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International Syndicated Lending: The Legal Context for Economic Development in Latin America

Joseph J. Norton*

International syndicated lending remains an important financing component in the ongoing economic development of Latin America. Many of these syndicates will be dominated by non-Latin American lending institutions. Latin financial institutions will, however, often be involved in the syndicate and in some instances, may serve as lead and/or agent bank for the syndicate. The non-Latin syndicate members will invariably seek to have the loan arrangement and the intercreditor relationship governed by New York or English law. Even where local law may be the governing law, U.S. and London loan syndicate structures and practices generally will remain highly influential.

This article is concerned with international syndicated lending in Latin America and the extent that it may be governed and/or shaped by U.S. law and practice. After a brief discussion of the current strength of the international syndicated lending market, consideration (with the primary emphasis on U.S. law and practice) is given to the following: (i) the differences between syndicated loans and loan participations; (ii) the syndicated loan arrangement itself; (iii) the intercreditor arrangement; (iv) the nature of loan transfers; and (v) the liability of the agent bank to syndicate members and to participating banks.

I. Background: The International Syndicated Lending Market

The environment for syndicated lending underwent significant changes from the period of 1970 to 1990. These changes have facilitated the development of the massive syndicated borrowings that currently dominate international lending markets.

In the 1970s, international banks were flush with petrodollars following the oil price shocks introduced by the OPEC countries, but faced weak corporate loan demand. Latin American borrowers were thus able to obtain loans at favorable rates at the expense of syndicated lenders, albeit at floating interest rates. In addition, in the 1970s and early 1980s the US money center banks were under political pressure to recycle petrodollars to lesser developed countries (LDCs) and, after the international debt crisis of 1982, to continue lending to Latin American sovereigns as part of a strategy to stabilize international finan-

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1. For a comparison to domestic U.S. Commercial lending practices, see Joseph Norton & Terry Conner, COMMERCIAL LOAN DOCUMENTATION GUIDE (1995).
cial markets and banking systems (by keeping distressed sovereign debt current through new loans, bankers and regulators were able to claim that the loans were performing and that the large lending banks were still solvent). 2

In the 1980s, the explosive growth of takeover finance in the US accelerated the increased use of loan syndications and participations by banks as they competed for business in the mergers and acquisitions (M&A), leveraged buyout (LBO) and real estate development loan markets. Although these categories of loans were facilitated in large part by issuances of junk-bonds, the large money center banks nonetheless fully participated in the speculative debt financing boom of the 1980s. 3

In the 1980s experts predicted that the process of financial disintermediation combined with the development of the interest rate and currency swap markets would render syndicated lending obsolete. The flexibility of the syndicated loan market has ensured its survival in the international financial community. As compared with the international bond or commercial paper markets, however, a syndicated loan facility remains a relatively inexpensive means of obtaining financing and allows the borrower to develop multiple banking relationships. 4 The continued growth of the syndicated loan market is nonetheless largely attributable to the more conservative lending practices of the 1990s.

The primary benefit of syndicated loan arrangements to banks is that banks can diversify credit risk by limiting their exposure to any one borrower, industry, or geographical region. In other words, banks can develop a diversified portfolio of high-quality commercial or real estate loans of modest size through loan syndications and participations, rather than through a handful of large loans where the failure of only one loan could have profound consequences on the bank's credit risk position. Diversification has also been facilitated by US bank regulators and credit rating agencies, which have placed informal pressure on banks to diversify their loan portfolios to minimize the impact of large defaults so that the massive bank and savings and loan (S&L) and bank failures of the 1980s are not repeated. 5 Hence, the common motivation of risk diversification in loan portfolios has been a driving force in the evolution of international syndicated lending.

The syndicated lending market has exploded in size and liquidity from 1990-1995. In 1994 alone, borrowings on international capital markets increased for the fifth straight year, increasing by a record 30 percent to US$1,258.3 billion, according to an Organization for Economic Cooperation and Development (OECD) report issued in March 1995, 6 with international syndicated loan and note facilities accounting for a majority of the increased borrowings. In fact, the increase was primarily due to a surge in medium-term bank loans to US$368.4 billion in 1995 from US$236.2 billion in 1994, and a 51 percent increase in

4. See Robert Hitchings, Syndicated Loans, BANKING WORLD No. 7, at 32 (July 1994).
5. Wienke, supra note 3.
medium-term Euronotes (EMTNs) to US$340.6 billion in 1995 from US$222.1 billion in 1994. With regard to syndicated loan facilities, these arrangements established a new record, totalling almost US$367 billion, an increase of 56 percent from the US$235.3 billion arranged in 1994.7

In addition, the International Finance Corporation (IFC), a private sector affiliate of the World Bank, reported that its syndicated lending programs with commercial banks increased almost 42 percent to US$2.6 billion in 1995, from US$1.8 billion in 1994.8 In Latin America, where the fallout from the Mexican liquidity crisis9 and peso attacks tightened access to international capital markets for firms in the region, IFC still approved investments of more than US$1 billion for 53 projects, in addition to US$1.2 billion in syndicated loan facilities.10 The principal reason for this recent rise in syndicated lending

7. See Borrowing On International Capital Markets Rose For Fifth Straight Year, 66 BNA BANKING REPORT, 383 (1996). Of this total, OECD countries and resident corporations accounted for US$326.9 billion, up from US$211.5 billion, and non-OECD countries increased their loans to US$41.5 billion in 1995, up from US$24.4 billion in 1994. In addition, all committed and uncommitted borrowing facilities increased to US$388.3 billion in 1995 from US$257.8 billion in 1994. This increase was due almost entirely to an increase in EMTNs to US$340.2 billion in 1995 from US$222.0 billion in 1994. Finally, Eurocommercial paper (ECP) programs expanded to US$44.6 billion from US$30.8 billion, and net issuances under existing EMTN facilities equalled US$174.6 billion, while under existing ECP facilities accounted for US$61 billion. Id. See also Richard Lapper, Syndicated Loans Surged to Record in 1994, Says BIS, The FINANCIAL TIMES (Feb. 17, 1995).


9. According to estimates from the World Bank, private capital flows to developing countries rose in 1995 to US$167.1 billion, a mere 5.23 percent increase from the US$158.8 billion in 1994, compared with annual increases of over 50 percent in each of the years from 1990-1993. See Private Capital Flows to Developing Countries Slowed in 1995, World Bank Says, BNA BANKING DAILY (Mar. 13, 1996). The total external debt of the developing countries rose in 1995 by almost 8 percent, to over US$2 trillion. Id. Foreign direct investment reached increased 12.7 percent to a record US$90.3 billion in 1995, up from US$80.1 billion in 1994. Portfolio investments, however, declined from US$67.1 billion in 1994 to US$55.7 billion in 1995, reflecting an enormous 37 percent decrease in equity flows, which dropped from US$34.9 billion in 1994 to US$22 billion in 1995. Id. Thus, the developments of 1994-1995 emphasized the greater susceptibility of portfolio flows to cyclical factors, contagion effects and short-term changes in investor sentiment. See generally WORLD BANK, WORLD DEBT TABLES: EXTERNAL FINANCE FOR DEVELOPING COUNTRIES (1995). This was clearly influenced by the effects of the Mexican foreign exchange liquidity crisis in 1994-1995.

10. Id. In other regions, IFC approved US$691 million for its own account and mobilized an additional US$752 million through loan syndications for 45 projects in Asia; US$318 million for 51 projects in sub-Saharan Africa; US$387 million in direct IFC lending and US$227 million in loan syndications for 34 projects in Central Asia, the Middle East, and North Africa; and US$403 million for 26 projects in Europe. Id. The IFC also introduced a new financing mechanism, an asset-backed certificate, in Mexico to mobilize new sources of long-term investment capital for Mexican companies, which is intended to extend the maturity of the financing available to such companies and to enable US and foreign institutional investors, such as insurance companies and pension funds, to participate in IFC syndications. Id.
was the combination of volatility in the US and international bond markets that led bor-
rowers away from fixed-income bond issues, and intense competition by the large interna-
tional banks to provide syndicated credits.\textsuperscript{11}

In 1995 and the first quarter of 1996, the syndicated loan market has been dominated
by high levels of liquidity in the banking sector, as strong demand for loans has kept inter-

est margins at extremely competitive rates. In particular, sovereign borrowers, (including
those of the European Union Member States, Scandinavia, Central Europe, and the
Mediterranean regions) have been active in the syndication market.\textsuperscript{12} Aside from syndi-
cated lending activity in the European Union, according to the Bank For International
Settlements (BIS), banks reporting to the BIS are lending more money to Asia but less to
Latin America. Almost all new loans are short-term, reflecting the continuing caution of
bankers about long-term lending commitments [Asian countries have now borrowed
more (US$280.3 billion) than Latin American countries (US$204.1 billion)].

Although US and UK commercial banks have been reducing their lending to private
Mexican companies, it is too early to speculate whether the Mexican devaluation of the
New Peso in December 1994 and ensuing liquidity crisis has led to a fundamental shift
away from Latin America.\textsuperscript{13} Noteworthy in this context, BIS figures indicate that Mexico
and Venezuela accounted for nearly the entire US$4.2 billion decrease for bank lending to
Latin America, and other Latin American countries all continued their respective borrow-
ings.\textsuperscript{14} Notwithstanding these BIS figures, in 1994 alone Latin American countries
accounted for US$12.25 billion in new global syndicated loans from 129 new facilities
(signed as of year-end 1994).\textsuperscript{15} Thus, aside from Mexico and Venezuela, Latin American
countries such as Argentina and Brazil continue to have access to the syndicated loan mar-
kets, the liquidity and volume of which have reached its highest levels.

\section{II. Differences Between Syndicated Loans and Loan Participations}

Multibank lending normally assumes one of two main forms: the syndicated loan
arrangement and loan participation arrangement.

\subsection{A. Syndicated Loan Arrangements}

A syndicated loan is made to a single borrower by two or more direct lending institutions,
on similar terms and conditions, using common documentation and administered by a
common agent bank or separate agent banks. Common documentation and direct co-

\begin{enumerate}
\item[12.] See Lapper, \textit{supra} note 11.
\item[13.] See BIS Banks Lending More to Asia; Report Says Most New Loans Short-Term, \textit{BNA Banking Daily} (Jan. 12, 1996). Recent evidence of this shift occurred in April 1995 when a massive
\item[14.] \textit{Id.}
\item[15.] See World: \textit{Global Syndicated Loan Volume 1994}, Reuter Textline Euroweek (Jan. 6, 1995),
available on LEXIS.
\end{enumerate}
lending are the crucial elements that hold the syndicate of lending banks together.16

1. **Parties and Structure**

There are normally three collective parties to a syndicated loan. These include the managing bank or lead lender, which usually becomes the agent bank for the syndicate and is responsible for negotiating the loan documentation. As agent the lead lender administers the terms of the loan agreement. There are also the syndicate member banks, which are normally approached by the managing bank or lead lender to join in the loan, and the borrower.

In general, the lead lender or co-managing lead lenders will finance the largest portions of the syndicated loan facility. Hence, differentiating among lead lenders in multiple financing facilities represents an effective way for the borrower to diversify its banking relationships.17

Principal lenders in the syndicated loan market are US commercial banks, Japanese commercial and trust banks, and European commercial banks, ranging from large international banks to smaller institutions with a domestic lending bias. Borrowers include banks and other financial institutions, private sector corporations, sovereign governments, local authorities, and state-owned entities. Syndicated loan facilities can have maturities of up to 12 years, but average maturities generally fall between five and eight years.18

Syndicated loans by their nature represent direct lending with assignments, where the lead lender sells off and assigns pro rata interests in a loan to other lenders which directly enter into lending arrangements with the borrower. Syndicate members, which are assigned an interest in the loan, have direct access to the borrower and are named in the loan documentation.19

The lead lender normally acts as agent for the other lenders in the origination and administration of the loan, and the other lenders are sold direct interests in the loan through an assignment by the lead lender of an interest in the loan.

The agent bank or banks will service and administrate the loan agreement. The duties of agent banks can be segmented into **administrative agents** (responsible for servicing the loan); **collateral agents** (responsible for custody of the collateral of the loan, if any exists) and **disbursement agents** (responsible to distribute loan interest payments).20

The syndicate does not necessarily have to be formed at the origination of the loan (although if it is, the syndicate members can and often do participate directly in the underwriting process). The lead lender may instead underwrite and even close the loan before selling portions to the syndicate members through assignments of interests in the loan and the underlying loan documents. The relationship between the lead lender and syndicate members may be governed by the loan agreement itself or, in larger and more sophisticated secured transactions, the syndicate members may sign separate agency and security agreements with the lead lender designating the rights, powers, and duties of the lead

17. Hitchings, supra note 16.
18. Id.
20. Wienke, supra note 3.
lender as the administrative agent bank relative to the other syndicate members, and the members' rights in the collateral, if any.\textsuperscript{21}

2. \textit{Primary Types of Loan Facilities.}

The syndicated loan market provides one of the most flexible forms of financing available. Borrowers use syndicated loans for many reasons, including simple working capital funding to asset-based financing, acquisition finance, project finance, and stand-by lines of credit.

There are several major types of loan facilities available to most borrowers. First, \textit{term loan facilities} are fully drawn by the borrower and are either repaid in full at maturity (bullet repayment) or through periodic repayments beginning prior to the final maturity (staged repayments). The borrower generally has the right to repay all or part of the loan at any time without paying a penalty, but cannot redraw any part which it has cancelled. Second, \textit{revolving credit facilities} give the borrower more flexibility with regard to the amount of principal outstanding during the life of the loan. As facility the loan matures and become repayable, the borrower has the right to redraw on the facility up to the maturity date of the loan. Third, \textit{evergreen facilities} are term loans which, with the approval of the lending syndicate, can be extended at certain pre-established periods. A typical evergreen facility would be one with an agreed period (e.g., six years) which would incorporate an annual option for the banks to extend the loan maturity date another year on a continuous basis. In other words, the loan would have a rolling six year maturity.

3. \textit{Advantages of Syndicated Lending to the Borrower.}

A syndicated loan arrangement is an effective method for borrowers to raise large sums of financing in one operation and to establish and maintain diverse banking relationships.\textsuperscript{22} Private and sovereign borrowers, however, have many other uses for syndicated loan facilities. First, these facilities can be used in part to refinance outstanding bond issues. Second, these arrangements can often represent significant reductions in cost of funds to the borrower. Third, revolving credit facilities have inexpensive drawdown costs and give the borrower considerable flexibility in determining when, how much, and in what currency it can use the funds. Fourth, syndicated loans, particularly standby facilities, can be used as a hedge against future bond market volatility. Finally, even less credit-worthiness corporate borrowers and sovereigns borrowers that may be considered less creditworthy have successfully entered the syndication market (e.g., Greece established a US$600 million syndicated loan facility in February 1995).\textsuperscript{23}

\textsuperscript{21} \textit{Id.}

\textsuperscript{22} For example, a recent sovereign loan to the Kingdom of Sweden for ECU 8 billion was underwritten by JP Morgan and a handful of other London city banks, prior to general syndication, within three days. \textit{See} Hitchings, \textit{supra} note 16. Another example is the US corporation Johnson & Johnson, where Citicorp arranged a US$1.2 billion loan syndication arrangement. \textit{See} Daniel Dunaiel, \textit{Citibank Beats Chase For $1.2B Loan Syndication}, \textit{The American Banker} (Aug. 1995).

4. Pricing of Syndicated Loan Facilities.

Syndicated loan facilities are normally priced on a floating-rate basis. The interest price of the loan is the margin above the interbank cost-of-funds charged to the borrower (usually expressed as a number of basis points above the interbank cost of funds). In London, the interbank cost of funds is the London Interbank Offered Rate (LIBOR). The United States, it is the prime or base lending rate.

Establishing the margin is one of the lead lender's critical tasks. It largely reflects the interbank market's perception of the borrower's creditworthiness, although other factors such as maturity, facility structure, and market demand for such loans may also affect pricing. Although the pricing of syndicated loans, especially those of sovereign borrowing facilities, have fallen to historically low levels, international banks nonetheless remain engaged in intense competition for the business primarily to establish and to maintain client relationships.24

The general syndication process has, however, been more difficult recently because international banks have been placing more emphasis on a larger premium on gaining the underwriting position for maintaining the client relationship. Hence, the number of institutions that participate in by large syndicated debt facilities, particularly those involving sovereign borrowers, has decreased to 30 or 40 of the world's largest international banks.

In addition to the receiving interest margin, banks can expect to receive various fees, such as management fees, participation fees, commitment fees, and underwriting fees.25 In becoming an underwriter, as opposed to a general member of the loan syndicate, a bank can enhance its position in several instances. The bank earns additional fees for its underwriting commitment, which takes on a disproportionate importance when the interest margins are low. Also, it represents a statement of commitment by the bank to the borrower in question. Further, the bank is virtually assured to gain "spinoff" business from the borrower for arranging the syndicated facility. Commercial bank executives are regularly required to approve corporate and sovereign commitments, and often the commitments are made purely on the basis of remaining competitive.26 As competition in the syndicated loan markets have kept it liquid for private and sovereign borrowers, international banks are increasingly requested to commit large amounts at the underwriting stage. This may raise questions of concentration risk and/or country risk in particular instances, and whether such commitments to individual borrowers or countries in general are prudent. Smaller banks which previously joined in the larger syndicated loan facilities have declined to join in recent syndications because they have been unable to provide such large commitments in a range of currencies, and many are further unable to fund themselves at the rate achieved by the borrower. In short, the interest margins in many large syndicated loan facilities are simply unfeasible for all but the largest banks.27

24. For instance, international banks generally view the opportunity to underwrite a central government syndicated loan facility as very prestigious, or a "trophy mandate," and indulge in the fact that typically sovereign loan facilities are not technically challenging. Horwood, supra note 23.
25. Id.
26. Id.
27. Id.
Notwithstanding the current demand and pricing levels for large syndicated loan facilities, international bank competition cannot keep the "borrowers market" ongoing indefinitely. This is especially true with regard to Latin American corporate facilities, as the effects if the Mexican liquidity crisis will likely sustain high interest margins for the region on US dollar-denominated syndicated loan facilities to reflect the newly emphasized "emerging market risks" inherent in Latin American countries following the crisis. The regional risks induced by volatile currency fluctuations and potential drains on foreign exchange reserves in the particular countries in question are, of course, in addition to the credit risk inherent in Latin American corporates and sovereigns alike.

B. Loan Participation Arrangements

Loan participation arrangements represent indirect lending wherein the originating lead lender sells participations in a loan or basket of loans through separate loan participation agreements to participating banks. The participating bank generally does not assist in the underwriting or negotiation of the loan; is unnamed in the loan documents as a lender; and normally has no direct recourse against the borrower. Moreover, by the terms of the loan participation agreement, the participating bank generally does not have a security interest in the collateral pledged by the borrower to secure the loan, but merely holds a contractual interest in the loan arising from the loan participation agreement with the lead lender.28

Loan participation agreements must address the same issues raised under the syndicated loan analysis in relation to the rights and duties of agent banks and participating banks. Although the US and international loan participation markets do not approach the current volume and liquidity of the respective syndicated loan markets, loan participations should continue to be important financing vehicles for lead lenders that have the power and respect of their participating banks.

