SURVIVING LENDER VIOLENCE: THE CASE FOR RESUSCITATING CONTRACTUAL GOOD FAITH IN NEW YORK

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In recent years, lender violence has become the preferred term for a rapidly developing restructuring market centered on the premise that a subset of lenders in a syndicate can increase their own recovery prospects at the expense of the remaining lenders in their group by engaging in a so-called "liability-management transaction." This term evokes images of rival factions of corporate lenders engaging in physical combat. Although these hyper-technical restructurings certainly fall short of the barbarity the label suggests, the reality is that lenders participating in the so-called violence can siphon hundreds of millions of dollars away from nonparticipating lenders and into their own pockets.

These transactions vary widely in structure as inventive borrowers push loan agreements to their limits. This Note explores the mechanics of several common types of liability-management transactions and identifies New York contract law as a motivating factor in their development. New York's aim in selecting its interpretive regime was to incentivize commercial parties to litigate in New York. The New York State Court of Appeals adopted a textualist interpretive regime in pursuit of this goal. Because liability-management transactions are engineered to comply with the letter but not the spirit of their agreement, they depend on textualism to succeed.

This Note calls for a limited revival of the implied covenant of good faith and fair dealing, first developed in early twentieth-century New York law, to arm courts in policing lender violence. These transactions certainly have the potential to be abusive if they are not already. This Note identifies a recent trend in the Appellate Division of the New York Supreme Court enforcing the implied covenant claim in intercreditor disputes. Finally, this Note argues that this trend is instructive, and courts should evaluate the reasonable expectation of parties and the commercial reasonableness of the particular transaction.

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INTRODUCTION

In 2020, Serta Simmons Bedding, LLC ("Serta") faced looming insolvency, in part due to the market headwinds accompanying the COVID-19 pandemic.[1] In response, Serta announced a restructuring transaction to provide the company with $200 million of new money and substantially reduce its debt.[2] Serta worked with a majority of existing lenders to conduct this transaction by amending its existing credit facility to allow for the issuance of new debt with priority over existing debt.[3] Along with providing a new-money loan, the lenders participating in the transaction exchanged their existing loans for newly issued loans with enhanced priority.[4] The net effect of these transactions was that an existing lender with a valid, first-priority interest in all of Serta's property who refused the opportunity to participate was subordinated to the tune of over $1 billion.[5]

The magnitude of loss for nonparticipating lenders provides ample cause to view similar transactions with heightened scrutiny. The size of the market implicated by these transactions exacerbates this concern. The U.S.

1. *See* Serta Simmons Bedding, LLC v. AG Centre St. P'ship (*In re* Serta Simmons Bedding, LLC), Ch. 11 Case No. 23-90020, Adv. No. 23-9001, 2023 WL 3855820, at *3 (Bankr. S.D. Tex. June 6, 2023).

2. *See id.* at *4–5.

3. *See id.*

4. *See id.*

5. The new-money tranche had a face value of $200 million, and the exchanged tranche had a face value of $875 million. The loans left behind were relegated to third in priority for access to their collateral in the case of a liquidation. *See id.*

leveraged loan[6] market has exploded since the end of the 2008 recession, reaching an estimated $1.4 trillion outstanding in June 2023.[7]

Lenders in the secured loan market secure their positions with a blanket lien[8] on all the borrower's assets.[9] This security interest ensures that, in the event of a default, these lenders are at the front of the proverbial line of creditors coming to collect on their collateral.[10] Because a lender with a blanket lien has a senior claim on all the borrower's assets, this lender, rather than the debtor, often effectively controls the restructuring process.[11] Nonetheless, years of accommodative monetary policy[12] have led to increasingly flexible or "loose" loan documents.[13] Inventive borrowers[14] have capitalized on this flexibility and retaken some control of the restructuring process with the innovation of hyper-aggressive restructuring transactions, termed "liability-management transactions."[15]

The species of liability-management transaction at issue in the litigation surrounding Serta is referred to in industry parlance as an uptier transaction.[16]

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6. Although there is not a uniform definition of a "leveraged loan," the term typically refers to a syndicated secured loan with high credit risk. Credit rating agencies define leveraged loans as those rated below investment grade, which is categorized as S&P's BB+ or lower. *See* S&P GLOB. MKT. INTEL., LEVERAGED COMMENTARY AND DATA (LCD): LEVERAGED LOAN PRIMER 8 (2020).

7. *See In re Serta Simmons Bedding, LLC*, 2023 WL 3855820, at *1.

8. The term blanket lien is used to refer to the secured lending practice of obtaining a security interest in substantially all the assets of the debtor, regardless of whether they are now owned or after acquired. For a discussion of the amendments to Article 9 of the Uniform Commercial Code (U.C.C.) that encouraged this trend, see generally Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1228–29 (2006) ("The modern security interest effectively covers not only a corporation's discrete assets, but also the synergy that each asset has with the others.").

9. *See* Vincent S.J. Buccola, *Sponsor Control: A New Paradigm for Corporate Reorganization*, 90 U. CHI. L. REV. 1, 12 (2023).

10. *See id.*

11. *See generally* Elizabeth Warren & Jay L. Westbrook, *Secured Party in Possession*, AM. BANKR. INST. J., Sep. 2003, at 12.

12. For a discussion of the Federal Reserve Bank's monetary policy following the 2008 recession, see generally Dario Caldara, Etienne Gagnon, Enrique Martínez-García & Christopher J. Neely, *Monetary Policy and Economic Performance Since the Financial Crisis*, 103 FED. RSRV. BANK ST. LOUIS REV. 425, 433–38 (2021).

13. One example of this flexibility is the elimination of maintenance covenants from loan agreements. Covenant-lite loans do not include maintenance covenants, which require borrowers to meet regular financial tests. In 2000, covenant-lite loans represented roughly 1 percent of the market, while in 2021, 86 percent of the $1.3 trillion in outstanding U.S. leveraged loans were covenant-lite. *See* Abby Latour, *Covenant-Lite Deals Exceed 90% of Leveraged Loan Issuance, Setting New High*, S&P GLOB. MKT. INTEL. (Oct. 8, 2021), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/covenant-lite-deals-exceed-90-of-leveraged-loan-issuance-setting-new-high-66935148 [https://perma.cc/LF46-YZX9].

14. In many cases, the borrowers are controlled by private equity sponsors. For the argument that private equity sponsors are now in control of the restructuring process, see generally Buccola, *supra* note 9.

15. *See* Bridget Marsh, *Liability Management Transactions*, LSTA (May 10, 2023), https://www.lsta.org/news-resources/liability-management-transactions-2/ [https://perma.cc/X6XW-6WKW].

16. *See id.*

An uptier transaction occurs when a financially distressed company works with a majority of its debtholders[17] to amend its credit agreement to allow the company to issue new debt with higher priority than its existing debt.[18] Uptier transactions have spawned extensive litigation and criticism.[19] One stinging complaint likened uptier transactions to "cannibalistic assault by one group of lenders in a syndicate against another."[20] Another sensationally described a "[s]ham [t]ransaction" involving "[p]hantom [n]otes" that were "violently detrimental[]" to the injured lenders and were the handiwork of a private equity sponsor with "lucrative (and sinister) aims."[21]

This Note explores the emergence and subsequent legal challenges to uptier transactions. It identifies the legal principles that facilitate uptier transactions and considers possible solutions. Part I provides background on the conventional corporate restructuring options and discusses the rise of liability-management transactions. It then outlines the constraints on uptier transactions under New York contract law. Part II explains the key features of uptier transactions and details the litigation in three high-profile cases. Part III suggests that New York's chosen method of contractual interpretation has aided the rise of liability-management transactions. It further calls for a limited expansion of the implied covenant of good faith and fair dealing to police creditor conduct.

I. Liability-Management Transactions and Contractual Constraints

The syndicated loan market has become a dominant way for issuers around the world to raise debt financing.[22] A syndicated loan is a secured loan made to a single borrower by a group of lenders, i.e., syndicate.[23] The so-called

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17. Majority here refers to a number just above the threshold required to amend the governing loan document. For example, if the governing agreement provided that lenders holding 50 percent of the balance of all outstanding loans may amend the agreement to allow for senior debt, the bare majority would be 50.1 percent.

18. *See* Marsh, *supra* note 15.

19. *See, e.g.*, Complaint, Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020 (N.Y. Sup. Ct. Nov. 7, 2020) [hereinafter Trimark Complaint]; Complaint, LCM XXII Ltd. v. Serta Simmons Bedding LLC, No. 21CV3987 (S.D.N.Y. May 4, 2021) [hereinafter Serta Complaint]; Complaint, ICG Glob. Loan Fund 1 DAC v. Boardriders, Inc., No. 655175/2020 (N.Y. Sup. Ct. Oct. 9, 2020) [hereinafter Boardriders Complaint]; Complaint, SSD Invs. Ltd. v. Wilmington Savs. Fund Soc'y, FSB, No. 654068/2022 (N.Y. Sup. Ct. Oct. 28, 2022) [hereinafter Incora Complaint]; Complaint, Ocean Trails CLO VII v. MLN TopCo Ltd., No. 651327/2023 (N.Y. Sup. Ct. Mar. 14, 2023) [hereinafter Mitel Complaint].

20. *See* Trimark Complaint, *supra* note 19, at 5.

21. *See* Incora Complaint, *supra* note 19, at 2, 22, 27, 36.

22. *See generally* Seung Jung Lee, Lucy Qian Liu & Viktors Stebunovs, Risk Taking and Interest Rates: Evidence from Decades in the Global Syndicated Loan Market (2017).

23. Syndicates often include banks and other nonbank lenders, including insurance companies, pension funds, and mutual funds. Many holders, including collateralized loan obligations, often acquire their position in the secondary market and do not play a role in the origination. *See* S&P Glob. Mkt. Intel., *supra* note 6, at 1.

"leveraged loan" is the riskiest species of syndicated loan, as it is, by definition, made to a borrower with a high credit risk.[24]

Private equity funds typically acquire their portfolio companies[25] through leveraged buyouts (LBOs).[26] The debt used to fund the LBOs often consists of a syndicated loan that is considered to be "leveraged" because it leaves the portfolio company with a high debt-to-equity ratio, often around ninety percent.[27] Higher leverage naturally corresponds to a higher risk of bankruptcy.[28]

The first part of this Note discusses the rise of uptier transactions, the bankruptcy concepts that motivate them, and the contractual constraints currently imposed on them. Part I.A provides an overview of corporate reorganization, illustrating the backdrop in which these transactions operate, and the corresponding implications should the transaction fail to save the company. Part I.B explains the constraints the Code places on a debtor's ability to grant superior liens. Part I.C discusses the rise of liability-management transactions and details their evolution and structure. Part I.D sets the context for loan agreement litigation. It explains New York's interpretative regime in commercial contract cases and discusses the potential limitations in its application to uptier transactions. It further highlights a few recent New York cases applying the implied covenant of good faith and fair dealing to intercreditor disputes.

A. *Overview of Corporate Reorganization*

Companies facing financial distress have two options to reorganize their capital structure: (1) seek to deleverage the company through an out-of-court workout by privately renegotiating the terms of their existing debt, or (2) file for bankruptcy and be subject to the statutory burdens imposed on the debtor by the U.S. Bankruptcy Code (the "Code").[29]

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24. *See supra* note 6 and accompanying text.

