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Delaware Bankruptcy Court Allows Debtor to Sidestep "Make-Whole" Payment

Bankruptcy Judge Christopher S. Sontchi recently ruled in the *Energy Future Holdings* case[1] that the debtor will not be required to pay the $431 million "make whole" demanded by bondholders upon the debtor's early payment of the bonds.[2]

In this proceeding, Delaware Trust sought to lift the automatic stay, to the extent it applied, to allow it to decelerate its outstanding indebtedness so that it could recover a $431 million premium on behalf of investors holding $2.3 billion in EFIH first-lien notes. These investors had declined to accept a settlement offering an incentive payment in exchange for waiving their right to litigate make-whole claims. The premium is referred to as a "make-whole" payment because it "literally makes the investor whole" for the interest that the creditor had contracted to receive when it lent the money. The payment is calculated to approximate what the "investor had contracted to receive from the issuer, and would have received but for the early repayment of the Notes, discounted to present value." The $431 million figure is an expert's estimate of how much more EFIH would have to pay on $4 billion worth of first-lien notes that it refinanced earlier in its Chapter 11 proceeding.

In analyzing Delaware Trust's request for relief from the automatic stay,[3] the Bankruptcy Court noted that Section 362 of the Bankruptcy Code authorizes bankruptcy courts to grant relief from the automatic stay for "cause." The factors courts generally use in determining whether cause exists are (1) whether any great prejudice to either the bankrupt estate or the debtor will result from a lifting of the automatic stay; (2) whether the hardship to the non-bankrupt party

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[1] *Delaware Trust Company v. Energy Future Intermediate Holding Company LLC (In re Energy Future Holdings Corp.)* (Case Nos. 14-50363 & 14-10979) (Bankr. Del. July 8, 2015)

[2] This opinion is the second opinion issued by Judge Sontchi about an assertion that EFIH was obligated to pay the investors in the EFIH first-lien notes a "make-whole" premium. In *Delaware Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 527 B.R. 178 (Bankr. D. Del. 2015), Judge Sontchi concluded that Delaware Trust was not entitled to a prepayment premium because (1) its debt was automatically accelerated by the bankruptcy filing, (2) the acceleration was not stayed by the automatic stay, and (3) its loan documents did not clearly provide the prepayment premium was owing in the event the maturity was accelerated as a result of a bankruptcy filing.

[3] Although Delaware Trust argued that the automatic stay did not apply, the bankruptcy court rejected this contention even though it had previously concluded that the automatic stay did not prevent the automatic acceleration of the debt: "the Court will grant summary judgment, in part, in favor of the EFIH Debtors on the Stay-Applicability Motion in that the automatic stay is applicable and the issuance of the notice of rescission was a stay violation." *Id.* at 202.

by maintenance of the automatic stay considerably outweighs the hardship to the debtor; and (3) the probability of the creditor prevailing on the merits. As part of this analysis, the court assumed that EFIH was solvent and that the award of the make-whole premium would not affect other creditors.

The court denied the indenture trustee's attempt to lift the automatic stay to decelerate the loan and pursue the make-whole premium. The court indicated that the investors would likely prevail on the merits because they would be able to establish their right to the make-whole premium post deceleration. But the court concluded that the prejudice to EFIH's estate, "in the form of the loss of hundreds of millions of dollars," outweighed the hardship to the investors of the EFIH first-lien notes. "The hardship to the Noteholders by maintenance of the automatic stay is, at most, equal to the hardship to the EFIH Debtors from lifting the automatic stay and therefore does not considerably outweigh the hardship to the EFIH Debtors." In reaching its conclusion, the court elevated the interest of EFIH's equity holder over the contractual agreement with the investors in the EFIH first-lien notes: "It is clear that, should the automatic stay be lifted, the Notes decelerated, and the Trustee's requested make-whole claim be paid, that such payment would substantially reduce the value of other EFIH stakeholder recoveries, including recoveries to equity (i.e.[,] EFH)." *Id.* at ¶60.[4]

Takeaway

In analyzing a lender's attempts to avoid the implications associated with the automatic acceleration of debt (that occurs upon a bankruptcy filing) where the applicable loan documents do not expressly provide that the lender is entitled to a make-whole premium post acceleration, it is possible that bankruptcy courts will engage in a results-oriented "balance of the hardships" analysis to determine if the requisite cause has been established to lift the stay without deference to the underlying contractual obligations. In *EFIH*, the court balanced the harm to EFIH's estate (specifically, the interest of EFIH's equity holder, Energy Future Holdings) against the harm to investors in the first-lien notes. Although the court followed a line of cases that recognized that a debtor's estate is defined broadly to include equity holders in the debtor, the court's approach appears to be at odds with a long line of cases that hold that general concepts of equity should not be relied on to elevate the interests of a debtor's equity holders over the contractual rights of creditors. These decisions include *In re Terry Ltd. Partnership*, 27 F.3d 241, 245 (7th Cir. 1994) (affirming the district court and reasoning "[a]fter reviewing the record and assuring itself that the contract default rate was conscionable and a reasonable means of protecting against the unforeseeable consequences of a default, the district court held that Equitable should not be deprived of its bargained-for rights in order to bestow upon Invex Holdings benefits in excess of its bargain"); *In the Matter of Chicago, M.S.P. & P.R. Co.*, 791 F.2d 524, 529 (7th Cir. 1986) ("We have not forgotten the venerable principle that a bankruptcy court can refuse to award interest that accrues on a creditor's claim after the petition for bankruptcy is filed.… But it is designed for cases where there is not enough money to pay all the creditors — so that there is a question whether one creditor should get interest while another doesn't even recover principal — and not for cases like this, where the debtor is solvent"); *Ruskin v. Griffiths*, 269 F 2d 827 (2d Cir 1959), cert. denied, 361 U.S. 947 (1960) (The court enforced the creditor's right to the default interest rate. Emphasizing the solvency of the debtor, the Second Circuit held that it would be "the opposite of equity to allow the debtor to escape the expressly-bargained-for result of its act," absent "any unjust delay in the proceedings" caused by the creditor); *In re Courtland Estates Corp.*, 144 B.R. 5, 9 (Bankr. D. Mass. 1992) ("This Court [previously] … allowed calculation of interest on oversecured claims with reference to the default rates set forth in the agreements of the parties. Accordingly, this Court will permit the calculation of interest on the Bank's overdue principal at the

[4] As noted in the court's ruling, the court assumed that EFIH was solvent and would not be rendered insolvent by the payment of the "make-whole" premium to the investors in the first-lien notes.

rate specified in the Note.… As the Debtor has paid all pre-petition unsecured creditors … the equities of the case do not compel a different result.… Indeed, use of [a different rate] would merely provide an undeserved windfall to the Debtor"); and *In re Consolidated Operating Partners, L.P.*, 91 B.R. 113, 116-17 (Bankr. D. Colo. 1988) ("When the debtor is solvent, the equities dictate that additional interest be paid to the secured creditor rather than to the debtor.… The benefit derived from any reduction in the contract rate would not inure to the creditors but instead would be a windfall to the debtor. Such a result would mean that any solvent debtor seeking to avoid the cost of default rate interest could file for Chapter 11. No such result was intended by Congress").

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