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Make Wholes / Prepayment Premiums and Cram Down

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Agenda

- Introduction
- Typical Prepayment Provisions
- Prepayment Premiums in Bankruptcy
- Cram Down: Momentive Implications

Introduction

In our presentation today we will cover the following three main topics:

- Typical Prepayment Provisions and Construction
- Enforceability of Prepayment Premiums Outside and Inside of Chapter 11
- Cramdown and Implications of Recent Caselaw

Typical Prepayment Premiums

Typical Prepayment Premiums

- New York law generally prohibits voluntary prepayment of fixed maturity term debt without lender consent.
- Debt instruments – if they allow prepayment -- often provide that they can not be prepaid without prepayment of a premium, such as a "make-whole" premium (a present value calculation that discounts the payments that would have been received if the bond had not been redeemed, calculated based on comparable treasury yields).
- Different types of debt instruments have different treatment for prepayment premiums in the event of acceleration of the debt.
- Generally speaking, outside of bankruptcy, prepayment premiums will be enforceable.

Typical Prepayment Premiums

- Many debt instruments provide that the debt may not be prepaid for a certain period, except with an agreed upon prepayment premium.
  - Investment grade bonds will often provide that the bonds are not prepayable prior to maturity unless a "make-whole" redemption payment is made.
  - High yield bonds will often provide that the bonds are not callable for a period of time, such as half the term of the bond, unless a make-whole redemption payment is made, and that the bonds are redeemable during the "call period" at specified redemption prices.
  - Some syndicated term loan agreements will include call protection that requires a prepayment premium in connection with an early repayment of the loan, typically a percentage of the outstanding principal amount of the loan that declines over time.

Typical Prepayment Premiums (cont'd)

- Many debt instruments provide that the debt can be accelerated upon certain events of default and that the debt is automatically accelerated upon the issuer's filing for bankruptcy.
- Different debt instruments handle prepayment premiums differently in connection with an acceleration of the debt.
    - Many broadly syndicated bonds do not expressly provide that the prepayment premium is due in connection with an acceleration of the debt.
    - Some broadly syndicated bonds provide that the call premium that would then have been payable is due if the acceleration is as a result of an intentional act by the issuer to avoid paying the call premium.
    - Many broadly syndicated term loan agreements that include a "call premium" do not expressly provide that the call premium is due in connection with an acceleration of the loan.

Typical Prepayment Premiums (cont'd)

- Financings in the institutional private placement market often expressly provide that the prepayment premium is due if the debt is accelerated.

- Some "mezzanine" financings and "rescue financings" expressly provide that the prepayment premium is due if the debt is accelerated.

Prepayment Premiums Outside of Bankruptcy

- Generally speaking, prepayment premiums are enforceable under typical state laws.
- In New York, a prepayment premium is generally analyzed under law applicable to liquidated damages provision.
- Actual damages are difficult to determine in advance.
- The liquidated damages amount should not be plainly disproportionate to the possible loss.
- Courts increasingly defer to negotiations of sophisticated parties unless the liquidated damages would be "an unreasonable penalty" – often considered an "I know it when I see it standard."

Prepayment Premiums in Bankruptcy

Typical Prepayment Premiums

- Key Bankruptcy Issues: what is a make-whole premium?
  - Unmatured Interest.
  - Liquidated Damages.
  - Penalty.
  - Expectation Damages.
  - None of the above.
  - The answer to this question is not uniform across jurisdictions or, in some cases, the same courthouse.
- The express language of the debt instrument is the single most important factor in the analysis. Avoid calling premium "unmatured interest" or a "penalty."
- Note: but even if the make-whole provision is artfully drafted, it still may be disallowed and unenforceable in a bankruptcy case.

Prepayment Premiums in Bankruptcy

- In a bankruptcy case, a prepayment premium that would be enforceable under state law outside of bankruptcy – that is clear and unambiguously drafted – may be enforceable.
- Liquidated Damages v. Unmatured Interest
  - Majority view treats make-whole as liquidated damages.
  - Minority view treats make-whole as unmatured interest.
    - Application of Section 502(b)(2) for unsecured or undersecured creditors – disallowance of unmatured interest.
    - Application of Section 506(b) for oversecured creditors – allow reasonable damages/charges that are specifically enumerated in applicable documents.

Prepayment Premiums in Bankruptcy (cont'd)

- Treatment as Penalty.
- Some bankruptcy courts have also recognized an expectation damages claim for non-prepayable debt that did not include a prepayment premium in the event of an acceleration.
  - However, this has not been uniform.
- Treatment in the context of settlements or solvent debtor.

Prepayment Premiums in Bankruptcy
Case Study: *In re Calpine Corporation*, 365 B.R. 392 (Bankr. S.D.N.Y 2007) ("Calpine I")

- Facts:
  - Issue before court: does a "trust indenture drafting omission relieve the debtors of the obligation to pay prepayment premiums or similar make-whole damages upon repayment in full of principal and interest short of the original maturing dates?"
  - Debtors sought to refinance DIP Facility and repay approximately $2.5 billion of secured debt.
  - The secured debt holders objected: agreements prohibit prepayment and/or provide them with right to seek make-whole damages.
  - Agreements did not require prepayment premium or include any form of liquidated damages provision if repaid prior to April 1, 2007; refinancing to occur prior to that date.
  - Agreements provide that bankruptcy filing is an event of default, and therefore debt was accelerated, and due and payable.
  - Debt was matured upon occurrence of Event of Default – e.g., filing of bankruptcy case.
  - Secured debt holders argued debtor was solvent, but court did not make any findings re solvency

Prepayment Premiums in Bankruptcy
Case Study: *In re Calpine Corporation*, 365 B.R. 392 (Bankr. S.D.N.Y 2007) ("Calpine I")

- Decision:
  - Indentures did not provide for liquidated damages or premium for repayment. Therefore could not be part of allowed secured claim under Section 506(b).
  - But, debt holders entitled to unsecured "expectation damages" because the lenders' "expectation of an uninterrupted payment stream has been dashed, giving rise to damages."
  - Bankruptcy Court found that 2.5 to 3.5 percent prepayment premium was appropriate proxy of damages to be awarded.

Prepayment Premiums in Bankruptcy
Case Study: *In re Solutia*, 379 B.R. 473 (Bankr. S.D.N.Y. 2007)

- Facts:
  - Outstanding notes were automatically accelerated as a result of the issuer's filing bankruptcy.
  - Note holders attempted to rescind the acceleration
  - Indenture had no-call provisions, but did not have a prepayment provision in the event of acceleration.
  - Note holders argued that they should be entitled to an expectation damages claim for interest through maturity of the notes.
  - Note holders were deemed overcollateralized, although the debtor was insolvent (e.g., unsecured creditors receiving equity in reorganized debtor in lieu of payment in full).

Prepayment Premiums in Bankruptcy
Case Study: *In re Solutia*, 379 B.R. 473 (Bankr. S.D.N.Y. 2007)

- Decision:
  - Court held that action to rescind acceleration of the notes violated the automatic stay.
  - Court found that since the notes had been accelerated, note holders did not have claim for post confirmation interest, change of control premium or any "expectation damages."
  - Court indicated that the indenture could have included a prepayment premium, but where sophisticated parties had not included such a provision, the court would not provide them with its equivalent through an "expectation damages" claim.

