



## Finance ADVISORY ■

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### **Caesars Case Again Highlights Disallowance Risk When Distressed Claim Transfers Fail to Comply with Assignment Provisions**

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Following the lessons of *In re Woodbridge Group of Companies LLC, et al.*, the bankruptcy court in *In re Caesars Entertainment Operating Co. Inc., et al.*, highlighted again the importance for parties trading bankruptcy claims to comply with express contractual transfer restrictions or else face the risk of disallowance. Because Stockton University failed to comply with the contractual provisions related to assignments, the court disallowed claims that Showboat Renaissance LLC purchased via assignment from Stockton.<sup>1</sup>

#### **Showboat Propco – Stockton – Renaissance Transfer**

In the *Caesars* decision, the claim in question arose from the sale of real property by Showboat Atlantic City Propco LLC to Stockton, which closed during December 2014. Following the sale, Stockton alleged that Showboat Propco had breached the purchase and sale agreement (PSA) and committed fraud by, among other things, failing to disclose a “use covenant” on the property that resulted in nearly \$10 million in damages. The use covenant on the land required the property to be used as a luxury hotel casino, but Stockton intended to build a university campus on the property.

The Showboat Propco PSA included provisions specifying that the agreement would “inure to the benefit of and be binding on the parties ... and their respective ... successors, and assigns.” Most importantly, the transfer provisions also noted that Stockton *could not assign its rights under the Showboat Propco PSA “without the prior written consent” of Showboat Propco.* A month following the closing of this sale, Showboat Propco, along with more than 150 other affiliated Caesars entities, filed for bankruptcy under Chapter 11. Thereafter, Stockton filed proofs of claim against Showboat Propco in May 2015 alleging damages under a variety of tort and breach of contract theories.

<sup>1</sup> *In re Caesars Entertainment Operating Co. Inc., et al.*, Chapter 11, No. 15 B 1145 (Jointly Administered) in the U.S. Bankruptcy Court for the Northern District of Illinois Eastern Division (Doc 8184).

Stockton then sold the property it had acquired from Showboat Propco in January 2016 to Renaissance for \$23 million. As part of the sale of the property, Stockton assigned to Renaissance its claims against Showboat Propco in the Caesars bankruptcy pursuant to a claims assignment agreement dated January 15, 2016. Stockton did not obtain the consent of Showboat Propco in connection with such sale. On February 23, 2016, Renaissance filed Bankruptcy Rule 3001(e) transfer notices to become record holder of the claims in the bankruptcy case. The debtors objected to the allowance of the Stockton claims on standing grounds. The court sustained the objection by the debtors but not on the standing grounds. The court concluded that although Renaissance had standing to “assert” the claims, the Stockton claims asserted by Renaissance would be disallowed in full because Renaissance did not have the ability to “enforce” such claims.

In holding that Renaissance could not enforce the Stockton claims, the court focused on Renaissance disclaiming any reliance on the Showboat Propco PSA because the Showboat Propco PSA was not relevant in determining whether Renaissance had rights to the Stockton claim. The argument put forth by Renaissance was based solely on Rule 3001(e). Renaissance contended that the rule provided Renaissance with an unequivocal right to transfer claims against the debtor regardless of the transfer language in the Showboat Propco PSA. The bankruptcy court disagreed, holding that the rule is merely procedural and does not render inapplicable transfer restrictions in a contract. The court noted that Rule 3001(e) just governs procedure, which requires evidence of a transfer to be filed when a claim is transferred after the proof of claim is filed, and creates a process for addressing objections to the transfer. In citing to the *Woodbridge* decision, the court stated that the procedural rule “certainly does not override anyone’s contract rights.”

### **Distinction Between Right to Assign vs. Power to Assign**

Interestingly, the court noted in a footnote that a viable argument could have potentially been advanced by Renaissance that although the assignment of the Stockton claims breached the Showboat Propco PSA, the assignment was still effective, leaving (1) the Stockton claims in the hands of Renaissance; and (2) Showboat Propco (as the non-breaching party) with a breach of contract action against Stockton. This was because the Showboat Propco PSA did not have express language providing that assignments done without obtaining the consent of Showboat Propco would be deemed null and void. The court noted that the governing law of the contract (New Jersey) followed the general rule held by many other jurisdictions that contractual provisions limiting or prohibiting assignments operate only to limit a parties’ *right* to assign the contract, but not their *power* to assign, unless the parties’ manifest a specific intent to the contrary.<sup>2</sup> Under such circumstances, failing to comply with these assignment provisions does not render the transfer unenforceable in the hands of the transferee; however, such failure does create a cause of action by the non-assigning party against the assigning party for breach of contract. Since Renaissance failed to make this argument and disclaimed reliance on the Showboat Propco PSA, the court held that the argument had been waived by Renaissance, rendering the argument moot.

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<sup>2</sup> See *Bel-Ray Co. Inc. v. Chemrite (PTY) Ltd.*, 181 F.3d 435, 441-43 (3d Cir. 1999).

Notably, the Showboat Propco PSA contained terms that differed from the applicable underlying contractual provisions in *Woodbridge*. As held by the *Woodbridge* court, the applicable promissory notes in *Woodbridge* not only limited the *right* to assign but also the *power* to assign. The notes specifically stated that any assignment done without obtaining the obligor's consent "shall be null and void." This distinction is an important one for claims trading market participants when reviewing assignment provisions. From the transferee's perspective, the fact that a contract only limits the *right* to assign (but not the *power* to assign) might make a transferee comfortable taking the risk of noncompliance with a consent requirement. In such circumstances, governing law in a number of jurisdictions (including New York) recognizes claims acquired by a transferee as enforceable by the transferee against the obligor, even if the transferor failed to obtain the consent of the obligor.<sup>3</sup> Under this scenario where only the *right* to assign is limited (and not the power to assign), the transferor faces the risk of a breach of contract claim being brought against it by the obligor, but the obligor would not be able to prevent the transferee from enforcing its rights against the obligor under the assigned contract.

## Takeaways

As noted in our [Woodbridge advisory](#), one possible way of avoiding the assignment restrictions to effectuate a transfer of the economic benefit of the Stockton claims from Stockton to Renaissance would have been to structure the transaction as the sale of an undivided beneficial interest in a participation. The Showboat Propco PSA did not have any express restrictions on selling participation interests. Typically, however, a buyer would prefer purchasing claims by assignment so that it will be the record holder of the claims in a bankruptcy proceeding. Under such circumstances, distributions, notices, and the right to make elections will come directly to the buyer/assignee. To the extent a party purchases via participation, the buyer faces the credit risk of its selling counterparty as well as a potential lack of control over any disputes or issues that arise in the participated claim. In a participation setting, who controls disputes and settlement of issues for objections on the claim will depend upon the contractual provisions. Parties need to be mindful of the same when negotiating the terms of a participation agreement.

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<sup>3</sup> See *University Mews Associates v. Jeanmarie*, 122 Misc.2d 434, 471 N.Y.S.2d 457 (1984) (holding that the assignment provisions "must specifically eliminate the power as well as the right to assign the contract ... otherwise the original obligor is given only the right to damages for its breach, but does not render the assignment ineffective").

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