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No Market Interest Rate and No Make Whole: *Momentive Performance* Court Rejects Lender Arguments Against Confirmation

September 17, 2014

On August 26, 2014, Judge Robert D. Drain of the United States Bankruptcy Court for the Southern District of New York ruled that (i) the debtors could satisfy the cramdown requirements of section 1129(b) of the Bankruptcy Code by issuing to certain secured noteholders replacement notes with interest rates calculated at the prime rate plus a non-payment risk component, as opposed to a market rate, and (ii) the debtors' noteholders were not entitled to payment of make-whole premiums as part of their allowed claims.[1] *In re MPM Silicones, LLC,* Case No. 14-22503-rdd (Bankr. S.D.N.Y.). By favoring a below-market risk premium in the cramdown context, this decision reinforces for lenders the importance of presenting clear evidence on plan feasibility and the risks facing a company post-chapter 11 emergence in order to be awarded higher interest rates on any cramdown paper. Consistent with other recent opinions on make-whole provisions, this decision also serves as a reminder that when negotiating the terms of an indenture, it is critical to explicitly set forth the situations in which a make-whole premium will be payable, as courts applying New York law may not infer the existence of a make-whole obligation unless the indenture is unambiguous.

Background

On April 13, 2014, MPM Silicones, LLC and certain of its affiliates filed for chapter 11 bankruptcy protection, and soon thereafter filed a prearranged plan of reorganization and obtained commitments for two exit financing facilities. Pursuant to the proposed plan, the oversecured holders of senior first lien notes and senior intermediate lien notes would receive payment in full in cash on account of their claims if they voted to accept the plan and waive their claims to make-whole premiums. If the noteholders voted to reject the plan, they would retain their right to argue for make-whole premiums and receive replacement notes equal to the principal amount of their

[1] Judge Drain also held that pursuant to the language of the senior subordinated noteholders's indenture, the debtors' second lien noteholders held claims senior to the claims of the debtors' senior subordinated noteholders. Because the indenture at issue explicitly discussed claim subordination, but did not discuss lien subordination, the Court rejected the subordinate noteholders' argument that the second lien noteholders did not hold senior debt because their liens were junior to the liens of other creditors.

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claims with interest calculated at the Treasury note rate plus a risk premium. The majority of both classes of noteholders voted to reject the plan, arguing that the proposed interest rates on the replacement notes were not "fair and equitable" and did not satisfy the cramdown standards of section 1129(b) of the Bankruptcy Code, and that the bondholders were entitled to make-whole premiums as part of their claims.

The Court's Opinion

In a very detailed oral ruling, Judge Drain rejected the noteholders' arguments. With respect to the interest rate on the debtors' proposed plan replacement notes, Judge Drain held that the formula approach advanced by the U.S. Supreme Court in *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004) was the proper method for calculating the appropriate interest rate. In Till, the Supreme Court held that the calculation of cramdown interest under section 1325(a) of the Bankruptcy Code, which is analogous to section 1129(b), should be calculated as the prime rate plus a risk premium of one to three percent.

Accepting *Till's* formula approach, Judge Drain rejected the noteholders' argument that market rates should be consulted to determine the applicable interest rates. The noteholders had relied upon footnote 14 of the *Till* decision, where the Supreme Court stated that "when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce." *Till*, 541 U.S. at 476, n.14. Judge Drain reasoned that the consideration of market rates would create a "coerced loan" approach that includes transaction costs and lender profits in its computation, an approach that the Supreme Court clearly rejected in *Till*. Further, Judge Drain rejected the noteholders' argument that the debtors' proposed exit financing facilities reflected a market rate that should be used to calculate the replacement notes' cramdown rate, finding that those facilities had a profit element inconsistent with the *Till* approach.

Applying the *Till* approach, Judge Drain determined that the debtors' proposed interest rate risk premiums reasonably reflected the risks to the feasibility of the debtors' plan. However, Judge Drain found that because the debtors' proposed cramdown rates were based on the Treasury rate, as opposed to the currently higher prime rate endorsed by the *Till* court, the debtors would need to add additional risk premiums of .5% to the replacement senior first lien notes and .75% to the replacement senior intermediate lien notes.

Judge Drain also rejected the noteholders' argument that they were entitled to make-whole premiums. The noteholders contended that the automatic acceleration of the debtors' pre-petition note obligations due to the bankruptcy filing constituted an optional redemption triggering the premium charges under the indentures. In reliance on the Second Circuit's decision in *In re AMR Corp.*, 730 F.3d 88 (2d Cir. 2013), Judge Drain held that the acceleration of the notes on the

petition date and the debtors' payment of the notes under the plan did not constitute an optional redemption requiring payment of a make-whole premium.

Further, Judge Drain found that under settled New York law, which governed the noteholders' indentures, a lender was not entitled to a make-whole premium, if it accelerated the balance of the loan, unless the applicable agreement explicitly provided for the payment of a make-whole premium upon acceleration. Here, Judge Drain determined that the indentures lacked language specifically providing for the payment of a make-whole premium upon the acceleration of the notes, and could not therefore overcome the rule under New York law that make-whole premiums are not payable upon acceleration.

Conclusion

The *Momentive Performance* decision presents critical guidance for lenders on two major issues. First, the opinion furthers the recent trend in certain jurisdictions of disallowing claims for make-whole and other pre-payment premiums or additional fees, interest, and costs sought by lenders. Creditors will need to be mindful of this shift in the law when evaluating their leverage in a restructuring. Further, *Momentive Performance* illustrates that the battle on plan feasibility can impact a bankruptcy court's determination of the appropriate interest rate for replacement or cramdown debt offered to secured creditors. If a bankruptcy court determines a plan is feasible for confirmation purposes, it still needs to assess the risk of the plan's success in determining the appropriate interest rate risk premium. Any lingering doubts raised by creditors as to a plan's feasibility can thus be used to influence the bankruptcy court's interest rate risk premium determination, and lenders should be aware of this when formulating plan feasibility challenges.

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