

RESTRUCTURING SYNDICATED LOANS: THE  
EFFECT OF RESTRUCTURING NEGOTIATIONS ON  
THE RIGHTS OF THE PARTIES TO THE LOAN  
AGREEMENT

MICHAEL GRUSON\*

Summary

- I. Introduction
- II. The legal relationship among the members of a lending syndicate before a restructuring
- III. Intercreditor relations during a restructuring
- IV. Relationship between lenders as a group and the borrower during a restructuring
- V. Conclusion

---

\* Of Counsel and previously partner of Shearman & Sterling LLP, Frankfurt am Main and New York; Law School University of Mainz, Germany (1962); M.C.L. (1963) and LL.B. (1964) Columbia University; Dr. iur., Freie Universität Berlin (1966).

## ABSTRACT

This article discusses the question whether the restructuring negotiations relating to syndicated loans affect the rights of the lenders by imposing restraints on the right of the lenders to enforce the loan similar to the restraints imposed by bankruptcy laws. Courts have held that the terms of the loan agreement will be enforced and have refused to read implied terms into loan agreements that would facilitate the restructuring process. In one case, however, the court stayed the enforcement procedures of one lender for a period of time to give the lenders and the debtor the opportunity to restructure the loan. This stay had a similar function as the automatic stay imposed by bankruptcy law. This article is timely in light of the IMF proposals to create proceedings for the restructuring of foreign debt.

## I. INTRODUCTION

Restructuring of large syndicated loans<sup>1</sup> has become commonplace. In many cases these syndicated loans are “international” in that one or several of the lenders are banks from countries other than the borrower’s country.

Since the global debt crisis that commenced in the early eighties, it has become quite customary for the lenders to get together with a borrower who is unable to service the loan in order to renegotiate the loan and to develop a debt restructuring program<sup>2</sup>. This

---

1 See generally about syndicated loans, their history and structure JOSEPH J. NORTON, *International Syndicated Lending: The Legal Context for Economic Development in Latin America*, 2-SUM NAFTA: *L. & Bus. Rev. Am.* 21–81; ROBERT P. McDONALD, *International Syndicated Loans* (1982).

2 For a discussion of different contractual clauses (collective action clauses) in connection with the restructuring of sovereign bonds, see HAL S. SCOTT, *A Bankruptcy Procedure for Sovereign Debtors*?, 37 *Int’l. Lawyer* 103, at 119 (2003).

development is an example of extrajudicial dispute settlement in an insolvency-type situation. In ordinary circumstances, when a debtor is unable to pay its obligations as they become due, the various creditors do not get together with the debtor to work the problems out because insolvency proceedings are available to deal with an insolvent debtor. National insolvency laws frequently do not offer a viable alternative in the case of syndicated loans, because the lenders do not wish to rely on the rigid insolvency laws of a foreign country or even those of their own country, because the lenders believe an extrajudicial arrangement will be more beneficial for them or because insolvency procedures are not available since the borrower is a sovereign<sup>3</sup>.

This article will not describe the restructuring process and the restructuring techniques. This has been done very well in other publications<sup>4</sup>. It is rather the aim of this article to analyze the legal

---

3 A major reform proposal regarding the implementation of a proceeding for restructuring foreign debt (Sovereign Debt Restructuring Mechanism) has been brought forward by the IMF, see ANNE KRUEGER, *New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking*, Address at Institute for International Economics Conference on Sovereign Debt Workouts: Hopes and Hazards (Apr. 1, 2002), available at <http://www.imf.org/external/np/speeches/2002/040102.htm> (last visited on October 10, 2003). Such proposal provides, *inter alia*, for a request by a majority of creditors imposing a standstill on payments and a stay on creditor litigation for a fixed period of time and a majority vote for approval of a restructuring plan. For a discussion of the Sovereign Debt Restructuring Mechanism, see HAL S. SCOTT, *supra* note 2, at 123 *et seq.*

4 With regard to the history of the international debt crisis and to general issues concerning restructuring of syndicated loan agreements, see LEE C. BUCHHEIT and RALPH REISNER, *Latin American Debt in the 1990s: A New Scenario for Creditors and Debtors*, 16 *Northw. J. Int'l L. & Bus.* 1–4 (1995); *Latin American Sovereign Debt Management – Legal and Regulatory Aspects* (RALPH REISNER, EMILIO J. CÁRDENAS and ANTONIO MENDES eds. 1990); DAVID SURATGAR, *The International Financial System and the Management of the International Debt Crisis*, Chapter 19 in: *Default and Rescheduling – Corporate and Sovereign Borrowers*, 151–160 (DAVID SURATGAR ed. 1984); KEITH CLARK and MARTIN HUGHES, *Approaches to the Restructuring of Sovereign Debt*, Chapter 11 in: *Sovereign Lending: Managing Legal Risk*, 131–137 (MICHAEL GRUSON and RALPH REISNER eds. 1984); MARK A. WALKER and LEE C. BUCHHEIT, *Legal Issues in the Restructuring of Commercial Bank Loans to Sovereign Borrowers*, Chapter 12, in: *Sovereign Lending: Managing*

rules applicable to such renegotiations and restructuring of syndicated loans. It will investigate whether the restructuring process has an effect on the contractual rights of the parties to the loan agreement. Although restructuring negotiations mainly involve syndicated loans, lenders under single bank loans or under promissory notes participate in the restructuring efforts. Although these single lenders have no contractual relationship with the other lenders, their rights under these agreements or notes may also be affected by the restructuring negotiation.

