Feature

KEY POINTS

- The recent *Westinghouse* decision (US District Court for the Southern District of New York) involving a dispute in a bankruptcy claim trade seems to depart from previously settled case law involving analogous trade disputes in the syndicated loan secondary market.
- In light of the differences in the syndicated loan trading market and the bankruptcy claims trading market, the *Westinghouse* decision highlights the need for bankruptcy claim traders to be conscious of who their counterparties are and clearly communicate their intentions and expectations at every point of the trade process.

Author Robert Scheininger

Bankruptcy claims trading: is a trade *truly* a trade?

In this article, Robert Scheininger compares *Westinghouse* to cases involving disputes in syndicated loan trades and discusses some of the differences between the bankruptcy claims and syndicated loan trading markets in order to draw some practical lessons.

INTRODUCTION

"A trade is a trade" is a fundamental tenet of the distressed secondary trading market. Market participants rely on the expectation that when two sophisticated parties agree to trade at a particular price, they will complete the trade notwithstanding subsequent price movement. That reliance provides stability and predictability to the robust distressed trading community. However, as highlighted in a 2018 bench decision in the Southern District of New York, if and when a trade has actually occurred may be subject to scrutiny and may differ in the context of bankruptcy claims as compared to the more established market of syndicated loan trading. Therefore, distressed debt traders and their advisors paid attention to *In re Westinghouse Electric Co., 588 B.R. 347 (Bankr. S.D.N.Y. 2018)* (*Westinghouse*). Although it is not yet clear whether the *Westinghouse* decision will impact the bankruptcy claims trading market, there are certainly lessons to be learned for those who regularly trade this product. In particular, clear communication between trading counterparties is essential in establishing a binding, enforceable agreement.

WESTINGHOUSE

In *Westinghouse* a trade dispute arose between Landstar Global Logistics, Inc., Landstar Inway, Inc. and Landstar Express America, Inc. (collectively, "Landstar"), on the one hand, and Whitebox Multi-Strategy Partners and Whitebox Asymmetric Partners (collectively, "Whitebox"), on the other hand. Landstar filed three proofs of claim in the Westinghouse Chapter 11 case and subsequently entered into communications with Seaport Global Holdings LLC (Seaport), acting as broker for Whitebox, for the potential purchase and sale of the Landstar claims.

Whitebox filed notices of transfer in respect of the Landstar claims in the bankruptcy court based on the communications between Landstar and Seaport (on behalf of Whitebox) despite no formal written agreement between the parties. Whitebox asserted that the communications between Landstar and Seaport constituted a "qualified financial contract" under s 5-701.b.2(i) of the New York General Obligations Law and therefore a binding and enforceable agreement existed without regard to whether further documentation was signed. Such a contract, argued Whitebox, meant that the parties were legally bound to a price and to negotiate in good faith to finalise the agreement and settle the trade. Whitebox asserted that Landstar then wished to get out of the trade because the market price moved after those initial communications and believed it could get a better deal elsewhere.

Landstar objected to the notices of transfer in the bankruptcy court stating (among other things) that no contract was formed since there was never a meeting of the minds between the parties. They argued that the discussions were subject to further agreement on material terms and the execution of written agreements and therefore the communications were merely a series of offers and counteroffers with no mutual agreement on terms.

In a bench decision on 20 July 2018, Judge Michael Wiles ruled in favour of Landstar concluding that there was no enforceable contract and the transfer notices should therefore be canceled and withdrawn, and the claims agent should recognise the Landstar entities as the proper owners of the claims. In particular Judge Wiles noted:

- Communications between Whitebox's broker (Seaport) and Landstar did not result in contract formation, notwithstanding the parties having agreed to price, because they agreed that any transaction would be "subject to" further documentation.
- There was no binding agreement because: (i) there was no offer and acceptance by the parties and therefore no meeting of the minds; and (ii) the totality of the communications between the parties (including Landstar informing Seaport that the trade was subject to review and approval by counsel and the transaction was subject to final documentation) reflected an intention by Landstar not to be bound to a trade or to an obligation to negotiate until final documentation.
- If a response to an offer is conditioned on additional or different terms, it is not considered acceptance of the offer. When Seaport accepted the original sell order from Landstar, the acceptance email included an additional term of trade not previously discussed (that being that the purchase agreement would include a recourse provision, which the court concluded was material based on expert testimony) and language that the trade was "subject to" documentation and diligence.

