The Enforceability of “Make-Whole” Premiums after *Momentive* and *Energy Future Holdings*

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Overview

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Typical Make-Whole Premiums
Typical Make-Whole 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 cannot be prepaid without a premium, such as a “make-whole” premium.
- A “make-whole” premium is generally a present-value calculation that discounts the payments that would have been received if the debt is not prepaid, calculated based on comparable treasury yields.
- Different types of debt instruments have different types of treatment for make-whole premiums in the event of acceleration of the debt.
Typical Make-Whole Premiums (cont’d)

• Many debt instruments provide that the debt may not be prepaid for a certain period of time, except with an agreed-upon make-whole premium.
  
  ➢ Investment grade bonds will often provide that the bonds/notes are not prepayable prior to maturity without a make-whole redemption payment.
  
  ➢ 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 without a make-whole redemption payment, 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 make-whole 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.
• Many debt instruments provide that the debt can be accelerated upon certain events of default and that the debt is automatically accelerated if the borrower files for bankruptcy.

• Different debt instruments handle make-whole premiums differently following the acceleration of the debt.

  ➢ Many broadly syndicated bonds do not expressly provide that the make-whole premium is due upon acceleration of the debt.

  ➢ Some broadly syndicated bonds provide that the call premium that would then have been payable is due if the acceleration results from 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 upon acceleration of the loan.
Typical Make-Whole Premiums (cont’d)

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

• Some “mezzanine” financings and “rescue financings” expressly provide that the make-whole premium is due if the debt is accelerated.
Enforceability of Make-Whole Premiums outside Bankruptcy
Make-Whole Premiums outside Bankruptcy

• Generally speaking, outside bankruptcy, make-whole premiums are enforceable.

• Make-whole premiums are enforceable under typical state laws.

• In New York, a prepayment premium is generally analyzed under law applicable to liquidated damages provisions:
  ➢ 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 by sophisticated parties unless the liquidated damages would be “an unreasonable penalty” – often considered an “I know it when I see it standard.”
Enforceability of Make-Whole Premiums in Bankruptcy
• Key Bankruptcy Issue: What is a “make-whole” premium?

a) Unmatured Interest
b) Liquidated Damages
c) Penalty
d) Expectation Damages
e) None of the above

❖ The answer to this question is not uniform across jurisdictions or, in some cases, the same courthouse.
• In a bankruptcy case, a make-whole premium that would be enforceable under state law outside bankruptcy – that is clearly and unambiguously drafted – may be enforceable.

• The express language of the debt instrument is the single most important factor in the analysis.

• Avoid calling the make-whole premium a “penalty.”

• Liquidated Damages vs. Unmatured Interest
  - Majority view treats make-whole premium as liquidated damages.
  - Minority view treats make-whole premium as unmatured interest.

• Note: even if the make-whole provision is artfully drafted, the make-whole premium may still be disallowed and unenforceable in a bankruptcy case.
• Some bankruptcy courts have also recognized an “expectation damages” claim for non-prepayable debt that did not include a make-whole premium in the event of an acceleration.
  ➢ However, this has not been uniform.
Make-Whole Premiums in Bankruptcy (cont’d)

• Bankruptcy Code
  ➢ Section 502(b)(2) applies to unsecured or undersecured creditors:
    ❖ disallowance of unmatured interest
  
  ➢ Section 506(b) applies to oversecured creditors
    ❖ allows reasonable damages/charges that are specifically enumerated in debt documents
Review of Relevant Case Law
Review of Relevant Case Law

1. Where no make-whole premium is included in debt documents
2. Whether make-whole premium is an unenforceable “penalty”
3. Whether make-whole premium is “reasonable” under Section 506(b)
4. Whether make-whole premium is “unmatured” interest under Section 502(b)(2)
5. Treatment of settlements regarding make-whole premium
6. Effect of voluntary default by borrower/issuer on make-whole premium
7. Effect of automatic acceleration on make-whole premium
1. Where make-whole premium is not included in debt documents
1. Where make-whole premium is not included in debt documents


- **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.
1. Where make-whole premium is not included in debt documents (cont’d)


• Facts (cont’d):
  ▶ 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
1. Where make-whole premium is not included in debt documents (cont’d)


- 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.
1. Where make-whole premium is not included in debt documents (cont’d)


• 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.
1. Where make-whole premium is not included in debt documents (cont’d)

_In re Calpine Corp._, 2011 WL 2421303 (S.D.N.Y. June 8, 2011) ("Calpine III")

- 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.
1. Where make-whole premium is not included in debt documents (cont’d)


• 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).