This article will address these issues under New York law. Although many international syndicated loan agreements stipulate a law other than New York law and a jurisdiction for the adjudication of disputes other than New York, nearly all cases in this area were decided by one court, the Federal District Court for the Southern District of New York.

## II. THE LEGAL RELATIONSHIP AMONG THE MEMBERS OF A LENDING SYNDICATE BEFORE A RESTRUCTURING

In a syndicated loan, a group of banks joins together to advance funds to a particular borrower on identical terms and pursuant to a single loan agreement<sup>5</sup>. The syndicated loan is advantageous to the lenders because it is typically negotiated by one or a few lead banks and the other lenders can take the passive role of source of funding. The borrower can arrange a larger facility than it could with a single bank without having to negotiate different agreements

---

*Legal Risk*, 139-156. With regard to special problems concerning judicial enforcement of debts of a sovereign state, see GEORGE WEISZ, NANCY E. SCHWARZKOPF and MIMI PANITCH, Selected Issues in Sovereign Debt Litigation in: *Latin American Sovereign Debt Management – Legal and Regulatory Aspects*, 230–268; GEORGES R. DELAUME, The Foreign Sovereign Immunities Act and Public Debt Litigation: Some Fifteen Years Later, 88 *Am. J. Int'l L.* 257–279 (1994).

5 LEE C. BUCHHEIT and RALPH REISNER, Inter-Creditor Issues in Debt Restructuring in: *Latin American Sovereign Debt Management – Legal and Regulatory Aspects*, *supra* note 4, 28, at 35.

with a multitude of banks<sup>6</sup>. The syndicated loan also assures equal treatment of the loans of all syndicate members to the borrower. Syndicated loans have a centralized management and decision-making structure but the role of the agent bank is merely ministerial<sup>7</sup> and the agent has no discretionary authority<sup>8</sup>. In addition, many syndicated loan agreements provide for a centralized decision-making process: certain matters can be regulated by a majority or qualified majority of lenders with binding effect on all lenders and other matters require unanimous consent of all lenders<sup>9</sup>. The lenders

---

6 *Idem*, at 35.

7 The agent bank performs tasks such as receiving communications from the borrower and passing them on to the syndicate, collecting and disbursing funds, receiving and distributing payments, etc. BUCHHEIT and REISNER, *supra* note 5, at 35; LEO L. CLARKE and STANLEY F. FARRAR, Defining rights and duties of managing and agent banks to co-lenders, Chapter 10 in: *Sovereign Lending: Managing Legal Risk*, *supra* note 4, 117, at 126–127; NORTON, *supra* note 1, at 42–47.

8 A typical provision in a syndicated loan agreement reads:  
Authorization and Action. Each Bank hereby appoints and authorizes the Agent to take such action as agent on its behalf and to exercise such powers under this Agreement as are delegated to the Agent by the terms hereof, together with such powers as are reasonably incidental thereto. As to any matters not expressly provided for by this Agreement (including, without limitation, enforcement or collection of the Notes), the Agent shall not be required to exercise any discretion or take any action, but shall be required to act or to refrain from acting (and shall be fully protected in so acting or refraining from acting) upon the instructions of holders of at least -% in principal amount of the Notes then outstanding (or if no Notes are at the time outstanding, upon the instructions of Banks having at least -% of the Commitments), and such instructions shall be binding upon all Banks and all holders of Notes; provided, however, that the Agent shall not be required to take any action which exposes the Agent to personal liability or which is contrary to this Agreement or applicable law. The Agent agrees to give to each Bank prompt notice of each notice given to it by the Borrower pursuant to the terms of this Agreement.

*See* CLARKE and FARRAR, *supra* note 7, at 127.

9 BUCHHEIT and REISNER, *supra* note 5, at 35. The majority decision would be required for waivers of nonfinancial covenants, declaration of an event of default and acceleration of the loan. Unanimity would typically be required for amendments to the payment terms of the loan, increases in the banks' commitments and waivers affecting the borrower's payment obligations. Typical clauses dealing with majority decisions in a syndicate loan agreement read:

in a syndicated loan are sometimes linked by a sharing provision. This is a contract clause designed to regulate the receipt of funds from the borrower to prevent individual banks from retaining more than a proportionate share of any payment<sup>10</sup>.

---

Amendments, Etc. No amendment or waiver of any provision of this Agreement or the Notes, nor consent to any departure by the Borrower therefrom, shall in any event be effective unless the same shall be in writing and signed by the Majority Banks, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given; provided, however, that no amendment, waiver or consent shall, unless in writing and signed by all the Banks, do any of the following: (a) waive any of the conditions specified in Article II, (b) increase the Commitments of the Banks or subject the Banks to any additional obligations, (c) reduce the principal of, or interest on, the Notes or any fees or other amounts payable hereunder, (d) postpone any date fixed for any payment of principal of, or interest on, the Notes or any fees or other amounts payable hereunder, (e) change the percentage of the commitments or of the aggregate unpaid principal amount of the Notes, or the number of Banks, which shall be required for the Banks or any of them to take any action hereunder or (f) amend this Section; and provided, further, that no amendment, waiver or consent shall, unless in writing and signed by the Agent in addition to the Banks required above to take such action, affect the rights or duties of the Agent under this Agreement or any Note.

