NO STANDING ROOM: HOW LENDER COLLECTIVE ACTION SUBVERTS BASIC PRINCIPLES OF CONTRACT INTERPRETATION

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Large, predominately asset-backed financings are seldom undertaken by a single lender. Most commonly, a lead lender will distribute the risk associated with such ventures by selling interests in the loan to other lenders. If the loan is "syndicated," an administrative agent will usually be elected to manage the loan on behalf of the lenders. In the wake of the 2008 financial crisis, and in particular, with the rise of commercial mortgage defaults, bank syndicates have faced increasing opposition from member lenders seeking to challenge the decisions of the administrative agent.

In response to these challenges, the doctrine of Lender Collective Action has arisen. In New York, Lender Collective Action has been asserted to compel unified action and quash minority dissent. In essence, the doctrine has stripped member lenders of their standing to assert rights or remedies under the credit documents. Unfortunately, in applying the doctrine, courts have abandoned traditional principles of contract interpretation.

This Note argues that the doctrine, although appealing, should not be asserted in order to undermine a member lender's traditional rights and remedies at law. To the extent that New York courts have used the doctrine to reason that lenders may impliedly waive such rights, this Note will take the position that Beal Savings Bank v. Sommer *should be overturned.*

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> In fact, four men such as they were—four men devoted to one another, from their purses to their lives; four men always supporting one another, never yielding, executing singly or together the resolutions formed in common; four arms threatening the four cardinal points, or turning toward a single point—must inevitably, either subterraneously, in open day, by mining, in the trench, by cunning, or by force, open themselves a way toward the object they wished to attain, however well it might be defended, or however distant it may seem. *The only thing that astonished D'Artagnan was that his friends had never yet thought of this.*[1]

I. INTRODUCTION

A. The Rules of the Game

In the world of secured credit, the players know the rules of the game, even if they do not always play by them. Imagine that a hypothetical lender provides a hypothetical borrower with a term loan[2] for the purchase of a new manufacturing facility. The lender expects that the loan will be repaid, with interest, by the maturity date,[3] in accordance with the terms of the governing credit documents.[4] The

[1] ALEXANDRE DUMAS, THE THREE MUSKETEERS 127 (Barnes & Noble Books 2004) (1884) (emphasis added).

[2] A "term loan" is an "installment loan, such as a loan one would use to buy a car. The borrower may draw on the loan during a short commitment period and repays it based on either a scheduled series of repayments or a one-time lump-sum payment at maturity (a bullet payment)." Steven Miller, *A Syndicated Loan Primer*, *in* STANDARD & POOR'S: A GUIDE TO THE LOAN MARKET 16 (Sept. 2011).

[3] The "date of maturity" is the date when a debt falls due, or the date by which the entire balance of the outstanding debt must be paid. BLACK'S LAW DICTIONARY 452 (9th ed. 2009).

[4] Under the "perfect-tender-in-time" rule, borrowers must repay the loan *in exact conformity* with the terms of the loan agreement. *See* Ellis v. Craig, 7 Johns. Ch. 7, 7 (N.Y. Ch. 1823) (holding that the *time* of payment is part of the contract, for the mutual benefit and convenience of both

lender also expects it will be entitled to enforce the terms of the contract as provided therein and will have redress to the courts in the event that the borrower defaults.[5]

In the interest of efficiency, the lender might elect an agent to manage the account on its behalf.[6] To protect its interests, the lender might place limitations on what the agent may or may not do without its express consent.[7] It might also spread the risk associated with any particular investment by seeking other lenders to join in the financial venture—by either syndicating the loan or selling "participations."[8]

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parties, and that borrowers may not therefore ordinarily alleviate themselves of the interest obligation by prepaying the loan); *see also* 5 STUART M. SAFT, COMMERCIAL REAL ESTATE FORMS 3d § 16:22 (2011) (describing common events of default, including non-conforming payment of obligations owed under the terms of the loan agreement).

[5] *See* 5 COMMERCIAL REAL ESTATE FORMS 3d, *supra* note 4, § 16:33 ("The rights and remedies section of the mortgage is a continuation of the default provisions because it establishes the mortgagee's options in the event the borrower and, possibly, the guarantor default in satisfying the terms of the mortgage . . . [and o]ne must remember that all of the rights and remedies of the lender are subject to whatever law is in effect in the jurisdiction where the property is located."); *see also* U.C.C. § 9-601(a) (2003) ("After default, a secured party . . . (1) may reduce a claim to judgment . . ."); RESTATEMENT (THIRD) OF PROP.: MORTGS. § 8.2 (1997) ("When an obligation secured by a mortgage becomes due, the mortgagee may . . . (a) obtain a judgment against any person who is personally liable on the obligation . . .").

[6] *See* 6 COMMERCIAL REAL ESTATE FORMS 3d, *supra* note 4, § 18:33 ("Loan documents in large loans frequently have provisions dealing with administrative agents and provide for the appointment, power, rights and immunities of the agent, reliance by other parties, events of defaults, sharing of costs, resignation and removal, and actions they must take with regard to the funds, documents, and loan delinquencies.").

[7] *Id.* See *also infra* Part III (providing select provisions from the credit documents at issue in *Beal Sav. Bank v. Sommer*, 865 N.E.2d 1210 (N.Y. 2007) as illustrative of how lenders *attempt* to limit the power of an agent without unduly inhibiting the agent's ability to manage the account on behalf of the principal).

[8] *See* 6 COMMERCIAL REAL ESTATE FORMS 3d, *supra* note 4, § 18:2 ("Unbeknownst to most borrowers, lenders frequently take in partners in loans that they make in an attempt to share the risk and to avoid compromising their regulatory lending limitations."). *See also infra* Part

These basic principles of finance do not change to any significant degree in the context of a "syndicated loan"—a loan that is provided by a group of lenders and is structured, arranged, and administered by one or several commercial or investment banks, known as the "agent" or the "arranger."[9] Borrowers know that they are required to repay their loans and lenders expect to be repaid.[10] If either party believes the loan agreement has not been honored, the courts must step in to settle the score.[11] Yet for syndicated loans, the New York courts have added another factor into the equation: the doctrine of Lender Collective Action.

Lender Collective Action is a judicially created technique of contract interpretation that resolves ambiguities in the credit documents in favor of unitary action—thereby permitting the agent of a bank syndicate to take action, or forbear from taking action, at the direction of majority lenders over the objection of minority lenders.[12] Lender Collective Action is, by definition, only used when a single lender or a small group of lenders seeks to block action supported by a majority of the syndicate.[13]

II (discussing the framework of syndicated loans and the efficiencies that result from collective action in the context of large, complex financial transactions); 6 COMMERCIAL REAL ESTATE FORMS 3d, *supra* note 4, § 18:5 (providing a sample "participation agreement").

[9] Miller, *supra* note 2, at 7.

[10] *See supra* note 4.

[11] Typically, parties will specify, in writing, the particular jurisdiction in which any and all claims arising out of the agreement will be brought, as well as the applicable law under which the terms of the agreement will be governed. *See, e.g.*, 6 COMMERCIAL REAL ESTATE FORMS 3d, *supra* note 4, § 18:19 (Sections 7.08 and 7.09).

[12] *See* Marc Abrams, Rachel C. Strickland & Keith H. Wofford, *Acting on a Syndicate's Behalf Over an Objecting Minority, in Lender 'Collective Action' Doctrine Provokes Controversy*, N.Y. L.J., Dec. 14, 2009, at 2 ("Collective action can now be considered a judicial trend towards interpreting credit documents to permit administrative or collateral agents acting on behalf of a majority of lenders to exercise *exclusive* control over credit decisions whether or not all lenders agree.") (emphasis added).

[13] *Id.*

The theory behind Lender Collective Action is simple: when lenders decide to join a bank syndicate,[14] they must envision a sort of "collective design" to the entity, and accordingly, must be willing to cede to the whole certain rights and remedies by subordinating their own rights as individual lenders.[15] By construing contractual terms liberally, New York courts have employed Lender Collective Action to resolve disputes arising from alleged ambiguities in the lender's credit documents.[16]

One would think that virtually all lenders, like the musketeer D'Artagnan, would see the strategic value of joining forces against a common object—a delinquent borrower or its guarantor.[17] And yet, in many instances, they do not.[18] Or worse, they do not realize that their credit documents are deficient in material respects—that they are

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[14] A "bank syndicate" is simply a term used to refer to the lenders and agent, collectively. They may also be referred to as a "syndicated credit facility," a "credit facility," a "lending syndicate," or "syndication."

[15] *See, e.g.*, Credit Francais Int'l, S.A. v. Sociedad Financiera de Comercio, C.A., 490 N.Y.S.2d 670, 683 (N.Y. Sup. Ct. 1985) (concluding that syndicated lenders should be treated as a single entity).

[16] In contract law, interpretation of a promise or agreement or a term thereof is the ascertainment of its meaning. RESTATEMENT (SECOND) OF CONTRACTS § 200 (1981). A term or provision is ambiguous if it is capable of capturing more than one meaning. Ambiguity may arise from imprecise drafting, clumsy sentence structure, the use of obtuse or unclear vocabulary, or from the coalescence of multiple contractual provisions on the same subject matter.

[17] *See, e.g.*, HSH Nordbank AG N.Y. Branch v. Swerdlow, 259 F.R.D. 64, 72 (S.D.N.Y. 2009) ("[L]enders are co-lenders of the Loan and thus *share a common interest* in enforcing defendants' obligations under the Guaranties.") (emphasis added).

[18] *See, e.g.*, Marc Abrams et al., *Intercreditor Issues and Subordinate Financing: "Tranche Warfare"*, 100110 ABI-CLE 33 ("In distressed debt situations, one generally considers the debtor as being the party seeking supervised protection. However, given the current credit market and the general sophistication of lending parties, the past few years have seen a marked rise in intercreditor disputes and judicial intervention to resolve them.").

ambiguous on which parties may exercise remedies against the borrower—until it is too late.[19] So what are courts to do?

B. Summary of Argument

This Note will analyze the current state of Lender Collective Action and will argue that, in many instances, the doctrine unjustifiably perverts basic principles of contract interpretation and the lender-borrower relationship—notably, the lender's right to obtain a judgment against a borrower for any outstanding balance of the loan that has become due. This Note will argue that courts should adopt a "clear statement" rule when determining which rights have been reserved to the agent of syndicated loans and which have been preserved by the individual lenders. As a result, this Note will take the position that courts should no longer use *Beal Savings Bank v. Sommers*[20] when interpreting contracts governed by New York State law. Certain equitable limitations will also be proposed.

Part II will outline the financial framework of the syndicated loan market. Part III describes the origins of Lender Collective Action while Part IV uses *Beal Savings Bank* as a case study on how Lender Collective Action is applied in party-specific litigation. Part V summarizes the post-*Beal* landscape of Lender Collective Action, with a primary focus on how courts have responded to (1) lenders asserting an individual right of action; (2) agent forbearance; and (3) agent credit bidding. Part VI sets forth certain proposals for adjusting how courts use Lender Collective Action, including the assumption that lenders do not eschew traditional characteristics of the lender-borrower relationship in vague or ambiguous manners. Certain equitable limitations will also be proposed.

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[19] *See id.* (describing the problems associated with resolving intercreditor disputes once bankruptcy proceedings have begun).

[20] Beal Sav. Bank v. Sommer, 865 N.E.2d 1210 (N.Y. 2007).

II. THE FINANCIAL FRAMEWORK OF SYNDICATED LOANS

Syndicated loans are the preferred method of financing transactions for which traditional, individual lines of credit prove inefficient or insufficient.[21] Starting with the leveraged buyout ("LBO") boom during the mid-1980s, the market for syndicated loans has increased dramatically over recent decades.[22] Unfortunately, considering the high-risk behavior of borrowers turning to bank syndicates for resources and assistance, the financial instability of the syndicated loan market has increased drastically as well. As of November 2009, there was over $438 billion in "distressed debt" nationwide—much of which was provided by syndicated lenders.[23]

A. The Credit Documents

The syndicated loan process often involves the drafting of a variety of contracts: the participation or syndication agreement, intercreditor agreement, credit agreement, guaranty agreement, and security agreement(s), to name a few (collectively, the "credit documents"). Intercreditor agreements are used in a variety of financial transactions and are governed primarily by the basic rules of contract law.[24] In the context of the bank syndicate, the intercreditor

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[21] Miller, *supra* note 2, at 7.

[22] *Id.* Alternatively, the loan could be structured as "mezzanine" level debt, though this structure has *also* come under increasing scrutiny in recent years. *See* 5 COMMERCIAL REAL ESTATE FORMS 3d, *supra* note 4, § 16:51 ("Not surprisingly, as a result of this increased risk, mezzanine loans usually had a higher interest rate but, it turns out, did not earn a return that was nearly high enough to offset the enormous risks the mezzanine lender took in the highly leveraged deals that mezzanine debt made possible.").

[23] Abrams et al., *supra* note 12, at 2 (citing DEBTWIRE NORTH AMERICA, http://www.debtwire.com).

[24] *See* Highland Park CDO I Grantor Trust, Series A v. Wells Fargo Bank, N.A., No. 08 CIV. 5723 (NRB), 2009 WL 1834596, at *4 (S.D.N.Y. June 16, 2009) (rejecting an interpretation that would render certain portions of an intercreditor agreement superfluous on the ground that it

agreement is used to define the rights and remedies of the creditors or member lenders.[25] By their very nature, intercreditor agreements are tailored to the needs of the member lenders and the borrower. As a result, intercreditor agreements are not highly standardized.[26]

At the heart of every credit agreement is an allocation of risk.[27] For banks and other institutional lenders, the principal credit risk factors are "default"[28] and "loss-given-default."[29] When assessing these risk factors, lenders will examine existing covenants and attempt to protect themselves contractually.[30] To mitigate these risks, a lender might require sponsorship on the loan, take a security interest in the borrower's collateral, provide for the exercise

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would run afoul of the basic principles of contract interpretation); *see also* Shultz v. Mfrs. & Traders Trust Co., 291 N.Y.S. 117, 120–21 (N.Y. App. Div. 1936) ("It is fundamental that it is the things upon which the minds of the parties were at one as demonstrated by the language used and the circumstances surrounding its use that govern in the interpretation of written agreements.").

