

2018 Year in Review: U.S. Bankruptcy Claim Trading

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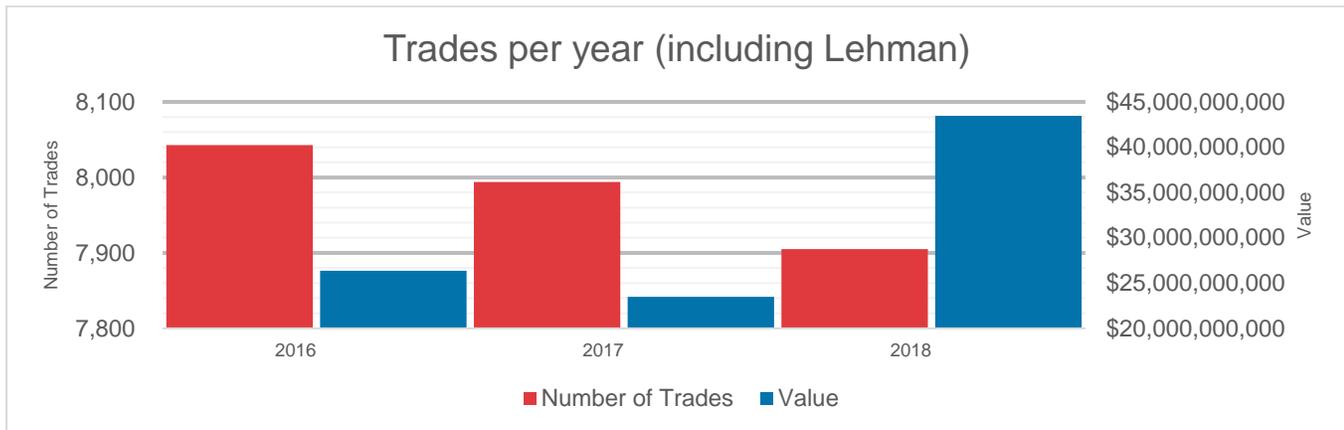
Introduction

With 2019 in full swing, we reflect on the world of bankruptcy claim trading in 2018.

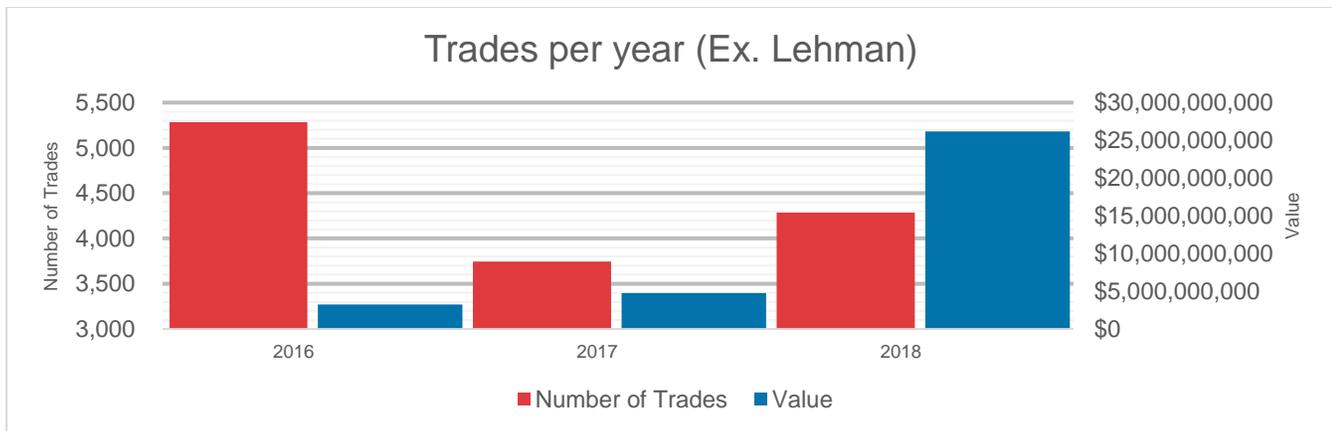
In this report we review bankruptcy claims trading data compiled by TrollerBk to better understand the recent trends in the claims trading market. Next we review some of the key legal issues that emerged in 2018 together with specific take-aways for bankruptcy claim traders and their advisors to consider in connection with their claims trading activity.

