POST-PETITION INTEREST AND NO-CALL CLAIMS

Make Whole And Acceleration - Arguments Against

Debts are automatically accelerated upon the commencement of the Debtors' chapter 11 cases by operation of law. *See In re Ridgewood Apts of Dekalb County, Ltd.*, 174 B.R. 712, 720 (Bankr. S.D. Ohio 1994) ("Even without specific contractual language, a bankruptcy filing acts as an acceleration of a debtor's obligations.")

Repayment made after acceleration is a payment made after maturity and by definition not a prepayment. See *In re LDH Realty Corp.*, 726 F. 2d 327, 329 (7th Cir. 1984) ("acceleration, by definition, advances the maturity date of the debt so that payment thereafter is not prepayment but instead is payment after maturity"); *Atl. Ltd. P'ship-IX v. John Hancock Mut. Life Ins. Co.*, 95 F. Supp. 2d 678, 681-682 (E.D. Mich. 2000) ("It is well settled, however, that a lender may lose its right to a [make-whole] premium when it elects to accelerate a debt. This is so because acceleration, by definition, advances the maturity date of the debt so the payment thereafter is not made but instead is payment after maturity."); see also Ridgewood Apts., 174 B.R. at 120 (stating that because the "essence of a bankruptcy organization under Chapter 11 is to restructure debt … [it] would be anomalous for acceleration of an obligation to be construed as a prepayment."); *Slevin Container Corp. v. Provident Fed. Sav. & Loan Ass'n*, 424 N.E. 2d 939, 941 (Ill. App. 3d 1981) (holding that repayment after acceleration is a payment "made after maturity and by definition not repayment.")

In re Solutia Inc., 379 B.R. 473 (Bankr. S.D.N.Y. 2007), debtors sought approval of a chapter 11 plan of reorganization that provided for repayment of certain senior secured notes. In addition to the debtors 'proposal to pay them the allowable principal amount of their claim plus the balance of the pending interest and prepetition accrued OID, the noteholders sought prepayment or make-whole amounts from the debtors' estates because the noteholders *expected* to receive a future income streeam over the life of the notes, which they would lose upon the payment of theiir prepetition claims under the plan.

The relevant indenture in Solutia did not provide for an early redemption of the notes and expressly required the debtors to pay principal and interest on the dates and times set forth in the notes. The relevant indenture in Solutia also contained a provision that called for the automatic acceleration of the notes upon "filing a proceeding for reorganization." After the debtors and the creditors' committee objected to the noteholders' proof of claim, the bankruptcy court held that "because the Notes were automatically accelerated [upon bankruptcy filing] any payment at this time would not be a prepayment. Prepayment can only occur prior to the maturity date.

In Solutia, the bankruptcy court expressly noted that New York law provides the waiver of any prepayment claims or premiums upon acceleration of the debt. ("Under New York law, the mortgagee upon acceleration may not retain or [recover] any unearned portion of the interest charged even if the collateral is sufficient.")

> "There can be no dispute that the [note indenture] provides for automatic acceleration upn filing a petition for reorganization. Upon acceleration the entire debt becomes due and owing. Acceleration moves the maturity date from the original maturity date to the acceleration date and that date becomes the new maturity date. The maturity date of the [notes] is now the Petition Date. This is the result that the [noteholders] bargained for in [the indenture].

POST-PETITION INTEREST AND NO-CALL CLAIMS

Make Whole And Acceleration - Arguments Against (cont'd)

Acceleration is defined by Black's Law Dictionary (8th ed. 2004) as "the advancing of a loan agreement's maturity date so that payment of the entire debt is due immediately."

In terms of expectation damages, some might argue that the creditors might have damages related to their expectation of future interest payments. However, where the creditors bargained to have their entire debt become immediately due and payable (to accelerate) upon a bankruptcy filing, these creditors are not entitled to expectation damages. The court in Solutia wrote:

> "It has long been settled in New York that a borrower does not have a right to prepay an instrument in the absence of a prepayment clause. Among the policy reasons behind forbidding prepayment is that the mortgagee has bargained for a stream of income over a fixed period of time. By incorporating a provision for automatic acceleration, the 2009 Noteholders made a decision to give up their future income stream in favor of having an immediate right to collect their entire debt."

In the absence of specific language providing for "dashed expectations" damages, the court cannot award a make-whole premium or no-call damages. See *In re Tri-State Ethanol Co., LLC*, 369 B.R. 481 (D. S.D. 2007) (holding that a loan agreement would not support a prepayment penalty upon acceleration of the debt because specific language to that effect was absent).

