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Energy Future Holdings and Contract Considerations in Drafting Make-Whole Provisions in Indentures

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I. General Background

A. The *Energy Future Holdings* Case[1]

Energy Future Holdings Corp., with its subsidiaries, is a Texas power company that was formed from the former TXU Corp. It filed for Chapter 11 relief in Delaware in April 2014, seven years after its creation, through a record leveraged buyout that was accomplished through the placement of billions of dollars of debt to hedge funds and investment firms. The business was divided between what was referred to as the "T" side and the "E" side. The "T" side included the Texas Competitive Electric Holdings (TCEH) unit and affiliates. The "E" side included, among other entities, Energy Future Intermediate Holding Company LLC and its subsidiary, EFIH Finance Inc. (collectively, EFIH). When the Energy Future Debtors filed their bankruptcy petitions, they had already negotiated settlements of claims with a significant number of their noteholders – agreements on what those noteholders would receive, in satisfaction of their note claims, upon court approval of debtor in possession (DIP) financing. But a significant number of other noteholders did not agree to settle their claims with the Debtors. These non-settling noteholders held their notes under an indenture (the "Indenture") issued by EFIH in August 2010 in conjunction with the issuance of 10.0 % Senior Secured Notes due 2020 (the "Notes").

[1] The principal opinion discussed herein is the opinion of the United States Bankruptcy Court for the District of Delaware (the "Bankruptcy Court") deciding the first phase of the make-whole litigation, rendered on March 26, 2015, and now reported at *In re Energy Future Holdings Corp.*, 527 B.R. 178 (Bankr. D. Del. 2015).

Upon the commencement of the case, the Debtors filed a DIP Financing Motion under which they would obtain post-petition financing at an interest rate of 4.25%; accelerate the outstanding Notes; and use the new financing in part to pay off all the outstanding principal and accrued interest on the Notes. The Debtors maintained that they were not required to pay any make-whole obligations or comparable damages.

The Indenture Trustee under the Indenture, as representative for the non-settling noteholders (the "Trustee") commenced litigating against the Debtors on several fronts. The Trustee (a) objected to the DIP Financing Motion in the main case; (b) objected to the Debtors' settlements with the settling EFIH first lien noteholders; (c) filed a motion seeking a determination that the automatic stay under 11 U.S.C. § 362(a) did not prevent the Trustee from reversing the acceleration of the Notes (or "decelerating" them); and (d) commenced an adversary proceeding against the Debtors seeking a declaratory judgment that "the EFIH Debtors are obligated to pay a $665.2 million redemption premium in connection with the proposed refinancing of the 10% Notes." *In re Energy Future Holdings Corp*., 513 B.R. 651, 654 (Bankr. D. Del. 2014).

The Trustee argued that the Noteholders were entitled to a secured claim for an amount described as the "Applicable Premium" in the "Redemption" section of the Indenture (and more generically referred to as a "make-whole" obligation). Its principal argument was that, under the terms of the Indenture, an "Optional Redemption" would occur when the Notes were repaid, triggering the Applicable Premium.

The Indenture included an "Optional Redemption" provision providing for the payment of an "Applicable Premium" under certain circumstances upon an early, voluntary repayment of the Notes. As the Bankruptcy Court noted, "[s]uch 'call protections' are common features in the indentures

governing the type of high-yield debt issued by the EFH corporate family."

Secondarily, the Trustee argued that (i) the EFIH Debtors intentionally defaulted by filing bankruptcy to avoid paying the Applicable Premium, and (ii) the repayment would be a breach of the Noteholders' right to rescind the Notes' acceleration.

Bankruptcy Judge Christopher Sontchi approved the DIP financing motion, and on June 19, 2014, the noteholders were paid the principal and interest that was due at that time. Their continued objection was preserved through the adversary proceeding.

In September 2014, the Bankruptcy Court issued an order to bifurcate the issues in the adversary proceeding. In the first phase, the Bankruptcy Court would determine: "whether EFIH is 'liable under applicable non-bankruptcy law for ... a Redemption Claim,' including the 'make-whole' or other 'damages ... under any no-call covenant, right to decelerate,' or applicable law." *Id.* at 183. If the Bankruptcy Court found EFIH liable for a Redemption Claim, then in the second phase, the Bankruptcy Court would determine whether the EFIH debtors are insolvent and whether that insolvency provides any defenses under the Bankruptcy Code to limit the Redemption Claim and the amount of the Redemption Claim. *Id.*

The issues on the first phase were presented to the Bankruptcy Court by way of cross-motions for summary judgment.[2]

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[2] These issues are similar to ones presented to and addressed by Bankruptcy Judge Robert Drain in the Southern District of New York in *In re MPM Silicones, LLC* ("*Momentive*"), Case No. 14-22503.

In the *Momentive* case, the pertinent language quoted from the Indenture there indicates that its language was at least substantially similar to that in the Indenture in *Energy Future*. *See In re MPM Silicones LLC*, 2014 WL 4436335 at * 11-12 (Bankr. S.D.N.Y. Sept. 9, 2014) (modified bench ruling) ["*Momentive I*"], *order affirmed by In re MPM Silicones, LLC,* 2015 WL 2330761 (S.D.N.Y., May 4, 2015) ["*Momentive II*"].

In contrast to *Energy Future*, procedurally, in *Momentive* these issues were presented through the indenture trustee's objections to the debtors' chapter 11 plan and its proposed treatment of the notes, *i.e.*, without recognition of the make-whole premium.

B. Make-Whole Calls and Redemption Premiums

"Redemption premium" has been defined as:

> Money over and above the face value of a callable bond that the issuer pays to bondholders if the bond is called. A callable bond is a bond that the issuer is permitted to redeem or repay before the maturity date, depriving the bondholder of future coupon payments. Usually the issuer does this if it can reissue the same amount of debt at a lower interest rate. The redemption premium exists to compensate bondholders for some of their lost interest payments. It is especially useful if they can only reinvest in securities with a lower return rate.

Farlex Financial Dictionary. © 2012.

Redemption premiums are often used in fixed rate bonds, and they serve as "call protection," allowing bondholders to lock in their yield for a period of time following the bond's issue date. With call protection, there is usually a non-call period in which the issuer is not permitted the option to redeem them, except pursuant to a "make-whole" feature; and there is also usually a period in which the issuer is required to pay a specified premium for opting to redeem the bonds prior to maturing before the stated maturity date. Make-whole calls first appeared in the bond markets in the mid-1990s and have become commonplace since then.[3]

During the non-call period, the bonds are permissibly redeemable at the option of the issuer pursuant to a "make-whole" call, which typically allows the issuer to redeem the bonds at a redemption price that equals the principal, the accrued and unpaid interest to the redemption date, and a make-whole premium based on the present value of the redemption premium that would be owed on the first day after the non-call period plus a hypothetical interest stream calculation for the period between the actual redemption date and the end of the non-call period. The concept is to give the bondholders the benefit of their bargain for losing the call protection prematurely.

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[3] Raymond James Financial, Inc., http://www.raymondjames.com/fixed_income_wholecall.htm (2015).

II. Pertinent Clauses in the Indenture at Issue in *Energy Future Holdings*

The following provisions of the Indenture were principally at issue:

(a) the definition of "Applicable Premium," within section 1.01, Article I;

(b) Optional Redemptions, Section 3.07, within Article III on Redemption;

(c) Events of Default – in particular, section 6.01(a), subparts (6) and (7), within Article VI on Defaults and Remedies; and

(d) Acceleration, section 6.02 in Article VI.

The text of these and related sections cited by the parties are set forth in Attachment A.

III. The Bankruptcy Court's Ruling in *Energy Future Holdings*

On March 26, 2015, the Bankruptcy Court in *Energy Future Holdings* issued its ruling in the first phase. With respect to the contract-based issues presented, the Bankruptcy Court found that the Indenture "is not ambiguous," and held:

> "a. The plain language of the Indenture does not require payment of an Applicable Premium upon a repayment of the Notes, following an acceleration under section 6.02 of the Indenture, arising from a default for the commencement of 'proceeding to be adjudicated bankrupt or insolvent' under section 6.01(a)(6)(i) of the Indenture; [and] …
>
> c. The Trustee's right under Section 6.02 of the Indenture to waive the automatic default arising from the EFIH Debtors' bankruptcy filing and rescind the acceleration of the Notes is not barred by the language in the Indenture extinguishing that right if rescission would 'conflict with any judgment of a court of competent jurisdiction' because the automatic stay under section 362 of the Bankruptcy Code is not a 'judgment of a court.' "

Delaware Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.), 527 B.R. 178, 183 (Bankr. D. Del. 2015). Thus, the Bankruptcy Court rejected the Trustee's contention that the Indenture's make-whole premium *automatically* became due upon the occurrence of the Notes' acceleration of the Notes as triggered by the bankruptcy filing.

