Can a Claim Transferee "Wash" the Claim from Disallowance Risk? Another Chapter in the Firestar Saga

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Abstract

Claims trading is an efficient avenue for creditors of bankrupt companies to quickly liquidate their prepetition claim by selling the claim, at a discount, rather than waiting out the bankruptcy process hoping to receive a recovery from the bankruptcy estate. Conversely, buyers are often willing to purchase a claim for a variety of reasons, including with an expectation that the bankruptcy estate's eventual distribution on account of the purchased claim will exceed the price they paid for the claim.

There are risks for a buyer when acquiring claims. For instance, many Chapter 11 plans propose the creation of a trust, overseen by a trustee or administrator, tasked with pursuing causes of action on behalf of the estate. Reconciliation of claims typically takes months or even years before distributions can be paid, if at all. Depending on how the liquidation process plays out, claims buyers carry the risk that any distribution ultimately received from the debtor will be lower than anticipated, and perhaps even less than the amount the buyer paid to purchase the claim.

Shrewd claim buyers build into their business model administrative delays and the risk of lower than initially anticipated distributions from a bankruptcy estate. However, having a purchased claim that is subsequently disallowed…