Momentive Deconstructed

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

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A Detailed Analysis of the Many Aspects of This Important Bankruptcy Court Decision

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Agenda

I. **Background**

II. **Make-Whole Dispute**

III. **Cramdown Dispute**

IV. **Intercreditor Dispute**

V. **Appeal Status Rulings**

Background

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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")
  - $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, with Apollo, the "Consenting Noteholders").
  - Apollo was also Momentive's prepetition controlling shareholder.

➢ ***Backstop Commitment Agreement***

- The Consenting Noteholders agreed to backstop a $600 million equity 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 value equal to the allowed amount of the claims
    - these toggle provisions were designed to encourage senior 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 the Rights Offering for additional New Equity
- Subordinated Notes
  - no distribution on account of subordination to Second Lien Notes

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Senior Lien Noteholder Voting

- The holders of the Senior Lien Notes (the "Senior Lien Noteholders") Trustees 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 "cramdown" the Plan over the objection of the trustees for the Senior Lien Notes (the "Senior Lien Trustees"), by means, among others, of using the *Till* standard for determining the cramdown rate of interest.

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.

Intercreditor Litigation

- The Senior Lien Trustees also filed actions (the "Intercreditor Actions") in New York State Supreme Court in June and July 2014, respectively, against the Consenting Noteholders in which they alleged that the Consenting Noteholders violated the second lien intercreditor agreement (the "Intercreditor Agreement") by, among other things, agreeing to receive "Common Collateral" or the proceeds thereof in respect of their claims before senior noteholders were paid in full in cash.
- The Intercreditor Actions were subsequently removed to the Bankruptcy Court.

Confirmation of Plan and Dismissal of Intercreditor Litigation

- 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.
- In a separate bench ruling delivered on September 30, 2014, Judge Drain dismissed the Intercreditor Actions against the Consenting Noteholders (largely with prejudice), but with the right to amend as to a number of allegations.

Make-Whole Dispute

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“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 that “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.

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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.
    - 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, courts have often found that no 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.)
    - Efforts to recast a post-acceleration make-whole claim as a breach of contract claim (typically for breach of a "no-call" provision) have generally not prevailed, although some courts have suggested that noteholders may assert such a claim against *solvent* debtors.
- Some courts have embraced, and others rejected, the proposition that make-whole premiums constitute unmatured interest, which may not be recoverable under section 502(b) of the Bankruptcy Code.
- 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.

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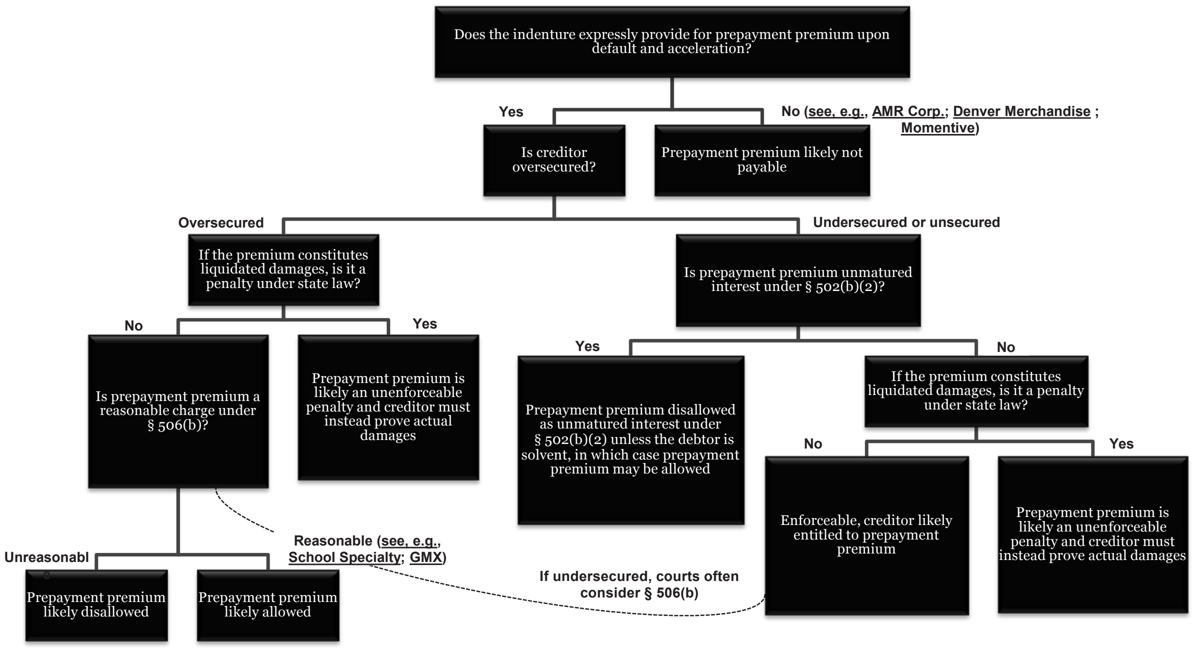
"Make-Whole" Premium Litigation Considerations*