25. Portfolio companies are companies that have been the target of acquisition by private equity firms. After acquiring the target, the private equity sponsor manages it for a while and then sells it or takes it public, in either case in the hopes of turning a profit for its investors. Along the way, the sponsor receives management fees as well as any distribution to equityholders. *See* Buccola, *supra* note 9, at 5.

26. In an LBO, a private equity firm funds the acquisition partially with its own assets (usually around 10 percent of the purchase price) and causes the portfolio company to borrow money to finance the rest (usually around 90 percent of the purchase price), using the portfolio company's assets as collateral and servicing the debt with the company's cash flow. *See* S&P GLOB. MKT. INTEL., *supra* note 6, at 3.

27. *See* Abby Latour, *Leveraged Loans Fuel Q2 LBOs at Fastest Pace Since Global Financial Crisis*, S&P GLOB. MKT. INTEL. (July 20, 2021), https://www.spglobal.com/marketintelligence/en/news-insights/latest-newsheadlines/leveraged-loans-fuel-q2-lbos-at-fastest-pace-since-global-financial-crisis-65503131 [https://perma.cc/N4H7-EJFG] (noting that leveraged loans used in LBOs alone range between $25 billion to $125 billion annually).

28. *See* STEPHEN A. ROSS, RANDOLPH W. WESTERFIELD & JEFFREY JAFFE, CORPORATE FINANCE 905–08 (9th ed. 2010).

29. *See* Stuart C. Gilson, Kose John & Larry H.P. Lang, *Troubled Debt Restructurings: An Empirical Study of Private Reorganization of Firms in Default*, 27 J. FIN. ECON. 315, 316 (1990).

Recently, financially stressed companies have increasingly sought to reduce leverage through out-of-court negotiations with their major creditors before filing for bankruptcy.[30] There are often advantages for both creditors and debtors in the expeditious implementation of an informal, out-of-court restructuring, or workout, as compared with the unpredictable costs and uncertainties of a formal bankruptcy filing.[31] An out-of-court workout aims to effectuate an agreement between a debtor and its creditors.[32] Typically, the debtor is either granted extensions on its debt payment obligations or obtains a reduction in its debt load.[33] When cooperating in this way, debtors and creditors can avoid the risks, costs, and delays of bankruptcy such that the potential "slice-of-pie" available to each is larger than in a Chapter 11 bankruptcy.[34]

In addition to workouts being expeditious, economical, and sensible,[35] companies that choose to reduce leverage out of court can also avoid some of the burdens that the Code imposes on debtors.[36] The Code forces debtors to devote substantial resources to classifying every creditor's claim,[37] even those that have not yet matured.[38] The debtor must further treat creditors within a class equally[39] and follow the "absolute priority rule."[40] Once the classes are designated, the Code enforces voting requirements for confirmation.[41] The most important of these constraints, in the context of uptier transactions—the constraints the Code places on a debtor's ability to subordinate existing secured lenders by issuing new debt in a traditional bankruptcy proceeding—are discussed in Part I.B.

30. *See* Conrad B. Duberstein, *Out-of-Court Workouts*, 1 AM. BANKR. INST. L. REV. 347, 347 (1993).

31. INSOL INT'L, STATEMENT OF PRINCIPLES FOR A GLOBAL APPROACH TO MULTI-CREDITOR WORKOUTS II 4 (2d ed. 2017).

32. *See* Duberstein, *supra* note 30, at 349.

33. *See id.*

34. *See id.* at 347.

35. *See In re* Colonial Ford, Inc., 24 B.R. 1014, 1016 (Bankr. D. Utah 1982).

36. *See id.* at 1016–17.

37. The term "claim" is defined broadly to include any type of debt. *See* 11 U.S.C. § 101(5) (including any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured").

38. Each proposed plan must organize claims into classes and specify which are not impaired. *See id.* § 1123(a).

39. *See id.* § 1123(a)(4).

40. Under the absolute priority rule, senior classes must be paid in full before junior classes receive anything. *See id.* § 1129(b)(2).

41. Creditors vote on a reorganization plan on a class-by-class basis. A class is deemed to have accepted the plan only if a majority of its members, holding at least two-thirds of the value of the claims, vote in favor. *See id.* § 1126(c).

B. Priming Liens in Conventional Reorganizations

In the syndicated loan market, a perfected first-out[42] position is always the first to recover outside of bankruptcy.[43] However, the Code allows debtors to obtain additional financing secured by a lien with equal or superior priority to all existing indebtedness.[44] So-called priming[45] liens provide the liquidity necessary for a business to wind up through liquidation or, more commonly, to reorganize effectively.[46] The ability to prime an existing lien is extraordinary, and the Code limits its use.[47] The primary substantive obligation under § 364 of the Code requires proof that the secured creditor who will be subordinated (or "primed") be adequately protected, notwithstanding the priming.[48] Adequate protection generally requires a detailed factual analysis of how the proceeds of the priming transaction will grow the pie enough such that the primed creditor is left no worse off.[49]

Liability-management transactions frequently involve priming outside of bankruptcy.[50] The new borrowing enables the debtor to fund continued operations or pay off maturing debts that it would otherwise be unable to refinance.[51] The aim is to extend the company's liquidity runway[52] without resorting to a costly Chapter 11 proceeding.[53] Interestingly, many out-of-court priming transactions occur in companies that were acquired by

42. "First-out" refers to the position that stands to recover first in a reorganization. The "second-out" or "third-out" positions naturally recover second and third, respectively. *See* LATHAM & WATKINS LLP, THE BOOK OF JARGON US CORPORATE & BANK FINANCE 54 (2d ed. 2018).

43. *See* U.C.C. § 9-322 (AM. L. INST. & UNIF. L. COMM'N 2023) (noting that "[c]onflicting perfected security interests . . . rank according to priority in time of filing or perfection").

44. *See* 11 U.S.C. § 364(c)–(d); 3 COLLIER ON BANKRUPTCY ¶ 364.05 (Richard Levin & Henry J. Sommer eds., 16th ed. 2023).

45. A priming lien is a "lien that arises and attaches after another validly recorded lien in such a way that the lien has equal or superior rights in the same collateral." *See Prime Lien*, BLACK'S LAW DICTIONARY (11th ed. 2019).

46. *See* Sandeep Dahiya & Korok Ray, *A Theoretical Framework for Evaluating Debtor-in-Possession Financing*, 34 EMORY BANKR. DEVS. J. 57, 68–69 (2017).

47. The Code requires that the debtor is unable to otherwise obtain credit, and the debtor must further provide adequate protection for the interests of existing lienholders. *See* 11 U.S.C. § 364(d).

48. *See id.*

49. *See* 3 COLLIER ON BANKRUPTCY, *supra* note 44.

50. *See infra* Parts II.A–C.

51. Companies that do not have sufficient free cash flow to pay their debts must refinance. Many existing loans were issued with substantially lower interest rates than those available in the market today. Consequently, once refinancing occurs, the free cash flow dedicated to debt service will increase, further stressing the company's liquidity. The date in which many existing obligations come due is often called the "Maturity Wall." *See* Peter Brennan, *Ballooning Maturity Wall a Growing Risk for Speculative-Grade Companies*, S&P GLOB. MKT. INTEL. (June 14, 2023), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/ballooning-maturity-wall-a-growing-risk-for-speculative-grade-companies-76110262 [https://perma.cc/9X5T-U4FL].

52. Liquidity runway means the amount of time a business has until its cash runs out.

53. *See* Marsh, *supra* note 15.

a private equity sponsor in an LBO.[54] The sponsor that owns the company wishes to keep it out of Chapter 11, where equity interests are frequently wiped out.[55]

C. The Rise of Liability-Management Transactions

For the majority of the history of corporate restructuring, the conventional wisdom has been that creditor groups are best served by coordinating their response to a debtor in financial difficulty.[56] Accordingly, the out-of-court restructuring process has been predicated on the norm that creditors within a class are entitled to proportional, or pro rata, treatment.[57] In court, the Code expressly enforces this norm by requiring equal treatment of claims within a class.[58] Out of court, the power of the commercial norm of ratable treatment operated such that it hardly mattered whether pro rata treatment was mandated.[59]

Uniform Commercial Code (U.C.C.) Article 9 provides the priority rules for security interests outside of bankruptcy.[60] Section 9-322 establishes the baseline that the priority between two secured creditors is determined by the order in which their security interests were perfected.[61] In the syndicated loan market, a syndicate obtains perfection through a common financing statement.[62] Section 9-339 is particularly relevant to liability-management transactions because it permits parties to contract around section 9-322's priority baseline, with some limitations.[63] Although it establishes that creditors "entitled to priority" may enter intercreditor agreements to subordinate each other's security interests,[64] it only permits the parties to alter their *own* priorities as between themselves.[65] Thus, whether a liability-management transaction comports with section 9-339 hinges on whether the original credit agreement permitted subordination without the consent of all lenders.

54. *See, e.g.*, Trimark Complaint, *supra* note 19, at 5 (noting the debtor was recently acquired in an LBO by Centerbridge and Blackstone); Incora Complaint, *supra* note 19, at 1 (noting the debtor was recently acquired in an LBO by Platinum Equity Advisors, LLC).

55. *See* 11 U.S.C. § 1129(b)(2)(B)(ii).

56. *See* Vincent S.J. Buccola, *Efficacious Answers to the Non-pro Rata Workout*, 171 U. PA. L. REV. 1859, 1863 (2023).

57. *See id.*

58. *See* 11 U.S.C. § 1123(a)(4).

59. *See* Buccola, *supra* note 56, at 1864.

60. *See* U.C.C. § 9-322 (AM. L. INST. & UNIF. L. COMM'N 2023).

61. *See id.*

62. *See* Bridget Marsh, *Summer Series: An Introduction to Intercreditor Agreements*, LSTA (July 21, 2023), https://www.lsta.org/news-resources/summer-series-an-introduction-to-intercreditor-agreements/ [https://perma.cc/AH4U-J8V8].

63. *See* U.C.C. § 9-339 cmt. 2 ("[A] person's rights cannot be adversely affected by an agreement to which the person is not a part.").

64. *See id.* § 9-339.

65. *See id.* § 9-339 cmt. 2. In the syndicated loan market, the entire syndicate perfects a security interest in the same filed financing statement. Because the subordinated lenders were party to the original credit agreement, they are subject to the subordination requirements provided therein.

In some sense, financially distressed businesses considering liability-management transactions are shopping for a more favorable statutory regime governing priming rather than contracting around the Code. By arbitraging around the governing statutory background, a company can subordinate secured lenders outside of bankruptcy without providing adequate protection. Two types of liability-management transactions companies have used to subordinate secured lenders outside of bankruptcy are discussed below. Part I.C.1 will discuss the first species of liability-management transactions to gain publicity in the market. It will further provide an example of such a transaction to illustrate its mechanics. Part I.C.2 will discuss the evolution of liability-management transactions and the concomitant rise of uptier transactions.

