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ALERT MEMORANDUM

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S.D.N.Y. Bankruptcy Court Continues Trend Against Enforcing Make-Whole Premiums

On August 26, 2014, the U.S. Bankruptcy Court for the Southern District of New York held that the automatic acceleration of debt resulting from a borrower's bankruptcy filing did not trigger the borrower's obligation to pay a make-whole premium to its lenders in satisfaction of their claims under a chapter 11 plan. In re MPM Silicones, LLC, Case No. 14-22503-rdd (Bankr. S.D.N.Y). Bankruptcy Judge Robert D. Drain's ruling reinforces the recent trend, particularly in the Southern District of New York, against enforcing make-whole premiums after acceleration unless the governing documents provide clear and unambiguous language to the contrary.

Background

MPM Silicones, LLC, and certain of its affiliates ("Momentive"), filed voluntary petitions for relief under chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code") on April 13, 2014. Momentive's prepetition debt obligations included $1.1 billion of 8.875% First-Priority Senior Secured Notes due 2020 and $250 million of 10% Senior Secured Notes due 2020 (the "Notes", and the holders of the Notes, the "Noteholders"), issued pursuant to indentures with substantially similar terms and governed by New York law (the "Indentures").

Under the plan proposed by Momentive (the "Plan"), Noteholders would be paid in full in cash if their classes were to vote in favor of the Plan, and would receive replacement notes with a value equal to the amount of their allowed claims if their classes voted against the Plan. Approximately one month after commencing its chapter 11 cases, Momentive sought a declaratory judgment from the Bankruptcy Court that no make-whole premium would be payable on the Noteholders' claims (the "Make-Whole Premium"). In addition, the indenture trustees for the Notes objected to the Plan on the grounds that Momentive was required to pay any premium contemplated by the Indentures and Notes upon a voluntary redemption. In response, Momentive argued that the automatic acceleration of the Notes triggered by the chapter 11 filings does not constitute an optional redemption under the Indentures, and that a lender may only recover a make-whole premium following a non-optional redemption if the operative governing agreements explicitly require the payment of such a premium in those circumstances, which the Indentures and Notes did not.

Bankruptcy Court's Bench Ruling

Judge Drain reasoned that it is well-established under New York law that a lender forfeits the right to a make-whole premium if it elects to accelerate the balance of a loan. However, there is an exception to this rule where the relevant instrument clearly and unambiguously calls for the payment of a make-whole premium even in the case of acceleration. See Transcript of Oral Decision on Confirmation at 34-35 (citing U.S. Bank National Association v. South Side House, 2012 U.S. Dist. LEXIS 10824 12-13 (E.D.N.Y.

January 30, 2012)). Here, the Indentures provided for automatic acceleration of the Notes upon a bankruptcy filing, which acceleration may be rescinded by the holders of a majority of each Note issuance, but Judge Drain ruled that the automatic stay prevents rescission of the automatic acceleration. Tr. 52. Relying on the Second Circuit's ruling in In re AMR Corp., 730 F.3d 88 (2d Cir. 2013), the Court held that Momentive's payment of the Notes under the Plan before the stated maturity (and after the automatic acceleration) was not an optional redemption and does not require Momentive to pay the Make-Whole Premium. Tr. 44. Furthermore, after reviewing the relevant case law, the Court determined that the language of the Indentures was not sufficiently explicit to overcome the general rule under New York law against the enforcement of a make-whole premium after acceleration. Tr. 40-41 (analyzing In re Chemtura Corp., 439 B.R. 561 (Bankr. S.D.N.Y. 2010); U.S. Bank National Ass'n., 2012 U.S. Dist. LEXIS 10824 at 21-24; In re School Specialty, Inc., 2013 WL 107, 127 (Bankr. D. Del. 2013)).

In reaching his conclusion, Judge Drain rejected the Noteholders' arguments that the provisions of the Indentures granting the right to payment of a "premium, if any" under the Indentures or Notes upon an automatic acceleration provide a sufficiently clear right to the Make-Whole Premium. The Court held that these provisions do not create a right to the Make-Whole Premium where it would not otherwise exist because the payment "of premium, if any" merely means that the other provisions of the Indenture govern the Noteholders' right to a make-whole premium, which in this instance require an optional redemption. Tr. 42. Notably, Judge Drain acknowledged another exception to the general rule, inapplicable to the facts before him, that could warrant enforcement of a make-whole premium: if the issuer intentionally defaults on its obligations to trigger acceleration and avoid the obligation to pay a make-whole premium. Tr. 36. In such a situation, a lender could seek enforcement of a make-whole premium after an automatic acceleration even if the governing agreements do not contain clear and unambiguous language providing for such payment.

Finally, the Court held that the Noteholders' are not entitled to damages in the full amount of interest scheduled through the stated maturity date for a purported "no-call" provision because such provisions are not enforceable in bankruptcy given the automatic acceleration that occurs under the Bankruptcy Code. Tr. 46 (citing HSBC Bank USA v. Calpine Corp., 2010 U.S. Dist. LEXIS 96792, 11-14 (S.D.N.Y. Sept. 15, 2012)). Moreover, the Court explained that section 502(b)(2) of the Bankruptcy Code precludes such claims for unmatured interest as damages for breach of either the no-call covenant or the rule of perfect tender, at least in cases where the debtor is insolvent. Tr. 46-47. Judge Drain implied that lenders could be entitled to a claim for damages either for breach of the no-call provision of the contract or New York's perfect tender rule if the debtor were solvent.

Significance of the Bench Ruling

The Bench Ruling is significant because it continues the trend, particularly within the Second Circuit, of courts refusing to enforce make-whole premiums after an automatic acceleration unless the governing agreements expressly and unambiguously require such payment. This is a departure from older, more creditor-friendly case law outside of the Second Circuit, in which courts held that make-whole premiums could be due even after an automatic acceleration from a bankruptcy filing. See In re Skyler Ridge, 80 B.R. 500, 507 (Bankr. C.D. Cal. 1987); In re Imperial Coronado Partners, Ltd., 96 B.R. 997 (B.A.P. 9th Cir. 1989). It remains

to be seen whether decisions in other jurisdictions, especially in Delaware, will adopt the Second Circuit's standard for make-whole premium provisions or will take a more lender-friendly approach.

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