THE FIDUCIARY ROLE OF THE MANAGER AND THE AGENT IN A LOAN SYNDICATE

by Charles Qu[*]

Introduction

In a syndicated loan arrangement, one or more of the lending banks coordinate the lending activities such as pre-contractual documentation, negotiation of the loan agreement and administration of the loan.

The coordinator(s) of such activities function as 'manager(s)' and as 'agent(s)' at different phases of a loan syndicate.

The nature of the relationship between the manager(s)/agent and the syndicate determines the parties' rights and duties. Whether the manager and agent are to be treated as fiduciaries of the syndicate has been a vexed issue for courts and academic commentators.

This paper tackles this issue. The discussion will be based on an examination of the fiduciary principles, the roles of the manager(s)/agent(s) in a syndicated loan arrangement, case law and academic treatises on this issue.

This paper is divided into three parts. Part 1 examines the fiduciary principles. Part 2 looks at the concept of loan syndication. Part 3 considers whether the manager(s)/agent functions as a fiduciary of the lending syndicate at different stages of the loan arrangement.

Fiduciary Principles

Principles of characterisation

Much judicial and academic effort has been expended on searching for a definitive fiduciary principle.[1] The notion of fiduciary relationship, however,

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still remains, as Sir Anthony Mason described it, 'a concept in search of principle'.[2] Notwithstanding this situation, commentators seem to agree that fiduciaries can be divided into two categories, status-based fiduciaries and fact-based fiduciaries.[3]

Status-based fiduciary relationships are those relationships the law perceives as being fiduciary as a matter of course. Examples of relationships of this category include trustee-beneficiary, director-company, agent-principal, solicitor-client, and, for some purposes, employer-employee and partner-partner.[4]

There are different theories as to the common denominator behind status based fiduciary relationships. One such theory is the undertaking theory formulated by Mason CJ in *Hospital Products*:

> The accepted fiduciary relationships are sometimes referred to as relationships of trust and confidence or confidential relations; cf *Phipps v Boardman,*[5] … . The *critical feature* of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense.[6]

However, the difficulty with this theory is that, as Justice McPherson has observed, not every fiduciary *undertakes* to act in the interests of another person. An employee, for example, does not usually undertake to act in the interests of his boss. It would be more accurate to say that he/she is *instructed* to act in the interest of another.[7] The writer agrees with Justice McPherson that it may be more accurate to say that the unifying feature of status-based fiduciaries is that they are all some sort of *an agent* with the mandate to conduct certain affairs of another.[8]

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1 For literature on this topic, see Sin KF, *The Legal Nature of the Unit Trust*, Clarendon, Oxford, (1997) 159, footnote 122.

2 Mason A, 'Themes and Prospects' in Finn PD (ed) *Essays in Equity* (1985) 242 at 246.

3 See above n 1 at 159-60 and Finn PD, (1989), 'Fiduciary Principles' in Youdan TG, (ed) *Equity, Fiduciaries and Trusts*, LBC, North Ryde, NSW, 33-54, although Finn used terms 'legal phenomenon' and 'factual phenomenon' to describe status-based fiduciaries and fact-based fiduciaries.

4 *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 68 per Gibbs CJ and 96 per Mason J.

5 [1967] 2 AC 46 at 127

6 Ibid at 68.

7 McPherson BH, 'Fiduciaries: Who are They?' (1998) 72 *ALJ* 288 at 289.

8 Ibid.

Fact-based fiduciary relationships arise *ad hoc* when the requisite elements are present in the actual circumstances of a relationship. There seem to be three possible requisite elements or tests for the establishment of a fact-based fiduciary relationship. They are:

Trust and confidence

As Dal Pont and Chalmers point out, '[t]he original concept of fiduciary obligations developed by the Court of Chancery in the late 18th century involved the existence of a relation of trust and confidence which may be abused'.[9] This principle is best summarized, according to Sin, in the words of McMullin J in *Farrington v Rowe McBride & Partners:*[10]

> A fiduciary relationship exists whenever there is a relationship of confidence such that equity imposes duties or disabilities upon the person in whom the confidence is reposed in order to prevent the possible absence of confidence.[11]

However, it has been held both by the Australian High Court and by the New Zealand Court of Appeal that the trust and confidence test is neither necessary for, nor conclusive of, the existence of a fiduciary relationship.

Undertaking

The undertaking test has been briefly described and discussed above.[12] Whereas it may not be accurate to describe all status-based fiduciary relationship as involving undertaking, undertaking can be indicative of the existence of a fiduciary relationship. An undertaking on the alleged fiduciary's part could create an entitlement to maintain a 'fiduciary expectation' on the part of the party to whom the undertaking has been made.[13] Once the expectation has been created, the alleged beneficiary 'should be entitled, on bare grounds of public policy, to have that expectation protected'.[14]

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9 Dal Pont GE and Chalmers DRC, *Equity and Trusts in Australia and New Zealand*, LBC, North Ryde (1996) 39.

10 [1985] 1 NZLR 83.

