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Trading Claims During Bankruptcy After *Allegheny, Apex, Revere*, and the New Rules: Is a Goal of Chapter 11 Now More Easily Obtained?

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I. Introduction

The decade of the 1980s witnessed many corporations besieged by their number one foe, the junk bond financed raider. As the decade ended, however, a growing number of investors and corporate debt raiders discovered a new market in post-petition bankruptcy proceedings. By trading claims held against companies in a Chapter 11 bankruptcy, new and better opportunities were created for mergers, acquisitions, and takeovers at lower transaction costs and higher profits. However, the legal problems surrounding these new markets have frequently impeded and frustrated their growth. The problem has been exacerbated by the competition between the courts' sense of fair play and the profit motive of business. The question then is, what role should the bankruptcy court play in post-petition trading of claims in a Chapter 11 proceeding? In addition to a historical discussion on trading claims, this article explores the basic considerations necessary to answer the question by analyzing what bankruptcy courts have done in the past, what they are presently doing, and what they should consider in the future. The bankruptcy courts' future considerations should maximize results for creditors through the efficient reorganization and distribution of a debtor's assets and liabilities.

II. Snapshots from the History of Trading Claims

A. *Debt Raiders: Who Are They? What Do They Do?*

As more and more deals from the debt drenched 1980s unravel, a new term is entering the Wall Street lexicon: debt raider.[1] A debt raider is an investor who trades in and possibly takes over cash-strapped or reorganizing companies by buying strategic layers of their debt.[2] Debt raiders come in all sizes, configurations, and levels of respectability.

Various entities, including investment banks, money managers, pension funds and universities, have raised close to 1.5 billion dollars to invest in troubled companies of all sizes.[3] Their targets are both publicly and privately owned bankrupt companies. Most of these funds are intended as passive investments in securities of companies in Chapter 11. Some funds, however, will be used to purchase or trade claims against bankruptcy debtors.[4]

Cost is the big difference between the debt raiders approach of today and the previous decades' acquisition plans, such as Leveraged Buy Outs ("LBOs").[5] Fundamental to an LBO is an analysis of the corporate worth. The overpriced equity sets the asking price. In contrast, buying up corporate debt on a discounted basis is a much cheaper route than buying control in a company. The debt raider's method, therefore, has the advantage of requiring less financial engineering.[6]

The successful techniques of these corporate debt raiders have not gone unnoticed by the more aggressive participants in the bankruptcy arena. Blending debt raider methods into the traditional practice of trading claims against insolvent debtors has yielded many successes. Thus, the door has been opened to the possibility of a more innovative debt restructuring for the Chapter 11 debtor. Nevertheless, trading claims in bankruptcy proceedings has also served to contrast the different objectives of law and economics.

B. *Dissolving the Stigma of Bankruptcy*

The removal of the stigma and financial embarrassment long associated with bankruptcy has encouraged trading in bankruptcy claims. The stigma began dissolving when Congress amended the Federal Bankruptcy Code in 1978. The language of the new Bankruptcy Code provides that a petitioner is no longer labeled as bankrupt under the law; rather the petitioner is a debtor.[7] Few among us have not had the personal experience of voluntarily being a debtor at one time or another - including several of our original thirteen states.[8] During the past decade, we have observed individuals and corporations enter Chapter 11 bankruptcy proceedings and exit as reorganized and operating entities. Continental Airlines, Texaco Oil, and ex-Governor John Connally are some of the more prominent names which have helped alter the way in which society views the merits of bankruptcy.

C. A Bad Start & the Nation's Capitol

Historically, investors (as the precursors to today's debt raiders) have long sought to acquire claims against bankrupt companies and governments. Creditors of these entities often chose to sell or trade their claims for fear of losing all of their assets or for other mitigating reasons. However, due to what we would characterize today as an " insider-trading 10-b" like violation, trading claims did not start off on the best footing.

