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The Eurocurrency Loan Agreement

- a comparison between English and Swedish law as the proper law

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Abbreviations

EC	European Community
EU	European Union
IMF	International Monetary Fund
LIBOR	London Interbank Offered Rate
UK	United Kingdom
US	United States

Summary

The subject of this thesis is to present the eurocurrency loan agreement and to discuss the importance of the governing law. In practice, the vast majority of eurocurrency loans are governed by English law, since that way the legal outcome of the contract will be certain and predictable. Even though the eurocurrency loan agreement has been the subject for several books and articles, especially in England, no one seems to have examined whether Swedish law would be a suitable choice of law for the agreement. Therefore this thesis has examined if Swedish law would be a suitable substitute.

There are several factors that influence the parties, when they choose the law that will govern their agreement. Primarily, the parties want a legal system that does not change the contents of the agreement, i.e. the chosen legal system must not interfere with the contract. The absolute majority of eurocurrency loan agreements are very extensive and detailed, regulating the parties' rights and obligations in an exact manner. Therefore, it is important for the parties to be able to rely on the agreement, without interference by rules in a legal system. Interference by external rules may destroy the presumptions upon which the loan agreement was entered into.

The analysis shows that Swedish law may be chosen to govern a eurocurrency loan agreement. For this purpose there is no need for the agreement to have some sort of connection to Swedish law. The greatest disadvantage, if Swedish law is chosen, would seem to be that there is no established case law on eurocurrency loan agreements. This may make the choice of Swedish law somewhat uncertain. Moreover, even though Swedish law of contracts is based on the principle of freedom of contracts, it contains several rules that may invalidate or modify an agreement. Most of those rules are not distinguishable for Swedish law, though, such as the rules on the formation of contracts and rules on misrepresentation. There are, however, a few rules that are not found under English law, which potentially may give rise to some amount of uncertainty. These rules are especially section 36 of the Contracts Act, and the doctrine of presupposed conditions.

However, it is submitted that these rules will not interfere with a normal eurocurrency loan agreement. If the contract is well drafted, covering all presumptions and prescribing for the consequences should they not be fulfilled, then the legal rules that may modify a contract because of changed circumstances will not affect the agreement. Moreover, section 36 will not be able to modify the contents of the agreement in any other way, since the contract terms will not be regarded as unfair in a relation such as the eurocurrency loan transaction.

The Swedish interpretation of contracts also differs from the English one. While a Swedish court will search for the parties' intention, an English court will look at the objective meaning of the words in the agreement, when interpreting the contract. The Swedish approach may introduce some degree of uncertainty, but if the contract is well drafted, this uncertainty will be excluded, since then there will be no room for unpredictable interpretations. Naturally, the contents of the

loan agreement will have to be adjusted in some extent, but on the whole, the parties will be able to include the same clauses in the contract, if Swedish law is the proper law, as when the contract is governed by English law.

The conclusion is therefore that, even though English law still would be a superior choice, Swedish law would be a suitable substitute. The parties must be aware of the differences, though, and adapt the contract in accordance with them.

Preface

Purpose

In this thesis the eurocurrency loan transaction is presented and discussed. A thorough examination of some of the most important contract terms will be provided, but primarily the importance of the governing law will be analysed. Eurocurrency loan agreements are habitually governed by English law, partly because London is the capital of the world's financial markets, but primarily because the legal outcome of the agreement will be certain and predictable under that law. With some exceptions, there seems to be very few investigations in the legal literature of whether there are other legal systems that successfully would be able to govern a eurocurrency loan agreement.

Therefore, the main objective of this thesis is to examine whether Swedish law would be a suitable choice of law for a eurocurrency loan agreement, or if Swedish law would interfere in any adverse way with the contents of such a contract. The relevant differences between a choice of Swedish and English law will be highlighted.

Limitation

The eurocurrency loan is a huge transaction and the loan agreement comprises a vast number of different clauses. It would be impossible, in a thesis such as this, to analyse all of the contract terms. Therefore, I will only discuss some of the most common and important terms, namely those that impose restrictions on the borrower. Further, even though interesting, I will not examine the special questions arising in loan transactions where the borrower is a state entity.

It should also be noted that, unless it is necessary, regard will not be taken to Swedish public law, such as banking laws. Public legislation does not follow general conflict rules and its applicability will not be affected by a choice of law in a contract. Swedish public law is therefore applicable to Swedish parties irrespective of whether English or Swedish law is the proper law of the contract, and therefore it will not be relevant in this thesis.

Method

This thesis is based on a variety of sources, such as different books, articles, preparatory works and case law from the UK, EC, Sweden and the US. The first part of the thesis, which deals with the governing law and the contract terms in a eurocurrency loan, is mainly based on English material. Especially the books by Wood and Tendon have been very helpful. The book by Dicey & Morris has also contributed a lot, especially to the presentation of the choice of law. The

second part of the thesis, dealing with whether Swedish law may be chosen as the proper law, is primarily based on preparatory works to the Swedish law of contracts. Books describing the Swedish law of contracts, primarily the ones by Adlercreutz, and books dealing with Swedish private international law, primarily by Bogdan, have also contributed a great deal.

The different articles have mainly been used to give the thesis its final shape, but they have also contributed largely when analysing the more complex issues. In addition, conversations with professors at the faculty of law in Lund and Stockholm, as well as lawyers dealing with international loan transactions, have been very helpful.

Outline

After the summary and preface, I will in chapter 4 give a brief introduction to the eurocurrency loan agreement. This introduction will include what a eurocurrency loan is, why it exists, how it is raised and who the parties are. In chapter 5, the question of governing law will be discussed. Why is the governing law important and what should the parties consider when choosing it? In chapter 6, some of the most common and important contract terms in a eurocurrency loan agreement will be presented and analysed. These contract terms are the main provisions imposing restrictions on the borrower. In chapter 7, the Swedish law's suitability in general, as governing law of a eurocurrency loan, will be examined. The considerations discussed in chapter 5 will be applied to a choice of Swedish law, and relevant parts of the Swedish law of contracts will be presented. In chapter 8, I will analyse whether the contract terms discussed in chapter 6 will be affected by a choice of Swedish law. Chapter 9, finally, will include general conclusions.

Introduction

An international financial transaction is a transaction that has contacts with more than one legal jurisdiction.[1] The legal problems arising out of such a transaction are very complicated, e.g. because it concerns parties of several nationalities with differing interests and objectives. At the same time it is also affected by multiple legal systems. To solve arisen problems, it is therefore necessary to study how the differences between legal systems are resolved.

Eurocurrency is not a special kind of currency, but is financial vernacular for money deposited with, and payable at, a branch of a bank outside the country where that money is legal tender, i.e. another country than the country of the currency.[2] Thus, a eurodollar is a US dollar deposit payable by a bank outside the United States. That bank's location does not have to be in a European country, as the term "euro" indicates, but can be in any country in the world.

International lending involves several sources of risk that differ from purely domestic lending. One is that the borrower resides in another country than the lender, and events may occur in that country, which could prevent the borrower from fulfilling his obligations under the agreement. For example, the borrower's country may impose exchange controls to overcome a sudden emergency in its balance of payments, which in turn will lead to the borrower being unable to make his repayments. In an international loan, the lender will therefore also take a country risk, which is associated with the conditions in the borrower's country.[3]

The funds in a eurocurrency loan may be raised by an issue of securities, such as a bond issue, or under a term loan agreement. The largest proportion of eurocurrency loans are constituted by term loan agreements entered into directly between the borrower and the lender.[4] The advantage of the term loan agreement, as opposed to e.g. a bond issue, is flexibility. The term loan can provide drawdown in tranches, as and when the funds are required; it may be revolving, i.e. the borrower can borrow, repay and re-borrow during the commitment period up to a stated maximum amount; the loan may be made available on a standby basis; and currency conversions are possible. These are advantages that are normally not met by a bond issue.[5]

Most of the loans in the eurocurrency market are too large for a single bank to be able, willing or permitted to provide the required funds. Therefore, these loans are raised by a syndicate of banks, who lend separate portions of the loan under the terms of a single agreement between the lenders and the borrower. This syndicated loan agreement is organised and administered by an agent

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[1] Wood 1995, p.3.

[2] Venkatachari, K., *The Eurocurrency Loan: Role and Content of the Contracts*, in Kalderén & Siddiqui (eds), Sovereign Borrowers, London 1984, p. 74.

[3] Walter, I., *Country Risk and International Bank Lending*, in Bradlow, D. D. (ed), International Borrowing, 2nd ed., Washington 1986, p. 277.

[4] Venkatachari, p. 74; See also Wood 1980, p. 233.

[5] Wood 1980, p. 233.

bank, which acts as a conduit pipe for payments and carries out various administrative duties.[6] The objective is that the borrower will only have to deal with one bank and not the entire syndicate. This makes it much more convenient, cheaper and faster than if the borrower would have to enter into several loan agreements to obtain the required funds. In the recent decades, the syndicated eurocurrency loan has become one of the most important and common ways to raise large amounts of funds in the international financial market.[7]

The eurocurrency loan may be secured, but the usual practice in the eurocurrency market, as opposed to domestic lending, is to lend without security. Normally, the lenders rely on a negative pledge clause instead.[8]

The borrowers in eurocurrency loans are state entities, governments, international organisations, provinces, municipalities, large industrial corporations and single-purpose project companies.[9] The eurocurrency loans are thus not concerned with consumer credit or small business finance.

The borrower's purpose of the eurocurrency loan may be to improve its finances generally, or maybe to finance a particular project. The latter case is usually referred to as "project finance", if the funds generated by that particular project are to be used as repayment of the loan. The borrowers most often require medium or long-term loans, i.e. three to fifteen years, to finance their investments.[10] To finance the loan, the lending bank enters the inter-bank deposit market (in London called "the London eurocurrency market") and obtains short-term funds to extend the loan to the borrower. These short-term funds are usually for a one, three, six, nine or twelve months period.[11] Since the loan to the borrower is for a longer period, while the bank has financed it by loans on a shorter term, the lending bank will have to renew its loan from the inter-bank market at the end of the short-term period. This is why the eurocurrency loans are most often based on a floating interest rate; the borrower is required to make interest payments at the same time as the lender is to repay and renew the short-term funds, and, moreover, the interest rate that the borrower pays to the lending bank changes periodically, when the rate at which the bank borrows changes. The majority of the eurocurrency loans are priced over the London Interbank Offered Rate for deposits, the LIBOR.[12]

Despite the variety of eurocurrency loans, such as bond issues, project finance and the term loan agreement, which may be syndicated, there are certain basic features common to them all. The contract terms presented in chapter 6 are some of the common features occurring in an unsecured

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[6] Venkatachari, pp. 74-75.

[7] Terrell, H. S.; Martinson, M. G., *Arranging and Marketing Syndicated Eurocurrency Loans*, in Bradlow, D. D. (ed), International Borrowing, 2nd ed., Washington 1986, p. 185.

[8] See section 6.4.3.

[9] Wood 1995, p. 3.

[10] Wood 1995, p. 4.

[11] Gabriel, Peter, *Legal Aspects of Syndicated Loans*, London 1986, p. 2.

[12] Gabriel, p. 2; See also Moffett, T., *The Mechanics of Eurodollar Transactions*, in Bradlow, D. D. (ed), International Borrowing, 2nd ed., Washington 1986, p. 286.

eurocurrency loan. However, that presentation cannot be made before the importance of the governing law is presented.

Governing law

Generally

International financial transactions are associated with some very complex legal issues. Much of them are the result of the fact that an international loan agreement necessarily involves the potential applicability of many systems of law.[13] In a syndicated loan, for example, there may be parties from several different countries. The borrower is often from one country, while the lenders may be banks or other credit institutes from all over the world. The laws of each of these countries, as well as e.g. the laws in the place where the contract was entered into and in the country of the currency, will impinge in one way or the other upon the contract.[14]

The potential applicability of a number of different legal systems introduces a significant element of uncertainty, e.g. as to the intrinsic validity, enforceability and interpretation of the legal documents involved, and moreover, to the rights and liabilities of the contract parties.[15] To find the solutions to such questions, one will have to identify which country's laws that will govern the various legal aspects of the transaction. This is done by turning to private international law, or conflict of laws.[16] It is in this context important to distinct between two basic stages in the legal process, after the legal issue is determined. Firstly, one will have to determine which legal system that governs the issue in question, which is the field of private international law. Secondly, one will have to discover the contents of the law so ascertained, which is the field of the domestic legal system concerned.[17]

To minimise the uncertainty, as regards applicable law of a transaction, an attempt is made in practice to apply one system of law to the transaction and, as far as possible, to exclude the applicability of other systems of law with which the transaction is connected. This is usually done by inserting a "choice of law" clause in the contract, which states that the contract shall be governed by a certain system of law - the proper law (*lex contractus*). The main purpose of this is to achieve certainty and predictability. If the parties omit to specify a system of law that shall govern the contract, the proper law will be the law that is deemed to apply on the basis of local conflict rules.[18] This will obviously lead to uncertainty and sometimes even disputes between the parties as to what legal system applies to the contract, something which is not desirable.

[13] Wood 1980, p. 1.
[14] Wood 1980, p. 28.
[15] Tennekoon, Ravi C., *The Law and Regulation of International Finance*, London 1991, p. 15.
[16] Bogdan 1992, p. 22.
[17] Wood 1980, p. 1.
[18] Wood 1980, p. 2.

Express choice of law

Generally

If the parties make an express choice of law, the principal legal systems they will choose between are:[19]

a) the law of the borrower's country,
b) the law of the lender's country,
c) the law of the market (such as the London Eurocurrency Market), or
d) a neutral system of law.

Since it is the lender who is in need of protection once he has parted from the money, he is often most anxious about the choice of law. Therefore it is usually the lender's will that prevails, should there be a conflict regarding the choice of law.

Factors influencing the choice of law

1. *Party autonomy*
Party autonomy, or the parties ability to choose freely the system of law that will govern their agreement, is recognised in most developed countries. The limitations that the law places upon this freedom may vary, though.[20] The merits of the party autonomy are that the rule confers a degree of certainty on an essential part of the contract and does not leave the parties in suspense until a decision of the courts. If a particular choice of law would be struck down, then the objectives of the choice of law will have failed and the parties may be bound to terms different from those originally intended.[21] It is therefore fundamental to begin with, when choosing the proper law, to ascertain that the desired legal system will permit the parties to choose that system of law to govern their contract. For instance, some legal systems will not permit that they are chosen, unless they have some kind of connection to the contract, e.g. that the transaction was entered into within its territory, or that one of the parties is a national or a resident of the country of the chosen legal system.[22]

Even before the Rome Convention[23] was given effect to in England, the English common law would give effect to an express choice of law that pointed out English law. This was the case even if the contract in question had little or no connection to England.[24] The only limitation in the party autonomy seemed to be public policy. In England today, the Contracts (Applicable Law)

[19] Wood 1995, p. 61.
[20] Wood 1980, p. 7.
[21] Wood 1980, p. 8.
[22] Tennekoon, p. 17.
[23] The EEC Convention on the Law Applicable to Contractual Obligations [80/934/EEC), ("the Rome Convention").
[24] *Vita Food Products Inc v Unus Shipping Co Ltd* [1939] AC 277, PC.

Act 1990 gives effect to the Rome Convention, a convention that should be applicable in all EU states.[25]

The Rome Convention is applicable to "contractual obligations in any situation involving a choice between the laws of different countries".[26] The Convention preserves the freedom to choose a system of law to govern a contract.[27] The choice must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. The parties may, by their choice, select the governing law to the whole or a part only of the contract (*dépeçage*), which means that the parties are free to choose different systems of law, to different parts of the contract. All in all, the Rome Convention permits a choice of law that involves the application of:[28]

> a) a law which has the closest connection with the contract,
> b) a law which does not have the closest connection, but which has some apparent connection with the transaction (such as the place of performance or the residence or nationality of one of the parties),
> c) a law which has no apparent connection to the contract, but which has some underlying connection, such as insurance, or connection with string contracts,
> d) a law which has no apparent or actual connection with the transaction, but which is chosen as a neutral law in an international contract (such as the choice of English law in a contract between a United States company and a Swedish company),
> e) a law which has no apparent or actual connection with a transaction, all of whose elements are connected with one other country (which is inevitably a rare occurrence).

By the above it is shown that there is no requirement in the Rome Convention that the chosen law must have some kind of connection with the transaction. The parties are free to choose which legal system they want.

2. *Insulation*

The proper law applying to the contract is the law as it exists from time to time.[29] The lender thus desires, as far as possible, to insulate the law applying to the contract from political interference by legal changes effected in the borrower's country. To achieve this insulation, the proper law must be an external system of law, i.e. another system of law than the law in the borrower's

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[25] All EU members have not ratified it yet.

[26] Article 1(1). It should be noted that *inter alia* bonds and other negotiable instruments are excluded from the Convention (Article 1(2)(c)). Moreover, if there are other rules as regards the choice of law, which are imposed by the European Community or by other international conventions, the Rome Convention will not be applicable, e.g. the EC Convention on insolvency procedures, (Articles 20-21 of the Rome Convention)).

[27] Article 3.

[28] Dicey & Morris, *The Conflict of Laws*, 12th ed., London 1993, p. 1214.

[29] *Re Helbert Wagg & Co Ltd* [1956] Ch 323. This is a general legal principle.

country.[30] To satisfy the borrower, the external system of law should be that of a jurisdiction in which the borrower has a reasonable degree of confidence.[31]

Historically, the most common changes protecting the national debtors have been moratorium legislation on foreign obligations, reduction of the interest rate by legislation, requirements that repayments must be made in local currency only to a local custodian, and exchange controls.[32] The effect of the insulation is that the lender can, by choosing an external law, have complete certainty in knowing that the borrower's country cannot unilaterally alter the obligations by changing the local law.

However, there are some limitations to the insulation. E.g., if an action is brought locally (perhaps because all the assets of the borrower are situated there), the local courts may disregard the external proper law to the extent that it conflicts with local overriding law, which may include the very laws intended to be avoided; in certain circumstances, a subsequent exchange control in the borrower's country may, if that country is an IMF member, achieve recognition in a few IMF states under Art VIII 2(b) of the Bretton Woods Agreement; and local insolvency proceedings are most often governed by local insolvency law.[33]

3. *Certainty and result predictability*

It is very valuable for the parties if they are able to predict the legal consequences of the particular clauses used in the contract.[34] The parties may then agree in the contract to clauses dealing with virtually every foreseeable eventuality there may be. If the parties do not have this ability to predict the outcome, the legal consequences of any subsequent occurrence will be uncertain and, thus, the risk of disputes will be higher. Ultimately, these disputes will be settled in court, which naturally is something the parties wish to avoid.

