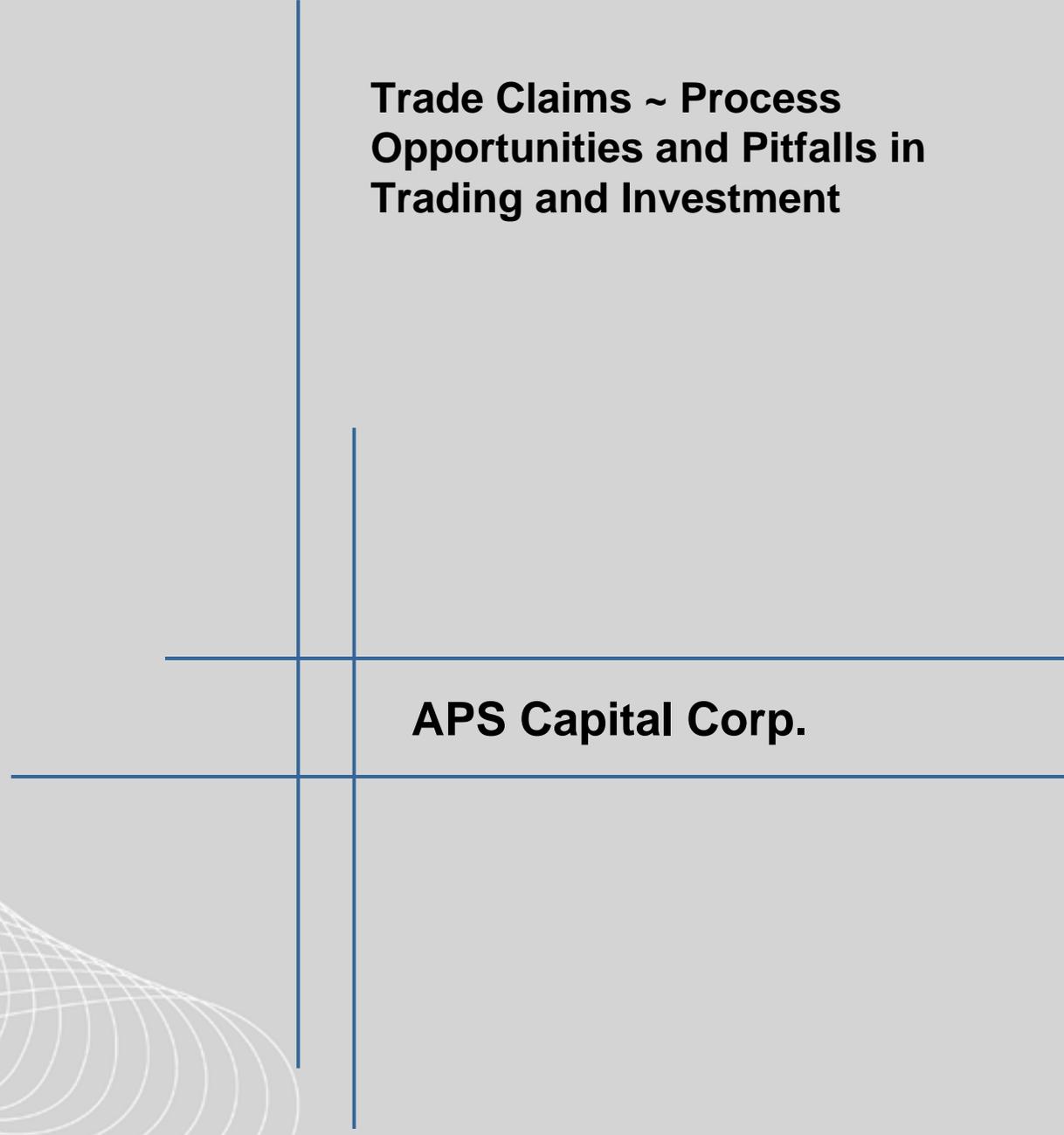


**Trade Claims ~ Process
Opportunities and Pitfalls in
Trading and Investment**



APS Capital Corp.

Company Overview

- ❖ APS Capital Corp. (“APS Capital” or “APSC”) is extensively involved with the trading and analysis of distressed situations with access to a sizable base of sophisticated investors. The firm specializes in helping financial buyers source bankruptcy trade claims and trade distressed bank debt and other private debt instruments.
- ❖ APSC is a wholly-owned subsidiary of APS Investment Services, Inc., a full-service investment firm specializing in investment banking, asset management, institutional securities brokerage, and investment analysis with an emphasis on the high yield and distressed universe. APS Investment Services, Inc. is ultimately held by American Physician Insurance Group, a publicly traded (Nasdaq:AMPH) firm that specializes in insurance services to the medical industry.

Sourcing Operations

- ❖ Our sourcing operations utilize an experienced sales and trading staff dedicated to bringing a supply of trade claims to our distressed debt clientele. Sourcing operations utilize proprietary sourcing techniques and protocols. Developed in-house, our sourcing protocols are adept at uncovering “motivated sellers.”
 - Our sourcing operations use a 4-step process to identify, categorize, engage and maintain original creditor contacts.
 - APSC has developed proprietary software applications designed to streamline and manage our sourcing operations.
 - Key to our sourcing operations is our reputation in the distressed investment industry. Large portions of our business is derived from referrals (opposing counsel, CFOs and credit managers) and repeat business.

Research

- ❖ APS Capital and its affiliates have been publishing high yield and distressed research for the last fifteen years.
- ❖ We make use of counsel and our knowledgeable research staff to understand and evaluate complex bankruptcy situations.
 - Trade creditor recoveries are dependent on many variables (including the allocation of residual enterprise value to deconsolidated Debtors in bankruptcies involving complicated capital structures). We understand the variables affecting recoveries and can provide financial as well as legal insight into many bankruptcy situations.
 - We leverage our extensive industry contacts (including financial advisors, attorneys and buy-side analysts) to assist in the analysis of each situation we cover.

Cases

Bankruptcy Cases Sourced by APS Capital Professionals:

