' Arguments

➢ ***Debtors' Arguments – Use of Formula Rate***

- The Debtors contended that the *Till* decision dictated the use of a "formula" approach, not a market analysis, in chapter 11 cases.
  - *Till* specifically held that Congress intended a single methodology for determining the present value of a future payment stream to apply under both chapter 11 and chapter 13 of the Bankruptcy Code.
  - Footnote 14 of *Till* does not require a market interest rate analysis and the Debtors followed *Till's* "straightforward and objective formula approach."

➢ ***Debtors' Arguments – Appropriate Formula Rate***

- The Debtors also contended that their specific formula for the cramdown rate on the Replacement Notes was appropriate for several reasons:
  - The use of a Treasury rate was appropriate because *Till* did not mandate the use of the prime rate, and other cases, including *Valenti*, used a Treasury rate as the benchmark.
  - The risk premiums for the Replacement Notes were appropriate in light of the Debtors' post-emergence circumstances.

Bankruptcy Court Ruling

- ***Bankruptcy Court Ruling – Use of Formula Rate***
  - The Bankruptcy Court rejected the Senior Lien Trustees' arguments and held that the "formula" approach was the correct methodology to establish a cramdown interest rate.
    - The Bankruptcy Court noted that the "first principles" of *Till* and *Valenti* rejected a market-based approach in favor of a formula approach.
    - The Bankruptcy Court also noted that Footnote 14 of *Till* was a "very slim reed" on which to contradict these first principles.
    - Relying on *Valenti*, Judge Drain concluded that a cramdown rate "should not contain any profit or cost element" and "it is highly unlikely that there will ever be an efficient market that does not include a profit element."
  - Although *Till* and *Valenti* concerned chapter 13 debtors, the Bankruptcy Court noted that they were likely intended to apply in chapter 11 as well.
    - Quoting *Till*, the Bankruptcy Court noted: "Congress likely intended bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under any of the many Code provisions requiring a court to discount a stream of deferred payments back to their present dollar value."

Bankruptcy Court Ruling (cont'd)

- ***Bankruptcy Court Ruling – Specific Formula Rate***
  - While approving the formula approach for cramdown interest rates, the Bankruptcy Court nevertheless increased the risk premiums by 0.5% and 0.75% for the First Lien and 1.5 Lien Replacement Notes, respectively.
    - The Bankruptcy Court noted that the prime rate discussed in *Till* accounted for some level of risk of nonpayment, while the Treasury rate proposed under the Plan did not.
    - Even after these adjustments, the cramdown interest rate on the First Lien Replacement Notes is still approximately 1% below the interest rate on the portion of the Exit Financing earmarked to repay the First Lien Notes, and the interest rate on the 1.5 Lien Replacement Notes is approximately 2.15% below the interest rate on the portion of the Exit Financing earmarked to repay the 1.5 Lien Notes.
- ***Senior Lien Trustees' Motion to Change Plan Votes***
  - Subsequent to the Bankruptcy Court's ruling, the rejecting Senior Lien Noteholders filed motions, pursuant to Bankruptcy Rule 3018, to change their votes to accept the Plan (*i.e.* to opt for payment in cash, albeit without the Applicable Premium).
    - The Bankruptcy Court denied these motions, ruling that it would not be proper to allow the Senior Lien Noteholders to undo the consequences of their timely exercised voting decisions with respect to the Plan.

Second Circuit Decision

Second Circuit Decision

- The Senior Lien Trustees appealed the make-whole and cramdown portions of the confirmation order, first, to the District Court and, then, to the Second Circuit.
  - Stays pending appeal were requested, but were denied by both the Bankruptcy and the District Courts.
  - The Plan went effective on October 24, 2014.
  - On May 4, 2015, the District Court affirmed the confirmation order in all respects.
- On October 20, 2017, the U.S. Court of Appeals for the Second Circuit issued an opinion holding that:
  - The Bankruptcy Court erred in not determining whether an efficient market existed to calculate the interest rate under the cramdown standard for secured creditors; and
  - The Senior Lien Noteholders were not entitled to payment of a make-whole premium.