[25] Comm. on Commercial Fin., ABA Section of Bus. Law, *Report of the Model First Lien / Second Lien Intercreditor Agreement Task Force*, 65 BUS. LAW. 809, 809 (May 2010).

[26] *Id.* Note that there may be commonalities across intercreditor agreements generally, in terms of specific contractual provisions. The wording of a "required lenders" or "unanimous consent" clause, for example, may be relatively similar from one transaction to the next. *See infra* notes 50–52 and accompanying text.

[27] *See generally* Anthony B. Kuklin, *Project Financing and the Real Estate Lawyer*, C974 ALI-ABA 143, 157 (1995) (describing the role of real estate counsel in using the credit documents to allocate the business risks associated with construction projects and other real estate acquisition transactions).

[28] "Default risk is simply the likelihood of a borrower's being unable to pay interest or principal on time," as per the terms of the credit agreement. Miller, *supra* note 2, at 13.

[29] "Loss-given-default risk" measures, in the event of default by the borrower, the severity of the loss to the lender. Investors assess this risk based on the collateral (if any) backing the loan and the amount of other debt and equity subordinated to the loan. *Id.*

[30] *Id.* at 23.

remedies in the event of default, and subordinate the rights of other creditors.[31]

Lenders prefer borrowers with strong sponsorship.[32] A lender may require the borrower's sponsor to become a "surety" or "secondary obligor" on the loan through the authentication of a guaranty agreement.[33] The secondary obligor is a backup source of payment from whom the lender may *immediately* demand payment if the borrower defaults and the loan becomes due.[34] The surety's obligations are *dependant* and *recursive*. The surety owes only when the borrower owes and only to the extent defined in some secondary set of documents (such as the guaranty agreement).[35]

A borrower could also enhance its credit by granting the lender a security interest in its collateral, including its real[36] or personal[37] property. A security interest is a lien, or legally

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[31] *See generally id.* at 16–30.

[32] *Id.* at 13 ("To the extent that the sponsor group has a strong following among loan investors, a loan will be easier to syndicate and, therefore, can be priced lower.").

[33] RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 1.1 (1996) ("[A] secondary obligor has suretyship status whenever: (a) pursuant to contract (the "secondary obligation"), an obligee has recourse against a person (the "secondary obligor") or that person's property with respect to the obligation (the "underlying obligation") of another person (the "principal obligor") to that obligee; and (b) to the extent that the underlying obligation or the secondary obligation is performed the obligee is not entitled to performance of the other obligation; and (c) as between the principal obligor and the secondary obligor, it is the principal obligor who ought to perform the underlying obligation or bear the cost of performance.").

[34] Miller, *supra* note 2, at 14 ("Among institutional investors, weight is given to an individual deal sponsor's track record in fixing its own impaired deals by stepping up with additional equity or replacing a management team that is failing.").

[35] *See* RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY §§ 17, 19.

[36] RESTATEMENT (THIRD) OF PROP.: MORTGS. § 1.1 (1997) ("A mortgage is a conveyance or retention of an interest in real property as security for performance of an obligation.").

[37] U.C.C. § 9-109(1) (2003) ("[This article applies to] a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract . . . .").

enforceable right, against collateral.[38] The "security agreement"[39] or "mortgage"[40] creates the security interest and defines the specific rights and remedies of the parties. The Uniform Commercial Code ("UCC") and Restatement (Third) of Property (Mortgages) govern secured transactions and create a default set of remedies that the lender may exercise against the borrower in the event of default. These remedies include the right to foreclose on the collateral[41] and obtain a judgment for any deficiency,[42] or in the alternative, to sue the borrower and any secondary obligors for the balance of outstanding debt.[43]

What constitutes an "event of default" depends on the exact wording of the relevant credit documents, but almost invariably includes late-payment or non-payment.[44] Still, the lender may not exercise remedies against the borrower until the loan becomes due. The borrower may cure the default by paying the lender the amount that is then-owing on the obligation or by performing any other duty required under the terms of the credit documents.[45] Lenders may avoid the borrower's ability to cure by including an "acceleration clause" in the credit agreement, thereby empowering the lender to declare the full obligation immediately due and payable.[46]

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[38] BLACK'S LAW DICTIONARY 1478 (9th ed. 2009).

[39] U.C.C. § 9-102(a)(73).

[40] RESTATEMENT (THIRD) OF PROP.: MORTGS. § 4.1.

[41] U.C.C. § 9-601(a); RESTATEMENT (THIRD) OF PROP. MORTGS. § 8.2(b).

[42] U.C.C. § 9-608(a)(4); RESTATEMENT (THIRD) OF PROP.: MORTGS. § 8.2(b).

[43] U.C.C. § 9-601(a); RESTATEMENT (THIRD) OF PROP.: MORTGS. § 8.2(a).

[44] *See supra* note 4. For a sample "Events of Default" provision, see 6 COMMERCIAL REAL ESTATE FORMS 3d, *supra* note 4, § 18:19 (including as an event of default: "[If t]he Borrower shall fail to pay any amount of principal of, or interest on, any Note or any stand-by fee hereunder when due and payable and, in the case of any failure to pay such interest, such failure shall remain unremedied for five Business Days . . . .").

[45] RESTATEMENT (THIRD) OF PROP.: MORTGS. § 8.1(b).

[46] Acceleration refers to the process of advancing a loan agreement's maturity date so that payment of the entire debt is due immediately. BLACK'S LAW DICTIONARY 12 (9th ed. 2009). An acceleration clause (or

Finally, lenders might protect their interests by subordinating the rights, remedies, and interests of other creditors—for example, by distinguishing between first-lien and second-lien lenders.[47] Second-lien structures provided much needed liquidity not otherwise provided for on an unsecured basis.[48] Falling default rates and the relatively narrow interest rate spreads available in the second-lien market (at least before the financial crisis) also helped spur a resurgence of the second-lien facility.[49]

B. Choosing the Right Remedy

When a borrower defaults on a loan, the lender must choose how to respond. The lender could (1) ignore the default; (2) give the borrower an opportunity to cure; (3) work with the borrower to negotiate a settlement (e.g., engage in a "workout"); or (4) exercise remedies against the borrower by accelerating the loan and either foreclosing on the collateral or seeking a judgment at law. But in a bank syndicate, who decides: the agent or the individual member lenders?

The terms of the credit documents is a good place to start. The intercreditor agreement—principally, the "required

demand clause) is a loan agreement provision that defines the specified events ("triggering events") that permit the creditor or agent to declare acceleration, such as failing to make payment or maintain insurance. *See also* RESTATEMENT (THIRD) OF PROP.: MORTGS. § 8.1(a).

[47] A "first-lien" and "second-lien" loan is a structured transaction in which the same collateral secures the interests of two separate, classified lender groups, but priority is given to one group over the other. The "first-lien" loan is secured by a "first priority lien," often on all or substantially all of the assets of the borrower. The "second-lien" loan is secured by a "second priority lien" on the same assets. The second-lien lenders can be thought of, then, as residual claimants; the second-lien lenders can recover on any remaining assets if and only if the interests of all first-lien lenders are fully satisfied. Comm. on Commercial Fin., *supra* note 25, at 809.

[48] *See* 5 WILLIAM L. NORTON, JR., NORTON BANKR. L. & PRAC. § 94:37 (3d ed. 2008) (arguing that second-lien structures provide liquidity, particularly to bankruptcy-prone entities, that senior lenders are unable or unwilling to provide).

[49] Comm. on Commercial Fin., *supra* note 25, at 809.

lenders" and "unanimous consent" clauses—will determine when the agent (or the members) can exercise remedies.[50] A "required lenders" clause sets the minimum percent of lenders (usually 51% or 66%) required to approve or overturn the actions of the agent.[51] By contrast, the "unanimous consent" clause prohibits the agent from taking specific, enumerated actions (such as amending, modifying, or waiving terms of the agreement) without the consent of *all* of the lenders.[52]

In most cases, disputes among lenders can be resolved without turning to the courts for assistance. The agent will propose a course of action, the lenders will vote on the matter, and the majority faction will prevail.[53] However, when the borrower becomes insolvent, the pool of assets

[50] Mark C. Simon, *Loan Sales And Syndications: Key Issues In A Troubled Time*, 563 PLI/Real 315, 324 (2009) ("At least from a document point of view, the decision as to whether to exercise remedies is one that can be made based on the requisite consent or vote. In a simple participation agreement where the lead lender retains the right to make that decision, the lead lender can make that decision. On a syndicated loan, either a majority or supermajority [e.g., the 'Required Lenders'] has to vote in favor of exercising remedies and then can exercise them."). Other actions require unanimous consent. *See infra* note 52.

[51] Simon, *supra* note 50. For example, in *Beal Savings Bank v. Sommer*, 865 N.E.2d 1210 (N.Y. 2007), under Section 9.1 of the Credit Agreement, the lenders authorized the administrative agent to act on their behalf in enforcing the provisions of the Agreement and, "in the absence of other written instructions from the Required Lenders . . . to exercise such powers . . . as are specifically delegated to or required of the Administrative Agent by the terms [of the Loan Documents], together with such powers as may be reasonably incidental thereto." *Id.* at 1211. Section 1.1 of the Credit Agreement defined the term "Required Lenders," in pertinent part, as those lenders holding at least 66-2/3% of the outstanding principal. *Id.* at 1211–12. The result was to require the agent to seek approval from a supermajority of the Lenders before exercising powers not specifically enumerated or reasonably incidental thereto.

[52] In *Beal Savings Bank*, Section 9.1 was subject to one important limitation: Section 10.1(f) of the Credit Agreement (the "Unanimous Consent" clause) provided that no amendment, modification, or waiver of the Loan Documents could be made by the agent "without the consent of all Lenders." *Id.* at 1217.

[53] Simon, *supra* note 50, at 324.

available to the lenders is limited and disagreements regarding the proper course of action may not be so readily resolved.[54] Lenders may be less inclined to work with the borrower, or may have an on-going relationship with the borrower that favors forbearance over foreclosure, and may argue that a proposed course of action is subject to the unanimous consent clause rather than the required lenders clause.[55] In response, the doctrine of Lender Collective Action has emerged.

III. ORIGINS OF THE COLLECTIVE ACTION THEORY

As early as 1985, credit documents governed by New York law have been interpreted to allow the agent to force its decisions upon a dissident minority faction.[56] At issue in each case is whether the member lender, or group of lenders, has standing to enforce the terms of the credit documents.[57]

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[54] *Id.* at 323 ("Lawyers have done everything they can think of in loan agreements, co-lending agreements and participation agreements to set up a co-lending process for functional and fair decision-making. However, when loans go into default, no document provisions are sufficient to assure that decision-making between multiple lenders will go smoothly. Even lenders who are in quite similar positions on a loan transaction may simply have differences of opinion, which are often exacerbated under stress.").

[55] *Id.* at 323–24 ("Of course, more often than not in the real world, the interests of the lenders are never quite as aligned as one would think. One lender might have a strong on-going relationship with the borrower, whereas for another, this is a one-shot transaction. A lender might itself be under financial stress and might be reluctant to put a transaction into default. One lender might be represented in the transaction by a loan officer who made the loan in the first place and has a vested interest in its success, whereas another lender may have turned the transaction over to a work-out group, which is considerably less enamored of the transaction and ready to foreclose . . . . Unfortunately, in reality, it may prove difficult to work out a loan without unanimous consent of the lenders.").

[56] *See* Credit Francais Int'l, S.A. v. Sociedad Financiera de Comercio, C.A., 490 N.Y.S.2d 670, 672–73 (N.Y. Sup. Ct. 1985); *see also* Abrams et al., *supra* note 12, at 2.

[57] Originally, the dispute focused on whether a member lender can act when the agent *refuses* to take action (with the support of the majority).

A. All for One, One for All

The origins of Lender Collective Action in New York date back to *Credit Francais*.[58] In *Credit Francais*, the borrower defaulted on a loan by failing to make payments according to the terms of the credit documents, and the plaintiff, a single member of an international syndicate of nine banks, sought a judgment for its pro rata share of the principal balance owing ($2 million or 12% to the remaining total outstanding debt).[59] The New York Supreme Court dismissed the plaintiff's suit for lack of standing: "[w]hen parties have agreed to operate through an agent or as a collective entity, whether it be a corporation, a partnership, a syndicate or a consortium, a unitary body is created, and only unitary action can be permitted."[60] Thus, the court concluded that only the syndicate could enforce the terms of the credit documents.[61]

The principle of unitary action was reasserted when Enron filed for bankruptcy in December 2001.[62] JP Morgan Chase Bank ("Chase"), the bank syndicate's agent, accelerated Enron's loan (at the time, $360 million remained outstanding).[63] The plaintiffs, certain members of the bank

See, e.g., *Beal Sav. Bank*, 865 N.E.2d 1210; Commercial Bank of Kuwait v. Rafidain Bank, 15 F.3d 238 (2d Cir. 1994); New Bank of New England v. Toronto-Dominion Bank, 768 F. Supp. 1017 (S.D.N.Y. 1991); *In re* Enron Corp., 302 B.R. 463 (Bankr. S.D.N.Y. 2003); *Credit Francais*, 490 N.Y.S.2d 670. More recently, cases involving Lender Collective Action have focused on whether the decision of the agent should be ratified according to the "required lenders" or "unanimous consent" provision. *See, e.g.*, *In re* Chrysler, Inc., 405 B.R. 84 (Bankr. S.D.N.Y. 2009); *In re* GWLS Holdings, Inc., No. 08-12430, 2009 WL 453110 (Bankr. D. Del. Feb. 23, 2009); *In re* Metaldyne Corp., 409 B.R. 671 (Bankr. S.D.N.Y. 2009); *In re* Delphi Corp., No. 05-44481, 2009 WL 2482146 (Bankr. S.D.N.Y. July 30, 2009).