1. Drop-Down Transactions

One of the earliest out-of-court priming mechanisms was the so-called drop-down.[66] In a drop-down, a borrower exploits a contractual trap door to transfer valuable collateral out of the reach of its existing lenders in order to pledge it to new lenders.[67] In such a transaction, existing lenders are subordinated because their collateral is given to someone else.[68]

In 2016, an infamous drop-down priming transaction occurred—the "J.Crew transaction."[69] The American apparel retailer J. Crew Group, Inc. ("J.Crew") had $1.2 billion of senior secured financing.[70] The company took advantage of contractual flexibility, transferring its existing lenders' valuable intellectual property collateral to new, wholly-owned subsidiaries that were not considered a party to the governing agreement.[71] The new, asset-rich, unrestricted subsidiaries were able to secure new liquidity.[72] Ultimately, the injured lenders sued under a breach of contract theory and the court denied all requested relief and upheld the transaction.[73]

Although J.Crew popularized the drop-down structure, it relied on some contractual flexibility on transfers within the corporate group.[74] In response to the J.Crew transaction, the leveraged loan market tightened loan documents to prevent borrowers from engaging in drop-downs.[75] As

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66. *See* Diane L. Dick, *Hostile Restructurings*, 96 WASH. L. REV. 1333, 1363 n.175 (2021).

67. *See id.* at 1362–63.

68. *See id.*

69. *See id.*

70. This debt structure was incurred in connection with a 2011 LBO in which two private equity sponsors took the company private. *See* Decision & Order at 2 n.3, Eaton Vance Mgmt. v. Wilmington Sav. Fund Soc'y, FSB, No. 654397/2017 (N.Y. Sup. Ct. Apr. 25, 2018).

71. The value of these assets was later estimated at more than $1 billion. *See* Dick, *supra* note 66, at 1363.

72. *See id.* at 1363–64.

73. *See id.* at 1365–66.

74. *See* Decision & Order, *supra* note 70, at 2–4.

75. *See* Jonathan Schwarzberg, *Investors Tighten Loan Documents with J Crew Blocker*, REUTERS (May 3, 2018, 3:45 PM), https://www.reuters.com/article/jcrew-blocker/investors-

contractual loopholes closed, J. Crew's inventiveness spurred debtors and sophisticated lenders to stretch the text of credit agreements in other ways.

2. Uptier Transactions

In J.Crew's wake, at least five non-pro rata refinancing transactions have resulted in litigation.[76] These transactions are distinct from drop-down transactions and termed uptier transactions because of two distinguishing features: (1) a bare majority of lenders in a syndicated facility amend their existing credit agreements to issue new debt with priority over existing debt, and (2) some lenders agree to exchange their existing loans for new priority loans at a discounted price.[77]

The paradigmatic uptier transaction depends on consent from a bare majority of outstanding debtholders to amend the existing credit agreement.[78] The resulting amendments allow for the creation of two new debt tranches with higher priority than existing debt.[79] First, they allow for participating lenders to fund a new money tranche with first-priority. They also allow for another new tranche with second-priority to be funded by participating lenders exchanging their existing debt for new, higher-priority debt at a price below par.[80] The company benefits from that discount capture as dollar-for-dollar deleveraging.[81] The post-transaction capital structure results in the new-money tranche at first-out priority, the exchanged tranche at second-out priority, and the remaining existing debt at third-out priority.[82]

An uptier transaction is possible only if the relevant debt agreement can be amended by a majority vote of the debtholders.[83] Although the transaction structure has been challenged in highly visible litigation, most existing credit

tighten-loan-documents-with-j-crew-blocker-idUSL1N1SA1W8/ [https://perma.cc/P6CW-NSNA].

76. *See* Trimark Complaint, *supra* note 19; Serta Complaint, *supra* note 19; Boardriders Complaint, *supra* note 19; Incora Complaint, *supra* note 19; Mitel Complaint, *supra* note 19.

77. *See* Buccola, *supra* note 56, at 1864.

78. *See* Marsh, *supra* note 15.

79. *See id.*

80. *See id.*

81. *See id.* As an example of how the exchange deleverages a company, in *Serta* the lenders exchanged their new second-priority debt for existing first-priority debt at a $74 for every $100 dollar exchange rate. The lenders further exchanged new second-priority debt for existing-second priority debt at a $39 for every $100 dollar exchange rate. The total face value of the new second-priority tranche was approximately $875 million, and the company deleveraged by approximately $400 million as a result of the discounted exchange. *See* Serta Simmons Bedding, LLC v. AG Centre St. P'ship (*In re* Serta Simmons Bedding, LLC), Ch. 11 Case No. 23-90020, Adv. No. 23-9001, 2023 WL 3855820, at *5 (Bankr. S.D. Tex. June 6, 2023).

82. *See* Shana A. Elberg, Evan A. Hill & Catrina A. Shea, *Uptier Exchange Transactions Remain in Vogue, Notwithstanding Litigation Risk*, SKADDEN, ARPS, MEAGHER & FLOM LLP (Feb. 2, 2021), https://www.skadden.com/insights/publications/2021/02/uptier-exchange-transactions [https://perma.cc/9AFD-L49U].

83. *See* Douglas S. Mintz, Ned S. Schodeka & Peter J. Amenda, *Recent Challenges to Uptiering Transactions*, AM. BANKR. INST. J., Dec. 2022, at 32, 32.

agreements still allow for new-money tranches of debt with enhanced priority to be completed by a simple majority of lenders.[84]

Uptier transactions frequently serve as lifelines to distressed companies by giving them access to much-needed new credit and further allowing for deleveraging through discounted exchanges.[85] Uptier transactions also benefit participating lenders, by giving them higher-priority secured claims.[86] In addition to the advantages for borrowers, especially participating lenders, uptier transactions can sharply diminish the value of nonparticipating lenders' debt.[87] These lenders are left with "deeply subordinated loans trading at steep discounts to pre-transaction value."[88] Their loans are more likely to be undersecured if the borrower ends up bankrupt.[89] By design, the losses suffered by nonparticipating lenders are the result of the higher recoveries for the participating lenders.[90]

D. Setting the Context for Loan Agreement Litigation: New York Contractual Interpretation and the Modern Duty of Good Faith

Litigation over uptier transactions has centered on whether they breach the governing credit agreements or the implied covenant of good faith and fair dealing. This has required courts to interpret these credit agreements.[91] This part of the Note describes the major interpretive regimes and the role of the implied covenant of good faith in each.

Contract interpretation is the largest single source of contract litigation.[92] Interpreting a contract involves "determining from the parties' words and other objective manifestations what must be done (or avoided) by the respective parties to conform to the terms of their agreement."[93] Accordingly, contract interpretation aims to determine the parties' intent at formation.[94] Accomplishing this task can be difficult, as contracts frequently

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84. *See* Justin Forlenza, *Justin Forlenza Speaks on Open Market Purchases*, CREDITOR RTS COAL. (May 12, 2023), https://creditorcoalition.org/justin-forlenza-speaks-on-open-market-purchases/ [https://perma.cc/TV5A-F8DD] (noting that "around 67% of loans in the CS Leveraged Loan Index still allow majority consent for uptier amendments as of Q1 2023").

85. *See* Marsh, *supra* note 15.

86. *See* Elberg, Hill & Shea, *supra* note 82.

87. *See id.*

88. *See id.*

89. *See id.* This type of transaction would not be possible in a bankruptcy proceeding. Rather, the debtor would have to provide for "adequate protection" of the secured lenders. *See* 11 U.S.C. § 364(d).

90. *See* Bek Sunuu, *A Closer Look at How Uptier Priming Loan Exchanges Leave Excluded Lenders Behind*, S&P GLOB. RATINGS (June 15, 2021, 1:04 PM), https://www.spglobal.com/ratings/en/research/articles/210615-a-closer-look-at-how-uptier-priming-loan-exchanges-leave-excluded-lenders-behind-11991317 [https://perma.cc/A2W4-VX7P].

91. *See, e.g.*, *infra* Parts II.A–B.

92. *See* Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926, 926 (2010).

93. *See* Tomhannock, LLC v. Roustabout Resources, LLC, 128 N.E.3d 674, 675 (N.Y. 2019).

94. *See* 11 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 30:2 (4th ed. 2012).

contain ambiguities and courts disagree on how to discern the parties' intent.[95]

The relevant interpretive regimes, as well as the implied covenant of good faith, which courts have applied to uptier cases, are discussed below. Part I.D.1 describes the two major theories of contractual interpretation, "textualism" and "contextualism." Next, Part I.D.2 discusses the implied covenant of good faith and how it has been applied differently by courts adhering to different interpretive regimes. Finally, because New York State contract law has governed all uptier transactions thus far, Part I.D.3 analyzes the textualist interpretive regime employed by New York state courts and the role of the implied covenant of good faith.

1. The Classic Divide in Contract Interpretation

Two major theories of contractual interpretation compete for dominance. These theories have multiple labels, but "textualism" and "contextualism" are the most useful.[96] According to the textualist theory, the interpretation focuses on the *text* of the contract.[97] Conversely, under the contextualist theory, the interpreter should emphasize reading the contractual language *in context*.[98] Both are analyzed in more detail in Parts I.D.2.a and I.D.2.b below.

a. Textualism

Textualist courts follow the "plain meaning rule"[99] and the "four corners rule."[100] The first step in interpretation is to assess whether the contract is ambiguous.[101] According to the four corners rule, the court may only

95. Ambiguity exists where a contract's terms "could suggest more than one meaning when viewed objectively by a 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." Orchard Hill Master Fund Ltd. v. SBA Commc'ns Corp., 830 F.3d 152, 156–57 (2d Cir. 2016) (citing Chesapeake Energy Corp. v. Bank of N.Y. Mellon Tr. Co., 773 F.3d 110, 114 (2d Cir. 2014)) (applying New York law).

96. Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Text and Context: Contract Interpretation as Contract Design*, 100 CORNELL L. REV. 23, 25–26 (2014).

97. Grumman Allied Indus., Inc. v. Rohr Indus., Inc., 748 F.2d 729, 733–34 (2d Cir. 1984) ("Adherents of the classical approach, animated by a belief that a contractual agreement manifests the intent of the parties in a completely integrated form, favor the construction of contracts by reference to the explicit textual language.").

98. *See id.* at 734 ("Modern . . . interpretation . . . seems to derive from the premise that a contextual inquiry is a necessary and proper prerequisite to an understanding of the parties' intent.").

99. The plain meaning rule is: "When a contract is unambiguous in the contested respect, the court must give the contract its unambiguous meaning as a matter of law." *See* STEVEN J. BURTON, ELEMENTS OF CONTRACT INTERPRETATION 111 (2009).

100. The four corner rule is as follows: when deciding whether a contract is ambiguous, a court may consider only the contract on its face, excluding all extrinsic evidence. *See* Aaron D. Goldstein, *The Public Meaning Rule: Reconciling Meaning, Intent, and Contract Interpretation*, 53 SANTA CLARA L. REV. 73, 75 (2013).

101. *See* 2 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS 257 (2d ed. 1998).

consider the agreement's text when deciding whether the contract is ambiguous.[102] If the court finds that the contract is unambiguous, it simply applies the text's "plain meaning" to the facts of the case.[103]

However, if the judge finds that ambiguity exists, the interpretation moves to a second step—"resolving the ambiguity."[104] At this stage, a textualist court considers extrinsic evidence regarding the contract's meaning.[105] Because textualist courts conduct the initial inquiry into whether an ambiguity exists without considering evidence outside the four corners of the agreement, the *text* is the only initial consideration.

b. Contextualism

Although contextualism also follows a two-stage process, its method for assessing whether ambiguity exists is different. Contextualists consider both the language of the agreement and all extrinsic evidence of the parties' intent when deciding whether an ambiguity exists.[106] Extrinsic evidence may include commercial circumstances, such as the course of performance of the contract, the course of dealing between the parties, and usage of trade.[107] Accordingly, contextualist regimes assessing whether ambiguity exists consider "all credible evidence offered to prove the intention of the parties."[108] Although extrinsic evidence plays an increased role, contextualist authorities emphasize that the contract's language remains the most important evidence.[109]

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102. Note that courts are permitted to consider the rules of grammar, the canons of construction and dictionaries, among other interpretive aids. It is only evidence from beyond the agreement that is proscribed. *See* Burton, *supra* note 99, at 126.

