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Chapter 38

Make-Whole and No-Call Provisions—Caveat Lender

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§ 38:1 Introduction

The death of the make-whole provision, or prepayment premium (a "premium"), has been expected with much anticipation by borrowers, debtors, and the junior lenders who tend to team up with their counterparts to void premiums to senior lenders in bankruptcies. However, the most recent bevy of cases by influential courts—and the majority of older cases—all allow premiums to be paid to lenders in bankruptcy, postacceleration, as long as the provision explicitly requires payment after acceleration.

Premiums, and groundwork for their use, have existed for some time,[1] beginning with the perfect-tender-in-time rule (the "perfect tender rule"),[2] a common law rule preventing the early payoff of a loan on the theory that the lender bargained for the entire stream of interest payments in the note, referred to as unmatured interest in the bankruptcy code. The next step in the evolution of the perfect tender rule was to incorporate the rule directly into the loan documents in the form of a no-call provision, to prevent early payoff. The concept of the premium developed as a natural extension of the perfect tender rule and no-call provisions, providing borrowers with another option, at a price. Indeed some courts have noted that while premiums are based on the concept of payment of unmatured interest, or yield maintenance, once the courts have determined that the premium is not an impermissible penalty under state law, a premium is treated differently from a strict calculation of unmatured interest.

Premiums have continued to evolve, first in state courts, and now in bankruptcy courts. While bankruptcy courts tend to strictly construe premiums against lenders, and often strain to find ways to avoid what they inherently deem to be a windfall to lenders—some going as far as saying that equity is entitled to recover before secured lenders should receive a premium—clear language that permits a postacceleration premium should win the day in court.

This clear language should be the focus of every lender that makes a loan and wishes to include a premium in the document drafting stage, or is looking to purchase debt on the secondary markets where a premium is priced into the value of the debt. For those lenders holding preexisting loans that are uncomfortable with the clarity of the premium language, bear in mind that loan modifications or forbearance agreements are excellent opportunities to clarify or conform problematic premium language.

In other words, caveat lender.

[Section 38:1]

[1]See *Kilpatrick v. Germania Life Ins. Co.*, 183 N.Y. 163, 75 N.E. 1124 (1905) (a lender's decision to foreclose on a mortgage upon default waived the right to recover a $1,000 bonus upon the borrowers satisfaction of the entire indebtedness prior to the original maturity date); *In re United Merchants and Mfrs., Inc.*, 674 F.2d 134, 6 Collier Bankr. Cas. 2d (MB) 321, Bankr. L. Rep. (CCH) P 69005 (2d Cir. 1982) (pre-Bankruptcy Code case finding Premium provision in 1973 loan documents enforceable).

[2]*Arthur v. Burkich*, 131 A.D.2d 105, 106, 520 N.Y.S.2d 638 (3d Dep't 1987) ("It has been settled law since the early 19th century that a mortgagor has no right to pay off his obligation prior to its stated maturity date in the absence of a prepayment clause in the mortgage or contrary statutory authority") (citing *Missouri, K. & T. Ry. Co. v. Union Trust Co.*, 156 N.Y. 592, 51 N.E. 309 (1898)).

§ 38:2 Recent treatment of premiums in bankruptcy courts

Premiums are not a new invention. Lenders and borrowers have been inserting these provisions in loan documents for more than a hundred years. As a result, state, federal and bankruptcy courts long have wrestled with the enforceability of premiums.[1]

Bankruptcy courts in particular have spent considerable time determining the enforceability of premiums. In light of the unique characteristics distinguishing bankruptcy from other areas of the law (including automatic acceleration of debts, relief from the automatic stay, payment of claims through plans of reorganization, and the requirement that claims satisfy both state law requirements and equitable bankruptcy considerations), premiums are more commonly in dispute in bankruptcy cases than elsewhere.[2]

Bankruptcy courts determining enforceability of a premium often employ a two-part test. First, is there a premium that is enforceable under applicable state law? If the premium passes this test, the second hurdle is the Bankruptcy Code itself. The courts must decide whether the premium at issue is enforceable under the strictures of the Bankruptcy Code, particularly Sections 506(b) and 502(b)(2).[3]

Issues that can impact the enforceability of a premium in bankruptcy include the following: 1) whether a debtor has intentionally defaulted in order to avoid paying a premium; 2) the impact of the automatic stay under the Bankruptcy Code; 3) New York's perfect-tender-in-time rule; 4) the solvency of the debtor; and 5)

[Section 38:2]

[1]See *Kilpatrick v. Germania Life Ins. Co.*, 183 N.Y. 163, 75 N.E. 1124 (1905) (state court case finding that a lender's decision to foreclose on a mortgage upon default waived the right to recover a $1,000 bonus upon the borrower's satisfaction of the entire indebtedness prior to the original maturity date); *In re United Merchants and Mfrs., Inc.*, 674 F.2d 134, 6 Collier Bankr. Cas. 2d (MB) 321, Bankr. L. Rep. (CCH) P 69005 (2d Cir. 1982) (pre-Bankruptcy Code case finding premium provision in 1973 loan documents enforceable).

[2]Premiums can involve substantial sums, over which lenders and borrowers are willing to litigate extensively. Recent significant bankruptcy cases have involved premium claims of $23.7 million (*In re School Specialty, Inc.*, 2013 WL 1838513 (Bankr. D. Del. 2013)), $60 million (*In re Solutia Inc.*, 379 B.R. 473, 49 Bankr. Ct. Dec. (CRR) 38 (Bankr. S.D. N.Y. 2007)), $200 million (*In re MPM Silicones, LLC*, 2014 WL 4436335 (Bankr. S.D. N.Y. 2014), order aff'd, 531 B.R. 321 (S.D. N.Y. 2015)), and $400 million (*In re Energy Future Holdings Corp.*, 533 B.R. 106 (Bankr. D. Del. 2015)).

[3]*EFH I and II, supra*; *In re School Specialty, Inc.*, 2013 WL 1838513 (Bankr. D. Del. 2013); *In re MPM Silicones, LLC*, 2014 WL 4436335 (Bankr. S.D. N.Y. 2014), order aff'd, 531 B.R. 321 (S.D. N.Y. 2015); *In re Doctors Hosp. of Hyde Park, Inc.*, 508 B.R. 697 (Bankr. N.D. Ill. 2014).

whether a claim exists for expectation damages in the absence of an explicit premium provision.

The terms of premiums can vary significantly from one loan document to the next, and the approaches taken by the courts in interpreting these provisions has not always been consistent. However, through the fog of many decisions by different courts, certain general rules can be extracted. The one overriding lesson to be learned from this exercise is that careful drafting can (almost) always ensure a favorable outcome.

§ 38:3 Is there an enforceable premium?

Premiums are not inherently violative of state law.[1] Depending on the precise terms of the loan documents and the nature of the premium to be paid, premiums are allowable. However, merely including language in one's loan documents calling for a premium upon early payment of the loan is often not sufficient to protect a lender's rights.

§ 38:4 Is there an enforceable premium?—Is a premium called for under the loan documents?

The first step is to determine whether there exists a premium that allows the lender to collect under the facts of the case. If the loan documents do not contain a provision that expressly requires payment of a premium to the lender, the courts will not award a lender damages for losses it may suffer in the event of an early payment. In *In re Calpine Corp.*,[1] the loan documents contained no-call provisions, prohibiting the borrower from prepaying the loan during certain times, but did not require payment of a premium in the event of a repayment during the no-call period. Though a later appellate decision disagreed, regarding the availability of expectation damages for breach of the no-call provision (see *infra* for a discussion of the no-call provision), the lender had no right to a premium in the absence of express language calling for such an obligation.