In a eurocurrency loan it is very desirable and valuable for the lender to be able to specify with certainty the circumstances that will give him an unqualified and immediate right to terminate the agreement and demand repayment of the outstanding debt (acceleration). The question is, if it is possible to specify such a right in a loan agreement, in a manner that would not be capable of interference and qualification by a court.[35] Under many systems of law,[36] courts have a power to interfere with such a right on the basis that the breach was not serious or because of the absence of proven loss, or on the grounds of reasonableness or fairness. Moreover, in some legal systems, a contract can only be set aside by a court judgement, even in the event of a contract breach. Under English law, on the other hand, it is possible to state which terms of the contract that are

[30] Wood 1995, p. 62.
[31] Wood, Philip R. *Selected Aspects of International Loan Documentation and Rescheduling*, in Kalderén & Siddiqui (eds), Sovereign Borrowers, London 1984, p. 126.
[32] Wood 1995, p. 62.
[33] Wood 1995, pp. 63-64; and Tennekoon, p. 34-38.
[34] Tennekoon, p. 20.
[35] Tennekoon, p. 21.
[36] E.g. art 1184 of the French Civil Code and art 1455 of the Italian Civil Code.

essential "conditions" of the contract and that a breach of them will confer a right to the lender to accelerate the loan. The English courts will not make tests of materiality, fairness, or whether the lender has suffered any loss because of the breach.[37]

It is also important that the court's ability to imply additional clauses, to those the parties have expressly included in the contract, is extremely limited and in those cases at least predictable. It is impossible to achieve certainty and predictability at the time of contracting, if the judges under a legal system are given a wide freedom to imply additional terms into a written contract, or even rewrite some parts of it, in accordance with the judge's perception of the parties' intention.[38]

According to Zweigert and Kötz,[39] the extent of this freedom depends on the approach of legal systems to the construction of contracts. They submit that there are two different approaches as to the construction of contracts. The first approach searches for the subjective intention of the parties, when interpreting the contract. This means, that the court may disregard the actual written words of a contract and instead give effect to the parties' perceived intention. This approach is exemplified by codes based on the French Civil Code.[40] The second approach emphasises that a contract must be interpreted strictly and literally in accordance with the external expressions of the parties. This approach is called the "expressionist" approach. The judge is primarily concerned with the objective meaning of the words in the contract, while the intention of the parties is only relevant in so far as it is reflected in the objective meaning of the words used. This expressionist approach is used in the English common law and systems based on it, such as New York and Australian law.[41] The approach can be seen in contracts governed by those legal systems, where the parties express their rights and obligations in clearly drafted clauses - writing a contract the Anglo-Saxon way. What is not claimed, is disclaimed.

The English courts will not read into a commercial contract additional clauses which would make the contract "fair" or "reasonable", nor will they improve the contract that the parties have made for themselves, however desirable the improvement might be.[42] As the House of Lords held in *Liverpool City Council v Irwin*[43], the English courts will not imply any term into the contract unless it is apparent that the contract would lack business efficacy without the implication of such a term.

As is quite understandable, the international financial community has preferred to use a system of law that is based on the more pragmatic and commercial expressionist approach, instead of a system based on the French Civil Code. The latter system may deprive a carefully drafted and

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[37] *Bunge Corpn v Tradax SA* [1981] 1 WLR 711, HL; and in *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827, HL.
[38] Tennekoon, p. 22.
[39] *Introduction to Comparative Law*, vol II, ch 7. See Tennekoon, p. 22.
[40] Tennekoon, p. 22.
[41] Tennekoon, p. 22.
[42] *Trollope & Colls Ltd v North West Metropolitan Regional Hospital Board* [1973] 1 WLR 601, HL.
[43] [1977] AC 239.

detailed contract from its commercial integrity, and expose it to the judge's perception of the parties' intention.[44]

4. *Conceptual sophistication of the legal system*
The system of law chosen must be capable of accommodating sophisticated and complex concepts, transactions, and structures within the framework of its legal terminology and legal rules.[45] English law has, since London has for a long time been the capital of the world's financial markets, a long tradition of dealing with international transactions.

5. *Language*
The language in which the international financial markets operate, and the language in which financing techniques are developed, are also factors influencing the choice of legal system. Since English in practice is the language of the international financial markets, English or New York law is often preferred.

6. *The forum of potential litigation*
The courts that are likely to be chosen by the parties to settle any disputes arising from the contract, are important factors when choosing legal system. It is very important and convenient that these courts are the courts of the country whose legal system is chosen to govern the contract. As is quite obvious, it is more likely that an English court will come to the right decision according to English law, than if a court without any knowledge of English law tries to settle the dispute. The parties might otherwise loose the desired certainty and predictability. Consequently, factors affecting the choice of the forum that will have jurisdiction over the contract, will also affect the question of choice of law.[46]

The choice of forum depends very much on the perception by the parties as to the sophistication and impartiality of the courts in the potential country and, moreover, on the prudent political stability in that country. States that are politically revolutionary are likely to be legally revolutionary as well.[47] In addition, the choice of forum is also influenced by:[48]

a) the existence of speedy and effective judicial remedies in the event of a breach of the contract;
b) whether or not there is a special court that is staffed by judges who are experienced in deciding and who regularly decide not merely ordinary commercial disputes, but also financial and business disputes with an international dimension;
c) the extent to which the judgements of that court will be recognised and enforced by the courts of other countries, especially in countries where the borrower's assets are located.

[44] Tennekoon, p. 23.
[45] Tennekoon, p. 23.
[46] Tennekoon, p. 23.
[47] Tennekoon, p. 24; and Wood 1980, p. 4.
[48] Wood 1980, p. 4; and Tennekoon, p. 24.

In practice these criteria have led to a choice of the High Court of England (which comprises within it the English Commercial Court) as a favoured forum in international financial contracts. The only other competing forum has generally been the Southern District Court of New York (especially the Second Circuit).[49]

7. *Familiarity, patriotism and convenience*
Both lenders and borrowers generally prefer that the contract is subject to a system of law with which they are familiar and therefore feel safe with, or a system of law that habitually has been applied to financial transactions. A massive and costly investigation of the pertinent legal system will also be saved. In addition, patriotism and convenience may influence the parties, when choosing the proper law.[50]

No choice of law

Even though the parties to an international loan agreement usually make an express selection of governing law in the agreement, there are sometimes occasions when no express choice is made. This could be because the loan is informally documented by an exchange of letters without legal clauses (not very common) or, more commonly, the omission is deliberate. This is particularly so in the case of loans to governmental borrowers, who are not prepared to compromise their sovereignty by submission to a foreign law. The lender, on the other hand, is often not willing to accept the application of the law of the borrower's country. Such an impasse is sometimes compromised simply by omitting any express choice of law.[51]

If no express choice of governing law is made, or if there is no choice to be inferred from the circumstances, the Rome Convention ascertains which legal system that applies. Article 4 states that, in these cases, a contract is to be governed by the law of the country with which it is most closely connected. That country is presumed to be the place of residence, or place of business, of the person who is to effect the performance which is characteristic of the contract.[52] However, the presumption does not apply if the characteristic performance cannot be determined, and, moreover, it will be disregarded if it appears from the circumstances as a whole that the contract is more closely connected to another country.[53] It should be noted that the Convention is of universal application. This means that the conflict rules that it lays down may result in application of the law of a state that is not a party to the Convention.[54]

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[49] Tennekoon, p. 24. It should be noted that the Rome Convention is not applicable to an agreement of the choice of forum (Art. 1(2)(d)).
[50] Wood 1980, p. 4; and Tennekoon, p. 24.
[51] Wood 1980, p. 10.
[52] Article 4(2).
[53] Article 4(5).
[54] Article 2; See also Dicey & Morris, p. 1199.

Conclusion

On the basis of the above considerations as regards what to consider when choosing the proper law, and considering that London is the capital of the world's financial markets, the law usually chosen in practice to govern contracts in the international financial markets, is English law.[55] Since English law recognises the principle of freedom of contract, the parties are thereby able to agree upon, almost without limitation, exactly how their transactions should be settled, without interference by a court.

In the event that the parties omit to choose the governing law, the law of the country with the closest connection to the contract will govern it. According to the presumption in Article 4(2) of the Rome Convention, the law of the country where the party who is to effect the performance which is characteristic of the contract has its residence or business, shall apply. In a loan transaction, the question is if that party is the borrower or the lender. In a normal loan transaction, maybe the law of the bank's country would be regarded as the proper law. However, in a syndicated loan this would be impossible, and therefore, the presumption in Article 4(2) would be breached by Article 4(5). England might then be regarded as the country most closely connected to the contract (Art. 4(1)), since London often is the place where the contract was entered into, the place of payment etc.

I will in the next sections examine the scope of the proper law. This examination will be made on the basis of English conflict rules, since the practice in the eurocurrency market normally is to choose English law as proper law.[56]

What does the proper law of the contract govern?

The proper law of the contract does by no means cover all aspects of the contract. It was well established at common law before the Rome Convention that the proper law of the contract determined its material or essential validity, its interpretation and effect, and its discharge.[57] There was also a rule that a contract was, in general, invalid in so far as its performance was illegal according to the law of the country in which the performance was to take place. The formation of a contract was governed by the law which would have been the governing law, had the contract been validly concluded. A contract was formally valid if it was valid either according to the law of the place where it was made or to the governing law.[58]

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[55] Tennekoon, p. 24. Sometimes the law of New York is chosen instead, which also is a good choice.

[56] It must be emphasised that it is important to separate the question of the proper law from the question of jurisdiction of the courts which will hear a dispute on the contract. If English courts have jurisdiction, they will enforce a contract governed by any system of law and, where the contents of that law is an issue, they will ascertain the foreign rules as a matter of fact on the basis of evidence from local experts. A Swedish court will act in the same way. Even though a related issue, I will not consider the question of jurisdiction further in this thesis.

[57] Dicey & Morris, p. 1190.

[58] Dicey & Morris, p. 1190.

The Rome Convention did not make any radical changes in this context. It provides that the proper law primarily governs:[59]

> a) the existence and validity of the contract, e.g. whether requirements such as offer and acceptance are satisfied;
> b) the formal validity of the contract, in the sense that it has complied with all necessary formalities. (Alternatively, a contract concluded between parties in the same country, is formally valid if it satisfies the formal requirements of the law of the country where it is concluded; or, if the contract is concluded between parties in different countries, the contract is formally valid if it satisfies the formal requirements of the law in one of those countries);
> c) interpretation of the contract;
> d) substance of performance, but not always the mode of performance;
> e) the consequences of breaches, including the assessment of damages in so far as it is governed by rules of law, within the limits of the powers conferred on the court by its procedural law;
> f) the extinguishing of obligations, including prescription and limitation;
> g) the consequences of nullity of the contract. The principal object of this rule is to deal with the restitution of benefits in the event of a finding that a contract is void under the proper law. The United Kingdom has reserved itself from this rule.[60]

It must be observed that the enumeration is not complete. Practically every issue, regarding the parties' reciprocal obligations, is governed by the proper law.

Limitations on the choice of law

Even though the Rome Convention will not invalidate a choice of law, it contains a number of provisions that may limit the effect of a choice of law. Except for limitations as regards consumer and employment contracts, which are of no relevance in this thesis, there are some limitations in the Convention as regards mandatory rules. Article 3(3) provides that the fact that the parties to a contract has chosen a foreign law, does not prevent application of mandatory rules of a country with which all other elements (other than the choice of law and jurisdiction) relevant to the situation, at the time of the choice, are connected.

A second limitation is stated in Article 7(2). This article provides that nothing in the Convention is to restrict the application of the rules of the law of the forum, in a situation where they are

[59] Articles 3(4), 8-10; See also Dicey & Morris, pp. 1255-1268.

[60] Article 10(1)(e) may be the subject of a reservation under Article 22(1), and the UK has availed itself of this possibility in section 2(2) of the 1990 Act.

mandatory irrespective of the law otherwise applicable to the contract (so called "overriding statutes").[61]

In Article 7(1) there is a third limitation to the choice of law. According to this article, mandatory rules of a country whose law is neither *lex fori* nor the proper law, *may* be given effect to, if the situation has a close connection to that country, if, and in so far as under the law of that country, those rules must be applied whatever law is applicable to the contract. However, this controversial provision does not have the force of law in the UK.[62]

Moreover, a choice of foreign law will not prevent the courts from disregarding a rule in the foreign law, if the application of the rule would be manifestly incompatible with the public policy of *lex fori*.[63]

In this context Wood claims[64] that an English court would not uphold an express choice of law, if the choice is made with a view to evading a mandatory rule of law that would have applied to the contract if an objectively connected proper law had been chosen. This "evasive rule" derives from the pre-Convention English common law.[65] According to Wood it is probably covered by the overriding mandatory law and public policy rules in Arts 3(3), 7(2) and 16 of the Convention.

In addition to the mentioned limitations, there are in practice other important matters that are not subject to the control of the proper law of an agreement. Including those expressly mentioned in the Rome Convention (discussed above), the main issues in the context of international financial transactions not covered by the proper law, may be summarised as follows:[66]

a) mandatory statutes and public policy (*lex fori*);
b) corporate constitution, powers, and authorities (*lex corporationis*);
c) aspects of security (complex rules). It is necessary to decide whether the borrower has created a "security interest" etc. to determine whether he has complied with his obligations under the negative pledge clause. This question, and which law that determines it, is discussed below;[67]
d) corporate insolvency (complex rules);
e) procedure (*lex fori*);[68]
f) overriding international conventions (*lex fori*).

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[61] Dicey & Morris, p. 1240.
[62] Section 2(2) of the Contracts (Applicable Law) Act 1990, under which the UK excluded the applicability of article 7(1). This was probably because the UK wanted the legal outcome of a contract to remain predictable under its law.
[63] Article 16. "Public policy is the bastion of all laws - it is ever changing according to the needs of society from time to time", Gabriel, p. 8.
[64] Wood 1995, p. 66.
[65] *Vita Food Products Inc v Unus Shipping Co Ltd* [1939] AC 277.
[66] Wood 1995, p. 70; See also Articles 1, 3, 7, 16, 21 in the Rome Convention.
[67] See section 6.4.3.3.
[68] See however Article 14 in the Rome Convention as regards law of evidence.

Since the law applicable to these matters will not be affected by the choice of proper law, I will not analyse them further in this thesis.

In conclusion, it is possible for the parties to decrease the uncertainty as to what law the transaction will be governed by, by making an express choice of law. Even if the parties have chosen a legal system that will govern their contract, there are still some matters that will be governed by other legal systems. It is therefore important for the parties to investigate which these potential legal systems are and how they might influence the transaction, instead of relaxing and being satisfied with the knowledge of the contents of the proper law. By doing this, the parties might avoid unpleasant surprises.

The contract terms

Generally

The structure of a eurocurrency loan is based upon a very simple agreement between the parties. In this basic agreement the lender promises to advance a certain amount of funds over a specified period, while the borrower promises to pay back the loan with interest. In a perfect world where nothing goes wrong such a contract would have been sufficient. However, in the real world things can go wrong and the legal difficulties and problems which may then arise are many and complex. Therefore a lot of other provisions are usually included in the loan agreement, in order to protect the parties' interests.[69] The majority of the clauses are inserted to ensure that the lender's interests are fully protected.

The contract can seem to be one-way, in which the lender is entitled to a lot of advantages. It is important to remember, however, that the lender parts from the money at the start, and then he is left with a piece of paper, while the borrower has got the funds. The contract must remain a good valid claim for the money over many years, but it is only a claim. It is nowhere near as strong as the possession of the money that it represents, and therefore it must be "lender friendly".[70] In this respect it is important for the lender not to become to anxious to cover all possible situations that may arise. Such provisions may become self-defeating and backfire on the lender, because they may not be enforceable or they may tie the hands of the borrower so it cannot function properly. Then the borrower might not earn enough money to repay the loan.[71]

The loan documentation shall make it clear how the different provisions of the contract shall be fulfilled, performed and enforced. Moreover, it should, as far as possible, "*anticipate and assess the various legal difficulties and problems that may arise and provide suitably for meeting or surmounting the difficulties and for finding solutions to, or steering clear of, the problems*".[72] It is also necessary to draft the contract terms so as to minimise the potential impact of economical and political changes and upheavals.

The eurocurrency loan is very flexible and can be advanced in many shapes and sizes. Naturally the legal documentation vary from one contract to another, but there are some provisions which are inevitably included in practically every eurocurrency loan agreement. Some of those will be dealt with in this chapter. It should be noted, however, that the law and practices in the financial market are constantly changing and therefore the clauses described below should only be regarded as illustrative.

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[69] Penn et al, p. 94.
[70] Wood, Philip R., *Selected Aspects of International Loan Documentation and Rescheduling*, in Kalderén & Siddiqui (eds), Sovereign Borrowers, London 1984, p. 139.
[71] Venkatachari, p. 78.
[72] Venkatachari, p. 77.

Conditions precedent

The loan contract between the lender and the borrower is normally entered into long before the (first) disbursement of funds. If the circumstances upon which the lender has based his decision to lend are not met, or if they have changed since the signing of the contract, the lender may not wish to disburse the funds. However, he is legally obliged thereto, since if he does not, he will breach a legally binding contract and the borrower may claim damages.[73]

In order to avoid his obligation to lend, until all matters upon which the loan is based are fulfilled, the lender will see to that certain provisions are inserted into the contract. These provisions, called conditions precedent, prescribe that the lender is not obligated to lend unless certain conditions are satisfied.[74]

The conditions precedent can generally be divided into two classes.[75] Firstly, there are conditions which must be satisfied before the lender's obligation to lend arises at all, i.e. before the first disbursement. Secondly, since in most term loans the disbursements are divided into several instalments, there are conditions to be satisfied prior to each disbursement. These conditions precedent thus serve to certify that certain circumstances are fulfilled, not only at the time of agreement, but also at every subsequent disbursement of funds.

The first type of conditions precedent seeks to ensure that the loan agreement is a valid and enforceable legal agreement and that the borrower has the power and all necessary authorisations to enter into the agreement.[76] Of course the contents of the provision will vary according to the circumstances in the specific case, but usually it will provide that the bank is not obliged to lend until it has received e.g.:[77] constitutional documents of the borrower and its authorisations, such as by-laws, memorandum and signature lists of persons authorised to execute the agreement; copies of all necessary governmental and exchange control consents, where necessary; and legal opinions as to the validity of the documentation and other matters, such as enforceability. These legal opinions are very important and should be made by lawyers from both the country of the proper law, as well as the borrower's country,[78] since both systems of law may affect the contract.[79]

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[73] Wood 1995, p. 18; see discussion below as regards the lenders' obligation to lend.
[74] Wood 1995, p. 16.
[75] Gabriel, p. 43; and Wood 1980, p. 235.
[76] Tennekoon, p. 68.
[77] Wood 1980, p. 235; Wood 1995, p. 16; and Tennekoon, p. 68.
[78] I.e. the place of incorporation of the borrowing entity.
[79] See chapter 5 above.

The second type of conditions precedent usually provides: that the representations and warranties[80] have to remain true on up-dated basis; that no event of default[81] (or event which with giving of notice, lapse of time or other conditions would constitute an event of default) has occurred; and sometimes that no material adverse change in the borrower's financial condition has occurred.[82] If these conditions precedent are not fulfilled prior to each disbursement, the lender's obligation to lend will be suspended. This mechanism will reduce the risk of throwing good money after bad.[83]

The question has been raised whether the lender may withdraw from his obligation to lend prior to the satisfaction of the conditions precedent.[84] The answer to this question seems to depend on the wording of the clauses in the agreement. There can be two kinds of conditions precedent.[85] Firstly, they can be terms forming conditional obligations in a legally binding contract, and thus the lender may not walk away from his obligation to lend. He may only suspend it. Secondly, there can be conditions precedent that have to be satisfied before the contract is concluded. In this latter case there is no obligation to lend (or any other obligation either), since there is no contract until the conditions precedent are fulfilled.

