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Chapman Client Alert

June 27, 2016 Current Issues Relevant to Our Clients

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

On June 3, 2016, the United States Bankruptcy Court for the District of Delaware (the "*Bankruptcy Court*") ruled that the intercreditor agreement between first lien noteholders and junior noteholders in *In re Energy Future Holdings Corp.*[1] did not require the junior noteholders to bear the cost of a previously disallowed make-whole payment to the first lien noteholders. As discussed in Chapman and Cutler's Client Alerts of February 29, 2016 and July 23, 2015 (the "*Client Alerts*"),[2] the Bankruptcy Court and the District Court for the District of Delaware (the "*District Court*") previously determined that the recovery by first lien noteholders of a make-whole was blocked by operation of the automatic stay of the U.S. Bankruptcy Code (the "*Bankruptcy Code*").[3] Thwarted from recovering the make-whole payment from the Debtors, the first lien noteholders argued that the junior noteholders were obligated to nevertheless turn over any proceeds recovered until the first lien noteholders received payment in full including the make-whole. The Bankruptcy Court disagreed.

Background

The underlying dispute relates to almost $3.5 billion of secured notes issued by Energy Future Intermediate Holding Company, LLC and EFIH Finance, Inc. (collectively, "*EFIH*"). The indenture under which the notes were issued provided that EFIH may only redeem the notes prior to December 1, 2015 if EFIH pays an "Applicable Premium" to the holders. The indenture additionally provided that upon an event of default, including a bankruptcy filing, the amounts due under the indenture would automatically accelerate and become due and owing in full. The indenture also permitted a majority of holders to rescind any acceleration and its consequences.

After EFIH's bankruptcy filing, the indenture trustee, at the direction of a majority of the dollar amount of the notes, delivered a letter to EFIH stating, among other things, that the noteholders: (a) waived the bankruptcy default, and (b) rescinded any automatic acceleration resulting from the bankruptcy default. EFIH subsequently commenced an adversary proceeding seeking a determination that the noteholders who had directed the trustee (and who had rejected an earlier settlement proposal by EFIH) were not entitled to any make-whole payment or related claim.

Both the Bankruptcy Court and the District Court refused to allow the first lien noteholders to decelerate the debt because (i) waiving the default and rescinding the automatic acceleration of the notes would require the lifting of the automatic stay and (ii) "cause" did not exist to lift the automatic stay.[4] The Bankruptcy Court held that because the hardship to the noteholders of maintaining the automatic stay was, at most, equal to the hardship to EFIH from lifting the automatic stay, cause did not exist to lift the stay. The noteholders appealed the Bankruptcy Court's decision.

The Intercreditor Decision

Having been denied a make-whole recovery from EFIH, the first lien trustee sought to recover the amount of the make-whole premium from junior noteholders, who had previously received a partial paydown of their second lien notes from the debtors. The first lien trustee argued that under the terms of an intercreditor Collateral Trust Agreement between first lien noteholders and junior noteholders, the junior notes trustee was required to turn over all distributions received from EFIH until the first lien trustee received payment in full of all 'obligations' owed to the first lien noteholders under the first lien indenture, which obligations, the first lien trustee argued, include the make-whole amount.

The first lien trustee argued that while the automatic stay might prevent the make-whole amount from maturing against EFIH, it was still an 'obligation' that was owing to the first lien noteholders under the applicable indenture and would need to be satisfied under the terms of the applicable intercreditor agreement before junior noteholders could retain any payments on account of their junior notes from EFIH.

The Bankruptcy Court disagreed, holding that because the first lien debt was never decelerated, the make-whole payment never became payable under the first lien indenture and was therefore not an 'obligation' under the intercreditor agreement. The court held that since deceleration is contingent on an order lifting the automatic stay, this contingency makes the applicable premium not payable under the first lien indenture and, therefore, not an 'obligation' under the terms of the collateral trust agreement.

Unless overturned on appeal, the Bankruptcy Court's intercreditor decision closes off the last route by which first lien noteholders might have succeeded in recovering the amount of their make-whole payment against EFIH.

As a reminder, if parties wish to receive a make-whole premium following a bankruptcy filing, the indenture must specify, in no uncertain terms, that such make-whole premium is required despite a bankruptcy filing.[5] While payment of such make-whole premium is not then absolutely guaranteed, such precise language should go a long way towards convincing a court that such payment was agreed upon and part of the parties' bargain.

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:

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1 *Delaware Trust Company, as Indenture Trustee and Collateral Trustee v. Computershare Trust Company, N.A. and Computershare Trust Company of Canada, as Indenture Trustee and Paying Agent (In re Energy Future Holdings Corp.)*, Adv. Proc. 14-50410(CSS) (Bankr. D. Del. June 3, 2016) (Opinion).

2 *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 *Delaware Trust Company, as Indenture Trustee v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 533 B.R. 106 (Bankr. D. Del. 2015) (the "*First Bankruptcy Decision*") affirmed by *Delaware Trust Company, as Indenture Trustee v. Energy Future Intermediate Holding Company LLC*, Civ. Action No. 15-620 RGA (D. Del. Feb. 16, 2016) (Memorandum Order) (the "*Mem. Op*").

4 First Bankruptcy Decision; Mem. Op. at 3-4 (citing, among others, *In re AMR Corp.*, 730 F.3d 88 (2d Cir. 2013) and *In re MPM Silicones, LLC*, 531 B.R. 321 (S.D.N.Y. 2015).

5 For an expanded analysis on these issues, see *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) and *Make-Whole Provisions Continue to Cause Controversy: What You Can Do to Avoid Litigation* (July 18, 2014).

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