"No-call" provisions that purport to prohibit optional repayment of debt within certain time periods have been found to be unenforceable in bankruptcy cases. See *In re Calpine Corp.*, 365 B.R. 392, 399 (Bankr. S.D.N.Y. 2007) ("Generally, no-call provisions that purport to prohibit optional repayment of debt are unenforceable in chapter 11 cases."); I*n re Vest Assocs.*, 217 B.R. 696, 699 (Bankr. S.D.N.Y. 1998)(allowing repayment of loan provided "it cannot be prepaid without the prior written consent of the holder"); *Cont'l Sec. Corp. v. Shenandoah Nursing Home P'ship*, 193 B.R. 769, 774 (W.D. Va. 1996) (affirming bankruptcy court's holding that "while there is a prepayment prohibition, [it] is not enforceable in this [Chapter 11] context"); *In re 360 Inns Ltd.*, 76 B.R. 573, 575-576 (Bankr. N.D. Tex. 1987)(authorizing repayment of a note depsite ten-year prohibition on repayment); *LHD Realty*, 726 F. 2d at 329.

In re Calpine Corp., 365 B.R. 392 (Bankr. S.D.N.Y. 2007), the debtor sought permission to enter into a replacement debtor-in-possession facility and, outside of a chapter 11 plan, to use those funds to refinance the debtors' existing debtor-in-possession facility and to prepay certain high-interest prepetition debt (the "Calgen Debt"). Certain holders of the Calgen Debt objected to the proposed refinancing on the grounds that certain "no-call" provisions in the applicable indenture prohibited prepayment until certain fixed times, or if prepayment was allowed, the lenders were entitled to a "make-whole" premium. The agreement did not include any form of liquidated damage provision for payment prior to the specified date. Althought the Calpine court found that the secured lenders were entitled to unsecured claims for damages for the debtor's breach of the no-call clauses, the Calpine court's reasoning was expressly rejected in Solutia because it "reads into agreements between sophisticated parties provisions that are not there" and "the court cannot supply what is absent." Solutia, 379 B.R. at 485; see also In re Vest Assocs., 217 B.R. 696, 699-700 (Bankr. S.D.N.Y. 1998)("Court cannot read into a contract damages provisions which the parties had failed to insert regarding the liquidation or calculation of damages arising out of the prepayment of a loan.")

Make Whole And Acceleration - Arguments Against (cont'd)

Any "make-whole" premium or "no-call" damages based on a loss of future income stream constitutes compensation for prospective unmatured interest, which is expressly disallowed under the Bankruptcy Code. See Section 502(b)(2) (providing in relevant part that "the court … shall allow such claim … except to the extent that … such claim is for unmatured interest).

POST-PETITION INTEREST AND NO-CALL CLAIMS

Make Whole And Acceleration - Arguments In Favor

Where a creditor holds a valid claim under applicable non-bankruptcy law, such claim should be allowed under the Bankruptcy Code Section 502(b), provided it is not otherwise prohibited by the Bankruptcy Code. *Travelers Cas. & Sur. Co. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 450 (2007) ("creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code") (*quoting Raleigh v. Ill. Dep't of Rev.*, 530 U.S. 15, 20 (2000); *Raleigh*, 530 U.S. at 24 (holding that although allowance of a claim is a federal matter, the validity of a claim is determined by state law).

Under New York law, a borrower "has no right to pay off his obligation prior to its stated maturity date in the absence of a prepayment clause …" *Friends Realty Assocs., LLC v. Wells Fargo Bank, N.A.P.*, 836 N.Y.S. 2d 565 (N.Y. App. Div. 2007) (quoting *Arthur v. Burkich*, 520 N.Y.S. 2d 638, 639 (N.Y. App. Div. 1987)).

In the absence of an express right to prepay under the agreement, the payment schedule agreed to by the parties must be enforced. *Arthur*, 520 N.Y.S. 2d. At 639.

Because "prepayment can impose daunting economic sacrifices upon a mortgagee," when a party attempts improperly to prepay an obligation, such prepayment constitutes a breach and the lender is entitled to prepayment damages. *See id.; Russo Enters., Inc. v. Citibank, N.A.*, 266 A.D. 2d. 528, 529 (N.Y. App. Div. 1999); *see also In re Calpine Corp.*, 365 B.R. 392, 399 (Bankr. S.D.N.Y. 2007) (finding that the lenders' "expectation of an uninterrupted payment stream has been dashed giving rise to damages" and "whilethe agreements do not provide a premium or liquidated damages for repayment during the period the Debtors propose, the CalGen Secured Lenders still have an unsecured claim for damages for the Debtors' breach of the agreements."