Loan participation arrangements have several particular regulatory and structural aspects which distinguish them from syndicated loan facilities and which has corresponding effects on the volume and liquidity of the market. Nonetheless, loan participations can provide an important function for syndicate members in a syndicated loan by allowing a member to reduce its interest in the syndicated arrangement, notwithstanding restrictions on direct assignment in the loan agreement.29

1. Comptroller of the Currency Regulations and Loan Participations

The Comptroller of the Currency (OCC), the primary federal regulator for national banks, issued Banking Circular No. 181 ("BC-181") to regulate loan participation arrangements following the highly publicized Penn Square bank failures involving numerous collapsed loan participation arrangements originated by Penn Square.30 BC-181 obligates

28. Where the loan participation agreement does not expressly provide, however, courts have held on occasion that the participating bank has an interest in the collateral underlying the loan. See discussion infra in this article.
29. Wienke, supra note 3.
national banks to establish written standards for loan participations, specifically requiring participating banks to individually analyze the credit risk and quality of the loan to be purchased, as well as the value and status of liens and collateral based on full credit information. In addition, BC-181 mandates that participating banks analyze the credit information about the borrower with the same prudence that would be required if the participating bank had originated the loan, and that participating banks cannot rely on the credit analysis of the lead lender.31

In sum, BC-181 specifically requires all national banks to ensure (i) written lending policies and procedures governing loan participations; (ii) an independent analysis of the credit quality of the loan by the participating bank; (iii) the borrower's agreement to make full credit information available to the lead lender; (iv) the lead lender's agreement to provide available information on the borrower to the participating banks; and (v) written documentation of all recourse obligations outlined in the rights and obligations of each party. These requirements have effectively eliminated the practice of blind reliance by participating banks on the lead lender's credit analysis of the borrower. Although BC-181 is not binding per se upon participating banks, its provisions have been directly utilized by several courts to establish standards of care between lead lenders and participating banks.32 Moreover, BC-181 itself provides that noncompliance would allow the OCC to seek appropriate corrective action through its administrative enforcement remedies.33

2. Risk-Based Capital Guidelines and Loan Participations.

The common desire of G-10 central banks and international commercial banks to reduce massive commercial bank exposure to LDC debt following the 1982 "debt crisis" led to increasing international regulation of capital adequacy for credit risk through the G-10 central banks.34 The Basle Committee on Banking Supervision revised and consolidated earlier proposals and issued the 1988 Capital Accord, with the objective of strengthening the international financial system by levelling out the competitive inequalities between international banks (which in turn had resulted from the disparity between each country's

31. Nonetheless, BC-181 recognized, however, that participating banks may consider the analysis performed by the lead lender as a part of its own "independent evaluation" of the loan if the lead lender disclosed its credit analysis. Lead lenders can thus potentially find themselves in a dilemma: either share traditionally confidential information regarding credit analysis and risk liability for inducing participating bank reliance on that information, or refuse to share the information and risk liability for nondisclosure. Wienke, supra note 3.


33. For example, the OCC may initiate enforcement actions against directors and officers of banks for noncompliance with the Circular and specifically prohibit them from considering loan participation arrangements in their official capacities. See, e.g., Office of the Comptroller of the Currency, Enforcement Action, Agreement By and Between Security National Bank of Superior, Superior, Nebraska, and the Office of the Comptroller of the Currency, OCC EA No. 94-4, 1994 OCC Enf. Dec. LEXIS 15 (Jan. 12, 1994).

regulatory requirements). The Capital Accord established a framework to ensure that (i) capital adequacy requirements would recognize the variations in the risk profiles of banking institutions; (ii) off-balance sheet exposures of banks would be considered in assessing capital adequacy; (iii) the disadvantages of holding liquid low-risk assets would be reduced; and (iv) that capital adequacy be related to the risk-weighted assets of commercial banks.

In the context of syndicated loans and loan participations, the imposition of credit risk-based capital adequacy requirements through the Capital Accord on banks has guided banks to prefer direct assignments over loan participations when a revolving credit facility with a commitment period of one year or more is involved. This is principally because the direct assignment of this type of facility results in the bank having no capital requirements for the portion of the facility sold. On the other hand, participation in such a revolving facility would require the selling bank to continue to allocate capital for the participation sold because the selling bank remains primarily liable to the borrower under the revolving credit commitment.


In the lucrative “merger and acquisition” (M&A), “leveraged buy-out” (LBO) and real estate development loans of the 1980s, US and international banks increasingly used syndication loan and loan participation arrangements to join in larger loan facilities with other lenders in excess of any particular institution’s regulatory lending limits because these limits generally applied only to each bank’s pro rata share of a syndicated loan. Hence, commercial banks specifically used loan participation arrangements in efforts to avoid violations of statutory lending limits under the National Banking Act.

Lending limits govern the maximum credit limits that a national bank can extend to a single borrower, and the National Banking itself limits national bank ensured credit exposure in this regard to 15 percent of the unimpaired capital and unimpaired surplus of the


36. It is worth observing that although OECD sovereign loans do not necessarily offer good returns on assets for international banks given the current syndicated lending market conditions, these assets are nonetheless zero risk-weighted under the 1988 Capital Accord. Thus, banks do not have to set aside any capital when taking the loan onto their books, which makes these loans somewhat more attractive and explains in part the willingness of banks to arrange facilities of such enormous size. See Horwood, supra note 23.

37. Wienke, supra note 3.

38. Id.

The regulations promulgated by the OCC under this statute have fine-tuned the statute with respect to loan participations. In effect, a portion of a loan or extension of credit sold as a participation interest by a bank on a nonrecourse basis (provided that the participation results in a prorata sharing of credit risk proportionate to the respective interests of the originating and participating banks) can be excluded from statutory lending limits. When the originating lender funds the entire loan, it must receive funding from the participating banks before the close of its next business day; otherwise, participation interests not received within the period will be treated as a loan by the originating bank to the borrower.

C. COMBINATIONS OF SYNDICATION AND PARTICIPATION ARRANGEMENTS

Although loan arrangements typically involve pro rata assignments or participations, it is common to find non-pro rata assignments or participations, which enables individual creditors to have the credit facility exposure (e.g., revolving, term, short maturity, extended maturity) that best suits their lending objectives. The use of such hybrid multibank loan structures may also encourage secondary market trading in syndicated loans and loan participations. Moreover, syndicated loan facilities can involve a combination of these alternatives with the assignment of direct interests to a primary lending group composed of money center and international banks which then assign or participate the loan to smaller regional lenders.

41. See 12 C.F.R. §. 32.2(j)(2)(vi)(A) (1995). Where a loan participation agreement provides that repayment must be applied first to the portion sold, a pro rata sharing will be deemed to exist only if the agreement also provides that, in the event of a default or comparable event defined in the agreement, participating banks must share in all subsequent retainments and collections in proportion to their percentage participation at the time of the occurrence of the event. Id.
42. See 12 C.F.R. §. 32.2(j)(2)(vi)(B) (1995). If the portions thereof attributed to the borrower exceed the originating bank’s lending limits, the loan will be treated as nonconforming subject to section 32.6, rather than a violation, if (i) the originating bank had a valid and unconditional participation agreement with a participating bank or banks that was sufficient to reduce the loan to within the originating bank’s lending limit; (ii) the participating bank reconfirmed its participation and the originating bank had no knowledge of any information that would permit the participating bank to withhold its participation; and (iii) the participation was to be funded by the close of the originating bank’s next business day. Id. Notwithstanding these precise rules, many US credit rating agencies tend to impose “creditworthiness” limits on bank loans far below the regulatory lending limits.
43. Wienke, supra note 3.
III. Syndicated Loan Arrangements

A. Solicitation of Syndicate Members and Formation of the Syndicate


The loan syndication process begins with a prospective borrower authorizing a particular lead lender to organize a loan syndicate. The lead lender will probably memorialize its proposed arrangement with the borrower by a letter of intent (sometimes, as often in the Euromarkets, the borrower, with the lender's assistance, will issue a formal written mandate to the lend lender). The letter of intent or mandate usually sets forth the principal financial terms of the proposed loan, including the amount of the loan, the interest margin, the repayment schedule, fees, special terms and choice of law. The stipulations in the letter of intent or mandate are normally not intended to be legally binding, and represent proposals lacking the force of law until the conclusion of negotiations and agreement on all of the materials to be terms in the loan agreement.\(^4\) The bank which receives the authorization from the borrower to underwrite the loan is called the managing, arranging, or lead lender, and its responsibilities include seeking prospective lenders for the syndicate (solicitations of interest), acting in cooperation and coordination with the borrower to prepare an appropriate solicitation packet (in Euromarkets often in the form of an "information memorandum" containing all of the necessary information concerning the prospective borrower), and to negotiate the loan documentation. The packet or memorandum is then circulated to prospective lenders to enable them to decide whether or not to participate in the syndicate. The solicitation materials will generally contain the term sheet giving details of the loan; details of the history and business of the borrower; details of the management of the borrower; and the borrower's financial statements.\(^5\) If all is found acceptable, the syndicate members will convene to negotiate the terms of the loan. At the conclusion of the negotiations, the lead lender's duties normally cease, and the syndicate usually appoints an agent bank to administer the loan (which, quite often will be the lead lender).

\(^4\) The mandate is (or should be) expressed as being subject to contract, otherwise the managing bank could be committed to its terms if sufficiently precise. This is because in many jurisdictions, including New York, there can be a contract even though not all of the terms have been agreed and formal documentation is intended to be completed later.

\(^5\) See Joseph J. Norton, International Syndications: A Transatlantic Perspective, in Joint Conference on International Banking and Finance Law - Buenos Aires, 1994 (on file with the International Financial & Tax Law Unit, Centre or Commercial Law Studies, University of London (QMW)), at 1; and Philip R. Wood, International Loans, Bonds, and Securities Regulation (Sweet & Maxwell 1995), at 6-5. Mr. Wood is the senior banking partner at Allen & Overy (London) and a Senior Fellow at the International Financial & Tax Law Unit, Centre for Commercial Law Studies, University of London (QMW), and is considered to be one of the leading international banking lawyers.

In some commercial jurisdictions, legislation has been introduced regulating the circulation of information to the public soliciting investment in securities in order to protect the public from securities fraud. Although such an information memorandum or solicitation packet is probably not a prospectus under the U.S. securities laws, it may be considered one in other jurisdictions. Hence, if an information memorandum is considered to be a prospectus under domestic securities laws, then it may (i) have to contain prescribed disclosures concerning the lead lender and borrower; (ii) need to be registered with the securities regulators of the country in question; and (iii) be subject to potential liability for misrepresentations or alleged omissions in connection with the solicitation that nullify or override exclusionary clauses in the syndicated loan agreement. However, the information memorandum will in all likelihood be exempted from securities regulation, as the circular would probably constitute a private offering (as opposed to a public offering) to sophisticated institutions or professional investors who do not need the protections of the securities laws; or the borrower would be a sovereign government or instrumentality or agency exempt from the securities laws.

With regard to syndicated loan and loan participation interests themselves, neither would in all likelihood be considered as "securities" within the scope of the U.S. securities laws (discussed infra) and if issued to foreign investors, would in any event remain beyond the scope of US securities regulation. In particular, prior US legislation and recent judicial decisions have exempted bank loan agreements and, absent particular circumstances, loan participation agreements from the scope of the Securities Act of 1933 and the Securities and Exchange Act of 1934.

Prior to the 1980s, several US courts had characterized loan participations as securities. This trend was cut short in the mid-1980s, however, as nearly all courts since then have held that loan participation interests are not securities under the 1933 and 1934

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46. Norton, supra note 45, at 3.
47. Norton, supra note 45, at 4-5.
48. The participating bank's motivation in claiming that the loan participation interest or certificate is a security under the US securities laws is to assert that the lead lender either made materially false or misleading statements about the borrower's financial condition, or otherwise omitted such information when it had a duty to disclose the information in connection with the sale of the loan participation interest. If the participating bank can prove that the participation interest is a security and that the lead lender made such statements or omissions, then the participating bank may rescind the loan participation agreement under section 12(2) of the 1933 Act (see 15 U.S.C. §. 77l(2) (1988)) or recover damages under section 10(b) of the 1934 Act (see 15 U.S.C. §. 78j(b) (1988)) and Rule 10b-5 promulgated thereunder (see 17 CFR §. 240.10b-5 (1995)). If the participating bank is unsuccessful in this regard, it must pursue common law fraud or misrepresentation claims against the lead lender, both of which normally have more difficult burdens of scienter or proof than the securities claims.
Acts.\textsuperscript{50} It is interesting to note, however, that the loan participations in these cases did not involve elements inherent in the statutory and common law definitions of "securities," but instead involved traditional banking characteristics. In particular, they were sold by banks to other banks, and not to the general public; they involved sophisticated negotiations among such banks, each of whom arguably possessed similar bargaining power; and collateral was often present to protect the participating banks.\textsuperscript{51}

As the distinctions between the banking and securities businesses have become increasingly blurred, a result is that similar instruments can be offered or sold to a broad investor audience pursuant to widely divergent regulatory schemes with varying disclosure requirements. Loan participation interests are an example of financial instruments offered and sold by banks that arguably function as investments, and are currently subject only to regulatory guidance, such as BC-181, under the federal banking laws. As such, the Securities and Exchange Commission (SEC) has opined that purchasers of loan participation interests which function as investments should be protected by the federal securities laws, whether the purchasers are individuals or corporate entities.\textsuperscript{52} The SEC and the US courts have not, however, addressed the question of whether this position would be extended to loan sales and, in particular, the secondary trading of syndicated debt.\textsuperscript{53}

The Second Circuit has issued two opinions in recent years which have complicated the analysis. First, in \emph{Banco Espanol de Credito v. Security Pacific Nat'l Bank},\textsuperscript{54} the Second Circuit held that sales of loan participations to institutional investors did not fall within the scope of the federal securities laws. This case involved the sale of "loan notes" promoted as alternatives to the issuance of commercial paper. The loan notes were unsecured instruments of varying maturities and interest rates, offered and sold to publicly solicited entities such as money market funds, corporate treasurers, and pension funds. After one borrower defaulted on a series of loan notes, the plaintiffs sued for rescission under section 12(2) of the 1933 Act, claiming that the defendant bank intentionally misrepresented the borrower's creditworthiness.

\textsuperscript{50} See Norton & Olive, supra note 49, at 21-22.33-21-22.36. See also First Citizens Fed. Sav. & Loan Ass'n v. Worthen Bank & Trust Co., 919 F.2d 510, 516 (9th Cir. 1990); McVay v. Western Plains Serv. Corp., 823 F.2d 1395, 1399 (10th Cir. 1987); Union Nat'l Bank of Little Rock v. Farmers Bank, 786 F.2d 881, 885 (8th Cir. 1986); McGill v. American Land & Exploration Co., 776 F.2d 923, 925 (10th Cir. 1985); Kansas State Bank of Holton v. Citizens Bank of Windsor, 737 F.2d 1490, 1494 and n5 (8th Cir. 1984).

\textsuperscript{51} See Richard Y. Roberts & Randall W. Quinn, \emph{Levelling the Playing Field: The Need For Investor Protection For Bank Sales of Loan Participations}, 63 Fordham L. Rev. 2115, 2117-18 (1995). Richard Y. Roberts is an SEC Commissioner, and Randall W. Quinn is the Senior Litigation Counsel of the SEC.

\textsuperscript{52} See Roberts & Quinn, supra note 51, at 2116-17.

\textsuperscript{53} It is worth noting that one court has found that commercial paper issued to the public at large by a nonbank institution under circumstances clearly indicative of fraud is within the scope of the federal securities laws. See \emph{In re NBW Commercial Paper Litig.}, 813 F. Supp. 7 (D.D.C. 1992). This case has not been utilized by any other U.S. courts.

\textsuperscript{54} 973 F.2d 51 (2d Cir. 1992), cert. denied, 113 S.Ct. 2992 (1993).
The district court held that the loan notes in question were not securities under the "family resemblance" test established by the U.S. Supreme Court in *Reves v. Ernst & Young* in 1990. The "family resemblance" test begins with a presumption that every note is a security, and is rebuttable if it can be shown that a note bears a "strong resemblance" to any instrument within a list of instruments that the Court has previously deemed not to be securities, or if the Court (as per four factors, discussed *infra*) decides that the note should in fact be on that list. These factors include an examination of (i) the transaction to assess the motivations that would prompt a reasonable seller and buyer to enter into the transaction; (ii) whether the note is an instrument in which there is common trading for speculation or investment; (iii) the reasonable expectations of the investing public; and (iv) whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the federal securities laws unnecessary.

In applying the family resemblance test, the district court in *Banco Espanol* specifically found that the "loan notes" were not securities. In considering the four factors, the district court found that the overall motivation of the parties was the promotion of commercial purposes and not investments in a business enterprise; the plan of distribution did not involve common trading, but instead was a limited solicitation to sophisticated investors and not to the general public; the contractual provisions of the loan participation agreements placed the sophisticated investors on notice that the instruments were participations in loans and not investments in business enterprises; and that the banking guidelines set forth by the OCC in BC-181, although not necessarily binding on particular parties, established a regulatory scheme applicable to the seller that made application of the federal securities laws unnecessary.

The Second Circuit Court of Appeals held that the district court properly applied the family resemblance test and affirmed the decision, with one dissenting opinion. The plaintiffs then filed a petition for rehearing, joined by the SEC as *amicus curiae*. Although the Second Circuit denied the petition, it did amend the original decision to narrow its scope in apparent response to the SEC's concerns. The amended decision emphasized that

57. *Id.* at 66-67.
60. *See id.* at 57-58 (Oakes, J., dissenting). Chief Judge Oakes cited with approval the concurring opinion in the Ninth Circuit's previous decision in *Great Western Bank & Trust v. Kitz*, 532 F.2d 1252 (9th Cir. 1976), wherein the Court stated that the crucial element of a commercial loan is the ability of banks to "verify the representations and take supervisory and corrective actions." *Id.* at 1261 (Wright, J., concurring). Chief Judge Oakes found that in the case before him, the loan note purchasers had no access to full credit information and no opportunity to perform or to receive a full credit analysis, and therefore that the family resemblance test rendered the loan notes as securities. *Banco Espanol de Credito*, 973 F.2d at 60 (Oakes, J., dissenting).
the ruling was limited to "loan participations as marketed in this case," and that "even if an underlying instrument is not a security, the manner in which participations in that instrument are used, pooled, or marketed might establish that such participations are securities." The amended decision also asserted that the loan notes in question were not sold to the general public, "thus limiting eligible buyers to those with the capacity to acquire information about the debtor." Notwithstanding the SEC's concerns, the US Supreme Court denied certiorari, presumably because the Second Circuit's decision created no conflict between federal circuit court decisions.

In 1994, the Second Circuit in Pollack v. Laidlaw Holdings, Inc. considered whether certain mortgage participation interests sold to the general public, purportedly secured by real estate collateral with relatively short maturities and fixed interest rates, were securities under the US securities laws. The mortgage participations were purchased by several "passive, unsophisticated investors" sold by nonbank corporate entities involved in the securities and investment counselling businesses. Although the district court held in an unreported opinion that the mortgage participations were not securities under the Banco Espanol decision, the plaintiffs filed an interlocutory appeal and the Second Circuit reversed the district court. The Second Circuit distinguished the Banco Espanol decision and held that the mortgage participations in question were securities under the family resemblance test, and clarified that the Banco Espanol decision was inapplicable to cases involving sales of such instruments to the general public. The Second Circuit's analysis with respect to the four factors of the family resemblance test is especially noteworthy. In considering the first factor, the Court emphasized that so long as the purchaser has an investment motive, the seller's motive is irrelevant. In considering the fourth factor, the Court asserted that the mere existence of another regulatory scheme applicable to the instruments in question (e.g., banking regulations and remedies under state property laws) did not imply that the protections of the federal securities laws were unnecessary.