• 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.
2. Whether make-whole premium is an unenforceable “penalty”
2. Whether make-whole premium is an unenforceable “penalty”


- 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.”
2. Whether make-whole premium is an unenforceable “penalty” (cont’d)


- **Facts (cont’d):**
  - Three months after the debtor’s bankruptcy filing, lender filed a foreclosure complaint against the affiliate, effectively accelerating the note.
  - 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.
2. Whether make-whole premium is an unenforceable “penalty” (cont’d)


- 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.
2. Whether make-whole premium is an unenforceable “penalty” (cont’d)


- Decision (cont’d):
  - 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.
3. Whether make-whole premium is “reasonable” under Section 506(b)
3. Whether make-whole premium is “reasonable” under Section 506(b)

*In re Schwegmann Giant Supermarkets Partnership*, 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 pre-bankruptcy.
3. Whether make-whole premium is “reasonable” under Section 506(b) (cont’d)

_In re Schwegmann Giant Supermarkets Partnership_, 264 B.R. 823 (Bankr. E.D. La. 2001)

• Facts (cont’d):
  - Lender continued to receive interest payments during entirety of bankruptcy.
  - Fee was approximately 18 percent of unpaid principal amount.
3. Whether make-whole premium is “reasonable” under Section 506(b) (cont’d)

*In re Schwegmann Giant Supermarkets Partnership, 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.
3. Whether make-whole premium is “reasonable” under Section 506(b) (cont’d)

_In re Schwegmann Giant Supermarkets Partnership_, 264 B.R. 823 (Bankr. E.D. La. 2001)

• Decision (cont’d):
  - 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.
3. Whether make-whole premium is “reasonable” under Section 506(b) (cont’d)


**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.)
3. Whether make-whole premium is “reasonable” under Section 506(b) (cont’d)


- Facts (cont’d):
  - 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.
3. Whether make-whole premium is "reasonable" under Section 506(b) (cont’d)


• 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 a claim held by oversecured creditor.)
4. Whether make-whole premium is “unmatured” interest under Section 502(b)(2)
4. Whether make-whole premium is “unmatured” interest under Section 502(b)(2)


• 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.
4. Whether make-whole premium is “unmatured” interest under Section 502(b)(2) (cont’d)


• Facts (cont’d):
  - 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.)
  - Make whole premium was in amount of $511,850. Triggered by post-petition sale of assets and redemption of bonds.
4. Whether make-whole premium is “unmatured” interest under Section 502(b)(2) (cont’d)


- Facts (cont’d):
  - 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.
4. Whether make-whole premium is “unmatured” interest under Section 502(b)(2) (cont’d)


- 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.
4. Whether make-whole premium is “unmatured” interest under Section 502(b)(2) (cont’d)


• 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.
4. Whether make-whole premium is “unmatured” interest under Section 502(b)(2) (cont’d)


• 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 In re 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.
5. Treatment of settlements regarding make-whole premium
5. Treatment of settlements regarding make-whole premium

_In re Chemtura Corp._, 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 provides for make-whole payment upon voluntary redemption prior to maturity.
  - No make-whole provision in 2026 Notes. Instead, indenture provided that notes may not be redeemed prior to their stated maturity date.

- Facts (cont’d):
  - Proposed Settlement Terms:
    - 2016 Notes: 42% of the Make-Whole 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.
5. Treatment of settlements regarding make-whole premium (cont’d)

_In re Chemtura Corp._, 439 B.R. 561 (Bankr. S.D.N.Y. 2010)

- Decision:
  - Court approved proposed settlement terms regarding make-whole for 2016 Notes and damage claim for 2026 Notes under Bankruptcy Rule 9019.
    - Bankruptcy Rule 9019 settlement standard: “lowest point in the range of reasonableness.”
    - Reasonable in light of split in case law.
  - Balanced decision between _Calpine I, Calpine II, In re Solutia_, and _Premier Entertainment Biloxi_.

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The Enforceability of “Make-Whole” Premiums after _Momentive_ and _EFH_
5. Treatment of settlements regarding make-whole premium (cont’d)

Chemetra Roadmap: Analysis of Make-Whole Provisions

- Was the make-whole provision triggered under the agreement as a matter of state law?
  - Yes
    - Are damages claimed enforceable under state law?
      - No
        - No damage claims allowed.
      - Yes
        - Reduce damage amount to comply with state law or disregard the provision?
          - Disregard provision.
            - No damage claims allowed.
          - Reduce damage amount.
  - No
    - No damage claims allowed.

- Are claims arising under make-whole provisions proxies for unmatured interest?
  - Yes
    - Is the debtor solvent?
      - No
        - Is the make-whole provision enforceable under bankruptcy law? (Is the amount “reasonable”?)
          - No
            - No damage claims allowed.
          - Yes
            - Allow make-whole damages as unsecured claims, to the extent enforceable under state law.
              - State law analysis
              - Bankruptcy law analysis
  - No
    - Is the debtor solvent?
      - No
        - Is the make-whole provision enforceable under bankruptcy law? (Is the amount “reasonable”?)
          - No
            - No damage claims allowed.
          - Yes
            - Allow make-whole damages as secured claims.

