30 Trading Claims and Interests

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¶ 30.01 INTRODUCTION AND REASONS FOR TRADING IN CLAIMS

As the trading of claims and interests in chapter 11 debtors has proliferated, so have the cases regulating this trading. This chapter discusses the rules governing the trading of claims and interests during a chapter 11 case, as well as pitfalls of which a claims purchaser should be aware.

The reasons for buying or selling a claim against a chapter 11 debtor vary widely. A creditor of a bankrupt entity may wish to sell its claim because it "needs cash now," to show a profit on a receivable that has already been written down or to benefit from the tax, accounting, or regulatory treatment of the sale of the claim. Buyers may wish to purchase claims against chapter 11 debtors for investment by buying low and selling high, to give the buyer additional leverage or a more meaningful role in the formulation of a chapter 11 plan of reorganization, as a means of acquiring some or all of the debtor's assets, or simply as a means of acquiring standing in the bankruptcy case by becoming a creditor or "party in interest" who has the right to be heard by the bankruptcy court on certain issues, to propose a plan of reorganization, or to take a Rule 2004 examination of the debtor, its officers, creditors, or other entities.

¶ 30.02 PROCEDURAL ASPECTS OF TRADING IN CLAIMS

[1] Current Statutory Procedures

Trading in bankruptcy claims is governed by Rule 3001(e) of the Bankruptcy Rules. This rule, which has been in effect since 1898, was amended in 1991 "*to limit the court's role to the adjudication of disputes regarding transfers of claims*."[1] Rule 3001(e) distinguishes between claims that were transferred before or after a proof of claim is filed, and between claims that were transferred absolutely or for security. In addition, Rule 3001(e) is not applicable to transfers of claims based upon "a publicly traded note, bond or debenture"[2] or to transfer of interests.

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Rule 3001(e)(1) governs claims that are transferred other than for security before a proof of claim is filed. Rule 3001(e)(1) simply provides that "if a claim has been transferred other than for security before proof of the claim has been filed, the proof of claim may be filed only by the transferee or an indenture trustee." Unlike the prior version of Rule 3001(e)(1), the transferor of the claim is not required to acknowledge the transfer, and the consideration paid for the claim need not be disclosed.

Rule 3001(e)(2) governs the transfer of claims other than for security after a proof of claim has been filed. Rule 3001(e)(2) provides that:

> <BQ>If a claim other than one based on a publicly traded note, bond, or debenture has been transferred other than for security after the proof of claim has been filed, evidence of the transfer shall be filed by the transferee. The clerk shall immediately notify the alleged transferor by mail of the filing of the evidence of transfer and that objection thereto, if any, must be filed within twenty days of the mailing of the notice or within any

1 See Advisory Committee at note to 1991 Amendment to Rule 3001(e) (emphasis added).

2 In contrast, the prior version of Rule 3001(e) only excepted bonds and debentures.

> additional time allowed by the court. If the court finds, after notice and a hearing, that the claim has been transferred other than for security, it shall enter an order substituting the transferee for the transferor. If a timely objection is not filed by the alleged transferor, the transferee shall be substituted for the transferor.</BQ>

Under the current version of Rule 3001(e)(2), the transferee need only file proof of the transfer of claim, but need not disclose the terms of the transfer.[3] Additionally, under the current version of Rule 3001(e)(2), notice need only be given to the transferor. If the transferor files a timely objection, the only inquiry before the court should be whether, under applicable nonbankruptcy law, the claim was transferred other than for security.[4] Rule 3001(e)(5) requires that a copy of the transferor's objection to the transferee's notice of transfer of claim, together with a notice of hearing, shall be mailed to the transferee at least 30 days before the hearing.

At least one bankruptcy court has held that during the 20-day period in which the alleged transferor has the opportunity to object, a court may still recognize the alleged transferee as a "party in interest" in the bankruptcy case, which results in standing for the prospective claimant to file motions or other papers in the bankruptcy case.[5] If the transferor fails to file a timely objection, the transfer of the claim would seem to be automatic.[6] Even though the language of Rule 3001(e)(2) appears to allow only the alleged transferor to file an objection, some courts

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[3] It was unclear under the former version of Rule 3001(e)(2) whether a transferee was required to disclose the consideration paid for the claim, if a proof of claim had previously been filed. Although the old version of Rule 3001(e)(1) specifically required that if no claim had been filed, the assignor was required to file a statement stating the consideration paid for the transfer, the prior version of Rule 3001(e)(2) simply required the notice of transfer to contain "evidence of the terms of the transfer." See generally, In re Allegheny Int'l, Inc., 100 B.R. 241 (Bankr. W.D. Pa. 1988) (permitting assignment of claim without disclosure of purchase price); In re Burnett, 306 B.R. 313 (B.A.P. 9th Cir. 2004) (reversing bankruptcy court's decision to disallow otherwise allowable claim for failure to disclose consideration paid for postpetition assignment of claim, where there was no evidence of breach of some specialized duty owed by the assignee).

[4] See, e.g., In re Kinderhill Corp., 199 F.3d 1322 (2d Cir. 1999) (affirming bankruptcy court's decision to deny substitution of transferor with transferee as claimant where no evidence of corporate authorization for the transfer was submitted); In re ARC Energy Corp., 122 F.3d 1060 (4th Cir. 1997) (affirming bankruptcy court's decision to deny substitution of claimant where judgment creditor of creditor of bankruptcy estate did not file appropriate writ to acquire lien on intangible personal property, as required by applicable state law); Preston Trucking Co., Inc. v. Liquidity Solutions, Inc. (In re Preston Trucking Co., Inc.), 333 B.R. 315 (Bankr. D. Md. 2005) (refusing to examine whether transfer of claim was for sufficient consideration); In re Altman Nursing, Inc., 299 B.R. 813 (Bankr. N.D. Tex. 2003) (bankruptcy court's review of objection to notice of claim transfer is limited to determining whether claim is valid under applicable law). But see In re Altman, 265 B.R. 652 (Bankr. D. Conn. 2001) (reviewing claim transfer to determine whether "collusion" between transferor and transferee should preclude court from substitution of claimant, where "collusion" not specifically prohibited by applicable law).

[5] Power Five, Inc. v. General Motors Corp. (In re Automotive Armature Co., Inc.), 219 B.R. 513 (S.D. Ind. 1998).

[6] Viking Assoc., L.L.C. v. Drewes (In re Olson), 120 F.3d 98, 100, 101-02 (8th Cir. 1997) (holding that section 105 does not empower a bankruptcy court to disallow a claim transfer where there is no objection to the transfer).

have denied, or indicated a willingness to deny, substitution of a claimant in the absence of an objection by the purported transferor.[7]

If the transferee fails to file the notice of transfer within a reasonable time, and the delay prejudices another party, then the court may find that an equitable remedy for the aggrieved party is appropriate.[8] Failure to file a claim does not void or nullify the transfer or affect title to the claim.[9]

To determine whether a transferee can file a notice under Rule 3001(e)(2), a court must first determine whether the disposition of the claim constituted a "transfer" for the purposes of Rule 3001. The Bankruptcy Code broadly defines the term "transfer" to include "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption."[10] In *In re Brickell*, the Eleventh Circuit held that the transfer of a claim to judgment creditors by means of a writ of garnishment pursuant to a final judgment by a state court constituted a "transfer" under Rule 3001(e)(2).[11] However, the Eleventh Circuit recognized that when an involuntary judicial transfer is granted as a prejudgment remedy, rather than as the result of a final judgment, the lack of finality for the remedy may preclude the application of Rule 3001(e)(2). The court reasoned that a disposition

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7 The courts are split on this issue, but the majority appears not to allow a party other than the alleged transferor to challenge the transfer in limited circumstances. See Viking Associates v. Drewes (In re Olson), 120 F.3d 98, 101 (8th Cir. 1997) ("where there is no dispute [by the alleged transferor], there is no longer any role for the court"); In re Lynn, 285 B.R. 858, 862 (Bankr. S.D.N.Y. 2002) (holding that third parties, including the debtor, do not have standing to object to claim assignment itself, but may have standing to contest the subsequent improper use of the assigned claim by the transferee); but see, Troy Savings Bank v. Travelers Motor Inn, Inc. (In re Travelers Motor Inn-Syracuse Inc.), 215 B.R. 485 (N.D.N.Y. 1997) (stating that any party in interest has standing to object to a procedural violation of Rule 3001, but disallowance of the transfer may only be permitted where the party in interest is prejudiced); In re Kreisler, 331 B.R. 364 (Bankr. N.D. Ill. 2005) (holding that trustee had standing to object to claims transfer because a trustee represents the interests of all of the unsecured creditors); In re Altman, 265 B.R. 652 (Bankr. D. Conn. 2001) (holding that, even in the absence of an objection by the alleged transferor, the bankruptcy court itself should carefully scrutinize a transfer for fraud or collusion).