11 Ibid at 94 in Sin KF, note 1 above 160.

12 As a possible basis for status-based fiduciary relationships see text accompanying footnote 6.

13 See above n 1 at 163

14 See above n 3 Finn at 46.

Vulnerability

The vulnerability test 'emphasizes the vulnerable position of the objects of the fiduciary test'.[15] This test was formulated by Wilson J of the Supreme Court of Canada *in Frame v Smith:*[16]

> (1) The fiduciary has scope for the exercise of some discretion or power.
> (2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.
> (3) The beneficiary is particularly vulnerable to or at the mercy of the fiduciary holding the discretion or power.[17]

Wilson J's test was approved in the leading Canadian case on fiduciary law, *LAC Minerals Ltd v International Corona Resources Ltd.*[18] In Australia the test has received the support of Dawson J in *Hospital Products.*[19] Dawson J held:

> the notion underlying all the cases of fiduciary obligation [is] that inherent in the nature of the relationship itself is a position of disadvantage or vulnerability on the part of one of the parties which causes him to place reliance upon the other and requires the protection of equity in acting upon the conscience of that other.[20]

As we can gauge from Wilson J's and Dawson J's comments, 'vulnerability' does not necessarily mean that the 'vulnerable' party is financially weak or lacks sophistication. In so far as one party to the relationship is placed at a disadvantaged position which causes him to place reliance upon the other, that party is 'vulnerable or at the mercy of the fiduciary holding the discretion or power'.[21] The vulnerable party in such a situation would need the protection of equity, which demands the other party act in accord with good conscience.

It should also be appreciated that, like the trust and confidence test, 'vulnerability is not…a necessary ingredient in every fiduciary relationship.'[22]

Each of the above three tests is only indicative of the existence of a fiduciary relationship. None of the factors discussed are necessary ingredients in a

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15 See above n 1 at 161.
16 (1987) 42 DLR (4th) 81 at 99.
17 Ibid.
18 (1989) 61 DLR (4th) 14 at 27 (per La Forest J and at 62-3 (per Sopinka J).
19 (1984) 156 CLR 41.
20 See above n 4 at 142.
21 *Frame v Smith* (1987) 42 DLR (4th) 81 at 99 per Wilson J.
22 *LAC Minerals Ltd v International Corona Resources Ltd* (1989) 61 DLR (4th) 14 at 39 per La Forest J.

fiduciary relationship. As Sin points out, 'they should be considered as 'factors' to be weighed up in identifying a relationship that would give rise to fiduciary obligations'.[23]

Fiduciary Obligations

To assess whether a fiduciary has breached his duties it will be necessary to know what the particular fiduciary obligations are. The traditional fiduciary obligations are best summarized in Simpson CJ's judgment *in Moss v Moss (No 2):*[24]

> There are…two well-settled principles applicable to this matter: (1) that no person in a fiduciary position may use that position to obtain a private advantage, and (2) that no person in a fiduciary position may enter into any engagement in which his personal interest conflicts, or may possibly conflict with his duty.

The two rules summarized in Simpson CJ's words are conveniently called 'the profit rule' and 'the conflict rule'.[25]

Fiduciary obligations, however, are not limited to the two traditional rules. For example, as Austin argues, the traditional rules do not cater for positive duties such as the duty to act in good faith for the benefit of the principal, the duty not to be fettered in exercising fiduciary discretion, or the duty to exercise discretion for proper purposes.[26] On the other hand, the profit rule and the conflict rule are not hard and fast rules in all situations. They can be modified and diluted in some situations.[27]

Loan Syndication

It often happens that a borrower needs to borrow more money than a single bank wishes to lend.[28] This leads to the formation of a loan syndicate. A

23 See above n 1 at 164

24 (1900) 21 LR (NSW) Eq 253 at 258.

25 For a discussion about the two rules see Austin RP, 'Moulding the content of fiduciary duties' in Oakley AJ (ed) *Trends in Contemporary Trust Law*, Clarendon Press, OUP, Oxford (1996), 158.

26 For more discussion see ibid 159-164.

27 See text accompanying note 62 for further discussion on this topic.

28 The bank may not have enough money to lend, or it is not willing to run the credit risk alone for a massive loan amount. See Sin KF, *Building Project Finance in Hong Kong: Law and Practice*, Butterworths, Singapore (1987) 34-35; Yoong WF, 'Liability of the lead bank for erroneous or inaccurate information' (1992) 22 *VUWLR* 285 at 285.

syndicated credit is a multi-bank loan arrangement whereby two or more lenders join together to make a loan to a single borrower on common terms based on a single lending document. It should be noted, however, that each lender has a separate contract with the borrower.[29] As mentioned above, a loan syndication is normally coordinated by a manager/agent bank, which is sometimes called a lead bank.

The Role of the Lead Bank

The lead bank plays different roles in the formation and operation of a loan syndicate. At the pre-contract stage, the lead bank plays an active role in the formation of the syndicate, including soliciting syndicate members, the preparation of information memorandum, and negotiating the terms of the loan agreement. At the post-contract phase, the agent coordinates tasks associated with loan payments and communications between the borrower and the syndicate.[30] The remainder of this part of the paper therefore considers the question whether the manager/agent bank should be regarded as the member banks' fiduciary by reference to its roles in the pre-contract phase and post-contract stage.

