TRADING CLAIMS IN BANKRUPTCY: DEBTOR ISSUES

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INTRODUCTION

This chapter discusses various claims-trading issues from the perspective of the debtor-in-possession. The subjects addressed are: (1) motions pursuant to 11 U.S.C. § 362 and § 105 to establish notification and approval procedures; (2) motions to designate transferred claims pursuant to 11 U.S.C. § 1126(e); (3) motions to equitably subordinate transferred claims pursuant to 11 U.S.C. § 510(c); (4) lockup agreements; (5) the 1991 amendment of Rule 3001(e)(2) of the Federal Rules of Bankruptcy Procedure; and (6) enforcement of claims-trading restrictions in pre-petition credit agreements.

I. MOTIONS FOR PROCEDURAL PROTECTION UNDER 11 U.S.C. § 362 AND § 105

The chapter 11 debtor may want to obtain procedural protections with respect to claims-trading. For instance, post-petition claims-trading of a certain volume might cause the debtor to lose a tax benefit net operating-loss ("NOL") which would otherwise be available to the debtor. Claimholders and claims traders may object to the imposition of such procedures on the basis that the procedures chill trading and decrease ability of claimholders to sell their claims for fair value. The seminal case is *In re Prudential Lines, Inc.*[1] The *Prudential* court found that the right to carry forward an NOL was property of the estate under 11 U.S.C. § 541(a)(1)[2] and 11 U.S.C. § 362(a)(3)[3] and that the taking of a worthless stock deduction by the debtor's sole shareholder that would deprive the debtor of the use of its NOL was an exercise of control over the property of the debtor under 11 U.S.C. § 362(a)(3).[4]

In *In re Phar-Mor, Inc.*,[5] the court found that sales of the debtor's stock could limit the debtor's ability to take an NOL, which would severely reduce the debtor's

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[1] 107 B.R. 832 (Bankr. S.D.N.Y. 1989).

[2] *See id.* at 836 (stating 11 U.S.C. § 541(a)(1) includes as estate property "all legal or equitable interests of the debtor in property as of the commencement of the case," and concluding Congress intended carry forward NOLs to come into estates through 11 U.S.C. § 541(a)(1)); *see also* Gibson v. U.S. (*In re* Russell), 927 F.2d 413, 417–18 (8th Cir. 1991) (finding debtor's decision to carry forward NOLs included estate property); *In re* Phar-Mor, Inc., 152 B.R. 924, 926 (Bankr. N.D. Ohio 1993) (concluding debtors may elect to include NOLs as estate property under 11 U.S.C. § 541(a)(1)).

[3] *See In re Prudential Lines, Inc.*, 107 B.R. at 835–36 ("[T]he definition of property under 362(a)(3) is governed by § 541 where Congress sought to define the bankruptcy estate's property.").

[4] *See id.* at 841–42 (quoting 11 U.S.C. § 382(a)(3), filing petitions stays "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate," and finding control exists where debtors dismember estates in violation of 11 U.S.C. § 362(a)(3)); *see also In re Phar-Mor, Inc.*, 152 B.R. at 927 (sale of debtor's stock within two months of court's decision constitutes control over NOLs as estate property).

[5] 152 B.R. 924 (Bankr. N.D. Ohio 1993).

cash flow.[6] The court found that NOLs were "property of the estate under the broad language of 11 U.S.C. § 541(a)(1) as a power or right which may be exercised by a debtor for its own benefit."[7] The court prohibited sale of the debtor's stock for two months under 11 U.S.C. § 362(a)(3), holding that such sales would be an exercise of control over the NOL, which was property of the estate.[8]

In *First Merchants Acceptance Corp.*,[9] the debtor filed a "Motion for Order under § 105 and § 362 of the Bankruptcy Code Establishing Notification and Approval Procedures for the Sale or Other Transfer of Certain General Unsecured Claims and Equity Interests."[10] The debtor wanted to receive notice of any proposed transfers of certain claims and an opportunity to object to any trades that would jeopardize its NOL.[11] The debtor cited, among other cases, *In re Ames Department Stores, Inc.*,[12] and *In re Pan Am Corp.*[13] The court entered its final order establishing notification procedures providing that the debtor would have 30 days to object to a proposed transfer after notice, in which event the proposed transfer would not become effective until approved by a final nonappealable order of the court.[14]

The bankruptcy court's equitable power to regulate claims-trading has been predicated on *American United Mutual Life Insurance Co. v. City of Avon Park*.[15] In *American United*, Justice Douglas, writing for the U.S. Supreme Court in a case decided under the Bankruptcy Act, wrote that the bankruptcy court was a court of equity that could "in the exercise of the jurisdiction committed to it grant or deny relief upon performance of a condition which will safeguard the public interest."[16]

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[6] *Id.* at 926.

> 26 U.S.C. § 172(a) permits the use of NOLs to offset future income, subject to certain limitations. One such limitation is 26 U.S.C. § 382(a), which limits the NOL deduction when a corporation experiences a change of ownership. The statute provides that a change of ownership occurs where the percentage of stock owned by one or more 5% shareholders increases by more than 50% over the lowest percentage owned by such shareholders at any time during a three-year moving test period.

id. at 925.

[7] *Id.* at 926.

[8] *See id.* at 927 (explaining NOLs are protected because as assets they help debtors reorganize, therefore benefiting creditors).

[9] No. 97-1500, 1998 Bankr. LEXIS 1816 (Bankr. D. Del. Jan. 20, 1998).

[10] *Id.* at *1– *2.

[11] *See id.* at *3–*5.

[12] No. 90 B 11233 (Bankr. S.D.N.Y. July 31, 1991). In opposition to the relief sought by the debtor in *In re Ames Dep't Stores, Inc.*, Solvation, Inc., argued that the proposed notification procedures were an unwarranted intrusion on the free trading of claims and that claims-trading is an economic activity that does not implicate section 362. Objection of Solvation, Inc. D/B/A Smith Mgmt. Co. & Smith Factors, Inc. to the Motion of the Ames Group for an Order Under sections 105 and 362 Establishing Notification and Approval Procedures for Trading in Claims Against the Ames Group, *In re* Ames Dep't Stores, Inc., No. 90 B 11233 (Bankr. S.D.N.Y. July 31, 1991).

[13] No. 91 B 10080 (Bankr. S.D.N.Y. 1991).

[14] *In re First Merch. Acceptance Corp.*, 1998 Bankr. LEXIS at *4.

[15] 311 U.S. 138 (1940).

[16] *Id.* at 145 (quoting SEC v. U.S. Realty & Improvement Co., 310 U.S. 434, 455 (1940)).

More recently, the bankruptcy court's power under section 105 was held to be limited to acts that implement or further a specific provision of the Bankruptcy Code.[17] In *First Merchants Acceptance* and *Phar-Mor*, the courts found that the debtor's NOL was estate property and was protected by the automatic stay of section 362.[18] This seems to satisfy the *Ahlers* test.