8 In re Crosscreek Apartments, Ltd., 211 B.R. 641, 645 (Bankr. E.D. Tenn. 1997) (quoting Venhaus v. Wilson (In re Wilson), 96 B.R. 257, 261 (9th B.A.P. 1988) ("[t]he rule's silence with regard to a time limit cannot be interpreted as giving a transferee *carte blanche* in the filing of such notice if a delay would result in prejudice to other parties")); Kreisler, 331 B.R. 364 (equitably subordinating transferee's claim where failure to timely file notice of transfer prejudiced unsecured creditors).

9 In re Celotex, 224 B.R. 853, 856 (Bankr. M.D. Fla. 1998) (quoting Crosscreek Apartments, "there is no indication that failure to comply with Rule 3001(e), without more, affects the enforceability of an otherwise valid transfer").

10 See 11 U.S.C. § 101(54).

11 See In re Brickell, 142 Fed. App'x 385 (11th Cir. 2005); but see NVLand, Inc. v. Vogel (In re Ocean Downs Racing Ass'n, Inc.), 164 B.R. 249 (Bankr. D. Md. 1993) (refusing to allow garnishment of chapter 11 trustee by judgment creditor of creditor of bankruptcy estate, regardless of whether the garnishment remedy is pre-judgment or final).

of a claim that is not final might impede and frustrate the policy of promoting the orderly and expeditious administration of a debtor's estate.[12]

It is not necessary that a proof of claim actually be filed in order to trigger the notice procedure set forth in Rule 3001(e)(2). In a case under chapter 11 of the Code, a proof of claim is "deemed filed" if it is listed in the debtor's schedules of liabilities, as long as it is not scheduled as disputed, contingent, or unliquidated.[13] Thus, a prudent claim assignee will follow the procedures set forth in Rule 3001(e)(2), even if no proof of claim has actually been filed as to a claim that is listed in the debtor's schedules as noncontingent, liquidated, and undisputed.[14] Likewise, where a creditor merges into another entity and is not the surviving entity, it may not be necessary to file a notice of transfer of the claim because a "transfer" may not have occurred. However, one court advised that, in an abundance of caution, the most prudent course of action for the surviving entity is to file a notice of transfer.[15]

¶ 30.03 COURT-IMPOSED REGULATION OF CLAIM TRADING

The 1991 version of Rule 3001(e) is intended to limit the court's role in claims trading. The advisory committee note to the current version of Rule 3001(e) states:

> <EXT>Subdivision (e) is amended to limit the court's role to the adjudication of disputes regarding transfers of claims. If a claim has been transferred prior to the filing of a proof of claim, there is no need to state the consideration for the transfer or to submit other evidence of the transfer. If a claim has been transferred other than for security after a proof of claim has been filed, the transferee is substituted for the transferor in the absence of a timely objection by the alleged transferor. In that event, the clerk should note the transfer without the need for court approval. If a timely objection is filed, the court's role is to determine whether a transfer has been made that is enforceable under nonbankruptcy law. This rule is not intended either to encourage or discourage postpetition transfers of claims or to affect any remedies otherwise available under nonbankruptcy law to a transferor or transferee such as for misrepresentation in connection with the transfer of a claim. "After notice and a hearing" as used in sub-division (e) shall be construed in accordance with paragraph (5).</EXT>

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[12] Brickell, 142 Fed. App'x at 390.

[13] See 11 U.S.C. § 1111(a).

[14] See In re Oxford Royal Mushroom Prods., Inc., 93 B.R. 390, 394-96 (Bankr. E.D. Pa. 1988); In re Heritage Village Church & Missionary Fellowship, 87 B.R. 17 (Bankr. D. S.C. 1988). But see, In re Rook Broadcasting of Idaho, 154 B.R. 970, 973 (Bankr. D. Idaho 1993) (holding that "deemed filing" pursuant to § 1111(a) does not trigger procedure of Rule 3001(e)(2)). See also In re Yates Development, 258 B.R. 36 (Bankr. M.D. Fla. 2000) (stating that Rule 3001(e)(1) does not require the transferee of a secured claim scheduled by the debtor to file a proof of claim after the assignment).

[15] In re Southern Pacific Transportation, 229 B.R. 119, 121 (E.D. Tex. 1999).

Courts have recognized that Rule 3001(e) was intended to limit their authority to regulate claim trading when there is no objection by the assignee.[16] Although Rule 3001(e) seemingly divests the court of authority to regulate transfers of claims, courts have continued the practice under the prior rule to regulate trading in claims under limited circumstances.[17]

Under prior versions of Rule 3001(e), courts routinely imposed restrictions on the transfer of claims, particularly when concerned that an assignor had insufficient information about the value of its claim.[18] For example, in *In re Allegheny International, Inc.*,[19] a case with an active market for claims, the bankruptcy court required the assignee, in addition to complying with Rule 3001(e)(2), to advise the debtor of proposed assignments of claims. The debtor was then required to provide the proposed assignor with its best estimate of the value of the claim to be assigned. Only after this procedure had been complied with would the court approve the transfer of claims.

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Likewise, in *In re Revere Copper & Brass, Inc.*,[20] the court refused to approve proposed assignments of claims until the proposed assignors had been given certain information relating to the value of the claims to be assigned. The court then granted the proposed assignors 30 days to revoke their assignment based on their review of the information provided to them. The court also required that, with respect to any future claim assignments, the proposed assignee provide the proposed assignor with information concerning any proposed plans of reorganization and the status of the chapter 11 case and plan. The court required that this information be provided to the proposed assignor both at the time of solicitation and at the time of payment for the claim.

Similarly, in *In re Johnson*,[21] after noting that the "court's only responsibility to creditors wishing to assign their claims is to see that they have received sufficient information to make an informed judgment," the bankruptcy court directed that any creditor could rescind its agreement to assign its claim at any time before filing a declaration that the creditor had read the court's

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[16] See In re Rook Broadcasting of Idaho, Inc., 154 B.R. 970 (Bankr. D. Idaho 1993) (noting that the 1991 amendments to Rule 3001(e) are designed to limit the court's role in claim transfers to adjudication of disputes regarding the transfer of claim and is not meant to encourage or discourage trading in claims); In re Odd Lot Trading, Inc., 115 B.R. 97 (Bankr. N.D. Ohio 1990) (1991 amendments to Rule 3001(e) designed to limit court's role in claim transfers).

[17] See generally, In re UAL Corp., 412 F.3d 775 (7th Cir. 2005) (enjoining equity trading to preserve net operating loss carry-forwards); Official Unsecured Creditors' Committee v. Stern (In re SPM Manufacturing Corp.), 984 F.2d 1305, 1314 (1st Cir. 1993) (stating that in limited circumstances a court may find a claims transfer invalid); In re Phar-Mor, Inc., 152 B.R. 924 (Bankr. N.D. Ohio 1993) (enjoining equity trading to preserve net operating loss carry-forwards); In re FRG, Inc., 124 B.R. 653, 656 (Bankr. E.D. Pa. 1991) (referring to the "era of heightened scrutiny of transfers of claims"); but see In re Olson, 120 F.3d 98, 101-02 (8th Cir. 1997) (holding that court can invalidate claims transfer in limited circumstances and only where transferor objects).

[18] The equitable power to regulate claim trading appears to have developed in American United Mutual Life Insurance Co. v. Cay of Avon Park, 311 U.S. 138 (1940), in which the Supreme Court held that bankruptcy courts may regulate certain aspects of claim trading despite the absence of a specific statutory authorization.

[19] 100 B.R. 241 (Bankr. W.D. Pa. 1988).

[20] 58 B.R. 1 (Bankr. S.D.N.Y. 1985).

[21] 117 B.R. 553 (Bankr. N.D. Cal. 1990).

order on assignment of claims. Any creditor not filing such a declaration could, the court noted, rescind its agreement to assign its claim at any time until distribution on the claims.

