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Secured Lender Review: 7 Cautionary Rules — Part I

Law360, New York (April 4, 2011) -- Over the past several years, many companies have experienced difficulty in emerging from Chapter 11 as reorganized entities. This phenomena stands out in the current distressed marketplace. Although there are multiple causes for the resulting decline in true Chapter 11 reorganizations, a number of controversial decisions issued by prominent courts have changed the restructuring landscape for all constituents, but most acutely for secured lenders. Based on these decisions, we have formulated seven practical and cautionary rules for secured lenders to consider as they navigate the changed terrain.[1]

Part I of this article sets forth Rules 1 through 4; Part II (to be published April 12, 2011) sets forth Rules 5 through 7. Part II of this article also provides practical guidance for secured lenders at the major stages of a transaction — from initial negotiation of the loan through restructuring and/or bankruptcy.

Rule Number 1: A vague or imprecise intercreditor agreement may not be enforced.

Rule Number 2: In certain parts of the country, including Delaware and Texas, collateral can be sold without honoring a secured lender's right to credit bid.

Rule Number 3: A 363 sale to a junior lender that violates the terms of the intercreditor agreement may be approved by the court, and a senior lender may have no rights on appeal if the sale has already closed “in escrow.”

Rule Number 4: In certain parts of the country, including New York, strategic investors seeking to implement loan-to-own strategies in a Chapter 11 case should proceed with caution.

Rule Number One: A Vague or Imprecise Intercreditor Agreement May Not Be Enforced.

An intercreditor agreement should clearly identify the relative rights of the parties. In the absence of razor-like precision, junior lenders may be able to assert themselves in the borrower’s bankruptcy case, even where doing so would violate the spirit of the subordination embodied in the intercreditor agreement.

In In re Boston Generating LLC, No. 10-14419 (SCC) (Bankr. S.D.N.Y. 2010), the debtor proposed to sell substantially all of its assets to a stalking horse bidder on an expedited schedule. Junior lenders objected to the bid procedures and to the 363 sale itself. Senior lenders sought to silence the juniors, claiming that the very terms of their intercreditor agreement prohibited any objection by the junior lenders.

Construing the terms of the intercreditor agreement,[2] the court found it did not contain an "unequivocal" and "express" waiver of the junior lenders' right to object as required under New York law. Accordingly, the court allowed the junior lenders to object to the bid procedures and to the 363 sale, even though their objections violated the "spirit" of the intercreditor agreement.

The opposite outcome was obtained in Ion Media Networks Inc. v. Cyrus Select Opportunities Master Fund Ltd. (In re Ion Media Networks Inc.), 419 B.R. 585 (Bankr. S.D.N.Y. 2009). In that case, junior lenders attempted to challenge the validity of liens on certain assets in the shared collateral package. The court declined to entertain the junior lenders' challenge, holding instead that under the "express" terms of the intercreditor agreement, the junior lenders had agreed "to be 'silent' as to any dispute regarding the validity of the liens."[3] Ion Media, 419 B.R. at 593-94.

Importantly, the court went on to note that plainly "worded contracts establishing priorities and limiting obstructionist, destabilizing and wasteful behavior should be enforced and creditor expectations should be appropriately fulfilled." Ion Media, 419 B.R. at 595.

The Bottom Line:

- Consider adapting the ABA Model Intercreditor Agreement to the specific terms of the deal.[4]

- In the intercreditor agreement, identify with specificity each right a junior lender is waiving, such as the right to (a) contest the validity of liens, (b) object to bid procedures, (c) object to a 363 sale of the borrower's assets, (d) seek appointment of an examiner or trustee, or (e) convert the case to Chapter 7.

- Specify in the intercreditor agreement that any dispute or ruling by the court about what constitutes "collateral" will not affect in any manner whatsoever (a) the lien and claim subordination provisions embodied in the agreement, (b) the relative priorities of each of the parties in and to the collateral, or (c) the relative priorities of each of the parties in and to any proceeds of the collateral or any payment.