The Bankruptcy Court held, however, that the terms of the Indenture *would* (in theory)

allow the Trustee to exercise its authority under the Indenture to waive the default and decelerate the Notes, making EFIH's refinancing in the bankruptcy an "Optional Redemption" under section 3.07 of the Indenture, thereby making the Applicable Premium (*i.e.,* the make-whole redemption claim) due and owing to the non-settling Noteholders. The catch is that the Trustee could exercise that authority postpetition *only* if the court were to lift the automatic stay, to allow the Trustee to waive the default and decelerate the Notes *nunc pro tunc* to a date on or before June 19, 2014, the date on which the Notes were repaid.

The Bankruptcy Court held that there is a genuine issue of material fact as to whether the Trustee can establish cause for such a *nunc pro tunc* lifting of the automatic stay. *Id*. at 183-84.[4]

The Bankruptcy Court further held that the bankruptcy filing did not constitute an "intentional default" of the Indenture. *Id*. at 195-96.[5] It ruled on certain other issues as well.[6]

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[4] The Bankruptcy Court did not indicate what the Trustee would need to show to be granted *nunc pro tunc* stay relief. As to that issue, in the American Airlines (*AMR Corp*.) case in the Southern District of New York, the bankruptcy court denied an indenture trustee's motion for stay relief to exercise rights under a make-whole provision, and that decision was ultimately affirmed by the Second Circuit, where the Court of Appeals wrote:

> We find no abuse of discretion in the bankruptcy court's conclusion that lifting the automatic stay would serve only to increase the size of U.S. Bank's claim (to an amount greater than that to which it is entitled pursuant to the Indentures), harming the estate and American's other creditors. "One of the principal purposes of the automatic stay is to preserve the property of the debtor's estate for the benefit of all the creditors." *In re Prudential Lines Inc.,* 928 F.2d 565, 573 (2d Cir.1991). We conclude that the bankruptcy court did not abuse its discretion in denying U.S. Bank's motion to lift the automatic stay.

In re AMR Corp., 730 F.3d 88, 112 (2d Cir. 2013) *cert. denied sub nom. U.S. Bank Trust Nat. Ass'n v. AMR Corp.*, 134 S. Ct. 1888 (2014).

[5] The Trustee argued that the Noteholders were entitled to relief on the ground that the reason the Debtors filed for bankruptcy relief was not because they were simply running out of cash, as they contended, but because they were "intentionally" seeking to avoid having to pay the Applicable Premium.

This could have proved useful in that some case law has held that when a debtor intentionally defaults in order to trigger acceleration and evade the prepayment premium, the debtor will remain liable for the make-whole notwithstanding acceleration of the debt. *Momentive I*, 2014 WL 4436335 at * 13.

However, the Bankruptcy Court held that "intent to deny the Trustee the Applicable Premium" was not grounds for relief, *inter alia*, because "the Indenture does not contain a provision stating that a premium will be owed if EFIH intentionally causes an event of default to avoid paying the Applicable Premium" and because the Trustee's evidence of such intent was insufficient. 527 B.R. at 195.

[6] In particular, the Bankruptcy Court held that the Trustee did not have a breach of Indenture claim based on the

IV. The Bankruptcy Court's Contract Analysis in *Energy Future Holdings*, With Comparison to the *Momentive* Case

A. Principles of Law Relied Upon for the Contract Interpretation

To a large degree, the *Energy Future* opinion is one of contract interpretation. That said, as noted in the District Court opinion affirming the bankruptcy court's ruling in *Momentive*: "[A]ll contracts signed among the parties operate against the backdrop of the relevant Bankruptcy Code provisions. The potential for an automatic stay upon the filing of a bankruptcy case is a part of the bargain to which the parties agreed." *Momentive II*, 2015 WL 2330761 at *13, n.12.

In *Energy Future*, as in *Momentive*, the governing contract provided that New York law was applicable, and the courts referred to New York law in their analysis. As is so often the case in disputed contract claims, the basic principles sound cut-and-dried, simple to understand and easy to apply. They include these, cited in *Energy Future*, which are standard to the common law of contracts:

- "[T]he Court need not look 'outside the four corners' of a complete document to determine what the parties intended," unless the written document is incomplete or its language is ambiguous. Neither party contended that the Indenture was an incomplete document, and neither party contended that the Indenture was ambiguous —although each party's "plain reading" led to competing results.

- A contract "is not ambiguous merely because the parties offer different constructions of the same term." [7]

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breach of the alleged "no-call" provision of section 3.07(c) of the Indenture because the Notes were not optionally redeemed and therefore section 3.07(c) was not applicable.

[7] The *Momentive* court expanded on the contract principles affecting the determination of whether a contract is ambiguous under New York law. The court wrote:

> "[A]n ambiguity exists where the terms of the contract could suggest more than one meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of customs, practices, usages and terminology as generally understood in the particular trade or business."
>
> ….
>
> As noted in several [previously-cited] authorities, the context of the entire agreement is important. The courts have cautioned (including when construing subordination language) that one should

- "The best evidence of what parties to a written agreement intend is what they say in their writing."

- "[S]hould there be an inconsistency between a specific and general provision of a contract, the specific controls"; and "a specific provision . . . governs the circumstance to which it is directed, even in the face of a more general provision."

- "A reading of the contract should not render any portion meaningless."

- Especially where a contract (in this case, the Indenture) "was negotiated at arm's length between sophisticated parties who were represented by counsel," the Court is unwilling to "read into agreements between sophisticated parties provisions that are not there."

Energy Future, 527 B.R. at 191-192.

The Bankruptcy Court also relied upon some points of New York law specific to this context, including:

- "[A]n indenture must contain express language requiring payment of a prepayment premium upon acceleration; otherwise, it is not owed."

- "[A] borrower's repayment after acceleration is not considered voluntary", because acceleration "moves the maturity date from the original maturity date to the acceleration date and that date becomes the new maturity date."

527 B.R. at 192, 195. *See also Momentive I*, 2014 WL 4436335 at *12 (citing "well-settled law in New York" that "a lender forfeits the right to" a prepayment premium "if the lender accelerates the balance of the loan.").

Further, as noted above, bankruptcy law (and other applicable substantive law) serves as a backdrop to the interpretation of contracts. To use the example in *Momentive* where that

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> not take an isolated provision that might be susceptible to one or more readings out of context, but should apply it instead in the context of the entire agreement, or construe it in a way that is plausible in the context of the entire agreement.

In re MPM Silicones, LLC, 2014 WL 4436335 at *3 (emphasis added).

The cited principle points implicitly to an area where contract interpretation can indeed become hazy: where a provision is reasonably "susceptible" to more than one reading, *but* taken in its entire "context" – which includes customs, practices, and terminology usages which matters are outside the four corners of the document – one of the alternate readings of the provision is not sufficiently "plausible" to render the provision "ambiguous."

principle was invoked, while the parties' agreement may reflect their "intent" that certain actions take place as a consequence of the filing of a bankruptcy by the issuer of the bonds, immediately and without interference, the parties may also be presumed aware of the "potential for an automatic stay upon the filing of a bankruptcy case … [as] part of the bargain to which the parties agreed." *Momentive II*, 2015 WL 2330761 at *13, n.12.

B. Application of the Law to the Facts

1. *Acceleration Was Clearly Triggered as a Remedy Under the Indenture Upon a Bankruptcy Filing*

The Bankruptcy Court began its analysis by turning to the "Acceleration" provision, section 6.02 of the Indenture. It provides in part that, in the case of an Event of Default under section 6.01 by reason of the filing of the bankruptcy case, "all outstanding Notes shall be due and payable immediately without further action." This, the Bankruptcy Court wrote, meant that the Notes were "automatically accelerated on the Petition Date and became due and payable without further action or notice of the Trustee or any Noteholder." *Id*. at 191-92.

As the Bankruptcy Court observed, section 6.02 contains no reference to the payment of the "Applicable Premium" upon an automatic acceleration, and section 3.07 (on redemption) is not referred to or incorporated into section 6.02 either. Rather, in the Indenture, the "Applicable Premium" (*i.e.,* the make-whole) is only referenced in connection with an *optional* redemption under section 3.07. Since express language is required for payment of a prepayment premium upon acceleration, the absence of any such express language here meant that it is not owed.[8]

[8] In *Momentive*, the court wrote:

> [I]t is "well-settled law," *South Side House*, 2012 U.S. Dist. LEXIS 10824, at *12, that, unless the parties have clearly and specifically provided for payment of a make-whole (in this case the Applicable Premium), notwithstanding the acceleration or advancement of the original maturity date of the notes, a make-whole will not be owed. Such language is lacking in the relevant sections of the first and 1.5 lien indentures and notes; therefore, they do not create a claim for Applicable Premium following the automatic acceleration of the debt pursuant to Section 6.02 of the

Notably, the Bankruptcy Court stated that these sophisticated parties *could have* bargained for a provision requiring a prepayment premium upon acceleration, but they did not. 527 B.R. at 192.

