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Post-Petition Trading in Chapter 11 Claims: A Call for Augmentation of Federal Rule of Bankruptcy Procedure 3001(e)(2)

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INTRODUCTION

During the trading mania of the last decade everything was for sale, even claims against bankrupt companies. Because bankruptcy has become a more prevalent and accepted means of financial restructuring, trading in claims against insolvent companies has emerged as a profitable activity for investors and a common feature of chapter 11 reorganizations. Investors purchasing claims against chapter 11 debtors create an


3. See C. Fortgang & T. Mayer, supra note 1, at 1-11; Elliott, The Wonderful World of Bankruptcy, Institutional Investor, Nov. 1988, at 68. A market for claims held against bankrupt debtors exists after the debtor has filed for chapter 11 protection, or post-petition, but before a plan of reorganization has been accepted by the voting creditors, or pre-reorganization. See C. Fortgang & T. Mayer, supra note 1, at 1-7.

Investors have also utilized the pre-reorganization claim market to control post-reorganization debtors. Investment bankers have proposed purchasing the debt of companies in chapter 11 as a means for acquiring control of those companies. See C. Fortgang & T. Mayer, supra note 1, at 105; First Boston Proposes Buying Bonds as a Takeover Technique, Corp. Fin. Wk., Mar. 28, 1988, at 1.


For a more in depth discussion of how claims purchases may be used to acquire a chapter 11 debtor, see generally C. Fortgang & T. Mayer, supra note 1, at chs. 7, 11, and 14.

4. The post-petition market is viable because the assignment of a claim usually transfers all rights and disabilities of that claim from the assignor to the assignee. See Shrop-
important market that can provide liquidity to cash-starved creditors who cannot wait for confirmation of the reorganization plan.\(^5\)

Bankruptcy courts, however, have been confronted with several problems coextensive with the rapid growth\(^6\) in the claim markets. Of particular concern has been the lack of disclosure in the chapter 11 post.petition, pre-reorganization market.\(^7\) Currently, two provisions impact on the post-petition claim markets. These provisions, Federal Rule of Bankruptcy Procedure 3001(e)(2) ("Rule 3001(e)(2)")\(^8\) and section 1125

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\(^5\) See, e.g., In re Revere Copper & Brass, Inc., 58 Bankr. 1, 2 (S.D.N.Y. 1985) (Revere was in bankruptcy for more than two and a half years before it achieved confirmation of its plan of reorganization); UNR Industries, Inc. and Subsidiaries File Reorganization Plan, P.R. Newswire, July 7, 1988 (Business Desk) (UNR commenced its chapter 11 case in July 1982 and still has not consummated a plan). A variety of post-petition debt has been traded, including privately placed debt securities, bank loan claims, trade claims, personal injury claims and damages for breach of contract actions. In re Wheeling-Pittsburgh Steel Corporation, Case No. 85-793 (Bankr. W.D. Pa. Jan. 15, 1987); C. Fortgang & T. Mayer, supra note 1, at 5-4.


\(^7\) See, e.g., In re Chateaugay (In re LTV Energy Products), No. 86 B 227342-405 slip. op., (Bankr. S.D.N.Y. Mar. 11, 1988) (court was concerned that major post-petition solicitation for claims constituted solicitation on plan without proper disclosure); In re Allegheny Int'l, Inc., 100 Bankr. 241, 243 (W.D. Pa. 1988) (same).

\(^8\) See Fed. R. Bankr. P. 3001(e)(2) (1987). This Rule requires filing of notice of the assignment with the court clerk. It traditionally has been ministerial in application. See infra notes 34-43 and accompanying text.
of the Bankruptcy Code, however, do not adequately address this lack of disclosure. These regulatory inadequacies have led to increasing intervention by courts in the market. Judicial meddling has resulted in inconsistent decisions and ad hoc remedies that could damage the reliability of the claim market.

Part I of this Note describes the mechanics of the post-petition, pre-reorganization chapter 11 claim market. Part II argues that existing legislation, rules and case law do not sufficiently regulate the modern post-petition claim market. Part III discusses recent decisions that have addressed the lack of disclosure in the post-petition market. Part IV of this Note establishes a framework for augmenting Rule 3001(e)(2). This Note concludes that increased disclosure, achieved through an amended Rule 3001(e)(2), coupled with limitations on judicial discretion, will stabilize the post-petition claim market while addressing recent judicial calls for disclosure.

I. BACKGROUND: WHY WOULD ANYBODY WANT TO BUY CLAIMS AGAINST A BANKRUPT COMPANY?

A. The Mechanics of Trading Chapter 11 Claims

Claims against bankrupt companies are "traded" by assignment. An investor solicits creditors of a bankrupt company to assign their claims at a certain percentage of face value.

Post-petition claim markets rest on the willingness of the investor to incur two risks. First, the post-petition investor gambles that the reorganization plan will pay creditors more than what the investor paid for...
the claim. Second, the post-petition investor gambles that a reorganization plan will be confirmed before the cost of carrying the investment—the time value of money—consumes whatever profit the investor hopes to make on the discount.

B. Chapter 11 of the Bankruptcy Code

The present bankruptcy code was enacted by Congress in 1978. It was enacted principally to consolidate older bankruptcy laws, deal with the rising tide of consumer credit since World War II, and to establish a more comprehensive system of bankruptcy courts.