Following the Banco Espanol and Laid Law Holdings decisions, the SEC has opined that as the convergence of the banking and securities businesses becomes more evident, the Second Circuit decisions may create problems for purchasers of loan and mortgage participations. The principal reason for this position is that if a security is not involved, the SEC is confined by jurisdictional limitations, and the afflicted purchasers would have

61. See Banco Espanol de Credito, 973 F.2d at 56.
62. Id. at 55.
63. See 113 S.Ct. 2992 (1993).
64. 27 F.3d 808 (2d Cir.), cert. denied, 115 S.Ct. 425 (1994).
65. See Laidlaw Holdings, Inc., 27 F.3d at 809-10.
66. Id. at 813-14.
67. Id. at 813.
68. Id. at 814-15. See also Marc I. Steinberg & William E. Kaulbach, The Supreme Court and the Definition of "Security": The "Context" Clause, "Investment Contract" Analysis, and Their Ramifications, 40 VAND. L. REV. 489, 512 (1987) (asserting that because federal banking regulations do not in and of themselves create private rights of action for investors, they are an ineffective substitute for the antifraud provisions of the federal securities laws). Courts are split on the question of whether mortgage interests in particular are securities, and the analysis is largely dependent on the nature of the investors and fraud in particular cases. See Roberts & Quinn, supra note 51, at 2125 and n71 (citing cases).
no right of action under the federal banking laws and would not be able to access the rescission or antifraud provisions of the federal securities laws.\textsuperscript{69} This concern may be compounded upon the observation that, even if the circumstances in a particular case would indicate that certain loan or mortgage participation interests (or even syndicated debt sold in secondary market trading) were securities, application of the federal securities laws to the sale of such instruments by \textit{banking institutions} would nonetheless remain a complicated venture for two reasons. First in part because securities issued by any bank are generally exempt from registration requirements under section 3(a)(2) of the 1933 Act.\textsuperscript{70} Second, certain provisions under the 1934 Act mandate that banking institutions engaged in securities brokerage activities are excluded from the sales practice regulations under the federal securities laws by virtue of their exclusion from the definitions of "broker" and "dealer" therein.\textsuperscript{71} This is further compounded by the fact that federal banking regulators have not yet issued any specific guidance or binding rules for banking institutions on the subject of loan sales to supplement BC-181.\textsuperscript{72} Thus, the SEC is currently involved in efforts to have Congress enact a functional regulation bill to address, among many other issues, loan participation and loan sale issues through statutory revisions.\textsuperscript{73} Nonetheless, the SEC's concerns could easily be met to curb abuses in this respect through rulemaking by the federal banking agencies.

3. \textit{Fraudulent or Negligent Misrepresentations or Omissions in Connection With Formation of the Syndicate.}

The potential liability for fraudulent or negligent misrepresentations or omissions in relation to the solicitation of syndicate members or participating banks is important to both the borrower and, more importantly, the lead lender/managing bank. With respect to the borrower, if the borrower induces the loan through misrepresentations (\textit{e.g.}, as to its financial status), the borrower may be liable for damages in light of rescission of the loan agreement. In practice, such misrepresentations as to the correctness of the information memorandum would be express events of default for the breach of warranty or representation clauses in the loan agreement, discussed \textitinfra. Damages would also be difficult to prove in this instance. Hence, so direct lawsuits against the borrower for misrepresenta-

\textsuperscript{69} See Roberts & Quinn, \textit supra note 51, at 2130.
\textsuperscript{72} Roberts & Quinn, \textit supra note 51, at 2130 and n105 (arguing that although banking regulators have recently issued guidelines and a superseding \textit Interagency Statement regarding the sale of nondeposit investment products by banks to supplement their programs, the guidelines and statement may not compensate for the omission of the securities law safeguards from federal banking laws and regulations).
\textsuperscript{73} \textit Id. at 2131-32.
tions as to the information memorandum are somewhat rare.\textsuperscript{74} With respect to the lead lender/managing bank, potential liability for such misrepresentations, discussed \textit{infra}, are quite serious because if the borrower eventually becomes insolvent because syndicate members or participating banks that enter into the agreement through misrepresentations or omissions by the lead lender will pursue that institution for all of their losses.\textsuperscript{75}

4. \textit{Exclusions from Liability.}

The inherent risks of lender liability involved with arranging a syndicate in connection with the information provided about the borrower guides lead lenders to exclude responsibility for and liability to syndicate members or participating banks which have the ability to obtain, analyze and render judgment on the borrower’s creditworthiness.\textsuperscript{76} Thus, the solicitation materials usually place primary responsibility for the information on the lender in the form of liability disclaimers. These disclaimers generally state that the information has not been independently verified by the manager; that the lead lender is not responsible for such information; and that all institutions receiving the memorandum should make their own independent analysis in deciding whether or not to become a syndicate member or to otherwise participate in the loan and not to rely on the judgment or assessment of the lead lender.\textsuperscript{77} Although such exclusions would in all likelihood not shield the lead lender from liability for \textit{fraudulent} misrepresentations or omissions, the lead lender will normally obtain an agreement of indemnity from the borrower to further protect the lender from misrepresentation liability.\textsuperscript{78}

5. \textit{Liability of Lead Lender For Syndicated Loan Documentation.}

The lead lender usually negotiates the terms of the loan agreement with the borrower and then forwards the draft agreement to the syndicate member counsel for further negotiation and approval. There exists the slight possibility that the loan documentation may be deficient or otherwise legally invalid, but the loan agreement would normally contain liability disclaimers in favor of the lead lender for the adequacy or validity of the loan documentation.\textsuperscript{79} Hence, it is unlikely in practice that the lead lender would be held responsible for such deficiencies unless it effectively acted as the \textit{agent bank for the syndicate} in negotiating the loan, the lead lender affirmatively misrepresented the terms of the loan agreement to syndicate members, or the lead lender had a fiduciary relationship with one or all of the syndicate members as per the terms of the loan agreement or under the particular circumstances of a given co-lending relationship. As these inquiries are largely fact

\textsuperscript{74} Norton, supra note 45, at 6.

\textsuperscript{75} See, e.g., George J. Wade & Randy L. Feuerstein, \textit{The Developing Law of Intercreditor Liability: Loan Participations}, in LENDER LIABILITY AND OTHER COMPLEX LITIGATION INVOLVING FINANCIAL INSTITUTIONS, C781 ALI-ABA 95 (Nov. 12, 1992) (available in WESTLAW).


\textsuperscript{77} Norton, supra note 45, at 11-12.

\textsuperscript{78} \textit{Id.} at 12.

\textsuperscript{79} \textit{Id.} at 13.
dependent, however, the claim must be strong enough to survive the application of liability disclaimers in the loan agreement (which is often not the case).

B. ROLE OF THE AGENT BANK

The final documentation for a syndicated loan facility is arranged and negotiated by the lead lender in agreement with the syndicate members. The typical syndicated loan agreement normally designates the lead lender as agent bank, and sets forth the rights, duties, and obligations of the lead lender and syndicate members in the secured or unsecured loan agreement. The larger and more sophisticated loan syndications, however, may involve separate agency agreements designating the rights and duties of the lead lender as agent bank and syndication agreements specifying the terms and conditions governing syndicate member actions. Although such agreements will normally have provisions similar to those of a typical loan participation agreement, they nonetheless delineate the specific duties and obligations of the agent bank and the direct co-lending arrangement inherent in the syndication.

The syndicated loan agreement should be cautiously drafted to protect both the agent bank and the syndicate members in the origination, closing, workout, and collection of the loan. In particular, the loan agreement or separate agency agreement should fully set forth the relationship between the agent bank and syndicate members, as well as the precise duties and authority of the agent bank. Precise drafting is important because an agent bank with ambiguous, broad or virtually unlimited authority under the terms of the loan agreement may bind the syndicate to additional loans or advances, or otherwise could expose the entire group to liability for its negligent conduct. These potential problems can be mitigated by limiting the agent bank's role to responsibilities that are carefully provided for in the agency or loan agreement. Enormous problems can arise if the agent acts beyond the scope of his duties or authority in relation to corresponding actions with the borrower.

Thus, agency law, and particularly aspects of implied, inherent and apparent authority in relation to agency law, are important concepts when considering the role of the agent in a syndicated loan arrangement. From the borrower's perspective, in times of financial distress and loan workouts, restructurings, or renegotiations, agency law may potentially bind the syndicate to the otherwise unauthorized actions of the agent bank. If the borrower reasonably believes that the agent bank possesses the power to act on behalf of the syndicate, the syndicate may become liable for the agent's actions, even though such actions were unwarranted under the terms of the loan agreement. This would arise principally under the concept of implied authority, which provides that the scope of an agent's authority to bind the principal is ascertained by determining what authority a reasonably

80. Wienke, supra note 3.
prudent person who is familiar with the pertinent business practice might rightfully believe the agent possesses. The law of agency may have varying applications in different jurisdictions. For instance, New York law generally has lenient standards for the duty of a given plaintiff to inquire as to the scope of an agent's authority.

There are several other aspects of the agent's role in syndicated loan and loan participation arrangements which merit recognition. First, the agent bank will expressly disclaim liability for negligence in managing or administering the loan on behalf of the syndicate members. This is because agent banks do not receive much compensation for their agency responsibilities in syndicated lending arrangements, and the risks and potential liabilities are quite disproportionate to the compensation involved. Thus, US courts have generally required unequivocal contractual language in syndicated loan and loan participation agreements to create fiduciary duties between agent banks and syndicate members or participating banks. In this respect, the syndicated loan agreement often states that

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82. For instance, under New York law an agent's authority may be actual or apparent. Actual authority is the result of the principal's consent manifested to the agent. See, e.g., C.E. Towers Co. v. Trinidad & Tobago Airways Corp., 903 F. Supp. 515, 523 (S.D.N.Y. 1995). An agent may be expressly given power to act on behalf of a principal or the authority may be implied. An agent may have implied authority to enter into a transaction when the principal by its own acts reasonably gives the appearance of authority to the agent. See Greene v. Hellman, 51 N.Y.2d 197, 204, 412 N.E.2d 433 N.Y.S.2d 75, 80 (1980). The existence of apparent authority depends on the factual showing that the third party relied upon the misrepresentation of the agent because of some misleading conduct on the part of the principal, rather than the agent. See Ford v. Unity Hosp., 32 N.Y.2d 464, 472-73, 299 N.E.2d 659 N.Y.S.2d 238, 244 (1973); C.E. Towers Co., 903 F. Supp. at 523. It must also be established that the third party reasonably relied on the representations set forth by the agent. See Hallock v. State, 64 N.Y.2d 224, 231, 474 N.E.2d 1178 485 N.Y.S.2d 510, 513, (1984).

83. The Second Circuit has held that the duty to additionally inquire arises when the situation creates circumstances which would lead a reasonable third party to believe that investigation would be necessary. See, e.g., Herbert Constr. Co. v. Continental Ins. Co., 931 F.2d 989, 995-96 (2d Cir. 1989). In this regard, it is only when the transaction is extraordinary or so novel that it should alert the third party to danger of fraud, that under New York law there would be a duty to inquire as to the agent's authority. See, e.g., Whitney v. Citibank N.A., 782 F.2d 1106, 1115-16 (2d Cir. 1986) (absent awareness of facts indicating that an agent is acting beyond its real or apparent authority, a third party is not obligated to investigate the matter further or search for some limitation on that partner's authority). Hence, when analyzing New York state law regarding apparent authority, the Second Circuit has held that unless the circumstances were unusual, thereby putting the third party on notice to inquire further, New York law would not require investigation beyond reliance on the action of the principal and agent. See Herbert Constr. Co., 931 F.2d at 996.

84. Norton, supra note 45, at 18. See, e.g., Colorado State Bank v. FDIC, 671 F. Supp. 706 (D. Colo. 1987) (holding that the language of the loan participation agreement in question unambiguously gave the agent bank the full discretion as to the collection and enforcement of the loan, and that the agreement did not indicate any duty on the part of the agent bank to protect the participating bank's interests).

85. See, e.g., Chemical Bank v. Security Pac. Nat'l Bank, 20 F.3d 375, 377-78 (9th Cir. 1994); Women's Fed. Sav. & Loan Ass'n v. Nevada Nat'l Bank, 811 F.2d 1255, 1258 (9th Cir. 1987). The concept of fiduciary duty among banks in this context is discussed further infra.
the agent bank is not responsible for the enforcement of the agreement, and is liable only for its own gross negligence or wilful misconduct. For instance, the Ninth Circuit Court of Appeals recently held that a lead lender's failure to file a UCC financing statement, resulting in subsequent losses to participating banks when the borrower was declared insolvent because the participated loan was unsecured, did not amount to gross negligence per se under the liability disclaimer in the loan agreement, and left the determination of what conduct constituted gross negligence as a matter for the jury.\textsuperscript{86}

Second, the syndicate members themselves are generally not willing to delegate overly broad discretionary management functions to the agent bank. Thus, the agent bank's functions are normally defined precisely and are narrow in scope.\textsuperscript{87}

\textsuperscript{86} See Chemical Bank, 20 F.3d at 377-78. Several cases involving the FDIC are also illustrative in this regard. First, in disposing of collateral on behalf of the failed institution, however, the receiving agency often does not necessarily keep the best interests of the participating banks in mind, and such banks can find themselves without any security for repayment and unable to assert claims against the receiver in this regard. In American Bank & Trust of Coushatta v. FDIC, 49 F.3d 1064 (5th Cir. 1995), the FDIC was appointed as receiver and liquidator of a failed lead lender, and sold real estate that served as collateral for loan participations for much less than several parties had previously bid on the property in an obvious attempt to favor its own interests over that of the participating banks, who held a subordinated tier of the participated debt. \textit{See id.} at 1065 & n1. The participating banks sued the FDIC, but district court granted summary judgment for the FDIC, premising its ruling on a clause of the loan participation agreements providing that the lead lender would exercise the same care with respect to the loan, and the collateral, if any, as it gives to loans and collateral in which it alone is interested, but it "shall not be liable for any action taken or omitted so long as it has acted in good faith." \textit{Id.} at 1065-66. The court held that the FDIC's actions "may have been negligent, imprudent, or bumbling, but because they were not intentionally malicious, the banks could not state a claim." \textit{Id.} at 1066. On appeal, the Fifth Circuit affirmed, and specifically asserted that above quoted clause did not impose a negligence standard, but rather imposed an anti-discriminatory standard which required the FDIC to treat the participating banks' loans the same as it treated its own loans, but that the FDIC's actions with regard to the ill-faulted sale of collateral was not intentionally malicious or in bad faith. \textit{Id.} at 1068-69. This case was quite similar to one previously considered by the Fifth Circuit in City Nat'l Bank v. United States, 907 F.2d 536 (5th Cir. 1990), where in two participating banks brought suit against the FDIC (as the successor-in-interest to the insolvent lead lender) for breach of contract, breach of the duty of good faith and fair dealing, and gross negligence for the FDIC's conduct in marketing a ranch that constituted collateral for a particular note. The FDIC had allowed the borrower to attempt to sell the ranch over a three-year period, despite evidence that the borrower was making no attempts to sell the property. After the sale of the ranch by the FDIC resulted in little proceeds, the participating banks sued the FDIC for gross negligence. The Court, acknowledging that the FDIC might have taken more efficient action in marketing the collateral, nonetheless failed to find that its conduct demonstrated conscious indifference required for gross negligence under Texas law. \textit{Id.} at 541-42. Notwithstanding these "disposition of collateral" cases, if the FDIC or other federal receiver properly honors loan participation contracts and pays participating banks, however, other creditors may in all likelihood not disturb such payments. \textit{See, e.g.}, \textit{In re Mt. Pleasant Bank & Trust Co.}, 526 N.W.2d 549, 556 (Iowa 1995).

\textsuperscript{87} Norton, \textit{supra} note 45, at 19.
1. **Appointments, Functions, and Removal.**

The syndicated loan and/or agency agreement should designate the agent bank’s duties and responsibilities in administering the loan, and in particular the administration of collateral, the payment and disbursement of loan proceeds, and the degree to which the agent bank can act independently of the syndicate members or other appointed agents. The syndicated loan and/or agency agreement should further delineate whether and under what circumstances the agent bank can be removed and provide mechanisms for the appointment of successor agents. Although the agent bank or the syndicate members would normally be entitled to elect a successor agent bank (unless otherwise designated in the loan or agency agreement), borrowers with strong bargaining positions may be able to place conditions on the replacement or appointment of successor agent banks.

Most importantly, and discussed further infra, the syndicated loan and/or agency agreement should set forth the duties and obligations of the administrative and/or collateral agent banks in administering the loan and either its or their authority to deal unilaterally with the borrower. It is particularly important that the syndicated loan and/or agency agreement specify the extent to which the borrower can rely upon the conduct of the agent bank and the syndicate members would be bound by those actions.

2. **Duties and Loan Administration.**

The general administrative duties of the agent bank will normally include (i) condition precedent duties (i.e., examine the authorizations, official consents, legal opinions, and other documentation furnished as a condition precedent to the advance of the loan to ensure compliance with the requirements of the loan agreement); (ii) acting as representative for the syndicate for the receipt of notices from the borrower for the borrowing of loans, selection of interest periods, prepayments, and to notify the syndicate members; (iii) determining the interest rate on the basis of quotations from reference banks and to certify the rate with the borrower and the banks; (iv) forwarding to syndicate members financial and other information received from the borrower under the loan agreement, and the power to call for proof of compliance and other information so as to monitor the progress of the borrower and its observance of the terms of the loan agreement; and (v) informing the syndicate members of actual or impending events of default of which it becomes

88. The loan agreement should specifically delineate the conditions under which the agent bank may be relieved of further administrative responsibilities and authority for its failure to discharge agent bank obligations in the administration of the loan.
89. Wienke, supra note 3.
90. If the syndicated loan or loan participation agreement does not fully delineate the contractual relationship between the agent bank and syndicate members or participating banks, courts will normally find that the agent bank has sole control over loan management, collection and enforcement despite objections by participating banks to the contrary. See, e.g., Mansura State Bank v. Southwest Nat’l Bank, 549 So.2d 1276 (La. Ct. App. 1989) (contractual relationship between the lead lender and participating bank rendered participating bank without basis for objecting to lead lender’s management of the loan); First Bank of Wakeeney v. People’s State Bank, 758 P.2d 236 (Kan. Ct. App. 1988) (in the absence of negotiated contractual provisions, the lead lender exercises sole control over loan collection and enforcement).
aware, and the power to accelerate the loan on the occurrence of an event of default (often coupled with the duty to accelerate if so instructed by a majority or supermajority of the members).^91

The power of the agent bank to accelerate at its own initiative is largely intended to enable the agent bank to accelerate only in emergency situations, as the bank will normally have time to consult with the syndicate members before accelerating the loan and initiating legal proceedings.^92 The syndicated loan and/or agency agreement should clarify the agent bank's duty or right to accelerate a loan immediately upon the event of default and to enforce the loan obligations by filing foreclosure or other legal proceedings. In general, the agent bank should have broad discretion to enforce loan covenants and to accelerate the loan upon default, but threatening or initiating such actions should require the consent or approval of a majority or supermajority of the syndicate members.^93 Conversely, the loan syndication and/or agency agreement can provide for either majority or supermajority vote of the syndicate members as the requirement to override any enforcement or other action taken or proposed by the agent bank with respect to the loan agreement.^94

As many large syndicated loans from the 1980s went into default, commercial banks sought to increase their influence in loan restructurings and workouts and thus became increasingly frustrated with unilateral actions taken by the lead lenders in the foreclosure and workout strategies. One of the principal issues in this regard was the general belief that lead banks would not aggressively pursue the troubled borrower by filing suit (especially when participating banks believed that the lead lender would not pursue the troubled borrower because such action would jeopardize the borrower's ability to repay other outstanding loans to the lead lender). Conversely, lead banks recognized that participating banks lacking a business relationship with the troubled borrower often wanted to undertake decisive actions that would interfere with its efforts in loan workouts by refusing to

^91. Norton, supra note 45, at 19-20. See, e.g., Clinton Fed. Sav. & Loan Ass'n v. Iowa-Des Moines Nat'l Bank, 391 N.W.2d 712 (Iowa App. 1986); 451 N.W.2d 44 (Iowa App. 1989); 473 N.W.2d 239 (Iowa App. 1991) (ultimately holding that the lead lender breached the terms of the loan participation agreement's requirements regarding notification to the participating bank in the event of a default and that the lead lender was negligent as well). Conversely, agent banks should generally not be given the authority to unilaterally undertake the following activities: (i) the release of collateral or liens; (ii) the extension of the loan maturity; (iii) the modification of repayment terms (of principal or interest on the loan); (iv) the release any guarantors from their agreements; and (v) the approval of any material modifications of the loan documents. Wienke, supra note 3. See, e.g., Penthouse Int'l Ltd. v. Dominion Sav. & Loan Ass'n, 855 F.2d 963 (2d Cir. 1988), cert. denied, 490 U.S. 1005, 109 S.Ct. 1639, 104 L.Ed.2d 154 (1989) (holding that although the loan participation agreement in question allowed the lead lender much discretionary power as to the means and manner of contractual performance of the loan agreement, the lead lender did not have the power to make material changes that made the participating banks less financially secure in their participation; the lead lender did not have the authority to waive or alter material contractual terms in the loan documentation or to discharge the borrower's obligations).

