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ARTICLES

Syndicating and Rescheduling International Financial Transactions: A Survey of the Legal Issues Encountered by Commercial Banks

In the world of international finance, corporations and governments may require large amounts of money quickly and inexpensively for a wide variety of purposes. Commercial banks have increasingly played a major role in financing these public and private entities. Syndicates of banks may be formed when corporate and sovereign borrowers wish to obtain a larger credit than individual banks may legally lend, desire, or have the capacity to lend. Commercial banks may syndicate many types of international financial transactions. The most pervasive of these are syndicated loans, with term loans the most common, and revolving and stand-by loans frequently used. These syndicated loans are funded primarily in Eurocurrencies (i.e., currency deposited outside the country in which it is legal tender), though domestic currencies may be used either separately, or in conjunction with Eurocurrencies. Of lesser importance are syndications of bankers' acceptances, letters of credit and guarantees.

Often, in the course of a financial transaction, syndicated or otherwise, the borrower will not be able to meet its debt obligations. A syndicate of commercial banks may decide to reschedule or refinance these debt obligations, allowing the borrower to re-organize its financial circumstances and restore its creditworthiness, instead of enforcing collection by whatever means are available. This article surveys the legal problems commercial banks encounter in syndicating and rescheduling international financial

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transactions. Attention will focus on the legal problems that exist between lenders in the formation of a syndicate, and the legal problems that lenders have with borrowers and which affect lenders *inter se* in the course of a transaction, including the rescheduling of a debt in the event of default.

This article proceeds in the following manner. Part I considers the legal issues that commercial banks may encounter in syndicating loan transactions. Outlined in this chapter are the three general methods of structuring loan syndications, and the various rights and duties of lead or managing banks in the formation of a syndicated loan, as well as the rights and duties of an agent bank in its administration. Part II examines some of the more important provisions of a syndicated loan agreement to determine the rights and duties of various parties under the transaction. Discussed, *inter alia*, are the basic types of syndicated loan agreements, the duties of an agent bank in the administration of a loan, the rights of lenders vis-à-vis a borrower in the event the borrower is unable to fulfill its obligations, the rights of lenders *inter se* in the operation of a loan, and provisions dealing with conditions precedent, representations and warranties, covenants, events of default, selection of governing law and forum, waivers of sovereign immunity, sharing clauses, waivers, and amendments of the loan agreement. Part III considers the syndication of bankers' acceptances, using the analysis in the earlier two parts as a framework from which to start. This part examines the different types of bankers' acceptances and syndication methods, and the mechanics of syndication methods. Part IV analyzes the rescheduling and refinancing of syndicated transactions. Particular attention is given to the mechanics of rescheduling and the legal provisions contained in rescheduling agreements that govern the relationships between lenders and a problem debtor, as well as those amongst the lenders.

I. Loan Syndications: Duties and Rights of Banks

A. General Syndication Structures

The duties and rights of the various banks in syndicated loan transactions vary depending on the method by which a loan syndication is structured. There are three basic structures of syndicated loan facilities.[1]

1. *Direct Loan Syndicate*

The direct loan syndicate is the first general structure. It is a multilateral loan agreement in which all the lenders, having signed a single loan docu-

1. The simple idea of three general structures has been borrowed from L. Mitchell, Forming a Bank Loan Syndicate, Kensington Institute, Washington, Project No. 99-26-07055, June 1980.

ment, advance funds to the borrower pursuant to the conditions under the agreement. Each bank has agreed to lend up to and receive payments commensurate with its contractual commitment. The obligations of the banks are several, and not joint, as each bank is expressly responsible for its own obligations and not those of any other bank.[2] A promissory note of the borrower to evidence further the loan transaction may be held by each syndicate member, depending on the practice of the lender.[3]

The direct loan syndicate is organized, depending on the size of the credit, by either a manager or a limited number of co-managers under the leadership of a lead manager, or perhaps that of co-leaders. Typically, most loans are led by one or two major banks which have been chosen by the borrower on the basis of a close historical relationship, a policy of rotating banks to develop relationships with other banks, or price and other considerations.[4] The lead bank is authorized by the borrower in a mandate letter to arrange the credit. Often, when the credit is very large, the lead bank forms a small management group of lenders called co-managers. These co-managers assist in the arranging of the credit, and are chosen because they are capable of funding a large portion of the loan and represent a good geographical mix.[5]

Concurrent with the formation of a management group is the drafting of a loan agreement by the legal counsel of the lead bank in a form acceptable to both the borrower and the lenders. Many of these loan provisions are subject to negotiation between the borrower and the lead bank, and are analyzed in Part II, below. Moreover, it is also common practice for the lead bank to prepare in conjunction with the borrower an information or placement memorandum. The memorandum not only describes the loan transaction, but also provides relevant financial and statistical data about the borrower, the guarantor (if any), and the country of the borrower and guarantor.

Once a management group has coalesced, the lead bank commits the group to the borrower to syndicate the loan. The commitment varies according to the size of the loan and the practice of the lenders. At an earlier time, either partially underwritten or best efforts commitment were prevalent. With the former commitment, the lead bank would commit the group to fund a substantial portion of the loan, but not all the loan. With the latter commitment, the lead bank would commit the group to use its best efforts to place the loan in the market, with a commitment to advance its portion of the loan only if the entire syndication is successful; otherwise, the borrower

2. P. Wood, Law and Practice of International Finance, 273 (1980).
3. R. Slater, *Syndicated Bank Loans*, J. Bus. L., May 1982, pp. 190–91.
4. H. Terrell and M. Martinson, *Arranging and Marketing Syndicated Eurocurrency Loans*, Bankers Magazine, Nov.-Dec. 1978, at 37, *infra* note 8, p. 15.
5. *Id.* at 36.

will have to go elsewhere for funds, or redraft the terms and conditions of the loan to correspond to the market. Today, the most common arrangement is for the management group to commit itself to provide a *fully underwritten credit*[6] in which the entire amount of the loan is provided by the group, irrespective of whether or not the group is successful in placing a portion of the loan outside the management group.

The lead bank, often in conjunction with the management group, solicits other banks (participating banks) to join the syndicate to lend whatever portion of the loan the management group as a whole does not wish to fund itself. In most cases, the participating banks are chosen by the lead bank, though some banks with whom a borrower wants a banking relationship, or who have earlier contacted the borrower, are asked. Usually the lead bank will assemble a large preliminary list of potential participants, based on each bank's participation in past syndications. The lead bank refines that list by determining which banks are willing to lend to particular borrowers on which terms, through its informal contacts in the market.[7] Those banks that are asked to participate are solicited over the telex. The amount sought and the terms and conditions of the loan are stated.[8] Moreover, the participating banks receive a copy not only of a draft loan agreement, but also of the information memorandum though the lead bank is not required to provide this latter document. With a fully underwritten syndication, the lead and managing banks typically retain as much as one-half to two-thirds of the commitments, with the remaining funds supplied by the participating banks. The lead bank is expected to take a share that is at least as large as that of any other bank in the management group, with 10 percent of the loan the average.[9]

Often, with smaller credits to well-known borrowers, the lead bank and its management group will fund the entire loan. Only the terms of the proposed transaction are communicated between banks because each bank, through its own credit department, knows the financial, economic, and political circumstances of the borrower well, rendering unnecessary information memoranda. These direct loan syndications are called "club deals,"[10] reflecting the ease at which a small group of closely knit banks can organize funding for a smaller credit.

Once the loan agreement between the lead bank, manager, co-manager, and participating banks and the borrower has been executed, an agent bank is chosen to administer the loan, usually from the ranks of the syndicate

6. *Id.*
7. *Id.* at 37.
8. L. Goodman, *Syndicated Eurocurrency Credits: Pricing and Practice* 20, Research Paper No. 8202 (Jan. 1982) (available at Federal Reserve Bank of N.Y.).
9. *Supra* note 4, at 37.
10. *Supra* note 8, at 22.

members, with the lead bank most often chosen. The agent bank not only disburses funds from the lenders to the borrower, but also collects payments from the borrower and disburses them to the lenders. Moreover, the agent bank monitors the financial behavior of the borrower to inform the syndicate banks of any important changes in its financial condition.

2. *Participation Syndicate*

A second important general structure of loan syndication is the participation syndicate. Many banks may be involved in a participation syndicate, but only a single bank, the lead bank, executes the loan agreement with the borrower, having negotiated the proposed credit terms with the borrower, and provided the funding from its own reserves. The lead bank will form the syndicate by entering into a participation agreement with other banks, usually, but not necessarily, after it has executed the loan agreement. The presence of the other banks need not be generally disclosed to the borrower. In effect, the lead bank under the participation agreement will sell to the participating banks an undivided interest in its loan in consideration for funds they will provide to the lead bank. Typically, these funds in turn are used by the lead bank to fund the participants' part of the loan. The lead bank agrees to pay to each participating bank receipts from the borrower commensurate with the bank's participation.[11] Although the participating banks fund part or perhaps all of the loan, they are not co-lenders under the loan agreement because the lead bank holds all the documents, including the promissory note from the borrower. The participating banks hold only a participation certificate from the syndicate leader to evidence their share of the loan.

The participation syndicate enables the lead bank not to compromise its particular business relationship with the borrower because the names of the participating banks are not generally disclosed to the borrower. The lead bank may be motivated to sell participations under the participation agreement for the same reasons given for a lead manager forming a direct loan syndicate, viz.: (1) the lead bank may wish to transfer to participating banks part of the risk of a loan; (2) the lead bank may have inadequate funds to finance the loan itself; and (3) the lead bank may be compelled by law or internal guidelines to sell participations, having exceeded a lending ceiling to a particular borrower. In the United States, for example, such ceilings exist for individual borrowers.

The lead bank may grant a participation in several ways, having provided prospective participating banks with an information memorandum or any other written or oral communication about the borrower. The most promi-

11. Wood, *supra* note 2, at 273.

nent methods of granting participations include assignments, sub-loans, and undisclosed agency.[12] Under an assignment, the lead bank may assign for a purchase price either its rights under the loan agreement against the borrower or only payments from the borrower when and if they are received *pro tanto* commensurate with consideration given by the participating banks. The purchase price is used by the lead bank to fund the loan. Under a sub-loan, a participating bank makes a loan directly to the lead bank. The repayment of the loan is solely contingent upon the lead bank receiving payments from the borrower and is secured by the participating bank with an assignment of proceeds. With undisclosed agency, the lead bank forms the syndicate before the execution of the loan agreement, acting as the agent on behalf of the syndicate, but without disclosing this agency relationship to the borrower. The lead bank is liable for all obligations toward the borrower under the loan agreement, especially if the loan agreement expressly or by implication claims that it applies to the stated parties therein. The lead bank can neither claim that it is merely an agent nor have a participant intervene as a principal, a serious disadvantage in the event, for instance that any one of the participating banks were in default of advancing funds during the drawdown of the loan to the borrower.

The lead bank in a participation syndicate administers the loan in much the same way as the agent bank in the direct loan syndication. Its rights and duties are delineated in the participation agreement with the participating banks.

3. *Direct Loan/Participation Syndicate*

The third general method of structuring a loan syndication combines the central characteristics of the first two structures discussed above. A lead manager or co-lead managers receive a mandate and form a direct loan syndicate involving many banks, any one of which, after the execution of the loan agreement, may, and often will, sell a partial undivided interest in its stated commitment to participant banks.

An agent bank is appointed to administer the loan agreement, with the lead bank typically being chosen to serve as the agent bank. The agent bank has duties to the banks who financed the loan agreement before its execution. It may have duties to the participating banks if any one of the banks which participated out a portion of its loans, for instance, makes an assignment of its payments from the borrower to the agent bank, which in turn distributes payments to the participating banks (typically on a pro rata basis).

12. Wood, *supra* note 2, at 274.

4. *Current Syndication Practice*

The choice of the general structure of loan syndications depends on several considerations, including, perhaps most importantly the ability of the lead bank to source, structure, and sell the loan and its past syndication practices. The direct loan syndicate has been favored by large U.S. money center banks, and by large and well-positioned European banks.[13] Large direct loan syndications are often facilitated by consortium banks, i.e., banks that are owned by large international banks and which can commit their own funds and those of their shareholders.

The participation syndicate has been favored by a majority of commercial banks in the United States.[14] Its usage in international finance has arisen from their domestic lending practices, the potential for the lead bank to gain prestige and influence, and management fees by acting as the sole lender to the borrower, and the flexibility afforded after the signing of the loan agreement in shifting risks and enhancing liquidity. Consortium banks also facilitate this type of structure because the major shareholders may purchase large portions of the loan after the execution of the loan agreement.

The direct loan/participation syndicate has been used more frequently during the past ten years by U.S. money center banks, regional banks, and by smaller banks. This structure enables smaller banks and regional banks not only to gain the prestige and earn the management fees associated with a very large direct loan syndication, but also to participate out a portion of the stated loan commitment.

B. Duties and Rights of Lead Banks and Managers

The duties and rights of lead banks and managers under participation and direct loan syndications are in many respects, similar under both syndication structures. It is assumed for expositional convenience in the discussion to follow, therefore, that the rights and duties of lead managers will also be those of lead banks, unless otherwise indicated.

1. *Sourcing and Structuring the Loan*

To arrange a syndication, a lead manager must secure a mandate letter from the borrower which authorizes the manager to arrange the loan according to its terms. In order to obtain such a mandate, a prospective lead manager makes a feasible offer to the borrower, having taken into consideration the current market conditions and needs of the borrower. The offer

13. *Supra* note 1, at 2.
14. *Id.*

outlines not only the financial terms such as the amount and maturity of the loan, the interest rate, the availability of the loan facility, the fees of the syndicate leader, but also, in summary form, other important clauses that have been standardized in loan agreements, most of which are conditions the bank wishes to impose to protect itself, e.g., events of default, waiver of sovereign immunity.

The legal status of the offer letter is subject to some uncertainty. If it is intended to be a purely commercial proposal binding in honor, and without the force of a legal commitment, the letter must state in unambiguous terms that it does not create legally binding obligations. Often managers can escape the presumption that an offer letter is a commercial document that is legally binding if accepted by the borrower with the words "subject to contract."[15] Otherwise, the offer—subject to its expiry—is open to acceptance by the bank, though many of the conditions of the offer will be subject to negotiation and subsequent amendment.

In the offer letter, a lead manager will commit himself to either a best efforts, or a partially or fully underwritten commitment.[16] A best efforts commitment is legally binding only to the extent that the lead manager must offer the loan to the market under a certain set of terms and conditions. If the commitment is to partially underwrite the amount of the loan, the amount not underwritten typically is syndicated on a best efforts basis. In the event of a fully underwritten commitment, a lead manager should make clear to the borrower that the borrower's commitment entails a legally binding obligation that at the time of signing, the banks in the syndicate commit the full amount of the loan. Once this commitment has been met, the borrower, and not the bank is entitled to the protection of the loan agreement. A lead bank in its offer letter will make a firm commitment to fully underwrite the loan, though it may include the right to participate the loan out at a later date.[17]

2. *Selling the Loan*

Once a mandate has been obtained from the borrower, the lead manager attempts to place the loan with other financial institutions. Even though the practices of soliciting commitments under the syndication structures differ in some respects, principal of which is the solicitation of banks before and after the execution of the loan agreement, the duties and rights of the lead manager and lead bank vis-à-vis other financial institutions during the selling of the loan do not vary markedly. In a direct loan syndication, a lead

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15. Wood, *supra* note 2, at 256–57.
16. *See supra* text accompanying note 6.
17. BEE, *Syndication*, OFFSHORE LENDING BY U.S. COMMERCIAL BANKS, Bankers Association for Foreign Trade, 160 (1975).

manager is responsible for preparing and distributing to other banks two or three documents when placing a loan. First, a "term sheet" describing the basic terms of the proposed financing, is prepared and distributed by telex to prospective banks. Second, usually accompanying the term sheet is an information memorandum—a document that presents, in addition to or in lieu of any other written or oral communication, relevant information about the borrower's financial, political and economic circumstances. This memorandum is prepared in conjunction with the borrower, using information which is submitted by the borrower and which often is modified by the lead manager. Third, the lead manager prepares a draft loan agreement which is distributed to financial institutions somewhat later than the term sheet and information memorandum if any.