103. *See id.* at 118 ("If the document does not appear to be ambiguous, the analysis ends; the plain meaning rule comes into play to require that the judge give the unambiguous meaning to the contract as a matter of law.").

104. *See* Joshua M. Silverstein, *The Contract Interpretation Policy Debate: A Primer*, 26 STAN. J.L. BUS. & FIN. 222, 230 (2021).

105. *See* Burton, *supra* note 99, at 118 ("If the contract is ambiguous on its face, extrinsic evidence is admissible [for the purpose of interpreting the contract.]").

106. RESTATEMENT (SECOND) OF CONTRACTS § 212 cmt. b (AM. L. INST. 2015) ("Any determination of meaning or ambiguity should only be made in the light of the relevant evidence of the situation and relations of the parties, the subject matter of the transaction, preliminary negotiations . . . , usages of trade, and the course of dealing between the parties.").

107. *See* U.C.C. § 1-303 (AM. L. INST. & UNIF. L. COMM'N 2023). A "course of performance" is the parties' sequence of conduct if the transaction involved repeated occasions for performance by a party, and the other party, with knowledge of the nature of performance, accepts performance without objection. *See id.* § 1-303(a). A "course of dealing" is the parties' conduct under prior contracts between them. *See id.* § 1-303(b). A "usage of trade" is a practice or method of dealing in the industry or location where the parties operate that the parties should know about and should expect to be followed with respect to the contract at issue. *See id.* § 1-303(c). For an overview of the types of extrinsic evidence, see generally, Burton, *supra* note 99, at 35–62.

108. Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 442 P.2d 641, 645 (Cal. 1968).

109. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 212 cmt. b ("[T]he words of an integrated agreement remain the most important evidence of intent[].").

In sum, under textualism, ambiguity must be apparent on the face of the agreement.[110] An apparent ambiguity is commonly called "patent" or "intrinsic."[111] Contextualism allows for the drawing of extrinsic evidence from surrounding circumstances to establish ambiguity.[112] Such an ambiguity is typically called "latent" or "extrinsic."[113] Put simply, textualist regimes recognize only patent ambiguities, whereas contextualist jurisdictions recognize both patent and latent ambiguities.

Scholars of contract law, beginning with Professors Samuel Williston and Arthur L. Corbin, have endorsed the basic textualist/contextualist framework.[114] Over time, variations of textualism and contextualism have appeared in case law.[115] In virtually every jurisdiction, there are "irreconcilable cases, frequent changes in doctrine, and confusion."[116] As a result of this disorder, most states fall somewhere along a continuum between textualism and contextualism.[117] Jurisdictions that employ a hard parol evidence rule[118] and strictly adhere to the plain meaning rule approximate a more textualist orientation.[119] In contrast, jurisdictions that apply a soft parol evidence rule and de-emphasize the plain meaning rule are more contextualist.[120]

2. The Implied Covenant of Good Faith and Fair Dealing

The text of the parties' agreement is central to interpreting the parties' intent; however, some courts will consider a variety of implied duties in addition to those written in the parties' agreement. The implied duty of contractual good faith in American jurisprudence originates in early New York law.[121] Perhaps the most famous implied-duty opinion was penned in

110. *See* Burton, *supra* note 99, at 111–12.
111. *See id.* at 107.
112. *See id.* at 112.
113. *See id.* at 107.
114. *See, e.g.*, Gilson, Sabel & Scott, *supra* note 96; Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 572–73 (2003).
115. 6 PETER LINZER, CORBIN ON CONTRACTS § 25.13 (Joseph M. Perillo ed. 2023).
116. Eric A. Posner, *The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contract Interpretation*, 146 U. PA. L. REV. 533, 540 (1998); *accord* WILLISTON & LORD, *supra* note 94, § 33:42 ("Not only do various jurisdictions disagree as to how and when extrinsic evidence of the circumstances surrounding the execution of a contract becomes admissible, but the decisions within a given jurisdiction are often difficult and sometimes impossible to reconcile on this point.").
117. *See* Silverstein, *supra* note 104, at 236.
118. The parol evidence rule instructs courts to "refuse to use evidence of the parties' prior negotiations in order to interpret a written contract unless the writing is (1) incomplete, (2) ambiguous, or (3) the product of fraud, mistake, or a similar bargaining defect." *See* Posner, *supra* note 116, at 534. The "hard" version of the rule declares a writing complete if it looks complete on its face. *See id.* at 535. The "soft" version of the rule declares "a writing complete only if the extrinsic evidence supports that determination." *See id.*
119. *See* Ethan J. Leib, *Interpretive Divergence: A Case Study of the New York Court of Appeals*, 50 J. LEG. 387, 396–97 (2024).
120. *See* Schwartz & Scott, *supra* note 92, at 938.
121. *See* Steven J. Burton, *History and Theory of Good Faith Performance in the United States* 2 (Univ. of Iowa Coll. of Law, Legal Studies Research Paper No. 2017–08, 2017),

1917 by a familiar hand, Judge Benjamin N. Cardozo. In *Wood v. Lucy, Lady Duff-Gordon*,[122] the court found an agreement to market clothing designs enforceable because it implicitly required "reasonable efforts," and the court would not suppose that "one party was to be placed at the mercy of the other."[123] This case now represents one of the earliest recognitions of the court's ability to imply obligations into a private contract.[124] Following the recognition of implied duties, the New York State Court of Appeals adopted an implied obligation of contractual good faith in *Kirke La Shelle Co. v. Paul Armstrong Co.*[125] Because minority lenders have argued that uptier transactions violate the implied covenant of good faith, this part describes the doctrine's historical underpinnings and its current application.

The implied duty of good faith is now implied in virtually every contract.[126] Broadly stated, good faith requires that "neither party to a contract shall do anything which has the effect of destroying or injuring the right of the other party to receive the fruits of the contract."[127] Although contractual good faith has received considerable attention from litigants, this has not resulted in a clear consensus on the doctrine. The contours of the doctrine shift from contract to contract, and as Judge Richard A. Posner commented, "the . . . cases are cryptic as to [the meaning of good faith] though emphatic about its existence."[128] The obligation seemingly prevents parties from seizing on ambiguity to act to benefit themselves, but the contract's express terms necessarily limit this power.[129]

As formal textualism increased in popularity among courts, the implied obligation of good faith faded into near irrelevance.[130] The elevation of the express terms of an agreement and the corresponding exclusion of extrinsic evidence leaves little room for such a flexible notion as an implied obligation of good faith.[131] As Judge Frank H. Easterbrook has observed, "we have reminded litigants that . . . [they] may not seek to litigate issues of 'good

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https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2742354 [https://perma.cc/Z6YV-EX28].

122. 118 N.E. 214 (N.Y. 1917).

123. *Id.* at 214.

124. *See* Jay M. Feinman, *Good Faith and Reasonable Expectations*, 67 ARK. L. REV. 525, 539–42 (2014).

125. 188 N.E. 163 (N.Y. 1933).

126. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 205 (AM. L. INST. 2015) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement"); U.C.C. § 1-304 (AM. L. INST. & UNIF. L. COMM'N 2023) ("Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement.").

127. Thyroff v. Nationwide Mut. Ins. Co., 460 F.3d 400, 407 (2d Cir. 2006) (citation omitted) (applying New York law).

128. Mkt. St. Assocs. v. Frey, 941 F.2d 588, 593 (7th Cir. 1991).

129. In New York, evidence from outside the agreement cannot be used to create an ambiguity; rather, it is only admissible if the agreement is facially ambiguous as to the conduct in question. *See infra* Part I.D.3.

130. *See generally* Michael P. Van Alstine, *Of Textualism, Party Autonomy, and Good Faith*, 40 WM. & M. L. REV. 1223, 1235–36 (1999).

131. *See id.*

faith' in lieu of abiding by explicit provisions of contracts."[132] The spread of textualism in contract interpretation led then-Judge Antonin Scalia to warn against reading the implied duty of good faith "out of existence."[133]

Despite its limitations in textualist regimes, contextualist jurisdictions endorse a more generous application of the duty of good faith.[134] Both the U.C.C. and the Restatement (Second) of Contracts embody this approach.[135] For example, "good faith" appears in approximately fifty provisions of the U.C.C.[136] However, given the primacy of the text, the modern version of good faith operates primarily to prevent acts that would hinder performance by another party only if the agreement is silent as to the conduct at issue.[137]

The interaction between express terms and more contextual factors, like the implied covenant of good faith, can be seen in a classic example, *Nanakuli Paving and Rock Co. v. Shell Oil Co*.[138] In this case, Nanakuli Paving and Rock Company ("Nanakuli") was a paving contractor that had a long-term requirements contract with Shell Oil Company ("Shell") for the supply of asphalt.[139] The contract provided that Nanakuli would pay "Shell's Posted Price at time of delivery."[140] Nanakuli committed itself to a paving contract before Shell delivered the asphalt needed to perform.[141] Shell increased its Posted Price, and Nanakuli sued for the lack of price protection.[142] The U.S. Court of Appeals for the Ninth Circuit held that the contract was broader than the express terms and that Shell failed to give sufficient advance notice of the price increase, thus violating the good faith obligation implied in dealings in Hawaii.[143]

In contextualist jurisdictions, the contract is not limited to its express terms. There is some degree of play in the joints, allowing for an application of contractual good faith where the express terms of an agreement do not directly address the conduct at issue.

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132. L.A.P.D., Inc. v. Gen. Elec. Corp., 132 F.3d 402, 404 (7th Cir. 1997).

133. Tymshare, Inc. v. Covell, 727 F.2d 1145, 1153–54 (D.C. Cir. 1984).

134. *See* Van Alstine, *supra* note 130, at 1241 (discussing the concurrent rise of contextualism and reemergence of contractual good faith).

135. RESTATEMENT (SECOND) OF CONTRACTS § 202(1) (AM. L. INST. 2015) ("Words and other conduct are interpreted in the light of all the circumstances.").

136. *See* Ernest Gellhorn, *Limitations of Contract Termination Rights—Franchise Cancellations*, 1967 DUKE L.J. 465, 570 n.17.

137. *See* Tagare v. Nynex Network Sys. Co. 994 F. Supp. 149, 159 (S.D.N.Y. 1997) (citation omitted) (stating that the duty of good faith and fair dealing "includes an implied undertaking on the part of each party that he will not intentionally and purposely do anything to prevent the other party from carrying out the agreement on his part").

138. 664 F.2d 772 (9th Cir. 1981) (applying Hawaii law).

139. *See id.* at 780.

140. *See id.*

141. *See id.*

142. No mention of price protection was made in the written contract. *See id.* at 793–94.

143. *See id.* at 806.