Thus, if the lender really does not want to be obligated to lend before the conditions precedent are fulfilled, he must see to that the conditions precedent clause is drafted accurately. It is in this respect important that the clause clearly states that there is no binding contract until the requirements in the clause are satisfied. In practice, however, it seems like the most common type of conditions precedent are those which are part of a binding contract, where the lender can only suspend his obligation to lend, should the conditions precedent not be fulfilled.[86] It should be noted that, if the lender is not committed to lend, the possibility that he will be entitled to, or that the borrower will agree to pay, a commitment fee, is not very likely.[87]

What, then, can a lender do if an event occurs where the whole agreement becomes a bad risk before the conditions precedent are due for satisfaction by the borrower, but without being in breach of any provisions giving the lender a right to terminate the agreement?[88] If the contract does not provide that the lender is entitled to withdraw from the agreement in such a situation, he is not able to do so without breaching the contract and thus being liable for damages. There is a possible way out for the lender at law. He can try to rely on the principle of *Bentworth Finance*

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[80] See section 6.3.

[81] I.e. an event that entitles the lender to accelerate the loan.

[82] Wood 1980, p. 235; Wood 1995, p. 17; Tennekoon, pp. 68-69; and Gabriel, p. 49.

[83] Wood 1995, p. 17.

[84] Tennekoon, p. 69; and Gabriel pp. 43-44.

[85] Gabriel, p. 44.

[86] See Wood 1995, p. 18; Gabriel p. 45; and Tennekoon, p. 70.

[87] There is usually a "commitment fee clause" in the contract, entitling the lender to a commitment fee just for making the funds available.

[88] Gabriel, p. 44.

Ltd v Lubert.[89] According to this case, a party may be entitled to withdraw from its commitments if he can show that it is "common understanding of people" to do so in such a business, if an event such as the one in question has occurred. To show this might not be an easy task, but it will naturally depend on the circumstances in each case.

Otherwise there is not much the lender can do without breaching the contract. However, in some cases it may be better for the lender to breach the contract and be liable for damages (which will be limited), than to disburse a large amount of funds to a borrower which probably will not be able to pay it back. It should be noted that under English law the borrower cannot obtain specific performance if the lender fails to lend - he cannot be forced to lend.[90] The sole remedy for the borrower is thus damages. That claim for damages may only include reasonably foreseeable losses, normally extra interest and costs incurred by the borrower for arranging a new loan,[91] and specially contemplated losses, such as inevitably default by the borrower on a contract being financed by the loan, or loss of contract on that loan. The lender will only be liable for these costs, however, if he is expressly on notice that the loan is to be used for that contract and of the potential consequences.[92] The borrower, on the other hand, must mitigate his losses.

Representations and warranties

Generally

A very important rule in bank lending is to "know your borrower".[93] This rule is obviously not as easy to follow in international lending, especially syndicated lending, as it is in domestic lending, since there is not the same close relationship between the lender and the borrower. However, there are certain fundamental facts about the borrower of which the lender must always be assured. These facts are usually incorporated within the loan agreement by the representations and warranties clause. Thus, representations and warranties are statements made by the borrower on the basis of which the credit is made available.[94]

Technically, representations and warranties differ. A representation is a statement made prior to the execution of the loan agreement, which induces the lender to enter into the loan agreement, whereas a warranty is a term of the contract itself.[95] In practice this is of lesser interest, partly because the difference lies in the remedies available at law, while the absolute majority of loan

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[89] [1968] 1 QB 680, CA; see also Gabriel, pp. 45-46.
[90] *South African Territories v Wallington* [1898] AC 309. See also Wood 1995, p. 18. It should be noted that damages is awarded by common law, while specific performance is an equitable remedy.
[91] *Prehn v Royal Bank of Liverpool* [1870] LR5 Exch 92.
[92] *Manchester & Oldham Bank v Cook* (1883) 49 LT 674; and *Wallis Chlorine Syndicate Ltd v American Alkali Co Ltd* [1901] TLR 656.
[93] Penn et al, p. 104.
[94] Wood 1980, p. 240.
[95] Wood 1980, p. 240.

agreements confer own express remedies, and partly because the loan agreements usually do not separate the two. Instead they are normally drafted cumulatively. The clause may thus read: "The borrower represents and warrants as follows ...".[96] In this way all representations are terms of the agreement and thus, made to warranties.

The representations and warranties traditionally fall into two categories. The first category gives assurances as to the legal validity of the borrower's obligations under the agreement (legal warranties), and the second relates to the financial, contractual and commercial condition of the borrower (commercial warranties).[97]

Contents

Naturally, it depends on the circumstances in each case which representations and warranties that are included in the loan agreement. However, I will present and analyse those which are usually part of a eurocurrency loan agreement.

The clause usually commences with a number of statements concerning the valid existence and authorisation of the borrower. These legal warranties are virtually identical with the conditions precedent. They include warranties by the borrower that it has the legal status and capacity to enter into the loan agreement and that it has obtained all internal and external authorisations, including exchange control permission, so that the borrower is able to enter into a legally valid and binding loan agreement. Interlinked with these representations and warranties are others, where the borrower represents and warrants that all his obligations in the agreement are legal, valid and binding commitments and, moreover, that the performance of the obligations will not violate any provisions in the borrower's constitutional documents or any laws, regulations or other contracts to which the borrower is a party. It should be noted that the representations and warranties do not make the warranted issues true, e.g. the validity of the agreement. The importance, however, lies in the remedies connected to a breach of the clause, should it be untrue or inaccurate.

The second category of representations and warranties, the commercial warranties, usually require the borrower to represent and warrant the accuracy of all financial statements and information previously submitted by the borrower to the lender and that no material adverse changes have occurred since the date of last accounts. This would also include that the accounts have been prepared in accordance with good accounting practice. Moreover, the borrower will be required to represent and warrant that no litigation, actual or known to be threatened, is pending against it, which would have a material adverse effect on its financial condition or ability to perform its obligations under the contract. In addition, the borrower will have to represent and warrant that it is not in default of any other of its financial agreements.[98]

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[96] Gabriel, p. 50; and Penn et al, p. 107.
[97] Penn et al, p. 104; Wood 1980, p. 240; and Wood 1995, p. 28.
[98] Tennekoon, p. 72; Penn et al, p. 104; Wood 1980, pp. 242-243; and Wood 1995, p. 29.

Objectives

Considering that the representations and warranties set out the contractual basis on which the lender makes the credit available, the reasons for having the provisions are:[99]

- to flush out potential problems in advance, since (at least responsible) borrowers will carefully investigate if they can warrant the contents of the clauses;
- they may operate as an estoppel against the borrower.[100] This is however of limited efficacy on both legal and practical grounds - a void contract is void and the damage is already done;
- it is normally an express event of default if any of the representations and warranties should be untrue, which enables the lender to terminate the agreement and demand immediate repayment of outstanding funds, and;
- as was shown above, the conditions precedent generally provide that the representations and warranties have to be satisfied on an updated basis before any funds are disbursed. The lender may thus suspend drawdowns if matters are not as warranted.

Scope

Depending on the drafting, the representations and warranties will be more or less extensive, and thus, more or less efficient. The provisions are sometimes expressed to remain true throughout the term of the agreement and not to be merely a snapshot at the date of when the agreement was signed. Such warranties, where the borrower takes the risk of future changes, are called "evergreen warranties".[101] The rationale of letting the borrower take the risk is that he has got the money, while the bank only has a piece of paper. Hence, the borrower should warrant that the piece of paper remains valid, even if it is beyond his control, which it may very well be if e.g. an exchange control is introduced.[102]

Representations and warranties are almost never, and should normally not be, qualified by statements to the effect that they are given to the best of the borrower's knowledge and belief. Since the provisions' purpose is to set out the premises on which the contract is based, and to confer remedies if those premises should be incorrect, the borrower's knowledge is irrelevant to the fact.[103]

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[99] Wood 1980, p. 240; Wood 1995, pp. 29-30; and Tennekoon, p. 71.
[100] *Balkis Consolidated Co v Tomkinson* [1893] A.C. 396.
[101] Wood 1995, p. 30.
[102] Wood 1995, p. 30.
[103] Wood 1980, p. 242.

Sometimes there is a requirement of materiality in the warranties. A common warranty in this context provides in outline that "there shall be no material adverse change in the borrower's financial condition". The difficulty with such a clause is trying to determine the meaning of the word material. In English law this would probably be determined by an objective test,[104] but it would still involve a great deal of uncertainty, which might in turn impair the efficiency of the remedies of the warranty. Thus, the lender should try to avoid such uncertainty whenever possible. Instead he may try to insert materiality tests, where a limit is specified above which an adverse change is deemed to be material or make the test subjective, e.g. "material in the opinion of the lender".[105]

Naturally the parties will take different views on all these points and they are all matters for negotiation in the circumstances of the case. It is important to note, however, that if there is a specific assumption upon which the lender is basing his decision to lend, he should see to that the assumption is covered by the representations and warranties clause.[106]

Remedies

As was stated above, normally a breach of the representations and warranties is made an event of default, enabling the lender to cancel his commitments and accelerate the outstanding funds. Even though this can be an effective remedy, there are some limitations to it:[107]

- If a legal defect contravening a warranty poisons the whole loan agreement, e.g. a breach of an exchange control regulation, then no acceleration can stem the venom.
- The lender may not be able to rely on the warranty if it confirms a matter of law, since he is presumed to know the law. This is not as bad as it seems, however, since foreign law will probably escape this limitation, and in any event, most legal warranties involve fact.
- If the lender with knowledge of a breach voluntarily advances the funds, his conduct may be regarded as a waiver.

In the event of a breach, the lender will also have a right to suspend his obligation to lend under the conditions precedent. In any event, one should not forget, as Wood points out,[108] that a warranty will not validate a loan that is legally invalid, but the remedy of acceleration gives the lender bargaining power to readjust the documentation to meet the problem, if possible.

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[104] *Docker v Hyams* [1969] 1 Lloyd's Rep. 333; *affd.* [1969] 3 All E.R. 808, C.A.; See also Gabriel, p. 58-60; and Penn et al, p. 105.
[105] Penn et al, p. 105.
[106] Gruson, M., *Legal Aspects of International Lending: Basic Concepts of a Loan Agreement*, in Daniel D. Bradlow (ed), International Borrowing, 2nd ed., Washington 1986, p. 301.
[107] Wood 1980, p. 241.
[108] Wood 1995, p. 29.

In the rare and unlikely event that the parties have omitted to provide for the consequences upon the happening of a breach, the general law may provide for remedies, such as rescission and damages. There are, however, a lot of uncertainty and unpredictability involved here. The fact is that to ascertain which remedy that is available according to English law, one has to determine if the term of the contract is a "condition" or a "warranty". A condition is considered essential to the contract and a breach entitles the innocent party to terminate the contract and claim damages. A warranty, however, affects certain less important aspects of the contract and the innocent party is only entitled to sue for damages and not to terminate the contract.[109] With this in mind it is easy to see why the parties would want to remove the uncertainty as to if a term is a condition or not, and instead agree in advance to which remedies should be available.[110]

Covenants

Generally

While the representations and warranties are the basis upon which the lender makes the loan facility available, there are other provisions, called covenants, which constitute the requirements that the borrower must comply with in the future during the loan period. Generally, the covenants try to maintain the basis formed by the representations and warranties.[111] The primary objective of the covenants thus is to protect the lender against the borrower becoming insolvent or getting into financial difficulties. This is achieved by restricting the borrower's freedom of action, and by providing guidelines within which the borrower is expected to operate for the duration of the loan. Since the lender does not have a vote for management, like equity owners do, but nonetheless has an interest in the capital invested in the borrower, the covenants are the lender's way of controlling the borrower.[112]

The covenants will obviously be subject to detailed negotiations between the lender and the borrower, since they have such sharply contrasting interests. The borrower naturally would want to keep as much of his freedom of management as possible untouched by the "intruding lender", while the lender will endeavour to impose suitable restrictions in order to protect his investment. The final result will, as with most provisions in a contract, ultimately depend upon the relative

[109] Gabriel, p. 53.

[110] It should also be noted that the representations may provide grounds for an action in damages under common law for fraudulent or negligent misrepresentation, if an inaccuracy is such that the whole loan agreement, including any remedies, is null and void. In the same way, if there are no express warranties in the contract, the law relating to misrepresentation of fact inducing a contract will apply to loan contracts, and thus, if a misrepresentation is made which induces the lender to enter into the loan contract, the lender may have remedies of damages and rescission. Damages , however, will not generally add anything to the claim for the debt itself. See Tennekoon, p. 71; and Wood 1995, p. 31; see also the Misrepresentation Act 1967.

[111] Tennekoon, p. 71; and Gabriel, p. 73.

[112] Wood 1995, p. 31.

bargaining power of the parties, but also on the type of transaction in question and on the competition between different lenders on the market.[113]

Accordingly, the scope of the covenants may vary, but there are some covenants that are almost always included in eurocurrency loan agreements.[114] These covenants are especially influenced by two features of eurocurrency lending. Firstly, the term of a eurocurrency loan is normally for a long period, usually 3-15 years but could be up to forty years. Secondly, a eurocurrency loan[115] is usually made available without any security. Thus, the lender expects to be repaid from the cash flow generated by the borrower's and its subsidiaries' businesses, rather than from the liquidation of their assets. Hence, since the lender does not have any security, it is not very likely that he will get his money back, should the borrower become insolvent. The borrower's compliance with the covenants is therefore very crucial to the lender.[116] On the other hand, a breach of a covenant will invariable constitute an event of default, which entitles the lender to accelerate the loan and demand immediate repayment of outstanding funds. The borrower will in this way have a strong incentive to comply with the terms of the covenants.[117]

Objectives

As was stated above, the main objective of the covenants is to protect the lender's investment. This is done in several ways and the following are some of the functions of the covenants in an unsecured loan to a corporate commercial borrower:[118]

> a) To preserve the *identity* of the borrower, which may be achieved by prescribing merger restrictions, maintenance of corporate existence, payment of franchise taxes (necessary in some jurisdictions to qualify the corporation to do business) and the renewal of corporate charters in those jurisdictions where the corporation does not have eternal life.
> b) To preserve or test *asset quantity and solvency*, and in particular to control the incurring of excessive liabilities. These covenants include e.g. different financial ratios, restrictions on disposals, on distributions to shareholders, on contingent liabilities and on borrowings.
> c) To preserve or test *asset quality* so as to protect the earnings potential of the borrower and the break-up value of the assets. Such covenants would include obligations to repair and insure, restrictions on disposals, on the leasing of assets, on the making of investments, on loans to third parties and on capital expenditure, and various financial ratios.

[113] Penn et al, p. 108.
[114] See below.
[115] As opposed to domestic lending.
[116] Tennekoon, p. 82.
[117] Wood 1995, p. 33.
[118] Wood 1980, p. 145; See also Wood 1995, pp. 32-33; Tennekoon, pp. 82-84; and Gabriel, p. 73.

d) To test the *liquid assets* out of which the obligations can be serviced without resort to the sale of capital assets on which the earning power is based. These covenants would include restrictions on borrowings and on contingent liabilities, prescriptions on minimum working capital and other financial ratios.
e) To control an *excessively rapid growth* which cannot be sustained by financial resources or management availability. Here the covenants include restrictions on mergers and the making of investments, limits on borrowings and on capital expenditures, and a restriction on substantial changes of business.
f) To preserve the *type of business* being financed, since the credit analysis differs between different businesses (e.g. a car company and an ice-cream company). Covenants covering this subject might be restrictions on substantial changes in businesses and restrictions on substantial acquisitions of companies or business.
g) To preserve the *equal ranking* of the claim against the assets on the insolvency of the borrower and to prohibit subordination or discrimination. These covenants primarily include the negative pledge, the pari passu clause and a clause restricting disposals.
h) To enable the lender to *monitor* the condition of the borrower and the terms of the loan. These covenants include an obligation to provide financial information and accounts of the borrower together with certificates that it has complied with the loan agreement and that there are no events of default.

The negative pledge clause

Naturally the lender wants to make sure that he will get his money back from the borrower. The most efficient way of achieving this would be for him to demand good collateral for the loan. However, it is not always possible or practical to lend on a fully secured basis.[119] Among other things, this could be because of fierce competition among creditors, or it could even be regarded as an insult for some debtors, if security was demanded from them.[120] In fact, unsecured lending has become standard practice both in capital markets and in most forms of very-high-value banking loans.[121]

Therefore, to give the unsecured lender some degree of comfort, the negative pledge clause has evolved. Basically it is a promise by the borrower that no other lender will receive security or be put in a superior position than the lender of the contract, and moreover, any security previously given and still subsisting should be discharged. The negative pledge thus seeks to secure that there will be enough unsecured assets left for the lender's unsecured claim, in the event of the

[119] Hobbs, T., *The Negative Pledge: A Brief Guide*, (1993) 7 JIBL, p. 269.
[120] Asiedu-Akrofi, D., *Negative Pledge Clauses in International Loan Agreements*, Law & Policy of International Business, Vol 26, 1995, p. 409.
[121] Allan, D., *Negative Pledge Lending: Dead or Alive?*, in R. Cranston & R. Goode (eds), Commercial and Consumer Law, (1992), p. 223.

borrower becoming insolvent. Otherwise the creditors with security will be repaid, while the unsecured creditors would probably be left with nothing.[122]

Of course there is a vast variety as regards the wording of the negative pledge. However, most of them either prohibit the borrower from encumbering his assets through the creation of security interests or other encumbrances, or require borrowers who encumber their assets to secure the creditor's claim equally and rateably in order not to subordinate the creditor's claim to those of other creditors. The former variant is usually called the basic or purely negative pledge clause, while the latter goes under the name of the affirmative or extended negative pledge clause.[123]

Purpose

While the main objective of the covenants in general is to protect the unsecured lender, the special purposes of the negative pledge are:[124]

- To prevent subordination of the unsecured loan. If the borrower would give security to another creditor, it would destroy the credit analysis that was the basis for the decision to lend without security.
- To enhance equality between creditors of the same class. If the assets available to the creditors are not sufficient to satisfy all their debts, they will all lose out to the same percentage, instead of some secured lenders getting back all their funds while the unsecured will get nothing. This is a somewhat romantic function, though.
- To indirectly prevent the borrower from incurring excessive liabilities, since no creditor will lend to a (nearly) insolvent borrower without security. This is precisely the time when the earlier unsecured lenders wish to ensure that the assets are not secured to claims by third party creditors. There is a saying in international lending, that no borrower should be borrowing in the first place, if he can only raise money by granting security. The negative pledge could in this context be complemented with a financial covenant, which would restrict excessive lending.

To put it in another way: the negative pledge (is supposed to) preserve(s) the assets and future revenues of the borrower and prevent the same from being used to secure other loans, in order to "secure" the repayment of the loan of the contract. It works together with the pari passu clause.[125] While the pari passu clause seeks to preserve the equality between unsecured lenders, the negative pledge seeks to ensure that all lenders are and remain unsecured.[126]

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[122] Penn et al, p. 110.