* This diagram illustrates general issues arising in make-whole litigation and does not reflect every issue that may be relevant to a court's analysis of a payment premium.

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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 Premiums 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 his subsequent ruling on the ICA Actions, 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 was unclear whether the damages flowing from 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 . . .."

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 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."

Key Takeaways

- *Momentive* follows prior Second Circuit precedent in holding that a make-whole premium will not be payable following automatic acceleration unless the debt documents explicitly so provide.
- The automatic stay will bar efforts to rescind the acceleration.
- Damages for violation of the perfect tender rule or breach of an alleged "no-call" provision may be disallowed as unmatured interest in insolvent debtor cases, but may be permissible in solvent debtor cases.

Cramdown Dispute

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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 the Exit Financing (and, therefore, lower than what most believed was an applicable "market" rate).

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 Supreme Court reasoned that a market rate may not be appropriate in chapter 13 given the lack of a free market for cramdown lenders, whereas, in chapter 11, there exists an efficient DIP lending market.
        - Judge Drain noted that the Supreme Court's reasoning in footnote 14 has been criticized for its understanding of DIP loans and its suggestion that DIP loans (and the rates a DIP lender may receive) are comparable to loans imposed upon dissenting creditors at cramdown. *Collier* notes that the only similarity between DIP financing and cramdown loans is that they both arise in chapter 11 case, and cramdown loans are more akin to non-bankruptcy loans given that they arise at confirmation.

Applicable Law (cont'd)

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

    - 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.

  - The Supreme Court in *Till* did not decide the proper scale for the risk adjustment, but noted that if a court determines that an "eye-popping" interest rate is necessary because there is heightened risk (likelihood of default, etc.), the plan probably should not be confirmed.

    - The risk adjustment "depends . . . on such factors as the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan."

  - The Supreme Court also rejected the coerced loan, presumptive contract rate and cost of funds approaches because such approaches are "complicated, impose[] significant evidentiary costs, and aim[] to make each individual creditor whole rather than to ensure the debtor's payments have the required present value."

Applicable Law (cont'd)

- ***Applicable Law – Case Law*** **(cont'd)**
  - The Supreme Court stated that chapter 13's cramdown provision does not require that a creditor be subjectively indifferent between present foreclosure and future payment—"[i]ndeed, the very idea of a 'cramdown' loan *precludes* [that] result: By definition, a creditor forced to accept such a loan would prefer to foreclose."
- Moreover, the Supreme Court stated that a lender's transaction costs and overall profits, which are embedded in the market rate of interest, "are no longer relevant in the context of court-administered and court-supervised cramdown loans."

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.

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 Treasury rate was also used because there is no other way to determine a starting point (base rate) for a fixed rate instrument. The Prime and Libor rates work for floating rate instruments, but not fixed rate instruments.
    - The risk premiums for the Replacement Notes were appropriate in light of the Debtors' post-emergence circumstances.

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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.

