



Enforcing Make Whole Premiums in Bankruptcy

Brian P. Campbell Jr., J.D. Candidate 2022

Cite as: *Enforcing Make Whole Premiums in Bankruptcy*, 13 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 4 (2021).

Introduction

A debt instrument typically has two components: principal and interest.¹ The lender usually has some expectation in receiving a certain amount of interest over the life of a loan.² The borrower may in many instances reduce the amount of the interest paid by pre-paying the loan in full prior to maturity.³ In certain instances, a lender will protect its interest recovery by including a “make whole premium” (“MWP”) in the loan.⁴ When borrowings are either paid back early or are accelerated forward by a default, MWPs provide for the payment of an additional amount by the borrower to “compensate the lender of the loss of anticipated interest.”⁵

Courts generally enforce MWPs when contracted-for by solvent parties.⁶ Bankruptcy courts' enforcement of MWPs have varied by forum. This Memorandum explores the differing Circuit approaches. Part I of this memo discusses the Third Circuit's enforcement of MWPs in

¹ See *In re Chemtura Corp.*, 439 B.R. 561, 596 (Bankr. S.D.N.Y. 2010).

² See *id.*

³ See *id.*

⁴ See *id.*

⁵ See *id.*

⁶ See, e.g., *Poughkeepsie Galleria Co. v. Aetna Life Ins. Co.*, N.Y.S.2d 420, 421–22 (Sup. Ct. 1998).

bankruptcies.⁷ Part II examines the Second Circuit’s general holding that MWP’s are unenforceable in bankruptcy,⁸ before assessing how parties can and have contracted around this general rule.⁹ After discussing how Fifth Circuit Bankruptcy Judges now analyze MWP’s,¹⁰ Part III reviews the Fifth Circuit’s withdrawn but consequential ruling that MWP’s are disallowed by the Bankruptcy Code.¹¹

Discussion

Title 11 of the United States Code (the “Bankruptcy Code”) defines a “claim” as a “right to payment,” a definition that “encompasses make-whole claims.”¹² The Bankruptcy Code also requires courts to disallow claims that are for “unmatured interest,” but leaves the term undefined.¹³ Determining whether payments to “compensate the lender of the loss of anticipated interest” are “unmatured interest” has thus been left open to judicial interpretation.¹⁴ The various analyses of three United States Courts of Appeal are discussed below.¹⁵

(I) The Third Circuit’s Presumption of Enforceability

On April 29, 2014, Energy Future Holdings filed a “Chapter 11 bankruptcy petition[] in the Bankruptcy Court for the District of Delaware,” hoping to retire and replace its pre-petition secured borrowings with lower-cost debt.¹⁶ Its creditors resisted the settlement, referencing a

⁷ See *In re Energy Future Holdings Corp.*, 842 F.3d 247 (3d Cir. 2016) (“*EFH*”).

⁸ See *Matter of MPM Silicones, L.L.C.*, 874 F.3d 787 (2d Cir. 2017) (“*MPM*”).

⁹ See *In re 1141 Realty Owner LLC*, 598 B.R. 534 (Bankr. S.D.N.Y. 2019).

¹⁰ See *In re Ultra Petroleum Corp.*, 624 B.R. 178 (Bankr. S.D. Tex. 2020) (“*Ultra IV*”). *Ultra*’s procedural history has run through three iterations. Here are their citations, from oldest to newest. *In re Ultra Petroleum Corp.*, 575 B.R. 361 (Bankr. S.D. Tex. 2017); *In re Ultra Petroleum Corp.*, 913 F.3d 533 (5th Cir. 2019); *In re Ultra Petroleum Corp.*, 943 F.3d 758, 760 (5th Cir. 2019).

¹¹ See *In re Ultra Petroleum Corp.*, 913 F.3d 533 (5th Cir. 2019).