Chapter 11 of the Bankruptcy Code seeks to enable businesses to

15. See id. For example, if a post-petition investor, wanting a 20-percent return, bought claims four years prior to plan consummation the investor would have to double its investment under the plan. See id. at 6-7.

In the Revere case, for example, the investor, Phoenix Capital, solicited assignments from Revere's creditors at “twenty percent (20%) of the face amount of any valid, uncontested and unpaid claim.” Revere, 58 Bankr. at 1 (quoting Letter Solicitations made by Phoenix Capital from November 5 to December 6, 1984 to Revere's creditors). In the November 30, 1984, edition of The Wall Street Journal, Revere Corporation announced that in the upcoming plan of reorganization creditor's would have three options: 65 percent cash; 60 percent cash plus 10 percent of their claim in Revere common stock; 39 percent cash, 46 percent in notes and 15 percent of the claim value in Revere common stock. Id. at 2 (citing Wall St. J., Nov. 30, 1984, at 10, col. 1). If these assignments had been approved by the court, Phoenix stood to make at least a 200-percent return on its investment in these post-petition claims. See id.


Congress left most procedural details for the Supreme Court to supply pursuant to its rule-making power. See id. The bankruptcy rule-making statute, 28 U.S.C. § 2075 (1987), enables the Supreme Court to provide rules for practice and procedure in bankruptcy. See G. Treister, Bankruptcy Law, supra, at 19. If Congress does not act within 90 days after receiving the rules proposed by the judiciary, those rules take effect and have the force of law as long as they are not inconsistent with the Bankruptcy Code or other statutes. See id. at 19-20.


20. As enacted in 1938, Chapter 11 of the Bankruptcy Act required that a reorganization plan be in the best interests of creditors, as well as being fair, equitable and feasible. See Commission on the Bankruptcy Laws of the United States, Report, H.R. Doc. No. 93-137, 93rd Cong., 1st Sess., pt. I, at 245 n. 19 [hereinafter Commission Report]. It was determined that because most chapter 11 cases involved voluntary petitions, the debtor would remain in possession of the bankrupt. See 5 Collier on Bankruptcy, ¶1125-02, at 1125-8 (1989) (citing Commission Report, supra, at 249-50 n.1). Therefore, the absence of a disinterested trustee in voluntary chapter 11 cases mandated additional protection of creditors’ best interests. See id. In 1952, Congress amended chapter 11 repealing the “fair and equitable” standard established fourteen years earlier. See id. at 1125-9 to
rehabilitate themselves as going concerns. Creditors of a chapter 11 corporation have significant influence over the management of the bankrupt. In fact, post-petition creditors holding significant claims against the bankrupt may be able to control the corporation after reorganization.

1978, chapters 10, 11, and 12 of the Act were consolidated into a single reorganization chapter. See id. at 1125-13 (citing 124 Cong. Rec. H11,101 (daily ed. Sept. 28, 1978); 124 Cong. Rec. S17,418 (daily ed. Oct. 6, 1978)). A goal of this consolidation was to ensure adequate disclosure. See id. §1125.02, at 1125-13 to 1125-14. The House report states:

The premise underlying the consolidated chapter 11 of this bill is the same as the premise of the securities law. If adequate disclosure is provided to all creditors . . . whose rights are to be affected, then they should be able to make an informed judgment of their own, rather than having the court . . . inform them in advance of whether the proposed plan is a good plan.

Id. 1125-14 (citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 226 (1977)).

22. The Supreme Court has observed that, "one of the painful facts of bankruptcy is that the interests of shareholders become subordinated to the interests of creditors." CFTC v. Weintraub, 471 U.S. 343, 355 (1985). As early as 1881 the courts recognized that, "the object of the whole [bankruptcy] proceeding is the preservation of the property for the benefit of the creditors." Taylor v. The Philadelphia & Reading R.R. Co., 7 F. 381, 385 (C.C.Ed. Pa. 1881).

Section 1102 of the Bankruptcy Code directs the bankruptcy court to appoint a committee of unsecured creditors, in the absence of a pre-petition creditors committee, "as soon as practicable after the order for relief." 11 U.S.C. § 1102(a)(1) (1988). According to section 1102(b), the creditor's committee is ordinarily to be made up of the seven largest creditors willing to serve. See id. at § 1102(b) (1988). Pursuant to section 1103(c), the creditors' committee has five specific powers over the formulation of the chapter 11 plan of reorganization. See id. at § 1103(c) (1988). These enumerated powers enable the creditor to consult with the trustee or the debtor in possession concerning the administration of the case, investigate the debtor's acts and financial condition, participate in the formulation of the reorganization plan, request appointment of a trustee and "perform such other services as are in the interest of those represented." See id. at § 1103(c)(5) (1988).

Section 1121 says that only the debtor has the right to file a plan and obtain creditor preferences until "after 120 days after the date of the order for relief." Id. at § 1121(b) (1988). However, any "party in interest" including the trustee, the debtor in possession, a creditor, and the creditors' committee may file a plan of reorganization if:

1. a trustee has been appointed under [chapter 1];
2. the debtor has not filed a plan before 120 days after the date of the order for relief under this chapter; or
3. the debtor has not filed a plan that has been accepted, before 180 days after the date of the order for relief under this chapter, by each class of claims or interests that is impaired under the plan.

Id. at § 1121(c) (1988).

Section 1103(c)(3) mandates that no matter who actually files the plan of reorganization, the creditors' committees may "participate in the formulation of [the] plan, advise those represented by such committee of such committee's determinations as to any plan formulated, and collect and file with the court acceptances or rejections of [the] plan." Id. § 1103(c)(3) (1988).

