

July 10, 2018

## Delaware Bankruptcy Court Finds Anti-Assignment Clauses in Debt Documents Enforceable in Claim Objection Fight with Postpetition Debt Purchaser

On June 20, 2018, Judge Kevin J. Carey of the United States Bankruptcy Court for the District of Delaware sustained an objection to a proof of claim filed by a postpetition debt purchaser premised on anti-assignment clauses contained in transferred promissory notes. *In re Woodbridge Group of Companies, LLC, et al.*, No. 17-12560, at \*14 (jointly administered) (Bankr. D. Del. Jun. 20, 2018). The Delaware Bankruptcy Court found that the anti-assignment provisions (i) were enforceable under Delaware law, tenets of contract law and the Uniform Commercial Code (“UCC”) and (ii) rendered the transfer of the notes void.

### Background

In 2016 and 2017, Woodbridge Mortgage Investment Fund 3A, LLC, issued three promissory notes to Elissa and Joseph Berlinger in the amount of \$25,000 each (the “Promissory Notes”). Each Promissory Note contained the following anti-assignment clause:

No Assignment. Neither this Note, the Loan Agreement of even date herewith between Borrower 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 Borrower’s written consent and any such attempted assignment without such consent shall be null and void.

The related loan agreement between the debtors and the Berlingers contained the following supplementary language:

Lender shall not assign, voluntarily, by operation of law or otherwise, any of its rights hereunder without the prior written consent of Woodbridge and any such attempted assignment without such consent shall be null and void. . . .

After Woodbridge and various affiliates commenced their chapter 11 cases, the Berlingers entered into an agreement with a fund that specializes in distressed investing to “sell, convey, transfer and assign” the Promissory Notes and all rights thereunder. The following month, the purchaser filed a proof of claim asserting a secured claim of \$75,000. The debtors subsequently filed a claim objection pursuant to 11 U.S.C. § 502(a).

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### Delaware Bankruptcy Court Decision

In deciding whether to enforce the anti-assignment clauses contained in the Promissory Notes, the court addressed three questions: (i) whether an anti-assignment clause contained in a promissory note is a valid restriction on assignment rights under Delaware law; (ii) whether a non-breaching party to a promissory note in payment default is bound by an anti-assignment clause; and (iii) whether the UCC overrides and nullifies an anti-assignment clause in a promissory note.

With respect to the first question, the court found that anti-assignment clauses in promissory notes are permitted under Delaware Law. The court observed that no provision of the Bankruptcy Code or overarching bankruptcy policy limits the court's authority to determine and enforce non-bankruptcy law concerning contractual restrictions on claim assignments. The court also noted that debt purchasers generally are sophisticated entities capable of conducting due diligence and rejected the notion that enforcing anti-assignment clauses would cause disruption in the claims trading market. While Judge Carey acknowledged that anti-assignment provisions typically are construed narrowly because of the importance of free assignability, he stressed that "there is a big difference between narrow construction and 'wholesale obliteration.'"

In construing the anti-assignment provisions in the Promissory Notes and related loan agreement, the court drew on the analysis set forth in *Southeastern Chester Cty. Refuse Authority v. BFI Waste Servs. Of Penn., LLC*, 2017 WL 2799160 (Del. Super. Ct. June 27, 2017) ("*Southeastern*"). In *Southeastern*, the Delaware Superior Court explained that the "modern approach to assignment clauses" distinguishes "between the *power* to assign and the *right* to assign." Under *Southeastern*, a contract provision that merely limits a party's right to assign, but not the power to do so, will allow for a valid assignment – *i.e.*, the assignment may constitute a breach of contract but is not null and void. A provision that restricts the power to assign renders a non-complying assignment void. Judge Carey found that the anti-assignment provisions in the Promissory Notes and the loan agreement manifested "a clear intent to restrict the *power* to assign as opposed to restricting only the *right* to assign." Thus, the court voided the transfer of the Promissory Notes from the Berlingers to the purchaser.

The court next considered whether the debtors' breach of the Promissory Notes rendered the anti-assignment clauses unenforceable and concluded that it did not. The court reasoned that a debtor's breach cannot modify or improve the contractual rights of a non-breaching debtholder. The court also noted that—consistent with its decision in *In re KB Toys, Inc.*, 470 B.R. 331, 343 (Bankr. D. Del. 2012), *aff'd sub nom.*, 736 F.3d 247 (3d Cir. 2013)—a claim purchaser holds a purchased claim subject to the same rights and disabilities as the original claimant. By violating the anti-assignment clause under the promissory note, the Berlingers created a "disability" in their claim. That disability traveled with the transferred claim when it was purchased by the purchaser, leaving the purchaser with no right to file a proof of claim.

The court turned to the UCC question last, holding that UCC § 9-408 – a provision which limits the enforceability of restrictions on the assignment of security interests in promissory notes – did not override or nullify the Promissory Notes’ anti-assignment provisions. The court rejected the purchaser’s argument that the drafters of the UCC intended for all sales of promissory notes to automatically create security interests, noting, among other things, that the proposed construction would render other provisions of the UCC superfluous.

**Conclusion**

*Woodbridge* highlights the importance of due diligence in debt/claim transfer transactions. While state laws may differ with respect to the validity or enforceability of anti-assignment provisions, a claim purchaser should proceed with caution in the face of such a provision. It remains to be seen whether alternative arrangements (such as an assignment of right to payment under a promissory note) can be used to circumvent an express restraint on assignment.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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