Published in *The Business Lawyer* (Winter 2026) Vol. 81, Issue 1

Exit Consents in a Liability Management World

*By Dennis Jenkins**

Standard loan agreements typically allow majority lenders (with the borrower) to amend most terms, excluding enumerated "sacred rights." LME proponents posit that this discretion gives the majority carte blanche *to incorporate loan amendments into expansive liability management transactions, so long as they do not technically alter sacred rights, even if the consequences disproportionately benefit the majority and functionally guaranty minority lenders will be unpaid. We may indeed all be textualists, but this conclusion is typically wrong and ignores important context and rules of plain meaning, logic, linguistics, and common sense. This paper details why, focusing on well-established interpretive principles under New York law and the objective evidence and logical processes that should guide interpretation of loan amendments being incorporated into LMEs.*

> Perhaps the sentiments contained in the following pages, are not *yet* sufficiently fashionable to procure them general Favor; a long Habit of not thinking a Thing *wrong*, gives it a superficial appearing of being *right*, and raises at first a formidable outcry in defence of Custom. But the Tumult soon subsides. Time makes more Converts than Reason.[1]

Liability management exercises ("LMEs") are a hot topic because they challenge previously accepted norms promoting transparency, predictability, good faith and fair dealing, and often, common sense. Increasingly, investors want to know if they violate legal or equitable boundaries. At their core, these are simply out-of-court debt restructurings, but over the past few years distressed companies have used increasingly complex machinations to reorder their balance sheets, often altering relative priorities (and therefore recoveries) among existing lenders in ways that could not be done in bankruptcy, while allowing shareholders to retain their equity. LMEs have been characterized as perpetrating "creditor-on-creditor" violence when a distressed company works in concert with a subset

* Dennis Jenkins is a partner at Willkie Farr & Gallagher LLP's Restructuring Department. This article neither contains legal advice nor establishes an attorney–client relationship in any form. The opinions expressed herein are attributable to the author alone, and they do not reflect the views, positions, or opinions of Willkie Farr & Gallagher LLP or other attorneys at the firm.

1. Thomas Paine, *Common Sense*, *in* 1 The Writings of Thomas Paine 67, 67–68 (Moncure Daniel Conway ed., 1894) (1776).

of its existing lenders to the detriment of other lenders in the same class or tranche. These "violent" LMEs are the focus here.[2]

The list of well-known companies participating in them is growing, including Travelport, Revlon, TriMark, Boardriders, Serta Simmons, AMC Entertainment, Mitel Networks, Robertshaw, and Wesco Aircraft, to name a few.[3] LMEs are tailored for each company's specific needs, but they use some common tools: transferring assets to unrestricted subsidiaries or non-guarantors (*i.e.,* away from existing lenders); releasing collateral; exchanging existing debt into new tranches of higher priority new debt; granting guaranties from corporate entities not previously obligated on the debt; securing and pledging intercompany debt; and/or raising new capital as super-senior secured obligations. These tools now have fashionable monikers such as "drop-down," "up-tier," "double-dip," "Chewy," and "pari-plus" transactions.

According to Standard & Poor's, given the growth of LMEs "[l]enders can no longer rely on realizing average par recoveries of 75%–80% (and more than 90% on a median basis) by virtue of their position at the top of the capital structure, with liens on substantially all assets."[4] Existing lenders (and opportunistic advisors sensing their own revenue opportunities) often preemptively ". . . approach distressed borrowers with proposals to provide much needed liquidity (and/or relief from pending debt maturities) in exchange for enhancing their position in the post-restructuring capital structure and to preemptively ensure they avoid being the disadvantaged party. The impact on disadvantaged lenders can be significant, including wiping out their recovery prospects in a subsequent default scenario."[5] Octus (formerly Reorg Research) analyzed seven major "drop-down" transactions between 2022–2024 and concluded that ". . . lenders agreeing to participate in drop-down transactions who were not in the ad hoc group driving the transaction had 18% to 64% of their pre-transaction value moved away from them in the transaction," and excluded creditors ". . . lost all of their value from a waterfall recovery perspective."[6] Value from excluded creditors

2. More specifically, this article focuses on the variant of "violent" LMEs that pit syndicated lenders holding loans of the same class or tranche under the same loan agreement against each other, resulting in a majority of holders devaluing a minority thereof without consent. Unless otherwise indicated, references to "aggressive" or "violent" LMEs mean LMEs that have this effect. *See generally* Diane Lourdes Dick, *Hostile Restructurings*, 96 WASH. L. REV. 1333, 1336 (2021) (describing recent developments in "'hostile' out-of-court private loan restructurings").

3. *See*, *e.g.*, Matt Wirz, *Coming to a Cash-Strapped Company Near You: Creditor-on-Creditor Violence*, WALL ST. J. (Aug. 19, 2024), https://www.wsj.com/finance/coming-to-a-cash-strapped-company-near-you-creditor-on-creditor-violence-2dfd4308?mod=livecoverage_web ("Grand alliances. Secret pacts. Betrayal. It's all in a day's work in the booming market for low-rated debt.").

4. Steve H. Wilkinson, *Credit FAQ: Demystifying Loan Liability Management Transactions and Their Impact on First-Lien Lenders*, S&P GLOB. (Oct. 30, 2024), https://www.spglobal.com/ratings/en/regulatory/article/241030-credit-faq-demystifying-loan-liability-management-transactions-and-their-impact-on-first-lien-lenders-s13304695.

5. *Id.*

6. Krishan Sutharshana, *Octus' Analysis of 7 Select Drop-Downs Measures Value Moved Away from Non-Ad-Hoc Secured Creditors to Junior Creditors or Company to Fund Cash Burn; Recent AMC, Del Monte Transactions Appear Most Aggressive*, OCTUS (Feb. 13, 2025), https://octus.com/resources/articles/octus-analysis-of-7-select-drop-downs/; *see also* Justin Forlenza, J.D., *Liability Management*

shifted in some form and combination to participating creditors and the company. Unfortunately, though not all that unexpectedly, LMEs generally fail to solve the capital structure problems that encourage them, leading the majority of companies engaging in LMEs to file for bankruptcy anyway.[7]

The relatively recent emergence of LMEs, particularly where they pit the same class of lenders against each other, coincides with the increase of non-bank lenders in debt markets. "Throughout the 20th century, corporate debt markets had a storied reputation as a genteel community where norms of mutual cooperation predominated, dampening many strategic proclivities."[8] This dynamic has changed rapidly as debt markets have grown to accommodate private, equity-backed companies' reliance on funded debt and as hedge and distressed funds have opportunistically purchased more distressed debt in secondary markets.[9] Non-bank lenders have "increasingly [been] willing to play iconoclast, thumbing their noses (if not giving the finger) to the *esprit de corps* that traditionally tempered opportunism in the corporate debt community of yesteryear."[10]

This creditor violence has resulted in expensive and business-disruptive litigation as complex as the underlying LME transactions themselves. But a simple truth is being lost in this complexity; the linchpin for most aggressive LMEs is the ability to integrate "exit consents" that engineer disparate treatment within the same tranche of lenders, benefitting the majority. Exit consents are debt agreement modifications approved by a majority of lenders in a specific class who execute a modification agreement and then immediately cease to be lenders in that class. Customary debt agreements permit a majority of lenders to modify most terms, other than specific "sacred rights" (such as the right to pro-rata repayment of principal at maturity), which require each affected lender's consent. So, majority-approved exit consents that alter the balance of control and value under a debt agreement between a tranche of lenders on the one hand and the borrower and its other stakeholders on the other are relatively unremarkable if they offer equal and ratable treatment to the minority lenders and preserve their sacred rights. Exit consents integrated into aggressive LMEs, however, do not offer such treatment, on the theory that the loan agreement gives the majority a virtual blank check to take value and control from similarly situated lenders within the same class or tranche of debt, often eviscerating their sacred right indirectly.

Standard syndicated loan agreements (the specific focus in this article) governed by New York law do not expressly permit majority lenders to integrate a loan modification into an LME that benefits a tranche's majority and exploits its minority. Recent LME proponents dubiously assert they do. This conclusion

Transactions: Quarterly Update Through Q3 2024, CreditSights (Oct. 16, 2024), https://v2.creditsights.com/articles/20084389 (on file with author) (finding high losses for non-participating lenders following bankruptcy filings).

7. *See* Wilkinson, *supra* note 4 (finding that 30 of 38 companies that executed LMEs ultimately defaulted or filed for bankruptcy).

8. Eric L. Talley & Sneha Pandya, *Debt Textualism and Creditor-on-Creditor Violence: A Modest Plea to Keep the Faith*, 171 U. Pa. L. Rev. 1975, 1979 (2023).

9. *See id.*

10. *Id.*

assumes that undefined guardrails for the majority's modification discretion for non-sacred terms means there are none—not even implied duties of good faith. It also relies on reasoning beyond the dictionary meaning of the loan agreement's modification clause, often cherry-picking from less than all the available evidence. Accepted rules of contract interpretation in strictly textualist jurisdictions like New York require more. Implementing the intent of the parties to an agreement starts by evaluating dictionary meaning but also considers the agreement's purposes, the text within the entire agreement as a whole, the circumstances of its application, and the inferences drawn by an objectively reasonable third-party familiar with the circumstances and the industry. In addition, if competing interpretations exist, a court should seek a commercially reasonable interpretation that sacrifices each party's major interests as little as possible, consistent with rules of logic and common sense. This well-established and more holistic process for contract interpretation, if correctly applied, often yields a reasonably correct interpretation and obviates the need for extrinsic evidence or judicially-implied terms.

This process has been overlooked or applied inconsistently when assessing modification clauses in the context of LME exit consents, resulting in potentially invalid transactions with billions in value at stake. With more than $500 billion of existing distressed bonds and loans outstanding[11] and many powerful interests pushing LMEs, the question of whether LMEs can (or should) integrate exit consents remains a pivotal issue. LMEs cannot hinge on an invalid exit consent, so a modification clause's meaning is a crucial threshold issue for future LMEs. The purpose of this article is to evaluate this meaning as comprehensively as possible to provide a better, if incomplete, foundation for considering the viability of LMEs conditioned on exit consents. This article must therefore cover significant ground, elucidating interpretive theory and logic, the structure and purpose of debt agreement terms, industry customs and practices, and relevant studies, commentaries, and law.

Part I of this article reviews the current use of exit consents in the context of LMEs and syndicated loans. Part II reviews applicable contractual interpretive principles under New York law, which governs most syndicated loans issued in the United States. And, Part III applies those principles to the conventional loan modification clause, concluding that majority lenders cannot use loan modification discretion to misappropriate value from the minority.

Part I. Exit Consents and LMEs

Given the capital pushing LMEs, it makes sense to evaluate modification clause meaning completely and carefully, starting with a general description of

11. *See* Shannon D. Harrington, *Distress Watch: 2024 Is Capping a 20% Decline in Troubled Debt*, Bloomberg L. (Dec. 17, 2024), https://www.bloomberglaw.com/bloomberglawnews/bankruptcy-law/XCRJ5E8000000?bna_news_filter=bankruptcy-law#jcite (noting that the volume of bonds and loans in Bloomberg Law's global distressed debt tracker was approximately $506.9 billion in the week ending December 13, 2024).

how exit consents are being deployed and inadequately challenged. Debt agreements that permit modifications of lender rights by majority vote are not new, nor are attempts to misuse them.[12] Under the current strain of LME, a distressed borrower asks a majority of its lenders to exchange all or part of their existing loan rights for new rights, which can include some combination of equity, collateral, pay down, fees, new obligations, and/or amended obligations.[13] As part of the transaction, the lender majority will often amend the loan agreement to (i) prevent any default that would otherwise be triggered by the LME, and (ii) strip important covenants and other protections from the remaining minority of holders who either refuse, or are not invited, to participate in the LME. The amendment is their last act as lenders in that class or tranche before exiting and receiving new rights.[14] Of course, this means the "exiting" lenders will not be bound by amendments specific to their former loans.

Historically, banks make up the vast majority of lenders under a loan or credit agreement. This is no longer the case, as non-bank, institutional investors such as hedge funds, mutual funds, collateralized loan obligation funds, private equity funds, and other investment funds now represent a majority of participants in the non-investment grade syndicated loan market.[15] From a contracting standpoint, an arranging or lead bank usually conducts diligence and negotiates the final loan terms.[16] Term lenders are not directly involved in negotiations over syndicated loan terms at inception and individually they have a limited ability to affect terms more generally in the market.[17] Instead, syndicated loan terms

12. *See* Charles H. Haines, Jr., *Corporations—Modification Provisions of Corporate Mortgages and Trust Indentures*, 38 MICH. L. REV. 63 (1939) (examining the existence and use of such clauses as far back as the late 1800s).

13. LMEs can involve loans or debt securities. Loan agreements and indentures are both interpreted as contracts under New York law. While the contract interpretive principles discussed herein apply to both indentures and loan agreements, this article focuses primarily on syndicated loan agreements and their related credit documents. *See* Kirschner v. JP Morgan Chase Bank, N.A., 79 F.4th 290, 295 n.1 (2d Cir. 2023) (quoting Reves v. Ernst Young, 494 U.S. 56 (1999)) ("A syndicated loan is a loan extended by a group of financial institutions (a loan syndicate) to a single borrower . . . at specified terms under the same credit facility."). While it is not the largest debt market or as large as securities markets, the syndicated loan market is nevertheless significant. The Board of Governors of the Federal Reserve System reports that as of the second quarter in 2024, the total amount of term loans outstanding at depository and non-depository institutions was approximately $1.56 trillion dollars. *See Syndicated Loan Portfolios of Financial Institutions*, FED. RES. SYS., https://www.federalreserve.gov/releases/efa/efa-project-syndicated-loan-portfolios-of-financial-institutions.htm (last updated Sept. 20, 2024).

14. *See*, *e.g.*, Audax Credit Opportunities Offshore v. TMK Hawk Parent, 72 Misc. 3d 1218(A), 2021 N.Y. Slip Op. 50794(U), at 5–6 (Sup. Ct. N.Y. Cnty. 2021) (describing TriMark's liability management exercise that hinged on a majority of lenders executing exit consents to subordinate minority lenders).

15. *See* Seung Jung Lee et al., *The U.S. Syndicated Term Loan Market: Who Holds What and When?*, FEDS Notes (Bd. Governors, Fed. Res. Sys., Nov. 25, 2019), https://www.federalreserve.gov/econres/notes/feds-notes/the-us-syndicated-term-loan-market-20191125.html.

16. *See* Frederick Tung, *Do Lenders Still Monitor?: Leveraged Lending and the Search for Covenants*, 47 J. CORP. L. 163, 168–78 (2021) (describing development and modernization of syndication process).

17. *See* Ali M. Stoeppelwerth, *United We Stand: Antitrust Aspects of Collaboration Among Corporate Bondholders*, 67 BUS. LAW. 393, 395, 404 (2012) (distinguishing antitrust concerns at the time loans are made versus when reorganizing, and recommending confining their collective efforts to pre-existing debentures).

are more likely to be influenced by macroeconomic trends, regulatory policy, interest rates, and supply and demand dynamics. For example, the Loan Syndications and Trading Association ("LSTA") reported that in Q4 2024, lenders competed for deal share "amidst a backdrop of waning M&A activity and paltry new supply," and "borrowers engaged in opportunistic activity, [and] pursued flexible terms," which in turn "led to deteriorating covenant protections" in loan agreements.[18] Banks tend to retain revolving and amortizing loans in the facility but sell riskier non-amortizing term loans to investors in the leveraged term loan market, so their incentive to negotiate for term lenders is somewhat limited to what will "clear the market."[19] On average, these riskier term loans are sold off within the first three months after issuance.[20]

Although not all loan agreements are exactly the same, today's modification clauses tend to be similar, if not boilerplate.[21] Loan agreements have long permitted modifications or waivers by a specified lender majority, subject to a few explicit exceptions that protect each lender's "sacred rights."[22] Amendments

18. *See* Elizabeth Yazgi, *Loan Market Covenant Trends—4Q24*, Loan Syndications & Trading Association (Jan. 23, 2025), https://www.lsta.org/news-resources/loan-market-covenant-trends-4q24/.

19. As private equity has funded a larger share of the economy, traditional banks have reduced both their monitoring role and relative share of loans to private equity-backed companies while passing on a greater share of the debt to non-bank lenders. *See* Sharjil Haque et al., *How Private Equity Fuels Non-Bank Lending* (Fin. & Econ. Discussion Series 2024-015, Bd. Governors, Fed. Res. Sys., Jan. 26, 2024), https://www.federalreserve.gov/econres/feds/files/2024015pap.pdf. As a result, private equity-backed borrowers are able to negotiate extremely borrower-friendly terms with the syndicating bank, who agrees to lighter covenants but takes a lower share of the risk. The ultimate non-bank lenders have relatively little involvement, if any, in pushing for loan terms other than to vote with their feet by not lending. The explosive growth of both private-equity backed companies and non-bank lending, however, has increased competition for lending opportunities, making this impractical in many cases.

20. *See* Lee et al., *supra* note 15 ("[B]anks (including the agent bank . . .) hold the vast majority of loans shortly after origination date, but then sell large shares of them off to institutional investors relatively quickly.").

