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Bankruptcy Law Update

Can One Member of a Lending Syndicate Enforce Remedies Under a Loan Agreement? Surprisingly, the New York Court of Appeals Says "No."

In a significant and somewhat surprising decision, the New York Court of Appeals recently held that, absent an express provision to the contrary, an individual lender in a syndicated loan is prohibited from enforcing its rights under the loan agreement or a related guaranty.

The case — *Beal Savings Bank* v. *Sommer*, 2007 N.Y. Slip. Op. 02437 (N.Y. March 22, 2007) — arose out of the bankruptcy of Aladdin Gaming, LLC (the "Borrower"). Originally, a group of 13 financial institutions advanced $410 million to the Borrower to develop the Aladdin Resort and Casino in Las Vegas. To support the loan, the Borrower's sponsors executed a Keep-Well Agreement in favor of the lenders and their administrative agent pursuant to which the sponsors and one of the Borrower's parent companies – the Sommer Trust (the "Trust") – agreed to infuse additional equity into the Borrower if a specified financial ratio fell below a certain minimum. In addition, the Keep-Well Agreement required the sponsors and the Trust to guarantee payment of the loans in the event of their acceleration.

The Aladdin casino filed for bankruptcy shortly after 9/11 and, as a result, the maturity of the loans accelerated automatically. Subsequently, in September 2002, the administrative agent and 36 of the 37 members of the lending syndicate (which collectively held 95.5% of the outstanding loans) entered into a settlement agreement with the Trust and two sponsors. The settlement agreement, among other things, required the administrative agent to forbear from enforcing the Trust's obligations under the Keep-Well Agreement. As consideration, the Trust (i) transferred to the administrative agent for the benefit of the lenders the Trust's interest in a shopping mall, and (ii) agreed to facilitate the sale of the Borrower's property. The settlement also provided for the distribution of $6.5 million in cash to the prepetition lenders (excluding the dissenting lender). The only lender that did not agree to the settlement – BFC Capital, Inc. – subsequently assigned its claim to Beal Savings Bank ("Beal").

Approximately 2½ years later, Beal sued to enforce the Keep-Well Agreement. The Trust moved to dismiss Beal's complaint on the ground that an individual member of the lending syndicate, such as Beal, could not enforce the loan documents in the event of a default; only the administrative agent acting at the direction of the required lenders (here, holders of 2/3 of the original principal amount of the loans) was empowered to enforce the agreements. Beal argued that, although the agreements authorized the administrative agent, under certain circumstances, to act on behalf of the lenders, the agreements did not preclude an individual lender from enforcing its rights. The New York State Supreme Court dismissed Beal's complaint and the Appellate Division affirmed. Beal then appealed to the New York Court of Appeals, which also affirmed.

Though it would seem axiomatic that a bank that makes a loan to a borrower and is not repaid is entitled to bring an action to get its money back, that was not permitted here. Why? According to New York's highest court, if individual enforcement action is desired, the parties to the loan agreement must include an express provision that permits each lender individually to enforce its rights in the event of a default. The absence of such a provision from this particular loan agreement persuaded the Court that the lenders intended only to act collectively through the administrative agent. Thus, once 95.5% of the lenders signed the settlement agreement they bound the holdout minority (here, just a single lender) to the settlement, including its forbearance provisions.

As support, the Court focused on the various loan agreement provisions that require the approval of a super-majority prior to the administrative agent taking enforcement action and that refer to the lenders collectively, rather than individually.[1] In particular, the Court focused on the section of the loan agreement that permits the administrative agent, upon the occurrence of an event of default, and upon the instruction of the holders of 2/3 of the original principal amount of the loans, to declare all loan amounts to be due and owing. This, the Court determined, evidences the parties' agreement that enforcement action can only be taken collectively upon the direction of a 2/3 super-majority, and not individually.

The Court, however, seems to have confused the voting requirement necessary for acceleration with the ability of the lenders to take enforcement action once the debt has been accelerated. The former clearly required a 2/3 super-majority; the latter did not. Moreover, the Court seems to have ignored that Beal's suit was against the Trust, as guarantor under the Keep-Well Agreement, not against the Borrower. The Keep-Well Agreement specifically provided that it shall be enforceable by the administrative agent *"and each Lender and their respective successors, transferees and assigns."* The Court of Appeals overlooked this language.

It is unclear whether the Court of Appeals simply got it wrong, or, as the dissent puts it, reached a "pragmatically appealing result" because 36 of 37 institutions agreed to the settlement. What is clear, however, assuming this decision stands[2], is that, under New York law, if individual enforcement action is desired, the loan agreements must expressly provide for it.

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[1] For example, the reference on the title page of the loan agreement to "various financial institutions," as lenders rather than individually named institutions.

[2] Beal has moved for reargument.

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This memorandum is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content. Questions concerning issues addressed in this memorandum should be directed to any member of the Bankruptcy & Corporate Reorganization Department.

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