In re Skyler Ridge, 80 B.R. 500, 507 (Bankr. C.D. Cal. 1987); see also *In re Imperial Coronado Partners, Ltd.*, 96 B.R. 997, 1000 (B.A.P. 9th Cir. 1989) (finding that prepayment was voluntary, notwithstanding automatic acceleration, and that the prepayment premium was enforceable because the debtor had the right to reinstate the debt in bankruptcy); *Calpine Corp.*, 365 B.R. at 399-400 (awarding damages claim resulting from prepayment despite automatic acceleration); *Petroleum & Franchise Funding, LLC v. Dhaliwal*, No. 09-CV-353, 2010 WL 342178, at *5 (E.D. Wis. Jan. 25, 2010) (finding that automatic acceleration of obligation did not destroy the right to a prepayment premium); *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 F. 2d. 1039, 1053 (2d Cir. 1982) (finding that acceleration of obligation upon breach was not exclusive remedy and because borrower voluntarily caused the acceleration, the prepayment premium was still payable); *In re Solutia Inc.*, 379 B.R. 473, 487-488 (Bankr. S.D.N.Y. 2007) (finding prepayment penalty was not triggered because there could be no prepayment upon automatic acceleration); *In re Ridgewood Apartments of DeKalb County, Ltd.*, 174 B.R. 712, 721 (Bankr. S.D. Ohio 1994). "If automatic acceleration of a debt defeats a prepayment premium clause, such a clause could never be enforced in a bankruptcy case." *Skyler Ridge*, 80 B.R. at 507.

POST-PETITION INTEREST AND NO-CALL CLAIMS

Make Whole And Acceleration - Arguments In Favor (cont'd)

When a prepayment clause is breached, damages are calculated by determining the discounted present value of the incremental interest income the lender loses due to the breach. *Ormesa Geothermal*, 791 F. Supp. At 416; see also *Russo Enters.*, 266 A.D. 2d. At 529 (stating that damages incurred by a mortgagee from improper payment can include "the loss of the bargained for rate of return, an increased tax burden, unanticipated costs occasioned by the need to reinvest the principal, and for those creditors anxious to ensure regular payments not unlike an annuity, it undoes the mortgagee's purpose in making the loan").

While state law governs a creditor's rights to assert a claim, whether such claim is allowed is determined by Bankruptcy Code Section 502(b). Pursuant to Section 502(b), a claim is allowed to the extent that "such claim is unenforceable against the debtor and property of the debtor under any agreement or applicable law …" Among the claims disallowed under Section 502(b) are claims for unmatured interest. The damages claims are alloweed under Section 502(b) because they are valid claims for money damages under state law. *Travelers*, 549 U.S. at 450-51; *Ormesa Geothermal*, 791 F. Supp. at 415-16.

Courts have routinely held that a prepayment charge is not unmatured interest. *See Noonan v. Fremont Fin. (In re Lappin. Elec. Co.)*, 245 B.R. 326, 330 (Bankr. E.D. Wis. 2000) ("this court is in agreement with a majority of courts that view a prepayment charge as liquidated damages, not as unmatured … interest that would be disallowed under Section 502(b)(2)"); *In re 360 Inns, Ltd.*, 76 B.R. 573, 576 (Bankr. N.D. Tex. 1987) (finding that prepayment penalties are not unmatured interest because the damages mature once the debtor proposes to repay the debt); *Calpine Corp.*, 365 B.R. at 399-400.

It is well established that the "filing of a bankruptcy petition is a voluntary act" *N.I.S. Corp. v. Hallahan (In re Hallahan)*, 936 F. 2d. 1496, 1505 n. 10 (7th Cir. 1991) (citing *United States v. Kras*, 409 U.S. 434, 445 (1973); see also *Splash v. Irvine Co. (In re Lion Country Safari, Inc. Cal.*), 124 B.R. 566, (Bankr. C.D. Cal. 1991) ("the filing of a bankruptcy petition by a debtor is a voluntary act"); *Nat'l Corp. Tax Credit, Inc. v. Franklin Arms Court, L.P. (In re Franklin Arms Court, L.P.)*, No. 03-A-00147, 2003 WL 1883472 at *9 (Bankr. N.D. Ill. Apr. 10, 2003 ("the Debtor's voluntary act of filing bankruptcy constitutes a major default under the Partnership Agreement").

