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Trading in Distressed Debt

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2009 undoubtedly will be a year of severe economic challenges. Analysts believe that the deepest recession since World War II will continue and worsen in the United States. Unemployment may well exceed 10%. With major financial institutions de-levering their balance sheets, credit was constricted for much of 2008 and likely will remain so for an extended period. Partly as a result, entire industries, from automobile manufacturing to retailing, are facing extreme contraction and even the prospect of collapse.

However, for the survivors of 2008's financial hurricane, 2009 also could be a year of unprecedented opportunity. Bank debt and bonds of good-quality companies are trading at historic lows. Hedge funds that have withstood the wave of investor redemptions, and private equity firms that have raised massive amounts of new capital but see few traditional investment outlets, may explore (or, for the veterans, reenter) the distressed debt market. While the economic and societal benefits of reintroducing liquidity to the debt markets are unquestionable, increased activity in this area no doubt will be met with increased regulatory scrutiny and litigation, particularly in the wake of the myriad financial scandals of the recent past. Some are buying for the enhanced returns available from reasonable credits, while others are buying on a "loan-to-own" basis with a view toward eventually becoming the equity owner of the underlying asset, and some are buying to profit from the potential "reorg" events that others will lead.

My partners **Richard G. Mason**, **Steven A. Cohen**, **Ian Boczko**, **Sarah A. Lewis**, and I have prepared a memorandum concerning the possession and use of information when buying and selling distressed debt (an abridged version of which was published in *The New York Law Journal*), which may be of use during the coming year. The rules and customs of the distressed debt market are somewhat different from those that govern other trading markets, and it is important to be careful with information to avoid a problem. This note is meant as a general guide, and particular circumstances will require more detailed analysis. Moreover, prudent investors would be well-advised to have their specific trading policies and procedures reviewed for regulatory compliance and tailored to reflect not only generalized "best practices" but the specific context and framework in which each investor operates.

The memo is available **here**.