

Delaware Bankruptcy Court Sustains Objection to Claim on a Note Transferred in Violation of Anti-Assignment Restriction

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The June 20, 2018 decision by the Delaware Bankruptcy Court in *Woodbridge Group of Companies, LLC* should prompt those involved in claims trading to reassess transactions where the underlying documents have anti-assignment provisions. Parties to loan transactions outside of a bankruptcy will also benefit from the court's guidance on when assignments constitute a breach of the operative agreements, rather than being outright void. The lesson for all is that the treatment of an anti-assignment provision under Delaware law turns on the language of the operative document.

Background

The debtor entered into a pre-petition loan agreement and issued three promissory notes related thereto to the lender, all governed by Delaware law. The notes contained the following anti-assignment clause:

No Assignment: Neither this Note, the Loan Agreement of even date herewith between [the debtor] and Lender, nor all other instruments executed or to be executed in connection therewith (collectively, the "Collateral Assignment Documents") are assignable by Lender without the [debtor's] written consent and any such attempted assignment without such consent shall be null and void.

The loan agreement further provided that the "Lender shall not assign, voluntarily, by operation of law or otherwise, any of its rights hereunder ..." without the debtor's written consent, or else the assignment would be null and void.

In the course of the debtor's bankruptcy, the lender assigned its notes to a claims purchaser, Contrarian Funds, LLC. Contrarian filed a proof of claim for amounts owed on the notes. The debtor objected to the claims under 11 U.S.C. § 502(d) on the grounds that the transfers were void (*i.e.*, Contrarian did not have a valid interest on which to submit a claim). Contrarian challenged the debtor's objection on three grounds: (1) the anti-assignment provision is not valid under Delaware law; (2) the debtor's breach of its payment obligations negated the anti-assignment provision; and (3) the Uniform Commercial Code (UCC) overrode the anti-assignment provision. The court disagreed with all of Contrarian's challenges and sustained the objection to the claim.

Delaware Bankruptcy Court Decision

First, Delaware law recognizes the validity of restraining assignability of contract rights, but construes such provisions narrowly. Attention is thus given to whether the anti-assignment provision not only restricts transfer, but also renders such transfer void. If there is merely a restriction on transfer, that controls the right but not the power to transfer. Where only the right to transfer is restricted, doing so will expose the violating party to a claim for breach of the agreement. If the intent is to eliminate the power to transfer, one must include language rendering the transfer void. In this instance, because the anti-assignment provisions read together eliminated both the right and power to transfer, the court found that the transfer to Contrarian was void and it had no basis on which to prosecute a claim against the debtor.

Second, any “disability” in a claim travels with the claim when it is acquired by a claim trader in a bankruptcy. This follows the principle that a non-breaching party cannot emerge post-breach with greater rights than it had pre-breach. Nevertheless, Contrarian cited Delaware cases supporting that where there is a material breach of an agreement, the non-breaching party is relieved of its performance obligations. Although the court agreed that the debtor’s failure to pay under the notes was a material breach and recognized the authorities cited by Contrarian, it found that the debtor’s breach did not eliminate the restriction on assignment by the lender. It is difficult to harmonize the court’s relatively conclusory finding with the case law relieving performance when there is a material breach. Language clarifying the treatment of an assignment following triggering events, such as a breach or insolvency, should be utilized to avoid leaving this outcome to the court’s view in a particular case.

Third, the UCC did not override the anti-assignment provision because Contrarian acquired the notes and not a security interest in the notes. UCC §9-408 is applicable only to grants of security interests and does not address a restriction on assignment of the instrument itself. UCC §9-406 endorses the enforceability of anti-assignment provisions governing the transfer of a note. The court’s ruling suggests that had the transfer been structured to provide Contrarian a security interest in the notes, UCC §9-408 might apply and override the anti-assignment provision.

In conclusion, it is unlikely that the *Woodbridge* decision will significantly impact the claims trading market. As the court noted, the modern claims trading industry is robust and fruitful, with the liquidity in claims being perhaps the most significant change in bankruptcy proceedings in the past decade. However, *Woodbridge* offers a cautionary tale for those transferring claims – warranting a careful assessment of the operative documents to identify and work around, if possible, any restraints on transfer.

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