

November 7, 2007

MEMORANDUM TO: Clients and Friends of the Firm

FROM: Louisa Watt
Roxanne Yanofsky (trainee solicitor)

RE: Bear Stearns Bank plc v Forum Global Equity Ltd [2007] EWCH 1576

The recent decision of the High Court in *Bear Stearns Bank plc (“Bear”) v Forum Global Equity Ltd (“Forum”)* [2007] EWCH 1576 established that parties to a distressed debt transaction concluded a binding oral contract at the time of the telephone conversation when agreement was reached on price, despite the settlement date, transfer mechanics and standard market convention terms being outstanding.

The English court decision is significant as it endorses prevailing debt market trading practices that an enforceable contract is created on the date on which the traders agree by telephone to make the trade, the “trade date”, regardless of when documentation is signed, or whether some terms of the trade are still outstanding. This certainty is welcomed as it confirms the position that parties to a trade may not renege on their obligations if the material basic terms of a contract are agreed orally, which is of particular importance in the distressed debt market where prevailing market conditions may make it attractive for one party to walk away from the transaction and avoid settlement. The decision is also of interest as it determined that the date that the breaching party gives notice that it will not proceed to closing is not necessarily the relevant date for the assessment of damages.

This memorandum provides a basic overview of the case, the legal issues involved and suggests some “best practice” guidelines for debt market participants to follow when concluding trades.

Background

Facts of the case

In January 2004, Forum acquired some debt by way of notes issued by Parmalat SpA and Parmalat BV (the “Notes”).

The Parmalat group collapsed financially in 2003 amid allegations of fraud and corruption and in December 2003, Parmalat entered into administration proceedings in the Italian court of Parma. The Italian markets were in considerable turmoil and on the day of the collapse, the Italian government passed a specific law, the Marzano Law Decree, to deal with the insolvency. This created a great deal of uncertainty as to the procedures that would be followed in the insolvency and what the expected outcome for creditors would be.

Forum filed claims in November in the administration in respect of the Notes and on 16 December 2004, Forum's claims were accepted by the administrators in the amount of around €25m (€18,043,542.38 for the Parmalat SpA note and €6,751,193.31 for the Parmalat BV note). The underlying value of the claims corresponding to the Notes was uncertain and unpredictable however, due to the untested Italian administration proceedings, and Forum decided to sell its interest in the claims.

After various telephone exchanges regarding price, on 14 July 2005, Bear orally agreed with Forum to purchase the Notes at a set price of €2.9m and referred to settlement being concluded sometime in August. Prior to this date, the parties had discussed that the documentation would be on "standard terms", but on the trade date, the actual "settlement date" for the trade was not determined; the structure of the transaction was also unresolved (sub-participation or legal transfer) and it was not clear which "standard terms" were applicable.

Soon after Bear's offer to purchase and on the same day, Bear agreed to sell half of its interest in the Notes to Morgan Stanley for €1.5m, subject to completion of its purchase from Forum.

Bear and Forum instructed lawyers and engaged in further telephone negotiations over a period of a few months regarding the settlement date, but did not reach agreement on a clear date due to the lack of certainty on how the Notes should be transferred. Bear prepared a Loan Market Association ("LMA") form of trade confirmation and the lawyers proceeded to negotiate transfer documentation on LMA standard terms. However, due to the complex nature of the Notes and Italian legal formalities, settlement of the transaction was delayed.

In early October 2005, the Court of Parma gave approval for the debt to be converted into equity by way of shares in a new Parmalat entity and the shares were listed on the Milan stock exchange on 6 October, for an initial price of €3.175 per share.

On 21 October 2005, Forum wrote to Bear that it had "*decided not to proceed with the execution of the documents of the transaction*" and stated that the "*transaction should have been settled in the period of time between the last week of August 2005 and the first week of September 2005 (the "Window Time")*".

By the time of the letter, the Notes had been converted into equity creating a profit for Forum, and Forum began to sell the shares.

Bear brought a claim to enforce the oral agreement made on 14 July 2005 and the High Court was asked to determine whether the oral agreement was binding, and if so, was it on LMA Standard Terms and Conditions for Distressed Trade Transactions.¹

Decision

Was there a binding contract between the parties?

Under English law, a contract is a legally enforceable agreement giving rise to obligations for the parties to it. The formation of a contract is complete when the four basic principles of offer, acceptance, consideration and intention to create legal relations are satisfied. Provided that the parties have shown an intention to be contractually committed, the court will recognise a contract even if there was deferred discussion on some aspects of the transaction, unless what remains outstanding is essential in that without it the contract is too uncertain or incomplete to be enforced.

The High Court held that a binding contractual agreement was clearly formed on 14 July 2005 when Bear put forward a “firm bid” of €2.9m which was accepted by Forum, therefore the parties intended to conclude a contract. This was despite the fact that a number of points of the trade were left unresolved, including agreement as to settlement date and the form of purchase. Forum’s essential obligation, agreed orally, was to ensure that Bear obtained the commercial benefit of the Notes and there was no legal reason why the parties could not later reduce the contract to writing.

The judge went on to say that in deciding whether the parties had the necessary intention to create legal relations it was important to consider the market in which the parties conducted their negotiations. Expert evidence attested that, whether the instruments were characterised as bonds or loans, the usual (although not invariable) point of contract for trading such assets was orally on a telephone conversation.²

Did the LMA Standard Terms and Conditions for Distressed Trade Transactions apply?

