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Utilizing and Interpreting Make Whole Provisions, including Practical Lessons for Deal Structure[1]

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I.
INTRODUCTION

Continuously tested and litigated in bankruptcy courts, "make-whole provisions," also known as "yield maintenance premiums" or "prepayment premiums," have largely survived challenges by various debtors. Of particular importance to case constituents and bankruptcy courts has been determining the applicability of these provisions vis-à-vis applicable state laws. In addition, bankruptcy courts have grappled with the applicability of make-whole provisions as they relate to the manner in which the debt is pre-paid, and if allowed, how the premiums are accounted for under the Bankruptcy Code. To wit, courts are often tasked with determining whether a creditor is entitled to a contractual make-whole premium if it accelerates the underlying note due to a default, or if the creditor's decision to accelerate the debt waives the opportunity to charge the premium insofar as acceleration deprives a debtor of the ability to redeem before maturity. Additionally, bankruptcy courts continue to grapple with the issue of whether make-whole provisions are allowable under Section 502(b)(2)[2] as unmatured interest or as a form of liquidated damages.

Subject to statutory rights that may exist under applicable state law, parties have thus far been free to contract for the allowance of make-whole premiums, generally coupled with wide discretion to also create a calculus for quantifying these premiums. Bankruptcy Courts have also generally been reticent to undermine or disrupt applicable state law by applying a federal law analysis. As of late, however, the Fifth Circuit has taken a different approach with the ruling in *Ultra Petroleum*[3] which in a general sense requires an additional layer of federal law analysis with respect to the question of whether federal bankruptcy law, and particularly Section 502(b)(2), disallows make-whole premiums, which is in stark contrast to the majority opinion that it does not.

This paper identifies and discusses several cases from various jurisdictions, how these jurisdictions have developed their respective case law with regard to make-whole provisions, and what to expect moving forward from the *Ultra Petroleum* ruling.

II.
THE USE OF MAKE-WHOLE PROVISIONS

A. Historic Allure to Lenders

Lenders have come to find make-whole provisions attractive as a means to protect their bargained-for revenue stream. More specifically, prepayment of a note can trigger a make-whole provision which is "designed to provide compensation for the deprivation of a noteholder's 'rights to maintain its investment in the note free from repayment'."[4] In other words, if a borrower pays off the note prior to its stated maturity date, a fee, or premium, becomes payable

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[2] Unless otherwise noted, "Section" or "§" references herein are to the United States Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.*

[3] *Ultra Petroleum Corp. v. Ad Hoc Comm. of Unsecured Creditors of Ultra Res., Inc.* (*In re Ultra Petroleum Corp.*), 913 F.3d 533 (5th Cir. 2019).

[4] *Id.* at 538.

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