

## In *Hertz*, the Delaware Bankruptcy Court Provides Guidance on Make-Whole Claims and Post-Petition Interest Payable in Solvent Debtor Cases

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On December 22, 2021, in a memorandum opinion on a motion to dismiss, the Bankruptcy Court for the District of Delaware (the "*Bankruptcy Court*") (i) provided further guidance as to what qualifies as "voluntary" redemption of debt for purposes of make-whole claims, (ii) held that, without more, a make-whole payment is not triggered by a redemption automatically resulting from a voluntary bankruptcy filing, if the governing contract only provides for payment of such premium prior to "maturity" and (iii) determined that neither the Bankruptcy Code nor the "solvent debtor exception" requires a solvent debtor to pay an unimpaired unsecured creditor post-petition interest at the applicable contract rate, finding that payment of interest at the federal judgment rate is sufficient. The Bankruptcy Court left open whether make-whole claims could be disallowed as unmatured interest.

### Background

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The Hertz Corporation and its affiliates ("*Hertz*") had its plan of reorganization (the "*Plan*") confirmed by the Bankruptcy Court in June 2021. The Plan classified four series of unsecured notes (respectively, the "*2022 Notes*", "*2024 Notes*", "*2026 Notes*" and "*2028 Notes*", and together, the "*Notes*") as unimpaired. Wells Fargo Bank, N.A. and US Bank, as indenture trustees under the Notes (the "*Trustees*"), disagreed with such classification, arguing, in an adversary complaint, that the Notes could not be considered unimpaired unless make-whole premiums under the Notes were paid to holders, together with post-petition interest on the Notes at the applicable contract rate. Hertz moved to dismiss the Trustees' claims.

### The Bankruptcy Court's Decision

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#### ***Make-Whole - Voluntariness***

Readers of our past client alerts on make-whole premiums, which are linked below,<sup>1</sup> will know that the Third Circuit, in *In re Energy Future Holdings Corp.* ("*EFH*"), has expressly held that a redemption of notes automatically triggered by a bankruptcy filing may trigger payment of a make-whole premium, even if the relevant acceleration provision of the notes does not expressly provide for such payment.<sup>2</sup> In so holding, the *EFH* court found that redemption provisions requiring "optional redemption" can be triggered by voluntary bankruptcy filings because even if the acceleration of the applicable notes is not itself voluntary, the filing is.

Here, Judge Walrath, following this holding of *EFH* (which is binding on all Delaware bankruptcy courts), held that while the acceleration provisions of the Notes failed to expressly provide for payment of a make-whole premium, the Notes' optional redemption provisions could, standing alone, require payment of a make-whole premium because Hertz voluntarily filed for bankruptcy and always had the option to reinstate the Notes. In so holding, the Bankruptcy Court rejected Hertz's attempt to draw a distinction between the present case and *EFH* on the basis that *EFH* filed for bankruptcy as part of a strategic attempt to avoid payment of a redemption premium.

Finally, Hertz argued that it was forced to file bankruptcy as a result of the prevailing COVID-19 pandemic, had no real choice to redeem the Notes given that the Plan presented the best outcome for all stakeholders in the case, and that reinstating the Notes would have put its entire reorganization in jeopardy. The Bankruptcy Court disagreed, explaining that even if the Plan presented the best outcome, the choice to file and not to reinstate the Notes was nevertheless voluntary.

### ***Make-Whole – Timing of Redemption***

The Bankruptcy Court then turned to Hertz's argument that even if its redemption of the Notes was voluntary, no make-whole premium could be due based on the terms of the indentures governing the Notes because they were not redeemed *prior* to their maturity, but rather *at the same time* as their maturity upon Hertz's bankruptcy filing.

The Bankruptcy Court agreed that for the 2022 Notes and 2024 Notes, the relevant redemption provisions only provided for a make-whole premium payable *prior* to "maturity" (including maturity upon a bankruptcy filing), and therefore no make-whole premium was due. The Bankruptcy Court reached this conclusion on the basis that while the relevant indentures elsewhere contained a defined term for "Stated Maturity" (being the original 2022 and 2024 maturity dates of the applicable Notes), the redemption provisions instead used the undefined term "maturity". The Bankruptcy Court concluded that with respect to the 2022 Notes and the 2024 Notes, and in applying the common meaning of "maturity" from the specific redemption provisions rather than the defined "Stated Maturity" appearing elsewhere in these indentures, Hertz redeemed such Notes on the date of their maturity, as accelerated by the bankruptcy, and therefore there was no redemption *prior* to maturity.