DELPHI



LEHMAN BROTHERS

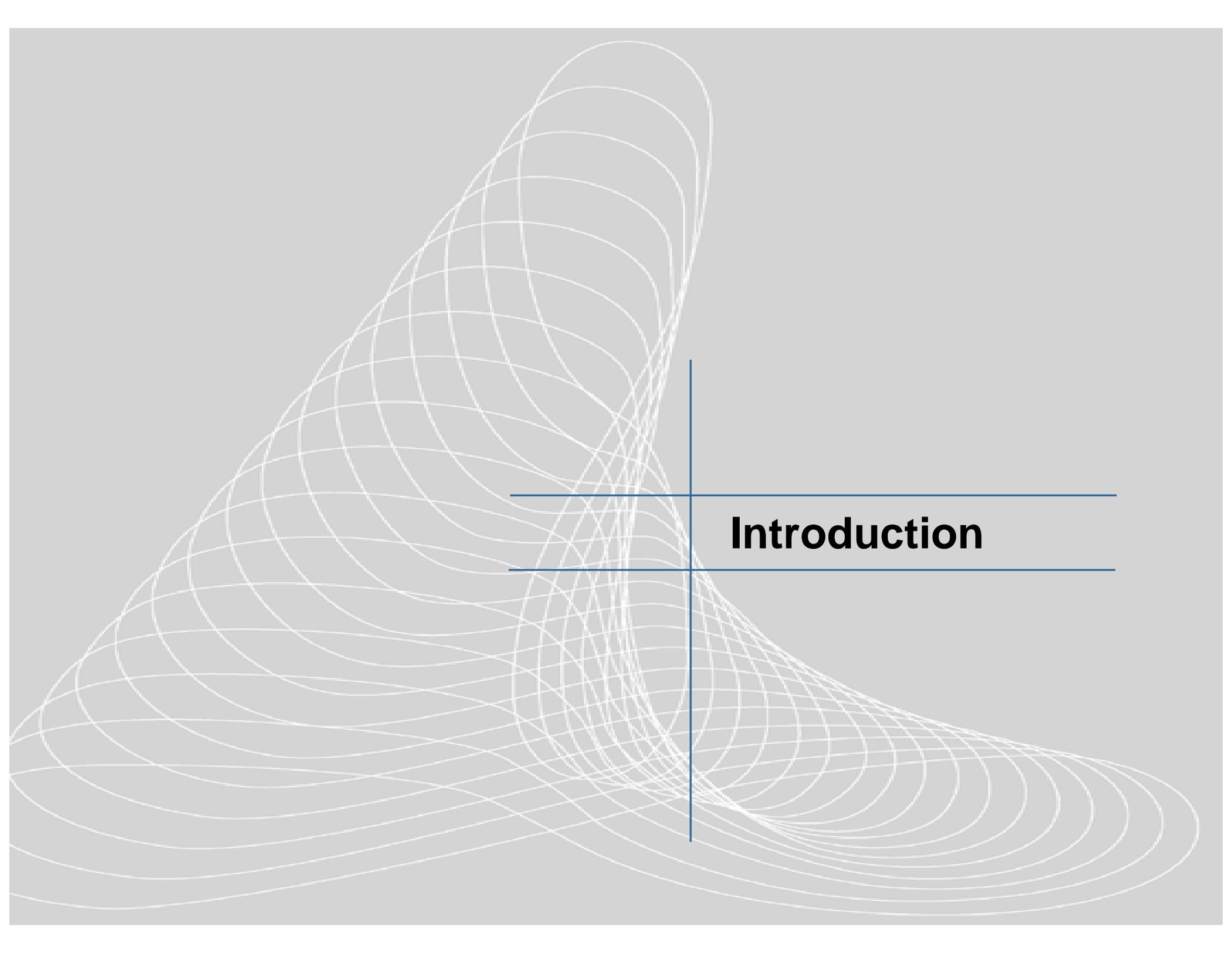


**TOWER
AUTOMOTIVE**



Adelphia



An abstract graphic on a light gray background. It features a series of overlapping, thin white circles that form a shape resembling a bell curve or a cloud. A blue crosshair, consisting of a vertical line and two horizontal lines, is centered over the graphic. The word "Introduction" is written in a bold, black, sans-serif font, positioned to the right of the vertical line and between the two horizontal lines of the crosshair.

Introduction

What are Trade Claims?

- ❖ Trade claims are private debt instruments representing a claim on a Debtor's estate arising prior to the commencement ("pre-petition") of the bankruptcy case.
- ❖ Claims can arise from a variety of pre-petition liabilities:
 - Pre-petition accounts payable. Amounts owing due to the provision of goods or services billed on credit (vendors, suppliers, professionals).
 - Rejected contract damages. Damages arising from executory contracts terminated under Section 365 of the Bankruptcy Code. (see pg. 33)
 - Rejected leases. Rejected leases under Section 365 of the Bankruptcy Code give rise to damages. (see pg. 33)
 - Deficiency claims. Secured claims give rise to a deficiency under Section 506 of the Bankruptcy Code for the portion of the claim where the collateral securing the claim is not sufficient to create an equity cushion (i.e. under collateralized).
 - Pension/OPEB underfunding. Pensions and/or Collective Bargaining Agreements that are rejected/ termination pursuant to Section 1113/1114 of the Bankruptcy Code give rise to unsecured claims.

What are Trade Claims? (cont.)

- ❖ Section 101(5) of the Bankruptcy Code defines a “claim” as a right to payment, or right to equitable remedy for breach of performance if such breach gives rise to a right of payment.
- ❖ The Code has steadily expanded the scope of “claims” over the years and the legislative history makes clear that “the Code contemplates that all legal obligations of the Debtor, no matter how remote or contingent, will be able to be dealt with in the case.¹ Thus, a “trade claim” can be a defined amount of money (e.g. account payable) or a contingent, unliquidated liability (e.g. asserted claim for breach of contract).
- ❖ Trade claims are generally evidenced in two ways: (1) via the Debtor’s Schedules of Assets and Liabilities (“Schedules”); or (2) via a valid and timely filed proof of claim (“POC”).
 - In most instances, a buyer of trade claims can rely on the amounts set forth in the Debtor’s Schedules. This happens via operation of Section 1111(a) which states in relevant part: “A proof of claim or interest is deemed filed under Section 501 of this title for any claim or interest that appears in the Schedules filed under Section 521(1) or 1106(a)(2) of this title, except a claim or interest that is scheduled as disputed, contingent, or unliquidated.”
 - A creditor’s POC is typically and sets forth the amount of the claim and the proper name and address of the creditor.

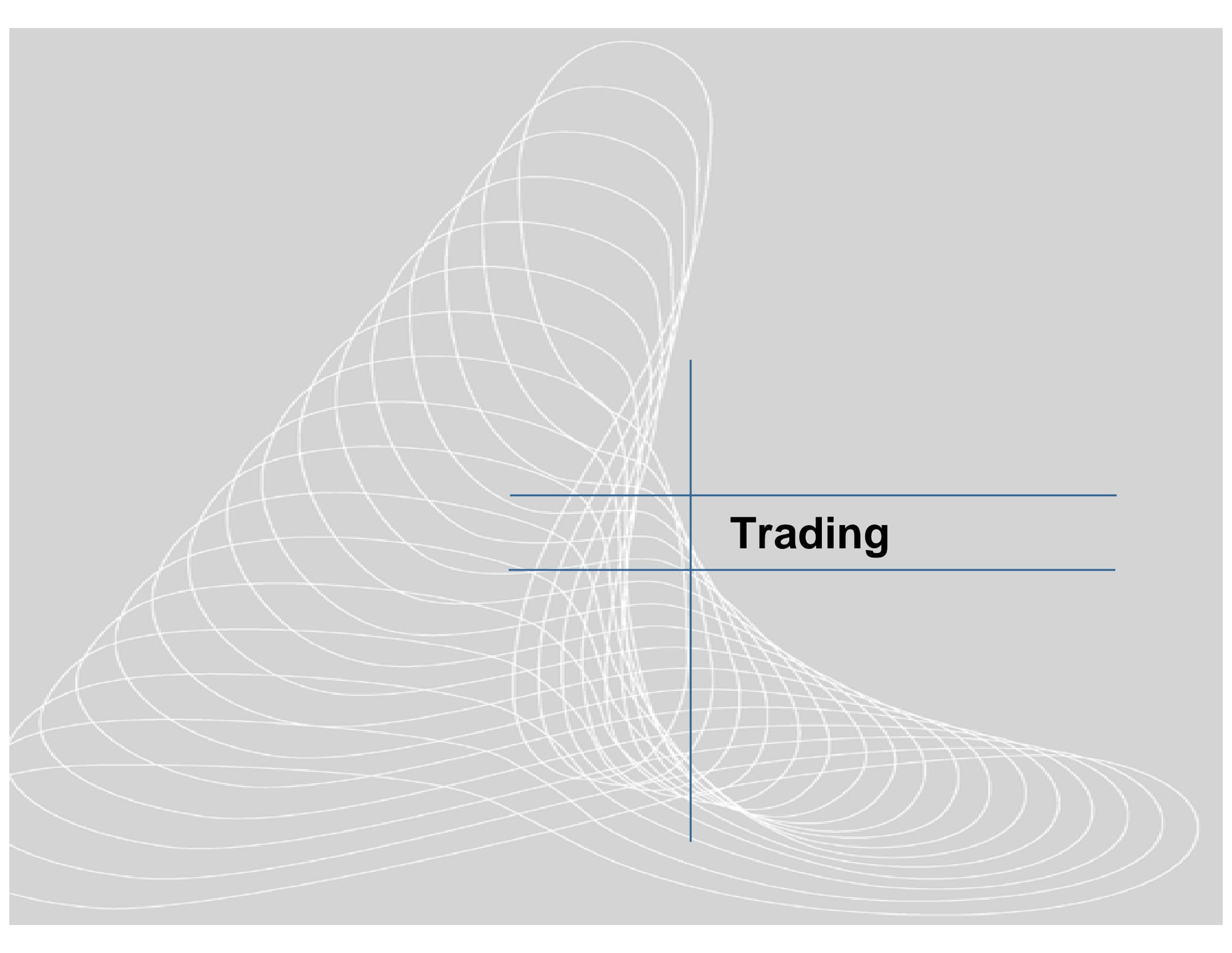
¹ S. Rep. No. 989, 95th Cong., 2d Sess. 22.