Event of Default. If any of the following events (“Events of Default”) shall occur and be continuing:... then, and in any such event, the Agent shall at the request, or may with the consent, of the holders of at least -% in principal amount of the Notes then outstanding or, if no Notes are then outstanding, Banks having at least -% of the Commitments, by notice to the Borrower, (i) declare the obligation of each Bank to make Advances to be terminated, whereupon the same shall forthwith terminate, and (ii) declare the Notes, all interest thereon and all other amounts payable under this Agreement to be forthwith due and payable, whereupon the Notes, all such interest and all such amounts shall become and be forthwith due and payable, without presentment, demand, protest or further notice of any kind, all of which are hereby expressly waived by the Borrower; provided, however, that in the event of an actual or deemed entry of an order for relief with respect to the Borrower or any of its subsidiaries under the Federal Bankruptcy Code, (A) the obligation of each Bank to make Advances shall automatically be terminated and (B) the Notes, all such interest and all such amounts shall automatically become and be due and payable, without presentment, demand, protest or any notice of any kind, all of which are hereby expressly waived by the Borrower.

- 10 BUCHHEIT and REISNER, *supra* note 5, at 36. A typical sharing provision in a syndicated loan agreement reads:

Sharing of Payments, Etc. If any Bank shall obtain any payment (whether voluntary, involuntary, through the exercise of any right of set-off, or otherwise) on account of the Advances made to it (other than pursuant to Section) in excess of its ratable

In spite of these joint features, lenders under syndicated loan agreements act independently in making the credit decisions, assuming the credit risk and advancing the funds. Each member of the lending syndicate is only responsible for its own loan commitment<sup>11</sup>.

### III. INTERCREDITOR RELATIONS DURING A RESTRUCTURING

If the borrower becomes unable to service the loan, it is in his interest that all lenders join the restructuring negotiations and that no lender resorts to an individual legal action. It is in the interest of the lenders that all lenders be treated equally by the borrower, i.e., that all payments be shared by all lenders. A successful lawsuit by a single lender might create unequal treatment. The lenders also realize that their negotiation power is stronger if they act as a group. During a restructuring, two levels of legal relationship must be reexamined: the relationship among the lenders and the relationship between the lenders as a group and the borrower.

---

share of payments on account of the Advances obtained by all the Banks, such Bank shall forthwith purchase from the other Banks such participations in the Advances made by them as shall be necessary to cause such purchasing Bank to share the excess payment ratably with each of them; provided, however, that if all or any portion of such excess payment is thereafter recovered from such purchasing Bank, such purchase from each Bank shall be rescinded and such Bank shall repay to the purchasing Bank the purchase price to the extent of such recovery together with an amount equal to such Bank's ratable share (according to the proportion of (i) the amount of such Bank's required payment to (ii) the total amount so recovered from the purchasing Bank) of any interest or other amount paid or payable by the purchasing Bank in respect of the total amount so recovered. The Borrower agrees that any Bank so purchasing a participation from another Bank pursuant to this Section - may, to the fullest extent permitted by law, exercise all its rights of payment (including the right of set-off) with respect to such participation as fully as if such Bank were the direct creditor of the borrower in the amount of such participation.

- 11 A lender will not be held responsible for the commitments of other syndicate members who defaulted in making their required advances. In this respect, a lending syndicate differs from an underwriting syndicate for securities.

As said before, the provisions of the syndicated loan agreement govern the relationship among the lenders, and, legally speaking, each lender has made a separate enforceable loan. The question arises whether, during a restructuring process in addition to the provisions of the loan agreement, legal rules apply to the relationship among the lenders that supplement or even supersede the contractual relationship. Such rules may, for instance, restrict an individual lender's right to enforce its loan in the interest of the restructuring process.

In *Credit Francais International, S.A. v. Sociedad Financiera de Comercio, C.A.*<sup>12</sup>, the court found an implied obligation of individual lenders under a syndicated loan agreement not to commence legal action against a borrower when the other banks had decided to refrain from such measures<sup>13</sup>. If a single lender, holding 12 percent of the entire credit, would be allowed to bring a suit unilaterally, the court argued, the other banks would be required as a matter of self-protection to bring their own lawsuits and this would make an orderly approach to refinancing of the debt impossible. Such unilateral action might jeopardize the majority banks' chances for ultimate payment in full<sup>14</sup>. Even before the decision in *Credit Francais* it had been argued by scholars that the typical syndicated loan agreements provide enough arguments

---

12 128 Misc. 2d 564, 490 NYS 2d 670 (N.Y. Sup. Ct. 1985).

13 The court said "When 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". 128 Misc. 2d, at 579, 490 NYS 2d, at 682. The court found that the lending consortium was a joint venture, to which partnership rules apply. *Idem* 128 Misc. 2d, at 581–582, 490 NYS 2d, at 684. The cause of action for debt owed a partnership resides in the partnership and not in the individual members. *Idem* The court held that plaintiff bank had no standing to sue individually. *Idem* 128 Misc. 2d, at 583, 490 NYS 2d, at 684. For a good comment on the case, see LEE C. BUCHHEIT, Is syndicated lending a joint venture? 4 *Int'l Fin. L. Rev.*, n° 8 (August 1985) 12–14.

14 *Credit Francais International, S.A. v. Sociedad Financiera de Comercio, C.A.*, *supra* note 12, 128 Misc. 2d, at 581, 490 NYS 2d, at 683–684.



for inferring that the parties have certain implied obligations, in particular a duty to cooperate in the control of the shared risk<sup>15</sup>. Other courts, however, have not followed *Credit Francais* and the decision was probably the result of a rather badly drafted agreement<sup>16</sup>.