In contrast, the Bankruptcy Court found that the redemption provisions of the indentures governing the 2026 Notes and 2028 Notes included a further provision providing for a make-whole premium payable upon redemption occurring at any time prior to a specified date (and not only prior to "maturity"), which date had not occurred before Hertz's petition date. Accordingly, because Hertz redeemed the 2026 Notes and 2028 Notes (as a result of automatic acceleration triggered by the bankruptcy filing) prior to the make-whole redemption date specified in the relevant indentures, Judge Walrath held that the petition date redemption *could* trigger payment of a make-whole premium on the 2026 Notes and 2028 Notes.

### ***Make-Whole – Potential Disallowance as Unmatured Interest***

While the Bankruptcy Court allowed the Trustees' make-whole claims under the 2026 Notes and the 2028 Notes to survive dismissal, Judge Walrath left open the possibility that such claims could nevertheless end up being disallowed as "unmatured interest" under the Bankruptcy Code. While the Bankruptcy Court noted that most courts that have addressed this issue have determined not to treat make-whole premiums as unmatured interest, it was not prepared to conclude that make-wholes cannot be disallowed on this basis. The Bankruptcy Court will instead hear fact evidence as to whether or not the relevant make-whole premiums could be said to constitute the economic equivalent of unmatured interest and be disallowed as such.

### ***Creditor Entitlement to Post-Petition Interest in Solvent Debtor Cases***

Turning to the Trustees' claim that they are owed post-petition interest on the Notes at the applicable contract rate as unimpaired, unsecured creditors in a solvent debtor case, the Bankruptcy Court (i) rejected the Trustees' argument that the Bankruptcy Code<sup>3</sup> requires a plan of reorganization to leave creditors' legal, equitable and contractual rights unchanged in order for such creditors to be considered unimpaired and (ii) further rejected the Trustees' argument that the so-called "solvent debtor exception," a judge-made equitable doctrine, required as a matter of equity that the holders of the Notes and similarly situated unimpaired, unsecured creditors of Hertz, as a solvent debtor, be provided their full contractual payment rights.

Rather, Judge Walrath adopted a more limited interpretation of the solvent debtor exception, holding that unimpaired, unsecured creditors of a solvent debtor are only entitled to post-petition interest at the federal judgment rate. In so doing, the Bankruptcy Court emphasized that its holding should be understood to be limited only to the issue of what post-petition interest unimpaired creditors must receive in the rare case where a chapter 11 debtor proves to be solvent and their claims are being paid in full in cash on the effective date of the plan.

## **Conclusion**

As before *Hertz*, the question of whether a particular make-whole provision is enforceable in a given case will continue to be fact specific, and the language of the underlying loan documents will still be ground zero for the battle over the enforceability of make-whole premiums. Creditors wishing to preserve their right to make-whole premiums

should continue to use clear and explicit language describing the circumstances under which the premiums must be paid.

While courts are not universally aligned on the treatment of unsecured creditors in solvent debtor cases, those finding themselves in the Bankruptcy Court in Delaware should also be aware that they likely will not be able to receive interest at their applicable contract rates, but will instead be required to accept interest payable at the generally lesser federal judgment rate.

## For More Information

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- 1 See *Is Momentive Losing Momentum?* (November 22, 2016); *Make-Whole Update: Texas Bankruptcy Court Awards Unsecured Bondholders' 'Enormous' Make-Whole Claim, with Interest, Over Solvent Debtors' Objection* (October 19, 2017); *Momentive vs. EFIH: Second Circuit Splits with Third Circuit on Make-Whole; Keeps Pressure on Lenders to Negotiate Express Make-Whole Provisions* (October 30, 2017); *Fifth Circuit Declines to Enforce Make-Whole Provisions in Bankruptcy* (March 12, 2019). *In re Energy Future Holdings Corp.*, 842 F. 3d. 247 (3d Cir. 2016).
  - 2 *In re Energy Future Holdings Corp.*, 842 F. 3d. 247 (3d Cir. 2016).
  - 3 The Bankruptcy Code is silent on what treatment unimpaired creditors must receive in a solvent chapter 11 debtor case.

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