Questions Raised by Cramdown Rate Ruling

- Are noteholders really in the same position as if they received the value of their claims immediately?
  - Senior, fully-secured debt traded below par after the ruling.
- The ruling clearly enhances debtors' leverage in negotiations with secured creditors.
  - Assuming that there is an impaired consenting class, a debtor can threaten to cramdown rejecting noteholders with below-market paper.
  - Noteholders who trip a deathtrap provision by rejecting the plan should not assume that a court will permit them to change their vote down the road. In *Momentive*, Judge Drain denied the senior noteholders' request to change their votes to accept the Plan and receive cash consideration.
- The full impact of the decision remains to be seen (and will depend, in part, on the outcome of pending appeals).
  - Will the decision impact exit financing needs?
  - Will the cost of first lien financing go up to account for increased risk?
  - Will *Momentive* impact intercreditor agreements? Can protections be built in?

Reform on the Horizon?

- The cramdown rate issue – and the *Momentive* cramdown rate ruling – are addressed in a recent report published by the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 (the "Commission").
  - The American Bankruptcy Institute (the "ABI") is a nonpartisan organization of bankruptcy professionals, judges and turnaround specialists; the ABI organized the Commission in 2011.
- The Commission made the following recommendations:
  - courts should not use the *Till* formula approach in chapter 11 cases;
  - if possible, courts should use a market rate; and
  - if a market rate cannot be determined for a particular debtor, courts should use "an appropriate risk-adjusted rate that reflects the actual risk posed in the case of the reorganized debtor, considering factors such as the debtor's industry, projections, leverage, revised capital structure, and obligations under the plan."
- The extent to which legislators will adopt and codify these recommendations remains to be seen.

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Intercreditor Dispute

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Intercreditor Dispute – Procedural Background

- ***Commencement of Intercreditor Actions***
  - On June 18, 2014 and July 16, 2014, respectively, the First and 1.5 Lien Notes Trustees commenced the Intercreditor Actions against JPMorgan Chase Bank, N.A., as Intercreditor Agent, the Second Lien Trustee, and the Consenting Noteholders (the "Intercreditor Defendants").
  - The complaints were filed in New York state court and were subsequently removed to the Bankruptcy Court, which has retained jurisdiction over them pursuant to the Plan.
- ***Releases and Retention of Jurisdiction Under the Plan***
  - One of the Senior Lien Trustees' objections to the confirmation of the Plan was that it provided for the release of the claims asserted against the Consenting Noteholders.
  - The Debtors, Apollo and the Ad Hoc Committee (the "Plan Support Parties") argued that the releases were appropriate under applicable precedent because, among other things, (i) the Consenting Noteholders were contributing $600 million to fund the Plan, (ii) the Consenting Noteholders were indemnified by the Debtors under the Plan, and (iii) the Intercreditor Actions were a backdoor attempt to subvert the Plan.
  - The Bankruptcy Court carved out the claims asserted in the Intercreditor Actions from the Plan releases, but retained jurisdiction over such claims.

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Intercreditor Dispute – Intercreditor Agreement

➢ ***Intercreditor Agreement – Applicable Provisions***

- Section 4.1 of the intercreditor agreement to which the Second Lien Notes were subject (the "Intercreditor Agreement") provides:

  "**Application of Proceeds.** After an event of default . . . has occurred . . . so long as the Discharge of Senior Lender Claims has not occurred, the ***Common Collateral or proceeds thereof*** received in connection with the sale or other disposition of, or collection on, such Common Collateral . . . shall be applied by the Intercreditor Agent to the Senior Lender Claims."

- Section 4.2 of the Intercreditor Agreement provides:

  "Any ***Common Collateral or proceeds thereof*** received by any . . . Second-Priority Secured Party in connection with the exercise of any right or remedy . . . Relating to the Common Collateral in contravention of this [Intercreditor] Agreement shall be . . . paid over . . . for the benefit of the applicable Senior Lenders."

- Pursuant to Section 1.1 of the intercreditor agreement, "Discharge of Senior Lender Claims" is defined in the Intercreditor Agreement as:

  "[P]ayment in full in cash . . . of (a) all Obligations in respect of all outstanding First-Lien Indebtedness . . . and (b) any other Senior Lender Claims that are due and payable or otherwise accrued and owing at or prior to the time such principal and interest are paid."