Prepayment Premiums in Bankruptcy
Case Study: *Premier Entm't Biloxi, LLC* v. *U.S. Bank Nat'l Assoc.* (*In re Premier Entm't Biloxi, LLC*), 445 B.R. 582 (Bankr. S.D. Miss. 2010)

- Facts:
  - Secured notes included a no call period.
  - Secured notes automatically accelerated in the event of a bankruptcy.
  - Secured notes provided that a prepayment premium applied if an Event of Default was the result of any willful action or inaction by the Issuer with the intention of avoiding the no call provisions.
  - Indenture did not include language that expressly preserved right to collect premium after acceleration or for payment during no-call period. Did include language that provided cumulative remedies "to the extent permitted by law."
  - Debtors were solvent.

Prepayment Premiums in Bankruptcy
Case Study: *Premier Entm't Biloxi, LLC* v. *U.S. Bank Nat'l Assoc.* (*In re Premier Entm't Biloxi, LLC*), 445 B.R. 582 (Bankr. S.D. Miss. 2010)

- Decision:
  - Court found that the indenture provided for automatic acceleration of the debt upon filing of the bankruptcy. But in the absence of specific language in the indenture authorizing payment of a premium, court cited *Solutia* with approval in holding Section 506(b) precluded any secured claim for that premium.
  - However, the court cited *Calpine I* with approval in holding that noteholders should be awarded an unsecured claim under Section 502 for their expectation damages because the notes were being prepaid at a time when the indenture would not have allowed for prepayment.
  - The court only awarded expectation damages because the debtors were solvent.

Prepayment Premiums in Bankruptcy
Case Study: *HSBC Bank USA v. CALPINE CORP.*, 2010 WL 3835200 (S.D.N.Y. Sept. 14, 2010) ("Calpine II")

- Addressing the Trustee's Appeal, Reversed Calpine I (in part): No basis in state law for recovery of expectation damages.
  - Bankruptcy rendered no-call provisions unenforceable. Therefore, debtor could not be liable for breach of unenforceable contract provision – and thus no basis for expectation damages.
  - 502(b)(2) also specifically disallows the claim for expectation damages because it disallows claims for unmatured interest.
  - Section 506(b) disallows premium because it was not specifically included in the notes. The notes provided for interest payments over the life of the loan, not a "charge" equal to lost interest payments.

Prepayment Premiums in Bankruptcy
Case Study: *In re Chemtura*, 439 B.R. 561 (Bankr. S.D.N.Y. 2010)

- Facts:
  - Terms of Notes: one indenture contained make whole (the "2016 Notes"); the other contained no-call/no prepayment provision (the "2026 Notes").
  - Make Whole in 2016 Notes: expressly provide for Make-Whole payment upon voluntary redemption prior to maturity.
  - Under 2026 Notes, no make-whole provision. Instead, indenture provided that notes may not be redeemed prior to their stated maturity date.
  - Proposed Settlement:
    - Make-Whole in 2016 Notes: *42%* of the amount that would be payable if Make-Whole were found to be enforceable.
    - 2026 Notes: $20 million claim to resolve damages claim for breach of no call provision, which is equal to *39%* of the amount that would be payable for such a breach.
  - Debtors were solvent.

Prepayment Premiums in Bankruptcy
Case Study: *In re Chemtura*, 439 B.R. 561 (Bankr. S.D.N.Y. 2010)

- Decision:
  - Court approved make-whole and damage claim under Rule 9019 settlement standards in light of split in case law – settlement fell within the "lowest point in the range of reasonableness."
  - Balanced decision between Calpine I, Calpine II, Solutia and Premier.

Prepayment Premiums in Bankruptcy
Case Study: *In re Trico Marine Servs.*, 450 B.R. 474 (Bankr. D. Del. 2011)

- Facts:
  - Indenture provides that the underlying obligations are subject to an optional redemption premium (referred to by the court as a "Make-Whole Premium") that mature only if and when the debtor elects, at its option, to redeem the obligations in whole or in part, at any time, at specified redemption prices.
  - As of the bankruptcy filing, aggregate amount of approximately $4.6 million owing under secured indenture.
  - Notes were unsecured, but U.S. Maritime Service guaranteed the notes. In exchange, U.S. Maritime Service held a first priority lien on certain vessels owned by the debtor.
  - Debtor sought to sell the vessels, and required U.S. Maritime's consent. In exchange for its consents to the sale, the U.S. Maritime Administration demanded that the debtor use proceeds to repay the outstanding notes (so as to ensure that the guarantee would not be called.)

Prepayment Premiums in Bankruptcy
Case Study: *In re Trico Marine Servs*., 450 B.R. 474 (Bankr. D. Del. 2011)

- Make whole premium was in amount of $511,850. Triggered by post-petition sale of assets and redemption of bonds.
- The debtor, argued, among other things, that the make-whole premium should be disallowed as unmatured interest pursuant to section 502(b)(2) of the Bankruptcy Code, or, in the alternative, that the make-whole premium was a general unsecured claim that was not covered by the guarantee. Implicitly conceding that the make whole premium was unmatured interest, the indenture trustee argued that the make-whole premium was covered by the guarantee and that it could, therefore, look to the Maritime Administration for payment of the make-whole premium. Not surprisingly, the Maritime Administration contended that the make-whole premium was not "interest" and thus, not covered by its guarantee.

Prepayment Premiums in Bankruptcy
Case Study: *In re Trico Marine Servs.*, 450 B.R. 474 (Bankr. D. Del. 2011)

- Decision:
  - Court held that prepayment premium was not unmatured interest: because the obligation itself comes due at the time of prepayment, any such prepayment premiums are not deemed to be "interest" simply because the amounts of such payments are based on calculations of future interest obligations that would have been incurred.
  - Make-Whole Premium was allowed – but due to certain drafting issues in the order approving the sale of assets and preservation of dispute over Make-Whole Premium, the Court only allowed the premium as an unsecured claim and not part of secured obligations under indenture.

Prepayment Premiums in Bankruptcy
Case Study: *In re Calpine Corporation*, 2011 WL 2421302 (S.D.N.Y June 8, 2011)

- Addressing the Debtor's Appeal, Reversed Calpine I (in part): The bankruptcy court lacked the legal authority under the circumstances to remedy the drafting omission by rewriting the contract terms.
  - The portion of the bankruptcy court's order awarding the trustee an unsecured claim for damages in the amount of a 3.5% premium was reversed and vacated.
  - The bankruptcy court improperly interpreted the unambiguous terms of the indentures when the court determined that the debtor was liable to the debt holders for damages to their expectation resulting from the debtor's repayment of the debt.

Prepayment Premiums in Bankruptcy
Case Study: *In re School Specialty, Inc., et al.*, 2013 WL 1838513 (Bankr. D. Del. April 22, 2013)

- Facts:
  - Upon either prepayment or acceleration of the term loan, the debtors were required to pay a make-whole payment. Pre-bankruptcy, the debtors and lender entered into forbearance agreement, which recognized (a) debtors' breach of minimum liquidity covenant and (b) acceleration of term loan. Neither the debtors nor the official creditors committee disputed that this breach occurred or that the term loan was accelerated pre-bankruptcy, triggering the debtors' obligation to pay the make-whole payment.
  - As of bankruptcy filing date, aggregate amount owing under Term Loan was approx. $95 million – which included a Make-Whole Payment of $23.7 million (or 25% of the total amount owing.)
  - Under New York law (which governs the loan agreement), prepayment premiums are treated like liquidated damages and are enforceable when actual damages are not easily ascertainable and when the amount of premium is not "grossly disproportionate" to the lender's possible loss.