Immediately after the Revolutionary War and prior to any federal bankruptcy law, many of the northern states were insolvent debtors.[9] During the war, these states had issued debt securities to pay their soldiers' wages and for military supplies. Members of the First Congress of the United States and some of their friends bought these debt securities at considerable discount (10 to 25 cents on the dollar). At the same time, the Congressmen were considering legislation that would have allowed the new federal government to purchase these same securities at 100% face value with the cash proceeds from the sale of public lands.[10]

James Madison responded by introducing legislation to deny the windfall to the congressional members. He proposed paying the original holders of the securities 100% of their value, but only paying prevailing market price to the subsequent debt security traders. Madison's bill was rejected by a House of Representatives in which 29 of the 64 total House members had purchased the discounted securities.[11] While Madison was not successful in stopping fiduciary insider-like trading of claims in 1790, subsequent history reveals the development of a substantial body of securities trading law that would vindicate his efforts and prohibit overreaching by future fiduciaries.

Ironically, this blatant abuse of the public trust generated a compromise that lead to an important historical decision. The bills which enabled the northern speculators to collect 100 cents on the dollar on the claims purchased at a discount passed both houses of Congress, but at a price. Southern Congressmen agreed to vote for the bills only if the nation's capitol would be moved to a site between Maryland and Virginia on the Potomac River.[12]

In spite of an embarrassing beginning, trading claims gained momentum and scope as the practice became more prevalent at the turn of the 20th century. In the 1920s and 1930s, investors purchased default railroad bonds and debentures.[13] Major Wall Street houses traded claims and stock for profit and for control in the wave of reorganizations that followed the Great Crash of 1929.[14] In the 1970s and 1980s, many of the bank creditors of Johns-Manville, Inc., Storage Technology Corporation, Penrod Drilling Corporation, and Wheeling-Pittsburgh Steel Corporation sold their claims to various investors, rather than seek control of the company, during the Chapter 11 reorganization of those corporations.[15] More recently, in the Chapter 11 reorganization of Revco D.S., Inc. there was an active market and even a secondary market for bank claims against the debtor.[16]

D. Examples of Taking Control

In late 1988, Japonica Partners L.P. strategically purchased all of the senior secured bank debt of Allegheny, International, Inc., a company that had filed for protection under Chapter 11 bankruptcy law.[17] Japonica went on to acquire the majority of the outstanding public debt of Allegheny which netted Japonica more say to influence the means by which a reorganization plan would eventually be adopted and approved by the Bankruptcy Court.[18] The effect was that Japonica had launched the first hostile tender offer for control of a Chapter 11 debtor by acquiring claims against the debtor.[19]

In another setting, trading claims played a crucial role in the success of a creative Chapter 11 debtor. The debtor, Apex Oil Company ("Apex'), was able to sell its major assets to a claims purchaser and then effect a " leveraged buyout" from bankruptcy. Rather than having an outside third party take control of the debtor, as in the Allegheny scenario, Apex regained the control of its company and its financial destiny. Briefly, this is how it worked.

Apex Oil Company had struck a financing deal in 1982 with a group of banks to receive a revolving credit line for up to approximately $740 million. Early in 1984, Apex suffered big losses as the United States oil market began to dry up. By 1986, Apex's futures contracts for oil and its own oil inventory had lost $175 million in value. Apex was in serious financial trouble. The banks accelerated their notes and began foreclosure proceedings on secured collateral in December of 1986. On Christmas Eve, 1987, Apex filed for Chapter 11 protection. Apex was facing claims from the banks for $545 million.[20]

Amidst threats, counter-threats and hostility from all parties, an asset acquisition vehicle affiliated with Horshom Industries, AOC Acquisition Corporation ("AOC"), and the banks attempted to negotiate a specialized purchase agreement. Under this agreement, the creditor banks would sell their claims against Apex to AOC at a discount. The banks would sell their $545 million in claims for $396 million. After more negotiations about representation and warranties and resell rights, an agreement was reached. The bank subsequently suggested that the bankruptcy court order the validity and priority of their liens and approve a waiver of any and all claims of Apex against the bank group. With the comfort zone of the banks sufficiently widened, Apex took the next step. Apex negotiated with AOC for the purchase of Apex's major assets by AOC. At that point AOC was holding $545 million in claims against the Chapter 11 debtor Apex, for which claims AOC had paid only $396 million. Apex then agreed to sell its major assets to AOC in exchange for the full face value of the $545 million in claims.

