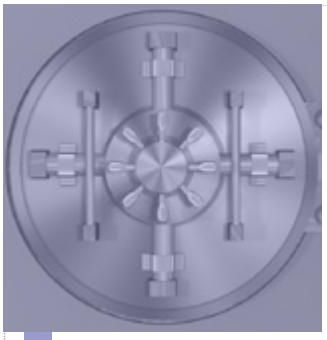

Secured Credit Committee
ABI Committee News

In This Issue: **Volume 6, Number 1 / July 2009**

Be Careful What You Contract For...

by Steven C. Krause

Davis Polk & Wardwell LLP; New York

Arvin I. Abraham

Davis Polk & Wardwell LLP; New York

Mark L. Giugliano

Davis Polk & Wardwell LLP; New York

Committee Officers

Upcoming Events

Contribute to the Newsletter

ABI World

Newsletter Archives

The recent decision of Hon. **Arthur J. Gonzalez** in the chapter 11 cases of Chrysler LLC and its affiliated debtors recalls the oft-repeated maxim "be careful what you wish for." *In re Chrysler LLC, et al.*, Case No. 09-50002 (AJG) (Bankr. S.D.N.Y. April 30, 2009). In the context of syndicated lending, lenders have "wished for" and contracted to enter into intercreditor agreements that appoint a single agent to act on behalf of the syndicate, usually subject to the consent of holders of a specified percentage of syndicated loans. Such agreements greatly reduce the costs of collective action and prevent individual lenders from negotiating preferential treatment for themselves at the expense of the rest of the syndicate. Who would not wish for such a quick, efficient and fair decision-making process?

In re Chrysler builds on past precedent to limit the rights of syndicate lenders to object individually to dispositions of their collateral after the borrower enters chapter 11. Judge Gonzalez's decision makes clear that an intercreditor agreement can be a double-edged sword, greatly reducing the transaction costs associated with a syndicated loan transaction, while at the same time stripping individual creditors of rights that would normally be considered sacrosanct in the borrower's bankruptcy.

To understand how we got here, we need some background: On April 30, 2009, the date Chrysler filed for bankruptcy protection, Chrysler, Fiat S.p.A. and New CarCo Acquisition LLC (New Chrysler), an acquisition vehicle formed by Fiat, entered into a master transaction agreement, pursuant to which Chrysler would transfer substantially all its operating assets to New Chrysler in exchange for $2 billion in cash and the assumption of certain liabilities. The parties sought court approval for this sale, free and clear of all liens and interests pursuant to §363 of the Bankruptcy Code. However, substantially all of Chrysler's assets served as security for a prepetition syndicated credit facility. The lenders in the credit facility had

entered into a collateral trust agreement, whereby designating J.P. Morgan as administrative agent and had granted to J.P. Morgan certain rights and powers in the event of a default by Chrysler. For instance, J.P. Morgan was authorized, upon obtaining the consent of holders of a majority of outstanding loans, to take any actions it "deem[ed] necessary to protect or preserve the Collateral and to realize upon the Collateral," including selling any or all of it.

Holders of a significant majority of the loans consented to the sale, but certain lenders dissented. A group of Indiana pension funds filed an objection alleging, *inter alia*, that a sale of assets pursuant to §363(f) could not take place without the consent of *all* parties having an interest in the collateral. In order to reach the question of required consent, Judge Gonzalez first had to decide whether the Indiana Funds had, pursuant to the collateral trust agreement, contracted away their right to act individually and therefore lacked standing to raise an objection.

To determine whether secured creditors, such as the Indiana Funds, have standing to object to the decisions of their syndicate agent, New York courts examined the terms of the relevant syndicate agreements. Generally, courts apply the canons of contractual interpretation to see if the individual creditor's rights have been contracted away. The standard canons include, but are not limited to, looking only to the express terms of the contract rather than "extrinsic evidence" and not reading in additional terms merely because a party becomes unhappy with the contract's outcome. *See, e.g., John Hancock Mut. Life Ins. Co. v. Amerford Int'l Corp.*, 22 F.3d 458, 462 (2d Cir. 1994). Specifically, for loan agreements with borrowers in bankruptcy, courts generally refuse to rewrite such agreements to provide dissenting syndicate lenders with implied rights "which are not expressly set forth in the agreements." *New Bank of New England v. Toronto-Dominion Bank*, 768 F. Supp. 1017, 1021 (S.D.N.Y. 1991).

In practice, courts have been unwilling to allow syndicate lenders to exercise individual rights, even when their dispute involves a contract containing far more ambiguous terms than those in the Chrysler credit agreement. For example, the *New Bank of New England* court would not hear the objections of an individual syndicate lender, even though the agreement granted only discretionary authority to the agent. 768 F.Supp. at 1022. Moreover, courts have read agreements that empower agents to act after receiving majority consent, but which are otherwise completely silent as to the presence or absence of a right to individual action, to "contemplate unified action by the Administrative Agent" and to preclude any individual lender from exercising such a right. *See, e.g., Beal Sav. Bank v. Sommer*, *et al.*, 865 N.E.2d 1210, 1215 (N.Y. 2007). Similarly, in *Delphi Corp., et al.*, the court found that a plain-meaning analysis of an intercreditor agreement, which contained no express provision either granting or denying creditors the individual right to act to enforce a payment obligation, indicated that the intent of the parties was to preclude the individual lenders from exercising such a right. Case No. 05-44481 (Bankr. S.D.N.Y. Dec. 1, 2008).

Based on these precedents, syndicate lenders face an uphill battle to establish standing to object to their agent's actions when the agent is acting pursuant to the terms of the syndicate agreement. However, dicta in *Beal* might have given some hope to syndicate

lenders chafing under the collective action requirements of their syndicate agreements by asserting that intercreditor agreements that intend to preclude individual enforcement of rights should state so explicitly. 865 N.E.2d 1210. Unfortunately for such lenders, in *In re Chrysler* Judge Gonzalez was not persuaded by the dicta in *Beal*, and his decision may well cast serious doubt on *Beal's* future applicability in this regard.

In *In re Chrysler*, Judge Gonzalez held that merely "not liking" the outcome of their agreement did not provide lenders a basis for individual objection. He concluded that the lenders had "contracted away their right to act inconsistently with the determination of the required [percentage of] lenders" which in the case at hand had endorsed the agent's decision. *In re Chrysler*, Dkt. No. 30 (Bankr. S.D.N.Y. Apr. 30, 2009). In this case, Judge Gonzalez found that the agent had acted in accordance with the specific terms of the loan agreement in approving the sale pursuant to §363 of the Code after receiving the required majority consent. *In re Chrysler*, Dkt. No. 30 at 25-30.

To the dismay of the Indiana Funds, the Second Circuit Court of Appeals expeditiously (without prior hearing by the district court) affirmed Judge Gonzalez's decision and the Supreme Court ultimately denied *certiorari*. Given the high profile and national importance of Chrysler, it is likely that this decision will be relied on often by parties arguing against allowing individual syndicate lenders to act in circumstances where intercreditor agreements provide for collective action. However, despite Chrysler's high profile, it is still unclear what effect, if any, this decision will have on whether and how lenders form syndicates, and how debtors choose to effect reorganizations under chapter 11, especially given the unique circumstances surrounding the case. One thing is clear: *In re Chrysler* serves to reinforce the maxim, "be careful what you contract for." Once contracted away, the right to individual action in the face of collective will is now even less likely to be available to syndicate lenders.