^92. Wood, supra note 45, at 6-21.

^93. Id. at 6-25.

^94. Wienke, supra note 3.
agree to a restructuring or rescheduling of the borrower's debt.95 Thus, the lead bank would be forced to buy out the dissenting participating bank in order to proceed with the workout.96

Several U.S. courts have addressed this situation, in varying contexts.97 For instance, in *Mark Twain Bank v. Continental Bank, N.A.*,98 after the borrower defaulted on payments the lead lender/agent bank requested that a participating bank consent to an extension of time, to which the participating bank refused. At the request of the other participating banks, the agent bank initially sent the borrower a notice of default and declared an acceleration of the loans. This notice was then rescinded after the borrower requested a restructuring of its loans, and the other lenders agreed that this was more desirable and rescinded the notice and entered into a Waiver and Amendment Agreement by which the borrower's term loan and revolving loan payments were deferred. After the deferral periods, the borrower still failed to make any payments. The participating bank sued the agent bank for alleged breach of the loan participation agreement by rescinding the notice of default without its consent or repurchasing its interest in the loan. The participating bank argued that when a default was declared and the loan was accelerated, a new "final maturity" date was established. Therefore, rescinding the notice of default had the effect of extending the final maturity date of the loan without its consent. The court observed that the term "final maturity date" was undefined, and therefore ambiguous. As such, the court disagreed with the participating bank's argument that the final maturity date was synonymous with the term "stated maturity date" located elsewhere in the loan agreement. The agent bank had the contractual right to declare a default, accelerate the loan, and modify the loan agreement without the participating bank's consent, but could not modify the final maturity date without the participating bank's consent.


96. *Id.*


In rendering judgment for the agent bank, the court opined as follows:

[Mark Twain’s (participating bank)] subjective intent that it would not have entered into the Participation Agreement if it did not have the expansive veto power it now claims to have been deprived of is immaterial if it was not disclosed to [Continental bank agent].

The contract language is clear that [Continental] was not required to repurchase [Mark Twain’s] participation interest in lieu of [Mark Twain’s] consent. Even assuming arguendo that [Continental] needed [Mark Twain’s] consent to modify the Credit Agreement and extend the interim loan payments or to change the “final maturity” date as interpreted by [Mark Twain], and chose to do either without [Mark Twain’s] consent, [Continental] was not then required to repurchase [Mark Twain’s] participation interest. Section 11 bestows a “right of repurchase” upon [Continental], not an “obligation to repurchase.” Such language makes a decision by [Continental] to repurchase [Mark Twain’s] participation interest...a purely voluntary one.99

In the present case, [Mark Twain] seeks an interpretation which “arms one bank to take advantage of the forbearance of others.” Its interpretation of Section 11 of the Participation Agreement would allow it to unilaterally force [Continental] to declare [TPI] in default and accelerate the loans, possibly putting [TPI] into bankruptcy. This “veto” power that [Mark Twain] claims it possesses would be extremely detrimental to the Lenders by undermining the very heart of the Credit Agreement. It would be ludicrous for one Participant with a $5 million share of the $85 million loan to be able to jeopardize the interests of the Lenders (of the remaining $80 million) as [Mark Twain] proposes.100

The Seventh Circuit considered a similar situation in First Nat’l Bank of Louisville v. Continental Bank, N.A.,101 wherein five banks entered into a loan agreement in which a US$60 million loan was made to a leasing company. The loan agreement was only for one year, but could be extended on a year-to-year basis if all banks agreed. After the borrower defaulted on the loan, the agent bank decided against calling in the loan. Instead, over the objections of one participating bank, the agent released the borrower’s collateral from the freeze that had gone into effect when the borrower had defaulted and subordinated the collateral to outside lenders so that the borrower could continue in business.102 Several months later, all banks (except for the same objecting participating bank) agreed to amend the terms of the original loan to waive the default and to extend the loan. The participating bank sued the agent bank, claiming that the agent bank and participating banks colluded to breach the loan agreement.

The Seventh Circuit found that there had been a technical breach of the loan agreement when the amendatory agreement was entered into without the participating bank’s consent, but that the breach caused no damages to the dissenting participating bank. The Court found that the agent bank was not required to declare a default and call the loan

99. Id. at 799-801.
100. Id. at 802 (emphasis added).
101. 933 F.2d 466 (7th Cir. 1991).
102. Id. at 468.
without a majority consent. Further, since the agent bank controlled the collateral, the participating bank could not collect on its note on the borrower's default. Thus, the participating bank was subject to majority rule. More importantly, however, the Court observed that the participating bank's argument would place it at an unfair advantage over the other banks involved in the loan arrangement:

The banks that had financed five-sixths of the loan thought it in their best interests not to call the loan, despite the borrower's default. Given that decision, it was in [First National's participating bank] interest to play dog in the manger, since while [Prime] obviously could not have paid back the entire loan...it might well have been able to turn over assets worth $10 million, had [Continental bank agent] not controlled the assets. But that depletion of [Prime's] assets might have jeopardized its survival, to the prejudice of the remaining lenders. Had [First National] called its loan, this might well have precipitated [Prime] into bankruptcy, in which event all the banks would probably have been losers. [First National] didn't want to take that chance. It is asking for an interpretation of the agreement that not only lacks textual support, but also arms one bank to take advantage of the forbearance of others.

Thus, if the agent bank's unilateral actions regarding the borrower would result in maintaining the borrower's solvency, notwithstanding the objections of syndicate members or participating banks, courts will likely be more favorable to uphold the agent bank's unilateral decisions in this regard.

The above cases demonstrate that borrower distress or insolvency often results in situations not originally anticipated by loan syndication or participation agreements. The agent bank may exercise its discretion unilaterally to the perceived detriment of a particular dissenting syndicate member or participating bank. At the inception of the loan facility, borrowers generally are reluctant to engage in discussions regarding their potential insolvency in the loan documentation, notwithstanding the obligatory default provisions. Lead banks and/or agent banks engaging in the syndication or participation of interests in the loan generally proclaim the positive aspects of the borrower, and avoid drawing attention to the insolvency ramifications of the loan transaction.

Many syndicated loan agreements fail to fully address the rights and duties of the agent bank and syndicate members if the loan becomes troubled and the process in which workout or restructuring negotiations may be conducted. The syndicated loan agreement should recognize and address these and other potential gaps in the agreement.

In addition, the syndicated loan agreement should specify the extent to which the agent bank or other syndicate members may enforce the agreement in the event of agent

103. Id. at 469-70.
104. Id. at 470.
105. Lead lenders and agent banks similarly avoid addressing the ramifications of their own potential insolvencies in the syndication or participation agreements. Moreover, bank officials and other persons responsible for originating the transaction are usually not the same persons who would be involved in a workout or restructuring of the loan, and may not consider the issues related to insolvency to be of particular importance. See David L. Eaton, Trouble With the Syndicate: Avoiding Disputes Over Syndicated Loan Documents and Participation Agreements in Insolvency, Lender Liability News, at 13 (1995).
106. Wienke, supra note 3.
or syndicate member default in loan workouts and restructurings. These agreements typically provide that only the agent bank can enforce the syndicate members' remedies, either in its own discretion or at the direction of an agreed upon percentage of the members. The agreements typically do not, however, address the fact that although only the agent bank can enforce the syndicate members' remedies, each lender has its own claim under the agreement.\textsuperscript{107} Thus, syndicated loan agreements should recognize that, notwithstanding the enforcement powers of the agent bank, each syndicate member has divided rights (i.e., that each bank has separate right of payment and can be considered a separate creditor holding a separate claim under the particular insolvency statute.\textsuperscript{108}

3. \textit{Payment and Disbursement of the Loan.}

The syndicated loan and/or agency agreement should delineate the scope of the agent bank's authority to approve loan advances and further state the conditions on the funding of loan advances. The agreement should also provide the circumstances under which the approval of the syndicate members may be required, and the extent to which the agent bank or other syndicate members may act unilaterally in this regard.\textsuperscript{109} It should be noted that the agent bank is the agent of the syndicate members and not of the borrower.\textsuperscript{110} Thus, unless clearly provided for in the syndicated loan agreement, the agent bank is not responsible for the default of a syndicate member for its failure to lend; and payments by the syndicate members to the agent bank for disbursement to the borrower will not discharge the members from their lending commitments if the agent bank becomes insolvent and does not distribute the funds to the borrower.\textsuperscript{111} Finally, the loan agreement should state whether defaulting syndicate member interests can be purchased by the agent bank after a default and, if so, set forth the terms for the payment of the purchase price and the funding obligations of the other members in the event of such a payment or default.\textsuperscript{112}

4. \textit{Payment of Fees and Expenses.}

The syndicated loan and/or agency agreement should indicate the extent to which the agent bank is entitled to be compensated for its services through administrative fees and expenses, and should authorize the agent bank to be fully reimbursed for all legal or consulting costs incurred in the origination, underwriting, closing, and enforcement of the loan facility. In addition to fees for administering the loan, the agent bank may be compensated through a retained yield between the interest rates paid by the borrower to the agent bank and the interest rate paid by the agent bank to the syndicate members. Finally, there are closing, restructuring and other facility-related fees which can be paid to the agent bank that or may not be shared with the syndicate members.\textsuperscript{113}

\begin{itemize}
  \item \textsuperscript{107} See Eaton, \textit{supra} note 105, at 12.
  \item \textsuperscript{109} Wienke, \textit{supra} note 3.
  \item \textsuperscript{110} Norton, \textit{supra} note 45, at 21.
  \item \textsuperscript{111} \textit{Id.} at 21.
  \item \textsuperscript{112} Wienke, \textit{supra} note 3.
  \item \textsuperscript{113} \textit{Id.}
\end{itemize}
5. **Conflicts of Interest.**

As a fiduciary, the agent bank is subject to the general rules applicable to fiduciaries. These include, among other things, the avoidance of conflicts of interest with the syndicate members; the inability of the agent bank to make "secret profits" from the agency arrangement; and the due diligence in the exercise of its powers and duties.114 The syndicated loan agreement should also address whether the agent bank can provide loans or other financial accommodations to the borrower, and the extent to which such loans may or may not be subordinated to the syndicate members' interests in the loan facility.115 Although syndicate members will tend to restrict other lending by the agent bank to avoid conflicts of interest, the agent bank will desire to preserve its right to provide other financings and financial accommodations to the borrower. Hence, agent banks and syndicate members may have competing interests in this regard, and a clear compromise should be established prior to closing the loan agreement.116

C. **RELATIONSHIP BETWEEN SYNDICATE MEMBERS**

1. **Severality and Lending Commitments.**

Syndicated loan agreements normally provide that each syndicate member will make loans up to its specified commitment during the commitment period. The syndicate members make the loan proceeds available to the agent bank, which then distributes them to the borrower. The duties owed to the agent bank by syndicate members include the payment of relevant administrative fees and the notification and reporting of any payments or receipts from the borrower.

The obligations of syndicate members to meet their loan commitments to the borrower are several and not joint. If one of the syndicate members cannot meet its lending obligations, the other members will not underwrite or guarantee to the borrower that the member will meet its obligations or otherwise remain solvent.117 If a syndicate member fails to lend, the agent bank generally can (as per the terms of the loan agreement) solicit other available banks to undertake the commitment and other obligations of the defaulting bank. The failure of a syndicate member to advance loan disbursements as per its lending commitment is generally delineated as an event resulting in intercreditor default and can result in suit by the borrower against the syndicate member or participating

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116. Ethical considerations also abound in loan participation arrangements which must be considered. See, e.g., E. Carolan Berkley, *Multiple Lender / Multiple Borrower Transactions Including Ethical Considerations*, in *PRACTICING LAW INSTITUTE, COMMERCIAL LAW & PRACTICE COURSE HANDBOOK SERIES, ASSET-BASED FINANCING INCLUDING SECURITIZATION AND ACQUISITION FINANCING IN 1994*, PLI Order No. A4-4447, 681 PLI/Comm 191 (Jan. 20-21, 1994), available on WESTLAW.

If the agent bank cannot find a substitute lender, it may assume the commitment itself to protect its reputation to prospective clients in the syndicated loan markets and sue the defaulting bank for damages or costs incurred, or let the borrower pursue a claim for damages incurred against that member. In addition, the rights of syndicate members under the syndicated loan agreement are normally expressed to be divided rights (owed to each individual member). The existence of divided rights emphasizes that separate loans are owed to each individual member, so as to avoid joinder of member actions and to enhance the individual members' rights to setoff against the borrower in the event of payment default or insolvency (as members may not be able to setoff a loan due to it against a deposit if the member owns the loan in undivided shares with the other banks).\textsuperscript{119}

2. *Syndicate Democracy.*

Syndicated loan agreements normally require the unanimous consent of the syndicate members for the amendment or waiver of important provisions in the agreement, but different voting majorities can be used for waivers of covenants and/or other provisions in the agreement. For instance, although the unanimous vote of syndicate members may be required for the waiver of a sharing provision, a simple majority or a two-thirds majority of syndicate members may be sufficient for a waiver of negative pledge clauses (discussed \textit{infra}).

There are situations where the majority of syndicate members can normally bind the minority members. For instance, provisions governing decision-making in relation to unexpected events affecting the entire syndicate can recognize the majority vote of syndicate members as sufficient. Syndicated loan agreements may also contain provisions that enable the majority of syndicate members to (i) agree on a formula for the recalculation of interest rates following default; (ii) preempt negotiations with the borrower following default; (iii) require the prior written consent of a majority of syndicate members for consideration of an amendment to the loan agreement; (iv) direct the agent bank to initiate actions on behalf of the syndicate members that limit the agent bank's discretion; (v) waive breaches of covenants or consents to the relaxation of covenants (such as the negative pledge clause, discussed \textit{infra}); (vi) determining whether or not an incorrect representation or an adverse change in the borrower's financial condition is material for purposes of events of default; and (vii) direct the agent bank to accelerate the loan following an event of default.\textsuperscript{120}

The majority vote may not be sufficient, however, for amendments to the loan agreement such as waiver of the conditions precedent to the advance of loans (so each member can unilaterally suspend its obligations to advance new money if a condition precedent is not met); and the power to reschedule loans or restructure the loan payments, interest

\textsuperscript{118} See, e.g., Penthouse Int'l Ltd. v. Dominion Fed. Sav. & Loan Ass'n, 855 F.2d 963 (2d Cir. 1988), cert. denied, 490 U.S. 1005, 106 S.Ct. 1639, 104 L.Ed.2d 154 (1989) (borrower sued participating bank that refused to fund its portion of a loan after the lead lender waived certain pre-closing conditions as to the loan agreement (although the original claims were brought by the borrower, the case ultimately involved issues regarding the duties owed by a lead lender to participating banks).

\textsuperscript{119} Norton, \textit{supra} note 45, at 14.

\textsuperscript{120} Id. at 15.
rate, principal due, or to change the currency of repayment. Finally, unanimous vote is normally required for the ratification of changes in the principal amount of the loan commitment of each creditor, interest payable, amortization dates and amounts of repayments. Majority vote, however, is normally sufficient to amend or waive a provision not otherwise subject to unanimity, such as events of default, including nonpayment, and inaccuracies in representations and warranties.

3. **Pro-Rata Sharing Provisions.**

In syndicated loan arrangements, the borrower makes payments to the agent bank, which then distributes them pro rata to the syndicate members. The borrower is discharged after paying the agent bank even if the agent bank fails to distribute the loan proceeds pro rata to the syndicate members. Hence, the syndicate members generally assume the risk of the agent bank's insolvency. Conversely, if the agent bank distributes payments to the syndicate members without having received the funds from the borrower, the syndicate members will normally be required under the loan agreement to refund those payments back to the agent bank with accrued interest. This "clawback" provision is intended to address the risk that the agent bank may distribute payments to the syndicate members prior to ensuring that it has received corresponding cleared funds from the borrower (normally accomplished by wire transfer). This is especially important with respect to international syndicated loan agreements, where the foreign borrower must pay in US dollars to accounts held in New York or London by a particular time on a particular day of the payment month.

In times of financial distress, the borrower may be pressured to make preferential payments to particular syndicate members and avoid making payments to other members. Concerns of such preferential payments are addressed by so-called sharing provisions, which reinforce these syndicate democracy concerns to some degree. Sharing provisions stipulate that in the event any individual syndicate member is paid more than its pro rata share, such member must pay the excess difference to the agent bank, who then redistributes the excess to syndicate members pro rata. The paying member is then subrogated to the claims of the other members who are paid. The sharing provision is also designed to ensure syndicate equality by the sharing of more indirect individual receipts of one syndicate member to the expense of other members. For instance, syndicate members or participating banks may attempt to obtain disproportionate payments from the borrower by

121. *Id.* at 16.


124. *Id.* at 17.
exercising a bank lien, setoff, attachment, counterclaim, litigation judgments, guarantees, or any disproportionate payments of principal or interest on advances owed to syndicate members by the borrower or by the guarantor. Sharing provisions thus discourage unilateral action by individual syndicate members because, upon receipt of direct or indirect payments, the member would only have to share the proceeds. Sharing provisions are also important in sovereign borrowings, because loan agreements for such borrowings lack mandatory pari passu (discussed infra) treatment of creditors in situations of "state insolvency" and no fraudulent preference doctrine exists for such borrowers. Finally, the sharing provisions may be drafted to exclude ancillary matters such as judgment proceeds received by a bank which individually sues the borrower (thus rewarding the diligent syndicate members) and receipts from a third party guarantor. In sovereign restructuring loans, payments in local currency and transactions comprising debt-equity swaps may be excluded (so as to allow banks to convert defaulted debt of an "insolvent" state into equity participations in local companies).

a. Sharing Mechanisms

There are two general types of mechanisms in sharing clauses: sharing through an agency arrangement and sharing through the purchase of participations. In sharing through an agency arrangement, a syndicate member that receives more than its pro rata share of any payments must inform the agent bank of such receipts. The agent bank then calculates and determines the minimum amount due to that member and then apportions the rest pro rata among the other members. This approach places the administrative

125. In this respect, the clause may allow for "double-dipping." For instance, a bank has $150 on deposit from the borrower and $100 on loan to the borrower. If the borrower defaults, the bank sets off against the deposit, leaving $50 of the deposit intact. Since the bank has now received $100 more than other syndicate members, it must pay $100 to the agent for distribution to all the banks pro rata. This payment comes from the bank's own funds. Hence, it acquires additional debt from the other banks by subrogation to the extent of the payments made to them. Thus, the borrower remains indebted to that bank which then sets off the remaining $50 of the deposit. This itself gives rise to a new duty to pay the other banks. The process continues until the entire deposit is used up, so the effect is as if the deposit had been charged to secure the participations of all other banks. See Wood, supra note 45, at 6-16.

126. See Derek Asiedu-Akrofi, Sustaining Lender Commitment to Sovereign Debtors, 30 COLUM. J. TRANSNAT'L L. 1, 10 & n35 (1992). Sharing provisions may also provide for exceptions to the general duty to share certain payments, including payments received through the agent bank, proceeds from suits to enforce sharing clause obligations against the agent bank or syndicate members, and payments resulting from legislation or regulation which makes the continuation of the transaction illegal, and debt-to-equity conversions, forfeiting transactions (involving the discounting of medium-term promissory notes and/or drafts related to an international transaction), and prepayments pursuant to on lending (when lenders and the original borrower agree that the proceeds of a new money loan will be transferred from the original borrower to a new obligor who will assume responsibility for repayment) and relending (where the lender lends the proceeds of borrower repayment to other borrowers in the original borrower's country) arrangements. See Asiedu-Akrofi, supra, at 10 and n37-39.