The debtors in *In re Service Merchandise Co.*,[19] filed a motion for an order pursuant to sections 362 and 105 establishing notification and hearing procedures for trading in claims against the debtor.[20] The debtors' motion sought the entry of an order under which transferors, prior to effecting claims transfers, would be required to either (1) provide at least ten days notice to the debtors of the proposed claims transfer or (2) file and serve a sworn certificate attesting that the transfer was an "excluded transfer."[21] Excluded transfers were those transfers that in aggregate amount would not trigger the loss of the debtor's NOLs.[22] To claim "excluded transfer" status, the holder would be required to certify that the sum of the aggregate principal amount of the transfer current claims and the aggregate principal amount of the transfer-acquired claims was less than $20 million.[23] With respect to proposed transfers subject to the ten-day notice provision, the debtors sought the right to a hearing (on not less than 20 days additional notice) so they could object to any proposed trade that might jeopardize their NOLs and a temporary delay of any

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[17] *See* Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988) (discussing power of bankruptcy court to be limited to bankruptcy code provisions); Wolff v. Fesco Plastics Corp. (*In re* Fesco Plastics Corp.), 996 F.2d 152, 154 (7th Cir. 1993) (stating that court may use equitable power only in accordance with Bankruptcy Code).

[18] *See In re First Merch. Acceptance Corp.*, 1998 Bankr. LEXIS 1816, at *1–*2 (approving section 362 motion in regards to NOLs); *In re* Phar-Mor, Inc., 152 B.R. 924, 926 (Bankr. N.D. Ohio 1993) (explaining key elements of stay are existence of property of estate and enjoining of all efforts by others to obtain possession or control of property).

[19] No. 399-02649, 2000 Bankr. LEXIS 1523, at *1 (M.D. Tenn. Dec. 20, 2000).

[20] Motion Order For Debtor Pursuant To 11 U.S.C. §§ 105 and 362 and Bankruptcy Rule 3001 Establishing Notification And Hearing Procedure For Trading In Claims Against Debtors, *In re* Serv. Merchandise Co., Inc., 2000 Bankr. LEXIS 1523 (M.D. Tenn. Dec. 20, 2000) (No. 399-02649) (Clerk's No.2439) [hereinafter *In re* Serv. Merchandise Debtors' Motion]. Before filing its motion, the debtor had engaged in a very aggressive discovery program, attempting to obtain an order that would authorize it, without the need to obtain specific Rule 2004 orders, to obtain detailed discovery from creditors concerning claims-trading from a period beginning approximately 90 days pre-petition. A number of creditors objected. The debtor then filed numerous applications for 2004 orders on an individual basis.

The pleadings in *In re Service Merchandise Co*. are available through the Internet. To access these pleadings, the reader may do the following: (1) go to http://www.tnmb.uscourts.gov/; (2) click on "Database Access" in the upper left-hand corner of the screen; (3) from pull-down menu, pick "mega-cases"; (4) go to the right to the next pull-down menu, and pick "Bankruptcy"; (5) go to the right and pick 99-02649; (6) in the box to the right of the word "cover sheet" (located in the middle half of the upper part of the screen), type in the numeral 2, then click on "find"; (7) The motions catalogued by "Clerk's number" will appear in reverse chronological order. Click on the appropriate clerk's number and the motion will appear in a different screen.

[21] *Id.* at 4.

[22] *Id.* at 3–4.

[23] *Id.* at 4.

proposed transfer until (and unless) the court determined that the transfer would not adversely affect the debtors' NOLs.[24]

Although the debtors had not yet filed a proposed plan of reorganization, much less a plan of reorganization that would make use of the NOLs to shelter future income, they argued that they needed to preserve the NOLs for possible use in a future plan of reorganization.[25]

A group of noteholders, among others, filed their objection.[26] Among the arguments against the debtors' motion were the following:

(1) The motion sought an injunction when no adversary had been filed and made no attempt to satisfy the standards for injunctive relief.[27]

(2) The motion sought to bind parties - future transferees - who had not been and could not be served.[28]

(3) The debtors failed to show that it could use the NOLs.[29]

(4) The proposed procedures would chill trading and were burdensome. Transactions in publicly traded securities usually settle in three days, not ten.[30] Any objection by the debtors would probably kill any trade. The proposed restrictions on trading proposed by the debtors would negatively affect the public interest in the free operation of public securities markets.

The Contrarian Group also proposed that if the court granted the debtors' motion, it should require certain modifications to the order, including:

> The Debtors should be ordered to disclose, upon request, the Debtors' calculation of how close large creditors are to the 50% income threshold; As 5% of all unsecured claims equals more than $32 million, a creditor should have to hold at least $30 million (not the $20 million proposed by the Debtor) before being subject to

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[24] *Id.* at 4–5.

[25] *See In re* Serv. Merchandise Debtors' Motion, *supra* note 20, at 6 n.2 (arguing debtors should be allowed "to use consolidated NOL's to offset future income" although no plan of reorganization was filed); Objection To Debtors' Motion For Order Pursuant To 11 U.S.C. §§ 105 and 362 and Bankruptcy Rule 3001 Establishing Notification And Hearing Procedure For Trading In Claims Against Debtor at 2, *In re* Serv. Merchandise Co., 2000 Bankr. LEXIS 1523 (M.D. Tenn. Dec. 20, 2000) (No. 399-02649) (Clerk's No. 2537) [hereinafter *In re* Serv. Merchandise Objection to Debtors' Motion] (asserting debtors have no reorganization plan or "factual predicates" entitling them to preserve NOLs).

[26] *See In re* Serv. Merchandise Objection to Debtors' Motion, *supra* note 25, at 1 (stating noteholders Contrarian Capital Management, LLC, Touchstone Capital, LLC, and Varde Partners (the "Contrarian Group") held approximately $65 million of 9-percent senior subordinated notes and $18 million of trade claims).

[27] *Id*. at 8 n.7. The Contrarian Group sought to distinguish *Phar-Mor* and *First Merchants Acceptance*, which cast the relief granted as enforcement of the automatic stay rather than entry of an injunction. The Contrarian Group argued that *Phar-Mor* relief was limited in duration, that the *First Merchants* relief was essentially unopposed, and that it was part of a pre-pack chapter 11 plan. In contrast, the debtor in *Service Merchandise* was at least a year away from confirming a plan. *See id.*

[28] *Id*. at 2.

[29] *Id*.

[30] *Id.* at 4.

