

# Commercial Law Newsletter

Joint Newsletter of the Commercial Finance and Uniform Commercial Code Committees



April 21, 2016

Spring 2016

## IN THIS ISSUE

### MARK YOUR CALENDARS

### FEATURED ARTICLES

#### CONTRACT DISPUTES AND THE INTERNATIONAL SALE OF GOODS

By [Matthew C. Brown, Esq.](#) and [Judd Lindenfeld, Esq.](#) and [Joseph W. Martini, Esq.](#)

#### SCOPE OF EUROPEAN "BAIL-IN" RULES

By: [Tess C. Virmani](#)

### UCC SPOTLIGHT

By [Carl S. Bjerre](#) and [Stephen L. Sepinuck](#)

### USEFUL LINKS AND WEBSITES

### ENDNOTES

### MARK YOUR CALENDARS

**May 5, 2016 – 1:00 p.m. to 2:30 p.m. EST – Base III Capital Retention Requirements: Impact on Loan Structures and Loan Documentation** (CLE Webinar) Click [here](#) for more documentation

**September 8-10, 2016 – ABA Business Law Section Annual Meeting – Boston, MA.** Click [here](#) for more information.

**November 18-19, 2016 – ABA Business Law Section Fall Meeting – Ritz-Carlton, Washington, DC**

**April 6-8, 2017 – ABA Business Law Section Spring Meeting – New Orleans, LA**  
Hyatt Regency New Orleans

## Joint Report from the Chairs

Dear Members:

Neal and I thought it fitting to devote this edition of the Chairs' Report to honor the life and legacy of PSU Dickinson School of Law Professor Emeritus Louis F. Del Duca, who passed away on November 27, 2015. Although I did not know Professor Del Duca as well as many of you did, I had the privilege to learn from him through his excellent UCC Institute programs in Chicago, and deeply admired his scholarship.

Several of the beautiful tributes to Professor Del Duca that have been published in various sources brought to mind some of his colorful sayings from 57 years of law teaching. He was known to exhort students, "People always want to know what to write down. Write this down." He also reminded his students not to overlook how various legal matters are handled by "our Civil Law friends."

Other tributes focused on his extraordinary dedication to law teaching and law students. When he retired, Professor Del Duca was the longest-serving member of the PSU Dickinson School of Law faculty. It has been said that the "vast majority" of current alumni of Dickinson Law learned Secured Transactions from Professor Del Duca, and countless others learned Sales, Comparative Commercial Law, EU Law, or other subjects from him. Described as a "pioneer in the globalization of legal education," he founded the school's Master of Comparative Law degree program, its first international program with the University of Florence, and similar programs in Austria and France. His devotion to students extended beyond the classroom, as well. In 2000, Professor Del Duca and his wife Frances endowed the Louis F. Del Duca scholarship for both JD and LL.M students.

Known to many as "the Duke," and to still others as "Luigi," Professor Del Duca was also a tremendous scholar. An elected member of the American Law Institute and the United States Secretary of State's Committee on International Trade Law, he also served as the United States' collaborator to the Rome International Institute for the Unification of Private Law (UNIDROIT). A prolific scholar, he confessed that he "long ago lost count" of the books and scholarly articles he had written. A colleague noted that merely his recent works filled an entire shelf in Trickett Hall's faculty display case.

Every tribute to Professor Del Duca remarked on his energy, his tremendous intellect and focus, and perhaps most of all his passion. It seems fitting, on that note, to close with some words from Professor Del Duca's long-time friend Colin Rule: "In almost every collaboration Lou was the main engine, crystalizing our focus and honing our language. It was great to work with him, not only because of his boundless energy, but because of the clarity of his thought and his hunger to distill the lessons from every experience." These words seem not only to frame Professor Del Duca's legacy beautifully, but also to pose a challenge to us to do the same.

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UCC Committee Chair  
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September 14-16, 2017 – ABA  
Business Law Section Annual  
Meeting – Sheraton Chicago Hotel  
& Towers and The Gleacher Center  
Chicago, IL

November 17-18, 2017 – ABA  
Business Law Section Fall Meeting  
– Ritz-Carlton, Washington, DC

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## PRO BONO MATTERS

What kind of pro bono work have you done recently? The pro bono committee is seeking stories from our members. We want to publicize the great work that business lawyers are doing in the pro bono area. This may include any type of pro bono work. For example, have you helped a small business settle a legal dispute? Perhaps you represented a tenant in a landlord tenant dispute, assisted with an immigration matter, or helped a homeowner with a foreclosure problem. We want to publicize some of these stories to encourage other business attorneys to become more involved helping needy clients. Please send your stories to Professor Candace M. Zierdt at the following address: [czierdt@law.stetson.edu](mailto:czierdt@law.stetson.edu).

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## WORKING GROUP ON DRAFTING HUMAN RIGHTS PROTECTIONS IN SUPPLY CONTRACTS

A new Working Group on Drafting Human Rights Protections in Supply Contracts is being formed to draft model contract language for companies who want to eliminate human trafficking, child labor, forced labor, and other human rights abuses in their supply chains. The new Working Group is a joint project of the UCC Article 1 and Article 2 Subcommittees together with the Implementation Task Force for the ABA Model Principles on Labor Trafficking and Child Labor. The mission of the new Working Group is to provide model contract clauses to interested businesses and trade associations. Ready-made, well drafted language will help move the

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## Featured Articles

### **CONTRACT DISPUTES AND THE INTERNATIONAL SALE OF GOODS**

By [Matthew C. Brown, Esq.](#) and [Judd Lindenfield, Esq.](#) and [Joseph W. Martini, Esq.](#)

Over twenty years ago, the Second Circuit remarked that “virtually no caselaw” exists interpreting the United Nations Convention on Contracts for the International Sale of Goods (“CISG”), a newly enacted treaty governing the international sale of goods with uniform rules of contract formation and interpretation.<sup>1</sup> Today, with over eighty signatory countries, including the United States, more than 3,000 reported CISG decisions are compiled into a searchable database maintained by Pace University’s Institute of International Commercial Law at <http://iicl.law.pace.edu/cisg/cisg>.

