Client Alert.

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Harbinger v. Wachovia: Could Arrangers of Syndicated Loans Have Increased Liability?

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A recent decision in *Harbinger Capital Partners Master Fund I, Ltd. v. Wachovia Capital Markets, LLC*, a case pending before the Supreme Court for New York County, has the potential to add further anxiety to an already jittery syndicated lending market. The decision on Wachovia's motion to dismiss Harbinger's complaints raises concerns about the liability of arrangers of syndicated loan facilities and the utility of boilerplate liability waivers in loan agreements. Regardless of how the case is ultimately decided, it provides a good opportunity for arrangers and lenders to reassess their exposure in this area.

BACKGROUND:

The case arises out of a massive fraud allegedly perpetrated by Le Nature's, Inc., a beverage manufacturer based in Pennsylvania. In September 2006, Wachovia arranged and syndicated a $285 million loan facility for Le Nature's. Shortly after the facility closed, it came to light that Le Nature's financial statements and records may have been fraudulently prepared. Within two months, Le Nature's filed for bankruptcy protection.

CLAIMS AGAINST WACHOVIA:

A group of lenders, in addition to filing a lawsuit against the company and certain executives, filed a lawsuit against Wachovia for its role in arranging and syndicating the facility. The plaintiffs accused Wachovia, among other claims, of perpetrating its own fraud against the lenders. Specifically, the plaintiffs alleged that Wachovia did not disclose material information they claimed Wachovia had about Le Nature's improper financial record keeping and financial strength. Further, the plaintiffs claimed that Wachovia distributed bank books and other marketing materials to the lenders as part of the syndication process that contained fraudulently prepared financial information of Le Nature's on which the lenders relied. Wachovia, in its motions, strongly denied the plaintiffs' allegations and argued that they neither concealed information that was unavailable to the lenders nor had a duty to share with the lenders any such information that may have existed.

FRAUD AND LOAN AGREEMENT EXCULPATION CLAUSES:

New York law requires, in addition to the traditional elements of a fraud claim[1], that a plaintiff allege that the defendant had a duty to disclose material information.

A customary clause in syndicated loan agreements is a disclaimer by the lenders of any reliance on the arranger in connection with the lenders' decision to extend credit to the borrower. Further, the lenders frequently agree that the arranger has no obligation to share any information it may have about the borrower. By including these exculpatory

[1] (i) The defendant made a material false representation, (ii) with the intent to defraud the plaintiff, (iii) upon which the plaintiff reasonably relied, and (4) that the plaintiff suffered damage as a result of that reliance.

clauses in loan agreements, arrangers seek to avoid the exact type of suit Wachovia is facing.

Le Nature's loan agreement had an exculpation clause. Wachovia argued to the court that even if it had material information about Le Nature's, the exculpation clause conclusively shows that it had no duty to share any such information with the lenders.

COURT'S DECISION:

The court agreed with Wachovia that a plaintiff who specifically disclaims reliance on information known to a contractual counterparty generally should not be permitted to recover for its failure to receive such information from the counterparty. The court further concluded that Wachovia's exculpatory clause was sufficient.

However, in a decision that many arrangers may find surprising, the court did not dismiss Harbinger's complaint. Rather, the court let the case continue to trial in reliance on the "peculiar knowledge" doctrine, which permits a plaintiff who executed an exculpatory clause nonetheless to recover where the concealed information was uniquely within the knowledge of its contractual counterparty against whom recovery is sought. The court's conclusion was in spite of Wachovia's arguments that the lenders had sufficient access to information and that the "peculiar knowledge" doctrine is not applicable to sophisticated parties like the lenders to Le Nature's.

IMPACT:

While it is premature to speculate how the court may finally rule on the fraud claims and the application of the "peculiar knowledge" doctrine, this decision is one that should be watched by arrangers and lenders in the syndicated loan market. Further, this decision has the potential to cause some immediate effects. For example, we expect arrangers to reconsider the text of their standard exculpatory language to ensure that it provides them with the greatest possible protection; we note that many such provisions we see do not fully disclaim liability and duties of arrangers. Some arrangers may seek further disclaimers and "big-boy" side letters with lenders, and others may reconsider their fee structure to take into account the possible increased risk. On the other hand, some lenders may try to weaken exculpatory provisions or seek additional information disclosures from borrowers.

Please contact us about issues raised here and any additional questions you may have.

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