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Second Circuit Gives *Momentive* Secured Creditors Another Shot at Market-Based Interest Rate in Cramdown Fight; Also Affirms Bankruptcy Court's Denial of Make-Whole Premium

On October 20, 2017, the U.S. Court of Appeals for the Second Circuit delivered a victory for secured lenders by remanding the District Court's order confirming the Debtors' proposed plan to determine whether an efficient market exists in connection with the appropriate interest rates on takeback paper issued to secured lenders under Momentive Performance Materials, Inc.'s ("MPM") chapter 11 "cramdown" plan.[1] Though the Second Circuit's decision provides clarity with respect to the application of the well-known *Till* approach, it leaves open several unanswered questions likely to result in continued litigation in this and other cases in the Second Circuit.

Background and the Bankruptcy Court Decision

MPM commenced prearranged chapter 11 cases in April 2014, entering bankruptcy with the support of many of its key constituencies and intending to emerge from bankruptcy within a relatively short time period.[2] MPM had issued $1 billion in second-lien notes, the holders of which unanimously accepted the plan. MPM, however, was unable to garner the support of holders of $1.35 billion in senior secured notes (the "Senior-Lien Noteholders" and the "Senior-Lien Notes"). To encourage Senior-Lien Noteholder support, the chapter 11 plan provided "deathtrap" treatment for satisfaction of the Senior-Lien Notes claims, pursuant to which Senior-Lien Noteholders would receive (i) if the class accepted the plan, a discounted cash payout, or (ii) if the class rejected the plan, takeback paper priced in accordance with *Till*'s formula rate approach.

The Senior-Lien Noteholders voted as a class to reject the chapter 11 plan and opposed confirmation principally on two points. First, they argued that the *Till* formula-based interest rates proposed for the takeback paper fell well below market-based interest rates[3] and thus did not treat the Senior-Lien Noteholders' claims in a "fair and equitable" manner, as required by section 1129(b) of the Bankruptcy Code.[4]

Second, the Senior-Lien Noteholders asserted that their Senior-Lien Notes claims should take into account a make-whole premium based on language in the Senior-Lien Notes indentures. More specifically, they alleged that MPM's redemption of the Senior-Lien Notes "at its option" prior to maturity triggered the make-whole premium.

The bankruptcy court confirmed the plan over the Senior-Lien Noteholders' objections, and the District Court affirmed. The Senior-Lien Noteholders further appealed the lower courts' decisions to the Second Circuit.

Decision on Appeal to the Second Circuit

On appeal, the Second Circuit generally endorsed the use of *Till*'s formulaic approach to determining interest rates for takeback paper; however, significantly, the Second Circuit held that *Till* should be applied only after a court has determined that an "efficient market" for the takeback paper does not exist. In doing so, the Court adopted the two-step approach set forth in the Sixth Circuit's decision in *In re American HomePatient, Inc.*: "[T]he market rate should be applied in Chapter 11 cases where there exists an efficient market. But where no efficient market exists for a Chapter 11 debtor, then the bankruptcy court should employ the formula approach endorsed by the *Till* plurality." [5] The Court emphasized that "disregarding available efficient market rates would be a major departure from long-standing precedent dictating that 'the best way to determine value is exposure to a market.'" Accordingly, the Court remanded the case to the bankruptcy court to assess whether an efficient market rate can be ascertained, and if so, to apply it to the replacement notes.[6]

Although the Second Circuit reversed in part the District Court's order regarding the interest rate issue, the Court sided with MPM (and the lower courts) on the issue of the make-whole premium. The Court held that MPM's issuance of the replacement notes was not a "redemption" that was at "MPM's option," as required to trigger the optional redemption clauses in the indentures and in turn the make-whole premiums. The Court accepted the argument that the make-whole premium did not apply once the debt had been accelerated due to bankruptcy because the indentures' acceleration provisions did not make specific reference to the make-whole premium. The Court here reasoned that the make-whole premium was not due for the "simple reason that the more specific Optional Redemption Clauses which grant the make-whole [were] not triggered and thus no premium [was] generated." The Court further noted that in the *AMR* bankruptcy the Second Circuit "concluded that a creditor's post-petition invocation of a contractual right to rescind an acceleration triggered automatically by a bankruptcy filing is barred because it would be 'an attempt to modify contract rights and would therefore be subject to the automatic stay.'"[7]