Second Circuit Decision (cont'd)

- On the cramdown interest issue, the Second Circuit's decision adopted a two-part test:
  - Applying a market interest rate, if an efficient market exists, to takeback debt in a cramdown,
  - Applying the *Till* formula method if an efficient market does *not* exist.
- On the make-whole issue, the Second Circuit's denial of a *Momentive* make-whole premium created what some have called a circuit split with the Third Circuit, which, in its November 2016 *Energy Future Holdings* decision, had approved the payment of a make-whole premium under similar circumstances (discussed further below).
- In light of the Second Circuit's Decision, the cramdown dispute has been remanded to Judge Drain for an evidentiary hearing as to the existence of an efficient market.
  - The Debtors filed a petition for rehearing *en banc*, which was denied on December 11, 2017.
  - On March 12, 2018, the Senior Lien Trustees filed petitions for certiorari to the Supreme Court, seeking review of the Second Circuit's make-whole decision.
  - The parties are targeting the third week of August for a trial before Judge Drain regarding cramdown rate.

Second Circuit Decision (cont'd)

- ***Interest Rate Dispute***
  - The Second Circuit first considered whether the interest rates on the Replacement Notes issued to the Senior Noteholders met the so-called "cramdown standard" of section 1129(b) of the Bankruptcy Code applicable to rejecting classes of secured creditors.
  - The Second Circuit observed that *Till* "made no conclusive statement as to whether the 'formula' rate was generally required in Chapter 11 cases" and adopted the Sixth Circuit's two-prong test to selecting an interest rate with respect to cramdown:
    - The market rate should be applied where an efficient market exists; but
    - Where no efficient market exists, the bankruptcy court should employ the *Till* formula.
  - The Second Circuit also noted that other courts, including the Fifth Circuit in *In re Texas Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d 324 (5th Cir. 2013), have held that financing markets 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."
  - The Second Circuit remanded the issue of whether an efficient market exists to the Bankruptcy Court, but suggested that an efficient market may exist for notes similar to the Replacement Notes.

Second Circuit Decision (cont'd)

- ***Make-Whole Dispute***
  - The Second Circuit next addressed whether the Senior Noteholders were entitled to make-whole payments and, affirming the Bankruptcy and District Court decisions, concluded that they were not.
  - The Second Circuit first agreed with the lower courts that the term "redemption" generally refers only to pre-maturity repayments of debt.
    - Relying on *In re AMR Corp.*, 730 F.3d 88 (2d Cir. 2013), the Second Circuit held that since the acceleration of debt alters the original maturity to the acceleration date, and since issuance of the Replacement Notes occurred post-acceleration, the issuance of the Replacement Notes could not, by definition, be a "prepayment," or a "redemption" for purposes of the indenture's "optional redemption" clause.
  - The Second Circuit then analyzed the circumstances of the issuance of the Replacement Notes to determine whether those actions were "optional."
    - The Second Circuit held, citing *AMR*, that "the obligation to issue the Replacement Notes came about automatically" and that "[a] payment made mandatory by operation of an automatic acceleration clause is not one made at MPM's option."
  - Finally, the Second Circuit agreed with the lower courts that the Senior Lien Noteholders' postpetition invocation of their contractual right to rescind the acceleration triggered by a bankruptcy filing was barred by the automatic stay as an attempt to modify contract rights.
    - Relying again on its decision in *AMR*, the Second Circuit stated that the right to rescind acceleration in bankruptcy would serve as "an end-run around [creditors'] bargain by rescission."

Second Circuit Decision (cont'd)

- ***Make-Whole Circuit Split***
  - The Second Circuit's make-whole decision created what some have called a circuit split with the Third Circuit's decision in *In re Energy Future Holdings Corp.*, 842 F.3d 247 (3d Cir. 2016).
  - In *Energy Future Holdings*, the Third Circuit held that:
    - The noteholders were entitled to repayment of an optional redemption premium at the make-whole price as a result of the repayment of their notes in bankruptcy.
    - Under New York law, a redemption may occur either before or after an automatic acceleration triggered by a bankruptcy filing.
    - Notwithstanding the "automatic" nature of acceleration under the indentures, the debtor's note repayments were, in fact, "voluntary."
      - The voluntary nature of the *Energy Future* debtors' repayments was evidenced by the fact that the noteholders had not asked to be repaid and, in fact, had sought to rescind the acceleration.