[Section 38:3]

[1] *In re Skyler Ridge*, 80 B.R. 500, 16 Bankr. Ct. Dec. (CRR) 1122, Bankr. L. Rep. (CCH) P 72167 (Bankr. C.D. Cal. 1987) (interpreting Kansas law); *Matter of LHD Realty Corp.*, 726 F.2d 327 (7th Cir. 1984); *In re Madison 92nd Street Associates LLC*, 472 B.R. 189, 56 Bankr. Ct. Dec. (CRR) 170 (Bankr. S.D. N.Y. 2012).

[Section 38:4]

[1] *In re Calpine Corp.*, 365 B.R. 392 (Bankr. S.D. N.Y. 2007), aff'd as modified, 2010 WL 3835200 (S.D. N.Y. 2010).

§ 38:5 Is there an enforceable premium?—Has the premium been waived?

A pivotal issue, which often arises in the bankruptcy context, is whether acceleration of the debt has caused the lender to waive its right to a premium. The courts agree that a lender who accelerates a loan generally forfeits its right to recover a premium. The rationale most commonly attributed to such outcomes is that when a loan is accelerated, it becomes fully mature. As the maturity of the loan has been advanced by the acceleration, there can be no prepayment of the loan.[1]

Lenders who voluntarily accelerate loans upon default, for the purpose of enforcing the lenders' remedies, can cost themselves the right to a prepayment premium in the process. In *Slevin Container Corp. v. Provident Federal Savings and Loan Assoc. of Peoria*,[2] the borrower under a real estate loan sold the subject property in violation of the loan documents prior to the maturity of the loan. The lender accelerated and demanded payment of a contractual premium. The court found that the lender's voluntary acceleration of the debt caused the loan to be fully mature, and, therefore, there was no prepayment and no premium owing.

However, lenders also can find themselves holding accelerated loans, and waived premiums, without taking any action at all. Loan documents commonly contain a list of events of default, the occurrence of which will authorize the lender to enforce certain remedies. While standard default provisions give lenders the option to accelerate upon most types of default, they also provide for automatic acceleration of the indebtedness upon the filing of a bankruptcy case by a borrower or guarantor (a "bankruptcy default acceleration").[3] This automatic contractual acceleration of the debt, in the absence of a carefully drafted loan document, will constitute a waiver of the lender's right to recover a premium.

[Section 38:5]

[1] *U.S. Bank Nat. Ass'n v. South Side House, LLC*, Bankr. L. Rep. (CCH) P 82170, 2012 WL 273119 (E.D. N.Y. 2012); *In re Denver Merchandise Mart, Inc.*, 740 F.3d 1052, 58 Bankr. Ct. Dec. (CRR) 274 (5th Cir. 2014); *In re Madison 92nd Street Associates LLC*, 472 B.R. 189, 56 Bankr. Ct. Dec. (CRR) 170 (Bankr. S.D. N.Y. 2012); *Matter of LHD Realty Corp.*, 726 F.2d 327 (7th Cir. 1984).

[2] *Slevin Container Corp. v. Provident Federal Sav. and Loan Ass'n of Peoria*, 98 Ill. App. 3d 646, 54 Ill. Dec. 189, 424 N.E.2d 939 (3d Dist. 1981).

[3] As an example, the indenture at issue in *MPM Silicones* stated as follows: "If an Event of Default specified in Section 6.01(f) or (g) with respect to MPM [which includes the debtor's bankruptcy] occurs, the principal of, premium, if any, and interest on all Notes shall ipso facto become and be immediately due and payable without any declaration or other act on the part of the Trustee or any Holders."

In *In re Solutia*,[4] the Bank of New York was the indenture trustee for a series of promissory notes issued by Solutia, Inc. with a 2009 maturity date. The notes provided that the filing of a reorganization proceeding is an event of default causing the notes to become "immediately due and payable" without any action by Bank of New York. When Solutia, Inc. filed bankruptcy in 2003, the indebtedness under the notes was automatically accelerated under the default provisions, advancing the maturity date to the petition date. Though the loan documents expressly called for payment of a premium upon a prepayment of the loan, the court found that Bank of New York had no claim for a premium in the debtor's bankruptcy case due to the acceleration of the debt. Any payment of the debt would necessarily be a payment after maturity, and, therefore, not a prepayment.[5]

Two closely watched, pending cases have reaffirmed this outcome in similar circumstances. *In re Energy Future Holdings Corp.*,[6] a case currently pending in the Bankruptcy Court for the District of Delaware, involves an attempt by first lien noteholders to recover a premium following a bankruptcy filing by their borrower. The notes had an original maturity date of 2020. In the bankruptcy, the borrower used DIP financing to pay the prepetition noteholders full principal and interest under the first lien notes, but certain noteholders sought additional recovery of a premium under the indenture. The indenture, which was governed by New York law,[7] provided for payment of a premium in the event the notes were redeemed prior to a certain date and contained a provision providing for Bankruptcy Default Acceleration. The bankruptcy court found that under the indenture, the debt was accelerated by the bankruptcy filing and that, in the absence of any express language requiring payment upon acceleration, there was no premium owing to the noteholders.

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[4] *In re Solutia Inc.*, 379 B.R. 473, 49 Bankr. Ct. Dec. (CRR) 38 (Bankr. S.D. N.Y. 2007).

[5] *Solutia*, 379 B.R. at 487–88.

[6] *In re Energy Future Holdings Corp.*, 527 B.R. 178 (Bankr. D. Del. 2015).

[7] If it seems that most of the cases on premiums look to New York law, that is because they do. Loan documents for sophisticated lenders and borrowers commonly contain choice of law provisions calling for New York law to apply to any interpretation of the documents. Courts in Delaware (*EFH*, *School Specialty*), Illinois (*In re Doctors Hosp. of Hyde Park, Inc.*, 508 B.R. 697 (Bankr. N.D. Ill. 2014)), Maryland (*In re Duralite Truck Body & Container Corp.*, 153 B.R. 708 (Bankr. D. Md. 1993)), Mississippi (*Biloxi*) and other states have interpreted the enforceability of premium provisions in loan documents under New York law.

In *In re MPM Silicones, LLC ("Momentive")*,[8] the borrower had issued a series of senior lien promissory notes which required payment of a premium in the event that the notes were redeemed prior to October 2015. The indentures governing these notes contained Bankruptcy Default Acceleration provisions. The borrowers filed bankruptcy in April 2014. The plan of reorganization provided that holders of the senior lien notes who accepted the plan would receive payment of their debt in full, without any premium, while holders of senior lien notes who rejected the plan would receive replacement notes, with the bankruptcy court to determine if such notes would include any amount for a premium. Certain holders of senior lien notes rejected the plan. They sought to recover a premium, arguing that the repayment of the principal and interest by the borrower through the replacement notes constituted a voluntary redemption of the debt, triggering the premium obligation. The bankruptcy court ruled that there was no premium owing due to the automatic acceleration of the debt upon the bankruptcy filing. As the maturity date of the senior lien notes had been advanced to the petition date, the repayment of the debt under the plan could not constitute a prepayment of the senior lien notes. This ruling was upheld on appeal to the district court. An appeal to the Second Circuit Appellate Court is pending at this time.

§ 38:6 Is there an enforceable premium?—Exceptions to waiver of the premium

Is a lender holding a defaulted loan forced to choose between acceleration and collecting a premium? Should bankruptcy default acceleration provisions be removed from loan documents to avoid the type of result seen in *EFH I* and *Momentive*?[1] Or can lenders protect their right to a premium notwithstanding acceleration of the indebtedness? Once again, careful drafting of

[8] *In re MPM Silicones, LLC*, 2014 WL 4436335 (S.D. N.Y. 2015).