- Specify in the intercreditor agreement that the failure to perfect the security interest in any of the collateral will not affect in any manner whatsoever (a) the lien and claim subordination provisions embodied in the agreement, (b) the relative priorities of each of the parties in and to the collateral, or (c) the relative priorities of each of the parties in and to any proceeds of such collateral or any payment.

Rule Number Two: In Certain Parts of the Country, Including Delaware and Texas, Collateral Can Be Sold Without Honoring a Secured Lender's Right to Credit Bid.

In 2010, the Third Circuit Court of Appeals ruled that a debtor could sell substantially all of its assets pursuant to a plan of reorganization without granting secured lenders the right to credit bid. See In re Philadelphia Newspapers LLC, et al., 2010 WL 1006647 (3d Cir. 2010).

The ruling was unsettling on many levels as it eviscerated the assumed protections of section 363(k) of the Bankruptcy Code, condoned a sale to a group which included former insiders and shareholders of the debtor, and serves as binding precedent for bankruptcy cases filed in the District of Delaware, the venue of choice for many debtors. Based on its far-reaching and momentous effects, the ruling has been widely reported.

The Philadelphia Newspapers decision adopted the rationale of the decision in Bank of New York Trust Co. NA v. Official Unsecured Creditors' Comm. (In re Pacific Lumber Co.), 584 F.3d 229 (5th Cir. 2009), in which the Fifth Circuit Court of Appeals held that secured lenders could not credit bid for assets following a judicial valuation of the collateral and a private judicial sale.

However, in In re River Road Hotel Partners LLC, Case No. 09-30029 (Bankr. N.D. Ill. October 2010), the court declined to follow the holding of Philadephia Newspapers and Pacific Lumber and held that the debtor could not propose bidding procedures for a “sale under a plan” that prevented the secured creditor from credit bidding its debt. It remains to be seen how other circuits will react to attempts by debtors to sell secured lenders’ collateral without honoring the right to credit-bid.

The Bottom Line:

- If the debtor needs the consent of the lender to use cash collateral or needs post-petition financing and the lender itself wishes to provide it, consider conditioning that consent on obtaining an order giving the lender the right to credit bid in the event of a sale of the collateral — whether that sale occurs pursuant to section 363, under or in connection with a Chapter 11 plan, or otherwise.

- In a sale of the debtor’s assets, consider submitting a cash bid for the collateral, conditioned on the debtor paying the secured claim in cash in full (i.e., with the sale proceeds) no later than a date certain.

Rule Number Three: A 363 Sale to a Junior Lender that Violates the Terms of the Intercreditor Agreement May Be Approved and a Senior Lender May Have No Rights on Appeal if the Sale Closes "In Escrow."

In In re Westpoint Stevens Inc., 600 F.3d 231 (2d Cir. 2010), two groups of creditors competed for the debtor's assets in a 363 sale. The first group held a majority of the senior debt (the "Contrarians"), and the second group held some senior debt and a majority of the junior debt ("Aretex").

The terms of Aretex' offer did not provide for the payment of the senior debt in cash in full. Instead, Aretex proposed to give the seniors stock in the new company (valued at $489 million). Aretex also proposed to give the juniors stock in the new company (valued at $95 million), and to pay $187 million in cash for additional shares After giving effect to these terms, Aretex would have a controlling stake in the new company.

When the bidding concluded, the bankruptcy court declared Aretex the winner notwithstanding the fact that the intercreditor agreement provided that until the senior debt was paid in cash in full, the junior lenders could not receive anything.

The Contrarians appealed and moved to stay entry of the sale order. However, rather than litigate the stay, the Contrarians agreed to allow the sale to close, while staying the distribution of the securities allocable to the junior lenders (i.e., Aretex and others) pending further order of the court.

On appeal, the district court held that distributions of securities to the holders of junior debt would violate the intercreditor agreement. Accordingly, the district court ordered the securities allocated under the plan to the junior debt holders be paid to the senior debt holders.