- Parties can make preliminary agreements to certain terms that bind them to engage in further discussions regarding other terms; however, it is imperative that if parties intend to be bound by email exchanges prior to the execution of definitive documentation, that intention should be made clear by the parties in the emails exchanged.
- If the parties clearly reserve the right not be bound unless and until a written agreement is signed, there is no binding agreement.
- Although "subject to" language may in certain circumstances provide a counterparty with the ability to walk away from an otherwise binding agreement, that analysis will be based on the "totality of the circumstances" to determine the expectations of the parties.
- The court also rejected Whitebox's argument that a "trade is a trade" is customary in the bankruptcy claims trading industry, noting with particular emphasis that the counterparty in the purported transaction was not a professional claims buyer or seller who understood the purported trading conventions.
- Market convention would not be sufficient to impose upon a counterparty that a binding contract exists. The court emphasised that "[i]f claim traders want their customs to be binding when they deal with non-professionals …, it is incumbent in them to set forth the terms in a clear and unequivocal way".

SYNDICATED LOAN TRADES

At first glance, the *Westinghouse* decision seems to depart from previously settled case law involving trade disputes in the syndicated loan secondary market.

Delphi

Goldman Sachs Lending Partners, LLC v High Riv Ltd Partnership 2011 NY Slip Op 52460 was a 2011 decision regarding a trade dispute between Goldman Sachs Lending Partners, LLC (Goldman) and High River Ltd Partnership (High River) involving syndicated loan trades on Loan Syndication and Trading Association (LSTA) standard forms. In July 2009, High River entered into nine trades with Goldman pursuant to which High River agreed to sell and Goldman agreed to buy an aggregate of US$140m of Delphi Corporation (Delphi) Tranche C bank debt. Each trade was confirmed in writing on standard LSTA distressed trade confirmations. Unbeknownst to Goldman, High River did not own the bank debt at the time of the trade, betting they could capitalise on what they expected to be a drop in the price. The price did not drop and High River did not make any attempt to cover the trade by buying the debt at a higher price. Goldman attempted to enforce the trade confirmations and sued High River for breach of contract and sought summary judgment. The court found that the trade confirmations are clear and unambiguous contracts governed by New York law in accordance with their terms and should be enforced. Therefore, Goldman was granted summary judgment on its breach of contract action.

KIK

Highland Credit Opportunities CDO, LP v UBS AG, 451 S. W.3d 508 (2014) involved an agreement by Highland Ltd (Highland) to purchase KIK Customs Products, Inc (KIK) debt from UBS AG (UBS). In March 2008, Highland agreed orally to purchase KIK debt from UBS. The oral trade was memorialised in an LSTA distressed trade confirmation, which provided that the trade was subject to "negotiation, execution and delivery of reasonably acceptable contracts and instrument of transfer". Shortly after the trade was agreed upon, the market price for the debt dropped. Highland allegedly delayed closing and refused to acknowledge the existence of the trade. Documents were eventually agreed upon, but Highland refused to settle the trade. UBS then sold the debt to another party after which the price recovered and Highland sued to enforce its right under the trade confirmation. There too the court concluded that the LSTA trade confirmation was a binding contract and the "subject to" language was a condition to settlement not a contingency of the binding nature of the initial agreement to trade.

Stonehill

In *Stonehill Capital Management, LLC v Bank of the West, 28 N.Y.3d 439, 68 N.E.3d 683 (N.Y 2016)*, Bank of the West (BOTW) conducted an auction for the sale of non-performing mortgage loans. Stonehill Capital Management (Stonehill) submitted a firm bid to purchase one loan and was the winning bid. The parties exchanged drafts of a trade confirmation that specified the trade was subject to the execution of a mutually acceptable loan sale agreement. However, no trade confirmation was ever finalised or executed. Shortly after the bid was accepted and the trade confirmed, the value of the loan increased significantly and BOTW informed Stonehill that it wished to break the trade, arguing that the "subject to" language in the unsigned trade confirmation showed that the parties did not intend to be bound until a written purchase agreement was executed. Stonehill sued for breach of contract and was successful at the trial court level in a decision that was later reinstated by the Court of Appeals. The Court of Appeals found that the totality of the actions and communication of the parties reflected an agreement to be bound by the trade and noted that the offering memorandum circulated in connection with the auction specified that bids were non-contingent final offers, so the bid and subsequent offer formed a binding contract. An email exchange stating that the bid was "[s]ubject to mutual execution of an acceptable [agreement]" and tender of a deposit was a post-agreement requirement necessary to consummate the transaction and not an indication that the parties did not intend to be bound absent a written agreement. The court concluded based on the "totality of the parties' actions and communications" that there was an enforceable contract despite no formal contract ever being signed.

In both the Delphi and KIK judgments, the court enforced the premise that a "trade is a trade" where, unlike in *Westinghouse*, the loan buyer and seller had entered into LSTA trade confirmations. Likewise, the court in *Stonehill* enforced a trade where the buyer's bid was accepted at auction "subject to" documentation and tender of a deposit notwithstanding the absence of any formal

Biog box
Robert Scheininger is a partner in Reed Smith's Financial Industry Group, based in the New York office. Email: rscheininger@reedsmith.com

written agreement. Why, then, did the court in *Westinghouse* reach the opposite conclusion? Differences between the bankruptcy claims trading and syndicated loan trading markets may help to provide an answer.