Reported decisions now include over 500 international disputes litigated in German courts, over 400 in Chinese courts, and nearly 200 cases from the United States – to name a few. While the CISG has come a long way, the modern business reality remains that commercial parties, sophisticated and otherwise, domestic and abroad, routinely sell millions of dollars of goods through purchase orders, invoices, and boilerplate commercial forms. Indeed, under the CISG, commercial parties in international markets are freed of a formal writing requirement altogether.<sup>2</sup>

What does this mean for attorneys called upon to resolve international contract disputes between commercial parties, manufacturers, distributors, and suppliers? If the CISG applies, counsel may end up litigating generously admitted evidence concerning the meaning of an agreement, among other things. In this article, we explain how the CISG’s approach to core contract principles, including writing requirements, parol evidence, and agreement terms, differs from the Uniform Commercial Code (“UCC”). Additionally, we offer practical suggestions for companies with cross-border disputes governed by the CISG.

### **The Writing Requirement**

A critical distinction under the CISG is that “a contract need not be evidenced by a writing.”<sup>3</sup> The CISG has no statute of frauds unlike the UCC rule requiring “some writing sufficient to indicate that a contract for sale has been made.”<sup>4</sup> Under the CISG, an agreement is formed whenever an offer “is sufficiently definite and indicates the intention of the offeror to be bound.”<sup>5</sup> Acceptance is effective through any “statement ... or other conduct ... indicating assent to an offer.”<sup>6</sup> Consequently, oral agreements under the CISG benefit from the same protections written contracts receive, regardless of the type of goods transacted or their value.

principles from the realm of admirable aspirations to the workday world where they can make a difference. The legal issues are interesting and challenging because the default rules of UCC Articles 1 and 2 and the UN Convention on Contracts for the International Sale of Goods (CISG) are geared more toward assuring the quality of the goods (e.g., tightly stitched soccer balls or good quality apparel) and largely ignore the problems of a labor force that may be working in life-threatening conditions. A core group of leading lawyers has already signed up to tackle the issues and draft language, but more participants are welcome. This project is truly a working group, and we hope that participants will help with legal research, drafting memoranda, crafting contract language, and writing annotations. We anticipate roughly monthly conference calls as well as live meetings (with a phone-in option) at the Annual and Spring meetings of the Business Law Section. We hope that this work will use commercial law to make the world a better place, and perhaps even to save lives. If you are interested, please contact Professor David Snyder of American University at [dsnyder@wcl.american.edu](mailto:dsnyder@wcl.american.edu).

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**VIEW CURRENT REPORTS AND DEVELOPMENTS OF THE FOLLOWING COMMITTEES AND TASK FORCES:**

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Is this an attractive feature for businesses involved in cross-border transactions? On the one hand, the lack of a writing requirement allows parties to avoid the tedium and cost of formalizing terms of their agreements. On the other, it leaves the door open for creative arguments that contract negotiations are, in fact, verbal agreements.<sup>7</sup> Company executives and managers are therefore wise to summarize negotiation sessions in email or memoranda with an eye toward providing the other side with an understanding of what was said and agreed to in a given business meeting. Doing so may limit company exposure, up front, and cabin the possibility of alleged verbal contracts otherwise allowed by the CISG.

### **The Parol Evidence Rule**

Another consequence of the CISG's lack of a writing requirement is that all relevant information is admissible to prove contract terms even if that evidence contradicts the written agreement.<sup>8</sup> This departure from the UCC's parol evidence rule prohibiting the introduction of extrinsic evidence to vary written contract terms expands the scope of permissible evidence in international trade. Accordingly, "all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties" are considered when determining the parties' obligations.<sup>9</sup>

For many businesses, this rule is problematic. It requires investigation into emails, communications, written agreements, and course of dealing for extrinsic evidence that actually contradicts an agreement reduced to writing. Put differently, exhibit and witness lists might grow exponentially in CISG litigation. Fortunately, a potential solution exists in the form of a merger clause limiting CISG tribunals to the "four corners" of an agreement when determining party intent under the CISG.<sup>10</sup>

### **Competing Terms**

What happens when the terms of an offer differ from the terms supplied by a counterparty when accepting or confirming the offer? This scenario is common in cross-border transactions. The UCC's approach to this battle of the forms inquiry, found in its oft-cited § 2-207, construes additional terms as part of a contract unless the offer expressly limits acceptance to the terms of the offer, the additional terms materially alter the offer, or a party objects to the additional terms within a reasonable time after notice of them is received.

The CISG goes one step further. Not only are conflicting material terms read out of the contract, they prevent a contract from forming in the first place: "A reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer."<sup>11</sup> The CISG's approach, therefore, "is an embodiment of the mirror image rule" requiring affirmative assent to all material terms before a contract is formed.<sup>12</sup> Commercial parties may, of course, disclaim the CISG's application to their agreement by affirmatively stating it does not apply.<sup>13</sup>

### **Standard Conditions**

Many businesses engaged in cross-border transactions are accustomed to having their standard conditions incorporated by reference into their contracts with suppliers, manufacturers, distributors, or other business partners. Does the CISG treat these terms any differently than the UCC?