The Second Circuit reversed the district court's ruling. The Second Circuit agreed that the terms of Aretex's winning bid violated the intercreditor agreement. However, the Second Circuit held that pursuant to the Bankruptcy Code, appellate review of the sale was statutorily moot.

Specifically, pursuant to Bankruptcy Code section 363(m), in the absence of a stay of the sale order, reversal or modification of the order on appeal would not affect the validity of such sale to Aretex as a good faith purchaser.[5]

The Bottom Line:

- If unsatisfied with the terms of a 363 sale, do not rely on a closing "in escrow." Consider pursuing a stay pending appeal and/or make sure the sale order reserves rights to argue that distributions made on account of the sale violate the intercreditor agreement.

Rule Number Four: In Certain Parts of the Country, Including New York, Strategic Investors Seeking to Implement Loan-to-Own Strategies in Bankruptcy Should Proceed with Caution.

The Chapter 11 case of In re DBSD North America Inc., 421 B.R. 133 (Bankr. S.D.N.Y. 2009), aff'd in part, rev'd in part Dish Network Corp. v. DBSD North America Inc. (In re DBSD North America Inc.), __ F.3d __, 2011 WL 350480 (2d Cir. 2011), casts some doubt on the ability of strategic investors to implement loan-to-own strategies.

In DBSD, the debtor's proposed plan provided for the repayment of the first lien debt with a new secured note, and for the holders of second lien debt to receive equity in reorganized DBSD. DISH Network, which competed with the debtor through its wholly owned subsidiary, purchased all of DBSD's outstanding first lien debt at par, and also bought that portion of the second lien debt which was not subject to a lock-up agreement (approximately 17 percent).

DISH voted both classes of claims against DBSD's plan. DBSD asked the bankruptcy court to "designate," or disallow, DISH's votes pursuant to Bankruptcy Code section 1126(e). That section provides that a bankruptcy court may designate the votes of "any entity whose acceptance or rejection of such plan was not in good faith ..." DBSD alleged that DISH acted in bad-faith based on the following:

- After the debtor filed a plan which proposed to pay the first lien debt with a new note, DISH bought the first lien debt at par. By overpaying for the first lien debt, DISH demonstrated that it was not interested in making a profit on the debt itself, but instead acquired the debt for other strategic purposes.

- DISH only purchased that second lien debt which was not subject to a plan support agreement so that it could vote these claims to reject the plan.

- DISH attempted to propose its own plan and approached the debtor about a strategic transaction.

- DISH's internal documents demonstrated that it purchased the first and second lien debt for the purpose of gaining control of DBSD.

The bankruptcy court concluded that DISH's actions constituted bad faith and therefore its votes in both the first lien and second lien classes should be disallowed. According to the bankruptcy court, DISH did not act to maximize recovery on its claim, but rather to gain control of DBSD outside of either the "traditional" plan or asset purchase process.

On appeal, the Second Circuit, affirmed the decision of the bankruptcy court, but attempted to narrow the breadth of that ruling by stating that acquisitions and other strategic transactions benefit all parties in bankruptcy, that creditors should continue to pursue such transactions, and that there is “no categorical prohibition” on purchasing claims with acquisitive or other strategic intentions. The Second Circuit left “for another day the situation in which a preexisting creditor votes with strategic intentions.” Id. at *20.

Other comments by the Second Circuit, however, seem to contradict its attempts to narrow the decision of the bankruptcy court. For example, the opinion states that its ruling should deter attempts by purchasers to “obtain a blocking position” and thereby “control the bankruptcy process for [a] potentially strategic asset,” and that using claims “bought to secure an advantage in pursuing that strategic transaction” can support a finding that the purchaser acted in bad faith. See id.

These broad statements call into question a fundamental strategy of distressed investors, namely, purchasing a significant position in the fulcrum security in order to obtain control of the equity of a reorganized debtor.

Importantly, in rendering its opinion, the Second Circuit ruled that whether or to what extent the debtor satisfied the cram-down standards of Bankruptcy Code section 1129(b) with respect to DISH’s claims was an unnecessary consideration. Because DISH’s votes had been designated, Bankruptcy Code section 1129(a)(8) (requiring acceptance of the plan by impaired classes) was inapplicable, as was satisfaction of the Bankruptcy Code’s cram-down provisions vis-à-vis DISH’s claim. See id. at 20-21.

