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Treatment of "Make-Whole" and "No-Call" Provisions by Bankruptcy Courts

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Although the bankruptcy court in In re Chemtura Corp. *did not rule on the merits of the extent to which make-whole and no-call provisions might be enforceable in bankruptcy, the decision provides a detailed road map for subsequent courts to evaluate the enforceability of these provisions. The authors of this article explain the decision.*

The Bankruptcy Court for the Southern District of New York recently considered the enforceability of claims for "make-whole" amounts and damages for breach of a "no-call" provision in *In re Chemtura Corp*. ("*Chemtura*").[1] These provisions are generally enforceable outside of bankruptcy, but enforceability in the context of a bankruptcy case is still unclear. In *Chemtura*, the court did not actually rule on enforceability but approved a settlement that allocated value to creditors on account of a make-whole clause and a no-call provision.

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"NO-CALL" AND "MAKE-WHOLE" PROVISIONS GENERALLY

Generally, a "no-call" provision prohibits the prepayment or redemption of debt before its maturity (or sometimes before a specified date).[2] This "hard call protection" is intended to protect the creditors' expectation that they will receive interest through the maturity date (or the "hard call" date).[3] Sometimes, the debt instrument will permit early prepayment or redemption, subject to payment of a "make-whole" provision. A "make whole" provision acts as a liquidated damages clause and provides a formula for determining what amount a debtor must pay in order to prepay its debt prior to maturity or the earlier "hard call" date.[4] These provisions are commonly included in bond indentures and, sometimes, in credit agreements.

CHEMTURA FACTS

The debtors' liabilities included, among other things, bonds issued under two separate indentures.[5] One indenture (the "2016 Notes") included a make-whole provision, and the other (the "2026 Notes") included a no-call provision.[6] If allowed in full, the aggregate claims for breach of these provisions in both indentures would have totaled approximately $170 million.[7] The debtors disputed payment of these amounts. Rather than litigate, the parties reached a settlement pursuant to which the debtors agreed to pay 42 percent of the potential liability under the make-whole provision and 39 percent of the potential liability for breach of the no-call provision that was memorialized in the debtors' reorganization plan.[8] The debtors' shareholders voted to reject the plan and objected to, among other things, the payment of any distributions to creditors on account of the make-whole provisions and/or claims for breach of the no-call provision.[9]

CONFLICTING DECISIONS

As a result of the challenge, the court had to determine whether to approve the settlement. The court began its analysis by examining the cases that had addressed the enforceability of make-whole and no-call provisions to rule on the reasonableness of the settlement.

In re Calpine Corp. ("*Calpine I*")

In *In re Calpine Corp*. ("*Calpine I*"),[10] the bankruptcy court:

- refused to enforce a no-call provision because to do so "would violate the purpose behind the Bankruptcy Code" by denying "a debtor the ability to reorganize because a creditor has contractually forbidden it;"[11]
- held that claims for breach of the no-call provisions did not provide the noteholders with the right to "seek prepayment premiums or 'make-whole' damages;"[12]
- held that claims for breach of the no-call provisions were not secured claims;[13] and
- ruled that breach of the no-call provision could support an unsecured claim for damages based on the bondholders' "expectation of an uninterrupted payment stream" and calculated that the amount of the damage claim would be equal to the premiums in the make-whole provisions.[14]

HSBC Bank USA, N.A. v. Calpine Corp. ("*Calpine II*")

On appeal, the district court in *Calpine* disallowed the unsecured claim for unmatured interest in the form of expectation damages for the debtor's repayment of the notes because the underlying indentures did not provide for such damages, and the court found that the Bankruptcy Code "require[d] the same result."[15] The district court further held that the no-call provisions were unenforceable because the debtor's bankruptcy filing constituted an event of default and accelerated the notes, making them immediately due and payable.[16] Because the no-call provisions were unenforceable, the debtor could not incur any liability for repaying the notes.[17] Additionally, "[d]ebtor's repayment did not occur prior to maturity, because accelerated debts are mature."[18] Although the district court acknowledged that repayment pursuant to acceleration could trigger a premium in other transactions, no such damages provision was evident in the indenture."[19] The district court's ruling is currently on appeal.