Source: Practical Law
5. Treatment of settlements regarding make-whole premium (cont’d)

Chemtura Roadmap: Analysis of No-Call Provisions

- Was the no-call provision breached under the agreement as a matter of state law?
  - Yes
    - Determine appropriate damages under state law.
  - No
    - No damage claims allowed.

- Are damages recoverable under no-call provisions, which are unenforceable in bankruptcy?
  - No
    - No damage claims allowed.
  - Yes
    - Are claims arising under no-call provisions proxies for unmatured interest?
      - No
        - Is the debtor solvent?
          - Yes
            - State law analysis
          - No
            - Bankruptcy law analysis
      - Yes
        - Allow no-call damages as unsecured claims to the extent enforceable under state law
        - No
          - No damage claims allowed.

Source: Practical Law
6. Effect of voluntary default by borrower/issuer on make-whole premium
6. Effect of voluntary default by borrower/issuer on make-whole premium

Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039 (2d Cir. 1982)

• Facts:
  - UV Industries, Inc. (“UV”) issued debt under 5 separate debentures indentures between 1965 and 1977.
  - Each indenture:
    - Permitted redemption prior to maturity for a fixed redemption price (principal, accrued interest, and redemption premium)
    - Provided acceleration as a non-exclusive remedy for default
    - Contained a “successor obligor” provision that allowed UV to assign debt to purchaser of “all or substantially all” assets, or else pay off the debt
6. Effect of voluntary default by borrower/issuer on make-whole premium

Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039 (2d Cir. 1982)

• Facts (cont’d):
  - March 1979: UV shareholders approved liquidating plan and sale of one of UV’s lines of business (44% of book value of assets).
  - April 1979: UV agreed to set aside a $155 million cash fund to satisfy the indenture debt.
  - November 1979: Sharon Steel Corp. bought all of UV’s remaining assets (51% of book value of assets).
  - UV sought to assign its indenture debt to Sharon Steel under the successor obligor provision; Indenture Trustees refused to accept assignment.
  - Not a bankruptcy case
6. Effect of voluntary default by borrower/issuer on make-whole premium

Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039 (2d Cir. 1982)

• District Court Decision:
  ➢ UV was not allowed to assign its indenture debt to Sharon Steel.
  ➢ Indenture debt was immediately due and payable.
  ➢ No claim by Indenture Trustees for redemption premiums.
  ➢ Constructive trust for $155 million to satisfy the indenture debt.
6. Effect of voluntary default by borrower/issuer on make-whole premium

Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039 (2d Cir. 1982)

• Second Circuit Decision:
  - Affirmed in part and reversed in part lower court’s decision.
  - Successor obligor clauses in debenture indentures are “boilerplate” provisions whose meaning is standardized and uniform.
    - Public debt cannot be assigned to another party in a liquidation unless “all or substantially all” assets are transferred to a single purchaser when liquidation plan is determined.
  - UV defaulted under the indentures by seeking to liquidate in March 1979 without assignment or payoff, and then seeking to assign debt to Sharon Steel.
6. Effect of voluntary default by borrower/issuer on make-whole premium

Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039 (2d Cir. 1982)

- Second Circuit Decision (cont’d):
  -Indenture Trustees were entitled to redemption premiums.
  -Acceleration provisions are explicitly permissive and non-exclusive.
  -Because UV voluntarily failed to take the requisite steps to pay off or assign the debt in March 1979, it voluntarily triggered a default.
  -A debtor/issuer who voluntarily triggers a default and allows the holders to accelerate the debt cannot escape the requirement to pay the redemption premium.

- Facts:
  - In 2013, Cash America completed a private offering of $300 million in notes due in 2018.
    - Indenture prohibited, among other things, sale of more than 10% of the company’s “consolidated total assets.”
    - In the event of default (except if the default is caused by a bankruptcy filing), indenture trustee had the option of:
      1. Accelerating the notes and making principal and interest immediately due and payable, or
      2. Pursue any other available remedy, including specific performance
6. Effect of voluntary default by borrower/issuer on make-whole premium (cont’d)


- **Facts (cont’d):**
  - Indenture also allowed Cash America the option to redeem the notes before the maturity date in exchange for a redemption premium.
  - In 2014, Cash America effectuated a tax-free spin-off of its e-commerce business “Enova” (which generated approximately 39% of Cash America’s revenue).
    - Cash America sold 80% of Enova’s outstanding shares of common stock
  - Noteholders declared default under indenture.
  - Instead of accelerating the debt, noteholders sought redemption premium.
  - Not a bankruptcy case.
6. Effect of voluntary default by borrower/issuer on make-whole premium (cont’d)