21. *See* Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039, 1048 (2d Cir. 1982) (describing indenture "boilerplate" provisions "standard in a certain genre of contracts" susceptible to standard expression as "distinguished from contractual provisions which are peculiar" to a particular indenture); *see also* Michael Bellucci & Jerome Mccluskey, The Lsta's Complete Credit Agreement Guide 512 (2d ed. 2016) [hereinafter LSTA Guide] ("[T]he general rule in all agreements is that no modification, supplement, or waiver can be effective unless it is approved by the majority or required lenders, the typical voting provision goes on to lay out some exceptions for which the consent of additional lenders is required. In these cases, the modification typically requires the approval of the majority or required lenders and the approval of either each lender (unanimous consent) or of each *affected* lender."). In multitranche agreements, lenders generally vote together "except where a proposed amendment affects loans of a specific tranche." *Id.* In such cases, voting is by tranche. Obviously, parties can agree to irregular variations, but the focus here is on the standard, most common form.

22. For example, Section 9.02(b) of the LSTA Form of Credit Agreement Investment Grade Term Loan provides in relevant part:

> Except as otherwise expressly set forth in this Agreement . . . no amendment or waiver of any provision of this Agreement or any other Loan Document, and no consent to any departure by the Borrower therefrom, shall be effective unless in writing executed by the Borrower and the Required Lenders, and acknowledged by the Administrative Agent, or by the Borrower and the Administrative Agent with the consent of the Required Lenders . . . provided that no such amendment, waiver or consent shall: . . .

to or waivers of "sacred rights" require each affected lender's consent, usually where (i) reducing principal, interest, or other fees payable under the loan agreement; (ii) postponing the date scheduled for any payment of such amounts or reducing, waiving, or excusing payment;[23] or (iii) changing or altering the pro rata sharing of payments required by the loan agreement.[24]

Standard modification clauses do not explicitly permit or prohibit exit consents, nor do they address the integration of exit consents into LMEs engineered to disproportionately benefit a loan tranche's majority. Challenges to exit consents can be relatively straightforward if they clearly modify the language of a sacred rights provision without requisite consent or breach sacred rights terms. More nuanced difficulty arises, however, where LMEs shift value to a class majority, adversely affecting minority sacred rights indirectly or functionally.

Consider, for example, the following hypothetical "drop down" transaction. A distressed borrower with $500 million of unsecured loan obligations needs $100 million of additional liquidity, but it owns high volatility assets presently worth only $250 million—$100 million of which is the equity value of its sole subsidiary. Debt issued under a syndicated credit facility is trading at 50 cents on the dollar. Its subsidiary has no indebtedness and did not guarantee the debt. The borrower's loan agreement prohibits it or its subsidiary from incurring any additional indebtedness.

(i) extend or increase any Commitment of any Lender without the written consent of such Lender . . . ;

(ii) reduce the principal of, or rate of interest specified herein on, any Loan, or any fees or other amounts payable hereunder or under any other Loan Document, without the written consent of each Lender directly and adversely affected thereby . . . ;

(iii) postpone any date scheduled for any payment of principal of, or interest on, any Loan, or any fees or other amounts payable hereunder or under any other Loan Document, or reduce the amount of, waive or excuse any such payment, without the written consent of each Lender directly and adversely affected thereby;

(iv) change Section 2.12(b) [Application of Insufficient Payments] or Section 2.13 [Sharing of Payments] in a manner that would alter the pro rata sharing of payments required thereby or change Section 7.02 [Application of Payments], in each case, without the written consent of each Lender directly and adversely affected thereby; . . . or

(vi) change any provision of this Section or the percentage in the definition of "Required Lenders" or any other provision hereof specifying the number or percentage of Lenders required to amend, waive or otherwise modify any rights hereunder or make any determination or grant any consent hereunder, without the written consent of each Lender . . . .

Loan Syndications & Trading Association, Form of Credit Agreement—Investment Grade Term Loan (Feb. 27 2023), https://www.lsta.org/content/form-of-credit-agreement-investment-grade-term-loan-feb-27-2023/.

23. *See* Bellucci & Mccluskey, *supra* note 21, at 514 ("The provisions of the credit agreement that require the lenders (at least all lenders within the same tranche) be treated ratably are fundamental.").

24. *See id*. at 513 ("The rule with respect to changing money terms in a credit agreement is the same that has been followed for decades in other debt instruments, including private placements and bond indentures; all require a higher level of approval whenever adverse changes to money terms are made.").

Assuming the borrower's asset value is unlikely to further materially decrease (and could actually increase in the future), a lender holding 20 percent of the term loans secretly contacts a few of its favored lenders to form a bloc with 55 percent of the term loans. They approach the borrower and agree to lend its non-guarantor subsidiary $100 million in a new secured loan if the borrower (i) transfers substantially all its assets to the subsidiary, and (ii) exchanges only their $275 million of term loans for $275 million of new unsecured term loans with the subsidiary as the borrower. The majority lenders agree to execute an exit consent amending the credit agreement to permit this transaction and also to add a provision to the otherwise customary waiver of consequential damages provision prohibiting lenders and the borrower from pursuing fraudulent transfer claims or breaches of fiduciary duties for seven years. The amendments are circulated only to the participating lenders who then execute them without prior notice to the other lenders, who learn of the amendments after the fact. As a result of this transaction, there is presently sufficient value to pay the majority lenders' new debt and 54 percent of their exchanged term loans, but the minority lenders—now structurally subordinated to $100 million of new debt and $275 million of the majority lender's exchanged debt at subsidiary—are likely to receive no recovery absent a future value increase.[25] While the exit consent has not textually amended any sacred rights, it has certainly altered the practical rights to repayment. Loan amendments enabling these types of integrated transactions are not explicitly addressed by the customary modification clause.

Part II. New York Law and Textualism

The meaning of a modification clause is determined by state contract law (often the law of New York) which governs a large proportion of agreements in the syndicated loan and debt securities markets.[26] The goal in every jurisdiction is to interpret contracts consistently, predictably, and efficiently but interpreting a contract—determining the parties' intent from their words, symbols, and actions—is easier said than done.[27] So, "[i]t is little wonder that

25. For an example of a drop-down LME with similar consequences, see the Del Monte transaction described in the verified complaint filed by Black Diamond Comm. Fin., L.L.C. against Del Monte Foods, Inc. *See* Verified Complaint Uder 8 Del. C. § 255, Black Diamond Comm. Fin., L.L.C. v. Del Monte Foods, Inc., C.A. No. 2024-1026-LWW, paras. 23–44 (Del. Ch. Oct. 9, 2024).

26. *See* Colleen Honigsberg et al., *State Contract Law and Debt Contracts*, 57 J.L. & Econ. 1031, 1032–33 (2014) (finding that ". . . New York law is used most frequently and is especially popular with multistate lenders," and the "primary state for debt contracts"). The focus of this article is New York law, which largely governs this interpretation of modification clauses in contracts. Of course, the laws of other jurisdictions can apply where parties select other governing law or the location of property or collateral implicates other law. The application of these laws, to the extent different, remains an issue for others to explore.

27. *See* 5 Arthur L. Corbin, Corbin on Contracts § 24.1 (rev. ed. 2024) (describing goals of contract interpretation); *see also* Michael L. Boyer, *Contract as Text: Interpretive Overlap in Law and Literature*, 12 S. Cal. Interdisc. L.J. 167, 168 (2003) ("Most lawyers, judges, and even scholars use a term such as 'interpretation' and proceed to engage in the act without a full realization that behind the word is a rich background and an entire field of textual study formally in existence since 390 B.C.").

'[t]he most common contract disputes are those that involve issues of interpretation.'"[28]

Strictly speaking, modification clauses address amendments or waivers by lenders at the moment of execution, without regard to lender status at any other time. "Courts have hewn strictly to the chronology required by the contracts," permitting lenders to amend and immediately exit.[29] Of course, this means that a majority can implement changes that affect only the minority who remain behind. Although it is arguably implicit in a number of decisions that uphold LMEs, no court has yet explicitly found that a typical modification clause grants a majority unlimited discretion to benefit itself at the minority's expense. Instead, courts have focused on whether the consequences of amendments or waivers impermissibly infringe sacred rights, not whether modification clauses more generally prohibit the majority from exploiting the minority. One reason may be that litigants have framed issues in this way; another may be that textualist jurisdictions like New York are loathe to imply terms. As the New York Court of Appeals put it: "Historically, we have been 'extremely reluctant to interpret an agreement as impliedly stating something which the parties have neglected to specifically include.'"[30]

Implied terms should be unnecessary to conclude modification clauses prohibit majority lenders from opportunistically using them to profit from the minority. Arguments to the contrary misstate or misunderstand New York contract law, its laws of evidence, and how to use inferences and logic to determine contract meaning. New York follows a strict approach to contract interpretation which seeks "the objective intent of the [contracting] parties,"[31] as guided by the plain meaning[32] and parole evidence rules.[33] This approach favors contracts

28. Corbin, *supra* note 27 (quoting Yuval Feldman & Doron Teichman, *Are All Contractual Obligations Created Equal?*, 100 Geo. L.J. 5, 33 (2011)).

29. *See Audax*, 2021 N.Y. Slip. Op. 50794(U), at *7; *see also* MeehanCombs Glob. Credit Opportunities Funds, LP v. Caesars Ent. Corp., 80 F. Supp. 3d 507, 517 (S.D.N.Y. 2015) (finding notes counted for amendment where their holders' "consents were given before the notes were sold").

30. ACE Sec. Corp. v. DB Structured Prods., Inc., 36 N.E.3d 623, 630 (N.Y. 2015) (quoting Vermont Teddy Bear Co. v. 538 Madison Realty Co., 807 N.E.2d 876, 879 (N.Y. 2004)).

31. Dish Network L.L.C. v. Am. Broad. Cos. (*In re* AutoHop Litig.), No. 12 Civ. 4155 (LTS) (KNF), 2013 U.S. Dist. LEXIS 143492, at *8 (S.D.N.Y. Oct. 1, 2013) (quoting Klos v. Lotnicze, 133 F.3d 164, 168 (2d Cir. 1997)).

32. *See* Greenfield v. Philles Records, Inc., 780 N.E.2d 166, 170 (N.Y. 2002) ("The fundamental, neutral precept of contract interpretation is that agreements are construed in accord with the parties' intent. The best evidence of what parties to a written agreement intend is what they say in their writing. Thus, a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms." (internal citations and quotations omitted)); Rainbow v. Swisher, 72 N.Y.2d 106, 109 (1988) ("Where . . . the contract is clear and unambiguous on its face, the intent of the parties must be gleaned from within the four corners of the instrument, and not from extrinsic evidence.").

33. *See* British Int'l Ins. Co. v. Seguros La Republica, S.A., 342 F.3d 78, 82 (2d Cir. 2003) ("[I]f the court finds that the terms, or the inferences readily drawn from the terms, are ambiguous, then the court may accept any available extrinsic evidence to ascertain the meaning intended by the parties during the formation of the contract." (internal citations and quotations omitted)).

integrated *ex ante* over *ex post* evidence of parties' intent.[34] These rules bar context evidence of intent unless a contract is ambiguous.[35] Theoretically, this approach reduces enforcement costs by giving contracting parties control *ex ante* to determine what evidence courts will use to determine intent and enforce their contracts, avoiding an *ex post* analysis that begins with the potential vagaries attendant to extrinsic evidence of subjective intent.[36] Whether textualism produces these results consistently is doubtful. Moreover, the approach also presents at least three practical problems. First, it is impossible to contract for every contingency. Second, it overoptimistically assumes that parties can select language *ex ante* that perfectly describes their intent without risk of an *ex post* finding of unintended ambiguity.[37] Third, under this approach judges are endowed

34. For the better part of the past century, textualists and contextualists have vigorously debated the proper approach to contract interpretation under U.S. law. At one end of the spectrum is Samuel Williston's proposition that in the absence of ambiguity the intent of contracting parties should be determined from the plain meaning of the agreement's language. At the other end is Arthur Linton Corbin's assertion that the parties' intent should be determined from both the language and extrinsic evidence as to intent. Valid arguments support both approaches (as well as new alternatives). *See* Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Text and Context: Contract Interpretation as Contract Design*, 100 Cornell L. Rev. 23, 34–43 (2014) (describing history and justifications for textualism and contextualism); Gregory Klass, *Interpretation and Construction in Contract Law*, *in* Georgetown Law Faculty Publications and Other Works 3–13 (2018), https://scholarship.law.georgetown.edu/facpub/1947 (last visited Feb. 13, 2025) (describing history and development of textualist and contextualist approaches to interpretation and construction).

35. *See*, *e.g.*, Morgan Stanley High Yield Sec., Inc. v. Seven Circle Gaming Corp., 269 F. Supp. 2d 206, 213–15 (S.D.N.Y. 2003) (holding that the prior agreement is excluded where the writing appears to embody a final agreement in view of thoroughness and specificity); Intershoe, Inc. v. Bankers Trust Co., 571 N.E.2d 641, 643–45 (N.Y. 1991) (same); Mitchill v. Lath, 160 N.E. 646, 646–48 (N.Y. 1928) (upholding the presumption and excluding evidence of collateral agreement to land sale contract); *see also* Tempo Shain Corp. v. Bertek, Inc., 120 F.3d 16, 21 (2d Cir. 1997) ("Ordinarily, a merger clause provision indicates that the subject agreement is completely integrated, and parol evidence is precluded from altering or interpreting the agreement."); Norman Bobrow & Co. v. Loft Realty Co., 577 N.Y.S.2d 36, 36 (App. Div. 1991) ("Parol evidence is not admissible to vary the terms of a written contract containing a merger clause.").

36. *See* W.W.W. Assocs. v. Giancontieri, 77 N.Y.2d 157, 162–163 (1990) (finding that the parol evidence rule "imparts 'stability to commercial transactions by safeguarding against fraudulent claims, perjury, death of witnesses . . . infirmity of memory . . . [and] the fear that the jury will improperly evaluate the extrinsic evidence'" (internal citations omitted)).

37. *See*, *e.g.*, Pac. Gas & Elec. Co. v. Thomas Drayage, 442 P.2d 641, 644 (Cal. 1968) ("A rule that would limit the determination of the meaning of a written instrument to its four-corners merely because it seems to the court to be clear and unambiguous, would either deny the relevance of the intention of the parties or presuppose a degree of verbal precision and stability our language has not attained."); *see* Stanley Fish, There's No Such Thing as Free Speech and It's A Good Thing, Too 142–44 (1994).

> Formalism is the thesis that it is possible to put down marks so self-sufficiently perspicuous that they repel interpretation; it is the thesis that one can write sentences of such precision and simplicity that their meanings leap off the page in a way no one—no matter what his or her situation or point of view—can ignore; it is the thesis that one can devise procedures that are self-executing in the sense that their unfolding is independent of the differences between the agents [readers] who might set them in motion . . . . [H]owever much the law wishes to have a formal existence, it cannot succeed in doing so, because—at any level from the most highly abstract to the most particular and detailed—any specification of what the law is will already be infected by interpretation and will therefore be challengeable.

Id.

with the ability to decide whether a reasonably prudent third party would objectively interpret language in more than one way.[38] This is not an entirely objective endeavor.[39]

Textualism's sequencing of plain language interpretation followed by construction only where interpretation fails also tends to leave little room for implied duties. For textualists, "[i]nterpretation is properly the process of applying the ordinary legal standard to the words or symbols used in order to determine their meaning or sense,"[40] while "construction" applies only when interpretation has run its course to fill any remaining gaps and to resolve ambiguity. Construction (or, "gap filling") ". . . gives special meaning to language for reasons other than the normal meaning of the words or the actual or apparent intent of the parties."[41] New York courts have generally found that gap filling (e.g., implying a covenant of good faith) rounds out obligations already specified in a contract but does not create new ones.[42] According to one commentator: "This leads to the view that absent a bargain in fact derived from words of agreement or implied in fact from party conduct, there is no hook for any sort of good faith requirement to attach itself."[43] In short, if plain language

38. *See* Data-Stream AS/RS Techs., LLC v. China Int'l Marine Containers, Ltd., No. 02 Civ. 6530 (JFK), 2004 U.S. Dist. LEXIS 6594, at *16 (S.D.N.Y. 2004) ("In order for the Court to find the language of the Agreement ambiguous, the Court would have to believe that a reasonable person examining the Agreement in its full and proper context, fully aware of the customs, practices and usage of terminology in the area of retainer agreements, would be capable of ascribing more than one meaning to the Agreement's language."); *Greenfield*, 780 N.E.2d at 171 ("A contract is unambiguous if . . . there is no reasonable basis for a difference of opinion". (internal citations omitted)); Topps Co., Inc. v. Cadbury Stani S.A.I.C., 526 F.3d 63, 68 (2d Cir. 2008) (finding that an agreement is ambiguous where "a reasonably intelligent person viewing the contract objectively could interpret the language in more than one way").

39. *See* Boyer, *supra* note 27, at 172 ("The power to impose one's own conception of what is or is not an 'ordinary use' of language and the power to make the sole determination regarding ambiguity are suspect and open to criticism."); *see also* Lawrence Solan, Terri Rosenblatt & Daniel Osherson, *False Consensus Bias in Contract Interpretation*, 108 Colum. L. Rev. 1268, 1273 (2001) (studying ambiguity and confirmation bias in contract interpretation, noting that a judge interpreting language typically has no way of determining whether "her own interpretation is widely shared").

