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Make-Whole/Prepayment Premiums Alive and Well in Bankruptcy (Well, at Least in New York)

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In *In re 1141 Realty Owner*, the Bankruptcy Court for the Southern District of New York issued an opinion—yet again—addressing the enforceability of make-whole/prepayment premiums in bankruptcy. Specifically, although generally enforceable outside bankruptcy, there is an ongoing debate on whether make-whole provisions are enforceable in bankruptcy and if so, when.

A yield maintenance default premium, also known as a prepayment or make-whole premium, is a clause that triggers the payment of an amount to compensate lenders when a loan obligation is paid before maturity. While non-bankruptcy courts liberally enforced make-whole provisions, in recent years, bankruptcy courts have strictly construed these provisions to preclude their enforcement unless expressly and meticulously triggered. Specifically, bankruptcy courts have focused on acceleration language included in loan documents and concluded that if a debt is accelerated on account of a borrower's default, the lender generally forfeits entitlement to make-whole payments, reasoning that acceleration advances the maturity date and thus represents the lender's decision to waive enforcement of the make-whole provision in favor of an accelerated debt, unless the loan expressly (and unequivocally) provides that the make-whole premium is due under the precise set of facts at issue.

On March 18, 2019, the Bankruptcy Court for the Southern District of New York provided further "clarity" on the language required to maintain a valid/enforceable make-whole provision when it enforced a make-whole provision in *In re 1141 Realty Owner*, No. 18-12341, notwithstanding the lender's post-default acceleration. The court held that "the make-whole premium at issue is enforceable under New York law" because the clause included "clear and unambiguous" language requiring payment of the make-whole payment even after default and acceleration. Specifically, the make-whole provision in the loan documents provided that "any payment following an Event of Default was deemed a 'voluntary prepayment' requiring the payment of the [make-whole fee]." Because the lender sent two event of default notices before it accelerated the loan, the bankruptcy court concluded that the make-whole provision was properly triggered and was enforceable and overruled the debtor's objection that the make-whole provision did not expressly state that it was due notwithstanding a prior acceleration.

In re 1141 Realty Owner marks a potential split between courts in the Second and Fifth Circuits. Among circuits having reviewed the issue—including the Second Circuit, Third Circuit, and Fifth Circuit—there is no consensus that make-whole provisions are enforceable under the Bankruptcy Code. For example, as recently as January 2019, the Fifth Circuit questioned whether make-whole provisions constituted claims for unmatured interest barred by Section 502(b)(2) of the Bankruptcy Code. *In re 1141 Realty Owner* also highlights a disagreement among courts and judges concerning the express language required to establish the enforceability of a make-whole provision post-acceleration. Compare *In re 1141 Realty Owner* (finding that post-default payment language established its enforceability) with *In re MPM Silicones LLC* (providing that post-default payment language was too general to trigger the application of the make-whole provision). Lenders and debtors must closely analyze the changing landscape.

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