[123] Asiedu-Akrofi, D., *Negative Pledge Clauses in International Loan Agreements*, Law & Policy of International Business, Vol 26, 1995, p. 409; and Hobbs 1993, p. 270.

[124] Wood 1980, p. 146; and Wood 1995, p. 34.

[125] See section 6.4.4.

[126] Harris, P. I., *Negative pledge*, in Kalderén & Siddiqui (eds), Sovereign Borrowers, London 1984, p. 156.

Scope

The scope of the negative pledge will depend on the wording of the clause, which may vary from one agreement to another. However, the prohibition should apply to both future and existing securities, so as to cover security already given, and include any subsidiary of the borrower, since the borrower could downstream assets to them. Moreover, the reference to security should include all forms of security interest, e.g. mortgage, lien, charge, hypothecation, pledge and any other encumbrance, so that there are as few loopholes for the borrower as possible.[127] Different legal systems will have different types of security interest. The lender should seek to include all relevant forms. The enumeration should be complete, since the terms have specific technical meanings. For example, if mortgage is left out, it would not be comprised by pledges or liens.[128]

However, while it is important to cover all eventualities, the lender should not tie the hands of the borrower to the extent that it will not be able to function properly. It must be borne in mind that it is in the lender's interest to keep the borrower's financial condition as healthy as possible.[129] The prohibition in the negative pledge cannot therefore be imposed without a number of exceptions and qualifications. Otherwise the prohibition would be too wide. The borrower would be in breach of the covenant in circumstances where the lender would have no practical objection to the creation of security interests by the borrower, i.e. liens arising by operation of law, such as those conferred on a repairer of chattels.[130] Other common exclusions are *inter alia*: security with (majority) bank consent, existing security on assets of after-acquired subsidiaries, security over assets in the ordinary course of trading etc.[131]

On the other hand, the negative pledge may also be too narrow. This is because the clause is usually restricted to a prohibition on transactions that create a security interest or similar encumbrance recognised in law, while it does not prohibit transactions which, although not recognised as security interest by law, have a similar commercial effect in practice.[132] These instruments are often called quasi-security instruments and include *inter alia* sale and lease back, title retention, sale and repurchase etc. Even though they are common in the day-to-day business of many companies, they have also evolved to become a way to avoid the negative pledge in international loan agreements.[133] By using those instruments, the borrower can raise capital that is effectively "secured" on its assets, without breaching the negative pledge.[134] For the borrower it is advantageous, because that way he will get lower interest rate, or alternatively, he may not be able to raise capital without granting "security". At the same time the new creditor will be satisfied, since he will increase the possibility of being repaid.

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[127] Wood 1995, p. 34; See also Gabriel, pp. 91-94 for an explanation of the different security interests.
[128] Harris, p. 161.
[129] Hobbs, p. 270; and Penn et al, p. 112.
[130] Tennekoon, p. 90.
[131] Wood 1995, pp. 36-37.
[132] Tennekoon, p. 90.
[133] Asiedu-Akrofi, p. 407.
[134] Wood, Philip R., *Title Finance, Derivatives, Securitisations, Set-off and Netting*, London 1995, p. 9.

To show how the quasi-security instruments work, I will describe the operation of sale and lease back. With this instrument, the debtor sells an asset to a finance house, which leases it back to the debtor for a period equivalent to the useful life of the asset. The lease instalments comprise amounts equal to principal and interest. If the lessee becomes insolvent, the lessor as owner of the asset will sell the asset and pay the lessee any excess of the sale proceeds over the accelerated rental payments due to the lessor. As is quite obvious, the lessor is in this way a super-priority creditor. In the absence of a negative pledge, the debtor could just as well have mortgaged the asset to the financier in return for a loan.

By the above, it is shown that the use of quasi-security instruments threatens to undermine the "security" function of the negative pledge. It would of course be possible to extend the wording of the negative pledge so as to include quasi-security instruments, or control the borrower's ability to enter into such transactions by specifically drafted clauses that put a financial limit to them. In reality, however, it would be extremely difficult to limit the prohibition to financial avoidance transactions only and to exclude ordinary trade transactions.[135] That is why most negative pledges are not extended to cover the quasi-security instruments.

In some jurisdictions, the courts may recharacterise the quasi-security instruments, i.e. the court will set aside the form of the transaction and instead see to its purpose. In this way the court may treat a quasi-security instrument as a loan secured on the asset and, thus, the transaction will be in breach of the negative pledge. Even though it is a theoretically possible way in those jurisdictions where the courts may recharacterise transactions, the lender should not rely on this possibility. The matter would be settled in court after a long and costly procedure, when it may be too late anyway (if the borrower has gone insolvent). In addition, there would be a long period of uncertainty until the judgement. English law generally does not recharacterise transactions, but instead it gives effect to the form, unless the transaction is a sham.[136]

Applicable law

As was shown in chapter 5, there are several jurisdictions impinging on an international loan agreement. The borrowers who have access to the eurocurrency loan market in London are usually located outside the United Kingdom and have subsidiaries in several countries. The assets over which a security interest might be created could thus be located in many different countries.[137] Even if English law would be the agreed proper law of the contract, this law does not necessarily govern all questions as regards security interests.

For example, would it be a breach of the negative pledge if a transaction, which does not constitute a security interest under English law, e.g. the sale and lease back discussed above, would be classified as a security interest in another country where the transaction is effected? In fact, there are two questions involved in this problem. The first question relates to the meaning of

[135] Tennekoon, pp. 90 and 92.
[136] Wood 1995, p. 36.
[137] Tennekoon, p. 92.

security interest etc. in the negative pledge covenant, while the second question relates to the legal nature and effect of the transaction in respect of the assets which are the subject of the transaction.[138]

The first question seems to be about the interpretation of the eurocurrency loan agreement, which is a matter for the proper law of the contract, in our case English law.[139] According to general conflict rules, the second question should not, however, be governed by the proper law of that contract.[140]

Firstly, one should distinguish between fixed assets and others.[141] It is submitted that under English conflict of laws, as regards fixed assets, the second question should be governed by the location of the assets, or the *lex situs*.[142] Any other way would be commercially unrealistic. Consequently, if a transaction is classified as a security interest according to the *lex situs*, a security interest has also been created within the meaning of the words in a loan contract governed by English law, even though according to English law no security interest has arisen. The negative pledge would thus be breached in such a situation. If, on the other hand, a transaction occurring in a foreign country would not be classified as a security interest according to *lex situs*, there should be no breach of the negative pledge, even if the transaction would be regarded as a security interest according to English law.

As regards merchant ships and civil aircraft, the law of the flag will govern the legal issues.[143] This is also the case, at least *prima facie*, when determining whether the craft is subject to a security interest. But, suppose a security interest is created over a craft according to another jurisdiction, which also will, and have the power to, enforce the security if necessary, irrespective of whether the security has been created in accordance to the law of the flag. It is submitted that the proper law should recognise that a security interest has been created, and thus, that a breach of the negative pledge has occurred, in both these cases.[144]

With regard to intangible movables, such as bonds or bank deposits, receivables, or rights under contracts, it is submitted that if a security interest is created in such an asset, and that security interest is enforceable under the *lex situs* or under the proper law of the legal document creating the security interest, English law (as the proper law of the contract) should regard that a security interest has been created.[145] The negative pledge should then be regarded as breached. This should be so even if the transaction under English law is not qualified as a security interest.

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[138] Tennekoon, p. 92.

[139] See also the Rome Convention, Article 10.

[140] It should be noted that the relation between the parties to the security-contract, but not that contract's consequences in relation to third parties, will be governed by the law decided by the Rome Convention.

[141] Tennekoon, p. 93. Fixed assets means in this context physical items, such as cars and buildings.

[142] Dicey & Morris, p. 960; and Tennekoon, p. 93.

[143] The crafts are deemed to be situate in their country of registration/port of registry.

[144] Tennekoon, p. 93; and Dicey & Morris pp. 935-936.

[145] Tennekoon, p. 94; See Dicey & Morris pp. 922-934 for how the *situs* is determined.

The pattern in this analysis seems to be that one has to determine whether a security interest has been created, and whether it is recognised by the courts of a legal system, which also has the jurisdictional power to enforce the security interest against the asset. Whenever this is the case, the negative pledge should be regarded as infringed.[146]

Remedies of the negative pledge

A breach of the negative pledge will invariably constitute an event of default, since it is on this clause that the unsecured loan is based. Accordingly, the theory behind unsecured lending is that, in the event of a default, the lender will *accelerate the loan*, demand repayment, proceed to summary judgement, and then execute against the borrower.[147] However, there is a major problem with enforcing the negative pledge by calling a default. In practically every loan agreement in the international loan market there will be a cross default clause included. This clause gives the creditors of the agreements the right to call default in the event that any other lender acquires a right under his loan agreement to accelerate the loan. The breach of the negative pledge in one loan agreement would in practice trigger the cross default clauses in all loan agreements to which the borrower is a party, and thus all those creditors could demand immediate repayment of all loan outstandings. The consequence would most likely be that the borrower would become insolvent. In this situation the secured creditors will have preference over unsecured lenders, and consequently, the creditor which called the default is more likely, than not, to precipitate the very event that the negative pledge was designed to prevent, i.e. a secured creditor obtaining a preferred position in a bankruptcy.[148] Moreover, at this point the borrower may not have any, or enough, unsecured assets left to repay the loan. Consequently, even though a good remedy in theory, calling a default and demand immediate repayment is often not the best of ways in practice. Instead the right to call a default is primarily used by the lender as a way to get a better bargaining position in negotiations for rescheduling the loan. A rescheduling may help the lender to recover at least some of the funds, before the investment is lost completely.[149]

Normally the primary remedy for breach of a commercial contract is *damages*. However, the lender would usually not have suffered any great damage except from the outstanding loan. A claim for damages against a borrower for breach of a negative pledge is therefore of no practical benefit to the lender, since he will already have a claim for the loan as a debt action.[150] Both claims would be unsecured and if the borrower does not have enough assets to repay the debt, he will surely not have assets to pay damages either.

Another way for the lender is to seek an *injunction* to restrain a threatened breach of the negative pledge. This, however, is only possible if the lender learns of the intended security interest before

[146] Tennekoon, p. 94.
[147] Allan, p. 225.
[148] Tennekoon, p. 95.
[149] Wood 1995, p. 46.
[150] Wood 1980, p. 163.

it is given, which is not very likely. Moreover, to grant an injunction is in discretion of the court, which makes it somewhat uncertain.[151]

In sum, the remedies against the borrower are not that great. The question then arises if there are any other ways for the lender to save his investment. There would seem to be three potential ways to attack the third party that has taken the security in breach of the negative pledge.

Even though the basic negative pledge does not by itself create a security interest in favour of the creditor of the contract, there has been a discussion whether it could be possible for him to invoke any equitable right against a subsequent creditor that takes security with knowledge of the negative pledge.[152] The issue has not been tried by English courts, but in the US it has been tried in a few cases. The outcome has been divided. In *Kelly v. Central Hanover Bank and Trust Co.*[153] the plaintiff alleged that the grant of security was a breach of the negative pledge, and that the defendant had notice of that clause. On this basis the plaintiff contended that it had some sort of equitable right against the defendant (the third party).[154] The claim was dismissed both on the facts and the law. In another case, *Coast Bank v. Minterhout*,[155] the court said that a negative pledge could give rise to an equitable lien, and the bank with the negative pledge was given a lien on wrongful security granted to a third party. However, this was probably much because it was shown that the parties from the beginning had intended to create a security device.

Accordingly, there is some authority, at least in the United States, supporting the argument that a negative pledge could give some right against a third party, but most of the states in the US tends to follow the Kelly case.[156] In England the courts would most likely not recognise the Coast Bank case, but instead dismiss such a claim, as in the Kelly case.[157]

However, there may be a claim for *damages against the third party* for the tort of procuring a breach of contractual relations.[158] It must be shown that the defendant knew about the existence of the negative pledge and intended to procure its breach, if he is to be made liable. Thus, actual knowledge by the defendant is required.[159] Wood submits that it would be enough if the third party creditor "has recklessly shut his eyes".[160] It could therefore be possible to argue that since

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[151] Tennekoon, p. 95.

[152] Goode, R., *Legal Problems of Credit and Security*, 2nd ed., London 1988, p. 22.

[153] 11 F. Supp. 497 (SDNY 1935) reversed 85 F. 2d 61 (2d Cir 1936).

[154] The plaintif contended: that it had an equitable lien on all the assets of the debtor company; that the negative pledge created "something in the nature of an equitable servitude"; that the defendant held the security as constructive trustees for the plaintiff; and that the plaintiff had a right of equitable reparation against the defendant for knowingly invading the plaintiffs right to continued performance of its contract by the debtor.

[155] 61 Cal 2d 311, 292 P 2d 265, 38 Cal Rptr 505 (1964).

[156] According to Ross Cranston, lecture at the London School of Economics, 14 November 1997; See also Penn et al, p. 114.

[157] Wood 1995, p. 39.

[158] Wood 1995, p. 38.

[159] *Swiss Bank Corpn. v Lloyds Bank Ltd* (1979) Ch 548, reversed on different grounds (1982) AC 584.

[160] Wood 1995, p. 38.

the negative pledges are so common in international loan documents, the third party must have had knowledge about the clause, which would be sufficient for liability.

A third potential way to proceed against a third party creditor taking security in breach of the negative pledge would be to rely on *the Rule of De Mattos v. Gibson.*[161] In this case, Knight Bruce LJ said that where a person acquires an asset from another, with knowledge of the existence of a previous contract in respect of that asset, a court could interfere to ensure that the acquirer of the property shall not use the property in a manner inconsistent with the contractual stipulations of which he is aware. However, the precise ambit of this rule is extremely unclear, and, in addition, subsequent case law has narrowed it down in scope,[162] which makes it very uncertain to rely on. In our case the court would probably dismiss a claim based on this rule.

Accordingly, the remedies for a breach of the negative pledge are not satisfactory. That is why in practice three alternative mechanisms have developed. They usually go under the names "equal security-", "same security-" and "automatic security" clauses and are inserted into the loan agreement.[163] An English court would have to determine whether the legal system having jurisdiction over the asset will recognise and give effect to these clauses, or an order of specific performance to make the borrower fulfil his obligation under the clause in question.[164]

The *same security* clause provides that if the borrower does grant a security interest to another creditor in breach of the negative pledge, the borrower shall procure that the lender of the contract will be equally and rateably secured on the same asset.[165] Some jurisdictions will not recognise a security created in this way, since the asset is future and has not been identified at the time of the agreement, or because of non-compliance with some other formality, such as registration. Under English law, prior specificity is not necessary. It is sufficient if the asset is identified at the time when the negative pledge is breached.[166] The problem is that if the borrower does not grant the creditor of the contract the same security, the third party will have the security interest in the asset alone. It would probably be impossible to erode that security interest by specific performance and create a new one in which the creditors rank equally.[167]

The *equal security* clause provides that if the borrower should grant security to another creditor, the borrower has to grant security to the original lender as well. The security has to be equal in value to that granted to the other creditor. Under English law the lender will not be secured by this clause, since the asset over which future security interest is being offered must be identified when the clause is intended to attach, if a security is to be created.[168] The equal security clause

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[161] (1859) 4 De G&J 276.
[162] *Port Line Ltd v Ben Line Steamers Ltd* (1958) 2QB 146.
[163] Wood 1980, p. 149; and Tennekoon, p. 95.
[164] Tennekoon, p. 96.
[165] Wood 1995, p. 39; and Tennekoon, p. 95.
[166] Wood 1995, p. 39.
[167] Tennekoon, pp. 95-96.
[168] Wood 1995, p. 40.

does not identify a specific asset, all it does is to point out any asset that is equal to the one secured. However, if the borrower still has got some unsecured assets left, after the breach of the negative pledge, the lender can enforce his contractual right by a decree of specific performance.[169]

The *automatic security* clause differs somewhat from the other two. While in the other two clauses the borrower was required to take positive action to give security to the lender, the automatic security clause seeks to create the same result, but without any action being taken by the borrower. It usually prescribes that if the borrower should grant security in breach of the negative pledge, then the original lender shall be secured upon the same assets, equally and rateably, with the third party being secured.[170] It is important under English law that the clause states that the security interest will attach to the same (and not equal) assets being secured to the third party, so the problem with identification is removed. The opinions are though divided if such a clause is effective. Goode and Tendon are of the opinion that the most the lender of the contract obtains by such a clause is nothing more than a contractual right.[171] If the borrower acts in breach of that right, the lender will not be secured, something he was not before the breach either. Others, such as Gabriel and Penn et al,[172] believes that once the borrower has infringed the negative pledge, but not before, the original lender will automatically have some sort of equitable security interest in the borrower's assets. However, the matter will be decided by local law anyway, and it is submitted that it is very unlikely that a foreign law will recognise such an equitable lien arising under English law.

In conclusion it seems like, even though the negative pledge is regarded as the most important covenant in the unsecured loan agreement, it is weak if the borrower disregards it. It is important to keep in mind that the negative pledge is not equivalent to security and it does not restrict other unsecured liabilities ranking equally with the lender's claim. Despite these shortcomings, the negative pledge is not unnecessary to include in the agreement, since most borrowers wish to comply with their undertaken obligations. Therefore, the negative pledge will most often fulfil its purpose.

The pari passu clause

The pari passu clause is a very important covenant. It requires the equal ranking of the borrower's unsecured debts on a forced distribution of available assets to unsecured creditors.[173] In some contracts the clause is inserted as an evergreen warranty, since it is often worded as if the

[169] Tennekoon, p. 95.
[170] Penn et al, p. 113.
[171] Goode, p. 20; and Tennekoon, p. 96.
[172] Gabriel, p. 89; and Penn et al, pp. 113-114; It should be noted, though, that any equitable charge which may ultimately be created will only give priority if it is perfected by registration under section 395 of the Companies Act 1985.
[173] Wood 1995, p. 41.

borrower warrants the equal ranking of unsecured debts.[174] Anyway, the primary objective of the clause is to ensure that the borrower has not, and will not, confer priority to any other unsecured creditor. The clause is usually drafted so that the obligations owed to the creditor will rank *at least* pari passu with other unsecured claims, in order to allow the borrower to incur unsecured debts that are subordinated to the lender's claim. If not drafted in this way, the clause will elevate such debts to the same position as the "original claim".[175]

It is important to note that the pari passu covenant relates to the question of priority of claims and not as to the time of payment, since this will depend upon the maturity of the different contracts. So, if a borrower pays off a debt to another creditor, before repaying the loan of the contract, this would not constitute a breach of the clause, even if the borrower later will not be able to repay the loan containing the pari passu covenant. The covenant is thus not broken merely because one creditor is paid before another. It is supposed to apply in situations where there are competing claims, like in the event of insolvency.[176]

Another important thing to note is that the covenant concerns only the ranking of unsecured claims. It does not prohibit the borrower from creating security on its assets. Should the clause require that the loan shall rank pari passu with all the borrower's liabilities, including secured claims, or forbid the creation of security, it would be a concealed negative pledge clause.[177] Moreover, where the ranking of unsecured claims is prescribed by law, the pari passu covenant cannot alter this priority. Therefore such claims are sometimes made exceptions to the equal ranking. On the whole, the clause is part of an agreement between two parties that will have no effect on third parties. However, the efficacy of the clause lies in the fact that a breach will invariably constitute an event of default, which entitles the lender to accelerate the loan and claim repayment of outstanding funds.[178]

Examples of claims often prescribed by law to rank ahead of ordinary unsecured debts in the event of bankruptcy are: bank deposits, claims of insurance company policy-holders, taxes, wages, liquidation costs etc. In some jurisdictions, especially Spain and Spanish-related jurisdictions, an unsecured creditor can achieve priority over other unsecured creditors, if their credit document is notarised in a prescribed way.[179] It should be noted that it is the law governing the bankruptcy that will determine the priority ranking, not the proper law of the loan agreement.