The Bottom Line:

- If purchasing debt for strategic reasons (a) do so prior to the filing of a disclosure statement or plan, and (b) do not pay in excess of the expected recovery on the debt if purchasing after the filing of a plan or disclosure statement.

- Direct or indirect competitors of a debtor (possibly including funds with material investments in the debtor's industry) should carefully study the DBSD opinion and subsequent developments before acquiring claims to control the debtor’s bankruptcy proceedings.

- If seeking control of the debtor, consider bidding for the assets or approaching the debtor’s board of directors regarding a purchase of the debtor’s assets.

- Be aware that if your votes are designated, the debtor may treat your claims without satisfying even the cram-down provisions of the Bankruptcy Code.

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[1] Due to the fact that intercreditor agreements are generally used to protect the rights of the senior lenders, this article is written from that perspective, although the many of the observations and drafting suggestions apply with equal force to junior lenders.

[2] The intercreditor agreement in Boston Generating provided that the senior lenders had “the exclusive right to enforce rights, exercise remedies and make determinations regarding the release, sale, disposition or restrictions with respect to the Collateral without any consultation with or the consent of” the junior lenders.

[3] The intercreditor agreement in Ion Media provided: Each of the Secured Parties acknowledges and agrees . . . to the relative priorities as to the Collateral ... [provided for in the security agreement] . . . and acknowledges and agrees that such priorities ... shall not be affected or impaired in any manner whatsoever including, without limitation, on account of ... any nonperfection of any lien purportedly securing any of the Secured Obligations (including, without limitation, whether any such Lien is now perfected, hereafter ceases to be perfected ... or otherwise is set aside, invalidated, or lapses).”

[4] A copy of the ABA Model Intercreditor Agreement is available at http://apps.americanbar.org/buslaw/committees/CL190029pub/materials/mica/20081109-draft.pdf.

[5] As a partial remedy for the Contrarians the Second Circuit did direct the distribution of additional equity to the senior lenders in an amount that still left Aretex in control of the company.

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Secured Lender Review: 7 Cautionary Rules — Part II

Law360, New York (April 11, 2011) -- In the recent past, the judiciary has issued a number of decisions which altered the restructuring landscape for all constituents, but particularly for secured lenders. Based on these decisions, we have formulated seven cautionary rules for secured lenders to consider. Part I of this article published on April 4, set forth Rules 1 through 4.

Part II of this article also provides practical guidance for secured lenders at the major stages of a transaction — from initial negotiation of the loan through restructuring and/or bankruptcy.

Rule Number 5: A plan proposed by junior lenders that crams-down senior lenders in violation of the terms of an intercreditor agreement can be confirmed.

Rule Number 6: A secured lender may be forced to accept a new note containing less favorable terms than existed prepetition in full satisfaction of its claim pursuant to the terms of a Chapter 11 plan.

Rule Number 7: Make-whole provisions and prepayment premiums may be unenforceable in bankruptcy unless the debt instrument expressly provides that such provisions survive the automatic acceleration caused by the filing of the bankruptcy petition.

Rule Number Five: A plan proposed by junior lenders that crams-down senior lenders in violation of the terms of an intercreditor agreement can be confirmed.

In In re TCI 2 Holdings LLC, 428 B.R. 117 (Bankr. D. N.J. 2010), over the categorical objection of senior lenders and despite the express contravention of the intercreditor agreement, junior lenders confirmed a plan which paid senior lenders only partially in cash while making a distribution to themselves.

In this Trump casino Chapter 11 case, the intercreditor agreement at issue preserved the junior lenders' right to act as general unsecured creditors. Id. at 140. Based on this provision, the junior lenders argued that they were entitled to file and have the court confirm their own reorganization plan — a plan which provided for the seniors to receive cash and a note as payment in full, and also provided for the juniors to receive equity in the reorganized debtors. Id. at 130-131, 140.