[Section 38:6]

[1] The *Momentive* court discussed the benefits of the bankruptcy default provision:

> a contractual acceleration provision goes well beyond the acceleration that occurs as a matter of bankruptcy law with respect to the determination of claims against the estate. One can . . . observe that as a matter of law the filing of the bankruptcy case itself accelerates debt. However, a contractual acceleration provision advances the maturity date of the debt in ways that have consequences in the bankruptcy case beyond the operation of this general bankruptcy law principle. For example, such acceleration may give rise to a right to damages under section 1124(2)(C) of the Bankruptcy Code if the debtor later attempts to decelerate and reinstate the debt. It also may give the creditor a right to a different type or amount of interest; and the presence or absence of such a provision may also affect rights against other parties including co-debtors.

Momentive, 2014 WL 4436335 at *23 (internal citations omitted).

the loan documents is key. If the loan documents contain a clear and unambiguous provision calling for a premium to be owed in the event of payment after acceleration, the courts will enforce that contractual language. This is true whether the acceleration is automatic upon a bankruptcy filing or due to a prepetition voluntary act by the lender.

However, the loan documents must be very specific in allowing for a premium after acceleration. In *Solutia*, the indenture stated that upon default and acceleration, all principal, interest, and "premium, if any" under the note would be due and owing. The court found that this reference to payment of a premium after acceleration was not specific enough to preserve the lender's right to collect the premium. In *Momentive*, similar language was found insufficient to save the lender's right to a premium following acceleration.

§ 38:7 Is there an enforceable premium?—Exceptions to waiver under bankruptcy default acceleration

Few courts dealing with bankruptcy default acceleration have found that the loan documents at issue expressly provide for a premium postacceleration, such that the acceleration will not effect a waiver of the premium.[1] As seen in *EFH I* and *Momentive*, recent bankruptcy cases have involved waiver of premiums due to the absence of the necessary contractual language. However, recent decisions make clear that carefully drafted language can preserve a premium even in case of a bankruptcy default acceleration.

In *In re Premier Entertainment Biloxi, LLC*,[2] the indebtedness under a series of notes was automatically accelerated by the bankruptcy filing. In rejecting the indenture trustee's claim for a premium on the basis that the acceleration advanced the maturity to the petition date, the bankruptcy court stated "[i]t is undisputed that the Indenture does not include language that expressly preserves the right of the Noteholders to collect a premium after acceleration or that requires payment of a

[Section 38:7]

[1]In a pre-Bankruptcy Code case under the former Bankruptcy Act, *In re United Merchants and Mfrs., Inc.*, 674 F.2d 134, 6 Collier Bankr. Cas. 2d (MB) 321, Bankr. L. Rep. (CCH) P 69005 (2d Cir. 1982), a loan agreement provided that upon default and acceleration, there would be due "an amount equal to the pre-payment charge that would be payable" if the debtor was prepaying the note. Based on this clear and unambiguous language, the appellate court upheld the lender's right to this premium, though it focused primarily on the question of whether the premium was allowable as liquidated damages.

[2]*In re Premier Entertainment Biloxi LLC*, 445 B.R. 582 (Bankr. S.D. Miss. 2010).

premium during the No-Call Period" and then cited to a New York state court decision requiring "clear contract language" to allow a premium after default and acceleration. In *HSBC Bank USA, N.A. v. Calpine Corporation*,[3] the debtors' bankruptcy filing constituted a default under a series of notes, automatically accelerating the indebtedness. In finding that the lenders had no right to recover a premium under the notes, the court pointed out that "the notes could have provided for the payment of premiums in the event of payment pursuant to acceleration." In *Momentive*, the court noted that if there was clear and unambiguous language in the loan documents calling for a premium in the event of automatic acceleration, it would be enough to qualify as an exception to the general rule that a premium is waived by acceleration. Ultimately, the court found the language in the notes inadequate to create such an exception.

§ 38:8 Is there an enforceable premium?—Exceptions to waiver for voluntary acceleration

A number of cases have shown that a lender's voluntary, prepetition acceleration of indebtedness following default need not result in a waiver of a premium. In *In re Madison 92nd Street Associates, LLC*,[1] the Chapter 11 debtor objected to a lender's proof of claim that included a premium in the amount of $3.1 million. The lender had accelerated the debt and obtained a prepetition consent judgment of foreclosure that included the premium, which was based on a loan agreement that provided for a premium of 5% of the balance of the loan "if the Loan is accelerated during the Lockout Period for any reason other than casualty or condemnation . . . ." Though the bankruptcy court rejected the debtor's attack on the prepetition consent judgment as barred by res judicata, the court further stated that the language of the loan agreement was clear and unambiguous, entitling the lender to the premium due to the prepetition acceleration of the debt.

A similar result also can be found in *In re CP Holdings, Inc.*,[2] where a court determined that language in a promissory note clearly obligated the debtor to pay a premium following the lender's acceleration of the debt. In *CP Holdings, Inc.*, the lender

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[3] *HSBC Bank USA, Nat. Ass'n v. Calpine Corp.*, 2010 WL 3835200 (S.D. N.Y. 2010).

[Section 38:8]

[1] *In re Madison 92nd Street Associates LLC*, 472 B.R. 189, 56 Bankr. Ct. Dec. (CRR) 170 (Bankr. S.D. N.Y. 2012).

[2] *In re CP Holdings, Inc.*, 332 B.R. 380 (W.D. Mo. 2005), aff'd, 206 Fed. Appx. 629 (8th Cir. 2006).

accelerated all indebtedness under a secured promissory note upon default. The debtor filed bankruptcy two months later. The debtor challenged the lender's proof of claim, which included a premium in excess of $2.6 million. The promissory note provided that in the event the holder accelerates the indebtedness, "the undersigned waives any right to prepay said principal sum in whole or in part without premium and agrees to pay a prepayment premium."

Two rulings from the Northern District of Illinois give further guidance on the requirements for premium provisions. In *In re Schaumburg Hotel Owner Limited Partnership*,[3] the debtor defaulted on its loan with Connecticut General prepetition. The lender sent a notice of default accelerating the indebtedness and filed a foreclosure action. Two days later, the debtor filed a voluntary Chapter 11 proceeding. The loan documents obligated the debtor to pay a premium of 10% of the outstanding indebtedness upon prepayment of the loan, "whether the payment is voluntary *or the result of prepayment created by the exercise of any acceleration clause after a default provided for hereunder or under the Mortgage or Security Documents.*"[4] The bankruptcy court rejected the debtor's argument that the voluntary acceleration of the debt waived the right to the premium, noting that the parties had specifically bargained for the premium to be due and payable upon default and acceleration.

The Bankruptcy Court for the Northern District of Illinois revisited the issue in *In re AE Hotel Venture*.[5] There, the court found that the lender was entitled to a premium notwithstanding the lender's prepetition acceleration of the indebtedness following default on the loan payments. The debtor sold its property in the bankruptcy case and the lender sought payment of a premium from the proceeds. The court recited the general rule that a lender waives its right to a premium when it accelerates. However, the promissory note stated that a payment of the debt, after a default but prior to a sale of the property "through foreclosure or the exercise of the other remedies" available to the lender would be deemed a voluntary prepayment, triggering the lender's right to a premium. The court in *AE Hotel Venture* referenced the holding in *Schaumburg Hotel*. Acknowledging that the premium language in the *AE Hotel Venture* loan documents did not mention acceleration, as did the note in *Schaumburg Hotel,* the court nevertheless found the language expressly provided for the premium even following a default.

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[3] *In re Schaumburg Hotel Owner Ltd. Partnership*, 97 B.R. 943 (Bankr. N.D. Ill. 1989).

[4] *Schaumburg Hotel*, 97 B.R. at 953.

[5] *In re AE Hotel Venture*, 321 B.R. 209, 44 Bankr. Ct. Dec. (CRR) 92 (Bankr. N.D. Ill. 2005).

