

Getting to Yes: The Role of Coercion in Debt Renegotiations

Law Working Paper N° 812/2024

January 2025

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ECGI Working Paper Series in Law

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A debt contract's value depends on the parties' ability to alter its terms. But although the rules of alteration are for that reason an important part of the design of debt instruments, the academic literature lacks a framework for making sense of them. Recent upheavals in restructuring practice have emphasized the practical importance of a working theory of alteration, however, and in particular of the rules governing what debtors can do to procure creditor acquiescence to proposed changes. This article develops a comprehensive account of the methods of consent solicitation broadly construed. We offer four principal contributions. First, we identify in general terms the features of a solicitation that can produce coercive dynamics and analyze the kinds and degrees of coercion embedded in notable solicitation methods. Second, we document the persistent availability of coercive methods under standard bond and loan contracts despite known means to prohibit them. Third, we show that economic considerations can justify coercion and might explain some observed contract practices. Fourth, we conclude that the most coercive prevailing techniques cannot be so easily justified and propose an approach to construing debt contracts that would restrain what are likely the most value-destructive solicitation methods without condemning longstanding and plausibly value-enhancing techniques.

Keywords: amendments, exchanges, consent solicitation, waiver, bond indenture, credit agreement, loan agreement, exchange offer, leveraged loan, high-yield bond

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COASE-SANDOR INSTITUTE FOR LAW AND ECONOMICS RESEARCH PAPER NO. 1020

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Acknowledgment: This working paper series is generously supported by the Coase-Sandor Institute at the University of Chicago Law School.

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A debt contract's value depends on the parties' ability to alter its terms. But although the rules of alteration are for that reason an important part of the design of debt instruments, the academic literature lacks a framework for making sense of them. Recent upheavals in restructuring practice have emphasized the practical importance of a working theory of alteration, however, and in particular of the rules governing what debtors can do to procure creditor acquiescence to proposed changes. This article develops a comprehensive account of the methods of consent solicitation broadly construed. We offer four principal contributions. First, we identify in general terms the features of a solicitation that can produce coercive dynamics and analyze the kinds and degrees of coercion embedded in notable solicitation methods. Second, we document the persistent availability of coercive methods under standard bond and loan contracts despite known means to prohibit them. Third, we show that that economic considerations can justify coercion and might explain some observed contract practices. Fourth, we conclude that the most coercive prevailing techniques cannot be so easily justified and propose an approach to construing debt contracts that would restrain what are likely the most value-destructive solicitation methods without condemning longstanding and plausibly value-enhancing techniques.

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Table of Contents

I.	Introduction.....	3
II.	The Coercive Potential of Consent Solicitations	7
A.	Four Dimensions of a Solicitation.....	9
1.	Ranking of the altered instrument	9
2.	Conditionality of the payment of an inducement.....	10
3.	Exclusivity of the offer of inducement	15
4.	Variability of the amount of debt eligible to consent	16
B.	Notable Combinations	19
III.	Contractual and Legal Constraints on Coercion	22
A.	Contractual Provisions	22
1.	Provisions mandating equal treatment	23
2.	Provisions restricting exclusivity	24
3.	Provisions restricting ballot stuffing.....	26
4.	Priority Restrictions	28
5.	Sacred rights	28
B.	General Legal Principles	30
1.	Covenant of good faith and fair dealing	30
2.	Intercreditor duties	33
3.	Sham transaction doctrines.....	35
IV.	Accounting for the Status Quo.....	36
A.	Contracting Failure-Based Explanations	37
B.	Surplus Maximization-Based Explanations	38
1.	Coercion is a problem of theory but not practice.....	38
2.	Offset pathologies of unanimity rules	40
3.	Reward active creditors.....	41
4.	Offset activism by debtholders motivated by side interests	42
5.	Preserve Financing Flexibility	43
6.	The Chapter 11 counterfactual	43
V.	An Interpretive Presumption	45
VI.	Conclusion	48

I. Introduction

How parties to a loan or bond contract can change the terms of their deal is an important if frequently neglected aspect of debt financing. At core, bonds and loans represent a company's obligation to repay a debt, with interest, over time. But only a small fraction of what goes into an indenture or a loan agreement relates directly to the debtor's financial obligations. Most of the material, by word count and complexity, consists of rules that bind the debtor while the debt is outstanding and which are designed to increase, relative to a naked promise to repay, the likelihood that the debtor will make good on its debt and that the investors will be able to recover otherwise if it doesn't. The problems of incomplete contracting plague these supporting rules, however. Parties to a debt contract thus try to articulate sensible parameters when they strike their agreement knowing full well that the world will change and might change in ways that undermine the initial terms' commercial desirability. Sometimes it will make sense for the deal to change.

For most of the last century, the law of debt contract alteration was a sleepy area both in practice and in the law journals.¹ For much of that time, the issue was hardly relevant. Bonds were the principal means for raising debt capital from dispersed investors, and most bonds were designed to be safe investments and so did not need the kinds of strict covenants that are apt later to interfere with the debtor's pursuit of valuable activities. Bankruptcy law could be called upon to structure renegotiation if the debtor's financial condition deteriorated enough. A brief window of action opened starting in the late 1980s, when junk bonds, then a recent invention, collided with a recession for the first time. The bond workout appeared to be a viable alternative to what was then still a cumbersome Chapter 11 process. New practices emerged. Most notably, debtors learned to spur bondholder participation by making exchange offers that were conditioned on the exchanging holder's provision of a so-called exit consent (that is, a consent to amend the terms of the debt out of which the holder is about to swap). Novelty led to an instructive flurry of scholarly interest in the nascent dynamics.²

¹ We refer to the contractual and other legal rules that structure change—whether through an amendment, a waiver, or an exchange of instruments—as alteration rules and the process by which a debtor seeks creditor approval for such a change as a consent solicitation. In some usages, “consent solicitation” refers only to the process of a debtor's seeking consent to a waiver or amendment from creditors who will continue to hold the affected bonds or loans. We deliberately use the term in a broader sense to include also a debtor's efforts to persuade creditors to accept an exchange offer or to provide exit consents before exchanging into a new instrument.

² See Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 *YALE L.J.* 232 (1987); John C. Coffee, Jr. & William A. Klein, *Bondholder Coercion: The Problem of Constrained Choice in Debt Tender Offers and Recapitalizations*, 58 *U. CHI. L. REV.* 1207 (1991); Victor Brudney, *Corporate Bondholders and Debtor Opportunism: In Bad Times and Good*, 105 *HARV. L. REV.* 1821 (1993); Marcel Kahan & Bruce Tuckman,

But an equilibrium soon took hold that lasted a quarter century. To revise a deal, it became customary for a debtor either to offer to all holders cash for consenting to an amendment of the indenture (or for waiving a default under it) or else to conduct an exchange offer with exit consents. The system that emerged seemed to work. It was practically possible to get deals done outside of bankruptcy, and bondholders fared reasonably well.³ In the loan world, meanwhile, the difficulties of solicitation scarcely existed. Until broadly syndicated loans became prominent after the financial crisis of 2008, the borrower's task in most cases was just to reach an understanding with the originating bank. Even if the bank had syndicated some of its exposure, it could be counted on, as "lead bank," to negotiate amendments and waivers with an eye to the good of the syndicate. There just wasn't much action in the mechanics of debt contract alteration.

In recent years, though, the longstanding order has largely collapsed. Some of the world's most elite law firms and financial advisors have made their marks devising novel approaches to consent solicitations. From the debtor's perspective, the stimuli have been both "defensive" and "offensive." On the defensive side, a seeming increase in activism by hedge funds specializing in distressed debt has induced companies to consider all available means to escape a threatened acceleration.⁴ On the offensive side, private equity-backed companies seeking to restructure unsustainable debt burdens without invoking Chapter 11 have proven willing to experiment with previously unthinkable techniques.⁵ The most talked-about development in leveraged finance and restructuring in recent years, sometimes described as "creditor-on-creditor violence," is a story first and foremost of dashed expectations about how consent solicitations work. More than hyperbolic labels are at stake. The new methods have spurred numerous

Do Bondholders Lose from Junk Bond Covenant Changes?, 66 J. BUS. 499 (1993); Marcel Kahan, The Qualified Case Against Mandatory Terms in Bonds, 89 NW. U. L. REV. 565 (1995). This scholarship identified three trade-offs associated with the solicitation of consents from dispersed bondholders—between majority and unanimity rules, between individual investors' "holdout" incentives and the prospect of an aggressive debtor railroading them into submission, and between the use of rules and standards in policing the dynamics.

³ William W. Bratton & Adam J. Levitin, *The New Bond Workouts*, 166 U. PA. L. REV. 1597 (2018) (workouts seem to work); Kahan & Tuckman, *supra* note 2 (bonds subject to an exchange offer have positive abnormal returns around announcement date).

⁴ See Marcel Kahan & Edward Rock, Hedge Fund Activism in the Enforcement of Bondholder Rights, 103 NW. U. L. REV. 281 (2009).

⁵ Vincent S.J. Buccola, Sponsor Control: A New Paradigm for Corporate Reorganization, 90 U. CHI. L. REV. 1 (2023).

rounds of litigation, with disaffected debtholders challenging the validity of putative “majority” or “supermajority” results.

Yet despite consent solicitations having become a frequently contested matter, debates touching on the subject remain frustratingly atomistic. The courts lack a general analytical framework for evaluating practices that can have substantial impact on investors and operating companies. Consequently litigation appears disordered and ad hoc. Academics, to the extent they have noticed the issue, have tended to focus on one or another practice rather than develop a general theory for assessing what is at stake.⁶

This article offers a comprehensive account of the methods (shy of bankruptcy) by which debtor companies seek to persuade lenders and bondholders to accept a change to their rights as creditors. Our aims are practical as well as theoretical. We thus develop guidelines for courts that could make decisions and bargains in the shadow of judicial decisions more predictable. But that ambition depends on our first having produced a reliable map of the possibility space—of the strategic properties of available solicitation techniques, the ways common contract provisions and background legal rules shape choices among techniques, and the reasons contracts look like they do. In that sense, we seek to make descriptive and analytical contributions in multiple registers.

The pole star orienting our analysis is coercion. By this we mean specifically a structural property of some solicitation methods that can induce debtholders to give requisite consent to a proposed alteration that will reduce the aggregate value of the affected debts.⁷ Coercion so understood is a useful starting point because its normative odor is unmistakable. Every plausible normative theory of contractual change regards a proposed change’s decrement to the affected debtholders’ wealth as, at minimum,

⁶ Academic studies of recent events in which solicitations loom large, especially non-pro rata “uptier” transactions (about which more below), have been useful, and we draw heavily on them. *See, e.g.,* Diane Lourdes Dick, *Hostile Restructurings*, 96 WASH. L. REV. 1333 (2021); Stephen J. Lubben, *Protecting Ma and Pa: Bond Workouts and the Trust Indenture Act in the 21st Century*, 44 CARDOZO L. REV. 81, 132–42 (2022); Diane Lourdes Dick, *Alliance Politics in Corporate Debt Restructurings*, 39 EMORY BANKR. DEV. J. 285 (2023); Douglas G. Baird, *Three Faces of Creditor-on-Creditor Aggression*, 97 AM. BANKR. L.J. 213 (2023); Ryan Schloessmann, *Covenant Control: The Case for Treating Uptier Transactions as a Form of Corporate Control*, 90 U. CHI. L. REV. 1197 (2023); Sneha Pandya & Eric L. Talley, *Debt Textualism and Creditor-on-Creditor Violence: A Modest Plea to Keep the Faith*, 171 U. PA. L. REV. 1975 (2023); Samir D. Parikh, *Creditors Strike Back: The Return of the Cooperation Agreement*, 72 DUKE L.J. ONLINE 1 (2023); Samuel Antill, Neng Wang & Zhaoli Jiang, *Creditor-on-Creditor Violence and Secured Debt Dynamics* (2024) (unpublished manuscript).

⁷ In other words, a proposal is coercive if and only if it will tend to induce requisite consent that a single investor owning all of the affected loans or bonds would withhold. Our usage is consistent with the literature, although we drop a limitation that previous authors seem implicitly to have assumed, namely that a coercive offer induces all affected creditors equally. *See, e.g.,* Coffee & Klein, *supra* note 2, at 1211; Brudney, *supra* note 2, at 1833–35.

important. And although a coercive offer need not reduce the aggregate value of affected creditors' holdings—an offer can be coercive and attractive on the merits at the same time—coercion undermines the probative value on that score of holders' professed consent. The more coercive a solicitation is, the less reliable its output will be. Making sense of debtholders' (and the law's) tolerance of coercive methods thus turns out to be the central task in giving an account of contract alteration.

We start by mapping debtors' opportunity space, showing how consent solicitations can be structured more or less coercively. Part II identifies four key dimensions that characterize any particular method of solicitation. It shows how each dimension can take on coercive or non-coercive properties. It then assesses three solicitation methods used frequently in practice or of recent vintage that are notable for their coercive potential.

Part III surveys common contractual provisions and background legal rules that may impinge on a debtor's ability to engineer a coercive solicitation. We find that there are contractual tools, so to speak, that could shut down coercive solicitation altogether—not merely *notional* contractual provisions of our own invention but provisions that parties have adopted in at least some contracts in some submarkets. We also find, however, that in practice indentures and loan agreements typically leave more or less room for debtors' choice. Courts, seeming to perceive that creditors can impose explicit guardrails to protect themselves, are similarly reluctant to announce a general principle against coercive techniques.

Our survey points up a suggestion that the judicial view implies: that some amount of debtor freedom to use coercion might be efficient or at least maximize the parties' surplus (rather than reflect “market failure”). Part IV identifies a variety of explanations for the status quo. We conclude that economic rationales plausibly justify some degree and certain types of coercion. This conclusion helps to explain the failure of contracts generally to prohibit all coercive solicitations and justifies the dominant judicial approach. On the other hand, we also conclude that market failure probably explains the contractual availability of some of the most coercive techniques.

