

Creditor Claims Trading Case Shows Disclosure Is Paramount

By **Kyle Arendsen** (December 6, 2022)

Online claims trading platform Xclaim Inc. came under scrutiny this past summer in the Madison Square Boys & Girls Club Inc.[1] bankruptcy case pending in the U.S. Bankruptcy Court for the Southern District of New York.

Since at least 2019, Xclaim has executed agreements with at least five notice and claims agent firms to synchronize their proofs of claim registers with Xclaim's website where such claims are posted for sale.[2]

The purpose of the real-time synchronization is to permit third parties to purchase and sell creditor claims on Xclaim's claims trading website using real-time data.

In exchange for the claims agents' cooperation, Xclaim pays the claims agents a small percentage of the commissions that Xclaim obtains for facilitating the trades on its website.

The private business relationships between court-approved claims agents and Xclaim has raised concerns in the Southern District of New York and requires claims agents to be fulsome and transparent in their disclosure to the bankruptcy courts.

All bankruptcy professionals can take away important lessons from the Xclaim matter.

Epiq's Retention

At Madison Square's first-day hearing on July 1, the bankruptcy court approved Epiq Corporate Restructuring LLC's retention as the debtor's claims agent on an interim basis, but requested that Epiq file a supplemental letter brief regarding its relationship with Xclaim.[3]

Epiq's supplement explained the Xclaim synchronization relationship and argued that the arrangement was entered into in Epiq's capacity as a private, for-profit enterprise, not as an agent of the clerk.[4]

On July 29, the court entered an order approving Epiq as the debtor's claims agent on a final basis with the caveat that Epiq could only continue any future relationship with Xclaim if Epiq first filed a new application explaining how the relationship was consistent with applicable law.[5]

To date, Epiq has not filed a supplemental application.

Court Denial of Continued Xclaim Arrangement

On Aug. 18, in what appears to contradict the previous July 29 final order, the Madison Square bankruptcy court issued a written opinion to explain the court's reasoning as to why Epiq's claim-sharing arrangement with Xclaim was impermissible.[6]

Under Title 28 of the U.S. Code, Section 156(c), a bankruptcy court may authorize the retention of a claims agent to assist the clerk of the court with the court's records, dockets,



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notices, calendars and other administrative matters. The claims agent may be compensated by a debtor's estate for performing these administrative functions.

In the Southern District of New York, claims agents must also abide by the court's protocol for the employment of claims and noticing agents under Section 156(c) and the code of conduct for judicial employees.

The court opined that neither the protocol nor the code of conduct authorized a claims agent to enter into an agreement with Xclaim whereby the claims agent would be paid for permitting Xclaim to synchronize its claims register.

Specifically, the protocol provides that a claims agent's retention "should be limited in scope to those duties that would be performed by a Clerk of Court" and requires such agent

to comply with all relevant statutory provisions and rules of procedure, including local rules of procedure, general orders and applicable guidelines.

Failure to comply with the protocol could subject the agent to be removed from the court's list of approved agents. Likewise, the code of conduct requires a claims agent "to avoid impropriety and the appearance of impropriety," in part by not advancing or appearing to advance the private interests of others or in any way use the public office for private gain.

Lastly, Title 28 of the U.S. Code, Sections 1914 and 1930, do not permit a clerk of the court to collect fees in exchange for providing benefits to select third-party private entities.

In contrast, a clerk may charge fees — which are paid to the U.S. Department of the Treasury — for matters related to filing a transfer of claim, which costs \$26, or for providing a copy of an electronic record, which costs \$31.

In its written decision, the bankruptcy court stated that Epiq could not collect a fee for providing electronic information about its entire claims register so that it can be synchronized with Xclaim's website to facilitate trades between creditors and potential claim purchasers.

The bankruptcy court held that Epiq is acting in its capacity as an agent of the clerk, and that Epiq's for-profit relationship with Xclaim went beyond activities authorized by Section 156(c).

Accordingly, because the clerk of the court would be barred from having such arrangement with Xclaim, a claims agent is also prohibited from entering into such arrangements.

