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Client Alert

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Another One Bites the Dust – *Energy Future* Decision Likely Precludes Future Arguments to Lift the Automatic Stay in the Make-Whole Context

Recently, before awarding bondholders any amounts on account of a make-whole or other similar liquidated damage provision upon a debt prepayment, courts have repeatedly insisted on clear and unambiguous language in the credit documents requiring such payment notwithstanding a bankruptcy filling and a related automatic acceleration. In the absence of such language, bondholders have attempted to raise numerous other arguments, which have been largely unsuccessful. In a recent decision in In re Energy Future Holdings Corp.,[1] the Delaware bankruptcy court decisively rejected (and likely laid to rest) one of these arguments — that "cause" exists to lift the automatic stay to waive a default and decelerate debt following an automatic bankruptcy acceleration.

Courts have uniformly upheld and enforced automatic acceleration provisions in credit agreements that serve to make debt due and payable upon a bankruptcy filing. In the make-whole context, this is important because if the debt is deemed due and payable as of the petition date, make-whole and other similar liquidation clauses, included in credit agreements to compensate lenders for early repayment and the loss of a guaranteed income stream at a set interest rate, have been held to be ineffective. The theory is that there can be no prepayment if the debt has become (via an automatic acceleration) already due and payable.

Indentures often provide a mechanism that would allow a majority of holders to waive a bankruptcy or other type of default, thereby allowing lenders to decelerate a prior debt acceleration. If operable, such provisions could be used to decelerate debt notwithstanding a bankruptcy, allowing a make-whole or payment due under another similar call provision to be due upon any early repayment. The automatic stay, which prevents any action to collect a debt, however, prevents holders from delivering such notices or waivers, frustrating lenders' ability to exercise their contractual right to decelerate. As a result, in most make-whole litigations, parties attempt to assert that "cause" exists to lift the automatic stay to allow for delivery of a default waiver, allowing for deceleration.

The bulk of published decisions on make-whole clauses in bankruptcy focus on whether the make-whole itself is due and payable given the specific indenture language, and whether the acceleration is enforceable. In *Energy Future*, however, these issues had already been decided upon summary judgment, and Bankruptcy Judge Sontchi was left to focus solely on whether "cause" existed to lift the stay. Finding that the governing standard was whether the harm to the holders outweighed the harm to the debtors, Judge Sontchi ruled that "cause" would likely never exist to lift the stay, because the harm that would befall the holders — the failure to receive the make-whole payment — would, at a minimum, equal the harm to debtors of having to pay the make-whole amount, and therefore, such harm to the holders would never "outweigh" the harm to debtors. The Court itself recognized that, given its determination, its holding would make it "extremely unlikely" that cause would ever be found to exist to lift the stay when similar factors were involved. Judge Sontchi's reasoning, therefore, if widely adopted, would close the door to further argument that "cause" exists to lift the automatic stay in the make-whole arena.

Background of the Decision

The *Energy Future* dispute related to $3,482,106,000 of 10% Senior Secured Notes Due 2020 (the "*Notes*"), issued by Energy Future Intermediate Holding Company, LLC and EFIH Finance, Inc. (collectively, "*EFIH*"), with original maturity of 2020. The Notes were issued pursuant to an Indenture dated August 17, 2010 (as later supplemented, the "*Indenture*") with CSC Trust Company of Delaware (the "*Trustee*"), serving as indenture trustee. The various parties agreed that the Notes were substantially oversecured.

The Indenture provided that EFIH may only redeem the Notes prior to December 1, 2015 (an "*Optional Repayment*") if it pays an "*Applicable Premium*" to the holders.[2] In addition, the Indenture provided for automatic acceleration upon an "event of default,"[3] which includes a bankruptcy filing. Importantly, the Indenture also provided

a majority of holders with the contractual right to, on behalf of all holders, rescind any acceleration and its consequences.[4] The Indenture contained no carve-out from payment of the redemption premium upon acceleration.

Prior to its bankruptcy filing, EFIH solicited, negotiated and obtained commitments for a financing that was, in part, intended to refinance the Notes at a lower interest rate but without the payment of the make-whole amounts. After commencing its bankruptcy, EFIH sought and obtained Court authorization for the financing. To induce noteholders to drop their claims for the Applicable Premium, EFIH agreed to repay noteholders the full principal amount of the Notes along with a small settlement amount.

Subsequently, the Trustee, at the direction of a majority of the dollar amount of the Notes, delivered a letter to EFIH stating, among other things, that the noteholders: (a) waived the bankruptcy default, and (b) rescinded any automatic acceleration resulting from the bankruptcy default.[5] EFIH subsequently commenced an adversary proceeding seeking a determination that the non-settling noteholders were not entitled to any make-whole payment or related claim.

