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Let The Buyer Beware—The Pitfalls of Buying Claims In Bankruptcy Cases

Bankruptcy court decisions from New York, Wilmington, and Chicago provide a costly reminder to bankruptcy claim purchasers that the principle of caveat emptor is alive and well. The sale of bankruptcy claims has become commonplace in bankruptcy cases over the years. Creditors are attracted to selling their claims in bankruptcy because it provides immediate cash and eliminates uncertainty about the recovery on the claim. In turn, claim buyers may acquire claims either to make a profit based on their superior knowledge of the case, or to secure some advantage in dealing with the debtor or its other creditors. For example, in *In re Fagerdala USA-Lompoc, Inc.*, Case No. 16-35430 (9th Cir. June 4, 2018), the Court of Appeals for the Ninth Circuit held that a secured creditor could purchase some of the general unsecured claims for the purpose of voting them against the debtor's plan and blocking confirmation, so long as the secured creditor simply was acting in its own enlightened self-interest.

Like any other sale transaction, the transfer of a claim from one party to another deserves some attention to detail, both in regard to the transferability of the underlying claim and the actual terms of purchase. Failure to attend to these details can result in costly disputes or loss of the value of the claim. For example, in *In re Woodbridge Group of Companies, LLC*, Case No. 17-12560 (Bankr. D. Del., June 20, 2018), Judge Kevin J. Carey upheld the enforceability of anti-assignment language in a promissory note and sustained a debtor's objection to a proof of claim filed by the purchaser of the promissory note. Similarly, in *In re Caesars Entertainment Operating Co., Inc.*, Case No. 15-1145 (Bankr. N.D. Ill., July 30, 2018), Judge A. Benjamin Goldgar disallowed claims held by an assignee of the original creditor when the debtor objected. Although the decision ultimately turned on issues of forfeiture and waiver in the presentation of arguments, the court also noted that certain of the claims, which were tort-based, were not assignable under applicable state law anyway (the *Caesars* decision also cited the *Woodbridge* holding). Finally, in *In re Westinghouse Electric Co. LLC*, Case No. 17-10751 (Bankr. S.D.N.Y., Aug. 1, 2018), Judge Michael E. Wiles considered whether a purported claims buyer had entered into enforceable contracts to buy previously filed claims. The contract documentation was comprised of email exchanges, and there were several disputes about pricing and other terms. The purported seller of the claims objected to notices that were filed, asserting that the claims had been sold. The court ultimately concluded that there never was a binding offer and acceptance to create an enforceable agreement to sell the claims, and that the original filer of the claims continued to hold the claims.

These decisions are all good reminders of the pitfalls that someone interested in buying a bankruptcy claim may wish to consider in the due diligence process prior to purchase. Only by analyzing the documentation evidencing the claim and understanding potential prohibitions or restrictions on the assignability of the claim can a proposed purchaser ascertain the likelihood that the transferred claim may be enforceable in its hands. As with any other purchase and sale transaction, a properly documented and executed sale contract will best evidence the deal terms.

For more information, or if you have questions about how the issues raised in this legal update affect your policies, practices, or other compliance efforts, please contact one of the following lawyers in the firm's Business Reorganizations, Bankruptcy, and Creditors' Rights Group:

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