The Manager's role at the Pre-Contract Stage

The prospective borrower normally contacts and gives a 'mandate' to a major bank to organize the syndicate on the terms proposed by the borrower. This bank is normally called the manager or lead bank. The lead bank is often the bank with which the borrower customarily does its banking business.[31] In some cases the lead bank invites a small number of other financial organizations to join it in organizing the syndicate. For our present purpose, however, let us assume the more common situation where the lead bank organizes the syndicate itself.

Aside from procuring prospective lenders, the manager is also normally responsible for the preparation of an information memorandum in conjunction with the borrower. In the meantime, the manager will be negotiating a loan agreement with the borrower. Once a certain level of agreement has been reached the draft loan agreement and the information memorandum will be circulated among other potential lenders ('participants'). The potential

29 Mugasha A, 'A Conceptual-functional approach to multi-bank financing' (1995) *JBFLP* 5 at 6.

30 See O'Sullivan J, 'The Roles of Managers and Agents in Syndicated Loans (1992) *Journal of Banking and Finance Law and Practice* 162, at 163-4.

31 The Security Pacific National Bank in *National Westminster Bank USA v Security Pacific National Bank*, 20 F 3d 375 (1994) is such an example.

participants may raise questions on and propose amendments to the information memorandum. The manager may deal with some of the questions itself. It may also take up some of the questions and propose amendments with the prospective borrower. Once the borrower, the manager and the other potential lenders have approved the draft agreement, the agreement is signed.

The manager's duty concludes upon the signing of the loan agreement. At this point of time the bank which was the manager begins to assume another role namely, acting as agent for the other lenders in the running of the transaction after the signing. The agent bank, however, does not have to be the lead bank.[32]

When the borrower gives the mandate to the manager to procure prospective lenders with the promise to pay certain fees for the manager's service, an agency relationship arises between the *borrower* and the manager. There seems to be little doubt about that.[33] Commentators' opinions, however, differ as to:

(1) whether the manager bank can be regarded as a fiduciary of the syndicate participants regarding its role in the preparation of the information memorandum, notwithstanding its agency relationship with the borrower, and

(2) whether the manager bank acts as agent in negotiating the terms of the loan contract.

The nature of the manager bank's relationship with the member banks at the pre-contract phase can be examined by considering these two questions.

Is the Manager Bank a Fiduciary of the Member Banks regarding the Preparation of Information Memorandum?

Although the manager bank acts as the borrower's agent in procuring lenders, it does not really act on behalf of the borrower in the same capacity regarding the preparation of information memorandum. That is because the manager bank does not prepare the information memorandum on behalf of the

32 For a description of the function of a syndicate manager, see Clarke L and Farrar SF, 'Rights and duties of managing and agent banks in syndicated loans to government borrowers' (1982) *University of Illinois Law Review* 229 at 229-230, 233; Slater R, 'Syndicated Bank Loans' (1982) *JBL* 173 at 174-177.

33 O'Sullivan J, 'The roles of managers and agents in syndicated loans (1992) *JBFLP* 162 at 174; Gabriel P, *Legal Aspects of Syndicated Loans*, Butterworths, London (1986) 147.

borrower. Rather, it does the job in conjunction with the borrower.[34] It follows that treating the manager bank as a fiduciary of the member banks in relation to the preparation of the disclosure documents does not place the manager bank in a situation where the duty it owes to the borrower and the duty it owes to the member banks conflict. In fact, the manager bank has been held as the fiduciary of the member banks regarding the preparation of information memorandum, at least where its function resembles that of a trustee acting as the debenture holder of a company. This was the situation in *UBAF Ltd v European American Banking Corporation.*[35] In that case the lead bank provided the participants with an information memorandum which contained false representation about the purpose of the loans and the borrowers' financial situation. When the borrower defaulted, the participants took action against the lead bank. The court held that the lead bank was acting in a fiduciary capacity for all the participants because '[i]t was the defendants who received the plaintiffs' money and it was the defendants who arranged for and held, on behalf of all the participants, the collateral security for the loan'.[36] What *UBAF* tells us is that it is not impossible for the lead bank to act as the borrower's agent and as a fiduciary of the potential member banks at the same time. *Natwest Australia Bank Ltd v Tricontinental Corporation Ltd*[37] can be seen as supporting this view. In this case, Tricontinental acted as the lead bank for a loan syndicate in which Natwest was a participant. Tricontinental concealed in the information memorandum the fact that the borrower had given guarantees to Tricontinental and another financier for loans granted to a subsidiary of the borrower. The borrower defaulted. The borrower's ability of discharging its debt owed to Natwest and other lenders was therefore diluted by the guarantees it had given to the lead bank and the other financier. The court did not find it necessary to discuss whether the lead bank owed fiduciary duties to Netwest regarding its role in the preparation of the information memorandum since it held that Tricontinental had breached the common law duty of care it owed to Netwest.[38] However, the *Netwest case* does show that in preparing the information memorandum, the lead bank has scope for unilaterally exercising discretion to affect member banks' legal or practical interests and the member banks, given their informational disadvantage, could be vulnerable to or at the mercy of the lead bank's holding of discretion. Therefore, under Wilson J's vulnerability test in *Frame v Smith*,[39] Ticontinental could have been held as a fiduciary of the member banks in relation with its role in the preparation of information memorandum.