¹² See 11 U.S.C. § 101(5)(A) (2018); Sam Lawland, *Make-Whole Claims in Bankruptcy*, 27 No. 4 J. Bankr. L. & Prac. NL Art. 1, 1 (2018).

¹³ See 11 U.S.C. § 502(b)(2) (2018).

¹⁴ See, e.g., *In re Chemtura Corp.*, 439 B.R. at 596.

¹⁵ Cf. *Wilmington Tr., N.A. v. Momentive Performance Materials, Inc.*, 138 S. Ct. 2653 (2018) (denying certiorari).

¹⁶ See *EFH*, 842 F.3d at 251.

contracted-for redemption premium worth over \$431 million.¹⁷ The Bankruptcy Court held that debtors could repay the secured debt without any premium as these notes were being paid upon a bankruptcy-induced acceleration—not redeemed at the borrower’s option.¹⁸ The District Court affirmed.¹⁹ On appeal, however, the Third Circuit concluded that the debtor “must pay the make-whole per the Indenture language before us.”²⁰

The Third Circuit emphasized that a debtor’s bankruptcy filing does not render contracted-for MWP clauses any less enforceable.²¹ Here, the debtor’s \$4 billion 10% ten-year indenture included a provision entitled “Optional Redemption” making MWPs due and payable if the debtor “redeem[ed] all or a part of the Notes at a redemption price equal to 100% of the principal amount of the Notes redeemed plus the Applicable Premium [*i.e.*, the make-whole] . . . and accrued and unpaid interest.”²² The indenture also provided that “all outstanding Notes shall be due and payable immediately without further action or notice” upon the filing of a bankruptcy petition.²³ According to the Third Circuit, the debtor’s decision to file for bankruptcy was a voluntary act that triggered the redemption provision of the indentures and the MWP’s satisfaction. Anything less would “conflict[] with th[e] indenture’s text and fail[] to honor the parties’ bargain.”²⁴ So long as “there were optional redemptions before a date certain, thereby triggering make-whole premiums,” the Third Circuit declared “the result is the same no matter the Indenture.”²⁵

¹⁷ *See id.* at 252.

¹⁸ *See In re Energy Future Holdings Corp.*, 527 B.R. 178, 192 (Bankr. D. Del. 2015); *accord In re Energy Future Holdings Corp.*, 539 B.R. 723, 733 (Bankr. D. Del. 2015).

¹⁹ *In re Energy Future Holdings Corp.*, 2016 WL 627343, at *1–3 (D. Del. Feb. 16, 2016).

²⁰ *See EFH*, 842 F.3d at 261.

²¹ *See id.*

²² *See id.* at 254.

²³ *Id.*

²⁴ *See id.* at 257.

²⁵ *See id.*

(II) The Second Circuit’s *MPM* Decision and its Successors

The United States Court of Appeals for the Second Circuit decided *MPM* a year after *EFH*.²⁶ Acknowledging *EFH*’s contrary conclusion, the Second Circuit has held that MWP’s are unenforceable when a “bankruptcy filing changes the date of maturity of the accelerated notes to the date of the petition.”²⁷ Even so, careful drafting may sidestep the Second Circuit’s ruling.²⁸

(A) *MPM*’s Standard

In April 2014, an overleveraged silicon manufacturer, *MPM*, “filed a petition under Chapter 11 and ultimately submitted a reorganization plan to the bankruptcy court.”²⁹ Two years earlier, *MPM* had issued \$1.35 billion in secured notes with a weighted fixed interest rate of 9.08% which “also called for the recovery of a ‘make-whole’ premium if *MPM* opted to redeem the notes prior to [their 2020] maturity.”³⁰ The Plan offered these noteholders either full cash payment (without any make-whole) or replacement notes with the option of “litigating in the bankruptcy court . . . whether they were entitled to the make-whole premium and the interest rate on the replacement notes.”³¹ Despite the noteholders’ rejection, the Bankruptcy Court confirmed that MWP’s need not be paid in bankruptcy,³² which the District Court affirmed.³³

The Second Circuit also affirmed, focusing on acceleration. *MPM* distinguished a debtor’s bankruptcy petition from voluntarily prepaying, concluding that “[a] payment made

²⁶ Compare *EFH*, 842 F.3d 247 (3d Cir. 2016), with *MPM*, 874 F.3d 787 (2d Cir. 2017).