According to the CISG, "standard conditions are only incorporated if one party attempts to incorporate the standard conditions and the other party had reasonable notice of this attempted incorporation."<sup>14</sup> In determining reasonable notice, the CISG considers "all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties."<sup>15</sup> In *Allied Dynamics Corp.*, the court concluded that "a reasonable person" would have been aware of standard conditions attached to an order confirmation even when written in a foreign language.<sup>16</sup> Another court concluded that standard conditions merely directing "the

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other party to a website which needs to be navigated in order for the standard conditions to be located” is not reasonable notice.<sup>17</sup> Accordingly, companies might benefit from clearly articulated, language specific, notice to their contracting partner that standard terms and conditions will apply to their agreement.

#### **Conclusion**

The CISG has covered much territory since its inception. In a complex fast paced global economy, knowing its contours before walking into the negotiation room, or sending a boilerplate purchase order, is vital to limiting company exposure and increasing the chances of successful contracting within international markets.

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#### **Scope of European “Bail In Rules”**

By: [Tess C. Virmani](#)<sup>18</sup>

Many U.S. financial market participants are now familiar with the commercial implications of new domestic regulations, but to be impacted by regulatory developments abroad is less anticipated. Such is the case with the European bail-in rules under the EU Bank Recovery and Resolution Directive (**BRRD**)<sup>19</sup>. As of January 1, 2016, European banks and certain other European loan market participants became subject to “bail-in” rules (**affected institutions**) under which certain of their unsecured liabilities are subject, at the election of applicable European regulatory authorities, to cancellation, write-downs, modification of terms, or conversion into equity to resolve and to recapitalize the affected institutions. These rules require that, when such institutions enter into contracts governed by non-European law (including agreements governed by the laws of New York and other states), the bail-in provisions must be acknowledged contractually. Affected institutions are required to give notice to their contractual counterparties that any such liabilities arising under agreements entered into or amended on or after January 1, 2016 are potentially subject to compromise in a bail-in by the applicable European regulatory authorities and to obtain the express contractual agreement of their counterparties to acknowledge that the obligations are subject to bail-in and to accept the terms of any bail-in as they apply to such contractual obligations.

Although many affected institutions are active participants in the U.S. loan market, the potential impact of the recognition provision requirement indeed goes beyond the loan market, and is relevant to many of their cross border transactions and all of their operations outside Europe. In the simplest loan case, an affected institution that is a borrower under a U.S. credit agreement will need to make sure that appropriate language is included in the agreement to acknowledge its lenders’ recognition and acceptance of the terms of any future bail-in of such borrower’s obligations thereunder. But there are also other, more common circumstances in which the affected institution’s obligations in other capacities, even as a lender, may trigger the requirement for counterparty agreement (including, with respect to credit commitment obligations (under a revolving credit facility or otherwise), obligations as a letter of credit issuer, unfunded participations in syndicated letter of credit or swingline facilities, and certain obligations in respect of secondary market transactions).

Upon learning of the looming impact of the bail-in rules, the Loan Syndications and Trading Association (**LSTA**) began educating the U.S. loan market in September 2015. The LSTA published a [market advisory](#)<sup>20</sup> recommending to market participants that they assess carefully which of their contracts contain obligations that will be subject to bail-in and when they must comply with the regulatory requirement for counterparties to acknowledge and agree in advance to bail-in. Throughout the fourth quarter of 2015, the LSTA led working group and market discussions to continue that education process. In December 2015, through member consultation and in coordination with Europe’s Loan Market Association (**LMA**), the LSTA published model recognition provisions for use in each of the primary and secondary loan markets. This article discusses the scope of the European bail-in rules, the LSTA recognition provisions and the market’s reaction since the rules became effective.



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## **Background – the European bail-in powers**

The ability to bail-in the claims of unsecured creditors is seen by the European financial regulatory authorities as a fundamental tool in the post-financial crisis reforms designed to ensure that failing financial institutions can be resolved and recapitalized without recourse to the publicly funded bail-outs that were a feature of the financial crisis. Although U.S. regulators are likely to adopt some sort of bail-in, preliminary indications are that any U.S. bail-in requirement would be limited to requiring systemically important institutions to issue specified amounts of long-term debt providing for bail-in. Because the U.S. regulators do not believe that bail-in resources should come from the banking sector, banking organizations would not be permitted to invest in such instruments.

The European bail-in tool is designed to be used pre-insolvency either to recapitalize an institution outside a formal insolvency proceeding so as to enable it to continue as a going concern, or to write-down liabilities that have been assumed by a bridge institution established to acquire the business of the failed institution with a view to capitalizing the bridge institution. The BRRD provides that the applicable resolution authorities will have powers to cancel or modify the institution's liabilities in a manner that reflects the hierarchy of claims in insolvency. These powers are broad: the interests of existing shareholders may be cancelled, diluted or transferred and the claims of unsecured creditors may be converted into equity, written down sufficiently to absorb the losses incurred, and other terms, including maturity and interest payable, may be varied. The object of the bail-in provisions is to achieve a comparatively smooth process for resolving and recapitalizing failing institutions without resort to publicly funded bailouts or the loss of going concern value that might otherwise be incident to a liquidation.