23. Section 1126(c) gives any creditor which holds two-thirds of the dollar amount of the debt and a majority of the numerical votes in a class effective control of that class.
Sections 1121 through 1129 of chapter 11 address the formulation and confirmation of reorganization plans for the debtor. These provisions create a flexible framework that allows debtors to restructure outstanding debt. Restructuring, however, requires the consent of the creditors. Chapter 11 was designed to ensure that creditors receive adequate disclosure before they vote on a proposed plan.

II. DEFINING THE PROBLEM

A. Section 1125(b)

In passing section 1125(b) of the Bankruptcy Code, Congress was concerned not that the creditors’ votes were based on misinformation, but that they were based on no information at all. Section 1125(b) requires that “adequate information” be furnished to creditors of a chapter 11 debtor. This information must be furnished before the creditors are

See 11 U.S.C. § 1126(c) (1988); S. Rep. No. 95-989, 95th Cong., 2d Sess. 122 (1978), reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5909. Control of either one—dollar amount or votes—places a negative veto power in the hands of the entity which has such control. See 5 Collier on Bankruptcy, ¶ 1126.03, at 1126-12 (1989). For example, a creditor who has two-thirds of the dollar amount of the claims held against the debtor (in all classes of debt) yet does not have one half of the votes will still be able to veto any plan of reorganization that it does not agree with, even though it does not control a majority of the votes. See In re Pine Lake Village Apartment Co., 19 Bankr. 819, 829-31 (S.D.N.Y. 1982). This is important to the analysis of the trade in bankruptcy claims because purchasers of multiple claims within a class are counted as having only one vote in that class. See In re Latham Lithographic Corp., 107 F.2d 749, 751 (2d Cir. 1939).

Therefore, control of at least two thirds of the dollar amount of all classes of debt held against the bankrupt means control of the reorganization plan. See, e.g., In re Apex Oil Co., 92 Bankr. 847 (E.D. Mo. 1988) (Apex Oil, company in chapter 11 reorganization, was taken over when company jointly owned by the Management Group and Höshman Corporation purchased $545,000,000 in bank debt for $396,000,000, thereby gaining control of reorganization plan); Leucadia National Corporation, Inc., filing on Schedule 13D dated Nov. 28, 1986 (Baldwin-United Corp. was reorganized, in parts, as PHLCorp Inc., when Leucadia acquired 39 percent of common stock of PHLCorp by purchasing claims due to receive stock under plan that had been confirmed but not yet consummated).

26. See 11 U.S.C. § 1126 (1988). There are instances in which not all creditors will be consulted on the plan, and when a plan proponent may have the power to “cram down” a plan on dissenting classes of impaired creditors. For an in-depth discussion of cram down, see Klee, All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code, 53 Am. Bankr. L.J. 133 (1979).

“Adequate information” means information in sufficient detail to enable a reasonable investor to make an informed judgment about the plan of reorganization. See In re Reverie Copper & Brass, Inc., 58 Bankr. 1, 3 (S.D.N.Y. 1985); 11 U.S.C § 1125(a)(1) (1988); 5 Collier on Bankruptcy, ¶ 1125.03, at 1125-20 to 1125-23. The type of information that will constitute adequate information in any particular instance will be assessed on a case-
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solicited to confirm a reorganization plan. Section 1125, therefore, affords the solicited creditor at least a minimum amount of information.

The chapter 11 claim market, however, operates before a plan of reorganization has been confirmed. Section 1125 on its face, therefore, does not impact on the post-petition assignment of claims in bankruptcy.

B. Rule 3001(e)(2)

Bankruptcy Rule 3001(e)(2) governs the assignment of claims after proof of the claims has been filed with the court. In its present form, Rule 3001(e)(2) requires only that the court be notified when a claim is assigned. Upon such filing, the court clerk must mail notice of the assignee. See by-case basis. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 409 (1977), reprinted in 1978 U.S. Code Cong. & Admin. News, 5963, 6365.

31. See S. Rep. No. 989, 95th Cong., 2d Sess. 121, reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5907. “A plan is necessarily predicated on knowledge of the assets and liabilities being dealt with on an [sic] on factually supported expectations as to the future course of the business . . . .” Id; see also Century Glove, Inc. v. First Am. Bank, 860 F.2d 94, 100 (3d Cir. 1988) (section 1125 sets floor of disclosure that is to accompany solicitation for approval of plan of reorganization).
32. See In re Revere Copper & Brass, Inc., 58 Bankr. 1, 2 (S.D.N.Y. 1985); C. Fortgang and T. Mayer, supra note 1, at chs. 1 & 7.
33. See Revere, 58 Bankr. at 3 n.2. Judge Abram stated: “[n]othing in this opinion should be construed to hold that a disclosure statement as contemplated by Code § 1125 is required before [the claim assignee] may buy claims.” Id.
34. Rule 3001(e)(2) states:

If a claim other than one based on a bond or debenture has been unconditionally transferred after the proof of claim has been filed, evidence of the terms of the transfer shall be filed by the transferee. The clerk shall immediately notify the original claimant...

If the court finds, after a hearing on notice, that the claim has been unconditionally transferred, it shall enter an order substituting the transferee for the original claimant, otherwise the court shall enter such order as may be appropriate.

35. See id.; infra note 37 and accompanying text.
assignment to the assignor. Rule 3001(e)(2) authorizes a hearing on notice without preceding request or suggestion from either party to the assignment.

