

March 20, 2007

MEMORANDUM TO: Clients and Friends of the Firm

FROM: Lucinda O. McConathy
Neil S. Binder

RE: North Carolina Court Issues Temporary Restraining Order Preventing Secondary Market Purchasers of Loan Participations from Asserting Tort Claims Against Administrative Agent and Lead Arranger of Syndicated Loan

Last week, on March 14, 2007, in a case that could have significant implications for loan trading, a North Carolina state court entered a Temporary Restraining Order (“TRO”) barring the assertion of certain litigation claims assigned in connection with the purchase of bank loans. *See Wachovia Bank, National Association et al. v. Harbinger Capital Partners Master Fund I, et al.*, 07-CVS-5097 (N.C. Superior Ct.). Should the court ultimately conclude that the litigation claims are unassignable, the decision could substantially limit the ability of lenders and their transferees to realize value on their holdings and could impair their ability to sell their loans in the secondary market.

The TRO purports to prevent down-stream transferees of syndicated loan participations from suing the syndicating bank for, among other things, fraud, misrepresentation, negligence, breach of fiduciary duty, conspiracy, or aiding and abetting wrongful acts – under the law of *any* state. According to the administrative agent and lead arranger (the “Agent”), North Carolina law applies to all claims brought by these syndicate lenders and their transferees because the underlying Credit Agreement contains a North Carolina choice-of-law provision, even though the documents used to effect the assignments contain no choice-of-law provision. Even aside from the choice-of-law provision, the Agent argues that it cannot be sued by the transferees. It contends that North Carolina law bars any assignment of personal tort claims and that, as a result, any company doing business in North Carolina is shielded from such claims by transferees. Indeed, it was out of concern that another court might not apply North Carolina law that the Agent sought a TRO to prevent the transferees from filing a lawsuit against it in any other state.

The North Carolina court has scheduled a hearing for March 22, 2007 to determine whether to continue the TRO in the form of a preliminary injunction. This will be the first opportunity for the transferees to be heard.

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Summary of Case

The case arises out of a credit facility established by Wachovia¹ on September 1, 2006, that included a \$265 million loan to Le-Nature's, Inc. ("Le-Nature's"). Wachovia syndicated all but \$17 million of the \$265 million loan. The underlying Credit Agreement is binding upon and for the benefit of the original lenders *and their successors and assigns*.

The Credit Agreement clearly permits lenders to assign their interests "in accordance with applicable law." In a separate section on "Governing Law," the Credit Agreement provides that the rights and obligations of the parties under the Credit Agreement and other credit documents "shall be governed by, and construed and interpreted in accordance with, the law of the State of North Carolina."

The Credit Agreement does not address what state's law would apply to the sale of interests in the syndicated loan, but Wachovia takes the position that North Carolina law applies, based on the provision in the Credit Agreement specifying that North Carolina law governs the rights and obligations of the parties to that Agreement. The Agent further argues that, as a company doing business in North Carolina, it is protected from any suit attempting to assert a tort claim that has been assigned to a plaintiff.

Only two months after closing on the credit facility, on November 1, 2006, an involuntary bankruptcy petition was filed against Le-Nature's in the United States Bankruptcy Court for the Western District of Pennsylvania. In news reports the next day, the management of Le-Nature's was accused of wholesale fraud.

Wachovia alleged in its TRO papers that, both before and after the bankruptcy filing, loans of Le-Nature's were trading on the secondary market. It also alleged that the transferees it is seeking to enjoin had purchased their interests after the bankruptcy filing and therefore with knowledge of the fraud exposed at Le-Nature's.

The Credit Agreement includes a standard form of assignment agreement to be used to trade the loans. The document expressly provides for (i) the transfer of rights under the underlying credit agreement, and (ii) the transfer of all claims, causes of action, or other rights arising under or in connection with the loan transaction – but only "to the extent permitted to be assigned under applicable law." The transfer form is silent as to what the applicable law is or how it might be determined. In addition, most, if not all, of the transferees entered into the LSTA's form Purchase and Sale Agreement for Distressed Trades, which provides for the transfer of claims and causes of action "to the extent permitted to be assigned under applicable law."

In the bankruptcy proceeding, the transferees were vocal in their criticism of Wachovia. They also sought discovery from Wachovia. In its papers in support of the TRO, Wachovia said, "[I]t is apparent that the [transferees] intend to assert claims that they believe have been assigned

¹ "Wachovia" refers to both Wachovia Bank, National Association, which is the Administrative Agent and Lead Arranger, and Wachovia Capital Markets, LLC, which is the Sole Bookrunner, and which marketed the loan syndicate participations.

to them directly (or indirectly through intermediate assignments) by prior members of the syndicate....”

So Wachovia struck first, going to court in North Carolina, where it maintains its headquarters, to try to prevent the transferees from bringing or maintaining any suit against it in any other jurisdiction or under any other state’s law. On March 14, 2007, Wachovia sought and obtained the TRO on an ex parte basis. This week it will attempt to extend the TRO by obtaining a preliminary injunction. In addition, by its lawsuit, Wachovia seeks a judgment declaring that the litigation claims are unassignable and thus seeks to permanently bar the transferees from bringing claims against Wachovia.

While in place, the TRO bars the defendants, a group of transferees, from asserting statutory or common law claims or causes of action in any jurisdiction under the laws of North Carolina or any other state. The prohibition includes, but is not limited to, claims for fraudulent or negligent omissions or misrepresentations, breach of fiduciary duty claims, and aiding and abetting various wrongful acts or omissions. The transferees have also been ordered not to sell or assign their rights to bring such claims.

It is important to note that the North Carolina court’s TRO decision was issued solely on the basis of arguments and papers submitted by Wachovia. At the hearing currently scheduled for this coming Thursday, March 22, 2007, the transferees will have their first opportunity to express an opposing view.²

Observations

The secondary loan market, as reflected in the LSTA form documents, assumes that litigation claims may be assigned along with the loan participations with which they are connected; but the market also recognizes that litigation claims may be assigned only to the “extent permitted to be assigned under applicable law.” If the North Carolina court ultimately concludes that the claims against the Agent for fraud and other torts are not assignable, that decision could change the market for distressed debt. For example, syndicating banks operating in North Carolina may insert choice-of-law provisions in credit documents that essentially immunize the banks (and perhaps, as a consequence, the borrowers) from suits by down-stream transferees arising in connection with syndicated loans. If the court adopts Wachovia’s even broader position that any entity doing business in North Carolina is shielded from any tort claim by an assignee, any syndicating bank operating in North Carolina could be immunized from suit. Either of these results could diminish the value of assignments of distressed debt and could affect liquidity in the market.

If you have any questions on the foregoing, please feel free to call Lucinda McConathy at 202.261.2992 or Neil Binder at 212.530.1809.

L.O.M.
N.S.B.

² We express no view as to whether or not there exist valid claims against Wachovia in connection with the Credit Agreement.