Make Whole Provisions Triggered Upon Acceleration of Debt In Bankruptcy Are Enforceable Absent Clear Contractual Language to the Contrary

In Delaware Trust Co. v. Energy Future Intermediate Holding Co., 842 F.3d 247 (3d Cir. 2016), the Third Circuit stated that (i) New York and federal courts deem the term "redemption" to include both pre- and post-maturity repayments of debt, (ii) refinancings of debt by Energy Futures Intermediate Holding Co. ("EFIH") with debtor-in-possession financing were optional redemptions, and (iii) although bankruptcy accelerated the maturity date of the debt, contract terms applicable before the acceleration remain applicable afterward, and held that the make-whole provisions were enforceable by EFIH noteholders after the filing of a bankruptcy petition by EFIH absent clear contractual language to the contrary.

The Third Circuit made its decision based upon the following contextual background. In 2010, EFIH issued approximately $4 billion of 10% senior secured first lien notes due in 2020. In 2011 and 2012, EFIH issued 11% senior secured second lien notes due 2021 and 11.750% senior secured second lien notes due 2022. The indentures governing the first lien notes and second lien notes had essentially similar make-whole provisions for optional redemptions that decreased annually and terminated prior to the scheduled maturity but with different optional redemption dates. Both indentures also contained acceleration provisions prompted by the filing of a bankruptcy petition by EFIH. However, the second lien note indenture provided that upon a bankruptcy acceleration *all principal of and premium, if any*, interest, *and any other monetary obligations* on the outstanding second lien notes were due and payable immediately. The first lien note indenture merely stated that all outstanding first lien *notes were due and payable immediately* upon the occurrence of a bankruptcy acceleration.

With market interest rates substantially decreasing, EFIH sought to refinance the first lien notes without paying the make-whole premium, which it erroneously believed it could cut off by filing a bankruptcy petition. Thus, on November 1, 2013, EFIH made an SEC 8-K filing disclosing that it would file for bankruptcy and refinance the first lien notes without paying any make-whole amount. Six months later, on April 29, 2014, EFIH filed a Chapter 11 bankruptcy petition. On June 19, 2014, EFIH paid off the first lien notes and refinanced such debt with debtor-in-possession financing at an interest rate of 4.25% resulting in an interest saving of $13 million per month. EFIH did not pay the make-whole amount of approximately $431 million to the first lien noteholders.

Shortly after entering bankruptcy, EFIH declared in another SEC 8-K filing that it reserved the right to redeem some or all of the outstanding second lien notes but asserted that it was under no obligation to do so. EFIH subsequently refinanced a portion of the second lien notes as well.

After granting leave to refinance the first lien notes and the second lien notes, the Bankruptcy Court held that neither the first lien noteholders nor the second lien noteholders were entitled to yield-protection despite the differences in the acceleration provisions of the two indentures. The Third Circuit reversed such ruling noting that it is the role of the courts to enforce the agreement made by the parties—not to add, excise or distort the meaning of the terms the parties choose to include in agreements and that adherence to such principles is particularly appropriate in cases involving interpretation of documents drafted by sophisticated, counseled parties and involving the loan of substantial sums of money.

Two Key Practice Takeaways. There are two practice takeaways to be gleaned from the Third Circuit's decision.

First, in drafting the remedies provisions in indentures and loan agreements consider including "premiums" and "all other obligations" dues with respect to the debt as amounts due upon acceleration in addition to principal and interest on the debt. The Third Circuit made note of the differences in the acceleration provisions in the first lien note indenture and the second lien note indenture (but did not base its ruling on such differences).

Second, in drafting language regarding premiums or make whole amounts due for payment of the debt other than on the stated maturity date, consider characterizing the transaction as a "redemption" premium as opposed to a "prepayment" premium or, if using the term "prepayment," drafting clear language that the prepayment premium is due post-acceleration. This practice point is based upon the Third Circuit's dicta noting that the term "redemption" includes both pre- and post-maturity repayments of debt. But with respect to "prepayment" of debt, once the maturity date is accelerated to the present, it is no longer possible to prepay the debt before maturity. Thus, the "prepayment" premium will not survive acceleration of maturity unless there is other clear language stating that the prepayment premium is due post-acceleration.