Prepayment Premiums in Bankruptcy
Case Study: *In re School Specialty, Inc., et al.*, 2013 WL 1838513 (Bankr. D. Del. April 22, 2013)

- Decision:
  - Bankruptcy Court held that make-whole claim was not grossly disproportionate under New York law.
  - Also found that such a make-whole claim would satisfy the Section 506(b) reasonableness standard (e.g. allowing liquidated damages as part of claim held by oversecured creditor.)

Prepayment Premiums in Bankruptcy
Case Study: *U.S. Bank Trust Nat'l Ass'n* v. *AMR Corp.* (*In re AMR Corp.*) , 730 F.3d 88 (2d Cir. N.Y. 2013)

- Facts:
  - In 2009 and 2011, American Airlines negotiated three financing transactions (the "prepetition notes"), each of which was secured by designated aircraft. On Nov. 29, 2011, American filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code, and on Oct. 12, 2012, it sought authority to incur $1.5B of new financing to be used, in part, to refinance the prepetition notes.
  - Indenture clearly provided that make-whole payment was not due upon a bankruptcy acceleration.
  - Indenture trustee argued that it should have relief from stay to waive any defaults and deaccelerate the prepetition notes.
  - Also argued that American's election under §1110(a) of the Bankruptcy Code – pursuant to which a debtor must cure all outstanding defaults (other than those arising solely from the bankruptcy filing) and perform all obligations under an aircraft financing – effectively deaccelerated the prepetition notes.

Prepayment Premiums in Bankruptcy
Case Study: *U.S. Bank Trust Nat'l Ass'n* v. *AMR Corp.* (*In re AMR Corp.*) 730 F.3d 88 (2d Cir. N.Y. 2013)

- Decision:
  - Court rejected make-whole payment based on plain language of indenture.
  - No relief from stay to deaccelerate.
  - Section 1110 did not unwind acceleration – did not require debtor to cure any defaults.
  - Citing with approval the district court's decision in Calpine and the bankruptcy court's decision in Solutia, the American court emphasized that the contract must provide explicitly for a premium following an acceleration of the debt if one is to be recoverable.

Prepayment Premiums in Bankruptcy
Case Study: *Bank of N.Y. Mellon* v. *Merchandise Mart, LLC* (*In re Denver Merch. Mart, Inc.*), 740 F.3d 1052 (5th Cir. 2014)

- Facts:
  - The issue on appeal was whether the debtor became liable for a $1.8 million prepayment consideration upon the pre-bankruptcy acceleration of a promissory note.
  - The promissory note included a provision providing that the debtor may prepay the note under certain circumstances but must also pay a prepayment consideration.
  - The promissory note did not require payment of prepayment consideration in the event of mere acceleration.
  - The debtor stopped making payments under the note, defaulting under its terms. The lender issued a notice of default which the debtor failed to cure.
  - The Lender argued that payment of the prepayment consideration, valued at $1.8 million, was required by the note's acceleration clause, notwithstanding the fact that the debtor essentially stopped making payments under the note after initially defaulting and never paid the note prior to the maturity date.

Prepayment Premiums in Bankruptcy
Case Study: *Bank of N.Y. Mellon* v. *Merchandise Mart, LLC* (*In re Denver Merch. Mart, Inc.*), 740 F.3d 1052 (5th Cir. 2014)

- The bankruptcy court disagreed with the lender on the following grounds: (i) some payment, whether voluntary or involuntary, must actually be made to trigger the obligation to pay the prepayment consideration; (ii) the rationale for requiring a prepayment consideration did not apply here; and (iii) the cases cited by the lender were inapposite because in each of those cases, the acceleration clause specifically provided that acceleration of the note would trigger the obligation to pay the prepayment consideration.
- The bankruptcy court noted that it would have been easy to expressly provide for payment of the prepayment consideration in the event of acceleration.

- The bankruptcy court therefore disallowed the claim for prepayment consideration.

Prepayment Premiums in Bankruptcy
Case Study: *Bank of N.Y. Mellon* v. *Merchandise Mart, LLC* (*In re Denver Merch. Mart, Inc.*), 740 F.3d 1052 (5th Cir. 2014)

- Decision:
  - The plain language of the prepayment consideration provision of the note required an actual prepayment, whether voluntary or involuntary, to trigger the obligation to pay the prepayment consideration, and no prepayment occurred here.
  - There was no language in the note which would *deem* the prepayment to have been made in the event of acceleration for any reason. Example of such language: "The undersigned borrower agrees that if the holder of this Note accelerates the whole or any part of the principal sum . . . the undersigned waives any right to prepay said principal sum in whole or in part without premium *and agrees to pay a prepayment premium*."
  - Under Colorado law, not considered liquidated damages due to breach of contract allowable under Section 506(b)

Prepayment Premiums in Bankruptcy
Case Study: *Paloian* v. *La Salle Bank N.A.* (*In re Doctors Hospital of Hyde Park, Inc.*), 508 B.R. 697 (Bankr. N.D. Ill. 2014)

- Facts:
  - The issue before the court was whether the yield maintenance premium was unenforceable as a penalty or whether the premium represented unmatured interest under *11 U.S.C. § 502(b)(2).*
  - Debtor's affiliate borrowed $50 million from lender and debtor executed a guaranty in favor of lender agreeing to satisfy those obligations which the affiliate owed under the express terms of the loan agreement.
  - Debtor's responsibility as guarantor was the same as the obligations otherwise owed by the affiliate, including the yield maintenance premium obligation, which was triggered, "in the event that all or any portion of the Note is accelerated."
  - Three months after the debtor's bankruptcy filing, lender filed a foreclosure complaint against the affiliate, effectively accelerating the note.

Prepayment Premiums in Bankruptcy
Case Study: *Paloian* v. *La Salle Bank N.A.* (*In re Doctors Hospital of Hyde Park, Inc.*), 508 B.R. 697 (Bankr. N.D. Ill. 2014)

- Facts:
  - Lender filed a claim in the debtor's bankruptcy that included a yield maintenance premium in the amount of $13,111,986.
  - Trustee of the debtor's estate sought to disallow the premium portion of the lender's claim as unmatured interest under *11 U.S.C. § 502(b)(2)*, or as an unenforceable penalty barred under New York state law.

Prepayment Premiums in Bankruptcy
Case Study: *Paloian* v. *La Salle Bank N.A.* (*In re Doctors Hospital of Hyde Park, Inc.*), 508 B.R. 697 (Bankr. N.D. Ill. 2014)

- Decision:
  - Court held that the premium is not a penalty because New York state law explicitly recognizes that a prepayment provision in a loan agreement is not a penalty.
  - The yield maintenance premium represents unmatured interest at the time of the bankruptcy filing because it was not due and owing as of the time of bankruptcy filing. The loan was not accelerated until three months post-petition when the lender commenced foreclosure proceedings.
  - Also held that it is a "false dichotomy" to argue that the premium cannot both be unmatured interest and liquidated damages, distinguishing *Trico Marine*.
  - There remained an issue of material fact to be determined at a later date as to whether or not the lender was undersecured when the bankruptcy was filed. If lender was undersecured at the time of the bankruptcy filing, the premium is barred by *§ 502(b)(2)*; if not, it may be recovered.

