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Chapman Client Alert

October 4, 2017 Current Issues Relevant to Our Clients

Make-Whole Update (*In re: Ultra Petroleum Corp., et al*): Texas Bankruptcy Court Awards Unsecured Bondholders' 'Enormous' Make-Whole Claim, with Interest, Over Solvent Debtors' Objection

On September 21, 2017, the United Stated Bankruptcy Court for the Southern District of Texas (the "*Bankruptcy Court*") in *In re: Ultra Petroleum Corp., et al* ("*Debtors*") ruled that holders (the "*Noteholders*") of notes issued pursuant to a Note Purchase Agreement (the "*NPA*")[1] entered into by debtor Ultra Petroleum's operating subsidiary Ultra Resources, Inc. ("*OpCo*") were entitled under the NPA to (i) what the court termed an 'enormous' make-whole payment, (ii) post-petition interest on their make-whole at the NPA's default rate, and (iii) recovery of related fees and expenses (collectively, their "*Make-Whole Claim*").[2] In so holding, the Bankruptcy Court rejected the Debtors' assertion that the Make-Whole Claim should be disallowed as either (i) unmatured interest barred by 11 U.S.C. § 502(b)(2); or (ii) an unenforceable liquidated damages provision under New York law. The Bankruptcy Court also rejected the Debtors' contention that any post-petition interest on the Make-Whole Claim should be assessed, at most, at the Federal Judgment Rate, awarding interest at the NPA's default rate instead. Notably, in contrast to recent make-whole decisions in the 2nd and 3rd Circuits, the Bankruptcy Court's decision was limited to the enforceability of the NPA's make-whole provisions rather than whether such provisions were sufficiently explicit to give rise to the Make-Whole Claim. This is likely the result of the NPA's make-whole provisions being stronger than the provisions that were at issue in recent make-whole cases.

Background

OpCo issued multiple series of unsecured notes (the "*Notes*") totaling approximately $1.46 billion pursuant to the NPA and three supplements in 2009 and 2010. Pursuant to the NPA, OpCo was entitled to "prepay" the Notes at 100% of principal plus a make-whole payment calculated as an amount equal to the excess, if any, of the discounted present value of the remaining scheduled payments on the Notes over the amount of the principal being prepaid. The NPA expressly provided that "[u]pon any Notes becoming due and payable [due to acceleration following an Event of Default], whether automatically or by declaration, such Notes [would] forthwith mature and the entire unpaid 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) . . . [would] all be immediately due and payable." The NPA was governed by New York law.

The Debtors, including OpCo, filed chapter 11 bankruptcy petitions on April 29, 2017. As a result of rising commodity prices, by the time the Debtors proposed their plan of reorganization (the "*Plan*"), they were solvent and proposed to pay their unsecured creditors in full, but, in the case of the Noteholders, without their Make-Whole Claim. On March 14, 2017, the Bankruptcy Court confirmed the Debtors' Plan, which treated the Noteholders as unimpaired, without making any final determination on their Make-Whole Claim.

Debtors asserted that payment of the Make-Whole Claim was not required because such claim (i) represents unmatured interest barred by 11 U.S.C. § 502(b)(2); and/or (ii) arises from an unenforceable liquidated damages provision under governing New York law. The Debtors also asserted that any post-petition interest on the Make-Whole Claim should be assessed, at most, at the Federal Judgment Rate, which was materially lower than the NPA's default rate. Noteholders argued in response that: (i) for the Noteholders' claims to be unimpaired under the confirmed Plan, the Debtors were required to pay the full Make-Whole Claim due under New York law; (ii) § 502(b)(2) is inapplicable to the Make-Whole Claim; and (iii) the Make-Whole Claim is fully enforceable under New York law. The Noteholders also argued that post-petition interest should be allowed on the Make-Whole Claim at the NPA's default rate. In a break from recent make-whole cases, the Debtors raised no objection to payment of the Make-Whole Claim on the basis that the language of the NPA was ambiguous or insufficiently specific to give rise to the obligation.[3]

The Bankruptcy Court sided firmly with the Noteholders and awarded their Make-Whole Claim in full with post-petition interest to be paid at the NPA's default rate.

The Make-Whole Decision

The Bankruptcy Court first dispensed with the Debtors' characterization of the Make-Whole Claim as an improper liquidated damages provision under New York law. The Debtors argued that the NPA failed to provide a reasonable measure of probable actual loss to the Noteholders and that the make-whole formula in the NPA actually overcompensated the Noteholders because they would be able to reinvest their principal at higher rates than that reflected by the formula. The

Bankruptcy Court, citing *JMD Holding Corp. v. Cong. Fin. Corp.*, 4 N.Y.3d 373, 380 (N.Y. 2005), found that "[a] liquidated damages provision is enforceable under New York law if the amount liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation[, but is a penalty that is not enforceable if] the amount fixed is plainly or grossly disproportionate to the probable loss." The Bankruptcy Court held that the "Debtors fail[ed] to rebut the Noteholders' claim for the Make-Whole Amount because they fail[ed] to prove that the damages resulting from [the] prepayment were readily ascertainable at the time the parties entered into the [NPA] or that they were conspicuously disproportionate to foreseeable damage amounts." In particular, the Bankruptcy Court emphasized that (i) the payment of both a make-whole amount and default interest on such amount, as was required by the NPA's make-whole formula, was not legally problematic, and (ii) while the Make-Whole claim was "enormous . . .the mere size of [such amount] fails to prove that [it] is conspicuously disproportionate to the foreseeable losses at the time the parties entered into the [NPA]."