40. 2 Samuel Williston, The Law of Contracts § 602 (1st ed. 1920); *see also* 1 Arthur L. Corbin, Corbin on Contracts § 534 (1st ed. 1952) ("When a court is filling gaps in the terms of an agreement, with respect to matters that the parties did not have in contemplation and as to which they had no intention to be expressed, the judicial process . . . may be called 'construction'; it should not be called 'interpretation'.").

41. Williston, *supra* note 40.

42. *See* Metro. Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504, 1517 (S.D.N.Y. 1989) ("[T]he implied covenant will only aid and further the explicit terms of the agreement and will never impose an obligation 'which would be inconsistent with other terms of the contractual relationship.'" (internal citations and quotations omitted)); Gottwald v. Sebert, 148 N.Y.S.3d 37, 47 (App. Div. 2021) ("The duty of good faith and fair dealing does not imply obligations inconsistent with contractual provisions."); King Penguin Opportunity Fund III, LLC v. Spectrum Grp. Mgmt. LLC, 135 N.Y. S.3d 363, 366 (App. Div. 2020) (finding that duty does not imply obligations "that were not bargained for"); Darabont v. AMC Network Ent. LLC, 141 N.Y.S.3d 856, 857 (App. Div. 2021) (implied duty cannot "impose obligations . . . beyond the express terms of the parties' agreement"); StarVest Partners II, L.P. v. Emportal, Inc., 957 N.Y.S.2d 93, 96 (App. Div. 2012) (finding that an implied covenant claim "may not be used as a substitute for a nonviable claim of breach of contract.").

43. Nicholas R. Weiskopf, Wood v. Lucy: *The Overlap Between Interpretation and Gap-Filling to Achieve Minimum Decencies*, 18 Pace L. Rev. 219, 220 (2008).

interpretation can provide an adequate answer, there is simply no gap to fill by implication.[44]

Invariably, the starting point for the textualist interpretive approach is "plain meaning," which generally denotes dictionary meaning.[45] As Professor Williston explained, in the first instance, interpretation involves ascertaining the meaning or sense of words from their ordinary or technical meaning ". . . because it is a natural supposition that persons addressed may be expected" to so understand such words.[46] Majority lenders seeking to exploit the minority isolate modification clauses and assert their dictionary meaning, thus permitting a single unambiguous interpretation. The particular wording and syntax of these provisions generally are not complicated, lending credence to this approach. If these provisions are given ordinary dictionary meaning in isolation from the rest of the loan agreement or LME, they permit a majority of lenders to amend or waive specified terms of the loan agreement. So long as the majority lenders execute a modification that does not directly amend sacred rights, it is, the argument goes, a valid amendment or waiver.

For the challenging minority lenders, this is ostensibly difficult to overcome because it ignores the rest of the agreement, its purpose, and the fact that the exit consent is being used as an integral part of a broader set of agreements implementing an LME. Reading a modification clause without this context ignores fundamental and well-accepted notions regarding human communication. There can be (and often is) a difference between "sentence meaning" and the meaning parties ascribe to language when they use it to communicate in a contract.[47] Textualists and contextualists do not disagree on this point, but instead disagree on

44. *See id*.

45. *See In re* Delta Air Lines, Inc., 381 B.R. 57, 64–65 (S.D.N.Y. 2008) ("A sound method for determining the plain meaning of words is to look at their dictionary definitions."); Mazzola v. County of Suffolk, 533 N.Y.S.2d 297, 297 (App. Div. 1988) ("[I]t is common practice for the courts of this State to refer to the dictionary to determine the plain and ordinary meaning of words to a contract."). Dictionaries are a helpful starting point for evaluating the *possible* meanings of a word, but cannot ultimately dictate meaning in a particular context. *See* Frank H. Easterbrook, *Text, History, and Structure in Statutory Interpretation*, 17 HARV. J.L. PUB. POL'Y 61, 67 (1994) ("[A] dictionary . . . is a museum of words, an historical catalog rather than a means to decode the work of legislatures."). Judicial reliance on dictionaries for objective meaning has been sharply criticized. *See, e.g.*, James Brudney & Lawrence Baum, *Oasis or Mirage: The Supreme Court's Thirst for Dictionaries in the Rehnquist and Roberts Eras*, 55 WM. & MARY L. REV. 483, 571–77 (2013) (criticizing judicial use of dictionaries as an objective source of authority for ordinary meaning).

46. WILLISTON, *supra* note 40, § 603. Williston identified four "standards of interpretation" for determining ordinary or technical meaning: (i) "the *popular* standard, meaning the common or normal sense of words"; (ii) the *local* standard, including "special usages of a religious sect, a body of traders, an alien population, or a local dialect"; (iii) the "*mutual* standard," covering the meanings mutually adopted by parties to a transaction; and (iv) the "*individual* standard" of one party to an act. *Id*.

47. *See* Robin Bradley Kar & Margaret Jane Radin, *Pseudo-Contract and Shared Meaning Analysis*, 132 HARV. L. REV. 1125, 1144–46 (2019) (summarizing the application of Paul Grice's philosophy of language and meaning to a broad range of legal questions). According to Kar and Radin, two of Grice's revolutionary ideas have remained uncontroverted: "there is a distinction between what a *sentence* means and what a *speaker* means by uttering a sentence within a particular conversational context . . . [and] when speakers use language to communicate, they speak in social context and implicitly rely on certain cooperative norms that govern the use of language to convey meanings." *Id*. at 1146.

how to deal with it. Even textualists must recognize that "[c]ommunication is successful not when hearers recognize the linguistic meaning of the utterance, but when they infer the speaker's 'meaning' from it."[48] Kar and Radin offer a simple example of this distinction in the form of a law professor's recommendation to a Supreme Court Justice seeking to hire a student as clerk:

> RECOMMENDATION LETTER
>
> Dear Justice –
>
> I am writing to recommend my student, Xavier Marshall, for a clerkship in your chambers. I know Xavier very well, having had him in four of my courses—two of which required extensive legal research and writing.
>
> Xavier showed up on time every single day. I hope you will give Xavier your most serious consideration.
>
> [signed][49]

The sentence meaning here imparts a few things: (i) Xavier Marshall was in four of the professor's classes; (ii) two of those classes required a lot of legal research and writing; and (iii) Xavier showed up to class on time and every day. "But the professor's recommendation also clearly implies, without any sentence ever saying, that the student is unqualified for a Supreme Court clerkship."[50] That the recommendation damns with faint praise is not contained in the sentence meaning, but it can be inferred from the "social and interpersonal nature of conversation."[51] The process of inferring meaning from sentence meaning is separate and distinct from the concept of gap filling (or supplying an omitted term), although the two processes are closely related. As one leading text notes: "[T]he borderline between terms implied-in-fact (i.e., agreed to in some meaningful sense by the parties themselves) and implied-in-law (imposed by the court) is not an easy one to draw."[52]

This is an important distinction because New York's plain meaning rule does not focus exclusively on the dictionary or sentence meaning out of context. Instead, the analysis looks at both ". . . the language and the *inferences* to be drawn from it."[53] After all, plain language is not itself intent but merely evidence of it. Consider, for example, whether a common form of Indemnification clause

48. Dan Sperber & Deirdre Wilson, Relevance: Communication and Cognition 23 (2d ed. 1995); *see also* Nicholas Allott & Benjamin Shaer, *Inference and Intention in Legal Interpretation*, *in* The Pragmatic Turn in Law: Inference and Interpretation in Legal Discourse 83–118 (Janet Giltrow & Dieter Stein eds., De Gruyter Mouton 2017) ("[I]n order to understand an utterance, the hearer infers what the speaker has intended to convey, using the linguistic material uttered as a clue.").

49. Kar & Radin, *supra* note 47, at 1147. Kar and Radin's example reproduced verbatim here is a variation on one of Paul Grice's most famous examples. *See id.* at 1147 n.29.

50. *Id.*

51. *Id.*

52. Charles Knapp et al., Problems in Contract Law 471–72 (8th ed. 2016).

53. *Alexander & Alexander Servs. v. These Certain Underwriters at Lloyd's*, 136 F.3d 82, 86 (2d Cir. 1998) (emphasis added).

should be read to cover Party B's attorney's fees incurred suing Party A under a contract:

> Party A shall indemnify and hold harmless Party B from and against any and all claims, demands, liabilities, costs, damages, expenses, and causes of action of any nature whatsoever arising out of or relating or incidental to this contract.

The dictionary meanings of "costs" and "expenses" clearly include "attorney's fees," and the rest of the clause requires only that they relate or be incidental to the contract. So, its plain meaning initially seems to cover the fees. This language must be considered, however, in the context of the "American Rule" that "attorney's fees are incidents of litigation and a prevailing party may not collect them from the loser unless an award is authorized by agreement between the parties, statute or court rule."[54] Because applying the sentence meaning of this clause would override the American Rule, courts ***do not infer*** that contract parties intend to override it, its underlying policies, or its fundamental allocation of risk, unless the contract is "unmistakably clear."[55] As a result, courts will not interpret the hypothetical clause above to include attorney's fees unless it also contains clearer language or context, such as "costs, (including attorneys' fees)" and/or express application to suits by one party against the other under the contract.[56]

Thus, the interpretive focus extends beyond language itself to all reasonable *inferences* that could be made by an objective, "reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages, and terminology as generally understood in the particular trade or business,"[57] and has given "each clause its intended purpose in the promotion of the primary and dominant purpose of the contract" under the specific circumstances of its application.[58]

The Second Circuit Court of Appeals applied this analysis to successor obligor clauses over 40 years ago in *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*[59] *Sharon Steel* involved the interpretation of standard indenture successor obligor clauses covering debt issued by UV Industries, Inc. ("UV"). These clauses permitted UV to sell, in one or more successive sales, all or substantially all its assets if the buyer assumed the indenture obligations. UV's shareholders approved a liquidation plan and the sale of substantially all of UV's assets through three sales. After UV sold the majority of its assets (as measured by revenue and profits) in the first two, Sharon Steel Corp. ("Sharon") agreed to assume $411 million of UV's subordinated debentures and buy UV's remaining assets plus approximately

54. *Sage Sys., Inc. v. Liss*, 39 N.Y.3d 27, 31 (N.Y. 2022) (analyzing a similar clause to the example here and holding that it should not be read to include attorney's fees).

55. *See id.* at 31–32.

56. *See id.*

57. Lightfoot v. Union Carbide Corp., 110 F.3d 898, 906 (2d Cir. 1997).

58. *See* Empire Props. Corp. v. Mfrs. Trust Co., 43 N.E.2d 25, 28 (N.Y. 1942); *see also* IKB Int'l, S.A. v. Wells Fargo Bank, N.A., 175 N.Y.S.3d 5, 9–10 (App. Div. 2022) ("[A]n agreement [should not] be read to produce a result that is absurd, commercially unreasonable or contrary to the reasonable expectations of the parties." (internal quotations and citations omitted)).

59. 691 F.2d 1039, 1048 (2d Cir. 1982).

$322 million in cash from the previous asset sales. Given the rise in interest rates in 1979, Sharon valued the debentures' below-market interest rates, seeking to assume and keep them outstanding. Holders of the debentures wanted to be repaid following the sale.

On appeal, the Second Circuit's threshold focus was on the interpretation of the successor obligor clauses. Sharon and UV argued that the lower court erred in failing to submit to the jury extrinsic evidence regarding the meaning of the clauses. The Second Circuit upheld the lower court on this point, expressing a now oft-cited policy favoring the consistent and uniform interpretation of boilerplate provisions as a question of law, not fact.[60] The Second Circuit then proceeded to evaluate the language of the successor obligor clauses without the assistance of extrinsic evidence, finding the literal sentence meaning unhelpful.[61] Instead, relying on similar interpretive exercises where courts looked to ". . . the particular context and evident purpose" when interpreting ". . . all or substantially all," the court found that ". . . a literal reading of the words 'all or substantially all' is not helpful apart from reference to the underlying purpose to be served."[62]

In light of the context and purpose of such clauses—and in reliance on commentaries and case law—the court found that it ". . . may be fairly *inferred* from the nature of successor obligor clauses" that they are designed to protect both borrowers and lenders, giving borrowers a measure of freedom to assign debt but also assuring lenders of a degree of continuity of assets.[63] In determining how to balance these competing interests, the court adopted the following commonsense rule:

> Where contractual language seems designed to protect the interests of both parties and where conflicting interpretations are argued, the contract should be construed to sacrifice the principal interests of each party as little as possible. An interpretation which sacrifices a major interest of one of the parties while furthering only a marginal interest of the other should be rejected in favor of an interpretation which sacrifices marginal interests of both parties in order to protect their major concerns.[64]

60. According to the Court, there "are no adjudicative facts relating to the parties for a jury to find" in connection with boilerplate provisions because they are standard and "not the consequence of the relationship of particular borrowers and lenders and do not depend upon particularized intentions of the parties to an indenture." *Sharon Steel*, 691 F.2d at 1048. The court also reasoned that uniformity in indenture interpretation is essential to the effective functioning of capital markets. *Id.*

61. The court rejected Sharon's proposed evidence of custom and usage and practical consideration because they did not tend to prove or disprove a material fact. *See id.* at 1048–49. However, its analysis implicitly allows for such evidence where it has a tendency to make the existence of a fact more or less probable. *See id.*

62. *Id.* at 1049.

63. *Id.* at 1051 (emphasis added). The court's holding relies on both the "Commentaries on Indentures (1971)" and cases interpreting similar language. *See id.* at 1049–50 (citing [Am. Bar Found.,] Commentaries on Model Debenture Indenture Provisions 1965 290 (1971); Atlas Tool Co. v. Comm'r 614 F.2d 860 (3d Cir. 1980); Campbell v. Vose, 515 F.2d 256 (10th Cir. 1975); B.S.F. Co. v. Philadelphia Nat'l Bank, 204 A.2d 746 (Del Ch. 1964)).

64. *Sharon Steel*, 691 F.2d at 1051. This rule was neither unfamiliar nor innovative, having been employed by New York courts to interpret loan documents and mortgages for at least three-quarters of a century. *See* Lisman v. Mich. Peninsular Car Co., 63 N.Y.S. 999, 1002 (App. Div. 1900) (applying in context of "perfect tender rule" for bond repayment).

Because UV's proposed transaction diminished the continuity of asset protection to facilitate sales with little functional significance, the court held that ". . . boilerplate successor obligor clauses do not permit assignment of the public debt to another party in the course of a liquidation unless 'all or substantially all' of the assets of the company at the time the plan of liquidation is determined upon are transferred to a single purchaser."[65] Finding the application of this rule simple to UV, the court ruled that the successor obligation provisions did not apply, and UV was obligated to redeem the debt.

Most of the attention on *Sharon* has since focused on its boilerplate policy and, to a much lesser extent, its balancing test.[66] Its reliance on inferential interpretation, however, simply applied already existing interpretive principles relating to evidence.[67] The New York plain meaning rule seeks parties' intent, using the language of their agreement as *evidence*.[68] Evidence is simply "[s]omething (including testimony, documents, and tangible objects) that tends to prove or disprove the existence of an alleged fact."[69] As Wigmore explained, there are two principles of evidence: (i) "[p]roof in the general sense,—the part concerned with the ratiocinative process of contentious persuasion," and (ii) "[a]dmissibility,—the procedural rules devised . . . to guard . . . against erroneous persuasion."[70] With respect to the "ratiocinative process" there should be no question that New York textualist interpretive rules for modification clauses should draw on inferences from the text of the clause within the context of the entire agreement, considering the purpose of the clause and the overall agreement, as well the manner and circumstances of its use.[71] This analysis ought to be from the

65. *Sharon Steel*, 691 F.2d at 1051.

66. *See* Talley & Pandya, *supra* note 8, at 1993 n.62 (discussing *Sharon*'s interpretive test and noting citations in court rulings thereto). The reasoning in *Sharon* has been applied beyond indentures more generally to contracts that affect financial markets. *See*, *e.g.*, Feaz v. Wells Fargo Bank, N.A., 745 F.3d 1098, 1105 (11th Cir. 2014) (finding reasoning applies to federally insured mortgage loans); *cf.*, Bellucci & Mccluskey, *supra* note 21, at 570–71 (describing "increasing convergence" of syndicated loan market and debt securities market).

67. *See* 2 Bender's New York Evidence § 122.01 (2024) ("All evidential proof is accomplished as a result of one or more inferences drawn from the evidence to the facts in issue." (internal quotations and citations omitted); *see also* Beech Aircraft Corp. v. Rainey, 488 U.S. 153, 163–64 (1988) (A common definition of "finding of fact" is . . . "[a] conclusion by way of reasonable inference from the evidence." (quoting Black's Law Dictionary 569 (5th ed. 1979)); Edward W. Cleary et al., McCormick on Evidence 27 (3d ed. 1984) ("There is no conceivable statement however specific, detailed and 'factual,' that is not in some measure the product of inference and reflection as well as observation and memory.").

68. *See Greenfield*, 780 N.E.2d at 170 ("The best evidence of what parties to a written agreement intend is what they say in their writing.").

69. *Evidence*, *in* Black's Law Dictionary (12th ed. 2024).

70. Jacob A. Stein, *The Quest for Colonel Wigmore*, 19 Litig. 43, 45 (1992) (quoting John Henry Wigmore, The Science of Judicial Proof (3d ed. 1937)).

