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INSOLVENCY AND AUTOMATIC ACCELERATION IN US CHAPTER 11: TO ACCELERATE, OR NOT TO ACCELERATE, THAT IS THE QUESTION

In an article first published in the February 2025 issue of *Butterworths Journal of International Banking and Financial Law*, the authors focus on the two approaches to acceleration following a bankruptcy filing. On the one hand, a typical US-style debt document provides for automatic acceleration on an insolvency event of default. On the other hand, many other jurisdictions typically do not include such automatic acceleration provisions in financing documents. This article discusses the primary differences between the Chapter 11 treatment of a loan that automatically accelerates the debt following an insolvency and a loan in which such acceleration is at the discretion of the lender.

In the US, a standard debt document will include a provision that terminates commitments and automatically accelerates the debt without notice or demand upon a set of broadly defined insolvency-related defaults, defaults which include a US Chapter 11 proceeding and similar proceedings under laws of other jurisdictions. In contrast, in Europe, it is much more typical for a bankruptcy default to be treated as any other default; that is, acceleration will not be automatic but will instead be at the option of the lender and it will require the delivery of notice. This article reviews the practical import of the difference between the two approaches in the context of a US Chapter 11 proceeding.

AUTOMATIC VS. NON-AUTOMATIC ACCELERATION FOLLOWING BANKRUPTCY

The US Approach: Automatic Acceleration Upon Bankruptcy Filing

In the US, the Bankruptcy Code provides that an automatic stay comes into effect immediately upon the commencement of a bankruptcy proceeding. The automatic stay acts as an injunction prohibiting, among other things, any act against the

Key Points

- Standard US financing documents provide for automatic acceleration upon an "insolvency event," a term that is often broadly defined.
- In contrast, in other jurisdictions including the UK, it is rare for a facility agreement to specify automatic acceleration if an event of default occurs, even in the face of an insolvency event.
- A primary driver behind these differing practices is the scope of the stay or moratorium that arises upon commencement of a proceeding; that is, in the US, the automatic stay prevents sending a default notice, or taking any other action to cause the acceleration of the debt.
- Where a financing document does not contain an automatic acceleration provision, the lender can still seek the full amount of the claim in the US bankruptcy as if the debt were accelerated, but it may lose its right to obtain default interest and certain fees that might otherwise be allowed had the debt been automatically accelerated.

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debtor or its property wherever located (subject to certain enumerated exceptions). The automatic stay allows the debtor a "breathing spell" from collection activities and litigation, protecting the assets of the debtor from piecemeal actions that might dismember valuable assets, thus negatively impacting creditor recoveries. A related tool in the Bankruptcy Code is the prohibition on *ipso facto* provisions. *Ipso facto* provisions are contractual provisions that terminate or modify the debtor's rights under the contract based on the debtor's financial condition or commencement of a bankruptcy case. While most *ipso facto* clauses are rendered void after a bankruptcy filing, there are exceptions.

Acceleration is not expressly addressed in the Bankruptcy Code and the modest bankruptcy case law related to acceleration issues is surprisingly inconsistent. Nevertheless, it appears to be generally accepted that automatic acceleration clauses in debt documents triggered by a bankruptcy filing do not violate the automatic stay nor the prohibition on *ipso facto* provisions. This conclusion has driven standard credit document drafting practice in the US: there is almost always, if not always, an automatic termination of commitments and acceleration of obligations upon an insolvency event of default. Because providing notice of the acceleration would violate the automatic stay, such debt documents also obviate the requirement to provide notice of an insolvency default and acceleration. This approach typically extends to any notice required to be provided under a corresponding guarantee by cross referencing to obligations due under the primary debt instrument (whether by acceleration or otherwise). Automatic acceleration and related clauses are thus intentionally drafted to allow a lender to make a claim for the full amount of the obligations against a guarantor provided the guarantee includes appropriate language.

With that background, it should come as no surprise that it is common in the US for both the primary obligor and the guarantor to commence proceedings together so that each may obtain the protections of the automatic stay. Absent collective bankruptcy filings, a non-filing guarantor entity could be subject to enforcement actions seeking the immediate payment of the full amount of the guaranteed obligations (plus accrued and accruing interest, fees, etc.).