As part of its analysis, the Bankruptcy Court found section 6.02 (on acceleration) to be the more "specific" provision of what occurs in the event of a default due to a bankruptcy filing, and therefore controlling over the more "general" provision (section 3.07) describing a redemption premium, citing the similar analysis by the Second Circuit in *In re AMR Corp.*, 730 F.3d 88 (2d Cir. 2013), *aff'g In re AMR Corp.*, 485 B.R. 279, 289 (Bankr. S.D.N.Y. 2013).

The Bankruptcy Court also looked to the treatment of comparable language in indentures by other courts, including *Momentive*,[9] and concluded that it "agrees with the holdings in these cases and finds that the acceleration provision in the Indenture does not include clear and unambiguous language that a make-whole premium … is due upon the repayment of the Notes following a bankruptcy acceleration." As a result, "the Applicable Premium is not owed." 527 B.R. at 194.

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indentures.

Momentive I, 2014 WL 4436335 at *14. That court proceeded, further in the opinion, to conclude that the plain language of the indentures requires the allowed claims of the indenture trustees for the litigating noteholders "to exclude any amount for Applicable Premium or any other damages based on the early payment of the notes." *Id*. at *18.

[9] It noted that *Momentive* found no make-whole obligation based on this comparable indenture language:

> ***Momentive***: "If an Event of Default specified in Section 6.01(f) or (g) [which includes a bankruptcy filing] with respect to the Company occurs, *the principal of, premium, if any, and interest on all the Notes shall ipso facto become and be immediately due and payable without any declaration or other act* on the part of the Trustee or any Holders.". . . *In re MPM Silicones, LLC, et al.*, No. 14- 22503 (Bankr. S.D.N.Y. June 18, 2014) (Dkt. No. 464-1) (emphasis added)); *Momentive*, 2014 WL 4436355, at *13-14.

The other cases considered were: *HSBC Bank USA, N.A. v. Calpine Corp*., 2010 WL 3835200 (Sept. 15, 2010); *In re Premier Entertainment Biloxi, LLC*, 445 B.R. 582 (Bankr. S.D. Miss. 2010); and *In re Solutia, Inc*., 379 B.R. 473 (Bankr. S.D.N.Y. 2007).

2. *The Redemption Premium Was Not Clearly Specified As a Remedy Tied to Acceleration*

The Bankruptcy Court considered but rejected the Trustee's argument that the "Optional Redemption" provision by itself either barred any repayment before December 1, 2015 (the end of the "no call" period) or established the noteholders' right to the make-whole premium in the event of a bankruptcy filing before that date, finding that the Trustee's reading of the pertinent provisions did not give meaning to each provision.

To begin with, the Trustee was relying on a provision in Article 3 on "Redemption," rather than in Article 6 on "Defaults and Remedies." 527 B.R. at 194. But "[o]ptional redemption under section 3.07 is an act separate and apart from automatic acceleration." *Id*. It includes a detailed noticing scheme for advance notice to noteholders of a redemption, none of which is required when the Notes become immediately due and payable. *Id*. The Bankruptcy Court pointed to several places in the Indenture that used phrases like "upon redemption, acceleration or otherwise" – thereby suggesting that the concepts were distinct within the Indenture.

Notably, the Bankruptcy Court also found that a prepayment redemption right or remedy is necessarily distinct from acceleration under New York law. This rested in part on the proposition that, under New York law, a borrower's repayment after acceleration is not considered "voluntary." 527 B.R. at 195. The notion that a repayment after acceleration cannot be a "voluntary redemption" in turn was based on the dual premises that (1) prepayment can, by definition, "only occur prior to the maturity date;" and (2) that "[a]cceleration moves the maturity date from the original maturity date to the acceleration date," making that date the new maturity date. *Id*. at 195, *quoting In re Solutia,* 379 B.R. at 484 & 488.

3. *The Trustee's Right to Rescind Acceleration Is Valid, But Limited by the Automatic Stay*

The Bankruptcy Court found that the third paragraph of section 6.02 of the Indenture, by its terms, does give the Trustee the right to waive the default caused by the bankruptcy filing and rescind the resulting acceleration with respect to the Notes – so as to preserve the Debtor's ongoing obligation to pay 10% fixed annual interest. *See* 572 B.R. at 196.

However, regardless of what the parties may have intended, the Trustee's implementation of this provision is limited by the automatic stay in § 362(a) of the Bankruptcy Code. *Id*. at 197. Sending a notice of rescission, or otherwise declaring the acceleration to be rescinded pursuant to section 6.02 of the Indenture,[10] would constitute an act to "collect, assess or recover" on a claim. *Id*., *citing* 11 U.S.C. § 362(a)(6), *Momentive*, *AMR Corp*., and *Solutia*.

V. Practice Considerations

Energy Future, together with the cases that preceded it addressing disputes over "make-whole" premiums, serve to identify a series of factors and considerations that one who is negotiating or drafting indentures with make-whole premiums will need to take into account. Taken from the standpoint of one who is drafting the indenture or related documents on behalf of the noteholders, these considerations include the following:

- The Indenture should include the concept of a make-whole premium not only in the optional redemption provision but also in the acceleration section and one should draft clear and unambiguous language in connection therewith.

[10] Theoretically, a rescission of the acceleration would preserve the Debtors' obligation to pay the requisite interest through the full term of the Notes, but would not necessarily trigger the payment of a make-whole premium. In this case, though, given that the full principal amount owed under the Notes was repaid on June 19, 2014 with the funds the Debtors obtained through DIP financing, and further given that the Trustee did object to the DIP financing and took other actions in bankruptcy court prior to the date of the repayment, the Bankruptcy Court ruled that it would treat the Trustee's stay relief motion as one for *nunc pro tunc* relief back to a date on or before June 19, 2014. 527 B.R. at 197. In turn, the Bankruptcy Court ruled that a rescission of acceleration on or before June 19, 2014 would make the DIP financing constitute an "Optional Redemption" under section 3.07 of the Indenture, and the make-whole premium would be due. *Id*.

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

Per Judge Drain in *Momentive*, alternative ways to draft make-whole provisions that would be enforceable upon automatic acceleration would be (i) "a provision that requires the borrower to pay a make-whole whenever debt is repaid prior to its *original* maturity;" or (ii) "an explicit recognition that the make-whole would be payable notwithstanding the acceleration of the loan." 2014 WL 4436335 at *15.

Several cases have identified language that would accomplish requiring a prepayment premium after a default and acceleration of the debt, including:

- "Upon Lender's exercise of any right of acceleration under this Note, Borrower shall pay to Lender, in addition to the entire unpaid principal balance of this Note outstanding at the time of the acceleration, (A) all accrued interest and all other sums due Lender under this Note and the other Loan Documents, and (B) the prepayment premium calculated pursuant to Schedule A." *In re 400 Walnut Associates, L.P.*, 461 B.R. 308, 320 (Bankr. E.D. Pa. 2011) rev'd on other grounds, 473 B.R. 603 (E.D. Pa. 2012).

- 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 United Merchants and Mfgrs.*, 674 F.2d 134 (2d Cir. 1982).

- "Each prepayment of the 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." *In re School Specialty*, 2013 WL 1838513 (Bankr. D. Del. 2013).

- Note and mortgage both provided for a prepayment premium if a prepayment occurred after an event of default. They stated that if, after an event of default and "at any time prior to a sale of the Mortgaged Property … either through foreclosure or the exercise of the other remedies available to the Payee," AE Hotel pays an amount sufficient to satisfy the debt under the Note, that payment will be deemed 'a voluntary prepayment,' and AE Hotel will be obligated to pay an additional 'prepayment consideration.' " *In re AE Hotel Venture,* 321 B.R. 209, 213 (Bankr. N.D. Ill. 2005).

- The Note Purchase Agreement included this provision: "If the maturity of any Series B Notes shall be accelerated under this § 11.1 by reason of the occurrence of an Event of Default, there shall become due and payable (and the Company will pay), as compensation to the holders of such Notes for the loss of their investment opportunity and not as a penalty, a premium equal to the Make–Whole Amount." *In re Anchor Resolution Corp.*, 221 B.R. 330, 334 (Bankr. D.Del. 1998).