²⁷ See *MPM*, 874 F.3d at 802-03 (“any payment on the accelerated notes following a bankruptcy filing would be a post-maturity payment.”).

²⁸ See *In re* 1141 Realty Owner LLC, 598 B.R. at 543 (“parties can . . . contract around the general rule.”).

²⁹ *MPM*, 874 F.3d at 792.

³⁰ See *id.* These indentures contained MWP’s with nearly identical language to the notes in *EFH*. Compare *MPM*, 874 F.3d at 801 (“the Senior-Lien Notes contain Optional Redemption Clauses, which provide for the payment of a make-whole premium (referred to as the ‘Applicable Premium’ in the indentures) if *MPM* were to ‘redeem the Notes at its option.’”), with *EFH*, 842 F.3d at 254 (discussing “Applicable Premium”).

³¹ See *id.*

³² See *In re* *MPM Silicones, LLC*, 2014 WL 4436335, at *17–18 (Bankr. S.D.N.Y. Sept. 9, 2014).

³³ See *In re* *MPM Silicones, LLC*, 531 B.R. 321, 338 (S.D.N.Y. 2015).

mandatory by operation of an automatic acceleration clause is not one made at MPM's option.”³⁴

In short, the Second Circuit held the MWP unenforceable when an automatic acceleration of secured loans came solely from a bankruptcy filing.³⁵ The goal of protecting creditors from prematurity repayment is irrelevant and MWPs unenforceable when “Debtors' payment was *post*-maturity, not ‘at or before’ maturity.”³⁶

In reaching its conclusion, the Second Circuit noted that “although the provisions at issue here do not expressly disallow the make-whole premium, the Optional Redemption Clauses, as we have seen, achieve this result.”³⁷ To be enforceable within the Second Circuit, indenture language must explicitly declare that no MWP is disallowed by an automatic acceleration clause’s existence.³⁸

(B) Enforcing MWPs after *MPM*

There are limits to the Second Circuit’s ruling against the bankruptcy enforceability of MWPs. In 2019, when a debtor claimed that Second Circuit lenders “forfeit[] a prepayment premium as a matter of law by accelerating the debt,” the Southern District of New York Bankruptcy Court intimated that “parties can and here did contract around the general rule.”³⁹ Unlike the indenture in *MPM*, the Loan Agreement at issue “require[d] the payment of the Yield Maintenance Default Premium with any post-default payment and not only when there is an optional redemption.”⁴⁰ The court was kind enough to provide a roadmap on rendering MWPs

³⁴ *MPM*, 874 F.3d at 803.

³⁵ *See id.* (“even assuming MPM's issuance of the replacement notes was a ‘redemption.’”).

³⁶ *Id.* (contrasting *EFH*, 842 F.3d at 255).

³⁷ *See id.* at 804.

³⁸ *See id.*

³⁹ *See In re 1141 Realty Owner LLC*, 598 B.R. at 543.