Similarly, in *Norwest Bank Minnesota v. Blair Road Associates, L.P.*,[6] a secured lender accelerated a commercial loan and filed a foreclosure action to recover its collateral. The promissory note provided for a premium upon any repayment of the principal debt after an event of default or acceleration of the debt, including under any foreclosure sale or right of redemption. The court found this clearly provided for both acceleration and collection of a premium upon default.

§ 38:9 Is there an enforceable premium?—A trap for lenders when there is no actual payment

A lender or lender's counsel reading this far may think that the sound approach is to draft loan documents stating that a premium is owing upon a payment of the indebtedness after any acceleration under the loan documents, whether voluntary or automatic. While such language will offer protection in the event of a bankruptcy filing followed by a loan payoff, either through refinancing or a liquidation sale, it could still leave the lender exposed in situations where there is no actual payment to trigger the premium obligation.

In *Northwestern Mutual Life Ins. Co. v. Uniondale Realty Associates*,[1] the lender accelerated and foreclosed on a mortgage following default. The note provided for payment of a premium in the event of a payment of the indebtedness after default and acceleration. In denying the foreclosing lender's request for a premium, the court found that the loan documents did not provide for a premium to be due and owing upon acceleration, but rather only upon payment following acceleration. The note also did not expressly state that "prepayment" would include a foreclosure sale or a redemption by the borrower.

In *In re Denver Merchandise Mart, Inc.*,[2] the appellate court affirmed the bankruptcy court's ruling that a lender who accelerated prepetition did not have a right to a premium in the borrower's bankruptcy case, despite language in the loan documents making the premium owing upon payment after acceleration of the debt. In addressing the problem, the court noted that the borrower had not actually paid the debt prior to the maturity date. The debtor defaulted and the lender accelerated, prompting the

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[6] *Norwest Bank Minnesota v. Blair Road Associates, L.P.*, 252 F. Supp. 2d 86 (D.N.J. 2003).

[Section 38:9]

[1] *Northwestern Mut. Life Ins. Co. v. Uniondale Realty Associates*, 11 Misc. 3d 980, 816 N.Y.S.2d 831 (Sup 2006).

[2] *In re Denver Merchandise Mart, Inc.*, 740 F.3d 1052, 58 Bankr. Ct. Dec. (CRR) 274 (5th Cir. 2014).

debtor's bankruptcy filing. The loan documents defined prepayment to include a prepayment of the principal debt after acceleration of the debt, including reinstatement in connection with a foreclosure, a foreclosure sale, or redemption by the borrower. The note also provided that the debtor shall pay the premium whether the prepayment is voluntary or involuntary, including in connection with the lender's acceleration of the debt.

In connection with a hearing on the debtor's plan of reorganization, the *Denver Merchandise Mart* court disallowed the lender's $1.8 million claim for a premium. The loan documents did not provide for a premium to be due and owing upon acceleration, but rather only upon a payment after acceleration. There was no actual payment by the borrower to trigger the premium obligation. In affirming the bankruptcy court's ruling, the Fifth Circuit stated that it would have been easy for the lender to have drafted the loan documents to provide that a prepayment would be deemed to have been made upon acceleration of the debt.[3]

§ 38:10 Filing bankruptcy as an intentional default

When a note or indenture contains a provision automatically accelerating indebtedness upon filing a bankruptcy petition, an alternative way for lenders to receive a make-whole payment is to argue that the only reason the debtor filed the bankruptcy petition was to trigger an automatic acceleration and avoid paying the premium.[1] Particularly in larger cases, where there are significant layers of debt, and varying, complex relationships, debtors will be likely to defeat this argument. For example, after finding that there was no clause in the indenture requiring payment of a make whole premium for causing an intentional default,[2] the *EFH* court held that taking advantage of bankruptcy provisions to avoid a make whole payment was not equivalent to defaulting solely to avoid paying the premium. Courts' predilection to construe this test in favor of the debtor and against the lender is exemplified by the *EFH* decision. Evidence adduced during

[3]The Fifth Circuit in *Denver Merchandise* cited to *CP Holdings, Inc.*, where the note stated "The undersigned [borrower] agrees that if the holder of this Note [lender] accelerates the whole or any part of the principal sum . . . the undersigned waives any right to prepay said principal sum in whole or in part without premium and agrees to pay a prepayment premium."

[Section 38:10]

[1]See, e.g., *In re Energy Future Holdings Corp.*, 527 B.R. 178 (Bankr. D. Del. 2015); *In re MPM Silicones, LLC*, 2014 WL 4436335, *13 (Bankr. S.D. N.Y. 2014), order aff'd, 531 B.R. 321 (S.D. N.Y. 2015); *U.S. Bank Nat. Ass'n v. South Side House, LLC*, Bankr. L. Rep. (CCH) P 82170, 2012 WL 273119, *10 (E.D. N.Y. 2012); *In re Chemtura Corp.*, 439 B.R. 561, 603, (Bankr. S.D. N.Y. 2010).

[2]*EFH I*, 527 B.R. at 191–94.

discovery included: (1) deposition testimony that " 'significant value could be unlocked' if [debtor] did not pay the make-whole after it filed for bankruptcy"; (2) written materials from different first lien debt holders pushing for a bankruptcy filing to avoid paying the make whole; and (3) the debtors' 8-K filing with the SEC stating that debtor "would file for bankruptcy and 'refinance' the EFIH Notes without paying 'any make-whole amount.' "[3] The *EFH* court weighed this evidence against "the collapse" of the debtor's active attempts to avoid bankruptcy, "overwhelming evidence that the Debtors filed bankruptcy because they were facing a severe liquidity crisis" and cited disparity of savings, to find that the purpose of filing bankruptcy was not to avoid the premium payment by intentionally defaulting.

In the court's view "to suggest that the Debtors refused to market and sell [a separate business], which may be worth $18 billion, to avoid having to pay a $400 million make-whole premium stretches the bounds of credulity. The EFIH Debtors are no different than any other debtor that is forced into bankruptcy because of financial reasons but decides to use the tools provided by that bankruptcy, such as the power to reject unprofitable leases, for business reasons."[4]

As such, even in smaller, less complex bankruptcies, it will be difficult for lenders to prevail based on this argument, and success will largely depend upon the unique facts of each case.

§ 38:11 Lifting the automatic stay to rescind acceleration

Recently, creative lenders have sought to lift the automatic

[3] *EFH I*, 527 B.R. at 188–89.

[4] *EFH I*, 527 B.R. at 191–94. See also, *In re MPM Silicones, LLC*, 2014 WL 4436335, *13 (Bankr. S.D. N.Y. 2014), order aff'd, 531 B.R. 321 (S.D. N.Y. 2015) ("Here, even if the trustees had not conceded this point, it is clear that the debtors' bankruptcy is not simply a tactical device to deprive the first and 1.5 lien holders of a make-whole claim."); *In re Chemtura Corp.*, 439 B.R. 561, 603 n.186 (Bankr. S.D. N.Y. 2010) ("A third layer might exist in some cases, though I don't think anyone could seriously argue that it applies here. If a bankruptcy case were filed with the *purpose* (or, arguably, a material purpose) of sidestepping a no-call provision, or to avoid liability for a make-whole . . . arguments to disallow claims based on either would be much weaker."). Cf. *Northwestern Mut. Life Ins. Co. v. Uniondale Realty Associates*, 11 Misc. 3d 980, 985, 816 N.Y.S.2d 831, 836 (Sup 2006) ("In the event that a court concludes that the borrower has defaulted intentionally in order to trigger acceleration and thereby avoid or evade a prepayment premium, the prepayment clause may be enforced, notwithstanding substantial authority which requires an explicit agreement to allow a premium after acceleration"); *Biancalana v. Fleming*, 45 Cal. App. 4th 698, 703–04, 53 Cal. Rptr. 2d 47 (6th Dist. 1996) ("We add that any question whether the all-encompassing words cover the prepayment penalty is resolved in favor of inclusion. This follows because an obligor could render the prepayment penalty clause meaningless by simply intentionally defaulting to provoke an acceleration and then tendering the amount due less a prepayment penalty.").

stay to rescind acceleration, which would allow them to receive a make-whole premium.[1] Like most other instances where there has been an automatic bankruptcy default acceleration and the operative agreement does not have a requirement that the make-whole premium must be paid postacceleration, these lenders have not met with success.