In a participation syndicate, the lead bank distributes only a copy of the executed loan agreement, and perhaps a copy of a document resembling an information memorandum, in lieu of, or in addition to, any other written or oral communication of the lead bank to prospective participants. The information memorandum may be compiled from relevant information supplied by the borrower to the lead bank for its own credit assessment, but typically is not prepared in conjunction with the borrower, given the very nature of the participation agreement which enables the lead bank to sell participations without the borrower's knowledge.

The lead manager, under a direct loan syndication and the lead bank, under a participation syndicate, may have duties to prospective syndicate members regarding not only the information memorandum, but also the credit documentation. Those duties are discussed below.

a. Information Memorandum

In preparing and distributing information memoranda, a lead bank manager may be responsible for any statements that are incorrect or incomplete. In deciding whether to participate in a syndicate, prospective syndicate members may rely upon the lead manager to state accurately the borrower's requirements and financial, political and economic circumstances. Even though the lead manager may expect that each bank leader will conduct its own credit assessment of the borrower without relying on the lead manager, the lead manager may nonetheless be liable for any omission or misrepresentation of material fact. Liability may stem not only from the securities legislation of the jurisdiction in which the memorandum is distributed, but also from non-statutory duties that may be imposed by common and civil law.

i. *Securities Legislation*. The information memorandum of the lead manager will be covered by the securities legislation of various countries in which that memorandum is distributed if the underlying loan transaction can be characterized as a security for purposes of the legislation. Unless there is an exemption, the lead manager may be subject to strenuous registration requirements, requiring a duty of accurate disclosure, the breach of which would invite onerous liabilities for misrepresentation. In this section, I shall briefly review the securities legislation of the United Kingdom, the United States, and Canada respectively.

(a) United Kingdom—An information memorandum is regulated by securities legislation in the United Kingdom, though the managing bank can evade liability for a misrepresentation through an applicable exemption. Under the Prevention of Fraud (Investments) Act of 1958, participations in a loan agreement would be characterized as a specified investment transaction, the result of which is the prohibition of an information memorandum.[18] An exemption may exist, however. If, for instance, the memorandum is issued by exempt dealers, a category which covers most banks, or is issued on behalf of a government or statutory corporation,[19] the information memorandum would not be prohibited.

Moreover, under the Companies Act 1948, as amended, the characterization of a promissory note evidencing a loan agreement as a debenture of a company, whether foreign or domestic, will result in the inclusion of specified information in an information memorandum.[20] Exemptions exist if, for instance, the distribution of the memorandum accompanies a private placement or, in the event the borrower is a foreign company, the memorandum is distributed to professional dealers in securities.[21]

(b) United States—In the United States, the law is still somewhat unsettled as to whether securities legislation applies to promissory notes and participation agreements under a loan transaction. Recent authority, however, suggests that notes and participation agreements issued in connection with commercial bank loans are not securities.[22] As a result, lead managers may be relieved from complying with the disclosure requirements that would otherwise apply to information memoranda, or, for that matter, any other oral or written communication, and being liable for any omissions or misstatements of material facts contained therein. However, lead managers should try to comply with these requirements in the event courts may rule that various aspects of loan syndications are subject to securities legislation. It will be worthwhile at this juncture to consider the manner in which securities legislation has applied to loan syndications.

The earlier confusion arose from whether or not the syndication of a loan that involved either a promissory note or participation agreement could be characterized as a security agreement so as to trigger the registration provi-

18. Prevention of Fraud (Investments) Act, 1958 (U.K.), 6 & 7 Eliz. 2, c.45.
19. Wood, *supra* note 2, at 258.
20. Companies Act, 1948 (U.K.) c.38, as am.
21. Wood, *supra* note 2, at 258.
22. CLARK and FARRAR, *Rights and Duties of Managing and Agent Banks in Syndicated Loans to Government Borrowers*, U. ILL. L. REV. 236 (1982).

characterized as a security agreement so as to trigger the registration provision of the Securities Act of 1933 (Securities Act)[23] and the anti-fraud provisions of the Securities Exchange Act of 1934 (Exchange Act).[24] A literal interpretation of the definition of security in the Securities Act suggests that loan syndication would be caught "unless the context already requires."[25] Indeed, some courts were willing to apply a literal reading when dealing with notes evidencing a grant of a participation. For instance, the court in *Lehigh Valley Trust Co. v. Central National Bank*,[26] a case where a promissory note evidencing the sale of a loan participation, held that almost all notes have been construed by the courts as defined by securities legislation. This literal reading suggests that loan participation offerings might be subject to registration requirements or due diligence standards as to completeness and veracity.

Other courts, however, have applied different types of tests,[27] none of which were entirely satisfactory. An investment-commercial test was applied to determine whether a security existed under either Act.[28] The courts reasoned that if a promissory note or participation agreement represents an investment, it is a security under both Acts. If it is not a security, then it is a commercial loan, and will not be caught by the Acts. The courts considered many factors structuring a loan transaction when applying the test. The test was rendered uncertain when it was found that each case should be decided on its own merits. A risk-capital test was considered.[29] The risk in a loan transaction was the prospect that the loan would not be paid. This test was rendered uncertain due to problems in evaluating risk. A "purpose" or "resemblance" test[30] created the presumption that any note or participation that was literally within the definition of security of either Act would be a security, unless the party claiming the converse could demonstrate that no purpose could be served by applying the Act. An "investment contract" test was also used to determine whether a participation in the note granted by a lead bank, or a noteless participation syndicate agreement, could be characterized as a security. This test, formulated in *SEC v. W.J. Howey Co.*,[31] defined an investment contract to be: (1) the investment money; (2) in a common enterprise; (3) with an expectation of profit; (4) solely from the

23. Securities Act of 1933, 15 U.S.C. §§ 77a-aa (1982).

24. Securities Exchange Act of 1934, 15 U.S.C. §§ 77b-78kk (1982).

25. Securities Act § 2(1). The definition of security in the *Exchange Act* is very much the same § 3(a)10, 15 U.S.C. § 78(c)(10)(1976).

26. 409 F.2d 989 (5th Cir. 1969).

27. For a brief discussion of these tests, which this article follows, see Ryan, *International Bank Loan Syndication and Participations*, INTERNATIONAL FINANCIAL LAW, LENDING, CAPITAL TRANSFERS AND INSTITUTIONS 30 (R. Rendell ed. 1980).

28. *See e.g.*, C.N.S. Enterprises, Inc. v. G. & G. Enterprises, Inc., 508 F.2d 1354 (7th Cir.) *cert. denied*, 423 U.S. 825 (1975); or, Lino v. City Investing Co., 487 F.2d 689 (3rd Cir. 1973).

29. *See e.g.*, Amfac Mtg. Corp. v. Arizona Mall of Tempe, Inc., 583 F.2d 426 (9th Cir. 1978).

30. Exchange National Bank v. Touche Ross & Co., 544 F.2d 1126 (2d Cir. 1976).

31. 328 U.S. 293 (1946).

efforts of others. A later decision de-emphasized the fourth element, thus creating a broader test; the *Hawaii*[32] test looked to whether the participant could exercise practical and actual control over the managerial decision of the enterprise.

If the note or participation could be characterized as a security, its issuance by a lead manager or lead bank may be subject to not only the disclosure requirements under the registration provision of the Securities Act, but also the disclosure requirements under the anti-fraud provisions of the Securities and Exchange Acts, unless a relevant exemption were to apply. With respect to the disclosure requirements, a lead manager could avail itself of a private placement exemption if it had taken measures to ensure that its syndication of the loan was without general solicitation or advertising, did not involve a public distribution and involved a small number of sophisticated offerees in financial and business dealings, each of which had been furnished or could gain access to sufficient and accurate information concerning the borrower.[33] The preparaton and distribution of an information memorandum by the lead manager to prospective banks, though not legally required, could qualify the syndication as having satisfied the informational requirements of the private placement exemption, even though the offerees may not have the necessary relationship with the borrower to have effective access to the relevant information to make an informed decision about joining the syndication. Conversely, if prospective bank lenders have effective access to relevant information, the informational requirement of the private placement exemption will be satisfied without the information memorandum.

Syndications exempt from the registration requirements of the Securities Act may nevertheless fall within the anti-fraud provision of the Securities Act and the Exchange Act, imposing a duty of due diligence upon the lead manager, if the information memorandum or, for that matter, any other oral or written communication by the manager to prospective lending banks, either omitted or made misstatements about material facts. Even though liability for a defective information memorandum will primarily attach to the borrower, a lending bank can and will look to the lead manager if the borrower is insolvent, and the lead manager knew, or in the exercise of due diligence should have known, of such misstatements or omissions.[34]

(c) Canada—Securities legislation in Canada may apply to a syndication involving Canadian banks as prospective lenders, or as prospective lead managers, but for exemptions contained in various provincial securities legislation. In Ontario, for instance, where many of Canada's banks have their headquarters, the Ontario Securities Act (OSA) would apply to syndications involving a note or participation agreement and would require

32. State of Hawaii v. Hawaii Market Center, Inc., 485 P.2d 105 (1971).
33. SEC v. Ralston Purina Co., 346 U.S. 119 (1953).
34. Colocotronif Tanker Sec. Litigation, 420 F. Supp. 998 (J.P.M. 1976).

disclosure if a literal reading of the definition of a security is made.[35] This applies to information memoranda supplied in Ontario by domestic as well as foreign lead banks.

Exemptions are available, however, from disclosure requirements if: 1) in the event the Canadian bank *qua* principal purchaser is a bank to which the Bank Act (Canada) applies;[36] and 2) in the event the Canadian bank *qua* lead manager either a) solicits not more than fifty prospective lending banks resulting in sales to no more than twenty-five purchasers, giving rise to a private placement exemption,[37] or b) places a security with a prospective lending bank if the aggregate acquisition exceeds more than \$97,000.[38]

The private placement and \$97,000 exemptions are not available to Canadian lead managers if information memoranda without a description of a contractual right of action are distributed to prospective lending banks. In the event of a misrepresentation contained in the information memorandum upon which lending banks rely in making a decision to join the loan syndication, the lending banks may either rescind their involvement in the syndication or seek damages against the borrower and the lead manager.[39] The lead manager is not responsible for damages with respect to a misrepresentation in the information memorandum, unless it knew of the misrepresentation or failed to conduct a reasonable investigation so as to provide reasonable grounds for a belief that there had been no misrepresentation.[40]

Under the 1980 Bank Act, a Canadian bank is permitted to act in concert with a consortium of lending or financing institutions to effect a loan notwithstanding that it may result in a private placement, so long as at least one-half of the loan is advanced by the syndicate, which may include foreign banks.[41]

ii. *Non-Statutory Duties Regarding Disclosure.* There may exist a non-statutory duty to disclose in addition to, or in lieu of, disclosure requirements of securities legislation, based on concepts of fraudulent or negligent misrepresentation. For instance, a lead manager may be subject to civil and criminal liability if it knew that a statement in an information memorandum was incorrect, or was reckless as to whether or not it was true, irrespective of whether the lead bank distributed the memorandum in its own name or as an agent of the borrower.[42]

In the event negligence is alleged by a lending bank, a claim for damages

35. O.S.A. s. 1(1)(40)(v).
36. O.S.A. s. 71(1)(a)(i).
37. O.S.A. s. 71(1)(p).
38. O.S.A. s. 71(1)(d).
39. O.S.A. Regulation 21.
40. O.S.A. s. 126(4).
41. Banks and Banking Law Revisions Act, Chap. 40, 1980–81, § 190(5).
42. Wood, *supra* note 2, at 259.

may be based on a theory such as that involved in *Hedley Byrne Co. Ltd. v. Heller & Partners Ltd.*[43] Whether liability will attach to the lead manager for a breach of duty of care depends on several factors under that approach, including the extent of the manager's involvement in preparing the information memorandum and the extent to which the lending bank relied on the memorandum in lieu of not having access to other relevant information about the borrower. The greater the reliance of the lending bank for information the leading manager knows the former bank cannot secure anywhere else, the more likely a duty of care is owed to the lending bank by the lead manager.[44]

Liability steming from the breach of these non-statutory duties may depend on the choice-of-law clause in the loan agreement, because of the typically broad geographic mix of lending banks. In the event the choice-of-law clause does not govern, the choice-of-forum clause in the loan agreement might dictate which law will be relevant through the application of the conflict rules of the forum.[45]

iii. *Limiting the Manager's Liability for Information Memoranda.* (a) Due Diligence Defense—The lead manager should satisfy itself that it has at least met the due diligence investigation standards specified by the securities legislation of the countries in which it distributes the memorandum, and each manager in a management group should review the memorandum with the same standard of due diligence as if it were alone responsible for its preparation.[46] Meeting these standards will probably preclude the application of non-statutory duties which exist in addition to, and in lieu of, the statutory duties, if any, prescribed by the securities legislation. The lead manager might review information not only with the borrower but also with either experts of the manager or independent analysts and experts. Sources of information should be official and verifiable, and wherever possible, sources should be asked to confirm in writing that the information is true.[47] Statements of opinion by the borrower should clearly be labelled and never asserted as facts. In addition, forecasts of the borrower should state its underlying assumptions[48] and methodologies. The lead manager might further reduce its duty to disclose information by distributing the memorandum only to banks that have as much information about the borrower as the lead manager.

In the event a change occurs in the borrower's circumstances between the

43. (1964) A.C. 465.
44. White v. Abrams, 495 F.2d 724 (9th Cir. 1974).
45. Clark and Farrar, *supra* note 22, at 237.
46. *Supra*, note 2, at 261.
47. *Supra* note 27, at 30.
48. Wood, *supra* note 2, at 262.

distribution of the memorandum and the execution of the loan agreement that would render incorrect an otherwise correct information memorandum, the lead manager should notify prospective lenders of the change, lest a failure to make a subsequent correction be construed by the courts as a fraudulent misrepresentation.