With the symmetry of a triple play, Apex purchased back its creditors' claims of $545 million and AOC walked away with major assets of Apex Oil valued somewhere between $396 million and $545 million. With the elimination of $545 million in debt Apex was able to complete the reorganization and remove itself from bankruptcy.[21]

E. Congress & The Savings and Loan Crisis

The rapidly expanding frequency and scope of trading claims has received increased attention from the courts and may likely receive even more scrutiny in the near future from Congress. This is predictable because of national and international events. Once the President, Congress, and the nation re-centers its collective attention away from the international "Desert Storm" operation in the Persian Gulf and returns to domestic matters, a major item on the national agenda is the savings and loan crisis. It requires little creative imagination to foresee the practice of trading claims emerging as a new arrow from the quiver in an effort to bring down this national debt nightmare. Congress would be asked to draft new regulations governing trading claims in at least three areas - banking, securities and bankruptcy. While this observation is speculative, in this writer's opinion, the event is within the realm of the possible.

In spite of trading claims' recent meteoric rise in the world of corporate finance, it has not enjoyed similar success in the bankruptcy courts. Some bankruptcy courts view trading of claims with distinct suspicion, an overreaction to profit taking, and a primary misunderstanding of the real world effect of trading claims on a successful reorganization. It is apparent from recent court decisions that reliance on the present language and intent of Bankruptcy Rule 3001(e) has contributed to the courts' discomfort in dealing with the practice of trading claims.

III. Regulatory Background & Mechanics

A. Overlooked For Nearly A Century

A look back in time at the growth path of bankruptcy rules governing trading of claims quickly reveals that Congress has had little success in keeping up with real world needs. In 1938, the heart of Chapter 11, as we know it today, was cleaved out of Chapter 10 of the Bankruptcy Act of 1898. Congress made such an effort because its members wanted to prevent small businesses from cluttering up the federal district courts' docket.[22] Consequently, Congress provided a simple form under Chapter 11. The separation of forms is important to note. Chapter 10 contained guidelines for trading claims and stock of debtors, but Chapter 11 did not.[23] In 1938, the country was emerging from the depression and the 1929 stock market crash. The focus, therefore, was to protect the security holding public. Congress was less concerned about trade and bank creditors.[24] Congress apparently assumed the relationship was such that creditors knew their debtor and thus needed less protection.[25] The law describes that kind of relationship as one in which the parties deal at "arm's length." It is a relationship, however, that has often been ignored by bankruptcy courts when faced with claims trading at 20 cents on the dollar.

Congress assumed that large corporations with publicly traded stock and securities would end up using Chapter 10 because it's provisions allow any party to file a petition, while Chapter 11 does not. In 1974, Congress heard testimony that revealed that fewer than 10% of all business reorganization cases were being filed under Chapter 10.[26] Even though large corporations with publicly traded securities were choosing Chapter 11 and not Chapter 10, there was still no rule in Chapter 11 cases that applied any of the safeguards of the Chapter 10 rules. Absent from Chapter 11 were the prohibitions against the misuse of fiduciary trust demonstrated by those 29 members of the First Congress. Congress had made a mistake which has still gone uncorrected today.[27]

One rule that did attempt to govern the assignment of claims in Chapter 11 bankruptcy remained virtually unchanged for nearly a century. The Supreme Court adopted the General Orders of Bankruptcy in 1898. General Order XXIII(c)(3) governed the assignment of claims and was the precursor to the previous rule, 3001(e).[28] In 1939, the rule was changed only from Roman to Arabic numeric designation, 23c(3). In 1975 the Supreme Court redesignated 23c(3) to 302(d)(1) and (2), and 10-401(c), without material change in substance. Again, in 1985, Rule 302 was restated without material change, and became the former Rule 3001(e)(1) and (2).[29] With almost a century passing without substantive change, the rule's fabric has been worn thin by recent court decisions. Rule 3001(e) has not aged gracefully. By early 1990 many Chapter 11 participants saw trading claims as a significant established practice in corporate bankruptcy proceedings. It therefore became evident to Congress that there was a need to adopt rules more responsive to real world conditions.[30]

