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Bankruptcy Court Relies on Plain Language of Indentures in Denying American Airlines Noteholders' Make-Whole Claim

Over the last few years, the enforceability of "make-whole" premiums in bankruptcy has received increasing attention. Loan documents often condition early redemption of outstanding debt obligations on paying a make-whole premium—a fee payable to the lender if the loan is called before its scheduled maturity. Make-whole premiums compensate the lender for the loss of future coupon payments that the lender would have received absent the early redemption. Recent cases have emphasized that a lender's entitlement to a make-whole premium depends primarily on the plain language of the credit documents.[1] Unsurprisingly then, in a recent decision arising from the chapter 11 cases of AMR Corp. and its related debtors (the "Debtors"), the Bankruptcy Court for the Southern District of New York relied heavily on the plain language of an indenture in rejecting certain secured lenders' make-whole claims.[2]

Background:

Debtor American Airlines, Inc. ("American") was party to three separate prepetition financing transactions secured by a discrete pool of aircraft. One of these transactions involved secured notes (the "2009–2 Secured Notes Financing"). The other two, which American entered into in July 2009 and October 2011, respectively, were structured as enhanced equipment trust certificate financings through secured equipment notes (together with the 2009-2 Secured Notes Financing, the "Prepetition Financing"). U.S. Bank Trust National Association ("U.S. Bank") was the loan trustee and security agent for the Prepetition Financing.

The indentures governing the Prepetition Financing (the "Indentures") contained several provisions regarding payment of a Make-Whole Amount (as defined in the Indentures). Section 4.02(a)(i) of the Indentures provided that upon an event of default due to the filing of a voluntary bankruptcy petition: "the unpaid principal amount of the Notes then outstanding, together with accrued but unpaid interest

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1 *See, e.g.*, *HSBC Bank USA, N.A.* v. *Calpine Corp.*, No. 07 Civ 3088, 2010 WL 3835200, at *4 (S.D.N.Y. Sept. 15, 2010) (denying make-whole claim because the debt documents did not explicitly provide for payment of premium upon acceleration); *In re Premier Entm't Biloxi LLC*, 445 B.R. 582, 633-34 (Bankr. S.D. Miss. 2010) (relying on plain language of indenture in denying make-whole claim that was payable only if debtors caused an event of default with the intention of avoiding no-call provision); *In re Solutia Inc.*, 379 B.R. 473, 488 (Bankr. S.D.N.Y. 2007) (denying claim for prepayment premium because lenders failed to contractually provide for payment of premium upon acceleration).

2 *U.S. Bank Trust National Association* v. *American Airlines Inc. (In re AMR Corp.)*, Bankr. No. 11-15463 (SHL), Adv. Nos. 12-01932 (SHL), 12-01946 (SHL), 2013 WL 209643 (Bankr. S.D.N.Y. Jan. 17, 2013).

thereon and all other amounts due thereunder (***but for the avoidance of doubt, without Make-Whole Amount***), shall immediately and without further act become due and payable . . . ."[3] Additionally, Section 3.03 of the Indentures stated that no Make-Whole Amount was payable "as a consequence of or in connection with an Event of Default or acceleration . . . ."[4] However, the Indentures also permitted American to voluntarily redeem the notes "at any time," subject to payment of the Make-Whole Amount.[5]

The Debtors filed for chapter 11 relief on November 29, 2011. On December 23, 2011 and January 11, 2012, American agreed to perform its obligations under the Prepetition Financing, including the payment of regularly scheduled principal and interest, pursuant to section 1110(a) of the Bankruptcy Code.[6] On October 9, 2012, the Debtors filed a motion for authority to obtain new, less expensive secured first-priority financing and to repay the Prepetition Financing without paying the Make-Whole Amount.

U.S. Bank objected, arguing that the Make-Whole Amount was due because the Debtors were voluntarily redeeming the notes, rather than redeeming "as a consequence of or in connection with" an acceleration, and in any event, the automatic acceleration provision was an unenforceable *ipso facto* clause. Alternatively, U.S. Bank sought to lift the automatic stay to exercise its right under the Indentures to waive the default and decelerate the debt. U.S. Bank also argued that the Debtors were impermissibly using section 1110 of the Bankruptcy Code as a sword to benefit from the automatic stay while avoiding payment of the Make-Whole Amount.

Analysis:

The Bankruptcy Court approved the Debtors' postpetition financing, and in doing so, rejected the noteholders' request for the Make-Whole Amount. Looking to the plain language of the Indentures, it held that the Debtors were not required to pay the Make-Whole Amount where a bankruptcy default triggered the automatic acceleration of the notes.[7] U.S. Bank had argued that Section 4.02(a)(i) of the Indentures did not apply because it required the loan trustee to take affirmative action to accelerate the debt. The Bankruptcy Court found that Section 4.02(a)(i) gave U.S. Bank the option to pursue remedies following certain events of default; however, where a default was premised on the filing of a voluntary bankruptcy petition, the Indentures explicitly stated that all amounts due, other than the Make-Whole

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3 *Id.* at *2 (emphasis added).

4 *Id.* at *5.

5 *Id.* at *2.

6 Section 1110(a) of the Bankruptcy Code permits a party with a security interest in aircraft and related equipment to take possession of its collateral notwithstanding the automatic stay unless, within 60 days of the bankruptcy filing, the debtor agrees to perform all of its contractual obligations and cure any non-bankruptcy defaults. *See* 11 U.S.C. § 1110(a).