- Decision:
  - Cash America defaulted on the indenture when it spun off 80% of Enova business because 80% of 39% book value exceeds the 10% threshold.
    - “Book value of all assets” does not mean “assets minus liabilities”
  - New York’s law of “perfect tender”
  - In the event of default (except default by bankruptcy filing), trustee can, _but is not required to_, accelerate the notes.
    - If debt is accelerated, lenders cannot collect make-whole premium (cites _Momentive_ bankruptcy court decision)
6. Effect of voluntary default by borrower/issuer on make-whole premium (cont’d)


- Decision (cont’d):
  - Where default is caused by issuer’s voluntary action (i.e., spin-off), _Sharon Steel_ controls and trustee has the option of choosing its remedy (including specific performance of the optional redemption provision and payment of make-whole premium)
  - _Sharon Steel_ does not require showing of “bad faith conduct” or “intent”
    - voluntary action (e.g., liquidation, spin-off) vs. involuntary action (e.g., bankruptcy filing)
  - Court directed the parties to meet and confer to calculate redemption price

- District Court’s decision is currently on appeal in Second Circuit
7. Effect of automatic acceleration on make-whole premium

Part A: When there is an explicit provision
7. Effect of automatic acceleration on make-whole premium: Part A – Explicit

**U.S. Bank Trust N.A. v. AMR Corp. (In re AMR Corp.), 730 F.3d 88 (2d Cir. 2013)**

- **Facts:**
  - In 2009 and 2011, American Airlines entered into three note indentures with U.S. Bank, each of which was secured by designated aircraft.
  - Indentures provided that make-whole premium is due upon voluntary redemption, but no make-whole premium is due upon event of default or upon acceleration.
  - In November 2011, American filed for bankruptcy.
    - American elected, pursuant to 11 U.S.C. § 1110(a), to continue to perform its obligations under the indentures.
  - In October 2012, American sought court authority to refinance the notes without paying the make-whole premiums.
U.S. Bank Trust N.A. v. AMR Corp. (In re AMR Corp.), 730 F.3d 88 (2d Cir. 2013)

• Facts (cont’d):
  ➢ U.S. Bank, as indenture trustee, argued:
    ❖ American must pay make-whole premiums to refinance the notes
    ❖ Automatic acceleration provisions for bankruptcy filings are unenforceable
    ❖ U.S. Bank should be granted relief from the automatic stay to waive default and decelerate the notes
    ❖ American did not comply with its § 1110(a) election because it did not pay the full accelerated amount due

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7. Effect of automatic acceleration on make-whole premium: Part A – Explicit (cont’d)

U.S. Bank Trust N.A. v. AMR Corp. (In re AMR Corp.), 730 F.3d 88 (2d Cir. 2013)

• Bankruptcy Court decision:
  ➢ Granted American authority to refinance notes.
  ➢ Denied U.S. Bank’s request for relief from stay to waive default and decelerate notes.
  ➢ American does not owe make-whole premium.
  ➢ American’s proposed refinancing is not a voluntary redemption of the notes.
  ➢ American complied with its § 1110(a) election by making regularly scheduled principal and interest payments.
7. Effect of automatic acceleration on make-whole premium: Part A – Explicit (cont’d)

U.S. Bank Trust N.A. v. AMR Corp. (In re AMR Corp.), 730 F.3d 88 (2d Cir. 2013)

• Second Circuit decision:
  ➢ Affirmed bankruptcy court decision.
  ➢ American’s voluntary bankruptcy filing was an event of default under the indentures and triggered the automatic acceleration of the notes that made the notes immediately due and payable (without the make-whole).
    ❖ Automatic acceleration provision does not provide trustee with the option to elect acceleration; it is self-operative.
    ❖ Relief from stay to decelerate notes would allow U.S. Bank to receive more from the estate than it could have received as of the filing.
    ❖ 2012 refinancing is a post-maturity date repayment, not a prepayment that would trigger the make-whole premium.
7. Effect of automatic acceleration on make-whole premium: Part A – Explicit (cont’d)


• Facts:
  ➢ In 1997, GC Merchandise Mart (“GCMM”) signed a promissory note in favor of Bank of New York Mellon (“Lender”) in exchange for $30 million loan, which included the following provisions:
    ❖ Default and acceleration provision that made principal, interest, and other amounts owed under the Note immediately due and payable in the event of default.
    ❖ Prepayment provision that required GCMM to pay prepayment consideration if GCMM prepays the Note.
  ➢ In 2010, GCMM stopped making regularly scheduled payments and defaulted on the Note.
7. Effect of automatic acceleration on make-whole premium: Part A – Explicit (cont’d)


• Facts (cont’d):
  ➢ Lender obtained an order appointing a receiver.
  ➢ GCMM and its subsidiaries and affiliates filed bankruptcy petitions.
  ➢ GCMM owed approximately $24 million to Lender.
  ➢ Prepayment consideration was valued at $1.8 million.
  ➢ Colorado law governs the Note.

