

Client Alert

Latham & Watkins Finance Department

When “Done” Means Done: A Victory for the LSTA’s Campaign to Bind Parties to Oral Trades

For over 17 years, the Loan Syndications & Trading Association (the LSTA) has provided the tools for the development of a more liquid market for the trading of syndicated loans – both by promulgating widely-accepted form trading documents and by spearheading the legislation adopted in New York in 2002 that eliminated statutory obstacles to parties being bound to oral trades. On October 2, 2012, the US Court of Appeals for the Fifth Circuit (Fifth Circuit), in the case of *Highland Capital Management, L.P. v. Bank of America, N.A.*,¹ held that a loan trade may be binding when agreed over the phone, even in circumstances when it is followed up by an email stating that the trade is “subject to appropriate consents and documentation.” The court permitted claims for breach of contract to go forward on the theory that the phone call created a binding agreement and that the “subject to” email invoked LSTA standard terms and precluded application of non-LSTA standard terms. The decision resolves uncertainty in the market following the district court’s decision dismissing the claim and represents a victory for the LSTA’s standard trade documents – and conforms to market practice and expectations that oral trades are binding.

LSTA’s Campaign to Bind Parties to Oral Trades

The LSTA has worked through two avenues to permit parties to bind themselves to oral debt trades: (1) legislative reform of the New York statute of frauds and (2) revision to the LSTA’s standard trade documentation. Beginning in October 2001, the LSTA began lobbying the New York state legislature to make an exception to the statute of frauds, which requires parties to enter into written agreements to create binding contracts for certain transactions (such as purchase and sale of real estate). At that time, the New York statute of frauds had already included exceptions for trading of securities and derivatives contracts, but it did not provide an exception for loan trading. The LSTA succeeded in obtaining legislative reform in April 2002, and the new law granting an express exception to the statute of frauds became effective on October 5, 2002.²

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Alongside legislative reform, in September 2002, the LSTA published revised forms of par and distressed loan trading confirmations to increase the certainty both that oral trades are binding and that they may be documented with electronic signatures. LSTA form trade confirmations currently require that that parties to a trade execute documentation, as applicable to their type of trade.³ Nevertheless, the orally binding nature of trades should not preclude enforcement of a trade even if documentation is never executed, and the LSTA standard terms make that clear.⁴

Fifth Circuit's Decision in *Highland Capital Management, L.P. v. Bank of America, N.A.*

The Fifth Circuit's decision stands as precedent that a party may assert a claim for breach of contract based on an allegation of an oral agreement to a loan trade under LSTA standard terms. In this case, Highland Capital Management, L.P. (Highland) alleged that it reached agreement with Bank of America, N.A. (BofA) for a trade of bank debt on a phone call in December 2009. On the same day, Highland sent an email to BofA to confirm the trade was complete, and BofA responded to confirm the agreement "subject to appropriate consents and documentation." Highland further alleged that the "subject to" email incorporated the LSTA's standard terms and did not permit either party to include non-standard terms.

The district court held that the "subject to" language in BofA's emails evidenced an intent not to be bound until the parties agreed to additional consents and documents, including consent of the borrower and agent. Highland argued that the district court erred based on market practice and the parties' course of conduct that both require that the parties expressly reserve any non-standard terms at the time of an agreement by phone, or any non-standard terms are waived. The Fifth Circuit agreed in a unanimous decision.

The decision is rather unremarkable as a legal matter—matters of contract interpretation at a motion to dismiss stage are relatively mundane. In the context of the loan trading market however, the decision is a vindication of the LSTA's efforts to create a statutory and documentary framework in which regular market participants rest assured that their trades over the phone will be enforceable. As the LSTA Handbook of Loan Syndications and Trading provides, and the Fifth Circuit quoted: "While the confirmation is the first step in closing a trade, it is not the first step in making a trade. The trade is actually made orally between two market participants."

The decision makes clear that the traders should be aware of any non-standard terms that their institutions seek to apply to any trade. Those terms must be included in the initial correspondence regarding the trade, or those terms will not be included in the contract created by the correspondence. The party seeking the inclusion of those non-standard terms would be able to include them in any subsequent documentation only if the counterparty, in its sole discretion, permitted their inclusion.

Endnotes

¹ Case No. 11-11139.

² New York law provides that the following type of agreement is exempt from the statute of frauds, among others: “an agreement . . . which is: . . . for the assignment, sale, trade, participation or exchange of indebtedness or claims relating thereto arising in the course of the claimant’s business or profession (including but not limited to commercial and/or bank loans, choses in action arising under or in connection with loan agreements and private notes, and including forward sales), but only to the extent that such indebtedness or obligation was not incurred by a natural person primarily for personal, family or household purposes.” N.Y. Gen. Oblig. Law 5-701(b)(2)(i).

³ See, e.g., LSTA Standard Terms and Conditions for Distressed Trade Confirmations (dated June 29, 2012), Sec. 10 (Transfer Documentation).

⁴ See, e.g., LSTA Standard Terms and Conditions for Distressed Trade Confirmations (dated June 29, 2012), Sec. 26 (Binding Effect) (“Neither party will assert as a defense to liability under such agreement the lack of a writing signed by it that would otherwise be required so satisfy any statute of frauds . . .”).

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