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Client Alert

Global Finance Practice Group
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Third Circuit Rules Make-Whole Provisions Enforceable in the *Energy Future* Bankruptcy

On November 17, the U.S. Court of Appeals for the Third Circuit (the "Court") made clear its stance on the question of enforceability of make-whole provisions in bankruptcy.[1] Bucking the recent trend seen in cases such as *In re MPM Silicones, LLC*, No. 14-22503-RDD, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd*, 531 B.R.321 (S.D.N.Y. 2015) ("*Momentive*"), the Court determined that such provisions, which are intended to compensate lenders for interest lost when borrowers pay notes prior to a specific date, are enforceable in bankruptcy notwithstanding the fact that bankruptcy filings often accelerate maturity.

Background and the Bankruptcy Court Decision

The debtors in the case, Energy Future Intermediate Holding Company LLC and EFIH Finance Inc. (collectively, "EFIH"), issued notes governed by two indentures, a first-lien indenture and a second-lien indenture. Each indenture contained a make-whole provision, termed an "Optional Redemption Provision," which provided that, prior to a specific date (different in each indenture, each a "Make-Whole Deadline"), EFIH could redeem all or part of the notes at a redemption price equal to the principal amount of the notes redeemed plus a make-whole premium. Each indenture also contained a separate acceleration provision that made all outstanding notes immediately due and payable if EFIH filed for bankruptcy. The acceleration provisions gave the noteholders the right to rescind any acceleration.

EFIH filed a voluntary bankruptcy petition in April 2014 and sought to refinance the notes without paying the make-whole premiums. Thereafter, the noteholders sought a declaration that the make-whole provisions were still applicable and sought to lift the automatic stay in order to rescind the acceleration of the notes that automatically occurred when EFIH filed bankruptcy. The bankruptcy court allowed EFIH to refinance the notes and concluded that EFIH, upon such refinancings (which occurred prior to the Make-Whole Deadlines), did not have to pay the make-whole premiums, reasoning that the indentures' acceleration provisions made no mention of the make-whole premiums. The bankruptcy court also denied the noteholders' request to lift the stay to rescind the acceleration of the notes. The district court affirmed.

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Decision on Appeal

The Court disagreed and, in reversing the lower courts, held that the refinancings were "optional redemptions" that occurred prior to the Make-Whole Deadlines and, thus, the refinancings triggered the make-whole premiums.

The Court rejected the argument that the make-whole premiums 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 premiums. Rather, the Court saw the optional redemption provision as separate and apart from the acceleration provision and, under basic contract interpretation principles, saw no reason why the provisions would not operate together. The Court explicitly rejected the view taken by the bankruptcy court for the Southern District of New York in *Momentive.* Analyzing nearly identical acceleration provisions, the court in *Momentive* held that an acceleration provision stating that "premiums, if any" would be due and payable immediately upon a bankruptcy filing was not specific enough to require payment of a make-whole premium in circumstances similar to those found in EFIH's case. Contrary to the *Momentive* analysis, the Court did not believe that specificity in the acceleration provision was necessary to apply the make-whole premiums contained in the EFIH indentures.

Finally, distinguishing "redemption" premiums from "prepayment" premiums, the Court ruled that the acceleration of the notes' maturity did not impact the viability of the make-whole premiums. Unlike a prepayment, which by definition cannot occur once a debt has been fully accelerated, a redemption can trigger a make-whole premium both pre-acceleration and post-acceleration. Thus, the acceleration of the debt, which occurred upon the bankruptcy filing, did not impact the analysis of whether a make-whole premium would be due. Here, the Court again rejected *Momentive's* conclusion that make-whole premiums would only be due on acceleration when a clear and unambiguous acceleration clause (*i.e.*, more specific than a boilerplate "premiums, if any") calls for it.

Conclusion and Lessons Learned

Notwithstanding the favorable result for the noteholders in this case, lenders and investors are better served by avoiding this type of dispute altogether through careful and clear drafting. Make-whole provisions should be drafted to clearly define what triggers make-whole payments, and acceleration provisions should be drafted to clearly and unambiguously provide that any make-whole premiums will be applicable notwithstanding an automatic acceleration of the indebtedness. The same caution should apply to other similar prepayment premium or call protection provisions.

It should also be noted that the Court's decision in this case is only binding on courts within the Third Circuit. It remains to be seen how other federal appellate courts (including the Second Circuit, which is currently considering an appeal of the *Momentive* decision) will approach this issue.

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[1] *Delaware Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.*), Case No. 16-1351 (3d Cir. Nov. 17, 2016).