The Non-US Approach: Acceleration is Discretionary

Outside the US, automatic acceleration can often be at best unnecessary, and sometimes actively unhelpful.

While some form of moratorium may come into effect upon commencement of a proceeding in the UK and many European jurisdictions, there is no straightforward equivalent of a US-style automatic stay. Lenders are thus still generally free to exercise their bankruptcy triggered acceleration rights (upon providing notice) at any date following the bankruptcy commencement. Where lenders have that same acceleration right on day 1 and on day 50, there is no reason to adopt automatic acceleration in credit documents.

Moreover, automatic acceleration can also create difficulties in certain EU and other jurisdictions that do not arise in the US. Specifically, in certain jurisdictions (and particularly in civil law jurisdictions), acceleration could lead to a company's technical "insolvency" – usually defined as liabilities in excess of assets or inability

to pay debt as it becomes due. In turn, such an insolvency finding may require the directors of the company to commence a formal bankruptcy proceeding or face civil and/or criminal liability. This is important because, in contrast with the US where Chapter 11 is by far the most common bankruptcy process, a European debtor will often be able to access multiple insolvency or pre-insolvency processes, and "forum shopping" – where a debtor company will seek to restructure in a favorable jurisdiction, even if it lacks any prior connection to it – is relatively common. Thus, a borrower who seeks to restructure its debt through a "light-touch" restructuring process not available in the US (such as a UK scheme) could, if faced with a broadly worded automatic acceleration provision, trigger a technical insolvency. The ultimate result: an unwanted insolvency proceeding (or proceedings) perhaps overseen by a receiver and/or engaging director liability. These are not typically favored options. In contrast, in the US, there is generally no legal duty imposed upon directors to commence a proceeding when faced with a technical insolvency. Rather, applicable law (such as Delaware or New York state law) generally leaves such a determination to the directors who are obligated to act in the best interests of the company and its constituencies.

TREATMENT OF ACCELERATED AND NON-ACCELERATED LOANS IN CHAPTER 11

While one acceleration approach may be favored over another acceleration approach for one reason or another, the question we seek to address in this article is whether there is a meaningfully different outcome between the two approaches should the borrower file for Chapter 11 in a US bankruptcy court. The following compares the two approaches with respect to four different issues.

Treatment of a Claim for the Principal Amount of Debt

A loan that is accelerated requires the borrower to pay 100% of the loan principal. This 100% claim is the amount that would be asserted due in a Chapter 11 bankruptcy case by a lender who holds an automatically accelerated claim triggered by a bankruptcy filing. In contrast, if a lender was faced with a default outside of bankruptcy that did not trigger an acceleration provision and that loan was payable in installments, the lender would likely be forced to seek recovery on missed installment payments piecemeal, bringing lawsuit after lawsuit after each payment is missed. However, that is not how most bankruptcy courts treat non-accelerated claims in a bankruptcy case.

A "claim" in bankruptcy is broadly defined in Section 101 of the Bankruptcy Code as including any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." And Section 502 of the Bankruptcy Code provides that such a claim may be allowed regardless of whether such claim is contingent or unmatured. Taken together, these two provisions support the proposition accepted by most courts that the filing of a bankruptcy petition serves to accelerate the principal amount of any unpaid obligations owed by the debtor as of the petition date for claim purposes, even if that amount is not due and owing and in the absence of any automatic acceleration provision in the underlying documents. *See In re Manville Forest Products Corp.,* 48 B.R. 293 (Bankr. S.D.N.Y. 1984), *aff'd. in part, rev'd. in part on*

other grounds, 60 B.R. 403 (S.D.N.Y. 1996). This has become known as "legal acceleration."

In summary, it is generally accepted that creditors holding claims that are contractually accelerated upon a bankruptcy filing or legally accelerated by operation of the provisions of the Bankruptcy Code are both entitled to assert a claim for 100% of the outstanding principal (plus, of course, any accrued and outstanding amounts owing as of the filing date).