(b) Conflicting Duties of Disclosure—A lead manager may have conflicting duties of disclosure, having obtained information about the borrower from another source on a confidential basis, but yet having a duty to disclose such information to prospective bank lenders. The conflict may be resolved depending on the type and relevance of the information. If the information is non-material, the leading manager will not have a duty of disclosure to prospective lending banks. But if the information is material, the lead manager may ask the borrower to either disclose the information itself, or permit the manager to do so. In any event, the disclosure need not be contained within the information memorandum because it could be made through various media, including a separate letter, a syndicate meeting, or through the manager's counsel.[49] The disclosure should of course take place before the execution of the loan agreement, and presumably allow prospective lending banks enough time to incorporate erstwhile unknown material information in its decision-making. In the event the borrower does not permit the material information to be disclosed, the manager should, with the borrower's permission, notify the prospective lending banks that some material information regarded as confidential by the borrower has not been disclosed, and that each lending bank should rely on its own information when making decisions.[50] A lead manager may have to relieve itself of its lead position in extreme circumstances.[51]

(c) Conflicts of Interest—A lead manager may also have conflicts of interest that it should disclose. Its interest in other loans to the borrower in the capacity of either lender, agent, trustee or affiliate of other lenders should be disclosed to prospective lending banks, as well as the management fee it is to receive in leading the syndication of the loan.[52]

(d) Exculpatory Disclaimers—A lead manager may attempt to use exculpatory clauses in either the information memorandum or the loan agreement to shield itself from memorandum misrepresentations that are actionable under statutory, criminal and civil provisions. The usefulness of these clauses depends on the jurisdiction and the circumstances. For instance, it is generally against public policy in many jurisdictions to use exculpatory provisions, for fear that (1) a party in a superior bargaining position may make itself immune from liability for any misrepresentation, even the most

49. Ryan, *supra* note 27, at 31.
50. *Id.*
51. Wood, *supra* note 2, at 262.
52. Wood, *supra* note 2, at 263.

flagrant, such as fraudulent misrepresentation, and (2) a party who bargains with an equal may impose a disclaimer that does not crystallize the risks borne by the two parties. Since banks in a syndication are not unequal at least with respect to public information about sovereign borrowers, an exculpatory disclaimer should not be void, unless it has not been specific enough to properly apprise prospective bank lenders of the risks allocated to them.[53]

A lead manager might use certain contractual techniques to evade liability for a defective misrepresentation. First, the lead manager may have each lender in the syndicate confirm that it had not relied upon the manager for the accuracy and completeness of the information memorandum or any other oral or written communications regarding the material circumstances of the borrower. The exclusion of reliance denies to the lending bank the premise that it had been induced by the misrepresentation to enter into the transaction.[54] Second, the lead manager may try to transform itself from a lesser or greater co-principal to a mere agent of the borrower in terms of the preparation and distribution of the information memorandum.[55] In order to reduce as much as possible its own responsibility in the preparation of the information memorandum, and emphasize that of the borrower, the lead manager should obtain a written statement from the borrower which is to be included in the information memorandum stating, among other things, that: (1) the borrower not only claims the information is true and complete, but also assumes responsibility for the information; and (2) the memorandum was prepared and distributed on behalf of the borrower by the lead manager.[56] And finally, the lead manager may obtain an indemnity from the borrower in the event an action for a misrepresentation involves the lead manager.

b. Loan Agreement Negotiation

After the distribution of the information memorandum, but before the execution of the loan agreement, prospective lending banks receive a copy of the draft loan agreement. The principal purpose of this exercise is to solicit comments from prospective lending banks about the loan documentation. Often the time pressures of funding a loan subject to the terms and conditions of the lead manager's mandate letter in a rapidly changing market preclude much meaningful discourse between prospective lending banks and the lead manager because the lending banks will have to commit themselves to the syndication before knowing the outcome of their comments. This may not be a problem because the lending banks will have relied

53. Ryan, *supra* note 27, at 31.
54. Wood, *supra* note 2, at 201.
55. Wood, *supra* note 2, at 261.
56. Ryan, *supra* note 27, at 40.

on the statements in the term sheet that the loan agreement will contain the standard provisions. This fact should not give rise to much concern since the documentation of syndicated loans is extremely standardized compared to that of the other financial transactions.[57] But in the event the lead manager and borrower make substantial changes in the draft loan documentation, providing inadequate protection to the lending banks, the issue of legal liability attaching to the lead manager arises.

The legal status of the claim of a lending bank will depend on the circumstances. In order to prove its claim for damages, a lending bank must satisfy the burden not only that the lead manager was negligent in negotiating the loan documentation with the borrower, but that its negligence caused a loss. The lead manager may claim as a defense that the draft loan agreement contained the standard exculpatory disclaimers with respect to its responsibility for the execution, collectability and sufficiency of the loan, among other things. Moreover, the lead manager may assert that the commitment of the lending bank to the syndicate without adequate documentation gives rise to a form of contributory negligence or estoppel denying any form of recovery.

The lead manager may seek to avoid liability in several ways, the most important of which are: (1) employ independent legal counsel, not its own counsel, to prepare and negotiate the documentation; (2) advise the lending banks to seek independent legal advice; (3) insert an exculpatory disclaimer; and, of course, (4) enable the lending banks to have adequate time to review and discuss with the lead manager the loan documentation.[58]

3. *After the Execution of the Loan Agreement*

The lead manager's responsibility to other banks usually ends with the signing of the loan agreement. The lead manager may undertake further responsibility to the syndicate, but in another capacity, that of agent, the duties and rights of which are discussed immediately below. Moreover, the leading manager may voluntarily assume the role of negotiator in rescheduling the loan agreement and inadvertently incur further liability which is discussed in Part IV, below.

C. Duties and Rights of Agent Banks

Since the duties and rights of agent banks under participations and direct loan syndications are very similar, it may be assumed that the term 'agent bank' applies to both syndications unless an explicit differentiation between the two is made. Moreover, it may be further assumed that the agent bank

57. Clarke and Farrar, *supra* note 22, at 240.
58. Wood, *supra* note 2, at 263.

was the lead manager under a direct loan syndication, and the lead bank under a participation syndication.

1. *Duties Owed by Agent Bank*

The agent bank owes to syndicate members the explicit duties to administer the contract as set out under the credit or participation agreement as the case may be. It may also owe implied duties, which exist outside the agreement and are imposed by the general law of agency of the country in which the agent bank is located. Agency agreements usually have language that precludes the application of these implied duties. While it is certainly advisable that the agent use such provisions to limit the scope of its duties, the agent should nonetheless consider these implied duties and discharge these burdens whenever possible. It is necessary at this juncture to consider what these implied duties may entail before looking at the often mechanical duties expressly stated in the contract.

2. *Implied Duties*

a. Scope of Implied Duties

The greatest implied duties of the agent bank will be those of a fiduciary, requiring the agent to act as a trustee on behalf of the syndicate banks. Lesser implied duties may also exist, subjecting the agent bank to duties not as rigorous as those borne by a fiduciary. An agent bank may have several fiduciary duties. The most important duty would be one of care and due diligence in the manner in which the agent would owe a duty to the lending banks to act with at least that degree of care and skill which the bank would exercise for its own account, unless a different standard is otherwise agreed upon.[59] This duty of care and due diligence far exceeds standard contractual duties in a syndication agreement, which hold the agent bank liable for only "gross negligence and wilful misconduct". The ambit of this duty covers at least the mechanical aspects of administering a syndicated loan such as keeping and rendering an account of money the agent bank has received or disbursed on behalf of the lending banks, and disclosing any significant remuneration for its services. Another fiduciary duty is for the agent bank neither to make secret profits out of its agency relationship nor to subdelegate its authority to administer the loan.

In addition, an agent bank as a fiduciary owes its principals a duty not to allow its responsibility as agent to conflict with the interests it may have stemming from several other capacities, all of which involve the borrower. Examples of other capacities in which an agent might be engaged that give rise to conflicts of interest include: (1) the agent might be a lending member of the syndicate or of another syndicate, having its own separate interests as

59. RESTATEMENT (SECOND) OF AGENCY § 379 (1958).

a bank; (2) the agent might be another agent under other credits to the borrower or its affiliates; (3) the agent might be a trustee for security holders of the borrower or its affiliates;[60] and (4) the agent might have cross-share holdings or cross-directorships with the borrower or its affiliates.[61] Since these conflicts of interest are often difficult to resolve, the agent bank may be held to much higher standards of due diligence because of the presumption that it had not acted in as objective and disinterested manner as it might have in administering the syndicated credit.[62]

An agent bank may try to reduce the conflicts inherent in acting in different capacities by using several techniques. Most common is for the agent bank to make complete and correct disclosure of these conflicts of interest to syndicate banks, and to obtain their consent thereto.[63] Disclosure most commonly occurs prior to the nomination of the agent, a step which precedes the commitment of prospective lending banks to the syndicated credit, but may also occur subsequent to the signing in the event the agent undertakes another capacity with respect to the borrower. In addition, the agent bank may resort to various exculpatory clauses, which are discussed in the immediately following section. Finally, in the event the credit encounters serious difficulties which put the agent at odds with itself in several capacities, the agent may exercise the successor agent provisions in the credit agreement,[64] though in practice syndicates are often reluctant to let an agent go because it is difficult to find an independent bank. The syndicate's refusal of the agent's resignation would give rise to a defense of estoppel were liability to attach itself to the agent's irreconcilable conflicts.

Finally, an agent bank as a fiduciary may owe a duty to disclose all material information arising out of its agency to its principals, unless it was bound by a superior duty to a third person. This material information would include advising lending banks about all relevant inside information obtained by the agent after the signing of the loan agreement. This duty would probably include notification of any breach of the conditions specified under the loan agreement. It may also include a duty to disclose confidential information acquired by the agent in some other capacity with the borrower. However, the duty to the borrower not to disclose confidential information will give rise under the agency agreement to conflicting duties of disclosure. The agent can always ask the borrower to disclose the confidential information through appropriate, and often informal, media to prospective bank lenders. Moreover, the agent could, with the borrower's permission, notify bank lenders that it has confidential information of the borrower acquired in

60. Ryan, *supra* note 27, at 35.
61. Wood, *supra* note 2, at 269.
62. *Id.*
63. Ryan, *supra* note 27, at 35.
64. Ryan, *supra* note 27, at 36.

a different capacity which it cannot disclose. Unless the syndicate banks agree to this nondisclosure of information due to a superior duty of confidence, the agent bank may have no other recourse in resolving its conflict but that of resigning its role as agent.[65] It is unlikely this will happen for the reasons cited above, thus protecting the agent from liability for losses caused by this conflict through estoppel.

b. Exculpatory Disclaimers

It is in the obvious interest of the agent to contractually preclude as many fiduciary duties as possible with the syndicate banks. Several such clauses have been incorporated into loan or participation agreements, including: (1) restricting the duties of the agent to only those powers and duties expressed in the agreement and those reasonably incidental thereto;[66] (2) inserting general immunities which state that the agent is not liable for any default or omission unless in the case of gross negligence or wilful misconduct;[67] (3) providing that the agent is not a fiduciary, a tactic taken to its semantic extreme by referring to the agent as the "administrative" or "servicing" bank; [68] (4) providing specific immunities which absolve the agent of several prospective areas of liability, including, for example, (a) the reliance on documents it believes genuine, or the advice and statements of legal counsel, independent consultants, and experts (b) nondisclosure of confidential information acquired in another capacity and (c) not relinquishing its other capacities with the borrower and its affiliation;[69] (5) vesting powers and duties in the banks individually so as to limit their reliance on the agent;[70] and (6) including of language to the effect that the agent in including exculpatory provisions is merely protecting itself in the event such duties may be (erroneously) imposed by an (unsophisticated) court, and is not contractually precluding a lending bank from asserting fiduciary duties it may have otherwise owed to it by the agent.

The success of exculpatory clauses depends very much on legislative and judicial policy. Judicial policy thus far has been to construe these provisions narrowly against the person relying on them. Any ambiguity in language which does not put the plaintiff on proper notice of the risks allocated to him will be resolved in favor of the plaintiff. Legislative policy in England, for example, denies the efficacy of exculpatory clauses, unless the court finds them fair and reasonable.[71]

65. Ryan, *supra* note 27, at 35.
66. Wood, *supra* note 2, at 236.
67. *Id.*
68. Clarke and Farrar, *supra* note 22, at 244.
69. Wood, *supra* note 2, at 269–270.
70. Wood, *supra* note 2, at 270.
71. *Id.*

3. *Express Duties*

An agent bank has many express duties which are set out in the contract. For the most part, these duties are mechanical, requiring very little or no discretion. Usually, discretion is limited to handling payments and documents, performing other mechanical matters, and, in the event of a default, enforcing provisions of the loan agreement on behalf of the syndicate.[72]

The restriction of discretion, converting the agent bank into a mere device to simplify the administrative burdens associated with the collection and disbursement of payments, often reflects mutual intentions. The agent desires less discretion, limiting its liability in a potentially troubled credit. Other banks, at least those in a direct loan syndication, desire to limit an agent's discretion in order to prevent the agent from developing a more substantial business relationship with the borrower.

The discretion of the agent however need not always be limited to mechanical duties. In a participation syndication, the lead bank often desires a broad discretion to administer and modify the terms of its credit without the consent of the lending banks. Moreover, in a direct loan syndication, it is often in the best interests of the agent and lending banks alike for the agent bank to have, and exercise, discretion, for instance, in bringing a lawsuit on behalf of the lending banks.[73] A discretionary power is typically granted by the delegation of duties and powers according to the terms of a loan agreement, including such other powers as are "reasonably incidental thereto."[74] These contractual discretionary powers are not expressly stated, except to the extent that the agent will be indemnified for expenses and losses incurred. It is the intention of the agent, and perhaps the lending banks, moreover, that these discretionary powers neither be co-extensive with nor be governed by fiduciary duties.

Four major mechanical duties are described below.

a. Disbursement and Collection of Funds

The agent bank acts as a disbursement and collection device for payments to and from the borrower and lending banks, respectively. The lending banks make their contribution available to an account in the name of the agent upon being given a reasonable notice by the agent that the borrower wishes to make a drawdown according to the terms of the loan agreement. On the date of the drawdown, the agent deposits the funds in the borrower's account, recording the funds received from the member banks. The agent bank is responsible for calculating the interest rates that will apply to the funds that will be disbursed. The price of money will be as provided in the

72. Ryan, *supra* note 27, at 34.
73. Ryan, *supra* note 27, at 36.
74. Emphasis mine.

loan agreement (usually at the rates at which reference banks designated in the loan agreement attract funds or make loans). Payments by the borrower on a repayment date are made to an agent's account. The agent promptly disburses payments received from the borrower commensurate with the lending banks' outstanding participations. Agent banks may often disburse more funds to a borrower on a drawdown and to syndicate banks on a repayment than what was received. The agent is not responsible for the shortfall as contemporary loan agreements contain claw-back clauses which enable the agent to be indemnified by the party responsible for the shortfall.[75]

b. Verifying Conditions Precedent

An agent bank is not permitted to make a disbursement of funds to the borrower on the initial drawdown until conditions precedent to the lending banks' obligations to provide funds have been satisfied. The agent bank is to receive all documentation pertinent to the proper execution of the loan agreement, including guarantees, security and legal opinions. The agent bank could determine whether or not the documentation conforms to the loan agreement, but it may incur potential liability for a negligent legal opinion supplied by its in-house counsel. The agent bank can shift what otherwise would be a serious legal risk by awaiting and entirely relying upon the legal opinion of the syndicate members, or independent legal counsel, having furnished the documentation of these respective parties.

c. Monitoring the Financial Condition of the Borrower

Usually the members in a direct loan syndication are responsible for monitoring the financial condition of the borrower. In the event the agent bank is empowered to do so, the agent's discretion may be reduced if the loan agreement confers an independent power upon each bank to call for information through the agent.[76]

d. Default Notification

An agent bank is instructed by the loan agreement to notify the lenders of an event of default. Its discretion is limited in two ways. First, loan agreements contain provisions specifying when an agent is deemed to have notice or knowledge of an event of default. Hence, an agent's deliberations over whether the syndicate should be notified of a minor or inadvertent default incurs the risk of liability for acting contrary to the agent's express duties. Second, once the agent has notified the syndicate members, it has the limited discretion of acting in the best interests of the syndication until

75. Wood, *supra* note 2, at 265–66.
76. Wood, *supra* note 2, at 266.

instructions are received from the syndication. These instructions usually reflect the directions of a majority of syndicate members as to their participation in the agreement.