Several cases have emphasized the right of a single lender to enforce its rights against the borrower in spite of the fact that the other lenders attempt to restructure the credit. Courts have held that the desire by the majority of lenders under a syndicated loan agreement to enter into restructuring negotiations does not prevent a single lender from enforcing its rights under the loan agreement. In *A.I. Credit Corp. v. The Government of Jamaica*<sup>17</sup>, a single lender brought suit to recover amounts due to it under a restructuring agreement among the borrower, the Government of Jamaica, and its various lenders (including plaintiff lender), even though virtually all signatories other than the plaintiff to the restructuring agreement had accepted a further rescheduling of principal amounts falling due under the restructuring agreement and had entered into new rescheduling agreements<sup>18</sup>. The court granted plaintiff's motion for summary judgment on the ground that the Jamaican restructuring agreement unambiguously gave individual lenders the right to sue individually for amounts due<sup>19</sup>. The court in *Jamaica* concluded:

---

15 NORBERT HORN, *The Restructuring of International Loans and the International Debt Crisis*, 12 *Int'l Bus. Law.* 400, at 405 (1984). The notion of implied inter-creditor obligation to forbear from pursuing independent legal remedies was rejected by BUCHHEIT and REISNER, *supra* note 5, at 37–38 and by BUCHHEIT, *supra* note 13, at 13–14.

16 BUCHHEIT and REISNER, *supra* note 5, at 38.

17 666 F. Supp. 629 (SDNY 1987).

18 *See idem*, at 630. Plaintiff was the assignee of a loan made by an original lender to Jamaica. *See* the discussion of the case in BUCHHEIT and REISNER, *supra* note 5, at 45.

19 *Idem*, at 631. The court said:

The language of the 1984 Agreement could hardly be more clear in establishing that AICCO's [the plaintiff's] right to pursue the debt owed to it by Jamaica is separate and divisible from the rights of its fellow creditors:

It is the clear and unambiguous language that prevents us from reading into this agreement, as urged by Jamaica, an implicit covenant to act collectively or a trade practice within the international banking industry of forbearance under these circumstances<sup>20</sup>.

In the celebrated case, *Allied Bank International v. Banco Crédito Agrícola de Cartago*<sup>21</sup>, the Government of Costa Rica initially had not engaged in restructuring negotiations but had unilaterally repudiated payment on loans to certain state-owned banks. Allied as agent for the lending syndicate had accelerated the debt and sued for the full amount of principal and interest. While the action was still pending before the U.S. district court, the parties began to negotiate a rescheduling of debt and later signed a rescheduling agreement. One lender did not accept the agreement. The district court reasoned that a judicial determination contrary to the Costa Rican directives could embarrass the United States government in

---

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 purpose. 1984 Agreement § 12.13.

That each bank has the right to sue Jamaica independently without the joinder of the other creditors, on what are in this respect, divisible debts, is reiterated throughout the agreement.

20 *Idem*, at 632.

21 757 F. 2d 516 (2d Cir.), cert. dismissed, 473 US 934 (1985). If the situs of the debt of the Costa Rican banks had been located in Costa Rica, the court would have given effect to the Costa Rican acts of state (the executive decree and the Central Bank action repudiating the loan) under the act of state doctrine. However, the court found that the situs of the debt was in the United States pointing to the agreed place of jurisdiction and place of payment in New York, the currency of payment (U.S. dollars), the location of the syndicate agent in the United States, the conduct of some negotiation in New York, the interest of the United States in maintaining New York's status as one of the foremost commercial centers of the world, and the interest of the United States to enforce dollar denominated debt payable in the United States and enforceable in United States courts in accordance with recognized principles of contract law. *Idem*, at 521–522. Because the situs of the debt was in the United States, the Costa Rican act of state had extraterritorial effect and would not be recognized by US courts. *Idem* See MICHAEL GRUSON, *The Act of State Doctrine in Contract Cases as a Conflict-of-Laws Rule*, 1988 *U. Ill. L. Rev.* 519, at 542–547.

its relations to the Costa Rican government and held that the act of state doctrine barred entry of summary judgment for plaintiff, the agent for the lending syndicate<sup>22</sup>. The one bank that had not accepted the restructuring agreement, Fidelity Union Trust Company of New Jersey, appealed. The Court of Appeals on rehearing overruled the district court and held for plaintiff lender. Neither Costa Rica's unilateral restructuring of private obligations nor an agreement of the parties to renegotiate the loan agreement renders the underlying obligations unenforceable<sup>23</sup>.

The courts are clear that a creditor has the right to choose whether to reschedule debt or to enforce, in accordance with the loan agreement, the obligation to repay the loan. The courts have resisted the argument made by debtors that it would further the aim of restructuring the debt if individual lenders were forced to forbear from pursuing independent legal remedies that jeopardize the common good of the creditors as a whole, and that courts should act—like bankruptcy courts—to protect the debtor and the orderly restructuring process. In *Jamaica*, the defendant had argued that a judgment in favor of the plaintiff lender would have a devastating financial impact on the Government of Jamaica but the court found that:

it is not the function of a federal district court in an action such as this to evaluate the consequences to the debtor of its inability to pay nor the foreign policy or other repercussions of Jamaica's default. Such considerations are properly the concern of other governmental institutions<sup>24</sup>.

---

22 566 F. Supp. 1440 (SDNY 1983).