The only issue to be resolved in a 3001(e)(2) hearing is whether the transfer of the claim in interest is unconditional: "[i]f the court finds . . . that the claim has been unconditionally transferred, it shall enter an order substituting the transferee for the original claimant . . . ." In the past, courts found that Rule 3001(e)(2) served the interests of sound administration by limiting trading on inside information and trading by fiduciaries of the debtor. Recently, however, bankruptcy decisions have recognized that 3001(e)(2) does not provide adequate disclosure.

The Judicial Conference Advisory Committee on Bankruptcy Rules has proposed certain amendments to Rule 3001(e). These proposed

37. See id. Until recently, assignments of claims were processed through a ministerial procedure that did not entail judicial scrutiny. See, e.g., In re Quakertown Shopping Center, Inc., 366 F.2d 95, 98 (3d Cir. 1966) (creditor could transfer its claim against debtor without court approval); C. Fortgang & T. Mayer, supra note 1, at 29 (description of 3001(e)(2) as traditionally ministerial in purpose and application). But see, e.g., In re Chateaugay (In re LTV Energy Products), No. 86 B 227342-405, slip. op. (Bankr. S.D.N.Y. Mar. 11, 1988) (court used Rule 3001(e)(2) "hearing" power to interrupt post-petition transfers); In re Allegheny Int'l, Inc., 100 Bankr. 241, 243 (W.D. Pa. 1988) (same); In re Revere Copper & Brass, Inc., 58 Bankr. 1, 2 (S.D.N.Y. 1985) (same).

38. See Fed. R. Bankr. P. 3001(e)(2); see also Revere, 58 Bankr. at 2-3 (court used Rule 3001(e)(2) "hearing power" to interrupt post-petition claim assignments); Allegheny, 100 Bankr. at 243 (same). Because Rule 3001(e)(2) does not require court approval of any claim assignment based upon a bond or debenture, it can only be used to protect creditors other than public security holders. See Fed. R. Bankr. P. 3001(e)(2); see also In re Apex Oil Co., 92 Bankr. 847, 863 (Bankr. E.D. Mo. 1988) (Rule 3001(e)(2) does not require court approval of any claim based upon bond or debenture).


40. See Fed. R. Bankr. P. 3001(e)(2) advisory committee's note; cf. Monroe v. Scofield, 135 F.2d 725, 726-27 (10th Cir. 1943) (director who purchased claim against insolvent corporation is precluded from recovering more than what she paid for it); In re Philadelphia & Western Ry. Co., 64 F. Supp. 738, 740 (E.D. Pa. 1946) (fiduciaries who purchased claims limited to recovery of price less any profits from other bonds purchased by them).


42. See Committee on Rules of Practice and Procedure of the Judicial Conference of the United States, Preliminary Draft of Proposed Amendments to the Bankruptcy Rules (August 1989) [hereinafter "Committee Proposal"]. The Committee has requested that the proposals be circulated to the bench, the bar and to the public generally for comment. See id. at xiv (Letter from Joseph F. Weis, Jr., Chairman, Standing Committee on Rules of Practice and Procedure, and James E. Macklin, Jr., Secretary (August 18, 1989)). The proposed new Rule 3001(e)(2) reads:

Transfer Other Than For Security After Proof Filed. If a claim other than one based on a publicly traded bond or debenture has been transferred other than for security after the proof of claim has been filed, evidence of the transfer shall

37. See id. Until recently, assignments of claims were processed through a ministerial procedure that did not entail judicial scrutiny. See, e.g., In re Quakertown Shopping Center, Inc., 366 F.2d 95, 98 (3d Cir. 1966) (creditor could transfer its claim against debtor without court approval); C. Fortgang & T. Mayer, supra note 1, at 29 (description of 3001(e)(2) as traditionally ministerial in purpose and application). But see, e.g., In re Chateaugay (In re LTV Energy Products), No. 86 B 227342-405, slip. op. (Bankr. S.D.N.Y. Mar. 11, 1988) (court used Rule 3001(e)(2) "hearing" power to interrupt post-petition transfers); In re Allegheny Int'l, Inc., 100 Bankr. 241, 243 (W.D. Pa. 1988) (same); In re Revere Copper & Brass, Inc., 58 Bankr. 1, 2 (S.D.N.Y. 1985) (same).

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changes limit the bankruptcy court’s role in the administration of claim transfers without addressing the lack of disclosure in the modern post-petition claim markets.43

III. THE POST-PETITION TRILOGY: RECENT JURISPRUDENCE IN THE POST-PETITION MARKET

Without regulation that specifically addresses inadequate disclosure, the chapter 11 claims market will continue to operate without the information necessary to ensure a fair and free marketplace.44 Rule 3001(e)(2) requires nothing more than filing of notification by the assignee and an assignor acknowledgement of the claim transfer with the court.45 Section 1125(b), on its face, is limited to solicitations for votes on proposed plans of reorganization.46 Courts, however, have attempted to fill this void with their own ad hoc remedies, which has caused uncertainty in the post-petition market.

Three recent cases have confronted the issue of disclosure in post-petition claim market.47 Each involved attempts by investors to have post-petition assignments approved pursuant to Rule 3001(e)(2). All three were brought before the court without any preceding request or suggestion from the claim assignor. Although the facts in each were strikingly similar, the results varied.48

The court in In re Revere Copper and Brass, Inc.49 was concerned that

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 20 days of the mailing of the notice or within any additional time allowed by the court. If the alleged transferor files a timely objection and 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.

