Make-Whole after Ultra: Key take-aways from the Fifth Circuit's decision in *Ultra*

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Background

- Ultra Resources Inc. (“OPCo”) issued ten series of unsecured notes totaling approximately $1.46 billion under the Master Note Purchase Agreement (“MNPA”).
- The MNPA was governed by New York law. Relevant provisions included:
  - Section 8.2(a), Pre-Payment provision, including a Make-Whole Amount
  - Section 11(g), Event of Default provision, providing for the occurrence of an Event of Default if “the Company …files a petition for relief or reorganization or arrangement or any other petition in bankruptcy….”
  - Section 12.1, “[S]uch Notes will forthwith mature and the entire principal amount of such Notes, plus…any applicable Make-Whole Amount determined in respect of such principal amount (to the full extent permitted by applicable law)…shall all be immediately due and payable…”
  - Notes which require interest at the Default rate on overdue payments
- OpCo’s bank debt also amounted to $999 million under a credit agreement dated October 7, 2011.
- Ultra Petroleum Corp. (“Holdco” and, together with OpCo, the “Debtors”) had issued approximately $1.2 billion of public bonds.

Background (cont'd)

- HoldCo guaranteed the MNPA Notes and the OpCo bank debt, but OpCo did not guarantee the Holdco Notes.
- Pre-petition reorganization discussions did not result in any agreement.
- On April 29, 2016 (the "Petition Date"), Holdco and OpCo filed voluntary petitions for chapter 11.
- Debtors' bankruptcy filing was an Event of Default under the MNPA, which automatically accelerated the principal balance of the Notes. The outstanding principal obligations under the Notes totaled approximately $1.46 billion as of the Petition Date.
- Debtors' First Plan of Reorganization on December 6, 2016 provided for separate classification and treatment of (1) principal and interest portions of the Note claims and (2) the Make-Whole portion of the Note claims.
- Debtors' Amended Plan classified principal, interest and Make-Whole together, along with the Revolver claims, as unimpaired Class 4 Claims, but noted that Debtors would only pay the Make-Whole and post-petition interest at the contract rate if ordered to do so by the Court.
- Court ordered Debtors to file objection by March 3, 2017.

Make-Whole: Substantial Majority of Cases Enforce Make-Whole as Liquidated Damages

- Multiple Bankruptcy, State and Federal Courts have recognized that Make-Whole is an enforceable liquidated damages provision and not unmatured interest (unsecured creditors are not entitled to recover unmatured interest under Section 502(b)(2) of the Bankruptcy Code):
  - In *In re Anchor Resolution*, 221 B.R. 330 (D. Del. 1998), the Bankruptcy Court for the District of Delaware held that the NPA formula for calculating the make-whole amount (based on a reinvestment rate of T +.50%) is reasonable and not a windfall, but rather a contractually bargained for result.
  - In *In re Chemtura*, 439 B.R. 561 (S.D.N.Y. 2010), the Bankruptcy Court for the Southern District of New York held that while bankruptcy accelerated "maturity" it did not accelerate the contractually defined "Maturity Date" referenced in the make-whole provision at issue (arguably disagreeing with a prior decision of that court, in *In re Solutia*, 379 B.R. 473 (S.D.N.Y. 2007), where the same court held that the make-whole provision at issue was not triggered upon repayment in bankruptcy because bankruptcy acceleration moved the maturity date to the acceleration date and, as a result, there was no prepayment).
  - In *In re Trico Marine Servs*., 450 B.R. 474 (D. Del. 2011), the Bankruptcy Court noted that the substantial majority of courts considering the enforceability of make-whole have concluded that make-whole or prepayment obligations are in the nature of liquidated damages rather than unmatured interest.
  - In *Chesapeake Energy Corp. v. Bank of N.Y. Mellon Trust Co*., 837 F.3d 146 (2d Cir. 2016), a non-bankruptcy federal court held that not only were noteholders entitled to make-whole premium as outlined in the indenture, but also post-petition interest to compensate for the failure to pay such amount when due.