23 757 F. 2d 516, at 519, 522. See *National Union Fire Insurance Co. v. The People's Republic of the Congo*, 729 F. Supp. 936, at 944 (SDNY 1989).

24 *A.I. Credit Corp. v. The Government of Jamaica*, *supra* note 17, at 633. See also *National Union Fire Insurance Co. v. The People's Republic of the Congo*, *supra* note 23, at 944–945 (court rejected Congo's argument that policy considerations dictate that court not enforce a default judgment against the Congo because such a judgment would interfere with an agreement with commercial bank creditors providing for rescheduling of Congo's external debt. The plaintiff was the only creditor to refuse participating in the rescheduling.)

Courts have held that a lender under syndicated loan agreements is entitled to enforce its rights in spite of an intended, ongoing or completed restructuring effort. The courts have strictly enforced the contractual rights of the individual lender and have not fashioned a court-made insolvency law. The corollary to the rule that the individual lender may exercise its contractual rights is that an individual lender is restricted to its contractual rights, and that the majority lenders under a syndicated loan may enforce their rights in accordance with the agreement and do not have an implied duty to the minority lenders to refrain from doing so. *CIBC Bank and Trust Company (Cayman) Ltd. v. Banco Central do Brasil*<sup>25</sup> was an action by a lender under a restructuring agreement of 1988 against the obligor under the agreement, the Central Bank of Brasil, and Citibank as agent bank under the agreement. Brazil had become unable to make regular payments under the restructuring agreement of 1988 and the parties had embarked on a new round of restructuring negotiations which resulted in a new agreement of 1992 under which the creditors could exchange their debt for 30-year bonds<sup>26</sup>. Two creditors, the Dart family and Banco do Brasil, did not convert into bonds their debt held under the 1988 agreement and remained creditors under the 1988 agreement. Plaintiff CIBC was the holder of record for the Dart family. Plaintiff sought acceleration of the entire principal amount owed under the 1988 agreement and payment of accrued and unpaid interest under that agreement.

The 1988 agreement permitted an acceleration of the debt upon a request of 50 percent of the banks calculated by holdings of debt. The majority of the remaining outstanding debt under the 1988 agreement was held by Banco do Brasil (the other lenders had exchanged their debt for bonds under the 1992 agreement). Plaintiff argued that Banco do Brasil's debt must be disregarded under

---

25 886 F. Supp. 1105 (SDNY 1995).

26 This restructuring was based on the model suggested by then-Secretary of the Treasury, NICHOLAS BRADY. *Idem*, at 1107.

principles of New York law in determining the majority of outstanding debt because Banco do Brasil was majority-owned by the Government of Brazil and had retained its debt under the 1988 agreement at the direction of the borrower, Central Bank of Brasil, in a bad faith maneuver designed to block plaintiff's acceleration attempt<sup>27</sup>. Plaintiff argued that, under New York law, there is an implied covenant of good faith and fair dealing that prohibits defendants from using the Banco do Brasil holdings to defeat plaintiff's acceleration<sup>28</sup>.

Plaintiff based its argument, among others, on the New York common law of compositions (and also on concepts of the Federal Bankruptcy Code). A composition is an agreement between an insolvent or an embarrassed debtor and his creditors, whereby the latter, for the sake of immediate or sooner payment, agree to accept a payment less than the whole amount of their claims, to be distributed pro rata, in discharge and satisfaction of the whole amount<sup>29</sup>. Prior to the adoption of the federal bankruptcy laws, New York had developed common law rules to interpret compositions and to address the relationship of the parties thereto. Parties to a composition owed each other "scrupulous good faith" and were subject to "principles of honest and fair dealing"<sup>30</sup>. On its face, the pre-federal bankruptcy law situation in New York is not dissimilar to the restructuring negotiations relating to syndicated loan agreements. The court, however, did not accept the similarity of the situations. It found this and the other arguments made by plaintiff to show why debt controlled by the debtor should be

---

27 *Idem*, at 1113–1114.

28 *Idem*, at 1114.

29 *Idem*

30 *Idem* See *ALMON v. HAMILTON*, 100 NY 527, 3 NE 580, 580 (1885). Plaintiff in *CIBC* relied principally on a rule of this body of law pursuant to which New York courts would disregard the votes of creditors who were controlled by the debtor in determining whether a composition should be approved. *CIBC*, *supra* note 25, at 1114 (citing further cases).

disregarded in a vote of creditors “while quite creative, wholly unpersuasive”<sup>31</sup>. Even if the court had generally accepted the argument that an implied covenant of good faith requires disregarding the debt owned by an entity controlled by the debtor when calculating whether an acceleration should be declared, it could not override the express provisions of the loan agreement before the court. The court said that in the case before it, the rights of the parties were spelled out in the 1988 agreement and it would not go behind the agreement and apply the composition rules<sup>32</sup>. The court did not see a gap in the 1988 agreement that had to be filled by reference to the general law<sup>33</sup>. The court also rejected the argument that the Central Bank, the borrower, breached an implied covenant of good faith and fair dealing by blocking plaintiff from accelerating<sup>34</sup>. The court said that the provision in the 1988

---

31 *Idem*, at 1115.

32 *Idem* (“In the instant case, on the other hand, the issue revolves around whether [Banco do Brasil] should be able to exercise rights that are already set out in the provisions of the existing ‘composition’, i.e [the 1988 agreement]”). *See also idem*, at 1116 (“In this instance, it is clear that the provisions of the [1988 agreement] expressly allow [Banco do Brasil] to retain [1988 agreement] debt and to vote its share of the debt in order to hinder an attempt at acceleration by another creditor”).