Second Circuit Decision (cont'd)

- ***Equitable Mootness***
  - Finally, the Second Circuit addressed and rejected the Debtors' argument that the Senior Lien Trustees' appeals should be dismissed as equitably moot.
    - Bankruptcy Courts invoke the equitable mootness doctrine to avoid disturbing plans of reorganization once implemented.
    - Where, as here, a plan has been substantially consummated, there exists a presumption that an appellant's challenge has been rendered equitably moot.
      - The presumption may be overcome, however, if the following five factors are met:
        - (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.

Second Circuit Decision (cont'd)

- ***Equitable Mootness (cont'd)***

  The Debtors argued that granting the relief requested by the noteholders would "alter a critical piece of the Plan resulting from intense-multi-party negotiation, thereby impact[ing] other terms of the agreement and throw[ing] into doubt the viability of the Plan," and accordingly, such relief "would cause debilitating financial uncertainty" to the emerging company.
  - The Second Circuit disagreed, stating that
    - The approximately $32 million in annual payments over a seven-year period that would result from an increased interest rate on the Replacement Notes would not threaten the Debtors' emergence or otherwise fail the five-factor test.
    - The Second Circuit did suggest, however, that this conclusion may have been different if the Debtors had been ordered to pay the asserted make-whole of approximately $200 million, or if redistribution had been required to comply with the subordinated notes' indenture.
  - The Second Circuit's rejection of the equitable mootness defense as to the cramdown and make-whole arguments continues a recent trend of courts applying the equitable mootness doctrine increasingly narrowly.

Second Circuit Decision (cont'd)

- ***Takeaways***
  - The Second Circuit's decision represents a significant victory for secured creditors who, since the issuance of the Bankruptcy Court decision, had confronted the ubiquitous prospect of being crammed down with potentially below-market take-back debt in restructuring negotiations.
  - However, the two-step approach adopted by the Second Circuit could result in expensive litigation between debtors and secured creditors as to whether there exists an efficient market and, if so, what the efficient market rate should be.
  - Additionally, the differing of opinions between the Second and Third Circuits on the make-whole issue may increase forum shopping for distressed issuers with potentially significant make-whole obligations.
    - Future issuers will also likely seek to more clearly draft around the issue of whether they have any obligation to pay a make-whole premium following a default or an acceleration in bankruptcy, with healthy issuers seeking to foreclose that possibility and distressed issuers allowing for that possibility.

Enforceable Make-Wholes After *Momentive*

- In his ruling, Judge Drain noted two ways for drafting make-whole premium provisions that would be enforceable after an automatic acceleration: "either [(1)] an explicit recognition that the make-whole would be payable notwithstanding the acceleration of the loan or [(2)] . . . a provision that requires the borrower to pay a make-whole whenever debt is repaid prior to its original maturity."

- Several cases have outlined language that would require the payment of a prepayment premium even after default and acceleration:
  - *In re 400 Walnut St. Assocs., LP* (Bankr. E.D. Pa. 2011) – "[u]pon Lender's exercise of any right of acceleration . . . Borrower shall pay to lender . . . the prepayment premium."
  - *In re United Merchants and Mfrs., Inc.* (2d Cir. 1982) – after default, requiring payment of "an amount equal to the pre-payment charge that would be payable if [the borrower] were pre-paying such Note at the time."
  - *In re School Specialty, Inc.* (Bankr. D. Del. 2013) – "Each prepayment of Term Loans . . . after acceleration thereof . . . or such amount otherwise becoming or being declared immediately due and payable . . . shall be accompanied by, a fee (the "Early Payment Fee") payable in cash."

- The Second Circuit's decision in *Momentive* did not undermine the validity of this analysis and it should be kept in mind when drafting future indentures.