3. New York Commercial Contract Law

The jurisdiction whose interpretive regime is most important for the loan market is, undoubtedly, New York.[144] It is also the regime that has been applied to each uptier transaction to date. As a result, this part will discuss both the textualist interpretive regime employed by New York courts and their application of the implied covenant of good faith. Part I.D.3.a discusses the interpretive regime employed by the New York State Court of Appeals to interpret contracts when dealing with sophisticated commercial transactors. Part I.D.3.b explains that as textualism came to dominate New York commercial contract law, implied obligations of contractual good faith necessarily receded. It further notes that the decline of implied good faith obligations is most pronounced in cases involving massive buyout sponsors.

a. New York Employs a Textualist Contractual Regime

The New York State Court of Appeals has adopted decidedly textualist rules of contract interpretation when considering an agreement between sophisticated transactors.[145] Indeed, New York law is well-known for "follow[ing] the traditional Willistonian approach to interpretation which embodies a hard parol evidence rule . . . gives presumptively conclusive effect to merger clauses, and, in general, permits the resolution of many interpretation disputes by summary judgment."[146] Scholars of New York contract law posit that this is because the regime promotes certainty, predictability, and finality in contracts among sophisticated commercial parties.[147] In some sense, New York is choosing a textualist interpretive regime because it believes that is what commercial parties want to maintain its status "as a commercial center."[148] This policy choice appears to have

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144. *See* Elliot Ganz, *Loan Market Norms: Unexpected as the New Normal*, LSTA (June 1, 2021), https://www.lsta.org/news-resources/loan-market-norms-unexpected-as-the-new-normal/ [https://perma.cc/8SRS-MFTZ] (noting that credit agreements are near universally governed by New York law).

145. *See* Leib, *supra* note 119, at 394–95; *see also* 159 MP Corp. v. Redbridge Bedford, LLC, 128 N.E.3d 128, 130 (N.Y. 2019) ("In New York, agreements negotiated at arm's length by sophisticated, counseled parties are generally enforced according to their plain language pursuant to our strong public policy favoring freedom of contract."); Oxford Com. Corp. v. Landau, 190 N.E.2d 230, 231 (N.Y. 1963) ("It is too well settled for citation that, if a written agreement contains no obvious or latent ambiguities, . . . the parties . . . may [not] testify to what the parties meant but failed to state.").

146. Schwartz & Scott, *supra* note 92, at 932.

147. *See generally* Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts*, 30 CARDOZO L. REV. 1475 (2009); Geoffrey P. Miller & Theodore Eisenberg, *The Market for Contracts*, 30 CARDOZO L. REV. 2073 (2009).

148. IRB-Brasil Resseguros, S.A. v. Inepar Investments, S.A., 982 N.E.2d 609, 612 (N.Y. 2012). For an analysis of textualism in commercial contracts see 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 (2023).

successfully induced commercial parties to choose New York as their preferred forum for syndicated loan disputes.[149]

The New York State Court of Appeals has repeatedly reaffirmed its commitment to textualism in "[c]anonical cases."[150] For example, in *W.W.W. Associates, Inc. v. Giancontieri*,[151] the court detailed New York's hard parol evidence rule, holding that "[e]vidence outside the four corners of the document as to what was really intended but unstated or misstated is generally inadmissible to add to or vary the writing."[152] Moreover, in *Greenfield v. Phillies Records, Inc.*,[153] the court reiterated its commitment to the plain meaning rule: "A written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms."[154] Given the continuing commitment of the New York State Court of Appeals to a hard parol evidence rule and strict adherence to the plain meaning rule, New York contract law is textualist. In a recent case, the New York State Court of Appeals succinctly explained: "Historically, we have been 'extremely reluctant to interpret an agreement as impliedly stating something which the parties have neglected to specifically include.'"[155]

b. Implied Duties of Good Faith in New York

Notwithstanding the fact that the implied covenant of good faith was first established by a New York court, New York's modern predisposition for textualism has led the New York State Court of Appeals to adopt a narrow view of the covenant in recent years.[156] Despite its broader application in contextualist jurisdictions, the fate of implied duties of contractual good faith in New York intercreditor disputes seems clear: the parties' failure to include an express limitation is taken as an affirmative agreement between them that no such limitation exists.[157]

New York's textualist disposition collided with the duty of good faith in an intercreditor dispute stemming from the leveraged buyout of RJR Nabisco ("RJR") in the late 1980s.[158] Under the terms of the deal, RJR incurred

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149. *See* Ganz, *supra* note 144 and accompanying text.

150. *See* Leib, *supra* note 119, at 394–96.

151. 566 N.E.2d 639 (N.Y. 1990).

152. *Id.* at 642; *see also* Jarecki v. Shung Moo Louie, 745 N.E.2d 1006, 1007–08 (N.Y. 2001).

153. 780 N.E.2d 166 (N.Y. 2002).

154. *Id.* at 170; *accord* Laba v. Carey, 277 N.E.2d 641, 644–45 (N.Y. 1971) (noting that New York law requires courts "give the words and phrases employed [in contracts] their plain meaning").

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

156. *See* Murphy v. Am. Home Prods. Corp., 448 N.E.2d 86, 91 (N.Y. 1983) (holding that good faith cannot supplant express contract terms).

157. *See, e.g.*, Teachers Ins. & Annuity Ass'n of Am. v. Wometco Enters., Inc., 833 F. Supp. 344, 349 (S.D.N.Y. 1993) ("[Where the contract] lacks specific language preventing plaintiff from unreasonably withholding consent, the Court cannot and should not rewrite the contract to include such language which neither of the parties saw fit to insert in the contract.").

158. *See* Metro. Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504 (S.D.N.Y. 1989) (applying New York contract law).

substantial debt on a pari passu[159] basis to existing debt.[160] The agreement governing the existing debt protected against subordination, but it allowed RJR to incur significant additional indebtedness of equal or lower priority.[161] The existing debtholders found themselves joined by many new creditors, all of whom would hold equal claims in the event of insolvency.

The debtholders of RJR sued for breach of the implied covenant of good faith and fair dealing.[162] In rejecting the claims and allowing the transaction to go forward, the court explained that "[s]hort of bankruptcy, the debt security holder can do nothing to protect himself against actions of the borrower which jeopardize its ability to pay the debt unless he . . . establishes his rights through contractual provisions set forth in the debt agreement."[163] This ruling was a blow to the implied covenant of good faith and fair dealing in cases involving New York commercial disputes. If parties fail to secure an unambiguous, express provision protecting their position, courts refuse to supply one of their own through implied terms.

c. A Recent Corollary Application of Good Faith to an Intercreditor Dispute

Perhaps surprisingly, given its textualist tilt, New York courts have recently expressed some openness to reversing course in the march toward textualism and allowing implied covenant claims in certain intercreditor disputes. In fact, there are two statutory definitions of good faith in the U.C.C., and, although New York has long recognized objective good faith, it recently adopted amendments to Article 9 that incorporate subjective good faith.[164]

In *AEA Middle Market Debt Funding LLC v. Marblegate Asset Management, LLC*,[165] an intercreditor dispute involving a syndicated credit facility was at issue.[166] Here, Archway Marketing Services Inc. ("Archway") was in the business of furnishing marketing logistics, fulfillment, and supply chain management services.[167] In 2016, Archway entered a $165 million credit facility secured by a blanket lien.[168] The credit facility provided broad

159. Pari passu is Latin for "by equal step" and in context refers to proportional or equal rights. *See Pari Passu*, BLACK'S LAW DICTIONARY (11th ed. 2019).

160. RJR was purchased for $24 billion, a large deal even measured by modern standards. *See Metro. Life Ins. Co.*, 716 F. Supp. at 1505–07.

161. *See id.* at 1508 (The agreement contained "express provisions . . . [that] permit mergers and the assumption of additional debt").

162. *See id.* at 1507.

163. *See id.* at 1518 (alterations in original).

164. These amendments were signed into law in New York by Governor Andrew M. Cuomo in 2014. *See* Assemb. B. A9933, 2013–2014 Leg. Sess. (N.Y. 2014) (codified as amended at N.Y. U.C.C. § 9-102(43) (McKinney 2023)).

165. 185 N.Y.S.3d 73 (App. Div. 2023).

166. *See id.*

167. AEA Middle Mkt. Debt Funding LLC v. Marblegate Asset Mgt., LLC, No. 650413/2019, 2021 WL 10429158, at *1 (N.Y. Sup. Ct. Nov. 18, 2021) *aff'd as modified*, 185 N.Y.S.3d 73 (App. Div. 2023).

168. *See id.* at *1–2.

flexibility for amendment for a group of lenders holding more than 50 percent of the outstanding loans.[169]

In mid-2018, Archway faced financial distress and defaulted.[170] A group of lenders holding a majority of the outstanding loans conducted a foreclosure sale[171] of the debtor wherein the debtor's assets were sold to an entity whose equity interests were wholly owned by the majority coalition.[172] The majority further recapitalized the new company, allowing majority lenders to exchange their debt for a first-out position, while the minority lenders were permitted to exchange their debt primarily for new unsecured loans.[173] The minority lenders received "in exchange for their secured loans approximately 13% of face amount recovery in the form of unsecured, unguaranteed, subordinated replacement term loans . . . , and [the majority lenders], in turn, received . . . the entire equity of Archway."[174] The minority lender group sued, alleging breach of contract and the implied covenant of good faith and fair dealing.[175]

On the breach of contract theory, the minority lender group asserted that the sale and recapitalization failed to protect their interest in the foreclosed collateral.[176] Under the governing credit agreement, the lenders precluded any party from overriding any lender's access to collateral or pro rata payment-sharing rights without their consent.[177]

The majority lender group asserted that the minority lenders were accorded pro rata treatment because they could exchange their debt for the newly issued debt (albeit subordinated) in the reorganized company.[178] To support this position, the credit agreement provided that the collateral agent ("Agent") may exercise discretion in acting on the direction of a majority of lenders.[179] Because the Agent enjoyed discretion, and the debt exchange was offered to all lenders, the majority acted within its rights.[180] The trial court accepted this view in granting the majority's motion to dismiss the contract

169. *See id.*

170. *AEA Middle Mkt. Debt Funding LLC*, 185 N.Y.S.3d at 80.

171. The majority lenders acquired the assets entirely with noncash consideration in a "credit bid." *See id.* at 85–87. A credit bid converts debt to equity through the exercise of legal remedies. *See id.* The assets here were purchased with debt in the new corporation. *See id.*

172. *See id.* at 82–83.

173. *See id.* at 85–86.

174. *See id.* at 83.

175. *See* AEA Middle Mkt. Debt Funding LLC v. Marblegate Asset Mgt., LLC, No. 650413/2019, 2021 WL 10429158, at *8 (N.Y. Sup. Ct. Nov. 18, 2021) *aff'd as modified*, 185 N.Y.S.3d 73 (App. Div. 2023).

176. *See AEA Middle Mkt. Debt Funding LLC*, 185 N.Y.S.3d at 85.

177. *See id.* at 85–86.

178. *See id.* at 86.

179. Specifically, section 9.1(a) states that the Agent can act by direction of a majority of lenders, "except in instances of amendment or waiver of any provision of the Credit Agreement." *Id.* at 78 n.8, 89.