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34 See O'Sullivan's description of the manager role in the preparation of information memorandum: ibid at 163.

35 [1984] 2 WLR 508.

36 Ibid at 520.

37 Unreported, Supreme Court of Victoria, BC9300770, 2493-of 1990.

38 Ibid at 132

39 Above n 17.

However, the view that the manager acts as the syndicate's fiduciary in relation to the preparation of information memorandum is not short of critiques. For example, Clarke and Fararra and O'Sullivan argue that as far as pre-documentary information disclosure is concerned, the participants themselves can make inquiry, given that they are themselves sophisticated financial institutions.[40] As far as Clarke and Farrar's view is concerned, it should be noted that they were commenting on syndicated loans to foreign governments. Their argument is that most information relevant to foreign governments is generally publicly available and therefore available to all potential members[41]. Participants should have little difficulty in accessing the relevant information and the manager should not be burdened with fiduciary obligations in relation to disclosure. However, we are concerned here not just with loans to government borrowers: whilst Clarke and Farrar's argument is plausible in the context of the government loans, it cannot be used to relieve the managers from its duties for other types of loan syndication. Information about non-government borrowers, such as the crucial information about the adequacy of the security provided in *UBAF*, for example, may not be publicly available. As Foy comments:

> [T]he syndicate leader having structured the transaction is the only party with access to all the information. They briefed the tax advisors, the lawyers, they did the cash flows, the sensitivity analysis, it is their client, their relationship, only they know where the weaknesses lie, where the advice may have been different if the assumptions were changed even if only slightly.
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> The participant is not afforded this opportunity to the same extent – the fees do not cover his expenses. His only assumption is that the syndicate leader has done his job. A risk assessment is made, but if the assumptions are fundamentally flawed the participant often goes the way of the 'proverbial lamb'.[42]

A second theory put forward to oppose the finding of a fiduciary relationship between the manager and participants in relation to pre-contract disclosure is the 'arm's length' view. This theory was also advanced by Clarke and Farrar in their discussion of syndicated loans to sovereign borrowers. Their view is that the:

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40 See above n 32 Clarke & Farrar at 239; note 33 above O'Sullivan 1992 at 177 and 173.

41 See above n 32 Clarke & Farrar at 239.

42 Foy BE, 'Syndicated lending - the syndicate participants' perspective' in 1992 *Banking Law and Practice - 9th Annual Conference 30 April and 1 May 1992, Gold Coast, Queensland*, International Business Communications, Redfern, NSW, 332 at 333.

> syndicated process represents a classic arm's length transaction and, therefore, fiduciary obligations should not be imposed on the manager.[43]

This view has the support of commentators such as Tennekoon, O'Sullivan, Yoong and Mugasha.[44]

The essence of this argument is that in an arm's length transaction, the element of trust and confidence is absent. It follows that no fiduciary relationship could arise out of an arm's length transaction.[45] The problem with this view is that it assumes that trust and confidence is a necessary ingredient in fiduciary relationships. However, this is not the case. It will be remembered that the trust and confidence test has been regarded by Gibbs CJ in *Hospital Products* as 'neither necessary for nor conclusive of the existence of a fiduciary relationship'.[46] If trust and confidence are not conclusive of the existence of a fiduciary relationship, then the existence of a fiduciary relationship should not be precluded merely because the relationship involves an arm's length transaction. The existence of the elements of 'undertaking' or 'vulnerability',[47] for example, are also indicative of the existence of a fiduciary relationship.

A further argument put forward against the imposition of fiduciary relationship in the manager/participants relationship regarding pre-documentation disclosure is that imposing fiduciary obligations on the manager would subject it to inescapable situations. The argument goes that assuming the borrower is a client of the manager, which is often the case, if the manager is the fiduciary of the participants and discloses the borrower's information to the participants it could be liable for breach of confidence. Yet if it refuses to disclose it could be liable for breach of fiduciary duty.[48]

The answer to this argument is that a banker's duty of secrecy owed to its clients is not absolute. As Bankes LJ pointed out in *Tournier*'s case,[49] a banker can disclose clients' information:

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43 Above n 32 Clarke & Farrar at 234

44 See Tennekoon RC, *The Law and Regulation of International Finance*, Butterworths, London (1991); note 35 above O'Sullivan (1992), note 28 above Yoong (1992), note 29 above Mugasha (1995) and Mugasha A, 'The Agent bank's possible fiduciary liability to syndicated banks' (1996) 27 *SBLJ* 403.

45 See above n 28 Yoong (1992) at 295.

46 (1984) 156 CLR 41 at 69.

47 For these two tests, see above notes 15 & 16 above and accompanying text.

48 See above n 28 Yoong (1992) at 295.

49 *Tournier v National Provincial Union Bank of England* [1924] 1 KB 461 at 473.

