December 18, 2018 - Last week, LSTA General Counsel participated in a podcast moderated by Sarah Gefter of Reorg Research on the topic of claims trading, a topic of great importance to many participants in the loan market. The podcast included Cindy Chen Delano of Whitebox Advisors and Peter Lupoff, a long-time participant in the distressed markets, and was sparked by an article he recently published, “Character is Doing Right When No One is Looking – Oral Commitments and Moral Casualness in Trading of Trade Claims”, focusing on the importance of the enforceability of oral commitments in claims trading.

After a brief description of the claims market, the panelists homed in on a few critical issues. First, there is a symbiotic relationship between vendors to companies that file for bankruptcy who sell their claims and distressed investors. By quickly valuing and monetizing vendor claims, investors provide liquidity and certainty to non-financial participants who do not have the expertise, nor desire, to participate in lengthy bankruptcy proceedings. They then pivoted to a disturbing recent trend in claims trading where a number of vendors have walked away from trades, arguing that the trades were subject to further documentation and not binding. The panelists asserted that, in reality, claims trades are complete when the parties agree on the price and amount of the asset being transferred and there are really no other terms to negotiate. They further noted that in all those cases, the price of the underlying assets increased materially soon after the sale of the assets. The panelists also noted that part of the problem is that there is substantial confusion by some judges over what is (and isn't) transferred in a claims trade. While investors assume the credit risk of a claim, they do not assume the risk of whether a claim constitutes a valid claim in bankruptcy. Finally, the panelists agreed that there is great moral hazard to, and threats to the liquidity of, a market where oral commitments are not binding. They urged the courts to see through the arguments made by remorseful sellers and hold the parties to the economic terms of their trades. The podcast is available here.