12 Other Contract Types

12.1 Introduction

The purpose of this short chapter is to provide a brief introduction to problems relating to multi-party contracts. Syndicated loans are a well-known form of multi-party contracts. They will be discussed in Volume III in more detail. In addition to multi-party contracts, this chapter will highlight some contract law aspects of Islamic finance.

12.2 Multi-Party Contracts

Most contracts are contracts between two parties. For example, a bilateral bank loan is a loan between one bank and one debtor. Some contracts are contracts between three or more parties (multi-party contracts).

A multi-party contract can be a contract between one party and a block of two or more parties. For example, a bank may lend money to two or more parties under the same contract (one bank – many debtors), or a debtor may borrow money from many banks under the same contract (many banks - one debtor). A syndicated loan is a typical example of the latter. A syndicated loan means a loan agreement between one debtor and many banks (the syndicate).

The contract can also be a contract between three or more separate parties. In corporate finance law, contracts between three or more separate parties range from simple shareholders’ agreements to complex master agreements in project finance or venture capital finance.

Legal aspects. Parties to a multi-party contract must address the same legal questions as contract parties in general. The number of parties nevertheless raises additional legal questions. Many traditional legal questions have already been discussed in DCFR which addresses the plurality of both debtors and creditors.¹ Some general remarks can nevertheless be made.

At a high level of abstraction, many of these questions are the same as the core questions in corporate governance (Volume I). Although a block of two more parties might not be regarded as a legal entity or a business organisation that must regulate its governance structure, it is useful to organise the actions, rights and obligations of the parties in advance.

¹ DCFR, Chapter 4 of Book III.
One should therefore address the following questions in the legal framework: Who represents the parties? How should the parties’ representatives act? How are the representatives remunerated, and what sanctions are available to the parties in the event of breach of duty? How should the parties act? How is power distributed between the parties? How is risk distributed between the parties? How is information managed? Exit and entry raise further legal questions.

Representation. Although two or more contract parties share the same interests, each of them may prefer to act on its own behalf.

Alternatively, contract parties may be represented according to the principles of agency. One of the contract parties or a third party will then act as agent on the behalf of all contract parties. To overcome administrative disadvantages, the contract parties may decide to use a separate legal entity.

In financial transactions, the parties may often use a trust construction. Their counterparty will try to make those parties confirm in advance that the agent’s actions will be attributable to them.

For example, a syndicated loan agreement could contain the following clause: “The Borrower shall, unless it is aware or should be aware of any irregularity, be entitled to assume that the Agent represents the Banks, and that all the necessary permission and consents have been obtained.”

Duties of the representative. The duties of the representative depend on the case. In syndicated loans, for example, the lead bank may sometimes be regarded as an agent of the syndicate banks. In this case, the lead bank can owe fiduciary duties to the syndicate banks.2

There is often an agreement setting out the duties of the agent. The agent must, in practice, ensure that its duties have been defined in detail the agreement contains limitations of liability. The agent will try to ensure that its obligations are mainly of a mechanical or administrative nature, and that it will not assume any responsibility for the usefulness of information disclosed to the parties that it represents.3

For example, a syndicated loan agreement could contain the following clause on the duties of the agent: “Each Manager and each Bank (other than the Agent) hereby irrevocably appoints the Agent to act as its agent under, and in connection with, this Agreement and irrevocably authorises the Agent to exercise such rights, powers and discretions as are specifically delegated to the Agent by the terms of this Agreement, together with all such rights, powers and discretions as are reasonably incidental thereto. The Agent has only those duties which are expressly specified in this Agreement and those duties are solely of a mechanical and administrative nature.”

The law governing agency. The law that governs agency has partly been left unclear in the Rome I Regulation.

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