Although trading activity continues to lag behind the historically high volumes seen during the height of the financial crisis, the statistical data on the following pages shows that the bankruptcy claims trading market continues to be active. Moreover, as seen in our discussion on key legal issues, the courts seem to be dealing with issues involving bankruptcy claim trading at a higher rate than ever before.

Statistics¹



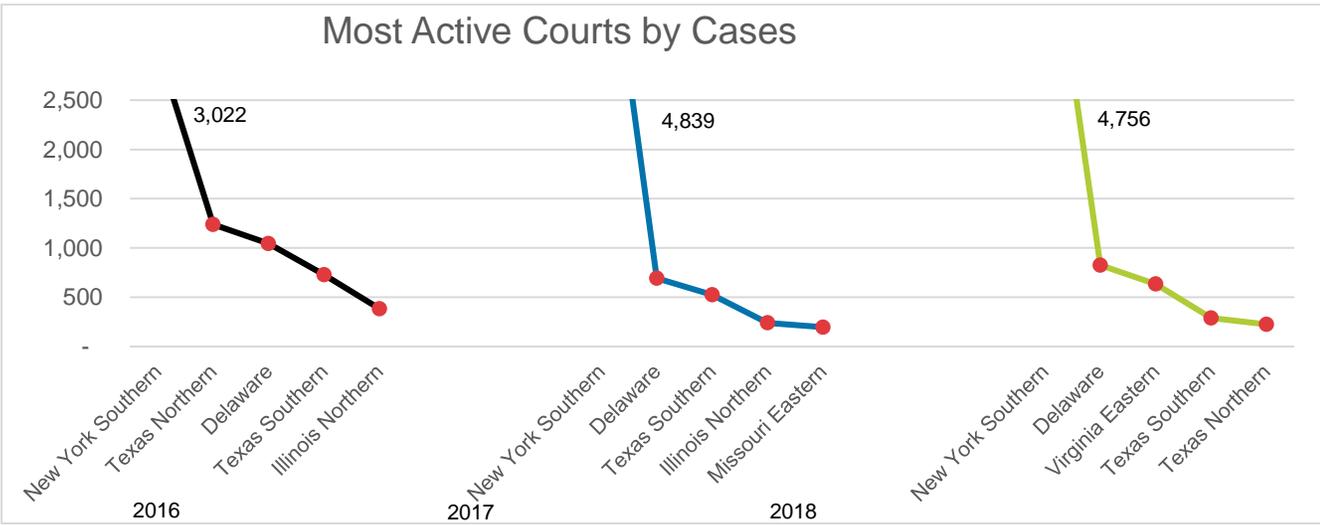
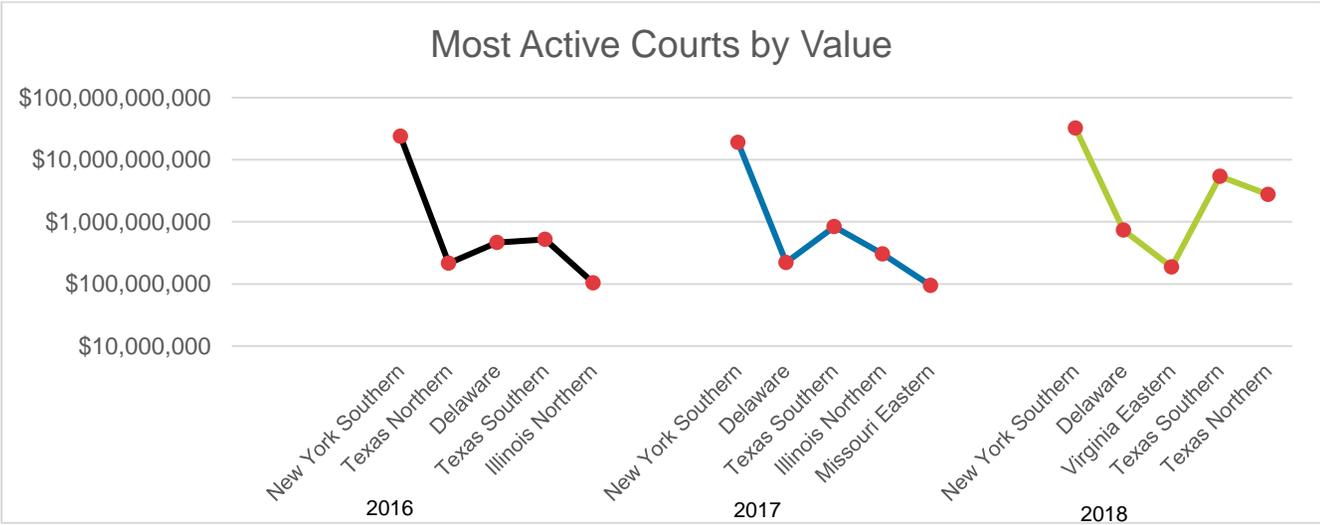
Trading volume seems to be trending lower based on number of trades, which is likely due to a reduction in the number of Lehman claim trading (per the below chart). Still, the aggregate value of trades jumped significantly in 2018 and could be trending higher going into 2019.



