September 19, 2013

Second Circuit Denies American Airlines Noteholders' Make-Whole Claim

The U.S. Court of Appeals for the Second Circuit recently affirmed the decision of the Bankruptcy Court for the Southern District of New York[1] allowing AMR Corp. and its related debtors to repay certain prepetition secured notes held by U.S. Bank Trust National Association ("U.S. Bank"), as trustee and security agent, without having to pay a "make-whole" premium.[2] Like the Bankruptcy Court, the Second Circuit pointed to the plain language of the credit documents in rejecting U.S. Bank's make-whole claims.[3]

Background:

Chapter 11 debtor American Airlines, Inc. ("American") was party to three U.S. Bank-led secured prepetition financing transactions (the "Prepetition Financing").

The Indentures governing the Prepetition Financing 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 a voluntary bankruptcy "the unpaid principal amount of the Notes then outstanding, together with accrued but unpaid interest 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 . . . ."[4] Separately, 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

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1 Our Client Memorandum dated January 28, 2013, "Bankruptcy Court Relies on Plain Language of Indentures in Denying American Airlines Noteholders' Make-Whole Claim," provides a detailed description of the Bankruptcy Court decision and can be found at http://www.paulweiss.com/media/1430129/28jan13amr.pdf.

2 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.

3 *U.S. Bank Trust National Association* v. *American Airlines Inc. (In re AMR Corp.)*, Case Nos. 13-1204-cv, 13-1207-cv, 13-1208-cv, 2013 WL 4840474 (Bankr. S.D.N.Y. Sept. 12, 2013).

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

acceleration . . . ."[5] However, the Indentures permitted American to redeem the notes voluntarily "at any time," but if American did that, it had to pay the Make-Whole Amount.[6]

American 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, a special interest provision that ensures, among other things, that aircraft financiers either get paid or get their collateral.[7] On October 9, 2012, American and its related debtors filed a motion 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, contending that the Make-Whole Amount was now due because American had chosen to redeem the notes voluntarily, rather than to redeem them "as a consequence of or in connection with" an acceleration and asserting that the automatic acceleration provision upon the bankruptcy filing was the consequence of an unenforceable *ipso facto* clause. Alternatively, U.S. Bank sought relief from the automatic stay to exercise its right under the Indentures to waive the default and deaccelerate the debt. Finally, U.S. Bank argued that American was impermissibly using section 1110 of the Bankruptcy Code as a sword to benefit from the automatic stay and to avoid paying the Make-Whole Amount.

On January 17, 2013, the Bankruptcy Court approved American's postpetition financing and rejected U.S. Bank's claim for the Make-Whole Amount.[8] The Bankruptcy Court relied on the plain language of the Indentures in concluding that American's chapter 11 filing automatically accelerated the notes and, as a result, American did not have to pay the Make-Whole Amount. U.S. Bank asked to appeal the Bankruptcy Court's decision directly to the Second Circuit and the Bankruptcy Court granted its request. On April 2, 2013, the Second Circuit agreed to hear U.S. Bank's appeal.[9] Before the Second Circuit, U.S. Bank made the same arguments it made to the Bankruptcy Court.[10]

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5 *Id.* at *2.

6 *Id.*

7 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 after 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).

8 *U.S. Bank Trust National Association* v. *American Airlines Inc. (In re AMR Corp.)*, 485 B.R. 279 (Bankr. S.D.N.Y. 2013).

9 *In re AMR Corp.*, 2013 WL 4840474 at *5.

10 *Id.*

Analysis:

The Second Circuit agreed with the Bankruptcy Court that the clear and unambiguous terms of the applicable Indenture provisions treated American's voluntary chapter 11 petition as a bankruptcy default that automatically accelerated the debt.[11] While non-bankruptcy events of default gave U.S. Bank the option to accelerate, the bankruptcy default resulted in automatic acceleration and the Indentures expressly stated that no Make-Whole Amount was due upon automatic acceleration.[12] Though American had not attempted to pay the outstanding accelerated debt before it filed its motion to obtain postpetition financing in October 2012, American's delay did not change the fact that as of the filing of the chapter 11 cases American owed and continued to owe the outstanding principal and any unpaid interest on the accelerated debt -- but no Make-Whole Amount.[13]

The Second Circuit considered and rejected each of U.S. Bank's attempts to overcome the Indentures' plain language: (i) the contention that under New York law only the lender could trigger acceleration (to the contrary, the Court found that New York courts recognized automatic acceleration), (ii) the invocation of deacceleration provisions of the Indentures (to enforce those would violate the automatic stay, the Court said), (iii) the characterization of American's repayment as "voluntary" (an impossibility, the Court reasoned, due to the automatic acceleration), (iv) invocation of the Bankruptcy Code's prohibition on *ipso facto* clauses (the Court found such clauses were not *per se* invalid, and the prohibition did not apply to these facts), and (v) violations of U.S. Bank's rights as an aircraft financier under section 1110(a) of the Bankruptcy Code (the Court found American had complied with section 1110(a) by performing its contractual obligations under the Prepetition Financing and curing non-bankruptcy defaults as the statute required; acceleration due to filing for bankruptcy was outside the scope of section 1110(a)).

Conclusion:

The Second Circuit's decision in *In re AMR Corp.* underscores the importance of careful drafting. To increase the likelihood of receiving payment on make-whole claims, lenders should ensure the documents clearly provide for payment of a make-whole premium upon automatic or other acceleration events, including upon automatic acceleration due to bankruptcy.[14]

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11 *Id.* at *6.

12 *Id.*

13 *Id.*

14 In another recent make-whole decision, the Bankruptcy Court for the Western District of Oklahoma enforced a make-whole premium that became due and payable under the terms of a senior secured notes indenture upon the automatic acceleration of the debt as a result of a bankruptcy filing. *In re GMX Resources, Inc.*, Case No. 13-11456 (Bankr. W.D. Okla. August 27, 2013) [Docket No. 683]. Paul Weiss represented the steering committee of senior secured noteholders in this litigation.

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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:

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