> Debtors' right to object, and the $30 million figure should be adjusted to the extent necessary to reflect either increases or decreases in claims allowed or allowable against the debtors.[31]The Debtors should be restricted from objecting until large creditor holdings surpass 45% (to give the Debtors a 5% or $32 million, margin of safety).[32]

The debtors filed their reply to objections to debtor's motion for order pursuant to 11 U.S.C. sections 105 and 362 and Bankruptcy Rule 3001 establishing notification and hearing procedure for trading in claims against the debtors.[33] In its reply, the debtors addressed the objection of the Contrarian Group and stated that it dealt with objections in a modified proposed form of order.[34]

On April 6, 2000, the court entered its order under 11 U.S.C. §§ 105, 362 and Bankruptcy Rule 3001 establishing notice and hearing procedures for trading in claims against debtors.[35] The order provided a noticing procedure that is calculated to kick in only when the contemplated claims trade is likely to trigger a loss in the debtor's loss in NOLs.[36]

> For purposes of this Order, the initial amount of the Triggering Amount shall be $25 million, and is calculated to equal approximately four percent (4%) of the Debtors' unsecured claims, based upon an estimate of total unsecured claims of $625 million. If the Debtors' estimate of the total expected allowable unsecured claims is adjusted from $625 million, and such adjustment is more than $100 million, then the Debtors shall recalculate the Triggering Amount as an amount equal to approximately four percent (4%) of the total expected allowable unsecured claims, as adjusted, and the Debtors shall file with this Court and serve on all known creditors a notice of such recalculated Triggering Amount.[37]

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[31] *In re* Serv. Merchandise Objection to Debtors' Motion, *supra* note 25, at 2–3.Clerk's # 2537 at 2–3.

[32] *Id.* at 17.

[33] Debtors' Reply To Objections To Debtors' Motion For Order Pursuant To 11 U.S.C. §§ 105 and 362 and Bankruptcy Rule 3001 Establishing Notification And Hearing Procedure For Trading In Claims Against Debtor, *In re* Serv. Merchandise Co., Inc., 2000 Bankr. LEXIS 1523 (M.D. Tenn. Dec. 20, 2000) (No. 399-02649) (Clerk's No. 2544) [hereinafter *In re* Serv. Merchandise Debtors' Reply to Objections to Debtors' Motion].

[34] *In re* Serv. Merchandise Debtors' Reply to Objections to Debtors' Motion, *supra* note 33, at 2 & Exhibit A.

[35] Order Under 11 U.S.C. §§ 105, 362 and Bankruptcy Rule 3001 Establishing Notice And Hearing Procedures For Trading In Claims Against Debtors, *In re* Serv. Merchandise Co, Inc., 2000 Bankr. LEXIS 1523 (M.D. Tenn. Dec. 20, 2000) (No. 399-02649) (Clerk's No. 2571) [hereinafter *In re* Serv. Merchandise Order].

[36] *Id.* at 2–4.

[37] *Id.* at 3.

All substantial claimholders (entities holding claims equal to or exceeding the trigger amount) were required to comply with the notice procedure.[38] Any acquisitions by a substantial claimholder would be null and void to the extent that the claimholder's claims exceeded the triggering amount.[39]

The debtor in *Service Merchandise*, by carefully tailoring the relief to focus on trades that would be likely to implicate the use of NOLs, was apparently able to satisfy any concerns the bankruptcy court had as to issues involving the impairment of markets in the trading of publicly held debt. However, the issues arising from debtors' attempts to obtain claims trading protections and procedures will likely continue to evolve.[40]

II. MOTIONS TO DESIGNATE (11 U.S.C. § 1126(E))

11 U.S.C. § 1126(e) provides: "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."[41] A vote designated under section 1126(e) is disqualified from voting.[42] The Bankruptcy Code does not define "good faith." But in applying section 203 of the Bankruptcy Act, the predecessor of section 1126(e) of the Code, [43] the Supreme Court said the prohibition against votes cast in bad faith was intended to apply to claimholders

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[38] *Id.* at 2.

[39] *Id.* at 4.

[40] Thomas Moers Mayer, in his paper "Liquidity, Disclosure and their Enemies: Securities Issues and Freezes in Chapter 11," presents a thesis that restrictions on claims trading for publicly held companies in chapter 11 to preserve NOLs are almost never economically justified. Mayer's model assumes the issuance of stock for debt pursuant to a plan of reorganization. He argues that the loss of liquidity caused by claims trading freezes, will cost the claims holders and new shareholders more in the value of the new shares than the value of the NOLs preserved. Mayer states that the illiquidity discount for securities is in the range of 30%. He points out that NOLs have a life of up to 20 years and preserving unrestricted use of NOLs under I.R.C. § 382(1)(5) may require, in addition to an injunction against claims trading during the chapter 11 case, a freeze of stock trading even after the chapter 11 case is over. Mayers states that debtor benefits from I.R.C. § 382(1)(5) only to the extent that it saves taxes from what it would pay under I.R.C. § 382(1)(6), and presents an algebraic analysis in support of his argument that the price shareholders pay in the lost liquidity is almost always greater than the value of the NOLs saved. Mayer's paper is included with materials from the American Bar Association Section of Business Law meeting held in conjunction with the National Conference of Bankruptcy Judges' meetings, October 17–20, 2001, Orlando, Florida.

[41] 11 U.S.C. § 1126(e) (2000).

[42] *See In re* Dune Deck Owners Corp., 175 B.R. 839, 843 (Bankr. S.D.N.Y. 1995) (explaining section 1126(e) authorizes court to disqualify vote if vote was not made in good faith); *see also In re* Pleasant Hill Partners, 163 B.R. 388, 395 (Bankr. N.D. Ga. 1994) (defining "designation" vote as vote not counted); *In re* Holly Knoll P'ship, 167 B.R. 381, 385 (Bankr. E.D. Pa. 1994) (discussing court's ability to designate vote under section 1126(e), thereby disqualifying it).

[43] *See In re* Landau Boat Co., 8 B.R. 432, 433 (Bankr. W.D. Mo. 1981); *In re Dune Deck Owners Corp.*, 175 B.R. at 843; *see also In re Pleasant Hill Partners*, 163 B.R at 393 (explaining legislative history of section 1126(e) shows it was derived from section 203 of Bankruptcy Act); *Dune Deck Owners Corp.*, 175 B.R. at 843 (stating section 1126(e) is derived from section 203 of Bankruptcy Act).

> . . . who 'by the use of obstructive tactics and hold-up techniques exact for themselves undue advantages from the other stockholders who are cooperating.' Bad faith was to be attributed to claimants who opposed a [fair] plan for a time until they were 'bought off;' those who 'refused to vote in favor of a plan unless . . . given some particular preferential advantage.'[44]

In *In re Allegheny International, Inc.*,[45] the bankruptcy court granted the debtor's motion under section 1126(e) to designate and disqualify the votes of the claims and interests acquired by Japonica Partners ("Japonica").[46] After the court approved the debtor's disclosure statement, Japonica, which was not a pre-petition creditor of the debtor, had purchased "only enough claims . . . [to obtain] a blocking position in the two highest classes which were impaired, ensuring that the debtor could not confirm its plan of reorganization."[47] The court noted that the two classes in which Japonica purchased claims had directly opposite interests with respect to the bank litigation.[48] Japonica was a voluntary claimant, having acquired its claims after the court approved the debtor's disclosure statement.[49] If Japonica was unhappy with the proposed distribution, it didn't have to acquire claims post-petition and after approval of the disclosure statement. The court found that Japonica, which was also the proponent of its own plan, had purchased its blocking position and cast its votes against the debtor with an ulterior purpose, that of asserting veto control over the reorganization process.[50] The court found these actions to be in bad faith and designated Japonica's votes pursuant to section 1126(e).[51] The court went further. Pursuant to section 105, it provided that the Japonica shares be put into a trust where they could not be voted on any matter.[52]

Other cases in which courts have dealt with the claims-designation issue as to traded claims:

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[44] Young v. Higbee Co., 324 U.S. 204, 213 n.10 (1945) (quoting *Hearings on Revision of the Bankruptcy Act: Hearing Before the Committee on the Judiciary of the House of Representatives*, 75th Cong. 6439 (1937)); *see also In re* Allegheny Int'l, Inc., 118 B.R. 282, 290 (Bankr. W.D. Pa. 1990) (stating votes must be designated when court determines creditor has cast his vote with ulterior purpose aimed at gaining some advantage to which he would not otherwise be entitled in his position).