Prepayment Premiums in Bankruptcy
Case Study: *CSC Trust Co.* v. *Energy Future Intermediate Holdings Co., LLC* (*In re Energy Future Holdings Corp.*), 2014 WL 3828283 (Bankr. D. Del. August 5, 2014)

- Facts:
  - One of several issues before the court was whether a discovery request for information regarding a debtor's valuation and solvency was relevant within the context of adjudicating a makewhole dispute.

Prepayment Premiums in Bankruptcy
Case Study: *CSC Trust Co.* v. *Energy Future Intermediate Holdings Co., LLC* (*In re Energy Future Holdings Corp.*), 2014 WL 3828283 (Bankr. D. Del. August 5, 2014)

- Decision:
  - Solvency of the debtor is relevant in the context of makewhole premium provisions (would affect the exact amount to be paid.)
  - If a makewhole provision is found to be applicable, the solvency of the debtor will affect how the court determines the specific amount required to be paid. If a debtor is solvent, the court is able to directly enforce the terms of the contract under state law, but when it is insolvent, the court will most likely have to make a decision based on equitable principles.

Prepayment Premiums in Bankruptcy
Case Study: *In re MPM Silicones, LLC, et al.*, No. 14-22503 (RDD) (Bankr. S.D.N.Y. Sept. 9, 2014)

Facts:

- The first and 1.5 lien holders claimed they were entitled to a contractual "make-whole" claim, or, barring such a claim, a common law claim for damages.

- The notes provided that the notes may not be redeemed at the borrower's option prior to October 15, 2015. Prior to October 15, 2015, the borrowers could redeem the notes at their option in whole or in part upon providing certain notice to the holders and at a redemption price equal to 100% of the principal amount of the notes plus a certain "Applicable Premium" and interest.

Prepayment Premiums in Bankruptcy
Case Study: *In re MPM Silicones, LLC, et al.*, No. 14-22503 (RDD) (Bankr. S.D.N.Y. Sept. 9, 2014)

Facts:

- Section 6.02 in the indentures provided that the trustee or the holders of at least 25 percent of principal amount of the outstanding notes, upon an event of default, can elect to accelerate the notes.
- Section 6.02 also provided that if an Event of Default specified in the indentures with respect to the debtors (which includes the debtors' bankruptcy) occurs, "the principal of, premium, *if any*, and interest on all the notes shall ipso facto become and be immediately due and payable without any declaration or other act on the part of the Trustee or any Holders."
- The indenture trustees for the first and 1.5 lien holders argued that the chapter 11 plan's payment of the holders with replacement notes entitled them to the "Applicable Premium," as they would receive such notes before October 15, 2015. Further such payment would be an optional or elective redemption under the provisions of the indentures and notes.

Prepayment Premiums in Bankruptcy
Case Study: *In re MPM Silicones, LLC, et al.*, No. 14-22503 (RDD) (Bankr. S.D.N.Y. Sept. 9, 2014)

Decision:

- Under New York law, the parties to an agreement can include a contractual provision providing for a specific right on behalf of the borrower or issuer to prepay the debt in return for agreed consideration that compensates the lender for the cessation of the stream of interest payments running to the original maturity date of the loan.
- Also under New York law, a lender forfeits the right to such consideration for early payment if the lender accelerates the balance of the loan. There are two exceptions (the first not at issue here): (i) when the debtor intentionally defaults in order to trigger acceleration and evade the prepayment premium; and (ii) when a clear and unambiguous clause calls for the payment of a prepayment premium or make-whole payment in the event of acceleration of, or the establishment of a new maturity date for, the debt.

Prepayment Premiums in Bankruptcy
Case Study: *In re MPM Silicones, LLC, et al.*, No. 14-22503 (RDD) (Bankr. S.D.N.Y. Sept. 9, 2014)

- Decision:
- Indentures provided for automatic acceleration of debt upon a bankruptcy event of default. However, the bondholders did not bargain for sufficient clarity in the indentures for the payment of a prepayment premium after the maturity of the notes had been accelerated.
- According to the court, the indentures lacked language that "clearly and specifically" provided for the payment of the make-whole in the fact of acceleration.
- Each of the references to other rights or "premiums, if any," (e.g., section 6.02) to be paid upon prepayment are not specific enough.
- Distinguished *Chemtura* on the grounds that the *Chemtura* court did not determine the merits of a make-whole and instead evaluated whether a settlement of a make-whole dispute fell within the lowest level in range of reasonableness.
- Finally, sections 506(b) and 502(b)(2) of the Bankruptcy Code disallowed any claim for damages.

Prepayment Premiums in Bankruptcy
Case Study: *In re Schwegmann Giant Supermarkets P'ship*, 264 B.R. 823 (Bankr. E.D. La. 2001)

- Facts:
  - Lender made prepetition loan in amount of $8.4 million.
  - Borrower waived right to prepay the loan, and recognized that any prepayment would result in damages to lender.
  - Prepayment penalty was described as "yield maintenance premium."
  - Assets sold to third party buyer for $15 million.
  - Lender filed proof of claim for principal, interest and unpaid prepayment premium.
  - The loan was not in default prebankruptcy.
  - Lender continued to receive interest payments during entirety of bankruptcy.
  - Fee was approximately 18 percent of unpaid principal amount.

Prepayment Premiums in Bankruptcy
Case Study: *In re Schwegmann Giant Supermarkets P'ship*, 264 B.R. 823 (Bankr. E.D. La. 2001)

- Decision:
  - Court held that lender was oversecured and therefore entitled to make-whole if it is a "reasonable fee."
  - Court held that fee in excess of 10% of principal deemed unreasonable.
  - Fee is unreasonable if it does not effectively estimate actual damages.
  - Make-whole further disallowed because lender did not introduce evidence of any damages it has or will suffer as a result of prepayment.