The seniors objected to the juniors' plan, and argued that the juniors' plan did not comply with the terms of the interecreditor agreement because it would provide a distribution to the junior lenders even though senior lenders were not being paid in full in cash, and did not require the junior lenders to remit their distribution to the senior lenders. Id. at 130-31, 139-40.

The court overruled the seniors' objection and confirmed the juniors' plan under Bankruptcy Code Section 1129(b) — the cramdown provisions of the Bankruptcy Code. The court reasoned that even though Bankruptcy Code Section 510(a) — the Bankruptcy Code section providing for enforcement of subordination agreements — generally requires the enforcement of subordination agreements in bankruptcy, this section was inoperable in a cramdown.

Specifically, the phrase contained in Section 1129(b) — "notwithstanding Section 510(a)" — made examination and enforcement of the intercreditor agreement irrelevant.[1] Id. at 140-41.

The court's ruling did not preclude the senior lenders from seeking damages for breach of contract against junior lenders. Id. at 142. However, because the confirmation order contained a finding that the seniors received the equivalent of 100 percent cash payment under the plan, it is questionable whether they could ultimately demonstrate that they suffered any damages.[2]

The Bottom Line:

- If possible, the intercreditor agreement should include waivers of a junior lender's rights as unsecured creditors in general, and specifically to propose a plan. Although these provisions would not prevent a cramdown by junior lenders, senior lenders may be able to rely on these provisions in a third-party action outside of bankruptcy court seeking to enforce the intercreditor agreement.
- The intercreditor agreement should provide that in the event that the seniors are paid with consideration other than cash, the juniors shall not seek an order of the court holding that such payment constitutes the equivalent of a 100 percent cash payment. The intercreditor agreement should also provide that if such an order is ultimately entered, it shall apply solely for purposes of cramdown under Section 1129(b) of the Bankruptcy Code, and shall not be binding on the seniors vis-a-vis the juniors in any action against juniors to enforce the terms of the intercreditor agreement or otherwise, and shall have no precedential effect in any such action.
- The intercreditor agreement should provide that in the event that the seniors are paid with noncash consideration without their consent — whether pursuant to a plan or otherwise — the seniors shall be entitled to receive a sum certain in liquidated damages from the juniors.
- Consider bargaining for anti-cramdown provisions in a cash collateral order or debtor-in-possession financing order.

Rule Number Six: A secured lender may be forced to accept a new note containing less favorable terms than existed prepetition in full satisfaction of its claim pursuant to the terms of a confirmable Chapter 11 plan.

In DBSD, the debtor proposed a plan which paid 100 percent of it's secured creditor's prepetition claim with a new note. See In re DBSD, 419 B.R. at 188-89. That new note had far less favorable terms — a) it PIK'd interest at the predefault, preforbearance rate of 12.5 percent per annum b) it matured in four years, with a balloon payment due at maturity; c) it eliminated or modified certain covenants; and d) it contained less restrictive cross-default provisions.

Repayment of the new note was highly speculative, in that it depended on an unidentified strategic investor or additional financing from an unknown source. Id.

Despite these debtor-friendly revisions, and even despite the risky nature of debtor's ability to repay the note at maturity, the court approved a cramdown of the secured lender.[3] The court concluded that the 12.5 percent interest rate was appropriate as the loan presented no "new" or "increased risk." Id. at 189-90.

The court noted that any risk was certainly present when the secured lender "purchased the first-lien debt at par." Id. The court also focused on the fact that the plan significantly de-levered the debtor and thus "considerably reduce[d]" the risk to the first-lien lender. Id.[4]

The Bottom Line:

- Consider bargaining for anti-cramdown provisions in a cash collateral order or debtor-in-possession financing order.

Rule Number 7: Make-whole provisions and prepayment premiums may be unenforceable in bankruptcy unless the debt instrument expressly provides that such provisions survive the automatic acceleration caused by the filing of the bankruptcy petition.

