

Awaiting 2nd Circ. Spin On Bankruptcy Claims Trading

Law360, New York (September 12, 2012, 1:25 PM ET) -- The Second Circuit Court of Appeals recently heard arguments in a case that could have substantial implications for the trading of bankruptcy claims.

While the court could choose to resolve the case, *Longacre Master Fund Ltd. v. ATS Automation Tooling Systems Inc.*, based on a straightforward analysis of New York contract law, it may also take the opportunity to consider the controversial claims trading case of *Enron v. Springfield Associates* decided several years ago by the district court for the Southern District of New York.

Enron held that a claim objection under Section 502(d) of the Bankruptcy Code based on the receipt of a voidable preference payment was valid only against the recipient of such payment, and could not be used to object to such claim in the hands of a good faith purchaser.

Longacre bought a claim from ATS in the Delphi bankruptcy case. Millions of dollars of trade claims are routinely bought and sold in large Chapter 11 cases; specialized firms look to buy claims at a discount and hold them for the many months (and not infrequently years) that it takes for a plan of reorganization to be confirmed and distributions to be made. The sellers are often small or medium-sized businesses that need the cash and are willing to sell in order to monetize the claim quickly.

Claim buyers often look to protect themselves by requiring the seller to take back the claim if the debtor objects to it. Longacre and ATS had such a provision in their agreement; it provided that Longacre, the buyer, would be entitled to a refund of the purchase price in the event that the claim was objected to and not fully resolved by ATS within six months, or was not likely to be resolved within a reasonable time thereafter.

Delphi did in fact object to the ATS claim under Section 502(d) of the Bankruptcy Code on the basis that ATS had received potentially voidable preference payments prior to the bankruptcy case. The claim was not resolved within the six month period and Longacre demanded that ATS take back the claim. ATS refused, and Longacre sued to enforce the agreement. The claim was ultimately resolved eight months later.

The lower court judge did not rule on whether ATS had met its requirement to resolve the claim within six month period or "a reasonable time thereafter." Instead, the judge examined the merits of the claim objection itself, and held, under the holding of *Enron v. Springfield Associates*, that the objection lacked merit and therefore ATS should not have been required to repurchase the claim.

Longacre contends on appeal that the district court improperly added new terms to the agreement, rather than applying the contract as written. ATS argues that the district court was correct to determine if any prejudice actually occurred to Longacre as a result of the objection.

The key question here is whether, in deciding this case, the Second Circuit weighs in on the merits of the Enron decision. A recent decision in a Delaware bankruptcy case rejected the analysis of Enron; a similar ruling by the Second Circuit could substantially alter the landscape for the buying and selling of claims in bankruptcy cases.

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