[45] 118 B.R. 282 (Bankr. W.D. Pa. 1990).

[46] *Id*. at 290.

[47] *Id.* (suggesting creditors had an "ulterior purpose").

[48] *See id*.

[49] *See id*. at 289.

[50] *See id*.

[51] *See id.* (holding designation or disqualification of creditor's votes was proper pursuant to court's discretion under section 1126 (e)).

[52] *See id.* at 303.

- In *In re Applegate Prop., Ltd.*,[53] an entity related to the debtor purchased sufficient unsecured claims to give the related entity the ability to block confirmation of a creditor's plan. Failure to disclose the transactions in the disclosure statement violated the requirement of section 1125(b) that a disclosure statement contain "adequate information."[54] Further, the court disqualified the purchasing entity's votes in opposition to the creditor's plan because the claims "were neither acquired nor voted in good faith."[55] The court held that as a matter of law, "[t]he purchasing of claims by an affiliate or insider of the Debtor for the sole or princip[al] purpose of blocking a competitor . . . [is not] in . . . good faith."[56]
- *In re First Humanics Corp.*,[57] distinguished the *Allegheny* case. In *First Humanics*, a management company ("HCC") that had been providing services to the debtor post-petition and had invested in the debtor found out that it was to be replaced as manager.[58] HCC purchased three small claims to secure its right to file a competing plan.[59] The debtor asked the court to apply section 1126(e) and designate the management company's claims.[60] The court refused, distinguishing *Allegheny* on the basis that HHC had acted in good faith.[61] The court said that the management company had not purchased the three claims for an ulterior motive, such as manipulation of the

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[53] 133 B.R. 827 (Bankr. W.D. Tex. 1991).

[54] *See* 11 U.S.C. § 1125(a)(1) (2000). "Adequate information" is defined as follows:

> [I]nformation of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan, but adequate information need not include such information about any other possible or proposed plan . . . .

Id.; see also In re Pecht, 57 B.R. 137, 139 (Bankr. E.D. Va. 1986) (stating section 1125(b) gives court authority to decline approval of disclosure statement if it does not give adequate information to entities that will have to vote on plan).

[55] *In re Applegate Property, Ltd.*, 133 B.R. at 836; *see also In re* Federal Support Co., 859 F.2d 17, 19 (4th Cir. 1988); *In re* Jeppon, 66 B.R. 269, 294 (Bankr. D. Utah 1986) ("Court may disregard vote of entity whose acceptance or rejection of plan was not in good faith.").

[56] *In re Applegate Property, Ltd.*, 133 B.R. at 835.

[57] 124 B.R. 87 (Bankr. W.D. Mo. 1991).

[58] *Id.* at 89.

[59] *See id.* The court held that HCC had standing to file a plan both as a creditor and as a party in interest. By its post-petition purchase of pre-petition claims, HCC secured its status as a creditor under section 1121(c). *Id.* at 92; *see also* 11 U.S.C. § 1121(c) (2000) ("Any party in interest, including the debtor, the trustee, a creditor's committee, an equity security holder's committee, a creditor, an equity security holder, or any indenture trustee, may file a plan . . . .").

[60] *See In re First Humanics Corp.*, 124 B.R. at 92.

[61] *See id.*

plan-confirmation process (*Allegheny*) or harassment, but simply to avoid litigation concerning its standing to file a plan.[62]

- In *In re Figter Ltd.*,[63] the secured creditor, Teachers Insurance ("Teachers"), purchased claims solely for the purpose of blocking confirmation of the debtor's plan of reorganization.[64] The court was clearly sympathetic to Teachers' argument that the debtor's plan contained terms that would seriously harm Teachers' collateral. The debtor sought to have the court designate the purchased claims under section 1126(e).[65] The court refused, finding that Teachers had acted out of enlightened self-interest in protecting its interest as the debtor's major creditor.[66] "[N]o bad faith is shown when a creditor chooses to benefit his interest as a creditor as opposed to some unrelated interest."[67]
- The most obvious difference in the facts of *Figter* and *Allegheny* is that in *Figter* the creditor was purchasing claims to protect its pre-petition security interest, while in *Allegheny*, Japonica was an investor without a pre-petition claim against the debtor.[68] But the pre/post distinction doesn't make a good bright-line test.[69] "These cases illustrate the bent of courts to find that, when entities without a special relationship with the estate purchase claims against it . . . whether to control the debtor (as in *Molded Products*[70] and *Automatic Equipment*[71]) or for other reasons . . . their claims will ordinarily not be limited either for voting or distribution purposes."[72]

III. MOTIONS TO DISALLOW OR SUBORDINATE CLAIMS PURCHASED AT A DISCOUNT BY A FIDUCIARY (11 U.S.C. § 510(C))

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[62] *See id.*; *contra In re* Beugen, 99 B.R. 961 (9th Cir. B.AP 1989) (holding vexatious litigant who had purchased claims to harass the debtor did not have standing to object to debtor's discharge).

[63] 118 F.3d 635 (9th Cir. 1997).

[64] *See id.* at 637.

[65] *See id.* at 638.

[66] *See id.* at 639–40.

[67] *Id.* at 635 (citing *In re* The Landing Assoc., Ltd., 157 B.R. 791, 803 (Bankr. W.D. Tex. 1993); *In re* Peter Thompson Assoc., Inc., 155 B.R. 20, 22 (Bankr. D. N.H. 1993).

[68] *See In re Fitger Ltd.* at 641; *In re* Allegheny Int'l, Inc., 118 B.R. 282, 289 (Bankr. W.D. Pa. 1990).

[69] *See* Sally S. Neely, *Investing in Trading in Claims and Interests in Chapter 11 Cases -- A Brave New World*, C836 ALI-ABA 109, 142–43 (1993) (noting per se rule to going concerns, both before and after filing of bankruptcy, is uncertain).

[70] Moulded Products, Inc. v. Barry (*In re* Moulded Products), 474 F.2d 220, 224 (8th Cir. 1973).