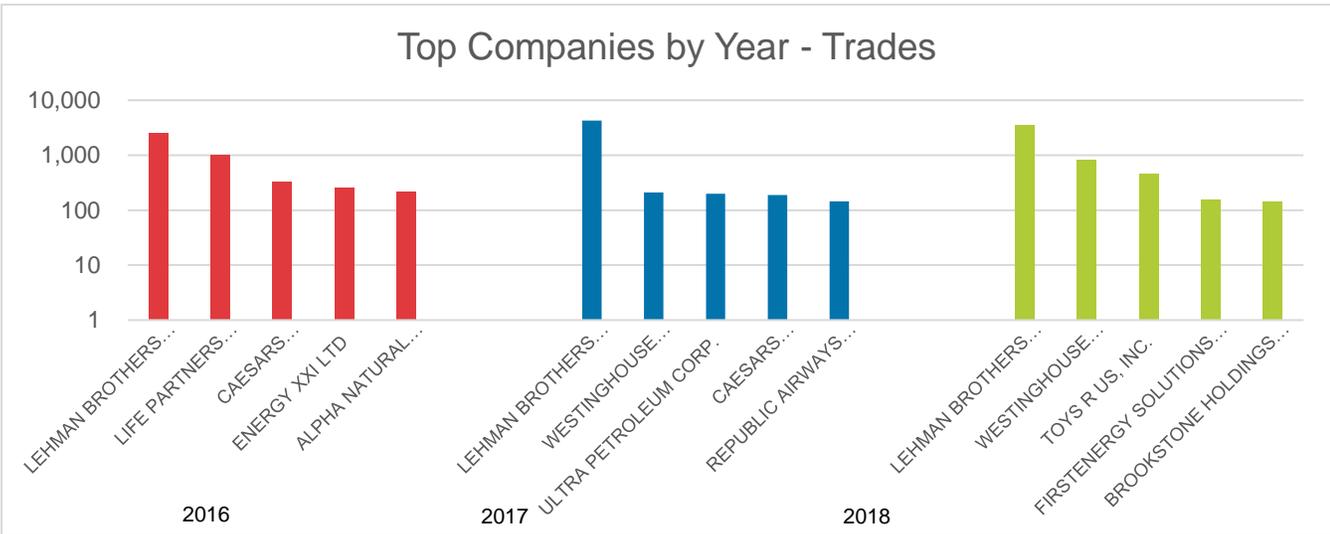
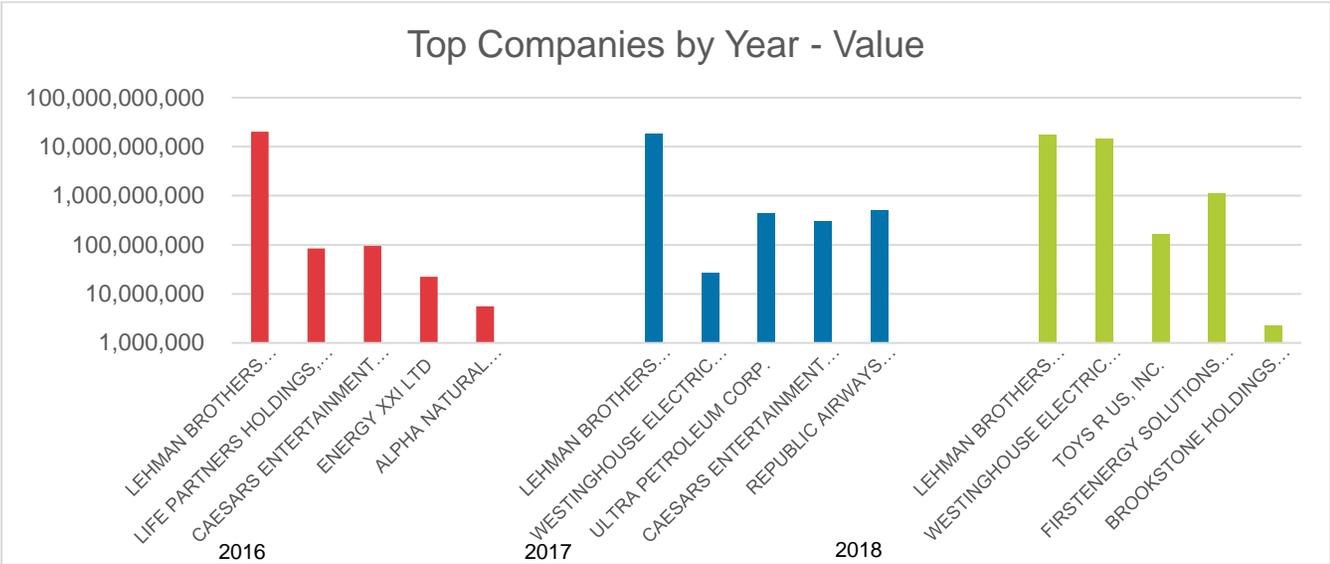
*Ex Lehman excludes trades from Lehman Brothers Holdings, Inc., Lehman Brothers, Inc. and Lehman Brothers Special Financing, Inc.