Probably the last judicial gloss applied on the prior version of Rule 3001(e) came in July of 1990 from the Honorable Burton R. Lifland, Chief

Judge of the United States Bankruptcy Court. Judge Lifland reasoned in *In re Ionosphere Clubs, Inc.* that "one of the primary objectives of the requirement in Bankruptcy Rule 3001(e) that claims be 'unconditionally transferred' is to enable the bankruptcy court to monitor the manner in which claims are transferred or assigned, and thereby prevent *inter alia* the improper proliferation of claims, wrongdoingand inequitable conduct."[31] During the same time frame that Judge Lifland was interpreting Rule 3001(e), the Bankruptcy Rules Advisory Committee was drafting the recently adopted change that would remove, among other things, most of the "monitoring" duty from Judge Lifland's court.

B. Mechanics - Old and New

The Bankruptcy Code does not establish procedures for the purchase or sale of claims. There are no bankruptcy rules relating to the transfer of claims prior to the filing of a bankruptcy petition. Prior to the adoption of the new rule, when a petition for reorganization was filed, previous Rule 3001(e) prescribed some restrictions on the transfer of claims not based upon "a bond or debenture." A claim might have been transferred by the creditor of a Chapter 11 debtor after the petition for bankruptcy was filed and before either a proof of claim had been filed or the claim had been scheduled.[32] All of this happened without notice, hearing, or judicial approval. Old Rule 3001(e) required a statement of transfer "acknowledging the transfer and stating the consideration therefore." Under the new rule, the "bond or debenture" language is deleted and replaced by "other than for security." The word "unconditionally" also has been deleted along with the statement of transfer language.[33] This substantive change can be viewed as further evidence of the decision of the advisory rules committee to reduce the courts' involvement in transferring claims.

Under the old rule if an investor acquired a claim after a creditor filed a proof of claim against the Chapter 11 debtor, then 3001(e)(2) would apply. This part of the rule required the transferee (purchaser of the claim) to file evidence of the "terms of" the transfer. Once this happened, the 20-day clock started, and during this time the creditor could object to the transfer. If the creditor/transferrer objected, the court could have still found the claims "unconditionally" transferred, and thereby approve the transfer. Under the new rule, however, "unconditionally" has been deleted from this section of the rule. More importantly, the new rule considerably scaled down the scope of any disclosures by deleting the phrase "terms of" from the previous requirement to provide evidence of the terms of the transfer. Obviously, the provision greatly distances the court from ever learning of the terms offered for the claims. Remembering that it was the knowledge of the terms in *Allegheny* that started Judge Cosetti on his road to opposition to the assignment, it's reasonable to expect that such judicial objections are not likely to recur in future similar cases.

The Committee on Bankruptcy Rules of Practice and Procedure of the Judicial Conference of the United States through its chairman Lloyd D. George, proposed in its June 5, 1990, memorandum changes to Rule 3001(e). The changes are significant and substantive. The first sentence in the following Advisory Committee Note helps to underscore the significance of the changes, and the remainder of the text explains the substantive reasons for the changes:

> Subdivision (e) is amended to limit the court's role to the adjudication of disputes regarding transfers of claims. If a claim has been transferred prior to the filing of a proof of claim, there is no need to state the consideration for the transfer or to submit other evidence of transfer. If a claim has been transferred other than for security after a proof of claim has been filed, the transferee is substituted for the transferrer in the absence of a timely objection by the alleged transferrer. In that event, the clerk should note the transfer without the need for court approval. If a timely objection is filed, the court's role is to determine whether a transfer has been made that is enforceable under non-bankruptcy law. This rule is not intended either to encourage or discourage post-petition transfers of claims or to affect any remedies otherwise available under non-bankruptcy law to a transferrer or transferee such as for misrepresentation in connection with the transfer of a claim. "After notice and a hearing" as used in subdivision (e) shall be construed in accordance with paragraph (5).[34]

There are those in the marketplace who say the new rule makes claims, such as bank loans, transferrable just by notifying the clerk of the court which would cut transaction costs, give bank credits the same liquidity as bonds, and, eventually lead to the securitization of distressed loans and trade credits.[35] Other observers contend that the relaxed rule should send a message to the courts. "The business of business is making deals. So let business buy and sell claims without undue interference of the bankruptcy court."[36] This observation summarizes the policy change in the courts' treatment of trading claims, law, and equity.