33 The court said that “[e]ven if I concluded that CIBC’s [the plaintiff’s] suggested implied covenant were appropriate, it would provide CIBC no assistance in this case. It is axiomatic that an implied covenant cannot override the express provisions of a contract.” *Idem*, at 1116 (citing New York cases). The court emphasized that the relationship between Banco do Brasil and Brazil was known to the parties to the 1988 agreement and had been addressed in the agreement; and that the drafters of the agreement would have excluded Banco do Brasil’s share of the debt from voting had they so intended. *Idem*, at 1116–1117. For a discussion of contract interpretation and omitted cases, *see* E. ALLEN FARNSWORTH, 2 *Farnsworth on Contracts*, Ch. 7 (1990).

34 *CIBC*, *supra* note 25, at 1118 (“As explained by another court in this district, the law in New York is clear that although the obligation of good faith is implied in every contract, it is the terms of the contract which govern the rights and obligations of the parties. The parties’ contractual rights and liabilities may not be varied, nor their terms eviscerated, by a claim that one party has exercised a contractual right but has failed to do so in good faith”, quoting *National Westminster Bank, USA. v. Ross*, 130 BR 656, 679 (SDNY 1991) and citing other cases).

agreement requiring a consent of 50 percent of the lenders for an acceleration implies the discretion to withhold such consent<sup>35</sup>. In sum, defendant only exercised its rights under the agreement by refusing to consent to an acceleration of the debt and such behavior is not actionable<sup>36</sup>.

Whereas in CIBC a minority lender attempted to exclude the majority lender when accelerating the loan, in another case the minority lender sought to reach the same result by arguing that the majority lenders were obligated to accelerate the loan. *New Bank of New England, N.A. v. Toronto Dominion Bank*<sup>37</sup> was an action by a minority lender under a syndicated loan agreement to compel the majority lenders, after the borrower had defaulted on the loan, to exercise the remedy of accelerating the loan. The minority lender argued that the majority lenders have an implied obligation of good faith to accelerate and foreclose the loan. The court held that the terms of the loan agreement gave the majority of lenders discretion whether or not to accelerate<sup>38</sup> and that the terms of the agreement precluded the minority lender from compelling the majority lenders to accelerate and foreclose<sup>39</sup>. The court refused to rewrite the unambiguous agreement among sophisticated parties by including implied obligations of the majority lenders or implied rights of the minority lenders<sup>40</sup>.

We must conclude that under United States case law a debt restructuring process does not affect or modify the contractual rights of the creditors among themselves. If a single creditor has a contractual right to enforce its claim against the borrower, the creditor may do so even if such action causes difficulties for all

---

35 *CIBC*, *supra* note 25, at 1118.

36 *Idem*.

37 768 F. Supp. 1017 (SDNY 1991). The case arose in the context of restructuring negotiations. *Idem*, at 1019.

38 *Idem*, at 1019.

39 *Idem*, at 1021–1023.

40 *Idem* The court said that, under the agreement, the minority lender was free to pursue its own remedies by suing the debtor to collect on its debt. *Idem*, at 1023.

other lenders. On the other hand, the rights of the majority not to accelerate a defaulted loan or to waive defaults is not modified by an implied obligation to the minority lender to exercise the right of acceleration or to refrain from exercising its right to waive a default.

#### IV. RELATIONSHIP BETWEEN LENDERS AS A GROUP AND THE BORROWER DURING A RESTRUCTURING

Restructuring negotiations are voluntary and under U.S. law lenders are not obligated to enter into negotiations with a debtor in difficulties. As the cases discussed above show, the majority lenders may accelerate the loan in accordance with its terms and each lender may enforce its loan if this is permitted by the loan agreement without regard to the interests of other lenders.

Once restructuring negotiations have commenced, the relationships among the parties are still governed by the existing loan agreement. The majority lenders do not lose their right to accelerate and enforce the loan, and the enforcement rights of each individual lender remain intact, all in accordance with the terms of the loan agreement. A rule which would restrict the contractual rights of the lenders during a renegotiation process would also restrict their bargaining position.

It has been suggested that a restructuring process is similar to a proceeding under Chapter 11 of the US Bankruptcy Code<sup>41</sup> and that concepts of Chapter 11 should apply<sup>42</sup>. Plaintiff in *Banco do Brasil*<sup>43</sup> has argued that common law composition rules should be applicable during the process of renegotiating<sup>44</sup>. It is interesting to note that syndicated loan agreements do not contain rules of conduct

---

41 11 USC. §§ 101–1330.

42 Note, Procedural Guidelines for Renegotiating LDC Debt: An Analogy to Chapter 11 of the U.S. Bankruptcy Reform Act, 21 *Va. J. Int'l L.* 305–341 (1981).

43 *Supra* note 25.

44 *See* text accompanying notes 29–36.



for lenders and the debtor during the process of restructuring the loan although the frequency of such restructuring would appear to make such provisions useful.