[1] Enjoining Transfers of Claims

Some courts have found authority to enjoin all transfers of claims when claim transfers threaten to destroy property of the estate such as net operating loss carryforwards (NOLs). For example, in *Pan Am Corp. v. All Unsecured Creditors of Pan Am*,[22] the bankruptcy court enjoined all creditors from transferring the debtor's publicly traded bonds or debentures and further held that any violation of the prohibition on transfers of claims disqualified the offending creditor from receiving any distributions under the plan.[23]

The Internal Revenue Code provides that net operating losses can be carried forward to offset taxable income in the future.[24] The Internal Revenue Code also provides that NOLs can be lost or restricted in their use in certain circumstances, such as where there is a change in ownership of the taxpayer as a result of stock transfers or the conversion of debt to equity.[25] A change in ownership of the debtor-taxpayer could occur not only where a sufficient amount of the debtor's equity changes hands, but also if a sufficient amount of the debt changes hands and the plan of reorganization calls for debt to be converted into equity. In some cases a single transfer or aggregate of transfers could lead to the loss of significant NOLs for the debtor. The basis provided by courts for enjoining the transfer of a debtor's equity is that such transfers could result in a loss of NOLs, which have been held to be property of the estate. Therefore, certain equity or debt transfers would violate the automatic stay. With increasing frequency, debtors are requesting injunctions that restrict trading of debt and equity.[26]

The seminal case for restricting debt and equity transfers to preserve a debtor's NOLs is *In re Prudential Lines, Inc*.[27] In *Prudential*, the debtor, two affiliates, and its parent were each in

[22] No. 91 B 10080-10087 (CB), Adv. Proc. No. 91-6175A (CB) (Bankr. S.D.N.Y. Oct. 3, 1991).

[23] It may be relevant that Pan Am never made any distributions whatsoever to its general unsecured creditors, thereby rendering the bonds worthless in any event. See also In re McLean Indus., Inc., Case No. 86 B 12238-12241, slip op. (Bankr. S.D.N.Y. Feb. 16, 1989) (enjoining transfers of claims to preserve debtor's net operating loss carry-forwards).

[24] See 26 U.S.C. § 172(a).

[25] See 26 U.S.C. §§ 381-84.

[26] See, e.g., In re WHX Corp., No. 05-11444 (ALG), slip op. (Bankr. S.D.N.Y. March 31, 2005); In re Loral Space & Communications Ltd., *et al.*, No. 03-41710 (RDD), slip op. (Bankr. S.D.N.Y. Oct. 23, 2003); In re Mirant Corp., *et al.*, No. 03-46590 (DML), slip op. (Bankr. N.D. Tex. Sept. 17, 2003); In re Fleming Cos., Inc., *et al.*, No. 03-10945 (MFW), slip op. (Bankr. D. Del. June 4, 2003); In re WorldCom, Inc., *et al.*, No. 02-13533 (AJG), slip op. (Bankr. S.D.N.Y. March 4, 2003); In re Conseco, Inc., *et al.*, No. 02-49671 (CAD), slip. op. (Bankr. N.D. Ill. Dec. 18, 2002); In re U.S. Airways Group, Inc., *et al.*, No. 02-83984 (SSM), slip op. (Bankr. E.D. Va. Sept. 29, 2002) In re Williams Communications Group, Inc., Case No. 02-11957 (BRL), slip op. (Bankr. S.D.N.Y. July 24, 2002); In re Metrocall, Inc., *et al.*, No. 02-11579 (RB), slip op. (Bankr. D. Del. June 6, 2002). See also Loan Syndications and Trading Association, Model NOL Order (November 2004), available at http://www.lsta.org/documents.asp.

[27] In re Prudential Lines, Inc., 928 F.2d 565 (2d Cir. 1991), cert. denied, 502 U.S. 821 (1991).

a chapter 11. The creditors' committee and a creditor of the debtor proposed a plan that would result in no distribution to the parent. In retaliation, the parent sought to take a worthless stock deduction that would destroy the debtor's NOLs.[28] The Second Circuit held that the NOLs were indeed property of the estate and that the parent's plan to take the stock deduction would be an exercise in control over the property of the debtor's estate and therefore a violation of the automatic stay.[29] This decision paved the way for courts to issue injunctions to restrict debt and equity transfers to preserve NOLs at the beginning of a bankruptcy case.

In *In re Phar-Mor, Inc.*, the debtor sought to enjoin the transfer of shares of the debtor's stock, citing the possibility that the transfer would jeopardize the debtor's $300 million net operating loss carryforward.[30] Reasoning that the NOLs constituted property of the debtor's estate under the expansive definition set forth in § 541(a) of the Code, the bankruptcy court enjoined all future transfers of the debtor's equity on the basis that such transfers would constitute a violation of the automatic stay. Orders enjoining transfers of claims have been entered in chapter 11 and chapter 7 cases.[31]

In a twist to what had become the accepted law on trading injunctions, the Seventh Circuit held in the *UAL* case that in imposing an injunction against equity trading, the bankruptcy court should have required some form of adequate protection for the stockholders, such as a bond, to protect them from losses in the value of their securities during the pendency of the trading injunction.[32] The court reasoned that the benefit of preserving the NOLs of any debtor will be realized by some debt or equity holders, but not all, and no investor should profit at the expense of another.[33]

The Seventh Circuit went on to attack the widely accepted basis for protecting NOLs. The court stated that reliance on §§ 105 and 362 of the Code to rationalize claims trading injunctions is "weak" because the former is "a means to enforce the Code rather than an independent source of substantive authority . . . and the latter speaks to the matter indirectly if at all."[34] "[Such a rationale] is weak enough to make a bond or adequate-protection undertaking obligatory before a bankruptcy judge may forbid investors to sell their stock on the market."[35] While *UAL* probably does not spell an end to claims trading injunctions for the protections of NOLs, it will undoubtedly embolden affected debt and equity holders to demand some form of adequate assurance from the debtor while the injunction is in force. Requiring a debtor to

[28] 928 F.2d at 566.

[29] 928 F.2d at 573.

[30] Phar-Mor, 152 B.R. 924.

[31] See In re Southeast Banking Corp., 1994 Bankr. LEXIS 2389 (Bankr. S.D. Fla. 1994) (enjoining transfer of stock in a chapter 7 bankruptcy case to preserve debtor's NOLs).

[32] UAL, 412 F.3d 775.

[33] 412 F.3d at 778.

[34] 412 F.3d at 778.

[35] 412 F.3d at 779.

commit scarce resources to provide adequate assurance will likely cause the debtor to scrutinize more closely the potential benefit of its NOLs and weigh the cost-benefit of providing adequate assurance.

¶ 30.04 ENFORCEMENT OF ASSIGNED CLAIMS

As a general rule, the assignee of a claim is entitled to enforce the assigned claim to the same extent that the claim could be enforced by the original holder of the claim.[36] Thus, a claim that is entitled to a priority should retain that priority in the hands of an assignee.[37] Likewise, absent wrongdoing, a creditor that purchases a claim at a substantial discount is entitled to enforce the claim to the full extent it can be enforced by the assignor.[38]

This general rule was enunciated by the U.S. Supreme Court in *Manufacturer's Trust Company v. Becker*.[39] In this case, close relatives and an office associate of directors of the debtor purchased at a discount certain bonds issued by the debtor. The indenture trustee for the bonds objected to the allowance of the purchasers' claims, asserting that their claims should be allowed at the price paid for the bonds rather than face value. The Supreme Court rejected this argument, holding that the purchasers' claims should be allowed at face value absent unfair dealing, bad faith, misrepresentation, deception, use of inside knowledge or strategic position, or any rivalry with the debtor.

The general rule that the assignee of a claim is entitled to enforce the assigned claim at its face value remains applicable under the Code. For example, in *In re Executive Office Centers, Inc.*,[40] an entity purchased, at a steep discount, a claim against the debtor secured by a mortgage.