[71] *In re* Automatic Equipment, 106 F. Supp. 699, 706 (D. Ne. 1952).

[72] Neely, *supra* note 69 at 145; *see also In re Moulded Prod.*, 474 F.2d at 224 (explaining there is no reason to limit unsecured claim since there was no breach of trustee's fiduciary duty); *In re Automatic Equipment*, 106 F. Supp. at 706 (finding there was no evidence of fraud, misrepresentation on part of trustee).

In *In re Papercraft Corp.*,[73] the creditors' committee brought a motion seeking to equitably subordinate, and objecting to, the claim of Citicorp Venture Capital, Ltd. ("CVC"), an insider that had purchased claims post-petition at a discount without disclosing its insider status to the sellers.[74] The court found that CVC's nondisclosure of its insider status (it made purchases through brokers) was inappropriate.[75] The court stated that it was adopting "a per se rule against 'insider trading' in bankruptcy cases absent pre-purchase disclosure of the insider's identity, connection to the debtor, and nature of the activity."[76] The court relied on *In re Norcor Manufacturing Co.*,[77] which in turn quoted *Pepper v. Litton:*[78] "A director is a fiduciary . . . . So is a dominant or controlling stockholder or group of stockholders . . . . Their powers are powers in trust."[79] The *Papercraft* court, referencing *Norcor*, stated, "The usual remedy for the improper purchase of claims at a discount by a fiduciary is to subordinate or disallow the fiduciary's claim to the extent its face amount exceeds the amount paid."[80] On appeal, the district court reversed and remanded and the parties cross-appealed.[81]

In *Citicorp Venture Capital, Ltd. v. Committee of Creditors Holding Unsecured Claims*,[82] the appeals court remanded.[83] The remedy for a fiduciary's inequitable conduct in buying claims against the chapter 11 debtor at a discount without notice to the debtor or creditors must at least deprive the fiduciary of its profit on claims.[84] Further subordination was appropriate only if supported by findings that justified the further remedy under equitable principles.[85] The court of appeals held that

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[73] 187 B.R. 486 (Bankr. W.D. Pa. 1995).

[74] *Id.* at 491; *see also* 11 U.S.C. § 510(c) (2000) ("[A]fter notice and a hearing, the court may--(1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest . . . .").

[75] *See In re Papercraft,* 187 B.R. at 491.

[76] *Id.* at 494.

[77] 109 F.2d 407 (7th Cir. 1940).

[78] 308 U.S. 295 (1939).

[79] *In re Norcor Mfg. Co.*, 109 F.2d at 411.

[80] *In re Papercraft,* 187 B.R. at 501.

[81] *See id*. at 502.

[82] 160 F.3d 982 (3d Cir. 1998).

[83] *See id*. at 992.

[84] *See id.* at 991 (stating remedy should deprive CVC of its profit on purchase of notes); *see also In re* Life Services, 279 B.R. 504, 511 (Bankr. W.D. Pa. 2002) (reiterating findings of Third Circuit in *In re Citicorp* depriving fiduciary from recovering profits from inequitably purchasing notes). *See generally* United States v. Noland, 517 U.S. 535 (1996) (discussing three part test needed in order to get equitable subordination as laid out in *In re* Mobile Steel Co, 563 F.2d 692, 699–700 (5th Cir. 1977)).

[85] *See Citicorp*, 160 F.3d at 991 (recognizing equitable subordination may be appropriate, but is not exclusive remedy available to bankruptcy court). *See generally* 11 U.S.C. § 510(c) (2000) (describing principle of equitable subordination as possible remedy available to bankruptcy courts).

CVC's fiduciary duty required it to "share everything that it knew with Papercraft's board and the Committee before commencing its purchases."[86]

On remand, the bankruptcy court made additional findings and increased the penalty imposed on the insider purchaser.[87] In addition to the subordination necessary to prevent the insider purchaser from recovering more than it paid, the court also ordered subordination to compensate nonselling creditors for lost interest and for reduction in the amounts available to creditors due to increased administrative and professional fees and expenses and postconfirmation United States Trustee fees incurred because of the conduct of CVC.[88] The court found that CVC had caused economic harm when it tied up the debtor's resources and caused significant delay in the reorganization as it pursued its own goals of blocking an existing plan and causing the debtor to file a competing plan containing CVC's purchase offer.[89] The court also found that CVC's claim should be subordinated in an amount necessary to compensate creditors for the fees and costs of the committee in bringing the adversary proceedings against CVC because this was also "economic harm caused by CVC's undisclosed claims purchasing."[90]

IV. LOCKUPS AND SECTION 1125(B)

A. The Debtor Texaco Locks Up Creditor Pennzoil's Vote

A debtor may wish to insulate itself from the uncertainties of claims-trading by claimholders and third parties by locking up the votes of one or more claimants without actually acquiring the claim.[91] The debtor may attempt to lock up votes by obtaining court approval of a stipulation that settles a creditor's claim, which stipulation controls the creditor's vote for a plan. These lockups have been challenged, usually without success, as violating 11 U.S.C. § 1125(b), which requires that solicitation of votes for a plan of reorganization be made only after the transmission of a court-approved disclosure statement.[92]

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[86] *See Citicorp*, 160 F.3d.at 988 (noting failure of that duty alone would support subordination depriving CVC of its profit from note transactions).

[87] *See In re Papercraft*, 247 B.R. at 632–33.

[88] *See id*. at 628–29 (describing how CVC caused delay and thereby created significant unnecessary expense).

[89] *Id.* at 629–30.

[90] *See id*. at 631 (stating fees related to filing of adversary claim were third type of economic harm caused by CVC's undisclosed claims purchasing).

[91] *See In re* Texaco Inc., 81 B.R. 813, 815 (Bankr. S.D.N.Y. 1988) (providing example of debtor's use of lockup and discussing solicitation of acceptances or rejections of plan of reorganization under 11 U.S.C. § 1125(b)).

[92] *See* 11 U.S.C. § 1125(b) (2000); *see also In re* General Homes Corp. FCMC, 134 B.R. 853 (Bankr. S.D. Tex. 1991) (discussing solicitation of votes after submission of disclosure statement). *See generally* John F. Wagner, Jr., *What Constitutes Improper Solicitation of Acceptance of Rejection of Reorganization Plan Under 11 USCA § 1125(b)*, 100 A.L.R. FED. 226 (1990) (discussing same).

