

# Recent Rulings Underscore Importance of Careful Drafting of Make-Whole Payment Provisions

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Under long-established common law, loans must be paid only upon maturity, not before. This “perfect tender in time” rule is the default rule in a number of jurisdictions. Many indentures and credit agreements therefore either bar prepayments altogether with “no call” provisions or permit prepayments with “make whole” provisions that require the payment of a specified premium to make up for the loss of future income.

A recent trilogy of decisions by the Bankruptcy Court for the District of Delaware in the *In re Energy Future Holdings Corp. (EFH)* Chapter 11 cases serves as a reminder of the need for careful drafting of make-whole provisions. (See *2014 Insights* article “[Enforcement of Make-Whole Provisions in Bankruptcy: The Importance of Careful Drafting](#).”) In *EFH*, Bankruptcy Judge Christopher S. Sontchi scrutinized and narrowly construed make-whole provisions in indentures governed by New York law. The decisions, which set a high bar for trustees seeking payment of make-whole premiums, follow and adopt a New York bankruptcy court’s September 2014 decision in *In re MPM Silicones, LLC (Momentive)*. (See *2015 Insights* article “[Recent Cases Highlight Potential Pitfalls for Distressed Investors](#).”)

## Background

In *EFH*, the first-lien notes issued by the debtors provided for automatic acceleration of payment to the lender upon debtor bankruptcy and for payment of a make-whole premium in the event of an optional prepayment prior to maturity. The *EFH* debtors sought to avoid payment of make-whole premiums, and before bankruptcy had publicly disclosed their intent to do so. At the outset of their Chapter 11 cases, the debtors obtained approval of debtor-in-possession (DIP) financing to pay in full the first-lien notes except for make-whole amounts. The first-lien noteholder trustee objected and attempted to preserve its make-whole payment claims by waiving the bankruptcy filing default under the first-lien indenture and decelerating the payment of notes. The trustee also moved for relief from the automatic bankruptcy stay, to rescind and reverse the automatic acceleration of the notes.

## March Decision



The Delaware bankruptcy court's rulings provide guidance for the clear drafting of indentures with make-whole or prepayment premiums.

In March 2015, the Delaware bankruptcy court ruled that the *EFH* debtors’ payment of the first-lien notes with the DIP financing did not constitute a redemption that triggered the make-whole premium. The court decided that under the express terms of the indenture, the first-lien notes automatically accelerated upon the bankruptcy filing and were due and payable without further action or notice. Likewise, the acceleration provision did not require payment of the make-whole premium, nor did it trigger the optional redemption provision. Instead, Judge Sontchi determined that the make-whole concept only was included in regard to an optional redemption under the indenture.

The bankruptcy court reasoned that New York law requires an indenture to “contain express language requiring payment of a prepayment premium

upon acceleration; otherwise, it is not owed.” The *EFH* indenture did not include such a provision, although such negotiated clauses have been upheld by courts. Moreover, New York law directs that specific contract provisions supersede more general provisions.

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The bankruptcy court concluded that the acceleration provision was a specific provision. Because it did not refer to either the make-whole premium or the optional redemption term, the court rejected the trustee's argument that the optional redemption provision was a wholesale bar to repayment before the original maturity date.

Judge Sontchi decided under New York law that "a borrower's repayment after acceleration is not considered voluntary" because the acceleration date becomes the new maturity date, rendering prepayment impossible, and EFH's bankruptcy filing automatically accelerated the notes, rendering them due and payable. Accordingly, the court concluded that post-petition repayment of the notes was not a voluntary prepayment and, under the indenture, did not trigger the make-whole premium.

## July Decision

In July 2015, Judge Sontchi denied the trustee's motion for automatic stay relief to rescind the automatic acceleration of the EFH first-lien notes. The trustee argued that because the debtors were solvent, make-whole payments could not constitute harm, but Judge Sontchi ruled that payment of the make-whole amounts would deprive the estates of an equal amount of distributable value, and that the interests of EFH equity holders could be considered. The court observed that if the automatic stay were lifted, decelerating the notes and triggering the make-whole payment obligation, the resulting harm would be no less than any harm to the noteholders from nonpayment of the make-whole premium. The court also rejected claims that nonpayment of the make-whole obligation would injure "investor expectations"

because the noteholders continued to acquire first-lien notes after EFH publicly disclosed its intention not to pay make-whole premiums in bankruptcy.

## October Decision

Judge Sontchi's third ruling addressed make-whole claims arising under EFH's second-lien notes. The terms of EFH's second-lien indenture were virtually identical to the indenture at issue in *Momentive*. Judge Sontchi explained that "there are only two ways to receive a make-whole upon acceleration under New York law: (i) explicit recognition that the make-whole would be payable notwithstanding the acceleration, or (ii) a provision that requires the borrower to pay a make-whole whenever debt is repaid prior to the *original* maturity." Adopting *Momentive*, Judge Sontchi held that the EFH second-lien indenture was not sufficiently specific to trigger the make-whole premium following acceleration.

## Implications

The Delaware bankruptcy court's *EFH* rulings expressly adopt the rule in *Momentive* and provide guidance for the clear drafting of indentures with make-whole or prepayment premiums: An indenture should either explicitly state that such premiums are payable notwithstanding automatic acceleration or explicitly require payment of make-whole or prepayment premiums if notes are at any time repaid before their original maturity date. Absent precise language in indentures, bankruptcy courts may rule that a make-whole premium is not payable following automatic acceleration upon a bankruptcy filing.