127. Wood, supra note 45, at 6-16.

128. Id. at 6-17.
responsibility upon the agent bank to collect, determine, and calculate each member's pro rata share of payments and to keep records of all transactions. In sharing through the purchase of participations, a syndicate member that receives more than its pro rata share of any payments is required to purchase participations in the principal of, or interest on, the unpaid advances of the other members. The sharing member receives a certificate of participation through which the receiving member assigns part of an outstanding loan to the sharing member. This mechanism imposes an administrative responsibility upon the agent bank to maintain records of all transactions of participations sold.129

b. Mandatory Prepayment Clauses

Mandatory prepayment clauses in syndicated loan agreements can mitigate the potential for sharing clauses to be circumvented. These clauses generally require that whenever a creditor is prepaid, the borrower must prepay the other creditors pro rata. The absence of pro rata payments to other creditors could be the basis for invoking the sharing provisions, as such payments may be considered disproportionate payments of principal or interest, or other than of principal or interest on advances.130

4. Private Borrowers and Insolvency Reorganization Plans.

If a borrower fails to meet its debt-servicing obligations and loan restructuring becomes necessary, individual syndicate members may choose not to participate in the restructuring of the borrower's debts and may not be forced by the syndicate majority to so participate unless the syndicated loan agreement provides otherwise. Syndicated loan agreements typically provide that most amendments can be implemented by either a majority or supermajority of the syndicate members, but that the unanimous vote of all members is required for matters relating to the financial terms of the loan, or the agent's role in administering the loan.131 The agreements do not often recognize, however, that insolvency reorganization plans authorized under certain national insolvency statutes, such as under the US Bankruptcy Code, may amend or preempt some or all of these provisions.132 Thus, the syndicated loan agreement should include provisions that, notwith-

129. See Asiedu-Akrofi, supra note 126, at 10-11. Although these sharing mechanisms exist to address instances of errors in payment, they may also provide sanctions against the failure or refusal by a syndicate member to share any disproportionate payments it receives. These sanctions include the loss of entitlement to receive and share in payments, loss of the right to sell participations to other banks, and loss of interest on sharing payments in default at the highest applicable interest rate. In addition, the other syndicate members can bring legal proceedings against the defaulting bank for breach of contract. This arises from the undertaking by syndicate members to specifically avoid undermining the obligations imposed by the covenants in the loan agreement. Id. at 11 and n40 (explaining the importance of sharing clauses in events and circumstances surrounding the Argentine government's prohibition of payments to British banks and subsequent discriminatory payments to non-British banks within the same syndicates).

130. See Asiedu-Akrofi, supra note 126, at 12.

131. These would include, e.g., the release of collateral; deferral of principal or interest; change in amount of principal or rate of interest; release of guarantor; and changing agent authority. See Eaton, supra note 105, at 12.

132. Id. at 12.
standing the fact that unanimous vote is required for given amendments, each syndicate member is entitled to vote as it desires on any reorganization plan that affects the loan.\textsuperscript{133} Further, the agreement should contemplate the appointment of an advisory committee by a selected percentage of the syndicate after default, as both an advisor to the borrower and a check and balance (or support) for the agent bank’s exercise of its discretionary powers. Finally, the syndicate member or participating bank, by virtue of the broad definition of “claim” against a debtor contained in the US Bankruptcy Code,\textsuperscript{134} may assert that it is the actual owner of a claim against the borrower and thus should be entitled to vote its interest in connection with the borrower reorganization plan and otherwise be considered a party-in-interest entitled to be heard on issues in the bankruptcy or insolvency proceedings.\textsuperscript{135} With particular emphasis on loan participation agreements, such agreements should address bankruptcy and reorganization voting issues, with the effect of leaving the power to vote for reorganization plans with the lead lender after transfer of the participation interest. In addition, the lead lender should consider whether participating bank consent is required, to ensure that the participating bank’s consent is not required for the voting of its interest in connection with a reorganization plan.\textsuperscript{136}

D. SYNDICATE PROTECTION CLAUSES

Most syndicated loan agreements include standard clauses to protect lenders from default risk, credit subordination, and failures of syndicate democracy. These clauses are contained in loan covenants, specifically designated events of default, choice of law clauses, and representations and warranties clauses.

\textsuperscript{133} In the US, these provisions should be supplemented by acknowledgements that each syndicate member recognizes that the provisions of 11 USC s. 1126(c) (stating the standards for acceptance of a plan by a class of claims) supersedes the unanimous vote provisions of the syndicated loan agreement. \textit{Id.} at 12-13. Moreover, the syndicated loan agreement should address the syndicate’s consent to a borrower’s use of cash collateral, which can be viewed as a release of collateral otherwise requiring unanimous consent under the loan agreement. The loan agreement may also consider distinguishing between the voluntary release of collateral by banks prior to acceleration or the borrower’s insolvency, with allowing use of cash collateral in the bankruptcy context, which could require less than unanimous consent. \textit{Id.} at 13.


\textsuperscript{135} See Eaton, supra note 105, at 13-14 (\textit{citing} 11 U.S.C. §. 1109(b); Bankruptcy Rule 3003(d) (providing a procedure for the beneficial owner of a claim to assert the right to be treated as the record holder of the claim)). The issue of whether the lead lender or participating bank is entitled to vote all or a portion of the claim against the debtor is important in determining whether certain requirements for class acceptance of a reorganization plan has been met within the scope of the Code. See 11 U.S.C. §. 1126(c). This is because the existence of multiple participating banks that are allowed to vote on a reorganization plan could make it much more difficult for a debtor or syndicate group to be assured that a majority of the bank group’s claims accept the reorganization plan. Eaton, supra, at 14.

\textsuperscript{136} \textit{Id.} at 14.
1. **Covenants.**

The syndicate obviously has a financial interest in the preservation of the borrower's capital, and therefore should be entitled to invoke certain checks and balances on borrower management to protect their interests. As the syndicate does not have the opportunity to vote for management, loan covenants represent these checks and balances. The breach of loan covenants result in an events of default, the possibility of which tends to encourage compliance by the borrower. The breadth of loan covenants will depend on the degree of risk undertaken by the syndicate; the nature of the borrower (e.g., public vs private sector); and whether the loan is secured or unsecured. The most important covenants in syndicated loan agreements include the pari passu clause, the negative pledge clause, the restrictions on disposals of assets clause, and financial covenants.

a. **Pari Passu Clause**

The *pari passu* clause prevents the borrower from assuming new debts which subordinate the interests of the syndicate members. This clause is designed to ensure the equal ranking of unsecured claims on liquidation of assets to unsecured creditors on the borrower's insolvency. For example, if the syndicated loan in question represents senior unsecured debt, the pari passu clause would likely state that "this loan is a direct, unsecured and unconditional obligation of the borrower and will rank pari passu with all other unsecured obligations of the borrower." The pari passu clause does not require concurrent or equal payment prior to that time, and does not restrict guaranteed loans or setoffs. The remedy for breach of this clause is purely an event of default, but is ineffective if the borrower is already subject to insolvency proceedings as the clause cannot be extended to affect secured borrowing.

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137. The loan covenants have various forms, with several common purposes that overlap to some extent with other clauses discussed infra. First, covenants serve to protect the equal ranking of claims against assets on the borrower's insolvency and to prevent subordination. Second, covenants preserve asset quality and thus protect the earnings potential of the borrower and the liquidation value of the assets. Third, this covenants can preserve asset quantity and solvency, and thus control the assumption of excessive liabilities. Fourth, covenants can be used to evaluate the liquid assets from which debt obligations can be serviced without resort to selling capital assets on which a borrower's earnings power is based. Wood, *supra* note 45, at 3-6. Finally, covenants can be used to preserve the type of business being financed, to control excessive growth that cannot be sustained by financial resources and management, and to enable the syndicate to monitor the condition of the borrower and the terms of the loan. *Id.* at 3-7.

138. *Id.* at 3-5.

139. *Id.*

140. *Id.*

141. *Id.* at 3-27.

142. *Id.* at 3-28.
b. **Negative Pledge Clause.**

The negative pledge clause is the most important covenant in the typical syndicated loan agreement. This clause will generally state that "whilst this loan is outstanding the borrower will not create or permit to subsist any mortgage charge, pledge, lien, or any other encumbrance whatsoever on its assets or revenue." Hence, in unsecured private sector borrowings, this covenant serves a dual function. The clause prohibits the creation of liens, encumbrances, mortgages, or other preferential arrangements regarding the assets of the borrower unless the borrower creates the same in favor of the lender. In doing so, it further ensures parity of treatment among creditors, thereby preventing a subordination of claims to those of other creditors. Moreover, in secured corporate borrowings, it prevents problems caused by subsequent secured lenders. Finally, in sovereign borrowings, it can be used to restrict attempted controls on the allocation of foreign reserves to another creditor.

The negative pledge clause should be drafted to apply existing and future security so as to encompass security granted prior to the syndicated loan facility. The clause should cover all forms of security, including mortgages, liens, charges, and pledges, and to security by subsidiaries and governmental entities of the borrower (e.g., to prevent a holding company borrower from arranging for its subsidiaries to charge their assets as collateral security for an unsecured borrowing by the holding company).

In syndicated loans secured by collateral, notwithstanding the existence of subordination agreements to the contrary, the negative pledge clause should be drafted to prevent (i) the availability of second-ranking security, or second mortgages in secured loans, because such mortgages are restrictive of management of a default or restructuring (junior creditors interfering with senior creditor recommendations); (ii) the potential for such creditors to have independent rights of enforcement and act in a manner that does not foster syndicate democracy; and (iii) junior creditors from gaining priority over fixed charged creditors.

Potential Limitations on the scope of the negative pledge clause include the recognition that the clause is not in and of itself security, does not restrict other transac-

143. See Russell, *supra* note 96, at 398-400 (discussing negative pledge clause).
144. Wood, *supra* note 45, at 3-12. Exclusions to the broad scope of this clause may include security with majority syndicate consent, liens arising by operation of law (trade debt or mechanics liens), security if the bank is equally and ratably secured on the same or equivalent assets (leading to loss of control to the other creditor), existing security on assets of after-acquired subsidiaries (enabling the borrower to acquire a company that has existing security), security on after-acquired assets to secure financing to acquire assets (allowing the borrower to purchase new assets and mortgage them for the price); security over goods, bills of lading, and insurance (ordinary course of trading activities); security over investment securities required by exchanges or clearinghouses in connection with trading on the exchange or transfers of securities; and security over claims to which there would be a right of setoff between the claim and the secured debt in the absence of such security. *Id.* at 3-17 to 3-20.
145. With sovereign borrowers, the covenant is generally limited to external indebtedness, which may be defined as debt which is payable in or calculated by reference to any foreign currency or owning to non-residents. This limitation is normally acceptable to banks since sovereign borrowers are not disposed to charge their assets to secure domestic obligations. *Id.* at 3-20.
146. *Id.* at 3-16.
147. *Id.* at 3-21.
tions having a similar effect of security (e.g., vendor/lessor title finance), and only results in an event of default, while the third party may gain secured status despite the existence of the clause.148

Hence, as the pari passu clause addresses unsecured indebtedness, the negative pledge clause addresses secured indebtedness. Thus, these two clauses protect lenders whether the borrower is sovereign or corporate, and they ensure equal ranking and prevent subordination and discrimination.

c. Restrictions on Disposals of Assets Clause.

The restrictions on disposals clause provides that the borrower not dispose of all or a substantial part of its respective assets. This clause is included to (i) prevent so-called "asset-stripping" of the borrower (e.g., a sale of the borrower's assets on credit to an associated company so that the productive assets of the borrower are converted into a claim on a worthless shell entity); (ii) prevent changes in the borrower's business; (iii) restrict large disposals of productive assets by the borrower to pay other creditors if the borrower is in financial distress; and (iv) to preclude the evasion of the negative pledge clause by quasi-security title finance arrangements, including sale-leaseback transactions and the factoring of receivables.149 Restrictions on disposals clauses may also address intra-group disposals, where the borrowing company disposes of assets to a subsidiary which subordinates the syndicate's claims even as the claims are still within the corporate group because the claim is against the parent company, not the subsidiary.150

d. Financial Covenants.

Financial covenants are more precise tests of the borrower's financial condition and represent "hair triggers" for default, in contrast to (for example) the more ambiguous "material adverse change" warranties or events of default. These covenants generally measure the liquidity, solvency, and capital adequacy of the borrower. There are four primary types of financial covenants used in international syndicated loan agreements. First is the minimum net worth covenant, defined to be paid-up share capital (plus subordinated loans) and consolidated reserves, less intangible assets such as goodwill, less cumulated

148. Id. at 3-22. Loan agreements can provide that if the borrower creates security in violation of the agreement, the syndicate is automatically deemed to be equally and ratably secured on the same asset that was mortgaged to the other creditor. This type of automatic security clause may fail, however, unless extended to after-acquired security and covered by compliance with notice filing requirements such as under the Uniform Commercial Code. In addition, many jurisdictions avoid security for pre-existing debt if granted close to the borrower's insolvency and if the debtor was insolvent at the time of granting such security as a preference. Id. at 3-24 to 3-26.

149. Id. at 3-29. Events which may be excluded from the clause include disposals with majority syndicate consent; disposals in the ordinary course of business; disposals for consideration in cash payable immediately; disposals of listed securities held for investment purposes, obsolete assets replaced by equivalent assets, and disposals of cash for the purpose for which such cash was raised. Id. at 3-31.

150. Id. at 3-30.
losses, revaluations, and deferred taxes. Second is the leverage ratio, defined as the ratio of total liabilities to tangible net worth. These ratios are both measures of borrower solvency.\textsuperscript{151} Third is the interest cover ratio, defined as the ratio of operating profit (net pre-tax group profit) to borrowing costs (interest and other costs of financial debt). This is a measure of liquidity and serves as a control on borrowings. Fourth is the dividend limitation covenant, which generally limits dividends and other corporate distributions to that of interest payable and consolidated after-tax profits.\textsuperscript{152} These financial covenants, and others not mentioned herein, can be applied on a continuous basis and accompanied by timely auditor checks, and should be subject to generally accepted accounting principles (GAAP).\textsuperscript{153}

2. Events of Default.

Events of default have four general effects as per the terms of the syndicated loan agreement. These include the right to accelerate the outstanding loan; the right to cancel future obligations to provide further loans; the right to suspend further loans under the "conditions precedent" clause; and recognition of the fact that an event of default may constitute a default under other loan agreements of the borrower through the cross-default clause, discussed \textit{infra}.\textsuperscript{154} Events of default can be (i) actual (nonpayment on the due date, at the required place, in the required currency, in the required funds); (ii) the result of noncompliance with warranties, representations, or covenants (often with designated grace periods within which the default can be cured); and/or (iii) anticipatory (insolvency of the borrower).\textsuperscript{155} The most far-reaching anticipatory event of default is the cross-default clause.

a. Cross-Default Clause.

The cross-default clause generally provides that if the borrower defaults on another loan or debt obligation, such default will trigger the cross-default clause and thus constitute a default in the syndicated loan agreement. This clause gives syndicate members the ability to be included in other debt restructuring negotiations, as it has the remedy of acceleration given that a default has occurred. It also limits preferential payments to other creditors since each creditor can also accelerate on the loan and basically stop the business. Thus, the cross-default clause has a stabilizing effect upon a borrower in distress: since all creditors with such a clause in their credit agreements can accelerate, none of them will accelerate because this would result in the borrower's insolvency.\textsuperscript{156} Limitations that borrowers may negotiate for the cross-default clause include limiting the debt to borrowings

\textsuperscript{151} The author notes that particular attention should be given to unrealized off-balance sheet activities, such as hedging programs and other OTC derivatives activities.

\textsuperscript{152} \textit{Id.} at 3-32.

\textsuperscript{153} \textit{Id.} at 3-33.

\textsuperscript{154} \textit{Id.} at 3-37.

\textsuperscript{155} \textit{Id.} at 3-38.

\textsuperscript{156} \textit{Id.} at 3-42.
and guarantees of borrowings (excluding such items as trade debt), pre-determined threshold amounts or to external debts (debts payable to foreign creditors in foreign currencies (common in sovereign loans)); and limiting the scope of defaults to actual accelerations of other loans, not the mere occurrence of a pending default (e.g., breach of warranties or covenants).157

b. Other Events of Default

There are many other events of default that can be included in the syndicated loan agreement. The more commonly listed events of default include the onset of liquidation and insolvency proceedings,158 “material adverse changes” in the borrower’s financial conditions (inherently) vague and subjective, thus easily argued by the syndicate as a means of leverage on the borrower),159 changes of control of the borrower (through the use of so-called “poison pills,” in order to prevent the manipulation of assets or assumption of huge borrowings to effectuate a takeover),160 and the inclusion of subsidiaries and guarantors in appropriate events of default because the default of a subsidiary can imply that the parent is in trouble).161 In addition, with regard to sovereign syndicated loan agreements, events of default should further include the initiation of rescheduling or restructuring programs for sovereign debt; foreign exchange controls; material adverse changes tailored to the activities of the particular government in question; central bank defaults on other debt obligations; the withdrawal from IMF membership or disregard or separation for IMF economic stabilization plans; the suspension of payments under a standby or non-observance of performance criteria in a standby; and the failure to properly disclose information related to sovereign credit ratings.

3. Choice of Law Clause.

In most jurisdictions, parties to a syndicated loan agreement may choose the governing law for all or part of the loan agreement provisions. The choice of law may be the law of the borrower’s jurisdiction, the law of the creditor’s jurisdiction, a neutral system of law, or that of a particular judicial district.162 The end result is that in the United States and

157. Id. at 3-43 to 3-44.
158. Id. at 3-46 to 3-47.
159. Id. at 3-48 to 3-49.
160. Id. at 3-50.
161. Id. at 3-51.
162. Id. at 5-1. The common factors that influence the choice of law for a syndicated loan agreement include non-legal preferences (familiarity, convenience); avoidance by the lender of a detailed investigation into a foreign legal system; commercial orientation, stability and predictability of a particular system; the ability to use lawyers having special experience in particular types of agreements; ease of language; and insulation from adverse legal changes in the borrower’s country (legislation, moratorium on foreign obligations; exchange controls; requirements that repayment must be made in the local custodian; limits on interest rates in times of sovereign financial distress). Id. at 5-3-5-4.
England, the lending syndicate can have complete certainty in knowing that the borrower's country cannot unilaterally alter its obligations by changes in local law. This certainty may not be absolute, however, for several reasons: (i) there may be no external assets capable of attachment to satisfy a judgment against the borrower; (ii) subsequent exchange controls in the borrower's country may achieve international recognition under Article VIII(2)(b) of the IMF Articles of Agreement and the loan agreement could potentially constitute an “exchange contract” under those provisions; and most importantly (iii) local insolvency proceedings will be governed by local insolvency laws, which tend to override choice of law clauses in financial agreements.

163. In member states of the European Union, most conflicts of laws rules in contracts are governed by the 1980 EC Rome Convention on the Law Applicable to Contractual Obligations (implemented in the United Kingdom by the Contracts Act of 1990). Article 3(1) of the Rome Convention expressly provides for freedom of choice of laws in contracts, so long as the choice is expressed with reasonable certainty by the terms of the contract. Id. at 5-9. Article 3(2) of the Rome Convention allows the parties to choose an applicable law either at the time the contract is concluded or at an earlier time, which effectively allows the parties to amend a previously designated choice of law. Id. at 5-12. Although article 3(3) of the Convention provides that where the parties have chosen a particular foreign law but all the other elements relevant to the transaction are connected with another country, the express choice within the contract shall not prejudice the rules or policies of another country, the provision is intended to prevent the use of an artificial applicable law to avoid mandatory rules of states and has limited effect on the overall choice of law analysis. Id. at 5-13.

164. Id. at 5-5.

165. Article VII, paragraph 2(b) of the Bretton Woods Agreement provides that: Exchange contracts which involve the currency of any Member and which are contrary to the exchange control regulations of that Member maintained or imposed consistently with the Agreement shall be unenforceable in the territories of any Member. This provision is designed to ensure that the exchange control regulations which have been enacted in a Member State of the Bretton Woods Agreement and in accordance with the Agreement will also be observed in all other Member States. At least one US court has opined that in essence, paragraph 2(b) is an “internationally imposed act of state doctrine.” See, e.g., Callejo v. Bancomer, S.A., 764 F.2d 1101, 1120 n27 (5th Cir. 1985).