Make-Whole: Distinguishable Cases

- A number of cases in the headlines over the past few years that did not enforce a Make-Whole claim involved different language than the MNPA.
  - In *In re AMR Corp.*, 730 F.3d 88 (2d Cir. 2013), the debtor was permitted to repay notes under the indenture without make-whole where the indenture explicitly stated that make-whole was not due following an acceleration (which had occurred automatically upon the bankruptcy filing).
  - In *In re MPM Silicones*, 2014 WL 4436335 (S.D.N.Y. 2014) ("*Momentive*"), the Bankruptcy Court for the Southern District of New York (District Court (531 B.R. 321 (S.D.N.Y. 2015)) affirmed in May 2015 and the Second Circuit (874 F.3d 787 (2d Cir. 2017), *cert. denied*, 138 S.Ct. 2653 (2018)) affirmed in 2017) held that noteholders were not entitled to make-whole because the bankruptcy acceleration moved the maturity date and the contract did not explicitly state make-whole was payable following a bankruptcy acceleration. The Second Circuit agreed with the lower courts that "redemption" generally only refers to pre-maturity repayments of debt. The Second Circuit also held that the automatic stay bars post-petition deceleration.
  - In *In re Energy Future Holdings Corp*., 533 B.R. 106 (D. Del. 2015) *("EFH")*, the Bankruptcy Court followed *Momentive* and other cases in holding that noteholders were not entitled to make-whole under their New York law-governed indenture, concluding that acceleration moves the maturity date and make-whole is only payable upon automatic acceleration if expressly provided in the relevant contract. The District Court affirmed; however, in December 2016, the Third Circuit reversed. The Third Circuit held that in the context of a redemption the make-whole was due and that the language of "make-whole, if any" in the Indenture provided a clear right to payment.
  - Worth noting was that even the lower courts in *Momentive* and *EFH* noted that their holding might be different in a solvent debtor case.

Debtors' Claims Objection

Debtors' Principal Arguments:

1. Make-Whole Amount should be disallowed as unmatured interest barred by Section 502(b)(2) of the Bankruptcy Code.
2. Make-Whole Amount, in the alternative, was an unenforceable liquidated damages provision under New York law.
3. If post-petition interest were awarded, it would be assessed, at most, at the Federal Judgment Rate ("FJR") because "the Legal Rate" in accordance with Section 726(a)(5) was, as Debtors argued, the FJR.
4. Noteholders' claims should be disallowed to the extent necessary to avoid a duplicative recovery - i.e., Debtors alleged that recovery of both the Make-Whole Amount and post-petition interest was duplicative (since the Make-Whole Amount is calculated by reference to post-petition interest).

Response to Debtors' Claims Objection

Noteholders' Response:

1. Make-Whole Amount was valid under New York law because the formula was repeatedly enforced by New York courts as a valid liquidated damages provision.

2. The Make-Whole Amount was not unmatured interest under the Bankruptcy Code.

3. Noteholders were entitled to all of their rights under the MNPA, including Make-Whole and post-petition interest because (1) the Debtors classified the Noteholders as unimpaired and (2) the Debtors were solvent. The purpose of the Make-Whole Amount (yield maintenance) and the post-petition interest (compensation for late payment) were different. *In re Vanderveer Estates Holds., Inc.*, 283 B.R. 122 (E.D.N.Y. 2002). One is an agreed measure of damages and the other is a remedy for failure to make timely payment.

4. Post-petition interest should be allowed at the Contractual Default Rate because Debtors provided no basis to follow cases that interpret Section 726(a)(5) to provide only for application of the FJR.

Reply in Support of Debtors Claims' Objection

Debtors' Reply:

1. Under the Bankruptcy Code, Noteholders were still unimpaired even if they did not receive all of their contractual rights under the MNPA because it is the Bankruptcy Code (Section 502(b)(2)), not the reorganization plan, that disallows post-petition interest.

2. Post-petition interest should be measured at the "legal rate" or the FJR.

3. Noteholders failed to explain why New York law permitted their duplicative recovery and why their "lost yield" was not unmatured interest.

4. Because Make-Whole Amount compensated the Noteholders for loss of unmatured interest payments, the Make-Whole Amount should be disallowed.

5. There was no "solvent debtor exception" under the Bankruptcy Code which would allow recovery of the Make-Whole Amount.

Ultra Hearing – May 16, 2017

- Judge Marvin Isgur, Bankruptcy Court for the Southern District of Texas.
- At the hearing, Judge Isgur focused on the following questions for the parties to respond to and then offered the opportunity for the parties to submit supplemental briefing:

1. Whether the Bankruptcy Code and the terms of the confirmed plan discharged the unimpaired claims under Section 1141 of the Bankruptcy Code.

    - On this point, Judge Isgur asked Debtors' Counsel: "[W]hat says you don't have to pay them? It has to be an 1141, and 1141 doesn't refer to allowed claims. But that's the heart of the impairment problem, I think."

2. Whether the Make-Whole Amount was enforceable under New York state law.

    - Specifically, on the question of "double-counting," Judge Isgur asked: "Under New York law if we decide there is double-counting to the point that it would be ... a penalty ... [d]o we disallow their make whole only to the extent that it double counts or do we disallow everything because they are an overreaching creditor and therefore they get nothing?"