Part V offers a tentative proposal addressed to judges that embodies these conclusions. In our view, judges should not hesitate to look through or unwind alterations achieved through the most coercive solicitation methods when the relevant contractual provisions are ambiguous or when the contract as a whole does not clearly anticipate the method. The logic of an interpretive presumption in this context parallels that of *contra proferentem*. Modesty about one's ability to weigh the costs and benefits of even highly coercive solicitation methods counsels against an approach that would rule out practices on which market participants might settle. On the other hand, to the extent that, as we believe, debtors can propose changes to standard contractual language more

easily than dispersed bond and loan investors can, debtors should bear the onus of specification.

II. The Coercive Potential of Consent Solicitations

The theory of incomplete contracting is the starting point for understanding debtor-creditor relationships. Creditors make an investment at t_0 , and the parties specify a lot of rules about how capital will be returned and what the debtor must, can, or may not do in the interim. At first approximation, those rules represent the parties' best bet about the way to maximize joint surplus. Everyone knows, however, that the world can change in ways that render these rules suboptimal. Indeed, initial rules are designed as they are in part because debtors and creditors have common knowledge *about uncertainty*. State-contingent control rights are a paradigmatic illustration of this idea.⁸

The vicissitudes of life being what they are, though, the contingencies built into a debt contract when it is formed will sometimes prove insufficient to the moment. Altering terms may then maximize joint surplus. Every debt contract thus contemplates the possibility of amendments or exchange offers (i.e., prospective changes) and waivers (i.e., retrospective changes).

In a bilateral context—one debtor and one creditor—revision is straightforward. The parties can recut the deal as though they were contracting *ab initio*.

The problem of change is more vexed with respect to bonds and loans that will be held by multiple creditors. For such instruments, collective-action problems among holders loom large. Holders might disagree about whether a particular change is for the best or they might have different interests. Indentures and loan agreements address the difficulties of aggregation in the first instance by defining thresholds of creditor consent—in colloquial terms, the amount of “votes”—needed to amend terms or waive a default. As relevant for our purposes, two such thresholds are typical. Most debt contracts predicate the amendment of most provisions on majority consent (more specifically, consent of the holders of a majority of the debt outstanding or committed under the contract to be altered). The other threshold is unanimity. The Trust Indenture Act requires that indentures governing publicly traded bonds condition changes of core payment terms on the consent of each affected holder. Virtually all bonds not subject to the Act and all loan agreements do the same. In addition, some items beyond core payment terms are often enumerated in the list of provisions that cannot be changed by

⁸ Philippe Aghion & Patrick Bolton, *An Incomplete Contracts Approach to Financial Contracting*, 59 REV. ECON. STUD. 473 (1992).

majority consent.⁹ These “sacred rights” typically include important financial terms—redemption premia, conversion rate—but little beyond.

The practical difficulty of achieving unanimity underscores the importance of another method, apart from amendment or waiver, by which debtors and creditors anticipate altering their deal. Since unanimous consent can be practically impossible to achieve, debtors seeking to alter a core payment term or “sacred right” can offer to exchange outstanding bonds or loans for new instruments featuring revised terms. To the extent that holders accept the offer, an exchange results in an alteration. Any creditors who do not accept the exchange can insist on the terms of the original deal; but, at the limit, where 100 percent of outstanding bonds or loans exchange into a new instrument, an exchange is functionally identical to an amendment. For that reason, we will often use the term “consent” to refer to creditors’ acceptance of an exchange offer as well as to the more specific context of approval of an amendment or waiver.

Exchange offers come with two additional wrinkles. First, some loan documents prohibit the debtor from acquiring outstanding bonds or loans other than through contractually specified redemption or repurchase procedures. Such prohibitions may practically forbid an exchange offer. Second, exchange offers are often combined with so-called exit consents. An exit consent is an exchanging debtholder’s agreement to amend the terms of the bonds or loans it is about to surrender. Exchange offers coupled with exit consents thus can entail alteration of core payment terms for exchanging holders and alteration of non-core terms for holders who do not exchange.

Wherever consent looms large, however, so, too, does the shadow of coercion. This Part maps the opportunity space with an eye to the coercive potential of various methods. We begin by discussing four dimensions that characterize any particular solicitation.¹⁰ We then sketch three techniques now in use that are notable for their coercive potential.

⁹ Marcel Kahan, *Rethinking Corporate Bonds: The Trade-Off Between Individual and Collective Rights*, 77 N.Y.U. L. Rev. 1040 (2002).

¹⁰ One could model the duration of an offer as a fifth dimension, because the amount of time debtholders have to weigh a solicitation can affect the practical degree of coercion they suffer. As we explain below, sufficient creditor coordination can nullify most of the forms of coercion we identify. Coordination takes time, however, and a short window may preclude it even in situations in which debtholders with enough time would organize to thwart their debtor’s proposed alteration. Duration does not entail its own coercive logic, however—it only exacerbates or ameliorates the practical significance of coercion otherwise established—and consequently we do not treat it further.

A. Four Dimensions of a Solicitation

1. Ranking of the altered instrument

A company seeking to alter its relationship to the holders of its loans or bonds can produce a coercive offer if its acceptance by some holders will predictably reduce the value of the instruments held by those who do not consent. A reliable way to produce such an affect is to increase the priority of payment enjoyed by consenting holders. This a debtor can accomplish easily through an exchange offer if, for example, the exchange instrument is secured by (a senior lien on) collateral, is contractually or structurally senior to, or matures sooner than, the bond or loan to be altered.¹¹

To see why a senior-junior exchange offer is coercive, consider the position of an atomistic holder of \$100 million principal amount of unsecured bonds due in a year. When the bonds mature, the issuing company will consist of an asset worth either \$80 million (with 90% probability) or \$120 million (with 10% probability). Assume that the company offers its holders to exchange their bonds for new, secured bonds, with the same maturity, at an exchange ratio of $\frac{9}{10}$ (that is, \$90 face amount of new bonds for every \$100 of outstanding bonds exchanged).

The holder evaluating her potential payoffs sees that her possible recoveries will depend on the fraction f of other holders who exchange. As more exchange into the senior instrument, a smaller amount of the company's value will be left, in bad states of the world, to be shared by the non-exchanging holders. If $f \geq \frac{8}{9}$, a holder who rejects the offer would get nothing in bad states of the world (because the full value of the company will go to exchanging holders) but would have received at least 80% of her original principal amount if she had accepted the offer; and if $f < \frac{8}{9}$, a holder who rejects the offer would get less than 80% of her original principal amount in bad states of the world but would have received 90% of her original principal amount if she had accepted the offer. While accepting the offer reduces the payout in good states of the world from 100% to 90%, it turns out that the expected payoff is higher for accepting holders for all values of f . (See Table 1.) For an atomistic holder, accepting the offer is thus a dominant strategy.

A holder of all the outstanding bonds, by contrast, would reject the offer. For such a holder, the payoff would be 82% if the offer is rejected but only 81% if the offer is accepted. The upshot is that a senior-for-junior exchange offer can lead creditors to "consent" to alter the terms of a debt contract despite the alteration making them

¹¹ Cash tender offers can produce a similar dynamic if reduction in the debtor's liquidity associated with the repurchases makes default on outstanding debt more likely.

collectively worse-off. In this sense, senior-for-junior exchange offers can create a dynamic resembling the classic prisoner's dilemma.¹²

Table 1: Exchange Offer Payoff Structure

		Firm Value is 80	Firm Value is 120	Expected Payoff
$f \geq 8/9$	Exchange	.9	>.8	>.81
	Don't exchange	1	0	.1
$f < 8/9$	Exchange	.9	.9	.9
	Don't exchange	1	<.8	<.82

Coordination cannot easily address prisoner's dilemmas. Even if holders could coordinate and agree informally with each other not to participate in the exchange offer, each holder would have an incentive to defect. Rather, holders would have to make commitments to each other, supported by sanctions for breach, to overcome the coercive dynamic.

2. Conditionality of the payment of an inducement

i. Consent Payments

When debtors seek to alter a debt relationship through an amendment or waiver, they frequently offer the creditors whose consent is needed a conditional cash payment or other sweetener. In such cases, the type of conditionality embedded in the offer of inducement itself bears on the coerciveness of the solicitation as a whole. There are three basic options or "games." Payment of the inducement to any particular holder can be conditioned on (1) the amendment or waiver threshold being met (whether or not the particular holder consented); (2) the holder offering its consent (whether or not the requisite majority of holders provided consents); or (3) the holder offering its consent *and* the majority consent threshold being met. The first option gives each creditor (who is seeking to maximize the value of its credit) an incentive to "vote" non-strategically

¹² Indeed, in our example, the payoff structure if there are only two holders each owning half of the bonds is the same as the payoff structure in the prisoner's dilemma.

	Exchange	Don't exchange
Exchange	.81	.9
Don't exchange	.9	.82

according to its view of what would be better—the altered instrument plus the consent payment or the status quo. Choice is more complex if, on the other hand, the debtor offers an inducement only to the creditors who consent.

Table 2 provides the payoffs a holder expects to receive, depending on whether it consents or not and whether it is likely to provide the pivotal “vote,” for each of the three games. The amount of the consent payment is C , and the value of the instrument under the status quo or as amended is respectively V_{sq} and V_a . We focus on the case where $V_a + C < V_{sq}$ and the amendment is thus not in the collective interest of debtholders. (If $V_a + C > V_{sq}$, the dominant strategy in each game is for holders to consent.)

As Table 2 shows, no coercion results in Game 1 where the inducement is to be paid to all affected holders conditional only on the requisite threshold of consent being reached. Each holder’s payoff will depend on the holder’s “vote” only the holder turns out to be pivotal. The holder thus has an incentive to consent if and only if $V_a + C > V_{sq}$ and the amendment is in the collective interest of all debtholders.

Table 2: Consent Payments

	Game 1: Payment if threshold reached (whether or not holder consents)		Game 2: Payment if holder consents (whether or not threshold is met)		Game 3: Payment if threshold reached <i>and</i> holder consents	
	Consents	Rejects	Consents	Rejects	Consents	Rejects
Threshold reached regardless of holder’s “vote”	$V_a + C$	$V_a + C$	$V_a + C$	V_a	$V_a + C$	V_a
Threshold reached only if holder consents	$V_a + C$	V_{sq}	$V_a + C$	V_{sq}	$V_a + C$	V_{sq}
Threshold not reached regardless	V_{sq}	V_{sq}	$V_{sq} + C$	V_{sq}	V_{sq}	V_{sq}

By contrast, inducements that are conditioned on a particular holder’s consent have a coercive element. If an inducement is to be paid to consenting holders whether or not the requisite threshold is achieved (Game 2), each holder is better off consenting, even if $V_a + C < V_{sq}$ and the amendment is *not* in the collective interest of all debtholders *unless* its decision turns out to be pivotal. For dispersed holders, of course, the likelihood of

being pivotal is small. In game theoretic terms, there are two Nash equilibria if $V_a + C < V_{sq}$: all holders consenting or else a bare majority of holders withholding consent (such that each non-consenting holder is pivotal to the solicitation failing). Getting to the latter equilibrium would require significant coordination.

A similar result holds when inducements are offered conditional *both* on a holder providing its consent *and* the requisite threshold being met (Game 3). Even if $V_a + C < V_{sq}$, holders are better off consenting when the solicitations would succeed irrespective of their own vote and worse off only when their decision would be pivotal.¹³ As in the case where the inducement is paid to consenting holders irrespective of the outcome, all holders consenting is a Nash equilibrium. Now, though, any set of actions that would lead the solicitation to fail also constitutes a Nash equilibrium (as any individual decision would either not change the outcome and hence not change the payoff structure or, if the holder is pivotal, would reduce the holder's payoff).

ii. Exit Consents

As noted earlier, amendments can also be combined with exchange offers through exit consents. To focus our analysis on potential coercion in the amendment process, we will assume that the exchange offer itself (unlike the offers we discussed in Section A.1) has no effect on the value of securities not participating in the exchange offer.

Exit consents can be structured in several ways. First, an exchange offer can be open to all holders but conditioned on the debtor receiving majority consents to the amendment. In such offers, the dominant strategy is for holders to consent to the amendment and participate in the exchange offer if and only if the value of the debt issued in the exchange offer V_E is above the status quo debt value V_{sq} (and hence in the collective interest of debtholders).¹⁴ These exchange offers are thus not coercive.

Second, an offer can be open only to holders who have provided an exit consent *and* be conditioned on receiving majority consents to the amendment. Such “dual-conditional” offers are structurally identical to solicitations for an amendment in which the consent payment is to be made only to consenting holders and only if the threshold is reached (substituting V_E for $V_a + C$)—and carry the same coercive potential. In such offers, the opportunity to participate in the exchange offer could be viewed as the “consideration” for the consent.

¹³ The argument here is similar to the argument why front-loaded tender offers for shares are coercive. *See, e.g.,* Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973 (2002).

¹⁴ If $V_E > V_a$, holders should accept the exchange offer; if not, they should reject the exchange offer.