180. *See id.*

claim.[181] The court noted that the minority lenders' allegations did not implicate a specific provision of the credit agreement sufficient to carry the burden of pleading.[182] The Appellate Division of the New York Supreme Court took an altogether different view, focusing on the pro rata sharing provisions and holding that the receipt of unsecured debt does not appear to comply with the pro rata requirement of receiving the same benefit as the majority lenders.[183]

Plaintiffs also brought a claim for breach of the implied covenant of good faith and fair dealing.[184] The minority lenders alleged that the majority acted in bad faith—designing the restructuring to defeat the minority group's expectation of pro rata treatment.[185] The majority "concealed the transaction from [the minority group] until it could be revealed as a *fait accompli*, withheld [necessary] information . . . in the restructuring process, and improperly structured a commercially unreasonable [transaction] designed to preclude effective participation by [the minority]."[186]

The majority lenders argued that because the minority also brought a breach of contract claim, the implied covenant claim was duplicative and barred.[187] The Appellate Division disagreed, finding cause to deny the motion to dismiss.[188] In doing so, the court focused on the reasonable expectation of the minority that they would receive the same benefits as each lender in the class.[189] Put simply, the court found that the reasonable expectations of the minority to receive their pro rata share of the collateral had been infringed.[190]

The court relied on *Credit Agricole v. BDC Finance, LLC*[191] for the proposition that a good faith claim is not precluded where it "alleges conduct that is separate from the conduct constituting the alleged breach of contract and such conduct deprived the other party of the benefit of its bargain."[192] In that case, the defendants manipulated and depressed bids for collateral.[193] There appears to be some subset of cases surrounding intercreditor disputes

181. *See* AEA Middle Mkt. Debt Funding LLC v. Marblegate Asset Mgt., LLC, No. 650413/2019, 2021 WL 10429158, at *33 (N.Y. Sup. Ct. Nov. 18, 2021) *aff'd as modified*, 185 N.Y.S.3d 73 (App. Div. 2023).

182. *See id.*

183. The court further noted that "[e]ven if minority lenders were not entitled to equity . . . at the very least, they were entitled to the noncash consideration, in whatever form, that satisfied their pro rata share of the monetary value of the foreclosed collateral." *AEA Middle Mkt. Debt Funding LLC*, 185 N.Y.S.3d at 89.

184. *Id.* at 77 n.3.

185. *See id*. at 90–91.

186. *See id.* at 90.

187. *See id.* at 90–91.

188. *See id.* at 91–93.

189. *See id.* at 91.

190. *See id.* at 91–93.

191. 22 N.Y.S.3d 847 (App. Div. 2016).

192. *AEA Middle Mkt. Debt Funding LLC*, 185 N.Y.S.3d at 90.

193. *See* Credit Agricole Corporate v. BDC Finance, LLC, 22 N.Y.S.3d 847, 847–48 (App. Div. 2016).

where New York's Appellate Division will allow a claim for contractual good faith; however, the state's highest court has yet to hear the issue.

II. COURTS CONFRONT UPTIER TRANSACTIONS

Uptier transactions have become a frequent source of recent litigation.[194] Part II will discuss the litigation surrounding three notable uptier transactions as case studies, evaluating the legal claims and corresponding rulings. Notably, these cases diverge in applying the implied covenant to similar transaction structures, yielding varying results. Part II.A will discuss *Audax Credit Opportunities Offsore Ltd. v. TMK Hawk Parent, Corp.*,[195] which involves TMK Hawk Parent, Corp. ("Trimark") and provides the strongest argument for minority lenders seeking to enjoin these transactions. Part II.B will discuss the litigation surrounding *Bayside Capital Inc. v. TPC Group Inc. (In re TPC Group Inc.)*,[196] the first uptier to be upheld on the merits. Part II.C will discuss the litigation surrounding *Serta Simmons Bedding, LLC v. AG Centre Street Partnership (In re Serta Simmons Bedding, LLC)*,[197] the uptier transaction subject to the most extensive litigation.

A. Trimark

One of the first uptier transactions to reach litigation involved Trimark, which was in the business of distributing food service equipment.[198] In 2017, two private equity firms[199] acquired a controlling interest in Trimark through a $1.265 billion LBO.[200] The LBO was financed by an $820 million syndicated loan with two tranches: a first-lien tranche with a total of $585 million and a second-lien tranche with a total of $235 million.[201] A loan agreement (the "Trimark Loan Agreement") governed the credit facility.[202]

The Trimark Loan Agreement provided that most of its provisions could be "waived, amended or modified . . . pursuant to an agreement or agreements in writing" by Trimark and a group of lenders holding more than 50 percent of the outstanding loans.[203] However, this right was limited by section 9.02[b][i][D] of the agreement, which provided that each lender had the right to veto any amendment that "directly and adversely" affected that

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194. *See, e.g.*, Trimark Complaint, *supra* note 19; Serta Complaint, *supra* note 19; Boardriders Complaint, *supra* note 19; Incora Complaint, *supra* note 19; Mitel Complaint, *supra* note 19.

195. No. 565123/2020, 2021 WL 3671541 (N.Y. Sup. Ct. Aug. 16, 2021).

196. Ch. 11 Case No. 22-10493, Adv. No. 22-50372, 2022 WL 2498751 (Bankr. D. Del. July 6, 2022).

197. Ch. 11 Case No. 23-90020, Adv. No. 23-9001, 2023 WL 3855820 (Bankr. S.D. Tex. June 6, 2023).

198. *See* Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541 (N.Y. Sup. Ct. Aug. 16, 2021).

199. These firms were Centerbridge and Blackstone. *See supra* note 54 and accompanying text.

200. *See Audax Credit Opportunities Offshore Ltd.*, 2021 WL 3671541, at *2.

201. *See id.*

202. *See id.*

203. *See id.* at *2–3.

lender by altering the order of application of proceeds.[204] Through a series of cross-references, the Trimark Loan Agreement adopted the order of application of proceeds as specified in the "Intercreditor Agreement."[205]

1. The Trimark Uptier

In 2020, Trimark faced pandemic headwinds and announced an uptier transaction to alleviate financial distress.[206] Under the terms of the deal, Trimark borrowed $120 million in new money from a majority group of its existing lenders under the Trimark Loan Agreement.[207] The new loan was secured by the same collateral as the first-lien debt issued under the Trimark Loan Agreement.[208] The transaction further allowed the participating majority group of lenders to exchange $307.5 million of existing 2017 debt for additional, newly-issued loans.[209] The exchanged loans were secured by the same collateral but had second-out priority—subordinated only to the new-money loan.

Moreover, this exchange occurred at face value while the loans traded at seventy-eight cents on the dollar.[210] As a result, the debt exchange netted the majority lenders approximately $67.65 million in additional value.[211] Although both the company and the majority lenders benefitted, the minority lenders were left subject to third-out priority, with over $500 million in new debt subordinating their position.[212]

To conduct this transaction, the majority lenders, who constituted a bare majority[213] of all lenders, amended the existing Trimark Loan Agreement. Specifically, they amended the definition of "Intercreditor Agreements" to include a new "Super-Priority Intercreditor Agreement," which stipulated that the newly-issued tranches both must be paid in full before lenders under the Trimark Loan Agreement receive access to the collateral.[214] The Trimark Loan Agreement was further amended to allow the company to prepay debt "at, below, and/or above par at its sole discretion[] on a non-pro rata basis."[215]

2. The Legal Challenges

The minority lenders sued both the majority lenders and Trimark in New York state court, alleging that the uptier transaction and resulting amendments to the Trimark Loan Agreement violated the express terms of

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204. *See id.*
205. *See id.* at *5.
206. *See id.* at *3.
207. *See id.* at *4.
208. *See id.*
209. *See id.*
210. *See id.*
211. *See id.*
212. *See id.* at *14.
213. Bare majority in this case means 50.1 percent. *See id.*
214. *See id.*
215. *See id.* at *5.

their contract and breached the implied covenant of good faith and fair dealing.[216] The court granted the majority lenders' motion to dismiss the claims alleging breach of the implied covenant of good faith and fair dealing,[217] but allowed the complaint to move forward with the claim for breach of contract.[218]

New York law instructs that a motion to dismiss a breach of contract claim must be denied where the contract is ambiguous to the conduct at issue.[219] Because the court found section 9.02[b][i][D][220] was subject to more than one reasonable interpretation, the breach of contract claim survived.[221] In its ruling, the court noted two plausible interpretations.[222] One interpretation suggested that section 9.02[b][i][D] prohibits anyone from placing a tranche of debt above the senior secured position in the waterfall.[223] Another plausible interpretation instructed that section 9.02[b][i][D] could require that the distribution of proceeds under the Trimark Loan Agreement remain unaffected.[224] In this view, the Trimark Loan Agreement simply applied the proceeds as instructed by the Intercreditor Agreement, and it was the Intercreditor Agreement, not the Trimark Loan Agreement, that placed the newly issued debt above the existing debt. Put simply, one could find section 9.02[b][i][D] was not implicated as the amendment did not "alter" the order prescribed in the Trimark Loan Agreement. However, the court did not reach the question of which interpretation was best.[225] Rather, because the court found ambiguity, the claim survived.[226]

The court quickly dispatched the implied covenant claim as duplicative.[227] In doing so, it found that if the participating lenders were within their rights to amend the original credit agreement, the implied covenant could not impose restrictions beyond what was outlined in the contract.[228] Further, if, in the alternative, the plaintiffs could prevail on the contract claims, the implied covenant claim would be duplicative because it arose from the same operative facts.[229] Its analysis, however, noted that the majority violated the

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216. *See id.* at *6.
217. *See id.* at *13.
218. *See id.* at *2.
219. *See* 150 Broadway N.Y. Assocs., L.P. v. Bodner, 784 N.Y.S.2d 63, 65 (App. Div. 2004); *accord* Excel Graphics Techs., Inc. v. CFG/AGSCB 75 Ninth Ave., LLC, 767 N.Y.S.2d 99 (App. Div. 2003) *dismissed*, 814 N.E.2d 464 (N.Y. 2004).
220. Pursuant to section 9.02[b][i][A]–[D], "[l]enders have the right to veto any amendment that 'directly and adversely' affects that [L]ender by: (a) increasing the Commitment of any Lender; (b) reducing the principal amount or rate of interest of any Loan; (c) postponing the maturity of any Loan; or (d) changing the 'waterfall' provisions in section 7.03 of the Original Agreement or Section 4.02 of the Collateral Agreement." *See Audax Credit Opportunities Offshore Ltd.*, 2021 WL 3671541, at *3.
221. *See id.* at *12–13.
222. *See id.*
223. *See id.* at *12.
224. *See id.*
225. *See id.*
226. *See id.*
227. *See id.* at *13.
228. *See id.*
229. *See id.*

commercial norm of collective action and offended what it referred to as the "all for one, one for all" spirit of a syndicated loan.[230] In March 2022, the case was resolved out of court through an undisclosed settlement, in which parties on both sides stipulated discontinuance with prejudice.[231]

B. TPC Group

The next uptier transaction involved the company TPC Group ("TPC") which was the first uptier to reach a decision on the merits.[232] TPC is a Texas-based petrochemical company.[233] In 2019, TPC entered into a $930 million syndicated credit facility secured by a blanket lien and governed by a loan agreement (the "TPC Loan Agreement").[234] The TPC Loan Agreement provided broad amendment power to lenders holding a simple majority of the outstanding loans.[235] But it provided that a 66 and 2/3 percent majority would be required for any amendment that releases "all or substantially all" of the collateral or otherwise modifies the agreement in any manner adverse to any lender.[236] Finally, the TPC Loan Agreement required consent from every affected lender for a select group of sacred rights, including an amendment that deals with the priority of payments.[237] The priority of payments, in turn, detailed that after administrative expenses have been paid, the proceeds are distributed ratably between the lenders.[238]

1. The TPC Uptier

After the issuance of the 2019 credit facility, TPC faced financial distress.[239] To alleviate liquidity concerns, TPC consummated an uptier transaction.[240] Under the deal, the company issued $153 million in new notes in 2021 and added another $51.5 million tranche in 2022.[241] The same assets secured the newly issued tranches as the 2019 credit facility.[242] This transaction was somewhat less aggressive than the paradigmatic uptier, as the majority lenders retained their position in the 2019 credit facility.[243]

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230. *See id.* at *1.

