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Chapman Client Alert

February 29, 2016 Current Issues Relevant to Our Clients

Make-Whole Update: Delaware District Court Follows New York's Lead in Disallowing Make-Whole Premium in Bankruptcy — Dispute Moves to Third Circuit

On February 16, 2016, the District Court for the District of Delaware (the "District Court") affirmed the decision of the Delaware bankruptcy court (the "Bankruptcy Court") in *In re Energy Future Holdings Corp.*,[1] that noteholders' claims for make-whole premiums may be blocked by the automatic stay of the U.S. Bankruptcy Code (the "Bankruptcy Code").[2] As previously discussed in Chapman and Cutler's July 23, 2015 Client Alert analyzing the Bankruptcy Court's decision (the "Client Alert"), courts have been requiring clear and unambiguous language in credit documents before awarding noteholders any amounts on account of a make-whole premium or other similar liquidated damages provisions upon a debt prepayment.[3] The District Court's decision follows this trend. The noteholders have now appealed the District Court's decision and the U.S. Circuit Court for the Third Circuit has now been tasked with deciding the issue.

Background

In a July 8, 2015 decision, the Bankruptcy Court decisively rejected arguments brought by the noteholders that "cause" existed to lift the automatic stay to allow the noteholders to waive a default and decelerate debt following an automatic bankruptcy acceleration.[4] Such deceleration would have entitled the noteholders to a make-whole premium upon a proposed early repayment of the notes in question. As more fully discussed in the Client Alert, the underlying dispute related to almost $3.5 billion of secured notes that had been issued by Energy Future Intermediate Holding Company, LLC and EFIH Finance, Inc. (collectively, "EFIH"). The Indenture under which the notes were issued provided that EFIH may only redeem the Notes prior to December 1, 2015, if EFIH pays an "Applicable Premium" to the holders. The Indenture, additionally provided that upon an event of default, including a bankruptcy filing, the amounts due under the Indenture would automatically accelerate and become due and owing in full. The Indenture also permitted a majority of holders to rescind any acceleration and its consequences.

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

In its July 8, 2015 decision, the Bankruptcy Court determined that rescinding the automatic acceleration of the notes would require the lifting of the automatic stay, which may only be lifted for "cause." The Bankruptcy Court held that because the hardship to the noteholders by maintenance of the automatic stay was, at most, equal to the hardship to EFIH from lifting the automatic stay, cause did not exist to lift the automatic stay. The noteholders appealed the Bankruptcy Court's decision.

The District Court's Decision

In a four-page order, the District Court upheld the Bankruptcy Court, finding that the Bankruptcy Court had not erred by refusing to lift the automatic stay thereby disallowing the trustee its contractual right to rescind. The District Court noted that the Trustee's arguments "appear to be little more than an effort to evade clear precedent that a bankruptcy stay prevents specific enforcement of such contractual rights."[5]

Citing Second Circuit precedents such as the *AMR Corp.*, *MPM Silicones* and *Calpine Corp.* decisions, the District Court held that any attempt to rescind the acceleration under the indentures is a modification of the parties' contract rights and therefore subject to the automatic stay.[6] Further, given that the noteholders' attempted deceleration was precluded as a matter of law by the automatic stay, and not by any act of the Debtors, the noteholders could not pursue an unsecured claim for the loss of the right to rescind the acceleration.[7]

Though the make-whole issue will not be settled until the Third Circuit issues a decision, if any, on the appeal of the District Court's decision, if the Bankruptcy Court had not already signaled the Delaware federal judiciary's alignment with the New York federal courts with respect to the enforceability of make whole premiums in bankruptcy, the District Court's decision certainly did.

As a reminder, if parties wish to receive a make-whole premium following a bankruptcy filing, the indenture must specify, in no uncertain terms, that such make-whole premium is required *despite a bankruptcy filing*.[8] While payment of such make-whole premium is not then absolutely guaranteed, such precise language should go a long way towards convincing a court that such payment was agreed upon and part of the parties' bargain.

For More Information

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1 *In re Energy Future Holdings Corp., et al.,* No. 15-620 (D.Del. February 16, 2016).

2 *Delaware Trust Company, as Indenture Trustee v. Energy Future Intermediate Holding Company LLC*, Civ. Action No. 15-620 RGA (D. Del. Feb. 16, 2016) (Memorandum Order) (the *"Mem. Op"*).

3 *Another One Bites the Dust – Energy Future Decision Likely Precludes Future Arguments to Lift the Automatic Stay in the Make-Whole Context* (July 23, 2015), available at http://www.chapman.com/media/publication/541_Chapman_Energy_Future_Automatic_Stay_Make-Whole_072315.pdf.

4 *Delaware Trust Company, as Indenture Trustee v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 533 B.R. 106 (Bankr. S. Del. 2015).

5 Mem. Op. at 3.

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

7 *Id.*

8 For an expanded analysis on these issues, see *Another One Bites the Dust — Energy Future Decision Likely Precludes Future Arguments to Lift the Automatic Stay in the Make-Whole Context* (July 23, 2015), available at http://www.chapman.com/media/publication/541_Chapman_Energy_Future_Automatic_Stay_Make-Whole_072315.pdf and *Make-Whole Provisions Continue to Cause Controversy: What You Can Do to Avoid Litigation* (July 18, 2014), available at http://www.chapman.com/media/publication/398_Chapman_Make-Whole_Provisions_Continue_to_Cause_Controversy_What_You_Can_Do_to_Aviod_Litigation_071814.pdf.

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