Finally, an exchange offer can be open to all holders and *not* conditioned on receiving majority consents. Such unconditional offers are of interest if holders have nevertheless an incentive to provide an exit consent because the value of the debt issued in the exchange offer is higher if the to-be-exchanged debt is amended, i.e. if $V_{E(a)} > V_{E(sq)}$. (See Table 3). In such an offer, accepting the exchange offer but not consenting to the amendment is never desirable. Even if the offer is not in the collective interest of debtholders ($V_E < V_{sq}$), there are two Nash equilibria as long as $V_{E(a)} > V_a$: all holders accepting and consenting and all holders rejecting the offer.¹⁵

Table 3: Exchange Offers not conditioned on receiving majority consents

	Accept and Consent	Accept and No Consent	Reject
Succeeds Regardless	$V_{E(a)}$	$V_{E(a)}$	V_a
Succeeds only if consent	$V_{E(a)}$	$V_{E(sq)}$	V_{sq}
Fails Regardless	$V_{E(sq)}$	$V_{E(sq)}$	V_{sq}

iii. Degrees of Coercion

In this section, we have identified several coercive structures where accepting an offer that is not in the collective interest of holders of the same debt is nevertheless a Nash equilibrium: consent payments that are made selectively to consenting holders regardless of whether the requisite consents are obtained; dual-conditional consent payments that are made only to consenting holders and only if the requisite consents are obtained (and, equivalently, exchange offers open only to holders that have provided an exit consent and are conditioned on receiving majority consents); and unconditional exchange offers where the amendment would increase the value of the debt offered in the exchange offer. In consent solicitations structured along any of these lines, an amendment that is not in the collective interest of debtholders may obtain the requisite majority even though a debtholder who knew that its decision would be

¹⁵ To render an exchange offer that is not conditioned on obtaining the requisite majority of consents non-coercive, the consideration for consenting would have to be decoupled from the exchange offer, for example by first conducting a consent solicitation with a consent payment to all holders (if the requisite majority of consents is obtained) and only then an exchange offer (involving no further consent solicitation). Under such a structure, if the offer is not in the collective interest of creditors ($V_{E(a)} + C < V_{sq}$), holders would either not consent (because $V_a + C < V_{sq}$) or not accept the exchange offer if consents are obtained (because $V_{E(a)} < V_a$).

pivotal (or a debtholder who holds all of the relevant outstanding bonds or loans) would not vote in favor of such an amendment.

However, the ability of debtholders to protect themselves through coordination differs between consent payments that are made selectively to consenting holders regardless of whether the requisite consents are obtained on one hand and the other structures on the other hand. In the other structures, if debtholders holding sufficient debt to make sure the amendment is not adopted make an informal agreement not to approve it, no debtholder would have an incentive to defect unilaterally from that coalition and deliver a consent. Defection would raise the likelihood that the defector's was pivotal (in which case the payoff is higher for not consenting) but any defection by a single holder would not raise the likelihood that the solicitation succeeds regardless (in which case the payoff is higher for consenting). In game theoretic terms, any coalition that holds enough votes to assure that the solicitation fails would be stable. Indeed, in this situation, it is not even necessary for holders to be able to communicate bilaterally. Thus, if there are three debtholders each holding one third of the debt, it would be sufficient for one of the debtholders to credibly commit not to deliver a consent. Given that information, it becomes the dominant strategy for each of the other holders likewise not to deliver a consent. Put differently, it is relatively easy to defeat these coercively structured solicitations through coordination.

By contrast, it is much harder to defeat consent payments that are made selectively to consenting holders regardless of whether the requisite consents are obtained. To be sure, a coalition that holds *just enough votes* to assure that the amendment is not adopted would constitute a Nash equilibrium. But for any wider coalition, this is no longer the case. But forming just such a bare coalition is a much harder task for two reasons: first, it presents a much narrower target; and second, non-members of the coalition would be better off than members (as they could consent and pocket the consent payment), generating a free-rider problem.

But while consent payments are made to consenting holders regardless of whether the requisite consents are obtained entail a high degree of coercion, such consent payments also entail high risks for the debtor: the debtor may be forced to make consent payments to consenting holders even if the requisite majority does not consent and the debtor therefore obtains no benefits from the consents obtained. For example, a debtholder group may form that holds sufficient debt to ensure that the amendment is not adopted, say 70%, but then uses the excess holdings (19%) to provide consents and cash in on a consent payment.

3. Exclusivity of the offer of inducement

When a debtor offers a consent payment to consenting holders only (rather than to all affected holders), the solicitation can be either inclusive or exclusive. In an inclusive solicitation, each holder of an affected instrument is invited to provide consent, and upon doing so to receive payment in proportion to the amount held. In an exclusive solicitation, by contrast, the debtor restricts its offer to a subset of the holders who collectively hold at least the requisite majority.

Exclusivity can be coercive in a distinctive sense. Unlike the coercive features described above, exclusivity allows some creditors to expropriate value from others—a dynamic that is sometimes described as creditor-on-creditor violence.¹⁶ While debtholders who are included in the offer typically benefit from the alteration (in conjunction with any consideration they receive for consenting),¹⁷ the excluded group is typically made worse off. As a result, there is no assurance that the alteration is beneficial to debtholders as a whole.

This feature means that a style of coordination in which the holders of an affected instrument mutually assure one another that they will reject a solicitation designed to make them collectively worse-off will not reliably succeed.¹⁸ Any such coalition is unstable. More technically, it is a dominant strategy for any debtholder invited to join the exclusive group to accept the invitation.

To see why, consider a case in which a single creditor has unilateral control over the success or failure of a solicitation, so that coordination is irrelevant. A company has \$500 million face amount of bonds outstanding with a market value of \$450 million. One investor owns just over half of the bonds, and the company proposes an amendment that will reduce the bonds' value by 10%. The alteration will therefore be in

¹⁶ E.g., Antill, Wang & Jiang, *supra* note 6.

¹⁷ If there is no majority holder, then, at least in theory, an exclusive solicitation can succeed even where the consenting holders are themselves made worse-off. The logic is similar to the conditional-consent dynamic described above. As long as a holder does better consenting than not, the debtor may be able to play the holders against each other. A debtor could announce, for example, that a consent payment will be made to the first 50% + 1 holders who deliver their consents. However, coordination to defeat the solicitation will be easier if even the participating holders are worse-off than under the status quo ante. Generally, exclusive solicitations are most problematic if the group of excluded creditors is large. Since there are practical and legal limits to the amount of externalities that can be imposed on non-participating holders, and these externalities must be sufficient to make selective exchange offers benefit both participating debtholders and the company, the smaller the percentage of non-participating debt, the more difficult it is to find an exclusive offer that would both be in the interest of the company and induce participating debtholders to consent.

¹⁸ Vincent S.J. Buccola, *Efficacious Answers to the Non-Pro Rata Workout*, 171 U. PA. L. REV. 1859 (2023).

the holders' collective interest only if they are offered an inducement—cash or new securities—worth at least \$45 million. If the inducement is to be paid to all holders willing to consent, then the debtor cannot offer anything less than that amount and cause the majority holder to accept the amendment. Not so if the solicitation is exclusive, however. The majority holder is better off if *it* receives an inducement worth more than \$22.5 million. The debtor, if it seeks only the majority holder's consent (and offers to pay a consent fee only to consenting holders), thus can structure a solicitation that, for example, pays the majority holder a \$30 million consent fee. The net result is that bondholders as group lose \$15 million, with the majority holder gaining \$7.5 million and the minority losing \$22.5 million. Perfect coordination among the minority holders cannot prevent the amendment and the majority holder has no incentive to join an anti-amendment coalition.

This is not to say that coordination with respect to exclusive solicitations is always irrelevant. If creditors can bind themselves effectively *ex ante* not to accept an exclusive offer, then coordination can defeat proposals that would make them collectively worse-off. Two fact patterns are worth considering. In one, the creditors don't know whom the debtor is likely to seek to deal with or exclude. In this situation, each creditor faces an identical expected loss from a future exclusive solicitation. Each thus has an incentive to enter a binding contract mutually forswearing the ability to consent to such a solicitation.¹⁹

In the other fact pattern, the debtor has revealed (or the creditors can otherwise infer) whom it will seek to deal with. In this situation, the excluded creditors would have to make a Coasian payment to the majority to persuade them to withhold consent. By tautology, if the alteration harms creditors as a group, there is some amount the excluded creditors could, and should be willing to, pay to sway the favored creditors. The amount the favored creditors will get from consent *has to be* less than the amount the excluded creditors will lose. But arranging Coasian payments among dispersed creditors generates a free rider problem on top of the regular coordination problem that may make it next-to-impossible to come to an agreement.

4. Variability of the amount of debt eligible to consent

In the ordinary case, the set of debt instruments relevant to a consent solicitation is fixed and known before the solicitation begins. That need not be the case, however. Some debt contracts allow the debtor to issue additional bonds or loans with identical characteristics to the outstanding instruments and that vote together with previously

¹⁹ Id.

outstanding ones on amendments and waivers. If a company issues such instruments, they will tend to dilute the voting power of creditors holding the preexisting debt.²⁰

A company's ability to issue additional debt capable of consenting to an amendment or waiver greatly enhances a solicitation's potential for coercion. Take any proposed amendment or waiver that is adverse to the collective interest of the existing creditors. Even if a single creditor held all debt outstanding before the solicitation, such that coercion via any of the features noted above were impossible, a determined debtor with enough capacity could still prevail by doubling the amount outstanding and inducing the investors receiving the newly issued securities to consent. A debtor can induce such consents by agreeing with the buyers of the new securities, in advance of issuance, to fix the purchase price below their expected post-amendment/waiver market value or offering a side payment that compensates them for any value decline.

Indeed, a debtor with capacity to issue additional securities could use the in terrorem effect of such an issuance to induce existing holders to consent to an alteration that makes them worse-off without actually having to issue any additional securities. Faced with the threat of having holders of newly issued securities approve and capture the value of the debtor's inducement, existing creditors—even if they have already formed a stable coalition—may consent as long as they receive some payment. In other words, if a debtor can issue additional debt that participates in the voting, and can do so in a selective way, then not consenting is no longer a Nash equilibrium for existing creditors.

²⁰ A debtor can also affect the composition of debt instruments by repurchasing debt. However, as long as all debtholders have identical interests, this would not generate coercion.

Table 4: Summary of Coercive Solicitation Features

	None accepting/ consenting	Bare majority not accepting/ consenting	Bare majority accepting/ consenting	Degree of coercion	Comment
Exchange Offers: participation and consummation conditional on consent	Nash	Nash	Not Nash	Low	
Exchange Offers: consummation conditional on consent	Nash	Nash	Not Nash	None	
Exchange Offers: participation and consummation not conditional on consent	Nash	Nash	Not Nash	Low	Entails risk for debtor if majority consents not obtained
Exchange Offers w/out consent solicitation that lower value of non-exchanged securities	Not Nash	Not Nash	Not Nash	Very high	Prisoner's dilemma-type offers
Payment made to all holders if majority consents	Nash	Nash	Not Nash	None	
Payment made to consenting holders if majority consents	Nash	Nash	Not Nash	Low	
Payment made to consenting holders even if majority fails to consent	Not Nash	Nash	Not Nash	High	Entails risk for debtor if creditors can coordinate a large minority of consents
Exclusive exchange offers: participating holders benefit	Nash but not THP	Not Nash	Nash	Medium	
Threat of issuing additional debt (ballot stuffing)/actual issuance	Nash but not THP	Not Nash	Not Nash	Extreme	If threat fails, debt can be altered by actual issuance of additional debt

B. Notable Combinations

Although the features we describe generate many possible combinations, three of the possible combinations presently dominate market practice.

Dual-conditional inclusive solicitations. For several decades, it has been common practice for debtors to procure amendments and waivers by offering all holders a dual-conditional payment or by conducting a dual-conditional exchange offer. In the former case, the debtor pays only holders who consent and then only if total consents exceed the requisite threshold for the amendment or waiver. In the latter case, the exchange offer is open to any holder who provided an exit consent, consents are required to be eligible to participate in the exchange offer, and consummation of the offer is conditioned on receiving the requisite consents.

In principle, as we have shown above, solicitations of this form are structurally coercive. In reality, however, it turns out that dual-conditional inclusive solicitations and exchange offers are generally not effective at railroading creditors into consenting to alterations not in their collective interest. Debtholdings tend to be concentrated, at least compared to public equities. Even if no creditor holds sufficient bonds or loans to control the outcome unilaterally, groups of creditors appear to form relatively easily. An empirical study conducted by one of us has found that bond values increase when a dual-conditional inclusive consent solicitation is announced, that bondholders often succeed in forming groups, and that these groups are effective in extracting concessions (in the form of higher consent payments) from the company.²¹ This indicates that actual or anticipated coordination generally overcomes the low level of coercion entailed in these solicitation techniques.

Exclusive uptiers. The last few years have seen a rapid increase in solicitations with a practically as well as theoretically coercive form. Perhaps the most striking and common is the non-pro rata uptier. This form of transaction came to prominence in the summer of 2020 and has diffused rapidly through restructuring practice.

An uptier transaction is designed to give the subject company an ability, which one or more debt contracts prevent, to borrow new money on a so-called super-senior basis. In its exclusive form, the uptier harnesses the coercive properties of both a senior-junior exchange and an exclusive inducement. The debtor offers holders of a bare majority of the relevant (usually secured) instruments an exclusive right to exchange their holdings

²¹ Kahan & Tuckman, *supra* note 2.

for new, senior securities if they will give exit consents stripping the existing debt of covenants and eliminating or subordinating associated liens that otherwise would prevent the contemplated new-money borrowing. If successful, the debtor gets access to fresh capital without a bankruptcy filing and the participating creditors take a priority position ahead of left-behind former fellow creditors.²² The bedding company Serta Simmons was the first to execute a non-pro rata uptier of secured loans and is still exemplary. The company had outstanding \$2.3 billion of first- and second-lien loans. To release the liens backing these loans would have required unanimous lender approval. At least arguably, though, a bare majority of lenders under each of the two facilities could permit the creation of new loans backed by priming liens. In the event, Serta entered a deal with 57% of its first-lien and a whisker more than 50% of its second-lien lenders, which saw the company borrow an additional \$200 million and the participating lenders swap into more valuable loans.