Entitlement to Post-Petition Interest and Other Fees

While the treatment of principal is clear, the case law surrounding creditor entitlement to post-bankruptcy interest and other fees in Chapter 11 is less clear. Nevertheless, there are two basic rules which lenders should be aware of with respect to their entitlement to post-petition interest and fees: (a) the underlying debt documents and applicable non-bankruptcy law must provide for interest and/or fees in the circumstances at issue (of note, not all debt documents clearly require the payment of prepayment fees after automatic acceleration); and (b) subject to certain limited exceptions, claims for post-petition interest are generally disallowed as "unmatured interest" pursuant to Section 502(b)(2) of the Bankruptcy Code.

With respect to post-petition interest, there are exceptions to disallowance in two circumstances of note. First, where the creditor asserting the claim is "oversecured" (*i.e.*, secured by collateral with value that exceeds the debt), the creditor is entitled to post-petition interest but only to the extent the value of the security exceeds the debt. *See* Bankruptcy Code Section 506(b). Second, where the debtor is solvent -- its debts are greater than its assets at fair valuation (this determination is frequently litigated) – the creditor is generally entitled to post-petition interest. This last situation is commonly referred to as the "solvent debtor" exception.

In situations where interest is allowed, the lender frequently can obtain interest at the higher default rate (which must be reasonable) only for amounts that are currently due and payable under the terms of the documents. Thus, where the underlying obligations are contractually accelerated, default interest should be sought on the full amount of the obligations that are due and owing as a result of the acceleration (that is, 100% of the amount due and owing). Where the principal has been accelerated by operation of law (*i.e.*, legal acceleration) in a Chapter 11 proceeding, the ability to obtain default-rate interest is less clear as the legal acceleration concept is limited (for the most part) to claim allowance.

A related issue is entitlement to assert make-whole fees. There has been substantial litigation regarding whether financial creditors are entitled to make-whole fees arising upon early repayment/prepayment of debt. Parties disputing entitlement to such amounts have taken the position that they are akin to "unmatured" interest and should be disallowed on that basis unless subject to an applicable exception to this general rule (*e.g.*, the creditor is oversecured or the debtor is solvent). *See, e.g., In re Hertz Corp.*, 120 F.4th 1181 (3d Cir. 2024). Where debt has been automatically (contractually) accelerated, parties have also disputed entitlement to such fees on the basis that repayment following acceleration is neither "voluntary" nor a "***pre***payment" owing to acceleration of the

maturity. While a detailed discussion is beyond the scope of this article, we note that such disputes typically arise where the documents have not expressly provided for payment of a make-whole *notwithstanding* automatic acceleration. *See, e.g., In re Energy Future Holdings Corp.*), 842 F.3d 247 (3d Cir. 2016).

In summary, whether a claim is accelerated contractually or as a matter of law, the claimant's entitlement to interest and fees is unlikely if the claim is unsecured and/or the debtor is insolvent. Where the claimant is oversecured and/or the debtor is solvent, however, the chances of obtaining interest and fees is more likely, so long as the contract clearly so permits. Finally, while the caselaw is not consistent, post-bankruptcy interest (including default interest) and fees are most likely to be obtained where the debt has been contractually (not legally) accelerated and the interest and fees are reasonable.

Claims Against Guarantors

A typical US guarantee will provide for a guarantee of payment when due (whether at stated maturity, by acceleration or otherwise) and the guaranteed obligations will include payment of principal and interest (including interest and fees that accrue after commencement of a bankruptcy case regardless of whether such interest and fees are allowed claims in such proceeding). Such guarantees typically do not require the satisfaction of any condition precedent, merely that the obligation is unpaid. Thus, when an obligation is accelerated by a bankruptcy filing of a primary obligor, the corresponding guarantee may be asserted for the full amount of the obligations.

If the guarantor has not filed for protection under the US Bankruptcy Code, the guarantee can be enforced immediately against the guarantor for *all* amounts then due including accelerated principal and prepetition interest. Where the guarantor has not filed for Chapter 11, interest and fees that accrue after commencement of a bankruptcy case – regardless of whether such interest and fees are allowed claims against the primary obligor in that obligator's Chapter 11 case – will also be owed by the guarantor.