When removing Lehman claim trades from the equation, there was a clear increase of bankruptcy claims trading in 2018 from both a volume and value perspective despite the fact that most statistics show a decrease in overall chapter 11 filings in 2018. We can see from here that the claims market is strong across many different bankruptcies and will likely continue to grow even as the various Lehman proceedings wind down.

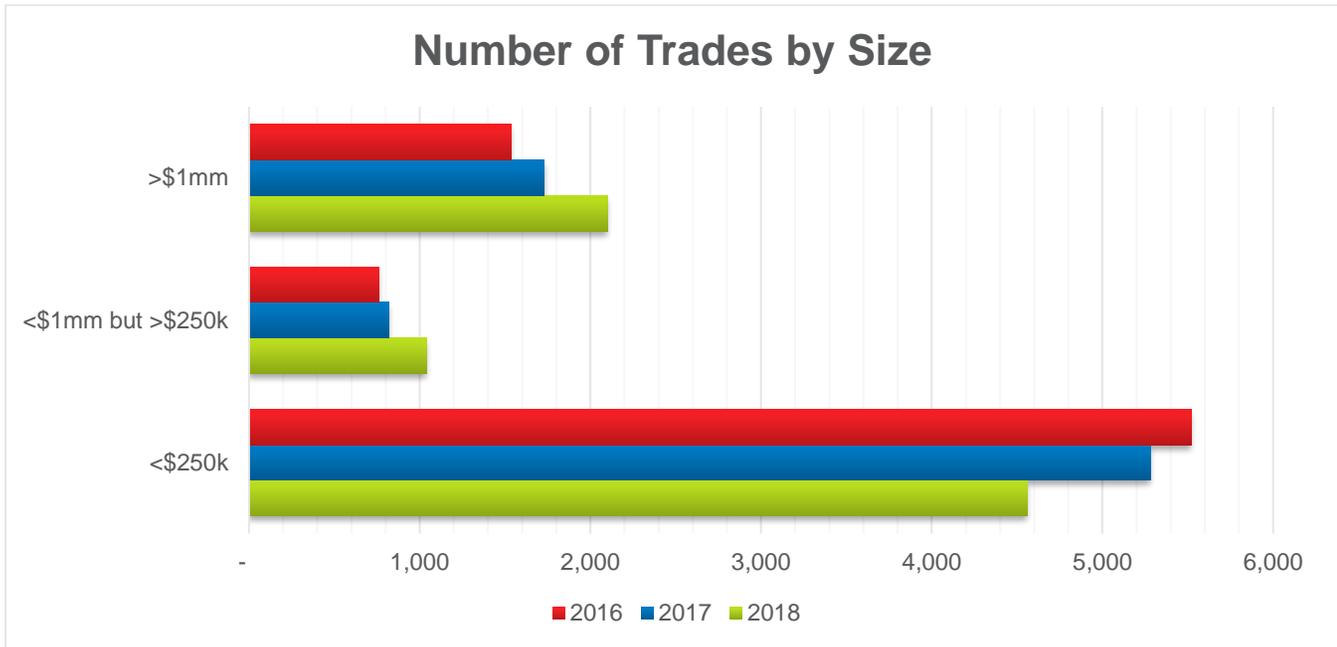
¹The amounts in the following charts are all approximate. In particular, the bankruptcy claim trades in the Lehman proceedings that are