IV. A Question of Fairness

A. Passive Turns Aggressive

Traditionally, an investor's role in bankruptcy proceedings was very limited and passive. Investors would take the long term view toward profits.

Until recently, the most common bankruptcy securities traded by investors were debt securities.[37] After buying the securities at a low price, most investors would wait and resell the security when the value of the security had bounced back, and, hopefully, profit from the spread in the price.

Even though in a Chapter 11 proceeding, the investor, as a shareholder, is able to exert some control of company operations through the stockholders' board of directors. So long as the bankruptcy court did not appoint a trustee, the company would remain as a " debtor in possession."[38] The 1980s saw more and more bankruptcies. Investors, schooled in the bankruptcy process, found ways to speed up the return on their investments. They began not only to use their equity position, but also their status as holders of various types of claims to gain access to the creditor committees which structured the reorganization plan for the debtor company. This new access gave the investor the opportunity to increase the size of the slice of the pie his class of claim would receive after the bankruptcy was settled.[39] It also was likely to increase overall profits.

B. Disclosure - A Judicially Crafted Device

The potential of an investor/claims purchaser to cash in on huge profits by actively seeking participation in the Chapter 11 reorganization process did not meet with full and supportive acceptance of most bankruptcy courts. Despite the limited role that bankruptcy judges are authorized to play in connection with the transfer of claims under Rule 3001(e), some judges have imposed the additional duty of disclosure on some, if not all, of the parties.[40]

Judge Abram's decision in *In re Revere Copper and Brass, Inc.* is a good illustration of the use of the disclosure requirement to ease one court's discomfort with the idea of trading claims. Two years after Revere Copper and Brass, Inc. (Revere) filed for Chapter 11 reorganization, the Phoenix Capital Corporation bought 28 different unsecured trade claims held against Revere. Phoenix had solicited its purchases by sending letter notices to the trade creditors. Phoenix paid 20 cents on the dollar for the claims.[41]

In compliance with then existing Rule 3001(e)(2), Phoenix sought a court order from Judge Abram to complete the assignment of the trade claims; however, she denied the motion. Judge Abram's ruling relied on Bankruptcy Code section 1125(a)(1) which called for a disclosure statement from the would-be claim purchasers to creditors " in sufficient detail to enable a hypothetical reasonable investor typical of holders of claims to make an informed judgment about the plan."[42] Clearly, Judge Abram was fearful that the creditors of Revere would sell their claims at huge discounts and Phoenix would make huge profits. Apparently, her Honor gave little weight, if any, to the " arm's length" business relationship of Phoenix and the trade claims.

In a variation on Judge Abram's reasoning, Judge Cosetti sitting in the Allegheny International bankruptcy proceeding ordered that would-be claims purchasers must make disclosure by notifying the debtor of proposed assignments, and further ordered the debtor to inform future claims sellers of the debtor's estimate of the value of such claims.[43] In this case, Judge Cosetti was concerned for the small creditors and how well they were informed about the proposed reorganization plan which was claiming a payment by Allegheny of 100 cents on the dollar.[44] Eventually these two decisions, *Revere* and *Allegheny*, and many others were reviewed by the Advisory Committee on Bankruptcy Rules. Logically, they asked the question, " Does anyone, other than the seller of claims, have any standing to object?" The committee answered that question in the negative and went on to propose amendments to Rule 3001(e) as previously discussed.

