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“If you lose money you lose much . . . If you lose faith you lose all.”
Eleanor Roosevelt

“[W]e’re all textualists now.”
Elena Kagan

INTRODUCTION

When Justice Kagan first made the now-infamous proclamation above, constitutional interpretation was no doubt her principal target. Judges, policy-makers, academics, and commentators of all stripes were embroiled in a decades-long battle over whether, when, and to what degree constitutional reasoning reaches beyond the text of the document. Champions of textualism happily savored this moment of victory: to its proponents, the late Justice Antonin Scalia notably among them, Justice Kagan’s proclamation was tantamount to capitulation. Textualism had not only entered the front stage of constitutional interpretation; it was now the headliner.

Had Justice Kagan’s concession been directed instead towards the legal interpretation of corporate credit agreements, two implications likely would have followed. First, she would have lost two-thirds of her audience. Second, nearly all those remaining would have considered her statement more a banal platitude and less a dramatic concession—because in the world of corporate debt, we have all been textualists for almost fifty years. Through a combination of evolutionary forces, textualism has come to dominate the interpretation and enforcement of virtually all major corporate and

1 Annie Ridout, Raise Your SQ: Transform Your Life with Spiritual Intelligence 227 (2023) (ebook).
4 There are several similar but distinguishable definitions of “textualism” in the contracts literature. For clarity, we adopt a variant of the definition offered by Daniel Markovitz and Emad Atiq: “‘Textualism’ in contract law can be defined as the view that (a) contractual obligations stem from the objective meaning of the parties’ speech acts, (b) writings trump oral communication, and (c) a text’s meaning must be inferred from a restricted evidence-base” (sometimes limited to the “four corners” of the contract itself). Daniel Markovitz & Emad Atiq, Philosophy of Contract Law, in STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Nov. 23, 2021), https://plato.stanford.edu/entries/contract-law/ [https://perma.cc/T9XP-FMWL].
commercial credit agreements. Although textualism also features prominently across many other domains of modern contract law, it competes for attention against rival approaches, including contextualism, intentionalism, purposivism, and implied duties (like the duty of good faith and fair dealing, meant to fill gaps in the express prescriptions of a contract). Collectively, these approaches shape the contours of contracts across many substantive domains, varying somewhat depending on parties, jurisdictions, and adjudicators. When it comes to creditor protections in corporate debt, however, these traditional rivals become little more than a sideshow, and strict textualist interpretation reigns supreme. It is widely recognized by practitioners and judges that credit protections turn critically, if not exclusively, on a close and literalist reading of express terms, with scant room for alternatives. Should a creditor assert protections that are not expressly and unambiguously codified in a writing, modern courts overwhelmingly conclude that those protections simply do not exist.

Corporate debt’s fascination with textualist interpretation is now so pronounced and unique that, in our estimation, it deserves its own moniker, one that we coin as debt textualism.

We are hardly the first to note the predominance of textualism in the corporate debt ecosystem. While the phenomenon is now so predominant that most practitioners take its presence for granted, some have flagged the effects that this approach can have on strategic behavior by parties when they negotiate debt contracts, renegotiate them, perform them, and litigate over breach. These strategic behaviors in corporate lending have grown

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6 See Elisabeth De Fontenay, Complete Contracts in Finance, 2020 WIS. L. REV. 533–539 (“[S]ophisticated parties should want to move away from standards in drafting agreements and away from contextual interpretation in their enforcement, towards rules and formalist interpretation.”).
7 See infra Section I.
8 See, e.g., Ethan J. Leib, Interpretive Divergence Between Statutory and Contract Interpretation: A Case Study in the New York Court of Appeals (manuscript at 8-10), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4424576 [https://perma.cc/UY52-CNUV] (presenting examples from the New York Court of Appeals); John C. Coates IV, Why Have M&A Contracts Grown? Evidence from Twenty Years of Deals 1 (Harvard L. Sch. Working Paper No. 333/2016, 2016) (noting that the number of words in M&A contracts have grown 167% from 1994 to 2014 in reaction to new case law, statutes, and financial risks as well as a new way to achieve the goals of contract parties); De Fontenay, supra note 6, at 537 (noting that transactional agreements prefer narrowly tailored provisions that are interpreted using a textualist approach).
9 See, e.g., Simone M. Sepe, Directors’ Duty to Creditors and the Debt Contract, 1 J. BUS. & TECH. L. 553, 553 (2007) (“[T]he adoption of a textualist interpretative rule, which mandates to consider accepted by creditors any risk they have not contractually excluded or limited, would (i) give both parties the right incentives to write more state-contingent contracts; and (ii) reduce uncertainty in legal relationships by ruling out the possibility of ex post completion of the contract (and of the duty itself) by the third adjudicator.”); Alan Schwartz & Robert E. Scott, Contract Theory and the Limits
particularly newsworthy and expensive in the last decade, as private equity sponsors finance countless corporate acquisitions with a war chest of funds dominated by debt securities.\(^{10}\) The dramatic shift towards leveraged finance enormously amplified the dollars at stake; and along with them, the rewards from contractual “strategery” on all sides have also grown gargantuan.\(^{11}\)

How did we get here? And should we want to stay? In this article, we explore the history and key drivers of debt textualism in case law over the last half century. We argue that the jurisprudential shift towards textualism initially grew out of two critical pragmatic realizations. First, many standard tools of contract interpretation (such as divining the shared “intent” of the parties) break down spectacularly when applied to complex credit facilities, which are intermediated by dozens, if not hundreds, of players, most of whom have never interacted with one another. Second, the widespread use of boilerplate provisions within debt securities that are widely traded in capital markets counsels for a uniform and transparent interpretation of provisions that pop up across different debt instruments—securing a predictability that should benefit borrowers, end investors, and all those in between. Textualism is not the sole path to desired uniformity, but it has long been a convenient and familiar one. Though some creative jurists have at times proposed alternative interpretive strategies (such as a modified good faith duty or extending fiduciary duties in the “zone of insolvency”)\(^{12}\), textualism’s pull has simply proven too strong, and most courts and practitioners had embraced it enthusiastically by the late 20th century.

The judicial embrace of textualism initially made sense. It seemed plausible that debt textualism could serve as a capable launchpad for rapid innovations in credit markets during the 80s and 90s. Although textualism’s claims to transparency have always been a little slippery,\(^{13}\) it does hold some

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\(^{11}\) See, e.g., MAX FRUMES & SUJEET INDAP, THE CAESARS PALACE COUP: HOW A BILLIONAIRE BRAWL OVER THE FAMOUS CASINO EXPOSED THE POWER AND GREED OF WALL STREET 28 (2022) (“In a span of two weeks in 2005, the private equity world changed forever. . . . Leverage buyout artists had become the richest men on Wall Street. . . .”).

\(^{12}\) See infra Section I.A.

\(^{13}\) See, e.g., Pacific Gas & Elec. Co. v Thomas Drayage, 442 P.2d 641, 644 (Cal. 1968) (“A rule that would limit the determination of the meaning of a written instrument to its four-corners merely because it seems to the court to be clear and unambiguous, would either deny the relevance of the
appeal for the large, quasi-anonymous, intermediated markets that undergird financial assets. Furthermore, its reliance on a limited constellation of accessible interpretive authorities made it an equal opportunity standard for all who have a stake in negotiated debt contracts, regardless of whether they were in the room where it happens. Throughout the 20th century, corporate debt markets had a storied reputation as a genteel community where norms of mutual cooperation predominated, dampening many strategic proclivities. Even if debt textualism was not perfect, then, these norms could—and often did—smooth out the rough edges.

In the last twenty years, however, the pragmatic rationale behind debt textualism has become severely strained, arguably past its breaking point. The rapid ascendency of returns-seeking private equity funds and their heavy reliance on debt finance contributed to this strain, along with the emergence of sophisticated, returns-driven distressed investors who eagerly buy up debt claims. Both groups were increasingly willing to play iconoclast, thumbing their noses (if not giving the finger) to the esprit de corps that traditionally tempered opportunism in the corporate debt community of yesteryear. The end result privileges ‘winning at all costs’ in contemporary debt-restructuring battles. Presuming that actors will moderate opportunism to conserve their reputational capital is now little more than a sentimental sucker’s play.

In this article, we argue that debt textualism played a key role in laying the groundwork for our present malaise by encouraging contracts to become increasingly bloated, complex, and rigid up to the point of buckling completely. The dense contractual landscape wrought by debt textualism, when freshly populated with a calculating coterie of financial mercenaries, has transformed corporate lending markets into an elaborate and costly contest of Hunger Games-worthy contractual “gotcha” where (a) lenders scour loan agreements for unappreciated loopholes to undercut borrowers; (b) borrowers do the same in an attempt to counteract lenders; and (c) permutated coalitions from both groups conspire to kneecap one another. The intention of the parties or presuppose a degree of verbal precision and stability our language has not attained.

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14 See, e.g., James M. Jasper, Mitchel Abolafia & Frank Dobbin, Structure and Strategy on the Exchanges: A Critique and Conversation about ’Making Markets’, 20 SOCIO. F. 473, 475 (2005) (“’Bond’ traders are socialized into a culture that values the institution and thus the long run. If they care about their reputations, they act properly.”).

15 See infra Section I.C.

16 See Frumes & Indap, supra note 11, at 21-29 (describing the colorful intransigence of several Caesar’s second-lien distressed investors when the private equity sponsor and other debt holders were attempting to fashion a collective restructuring that would require each of them to make concessions).

The end result is bitterly ironic: The current landscape severely undermines the very goals of transparency, uniformity, and predictability that textualism was supposed to deliver, as investors and issuers mercenarily scavenge through a wordy forest of express contractual terms, hoping to uncover unforeseen opportunities to blindside their adversaries. As a result, the advertised predictability of debt textualism devolved into an aleatory parlor game over who emerges as the best (or the luckiest) scavenger. The resulting uncertainties are not just confined to direct participants; they also have profound implications for company viability, affecting workers, customers, suppliers, and other corporate stakeholders. They even spill over to systemic risk concerns because deleterious disputes over distressed debt provisions are likely to be strongly correlated with an economic downturn (which some predict is on the horizon, as of this writing\textsuperscript{18}). The bottom line, we argue, is that our current reality of debt textualism imposes significant, unreasonable burdens on lenders, borrowers, credit markets, and society at large.

If our diagnosis is correct, then what is to be done? We offer a range of possible solutions, from the judicial to the regulatory to the practical. The broad unifying and eponymous directive of our proposal is to keep the faith. Most immediately, courts can play an important role in renewing neglected doctrines that deemphasize textualism in favor of other reasonably predictable interpretive tests. A resuscitated implied duty of good faith and fair dealing—itself an early cast-off in debt textualism’s conquest—could be appropriately modified to turn on objectively verifiable metrics. Indeed, a pivotal catalyst in our star-crossed embrace of debt textualism was the failure to “keep the good-faith” doctrine as a viable contender. Legislators and regulators can also play an important role in keeping faith in market integrity by utilizing their regulatory mandate as stewards of systemic risk and investor protection to help define, delineate, and constrain the practices and payoffs associated with destructive incentives of private equity sponsorship and distressed debt investing. Moreover, spurred by prudently designed legal doctrines and regulatory interventions, private contracting can return to favoring value creation over rent dissipation. And finally, even if debt textualism manages to stand its ground, private contracts could creatively use its rigidity and complexity for the greater good.

We flag an important caveat to our analysis before proceeding: Our focus here is largely devoted to contract law and doctrine, and potential doctrinal and policy prescriptions that enable and regulate contracting. We do not

devote much time to topics related to post-filing bankruptcy proceedings, such as equitable subordination, fraudulent conveyance, the Chapter 11 process, and others. This choice is largely deliberate, in light of the fact that bankruptcy scholars have developed a rich and helpful literature around these topics.19 Most of the significant current debates, even in bankruptcy contexts, concern contracts and recapitalizations that occur outside of, prior to, or in lieu of, the filing of bankruptcy. We note in this spirit that bankruptcy courts, not infrequently, find themselves attempting to apply ordinary contract principles, too.20

Our analysis proceeds as follows. Section I chronicles the rise of debt textualism since the early 1980s, as courts increasingly confronted a contractual landscape that necessitated modifications of traditional “intent”-based contract interpretation approaches. We describe how textualism prevailed over plausible alternatives, such as a modified version of good faith, by the early 2000s as a means for achieving purported uniformity and predictability. The Section closes by examining a recent case study involving the now-bankrupt Revlon corporation where debt textualism spawned nearly intractable deadlocks among irritable participants. Section II provides a normative assessment of debt textualism, arguing that while the approach might have been attractive four decades ago, the evolution of debt markets and market norms since then has revealed its substantial drawbacks. Section III explores several pragmatic, doctrinal, and regulatory reforms that provide a way to “keep the faith” in uniform, predictable, and non-opportunistic debt markets by, among other things, rediscovering neglected non-textualist approaches, and imposing stronger regulatory guardrails to regulate opportunism and systemic risk.

