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Chapman Client Alert

November 21, 2016 Current Issues Relevant to Our Clients

Is *Momentive* Losing Momentum?

Third Circuit Reverses District Court and Enforces Post-Acceleration Make-Whole in *Energy Future* Decision

In a break from recent decisions in the New York and Delaware Bankruptcy and Federal District Courts, on November 17, 2016, the Third Circuit Court of Appeals reversed the District Court's decision in the *Energy Future* case,[1] finding that make-whole premiums were in fact payable upon a "redemption" (as opposed to a "prepayment") even if such redemption occurred after a bankruptcy filing and the automatic acceleration of the underlying debt where the applicable indentures did not otherwise provide.

As discussed in prior Chapman Client Alerts,[2] the trend in recent cases in both New York and Delaware Bankruptcy and Federal District Courts has been to require explicit contractual provisions clearly providing for the payment of a make-whole premium or other similar yield protection or a prepayment premium to the extent such premium was being sought after the filing of a bankruptcy proceeding and the automatic acceleration of the underlying loans or bonds. In the notable recent *Momentive*[3] decision, which is currently the subject of a pending appeal in the Second Circuit, the District Court for the Southern District of New York disallowed a make-whole provision, ruling that after the underlying debt has been accelerated, a make-whole premium will only be due if the agreement "clearly and unambiguously" provides for it.[4] The Third Circuit's decision is a clear break from this recent trend, at least where the loan documents provide for the payment of a premium upon a "redemption" as opposed to a prepayment of the loans. Moreover, at least until the Second Circuit's appeal of *Momentive* is decided, this decision may give noteholders greater leverage to require the payment of make-whole premiums.

Background

The *Energy Future* dispute related to billions of dollars of first lien notes issued in 2010 (due 2020) and second lien notes issued in 2011 and 2012 (due in 2021 and 2022, respectively) (collectively, the "*Notes*") by Energy Future Intermediate Holding Company, LLC and EFIH Finance, Inc. (collectively, "*EFIH*"). The Notes were issued pursuant to indentures (the "*Indentures*") with Delaware Trust Company (f/k/a CSC Trust Company of Delaware) as trustee for the first lien notes and with Computershare Trust Company, N.A. and Computershare Trust Company of Canada as trustees for the second lien notes (collectively, the "*Trustees*").

The Indentures provided that EFIH could only effect an "*Optional Redemption*" of the Notes prior to a date certain (December 1, 2015 for the first lien Notes due in 2020, May 15, 2016 for the second lien Notes due in 2021 and March 1, 2017 for the second lien Notes due in 2022) if it paid an "*Applicable Premium*" to compensate the holders for the future yield that would be lost upon such redemption. In addition, as is commonly the case, the Indentures provided that the Notes would automatically accelerate upon a bankruptcy filing by EFIH.

In 2013, after interest rates had dropped, EFIH announced in a filing with the Securities and Exchange Commission a plan whereby it would commence bankruptcy proceedings and refinance the Notes in chapter 11 without paying the make-whole amounts (estimated to be in the hundreds of millions of dollars). The make-whole payment would otherwise have been payable upon a refinancing outside of a bankruptcy. EFIH believed that the make-whole premiums would not be due upon a refinancing that occurred after its bankruptcy filing had triggered the automatic acceleration of the maturity of the Notes.

After filing chapter 11 in Delaware in April of 2014, EFIH proceeded to seek bankruptcy court approval of the proposed refinancing of the Notes. The Trustees countered by initiating adversary proceedings seeking declarations that the proposed refinancings would trigger and require payment of the make-whole premiums under the Indentures.

The bankruptcy court granted EFIH authority to effect the refinancings, and, months later, ruled that the make-whole amounts were not triggered under the Indentures by a post-acceleration repayment of the Notes. The bankruptcy court reasoned that the Notes were being repaid by reason of acceleration rather than as an optional redemption, and that the acceleration clause of the first lien Indenture did not specify

that the make-whole amount was due upon or after acceleration of the Notes. The court reached the same conclusion with respect to the second lien Notes, even though the second lien Indenture contained a different acceleration provision that required payment of "all principal of and premium, if any." The district court agreed, and the Trustees appealed to the Third Circuit.

The Third Circuit Decision

The Third Circuit, applying New York law, rejected the arguments of EFIH as well as the logic of *Momentive* in reversing the lower courts, and upheld the make-whole premiums. The court ruled that the refinancings were "optional redemptions" even though they occurred post-acceleration, that the optional redemption provisions of the Indentures required payment of the make-whole premiums, and that the acceleration provisions did not provide otherwise.

In interpreting the make-whole clauses that were set forth in the "*Optional Redemption*" provisions of the Indentures, the court relied on rulings of New York and federal courts to determine that the concept of "redemption" was broad enough to include repayments of debt prior to and after acceleration.[5]

The court further determined that the refinancings were "optional" redemptions even though they occurred post-acceleration and during a bankruptcy case, noting that the chapter 11 filing was voluntary, and that even once EFIH was in chapter 11, it retained the option of reinstating the debt in a plan rather than repaying it.[6] The court noted that EFIH's express pre-bankruptcy pronouncements that EFIH intended to commence bankruptcy proceedings for the very purpose of refinancing the Notes was also indicative of the voluntary, optional nature of the refinancings.[7]

In the absence of any language clearly stating that the make-whole premiums were not payable after acceleration (such as the court found existed in the indentures in the *AMR* case[8]), the court found that the "optional redemption" provisions and the acceleration provisions of the Indentures could be read consistently together, giving effect to each, by requiring that the make-whole premiums be paid as a result of the refinancings.[9] Notably, in reaching this conclusion the Third Circuit expressly rejected as "unpersuasive" the reasoning of the *Momentive* decision that would not enforce a make-whole provision post-acceleration without specific contractual language to that effect, stating that "the result in *Momentive* conflicts with that indenture's text and fails to honor the parties' bargain."[10]

Finally, the court distinguished cases that refused to enforce "prepayment premiums" for post-acceleration repayments of debt from the facts of *Energy Future*, where the Indentures provided for yield-protection upon a voluntary redemption.[11] By definition, there can be no prepayment after debt (and the maturity of that debt) is accelerated. By contrast, however, the court reasoned that "redemption" of debt may still be effected post-acceleration, and make-whole provisions may be enforced post-acceleration when they are not styled as "prepayment premiums."[12]

Clearly, the question of whether a particular make-whole provision is enforceable in a given case will continue to be fact specific, and the language of the underlying loan documents will still be ground zero for the battle over the enforceability of make-whole premiums. Creditors wishing to preserve their right to make-whole premiums should continue to use clear and explicit language describing the circumstances under which the premiums must be paid. However, the Third Circuit's ruling in *Energy Future* provides helpful guidance as to the principles that the courts may use to interpret those provisions. In the Third Circuit, at least, the argument that redemption-based make-whole provisions should not be enforced post-acceleration unless the contractual provisions specifically so require, has been rejected. The pending appeal of *Momentive* will undoubtedly be closely watched to see if the Second Circuit agrees.

For More Information

If you would like further information concerning the matters discussed in this article, please contact any of the following attorneys or the Chapman attorney with whom you regularly work:

Laura E. Appleby
New York
212.655.2512
appleby@chapman.com

Todd J. Dressel
San Francisco
415.278.9088
dressel@chapman.com

Michael Friedman
New York
212.655.2508
friedman@chapman.com

Larry G. Halperin
New York
212.655.2517
halperin@chapman.com

James Heiser
Chicago
312.845.3877
heiser@chapman.com

James P. Sullivan
Chicago
312.845.3445
jsulliva@chapman.com

Stephen R. Tetro II
Chicago
312.845.3859
stetro@chapman.com

Franklin H. Top III
Chicago
312.845.3824
top@chapman.com

Steven Wilamowsky
New York
212.655.2532
wilamowsky@chapman.com

Aaron M. Krieger
Chicago
312.845.3487
akrieger@chapman.com

1 *In re Energy Future Holdings Corp.*, 16-1351, __ F.3d ___ (3d Cir., Nov. 17, 2016) (the "*Opinion*").

2 *See* "Make-Whole Update: Delaware Bankruptcy Court Rules Intercreditor Agreement Does Not Permit First Lien Noteholders to Demand Payment of Previously Disallowed Make-Whole from Junior Noteholders" (June 27, 2016); "Make-Whole Update: Delaware District Court Follows New York's Lead in Disallowing Make-Whole Premium in Bankruptcy – Dispute Moves to Third Circuit" (February 29, 2016); "Another One Bites the Dust – Energy Future Decision Likely Precludes Future Arguments to Lift the Automatic Stay in the Make-Whole Context" (July 23, 2015).

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

4 *Momentive*, 531 B.R. at 338.

5 Opinion at 14-15.

6 Opinion at 15.

7 Opinion at 16.

8 *In re AMR Corp.*, 730 F.3d 88 (2d Cir. 2013).

9 Opinion at 16-19.

10 Opinion at 20.

11 Opinion at 21-27.

12 Opinion at 24-27.

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