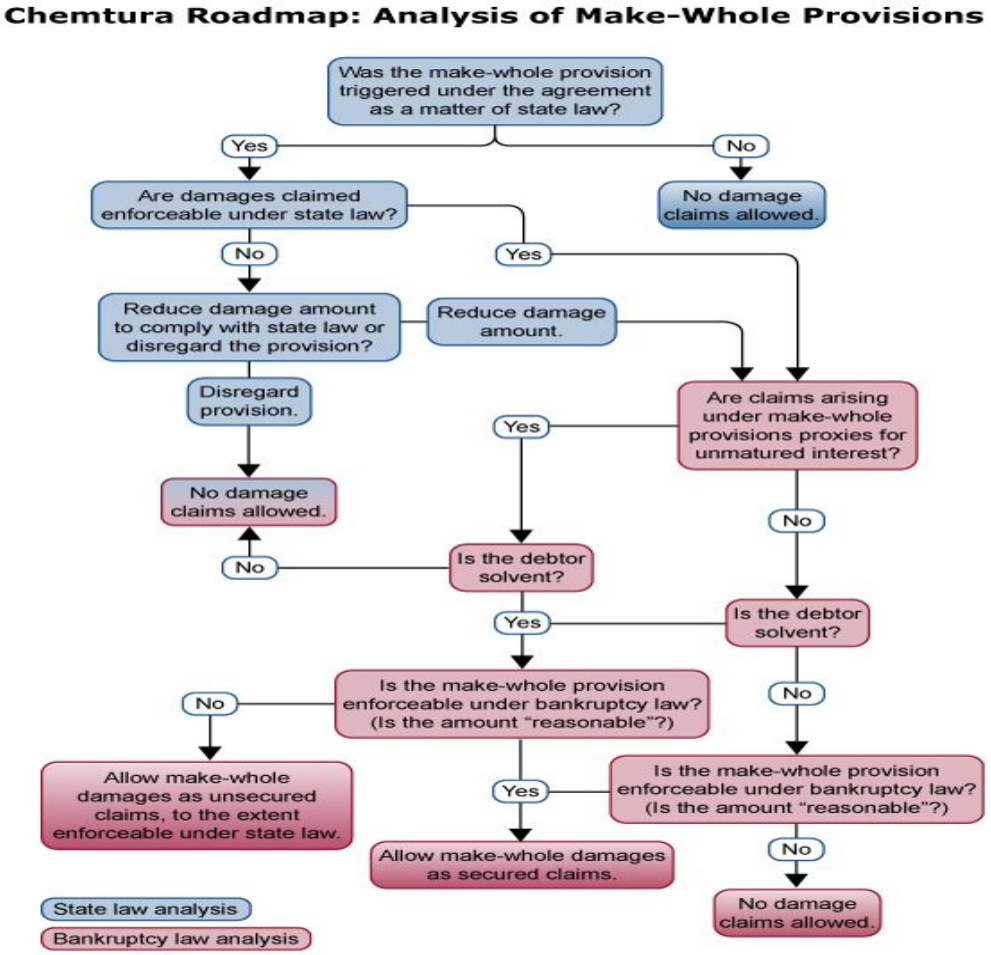
Prepayment Premiums in Bankruptcy
Case Study: *In re Schwegmann Giant Supermarkets P'ship*, 264 B.R. 823 (Bankr. E.D. La. 2001)

- Balance of equities favored debtor:
  - Look to prejudice to junior creditors.
  - Fee does not redress lender's losses, but instead penalizes the debtor and junior creditors for the debtor's filing of a chapter 11.
- Distinguished case where different debtor had defaulted on a note and the creditor had accelerated the loan, begun a foreclosure process and appointed a receiver for the collateral before the debtor filed for bankruptcy.

Prepayment Premiums Summary Takeaways

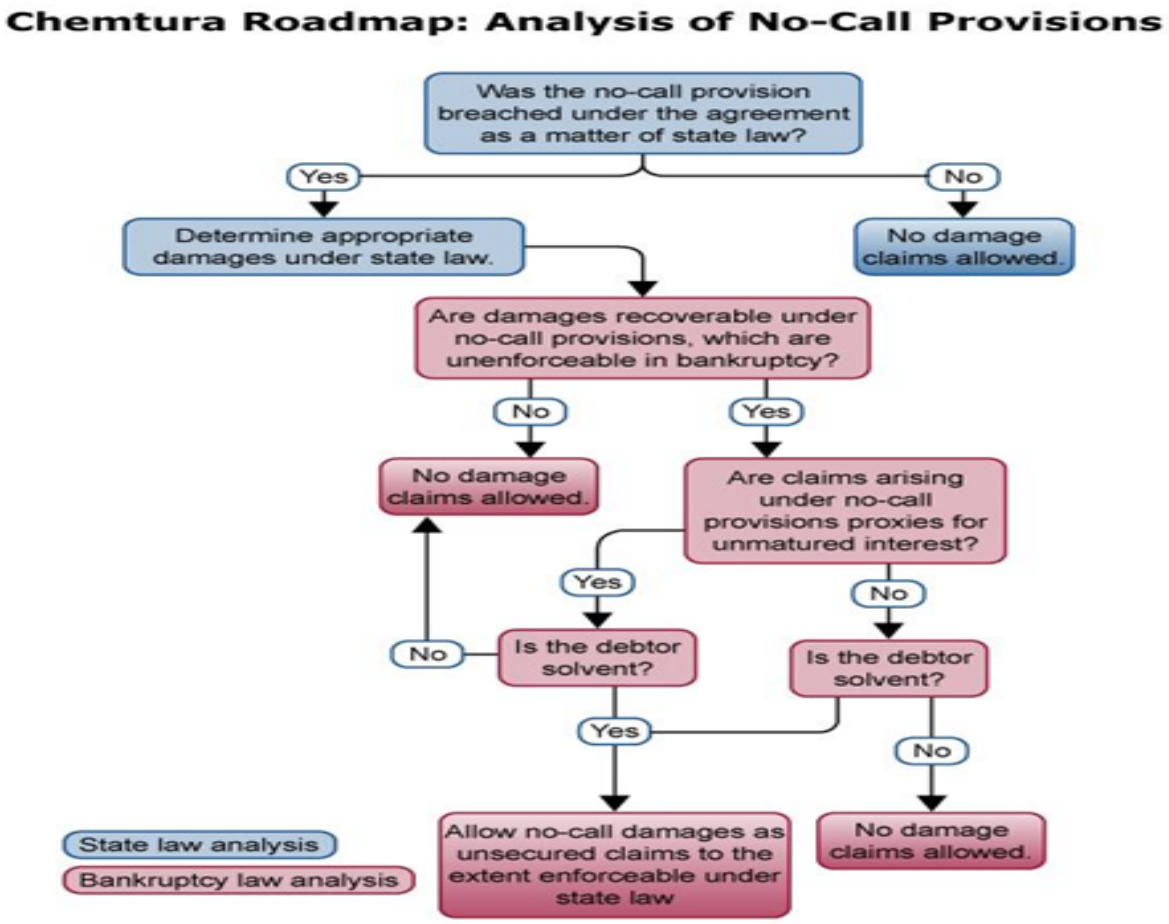
- Accelerate pre-bankruptcy.
- Indenture/notes should specifically provide for payment of premium after acceleration for any reason, including the commencement of a bankruptcy case.
- Indenture/notes should specifically provide that noteholders are entitled to "cumulative remedies to the maximum extent permitted by law."
- Better result if your debtor is solvent.
- Better result if approval of premium is part of a settlement supported by the debtor.
- Avoid Louisiana.
- Get actively involved in pre-bankruptcy workout negotiations.
- Any forbearance agreements should provide clear and unambiguous language that (a) the debt has been accelerated and (b) the make whole premium is reasonable, due and payable as part of the principal amount of the debt.
- Not bulletproof, but better than relying on creative bankruptcy lawyering after the commencement of a chapter 11 case.