What “Motivates” Trade Creditors

- ❖ Trade creditors are not natural holders of distressed paper and in many instances choose to sell their claim into an illiquid and non-transparent market. These holders are motivated to sell for a variety of reasons:
 - The vast majority of trade creditors lack the proper financial expertise to understand the economic variables responsible for determining the value of their claim;
 - Trade creditors generally do not have ready access to sophisticated bankruptcy counsel (or don't want the ongoing expense) which is necessary to properly administer, defend and monitor a bankruptcy claim;
 - Creditors lack the accounting or financial flexibility to endure a lengthy workout and restructuring process
 - Creditors can gain immediate financial statement benefits from the sale of their claim; and
 - Creditors are either not set up to hold post-reorganization equity (common mode of recovery to general unsecured creditors) or do not wish to take on the associated risk/reward position

Attractiveness of Investment

- ❖ Why would a distressed debt investor give up the liquidity of public securities for the private debt trading market of trade claims?
 - Trade claims can be purchased at a significant discount to otherwise *pari passu* securities. The discount varies but is often in the range of 5-20%.
 - Trade claims present a NEW arbitrage opportunity for investors who like intra-capital structure arbitrage plays (e.g. short structurally subordinate bonds – long structurally senior trade claims).
 - Trade claims provide a unique opportunity to take advantage of the “motivated seller” phenomenon (akin to the forced selling often seen by Mutual Funds in defaulted bonds). However, trade creditors are often much less sophisticated than other investment institutions who become natural sellers of bank debt and bonds in bankruptcy situations.
 - Trade claims are not generally followed by Wall Street investment banks, but proprietary research efforts like ours can frequently uncover misvalued situations.
- ❖ In addition to the above, purchase of trade claims gives a distressed bond/bank debt buyer important leverage when attempting to assert influence or control over a restructuring scenario. This is a common tactic of savvy distressed debt specialists who understand the significant advantages of having a voice in multiple levels of the capital structure (or through various classes of unsecured indebtedness).



Trading

Trading Timeline

(1) Negotiating phase. APSC presents investment opportunity to Client. APSC presents counterparty characteristics (D&B, credit rating), size and anticipated level (offer if available). Ideally, Client gives APSC an open limit order to negotiate with claims holder as riskless-principal.

1 day – 2 weeks

(2) Oral agreement. At direction of the buyer, APSC reaches agreement with original creditor on principal material terms of trade. Confirmations are circulated and due diligence requests are made.

T + 1-5

(3) Confirmations executed. APSC receives all confirmations and due diligence phase continues. APSC circulates draft Purchase and Sale Agreements ("PSA") to the appropriate parties.

T + 4-8

(4) Due diligence – Legal review. APSC concludes its preliminary due diligence review. Transaction documents still in negotiation, review and comment period.



Trading Timeline

T + 8-28



(5) Agreement. Due diligence review is complete and agreements are reached on the PSA's for all sides. Documents are executed via a DVP format (i.e. signatures are delivered and funds are wired within one business day).



1-4 days (post-closing)

(6) Transfers docketed. APSC (or the buyer) coordinates the filing of 3001(e) transfer notices and evidences of transfer with the relevant bankruptcy court.

3-4 weeks
----->

(7) Follow-up. Buyer must follow-up with claims agent to ensure the claims register properly reflects the new owner of the claims.

Due Diligence - Proof of Claim

APSC conducts preliminary POC due diligence on the claim(s). Due diligence should include:

- Examination of the “basis for the claim” and any supplementary statements in support thereof.
- Reconciliation of the amount asserted in the POC and all supporting documents.
- Review of docket stamp to ensure the POC meets the Bar Date.

Note: Under Bankr. Code 502(a), a claim for which a proof of claim has been filed is deemed "allowed" unless a party in interest (e.g. a bankruptcy trustee or the Debtor) objects to the claim, in which case the bankruptcy court will conduct a hearing to determine whether, or to what extent, a claim should be allowed.

FORM B19 (Official Form 19) (04/05)

UNITED STATES BANKRUPTCY COURT		DISTRICT OF	PROOF OF CLAIM
Name of Debtor	Case Number		<p>NOTE: This form should not be used to make a claim for an administrative expense arising after the commencement of the case. A "request" for payment of an administrative expense must be filed pursuant to 11 U.S.C. § 503.</p> <p>Name of creditor (The person or other entity to whom the debtor owes money or property):</p> <input type="checkbox"/> Check box if you are aware that anyone else has filed a proof of claim relating to your claim. Attach copy of statement giving particulars. <p>Name and address where notices should be sent:</p> <input type="checkbox"/> Check box if you have never received any notices from the bankruptcy court in this case. <input type="checkbox"/> Check box if the address differs from the address on the envelope sent to you by the court. <p>Telephone number:</p> <p>Account or other number by which creditor identifies debtor:</p> <p>Check here <input type="checkbox"/> employee of this claim <input type="checkbox"/> employee of a previously filed claim, dated _____</p> <p>1. Basis for Claim</p> <input type="checkbox"/> Goods sold <input type="checkbox"/> Retiree benefits as defined in 11 U.S.C. § 1114(a) <input type="checkbox"/> Services performed <input type="checkbox"/> Wages, salaries, and compensation (fill out below) <input type="checkbox"/> Money loaned <input type="checkbox"/> Last four digits of SSN _____ <input type="checkbox"/> Personal injury/wrongful death <input type="checkbox"/> Unpaid compensation for services performed <input type="checkbox"/> Taxes <input type="checkbox"/> from _____ to _____ <input type="checkbox"/> Other _____ (date) _____ (date) <p>2. Date debt was incurred: _____ 3. If court judgment, date obtained: _____</p> <p>4. Total Amount of Claim at Time Case Filed: \$ _____ (unsecured) _____ (secured) _____ (priority) _____ (Total)</p> <p>If all or part of your claim is secured or entitled to priority, also complete Item 5 or 7 below.</p> <input type="checkbox"/> Check this box if claim includes interest or other charges in addition to the principal amount of the claim. Attach itemized statement of all interest or additional charges. <p>5. Secured Claim.</p> <input type="checkbox"/> Check this box if your claim is secured by collateral (including a right of setoff). <p>Brief Description of Collateral:</p> <input type="checkbox"/> Real Estate <input type="checkbox"/> Motor Vehicle <input type="checkbox"/> Other: _____ <p>Value of Collateral: \$ _____</p> <p>Amount of mortgage and other charges at time case filed included in secured claim, if any: \$ _____</p> <p>6. Unsecured Nonpriority Claim _____</p> <input type="checkbox"/> Check this box if: (a) there is no collateral or lien securing your claim; or (b) your claim exceeds the value of the property securing it; or (c) it is an unsecured claim or only part of your claim is entitled to priority. <p>7. Unsecured Priority Claim.</p> <input type="checkbox"/> Check this box if you have an unsecured priority claim. <p>Amount entitled to priority: \$ _____</p> <p>Specify the priority of the claim:</p> <input type="checkbox"/> Wages, salaries, or commissions (up to \$10,000)* earned within 180 days before filing of the bankruptcy petition or cessation of the debtor's business, whichever is earlier - 11 U.S.C. § 507(a)(3) <input type="checkbox"/> Contributions to an employee benefit plan - 11 U.S.C. § 507(a)(4) <input type="checkbox"/> Up to \$2,225* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use - 11 U.S.C. § 507(a)(6) <input type="checkbox"/> Alimony, maintenance, or support owed to a spouse, former spouse, or child - 11 U.S.C. § 507(a)(7) <input type="checkbox"/> Taxes or penalties owed to governmental units - 11 U.S.C. § 507(a)(8) <input type="checkbox"/> Other - Specify applicable paragraph of 11 U.S.C. § 507(a)(____) <p>*Amounts are subject to adjustment on all 180 and every 3 years thereafter with respect to cases commenced on or after the date of adjustment: \$10,000 and \$20,000 limits apply to cases filed on or after 4/20/01. Pub. L. 109-8.</p> <p>8. Credits: The amount of all payments on this claim has been credited and deducted for the purpose of making this proof of claim.</p> <p>9. Supporting Documents: Attach copies of supporting documents, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, court judgments, mortgages, security agreements, and evidence of perfection of lien. DO NOT SEND ORIGINAL DOCUMENTS. If the documents are not available, explain. If the documents are voluminous, attach a summary.</p> <p>10. Date-Stamped Copy: To receive an acknowledgment of the filing of your claim, enclose a stamped, self-addressed envelope and copy of this proof of claim.</p> <p>Date: _____ Sign and print the name and title, if any, of the creditor or other person authorized to file this claim (attach copy of power of attorney, if any): _____</p> <p>THIS SPACE IS FOR COURT USE ONLY</p>

Penalty for presenting fraudulent claim: Fine of up to \$500,000 or imprisonment for up to 5 years, or both. 18 U.S.C. §§ 132 and 3571

Due Diligence - Invoices, etc.