231. *See* Joint Stipulation and Order of Stay, Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020 (N.Y. Sup. Ct. Jan. 11, 2022).

232. Bayside Cap. Inc. v. TPC Grp. Inc. (*In re* TPC Grp.), Ch. 11 Case No. 22-10493, Adv. No. 22-50372, 2022 WL 2498751, at *1 (Bankr. D. Del. July 6, 2022).

233. *See id.*

234. *See id.* at *2.

235. *See id.* (noting that there are some exceptions to the general power of 50.01 percent of outstanding lenders to amend the TPC Loan Agreement).

236. *See id.*

237. *See id.* at *3.

238. *See id.*

239. *See id.* at *4.

240. *See id.* at *1.

241. *See id.* at *5.

242. *See id.*

243. *Compare id.* at *10, *with* Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *4 (N.Y. Sup. Ct. Aug. 16, 2021) (noting that the participating lenders exchanged all of their outstanding debt under the original facility).

Nonetheless, the result for the minority lenders was subordination to the tune of $204.5 million.

The uptier was accomplished by a majority group[244] of lenders' amendments to the TPC Loan Agreement, whereby the newly issued tranches were placed above the existing facility in the priority of payment.[245] Shortly after that, TPC voluntarily filed for Chapter 11 reorganization, and the minority lender group commenced an adversary proceeding to seek to void the uptier transaction.[246]

2. The Legal Challenges

The only theory the minority lenders challenged the transaction under was a claim for breach of contract.[247] They alleged that the subordination occurred because of the issuing of two new priority tranches of debt that altered the priority of payments, thereby requiring their consent as a "sacred right."[248] Conversely, the majority lenders asserted that only amending the TPC Loan Agreement to alter the priority of payments within the same class of debt would violate the lender's sacred rights.[249] In this view, so long as the facility's proceeds (or whatever is left of them) are applied proportionally among lenders, the agreement has not been amended to alter the priority of payments.[250] The court ultimately found for the majority lenders, holding that the uptier did not breach the terms of the TPC Loan Agreement.[251]

Taking note of the decision in *Trimark*, the court explained the divergent interpretations urged by both parties.[252] One is that the unanimous consent right for pro rata sharing prohibited subordination.[253] The other argues that this provision merely ensured that the collateral (no matter what is left of it) is distributed equally among lenders.[254] In weighing these interpretations, the court focused on the hierarchy of consents that the TPC Loan Agreement required to effect certain transactions.[255] The TPC Loan Agreement generally provided for control by the majority, stating that a super-majority of two-thirds was required to release all or substantially all of the collateral,

244. The group of lenders held more that 67 percent of the outstanding loans. *See In re TPC Grp.*, 2022 WL 2498751, at *10.
245. *See id.*
246. *See id.* at *5–6.
247. *See* Ad Hoc Group of Non-Consenting Noteholders' Motion for Summary Judgement, Bayside Capital Inc. v. TPC Grp. Inc. (*In re* TPC Grp.), No. 22-10493 (Bankr. D. Del. June 2, 2022).
248. *See id.* at *5, 8 ("These purported amendments to the Original Indenture . . . have changed the application of proceeds of collateral in a way adverse to all Senior Noteholders—namely, by subordinating the Senior Secured Notes.").
249. *See In re TPC Grp.*, 2022 WL 2498751, at *10.
250. *See id.*
251. *See id.* at *10–12.
252. *See id.* at *10–11.
253. *See id.*
254. *See id.*
255. *See id.* at *11–12.

and then identified certain rights that required unanimous consent or "sacred rights."[256]

In its ruling, the court spent considerable time concluding that reading the pro rata sharing provision as prohibiting subordination would be inconsistent with the hierarchy of amendments.[257] Subordination of a lien to that of another lender is less drastic of an intrusion on the rights of a lender than simply releasing all the collateral.[258] There are a variety of reasons that a lender may want to subordinate its lien in favor of a new lender.[259] Therefore, in the court's view, it would have been anomalous to read the TPC Loan Agreement as permitting a two-thirds majority to release all the collateral but requiring unanimous consent to take on additional senior indebtedness.[260]

Thus, the pro rata sharing provision aimed to ensure proportional distributions and should not be read as an antisubordination provision in disguise.[261] Judge Craig T. Goldblatt further noted that "[t]here is nothing in the law that requires holders of syndicated debt to behave as [m]usketeers."[262] To the extent lenders want to be protected against self-interested actions by borrowers and other lenders, they must include express protections in their agreements.[263]

C. Serta

The uptier transaction subject to the most extensive litigation undoubtedly involves Serta.[264] With its corporate affiliates, Serta is one of North America's largest bedding manufacturers and distributors.[265] For the ten years preceding 2020, Serta held the largest percentage of the industry market share.[266] In 2016, Serta entered into a credit facility governed by a loan agreement.[267] This 2016 credit agreement provided Serta with $2.4 billion in first-lien and second-lien term loans.[268]

The 2016 credit agreement stated that all its provisions may be "waived, amended or modified" by agreement "in writing entered into by [Serta] and the Required Lenders" (i.e., lenders holding collectively a majority of the

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256. *See id.*
257. *See id.*
258. *See id.* at *12.
259. Consider the case where a company faces insolvency. An existing lender may not want to increase its exposure to a high credit risk by providing new capital. However, that lender would be happy to subordinate its lien in favor of another lender who is willing to lend new-money if the deal increases the recovery prospect. *See id.*
260. *See id.*
261. *See id*. at *11–12.
262. *See id.*
263. *Id.*
264. *See generally* Serta Simmons Bedding, LLC v. AG Centre St. P'ship (*In re* Serta Simmons Bedding, LLC), Ch. 11 Case No. 23-90020, Adv. No. 23-9001, 2023 WL 3855820 (Bankr. S.D. Tex. June 6, 2023).
265. *See id.* at *1.
266. *See id.*
267. *See id.* at *2.
268. *See id.*

outstanding debt).[269] The lenders had the right to receive payments and proceeds from collateral pro rata.[270] These pro rata sharing rights could not be altered without the consent of all adversely-affected lenders.[271]

However, the 2016 credit agreement contained an exception that permitted Serta to engage in a limited set of transactions on a non-pro rata basis.[272] The provisions requiring the consent of all affected lenders contained a carve-out for "transactions permitted under Sections 2.22, 2.23, 9.02(c) and/or 9.05(g)."[273] Section 2.22 enabled Serta to engage in an exchange of first-lien loans for new loans incurred as part of an "incremental credit facilit[y]."[274] Section 2.23 permitted Serta to extend the maturity date.[275] Section 9.02(c) allowed Serta to "refinance or replace existing first-lien debt with 'replacement term loans.'"[276] Section 9.05(g) authorized Serta to "'purchase' loans from existing first-lien lenders either '(A) through Dutch Auctions open to all Lenders holding the relevant Term Loans on a pro rata basis or (B) through open market purchases.'"[277]

1. The Serta Uptier

In 2020, Serta, as a result of pandemic headwinds, entered an uptier transaction to recapitalize the company.[278] Serta issued $200 million of new-money, first-priority debt, and $875 million of second-priority debt funded through exchanges[279] of the majority lenders' existing loans.[280] Under this exchange, the company deleveraged by approximately $227.5 million and secured $200 million in new money, while the minority was subordinated by over $1 billion.

This uptier differed from the previous transactions, as there was a competitive process involving liability-management proposals from multiple lender groups.[281] The majority lenders amended the 2016 credit agreement

269. *Id.*
270. *See id.*
271. *See id.*
272. *See id.*
273. *See id.*
274. Corrected Brief for Appellants LCM Lenders at 3, *In re* Serta Simmons Bedding, LLC, No. 23-20181 (5th Cir. Aug. 3, 2023).
275. *See id.*
276. *See id.* (quoting Record on Appeal at 276–77, *In re* Serta Simmons Bedding, LLC, No. 23-20181 (5th Cir. 2023)).
277. *See id.* (quoting Record on Appeal at 287–88, *In re* Serta Simmons Bedding, LLC, No. 23-20181 (5th Cir. 2023)).
278. *In re Serta Simmons Bedding, LLC*, 2023 WL 3855820, at *3.
279. These loans were exchanged at $0.74 on the dollar. *Id.* at *5.
280. *See id.* at *5.
281. A drop-down proposal by certain lenders "would have siphoned off a large portion of collateral—including Serta Simmons Bedding's [valuable] intellectual property—away from the [existing] first-lien lenders and into a newly formed subsidiary to benefit those participating lenders alone." *See* Adversary Complaint at 4, Serta Simmons Bedding, LLC v. AG Centre St. P'ship (*In re* Serta Simmons Bedding, LLC), Ch. 11 Case No. 23-90020, Adv. No. 23-9001, 2023 WL 3855820 (Bankr. S.D. Tex. June 6, 2023).

to consummate this transaction, allowing Serta to take on new debt and incur new liens.[282]

2. The Legal Challenges

In June 2020, a group of minority lenders sued under breach of contract and contractual good faith theories in New York state court to prevent the 2020 transaction from closing.[283] The new-money portion of this uptier transaction was not particularly controversial; instead, the litigation focused on the exchange under the "open market purchase" exception.[284]

The state court denied the requested relief, finding that the minority lenders were not likely to succeed on the merits because the credit agreement "seems to permit[] the debt-to-debt exchange on a non-pro rata basis as part of an open market transaction" and that "[s]ince the amendments do not affect plaintiffs so-called 'sacred rights' . . . plaintiffs' consent does not appear to be required."[285]

Following the state court's refusal to grant an injunction, another group of minority lenders, the LCM lenders, filed suit in federal court challenging the validity of the 2020 transaction.[286] The facts of the LCM lenders' suit differed slightly from the initial state court litigation, as the LCM lenders were excluded from the bidding process.[287] The LCM lenders' complaints argued that the 2020 transaction breached the terms of the 2016 credit agreement and the implied covenant of good faith and fair dealing.[288] The defendants moved to dismiss the complaint.[289] The court denied Serta's motion to dismiss and allowed the LCM lenders to continue to pursue their claims.[290]

On the claim for breach of contract, the court found a reasonable basis for a difference of opinion as to whether a debt exchange properly fits into the plain meaning of the open-market exception.[291] Subsequently, the court found, "even if an open-market purchase under the Agreement did not require that all lenders be privy to a debt-[exchange] offer, the Court [was] unable to conclude as a matter of law that the Transaction was expressly permitted by [the open-market exception]."[292] The court went on to acknowledge that the 2016 credit agreement seemed to contemplate debt exchanges subject to