Noteholders' Post-Hearing Brief

- The Court should not perform calculations because the parties agreed on how to calculate each aspect of the Make-Whole Amount, default interest on principal, and default interest on payment for the Make-Whole Amount.
- Section 1124(1) of the Bankruptcy Code requires that an unimpaired creditor receive its rights under applicable law, undiminished by the limitations of Section 502, i.e., for Noteholders, the Make-Whole Amount and contractual default rate of post-petition interest.
- Because Debtors were solvent, they should honor their contractual obligations to pay the Make-Whole Amount and post-petition interest.
- Under New York law, the Make-Whole and default interest provisions are not penalties but enforceable claims.
    - The obligation to pay default interest was not unenforceable as "double-counting" - the Make-Whole compensated Noteholders for loss of yield and post-petition interest compensated Noteholders for the late payment of amounts due.
    - Even if the Court found the "double-counting" argument compelling, there could be no double counting as to post-petition interest:
        - In excess of T+50 (since this was the discount factor applied in the Make-Whole formula)

Noteholders' Post-Hearing Brief (cont'd)

  - In the amount of the 2% default rate (since the Make-Whole formula used the contract, not default rate)
  - On the Make-Whole Amount itself
- If the Court found the entire default interest clause unenforceable for double-counting, the MNPA provided that the default interest clause could be severed, leaving intact the Make-Whole.

- Section 726(a)(5) did not apply to the treatment of unimpaired creditors under a confirmed plan in a chapter 11 case; and, even if Section 726(a)(5) applied, that Section references the "legal rate" which varies depending on what the claim is for (e.g., taxes, support obligations, etc.). In this case, it would be the contractual rate.

Bankruptcy Court Judgment: Victory for Make-Whole

On September 21, 2017, Judge Isgur entered an order, which among other things, held that:

- The Make-Whole was an enforceable liquidated damages provision under New York law; the Judge did not specifically determine that the Make-Whole Amount was not unmatured interest because the Noteholders were unimpaired;
- Because the Debtors classified the OpCo Notes as unimpaired under the plan of reorganization, pursuant to Bankruptcy Code Section 1124(1), the Debtors could not propose to alter the OpCo Noteholders' rights to the Make-Whole Amount and post-petition interest as provided for in the MNPA, notwithstanding Section 502(b)(2); and
- Because the Make-Whole Amount compensated the OpCo Noteholders for early payment of the Notes and the post-petition interest at the default rate compensated for late payment on amounts owed, including both principal and the Make-Whole Amount, there was no double counting.

Fifth Circuit Panel Decision: January 17, 2019

- Unimpairment
  - Section 1124(1) refers to “plan” and therefore a claim is not impaired under Section 1124 of the Bankruptcy Code if the statute, and not the plan, does the impairing.
  - Impairment is only evaluated after the claim disallowance provisions of Section 502(b) are applied.
  - According to the Fifth Circuit, the Noteholder claims can therefore still be classified as unimpaired even if they do not receive Make-Whole and post-petition interest if the claims allowance provisions of the Code do not permit Make-Whole and post-petition interest as part of an unsecured creditor’s claim.
- The Solvent Debtor Rule
  - The Fifth Circuit noted that the Noteholders argue that the solvent debtor rule is a long standing rule that permitted unsecured creditors to claim that interest continues to accrue despite the bankruptcy filing if the Debtor was solvent, and, therefore, given the Ultra circumstances, post-petition interest was due to Class 4 Creditors.
  - The Fifth Circuit commented it was skeptical that the solvent debtor rule continued to exist after the passage of the Bankruptcy Code, but remanded the question to the bankruptcy court for consideration.

Fifth Circuit Panel Decision: January 17, 2019 (cont'd)

- Make-Whole
  - The Fifth Circuit held that Make-Whole was unmatured interest and, therefore, disallowed under Section 502(b)(2) of the Bankruptcy Code, since:
    - It was the economic equivalent of interest
    - The facts of the case showed that it was unmatured as of the petition date
    - The other decisions to the contrary weren't persuasive
  - The solvent debtor rule would operate as an exception to the disallowance provision of Section 502(b)(2) <u>if the rule survived the enactment of the Bankruptcy Code.</u>

Fifth Circuit Panel Decision: January 17, 2019 (cont'd)

- Post-Petition Interest
  - The Fifth Circuit distinguished between post-petition interest as part of a claim versus post-petition interest on a claim.
  - The Fifth Circuit noted there were two potential paths to interest, (1) the general post-judgment interest statue (federal judgment rate) which would promote uniformity of rate or (2) equity.
  - The Fifth Circuit concluded that the Class 4 Creditors did not have a legal right to interest, and that the underlying contract did not provide for the contract rate of interest to apply on bankruptcy judgments.