This bail-in regime is required to be implemented by the member states of the European Union (**EU Member States**)<sup>21</sup> pursuant to the BRRD. These regulatory requirements, which generally went effective on January 1, 2016, are subject to detailed implementation by regulatory authorities of the applicable EU Member States for institutions within their jurisdiction. In Europe, any resolution actions taken by the relevant authorities in any member state of the European Union would be recognized and given effect throughout the other EU Member States as a matter of law pursuant to changes introduced to the Credit Institutions Winding Up Directive<sup>22</sup> by the BRRD. For this reason, no changes are required for any contracts governed by the law of any EU Member State. Such recognition will be extended to the European Economic Area (**EEA**)<sup>23</sup> in due course. In other jurisdictions, including the United States, because the provisions will not be automatically recognized or implemented, the European regulators have, pursuant to Article 55 of the BRRD (**Article 55**), required affected institutions entering into contracts under the laws of such other jurisdictions creating liabilities subject to bail-in to obtain the contractual agreement of their counterparties to the bail-in of the affected liabilities (a **recognition provision**) and may impose regulatory sanctions on those that fail to comply.

## **Contractual recognition of bail-in – requirements for affected European institutions under Article 55**

Article 55 applies to EU (and other EEA) regulated banks and certain investment firms, financial holding companies and financial institutions that are subsidiaries of any of the above. Article 55 does not apply to US subsidiaries of European institutions or European branches of US banks, but it does apply to U.S. branches of European institutions. As of the date of this writing, Article 55 has been implemented in all of the EU Member States other than Poland, but none of Iceland, Liechtenstein, or Norway.<sup>24</sup>

The contractual recognition rule applies to all non-EEA liabilities of affected institutions incurred on or after January 1, 2016 except for liabilities that are excluded by Article 55(1) of the BRRD (including, in broad terms, secured liabilities (to the extent of the security) and several other specified categories which, unfortunately, are not applicable to the relevant liabilities for the U.S. loan market). It is also important to remember that although robust segments of the loan market, such as the leveraged loan market, contain senior secured loans, that security relates to that given by the borrower to the lenders with respect to the borrower's obligations and does not render a lender's obligations secured.

Although the BRRD does not include a definition of "liability," Article 44 of the BRRD makes clear that the bail-in rules apply to "all" liabilities which are not expressly excluded. For UK institutions, the UK's Prudential Regulatory Authority (**PRA**) has defined "liability" as any debt or liability to which a relevant institution is subject, whether it is present or future, certain or contingent, ascertained or sounding only in damages. There was some hope for greater clarity in the [technical standards published on July 3, 2015 by the European Banking Authority](#) for adoption by the European Commission for application in all EU Member States (the **Draft**

RTS),<sup>25</sup> but many issues are still unsettled and the Draft RTS has not yet been adopted. However, in November 2015 the PRA introduced a modification by consent procedure for its regulated institutions, which would be available on a case by case basis, and when granted, disappplies the PRA's Article 55 rules with respect to a liability where compliance is impracticable.<sup>26</sup> The rules would be disappplied until the earlier of June 30, 2016 or when the relevant rules are amended or revoked. More recently, the PRA proposed to amend its Article 55 rules to make the impracticability exclusion a continuing feature for all firms as of July 1, 2016 when the amended rules are proposed to take effect.<sup>27</sup>

### Scope of Article 55

Given the guidance currently available, the scope of liabilities which trigger Article 55 requirements is broad. With respect to an affected institution's obligations as a lender, that institution's credit commitment obligations (under a revolving credit facility or otherwise), obligations as a letter of credit issuer, and unfunded participations in syndicated letter of credit or swingline facilities all fall within the scope. Moreover, a lender's indemnification obligations under a credit agreement and even certain nonmonetary obligations, such as confidentiality obligations, can arguably require contractual recognition of bail-in.<sup>28</sup> In the secondary market, the obligation of a buyer to pay the purchase price to the seller would clearly trigger the Article 55 requirements, as could indemnification obligations of any counterparty that is an affected institution.

It is important to remember that the Draft RTS clarifies that it is not only new liabilities as of January 1, 2016, but also material amendments of pre-January 1 liabilities that trigger the Article 55 requirements. Moreover, liabilities created after January 1, 2016 under agreements entered into before that date and liabilities issued after January 1, 2016 under debt instruments entered into before that date are captured – even if there is no amendment to the preexisting agreement. For instance, a letter of credit issued after January 1, 2016 under a preexisting credit agreement would trigger the Article 55 requirements. For an affected institution lender's funding obligations under a preexisting revolving credit agreement, the obligations to fund after January 1, 2016 would not trigger Article 55 requirements (unless the agreement was materially modified); however, for an affected institution who becomes a lender under that agreement after January 1, 2016, such funding obligations would be new liabilities for that entity and therefore, the Article 55 requirements would be triggered. This is an interesting conundrum for affected institutions active in the secondary market.