denominated in foreign currencies have been excluded from these figures. In addition, the value of a small percentage of trades included in these charts is expressed in units. This is typically the case where underlying claims are unliquidated so the amounts are not known.



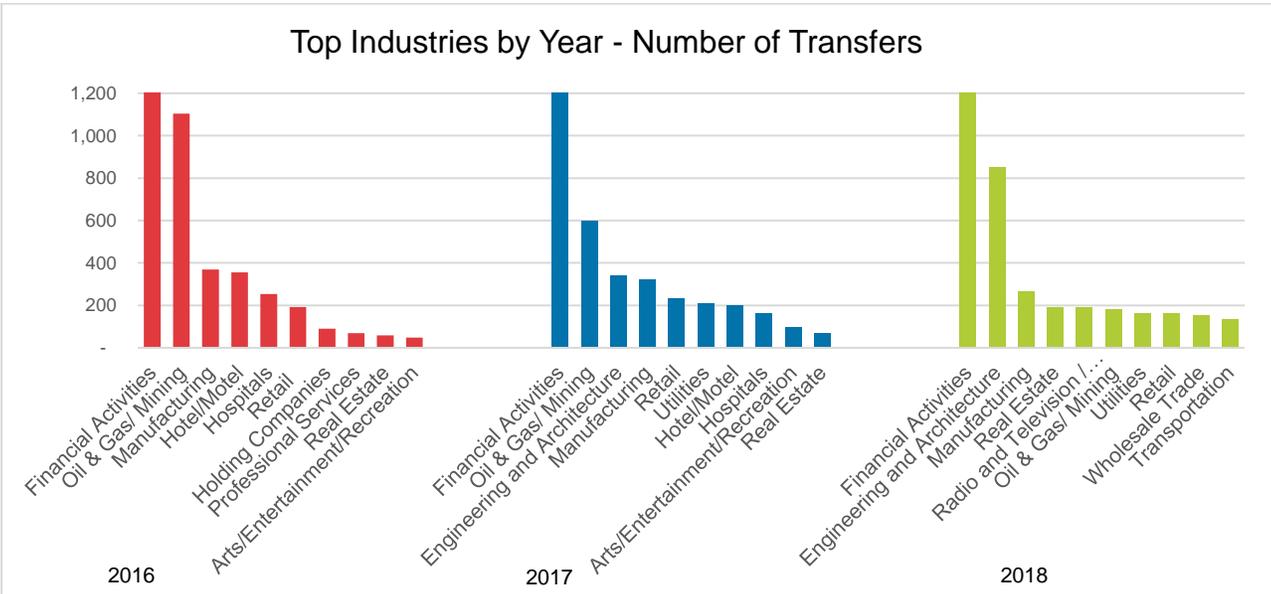
New York Southern District is clearly the most active court for claims traders from both a value and volume perspective whereas activity in the Texas courts seem to be trending downwards, presumably due to the decrease in active Oil & Gas/Mining cases over the last few years.



