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Trader with 'Scattered' History Sees Another Company into Chapter 11

ByStephanie Gleason

Prospect Capital Corp. had planned a foreclosure sale for May 1 on the undrilled gas wells securing the more than \$88.8 million in debt H&M Oil & Gas owed it. But when H&M filed for Chapter 11 on April 30, halting the sale, all the private equity firm could do was watch—and it looked to Prospect like the “bad boy of Chicago arbitrage,” Leon Greenblatt, was at it again.

If oil and gas exploration company H&M doesn't start drilling, the leases can be terminated, Prospect said, diminishing the H&M assets that are protecting Prospect's investment in the company. H&M has until August to start drilling in one county before the leases are lost and 50% of the collateral securing Prospect's loan is gone, it said.

Prospect has asked the court to allow it to go ahead with the foreclosure sale before the wells no longer belong to H&M. But until the court rules on the matter, Prospect's hands are tied.

However, H&M's history of defaulting on loans and losing oil leases are only part of Prospect's unease about H&M's trip into Chapter 11. The company was put into bankruptcy by Chicago trader and H&M manager Leon “Chip” Greenblatt, a man with some experience in bankruptcy courts.

“Greenblatt, [H&M Oil & Gas's] manager, purported CFO and principal, has a long history of misusing corporate formalities and the bankruptcy system for his own gain,” Prospect said in documents filed with the U.S. Bankruptcy Court in Dallas. “Greenblatt has a history of using his web of corporations to defraud creditors.”

The company included a “non-exhaustive list of Greenblatt's misuses of the bankruptcy system” with their objection. The list includes 12 separate instances.

Greenblatt stormed onto the bankruptcy scene in the mid-1990s, when steel company LTV Corp. was in Chapter 11.

In LTV's bankruptcy, he made \$27 million in 22 days, [according to BusinessWeek](#), by finding a loophole that an appeals court later ruled was legal.

LTV's plan of reorganization issued stockholders warrants that allowed them to buy stock in the new company for 3.2 cents a share—but the old stock traded for 18 cents a share. The warrants outnumbered the shares and so Greenblatt's company, Scattered Corp., sold stock and bought warrants, ultimately selling more shares of the stock than even existed—180 million.

The move made him a cult hero among traders, [the Chicago Tribune said](#). But since his initial bankruptcy court victory, he's been hammered by judges, including Judge Richard Posner of the U.S. Circuit Court of Appeals for the Seventh, who'd handed down the ruling that cleared Greenblatt's LTV trades.

"Greenblatt's evasive and at times incredible testimony, and his orchestration of a scheme aimed at a palpable misuse of bankruptcy, raise serious ethical and perhaps legal concerns," Posner said in a case involving the bankruptcy of South Beach Securities Inc., according to the Prospect objection.

That decision affirmed a bankruptcy court's refusal to confirm a Chapter 11 plan in which net operating losses, sometimes used to offset future taxes, were the bankrupt company's primary asset, [according to law firm Jones Day](#). Greenblatt was president and sole employee of the company that owned the bankrupt securities broker. The company trying to acquire the tax refunds was Scattered Corp., where Greenblatt is a principal.

Prospect claimed in the objection that Greenblatt and his known entities (it lists 14) have filed at least 10 unsuccessful bankruptcy proceedings, "many of which have been dismissed for bad faith or other malfeasance by Greenblatt."

H&M's bankruptcy lawyer, Aaron Tobin, said by email that he and Greenblatt don't believe this is "an accurate representation of what happened in the past nor do we see how the allegations are relevant to H&M's attempt to successfully reorganize and satisfy its creditors.

"Nevertheless, many of the unrelated actions that Prospect references in its filings were resolved to the satisfaction of all interested parties during or after the bankruptcy cases referenced," Tobin said.

In court filings, H&M has responded to Prospect's objection, saying that it doesn't intend to let the oil well leases terminate so there's no reason for the bankruptcy court to allow Prospect to move ahead with the foreclosure. It requested permission to tap \$5 million in bankruptcy financing from Greenblatt's Scattered Corp. that it said will allow it to fund drilling of three wells within the first 120 days of the case.

Tobin said he's optimistic this proposal will resolve Prospect's concerns. "The proposal will allow for the protection of the creditors and for the debtor to successfully reorganize," he said.

H&M also said it didn't file for bankruptcy for the sole purpose of halting Prospect's foreclosure, but also so that it could reorganize and obtain financing to drill.

In addition, Greenblatt, who filed H&M's bankruptcy petition, is not actually involved in the company's day-to-day operations, the company said.

A hearing on Prospect Capital's request is scheduled for Wednesday.

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