71. *See Alexander & Alexander*, 136 F.3d at 86 (finding that ambiguity determined based on the "terms, or the inferences readily drawn from the terms"); Commer. Lubricants, LLC v. Safety-Kleen Sys., No. 14-CV-7483 (MKB), 2017 U.S. Dist. LEXIS 125557, at *28 (E.D.N.Y. Aug. 8, 2017) (finding exclusivity agreement ambiguous as a matter of law where the evidence does not point unerringly in a single direction but is capable of supporting conflicting inferences); Quantum Maint. Corp. v. Mercy Coll., 798 N.Y.S.2d 652, 656 (Sup. Ct. 2005) (finding "where the interpretation of a contract term is susceptible to varying reasonable interpretations . . . intent must be gleaned

perspective of a reasonably intelligent person familiar with such agreements and the lending industry.

Lee Epstein and Gary King in their article, *The Rules of Inference*, contend that legal scholars, professors, attorneys, and judges have too often ". . . ignored the rules of inference and applie[d] instead the 'rules' of persuasion and advocacy."[72] Inference is ". . . the process of using the facts we know to learn about facts we do not know."[73] Courts in New York have referred to this process as ". . . a reasoned, logical decision to conclude that a disputed fact exists on the basis of another fact that is known to exist."[74] It is not a suspicion or guess but ". . . is drawn on the laws of logic and not judicial idiosyncrasies,"[75] and should not ". . . give any construction to the terms of a written contract that may be in conflict with the clearly expressed language of the written agreement."[76]

There are three major types of inferences: deductive, inductive, and abductive.[77] The distinction between these is that with deductive inferences ". . . what is inferred is *necessarily* true if the premises from which it is inferred are true; that is, the truth of the premises *guarantees* the truth of the conclusion."[78] Inductive and abductive inferences are "*ampliative*, meaning that the conclusion goes beyond what is (logically) contained in the premises."[79] They ". . . provide some *degree of support* for the conclusion, where such support means that the truth of the premises indicates with some *degree of strength* that the conclusion is true."[80] In addition, inductive and abductive inferences are "nonmonotonic," meaning "the addition of new premises can cast doubt on the validity of the original inference."[81] While legal reasoning relies to some extent on these inferences in different contexts, factfinding—such as determining the intent of contracting

from disputed evidence or from inferences outside the written words" (internal quotations and citations omitted)).

72. 69 U. Chi. L. Rev. 1, 9 (2002).

73. *Id.*

74. People v. Hansel, 159 N.Y.S.3d 560, 565 (App. Div. 2022) (quoting United States v. Pauling, 924 F.3d 649, 656 (2d Cir. 2019) (internal quotations and citations omitted)).

75. *Pauling*, 924 F.3d at 656 (internal quotations and citations omitted).

76. Gen. Elec. Co. v. Compagnie Euralair, S.A., 945 F. Supp. 527, 529 (S.D.N.Y. 1996) (internal quotations and citations omitted).

77. *See* Igor Douven, *Abduction*, *in* The Stanford Encyclopedia of Philosophy (Edward N. Zalta ed., 2021), https://plato.stanford.edu/archives/sum2021/entries/abduction/ (last visited Feb. 17, 2025).

78. *Id.*

79. *Id.* Abductive inferences rely primarily on explanatory considerations whereas inductive inferences rely on statistical data. *See id.*

80. James Hawthorn, *Inductive Logic*, *in* The Stanford Encyclopedia of Philosophy (Edward N. Zalta & Uri Nodelman eds., 2024), https://plato.stanford.edu/archives/sum2024/entries/logic-inductive/ (last visited Jan. 24, 2025); *see also* Nevin Climenhaga, *Evidence and Inductive Inference*, PhilSci Archive, https://philarchive.org/archive/CLIEAIv1 (last visited Sept. 19, 2026 ("On one conception, an inductive inference should make its conclusion more probable than not. On another conception, it need only make its conclusion more probable than it would otherwise be. The former fits with a conception of inference more generally as a cognitive process that results in belief. The latter fits with a conception of inference more generally as a cognitive process that includes not only changes in first-order beliefs, but also changes in degrees of belief and/or beliefs about probabilities." (internal citations omitted)).

81. Vern R. Walker, *Theories of Uncertainty: Explaining the Possible Sources of Error in Inferences*, 22 Cardozo L. Rev. 1523, 1525 (2001).

parties—is abductive.[82] The premises of abductive inferences are often referred to as evidence.

It is beyond the scope of this article to explain the theories of inferential logic as applied to factfinding and legal reasoning, other than to make three broad and general observations. First, not all inferences are equal in value. Good nonmonotonic inferences presumably meet the following conditions: "The logic should make it likely (as a matter of logic) that as evidence accumulates, the total body of true evidence claims will eventually come to indicate, via the logic's measure of support, that false hypotheses are probably false and that true hypotheses are probably true."[83] Second, nonmonotonic inferences in factfinding are often based on incomplete information and can produce conflicting or unreliable inferences. Third, a critical function of factfinding is evaluating the probative force of an inference or the relative "soundness of an inference from evidentiary propositions to a conclusion."[84] Commentators have proposed various theories for handling these uncertainties in different factfinding situations, including cases involving distinctions between "junk science" and scientific knowledge, "lost chance" tort cases, and "indeterminate plaintiffs" in toxic tort cases.[85] Epstein and King contend that a key to making inferences more accurate and less uncertain is to reveal the target of the inference and as much as possible about the inferential process of gathering and observing known facts.[86] Another commentator describes the "inference to best explanation" model of fact finding as follows:

(1) inferring from the evidence a plausible explanatory hypothesis (reasoning from evidence to hypothesis);

(2) testing the hypothesis with new evidence (reasoning from hypothesis to evidence);

(3) comparing the hypothesis with rival explanations; [and]

(4) assessing the hypothesis with the relevant criteria.[87]

There is no established model for processing the probative value of the many inferences implicated when interpreting a loan agreement or modification clause, but the goal should be to ". . . explain the extent to which the available evidence warrants a particular conclusion and the kinds and degrees of uncertainty associated with that conclusion."[88]

82. *See* Giovanni Tuzet, *Abduction, IBE and Standards of Proof*, 23 Int'l J. Evidence & Proof 114, 115–16 (2019) (summarizing arguments regarding fact-finders' use of abduction and "inference to the best explanation"). The references herein to abductive inferences are intended to cover generally both abductive inferences and "to the best explanation," understanding that the precise scope of each in the context of fact-finding can be further refined or defined differently. *See id*.

83. Hawthorne, *supra* note 77; *see also* Tuzet, *supra* note 79, at 117 (describing inference to best evidence fact-finding model that tests and corroborates initial abductive inferences).

84. Walker, *supra* note 78, at 1523.

85. *See id*. at 1523–26 (describing different theories).

86. *See* Epstein & King, *supra* note 69, at 31–34.

87. Tuzet, *supra* note 79, at 117.

88. Walker, *supra* note 78, at 1525–26.

Part III. Inferring Modification Clause Meaning

With the foregoing in mind, how should a court interpret a modification clause? A few things are clear from the customary "sentence meaning." It covers and protects the rights of all lenders—both majority and minority. On the one hand, majority lenders have authority to amend a significant amount of the agreement without minority consent, including covenants, which can increase credit risk and shift material value and control away from lenders to other stakeholders. On the other hand, minority lenders' sacred rights cannot be amended without their consent. The standard clause provides that modifications are not effective unless in writing and executed by the relevant parties but does not expressly prohibit or permit an exit consent as part of an LME that disparately benefits the majority at the expense of the minority. Sentence meaning alone does not express the "intent of the parties" in this respect. While a court could certainly consider evidence of particularized intent, course of performance, custom and usage, or practical construction, it will often be unavailable or unhelpful.[89] In any event, a court must consider context, considering not only the entire agreement but also its purpose and the manner and circumstances of its use. This type of evidence is circumstantial, never directly proving the parties' intent.[90] So, a court must infer meaning.

The LME Hypothesis

The starting point for this inferential analysis is to identify the target—specifically whether the objective intent of the parties to a customary syndicated loan agreement is to permit a majority of lenders to modify provisions where: (i) the modification is integrated into an LME that would not occur without the modification; (ii) the majority will immediately cease being lenders of the same tranche after executing the amendment; (iii) the majority will receive benefits as part of the LME that are not equally and ratably offered to the minority in the same tranche; and (iv) the LME results in a disproportionate value transfer away from the minority. LME proponents present a simple interpretation (hypothesis): The plain language of a customary modification clause authorizes majority lenders to modify any provision of the agreement, other than enumerated sacred rights or rights uniquely affecting agents, so long as it is done in writing and signed by the requisite parties. Therefore, the parties intend the majority to have complete discretion to advance such modifications, whether or not they benefit or harm lenders equally or disparately. In short, majority lender actions not expressly prohibited are permitted. In effect, this reflects the intent of the

89. *See, e.g.*, Excluded Lenders v. Serta Simmons Bedding, L.L.C., 125 F.4th 555, 582 (5th Cir. 2024) (finding that course of performance argument in LME context fails where relevant actions do not encompass a considerable period of time, occur on a single occasion, or do not involve all parties).

90. *See* People v. Bretagna, 83 N.E.2d 537, 538 (N.Y. 1949) ("[C]ircumstantial evidence puts before the tribunal facts which, alone or with others, are in some degree but indirectly, probative of one or more of those principal, or 'res gestae' facts, and from which one or more of those principal facts may properly be inferred.").

parties to give the majority control of value distribution vis à vis their class of lenders as well as between the lenders and other stakeholders.

This conclusion flows from several premises. The modification clause expressly limits amendments altering sacred rights but also gives majority lenders vast power to eliminate or amend covenants (and other non-sacred rights). Through this power, the majority may shift value to favored stakeholders and lenders disparately or on any other basis. Because this power has no express limits, modification clauses protect sacred rights only technically or legally but not functionally.[91] So long as excluded lenders retain the legal and pro-rata right to repayment of principal and interest at maturity, their primary interest under a loan agreement (i.e., repayment) is preserved. Moreover, lenders have no contractual right to participate in future transactions with the borrower, so the borrower may agree to new transactions with any third party as part of an LME, including a subset of existing lenders. Indeed, existing lenders are often a common source of additional capital because they already know the borrower. Syndicated lenders are sophisticated investors who generally ". . . fight to create and include covenants that protect their rights," or, at minimum, consider loan agreement terms carefully before investing.[92] They are aware or deemed to be aware that loan agreements governed by New York law are construed strictly from a textualist, plain meaning approach and that courts are reluctant to interpret agreements as impliedly stating something the parties neglect to specifically include. In addition, some courts have inferred in similar bondholder indenture contexts that if something is not expressly prohibited, it is permitted ("subject to other positive law").[93] Because lenders can negotiate for language preventing majority lenders from appropriating minority lender value through non-pro rata

91. This premise was foundational in *Ocean Trails CLO VII v. MLN Topco Ltd.*, 225 N.Y.S.3d 192, 195 (App. Div. 2024) where the court dismissed disfavored lenders' claims that the non-pro-rata, uptier LME of Mitel Networks Corporation failed to comply with sacred modification rights indirectly or functionally. The relevant loan provisions did not explicitly prohibit or permit the LME, so the court had to decide whether the modification clauses were intended to cover functional modifications even in the absence of actual, textual modifications (as argued by plaintiffs). The court reasoned that "[h]ad the parties wanted an effective or functional amendment to be covered, they could have used language to that effect." *Id.* Relying on *Quadrant Structured Products Co., Ltd. v. Vertin*, 16 N.E.3d 1165, 1172 (N.Y. 2014), the court inferred that the modification provisions "suggest[ed]" they covered only "an actual, textual amendment," not "effective or functional amendment[s]." *See Ocean Trails*, 225 N.Y.S.3d at 195.

92. GPC XLI L.L.C. v. Loral Space & Commc'ns Consol. Litig. (*In re* Loral Space & Commc'ns Consol. Litig.), Nos. 2808-VCS & 3022-VCS, 2008 Del. Ch. LEXIS 136, at *137 (Del. Ch. Sept. 19, 2008). ("Noteholders are generally sophisticated investors who fight to create and include covenants that protect their rights."); *see also* Bellucci & Mccluskey, *supra* note 21, at 549 (discussing loan assignment provisions and a borrower's interest in lenders who are "sophisticated, experienced, and borrower-friendly").

93. *See, e.g.*, Waxman v. Cliffs Nat. Res., Inc., 222 F. Supp. 3d 281, 295 (S.D.N.Y. 2016) ("In dealing with a company's bondholders, that which is not prohibited is permitted. 'Indentures are to be read strictly and to the extent they do not expressly restrict the rights of the issuer, the issuer is left with the freedom to act, subject only to the boundaries of other positive law.'" (quoting *In re* Loral Space & Commc'ns Inc., Nos. 2808-VCS & 3022-VCS, 2008 WL 4293781, at *35 (Del. Ch. Sept. 19, 2008))).

exit consents, the failure to do so most likely means they do not intend to so limit the majority.[94]

This general logic has been applied in LME challenges, albeit not explicitly to the intended scope of modification clause discretion. In Serta Simmons Bedding's case, for example, the Bankruptcy Court dismissed the claims of excluded minority lenders who argued that an LME violated their sacred rights.[95] The court interpreted the "loose" credit agreement against the excluded lenders, finding that they were aware of and understood the implications of this looseness and could have easily avoided the LME ". . . with the addition of a sentence or two."[96] The court reasoned:

> Lender exposure to these types of transactions can be easily minimized with careful drafting of lending documents. While the result may seem harsh, there is no equity to achieve in this case. Sophisticated financial titans engaged in a winner-take-all battle. There was a winner and a loser. Such an outcome was not only foreseeable, it is the only correct result.[97]

94. Standard modification clauses do not (but presumably could) expressly provide that every amendment not expressly prohibited is permitted, even if integrated into an LME. Therefore, the LME proponent's logic likely relies on inferences similar to those espoused by the canon *expressio unius est exclusio alterius* ("the expression of one thing is the exclusion of the other"). *See* Chevron U.S.A. v. Echazabal, 536 U.S. 73, 81 (2002) ("The canon depends on identifying a series of two or more terms or things that should be understood to go hand in hand, which are abridged in circumstances supporting a sensible inference that the term left out must have been meant to be excluded."). As applied to contract interpretation, where sophisticated parties omit a term, especially where that term is readily found in other similar contracts, a court may infer the parties intended the omission and will not imply the term. *See Quadrant*, 16 N.E.3d at 1172 (finding that a "no action clause" preventing actions under "the indenture" did not preclude common law securities actions). Proponents of LMEs point to a short list of requirements for majority modifications of non-sacred terms; they need only be in writing and executed by the appropriate parties. They infer that addition of a list of modifications requiring supermajority or each lender's approval is deliberately exclusive and all other unexpressed limits are intentionally excluded. Courts, however, have cautioned that this canon is a non-dispositive aid to interpretation that should be used only when "circumstances support a sensible inference that the term left out must have been meant to be excluded." NLRB v. SW Gen., Inc., 580 U.S. 288, 290 (2017); *see also* Solus Alt. Asset Mgmt., LP v. Delphi Auto. PLC, 553 B.R. 20, 32 n.20 (Bankr. S.D.N.Y. 2016) ("[M]axims . . . should not be used to exclude too readily, as if ignoring guests at a party, the legitimate possible meaning of an agreement."). It "properly applies only when in the natural association of ideas in the mind of the reader that which is expressed is so set over by way of strong contrast to that which is omitted that the contrast enforces the affirmative inference." *Chevron*, 536 U.S. at 81. Importantly, modification clauses *do* express limits for sacred rights, and default or mandatory rules of contract law—such as requirements for consideration and good faith—remain even if unexpressed. All of this leaves open questions about the scope of modification discretion and how to reconcile potential conflicts when a majority modification indirectly or functionally affects sacred rights. As explained *infra*, the association of these issues is not so natural as to support a conclusion that what is not expressly prohibited is permitted. *See also* Harrington v. Purdue Pharma L.P., 603 U.S. 204, 218 (2024) (finding that the "catchall" in 11 U.S.C. § 1123(b)(6) must draw meaning from surrounding provisions and that *ejusdem generis* canon does not permit an inference that "everything not expressly prohibited is permitted").

95. *See* Serta Simmons Bedding, LLC v. AG Ctr. St. P'ship, Nos. 23-90020, 23-9001, 2023 Bankr. LEXIS 1479 at *35–37, *39–42 (Bankr. S.D. Tex. June 22, 2023), *rev'd sub nom. Excluded Lenders*, 125 F.4th 555.

96. *See id.* at *40–41.

97. *Id.* at *41–42. In dicta, the court found it "irrelevant" that excluded lenders were not invited to participate in the LME, because they did not object on that basis and did not produce evidence

On appeal the Fifth Circuit Court of Appeals reversed the bankruptcy court's holding that the LME's debt-for-debt exchange constituted a permissible open market purchase, and remanded for reconsideration on the breach of contract claims because ". . . little substantive discussion of the breach of contract issue," was before the court.[98]

There is some allure to the logic underlying the LME hypothesis, but its reasoning is at best incomplete and at worst flawed. It must be tested in light of all the available evidence in context and measured against alternative interpretations. The following sections lay out further evidence that a reasonably intelligent third party should consider, including the context of the entire integrated agreements; relevant customs, practices, usages and terminology; and the intended purposes of a modification clause under the specific circumstances of its application.