- Bankruptcy Court decision:
  - Some payment – voluntary or involuntary – must actually be made to trigger the prepayment obligation.
  - Acceleration provision should specifically provide that acceleration triggers the prepayment obligation.
    - It is easy to expressly provide for prepayment premium in the event of acceleration.
  - Court disallowed $1.8 million prepayment consideration.
  - District Court affirmed.
7. Effect of automatic acceleration on make-whole premium: Part A – Explicit (cont’d)


• Fifth Circuit decision:
  ➢ Affirmed lower court decisions: no prepayment consideration is due.
  ➢ Under Colorado law:
    ❖ Lender has the right to refuse prepayments without prepayment premium.
    ❖ Unless the contract specifically provides otherwise, lender cannot collect prepayment premium if lender accelerates the note, unless borrower intentionally defaulted to avoid additional interest.
    ❖ Prepayment premium/penalty is not liquidated damages: not subject to reasonableness standard and 11 U.S.C. § 506(b).

- Fifth Circuit decision (cont’d):
  - The Note requires payment of the prepayment consideration only upon prepayment.
    - Here, there was no prepayment.
  - The Note could have specifically stated that upon acceleration, the prepayment premium also becomes immediately due and payable.
    - Here, the Note does not contain such language.
7. Effect of automatic acceleration on make-whole premium

**Part B:** When debt documents are silent
7. Effect of automatic acceleration on make-whole premium: Part B – Silence

_Florida Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.), 842 F.3d 247 (3d Cir. 2016)_

- **Facts:**
  - Pre-bankruptcy, EFIH issued first-lien notes due in 2020 and second-lien notes due in 2021 and 2022.
    - Redemption provision in each indenture requires make-whole payment if EFIH opts to redeem notes before maturity.
    - Acceleration provision in each indenture automatically makes all outstanding notes immediately due and payable if EFIH files a bankruptcy petition. Second-lien indenture also makes premium due.
  - In 2013, EFIH filed a Form 8–K disclosing its proposal to file for bankruptcy and refinance the notes without the need to pay the make-whole premiums.
7. Effect of automatic acceleration on make-whole premium: Part B – Silence (cont’d)

*Delaware Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.), 842 F.3d 247 (3d Cir. 2016)*

- Bankruptcy Court and District Court decisions:
  - In 2014, EFIH filed voluntary bankruptcy petitions, which triggered the automatic acceleration provisions in the indentures.
  - Bankruptcy Court authorized EFIH to refinance notes post-petition.
  - EFIH was not required to pay the make-whole premiums.
  - Bankruptcy Court relied on *Momentive* decisions.
  - District Court affirmed bankruptcy court’s ruling.
Delaware Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.), 842 F.3d 247 (3d Cir. 2016)

- Third Circuit decision:
  - Reversed bankruptcy court and district court decisions.
  - Note holders are entitled to make-whole premiums.
  - EFIH’s post-petition refinancing is an optional redemption before maturity that triggers make-whole obligation, notwithstanding the automatic acceleration of the notes upon EFIH’s bankruptcy filing.
  - Court distinguished between “redemption” and “prepayment” premium.
    - Automatic acceleration did not automatically cancel EFIH’s obligation to pay the make-whole premium triggered by early redemption.
    - Debt documents should explicitly provide that acceleration terminates the availability of make-whole premium.
7. Effect of automatic acceleration on make-whole premium: Part B – Silence (cont’d)

*Delaware Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.), 842 F.3d 247 (3d Cir. 2016)*

- Current status:
  - EFIH petitioned Third Circuit for rehearing: certify redemption vs. prepayment premium to NY’s Court of Appeals, or wait until Second Circuit decides *Momentive* appeal.
    - Approximately $900 million in make-whole premiums at stake.
  - EFH amended its chapter 11 plan three times since Third Circuit’s ruling.
    1. Full payment
    2. Settlement for substantial recoveries
    3. Claims reserve for make-whole premiums and make-whole litigation committee to oppose Third Circuit’s ruling
  - Plan confirmation hearing is scheduled to begin on February 14, 2017.
7. Effect of automatic acceleration on make-whole premium: Part B – Silence (cont’d)


• Facts:
  - In 2010, Momentive added to its existing capital structure and issued second-lien notes.
    - Indenture provided for a make-whole premium is notes were redeemed before October 2015.
    - Indenture provided that if Momentive voluntarily filed for bankruptcy, notes would be automatically accelerated and “principal, premium if any, and interest” would become immediately due and payable.
  - Momentive’s chapter 11 plan provided for no make-whole premium.
7. Effect of automatic acceleration on make-whole premium: Part B – Silence (cont’d)