### The LSTA Recognition Provisions

As background, the LSTA recognition provisions are a product of the balancing of two competing considerations. On the one hand, the Draft RTS lists certain mandatory technical elements.<sup>29</sup> On the other hand, the LSTA was cognizant that a form recognition provision for use in New York law governed agreements needed to be drafted in a commercial manner with a view to being as acceptable to the receiving counterparty as possible, particularly in light of the fact that, unlike the affected institution, there is *no requirement* on the counterparty to agree to a recognition provision. Therefore, while the LSTA and LMA coordinated in the development process, the LSTA's form of contractual recognition provision for use in the primary market, the [LSTA Variant](#), is drafted more narrowly than the recognition provision published by the LMA, and incorporates the elements appropriate for the typical liabilities of lenders party to a credit agreement.<sup>30</sup>

To meet the technical requirements, the non-EEA party acknowledges that the unsecured liabilities of the affected institution may be subject to the write-down and conversion powers of the affected institution's resolution authority, and acknowledges and agrees to be bound by the application of the resolution authority's write-down and conversion powers and their potential effects, including a reduction of the amount outstanding, the conversion of the liability into shares of the affected institution, or a variation of terms of such liability. The Draft RTS also requires a description of the write-down and conversion powers of each applicable EEA resolution authority in accordance with the national law implementing the European bail-in rules. The applicable definitions, therefore, contain a reference to the [LMA Bail-in Legislation Schedule](#), maintained and updated on the LMA's website, which sets forth the relevant national implementing legislation and write-down and conversion powers. For the secondary market, the LSTA's [Recognition Provision for LSTA Secondary Market Documents](#) is substantially identical to the LSTA Variant, but has been modified for use in a bilateral trading context.

In addition to the model recognition provision itself, the LSTA Variant contemplates a modification of the "Defaulting Lender" definition of the LSTA's 2014 Model Credit Agreement Provisions (**LSTA MCAPs**) to extend its scope to a European lender subject to a bail-in, as it is not possible to allow for a reduction in commitments without considering the broader effects of this on the other parties to the agreement. This change offers a pragmatic approach to arrangements relating to fronting exposures and other provisions affected by a reduction in commitments and the reinstatement of bailed-in commitments using existing LSTA MCAPs and procedures familiar to the loan market.

*How have the markets reacted?* There was a learning curve as market participants, particularly borrowers, became educated on the Article 55 requirements, but fortunately the LSTA Variant is now being included in term sheets and credit agreements for new deals and material amendments as a matter of course. It seems that even US agent banks who may not be directly affected by Article 55 are proactively including the language to preserve maximum flexibility for syndication (and subsequent loan trading). Presumably borrowers have also determined such benefits outweigh the cost that the absence of a recognition provision may incline a New York court to not recognize the enforceability of a bail-in action. In the secondary market, trading counterparties were slower to include the provision in their trades, but an increasing number of par trades this year have included the LSTA recognition provision in their trade

confirmations. A secondary market quandary that remains unresolved is how European institutions can trade in pre-2016 loans with continuing or future lender obligations which trigger Article 55 requirements for such new lender, but where such agreement would not ordinarily need a recognition provision. There has not been an observed resultant change in 2016 trading activity, but one explanation may be that UK institutions are taking advantage of the modification by consent they have received while non-UK institutions may be waiting for the Draft RTS to be adopted in final form.

## Conclusion

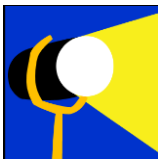
It is foreseeable that the remainder of 2016 will see parties continuing to include recognition provisions, where applicable, in their primary and secondary market transactions. What is less clear, however, is if any of the industry's lobbying efforts, at either the national government- or European Commission-level, to narrow the scope of liabilities which trigger Article 55 requirements or otherwise provide for an impracticability exclusion will be successful.

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## UCC Spotlight

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By [Carl S. Bjerre](#) and [Stephen L. Sepinuck](#)



The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code or related commercial laws. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is to shine a spotlight on analytical errors, and thereby provide practitioners and judges with reason to disregard the decisions.

### *Chase v. Wells Fargo Bank,* [2016 WL 143496](#) (N.Y. App. Div. 2016)

This is a rather brief case involving enforcement of a security interest in a New York co-op. The court's ruling was correct as was the bulk of its analysis, but its reference to a "recognized market" was completely off base.

Under New York law, a co-op consists of shares of stock allocated to a cooperative apartment and a proprietary lease to that apartment. Both of these are treated as personal property, not real property, and hence a security interest in them is governed by Article 9 of the New York Commercial Code, not by real property law.

The debtor in this case had borrowed \$140,000 and secured the debt with her interest in a co-op. After she defaulted, the secured party sent notification that it intended to dispose of her shares and proprietary lease by private sale. The debtor brought an action seeking to vacate the notification of a private sale, enjoin the secured party from proceeding with the sale, and compel the secured party to commence a foreclosure action. In a scant few paragraphs, the court concluded that the debtor had failed to demonstrate her entitlement to any of the requested relief.

Although the debtor claimed that the secured party had failed to comply with New York's non-uniform § 9-611(f), which requires a 90-day notification of a disposition of an interest in a co-op, the court properly noted that the sale described in the notification had not occurred and that nothing prevented the secured party from scheduling and conducting a future sale, provided it gave proper notification.

The court then turned to the debtor's claim that a nonjudicial sale of co-op would not be commercially reasonable. The court's entire discussion of the issue was the following single sentence: "To the contrary, [a] disposition of collateral is made in a commercially reasonable manner if the disposition is made . . . at the price current in any recognized market." 2016 WL 143496, at \*2 (quoting § 9-627(b)(2)).

The court was quite correct in denying the debtor injunctive relief. While the judiciary is empowered to restrain creditor enforcement efforts that fail to comply with Article 9, *see* § 9-625(a), the debtor offered no reason why such a sale would be commercially unreasonable or would otherwise not comply with the law. However, the court was quite incorrect in suggesting that a private sale of a co-op would be on a recognized market.