It is common for secured debt instruments to contain provisions which either expressly prohibit prepayment of the underlying debt (referred to as "no-call" provisions), or which permit prepayment but require additional charges or fees (referred to as "prepayment premiums") or compensation for the loss associated with early payment (referred to as "make-whole" payments).

The enforceability of these no-call provisions, prepayment premiums and make-whole payments in bankruptcy has been widely litigated with secured lenders at times being unable to receive the benefit of their bargain due to faulty documentation.

In In re Calpine Corp., 365 B.R. 392 (Bankr. S.D.N.Y. 2007) (Calpine I), the debtor sought authorization to prepay certain debt, even though the indenture in issue contained no-call provisions. Calpine I, 365 B.R. at 398-400. The secured lenders argued that such prepayment was prohibited by the express terms of the indenture. In the alternative, if the prepayment was permitted, the secured lenders asserted that they were entitled to a secured claim equal to the amount of interest they expected to receive over the life of the loan and/or the prepayment premiums provided in the indenture. Id.

In making its decision, the bankruptcy court noted the well-established principle that all indebtedness of the debtor is automatically accelerated upon the filing of a bankruptcy petition and that no-call provisions are not specifically enforceable in bankruptcy cases. Calpine I, 365 B.R. at 397.

Under the facts before the court, the no-call provisions did not expressly provide that they remained in effect following automatic acceleration caused by the debtor's bankruptcy filing. Accordingly, the court held these no-call provisions were not specifically enforceable and permitted the debtor to prepay the indebtedness.

Nonetheless, the bankruptcy court granted the lenders' unsecured claims on account of their "expectation damages" resulting from the breach of the no-call provisions in an amount equal to the interest the lenders expected to receive over the life of the debt instruments.

On appeal, HSBC Bank USA NA v. Calpine Corp., 2010 U.S. Dist. LEXIS 96792 (S.D.N.Y. 2010) (Calpine II), the district court held that the no-call provisions were unenforceable, but disallowed the grant of the unsecured claim. Calpine II, at 10-12.

Critical to the court's ruling was that the debt instruments failed to expressly provide that the no-call provisions and related prepayment charges were enforceable after the debtor filed its bankruptcy petition.[5] Id. By failing to expressly provide for the post-petition enforcement of these provisions, the court believed the lenders chose to forego any prepayment premiums in favor of an immediate right to collect their entire debt after a bankruptcy event of default. Id. at 14-16.

Therefore, according to the court, providing the lenders with "expectation damages" would grant the lenders damages for which they had not bargained. Id. Additionally, since the claim for expectation damages was tantamount to a claim for un-matured interest, since the lenders were not oversecured, and since the debtor was not solvent, the lenders were not entitled to the payment. Id. at 23-24.

A contrary conclusion was recently reached in In re Premier Entertainment Biloxi, 2010 Bankr. LEXIS 2994 (Bankr. S.D. Miss. 2010). In Biloxi, the court agreed with Calpine I, and found that the lenders were entitled to expectation damages in the form of an unsecured claim. Biloxi, at 130-31.

The Biloxi court issued this ruling even though the debt instruments did not expressly provide that the prepayment premiums remained due following automatic acceleration caused by a bankruptcy filing. Id. Although the court did not equate the "prepayment" premium to unmatured interest, the debtor's solvency was critical to the allowance of the claim. Id. at 138-48.

More recently, in In re Chemtura, No. 09-11233 (REG) (Bankr. S.D.N.Y. 2010) (Slip Op. Oct. 21, 2010), the court approved a settlement which allowed unsecured lenders to receive claims for prepayment premiums.[6] In so doing, the court found the terms of the settlement — and the unsecured claims awarded therein — to be reasonable. Although the court did not make express findings regarding the enforceability of the prepayment premiums, it did find that there was a reasonable basis for the debtor to conclude that the claims were enforceable.

In making its determination about the reasonableness of the settlement, the Chemtura court undertook a two part inquiry: First, were the prepayment premiums enforceable under state law and second, were the claims for prepayment premiums enforceable under the Bankruptcy Code.