V. Economics

A. The Good

Generally, when a company files a bankruptcy petition for Chapter 11 the creditors holding claims and interests against the debtor are losing money. Consequently, the architects of the reorganization plan are usually focused on minimizing losses so that their respective institutions can focus on profit making activities elsewhere. In contrast, claims purchasers bring a more optimistic agenda to the negotiating table. This optimism comes from the fact that their voluntary presence at the table is predicated on increasing the newly acquired claims to make money. Mr. Sam Iapalucci astutely characterizes this difference in perspectives as " emotional money" versus " rational money."[45] The former being the original creditors and holders of debt interest and the latter being the investing claims purchaser. Rational money claims purchasers are often times more successful in reaching settlement of the economic terms of the reorganization plan.[46] This is true because the new claims purchaser bears none of the kind of hostility growing out of unsuccessful pre- and post-petition negotiations between debtors and original creditors. For these parties the difference in trading claims is their profit making activity.[47]

Trading claims appears to have the potential of becoming a healthy practice in bankruptcy proceedings. This is not surprising because trading claims is premised upon a compelling and persuasive fundamental reason. That is, original creditors do not want to be part of bankruptcy proceedings any more than they want to lose money. On the other hand, some investors/debt raiders see trading claims in bankruptcy as an attractive opportunity.

From the creditor's position " emotions" are often further layered by the creditor's own real world needs. Of course, such needs vary depending upon who is the creditor, for example:

(1) some creditors may be compelled to sell their claims out of a need for cash;
(2) others may not want to take the time or trouble to follow a lengthy Chapter 11 proceeding;
(3) a sale of a claim may also be necessary to establish a tax loss; however, severe restrictions exist;
(4) creditors, such as financial institutions, may trade their claims to avoid receiving certain types of distributions -- for example, stock -- and the ensuing regulatory or other complications;
(5) some creditors will sell their claims on the "loyalty" theory that they will be better able to recoup losses on their claims in their future business dealings with the debtor;
(6) certain creditors sell because they view the current and future relationships with the debtor far more important than any recovery on a claim based on the debtor's past failure to pay.

Law firms are likely to take this attitude towards their larger corporate clients.[48]

It is readily obvious that there are several motivating benefits which bring the original claims holder to trade, sell, or transfer their claims. One can only speculate as to who first approached whom in contemplation of making a deal to trade a claim.

B. The Bad

There is a downside to the debtor's and the creditor's participation in trading claims. Recent tax law developments have imposed significant tax risks on a debtor corporation whose claims are traded during, or in some cases before or after, the bankruptcy proceeding.[49] Tax law changes under the Tax Reform Act of 1986 have radically altered tax treatment of net operating loss ("NOL") conveyors following an "ownership change." Now there are severe restrictions on the use of NOL conveyors.[50] While a detailed analysis of tax consequences is beyond the scope of this article, the message is clear - if you are going to be a participant in trading claims see your tax consultant and/or tax attorney.

C. The Silly

On August 2, 1990, the honorable Chief Judge Joseph L. Cosetti sought, in his lengthy *In re Allegheny International, Inc.*[51] opinion, reliance on the secondary authority of Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law*, to aid him in setting forth the purpose of Chapter 11 versus Control Profit. Judge Cosetti's opinion sets out the following text from that treatise as follows:

> The basic problem that bankruptcy law is designed to handle, both as a normative matter and as a positive matter, is that the system of individual creditor remedies may be bad for the creditors as a group when there are not enough assets to go around. Because creditors have conflicting rights, there is a tendency in their debt-collection efforts to make a bad situation worse. Bankruptcy law responds to this problem . . . . Bankruptcy provides a way to make these diverse individuals act as one, by imposing a *collective* and *compulsory* proceeding on them . . . . This is the historically recognized purpose of bankruptcy law and perhaps is none too controversial in itself.[52]

Immediately, the opinion continues with a conclusion from Judge Cosetti that:

> The purpose of reorganization is to offer an opportunity to maximize results for all creditors and interest holders. Japonica's actions . . . make abundantly clear that it is control profit that they seek. This control profit will not be shared through a reorganization plan . . . . Japonica intends to use its newly acquired control to extract economic profit for itself, not to maximize the results for all creditors.[53]