Courts commonly view attempts to rescind acceleration as a violation of the automatic stay because it is an attempt to collect a debt. The *Solutia* court gives the most explicit explanation of this concept.

> This court finds that where the indenture provides for automatic acceleration any attempt at deacceleration would violate the automatic stay since it is a direct attempt to get more property from the debtor and the estate, either through a simple increase in the amount of a pro-rata plan distribution or through recovery of a greater amount of the collateral which secures the claim. In either case, deacceleration is an attempt to "assess" an increased claim against the amount of the surplus that would otherwise be available to the estate and creditors.[2]

There may still be hope—for oversecured lenders. Where a creditor is oversecured—as was the case in *EFH I*—courts will consider solvency, and the effect of allowing a make-whole premium to be made, in their analysis. For example, the *EFH I* court looked to whether there was cause to lift the automatic stay because the debtors were solvent. In noting that "a debtor's solvency may, in certain cases, be a relevant consideration in determining whether cause exists to lift the automatic stay[,] it is

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[Section 38:11]

[1] *EFH, supra,* at 27 ("Were the Court, however, to lift the automatic stay, *nunc pro tunc* to a date on or before June 19, 2014, to allow the Trustee's rescission notice to take effect then the automatic default would be waived, the Notes would no longer be immediately due and the refinancing would require payment of the Applicable Premium.").

[2] *Solutia*, 379 B.R. at 485. See also *In re AMR Corp.*, 485 B.R. 279, 294, 57 Bankr. Ct. Dec. (CRR) 146 (Bankr. S.D. N.Y. 2013), aff'd, 730 F.3d 88, 58 Bankr. Ct. Dec. (CRR) 122 (2d Cir. 2013), cert. denied, 134 S. Ct. 1888, 188 L. Ed. 2d 913 (2014) ("Any deceleration of these notes, however, is barred by the automatic stay imposed by the filing of this bankruptcy."); *EFH I*, 527 B.R. at 197 ("Sending a notice of rescission is an act to 'collect, assess or recover' on a claim, especially when the Noteholders have already been paid their full principal and accrued interest."); *Momentive*, 2014 WL 4436335 at *19 ("[T]he automatic stay does, in fact, apply to the sending of a rescission notice."); cf. *In re Enron Corp.*, 300 B.R. 201, 212, 42 Bankr. Ct. Dec. (CRR) 5 (Bankr. S.D. N.Y. 2003) ("by seeking to enforce the terms of the Employment Agreement, and by unilaterally seeking to terminate same and invoke its damages provisions, the Court finds that Claimant violated the automatic stay.").

not the sole factor to be considered by the Court."[3] The court ultimately found there was "a genuine issue of material fact as to whether cause exists to lift the automatic stay."[4] After a two-day trial, in *EFH II*[5] the court denied the request to allow deceleration. It stated:

> i. Notwithstanding that the . . . Debtors are presumed solvent . . . based upon the totality of the circumstances, cause does not exist to lift the automatic stay to allow the Trustee to waive the default and decelerate the Notes.
>
> ii. Great prejudice to either the . . . Debtors' estate or the . . . . Debtors, in the form of the loss of hundreds of millions of dollars, will result from a lifting of the automatic stay.
>
> iii. The hardship to the Noteholders by maintenance of the automatic stay is, at most, equal to the hardship to the . . . Debtors from lifting the automatic stay and therefore does not considerably outweigh the hardship to the . . . Debtors.[6]

In denying the relief request, the *EFH II* court made specific note of the opportunities presented to the two petitioning note holders that offered testimony in support of lifting the automatic stay. Among other things, the court noted that (1) both continued to purchase claims or interests in the bonds from their initial

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[3]*EFH I*, 527 B.R. at 198; see also, *In re AMR Corp.*, 485 B.R. 279, 295, 57 Bankr. Ct. Dec. (CRR) 146 (Bankr. S.D. N.Y. 2013), aff'd, 730 F.3d 88, 58 Bankr. Ct. Dec. (CRR) 122 (2d Cir. 2013), cert. denied, 134 S. Ct. 1888, 188 L. Ed. 2d 913 (2014) ("In determining whether 'cause' exists to lift the stay for prepetition litigation, courts in this Circuit consider twelve factors (the "Sonnax Factors") . . . . While many of these factors specifically relate to efforts to lift the stay to pursue proceedings in other courts, the twelve factors also include more general considerations that are applicable here, including the lack of any connection with or interference with the bankruptcy case and the impact of the stay on the parties and the balance of harms.") (internal citations omitted); *In re AMR Corp.*, 730 F.3d 88, 112, 58 Bankr. Ct. Dec. (CRR) 122 (2d Cir. 2013), cert. denied, 134 S. Ct. 1888, 188 L. Ed. 2d 913 (2014) ("We find no abuse of discretion in the bankruptcy court's conclusion that lifting the automatic stay would serve only to increase the size of [the secured creditor's] claim (to an amount greater than that to which it is entitled pursuant to the Indentures), harming the estate and American's other creditors. 'One of the principal purposes of the automatic stay is to preserve the property of the debtor's estate for the benefit of all the creditors.' "); *Momentiv*e, 2014 WL 4436335, at *23 ("Thus, the first and 1.5 lien trustees' request for stay relief should not be granted to permit such a material change to be effectuated. Key 'Sonnax factors' regarding the impact of rescission and deceleration on the parties and on the case strongly argue against granting such relief.").

[4]*Momentiv*e, 2014 WL 4436335, at *23.

[5]*In re Energy Future Holdings Corp.*, 533 B.R. 106 (Bankr. D. Del. 2015) ("*EFH II*").

[6]*EFH II*, 533 B.R. at 110-11.

purchase of the debt until trial, and (2) that both "could have invested in the first lien DIP but chose not to do so."[7]

Finding that the burden of proof was on the debtors "but only after the Trustee makes a prima facie case that it is entitled to relief,"[8] the court looked to the cause standards applicable in lifting the automatic stay in Delaware bankruptcy courts, and considered:

> (1) whether any great prejudice to either the bankrupt estate or the debtor will result from a lifting of the automatic stay; (2) whether the hardship to the non-bankrupt party by maintenance of the automatic stay considerably outweighs the hardship to the debtor; and (3) the probability of the creditor prevailing on the merits.[9]

In finding significant prejudice to the estate, the *EFH II* court looked at the effect of lifting the stay on equity holders in addition to creditors, and noted that "[l]ifting the automatic stay would, thus, cause nearly half a billion dollars to leave the estate,"[10] which approached $1 billion when the second lien noteholders' anticipated motion was included.[11]

In finding that the harm to the creditors did not considerably outweigh the harm to the debtors, the court noted that the monetary harm was equivalent to both the noteholders and the debtor.[12] It also noted:

> the reality that every restructuring proposal made in these cases to date has needed to grapple with the interdependent restructurings of [the debtor] and its two major subsidiaries . . . . Thus, if the Trustee were permitted to lift the automatic stay and expand its own claim by $431 million, it would cause great prejudice not only to the Debtors, but also to their equity holder, EFH, which, in turn would significantly complicate efforts to successfully restructure [EFH][13]

Among other secondary arguments, the *EFH II* court disregarded the benefit to the debtors of NOLs because "for an NOL to have value, there must be income tax liability against which to use any NOLs" and there was no evidence that the debtors were

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[7] *EFH II*, 533 B.R. at 113.