Regarding the first question, the court held that prepayment premiums would be enforced under New York law (which governed the debt instruments) so long as a) the agreements expressly provided that the prepayment premiums would remain due following automatic acceleration caused by a bankruptcy filing; and b) the prepayment premium itself reasonably compensated the lenders for damages and did not represent a penalty. Chemtura, Slip. Op. at 56-60.

With respect to the second question, the court found that while the prepayment premiums were enforceable as a contractual matter, the ability to assert a claim for the prepayment premiums depended on the financial condition of the debtor. The court reasoned that the prepayment premiums are “proxies” for claims for unmatured interest and therefore should be disallowed except to the extent the debtor is solvent and secured creditors will receive post-petition interest on their claims. Id. at 60-64.[7]

The Bottom Line:

- Debt instruments must make clear that no-call provisions and prepayment premiums survive automatic acceleration caused by the filing of a bankruptcy petition by the borrower.
- Debt instruments should make clear that upon an event of default, the prepayment premium shall be added to the principal amount of the indebtedness. This provision will help mitigate arguments that the prepayment premium constitutes or is a proxy for future interest payments.
- The prepayment premium must be clearly identified and must be “reasonable.” In other words, it should reasonably approximate the damages that lenders might incur if the debt were prepaid prior to scheduled maturity — i.e., nonreceipt of anticipated interest payments.

Conclusion

The following issues should be considered by secured lenders at critical junctures in the lifespan of an investment:

Negotiating the Loan Documents

The Debt Instrument

- Provide that no-call provisions and prepayment premiums survive automatic acceleration caused by the filing of a bankruptcy petition by the borrower. (Calpine/Biloxi/Chemtura).
- Provide that upon an event of default, the prepayment premium will be added to the principal amount. (Calpine/Biloxi/Chemtura).
- Clearly identify the prepayment premium and make it a reasonable approximation of the damages that might be incurred if the debt were prepaid prior to scheduled maturity — i.e., nonreceipt of anticipated interest payments. (Calpine/Biloxi/Chemtura).

The Intercreditor Agreement

- Include a waiver of junior lender's rights as unsecured creditors. Identify with specificity each right a junior lender is waiving — i.e., the right to object to bid procedures or the 363 sale itself, or to move to appoint an examiner, or to propose a plan (Boston Generating).
- Specify that any dispute or ruling by the court about what constitutes "collateral" or the failure to perfect the security interest in the collateral will not affect a) the lien and claim subordination provisions embodied in the agreement; b) the relative priorities of each of the parties in and to the collateral, the proceeds of the collateral or any payment (Ion Media).
- Provide that in the event that the seniors are paid with consideration other than cash, the juniors shall not seek an order of the court holding that such payment constitutes the equivalent of a 100 percent cash payment. (TCI 2 Holdings).
- In the event that the seniors are paid with noncash consideration without their consent — whether pursuant to a plan or otherwise — provide that the seniors are entitled to receive some amount of liquidated damages. (TCI 2 Holdings).

Bankruptcy of the Borrower

Acquiring Claims/Strategic Investments:

- Direct or indirect competitors of a debtor (possibly including funds with material investments in the debtor's industry) should study the DBSD opinion and subsequent developments carefully before acquiring claims to control the debtor's bankruptcy proceedings.
- If purchasing debt for strategic reasons, do so prior to the filing of a disclosure statement or plan. If purchasing the debt following the filing of a disclosure statement or plan, do not pay in excess of the projected recovery on the debt (DBSD).
- If seeking control of the debtor, consider bidding for the assets or approaching the debtor's board of directors regarding a purchase of the debtor's assets (DBSD).

Cash Collateral and DIP Financing Orders

- Consider conditioning consent to use cash collateral and/or the provision of post-petition financing on obtaining an order giving the lender the right to credit bid in the event of a sale of the collateral — whether that sale occurs pursuant to Section 363, in connection with a Chapter 11 plan, or otherwise (Philadelphia Newspapers).
- Consider bargaining for anti-cramdown provisions in a cash collateral order or debtor-in-possession financing order. (DBSD).