Exclusive uptiers appear to be very effective. Although still but a few years on from the first executed transaction, dozens of companies already have used exclusive uptiers to modify their debt. Unlike dual-conditional inclusive consent solicitations, exclusive uptiers not only succeed in attracting the requisite consents to alterations but reduce the aggregate value of the debt held by the pre-transaction creditors.²³ Recently, vulnerable creditors have begun to bind themselves together via “cooperation agreements” that prohibit defection and are designed to be specifically enforceable. Thus, the possibility of coordination is apparent. On the other hand, one evident use of cooperation agreements is, and has been, to arrange a stable majority coalition that can reap the benefits of an exclusive solicitation.

Recently the Fifth Circuit called into question one contractual means by which loan borrowers have claimed authority to pursue exclusive uptiers.²⁴ Whether the decision will prove to be more than a speed bump for debtors seeking to pursue an exclusive uptier is an open question. For now, though, bond issuers and at least some borrowers seem poised to continue using the technique.

Ballot stuffing. The other most notable development has been with respect to ballot stuffing. Ballot stuffing is, in principle, the most extreme coercive technique. Yet, it has not been frequently employed. One reason may be that ballot stuffing is not always

²² Vincent S.J. Buccola & Greg Nini, *The Loan Market Response to Dropdown and Uptier Transactions*, 53 J. LEGAL STUD. 489 (2024).

²³ Adam B. Badawi, Vincent S.J. Buccola & Greg Nini, *Price Discipline for Non-Price Loan Terms* (2024) (unpublished manuscript) (estimating net effect of the three uptiers executed in 2020).

²⁴ *In re Serta Simmons Bedding, L.L.C.*, _ F.4th _ 2024 WL 5250365 (5th Cir. Dec. 31, 2024). For discussion of the decision’s logic, see *infra* notes x–y and accompanying text [Part III.A.2].

possible. A debtor can stuff the ballot only if the relevant indenture or loan agreement permits the issuance of additional instruments that can vote together with pre-existing securities. And even if it is in principle permitted to issue such securities, the amount is often capped, either directly or by virtue of other, general limits on the incurrence of additional *pari passu* debt.

Ballot stuffing has been tried in only a handful of instances, to our knowledge all quite recent. In two cases, a debtor sought to issue additional bonds to procure a “defensive” waiver of a putative default asserted by an activist bondholder that had accumulated a majority stake in the then-outstanding securities. Neither attempt to stuff the ballot withstood judicial scrutiny, however, albeit for case-specific reasons.²⁵ In several other instances, a company has issued additional debt offensively, so to speak, as part of an effort to restructure liabilities outside bankruptcy.²⁶ The technique seems to have worked in a couple of cases. Recently, however, a bankruptcy judge dealing with the fallout of an uptier that had been predicated on a pre-transaction ballot stuffing has suggested that he will treat the issuance of additional notes as a sham (about which more below).²⁷

It appears, then, that ballot stuffing solicitations face legal as well as practical limits. Importantly, though, none of the judges confronting an instance of attempted ballot stuffing has opined that the technique is generically invalid. Even if rarely employed, then, the threat of ballot stuffing may affect the outcome of some consent solicitations. In addition, the potential for ballot stuffing is likely to affect bondholder monitoring and enforcement. Monitoring to detect and enforcing violations is expensive. To the extent that a company can easily (i.e. cheaply) escape from a default through ballot stuffing, incentives to invest in monitoring to determine whether a default has occurred or in enforcing covenants are reduced. Specifically, market participants that specialize

²⁵ In one case, a court held that the votes of holders of the additional bonds would not count because conditions in the indenture for issuing them had not been satisfied. *U.S. Bank N.A. v. Windstream Services, LLC*, 2019 WL 948120 (S.D.N.Y. 2019). In the other case, the court interpreted an exceedingly unusual waiver clause to bar the votes of holders of bonds issued after the putative default had occurred. *Antara Capital Master Fund LP v. Bombardier, Inc.*, 2023 WL 2566166 (N.Y. Sup. Ct. Mar. 17, 2023) (interpreting a clause that provided that “the Holders of a majority in aggregate principal amount of the Securities at the time Outstanding with respect to which a default or breach or an Event of Default shall have occurred and be continuing shall have the right exercisable by Act of such Holders to waive any past default or breach or Event of Default and its consequences” to mean that only holders of securities outstanding at the time a default has occurred can waive such a default).

²⁶ *Aimco CLO 10 Ltd. v. Revlon, Inc. (In re Revlon, Inc.)*, No. 22–10760 (DSJ), 2023 WL 2229352 *5–6 (Bankr. S.D.N.Y. Feb. 24, 2023) (Revlon); *In re Wesco Aircraft Holdings, Inc.*, No. 23–90611, Dkt. #1466 (Bankr. S.D. Tex. July 10, 2024) (Incora).

²⁷ *In re Wesco Aircraft Holdings, Inc.*, No. 23–90611, Dkt. #1466 (Bankr. S.D. Tex. July 10, 2024).

and monitoring and enforcement may forgo examining potential violations of debt agreement where the company is permitted to issue additional securities—and where ballot stuffing is thus an option—leaving more violations undetected and reducing deterrence.

III. Contractual and Legal Constraints on Coercion

The methods a debtor might use in any particular instance to procure creditor consent are a function of the contract it seeks to modify as well as background legal norms. This Part surveys common contractual provisions and other legal rules that may constrain debtors' freedom to employ coercive techniques.

Our summary observation is that these constraints in the aggregate do not embody an anti-coercion concept as such. Indentures and loan agreements feature a variety of terms that can rule out one or another coercive method of solicitation, under one or another constellation of possible facts. No provision aims at the problem directly, however, and some provisions even invite coercion. For example, some bond indentures expressly condone the use of exit consents.²⁸ In short, the provisions typically found in indentures and loan agreements resist any coherent, descriptive theory of alteration. Meanwhile, judges have declined to impose the kind of general theory of solicitation that contracts lack.²⁹ Thus, although courts remain willing at least to entertain argument that any single, highly coercive solicitation is inconsistent with general principles of contract law or equity, the relationship of coercion to legality is quite unclear.

A. Contractual Provisions

Indentures and loan agreements have remarkably little to say directly about the processes through which debtors may or must solicit the consent they need to alter terms. Several provisions that rule out one or another form of coercion are common in at least some kinds of debt contracts. And a number of provisions that indirectly limit a debtor's ability to deploy coercive techniques in some circumstances are widespread. These restrictive provisions can be understood as existence proofs of the notional

²⁸ See, e.g., Caesars Entertainment Corp., Indenture, 5.00% Convertible Senior Notes due 2024, dated as of Oct. 6, 2017, § 9.02(a) (clarifying that the consents comprising a requisite majority "include[e] consents obtained in connection with a tender offer or exchange for the Notes").

²⁹ Two recent papers are critical of judicial literalism in creditor-related disputes. Pandya & Talley, *supra* note 6; Jared A. Elias & Elisabeth de Fontenay, *Law and Courts in an Age of Debt*, 171 U. PA. L. REV. 2025 (2023).

capacity of debt contracts to prevent coercive solicitations. Yet most contracts, at least by their explicit terms, allow the debtor to choose among various coercive methods.

1. Provisions mandating equal treatment

Debt contracts can and, to a lesser extent, do use a simple provision to rule out structural coercion when a debtor seeks to pay for an amendment or waiver. What we call an equal treatment provision requires the debtor to pay the holders of all affected instruments, not only the consenting holders, any inducement it wishes to offer. Equal treatment provisions remove structural coercion because they cause each creditor's fate to hinge on the consent solicitation's overall success rather than on the holder's own contribution (or not) to the requisite majority. From a game-theoretic perspective, a holder should thus consent if and only if the consent

A common provision ensures that cash and similar inducements offered to procure consent to an amendment or waiver goes to all affected holders:

The Company will not, directly or indirectly, pay or cause to be paid any remuneration, whether by way of supplemental or additional interest, fee or otherwise, or grant any security or provide other credit support, to any holder of the Notes as consideration for or as inducement to the entering into by any holder of the Notes of any waiver or amendment of any of the terms or provisions of this Agreement unless such consideration is concurrently paid, or security is concurrently granted or other credit support is concurrently provided, on the same terms, ratably to the holders of all the Notes then outstanding even if such Purchaser or holder did not consent to such waiver or amendment.³⁰

Equal treatment provisions are sometimes found in agreements governing privately placed notes³¹ though not in indentures for publicly traded bonds.³²

While equal treatment provisions would prohibit coercive consent payments, they might still allow debtors to pursue a coercive solicitation by other means. In particular, these provisions do not unambiguously prevent a debtor's embedding its inducement for an amendment or waiver in an exchange instrument (the amendment or waiver

³⁰ See, e.g., CHS Inc., Note Purchase Agreement, April 18, 2024, Exhibit 1 to Form 10-Q filed July 10, 2024; New Jersey Natural Gas Company, Note Purchase Agreement, June 26, 2024, Exhibit 1 to Form 8-K, July 1, 2024, Section 17.2(b).

³¹ [over 2000 hits in Westlaw Edgar search for "directly #or indirectly, pay #or cause #to #be paid any remuneration, #whether #by way #of supplemental #or additional interest, fee #or otherwise"]

³² Marcel Kahan & Bruce Tuckman, Private Versus Public Lending: Evidence from Covenants, in *The Yearbook of Fixed Income Investing* 253, 259 (John D. Finnerty & Martin S. Fridson eds., 1996).

being an exit consent), rather than paying it as a fee,³³ and would probably not inhibit ballot stuffing.³⁴

Loan agreements often contain even more a far-reaching equal treatment provision in the form of a “sharing of payments” covenant. Under that covenant, a lender who obtains any non pro-rata payment on account of its loan is required to purchase from the other lenders a participation in their loans to reestablish each lender’s proportionate share. Many such agreements provide for exceptions to these sharing covenants for payments received in Dutch auctions and open market purchases. Such sharing provisions in credit agreements would probably preclude dual-conditional consent payments as well as consideration consents embedded in exchange instruments.

2. Provisions restricting exclusivity

An alternative provision requires the debtor to offer consent payments, on equal terms, to all holders of the relevant debt who will consent but allows the debtor to pay only those who do in fact consent. These are occasionally found in bond indentures, much more frequently than are equal treatment provisions, but do not generally appear in loan agreements. A typical equal opportunity clause reads as follows:

Neither the Company nor any Affiliate of the Company shall, directly or indirectly, pay or cause to be paid any consideration, whether by way of interest, fee or otherwise, to any Holder for or as an inducement to any consent, waiver or amendment of any of the terms or provisions of this Indenture or the Securities unless such consideration is offered to be paid

³³ One can see an argument on this matter. Although formally exit consents involve no payment, functionally they tie a benefit—the right to participate in a tender or exchange offer—to the provision of consent. This benefit could be regarded as a payment. From that perspective, requiring the consent payments be paid to all holders if the requisite consents are obtained would require that tender and exchange offer be open to all holders if the requisite consents are obtained. And requiring that consent payments must be offered on equal terms to all consenting holders would prohibit exclusive exchange offers with exit consents.

³⁴ Ballot stuffing entails two steps: the issuance of additional instruments to consent to the proposed alteration and the solicitation of consents themselves. Equal treatment provisions clearly govern the latter. But they do not obviously say anything about issuance of the ballot stuffing instruments. To the extent a purchaser’s inducement is embedded in the (discounted) price it pays for the instruments, it is not clear that the transaction involves a consent payment within the meaning of the standard provision. It is possible to read equal treatment provisions as implicitly prohibiting any consideration for consents that cannot be paid to all bondholders equally. Under that interpretation, both ballot stuffing and exchange offers conditional on consents would not be permitted. That a court would interpret a standard equal treatment provision in this way, however, is far from clear. In any case, the type of agreements containing equal treatment provisions generally do not permit issuance of new securities that vote alongside previously issued securities.

to all Holders that so consent, waive or agree to amend in the time frame set forth in solicitation documents relating to such consent, waiver or agreement.³⁵

Provisions of this sort clearly prohibit exclusive solicitations for an amendment or waiver. It is less clear how they would apply to analogous exchange offers, however. In an exchange offer conditioned on exit consents, the debtholder's right to participate in the exchange is arguably consideration for its consent; surely such a right has economic value. From that perspective, the opportunity to participate in an exchange would, it seems, have to be offered on equal terms to all holders. But the lack of any explicit reference to exchange-offer participation rights, coupled with explicit invocation of terms associated with cash transfers—"payment," "interest," "fees"—leaves doubt about the typical provision's application to the exchange context. Moreover, equal opportunity provisions, like equal treatment provisions (but unlike broad sharing provisions), would permit senior-junior exchange offers (which do not entail consents).

Application of this provision to ballot stuffing raises even thornier issues. Even if ballot stuffing is conceived of as an exchange of the ballot-stuffing instruments on one hand for a payment of money and an agreement to consent on the other hand—such that there is consideration for the consents—an equal opportunity provision would be satisfied if existing holders were also given the opportunity to buy ballot-stuffing instruments on the same terms. This would not prevent ballot stuffing. It would only assure that, to the extent purchasers of to-be-issued securities are getting a sweet deal, existing bondholders can participate in the deal if they are willing to provide consents.³⁶

The relatively low frequency and arguably limited reach of standard equal opportunity clauses suggest that the norm of inclusive solicitations that developed in practice starting in the 1980s may have developed for practical reasons—the more holders are solicited, the more likely is it to obtain the requisite consents—or out of concern that a judge might enjoin an exclusive offer (about which more below) rather than as a result of a contractual directive. In any case, the norm that all holders be

³⁵ Freeport-McMoran Copper & Gold Inc., Indenture, 10-1/8% Senior Notes due 2010, Jan. 29, 2003, Section 9.07. Westlaw-Edgar search found 898 documents between 1996 and 2024 that contained the search phrase “unless such consideration is offered to be paid to all Holders that so consent.”