[8] *EFH II*, 533 B.R. at 117.

[9] *EFH II*, 533 B.R. at 117.

[10] *EFH II*, 533 B.R. at 119.

[11] *EFH II*, 533 B.R. at 119. Perhaps recognizing that the second lien noteholders were of a different priority than the first lien noteholders, the *EFH II* court noted that the near half-billion dollars of additional indebtedness that would result from lifting the automatic stay was sufficient harm in and of itself to weigh in favor of the debtors. *EFH II*, 533 B.R. at 118-19.

[12] *EFH II*, 533 B.R. at 118–19.

[13] *EFH II*, 533 B.R. at 120.

"generating sufficient income such that any additional NOLs would provide any additional benefit to" the debtors.[14] Likewise, the court disregarded the trustee's argument that the benefit of "interest savings to the . . . Debtors on one hand . . . [as compared to the] reinvestment benefits to the Noteholders on the other"[15] did not foist the balance of harm on the noteholders, as there was no evidence that the "Noteholders could have earned more through reinvestment than the EFIH Debtors saved through interest savings,"[16] ultimately holding that the difference in these amounts was still appropriately tracked by the make-whole premium and nothing else.

Other courts have analyzed what constitutes "cause" to lift the automatic stay, and while the underlying test may be stated differently,[17] the factors are similar. As the bankruptcy court found in *In re AMR Corp.*:[18]

> While many of these factors specifically relate to efforts to lift the stay to pursue proceedings in other courts, the twelve factors also include more general considerations that are applicable here, including the *lack of any connection with or interference with the bankruptcy case* and the *impact of the stay on the parties and the balance of harms*.[19]

In denying the lender's motion to lift the automatic stay, among other things, the *AMR* court noted with disfavor the timing of the lender's motion—filed "one year into these cases,"[20] and after (1) a motion for postpetition financing was pending sub judice, and (2) the debtor "sought to pay the balance of the Prepetition Notes." Citing "the obvious harm to the estate from such a contractual modification *now*,"[21] and characterizing the motion as "an attempt to change the facts on the ground,"[22] the court denied the lift-stay motion.

This reasoning was later upheld on appeal, and similar equitable principles were relied on in the *Momentive* decision in deny-

[14] *EFH II*, 533 B.R. at 121.

[15] *EFH II*, 533 B.R. at 121.

[16] *EFH II*, 533 B.R. at 122.

[17] Compare the 12-factor test in *In re Sonnax Industries, Inc.*, 907 F.2d 1280, 1286, 23 Collier Bankr. Cas. 2d (MB) 132 (2d Cir. 1990) with the three-part test discussed supra in EFH II.

[18] *In re AMR Corp.*, 485 B.R. 279, 57 Bankr. Ct. Dec. (CRR) 146 (Bankr. S.D. N.Y. 2013), aff'd, 730 F.3d 88, 58 Bankr. Ct. Dec. (CRR) 122 (2d Cir. 2013), cert. denied, 134 S. Ct. 1888, 188 L. Ed. 2d 913 (2014).

[19] *In re AMR Corp.*, 485 B.R. at 295 (emphasis added).

[20] *In re AMR Corp.*, 485 B.R. at 295.

[21] *In re AMR Corp.*, 485 B.R. at 295–96.

[22] *In re AMR Corp.*, 485 B.R. at 295–96.

ing lender motions to lift the automatic stay.[23] In short, a lender will have to support any motion to lift the automatic stay to effect a deceleration with significant equitable considerations and demonstrate that deceleration will not result in a windfall to the lender at great harm to the debtor and, even, equity.

§ 38:12 Ipso facto clauses usually do not void automatic bankruptcy acceleration provisions

While it is tempting to consider the ipso facto nature of bankruptcy default acceleration provisions as a ground for disqualifying such a provision, ipso facto clauses are not categorically impermissible; ipso facto voidability is limited to very specific scenarios. The Second Circuit reviewed this issue in depth in *In re AMR Corp.*[1] After strictly applying the automatic bankruptcy acceleration provision, the Second Circuit found that there are three specific sections of the Bankruptcy Code which ban ipso facto clauses—§ 365(e)(1) invalidating automatic acceleration in executory contracts and leases, § 541(c)(1)(B) invalidating clauses which terminate a debtor's interest in property upon filing a bankruptcy, and § 363(l) which gives the trustee the right to use, sell, or lease property despite any ipso facto clauses.

> [There are] three provisions in the Bankruptcy Code that decline enforcement of *ipso facto* clauses in specified circumstances. First is § 365(e)(1) of the Code, which [voids *ipso facto* clauses in executory contracts or unexpired leases] . . . . By its terms, § 365(e)(1) is inapplicable here. Both parties agree that the Indentures are not executory contracts—contracts "on which performance remains due to some extent on both sides," . . . and neither argues that this case involves an unexpired lease. The bankruptcy court therefore did not err in concluding that "Section 4.02(a)(i) is not an invalid *ipso facto* clause" pursuant to this provision.
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> The two remaining provisions, § 541(c)(1)(B) and § 363(l), are similarly inapposite. Section 541(c)(1)(B) provides that once a bank-

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[23] *In re AMR Corp.*, 730 F.3d 88, 112, 58 Bankr. Ct. Dec. (CRR) 122 (2d Cir. 2013), cert. denied, 134 S. Ct. 1888, 188 L. Ed. 2d 913 (2014) ("We find no abuse of discretion in the bankruptcy court's conclusion that lifting the automatic stay would serve only to increase the size of [the secured creditor's] claim (to an amount greater than that to which it is entitled pursuant to the Indentures), harming the estate and American's other creditors. 'One of the principal purposes of the automatic stay is to preserve the property of the debtor's estate for the benefit of all the creditors.' "); *Momentive*, 2014 WL 4436335, at *23 ("Thus, the first and 1.5 lien trustees' request for stay relief should not be granted to permit such a material change to be effectuated. Key 'Sonnax factors' regarding the impact of rescission and deceleration on the parties and on the case strongly argue against granting such relief.").

[Section 38:12]

[1] *In re AMR Corp.*, 730 F.3d 88, 58 Bankr. Ct. Dec. (CRR) 122 (2d Cir. 2013), cert. denied, 134 S. Ct. 1888, 188 L. Ed. 2d 913 (2014)

> ruptcy case is commenced, any property interests of the debtor become property of the bankruptcy estate, notwithstanding any *ipso facto* clause that "effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property." But Sections 4.01(g) and 4.02(a)(i) do not prevent property of American from becoming property of the estate. Finally, § 363 of the Code gives the bankruptcy trustee general powers to use, sell, or lease property of the estate, and § 363(l) makes clear that the trustee has such powers, notwithstanding any *ipso facto* clause. The Indenture clauses at issue here, however, do not prevent the bankruptcy trustee from using, selling, or leasing estate property, and so do not fall within § 363(l)'s terms.
>
> U.S. Bank argues that these statutory provisions "broadly prohibit the enforcement" of *ipso facto* clauses, and apparently regardless whether they by their terms apply. The Appellant cannot identify any provision of the Bankruptcy Code, however, that provides support for such a per se prohibition. Moreover, the specificity of the provisions on which U.S. Bank does rely—which demonstrate that Congress clearly knows how to limit or negate the effect of *ipso facto* clauses when it wants to—counsels against the position that U.S. Bank urges here.[2]

Other courts have found as much, although without providing this level of detail.[3]