The Evidence

How a modification clause is used depends on the specific circumstances of each case. Context is important. LME proponents often strategically and intentionally isolate LME steps—using separate agreements, transactions, and timing—to avoid contract breaches. This is especially true for exit consents, which are typically executed early and ostensibly in consideration for a nominal consent fee, ignoring everything else majority lenders may receive. Generally, New York law respects contracting parties' clearly expressed intent with respect to the separateness of multiple writing and transactions.[99] Nevertheless, where parties use legal form to camouflage the true substance of transactions and agreements, courts will not be constrained by form or feigned expressions of intent. Courts will treat multiple transactions and agreements as a single transaction or agreement if they substantively effectuate the same purpose or plan. This is true as a cannon of contract interpretation and general equity.[100] "New York law requires that all writings which

that such an invitation was required. *Id*. at 34. According to the court, "[a]bsent a contractual or legal duty to do so, the failure . . . to receive an invitation is just a fact of commercial life." *Id*. at 34. The scope of modification discretion, however, is a distinct issue that was not directly addressed in the decision.

98. *See Excluded Lenders*, 125 F.4th at 584. The Fifth Circuit did not condone or address the bankruptcy court's "winner" and "loser" logic directly, but it did note that critics have referred to uptier LMEs as "cannibalistic," "supper-aggressive," "acts of financial war," and "unthinkable" relative to prior commercial norms. *See id*. at 567 (internal citations and quotations omitted).

99. *See, e.g.*, TVT Records v. Island Def Jam Music Grp., 412 F.3d 82, 89 (2d Cir. 2005) ("[W]hether multiple writings should be construed as one agreement depends on the intent of the parties . . . . [which] is a matter of law for the court" in the absence of ambiguity (internal quotations and citations omitted)), *cert. denied*, 548 U.S. 904 (2006).

100. Courts elevate substance over form to determine the rights and obligations of parties to contracts. A number of doctrines apply this basic principle to a variety of circumstances, including the step-transaction, the integrated transaction, the collapsing transactions, sham transaction, de facto merger, recharacterization, and the economic substance doctrines. *See, e.g.*, Liona Corp. v. PCH Assocs. (*In re* PCH Assocs.), 949 F.2d 585, 597 (2d Cir. 1991) (looking to substance not form to determine whether the transaction was a secured financing); *In re* Sabine Oil & Gas Corp., 547 B.R. 503, 540–41 (Bankr. S.D.N.Y. 2016) (applying collapsing doctrine to fraudulent transfer claims); Chem. Bank v. Meltzer, 712 N.E.2d 656, 661–62 (N.Y. 1999) (applying substance over form doctrine

form part of a single transaction and are designed to effectuate the same purpose be read together, even though they were executed on different dates and were not all between the same parties."[101] "[E]quity looks to the substance and merits rather than the form of a transaction"[102] and does not ". . . suffer the mere appearance and external form to cancel the true purposes, objects and consequences of a transaction."[103] In most cases where an LME would not occur without the exit consent, courts should interpret the modifications as part of the LME, viewing all the transactions and agreements as components of a single plan.[104] Accordingly, the benefits a majority receives (and at whose expense) in an LME contingent on an exit consent matter for purposes of evaluating the meaning of a modification clause. The extent to which an LME functionally transfers value from minority to majority lenders or other stakeholders will vary, but the fact that many do so is generally accepted.[105]

Unsurprisingly, the purpose of a contract and its provisions is given great weight in evaluating meaning.[106] For a loan agreement, purpose is best described within one of three broad categories—the "basic financial terms,"[107] damage mitigation, and intra-lender relations. The following sections outline each of these.

to preserve guarantor's subrogation rights); GKK 2 Herald LLC v. City of N.Y. Tax Appeals Trib., 63 N.Y.S.3d 20, 27 (App. Div. 2017) (sanctioning use of the step transaction doctrine to determine tax liability).

101. This Is Me v. Taylor, 157 F.3d 139, 143 (2d Cir. 1998) (holding that individual defendants who were not parties to a contract containing a pay or play clause could nevertheless be held liable for the obligations when considering other contracts and circumstances related to the hiring of an actress).

102. Skaneateles Sav. Bank v. Herold, 376 N.Y.S.2d 286, 290 (App. Div. 1975) (preserving pre-existing creditor lien priorities where a promissory note was marked as "paid" in debt consolidation transaction because the underlying substance of the transaction was an exchange not a repayment); *see also* 55 N.Y. Jur. 2d *Equity* § 80 (2024) ("[E]quity regards only the substance of things, and . . . [i]n ascertaining the merits of a case, it avoids the exaltation of form above substance by examining the substance and disregarding the particular terminology adopted to typify the transaction.").

103. Am. Broad. Cos., Inc. v. Wolf, 430 N.Y.S.2d 275, 281–82 (App. Div. 1980), *aff'd on other grounds*, 420 N.E.2d 363 (N.Y. 1981) (holding that defendant breached pre-existing contract when he entered into two new contracts intending to avoid the good faith negotiation and first refusal rights in pre-existing contract (internal quotations and citations omitted)).

104. *See*, *e.g.*, *Audax*, 2021 N.Y. Slip Op. 50794(U), at *8 (finding that the TriMark transaction documents formed a single agreement for purposes of the modification clause and that defendants' argument that the provision can only be read as applying to the portion of the LME on which they choose to focus was unavailing on motion to dismiss).

105. *See* Diane L. Dick, *Alliance Politics in Corporate Debt Restructurings*, 39 Emory Bankr. Dev. J. 285, 289 (2023) ("[L]enders that participate in a hostile restructuring receive some economic benefits in the form of new credit enhancements and new investment opportunities, while nonparticipating lenders pay the price by losing payment priority and lien rights."); *see also infra* notes 104–06.

106. *See* Matter of Crystal Run Galleria LLC v. Town of Wallkill, 141 N.Y.S.3d 274, 281 (Sup. Ct. 2021) ("The manifest purpose the parties sought to accomplish is of paramount significance. It takes precedence over all other canons of construction." (internal citations and quotations omitted)).

107. *See* Bellucci & Mccluskey, *supra* note 21, at 512; Commentaries on Model Debenture Indenture Provisions 1965, *supra* note 60, § 9-2, at 307 (describing "basic financial terms" of debentures as "payment of the principal amount, the interest rate, the redemption premium, the maturity, the place of payment, the currency in which payable and the right to institute suit for any default in such payment").

Basic Financial Terms

The basic financial bargain in virtually every syndicated loan is the same. Lenders loan money for a period of time in exchange for borrower's promise to repay the principal amount of the loan in the future together with interest and fees. This exchange forms the foundation of the transaction. At the inception or funding of the transaction, the borrower legally obligates itself to repay principal and interest, and each investor has reasonable expectations that it will be repaid in full at maturity.[108]

Damage Mitigation

However, syndicated lenders' expectation interests are rarely, if ever, binary (i.e. payment in full or nothing at all).[109] Debt agreements also manage and maximize recoveries (especially relative to other stakeholders) when repayment in full is not possible by allocating value[110] and control among stakeholders[111] and establishing parameters for renegotiation. This damage mitigation function is accomplished through an agreed-upon combination of interest rate, covenants, and property/collateral rights incorporated into the loan agreement.[112] Through covenants—affirmative, negative, and financial—a borrower may agree to amelio-

108. Virtually every loan inherently carries credit risk (i.e., the prospect that it may not be repaid). *See* Off. of the Comptroller of the Currency, Rating Credit Risk, Comptroller's Handbook 1 (Apr. 2001) (updated June 26, 2017), https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/rating-credit-risk/pub-ch-rating-credit-risk.pdf ("Credit risk is the primary financial risk in the banking system and exists in virtually all income-producing activities."). It should be axiomatic, however, that when funding a loan, the lender expects repayment. Otherwise, it would not make the loan. This is at least implicitly, if not explicitly, acknowledged in various provisions of a loan agreement. Repayment provisions commonly provide that payments are to be made "without condition or deduction for any counterclaim, defense, recoupment or setoff," and the borrower indemnifies each lender for "any and all losses, claims, damages, liabilities and related expenses . . . arising out of, in connection with, or as a result of . . . any loan." *See*, *e.g.*, LSTA Form Term Loan, *supra* note 22, §§ 2.12(a), 9.03(a). Covenants, agreements, representations, and warranties made by the borrower continue in full force and effect until all obligations under the loan agreement have been paid. *See id.* § 9.05. Furthermore, many loans contain a representation and warranty at closing that the borrower is solvent with the ability to repay its debts as they come due. *See id.* § 3.17.

109. *See* Barry E. Adler & Marcel Kahan, *The Technology of Creditor Protection*, 161 U. Pa. L. Rev. 1773, 1774–75 (2013) ("Breach of a money obligation typically implies a lack of cash, which impairs any nominal damages remedy. To address the inadequacy of damages, loan agreements often include [covenants].").

110. *See*, *e.g.*, Falk Bräuning, Victoria Ivashina & Ali Ozdagli, *High-Yield Debt Covenants and Their Real Effects* (Fed. Res. Bank of Bos., Research Dep't Working Paper No. 22-5, 2022), https://www.bostonfed.org/publications/research-department-working-paper/2022/high-yield-debt-covenants-and-their-real-effects.aspx (finding that latent incurrence and maintenance covenant violations lower equity returns and that contractual constraints underlying incurrence covenants have economic consequences before bankruptcy and any shift in control rights).

111. *See* Adler & Kahan, *supra* note 106, at 1774–75 (describing debt as a tool to control investor–manager conflict and shareholder–creditor conflicts).

112. *See* Philip E. Strahan, *Staff Report No. 90: Borrower Risk and the Price and Nonprice Terms of Bank Loans*, Fed. Res. Bank of N.Y. (Oct. 1999), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr90.pdf (finding that lenders structure loan agreements with both economic and non-economic terms to mitigate credit risk and monitor borrowers over time, using a variety of contract features to "control adverse selection and moral hazard problems"); Moritz Hiemann, *Covenants, Interest Rates, and the Cost of Debt*, Colum. Bus. Sch. 33 (2020), https://business.columbia.edu/

rate information asymmetry by providing private information about its business or prospects over time[113] and constrain moral hazard by limiting risk-taking activities and specifying the conditions for transferring control from shareholders to the lenders.[114] Following a default, the grant of collateral and liens is an additional lever that transfers control (and often value) to a lender.

Collectively, these terms have the virtue of balancing risks and inefficiencies among lenders, borrowers, and other stakeholders.[115] But they also come with costs. If over inclusive, they can prevent a borrower from making decisions, discourage a borrower from taking appropriate risks or pursuing value-maximizing ventures, and, following default, precipitate liquidation. In addition, granting collateral constrains future financing and, following default, may destroy going-concern value.[116] Borrowers with excessive amounts of high-cost debt may also experience "debt overhang" which discourages new capital raising if incremental profits will only benefit existing creditors instead of new investors.[117]

Each loan agreement is tailored to a specific borrower's situation, with a unique balance of these interests and risks.[118] However, they do have at least two things in common. They require repayment of principal and interest in full at maturity. When that is not possible, they also seek to maximize (not minimize) the amount of repayment through an agreed-upon allocation of value and control as between the lenders, on the one hand, and the borrower and its other stakeholders, on the other.[119] In effect, every syndicated loan agreement

sites/default/files-efs/pubfiles/26305/Debtcovenantsv7.pdf (finding that interest rates and covenants work in tandem to address the agency cost of debt).

113. *See* Peter R. Demerjian, *Uncertainty and Debt Covenants*, 22 Rev. Acct. Stud. 1156–97 (2017), https://accounting.wharton.upenn.edu/wp-content/uploads/2016/10/Demerjian.pdf (evaluating role of financial covenants in connection with uncertainty, information asymmetry, and renegotiation).

114. *See* Albert Choi & George Triantis, *Market Conditions and Contract Design: Variations in Debt Contracting*, 88 N.Y.U. L. Rev. 51, 53 (2013).

115. *See* Tung, *supra* note 16, at 163–67 (describing lender influence on borrower's governance and financial and investment policies through covenants, remedies, and renegotiation).

116. *See* Choi & Triantis, *supra* note 111, at 59 ("First, the covenant restrictions may be over-inclusive and constrain the borrower's flexibility to take good, as well as bad, actions. Second, the transfer of control to the lender upon default may destroy going-concern value because of the lender's inefficient incentives to forego risky but profitable projects and to liquidate the borrower's assets. Third, although the parties may avoid this inefficiency by renegotiation, the renegotiation process can be costly . . . . Similarly, [granting] collateral . . . raises the cost of future borrowing and may impede the financing of profitable projects[, and] . . . the secured lender's enforcement against the collateral may threaten to destroy synergies and going-concern value, or necessitate costly renegotiation.").

117. Stewart C. Myers, *Determinants of Corporate Borrowing*, 5 J. Fin. Econ. 147, 149 (1977) (arguing that too much risky debt can inhibit investment if shareholders have to share returns from the investment with creditors).

118. *See* Choi & Triantis, *supra* note 111, at 52 ("[C]ovenants in commercial debt contracts vary considerably in their scope, intensity, and tightness across borrowers with different characteristics. There is clearly a significant degree of customization and malleability in covenant patterns over time.").

119. *See* Hiemann, *supra* note 109, at 2 ("Moreover, optimal contract terms can vary across a range from restrictive covenants with low interest rates to loose covenants with high interest rates, depending on the characteristics of the investment to be financed.").

establishes at inception both a cap and a potential floor for lenders' repayment expectation interests.[120]

Managing Intra-Lender Relations

Lenders in a syndicated loan are not a static, monolithic group, but instead include traditional banks, hedge funds, mutual funds, collateralized loan obligation funds, and other non-bank, institutional investors—often with different investment philosophies, mandates, holding periods, or bases in the loans.[121] This diverse lender body can also change over time as loans trade at varying values. Where a loan agreement covers multiple lenders, it also manages intra-lender relationships relating to the making of loans, payments, remedies, and amendments.

(i) Pro-Rata Treatment

The "general principle in virtually all credit agreements is that the lenders are treated on a 'ratable' basis."[122] This is true of both their rights and obligations. According to the Bellucci and McCluskey: "Each lender is to make loans, and be paid principal and interest, on a strictly ratable basis with all other lenders of the same tranche."[123] This is more than aspirational; "[t]he provisions of the credit agreement that require the lenders (at least all lenders within the same tranche) be treated ratably are fundamental."[124] According to the Fifth Circuit Court of Appeals: "Ratable treatment is an important background norm of corporate finance. Pursuant to this norm, a borrower must treat all of its similarly situated lenders, well, similarly. Ratable treatment is such an important norm that it is often described as a lender's

120. *See id.* at 1 ("Debt financing incurs a latent inefficiency due to a misalignment of risk preferences between borrowers and lenders . . . . [M]uch attention has been devoted to the role of creditor rights, particularly in the form of covenants, in mitigating the preference misalignment problem. As contract clauses agreed upon ex ante, covenants can channel decisions toward the socially optimal outcome through the strategic assignment of contingent control rights to either contracting party. At the same time, stricter covenants transfer wealth from the borrower to the lender and therefore require compensatory adjustments to the stated interest rate. Interest rates, in turn, interact with the preference misalignment problem and thus with the optimal covenant design choice. Contract terms must therefore be optimized jointly with respect to both efficiency and the division of payoffs between borrower and lender.").

121. *See* Bellucci & Mccluskey, *supra* note 21, at 2 ("In 2015 nonbank lenders represented about 86 percent of the participants in syndicated noninvestment grade facilities."). Tung summarizes the loan arrangement process as follows:

> Today, banks continue to arrange syndicated loans, but they sell most of their loans in secondary loan markets to non-bank institutional investors. Larger and more disparate lender groups make loan renegotiations ("workouts") more difficult. Different types of institutions hold differing priorities. A non-bank lending group may include collateralized loan obligations (CLOs), loan mutual funds, insurance companies, foreign investors, and pension funds, among others. The presence of heterogeneous lending institutions complicates the renegotiation of a loan agreement.

See Tung, *supra* note 16, at 157.

122. Bellucci & Mccluskey, *supra* note 21, at 520.

123. *Id.* at 514. This is often reflected in language that provides that the Lenders' obligations to make Loans are "several and not joint." *See*, *e.g.*, LSTA Form Term Loan, *supra* note 22, § 2.12(e).

124. *Id.*

'sacred right' under syndicated loan agreements."[125] It is indeed a principal aim of credit agreements to prevent a majority of lenders from engineering around this fundamental notion of ratability to the detriment of a minority.[126] In short, equal and ratable treatment of lenders is the rule, not the exception.

(ii) Remedies

When it comes to remedies following default, loan agreements balance individual and collective rights. Ordinarily, individual lenders retain their sacred rights, as well as the right to exercise setoff rights and file proofs of claim, provided payments received remain subject to the pro rata sharing provisions. But lenders often agree that the agent may (and at the direction of a majority shall) exercise rights and remedies on behalf of the lenders.[127] Although a majority may direct such exercise, the agent nevertheless acts in its agent capacity for and on behalf of all lenders collectively. These provisions reflect an *ex ante* agreement to sacrifice certain individual rights for the ". . . 'salutary purpose' of benefiting the venture as a whole."[128] New York courts have referred to this as "collective design," precluding individual lender action unless explicit individual authority is granted, sacred rights are affected, or they do not serve the venture as a whole.[129] The LSTA Guide explains that "[c]redit agreements containing such provisions expressly funnel any claims through the administrative agent and thereby head off any risk of free-agent lenders pursing their own claims that may or may not be consistent with, or otherwise benefit, the broader syndicate."[130] "Absent extenuating circumstances, such as conflicts of interest,

125. *Excluded Lenders,* 125 F.4th at 565 (internal citations and quotations omitted).