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[36] Manufacturers Trust Co. v. Becker, 338 U.S. 304 (1949) (Bankruptcy Act case enunciating general rule); Citibank v. Tele/Resources, 724 F.2d 266, 269 (2d Cir. 1983) (assignee succeeds to all rights of assignor); Carnegia v. Georgia Higher Educ. Assistance Corp., 691 F.2d 482, 483 (11th Cir. 1982) (assignee steps into shoes of assignor and acquires both benefits and limitations of assigned claim); Enron Corp. v. Avenue Special Situations Fund II, LP, *et al.* (In re Enron Corp.), 333 B.R. 205, 223 (Bankr. S.D.N.Y. 2005) ("There is no basis to find or infer that transferees should enjoy greater rights than the transferor."); In re Dow Corning Corp., 250 B.R. 298, 350 (Bankr. E.D. Mich. 2000) (where limitations period already expired at time claim is acquired by the United States, then claim is acquired subject to this "pre-existing infirmity" and will not be revived by its transfer to government); In re Oaks Partners, Ltd., 141 B.R. 453, 460 (Bankr. N.D. Ga. 1992) (allowing assigned secured claim in face amount rather than in amount paid for claim); but see In re S & D Foods, Inc., 110 B.R. 34, 37 (Bankr. D. Colo. 1990) (purchaser of claim at discount not permitted to assert equitable subordination claim).

[37] Shropshire, Woodliff & Co. v. Bush, 204 U.S. 186, 189 (1907) (holding that priority wage claims retain their priority even after assignment); SPM Mfg. Corp., 984 F.2d at 1318 ("Under [applicable non-bankruptcy] law a valid assignment of a debt does not divest the claim of its priority or alter the debtor's obligation to pay the debt; the assignee steps into the shoes of the assignor for the portion of the claim assigned"); Dorr Pump & Mfg. v. Heath, 125 F.2d 610, 611 (7th Cir. 1942) (priority wage claim held to retain priority even after assignment to director and shareholder of debtor); Citibank, *supra*; In re Executive Office Centers, Inc., 96 B.R. 642, 649 (Bankr. E.D. La. 1988) ("Once a claim is assigned, the assignee succeeds to all rights of his transferor").

[38] In re Executive Office Centers, Inc., 96 B.R. 642 (Bankr. E.D. La. 1988).

[39] 338 U.S. 304 (1949).

[40] 96 B.R. 642 (Bankr. E.D. La. 1988).

The bankruptcy court rejected the position that the assignee of the claim should be forced to accept a limited recovery on its assigned claim. In rejecting the argument that the assignee would reap a windfall based on the discounted purchase price, the bankruptcy court relied on the lack of proof of a breach of fiduciary duty, fraud, misrepresentation, or overreaching by the assignee.

¶ 30.05 DEFECTS AND DEFENSES TO ASSIGNED CLAIMS

Just as an assignee may exercise all the assignor's rights with respect to the assigned claim, the assigned claim may remain subject to any defects or defenses that may exist. For example, in the *Enron* case, in a matter of apparent first impression, a bankruptcy court sitting in the Southern District of New York held that where a bank that sold its interest in a loan allegedly engaged in "inequitable conduct" wholly unrelated to the transferred loan interest, that interest remained subject to equitable subordination in the hands of good- faith purchasers based on the acts of the transferor.[41] The court reached this conclusion by reasoning that a transferee of a claim should be in no better position than the transferor, and relying most heavily on a 1906 decision of the U.S. Supreme Court and a 1942 Eighth Circuit decision.[42]

The *Enron* decision is significant not only for its holding but also for the fact that the claim involved substantial sums transferred to and from sophisticated institutional banks and investors. It remains to be seen whether this decision withstands the inevitable appeal, whether other courts will follow this decision, and, if so, whether the holding is expanded to include prepetition claim transfers as well as postpetition claim transfers.

Likewise, as argued by the debtor in *Enron*, it is possible that the claim will be subject to disallowance pursuant to § 502(d) of the Code. Section 502(d) provides for the *disallowance* of "any claim of any entity" that, among other things, has failed to repay funds owing on account of an avoidable preference, fraudulent transfer, or other voidable transaction. There are no reported decisions resolving the issue whether a transferred claim should be disallowed pursuant to § 502(d) when the assignor rather than the assignee was the recipient of the unreturned voidable transfer. Because it is not clear from the plain wording of § 502(d) whether the claim remains a claim "of" the assignor that received the voidable transfer, it is uncertain how a court would resolve this issue. It is also unclear whether the case might be resolved differently if the assignee paid value for the claim or if the transferred claim was traded on a public securities market.

¶ 0.06 LIMITATIONS ON RECOVERIES FROM CLAIMS ASSIGNED TO FIDUCIARIES OR INSIDERS OF THE DEBTOR

Although there is no provision in the Code regulating trading of claims by fiduciaries, the courts have used their equitable powers to limit recoveries of certain fiduciaries who breach their duties by trading in claims. In these situations, claim recoveries have been limited or subordinated to other claims based on a showing of self-dealing, bad faith, misrepresentation, conflict of interest,

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[41] Enron Corp. v. Avenue Special Situations Fund II, LP, *et al.* (In re Enron Corp.), 333 B.R. 205, 237 (Bankr. S.D.N.Y. 2005).

[42] 333 B.R. at 223.

breach of fiduciary duty, or utilization of inside knowledge.[43] The power of the bankruptcy courts to fashion remedies for what they perceive to be inequities in claim trading by fiduciaries is derived from *American Mutual Life Insurance Co. v. City of Avon Park*.[44]

In *Avon Park*, a chapter IX reorganization under the Bankruptcy Act of 1898 (the Act), the debtor-city's fiscal agent purchased at a substantial discount bonds issued by the debtor. The debtor's fiscal agent then solicited votes accepting a proposed plan of reorganization from other bond holders, without disclosing his acquisition of the bonds. The Supreme Court stated:

> <EXT>Where such investigation discloses the existence of unfair dealing, a breach of fiduciary obligations, profiting from a trust, special benefits for the reorganizers, or the need for protection of investors against an inside few or of one class of investors from the encroachments of another, the court has ample power to adjust the remedy to meet the need. The requirement of full, unequivocal disclosure; the limitation of the vote to the amount paid for the securities . . ., the separate classification of claimants . . ., the complete subordination of some claims . . . indicate the range and type of the power which a court of bankruptcy may exercise in these proceedings. That power is ample for the exigencies of varying situations. It is not dependent on express statutory provisions. It inheres in the jurisdiction of court of bankruptcy.[45]</EXT>

This principle remains effective under the Code. For example, in *Allied Eastern State Maintenance Corp. v. Miller (In re Lemco Gypsum, Inc.)*,[46] two creditors obtained joint and several judgments against the debtor and two of its insiders. In order to satisfy the judgment against themselves, the insiders purchased the entire first judgment, which was based on a contract claim, for less than 25 percent of its face value. The second judgment was based on the debtor's default under certain bonds issued by the debtor, but guaranteed by the insiders. The insiders paid the judgment debtor the full amount of the second judgment, in exchange for an assignment of the defaulted bonds. The insiders then asserted both the judgment claim and the claim based on the defaulted bonds against the bankruptcy estate.

Certain creditors of the debtor moved to equitably subordinate the insiders' claims. The bankruptcy court held that the insiders' claim based on the defaulted bonds, which the insiders had satisfied at full face value, should not be subordinated because of the lack of inequitable

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[43] E.g., Official Unsecured Creditors' Committee v. Stern (In re SPM Manufacturing Corp.), 984 F.2d 1305, 1314 (1st Cir. 1993) (stating that "[a]n assigned claim may be limited if the assignment involves a breach of fiduciary duty or fraud and the breach of duty or fraud enables the assignee to acquire the claim for inadequate consideration."); Preston Trucking Co., Inc. v. Liquidity Solutions, Inc. (In re Preston Trucking Co., Inc.), 333 B.R. 315, 336-37 (Bankr. D. Md. 2005) (quoting SPM Mfg.); In re Executive Office Centers, Inc., 96 B.R. 642 (Bankr. E.D. La. 1988). See also In re Los Angeles Lumber Prods. Co., 46 F. Supp. 77 (S.D. Cal. 1941) (fiduciary who had failed to disclose that he "had complete information concerning all appraisals made of the property and the assets of the debtor and subsidiaries and of all financial statements which were furnished monthly to the directors" was prohibited from realizing a profit from his trading in the debtor's bonds).

[44] 311 U.S. 138 (1940).

[45] 311 U.S. at 145-46.

[46] 911 F.2d 1553 (11th Cir. 1990).

conduct by the insiders or prejudice to the debtor. The court reasoned that the debtor would be primarily liable on the bonds even if the insiders had remained as guarantors: "The equitable subordination of the bond claim under the facts of this case transgresses the public policy we have often expressed: 'a desire not to discourage those most interested in a corporation from attempting to salvage it through an infusion of capital.'"[47]

In contrast to the bond claim, the bankruptcy court did equitably subordinate the insiders' judgment claim to the extent the face value of the judgment claim exceeded the insiders' cost of acquiring the claim. In equitably subordinating a portion of the judgment claim, the court reasoned that the entire judgment presumably could have been settled for $30,000, the amount paid by the insiders to obtain the judgment. The court found that by purchasing the judgment at a discount, but taking an assignment of the full amount of the judgment, the insiders were motivated by their own self- interest rather than that of the debtor and their action inured to their own benefit and to the detriment of the debtor's creditors.

