

# THE RIGHTS OF INDIVIDUAL LENDERS IN MULTI-LENDER LOANS TO ENFORCE REMEDIES

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*The author explains that case law makes clear that the language adopted in the loan documents will likely determine whether an individual lender has the right to enforce remedies.*

**A**n issue litigated with some frequency is the right of a minority lender in a multi-lender loan arrangement to bring suit on its own to enforce contractual remedies against the borrower or related parties, such as guarantors. As often is the case, the issue would not arise in the first place if the loan documents dealt with it directly. In the absence of direct language, the determination of this issue generally turns on the court's view of the intent of the parties as gleaned from other, less direct, language. A recent case from New York's highest court, *Beal Savings Bank v. Sommer*,<sup>1</sup> determined that the lenders did not have individual standing based upon various provisions in the loan documents there. The dissent in that case, however, as well as earlier precedent, presents compelling reasons which may be applicable in other settings as to why individual enforcement rights may exist.

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## PRIOR CASE LAW

Prior to the New York Court of Appeals' decision in *Beal Savings Bank*, numerous court decisions addressed the issue of whether an individual lender can enforce remedies. Discussed below are some of the more frequently cited cases.

In *Credit Francais Int'l, S.A. v. Sociedad Financiera de Comercio, C.A.*,<sup>2</sup> a New York trial court ruled the individual lenders had no standing to enforce remedies which, the court found, belonged to the lending group as a whole. The court noted that the loan transaction there was between the borrower and the lending consortium, not the individual banks. The court viewed as significant the agent's authority as set forth in the loan documents to act on behalf of the lenders collectively on its own initiative or at the direction of the majority lenders. The agreement gave other significant powers to the agent, including the power to declare the entire amount due, and also the power to refrain from accelerating "unless otherwise directed by the majority depositors." The court found that "no individual bank is given those rights."<sup>3</sup> The court also pointed to a sharing arrangement clause by which, if any individual lender obtained payment, it was deemed to be acting as agent on behalf of all the lenders in collecting their pro rata shares. The court found that this structure was intended to prevent the possibility of multiplicity of suits by individual lenders perhaps working at cross purposes, concluding:

"When parties have agreed to operate through an agent 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."<sup>4</sup>

The court rejected the argument that the following clause suggested individual action was permitted: "The rights granted to the Agent, the Manager or the Depositors hereunder...and any rights available to them at law or in equity shall be cumulative and may be exercised in part or in whole from time to time."<sup>5</sup> The court found this provision not to trump the overall scheme to have the agent act for the consortium.

In *A.I. Credit Corp. v. Government of Jamaica*,<sup>6</sup> a New York federal district court found that the individual lenders had standing to bring suit against the borrower. In that case, the loan agreement contained the following provision:

“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 proceeding for such purpose.”<sup>7</sup>

In response to the argument of the borrower, the Government of Jamaica, that only the agent bank was expressly authorized to institute suit, the court observed that the agreement established a very limited role for the agent, mainly involving mechanical and clerical functions. Finding the agreement to be unambiguous, the court rejected Jamaica’s efforts to introduce parol evidence of customs in the international banking industry concerning forbearance.

In *New Bank of New England, N.A. v. Toronto-Dominion Bank*,<sup>8</sup> one lender in a lending group refused to consent to a default waiver and sought to accelerate the loan. The intercreditor agreement, however, provided that the power to accelerate vested in the majority lenders.<sup>9</sup> Relying on the Seventh Circuit’s analysis in *Carondelet Savings & Loan Ass’n v. Citizens Savings & Loan Ass’n*,<sup>10</sup> the court, applying California law, found that no provision in the agreement permitted a minority lender to compel acceleration. While a sole lender was precluded from accelerating, the court found a sole lender could sue the borrower to recover its portion of the debt. The court based this conclusion on a clause in the credit agreement that the rights and remedies thereunder, including the right to accelerate, were not exclusive of any rights, powers and privileges provided by law or in equity.<sup>11</sup>

The Second Circuit Court of Appeals addressed the issue in *Commercial Bank of Kuwait v. Rafidain Bank*,<sup>12</sup> concluding that an individual lender, in fact, had standing to sue. The loan documents there authorized only the lead banks to bring suit after obtaining the approval of the majority of participating banks. The court found this provision “did not abrogate the rights of participating banks to sue on their own.” Significantly, however, the ruling

in that case was based on English law that an undisclosed principal has standing to sue on a contract, except when “the terms of the contract expressly or impliedly confine it to the parties to it.”<sup>13</sup> Because the agreements provided that the rights of the parties “under general law” were reserved, the court found that the agreements did not expressly or implicitly preclude an individual lender from bringing suit.

In the Enron bankruptcy case, the New York federal district court affirmed the bankruptcy court’s determination that an individual lender lacked standing to pursue remedies that belonged to the lending group as a whole.<sup>14</sup> Under the loan documents there, an agent appointed to represent the lender group was authorized to file claims and to institute legal proceedings. In fact, under the agreements, the lenders appointed the agent as their “attorney-in-fact, with full authority in the place and stead of [the lenders]...to file any claims or take any action or institute any proceedings....” The court found the agreements did not contemplate individual lenders bringing individual suits. The court rejected reliance on a provision in the agreement that the agent and the lenders “shall have, in addition to all other rights and remedies under the Agreement or otherwise, all other rights and remedies provided under the UCC of each applicable jurisdiction and other applicable laws, which rights shall be cumulative.”<sup>15</sup> The bankruptcy court found that the lenders could enforce only those rights they had that were not inconsistent with the loan documents.

## THE BEAL SAVINGS BANK CASE

In March 2007, the New York Court of Appeals issued its decision in *Beal Savings Bank v. Sommer* holding that an individual lender did not have standing to enforce remedies.<sup>16</sup> In that case, 36 of the 37 lenders that participated in the loan had entered into a settlement agreement by which they directed the loan’s administrative agent to forebear from enforcing certain obligations. Beal Savings, which owned a 4.5 percent interest in the loan, was the lone holdout. Thereafter, Beal Savings brought an action against the borrower’s sponsors seeking recovery of Beal’s pro rata share or, alternatively, the entire loan amount. The loan documents did not directly address whether an individual lender could enforce remedies.

## THE LOAN DOCUMENTS

The court analysis in *Beal Savings Bank* turned on its review of two loan documents, a Credit Agreement and a Keep-Well Agreement. The Credit Agreement set forth the basic loan terms. Under the Keep-Well Agreement, loan sponsors made equity contributions to the borrower and further agreed to guarantee certain payments. Various provisions in each of these agreements setting forth the rights of the parties were critical to the court's determination.

Important to the court's analysis were several provisions in the Credit Agreement. For one, Section 9.1 of the Credit Agreement authorized the administrative agent to act on the lenders' behalf 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." The term "Required Lenders" was defined as those holding at least 66-2/3 percent of the outstanding principal. The Credit Agreement further authorized the agent to engage in various ministerial actions, such as collecting payments and reviewing financial statements. However, this clause made clear that the Required Lenders could dictate the agent's actions.

Article 8 of the Credit Agreement, dealing with events of default, provided that, upon default, the agent could give a 30-day default notice to the borrower. The provision continued that, thereafter, the agent, at the direction of the Required Lenders, may "exercise any or all rights and remedies at law or in equity" including the right to recover judgment against the sponsors under the Keep-Well Agreement. Article 4 of the Credit Agreement provided that, if any lender received a payment such as by way of set-off, it was required to share any excess of its pro rata share of payments with the other lenders.

Finally, Section 10.20 of the Credit Agreement, a cumulative remedies section, provided that "[n]o right or remedy conferred upon the administrative agent or the lenders in this Agreement is intended to be exclusive" and "every such right and remedy shall be cumulative...to every other right or remedy contained in the other loan documents...."

As with the Credit Agreement, the Keep-Well Agreement was made in favor of the administrative agent and the lenders. The Keep-Well Agreement made clear that it was to be read in conjunction with the Loan Agreement, it providing that it was a “[l]oan document executed pursuant to the Credit Agreement and shall (unless otherwise expressly indicated herein) be construed, administered and applied in accordance with the terms of the provisions thereof.”

Section 18(b) of the Keep-Well Agreement provided that it was binding upon the sponsors and their successors and shall “be enforceable by the Administrative Agent and each Lender” and their assigns. Section 18(e) of the Keep-Well Agreement was a cumulative remedies section, containing the same language as Section 10.2 of the Credit Agreement.

## THE LITIGATION

Beal Savings brought suit against the sponsors seeking to exercise remedies against them under the Keep-Well Agreement. Specifically, Beal Savings brought the action under Section 4 of the Keep-Well Agreement which provided that in the event of an acceleration of the loan, “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.”

The defendants moved to dismiss Beal Savings’ claims asserting that Beal Savings lacked standing to bring individual claims. The New York trial court granted the motion on the grounds that the language of the loan agreement precluded Beal Savings from recovering an individual judgment under the Keep-Well Agreement. The intermediate appellate court affirmed, finding that the Keep-Well Agreement was to be administered in accordance with the terms of the Credit Agreement which, for an event of default, authorized only the administrative agent to act upon the instruction of the Required Lenders. Thus, the intermediate appellate court found this clause gave an individual lender no enforcement rights.

## THE COURT OF APPEALS' DECISION

The lower courts' decisions were affirmed by New York's Court of Appeals. After engaging in a thorough contractual analysis, the Court of Appeals found that the agreements adequately demonstrated the intent of the parties not to permit an individual lender to pursue remedies.

The court began its analysis by observing that Section 18(a) of the Keep-Well Agreement provided that it was "to be construed, administered and applied" in accordance with the Credit Agreement. Looking then to the Credit Agreement, critical to the court was Section 8.3 which permitted the administrative agent to enforce remedies "upon direction of the Required Lenders." The court, as had the lower court, found this language indicated that only upon direction of the Required Lenders could rights and remedies be exercised.

To support its holding, the court also looked to more general provisions in the Credit Agreement, including Section 9.1 by which "[e]ach Lender authorize[d] the Administrative Agent to act on behalf of such Lender." Also significant was Section 4.8 which required any lender that obtained payment to return the excess of its pro rata share to be shared ratably with the other lenders. This provision, the court found, "underscores the collective design of the agreements that Lenders share the risks of potentially unequal treatment."<sup>17</sup> The court also placed some weight on the fact that the cover page to the Loan Agreement did not name the individual lenders, but rather referred to the lenders as "Various Financial Institutions."

For its part, Beal Savings relied on Section 18(b) of the Keep-Well Agreement which specifically provided that it was "enforceable by the Administrative Agent and each Lender..." The court found this language did not expressly override the specific exercise of remedies language in Section 8.3 of the Credit Agreement. The court further found that Beal Savings' interpretation of this provision would render Section 8.3 meaningless "because there would be no reason to provide that the Required Lenders could enforce the agreements by super majority directing the Administrative Agent to act."<sup>18</sup> Finally, the court rejected Beal Savings' argument that the cumulative remedies provision supported individual action. The court found that this section did not provide to each lender "express grants of enforcement in the event of default."

## THE DISSENT

While six Court of Appeals judges joined in the court's decision, one judge dissented. The dissent started from the premise that, unless the right of an individual lender to pursue remedies was expressly taken away by the loan documents, it was presumed to exist: "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."<sup>19</sup> The dissent found that an agreement that no suit would be brought by minority lenders could be stated in the following plain language: "No suit shall be brought except by the Administrative Agent, acting upon the written instructions of the Required Lenders."<sup>20</sup> The dissent concluded that because no such language, or anything that could be read as its equivalent, was included in the loan documents, the right of an individual lender to pursue claims should have been allowed.

The dissent relied on several provisions of the loan documents. For one, Section 2.1 of the Credit Agreement provided that each lender "severally" agreed to make the loans. The dissent reasoned that the normal expectation of such a lender would be that it would be able to sue to recover its loan unless the agreement provided otherwise. The dissent rejected the majority's reliance on Section 8.3 of the Credit Agreement, which provided that the agent could exercise remedies upon a direction of the Required Lenders. The dissent noted that this section did not state that no lender may exercise its own rights: "A statement that an agent may act on a principal's behalf does not mean that the principal has disabled itself from acting on its own."<sup>21</sup> The majority had relied on Section 9.1 of the Credit Agreement by which each lender authorized the agent to act on its behalf. The dissent viewed this as a grant of authorization, not an exclusion.

The dissent found compelling the provision in Section 10.20 of the Credit Agreement that "[n]o right or remedy conferred upon the Administrative Agent...in this Agreement is intended to be exclusive of any other right or remedy contained in the Loan Documents or at law and equity," concluding that "this language should remove all doubt about the matter."<sup>22</sup>

The dissent recognized the intuitive sensibility of the majority's construction that, if 34 out of 35 lenders are satisfied with the deal, "the 35th

should not be allowed to upset the applecart.” But the dissent looked beyond the immediate facts to the potential ramifications of the majority’s holding in other settings. As the agent here was authorized to act upon the direction of 66-2/3 percent of the lenders, the dissent reasoned that lenders holding a 66.6 percent interest could be stymied from taking action. The dissent concluded: “Thus, the majority’s decision, while reaching a pragmatically appealing result, essentially reads into the loan documents language that would compel results far less appealing.”<sup>23</sup>

## CONCLUSION

As the case law makes clear, the language adopted in the loan documents will likely determine whether an individual lender has the right to enforce remedies. Without a provision directly establishing or negating such a right, the courts will resort to distilling the intent of the parties from other contractual provisions. This can be an inexact exercise, as a comparison of the majority’s and dissent’s opinions in *Beal Savings Bank* amply demonstrates. Loan parties would eliminate fodder for future litigation by clearly addressing the issue. As suggested by the dissent in the *Beal Savings Bank* case, this is easily done using simple language.

## NOTES

- <sup>1</sup> 2007 N.Y. Slip Op. 02437 (N.Y. Mar. 22, 2007).
- <sup>2</sup> 128 Misc. 2d 564, 490 N.Y.S. 2d 670 (N.Y. Co. 1985).
- <sup>3</sup> *Id.* at 578, 490 N.Y.S. 2d at 681.
- <sup>4</sup> *Id.* at 579, 490 N.Y.S. 2d at 682.
- <sup>5</sup> *Id.*
- <sup>6</sup> 666 F. Supp. 629 (S.D.N.Y. 1987).
- <sup>7</sup> *Id.* at 631.
- <sup>8</sup> 768 F. Supp. 1017 (S.D.N.Y. 1991).
- <sup>9</sup> *Id.* at 1020.
- <sup>10</sup> 604 F.2d 464 (7th Cir. 1979).
- <sup>11</sup> *New Bank of New England*, 768 F. Supp. at 1023.
- <sup>12</sup> 15 F.3d 238 (2d Cir. 1994).
- <sup>13</sup> *Id.* at 243 (quoting *Teheran-Europe Co. v. S T Belton (Tractors)*, [1968] 2 Q.B.

545).

<sup>14</sup> *In re Enron Corp.*, 2005 WL 356985, at \*1 (S.D.N.Y. Feb. 15, 2005).

<sup>15</sup> *Id.* at \*7.

<sup>16</sup> 2007 N.Y. Slip Op. 02437, at \*11-12.

<sup>17</sup> *Id.* at \*9.

<sup>18</sup> *Id.* at \*8.

<sup>19</sup> *Id.* at \*12 (Smith, J., dissenting).

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at \*13.

<sup>23</sup> *Id.* at \*14.