Perhaps the best-known example of a debtor's use of a lockup occurred in *In re Texaco Inc.*[93] Texaco obtained court approval of its settlement of Pennzoil's multibillion-dollar judgment. The settlement bound Pennzoil to support only Texaco's plan of reorganization.[94]

> Pennzoil and Texaco will use their best efforts to obtain confirmation of the Plan in accordance with the Bankruptcy Code as soon as practicable in the Reorganization Case . . . . Pennzoil and Texaco shall not agree to consent to, or vote for any modification of the Plan unless such modification has been agreed to by the other party. Neither Pennzoil nor Texaco shall vote for, consent to, support or participate in the formulation of any other plan in the Reorganization Case.[95]

Texaco's largest shareholder, Carl Icahn, objected on the basis that the settlement violated section 1125(b) because it was a solicitation of Pennzoil's vote prior to the circulation of an approved disclosure statement.[96] "An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement . . . containing adequate information."[97] The bankruptcy court determined that the settlement did not violate section 1125(b) because it "[did] not constitute a solicitation of Pennzoil's acceptance or rejection of Texaco's plan . . . . The solicitation of Pennzoil's vote must await the approval of the disclosure statement. Indeed, Pennzoil is not required to cast any ballot at all."[98] This may be a distinction without a difference.[99]

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[93] 81 B.R. 813 (Bankr. S.D.N.Y. 1988).

[94] *See id.* at 814–15.

[95] *See id*. (quoting Article III of stipulation and agreement).

[96] *See id.* at 815.

[97] 11 U.S.C. § 1125(b).

[98] *In re Texaco Inc.*, 81 B.R. at 815; *see* Arthur Skeel, Jr., *The Nature and Effect of Corporate Voting in Chapter 11 Reorganization Cases*, 78 VA. L. REV. 461, 518 n.223 (1992) (examining lock-up agreement in Texaco).

[99] This decision has been harshly criticized.

> If an agreement to support a proponent's plan and not to support any other . . . does not constitute a 'solicitation,' it is not clear what does. *Texaco* would allow any plan proponent to lock–up the votes of all creditors merely by settling the allowed amount of each creditor's claim with a stipulation binding the creditor to vote only for the debtor's plan and not for any other plan.

Chiam T. Fortgang & Thomas Moers Mayer, *Trading Claims and Taking Control of Corporations in Chapter 11*, 12 CARDOZO L. REV. 1, 106 (1990); *see also* Paul R. Glassman, *Solicitation of Plan Rejections Under the Bankruptcy Code*, 62 AM. BANKR. L.J. 261, 268 (1988) (regarding *Texaco's* interpretation of 'solicitation' as extremely narrow); Wagner, *supra* note 92, at 234 (citing Texaco's narrow interpretation of 'solicitation').

B. Management Uses An Option To Lock Up Claims

In *In re Apex Oil Co.*,[100] post-petition, management and a management-related corporation (the "management group") bought an extendable 30-day option to acquire bank debt against Clark Oil at a discount of $150 million.[101] Clark Oil was a subsidiary of the debtor and held most of its operating assets.[102] The management group then obtained court approval to buy Clark Oil for cash plus the bank debt.[103] Because of the deep discount in the bank debt, no other entity could make a competitive bid.

Getty objected to the proposed sale on several grounds, most strongly on the basis that the $150 million discount given by the lenders was the result of unfair insider intervention and that this resulted in Getty's being locked out of the bidding.[104] Getty argued that the debtor had breached its fiduciary duties by failing to unlock the discount and make it available to other bidders and that Getty should also have the benefit of the $150 million discount.[105] If this happened, Getty argued, it would offer $85 million more than the management group offered, thus providing a benefit to the estate.[106] Getty argued that because of the alleged breach of fiduciary duty by the management group, the court should use its equity powers to unlock the note-purchase agreement so that Getty could acquire the notes for the same price the management group was to pay.[107]

In approving the sale to the management group, the court found that the lender discount was not the result of unfair insider dealing.[108] Neither were the lenders required to give Getty the same $150 million given to the lender group.[109] The court cited the unanimous support by creditors in approving the sale to the management group, and in reciting a lengthy history of post-petition negotiations, the court clearly felt that Getty and others had at least at one time participated in a competitive negotiation process for the acquisition of the assets.[110]

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[100] 92 B.R. 847 (Bankr. E.D. Mo. 1988).
[101] *See id.* at 850.
[102] *See id.* at 849.
[103] *See id.* at 869.
[104] *See id.* at 871.
[105] *See id.*
[106] *See id.* at 871.
[107] *See id.*
[108] *See id.* at 872.
[109] *See id.* at 871.
[110] *See id*. at 873–74. One commentator finds the result noteworthy: "The *Apex* transaction was remarkable. Apex's managers found a way to lock-up the crown jewel of their own debtor without competition and at minimal risk, notwithstanding prohibitions against such a transaction discussed in Part II(B) of this article." Fortgang & Mayer, *supra* note 99, at 109–10. The prohibitions referred to are those that limit trading by fiduciaries. A close reading of *Apex* leads to a less simple conclusion. Although the Apex managers did end up with an exclusive option to purchase lender debt, thus eliminating the Getty bid, the court reviewed the lengthy history of negotiations between various parties in the case, including Getty, and clearly felt that Getty had been in a position to fairly compete for acquiring the assets for a long time

C. Lockup Agreements Still Face Scrutiny

Despite the court's approval of the lockup agreements in *Texaco* and *Apex*, such agreements can still face close scrutiny. In *Greater Bay Hotel & Casino, Inc.*,[111] the unsecured creditors' committee[112] signed an agreement with two limited liability companies controlled by Carl Icahn in which the committee agreed "to be irrevocably bound" to support only Icahn's plan (the "High River Plan") and to recommend that unsecured creditors vote to reject the competing plan of Park Place Entertainment Corporation (the "Park Place Plan") and any other competing plan.[113] Further, each member of the committee agreed to vote to accept the High River Plan.[114] Park Place and Merrill Lynch Asset Management, a creditor, filed a joint motion to set aside the lockup agreement in part and disqualify counsel for the committee.[115]

Park Place and Merrill Lynch argued that the Park Place Plan was superior to that of High River and that the committee was violating its duty to work to maximize the dividend to unsecured creditors.[116] Park Place and Merrill Lynch also argued that the lockup agreement reflected an illegal solicitation of the individual members of the committee, in violation of section 1125(b).[117] Having unsuccessfully challenged a lockup in *Texaco*,[118] Icahn now was unsuccessful as the proponent of a lockup: the court held in part that any agreement between High River and the Committee, to the extent that it purports to irrevocably bind the Committee to support a High River Plan, is unenforceable against the Committee as

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before the debtor's management acquired the option. *Apex*, 92 B.R. at 873. The cases seem to indicate that disclosure is the most important issue when a debtor's fiduciary purchases claims. *Id.* at. 872. But it is hard to reconcile the *Apex* holding with *Applegate's* statement that "[t]he purchasing of claims by an affiliate or insider of the Debtor for the sole or principle [sic] purpose of blocking a competitor . . . [is not] in good faith." *In re* Applegate Prop., Ltd., 133 B.R. 827, 835 (Bankr. W.D. Tex. 1991).

[111] No. 98-10001 (Bankr. D. N.J. 2002); *see also In re* Stations Holding Co. (Bankr. D. Del. 2002) (no. 02-10882) (MFW). Transcript of Omnibus Hearing Before Honorable Mary F. Walrath (rejecting counting of votes which were retained post-petition, but pre-confirmation on basis that it violated section 1125).