- Bankruptcy Court decision:
  - Lender forfeits right to demand prepayment premium if lender has accelerated the loan unless:
    - intention default by debtor, or
    - clear and unambiguous clause requires prepayment premium notwithstanding acceleration.
  - Court treats make-whole “prepayment” premiums and make-whole “redemption” premiums interchangeably.
  - Momentive owed no make-whole redemption premium.
7. Effect of automatic acceleration on make-whole premium: Part B – Silence (cont’d)


• District Court decision:
  - Note holders not entitled to make-whole premium following acceleration of notes.
  - Indenture must clearly and unambiguously preserve a holder’s entitlement to make-whole premium in the event of acceleration (including automatic acceleration).
  - Court found acceleration provision in Momentive indenture providing that the “premium, if any” would become immediately payable upon acceleration ambiguous.
  - Court treated prepayment and optional redemption interchangeably.

- Current status:
  - Note holders appealed district court’s decision to Second Circuit.
    - Argued that acceleration triggered by Momentive’s bankruptcy filing did not cancel holders’ right to receive the make-whole premium, and that holders’ contractual right to rescind acceleration should not be prevented by the automatic stay.
  - Arguments were heard on November 9, 2016.
  - Following the Third Circuit’s EFH decision, each side submitted letters to the Second Circuit in further support of their respective positions.
  - The Second Circuit has not yet issued its decision.
Summary of Takeaways regarding Make-Whole Premiums
Takeaways regarding Make-Whole Premiums

• Negotiation of debt documentation:
  ➢ Lenders/Investors may seek:
    ❖ explicit provisions for the payment of make-whole premium after acceleration for any reason, including commencement of a bankruptcy proceeding
    ❖ explicit text providing that lenders/investors are entitled to cumulative remedies to the maximum extent permitted by law
  ➢ Issuers may seek to include explicit language that makes it clear that no make-whole premium is applicable
Takeaways regarding Make-Whole Premiums (cont’d)

*From a Lender/Investor’s perspective generally:*

- **Pre-bankruptcy, there are advantages to:**
  - Accelerating the debt pre-bankruptcy.
  - Getting actively involved in pre-bankruptcy workout negotiations.
    - Not bulletproof, but may put lender/investor in a better position than just relying on creative lawyering after bankruptcy case commences.

- **Jurisdiction:**
  - Avoid Louisiana; possibly also Colorado.

- **Settlements:**
  - Premium should be included in settlement supported by the debtor.

- **Debtor’s Solvency:**
  - Better result if debtor is solvent.
## Takeaways regarding Make-Whole Premiums (cont’d)

### Enforceability of Make-Whole Premium following *EFH* (3rd Circuit)

<table>
<thead>
<tr>
<th>Provisions Included in Debt Documents</th>
<th>Pro Borrower &amp; Issuer</th>
<th>Pro Lender &amp; Noteholder</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><em>(less likely that make-whole will be enforced)</em></td>
<td><em>(more likely that make-whole will be enforced)</em></td>
</tr>
<tr>
<td>Make-whole triggered by “prepayment.”</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Make-whole triggered by “redemption.”</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Make-whole is explicitly triggered by “redemption” before the original maturity date, notwithstanding acceleration.</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Make-whole is a “redemption” premium and acceleration does not affect the original maturity date.</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Upon acceleration (including automatic acceleration triggered by bankruptcy filing), all outstanding debt/notes, accrued and unpaid interest, and make-whole premium become immediately due and payable.</td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>
## Takeaways regarding Make-Whole Premiums (cont’d)

<table>
<thead>
<tr>
<th>Provisions Included in Debt Documents (cont’d)</th>
<th>Pro Borrower &amp; Issuer</th>
<th>Pro Lender &amp; Noteholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acceleration explicitly terminates obligation to pay make-whole premium.</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Acceleration explicitly does not terminate obligation to pay make-whole premium.</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Make-whole is a &quot;prepayment&quot; premium and debt documents are silent about the effect of acceleration on the make-whole premium.</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Make-whole is a “redemption” premium and debt documents are silent about the effect of acceleration on the make-whole premium.</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Make-whole is a “redemption” premium and acceleration explicitly terminates right to optional redemption.</td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>
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Professional Profiles
Alan Bannister is a partner in the New York office of Gibson, Dunn & Crutcher and a member of the Firm’s Capital Markets, Global Finance and Securities Regulation and Corporate Governance Practice Groups.