II. Syndicated Loan Agreements

Syndicated loan agreements are lengthy documents, with many provisions governing the contractual relationships among the lenders, borrower and agent bank. In a direct loan syndication, the provisions govern the relationships between the borrower and the lenders, that amongst the lenders themselves, and that between the lenders and the agent bank, though occasionally this last relationship will be governed by a separate agency agreement to which the borrower is not a party. In a participation syndication, the documentation is simpler, with the loan agreement governing only the relationship between the borrower and lender; after the execution of the loan agreement, the relationship of the participating banks and the lead bank qua agent is determined. An overview of the types of syndicated loans and of the more important provisions that govern the relationships of lender, borrower, and agent in a direct loan syndication is provided below.

A. Syndicated Loans

International loan syndications have exhibited an increasing flexibility with respect to pricing, funding, repayment, and length of the loan. The most common type of syndicated loan is a term loan. A term loan may be characterized as the lending of funds to a borrower for a specified period of time after the execution of the loan agreement, with a commitment period of three to five years comprising a medium-term loan. The borrower obtains funds by drawing down the loan, with the entire amount usually drawn down early in the life of the agreement. The repayment of the term loan is pursuant to an amortization schedule. The schedule varies according to the loan agreement, with some amortization commencing with the first draw down of funds, to "bullet" loans, where there is no amortization over the commitment period except at its expiration, at which time the principle is entirely repaid.

A revolving credit loan provides the borrower with more flexibility than a term loan with respect to draw down and repayment provisions. The borrower can borrow, repay, and reborrow during the length of the loan up to a specified ceiling. An 'evergreen' revolving loan facility involves an option to negotiate early an extension of the commitment period, usually at the election of the lender.

A stand-by loan enables a borrower obtain funds at any time during the commitment period for the entire amount of the credit. The stand-by loan agreement is essentially a contingent contract under which the borrower has the option to draw down funds to meet an adverse event or other financial needs. It is to be distinguished from a term loan: the borrower's needs under a term loan are imminent; under a stand-by, only contingent. Sovereign borrowers may use a stand-by line of credit, for instance, to defend the integrity of their currency in foreign exchange markets in the event of balance of payment problems.

Loan agreements vary greatly with respect to setting the price at which the borrower must pay for funds. Market pressures have created loan facilities with interest rate options which differ according to maturity as well as the market in which lenders will obtain funds. International syndicated loans are predominantly funded using Eurocurrencies. In principle, there are as many types of Eurocurrencies as nations whose currency is internationally accepted as legal tender, though Eurodollars are the primary Eurocurrency. Moreover, there are many Eurocurrency markets throughout the world, with the largest centered in London.

The cost of a Eurocurrency financing to a borrower is the funding cost of the Eurocurrency to the lender, plus a margin determined by negotiation. The funding cost of Eurodollars in London, for instance, is the London interbank offered rate (LIBOR).[77] This is the rate at which banks in the London market are prepared to lend to each other. Historically, LIBOR for Eurodollars has been lower than the U.S. domestic prime rate for U.S. dollars. There are several reasons for this advantage, principal of which is that Eurodollars are not subject to national monetary control, and as a result, are not subject to the costly prescribed requirement ratios on domestic dollar deposits.

Recently, international syndicated loan agreements have provided borrowers with the option to borrow a currency at the prime rate. For instance, borrowers may elect to borrow U.S. dollars from domestic U.S. banks at prime, rather than (Euro)dollars from London at LIBOR. The advantage of this option is the result of the different funding practices in the two markets. To provide Eurodollar loans, a bank must acquire a Eurodollar deposit, which is made for a short term at a fixed rate. Since Eurodollar deposits are short term and Eurodollar loans are usually long term, the bank must acquire several sequential short-term Eurodollar deposits to fund a long-term Eurodollar loan. The LIBOR of the loan would remain fixed for the duration of the short-term deposit, but would change commensurate with the cost of acquiring a new Eurodollar deposit, when the old one expired. Due to the mismatching of maturities, the LIBOR would float over the

77. The interbank offered rate for lesser Eurocurrency markets is for instance, HIBOR for Hong Kong, BIBOR for Bahrein, and so on.

duration of the loan, but would remain fixed for a given length of time. The U.S. prime rate applicable to the loan, on the other hand, floats daily under the terms of the loan agreement. The borrower would elect to choose the prime rate, if he expects it to fall and remain lower than the fixed LIBOR for a specific interest period determination.

In some loan agreements, a borrower may have other interest rate choices. For instance, he may be able to choose an interest rate based on quotations for certificates of deposit (CDs) adjusted for reserve costs and the cost of insuring CDs with the Federal Deposit Insurance Corporation. This rate may be fixed or floating.[78]

B. Provisions Governing Syndicated Loan Agreements

Provisions in international syndicated loan agreements, which are typically drafted by the legal counsel of the managing bank, can be roughly classified as having either procedural or substantive importance in the loan transaction. The procedural provisions cover the mechanics of the loan transaction ranging from the initial disbursement of funds to the final payment of principal and interest. These provisions govern primarily the role of the agent bank in administering the loan. The substantive provisions, on the other hand, determine the remedies the lending banks can effect, were an event of default to occur in the course of the loan. These two general types of provisions are outlined below, considering some of the legal problems lending and agent banks will encounter in a loan transaction. Both the syndication of acceptance financing and the rescheduling of financial transactions by commercial banks involve documentation similar to syndicated loan agreements.

1. *Procedural Provisions*

International syndicated loan agreements have become standardized in many respects, some of which are discussed in this section in order to provide some idea of the manner in which these agreements are executed.

a. Advances

Upon the execution of the loan agreement, the lending banks severally undertake to fund a proportionate amount of the active loan and each of the draw downs specified in the agreement. The borrower notifies the agent bank of the date and the aggregate amount of the draw down. The agent bank, in turn, notifies the lending banks regarding the date, aggregate amount, initial interest, and each bank's ratable portion of the borrowing.

78. Wall and Geary, *Interest Rate Options, Funding Practices, and Yield Protections*, INT'L FIN. L. REV. 23, (Oct. 1982).

The amount for which each bank is responsible is credited to the agent bank. The amount is subsequently transferred by the agent to the borrower's account.

The obligation of each lender to make an advance upon each borrowing is not binding unless the agent bank receives the requisite documentation satisfying the conditions precedent inherent to the loan agreement. The conditions precedent are of two types, corresponding, respectively, to the initial borrowing and all subsequent borrowings. With respect to the initial borrowing, the agent bank must usually be furnished with: (1) applicable guarantees or security, if any; (2) copies of all necessary corporate or governmental organic documents, including board authorizations and governmental authorizations and approvals, such as exchange controls consent; (3) copies of the constitutional documents of the borrower; (4) legal opinions on behalf of the borrower and lending banks; (5) certification of the names and signatures of persons authorized to sign on behalf of the borrower; and (6) promissory notes, depending on the jurisdiction evidencing the loan agreement. With respect to furnishing notes, in the United States and civil code countries, banking practice requires that loans be evidenced by promissory notes; in the United Kingdom, notes have never been used, with monies having been advanced by overdraft.[79]

Counsel on behalf of the borrower generally expresses an opinion that the various obligations of the borrower under the loan document are valid, binding and enforceable. In addition, the borrower's counsel will usually express an opinion that: (1) the borrower, if a corporation, is duly organized under the laws of its jurisdiction; (2) the execution, delivery and performance by the borrower of the credit agreement have been duly authorized by all necessary corporate action, and do not contravene charters, contracts or existing law applicable to the borrower; (3) all authorizations or approval from any governmental authority or regulatory body have been duly obtained by the borrower and are in full force and effect; and (4) the security instruments provided under the agreement, if any, have been registered and perfected.

Special counsel on behalf of the lenders and the agent bank will seek to provide an opinion regarding the law governing the credit documents. The scope of the opinion rendered may vary, however. The opinion may be that the loan documentation is a legal, valid and binding obligation of the borrower, and enforceable against the borrower pursuant to its terms. Another type of opinion is that the credit documentation is in substantially acceptable legal form.[80]

79. Wood, *supra* note 2, at 244.
80. Ryan, *supra* note 27, at 44.

With respect to subsequent advances on each of the draw downs specified in the loan agreement, including the first borrowing, the obligation of the lending banks is subject to further conditions precedent. These include that the representations and warranties made by the borrower are correct on and as of the date of such borrowing as though made on that date; and that no event which would comprise an event of default pursuant to the loan agreement has occurred and is continuing. Failure by the borrower to satisfy these conditions during any period of the loan agreement enables the lending banks not only to suspend disbursement or draw down dates, but also to seek remedies, a subject that is discussed in Part II. B. 2.a.ii, below.

b. Interest Rate Determination

The agent bank is responsible for determining the interest rate for each draw down of new funds, and, of course, the rate at which old borrowings are rolled over. Usually the agent will determine the interest rate of Eurodollars, for instance, on the basis of applicable quotations of LIBOR furnished to and received by the agent from reference banks in London two business days prior to a draw down of new funds, or the commencement of an interest period, at which old funds are rolled over. The reference banks are specified by the loan documentation and in the event one or more of the reference banks are unable to provide a quotation, the interest rate typically is to be based upon the quotation given by the remaining banks. Furthermore, in the event U.S. dollars are not available in sufficient quantities from London, or the agent receives word from a majority of lending banks that the LIBOR will not reflect the cost of funding a borrowing, the agent is to notify the borrower and lending banks. The agent at this juncture is to enter into good faith negotiations with the borrower to determine an alternative interest rate that reflects the costs of funding the borrowing to a majority of banks. If no alternative rate is agreed upon, the agent is to notify the borrower of the interest rate at which the majority banks will provide funds. If the borrower finds the alternative rate objectionable, he may elect to prepay the active loan; otherwise, the alternative rate will apply to the new interest period. Of course, in the multi-interest rate option, the documentation will be difficult.

c. Repayment

The repayment of the loan is made according to an amortization schedule agreed upon by the borrower and lending banks at the conclusion of negotiations, and incorporated in the loan documentation. Payment is made when the borrower deposits funds in the agent's account. The agent will distribute these funds ratably to the lending banks. Since the agent bank may assume that the borrower will be making payments on the due date unless it is informed otherwise, the agent may in reliance upon such an assumption distribute its own funds on the due date to the lending banks. In the event the borrower fails to make a full payment on the due date, the agent bank may be indemnified by each lending bank an amount equal to the distributed funds of the agent bank, with interest thereon.

2. *Substantive Provisions: Lending Banks and Borrower*

The substantive provisions in the loan agreement that are intended to govern the various relationships among borrower, lending banks and agent banks are varied. The protection lending banks seek against the prospect of a borrower defaulting are found in the provisions regarding representations and warranties, covenants, events of default and governing law. These provisions will be discussed in this section. The substantive provisions regulating the relationships of lending banks *inter se* will be discussed in the following section.

a. Representations and Warranties

The borrower makes certain representations and warranties to the lending banks in the loan documentation. Both types of statements provide information to the lending banks about the financial, commercial and contractual condition of the borrower and the legal validity of the obligations it will assume under the loan agreement. Representations and warranties differ, however, in a technical sense. A warranty is a term inherent to the loan agreement, whereas a representation is a statement of certain facts made prior to or at the time of the execution of the loan agreement which induces the lending banks to enter into the contract.[81] These technical differences do not affect the express remedies afforded lending banks under the loan agreement, though they may give rise to different remedies at common law, a matter to be discussed shortly.

i. *Types.* Representations and warranties included in loan documentation vary principally according to the nature of the borrower. For instance, a corporate borrower, whether foreign or domestically owned, or privately or publicly owned, is required to provide several "legal" and "commercial" representations and warranties according to current market practice. A list of the legal representations and warranties applicable to a corporate borrower would include statements that: (1) the borrower is duly incorporated, validly existing, and in good standing under the laws of its jurisdiction; (2) the borrower is acting within its corporate powers in the execution and performance of the loan agreement, having been duly authorized by the relevant corporate procedures; (3) the loan agreement is a legal, valid and binding obligation of the borrower, enforceable pursuant to its terms; and (4) the borrower has obtained all official consent regarding the making and

81. Wood, *supra* note 2, at 240.

performance of the loan agreement. A similar list of commercial representations and warranties would include statements regarding (1) the borrower's financial condition, including a recently audited financial statement providing full, true, and plain disclosure of its business operations, assets and liabilities; (2) the borrower's involvement in material litigation, administrative proceedings, and tax disputes; and (3) a representation that the borrower is not in default under relevant ancillary agreements.

Those representations and warranties would differ significantly were the borrower a sovereign state or a state-related institution. Perhaps most important would be statements that the loan is required for the private and commercial acts of the borrower rather than a public or governmental act and that the borrower is subject to commercial law with respect to the obligations it assumes under the loan agreement.[82]

ii. *Remedies.* The representations and warranties made by a borrower must be true, at least with respect to the execution of a loan agreement and the initial borrowing of funds and typically with respect to subsequent borrowings. The veracity of these statements is a condition precedent to the disbursement of funds, providing lending banks in the event of an untrue or misleading statement with two express contractual remedies. First, the lending banks may suspend all subsequent lending to the borrower until such time as the representation is no longer incorrect or the condition precedent has been waived by the lending banks.[83] Second, the lending banks may wish to cancel the undrawn portion of the loan,[84] an irrevocable decision that repudiates the contract, not allowing the borrower to cure the defect in its statements. A third possible contractual remedy is that the lending banks may wish to accelerate the outstanding loan, declaring the drawn-down portion immediately due and repayable. The acceleration remedy is triggered when the untrue or inaccurate representation or warranty can be characterized as an express event of default, discussed in Part II.B.2.c, below.

In the absence of express contractual remedies under the loan agreement, the lending banks may resort to the common law remedies of rescission and damages for breaches of representations and warranties.[85] Although there is some confusion about the relationship between the remedies for breach of representations and for breach of warranties, the claim of damages under either head will not exceed the amount recoverable under the express contractual remedy of acceleration.[86]

82. Wood, *supra* note 2, at 243.
83. Clark and Taylor, *Representations and Conditions Precedent in Eurocurrency Loan Agreements*, INT'L FIN. L. REV. 28 (July 1982).
84. *Id.* at 29.
85. *Id.*
86. *Id.*

b. Covenants

Covenants provide another means by which lending banks can protect themselves from the event of a borrower becoming unable to repay a loan. Covenants are promises the borrower undertakes to fulfill during the life of the loan, and as such become the parameters within which the borrower is expected to operate, determining to a large extent what a borrower may or may not do in a manner consistent with his ability to repay the loan. Lending banks favor covenants because covenants provide banks with considerable influence over the borrower's action; the borrower, on the other hand, wishes to be free of these contractual constraints on its action. Negotiations between the lead manager and borrower determine the extent to which the lending banks under a loan agreement can control a borrower.

i. *Types*. The scope and purpose of covenants depend largely upon the nature of the borrower and the circumstances underlying the loan negotiation. Covenants restraining sovereign borrowers will be different from those restraining corporate borrowers. Moreover, within each basic type of borrower, differences will exist, depending on the creditworthiness of the borrower (e.g., oil-rich sovereigns vs. financially troubled corporations), as well as the type of activity for which the loan is provided (e.g., mergers vs. project financings). Since most international lending is unsecured, two covenants are invariably used to provide lenders with some protection against other creditors, in the event the borrower becomes insolvent and is subsequently liquidated: (1) the negative pledge; and (2) the *pari passu* covenant.