126. *See* Bellucci & McCluskey, *supra* note 21, at 514 (explaining that amendment provisions require each lender's consents to prevent lenders from engineering around this fundamental right of ratable treatment).

127. *See, e.g.,* LSTA Form Term Loan, *supra* note 22, §§ 9.02(a), 7.01. Section 7.01 provides that upon and during a continuance of an "Event of Default," the agent may—and at the request of the "Required Lenders" shall—accelerate the loans and exercise all rights and remedies "on behalf of itself and the Lenders." *Id.* § 7.01. Section 9.02(a) provides that "[n]otwithstanding anything to the contrary contained herein" the authority to exercise rights and remedies is vested exclusively in the agent "for the benefit of the Lenders." *Id.* § 9.02(a).

128. *See Audax*, 2021 N.Y. Slip Op. 50794(U), at *22. In *Audax*, the New York Supreme Court refused to enforce a no action clause that had been amended as part of an LME because it did not reflect an *ex ante* agreement but was instead "an act of *self*-interest, not a consensual decision to promote the interest of the 'investment vehicle in general.'" *See id.* at *23–24.

129. *See* Beal Sav. Bank v. Sommer, 865 N.E.2d 1210, 1214 (N.Y. 2007) (finding that agreements authorized agent to "act on behalf of the lenders collectively by its own initiative or at the direction of a majority of lenders"); CNH Diversified Opportunities Master Account L.P. v. Cleveland Unlimited, Inc., 160 N.E.3d 667, 678 (N.Y.2020) (holding that strict foreclosure that purported to cancel notes of dissenting minority holders without their consent violated individual rights protected by indenture and Trust Indenture Act to sue for payment of principal and interest).

130. Bellucci & Mccluskey, *supra* note 21, at 474; *see also* Feldbaum v. McCrory Corp., C.A. Nos. 11866, 11920, 1992 Del. Ch. LEXIS 113, at *18–20 (June 1, 1992) (finding this to be the "primary purpose" of collection action clauses); Commentaries on Model Debenture Indenture Provisions 1965, *supra* note 104, § 5-7, at 232 (explaining same rationale for limitation on suits in indenture, also recognizing "[a]n additional purpose is the expression of the principle of law that would otherwise be implied that all rights and remedies of the indenture are for the equal and ratable benefit of the holders").

courts generally give substantial deference to the notion of the administrative agent playing the lead role when it comes to pursing remedies."[131] These types of provisions generally create a collective or community of interests for the equal and ratable benefit of all the lenders.

(iii) Modification Clauses in Context

Modification clauses must be considered in the foregoing context. Inevitably, parties cannot contract for all contingencies, so they anticipate that renegotiation may be necessary in the future for a number of reasons. When negotiating the terms of a loan, lenders will gather information regarding the borrower from a number of sources, both public and private, including information from the borrower regarding past financial results and future financial projections, and the lenders' own knowledge of the industry and economic conditions.[132] But there will always be some level of information that is unknown or unknowable, including changes precipitated by future industry and macroeconomic changes, as well as the borrower's own investment and operational choices over time. Loan agreements must address this uncertainty *ex ante*, with the understanding that relevant information may be revealed over time.[133] Generally, they do so in two ways. As indicated above, they build in mitigation terms (such as maintenance or incurrence covenants), the triggering of which gives lenders two choices: (i) calling a default and exercising remedies, or (ii) renegotiation.[134] Both of these choices reflect a transfer of power or control to the lenders.[135]

When considering these choices, lenders must determine which increases the likelihood of repayment. While both paths pose inherent risk, it should be axiomatic that lenders *qua* lenders will pursue a path that maximizes the likelihood of recovery on their loans. They do not knowingly reduce their recovery chances or simply shift value to others with no corresponding benefit. Exercising remedies can be costly, uncertain, and time consuming, especially if bankruptcy is involved. Renegotiation may allow lenders to avoid these risks and costs, but

131. Bellucci & Mccluskey, *supra* note 21, at 529; *cf*. Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp., 846 F.3d 1, 8–13 (2d Cir. 2017) (reviewing history of Section 316(b) of the Trust Indenture Act of 1939, 15 U.S.C. § 77ppp(b), and the balance of individual and collective rights in context of collective actions clauses in indentures).

132. *See* Off. of the Comptroller of the Currency, Leveraged Lending, Comptroller's Handbook 1, 18 (Feb. 2008), https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/leveraged-lending/pub-ch-leveraged-lending.pdf ("As in all loans, the credit evaluation of the borrower involves a thorough understanding of the purpose and terms of the credit, the borrower's capacity to repay, and the quality of the secondary repayment sources.").

133. *See* Mitchell Berlin & Loretta J. Mester, *Debt Covenants and Renegotiation*, 2 J. Fin. Intermediation 95, 97, 119 (1992) (studying the value of option to renegotiate relative to borrower's *ex ante* creditworthiness and quality of information provided to lenders).

134. *See* Demerjian, *supra* note 110, at 1156–58 (finding that financial covenants transfer control to creditors for purposes of renegotiating contracts).

135. Renegotiation in LMEs does not always follow an actual default, but they regularly occur when loans are trading below par, reflecting a market belief that there is an increased risk of nonpayment or an imminent default. It is often the threat of an imminent default that precipitates negotiation under such circumstances.

it can also materially shift interests and value as between the lenders on the one hand and the borrower and its other stakeholders on the other.

A modification clause provides parameters for altering this balance *ex post*. If multiple lenders are involved, the modification clause must balance not only the interests of the borrower vis à vis the lenders, but also the interests among the lenders themselves. The presence of multiple lenders in a loan can materially alter a borrower's relationship with its lenders, shifting incentives to monitor the borrower and creating coordination problems that can impede renegotiation. How syndicates are formed can intentionally make renegotiation easier or more difficult as can the specific terms of the modification clause itself.[136] A primary purpose of a modification clause is to manage holdout friction,[137] typically by providing more flexibility for some contractual changes, such as covenants, while limiting changes to sacred rights.[138] Holdout friction is a double-edged sword. If the syndicate includes many lenders who are unlikely to easily agree to amendments, the friction can impose discipline on a borrower, but it can also make some beneficial amendments more difficult to implement when needed.[139]

Holdouts are not unique to restructurings, but their presence when a company or borrower is insolvent or in distress is so pervasive that corporate, contract, and bankruptcy laws all address them.[140] The need to manage holdout friction in multiple lender situations has long been recognized. In *Sage v. Cent. R. Co.*, the United States Supreme Court interpreted a mortgage giving a bondholder majority the right to direct the trustee to purchase collateral and thereafter transfer it to a new company ". . . organized upon such terms, conditions, and limitations, and in such manner, as the holders of a majority of said outstanding bonds . . . shall, in writing, request or direct."[141] The court affirmed an order sanctioning a reorganization arrangement that implemented transactions consistent with these terms, reasoning that the "large discretion" granted to the trustee was appropriate and consistent

136. *See* Mitchell Berlin, *Dancing with Wolves: Syndicated Loans and the Economics of Multiple Lenders*, Fed. Res. Bank of Phila. 1–7 (2007), https://www.philadelphiafed.org/the-economy/banking-and-financial-markets/dancing-with-wolves-syndicated-loans-and-the-economics-of-multiple-lenders (summarizing research on nature of borrower's relationship with lenders).

137. "Holding out" occurs when a minority of lenders either refuses to consent to an otherwise beneficial transaction with the goal of obtaining better treatment for itself or "free rides" to obtain benefits without paying its share of the costs of such transaction.

138. *See* Stephen J. Lubben, *Holdout Panic*, 96 Am. Bankr. L.J. 1, 5 (2022) (describing basic restructuring challenge "to find the point at which illegitimate power of holdouts is reduced without trampling on the legitimate rights of minority creditors").

139. *See* Berlin, *supra* note 133, at 7 (arguing that loan syndicates may be "designed to be very tough in contract negotiations over the core contract terms—to maintain a credible threat to discipline borrowers—while they are also designed to permit monitoring through stringent covenants that can be renegotiated relatively easily.").

140. Lubben, *supra* note 135, at 13 ("An individual creditor can be either an oppressed minority investor or a holdout. Majority holders can be either the group seeking an efficient and beneficial restructuring, or effectively an insider, collaborating with more formal insiders, to extract value from minority creditors. Which reality is genuine is highly dependent on the particular facts of the case at hand, and may be quite difficult for an outsider to discern. Restructuring law attempts to balance this uncertainty by providing a series of checks and balances.").

141. 99 U.S. 334, 337 (1878).

with law.[142] According to the court, the interests of numerous bondholders often create "diversities of views" that lead to "more than one combination, and a strife between" bondholders that can result in disparate and disadvantageous treatment.[143] Conversely, "[a]nother evil, that observation shows to be very frequent" occurs when a beneficial transaction is desired by the majority but is ". . . resisted by a small minority, unless they, the minority, are paid in full, or superior advantages are conceded to them at the expense of their fellow."[144] The *Sage* court found the mortgage provision to be reasonable because it balanced these competing interests, ". . . preventing the minority of the bondholders from forcing unreasonable and inequitable concessions from the majority," while preventing the majority from ". . . crush[ing] out rights of the minority, or subject[ing] them to any disadvantage. It [implicitly] authorized only such arrangements as would inure equally to the benefit alike of the majority and the minority."[145] This is the same balancing act reflected in syndicated loan modification clauses today.[146]

Just as it is difficult, if not impossible, to draft a loan agreement that anticipates every contingency, it is also difficult to draft a modification clause that gives lenders and a borrower the exact flexibility and protection each may desire when future circumstances warrant consideration of modifications.[147] A borrower, of course, would prefer to have the right to modify a loan agreement without any lender consent and holdout friction. The majority of lenders would optimally like sole control over amendments without holdout friction and the ability to take value from other stakeholders, including minority lenders. And the minority would prefer to have the right to approve all amendments both for protection from the majority and to benefit from holdout fiction. Majority and minority lender interests, however, are amorphous *ex ante* because lenders do not know who will be in the majority or minority in the future. Theoretically,

142. *Id.* at 343–45.

143. *Id.* at 340.

144. *Id.*

145. *Id.* at 341.

146. Most of the recent studies evaluating coercive consents focus on bondholders, but the fundamental tensions between bondholders and an issuer are the same as those between lenders and a borrower under a loan agreement. *See* 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, 1216 (1991). Coffee and Klein describe two problems faced by bondholders in coercive exit consents: "The bondholder must fear both the issuer's threats and its fellow bondholders' opportunism . . . . On the one hand . . . coercion may allow the issuer . . . to 'welch' on its indebtedness. On the other hand, the holdout problem may justify some coercion in order to prevent the minority from frustrating the majority's interest in achieving a necessary scaling down of the corporation's debt in a way that taxes all bondholders evenly." *Id.*; *see also* Kenneth Daniels & Gabriel G. Ramirez, *Debt Restructurings, Holdouts, and Exit Consents*, 3 J. FIN. STABILITY 1–2 (2007) (finding that ". . . the likelihood of using an exit consent is associated with proxies for hold-out problems").

147. *See* Diane Lourdes Dick, *Alliance Politics in Corporate Debt Restructurings*, 39 EMORY BANKR. DEV. J. 285, 320–27 (2023) (discussing potential terms and balances in modification provisions); *see also* BELLUCCI & MCCLUSKEY, *supra* note 21, at 515 ("Determining whether a particular amendment requires unanimous consent or instead only requires a lesser consent threshold is sometimes less than certain.").

an optimal agreement should be the one that most efficiently balances these interests while enabling beneficial renegotiations.[148]

When the goal is to equally and ratably maximize the recovery for all lenders, the conventional modification clause functions relatively well under most circumstances.[149] These clauses retain the holdout problem for changes to sacred rights, but in a distressed or default situation where these are most likely to matter, bankruptcy law provides the ultimate leverage to overcome this friction. As indicated above, loan modifications to non-sacred right provisions can transfer substantial value and control away from lenders to other stakeholders, including by permitting additional debt, subordination, or the grant of collateral to others. There may be situations, however, where change is necessary to attract new capital or permit other value maximizing transactions that are otherwise prohibited by the loan agreement. If all the lenders conclude the transactions are necessary to maximize recoveries on their loans and no lender seeks extra value as a holdout, notwithstanding any increased risks, they should vote to modify the loan agreement to permit the transactions. Giving a majority control mitigates holdout friction, any friction caused by differences in opinion regarding risks or benefits of proposed transactions, and procedural costs related to obtaining consents from 100 percent of the lenders. If changes are also needed to sacred rights, the ability to alter non-sacred rights permits the majority to exercise a considerable amount of coercion through the use of exit consents modifying non-sacred rights.[150] So long as these transactions always give the minority the option to participate in the relevant transactions on an equal and ratable basis as the majority, the modifications arguably do not transfer value to the majority from the minority without consent.

148. Recent studies evaluating the rise of "covenant lite" loan agreements suggest these loan terms may not be the result of lower credit standards. Instead, many loan agreements contain "split control rights." Revolving lenders continue to have more traditional maintenance covenants in loan agreements and are naturally in a better position to monitor and control debtors. Giving revolving lenders this additional leverage makes sense for at least two reasons. First, revolving lenders ordinarily have better information regarding the borrower and are in a better position to monitor and control a borrower's behavior. Second, giving revolving lenders the sole leverage to renegotiate terms upon a breach of a maintenance covenant mitigates bargaining friction that could exist if all lenders in the facility could veto changes. In short, evidence—including lower default rates—suggests that covenant lite loans with split control rights are not intended to increase risky behavior, but they are designed to make monitoring and renegotiation more efficient for all lenders. *See* Edison Yu, *Banking Trends: Measuring Cov-Lite Right*, FED. RES. BANK OF PHILA. 5 (2018), https://www.philadelphiafed.org/the-economy/banking-and-financial-markets/banking-trends-measuring-cov-lite-right.

149. *See* Coffee & Klein, *supra* note 143, at 1216–17 (arguing that coercive exchanges should neither be wholly legitimized nor eliminated, but should be permitted where they can be balanced and disciplined for stakeholders); Andrew L. Bab, *Debt Tender Offer Techniques and the Problem of Coercion*, 91 COLUM. L. REV. 846, 889–90 (1991) ("The exit consent solicitation and other techniques used by financially troubled issuers and assailed as coercive have not been invalidated in any court . . . . [E]vidence strongly suggests that these techniques have only a marginal impact and cannot pressure bondholders into tendering at an unfair price.").

150. *See* Katz v. Oak Indus. Inc., 508 A.2d 873, 880–81 (Del. Ch. 1986) (holding that consent solicitation linked to exchange offer was permitted by indenture, was not "wrongfully coercive," and did not violate implied duties of good faith where offer was made to all noteholders); *see also* Coffee & Klein, *supra* note 143, at 1224–25 n.55 (noting that the TIA does not prohibit amendment of other "important protective covenants" in an indenture besides core payment terms, the threat of which could be used to coerce holdout bondholders).

A rational lender with fiduciary duties to its own investors could not be blamed for agreeing *ex ante* that a majority of lenders can modify non-sacred rights on an equal and ratable basis for at least three reasons. First, the future majority might seek to eliminate holdout friction. Second, if it is in the minority, it should generally benefit from majority decisions because majority lenders have fiduciary duties to their investors and should make decisions in good faith and in the best interests of their own loans, thereby affecting the minority's position similarly. Third, lenders retain some modicum of protection in law and equity from fraudulent transfers and breaches of fiduciary duties by officers and directors, although these protections have often proven inadequate or outside their control.

However, this reasoning does not apply if loan agreements grant a majority of lenders the right to use modification clauses in their sole discretion to appropriate value from the minority.[151] Lenders evaluate credit risk (i.e. risk of nonpayment) at the inception of a loan and price the loan's interest rate accordingly. Lenders generally do not know which loans will be in a majority or minority in the future, and loans are not initially priced based on actual or potential majority status. They all initially trade similarly on account of the sacred rights of pro rata treatment and the collective design of the loan agreement. If at the inception of a loan lenders expect loans to carry an additional risk of non-payment attributable to the majority's ability to engineer non-pro-rata treatment among the syndicate of lenders, there should be some evidence that lenders account for this risk.[152] Given the importance of this issue and the potential for a majority windfall and complete loss for the minority it could be presumed in the absence of evidence to the contrary that it is not priced into loans at inception in such a way as to compensate the minority for that risk.

Further, granting a majority such rights effectively turns the holdout problem on its head, creating an entirely new set of inequities and concerns, trading one disequilibrium (holdout friction) for another (majority tyranny). Giving the majority the right to unreasonably and inequitably extract concessions from the minority is not the appropriate response to the minority unreasonably and inequitably extracting concessions from the majority as holdouts. Giving a majority of lenders carte blanche through modification clauses to indirectly or practically alter ratable treatment or other sacred rights arguably renders the provisions superfluous—a result contrary to interpretive principles.[153]

151. This reasoning might arguably hold for a lender who knows that it will control the majority of loans in the future and who has no concerns over any reputational harm it might suffer exercising that control to disadvantage other lenders.