Mr. Bannister concentrates his practice on securities and other corporate transactions, acting for underwriters and issuers (including foreign private issuers), as well as strategic or other investors, in high yield, equity (including ADRs and GDRs), and other securities offerings, including U.S. public offerings, Rule 144A offerings, other private placements and Regulation S offerings, as well as re-capitalizations, NYSE and NASDAQ listings, shareholder rights offerings, spin-offs, PIPEs, exchange offers, other general corporate transactions and other advice regarding compliance with U.S. securities laws, as well as general corporate advice. Mr. Bannister also advises issuers and underwriters on dual listings in the U.S. and on various exchanges across Europe, Latin America and Asia.

Mr. Bannister also regularly advises companies in connection with cross-border equity tender offers. In addition, he also advises companies and dealer-managers on liability management transactions (including debt tenders, exchange offers and consent solicitations). Further, he has extensive corporate and securities experience in connection with corporate restructuring, routinely advising companies, creditors and hedge funds in connection with debt exchange offers, high yield refinancing, rescue rights offerings and other capital infusions (and the related liquidity issues for such investments).

Mr. Bannister regularly advises U.S. and non-U.S. registrants on their reporting obligations under the U.S. Securities Exchange Act of 1934, their obligations under the Sarbanes-Oxley Act, the Dodd Frank Act and stock exchange corporate governance requirements, as well as (for U.S. registrants) advising on other Exchange Act issues relating to Regulation FD, Section 16 and the proxy statement requirements of Regulation 14A.

Mr. Bannister received his Juris Doctor, *summa cum laude*, from the University of Alabama in 1988, where he was a member of the Order of the Coif, articles editor for the *Alabama Law Review* and a Hugo Black Scholar. He received a B.S. (Accounting) from Auburn University in 1984. Alan is a member of the Board of Trustees for the University of Alabama School of Law Foundation, and is a frequent writer and speaker on securities laws matters.
Robert A. Klyman is a partner in the Los Angeles office of Gibson, Dunn & Crutcher and Co-Chair of Gibson Dunn's Business Restructuring and Reorganization Practice Group. Mr. Klyman represents debtors, acquirers, lenders and boards of directors. His experience includes advising debtors in connection with traditional, prepackaged and "pre-negotiated" bankruptcies; representing lenders and other creditors in complex workouts; counseling strategic and financial players who acquire debt or provide financing as a path to take control of companies in bankruptcy; structuring and implementing numerous asset sales through Section 363 of the Bankruptcy Code; and litigating complex bankruptcy and commercial matters arising in chapter 11 cases, both at trial and on appeal.

Mr. Klyman has been widely and regularly recognized for his debtor and lender work as a leading bankruptcy and restructuring attorney by Chambers USA; named as one of the world's leading Insolvency and Restructuring Lawyers by Euromoney; listed in the K&A Restructuring Register, a leading peer review listing, as one of the top 100 restructuring professionals in the United States; named as a "Top Bankruptcy M&A Lawyer" by The Deal's Bankruptcy Insider; named as one of the 12 outstanding bankruptcy lawyers in the nation under the age of 40 (in 1999, 2000, 2002 and 2004) by Turnarounds & Workouts; and one of "20 lawyers under 40" to watch in California by the Daily Journal. Mr. Klyman was recently selected by his peers for inclusion in The Best Lawyers in America© 2017 in the field of Bankruptcy and Creditor Debtor Rights.

Mr. Klyman developed, and for the past 17 years co-taught, a case study for the Harvard Business School on prepackaged bankruptcies and bankruptcy valuation issues. He has also taught classes on dealmaking in the bankruptcy courts at the University of Michigan Business School and UCLA Law School. Mr. Klyman is also a member of the ABA Subcommittee responsible for drafting a Model Bankruptcy Asset Purchase Agreement.

Mr. Klyman received both his J.D. from the University of Michigan Law School in 1989 and his B.A. degree from the University of Michigan in 1986. Mr. Klyman is admitted to the California Bar. Prior to joining Gibson Dunn, Mr. Klyman was a partner at the firm of Latham & Watkins for more than 17 years.
Matthew J. Williams is a partner in the New York office of Gibson, Dunn & Crutcher and is a member of Gibson Dunn's Business Restructuring and Reorganization Practice Group. He represents financial institutions, creditor groups, committees and debtors in complex restructurings. Mr. Williams has been consistently ranked among the top Bankruptcy and Restructuring lawyers in New York by Chambers USA: America's Leading Lawyers for Business for his “exemplary legal skills, superb intelligence and exceptional forward-thinking,” his “winning combination of business acumen and legal expertise,” his ability to “give an opinion as opposed to just spotting issues” and his “detail-oriented approach.” He is praised by creditor and bondholder clients as a “fantastic young partner who gets the issues, is great at working with hedge funds, and understands the way we think about the world” and someone who “gives good commercial and practical advice.” Mr. Williams was named a Law360 “MVP” in Bankruptcy for 2015 – one of ten “elite attorneys” recognized – for his “successes in record-breaking deals and complex global matters.” In 2010, he was recognized as one of 12 “Outstanding Young Restructuring Lawyers” in the nation by Turnaround & Workouts Magazine. That same year, Law360 called him one of the “Rising Stars” in restructuring and “one of the 10 bankruptcy attorneys under 40 to watch.”