It was mentioned above that if it comes to the lender's attention that his claim on the borrower will not be afforded equal ranking with other unsecured claims in a bankruptcy or insolvency, the lender will have the right to accelerate the loan. However, this right will only help the lender if the breach is discovered before the insolvency of the borrower. Otherwise it may be too late. The

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[174] Gabriel, p. 62.
[175] Penn et al, p. 115.
[176] Gabriel, p. 64; See also Wood 1980, p. 156; and Wood 1995, p. 41.
[177] Wood 1995, p. 41.
[178] Penn et al, p. 115.
[179] Wood 1980, p. 156; and Wood 1995, p. 41.

probability that the lender will learn about the breach in advance is not very likely, so whether the clause will achieve its desired purpose will depend upon how effectively the lender can monitor the borrower.[180] Most borrowers, however, would want to comply with their obligations, since the cost of lost reputation would otherwise be huge. Therefore the pari passu clause will serve its purpose in most cases.

The asset disposal covenant

The asset disposal covenant tries to preserve both the quality and the quantity of the borrower's assets, in the sense that it seeks to prohibit large-scale disposals of revenue-generating assets.[181] It also prevents asset-stripping, i.e. a sale of the borrower's assets on credit to an associated company, which may turn the productive assets into a claim on (usually a worthless) company. The clause further prevents a creeping change of business of the borrower.[182]

The covenant would usually provide that the borrower will not, and will procure that each of its subsidiaries will not, dispose of all or a substantial part[183] of its respective assets, except in the ordinary course of its business. In addition, the covenant usually covers not only single disposals at, or above, the specified amount, but also a series of individually minor transactions, related or not, which cumulatively will exceed the threshold.[184] It is natural to allow the borrower to sell its products and inventory in the ordinary course of business, so that e.g. a car manufacturer can sell its cars, even though they represent a substantial amount, but not the manufacturing plant.[185] It is easy to see why the lender does not want the borrower to dispose of its revenue-generating assets, since it is these assets that ascertain the repayments of the loan.

Sometimes the covenant is reinforced by a clause requiring the borrower to have a certain level of insurance on specified assets and against specified risks, obviously to increase the protection of the assets to which the lender must look for eventual repayment.[186]

The covenant will also limit any evasion of the negative pledge clause by quasi-security instruments, such as sale and lease-back, sale and repurchase or factoring of receivables. However, the covenant will not cover transactions where the property is not the borrower's in the first place, such as hire-purchase or leveraged leasing.[187] Moreover, the covenant would cover

[180] Penn et al, p. 116; See also Gabriel, p. 63; and Tennekoon, p. 89.
[181] Tennekoon, p. 86.
[182] Wood 1995, p. 42.
[183] Cumulative disposals of 10 to 15 per cent may be regarded as substantial: see *Commercial Union Assurance Co Ltd v Tickler Ltd*, March 4, 1959, unreported. See also Wood 1995, p. 42.
[184] Tennekoon, p. 86; and Wood 1995, p. 42.
[185] Tennekoon, p. 86.
[186] Penn et al. p. 116.
[187] Gabriel, p. 98; and Wood 1995, p. 42.

disposals in pursuance of a plan to merge the borrower with another company, whereby the parties transfer all their assets and liabilities to a newly formed company.[188]

The asset disposal covenant is of great importance in practice, since it will be effective when it is needed the most and a breach will trigger the default clause. It is when the borrower is in financial difficulties that it will have the greatest tendency to sell off its capital assets and thus jeopardise the repayment of the loan and its future survival. It should be noted, though, that if the borrower sells its assets in breach of the covenant, it may be too late for the lender when he finds out, since the damage is already done and there might not be sufficient assets left to repay his loan. Strict monitoring of the borrower's business is the cure.[189]

There may be difficulties to determine the scope, when drafting the asset disposal covenant. On the one hand, it may be too narrow and then relevant assets may fall outside the prohibition. On the other hand, it can be drafted very widely, but this may tie the hands of the borrower so that it cannot perform its day to day business properly.[190] In the latter case, the parties would have to agree to numerous exceptions. Ericsson has suggested a solution to the problem, which is somewhat creditor-friendly.[191] According to Ericsson, the covenant should be drafted very widely and have as few exceptions as possible. Then the creditor should in practice only call a default when grave breaches occur, but not when the breach is minor. In this way "a fair balance would be reached".[192]

Except for the obvious objection that the creditors could call a default at their own discretion, as Ericsson himself points out, his proposition has a major deficiency. Every time the borrower theoretically is in breach of the covenant, i.e. even in the event of a minor breach where the creditor is not supposed to call a default, it would trigger the cross default clauses in all other loan agreements to which the borrower is a party. The consequence of this would be that all creditors, who have advanced funds to the borrower subject to such cross default clauses, could demand immediate repayment of all their outstanding funds, which may bring down the lender like a house of cards.

Financial covenants

The financial covenants are very important for the protection of the lender's invested funds. They prescribe certain levels of financial performance which the borrower must maintain to ensure that it will be able to meet its payments of interest and repayments of principal, as and when they fall due. In this way they serve the positive function of disciplining and directing financial policies,

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[188] Tennekoon, p. 86.

[189] See the information covenants below.

[190] See also under section 6.4.3.2 for a similar discussion as regards the negative pledge clause.

[191] Ericsson, Lars, *International Syndicated Loans*, Diploma Paper (unpublished), Lund University spring-term 1997, tutor: Krister Moberg, p. 59.

[192] Ibid.

e.g. by controlling excessive growth, limiting dangerous liabilities and restricting drains on cash resources.[193] They also function as early warning signals, since if the specified levels of performance are not fulfilled, it is likely that the borrower soon will be in difficulties with regard to its obligation to repay the loan. The lender will thereby be entitled to accelerate the loan before actual insolvency. The financial covenants offer a relatively easy way for the lender to monitor that the borrower's financial performance is sufficient to pay back the loan.[194]

There are a lot of different financial covenants that may be used in eurocurrency loan agreements. Each has its own purpose, so it is normally not sufficient to insert only one of them into the contract. To obtain the desired effect of protecting the lender's investment, several financial covenants are thus needed. The covenants will measure liquidity, solvency and capital adequacy in various ways, but usually not the quality of the assets.[195] Should the borrower have any specific weaknesses of which the lender has been informed, e.g. by their credit evaluation of the borrower, these weaknesses are usually specially monitored. Usual financial covenants included in a eurocurrency loan agreement are the debt to equity ratio, the minimum net worth ratio, the current ratio, the minimum working capital and the distribution restriction.[196]

The *debt to equity ratio* is perhaps the most important ratio, as it measures the capital adequacy of the borrower. It compares the value of the borrower's net assets, after deduction of its liabilities, to its liabilities and thus gives an indication of the assets available to meet liabilities. This ratio will require that the borrower's debts should not at any time exceed a certain multiple of the sum of its share capital and accumulated profits or reserves. It ensures that the borrower will not over-borrow, but instead use borrowings, equity and profit in prudent proportion, when expanding its business. Over-borrowing is undesirable, since it might erode the net asset base of the borrower, so that it cannot repay the loans as they fall due.[197]

The minimum net worth ratio measures the solvency of the borrower and is complementary to the debt to equity ratio. It requires the borrower to maintain a minimum figure for its net assets after deduction of its liabilities. To simplify, one can say that the ratio gives an indication of what would be left if all of the borrower's assets were sold at book value and all its liabilities were paid in full. It is important to note that certain intangibles, such as goodwill, are not included as assets in this and other ratios, since, in a liquidation, they are generally worthless.[198]

The current ratio is a liquidity test and thus tests if the borrower has sufficient liquid resources to pay its current debts as they fall due, without having to sell capital assets. Current debts are usually defined as those payable on demand or within a year, while current assets, or liquid assets, are in general defined by reference to generally accepted accounting principles, and may include

[193] Wood 1980, p. 160.
[194] Tennekoon, pp. 82-83.
[195] Wood 1995, p. 43. A special clause will often regulate the asset quality. See the asset disposal covenant.
[196] Tennekoon, pp. 44-45; Gabriel, p. 98; and Wood 1980, pp. 160-161.
[197] Tennekoon, p. 84; and Wood 1980, p. 160.
[198] Wood 1980, pp. 160-161; Wood 1995, p. 43; and Tennekoon, p. 85.

cash and marketable securities etc. *The working capital minimum ratio* also aims at preserving the liquidity of the borrower. It requires the borrower to keep a minimum level of liquid assets in excess of its current liabilities.[199]

The distribution restriction puts a limit on the amount of profits that the borrower may pay as dividends to shareholders and also restrains other ways of depletion of funds from the borrower.[200]

The financial covenants are usually, and should be, clearly defined in order to prevent accidental or deliberate avoidance by the borrower.[201] They are thus very precise, which makes it easy for both parties to determine if a breach has occurred, since the parties will only have to ascertain if the reality has deteriorated from a certain minimum level. These financial covenants are therefore preferable to less precise provisions, such as "material adverse change" clauses.[202]

Despite their objective clarity, the financial covenants have a few shortcomings. Firstly, the financial statements take time to prepare. They are usually based on the last audited accounts, which may be many months out of date. The lender may therefore not be aware of a breach until long after it has occurred. Then it might already be too late, if the situation has deteriorated.[203]

Secondly, as Wood puts it, "accounting is an art, not a science".[204] There are a lot of different accounting methods, and they vary enormously from one country to another. Each one of those methods may give different results and there is the risk that the borrower will take advantage of these differences to avoid the financial covenants. Bankers tend to rely on certain generally accepted accounting standards, but those standards may still change during the existence of the loan. It is obvious that it could be devastating for the lender, if he would rely on one set of standards, e.g. those applied in his home jurisdiction, while the borrower is using another set. It is therefore important that the parties agree to which accounting standards that should be used by the borrower, and if generally accepted changes thereto should be followed.[205]

Thirdly, one must bear in mind that the accounts on which the financial covenants are based, are prepared on the basis that the borrower is a going concern. Should the borrower run into financial difficulties and have to liquidate, the break-up value of the assets are much lower than those shown in the accounts.[206] Finally, one must not forget that financial covenants will never be better than the financial information supplied by the borrower.[207]

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[199] Tennekoon, p. 85; and Wood 1980, p. 161.
[200] Wood 1980, p. 161.
[201] Penn et al, p. 109.
[202] Wood 1980, p. 160.
[203] Wood 1980, p. 162; Wood 1995, p. 44; and Penn et al, p. 109.
[204] Wood 1980, p. 162.
[205] Penn et al, p. 109, and Wood 1980, p. 162.
[206] Wood 1980, p. 162.
[207] Penn et al, p. 110.

Information covenants

In order to monitor the performance of the borrower's financial and business position, its compliance with the financial covenants and potential defaults, the loan contract usually contains a specific clause according to which the borrower is required to supply a substantial amount of information to the lender. This would often include all information the lender considers reasonably necessary. If the loan agreement does not contain such a provision, the only information the lender will have access to is the information available for the public, which often is not enough. [208]

As regards financial information, the borrower would therefore often be required to deliver, not only the usual annual audited account, but also additional accounts on e.g. a quarterly basis. The lender must be aware of, though, that the accounts, which are made available especially for him, may not be audited. The financial covenants will also include compliance certificates, which require the auditors and some of the senior officers to certify the accuracy of the information, its compliance with the financial ratio covenants, and that no default has occurred.[209]

Other information the borrower has to supply to the lender may be e.g. any information despatched by the borrower to its shareholders or other creditors, information about any threatened or pending litigation, any default, or any other information about the borrower's financial condition and operation, as the lender may request. In addition to this, the lender may sometimes require a right of access and inspection of the borrower's property and records. Such a provision may not always be legal, due to e.g. confidentiality requirements.[210] As always, the party with the strongest negotiation position will ultimately determine the contents and drafting of the provisions.

Other covenants

When the lender decides to lend money to the borrower, he has made this decision on the basis of what type of business that the borrower is involved in, as well as on the borrower's identity and financial position. Should any of these grounds change, the lender's credit analysis will no longer be accurate and the investment may be less attractive than it was at the time of contracting. To preserve the identity of the borrower and to prevent a change in business of the borrower, a *change of business covenant* and a *merger control covenant* is normally inserted into the contract.[211]

[208] Tennekoon, p. 83; and Wood 1995, p. 44.
[209] Wood 1995, pp. 44, 430-431.
[210] Wood 1995, pp. 44, 430.
[211] Gabriel, p. 73.

The type of business being financed is important. There are big differences between a car manufacturer and a waste dealer. Therefore the borrower's business has to be preserved, if the lender want to get his money back. Naturally, the lender may give his consent to a change of business, should it seem to be profitable.[212] The width of the clause will be a question of negotiation between the parties.

The objective of the merger covenant is to maintain the identity of the borrower, and thus, to ensure that the assets of the borrower remain intact.[213] Under English law there is no precise meaning to the word "merger". Therefore it is important to define exactly what is prohibited by the clause. For example, there is usually a prohibition against fusions, where a company transfers all its assets and liabilities to another company, which in turn issues shares to the shareholders of the first company, which is then resolved. Alternatively, a third company is created into which both the other companies transfer their assets and liabilities and then the third company issues shares to the former shareholders. In such situations, the identity of the borrower would change and the merger clause would prohibit it.[214] The merger covenant works hand in hand with the asset disposal- and change of business covenant. Sometimes they will overlap, but, for the creditor, it is better to be safe than sorry.

There are other covenants as well, such as environmental compliance etc., but those mentioned above are the most common. What kinds of covenants that ultimately will be inserted in a contract, is naturally depending on the type of transaction and on the parties involved.

Remedies

In the event of a breach of one of the covenants, there are several remedies available for the lender. Most of them were discussed above in relation to the negative pledge, why I will only make a quick enumeration here. The remedies available will include:[215] suspension of new loans (under the conditions precedent clause); an event of default, which entitles the lender to accelerate the loan and cancel further commitments to lend; sometimes the lender can seek an injunction to restrain a threatened breach, but this remedy is only available if the lender takes action before the breach; damages, but in general this will not add anything to the claim for the outstanding funds; specific performance; and sometimes a claim against a third party taking security in breach of the negative pledge.

[212] Gabriel, p. 74.

[213] Tennekoon, p. 86; and Gabriel, p. 76; The meaning of the word merger is an issue governed by the proper law, while the legal nature or legal incidents of the transaction in question is a matter for the law of the place of incorporation.

[214] Wood 1980, p. 157.

[215] Wood 1995, p. 33.

Swedish law as the governing law

Introduction

It was submitted in chapter 5, that the normal practice in the eurocurrency loan market is to choose English law as the proper law of the loan agreement. In this and the next chapters, I will analyse if it is possible, and in that case whether it would be suitable, for the parties to choose Swedish law as the proper law. This question could be relevant e.g. when both or one of the parties are Swedish. Why should these parties choose, for them the unfamiliar, English law, if Swedish law should prove to be just as effective? Another situation when Swedish law could be chosen is when two foreign parties want a neutral choice of law. Firstly some general remarks about choosing Swedish law will be discussed. Then I will in the next chapter analyse how Swedish law would treat the contract terms discussed above.

Party autonomy

The first question to be answered when choosing the proper law is, as was stated in chapter 5, whether the desired legal system will permit the parties to choose that system of law. According to Swedish law, as it was before Sweden became a member of the European Union, the parties were free to choose the proper law of their contract. There was no requirement that there had to be a connection between the law and the contract, as long as a *reasonable interest*, by one of the parties, or both of them, in the choice of law could be established.[216]

Since Sweden has joined the European Union, it has to give effect to the Rome Convention on the Law Applicable to Contractual Obligations.[217] The convention will probably be incorporated with Swedish law on the first of July 1998.[218] In fact, the Swedish courts have already begun to apply the principles behind the convention, and since it soon will be applicable in Sweden, I will presuppose that it is applicable in Sweden. The rules applicable in Sweden, as regards the proper law of contracts, are thus practically the same as those in England, including the scope of the proper law. For a presentation of the Rome Convention, see chapter 5 above.[219]

Hence, Swedish law recognises full party autonomy, and Swedish law can therefore be chosen to govern a eurocurrency loan agreement.[220]

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[216] Bogdan 1992, p. 235.

[217] See note 23 above.

[218] Government bill 1997/98:14, p. 1.

[219] It should be noted, though, that Sweden will not reserve itself from Articles 7(1) and 10(1)(e), as the United Kingdom has done. These differences will not be analysed further in this thesis.

[220] Article 3, Rome Convention. See also section 5.2.2 above. The reader is once again reminded that the Rome Convention is not applicable to bonds and other negotiable instruments. Since Swedish law recognises party

Insulation

Lenders usually wish to insulate the law applying to the contract from political interference by the borrower's country.[221] Therefore, Swedish law should not be chosen, if the lender wants to be completely certain that the Swedish legislator cannot alter a Swedish borrower's obligations by a change of law. However, it is submitted that the lender does not have to worry too much about this problem. Sweden is a politically and economically stable country, and the possibility that it would introduce new legislation to protect national debtors is not very likely. Exchange controls, for example, may at present only be introduced if Sweden is engaged in war or at risk of war, or if there are extraordinary circumstances which are induced by war, or risk of war, which Sweden has been engaged in; war outside Sweden's territory; a serious accident, act of violence, epidemic or the like; or extremely large short-term capital movements.[222] There is also a moratorium legislation,[223] which, under similar circumstances, may allow a respite for the repayment of debts.

However, according to the principle of free movement of capital within the European Union, Sweden is not allowed to impose restrictions on this freedom.[224] The prohibition is not only applicable as regards capital movements between member states, but also in relation to third countries. The provision is directly applicable and may thus be relied on by individuals before national courts to render national rules contrary to it inoperative.[225]

Moreover, when both the parties are Swedish, which they may be even though it is an international transaction, there seem to be no reason why the Swedish legislator would impose regulations that protects the borrower, since that would at the same time hurt another national, namely the lender. One should not be to sure in this respect, though, since politicians sometimes introduce legislation to redistribute assets.

It should further be noted that a Swedish court will not enforce a foreign country's exchange control laws, or any other foreign laws that have a public interest, unless Sweden is obligated thereto by international conventions.[226] Even though Sweden is a member of the IMF and has ratified the Bretton Woods Agreement, Article VIII 2(b) is not part of Swedish law. Therefore, the provision will not interfere. The principle of free movement of capital in Article 73(b) of the EC Treaty will also infringe the possibilities to recognise a foreign country's exchange control laws. Therefore, if a borrower claims that it is prevented from repaying the loan by reason of an

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autonomy outside the scope of the Rome Convention as well, this will not cause any problems, though.