The Eighth Circuit reversed a bankruptcy court decision to subordinate claims purchased by an insider.[48] There, insiders of a chapter 7 debtor purchased all unsecured claims against the chapter 7 estate for substantially less than the value of the estate's assets for the purpose of obtaining a dismissal of the case and the return of the assets to the debtor.[49] The bankruptcy court found that the insiders' purchase of the claims constituted "an overreaching attempt to interfere with the administration of the estate; and [that the claims had been acquired] through the dissemination of false, misleading, and incomplete information to creditors . . ."[50]

Based on this finding, the bankruptcy court chose to treat the claim assignments as assignments for only that portion of the face value of each claim equal to the amount paid by the insiders, even though none of the unsecured creditors filed a timely objection to the transfers.[51] The "unassigned" portion of each claim was then returned to the assignors and the assigned portion of the claims, which were now held by the insiders, were subordinated to the claims of noninsiders pursuant to § 105 of the Code.

The Eighth Circuit reversed, however, finding that § 105 does not empower a bankruptcy court to disallow a claim transfer where there is no objection to the transfer.[52]

One bankruptcy court held that "it is appropriate to apply a *per se* rule prohibiting insiders of a debtor from purchasing claims against it without disclosing their identity and

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[47] 911 F.2d at 1557.

[48] Viking Assoc., L.L.C. v. Drewes (In re Olson), 120 F.3d 98, 100 (8th Cir. 1997).

[49] 120 F.3d at 100.

[50] In re Olson, 191 B.R. 991, 993 (Bankr. D. Minn. 1996).

[51] 120 F.3d 102.

[52] 120 F.3d at 101-02.

connection with the debtor."[53] This conclusion was, however, reversed by the district court, which was affirmed by the circuit court. On appeal, the district court held that the bankruptcy court's creation of the per se rule was an impermissible formulation of federal common law because nothing in the Code prohibits insiders of a debtor from purchasing claims without disclosure of their identity or connection with the debtor.[54]

The Third Circuit agreed with the district court and observed that the opportunity to purchase the assigned claims constituted a corporate opportunity that the insider should have disclosed to the debtor's board and creditors' committee prior to purchase.[55] That breach of fiduciary duty itself, the Third Circuit concluded, warranted equitable subordination, in an amount sufficient to at least deprive the insider of the profit gained on the purchase of the claims.[56]

In contrast, in *In re UVAS Farming Corp.*,[57] a case relied upon by the bankruptcy court in *Papercraft*, the court did enunciate a per se rule that a director purchasing claims against his bankrupt corporation can enforce those claims only to the extent of the amount paid for the claims. Despite the holding of *UVAS Farming*, most courts do not enforce a per se rule prohibiting trading in claims by fiduciaries of the debtor.[58] Still, an insider or fiduciary of the debtor, as well as any entity with a sufficiently close relationship to an insider or fiduciary of the debtor, would be well advised to disclose its relationship to sellers of claims, as well as to advise the debtor and creditors' committee of its claim-trading activities. Even though claims trading by an insider or fiduciary might not be prohibited per se, other equitable remedies may be available, such as equitable subordination as seen in *Papercraft*.

¶ 30.07 ACCEPTANCE, REJECTION, AND PROPOSAL OF PLANS OF REORGANIZATION

A common motive for acquiring claims against a bankruptcy estate is to obtain additional leverage in connection with the acceptance or rejection of a plan of reorganization or to gain standing to file a plan of reorganization. An entity seeking to acquire claims for purposes of influencing the plan voting process must be aware that its influence in this process could be severely limited if its acceptance or rejection of a plan is designated as not being "in good faith"

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[53] Committee of Creditors Holding Unsecured Claims v. Citicorp Venture Capital, Ltd. (In re Papercraft Corp.), 187 B.R. 486, 491 (Bankr. W.D. Pa. 1995) (partially withdrawing and vacating 1994 opinion in same case).

[54] Committee of Creditors Holding Unsecured Claims v. Citicorp Venture Capital, Ltd. (In re Papercraft Corp.), 211 B.R. 813, 821 (W.D. Pa. 1997).

[55] Committee of Creditors Holding Unsecured Claims V. Citicorp Venture Capital, Ltd. (In re Papercraft Corp.), 160 F.3d 982, 988 (3d Cir. 1998).

[56] 160 F.3d at 991.

[57] In re UVAS Farming Corp., 91 B.R. 575 (Bankr. D. N.M. 1988).

[58] At least one court has authorized a committee member to institute a "Chinese wall" to permit it to continue trading in claims throughout the pendency of the case. In re Federated Dep't Stores, Inc., 1991 WL 79143 (Bankr. S.D. Ohio 1991).

or if the creditor is counted as having only a single vote despite its acquisition of multiple claims. However, acquisition of a claim is sufficient to give an entity standing to file a plan of reorganization.

[1] The Good-Faith Principle

Section 1126(c) of the Code provides that a class of claims has accepted a plan if creditors holding "at least two-thirds in amount and more than one-half in number of the allowed claims of such class . . . that have accepted or rejected such plan" have accepted the plan. Section 1126(c), however, excepts from the § 1126 tabulation the votes of entities "designated" under § 1126(e) of the Code. Section 1126(e) provides:

> <BQ.(e) On request of a party in interest, and after notice and a hearing, the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title.</BQ>

A creditor may thus effectively be denied the right to vote on a plan if it does not vote "in good faith."

The Code does not define when a vote is cast "in good faith." However, the courts have found that votes were not cast in good faith in a variety of circumstances, including when competitors of the debtor voted to reject the debtor's plan for the purpose of destroying the debtor's business,[59] when a creditor was paid by the plan proponent to vote to accept the plan,[60] when a creditor sought to obtain control over the debtor,[61] when a creditor-plan proponent sought to block a competing plan,[62] and when a creditor sought to block a proposed plan for leverage to limit his own liability to the debtor.[63] As a general rule, however, courts have not found that votes were cast in bad faith when the voting creditor simply sought to protect its own interest. For example, courts have refused to designate a creditor's vote pursuant to § 1126(e) when the creditor acquired claims to protect other claims already held by that creditor,[64] when a party in interest acquired a claim against the debtor to permit it to propose its own plan of reorganization that would preserve its management agreement with the debtor,[65] or when a creditor acquired a secured claim and then voted to reject the plan.[66]

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[59] In Re MacLeod Co., Inc., 63 B.R. 654 (Bankr. S.D. Ohio 1986).

[60] In Re Featherworks Corp., 36 B.R. 460 (E.D.N.Y. 1984).

[61] In Re Allegheny Int'l, Inc., 118 B.R. 282 (Bankr. W.D. Pa. 1990).

[62] In Re Applegate Property, Ltd., 133 B.R. 827 (Bankr. W.D. Tex. 1991).

[63] Zenter GBV Fund IV v. Vesper, 19 Fed. App'x 238 (6th Cir. 2001).

[64] Figter Ltd. v. Teachers Ins. and Annuity Ass'n of Am. (In re Figter Ltd.), 118 F.3d 635 (9th Cir. 1997); In Re Gilbert, 104 B.R. 206 (Bankr. W.D. Mo. 1989).

[65] In Re First Humanics Corp., 124 B.R. 87 (Bankr. W.D. Mo. 1991).

[66] In Re Marin Town Center, 142 B.R. 374 (N.D. Cal. 1992).