In a recent decision, the court moved closer to the notion that a lawsuit by a single lender should not disturb ongoing restructuring efforts by the majority lenders and the borrower. *Pravin Banker Associates, Ltd. v. Banco Popular del Peru*<sup>45</sup> arose out of the inability of a state-owned bank to repay short-term debt<sup>46</sup>. The short-term loans had been extended by Mellon Bank (and not by a bank syndicate) to Banco Popular<sup>47</sup> and were later sold in the secondary market to plaintiff *Pravin*<sup>48</sup>. In 1992, the Peruvian Superintendent of Banks determined that the borrower, Banco Popular, should be dissolved and its assets liquidated, since Banco Popular had failed to maintain the minimum liquidity required by law and had failed to pay its creditors<sup>49</sup>. A committee of liquidators was appointed to administer the dissolution procedures which included an opportunity for creditors to file claims. *Pravin* did not participate in the liquidation process but brought a lawsuit in New York seeking payment of principal and interest<sup>50</sup>. The defendant argued that if this lawsuit would go forward all other lenders to Peruvian entities who had stayed their lawsuits would reactivate such suits<sup>51</sup> and the ensuing stampede to find and attack Peru's overseas assets would both seriously disrupt Peru's foreign trade and undermine its ongoing attempts at economic structural reforms<sup>52</sup>.

---

45 165 BR 379 (SDNY 1994) ("Pravin I").

46 *Idem*, at 381.

47 The original loans by Mellon Bank had already been restructured in 1983 and the terms of the settlement were guaranteed by the Peruvian government. In 1984 Banco Popular was unable to repay principal on the loans to Mellon. *Idem*

48 *Idem*, at 382.

49 *Idem*, at 383.

50 *Idem*

51 *Idem*.

52 *Idem*.

The court stayed *Pravin's* action for six months by way of an adjournment of plaintiff's motion for a summary judgment<sup>53</sup>. The decision is principally based on the accepted notion of judicial self-restraint —labeled “international comity”— that a U.S. court should recognize foreign bankruptcy proceedings<sup>54</sup>. This concept was applicable because the borrower was in the process of being liquidated in an orderly proceeding. The court could have stopped here, but it added United States policy interests as a second basis for its decision to stay the action. It emphasized the fact that there were ongoing negotiations between Peru and its creditors, that Peru was engaged in programs of economic adjustment and structural reforms in compliance with policies of the International Monetary Fund (IMF) and in cooperation with the IMF, and that a stay would not abrogate *Pravin's* ability to enforce its contract rights in the future<sup>55</sup>.

---

53 *Idem*, at 389. The stay was later extended by 60 days to enable the parties to submit responses to certain questions posed by the court about the status of the Peruvian restructuring process. *Pravin Banker Associates, Ltd. v. Banco Popular del Peru*, 1995 WL 102840 (SDNY 1995) (“*Pravin II*”). The actual effect of the two stays and the related motion practice has been to delay the proceedings for almost 18 months. *Pravin Banker Associates, Ltd. v. Banco Popular del Peru*, 895 F. Supp. 660 (SDNY 1995) (“*Pravin III*”).

54 *Pravin I*, *supra* note 45, at 384. The court stated that “[p]rinciples of international comity call for the recognition of foreign proceedings to the extent that such proceedings are determined to be orderly, fair and not detrimental to the nation’s interests”. *Idem* The court said that foreign bankruptcy proceedings, such as the one involving Banco Popular, are regularly recognized by the courts of the United States as legitimate proceedings directing the dissolution and adjudication of overseas business interests and that Peru’s liquidation procedure for Banco Popular satisfies American notions of fundamental fairness. *Idem*, at 384, 385–386 (citing authorities). The theory on which the recognition of foreign bankruptcy proceedings is based is usually referred to as “international comity”. *Idem*, at 384. For a discussion of the concepts of comity as a basis for the recognition of foreign bankruptcy judgments, in spite of a New York governing law clause, see MICHAEL GRUSON, *The Act of State Doctrine in Contract Cases as a Conflict-of-Laws Rule*, *supra* note 21, at 554–560; MICHAEL GRUSON, *International Agreements*, Chapter 6, §§ 6.06, 6.10 in *Commercial Contracts, Strategies for Drafting and Negotiating* (Morton Moskin, ed. 2004 Supp.).

55 *Pravin I*, *supra* note 45, at 386–389. Even in *Allied*, *supra* note 21, the court found the IMF to be an integral component to US foreign debt policy (757 F. 2d, at 516)

The court further stressed that Peru was in compliance with U.S. policy as expressed in the International Debt Management Act of 1988<sup>56</sup> and in certain pronouncements by the Executive<sup>57</sup>. These policy factors supported a need for a stay.

Thus, although the *Pravin* court has stated in *Jamaica*<sup>58</sup> that the policy concerns are generally beyond the reach of the courts and presumably would not lead to a dismissal of a lender's action, the court justified a temporary delay of six months on the basis of such policy concerns. The stay sought to accomplish a balance between the right of a creditor to enforce its rights under its agreement and the interest of the other creditors and the borrower to restructure the loan through the procedure established by the IMF<sup>59</sup>.

Nearly 18 months later, the court in *Pravin III* faced again the tension between (1) the rights of a minority creditor to enforce its rights under a contract and (2) the interests of the majority creditors and the borrower in having an orderly restructuring process<sup>60</sup>. The court found that the negotiations to resolve Peru's commercial debt problem were proceeding apace<sup>61</sup>, that the provisions of Peru's privatization program did not discriminate against the trade debt held by plaintiff<sup>62</sup>, that a tolling declaration by Peru tolled the statute of limitation on short-term debt and that plaintiff would have the benefit of this tolling declaration if the lawsuits were dismissed<sup>63</sup>.

---

but, in *Allied*, Costa Rica's acts were inconsistent with the us foreign debt policy. *Pravin I*, at 387.