APSC conducts preliminary invoice and back-up due diligence.* Invoice due diligence should include:

- Examination of invoices supporting the claim. Reconciliation of debits and credits from invoices reviewed.
- Examination of Debtors Schedules and Statements of Financial Affairs (“SOFA”) to identify potential preference payments that the creditor may have received.
- Reconcile amount claimed on the creditor’s POC vs. the amount that is evidenced on the Debtor’s Schedules.

* APSC makes no representation or warranty regarding the accuracy, completeness or quality of such review.

ENGELHARD
Invoice
www.engelhard.com

TELEPHONE (732) 205-5720 FAX (732) 205-7453

INVOICE NO.	INVOICE DATE	DATE DUE	PAGE
1600204	07/25/05	09/27/05	1

PAYMENT NET 60 DAYS FROM INVOICE DATE
TERMS

PLEASE SEND PAYMENT TO

ENGELHARD CORPORATION
P.O. Box 7777-U7985
PHILADELPHIA PA 19125-7985

CUSTOMER ACCOUNT: 15759
DELPHI ENERGY & ENGINE MGMT SYSTEMS
GENERAL MOTORS CORPORATION
4800 S. SAGINAW STREET
P.O. BOX 1260
FLINT MI 48901

SHIP TO: 15960
DELPHI ENERGY & ENGINE MGMT SYSTEMS
8600 CENTRAL FREEWAY NORTH
ATT: PLANT SECURITY
WICHITA FALLS TX 76306

ITEM NO.	DESCRIPTION	QUANTITY	UNIT PRICE	TOTAL PRICE	CUSTOMER REFERENCE	DATE
102	PT TARGET PER DELPHI DWG #10-700010	3537.245	\$2.3000	\$8,135.66		07/25/05
	SHEET #27 REV E, LDW MASS DESIGN SYSTEM		OR			
	TARGET STAMPED EOS-030	1.000	EA			
*** ADDITIONAL CHARGES *** Cert Of Analysis Charge						
Tracking Number: 6169 2987 4779						

102 of Metal deducted from Acct 8224/650-10
DELPHI-E (ENERGY AND ENG)
113.725 PT

Part Number: 79027
PT TARGET PER DELPHI DWG #10-700010 3537.245 \$2.3000 \$8,135.66
SHEET #27 REV E, LDW MASS DESIGN SYSTEM OR
TARGET STAMPED EOS-030 1.000 EA

*** ADDITIONAL CHARGES ***
Cert Of Analysis Charge

Tracking Number: 6169 2987 4779

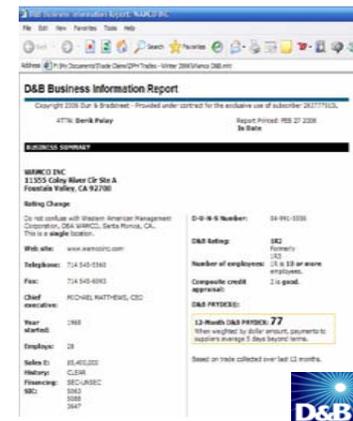
PLEASE PAY THIS AMOUNT **\$8,135.66**

ORIGINAL Thank You For Your Business

Due Diligence - Counterparty

APSC performs counterparty due diligence on upstream original creditors:

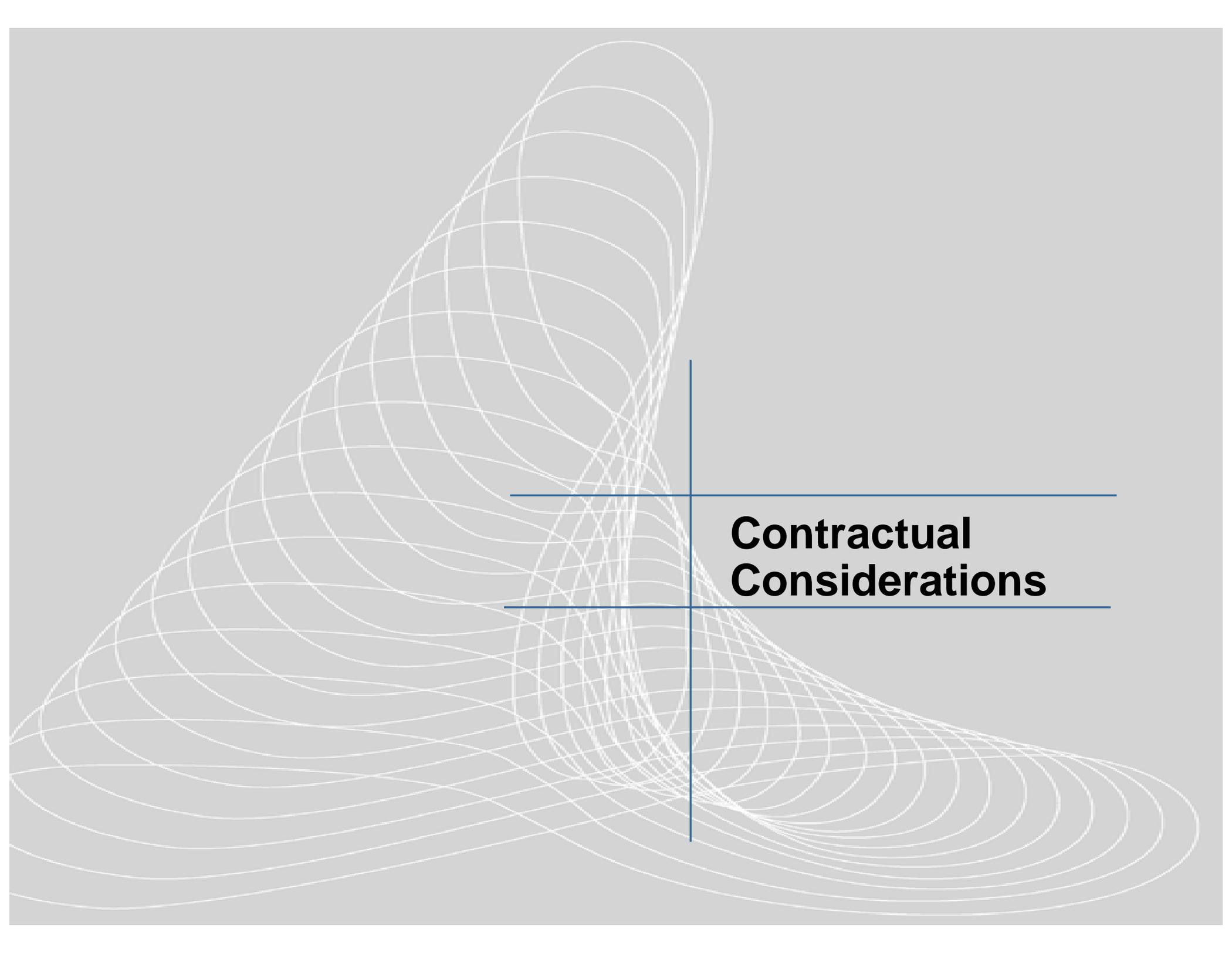
- Impairment and indemnity protections are only as good as the credit quality of your counterparty.
- D&B ratings in conjunction with creditor supplied financials are used where the creditor does not have public debt ratings (i.e. S&P, Moody's or Fitch).
- Other indicative information of stability: amount of debt, number of employees, general industry, year established, assets.