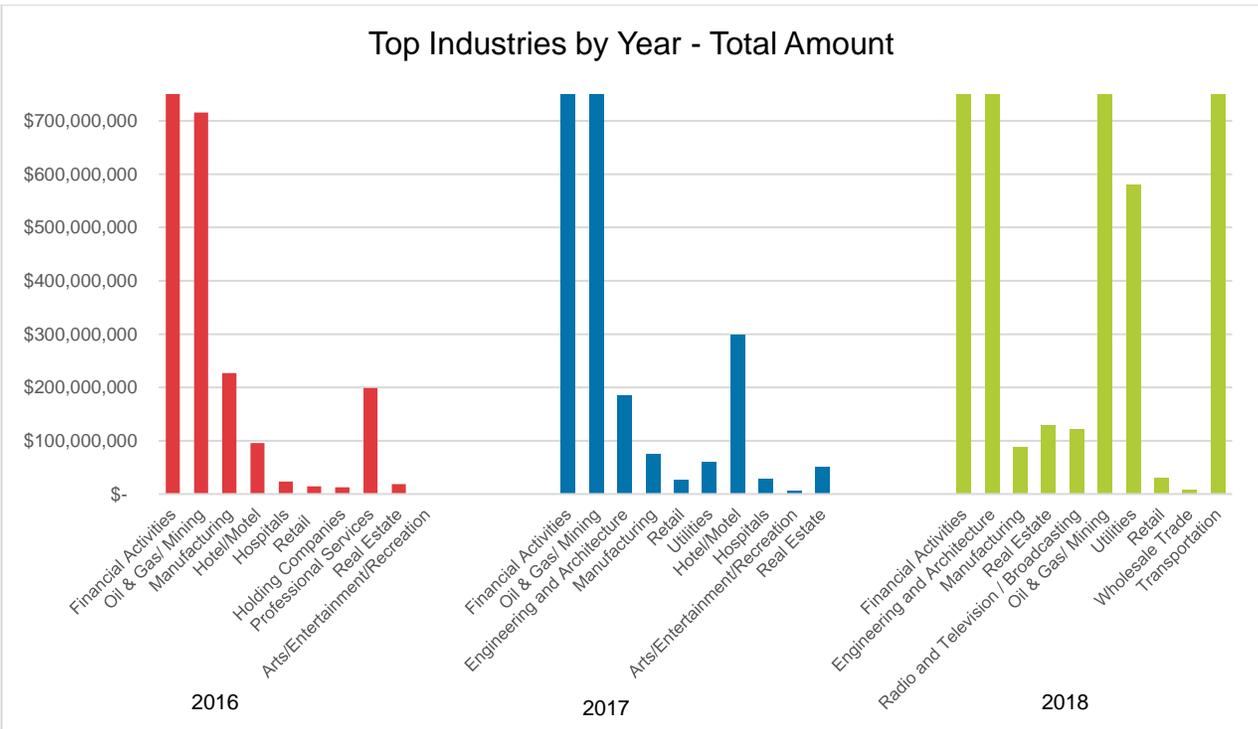
Lehman continues to lead the way in active cases although Westinghouse, Ultra Petroleum, Caesars and Toys R US were all active names in the claim trading market.