> (a) where disclosure is under compulsion by law; (b) where there is a duty to the public to disclose; (c) where the interests of the bank require disclosure; (d) where the disclosure is made by the express or implied consent of the customer

Disclosure in the context of information memorandum may be compelled by statute law such as s 52 of *Trade Practices Act* 1974, which prohibits corporations from engaging in misleading or deceptive conduct in trade and commerce, given that silence can amount to misleading and deceptive conduct if it causes a person to entertain a misconception.[50] At common law, *Derry v Peek*[51] establishes that where false information is provided with knowledge or the persons preparing the information were reckless as to its truth or falsity, the deceived will have an action for fraudulent misrepresentation.

Obviously, where disclosure is necessary for avoiding misleading and deceptive conduct or fraudulent misrepresentation, disclosure can and indeed must be made under the compulsion of law. Moreover, if the manager bank's interests require disclosure, disclosure would not render the bank liable. Indeed, if the manager is aware that the information memorandum contains misrepresentation, it is in the interests of the manager bank to disclose the fact to the syndicate. Further, *CIBC v Syani*[52] clearly establishes that a bank can disclose a customer's information in order to prevent a third party from being affected by fraud or misrepresentation. Disclosure under such circumstances is not likely to amount to a breach of the duty of confidence owed to the bank's client. If the manager may disclose the borrower's information where circumstances dictate, then treating the manager as a fiduciary in relation to it role in the preparation of the information memorandum will not place it in an impossible situation.

The above analysis seems to suggest that there are no insurmountable technical hurdles to treating the manager as the syndicate members' fiduciary with regard to the preparation of information memorandum, notwithstanding the fact that it acts as the borrower's agent in soliciting lenders while the memorandum is prepared. The nature of the lead bank's role at the other stages of the loan process, discussed below, supports this view.

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50 S 4(2)(a) *Trade Practices Act* 1975 provides that a reference to engaging in conduct is to read as a reference to both doing or refusing to do any act. However, the omission to do the act must be deliberate: *Rhone-Poulenc Agriochimie v UIM Chemical Services Pty Ltd* (1986) ATPR (Digest) 46-010 per Bowen CJ.

51 (1889) 14 App Cas 337.

52 [1994] 2 WWR 260 (BC CA)

Is the Manager the Agent of the Syndicate Members in Negotiating the Terms of the Loan Agreement with the Borrower?

There are three schools of thought on this issue. The first one is represented by Lehane. It holds that at the time negotiation of the loan contract commences, the manager, who was the agent of the borrower at earlier stages, switches to being the agent of the participants. As such, the manager from this point of time onwards owes fiduciary duties to the participants, since an agent is a status-based fiduciary.[53]

The second school of thought, which is represented by O'Sullivan, holds that the mandate letters 'not only constitute the manager the agent of the borrower for the purposes of procuring lenders but also constitute the manager the borrower's agent to procure banks to lend to the borrower on certain terms, for example, as to amount, duration, pricing, security and other items dealt with in the mandate letters' and the manager's job in this second agency role is 'to ensure that the documentation reflects the terms of the mandate letter'. That being so, the manager cannot be the participants' agent: it cannot at the same time be the borrower's agent and the participants' agent for the negotiation of the loan contract. Otherwise the manager would face a conflict of duties situation.[54]

According to the third school of thought, which is represented by Gabriel, although the manager acts as the agent for the borrower with regard to the formation of the syndicate, it acts for itself, rather than acting as the agent for either the borrow or the participants, in the negotiation of the loan contract. 'So far as the participants also only getting the benefit, or disadvantage, of the lead's negotiation with the borrower, it is actually a matter extraneous to the lead manager'.[55]

The present writer is inclined to the view that the first school of thought, represented by Lehane, is the preferable one. The soundness of Lehane's view will unfold in the course of analyzing the second and the third schools of thought.

Let us start with the second school of thought. O'Sullivan's view that the manager acts as the borrower's agent in the negotiation of the loan contract does not seem to stand up. That is simply because the borrower and the manager are not on the same side of the negotiation table. The manager is itself

53 This point of view is held by Lehane, discussed in O'Sullivan, see above n 33 at 174-1775.

54 See above n 33 Sullivan at 174.

55 See above n 33 above Gabriel at 147.

a lender. As such, it would want the best price for the service it is to render (in its capacity as a lender, not the manager), whereas the borrower would invariably want the lowest price possible for the service. Thus it would be unrealistic to characterize the manager as the borrower's agent for the negotiation of the loan contract.

If the manager cannot be realistically regarded as the agent of the borrower is it correct to suggest that the manager acts only for itself in the negotiation of the loan agreement? If it can, then it cannot be regarded as the agent, and hence a fiduciary, of the syndicate.

Doubtless, when negotiating the loan contract, the manager is perfectly entitled to have its own rights in mind, but it may not be correct to say the manager needs *only* to have its own rights in mind. In the case of a syndicated loan, each lender has a separate contract with the borrower even though the separate contracts are contained in one document.[56] In other words, lenders are to be severally liable in case the loan agreement is breached. It follows that when the manager negotiates the loan agreement with the borrower, it is in fact negotiating not only for itself but also on behalf of all other lenders. It can therefore be concluded that when negotiating the loan contract with the borrower the manager acts as an agent for the syndicate. It follows then that the manager would owe other lenders fiduciary duties, since an agent, it will be remembered, is a status-based fiduciary. That is to say that Lehane's view that at the time negotiation of the loan contract commences, the manager, who was the agent of the borrower at earlier stages,[57] switches to being the agent of the participants, is the correct one.

