

## Make Sure the Make-Whole Provision Is Favorably Drafted: Bankruptcy Court in American Airlines Rejects Make-Whole Premium Based on Indenture Language

On January 17, 2013, the United States Bankruptcy Court for the Southern District of New York decided that American Airlines (American) was not obligated to pay certain make-whole premiums set forth in some of its loan indentures at the time that American refinanced the applicable loans. A make-whole premium typically allows a lender to be compensated for having to reinvest in a lower interest-rate environment when a borrower prepays its debt before the original maturity date. The Bankruptcy Court concluded that the plain meaning of the relevant indenture terms was that no make-whole premium would be due upon repayment by American of the loans after the automatic acceleration that occurred as a result of American's bankruptcy filing. While this specific make-whole premium was not allowed, this case stands for the proposition that a make-whole premium will be allowed if properly drafted and provided for.

### Background

Prior to its bankruptcy filing, American entered into three secured aircraft loan facilities (among others), including two Enhanced Equipment Trust Certificate (EETC) facilities (collectively, the Loans). As the Loans were secured by aircraft entitled to certain protections under section 1110 of the Bankruptcy Code (Section 1110), American had been making its debt service payments to U.S. Bank (as trustee on behalf of the lenders on the Loans) during the bankruptcy in order to keep using the aircraft. American sought the Bankruptcy Court's approval to enter into a new \$1.5 billion EETC facility (at an interest rate lower than that on the existing Loans) and repay the Loans without a make-whole premium.

### The Decision

The Bankruptcy Court held that no make-whole premium was payable, based on the plain meaning of the relevant indenture terms. American's bankruptcy filing constituted an event of default under each of the indentures. The indentures unambiguously provided that a bankruptcy filing would automatically accelerate the Loans without any further action by the lenders. In such a scenario, the indentures specifically provided that the Loans were payable in full but without the make-whole premium that was payable under the terms of the indentures in other cases of repayment of the Loans: "if an Event of Default [caused by American's bankruptcy filing] shall have occurred and be continuing, then and in every such case the unpaid principal amount of the [Loans] then outstanding, together with accrued but unpaid interest thereon and all other amounts due thereunder (**but for the avoidance of doubt without Make-Whole Amount**), shall immediately and without further act become due and payable..." (emphasis added). In view of this specific contractual provision, the Bankruptcy Court held that no make-whole premium was payable.

The Bankruptcy Court rejected several arguments made by U.S. Bank in an effort for the make-whole premium to apply to American's repayment of the Loans. U.S. Bank's arguments included that (i) the automatic acceleration clause was not enforceable under New York law (which governed the indentures) because the lenders did not choose to invoke the clause; (ii) the automatic acceleration clause constituted an *ipso facto* clause invalid pursuant to the Bankruptcy Code; (iii) American's repayment of the Loans would be a voluntary prepayment, as to which the indentures provided that the make-whole premium was payable, even though the Loans had been automatically accelerated; and (iv) U.S. Bank could decelerate the Loans, either by contractual right or the lifting of the automatic stay in American's bankruptcy. The Bankruptcy Court also explained that American's Section 1110 election did not obligate it to make the make-whole premium. The Section 1110 election only required that American perform its scheduled obligations (i.e., normal debt service) under the indentures (but not cure a default based solely on its

bankruptcy filing). American's Section 1110 election only entitled U.S. Bank to payments due under the indentures.

### Conclusion

As the Bankruptcy Court concluded, "[e]ach contract is different, of course, and parties are free to draft their contracts as they wish." Lenders seeking to ensure enforcement of a make-whole premium if a borrower files for bankruptcy should craft unambiguous contractual language providing for payment of the make-whole premium under the circumstances.

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