Article 9 contains three references to a recognized market. Section 9-610(c) allows a secured party to buy at a private sale if the collateral is of a kind that is customarily sold on a recognized market. Section 9-611(d) allows a secured party to sell, without prior notification, collateral that is of a type customarily sold on a recognized market. Finally, § 9-627(b) conclusively treats a disposition as conducted in a commercially reasonable manner if the disposition is made either in the usual manner on a recognized market or at the

price current in a recognized market. For each of these purposes, the concept of a recognized market is “quite limited; it applies only to markets in which there are standardized price quotations for property that is essentially fungible, such as stock exchanges.” § 9-627 cmt. 4. The comments add that the New York Stock Exchange is a recognized market but that “[a] market in which prices are individually negotiated or the items are not fungible is not a recognized market, even if the items are the subject of widely disseminated price guides or are disposed of through dealer auctions. § 9-610 cmt. 9.

Each New York co-op is unique and prices for co-ops are individually negotiated. Consequently, they are not traded on a recognized market. The court was wrong to suggest the opposite.

***In re Tusa-Expo Holdings, Inc.,***  
**2016 WL 360795 (5th Cir. 2016)**

This is a fascinating and potentially important case about preferential transfers and proceeds of collateral. The court might have reached the correct result, but its analysis is seriously flawed.

The facts are somewhat complicated but can, for the purposes of this discussion, be simplified as follows: Tusa Office was a retailer of furniture manufactured by Knoll, Inc. Tusa granted a security interest in its existing and after-acquired accounts to Knoll, to secure its obligation to pay for furniture Tusa purchased from Knoll. Tusa later entered into a revolving credit facility with Textron Financial. Under that facility, Tusa granted Textron a security interest in its existing and future accounts and agreed to have Tusa’s account debtors make payment to a lockbox established and maintained by Textron. By agreement, Knoll subordinated its security interest in most of the accounts to Textron’s security interest.

Textron swept the lockbox daily. This action increased the available credit to Tusa on its revolving loan and, on Tusa’s request, Textron regularly made new advances to Tusa’s operating account. Tusa used some of those funds to pay Knoll. After Tusa filed for bankruptcy protection, the trustee sued Knoll to recover some of those payments as avoidable preferences. Knoll, which was undersecured, claimed that the payments it received were part of its collateral, and hence did not enable it to receive more than it would have had the payments not been made and the Tusa’s assets liquidated.

The bankruptcy court ruled for Knoll, *See In re Tusa-Expo Holdings, Inc.*, 496 B.R. 388 (Bankr. N.D. Tex. 2013), concluding that the trustee had not satisfied § 547(b)(5). The district court affirmed, and the trustee then appealed to the Fifth Circuit, which also affirmed.

The circuit court began its analysis by noting that while a transfer to an undersecured creditor normally has preferential effect, a transfer of the collateral to an undersecured creditor will not. *See In re El Paso Refinery, L.P.*, 171 F.3d 249, 254-55 (5th Cir. 1999). Because the trustee claimed that the payments to Knoll were not made from Knoll’s collateral, the court concluded that it needed to determine whether the proceeds of the accounts receivable remained Knoll’s collateral after being transferred (1) into the lockbox, (2) out of the lockbox when swept by Textron, and (3) into Tusa’s operating account.

As to the first issue, the trustee argued that the deposits into the lockbox constituted transfers of “money,” and therefore the transferee – which the trustee argued was Textron – took free of Knoll’s security interest under § 9-332(a). The court had little difficulty concluding that the lockbox, although administered by Textron, was nevertheless property of Tusa. As a result, Textron was not at this stage the transferee and hence § 9-332(a) did not apply. This conclusion was correct but the underlying premise – that the deposits involved money – was wrong. Money is a defined term in the UCC. It means a medium of exchange authorized or adopted by a domestic or foreign government. § 1-201(b)(24). In short, paper currency and coins. Almost nobody pays bills with money. They send checks and initiate funds transfers. Consequently there was almost certainly no money transferred to the lockbox or held in the lockbox. The court’s implicit acceptance of the trustee’s argument to the contrary is unfortunate and seems to have infected its analysis of the second issue.

As to the transfers out of the lockbox – the sweeps by Textron – the trustee argued that § 9-332(b) applies. That subsection provides that “a transferee of funds from a deposit account takes free of a security interest in the deposit account,” subject to an exception for collusion that is not material to this case. The court rejected this argument based on § 9-332(b)’s “plain language” referring only to “a security interest in [the] deposit account” as opposed to a security interest in the deposited “funds.” In other words, the court concluded that the protection afforded by § 9-332(b) is limited and does not strip off a security interest in deposited funds as opposed to the deposit account itself. But this was wrong in at least one of two ways. First, the purported distinction between the deposit account and the deposited funds, as assets, is utter nonsense. A deposit account not a bailment or a trust and never “contains” any “funds.” A deposit is merely an unsecured loan to the bank; a deposit account is nothing more than the depositor’s right to be repaid by the bank; and as a result, there is and can be no security interest in the funds as distinct from the depositor’s right to be repaid (*i.e.*, some or all of the balance of deposit account). Second, the clear legislative intent of § 9-332(b) applies with equal strength regardless of whether the security interest in question originated with receivables traced into the account (as in *Tusa-Expo*) or with the deposit



account as original collateral (as in a state court precedent followed by this court in limiting the statute). Properly understood, § 9-332(b) did apply. Consequently, when Textron swept the lockbox, it took free of Knoll's security interest.