The Decision

Because a number of rulings had been entered by the Court with respect to issues arising under the Indenture, the only issue remaining before the Court was whether cause existed to lift the automatic stay.[6]

The Court began its legal analysis by noting that the automatic stay may only be lifted for "cause."[7] To determine whether cause exists, Delaware courts examine the prejudice that results from lifting the stay and, importantly, whether the harm to "the non-bankrupt party by maintenance of the automatic stay considerably outweighs the hardship to the debtor …."[8] After analyzing the various harms that would befall the two sides, the Court found that "[i]f the Court declines to lift the automatic stay, the harm to the Noteholders is straightforward — it is, at most, the value of the Applicable Premium …."[9] The Court found that if it lifted the automatic stay, the harm to EFIH's estate would be the exact same amount. Therefore, the Court held that the hardship to the noteholders by maintenance of the automatic stay is, at most, equal to the hardship to EFIH from lifting the automatic stay and therefore would not "considerably outweigh" the hardship to EFIH.

The Court also considered that numerous other issuances of debt contained similar indenture provisions and, if the stay was lifted in this instance, those holders would likewise seek payment of their make-whole amounts.[10] The Court estimated that lifting the automatic stay could potentially cause nearly half a billion dollars to leave the estate.

The Court also stated that the non-settling noteholders, many of whom bought their debt at a discount and after the bankruptcy filing, knew of the risk of not being paid the make-whole and could have mitigated their loss by: (i) investing in EFIH's DIP Financing and/or (ii) obtaining amounts related to settlement.

The Court, citing the recent *MPM Silicones* case from the New York Bankruptcy Court, also dismissed the argument that the automatic stay violated their contractual rights.[11]

In reaching its holding the Court recognized that its decision would "make[] it extremely unlikely that a creditor operating under a [similar indenture would] … be able to obtain relief from the automatic stay to waive a default arising from an issuer's bankruptcy filing and to rescind acceleration."[12] It is important to note, however, that the Court left the door open to the payment of make-whole amounts notwithstanding an automatic acceleration upon a bankruptcy filing.[13]

Although other bankruptcy courts will not be required to follow Judge Sontchi's opinion, other courts may find his reasoning persuasive. To afford additional protection against a similar decision in the future, as we have previously stated in a past client alert, "Make-Whole Provisions Continue to Cause Controversy," to the extent parties wish to receive a make-whole following a bankruptcy filing, the indenture or other credit document must specifically provide, in clear and unambiguous language, that the make-whole or other liquidated damage amount is due and owing upon an early payment regardless of any automatic acceleration or other action taken by lender to protect its rights.

While payment of a make-whole amount is not guaranteed, the inclusion of specific and clear language detailing that a make-whole is due notwithstanding a bankruptcy filing and a related automatic acceleration may go a long way towards convincing a court that such payment was agreed upon and part of the benefit of the parties' bargain.

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1 Adversary Case No. 14-50363 (Bankr. Del. July 8, 2015) (the "*Opinion*").

2 The Indenture also provides that EFIH may redeem the Notes after December 1, 2015, by paying the redemption prices set forth in Section 3.07(d) of the Indenture.

3 Indenture § 6.02.

4 Indenture § 6.02, which states, in part:

> The Holders of at least a majority in aggregate principal amount of the Notes by written notice to the Trustee may

. . . rescind any acceleration with respect to the Notes and its consequences (so long as such rescission would not conflict with any judgment of a court of competent jurisdiction).

5 Given that this notice was delivered following the Petition Date, the Court would later hold that sending this notice was an act to "collect, assess or recover" on a claim, in violation of the automatic stay, making such notice void.

6 As part of the Summary Judgment Decision, the Court found that "[a] genuine issue of material fact exists that requires a trial on the merits as to whether the Trustee can establish cause to lift the automatic stay, *nunc pro tunc* to a date on or before June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes." (Summary Judgment Decision ¶ 8(f).)

7 11 U.S.C. § 362(d)(1).

8 *In re Downey Fin. Corp.*, 428 B.R. 595, 609 (Bankr. D. Del. 2010).

9 Opinion at 25. One of the Trustee's experts calculated the make-whole amount as approximately $431 million.

10 *Id*. at 26, stating that the EFIH Second Lien Trustee previously indicated that it would be filing a lift stay motion (4/13/15 Ltr. G. Horowitz to Court, at 3 (No. 14-50363, D.I. 260); 4/22/15 Trial Tr. 63:1-8 (Closing)).

11 The *MPM Silicones* court previously held "[i]t matters not that the Senior Lien Noteholders' right to rescind the acceleration of the debt was canceled by the application of the automatic stay pursuant to section 362 of the Bankruptcy Code. The Debtors correctly point out that all contracts signed among the parties operate against the backdrop of the relevant Bankruptcy Code provisions. The potential for an automatic stay and the effect of the Code's automatic acceleration of the Notes upon the filing of a bankruptcy case is a part of the bargain to which the parties agreed." Memorandum Decision, *In re MPM Silicones, LLC*, No. 7:14-cv-07492-VB at 26, n.12 (S.D.N.Y. May 4, 2015) (Dkt. No. 31).

12 Opinion at 37.

13 The Court stated that:

> That is not to say that a creditor can never successfully pursue a make-whole claim. For example, unlike in this case, an indenture might provide for payment of a make-whole claim in a manner that does not implicate the automatic stay. Whether such a claim would be successful is an issue for another day. Under the facts of this case, however, the Trustee must obtain relief from the automatic stay for the Applicable Premium to be due and owing to the non-settling Noteholders and there is insufficient cause for the Court to lift the stay.
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> *Id*. at 38.

For More Information

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