POST-PETITION INTEREST AND NO-CALL CLAIMS

Post-petition Interest

Noteholders are not entitled to recover post-petition interest on their claims because they hold only unsecured claims. Statutorily, unsecured creditors are not entitled to recover post-petition interest on their claims. See Section 502(b)(2)(providing in relevant part that "the court … shall allow such claim … except to the extent that … such claim is for unmatured interest"); *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 373-74 (1988) (holding that undersecured creditors, like unsecured creditors, are not entitled to post-petition interest where an estate is insolvent); *Frito-Lay v. LTV Corp. (In re Chateaugay Corp.)*, 156 B.R. 391, 403 (S.D.N.Y. 1993) ("[section] 502(b) bars post-petition interst on a pre-petition unsecured claim"); *In re Lapworth*, No. 97-34529, 1998 WL 767456, *3 (Bankr. E.D. Pa. Nov. 2, 1998).

Although some courts have recognized a limited exception to this rule where the debtor is solvent, reasoning that a plan may be confirmed only if impaired class members receive as much as they would in a chapter 7 liquidation, see Section 1129(a)(7)(A)(ii).

Moreover, even where a debtor is solvent, the court nevertheless retains discretion to deny the payment of post-petition interest to unsecured creditors based upon the equities of the case. *In re Shaffer Furniture Co.*, 68 B.R. 827, 830 (Bankr. E.D. Pa. 1987) ("The Debtor's solvency permits, as opposed to requires, us to prioritize the unsecured creditors' claims for post-petition interest over the return of the available cash reserves to the Debtor, depending on the 'equities of the case.'") abrogated on other grounds by *In re Chiapetta*, 159 B.R. 152 (Bankr. E.D. Pa. 1993). See also *In re Shaffer Furniture Co.*, 68 B.R. at 830; *Nat'l Union Fire Ins. Co. v. Gardner (In re Gardner)*, No. 90-1851, 1990 WL 192478 at *2 (E.D. La. Nov. 28, 1990) ("The decision to award post-petition interest depends on the equities of the case.").

Unsecured creditors are generally prohibited from recovering post-petition or default rate interest. See Section 502(b)(2). However, an exception to this general rule exists when the debtor is solvent. *In re W.R. Grace & Co.*, No. 01-1139-JKF, 2009 WL 1469831, at *2 (Bankr. D. Del. May 19, 2009); *In re Coram Healthcare Corp.*, 315 B.R. 321, 344 (Bankr. D. Del. 2004). And, when a debtor is solvent, there is a presumption that post-petition interest should be paid at the contractual default rate. *See W.R. Grace*, 2009 WL 1469831, at *4; *Official Comm. Of Unsecured Creditors v. Dow Corning Corp. (In re Dow Corning Corp.)*, 456 F. 3d 668, 679 (6th Cir. 2006) ("when a debtor is solvent, then, the presumption is that a bankruptcy court's role is merely to enforce the contractual rights of the parties …").

Bankruptcy courts should not deny post-petition interest in solvent debtor situations. *See Dow Corning Corp.*, 456 F. 3d at 670 ("Solvent-debtor cases present a situation where all parties ought to be granted the benefit of their bargains, unless the equities compel a contrary result.").

POST-PETITION INTEREST AND NO-CALL CLAIMS

Post-petition Interest (cont'd)

Courts applying the "solvent debtor" exception have done so reasoning that a plan may be impaired only if impaired class members receive as much as they would in a chapter 7 liquidation (Section 1129(a)(7)(A)(ii)) and the liquidation requires property of a solvent estate to be distributed "in payment of interest ***at the legal rate*** from the date of filing of petition on any claim." (Section 726(a)(5)).; see *In re Fesco Plastics Corp.*, 996 F. 2d 152, 155 (7th Cir. 1993).

The Bankruptcy Code does not define the phrase "at the legal rate" and thus, the Court is left to determine the meaning of the phrase as used in Section 726(a)(5). An examination of the statute compels the conclusion that the phrase means interest at the federal judgment rate. See *Onink v. Cardelucci (In re Cardelucci)*, 285 F. 3d 1231, 1234 (9th Cir. 2002); *In re Dow Corning Corp.*, 237 B.R. 380, 387 (Bankr. E.D. Mich. 1999); *In re Country Manor of Kenton, Inc.*, 254 B.R., 179, 183. By using the definitive phrase "the legal rate" instead of the less precise phrase "a legal rate" in Section 726(a)(5), Congress intended that a single uniform sourrce be used to calculate post-petition interest.

Courts have long expressed their disfavor of compound interest on judgments and allowed claims, both as a matter of statutory entitlement and equitable principles. See *Vanston Bondholders Protective Comm. V. Green*, 329 U.S. 156, 165 (1946) ("we do not think that imposition of interest on that unpaid interest can be justified by 'an application of equitable principles'"); *In re Norcor Mfg. Co.*, 36 F. Supp. 978, 980 (D.C. Wis. 1941) ("There is no statutory authority for allowing compound interest on claims that are alloweed in bankruptcy."