Mr. Williams has taken a lead role in numerous high-profile restructurings and cross-border proceedings including Triangle USA Petroleum Corporation (Ad Hoc Bondholder Group); Puerto Rico Electric Power Authority (Bondholder in connection with successful challenge to Puerto Rico’s bankruptcy statute); The Sports Authority (Chapter 11 Debtor); Brookstone Holdings Corp. (Plan Sponsor and purchaser of 100% of equity); Arcapita Bank (Chapter 11 Debtor); General Motors (Trustee for $23 billion in bonds and Liquidating Trustee administering wind down of estate); Dynegy (Subordinated Noteholders); Nortel (363 Bidder); Trident Resources (Ad Hoc Lender Group and Backstop Party); CIT Group (Trustee for $2 billion in bonds); Ambassadors’ Cruise Group (Secured Lenders and Stalking Horse Purchaser); Loehmann’s Department Stores (Secured Lender, Rights Offering Backstop Party and Plan Sponsor); General Growth Properties (DIP Lender); Vitesse Semiconductor (Ad Hoc Bondholder Group); Dana Corporation (Official Creditors’ Committee); Footstar Corporation (Official Equity Committee); and Leap Wireless (Official Creditors’ Committee).

In addition, a significant component of Mr. Williams practice consists of his representation of numerous hedge funds in connection with their analyses of complex capital structures and their investments in distressed situations. He has written numerous articles discussing debt recharacterization, purchasing claims in distressed companies and issues involving official committees. He is the author of a book chapter regarding international insolvency and Chapter 15 of the Bankruptcy Code, and his insights on bankruptcy and business issues have been frequently cited in numerous publications and by numerous organizations, including the Wall Street Journal, Bloomberg Business News, Law360 and others.

Mr. Williams received his Juris Doctor, with high honors, from Rutgers University School of Law. He obtained his Bachelor of Arts degree from the College of New Jersey, cum laude. Mr. Williams clerked for the Honorable Francis G. Conrad, in the U.S. Bankruptcy Court, District of Vermont, following law school. He is admitted to practice law in New York.
Sabina Jacobs is an associate in the Los Angeles office of Gibson, Dunn & Crutcher. She is a member of the Business Restructuring and Reorganization and Global Finance practice groups. Ms. Jacobs practices in all aspects of corporate reorganization and handles a wide range of bankruptcy and restructuring matters, representing debtors, lenders, equity holders, and strategic buyers in chapter 11 cases, sales and acquisitions, bankruptcy litigation, and financing transactions. Ms. Jacobs also represents borrowers, sponsors, and lending institutions in connection with acquisition financings, secured and unsecured credit facilities, asset-based loans, and debt restructurings.

Recent Representative Bankruptcy Matters
• Sports Authority Holdings, Inc. and its subsidiaries in their chapter 11 cases in the Bankruptcy Court for the District of Delaware (currently pending).
• The Yucaipa Companies in the Fresh & Easy, LLC chapter 11 case in the Bankruptcy Court for the District of Delaware.
• The Standard Register Company and its subsidiaries in their chapter 11 cases in the Bankruptcy Court for the District of Delaware.

Recent Representative Finance Matters
• A major transportation and logistics company in the financing for the purchase of a strategic acquisition and its subsequent refinancing.
• A global footwear manufacturer and its subsidiaries in a complex restructuring.
• A real estate investment and development company in a refinancing in connection with the acquisition of a hotel.

Prior to joining Gibson Dunn, Ms. Jacobs served as the law clerk to the Honorable Brendan L. Shannon of the United States Bankruptcy Court for the District of Delaware from 2010 to 2011 and was an associate with Latham & Watkins LLP from 2011 to 2014. Ms. Jacobs earned her Juris Doctor *cum laude* in 2010 from Loyola Law School, Los Angeles, where she served as Editor-in-Chief of the *Loyola of Los Angeles Law Review* and was elected to the Order of the Coif. While in law school, she also held judicial externships with the Honorable Richard M. Neiter and the Honorable Thomas B. Donovan, both of the United States Bankruptcy Court for the Central District of California.

Most recently, Ms. Jacobs is the author of “Possible Make-Over for Make-Wholes After EFH Decision,” which is published in the January 2017 issue of the *American Bankruptcy Institute Journal*. She also served as a staff attorney for the ABI Commission to Study the Reform of Chapter 11 and edited the *Final Report and Recommendations* of the ABI Commission.