The negative pledge covenant prohibits the borrower from granting security interests in its assets or revenues in favor of other creditors. This provision ensures that the lending banks will be treated equally with other creditors who might otherwise, in the absence of the pledge, be granted a mortgage, charge, pledge, loan, or other encumbrance on the borrower's assets or revenues, thereby taking priority in a liquidation of the borrower and leaving the lending banks a subordinate, unsecured interest, with rights against the balance, if any. The negative pledge can achieve the same purpose when applied against sovereign borrowers, though the context is different with respect to the security interests prohibited. Negative pledges will create equality between creditors, by preventing the pledging to a single creditor of a sovereign's foreign currency reserves, or external assets in the hands of foreign institutions.[87]

Negative pledge provisions may be relaxed somewhat to take into consideration the realities of the borrower's commercial life. The most common exceptions to negative pledges as an absolute covenant are: (1) prior and

87. Wood, *supra* note 2, at 146.

existing security interests on assets; (2) subsequent security interests assumed in the purchase of an asset, such as land subject to an existing mortgage; (3) liens which arise by operation of law, such as repairers' liens for the price of repair work; and (4) "equal and ratable security" clauses by which the borrower is allowed to create security interests in favor of other creditors so long as the lending banks are given the benefit of concurrent and equal and ratable security in some other asset (notwithstanding the problems of comparable security interests in different assets).[88]

The *pari passu* covenant usually accompanies the negative pledge. Its role is to ensure that the rights of the lending banks will always rank at least *pari passu* with the rights of the borrower's other unsecured creditors. As a result, the *pari passu* provision prevents the subordination of the lending banks to other unsecured creditors; the negative pledge covenant, the subordination of lending banks to secured creditors.

The *pari passu* provision is relevant in the event an insolvent corporate borrower is involuntarily liquidated. The lending banks will be entitled to share pro rata in the distribution of assets. In the event that the corporate laws governing the borrower will rank the unsecured claims, however, the covenant will not prevent the lending banks from being discriminated against.[89] In the context of the sovereign borrower, the *pari passu* covenant has a different effect. This provision will prevent sovereign borrowers from discrimination against the lending banks in the payment of creditors out of general revenues or foreign currency reserves.

In addition to negative pledge and *pari passu* covenants, the lending banks may negotiate with corporate borrowers to include several others, the most important of which are financial covenants. These covenants provide the lending banks the opportunity of regulating the broad decisions undertaken by the management of a corporation. So long as they are not too restrictive, these covenants can provide the corporate borrower with enough discretion to undertake corporate opportunities without compromising the concern of the lending banks that the borrower may grow excessively or undertake excessive liabilities. Financial covenants comprise several financial tests, which the agent bank or the lending banks can monitor, upon the receipt of the borrower's annual financial statements as a condition of the loan documentation. Included in this set of financial tests are measures to determine the debt-equity ratio, the net-worth minimum, the ratio of current assets to liabilities, the net current assets, minimum capital requirements, and so on.[90] The extent to which these tests protect the creditors depends in large part on the interpretation of the annual reports,

88. Clark and Taylor, *Conditions Precedent and Covenants in Eurocurrency Loan Agreements*, INT'L FIN. L REV. 18 (August 1982).
89. Wood, *supra* note 2, at 156.
90. Wood, *supra* note 2, at 160–61.

the accounting principles underlying which are subject to wide variations and rapid changes amongst countries.[91] Other covenants included in loan documentation may restrict a corporate borrower from merging or from using its funds in a manner other than the purpose for which they were given, and, in the case of project financing, may compel the completion of the project at a certain time.

ii. *Remedies.* In the event of a breach of covenant, the lending banks may have recourse against the borrower under the express terms of the loan agreement and at common law. Remedies under the loan agreement are identical to those for breach of representations and warranties described in Part II.B.2.a.ii, above: suspension and cancellation of scheduled borrowings and acceleration of previous borrowings. At common law, the lending banks may sue for damages for breach of covenant. This remedy will not augment the remedies the banks have under the loan agreement since the damages can only be an amount equal to the repayment of the loan under the contractual acceleration remedy. Discretionary remedies, such as specific performance and injunctions, may apply only when other remedies such as damages and rescission are unavailable.

c. Events of Default

Events of default are failures of the borrower to perform contractual obligations undertaken in the loan agreement. These events of default may be a breach of the loan agreement itself or an anticipatory breach whereby it is presumed that the borrower will inevitably breach the loan agreement. The characterization of a failure of the borrower to perform its obligations under the loan agreement enables the lending banks to suspend, and subsequently cancel, any undrawn portion of the loan, and accelerate the remaining balance of the loan.

i. *Types.* The events of default included in a loan agreement vary according to the type of borrower. It is common for a corporate borrower to be subject to several specific events of default clauses including (1) non-payment, including failure to pay principal and interest due under the loan agreement; (2) non-compliance in the performance of any of the covenants under the loan agreement; and (3) inaccuracies in any representation or warranty made or deemed made by the borrower. Though these provisions may seem harsh, imposing unduly onerous terms on the borrower, several mitigating techniques have been used in loan agreements. For instance, the non-payment and non-compliance events are subject to grace periods, within which a borrower may cure an inadvertent and trivial failure. Moreover, materiality tests are frequently provided (e.g., "in any material

91. Logan, *Term Loan Agreements*, INTERNATIONAL FINANCIAL LAW, LENDING, CAPITAL TRANSFERS, AND INSTITUTIONS 15 (Robert Rendell ed. 1980).

respect") so that trivial misrepresentation or breaches or warranty will not be characterized as an event of default.

Clauses anticipating events of default under a loan agreement with a corporate borrower are also varied. The most important is a cross-default clause under which a default by the borrower under any indebtedness permits the lending banks to accelerate the outstanding balance of the loan. Of course, this clause may be less effective than intended because information about an event of default under another loan agreement may be disclosed neither by the other creditors nor by the borrower, a possibility which would preclude the triggering of the cross-default clause.[92] Insolvency is another anticipatory event of default. This event is subject to evidentiary problems in proving insolvency. If objective tests are included in the loan documentation, such as the inability to pay debts when they fall due,[93] they must be drafted to take account of the bankruptcy and insolvency laws of the borrower's jurisdiction,[94] lest failure to do so prevent the attachment of the borrower's assets to a judgment claim. Moreover, these tests for insolvency should consider liquidation and dissolution proceedings, subject to a grace period in order to protect the borrower against actions served without due cause.[95]

A provision dealing with a change in ownership of the borrower is usually included in loan documentation as an event of default. The lending banks often make their credit decisions on the expectation that present ownership and control will remain unchanged throughout the life of the loan agreement. Nationalization or conversely, "privatization" or being taken-over by another private group are events which make lending banks wish to review their position as creditors, since any of these events may be regarded as indicative of future default.

Finally, an omnibus event of default category called the material adverse change provision is inserted in the loan documentation to apply to any adverse events that are not expressly contemplated in the loan agreement under other default categories. This provision applies to unexpected events, the occurrence of which, in the opinion of the lending banks, impairs the ability of the borrower to perform its obligations under the loan agreement. Though a discretionary event of default, it is unlikely that a court would not uphold the decision of creditors to accelerate the loan unless the decision were unreasonable in light of the changed position of the borrower's circumstances.

There is always a question in the drafting of events-of-default clauses

92. Clark and Taylor, *Events of Default in Eurocurrency Loan Agreements*, INT'L FIN. L. REV. 13 (Sept. 1982).
93. Wood, *supra* note 2, at 167.
94. Logan, *supra* note 91, at 19.
95. Wood, *supra* note 2, at 167.

whether other parties related to the corporate borrower should be included. It is usually the practice to include, for instance, the guarantor of the borrower's loan. Otherwise, the lending banks may not have much recourse to the guarantor in the event of the borrower defaulting, were the guarantor itself in default. In additon, the subsidiaries of the borrower should be monitored for default, since the liquidation or dissolution of the subsidiary might affect the creditworthiness of the entire group of companies.[96]

With respect to sovereign borrowers, events of default provisions are similar to those for corporate borrowers, but limited in number. For instance, events of default are typically limited to non-payment, non-compliance, inaccuracies in warranties and representation, cross-default, and "material adverse change" clauses.[97]

ii. *Remedies.* Events of default enable the lending banks to resort to the contractual remedies inherent in the loan documentation. As mentioned above, these remedies include the right to hold in abeyance, and subsequently suspend, undrawn portions of the loan, and to accelerate the outstanding balance. Moreover, the lending banks may have recourse to default interest under the loan documentation. The rate of default interest applies to any delayed payment of principal and interest, irrespective of whether or not the loan had been accelerated. The rate of default interest is usually a small premium of 1% or 2% higher than the rate specified for an interest period under the loan documentation, an additional amount reflecting the lending banks' extra costs involved in dealing with the defaulted loan. An excessive premium that did not adequately reflect these costs may be void if characterized as a penalty designed to terrorize the borrower into performance.[98]

Though events of default enable lending banks to accelerate the outstanding balance under a loan agreement, lending banks may consider waiving this remedy if the borrower in the absence of the loan acceleration is, or can be expected to, become creditworthy. The reasons for waiving an event of default are varied, principal of which is the self-interest of the lending banks. The acceleration of the loan to a corporate borrower will probably cause its insolvency, the consequence of which is that the lending banks may receive less in the distribution of assets upon the involuntary distribution of the borrower than upon the repayment of the loan, over a longer period of time. This subject is discussed further in Part IV, below. Acceleration of the loan as a contractual right, therefore, is exercised only as a last resort, usually when, in the judgment of the lending banks, the borrower will eventually be liquidated in the absence of the acceleration, a fact which compels the banks to take action as soon as possible to protect their position.

96. Wood, *supra* note 2, at 169.
97. Wood, *supra* note 2, at 165.
98. Clark and Taylor, *supra* note 92, at 15.

d. Governing Law

The selection of the law to govern the loan agreement between the borrower and the lending banks is usually one of the most important provisions in the loan documentation, though frequently the most terse. The governing law determines the rights and obligations of the parties. To the extent that the governing law may vary considerably, the parties wish to select that law which affords the greatest protection in the event that rights under the loan transaction must be enforced.

i. *Express Choice of Law.* The parties to a loan agreement usually have complete autonomy when selecting the law to govern their obligations and duties. Often the parties are at cross-purposes in the selection of a law, with the actual choice depending on several factors, foremost of which are the bargaining strength of the respective parties and the protection each party seeks under the agreement. The lending banks prefer selecting either the law of a major commercial country or state, often the one in which the loan is funded such as England or New York, or the law of the country (or, in the case of Canada and the United States, the province or state respectively) in which they are located. The former basis for selecting a law reflects the desire of the lending banks to have a well-developed, stable and predictable body of commercial law governing complex international transactions so that the parties may develop reasonable expectations about the operation of the loan agreement. The latter basis provides the lending banks with a legal system with which they are familiar, obviating the need to investigate the legal risk entailed by the selection of a foreign law. Often these criteria merge for many lending banks in a widely dispersed syndication of banks, reflecting several nationalities including New York and London based banks. The borrower, on the other hand, often prefers the jurisdiction in which it is located, especially if it is a sovereign borrower. Apart from being familiar with its own laws, the borrower may be the beneficiary of retroactive legislation designed to protect its interests.

The wishes of the lending banks usually prevail, because in part they are not compelled to lend funds if their position under a loan transaction is not adequately protected. Otherwise, the lending banks, once having disbursed the loan, and effectively meeting their only obligations under the loan agreement, would be in a vulnerable position depending on a legal system with which they are unfamiliar or in which they cannot repose much confidence to protect their rights to the payment of principal and interests. Although the borrower could go elsewhere in a competitive loan market, other syndicates would probably be willing to compromise less on governing law than on the spread charged on funding the loan: the former factor protects the corpus of the loan, i.e., the expected repayment of principal and interest; the latter protects only the expected profit. The instances in which the foreign borrower will object to the lender's choice of governing law is limited usually to foreign governmental borrowers, which for policy reasons or domestic legal constraints prefer their own domestic law to govern, or at the very least, the absence of any choice of governing law.[99]

The imposition of the lender's choice of governing law does not completely insulate the loan agreement from the law of the borrower's country. Legal issues regarding the legal status of the borrower, the corporate power of the borrower to enter into the loan agreement, the liability of its officers for debts, and so on, are determined by the law of the foreign borrower.[100] Moreover, in the event that the borrower's assets are not situated outside its country, any enforcement action taken against these assets may find the local court ignoring the foreign governing law to the extent it conflicts with domestic laws pursuant to its own conflict-of-law rules.[101]

The extent to which the lending banks cannot insulate completely their choice of law from the law of the borrower should be the focus of concern of the lending banks. An inquiry into the laws of the borrower's country is warranted to determine the validity and effectiveness of the governing law. Often, the prospect of undertaking proceedings subject to the law of the borrower's country, i.e., enforcement against its assets located only in its country, has given rise to two-tiered choice of law clauses: the agreement shall be governed by the lender's choice of law, except in the event proceedings are brought in the courts of the borrower's country, at which point the laws of the borrower's country would apply.

ii. *Absence of a Choice-of-Law Clause.* Occasionally, parties to a loan agreement will not make an express selection of governing law. Usually the absence of a choice reflects a compromise in which the borrower, for a number of reasons, especially if it is a sovereign borrower, will not submit to the laws of a foreign jurisdiction, and the lenders will not submit to the vagaries of the borrower's domestic law. Because the loan agreement cannot sustain itself, some law must apply in the event the loan agreement must be enforced.

The international rules for selecting a law to govern a loan agreement in the absence of an express choice are unsettled, with several competing theories having international currency. Usually courts first determine whether there has been a tacit choice of law. The choice is strongly evidenced by the lenders' selection of their country's courts to have jurisdiction in the case of a dispute, or in the event of a multinational representation of lenders, the selection of the courts in the country of the agent. Unfortunately, the tacit choice approach is somewhat suspect because it provides the courts of the lender with a presumption that there must be a coincidence

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99. Logan, *supra* note 91, at 17.
100. Wood, *supra* note 2, at 6.
101. *Id.*

between forum and governing law, even though the absence of governing law, especially the lenders', strongly suggests the product of compromise in which neither the borrower's nor the lenders' law could be chosen.

Beyond tacit choice lie several theories upon which a court may base its determination of the governing law. One is the "center of gravity theory," otherwise known as the "most significant relationship" test, which provides a presumption that the system of law with which the loan agreement is most closely connected should apply.[102] The plans of contract negotiation and execution, the place of currency or of the loan funding, for example, are nexi which may, given the weighing calculus of a court, determine the governing law. Predictability is not the consequence of this test, however, if the loan transaction is connected to too many factors.

Another approach often taken is the application of rigid presumptions, usually looking to the law of place of contracting or performace.[103] The former is suspect, though, because the execution of a contract may not bear any relationship to the contract. The latter test is more appropriate, usually favoring the laws of the country in which the agent bank is located, because the agent bank receives the borrower's payment of principal and interest.