Id. at 77-78 (emphasis omitted).

43. See id. at 80-81. Even though the amended rule is meant to have a neutral effect on post-petition trading, the proposal seems to have been sparked by recent judicial interruptions of chapter 11 claim transfers where there was no preceding assignor objection. See In re Chateaugay (In re LTV Energy Products), No. 86 B 227342-405 slip op., (Bankr. S.D.N.Y. Mar. 11, 1988); In re Allegheny Int'l, Inc., 100 Bankr. 241, 243 (W.D. Pa. 1988); In re Revere Copper & Brass, Inc., 58 Bankr. 1, 2 (S.D.N.Y. 1985); see also Committee Proposal, supra note 42, at xxv ("Rule 3001 is amended to limit the court's role in connection with transfers of claims.").

44. The best way to ensure that a market operates efficiently and freely is to provide the marketplace with as much pertinent information as possible without chilling it with undue regulation. See C. Fortgang & T. Mayer, supra note 1, at 75-76.


46. See 5 Collier on Bankruptcy ¶ 1125.03(2), at 1125-23.


49. 58 Bankr. 1 (S.D.N.Y. 1985). Revere concerned the assignment of 28 claims against Revere, a chapter 11 debtor; to a third party investor. See id. at 1. Revere peti-
post-petition claim assignors had been too eager to sell their claims at steep discounts and may have done so without adequate information. Judge Abram also sensed that the claim assignee ("Phoenix") stood to make an extremely large profit.

Revere addressed the problem of inadequate disclosure by allowing claimants thirty days to rescind their assignments before approving the transfers. Judge Abram stated that subsequent claim assignments to Phoenix would not be approved unless the claimants were advised of the pertinent terms of Revere's reorganization plan.

Judge Abram suggested that section 1125 should extend to third-party claims purchases. In a footnote, however, she stated, "[n]othing in this

50. See id. at 2. Judge Abram stated:
One of the evils attendant upon a solicitation of assignment of claims for a cash payment such as is being made by Phoenix is that solicited creditors may be unaware of their rights and options and fall prey to the belief that bankruptcy inevitably will result in their receiving the proverbial 10 cents on the dollar or worse.

Id.

Judge Abram expressed this concern even though seventeen of the twenty-eight assignments came after the November 30 Wall Street Journal article outlining terms of Revere's proposed plan. See id. (citing Wall St. J., Nov. 30, 1984, at 10, col. 1).

51. Cf. id. at 2-3 (court worried that assignees may profit from creditors' ignorance of the bankruptcy process and lack of adequate information).

52. See id. at 3.

53. See id.

54. Judge Abram implicates section 1125's relevance to post-petition solicitations by third party investors when, in the body of the opinion, she describes section 1125's disclosure requirements and goes on to observe that the assignors in this case were not provided with enough disclosure. Judge Abram stated:

Bankruptcy Code § 1125 prohibits solicitation of acceptances or rejections of a filed plan unless the solicitation is accompanied or preceded by a disclosure statement. The disclosure statement must contain adequate information . . . .

The assignor-claimant [sic] have not been shown to been given [sic] sufficient
opinion should be construed to hold that a disclosure statement as contemplated by Code § 1125 is required before Phoenix may buy claims. Notwithstanding Judge Abram's disclaimer, *Revere* rests on a broad interpretation of section 1125(b). *Revere*, if not limited, would classify claims purchases by third-party investors as solicitations on a plan of reorganization.

The Phoenix claims purchases were, however, in no way connected with such a plan. Phoenix, a third-party investor, simply sought to speculate on the outcome of the reorganization. Furthermore, this broad interpretation is contrary to recent case law that has narrowed the application of section 1125(b) and limited the definition of what constitutes a solicitation on a plan.

Judge Cosetti in *In re Allegheny International, Inc.*, also addressed the disclosure problem. In a memorandum opinion, Judge Cosetti directed investors who had purchased claims at a discount to offer the claim assignors a chance to rescind their assignments. Upon motions

information by Phoenix that they might make an informed judgment about the offer made to them.

*Id.* at 2-3. (footnote omitted).

55. *Id.* at 3 n.2. Judge Abram noted that her decision was concerned only with ensuring that overreaching is not overlooked by the ministerial task of approving assignments pursuant to 3001(e)(2). *See id.*

56. *See id.* at 3; *see also In re Allegheny Intl, Inc.*, 100 Bankr. 241, 242 (W.D. Pa. 1988) (citing *In re Revere Copper & Brass*, Inc. 58 Bankr. 1 (S.D.N.Y. 1985) (the Allegheny court also took a broad view of § 1125(b)); C. Fortgang & T. Mayer, *supra* note 1, at 55 ("there was little or no authority either under the Code or even under the Act for the rescission of [Phoenix's] purchases").


58. *See Allegheny*, 100 Bankr. at 242 n.3; *Revere*, 58 Bankr. at 2; *supra* note 15 and accompanying text.

59. *See, e.g.*, Century Glove, Inc. v. First American Bank, 860 F.2d 94, 101-02 (3d Cir. 1988) (intercreditor communications about alternate plans are not subject to section 1125); TWA v. Texaco (*In re Texaco*), 81 Bankr. 813, 815 (S.D.N.Y. 1988) (agreement to settle Pennzoil's suit for $3 billion in return for Pennzoil's support for debtor's plan did not constitute solicitation of acceptance).