⁴⁰ *See id.*

enforceable.⁴¹ Expressly drafting that a MWP will be payable regardless of acceleration and regardless of bankruptcy minimizes the contrasting rationales of *MPM* and *EFH*.⁴²

By choosing not to follow *EFH*, the Second Circuit made things more difficult for post-petition creditors expecting MWP payouts. Even though debtors may prefer to file their bankruptcies in the Second over the Third Circuit, litigants should use *1141 Realty Owner LLC* as a checklist to determine whether the MWP language in their instruments will be enforced.⁴³

(III) Assessing Potential *Per Se* Unenforceability in the Fifth Circuit

Ultra Petroleum, suffering from “a precipitous decline in natural gas prices . . . filed voluntary chapter 11 petitions on April 29, 2016.”⁴⁴ During the bankruptcy case, “a post-petition uptick in natural gas prices” allowed “Ultra to propose and confirm a chapter 11 plan paying its creditors in full.”⁴⁵ However, this plan failed to recognize the contracted-for default interest rate and the agreed-upon MWP.⁴⁶

(A) What came before the *Ultra IV* Decision

Prior to filing, Ultra’s Operating Company had issued debentures under a Master Note Purchase Agreement.⁴⁷ This agreement provided that “[o]ne event of default was the filing of a bankruptcy petition,” upon which “the entire unpaid principal, accrued but unpaid interest, and

⁴¹ See *id.* at 544 (“One way to ensure that a make-whole premium is payable even after acceleration is to say so explicitly. Another way to ensure that the make-whole premium is payable even after acceleration is to render acceleration irrelevant and . . . make the premium contingent on any post-default payment. Deeming the post-default payment to be a ‘voluntary prepayment’ does not forfeit the Yield Maintenance Default Premium; it confirms the parties’ intent that it must be paid even if it is not an actual prepayment.”).

⁴² See *id.* at 543–44.

⁴³ The presence and absence of such language has consequences even beyond the Second and Third Circuits’ split. Despite citing to both *MPM* and *EFH*, a Chapter 11 debtor in West Virginia’s Northern District was specifically faulted for failing to “direct[] the court to any contractual language that provides for a make-whole premium post-acceleration.” See *In re Tara Retail Grp., LLC*, 2018 WL 4501136, at *2–*3 (Bankr. N.D.W. Va. Sept. 19, 2018).

⁴⁴ *Ultra IV*, 624 B.R. at 181–82.

⁴⁵ See *id.* at 181.

⁴⁶ See *id.* at 183.

⁴⁷ See *id.* at 182.

the Make-Whole Amount came due for each Note.”⁴⁸ Despite the company’s solvency, the “OpCo Funded Debt Claimants” argued they were impaired by the debtor’s plan failing to pay the make-whole amount (\$201 million) and post-petition interest at the contractual default rate (\$186 million).⁴⁹ Unlike *EFH* and *MPM*, which had relatively straightforward procedural histories, *Ultra*’s facts have been rehashed several times.

The bankruptcy court concluded in 2017 that the OpCo Funded Debt Claimants would be impaired until they were paid their MWP and post-petition interest.⁵⁰ On appeal, the Fifth Circuit reversed in part and vacated in part, ruling that “the creditors can recover the Make-Whole Amount if (but only if) the solvent-debtor exception survives Congress’s enactment of § 502(b)(2).”⁵¹ The same panel of judges then treated the OpCo Funded Debt Claimants’ request for a rehearing *en banc* as a request for a rehearing before themselves—rather than the full Fifth Circuit. Declaring their earlier opinion “withdrawn, and the following opinion [] substituted,” the Circuit Judges largely demurred, holding that “the bankruptcy court should consider the Make-Whole Amount, the appropriate post-petition interest rate, and the applicability of the solvent-debtor exception on remand.”⁵²

(B) *Ultra IV*’s liquidated damages interpretation

The Bankruptcy Court for the Southern District of Texas answered the Fifth Circuit’s open-ended questions. *Ultra IV* ultimately held that the debtor must pay the MWP owed under its debt documents as it “represents liquidated damages and should not be characterized as unmatured interest, or its economic equivalent . . . [and t]he Bankruptcy Code allows the Make-

⁴⁸ *See id.*

⁴⁹ *See In re Ultra Petroleum Corp.*, 943 F.3d 758, 761 (5th Cir. 2019).

⁵⁰ *See In re Ultra Petroleum Corp.*, 575 B.R. 361, 370–71 (Bankr. S.D. Tex. 2017).