Where a guarantor of an accelerated debt also files for bankruptcy, a common occurrence in the US, the guarantor is typically automatically (that is, without notice) fully liable under the guarantee to the same extent as the primary obligor (*i.e.*, all 100% of principal and interest). In such a circumstance, it is generally accepted that creditors are able to assert the full amount of their claims against the primary obligor and the guarantor or guarantors so long as they do not recover more than 100% of the amount owed. (This can have a material impact on recoveries where assets are held in different corporate "buckets" and a guarantee has been provided by each debtor entity.)

To the extent that the obligations under a guarantee agreement are not automatically due and payable upon a bankruptcy default of the primary obligor and are instead subject to further conditions such as delivery of a demand notice to the guarantor, the automatic stay may prevent satisfaction of these conditions. Of course, recognizing that the definition of a claim under the Bankruptcy Code is broadly defined and claims may be allowed even where contingent or unmatured, such an "unmatured" guarantee claim will likely benefit from the same "legal acceleration" analysis as set forth above (*i.e.*, that bankruptcy will operate as an

acceleration of contingent and unmatured claims). However, creditors should be aware that where the ability to assert a claim under a guarantee is conditional, opposition may be raised on the basis that the guarantee is not due and payable, and the ultimate outcome will depend on the specific circumstances including the terms of the guarantee. Of note, many non-US-style guarantees generally require the provision of notice, which would be subject to the automatic stay to the extent the guarantor is also a debtor.

In summary, while guarantees are valuable, lenders should expect that any affiliate of a Chapter 11 debtor that is also obligated on a loan (for example, as a guarantor) will also file for Chapter 11, assuming it can legally do so (certain entities may not be able to file for bankruptcy for one reason or another). In a situation where a guarantor files for bankruptcy but the lender does not benefit from an automatic (contractual) acceleration clause, the lender should still benefit from the legal acceleration construct noted above; that is, the guarantee should be construed as "accelerated" for purposes of asserting a claim in the Chapter 11 case for otherwise contingent amounts.

Ability to Reinstate a Loan

Bankruptcy Code Section 1124(c) permits a debtor to effectively "reinstate" existing loans or contracts following a default. The debtor accomplishes this through a Chapter 11 plan that (i) "cures" payment or performance defaults, other than defaults related to a debtor's financial condition (i.e., *ipso facto* defaults), (ii) compensates the counterparty for damages caused by reliance upon the right to accelerate, and (iii) affirms the instrument according to its original terms. In many cases, the ability to effectively "deaccelerate" the debt has clear benefits to a debtor to the extent that the debtor has pre-bankruptcy debt instruments with long maturities and interest rates lower than the market rate at the time of emergence.

Of note, courts have reached varying conclusions as to what is required in order to "cure" breaches that triggered the payment of interest at the default rate. While a recent decision in the Southern District of New York's *Golden Seahorse* bankruptcy case provided a painstakingly detailed analysis of relevant issues and survey of the caselaw, there can be no doubt that courts will continue to reach differing conclusions, and that each factual situation must be analyzed separately. *See In re Golden Seahorse*, 652 B.R. 593 (Bankr. S.D.N.Y. 2023). Nevertheless, what appears to be clear is that what constitutes a proper "cure" is not tied to whether the underlying obligation was contractually or legally accelerated.

KEY TAKEAWAYS

- Failure to include an automatic acceleration provision will not likely preclude the filing and/or allowance of a claim in a US Chapter 11 bankruptcy case for the entire principal amount of the debt due to the "legal acceleration" construct that is accepted by most courts.
- If a claim is not automatically accelerated, amounts due other than the principal – such as interest and fees, assuming otherwise contractually applicable and assuming the claim is oversecured or the debtor is solvent – are more likely to be denied although the case law is not well developed.

- Guarantors that are affiliates of a Chapter 11 debtor often also file for Chapter 11, if legally permitted. As such, enforcement rights against such a guarantor are likely to also be stayed.
- Whether an obligation is contractually or legally accelerated, a lender will typically be able to assert the full amount of their claim against both the primary obligor and each guarantor in a Chapter 11 so long as it does not recover more than 100% of its claim.
- Whether a debt has been accelerated or not, a Chapter 11 debtor has the option to cure and reinstate the original debt terms. While it appears likely that default rate interest must be paid as part of that cure, court analysis has been limited and confusing and thus the outcome is not certain.

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