- The Indenture should contain a provision stating that a premium will be owed if the issuer intentionally causes an event of default to avoid paying the make whole premium.

- The short phrase "the premium, if any," as was used in the indenture in *Momentive*, should not be used as it is inadequate and ineffective. The bankruptcy court in *Momentive* pointed out that the various references in the indenture to " 'premiums, if any,' to be paid upon prepayment" were "not specific enough … to overcome" New York law's specificity requirement for a make-whole claim to be payable post-acceleration. *Momentive I*, 2014 WL 4436355, at *15. The District Court agreed. *Momentive II*, 2015 WL 2330761 at *12 (emphasis added).

- The Indenture should provide for a fee, cost or charge [the make-whole premium] for a breach of the purported right to rescind. This addresses the application of §506(b) which allows oversecured creditors with an allowed claim for reasonable fees, costs or charges when the amounts are provided for under the agreement and case law holding damages sought for asserted breach of an alleged right to rescind, if not set forth in the Indenture, cannot be allowed as a secured claim.

Attachment A to *Energy Future Holdings* and Contract Considerations in Drafting Make-Whole Provisions in Indentures

Pertinent Provisions of the Indenture

From Article I: Definitions

Section 1.01 Definitions,

"Applicable Premium" means, with respect to any Note on any Redemption Date, the greater of:

(1) 1.0% of the principal amount of such Note; and

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

From Article III: Redemption

Section 3.01 Notices to Trustee.

If the Issuer elects to redeem the Notes pursuant to Section 3.07 hereof, it shall furnish to the Trustee, at least five Business Days … before notice of redemption is required to be mailed … to Holders …, an Officer's Certificate setting forth [the terms of the redemption].

Section 3.07 Optional Redemption.

(a) Notes Make Whole Redemption. At any time prior to December 1, 2015, the Issuer may redeem all or a part of the Notes at a redemption price equal to 100% of the principal amount of the Notes redeemed plus the Applicable Premium as of, and accrued and unpaid interest to, the date of redemption (the "Redemption Date"), subject to the right of Holders of Notes of record on the relevant Record Date to receive interest due on the relevant Interest Payment Date.

(b) Notes Equity Redemption. Prior to December 1, 2013, the Issuer may, at its option, on one or more occasions, redeem up to 35% of the aggregate principal amount of Notes at a redemption price equal to 110.000% of the aggregate principal amount thereof, plus accrued and unpaid interest to the Redemption Date, subject to the right of Holders of Notes of record on the

relevant Record Date to receive interest due on the relevant Interest Payment Date, with the net cash proceeds of one or more Equity Offerings; provided that [two conditions are met] …. Notice of any redemption upon any Equity Offerings may be given prior to the redemption thereof, and any such redemption or notice may, at the Issuer's option and discretion, be subject to one or more conditions precedent, including, but not limited to, completion of the related Equity Offering.

(c) Except pursuant to clause (a) or (b) of this Section 3.07, the Notes shall not be redeemable at the Issuer's option prior to December 1, 2015.

(d) Notes Optional Redemption. From and after December 1, 2015 the Issuer may redeem Notes, in whole or in part at the redemption prices (expressed as percentages of principal amount of the Notes to be redeemed) set forth below, plus accrued and unpaid interest to the Redemption Date, subject to the right of Holders of Notes of record on the relevant Record Date to receive interest due on' the relevant Interest Payment Date, if redeemed during the twelve-month period beginning on December 1 of each of the years indicated below:

Year	Percentage
2015	105.000%
2016.....	103.333%
2017.....	101.667%
2018 and thereafter.....	100.000%

(e) Any redemption pursuant to this Section 3.07 shall be made pursuant to the provisions of Sections 3.01 through 3.06 hereof.

From Article 6: Defaults and Remedies

Section 6.01 Events of Default.

(a) An "Event of Default" wherever used herein, means any one of the following events (whatever the reason for such Event of Default and whether it shall be voluntary or involuntary or be effected by operation of law or pursuant to any, judgment, decree or order of any court or any order, rule or regulation of any administrative or governmental body):

. . .

(6) the Issuer or any Significant Subsidiary …, pursuant to or within the meaning of any Bankruptcy Law:

(i) commences proceedings to be adjudicated bankrupt or insolvent;

(ii) consents to the institution of bankruptcy or insolvency proceedings against it, or the filing by it of a petition or answer or consent seeking reorganization or relief under applicable Bankruptcy Law;

(iii) consents to the appointment of a receiver, liquidator, assignee, trustee, sequestrator or other similar official of it or for all or substantially all of its property;

(iv) makes a general assignment for the benefit of its creditors; or

(v) generally is not paying its debts as they become due;

(7)a court of competent jurisdiction enters an order or decree under any Bankruptcy Law that:

(i) is for relief against the Issuer or any Significant Subsidiary …, in a proceeding in which the Issuer or any Significant Subsidiary …, is to be adjudicated bankrupt or insolvent;

(ii) appoints a receiver, liquidator, assignee, trustee, sequestrator or other similar official of the Issuer or any Significant Subsidiary …, or for all or substantially all of the property of the Issuer or any Significant Subsidiary …; or

(iii) orders the liquidation of the Issuer or any Significant Subsidiary …;

and the order or decree remains unstayed and in effect for 60 consecutive days;

. . . .

(b) In the event of any Event of Default specified in clause (4) of Section 6.01(a) hereof, such Event of Default and all consequences thereof (excluding any resulting payment default, other than as a result of acceleration of the Notes) shall be annulled, waived and rescinded, automatically and without any action by the Trustee or the Holders, if within 20 days after such Event of Default arose:

(1) the Indebtedness or guarantee that is the basis for such Event of Default has been discharged; or

(2) the holders thereof have rescinded or waived the acceleration, notice or action (as the case may be) giving rise to such Event of Default; or

(3) the default that is the basis for such Event of Default has been cured.

Section 6.02 Acceleration.

If any Event of Default (other than an Event of Default specified in clause (6) or (7) of Section 6.01(a) hereof) occurs and is continuing under this Indenture, the Trustee or the Holders of at least 30% in aggregate principal amount of the Notes may declare the principal, premium, if any, interest and any other monetary obligations on all the then outstanding Notes to be due and payable immediately. Upon the effectiveness of such declaration, such principal and interest shall be due and payable immediately. The Trustee shall have no obligation to accelerate the Notes if and so long as a committee of its Responsible Officers in good faith determines acceleration is not in the best interest of the Holders of the Notes.

Notwithstanding the foregoing, in the case of an Event of Default arising under clause (6) or (7) of Section 6.01(a) hereof, all outstanding Notes shall be due and payable immediately without further action or notice.

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

Section 6.03 Other Remedies.

If an Event of Default occurs and is continuing, the Trustee may pursue any available remedy to collect the payment of principal, premium, if any, and interest on the Notes or to enforce the performance of any provision of the Notes or this Indenture.

. . . .

Section 6.04 Waiver of Past Defaults.

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

Section 6.10 Rights and Remedies Cumulative.

[N]o right or remedy herein conferred upon or reserved to the Trustee or to the Holders is intended to be exclusive of any other right or remedy, and every right and remedy shall, to the extent permitted by law, be cumulative and in addition to every other right and remedy given hereunder or now or hereafter existing at law or in equity or otherwise. . . .

Drafting Issues in Connection with Forbearance Agreements

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I. Forbearance as Reasonably Equivalent Value Defense to a Fraudulent Conveyance Action

Suppose that you are representing a lender in connection with a commercial loan to a currently insolvent borrower, which is in default. The lender is demanding additional collateral in consideration of forbearing from the exercise of its default rights and remedies for a period of one year. As counsel to the lender, you are concerned about the borrower filing a bankruptcy petition in the foreseeable future, and are thus worried that the the grant of the additional collateral may be found to constitute a fraudulent conveyance in a bankruptcy case. As the draftsperson, what can you do to minimize the risk?

There is substantial case law supporting the proposition that forbearance may be "reasonably equivalent value" to defend against a fraudulent conveyance action involving "constructive fraud". *In re Exide Technologies, Inc*., 299 B.R. 732 (D. Del. 2003); *Maxwell S. Pfeifer, et. al v. Hudson Valley Bank*, 58 Bankr. Ct. Dec. 60 (S.D. N.Y. 2013); *Anand , et. al v. Nat. Rep. Bank of Chic*., 239 B.R. 511 (N.D. Ill. 1999). While each case will stand or fall on the specific facts and circumstances, there is language which you can place in a forbearance agreement to maximize the chances that a court will find that the lender has given "reasonably equivalent value" for the additional collateral, or at least will materially reduce the assets or asset value of what must be returned to the debtor or a trustee.