⁵¹ *See In re Ultra Petroleum Corp.*, 913 F.3d at 547 (finding the same for the collection of post-petition interest).

⁵² *See In re Ultra Petroleum Corp.*, 943 F.3d at 760, 766.

Whole Amount.”⁵³ The court purposefully kept its liquidated damages analysis narrow, refusing to consider “whether some hypothetical liquidated damages clause conceivably compensates a creditor for unmatured interest.”⁵⁴ Despite such narrowness, a liquidated damages interpretation is not unprecedented—even where the *MPM* and *EFH* decisions left it unaddressed.⁵⁵

No Circuit Court has construed MWP as liquidated damages provisions. Until a higher ruling is issued, New York cases do provide some context. Liquidated damages provisions are enforceable where the “amount liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation.”⁵⁶ Therefore, bankruptcy enforceability under liquidated damages interpretations will likely continue to turn on whether the MWPs are “proportionate” to probable losses.⁵⁷

(C) Lingering fallout from the Fifth Circuit’s withdrawn ruling

From January through November 2019, the U.S. Court of Appeals for the Fifth Circuit held MWPs were per se unenforceable in bankruptcy.⁵⁸ The Fifth Circuit went the furthest of all bankruptcy courts and Circuits in unequivocally classifying MWPs as “unmatured interest,” only to double back and withdraw its pronouncement.⁵⁹ The withdrawn January 2019 decision

⁵³ See *Ultra IV*, 624 B.R. at 184. The court also held that the common law rooted solvent-debtor exception “that the solvent debtor must pay its creditors in full before the debtor may recover a surplus” was not discarded by the Bankruptcy Code. See *id.* Consequently, such debtors must pay post-petition interest at the contractual default rate. See *id.*

⁵⁴ See *id.* at 186.

⁵⁵ See *In re Sch. Specialty, Inc.*, 2013 WL 1838513, at *5 (Bankr. D. Del. Apr. 22, 2013) (holding a MWP to be an enforceable liquidated damages clause); *In re Trico Marine Servs., Inc.*, 450 B.R. 474, 481 (Bankr. D. Del. 2011) (same).

⁵⁶ *JMD Holding Corp. v. Cong. Fin. Corp.*, 4 N.Y.3d 373, 380 (2005) (quoting *Truck Rent-A-Ctr., Inc. v. Puritan Farms 2nd, Inc.*, 41 N.Y.2d 420, 425 (1977)).

⁵⁷ See *In re Sch. Specialty, Inc.*, 2013 WL 1838513, at *5 (assessing whether the “Make Whole Payment is not ‘plainly disproportionate’ to the lender’s probable loss.”).

⁵⁸ See *In re Ultra Petroleum Corp.*, 913 F.3d 533 (5th Cir. 2019), *opinion withdrawn and superseded on reh’g*, 943 F.3d 758 (5th Cir. 2019).

⁵⁹ Compare *In re Ultra Petroleum Corp.*, 913 F.3d at 548 (“those decisions taking a different view [of per se MWP unenforceability] are unpersuasive”), with *In re Ultra Petroleum Corp.*, 943 F.3d at 765 (“[t]he bankruptcy court is often best equipped” to determine an MWP clause’s enforceability).

signaled that any MWP's owed to unsecured creditors would be disallowed under Section 502(b)(2) of the Bankruptcy Code as a matter of law.⁶⁰

This per se prohibition on MWP's enforceability was unprecedented. Even the Second Circuit's adverse ruling on MWP's did not consider them per se unenforceable.⁶¹ Should *Ultra IV* be reversed on appeal by resurrecting this earlier reasoning, the current MWP split between the Second and Third Circuits could explode.⁶² Fifth Circuit filings would enable issuers, even with perfected "MPM-protected" contractual clauses, to entirely avoid paying MWP's post-petition.⁶³ Construing MWP's as per se "unmatured interest" would funnel every forum-shopping debtor to the Fifth Circuit's bankruptcy courts.⁶⁴

Until the Supreme Court resolves the split, MWP enforcement within Fifth Circuit bankruptcies will proceed case-by-case.⁶⁵

Conclusion

The Bankruptcy Code is essentially silent on the enforceability of make-whole premiums. As discussed, several United States Courts of Appeal have addressed MWP's differently.