³⁶ There are additional complications with applying this provision to ballot stuffing. For one, a debtor looking to stuff the ballot can arrange a deal with a hedge fund or other investor who is not already a holder and whom standard anti-favoritism language therefore does not capture. Second, even if the purchaser of to-be-issued instruments is an existing holder, the arrangement need not necessarily involve an express agreement between the company and the holders of the to-be-issued debt instruments. In cases where the prospective holders of the to-be-issued instruments hold other investments that will increase in value if the requisite consents are obtained, an agreement is unnecessary.

offered to participate on equal terms has shattered in the last five years. It still operates in low-stakes amendment and waiver contexts, but has largely been displaced in relation to alterations that aim to remake a debtor's capital structure. Hence the proliferation since 2020 of no-pro rata uptiers.

Note that it was long standard for syndicated loan agreements to prohibit altogether the debtor (or its affiliates) repurchasing loans through market transactions. The typical agreement thus prohibited exchange offers of all types, whether designed to effect an exclusive uptier or not, independent of the sharing rule discussed above. During the financial crisis, however, the blanket prohibition of repurchases stopped debtors and their financial sponsors from providing much-needed liquidity to the loan secondary market, and many market participants concluded that the traditional rules should go. A variety of responses emerged. Some loan agreements now resemble bond indentures, in that they give the borrower an unfettered ability to repurchase loans as it sees fit. Such agreements not only dispense with an equal treatment requirement; they lack even an equal opportunity principle. Other loan agreements preserve the traditional rule against debtor repurchases but carve out exceptions for two specified repurchase methods: a Dutch auction in which all lenders are invited to participate or an "open market" transaction. Many borrowers who have pursued an exclusive uptier have grounded their authority to do so in the notion that their exchange offers are made in the "open market." In the context in which the exception emerged, though, its function, like that of the Dutch auction exception and in contrast to the effect of indenture-like license, seems to be merely to create a limited equal opportunity carve-out in an otherwise equal treatment regime.³⁷

3. Provisions restricting ballot stuffing

The simplest way for a debtor to stuff the ballot box would be to issue new instruments to an affiliate, have the affiliate provide necessary consents, and then retire the instruments. A ubiquitous provision precludes this approach, however. For publicly traded bonds, the Trust Indenture Act mandates that debtor- or affiliate-owned holdings be disregarded for voting and similar purposes.³⁸ A functionally similar if not

³⁷ The Fifth Circuit's decision in *Serta Simmons* is consistent with this view, *see* _ F.4th _, 2024 WL 5250365 (5th Cir. Dec. 31, 2024), but the court largely eschews functional analysis.

³⁸ 15 U.S.C. § 77ppp(a) (providing that "indenture securities owned by any obligor upon the indenture securities or by any person directly or indirectly controlling or controlled by or under direct or indirect common control with any such obligor shall be disregarded").

identical provision is standard in agreements governing privately placed bonds and syndicated loans, as well.³⁹

A debtor who wants to stuff the ballot box must therefore find a willing counterparty not under common control. In practice, this appears not to be an overwhelming challenge, however. The debtor might, as in *Windstream*, look to existing investors who would benefit from the proposed alteration. Or it might, as in *Bombardier*, arrange a deal with a third-party fund manager who has a “special situations” investment mandate. One could imagine courts being persuaded to think of such a counterparty as a limited-purpose affiliate whose consent must be disregarded. It is not a giant leap to say that a purchaser who legally binds itself to vote as the debtor wishes is under the debtor’s control albeit in a limited respect. But such an approach would pose serious administrative difficulties and, although the issue has not been thoroughly litigated, is unlikely to carry the day.⁴⁰ Consequently the rule that affiliate-owned instruments are to be disregarded leaves significant scope for ballot stuffing.

In those contracts that in principle permit issuance of new debt that has the same rights, and votes along, previously issued debt, the main constraint is the general debt incurrence covenant. To sway the outcome of a vote—especially on a proposed alteration that would reduce the value of the instruments to be altered—may require issuing a lot of new debt. If the contract gives the debtor generous incurrence and lien baskets, or if the debtor is in a reasonably strong financial position (as may be the case in some “defensive” ballot stuffing episodes), the covenants won’t matter; but they will if capacity is tight.

The importance of new-issuance capacity was highlighted in the *Windstream* litigation.⁴¹ Aurelius, an activist hedge fund, had acquired a majority stake in a *Windstream* bond issue and sent the company a notice of default regarding a covenant

³⁹ Some loans to private equity-backed borrowers permit a bona fide credit fund affiliated with the sponsor to vote a specified, limited amount of the loans—up to 20%, say.

⁴⁰ Courts have determined that a bondholder who provides an exit consent in conjunction with an inclusive exchange offer does not by doing so render itself an affiliate of the debtor, even though the consent is a condition for participation in the exchange. *Katz v. Oak Indus. Inc.*, 508 A.2d 873, 881 (Del. Ch. 1989) (“That the consent is to be given concurrently with the transfer of the bond to the issuer does not in any sense create the kind of conflict of interest that the indenture’s prohibition on voting treasury securities contemplates. Not only will the proposed consents be granted or withheld only by those with a financial interest to maximize the return on their investment in Oak’s bonds, but the incentive to consent is equally available to all members of each class of bondholders. Thus the ‘vote’ implied by the consent solicitation is not affected in any sense by those with a financial conflict of interest.”)

⁴¹ See Vincent S.J. Buccola, Jameson K. Mah & Tai Zhang, *The Myth of Creditor Sabotage*, 87 U. CHI. L. REV. 2029, 2062–68 (2020) (describing the attempt to issue additional bonds in greater detail).

violation. Unable to get existing bondholders to consent to a waiver of the default (as Aurelius held a blocking position and Windstream was not willing to negotiate with Aurelius), Windstream tried to issue additional notes. The court, however, found that issuance of the securities violated the limitations on indebtedness covenant in the bond indenture and held that the securities could not be counted for voting purposes as they had not been validly issued.⁴²

4. Priority Restrictions

While loan agreements and bond indentures contain relatively few, if any, provisions regulating the process of obtaining consents to amendments or waivers, they regularly contain covenants addressing the relative priority of its debt. Thus, one of the most common provisions contained in both investment-grade and below-investment grade debt is a negative pledge clause which restricts the amount of secured debt that a debtor can issue.⁴³ Below-investment grade debt, for which the issue of relative priority is most acute, contain detailed provisions restricting when a debtor may incur new indebtedness and dealing with other ways to affect the priority structure, including debt issued by subsidiaries, subsidiary guarantees, and contractually senior debt.⁴⁴ Thus, for example, while debtors are generally permitted to refinance existing indebtedness even a times when they are generally prohibited from incurring new indebtedness—under a so-called “permitted refinancing” basket of the debt incurrence covenant—this basket is only accessible if the refinancing indebtedness would not have priority over the refinanced indebtedness.⁴⁵

5. Sacred rights

Every debt contract enumerates categories of amendment that the debtor can make only with the consent of each affected creditor. A majority of creditors is thus powerless to alter sacred rights possessed by non-consenting minority creditors. By limiting the type of amendments a majority of debtholders can approve over the opposition of a

⁴² Under the covenant, Windstream could issue debt only if its Consolidated Leverage Ratio was below a certain level (which it was not) or if the newly issued bonds fell into one of several enumerated baskets. At trial, Windstream argued that the bonds fell into the basket for Permitted Refinancing Indebtedness. Somewhat embarrassingly for Windstream, however, it had made a binding admission in its interrogatories which, the court found, rendered the exception for Permitted Refinancing Indebtedness unavailable. See *US Bank N.A. v Windstream Services, LLC*, 2019 WL 948120 *21 (SDNY).

⁴³ See, e.g., Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L. J. 857, 921-23 (1996) (citing empirical studies).

⁴⁴ See, e.g., Model Negotiated Covenants and Related Definitions, 61 BUS. LAW. 1439 (2006).

⁴⁵ Id., Definition of Refinancing Indebtedness

minority, sacred rights can ameliorate the magnitude of potential coercion in dual-conditional or exclusive exchange offers and offensive ballot stuffing.

The chief sacred rights, found in virtually all debt contracts, relate to payment terms: each creditor's right to receive principal and interest payments on the agreed-upon dates.⁴⁶ These undergird any other sacred rights, because there is nothing to "protect" if the debtor's obligation to pay is scaled down or discharged. And they have purchase for in-the-money creditors, especially as the maturity date of their instruments draws near.

But the payment-related sacred rights aren't as powerful as one might think because courts have given them a narrow construction. Basically, they prevent only amendments and waivers that would alter the debtor's formal obligations to pay. Changes that merely reduce the likelihood that the debtor will in fact pay, even to near-zero odds, for instance by authorizing the debtor to transfer assets away from creditors' reach, are permissible with mere majority consent unless the indenture or loan agreement specifically provides otherwise.

Another important type of sacred right relates to liens and payment priority. In contracts governing secured instruments, it has long been common to condition the release of liens supporting the debtor's obligations on unanimous creditor consent. More recently, after the advent of the uptier transactions described above—which are predicated on a majority of creditors giving exit consent to subordinate the remaining instruments—it has become common to make lien and payment *priority*, not lien maintenance, a sacred right.⁴⁷ Such provisions can preclude a debtor's ability to make a coercive solicitation in which the coercion is a product of a senior-junior exchange.⁴⁸

For the most part, though, debt contracts leave substantial room for reducing the value of loans and bonds through an amendment. In particular, most contracts allow the debtor, with the consent of a bare majority of the creditors, to take the following

⁴⁶ The Trust Indenture Act requires that indentures governing publicly traded bonds include these terms among the sacred rights. Section 316(b) provides that "the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder...." Virtually all privately placed notes as well as syndicated loans include equivalent terms.

⁴⁷ Buccola & Nini, *supra* note __.

⁴⁸ Loans, more than bonds, also protect a pro rata recovery norm. Most loan agreements have a clause known as a "ratable sharing" clause that requires a lender who receives payment in excess of its ratable amount to share with fellow lenders. The ratable sharing clause usually cannot be amended without unanimous consent. This can have implications for exclusive solicitation techniques predicated on the borrower offering some lenders more than others. In general, loan agreements inhibit exclusive solicitations more than indentures do.

actions that protective covenants would otherwise prohibit: (1) incur additional debt (2) grant liens; (3) remove assets from the business; (4) structurally subordinate existing instruments; and, although this is less clear, (5) curtail individual creditors' enforcement powers.

B. General Legal Principles

Contract provisions bearing on solicitation technique are written against the background of, and may seek to modify, general legal principles. Three doctrines are most relevant to our topic. Under current law, however, all are highly uncertain, each in its own way. The implied covenant of good faith and fair dealing and the sham-transaction doctrine are established concepts, but their application to particular circumstances is contested to say the least; meanwhile so-called *intercreditor* duties might apply in a relatively straightforward fashion but may be defunct.

1. Covenant of good faith and fair dealing

Under New York contract law, which applies to most debt contracts, and the law of most other states, every contract is subject to an implied covenant of good faith and fair dealing.⁴⁹ Courts, however, have generally given a very limited scope to the implied covenant when dealing with debt securities subject to lengthy express provisions. Thus, in *Metropolitan Life Insurance v. RJR Nabisco, Inc.*,⁵⁰ Judge Walker acknowledged in principle that “a court will read an implied covenant of good faith and fair dealing into a contract to ensure that neither party deprives the other of ‘the fruits of the agreement.’”⁵¹ He then continued to reason, however, that in bond agreements, the implied covenant must “derive[] its substance directly from the language of the” agreement and concluded that “[Where] plaintiffs' contractual rights [have not been] violated, there can have been no breach of an implied covenant.”⁵² Under that rationale, the implied covenant is more of a tool for interpreting express bargained-for rights than a separate restraint.

Two 1986 cases decided by Delaware Chancellor Allen, one involving a dual-conditional inclusive exchange offer⁵³ and the other involving a dual-conditional

⁴⁹ See, e.g., *Van Gemert v. Boeing Co.*, 553 F.2d 812, 815 (2d. Cir. 1977); *Greenwich Village Assoc. v. Salle*, 110 A.D.2d 111, 115, 493 N.Y.S.2d 461, 464 (1st Dep't 1985).

⁵⁰ 716 F. Supp. 1504 (S.D.N.Y. 1989)

⁵¹ *Id.* at 1517.

⁵² *Id.*

⁵³ *Katz v. Oak Indus. Inc.*, 508 A.2d 873 (Del. Ch. 1986).

inclusive consent payment,⁵⁴ specifically address whether certain coercive structures for obtaining creditor consents violate the implied covenant. Chancellor Allen seems to envision a somewhat broader scope for implied covenants than Judge Walker. For him, the relevant inquiry is whether it is “clear from what was expressly agreed upon that the parties who negotiated the express terms of the contract would have agreed to proscribe the act later complained of as a breach of the implied covenant of good faith—had they thought to negotiate with respect to that matter.”⁵⁵ In holding that the dual-conditional inclusive exchange offer in *Katz* did not violate the implied covenant, he reasoned:

[T]here is nothing in the indenture provisions granting bondholders power to veto proposed modifications in the relevant indenture that implies that [the debtor] may not offer an inducement to bondholders to consent to such amendments. Such an implication, *at least where, as here, the inducement is offered on the same terms to each holder of an affected security*, would be wholly inconsistent with the strictly commercial nature of the relationship.⁵⁶

Chancellor Allen’s reasoning in *Katz* just leaves open the possibility that *exclusive* consent payments and exchange offers, where the inducement is not offered on the same terms to each holder of an affected security, may violate the implied covenant.