Consider the following clause to put into a forbearance agreement:

> The Borrower agrees that it is receiving substantial value in the form of the forbearance being given by Lender. A forbearance for "X" months provides the Borrower with a viable opportunity to restructure its business, access additional capital, bring in a consultant, etc. in order to return to profitability prior to the

> expiration of the forbearance period. Furthermore, the Lender's decision not to foreclose, force a bankruptcy proceeding, impose a default interest rate, increase the existing rate of interest, or charge a forbearance fee provides additional value to the Borrower. Having had the advice of legal counsel, the Borrower agrees that the forbearance granted by the Lender constitutes "reasonably equivalent value" for the granting of the additional collateral to Lender, and that in any action brought by the Borrower as a debtor-in-possession or a trustee succeeding to the Borrower's rights in any bankruptcy or similar liquidation proceeding, the Borrower shall be irrevocably bound by such statements as admissions and/or stipulated facts.

As with many other types of similar provisions, such as a waiver of the automatic stay provision, there is no guaranty that the above clause will be strictly enforced by a court. However, the clause does not interfere with any of the basic principles of bankruptcy, i.e. the ability to get a fresh start. While obviously the borrower will allege that it was "forced" to agree to the language, and a trustee will argue that the admission should not be binding on him or her, the clause will at least give the Lender an initial "leg up" in establishing reasonably equivalent value.

In fact, just recently, in the case of *1756 W. Lake St., LLC v. American Chartered Bank*, Case No. 14-3435 (May 15, 2015), the Seventh Circuit affirmed the granting of summary judgment in favor of a lender in a fraudulent conveyance proceeding. In this case, the borrower delivered a deed in lieu in escrow to the lender's agent pursuant to the terms of a forbearance agreement, which could be recorded if there was a default. The borrower defaulted, and the deed was recorded. The borrower claimed that, because the property in question was worth $200,000 more than the debt, it had not received reasonably equivalent value in exchange for the deed. One of the lender's arguments was that the forbearance it provided to the borrower over a period of 3-4 years was worth at least the $200,000 difference between the value of the collateral and the debt. The court agreed with the lender, relying on the fact that in three of the years in question, the borrower had gross income of more than $435,000.00.

II. Debt Forgiveness Conditioned on No Filing of Bankruptcy Petition.

Sometimes as part of a forbearance or modification agreement, the lender is willing to offer a partial forgiveness of debt provided that the reduced amount is paid by a date certain. Often this provision is coupled with a condition that a bankruptcy petition not be filed within "X" months of the date of the agreement (or the date of the last payment). The motivation for the lender may be to avoid a preference action, or just for the lender to avoid incurring the additional burdens and expenses involved with a bankruptcy proceeding. The issue presented is whether these types of clauses are enforceable or should be set aside as "ipso facto" clauses which are unenforceable under the Bankruptcy Code.

Hypothetical

Borrower currently owes the lender $5,000,000.00. The parties enter into a forbearance agreement which includes the following clause:

> The Borrower shall be entitled to receive a release of all debt in the event that all of the following conditions are strictly satisfied: (i) if within six (6) months from the date of this agreement, Borrower pays the sum of $4,500,000.00 to the Lender; (ii) there are no events of default under the Loan Documents; and (iii) the Borrower does not file (or have filed against it) a bankruptcy petition under any chapter of the United States Bankruptcy Code or similar insolvency proceeding under state law within one (1) year from the date of this Agreement.

Borrower timely pays the $4,500,000.00, but files a bankruptcy petition less than a year following the date of the agreement. The lender files a proof of claim in the amount of $500,000.00, and the debtor objects to the claim. How should the court rule?

An "ipso facto" clause is a contract or lease provision which terminates or modifies a debtor's interest in property based on the financial condition of the debtor. Generally speaking, the Bankruptcy Code invalidates clauses which deprive the debtor of the right to use, sell or lease

property (11 U.S.C. §363(l)) or prevents the debtor's property from becoming property of the bankruptcy estate (11 U.S.C. §541(c)(i)), based on the debtor's financial condition or the filing of a bankruptcy petition. Finally, ipso facto clauses in executory contracts which terminate or modify the contract or a right or obligation of the debtor thereunder are generally not enforceable. 11 U.S. C. §365(e). Congress decided to limit the enforceability of ipso facto clauses because they are thought to lead to the forfeiture of valuable assets and/or hamper the debtor's chances of a successful rehabilitation. However, Congress expressly provided for exceptions, and permitted in the Bankruptcy Code for certain ipso facto clauses to be enforceable.

There is a body of case law which supports the enforceability of ipso facto clauses in certain situations not expressly covered by the exceptions, as long as they don't appear in executory contracts or interfere with the debtor's ability to obtain a "fresh start". On the other hand, some bankruptcy courts have invalidated ipso facto clauses not even covered by one of the three Code sections set forth above. Consequently, if you are analyzing a contractual provision which is or "looks like" an ipso facto clause which is not clearly addressed by one of the Code sections referred to above, the outcome will likely be unclear.

There is little case law which provides any significant guidance on whether or not the type of provision addressed above will be enforceable. Whether the forbearance agreement will be deemed to constitute an executory contract will be determined on a case by case basis. A lender will argue that the clause is enforceable because: (i) it is not an ipso facto clause but rather simply a condition for debt forgiveness which was not satisfied; and (ii) it was an important bargained-for term of the agreement, on which the Lender relied in granting a conditional discount of the debt. If the agreement is enforced in a bankruptcy court, the borrower/debtor

would be reaping the benefit of an agreement never made and the court would be, in essence, amending the agreement. Conversely, a borrower/debtor will contend that the clause is an invalid ipso facto clause: (a) under Section 365(e)(1) of the Bankruptcy Code because the agreement is executory and the debtor's rights are being modified because of the bankruptcy filing; and (b) under Section 541(c)(1) of the Bankruptcy Code because the restoration of the full debt upon the bankruptcy filing is, in essence, depriving the estate of $500,000.00 in assets.

An alternative to the above provision, which may not provide as much protection to the lender, but may be less likely to be held to constitute an unenforceable "ipso facto" clause appears below:

> If, pursuant to any insolvency or bankruptcy law or for any other reason, any amount received by the Lender on account of the Note is required to be returned to the Borrower or paid to a trustee or any other third party, then as of the date on which the Lender makes such payment: (i) the amount of the returned payment(s) shall be reinstated as a principal amount due under the Note; and (ii) the release [or debt forgiveness] provided for in Section _ above shall be automatically terminated. The provisions of this Section shall survive the termination of this Agreement and the other Loan Documents.

III. Obtaining a Release from Spouse for ECOA Violations When There Has Been a Violation.

Assume that a lender has retained you to represent it in connection with a defaulted loan. After reviewing the credit file, you determine that the lender may have violated the Equal Credit Opportunity Act ("ECOA") by taking an unlimited and unconditional guaranty from husband and wife without conducting any investigation as to whether a guaranty from the husband would be sufficient. The husband is the president of the borrower, and the wife has no connections with the borrower. The lender tells you that because all of the husband's assets are owned jointly with his wife, his guaranty alone is worthless. The only chance that the lender has for getting out whole is with the joint assets of husband and wife. The lender asks you what can be done to maximize the chances of the wife's guaranty being enforceable. Advising the wife that her

guaranty may not be enforceable, and asking her to sign a new guaranty is not considered a viable option. You advise the lender to negotiate a forbearance agreement which will include: (i) a confirmation by the wife of her guaranty liability; and (ii) a general release to be executed by the borrower, the husband and the wife releasing the lender from all claims relating to the banking relationship, including but not limited to any and all violations of the federal and state ECOA. The release and confirmation language may look like the following:

RELEASE. IN ORDER TO INDUCE THE LENDER TO ENTER INTO THIS AGREEMENT, THE OBLIGORS EACH FOREVER RELEASE AND DISCHARGE THE LENDER, AND LENDER'S AFFILIATES, AND THE LENDER'S AND ITS AFFILIATES' OFFICERS, DIRECTORS, EMPLOYEES, ATTORNEYS, AND AGENTS (COLLECTIVELY, THE "RELEASED PARTIES") FROM ANY AND ALL CLAIMS, CAUSES OF ACTION, SUITS AND DAMAGES (INCLUDING CLAIMS FOR ATTORNEYS' FEES AND COSTS) WHICH OBLIGORS EVER HAD OR MAY NOW HAVE AGAINST ANY OF THE RELEASED PARTIES AS OF THE DATE HEREOF ARISING OUT OF OR RELATED IN ANY WAY TO THE NOTES, THE LOAN DOCUMENTS OR THE ADMINISTRATION THEREOF, WHETHER KNOWN OR UNKNOWN, WHETHER SUCH CLAIM CONSTITUTES AN AFFIRMATIVE CAUSE OF ACTION OR A DEFENSE, INCLUDING BUT NOT LIMITED TO, ANY AND ALL CLAIMS BASED UPON OR RELYING ON ANY ALLEGATIONS OR ASSERTIONS OF DURESS, ILLEGALITY, UNCONSCIONABILITY, BAD FAITH, BREACH OF CONTRACT, REGULATORY VIOLATIONS, INCLUDING, BUT NOT LIMITED TO VIOLATIONS OF THE FEDERAL AND MARYLAND EQUAL CREDIT OPPORTUNITY ACTS, NEGLIGENCE, MISCONDUCT, OR ANY OTHER TORT, CONTRACT OR REGULATORY CLAIM OF ANY KIND OR NATURE. THIS RELEASE IS INTENDED TO BE FINAL AND IRREVOCABLE AND IS NOT SUBJECT TO THE SATISFACTION OF ANY CONDITIONS OF ANY KIND. THIS RELEASE DOES NOT RELEASE ANY CLAIMS OR DEFENSES ARISING FROM A BREACH OF THIS AGREEMENT BY LENDER. THE OBLIGORS EACH ACKNOWLEDGE AND AGREE THAT THEY HAVE READ THIS RELEASE AND HAVE MADE THIS RELEASE OF THEIR OWN FREE WILL, HAVING OBTAINED ADVICE OF COUNSEL.

What issues are outstanding? Is a violation of ECOA a defense to a suit on a guaranty or does it just provide a damages remedy? Can the damages permitted under ECOA equal the amount that the wife would have to pay? Is the statute of limitations applicable to a defense under ECOA or just to an affirmative claim? Is a release of an ECOA claim enforceable as a

"knowing and intelligent waiver of a known right" when the spouse is not aware that she has a valid ECOA claim or defense? Does it matter whether the spouse is represented by counsel in connection with the forbearance agreement? If you are in the Fourth Circuit, it's "good to be a lender" if you have a general release of claims obtained through a forbearance agreement. In *Ballard v. Bank of America*, 734 F. 3d 308 (4th Cir. 2013), the Fourth Circuit held that even if the lender committed an ECOA violation, such claim could be released pursuant to a general release in a forbearance agreement, unless it was obtained through intentional misconduct or was not knowing and voluntary. What would be "intentional misconduct"? Possibly, it would be where a lender "manufactured" a default in order to obtain a release in a forbearance agreement. Must the spouse know that there has been an ECOA claim in order to waive it? The answer is "probably not." Must a person have an attorney representing them in connection with the forbearance agreement in order for the release to be effective? The answer is "probably yes", if the person is uneducated or doesn't speak English very well. If the obligor does not have counsel, it would be best to include in the forbearance agreement that the obligor was afforded the opportunity to obtain counsel.

The above release language contains a specific reference to ECOA. If during workout negotiations, an obligor has raised claims of ECOA violations, you will be safer to include specific references to ECOA in your release, although, at least in the Fourth Circuit, it may not be necessary. If the issue has not been raised, and you believe as lender's counsel that there is risk of an ECOA violation, you may want to think further about including the specific reference. This could be a double-edged sword, as you may "tip the obligor off" of the potential claim.

IV. All of Obligors Unwilling to Sign Forbearance Agreement

After default under the company's loan documents, the lender, which you represent, has agreed to enter into a forbearance agreement. However, in negotiating the document, it becomes evident that not all of the original obligors under the loan agreements are willing to execute the forbearance agreement. What are the risks is moving forward and what can your client include in the agreement to protect it? As has been recognized above, forbearance agreements often aide the lender to determine whether the company is capable of improving its performance prior to moving to foreclose on its assets – recognizing that increased performance is more likely to yield a higher return on its investment than foreclosure and liquidation. Thus, the lender decides to move forward and give the company a necessary breathing spell to address its performance issues. Although there is very little case law regarding this issue, there are a couple of practical provisions that should be included in a forbearance agreement to protect the lender:

- There should be an express acknowledgement by the signing obligors that the Lender required all obligors to sign, but despite good faith efforts of the signing obligators – they were unable to procure such signatures.
- There should also be an express acknowledgement that the failure of the non-signing obligors or the signing of the signing obligors in no way affects any of the obligors' liability under the loan documents.
- Depending on the status of the company, additional collateral of the signing obligors could be pledged to cover the consideration being provided to the non-signing obligors in connection with the forbearance or the signing obligors could provide some type of additional guaranty in connection with payment.

V. Enforcement of Affirmative Foreclosure Provisions

Your lender client has agreed to enter into a forbearance agreement and would like to include as many provisions as possible to "bankruptcy proof" itself. One of these provisions would be to include a prepetition stay waiver. An example would be as follows.

> *Prepetition Stay Waiver*. In the event that the Borrower files a petition under the Bankruptcy Code or under any other similar federal or state law, the Borrower unconditionally and irrevocably agrees that the Lender shall be entitled to, and the Borrower hereby unconditionally and irrevocably consents and will not contest, to relief from the automatic stay to allow Lender to exercise its rights under the Loan Documents with respect to the Collateral, including taking possession of the Collateral, collecting rents, foreclosing its mortgage lien or otherwise exercising its rights and remedies with respect to Collateral. In such event, Borrower hereby agrees it shall not, in any manner, oppose or otherwise delay any motion filed by the Lender for relief from the automatic stay.

The question then turns to whether or not such a provision will ultimately be enforceable if the borrower files for bankruptcy protection. Generally speaking, a party cannot waive notice requirements prior to foreclosure unless such waiver was provided ***after*** such party defaulted under the loan agreement. *See, e.g. U.C.C. §§9-611, 9-624*. Although traditionally courts have also rejected stay waivers contained in forbearance agreements, the current trends seems to be moving towards approval of such waivers.[1] Those courts that uphold the prepetition waiver "espouse the view that enforcing such agreements furthers the legitimate public policy of encouraging out-of-court restructuring and settlements." *In re: Atrium High Point. Ltd.*, 189 B.R 599, 606 (Bankr. M.D.NC 1995); *In re Cheeks,* 167 Bankr. 817, 818 (Bankr. D.S.C. 1994); *In re: Club Tower L.P*, 138 B.R. 307, 312 (Bankr. N.D.Ga. 1991) (pre-petition agreements regarding relief from stay are enforceable and support the public policy of encouraging out-of-court

[1] Notwithstanding any waiver, the lender will, of course, still need to seek stay relief from the bankruptcy court before exercising any remedies.

settlements); *In re Excelsior Henderson Motorcycle Mfg. Co.*, 273 B.R. 920 (Bankr. S.D.Fla. 2001. Those courts have refused to approve the enforcement of these waivers generally rely on the policy of protecting the debtor's creditors. *See*, *In re Sky Group Int'l, Inc.*, 108 B.R. 86 (Bankr. W.D. Pa. 1989) (holding that a prepetition waiver was not self-executing or per se enforceable).

Three basic approaches are used by courts: (1) uphold the stay waiver in broad unqualified terms on the basis of freedom of contract, (2) reject the stay waiver as unenforceable per se as against public policy, and (3) treat the waiver as a factor in deciding whether "cause" exists to lift the stay. *In re: Triple A & R Capital Investment, Inc.*, 519 B.R. 581, 584 (Banrk. D.P.R 2014). It appears that more and more courts are adopting the third approach – which allows it to examine the waiver on a case by case basis. By adopting a case by case approach, the Court can hear from other parties in interest who oppose the stay relief and determine the appropriate result based on the equities of each particular case. It is also worth noting that in *Triple A&R Capital*, the court found that the post-petition affirmation of the waiver in its loan documents to be dispositive – another practice pointer for lenders to include in any post-petition agreements.