Analysis of: Make-Whole Provision and No-Call Provisions*



* Source: Practical Law

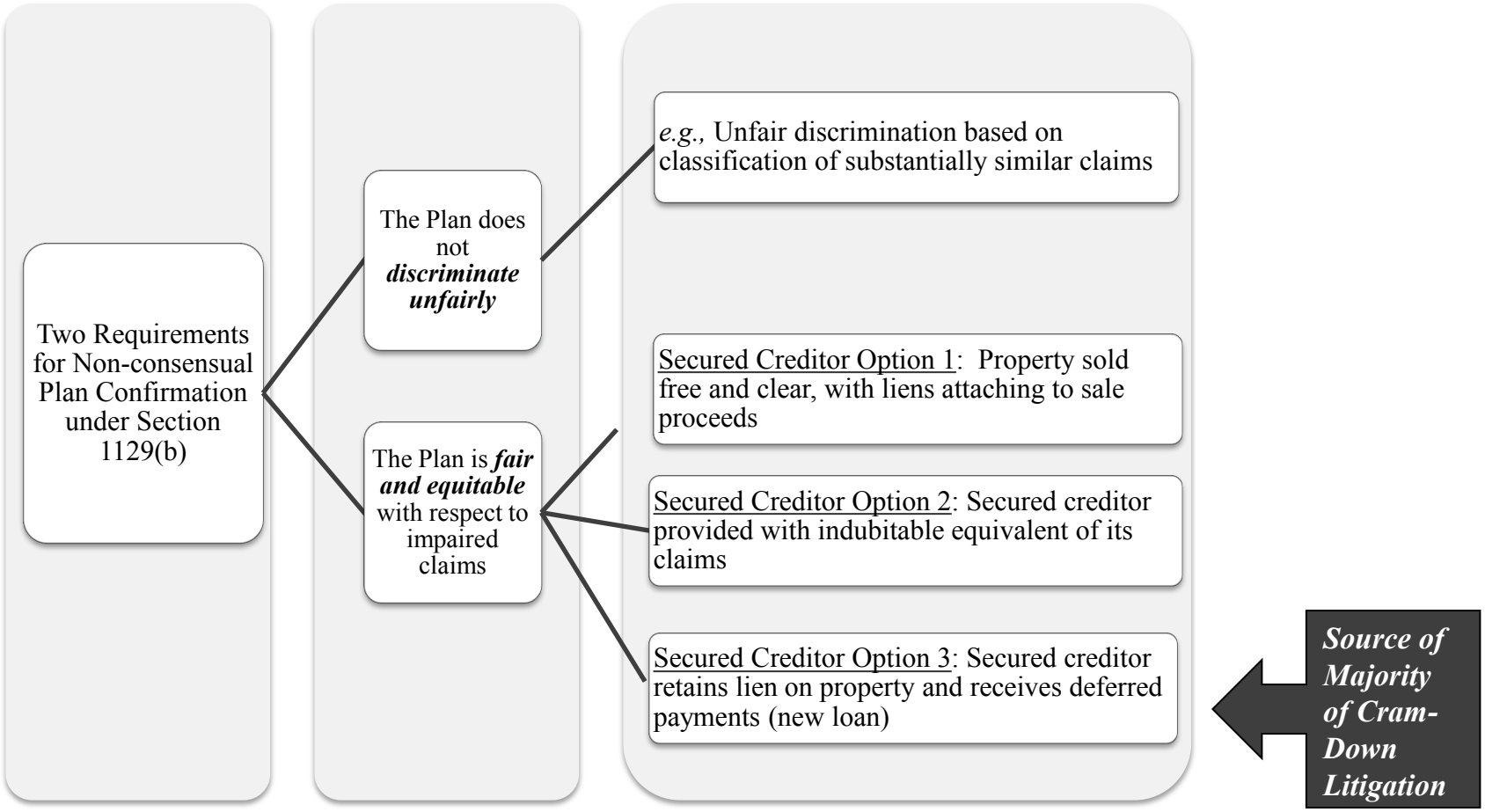
Analysis of: Make-Whole Provision and No-Call Provisions*



* Source: Practical Law

Cram Down: Momentive Implications

Cram-Down Statutory Framework: Nonconsensual Confirmation (Section 1129(b))

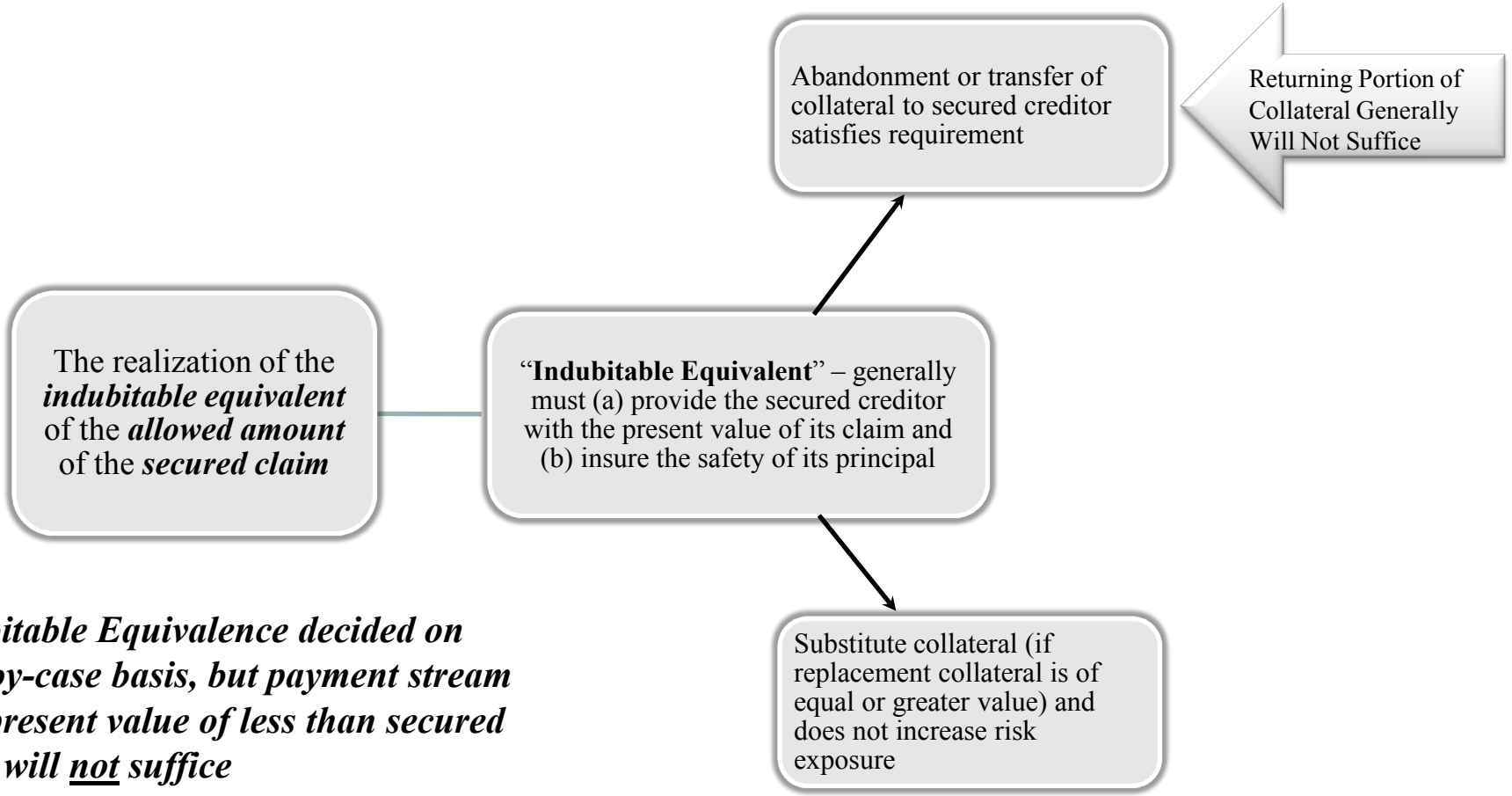


Cram-Down Option 1: Property Sold, Lien on Proceeds

The ***sale*** of the ***prepetition collateral*** free and clear of the secured creditor's lien, with the lien attaching to the ***proceeds***