There has been a significant amount of litigation concerning whether a plan proponent that acquires claims to obtain confirmation of its own plan or to block confirmation of a competing claim has cast its ballot in "good faith." The cases are unanimous that good-faith voting does not demand "selfless disinterest."[67] The Supreme Court has stated that the purpose of imposing a good-faith standard on plan voting is to prevent the use of "obstructive tactics and hold up techniques" to procure an unfair advantage over other creditors in the confirmation process.[68] As stated in the seminal case of *Allegheny International*:

> <EXT>The mere fact that a purchase of creditors' interests is for . . . securing the approval or rejection of a plan does not of itself amount to "bad faith[,]" [w]hen that purchase is in aid of an interest other than an interest of a creditor, such purchases may amount to bad faith . . . [a]nd certainly there is "bad faith" when those purchases result in discrimination in favor of creditors selling their interests.[69]</EXT>

The courts have been more likely to disqualify a creditor from voting on a plan if that creditor acquired its claim after the commencement of the bankruptcy case. For example, in *Allegheny International* Japonica Partners purchased a significant number of claims against the debtor's estate during the voting period on the debtor's plan, and thereby obtained a clear blocking position that made confirmation of the plan difficult, if not impossible. Japonica also filed its own competing plan at the eleventh hour. Japonica's plan was significantly less favorable to most creditors than the plan that had been proposed by the debtor. In order to overcome the risk that the court might confirm the debtor's plan, Japonica purchased enough claims to defeat the debtor's plan and thereby attempted to force the court to confirm its plan, which was designed to give Japonica control over the debtor.

The debtor then filed a motion requesting that the court disallow Japonica's votes against the debtor's plan as being cast in bad faith. The court subsequently disallowed Japonica's votes, finding that they had been cast in bad faith because Japonica's purpose in buying the claims was not to further its own economic interest as a creditor but to gain control of the debtor. This finding, the court concluded, was evidenced by the fact that Japonica did not purchase its claims until after the debtor's plan had been proposed and Japonica had filed its own plan and Japonica had paid more for certain claims than its plan proposed to distribute to the holders of those claims.

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[67] See, e.g., In re Federal Support Co., 859 F.2d 17, 19 (4th Cir. 1988); In re Sunflower Racing, Inc., 219 B.R. 587 (Bankr. D. Kan. 1998); Three Flint Hill Ltd. Partnership v. Prudential Ins. Co. (In re Three Flint Hill Ltd. Partnership), 213 B.R. 292 (D. Md. 1997); In re Holly Knoll Partnership, 167 B.R. 381, 385 (Bankr. E.D. Pa. 1994); In re Applegate Property, Ltd., 133 B.R. 827, 834 (Bankr. E.D. Tex. 1991).

[68] See Young v. Higbee Co., 324 U.S. 204, 210-11 (1945) (discussion of § 203 of chapter X of the Act, the predecessor statute to § 1126(e)).

[69] In re Allegheny Int'l, Inc., 118 B.R. 282, 289 (Bankr. W.D. Pa. 1990) (quoting In re P-R Holding Corp., 147 F.2d 895, 897 (2nd Cir. 1945)). See also Applegate Property, 133 B.R. at 834 and Gilbert, 104 B.R. at 216 (both quoting this language with approval).

In *Applegate*,[70] another case involving acquisition of claims in a competing plan context, the bankruptcy court found that claims cast against a competing plan by an affiliate of the debtor had not been cast in good faith:

> <EXT>The purchasing of claims by an affiliate or insider of the Debtor for the sole or principal purpose of blocking a competitor from purchasing such claims is an obstructionist tactic done in contemplation of gaining an unfair advantage over other creditors. Such conduct cannot, as a matter of law, be in good faith. . . . This Court is unable to ascertain any independent, legitimate interest which would justify the purchase of these claims by [the debtor's affiliate] than to obstruct the competing plan proponent. . . . The sole purpose was to ensure the confirmability of their own plan, partly by locking in an affirming impaired class (though that effort founded on § 1129(a)(10) as discussed earlier in this decision), and partly by blocking an acceptance by that same impaired class in the [competing plan]. That purpose will not withstand the "good faith hurdle imposed by § 1126(e)."</EXT>

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Courts have not imposed a per se rule disallowing votes by creditors acquiring claims during the course of the bankruptcy case. For example, in *In re Figter Ltd.*,[71] Teachers Insurance, the only secured creditor of the debtor, desired to ensure confirmation of its proposed plan of reorganization rather than risk confirmation of the competing plan proposed by the debtor. In furtherance of this goal, Teachers purchased 21 of the 34 claims in the only impaired class under the debtor's proposed plan, thus making it impossible for the debtor to obtain a consenting class of impaired claims. In rejecting the debtor's argument that Teachers' rejections of the debtor's plan were not "in good faith," the court reasoned that "if Teachers acted out of enlightened self-interest, it is not to be condemned simply because it frustrated Figter's desires. That is true, even if Teachers purchased Class 3 claims for the very purpose of blocking confirmation of Figter's proposed plan."[72]

Likewise in *In re Gilbert*, [73] a prebankruptcy general unsecured creditor, who was also a business associate of the debtor, purchased additional claims against the debtor's estate after the commencement of the bankruptcy case for the purpose of ensuring that the debtor's plan was confirmed and the creditor, therefore, received its proposed plan distribution, which was greater than what he would have received in a chapter 7 liquidation. In concluding that the creditor's claim had been cast in good faith, the court reasoned that the creditor had cast its vote in furtherance of its interest as a creditor, rather than for some other purpose.

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[70] In re Applegate Property, Ltd., 133 B.R. 827, 835 (Bankr. E.D. Tex. 1991).

[71] 118 F.3d 635 (9th Cir. 1997); see also Park Plaza Assoc. Ltd. Partnership v. Connecticut Gen. Life Ins. Co., (In re 255 Park Plaza Assoc. Ltd. Partnership), 100 F.3d 1214, 1219 (6th Cir. 1996) ("[w]hile a plan-proponent's purchase of votes may shed light on that proponent's motive, whether bad faith exists can only be decided after an analysis of the facts of each case").

[72] 118 F.3d at 639.

[73] 104 B.R. 206 (Bankr. W.D. Mo. 1989).

In *In re Marin Town Center*,[74] the bankruptcy court disallowed the vote of an entity that acquired a secured claim and a number of smaller unsecured claims against the debtor's estate on the basis that it would be unfair to permit this entity to dilute the votes of the other unsecured creditors. The district court reversed the bankruptcy court's decision, stating:

<EXT>A vote cannot be said to have been cast in bad faith simply because it was voted for the purpose of blocking confirmation of a reorganization plan. In fact, rejection of a plan by a party largely interested in the Debtor before his acquisition of controlling rights, who withholds consent to a plan primarily because he believes its consummation will be more injurious to his investment in the debtor than liquidation, meets the standard of good faith.[75]</EXT>Similarly, in *In re First Humanics Corp.*,[76] the court found that HCC, a party in interest that acquired a claim against the debtor's estate postbankruptcy, had not voted the claim in bad faith. There, the debtor was a nursing home. Under the debtor's proposed plan of reorganization, the debtor was to terminate its management agreement with HCC. After the proposal of the debtor's plan of reorganization, HCC acquired three prepetition unsecured claims with a face value of $1,187.77, as well as some bonds issued by the debtor. The purpose in acquiring the claims was to gain standing to propose its own plan of reorganization, pursuant to which its management agreement with the debtor would be continued.

The debtor objected to HCC's standing to file a plan of reorganization, as well as the good faith of HCC's vote. The court found that, as a creditor, HCC had standing to file its own plan of reorganization. The court also concluded that HCC's vote should not be disqualified as having been cast in bad faith. In so holding, the court distinguished the facts from those in *Allegheny* on the basis that HCC had not purchased the claims with the intent to block, impede, or in any way manipulate confirmation of the debtor's plan. HCC's purchase of the claims and bonds was done in good faith and not by any means prohibited by law, and HCC's proposed plan might be more favorable to other creditors than the plan proposed by the debtor.

¶ 30.08 PLAN CONFIRMATION: COUNTING MULTIPLE CLAIMS FILED BY THE SAME CREDITOR

An entity that acquires multiple claims against a bankruptcy estate risks dilution of its voting power depending on how votes are counted, even if the creditor's ballots are not designated as being cast in bad faith. Section 1126(c) of the Code provides:

> <BQ>(c) A class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class . . .</BQ>

Because § 1126(c) requires that claims be counted as well as weighed in determining whether an impaired class has accepted or rejected a plan of reorganization, an entity that has acquired multiple claims in a single class risks dilution of its voting power if the entity is counted

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[74] 142 B.R. 374 (N.D. Cal. 1992).

[75] 142 B.R. at 379 (quoting In re Pine Hill Collieries Co., 46 F. Supp. 669, 671 (E.D. Pa. 1942)).