I. THE EMERGENCE AND EVOLUTION OF DEBT TEXTUALISM

To better understand why and how debt textualism emerged on the scene, it is important to begin by understanding how we adopted it. While textualism plays a role in all areas of contracts, it has not generally gained, or at least has not preserved, the central role it enjoys in corporate debt arrangements. To understand the branching of contract law’s evolutionary tree, we review some common law precepts for contract interpretation. Contractual disputes about meaning are not new, and courts have long been required to both interpret express terms and fill out contractual gaps using implied duties. Both tasks are central to contract interpretation.

19 See generally Frumes & Indap, supra note 11 (collecting references).
20 See infra notes 100-06 and accompanying text.
First, we consider the standard approach to interpreting an express term where the parties attach differing meanings to the term. How should a court adjudicate this dispute? This question—a staple of first-year contracts classes—generates a familiar pecking order of interpretive tools, comprised of textualism, contextualism, intentionalism, purposivism, functionalism, and other approaches. Intentionalism comes first: If the evidence dispositively shows that the parties ascribed the same meaning to a disputed term at the time of contract formation, that shared intent governs regardless of other objective indicia. When the parties subjectively attach inconsistent meanings to a term, but one party (and only one) reasonably knows her counterpart’s interpretation, disputes are settled in favor of the less informed party’s interpretation.

In many cases, dispositive evidence of shared subjective intent proves unavailing, and the parties’ competing interpretations are metaphorical ships passing in the night. Contract interpretation doctrine adapts to these scenarios, instructing courts to shift gears and decipher an ‘objective’ meaning for the disputed term. This approach directs courts to give great weight to the “principal purpose” of the term, if ascertainable based on the facts of the case. Courts then work through the remainder of the pecking order, beginning with a textualist undertaking to assess generally prevailing plain

\[\text{See, e.g., Restatement (Second) of Contracts § 201(3) (Am. L. Inst. 1981) ("Except as stated in this Section, neither party is bound by the meaning attached by the other, even though the result may be a failure of mutual assent.").}\]

\[\text{See, e.g., Restatement (Second) of Contracts § 201(2)(b) (Am. L. Inst. 1981) ("[T]hat party had no reason to know of any different meaning attached by the other, and the other had reason to know the meaning attached by the first party.").}\]

\[\text{Sometimes they are literal ones too. See Raffles v. Wichelhaus 159 Eng. Rep. 375, 375 (Ex. 1864) (noting the parties had a misunderstanding during their agreement, referring to two different ships which both happened to be named “Peerless”); Eric L. Talley, Peerless (May 16, 2022), https://ssrn.com/abstract=4116830 [https://perma.cc/BP22-7JMH] ("Except there was just one glitch: Evidently, unbeknownst to either party, there were actually two cargo ships sailing from Bombay to Liverpool, just weeks apart from one another. And both ships . . . as it happened . . . were named . . . Peerless.").}\]

\[\text{See, e.g., Frigaliment Importing Co. v. B.N.S. Int’l Sales Corp., 190 F. Supp. 116, 119 (S.D.N.Y. 1960) (describing a contractual dispute over the meaning of ‘chicken,’ and noting the court has reviewed the negotiations between the parties, the industry’s trade usage, and witness testimony to ascertain the meaning envisioned by the parties to the agreement).}\]
meaning, moving next to course of performance, then to course of dealing, and finally to trade usage. If none of these approaches breaks ground—and the disputed term is material—then the contract may simply be deemed void. If the disputed term is a minor one, courts are more inclined to deploy a default term to fill the gap.

This second option—gap filling—plays an even broader role in contract interpretation. Contracts are generically and unavoidably incomplete and riddled with gaps, where express terms fail to prescribe what is required for certain contingencies. Contractual incompleteness emanates from many causes, including bounded foresight, transaction costs, linguistic limitations, and even deliberate ambiguity—in other words, provisions intentionally left to courts to decide the meaning of. In every case, a court wishing to enforce a contract must deploy a gap-filling rule to assess and adjudicate the parties' obligations. As a result, a vast number of contractual gap-fillers have been generated over the years (too many to catalog here). One of the most important to emerge from this gap-filling function is the duty of good faith and fair dealing ("good faith" for short)—an implied obligation that applies to the performance and enforcement of every contract.

26 See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 202(3)(a) (AM. L. INST. 1981) ("[W]here language has a generally prevailing meaning, it is interpreted in accordance with that meaning . . ."); U.C.C. § 2-208(2) (AM. L. INST. & UNIF. L. COMM’N 2001) ("The express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (Section 1-205).").

27 See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 202(4) (AM. L. INST. 1981) ("Where an agreement involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection is given great weight in the interpretation of the agreement."); UCC § 2-208(2) (AM. L. INST. & UNIF. L. COMM’N 2001).

28 See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 202(5) (AM. L. INST. 1981) ("Wherever reasonable, the manifestations of intention of the parties to a promise or agreement are interpreted as consistent with each other and with any relevant course of performance, course of dealing, or usage of trade."); UCC § 2-208(2) (AM. L. INST. & UNIF. L. COMM’N 2001) ("The express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other . . .").

29 Id.

30 See, e.g., Raffles v Wichelhaus 159 Eng. Rep. 375, 376 (Ex. 1864) (finding no binding contract between parties because of the misunderstanding over a material term); RESTATEMENT (SECOND) OF CONTRACTS § 201(3) (AM. L. INST. 1981) ("Except as stated in this Section, neither party is bound by the meaning attached by the other, even though the result may be a failure of mutual assent.").

31 See, e.g., U.C.C. § 2-208(2) (AM. L. INST. & UNIF. L. COMM’N 2001) (missing quality provisions filled in with the Implied Warranty of Merchantability); U.C.C. § 2-308 (AM. L. INST. & UNIF. L. COMM’N 2001) (missing place of delivery filled in with the seller’s place of business/residence); RESTATEMENT (SECOND) OF CONTRACTS § 347 (AM. L. INST. 1981) (missing remedy provisions filled with expectation damages, subject to some exceptions).
Substantively, the duty of good faith requires both sides to behave in a manner that is consistent with shared intent, so as not to deprive their counterparty of the “fruits” of the contract or undercut its principal purpose. As described in a pivotal Ninth Circuit opinion:

This covenant not only “requires each contracting party to refrain from doing anything to injure the right of the other to receive the benefits of the agreement . . . but also [imposes] the duty to do everything that the contract presupposes that he will do to accomplish its purpose.”

To a large extent, the duty of good faith embodies an “anti-loophole” mandate. It prohibits parties from opportunistically seizing upon contractual ambiguities that arguably give them the discretion to take actions that benefit themselves, if doing so would be inconsistent with the common purpose the parties envisioned when executing their agreement.

Because good faith duties often value the ‘spirit’ or ‘common purpose’ of an agreement above potential textual loopholes, the contours of the doctrine vary from contract to contract. Many courts have observed that precise articulations of the standard are elusive if not impossible to identify. Given the doctrine’s dependence on context, parties can, and often do, adopt express contractual terms to shed light on purpose, which, ultimately, shapes judicial application of the good-faith doctrine. This gives good faith at least some of the trappings of a standard “default” rule. Nevertheless, parties are not permitted to waive or disclaim good faith duties writ large, and the existence of good faith, as opposed to the contours of its content, is an immutable rule.

The duty of good faith, like the other interpretation tools for express terms mentioned above, is common in all contracts. Well, almost all of them.

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32 See, e.g., 17A CORPUS JURIS SECUNDUM Contracts § 454, Westlaw (database updated Feb. 2023) (“The implied covenant or duty of good faith and fair dealing requires a party to a contract to refrain from doing anything that will destroy or injure the other party’s right to receive the benefits or fruits of the agreement.”).


34 See, e.g., City of Rome v Glanton, 958 F. Supp 1026, 1038 (E.D. Pa. 1997) (“The obligation to act in good faith in the performance of contractual duties varies somewhat with the context and is impossible to define completely, but it is possible to recognize certain strains of bad faith which include: evasion of the spirit of the bargain; lack of diligence and slacking off; willful rendering of imperfect performance; abuse of a power to specify terms, and interference with or failure to cooperate in the other party’s performance.”).

35 See U.C.C. § 1-102(3) (AM. L. INST. & UNIF. L. COMM’N 2001) (“The effect of provisions of this act may be varied by agreement . . . except that the obligations of good faith, diligence, reasonableness and care prescribed by this act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.”).
A. The Evolution of Corporate Debt Markets and the Waning Duty of Good Faith

Although the origin story of credit agreements begins with the common law of contracts, their development has since been dictated by how these contracts have evolved into quasi-securities. In the late 20th century, debt contracts grew from bespoke arrangements into fungible financial commodities, produced en masse with highly similar boilerplate terms, frequently trading on anonymous public exchanges. Each contract was tied to a complex web of originators, underwriters, trustees, intermediary purchasers, and secondary market purchasers. The presence of increasingly interconnected power players in any one debt contract created the practical impossibility of realistically divining the ‘intent of the parties.’ There were simply too many of them, connected in too many complex ways.

A watershed moment in the evolution of debt textualism in U.S. contract law is the late Judge Ralph Winter’s opinion in Sharon Steel v. Chase Manhattan Bank. Although Sharon Steel is over 40 years old, the facts giving rise to the case are not dissimilar from what we see today. Sharon Steel Corp. acquired the assets of U.V. Industries (“UV”), its predecessor in interest. At the time of the asset sale, UV had issued several interest-bearing public debentures with fixed-rate coupons that ranged between 5.375% to 9.25% per annum. Most of these bonds were issued in the late 1960s through mid-1970s, when prevailing interest rates were relatively low. However, by the end of the 1970s, interest rates had skyrocketed: Prevailing rates for corporate borrowing far exceeded rates UV was paying on the bonds. As a consequence, UV bonds were trading at a steep discount to their face value.

While a steep discount can sometimes be a tell of financial distress, here it substantially, if not wholly, resulted from a precipitous spike in benchmark interest rates (Figure 1). In such situations, a legacy fixed-rate borrower is placed in a particularly advantageous position, with payment obligations that now look cheap by comparison. Lenders, in contrast, lose out, sitting on investments that yield far less than competitive rates, which in turn induces the pricing discount (given that yields and prices move in opposite directions). As a result, lenders are typically itching to find a way to free up and redeploy the principal, while borrowers do everything in their power to keep the debt contract in place.

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36 Sharon Steel, 691 F.2d 1039 (2d Cir. 1982).
37 Sharon Steel, 691 F.2d at 1042.
38 Id.
This is the dynamic that fed the central dispute in *Sharon Steel*. For a variety of unrelated reasons, UV deemed it prudent to sell its business to a third party(ies), to be completed in one year’s time.\(^39\) One of the key “assets” that UV controlled was, ironically enough, its debt, now featuring below-market-rate coupon obligations and trading at a sizable discount. All else constant, both UV and its successor in interest would want to keep the bonds deployed as long as possible. However, UV also had three major operating subsidiary divisions that were also intended to be the main part of the deal;\(^40\) because of the tight transaction deadline set by UV, the sales process required some flexibility, particularly in finding willing buyers to onboard the various assets in a sale. UV was quickly able to find takers for two of its operating divisions, and it promptly closed sales with them, unloading the first for $345 million, and the second for $150 million.\(^41\) After issuing a dividend to shareholders of around $150 million, UV was left holding the remaining cash,

\(^{39}\) *Id.* at 1045.

\(^{40}\) These consisted of the Federal Pacific Electric Company (accounting for 60% of revenue and 81% of operating profits); a variety of oil and gas properties (2% of revenues; 6% profits) and the Mueller Brass Corp. (38% operating revenues; 13% profits). *Id.*

\(^{41}\) *Id.*
one last operating division, and the below-market-rate debt. Sharon Steel entered the fray to purchase what was left.

The way that UV had conducted the sales process posed a problem for preserving the bonds. As a general matter, when a corporate borrower liquidates, so too do its general obligations, and they must be satisfied immediately. However, most bond indentures also include a carve-out from this usual rule via a “successor obligor” provision, which allows a bona fide purchaser to keep the debt intact so long as they have purchased “all or substantially all” of the assets of the seller. Here, because two of UV’s major operating subsidiaries had already been sold off, the appearance of a liquidation posed an inconvenient obstacle to structure any UV-Sharon Steel sale that kept the debt intact. Their solution was (1) to simply treat the cash they received for the earlier divisional sales as an “asset” of UV; (2) to couple that cash “asset” with remaining operating subsidiary; and (3) to sell off the subsidiary and the pile of cash in return for a different pile of cash paid by Sharon Steel. This cash-for-cash “sale” of UV to Sharon Steel was essentially Kabuki theater, in which the parties bi-directionally exchanged hundreds of millions of dollars, all for the end of dressing up the transaction to look like a “sale of all or substantially all” UV’s assets, thereby allegedly triggering the carve-out.

After Sharon Steel took these steps and declared its intent to keep UV’s legacy bonds intact, bondholders led by Chase Manhattan (“Chase”) cried foul, arguing that regardless of how the deal was adorned, it was functionally the last stage of a piece-by-piece liquidation of UV, and not a “sale of all or substantially all assets” pursuant to the bond indenture. They argued UV had consequently defaulted, which required its successor Sharon Steel to answer for either (a) the $411 million acceleration of face value of the loans due and payable immediately, or (b) a “deemed redemption” of the bonds, which would require Sharon Steel to pay that same face value plus a premium. After the district court ruled in Chase’s favor on summary judgment and ordered accelerated payment of the face value on the bonds, Sharon Steel appealed to the Second Circuit.