- **<u>Sale</u>:**
  - Sale performed subject to secured creditor's right to credit bid;
  - Plan must provide for or anticipate (in context of post-confirmation transaction) the sale; and
  - Section 1123 anticipates that a sale of some or all of assets can be a means to implement the plan.
  - <u>Lien Attaching to Proceeds</u>: Lien must transfer to proceeds of that collateral, be they cash, notes or other property received in exchange. ***Can't sell different collateral and transfer lien to those proceeds.***

Cram-Down Option 2: Examples of Indubitable Equivalence



Indubitable Equivalence decided on case-by-case basis, but payment stream with present value of less than secured claim will not suffice

Cram-Down Option 3: "New Loan" Approach

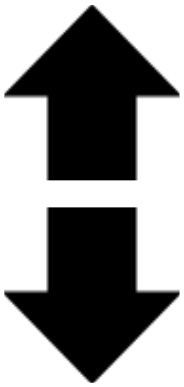
Requirements

- Secured creditor must retain the liens securing its claim.
- Must receive deferred cash payments:
  - (i) totaling at least the allowed amount of its secured claims, and
  - (ii) equal to a value, as of the effective date of the plan, of at least the value of the creditor's interest in the secured property.

Face Value of "New Loan"
Must total at least the allowed amount of creditor's secured claims

A claim is secured to the extent of the value of the creditor's interest in the estate's interest in the collateral

(Valued on the Effective Date of the Plan)



Oversecured Creditor: Oversecured creditors will be limited to a face amount of new notes in the amount of their claim(i.e. if a $50 claim is secured by collateral worth $100, new notes will have a face value of $50).

Undersecured Creditor: Undersecured creditors will be limited to a face amount of new notes in the amount of the collateral (i.e. if a $150 claim is secured by collateral worth $100, new notes will have a face value of $100).

Discount Rate of "New Loan"
Must provide present value (on the effective date) equal to at least the value of the creditor's interest in the secured property

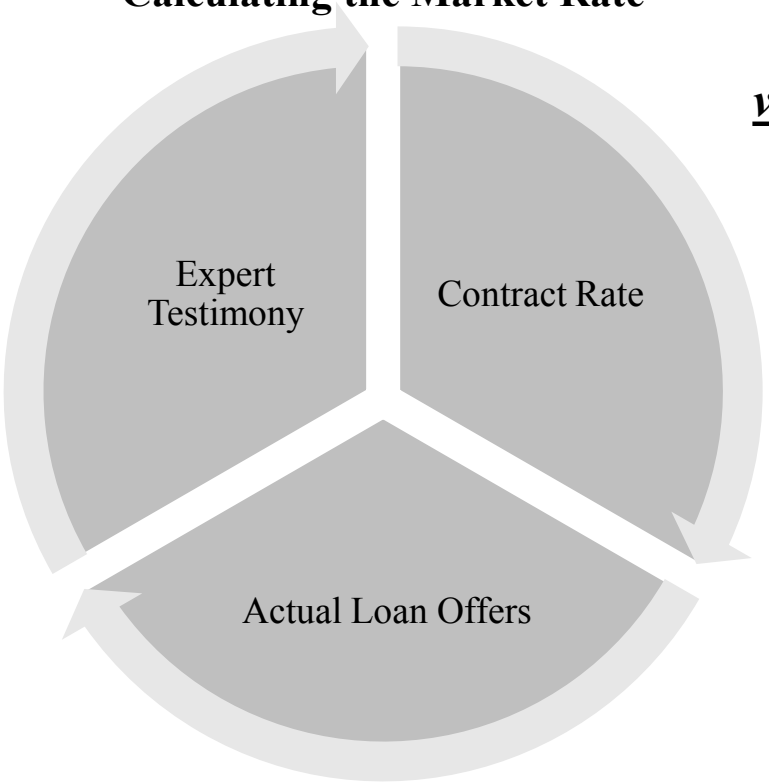
Two Alternative Approaches to Determining "Value"

Prime Plus/Formula Approach: Interest rate on the new loan set at the prime rate (as of the effective date) plus a nominal increase (typically 1%-3%) for credit risk.

Efficient Market Approach: Where an efficient market for the type of loan in question exists, the interest rate on the new loan is set at the market rate.

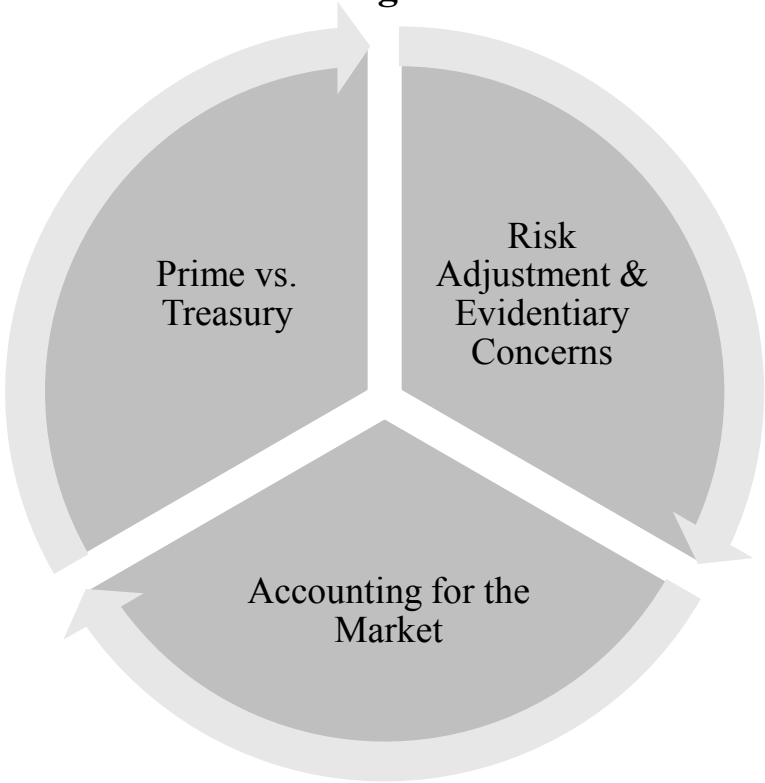
Calculating the Rate

Calculating the Market Rate



versus

Calculating the Formula Rate



Case Law Prior to Momentive:

Till v. SCS Credit Corporation

- Case Facts:
  - Individual Chapter 13 debtors had borrowed $8,000 to purchase a truck, with a 21% interest rate.
  - In bankruptcy, the truck was valued at $4,000.
  - The debtors sought to cram-down the undersecured lender by providing a new loan, secured by the truck, with an interest rate equal to the prime rate plus 1.5%.

Supreme Court Ruling

- Present Value of Claim: The Court adopts the "**Formula Approach**" or "**Prime Plus Rate**" under which the rate is determined independent of lender's particular financial circumstances.

- Burden of Proof: The secured creditor must present evidence to support adopting a higher rate.

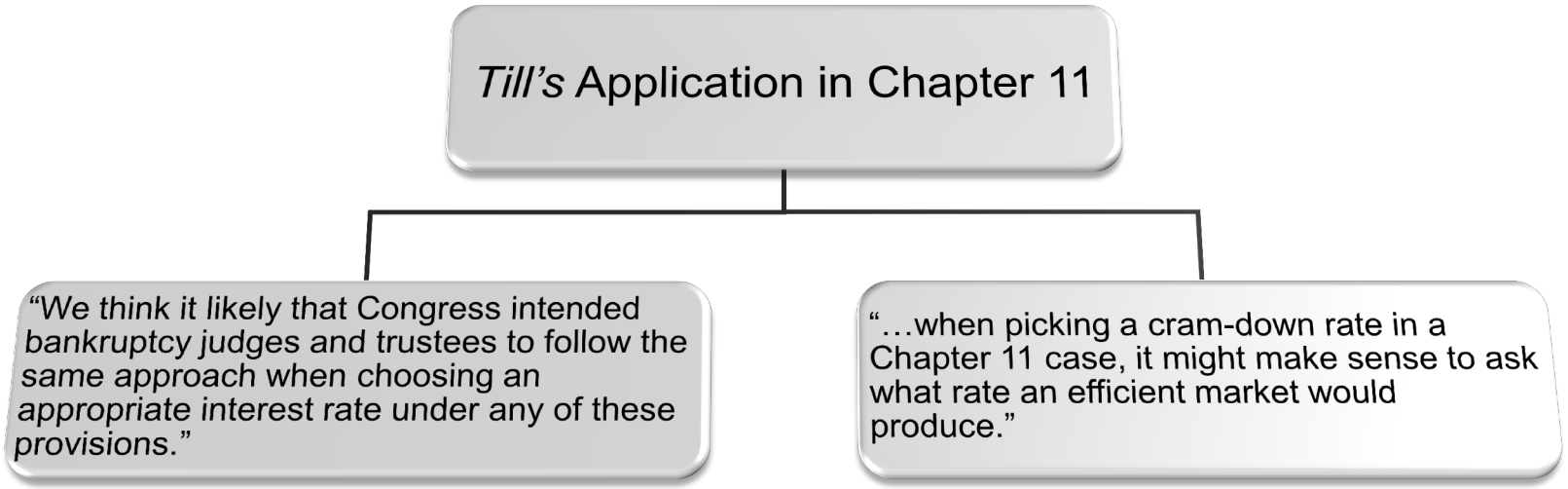
Calculating the Cram-Down Rate under *Till*

- Commence with **Prime Rate** and **Risk Adjust** for the following: (a) probability of plan failure; (b) rate of collateral depreciation; (c) liquidity of capital markets; and (d) administrative expenses.

- Feasibility: Rate reflects both lender's risk and Court's interest in not "doom[ing] the plan."

- ***The Court declined to rule on the proper scale for risk adjustment but noted past courts have used a 1-3% estimate.***

Applying Prime Plus in Chapter 11:
Till's Conflicting Guidance/Competing Footnotes



Cram-Down Litigation Post *Till*

Multiple courts have held that Till's precedential value should be limited.*

"While many courts have chosen to apply the Till plurality's formula method under Chapter 11, they have done so because they were persuaded by the plurality's reasoning not because they considered Till binding."
- *In re Texas Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d 324 (5th Cir. 2013).

Certain courts applying Till have adopted a two-step "Hybrid" approach to calculate interest rates

* *See In re Am. HomePatient, Inc.*, 410 F.3d 559 (6th Cir. 2005); *In re NW Timberline Enters., Inc.*, 348 B.R. 412 (N.D. Tex. 2006) (using formula rate where no market for risky post-emergence loans exists).

The Momentive Case (Facts)

- Prior to bankruptcy, the debtors had three classes of secured debt: (i) First Lien, (ii) 1.5 Lien, and (ii) Second Lien.
- The First Lien and 1.5 Lien indentures contained a make-whole provision which was disputed.
- The debtors filed a bankruptcy petition accompanied by a plan support agreement signed by 85% of the Second Lien holders.
- The Plan did not recognize the make-whole, but contained a toggle provision which provided the First Lien and 1.5 Lien Holders with (i) cash payment in full if they accepted the plan, or (ii) take-back notes with under-market interest rates (3.6% for First Lien and 4.1% for 1.5 Lien) if they rejected the Plan.
- The Second Lien Holders were to receive 100% of the equity under the plan.
- The First Lien and 1.5 Lien holders rejected the Plan, and litigated both the make-whole and the interest rate on the cram-down paper.

The Momentive Case (Arguments)

- Secured Noteholder Arguments for Market Rate:
  - Secured Noteholders argued that a market rate for the notes was required to provide them with the present value of their secured claims today.
  - Heavy reliance was placed on the *Till* footnote stating that an efficient market approach might be preferable in a chapter 11 context and subsequent case law applying the "hybrid" approach.
  - Secured Noteholders argued that an efficient market did in fact exist, as evidenced by commitments for exit financing received by the debtor with market interest rates of 5% (first lien) and 7% (second lien).
- Debtor Arguments for Prime Plus Rate:
  - The Debtors argued that the "value" required under the cram-down standard is value as determined by a court, not value as determined by a market.
  - The plain language of *Till* provides that, on a theoretical level, secured creditors in a cram-down scenario are entitled to receive compensation for (i) loss of the time value of money (i.e. the prime rate), and (ii) credit risk (i.e. the "plus" portion of the Prime Plus Rate). Secured lenders are not entitled to receive the additional "profit" element of a secured loan.

The Momentive Case (Decision)

- The Momentive Court ruled in favor of the Debtors' application of the Prime Plus Rate.
- The decision was based upon both the purported terms and the logic of *Till*.
  - **Terms**: The *Till* Court stated in its plurality opinion that the appropriate method of calculation should apply to all chapters of the Bankruptcy Code.
  - **Logic**: One of the guiding principles of the *Till* decision is that the appropriate discount rate in a cram-down scenario should not include a profit element.
    - Market rates (including the committed exit loans) inherently include a profit element in addition to compensation for the time value of money and credit risk.

The Momentive Case (Concerns/Implications)

- Concerns:
  - The Court's reasoning that the **terms** of *Till* are binding is questionable.
    - *Till* is a plurality opinion, which is arguably not binding other than for the specific case at hand.
    - The "competing footnotes" may not actually be inconsistent. The "hybrid approach" is consistent with both footnotes – it can be used for any chapter of the Bankruptcy Code, and, in a chapter 11, would most often result in application of the efficient market rate.
  - The Court's reasoning that the **logic** of *Till* is persuasive may be misapplied
    - The Judge assumes that loans contain three compensation elements: (i) lost time value of money, (ii) credit risk, and (iii) profit.
    - It is not clear, however, that an efficient lending market will result in market interest rates that contain a profit element above and beyond compensation for credit risk.

The Momentive Case (Concerns/Implications)

- Implications:
  - One in a series of recent cases limiting the rights of secured lenders (adequate protection, credit bid, and now protection against cramdown all under attack).
  - Increases leverage of unsecured creditors and debtors
  - Secured creditors will try to negotiate protections in prepetition intercreditor agreements
  - Secured creditors will try to negotiate 'first day' protections as part of DIP / adequate protection packages. Disputes likely to arise at final DIP hearings.
  - First liens will Increases risk/rate of any lender willing to provide rescue financing (due to subsequent cramdown concerns)
  - Decreases need for exit financing commitments (borrower already has 'committed' financing at a "prime plus" rate)

Analysis of These Issues Can Be Tricky, So Feel Free to Call:

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