An alternative perspective on ipso facto clauses is presented in

[2]*In re AMR Corp.*, 730 F.3d 88, 106-7, 58 Bankr. Ct. Dec. (CRR) 122 (2d Cir. 2013), cert. denied, 134 S. Ct. 1888, 188 L. Ed. 2d 913 (2014) (internal citations and quotations omitted); *In re AMR Corp.*, 485 B.R. 279, 296, 57 Bankr. Ct. Dec. (CRR) 146 (Bankr. S.D. N.Y. 2013), aff'd, 730 F.3d 88, 58 Bankr. Ct. Dec. (CRR) 122 (2d Cir. 2013), cert. denied, 134 S. Ct. 1888, 188 L. Ed. 2d 913 (2014) ("But numerous courts in this jurisdiction have held that '[a]s a matter of statute, the question whether a bankruptcy default clause should be treated as an invalid *ipso facto* clause depends on whether the contract at issue is an executory contract or unexpired lease' "); cf. *In re General Growth Properties, Inc.*, 451 B.R. 323, 329, 55 Bankr. Ct. Dec. (CRR) 6, 65 Collier Bankr. Cas. 2d (MB) 1351 (Bankr. S.D. N.Y. 2011) ("As a matter of statute, the question whether a bankruptcy default clause should be treated as an invalid *ipso facto* clause depends on whether the contract at issue is an executory contract or unexpired lease."); *In re Saint Vincent's Catholic Medical Centers of New York*, 440 B.R. 587, 601-02, 53 Bankr. Ct. Dec. (CRR) 257 (Bankr. S.D. N.Y. 2010) ("Generally, mortgages are not executory contracts"; and "[t]he Court concludes that § 541(c)(1)(B) does not invalidate the clause including commencing a bankruptcy among the events of default. The collateral unquestionably came into the bankruptcy estate. The question is how much the Creditor may recover from the sale on account of its first-priority mortgage, not whether the collateral is property of the estate.").

[3]*In re United Merchants and Mfrs., Inc.*, 674 F.2d 134, 143-44, 6 Collier Bankr. Cas. 2d (MB) 321, Bankr. L. Rep. (CCH) P 69005 (2d Cir. 1982) ("As long as the provision is valid under state law, as is the case here, there is no warrant in the statutes or in the case law for rejecting it merely because it is triggered by the filing of a Chapter XI petition rather than by some other event of default").

In re Texaco Inc.[4] In a somewhat inverted scenario, the *Texaco* court denied a lender's motion to lift the automatic stay to permit acceleration based on an ipso facto clause in the indenture. In finding the contract executory, the *Texaco* court stated:

> Some of the continuing obligations of [debtor], other than payment of the notes include (a) Maintaining an office where the Notes may be presented for payment. (b) Maintaining a current list of names and addresses of security holders. (c) Effecting transfers and exchanges of securities. (d) Replacing lost, mutilated or destroyed securities. (e) Delivery of securities to the Trustee for cancellation. (f) Redeeming securities. (g) Depositing the redemption price. Similarly, the Indenture Trustee has continuing obligations under the Indenture such as (a) The commencement of litigation to enforce the Indenture. (b) [F]iling proofs of claim. (c) Fixing record and payment dates. (d) Giving notices of default. (e) Submission of reports to Note holders. (f) Filing reports in compliance with 15 U.S.C. §§ 77aaa to 77bbb . . . . In light of the fact that performance remains due on both sides, the Indenture may be classified as an executory contract.[5]

While at least one other court has distinguished *In re Texaco's* holding, citing to the fact that the *Texaco* creditors were unsecured and that "[g]enerally, mortgages are not executory contracts," the distinction appears to artificial and, unsupported with reasoning, does not undermine the *Texaco* court's analysis of whether or not the indenture was executory.

All of this highlights the uphill battle that lenders confront when seeking affirmative relief that would provide them with a significant make-whole premium. Ultimately, the more recent cases demonstrate that it would take a willing court and a very specific set of circumstances for lenders to invalidate a bankruptcy default acceleration as an impermissible ipso facto clause to receive a make-whole premium payment.[6]

§ 38:13 Perfect tender in time, § 502(b)(2) and § 506(b)

The perfect tender rule is a common law principle that a loan with an interest component entitles a lender to the full stream of interest payments, preventing a borrower from "calling" or paying off the note early. For this reason it is often referred to as a

[4] *In re Texaco Inc.*, 73 B.R. 960, 16 Collier Bankr. Cas. 2d (MB) 1398, Bankr. L. Rep. (CCH) P 71812 (Bankr. S.D. N.Y. 1987).

[5] *In re Texaco Inc.*, 73 B.R. at 964.

[6] *St Vincent's*, *supra*, at 601 ("The Court has examined the list of Creditor's obligations described by Plaintiffs, and finds that none of these obligations are so material that a breach would excuse Debtor's obligation to perform.").

"no-call" provision.[1] But while no-call provisions are enforceable under state law[2] (generally analyzed as liquidated damages),[3] to be enforceable in a bankruptcy case the no-call provision must set forth the amount to be paid, or some formula.[4] A specification of damages in the agreement is required because, without it, the measure of damages would be based on the amount of interest that would have been earned had there been no bankruptcy.[5]

[Section 38:13]

[1]See, e.g., *Momentive*, 2014 WL 4436335 at *16 ("That sentence, they contend, sets forth a 'non-call' ").

[2]*Momentive*, 2014 WL 4436335 at *16 ("New York law would, in fact, provide for such a claim for breach of the rule of perfect tender, at least one for specific performance"); *Northwestern Mut. Life Ins. Co. v. Uniondale Realty Associates*, 11 Misc. 3d 980, 984, 816 N.Y.S.2d 831, 835 (N.Y. Sup. Ct. 2006) ("Under the perfect tender in time rule a mortgagor has no right to prepay a note prior to its maturity date in the absence of a prepayment clause in the mortgage or contrary statutory authority and such rule has been settled law since the early 19th century") (internal quotations omitted).

[3]*Uniondale Realty Associates*, 816 N.Y.S.2d at 836 ("When a clear and unambiguous clause which calls for payment of the prepayment premium or a sum equal thereto, at any time after default and acceleration is included in the loan agreement, such clause is analyzed as liquidated damages and is generally enforceable"); *In re Madison 92nd Street Associates LLC*, 472 B.R. 189, 56 Bankr. Ct. Dec. (CRR) 170 (Bankr. S.D. N.Y. 2012) ("A liquidated damages clause is valid under New York law if: (1) actual damages are difficult to determine, and (2) the sum is not 'plainly disproportionate' to the possible loss . . . . The party seeking to avoid the liquidated damages clause bears the burden of proving that it is a penalty, and must demonstrate either that the damages flowing from prepayment were readily ascertainable at the time the parties entered into the lending agreement or the prepayment premium is 'conspicuously disproportionate' to the lender's foreseeable losses.).

[4]*Momentive*, 2014 WL 4436335 at *16 and 17 (finding a no-call provision unenforceable because "the indentures and notes do not contain a covenant stating the amount owing upon the voluntary call of the notes with the exception of sections [discussing the make-whole premium, which the court determined to be inapplicable because of the Bankruptcy Default Acceleration]" and "no provision of the indentures and notes (except as already found to be inapplicable in light of the acceleration of the debt) provides for an additional premium to be paid upon the prepayment of the notes."); *In re Calpine Corp.*, 365 B.R. 392, 398–99 (Bankr. S.D. N.Y. 2007), aff'd as modified, 2010 WL 3835200 (S.D. N.Y. 2010) ("Absent a provision in the underlying agreement authorizing the payment of fees, costs or charges, the secured party is prohibited from incorporating such amounts into its allowed secured claim.") *reversed on other grounds* by Calpine II.