152. The evidence may actually be to the contrary. When majority lenders execute a cooperation agreement in anticipation of an LME, their loans will trade higher than the loans of the excluded minority lenders. In other words, the majority premium comes *ex post*.

153. "An interpretation of a contract that has the effect of rendering at least one clause superfluous or meaningless is not preferred and will be avoided if possible. Rather, an interpretation that gives a reasonable and effective meaning to all terms of a contract is generally preferred to one that leaves a part unreasonable or of no effect." Galli v. Metz, 973 F.2d 145, 149 (2d Cir. 1992); *see also* Columbus Park Corp. v. Dep't of Hous. Pres. & Dev., 598 N.E.2d 702, 708 (N.Y. 1992) ("a construction which makes a contract provision meaningless is contrary to basic principles of contract interpretation"); *cf.*

Evidence from case law and industry commentaries supports this conclusion.[154] Case law and commentaries interpreting similar modification clauses in indentures for debt securities, which are also interpreted as contracts under New York law, are instructive.[155] The *Commentaries*, for example, address the limits on the same types of modification clauses in indentures:

> It has been stated as a general rule that the power granted in an indenture to a majority of bondholders to bind the minority must be exercised in good faith. Thus, in *Hackettstown National Bank v. D. G. Yuengling Brewing Co.*, the court held that an agreement by a collusive majority waiving conditions and postponing the payment of interest for the purpose of compelling the minority to sell out to them would not bind the minority.[156]

Hackettstown involved the interpretation of an indenture modification clause that permitted three quarters of the bondholders to modify bondholder rights, including the time for payment of principal or interest. After the defendant brewing company defaulted on the interest payments due in January and July of 1894, Hackettstown National Bank accelerated the bonds and demanded payment in accordance with the terms. However, before the Bank's notice of acceleration, David G. Yuengling, the principal stockholder of the defendant, entered into an agreement with John F. Betz ". . . which had for its object the purchase of a sufficient number of the bonds to enable Betz, in conjunction with Yuengling, and some of his relatives and friends, who were likewise bondholders, to control three-fourths in value of the outstanding bonds of the series."[157] Under the agreement, Betz would buy sufficient bonds to control a foreclosure and Yuengling personally agreed to pay any coupons maturing on the bonds purchased by Betz after January 1, 1895. By December 1894, the total bonds controlled by

Marblegate, 846 F.3d at 8–13 (Straub, J., dissenting) (arguing that the plain meaning of Section 316 (b) prohibits even indirect impairment of sacred rights).

154. *See* Lightfoot v. Union Carbide Corp., 110 F.3d 898, 906 (2d Cir. 1997) (finding that interpretation is guided by "the customs, practices, usages and terminology as generally understood in the particular trade or business"); Skandia Am. Reinsurance Corp. v. Scheneck, 441 F. Supp. 715, 724 (S.D.N.Y. 1977) ("It is presumed that the parties had [the relevant] law in contemplation when the contract was made, and the contract must be construed in that light." (citing Dolman v. United States Trust Co., 157 N.Y.S.2d 537, 541–42 (1956))).

155. *See* Bellucci & Mccluskey, *supra* note 21, at 513 (noting that syndicated credit agreement amendment rules follow those used in other debt instruments, including indentures); *id.* at 571 ("What has been relatively pronounced in more recent times, however, has been the convergence between the high-yield or 'junk' bond market and the leveraged loan market as the investor base, covenants and other deal terms, pricing dynamics, and liquidity in the two markets have become increasingly integrated and interdependent.").

156. Commentaries on Model Debenture Indenture Provisions 1965, *supra* note 104, § 9-2, at 307 (citing Hackettstown Nat'l Bank v. D.G. Yuengling Brewing Co., 74 F. 110 (2d Cir. 1896)). The *Commentaries*, which courts have repeatedly relied on to interpret indentures, also reference Haines, *supra* note 12. Haines evaluates modification provisions in corporate mortgages and trust indentures, finding that "it is the settled policy of the courts to construe rigidly against the majority" powers of modification granted in modification provisions and that such powers must "be used only for the common good of all . . . . [W]hen the alteration does not prefer the majority, nor show bad faith, nor appear patently unsound from the selfish view of a secured creditor, modification plans will be upheld." *Id.* at 66–68.

157. *Hackettstown Nat'l Bank*, 74 F. at 111.

Betz and Yuengling exceeded three fourths of the issue. In December 1894, these holders executed an agreement postponing interest coupons, whether past due or to become due on or before July 1, 1896, to January 1, 1900, and the agreement was memorialized by the company and the trustee. At a meeting of bondholders on December 29, 1894, the same bondholders passed an extraordinary resolution pursuant to the indenture to the same effect.

The trial court refused to submit to the jury the question of whether the bondholder amendments were valid on the basis that at least three quarters of the bondholders had executed the consent. The Second Circuit held that this was error and reversed, citing to the well-settled principle requiring majority bondholders to exercise delegated powers in good faith:

> Agreements between bondholders lodging in the majority in interest the power of control over the common fund contemplate that those having the largest interest in its conservation will be the most zealous. They are intended to minimize the power of a factious minority to thwart the general good. But every delegation of power implies that it will be honestly exercised.[158]

The court found that ". . . if the consent was made and the resolution passed by the majority of bondholders, not in the common interest of all . . . it was a corrupt and unwarranted exercise of the power of the majority."[159] The Second Circuit reasoned that such actions would violate the "community of interest" among the bondholders that ". . . 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."[160] Although Betz and Yuengling had the right to purchase and vote the bonds, the court found that under this community of interest ". . . no purchaser could acquire any right to employ them as instruments in a conspiracy to defraud the minority bondholders."[161]

It is not clear whether the *Hackettstown* court found the majority's duty of good faith as matter of interpretation based on language and reasonable inference or as a matter of construction or other gap filling.[162] The Court of Appeals of New York would not decide *Wood v. Lucy, Lady Duff-Gordon*—which recognized implied duties of good faith—for another 20 years.[163] But *Hackettstown*'s reasoning has deep roots in pre-existing equity. The Second Circuit borrowed its "community of interest" reasoning from the United States Supreme Court's decision in *Jackson*,[164] which involved "a bill in equity" brought by bondholders for equitable relief from a mortgage bondholder's purchase of mortgaged property through a judicial sale in collusion with borrower's management and

158. *Id.* at 113.
159. *Id.* at 113–14.
160. *Id.* at 112 (citing Jackson v. Ludeling, 88 U.S. (21 Wall.) 616, 617 (1874)).
161. *Id.* at 114.
162. *See* Weiskopf, *supra* note 43, at 226–27 (suggesting that "[t]he exhaustion of all interpretive steps is not needed to create a 'gap' designed to leave room for mandated observance of perceived minimum decencies in the course of performance").
163. *See* 118 N.E. 214 (N.Y. 1917).
164. 88 U.S. 616.

directors. Although the buying parties had technically complied with the "legal forms" with respect to the sale, the court found it to be "grossly inequitable" throughout.[165] The court invalidated the sale and restored the mortgage liens, reasoning that if it were to sustain the sale, it ". . . should sanction a great moral and legal wrong, give encouragement to faithlessness to trusts, and confidence reposed, and countenance combinations to wrest by the forms of law from the uninformed and confiding their just rights."[166] The court also held that the single bondholder breached a duty to act for the collective benefit of the other bondholders, reasoning that:

> When two or more persons have a common interest in a security, equity will not allow one to appropriate it exclusively to himself, or to impair its worth to the others. Community of interest involves mutual obligation . . . . [I]t would be against the principles of equity to allow a single creditor to destroy a fund to which other creditors had a right to look for payment.[167]

More generally, at least implicitly, these cases and the pro-rata treatment reflected in loan agreements echo the similar and long-standing equitable principles protecting creditors' rights against unfair discrimination[168] and to be treated fairly and equitably.[169] Cases in equity have also long held that compositions of creditors—contractual restructurings—are ". . . founded upon the basis of entire equality and reciprocity among all the creditors," requiring ". . . the utmost good faith."[170] If made in bad faith or with secret arrangements, they are utterly

165. *Id*. at 631.

166. *Id*. at 632.

167. *Id*. at 622–23; *cf*. *Marblegate*, 846 F.3d at 11–12 (citing legislative history of Section 316(b) of the Trust Indenture Act of 1939 demonstrating legislative concerns with majority bondholders making specified changes to all bondholders' rights to payment of principal and interest through "reorganization[s] by contract" or "formal changes to the contractual terms governing the debt").

168. *See* Am. United Mut. Life Ins. Co. v. Avon Park, 311 U.S. 138, 143–45 (1940) (invalidating Chapter IX plan where fiscal agent granted a "special favor or inducement" not available to other creditors, in violation of the general rule prohibiting unfair discrimination and requiring equality among similarly situated creditors); *see also* Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11,* 72 Am. Bankr. L.J. 227, 249 (1998) ("Under the Markell test, a rebuttable presumption of unfair discrimination arises when there is: (1) a dissenting class; (2) another class of the same priority; and (3) a difference in the plan's treatment of the two classes that results in either (a) a materially lower percentage recovery for the dissenting class (measured in terms of the net present value of all payments), or (b) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution.").

169. *See* Czyzewski v. Jevic Holding Corp., 580 U.S. 451, 465 (2017) (explaining that the bankruptcy code is "designed to enforce a distribution of the debtor's assets in an orderly manner . . . in accordance with established principles rather than on the basis of the inside influence or economic leverage of a particular creditor"); Case v. Los Angeles Lumber Co., 308 U.S. 106, 117, 123 (1939) (finding that "fair and equitable" are "words of art" that respect absolute priority, having "acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations").

170. 1 Joseph Story, Commentaries on Equity Jurisprudence, as Administered in England and America § 378 (12th ed. 1877); *see also* CIBC Bank & Trust Co. v. Banco Cent. Do Brasil, 886 F. Supp. 1105, 1114 (S.D.N.Y. 1995) (quoting Almon v. Hamilton, 3 N.E. 580, 580 (N.Y. 1885)) (finding that, in approving a composition, the law "'enforces wholesome morality, and inculcates the principles of honest and fair dealing by defeating any advantage attempted to be gained, either by working upon the necessities of the debtor, or by colluding with him'").

void.[171] Justice Story summarized equity's general focus on protecting creditors over 100 years ago when he wrote:

> It must be a fundamental policy of all enlightened nations to protect and subserve the rights of creditors; and a great anxiety to afford full relief against frauds upon them has been manifested not only in the civil law, but from a very early period, in the common law also.[172]

Modification clauses are drafted with this context and history as background. Because the borderline between terms implied-in-fact and implied-in-law is blurred, cases interpreting the covenant of good faith and fair dealing also provide helpful context for interpreting modification clauses. New York courts have recognized implied covenants since Justice Cardozo's decision in *Wood v. Lucy, Lady Duff-Gordon*, where he reasoned promises could be implied where an agreement, although lacking a promise, ". . . may be 'instinct with an obligation' imperfectly expressed."[173] More recently, two seminal cases evaluated the New York implied covenant of good faith and fair dealing in the context of indenture exit consents. *Katz v. Oak Indus. Inc.*,[174] and *Kass v. E. Air Lines, Inc.*,[175] hold that exit consents can be coercive so long as they are not "wrongfully" so.[176] The courts do not define "wrongful coercion," but they both implicitly reasoned that the relevant exit consents in those cases were not wrongful, in part, because the incentives for consent were offered equally and ratably to all the bondholders.[177] Integral to the court's holding in *Katz* was its finding that the linking of an exchange offer and consent solicitation did not involve a risk that bondholder interests "will be affected by a vote involving anyone with a financial interest in the subject of the vote other than a bondholder's interest."[178] Specifically, the court found:

> 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 [the] 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.[179]

171. *See* Story, *supra* note 167, § 379.
172. *Id.* § 350.
173. 118 N.E. at 214.
174. 508 A.2d 873 (Del. Ch. 1986).
175. Nos. 8700, 8701, 8711, 1986 WL 13008 (Del. Ch. Nov. 14, 1986).
176. The *Katz* court held that a breach of the implied covenant may be found where 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." *Katz*, 508 A.2d at 880.
177. *See id.* at 881; *Kass*, 1986 WL 13008, at *15; s*ee generally* James H. Millar, *Revisiting Good Faith and Fair Dealing Challenges by Non-Participating Holders to Indenture Amendments Effectuated Through Use of Exit Consents*, *in* Norton Annual Survey of Bankruptcy Law 151 (2017) (discussing *Kass* and *Katz* and implied duties in context of non-pro rata exit consents).
178. *Katz* 508 A.2d at 881.
179. *Id.*

Had the consents in *Kass* and *Katz* not involved equal and ratable opportunities for the minority lenders, the courts' reasoning indicates they could have found that, while the indenture furnished the majority of lenders with modification discretion, that discretion had to be exercised on an equal and ratable basis for all the lenders.[180]

This conclusion is bolstered by other implied duty cases holding that even when contractual discretion is explicitly granted under a contract, it has implied limits. Under New York law, "[w]here the contract contemplates the exercise of discretion, [the implied duty of good faith and fair dealing] includes a promise not to act arbitrarily or irrationally in exercising that discretion."[181] Further, a contract party must exercise "discretion as would a reasonable person"[182] and may not use it ". . . malevolently, for its own gain as part of a purposeful scheme designed to deprive its counterparty of the benefits of a contract."[183] A seminal case for this proposition is *Dalton v. Educational Testing Services*, 87 N.Y.2d 384 (N.Y. 1995). In *Dalton*, a standardized testing firm refused to release a student's second test score, which had increased by an unusually large margin relative to a previous score, concluding that someone else may have completed the test. The parties' contract allowed the student to provide relevant information supporting the validity of the test score, but the testing firm did not consider it. The Court of Appeals of New York held that this breached the implied duty of good faith and fair dealing.[184] The court found that the firm had discretion when considering additional information but reasoned that it came with an implied ". . . promise not to act arbitrarily or irrationally in exercising that discretion."[185] Under this standard, a court will ordinarily not interfere with the exercise of discretion unless it is performed arbitrarily or irrationally, but the court reasoned that the firm's complete failure to even exercise discretion was clearly a breach of this duty.[186] New York law recognizes limits in contractual discretion which should apply to limit the discretion granted to majority lenders in loan agreements.

180. *Compare*, *In re* Loral Space & Commc'ns Inc., Nos. 2808-VCS & 3022-VCS, 2008 WL 4293781, at *35 (Del. Ch. Sept. 19, 2008) (holding that disparate payment for consent was not prohibited by implied duties where (i) no indenture amendment was involved and (ii) bondholders were being redeemed early with payment in full (absent make whole)), *with* Whitebox Convertible Arbitrage Partners, L.P. v. World Airways, Inc., 2006 WL 358270 (N.D. Ga. Feb. 14, 2006) (holding special incentives to certain bondholders in two partial redemptions violated express covenant in indenture on partial redemptions and implied duty of good faith and fair dealing).

181. Cordero v. Transamerica Annuity Serv. Corp., 211 N.E.3d 663, 670 (N.Y. 2023) (internal citations omitted).

182. Rus, Inc. v. Bay Indus., Inc., 322 F. Supp. 2d 302, 310 (S.D.N.Y. 2003) (citing Misano di Navigazione, Spa v. United States, 968 F.2d 273, 274–75 (2d Cir. 1992)).

183. Najjar Grp., LLC v. W. 56th Hotel LLC, 850 F. App'x 69, 72 (2d Cir. 2021) (summary order) (alteration adopted; internal quotations and citations omitted).

184. *Dalton*, 87 N.Y.2d at 392–93.

185. *Id*. at 389.

186. *Id*. at 392–93; *see also* Whitestone REIT Operating P'ship, L.P. v. Pillarstone Cap. REIT, 2024 Del. Ch. LEXIS 16, at *25–27 (Jan. 31, 2024) (holding that adoption of shareholder rights plan that frustrated redemption right under a limited partnership agreement breached the implied duty of good faith and fair dealing where investor reasonably expected at time of contracting that it would be able to redeem without penalty).

While plain language and commonsense inferences should make it unnecessary to gap fill with implied duties, both processes should produce the same result. In addition, it is not necessary to expressly prohibit fraudulent transfers, bad faith, or other inequitable conduct in a contract, so the lack of language requiring the majority to act in good faith, ratably, or equitably cannot conclusively establish freedom to act otherwise.

Finally, fundamental principles of contract formation may also suggest minority lenders do not intend to give majority lenders unlimited authority to bind them through modifications. Under New York law "fundamental to the establishment of a contract modification is proof of each element requisite to the formulation of a contract, including mutual assent to its terms" and consideration.[187] It is often difficult, however, to establish that consideration is being provided to minority holdout lenders who do not execute an exit consent. They do not receive a "consent fee" if they do not execute the modification, and many exit consents arguably only provide benefits to the borrower and exiting majority lenders. A loan modification arguably cannot bind minority lenders without consideration being provided to them. There is however a narrow exception to this rule where the modification is in writing and signed either by the party against whom the amendment is sought to be enforced or "by his agent."[188] It is beyond the scope of this article to evaluate the specifics or parameters of this agency relationship but, to the extent majority lenders intend to bind minority lenders without their consent and without consideration in reliance on N.Y. Gen. Oblig. Law § 5-1103, they arguably do so as agents. Similar principles which render covered agreements and transfers void unless they are in writing and executed by the affected party or "its agent" apply under the statute of frauds.[189]

Of course agents are fiduciaries that ". . . must act in accordance with the highest and truest principles of morality" and good faith.[190] They cannot acquire indirect advantages performing their duties and obligations as agents at the

187. *See* Dallas Aero., Inc. v. CIS Air Corp., 352 F.2d 775, 783 (2nd Cir. 2003); *see also* Nassau Trust Co. v. Montrose Concrete Prods. Corp., 436 N.E.2d 1265, 1269 (N.Y. 1982), *appeal denied*, 57 N.Y.2d 674 (1982) ("Modification of the terms of a mortgage requires consideration except when a statute, such as section 5-1103 of the General Obligations Law dispenses with the need for consideration when a writing . . . exists.").