The Post Contract Stage: Is the Agent Bank the Agent of the Syndicate Members in the Operation of the Loan?

A syndicate usually appoints one of its members to be the agent bank. The agent bank's responsibility is largely for channelling payments and communications between the borrower and the syndicate.[58]

The agent is usually appointed by virtue of an agreement between the agent and the banks. This agreement is more often than not included in the loan

56 See above n 30.

57 Of course, the manager bank could also be held as a fiduciary of the syndicate members with regard to the preparation of information memorandum prior to the loan contract negotiation, as discussed above.

58 See above n 1 at 35; note 32 above Slater (1982) 177.

agreement between the syndicate and the borrower.[59] Therefore prima facie an agent-principal relationship exists between the agent and the participants. This prima facie agency relationship arises out of the agreement, which is the basic way in which agency relationship arises.[60]

If there is an agency relationship between the agent and participants then prima facie the agent owes fiduciary duties to the participants since, it will be remembered, agent-principal is status-based relationship. However, it has been argued that the agent bank's role is somewhat different from a typical agent's role and that the relationship between the agent banks and the participants is not a fiduciary one.[61] It is thus necessary to discuss the agent bank's role in order to determine the nature of the relationship between the agent bank and the syndicate members.

Usually, agency means a relationship in law which connotes 'an authority or capacity in one person to create legal relations between a person occupying the position of principal and third parties'.[62] The relationship 'can only be established by the consent of the principal and the agent'.[63] Prima facie, agency relationship in the context of a loan syndicate is established by the consent of both the agent bank and the participants, since the relationship is established by virtue of the agreement between the agent bank and the participants.

A loan agreement could contain provisions that purport to exclude fiduciary duties that an agent bank might otherwise owe to the participants.[64] However, such a clause may not necessarily be effective in excluding fiduciary relationships that might exist between the relevant parties. For example, in *Customs and Excise Comrs v Pools Finance (1937) Ltd*,[65] a provision denying any agency was disregarded by the Court of Appeal, which held that notwithstanding the exclusion clause the substance of the transaction showed an agency. By parity of reasoning, a provision denying fiduciary relationship can also be disregarded if the substance of the transaction showed an agency. So, where fiduciary obligations are purportedly excluded from a syndicated

59 Cresswell PJ et al, *Encyclopaedia of Banking Law*, Butterworths, London (1992) para 5351.

60 Reynolds FMB, *Bowstead and Reynolds on Agency*, (16th ed) London, Sweet & Maxwell (1996) 5.

61 See above n 32 Clarke & Farrar (1982) 244 – 249; n 44 Mugasha (1996).

62 *International Havester Co of Australia Pty Ltd v Carrigan's Hezeldene Pastoral Co* (1958) 100 CLR 644 at 652 in Gabriel (1986) 151.

63 *Barnac Grain Co Inc v HMF Faure & Fairclough Ltd* [1968] AC 1130 at 1138 HL, per Lord Pearson in Gabriel (1986) 151.

64 For an example, see above n 59, clause 19.3 of the precedent 'Syndicated Eurodollar term loan agreement'

65 [1952] 1 All ER 775, CA

loan agreement, whether the agent bank in fact still owes the participants fiduciary duties should be determined by examining the substance of the relationship of the parties in normal circumstances against the factors indicating the existence of a fiduciary relation.

The existence of a fiduciary relationship between the agent and participants in the context of a loan syndicate, it is submitted, can be proved by applying the vulnerability test, one of the three tests the satisfaction of one of which will suffice to establish a fiduciary relationship, discussed above.[66] To see whether the agent bank owes fiduciary duties to the participants regardless of whether the agent bank is to be treated as the prima facie agent, the three factors[67] which constitute the test formulated by Wilson J in *Frame v Smith*[68] should be considered:

Ability to unilaterally exercise discretion

An agent is capable of creating a legal relationship between the principal and third parties, discussed above. Thus prima facie the agent bank is capable of unilaterally exercising its power or discretion so as to affect the participants' legal or practical interests. Even if one accepts that the role of the agent bank in a loan syndicate is somewhat different from a conventional agent, the provisions in a standard loan agreement seem to give the agent bank the capability to unilaterally exercise its power or discretion. For example, a standard loan agreement normally provides that:

> … In the exercise of any right or power and as to any matter not expressly provided for by this Agreement the Agent may act or refrain from acting in connection herewith in accordance with the instructions of the Majority Banks and shall be fully protected in so acting. *In the absence of any such instructions, the Agent may act or refrain from acting as it shall see fit. Any such instructions shall be binding on all the Banks.*[69]

The italicized sentences unequivocally give the agent power to make binding decisions in the absence of the participants' direction. The agent bank is also empowered to exercise discretion without having to have the participants' directions. The power to declare events of defaults and acceleration, discussed below, is such an example. If the agent bank is able to exercise discretion to bind the participants it would follow that it is in a position unilaterally to

66 At pp2-4.
67 See above n 18 and the accompanying test.
68 See above n 17.
69 See above n 59 at K895 cl 19.2 (Emphasis by the present author).

exercise its power or discretion so as to affect the beneficiary's legal or practical interests.