282. *See id.* at 3.
283. N. Star Debt Holdings, L.P. v. Serta Simmons Bedding, LLC, No. 652243/2020, 2020 WL 3411267, at *3 (N.Y. Sup. Ct. June 19, 2020).
284. *See generally* Serta Complaint, *supra* note 19.
285. *See N. Star Debt Holdings, L.P.*, 2020 WL 3411267, at *8.
286. *See* LCM XXII Ltd. v. Serta Simmons Bedding, LLC, No. 21CV3987, 2022 WL 953109, at *2 (S.D.N.Y. Mar. 29, 2022).
287. *See id.* at *3.
288. *See id.* at *1.
289. *See id.*
290. *See id.* at *16.
291. *See id.* at *8.
292. *Id.*

antisubordination language specifically.[293] However, these provisions did not curtail the ability to retire loans via the open market.[294]

After this decision, Serta filed for bankruptcy under Chapter 11 in the U.S. Bankruptcy Court for the Southern District of Texas and sought a declaratory judgment that the 2020 transaction was valid.[295]

Contrary to the U.S. District Court for the Southern District of New York, the bankruptcy court granted partial summary judgment, holding that the meaning of the open-market purchase exception was unambiguous, and that the debt-exchange transaction was expressly permitted under the open-market purchase exception.[296] Ruling from the bench, the bankruptcy judge explained, "[w]hen I get to [the open-market purchase exception], there is simply no ambiguity in my mind."[297] Further, the judge stated: "I sit in with these matters every single day and again, there is just no—there is no doubt in my mind."[298] In so ruling, the court emphasized that the exchange "was the result of good-faith, arm's length negotiations by economic actors acting in accordance with the duties owed to their respective creditors, investors and owners."[299] The court found that the transaction was binding and enforceable in all respects, denying all claims for breach of contract, breach of the implied covenant of good faith and fair dealing, and all other requested relief.[300]

The minority lenders appealed the ruling on the meaning of the open-market purchase exception to the U.S. Court of Appeals for the Fifth Circuit, where it remains at the time of this writing.[301]

III. CLARIFYING THE ROLE OF NEW YORK'S TEXTUALISM IN LIABILITY-MANAGEMENT TRANSACTIONS AND THE ARGUMENT FOR A REVIVAL OF CONTRACTUAL GOOD FAITH

The outcome of each case turns on the court's interpretation of the loan agreement's express terms and application of the implied covenant of good faith and fair dealing.[302] This Note takes the position that New York contract law has played a significant role in allowing liability-management transactions to develop. It further highlights that these transactions have the potential to be abusive and suggests that courts revive contractual good faith to police the boundaries and prevent the destruction of value. Part III.A argues that New York's commitment to textualism in contract construction

293. *See id.* at *9.
294. *See id.*
295. *See* Serta Simmons Bedding, LLC v. AG Centre St. P'ship (*In re* Serta Simmons Bedding, LLC), Ch. 11 Case No. 23-90020, Adv. No. 23-9001, 2023 WL 3855820, at *6–8 (Bankr. S.D. Tex. June 6, 2023).
296. *See id.* at *7.
297. Corrected Brief for Appellants LCM Lenders, *supra* note 274, at 11.
298. *Id.* at 12.
299. *See In re Serta Simmons Bedding, LLC*, 2023 WL 3855820, at *12.
300. *See id.*
301. *See id.* at *7.
302. *See supra* note 290 and accompanying text.

has facilitated the rise of uptier transactions. Part III.B argues that notwithstanding New York's predilection for textualism, there are cases in which the implied covenant of good faith can apply. It further argues that judges should revive the covenant to police creditor conduct and prevent abuse.

A. New York's Textualism Facilitates Uptier Transactions

Textualism in New York contract construction has facilitated the recent trend of uptier transactions. The plain meaning rule and the four corners rule provide the cornerstone of New York's interpretive regime.[303] The regime's inflexibility has largely foreclosed the consideration of anything other than a contract's express terms.[304] This is perhaps most evident in the rise of textualism and the corresponding demise of the implied obligation of contractual good faith.[305]

The textualist paradigm in New York incentivizes debtors and lenders to scour their agreements for provisions that may be interpreted to allow them to act to enrich themselves at the expense of others.[306] With obligation of contractual good faith all but irrelevant, holders of leveraged loans are left playing a game of "whack-a-mole," guessing which clause a competing lender group might exploit—with only the written protections bargained for in the agreement governing their securities.[307]

Notably, loan agreements have grown increasingly loose with the accommodative credit market following the 2008 recession.[308] As a result, some borrowers are left with scant credit agreements as their sole protection from creditors jostling to secure payment priority.[309] Even further, the provisions that are bargained for are interpreted quite narrowly, with a focus only on the plain meaning of the words.[310] Consequently, lenders to a distressed company have ample incentive to comb through their loan agreements for contractual loopholes that may allow some sort of liability-management solution, which can be structured to comply with the literal terms of the agreement.[311] This incentive may be more pronounced in companies recently acquired in an LBO, wherein the private equity sponsor

303. *See supra* note 145 and accompanying text.
304. *See* Van Alstine, *supra* note 130.
305. *See generally supra* Part I.D.3.b.
306. If a lender group is the first to consummate an uptier, they stand to recover handsomely. In *Trimark*, the majority lenders recovered approximately $70 million above the market value of their position. *See* Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *11–12 (N.Y. Sup. Ct. Aug. 16, 2021).
307. In many circumstances, the ultimate holder of the loan plays no role in its origination (e.g., Collateralized Loan Obligations). *See supra* note 23 and accompanying text.
308. *See supra* note 13 and accompanying text (noting that maintenance covenants have largely been eliminated from loan agreements).
309. *See supra* note 145 and accompanying text.
310. *See supra* note 155 and accompanying text.
311. *See generally supra* Part II.C.

is eager to prevent the diminution of its equity position in a Chapter 11 proceeding.[312]

This part, using decisions in recent uptier cases, illustrates how New York law's commitment to textualism has facilitated the rise of uptier transactions. Part III.A.1 explains that the hard version of the parol evidence rule adopted in New York excludes the consideration of anything but the text—absent any patent ambiguity or incompleteness. This necessarily excludes any market norms. Part III.A.2 describes how the plain meaning rule bifurcates antisubordination and pro rata sharing into distinct rights that must be separately bargained for. Part III.A.3 demonstrates the futility of the implied covenant of good faith and fair dealing in disputes between sophisticated commercial transactors.

1. The Hard Parol Evidence Rule Excludes Extrinsic Evidence

It is well settled that the New York State Court of Appeals has adopted a hard version of the parol evidence rule.[313] The rule requires courts to determine whether an agreement is ambiguous by considering only the text.[314] Nonetheless, the courts applying New York law have reached inconsistent conclusions about whether a contract is ambiguous even when considering the same set of facts.[315] The New York Appellate Division in *Trimark* noted the shared spirit of the lending syndicate, going as far as to call it "all for one, one for all."[316] This aspirational spirit is incongruous with the U.S. Bankruptcy Court for the District of Delaware, where "[t]here is nothing in the law that requires holders of syndicated debt to behave as [m]usketeers."[317] It seems that the spirit of the agreement cannot supplant an agreement's express terms.[318] This is made clear by the Bankruptcy Court for the Southern District of Texas in *Serta*, where the court took the view that if the majority lenders were within their rights to amend the original credit agreement, any unexpressed norm could not be used to impose restrictions going beyond what was outlined in the contract.[319]

312. *See supra* note 55 and accompanying text.
313. *See supra* note 146 and accompanying text.
314. *See supra* note 118 and accompanying text.
315. *See supra* Part II.C.2 (noting that the Southern District of New York and the Bankruptcy Court for the Southern District of Texas reached opposite conclusions considering the same facts).
316. *See* Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/2020, 2021 WL 3671541, at *1 (N.Y. Sup. Ct. Aug. 16, 2021).
317. Bayside Cap. Inc. v. TPC Grp. Inc. (*In re* TPC Grp. Inc.), Ch. 11 Case No. 22-10493, Adv. No. 22-50372, 2022 WL 2498751, at *12 (Bankr. D. Del. July 6, 2022).
318. *See* Murphy v. Am. Home Prods. Corp., 448 N.E.2d 86, 91 (N.Y. 1983).
319. *See* Serta Simmons Bedding, LLC v. AG Centre St. P'ship (*In re* Serta Simmons Bedding, LLC), Ch. 11 Case No. 23-90020, Adv. No. 23-9001, 2023 WL 3855820, at *13 (Bankr. S.D. Tex. June 6, 2023) (noting "[t]he Court's inquiry is further constrained by the entirety of the terms in the agreement.").

In New York, the unexpressed norm of ratable treatment in workouts is inadmissible in litigation absent incompleteness or patent ambiguity.[320] The hard parol evidence rule dictates that extrinsic evidence cannot be used to create ambiguity.[321] The *TPC* court shunned the opportunity to consider extrinsic evidence, preferring to conduct a searching review of the various lender protections in the credit agreement and engaging in a hypertextualist analysis of the type of action allowed by each rung of the amendment hierarchy.[322] This example illustrates that faithful adherence to text renders the unexpressed spirit of a contract irrelevant. No matter how ubiquitous a commercial norm, courts must set aside the unstated spirit of an agreement in favor of its express terms in a textualist regime like New York.

2. The Plain Meaning Rule Distinguishes Pro Rata Sharing from Antisubordination

The plain meaning rule requires courts to apply the unambiguous ordinary meaning of a contract's express terms to the facts of the case.[323] In the litigation related to uptier transactions, minority lenders often claimed that the uptier transactions, which resulted in their subordination, violated the protections they had bargained for regarding any transaction affecting pro rata sharing.[324] These minority groups argue that pro rata sharing protections are equivalent to or include antisubordination provisions.[325] Conversely, the majority lenders argue for a narrow interpretation that simply mandates that all lenders within a class receive the same proportion of collateral proceeds—providing no protection against structural subordination to a new money tranche.[326]

The Appellate Division of the New York Supreme Court in *Trimark* and the Southern District of New York in *Serta* found ambiguity in the pro rata sharing protections to allow the breach of contract claims to survive motions to dismiss.[327] The courts reaching the merits took an altogether different view.[328] These courts echoed the statement from *Metropolitan Life Insurance Company v. RJR Nabisco, Inc.*,[329] which said that courts may only provide expressly negotiated protections.[330] It seems reasonably clear that the ordinary meaning of pro rata sharing merely guarantees equal treatment

320. *See supra* note 103 and accompanying text.
321. *See supra* note 129 and accompanying text.
322. *See supra* note 255 and accompanying text. Interpreting a contract in order to give effect to each provision—sometimes called the canon against surplusage—is a classic tool of construction available to courts in a textualist jurisdiction. *See supra* note 102 and accompanying text.
323. *See supra* note 99 and accompanying text.
324. *See, e.g.*, *In re Serta Simmons Bedding, LLC*, 2023 WL 3855820, at *7.
325. *See* Bayside Cap. Inc. v. TPC Grp. Inc. (*In re* TPC Grp. Inc.), Ch. 11 Case No. 22-10493, Adv. No. 22-50372, 2022 WL 2498751, at *12 (Bankr. D. Del. July 6, 2022).
326. *See supra* note 250 and accompanying text.
327. *See supra* Part II.A.; *see also supra* