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Chapman Client Alert

October 30, 2017 Current Issues Relevant to Our Clients

Momentive vs EFIH: Second Circuit Splits with Third Circuit on Make-Whole; Keeps Pressure on Lenders to Negotiate Express Make-Whole Provisions

The United States Court of Appeals for the Second Circuit has affirmed the district court and the bankruptcy court's determinations in *MPM Silicones, LLC* ("*Momentive*")[1] that Momentive's senior noteholders are not entitled to recover any make-whole premium on account of the replacement of their notes in Momentive's bankruptcy. In so holding, the court rejected noteholders' argument that they are entitled to the make-whole premium because when Momentive issued replacement notes under its plan of reorganization, it "redeemed" the notes "at its option" prior to maturity. The Second Circuit, following its earlier decision in *In re AMR Corp.*[2], refused to read any make-whole entitlement into the indentures' optional redemption clauses, which provided for a make-whole if Momentive redeemed the notes "at its option," since early redemption that is the result of an automatic acceleration triggered by a bankruptcy filing is not "at [the borrower's] option." This is in stark contrast to the Third Circuit's recent holding in *In re Energy Future Holdings Corp.* ("*EFIH*")[3], in which that court determined that a similar in-bankruptcy refinancing was an "optional" redemption even though it occurred post-acceleration and during EFIH's bankruptcy case, finding 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.

Background

As we have discussed in earlier client alerts[4], both the Momentive bankruptcy court and district court disallowed noteholders' entitlement to their contractual make-whole premium, ruling that after their underlying debt was automatically accelerated as a result of Momentive's bankruptcy filing, such premiums would only have been due if the governing indentures "clearly and unambiguously" provided for it. The lower courts determined that the relevant "optional redemption" provision of the indentures did not clearly and expressly so provide and held that a refinancing in bankruptcy (even following a voluntary filing) is not "optional" because it is triggered automatically. The lower courts also refused to read a provision in the indentures' automatic acceleration clauses, which provided for payment of a "premium, if any" upon such acceleration, as granting any right to a make-whole since they found no make-whole premium due under the "optional redemption" clauses. Finally, the lower courts refused to allow the noteholders to "deaccelerate" their debt in order to give rise to a make-whole entitlement and undo the damage done by the automatic bankruptcy acceleration because they held that allowing such deacceleration would amount to an "end run" around the other terms of the indenture and would violate the automatic stay. The Second Circuit affirmed the lower courts' rulings in each of these respects.[5]

The Second Circuit Affirms

On appeal, the noteholders argued: (i) that they were entitled to the make-whole under the indentures' optional redemption clauses; (ii) that they were entitled to it under the indentures' acceleration clauses; and (iii) even if the indentures did not allow for a make-whole premium upon acceleration, they should not have been permanently barred from exercising their contractual right to rescind acceleration and thereby obtain the make-whole premium. Citing principally to *In re AMR Corp,* as the bankruptcy and district courts did, the Second Circuit rejected each of those arguments.

First, the court held that the repayment of the notes happened post-maturity (since Momentive's bankruptcy filing accelerated the maturity date of the notes to the petition date, and the redemption occurred later) and since the notes were not voluntarily redeemed ("at the [borrower's] option"), but rather were redeemed as a result of the automatic bankruptcy acceleration of the debt. The court obliquely recognized in its ruling that this particular holding was in direct contrast to the recent *EFIH* ruling from the Third Circuit, which held that a redemption of notes on substantially similar terms under substantially similar facts did trigger a make-whole entitlement. The Second Circuit rejected as irrelevant a distinction made by the Third Circuit in *EFIH* between "redemption" (payment *at or prior to* maturity) and "prepayment" (payment *before* maturity) in interpreting the indentures since, the court held, the notes were, in any event, repaid *after* maturity.

Second, the court, refused to read the indentures' acceleration clauses as giving rise to an entitlement to a make-whole merely because they provided for payment of a "premium, if any." As the court stated, "the make-whole premium is not due pursuant to the Acceleration Clauses' reference to 'premium, if any,' for the simple reason that the more specific Optional

Redemption Clauses which grant the make-whole are not triggered and thus no premium has been generated."

Finally, the court held that the noteholders' invocation of their right to rescind acceleration under the indentures is barred because it would be "an attempt to modify contract rights and would therefore be subject to the automatic stay." The court therefore held that "because the right to rescind acceleration here would serve as an end-run around their bargain by rescission," the lower courts correctly concluded that the automatic stay barred rescission of the acceleration of the notes.

Conclusion

Following this decision, whether a particular make-whole provision will be enforceable in a given case will continue to be fact specific, and the language of the underlying loan documents will remain critical. In both the Second and Third Circuits, 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, and creditors must be aware that, unless the Supreme Court addresses this nascent circuit split, the Second Circuit will be a less forgiving venue for make-whole litigation than the Third. Since bankruptcy venue choices are almost always at the option of the debtor, however, creditors will be well served negotiating make-whole provisions to the stricter requirements of the Second Circuit.

For More Information

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1 *In re MPM Silicones, LLC*, 2017 WL 4700314 (2d Cir. Oct. 20, 2017).

2 *In re AMR Corp.*, 730 F.33d 88 (2d Cir. 2013).

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

4 See MPM Silicones Latest Court to Whittle Away at Secured Creditor Protections: Plan Confirmed Providing Secured Creditors with Below Market Replacement Notes (September 29, 2014); S.D.N.Y Affirms MPM Silicones' "Prime Plus" Formula for Cramdown Interest Rates, Likely Harming Creditor Recoveries (May 18, 2015); Is Momentive Losing Momentum? (November 22, 2016).

5 The Second Circuit, did, however, reverse the lower courts on a separate and unrelated issue having to do with the appropriate Chapter 11 cramdown interest rate on replacement notes, which is the subject of a separate Chapman & Cutler LLP client alert. See Second Circuit Reverses MPM Silicones' "Prime Plus" Formula for Cramdown Interest Rates, Delivering Secured Creditors a Welcome Victory and Resetting Market Expectations (October 30, 2017).

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