Finally, flexible methods may be used to determine the governing law, including providing the most just result given the particular circumstances, applying the law of the state having the most urgent policy interest in having its law applied (the "governmental interest analysis approach,") and omnibus theories incorporating various provisions of the conflicts restatement to achieve greater predictability in conflict resolution.[104]

In order to develop reasonable expectations about the performance of the borrower's obligations under a loan agreement, the lending banks can minimize the lack of predictability that runs with the absence of an express choice of law. The unsettled international rules regarding choice of law suggest that the lending banks compel the borrower to submit to the jurisdiction of the courts in the country with the desired law, or at the very least, arrange the loan in such a way that most of its aspects are connected to the country whose law they desire to be applied, i.e., the negotiation, execution and performance of the loan should occur in the desired country.

e. Jurisdiction

i. *General Considerations.* The parties to a loan agreement may also expressly select a court to have jurisdiction over a loan agreement in the event a dispute over its terms arises. Although the selection of a forum may be of value to a borrower (e.g., litigation costs may differ significantly or the

102. Wood, *supra* note 2, at 12.
103. Wood, *supra* note 2, at 17.
104. Wood, *supra* note 2, at 15–16.

borrower may be the party bringing the action because the agent bank, for some reason may not advance funds on a draw down), the lending banks often have the most to gain, since any dispute that must be adjudicated by the courts will likely involve an execution judgment against the assets of the borrower. Instead of relying upon the domestic, and perhaps hostile, courts of the borrower's country to render judgment, the lending bank in selecting an external forum will confer on courts the jurisdiction they may not otherwise have to adjudicate a claim against the borrower. The choice of external forum preserves the valuable option of proceeding against the borrower's external assets, in the events that the borrower's courts do not attach judgment against its domestic assets and foreign courts are unwilling to enforce a domestic-court judgment.

The legal considerations underlying the choice of an external forum are often concurrent with those underlying the choice of a governing law. An external forum complements an external governing law because without the former, the lending banks will have to rely upon the borrower's court to apply an external governing law which may be subject to the primacy of domestic laws in the event of conflicts of laws over the attachment or execution of assets. Moreover, the choice of an external forum should coincide with the choice of a governing law, in order to achieve greater predictability, and obviate the procedural inconvenience for a court to apply the law of another country to a loan agreement. Finally, the choice of external forum should depend on a court that is experienced in commercial litigation and impartial to international disputes.[105]

ii. *Scope of Jurisdiction.* The express submission of a borrower to an external forum is generally all that is required to confer jurisdiction on that court. In the absence of this express submission, the court may have to resort to "long-arm" statutes to exercise personal jurisdiction over the borrower, the application of which usually depends on some form of contract between the forum and the borrower. In any event, the extent to which courts can exercise their powers, whether conferred by contract or statute, depends on several factors, the relevance of which vary, depending on the nationality of the court. Although a summary of these factors is beyond the scope of this article, a few factors will be mentioned. For instance, in the event of the express submission of the borrower, a court may not exercise its jurisdiction unless a borrower, given the condition of a loan agreement, has expressly appointed an agent situated in the jurisdiction of the forum on whom process may be served.[106]

Some courts will require as a necessary but not sufficient condition in the

105. Wood, *supra* note 2, at 59.
106. Gruson, *Legal Aspects of International Lending*, HANDBOOK OF INTERNATIONAL BUSINESS, at 27–19. (I. Walter ed. 1982).

exercise of their jurisdiction that at least one of the litigants to be a citizen of the forum's state, a condition which provides subject matter jurisdiction which cannot be conferred by the parties themselves. Once subject matter jurisdiction is present, a court may consider: (1) the defendant's connection with the forum; (2) the connection of the transaction to the forum; and (3) the location of assets in the territory over which the forum has jurisdiction.[107]

A court which has jurisdiction over a dispute arising from the loan agreement may in its own discretion choose not to exercise its powers. A court, for instance, may refuse jurisdiction upon the basis of *forum non conveniens*. This doctrine enables a court to refuse jurisdiction if it considers itself to be a seriously inconvenient forum of adjudicating a dispute, and a more appropriate forum is available. The practical significance of this doctrine, however, is limited if the parties have sufficient resources to litigate in any court in the world.[108]

iii. *Exclusive Jurisdiction.* An exclusive choice of forum serves two functions. The first is that it is a submission to the jurisdiction of a particular court by both parties to a loan agreement. Second, and the obverse of the first function, is that the potential jurisdiction of all other courts have been ousted. The second function is important to a borrower in that it prevents the lending banks from looking at several fora, seeking the most advantageous jurisdiction.

iv. *Sovereign Immunity.* Sovereign immunity poses special problems with respect to exercising jurisdiction and enforcing judgments. Unless a sovereign borrower has contractually waived its immunity, or falls under one of the statutory exceptions provided for by a relevent "state immunity" act, the court can neither enforce judgment nor exercise its jurisdiction. The topic of state immunity is briefly considered in the following section.

f. Sovereign Immunity

Today, sovereign states and state entities undertake the lion's share of the borrowing in the syndicated credit market. Without special attention being paid to the drafting of loan documentation, the lending banks may not have any legal recourse against a sovereign borrower in the event of a dispute, as the latter could claim sovereign immunity, a time-honored doctrine that immunized sovereign borrowers from court action. The doctrine has been in retreat recently. Case law and the subsequent codification of its principles in the state immunity legislation of the United Kingdom, the United States, and Canada, for example, have restricted the doctrine.

Lenders have two lines of legal defense in dealing with sovereign immu-

107. Wood, *supra* note 2, at 61–66.
108. Wood, *supra* note 2, at 68.

nity. The first is that the lenders induce the sovereign borrower to waive explicitly immunity from suit, immunity from attachment of assets in aid of execution, and immunity from execution upon judgment.[109] This approach is not always available, however, due to the inequality in bargaining positions between sovereign and the syndicate of lending banks. The second line is that the lenders rely upon sovereign immunity legislation, structuring the loan transaction in such a way so that it falls within the exceptions provided to immunity by the relevant legislation. To appreciate this second line of defense against sovereign immunity, a cursory survey of the statutes of the United Kingdom, the United States, and Canada follows.

i. *United Kingdom State Immunity Act 1978.* The United Kindgom passed the State Immunity Act in 1978,[110] enabling the country to become a party to the European Convention on State Immunity. One of the principal thrusts of the legislation was to preserve recent case law which permitted suit and enforcement if and when the sovereign entered into a transaction that was commercial (*jure gestionis*), and not governmental (*jure imperii*) in nature.[111] Another thrust of the legislation was to circumvent earlier case law which held that, unless a sovereign had submitted to the jurisdiction of English courts, no action could be brought; and even in the event of submission, a judgment might be permitted, though an execution could only occur with the sovereign making a separate waiver of immunity in regard to execution.[112] A contractual waiver of immunity from execution in loan agreements was later held to be without legal effect.[113]

As a result, the Act states that sovereigns are immune from suit unless the transaction is caught by one of the exceptions, which include: (1) submission (section 2) to English jurisdiction as an express acceptance of English governing law and waiver of immunity are not sufficient in themselves; and (2) commercial transactions (section 3) which by definition include "any loan or other transaction for the provision of finance and any guarantee or indemnity in respect of any such transaction or of any other financial obligation." Moreover, the Act states that sovereigns are immune from execution without the consent of the state except against property used for commercial purposes. The Act does not prevent set-off, however, because the funds can be appropriated by the lending banks without judicial intervention.

The Act does not distinguish between the state on the one hand, and state entities and separate state bodies on the other hand, in the scope of immunity accorded. For instance, state entities such as central banks, nationalized

109. Gruson, *supra* note 106, at 27–15.
110. State Immunity Act, 1978 (U.K.) c.33.
111. Trendtax Trading Corp. v. Central Bank of Nigeria (1977), 1 All. E.R. 881.
112. Duff Development Co. Ltd. v. Government of Kalantan (1924), A.C. 797.
113. Kahan v. Pakistan Federation (1951), 2 K.B. 1003.

industry and so on are subject to suit if the loan transaction is not in the exercise of sovereign authority; and in the event that it is, the state entity still has no immunity if caught by one of the exceptions. The Act does not apply retroactively.

ii. *United States Foreign Sovereign Immunities Act 1976.* The United States Foreign Sovereign Immunities Act of 1976 (FSIA)[114] was designed to codify the distinction the Department of State made in the Tate Letter of 1952 between the commercial and governmental nature of a transaction. It was recognized that only the latter type of transaction was subject to the defense of immunity. The Act also sought to eliminate the administrative influence the State Department exercised on behalf of a foreign state on domestic courts deliberating about the nature of a transaction. It was felt that this lack of intervention would create more predictability and uniformity in the courts' decisions.[115]

The approach of the FSIA is similar to the U.K. Act in that it granted extensive sovereign immunity subject to several exceptions. A foreign state, including, corporate instrumentalities in which the state owns a majority of shares or interest,.is immune from U.S. jurisdiction unless, *inter alia*: (1) there has been an express or implied waiver of immunity; (2) the transaction is commerical in nature and was carried on in the United States; or (3) the transaction was performed within, or having direct effect within, the United States in relation to a commercial activity of the foreign state elsewhere.[116] The property in the U.S. of a foreign state, whether or not it is commercially used, is not immune from exception upon a judgment, and attachment in aid of execution, if the foreign state expressly or implicitly waives its immunity. Moreover, in the absence of a waiver, commercially used property that is or was used for the commercial activity upon which suit is predicated is not immune.[117]

In the absence of an express or implied waiver, the lending banks would not have much legal recourse to the assets of the sovereign borrower under the FSIA. Commercially used property caught by one of the exceptions is not likely to be involved in many financial transactions, and the right of set-off falls outside the Act. Moreover, the property of the central bank or a foreign state is immune from any attachment and execution in the United States, as well as the U.K., because both countries wish to encourage the holding of reserves in their respective money markets.[118] The only relevant

114. U.S. Foreign Sovereign Immunities Act of 1976, 28 U.S.C. §§ 1330, 1332, 1391, 1441, and 1602 *et. seq*.

115. Wall, *Waiver of Sovereign Immunity Under United States Law*, INT'L. FIN. L. REV. 28 (November 1982).

116. *Supra* note 114, Section 1605.

117. *Supra* note 114, Sections 1608 and 1609.

118. Wood, *Law and Practice of International Finance*, vol. 2, INTERNATIONAL BUSINESS & LAW SERIES, at 4–32, 34 (1983).

assistance the FSIA would make available in the absence of a waiver is in the event that a claim is based upon a commercial activity carried on by an agency or instrumentality of a foreign state in the United States or upon an act performed within, or having direct effect within, the United States in relation to its activities elsewhere. In this instance, the property of the agency or instrumentality would attach in aid of execution or from execution upon judgment, irrespective of whether or not the property was commercially used, and used in the activity upon which suit is brought. For instance, a borrowing of funds from U.S. commercial banks in the United States by the agency or instrumentality could be characterized as such a commercial activity that would de-immunize its property held in the United States, if any, from execution upon judgment.[119]

iii. *Canada State Immunity Act 1982.* Canada passed its own State Immunity Act in 1982.[120] It follows the U.K. and U.S. acts in validating the extensive immunity of sovereigns subject to several exceptions, including: (1) express submission to Canadian jurisdiction before or after suit is brought;[121] (2) express or implicit waiver of immunity from attachment execution, arrest, detention, seizure, or forfeiture;[122] and (3) engaging in commercial activity whereby any particular transaction or course of conduct is of a commercial character. Unfortunately, the Act does not define commercial act as, in part, "any loan or other transaction for the provision of finance and any guarantee or indemnity," as the U.K. Act does. Instead, the Canadian Act leaves the meaning subject to judicial interpretation, creating uncertainty as to whether, for instance, a sovereign stand-by line of credit to defend a domestic currency against depreciation would be construed as a commercial act.

g. Other Provisions

Eurocurrency syndicated loan agreements have standardized provisions designed to protect the yield that lenders earn on the loan throughout its operation. The yield is the fixed spread representing the difference between the LIBOR cost of the Eurocurrency funding to the lender and the rate of the loan paid by the borrower. The borrower is to indemnify the lenders in the event that there are increased costs of funding due to a change in law, reserve requirements, and other monetary requirements. Moreover, payments by the borrower must be made free of withholding and all other foreign taxes.[123]

119. Gruson, *supra* note 106, at 27–14.
120. State Immunity Act, S.C. 80-81-82, c.95.
121. Sec. 4(2)(a).
122. Sec. 11(1)(a).
123. Gruson, *supra* note 106, at 27-11.

3. *Substantive Provisions: Lending Banks Inter Se*

a. Amendments and Waivers: Unanimity and Majority Rule

A direct loan syndication involves many lenders with divergent interests based on several factors, including their position in managing and arranging the syndicate, their closeness to the borrower, and the importance of their loan commitment to the syndicated credit as well as to their own portfolio of assets. In the event decisions must be made about managing those aspects of the loan not delegated to the agent bank, some express provisions are required to reconcile the divergent interests of the lending banks, lest an impasse develop.

The practice of international loan syndications has given rise to two different approaches to this problem, depending largely on the type of banks involved in the syndication. In the case of a very heterogeneous syndication, with many banks possessing diverse asset bases not necessarily correlated with their commitment to the loan syndication, decisionmaking tends to be two-tiered: (1) unanimity is required to ratify changes made in the principal amount of the loan commitment of each lender, the interest payable on the principal amount and the amortization dates and amounts of repayment;[124] and (2) a majority, often a simple one, of lending banks is required to make any amendment to or waive any provision of the loan agreement not subject to unanimity, with the majority determined by the value of the commitments of the lending banks rather that the number of lenders.

The division between these two provinces of decision-making will vary depending on the dynamics of the formation of the syndication. Typically more changes are subject to lender unanimity than are listed above. The compromise struck between unanimity and majority rule reflects the concern smaller banks may have in protecting their involvement in the syndication, especially in the event of either rescheduling or increasing a loan to a borrower whose creditworthiness has become suspect. Unanimity allays the fear of the smaller bank that its interest will be sacrificed to the common interests of the borrower and major lenders arising out of interests extrinsic to, and concurrent with, the loan transaction. On the other hand, the large lending banks are protected from the action of the smaller banks through the majority rule. Majority rule applies to decisions regarding the waiving of events of default, which would include at least default events such as non-payment, non-compliance with covenants and inaccuracies in representations and warranties. As a result, dissenting banks could neither accelerate the loan in order to collect its portion of the loan commitment,

124. Stansbury, *Legal Aspects of Syndicated Eurolending*, INTERNATIONAL FINANCIAL HANDBOOK, at 1–3.520 (A. George and I. Giddy ed.) (1983).

nor default on its obligations to provide further monies on subsequent draw-down periods without contractual sanctions being applied.

The two-tiered decisionmaking procedure effects will lead to tensions between the syndicate lending banks in the event of rescheduling the loan, as is discussed in Part IV, below.

