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Bankruptcy & Financial Restructuring ADVISORY ■

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Delaware District Court Affirms Bankruptcy Court's Ruling Allowing Debtor to Sidestep a "Make-Whole" Payment

The U.S. District Court for the District of Delaware recently affirmed the bankruptcy court's ruling in the *Energy Future Intermediate Holding* (EFIH) case finding that the debtor was not required to pay a $431 million "make-whole" premium demanded by bondholders in connection with the debtor's satisfaction of the bonds. *Delaware Trust Company v. Energy Future Intermediate Holding Company LLC*, No. 1:15-cv-00620, Feb. 16, 2016. In its ruling, the district court concluded that "the Bankruptcy Court did not err by holding that the Noteholders' contractual right to [rescind the automatic acceleration of amounts owing on the bonds upon the debtor's bankruptcy filing] was subject to the automatic stay and did not otherwise provide grounds for a damages claim."

Background

When the bankruptcy case was filed, the indebtedness outstanding on the bonds was automatically accelerated pursuant to an "automatic acceleration" provision in the bonds. In the bankruptcy court, the trustee for the bonds 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 "make-whole" premium upon payment of $2.3 billion in EFIH first-lien notes. 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 was 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 was an expert's estimate of how much more EFIH would have to pay on first-lien notes that it refinanced earlier in its Chapter 11 proceeding. Investors holding $2.3 billion in first-lien notes had declined to accept a settlement offering an incentive payment in exchange for waiving their right to litigate make-whole claims.

The bankruptcy court held that, although the noteholders had the contractual right under the indenture to rescind acceleration and be paid the make-whole, that right was stayed under the automatic stay, 11 U.S.C. § 362, and that as a result, the noteholders' claim for the make-whole (or for damages for frustration of the right to rescind) was not allowable under the Bankruptcy Code's claims allowance provision, § 502(b)(l).

The trustee argued that the bankruptcy court erred by not allowing it to pursue its contractual right to rescind acceleration within the bankruptcy proceeding because the automatic stay operates only as a *procedural* stay of debt collection outside the bankruptcy court and does not disallow a substantive claim to which the noteholders were entitled under state law by virtue of their contractual right to rescind acceleration. In the alternative, the trustee argued that it should at least be able to pursue a damages claim for breach of its contractual right to rescind acceleration under the indenture.

Court's Analysis

The district court rejected both of the trustee's arguments. The district court stated it did not think "the Bankruptcy Court committed legal error by not allowing Trustee to pursue its contractual right to rescind" because "[t]o the extent Trustee argues that it should be able to actually rescind the acceleration within the Bankruptcy proceeding, rendering it able to pursue the make whole amount under § 3.07 of the Indenture, its arguments appear to be little more than an effort to evade clear precedent that a bankruptcy stay prevents specific enforcement of such contractual rights."

Turning to the trustee's second argument that the trustee should be able to pursue a claim for damages for breach of its rescission right, the district court noted that "the Bankruptcy Court correctly concluded that the Indenture did not expressly provide for damages for breach of the right to rescission, thereby disallowing a secured claim for damages." The district court went on to state that it also found persuasive those district court decisions that did not allow parties to pursue unsecured claims for damages for breach of no-call provisions in indentures.

Takeaway

This holding is yet another in a series of cases where courts have read provisions governing prepayment premiums and acceleration narrowly and disallowed such premiums absent explicit contractual language mandating payment following acceleration by the lender. *See also, e.g., In re MPM Silicones, LLC (In re Momentive)* 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014); *HSBC Bank USA, N.A. v. Calpine Corp. (In re Calpine Corp.), 2010 WL 3835200* (S.D.N.Y. 2010) (plain language of debt instruments did not provide for payment of premiums after acceleration). Lenders should take special caution in drafting such provisions in debt instruments. Failure to use specific and unambiguous language may result in having the premiums disallowed in a borrower's bankruptcy case.

The trustee has appealed the district court's order to the Third Circuit.

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