Unfortunately for Sharon Steel, its second bite at the apple actually worsened its fate. Writing for a unanimous panel, Judge Ralph Winter

42 Id.
43 Id. at 1046.
44 Sharon Steel v. Chase Manhattan Bank, 691 F.2d 1039, 1045 (2d Cir. 1982)
45 Id. at 1049.
46 Id.
47 Id.
48 Id. at 1047.
49 Id. at 1041-42.
strongly affirmed the trial court’s summary judgment ruling on liability; the court also increased the damages, finding that UV’s maneuver triggered the redemption provision in the bonds which required payment of a premium beyond face value.\textsuperscript{50}

The liability portion of Winter’s opinion made at least two significant contributions kickstarting a 40-year evolution in contract law doctrine governing corporate credit. The first was to underscore that while the interpretation of bondholder protections is a matter of common law contract, applying those principles gets tricky when the terms are the product of a highly intermediated contract containing boilerplate provisions that recur, almost verbatim, across countless bond indentures trading in public exchanges. Judge Winter made a strong play for uniform interpretations in such settings, positing that predictability was perhaps even more important than accuracy:

Whereas participants in the capital market can adjust their affairs according to a uniform interpretation, whether it be correct or not as an initial proposition, the creation of enduring uncertainties as to the meaning of boilerplate provisions would decrease the value of all debenture issues and greatly impair the efficient working of capital markets. Such uncertainties would vastly increase the risks and, therefore, the costs of borrowing with no offsetting benefits either in the capital market or in the administration of justice. Just such uncertainties would be created if interpretation of boilerplate provisions were submitted to juries sitting in every judicial district in the nation.\textsuperscript{51}

The upshot of this now-famous excerpt was that, at least for corporate debt cases, the panel jettisoned any theory of contract interpretation that would require a factfinder to embark on a vision quest for the shared intent of the parties. Such divinations were logically incoherent exercises, inevitably destined to fail. Instead, the court held that these interpretation questions should be treated entirely as issues of law and not of fact.\textsuperscript{52}

Judge Winter’s second contribution presented a novel interpretive test in the form of a revised duty of good faith. Although traditional incarnations of the good faith doctrine are based on divining the parties’ shared intent, which was a near impossibility in Sharon Steel, it was still possible to conjure up a modified version based on a more objective and verifiable calculus. Judge Winter floated an idea for adjudicating between competing interpretations of the term “all or substantially all of UV’s assets,” writing:

\textsuperscript{50}Id. at 1053.
\textsuperscript{51}Id. at 1048.
\textsuperscript{52}Id.
Where contractual language seems designed to protect the interests of both parties and where conflicting interpretations are argued, the contract should be construed to sacrifice the principal interests of each party as little as possible. An interpretation which sacrifices a major interest of one of the parties while furthering only a marginal interest of the other should be rejected in favor of an interpretation which sacrifices marginal interests of both parties in order to protect their major concerns.53

By introducing an explicit tradeoff of interests, Judge Winter’s modified good-faith duty squared intuitively with economic welfare calculus, reminiscent of Judge Learned Hand’s similar pronouncement in tort law three decades earlier,54 which also prescribed a comparison of benefits and burdens.

After setting up this doctrine, the court concluded that applying its test was “not difficult” and “not . . . even close.”55 Judge Winter wrote that protecting the entire pool of assets standing behind an indenture was a “major interest” of bondholders.56 Were Sharon Steel/UV allowed to treat this transaction as a sale of all or substantially all assets, it would render these protections almost valueless, while prohibiting such treatment would honor the significant interest of lenders in ensuring the “continuity of assets” in the business that is obliged to service the loan.57 The motivation to preserve low-interest debt was not only less significant, but maybe even absurd: If Sharon Steel’s claim was correct that its cash-for-cash transaction represented a sale of all or substantially all of its assets, then in reality UV industries still had not sold off all its assets, and it had simply converted them into another pile of cash.58

At its core, Judge Winter’s proposal deemphasized the parties’ actual intent in contracting and replaced it with an imputed common purpose that commercial parties are presumed to share: maximizing the expected joint economic surplus available to the parties. Such a purpose makes considerable sense regardless of how the surplus is distributed because the parties can reallocate the now-maximized pie by adjusting pricing formulas. Contracting parties pursuing this goal would jointly favor a rule that deems a discretionary act by a party (like UV’s structuring of the sale to Sharon Steel) to be consistent with good faith so long as it passes muster under a cost-benefit

53 Id. at 1051.
54 See United States v. Carroll Towing Co., 159 F.2d 169, 173 (2d Cir. 1947) (weighing the expected gravity of an injury against the burdens of taken precaution).
55 Sharon Steel v. Chase Manhattan Bank, 691 F.2d 1039, 1051 (2d Cir. 1982).
56 Id.
57 Id. at 1050.
58 Id. at 1051.
calculus. Judge Winter’s good-faith formulation boils down to a single imperative: *Don’t Shrink the Pie (DSP)*, as illustrated in Figure 2.

**Figure 2: Judge Winter’s DON’T SHRINK THE PIE CONCEPTION OF GOOD FAITH & FAIR DEALING**

The Figure presupposes that two parties, X and Y, disagree over whether their contract permits one of them (here X, shown on the horizontal axis) to take a discretionary action assumed to serve X’s interests, when the act also affects the interests of the other contracting party (here Y, on the vertical axis). The dispute could concern either a disagreement over whether an *express* provision allows the disputed act (so that good faith serves to arbitrate between competing interpretations), or whether an *implied* obligation allows the disputed behavior when the writing is silent on the issue (so that good faith functions as a gap filler).  

Point A is the designated baseline in the diagram, representing the parties’ expected payoffs when X is prohibited from taking the contemplated action (and normalized to be situated at the

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59 Note that it was the former question—interpreting an express successor obligor provision—that animated the *Sharon Steel* dispute. It is not altogether clear whether Winter would have extended the DSP approach to a situation that required gap filling. *Id.* at 1049 (“[T]he debt securityholder can do nothing to protect himself against actions of the borrower which jeopardize its ability to pay the debt unless he . . . establishes his rights through contractual provisions set forth in the . . . indenture.”) (quoting AMERICAN BAR FOUNDATION, COMMENTARIES ON INDENTURES 1-2 (1971)).
Points B, C and D represent three alternative scenarios for payoffs that might be obtained when X is permitted to take the contemplated action. Judge Winter’s formulation essentially asks whether any adverse costs imposed on Y are justified by the benefit accruing to X. In the diagram, if X’s action would result in Point B emerging (or any other point in the dark shaded region where Y’s expected detriment exceeds X’s expected benefit), the DSP standard would interpret the contract to prohibit X from acting. Alternatively, if X’s action would shift payoffs to either Point C (where X’s gain exceeds Y’s detriment) or Point D (where both parties expect a benefit), the DSP standard would countenance X’s action. A textualist approach, by contrast, would permit X to act in all cases (including Point B), because there is no unambiguous express prohibition of the disputed action.

The downward-sloping boundary represents a “zero-sum” scenario where X’s expected benefit exactly offsets Y’s expected detriment. While seemingly an edge case for Winter’s test, this is an important scenario in financial contracting because financial contracts serve to divide cash flows across specified future contingencies, which is a zero-sum transfer payment by construction. Even here, the payoff structure need not be zero-sum when assessed ex ante, when prospective risk premiums and incentives also come into play. Therefore, financial contracts may not regularly fall on this zero-sum boundary, at least when one incorporates ex ante considerations, rather than focusing on ex post. When a bona fide edge case emerges, it is more practical for the non-discretionary party, such as the one conventionally alleging default, to ordinarily bear the burden of showing a lack of good faith by the other party, pushing the edge case in favor of X’s discretion.

Notwithstanding the possibilities presented by the DSP approach, the court’s suggestion was largely overshadowed by the first contribution instead. The most cited excerpt of Judge Winter’s contributions is his first insight: boilerplate provisions in corporate debt agreements must have a uniform interpretation. It is hard to find a contract interpretation opinion involving

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60 The Figure suppresses consideration of actions by X that result in a negative expected payoff to X, implicitly assuming that X will act rationally in the interests of maximizing their own expected payoff.

61 Though not a central focus of this article, Figure 2 is also helpful for understanding how the DSP conception of good faith may be distinguished from the more exacting fiduciary duties of X. If X owed Y a fiduciary duty, then X cannot use her discretion to enrich herself unless she can demonstrate that doing so is “entirely fair” to Y. This more rigorous obligation would rule out both Point B and Point C (where X’s action harms Y). Point D might be allowed, however, under the theory that X’s action benefits Y, is therefore substantively fair, and accordingly passes muster under the entire fairness test. See, e.g., In re Trados Inc. S’holder Litig., 73 A.3d 17 (Del. Ch. 2013) (upholding a merger as fair when common stockholders gained nothing from it); In Re Tesla Motors, Inc. S’holders Litig., No. 12711-VCS, 2022 WL 1237185, at *31 (Del. Ch. Apr. 27, 2022) (finding that Tesla paid a fair price to acquire another firm).
corporate debt that does not throw in a string cite to Judge Winter’s contribution. Sharon Steel is in fact ubiquitous with this principle. The DSP standard, in contrast, has made less of an impact in subsequent case law.62 Rather, a line of cases following Sharon Steel embraced a different approach to achieve “uniformity”: textualism, i.e., construing express provisions strictly against the creditor, while allowing little to no margin for good faith and fair dealing strictly construed boundaries.

B. Private Equity and the Leveraged Buyout Market

Just as the Sharon Steel opinion dropped, the leveraged buyout (LBO) market in the United States began to take off. Fueled in part by a revolution of various types of fixed income bonds, such as high-yield “junk” bonds (famously created and propounded by Drexel Burnham Lambert and Michael Milken), several private equity (PE) firms began setting their sights on buying “underpriced” public companies and pulling them off of public markets.63 The implications of this LBO wave were appreciable, both for the economy and the evolution of debt textualism.

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62 To take one measure, as of this writing, Westlaw’s metric of headnote citations reports that Sharon Steel has been cited in 29 subsequent judicial opinions for the proposition that boilerplate provisions should be subject to uniform interpretations, but only 5 times for its articulation of the DSP standard. Citations to Sharon Steel, WESTLAW, www.westlaw.com (navigate to Sharon Steel page; then scroll to table titled “West Headnotes.”).

63 For a look into the operations at Drexel Burnham Lambert and Michael Milken’s role as the “junk bond king” and subsequent litigation against Milken, see generally CONNIE BRUCK, THE PREDATORS’ BALL: THE INSIDE STORY OF DREXEL BURNHAM AND THE RISE OF THE JUNK BOND RAIDERS (1988).
In a standard take-private transaction (Figure 3), a PE fund contributes a modest amount of capital into a special purpose entity (SPE), usually a corporation created solely to execute the transaction, and then causes the SPE to raise additional capital through loan commitments from debt capital investors (see left panel). This is done to execute a cash acquisition of an existing public company. The public target company often carries some legacy debt, but the PE sponsor aims to increase that debt load further to take advantage of both tax benefits and juiced returns for the PE fund. Consequently, the PE firm couples its limited partners’ investments with significant third-party debt commitments to buy out the target’s public shareholders, often paying them a hefty premium. When the PE firm’s special purpose acquisition vehicle merges with the public target, both entities’ assets and liabilities are also merged by operation of law. This leads to a substantial windfall for departing shareholders and a successful takeover by the PE firm. The deal also creates a company that is characterized by a capital stack heavily saddled with debt (see right panel).

Judge Winter’s guideposts from *Sharon Steel* were cemented as the LBO market developed. The question of bondholder rights, either express or implied, became prominent in the infamous buyout of RJR Nabisco in the late 1980s. There, the storied private equity firm Kohlberg Kravis Roberts & Co. (KKR) prevailed in a competitive bidding process against the incumbent management of RJR in a deal valued at over $25 billion, which is colossal even...
by 2023 standards. New PE lenders taking on the debt side of the deal were sophisticated parties who knew that once the deal closed, the company would be heavily leveraged and present a potential insolvency risk. These were contingencies they presumably priced into their loan agreements. However, the legacy public bondholders of RJR were not so lucky, having purchased bonds long before RJR was an LBO target. Although the existing bondholders had some protections (for example, their claims could not be subordinated to those of new creditors), the indentures did not provide strong protections against additional indebtedness of equal or lesser priority. At this point, their claims were among a crowded creditor pool who would try to collect in the event of insolvency—a prospect that looked increasingly likely with the added debt that the LBO caused RJR to take on. As a result, the market value of the legacy bonds plummeted.