The screenshot shows a D&B Business Information Report for WAWICO INC. The report includes the following details:

- Company Name:** WAWICO INC.
- Address:** 11353 Colby River Cir Ste A, Fremont, CA 94528
- Rating Change:** Do not confuse with Western American Management Corporation, 204 Wawico, Santa Monica, CA. This is a single source.
- Web site:** www.wawico.com
- Telephone:** 714 545-5183
- Fax:** 714 545-6953
- Chief executive:** MICHAEL MATTHEWS, CEO
- Year started:** 1983
- Employees:** 28
- Sales \$:** \$5,452,000
- Industry:** C-239
- Financing:** SECURIT
- NAIC:** 5362
- SIC:** 2847
- D-U-N-S Number:** 04 991-0398
- D&B Rating:** B2
- Number of employees:** 28
- Composite credit approval:** 2 is good
- D&B PAYSCORE:** 77
- 12 Month D&B PAYSCORE:** 77
- Notes:** When analyzed by D&B analyst, payments to suppliers average 3 days beyond terms.
- Based on trade collected over last 12 months.**

Counterparty due diligence is important since the ability to seek recourse under the representation/warranties (“Reps/Warranties”) (see p. 21) and disallowance protections (see p. 22) are dependant on the credit risk of the seller.

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**Contractual
Considerations**

APSC Transaction Framework

- ❖ APS Capital may act as either a “Riskless-Principal” or “Agent” on trade claim transactions.
- ❖ A Riskless-Principal structure meant to mimic the trading mechanics that are common for broker-dealers in the bond (as sanctioned by the Bond Market Association) and bank debt (as sanctioned by the Loan Syndication and Trading Association) markets and ensures that:
 - (1) we maintain control over the process and transaction (i.e. we can move transactions toward a close with our operating and negotiating experience);
 - (2) we limit risk on transactions to the benefit of our bargain (i.e. our spread); and
 - (3) we maintain our relations and image within the credit community.
- ❖ Limited recourse to APSC is the main result of the Riskless-Principal format. Buyers must look to the “upstream” seller for counterparty risk.

APSC Transaction Framework, cont.

- ❖ A Riskless-Principal format requires the negotiation of two assignment documents:
 - First, a buyer must negotiate and approve the “**upstream**” assignment agreement (i.e. the PSA between the original creditor and APSC) (the “Upstream PSA”). This is the document where the buyer’s rights in the trade claim derive.* The Upstream PSA is a pro-buyer document and most of our trading partners like its content and format.
 - Second, a buyer must negotiate and approve the “**downstream**” assignment agreement (i.e. the PSA between APSC and the buyer) (the “Downstream PSA”). This is the document where buyer takes possession of the trade claims. Key elements in this document are: (a) **flip representations**, (b) **recourse pass-throughs**.

* For “secondary” trades (i.e. trades where the original holder has already sold a claim to an investment institution (“Buyer #1”) and Buyer #1 is now selling to a secondary buyer (“Buyer #2”), Buyer #2’s rights will derive from the original sale of the claims to Buyer #1. However, Buyer #2 is in a position to negotiate step-up provisions (i.e. Buyer #1 “steps into the shoes” of the original seller and provides direct representations and warranties as well as disallowance, impairment and indemnification protections). A buyer in the secondary market should always ask prior to the trade date whether the seller will provide him with “step-ups.” Note: this is exactly what APSC does not do in its transactions. We pass through all credit risk as a riskless-principal.

Downstream Contractual Provisions

- ❖ Flip representations: APSC will not make any direct representations regarding the validity of the claim. Buyer will take (via assignment) all of the Reps/Warranties APSC negotiated in the Upstream PSA (such document being formally vetted by buyer's counsel). Note: This concept is almost identical to the flip-rep concept utilized for LSTA/LMA bank debt trading.
- ❖ Recourse pass-through: APSC utilizes a pass-through mechanism for disallowance and impairment protections. The mechanism leaves impairment risk ultimately with the buyer, but allows APSC the option of stepping up for a disallowance event.
 - Limited recourse ("buy-in"): At a minimum APSC must pay for an "impairment" to the extent of its spread (i.e. profit on the transaction). This is a just result: APSC is not taking any of the "investment rewards", so it should not be subject to any of the "investment risks."

Upstream Contractual Provisions

- ❖ Basic tenet: The purchaser of claims assumes all of the rights and disabilities of the seller's claim.
- ❖ Material provisions to be aware of in upstream assignment documentation:
 - Assignment: Ensures that all right, title and interest in the claim and all contracts, invoices, purchase orders, choses-in-action, cure payments, etc. are being assigned.
 - Reps/Warranties: An array of representations and warranties should be obtained as they relate to the ownership, validity and absence of encumbrances to the claim. Reps/Warranties also serve to “smoke out” potential issues with a claim.
 - Indemnification: Purchaser receives indemnification for breach of representations and claim impairment.
 - Big Boy clause: Our language is fairly standard (originated from LSTA docs). “Insider” status should be disclosed if the buyer meets certain requirements (see page 28).

Upstream Provisions, cont.

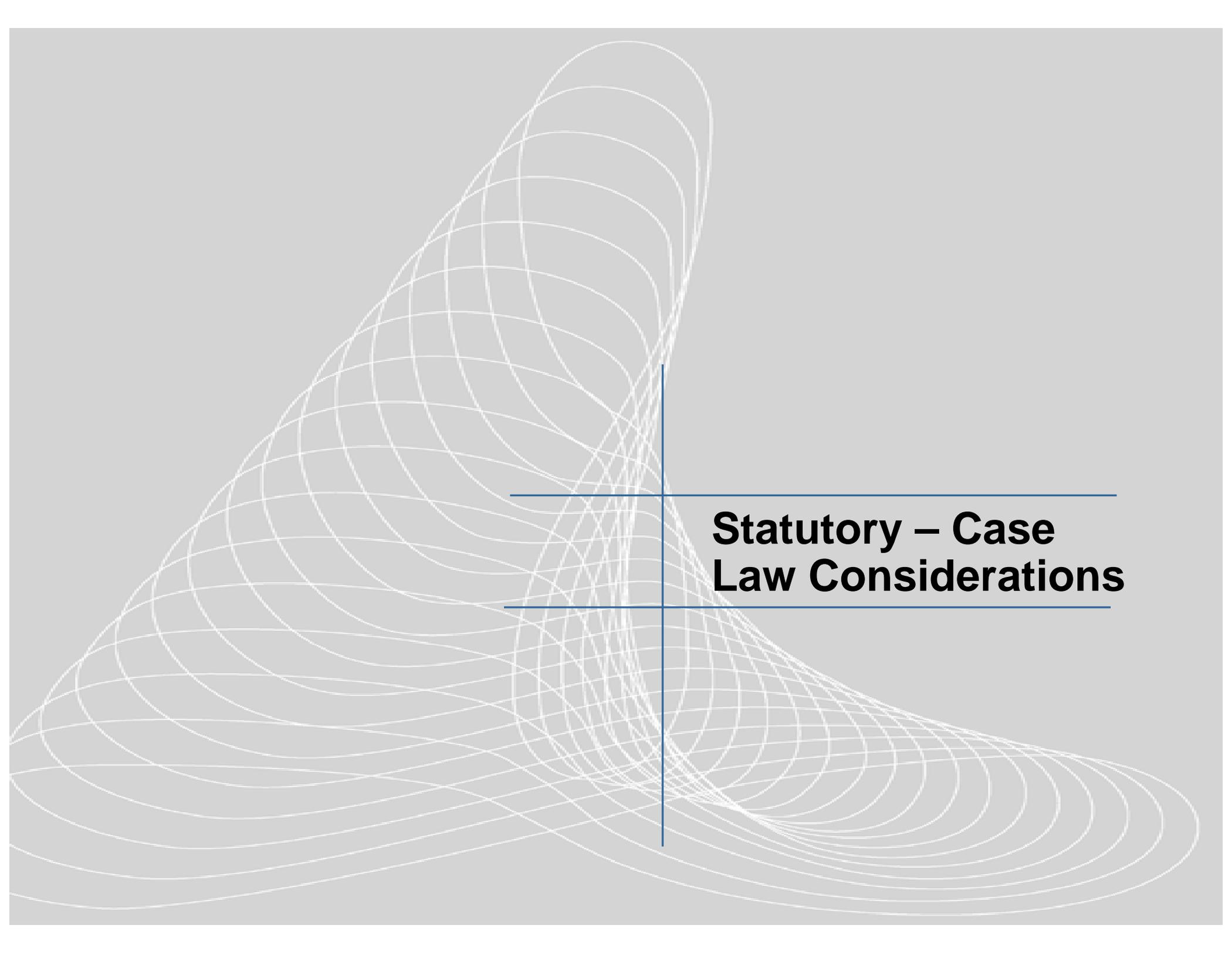
- Impairment: Creditors will want to limit the scope, interest rate, and/or timing of a disallowance event. We will normally not give many concessions in this area.
 - Our standard impairment protections contain a choice of remedy clause where the original creditor retains the right to defend the claim. This right expires 90 days after a written “demand” has been served. Investors should carefully consider whether they want to grant this voluntary right (although we believe it is the best way to ensure a creditor’s defense of the claim).
- Excess claims: The Upstream PSA contains provisions which allows the buyer to purchase any excess portion of the claim after allowance. Our default is to make this provision optional for the buyer. Excess claims and impairment are covered in depth below in the Section titled “Ping Pong Provisions” (see page 24).
- Assignment: Key to the liquidity of our Upstream PSA is the assignability provisions. Often, a creditor will want to limit the scope of this section (e.g. right of first refusal, written consent, etc.). It is imperative that the original assignment document (and all reps, warranties and covenants) freely travel with subsequent assignments. Limitations of free alienability lead to liquidity problems and should be avoided.

