INTRODUCTION: ABI GUIDE TO TRADING CLAIMS IN BANKRUPTCY
ABI COMMITTEE ON PUBLIC COMPANIES AND TRADING CLAIMS

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In this issue, The American Bankruptcy Institute Law Review begins a periodic publication of the unpublished chapters of the ABI Guide to Trading Claims in Bankruptcy. This project has been in the works for a number of years, and upon completion, subsequent chapters will begin to appear in this publication as appropriate.

Why is a guide to trading claims an appropriate subject for this publication? Perhaps nothing has changed the face of bankruptcy in the last decade as much as the new found liquidity in claims. Under the old form of bankruptcy, creditors could not expect a distribution, if any, on account of their claims until the end of the case. Indeed, a debtor's ability to delay the end of a case was often instrumental in reducing the size of creditors' dividends.

Enter claims trading. Now, in almost every size case, there is an opportunity for creditors to exit the bankruptcy in exchange for a payment from a distressed debt trader who bets that its ultimate distribution will exceed the purchase price. The exiting creditor gets certainty and immediate payment. The purchaser gets an investment. For most purchasers, the investment is simply to receive a return on its investment that exceeds its cost of acquisition by a profitable margin. For others, the payoff may be to obtain additional leverage in connection with its existing position in the case or to put it in a position to acquire the company. In any event, the purchaser has made an analysis of the worth of its investment and expects a reasonable return. This creditor is very different from the trade creditor who wants to keep its customer in business or the bank officer who just wants to make sure that the distribution exceeds the written down value of the loan.

Courts, debtors, and regulators are still trying to figure out how to react to this new breed of creditor that has paid less than face value for its claim, does not always care if the business survives, and can obtain confidential information while still wanting to trade in the debt of the debtor. In this issue, we confront three questions relevant to this area.

First, in an article entitled *Are Bankruptcy Claims Subject to the Federal Securities Laws?* by the Honorable Robert D. Drain, Bankruptcy Judge for the United States Bankruptcy Court for the Southern District of New York and Elizabeth J. Schwartz, we discuss whether the securities laws govern the trading of claims. While we conclude they do not, this is an evolving area and the answer is subject to change. The federal law generally regulating third-party purchases of securities, commonly known as the Williams Act, is only applicable to equity securities and has not been extended to debt. The trading of bank debt has become

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increasingly standardized through the use of the LSTA form but has not yet reached the level of uniformity required for regulation. Trade creditors receive uniform solicitations from professional debt traders. All of this activity occurs without securities law regulation but subject to the laws against fraud.

Second, in an article by Geoffrey Groshong, a partner at the Seattle based law firm of Miller Nash LLP, and committee co-chair, we review the debtor's reaction to this trading in *Trading Claims in Bankruptcy: Debtor Issues*. Theoretically, the only means to regulate the trading of claims in bankruptcy is contained in Federal Rule of Bankruptcy Procedure 3001, which is only designed to assure that the buyer and seller agree that the claim has been sold and that the debtor knows who to pay. Nonetheless, debtors have had some success in controlling the trading of their claims by utilizing the threat that a change in the composition of its creditor body can jeopardize the value of its net operating loss. Moreover, despite law that clearly provides a creditor may vote in its own interest for or against a plan of reorganization, debtors continue to seek designation of votes of creditors who attempt to acquire them or use the acquisition of claims to otherwise control the process.

Finally, in this issue, Guy Moss of the Boston office of Bingham McCutchen, discusses the issues facing the purchasers of consumer debt in his article entitled *The Risks of Purchasing and Collecting Consumer Debt*. This market has its own unique issues that are further complicated by the emerging market in discharged debt and chapter 13 payment streams. Courts have faced, or will be required to face, attempts to solicit "voluntary" repayment of discharged debt, the use of reaffirmation agreements to accomplish that goal and even the securitization of this pool of assets. Existing law provides some guidance in confronting these issues but it remains to be seen whether consumer debtors will have any control over who becomes their creditors and whether purchasers of consumer debt will be able to steer clear of the stringent rules applied to consumer debt both in and out of bankruptcy.

In future issues, the committee hopes to publish its chapters on the trading of bank debt, trade debt, public debt, and sovereign debt. We will also discuss the continuing vitality of the champerty doctrine which once prevented the acquisition of debt for the purpose of commencing litigation. An annotation of the standard LSTA form is in the works, as well as a study of the ability of distressed traders to sit on creditors' committees.

We hope you find the current articles to be of use and we will continue to move toward the ultimate publication of the complete guide.