[112] Creditors' committees and debtors-in-possession are both fiduciaries in a chapter 11 case with a duty to maximize the dividend to unsecured creditors. *See* 11 U.S.C. § 1107(a) (2000); *Apex*, 92 B.R. at 867.

[113] Memorandum of Law in Support of Motion for Order Setting Aside Lock-up Agreement, Disqualifying Committee Counsul and Prohibiting Committee from Acting as Co-Proponent Of or Making Any Recommendation To Creditors in Support of a Plan Proposed By High River.

[114] *See id.* at 2, 6.

[115] *See id*.

[116] *See id*. at 3–5.

[117] *See id.* at 6.

[118] *In re* Texaco Inc., 81 B.R. at 818 (denying Icahn's motion to set aside lock-up agreement).

a matter of law and is therefore void.[119] Though not specifically stated, it appears that the court implicitly found that the lockup agreement violated section 1125(b).[120]

V. AMENDMENT OF BANKRUPTCY RULE 3001(E)(2)

Bankruptcy Rule 3001(e)(2) was amended in 1991 "to restrict the bankruptcy court's power to inspect the terms of [claims] transfers."[121] In *In re Olson*,[122] the court reviewed an order of the bankruptcy court that had allowed a transferred claim only up to the amount of the purchase price and subordinated the purchased claims to the claims of the unsecured creditors.[123] The bankruptcy court found that the insider purchasers had "abused the bankruptcy process by purchasing all of the claims against the estate at a fraction of what they were worth" and had obtained many of the claims transfers by providing the transferors "with false, misleading, and incomplete information."[124] The bankruptcy court had also determined that Bankruptcy Rule 3001(e)(2) did not limit the bankruptcy court from inquiring into the transfer of claims and providing "appropriate remedies where necessary to prevent the abuse of process."[125] The bankruptcy court relied on 11 U.S.C. § 105 for authority to impose remedies.[126]

The Eighth Circuit overturned the bankruptcy court's order, finding that "Rule 3001(e)(2) requires the court to issue an order substituting Viking for the unsecured creditors as the owners of the clams against the estate."[127] The language of the rule is mandatory and directs the court to substitute the name of the transferee for that of the transferor in the absence of a timely objection from the transferor, and none of the transferors objected.[128] Further, the 1991 Advisory Committee Note states that the purpose of the amended rule is "to limit the court's role to the adjudication of disputes regarding transfers of claims."[129] The text of the rule makes

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[119] Order Resolving Motion By Park Place and Merrill Lynch Asset Management to Set Aside Lock-up Agreement Disqualifying Counsel For Creditor Committee and For Other Relief.

[120] *See id*. Icahn may have lost the battle, but he won the war. *See In re Greate Bay*, 251 B.R. at 218. (finding both the Park Place Plan and the High River Plan were confirmable and confirmed the High River Plan).

[121] *See* SPM Mfg. Corp. v. Stern (*In re* SPM Mfg. Corp.), 984 F.2d 1305, 1314 n.9 (1st Cir. 1993).

[122] 120 F.3d 98 (8th Cir. 1997).

[123] *Id.* at 99-100.

[124] *See id.* at 100–01.

[125] *In re* Olson, 191 B.R. 991, 1004 (Bankr. D. Minn. 1996).

[126] *Id.* at 1003.

[127] Viking Assocs., L.L.C. v. Drewes (*In re* Olson), 120 F.3d 98 (8th Cir. 1997).

[128] *See id.*

[129] *See* FED. R. BANKR. P. 3001 advisory committee's note (1991); *see also In re* Lifestyle 80's Inc., 187 B.R. 156, 157 (Bankr. D. N.J. 1995) (construing Rule 3001 to limit court's role to adjudication of disputes regarding transfers of claims); *In re* Rook Broadcasting, 154 B.R. 970, 973 (Bankr. D. Idaho 1993) (interpreting Rule 3001 to limit court's role to disputes involving transfers of claims).

it clear that the existence of a "dispute" depends on an objection by the transferor.[130] "Where there is no dispute, there is no longer any role for the court."[131]

VI. ENFORCEMENT OF CLAIMS-TRADING RESTRICTIONS IN PRE-PETITION CREDIT AGREEMENTS

A borrower may negotiate provisions in its pre-petition credit agreements which restrict the lender's trading of its claims. In the matter of *Comdisco, Inc.*,[132] Comdisco and certain of its domestic and foreign affiliates entered into pre-petition credit agreements (the "Agreements") for a $550,000,000 credit facility.[133] Under the Agreements, Comdisco's approval was required before participating lender could assign all or a portion of its rights under the Agreements.[134] Comdisco could not unreasonably withhold approval.[135] Comdisco and 50 of its domestic affiliates later filed chapter 11 petitions. The foreign affiliates did not file.[136]

The lenders filed a motion seeking an order allowing them to trade their claims without the debtors' consent, on three alternative grounds.[137]

The lenders first argued that Bankruptcy Rule 3001(e)(2) allowed transfer, notwithstanding the anti-assignment provisions in the Agreements.[138] Because of the borrowers' defaults, all obligations of the lenders to lend money to Comdisco

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[130] *See In re* Zalehha, 162 B.R. 309, 314 (Bankr. D. Idaho 1993) (arguing claim is disputed if alleged transferor objects); *see also In re* Alliance Aerospace, LLC, 280 B.R. 752, 755 (Bankr. M.D. Ga. 2002) (limiting court intervention to situations in which transferor objects to transfer of claim); *In re Lifestyles 80's Inc.*, 187 B.R. at 157 (discussing need for court intervention only when dispute occurs and without objection by alleged transferor no need for court approval).

[131] Viking Assocs., L.L.C. v. Drewes (*In re* Olson), 120 F.3d 98, 102 (8th Cir. 1997). Rule 3001(e)(2) deals with transfers of claims other than for security after a proof of claim is filed. Rule 3001(e)(1), which deals with transfers of claims other than for security before the proof of claim is filed, has no provisions concerning objections. 28 U.S.C. § 2075 provides in part that the "rules shall not abridge, enlarge, or modify any substantive right."

[132] *In re* Comdisco, Inc., 272 B.R. 671 (Bankr. N.D. Ill. 2002).

[133] Note that the facts of *In re Comdisco* in footnotes 138–141 are taken from the Lenders' Motion. *See* Motion for Order Pursuant to U.S.C. § 105(A) and Fed. R. Bankr. P. 3001 (A) Clarifying That The Banks' Interests Under The Pre-Petition Credit Agreements Constitute Claims That Can Be Freely Transferred Without The Consent Of The Debtor Or Approval Of The Court Pursuant To Rule 3001 Of The Federal Rules Of Bankruptcy Procedure Or, In The Alternative, That (B) The Terms Of The Pre-Petition Credit Agreements Requiring The Consent Of Comdisco To Effectuate Assignment Of Bank Interests Is Ineffective Under Applicable Law Or, In The Alternative, (C) Requiring Comdisco To Consent To The Assignment Of Interests Under The Pre-Petition Credit Agreements at 2, *In re* Comdisco, Inc., 272 B.R. 671 (Bankr. N.D. Ill. 2002) (No. 01-24795) [hereinafter *In re* Comdisco Lenders' Motion].