[5]*In re Calpine Corp.*, 2010 WL 3835200 at *17 ("However, the measure of a claim based on New York's rule of perfect tender or a non-call right that does not provide for liquidated damages would be the difference between the present value of the interest to be paid under the . . . notes through their stated maturity and the present value of such interest under the replacement notes to be provided . . . under the chapter 11 plan, which should equate to unmatured interest. Accordingly such a claim also would be disallowed as unmatured inter-

Such a claim is specifically precluded by (1) the prohibition against payment of unmatured interest in § 502(b)(2),[6] and (2) the fact that a lender is not entitled to include charges as part of its secured claim unless those charges are supported by the loan documents in accordance with § 506(b).[7]

This is true unless, of course, the debtor happens to be solvent, although very few cases reference this possibility.[8] In *In re Premier Entertainment Biloxi LLC*,[9] after noting that the credi-

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est under section 502(b)(2) of the Bankruptcy Code. It is not interest that has accrued during the bankruptcy case, but would, rather, accrue in the future, at least to 2015 if not to 2020, the original maturity date of the notes, and, therefore, would not be an allowed claim under section 502(b)(2).") (internal citations omitted).

[6]§ 502(b) states:

> Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—
>
> . . .
>
> (2) such claim is for unmatured interest . . ..

[7]*Calpine II*, at *6 ("Second, as discussed supra, no damages are recoverable merely because of the no-call provisions in the notes. The no-call provisions became unenforceable once Debtor filed for bankruptcy, and neither note specifically required a payment in the event of acceleration. Accordingly, Trustee does not have a valid claim for damages under state law."); *EFH I*, at 31 ("Oversecured creditors have allowed claims for 'reasonable fees, costs, or charges' when those amounts are 'provided for under the agreement . . . under which such claim arose.' "); *In re Vest Associates*, 217 B.R. 696, 699 (Bankr. S.D. N.Y. 1998) (lenders "conceded that because the note does not include a damage or penalty provision in the event of the Debtor's prepayment, they cannot recover damages for any lost interest opportunity or other damages resulting from the prepayment."); *Continental Securities Corp. v. Shenandoah Nursing Home Partnership*, 188 B.R. 205, 214 (W.D. Va. 1995), aff'd, 193 B.R. 769 (W.D.Va.), aff'd, 104 F.3d 359 (4th Cir. 1996) ("a typical prepayment penalty provision contained in a lending instrument is a "charge" within the meaning of § 506(b), and as such, is subject to that provision's requirement that the instrument provide for payment of the charge before the court may allow it as part of a creditor's secured claim."). Cf. *Debentureholders Protective Committee of Continental Inv. Corp. v. Continental Inv. Corp.*, 679 F.2d 264, Bankr. L. Rep. (CCH) P 68724 (1st Cir. 1982) ("Where the debtor is *solvent,* the bankruptcy rule is that where there is a *contractual* provision, valid under state law, providing for interest on unpaid instalments [sic] of interest, the bankruptcy court will enforce the contractual provision with respect to both instalments [sic] due before and instalments [sic] due after the petition was filed.")

[8]*In re Chemtura Corp.*, 439 B.R. 561, 604–05 (Bankr. S.D. N.Y. 2010) ("*Premier Entertainment Biloxi* permits allowance of such a claim under those circumstances, and in a solvent debtor situation, I think there's a good likelihood that other courts will as well.").

[9]*In re Premier Entertainment Biloxi LLC*, 445 B.R. 582, 646 (Bankr. S.D.

tors did not have a secured claim, and therefore § 506(b) restrictions on charges were not implicated, the court found that "the possibility of an unsecured claim under § 502"[10] can allow for a claim for loss of the stream of interest payments. The language at issue in the indenture was somewhat of a catchall "that '[a]ll remedies are cumulative to the extent permitted by law,' "[11] which, the court found, "reflect[ed] the agreement of the parties that common law damages are an available remedy for breach of the No–Call Provision."[12] Amalgamating the differences, the *Biloxi* court found that

> In sum the unavailability of specific performance as a remedy and the lack of a stipulated LIQUIDATED damages provision in the Indenture *do not prohibit the allowance of an award of expectation damages to the Claimants* as an alternative remedy for breach of the No–Call Provision, *as an unsecured claim*. At the time of contract formation, the Claimants contemplated performance of the Indenture, including the No–Call Provision.[13]

As a result, "the amount of [the Noteholders'] damages is the present value difference between the market interest rate and the contract interest rate at the time the Notes were repaid."[14] Significantly, the *Momentive* court denied claims by secured lenders for the inverse reasoning,[15] but distinguished *Biloxi* with approval. The *Momentive* court found that:

> The two cases relied upon by the [noteholders] for the contrary proposition [that damages for violating a no-call are barred by § 502(b)(2) as unmatured interest] actually are consistent with the foregoing analysis. The debtors in both cases (unlike here) were solvent and, therefore, the courts found them to be subject to an exception to section 502(b)(2) of the Code's disallowance of claims for unmatured interest under either equitable principles, as set forth in the legislative history to section 1124 of the Bankruptcy

Miss. 2010).

[10] *In re Premier Entertainment Biloxi LLC*, 445 B.R. at 635.

[11] *In re Premier Entertainment Biloxi LLC*, 445 B.R. at 636.

[12] *In re Premier Entertainment Biloxi LLC*, 445 B.R. at 636.

[13] *In re Premier Entertainment Biloxi LLC*, 445 B.R. at 636.

[14] *In re Premier Entertainment Biloxi LLC*, 445 B.R. at 646.

[15] *Momentive* 2014 WL 4436335 at *17 ("However, the measure of a claim based on New York's rule of perfect tender or a non-call right that does not provide for liquidated damages would be the difference between the present value of the interest to be paid under the first and 1.5 lien notes through their stated maturity and the present value of such interest under the replacement notes to be provided to the [first] and 1.5 lien holders under the chapter 11 plan, which should equate to unmatured interest.").

> Code, or because of the application of the best interests test in section 1129(a)(7) of the Code when the debtor is solvent.[16]

As such, despite the prohibition on payment of unmatured interest, an unsecured creditor may be able to obtain where the debtor is solvent—a narrow, but relevant, exception to the unmatured interest rules in the Bankruptcy Code.

§ 38:14 Conclusion

Premiums are alive and well, although somewhat curtailed by courts' tendencies to strictly construe them against secured lenders. The recent decisions leave a fairly clear road map for lenders preparing loan documents. The documents must contain language expressly providing for payment of a premium, as one cannot rely on the courts to imply the existence of such a right or to find a right to damages for violation of the perfect tender rule. The make-whole provision should be tied to a formula aimed at calculating the lender's anticipated losses due to early payment, should recite the sophisticated nature of the parties and acknowledge the parties' understanding that it will be difficult to calculate the lender's damages in the event of a default. The lender can include automatic acceleration upon bankruptcy in the event of default, but the documents must clearly state that the premium shall become due and owing upon acceleration, whether voluntary or involuntary. Finally, the make-whole provision should clarify that it is due and owing regardless of whether any actual prepayment is made.

For those lenders holding loan documents that do not contain such clear make-whole language, a loan modification, forbearance agreement, or loan renewal presents an opportunity to tighten up the make-whole language. Barring that, a lender can use this chapter as an indication of what is likely to happen. A bankruptcy default acceleration will waive a lender's right to a premium. A bankruptcy filing by a borrower will likely have the same effect, although without a bankruptcy default acceleration provision, a lender will have fewer protections, such as the right to "damages incurred as a result of any reasonable reliance . . . on [the] contractual provision"[1] should the borrower later decelerate the loan and reinstate the debt. Unless there are very good facts for the lender, it is difficult to resurrect the premium by arguing that the borrower defaulted, or filed bankruptcy with the sole intent of avoiding the premium. Once a borrower files bankruptcy, lenders will face an uphill battle to rescind acceleration,

[16] *Momentive,* 2014 WL 4436335 at *17 (internal citations omitted).

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[1] 11 U.S.C.A. § 1124(2)(C).

unless the borrower is solvent, which, although infrequent, does happen. So . . . be careful and caveat lender.