[58] *See Credit Francais*, 490 N.Y.S.2d at 672–73.

[59] *Id.* at 683.

[60] *Id.* at 682.

[61] *Id.*

[62] In re *Enron Corp.*, 302 B.R. 463.

[63] *Id.* at 467.

group,[64] however, were unhappy with the fact that Chase refused to foreclose on the collateral—namely, a "Make Whole" guaranty in the amount of approximately $360 million.[65] As a result, the bank group sought to lift the automatic stay, granted pursuant to Section 362 of the Bankruptcy Code,[66] and recover on the collateral.[67] Enron and the creditors' committee objected.[68]

Since the laws of New York governed the credit documents,[69] the Bankruptcy Court for the Southern District of New York turned to New York case law for guidance. The court cited *Credit Francais* for the proposition that unified action was required in the face of default and that only the agent could pursue remedies against the borrower.[70] As the court reasoned, "[t]he purpose of contracting in advance to restrict enforcement to a single agent is to prevent the chaos that would ensue if multiple lawsuits were initiated by each lending bank with, possibly, divergent interests."[71] If the lenders wish to preserve their right to foreclose on the collateral or pursue a judgment against the lender, the court concluded, they must do so *explicitly* in the credit documents.[72]

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[64] The plaintiffs were members of a lending syndicate that had provided Enron with $375 million in refinancing for the acquisition of a manufacturing facility at one of its fully owned subsidiaries. *Id.*

[65] *Id.*

[66] 11 U.S.C. § 362 (2010) (preventing the enforcement, against the debtor or against property of the estate, of certain liens perfected before the commencement of bankruptcy proceedings).

[67] In re *Enron Corp.*, 302 B.R. at 465–67.

[68] *Id.* at 469. The "Creditors' Committee" was the Official Committee of Unsecured Creditors appointed by the U.S. Trustee pursuant to Section 1102 of the Bankruptcy Code. *Id.* at 465.

[69] *Id.* at 472 n.8.

[70] *Id.* at 472–75.

[71] *Id.* at 472–73.

[72] *Id.* at 477 ("[The parties] could have negotiated to allow the individual members of the Bank Group to sue individually if all members joined in the lawsuit or even if a majority joined in any such suit. Instead, pursuant to the terms of [the agreements], the desire of a majority of the members of the Bank Group . . . to enforce compliance with the agreements could only be implemented by Chase, as Collateral Agent,

B. Dream of Revenge

Of course, a dissatisfied member lender could, with the support of the required lenders, direct the agent to take the desired course of action—such as to exercise remedies against the borrower and foreclose on the collateral.[73] However, as a practical matter, this may not be feasible; it can be difficult for a non-agent bank to marshal enough votes to do so, particularly when the agent itself owns a substantial portion of the loan.[74] Indeed, where the credit documents impose a supermajority requirement for joint action, it may be *impossible* for an individual member lender to garner the votes needed without the support of the agent.[75]

Thus, as suggested by *In re Enron Corp.*, one solution for the lone lender bent on confronting the borrower is to make it clear in the governing credit documents that the rights granted to the agent are not exclusive of any rights traditionally retained by individual member lenders. For example, in *New Bank*, the borrower entered into a syndicated loan with four institutional lenders.[76] When the borrower defaulted in making payments due under the credit agreement, the agent and a majority of the lenders refrained from accelerating the loan.[77] The plaintiff, a member lender

after written demand was made upon Chase, as Collateral Agent, by the Required Lenders.").

[73] Simon, *supra* note 50, at 325.

[74] *Id.*

[75] *Id.* It would be impossible for a lender to garner the necessary votes if, for example, the agent owns more than a 33% interest in the loan.

[76] New Bank of New England v. Toronto-Dominion Bank, 768 F. Supp. 1017, 1019 (S.D.N.Y. 1991).

[77] *Id.* at 1020. The agent, and two of the three other lenders, sent the plaintiff a letter stating that "as Majority Lenders, [they had agreed] to refrain from declaring an acceleration under Section 11.1 of the Senior Credit Agreement as a result of the currently existing payment default thereunder." The letter also stated that the agreement to refrain from accelerating was given in order to negotiate for a restructuring of the borrower's capital structure. *Id.*

of the syndicate, did not consent to the waiver.[78] Instead, the plaintiff bank brought suit against the agent, demanding that the loan be accelerated.[79] Under the express language of the credit agreement, the court found that the plaintiff could not *compel* the syndicate to accelerate.[80] Also, since acceleration is a remedy of contractual creation, the plaintiff itself had no right to accelerate the loan, or any portion thereof.[81]

Ultimately, lenders are stuck with the documents they draft.[82] Nevertheless, as the court reasoned, the doctrine of Lender Collective Action did not apply in this instance because the contract specifically preserved the rights, powers, or privileges of the member lenders.[83] Thus, the plaintiff was free to pursue its own remedies at law when such remedies arose—namely, suing the borrower to collect on the debt *when it became due.*[84] Therefore, while the individual lender retained some ability to personally enforce its interest, that ability was sharply limited by the credit agreement's provision requiring collective action for acceleration.[85]

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[78] *Id.*

[79] *Id.*

[80] Section 11.1 only permitted the "Majority Lenders" (e.g., those lenders holding at least 50% of the aggregate unpaid principal amount of the notes) to accelerate the loan. *Id.* at 1019.

[81] *Id.* at 1023.

[82] *Id.* at 1021 (holding that courts have generally refused to rewrite agreements to provide lenders with any rights which are not expressly set forth in the credit documents).

[83] Here, the intercreditor agreement provided: "The rights, remedies, power and privileges herein provided are cumulative and not exclusive of any rights, powers and privileges provided by law or in equity." *Id.* at 1023.

[84] *Id.* Here, the loan had not been accelerated so the lender had to wait until the loan became due before seeking a judgment against the borrower.

[85] Although the date of maturity for the notes at issue in *New Bank* was never stated, if they bore a common ten-year term, the lender would have had to have waited until August 25, 1998—another seven years—in order to collect the full balance of the outstanding debt. *See id.* at 1019.

Indeed, the right of the lender to sue the borrower for repayment of the outstanding principal on or after the date of maturity is a traditional remedy in common-law countries.[86] In *Commercial Bank*, for instance, a syndicate of banks provided the Republic of Iraq, acting through several government-owned banks (the "Iraq Banks"), with roughly $1.1 billion in financing, $33 million of which was provided by the Commercial Bank of Kuwait ("Commercial").[87] After the Gulf War broke out in 1991, the Iraq Banks stopped making payments, thereby violating the credit agreement with the syndicate.[88] Commercial sued the Iraq Banks to recover its pro rata share of the principal, which had come due by the time litigation commenced.[89]

According to the Second Circuit, since the syndicate had included both a cumulative remedies clause and a pro rata sharing clause, Commercial was entitled to sue the Iraq Banks for any sums owed once they became due:

> While the participation agreement at issue . . . authorizes the [agent] to sue 'only if requested to do so by the Majority Banks,' this provision does not abrogate the rights of participating banks to sue on their own. Indeed, the agreement points the other way, providing that the rights of the parties 'under the general law' are expressly reserved. We believe that this includes the right to sue as an undisclosed principal as allowed under the governing English law.[90]

Alternatively, it could sue the borrower for each installment payment that came due, yet this would undoubtedly be a prohibitively costly endeavor.

[86] *See* Commercial Bank of Kuwait v. Rafidain Bank, 15 F.3d 238, 243 (2d Cir. 1994) ("It is a well-established rule of English law that an undisclosed principal can sue and be sued on a contract . . . save in those cases when the terms of the contract expressly or impliedly confine it to the parties to it.") (quoting Teheran-Europe Co. v. S T Belton (Tractors) Ltd., [1968] 2 Q.B. 545 (Eng.)). The Restatement Second of Agency has adopted a similar standard. *See infra* note 127 and accompanying text.

[87] *Commercial Bank of Kuwait*, 15 F.3d at 239.

[88] *Id.*

[89] *Id.* at 241.

[90] *Id.* at 243.

Accordingly, the Second Circuit affirmed the district court's order entering a default judgment in favor of Commercial.[91]

IV. *BEAL SAVINGS BANK*: A CASE STUDY

For the better part of two decades, *Credit Francais* remained a non-binding but persuasive source of authority for unitary action. It was not until 2007, when the New York Court of Appeals took up the issue in *Beal Savings Bank v. Sommer*,[92] that the doctrine of Lender Collective Action became solidified in New York law, emerging as a model for how to defeat minority opposition to agent action.

A. The Facts

The Aladdin Resort and Casino in Las Vegas, Nevada (the "Aladdin") was in financial trouble from the day it opened its doors on August 18, 2000.[93] Two years earlier, in February of 1998, Aladdin Gaming, LLC (the "Borrower") entered into a Credit Agreement with a lending syndicate of thirteen individual institutions (the "Lenders").[94] The Lenders provided the Borrower with $410 million for capital improvements at the Aladdin[95] and appointed an agent—the Bank of Nova Scotia, and later its successor, BNY Asset Solutions, LLC—to administer the syndicate.[96]

Less than one month before the Aladdin was to reopen, the Borrower requested and obtained an additional $50 million for last-minute renovations.[97] To secure the supplemental funds, the Borrower's parent company, the Sommer Trust (the "Trust"), agreed to become a sponsor, or

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[91] *Id.* at 244.

[92] *See* Beal Sav. Bank v. Sommer, 865 N.E.2d 1210 (N.Y. 2007).

[93] Charleston Commc'ns, *History of the Aladdin*, http://www.a2zlasvegas.com/hotels/history/h-aladdin.html (last visited Mar. 5, 2012).

[94] *Beal Sav. Bank*, 865 N.E.2d at 1211.

[95] *Id.*

[96] *Id.*

[97] *Id.* at 1212.

guarantor, under a Keep-Well Agreement.[98] One year later, the Aladdin was still struggling to break even, and in the wake of September 11, 2001, the Borrower filed for bankruptcy.[99] At the time the Borrower sought bankruptcy protection, thirty-seven pre-petition lenders were members of the lending syndicate.[100]

Immediately thereafter, one of the thirty-seven original lenders assigned its 4.5% participation interest in the outstanding principal to BFC Capital, Inc ("BFC").[101] Two weeks later, on September 30, 2002, the Agent entered into a Settlement Agreement with the Trust, under which the Agent agreed to perpetually forbear from enforcing any obligations that the Trust owed under the Keep-Well in exchange for certain consideration on the part of the Trust.[102] Thirty-six of the Lenders, holding 95.5% of the outstanding principal amount, agreed that recovery under the Keep-Well would be less profitable than under the Settlement Agreement; BFC was the only lender who refused to release the Sponsor from its obligations under the Keep-Well.[103] The Settlement Agreement was entered into over BFC's objection.[104]

On April 6, 2005, BFC's assignee, Beal Savings Bank, filed a lawsuit against the Trust under Section 4 of the Keep-

[98] The Keep-Well was a sponsorship agreement, separate from but dependant upon the original Credit Agreement, between the Agent, the Lenders, and certain Sponsors of the Borrower. Under Section 2 of the Keep-Well, the Sponsors agreed to make equity contributions to the Borrower in the event that the Borrower became financially unstable, as defined therein. Additionally, Section 4 stated that in the event of acceleration under Section 8.2 and Section 8.3 of the Credit Agreement, the Sponsors guaranteed payment of the accelerated amount to the Administrative Agent for the benefit of the Lenders. *Id.* at 1211.

[99] *Id.* at 1212.

[100] *Id.* at 1213.

[101] *Id.* at 1212.

[102] *Id.* at 1213.

[103] *Id.*

[104] *Id.*

Well,[105] seeking either (1) $90 million, to be split pro rata among the Lenders, or (2) in the alternative, its pro rata share thereof.[106] The Trust filed a motion to dismiss on the ground that "no individual member of the consortium was empowered to enforce the agreements in the event of default, and only the Administrative Agent, at the behest of a supermajority of Lenders, could do so."[107]

After extensively analyzing the credit documents, as well as the history of Lender Collective Action in the region, the Court of Appeals concluded that "the parties intended for collective action in the event that the obligations of the Borrower could be accelerated."[108]

B. The Court's Reasoning

The question that the court faced, simply stated, was whether the plaintiff, Beal Savings Bank, a member of the lending syndicate, could sue the Trust in order to enforce the Trust's guaranty under the Keep-Well. As suggested at the outset of this Note, the court supported its assertion with both contractual[109] and equitable[110] considerations.

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[105] Section 4 of the Keep-Well provided: "In the event that the Obligations of the Borrower under the Credit Agreement shall be accelerated pursuant to the provisions of Section 8.2 or 8.3 thereof, the Sponsors guarantee and agree to pay the Accelerated Payment Amount to the Administrative Agent for the benefit of the Lenders not later than forty (40) days following the date of such acceleration." *Id.* at 1216.

[106] *Id.* at 1213. The Credit Agreement included a pro rata sharing clause declaring that if a Lender receives any payment, such as by setoff, it must share any excess of its pro rata share of payments with the other Lenders. *Id.* at 1216–17 (discussing Section 4.8 of the Credit Agreement).

[107] *Id.* at 1213.

[108] *Id.* at 1219.

[109] Naturally, in a case based on contract interpretation, the majority's argument focused on the credit documents themselves, as well as the *ex ante* intent of the parties: "The specific, unambiguous language of several provisions, read in the context of the agreements as a whole, convinces us that, in this instance, *the lenders intended* to act collectively in the event of the borrower's default and to preclude an individual lender from disrupting the scheme of the agreements at issue." *Id.* at 1211 (emphasis added).