Despite the court finding that generally “*the law will imply any term necessary to give business efficacy to what was agreed*”, meaning that the contract would be performed within a reasonable time, it did not find in this case that the LMA terms were incorporated.

¹ The relevance of this being, that if the transaction was on LMA terms, then clause 2 of the LMA Standard Terms and Conditions for Distressed Trade Transactions would provide certainty that a binding contract for the sale or participation by the seller to the buyer of the purchased assets comes into effect upon oral agreement of the terms on the trade date. This clause further specifies “The Seller and Buyer acknowledge that events occurring subsequent to the Trade Date shall not relieve the parties of their obligations under the Confirmation”.

² Judgment, para. 172.

At the time of the call the parties did not refer specifically to “LMA standard terms” and the court concluded that “*there was no convincing evidence of a notorious usage or custom that LMA standard terms should apply to sales of any kind of note or instrument.*”³ Given the unusual nature of the Notes and the corresponding claims, there was no established practice as to how they were traded, and furthermore, Bear had concluded previous Parmalat trades not on LMA terms.

At the time of this trade, U.S. market participants were often using LSTA terms and conditions when trading European assets, therefore despite the parties referring to “standard terms” during telephone conversations, this was not enough to imply the LMA terms to the transaction. It is highly recommended therefore, if traders want to settle on LMA or LSTA terms, that the relevant market standard terms and conditions be explicitly specified as applicable at the time of the trade.

What was the assessment of damages?

The general rule is that, where there is an available market for the goods in question, damages be assessed by reference to the difference between the contract price and the market price, or current price of the goods when they should have been delivered. The date for assessment of damages was contentious as the market price of the shares in the new Parmalat SpA at the time of Forum’s refusal to proceed (October 2005) was considerably lower than the market price on the date that Bear learned conclusively that the shares had been disposed of by Forum and there was therefore no possibility that Forum would deliver (August 2006).

Forum further contended that the onward sale to Morgan Stanley should be taken into account and argued that damages should be awarded on the basis that if Bear had concluded the sale to Morgan Stanley, the profit would have only been €112,000.00. If the contract with Morgan Stanley was ignored, and damages awarded only by reference to the market price of the shares in the new Parmalat SpA, then the damages would not put Bear in the position it would have been in had the contract been fulfilled, but would overcompensate them. This argument was rejected on the basis that it was not within the contemplation of Forum on 14 July 2005 that in the ordinary course of events Bear was likely to sell on all, or some of, the Notes.

The question then arose as to what date should be used to assess the damages as the share price in Parmalat fluctuated. The price at 21 October 2005 (when Freshfields sent the letter informing Bear that Forum were not concluding the transaction and therefore the time of the breach of contract) was at €2.35, which would result in damages of approximately €1m.

Bear argued that damages should be assessed based on the price on 24 August 2006, being the date upon which lawyers confirmed on behalf of Forum that Forum had sold its shares, therefore

³ Judgment, para. 146. following Chitty on Contracts, 29th Ed (2004) Vol.1 at para 13 – 018

the date on which Bear learned conclusively that the contract was lost and there was no realistic chance that Forum would deliver under it. Only when Bear knew that the shares had been sold could it then have gone out on the market and bought further shares to mitigate its loss. The court found in favour of Bear and applied the price at 24 August 2006 (the date on which Bear received the lawyer's letter) of €2.67 per share, increasing Bear's damages to €1.6m.

Recommended Best Practice following the decision

Whilst the decision does not specifically address what elements are required on a call between traders to constitute a binding contract, it did provide confirmation that an oral agreement between parties will generally be effective as long as the material terms of the agreement are agreed. In this case the agreement on price was the determining factor, although a court will look at all the circumstances to decide whether there is an intention to be legally bound.

We can therefore draw the conclusion that as "best practice" traders should agree the following basic elements on a telephone trade:

- name and amount of debt/claims;
- price;
- interest convention (trades flat/settled without accrued);
- form of purchase – legal transfer / sub-participation (if by sub-participation, specify whether voting and/or information rights apply); and
- LMA / LSTA or other market terms (par or distressed /debt or claims).

If a trader stipulates that LMA terms apply then under Clause 2 of the LMA standard terms and conditions (both par and distressed) a binding contract will come into effect upon "oral or, as the case may be, written agreement of the terms on the Trade Date."

A further issue of note was that some of the telephone conversations took place on mobile phones therefore were not recorded, and those that were recorded, were subsequently lost or destroyed by Bear. Parties should therefore consider carefully their internal document retention policies (including the making and preservation of telephone calls) in order to ensure adequate records are available in the event of any dispute.

Concluding remarks

Whilst reference to the applicable standard market terms is important to give certainty to the binding effect of an oral trade, the decision in this recent case provides comfort that even without some of these material terms being agreed upon in oral negotiations, it is possible that a trade will be enforceable and the court will take into account market practice when making its decision on the specifics of the case. This should have the effect of providing some welcome reassurance to traders, particularly in turbulent markets, that an oral agreement will be enough to prevent a party pulling out of a trade before the documents are executed if the deal becomes less attractive in the interim.

* * *

This memorandum has been provided as a service to clients and other friends of the RK&O to report on recent developments that may be of interest. The information provided herein is general and not intended to constitute legal advice.

For any questions relating to debt trading matters, please do not hesitate to contact Carl Winkworth or Louisa Watt in our London office on +44 (0) 207 033 3150, or Jon Kibbe or Paul Haskel in our New York office on +1 212 530 1800. For litigation matters please contact Brian Fraser in New York on +1 212 530 1820.