

Transferred Rights Under LSTA Purchase and Sale Agreement
After M. Fabrikant & Sons, Inc.

by

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The Situation

M. Fabrikant & Sons, et al. (the “Debtors”), commenced a chapter 11 bankruptcy case on November 17, 2006. In exchange for allowing the Debtors to use their collateral (which was pledged to several lenders under the terms of a credit agreement), the Court granted the Debtors’ lenders adequate protection, pursuant to the Final Order Authorizing Debtors’ Use of Cash Collateral and Granting Adequate Protection Claims and Lien (the “Order”), which included an administrative priority claim for the reimbursement of a lender’s reasonable expenses relating to all proceedings in connection with the enforcement and validity of the prepetition agreements (the “Reimbursement Rights”). After the Order was entered, the original lenders (the “Sellers”) sold their loans on the secondary market to the current lenders (the “Buyers”) under standard LSTA documents.

About one year later, the Official Committee of Unsecured Creditors sued the Sellers seeking to, among other things, avoid for the benefit of the Debtors’ estate, the security interests granted to the Sellers. The Sellers incurred substantial legal fees defending against this adversary proceeding and, as such, when the Debtors filed a plan that failed to provide for payment of the Sellers’ legal fees, the Sellers objected to the plan arguing that: (a) the legal fees constituted Reimbursement Rights which were Retained Interests under the LSTA standard documents and not transferred to the Buyers and (b) the failure to provide for their payment in full to the Sellers violated the Bankruptcy Code’s priority scheme.

Transferred Rights, Retained Interests and Adequate Protection Payments

On April 9, 2008, Chief Judge Stuart Bernstein overruled the Sellers’ objection to the Debtors’ plan. In doing so, Judge Bernstein focused on the standard LSTA purchase and sale agreement, finding that the Sellers *had* transferred their post-transfer reimbursement rights to the Buyers, and consequently, the Reimbursement Rights were not required to be paid in full under the plan.

Under the LSTA’s terms for the purchase and sale of distressed trades, “Transferred Rights” include, among other things:

any and all of Seller’s right, title, and interest in, to and under the [bank loans] and the [c]ommitments (if any) and, to the extent related thereto, the following (excluding, however, the Retained Interest, if any): all claims (including “claims” as defined in Bankruptcy Code §101(5)), suits, causes of action, and any other right of Seller or any Prior Seller, whether known or unknown. . . .

Retained Interest is defined as follows:

if “Settled Without Accrued Interest” is specified in the Transaction Specific Terms, the right retained by Seller to receive, in accordance with the provisions of section 8.3, payments or other distributions, whether received by setoff or otherwise, of cash (including interest), notes, securities or other property (including Collateral) or proceeds paid or delivered in respect of the Pre-Settlement Date Accruals or the Adequate Protection Payments (if any); provided that Retained Interest shall not include PIK Interest.

Finally, Adequate Protection Payments (the narrowest of the three definitions) means, with respect to the “Transferred Rights,” amounts (other than “PIK Interest”) ordered to be paid by the Bankruptcy Court as adequate protection under an “Adequate Protection Order” for the loans and obligations owed under the “Credit Agreement” that accrue during the period before (but excluding) the earlier of (a) the Settlement Date and (b) T + 20. None of these definitions had been tested by the courts until this decision.

The Analysis

The Sellers asserted that the Reimbursement Rights were not transferable because they: (a) fell outside of the Bankruptcy Code’s definition of claim which excludes claims arising post-petition, such as the Reimbursement Rights; (b) were personal to the Sellers; (c) were counterclaims preserved by paragraph 22 of the Order and (d) were future rights unable to be assigned. The Court disagreed with each of these assertions declaring generally that the LSTA transfer agreements represent an “all-encompassing assignment of rights” (Decision at 18) and, more specifically, that the Reimbursement Rights fell squarely within the definition of Transferred Rights because they were contingent indemnification rights related to and arising in connection with the Credit Documents or the transactions related thereto or contemplated thereby (Decision at 15).

Conclusion

The decision makes clear that the rights assigned to a buyer under the standard LSTA documents are broad and include both contingent and postpetition claims unless specifically excluded. Thus, lenders that are, or may be, subject to lender liability or other litigation, should explicitly negotiate carve outs at the time of trade.