[221] See section 5.2.2 above.

[222] 1992 Act on Exchange- and Credit Control (Act no. 1602).

[223] The 1940 Act no. 300, changed by The 1989 Act (no. 243), (Lag ang. förordnande om anstånd med betalning av gäld m.m. (moratorielag)).

[224] Art 73(b) in the EC Treaty; see also Joined Cases C-163/94, C-165/94 and C-250/94 Sanz de Lera [1995] ECR I-4821.

[225] Joined Cases C-163/94, C-165/94 and C-250/94 Sanz de Lera [1995] ECR I-4821.

[226] Bogdan 1992, pp. 79-83; See also NJA 1961 p. 145 (Swedish Supreme Court).

exchange control introduced by its home state, a Swedish court will not recognise that the borrower is relieved of its obligation to repay the loan. Such a claim will be dismissed.

Swedish law can therefore successfully be chosen to fulfil the objective of insulation, in any event as an external system of law or where both parties are Swedish. The possibilities to impose different kinds of protective measures are not more remarkable than in other countries. As regards exceptions from the free movement of capital,[227] the Community should decide such circumstances, and thus, there are no differences between Sweden's and England's ability to impose restrictive legislation in this context.

Certainty and result predictability

In order to avoid uncertainty about the future, it is valuable for the parties to be able to predict the legal consequences of the contract. This is achieved by regulating as much as possible in the contract, while the ability of the proper law to interfere should be minimal. The Swedish law of contracts, which is inspired by German law, consists of legislation, practice and custom. Most of those rules are only applicable if nothing else is prescribed by the contract - they are supplementary - but outside the scope of the relatively few written rules, there are a great deal of uncertainty. It is therefore often up to the parties to look after their own interests and agree to the conditions that shall regulate their transaction.

The principles that the Swedish law of contracts is based upon, are the principles of freedom of contract and *pacta sunt servanda*, i.e. the parties may agree to anything they want and that agreement shall be followed.[228] However, from these principles there are some exceptions, primarily to protect a weaker party, such as consumers and employees.

The exceptions from the freedom of contract principle are mandatory rules that may modify or render a contract (or a term therein) invalid. These rules exist to protect parties from certain undesired situations, in otherwise legally binding contracts.[229] That a contract is invalid means that, because of some kind of deficiency, it cannot be enforced in accordance with its contents or in accordance with the legal effects typically applicable to it. The consequences, if a contract is rendered invalid, are therefore that sometimes the contract, or part of it, cannot be enforced at all, sometimes a party is not bound to it, and sometimes the contents will be modified.[230] It should not be forgotten, though, that if a contract is declared invalid, a party may in some situations be entitled to damages.

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[227] Articles 73c-h in the EC Treaty.
[228] Adlercreutz I, p. 131.
[229] Adlercreutz I, p. 34. It should be noted that the Contracts Act deals with "legal acts" (Sw. "rättshandling"). I will, since the thesis is about contracts, instead talk about "contracts".
[230] Adlercreutz I, pp. 221 and 225.

A contract or a term in a contract may be rendered invalid because of: deficiencies in the formation of a contract; certain circumstances occurring at the time of contracting; the contents of the contract is forbidden; the doctrine of presupposed conditions[231]; and if the contract terms are found unfair.[232]

Deficiencies in the formation of a contract

Naturally a contract will be invalid if it has not been entered into properly. The only situation in this context that would be relevant in respect of a eurocurrency loan, is the requirement that the parties must have the power and authorisations necessary to enter into an agreement. As was shown in chapter 6, the conditions precedent, and the representations and warranties, seek to ensure *inter alia* that all these requirements are fulfilled. The rule will therefore not normally interfere, and in any event, Swedish law does not contain any strange features in this respect. It should be observed, though, that the time when the parties are considered to be bound by a contract, may vary between English and Swedish law.[233]

Circumstances occurring at the time of contracting[234]

To the circumstances occurring at the time of contracting, which may render a contract invalid, is firstly the event that one of the parties has suffered from some sort of psychological defect, and thereby not being capable of understanding what he has done.[235] Since a eurocurrency loan is such a large and important transaction, with several people involved, and the negotiations are extensive, it is not very likely that an event such as this will occur. Should the event occur and the contract be rendered invalid, the other party could be entitled to damages, though, if he was in good faith. It is submitted that the possibility that a eurocurrency loan agreement would be rendered invalid on these grounds could be ignored. In any event, under these circumstances a contract would be void in most jurisdictions, and therefore, a choice of Swedish law will not be special.

Secondly, improper behaviour at the time of contracting may also make the contract invalid.[236] According to these rules, a contract may be declared void if an improper conduct by one party has induced the other party to enter into the contract, thereby affecting its contents. The forbidden conduct in question is grave and is also a criminal offence in the Swedish Penal Code. Sections 28-29 of the Contracts Act deal with duress, and section 30 deals with fraud. Two types of duress are distinguished. The more serious type in sec. 28 is such as is carried out by violence to the

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231 In Swedish: "Förutsättningsläran".
232 In Swedish: "Oskälig".
233 See Adlercreutz I, pp. 227-236 and 299-309.
234 This section is based on Adlercreutz I, pp. 237-274.
235 There are primarily two statutes governing this issue: the Contracts Act of 1915 (no.218) section 33, and statute of 1924 (Act no. 323) .
236 Section 28-31 of the Contracts Act.

person or by a threat involving imminent danger. All other duress belongs to the less serious type in sec. 29. Section 31 deals with "undue influence" and is a kind of usury provision. The provision prevents a person from "taking advantage of the distress, thoughtlessness or dependent position towards him of another person in order to acquire advantages which are obviously disproportionate to the consideration given or for which no consideration is given".

These provisions are not distinguishable for Swedish law. They all have their counterparts in most jurisdictions. English law, however, does not have any usury laws (except for consumer transactions and rules in the Insolvency Act 1986). It is submitted, though, that section 31 of the Swedish Contracts Act will not be relevant for a normal eurocurrency loan, since, to be applicable, it requires an obvious disparity between the acquired advantages and the other party's obligations. Normally such a situation will not occur between two parties in the eurocurrency market.[237]

Thirdly, Section 32 of the Contracts Act regulates a very debated subject. It deals with a "declaration of intention" which, owing to miswriting or some other mistake, is given contents other than were intended. According to the first paragraph, the party making the offer is not bound by it, if the other party was in bad faith as regards the mistake. According to the second paragraph, which regulates the situation where the error occurred after the declaration was sent, e.g. via telex or by messenger, the first party is not bound by the declaration, even if the other party was in good faith. The first party has to give notice about the error as soon as he learns about it, though. Section 32 is based on "the principle of reliance", meaning that a promisee who in good faith relies on the contents of a promise is protected against the mistake of the promisor.[238]

Even though section 32 may give rise to some amount of uncertainty, it is submitted that it will not affect a eurocurrency loan. Since the transaction involves such a large amount of money and is subject to lengthy negotiations, neither party is likely to enter the agreement without a thorough investigation of what the agreement contains and what respective party has undertaken.

In section 33 of the Contracts Act, there is a general provision regulating circumstances occurring at the time of contracting. It states that a contract is void if the circumstances at the time of contracting were such that it would be contrary to "good faith and fair dealing"[239] to invoke the contract with knowledge of the circumstances. It is further required that the other party had knowledge of the circumstances at the time of contracting. Examples of such circumstances are where a person has entered into a contract without understanding the meaning of it, because of disease, old age, intoxication or similar reasons.[240] Furthermore, the provision can be applied in situations where, even though not committing fraud, a person acts dishonestly, by omitting to

[237] As an example, it could be mentioned that the margin on the interest rate, i.e. the lender's profit, is normally not more than one per cent.
[238] Adlercreutz I, p. 256.
[239] In Swedish: "Tro och heder".
[240] NJA II 1915 p. 262.

mention facts known to him, which would have been decisive for the other party, when he entered into the contract.

In a normal eurocurrency loan relation, where both parties are serious business enterprises, this provision should not interfere. However, if one of the parties acts dishonestly at the time of contracting, the provision could help the other party to withdraw from the agreement. From the lender's point of view, the provision would probably not add anything to all clauses in the loan agreement, according to which he is entitled to accelerate the loan, e.g. the conditions precedent and the warranties. In any event, it is submitted that the existence of section 33 of the Contracts Act, or any of the other rules regulating misrepresentation, is not a reason to avoid Swedish law, when choosing the proper law of the contract. English law of contracts also prescribes rules on misrepresentation, according to which a party may rescind the transaction.[241]

Invalidity because of prohibited contents

A contract can be rendered invalid because it is contrary to legislation or public policy (*pactum turpe*).[242] An example is where a party undertakes to commit a criminal offence. It is submitted that a normal eurocurrency loan will not be subject to these rules and in any event, Swedish law does not differ in this area, in comparison with other jurisdictions.

The doctrine of presupposed conditions

Another, and in many ways special, way to render a contract invalid, or to modify its contents, is the doctrine of presupposed conditions.[243] This doctrine has evolved in the courts' practice and by legal scholars, but the scope and applicability of the doctrine is extremely uncertain. There are, however, some general features of it that shall be presented here.

The doctrine of presupposed conditions is not only applicable when the circumstances at the time of contracting proves to be incorrect, but also when later development has changed the presumptions under which the contract was entered into (*error in motivis*). To invoke the doctrine, the presumption must have been essential to the party - he would not have entered into the agreement, had he known the presumption was wrong. Moreover, the other party must have known, not only about the presumption, but also about its essentiality to the first party.[244]

There are also some other less specified requirements that have to be fulfilled to make the doctrine applicable. However, it should be noted that in general each of the parties should bear the risks that their presumptions may be wrong and that they are not made conditions to the

[241] See Wood 1995, e.g. pp 314-315.
[242] Adlercreutz I, p. 275.
[243] In Swedish: "Förutsättningsläran". See more about this doctrine in Adlercreutz I, pp. 269-273 and 284-285; and Adlercreutz II, pp. 130-136.
[244] Adlercreutz I, p. 271.

agreement.[245] It is submitted that a well drafted eurocurrency loan will probably not be subject to the doctrine of presupposed conditions, since all essential presumptions are (or should be) included in the loan agreement. For example, the representations and warranties clause should include all presumptions upon which the lender has based his decision to lend. Should they prove to be incorrect, the loan can be accelerated. On the other hand, in the unlikely event that a eurocurrency loan does not contain the mentioned provisions, the doctrine of presupposed conditions could be invoked to modify or even nullify the contract, should an essential presumption become incorrect. However, the result will not be different than if the agreement would have been well drafted. Therefore the existence of the doctrine of presupposed conditions is not a reason to avoid Swedish law, when choosing the proper law.

Unfair contract terms

Under Swedish law, there are to be found several ways for the courts to modify or set aside contract terms that are so disadvantageous for one party, that they are deemed to be unfair.[246] The terms can be set aside by the general provision in section 36 of the Contracts Act, the court's interpretation and the 1984 Act on Contract Terms between Merchants.[247] In this latter Act, the Market Court can prohibit for the future any improper terms found in contracts between businessmen, but it will not interfere with a contract already entered into. The act's main purpose is to strengthen the smaller companies' position on the market, but formally it is applicable to all contracts between enterprises.[248] However, the act is not applicable to contract terms in a business that is subject to supervision by the Financial Supervisory Authority, such as banks and credit market companies. Therefore the 1984 Act will not be considered further in this thesis.[249]

Section 36 of the Contracts Act

Section 36 of the Contracts Act is the main general provision in the Swedish law of contracts empowering the courts to modify or set aside a contract term, if it is found to be unfair, having regard to other parts of the contract, to what occurred at the making of the contract, to later development (which makes the provision complementary to many of the provisions discussed above) and to other circumstances. Moreover, if the term is of particular importance, other parts of the contract can be modified or set aside, or the whole contract can be set aside entirely, all depending on what the parties have claimed and what the court finds most appropriate.[250]

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[245] Adlercreutz I, p. 271.

[246] In Swedish: "oskälig".

[247] Act no. 292. There is a similar act for consumer contracts, 1994 Act no. 1512. Contract terms can also be set aside if they are contrary to mandatory legislation, but appart from those presented, there are none relevant for a eurocurrency loan.

[248] Government bill 1983/84:92, pp. 8 and 11.

[249] Should the lender not be subject to supervision by the Financial Supervisory Authority, the 1984 Act would not be interesting anyway, since it cannot interfere with existing contracts.

[250] Swedish Code of Judicial Procedures, chap. 17 sec. 3.

Section 36 clearly differs from the other provisions in the Contracts Act discussed earlier. Unlike the others, it deals *inter alia* with the contents of a contract and not only with the circumstances at the time of contracting and, moreover, the consequences, should a contract be contrary to it, is not only invalidity, but also modification. It should also be pointed out that section 36 may be regarded as an "international mandatory rule" under Article 7 in the Rome Convention.[251]

Even if section 36 to a large extent is aimed against standard contracts and the like, it can also be used to modify individual contract terms. The courts may not only consider whether the application in a special case would be unfair, but also whether any term should be considered unfair altogether, without regard to the consequences in the special case.[252]

Above was enumerated what factors the courts should consider when determining whether or not a contract term is unfair. It is important to note that the courts shall not consider a term in isolation, but shall regard it in its context of the contract in general.[253] A term, which in isolation may seem to be unfair, may be compensated by an advantage in another term of the contract, and thus, the contract term will be regarded as fair.[254] If, for example, a contract involves a high degree of risk, the terms of the contract may be allowed to be stricter. The courts will have to balance the one party's need of protection, against the point of view that an agreement should be a certain and predictable way to regulate transactions.

It is explicitly stated in the provision that the courts shall take into account whether a party is a consumer, or occupies a similar inferior position in relation to the other party of the contract. However, the provision is by no means confined to such situations. It is applicable to agreements between business enterprises and consumers but also to agreements where both the parties are business enterprises or private persons.[255] The provision can even be applied in favour of a superior party, e.g. when the circumstances have changed in a way that could not reasonably have been foreseen, or to increase an interest rate, should the agreed rate prove to be improperly low.[256]

Examples of clauses that section 36 *may* strike down as being unfair, are acceleration clauses, penalty clauses, forfeiture clauses, liquidated damages clauses and exemption clauses. Normally, a certain equivalence between a breach of a contract and its consequences is required, if such a clause should be regarded as fair.[257] Moreover, contract terms which leaves it up to one of the parties alone to decide when it is fulfilled, will often be struck down as being unfair.[258]

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[251] Government bill 1997/98:14, p. 28. However, this is disputed and therefore the possibility that a foreign court will apply the rule as an international mandatory rule is very doubtful.
[252] SOU 1974:83, p. 194; government bill 1975/76:81, p. 111.
[253] SOU 1974:83, p. 131.
[254] Government bill 1975/76:81, p. 118.
[255] See Swedish Supreme Court NJA 1979 p. 666.
[256] Government bill 197576:81, p. 127.
[257] SOU 1974:83, pp. 153-155; government bill 197576:81, p. 119.
[258] SOU 1974:83, p. 149; government bill 197576:81, p. 118.

In the preparatory works to section 36, its relationship to international transactions is discussed.[259] It is there noted that if the provision would be widely used by Swedish courts, the effect may be that the parties may, by a jurisdiction clause, choose a foreign court to settle disputes arising out of the contract, something which is not desirable. Moreover, it would seem to be less suitable to modify a contract term by the provision, if the same term would be applied strictly in accordance with its wording, should a similar dispute be settled by a foreign court. Nonetheless, it was submitted in the preparatory works that the application of section 36 should not be excluded from international transactions, since often the parties in such transactions are not equal. Instead, Swedish courts should apply the legal principles that are acknowledged in Sweden. However, it was pointed out that regard must be taken to general practice in the trade in question, especially if the parties are business enterprises. It was also pointed out that the general provision in section 36 must be applied objectively, so that it would not be taken as a means to protect Swedish parties.

In a contract relation between two business enterprises, section 36 should be applied more restrictively.[260] It is primarily small enterprises that should be protected against larger and superior companies. Two socially and economically equal parties should in general be able to look after their own interests, without interference by a court.[261] This is particularly so if the term in question has been subject to detailed negotiations between equal parties. Under such circumstances, section 36 would normally not be applied. The general practice of a special trade may also affect the court's assessment.[262]

The main field where section 36 could be applied, in relations between equal business enterprises, would thus seem to be where development has lead to changed circumstances, which could not have been predicted by the parties, particularly with regard to contracts with long duration. Most situations will be covered by a well drafted contract, though. But if the changed circumstances are not covered by the contract, and those circumstances will make the enforcement of the contract unfair, section 36 may be used to settle things in a just and equitable way.[263]

It is submitted that the parties in a eurocurrency loan are most often fairly economically equal and have equal knowledge of the transaction and the meaning of the terms in the agreement. The relation in a eurocurrency loan is not the same as in normal loan agreements, where the lender often imposes every provision autocratically. The borrowers in eurocurrency loans are instead often able to decide a great deal over the contents of the contract.[264] This depends on several things, but primarily it is because the parties are on a fairly equal footing, the banks are eager to lend money because there are a surplus of funds on the market, and by lending they will also establish new and valuable connections. Moreover, because of harsh competition between different banks on the market, a bank cannot afford to demand too strict conditions in a loan

[259] SOU 1974:83, pp. 161-162; government bill pp. 130-131.
[260] Government bill 197576:81, pp. 104-105.
[261] Government bill 197576:81, p. 104.
[262] Government bill 197576:81, pp. 108 and 119-120.
[263] Government bill 197576:81, p. 127.
[264] According to Jan Wetterberg, senior partner at Mannheimer Swartling Advokatbyrå, Malmö.

agreement. It should be stressed that the eurocurrency loan agreement is a "give-and-take" relation, where a party receives a benefit by giving up another, e.g. the borrower may lend without security, but at the same time his freedom of action will be more restricted. Of course all individual relations and agreements will differ, though, and there may be situations where a lender, and sometimes even a borrower, will be in a superior position.

Finally, it is important to remember that section 36 is not intended to be used to make all contracts fair. A good deal should be allowed to be a good deal. But the provision may give the parties an incentive to renegotiate their contract, for example if the circumstances have changed. Moreover, one should not forget that, even though a contract is rendered invalid, the parties would still have to restore what they have received by the other party. This is something the borrower probably would want to avoid, but nonetheless it may be the consequence if section 36 is invoked, since the whole contract may be rendered invalid if an important term of it is found unfair. The practical importance of section 36 is thus somewhat decreased, since a party not wanting the whole agreement to become invalid, may avoid to invoke the provision.

Construction of contracts

As we saw in section 5.2.2, Zweigert and Kötz submitted that there are two different approaches to the construction of contracts. Swedish law would seem to use the first approach, the one that searches for the subjective intention of the parties, when interpreting a contract. A Swedish court may thus disregard from the written words of a contract and instead give effect to the parties' perceived intention. The court may also construe a contract against the party who drafted it, if it is unclear. Moreover, if an issue is not regulated in the contract, and the parties' intention cannot be ascertained, the court may settle the dispute by looking at supplementary legislation or how such questions are usually settled in practice, and therefore, additional provisions may be added to the contract.[265] Section 36 of the Contracts Act may also be used.