VI. Extent and Enforcement of Pre-negotiation Forbearance Term Sheet

The parties have agreed to enter into a forbearance agreement – what should you advise your client as to the next step – should it be a term sheet to ensure that there is a meeting of the minds before the lender agrees to a temporary standstill or is it more effective to simply negotiate the actual terms of the forbearance agreement. There are certainly pros and cons in proceeding with a term sheet. A term sheet will ensure that there are no surprises as to the terms of the

forbearance agreement – but that begs the question as to what should be included in the term sheet itself. If it includes each and every material point – would the time and effort simply be better spent in negotiating the forbearance agreement? If the terms are too general, there is the risk that the parties will engage in heavy negotiations over the material terms of the forbearance agreement. Likewise, if the terms are too general they will not be enforceable and the term sheet will simply be treated as an agreement to negotiate in good faith. *See e.g. Vargas Realty Enters v. CFA W. 111 St., LLC (In re Vargas Realty Enters.),* 440 B.R. 224, 236 (S.D.N.Y. 2010), *See Fairbrook Leasing, Inc. v. Mesaba Aviation, Inc.*, 295 F. Supp.2d 1063, 1069-70 (D. Minn. 2003). In *Fairbrook*, the court noted that certain prenegotiation agreements could be enforceable if "all parties agree on the points that require negotiation and is preliminary only as to form.", *citing Adjustrite Systems, Inc. v. GAB Bus. Servs., Inc.*, 145 F.3d 543, 548 (2d Cir. 1998). However, if the term sheet simply provides a framework for agreement and binds the parties to negotiate in good faith within that framework – the term sheet is not enforceable. *Id.* Accordingly, if the parties seek to enter a term sheet, it should include all material terms, such as:

- Identify all obligors (borrowers, guarantors and pledgers of collateral), identify the loan documents and security documents, list the defaults and detail the current amount of outstanding bank debt, including fees.
- Provide a standstill period and termination date until with the lender will agree to forbear.
- Provide for any forbearance fees to be paid by the debtor.
- Confirm all obligations under the loan documents.
- Expressly provide for the terms of the forbearance – will not accelerate, discontinue lending, demand payment, enter judgment or execute on any judgment. Also, should identify what the lender can do – act to perfect or protect collateral, defend against 3rd party actions, and purse non-party obligors.

There are dozen other terms that may be appropriate for any specific case, but in order to ensure the enforceability of a term sheet, the parties should identify all material terms subject only to formal documentation.

Subordination Agreements With **Bankruptcy** in Mind

By: Joel I. Sher

SUBORDINATION and Bankruptcy

- "'Subordination,' though not defined by the Code, has a common understanding in the law, reflected in Black's Law Dictionary, which defines subordination as: "The act or process by which a person's rights or claims are ranked below those of others." . . *Subordination thus affects the order of priority of payment of claims in bankruptcy* . . ." *In re 203 N. LaSalle St. P'ship*, 246 B.R. 325, 331 (Bankr. N.D. Ill. 2000) (emphasis supplied).
- Purusant to § 510(a) of the Bankruptcy Code, "A subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law."
- The construction of private contracts is ordinarily governed by state law and indentures, which are contracts, are generally construed in accordance with principles of state contract law. *See In re K-V Discovery Solutions, Inc.*, 496 B.R. 330, 337 (Bankr. S.D.N.Y. 2013), *as corrected* (Aug. 28, 2013).

A Difference of Payment: Subordination Issues Matter

- Because inter-creditor subordination agreements are enforceable in bankruptcy cases the outcome of issues surrounding subordination provisions in the context of distributions involve significant monetary stakes, especially where unsecured claimants are rarely paid in full.

- For example, the Bankruptcy Court in *In re NationsRent, Inc.*, 381 B.R. 83 (Bankr. D. Del. 2008), noted that if certain claims constituted "Senior Debt" under the Note Indenture and thus triggered the Indenture's subordination clause, the Noteholders (which would be subordinated to such claims) would receive a *de minims* distribution, while the other claimants would receive $13 million of their $15 million in claims.

- Litigation of subordination related issues can be costly and result in fact and expert discovery, especially if subordination language is found to be ambiguous.

A FEW DRAFTING NOTES

Clarity: Avoid Ambiguity and Harsh Results

Though obvious it bears stressing- clearly identify/define in the indenture subordination provision the exact obligations to which the note is subordinated and clearly think through all definitions. For instance, tailor broadly (or narrowly) what is considered/defined as a "senior debt" or "senior indebtedness" and exclusions thereto. Pay very close attention to the breadth of all definitions and exclusions to avoid potentially harsh results.

- **Case Example**: In *In re NationsRent, Inc.*, 381 B.R. 83 (Bankr. D. Del. 2008), the court addressed subordination language in an indenture that all parties agreed was unambiguous.
  - The indenture for the "Senior Subordinated Notes" provided that payment on the Notes was subordinated and junior in right to all "Obligations on the Senior Debt." The definition of Senior Debt *excluded "Indebtedness to, or guaranteed on behalf of, **any** shareholder, director, officer or employee of the Company."*
  - The bankruptcy court concluded that claims for deferred purchase price consideration owed to certain transferors in connection with the debtor's acquisition of companies through mergers (the "Make-Whole Claims") did not constitute "Senior Debt" because the claimants were shareholders of the debtor and thus fell within the exclusion from Senior Debt of indebtedness to "any shareholder."
  - Focusing on the word "any", the court reasoned that the "Indenture is unambiguous that all shareholders are excluded form eligibility for 'Senior Debt' status" – no matter how many shares owned.

Continued - Clarity: Avoid Ambiguity and Harsh Results

- **Case Example**. In *In re MPM Silicones, LLC*, No. 14 CV 7471 VB, 2015 WL 2330761 (S.D.N.Y. May 4, 2015), appeal filed 2nd Cir. June 1, 2015, the district court affirmed the bankruptcy court's interpretation of the definition of senior indebtedness in a note indenture.
  - The indenture for the "Subordinated Notes" provided that such Notes are "subordinated in right of payment . . . to the prior payment in full of all existing and future Senior Indebtedness of the Company."
    - The Indenture defined Senior Indebtedness as "all Indebtedness ... unless the instrument creating or evidencing the same or pursuant to which the same is outstanding expressly provides that such obligations are subordinated ***in right of payment*** to any other Indebtedness of the Company[;] [the "Base Definition"] . . . provided, however, that Senior Indebtedness shall not include . . ."
      - "4) any Indebtedness or obligation of the Company or any Restricted Subsidiary that ***by its terms*** is subordinate or junior ***in any respect*** to any other Indebtedness or obligation of the Company . . .including any Pari Passu Indebtedness."
  - The Debtors asserted and the District Court (and Bankruptcy Court) agreed that the Second Lien Notes, which were secured by a junior lien, constituted Senior Indebtedness and did not fall within the exclusion clause, because that plain language excluded only payment subordination, not lien subordination, from the definition of Senior Indebtedness.
  - The District Court reasoned: "The Base Definition of Senior Indebtedness excludes debt that is 'subordinated in right of payment' to any other debt. The words 'in right of payment' clearly refer only to payment subordination; thus, the Base Definition excludes only indebtedness subordinated by payment from the definition of Senior Indebtedness."
  - The District Court rejected the argument of the indenture trustee (on behalf of the Subordinated Notes) that the "in any respect" language in the exclusion was broad enough to include lien and payment subordination because the exclusion "can only clarify or augment the Base Definition; they are not a substitute for the Base Definition." That is, the "in any respect" language clarified the Base Definition by ensuring the exclusion of indebtedness that is subordinated in right of payment "by its terms."

Continued - Clarity: Avoid Ambiguity and Harsh Results

- Think about senior obligations and debt definitions and exclusions in a context specific to the issuer and the issuer's business, creditors, and particular types of obligations.
- To the extent possible, consider potential future events, including assignments and terminations of debts and obligations, that may restrict or eliminate the effect of subordination language and/or adversely impact (or exclude) subsequently incurred debts or obligations from seniority status.
  - In *In re K-V Discovery Solutions, Inc.*, 496 B.R. 330 (Bankr. S.D.N.Y. 2013), the bankruptcy court determined that the plain language of junior note indenture subordination language defining "Senior Indebtedness" included post-petition interest, but limited such interest to a particular "Credit Facility." Based on the court's ruling, post-petition interest on subsequently issued Senior Notes (unrelated to the "Credit Facility") did not fall within "Senior Indebtedness."

Example of Potentially Ambiguous Subordination Language in Note Indenture

"Senior Indebtedness" means, whether outstanding on the Issue Date or thereafter issued, created, incurred or assumed, the Senior Notes and all amounts payable by the Company under or in respect of all other Indebtedness of the Company, including premiums and accrued and unpaid interest (including interest accruing on or after the filing of any petition in bankruptcy or for reorganization relating to the Company at the rate specified in the documentation with respect thereto whether or not a claim for post filing interest is allowed in such proceeding) and fees relating thereto; *provided, however,* that Senior Indebtedness shall not include:

(4) any accounts payable or other liability to trade creditors arising in the ordinary course of business (including Guarantees thereof or instruments evidencing such liabilities);

The Potential Issue– What is a "trade creditor" where that term is not defined in the Indenture and claimants in a bankruptcy case with large unsecured claims assert they are, or are not "trade creditors" and, therefore, that the above noteholders are (or are not) subordinate to such claimants in any distribution?