The bulk of the market continues to be occupied by smaller claims trading (with small claims defined as \$250k or less). Still, there was an increase in the number of mid and large trades (between \$250k and \$1mm and above \$1mm respectively) in 2018 as compared to the smaller claims trades. That may be due to increased activity at the larger broker-dealers (since they will not typically focus on smaller trades) as opposed to some of the boutique claim traders.



*Categories exceeding the chart are in excess of 3,500 transfers



*Categories exceeding the chart are in excess of \$15 billion

Financial Activities continue to lead the way from an industry perspective (primarily due to Lehman); however, Engineering and Architecture jumped considerably in 2018 as Oil & Gas/Mining continues to fall.

Key Legal Issues

Anti-assignment clause (Woodbridge, Caesars)

- In re Woodbridge Group of Companies, LLC, No. 17-12560, 2018 WL 3131127 (Bankr. D. Del. Jun. 20, 2018) – the bankruptcy court upheld a provision in a promissory note restricting the lender’s ability to assign a note without the borrower’s prior written consent (without which such assignment would be null and void) and ruled in favor of the debtor/borrower who objected to the proof of claim filed by the transferee of the note on the basis of the anti-assignment provision. The court specifically noted the “null and void” language in the anti-assignment clause, ruling that such language signaled a restriction on the *power* of a holder to assign rendering any purported assignment null and void, rather than a restriction on the *right* to assign, which would merely give rise to breach of contract claims between the holder and the borrower.
- In re Caesars Entertainment Operating Co. Inc., et al., No. 15-01145 (Doc. 8184) in the U.S. Bankruptcy Court for the Northern District of Illinois Eastern Division.– a purchase and sale agreement for real property contained a provision restricting assignment without the seller’s prior written consent. The purchaser alleged that the seller breached the purchase and sale agreement and committed fraud by (among other things) failing to disclose a “use covenant” on the property. The purchaser sought to recover nearly \$10 million in damages from the seller arising from its alleged breach and fraud. Shortly after closing the purchase and sale agreement, the seller filed for chapter 11 protection. In connection with the purchaser’s subsequent sale of the property to a new buyer, the original purchaser also sought to transfer its claims for breach and fraud against the original seller arising under the purchase agreement to the new property buyer pursuant to a claims assignment agreement filed in the seller’s bankruptcy case. The debtor objected to the allowance of the claims and the bankruptcy court sustained the debtor’s objection, citing *Woodbridge*, because, contrary to the requirements of the underlying purchase and sale agreement, the seller never gave written consent to the transfer. The court commented that Bankruptcy Rule 3001(e) is procedural and cannot override underlying contract rights.

Takeaways:

- **Diligence:** Make sure you properly diligence all underlying documents giving rise to a claim prior to purchasing the claim with a particular focus on anti-assignment clauses.
- **Alternative Structures:** If the underlying claim documents contain anti-assignment provisions, consider settling via participation or an alternative settlement method.

Key Legal Issues

When is a trade binding? (Westinghouse)

- In re Westinghouse Electric Co., 588 B.R. 347 (Bankr. S.D.N.Y. 2018) – the bankruptcy court ruled that a series of communications between a claim seller and a broker for a claim purchaser did not constitute a binding agreement to trade because the totality of the communications between the parties did not reflect a meeting of the minds or offer and acceptance. The court determined that such communications reflected an intention by the claim seller not to be bound to a trade or to an obligation to negotiate further. The court rejected the argument that customs in the claims trading industry are that an oral trade is a binding qualified financial contract under Section 5-701 of New York General Obligation Law, noting that industry participants "ought to be clear and direct in setting forth their agreements in the emails they exchange," especially when dealing with less experienced counterparties. Accordingly, the court ruled that the notices of transfer of the claim should be canceled and the original holder recognized as the claimant.