Upstream Provisions, cont.

- Interest rate: Being flexible on impairment may be an advisable tactic to preserve other protections and demonstrate the presence of good faith. It is our opinion that a small concession in the interest rate goes a long way to quell other material objections to the PSA. A potential catch-up feature can be incorporated into the default section (i.e. default rate).
- Dispute resolution: Most of our clients wish to retain their right to use the hammer of trial court litigation (NY jurisdiction, waiver of jury trial). Because of this, we use traditional litigation as the *default* provision.
 - We suggest the use of an International Arbitration (ICC Rules) framework where the upstream counterparty is a foreign company (must be from country that is a signatory to the NY Convention). Foreign courts are required to enforce arbitration judgments conducted in accordance with ICC rules. A court order from a US court does not have the same universal recognition in signatory countries.
 - We also believe that ADR (as governed by the American Arbitration Association) is the most expedient and economical way to dispense with disputes for domestic transactions and should be a goal for future adoption.

Upstream Provisions, cont. (Ping Pong)

- ❖ Customary assignment documents contain reciprocal covenants re: additional and disallowed claims.
 - *Excess claim* adjustments require (upon notice from the original creditor) the buyer to fund additional claims at the original purchase rate. Default APSC transaction documents make this adjustment an option of the buyer.
 - *Impairment* and *indemnity* protections protect a purchaser where a claim is not allowed in the full principal amount specified in the transaction documents. The Upstream PSA allows a buyer to receive attorneys fees and costs for collection of disallowed claims.
 - APSC transaction documents contain “hair trigger” impairment clauses designed to activate impairment protections at the earliest possible date. This activation is voluntary, giving the buyer flexibility to actively defend the claim or immediately pursue impairment protections.
 - APSC attempts to extract the highest “impairment rate” possible from original creditors.

An abstract graphic on a light gray background. It features a series of white, overlapping, wavy lines that form a shape resembling a bell curve or a cloud, tapering towards the right. A blue crosshair is centered over the graphic, with a vertical line and a horizontal line intersecting at the center. The text 'Statutory – Case Law Considerations' is positioned to the right of the vertical line, between the horizontal lines of the crosshair.

**Statutory – Case
Law Considerations**

Securities Laws

- ❖ There are no reported decisions treating trade claims as securities and most commentators and judges do not believe that the securities laws can be applied to the sale, transfer and ownership of these claims.
- ❖ The analysis is complex, but derives from Supreme Court precedent under the *SEC v. W.J. Howey* test for “investment contracts” and the *Reves v. Ernst & Young* “family resemblance” test.
- ❖ For a superb overview of the issues see Hon Robert Drain, *Are Bankruptcy Claims Subject to the Federal Securities Laws?*, 10 ABI Law Rev. 569 (2004).

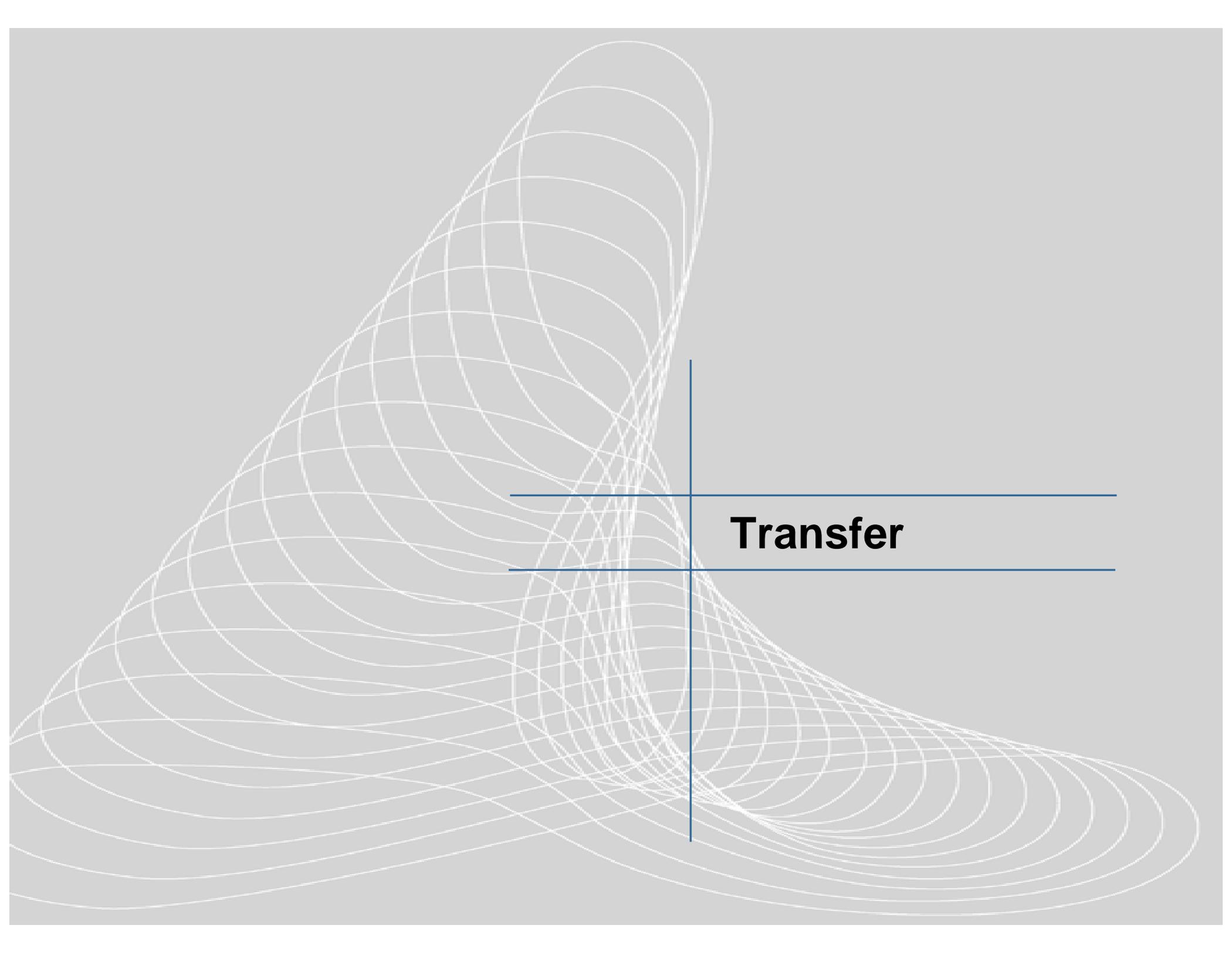
Succession Risks

- ❖ While the free alienability of claims allows the transferee to succeed to all rights of the seller, the doctrine also has potentially negative impacts: (1) possible equitable subordination; and (2) preference/avoidance liability.
 - Equitable subordination¹: A Bankruptcy Court can equitably subordinate (i.e. designate or alter the priority chain) claims under Section 510(c) for various reasons (including aiding and abetting fraud, insider trading, breach of fiduciary duty, etc.). A claims purchaser may inherit the taint of upstream conduct of previous holders.
 - Avoidance liability: A claim purchased in bankruptcy can be subject to the avoidance provisions of Section 502(d) where the original creditor received a preference payment (i.e. payment on the account of an antecedent debt within the 3 month period prior to bankruptcy).
 - When purchasing in the secondary market APSC upstream documents contain protections in the form of “Bad Acts” representations and warranties. These reps encompass the “acts, conduct and omissions” of the original creditor. The reps are given teeth through the use of rigorous impairment and indemnification language.