Chancellor Allen’s second case, *Kass v. Eastern Air Lines*, largely accords with *Katz* and acknowledged that the implied covenant can in principle go beyond the express terms..⁵⁷ Like *Katz*, the court held that the dual-conditional inclusive consent payment at issue did not violate the implied covenant (such payments, as we had shown earlier, structurally resemble dual-conditional inclusive exit consents, such as the one in *Katz*), but in dicta expressed even more reservations about exclusivity:

[H]ad Eastern not made its offer to all bondholders on the same terms, but had it privately paid money to sufficient holders to carry the election, one would, without more, feel some confidence in concluding, provisionally at least, that such conduct was so inconsistent with the concept of voting implied by the amendment provision

⁵⁴ *Kass v. Eastern Air Lines*, Civ. No. 8700, 1986 WL 13008 (Del. Ch. Nov. 14, 1986).

⁵⁵ *Katz*, 508 A.2d at 880.

⁵⁶ *Id.* at 881 (emphasis added). An English case, *Assénagon Asset Mgmt. S.A. v. Irish Bank Resolution Corp.*, [2012] EWHC (Ch) 2090 (Eng.), came to the opposite conclusion.

⁵⁷ *Kass* at *4 (“the parties occasionally have understandings or expectations that were so fundamental that they did not need to negotiate about those expectations’ ... [M]odern contract law tends to enforce these unstated, reasonable expectations by employing the language of implied covenants of good faith.”).

that it constituted a violation of what must have been the reasonable expectation of the contracting parties.⁵⁸

Though *Katz* and *Kass* are open, or even sympathetic, to the notion that good faith and fair dealing categorically prohibit exclusive solicitations, subsequent cases have not endorsed such a capacious understanding of the implied covenant. Recently, in litigation concerning an exclusive uptier engineered by Mitel, New York's Appellate Division held squarely that the implied covenant does *not* require that exchange offers be inclusive.⁵⁹ Even courts that have been keen to grant discovery on whether a challenged exclusive uptier comported with good faith and fair dealing have been obscure about the significance of exclusivity per se.⁶⁰ Judges differ as to whether they think exclusivity is relevant to the propriety of a solicitation, but a reader of case law can't conclude much more with confidence.

How the implied covenant applies to ballot stuffing solicitations is perhaps even less clear. The *Windstream* court didn't need to reach the merits of the claim because the plaintiff indenture trustee prevailed in the case on other grounds.⁶¹ Same goes for *Incora*

⁵⁸ *Id.* at *5. In *Kass*, Chancellor Allen also addressed, and rejected, the argument that the vote buying inherent in consent payments constitutes a legal wrong. Unlike political vote buying, vote buying in the context of shareholder or creditor voting is not inherently wrong but must be examined in light of its object or purpose. While vote buying for the purpose of disenfranchising some bondholders could be problematic, the vote buying at bar, "made publicly to all voters on the same terms-that each bondholder is free to accept or reject it," did not fall into that category. Though *Kass* does not directly address ballot stuffing, it plausibly supports the argument that ballot stuffing involves disenfranchisement, at least in cases like *Windstream*, where it is done for the express purpose of obtaining consents to amendments that existing bondholders refused to provide

⁵⁹ *Ocean Trails CLO VII v. MLN Topco Ltd.*, _ N.Y.S.3d _, 2024 WL 5248898 (App. Div. 1st Dept. Dec. 31, 2024); *see also* *Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp.*, Index no. 565123/2020 (N.Y. Sup. Ct. Aug. 16, 2021) (reasoning that compliance with express contractual language was "the end of the story" when it comes to an exclusive uptier's legal validity).

⁶⁰ *See* *ICG Global Loan Fund 1 DAC v. Boardriders, Inc.*, Index no. 655175/2020, Doc. 160 (N.Y. Sup. Ct. (Oct. 17, 2022), slip op. at 23–24 (denying motion to dismiss good faith and fair dealing theory while observing that "defendants worked in concert and in secret to deprive plaintiffs of the benefit of their bargain, i.e., pro rata distribution of loan repayments, in bad faith," but declining to say what role "secrecy" and "concert" played in the judgment); *LCM XII Ltd. v. Serta Simmons Bedding, LLC*, 21 Civ. 3987 (KPF), 2022 WL 953109 *16 (S.D.N.Y. Mar. 29, 2022) (denying motion to dismiss good faith and fair dealing theory where excluded lenders alleged that the borrower had "engaged in furtive negotiations with a select few creditors, manipulated the [loan agreement], and struck a deal at [the excluded lenders'] expense," but declining to say what made negotiations improperly "furtive").

⁶¹ *U.S. Bank N.A. v. Windstream Services, LLC*, 2019 WL 948120 *19 n. 11 (S.D.N.Y. Feb. 15, 2019).

(though an analyst less wedded to formal legal categories could interpret the sham transaction doctrine Judge Isgur applied, see below, as a species of implied covenant). The only reported opinion on the matter is in *Bombardier*, where Justice Borrok denied a motion to dismiss a claim grounded in the company's duty of good faith and fair dealing. Borrok conceded that the plaintiff noteholders had not bargained for a right to prevent the kind of dilution that underlay the transaction—Bombardier's merely issuing additional notes would not be a problem—but concluded that the company had plausibly violated its duty of good faith "in issuing new debt at a discount and without redeeming the existing note holders so as to avoid their obligation to pay [a make-whole]." ⁶²

2. Intercreditor duties

Another avenue for attacking exclusive consent solicitation and ballot stuffing is the notion that creditors that own debt issued under the same agreement owe duties to each other. The notion that such duties exists goes back a long time, to be precise to the 1896 Court of Appeals for the Second Circuit case *Hackettstown National Bank v. D.G. Yuengling Brewing Co.*⁶³ In that case, John Betz acquired a majority of mortgage bonds. Betz was induced to do so by David Yuengling, a principal stockholder of the debtor, who offered to pay Betz any interest due on these bonds and had the option to purchase the bonds from Betz. Betz then agreed, on behalf of all holders of mortgage bonds, to a postponement of any interest due on the bonds.

Reversing the trial court, the court of appeals held that consents to the postpone of interest were not valid. The court reasoned:

We cannot doubt that a consent to postpone the payment of the demands of the minority bondholders, made collusively by majority bondholders for the purpose of defeating the remedy of the minority, and not in the exercise of an honest discretion in the general interest, is not a consent within the meaning of the eleventh condition; or that a vote at a meeting of bondholders, sanctioning a modification of the rights of the bondholders, passed by the corrupt majority for the purpose of effectuating such a collusive consent, is not within the power contemplated by the provision in the trust deed.

Community of interest, whether in the case of partners or security holders, creates mutual obligation, and imposes upon all persons occupying that position the duty of acting in the utmost good faith towards the interests of their associates.

⁶² Antara Capital Master Fund LP v. Bombardier Inc., Index no. 650477/2022 (N.Y. Sup. Ct. Dec. 22, 2023), slip op. 15–17.

⁶³ 74 F. 110 (2d Cir. 1896)

Upon this principle it was declared in *Jackson v. Ludeling*, 21 Wall. 617, that a holder of certain bonds, part of a series secured by a corporate mortgage, had no right to employ them as an instrument by which he could make an illegitimate profit out of the mortgaged property at the expense of the other bondholders. ...

The fact that Betz purchased the bonds in the interest of the principal stockholder of the company, and for the purpose of controlling the rights of the minority bondholders, is important only as it serves to throw light upon the bona fides of the consent and vote. He had a right to make the purchase, and, having acquired title to the bonds, succeeded to all the rights of an ordinary bondholder. Yuengling himself might have purchased them, and by doing so would have acquired the same rights. Any purchaser of the bonds was entitled to use them for the purpose of effectuating an honest consent to postpone payments due. But no purchaser could acquire any right to employ them as instruments in a conspiracy to defraud the minority bondholders.⁶⁴

Yet despite its dramatic language and venerable provenance, hardly anyone cites *Hackettstown*. Of the five reported cases citing it (according to a Westlaw search), four are over 100 years old and do not involve a similar fact pattern.⁶⁵ The last, *CIBC Bank & Trust Co. v. Banco Central do Brasil*,⁶⁶ is of greater interest. *CIBC* involved a multi-year deposit facility agreement between Brazil and its creditors that gave creditors the right, upon an event of default, to accelerate the debt by a majority vote. One of the creditors was Banco do Brazil. Banco do Brazil was 51% owned by the Brazilian treasury and also an obligor under the facility agreement. While most of the creditors under the facility subsequently exchanged their debt, the plaintiffs and Banco do Brazil did not.

Plaintiffs argued, among others, that Banco do Brazil kept its debt in violation of the implied covenant of good faith and fair dealing in order to deprive them of the requisite majority to accelerate and referred to *Hackettstown* in their oral argument. Judge Presca, in a footnote, distinguished *Hackettstown* on two grounds. First, *Hackettstown* involved a conflicted bondholder affirmatively agreeing to modification of bondholder rights while the case at bar involved a conflicted creditor passively failing to seek an acceleration. Second, and in her words more significantly, *Hackettstown* involved a case where the

⁶⁴ *Id.* at 112–14.

⁶⁵ The few law review articles making more than cursory mention of *Hackettstown* include Randall Klein & Danielle Juhle, *Majority Rules: Non-Cash Bids and the Reorganization Sale*, 84 AM. BANKR. L.J. 297, 308–14 (2010); William W. Bratton & G. Mitu Gulati, *Sovereign Debt Restructuring and the Best Interest of Creditors*, 57 VAND. L. REV. 1 (2004); Coffee & Klein, *supra* note 2; Keegan S. Drake, *The Rise and Fall of Exit Consents*, 63 DUKE L.J. 1589 (2014); and Bratton & Levitin, *supra* note 3.

⁶⁶ 886 F. Supp. 1105, 1110 (S.D.N.Y.1995).

conflict emerged “surreptitiously” after the bonds were issued while in the case at bar, Banco do Brazil had been a creditor when the facility agreement was drafted, Banco do Brazil had not since then acquired any additional debt, and the drafters of the agreement had been aware of Banco do Brazil’s conflict.

The dearth of case law referring to *Hackettstown* may indicate that the principle of the case is no longer considered good law.⁶⁷ On the other hand, the case not been explicitly overruled and at least some commentators have opined that it is underutilized.⁶⁸ On its face, the rationale of the decision could restrict exclusive uptiers or ballot stuffing. Even under Judge Presca’s narrow reading, run-of-the-mill uptiers and ballot stuffing transactions would seem to involve “consent ... made collusively by majority bondholders for the purpose of defeating the remedy of the minority, and not in the exercise of an honest discretion.”⁶⁹ But, of course, the fact that *Hackettstown* does not seem to have been raised in the several litigations involving uptiers and ballot stuffing suggests that litigators lack confidence in its practical authority.

3. Sham transaction doctrines

Courts have some license to disregard a transaction that parties claim to have executed if it lacks economic substance and was undertaken only to achieve a result that would have been impermissible otherwise. Depending on context, this idea goes by various names—sham transaction doctrine, integrated transaction doctrine, step transaction doctrine, collapsing doctrine—but they come to the same thing: a court needn’t defer to parties’ preferred sequencing of steps in an economically singular deal.

Judge Isgur recently brought this idea to bear in *Incora*. The company wished to do an exclusive uptier. Under the relevant indentures, however, a supermajority of noteholders were required to approve amendments creating the desired lien subordination. There was no such supermajority. So, the company issued additional notes to affiliates and others who had agreed to participate in the uptier. The additional notes *created* the requisite supermajority, the holders of which then immediately consented to the relevant indenture amendments and exchanged into newly authorized, super-senior debt instruments.

Judge Isgur disregarded the ballot stuffing issuance and, on that basis, concluded that the amendments had been ineffective. The putative issuance of notes did not stand on its own. It lacked economic substance and was contrived only to change the outcome

⁶⁷ See Bratton & Gulati, *supra* note 65.

⁶⁸ Klein & Juhle, *supra* note 65, at n. 43.

⁶⁹ *Hackettstown*, 74 F. at 112.

of the consent solicitation. Above the threshold needed to achieve that end, even the amount of bonds the company issued was arbitrary. The company and the note purchasers had already agreed on the economics of the deal—indeed they had executed signature pages of documents memorializing their agreement—such that they could simply adjust the exchange ratio to account for a bigger or smaller amount of new notes. It would have been fine for the company to issue the notes and then, later, solicit an uptier on an exclusive basis. But because the additional notes issuance didn't represent an economic trade, Judge Isgur ignored them their ostensible voting power.

IV. Accounting for the Status Quo

Simple models of optimal contract theory predict that a debtor and the investors who buy its loans or bonds should agree to alteration rules that they anticipate will maximize their joint surplus. Symmetrically informed parties should strike non-price terms that maximize the surplus attributable to their interaction and divide the spoils through a price term. Network effects imply that parties undertaking a familiar transactional form will often do best to adopt market-standard terms.⁷⁰ But in a standard model, they strive nevertheless to create as much wealth as they can. This goes for second-order rules relating to contract alteration as it does to first-order allocations of authority.⁷¹

The theory poses a puzzle—how to explain the persistence of debtors' ability to use coercive solicitation techniques. By tautology, coercive techniques allow debtors to alter their contracts in ways that reduce the value of loans and bonds their creditors hold. Such a power would maximize surplus if debtors could be counted on so to alter their contracts only when the benefits to other investors, such as equity holders, exceed harms to the affected creditors. But that is no trivial condition. One can imagine how differently corporate contracts would be written if it were. From first principles, then, one ought to be skeptical of coercive solicitation. On the other hand, accounting for the persistence of negative-value terms in markets composed of sophisticated and well capitalized investors is itself no easy task. The plausible conviction that, in the long run,

⁷⁰ Marcel Kahan & Michael Klausner, Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate"), 83 VA. L. REV. 713 (1997).