Takeaways:

- **Clear Communications:** Make sure your intentions are clearly stated in all correspondence, trade recaps and trade confirmations. If the intention is to make the trade contingent on negotiation of transfer documents, diligence or otherwise that should be clearly stated. If the intention is to create a binding agreement once price is agreed, that should be clearly stated.
- **Know Your Counterparty:** It is insufficient to rely on market convention and norms, particularly when dealing with a counterparty that does not regularly deal in the claim trading market. The fact that a counterparty is sophisticated is not enough to assume that they are familiar with or agreeing to be bound by market practice in an area in which they don't regularly deal.
- **Confirm Trade in Writing:** Westinghouse likely never would have occurred had the parties entered into a binding trade confirmation from the outset. This is particularly important when dealing with a counterparty that is unfamiliar with market convention.

Key Legal Issues

Creditor Can Block Confirmation of a Chapter 11 Plan through the Purchase of Claims (*Fagerdala*)

- *Pacific Western Bank, et al. v. Fagerdala USA-Lompoc, Inc.*, 891 F.3d 848 (9th Cir. 2018) - The Ninth Circuit reversed an earlier bankruptcy court decision, which had held that a senior secured claimant's purchase of unsecured claims for the express purpose of blocking a debtor's plan of reorganization was bad faith. Although a creditor is entitled to act in its own self-interest and may even purchase claims in order to block a plan, the bankruptcy court ruled that it cannot do so if it would result in an unfair disadvantage and prejudice the remainder of the class of claims. In this case, the senior secured creditor only purchased a small portion of the relevant class in order to block the vote and the bankruptcy court found that would be unfair to the unsecured creditors who owned the majority of the class. On appeal, the Ninth Circuit reversed the bankruptcy court's decision ruling that a creditor voting to accept or reject a plan does not act in bad faith merely because it acts in its self-interest; indeed, a creditor that votes in its own self-interest as a creditor may purchase claims for the very purpose of blocking confirmation of a proposed plan. Only where there is some motive "ulterior to the purpose of protecting a creditor's interest" is a finding of bad faith justified. Moreover, the *Fagerdala* court held that the mere fact that a creditor offered to purchase only a subset of unsecured claims—just enough to block a plan—does not show ulterior motive outside of the creditor's interest as a creditor.

Takeaways:

- **Creditors Can Purchase Claims in the Ninth Circuit in Order to Block a Plan in Most Circumstances:** The purchasing of claims for the purpose of securing the approval or rejection of a plan is permissible absent some other indicia of bad faith. The purchase of a subset of claims—just enough to obtain a blocking position—does not amount to bad faith.

Reed Smith Bankruptcy Claims Trading Practice

Reed Smith's bankruptcy and claim trading practice combines transactional attorneys who possess a deep understanding of, and extensive experience in, bankruptcy claims trading with creditor-side bankruptcy attorneys who have extensive experience in analysing, filing and enforcing bankruptcy claims. Our team works seamlessly across all industries and jurisdictions (both domestic and international) advising clients on the purchase and sale of bankruptcy claims. From the initial diligence, to drafting, review and negotiation of transfer documentation through claim enforcement in the bankruptcy process, we provide clients with the full spectrum of guidance on bankruptcy claim trading. Our attorneys have assisted clients with thousands of bankruptcy claim trades with aggregate notional amounts in the billions of dollars.

We have advised claim purchasers and sellers in the following recent cases:• Lehman; Ultra Resources (UPL); Madoff Feeder Funds; Westinghouse; Seadrill Limited; Sears Canada; Toys R Us, Target Canada; Stanford Liquidation; Telemar; and Videology.

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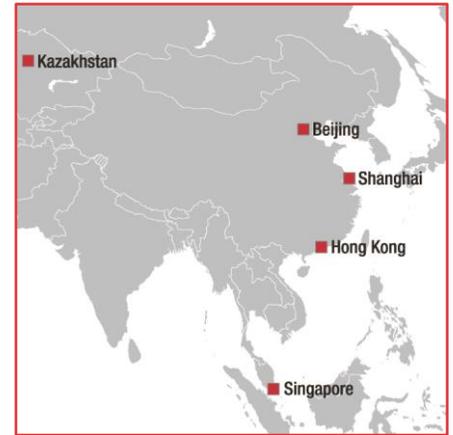
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