60. 100 Bankr. 241 (W.D. Pa. 1988). In *Allegheny*, Phoenix Capital, Drexel Burnham Lambert, Cowen & Co., and AI Investment Partners, L.P., purchased claims at a discount from the original creditors of Allegheny, International. *See id.* at 242. The discounts offered in the various solicitations ranged from Phoenix's 20 percent of face value to Cowen & Co.'s 75 percent of face value. *See id.* at 243. Judge Cosetti noted that the assignors (i.e. Pittsburgh National Bank) were sophisticated financial institutions who understood the implications of their actions. *See id.* at 242. Nevertheless, upon learning that Allegheny had filed a 100-cent plan, Judge Cosetti ordered third party investors to allow the claim sellers to rescind their assignments. *See id.* at 243 (citing Memorandum Opinion and Order of November 3, 1988). Here, as in *Revere*, the court acted on its own initiative. There were no preceding objections from any of the claim assignors. *See id.* at 243. Judge Cosetti stated "[w]e were especially concerned because the plan of reorganization pending at the time of our opinion proposed to pay many of the assignors 100% of their claims." *Id.* at 242.

In December of 1988 the investors motioned Judge Cosetti to reconsider his November decision. Cosetti granted the motions for reconsideration, and held that assignments would be approved pursuant to normal Rule 3001(e)(2) procedure. *See id.* at 242.

61. *See id.* at 242.
for reconsideration, the Judge reversed his order and approved the assignments. Approval was conditioned upon an order requiring future debtors to provide potential assignors with information regarding the value of the claims. The reasoning in Allegheny and Revere was similar.

Allegheny applied section 1125(b) broadly and adopted an expansive view of what constitutes a solicitation on a plan. Allegheny is not clear, however, as to whether section 1125(b) actually applies to claim assignments where the assignee is an unrelated third-party investor. Judge Cosetti acknowledged that if the solicitations had been made not by third-party investors, but by the debtor itself, the court would be forced to apply section 1125(b) disclosure requirements to the transaction. Yet the decision recognized that section 1125(b), as written, does not apply to chapter 11 claim assignments to third party investors.

Allegheny suggests that, if given the chance, some bankruptcy judges would apply section 1125(b) disclosure to third-party dealings in claim markets. Judge Cosetti called for new legislation in this area.

Judge Cosetti established an informal supplement to Rule 3001(e)(2) to regulate future claim assignments. It required potential assignees to

62. See id. at 244.
63. See id. at 243.
64. Judge Cosetti stated that "[d]entical concerns and a similar remedy were expressed by the court in In re Revere." See id. at 242. Both Judge Cosetti and Judge Abram were concerned that, because of a lack of adequate disclosure, creditors were selling their claims at steep discounts, without fully understanding their rights. See id. at 242 (citing In re Revere Copper & Brass, Inc., 58 Bankr. 1 (S.D.N.Y. 1985)).
65. See id. at 243. Judge Cosetti stated: "Section 1125(b) of the Bankruptcy Code, 11 U.S.C. § 1125(b), prohibits solicitation before a disclosure statement has been disseminated. We remain troubled that the process by which claims are solicited constitutes solicitation, but does not provide even a minimum of information." Id.
66. See id. at 243; see also In re Revere Copper & Brass, Inc., 58 Bankr. 1, 3 n.2 (S.D.N.Y. 1985) (Judge Abram also stated that post-petition claims purchases by the debtor would require section 1125(b) disclosure).
68. Judge Cosetti said:

the Bankruptcy Code does not permit a debtor to pay its pre-petition debts to suppliers, at a discount or otherwise, before confirmation of the plan, but it appears to allow third parties to purchase the claims of those suppliers at discounts, which are sometimes outrageous, without any disclosure.

Id. at 243.

This is in line with present case law which has sought to avoid broadening the scope of section 1125(b). See supra note 59 and accompanying text.
69. Cf Allegheny, 100 Bankr. at 243 (court suggests the application of section 1125 disclosure to post-petition solicitations by third-party investors).
70. "We hope that Congress will address these concerns in the future." Id. at 243.
71. Even though Allegheny seems to call for an extension of the traditional application of section 1125(b), it ultimately relies on Rule 3001(e)(2) to impose extra disclosure requirements. See id. at 243-44. This seems to suggest that the answer to any disclosure problems lies not in section 1125(b), but in Rule 3001(e)(2).
72. Compare Allegheny, 100 Bankr. at 243-44 ("Prospective assignments will require compliance with Bankruptcy Rule 3001(e)(2), as modified by this order.") with In re Revere Copper & Brass, Inc., 58 Bankr. 1, 3 (S.D.N.Y. 1985) ("Phoenix is advised that as
give notice of the transfer not only to the court and to the assignor, but also to the debtor. The debtor would then have to provide the claim assignor with its best estimate of the claim's value. The onus of disclosure would fall not on the investor-assignee, but on the debtor in possession.

In *In re Chateaugay (In re LTV Energy Products)*, Regal Inc. sought to acquire control of LTV Energy Products, a chapter 11 debtor and a subsidiary of the LTV Corporation. Notwithstanding Regal's objections, Judge Lifland and the debtor surmised that Regal's post-petition solicitation for claims was a vehicle for the acquisition.

To any claims assigned to it that the court will in the future decline to approve the assignments unless . . . claimants have been advised . . . of the pertinent terms of Revere's announced or any subsequently filed plan.