The court began its analysis by announcing selected "governing principles" of contract interpretation, including the four corners rule,[111] the full effect rule,[112] and the cannon of *noscitur a sociis*.[113] The court also outlined the application of certain lender remedies at common-law, including when a lender may or may not sue as an undisclosed principal[114] or accelerate the loan.[115]

When applying these principles and common-law rules to the credit documents, the court clearly—and correctly—found that there was no *express* provision authorizing any lender to take individual action against the

[110] Throughout the opinion there is a constant tone of reassurance–that Lender Collective Action is appropriate *in this case* because of the great inequities that would flow were the court to allow a single lender, holding only a fraction of the outstanding debt, to prevent the syndicate from collecting as much from the borrower as possible given the circumstances. "Thus," the court reaffirmed, "the provisions concerning amendment, modification and waiver of the agreements do not preclude the Administrative Agent and 95.5% of the Lenders from attempting to recover on as much of the Trust's obligations as they could." *Id.* at 1218. The problem is that they *do* prevent the agent from taking action if such action constitutes an amendment, modification, or waiver. As *In re Enron* demonstrated, the fact that a majority of the lenders have acceded to the action does not override the plain language of the contract. *Id.*

[111] *Id.* at 1213 ("Construction of an unambiguous contract is a matter of law, and the intention of the parties may be gathered from the four corners of the instrument and should be enforced according to its terms.").

[112] *Id.* ("The court should construe the agreements so as to give full meaning and effect to the material provisions [and] . . . [a] reading of the contract should not render any portion meaningless.").

[113] *Id.* at 1213–14 ("Further, a contract should be read as a whole, and every part will be interpreted with reference to the whole; and if possible it will be so interpreted as to give effect to its general purpose.") (citation omitted). Literally, *noscitur a sociis* is a canon of construction holding that the meaning of an unclear word or phrase should be determined by the words immediately surrounding it. BLACK'S LAW DICTIONARY 1160–61 (9th ed. 2009). For the purposes of this Note, the cannon is persuasive when interpreting credit documents and is routinely employed by courts advancing Lender Collective Action.

[114] *Beal Sav. Bank*, 865 N.E.2d at 1218 ("[A]n undisclosed principal can sue on a contract except when the terms of the contract expressly or impliedly confine it to the parties to it.") (citation omitted).

[115] *Id.* at 1216.

Borrower (or the Trust) in the event of default.[116] Indeed, such authorization rarely appears in either the intercreditor agreement or guaranty agreement.[117]

On the contrary, with respect to the Keep-Well (and Section 8.3 of the Credit Agreement, as referred to therein), "[t]he only entity section 4 mentions as having the right to pursue default remedies is the Administrative Agent."[118] In

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[116] *Id.* at 1215.

[117] Given the common-law rule that a principal (even an undisclosed one) can sue on a contract, whether or not such an authorization is provided for contractually, it may not be altogether surprising that syndicates do not include a residual rights clause in their intercreditor agreements, nor should it be surprising that there is little pressure from individual lenders to include such clauses. *See supra* note 86. *But see* A.I. Credit Corp. v. Gov't of Jam., 666 F. Supp. 629 (S.D.N.Y. 1987) (discussed in *Beal Savings Bank*).

[118] *Beal Sav. Bank*, 865 N.E.2d at 1216 (concluding that Section 4 of the Keep-Well underscores the collective enforcement scheme envisioned by the member lenders). Section 8.3 provided:

> If any Event of Default . . . shall occur for any reason, whether voluntary or involuntary, and be continuing, the Administrative Agent, upon the direction of the Required Lenders, shall by notice to the Borrower declare all or any portion of the outstanding principal amount of the Loans and other Obligations . . . to be due and payable or the Commitments . . . to be terminated, whereupon . . . the Borrower shall automatically and immediately be obligated to deposit with the Administrative Agent cash collateral in an amount equal to all Letter of Credit Outstandings . . . . In addition to the foregoing, the Administrative Agent upon direction of the Required Lenders may, without further notice of default, presentment or demand for payment, protest or notice of non-payment or dishonor, or other notices or demands of any kind . . . exercise any or all rights and remedies at law or in equity (in any combination or order that the Lenders may elect, subject to the foregoing), including, without prejudice to the Lenders' other rights and remedies, the following: . . . (h) recover judgment on the Completion Guaranty or the Keep-Well Agreement either before, during or after any proceedings for the enforcement of the Lenders' rights and remedies hereunder or under the other Loan Documents.

Id. at 1215.

this sense, the Agent's functions were not merely mechanical or ministerial;[119] the Agent was empowered to exercise remedies against the Borrower in the event of default (but only upon the direction of the Required Lenders).[120]

But what about the individual lenders? Could *they* enforce the terms of the credit documents? Remember *New Bank*: a member lender cannot *compel* the syndicate to accelerate the loan on default.[121] Moreover, the Trust's obligations were *dependent and recursive*—the Trust only owed when the Borrower owed, and only to the extent defined in the Keep-Well.[122]

But Beal Savings Bank was not trying to compel the syndicate to accelerate. When the Borrower filed for bankruptcy protection, the filing itself constituted an event of default under the Credit Agreement that resulted in the automatic acceleration of all of the Borrower's obligations thereunder.[123] As a result, the Trust became immediately liable for the "Accelerated Payment Amount" under the Keep-Well Agreement.[124] In the words of the New York Court of Appeals, "neither the Credit Agreement nor the

[119] The *Beal Savings Bank* court recognized that, when granted only limited functions, an agent would not be afforded much deference in decision-making. *See id.* at 1216. However, the court held that the setting of interest rates and the concurrent ability to review the borrower's financial documents, along with the fact that only the name of the agent was included on the cover of the Credit Agreement, was sufficient to support a finding that the agent was not a mere technocrat. *Id.* Here, the words of Justice Moody seem particularly appropriate: "It is difficult to deal with a proposition of this kind except by saying that it is not true." Hunter v. City of Pittsburgh, 207 U.S. 161, 177 (1907). If *those* are the indicia of the agent's actual authority to bind, it is indeed difficult to imagine *any* circumstances in which only ministerial powers might be found. *Cf. A.I. Credit Corp.*, 666 F. Supp. at 631 (where the credit documents specifically limited the agent to "perform[ing] the mechanical and clerical functions" of the syndicate).

[120] *Beal Sav. Bank*, 865 N.E.2d at 1216

[121] *See supra* note 81 and accompanying text.

[122] *See supra* notes 35, 98.

[123] *See* Complaint at 2–3, Beal Sav. Bank v. Sommer, 865 N.E.2d 1210 (N.Y. 2007) (No. 05601222).

[124] *Id.*

Keep-Well contains an explicit provision stating that a Lender may—or may not—take individual action in the event of default."[125] Yet Section 10.20 of the Credit Agreement *explicitly* granted "the Administrative Agent *or the Lenders* remedies at law and in equity in addition to every other right or remedy" contained in all Loan Documents.[126]

New Bank and *Commercial Bank* both indicate that cumulative rights clauses preserve the lenders' common law right to seek a judgment against the *borrower* when the *loan* becomes due. Here, the issue was twofold: whether individual lenders have a remedy at law to enforce a *guaranty* that has come due, and second, whether such right was waived by the lenders when they authorized the lender to take action on their behalf in Section 4 of the Keep-Well.

The fact that the lenders authorized the Agent to act on their behalf and at their direction does not speak to the ability of the lenders to act *on their own behalf*. Under the Restatement of Agency, as under English law, a third party (the borrower or guarantor) who has dealt with an agent for an undisclosed principal (the lender) is, upon knowledge of the principal's existence, in the same position as a third party who has dealt with an agent of a disclosed principal.[127] This approach does not permit the third party to delay rendering performance to the newly disclosed principal.[128] The Trust, upon learning of the plaintiff's existence, owed the Bank the same duties as it owed the Administrative Agent—specifically, to pay the Accelerated Payment Amount not later than forty days following the date of acceleration.[129]

[125] *Beal Sav. Bank*, 865 N.E.2d at 1215

[126] *Id.* at 1217 (emphasis added).

[127] RESTATEMENT (THIRD) OF AGENCY § 6.07 cmt. a (2006) (stating the basic principle "that, when an agent enters into a contract on behalf of an undisclosed principal, the third party, the principal, and the agent become parties to the contract" and that such parties shall have "the same rights, liabilities, and defenses against each other as if the principal made the contract personally").

[128] *Id.*

[129] *Beal Sav. Bank*, 865 N.E.2d at 1216.

This self-executing provision required neither the lenders nor the Administrative Agent to take any action for the payment to become due; it was due the moment the default (i.e., the filing for bankruptcy protection) occurred. Thus, when the Trust failed to make the payment, the plaintiff exercised its "remedies at law" to collect, *on behalf of the bank syndicate*, the debt that was owed thereto.[130]

To the extent that the credit documents seem to preserve each lender's individual ability to exercise rights and remedies at law, the court was unconvinced.[131] To avoid a majority hold-up, the court reasoned that the consent of the required lenders was all that was required to approve the Agent's forbearance[132] and prevent the initiation of successive lawsuits by individual lenders.[133] In the process, the court summarily distinguished *A.I. Credit Corp.*[134] and

[130] *See supra* notes 105, 106 and accompanying text; *see also* Kirschbaum v. Merchs. Bank of N.Y., 71 N.Y.S.2d 79, 80 (N.Y. App. Div. 1947) ("A member of a partnership seeking to recover from a third party a debt due the partnership *must bring the action on behalf of and for the benefit of the partnership* and may not recover upon such an obligation individually. The cause of action resides in the partnership and not in one of its members.") (emphasis added); *supra* note 86 (describing the principal's right to sue on the contract).

[131] *See, e.g.*, *Beal Sav. Bank*, 865 N.E.2d at 1217 ("The purpose of section 18 (e) is to assure that the Agent's *or a Lender's failure or delay in enforcing rights* is not a waiver of those rights. Both these provisions—intended to preserve alternate remedies—do not provide to each Lender express grants of enforcement in the event of default.") (emphasis added). Nevermind the fact that, as the court quoted, the "lender's failure or delay in enforcing rights" was explicitly not a waiver of such rights, which necessarily assumes that the lender *has* rights and remedies under the credit documents. *Id.*

[132] *Id.* at 1219 ("Here, the supermajority vote is meant to protect all Lenders in the consortium from a disaffected Lender seeking financial benefit perhaps at the expense of other debtholders.").

[133] *Id.*

[134] In *A.I. Credit Corp. v. Government of Jamaica*, 666 F. Supp. 629, 631 (S.D.N.Y. 1987), the parties explicitly provided: "The amounts payable at any time hereunder to each Bank shall be a separate and independent debt and each Bank shall be entitled to protect and enforce its rights arising out of this Agreement, and it shall not be necessary for any other Bank to be joined as an additional party in any proceedings for such

Commercial Bank,[135] while following *Credit Francais*[136] unwaveringly.

However, the court's treatment of *New Bank* was particularly problematic. As the court in *Beal Savings Bank* stated, the issue in *New Bank* was one of a lender attempting to compel the syndicate to accelerate.[137] The credit documents were unambiguous on this issue; the *New Bank* plaintiff clearly lacked standing to assert such claims. Yet the *New Bank* court explicitly stated that a lender who had included a cumulative remedies clause in the credit documents could pursue such remedies at law once the debt became due.[138] As a result, the majority in *Beal Savings Bank* cites *New Bank* with approval, even though *New Bank* fails to resolve the issue, and in fact, likely favors the position of the plaintiff.[139]

Recognizing the inconsistencies in the majority's argument, the dissent stressed that a lender's expectation interests should not be so readily dismissed:

purpose." The *Beal Savings Bank* court reasoned that, when combined with an Agent Authorization clause that limited the Agent's function to merely ministerial tasks, Lender Collective Action was properly rejected in *A.I. Credit Corp. Beal Sav. Bank*, 865 N.E.2d at 1218. Here, however, the parties had not included a specific clause authorizing individual enforcement of rights in the event of default, and the New York Court of Appeals was not willing to read one into the agreement. *Id.* at 1218–19.

135 The *Beal Savings Bank* court reasoned that *Commercial Bank* was unpersuasive merely because it was "based on English law." *Id.* at 1218. *But see infra* note 196.

136 *Beal Sav. Bank*, 865 N.E.2d at 1214.

137 *Id.* at 1214–15.

138 *See id.* at 1220 (Smith, J., dissenting).

139 *See id.* ("The majority mistakenly cites *New Bank* as supporting its position . . . . A right of acceleration, unlike the basic right to sue for money that is already due, does not exist except to the extent that a contract provides for it. The *New Bank* court itself pointed out this distinction: 'although acceleration and foreclosure are contractual remedies which may not be exercised without a majority vote of the Lenders, NBNE is free to pursue its own remedies at law by suing Noble to collect on its debt to NBNE.' Beal should be no less free to pursue its own collection remedy here.") (citations omitted).

> A bank that lends money to a borrower and is not repaid is entitled to sue to get its money back. That is, at least, the assumption that most banks surely make when they enter into loan agreements. A bank that is part of a lending group can, of course, agree that no suit will be brought unless a majority or supermajority of the lenders agree to take action, but if that agreement is made, it should be stated in plain language in the document. It is not hard to say: "No suit shall be brought except by the Administrative Agent, acting upon the written instructions of the Required Lenders." No such language, or anything that can fairly be read as its equivalent, appears in this Credit Agreement or Keep-Well Agreement, and I dissent from the majority's decision to read it in.[140]

In the end, the issue in *Beal Savings Bank* may seem remarkably unremarkable. By authenticating the Settlement Agreement with the Borrower and the Guarantor, the Agent agreed to forbear from exercising its lawful remedies. The minority argued that the forbearance constituted a waiver. Under the express terms of the credit documents, it did not.[141] Yet the court went a step further, concluding that a lender could *impliedly* waive its rights to enforce the terms of the credit documents, including its right to seek a judgment against the Guarantor. Thus, Lender Collective Action was born—if a lender did not expressly provide for a right or remedy in the credit documents, even ones traditionally held under the common law, it risked having a court find that such rights were waived, and that they were to be exercised *only* by the agent, exclusive of the individual lenders.

[140] *Id.* at 1219.