[76] 124 B.R. 87 (Bankr. W.D. Mo. 1991).

as having only a single vote, rather than a number of votes equal to the number of claims held. [77] If a creditor holding multiple claims in a single class is counted as having only a single vote, the creditor cannot single-handedly assure acceptance of that plan unless it acquires each claim in that class. However, if a creditor is given a vote for each claim it holds in a particular class, that creditor need only acquire more than one-half in number of claims in that class of claims to assure that class's rejection of a plan.

Several decisions addressing this issue have found that, absent designation pursuant to § 1126(e), a creditor is entitled to a vote for each claim held.[78]

In *In re Figter, Ltd.*, Teachers Insurance, the only secured creditor of the debtor, purchased 21 of the 34 claims in the only impaired class under the debtor's proposed plan of reorganization. Teachers then voted each of these claims against confirmation of the debtor's plan. In holding that Teachers had the right to vote each of these claims separately, the Court of Appeals for the Ninth Circuit reasoned as follows:

> <EXT>It would not make much sense to require a vote by creditors who held "more than one-half in number of the allowed claims" while at the same time limiting a creditor who held two or more of those claims to only one vote. If allowed claims are to be counted, they must be counted regardless of whose hands they happen to be in.[79]</EXT>

In *In re Concord Square Apartments of Wood County, Ltd.*, Ottawa, a secured creditor of the debtor, purchased certain unsecured claims against the debtor's estate. In the context of a motion for relief from stay filed by Ottawa, the bankruptcy court was asked to determine the number of votes Ottawa could cast for or against a plan of reorganization. In holding that Ottawa could file a separate vote for each claim it held, the court reasoned:

> <EXT>The Court finds that a purchaser of claims is entitled to a vote for each separate claim it holds. This conclusion is supported by 11 U.S.C. § 1126(c), which states "A class of claims has accepted a plan if such plan has been accepted by creditors,. . . that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors . . . that have accepted or rejected such plan. The language distinguishes between claim-holders and claims." The formula contained in § 1126(c) speaks in terms of the number of claims, not the number of creditors, that actually vote for or against the plan. Thus, a creditor such as Ottawa, which holds multiple claims, has a voting right for each claim it holds.[80]</EXT>

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[77] The risk of dilution is not present for entities holding interests rather than claims as § 1126(d) of the Code simply requires that a class of interests has accepted a plan if accepted by holders of such interests that hold at least two-thirds in amount of the allowed interests of such class that have accepted or rejected such plan.

[78] See Figter Ltd. v. Teachers Ins. and Annuity Ass'n of Am. (In re Figter Ltd.), 118 F.3d 635 (9th Cir. 1997); In re Lehigh Valley Professional Sports Club, Inc., No. 00-11296DWS, 2001 WL 1188246 (Bankr. E.D. Pa. Sept. 7, 2001); In re Concord Square Apts. of Wood County, Ltd., 174 B.R. 71, 74 (Bankr. S.D. Ohio 1994); In re Gilbert, 104 B.R. 206, 211 (Bankr. W.D. Mo. 1989).

[79] 118 F.3d at 640.

[80] 174 B.R. at 74 (quoting Gilbert, 104 B.R. at 210).

Likewise, in *In re Gilbert*, Stulz, a prebankruptcy general unsecured creditor of the debtor who was also a business associate of the debtor, purchased additional claims against the debtor's estate after the commencement of the bankruptcy case for the purpose of ensuring that the debtor's plan was confirmed. The *Gilbert* court concluded that Stulz was entitled to one vote for each claim it held:

> <EXT>The formula contained in § 1126(c) speaks in terms of the number of claims, not the number of creditors, that actually vote for or against the plan. The separateness of Stulz' two claims and his entitlement to two votes is not the result of any legal fiction or product of some form of bifurcation as the United States suggests. Each claim arose out of a separate transaction, evidencing separate obligations for which separate proofs of claim were filed. . . . Stulz acquired two distinct rights to payment through two separate and unrelated arms' length transactions. Further, Debtors' Plan contemplated two separate claims before Stulz paid consideration and took assignment of MTI's unsecured claim. Stulz is entitled to one vote for each of his unsecured Class X claims.[81]</EXT>

Although the *Figter, Concord Square*, and *Gilbert* courts resolved the vote- counting issue in such a way as to give effect to the plain wording of § 1126(c), they left a number of issues unresolved. For example, suppose a creditor has acquired multiple claims from a single creditor or has acquired the claims before the filing of proofs of claim and proceeds to file only a single proof of claim on account of its multiple "rights to payment." This issue could also arise in connection with a bondholder who purchases multiple bonds issued by a single debtor or even an ordinary trade creditor that sells goods to the debtor over a period of time pursuant to multiple invoices. This area is, therefore, ripe for litigation even in contexts in which a creditor holds what would typically be considered to encompass a single claim.[82]

¶ 30.09 INSIDER STATUS OF ASSIGNED CLAIMS

An issue related to the counting of claims is whether a claim transferred from an insider to a noninsider or from a noninsider to an insider either loses or retains its status as an insider claim.[83] Whether a claim is deemed to be an insider claim is important in the context of confirmation of a plan of reorganization. Section 1129(a)(10) of the Code requires that "[i]f a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, *determined without including any acceptance of the plan by any insider*."

Because § 1129(a)(10) speaks in terms of a holder of a claim rather than the claim itself, each court to consider the issue has concluded that a transferred claim does not retain or lose its insider status upon transfer. For example, in *In re Concord Square Apartments of Wood County, Ltd.*, [84] a secured creditor moved for relief from stay to foreclose on its collateral. The sole basis

[81] 104 BR. at 211 (citations and footnote omitted).

[82] The practice in many courts continues to be to count the number of creditors rather than the number of claims accepting or rejecting a plan. This is likely a carry-over from chapter XI of the Act, which spoke in terms of the number of creditors rather than the number of claims accepting or rejecting a class.

[83] The term "insider" is defined in § 101(31) of the Code.

[84] 174 B.R. 71 (Bankr. S.D. Ohio 1994).

asserted by the secured creditor for the granting of stay relief was the debtor's inability to meet the confirmation requirement of § 1129(a)(10) that at least one class of impaired claims accept the plan, without including any acceptance of the plan by an insider. In order to defeat the stay relief motion, an affiliate of the debtor that held several general unsecured claims against the debtor proposed to transfer those claims to a noninsider entity, thereby creating the possibility that a class of noninsider impaired claims might accept the debtor's plan of reorganization.

The bankruptcy court held that the "insider" status of a claimant does not, as a matter of law, transfer with a claim upon the sale or assignment of that claim to a third party."[85] Although the court acknowledged that an assignment of claim generally subjects the transferee to any defects in the claim, the court reasoned that § 1129(a)(10) distinguishes between the status of a claim and the status of the claim holder. The court also noted that the status of a third-party transferee as an insider is a question of fact to be determined after the transfer is effected.

In *In re Holly Knoll Partnership*,[86] the court likewise held that when a municipality's tax claim against the debtor's estate was assigned to an insider before the plan voting deadline, that claim must be considered an insider claim that could not be counted for purposes of § 1129(a)(10)'s determination of whether an impaired class of claims had voted to accept the plan.[87]

¶ 30.10 ACQUIRING A CLAIM TO OBTAIN STANDING

An entity may wish to acquire claims for the purpose of gaining standing in the case to (1) file a plan of reorganization; (2) take a Rule 2004 examination of the debtor, its officers, or creditors; (3) object to a claim; (4) confer status as a "party in interest" and thereby obtain standing to appear and be heard on any one of a number of issues; or (5) simply entitle it to obtain notice of various actions in the debtor's case.

Section 1121(c) of the Code provides that with certain limitations any party in interest, including a creditor or equity security holder, may file a plan of reorganization. Section 101(10) of the Code defines "creditor" to include an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor." Accordingly, the plain meaning of the Code dictates that a creditor be authorized to file a plan of reorganization, regardless of when or how the creditor acquired its claim.[88]

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[85] 174 B.R. at 75.

[86] 167 B.R. 381, 385-86 (Bankr. E.D. Pa. 1994).

[87] See also In re Applegate Property, Ltd., 133 B.R. 827, 833 (Bankr. W.D. Tex. 1991) (same).

[88] See, e.g., In re Rook Broadcasting of Idaho, Inc., 154 B.R. 970, 972-74 (Bankr. D. Idaho 1993) (holding that entity that purchased claim had standing to file plan of reorganization); In re First Humanics Corp., 124 B.R. 87 (Bankr. W.D. Mo. 1991) (permitting party who purchased claims against the debtor postpetition for sole purpose of gaining standing to file plan of reorganization had standing to file plan); In re Allegheny Int'l, Inc., 118 B.R. 282 (Bankr. W.D. Pa. 1990) (same); In re American 3001 Telecommunications, Inc., 79 B.R. 271, 272 (Bankr. N.D. Tex. 1987) (creditor had purchased unsecured claim in the amount of $33.60 gained standing to file plan of reorganization).