Intercreditor Dispute – Senior Lien Trustees' Complaints

- ***Senior Lien Trustees' Complaints***
  - The Senior Lien Trustees alleged in their complaints that the Second Lien Noteholders took (or would take) the following actions that breached the Intercreditor Agreement:
    - Opposing payment of First Lien Trustee's financial advisor fees as adequate protection
    - Supporting the Debtors' entry into the DIP Facilities and grant of priming liens
    - Intervening in the Make-Whole Dispute (i.e., objecting to the make-whole claim)
    - Entering into the RSA and supporting a plan providing for Senior Lien Notes' cramdown
    - Receiving proceeds of "Common Collateral" prior to the payment in full in cash of the Senior Lien Notes by receiving either during the cases or through the Plan
      - the $30 million backstop fee,
      - reimbursement of professional fees and expenses
      - distributions of New Equity
  - The complaints included little detail with respect to certain of these allegations.

Intercreditor Dispute – Motions to Dismiss

- ***Intercreditor Defendants' Motions to Dismiss***
  - The Intercreditor Defendants filed motions to dismiss the complaints, arguing as follows:
    - ***Rights as Unsecured Creditors*** – The Intercreditor Agreement expressly preserves the right of holders of Second Lien Notes as unsecured creditors and all of the alleged actions could be and were taken in such holders' capacity as unsecured creditors.
    - ***Participation in Make-Whole Dispute*** – No provision of the Intercreditor Agreement prohibits contesting the *amount* of the Senior Lien Noteholders' claims.
    - ***Support of Cramdown Treatment*** – The Intercreditor Agreement lacks the specificity required to waive the right to support a cramdown plan.
    - ***DIP Loan*** – The Intercreditor Agreement prohibits *objecting* to a new loan supported by the Senior Lien Trustees, not *supporting* any new loan.
    - ***Fees and Expenses*** – The receipt of fees and expenses by the Consenting Noteholders' under the RSA and BCA was not prohibited because such reimbursement was on account of their support of the Plan and backstopping the Rights Offering, not their roles as secured creditors.

Intercreditor Dispute – Motions to Dismiss (cont'd)

- ***Intercreditor Defendants' Motions to Dismiss (cont'd)***

  - **Receipt of New Equity**. New Equity is not Common Collateral because the Senior Lien Noteholders do not have a lien on it, nor is New Equity proceeds of Common Collateral.

    - The New Equity is issued to the Second Lien Noteholders in exchange for the cancellation of their claims and liens, which are the property of the Second Lien Noteholders, and ***not*** in exchange for any portion of the Common Collateral.

    - All Common Collateral remains intact and will secure the Replacement Notes.

    - The Legislative History of section 1129(b)(2)(A) says that equity in the reorganized debtor can ***never*** constitute an "indubitable equivalent" of a secured claim.

  - Even had the New Equity been the proceeds of Common Collateral, pay over would not be required as the Senior Lien Notes were to be discharged under the Plan.

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Intercreditor Dispute – Bankruptcy Court Ruling

- ***Bankruptcy Court Ruling on Motions to Dismiss***

  - On September 30, 2014, the Bankruptcy Court issued a ruling dismissing all counts, but permitting the Senior Lien Trustees to seek to plead certain claims with more specificity.

  - The Bankruptcy Court concluded as follows:

    - **Adequate Protection.** The Bankruptcy Court dismissed this cause of action, but permitted the First Lien Trustee to replead with more specificity.

    - **Support of DIP Facilities.** The Intercreditor Agreement did not prohibit the Intercreditor Defendants from supporting the DIP Facilities and the Senior Lien Trustees themselves did not object to the priming aspect of the DIP Facilities.

    - **Make-Whole Amount.** The Bankruptcy Court had already found that the Senior Lien Trustees had no right to receive the Applicable Premiums under the Senior Indentures, and even if they did the Intercreditor Defendants would not have breached the Intercreditor Agreement by objecting to the payment of the Applicable Premiums.