In the event that the lending banks are fairly homogeneous, and few in number, a unanimity approach, or at least one not requiring a majority, may be adopted by the lending banks. The reasons for this approach are two-fold: (1) the sophistication of the lending banks and the relative nondivergence of their interests makes it unnecessary to have a majority rule to circumvent a bank dissenting to a step which is in the interests of the lending banks as a whole; and (2) the commitment of each bank is too large to be subject to the majority decision of the other banks.[125]

b. Sharing of Payments

Lending banks in a syndicate usually subscribe to egalitarian principles to regulate the receipt of payments which arise from either the normal operation of the loan or the collections occasioned by an event of default: no one bank is entitled to receive payments in excess of its pro rata commitment of funds to the syndicate, and in priority to the other banks. Sharing of payments clauses are easily applicable during the normal operation of the loan. The borrower remits payments of principal and interest to the agent bank, which in turn distributes the receipts commensurate with the lending commitment of each bank. These sharing clauses preclude the borrower from giving preferential treatment to any one lender. In the event a particular lending bank is singled out to receive funds prior to the other syndicate banks, it typically is under a contractual duty to return the entire amount with interest to the agent bank for a subsequent redistribution to the remaining lending banks. In the absence of a sharing clause, it is thought that the lending bank subject to preferential treatment is under a duty to hold the monies on constructive trust for subsequent redistribution by the agent bank.[126]

The operation of sharing clauses during a default is more problematical, however. Prior to joining a syndicate, a lending bank may often hold a deposit from the borrower which it expects to set off against its unpaid share of the syndicated loan in the event of default. Moreover, it may hold a security of the borrower from previus loan commitments, the proceeds from the disposition of which would be applied towards its unpaid share. The prospect of sharing the funds arising from these sources may discourage banks from joining a syndicate, or if they are major banks, may preclude the

125. Wood, *supra* note 2, at 271.
126. Wood, *supra* note 2, at 272.

incorporation of such sharing clauses in the loan documentation. One solution that has been adopted is for the lending bank, which receives payment from either set-off or the disposition of a security in excess of the amount to which it is entitled on a pro rata basis, to purchase from the other lending banks participations in their advances to the borrower in such amounts that the excess payment received by the lending bank is shared ratably with the other banks. Another solution is that a lending bank which has advanced funds to a borrower through a syndicate by sharing provisions and otherwise without sharing obligations may allocate funds from the exercise of set-off first to its loans in which there are no sharing obligations with the balance, if any, applied to the loans governed by these sharing provisions.[127]

III. Syndicated Acceptance Financing

Syndicated bankers' acceptances comprise a relatively new method by which banks provide credit to a customer without necessarily advancing their own funds, and at a cost lower than that of borrowing. It is used specifically to finance transactions, such as short-term trade, which qualify under statute and administrative discretion over favorable regulatory treatment designed to reduce the credit costs of this facility. The syndication of acceptance financing, moreover, is not unlike the syndication of term-loan agreements—Eurocurrency or otherwise—as banks form syndicates before and after the acceptance financing agreement is executed, and either to comply with domestic lending ceiling requirements or to transfer the risk inherent in this type of credit to others. In addition, the loan documentation underlying acceptance financing is similar to that underlying term-loan agreements, with, at the very least, provisions regarding representations, warranties, covenants, and events of default. Some of the issues encountered in the syndication of acceptance financing are discussed below.

A. Types of Bankers' Acceptances

Acceptance financing is used throughout much of the world as a vehicle by which a bank can advance credit to a bank customer without necessarily using its own funds. In New York, the instrument evidencing this arrangement is called a banker's acceptance (BA); in London, a sterling acceptance. The instrument itself is a time draft (or, in another parlance, a term bill of exchange) drawn by the customer (drawer) on a bank (drawee) and accepted by the drawee bank (acceptor). Acceptance by the (drawee/acceptor) bank commonly consists of the word "accepted" with the date of

127. Stansbury, *supra* note 124.

maturity stamped across the draft, though other words such as "certified" or "good," accompanied by a signature, are also adequate.[128]

The act of acceptance is legally significant. It transmogrifies the draft drawn on the bank by a customer into a signed promise that the bank will honor the draft upon its maturity. As a consequence, the accepting bank is primarily liable to the holder of the BA to pay the value thereof at its maturity. The borrower, on the other hand, unless he writes "without recourse" on the instrument, is liable to a subsequent holder of the BA in the event the accepting bank should dishonor the instrument at its maturity.[129] Since the act of acceptance entails a degree of risk the bank must bear, the drawer will pay the bank an acceptance fee in consideration for its accepting the draft.

The drawer of the accepted draft can sell the BA to either the accepting bank or to the market for a discount, which represents the value of money today for an amount paid at a later date. In each case, the drawer can be put into funds immediately after the time draft is accepted. The accepting bank need not buy the BA, but if it does, it will advance funds to the drawer. The normal practice in New York is for the acceptance to be sold to the accepting bank; in England, the acceptance may be sold by the accepting bank in the market at the request and for the account of the drawer.[130] In the event the accepting bank does not act as agent for the drawer, the bank may either hold the instrument to maturity, or discount it in (resell it to) the market. In the former case, the bank ultimately advances its own funds to its customer; in the latter case it does not.

The market for BAs in the United States is an over-the-counter market comprised of about 16 non-bank dealer firms, most of which are in New York, whose clients range from foreign central banks and governments to domestic and foreign private investors, all of whom wish to hold this relatively risk-free instrument to maturity.[131] In London, the sterling acceptances are sold to Discount Houses, and other types of investors such as corporate treasurers and commercial banks which have a need for various types of short-term instruments, including Treasury Bills and acceptances. The Discount Houses may in turn sell acceptances to the Bank of England, whereas in the United States they may be bought by the Federal Reserve through normal market operations.[132] Eventually the BA will mature. The accepting bank at maturity will pay the value specified on the BA, thereby

128. Ryan, *What a Lawyer Should Know About Bankers' Acceptances*, THE PRACTICAL LAWYER, Vol. 27, Mar. 1981, at 52.
129. *Id.* at 52.
130. Peet and Robertson, *How to Arrange Syndicated U.S. Eligible Bankers' Acceptance Financings*, INT'L FIN. L. REV., Sept. 1982 at 17.
131. Ryan, *supra* note 128, at 53.
132. Peet, *supra* note 130, at 17.

discharging not only its own primary obligation, but also the secondary obligation of the drawer to the holder of the BA.

Underlying the creation of a BA is an executed acceptance credit agreement between the accepting bank and its customer, the drawer of the BA. This separate contract is necessary because it obligates the drawer, in consideration for the one or more drafts drawn on and accepted by the bank, to pay the amount of each draft to the accepting bank before or on the date of maturity. As a result, the accepting bank will be concurrently reimbursed by the drawer the very amount it pays to the holder of the BA at its maturity.

A banker's acceptance may be categorized as either eligible or ineligible pursuant to statute or administrative discretion. An eligible BA is entitled to certain regulatory advantages to which an ineligible one is not. These regulatory advantages ultimately mean that the cost of eligible acceptance financing will be less than that of normal bank borrowing. In the United States, these regulatory advantages include: (1) the proceeds received by the accepting bank from its sale of an eligible BA are not subject to reserve requirements, a monetary regulation which imposes higher costs of providing credit; (2) the primary liability of an accepting bank on the BA is not subject to the aggregate indebtedness limit imposed by statute,[133] though it is subject to a separate ceiling on eligible BA's,[134] and (3) the liability of the drawer under the acceptance credit agreement is not subject to the bank's lending limits to a drawer[135] (unless the bank has not sold the BA to the market) though there is a separate ceiling on BA's for each customer.[136] These exemptions are available to national U.S. banks; the treatment accorded state chartered banks, non-member U.S. banks, and U.S. branches and agencies of foreign banks is different, and is not treated here. In the United Kingdom, only the exemption from reserve requirements applies. There are no statutory ceilings on BA creation as the Bank of England exercises informal control over the volume of each bank's acceptances.

The eligibility of a BA depends on the nature of the transaction that gives rise to the drawer's need for acceptance financing. In the United States, the requirements for the eligibility of a BA created by a member bank of the Federal Reserve System were stated in broad statutory terms in the Federal Reserve Act of 1912.[137] Since then, the administrative practice of the Board of Governors of the Federal Reserve System has resulted in numerous published rulings, the result of which has made the ascertaining of eligibility a technical exercise. To be eligible, the BA must generally finance transac-

133. 12 U.S.C. § 82.
134. 12 U.S.C. § 372.
135. 12 U.S.C. § 84.
136. 12 U.S.C. § 372.
137. 12 U.S.C. § 372.

tions that involve: (1) the importation or exportation of goods, not necessarily involving parties situated in the United States; (2) the shipment of goods within the United States; or (3) the storage of goods. The BA must be drawn for a short term not to exceed 180 days.[138] The denominating of a BA in foreign currency, in itself, does not bar eligibility.[139] In the United Kingdom, eligibility is determined by the Bank of England, which publishes and distributes guidelines. At one time, the administrative practice of the Bank permitted the use of BAs for a wide variety of purposes extending beyond trade and trade-related transactions. The basis for eligibility has narrowed considerably to financing which is short-term, self-liquidating, and related to trade. Bills of exchange drawn for working capital purposes, for instance, as well as bills the terms of which exceed 180 days, are no longer eligible.

Since the administrative practice of the Bank of England and the Federal Reserve System are extremely complex, and constantly evolving, any discussion of eligibility beyond the general positions outlined above is beyond the scope of this article.

B. Syndication

The syndication of a BA stems from the general reasons which underlie the syndication of any financial transaction. For instance, a bank does not wish to absorb the entire risk associated with being the sole primary obligor/payee in the event the drawer under the acceptance credit agreement defaults. Moreover, a bank may often be incapable of financing large acceptances, or find it commercially imprudent to do so for fear of "crowding-out" or depreciating the value of its own commercial paper as a source of funds. Finally, in some jurisdictions, like the United States, a bank may be legally constrained from creating acceptances in excess of some ceiling for individual customers or for all customers.

1. *Syndication Methods*

Acceptance syndication techniques are not unlike those involved in syndicating term-loan agreements. The direct acceptance syndication involves a multilateral acceptance credit agreement, in which all the banks agree to accept and discount drafts drawn by the drawer. The obligations of the banks are several and not joint, as each bank assumes a primary obligation for only the draft drawn on and accepted by it.

A participation acceptance syndicate involves several banks, but accep-

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138. 12 U.S.C. § 372. For an excellent discussion of eligibility of acceptance, see *supra* note 130, at 18–20.

139. Peet, *supra* note 130, at 17.

tances would be created by only one bank, the lead bank. In this case, the lead bank would execute the acceptance credit agreement with the customer and assume a primary obligation for the drafts drawn on and accepted by it. The remaining banks would enter the syndicate after the creation of acceptances by the lead bank under a participation contract or some other agreement that obligates each bank in the syndicate to pay its pro rata share of the acceptor bank's liability in the event the drawer defaults.[140]

The first two techniques may be easily combined in an acceptance facility in which several acceptances are created on a drawdown, with some banks subsequently deciding to participate out to other banks an interest in the payment to which it is entitled under the acceptance credit agreement in consideration for money and an obligation from each participant to share in the acceptor bank's liability in the event of default.[141]

2. *Mechanics of Direct Acceptance Syndicates*

Under a multilateral acceptance credit agreement, the syndicate banks agree to accept and discount drafts drawn by the drawer upon a notice to an agent bank. In order to receive funds quickly, the drawer supplies each bank, or the agent, depending on the acceptance facility and syndicate agreement, with signed and endorsed drafts incomplete as to date, amount and maturity. The banks or the agent have the drawer's power of attorney to complete drafts; in a very streamlined acceptance facility, the agent will have the bank's power of attorney to accept the drafts presented pursuant to the terms of the facility. Once the drafts are accepted and discounted in (sold to) the market, the agent makes the proceeds available to the drawer.[142] Upon maturity, a bank is responsible for each acceptance it created and receives payments from the agent (who has received payments from the drawer) pursuant to the terms of the acceptance facility.

3. *Documentation under Direct Acceptance Syndicates*

The documentation under an acceptance credit agreement is similar to that in a syndicated loan agreement, discussed above in Part II.B. Provisions cover the mechanics such as determining the rate of discount and the acceptance commission and specifying the drawdown and repayment procedures. Other provisions protect the credit position of the banks, such as representations and warranties, covenants, events of default, governing law, forum, and waivers of sovereign immunity, if necessary.

140. Ryan, *supra* note 128, at 65.

141. There is some debate in the United States about whether or not an acceptor bank may subtract the portions of the B.A. it participates out to other banks from its aggregate creation of acceptances so as not to exceed the acceptance ceiling to an individual drawer or in aggregate. This debate is expressed well by Ryan, *supra* note 128, at 65–66.

142. Peet, *supra* note 130, at 20.

IV. Rescheduling

A. Introduction

Borrowers, whether they be corporate or sovereign, often find themselves in trouble under existing syndicated credit arrangements with commercial banks. An event of default is either imminent, or has occurred when the borrower is unable to meet its liabilities as they become due. Commercial banks can choose between two courses of action upon this type of declared or imminent default. They may either enforce collection of the borrower's assets by whatever means possible or (2) reschedule and refinance the obligations of the borrower. Improbable as it seems, it is unlikely that the first course will be selected. The reasons are varied.

Apart from secured transactions, which are not commonplace in the realm of international finance except for ship and project finance,[143] syndicates of commercial banks may exercise the right of set-off against whatever deposits are currently in a member's possession, as well as bring suit and enforce judgment, by either attachment or execution. The deposits subject to set-off are almost always insufficient, frequently having been depleted in large part to prevent a default. Moreover, the deposits of a bank engaged in other syndicated credits have to be shared amongst all the banks in all the syndicates.

Attachment and execution against the borrower's assets are also not without problems, as is discussed in Part II.B.2.f., above. For example, in the case of the foreign borrower, the attachment or execution of assets may cause voluntary or involuntary bankruptcy. A piecemeal seizure of assets by one syndicate of creditors may cause other creditors, syndicated or otherwise, to rush into enforcement proceedings under their cross-default clauses. Bankruptcy liquidation will lead to a freezing of claims and perhaps a *pari passu* distribution of the proceeds realized from the liquidation to the assets, except in those jurisdictions where preferential treatment is accorded domestic creditors over foreign creditors. In all likelihood, the distribution of assets will yield much less than the collective claims of the creditors.

The sovereign borrower is treated differently under enforcement proceedings because state insolvency is not governed by the same rules as corporate bankruptcy. A court can neither seize nor sell a sovereign's territory in satisfaction of a debt. Other domestic assets can be protected by retroactive legislation, with perhaps declaration of a moratorium on foreign debt. External assets, moreover, may not be entirely subject to enforcement proceedings. Issues of sovereign immunity impose obstacles leaving little to provide satisfaction for the enforcement of a judgment. Even the reserves of the central bank of the sovereign debtor may be immune from suit and judgment.

143. *Supra* note 2, at 326.

Enforcement proceedings and bankruptcy are measures of the last resort. It is much better to renegotiate the credit agreement with the debtor, either rescheduling the amortization schedule of principal and interest, or providing refinancing—"new money"—so that a default can be avoided. The hope of the syndicate with the second course is that the debtor will have the opportunity to reorganize its finances and, in turn, restore its capacity to meet its obligations. Even in those cases where it is all but impossible for a debtor to meet all its obligations, a syndicate hopes that the part performance of the borrower's obligations will provide a greater amount than that realized under enforcement proceedings and set-off; it is never the province of commercial banks to provide aid to a chronic debtor.

The following discussion surveys many of the legal issues that underlie the rescheduling and refinancing of syndicated credits and, for that matter, all commercial bank credit. In that discussion, "rescheduling" means loosely the deferral of debt obligations in arrears and in imminent default and "refinancing" means the providing of "new money" to help the debtor repay its debt obligations in arrears and in imminent default. It should be kept in mind that throughout the following discussion, only the general structure of rescheduling is presented because rescheduling agreements, unlike syndicated agreements, have not yet become standardized.