188. *See* N.Y. Gen. Oblig. Law § 5-1103 (Consol. 2025) ("An agreement, promise or undertaking to change or modify, or to discharge in whole or in part, any contract, obligation, or lease, or any mortgage or other security interest in personal or real property, shall not be invalid because of the absence of consideration, provided that the agreement, promise or undertaking changing, modifying, or discharging such contract, obligation, lease, mortgage or security interest, shall be in writing and signed by the party against whom it is sought to enforce the change, modification or discharge, or by his agent.").

189. *See id.* § 5-701 ("Every agreement, promise or undertaking is void, unless it or some note or memorandum thereof be in writing, and subscribed by the party to be charged therewith, or by his lawful agent . . . ."); *id.* § 15-301 ("A written agreement or other written instrument which contains a provision to the effect that it cannot be changed orally, cannot be changed by an executory agreement unless such executory agreement is in writing and signed by the party against whom enforcement of the change is sought or by his agent.").

190. Elco Shoe Mfrs., Inc. v. Sisk, 183 N.E. 191, 192 (N.Y. 1932).

principal's expense.[191] An agent acting adversely to a principal is guilty of fraud[192] and must deliver to the principal anything it receives as a result of a violation of its duty.[193] Case law has not focused on this yet in the context of LME exit consents, but depending on the circumstances it could support a conclusion that the discretion granted by the minority to the majority to modify a loan agreement must, at a minimum, be exercised in good faith and on an equal and ratable basis for all lenders.

Alternative Hypotheses and Sharon Steel

Ultimately, determining parties' intent requires a court to choose among reasonable inferences. The LME hypothesis fails to consider a modification clause in context and hinges on the inference that lenders in the same class intend to enable a future, unknown majority of the class to modify the loan agreement immediately before exiting in order to increase its repayment prospects at the minority's expense.[194] Based on the evidence outlined above, this hypothesis fails to weigh fully the objective expectations of lenders, both at loan inception and the time of renegotiation. As a result, it is arguably neither the most reasonable nor best conclusion relative to alternatives.

A modification clause is unnecessary to change a loan agreement. Without it, lenders know *ex ante* that, if change becomes necessary in the future, they will still have the option to renegotiate or rely on existing rights, exercising remedies following an event of default. With or without a modification clause, there is no reason to infer that any syndicate lender is likely to accept modified terms that it believes or knows will leave it worse off than the status quo. Even when sanctioning disproportionate treatment through an LME *ex post*, majority lenders do not agree to it unless they believe it increases their own, then-existing potential investment return. So, it should be self-evident that, with or without a modification clause, the *ex ante* intent of the parties to a loan agreement is to give each lender or some defined majority of lenders the discretion to negotiate future modification proposals that do not worsen their own then-existing loan repayment prospects.

This context is critical because the conventional modification clause certainly gives the majority discretion to shift value and property rights through *ex post* modifications, and this power (if unlimited) can eviscerate sacred rights, at least practically. Loan agreement language, however, also evidences a collective design and an intent to protect sacred rights, such as pro rata repayment.[195] These limits and the grant of discretion can be reasonably harmonized in the

191. *See* Sokoloff v. Harriman Estates Dev. Corp., 754 N.E.2d 184, 189 (N.Y. 2001).
192. *See* Ryan v. Simons, 98 N.Y.S.2d 243, 247 (Sup. Ct. 1950).
193. *See Sokoloff,* 754 N.E.2d at 189.
194. *See supra* notes 88–95.
195. *See* ICG Global Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020, 2022 N.Y. Misc. LEXIS 10375, at *24 (Sup. Ct. Oct. 17, 2022) (rejecting narrow reading of sacred rights provisions on motion to dismiss because a narrow reading would vitiate equal repayment provisions and be contrary to court's obligation to consider context of the entire agreement).

LME context without rendering any provision meaningless if sacred rights are at least legally (if not functionally) preserved, and either (i) the modifications alone are clearly and objectively intended to improve the majority's then-existing loan repayment prospects directly rather than from other new value or consideration (thereby similarly treating the minority's loans), or (ii) the minority is offered equal and ratable treatment with the majority. This does not mean that all changes require unanimous consent or that they must result in pro rata treatment. It simply means that all lenders in the same tranche should be offered the same consideration and treatment options directly or indirectly linked to the modification. If a minority of lenders refuses the offer, the majority may proceed.[196]

This interpretation is consistent with the "collective design" of the loan agreement and the purpose of mitigating holdout friction. In effect, this creates three potential *ex post* renegotiation results: (i) modifications that treat lenders the same or disparately with each affected lender's consent, (ii) modifications that treat all lenders the same with majority consent, and (iii) modifications with majority consent that treat holdouts disparately only because they refused to accept equal and ratable treatment with the majority. No reasonable or logical basis exists, however, to infer lenders agree *ex ante* that a future, unknown majority of lenders can use this discretion to benefit themselves at the expense of the minority when repayment in full is unlikely. This turns the holdout problem into a tyranny of the majority and converts the clause into an optional indemnity or guaranty, allowing majority lenders to take minority value to support their claims. In extreme cases, it can also render sacred right provisions completely superfluous. Similarly, there is no basis to infer that a contract's failure to expressly prohibit fraudulent transfers, bad faith, or other inequitable conduct, means the majority's modification discretion is unlimited or that it has license to act inequitably. In fact, case law and history support the exact opposite inference.

Arguments that sacred rights need be preserved legally but not functionally are also a red herring and obscure the LME's adverse effects on all the other obligations and agreements contained in a loan agreement, including complex agreements regarding the balance of control and risk among stakeholders. Even if an LME preserves sacred rights, it often still adversely affects minority lenders by transferring value, control, and property away from them. This is easy to see where collateral is released from a lien or liens are subordinated to

196. In litigation over the Wesco Aircraft Holdings, Inc., 2022 LME, the bankruptcy court commented in dicta that indentures permitting supermajority approval for lien releases implicitly contemplated future, non-pro rata transactions. *See* Report and Recommendation at 3, Wesco Aircraft Holdings, Inc. v. SSD Invests. Ltd., Adv. No. 23-3091 (Bankr. S.D. Tex. Jan. 15, 2025), ECF No. 1519. This is correct only generally in the sense that, if a transaction linked to a modification allows all lenders to participate equally and ratably, and a minority holdout refuses to participate, then, so long as sacred rights are not modified, the majority may proceed on a non-pro rata basis without unanimous consent. In such case, the parties have all elected *ex post* to participate or not, and the majority cannot be faulted for any difference in treatment. These provisions do not, however, expressly authorize a majority of lenders to use the modification clause to pursue a non-pro rata transaction that is not offered to the minority and thus exploits them.

senior liens. This alters the minority lenders' existing *in rem* rights; stripping covenants has a similar affect by ceding control and value to the company and other stakeholders. Thus, even where sacred rights are legally or technically unaltered by an LME, lenders often still lose real or personal property rights through loan modifications. The typical loan agreement prohibits a majority from releasing collateral or covenants solely with respect to the minority lenders while keeping the collateral and covenants for themselves, but exit consents integrated into aggressive LMEs can have this effect under the LME hypothesis. Preserving sacred rights legally but not practically does not answer the question of whether non-pro rata loan modifications exceed modification discretion more generally.

A better explanation is that a modification clause is intended to protect lenders equally and ratably, even with respect to amendments to non-sacred terms and especially since the primary interest of the lenders under a loan agreement is pro rata repayment. Considering the collective design of a loan agreement, basic principles of contract law, case law, and commentaries, minority lenders could reasonably expect the majority to act for the benefit of all lenders equally and ratably, whether that be in exercising remedies or amending the agreement. Even if this were not true, and a specific situation warrants non-pro rata treatment, the minority should nevertheless expect that majority lenders will exercise amendment discretion consistent with agency principles or, at a minimum, principles of good faith and fair dealing.

Of course, sophisticated parties could demand different terms that explicitly explain their intent, but that charge applies to both sides of this debate. It may actually apply with more force to the borrower and arranger responsible for negotiating terms than it does to term lenders who routinely have little say in the terms. For example, borrowers could negotiate for language expressly providing that "all modifications not expressly prohibited, including modifications integrated into LMEs that disproportionately benefit majority lenders, are permitted," but they do not. The failure to negotiate such terms does not logically lead to an inference that minority lenders intend to give the majority unbounded modification discretion. Like a false dilemma (or false dichotomy) fallacy, this conclusion ignores that anticipating and contracting for contingencies is costly and there are many reasons—both practical and strategic—that parties decide to leave a contract silent or incomplete.[197] More specifically, modification clauses arguably already protect sacred rights practically and until recently have worked relatively well under market norms. It could also mean that the absence of more explicit language is intentional—not intended to give majority

197. *See* Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 822 (1992).

> Incompleteness of contracts is also a function of the parties' interests. Settling in advance even those contingencies that can be foreseen is costly. Many foreseeable contingencies, given their low probability, are better left unnegotiated ex ante in the hopes that they will not materialize or will be handled cooperatively ex post if they do. And strategic considerations may lead one or both parties to remain silent about a particular issue.

Id.

lenders carte blanche to appropriate value but to rely on judicial limits on a case-by-case basis as determined in accordance with established principles of good faith and fair dealing, equity, agency, or the balancing test articulated in *Sharon*.[198] Interpreting the conventional syndicated loan modification clause as evidencing an intent to permit any act that is not explicitly prohibited ultimately requires unreasonable or flawed logic that relies on irrelevant, inconsistent, ignored, and/or incomplete evidence.[199]

While evidence suggests a better and perhaps the best inference is that a modification clause does not authorize a majority to benefit itself while disenfranchising the minority through an exit consent, recent LMEs depend on the contrary view. So, assuming these contrary views are objectively reasonable, modification clauses are ambiguous. As to preserving sacred rights legally and practically, courts have already found that similar language under TIA § 316(b) is ambiguous and capable of more than one meaning.[200] Cases interpreting exit consents have, at least implicitly, also found that exit consents must apply to lenders equally and ratably.[201] In most cases, given the syndication process, the typical loan modification clause will not depend upon particularized intentions of the borrower and the affected lenders. The court must measure the probative force of each inference to determine the "objective" intent of the parties and resolve any uncertainty regarding competing or conflicting inferences. That exercise, while essential, is not completely objective, and it does not necessarily increase certainty and predictability in interpretation of standard loan agreement clauses.[202]

198. *See id*. at 865–66 ("Silence . . . can constitute 'indirect' consent to courts using these default rules to supply terms when a gap exists in the parties' expression of consent.").

199. LME proponents contend that customary, majority-governed modification discretion gives majority lenders carte blanche to do whatever they want (so long as they do not alter terms of sacred rights). This argumentum ad ignorantiam fails to consider, among other things, that limits nevertheless exist, both as a matter of law and common sense. For example, otherwise applicable law prohibits the majority from amending a loan agreement to permit prospective fraud or compositions of creditors that secretly benefit a subset of the creditors. See, e.g., White v. Kuntz, 107 N.Y. 518, 525 (N.Y. 1887) ("[E]very agreement made by one creditor for some advantage to himself over other creditors who unite with him in a composition of their debts, is fraudulent and void."); Sterling Nat'l Bank & Tr. Co. v. Giannetti, 384 N.Y.S.2d 176, 176 (N.Y. App. Div. 1976)("[A] written waiver in any form cannot operate to shield a party from his own fraud."). One could also imagine absurd amendment proposals that stretch other contract principles beyond legal and equitable limits. It is hard to imagine that a customary majority modification provision should be interpreted to permit a majority of lenders to approve an amendment binding other lenders to buy a set quantity of borrower's products in the ordinary course of business as a way of increasing borrower's liquidity.

200. *See Marblegate,* 846 F.3d at 6 (finding the phrase "right . . . to receive payment" under TIA § 316(b) ambiguous with respect to protection of legal versus practical rights); CNH Diversified Oppt's Master Acct. L.P. v. Cleveland Unlimited, Inc., 160 N.E.3d 667, 674–75 (N.Y. 2020) (implicitly finding language in indenture similar to TIA § 316(b) ambiguous). *Marblegate* and *Cleveland Unlimited* did not involve modifications to indentures but instead involved a foreclosure and strict foreclosure, respectively, that indirectly affected bondholders' sacred rights. *See generally* George W. Shuster, *The Trust Indenture Act and International Debt Restructurings*, 14 Am. Bankr. Inst. L. Rev. 431, 438–39 (2006) (evaluating TIA § 316(b) legislative history and meaning).

201. *See Katz*, 508 A.2d at 881; *Kass*, 1986 WL 13008, at *15.

202. *See* R. George Wright, *Objective and Subjective Tests in the Law*, 16 U. N.H. L. Rev. 121, 124 (2017) ("What is thought by the law to be subjective actually pervades and informs, in multiple ways, what is thought to be objective, and vice versa. The objective and the subjective, in effect, unavoid-

Fortunately, the Second Circuit has provided a commonsense solution. Under such circumstances, the wisdom of *Sharon* becomes evident. It is unnecessary to determine precisely which inferences are best. If inferences lead to two alternative interpretations, making the provision ambiguous, *Sharon* demands a construction that sacrifices the principal interests of each party as little as possible. Absent unusual circumstances, this should prohibit the majority from using exit consents integrated into an LME to extract value at the minority's expense.[203] This conclusion takes virtually nothing from the borrower's and majority's valid interests in limiting holdout friction in renegotiation while protecting the lenders' sacred rights of payment and pro rata treatment. If the majority wants to pursue an LME, it can offer all the lenders the same terms the majority will get. Its unwillingness to do so should create a rebuttable presumption that it is seeking to extract value from the minority to fund the LME in violation of sacred rights, equitable principles, and minimum decencies.[204] This is precisely what has been happening in the most aggressive LMEs.

Conclusion

"Disfavored lenders" have largely followed a similar script, alleging LME-integrated loan amendments are void because they fail to comply with sacred right amendment provisions that require each affected lender's consent. Because smart LME proponents do not textually amend these provisions, legal challenges have focused on whether amendments to non-sacred rights that functionally alter or eviscerate sacred rights must comply with consent requirements.[205] These challenges ask courts to infer meaning too narrowly with insufficient guidance and context. More importantly, they bypass a threshold and potentially dispositive preliminary question: whether majority lenders may amend any loan provision (sacred or not) using an exit consent integrated into an LME that benefits the majority at the expense of the minority. In other words, whether majority lenders have abused or exceeded modification discretion generally (not just with respect to sacred rights) when integrating amendments into a broader

ably help define and comprise each other. The law's attempts, in various contexts, to differentiate or combine objective and subjective tests are thus inevitably fruitless.").

203. Such a conclusion is arguably consistent with the New York rule "that ambiguities in contracts should be construed against the drafter." Albany Sav. Bank, F.S.B. v. Halpin, 117 F.3d 669, 674 (2d Cir. 1997). If a borrower wants to retain a right to allow majority lenders to appropriate value from the minority it should make that right explicit. Term lenders are rarely, if ever, in a position to negotiate such terms *ex ante*.

204. *See* Weiskopf, *supra* note 43, at 220 ("[G]ood faith precepts are typically infused into contractual arrangements in an effort to preserve 'minimum decencies.'").

205. *See*, *e.g.*, Amended Complaint at 59–62, Axos Fin., Inc. v. Reception Purchaser, LLC, Index No. 650108/2025 (N.Y. Sup. Ct. 2025), NYSCEF Doc. No. 14 (seeking declaratory judgment to void STG Distribution, LLC's LME-related loan amendments for failure to obtain every affected lender's consent under sacred right modification provisions); Amended Complaint at 56–59, Ocean Trails CLO VII v. MLN Topco Ltd., Index No. 651327/2023 (N.Y. Sup. Ct. 2023), NYSCEF Doc. No. 30 (seeking same in Mitel's LME litigation); Complaint at 42–44, Audax Credit Opportunities Offshore v. Tmk Hawk Parent, Index No. 565123/2020 (N.Y. Sup. Ct. 2020), NYSCEF Doc. No. 1 (seeking same in Trimark's LME litigation).

LME transactions to benefit majority lenders at the expense of the minority. If so, the non-pro-rata LME is likely prohibited to the extent dependent on the loan modification.

Application of this rule will depend on the specifics of each modification clause, exit consent, and LME, but the interpretive process and application of inferential logic should always require the foregoing process and considerations. Where a modification clause is silent on the majority's ability to disenfranchise minority lenders, plain meaning interpretation cannot ignore logic and common sense and should lead to a conclusion that absent specific evidence to the contrary minority lenders do not intend to give the majority license to seize their value. The proper application of inferential logic and common sense in this manner could simplify future LME challenges and restore some of textualism's intended transparency, consistency, and predictability.