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FIFTH CIRCUIT REVERSES COURSE ON ALLOWABILITY OF MAKE-WHOLE PROVISIONS IN BANKRUPTCY

On November 26, 2019, a panel of the United States Court of Appeals (the "Court") for the Fifth Circuit vacated its own prior decision in *In re Ultra Petroleum Corp.*, which stated that make-whole provisions included in a loan agreement are likely unenforceable in bankruptcy. The Fifth Circuit panel issued a new opinion, stating that there is no reason to believe that make-whole provisions are unenforceable where the debtor is solvent.

In its original decision, rendered in January 2019, the Fifth Circuit, in addressing an appeal of a bankruptcy court decision, reasoned that Section 502(b)(2) of the Bankruptcy Code disallows claims for unmatured interest in a bankruptcy case and that make-whole premiums appear to be claims for unmatured interest.[1] The Fifth Circuit noted that it was possible, though unlikely, a "solvent-debtor exception" existed under the former Bankruptcy Act that survived the enactment of the current Bankruptcy Code in 1978, which would permit the enforcement of make-whole provisions in cases where the debtor was solvent.[2] However, since the bankruptcy court did not expressly rule on the allowability of the make-whole premium, the Fifth Circuit, while stating it was doubtful that such exception continued to exist, remanded the case to the bankruptcy court for a final determination.

The Fifth Circuit's original decision was controversial for a variety of reasons. First, the decision was inconsistent with prior decisions of the Fifth Circuit, which held in other contexts that make-whole premiums are not claims for interest.[3] Second, a solid majority of the courts throughout the United States addressing the issue have held that make-whole premiums constitute claims for liquidated damages and are not claims for unmatured interest.[4]

[1] 913 F.3d 533 (5th Cir. January 17, 2019).

[2] 913 F.3d at 547 ("The creditors can recover the Make-Whole amount if (but only if) the solvent-debtor exception survives Congress's enactment of § 502(b)(2). We doubt it did.").

[3] *Achee Holdings. LLC v. Silver Hill Fin., LLC*, 342 Fed. App'x 943 (5th Cir. 2009) ("Texas courts hold that a prepayment penalty is not interest"); *C.C. Port, Ltd. v. Davis-Penn Mortg. Co.*, 61 F.3d 288, 289 (5th Cir. 1995) ("a prepayment premium is not compensation for the use, forbearance, or detention of money, rather, it is a charge for the option or privilege of prepayment.") (emphasis supplied; citations omitted); *Parker Plaza v. UNUM Pension & Ins. Co.*, 941 F.2d 349, 352 (5th Cir. 1991) ("a prepayment premium is a charge for the option or privilege of prepayment…and as such it is not 'interest'") (citations omitted).

[4] *In re Trico Marine Services, Inc.*, 450 B.R. 474, 480 (Bankr. D. Del. 2011) ("Research reveals that the substantial majority of courts considering this issue have concluded that make-whole or prepayment obligations are in the nature of liquidated damages rather than unmatured interest, whereas courts taking a contrary approach are distinctly in the minority.").

The claimants responded to the Fifth Circuit's original decision by filing a motion seeking to have the appeal reheard *en banc* by the entire Fifth Circuit.[5] On November 26, 2019, the panel of the Fifth Circuit that rendered the original decision reversed course by: (i) converting the motion for a rehearing *en banc* to a motion for rehearing before the original panel of judges that heard the appeal; (ii) withdrawing the Court's original opinion; and (iii) vacating that portion of the Court's original opinion relating to the make-whole premium.[6]

The Fifth Circuit panel then issued a new opinion, which acknowledged that the allowability of make-whole premiums had "'become [a] common dispute' in modern bankruptcies." In complete contrast to its original opinion, which doubted the continued viability of a "solvent-debtor exception," the Fifth Circuit panel stated in its amended opinion on rehearing: "Our review of the record reveals no reason why the solvent-debtor exception could not apply." The Court then noted: "As other circuits have recognized 'absent compelling equitable considerations, when a debtor is solvent, it is the role of the bankruptcy court to enforce the creditors' contractual rights.'" Since the bankruptcy court never decided the issue of the allowability of the make-whole premium, the Court remanded the case to the bankruptcy court for a final determination of the allowability issue.

The Court's amended opinion is important because the sweeping language contained in the Court's original opinion strongly suggested that all make-whole premiums are unenforceable. By contrast, the Court's revised opinion strongly suggests, but does not ultimately decide, that make-whole premiums are enforceable in the context of solvent debtors.

However, the Fifth Circuit's opinion may not be a complete victory for secured lenders whose loan documents contain make-whole provisions. For example, the Fifth Circuit's continued reliance upon a "solvent-debtor exception" suggests that a make-whole premium may not be allowed in those cases in which the secured lender is oversecured (*i.e.*, the value of its collateral exceeds the amount of its claim), but the debtor is insolvent.

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[5] *En banc* means that all judges of the Court of Appeals for the Fifth Circuit would hear and determine the case on rehearing, as opposed to a three-judge panel that would typically hear an appeal.

[6] *In re Ultra Petroleum, Inc.*, 943 F.3d. 758 (5th Cir. November 26, 2019).