B. Rescheduling Mechanics

1. *Generally*

Problem debtors usually have several classes of creditors, all of whom have different entitlements to the amortization of the borrower's debt. The classes of creditors to a sovereign borrower, for instance, may include commercial banks, bondholders, foreign governments, and international organizations; those of a corporate borrower, commercial banks and holders of various types of debt securities, including bonds, debentures, and notes. A problem debtor must usually renegotiate with all classes of creditors, if it must renegotiate with one class. It is the rule that the economic problems that give rise to the rescheduling of one class will generally apply to all classes. It is necessary, however, for the problem debtor to negotiate a separate agreement with each class of creditors, rather than a common agreement will all classes of external debt. Renegotiations are difficult with any one class of creditors, let alone all classes of creditors who have widely diverging interests and expectations.

2. *Commercial Bank Rescheduling*

The renegotiation of commercial bank debt may involve one or several groups of commercial banks. When there are several groups of banks, usually formed on a national and/or syndicated basis,[144] the renegotiation with the problem debtor will not proceed on a united front. Some groups drive a harder bargain than others, perhaps ultimately impairing the capacity of the borrower to perform its obligation to any one group, let alone all groups. Divisive and perhaps as myopic as it seems, the presence of several groups reflects what its members in their own self-interest regard as the best institutional vehicle by which to protect their diverse interests in and their expectations of the debtor's resolution of its problems.

Often, though, only one group of commercial bank creditors is involved in a renegotiation. At the invitation of the debtor, several major creditors establish a steering commitee to lead the renegotiation.[145] Usually no legal authority vests in the steering committee, though it enjoys the approval of most commercial banks. The purpose of the steering committee is to achieve administrative convenience and efficiency in putting together a financial package which the other banks may or may not accept.

A single bank, called a servicing institution, is responsible for the administration of "new money" under a refinancing[146] and the distribution of receipts under a rescheduling and refinancing if and when the debtor makes repayment.

3. *Type of Debt Rescheduled*

There is no general rule as to what type of commercial bank debt is likely to be rescheduled. As a starting point, only current and imminent arrears may be rescheduled, the bulk of which is debt arising under several syndicated credits. The reason is often due to circumstances. A debtor faced with imminent insolvency announces a cut-off date on which a suspension of payments to creditors will occur, and invites rescheduling negotiations.[147] Creditors recognize the need to reschedule the debt in arrears or in imminent default in order to provide the debtor with some time to reorganize its financial circumstances and regain its creditworthiness. In the event that the debtor's problems are likely to be chronic, the creditors may wish to reschedule all long-term debt. The creditors may recognize that such a policy is practically difficult. Any fresh debt incurred before the execution of a rescheduling agreement requires constant revision of the documentation. In addition, such wholesale rescheduling may be tactically imprudent as well. The long-term capacity of the debtor to repay its debt may be impaired because the rescheduling of all debt decreases the debtor's ability to raise

144. *Supra* note 118, 4–137.
145. *Id.*
146. Wickersham, *Rescheduling of Sovereign Bank Debt*, INT'L FIN L. REV. Sept. 1982, at 9.
147. Wood, *supra* note 118, at 4–116.

fresh capital during the period between suspension and the execution of the rescheduling agreement.

4. *Rescheduling Methods*

There are two general methods by which rescheduling may be achieved.[148] The first involves the debtor assuming the obligation to repay the rescheduled amount pursuant to the conditions and terms of the new agreement concurrent with the creditors discharging the debtor from the obligation of its old debt to the extent of the rescheduled amount. The second involves a roll-over in which refinancing loans are used to repay the amount to be rescheduled.

A rescheduling of multicurrency obligations by whichever method typically entails a conversion of the debt into a single currency. Conversion facilitates the administration of the rescheduling agreement by providing a common base for determining interest periods and pro rata repayment. Conversion can be controversial, however, as creditors will receive too much foreign currency relative to their domestic currency, if and when the debtor can make payments. The forward exchange market offers only an imperfect hedge against prospective exchange loss because the creditor may not be able to satisfy a forward contract for its own currency with the foreign currency paid by the debtor, if the debtor makes infrequent payments due to its financial difficulties.

5. *Creditors Not Consenting to Rescheduling*

The creditors who do not agree to the rescheduling agreement are not bound by its provisions. The obligations of the debtor to and the rights of the dissenting creditors are governed by the original syndicated loan. Under the syndication agreement, the dissenting creditors may not be able to accelerate the original debt because banks representing a majority by value can waive an event of default, namely, the debtor's failure to amortize the loan as scheduled. The waiver will remain effective in the post-rescheduling period, however, even if the majority banks release the debtor from the short-term debt—the majority banks will still have an interest in the unrescheduled medium-term debt governed by the original syndicated agreement.

In the event the rescheduling involves refinancing, the dissenting banks may have a claim in the proceeds of the "new money" under the provision of the original syndicated loan agreement. These proceeds are technically a repayment of the old debt, to which pro rata sharing provisions apply.[149]

148. Wood, *supra* note 118, at 4–139.
149. *Id.*

C. Rescheduling Agreement Provisions

1. *Provisions Regarding Debtor and Banks*

A rescheduling agreement is not unlike a Eurocurrency syndicated term loan with respect to many of the provisions it contains. Several of the provisions, however, such as negative pledge and cross-default and events-of-default clauses are more finely attuned to the problems of rescheduling in order to protect the creditors involved in the rescheduling without impairing the capacity of the debtor to pay. Moreover, new clauses specific to rescheduling are included so as to protect the interests of the creditor against other creditors, commercial banks or otherwise.

a. Most-Favored-Debt Clause

An important provision that provides for the *pari passu* treatment of commercial bank credits under a rescheduling is the most-favored-debt clause. Sovereign debtors, for instance, may renegotiate with all their classes of creditors, if they must renegotiate with the commercial banks. The clause is drafted in order to prevent another class of creditors under a separate rescheduling agreement from receiving preferential treatment, subject to negotiated exceptions. Usually this clause is accompanied by clauses mandatorily requiring proportionate prepayment of the rescheduled bank credit, if other rescheduled credit in arrears is paid on more favorable terms.[150]

b. Negative Pledges

A negative pledge prevents the borrower from granting a security interest in its assets in favor of other creditors. In a rescheduling agreement, its purpose should be to protect the interests of the commercial banks, without impairing the capacity of the debtor. As a result, a carefully drafted negative pledge should distinguish between the normal operations of the debtor and financial transactions which convey preferential rights over assets or revenues of the debtor to another class of creditors.

In the case of sovereign debtors, the purpose of the negative pledge is to prevent the preferential diversion of the available foreign currency reserves and external assets; the only means by which an external debt can be satisfactorily paid. Since the amounts of foreign currency earnings and reserves are likely to be very limited when there has been a rescheduling, it is in the interests of the commercial banks to extend the definition of external debt to include all foreign currency debt, and not merely debt arising from the sovereign's loan obligations.[151] Moreover, the negative pledge should

150. Wood, *External Governing Law—Fortress or Paper House*, INT'L FIN. L. REV. July 1982, at 4.

151. Wood, *supra* note 118, at 4–145.

be extended to all instrumentalities of the state so as to prevent the diversion of foreign currency earnings from these entities, though compromises will be warranted with respect to central banks.[152]

With respect to both corporate and sovereign debtors, the negative pledge cannot be made so wide that any security given to a subsequent creditor would be indiscriminately prohibited. Otherwise, the debtor's normal operations will be adversely affected. Exceptions must be made to an extensive negative pledge to accommodate the commercial realities of the debtor. For instance, sovereign debtors must continue to purchase essential imports, which may require additional borrowing and some security in the transaction.[153] In addition to the exceptions enumerated in Part II.B.2.b.i above, exceptions may include purchase money security interests, security given under project finance, and security created in export transactions, such as letters of credit.[154]

In the event the negative pledge does not catch every transaction, the rescheduling agreement may use the phrase "preferential arrangements of any kind, the practical effect of which is to create a security interest" to provide the creditors with some flexibility, though at the cost of inducing uncertainty with respect to the debtor and the party with which it transacts.[155]

c. Cross-Default

Cross-default clauses found in the normal loan transaction cannot be adopted without some modification in the rescheduling agreement. The purpose of the cross-default is to provide banks with the right to accelerate the loan as soon as it is discovered that other lenders may declare an event of default. In the context of rescheduling, sensitive cross-default clauses may not work to the benefit of lenders and debtor, since the debtor is likely to be in default under a number of agreements. It is better to limit the cross-default to actual accelerations.[156] This principle applies even when several consortia of lenders are involved since in the self-interest of all the creditors, there is likely to be an uneasy truce regarding acceleration. It typically is not difficult for these groups to recognize that an acceleration by all groups would completely destroy the current or prospective creditworthiness of the debtor, leaving every creditor worse off.

152. A. Pergam, *Legal Terms and Conditions: The Borrower's Perspective* (Edited text of remarks prepared for seminar on "Critical Legal Issues—Rescheduling and Default"), Euromoney International Finance Conference, London, March 16, 1983, at 7.

153. Wickersham, *supra* note 146, at 9.

154. Wood, *supra* note 118, at 4–146.

155. Pergam, *supra* note 152, at 9.

156. Wood, *supra* note 118, at 4–148.

d. Events of Default

A rescheduling agreement includes the usual events of default found in syndicated loan agreements, i.e., non-payment, breach of warranty, material adverse changes, and so on. Special events of default are included in rescheduling agreements with sovereign debtors. These special events are related to the sovereign debtor's compliance with stringent economic programs of the International Monetary Fund (IMF) which are designed to improve the creditworthiness of the sovereign. Although the commercial banks wish to have the sovereign adopt the economic policies of the banks as a precondition to a rescheduling, the sovereign usually resists these overtures as an unacceptable encroachment upon its powers. To circumvent this objection, the banks incorporate by reference as a positive covenant the arrangements the sovereign maintains with the IMF. The failure of the sovereign to comply with these arrangements constitutes an event of default. As a result, rescheduling agreements, unlike syndicated agreements, impose very extensive economic controls upon the sovereign debtor.[157]

e. Jurisdiction, Forum and Sovereign Immunity

A rescheduling agreement has express provisions requiring the agreement to be governed by foreign law and the debtor to submit to the laws of a foreign forum. An express waiver of sovereign immunity is required of sovereign debtors. These waivers are more extensive than those included in loan agreements governing the original debt. For instance, the U.K. State Immunity Act, 1978 does not apply retroactively. The original debt predating the Act will, as a result of the rescheduling, be caught by its provisions, subjecting more external assets to suit and enforcement under the laws of an English forum. In addition, more of the sovereign's external assets are subject to foreign attachment in the event of default on the rescheduling agreement. Although the original debt may have been incurred by the state itself or one of its instrumentalities, the inclusion of the state, central bank and state instrumentalities as joint and several obligors either directly or as guarantors under the rescheduling agreement has the effect of subjecting more external assets to foreign suit and enforcement.[158]

f. Miscellaneous

The banks require the debtor to provide as much information as possible so that they are better able to monitor the debtor's performance in improving its capacity to pay. Debtors, especially sovereign debtors, are sensitive about disclosing too much information, especially information which must be prepared specifically for the creditor banks. One approach that provides

157. *Id.*, at 4-144.
158. *Id.*, at 4-142.

a compromise between these conflicting interests, at least with respect to sovereign debtors, is providing of reports and information limited to general data.[159]

2. *Provisions Regarding Commercial Banks Inter Se*

a. Generally

All the banks holding debt eligible for rescheduling may sign the rescheduling agreement. The agreement becomes binding only when creditors holding a sufficient threshold of eligible debt, usually at least a simple majority, have executed or given assent to the agreement. The rescheduling agreement does not bind those creditors who have not provided their signatures, though some provision may be made for subsequent accession by eligible creditors within a specified period.[160]

b. Sharing Clause

The rescheduling agreement provides that the participating banks will share the receipts obtained under the rescheduling agreement on a pro rata basis. These receipts include payments by the sovereign debtor and amounts obtained through the exercise of set-off.

c. Amendments and Waivers: Unanimity and Majority Rule

A rescheduling agreement usually contains the same rules applying to amendment and waivers as those found in syndication agreements. Unanimity is required to ratify changes made in the principal amount of the loan commitment of each creditor, the interest payable, and the amortization dates and amounts of repayment. A majority vote, usually a simple one, is required to make an amendment to or waive any provision of the loan not subject to unanimity. Majority rule, for instance, would apply to waivers of events of default such as non-payment, non-compliance with covenants, and inaccuracies in representations and warranties.

Unfortunately, this two-tiered decision-making may lead to impasses fatal to the rationale underlying the rescheduling agreement. For instance, a rescheduling agreement may have to be refinanced because the debtor is still in some financial difficulty, though perhaps not as serious as during the period prior to the execution of the agreement. A sufficient majority of banks can waive an event of default and overrule a dissenting minority which may wish to accelerate the loan and seek suit and enforcement against the debtor's assets. On the other hand, unanimity is required to refinance the rescheduling agreement in order to permit the debtor some immediate relief.

159. Wickersham, *supra* note 146, at 10.
160. Wood, *supra* note 118, at 4–141.

One approach that leads to fewer impasses is to replace the unanimity rule with a higher majority by value.[161] This would at least allow the banks engaged in rescheduling greater flexibility in subsequent dealings with a problem debtor, though those creditors which are only lukewarm to a rescheduling agreement may not participate due to their prospective loss of veto power.

3. *Provisions Regarding Agents and Steering Committee*

Since the financial problems of the debtor may recur in the course of the rescheduling agreement, the banks comprising the steering committee and the bank undertaking the role of the servicing institution insist upon more extensive protection than that required by syndicate agents. The servicing institution prefers extensive provisions in the new agreement to limit its responsibilities to ministerial duties of a mechanical and clerical nature, and contractually, at least, to exclude potential problems arising from fiduciary duties. Moreover, it seeks extensive indemnities for damages and costs incurred in performing these duties.

The banks comprising the steering committee prefer extensive waivers of liability from other banks regarding that committee's negotiating efforts and representations, as well as seek indemnities for the expenses incurred in the renegotiation.

V. Conclusion

Internationally syndicated financial transactions undertaken by commercial banks grew very rapidly in the seventies. The methods of syndication became routine and the legal provisions governing the rights and duties of the various parties under a syndicated transaction were standardized. The rescheduling of sovereign debt in the eighties has blemished somewhat the rapid growth of syndicated transactions in the seventies. It has been estimated that of the over $700 billion currently owed by the developing and East bloc countries to commerical banks, governments,[162] and international financial institutions, $100 billion alone came due and was not paid in 1983.[163] Furthermore, the rescheduling of amounts similar to those rescheduled in 1983 will take place during subsequent years, straining the limits of the international financial system.

The role of the international financial lawyer is clear. A great deal of legal and financial innovation will be required to prevent sovereign and corporate

161. Wickersham, *supra* note 146, at 11.
162. Palmer, *The Debt-Bomb Threat*, TIME, Jan. 10, 1983, at 32.
163. Francis, *Global Analysts Gaze at the Financial Future*, TORONTO STAR, May 15, 1983, at C4.

borrowers from defaulting on payments of principal and interest, and disrupting, perhaps irreparably, the international financial system. Although there is some precedent in rescheduling the obligations of sovereign borrowers, and perhaps to a greater extent those of corporate borrowers, rescheduling techniques and the provisions regulating the rights and duties of parties to the rescheduling agreement have not become standardized. But work on and research into the general area of rescheduling syndicated transactions will not be without its rewards if the challenge of resolving the current crisis of corporate and sovereign insolvency is to be met.