[141] *Id.* at 1217. Under Section 18(e) of the Keep-Well: "No failure on the part of the Administrative Agent or any Lender to exercise, and no delay in exercising, any right" would be deemed a waiver. As the court concluded, "[T]he Settlement did not release the Trust of its obligations by amending, modifying or waiving any provision in the agreements . . . ." *Id.*

V. *BEAL SAVINGS BANK*: REDUX

In the wake of *Beal Savings Bank*, lower courts attempted to synthesize the Court of Appeal's groundbreaking ruling with existing precedent. Generally, these cases have involved one or more of the following scenarios (1) lenders seeking a judgment against a defaulting borrower; (2) agent forbearance; or (3) agent credit bidding.

A. Individual Right of Action

The one question that *Beal Savings Bank* clearly resolved is whether a member lender of a bank syndicate can impliedly waive its rights to seek a judgment against the borrower when there is no express authorization to do so in the credit documents.[142] When the parties to a contract have not agreed with respect to a term that is essential to a determination of their rights and duties, the court must supply a term that is reasonable in the circumstances.[143] Pursuant to *Beal Savings Bank*, if the required lenders make an election by directing the agent not to pursue legal action, it is reasonable for a court interpreting credit documents governed by New York law (as most are) to conclude that a dissenting lender does not have standing to seek a judgment against the debtor on the ground that such lender has implicitly waived such right of recourse.[144]

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[142] In *Beal Savings Bank*, there was no clause that provided the members with a right to sue. "Had the parties intended that an individual have a right to proceed independently," the court concluded, "the Credit Agreement or the Keep-Well should have expressly so provided." *Id.* at 1218 (citing *A.I. Credit Corp.* for an appropriate example of an "individual remedies clause"). *See also* Simon, *supra* note 50, at 324–25. ("For example, it occasionally happens that the agent bank refuses to enforce loan agreement provisions against the borrower and seems to have an inappropriate bias (i.e., the agent bank is a leading lender to such borrower and does not want to jeopardize its business relationship with the borrower, even at the cost of tolerating some defaults on the specific loan).").

[143] RESTATEMENT (SECOND) OF CONTRACTS § 204 (1981).

[144] *Beal Sav. Bank*, 865 N.E.2d at 1216; *see also id.* at 1211 (reasoning that lenders intended to act collectively in the event of the borrower's

B. Forbearance

The next issue that courts interpreting New York law have faced is whether the agent of a bank syndicate may take actions that seem to violate the spirit of the credit documents, yet are not expressly prohibited by the terms thereof. Take *In re Delphi*,[145] for example. When the Delphi Corporation filed for bankruptcy protection in 2005, the agent of Delphi's syndicated debtor-in-possession ("DIP") creditors forbore from collecting on the borrower's debt at the direction of a majority of the lenders.[146] Considering the "collective design" of the syndicate, as well as the policy concerns surrounding the potential insolvency of the borrower, the Bankruptcy Court held that the agent had the right to not only exercise remedies afforded it, but also to forbear from exercising the same, unless contrary intentions are explicitly provided.[147] Since nothing in the credit documents explicitly prohibited the agent from forbearing, the court reasoned that the agent had the authority to forbear at the direction of a majority of the lenders.[148]

But what happened when the maturity date arrived? The purpose of the forbearance was to buy time so that the parties could execute an "accommodation agreement,"[149]

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default and to preclude an individual lender from disrupting the scheme of the agreements at issue).

[145] *In re* Delphi Corp., No. 05-44481, 2009 WL 2482146 (Bankr. S.D.N.Y. July 30, 2009).

[146] *See* Transcript of Hearing Held on December 1, 2008 at 10:56 a.m. at 152–53, *In re* Delphi Corp., No. 05-44481 (Bankr. S.D.N.Y. Dec. 1, 2008), *available at* http://www.dphholdingsdocket.com/Docket/SearchResults.asp?SH=1 (Court Docket #14582, filed 12/11/2008) [hereinafter Transcript of Hearing].

[147] *Id.* at 45 (stating that the court would not look beyond the four corners of the contract when determining whether or not the Agent is permitted to act at the discretion of a mere majority of lenders).

[148] *See id.* at 156.

[149] For the full Accommodation Agreement, see Order (I) Supplementing January 5, 2007 DIP Refinancing Order (Docket No. 6461) and Authorizing Debtors to Enter Into and Implement Accommodation Agreement with Agent and Participating Lenders and (II) Authorizing Debtors to (A) Enter Into Related Documents and (B) Pay Fees in

under which the borrower and lenders would renegotiate the terms of the credit agreement and provide for a restructuring plan under Chapter 11 of the Bankruptcy Code.[150] Under the terms of the credit documents, the agent would need unanimous consent of the lenders if it wished to extend or otherwise modify the maturity date.[151] The essence of the accommodation agreement was to do just that: according to the GM-Delphi Agreement, dated May 9, 2008, among the borrower, the guarantors, the DIP Lenders, and their agent, JP Morgan Chase, the DIP lenders would have to agree to a forbearance with respect to the Maturity Date.[152]

It would seem, then, that the consent of all DIP lenders would be required. Not so, ordered the court.[153] In sanctioning the agent's effective modification of the loan, the Bankruptcy Court stated that its forbearance decision was "directly supported by" *Beal Savings Bank*.[154] The court even cited the language of *Beal Savings Bank*: "the fact that forbearance has a *similar effect* to extension is insufficient to override the parties' agreements with regard to collective action to enforce their respective rights under the DIP credit agreement."[155]

Connection Therewith ("Dip Accommodation Order"), *In re* Delphi Corp., No. 05-44481 (Bankr. S.D.N.Y. Dec. 3, 2008) (No. 14515), *available at* http://www.dphholdingsdocket.com/Docket/SearchResults.asp?SH=1 [hereinafter DIP Accommodation Order].

[150] *See* Transcript of Hearing, *supra* note 146, at 152–53.

[151] *See id.* at 109 (referring to Section 10.09 of the Credit Agreement).

[152] *See* Order Authorizing Debtors to Enter (I) Second Amendment to Arrangement with General Motors Corporation Approved Pursuant to Second Dip Extension Order (Docket No. 13489) and (II) Partial Temporary Accelerated Payment Agreement ("GM Arrangement Second Amendment Agreement Approval Order"), *In re* Delphi Corp., No. 05-44481 (Bankr. S.D.N.Y. Dec. 3, 2008) (No. 14514), *available at* http://www.dphholdingsdocket.com/Docket/SearchResults.asp?SH=1.

[153] *See* DIP Accommodation Order, *supra* note 149, at 1–10.

[154] *See* Transcript of Hearing, *supra* note 146, at 155 (referring to Section 2.25 of the Credit Agreement).

[155] *Id.* at 157 (emphasis added).

C. Credit Bidding

Generally, after a secured creditor forecloses on the debtor's property, it must hold a foreclosure sale.[156] Alternatively, the creditor may agree to take the collateral in complete satisfaction of the debt ("strict foreclosure").[157] If a sale is held, the creditor may bid on and purchase the collateral, crediting the sale price against the outstanding debt.[158] If the borrower is in bankruptcy, a Section 363 sale may be held, whereby a secured creditor may bid at an auction some or all of its collateral and "offset such claim against the purchase price of such property."[159]

Since the financial crisis of 2008–2009, agents have been under increasing pressures to collect on troubled assets.[160] As the capital markets for debtors-in-possession[161] and exit financing[162] continue to struggle, agents have had to rely

[156] U.C.C. § 9-610(a) (2003); RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 8.2 (1997).

[157] *See generally* U.C.C. § 9-620 (2003); RESTATEMENT (THIRD) OF PROP.: MORTGS. § 3.1, cmt. f (1997) (permitting creditor to take a deed in lieu of foreclosure).

[158] U.C.C. §§ 9-610(c), 9-615(a)(2); RESTATEMENT (THIRD) OF PROP.: MORTGS. § 8.4.

[159] 11 U.S.C. § 363(k) (2010).

[160] Abrams et al., *supra* note 12, at 2.

[161] A debtor-in-possession ("DIP") is a Chapter 11 or Chapter 12 debtor that continues to operate its business as a fiduciary to the bankruptcy estate. With certain exceptions, the debtor-in-possession has all the rights, powers, and duties of a Chapter 11 trustee. BLACK'S LAW DICTIONARY 464 (9th ed. 2009). DIP lending is the process by which debtors-in-possession obtain financing to cover ongoing business operations or short-term capital improvement projects.

[162] When debtors emerge from restructuring, they will typically need to find sources of capital to finance ongoing operations and business plans. This process is referred to as "exit financing." *See generally* Penny G. Friedman, *Proper Exit Financing Is Key to Chapter 11 Emergence Challenges Abound for Debtors, Lenders Alike*, TURNAROUND MGMT. ASS'N, (July 1, 2004), http://www.turnaround.org/Publications/Articles.aspx?objectID=3431.

increasingly on alternatives to the traditional Chapter 11 plan of reorganization,[163] including credit bidding.

Such experimentation has not been without criticism, particularly where the syndicate itself is classified into first- and second-lien classes.[164] While the market for second-lien loans has grown, so has the pressure on agents to protect the interests of the first-lien lenders, potentially to the detriment of the second-lien lenders.[165] Agents of bank syndicates have turned to Lender Collective Action to justify credit bidding in face of lender opposition.[166]

Unsurprisingly, whether an agent can credit bid on behalf of the syndicate depends entirely upon the language of the credit documents. If, for example, the credit documents empower the agent to exercise all rights and remedies provided in the credit documents, "together with such powers as may be reasonably incidental thereto,"[167] then few courts would say that the right to credit bid is per se beyond the scope of the agency.[168] Indeed, because of the fundamental

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[163] At a very basic level, Chapter 11 allows an insolvent business, or one that is threatened with insolvency, to reorganize its capital structure under court supervision (and subject to creditor approval) while continuing its normal operations. BLACK'S LAW DICTIONARY 264 (9th ed. 2009). *See generally* 11 U.S.C. §§ 1101–1174.

[164] *See infra* Part VI.B.

[165] *See infra* notes 239, 241 (describing the mechanisms for creating a "silent second," a class of second-lien lenders that has no say over the administration of the loan).

[166] Abrams et al., *supra* note 12, at 2.

[167] Beal Sav. Bank v. Sommer, 865 N.E.2d 1210, 1211 (N.Y. 2007).

[168] *See, e.g.*, *In re* Chrysler, 405 B.R. 84 (Bankr. S.D.N.Y. 2009), *aff'd*, 576 F.3d 108 (2d Cir. 2009) (approving a credit bid by the agent, free and clear of any liens, for only a fraction of the principal amount of the loan, over the objection of minority lenders holding a 7.5% interest in the principal); *In re* GWLS Holdings, Inc., No. 08-12430, 2009 WL 453110, (Bankr. D. Del. Feb. 23, 2009) (rejecting the argument that the amendment provision in the Credit Agreement precludes the agent from credit bidding all of the debt and concluding that the exercise of remedies under the Collateral Agreement is not a waiver, amendment, supplement or modification of the Credit Agreement); *In re* Metaldyne, 409 B.R. 671 (Bankr. S.D.N.Y. 2009) (approving a credit bid of 100% of the prepetition term debt over the objection of a lender holding less than 1% of the same

nature of the right,[169] most courts would allow an agent to credit bid unless there is an express contractual provision in the credit documents stating otherwise.[170] There is genuine controversy, however, as to the extent of the right and the scope of its exercise, particularly where the agent attempts to credit bid the full amount of the debt over the objection of a substantial minority of lenders.[171]

VI. MOVING FORWARD

It is unclear if there is any bright-line test for when, or how, courts will apply Lender Collective Action.[172] While parties are free to define rights and remedies as they see fit, it is still the courts that give meaning to the text of private agreements.[173] Unless constrained by the legislature, the courts will have the final word on the issue of Lender Collective Action. With these considerations in mind, this Note will attempt to provide a justification for the theory's existence, while also proposing certain limitations to account for the theory's shortcoming, including the adoption of (1) a

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despite a provision in the credit documents that "prohibits amendments that . . . release all or substantially all of the Collateral from the Liens of the Security Documents, without the written consent of each Lender").

[169] *See* Keith A. Simon, *Credit Bidding by a Syndicated Lending Group: Understanding the Complexities of § 363(k) of the Bankruptcy Code*, 18 J. BANKR. L. & PRAC. 6 Art. 5, 9 (Nov. 2009) (placing special emphasis on credit bidding in the context of syndicated loans and analyzing recent case law on the matter).

[170] It is possible that a court might also prevent an agent from credit bidding where the action would result in inequity for the lenders or the syndicate. Alternatively, a court might permit the credit bid, but with certain restrictions, such as an aggregate limit or a member approval procedure. At this point, however, it is too early to say whether any limitations will be placed on the option, equitable or otherwise.

[171] For more on credit bidding, see *infra* Part VI.C (proposing stronger equitable limitations on the ability of the agent to credit bid over the objection of junior lenders when doing so would unfairly extract value from the borrower at the expense of the junior faction).

[172] Abrams et al., *supra* note 12, at 2.

[173] *Id.*

"clear statement" rule; and (2) equitable or fairness limitations.

A. Justifications

The classic justification for Lender Collective Action is that the theory is a proper interpretive tool that furthers institutional goals without impeding the syndication process or frustrating individual expectation interests.[174] Delegation is the *sine qua non* of syndication.[175] To decentralize is to destabilize: Lender Collective Action binds the various actors and prevents unnecessary or counterproductive dissention.[176] Moreover, through democratization (e.g., voting structures), the delegation function is responsive to the needs and wishes of the various constituent lenders.[177]

By the same token, syndicated lenders are highly sophisticated (as are the lawyers who represent them), and collective action is anticipatable.[178] The agent can only override the wishes of a dissenting minority to the extent that the minority has contractually subordinated its own interests to those of the collective whole.[179] A lender that wishes to have a veto may provide for one through careful

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174 Marc Abrams & Rachel C. Strickland, *For: A Consensual Solution For the Greater Good, in Lender 'Collective Action' Doctrine Provokes Controversy*, N.Y. L.J., Dec. 14, 2009, at 3.

175 *Id.*

176 *Id.*

177 *Id.*

178 *Id.*

179 *See* Michael T. Madison et al., *Participant Relations In a Troubled Loan—Fraud and Misrepresentation*, 2 L. REAL EST. FINANCING § 11:18 (2011) ("Banks are sophisticated institutions. In negotiating a participation agreement, the bargaining positions of the parties are roughly equal and, therefore, the area of loan participation is not an area of commerce in which the courts need to intervene to protect the uninformed or the weak."). *But see* Citadel Equity Fund Ltd. v. Aquila, Inc., 371 F. Supp. 2d 510, 512 (S.D.N.Y. 2005), *aff'd*, 168 F. App'x 474 (2d Cir. 2006) ("The parties are sophisticated and well advised[, yet t]his dispute demonstrates that the disposition of substantial sums of money can result in surprisingly different views of the most carefully contemplated contract.").

attention to and precise drafting of the credit documents.[180] Accordingly, minority lenders can hardly complain when they find themselves in a predicament that they could have reasonably foreseen and around which they could have contractually negotiated.[181] Thus, some have argued that a minority lender's expectation interests are not frustrated when it is held to the terms of the agreement for which it has negotiated.[182] Where the lenders have envisioned a uniform response to borrower default, they claim, Lender Collective Action is appropriate, even if the language of the credit documents is unclear or ambiguous on the issue.[183]

B. Criticism

But not so fast! Maybe some lenders *do* envision unified action when joining a syndicate,[184] or at the very least, *should*.[185] But, what about our judicial system's adherence to traditional methods of contract interpretation? Some, like New York bankruptcy attorney, Keith Wofford, have argued that the theory is ignorant of basic principles of contract law and needlessly restructures the common-law landscape.[186] According to Wofford, Lender Collective Action is actually a tool of *elite* institutional lenders: the theory allows large, liquid creditors to use their positions to entrench themselves

[180] Abrams & Strickland, *supra* note 174, at 3.

[181] *Id.*

[182] *Id.*

[183] *See supra* note 15 and accompanying text.

[184] *See* Paul J. Epstein, *Beal v. Sommer: Did Decision on Collective Action in Exercise of Lenders' Remedies Reflect Contracting Parties' Intent?*, 125 BANKING L.J. 240, 246 (2008) (concluding that the result reached by the majority in *Beal Savings Bank* may have accurately reflected the intent of the lenders, and market practice generally, even if such a result was not clearly supported by the text of the credit documents).

[185] *See supra* notes 174–177.

[186] Keith H. Wofford, *Against: A Violation of New York Law and Good Policy, in Lender 'Collective Action' Doctrine Provokes Controversy*, N.Y. L.J., Dec. 14, 2009, at 4.

by enhancing majority power at the expense of the minority.[187]

1. Say What You Mean

The most fundamental flaw of Lender Collective Action stems from a misunderstanding of agency and contract law. According to Wofford:

> The entitlements traditionally reserved as the exclusive domain of individual lenders, namely, the right to obtain repayment of principal at maturity, the right to receive payment of interest at the agreed rate and at agreed intervals, and the right to bar releases of all or substantially all loan collateral and guarantees, legally cannot and should not be denied by means of "collective action" doctrine.[188]

In many instances, courts have relied upon affirmative delegations to the agent as adequate grounds for implying a negative, reciprocal discharge of a right or remedy on the part of the member lender.[189] Yet a delegation of power to an agent does not equate to an abdication of power by the principal.[190] A lender can authorize the agent to sue on its

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[187] *Id.*

[188] *Id.*

[189] *See, e.g.*, Beal Sav. Bank v. Sommer, 865 N.E.2d 1210, 1213 (N.Y. 2007) (holding that no individual member of the consortium was empowered to enforce the agreement in the event of default where the credit documents only mentioned the Administrative Agent in relation to such tasks); *see also* Credit Francais Int'l, S.A. v. Sociedad Financiera de Comercio, C.A., 490 N.Y.S.2d 670, 684 (N.Y. Sup. Ct. 1985) ("It is axiomatic in partnership law that 'a member of a partnership seeking to recover from a third party a debt due the partnership must bring the action on behalf of and for the benefit of the partnership and may not recover upon such an obligation individually. The cause of action resides in the partnership and not in one of its members.'"); *In re* Enron Corp., 302 B.R. 463, 477 (Bankr. S.D.N.Y. 2003) (using similar language to dismiss a suit brought by an individual lender rather than the collective syndicate, even though almost *all* of the lenders had joined the suit by the time litigation ensued).

[190] RESTATEMENT (THIRD) OF AGENCY § 1.03, cmt. c (2006).

behalf without necessarily giving up its own right to sue on its own behalf, or on behalf of the entity.[191]

As such, the *Credit Francais* court's analogy of the bank syndicate to a partnership,[192] though apt, is misplaced. The fact that the partner can seek a judgment on behalf of the partnership acknowledges the fact that the individual partner *has standing* to seek the judgment.[193] Thus, where a lender participates in syndication, the only thing that changes is the *form* of the remedy, not the right to exercise the remedy itself.[194] Though there may be practical reasons why a syndicate would choose not to permit its members to individually seek a judgment in the event of default,[195] as a matter of contract interpretation, the reasoning of *Beal Savings Bank* is unpersuasive.[196]

So what are courts to do? As previously indicated, Lender Collective Action case law focuses largely on the specific terms of the governing credit documents. Generally,

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[191] *See supra* note 134.

[192] *See Credit Francais*, 490 N.Y.S.2d at 684.

[193] *See supra* note 127 and accompanying text.

[194] The remedy may be fashioned as either a recovery on behalf of the entire entity or the member's pro rata share of the collective remedy. *See Beal Sav. Bank*, 865 N.E.2d at 1213 (where the plaintiff sought $90 million to share with the other Lenders or, in the alternative, its pro rata share thereof). But in either instance, the principal is still permitted to bring the action.

[195] To be sure, lenders can contract around *Beal Savings Bank* if they so choose or they can refuse to participate in syndications altogether if they fear the risk of being unable to pursue remedies on their own. Alternatively, lenders could increase the rate of interest that they charge to account for this risk.

[196] For example, the *Beal Savings Bank* court distinguished *Commercial Bank* on the mere ground that it was "based on English law." *Beal Sav. Bank*, 865 N.E.2d at 1218. Yet much of American common law is based on English traditions and customs. Contract law itself is largely a relic of Continental doctrine. Such an argument could hardly stand scrutiny in other areas of law, such as torts, property, or criminal law. Moreover, the Restatement explicitly adopts a similar standard. *See supra* notes 127–28. If the Restatement rule is the same as the English rule, it makes little sense to disregard *Commercial Bank* simply because the governing law is not identical.

unambiguous terms should be given their "plain meaning,"[197] yet credit documents are often subject to "differing yet rational interpretations."[198] The standard cure for ambiguity is to place the term or provision "in context" using either intrinsic[199] or extrinsic[200] evidence. Accordingly, credit documents must be read "as a whole," and industry customs or terms-of-art may be imported to ascertain the true intent of the parties.[201] As a practical matter, credit agreements rarely foreclose the right of a lender to sue for payment upon breach.[202] Does silence in the credit documents manifest an intention on the part of the lender to preserve its right of private action or to abandon it in favor of collective action? According to *Beal Savings Bank*, a broad delegation of authority to the agent *implies* that the parties intended for collective action in the event of default.[203]

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[197] RESTATEMENT (SECOND) OF CONTRACTS § 202.3 (1981) ("Unless a different intention is manifested, (a) where language has a generally prevailing meaning, it is interpreted in accordance with that meaning . . . .").

[198] Abrams et al., *supra* note 12, at 2.

[199] Generally, a court will place a term in context by examining the contract as a whole, or other related documents. RESTATEMENT (SECOND) OF CONTRACTS § 202.2 ("A writing is interpreted as a whole, and all writings that are part of the same transaction are interpreted together.").

[200] An appropriate context might include a course of dealing, industry usage, or other terms and provisions within the same or accompanying documents. *Id.* § 202.5 ("Wherever reasonable, the manifestations of intention of the parties to a promise or agreement are interpreted as consistent with each other and with any relevant course of performance, course of dealing, or usage of trade.").

[201] *See, e.g.*, R/S Assocs. v. N. Y. Job Dev. Auth., 771 N.E.2d 240, 242 (N.Y. 2002) ("Unless the court finds ambiguity, the rules governing the interpretation of ambiguous contracts do not come into play. Thus, when interpreting an unambiguous contract term evidence outside the four corners of the document is generally inadmissible to add to or vary the writing.") (citations omitted). This "four corners" approach emphasizes the use of competing provisions within the same or accompanying documents, as well as industry custom; though extrinsic evidence would generally be inadmissible unless ambiguity is found.

[202] Wofford, *supra* note 186, at 4.

[203] Beal Sav. Bank v. Sommer, 865 N.E.2d 1210, 1218 (N.Y. 2007) ("[A]n undisclosed principal can sue on a contract except when the terms of

This Note disagrees, proposing instead that courts should adopt a contract version of the "clear statement rule" for the abrogation of remedies traditionally provided at law. The "clear statement" rule is a canon of statutory construction that provides that, when a statute may or may not be interpreted to override long-standing rights, or make a large policy change, courts should not interpret the statute to make the change unless the intention of the legislature is clearly stated in the statute.[204]

The rule is based on the assumption that parties do not make major, fundamental changes to pre-existing or default rules in a vague or unclear manner.[205] It could be argued that applying the "four corners" and "plain meaning" rules would lead to the same result as a "clear statement" rule—by giving terms their traditional, common meaning and by limiting the terms of the contract to those expressly made within the four corners of the document. Insofar as this is a true statement of the rules, they have been insufficient to reach the results advocated herein.[206] Thus, a stronger version—namely, the contract equivalent of a "clear statement" rule—is necessary.

Courts interpreting contracts governed by New York law should refrain from turning to Lender Collective Action when doing so would abrogate a lender's traditional remedies

the contract expressly or impliedly confine it to the parties to it.") (citation omitted). Because nothing in the credit documents expressly confined the right to sue on the contract to the parties—i.e., the agent and the borrower—the court must have concluded that the contract did so implicitly.

[204] For a modern application of the Rule, see *Morrison v. National Australian Bank Ltd.*, 130 S. Ct. 2869, 2883 (2010) (finding that the "presumption against extraterritoriality" is a long-standing principle of statutory construction and that if the legislature wishes to apply a specific statute extraterritorially, a clear statement in the text of the statute to do so is required).

[205] *See, e.g.*, United States v. Bass, 404 U.S. 336, 349 (1971).

[206] For example, see the court's treatment of the "four corners" and "plain meaning" rules in *Beal Savings Bank*. *See supra* Part IV.B.

at law.[207] A clear statement limitation would serve as a sort of gap-filling device by resolving ambiguities in favor of *default remedies at law*, including the right to enforce the terms of the credit documents and seek a judgment for any outstanding obligations once they become due.[208] Insofar as a clear statement rule could be applied in practice, its effect would be to severely limit the extent to which *Beal Savings Bank* would retain any precedential value—either as a model of contract interpretation or for its holding that lenders may *impliedly* waive their right to seek a judgment.

2. And Mean What You Say

"Thou shalt not modify, amend, or waive the terms of the agreement without the express, unanimous consent of the lenders." A simple imperative, yet it is one that has confused and overwhelmed New York courts. When lenders include a unanimous consent clause in the credit documents, they intend to preserve their veto power over the decisions of the agent, at least with respect to enumerated categories of action.[209] Yet, in the wake of *Beal Savings Bank*, lower courts have permitted agents to act or forbear even though

[207] Principally, this Note argues that a court should not apply Lender Collective Action in order to prevent individual member lenders from obtaining a judgment against the borrower (or the guarantor) when such sums become due. *See* Wofford, *supra* note 186, at 4 (discussing the fundamental nature of the individual right of action in terms of lender expectation interests). This Note does not address the full range of remedies available at law.

[208] In this context, the "default rules" would be those rights and remedies available at common law, provided by statute, or otherwise. Note that such language is often provided in credit documents already and is often overlooked by courts applying Lender Collective Action. *See, e.g.*, Beal Sav. Bank v. Sommer, 865 N.E.2d 1210, 1217 (N.Y. 2007) ("Section 10.20 of the Credit Agreement grants the Administrative Agent *or the Lenders* remedies at law and in equity 'in addition to every other right or remedy' contained in all Loan Documents.") (emphasis added).

[209] *See supra* note 96.

the action is functionally the same as one of the "prohibited" actions.[210]

In a workout scenario, the most precious commodity is time; often, the more time that passes, the deeper the borrower's hole grows.[211] If done correctly, a forbearance of legal remedies can give the borrower much needed breathing room, while still allowing the lender to save both time and money. In some cases, the lender can end up obtaining title to the collateral faster under a workout than under traditional foreclosure proceedings.[212] However, when an agent forbears from exercising the remedies provided in the credit documents, minority lenders argue that it must first seek the unanimous consent of the lenders.[213] This is particularly true when the agent seeks to enter into a "forbearance agreement" with the borrower, under which the agent agrees to forbear from exercising remedies, *even after* the date of maturity. According to the minority lenders, forbearing from exercising remedies is the same as a waiver or modification, which would clearly require the unanimous consent of the lenders.[214]

However, the New York courts say that to forbear[215] is *not* to waive.[216] Even if a forbearance agreement has a "similar

[210] Relying on *Beal Savings Bank*'s "similar effect" language, *see Beal Savings Bank*, 865 N.E.2d at 1217, lower courts and bankruptcy courts have permitted agents to take actions not explicitly barred by the credit documents despite similar results, *see supra* note 146.

[211] Stephen Benko, *A Mortgage Lender's Guide to Workouts*, REAL EST. FIN. J., Spring 1991, at 12.

[212] *Id.* at 13.

[213] *See In re* Delphi Corp., No. 05-44481, 2009 WL 2482146 (Bankr. S.D.N.Y. July 30, 2009).