⁷¹ Absent externalities, the rule that maximizes joint surplus is also socially efficient. Rules relating to contract alteration do not obviously impose large externalities. In some circumstances, however, such rules can bear on a company's investors who are not party to the subject contract, for example the holders of loans or securities the debtor issued earlier in time. Because the conditions for a Coasian bargain may not hold, we use maximization of the parties' joint surplus as our benchmark.

markets of this sort produce commercially reasonable terms may account for some of the judicial reticence to deploy generic doctrines to police solicitations.

Our aim in this Part is to explain why debt contracts don't categorically bar coercive modes of consent solicitation. More specifically, we ask whether the status quo is best explained by market failure or else aspects of the debtor-creditor relationship that can make provisions that permit coercive techniques part of a value-maximizing deal. Our summary view is that market reasons probably explain the persistence of some forms of coercive techniques, especially dual-conditional inclusive solicitations, but that the most coercive techniques are hard to account for other than as artifacts of contracting failure.

A. Contracting Failure-Based Explanations

The task here is to explain why the contracting processes in the bond and syndicated loan markets could persistently yield provisions that allow modes of consent solicitation that can be expected to yield negative net value. The explanations we offer will be familiar to academics, and we rehearse them only briefly for that reason. But we emphasize that, although the relevant parties are sophisticated and well capitalized, the contracting environment in debt issuance may be fertile ground for some rather generic explanations of contracting failure: a one-to-many contracting framework with limited time for dickering in which non-price terms broadly speaking are worth relatively little (in expectation) and will matter at all only in remote (meaning unlikely and temporally distant) circumstances.

One possibility is that debt investors in the primary market may be myopic. The typical debt buyer holds a portfolio of loans or bonds. The overwhelming majority of are repaid without fuss. Even among the set of debts that become stressed, the probability of a dispute between the debtor and creditors is small. Given these expectations, second-order rules that might turn out to matter may not appear important when financing is being lined up. Debt buyers forced to move quickly on a deal may think that non-price terms are even less important than they are. Or they may take a lesser-fool approach, believing that they will unload the debt to a secondary market buyer before the credit's risks materialize or indeed are foreseen by others.

Alternatively, debt investors may recognize a problem but have a hard time altering the boilerplate. There are fixed costs to fighting, and any individual bond buyer expects to reap a small share of the surplus associated with even a genuine (but modest) improvement in the debt contract. If the problem is big enough in magnitude,

presumably the debt buyers will agitate for a fix,⁷² or else charge the debtor for failing to fix it (which would force the debtor to internalize costs and induce change),⁷³ but the thresholds for such action in terms of magnitude and salience may be higher than a naïve observer would expect. Unless a given bond buyer can spread costs across a large pool, even sensible changes might not be worth pursuing.

Relatedly, it may not pay for investors in primary markets to closely examine the nitty-gritty details of complex provisions. Even if an individual investors were to find a suboptimal provision, the debtor would have little incentive to change it unless other investors also pay attention to the provision. This could generate an equilibrium where investors assume that the provisions that they do not focus on contain various loopholes that enable a certain degree of debtor opportunism and price that opportunism into their investment decision. Individual debtors, in turn, have no incentives to close these loopholes even if doing so would be surplus-increasing.

Note that a non-pricing constraint must accompany any explanation for the status quo that depends on imperfections in the bargaining environment. Whether or not the costs of explicit negotiation are worth overcoming, the proponent of a debt contract (typically although not always the debtor) has an incentive to craft surplus-maximizing terms if the buyers are likely to “charge” for the terms proposed.⁷⁴

B. Surplus Maximization-Based Explanations

The more intriguing question is how, if at all, it could be optimal for an indenture or loan agreement to allow the debtor to use coercive methods in soliciting consents. This section identifies six possibilities. We interpret them, in the aggregate, to plausibly justify some debtor leeway.

1. Coercion is a problem of theory but not practice

Commentators enamored with game theory see coercion as a problem. The games depend on stylized assumptions about behavior, however. They assume one-time interactions so that players lack incentive to develop a reputation for commercial

⁷² See Vincent S.J. Buccola & Greg Nini, *The Loan Market Response to Dropdown and Uptier Transactions*, 53 J. LEGAL. STUD. 489 (2024); Mitu Gulati & Marcel Kahan, *Contracts of Inattention*, 46 LAW AND SOCIAL INQUIRY 1115 (2021).

⁷³ But see Adam B. Badawi, Vincent S.J. Buccola & Greg Nini, *Price Discipline for Non-Price Loan Terms* (2024) (unpublished manuscript) (finding only weak and fragile evidence that investors price a reasonably important non-price term, namely a loan’s susceptibility to an uptier).

⁷⁴ Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

reasonableness and are often based on widely dispersed debtholdings. Such assumptions do not characterize the leveraged debt markets. Two possibilities are especially important in this regard, each of which to the extent it describes the real world should dampen concerns about coercive solicitation methods. First, norms or related sources of reputational sanction might dissuade debtors from proposing alterations that harm the affected creditors as a group. Second, the investors who hold loans and bonds are able to coordinate sufficiently well to reject coercive solicitations that would harm them collectively.

If reputation were a strong enough force, it would justify every type of coercive solicitation method we have identified. Buyers of debt instruments would rationally agree to allow the debtor to change their deal however it might see fit, secure in the belief that the debtor would alter terms only when doing so would increase the expected value of the affected debts.

Debtor reputation seems, however—to us and we think to market participants—to provide only a modest constraint that has declined in power during the last decade. Whatever egalitarian or process-based norms existed in the 1990s or 2000s appear to have gone out the window. If anything, repeat players in the restructuring economy, including the lawyers and bankers who advise debtors and their creditors, seem to have settled on an expectation that debtors can and perhaps *should* stand on their literal rights. Beyond casual evidence, many longstanding and continuing practices in debt contracting imply that market participants believe reputational constraints to have limited efficacy. Indentures and loan agreements feature numerous provisions prohibiting the debtor from taking actions that might not be in the best interest of creditors. These restrictions would be pure cost, a drag on possibly value-maximizing discretion, if debtholders were willing to lean heavily on debtors' reputational incentives.⁷⁵ Moreover, coercive techniques are often employed in last-period settings. To be sure, some debtors are controlled by private equity firms, which are repeat players and may care about their reputations even if an individual portfolio company is about to go under. But others are not and for them reputation would offer no meaningful constraint.

The second possibility—that bond and loan investors can easily coordinate—would justify inclusive but coercive solicitation methods, for example conditional offers of payment for consent or exchange offers conditioned on exit consents. Empirical evidence suggest that these structures, while coercive in theory, in fact do not harm

⁷⁵ And these are often last-period problems (though the PE phenomenon complicates that point; see Buccola, *Sponsor Control*, *supra* note 5, at 25–31).

creditors because they can and do coordinate.⁷⁶ The prospect of coordination cannot so easily justify exclusive offers, however, since coordinating across the insider-outsider divide is substantially harder.⁷⁷ The number of uptiers we have seen since 2020 confirms that coordination among creditors to resist—rather than take advantage of—coalition fracture is hard and that creditors that are not in the in-group suffer material losses. Coordination certainly could not justify ballot stuffing.

2. Offsetting pathologies of unanimity rules

Distressed restructurings are plagued by the holdout problem. The holdout problem arises because core payment terms cannot be changed via majority consents. Consider our example from Section II.A.1. where a debtor has \$100 in debt and an asset worth either \$80 million (with 90% probability) or \$120 million (with 10% probability) but now add the assumption that eliminating financial distress would increase the asset's value to, respectively \$85 and \$125. If the company were to restructure by exchanging \$50 in debt for 90% of the equity in the company, everyone would be better off: the value to creditors as a whole would rise from \$82 to \$85.1 and the value of the pre-restructuring equity would rise from \$2 to \$3.9. But individual creditors would be better off holding out—not agreeing to the restructuring hoping that other creditors will and ending up with debt of the restructured firm worth 100% on the dollar.

One way to reduce the holdout problem would be lower the value of the debt that does not agree to participate in the restructuring. This could be done by issuing giving holders that participate in the restructuring senior debt or stripping the pre-restructuring debt of covenants via exit consents and then have the company take actions that benefit holders of securities in the exchange offer at the expense of holdout creditors—all hallmarks of the coercive techniques we discussed above.

But while the holdout problem can justify a senior-junior exchange offer that is part of a transaction that also includes an exchange of debt for *more junior* securities (such as a restructuring involving an exchange of debt for equity) and thus creates a holdout problem, it does not justify the other coercive techniques: it would not justify dual-conditional exchange offers or consent payments since merely conditioning the offer or payment on approval by the requisite majority would do the trick; it would clearly not justify exclusive solicitations since the aim is to obtain the greatest participation of pre-restructuring creditors; nor would it justify ballot stuffing.

⁷⁶ Kahan & Tuckman, *supra* note 2.

⁷⁷ See *supra* Section II.A.3.

3. Rewarding active creditors

The games developing the problem of coercion typically assume (as we assumed above) that debtholders are identical (except perhaps in the amount of debt they hold) and have complete information. On those assumptions, a debtor cannot create value by treating them differently. That might not follow if the assumptions are relaxed.

The first issue is that information is not free. Assessing a debtor's possibilities—financial, operational, contractual—in advance of its distress is valuable because it can lead to the resolution of financial frictions before they result in economic loss, but is costly to undertake. If all holders of a debt that needs restructuring are treated identically, the holders who fail to invest in analysis can free ride on the wisdom of those who do invest. In the extreme, some free-riding holders may not even bother to “vote” by returning the consent solicitation materials furnished by the debtor. The active creditors, so to speak, have no way to recoup the costs of their analysis and efforts. This problem might not matter much in a world of reciprocal responsibilities. For example, in the heyday of syndicated bank lending, the lead banker on one deal would expect to be able to “free ride” on another's banker's attention in the next. But such reciprocity is largely absent in the bond and leveraged loan worlds today, in which investors are not only relatively atomized but also engage in a variety of investment styles, some more passive and diversified than others, such that no tit-for-tat may be possible.

Debtholders may also vary in ability or willingness to negotiate incremental financing. Like monitoring, negotiating the terms of incremental financing generates positive inter-creditor externalities. Like monitoring, participating in these negotiations is costly and so will tend to be under-produced if all affected holders are offered equal treatment.

The imperative to reward active creditors, whether for monitoring or negotiations, supplies an affirmative justification for dual-conditional consent solicitations and exchange offers. It may even justify exclusive solicitation methods. At least in theory, the costs of coercion and the costs of creditor free-riding pose a dilemma. One cannot be rid of both, and if the marginal costs of free-riding exceed those of exclusive solicitation methods, so much the worse for inclusion. At the same time, the discrepancy in treatment between debtholders in the inside exclusive group and debtholders on the outside should not exceed the costs of monitoring and negotiating divided by the probability of reaching an agreement. The keenness with which loan and bond holders today appear to jockey for a place in the “participating” coalition, and the fact that creditors on the outside are not even invited to participate in negotiating the terms of incremental financing, suggests that, at least as practice has developed, exclusive methods are used to do more than compensate for creditor efforts.

4. Offsetting activism by debtholders motivated by side interests

Ballot stuffing is sometimes deployed defensively in response to creditor activism. Loan agreements and bond indentures contain lengthy and complex covenants. Violations of these provisions results in a so-called “default.” But whether a debtor has complied with these covenants is often not easy to determine. Many defaults are either opaque—the relevant facts are not easy to determine—or disputed —there is some ambiguity as to whether a certain set of facts entails a violation of the covenant.⁷⁸ To identify and pursue defaults, it thus takes significant investment in actively monitoring compliance and willingness to litigate against the debtor.

Most creditors do not make such investments. They either lack a sufficient stake in the debt to warrant the expenditure, or lack the requisite expertise, or have other reasons to stay on good terms with the debtor. Instead, an equilibrium has evolved in which specialized activist hedge funds engage in monitoring for covenant compliance. Once they find a potential violation, they acquire a significant (often majority) stake, and then pursue their remedies. In doing so, they serve two useful functions. First, they enforce debtholders’ rights after a covenant breach has occurred. And second, the increased prospect of having breaches detected and remedies pursued deters debtors from breaching covenants in the first place.⁷⁹

Activist hedge funds, of course, do all of this in order to make money. In some cases, the interests of activist hedge funds may diverge from the interests of their fellow creditors, in particular because they also hold other investments. For example, once a covenant breach has been detected, an activist hedge fund may try to accelerate—to declare the outstanding debt due immediately—thereby pushing the debtor into bankruptcy, in order to make money on a credit default swap that the hedge fund has purchased, even if doing so is not in the interest of creditors at large. While their fellow creditors would be willing to waive the underlying covenant violations, perhaps in exchange for a modest fee, the activist fund may demand a much larger fee or insist on acceleration. If the activist funds holds a majority of the outstanding debt, of course, it can block any waiver that is not to its liking. When that is the case, then from an *ex post* perspective, ballot stuffing can be welfare enhancing.

But even acknowledging this possibility does not provide much of a justification for permitting ballot stuffing *ex ante*. If ballot stuffing is permitted, it cannot be easily confined to cases where it is beneficial *ex post*. Rather, ballot stuffing, when not

⁷⁸ Mitu Gulati & Marcel Kahan, *Cash America and the Structure of Bondholder Remedies*, 13 CAP. MARKETS L. J. 570, 583–84 (2018).

⁷⁹ Kahan & Rock, *supra* note 4.

otherwise constrained by the provisions in the loan agreement or indenture, would enable the debtor to procure waivers for *any* covenant violation with little or no payments to the pre-default creditors. This, however, would radically reduce the incentives for activist hedge funds (or anyone else) to monitor for covenant compliance.

For ballot stuffing to be desirable *ex ante*, therefore, the gains from those instances where ballot stuffing would be desirable *ex post* must exceed the sum of the losses from instances where ballot stuffing would be undesirable *ex post* and the losses from the increased number of violations that are undeterred or remain undetected due to reduced monitoring. If it were, indeed, desirable to reduce debtor remedies and incentives for activist hedge funds to monitor compliance of opaque and ambiguous covenants to such a great extent, a much simpler solution would be to include fewer and narrower covenants in loan agreements and indentures in the first place.