167. Wood, supra note 45, at 5-6.
In the United States, many states have applied various types of “most significant contacts” tests to determine whether the parties’ choice of law would be honored.\textsuperscript{168} The states having particularly significant international commercial and financial transactions, however, have enacted specific choice of law statutes that modify the “most significant contacts” approach. For example, in 1984 the New York General Obligations Law was amended to enable parties to choose New York law for transactions in excess of US$250,000 regardless of the relationship of the parties or the contract to the state of New York.\textsuperscript{169}

Choice of law clauses should be distinguished from forum selection clauses. Most syndicated loan agreements contain express forum selection clauses so that the rationale upon which courts exercise jurisdiction is of less relevance. The primary purpose of such clauses is to provide an additional forum outside of the borrower’s country as an option for the enforcement and the adjudication of disputes related to the loan agreement.\textsuperscript{170} Although choice of law and jurisdiction are theoretically separate concepts, the forum selected should follow the choice of law in order to confer greater predictability in the expected result from litigation.\textsuperscript{171} The use of choice of law and forum selection clauses together limits the uncertainty inherent in large syndicated loan agreements where all parties concerned may potentially be exposed to a multiplicity of actions in many countries, and to so-called “forum shopping” whereby the lender or holder of the syndicated loan or participation interest brings suit in a jurisdiction most favorable to its position and disadvantageous to the borrower.\textsuperscript{172} In practice, the agent bank’s view on choice of law generally prevails for the reason that in most financial contracts there would not be a factual dispute or complex factual or legal issue, but merely that of nonpayment.\textsuperscript{173} In the United States, the state of New York has enacted specific forum selection statutes governing the applicability of forum selection clauses. In particular, section 5-1402 of the New York General Obligations Law provides that if a contract with a foreign party choosing New York law involves at least US$1 million, the choice of a New York forum for the adjudica-

\textsuperscript{168} See, e.g., Bank of America Nat’l Trust & Sav. Ass’n v. Envases Venezolanos, S.A. et al., 740 F.Supp. 260, 264 (S.D.N.Y. 1990) (observing that prior to the passage of the New York choice of law statute, New York courts had held that “while the parties’ choice of law is to be given considerable weight, the law of the jurisdiction with the ‘most significant contacts’ is to be applied,” (citing cases)), aff’d, 923 F.2d 843 (2d Cir. 1991). The issue could be further complicated if 12 U.S.C. § 632 could be invoked. Section 632 is a jurisdictional provision that grants federal district courts original jurisdiction in actions involving disputes over international banking where one of the parties is a corporation organized under the laws of the United States, and actions whose federal court jurisdiction are based on section 632 are deemed to have arisen under the laws of the United States and could subject the analysis to federal, rather than state, choice of law rules. Bank of America Nat’l Trust & Sav. Ass’n, 740 F. Supp. at 265. However, where the action is based upon diversity jurisdiction, and the parties expressly indicate a choice of law in the contract or agreement in dispute, New York courts will in all likelihood invoke the forum state’s choice of law rules rather than federal common law rules. See id. at 265 and n2. Thus, with the passage of section 5-1401, discussed infra in the text, the complications presented by 12 U.S.C. § 632 are probably illusory.


\textsuperscript{170} Wood, supra note 45, at 5-26.

\textsuperscript{171} Id. at 5-28.

\textsuperscript{172} Id. at 5-36.

\textsuperscript{173} Id.
tion of disputes under the contract must be given effect. This statute largely overrides the ability of international parties to argue for dismissal of the suit under the doctrine of forum non conveniens. The forum selection statute has been applied in the direct context of an international syndicated loan agreement in recognition of the public policy behind the enactment of the statute. Even so, the forum selection clause must be drafted with finality to have the desired binding effect. If the forum selection clause is unquestionably permissive in scope, the doctrine of forum non conveniens may still be invoked to the detriment of the syndicate.

175. In New York, the forum non conveniens statute, CPLR 327, was expressly amended by the passage of the forum selection statute, and new subsection (b) now provides: (b) Notwithstanding the provisions of subdivision (a) of this rule, the court shall not stay or dismiss any action on the ground of inconvenient forum, where the action arises out of or relates to a contract, agreement or undertaking to which section 5-1402 of the general obligations law applies, and the parties to the contract have agreed that the law of this state shall govern their rights and duties in whole or in part.
177. For instance, in Credit Francais, the forum selection clause, while identifying jurisdictions in which suit “may” be brought, thus implying a permissive clause, was nonetheless supplemented with “finality” language such as the borrower’s “irrevocable consent” to suit in those designated forums at the agent bank’s election and the borrower’s waiver of forum non conveniens. See Credit Francais, 490 N.Y.S.2d at 674. Accord Cambridge Nutrition A.G. v. Fotheringham, 840 F. Supp. 299, 301-02 (S.D.N.Y. 1994).
178. For instance, in Proyecfin de Venezuela, S.A. v. Banco Industrial de Venezuela, S.A., 760 F.2d 390 (2d Cir. 1985) (Proyecfin I) the Second Circuit recognized the forum selection clause as permissive in its language (“may be brought”), and “left open the possibility that an action could be brought in any forum where jurisdiction can be obtained either inside or outside of Venezuela.” Id. at 396. Permissive forum selection clauses are not at all comparable to the clause addressed in the leading U.S. Supreme Court case on this point, Bremen v. Zapata Offshore Co., 407 U.S. 1, 92 S.Ct. 1907, 32 L.Ed.2d 513 (1972), wherein the governing contract stated that “[a]ny dispute arising must be treated before the London Court of Justice.” Id. at 2, 92 S.Ct. at 1909. In interpreting this provision, the Supreme Court concluded that “the forum clause should control absent a strong showing that it should be set aside,” see id. at 15, 92 S.Ct. at 1916, unless the party seeking to escape application of the clause “could clearly show that [its] enforcement would be unreasonable and unjust, or that the clause was invalid for such reasons as fraud or overreaching.” Id. In considering the case for a second time, the Second Circuit in Proyecfin II held that use of such a permissive forum selection clause, notwithstanding would not preclude the forum non conveniens analysis. See Blanco v. Banco Industrial de Venezuela, S.A., 997 F.2d 974, 979-80 (2d Cir. 1993) (Proyecfin II).
4. **Representations and Warranties.**

International banking practitioners generally distinguish between legal and commercial warranties. Legal warranties address the legal validity of the syndication agreement, while commercial warranties address the borrower's financial condition or creditworthiness. These clauses are important because they establish the contractual basis for which the loan is made and are investigatory in practice (and thus tend to unveil potential problems). An express event of default occurs if a warranty is incorrect, which gives the bank bargaining power to address the problem such as the suspend subsequent drawdowns under the conditions precedent clause. Warranties are often expressed to remain continuous in effect so that the borrower takes the risk of future legal changes (e.g., exchange controls, embargoes, changes in bankruptcy or secured transactions law affecting priority or collateral). By using warranties, the syndicate can also effectively provide for a material adverse change in the borrower's financial condition as an event of default. Materiality and group tests can be used in commercial warranties, and are useful in instances of potential default despite their inherent vagueness. In addition to setting forth the borrower's representations and warranties, the loan syndication agreement should set forth any particular representations and warranties that the agent banks and syndicate members make in connection with the underwriting and administration of the loan facility.

5. **Arbitration Clauses.**

Arbitration as a method of settling financial disputes is not generally favored for use in creditor-borrower disputes in international syndicated loan agreements. Commercial lenders normally desire to ensure the certainty of predictable judicial interpretation of

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179. These would include, but not be limited to, the legal status of the borrower; the powers of the borrower; the authorizations of the borrower; that all necessary consents to the performance of the borrower's obligations have been obtained (e.g., exchange control consents with sovereign borrowers); that the loan agreement does not conflict with the laws, constitution, or contracts of the borrower's jurisdiction; the legal validity and enforceability of the borrower's obligations; the pari passu ranking of loans with other unsecured debt; with secured loans, title to secured assets, priority of security, validity on insolvency and against third parties, and non-revocability as a bankruptcy preference; that the information memorandum is materially correct and not materially misleading through material misrepresentations or omissions, and that the repayment projections are reasonably based. See Wood, supra note 45, at 3-1 to 3-2.

180. These would include, but not be limited to, disclosure of material ongoing litigation; validity of borrower's accounts and financial condition; that no material adverse changes have occurred since the last reported accounts; and no material defaults on contracts or other debt. See Wood, supra note 45, at 3-1 to 3-2.

181. *Id.* at 3-4.

182. *Id.*

183. With regard to loan participation agreements, these provisions should establish that the syndicate members are entitled to examine all loan documentation and to establish compliance with Comptroller of the Currency (OCC) Banking Circular No. 181, discussed supra note 30, the loan agreement should state that the syndicate members warrant that they have entered into the loan agreement based on their own independent analysis of the borrower's creditworthiness and independent review of the underwriting decisions. Wienke, *supra* note 3.
syndicated loan agreement provisions in somewhat neutral forums, such as New York or London.\textsuperscript{184} The anti-arbitration attitude among international commercial banks is related to lender-borrower disputes, such as with regard to events of default, as opposed to intercreditor disputes between agent banks and syndicate members. In the context of intercreditor disputes in syndicated loan arrangements, arbitration may be a much more practical approach to resolving such disputes than resorting to expensive, time consuming litigation.

6. \textit{Termination and Acquisition of Title in Real Estate Syndications.}

The syndicated loan agreement should address the terms and conditions under which the agreement is subject to termination. In addition, when secured syndicated loan facilities involving real estate or other assets as collateral are terminated, the agreement should delineate the means by which the syndicate members acquire title to the assets and the degree to which the agent bank may continue to bind the syndicate members in the sale and disposition of the collateral.\textsuperscript{185} Finally, the agreement should anticipate potential lender environmental liability concerns, particularly in the U.S., given (i) the risk that real estate collateral may decrease in value as a result of pre-existing contamination or contamination arising during the life of the loan; (ii) the potential impact of such liabilities on the borrower’s financial stability; (iii) the potential subordination of security interests in the real estate under government legislation, such as the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), as amended by the Superfund Amendments and Reauthorization Act of 1986 (SARA); and (iv) potential for direct lender liability under CERCLA and state environmental statutes.\textsuperscript{186}

E. \textbf{LOAN TRANSFERS: ASSIGNMENTS AND SUB-PARTICIPATIONS OF LOAN INTERESTS}

The syndicated loan agreement should consider whether the syndicate members may grant participation interests in the loan to other third-party lenders or investors, or otherwise directly assign such interests in syndicated loan. There are four primary means of secondary participation in loans: assignment, subparticipation, novation,\textsuperscript{187} and risk par-

\textsuperscript{184} See Wood, supra note 45, at 5-57.
\textsuperscript{185} Wienke, supra note 3.
\textsuperscript{187} In novations, the lead lender, the participating bank, and the borrower agree or consent to novate a portion of the loan agreement to the participating bank. Wood, supra note 45, at 7-29. In essence, the participating bank is substituted for the rights and obligations of the lead lender according to the participating bank’s share and the lead lender is released from its appropriate share of those obligations. The participating bank thus becomes a new party to the syndicated loan agreement, and obtains both the rights and obligations of the lead lender, and the lead lender is repaid out of the new loan by the participating bank. Id. at 7-28. The advantage inherent in a novation is that continuing obligations of a lead lender (to make new advances or to indemnify the agent) are transferred to the participating bank and the lead lender is released from its obligations to underwrite the participating bank’s lending commitment if the participating bank fails to lend. Id. at 7-30.
Secondary participation by assignment and subparticipation are the most common methods.

1. Assignment.

In assignments of loan interests, the lead lender assigns a portion of the loan to the participating bank. The transfer could be effected by declaration of assignment coupled with a trust or a simple transfer of loan proceeds. As assignee, the participating bank normally acquires direct rights against the borrower under the loan agreement and thus has the benefit of the entire loan agreement. The loan agreement may set forth conditions precedent assignments and address whether or not the assignor-syndicate member will be released from its loan obligations. In particular, the loan agreement may limit assignments of the loans to qualified institutional investors in order to ensure that assignees have the requisite sophistication and net worth necessary to participate in the lending syndicate. Multinational corporate borrowers may negotiate restrictions limiting the extent to which assignments may be undertaken and whether or not assignee institutions can become syndicate members. Moreover, large syndicated loan arrangements may grant the agent bank the right of first refusal to acquire any portion of the loan that has been proposed for assignment. Syndicated loan agreements may also require the borrower's consent before a syndicate member can assign all or part of its interest to another party. The borrower's consent may not be required, however, if events such as payment default or acceleration occur. Assignments create important legal issues for considera-

188. In risk participations, the participating bank guarantees part of the loan owed by the borrower to the lead lender. See Wood, supra note 45, at 7-2. The distinguishing factor with risk participations is that the participating bank does not provide funding to the lead lender, but merely assumes the risk of default. Id. at 7-35. As a partial guarantee, this transaction requires analysis of the guaranty law of the particular jurisdiction. The participating bank acquires none of the rights and benefits under the loan agreement until subrogated. Id. at 7-36. Risk participations are generally inadvisable if the loan agreement contains a pro rata sharing clause which applies to payments of the lead lender's participation from any source, notwithstanding the borrower. In this instance, the lead lender would have to share payments received under the guarantee with the other syndicate members. Thus, the impact of the pro rata sharing clause may cause the participating bank to guarantee the entire syndicate. Id. at 7-35.

189. Wienke, supra note 3. Under New York law, a true assignment occurs only where the assignor retains no control over the funds, no authority to collect and no power to revoke. See, e.g., Miller v. Wells Fargo Bank Int'l Corp., 540 F.2d 548 (2d Cir. 1976); NatWest USA Credit Corp. v. ALCO Standard Corp. et al., 858 F.Supp. 401, 413-14 (S.D.N.Y. 1994). Contracts with prohibitions on assignment, however, are acceptable but must have particularized language to that effect. See, e.g., Allhusen v. Caristo Constr. Corp., 303 N.Y. 446, 103 N.E.2d 891 (1952).

190. Wood, supra note 45, at 7-7.

191. The agent bank and syndicate members may also be given "co-sale rights" in proposed assignments, under which the proposed assignor may be required to provide the other members with a right to participate in the sale through a sale of their pro rata interest in the loan.

192. Conversely, borrower consent is generally not required for a syndicate member's sale of loan participation interests. See Eaton, supra note 105, at 13.

193. Id. at 13.
As the syndicated loan market developed in the early 1980s, secondary participations by way of direct assignments were the preferred choice among commercial banks because borrower cooperation in such assignments during the more speculative US M & A, LBO and real estate lending in this period gave commercial banks greater flexibility to facilitate such business. As higher quality credit facilities now dominate the syndicated loan markets, it is now becoming on average more difficult to obtain the borrower's consent to permit unlimited assignment rights because highly rated borrowers generally want to know who their lenders are and desire smaller lending groups. Hence, creditworthy borrowers tend to negotiate restrictions on the assignability of their loans, which may in turn lead to increased...


196. There are many US cases which have mainly been concerned with setoff by borrowers against the insolvent lead lender, the effectiveness of which is dependent upon whether the participation was intended to be an assignment or trust of part of the loan, or was intended to be a sub-participation which did not give the participating bank a proprietary interest in the loan to the borrower. In most of these cases, poor documentation resulted in many ad-hoc decisions by courts based on the particular circumstances of the case in question. For a thorough analysis of assignment and characterization of the loan participation interest in this regard, see Norton & Olive, supra note 49, at § 21.03[2]. For the early framework decisions, see, e.g., In re Yale Express System, Inc, 245 F. Supp. 790 (S.D.N.Y. 1965) (holding that a participating bank had no right to setoff the borrower's deposits since there was no direct debtor/creditor relationship between the borrower and the participating bank; in the absence of such a relationship, there is no right to setoff, particularly where the participation agreement itself did not establish the existence of any debtor/creditor relationship between the participating bank and the borrower); FDIC v. Mademoiselle of California, 379 F.2d 660 (9th Cir. 1967) (borrower could setoff debt owed by insolvent lead lender against participating bank who acquired proprietary interest in a loan); Stratford Fin. Corp. v. Finex Corp., 367 F.2d 569 (2d Cir. 1966); In re Alda Commercial Corp., 327 F. Supp. 1315 (S.D.N.Y. 1971). Following these decisions, the troubled oil and gas loans of the 1980s emphasized that participating banks have no direct access to the borrower for the collection of loan obligations or to the borrower's collateral bank accounts to setoff accounts against delinquent loans. Hence, participating banks are normally forced to assume the role of unsecured creditors under the loan participation agreement against an insolvent lead lender. This exact situation occurred in the Penn Square Bank crisis, where the lead lender became insolvent after selling participations in oil and gas loans to many leading banks, which had a domino effect upon many participating banks. See, e.g., Hibernia Nat'l Bank v. FDIC, 733 F.2d 1403 (10th Cir. 1984) (Penn Square case involving borrower setoff on insolvency of lead lender); Chase Manhattan N.A. v. FDIC, 554 F. Supp. 261 (W.D. Okla. 1983); Seattle-First Nat'l Bank v. FDIC, 619 F. Supp. 1351 (W.D. Okla. 1985) (holding that participating banks must bear the market risk of their participations and that loan participating banks are further responsible for investigating the creditworthiness of both the lead lender and the borrower); Northern Trust Co. v. FDIC, 619 F.Supp. 1340 (W.D. Okla. 1985) (same).
secondary participations through loan participation arrangements.\textsuperscript{197} Thus, highly-rated as borrowers tend to negotiate anti-assignment clauses in the syndicated loan agreement and normally waive its rights to setoff in this regard, these issues in practice largely arise in the context of less creditworthy borrowers in syndicated loan arrangements.\textsuperscript{198}

2. Subparticipations.

In subparticipations, the lead lender agrees to pay the participating bank amounts equal to the participating bank's share of payments received by the lead lender from the borrower. In particular, the participating bank normally places a deposit with the lead lender in the amount of its participation; the lead lender agrees to pay the participating bank amounts equal to the participating bank's share of the receipts by the lead lender from the borrower when and if received.\textsuperscript{199} Absent provisions to the contrary, payments to the participating bank are normally conditional on the lead lender receiving corresponding amounts from the borrower. The lead lender does not assign or declare a trust of any part of the original loan in favor of the participating bank. The effect of the transaction is that the participating bank is merely a creditor of the lead lender and not the borrower, and if the lead lender becomes insolvent, the participating bank becomes an unsecured creditor of the lead lender and has no direct claim against the borrower\textsuperscript{200} because it is not an assignee.\textsuperscript{201} Thus, the participating bank assumes the risk of the borrower defaulting and the lead lender becoming insolvent, and has no right of recourse against the lead lender.\textsuperscript{202} The debtor-creditor relationship between lead lender and participating bank may change, however, where the subparticipation transactions are structured so as to give the participating bank an interest in the collateral securing the loan.

3. Loan Participations and Characterization of Lead Lender-Participating Bank Relationship.

The participating bank's decision to invest in a given loan transaction is ordinarily influenced upon its determination of (i) the creditworthiness of the borrower; (ii) the quality of

\textsuperscript{197} Wienke, supra note 3.

\textsuperscript{198} For a summary of the principles concerning assignment and setoff, see Wood, supra note 45, at 7-6 to 7-17.

\textsuperscript{199} Id. at 7-18.

\textsuperscript{200} See Norton & Olive, supra note 49, at 21-17 to 21-18; Ten Mile Indus. Park v. Western Plains Serv. Corp., 810 F.2d 1518, 1525 (10th Cir. 1987) (participating banks acquire no rights against borrowers); Simms v. Biondo, 816 F. Supp. 814, 824-26 (E.D.N.Y. 1993); Mason & Dixon Lines, Inc. v. First Nat'l Bank of Boston, 86 Bankr. 476, 478-79 (N.D.N.C. 1988), aff'd, 883 F.2d 2 (4th Cir. 1989). Interests in the collateral and guarantees on the loan are not generally transferred to the participating bank, which instead gains these benefits indirectly as the proceeds of a guarantee or foreclosed security received by the lead lender should result in its obligation to pay the participating bank proportionately.