Discretion and vulnerability

The scope for the exercise of discretion or power on the part of the alleged fiduciary and vulnerability on the part of the alleged principal, the two elements in Wilson J's formula, need to be discussed together. That is because the fact that an alleged fiduciary's ability to unilaterally exercise his discretion to affect the legal and practical interests of his principal itself indicates that the beneficiary is in a vulnerable position.

Vulnerability

It has been argued that the fact that the lenders in a syndicated loan are all sophisticated financial institutions argues against the existence of fiduciary relationship between the agent and participants.[70] The rationale, presumably, is that sophisticated institutions are not vulnerable and a fiduciary relationship cannot be made out because the vulnerability element is absent. The answer to this argument can be summarized into two points:

First, not all participants are sophisticated big banks. Usually the manager/agent banks are the largest and most sophisticated international banks. The participants, however, could include new, smaller and obviously less sophisticated banks.[71] Further, in Australia the trend after the *Wallis Report* will be that a wider range of entities will be able to participate in what were traditionally regarded as banking activities.[72] Wider participation in banking activities means that smaller, less sophisticated entities will be able to act as participants in loan syndicates. It follows that participants can be vulnerable vis-a-vis the agent bank in terms of sophistication and financial strength.

Secondly, even sophisticated participants can be in a vulnerable position when the agent bank exercises its discretion. As will be discussed below, there are occasions in which the agent bank is able to exercise discretion unilaterally so as to determine the legal interests of the participants.

Because of the close relationship between the manager/agent bank and the borrower, the agent would have easier access to the borrower's information. The informational advantage the agent possesses is susceptible to abuse. This is

70 For example, see above n 44 Mugasha (1996) 410,
71 See above n 32, Clarke & Farrar (1982) 235.
72 See *Australian Corporations and Securities Law Reporter* [P602-031].

well illustrated in the New Zealand High Court case, *NZI Securities Ltd v Unity Group Ltd*.[73] In this case, the agent bank took security from the borrower to secure an independent loan, which had been previously unsecured, when it learnt that the borrower was in financial difficulties. This move diluted the potential collateral available to the other syndicate banks, whose loans were unsecured. The issue of fiduciary obligations was not argued in this case since the defendant's counsel conceded the existence of fiduciary obligations, which the court held as appropriate.[74] In an *NZI Securities* situation, the sophistication and financial strength of the participants does not make them less vulnerable to the agent bank's exercise of its discretion in an unconscionable manner. In such a situation, the disadvantaged position the participants were placed in, according to Dawson J in *Hospital Products*,[75] would require the protection of equity which demands the agent to act upon its conscience.

Discretion

It has been argued by some commentators that usually the agent bank in a loan syndicate has only very limited mechanical discretion and the agent therefore should not be held as owing fiduciary obligations to the participants.[76] The rationale of this argument must be that if the agent does not have real discretion to exercise, the agent could in no way affect the participants' legal or practical interests. In order to evaluate this argument one needs to take a look at the nature and the amount of the discretion an agent bank normally has, as well as the instances in which an agent bank is able to exercise its discretion.

a) The nature of the agent's discretion

It seems beyond doubt that the agent bank's discretion is more mechanical than that of an ordinary agent since its tasks are viewed as largely one of collector, conduit and communications link between the parties.[77] However, the mechanical nature of the agent's task does not necessarily mean that the agent's exercise of discretion is not able to affect the legal and practical interests of the participants. The example Gabriel gives is quite telling:

> …[t]he agent is usually under a mechanical duty to receive documents from the borrower, in satisfaction of the conditions precedent requirement.

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73 Unreported, February 11 1992, CP 575/91, Wylie J in Mugasha (1996), above n 44 at 410.

74 Above n 30 at 16.

75 See above n 21 and the accompanying text.

76 See above n 33 above O'Sullivan 1992 at 183; note 32 above Clarke & Farrar (1982) 244-245.

77 Ibid, O'Sullivan (1992)183; also, see n 28 above, Sin (1987) 35-36.

> The loan will only be extended by the syndicate to the borrower upon the agent being satisfied with the documents submitted by the borrower. Should the agent wrongfully accept the documents and the loans are extended by the syndicate to the borrower it may be flying in the face of common sense to say the legal relation between syndicate and borrower is not affected. The syndicate would have extended a huge sum of money to a third party without proper compliance with the agreement by the third party.[78]

b) The amount and significance of the agent's discretion

If the discretion given to the agent bank is largely mechanical, the amount of the discretion is necessarily relatively small, as compared to that of an ordinary agent. Again, that does not mean that the agent's exercise of discretion is incapable of affecting the interests of the participants: as Gabriel points out, the amount of agent's discretion may be small, but a syndicated loan transaction normally involves a large amount of money and even a miniscule discretion may have serious effects on the participants when exercised wrongly.[79]

c) The instances in which the agent is able to exercise its discretion

In order to ascertain further how the agent's exercise of discretion could affect the participants' legal and practical interests, it will be necessary to consider in what instances the agent has discretion to exercise.