On Sept. 1, Xclaim appealed the bankruptcy court's decision and also filed a motion to clarify whether Epiq could still contract with Xclaim.[7]

The court's Aug. 18 written decision forbids such action but the prior final order approving Epiq's retention seemingly permitted a business relationship under different, undetermined circumstances.

Miscellaneous Proceeding

On Aug. 25, U.S. Bankruptcy Judge Martin Glenn opened a miscellaneous proceeding and ordered a number of claims agents to provide detailed disclosures regarding their relationships with Xclaim.[8]

After reviewing the disclosures, the bankruptcy court reserved the right to sanction any of the claims agents who had a for-profit synchronization arrangement with Xclaim, order the disgorgement of fees the claims agents received from Xclaim, and/or suspend the claims agents from the court's list of approved notice and claims agents.[9]

Of the eight claims agent responses, five reported having a previous relationship with Xclaim and three reported never having an arrangement with Xclaim.[10] Of the five claims agents who had a relationship with Xclaim, the fees earned from the relationship were minimal and only ranged from approximately \$1,000 to \$17,000.

On Nov. 17, the bankruptcy court held that the U.S. trustee could continue conducting discovery related to the claims agents' relationships with Xclaim.[11]

The bankruptcy court refused to pre-rule on any of the sanctions it could impose on the claims agents but noted that sanctions could include removal of the claims agents from the bankruptcy court's approved list of agents, or as the bankruptcy court put it, a death sentence.

Takeaways

Full disclosure to the bankruptcy court is paramount, especially when requesting authorization to be retained as a professional.

Indeed, being a disinterested party that is capable of carrying out its duties is the bare minimum requirement that a bankruptcy professional must satisfy.

Professionals should take heed from this Xclaim debacle — when in doubt, always disclose. And although hindsight is 20/20, bankruptcy professionals should always review local rules and procedures closely when filing retention applications.

When advising claims traders, it is critical that professionals consult with the official claims register to ensure that the applicable third-party trading platform is reflecting the most recent information. Since the holding in Madison Square and the miscellaneous proceeding, trading platforms may not be directly synchronizing their websites with the official claims register.

Accordingly, for the moment, before any claims trader executes a trade, they should first confirm that the information reflected on the trading platform is accurate.

Time will tell whether bankruptcy courts will permit trading platforms like Xclaim to synchronize their websites with a claims agent's claims register in order to provide real-time data to claims traders.

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[1] Case No. 22-10910 (SHL) (Bankr. S.D.N.Y. 2022).

[2] See *In re Matter of Certain Claims and Noticing Agents' Receipt of Fees in Connection with Unauthorized Arrangements with Xclaim Inc.*, Case No. 22-00401 (MG) (Bankr. S.D.N.Y. 2022).

[3] Case No. 22-10910 (SHL) [Docket No. 33] (Bankr. S.D.N.Y. July 1, 2022).

[4] Case No. 22-10910 (SHL) [Docket No. 55] (Bankr. S.D.N.Y. July 13, 2022).

[5] Case No. 22-10910 (SHL) [Docket No. 86] (Bankr. S.D.N.Y. July 29, 2022).

[6] Case No. 22-10910 (SHL) [Docket No. 143] (Bankr. S.D.N.Y. Aug. 18, 2022).

[7] Case No. 22-10910 (SHL) [Docket Nos. 180, 181] (Bankr. S.D.N.Y. Sept. 1, 2022).

[8] Case No. 22-00401 (MG) [Docket No. 1] (Bankr. S.D.N.Y. Aug. 25, 2022).

[9] Case No. 22-00401 (MG) [Docket No. 19] (Bankr. S.D.N.Y. Sept. 30, 2022).

[10] Case No. 22-00401 (MG) [Docket Nos. 37, 39, 41, 42] (Bankr. S.D.N.Y. Nov. 4, 2022).

[11] Case No. 22-00401 (MG) [Docket No. 47] (Bankr. S.D.N.Y. Nov. 17, 2022).