In re Solutia

In *In re Solutia* ("*Solutia*"),[20] bondholders relying on *Calpine I* sought similar "expectation damages" for future interest income that they expected to receive under their indenture but wouldn't because of a breach of a no-call provision.[21] The court disallowed the claim and held that there was no "prepayment" (prohibited by the no-call provision) because the indenture provided that the notes were automatically accelerated (and thus fully matured) as a result of the bankruptcy filing.[22] Because prepayment could only occur *prior* to maturity, the court ruled that the debtor had not prepaid its debt.[23]

In re Premier Entm't Biloxi LLC

In *In re Premier Entm't Biloxi LLC*,[24] the bankruptcy court (i) rejected a contention that the make-whole provision gives rise to a secured claim,[25] and (ii) ruled that breach of the no-call provision would give rise to an unsecured claim in cases where, as here, the debtor is solvent.[26] This decision is also on appeal.

CHEMTURA COURT APPROVES SETTLEMENT AND CONFIRMS PLAN

After reviewing the relevant authorities, the *Chemtura* court suggested a two-pronged analysis to determine whether the make-whole and no-call provisions are enforceable.[27] First, a court should examine, under state law, (i) whether the no-call provision was actually breached and (ii) whether the damages calculation was appropriate.[28] Next, the court should look to bankruptcy law to determine whether any surviving state law claims would have to be disallowed under the Bankruptcy Code or relevant, albeit conflicting, case law.[29]

As to the first prong in the analysis, the court evaluated the language of the indentures under state law.[30] With respect to the 2016 Notes, the court indicated that a good argument existed that the make-whole was actually breached because the entitlement to the make-whole amount was

based on payment before the "*Maturity Date*" (as opposed to payment before "Maturity," to distinguish it from *Solutia*).[31] The bankruptcy court questioned, however, whether the formula for calculating the make-whole payment resulted in payment of lost interest or an unjustifiable penalty.[32] With respect to the no-call provision in the 2026 Notes, the court said that there was a drafting concern in light of *Solutia* — "inadequate drafting to give [the noteholders] the state law rights they wish to enforce."[33] It remained unclear as to whether there was a prepayment due to certain contractual ambiguities.[34]

As to the second prong of the analysis, the court evaluated whether allowable state law claims should be allowed in the bankruptcy context.[35] In this regard, the court identified the unsettled nature of several critical issues: (i) whether creditors can recover *damages* under a provision that may not be specifically enforceable (*see Calpine II*); (ii) whether no-call damages and make-whole premium are a proxy for unmatured interest that is not permitted under Section 502(b)(2) of the Bankruptcy Code; and (iii) whether unmatured interest is recoverable when (as in *Chemtura*) the estate is solvent.[36]

The court ultimately approved the settlement and found it "well within the 'range of reasonableness.'"[37] The court did *not* rule on the merits of the extent to which make-whole and no-call provisions might be enforceable in bankruptcy. Rather, the *Chemtura* decision provides a detailed road map for subsequent courts to evaluate the enforceability of no-call and make-whole provisions. One fact is certain — the case law remains unsettled in the lower courts. A ruling from the Second Circuit in the *Solutia* case should generate some certainty.

NOTES

1 No. 09-11233 (Bankr. S.D.N.Y. Oct. 21, 2010).
2 *See id*. at 50.
3 *See id*. at 49-50.
4 *See id*. at 49.
5 *Id*. at 3.
6 *Id*. at 50-51.

[7] *Id*. at 6.
[8] *Id*. at 50-51, 5.
[9] *Id*. at 55-56.
[10] 365 B.R. 392 (Bankr. S.D.N.Y. 2007).
[11] *Id*. at 397.
[12] *Id*. at 397.
[13] *Id*. 399.
[14] *Id*. at 399-400.
[15] *HSBC Bank USA, N.A. v. Calpine Corp.,* Case No. 07 Civ 3088, at *3-4 (S.D.N.Y. Sept. 14, 2010) ("*Calpine II"*).
[16] *Id*. at *3.
[17] *Id*. at *4.
[18] *Id*.
[19] *Id*.
[20] 379 B.R. 473 (Bankr. S.D.N.Y. 2007).
[21] *Id*. at 480-481.
[22] *See id*. at 483-485.
[23] *Id*.
[24] No. 07-05043, 2010 WL 3504105 (Bankr. S.D.Miss. Sept. 3, 2010).
[25] *Id*. at *39.
[26] *Id*. at *48-49.
[27] *Chemtura*, slip op. at 56.
[28] *Id*.
[29] *Id*.
[30] *Id*.
[31] *Id*. at 57.
[32] *Id*. at 58-59.
[33] *Id*. at 59-60.
[34] *Id*. at 60.
[35] *Id*. at 60.
[36] *Id*. at 61-64.
[37] *Id*. at 65.