



English Court Rules on Unwinding of Distressed Debt LMA Trades



IN SHORT

The Situation: The English Commercial Court heard a dispute regarding a back-to-back trade of distressed debt between an upstream seller and a downstream buyer, via a "riskless principal" broker, which contained an express unwind provision.

The Result: The court upheld the express drafting of the unwind provision in both the upstream and downstream trades, and required both trades to be unwound by the relevant parties.

Looking Ahead: LMA secondary market participants should continue to take care when drafting "other terms of trade" such as an unwind provision in an LMA trade confirmation, and especially so where any terms could result in an amendment to the economic outcome agreed on the trade date.

Background

Exotix entered into two back-to-back "riskless principal" distressed secondary trades under the LMA Standard Terms and Conditions for Par and Distressed Trade Transactions and English law. Both trades included the right to unwind the trade if registration of the relevant transfers by the National Bank of Ukraine had not taken place by a certain date—such date being capable of extension by agreement of the parties. Ultimately, registration had not taken place by the designated date, nor was the designated date extended.

A dispute arose as to whether the unwind could be exercised by the buyer, including whether the unwind provision could be exercised only "in good faith", i.e. for reasons other than the significant reduction in the price of the debt after the trade date. When the downstream buyer sought to unwind its trade with Exotix (and consequently, Exotix sought to unwind its trade with its upstream seller), the upstream seller argued that it was not required to unwind the transaction.



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The English Commercial Court's Decision

The unwind provisions were upheld such that both trades were required to be unwound. The court declined to imply a term into the trades to the effect that the unwind provisions could be exercised only for a limited range of reasons. As a result, the trades could be unwound because the value of the distressed debt had reduced in the intervening period.

The parties were returned to the positions they would have been in had the trades not occurred, with the seller required to take the asset back and the cash returned to the buyer. Further, the court held that the buyer and broker had acted reasonably and in good faith, and that there was no breach of the further assurances clause in the LMA Standard Terms and Conditions for Par and Distressed Trade Transactions. As such, the interconnected trades were entitled to be unwound.

Jones Day acted for Exotix Partners LLP, the matched principal broker in this matter.

TWO KEY TAKEAWAYS

1. LMA secondary market participants should continue to take care when drafting "other terms of trade" in an LMA Trade Confirmation, and especially so where any terms could result in an amendment to the economic outcome agreed on "Trade Date". If the intention is to limit the circumstances in which a trade can be unwound, this intention should be clearly provided for in the drafting.

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2. The court also ruled that absent fact or agreement to the contrary, a broker/dealer acts in a principal capacity, and not as an agent of either the seller or buyer.

preparation of this Commentary.

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