Judge Cosetti's condemnation of Japonica Partners "control profit"[54] may have been accurate on the facts before him, but seems somewhat overbroad as a general statement of law.[55] "It is not clear why the acquisition of a 'control profit' by a claims buyer should, in and of itself, be prohibited under the Bankruptcy Code."[56] Control profit can easily be established by new money from a third party who has not made the purchase of even one claim. The third party non-claims purchaser can obtain control profit by funding the reorganization plan even over the dissent of individual creditors.[57] Similarly, an original creditor or shareholder can also acquire a control profit by agreeing to forego cash or debt securities in exchange for the debtor's equity.[58]

Therefore, it is not inequitable to claims purchasers seeking control profit that the court allow dissenters of the plan greater rights to block that plan just because the creditor happens to be a claims purchaser and not the original creditor or third party new money.[59] This paradoxical reasoning is perhaps silly.

VI. Conclusion

One of the major goals of a Chapter 11 reorganization is to achieve the most efficient redistribution of the debtors assets and liabilities. Sometimes complete liquidation represents the most efficient redistribution, but only as a last resort. The free and open trading of claims unimpeded by administrative rule or overly protective courts offers one of the soundest ways to achieve this goal.

If a creditor extends credit to a debtor based upon criteria acceptable to that creditor, then the creditor has made a business judgment designed presumably to create a profit in the face of known risks. If in the course of events the debtor becomes insolvent and seeks the protection of Chapter 11 in a Bankruptcy Court, then the creditor should not be surprised or caught short because this event had to have been calculated as part of the original risk and credit criteria. Consequently, any creditor (large or small) would be able, at any point in time, to revalue its claim.

Should a third party investor offer to purchase the claim(s) held against a debtor in Chapter 11, the original creditor would be able to respond, based upon its needs, with what represents to the creditor it's most maximized and cost efficient response to the offer. The creditor would either keep the claim for having valued it higher than the claims purchaser's offering price or accept a negotiated price and sell.

On the other side of the coin, a trader in claims seeks an opportunity to purchase an asset from the creditor for adjusted value reestablished by the debtor's insolvency. Such value judgment, not unlike the original creditor's value judgment, is based upon criteria and risk that are acceptable to the claims purchaser. The claims purchaser, by virtue of its opportunity to have established the adjusted value of the asset, will have greater margin within which to work than the original creditor. This wider margin will likely increase the probability of reaching an approved reorganization plan and create a restructured debtor that subsequently emerges with the most efficient redistribution of assets and liabilities.

In conclusion, trading of claims, particularly under the new proposed Rule 3001(e) and a more trusting court, can well serve one of the primary goals of bankruptcy law: to achieve the most efficient redistribution of the debtor's assets and liabilities.

Endnotes

[1]David Gillen, *Debt Raiders Put New Spin on Takeovers After Wreckage of Junk-Financed Buy Outs*, The Bond Buyer, Aug. 24, 1990, at 3.

[2]*Id.*

[3]David C. L. Frauman & Stephen J. Blauner, *Bankrupt Entities Targeted: Trading Claims Can Serve As The Basis to a Takeover*, N.Y. L. J., June 4, 1990, at 5 (citing Robert Lowenstein, *Goldman Sachs Raises Funds for Firms in Distress*, Wall St. J., Apr. 16, 1990, at C1.).

[4]*Id.*

[5]"Leveraged buyout refers to the acquisition of the stock of a company ('target company') where a significant portion of the stock's purchase price is borrowed and where the loan is assumed (and repaid) by the target company itself. The selling shareholders of the target company generally receive cash for their stock from the proceeds of the loan. Because the target company, which must repay the loan, does not receive or retain any loan proceeds, any lien or security interest granted the lender may be voidable as a fraudulent conveyance. The lenders' claims under the loan may also be void for the same reason." Chaim J. Fortang & Thomas Moers Mayer, *Trading Claims v. Taking Control of Corporations in Chapter 11*, 12 Cardozo L. Rev. 1, 15 n.81 (1990) (citing David Gray Carlson, *Leveraged Buyouts in Bankruptcy*, 20 Ga. L. Rev. 73 (1985).

[6]Gillen, *supra* note 1, at 3.

[7]11 U.S.C. § 101(12) (1988).