Section 1109(b) of the Code provides that a party in interest, including a creditor or equity security holder, "may raise and may appear and be heard on any issue in a case under this chapter." Similarly, Rule 2002 requires notice of certain acts to be given to all creditors, and Rule 2004 authorizes any party in interest to file a motion for authorization to conduct an examination of "any entity" on certain subjects. An entity acquiring claims against a debtor's estate, therefore, gains the right to obtain notice of certain actions in the bankruptcy case, conduct examinations pursuant to Rule 2004, object to stay relief, file objections to claims, object to a sale of the debtor's assets or confirmation of its plan of reorganization, request the appointment of an examiner or trustee, or appear and be heard on any matter arising during the course of the bankruptcy case.

¶ 30.11 ACQUIRING CONTROL BY BUYING STOCK

A method of obtaining control over a chapter 11 debtor is to buy a controlling interest in one or more classes of the debtor's stock. Once in control of the debtor's stock, the shareholders may elect a new slate of directors and thereby take control of the debtor. Under certain circumstances, acquisition of control of the debtor's stock may be an effective mechanism to displace management or to control the timing or contents of a plan of reorganization.

As a general rule, shareholders of a corporation undergoing chapter 11 reorganization retain their right to hold shareholder meetings and elect directors.[89] An exception to this general rule is that a bankruptcy court may enjoin the shareholders' right to elect a new board upon a showing of "clear abuse."[90] Likewise, shareholders may not be authorized to hold a shareholders' meeting if the corporation is insolvent. As stated in *Manville Corp. v. Equity Security Holders Committee (In re Johns-Manville Corp.)*, "[w]e note that if Manville were determined to be insolvent, so that the shareholder's lack equity in the corporation, denial of the right to call a meeting would likely be proper, because the shareholders would no longer be real parties in interest."[91] Thus, if the debtor is insolvent, acquisition of a debtor's stock may not be an effective acquisition strategy.

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¶ 30.12 SECURITIES LAW CONSIDERATIONS

An entity acquiring claims against or interests in a chapter 11 debtor should consider whether it is bound by nonbankruptcy federal law governing the acquisition of claims against or interests in debtors. These laws include the antifraud provisions of the Securities Act of 1933, the Securities and Exchange Act of 1934, and Rule l0b-5 promulgated thereunder.[92]

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89 See Manville Corp. v. Equity Security Holders Committee (In re Johns-Manville Corp.), 801 F.2d 60, 64 (2d Cir. 1986) (referring to the "well-settled rule that the right to compel a shareholders' meeting for the purpose of electing a new board subsists during reorganization proceedings").

90 801 F.2d at 64.

91 801 F.2d at 65, n. 6.

92 The Securities Act of 1933, 15 U.S.C. §§ 77A—77AA (1994), the Securities Exchange Act of 1934, 15 U.S.C. §§ 78A—7811 (1994).

The publicly traded debt and equity securities of a bankrupt entity remain subject to the Securities Act of 1933, the Securities Exchange Act of 1934, the rules promulgated thereunder, and all other federal securities laws. Section l0B of the Exchange Act and Rule l0b-5 require an insider with material nonpublic information to disclose that information before trading in the corporation's securities.[93]

The antifraud provisions of the Exchange Act are intended to protect purchasers of "securities" by providing them with complete and accurate disclosure to help them determine the value of the securities being purchased. Because the antifraud provisions apply only to "securities," it must first be determined whether the claims or interests being traded are, in fact, securities. Section 3(a)(10) of the Exchange Act defines a security as follows:

> <BQ>(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt of, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency, or any note, draft, bill of exchange or bankers' acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.[94]</BQ>

In *Reeves v. Ernst & Young*,[95] the Supreme Court adopted the "family resemblance" test to determine whether a note is a security. Under the family resemblance test, a court must determine whether a note more closely resembles an investment or an ordinary commercial transaction. Under this test, there is a presumption that a note is a security because "the Securities Acts define 'security' to include 'any note.'" If a note "bears a strong family resemblance to a commercial note rather than an investment note, then it is not a security."[96]

In determining whether a note is a security, the Court adopted a four-factor test:

1. The purpose of issuance of the note
2. Whether there is "speculation or investment"
3. "The reasonable expectation of the investing public"

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[93] See, e.g., In re Federated Dep't Stores, Inc., 1991 WL 79143 (Bankr. S.D. Ohio 1991) (imposing "Chinese wall" for brokerage firm that was member of official creditors' committee and wished to continue trading in the debtor's securities).

[94] The definition of "security" in § 1(1) of the Securities Act of 1933 is almost identical to the definition of "security" in the Exchange Act, except the Securities Act definition also includes "evidence of indebtedness."

[95] 494 U.S. 56 (1990).

[96] 494 U.S. at 67.

4. "Whether there is some factor such as the existence of another regulatory scheme [that] significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary."

There are no reported decisions dealing squarely with the issue whether a claim against a chapter 11 debtor is a security. However, in *In re Allegheny International*,[97] the bankruptcy court was concerned about the trade creditors' relatively minimal amount of knowledge and information concerning the bankruptcy case and process, as well as the solicitation materials being distributed by an entity seeking to acquire a substantial portion of the claims against the debtors. In seeking to level the playing field for all creditors, the bankruptcy court stated that "*[b]y the filing of a bankruptcy case, a market in non-publicly traded securities is created.*"[98] Although the bankruptcy court referred to claims against the debtor's estate as "securities," the court did not seek to apply the securities laws to the trading of these claims.

In *In re Revere Copper & Brass, Inc.*,[99] the bankruptcy court had a similar concern about the lack of knowledge of creditors being asked to sell their claims by the same creditor that was purchasing claims in *Allegheny*. The *Revere* court approached the issue as one of disclosure pursuant to § 1125(a) of the Code. The *Revere* court did not refer to the trade claims as "securities."[100]

However, applying the family resemblance test enumerated in *Reeves* raises a possibility that a court could find certain claims to be securities, regardless of whether the claims were securities at the time they were initially acquired. For example, an ordinary general unsecured trade claim would not likely be found to be a security due to the commercial nature of the transaction giving rise to the claim. However, once that trade claim is converted into a bankruptcy claim and aggregated with other similar claims, a court might find that a purchaser of the claim is motivated by investment rather than commerce, thereby tending to make the claim resemble a security.[101] In a large chapter 11 case, there may also be a "common trading for speculation or investment" in unsecured trade claims, thereby giving trade claims another attribute of a security. Furthermore, depending on the stage of the chapter 11 case, there may be substantial speculation that an ordinary trade claim will be converted into a debt or equity security.

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[97] 100 B.R. 241 (Bankr. W.D. Pa. 1988).

[98] 100 B.R. at 243 (emphasis added).

[99] 58 B.R. 1 (Bankr. S.D.N.Y. 1985).

[100] See also In re Pleasant Hill Partners, 163 B.R. 388, 392 (Bankr. N.D. Ga. 1994) (noting lack of need for additional disclosure by entity that purchased all unsecured claims against debtor's estate except a single $24 claim, and noting that the instant case does not involve the purchase and sale of "securities"); In re Odd Lot Trading, 115 B.R. 97, 100 (Bankr. N.D. Ohio 1990) (distinguishing trading in claims from trading in "stocks and bonds, which . . . are still actively being traded subject to securities laws" and stating that "[i]t is apparent that Congress did not enact into the Code any statute governing the trading of claims").

[101] See, e.g., Los Angeles Trust Deed and Mortgage Exchange v. SEC, 285 F.2d 162 (9th Cir. 1960) (holding that when a home mortgage is resold on the secondary market, it becomes a "security"), cert. denied, 366 U.S. 919 (1961).

Nevertheless, it is clear that the securities laws were written to protect purchasers rather than sellers of securities. Except in a rare case of a fiduciary to a chapter 11 debtor, it is the seller rather than the purchaser of a trade claim who lacks information and thus needs protection. The securities laws were neither written to protect sellers of securities nor to apply to chapter 11 cases. It would, therefore, be potentially dangerous for a court to apply the securities laws to claims against a chapter 11 debtor.

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