73. See Allegheny, 100 Bankr. at 243-44.
74. See id. at 243-44.
75. See Allegheny Int'l, Inc., 100 Bankr. 241, 243-44 (W.D. Pa. 1988). Unlike *Revere*, *Allegheny* shifted the burden of disclosure onto the debtor in possession. The debtor would have a better understanding of the value of the claims being solicited for assignment. Compare id. at 243-44 (required debtor to provide assignor with disclosure) with *Revere*, 58 Bankr. at 2-3 (required assignee to provide assignor with disclosure statement). Judge Cosetti would interject the debtor, who may not support the assignments, into a private transaction between the investor and the potential assigning creditor. In contrast, legislative history indicates that 3001(e)(2) was enacted to require limited disclosure from the post-petition transferee, not from the debtor. See Fed. R. Bankr. P. 3001(e)(2) advisory committee's note. More importantly, involving the debtor in post-petition transactions may raise unnecessary conflict of interest problems as well as difficulties in determining exactly what the debtor would be required to disclose.

77. See *In re Chateaugay (In re LTV Energy Products)*, No. 86 B 227342-405, slip op. (Bankr. S.D.N.Y. Mar. 11, 1988); see also Transcript of Hearing on Motion by Regal Int'l to Reconsider, March 11, 1988, Order Declining to Approve the Transfer of 456 Claims, at 6-7 (Bankr. S.D.N.Y. Sept. 19, 1988) ("Regal has stated unqualifiedly before this Court on various occasions . . . that it would like to acquire through formulation and presentation of a Plan of Reorganization related to LTV Energy Products [sic]" (comments of Mr. Hazan, attorney for Regal, Inc)).
78. See id. at 7; C. Fortgang & T. Mayer, supra note 1, at 105-08. In *Chateaugay*, Regal formed a shell corporation called EPA, Inc., to buy LTV Energy Product's debt. See C. Fortgang & T. Mayer, supra note 1, at 105. EPA mailed solicitations to every unsecured creditor of LTV Energy Products, offering 33 cents for every dollar amount of unliquidated claims held against LTV. See id. Over 456 creditors accepted EPA's cash offer. EPA duly filed notices of transfer with the bankruptcy clerk for the Southern District of New York, pursuant to 3001(e)(2). See id.; see also Regal's Memorandum of Law in Support of Motion for Reconsideration at 1-2, *In re Chateaugay*, No. 86 B 227342-405, slip op. (Bankr. S.D.N.Y. Mar. 11, 1988) (Case Nos. 86 B 11270 through 86 B 11334); Debtors' Memorandum of Law in Opposition to the Motion at 2-3, *In re Chateaugay*, No. 86 B 227342-405, slip op. (Bankr. S.D.N.Y. Mar. 11, 1988) (Case Nos. 86 B 11270 through 86 B 11334). LTV Energy Products, however, disagreed with Regal over the pace of the reorganization and Regal's desire to control the reorganized debtor. LTV Energy Products, therefore, challenged the assignments. See *Chateaugay*, No. 86 B 226342-405, slip op.

Unlike *Allegheny* and *Revere*, the assignment controversy was pursued, not by the overseeing bankruptcy judge, but by the debtor. See C. Fortgang & T. Mayer, supra note 1, at 105. It should be noted that even though the debtor, a party in interest, objected to the assignments, the actual assignors did not. See Regal's Memorandum of Law in Sup-
Judge Lifland refused to approve the transfers. He was concerned that Regal, by proposing what amounted to a solicitation on a plan without the requisite disclosure, circumvented protections offered creditors by section 1125. Judge Lifland attached a "Chamber Supplement" to Rule 3001(e)(2) to apply to all future claim assignments.

Judge Lifland did not extend the traditional applications of 1125(b). He instead opted to augment the bankruptcy rules through a specific chamber supplement requiring disclosure of the consideration paid for the claim and representation that the assignment was not solicited by misinformation.

The bankruptcy courts have struggled with regulations and rules that are inadequate to address the expanding market in post-petition claims. The response to this problem has been a series of inconsistent and ad hoc judicial remedies that begs for some regulatory guidance. The bankruptcy courts have recognized that they are not regulatory mechanics and that more effective regulation should come from the appropriate...
rule-making bodies. Continued uncertainty in the jurisprudence of post-petition claim assignments will make the market less attractive to investors. Accordingly, it would be more difficult for cash-poor creditors to liquidate their claims. Adoption of supplemented procedures would provide desperately needed guidance.

IV. RESOLUTION: A CALL FOR AUGMENTATION OF RULE 3001(e)(2)

A. Disclosure

Bankruptcy decisions have noted that existing regulation fails to provide for significant disclosure in the post-petition claim markets. Rule 3001(e)(2) should be amended to require certain de minimis levels of disclosure from the post-petition assignee.

Requiring the assignee to divulge the amount paid for the claim would notify other interested parties of the claim's trading value. It would also enable potential assignors to gauge the value of their own post-petition claims. This would make the post-petition market more efficient.

The assignee should further represent that the claim was not solicited through the use of misinformation or omission. This representation would address recent concerns over possible insider trading in the post-petition market. Such a requirement would create an affirmative duty on the part of the assignor to disclose any information that contradicted the claim solicitation.