[8]Fortang & Mayer, *supra* note 5, at 25,

[9]*Id.*

[10]*Id.*

[11]*Id.* at 25-26.

[12]*Id.* at 26 n.133.

[13]Frauman & Blauner, *supra* note 3, at 6.

[14]Fortang & Mayer, *supra* note 5, at 8.

[15]*Id.* at 3.

[16]*Id.* at 3 n.17.

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

[18]*Id.*

[19]Fortang & Mayer, *supra* note 5, at 10.

[20]*In re Apex Oil Co.*, 92 B.R. 847, 853-54 (Bankr. E.D. Mo. 1988).

[21]*Id.*

[22]Fortang & Mayer, *supra* note 5, at 10.

[23]*Id.*

[24]*Id.* at 11.

[25]*Id.*

[26]*Id.* at 12 n.69.

[27]*Id.* at 12.

[28]Fed. R. Bankr. P. 3001(e). The rule reads in part:

> *Transferred Claim*
>
> (1) *Unconditional transfer proof before filed.* If a claim other than one based on a bond or debenture has been unconditionally transferred before proof of claim has been filed, the proof of claim may by filed only by the transferee. If the claim has been transferred after the filing of the petition, the proof of claim shall be supported by (A) a statement of the transferrer acknowledging the transfer and stating the consideration therefor or (B) a statement of the transferee setting forth the consideration for the transfer and why the transferee us unable to obtain the statement from the transferor.
>
> (2) *Unconditional Transfer After Proof Filed.* 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 by mail of the filing of the evidence of transfer and that objection thereto, if any, must be filed with the clerk within 20 days of the mailing of the notice or within any additional time allowed by the court. 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 . . . .

[29]*Id.*

[30]*See, e.g., In re Ionosphere Clubs, Inc.*, 119 B.R. 440 (Bankr. S.D.N.Y. 1990).

[31]*Id.* at 443.

[32]A proof of claim or interest is deemed filed under section 501 of the Bankruptcy Code for any claim or interest that appears in the schedules filed under sections 521(1)

or 1106(a)(2) of the Code, except a claim or interest that is scheduled in dispute, contingent, or unliquidated.

[33] "Unconditional" was the focal point on which the court decided the question in *In re Ionosphere Clubs, Inc.*, 119 B.R. 440 (Bankr. S.D.N.Y. 1990) of whether claims having the face value of $2,547,312.29 had been " unconditionally" transferred. Had the new rule been in effect the need for this litigation would have been unlikely.

[34] Fed. R. Bankr. P. 3001 advisory committee's note.

[35] Gillen, *supra* note 1, at 5.

[36] Interview with Mr. Sam Iapalucci, Treasurer and Chief Financial Officer of Allegheny International, Inc. (Dec. 7, 1990).

[37] *See, e.g., In re Johns-Manville Corp.*, 801 F.2d 60 (2d Cir. 1986).

[38] *Id.*

[39] Frauman & Blauner, *supra* note 3, at 2.

[40] *Id.* at 8.

[41] *In re Revere Copper & Brass, Inc.*, 58 B.R. 1 (Bankr. S.D.N.Y. 1985).

[42] *Id.* at 2.

[43] *In re Allegheny Int'l, Inc.*, 100 B.R. 241, 242 (Bankr. W.D. Pa. 1988).

[44] *Id.*

[45] Interview with Iapalucci, *supra* note 36.

[46] Fortang & Mayer, *supra* note 5, at 114.

[47] *Id.* at 114-15.

[48] *Id.*

[49] *Id.* at 111.

[50] *Id.*

[51] *In re Allegheny Int'l, Inc.*, 118 B.R. 282, 299 (Bankr. W.D.Pa. 1990).

[52] *Id.* (emphasis in original).

[53] *Id.*

[54] Judge Cosetti was using the term " control profit" as the method by which Japonica had acquired claims with the clear purpose of achieving control of the debtor.

[55] Fortang & Mayer, *supra* note 5, at 84.

[56] *Id.* at 85.

[57] *Id.*

[58] *Id.* at 85 n.406.

[59] *Id.* at 85.

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