Metropolitan Life Insurance (MetLife) and other legacy bondholders of RJR sued, alleging breach of contract and fraud. Although some of the plaintiffs’ fraud claims were allowed to go forward, Judge John Walker Jr. of the Southern District of New York dismissed the breach of contract claim. More specifically, the court dismissed the good faith allegation that MetLife advanced: if MetLife (or more likely the underwriter) failed to negotiate express provisions prohibiting this type of LBO, there was no impetus for the court to ride to the rescue. The court relied on an ABA commentary on indentures to reach its conclusion:

[T]he significant fact, which accounts in part for the detailed protective provisions of the typical long-term debt financing instrument, is that the lender (the purchaser of the debt security) can expect only interest at the prescribed rate plus the eventual return of the principal . . . . Short of bankruptcy, the debt security holder can do nothing to protect himself against actions of the borrower which jeopardize its ability to pay the debt unless he . . . establishes his rights through contractual provisions set forth in the debt agreement or indenture.


66 Id. at 1508.

67 Id.

68 Id. at 1518 (quoting AM. BAR FOUND., COMMENTARIES ON INDENTURES 1-2 (1971)).
The court reasoned that in the absence of any explicit prohibition in the bond indenture, RJR and KKR were free to structure the transaction as they saw fit. The court conceded that while the indenture did not explicitly prohibit LBO transactions like this, neither did it expressly permit them. Rather, the contract was simply silent on the issue. Nevertheless, Judge Walker wrote that it was the absence of prohibitions in the contract that was most significant, thereby suggesting that the indenture’s silence should be construed to allow such transactions.

The court’s review of the KKR buyout served as a template for other courts to channel Judge Winter’s opinion in _Sharon Steel_. While a strong majority of courts agreed with Judge Winter’s first prescription (that boilerplate language necessitated uniform interpretations), later opinions discounted or ignored his second prescription (using a DSP formulation of good faith to assess the permissibility of discretionary acts). A consensus version of good faith began to emerge in debt cases that diverged from Judge Winter’s proposal: if corporate creditors failed to secure an unambiguous, express provision protecting them, courts were loath to supply one of their own through implied terms regardless of whether the pie would grow or shrink as a result. This definition of good faith rendered it toothless.

C. The Effects of LBOs on Debt Restructuring Law

Debt restructuring law also developed around the same time as the KKR buyout. Since the 1980s, financially-distressed corporate borrowers have been experimenting with strategic ways to pit their creditors against one another, all to the borrowers’ benefit. So-called “exit-exchange” offers in public debt restructuring were a particularly significant development.

When a company falls into financial distress, it is by definition on the brink of insolvency. While the company is still able to satisfy claims, distressed firms are on their last remaining lifeline and necessarily operate

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69 Id. at 1519 (“[T]here admittedly is not an explicit indenture provision to the contrary of what plaintiffs now claim the implied covenant requires. That absence, however, does not mean that the Court should imply into those very same indentures a covenant of good faith so broad that it imposes a new, substantive term of enormous scope.”).

70 See infra Section I.C.

71 See _Met. Life Ins._, 716 F. Supp. at 1519 (discussing the Court’s reluctance to imply a duty of good faith). The facts of the case may have also contributed to Judge Walker’s decision, since several of the MetLife debentures previously had covenants that would have precluded a leveraged buyout of the type KKR pulled off, but those provisions were renegotiated with bondholders’ consent. MetLife itself was aware of the risks and had already experienced LBO transactions that wiped out its debt position (though by hedging through equity positions it was left unscathed).

72 For a discussion of the strategy behind exit exchange offers, see Antonio Bernardo & Eric Talley, _Investment Policy and Exit-Exchange Offers Within Financially Distressed Firms_, 51 J. FIN. 871, 873 (1996).
very close to the margin. Those holding debt claims in these firms are aware of potential insolvency because they are subject to the pain upon default. As a result, shareholders running the company would like nothing better than to restructure their debt. Their creditors might want them to do that, but most creditors would rather avoid making concessions themselves; they would rather the pain of debt restructuring be taken out on other creditors. Since this is a uniform tendency among lenders, no one creditor ever volunteers to take one for the team, which makes debt restructuring more difficult to accomplish.

Due in part to this complex calculus, measures to facilitate debt restructuring have a Schrödinger’s Cat quality—simultaneously representing features and bugs. On the one hand, restructuring provides avenues for relief by breaking the creditor logjam for debtors who are underwater either because of unfortunate circumstances or bad luck. On the other hand, the option to restructure is also a tempting safety net for the moral hazards of borrowers who assume they can just restructure down the road; this can incentivize borrowers to make risky decisions or divert value to themselves or both. Corporate finance debates converge along how “easy” versus “impossible” it should be in a given circumstance to pull off a debt restructuring.73

The Trust Indenture Act (TIA), a Depression-era statute, adds yet another layer to the contours of debt restructuring law. Generally, publicly-traded debt securities (as well as non-publicly traded debt obligations that do not qualify for an exemption) are bound to a series of mandatory rules, including governance by an indenture administered by a trustee, under the TIA.74 Section 316(a) of the Act imposes a de facto unanimity requirement if a borrower wishes to alter the “central terms” of an indenture, defined as principal or interest.75 Therefore, if a borrower wanted to get the consent of bondholders to restructure the contract’s central terms, the borrower cannot “cram down” this kind of change on any note holders who oppose it. In essence, this creates a veto right for any holdouts.

74 See INDENTURE AND INDENTURE TRUSTEE: GOVERNING LAWS, PRACTICAL LAW PRACTICE NOTE (2023), Westlaw 9-386-4929 (providing background on the TIA, including its application and exceptions).
75 See Trust Indenture Act, 15 U.S.C. § 316(a) (“Notwithstanding any other provision of the indenture . . . the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture . . . shall not be impaired or affected without the consent of such holder.”).
At the same time, the TIA does not impose a unanimity requirement on debtors who wish to alter other terms or content of the contract that fall outside of “core” terms regarding principal or interest. Many indentures allow bond holders to remove certain covenants by a majority or supermajority vote.\textsuperscript{76} In the mid-1980s, distressed debtors figured out how to manipulate this framework.\textsuperscript{77} Instead of adjusting the core terms of a given series of debt, debtors would offer to enter an exchange transaction with creditors. They would receive new debt securities with lower aggregate face value that stood higher up in the debt stack, allowing them to cut the line against those creditors who did not consent to the exchange. While most indentures, even relatively lax ones, have covenants that prohibit this type of subordination, these covenants could usually be waived by a majority vote of the bondholders.\textsuperscript{78} The exit-exchange offer therefore exploits the possibility of waiver by majority.\textsuperscript{79} Significantly, only those debt holders who consent to the restructuring are eligible to participate in the offer. Consenting bond holders are asked to vote to change the rules to allow people to “cut the line” ahead of them to collect; in exchange, they are given first dibs on the right to cut the line. This proposition ingeniously side-steps the TIA’s prohibitions on non-unanimous changes to core terms. It also creates a potential collective action problem where note holders could rush the exits, based on fears that other creditors will edge them out and cut the line before them.

This type of offer created a problem of “structural coercion” for debtholders.\textsuperscript{80} In \textit{Katz v. Oak Industries}, defendant Oak Industries executed one of these transactions with its distressed bondholders.\textsuperscript{81} When Katz, a nonconsenting holdout, sought a preliminary injunction, the Delaware Court of Chancery denied his motion. The court followed the reasoning in \textit{Metropolitan Life}, and put an even finer point on the notion that ordinary

\begin{itemize}
\item \textsuperscript{76} See, e.g., Revised Model Simplified Indenture Section 9.02, 55 BUS. LAW. 1115, 1146 (“The Company and the Trustee may amend this Indenture or the Securities with the written consent of the Holders of at least a majority in Principal amount of the Securities.”).
\item \textsuperscript{77} See Bernardo & Talley, supra note 72, at 871-74 (providing a history of this period); \textit{In re Dell Techs. Inc. Class V Stockholders Litig.}, 2018-0816-JTL, 2020 LEXIS 211, at *43-47 (Del. Ch. June 11, 2020) (same).
\item \textsuperscript{78} Bernardo & Talley, supra note 72, at 871-74.
\item \textsuperscript{79} Such restructuring proposals first offer the creditor an “exchange” option, permitting them to tender their securities back to the firm in exchange for some other security (usually smaller but more senior debt). In doing so, the debt holder also grants their “exit consent” via a vote to weaken/negate various financial covenants that would otherwise prohibit the exchange. See generally Bernardo & Talley, supra note 72 (explaining the “simultaneous” process of creditor “consent to debt restructuring and tendering of debt”).
\item \textsuperscript{81} 508 A.2d 873, 875 (Del. Ch. 1986) (“[T]he offer is an integral part of a series of transactions that together would effect a major reorganization and recapitalization of Oak.”).
\end{itemize}
contract claimants are not entitled to the same type of special treatment that shareholders enjoy. Chancellor Allen did not cite to Sharon Steel but effectively rejected Judge Winter's utilitarian “don’t shrink the pie” rationale. Instead, the court approved the idea that borrowers may try to use their discretion to pursue their own gains at creditors’ loss. Even accepting that as a potential problem, it is outside the courts’ control:

[The plaintiff’s complaint] that “the purpose and effect of the Exchange Offers is to benefit Oak’s common stockholders at the expense of the Holders of its debt”—does not itself appear to allege a cognizable legal wrong. It is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation’s stockholders; that they may sometimes do so “at the expense” of others . . . does not for that reason constitute a breach of duty. It seems likely that corporate restructurings designed to maximize shareholder values may in some instances have the effect of requiring bondholders to bear greater risk of loss and thus in effect transfer economic value from bondholders to stockholders . . . . But if courts are to provide protection against such enhanced risk, they will require either legislative direction to do so or the negotiation of indenture provisions designed to afford such protection.

Katz is representative of a discernible trend towards debt-textualism that grew among courts during the 80s and 90s. The approach prescribed that credit agreements and indentures should be subject to strict textual interpretation, and that most ambiguities in obligations beyond the central terms of principal and interest should favor the borrower and its shareholders. If a creditor wished for greater protection, only express provisions, and not the duty of good faith, could do the job. Creditors began to explore other avenues by which to win back some judicial love, as a result. In each instance, what looked like early signs of victory ultimately proved fleeting.

82 See id. at 879 (“Under our law—and the law generally—the relationship between a corporation and the holders of its debt securities, even convertible debt securities, is contractual in nature . . . . Arrangements among a corporation, the underwriters of its debt, trustees under its indentures and sometimes ultimate investors are typically thoroughly negotiated and massively documented. The rights and obligations of the various parties are or should be spelled out in that documentation. The terms of the contractual relationship agreed to and not broad concepts such as fairness define the corporation’s obligation to its bondholders.”).
83 Id. at 879.
84 In recent years, the contours of the TIA been put in a state of flux. In Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Corp., the Second Circuit, reversing the district court, declined to extend TIA protections to a restructuring that allegedly interfered with a “core term” or “sacred right” enjoined by the lenders. 846 F.3d 1 (2d Cir. 2017), reh’g denied, No. 15-2124 (2d Cir. Mar. 21, 2017). The Southern District of New York had previously deemed the refinancing to impair “central terms” under the TIA and employed a broad reading of noteholders’ rights. Marblegate Asset Mgmt. v. Educ. Mgmt. Corp., 75 F. Supp. 3d 592, 610-11 (S.D.N.Y. 2014). The split Second Circuit panel
notably, creditors pursued a decade-long effort to obtain rights commonly identified with shareholders: fiduciary obligations. Traditionally, a debt holder’s fiduciary claim is strongly at odds with the corporate law template, whereby only shareholders can benefit from fiduciary duties and other stakeholders need not apply. These same considerations reinforced Chancellor Allen’s assessment that of course boards could do everything in their power to augur the fortunes of shareholders, even if it came at creditors’ expense.

Nevertheless, small gaps opened up in the shareholder/creditor distinction in the late 20th century, giving debt holders some hope for change. For example, creditors found opportunity in disputes between shareholders and junior creditors regarding corporate actions taken when the disputed business was in the so-called “zone of insolvency,” i.e., not yet insolvent, but one bad earnings report from crossing over. For firms in financial distress, the tradeoff between shareholder value and debt-holder protection presents a stark choice, because both constituencies can legitimately assert that they are “residual claimants” on firm value. It became an open question as to whether corporate directors should be obliged to maximize a firm’s total value in such situations, or if directors are still permitted, if not required, to focus solely on maintaining shareholders’ interests. This confusion arose from a famous footnote in the 1991 Delaware case, Credit Lyonnais v. Pathe Communications. Chancellor Allen, of the Katz opinion, wrote for the court in dicta that once a firm is inside the zone of insolvency, directors’ fiduciary obligations move beyond shareholder primacy; instead, they expand to cover the “community of interests that the corporation represents,” even if the corporate actions necessary to advance these interests are inconsistent with actions that maximize shareholder returns.

For more than 15 years, courts grappled with the meaning of the Credit Lyonnais footnote, as lenders repeatedly brought fiduciary claims against firms in the zone of insolvency to challenge corporate decisions that benefited
shareholders at the expense of creditors.\textsuperscript{89} It wasn’t until 2007 that the Delaware Supreme Court finally settled the debate.\textsuperscript{90} In \textit{North American v. Gheewalla}, the court reversed course and held that creditors have no rights under fiduciary law as long as the distressed firm is not yet actually insolvent.\textsuperscript{91} Specifically, the court held that:

When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners.\textsuperscript{92}

\textit{Gheewalla} resolved the debt-equity conflict simply by ruling out directors’ fiduciary obligations to creditors outside of insolvency. What had once seemed like a promising avenue for distressed creditors to get protection through implied duties and equitable protections was ultimately little more than jurisprudential smoke and mirrors.

