

# Client Alert

Financial Restructuring Practice Group

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## New Decision on Enforceability of Make Whole Provisions

Another bankruptcy court—this time in New York—has weighed in on the issue of whether “make whole” provisions are enforceable in bankruptcy. *See In re MPM Silicones, LLC, et al. (a/k/a Momentive Performance Materials).*

**What is a “make whole” provision?** It is a provision in a loan agreement or indenture that requires a borrower to pay the lender a premium for any payment made by the borrower prior to its due date. The premium is intended to compensate the lender for the interest that it would have otherwise earned on the outstanding obligation had it not been prepaid.

**What is the problem in bankruptcy?** The filing of bankruptcy by a borrower automatically accelerates all obligations owed to the lender making the obligations due and owing. That is what happened to Momentive. Bankruptcy was filed, the obligations were automatically accelerated and then Momentive sought to pay the noteholders under a plan but did not provide for payment of the make whole premium. Momentive argued that because the payment would be received *after* maturity, it was not a prepayment prior to maturity and therefore the make whole provision did not apply. The Bankruptcy Court agreed, finding that the contractual language providing for the make whole payment did not specifically provide for a payment after acceleration.

**What can be done to protect “make whole” provisions?** Enforcement is a matter of state contract law. Careful drafting with the following points in mind is critical:

- Avoid any ambiguity about what triggers the payment.
- Clearly state that the make whole premium is payable regardless of acceleration or other enforcement actions taken by the lender.
- Limit the amount of the make whole premium so that it is proportionate to the lender’s expected loss due to early repayment. Avoid any appearance of imposing an impermissible penalty on the borrower.
- If the obligations are secured, be clear in the collateral documents that the make whole obligations are secured as well.

For more information, contact:

**Sarah R. Borders**  
+1 404 572 3596  
sborders@kslaw.com

**Jeffrey R. Dutson**  
+1 404 572 2803  
jdutson@kslaw.com

**King & Spalding**  
*Atlanta*  
1180 Peachtree Street, NE  
Atlanta, Georgia 30309-3521  
Tel: +1 404 572 4600  
Fax: +1 404 572 5100

[www.kslaw.com](http://www.kslaw.com)

**Is this decision part of a trend?** Yes. Similar recent cases include *In re Denver Merchandise Mart, Inc.* (5th Cir.) (denying make whole claim), *In re AMR Corporation* (2d Cir.) (denying make whole claim), and *In re School Specialty, Inc.* (Delaware Bankruptcy Court) (allowing make whole claim because, among other things, the language in contract was clear).

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