\textsuperscript{201} The participating bank is not a direct creditor to the borrower, so there normally exists no right to setoff between borrower and participating bank.

the collateral; (iii) the terms of the underlying loan; (iv) the financial terms of the proposed participation arrangement; (v) the recommendation of the transaction by the lead lender; and (vi) the experience and stability of the lead lender. The courts and regulators have made it clear that participating banks cannot rely on the credit analysis of the lead lender. However, the benefits of the indirect loan participation agreements versus direct syndicated loan arrangements are subject to some confusion because syndicated loan agreements normally do not provide the syndicate members with direct access to the borrower and its collateral, current reporting information, and other related information. This uncertainty has been buttressed by insolvency cases involving loan participations, as many participating banks have encountered loan workout negotiations, foreclosures, and bankruptcy proceedings as a result of purchasing participation interests in speculative loans through subparticipation-type transactions. Participating banks can incur substantial problems if the lead lender becomes insolvent. For instance, U.S. receivers for insolvent banking institutions/lead lenders will often argue that participating banks are merely general unsecured creditors of the lead lender, rather than owners of interests in the loans themselves, thus allowing them to subordinate the interests of participating banks. Following recent US cases, lead lender insolvency problems can be mitigated or eliminated by specifically providing in the loan participation agreement that the loan participation arose by virtue of an "absolute sale" of the loan and that the lead lender holds the participating banks' interest in the loan as a trustee. As the U.S. cases indicate, the characterization of the lead lender-participating bank relationship as one involving a trust arrangement, even where the loan participation agreement contains language that the lead lender "shall be a trustee for the benefit of and accountable" to the participating bank, is still a risky proposition.

203. *See In re Woodson Co.*, 813 F.2d 266, 271 (9th Cir. 1987).
In the context of borrower financial distress, particularly when coupled with lead lender insolvency, loan participation agreements raise certain complex issues distinct from those in syndicated loan agreements as participating banks sue lead lenders in attempts to recover their participated funds. These issues focus on the proper characterization of the lead lender-participating bank relationship in connection with loosely worded loan participation agreements. The issue is of primary importance to loan participations when the lead lender itself becomes insolvent, and the participating bank asserts that its loan participation interest is vested with some badge of ownership interest in the underlying loan or collateral, so as to avoid being unsecured in the ensuing bankruptcy proceedings.

a. Non-Mortgage Loan Participations.

Courts and legal scholars have debated as to the correct characterization of the relationship between the lead lender and the participating banks in times of borrower or lead lender insolvency. This relationship determines the nature of the participating bank's interest in the loan and the underlying collateral. The minority position treats the participation interest as a mere loan by the participating bank to the lead lender. According to this view, the participating bank has an ownership interest only in collections of the loan proceeds, and will share pro rata in all borrower payments of principal or interest. The majority view, however, characterizes the participation interest as a transfer of ownership interest in the loan and collateral to the participating bank. Under the majority view, the participating bank has an ownership or trust interest in the loan and underlying collat-
eral, not just in the collections from the loan. Courts that follow the majority position have recognized, however, that some loan participation transactions more closely resemble debtor-creditor arrangements, or disguised loans, rather than sales of true participation interests. In the context of non-mortgage loan participations, the issue is one of drafting and documentation. U.S. courts in the non-mortgage loan participation context have generally held that loan participation transactions transfer ownership interests in the underlying loan and collateral when and if the factors surrounding the transaction and related documentation are consistent with the characterization of the transaction as a sale or assignment.

Complex facts will often confuse the analysis of this issue. For instance, at least one court has addressed whether participating banks have rights against third parties beyond the scope of the loan participation agreement in an action by participating bank against third-party defendants for conversion of non-real estate collateral securing an interest in the loan participations. In First Nat'l Bank of Belleville v. Clay-Hensley Commission Co., a participating bank alleged that it had an interest in a promissory note and farm product collateral security in a loan by virtue of having become a participating bank in the loan, and that its action for conversion of farm product collateral against third-party defendants should not have been dismissed. The loan participation agreement resolved to the agent

213. See, e.g., Batesville Inst. v. Kauffman, 85 US 151, 154, 21 L.Ed.775 (1873) ("If a part only of the debt is assigned, a pro tanto portion of the security follows it."); Franklin, 683 F.2d at 128 n9; Jefferson Sav. & Loan Ass'n v. Lifetime Sav. & Loan Ass'n, 396 F.2d 21, 24 (5th Cir. 1968); In re Drexel Burnham Lambert Group, Inc., 113 Bankr. 830, 842-44 (Bankr. S.D.N.Y. 1990) ("The lead bank, by participating the loan, assigns, transfers, and conveys an undivided ownership interest in the collateral for the participated loan to the participant...Accordingly, the loan participants are entitled to their shares as beneficiaries of a trust."); NatWest USA Credit Corp. v. ALCO Standard Corp. et al., 858 F. Supp. 401, 407-08 (S.D.N.Y. 1994) (asserting that the participating bank, by purchasing a participation interest in the lead lender's loans to the borrower, obtains the benefits of the lender's security interest and priority of payment); Asset Restructuring Fund, L.P. v. RTC, 886 S.W.2d 548, 551 (Tex.App.-Austin 1994, no writ); Northern Bank v. FDIC, 496 N.W.2d 459 (Neb. 1993); Mark E. MacDonald, Loan Participations As Enforceable Property Rights in Bankruptcy — A Reply to the Trustee's Attack, 53 AM. BANKR. L.J. 35, 38-43 & n13 (1979); David B. Simpson, Loan Participations: Pitfalls For Participants, 31 BUS. LAW. 1977 (1976); Peter F. Coogan, Homer Kripke, and Frederic Weiss, The Outer Frings of Article 9: Security Interests in Money and Deposits, Negative Pledge Clauses, and Participation Agreements, 79 HARV. L. REV. 229, 271 (1965).


215. See, e.g., Asset Restructuring Fund, L.P., 886 S.W.2d at 552-53. In addition, as few cases have dealt with the characterization issue after the collateral underlying the transaction has already been foreclosed upon, the limited view is that the participating bank holds equitable title and thus some sort of ownership interest in the former collateral, and thus the proceeds of that collateral under "after acquired" security clauses in the loan agreement or possibly under the provisions of Article 9 of the Uniform Commercial Code, in amounts equal to the extent to which the bank had funded the loan. See, e.g., Jefferson Sav. & Loan Ass'n, 396 F.2d at 24; Asset Restructuring Fund, L.P., 886 S.W.2d at 554. No court has yet determined the precise type of interest a participating bank has in the underlying foreclosed upon collateral of a loan participation transaction. See Asset Restructuring Fund, L.P., 886 S.W.2d at 554 n5.

bank all loan servicing decisions and required that it "use the same degree of care and diligence that a bank would be expected to use in servicing a loan made on its own account; and if, having used such degree of diligence, a loss should occur" the agent bank would not be responsible for such loss.\textsuperscript{217} The analysis required whether an interest in the collateral securing a loan automatically inures to a participant bank, and whether a participant bank has a right of action under the loan participation agreement against anyone other than the lead bank. The court recognized that authorities were split on the question of whether a participating bank has legal rights arising out of the loan participation agreement against any parties other than the lead lender.\textsuperscript{218}

The situation can be reversed, however, if the FDIC or other U.S. federal agency becomes receiver for the participating bank and the lead lender becomes insolvent as well. For instance, in \textit{Bernard v. Fireside Commercial Life Ins. Co.},\textsuperscript{219} the FDIC filed a petition for intervention in ongoing litigation as receiver for a failed bank that purchased a "participation interest" in an existing loan from an insurance company that had itself become insolvent. The FDIC argued that the transaction between the insurance company and partici-

\begin{footnotesize}
\begin{enumerate}
\item \textit{Id.} at 218.
\item \textit{See, e.g., Franklin v. Commissioners of Internal Revenue, 683 F.2d 125, 128 (5th Cir. 1982) (terms of participation agreement govern participation relationship); cf. Jeffery Hutchins, \textit{What Exactly is a Loan Participation?}, 9 RUT.-CAM. L.J. 447, 474 (1978) (participation should not be viewed as an assignment of proceeds only); First State Bank v. Towboat Chippewa, 402 F. Supp. 27, 33 (N.D.Ill. 1975) (although the relations among lead lenders and participating banks are governed by a participation agreement or certificate, in practice the purchaser of a loan participation buys an undivided share of the loan made by the lead and an undivided share of the collateral which secures the loan). The appellate court dismissed the participating bank's claim, finding that the bank did not have a security interest in the collateral. The court, however, did intimate that "in many instances the terms of the participation agreement do not fully define the relationship between the lead lender and participating banks. The court adopted the following reasoning in this regard: [Whatever] the provisions of the participation agreement, if the loan is indeed a participation and not a joint undertaking whereby several parties advance funds directly to the borrower and take in return either directly or through an agent bank notes payable to each and individual portions of security, then one party-the lead-advances all funds, takes back all applicable notes and security, and in circumstances where filing is in order files as the only secured party. In the participation case the lead is the only secured party, and so far as the participated loan is concerned [the] lead is the only party empowered to collect it since [the] lead is the only party to whom it is owed. The participants can look only to their lead for satisfaction of claims arising out of the transaction; they are not themselves creditors of the borrower and so cannot assert creditor claims against the borrower. This is not to say that participants cannot enter into separate side contracts with the borrower providing for rights to set-off and the like... This review suggests that the participant's partial and undivided interest in the borrower's note and underlying collateral represents its security for a loan it really makes to the lead, not for the participation it purchases in the lead's loan to the borrower. For this reason, the participant can look only to the lead for payment and cannot assert a claim against the borrower since in fact the participant is not legally related to the borrower at all. \textit{See First Nat'l Bank of Belleville, 525 N.E.2d at 221-22}. Hence, the Court held that the loan participation agreement did not assign or otherwise grant an interest in the collateral to the participating bank, and that the bank had no interest in or right to possession of the collateral, and its conversion action was dismissed. \textit{Id.} at 222.
\item 633 So.2d 177 (La.Ct.App. 1993).
\end{enumerate}
\end{footnotesize}
The participating bank was a loan to the insurance company, rather than a sale of participation interest, so that the participating bank would be relegated to the status of an unsecured creditor without a claim to any specific funds. The court observed that, in connection with the sale of the participation interest, the insurance company attached a letter to the participating bank that it "...unconditionally and absolutely agrees to repurchase...in whole or in part, that certain loan participation certificate..." The court agreed with the trial court in that the transaction constituted a loan rather than a sale in large part because the insurance company unconditionally agreed to repurchase the loan participation interest.

b. Mortgage Participations.

Lead lender insolvencies can be particularly complicated in connection with secondary mortgage market transactions, where mortgage participations are frequently sold between lenders and other investors. In response to these complications, the U.S. Congress enacted section 541(d) of the US Bankruptcy Code. The purpose behind section 541(d) is to protect the secondary mortgage market where the mortgage seller retains legal title of the documents only in order to service the mortgage notes. Section 541(d) is a codification of the law in many states, including that of New York, which exempts secondary mortgage market participants from compliance with State recording laws regarding perfection of the interests of assignment purchasers. Pursuant to section 541(d), courts have the authority to recognize the division of legal and equitable interests in and to the mortgages, provided that the transaction is a true mortgage participation. The bankruptcy trustee will hold the property (i.e. the note and deed) subject to the outstanding and superior equitable interests of the beneficiaries. As a result, the notes and their proceeds will be held in trust for the purchasers of participation interests. Section 541(d) applies only to parties who are found to be actual participants in the secondary mortgage market. If the transactions are more properly deemed as loans rather than purchases of participation interests, the participating banks would not have perfected assignments of

220. Bernard, 633 So.2d at 186.
221. Id. at 187. Cf. Savings Bank of Rockland County v. FDIC, 668 F. Supp. 799, 804-08 (S.D.N.Y. 1987) (holding that although non-binding authority weighs in favor of finding that the participation transaction was a loan in accordance with the FDIC's position, and against determining that the transaction at issue here was a purchase and sale, on equitable grounds a distribution from the receivership estate in priority to the general creditors would be awarded). In particular, the court opined that: The [participation] agreement must clearly indicate that the lead bank is under no obligation whatsoever to repurchase the participation interest from the participating bank. The Comptroller of the Currency has consistently taken the position that loan participation involving national banks subject to any formal or informal repurchase agreement are not true participations, but are actually extensions of credit by the participating bank to the lead banks. Id. at 186 (emphasis added).
222. Section 541(d) provides in pertinent part: Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a) of this section only to the extent of the debtor's legal title to such property, but not the extent of any equitable interest in such property that the debt does not hold. U.S.C. §. 541(d).
223. See, e.g., In re Sprint Mortgage Bankers Corp., 164 Bankr. 224, 228 (bankr. S.D.N.Y. 1994).
the mortgages, since the interests in the original notes normally would not be perfected by possession pursuant to state law. Therefore, participating banks would only be unsecured creditors of the selling bank's, and would share in a distribution of the estate on a pro rata basis, along with other similarly situated investors.224

Hence, in the mortgage participation context, in order to best preserve the bankrupt estate, the bankruptcy trustee would attempt to keep the remaining assets of the insolvent lead lender (or selling bank) within the estate by arguing that the participating banks simply made loans to the lead lender, and thus attempt to characterize the lead lender-participating bank relationship as purely one of debtor-creditor.225 Conversely, the participating banks would argue that it purchased mortgage loan participation interests and therefore have fractional ownership or trust interests in the notes and deeds of trust securing the real estate collateral for the loans.

Whether the notes and deeds of trust are assets of the given bankrupt estate would depend largely on the proper characterization of the transaction. The participating bank would claim that section 541(d) of the Bankruptcy Code applied to the transaction, and argue that the lead lender or selling entity at most holds legal title to the real estate collateral, and that the participating banks hold equitable title to property which is excluded from the bankrupt estate. The issue of whether the participating banks hold equitable title would therefore turn on whether they would be owners of loan participation interests or merely lenders. If the relationship is merely one of debtor-creditor, then section 541(d) would not apply. The determination of whether participating banks own fractional interests in the notes and mortgages underlying the participations or whether they are part of the insolvent lead lender's estate is very important not only to the participating banks, but also to the future administration of the bankrupt estate and the rights of general creditors.

A typical mortgage participation transaction involves a lead lender which retains some interest in the transaction, possession of the note, and the power to foreclose on the

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224. Id. at 228.
225. This situation is quite similar to the arguments that would be posed by a government agency which places the lead lender into receivership and assumes control over its assets. In the event of the FDIC or other governmental entity being appointed as liquidator or receiver and stepping into the insolvent lead lender or borrower contracts, such entities have every interest in seeking to avoid or reduce the participating bank's interests so as to increase the value of the failed institution for future sale or reorganization. Thus, participating banks in all likelihood would have difficulty in seeking to establish setoff or other direct access rights to the borrower's collateral. This is especially so if the FDIC or other government agency becomes receiver for the insolvent lead lender, because the FDIC or a receiver for the insolvent institution may be entitled to characterize the participating bank's interest in the loan participation as an unsecured loan to the lead, as opposed to an undivided interest in the loan to the borrower, thus precluding the participating bank's rights to the collateral. On the other hand, if the transaction is treated as an actual "sale," the participating bank could share in recoveries made by the FDIC or the receiver for the lead lender. See, e.g., InterFirst Bank of Abilene, N.A. v. FDIC, 590 F. Supp. 1196 (W.D. Tex. 1984), aff'd, 777 F.2d 1092 (5th Cir. 1985). The arguments would be reversed if the FDIC or other government agency becomes receiver for the failed participating bank and the lead lender becomes insolvent as well. In this instance, the FDIC will argue that the transaction between lead lender and participating bank is merely a loan rather than a true participation interest.
collateral of the mortgagor. The question of whether such arrangements are best characterized as establishing creditor-debtor relationships, trust relationships, or are present assignments coupled with an agency between lead lenders and participating banks is subject to various factors depending on the jurisdiction. 226 With respect to whether a given transaction constitutes a mere loan or a true sale of mortgage participation interest, courts have recognized that a true mortgage participation normally possesses the following characteristics: (i) money is advanced by the participating bank to the lead lender; (ii) the participating bank's right to repayment only arises when a lead lender is paid; (iii) only the lead lender can seek legal recourse against the borrower; and (iv) the document is evidence of the parties' true intentions. 227 New York courts generally consider four factors which may indicate that a loan, and not a mortgage participation, is involved in a given transaction. These factors include: (i) guarantee of repayment by the lead lender to a participating bank; (ii) participation agreements which lasts for a shorter or longer term than the underlying obligation; (iii) different payment arrangements between borrower and lead lender and lead lender and participating bank; and (iv) discrepancies between the interest rate due on the underlying note and interest rate specified in the participation. 228

The guarantee of repayment by the lead lender to the participating bank is often the crucial element in determining classification of a given transaction. 229 The existence of a guarantee in most cases will result in the characterization of the lead lender-participating bank relationship as one of debtor-creditor. For example, in In re Woodson Co., 230 a mortgage broker had a loan portfolio composed of approximately 380 loans secured by deeds of trust to real estate, and approximately 2,200 investors furnished funds for the loans. 231 After filing for bankruptcy, the broker's trustee asserted that the loans were the property of the bankrupt estate, and that it was entitled to hold all collections on the loans until the investors' rights were determined in the bankruptcy proceedings. The Ninth Circuit found that the quasi-participation arrangement represented a debtor-creditor, as opposed to a trust, relationship primarily because the broker/lead lender did not retain a percentage participation in any of the loans, and it further relieved the participating investors of any


228. In re Sprint Mortgage Corp., 164 Bankr. at 228; In re Coronet Capital, 142 Bankr. at 80.

229. See In re Sackman Mortgage Corp., 158 Bankr. at 932-33; In re Coronet Capital Co., 142 Bankr. at 80.

230. 813 F.2d 266 (9th Cir. 1987).

231. The debtor mortgage broker located “permanent fund” investors or “revolving fund” investors to “take out” the interests on the limited partnership in the loans. The limited partnership, of which the mortgage broker was the sole general partner, would then assign fractional interests in specific promissory notes and deeds of trust to the investors. The assignments were recorded in the appropriate offices, and the broker kept possession of the promissory notes until paid or discharged by foreclosure. Id. at 268.
risk of loss in the arrangement. Thus, where the lead lender does not merely guarantees a certain return, but effectively guarantees against all risk of loss, such a transaction is entirely different from traditional loan participation transactions where participating banks share in credit risk and must rely on the creditworthiness of the borrower and the collateral.

IV. Lead Lender and Agent Bank Liability to Syndicate Members and Participating Banks

The precise scope of the lead lender's and/or agent bank's duties may lack clarity because they often depend on the construction of the syndicated loan and agency agreement (if a separate agency agreement exists). The degree of discretion granted to the agent bank may further influence the characterization of its relationship with the syndicate members. Intercreditor liability issues have received extensive treatment in U.S. courts over the last decade in disputes between lead lenders and participating banks in loan participation agreements. As the relationship between lead lenders and participating banks in loan participation arrangements is normally more akin to that of seller and purchaser (as opposed to that of co-lender between the agent bank and syndicate members), most of the lender liability issues arise in relation to the solicitation process where the participating bank sues the lead lender for (i) negligent or fraudulent affirmative misrepresentations, (ii) fraudulent omissions or concealment, and/or (iii) breach of fiduciary duty, in connection with its purchase of the loan participation interest. These claims are normally brought only upon the borrower's default, insolvency or other financial distress. The legal principles involved, however, are fully applicable in the syndicated loan context with intercreditor disputes between agent banks and syndicate members.