\textbf{D. Debt Textualism Brewing in Private Credit Markets}

Initially, debt textualism developed in cases involving public bond markets because a large fraction of corporate debt existed in these markets. By the turn of the 21st century, however, an increasing amount of debt became privately held either through syndicated/leveraged loans or various types of asset-backed collateral pools, and it was no longer traded on public exchanges.\textsuperscript{93} Some of this debt was not subject to the TIA, because it was

\textsuperscript{89} See Russell C. Silberglied, \textit{Can a Creditors’ Committee Be Granted Standing to Sue for Breach of Fiduciary Duty?}, AM. BANKR. INST. J., Mar. 2011, at 16 (“This led to a multitude of complaints, mostly filed in bankruptcy courts, by creditors’ committees, litigation trusts or trustees, against directors for breach of fiduciary duties for alleged failure to prefer the interests of creditors over stockholders of insolvent or troubled, but arguably solvent, companies.”).

\textsuperscript{90} As it turns out, this was not quite the end of the debate—the exact same difficulties re-emerged in a series of recent cases pitting common against preferred shareholders, where the corporation is in the “zone of insolvency” for preferred shareholders. See Sarath Sanga & Eric L. Tulley, \textit{Don’t Go Chasing Waterfalls: Fiduciary Duties in Venture Capital Backed Startups 9-11} (European Corp. Gov. Inst., Working Paper No. 634/2022, 2023), https://ssrn.com/abstract=3721814 [https://perma.cc/Y4UJ-YLUU] (discussing conflicts between common and preferred shareholders and the resulting legal uncertainty).


\textsuperscript{92} Id.

exempted from general securities regulations requirements. Since then, though a relatively small slice of the market, private debt facilities have grown rapidly.

**Figure 4: Syndicated Loan Market Size and Risk Characteristics**

These financial tools are especially prominent in the LBO and leveraged recap contexts today, such as PE deals, distressed debt offerings, and public company recapitalizations. The rapid proliferation of complex lending facilities is a vestige of the cataclysmic growth of private capital markets since

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94 Syndicated loans have historically been treated as non-securities and are exempt from securities disclosure requirements. For a discussion of the legal framework applied to determine when and whether syndicated loans may be subject to securities requirements, see Elisabeth de Fontenay, *Do the Securities Laws Matter? The Rise of the Leveraged Loan Market*, 39 J. CORP. L. 725, 747 (2014).


the early 2000s. It is now typical to place a “private” syndicated debt offering in the hands of hundreds, if not thousands, of investors and/or funds.97 This market has grown substantially in the last decade.98 Outstanding balances have been consistently held in roughly equal proportions by both depository banks and non-depository institutions, including investment banks and funds, each clocking in comfortably at over $1 trillion today.99 Non-depository institutions, which face less regulatory oversight, also tend to hold the riskiest loan balances, holding nearly twice the fraction of highly risky or in-default loans as those held by depository institutions.100

In theory, the expansion of private debt presented another opportunity for courts to confront interpretational challenges; courts could consider whether the approach in this context would differ from the context of publicly traded bonds. Intuitively, the benefits of uniform interpretation would diminish in private debt contexts, where secondary trading markets are traditionally smaller and less liquid with fewer financial intermediaries. While these differences might have supported a distinct version of implied duties for private debt instruments, it became clear that judicial interpretations of private debt instruments would mimic that of their public counterparts.101 Debt textualism seamlessly infiltrated the jurisprudence around leveraged and syndicated loans, smuggling in with it additional consequences of contractual bloat, complexity and rigidity.

97 For example, a recent case addressing the question of whether syndicated loans are securities discussed “a $1.775 billion syndicated loan transaction . . . [where] Defendants offered and sold to the Trust’s beneficiaries—approximately seventy institutional investor groups, comprised of roughly 400 mutual funds, hedge funds, and other institutional investors . . . debt obligations of Millennium Laboratories LLC . . . .” Kirschner v. JPMorgan Chase Bank, N.A., No. 17 Civ 6334 (PGG), 2018 WL 4565148, at *1 (S.D.N.Y. Sept. 24, 2018).
98 See Figure 4 (displaying the growth of the last decade in this field).
99 Id.
100 For purposes of Figure 4, “highly risky” refers to loan balances estimated to face at least a 25% probability of default.
101 See, e.g., Jamie Sec. Co. v. The Ltd., Inc., 880 F.2d 1572, 1576 (2d Cir. 1989) (“Since the Debenture terms and the Indenture provisions are clear and unambiguous when examined as a whole, we find no need to resort to extrinsic evidence to aid in our interpretation here.”); Chesapeake Energy Corp. v. Bank N.Y. Mellon Tr. Co., 837 F.3d 146, 150-51 (2d Cir. 2016) (holding that the debenture terms determined damages awarded, instead of equitable principles); Lockheed Martin Corp. v. Retail Holdings, N.V., 639 F.3d 63, 69 (2d Cir. 2011) (“When an agreement is unambiguous on its face, it must be enforced according to the plain meaning of its terms.”); White v. Cont’l Cas. Co., 878 N.E.2d 1019, 1021 (N.Y. 2007) (“Thus, if an agreement on its face is reasonably susceptible of only one meaning, a court is not free to alter the contract to reflect its personal notions of fairness and equity.”); First Lincoln Holdings, Inc. v. Equitable Life Assurance Soc’y, 164 F. Supp. 2d 383, 393 (S.D.N.Y.2001) (holding that the terms in an annuity contract were unambiguous and thus controlling); Bank N.Y. Mellon v. Realogy Corp., 979 A.2d 1113, 1121-22 (Del. Ch. 2008) (holding that the plain meaning of “loan” encompassed more than borrowings in cash, despite norms for credit agreements).
E. The Wages of Debt Textualism: Revlon Roulette

The structure of debt textualism encourages parties to credit agreements to scour express terms for loopholes, land mines, and hooks for opportunism. Each of these activities has helped provide a foundational leg supporting an elaborate chess board that is the game of debt contracting. Over time, participants in the credit game figured out ways to manipulate the pieces on the board to their advantage. A particularly extensive chess game between PE sponsors and lenders is the one between the now-bankrupt Revlon and its 2016 term loan facilities. While Revlon’s relationship with its creditors is perhaps best known for the nearly $1 billion mistaken payment that Citibank dispatched to Revlon lenders in 2020,\(^{102}\) launching extensive litigation,\(^{103}\) the wellspring for that cataclysmic snafu was an epic battle of gamesmanship among distressed borrowers and distressed debt investors, all enabled by debt textualism.

In 2016, Revlon took out a $1.8 billion term loan from a syndicate of several sophisticated counterparties for its strategic acquisition of high-end cosmetics retailer Elizabeth Arden.\(^{104}\) It consisted of a 180-page term loan agreement spelling out a structure in which the loans would be backed by a variety of assets largely consisting of intellectual property (IP) owned by Revlon’s chief operating subsidiary, Revlon Consumer Products Corporation (RCPC).\(^{105}\) The note agreement also stipulated that Revlon had to make periodic interest payments up until 2023, when the loan and the balance became payable.\(^{106}\)

In early 2020, Revlon fell into financial difficulties and needed additional capital infusions.\(^{107}\) Taking a page from the exit-exchange offers playbook of four decades ago, Revlon executed a maneuver with its term loan investors that bore substantial similarities to what has commonly become known as an “up-tier” transaction (Figure 5). A typical uptier transaction involves a highly


\(^{103}\) See infra Section II.B.


\(^{105}\) These IP assets included, inter alia, those assets associated with the newly-acquired Elizabeth Arden line.

\(^{106}\) Revlon contracted with Citibank, N.A. (Citi), who was designated the administrative agent for processing periodic payments and making appropriate bank transfers. Citibank, N.A., 49 F.4th at 81.

\(^{107}\) See id. (“By spring 2020, liquidity had become tight for Revlon . . . . Revlon tried to raise additional capital to meet its immediate financial obligations . . . .”).
leveraged company that has a substantial amount of secured first-lien loans backed by valuable collateral. The up-tier proposal is a type of exchange offer where select first-lien lenders get the opportunity to tender their claims in exchange for a newly issued obligation.\footnote{Although we spotlight the Revlon transaction here, it is worth noting that these sorts of battles are almost the norm in distressed companies, either through similar up-tier structures or similar variations, such as drop-downs and spin-offs. Similar battles ensnared J.Crew, Serta-Simmons, Caesar’s, the TPG Group, Sears, and countless others. See Shannon D. Harrington, The Fear of Being J. Crewed Roils Leveraged Loans, BLOOMBERG L. (Jan. 28, 2023, 2:58 PM) https://www.bloomberglaw.com/bloomberglawnews/mergers-and-acquisitions/XkC9MKF8000000?bna_news_filter=mergers-and-acquisitions#jcite [https://perma.cc/L7TQ-NZKW] (describing J.Crew’s movement of assets “into an unrestricted subsidiary and borrow[ing] $300 million against it”); Diane Lourdes Dick, Hostile Restructurings, 96 WASH L. REV. 1333, 1362–63 (2021) (detailing J.Crew’s drop-down restructuring in 2016); Vincent S.J. Buccola & Greg Nini, The Loan Market Response to Dropdown and Uptier Transactions 2–4 (June 29, 2022) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4143928 [https://perma.cc/3YYH-E9YV] (detailing changes to loan contracts in light of the J.Crew and Serta Simons transactions).}

**Figure 5: Canonical “Up-Tier” Restructuring Transaction**

Two features of the transaction involve a considerable amount of financial hardball, as illustrated in Figure 5. First, in a typical up-tier transaction, the new debt security is not usually swapped straight up, but the participating lenders must make concessions on face value, interest and tenor, and, increasingly, an additional financial investment. A concomitant to this exchange is that participating lenders must vote to remove financial covenants that would otherwise restrict or prohibit the transaction; this means that...
collateral protections will be stripped out from the first-lien loans, enabling the collateral to be redeployed as security for the new debt issuance. Second, unlike traditional exit-exchange offers, the up-tier is not open to all debt holders ratably; instead the borrower plays favorites and recruits only a necessary number of lenders to authorize a vote for covenant removal (in the Figure, that number is 60%). These additional maneuvers are particularly cruel for the remaining (“non-participating”) lenders left behind, forcing those lenders backward in line and vacuuming out the critical collateral protections that made the investments attractive in the first place. Still, the up-tier transaction recruits only the bare minimum of a needed majority to remove the collateral. In Revlon’s case, the up-tier allowed consenting lenders to exchange their claims for the right to purchase newly-issued debt securities with less attractive financial terms. However, participating lenders enjoyed protection from the Elizabeth Arden IP collateral, which was removed from the term loan protections pursuant to the covenant vote. Creditors who voted to approve the restructuring would effectively be permitted to “cut the line” to collect ahead of any holdouts.

Anticipating these maneuvers, non-participating lenders realized that they could only find protection through safety in numbers: if they could collectivize enough creditor claims, they would be able to outmaneuver the up-tier by locking up a majority of no-votes. Several large creditors managed to coordinate with each other and executed a mutual cooperation agreement where they agreed to vote against the planned May 2020 restructuring. ¹⁰⁹ This effort proved effective, and it seemed by mid-spring 2020 that the up-tier could not garner sufficient support to go through.

But Revlon fought back. ¹¹⁰ Facing mounting collective resistance from non-participating lenders, Revlon developed a counter-attack: in late spring 2020, the company entered into several new revolving lines of credit, all with existing term lenders who already manifested support for the restructuring plan. This new borrowing had little to do with Revlon’s capital needs – it was all about manufacturing votes. Hidden within the 2016 term loan agreement was a provision that bestowed additional votes on new “revolving commitments” extended to any existing term lender, which were votes that the lenders were entitled to cast alongside their existing claims to consent to a restructuring. By entering into such “sham” transactions with a hand-picked squad of favored creditors, non-participants argued, Revlon deliberately

¹⁰⁹ For a summary of the strategy deployed by Revlon’s lenders and Revlon in this debt dispute, see Talley, Discharging, supra note 17, at 161 (“[I]n something of a surprise, several large creditors managed to coordinate with one another, executing a mutual cooperation agreement in which they collectively agreed to vote against the planned May 2020 restructuring.”).

¹¹⁰ See id.
bought the vote. When the dust settled in May 2020, Revlon’s counter-strategy paid off; the majority of 2016 term loan creditors, joined by new votes tied to the revolvers, narrowly approved the restructuring proposal by a bare half of one percent. This narrow victory enabled the collateral removal and significantly undermined the remaining value of the 2016 term loans.

Outmaneuvered in the ballot box, the non-participating lenders proceeded to the jury box, alleging, among other things:

(a) that the refinancing had breached the 2016 term loan agreement; (b) that the new revolvers also abrogated the agreement; (c) that the restructuring was invalid; (d) that all of this had been done with Citi’s active assistance and encouragement; and (e) that the principal balance on the term loans was immediately due and payable.