We have already referred to one of such instances, ie when the agent bank exercises discretion regarding the receipt of documents from the borrower, in satisfaction of the conditions precedent requirement. We are satisfied that the manner in which the discretion is exercised in this instance affects the legal and practical interests of the participants.

Another important discretion the agent is able to exercise is declaration of events of defaults and acceleration.[80] A clause on acceleration would normally provide that when an event of default occurs, 'the Agent may, and shall if so directed by the Majority banks[81] 'make the relevant declaration. The word *may* here indicates the agent's discretion. The word means that, when an event of default occurs, absent direction by the participants, the agent bank has the discretion to take the appropriate action. The agent bank's exercise of discretion

78 See above n 33 Gabriel at 152.

79 Ibid.

80 See above n 59 at K 895 cl 17.2. Other discretions the agent is able to exercise include:
1) Determination of default interest: ibid K 880 cl 10.4, and
2) Appropriations in the case of partial payment by borrower: ibid K895 cl 17.2.

81 Ibid. K895 cl 17.1.

in declaring the event of default can affect the participants' legal and practical interests. Again, a hypothetical situation described by Gabriel is helpful to illustrate the point:

> Take the case of negative pledges. If the borrower is about to breach it and grant a security to a third party the consequences may be disastrous for the lenders. Having a second right to a property instead of first may mean the difference between being fully repaid and not receiving any repayment at all.[82]

Under such circumstances the syndicate should apply for an injunction to restrain the breach. However, the syndicate would not be able to do this without necessary information. Given that the borrower is often the agent bank's customer in other capacities, as discussed above, the agent bank may well be the only party to have access to, or who possess, the information. If that is the case, prompt action on the part of the agent bank would safeguard the interests of the syndicate. On the other hand, belated action or failure to act may result in a failure for the syndicate to obtain any repayment from the borrower. Thus, the manner in which the agent bank exercises its discretion can fundamentally affect the participants' legal and practical interests.

A further discretion the agent can exercise is the decision as to the mode of payment, given that different forms of non-cash payment are available, thanks to the advance of technology, and are acceptable to the court.[83]

In a syndicated loan disbursements are made to the borrower in several instalments. Repayment of interest begins soon after the first installment is made. A non-repayment is normally regarded as an event of default.[84] If a certain unconventional method of repayment is authorized by the agent without the participants' knowledge, the participants may make disbursements under the wrong impression that the repayments due have already been made on the part of the borrower. That is because the normal practice is that the agent would use its own funds to pay the syndicate in anticipation of the repayments from the borrower. The participants, having been paid in advance, may never realize that defaults have occurred until the agent seeks to recover under the 'claw-back' clause.[85] Consequently the participants would not be in a position to direct the agent to declare an event of default and acceleration. The agent's exercise of discretion regarding the modes of repayment thus could adversely affect the participant's legal interests.

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82 See above n 33 Gabriel at 154.
83 See discussion in ibid at 158.
84 See above n 59 at K893 cl 17.1 (a).
85 See above n 33 Gabriel at 159.

We have seen from the above discussion that the role of an agent bank in a loan syndicate satisfies the tests laid down by Wilson J on the existence of fiduciary relationship. That is because situations exist where:

1) the agent has scope to exercise discretion;

2) the agent is able to unilaterally exercise discretion so as to affect the legal and practical interests of the participants, and

3) the participants are vulnerable when the agent bank exercises its discretion.

This conclusion, read in conjunction with the fact that an agent is a prima facie fiduciary of its principal and that agency is the unifying feature of the status based fiduciaries[86] argues strongly for the existence of fiduciary relationship between an agent bank and the participants in a loan syndicate.

Conclusion

The manager bank can be regarded as a fiduciary of the loan syndicate as soon as the loan arrangement commences. The fact that the manager bank acts as an agent for the borrower in soliciting lenders does not preclude it from acting as a fiduciary for the member banks at the pre-contract stage. An information memorandum is normally prepared by the manager and the borrower jointly. That is, the manager does not act as the agent for the borrower in the preparation of the document. In fact, the manager bank can be treated as the syndicate members' fiduciary in preparing the disclosure documents, at least where it has the scope for unilaterally exercising discretion to affect member banks' legal or practical interests. In negotiating the loan agreement, the manager acts as the agent of the syndicate since it is the manager who will be doing the bargaining and it is a member of the lenders' team.

The agent bank in the operation of a syndicated loan should be regarded as the syndicate's fiduciary. That is because an agency relationship between the agent bank and the member banks arises from the loan agreement and an agent is a prima facie fiduciary. The agent bank must be presumed to be the agent of the syndicate. It would be difficult to displace this presumption as the agent is in a position to unilaterally exercise its discretion so as to affect the syndicate members' legal and practical interests and the member banks are vulnerable when the agent exercises its discretion given the informational advantage of the agent.

86 See discussion above in page 2.