If the court had analyzed the second issue properly, and concluded that Knoll had no security interest in the funds swept by Textron, it would have had to then deal with a very interesting question: whether Knoll's security interest somehow re-attached when Textron advanced new funds to Tusa's operating account. Could the operating account contain identifiable proceeds of the accounts or of the lockbox even though, in the interim, the security interest was lost? In an economic sense, the new advances are traceable to the proceeds of the accounts. Had the account debtors not paid, Textron would likely not have made its subsequent advances. However, in a property sense, the break in the chain – the lapse in the continuity of attachment – would seem to be quite a problem for Knoll. Perhaps, depending on the nature of the contracts, the missing link could be found. For example, if Knoll had a contractual right to draw on a line of credit, that right would be a general intangible. If, by paying down the debt, Knoll expanded its right to draw, that enhanced general tangible might be identifiable proceeds of the payment, and hence proceeds of the lockbox. The subsequent advance might then be identifiable proceeds of the general intangible.

That is a lot of ifs, however, and the analysis hinges in part of the subsequent advance being based on a line of credit, rather than new accounts. In any event, we will never know how the court would have approached this issue because it fundamentally erred before it reached this portion of the analysis.

*In re Estate of Nardoni*,  
[2015 WL 1514908](#) (Ill. App. Ct. 2015)

In this case the court mistakenly wiped out the full amount of a guarantor's liability to a secured lender, failed to correct several errors affecting the law of co-suretyship, and misunderstood the relationship between the common law of suretyship and UCC Articles 3 and 9.

The late Dennis Nardoni had guaranteed the full amount of a \$1 million demand loan made to a corporation of which he was the president. There was also collateral for the loan, in the form of securities owned by Nardoni and the borrower, held indirectly in a securities account over which the lender had control by agreement. After Nardoni's death but before the calling due of the loan, the intermediary – a hedge fund that at the time was apparently anticipating liquidation – converted the assets in the securities account to certificates in the lender's name rather than the debtors' names and forwarded the certificates to the lender. The debtors tried to get possession of the certificates from the lender with a view to liquidating the securities and applying the proceeds to payment of the loan, but the lender refused and kept the certificates in its vault for fully two years without exercising any Article 9 remedies. Six months into this two-year period, the borrower ceased making payments, on the grounds that the lender had essentially repaid itself in full by keeping collateral. In the meantime, the lender, still possessing the certificates, brought a claim against Nardoni's estate for the amount owing on the loan.

The trial court not only denied the lender's motion for summary judgment against the estate, but also went so far as to grant the estate's cross-motion for summary judgment, completely negating the estate's potential liability under the guaranty. The appellate court affirmed, looking to comment 3 of § 9-610 for the proposition that “[i]f a secured party . . . holds collateral for a long period of time without disposing of it, and if there is no good reason for not making a prompt disposition, the secured party may be determined not to have acted in a ‘commercially reasonable’ manner.” (The appellate court rightly stayed away from the trial court's more loosely stated rationale that the lender had “essentially taken” the collateral by accepting the certificates in its own name. In fact the mere reissuance of security certificates in a lender's name does not constitute a disposition, and Article 9 now expressly rejects the idea that “constructive strict foreclosure” may result from a secured party's inaction. *See* §§ 9-619(c), 9-620 cmt. 5.)

Even if the lender's prolonged inaction was commercially unreasonable, though, this should not necessarily have negated the estate's liability on the guaranty. Instead, the estate as a secondary obligor and debtor should have been put to its proof on the amount of damages caused by the lender's conduct. *See* § 9-625(b), (c)(1) (imposing liability for losses caused to obligors and debtors, among others, by a person's failure to comply with Article 9). The opinion of course does not explore the amount of those damages, so they may have been anywhere from substantial to low or nil. (The opinion contains no facts suggesting, for example, that the estate liquidated other assets at a loss in preparing to make payment to the lender, or that the estate as debtor incurred any loss relating to other financing arrangements. *See* § 9-625(b), second sentence.) Article 9's rebuttable presumption against recovery would be inapplicable here because the lender's suit does seek recovery for a deficiency. *See* § 9-626(a) (governing the burden of proof as to “liability . . . for a deficiency”). And for the same reason, the “absolute bar” to recovery on a deficiency imposed under some states' case-law would be inapplicable too, quite aside from the fact that this case involved a business loan while the absolute bar is confined to consumer transactions. *See id.*; § 9-626(b).

Moreover, the amount of the estate's potential liability erased by the court was even larger than the appellate court realized, for reasons stemming from errors regarding co-suretyship in the court below. In addition to Nardoni's own guaranty for the full \$1 million loan, a

business associate of Nardoni's had given a guaranty capped at \$700,000, and a second business associate of Nardoni's named Duggan was also supposed to have given a guaranty capped at \$700,000. But Duggan's guaranty was never executed, and the trial court used the absence of this document as a reason to cut Nardoni's estate's liability from \$1 million to \$300,000, on the grounds that "the estate had essentially lost \$700,000 in recourse against a co-guarantor." This was almost certainly a mistake in fully three separate ways. First, the loan agreement had framed the supplying of Duggan's guaranty as an "affirmative covenant" of the borrower, which means that it was probably also a constructive condition precedent to the lender's obligations – but this is quite different from being a condition precedent to Nardoni's obligations. Second, even if the missing Duggan guaranty had in fact been supplied as the loan agreement contemplated, Nardoni's right of reimbursement from Duggan would have been limited by Duggan's "contributive share," *i.e.*, in this case not \$700,000 but \$333,333.34. *See* Restatement (Third) of Suretyship and Guaranty § 57(1) (dividing the \$1 million "aggregate liability of the cosureties to the obligee" by the number of cosureties unless a smaller limit is contractually provided). And third, even this smaller amount would properly be relevant only in an action by the estate for contribution from Duggan – but instead the trial court took it "off the top" from the estate's obligation to the lender. Without these errors, the estate's liability could have been as high as the full \$1 million amount of Nardoni's own guaranty (subject of course to the level of damages provable by the estate under § 9-625(b)).