56 22 USC. §§ 5321–5333 (2000). See also 22 USC. § 286 (2000).

57 *Pravin I*, *supra* note 45, at 386–389.

58 *A.I. Credit Corp. v. Gov't of Jamaica*, *supra* note 17. “[I]t is not the function of a federal district court in an action such as this to evaluate the consequences to the debtor of its inability to pay nor the foreign policy or other repercussions of Jamaica's default”. *Idem*, at 633.)

59 See *Pravin III*, *supra* note 53, at 662.

60 Plaintiff had renewed its motion for summary judgment.

61 *Pravin III*, *supra* note 53, at 662.

62 *Idem*, at 663.

63 *Idem*, at 664.

The court reemphasized that the successive stays in the action were justified by principles of international comity. The court first reiterated that a U.S. court will defer to foreign courts in liquidating or winding up the affairs of their own domestic business entities<sup>64</sup> but then emphasized that international comity applies to protect debt restructuring negotiations that are consistent with United States policy which encourages commercial bank creditors to participate in debt restructuring negotiations on a voluntary basis<sup>65</sup>. It seems clear that the court would have stayed the action under the theory of international comity even if the borrower had not been the subject of liquidation proceedings.

The court contrasts these policies with the contractual rights of the creditors which cannot be abrogated by voluntary participation in debt rescheduling negotiations<sup>66</sup>. The court emphasized the responsibility of New York as one of the foremost commercial centers of the world and as an international clearing center for United States dollars, and New York's interest in encouraging foreign debtors to pay debts due in New York<sup>67</sup>. In favor of

---

64 *Idem*, at 664. The court cites *Cunard Steamship Co. Ltd. v. Salem Reefer Services A.B.*, 773 F. 2d 452, 458 (2d Cir. 1985) and *Drexel Burnham Lambert Group v. Galadari*, 777 F. 2d 877, 881 (2d Cir. 1985).

65 *Pravin III*, *supra* note 53, at 665–666, quoting *Nat'l Union Fire Ins. Co. v. The People's Republic of Congo*, *supra* note 23, at 944, n. 5. This United States policy is expressed in the so-called Brady Plan on international debt markets. *Idem*

66 *Pravin III*, *supra* note 53, at 665. The court in *Allied*, *supra* note 21, held that while creditors may agree to renegotiate conditions of payment “the underlying obligations to pay nevertheless remain valid and enforceable.” 757 F. 2d, at 519, and the court in *Nat'l Union Fire Ins. Co. v. The People's Republic of Congo*, *supra* note 23, held that “participation in international debt rescheduling agreements is voluntary; foreign governments may not unilaterally impose debt restructuring agreements on unwilling private creditors.” *Idem*, at 944.

67 *Pravin III*, *supra* note 53, at 665. The *Allied* court, *supra* note 21, at 521–522 said that the United States' interest in “ensuring that creditors entitled to payment in the United States in United States dollars under contracts subject to the jurisdiction of United States courts may assume that, except under the most extraordinary circumstances, their rights will be determined in accordance with recognized principles of contract law”.

enforceability of plaintiff's claim, the court pointed also to the very large secondary market in sovereign debt which plays an important and useful role in the efforts to deal with sovereign debt by providing market liquidity. However, this market created a group of creditors that do not have the same long-range interests as the commercial bank creditors who were the original lenders<sup>68</sup> and enforceability of the debt has a beneficial effect on this secondary market<sup>69</sup>.

Balancing these policies, the court decided to grant plaintiff's motion for summary judgment and held that enforcement of the terms of the credit agreement comported with United States policy<sup>70</sup>.

## V. CONCLUSION

The principal rule followed by the courts – or rather the only court involved in these cases, the U.S. District Court for the Southern District of New York—in connection with restructuring syndicated loans is that the terms of the loan agreement governs and will be strictly enforced. The courts have not read implied terms into credit agreements which would facilitate the restructuring process, either by increasing the right of a minority lender or decreasing the rights

---

68 *Pravin III*, *supra* note 53, at 666.

69 *Idem*, at 667.

70 *Idem*, at 668. The court noted that the United States Attorney General had not submitted a Statement of Interest. *Idem*, at 667. *See* 28 USC. § 517 (2000). The court said that in the absence of an authoritative statement of policy from the Executive Branch, the court remains bound by the authority of controlling precedents, in particular the *Allied* decision, *supra* note 21. *Pravin III*, *supra* note 53, at 667. Thus, the court left an opening that a balancing of the conflicting interests could lead to a different result if the United States expressed a view in a Statement of Interest. Statements of Interest were filed by the United States, for instance, in *Allied*, *supra* note 21, and in *CIBC Bank and Trust Company (Cayman) Limited v. Banco Central do Brasil*, *supra* note 25 (requesting denial of plaintiff's request for a declaration that it is entitled to declare an acceleration under the loan agreement).

of the majority lenders or by modifying the rights of the lenders as a group.

In a recent case, however, the court has stayed enforcement procedures for a period of time in order to give the lenders and the debtor the opportunity to restructure the loan. This stay had a similar function as the automatic stay imposed by bankruptcy laws. At the end of the period, the basic right of a lender to enforce its claim prevailed, even though the restructuring was not completed at that time. Thus, the court sees in the strict adherence to the bargain of the parties as reflected in the contract a value which outweighs the inconveniences of a single lender disrupting the restructuring process. Experience has shown that lenders and borrowers in large syndicated loan agreements have been able to deal with such disruptions.