Conclusion and Outlook

This decision is favorable to secured lenders in that it reduces the risk that a chapter 11 debtor will successfully apply a low, formula-based interest rate in a cramdown plan where a market-based alternative exists. However, the opinion leaves several questions unanswered. First, the opinion only requires a market-based rate where an "efficient market" exists, but what constitutes an "efficient market"? For example, would the "efficient market" be limited to exit financings, or would it also include "healthy" non-bankruptcy financings? Second, assuming an "efficient market" exists, what steps must a debtor take to demonstrate that the rate proposed by the debtor is in fact consistent with that "efficient market"? Will expert testimony regarding market comparables be sufficient, or will bankruptcy courts require (or at least defer significantly to) "market check" processes run by either the debtor or other parties-in-interest? The Second Circuit's opinion provides little guidance on these issues, which may mean future protracted litigation in an attempt to gain clarity.

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[1] *Apollo Global Mgmt., LLC v. BOKF, NA (In re MPM Silicones, LLC)*, 2017 U.S. App. LEXIS 20596 (2d Cir. Oct. 20, 2017).

[2] Prior to its chapter 11 filing, MPM issued three classes of notes relevant to the Court's decision: (i) subordinated unsecured notes; (ii) second-lien "springing" notes; and (iii) first-lien and 1.5-lien secured notes, collectively the Senior-Lien Notes. The subordinated unsecured notes and second-lien notes presented another issue discussed in the Second Circuit's decision—specifically, whether the second-lien notes had priority over the subordinated notes. The Court considered the notes and agreements between the creditors and held that, despite the ambiguity present in the documents, the second-lien notes indeed had priority over the subordinated notes.

[3] At issue in *Till* was the appropriate interest rate to apply to a sub-prime automobile loan in a chapter 13 case. In *Till*, the chapter 13 plan provided that the debtors would pay interest at a rate of 9.5%, which was 1.5% above the national prime rate. The lender objected, arguing that the debtors must pay the contract rate of 21% to compensate the lender adequately under the Bankruptcy Code. The Supreme Court sided with the chapter 13 debtors, finding that the present value of a lender's secured claim should be calculated using the "formula" approach, which bases the interest rate on the national prime rate and generally adjusts that rate upward between 1% and 3% to compensate for additional risk and circumstance. The Supreme Court, however, noted that the formula approach may not be well-suited to chapter 11 cases because there is generally a "free market of willing cramdown lenders," where no such market exists for debtors in chapter 13 cases.

[4] Chapter 11 of the Bankruptcy Code permits confirmation of a plan of reorganization over the objection of a non-accepting class of creditors so long as the plan "does not discriminate unfairly and is fair and equitable" with respect to such class. 11 U.S.C. § 1129(b)(1). To be "fair and equitable," a secured creditor must receive, among other things, deferred cash payments with a present value equal to the lender's interest in its collateral. 11 U.S.C. § 1129(b)(2)(A)(i).

[5] 420 F.3d 559 (6th Cir. 2005).

[6] MPM also argued that the creditors' appeals should be dismissed based on equitable mootness. The Court ultimately disagreed with this argument, holding that the factors that must be satisfied in order to overcome a mootness presumption, as articulated in *In re Chateaugay Corp.*, 988 F.2d 322 (2d Cir. 1993), were not met.

[7] *See In re AMR Corp.*, 730 F.3d 88, 102-03 (2d. Cir. 2013).