BANKRUPTCY CLAIMS TRADING v SYNDICATED LOAN TRADING

Although the bankruptcy claims trading and syndicated loan trading markets feature many of the same participants and share similar conventions and norms, a number of important differences may bear upon a court's analysis of the binding nature of a trade. These differences include:

- There is no standardised documentation in the bankruptcy claims market whereas the syndicated loan trading market in the US uses standard trading documents published by the LSTA. Accordingly, the phrase "subject to documentation" in connection with a trade recap or trade confirmation could have different implications in a bankruptcy claims trade than those in a syndicated loan trade. Moreover, whereas trade confirmations are not always executed in bankruptcy claims transactions, LSTA trade confirmations are almost always executed shortly after a syndicated loan trade is agreed.
- Parties in both markets are typically sophisticated financial institutions or companies (though there may be some exceptions in bankruptcy claims trading where small claims are sold by individuals or small businesses). In the syndicated loan trading market almost all market participant are *both* sophisticated *and* familiar with the LSTA trading documentation and market convention whereas many bankruptcy claim sellers, while generally sophisticated on financial matters, may not necessarily be familiar with market convention.
- In the syndicated loan trading market many of the parties regularly trade with one another whereas in the bankruptcy claims market that is not always the case. Reputational and relationship concerns motivating a loan trader not to break a trade may not apply to a bankruptcy claim seller.
- A purchaser of a position in a syndicated loan will often have to perform far less independent diligence (other than review of the relevant loan documents) since all lenders in the syndicate will typically be treated the same. On the other hand, the bespoke and often uncertain nature of a bankruptcy claim (particularly those not yet stipulated in an allowed amount by final order of the court) will often require the claim purchaser to conduct substantial diligence on a particular claim. Often that diligence is conducted after the parties agree on price, thus making a diligence contingency significant.
- Typically syndicated loans will have an administrative agent who is charged with administering the loans (including loan transfers) and enforcing the loan obligations on behalf of the syndicate of lenders if necessary. There is no such concept in bankruptcy claims and, therefore, each claim purchaser is responsible for notifying the court and debtor of any claim transfer and enforcing the creditor's rights in respect of the claim if necessary.

CONCLUSION AND LESSONS LEARNED

The courts in all of the above cases apply a totality of circumstances test to assess the parties' intent to be bound. In *Westinghouse* the court concluded that the parties' communications, taken together, did not satisfy New York law requirements for a binding and enforceable contract. In each of Delphi, KIK and *Stonehill*, where there was an executed trade confirmation and/or clear communications showing the parties' intention to be bound, the respective courts concluded there was a binding contract. Although the impact of *Westinghouse* remains to be seen, the better view is that *Westinghouse* is a case of bad facts, not the proposition that courts may take a different view with respect to bankruptcy claim trades than syndicated loan trades. Practical lessons from *Westinghouse* to mitigate the risk of a court concluding that a preliminary agreement to trade at a particular price is not enforceable (which are particularly applicable to bankruptcy claims traders given the differences between the bankruptcy claims trading and syndicated loan trading markets discussed above) are as follows:

- Communications are key. Ultimately *Westinghouse* turned on the specific facts and, in particular, the email exchanges between the parties during the initial stages of the trade. It is those communications that a court is likely to focus on when determining whether there was intent to bind the parties and, in turn, whether an enforceable contract exists.
- Wherever possible, confirm the trade in writing. If the intention is to make the trade contingent on negotiation of transfer documents, diligence or anything else, that should be clearly stated in the trade confirmation.
- Know your counterparty. It is insufficient to rely solely on market convention and norms, particularly when dealing with a counterparty that does not regularly deal in that particular market. The fact that a counterparty is sophisticated should not lead to an assumption that it is familiar with, or agrees to be bound by, market practice in which it does not regularly transact. Expectations should be clearly stated.
- Close your trades as soon as possible. Almost all broken trades (both in syndicated loan trading and bankruptcy claims trading) are a result of price movement after the trade date. Smooth co-ordination between front office, operations and legal will increase efficiency in the closing process and thereby considerably reduce broken trade risk. ■

Further Reading:

- Loan Market Association Buy-in/Sell-out "BISO": why is it almost never used? (2017) 10 JIBFL 636.
- Preying on distressed debt: limiting the scope for transfer to vulture funds (2018) 1 JIBFL 9.
- LexisPSL: Banking and Finance blog: Tackling settlement delays in the LMA secondary loan market.