[214] *See generally* Transcript of Hearing, *supra* note 146.

[215] To "forbear" is to refrain from enforcing a right, obligation, or debt. Strictly speaking, *forbearance* denotes an intentional negative act, as opposed to an *omission*. BLACK'S LAW DICTIONARY 717 (9th ed. 2009). To perpetually forbear, then, is to intentionally refrain from *ever* enforcing the rights and remedies provided in the credit documents.

[216] To "waive" is to voluntary relinquish, forfeit, or abandon—by express or implied means—a legal right or advantage. *Id.* at 1717. It is, in a more contrived manner of speaking, "one of those words of indefinite connotation in which our legal literature abounds; like a cloak, it covers a

effect" as a waiver agreement, credit documents rarely require the agent to seek the unanimous consent of the lenders to forbear from exercising remedies against the borrower. As courts interpreting New York law have reasoned, if lenders desired such a limitation, then they should have provided for it in the credit agreements.[217] Perhaps this is a reasonable response for short-term, temporary forbearances, but for long-term or perpetual forbearances (which resemble a waiver or modification), the lenders have made a concerted effort to provide for a veto and courts should not so lightly draw a line between actions that are functionally equivalent.

The Second Circuit has implicitly acknowledged the reasonableness of such an approach in *Citadel Equity Fund*.[218] In *Citadel Equity Fund*, the borrower had entered into a credit agreement with a syndicated credit facility for approximately $430 million in financing.[219] When the borrower failed to comply with certain refinancing conditions, the plaintiff, a private equity fund, demanded that the borrower pay a mandatory prepayment, as required by Section 2.7(d) of the credit agreement.[220] Unfortunately, the required lenders had other things in mind. On September 14, 2004, the required lenders, holding two-thirds of the outstanding debt under the credit facility, informed the borrower that it would not enforce the mandatory

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multitude of sins." WILLIAM R. ANSON, PRINCIPLES OF THE LAW OF CONTRACT 419 (Arthur L. Corbin ed., 3d Am. ed. 1919).

[217] *See supra* notes 153–55.

[218] Citadel Equity Fund Ltd. v. Aquila, Inc., 371 F. Supp. 2d 510, 521–22 (S.D.N.Y. 2005), *aff'd*, 168 F. App'x 474 (2d Cir. 2006).

[219] *Id.* at 513.

[220] *Id.* ("According to Citadel, the purpose of Section 2.7(d) was to protect the lenders against the risk that Aquila would fail to pay, refinance, retire, or otherwise defease the Senior Notes in a timely manner. Citadel and the other lenders had an interest in seeing that Aquila met its obligations under the Senior Notes in order to protect the lenders from a cross-default that could interfere with their economic interest in the outstanding loans under the Credit Agreement.").

repayment (and premium) due under Section 2.7.[221] But was the lenders' notice effective?

The court noted that in most cases of default, the loans would only become due and payable if the required lenders so elected.[222] By contrast, the mandatory prepayment provisions under Section 2.7(d) occurred automatically upon the occurrence of the preconditions set forth therein, much like the Trust's obligations under the Keep-Well Agreement in *Beal Savings Bank*, where when the conditions were not met, the Loans became "due and payable" without any action on the part of the lenders.[223] The court went on to conclude that, even if the required lenders had the authority to waive the mandatory prepayment requirement (meaning, even if it was not *mandatory*), "the waiver at issue here was invalid because it was not based on the unanimous consent of all the lenders."[224]

To be fair, in *Citadel Equity Fund*, the letter that the required lenders sent to the borrower explicitly stated that the lenders were "waiving" the requirements of Section 2.7(d).[225] But what if they had instead stated that they were "forbearing" from collecting on the debt due under Section 2.7? Does such a difference in form alter the underlying substance of the transaction? Should it? On the one hand, there are meaningful short-term economic differences between a waiver agreement and a forbearance agreement.[226]

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[221] *Id.* at 515.

[222] *Id.* at 519.

[223] *Id.*

[224] *Id.* at 520 (citing the unanimous consent clause).

[225] *Id.* at 515.

[226] There is at least one significant legal difference between forbearance and waiver: "A forbearance agreement will not eliminate the default. To the contrary, a forbearance agreement expressly preserves the default, and the lender only agrees to refrain from exercising its remedies during the forbearance period. A waiver agreement, on the other hand, waives the default and restores the parties to their pre-default positions." Scott G. Night & Craig S. Unterberg, *Waiver, Forbearance Agreements After Default*, HAYNES & BOONE, LLP, http://www.haynesboone.com/waiver_forbearance_agreements_after_default/ (last visited Mar. 5, 2012).

Yet, to the extent that it is consistent with both the above mentioned "clear statement" rule and the general canon of *expressio unius*,[227] preventing agents from taking actions that are functionally equivalent to a modification or a waiver would more accurately reflect basic principles of contract interpretation by avoiding rendering portions of the credit documents functionally meaningless.[228] At the very least, agents should not be entitled to extend the maturity date (i.e., modify the agreement) under the guise of forbearance. To the extent that they have allowed such action, New York courts have vastly overextended the "similar effect" language of *Beal Savings Bank*.

C. Duty Before Everything: Beyond Interpretation

Most intercreditor agreements recognize the importance of allowing the agent to exercise remedies, even without the unanimous consent of the lenders—to execute singly, or together with the required lenders, the resolutions formed in common under the credit agreement. What limitations, then, should be applied to an agent exercising such remedies on behalf of the syndicate?

Consider, for example, a typical foreclosure proceeding, in which the syndicate obtains a judicial foreclosure on the

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Thus, under a forbearance agreement, the borrower will still be liable for the default interest rate, while under a waiver agreement, it will not.

[227] Under the maxim *expressio unius est exclusio alterius*, the expression in a contract of things of a class implies the exclusion of all not expressed, even though all would have been implied had none been expressed. However, the rule should not be used to contradict a clear expression of intent. 17A C.J.S. *Contracts* § 327 (2010). In the context of statutory interpretation, New York courts have made it clear that the cannon should *not* be applied when doing so would frustrate the purpose of the statutory provision. *See In re* Bath & Hammondsport R.R. v. N.Y. State Dep't of Envtl. Conservation, 539 N.E.2d 560, 560 (N.Y. 1989).

[228] Wofford, *supra* note 186, at 4. For example, forbearing from exercising remedies after the date of maturity would effectively constitute an extension of the maturity date (e.g., a modification). Likewise, perpetually forbearing from collecting on mandatory payments due under the contract would constitute an effective waiver of those provisions. The unanimous consent clause should be triggered in both of these situations.

borrower's property (e.g., the manufacturing facility) and holds a foreclosure sale.[229] The borrower and guarantor are entitled to an offset of the purchase price of such collateral at the foreclosure sale against the outstanding debt owed.[230] If there is a secondary class of lenders, then the proceeds from the foreclosure sale are applied first to the senior debt obligation and then, if any proceeds are remaining, to the junior debt obligation.[231] Alternatively, the creditors may obtain a "strict foreclosure" on the collateral in satisfaction of all or part of *both* the first- and second-lien obligations.[232]

In either case, the purchase price of the collateral is offset against the outstanding debt and the lender may obtain a judgment for any deficiency.[233] Note that, if it is determined that the fair market value of the collateral is greater than the foreclosure sale price, then the borrower is entitled to an offset against the deficiency in the amount by which the fair market value, less the amount of any liens on the real estate that were not extinguished by the foreclosure, exceeds the sale price.[234] Similar rules apply in the context of a bankruptcy proceeding where the debtor is in possession of the collateral and the creditors bid on the assets at a sale pursuant to Section 363 of the Bankruptcy Code in complete or partial satisfaction of the debtor's outstanding obligations.

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229 *See generally supra* notes 41–43.

230 U.C.C. § 9-615(a) (2003); RESTATEMENT (THIRD) OF PROP.: MORTGS. § 8.2(b) (1997).

231 *Id.*

232 U.C.C. § 9-620; RESTATEMENT (THIRD) OF PROP.: MORTGS. § 8.2(b).

233 U.C.C. § 9-608(a)(4); RESTATEMENT (THIRD) OF PROP.: MORTGS. § 3.1(c), cmt. f (permitting "deed in lieu" of foreclosure agreements); 11 U.S.C. § 363 (2010) (permitting credit bidding if full or partial satisfaction of the outstanding debt).

234 RESTATEMENT (THIRD) OF PROP.: MORTGS. § 8.4(d); *see generally* U.C.C. § 9-610(b) (requiring foreclosure sales to be performed in a "commercially reasonable manner"). For example, if the outstanding debt is $1.5 million, the collateral has a fair market value of $1 million, and the secured creditor, acting in bad faith, purchases the collateral for $250 thousand, then the debtor and guarantor are entitled to an offset against the deficiency in the amount of $750 thousand, thereby leaving an outstanding obligation of $500 thousand.

In certain instances, accepting collateral in satisfaction of the outstanding debt (through credit bidding or otherwise) may be inconsistent with notions of "fairness" towards minority lenders. For example, if the agent credit bids the entire face value of the outstanding debt, then there *is* no deficiency; the entire debt is extinguished and the obligations of the borrower are discharged. To the extent that there is a class of second-lien lenders, the "cram down" implications of credit bidding can be troubling. In such instances, the second-lien lenders, as members of the syndicate, have the entire face value of *their* debts extinguished as well. Thus, such lenders are not entitled to a deficiency judgment against the borrower, even if the fair market value of the manufacturing facility is only enough to pay off the outstanding balance of the first-lien lenders.[235]

In other bankruptcy proceedings, it is much harder for the first-lien lenders to "cram down" second-lien lenders because the bankruptcy code requires that a plan of reorganization be "fair and equitable" to all classes of lenders.[236] For example, if the syndicate decides that foreclosure would be less profitable than continued operation of the manufacturing facility, it might engage in a workout to restructure the borrower's debt under Chapter 11 of the Bankruptcy Code. Under Chapter 11, the borrower's creditors must vote on any plan of restructuring.[237] If the creditors are classified, each class usually has a right to vote on any proposed plan.[238] In some cases, a plan may be

[235] *See* PowerPoint Presentation by Donald S. Bernstein, Karin S. Day, Jason Kyrwood & Brian Resnick, Attorneys, Davis Polk & Wardwell LLP, to Loan Syndications & Trading Ass'n (Sept. 24, 2009), at 17, *available at* www.lsta.org/WorkArea/downloadasset.aspx?id=7582 (download only) [hereinafter Davis Polk Presentation].

[236] *See* 11 U.S.C. § 1129(a)(8), (b)(1) (voiding a plan of reorganization where it is not accepted as an injured class of claimants). *See also* Latham & Watkins LLP, Client Alert: Second Lien Financings—Answers to the Most Frequently Asked Questions (Apr. 15, 2004), at 5, *available at* http://www.lw.com/Resources.aspx?page=FirmPublicationDetail&attno=02065&publication=967 [hereinafter Latham Client Alert].

[237] *See* 11 U.S.C. § 1129(a)(8)(A).

[238] *See id.* § 1129(a)(7)(A)(i).

approved over the objections of a class of creditors if such a plan is fair and equitable to all classes.[239] The standard for what is "fair and equitable" is higher for secured lenders than it would be for unsecured lenders, thus giving second-lien lenders greater leverage during restructuring negotiations.[240]

Unfortunately, when the second-lien lenders are members of the same lending syndicate as first-lien lenders, the agent may be able to by-pass these statutory safeguards by asserting Lender Collective Action and arguing that the second-lien lenders have constructively "accepted" the terms of the reorganization plan (or in liquidation proceedings, the foreclosure sale) by permitting first-lien lenders to vote on their behalf. In syndicated transactions, for example, counsel to first-lien lenders have created a so-called "silent second" by incorporating second-lien structures into the intercreditor agreements themselves, subordinating virtually all of the rights of the second-lien lenders, and redefining the dispute-resolution clauses in a way that requires only the approval of the first-lien lenders for agent actions.[241] When the interests of creditors are prioritized in such a manner, the agent may be able to "cram down" a restructuring plan over the objection of the entire class of second-lien lenders. Nevertheless, the Bankruptcy Code's focus on fairness is instructive.

Although Wofford has argued that credit bidding should only be permitted where explicitly authorized by the applicable credit documents,[242] a credit bid is not a waiver, amendment, or modification of the credit documents, and therefore should not be construed to fall within the ambit of

[239] A class of creditors that is forced to accept the terms of a plan that it voted against is said to be *"crammed down."* Latham Client Alert, *supra* note 236, at 5.

[240] *Compare* 11 U.S.C. § 1129(b)(2)(A) *with* 11 U.S.C. § 1129(b)(2)(B).

[241] Comm. on Commercial Fin., *supra* note 25, at 810. For example, the "Required Lenders" clause might state that only the approval of *a majority of the first-lien lenders* is required for the agent to take action on behalf of the syndicate.

[242] Wofford, *supra* note 186, at 5.

most "unanimous consent" provisions.[243] Instead, credit bidding is an independent statutory remedy at law.[244] Like the right to pursue a judgment at law, the credit bid should be considered a non-exclusive remedy exercisable by either the lenders or the agent.

However, there is still the problem of first-lien lenders appropriating value at the expense of the second-lien lenders if the "required lenders" clause is defined as a majority of only the *first-lien* lenders.[245] The real concern, it seems, is whether the foreclosure price is reflective of the fair market value of the collateral. Under the Restatement (Third) of Property (Mortgages), when real property is sold below its fair market value, the sale is valid but the amount that a creditor can obtain from the obligated parties is diminished.[246] This restriction does not apply to junior lienholders, however, when the junior lienholder does not acquire the property:

> The junior lienholder in this setting does not acquire the real estate, it is not in a position to achieve a recovery that exceeds the mortgage obligation and thus no unjust enrichment will occur . . . . [T]he junior lienholder arguably is able to protect itself by bidding at the senior sale and, in so doing, either obtain real estate that is worth enough to cover its

[243] *But cf. id.* (arguing that credit bidding has the effect of a waiver, modification, or amendment).

[244] 11 U.S.C. § 363.

[245] Imagine, for example, a bank syndicate divided into first- and second-lien lenders and administered by a common agent. What happens if lenders holding $51 million of a $100 million first-lien credit facility direct the agent to credit bid all of the first-lien debt *and* the entire $1 billion second-lien credit facility (over the objection of holders of $49 million of the first-lien credit facility and all of the second-lien lenders)? If the required lenders are defined as only a majority of the first-lien creditors, the agent would be able to credit bid the entire $1.1 billion, *even if* the collateral was only worth, for example, $51 million. *See* Davis Polk Presentation, *supra* note 235, at 17 ex. D; *see also supra* note 55 (discussing reasons why one lender might want to take action that is detrimental to the syndicate, such as an ongoing relationship with the borrower or the prospect of providing future financing to the borrower).

[246] RESTATEMENT (THIRD) OF PROP.: MORTGS. § 8.4(d) (1997).

> obligation or, if another person is the ultimate purchaser, insure that the sale yields enough surplus to satisfy its lien out of the sale proceeds. However, unlike the foreclosing mortgagee who is able to bid up to the mortgage obligation without advancing new funds, each dollar the junior lienholder bids at the senior sale will represent an additional investment in the real estate. Thus, it seems unfair to compel the junior lienholder to take such a course of action in order to preserve its right to recover on the junior obligation.[247]

The risk of appropriating value at the expense of minority lenders is greatest when the bank syndicate is classified and the rights and remedies of the second lienholders are completely subordinated to those of the first lienholders.[248] Under the Restatement approach, the exemption from the deficiency offset would not apply to the second-lien lenders who are out of the money because, as a member of the syndicate, the second-lien lender *would* be acquiring the property, even if it had no say in the matter.

One solution is for Bankruptcy Courts to be as critical as possible of the language in intercreditor agreements and, as suggested above, to deprive second-lien lenders of standing to object to the syndicate's proposed course of action *only* when such a waiver is made explicit and clear.[249] In *In re Boston Generating*, for example, the Bankruptcy Court for the Southern District of New York entered an order upholding the right of the second-lien lenders to object to bidding procedures proposed for a Section 363 sale on the ground that the intercreditor agreement did not specifically deprive the second-lien lenders of standing to assert such claims.[250] Although the intercreditor agreement provided first-lien lenders with the "exclusive right to . . . make

[247] RESTATEMENT (THIRD) OF PROP.: MORTGS. § 8.4, cmt. d.

[248] *See supra* note 245 (discussing Davis Polk Presentation, Example D).

[249] *See supra* Part VI.B.1.

[250] *In re* Bos. Generating, LLC, 440 B.R. 302, 320 (Bankr. S.D.N.Y. 2010).

determinations regarding the . . . sale" of collateral, the Bankruptcy Court concluded that such language was not *specific* enough to extend to the second-lien lenders' right to object to the bidding procedures at a Section 363 sale—a right traditionally granted to lenders under the Bankruptcy Code.[251] Unfortunately, *Boston Generating* may be easily distinguished in the future; a court wanting to overcome the objection and permit a Section 363 sale to proceed will emphasize the general language to reign in the arguments advanced by a minority of lenders.[252]

However, there is another option. In part, courts can limit the risks outlined above by turning back to the language of *Credit Francais*. The analogy of the bank syndicate to the corporation or partnership carries with it certain vestiges of the corporate form.[253] It would be a non sequitur to merely suggest that agents of syndications owe a duty of loyalty to the member lenders.[254] More precisely, by analogizing the syndicate to a "close corporation," four reasonable fiduciary duties could be found to be owed between lenders and the agent and among member lenders: (1) to act with reasonable diligence, care and skill; (2) to act with good faith in furtherance of each other's interests; (3) to

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[251] *Id.* at 316, 319–20 (stating that a secured lender may only waive its rights to object to a Section 363 sale in a manner that is "clear beyond peradventure that it has done so," concluding that nothing in the intercreditor agreement clearly waived such rights on the part of the second-lien lenders, and citing Section 6.2 of the ABA Model Intercreditor as exemplary of an express waiver of such rights).

[252] Mark N. Berman & Jo Ann J. Brighton, *An Update on Second-Lien Financings and Intercreditor Agreements: Part II*, 30-MAR AM. BANKR. INST. J. 28, 63 (2011). *See also In re* Chrysler LLC, 405 B.R. 84 (Bankr. S.D.N.Y. 2009) (permitting the agent to credit bid over the objection of the minority faction on the ground that the minority had no standing to object); *In re* Gen. Motors Corp., 407 B.R. 463, 496, (Bankr. S.D.N.Y. 2009), *cert. denied*, 409 B.R. 24, 51, *and aff'd*, 430 B.R. 65 (S.D.N.Y. 2010) (same).

[253] This Note does not address in any great detail the adequacy of the analogy, though it does seem persuasive and courts have used it in the past. *See, e.g.*, Credit Francais Int'l, S.A. v. Sociedad Financiera de Comercio, C.A., 490 N.Y.S.2d 670, 682 (N.Y. Sup. Ct. 1985).

[254] RESTATEMENT (THIRD) OF AGENCY § 8.1 (2006).

disclose fully all relevant business information to one another; and, perhaps most importantly (4) to refrain from using their position to gain special advantage over another.[255]

These fiduciary duties would place serious limits on the ability of a majority faction[256] to "cram down" a workout plan that would sell off substantially all of the borrower's assets at a price that is unresponsive to their fair market values. Moreover, when the credit-bidding agent is also a first-lien lender, the agent's actions would constitute a sort of "self-dealing."[257] In syndicated transactions, a fairness standard could be implemented for "self-interested" transactions and would require a fair price, benefits for the entire syndicate, and the "earmarks of an arms length transaction."[258] Although the agent would not be barred from accepting collateral in complete or partial satisfaction of the debt, the transaction would need to pass this stricter "overall fairness" standard in order to be approved. Finally, this limitation would be consistent with the Bankruptcy Code, which in many instances forces the courts to consider what is fair to all parties involved.[259]

The next question might be whether bank syndicates could "opt out" of, or contract around, these fiduciary duties. In many instances, intercreditor agreements already do; for

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[255] *See* Rosenthal v. Rosenthal, 543 A.2d 348, 352 (Me. 1988) (announcing these four duties in the context of the close corporation); *see also* Mary Siegel, *Fiduciary Duty Myths in Close Corporate Law*, 29 DEL. J. CORP. L. 377, 380 (2004) ("Since there are a wide variety of reasons why statutory or contractual remedies may be ineffective, the extent and availability of fiduciary obligations provide another source of protection.").

[256] This includes the agent as well as the individual lenders within the majority faction.

[257] In most states, actions that constitute corporate "self-dealing" are subject to even greater scrutiny than normal transactions. *See, e.g.*, Lewis v. S.L. & E., Inc., 629 F.2d 764, 768 (2d Cir. 1980) (applying an overall fairness test); Kahn v. Lynch Commc'n Sys. Inc., 638 A.2d 1115 (Del. 1994) (same).

[258] *See Lewis*, 629 F.2d at 772–73 (holding that a transaction is not fair and reasonable when shareholders use their majority power to pay unreasonably low rent for the use of a facility at the expense of shareholders).

[259] *See supra* notes 239–42.

example, by explicitly sheltering lenders from any liability other than that which is expressly provided for therein.[260] Likewise, although agents clearly owe certain duties to the syndicate and the member lenders, as outlined above, agent liability for its actions or omissions is often qualified by gross negligence or willful misconduct.[261]

On the one hand, those who believe in the power of contract over government mandate (so-called "contractarians"), view most business enterprises simply as a nexus of contracts and have, as a result, argued that corporations and partnerships should be entitled to "opt out" of the fiduciary duties owed by the entities' agents to the principals, if such principals so choose.[262] By contrast, others have recognized that business organizations are not simply a nexus of contracts; they are organizational forms with a set of state-given benefits that have a dramatic impact on the everyday lives of citizens of the state.[263]

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[260] *See, e.g.*, New Bank of New England, N.A. v. Toronto-Dominion Bank, 768 F. Supp. 1017, 1023 (S.D.N.Y. 1999) (rejecting plaintiff's negligence and breach of fiduciary duty claims against co-lenders on the ground that the intercreditor agreement provided that "no creditor 'shall have any liability . . . except as expressly provided herein.'").

[261] *Id.* at 1023 ("As for TD Trust . . . Section 7(a) of the Intercreditor Agreement provides that the agent 'shall be liable for its own gross negligence or willful misconduct.'"). In *New Bank*, because the agent owed no duty to the plaintiff to declare a default, and owed only a duty to follow the declarations of the required lenders (which had determined that they did not want to declare a default), the failure to make such a declaration did not constitute negligence. We may query, however, whether a similar result should be reached if the agent's assent is required in order to achieve the minimum percent ownership threshold under the required lenders clause.

[262] *See generally* Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 71 (1990) (responding to proposals for stronger, mandated fiduciary duties and concluding that, "[e]ven where liability rules are appropriate, they should be regarded as standard form contractual provisions that can be drafted around").

[263] *See, e.g.*, Grant M. Hayden & Matthew T. Bodie, *The Uncorporation and the Unraveling of "Nexus of Contracts" Theory*, 109 MICH. L. REV. 1127, 1139 (2011).

Admittedly, the bank syndicate would not exist but for a series of contracts (e.g., a complex set of credit documents),[264] and sophisticated lenders are arguably in less need of protection from wayward agents than are corporate shareholders. Yet, if the recent financial crisis has taught us anything, it is that the "private ordering" of institutional lenders and corporate borrowers can have devastating consequences on the state's citizens.

Although this Note does not attempt to settle the ongoing debate between these two camps, it does find the justifications for stronger default fiduciary duties persuasive. Whether such duties should be *mandatory* or *optional* is beyond the scope of this Note. When determining the standards by which such agents' action should be judged, the Restatement of Agency is a nice place to start.[265] To the extent that courts have been hesitant to scrutinize the actions of the lending syndicates' agents, perhaps it is time to go a step further by imposing duties that resemble those found in a close corporation and, equally important, actually holding agents to such standards.

VII. CONCLUSION

The bank syndicate—a group of member lenders devoted to one another, from their purses to their remedies, executing singly or together the resolutions formed in common—must inevitably open themselves a way toward the object they wish to attain—namely, the assets of the borrower—however distant or unlikely default may seem at the outset of the venture. What is truly is astonishing is the extent to which disagreement arises among member lenders

[264] *See supra* Part II.A (discussing the financial and legal framework of syndicated credit facilities).

[265] *See* Charles L. Menges, *An Agent's Liability to Co-Lenders in Syndicated Loan Transactions*, PROB. & PROP., Feb. 2003, at 45, 46 (adopting the Restatement of Agency approach and finding that as a fiduciary, an agent is bound to the exercise of the utmost good faith, loyalty, and honesty toward its principals, the member lenders, to an extent that is comparable to that of a trustee).

concerning the proper course of action and the pervasiveness of litigation surrounding the matter.

And yet, perhaps our duty-bound hero's sense of unity with his faithful companions is a bit much.[266] After all, it is only through disagreement, through open *confrontation*, that the three Musketeers see the value in joining D'Artagnan against a common enemy.[267] Going it alone, it seems, can be productive, at least until the others wise up. As a threshold matter, members of bank syndicates can avoid Lender Collective Action by anticipating problems early and by clearly providing solutions for them in the credit documents. Unfortunately, to err is human. As long as imperfections in credit documents exist, the courts will be asked to resolve indefinite language and seemingly contradictory contractual provisions.

While this Note has not focused on the issue, one might question why creditors have not reacted in any significant way to this novel development in New York law.[268] Whatever the reasoning may be for the survival of Lender Collective Action, it is sufficient for present purposes that the anomaly presents itself. To the extent that ambiguity truly exists, Lender Collective Action may be an effective tool for discerning the *a priori* intent of the parties and for settling disputes between the litigants. Indeed, there may be compelling reasons why the members of a bank syndicate

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[266] *See supra* note 1 and accompanying text.

[267] *See* DUMAS, *supra* note 1, at 91–101.

[268] As an illustrative example, consider the credit documents from *In re Metaldyne Corp.*, 409 B.R. 671 (Bankr. S.D.N.Y. Aug. 12, 2009), which permitted the agent to credit bid on behalf of the syndicate over the objection of minority lenders. The applicable language in *Metaldyne* was almost identical to that found in the credit documents from *In re GWLS Holdings, Inc.*, No. 08-12430 (PJW), 2009 WL 453110 (Bankr. D. Del. Feb. 23, 2009). Yet in the nearly seven months between the two cases, none of the seemingly problematic language in *Metaldyne*'s credit documents was removed, nor were any express limitations on the agent's ability to credit bid added. Had either of these occurred, the minority lender in *Metaldyne* would not have found itself is such a predicament. As we speak, credit documents continue to be produced containing language that is unresponsive to *GWLS*'s holding.

would *prefer* limiting the ability each member lender to wreak havoc upon the borrower by independently exercising remedies against it.[269]

But plain language trumps unspoken preference. Courts must respect the terms of credit documents, even if they do not agree with the specific outcomes. As a matter of contract interpretation, courts must preserve traditional remedies at law.[270] When exercising their equitable powers, Bankruptcy Courts must not abandon the interests of second-lien creditors by "blindly follow[ing] the hue and cry of the most vocal special interest groups."[271] In a capital market characterized by volatility, reasonable limitations must be placed on Lender Collective Action, a doctrine that is often unsound as a method of contract interpretation.

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[269] *See supra* notes 71, 181–83.

[270] *See* Wofford, *supra* note 186.

[271] Comm. of Equity Sec. Holders v. Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983) (reversing the order of the Bankruptcy Court for the Southern District of New York authorizing the sale of debtor's primary asset under Section 363 of the Bankruptcy Code on the grounds that the order failed to adequately consider the diverse interests of the debtor, creditors, and equity holders, and that the proposed sale was not sufficiently grounded in an articulated sound business justification).