7 *In re AMR Corp.*, 2013 WL 209643, at *5.

Amount, were "immediately and without further act . . . due and payable without presentment, demand, protest or notice . . . ."[8] Additionally, the Bankruptcy Court rejected U.S. Bank's argument that acceleration under New York law must be elected by the lender and cannot be invoked by the borrower, noting that numerous decisions have affirmed automatic acceleration clauses with little comment.[9]

The Bankruptcy Court concluded that not only Section 4.02(a)(i) of the Indentures, but also Section 3.03 "clearly cover[ed] the situation at hand" because it involved both an event of default and an acceleration.[10] U.S. Bank had maintained that Section 3.03 only prohibited make-whole payments "as a consequence of or in connection with an Event of Default or acceleration." According to U.S. Bank, because the Debtors wanted to voluntarily refinance their prepetition debt to take advantage of the beneficial refinancing terms available in the market, Section 3.03 was inapplicable. The Bankruptcy Court, however, rejected this argument, stating that, "while the phrase 'in connection with' is not defined under the Bankruptcy Code, . . . it has been given a broad construction in other contexts such as securities law."[11]

U.S. Bank also contended that Section 4.02(a)(i) was an unenforceable *ipso facto* clause.[12] However, the Bankruptcy Court sided with numerous Southern District decisions in holding that *ipso facto* clauses are not *per se* invalid except where contained in an executory contract or unexpired lease.[13] Because the parties conceded that the Indentures were neither executory contracts nor unexpired leases, the Court refused to invalidate Section 4.02(a)(i) as an *ipso facto* provision.

Even if Section 4.02(a)(i) automatically accelerated the debt upon the Debtors' bankruptcy filing, U.S. Bank argued it could waive the event of default and decelerate the debt. Although the Indentures permitted such deceleration, the Court held that the automatic stay barred U.S. Bank from doing so. Stay

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8 *Id.* at *6. The Court observed that U.S. Bank appeared to concede that the notes had automatically accelerated because U.S. Bank, in its proof of claim, cited to Section 3.03 of the Indentures as the basis for its entitlement to the Make-Whole Amount. *Id.*

9 *Id.*

10 *Id.* at *5.

11 *Id.*

12 An *ipso facto* clause is a clause in a contract or lease "that modif[ies] the relationship of contracting parties due to the filing of a bankruptcy petition." *Id.* at *10 (quoting *Reloeb Co.* v. *LTV Corp. (In re Chateaugay Corp.)*, 1993 U.S. Dist. Lexis 6130, at *14 (S.D.N.Y. May 10, 1993)).

13 In *In re W.R. Grace & Co.*, 475 B.R. 34, 154 (D. Del. 2012), the District Court for the District of Delaware cited "the general trend of the federal courts that the prohibition against *ipso facto* clauses is not limited to actions [involving executory contracts or unexpired leases]" in holding that an event of default premised on a bankruptcy filing was an invalid *ipso facto* provision. The Bankruptcy Court in *AMR*, without rejecting *W.R. Grace* outright, stated that the instant dispute was factually distinguishable. *In re AMR Corp.*, 2013 WL 209643, at *10, n.13.

relief was inappropriate here because U.S. Bank was collecting scheduled payments under the Indentures, and a deceleration of the debt (and subsequent make-whole payment) would cause "obvious harm to the estate."[14]

Finally, U.S. Bank claimed that the Debtors' attempt to refinance without paying the Make-Whole Amount was inconsistent with the Debtors' exercise of rights under section 1110(a) of the Bankruptcy Code. U.S. Bank asserted that, by exercising their section 1110(a) rights and continuing to perform under the Indentures, the Debtors acted as though a bankruptcy event of default had not occurred; thus, the Debtors could not now argue that the notes had accelerated following a bankruptcy default, thereby avoiding their contractual obligation to pay the Make-Whole Amount. The Bankruptcy Court disagreed. Judge Lane noted that section 1110(a) of the Bankruptcy Code requires only that a Debtor continue performing its contractual obligations and cure any non-bankruptcy defaults. The Debtors were under no duty to cure the bankruptcy default, which arose automatically upon commencement of the chapter 11 case, and the Debtors' compliance with section 1110(a) of the Bankruptcy Code did not erase such event of default. Because the Indentures provided that the Make-Whole Amount was not due in connection with an acceleration, the Debtors satisfied their obligations under section 1110(a) by continuing to pay principal and interest while refusing to pay the Make-Whole Amount.

Conclusion:

In re AMR Corp. highlights the importance of careful drafting. It is consistent with cases like *Calpine* and *Solutia*, which suggest that a court will be guided by the documents negotiated by sophisticated parties. Accordingly, unless the governing loan documents are specific in providing for payment of a make-whole premium upon acceleration, lenders' make-whole claims will likely come up short.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Alan W. Kornberg	Stephen J. Shimshak	Andrew N. Rosenberg
(212) 373-3209	(212) 373-3133	(212) 373-3158
akornberg@paulweiss.com	sshimshak@paulweiss.com	arosenberg@paulweiss.com

Associate Adam M. Denhoff contributed to this client alert.

[14] *Id.* at *9.