⁶⁰ See *In re Ultra Petroleum Corp.*, 913 F.3d at 548 n.6 (MWP's "walk, talk, and act like unmatured interest.").

⁶¹ Cf. *In re 1141 Realty Owner LLC*, 598 B.R. at 543 (noting how MPM did not prohibit parties from "contract[ing] around [its] general rule.").

⁶² While *Ultra IV* has not yet been appealed, certain practitioners believe the Fifth Circuit still has a great deal to say on MWP's. See Lisa Laukitis et al., *Fifth Circuit To Weigh Enforceability of Make-Whole Premiums in Chapter 11*, 2021 Insights (Skadden, Arps, Slate, Meagher & Flom LLP and Affiliates), Jan. 26, 2021, at 40 ("The final resolution of the *Ultra* make-whole premium dispute is far from complete . . . How the Fifth Circuit will view the make-whole issue when it returns in the coming year remains to be seen.").

⁶³ See *id.*

⁶⁴ The Fifth Circuit's recognized solvency exception could be used to enforce the MWP's in *Ultra IV*'s successor cases. See *In re Ultra Petroleum Corp.*, 913 F.3d at 547 ("the creditors can recover the Make-Whole Amount if (but only if) the solvent-debtor exception" is proven). Other creditors would be hard-pressed to raise such an argument. The Supreme Court declared that "11 U.S.C. § 726(a)(5) provides that postpetition interest is allowed on unsecured claims" when debtors are proven to be solvent. See *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 379 (1988); see also 11 U.S.C. § 1129(a)(7) (2018); 11 U.S.C. § 1124 (2018). Barring underlying business upswings like 2016's natural gas bull market, creditors have only been able to prove debtors solvent "in the (admittedly rare) case." See *Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. at 379.

⁶⁵ See *In re Ultra Petroleum Corp.*, 943 F.3d at 765 ("the dynamics of the individual case" will determine whether a MWP is enforceable).

Emphasizing contractual intent, the Third Circuit has broadly endorsed MWPs as enforceable in bankruptcy.⁶⁶ The Second Circuit created a split by holding that MWP clauses generally do not survive a debtor's bankruptcy filing.⁶⁷ Notwithstanding *MPM*'s adverse ruling, certain bankruptcy judges have found that proper drafting can render MWPs enforceable both within-and-without Second Circuit courts.⁶⁸

The only other circuit to address MWPs withdrew its contribution to the split and remanded.⁶⁹ After four cases, the Bankruptcy Court of Texas's Southern District has held MWPs to be liquidated damages provisions and enforceable on a case-by-case review.⁷⁰

Until the Supreme Court grants certiorari,⁷¹ the enforceability of MWPs in bankruptcy will continue to depend on the debtor's choice of forum.

⁶⁶ See *EFH*, 842 F.3d at 257, 261.

⁶⁷ See *MPM*, 874 F.3d at 801–04.

⁶⁸ See *In re* 1141 Realty Owner LLC, 598 B.R. at 544.

⁶⁹ See *In re* Ultra Petroleum Corp., 913 F.3d 533, 548 (5th Cir.), *opinion withdrawn and superseded on reh'g*, 943 F.3d 758 (5th Cir. 2019).

⁷⁰ See *Ultra IV*, 624 B.R. at 184.

⁷¹ *Cf.* *Wilmington Tr., N.A. v. Momentive Performance Materials, Inc.*, 138 S. Ct. 2653 (2018) (denying certiorari).