Considerations Post-Ultra

- What's the status of Make-Whole Post Ultra?
  - Payment of the Make-Whole in connection with an optional prepayment of Notes is not threatened by the Ultra decision; its enforceability should still be upheld based on a state law liquidated damages analysis.
  - If Ultra stands, consideration will have to be given to other liquidated damages formulas for use in bankruptcy.
  - Using a fixed payment amount based on a percentage of the principal amount of the Notes (even if the percentage declines over the life of the Notes) should improve noteholders' position relative to Section 502(b)(2) of the Bankruptcy Code but could weaken the position with respect to the liquidated damages analysis.

Document & Drafting Considerations Post-Ultra

- Timing of acceleration in connection with forbearance agreements
- Clarify that contract rate of interest applies not only on overdue amounts, but on judgments representing same
- Overall market considerations regarding a new compensation structure upon acceleration; set prepayment premiums rather than Make-Whole formula

Document & Drafting Considerations Post-Ultra (cont'd)

Timing of acceleration in connection with forbearance agreements.

- Consider accelerating notes and triggering Make-Whole upon a "significant" default and forbearance request; Required Holders can rescind.
  - Pro: In the event of a bankruptcy filing prior to resolution of the situation, the Make-Whole will not be "unmatured".
  - Con: Not a solution for every situation if the issuer is a public company and/or the acceleration will trigger cross-defaults in other financing documents and material contracts.

Model Form Language:

Section 12.3. Rescission. At any time after any Notes have been declared due and payable pursuant to Section 12.1(b) or (c), the Required Holders, by written notice to the Company, may rescind and annul any such declaration and its consequences if (a) the Company has paid all overdue interest on the Notes, all principal of and Make-Whole Amount, if any, on any Notes that are due and payable and are unpaid other than by reason of such declaration, and all interest on such overdue principal and Make-Whole Amount, if any, and (to the extent permitted by applicable law) any overdue interest in respect of the Notes, at the Default Rate, (b) neither the Company nor any other Person shall have paid any amounts which have become due solely by reason of such declaration, (c) all Events of Default and Defaults, other than non-payment of amounts that have become due solely by reason of such declaration, have been cured or have been waived pursuant to Section 17, and (d) no judgment or decree has been entered for the payment of any monies due pursuant hereto or to the Notes. No rescission and annulment under this Section 12.3 will extend to or affect any subsequent Event of Default or Default or impair any right consequent thereon.

Document & Drafting Considerations Post-Ultra (cont'd)

Add language to the note that the contract rate of interest applies not just on overdue payments (and prepayments) but on any judgments awarded in respect of same.

Model Form Language:

Form of Note:

. . .(b) to the extent permitted by law, on any overdue payment (including any overdue prepayment) of principal, any overdue payment of interest and any overdue payment of any Make-Whole Amount, and any judgments on account of the foregoing, payable semi-annually as aforesaid (or, at the option of the registered holder hereof, on demand) at a rate per annum from time to time equal to the Default Rate.

Document & Drafting Considerations Post-Ultra (cont'd)

Make-Whole for Voluntary Redemptions and Set Premiums following Default

- Standard Make-Whole formula for optional redemptions by the Issuer.
- Set pricing for default and acceleration, depending on timing of default.
  - For example, for a 10 year note,
    - In years 1-3, 107%
    - In years 4-7, 105%
    - In years 7-10, 103%
- New York courts and courts interpreting New York law have held that a percentage premium is enforceable where the damages were incapable of being set at the time of contracting and the prepayment premium was not plainly disproportionate to the probable loss.

Document & Drafting Considerations Post-Ultra (cont'd)

Sample Optional Redemption Language

Optional Redemption of 6.95% Senior Notes.

(a) Subject to the terms and conditions of the Indenture, at any time prior to December 1, 2027 (the date that is three months prior to the Maturity Date), the 6.95% Senior Notes are redeemable at the option of the Company in whole or in part at a Redemption Price equal to the greater of:

(i) 100% of the principal amount of the 6.95% Senior Notes to be redeemed; or

(ii) as determined by the Quotation Agent, the sum of the present values of the Remaining Scheduled Payments of principal and interest on the 6.95% Senior Notes to be redeemed (not including any portion of payments of interest accrued as of the Redemption Date), calculated as if the Maturity Date of such 6.95% Senior Notes was December 1, 2027 (the date that is three months prior to the Maturity Date), discounted to the Redemption Date on a semiannual basis at the Adjusted Treasury Rate, plus 20 basis points;

plus, in either of the above cases, accrued and unpaid interest thereon to but not including the Redemption Date.

Questions?