363 Sale

- In a sale of the debtor's assets, consider submitting a cash bid for the collateral, conditioned on the debtor paying the secured claim in cash in full (i.e., with the sale proceeds) no later than a date certain (Philadelphia Newspapers).

- If unsatisfied with the terms of a 363 sale, do not rely on a closing "in escrow." Consider a stay pending appeal and/or preserve rights in the sale order to challenge the distribution of the sale proceeds. (Westpoint Stevens).

--By Ancela R. Nastasi and Keith N. Sambur, Richards Kibbe & Orbe LLP

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The opinions expressed are those of the authors and do not necessarily reflect the views of the firm, its clients, or Portfolio Media, publisher of Law360. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] Section 1129(b) provides: "Notwithstanding Section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court ... shall confirm the plan." 11 U.S.C. § 1129(b). A contrary result was reached in In re Consul Restaurant Corp., 146 B.R. 979, 988 (Bankr. D. Minn. 1992).

[2] The authors note that parties appealed the court's confirmation order on other grounds. See Beal Bank, S.S.B et. al v. Ad Hoc Committee et al, No. #1-10-cv-03120, pending in the U.S. District Court for the District of New Jersey.

[3] In rendering its opinion, the Second Circuit did not consider the terms of the cramdown. See Dish Network Corp. v. DBSD North America Inc. (In re DBSD North America, Inc.), __ F.3d __, 2011 WL 350480, *20-21 (2d Cir. 2011). Accordingly, the bankruptcy court's ruling on cramdown may be construed as dicta as opposed to binding authority.

[4] Some would argue that the secured lender in DBSD fell on disfavor with the court as a direct result of its loan-to-own strategy (see supra, Part IV), and that this led to the unfavorable ruling. Others would argue, however, that given the Supreme Court's ruling in Till v. SCS Credit Corp., 541 U.S. 465 (2004), the DBSD result could have been even worse. In Till, the Supreme Court held in the context of a Chapter 13 case, the appropriate rate of interest a debtor must pay its secured lenders is the prevailing prime rate adjusted by a risk factor. In selecting the risk factor adjustment, the court noted the rate should be "high enough to compensate a creditor for its risk but not so high as to doom the bankruptcy plan." Many courts have interpreted this to mean — and have applied — a risk factor adjustment of as little as 1 to 3 percent. Although Till is a Chapter 13 case, courts have applied its reasoning in Chapter 11 cases. See, e.g., SPCP Group LLC v. Cypress Creek Assisted Living Residence Inc., 434 B.R. 650, 654-55 (M.D. Fla. 2010) (court approved cramdown of secured creditor with a note which paid 5.5 percent by concluding that an "efficient lending" market did not exist due to the freeze in credit markets and therefore used a formula approach, as in Till, adding 2 percent to the then prime rate of 3.5 percent).

[5] In this regard, the district court adopted the reasoning of the court in In re Solutia Inc., 379 B.R. 473 (Bankr. S.D.N.Y. 2007), which also disallowed claims for prepayment premiums because the debt instruments failed to provide that such amounts would be due following automatic acceleration of the debt upon the bankruptcy filing.

[6] Although the case involved unsecured indentures, the case remains instructive for secured lenders.

[7] In its analysis, the court did not rule on whether, even if the pre-payment premium is a proxy for future interest, the pre-payment premium could be allowed where the debtor is insolvent, but the secured creditor is oversecured under Bankruptcy Code section 506(b). Bankruptcy Code section 506(b) provides that if a creditor is oversecured there shall be allowed "interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement." The notion that prepayment premium is a proxy for future interest payments also departed from those cases finding that prepayment premium is recognized as encompassed in the term "charges." See, e.g., In re Imperial Coronado Partners Ltd., 96 B.R. 997, 1000 (9th Cir. B.A.P. 1989) ("prepayment premium is clearly a 'charge provided for under the agreement'" under which such claim arose); In re Out-door Sports Headquarters Inc., 161 B.R. 414, 424 (Bankr. S.D. Ohio 1993).