An amendment to 3001(e)(2) should also require that post-petition claim solicitations include notice to the potential assignors of the possi-

86. See, e.g., Allegheny, 100 Bankr. at 243 (court asked for legislative guidance); Revere, 58 Bankr. at 3 n.2 (court was reluctant to apply section 1125(b) to post-petition trading by third-party investors). These rule-making bodies include the Supreme Court, see 28 U.S.C. § 2075 (1988), or the district courts themselves. See Fed. R. Bankr. P. 9029.


88. See id. at 23-25; see also Allegheny, 100 Bankr. at 242 (argument of Cowen & Co. in favor of order of subrogation of assignments).

89. See infra notes 91-97 and accompanying text.


91. See Supplement to Rule 3001(e)(2), supra note 41.

92. By analogy, Rule 3001(e)(1), which deals with claim transfers before the claim itself was filed, requires that "evidence of the transfer" shall be supported by "a statement of the transferor acknowledging the transfer and stating the consideration therefor." See Fed. R. Bankr. P. 3001(e)(1); see also supra note 44 and accompanying text (the greater the amount of pertinent disclosure the more efficient the market).

bility of higher yields from reorganization payouts. Such a change would be a small step toward ensuring that the post-petition assignor had a basic understanding of the reorganization process.94

In addition, 3001(e)(2) should be extended to include a brief period during which assignors could rescind their claim transfers. This amendment would mollify the pressure assignors face when confronted with post-petition solicitations offering immediate cash for their claims and would, therefore, reduce panic selling.95

Taken together, these proposed amendments to Rule 3001(e)(2) would address recent judicial calls for increased disclosure in the chapter 11 post-petition claims market, without unduly burdening the market with regulation.96

B. Judicial Intervention Only at the Request or Suggestion of the Claim Assignor

Augmentation of Rule 3001(e)(2) with stronger disclosure provisions would make it unnecessary for the courts to intervene in the post-petition markets in most instances. Adopting such requirements should circumscribe authority of bankruptcy judges to interrupt post-petition assignments randomly without prior request or suggestion by the claim assignor. The Preliminary Draft of Proposed Amendments to the Bankruptcy Rules would change Rule 3001(e)(2) to require judicial approval of post-petition claim assignments unless the assignor filed timely objection with the court.97 This would take the bankruptcy court out of the post-petition assignment process and confine it to its traditional ministerial function of approving claim transfers.98

94. See, e.g., Allegheny, 100 Bankr. at 243 (court was concerned that post-petition investors may be able to take advantage of their superior knowledge of the chapter 11 process to the detriment of the original claimants); In re Revere Copper & Brass, Inc., 58 Bankr. 1, 2-3 (S.D.N.Y. 1985) (same).

Some solicitations contained language notifying solicited claimants of higher yields upon reorganization. See Supplement to Rule 3001(e)(2), supra note 41. The solicitation from EPA/Regal to creditors of LTV Energy Products stated, "[t]here is currently no reorganization plan proposed by the company or the creditors. If and when there is claimants may or may not have an opportunity for higher recoveries." Id. at 6. But see Revere, 58 Bankr. at 1 (Allegheny's letter provided no such language).

95. The Revere court allowed claim assignors a thirty-day period in which to revoke their claim transfers. See Revere, 58 Bankr. at 3. As the court further noted: "One of the evils attendant upon a solicitation of assignment of claims for a cash payment . . . is that solicited creditors may be unaware of their rights and options." Id. at 2; see also Allegheny, 100 Bankr. at 243 (court was concerned that small unsophisticated creditors were panic selling their claims to more sophisticated post-petition investors).

96. See supra note 44 and accompanying text.

97. See Committee Proposal, supra note 42, at 76-81.

98. See, e.g., Committee Proposal, supra note 42, at 80-81 advisory committee's note ("Subdivision (e) is amended to limit the court's role to the adjudication of disputes regarding transfers of claims.") (emphasis omitted); see also In re Quakertown Shopping Center, Inc., 366 F.2d 95, 98 (3d Cir. 1966) (creditor may voluntarily transfer his claim without approval of bankruptcy court); Fed. R. Bankr. P. 3001(e)(2) advisory committee's note (the intent behind the rule was fundamentally administrative); C. Fortgang &
This change is necessary to limit the destabilizing effect of the recent judicial intervention in the post-petition market.99 Because the parties usually involved are sophisticated institutional investors and creditors, such intervention is largely unnecessary.100 Furthermore, the bankruptcy courts' general equitable powers to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions"101 of the Code would not be affected.

CONCLUSION

The post-petition chapter 11 claims market infuses desperately needed liquidity into a process usually starved for cash. The viability of this market depends upon the willingness of third party investors to gamble on the outcome of unpredictable reorganizations. Recent judicial ventures into the post-petition market, precipitated by a lack of adequate disclosure provisions, resulted in varying remedies. Continued ad hoc and inconsistent decisions will discourage investors from speculating in the market for post-petition claims.

Therefore, bankruptcy judges should be given guidance on how to administer this growing market fairly and effectively. Augmentation of Rule 3001(e)(2), as suggested in this Note, is a logical vehicle for providing such guidance and ensuring consistency and stability in the post-petition market.

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T. Mayer, supra note 1, at 26 (Rule 3001(e)(2) imposes relatively innocuous restrictions on claims trading).


100. See In re Allegheny Int'l, Inc. 100 Bankr. 241, 242 (W.D. Pa. 1988); C. Fortgang & T. Mayer, supra note 1, at 71-72. But see In re Revere Copper & Brass, Inc., 58 Bankr. 1 (S.D.N.Y. 1985)(court was concerned that claim assignors were in fact unsophisticated).