The Swedish construction method thus differs quite a lot from the English, where the judge primarily is concerned with the objective meaning of the contract, while the parties' intention is only relevant in so far as it is reflected in the objective meaning of the words used. Moreover, the judge will not imply additional clauses into a contract. The result of the contract will be predictable, since, except for some minor exceptions, the objective wording of the contract will be followed.

The Swedish courts' construction may be a disadvantage. It is more difficult for the parties to predict the outcome of a contract, if the court in a future dispute may construe the contract in another way than the objective meaning of the words, or if the court may imply additional clauses. However, it is submitted that most of the uncertainty and unpredictability, caused by the Swedish construction technique, can be avoided. The problems will obviously arise in relation to incomplete and unclear contracts. But if the parties draft their contract as clear and complete as

[265] Adlercreutz II, pp. 10-11.

possible, and moreover, state that their will and intention are that the contract should be construed in accordance with its objective meaning, the effect should be practically the same as when an English court construes a contract.

A eurocurrency loan most often tries to cover all eventualities, and the drafting is at least relatively clear. If the parties are aware of how the Swedish courts will construe the contract, and thus expressly state their intentions in the contract, it would be possible to exclude the possibility that the court will construe the contract in an unpredictable way.

However, the parties do not always express themselves clearly, maybe because they rather want to have an unclear contract than having to negotiate for months for a perfect drafting. In these cases, there will be room for the court to construe the contract in accordance with the parties' perceived intention. Most often this would not lead to an unpredicted outcome, though. It is also questionable if the English courts' interpretation would be better. It is submitted that if the parties observe and are aware of the differences between Swedish and English courts' construction of contracts, the legal outcome will normally not be unpredictable if Swedish law is chosen.

Conceptual sophistication of the legal system

Swedish law is a well-developed system of law. Sweden has for a long time been industrialised and the law has followed the industrial and economical developments. Banking is a business well known and international transactions are common in Sweden. It is therefore submitted that Swedish law is capable of accommodating a eurocurrency loan transaction.

Language

As was stated above, English is the official language in the international markets. Since English is the second language for most Swedes, and since practically all businessmen and lawyers in Sweden, involved with international transactions, use the English language, it is submitted that there will not be a language problem, if Swedish law is chosen to govern a eurocurrency loan.

Forum

As was shown in section 4.2.2, it is important and convenient that the court chosen by the parties to settle any dispute arising from the contract, is a court of the country whose legal system is chosen to govern the contract. Therefore, factors influencing the choice of forum will also affect the choice of law. It should be noted, though, that both Swedish and English courts are willing to apply foreign legal systems, if required.[266]

[266] The Swedish courts may instruct the parties to present the contents of relevant parts of the foreign legal system, if it is not known to the court (Code of Judicial Procedure chap. 35 sec. 2). This is also the case in England, since

It is submitted that Sweden is a politically stable country without any revolutionary tendencies. There is therefore no tendency for it to be legally revolutionary either. Moreover, it is submitted that Swedish courts are impartial when settling disputes. There are also speedy and effective judicial remedies, in the event of a breach of a contract. For example, the court may impose injunctions or specific performance to restrain a threatened breach, to prevent asset-stripping or to make a party act in a desired way.[267] However, there is no public court that is specialised in international financial business disputes. If the parties want their disputes to be settled by Swedish judges experienced in international transactions, they should therefore choose the Arbitration Institute of the Stockholm Chamber of Commerce as the forum of the contract.[268]

The extent to which judgements of Swedish public courts and arbitrations will be recognised and enforced by courts in other countries, depends on (reciprocal) international treaties.[269] Therefore no general answer can be given to the question of recognition and enforcement - each case must be examined individually.[270] But since Sweden generally does not recognise foreign judgements of courts in non-convention countries, Swedish judgements will probably not be recognised in those countries either. It is submitted that there are no major differences between English and Swedish judgements in this respect. However, an English judgement will probably be recognised in more countries than a Swedish judgement, since England is a party to a greater number of conventions, especially in relation to countries in the Commonwealth.[271] It is therefore advisable for the lender to investigate, before choosing a Swedish court, whether Sweden has entered into recognition treaties with the countries where the borrower's assets are located, or whether a Swedish judgement nonetheless will be recognised in those countries.

Familiarity

If the parties are Swedish, or even Scandinavian, the Swedish legal system will be familiar, and therefore, no extra investigation of its contents will be needed. Otherwise, if the parties are totally unfamiliar with it, Swedish law would be just as any foreign system of law, maybe even a bit more exotic. In this respect English law would be more satisfactory, since the parties would know that it has habitually and successfully been applied to international financial transactions similar

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foreign law is regarded as a matter of fact and not of law.

[267] E.g. Code of Judicial Procedure chap. 15.

[268] The procedure will take place in accordance with e.g. the Arbitration Act of 1929 (act no. 145) or the ICC procedures, depending on the parties' choice.

[269] Most countries in the western Europe are parties to the Brussels (or Lugano) Convention on Jurisdiction and Enforcement of Judgements in Civil and Commercial Matters of 1968. Sweden is a party to the Lugano Convention, but will soon ratify the Brussels Convention instead, since Sweden now is a member of the European Union. The recognition and enforcement of arbitration is governed by the New York Convention on Recognition and Enforcement of Foreign Arbirations of 1958.

[270] Bogdan 1992, p. 272.

[271] For English recognition treaties, see Tennekoon, p. 24, note 20. For Swedish dito, see SÖ (Statens överenskommelser med främmande makt).

to the one they will take part in. There is therefore especially one great disadvantage with choosing Swedish law, in comparison with English law. Under English law there is a well-established case law on eurocurrency loan transactions. The case law in Sweden on the subject could be regarded as non-existing.

Conclusion

As we have seen, Swedish law can be chosen as the proper law of a eurocurrency loan agreement. Most of the general remarks also showed that there would be no major disadvantage, if the parties would choose Swedish law to govern their agreement, as long as the differences in relation to English law are observed. The absence of case law may be regarded as a deficiency, though.

Even though the Swedish law of contracts is based on the principle of freedom of contract, it contains both mandatory and supplementary rules. The Swedish Contracts Act is far from exhaustive, though, and there is a great deal of uncertainty outside the scope of the written rules. It is therefore important, when entering a contract, to make it as comprehensive as possible, so as to minimise the uncertainty, should a conflict arise.

Most of the Swedish rules that may render a contract invalid are the same as in other jurisdictions, including the English, and they will not interfere with a normal eurocurrency loan agreement. However, some of the Swedish rules are not found in the English law of contracts. The most characteristic rules are those which may invalidate or modify a contract because of changed circumstances or unfair contents. Since they are mandatory, they cannot be evaded from by skilful drafting. Of course the existence of these rules will decrease the predictability and certainty of a contract. But they will not necessarily interfere with a eurocurrency loan.[272] The fact is that the primary purpose of these rules is to protect weaker parties, which are in an inferior position, from superior parties imposing unjust contract terms. A eurocurrency loan, in which both parties most often are fairly equal, is subject to negotiations during a long period of time and several lawyers from both parties scrutinise the wording before signing. The loan agreement will hardly get its contents by an oversight. There is a well-established practice of the contents of the agreement. To be found unfair by a Swedish court, a term in such a contract must be extremely improper.

The Swedish courts' construction of contracts also differs from the English courts'. If the parties want to be absolutely sure that the courts will not construe the contract in any other way than its objective meaning, Swedish law should not be chosen as the proper law. However, it is submitted that this problem may be avoided, if the contract is clearly and extensively drafted, and if the parties' intention will be clearly specified. Then, there will be no room for another interpretation than the objective meaning of the words used. There is also another possibility. The parties could use the opportunity given to them in the Rome Convention to divide the contract as regards the

[272] See chapter 8.

proper law (dépeçage). In this way it might be possible to choose Swedish law to govern the contract in general, while the interpretation of it should be in accordance with English law.[273]

[273] It is not certain that this is possible. Some say that dèpeçage only means that the parties may choose different legal systems to different parts of the contract. However, there is no case law on the subject and the wording of the Convention does not directly contradict my proposal.

The contract terms under Swedish law

Generally

In this chapter, I will analyse whether the contract terms discussed in chapter 6 will be affected in any adverse way by a choice of Swedish law. When doing that, I will only consider those rules that may be applicable in normal business relations, i.e. where no fraud etc. has occurred. I will also discuss some other issues, which, even though not depending on the choice of law, may be interesting in the context.

Before starting the analysis, it must be stressed that, when determining whether a term is unfair according to section 36, one should regard the term in its context of the whole agreement. My analysis of the contract terms in this thesis will therefore not be completely accurate, since there are so many other contract terms to be considered, which are not dealt with in this thesis. However, I will nonetheless try to ascertain whether section 36 of the Contracts Act may interfere with any of the presented contract terms.

Conditions precedent

The conditions precedent seek, as we have seen, to suspend the lender's obligation to lend until all matters upon which the loan is based are fulfilled. In this way the parties also cover what will happen if the circumstances would change. The first group of conditions precedent has to be fulfilled before the first disbursement, and the second group has to be fulfilled prior to each subsequent disbursement, if there are any. The provisions thus point out under which circumstances the lender has to advance funds to the borrower. Since Swedish law of contracts is based upon the principle of freedom of contract, it is perfectly in order for the parties to include such provisions. It is even advisable for them to try to cover all eventualities, since the parties that way will exclude the possibility that the court will establish the parties' perceived intention through construction, e.g. in the event of changed circumstances, and therefore unpredicted outcomes will be avoided.

Just as under English law, it is under Swedish law important for the parties to state clearly in the contract whether or not there is a binding contract before the conditions precedent are fulfilled, so there will be no doubts about it.

It is submitted that the contents of the conditions precedent will not be affected by any Swedish contractual rules. The conditions precedent cannot generally be regarded as unfair and the application of them will not lead to unfair situations, since all they do is to point out under which circumstances one of the parties is obliged to perform. The lender, who advances a considerable amount of money, naturally wants to set out some conditions before parting from the money.

None of the normal conditions precedent are unreasonable, no party undertakes to fulfil anything extremely burdensome and the contents of the clause is subject to lengthy negotiations. Since the parties also are fairly equal and the conditions precedent are part of the practice in the eurocurrency market, the possibility that they will be set aside or modified is minimal.

However, the application of the Swedish rules concerning changed circumstances are not excluded, should an event occur that the parties have not foreseen. Those rules might entitle the lender to withdraw from his obligation to lend, should the changed circumstances make it very burdensome. The doctrine of presupposed conditions would probably not come into question, though, since all presumptions that the parties were aware of at the time of contracting would most likely be included in the contract. That leaves us with section 36 of the Contracts Act. If the contract, as to the rest of its contents, is very detailed, an omission to regulate the changed circumstances in question will undoubtedly indicate that the lender is obliged to fulfil its obligation to lend under the new circumstances as well. Such a sophisticated party as the lender will have great difficulties with arguing that the omission is due to an oversight. Once again it must be pointed out that the parties in a eurocurrency loan are very sophisticated and they should generally be able to look after their own interests in the contract. Therefore, an omission to include all circumstances, under which a party is not obligated to perform, will normally not relieve the party from performing, just as under English law. However, if it is shown that the parties have not been able to predict the changed circumstances (which is not very likely), and these circumstances will make it very burdensome to perform, there is a small possibility that the obligation to lend might be modified or set aside. The reader is reminded that there is a similar way under English law for a party to withdraw from its obligations; the principle of *Bentworth Finance Ltd v Lubert*.[274]

Under normal circumstances, the lender is bound by his obligation to lend, though. However, there is a great theoretical difference between the legal consequences under Swedish and English law, should the lender breach the obligation to lend. Under English law the borrower is entitled to damages, but cannot obtain specific performance.[275] Under Swedish law, on the other hand, the lender cannot escape his obligation to lend by paying damages, if the borrower still wants the bank to perform, i.e. disburse the funds in accordance with the contract. The fact is that a Swedish court may order the lender under penalty of a fine to fulfil his obligation to lend.[276] It is therefore very important for the lender to include all circumstances, under which he does not want to be obligated to lend, in the contract. An omission may be a very expensive mistake.

However, this situation would probably never occur in practice. Should the lender refuse to lend, the borrower would only sue for damages and try to arrange a new loan somewhere else.

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[274] See section 6.2 above.

[275] See section 6.2 above. It should be noted that damages is awarded by common law, while specific performance is ordered by equity.

[276] According to Peter Westberg, Professor in Judicial Procedure at Lund University and Jan Kleineman, Professor in Civil law at Stockholm University. In general, it is easier to force a party to perform under Swedish law than under English law. See more about this in Olsen, Lena, *Borgenärens val vid kontraktsbrott*, Stockholm 1997

Therefore the difference between the English and Swedish remedies in this context seems to be at the theoretical level only.

Naturally, the lender will not be obligated to lend if the borrower, when entering the contract, has omitted to mention vital information. Such situations are normally covered by the conditions precedent anyway. Should they not be covered, the lender may rescind the transaction under both Swedish and English law.[277]

Representations and warranties

As shown in section 6.3**,** the representations and warranties form the basis upon which the lender makes the loan available. In these provisions, the borrower warrants *inter alia* the accuracy of given statements and information, and that certain circumstances do not exist. Hereby the risk of the warranties being false is borne by the borrower. Such contract terms are in general perfectly all right according to Swedish law. A party may warrant as much as he likes, since the parties are free to agree to the conditions in their contract.

Some may think that it would be unfair if a party undertakes to warrant so many issues, and thereby taking a high degree of risk. They may therefore think that section 36 might be applied to modify the situation. It is submitted that the contents of the representations and warranties discussed in this thesis will not be subject to interference by Swedish law of contracts. There is nothing unfair with one party warranting different issues, when both parties are equal business enterprises and when the contract has been negotiated and scrutinised during a long time before signing.[278] The preparatory works to section 36 also points out that if the parties have agreed to which of them should bear the risk of an event, that agreement should not be modified if the event should happen.[279] Moreover, the application of the representations and warranties does not lead to any extremely unfair conditions. The provisions exist to protect the lender, who, after he has parted from the money, is in a very delicate position and in great need of protection. Also, the representations and warranties clause is part of a well-established practice in the eurocurrency loan market, which also makes interference by Swedish law less likely.[280]

However, as was mentioned in section 6.3, some warranties may be drafted in a way that entitles the lender alone to determine whether or not a material adverse change has occurred. It is strongly advised against such a drafting, since it may be struck down by section 36 as being unfair. According to the preparatory works,[281] provisions that give one party the right to autocratically decide a matter, is a perfect example of when section 36 may be applied. Even though it is less likely that section 36 will be applied on a eurocurrency loan agreement, since none of the parties

[277] Wood 1995, p. 315; and e.g. section 33 of the Swedish Contracts Act.
[278] Government bill 1975/76:81, e.g. pp. 118-119.
[279] Government bill 1975/76:81, p. 127.
[280] Government bill 1975/76:81, pp. 119-120.
[281] Government bill 1975/76:81, p. 118; SOU 1974:83, pp. 149-151.

are directly in a position needing protection against a superior party, the parties should avoid the mentioned drafting. Instead they should insert objective materiality tests. By doing this they will also exclude the possibility that the Swedish courts will construe the provision in any other way than originally intended.

In sum, it is submitted that Swedish law, as the proper law, will not affect the contents of the representations and warranties clause in any adverse way. Naturally it will depend on what is included in the provision, but the normal warranties discussed above will not be affected. However, it is the remedies in the event of a breach that make the representations and warranties important, and therefore an opinion on the efficiency of the provisions under Swedish law cannot be given before investigating to what extent Swedish law will affect the desired remedies.

Normally a breach of the representations and warranties is made an event of default, enabling the lender to terminate the loan and demand immediate repayment of outstanding funds. The lender is also entitled to suspend further disbursements of funds under the conditions precedent clause. Under Swedish law of contracts, however, the remedy in the event of a breach of contract must generally be in proportion to the breach. If the breach is not material, the other party is in general not entitled to terminate the agreement.[282] See section 8.5 below for a discussion of whether the remedies usually available in a eurocurrency loan will be affected by Swedish law.

Covenants

Generally

The covenants are, as shown in section 6.4, the contractual rules which the borrower must comply with during the loan period. Since Swedish law is based on the freedom of contract principle, the parties are, at least *prima facie*, free to agree to such restrictions of their freedom of action. But the result must not be unfair. It is natural for a lender to restrict the borrower's freedom of action in some extent, especially when the loan is unsecured. One must remember that it is the borrower who has got the money, and therefore, it is important for the lender that the former will run his business properly.

With this in mind, it is submitted that Swedish law of contracts will not modify or nullify the covenants, at least not those discussed in this thesis. I have based this conclusion on the same grounds as those presented above, under the sections dealing with the conditions precedent and representations and warranties, namely, that the parties are both fairly equal business enterprises that should look after their own interests, the covenants are part of a well established practice, the contents of the contract have been negotiated and scrutinised by lawyers from both parties for months and the application of the covenants will not lead to any unfair conditions, if they are seen in the context of the contract as a whole. The possible unfairness that at first sight may arise out

[282] Government bill 1975/76:81, pp. 119 and 139-140.

of some of the covenants, such as the asset disposal covenant, is neutralised by other advantages for the borrower, e.g. the fact that the loan is unsecured.

However, just as with the representations and warranties, the efficacy of the covenants cannot be determined before analysing whether or not Swedish law will affect the desired remedies. That analysis will be made in section 8.5. Therefore, I will in the next section only discuss how some of the problems arising under the negative pledge clause will be dealt with according to Swedish law.[283] There are of course other interesting questions as regards the covenants that could be discussed, but most of them are not affected by the choice of the proper law, and therefore, they fall outside the scope of this thesis.[284]

The negative pledge

The negative pledge clause is a substitute for security interest, according to which the borrower undertakes not to grant security to any other creditors.[285] It is under Swedish law, as was submitted above, possible for the parties to agree to such a "negative obligation" without interference.[286] But will the negative pledge give the lender a right to security against a third party, or is it just a contractual right between the parties?

To be secured under Swedish law the main rule is, as regards chattels, that a transfer of possession must have taken place - the asset must have been handed over. Thereafter the asset must remain in the creditor's possession. If the chattel is in possession of a third party, that party must be notified.[287] If the asset is returned to the debtor, or if he may dispose of it at his will, there exists no valid security interest. The requirement of transfer of possession may be evaded, if the transaction is registered and published in accordance with the Chattel Sales Act[288] or by using conditional sales.[289] Another non-possessory security interest under Swedish law is the so called "företagshypotek". This is a special security interest in the flow of assets of a business enterprise, similar to the English floating charge. To be effective, this security interest must be registered.[290]

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[283] The negative pledge is very infrequently discussed in the Swedish legal literature and preparatory works. See however Hessler, H., *Allmän sakrätt*, Stockholm 1973, p. 418; Bylund, B.G., *Något om s.k. negativa klausuler i låneavtal*, in Festskrift till Knut Rodhe, Stockholm 1976; Håstad, T., *Sakrätt avseende lös egendom*, 5th ed, Stockholm 1994, p. 272; and SOU 1969:13, pp. 15 and 77.

