LIABILITY OF LENDERS TO OTHER LENDERS FOR MISLEADING AND DECEPTIVE CONDUCT

— Recent Developments

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I am tempted to say that, under English law, there is virtually no risk that an agent banker/seller of a participation would have liability to a syndicate member or a purchaser of a participation in the absence of fraudulent or negligent misrepresentation and that fraudulent or negligent misrepresentation would be interpreted in the way we really mean those terms rather than an artificially created and expansive term. And I would then be tempted to sit down and give back to you the ten minutes that I took from you this morning by over-running my talk! But I think Bob would feel that perhaps I had not sung for my supper, so I will mention three issues where there could conceivably, under some circumstances, be liability imposed.

First, I will mention a case in the early part of the 1980s **UBAF Limited v European American Banking Corporation**. European American was a New York based bank which was putting together a loan syndicate for the Colocatronis Shipping group. In fact the money was going to be used in part to pay out prior loans of European American. In connection with the syndication they made statements, including in the information memorandum, that the Group was a perfectly sound and proper company and that the loan was a good one. As it turned out, the loan was an unfortunate one - the shipping market went down, the collateral was not of the value that people thought it was, and a number of law suits were brought against European American. One of these law suits, incidentally, in New York created some interesting conclusions about whether or not participations constituted securities for purposes of the US securities laws. But in the UK, where UBAF brought its suit, there were various defences made with respect to statute limitations and authority of the person signing the information memorandum. In the course of this procedural jockeying there was an appeal and an opinion that was rendered which held that the case could proceed regardless of questions as to the authority of signing and the passage of time. Towards the end of the decision the court, however, not necessarily as a required part of the decision, said: 'If therefore it was within the defendant's knowledge at any time while it was carrying out its fiduciary duties that the security was as the plaintiff alleges inadequate there must we think clearly have been its duty to inform the participants of that fact and its continued failure to do so would constitute a continuing breach of its fiduciary duty. Whether the plaintiff will be able to establish such a breach as a matter of fact is a question on which we express no opinion ...'. But then the court went on to say this is a triable issue.

There it is, that is the language that has not been acted on, expanded or really gone anywhere. But there does seem to be at least somebody, some judge who thinks that there may be circumstances under which an agent bank could have a fiduciary duty to a participating bank. Whether or not that would be construed to expand the proper interpretation of what is a negligent or wilful misrepresentation, no one knows - I tend to doubt it.

There is another concept in the United Kingdom regarding what are called the shadow directors. Section 214 of the *Insolvency Act* 1986 creates liability for directors of insolvent companies who carry on trading to the detriment of the company's creditors. Now what does this have to do with banks? Well, the aim of section 214 is to protect creditors from directors who are either aware or should be aware that their company is going to become insolvent, but nonetheless continue trading and thereby reduce the assets available to meet debts owed to creditors. Who is liable for this? Section 214(7) imposes liability on directors. Director includes any person occupying the position of director by whatever name used - de facto director. Section 214(7) includes as a director a shadow director. Section 251 defines a shadow director as a person in accordance with whose directions or instructions the directors of a company are accustomed to act. The definition fortunately contains a proviso intended to protect the company solicitors, accountants and other professional advisers by an exclusion that says but so that a person is not deemed a shadow director by reason only that the directors act on advice given by him in a professional capacity. I like that exception; not for the obvious reason, but also because there is an implication that somebody believes that clients do act on the advice that solicitors give.

How does this relate to banks? Well, let us take a situation where a bank, in the context of a work-out situation, begins to exert control over the company - appoints a financial operating officer, tells the company what it must do or it will pull the plug. There is a whole web of instructions built up and in effect the bank begins to run the company. In theory that bank could be regarded as a shadow director. Further, when a large English corporation, one that is worthwhile in terms of the number of creditors it has got, begins to experience serious difficulties, the bank creditors will get together, all the bank groups, and appoint a steering committee with a lead bank. They will begin negotiations with a view to entering into a standstill agreement where the banks will agree to hold off provided that the company does certain things. There is an inescapable risk, I suppose, that in this context the lead bank could be deemed to be a shadow director. However, where this has occurred, banks tend to be very clear in their formal pronouncements that they are not forcing the company to do anything. Of course, as a practical matter while they are making these formal pronouncements, everybody is quite clear that the banks are in fact running the company. There have been no cases of which I am aware where banks under these circumstances have actually been found to have liability. There have been cases where the court has found that an issue exists for trial as to whether or not a bank should have a liability.

Finally, I would mention the *Financial Services Act*, which as I mentioned this morning provides that 'investment', a broadly defined term which includes many products, can only be offered by authorised persons and that authorisation is subject to disclosure requirements and certain obligations. One of the instruments included within the definition of investment is the debenture, and a debenture then is specifically defined to include certain specific types of instruments and, at the end of that definition, any other instrument evidencing a debt or obligation - very broadly defined. Now, technically I suppose, a loan participation, a sub-participation as opposed to a participation in a syndicated credit, could be viewed as an evidence of indebtedness. There are a number of very arcane arguments as to why the term 'debenture' would not include a sub-participation, and claims have not been raised under this in that context. It is pretty much everybody's belief that this provision would not be invoked in the context of the sale of a participation.

However, there is one caveat. If you had a sub-participation that was certificated and perhaps transferable, I would think a little bit more about the issue. Even in those circumstances, however, there would only be liability if one were dealing with somebody who was a private person as opposed to a non-private person which would include most of their banks. So the chances of there being exposure are really pretty small. Even if there is exposure, recourse here is not through a suit for misrepresentation, but disciplinary proceedings with the relevant self-regulatory organisation which would have the right to impose compensation requirements. But this I think would be regarded as a highly theoretical risk.