Insiders

- ❖ Neither the Bankruptcy Code nor the Rules prohibit trading by “fiduciaries” (including insiders). Nonetheless, case law has established that fiduciaries who purchase or sell claims of insolvent companies may face serious consequences, such as limitation of their recovery to the amount paid (*In re Papercraft*, 187 B.R. 486 (Bankr. WD Pa 1995)) or equitable subordination under Section 510(c) of the claim beyond disgorgement of profit or designation (i.e. disqualification) of their votes pursuant to Section 1126(e).
 - Fiduciaries include: (1) officers and directors, (2) controlling shareholders, (3) one who has access to material non-public information, and (4) official committee members.
 - It is advisable to specifically avoid claims being sold from an Unsecured Committee member.

- ❖ Disclosure is key and the mere existence of a fiduciary status doesn’t necessarily cause a problem. At a minimum, protective measures for insiders who buy trade claims should include the following: (1) a full disclosure of the insider’s status; (2) a full disclosure of the insider’s actions; (3) use of an externally vetted “big boy” provision (preferably in a conspicuous position), and (4) establishment of an “Information Wall.”
 - APSC documents incorporate a “big boy” clause as a standard provision.
 - APSC advises consulting with outside counsel if any client feels it may be considered a “fiduciary” pursuant to the factors above.



Transfer

Transfer – Court Requirements

- ❖ For a valid transfer of a claim to occur, the procedural requirements of Rule 3001(e) must be observed. Amended in 1991, the former rules gave courts wide latitude to review and police the claims transfer process. After the amendments, Courts can only review transfers upon objection from the seller or “transferor”.
- ❖ Rule 3001(e) requires:
 - Transferees trading on the “scheduled amount” prior to the filing of a POC must file a POC with the Court. An “evidence of transfer” is not required (although standard APSC procedure is to include such document for the claims agent). Rule 3001(e)(1).
 - Assignments trading after a POC has been filed must comply with Rule 3001(e)(2) which requires the filing of a Notice of Transfer and an “Evidence of Transfer.”
- ❖ The clerk of the Court (or a claims agent, if any) has the duty to notify the Transferor. The Transferor then has 20 days to object to the transfer.
- ❖ If an objection is filed, then relevant state law shall govern the enforceability of the assignment. Our forms contain New York choice of law provisions as a default which are generally more favourable (and predictable) with regard to the assignment of bankruptcy claims and choses-in-action.

Transfer – continued...

- ❖ The standard industry practice is for the Buyer of claims to coordinate the filing of all Transfer Notices and Evidences of Transfer.
- ❖ APSC may perform this back office function as a value-added service for our clients in limited circumstances. APSC uses its network of bankruptcy court and claims agent contacts to streamline the transfer process.

3001(e)

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re: Case No. 05-44481
DELPHI CORPORATION, et al. Chapter 11, Joint Administration
Claim No. RE EXHIBIT E
1674,388.01

Debtors

NOTICE TO TRANSFER OF CLAIM PURSUANT TO FRBP 3001(c)(2)

To: ("Transferee") US Fastzone Corporation
3900 Mount Rd.
Spring House, PA 40310

Please take notice that the transfer of 100% of your Claim(s) (as defined in **Exhibit A and B hereto**), in the amount of \$674,388.01 in the bankruptcy case referenced above, together with all applicable interest, fees and expenses thereto, has been transferred (unless previously assigned by court order) to:

From: ("Transferor") APC Clearing, Inc.
Attn: Matthew Harshon
1382 Capital of Texas Hwy.
Suite No. 8-220
Austin, Texas 78746

Evidence that Transferor has assigned all of its right, title and interest in the Claim(s) to Transferee is attached hereto as **EXHIBIT A**.

No action is required if you do not object to the transfer of your claim. HOWEVER, IF YOU OBJECT TO THE TRANSFER OF YOUR CLAIM, WITHIN TWENTY (20) DAYS OF THE DATE OF THIS NOTICE, YOU MUST FILE A WRITTEN OBJECTION WITH:

United States Bankruptcy Court
Southern District of New York
Attn: General Deputy Clerk
One Bowling Green
New York, NY 10004-1408

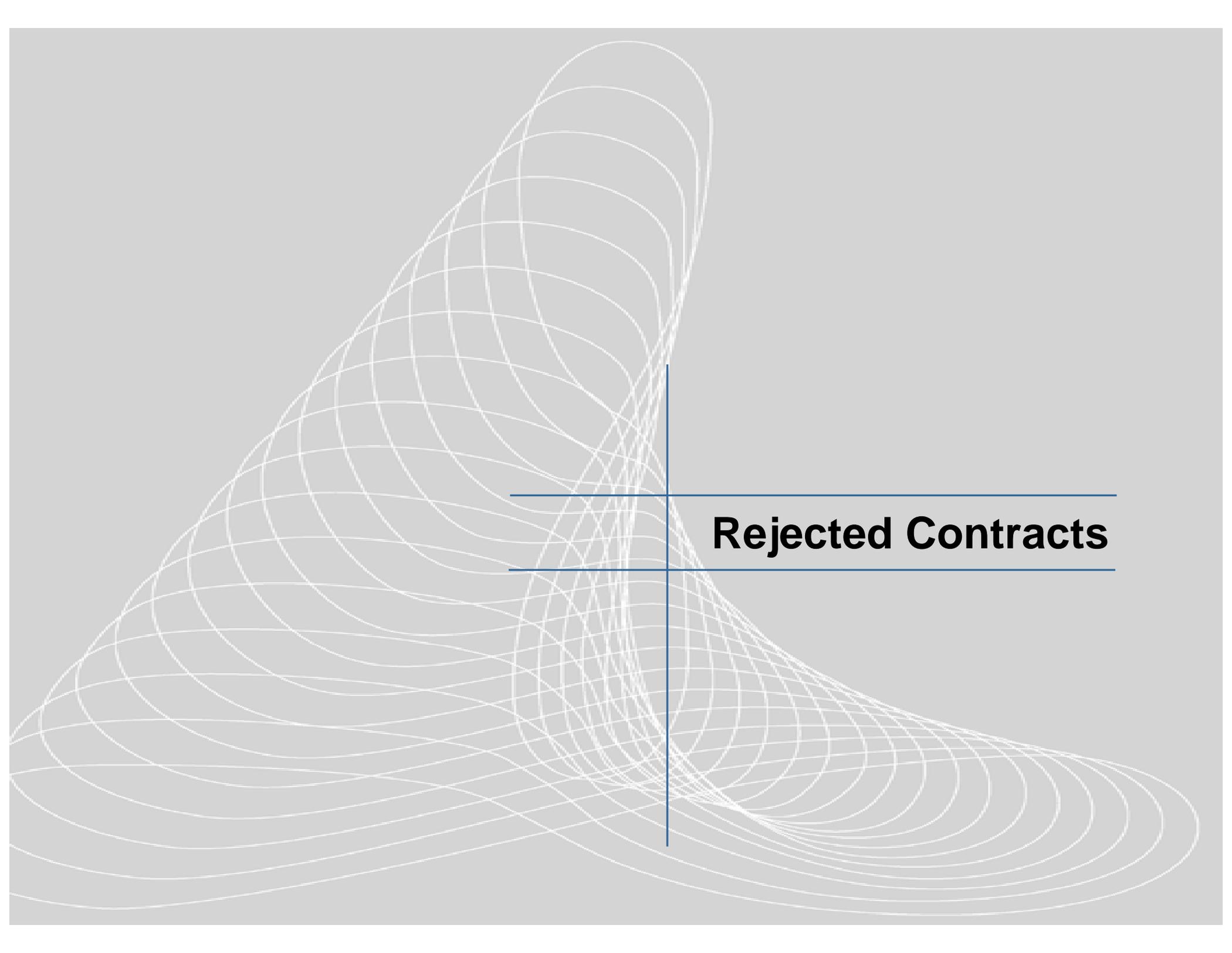
If you file an objection a hearing will be scheduled. If you do not file an objection, or it is not timely filed, the transferee will be substituted on the Court's records as the Claimant. SEND A COPY OF YOUR OBJECTION TO THE TRANSFEREE.