[284] Such questions will be solved in the same way irrespective of the choice of law of the contract. For example, insolvency procedures will be regulated by local law. The efficacy of the pari passu clause will be affected by that law. Claims prescribed by law to rank ahead of ordinary unsecured debts in the event of insolvency are in Sweden regulated in the 1970 Priority Act (no. 979).

[285] See the 1987 Banking Act (Swe: "Bankrörelselagen") chap. 2 sec. 13, which regulates under which circumstances a Swedish bank may lend without security.

[286] See also Rodhe, Knut, *Lärobok i obligationsrätt*, 6th ed, Stockholm 1986, pp. 40 and 83.

[287] Håstad 1994, pp. 275-285 and 292. See also 1936 Act no. 88. Security rights in ships and aircrafts, however, is created through registration, see Håstad 1994, p. 291.

[288] 1845 Act no. 50 (Swe: "Lösöreskköplagen").

[289] Bogdan, 1978, p .15; See also Håstad 1994, p. 284.

[290] Bogdan 1978, p. 16. See also 1984 Act no. 649.

The security rights in promissory notes to bearer or to order are given in pledge by transfer of possession or by notification to the third party having the possession,[291] which is also the case with shares etc. As regards notes to a specified person and pecuniary claims for goods sold or services done, security rights are given in pledge by notification to the debtor.[292] Security rights in real property are given by way of mortgage, where the mortgage deed must be handed over to the creditor.[293]

If these requirements are not fulfilled, there exists no valid security right. Moreover, to be a valid security interest under Swedish law, the asset over which the security interest is created must be specified, something which the negative pledge normally does not fulfil.[294] Therefore it is submitted that the negative pledge clause does not give right to security under Swedish law, and a third party will thus not be affected by it.[295] It will merely be a contractual right between the parties. It is further submitted that the same-, equal- and automatic security clauses will not change this view. The lender will be entitled to an order of specific performance, though, to make the borrower act in accordance with the contract terms, should he disregard them.[296]

When the loan agreement is governed by English law, it is very important to make a complete enumeration of which security interests that should be covered by the negative pledge. Those security interests that are left out will not be covered, since the court will interpret the contract strictly in accordance with its objective meaning. It is submitted that if the contract is governed by Swedish law, it is not quite as important to enumerate all security interests that are intended to be covered. It is sufficient if it is evident what the parties intended at the time of contracting, since a Swedish court when interpreting the contract will try to establish the parties' original intention. However, to avoid unpleasant surprises and uncertainty, it is advisable for the parties to be just as precise as if the contract was governed by English law. This will exclude the risk that the court will construe the contract in any other way than originally intended. There is too much money involved to be careless.

The Swedish way of interpreting a contract may be helpful to strike down transactions that try to avoid the negative pledge clause, such as the quasi security instruments. By looking at the purpose of the transaction in question and the objective of the negative pledge, the court may recharacterise the transaction and establish that a breach of the negative pledge has occurred.[297] As was stated above, in section 6.4.3.2 *in fine*, the lender shall not regard himself totally protected, though, but hopefully it will deter the borrower from trying to avoid the negative pledge. If nothing else, it may increase the lender's power to reschedule the loan, should the lender's financial situation worsen because of avoidance transactions by the borrower.

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[291] 1936 Promissory Notes Act (no. 81), sec. 10 and 22; See also Håstad 1988, p. 421.
[292] 1936 Promissory Notes Act, sec. 10 and 31.
[293] Jensen, Ulf, *Panträtt i fast egendom*, 4th ed. Uppsala 1994, p. 45.
[294] Håstad 1994, p. 324.
[295] See also Hessler, Henrik, *Allmän sakrätt*, Stockholm 1973, p. 418.
[296] Code of Judicial Procedure, chap. 13 sec. 1.
[297] SOU 1974:83, p. 134.

Moreover, under Swedish law the owner of the asset, in transactions such as sale and lease back, may not be protected against the debtor's other creditors, since the debtor still has possession of the asset.[298] It is not sufficient if the new owner takes possession of the asset for a short while and then returns it to the seller, since the requirement of transfer of possession will not be validly fulfilled. It seems as if, when coming to this conclusion, the Swedish Supreme Court thought it important that the purpose of the parties' was to give the asset back to the seller, shortly after the transaction.[299] To be fully protected from the seller's other creditors, the new owner must comply with the requirements in the Chattel Sales Act.[300] By these requirements the borrower cannot secretly exclude its assets from the unsecured lenders, since they will hopefully take notice of the publication.

In this context the Swedish conflict rules, as regards security interests, may be discussed shortly. It is submitted that they are similar to the English rules discussed above.[301] The main rule is thus that the validity of a security interest is governed by the *lex situs* (or *lex rei sitae*).[302] Therefore, if a security interest has been validly created in accordance with the *lex situs*, it will also be recognised as such by Swedish law.[303] A Swedish court will therefore regard the negative pledge as breached, if a valid security interest has been created abroad, even if under Swedish law the transaction would not constitute a valid security interest.

In summary, it seems like Swedish law, as the proper law of the contract, will not interfere with the negative pledge in any adverse way. In some areas Swedish law may even increase the protective effect of the clause, e.g. as regards avoidance transactions. The negative pledge does not give right to any security, though, something that it might arguably do under English law.

Remedies

Normally a breach of the representations and warranties or the covenants is in the contract made an event of default, enabling the lender to terminate the loan and demand immediate repayment of outstanding funds. The lender will also, as an alternative, be entitled to suspend future disbursements under the conditions precedent clause. Under Swedish law of contracts, however, the remedy in the event of a breach of contract must generally be in proportion to the breach.[304] If

[298] It must be noted, though, that this issue is not regulated by the proper law of the contract, but by the law of the country where the transaction took place (*lex situs*). It may nonetheless be interesting to mention the issue in this context.
[299] NJA 1925 p. 535; and NJA 1934 p. 193.
[300] Håstad 1994, p. 219.
[301] See section 6.4.3.3.
[302] Bogdan 1992, p. 262.
[303] Bogdan 1992, p. 264. Note, however, that to remain a valid security interest, it must remain valid according to the *lex situs* at each particular moment. If the charged asset is moved to another country, it is therefore the new *lex situs* that will determine if there still exists a valid security interest.
[304] SOU 1974:83, p. 153.

the breach is not material, the other party is in general not entitled to terminate the agreement. Should a contract entitle a party to terminate the agreement in the event of a minor breach, section 36 may be invoked to modify such a provision.[305] A precondition is, however, that the prescribed remedy is found unfair.

As we have seen earlier, the application of section 36 is meant to protect a weaker party from contract terms imposed by a superior party taking advantage of the situation.[306] As has repeatedly been mentioned in this thesis, both of the parties in a eurocurrency loan are business enterprises, they are fairly equal and both of them are able to influence the contents of the contract. The contents of the contract have been scrutinised by lawyers from both parties and, moreover, the default mechanism in these circumstances is a well-established practice in the eurocurrency market.

Even though some of the events which are made an event of default in the contract may not be in proportion to the remedy of acceleration, the lender is in need of this protection as a means of making the borrower perform in accordance with its obligations. The right to accelerate the loan must be seen in its context of the agreement. As has been shown, the lender does normally not have a security for his claim. All the lender has got after he has disbursed the funds is a piece of paper, namely the loan agreement. The lender would probably not have entered into the agreement under such circumstances, if he knew that he would only be entitled to accelerate the loan when the contract breach is material.

The minor breaches are often early warning signals of that the borrower soon will not be able to repay the loan. If the lender must wait until a material breach occurs, he will probably not get his money back.[307] Moreover, as already stated, the lender does normally not use his right to accelerate the loan anyway. But if he would not be entitled to that right, he would not even be able to bring pressure to bear on the borrower, so the loan can be renegotiated on reasonably favourable terms, should it be necessary. If Swedish law would require a material breach of contract to entitle the lender the right to accelerate the loan, the lender's safety net would be destroyed. In that case, there is no way that a lender would agree to lend on an unsecured basis, if Swedish law would be the proper law. As was pointed out in the preparatory works, that is not a desired situation.[308] It is very important for business enterprises in general, and creditors in particular, to be able to rely on the contracts they have entered into. Otherwise the economical growth may be impeded.

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[305] Government bill 1975/76:81, pp. 119 and 139-140; See also Swedish Supreme Court NJA 1971 p. 23.

[306] See Swedish Supreme Court NJA 1979 p. 666, where the court applied section 36 on a contract between two business enterprises. It was underlined that, even though both parties were business enterprises, they were not equal and the inferior party had not understood the meaning of the contract term. Moreover, the inferior party was not in a position being able to influence the contents of the contract.

[307] That would, in my opinion, be unfair.

[308] SOU 1974:83, pp. 161-162; government bill 1975/76:81, pp. 130-131.

It is, on the basis of the foregoing discussion, submitted that in a relation such as the eurocurrency loan transaction, it cannot be regarded as unfair to entitle the lender to accelerate the loan, even in the event of minor breaches of contract.[309] Section 36 will thus not interfere and modify the acceleration mechanism. The possible disproportion between contract breach and remedy (acceleration) is neutralised by the fact that the borrower may borrow such a large amount of money on an unsecured basis.[310]

As I have shown, the lender will under English law also be entitled to other remedies than acceleration. I will now investigate whether these remedies will be available under Swedish law as well.

If the borrower intends to breach the contract and the lender becomes aware of it in advance, the enforcement authority may order the borrower under penalty of a fine not to take action, e.g. if he is about to breach the negative pledge clause. Likewise, if the borrower does not fulfil its obligations, e.g. to give the lender same or equal security under the extended negative pledge, he may be forced to perform.[311] The similarities to the English injunction and specific performance are obvious.

In the event of a breach of contract, the lender may also be entitled to damages. Under English law the lender will only be entitled to a claim for the loan and accrued interest,[312] which makes it quite superfluous. Under Swedish law, on the other hand, the lender may in addition be entitled to future loss of interest.[313] This is of little importance in practice, though, since if the borrower is not able to repay the loan, a claim for damages will not improve the situation.

A difference between English and Swedish law that may be important, though, is the possibility under Swedish law to include penalty clauses in the contract. Under English law there is a rule against penalties. It is a rule by which the court will refuse to sanction legal proceedings for recovery of a penalty sum, on the grounds of public policy.[314] Under Swedish law, penalty clauses are allowed and will be enforced by the courts. They may be disregarded or modified, though, if they are found to be unfair.[315]

Finally, if a third party takes security in breach of the negative pledge clause, he might under English law be liable for damages.[316] There is some authority that this may be the case under

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[309] See also SOU 1974:83, p. 168.
[310] See also SOU 1974:83, p. 128.
[311] Rodhe, pp. 170-175.
[312] A clause in the contract which provides that in the event of breach the loan would immediately become repayable and that interest for the full term would be payable at once, constitutes a penalty, which will be disregarded by the courts. See *The Angelic Star* [1988] 1 FTLR.
[313] Hellner, Jan, *Speciell avtalsrätt II Kontraktsrätt*, 2nd ed, Stockholm 1993, p. 210.
[314] See *The Angelic Star* [1988] 1 FTLR, CA.
[315] Section 36 may be applied. See Government bill 1975/76:81, pp. 140-141; and Rodhe, pp. 249-254.
[316] See section 6.4.3.4 above.

Swedish law as well, but the situation is far from clear.[317] Anyway, to be liable, the third party must have had actual knowledge of the negative pledge, i.e. he must have acted clearly improper. Under both legal systems it seems to be hard to make a third party liable, even though it might be somewhat easier under English law. It should be noted, though, that this question will not be affected by the choice of law of the loan agreement.

In summary, it seems as if the remedies available, when English law is chosen to govern the loan agreement, will be effective under Swedish law as well. Since I have earlier come to the conclusion that Swedish law will not interfere in any adverse way with the contents of the discussed contract terms, it is now also submitted that the objectives of those contract terms will be fulfilled under Swedish law, just as good as under English law.

[317] In communication with Jan Kleineman, Professor in Civil Law at Stockholm University. Kleineman underlines, though, that the third party's liability under these circumstances is somewhat uncertain. See also Bylund, p. 123 and Håstad 1994, pp. 429-441. It would be beyond the scope of this thesis to investigate this complex issue further.

General conclusions

The eurocurrency loan is a huge transaction. It does not only involve a large amount of money - the legal documentation forming the contract is also of great dimension. This is primarily because the parties try to foresee every possible situation and regulate them in the agreement. The law that will govern the contract is therefore very important, since it may affect the contents of the contract.

Most legal systems permit the parties to freely choose a system of law to govern their contract. The parties desire a legal system that makes the legal outcome of the agreement as certain and predictable as possible, i.e. a legal system that recognises the principle of freedom of contract. If the parties have agreed to everything in their contract, it is not desirable if the governing law could interfere and change that agreement.

English law has in practice become the international trade law. Under English law the parties may agree to virtually anything they want, and the contract will be construed strictly in accordance with its objective meaning. There is a saying under English law, that what is not claimed, is disclaimed. The parties may therefore under English law regulate their transaction precisely as they wish, without later interference. Should they forget anything, they will have to suit themselves.

Sometimes there could be situations when the parties do not want English law to be the proper law of the contract. This could be because one of the parties is English and they want a neutral law, or because they are not familiar enough with English law. There might be another legal system that they are more familiar with, e.g. their home jurisdiction. If another system of law is chosen, it is therefore important to investigate how the eurocurrency loan will be affected by that other legal system. In this thesis Swedish law has been examined and compared with English law.

Under Swedish law the parties are free to choose the proper law. This party autonomy is regulated by the same international convention as under English law, namely the Rome Convention. The scope of the governing law will also be the same as under English law. Even though Swedish law of contracts is based on the principle of freedom of contract, there are some threatening clouds that must be observed. The fact is that the freedom of contract has some exceptions, which may modify or render a contract invalid, and the Swedish courts' interpretation of contracts differs from the English.

Most of the Swedish rules that may interfere with a contract are the same as in other jurisdictions, such as rules on the formation of contracts and on misrepresentation. Apart from these "normal" rules, which will in general not interfere with a eurocurrency loan agreement, there are others which are not found under English law. Primarily the doctrine of presupposed conditions and section 36 of the Contracts Act must be observed.

The doctrine of presupposed conditions may render a contract invalid, if an essential presumption proves to be incorrect and the other party had knowledge about it. However, it is submitted that this doctrine will not interfere with a eurocurrency loan agreement, since all the essential presumptions are (or are supposed to be) covered by the contract. Should the presumptions prove to be incorrect, the contract has already regulated what will be the consequences. Therefore the doctrine of presupposed conditions will not be applicable.

The general provision in section 36 of the Contracts Act may modify or render a contract (or a term therein) invalid, if it is found to be unfair. The general provision is primarily supposed to protect weaker parties, such as consumers, from superior parties taking advantage of their supreme position. However, the provision applies to transactions between business enterprises as well, but more restrictively. Even though some of the contract terms in a eurocurrency loan agreement are expressly mentioned in the preparatory works to section 36 as clauses that may be regarded as unfair, I have come to the conclusion that section 36 will not interfere with a normal eurocurrency loan agreement. The reason for this is simply that the contract terms in the agreement are not unfair.

When determining whether or not a contract term is unfair, the different clauses must not be seen in isolation, but in the context of the contract and the transaction as a whole. The eurocurrency loan is most often unsecured, while it comprises a large amount of money. The lender is therefore in need of a high degree of protection, since he takes a high risk. If he would not be entitled to that protection, he would probably not lend on an unsecured basis. Moreover, the parties are highly sophisticated and fairly equal business enterprises, which should be able to look after their own interests, the contents of the contract has been scrutinised by lawyers from both parties and the contract terms are part of a well established practice in the eurocurrency loan market. The eurocurrency loan transaction is a "give and take agreement". The one party's disadvantage in one clause is neutralised by advantages in other clauses. Therefore section 36 will not interfere, since the contract terms will normally not be regarded as unfair.

Section 36 may also be used to modify a contract, if changed circumstances would make the contract unfair. However, it is submitted that this situation will not be relevant if the contract is well drafted. Just as with the doctrine of presupposed conditions, section 36 will not affect the agreement, since the changed circumstances would already be covered by the contract.

If the parties draft the agreement accurately, it will thus be left alone. However, it must be stressed that the parties should avoid clauses that give the power to determine if a matter has occurred, to one of the parties only. Such autocratic right of determination may be struck down as being unfair, since it may be used gratuitously. Instead objective materiality tests should be inserted, which will also exclude unnecessary difficulties with the interpretation of the contract.

The Swedish courts' interpretation of contracts must also be observed. The interpretation technique used by Swedish courts differs quite a lot from the English. When interpreting a

contract, a Swedish court will search for the parties' intention. The objective meaning of the contract may thereby be ignored. This can obviously lead to some uncertainty and even unpredictable outcomes, which is not desirable. However, it is submitted that this will not be a serious problem in a normal eurocurrency loan, and, moreover, it can be avoided. Normally, the agreement is so well drafted that the court will not have to search for a perceived intention. The court's investigative interpretation may thus be contracted out. If the contract is drafted very carefully, covering all eventualities, the contract will be followed in accordance with its meaning. To be really certain, the parties can also state in the contract that it is their will and intention that the contract should be interpreted in accordance with its objective meaning, if that is what they want.

If it is not stated in the contract that the parties want it to be interpreted in accordance with its objective meaning, the Swedish interpretation may be used to decrease the extent of the contract. For example, the negative pledge clause will not have to enumerate all different kinds of security interest. They would all be covered anyway. It would be sufficient to state something like "the borrower is not allowed to grant, or permit to subsist, any security interest or other encumbrances...". However, it is advised against such a drafting. The parties should continue to draft the contract the Anglo-Saxon way, even under Swedish law. It is better to be safe than sorry, and it is more convenient for the parties to have everything included in the contract.

As to the rest of the general considerations, that should be considered when choosing the proper law, such as language and sophistication of the legal system, there seems to be no problems with choosing Swedish law, as long as the differences from English law are observed. It should be noted, though, that there is no public court in Sweden that is especially experienced with international loan transactions. It is therefore advisable that the parties should choose arbitration, e.g. the Stockholm Chamber of Commerce. Moreover, a fact that cannot be ignored is that there is no well-developed case law on eurocurrency loan transactions in Sweden, which is a disadvantage in comparison with English law.

In summary, then, it is submitted that Swedish law would be a suitable choice of law to govern a eurocurrency loan agreement. If the parties draft the contract accurately, there will be no interference at all by Swedish law, and the objectives of the contract terms will be fulfilled. However, it cannot be disregarded from that English law will on the whole be a superior choice of law. It seems as if it will be more complicated, if Swedish law is chosen, at least if the parties are not Swedish. Non-Swedish parties will have to investigate the contents of Swedish law, and the potential uncertainty that some of the rules in the law of contracts introduce, may deter them from choosing Swedish law. English law would, for those parties, be a better choice, since they will know that English law has successfully been used before. On the other hand, for those parties that want to avoid English law, Swedish law would be a satisfactory substitute.

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