Nardoni's guaranty had waived the common-law defense of impairment of the collateral, and the appellate court refrained from ruling on the waiver's enforceability, for two incorrect reasons. First, the court thought that impairment of the collateral was distinct from commercially unreasonable conduct, but in fact the latter is one variety of the former. *See* Restatement (Third) of Suretyship and Guaranty § 42(2)(d). And though many varieties of impairment of the collateral (for example, failure to maintain perfection) may generally be waived as defenses, *id.* § 48(1), waivers of the secured party's duty of commercial reasonableness are made ineffective by UCC § 9-602(7), which takes precedence over the common-law rules, *see (id.)* § 4 (law of secured transactions takes precedence). Second and more strikingly, the court mistakenly thought it important that this transaction involved no negotiable instrument. The lender's lawyers had apparently convinced the court that Article 3's rules on impairment of collateral (*see* UCC § 3-605(d) or, in states without the 2002 amendments, subsection (e)) were exhaustive, rather than just one instantiation of broader suretyship principles. Overall, in this case, a correct analysis of Nardoni's waiver would simply have noted the § 9-206(7) point and permitted the lender to recover, subject again to any damages provable under § 9-625(b) as discussed above.

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## Endnotes

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<sup>1</sup>See *Delchi Carrier v. Rotorex Corp.*, 71 F.3d 1024, 1027-28 (2d Cir.1995).

<sup>2</sup>*Claudia v. Olivieri Footwear Ltd.*, No. 96 Civ. 8052 (HB) (THK), 1998 WL 164824, at \*5 (S.D.N.Y. Apr. 7, 1998).

<sup>3</sup>*Id.*

<sup>4</sup>UCC § 2-201.

<sup>5</sup>CISG. art. 14.

<sup>6</sup>*Id.* art. 18.

<sup>7</sup>See *MCC-Marble Ceramic Ctr., Inc., v. Ceramica Nuova d'Agostino, S.p.A.*, 144 F.3d 1384, 1387-92 (11th Cir. 1998).

<sup>8</sup>See *id.* at 1387-90.

<sup>9</sup>CISG art. 8(3).

<sup>10</sup>*Cedar Petrochemicals, Inc. v. Dongbu Hannong Chem. Co.*, No. 06 Civ. 3972 (LTS)(JCF), 2011 WL 4494602, at \*5 (S.D.N.Y. Sept. 28, 2011).

<sup>11</sup>CISG art. 19(1).

<sup>12</sup>*Roser Techs., Inc. v. Carl Schreiber GmbH*, No. 11 cv 302 ERIE, 2013 WL 4852314, at \*5 (W.D. Pa. Sept. 10, 2013).

<sup>13</sup>*Id.* at \*7.

<sup>14</sup>*Id.* at \*6.

<sup>15</sup>CISG art. 8(3).

<sup>16</sup>*Allied Dynamics Corp v. Kennametal, Inc., No. 12-CV-5904 (3FB) (AKT)*, 2014 WL 3845244, at \*11 (E.D.N.Y. Aug. 5, 2014).

<sup>17</sup>*Roser Techs.*, 2013 WL 4852314, at \*9.

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<sup>19</sup>Directive 2014/59/EU.

<sup>20</sup>The LSTA turned to Elizabeth Leckie at Allen & Overy LLP for assistance in drafting the September 22, 2015 advisory and the LSTA Recognition Provisions.

<sup>21</sup>Austria, Belgium, Bulgaria, Cyprus, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and United Kingdom.

<sup>22</sup>Directive 2001/24/EC

<sup>23</sup>The EEA is comprised of the EU member states, Iceland, Lichtenstein and Norway.

<sup>24</sup>The LMA's EU Bail-in Legislation Schedule dated February 1, 2016 is available at <http://www.lma.eu.com/pages.aspx?p=499>.

<sup>25</sup>Final Report: Draft Regulatory Technical Standards on the Contractual Recognition of Write-down and Conversion Powers Under Article 55(3) of Directive 2014/59/EU, EBA/RTS/2015/06, 3 July 2015.

<sup>26</sup>The PRA's: Modification by Consent of Contractual Recognition of Bail-in Rules 1.2 & 2.1, dated November 25, 2015, is available at <http://www.bankofengland.co.uk/prs/Documents/authorisations/waiverscr/modbyconbailin.pdf>.

<sup>27</sup>The PRA's consultation paper on amending its Contractual Recognition of Bail-in Rules, dated March 15, 2016, is available at <http://www.bankofengland.co.uk/prs/Pages/publications/cp/2016/cp816.aspx>.

<sup>28</sup>The LMA's Recommended Form of Bail-in Clause and User's Guide, dated February 1, 2016, discusses different nonmonetary obligations which may trigger Article 55 requirements.

<sup>29</sup>See Article 3 of the Draft Regulatory Technical Standards on the Contractual Recognition of Write-down and Conversion Powers under Article 55(3) of the BRRD, *supra* note 24.

<sup>30</sup>The LSTA Variant is appropriate for use in a New York law-governed credit agreement, but is easily adaptable for use in other primary market agreements should parties choose to include it.