It was this dispute—born out of a monumental standoff between creditors and borrowers playing “gotcha” with the text of their loan agreement—that provided the dramatic backdrop for Citi’s mistaken payment while acting as an administrative agent for the loans and attempting to roll up participating lenders into their new debt securities. While we have covered the details of this latter snafu elsewhere, we recount this background to show how Citi’s infamous “mistaken payment” snafu is difficult to appreciate without knowledge of the chess game preceding it, largely facilitated by the incentive structure wrought by debt textualism.

The Revlon saga underscores the fact that debt textualism can visit significant collateral damage that transcends the legal and financial brinkmanship of contemporary distressed debt battles. True to form, the controllers and term note holders angled at considerable cost to devise clever tactics to outmaneuver each other. Eventually those tactics drew in other participants, including Citi and almost every other stakeholder at Revlon: as the term loan parties duked it out with one another in the courts, the company sank ever deeper into distress. In the process, everyone played hot potato with a significant portion of Revlon’s debt, disclaiming ownership and stewardship of those claims. By the time Revlon finally declared bankruptcy

111 Talley, Discharging, supra note 17, at 162 (explaining that “UMB Bank—a purported assignee of several objecting lenders—filed the 117-page complaint detailing” the bank’s objections to August 12, 2020 transactions that effectively undercut the collateral backing the loan).

112 Id.


114 See Citibank, N.A. v. Brigade Cap. Mgmt., LP, 49 F.4th 42, 94-95 (2d Cir. 2022) (Park, J., concurring) (“This delay has had dire repercussions for Revlon . . . .”)
in the summer of 2022,115 what was already looking like a challenging insolvency became a Byzantine maze that courts are still attempting to sort through. At its core, much of Revlon’s current troubles owe their existence to a debt landscape where the parties were more obsessed with fighting over shares of a shrinking pie than attempting to grow it or even preserve it.116

Not only has our commitment to debt textualism fed the chess game of the Revlon dispute, but these logjams are now harder to break than ever. The expansion of debt finance, fueled by a two-decade explosion of PE and distressed debt investors, has pushed a mountainous stack of chips to the middle of the table and eroded traditional extra-legal norms of cooperation, providing an appreciable incentive for parties to fight things out to the death.

II. EVALUATING DEBT TEXTUALISM THROUGH A NORMATIVE LENS

Up until this point, we traced the evolution of debt-textualism in state and federal courts largely as a descriptive matter. Given courts’ investment in the practical outcome of predictability around assets traded in capital markets, it is not surprising that the judiciary coalesced around abandoning “intent-based” tests for traded debt claims. It is only slightly surprising that this philosophy transcended its roots in public bond markets and now generally pervades corporate debt markets.117 But it is most surprising that courts embraced this brand of uniformity. Rather than adopt Judge Winter’s “don’t shrink the pie” standard for the duty of good faith,118 courts have shrunk the good faith doctrine to virtually nothing, rendering it largely toothless. Instead, courts now hew closely to the plain meaning of express terms in interpreting creditors’ rights in a contract; if they cannot find an express protection, there will be no such protection under an implied duty. The absence of evidence concerning creditor protections written explicitly into a contract really does count as evidence of absence in the universe of corporate debt.

In this section, we step back a bit to consider the normative implications of debt-textualism. Specifically, we ask whether a debt textualist approach is able to maximize the ratio of social benefits to social costs. In the end, even if adherence to debt textualism led to acceptable outcomes early on, it is less


116 All of this behavior ran counter to Judge Winter’s contribution in Sharon Steel. 691 F.2d 1039, 1042 (2d Cir. 1982). He passed away at the end of 2020, right in the middle of the Revlon-Citi showdown.

117 See supra Section I.B. This is only slightly more surprising because much of the syndicated debt and leveraged loan markets are also traded in OTC markets even if not on the exchanges.

118 See supra Section I.B.
clear whether this is a socially beneficial framework under today’s market conditions.

A. Benefits of a Debt Textualist Approach

There is a plausible reason that we are all textualists now in corporate debt contracts. Although some dismiss the normative case for textualist approaches writ large, we can appreciate the distinct advantages it carries in corporate financial markets. Debt textualism is a plausible way to effectuate the strong call for uniformity and predictability of provisions in credit agreements. By excluding virtually all creditor protections beyond those clearly articulated in the express terms of a contract, courts may well avoid creating more uncertainties that can occur when judicial actors apply “squishy” standards to address implied duties. Even Judge Winter’s alternative “don’t shrink the pie” approach to good faith can create unpredictability as courts attempt to quantify whether an exercise of discretion affects major and minor interests of either party.

Predictability remains an important goal because it is helpful for both litigants and transactional lawyers – it allows parties to a contract to consider the likely implications of each boilerplate term they include ex ante. As lawyers develop more and more boilerplate terms, each grounded by a hopefully predictable textualist application, the system enables parties to tailor their contracts based on the selection of terms available. Parties can “choose their own adventure” in each contract by picking from permutations of express, boilerplate terms. The availability of menu-based options for boilerplate terms can provoke further growth, development, and evolution of contractual norms and forms, even supporting experimentation with mutations on boilerplate, many of which may be adapted and/or adopted on a wide-scale basis.

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119 For a discussion on the normative value of this practice by transactional lawyers, see KATHARINA PISTOR, THE CODE OF CAPITAL 161. Pistor writes, “These legal modules [i.e., property and collateral law, trust, corporate, and bankruptcy law, and contract law] comprise the toolkit lawyers use to cloak assets in the attributes of capital; to arbitrage around legal constraints; and . . . to hand their clients the powerful defense, ‘but it is legal.’” Id.

120 See Matthew Jennejohn, Julian Nyarko & Eric Talley, Contractual Evolution, 89 U. CHI. L. REV. 901, 917 (2022) (attributing contractual innovation to a combination of clients screening for quality in their attorneys, law firms developing internal incentives to promote innovation in service of clients and deter overreliance on boilerplate language, and industry trade associations reducing the coordination costs that could limit contractual innovation).
B. Drawbacks of Debt Textualism

While debt textualism no doubt has some beneficial features, it also imposes subtler costs upon parties and the ecosystem of drafting and adjudication. We focus on three particular drawbacks: (1) contractual bloat, (2) complexity, and (3) rigidity.

First, we consider contractual bloat. Debt textualism places a heavy interpretive thumb on the scale in service of borrowers. If creditors want protection, implied duties are of little use so they are better served by extracting express protections. Many creditors do exactly that, multiplying express provisions in any one contract. In many ways, lenders and underwriters have no current alternative. The moment of execution of the deal might be their last best hope to lock in any downstream rights. But the incentive to write down every foreseeable protection into the contract has obvious implications for the sheer size of debt agreements. As creditors grew wary of not including express provisions in recent decades, the terms of a standard debt contract grew exponentially.

Next, we consider the increasing complexity of contracts: as indentures and loan agreements have grown longer year after year, so too has their internal complexity. The specific provisions of a new express term may import considerable complexity in variations and definitions, which presents a challenge for textualist courts. For example, scholars have documented the growth in prevalence and complexity of EBITDA-related debt covenants in contracts over the past twenty years and the growing uncertainties about how

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121 See Talley, Discharging, supra note 17, at 154 (detailing the number of Revlon’s blocking provisions); see also Vincent S.J. Buccola & Greg Nini, The Loan Market Response to Dropdown and Uptier Transactions (June 29, 2022) (unpublished manuscript) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4143928 [https://perma.cc/ASQ2-VqMW] (finding that “the frequency of contracts that block uptiers had nearly doubled” since the Serta transaction).

122 See, e.g., James Greene, Longer and Longer the Sequel: Bonds Follow the Trend, WHITE & CASE (Sept. 30, 2020), https://www.whitecase.com/insight-alert/longer-and-longer-sequel-bonds-follow-trend [https://perma.cc/X54J-QQJD] (describing how the length of the Description of Notes has increased significantly, but positing that added length “is a small price to pay if it ensures that issuers and bondholders are able to meet their overall goals after the ink has dried”).

123 See Cathy Hwang & Matthew Jennejohn, Deal Structure, 113 NW. U. L. REV. 279, 283-84 (2018) (“[Modern contracts] are longer, tackle more difficult issues, and are harder to read and understand. Most importantly, modern contracts are structurally complex . . . .”). Some have defined contractual complexity not in textual terms, but in economic terms based on the interactions between the borrower and creditor. Under those terms, the relationship between cov-lite loans and contractual complexity is inverse. See, e.g., Victoria Ivashina & Boris Vallée, Complexity in Loan Contracts 21-22 (Nat’l Bureau of Econ. Rsch., Working Paper No. 27316, 2022) (“Cov-lite” loans are covered by credit agreements where financial covenants do not have an automatic periodic verification but are checked only upon occurrence of certain actions by the borrower . . . . We find that contractual complexity is positively correlated with covenant weakness: everything else equal, contracts that are cov-lite, have fewer financial covenants, and have more slack, are more complex.”).
to interpret the term, particularly when the very definition of EBITDA\textsuperscript{124} has become technical, unclear, and sometimes internally conflicting within the contract.\textsuperscript{125} But complexity is not simply an intraterm phenomenon. Each provision not only must be discerned on its own, but also on how it interacts with other provisions. When, for example, does one provision take precedence over, or submit to, another provision that appears to prescribe an inconsistent outcome? As the sheer number of express provisions in contracts grows, the number of mutual interactions between provisions expands even faster.

Finally, consider rigidity: the growth in length and complexity of credit agreements has also made it riskier (not to mention downright unpleasant) to move out of tried-and-true structures. It can be difficult to anticipate how changing a single term in a long, complex writing might alter courts’ assessment of the provision. While transactional lawyers are theoretically empowered to choose their own adventure, they can be disinclined to rock the boat by adopting provisions whose “plain meaning” has yet to be tested before the courts or provisions that may alter a court’s interpretation of other provisions in the deal that the drafter did not intend to alter. This hesitance to rock the boat makes debt market participants risk averse to experimentalism. When this rigidity combines with the reliance of courts on debt textualism, it creates a new sort of parlor game: parties scavenge the language of agreements for hidden inconsistency, loopholes, or imperfections, and engineer novel strategies to exploit those imperfections to maximal advantage for their clients. It is a lucrative practice when the stakes are high and the hunting ground is dense and vast, making leveraged loan agreements a perfect site for contractual expansion and rigidity. As leveraged finance has expanded in the last two decades, these opportunities have become more tempting.

At the same time, both sides have significant incentives to “lawyer up” in order to play this parlor game. Neither party is overly concerned about creating value as much as forcing transfers of economic rents. As a result, a large part of the effort put into rejiggering a contract is socially wasteful.

\textsuperscript{124} “EBITDA” is a term that measures the profitability of a business. It is shorthand for “earnings before interest, taxes, depreciation and amortization.” See Paulie Walnuts Gualtieri Explaining EBITDA, YOU TUBE, https://www.youtube.com/watch?v=d4vXr-C1wuw ([https://perma.cc/UHP6-GLSP] (“[It] gives the true picture of a company’s profitability.”).

\textsuperscript{125} Adam B. Badawi, Scott D. Dryeng, Elisabeth de Fontenay & Robert W. Hills, Contractual Complexity in Debt Agreements: The Case of EBITDA 1-2 (Duke L. Sch. Pub. L. & Legal Theory Series, No. 2019-67, 2022) (underscoring that the manner EBITDA is defined “in bank contracts is often significantly different than simply adding interest, taxes, depreciation, and amortization to net income,” and finding that “more expansive EBITDA definitions tend to appear in loans that are more difficult or costly to negotiate,” while “addbacks are more common when the probability of a false positive signal associated with EBITDA or EBITDA-based covenants seems greater”).
Even worse, the outcome of the game grows more volatile, as shifting coalitions and ever-more complex scavenger hunts produce results that can be irregular and difficult to predict. The chess game of mutual rent extraction that debt textualism spawns is not new. Many of the costs we discuss have long been criticisms of debt textualism. Nevertheless, we argue that the stakes have grown considerably in debt restructuring as the battles have become more pitched, more expensive, and less predictable. While the advantages of uniformity, transparency, and predictability are no doubt appreciable, debt textualism seems unwittingly to have delivered the opposite: a landscape that is less uniform, less transparent, and chronically unpredictable. Debt textualism's features have thus metamorphosized into a monstrous bug.

III. REFORMING DEBT TEXTUALISM AND KEEPING THE FAITH

Debt textualism's key role in shaping incentives in corporate debt markets has become questionable, possibly to the point where its burgeoning costs are no longer justified by its benefits. To the extent that the case favoring debt textualism is losing its holding power, we consider whether there is anything we can and/or should do about it. In this section, we offer a variety of approaches, none of which are mutually exclusive: (a) let the market develop a solution; (b) push for judicial intervention; and (c) push for legislative/regulatory intervention.

A. Leave It to the Market?

To start, we could just give market forces more room to devise private solutions to the problem of debt textualism. If we are correct that the system has progressively introduced more costs than benefits, then market participants have an incentive to tackle those problems with their own contractual innovations. Most obviously, if parties collectively dislike the judicial abandonment of good faith, nothing prevents them from baking their own express good-faith duties into their credit agreements, through which they contractually instruct a court (even a textualist court) to deploy Winterian good-faith calculus. Parties could also adopt targeted textualist "fixes" meant to defuse problems of debt-textualism-driven opportunism, such as joint cooperation agreements among debtors and Revlon blockers. To the extent

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126 Even the approach of leaving things to the market does not preclude judicial, legislative, and regulatory interaction because interventions on market structure establish the foundational conditions on which markets operate.