232. Id. at 271. See also In re S.O.A.W. Enterp., Inc., 32 Bankr. 279, 282 (Bankr. W.D.Tex. 1983) (holding that transactions were disguised loans rather than sales of loan participation interests primarily because the participating bank had no risk of loss, as a participating bank normally assumes the same risks as the person selling the participation); In re Executive Growth Investments, Inc., 40 Bankr. 417 (Bankr. C.D. Cal. 1984) (finding that whether the participating bank bore the risk of loss in the event of nonpayment was the dispositive issue in determining whether a transaction transferred ownership of a fractional interest in a promissory note); In re Columbia Mortgage, Inc., 20 Bankr. 259 (Bankr. W.D.Wash. 1981) (holding that there was a valid sale of a participation interest in a transaction where the selling bank and participating bank shared ratably in the expense and income of disposing of property upon default); In re Alda Commercial Corp., 323 F.Supp. 1315 (S.D.N.Y. 1971) (finding that arrangement whereby "joint venturers" provided funds to the debtor was a disguised loan rather than a joint venture because there was no sharing in the profits of the debtor nor did the petition play any part in the management of accounts).

233. Id. at 271-72 and n.6. Accord In re Sprint Mortgage Corp., 164 Bankr. at 229. Cf. In re Golden Plan of California, 829 F.2d 705 (9th Cir. 1987) (second amended opinion) (holding that the transactions were purchases and sales of notes and deeds of trust; in contrast to In re Woodson Co., the payments were not guaranteed as the notes involved were assigned without recourse, and upon foreclosure the purchasers were left to their own remedies against the borrowers, and thus bore the ordinary risks of ownership).

234. For a full discussion of lender liability in the context of loan participation cases, see Norton & Olive, supra note 49, at, inter alia, §21.04.
A. FRAUDULENT MISREPRESENTATION AND CONCEALMENT

Syndicate members and participating banks may attempt to hold lead lenders and agent banks liable for fraudulent misrepresentations, fraudulent concealment and/or constructive fraud in connection with the syndicated loan or loan participation transaction, and thereafter seek to rescind the transaction. In order to establish actionable fraud by the lead lender or agent bank, the syndicate member or participating bank must prove that the lead lender made material misrepresentations (either false statements or omissions), with either the knowledge that the statements were false or the intent that the concealment or nondisclosure will mislead the syndicate member or participating bank, that the member or bank justifiably relied on the representation or omission and thereby suffered damages.235

1. Fraudulent Concealment and the Duty to Disclose.

In the context of syndicated loan or loan participation disputes, fraud claims will most often be pled under the guise of fraudulent concealment. For instance, the participating bank would argue that the lead lender had a duty to disclose certain information that was material to the bank's decision to enter into the loan participation transaction. The specific situations where a duty to disclose may arise are not necessarily uniform among jurisdictions. Under New York law, lead lenders and other contractual parties generally have a duty to disclose in three situations. First, where the party has made a partial or ambiguous statement, on the theory that once a party has undertaken to mention a relevant fact to the other party it cannot give only half of the truth. Second, when the parties stand in a fiduciary relationship with each other. Third, where one party possesses superior knowledge, not readily available to the other, and knows that the other is acting on the basis of mistaken knowledge.236 New York courts have generally opined that where a participating bank has an opportunity equal to that of the lead lender to obtain information concerning the borrower, such information is deemed to be readily available, and the participating bank is expected to protect itself in a business transaction. Yet, in an increasing number of situations, the participating bank may not required to conduct investigations to unearth facts and defects that are present, but not necessarily "manifest."237

As the relationship between the lead lenders and participating banks is contractual in nature, however, U.S. courts have generally not imposed an affirmative duty on the lead lender to disclose material information about the borrower to the participating banks.238 This is because most courts considering the issue have held that, as per so-called reliance disclaimers in loan participation or syndicated loan agreements, the contractual language

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237. See Banque Arabe I, 819 F. Supp. at 1290. Hence, the duty to disclose is imposed only when the material knowledge is not "readily available" to the injured party. Id. at 1290.
238. Nonetheless, the Eighth Circuit has held that a duty of disclosure does arise when the lead lender stands in a fiduciary or confidential relationship with the loan participants. See Union Nat'l Bank of Little Rock v. Farmers Bank, 786 F.2d 881, 885-86 (8th Cir. 1986).
disclaimers override any common law duty of disclosure. Other courts have held that a duty of disclosure arises only in the context of a fiduciary or confidential relationship, and that banks will not become subject to a fiduciary duty invoking disclosure obligations unless the bank has expressly accepted such a duty in the agreement. New York law provides that "[e]ven an express disclaimer will not be given effect where the facts are peculiarly within the knowledge of the party invoking it." Thus, such courts may disregard the provisions in loan participation agreements which disclaim reliance on the of the participating bank on the lead lender with respect to its statements pertaining to the evaluation of creditworthiness of the borrower if the lead lender fails to disclose facts peculiarly within the knowledge of the lead lender. In particular, the Second Circuit has declared that where a party specifically disclaims reliance upon a representation in a contract, that party cannot, in a subsequent action for fraud, assert it was fraudulently induced to enter into the contract by the very representation it has disclaimer. Notwithstanding reliance disclaimers in the respective agreements, reasonably prudent syndicate members or participating banks would probably not be absolved from engaging in surface inquiries as to matters relevant to repayment of the loan when such inquiries would not contravene the parameters of the loan participation arrangement.


In order to be held liable for fraudulent concealment, the concealed or omitted information must be material to the decision of the participating bank to enter into the loan participation transaction. Under New York law, omitted information is deemed material if it "would have assumed actual significance in the deliberations of the reasonable [purchaser]," and the material information "goes to the essential factual essence of the

239. See, e.g., Bank of the West, 41 F.3d at 477-78 ("[Valley National] might choose to advance millions of dollars without making an independent credit evaluation, in reliance on [Bank of the West's] judgment, even though it promised not to do that. That might be a rational business judgment, if experience with [Bank of the West] had always been very good...But the contract could and did control whether such reliance would be justifiable for purposes of a fraud claim..."); Banco Totta e Acores v. Fleet Nat'l Bank, 768 F. Supp. 943 (D.R.I. 1991) (rejecting participating bank claims for innocent, negligent and intentional misrepresentation in finding that participating bank could not have justifiably relied on the lead lender's representations regarding the borrower's financial status when the loan participation agreement explicitly provided that the credit decision of said bank was "based solely upon its own independent credit evaluation of the loan, the borrower's creditworthiness and the value and lien status of the collateral."); Bank of Chicago v. Park Nat'l Bank, 640 N.E.2d 1288 (Ill.Ct.App. 1994) (same); First State Bank v. American Nat'l Bank, 808 P.2d 804 (Wyo. 1991) (same).

240. See, e.g., First Citizens Fed. Sav. & Loan Ass'n v. Worthen Bank & Trust Co., 919 F.2d 510, 513-14 (9th Cir. 1990); Banco Urquijo, S.A., 861 F. Supp. at 1248. The Second Circuit has similarly held that correspondent banking relationships do not give rise to fiduciary duties. See, e.g., Aaron Ferer & Sons, Ltd. v. Chase Manhattan Bank, 731 F.2d 1291, 122 (2d Cir. 1984).


242. Id. at 1291-92.

243. See Banque Arabe et Internacionale d'Investissement v. Maryland Nat'l Bank, 57 F.3d 146 (2d Cir. 1995) (Banque Arabe III).
In connection with the solicitation of participating banks, New York courts have observed that alleged omissions having to do with projected repayments by the borrower would be material if they significantly affected the participating bank's reasonable decision to fund the participation. Thus, lead lenders may incur a duty to recognize the importance of repayment for the participating bank's funding decision.

3. Alleged Fraudulent Concealment and Presumption of Reliance.

Reliance disclaimers in loan participation agreements have generally been found to preclude participating banks from arguing that they relied on the credit analysis and judgment of certain lead lenders in connection with purchases of syndicated loan or loan participation interests. In at least one New York case, however, participating banks have argued that the element of reliance may be presumed in common law fraudulent concealment claims once the plaintiff has established the element of materiality. This argument in essence parallels the rebuttable presumption doctrine available in material fraudulent omission disclosure cases under section 10(b) of the Securities and Exchange Act of 1934 and SEC Rule 10b-5 promulgated thereunder. In this particular case, the district court held that the participating bank could not successfully incorporate the presumption of reliance standard for Rule 10b-5 fraudulent omission claims into common law fraudulent concealment claims because the latter type of claims must be supported by a showing of direct reliance on the misrepresentation or omission. Moreover, the court held that such claims are distinguishable from actions brought under the federal securities laws, which permit a rebuttable presumption of reliance in certain fraudulent concealment cases and, in some jurisdictions, where the plaintiff purchases his shares on the open market under the "fraud on the market" theory. Finally, most courts in other jurisdictions have similarly rejected affirmative fraudulent misrepresentation claims by participat-

244. See Banque Arabe et Internationale d'Investissement v. Maryland Nat'l Bank, 850 F.Supp. 1199, 1216 (S.D.N.Y. 1994) (Banque Arabe II) (citing cases), aff'd, 57 F.3d 146 (2d Cir. 1995).
250. Id. at 1219 (citing Turtur v. Rothschild Registry Int'l, Inc., No. 92 Civ. 8710, 1993 WL 338205, 1993 U.S.Dist. LEXIS 11939 (S.D.N.Y. Aug. 25, 1993) (citing cases)); see also Mirkin v. Wasserman, 5 Cal. 4th 1082, 23 Cal.Rptr.2d 101 (1993) (rejecting extension of the presumption of reliance doctrine evident in Rule 10b-5 claims to common law fraud). The district court also rejected application of the presumption of reliance doctrine in common law fraud cases and opined that although it could envision cases outside of the securities context in which the existence of a market could support a presumption of reliance based on the fraud on the market theory, such conditions do not exist with respect to the participation loan arrangement between MNB and BAIL. In a participation loan arrangement there is, generally, no intermediate source of information. The information is provided specifically by the lead bank, and it is upon this information that the participant asserts its fraud claim. Id. at 1219-1220 and n10.
ing banks against lead lenders when the participating banks failed to show justifiable reliance in situations where such banks had the ability and right to perform their own investigations of the borrower.\(^{251}\)

4. **Alleged Fraudulent Concealment and Scienter.**

Proving that the lead lender acted with the requisite scienter in fraudulent concealment cases is an extremely difficult undertaking for the syndicate member or participating bank, and as a consequence is usually unsuccessful. In one New York case the participating banks argued that recklessness was sufficient to constitute scienter in common law fraud claims, but the court rejected this argument.\(^{252}\) Under New York law, where parties cannot offer proof of direct knowledge of the defendant’s state of mind in fraud claims, the plaintiff has two options in alleging scienter. First, the plaintiff can infer scienter from facts showing that the defendant had a motive to defraud and an opportunity to do so. Second, the plaintiff can infer scienter from circumstantial evidence demonstrating conscious behavior on the part of the defendant.\(^{253}\) These standards are generally representative of other jurisdictions in this respect.

B. **NEGLIGENT MISREPRESENTATION**

In considering negligent misrepresentation claims in connection with syndicated loan or loan participation arrangements, most courts have recognized that no cause of action for negligent misrepresentation\(^{254}\) exists “in the absence of a special relationship of trust or confidence between the parties.”\(^{255}\) Thus, an ordinary contractual or banking relationship, without a previous or continuing relationship, is generally insufficient in most jurisdictions to establish the requisite special relationship between lead lenders and participating banks.\(^{256}\) Therefore, negligent misrepresentation claims have largely been ineffective

\(^{251}\) See, e.g., *Banco Urquijo, S.A.*, 861 F. Supp. at 1249 (“Beyond the weakening of its loan terms and covenants, Plaintiffs’ employees and officers...failed to act as prudent bankers act. Such bankers perform their own ‘due diligence’ inquiries and make their own credit evaluations of potential borrowers. Plaintiffs did not do so. Prudent bankers monitor and review their loans regularly. Plaintiffs did not do so. Prudent bankers demand current financial statements before renewing loans. Plaintiffs did not do so.”).

\(^{252}\) *See Banque Arabe II*, 850 F. Supp. at 1223 & n12 (summarizing split of authority on this point).

\(^{253}\) *Id.* at 1223 (citing *Zvi Trading Corp. Employees’ Money Purchase Pension Plan & Trust v. Ross (In re Time Warner Inc. Secs. Litig.*, 9 F.3d 259, 269 (2d Cir. 1993)).

\(^{254}\) The tort of negligent misrepresentation is described in section 552 of the Restatement (Second) of Torts as follows: (1) One who, in the course of his business, profession, or employment, or in a transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information. *See, e.g.*, *Banco Urquijo, S.A.*, 861 F. Supp. at 1248.

\(^{255}\) *Banque Arabe I*, 819 F. Supp. at 1292 (citing cases).

\(^{256}\) *Id.* at 1292 (citing cases) (holding that “where a future relationship between the parties is the basis of a special relationship, the duration of that relationship must generally be long term.”).
in the syndicated loan and loan participation contexts. The Second Circuit has specifically held that in the case of arm's length negotiations or transactions between sophisticated financial institutions, no extra-contractual duty of disclosure exists. The Court has asserted that this ruling applies to loan participation agreements, in which there is deemed to be no fiduciary relationship unless expressly and unequivocally created by contract.

C. Breach of Fiduciary Duty

In syndicated loan or loan participation agreements, the only relationships which contain aspects of fiduciary duties are the joint venture, agency, and trust relationships. As no U.S. courts beyond the sovereign debt restructuring context have found a syndicated loan or loan participation agreement to constitute a joint venture, the characterization of the fiduciary relationship lies between an agency and trust arrangement. The primary difference between a fiduciary duty arising from an agency arrangement from that of a trust is that the agent bank or lead lender in an agency relationship would be subject strictly to the terms of the agreement, but in a trust relationship would be subject to additional common law fiduciary rules. Thus, the duties of an agent bank or lead lender in a fiduciary relationship of trust and confidence with the syndicate members or participating banks would be far more onerous than under an agency relationship. Courts have repeatedly decided against characterizing the relationship between agent bank or lead lender and syndicate members or participating banks as a trust relationship. New York courts have held that "in the case of arms length transactions between large financial institutions, no fiduciary duty exists unless one was created in the agreement." Moreover, as the terms of the relative agreement almost invariably create an agency relationship, as opposed to one of trust, between the agent bank or lead lender and its syndicate members or participating banks, the vast majority of courts have thus held that no fiduciary duty exists

257. See Norton & Olive, supra note 49, § 21.04[2] (discussing negligent misrepresentation cases in the context of loan participations). Negligent misrepresentation claims by participating banks have been precluded where both the lead lender and participating banks were negligent in evaluating the creditworthiness of the borrower. See, e.g., Banco Urquijo, S.A., 861 F. Supp. at 1248-49.


260. See Credit Francais Int'l S.A., 490 N.Y.S.2d at 680-83 (characterizing contractual relationship between lone dissenting syndicate member and agent bank to be a joint venture prohibiting dissenting bank from bringing suit against sovereign borrower after default).


262. See Lott, Makel & Evans, supra note 19, at 742-43.

263. Banque Arabe I, 819 F. Supp. at 1290 (citing cases).
between lenders in the loan syndication or participation context. In considering the existence of a fiduciary duty to be entirely factual, however, several courts have not dismissed fiduciary duty claims by participating banks in this regard, especially where the agent bank's fiduciary responsibilities are emphasized in the loan participation agreement.

As a general rule, the majority of U.S. courts hold that all contracts, including syndicated loan and loan participation agreements, are subject to an implied covenant of good faith and fair dealing. Many courts have held that this covenant cannot be used to rewrite the express terms of loan agreements. Moreover, almost all courts that have considered the question in the context of syndicated loan or loan participation agreements have held that no intercreditor duty of good faith and fair dealing arises between lenders in this regard. Notwithstanding the possible existence of a common law fiduciary duty owed from lead lenders to syndicate members or participating banks, an agent bank or lead lender can escape liability if courts uphold the exculpatory clauses found in most syndicated loan or loan participation agreements. A typical exculpatory clause limits the standard of care necessarily exercised by the agent bank or lead lender to the "same standard of care exercised in the case of arms-length transactions between financial institutions, no fiduciary duty relationship exists unless one was created in the (participation) agreement';

264. See Norton & Olive, supra note 49, § 21.04[3] (discussing cases). Although the lead lender may have fiduciary obligations as an agent to the syndicate members, courts have been reluctant to impose such obligations on the lead lender in loan syndication or loan participation arrangements. For example, several courts have held that banks engaged in commercial arms-length loan syndications and participations are generally not held to a fiduciary standard. See, e.g., Worthen Bank & Trust Co., 919 F.2d at 514; Banco Urquijo, S.A., 861 F. Supp. at 1249; Banque Arabe I, 819 F. Supp. at 1290; Banco Espanol de Credito, 763 F. Supp. at 45 (holding that "[i]n the case of arms-length transactions between financial institutions, no fiduciary duty relationship exists unless one was created in the (participation) agreement''); Peoples Heritage Sav. Bank v. Recoll Mgmt, Inc., 814 F. Supp. 159, 169-71 (D.Mass. 1993) (holding that a participating bank's claims of breach of fiduciary duty, holding that a fiduciary duty arises only where one party is placed in a position of trust or confidence by the other and there is a great disparity of position and influence between the parties); New Bank of New England, 768 F. Supp. at 1021 (same); Seattle-First Nat'l Bank, 619 F. Supp. at 1344; Richard E. Weiner, Rights of Participant Bank Against Lead Bank in a Participation Agreement, 104 BANKING L.J. 529, 532 (1987).


266. See, e.g., In re Continental Resources Corp., 799 F.2d 622, 625 (10th Cir. 1986); Banco Espanol de Credito, 763 F. Supp. at 44.

267. A majority of states, as well as the Restatement (Second) of Contracts (§. 205) and the Uniform Commercial Code (§. 1-203) recognize as a general principle of contract law that the parties to a contract must perform their duties under the contract in good faith. Although several courts have imposed a duty of good faith and fair dealing upon the lead lender in its dealings with participating banks, the majority of courts have dismissed the application of this doctrine, with some courts going so far as holding that the obligation should not be imposed beyond the context of the express provisions of the UCC. See, e.g., Peoples Heritage Sav. Bank, 814 F. Supp. at 168-69; Banco Espanol de Credito, 763 F. Supp. at 44; Royal Bank of Canada v. FDIC, 733 F. Supp. 1091, 1097-98 and n11 (N.D.Tex. 1990).

268. See, e.g., Reyes v. Atlantic Richfield Co., 12 F.3d 1464, 1472 (9th Cir. 1993) (duty to disclose exists in business transaction if there is a fiduciary or other similar relationship of trust and confidence between the parties); Lighting Tube v. Witco Corp., 4 F.3d 1153, 1185 (3d Cir. 1993) (same).
that it exercises in the administration and servicing of its loan for its own account” and limits liability to the syndicate member or participating bank to that of gross negligence or wilful misconduct. The existence of a fiduciary duty between lenders has been recognized in some jurisdictions as fact dependent. Hence, the syndicated loan or loan participation agreements should clearly specify whether the agent or lead lender assumes any particular duty or fiduciary obligation to co-lenders or participating banks. To the extent that syndicate members or participating banks desire to rely on any assumption of fiduciary duties by the lead lender or agent bank, the agreement should clearly delineate those duties. The lead lender, however, should be keen to avoid assuming any fiduciary obligations and thus should normally agree to service the loan only using the “same degree of care” as the agent bank would use in servicing a loan held for its own account. This should probably not exceed the agent bank’s agreement to hold loan documents and insurance or condemnation proceeds or other collateral in trust for the syndicate members or participating banks.

V. Concluding Observations

The syndicated loan markets will continue to play an important part in Latin American finance in the years to come. Both private sector and sovereign borrowers alike can use syndicated loan and loan participation arrangements to facilitate their capital raising or other financial needs. Although syndicated loan and loan participation arrangements have their respective differences, many of the legal and contractual principles which underlie these transactions are quite similar. These markets will continue to evolve as secondary markets for loans and credit derivatives emerge in Latin America. Thus, financial institutions should thoroughly understand the underlying principles and legal relationships inherent in syndicated loan and loan participation transactions.

269. See Chemical Bank, N.A., 20 F.3d at 377 (agent bank breached fiduciary duty, but court enforced exculpatory clause to limit fiduciary’s liability to gross negligence or wilful misconduct); City Nat’l Bank, 907 at 541-42 and n2 (same).

270. Wienke, supra note 3.