[134] *Id*. at 3.

[135] *Id.*

[136] *Id.* at 2.

[137] *Id.* at 2–3.

[138] *In re* Comdisco Lenders' Motion, *supra* note 133, at 5–6; *see also* FED. R. BANKR. P. 3001(e)(2) (2002) (permitting transfer of claim without debtor requiring consent or notification of transfer or court approving transfer); 9 COLLIER ON BANKRUPTCY ¶ 3001.08 at 1(Lawrence P. King et al. eds., 15th ed. Rev. 1997) (stating there is "no requirement that notice of transfer of a claim be given to the debtor or other parties in interest.").

had automatically terminated, so that the lenders had fully executed all of their obligations under the agreements.[139] The lenders had filed a proof of claim, and all they had to do to assign a claim was to follow the requirements of Rule 3001(e)(2).[140]

The lenders next argued that New York law renders consent to assignment clauses generally invalid unless the contract specifically states that the assignment will be void without the consent of the applicable party.

Finally, the lenders argued that Comdisco's argument for withholding consent to assignment was that it didn't want to work with unfamiliar debt holders in the chapter 11.[141] This was unreasonable, argued the lenders, because the debt was publicly held, and the owners of publicly traded bonds and debentures change on a daily basis.[142] Also, the lenders argued, they already had the ability to sell participations, which, they argued, were similar to assignments.[143]

Comdisco made the following arguments in opposition: the credit agreements covered Comdisco's foreign (non-debtor) subsidiaries, and actions against the foreign non-debtor subsidiaries were not stayed.[144] Comdisco was engaged in ongoing plan negotiations with the pre-petition lender group.[145] A change in the composition of the lender group could result in: (a) disruption of plan negotiations, and (b) the claim transferees taking actions against the foreign subsidiaries resulting in a loss of value and impeding Comdisco's recovery efforts.[146] Comdisco and the existing lender group had reached an informal standstill regarding the treatment of the non-debtor foreign subsidiaries.[147]

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[139] *In re* Comdisco Lenders' Motion, *supra* note 133, at 5 (arguing all obligations of banks to lend money to Comdisco under Credit Agreements terminated on Petition Date, thus making Banks' obligations fully executed).

[140] *Id.* at 5–6; *see also* FED. R. BANKR. P. 3001(e)(2) (stating transfer procedures); *In re* Heritage Village Church and Missionary Fellowship Inc., 87 B.R. 17, 18 (Bankr. D. S.C. 1988) (stating Rule 3001(e)(2) governs unconditional transfer after proof filed).

[141] *In re* Comdisco Lenders' Motion, *supra* note 133, at 8; *see* Pro Cardiaco Pronto Socorro Cardiologica, S.A. v. Trussell 863 F. Supp. 135, 137 (S.D.N.Y. 1994) (holding New York Courts treat contract clause prohibiting assignment invalid unless "clear language is used and the plainest words have been chosen.").

[142] *In re* Comdisco Lenders' Motion, *supra* note 133, at 9–10.

[143] *Id.* at 10.

[144] *See* Debtors' Objection to Motion for Order Pursuant to U.S.C. § 105(A) and Fed. R. Bankr. P. 3001 (A) Clarifying That The Banks' Interests Under The Pre-Petition Credit Agreements Constitute Claims That Can Be Freely Transferred Without The Consent Of The Debtor Or Approval Of The Court Pursuant to Rule 3001 Of The Federal Rules Of Bankruptcy Procedure Or, In The Alternative, That (B) The Terms Of The Pre-Petition Credit Agreements Requiring The Consent Of Comdisco To Effectuate Assignment Of Bank Interests Is Ineffective Under Applicable Law Or, In The Alternative, (C) Requiring Comdisco To Consent To The Assignment Of Interests Under The Pre-Petition Credit Agreements, *In re* Comdisco, Inc., 272 B.R. 671 (Bankr. N.D. Ill. 2002) (No. 01-24795) [hereinafter *In re* Comdisco Debtors' Objection to Lenders' Motion].

[145] *See id.* at 3–4.

[146] *See id.* at 3, 5.

[147] *See In re* Comdisco Debtors' Objection to Lenders' Motion, *supra* note 144, at 3.

The Court denied the lenders' motion on alternative grounds.[148] First, the controversy was not ripe. The lenders were requesting the blanket voiding of an anti-assignment provision where the record before the court did not establish any specific assignment of lender group debt, much less that Comdisco had refused to consent to such assignment.[149] The only basis for the lenders' motion in the Federal Rules of Bankruptcy Procedure is Rule 7001 and the lenders should have sought relief by an adversary proceeding.[150]

Alternatively, as to Rule 3001: the rule makers did not intend to, and likely didn't have the authority to void anti-assignment provisions in contracts. Rule 3001 is a procedural rule.[151] It only has effect after the transfer has already taken place. It pre-supposes a valid transfer. The rule does not say that legal restrictions on claims assignment, whether in a contract or in nonbankruptcy law are void or not applicable in a bankruptcy case.

CONCLUSION

While Rule 3001(e)(2) as amended is no longer a basis for judicial intervention in claims-trading, the other strategies discussed above, including seeking procedural protections for NOLs pursuant to section 105 and section 362, motions to designate under section 1126(e), equitable subordination under section 510(c), lockups, and the enforcement of contractual restrictions on claims assignment in pre-petition credit agreements remain as vehicles for debtors to attempt to gain control over the claims-trading process in chapter 11 cases.

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[148] Order Denying The Motion (A) Clarifying That The Banks' Interests Under The Pre-Petition Credit Agreements Constitute Claims That Can Be Freely Transferred Without The Consent Of The Debtor Or Approval Of The Court Pursuant To Rule 3001 Of The Federal Rules Of Bankruptcy Procedure Or, In The Alternative, That (B) The Terms Of The Pre-Petition Credit Agreements Requiring The Consent Of Comdisco To Effectuate Assignment Of Bank Interests Is Ineffective Under Applicable Law Or, In The Alternative, (C) Requiring Comdisco To Consent To The Assignment Of Interests Under The Pre-Petition Credit Agreements, *In re* Comdisco, Inc., 272 B.R. 671 (Bankr. N.D. Ill. 2002) (No. 01-24795) [hereinafter *In re* Comdisco Order].

[149] *In re* Comdisco Order, *supra* note 148, at 2. *See generally* 11 U.S.C. § 365 (2000) (stating rules governing assignability of executory contract and unexpired leases).

[150] *In re* Comdisco Order, *supra* note 148; *see also* FED.R.BANKR.P. 7001 (specifying proceeding to obtain equitable relief, or proceeding to obtain declaratory judgment relating thereto is adversary proceeding).

[151] *See* FED.R.BANKR.P. 3001 (stating proof of claim is written statement setting forth creditor's claim).