Arbitration Provisions

- If desirable, include an arbitration provision in an indenture (or other agreement) covering all disputes - there is nothing to lose.
  - In addition to defining what disputes are subject to arbitration, an arbitration agreement should expressly provide for who decides whether a particular dispute is arbitrable: the arbitrator or the court. In traditional litigation between contracting parties, courts have enforced such provisions and left the question of arbitrability to the arbitrator where the arbitration provision so provides. *See Peabody Holding Co., LLC v. United Mine Workers of Am., Int'l Union, 665 F.3d 96, 101* (4th Cir. *2012*).

- With respect to arbitration provisions in indentures including disputes over subordination agreements or provisions, such an arbitration provision may not be enforced by a bankruptcy court as a result of the context in which the subordination dispute arises
  - Arbitration provisions are not necessarily enforceable in the bankruptcy context; enforcement depends on the nature of the claims at issue, whether such claims are "core" or "non-core", and other policy related considerations. *See, e.g., In re Porter-Hayden Co.*, 304 B.R. 725, 736 (Bankr. D. Md. 2004); *In re CIT Grp. Inc.*, No. 09-16565 ALG, 2012 WL 831095, at *2 (Bankr. S.D.N.Y. Mar. 9, 2012).

- Additionally, an arbitration provision in an indenture may not be enforceable against a creditor or claimant who was not a party to the indenture.
  - Indentures are typically instruments between the issuer, any guarantors, the indenture trustee, and the ultimate noteholders. A claimant against a bankruptcy estate that asserts payment priority based upon an indenture subordination provision may not be a direct party or signatory to that indenture. Consequently, state law analysis would be necessary to determine if such a claimant could be bound by an arbitration agreement in a note indenture under a third-party beneficiary, equitable estoppel, or related theory. *See generally In re Rus*hing, 443 B.R. 85, 94 n.4 (Bankr. E.D. Tex. 2010); *In re Latimer*, 489 B.R. 844 (Bankr. N.D. Ala. 2013).

Defining Senior Debt to Include Post-Petition Interest

- *Background: The Rule of Explicitness and the Bankruptcy Act*
  - The Bankruptcy Code and the prior Bankruptcy Act generally disallow post-petition interest on unsecured claims.
  - The Bankruptcy Act did not have a subordination provision like 11 U.S.C. § 510(a).
  - Courts, prior to adoption of the Bankruptcy Code, held that only unequivocal language in a subordination agreement could overcome the general bar on recovery of postposition interest, the Rule of Explicitness
- *The Bankruptcy Code and § 510(a), Survival of Rule of Explicitness?*
  - There is disagreement among courts as to whether the Rule of Explicitness survived enactment of the Bankruptcy Code and § 510(a) and whether the need for explicitness of post-petition interest is a matter governed by state or federal law. *Compare In re K-V Discovery Solutions, Inc.*, 496 B.R. 330 (Bankr. S.D.N.Y. 2013), *with In re Bank of New England Corp.*, 364 F.3d 355 (1st Cir. 2004) (concluding indenture ambiguous as to post-petition interest because provided for payment of "interest due or to become due" and remanding back to bankruptcy court for trial).
- *To Avoid Uncertainty - Explicitly Include the Payment of Post-Petition Interest as part of the definition of Senior Debt in an Indenture*
  - Example language " . . . All amounts payable by the Company under or in respect of all other Indebtedness of the Company, including premiums and accrued and unpaid interest (including interest accruing on or after the filing of any petition in bankruptcy or for reorganization relating to the Company at the rate specified in the documentation with respect thereto whether or not a claim for post filing interest is allowed in such proceeding)"

ADDITIONAL NOTES

Waiver and Subordination Provisions

- No Waiver of Benefits Under Subordination Agreement When File a Tardy Proof of Claim
  - In *In re Franklin Bank Corp.*, 526 B.R. 527 (D. Del. 2014), appeal filed on Aug. 27, 2014, the district court vacated and remanded a bankruptcy court decision determining that senior noteholders waived their rights under subordination provision in junior note indenture by filing a tardy proof of claim in Chapter 7 case over two years after the bar date or, alternatively, the late-filing warranted equitable subordination.
  - Concerning waiver, the district court applied applicable state law waiver principles and determined the record evidence was insufficient to support a finding of waiver based upon "serious prejudice" or the failure to file a timely claim.
  - Concerning equitable subordination, the district court concluded there was no evidence of inequitable conduct and opining that to equitably subordinate a claim solely due to tardiness is inconsistent with "the statutory interplay between sections 726 and 510, and a violation of the contractual framework entered into by the parties for prioritizing the claims in this bankruptcy proceeding."

Drafting Intercreditor Agreements

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Intercreditor Agreements and Bankruptcy

- Introduction of Model Intercreditor Agreement:
  - Prepared by ABA task force and available on ABA website
  - Womble Carlyle attorney was chair of task force
  - Available in Word and PDF formats
  - Extremely thorough, approximately 77 pages
  - Includes guidance and alternatives for controversial provisions

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Intercreditor Agreements and Bankruptcy

- Examples of key provisions in bankruptcy proceeding:
  - "Silent Second" provisions / standing / prohibition on objections
  - Sales free and clear / valuation of lien
  - Credit bidding
  - Advanced waiver of automatic stay
  - Voting / classification / plan support

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Intercreditor Agreements and Standing

- Standing of second lien creditors to object to section 363 sale:
  - Intercreditor Agreement must be crystal clear
  - In re Boston Generating, LLC, 440 B.R. 302 (Bankr. S.D.N.Y. 2010)
  - Court referred to "the perfect storm of a poorly drafted agreement and the ill-defined scope of section 3.1(g)'s retained right to object as an unsecured creditor"
  - Court cited Model ABA ICA, which includes express waiver of right to object to sale in section 6.2; language in this ICA was much less clear
  - Court concluded that second liens had standing to object to sale

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Intercreditor Agreements and Sales Free and Clear

- Bankruptcy Code section 363(f) governs sales free and clear:

  "(f) The trustee may sell property . . . free and clear of any interest . . . of an entity . . . only if—

  (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

  (2) such entity consents;

  (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

  (4) such interest is in bona fide dispute; or

  (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."

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Intercreditor Agreements and Sales Free and Clear

- Bankruptcy Code section 363(f) governs sales free and clear:
  - May apply to second liens where second liens are out of the money and do not consent
  - Face amount:
    - 9th circuit: Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC), 391 B.R. 25 (B.A.P. 9th Cir. 2008)
    - Delaware: In re Kellstrom Indus., Inc., 282 B.R. 787 (MFW) (Bankr. D. Del. 2002)
  - Actual value of collateral:
    - New York: In re Becker Indus. Corp., 63 B.R. 474 (S.D.N.Y. 1985)
    - New York: In re Boston Generating, LLC, 440 B.R. 302 (Bankr. S.D.N.Y. 2010)
    - Delaware: Sale Order, In re Cyber-Defender Corp., Case No. 12-10633 (BLS) (Docket No. 192) (Bankr. D. Del. May 7, 2012)
  - Evan F. Rosen, Note, "A New Approach to Section 363(f)(3)," 109 MICH. L. REV. 1529 (2011)

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Intercreditor Agreements and Sales Free and Clear

- Bankruptcy Code section 363(f) governs sales free and clear:
  - May apply to second liens where second liens are out of the money and do not consent
  - Intercreditor Agreement should have provision stating how "value" is to be calculated for purposes of section 363(f)(3)

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Intercreditor Agreements and Credit Bidding

- Bankruptcy Code section 363(k) governs right to credit bid:

  "(k) At a sale . . . of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property."

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Intercreditor Agreements and Credit Bidding

- Cases discuss disputes surrounding second lienholders' right to credit bid:
  - In re Daufuskie Island Props., LLC, 441 B.R. 60 (Bankr. D.S.C. 2010)
  - Lange v. Schropp (In re Brook Valley IV, J.V.), 347 B.R. 662 (BAP 8th Cir. 2006)
  - Spillman Inv. Group, Ltd. v. Am. Bank of Tex. (In re Spillman Dev. Group), Case No. 05-14415 (FM), 2008 Bankr. LEXIS 3238 (Bankr. W.D. Tex. Sept. 2, 2008)
  - Lewis v. Dimas, LLC (In re Dimas, LLC), Case No. NC-06-1151-BuSPa, 2006 Bankr. LEXIS 4908 (B.A.P. 9th Cir. Dec. 19, 2006) (mentioned in dicta)

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Intercreditor Agreements and Credit Bidding

- Some cases also involve disputes among the first lienholders regarding their right to credit bid:
  - In re GWLS Holdings, Inc., Case No. 08-12430 (PJW), 2009 Bankr. LEXIS 378 (Bankr. D. Del. Feb. 23, 2009)
- Intercreditor Agreement should clearly articulate terms pursuant to which first and second lienholders may credit bid

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