127 See generally Jennejohn, supra note 120 (developing a model of contractual innovation in corporate transactional contexts).

128 See Sujeet Indap & Ortenca Aliaj, Running Out of Road: Apollo Gears Up for Carvana Showdown, FIN. TIMES (Jan. 6, 2023), https://www.ft.com/content/8ea9678f-bfaf-475e-8b5a-
that market participants bear most or all of the substantial costs stemming from debt textualism, one might expect them to make this move, perhaps with modest prodding.\textsuperscript{129}

We are sympathetic to this position, but ultimately unpersuaded by it. Even though both good-faith and “efforts” provisions work their ways into a variety of commercial contracts, including some credit agreements, several factors cast doubt on whether unalloyed market forces can sufficiently counter the worst ills of debt textualism. First, a contractual choice \textit{ex ante} by the parties to embrace an express good faith provision does not guarantee that the \textit{ex post judicial factfinder} will play along.\textsuperscript{130} There are many examples where courts have simply refused to meaningfully enforce behavior standards (such as in efforts and good-faith clauses), notwithstanding their express inclusion.\textsuperscript{131} Consequently, the parties would be disinclined to bear the costs of negotiating and drafting a good faith provision anticipating a potentially uncooperative court. Second, even if a judge were willing to enforce a good faith provision, there is no lengthy precedent that shows how a court should apply it in corporate debt cases. Predictability of outcomes is a game with network externalities, and term innovators are often reluctant to serve as the canary in the coal mine. Third, agency costs can also distort economic incentives. Because corporate debt markets are highly intermediated, while borrowers are typically represented at the negotiation table, the end holders of the debt typically are not. The arrangers/underwriters who negotiate, presumably on end purchasers’ behalf, are unlikely to act to maximize creditors’ payoff over their own payoffs. Finally, even in the absence of agency costs, the deal between the borrower and lender does not generally internalize many external costs, ranging from legacy lenders to employees to customers. The prevalence of boilerplate terms suggests that corporate debt arrangements can channel systemic risks into the economy through a heightened correlation of debt securities tied together by boilerplate terms. Therefore, while market forces should play some role in reforming debt

\textsuperscript{129} For example, English common law’s longstanding rejection of the implied duty of good faith spawned a cottage industry of express good faith provisions in English contracts. See \textsc{Richard Cumbley & Peter Church, Contracts: Good Faith} (2022), Thomson Reuters Practical Law UK w-003-1201 (explaining that express good faith clauses “help to fill any gaps in the contractual relationship and encourage both parties to act in a fair and honest way”).

\textsuperscript{130} See Charles J. Goetz & Robert E. Scott, \textit{The Limits of Expanded Choice: An Analysis of the Interaction Between Express and Implied Contract Terms}, 73 \textsc{Calif. L. Rev.} 261, 284 (1985) (“While evidence of contractual context is frequently useful in clarifying meaning, courts may misuse it in deciding that, no matter what the express terms seem to say, the apparent meaning is unreasonably peculiar in the circumstances of the transaction.”)

\textsuperscript{131} \textit{Id.} at 284-85 n.64 (collecting cases).
textualism, prudent interventions will also be necessary to alter the baseline conditions for market interaction.

Another potential complication is how cyclical debt contracts have been over time. Debt contracts regularly cycle through various “covenant-lite” (cov-lite) fads depending on the receptivity of the institutional investing crowd. The movement toward cov-lite loans, which contain few financial covenants by borrowers/debtors, has been episodically broad and robust in recent decades.132 Cov-lite loans grew across the leveraged lending market just prior to the 2008 financial crisis, mostly concentrated among PE sponsors.133 Once issued, these loans provided far less control or disclosure to the creditor, leaving lenders more in the dark than with heavily covenanted instruments that mandate default-related disclosures.134 The shift to a predominantly cov-lite lending framework in leveraged loans has been explained by some as a concerning development caused by the disincentivization of efficient monitoring by banks and other holders of debt.135

Cov-lite cycles may provide a “reboot” to address contractual bloat—a reduction in the number of covenants effectively cleans up and shortens credit agreements. While this could be beneficial, removing financial covenants while leaving the debt textualist regime intact is a game of Russian Roulette, leaving behind dangerously few creditor protections for courts to interpret and permitting virtually any discretionary action by the borrower with no tenable duty of good faith. As a result, the role of cov-lite loans in financial downturns brings its own costs and benefits. On the one hand, cov-lite represents a potential salve from a credit crisis, providing flexibility to borrowers in real-time to keep the cash flowing.136 On the other hand, this


134 Mark Laber & John Yozzo, Covenant-Lite Leveraged Loans: Time-Tested or Time Bomb?, AM. BANKR. INST. J., Oct. 2017, at 26 (“Such remedies, whatever form they take, provide a lender with some actionable recourse before a credit deteriorates badly, or compensate the lender for a loan that unexpectedly becomes riskier.”).

135 See id. (“Without maintenance covenants, a lender has little ability to intervene in a troubled credit until an event of default occurs.”).

flexibility imposes costs on others: cov-lite loans are minefields for creditors, who in a time of crisis likely need to be able to manage, or at least comprehend, their losses more quickly. A movement back to cov-lite structures would therefore likely be short-lived amid economic slow-downs, and even higher rates and spreads can make cov-lite loans act like lottery tickets. Relying on cov-lite indentures is more common under strong economic times, when credit is free flowing and more accessible; it may also be a type of market failure, as lenders or arrangers discount the odds of future distress excessively. Cov-lite lending is therefore a practice that develops in a low-interest rate environment, and reliance on it during periods of financial growth can harm creditors under a debt textualist regime as market conditions worsen, inviting future waves of opportunism.

Market forces could also use debt textualism for both their advantage and to create more socially beneficial outcomes. For example, some commentators have suggested meaningful structural commitments to decarbonization, which can be made durable through a contractual incentive (or “green pill”) that visits adverse consequences on a corporation if it fails to meet its climate reduction goals. Certain types of green pills are easily frustrated, particularly when entered into with corporate shareholders who later shift allegiances to maximizing returns and become complicit in undoing the corporation’s commitments. Climate-related covenants baked into corporate debt via so-called “green” bonds could better cement these equity-related commitments because of how intractable contracts are under the regime of debt textualism. While nothing prevents debt holders from coming back to the table to cut climate commitments out of their contracts, the current strategic posturing that surrounds, and often frustrates, restructuring efforts could provide some friction when it comes to changing climate undertakings. Encouraging effective green covenants in corporate debt instruments (for example, by subsidizing the activity with tax incentives)

137 Whitehead, supra note 133, at 676.
138 Short-termism is a type of market failure that is thought to be common in commercial contexts. See generally Michal Barzuza & Eric L. Talley, Long-Term Bias, 2020 COLUM. BUS. L. REV. 104.
could be an effective path to their durability—salvaged by the most unlikely of heroes: debt textualism.\footnote{It is worth noting the caveat that even as debt textualism invites strict enforcement by the holders of debt, it may also invite strategic manipulation by borrowers (particularly for instruments affected by financial distress). \textit{See supra} notes 70-79 and accompanying text. Such a fate could also theoretically befall credit agreements with climate covenants, too. Viewed from this perspective, debt textualism may be most helpful in green finance for companies that are not bordering on distress, or, alternatively, for more senior tranches of debt with strong anti-subordination prohibitions and collateral protections.}

The advantages of simply leaving things to current market forces without a coordinating effort on other fronts seem pretty limited. Other complementary interventions are also needed.

\textbf{B. Judicial Intervention}

Contract interpretation is a matter of law, at least in the first instance, so courts are uniquely positioned to play a role in interpreting express provisions and filling evident gaps in contractual language out of necessity. While the standard approach to debt textualism is to interpret express language strictly, judges can change course by placing a heavy thumb on the scale favoring the borrower (the primary trigger for current creditor-on-creditor violence) and employing gap fillers with rarity. The first and easiest step for courts to take would be to compensate on the margins for debt textualism's unintended consequences. This approach bends other doctrinal analyses to implement ad hoc corrections. A second, and maybe more durable response for courts, would be to reassess the underlying rationale of debt textualism. This alternate approach would enhance creditors' protections while still preserving some measure of transparency, uniformity and predictability. Here, judges may wish to revisit Judge Winter's prescriptions from \textit{Sharon Steel} and revive a more generous conception of good faith.\footnote{\textit{Sharon Steel} v. Chase Manhattan Bank, 691 F.2d 1039, 1042 (2d Cir. 1982). \textit{In re Citibank}, 520 F. Supp. 3d 390, 450-51 (S.D.N.Y. 2021).}

First, courts could combat the ills of debt textualism by deploying back-door, \textit{sub rosa} equitable interventions from other seemingly unrelated areas of corporate and commercial law. Take, for example, \textit{In re Citibank}, discussed above. Judge Furman laid down a nearly impossible prescription for banks in Citibank's position wanting to avoid future exposure under the discharge-for-value doctrine: “[B]anks could—and, perhaps after this case, will—take other relatively costless steps to both minimize the risk of errors and increase the probability of clawing back erroneous payments . . . . [T]he banking industry could—and would be wise to—eliminate the risk altogether by taking these or similarly modest steps.”\footnote{\textit{In re Citibank}, 520 F. Supp. 3d 390, 450-51 (S.D.N.Y. 2021).} While we disagree with Judge Furman's notion that it would be “costless” for parties to anticipate and avoid every possible...
of future outcome involving a mistaken payment in a debt contract, we see Judge Furman’s suggestion as a back-door check on opportunism by Revlon and Citi, which worked together to implement the restructuring transaction that spawned the initial dispute. In doing so, Judge Furman deployed the discharge-for-value doctrine, which was a risky stretch. For better or for worse, New York state courts developed this doctrine for the limited purpose of ensuring finality in electronic funds transfer, easing a glidepath to dealmaking. The doctrine was not, however, developed with the particular aim of being a general sanction for carelessness or a punishment for prior opportunism. Still, discharge-for-value is a highly equitable doctrine that evolved from the also highly equitable principles of restitution. Given the history of the rule, then, Judge Furman may well have attempted to deploy the courts’ equitable discretion to impose on Citi a type of “pay-back” for having facilitated the opportunistic restructuring of Revlon’s debt. If Citi was going to reap significant fees from its opportunistic Revlon up-tier, then it could also be made to pay for the costs, no matter how high, of a calamitous payment mistake in administering the loans. The court’s holding might be read to illustrate how courts can use equitable powers in ad hoc ways to deter or punish socially wasteful behavior, even if doing so is difficult to pull off directly under a debt textualism regime.

There are some limitations to this sub rosa strategy: most notably, the types of logical stretches needed to apply compensatory equitable decisions can be appealed, and here Citi was ultimately vindicated by the Second Circuit. However, even before it was reversed, Judge Furman’s intervention triggered textualist countermeasures, as transactional lawyers rapidly adapted

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144 The authors have commented extensively on facets of the Citibank opinion and the subsequent developments in contract law that it triggered. See generally Talley, Discharging, supra note 17, at 147; see also Sneha Pandya & Eric Talley, supra note 113.
145 See supra Section I.E.
147 See Talley, Discharging, supra note 17, at 166–69 (describing the development of the DFV doctrine).
148 Typically, the underwriter on the original debt placement stays to act as administrative agent on the loans. See Iñaki Aldasoro, Sebastian Doerr & Haonan Zhou, Non-Bank Lenders in the Syndicated Loan Market, BIS Q. REV., Mar. 2022, at 15, 17, https://www.bis.org/publ/qtrpdf/r_qt2203c.pdf [https://perma.cc/9CHY-KVCC] (“[Underwriters] typically act as the agent bank and perform due diligence. They ensure screening and monitoring, govern the terms of the loans and enforce covenants . . . . [They] retain a larger portion of the loan on their balance sheets, while participants often sell their tranches on the secondary market . . . .”).
149 At the same time, debt-textualism is still prominent. See, e.g., Citibank v. Brigade Cap. Mgmt., 49 F.4th 42, 78–79 (2d Cir. 2022) (declining the DFV defense). Scholars agree that textualism has its benefits in reigning in the courts’ discretion as well. See, e.g., Sepe, supra note 9, at 559 (“The adoption of a textualist interpretative rule . . . . would eliminate the risk of value-decreasing judicial errors in the enforcement of the debt contract.”).
150 Citibank, 49 F.4th at 78–79.
to incorporate so-called “Revlon Blocker[s]” into new financings that explicitly rejected the discharge-for-value defense (in some cases disclaiming the Citibank opinion by name).\footnote{Talley, Discharging, supra note 17, at 200-05 (outlining the birth of the Revlon Blocker).} Consequently, the judges using equitable actions as a “backstop” to check debt textualism still rely on a combination of conditions: (1) the potential for remaining “gaps”, i.e., situations not expressly covered by the clauses; (2) maintaining a link between meaning and function in the process of interpretation, through which the meaning of a clause is inherently linked to what the clause does; and (3) a court’s overarching goal that contractual allocations remain fair (or at least not wasteful).\footnote{David Ramos Muñoa, Can Complex Contracts Effectively Replace Bankruptcy Principles?: Why Interpretation Matters, 92 AM. BANKR. L.J. 417, 419-20 (2018).} When these conditions are satisfied, courts are well-suited to engage in such \textit{sub rosa} strategies because they are typically already familiar with restructuring or bankruptcy proceedings and can use their expertise to intervene along multiple margins.\footnote{Id.}

Courts could also confront debt textualism directly, deemphasizing its role in interpreting credit agreements. One obvious method would be to embrace (or re-embrace) Judge Winter’s “don’t shrink the pie” formulation of the duty of good faith. While courts have strayed from engaging Winter’s test in the progressive embrace of debt textualism, it may be worth assessing whether a DSP-style good-faith doctrine might be put back into service. Limiting parties’ use of discretion to acts that do not shrink the pie arguably places parties in the situation they would reasonably seek \textit{ex ante}, and it imposes a standard that is less susceptible to opportunism. While the DSP account of good faith concededly represents more of a standard than it does a rule, it need not dramatically undermine predictability for two reasons: (1) Judge Winter’s articulation of the test was fairly precise and rooted in objective forms of evidence of burdens vs. benefits; and (2) the shenanigans we regularly witness under debt textualism among borrowers and lenders have already introduced a costly and uncertain environment.\footnote{See supra Section I.B.}

Furthermore, our call for a return to a workable good faith standard has been met with some acceptance in the courts. In several pending cases...
involving up-tier transactions, plaintiffs have raised good faith claims; in some instances, courts have shown a willingness to entertain them. A pair of ongoing cases, for example, involve an up-tier transaction by Serta Simmons Bedding LLC (Serta Simmons)—one before the New York State Supreme Court and the other before the U.S. District Court for the Southern District of New York.\footnote{156} Certain non-participating lenders sued in state court arguing that the up-tier transaction ran against a waterfall provision in the contract because it impacted the pro rata share payouts written into the agreement while other non-participating lenders sued in federal court arguing that the transaction breached the contract agreement. On the first, the state court refused to grant a preliminary injunction; but on the second, the federal court allowed the case to go forward past the motion to dismiss stage. The state court focused on plaintiffs’ argument that the transaction was not authorized under the “open-market purchase exception” and found the language was sufficiently imprecise as to block a decision in an early stage of litigation. More significantly, the court also found that the implied breach of covenant claims could proceed because the complaint sufficiently alleged that Serta Simmons “deprived [plaintiffs] of the benefit of their bargain in bad faith.”\footnote{157} In so doing, the court directly opened the door to revive Judge Winter’s proposition that the duty of good faith could have teeth in protecting creditors.

Additionally, in *ICG Global Loan Fund 1 DAC v. Boardriders Inc.*, the New York State Supreme Court agreed with the Southern District of New York’s reading of the “open market exception”—it was open to additional interpretations, so the case could proceed past the motion to dismiss stage.\footnote{158} The court specifically noted that it looked beyond the single provision to read the contract in full.\footnote{159} Importantly, the court followed the Southern District of New York in *Serta Simmons* by upholding an implied duty claim on the basis that defendants “worked in concert and in secret to deprive plaintiffs of the benefit of their bargain.”\footnote{160}

However, not all courts are receptive to hearing claims about good faith obligations. In *In re TPC Group Inc.*, non-participating lenders challenged a


\footnote{157} Douglas S. Mintz, Ned S. Schodek & Peter J. Amend, *Recent Challenges to Uptiering Transactions*, AM. BANKR. INST. J., Dec. 2022, at 32, 37; see also North Star Debt Holdings L.P., slip op. at *7 (holding that plaintiffs were deprived of their bargain); LCM XXII Ltd., at *14 (finding that defendants also “deprived the other party of the benefit of its bargain”).


\footnote{159} Id. at *17-18.

\footnote{160} Mintz et al., *supra* note 157, at 37; *ICG Global Loan Fund 1 DAC*, slip op. at *24.
Debt Textualism and Creditor-on-Creditor Violence

pre-bankruptcy up-tier transaction in the U.S. Bankruptcy Court for the District of Delaware.\textsuperscript{161} Lenders similarly alleged both express and implied claims. As to the former, they argued that the up-tier impermissibly undercut their “sacred rights” associated with the waterfall procedures in the indenture.\textsuperscript{162} The bankruptcy court was not convinced by this claim, noting that while the plaintiff’s proffered interpretations of the waterfall provision were plausible, the textualist approach would win out because “New York law provides that contractual language must be understood through the lens of ‘the customs . . . as generally understood in the particular trade or business.’”\textsuperscript{163} As to the implied duties claims, the court dismissed them out of hand, finding that they were indistinguishable from a breach-of-contract claim.\textsuperscript{164}

To the extent that courts continue to be receptive to employing a good faith calculus in debt restructuring disputes, their efforts may also catalyze and facilitate private contracting endeavors too. As judges produce more case law applying a reconstituted duty of good faith and fair dealing, their decisions could provide a useful baseline for parties to assess whether and how to design their own express good faith obligations, potentially auguring further expansion and refinements of jurisprudence in the area.

C. Legislative and Regulatory Intervention

A third avenue for reform is through legislative and regulatory oversight. We argue that PE’s next phase will be defined by firms entering into increasingly complex debt contracts that ascribe to the principles of debt-textualism. If courts can intervene at the level of deciding which express terms are equitable in debt contracts, then there is an opportunity for Congress and financial regulators to intervene on the basis of which parties invest in PE funds that then engage in highly leveraged transactions, i.e., the greatest drivers of the current rise in debt financing. Congress can expand regulatory agencies’ authority to monitor debt markets and PE arrangements under both systemic risk and investor protection aims.

First, Congress and financial regulators are charged with protecting the public and the financial system from systemic risk. In the same way that the

\textsuperscript{162} Id. at *3.
\textsuperscript{163} Id. at *11.
\textsuperscript{164} Id. at *12 (“So while the various 2021 transactions may have violated what the Trimark court (perhaps aspirationally) called the ‘all for one, one for all’ spirit of a syndicated loan, the transactions did not violate the letter of the applicable agreements in a manner that gives rise to a claim by the objecting noteholders.”). For a more thorough description, see Randall Klein, Lender Liability Management: Restoration of the Duty of Good Faith, GOLDBERG Kohn (Apr. 22, 2022), https://www.goldbergkohn.com/newsletter-138.html [https://perma.cc/SGF3-LEZP].
interconnectedness of financial institutions deemed “too big to fail” can lead to across-the-board economic downturns, as one failing firm brings the others down, some similarities may carry over here in the form of common boilerplate contract terms for complex deals between and involving these institutions. Legislators and regulators are equipped with unique intervention points in the financial system. Boilerplate language copied and pasted across most, if not all, debt deals presents the risk that when one deal tied up with the money of a large syndicate of lenders triggers a default, liquidity dries up across the rest of the system. Increased avenues for borrower opportunism here leave creditors (those same large financial institutions) at the whim of borrowers manipulating those same contract terms. The existence of these readily manipulable terms is by definition a form of systemic risk; the strategic manipulation of a boilerplate term in a single contract involving any major institution has automatic effects on the interpretation of the same term in other indentures. Congress and financial regulators should focus on the possibility of infected terms in one indenture impacting the status of other indentures so as to reduce systemic risk before it bubbles over.

The broader conversation about PE’s role in increasing systemic risk to the financial system centers on its fast and loose management practices and keen focus on increasing its payout through dividends without protecting workers in the companies these firms acquire and manage. It is a seemingly private practice—the purchase, management, and eventual sale of companies that take on distressed debt for the PE firm—with a public impact on working families. Scholars have suggested that the public may be more involved with PE transactions than has been traditionally understood in the form of pension plans’ investment in PE funds. Public pension plans have grown to be some of the largest investors in PE, seeking a return in what has been a low-interest

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165 See CONGRESSIONAL RESEARCH SERVICE, SYSTEMICALLY IMPORTANT OR "TOO BIG TO FAIL" FINANCIAL INSTITUTIONS 3 (last updated Sept. 24, 2018), https://crsreports.congress.gov/product/pdf/R/R42150 [https://perma.cc/KE3N-VRGT] (discussing the policy considerations when assessing systemic risk of “too big to fail” financial institutions that are designated as such “because of their size or interconnectedness”).


rate environment. The uniquely public nature of pension plans, guaranteed by taxpayers, has introduced greater government scrutiny into the activities of PE funds and opened the door for regulators to analyze excessive risk-taking in the market. These funds are in many ways now tied to the retirement funds of average people, public pension plans, and retail investors by way of mutual funds investing in firms that utilize corporate debt to conduct risky transactions, all of whom would be impacted in the event of a market downturn.

Corporate debt is a complex product of uncoordinated market forces responding to the courts’ embrace of debt-textualism. Corporate debt is also subject to the limits imposed by legislators and regulators who can define and coordinate the permissible bounds of risk-taking by companies raising their funds through institutional and large public investors. In a market where even senior corporate debt, a supposedly safe vehicle for risk-intolerant investors, might be no less risky than transparently speculative bets when much of it is used for leveraged buy-outs by PE firms, Congress has a role to play to protect the public interest. The Stop Wall Street Looting Act, introduced in the Senate by Senators Warren, Brown, and Baldwin, is one attempt to address excessive risk-taking and gamification of the financial system by PE firms.

Second, investor protection is another policy mandate that legislators and regulators should prioritize to evaluate risk accumulation in debt markets. While borrowers entering into syndicated and private loan agreements are generally sophisticated institutional investors, these instruments have operated outside the scope of disclosure requirements that apply to other financial instruments for a long time. This is in part by design—disclosure

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168 See id. at 842 (“Sometimes held up as an elite private contracting setting, the $4.5 trillion private equity industry is actually funded in significant part by capital that comes from public retirement funds.”).


170 Regulators have also focused on systemic risk arising out of the syndicated loan market in recent years. See, e.g., Sam Fleming, Janet Yellen Sounds Alarm Over Plunging Loan Standards, FIN. TIMES (Oct. 25, 2018), https://www.ft.com/content/04352e76-d792-11e8-a854-33d6f82e62f8 [https://perma.cc/BD64-46NV] (describing the deterioration in standards and other systemic risks of leveraged loans).

requirements apply to instruments labeled as “securities” and applying that label to complex debt instruments would upend lending as we know it. At the same time, with little to no sunlight to disinfect this market of excessive risk-taking (whose market actors are the same ones that helped spawn shadow banking) investors are left in the dark about how much risk these investments actually entail and exactly how intertwined these loans are with the financial futures of firms and companies.

While publicly-traded companies regularly disclose contract terms as offered in new instruments, whose details are available on EDGAR, no comparable requirements exist for privately-traded companies. Congress could provide a new category of instruments or companies subject to such disclosure, either by expanding the scope of the term “security” to cover this form of debt or requiring some similar disclosure requirements for private companies. This regulatory change could open the door for investors (many of whom are public entities) to better monitor risk-taking behavior ex ante rather than ex post through bankruptcy proceedings. Regulatory scrutiny has the potential to help stabilize the cycle of leveraged lending to LBOs and would allow investors, even highly sophisticated ones, to better assess the nature and vulnerabilities of their front-end investments.

Of course, congressional and executive oversight of the debt markets could lead to further confusion and unpredictability for investors, creditors, and borrowers. Additional requirements by Congress and regulators could be viewed as burdensome express contractual fixes and invite disputes about their interpretation—addressing the problem in the short/medium term but inviting later opportunism and imposing greater borrowing costs on market participants as they work to outflank legislative and regulatory mandates. These reforms are all suggestions that could, in concert, limit the predominance of debt textualism and better protect contracting parties moving forward.

CONCLUSION

The increasing complexity of credit markets, fueled in no small part by PE and distressed debt investing, is a major cause for concern among direct market participants as well as broader corporate and economic stakeholders. In this article, we identify an important doctrinal co-conspirator that—we

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172 This is a live question—the Millennium Health case is still being decided on appeal. See also Joel Crank, Rethinking Kirschner v. J.P. Morgan: How Securities and Banking Laws Should Apply to Syndicated Loans, 93 COLO. L. REV. 1095, 1102-04 (2022) (describing how the Securities Acts interface with leveraged loans).

173 See, e.g., Talley, Discharging, supra note 17, at 200-05 (chronicling the rise of “Revlon Blocker” provisions in corporate loan agreements and bond indentures).
argue—helped bring about our current state of affairs: the embrace and wide scale acceptance of debt textualism as the principal means to interpret corporate debt contracts. Sophisticated financial actors devised decades-in-the-making strategies predicated on gaming textualism, and their interactions increasingly played out beyond public scrutiny and introduced appreciable costs and systemic risk concerns with potentially large private and public implications. Our contribution has aimed to go beyond merely isolating debt textualism as a key driver of this trend, but also to suggest various arenas for reform and even a way to salvage some additional benefits of debt textualism in its current state. Even if we’re all textualists now—at least for the moment—we still have the tools at our disposal to free ourselves from this interpretive regime and to regain some semblance of (good) faith.