Intercreditor Dispute – Bankruptcy Court Ruling (cont'd)

- ***Bankruptcy Court Ruling on Motions to Dismiss (cont'd)***

  - **Cramdown.** The Intercreditor Defendants' support for a plan including cramdown treatment for the Senior Lien Notes did not constitute a breach of the Intercreditor Agreement, because the Intercreditor Agreement did not contain specific language that required them to "yield in all respects to the senior secured lenders until the senior secured lenders are paid in full."

  - **Fees and Expenses.** The agreement to pay the Consenting Noteholders the backstop fee did not breach the Intercreditor Agreement because the fee was being paid to the Consenting Noteholders in their capacity as backstop parties, not secured creditors. The Bankruptcy Court, however, permitted the Senior Lien Trustees to replead with more specificity the allegation that the Intercreditor Defendants received reimbursement of fees and expenses as secured creditors.

Bankruptcy Court Ruling (cont'd)

➢ ***Bankruptcy Court Ruling on Motions to Dismiss (cont'd)***

- **Receipt of New Equity.** New Equity is not the proceeds of Common Collateral. The Common Collateral was not altered or diminished and the Senior Lien Trustees would retain their liens on exactly the same collateral pursuant to the Plan.
  - New York Uniform Commercial Code section 9-102(64) provides that "proceeds" include, among other things:

    "(A) whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral; (B) whatever is collected on, or distributed on account of, collateral; (C) rights arising out of collateral; (D) . . . claims arising out of the loss . . . or damage to, the collateral; or (E) . . . Insurance payable by reason of the loss . . . of, . . . or damage to, the collateral."
  - As a matter of law, the New Equity is not proceeds of Common Collateral because, for "proceeds" to arise, collateral must be changed or altered in some way.

    "[T]he term proceeds properly includes whatever the assets the debtor receives by virtue of an event that exhausts or consumes some of the collateral's economic value or productive capacity."

Bankruptcy Court Ruling (cont'd)

- ***Bankruptcy Court Ruling on Motions to Dismiss (cont'd)***
  - The Senior Lien Trustees were granted 30 days from Bankruptcy Court's entry of the order dismissing their complaints to file a motion seeking leave to file an amended complaint that pleads certain of the causes of action with more specificity (as referenced above).

Motions to Amend

- On November 14, 2014, the Senior Lien Trustees filed their motions for leave to amend their respective complaints.
- After a hearing on January 16, 2015, the Bankruptcy Court denied the Senior Lien Trustees' motions but permitted the Senior Lien Trustees to file new motions for leave to file further amended complaints. The Bankruptcy Court made several rulings that narrowed the scope of the claims the Senior Lien Trustees could allege.
  - Specifically, the Bankruptcy Court dismissed with prejudice the cause of action based on the allegation that the Intercreditor Defendants received reimbursement of professional fees and expenses under the Final DIP Orders.
  - The Bankruptcy Court authorized the Senior Lien Trustees to file amended complaints that included more specific allegations regarding (i) whether the Intercreditor Defendants actually received their fee and expense reimbursements pursuant to the RSA and the BCA in their capacities as secured creditors, and in so doing breached the Intercreditor Agreement; and (ii) whether a claim for breach of the implied covenant of good faith and fair dealing can be based on such specific factual allegations.
- The First Lien Trustee (but not the 1.5 Lien Trustee) filed the authorized motion seeking leave to file a further amended complaint on March 2, 2015, and a hearing on it is scheduled for May 8, 2015. In lieu thereof, on March 16, 2015, the 1.5 Lien Trustee filed an appeal of the Bankruptcy Court's two prior orders dismissing its claims.

Appeal Status

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Appeal Status

- The Senior Lien Trustees appealed the make-whole and cramdown portions of the confirmation order and requested a stay pending appeal. Their stay requests were denied.
- The Plan went effective on October 24, 2014.
- The Senior Lien Trustees' appeals are currently pending before the District Court for the Southern District of New York.