In response to the Debtors' argument that 11 U.S.C. § 502(b)(2) precludes the allowance of the Make-Whole Claim because it is merely a proxy for unmatured interest, the Bankruptcy Court held that the Debtors' Plan, which treated the Noteholders as unimpaired, rather than 502(b)(2), controlled and that unimpairment requires payment of all state law claims, including the Make-Whole Claim. The Bankruptcy Court reasoned that "[i]n a chapter 11 case, a discharge is granted under 11 U.S.C. § 1141(d) [and] [u]nder § 1141(d), the extent of the discharge is governed by the terms of the confirmed plan. . . [and because the] Plan provides that the Noteholders' claims are not impaired . . . [t]he Debtors' liability on the Make-Whole [Claim] is thus not discharged under § 1141(d) unless the Make-Whole [Claim] are actually paid in their state law amount." The Bankruptcy Court also held that the "Debtors' obligation to pay the Noteholders the Make-Whole [Claim] arose on the Debtors' petition date, the applicable date of the Debtors' default under the [NPA] and [c]onsequently, interest payments on the outstanding balance of the Notes [must be] calculated [from] the Debtors' petition date." This holding allowed the Bankruptcy Court to avoid a determination of whether or not make-whole claims in future cases should be treated as unmatured interest for purposes of 502(b)(2), but provides extensive protection for creditors of solvent debtors. Finally, the Bankruptcy Court rejected the Debtors' argument that, while unsecured creditors may undeniably receive post-petition interest on their claim if a debtor is solvent, interest on the Make-Whole Claim should be assessed, at most, at the Federal Judgment Rate provided for by 11 U.S.C. § 726(a)(5). Again relying on the Noteholders' unimpaired status under the Plan, the Bankruptcy Court held that "[t]he Debtors fail[ed] to rebut the Noteholders' claim for post-petition interest at the rate listed in the [NPA] because the Noteholders' claims are treated as unimpaired under the Debtors' chapter 11 plan [and that] [p]aying post-petition interest on the Make-Whole [Claim] at the federal judgment rate instead of the rate within the [NPA] would cause the Noteholders to be impaired." As the Bankruptcy Court explained, "Section 726(a)(5) is not applicable to the Noteholders' post-petition claims because its only application in a chapter 11 case-through the 'best interest of creditors' test in 11 U.S.C. § 1129(a)(7) — limits *impaired*, not unimpaired, claims."

Unless overturned on appeal, the Bankruptcy Court's decision provides comfort to noteholders of solvent Debtors that their make-whole claims will be paid in full, with interest at the default rate if the Debtor seeks to treat them as unimpaired under their plan of reorganization. For noteholders of insolvent debtors, the decision remains helpful for its refusal to deny the make-whole as an improper liquidated damages clause merely because of its 'enormous' size. This decision is also notable for what it does not address: the language of the NPA giving rise to the Make-Whole Claim. While recent decisions in *In re Energy Future Holdings Corp.* (3rd Circuit) and *In re MPM Silicones, LLC* (S.D.N.Y.)[4] have extolled the virtues of specific and unambiguous make-whole clauses that clearly provide for payment of such amounts following bankruptcy filings, in the instant case, no challenge was raised against the language of the NPA. The NPA may therefore serve as an exemplar of good make-whole drafting.

For More Information

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1 The full text of the NPA is available at ECF. No. 1215-1.

2 *In re: Ultra Petroleum Corp., et al*, No. 16-32209 (Bankr. S.D.T.X., Sept. 21, 2017) (ECF. No. 1569) (the "*Opinion*").

3 *See, generally,* Chapman and Cutler LLP Client Alerts: "Is Momentive Losing Momentum" (November 22, 2016), "Make-Whole Update: Delaware Bankruptcy Court Rules Intercreditor Agreement Does Not Permit First Lien Noteholders to Demand Payment of Previously Disallowed Make-Whole from Junior Noteholders" (June 27, 2016), "Delaware District Court Follows New York's Lead in Disallowing Make-Whole Premium in Bankruptcy – Dispute Moves to Third Circuit" (February 29, 2016), "Another One Bites the Dust – Energy Future Decision Likely Precludes Future Arguments to Lift the Automatic Stay in the Make-Whole Context" (July 23, 2015), "Make-Whole Provisions Continue to Cause Controversy: What You Can Do to Avoid Litigation" (July 18, 2014).

4 *See supra* at n.3 for prior Chapman and Cutler LLP client alerts on these cases.

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