5. Preserving financing flexibility

Indentures and loan agreements might allow senior-junior exchange offers, in particular, despite their coercive potential because they are hard to distinguish from valuable refinancing transactions. Consider, for example, a debtor that wishes to issue new senior debt and use the proceeds to repurchase and retire outstanding bonds or loans over time as circumstances warrant. It might well be part of an optimal arrangement to allow the debtor flexibility to do so. But to define the difference between a sequential issuance and repurchase, on one hand, and an exchange transaction, on the other, is not a trivial task.

Many loan agreements and bond indentures, in particular those related to below-investment grade debt, contain covenants limiting the debtor's incurrence of additional indebtedness or regulating the priority structure of new debt. These covenants, when present, indirectly regulate the extent to which a debtor can pursue a senior-junior exchange offer. A *per se* prohibition would thus make little sense. And prohibiting all transactions that in some way resemble senior-junior exchange offers may excessively limit the debtor's financing flexibility. Such flexibility is desirable because many financing transactions, even if they are adverse to the interests of debtholders, nevertheless increase overall value.

6. The Chapter 11 counterfactual

The optimal contractual rules governing solicitation depend on the rules of Chapter 11. In a bankruptcy, the Code displaces contractual alteration rules in favor of a one-size-fits-all set of procedures for plan confirmation. At first approximation, a debtor who receives the consent of two-thirds of the holders (by dollar amount) of each class of claims it proposes to impair can effect the changes outlined in its plan of reorganization

irrespective of what the contracts underlying the affected debts might say.⁸⁰ To the extent that bankruptcy's plan confirmation rules allow a debtor to pursue coercive tactics that would not be allowed under its debt contracts, a debtor might thus invoke Chapter 11 for the edge it gives. But bankruptcy is also expensive compared to a non-judicial process of debt alteration. Out-of-pocket costs are higher, and non-pecuniary costs to the debtor's brand are greater.⁸¹ A world in which debtors can opt into a judicially supervised regime that allows coercive tactics is one in which the optimal contract might allow coercive solicitation methods outside bankruptcy even if the ideal world would prohibit coercion altogether.

Whether bankruptcy law in fact allows debtors to propose coercive alterations is a vexed question. For present purposes, we can only sketch a couple of senses in which it may. A naïve understanding of Chapter 11 would seem to point toward what we have called an equal treatment rule. Thus the Code requires plans to "provide the same treatment for each claim ... of a particular class" unless the claimholder consents to something else.⁸² And courts have long policed debtors' ability to "buy" votes other than through consideration provided under the plan.⁸³

One might think that these and other, similarly motivated norms would preclude the proposition of coercive plans. But it is not that simple. A variety of techniques can be and in recent years have been used to replicate some of the coercive features described above. The intra-class "death trap," for example, is a plan feature which provides that a claimholder's recovery under the plan will depend on its vote.⁸⁴ Claimholders who vote in favor of the plan get one basket of consideration; those who vote against get another, lesser basket. This feature replicates what we call a dual-conditional inclusive solicitation. The debtor's offer is open to all claimholders, but those who vote for the proposed alteration receive more than those who vote against, but will still be bound by, the proposed terms. Debtor-in-possession and exit financing agreements have been structured to produce exclusivity. The offer of lucrative "backstop" fees to a subset of claimants who will support a rights offering—and whose

⁸⁰ 11 U.S.C. § 1129(a)(8)(A).

⁸¹ Samuel Antill & Megan Hunter, *Consumer Choice and Corporate Bankruptcy* (2023) (unpublished manuscript) (evidence that Chapter 11 causes consumer flight); Jared A. Ellias, *Employee Bankruptcy Trauma* (2024) (unpublished manuscript) (mixed evidence on Chapter 11 causing labor flight).

⁸² 11 U.S.C. § 1123(a)(4).

⁸³ See, e.g., *In re Quigley Co., Inc.*, 437 B.R. 102, 125–29 (Bankr. S.D.N.Y. 2010) (concluding that a proposed plan could not be confirmed because the debtor's parent "bought" a class's acceptance).

⁸⁴ See David A. Skeel, Jr., *Distorted Choice in Corporate Bankruptcy*, 130 YALE L.J. 366 (2020) (discussing the coercive potential of such death traps).

votes are necessary and sufficient to a consensual plan confirmation—has become an especially prominent mechanism for doing so.⁸⁵ The bankruptcy judges who have opined on the matter have held that such fees do not constitute “treatment” for claims and are not presumptively otherwise prohibited vote buying.⁸⁶ They thus appear to be valid. Yet they are in effect selective, conditional solicitations.

How important the bankruptcy alternative is to optimal contract design is an open question. The key question is to what degree Chapter 11 is (from a debtor’s perspective) a substitute for contractually governed alteration procedures. The more substitutable it is, the greater the impact that bankruptcy rules will have on optimal contract design. Perhaps the most important consideration is relative cost. As bankruptcy costs grow relative to the costs of an out-of-court transaction, Chapter 11 becomes a less perfect substitute—less of an “outside option” for debtors—and so less of a constraint on contract design.

V. An Interpretive Presumption

Any policy recommendation suitable to our uncertainty about the reasons for the status quo in alternation law must necessarily be modest. A comprehensive response might be appropriate if contracting frictions were the only plausible explanation, or the causally most potent explanation. But at least some of the value-enhancing explanations outlined above surely weigh in the balance. Consequently one wants to tread lightly on the subject.

We think, however, that the law would improve if judges were to read debt contracts with a presumption that is skeptical of coercive solicitation methods not in long and widespread use or not regularly addressed by express provisions. More specifically, we think judges asked to set aside a contested alteration and forced on that account to parse an ambiguous provision or construe the sense of a contract as a whole ought to presume that debtors are not permitted to undertake exclusive solicitations (except as necessary to preserve an exemption from securities registration requirements) or to stuff the ballot box (by issuing additional voting instruments for the purpose of obtaining consents that current holders are unwilling to provide). Whether such a presumption is best understood as an interpretive canon—something like a clear-statement rule—as a way of implementing the covenant of good faith and fair dealing, or as derived from intercreditor duties does not especially concern us. The

⁸⁵ See Vincent S.J. Buccola, Adi Marcovich Gross & Matthew McBrady, *The Backstop Party* (2024) (unpublished manuscript).

⁸⁶ *Id.*

point either way is that a definite indication that the indenture or loan agreement means to permit even highly coercive methods should override skepticism. If the contract provides expressly that the debtor can offer an exchange or consent payment to a favored subset of holders, or can issue additional voting instruments for the purpose of procuring a requisite majority for an waiver or amendment that the present set of debtholders are unwilling to provide, we don't see a strong case for countermanding. But the default should be that only long-established coercive techniques such as dual-conditional inclusive consent payments or exchange offer with exit consents are permitted.

The idea applies not only to the effect courts give silence, but also to their construction of ambiguous clauses. Our proposal in this sense offers an additional ground of support for the Fifth Circuit's decision, nominally at least a purely textual decision, in *Serta Simmons*.⁸⁷ Whether or not "open market" is a self-evident construct, a provision allowing the borrower to make open market but not other purchases is not obviously designed to bless exclusive consent solicitations. That consideration alone should, on our view, lead judges to give the permission a narrow construction. If a loan agreement were explicitly to allow the borrower, as some very recent agreements do, to "make *privately negotiated* and/or open market purchases," then, on our view, the analysis would be quite different because privacy really does suggest exclusivity.

What's the point of an interpretive presumption? We see the default rule as a mechanism to (imperfectly) disambiguate between what we call the contracting failure-based explanations of the status quo and the surplus maximizing-based explanations.

Underlying the mechanism are two observations: first, the debt buyers are more likely to be sensitive to contract defects that relate to express provisions included in the contract than to defects that relate to omissions from a contract; and second, that debt buyers appear to be more able to resist changes to contracting norms than to propose them. This asymmetry is a function of current institutional dynamics rather than anything inherent to the role of a capital provider. In today's leveraged finance primary markets, the debtor typically sets the agenda, choosing the standard form and outlining non-standard provisions in a term sheet. As we understand, debtors are responsible for most of the recent innovations in leveraged debt contracts.⁸⁸ Debtors are represented by counsel that looks out for their interests; debt buyers are only indirectly represented by the counsel for underwriters or loan arrangers, which have limited reputational incentives to look out for the interest of debt buyers and want to retain good relations

⁸⁷ *In re Serta Simmons Bedding, L.L.C.*, _ F.4th _, 2024 WL 5250365 (5th Cir. Dec. 31, 2024).

⁸⁸ *Id.*

with debtors.⁸⁹ Debt buyers on their own sometimes resist innovations but rarely agitate for a new construct.⁹⁰ In theory, this needn't be so. In theory, debt buyers could organize to lobby for a contracting standard. The bond underwriter or loan arranger could act as a surrogate to that end. And indeed loan buyers did spur a shift in the way agreements deal with Serta-like uptier exchanges.⁹¹ But that change appears to be anomalous and not entirely successful at achieving the lenders' underlying goals.

To illustrate our proposal's logic, suppose first that allowing debtors to pursue a highly coercive solicitation method—let's consider an exclusive solicitation such as an uptier exchange—is frequently (or usually) surplus-maximizing. In such a world, one would expect debtors quickly to update their standard forms and debt buyers to buy the bonds and loans they govern eagerly. Specifying debtor flexibility would be a free lunch. Our proposed default rule would have a minimal impact. In a transition phase, to be sure, the impact would be negative. Outstanding debts subject to an ambiguous governing document would become marginally less valuable on account of the presumption. But practice would coalesce around a stated norm in which exclusive solicitations are permitted.

By contrast, suppose that contracting failures explain the status quo. Allowing debtors to alter their contracts through an exclusive solicitation is generally value-destructive (though valuable *to the debtor*), but debt buyers are inattentive to terms (and lack of terms) that are not *new* or are uncertain—rationally or not—about what exactly a particular contract allows. In any case they do not *price* a bond or loan differentially. In this world, as in the other, debtors would prefer to be able to pursue exclusive solicitations. Now, though, they would have to highlight for debt buyers' review language authorizing the technique. The default could be sticky because of salience or other sources of asymmetry between familiar and novel terms.

Like all default rules, our proposal goes only so far. If debt buyers are sufficiently inattentive to the contracts they enter, a presumption is moot. But we understand inertia to have a non-negligible influence on the content of debt contracts. To the extent it does, the exceedingly small costs of our proposed presumption (in case we are wrong about the value of highly coercive methods) are worth bearing.

⁸⁹ Marcel Kahan, *The Qualified Case Against Mandatory Terms in Bonds*, 89 NW. U. L. REV. 565, 613–20 (1995)

⁹⁰ See Gulati & Kahan, *supra* note 72.

⁹¹ Buccola & Nini, *supra* note 72.

VI. Conclusion

In this article, we have developed a comprehensive account of coercive techniques by which companies seek to induce lenders and bondholders to accept a change to their rights as creditors. By coercive, we mean a structural property of some solicitation methods capable of inducing debtholders to give requisite assent to a proposed alteration that will reduce the aggregate value of the affected debts. By implication, if the affected debt were held by a single owner, that owner would not have agreed to the alteration of the terms. If a change in terms is procured through a coercive technique, assent to the alteration no longer creates a presumption that the alteration is in the mutual interest of the company and its debtholders.

We offer four principal contributions. First, we identify and analyze, from a game-theoretic perspective, the key dimensions of coercion. Specifically, coercion can result from the ranking of an altered instrument relative to the pre-alteration ranking; conditionally of the payment made or the eligibility to participate in an exchange offer on having consented to an alteration; exclusivity of an offer of inducement; and manipulation of the amount of debt eligible to consent. Although the options along these dimensions generate many possible combinations, three of the possible combinations presently dominate market practice: dual-conditional inclusive solicitations and exchange offers, which entail a relatively mild degree of coercion and which have been employed for several decades; and exclusive uptiers and ballot stuffing, both of which are more strongly coercive and of more recent vintage.

Second, we document the persistent availability of coercive methods under standard bond indentures and loan agreements. The only coercive technique systematically addressed by standard bond and loan contracts relates to offers to exchange a lower ranked instrument for a higher ranked one. My contrast, even though there are provisions that parties have adopted in at least some contracts in some submarkets that could shut down coercive solicitation altogether, most bond and loan contracts are silent as to whether and when the other techniques may be employed. Courts, in turn, have been reluctant to use doctrinal tools like the implied covenant of good faith and fair dealing in order to announce any general principle against coercive techniques.

Third, we show that efficiency-based considerations may explain some observed contract practices. In particular, the desirability of maintaining financing flexibility may explain the manner in which contracts address offers to alter the ranking debt instruments; and the relative ease to defeat coercion through coordination, the desirability of rewarding active creditors, and the availability of similar coercive techniques with a Chapter 11 proceeding may explain the failure to regulate dual-conditional inclusive solicitations.

Finally, we conclude that the more coercive prevailing techniques cannot be so easily justified and propose an approach to construing debt contracts that would restrain what are likely the most value-destructive solicitation methods without condemning longstanding and plausibly value-enhancing techniques. Modesty about one's ability to weigh the costs and benefits of even highly coercive solicitation methods counsels against an approach that would rule out practices on which market participants might settle. Rather, in our view, judges should not hesitate to look through or unwind alterations achieved through exclusive offers of inducement or ballot stuffing when the relevant contractual provisions are ambiguous or when the contract as a whole does not clearly anticipate the method. The burden of specification of the permissiveness of these techniques, in other words, shifted to the debtor which, we believe, debtors can propose changes to standard contractual language more easily than dispersed bond and loan investors can.

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