Filed and docketed with US
Bankruptcy Court



Coordinate and follow-up with
Claims Agent

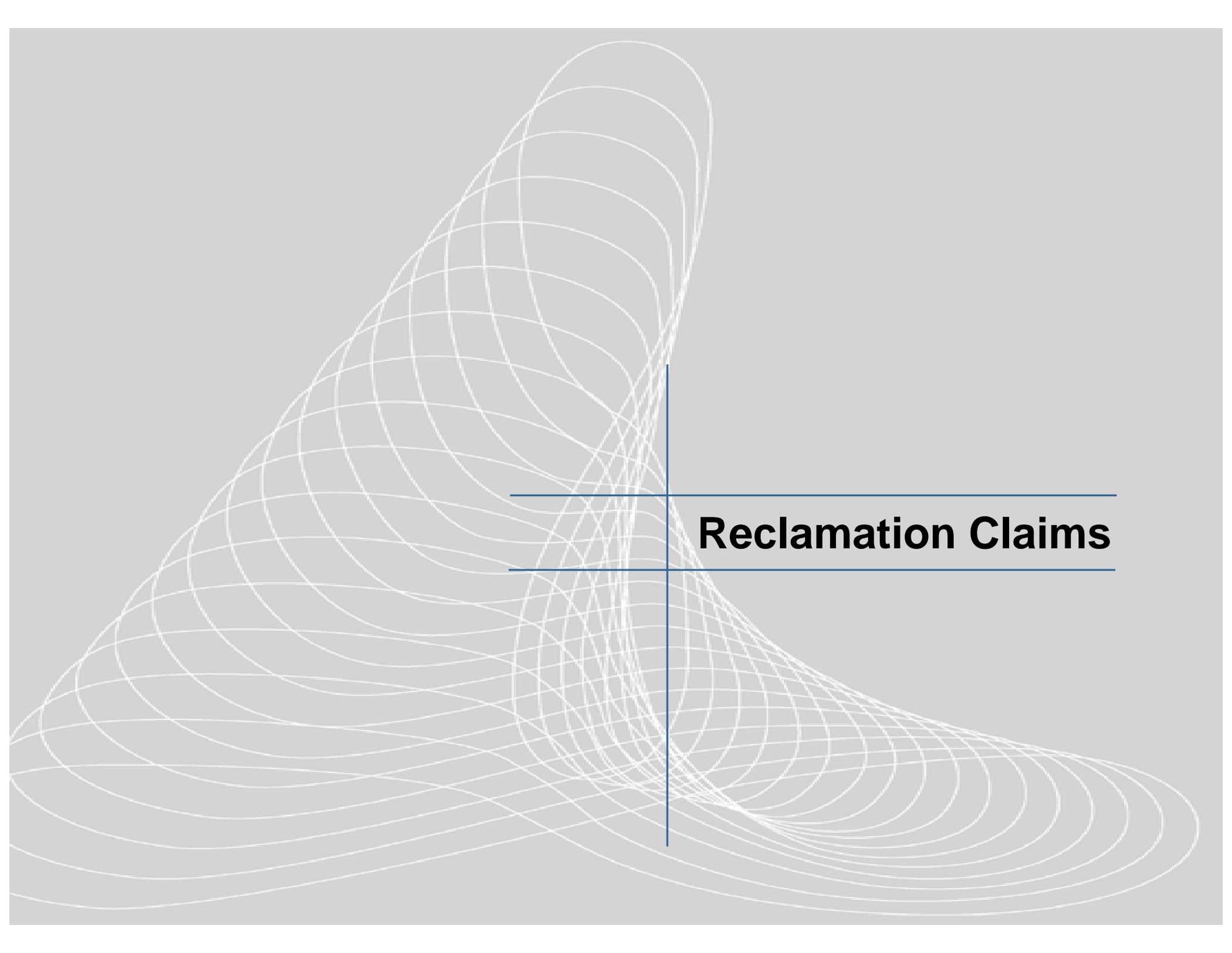




Rejected Contracts

Rejected Contracts

- ❖ If an un-assumed executory contract or unexpired lease is rejected after the Petition Date, the rejection results in a non-administrative unsecured claim for damages.
 - By rejecting the contract or lease, the Debtor forgoes the benefits of performance by the other party, avoids the burden of performance by the estate, and creates a claim against the estate which is a non-administrative claim deemed to have arisen prior to the Petition Date.
- ❖ A party to a rejected contract normally holds an unsecured claim for the **full amount** of the damages. Code Section 365(g).
 - Damages will be calculated according to state law and pursuant to the damages/breach provisions of the underlying contract.
 - Note: An order approving rejection does not in itself determine whether the contract is valid in the first place. A Debtor that rejects a contract reserves its rights to move the court to set the contract aside.
- ❖ A lessor of a rejected real property lease has its damages **limited** by Code Section 502(b)(6).
 - The landlord's claim for damages is limited as follows: the rent reserved by such lease, without acceleration, for the greater of **one year, or 15%, not to exceed three years**, of the remaining term of the lease.

The background features a series of white, overlapping, wavy lines that create a sense of depth and movement, resembling a stylized landscape or a complex data visualization. A blue crosshair is centered on the page, with a vertical line and a horizontal line intersecting at the origin. The text 'Reclamation Claims' is positioned to the right of the vertical line, between the horizontal lines.

Reclamation Claims

Reclamation

- ❖ A creditor's reclamation rights arise under state law, §2-702(2) of the Uniform Commercial Code (“UCC”). Once a debtor files for bankruptcy protection, §546(c) of the Bankruptcy Code (“Code”) preserves a creditor’s state law reclamation rights, enhances those rights and creates additional requirements and defenses.
 - Reclamation only applies to claims arising from the shipment of **goods** (i.e. not the provision of services).
- ❖ Bottom line: Assuming administrative solvency, reclamation claims falling within the §§ 546(c)(2) and 503(b)(9) period will be paid at par either during the course of the cases (usually through payment of critical vendor claims), or most likely, at the end of the case as an administrative priority claim.
 - Key: Cases will benefit from §546(c)(2) and §503(b)(9) which has an automatic (i.e. no demand or creditor maneuvers required) administrative priority claim mechanism for all goods delivered within a 20 day window prior to the Petition Date.

Reclamation cont.

- ❖ Because reclamation claims are generally paid at par, these claims trade on a time value of money basis. Some reclamation claims become a windfall for the purchaser where a seller does not realize the value, or existence, of its §546(c)(2)/§503(b)(9) claim. Intelligent buyers, however, must understand the law and be aware of certain pitfalls.
 - Unless allowed as an administrative claim, APSC generally does not recommend paying a premium on claims falling outside §§ 546(c)(2) and 503(b)(9) status.

- ❖ A creditor seeking to reclaim goods must satisfy all the following requirements:
 - The Debtor must have been ***insolvent*** when it received the goods;
 - The Creditor must make ***written demand*** for return of the goods;
 - The demand must meet certain ***time periods***; and
 - The Debtor must still ***“possess”*** the goods.

Reclamation, cont.

- ❖ Debtor's insolvency: Insolvency is defined in UCC §1-201(23) which contains an "equity" test (i.e. Debtor can not pay its bills in the ordinary course) and a "balance sheet" test (i.e. Debtor's liabilities are greater than its assets).
- ❖ Written demand: The demand should, at a minimum, identify the goods by invoice number, date and amount.
- ❖ Time periods: §546(c) requires the demand to be sent not later than 45 days after the date of receipt of such goods by the Debtor or not later than 20 days after the Petition Date if the 45 day period has expired.
- ❖ "Possession": A creditor may only reclaim identifiable goods that are in the Debtor's possession when the demand is made.
 - The goods can not have been sold, altered, processed, commingled with other goods, which are not of like kind and grade or otherwise disposed of by the time the Debtor receives the demand.

Reclamation Defenses

- ❖ A Debtor has a number of defenses against reclamation demands:
 - Sales to buyers in the ordinary course: Under UCC §2-702(3), a reclaiming creditor is subordinate to the rights of an ordinary course good-faith purchaser for value.
 - Impact of Secured Lender: Situations where a secured lender has a perfected security interest in all of a Debtor's inventory will abrogate reclamation rights.
 - Knowledge of Insolvency: A minority of courts have held that a creditors knowledge of a debtors insolvency is a defense to the reclamation claim.

Contact Us



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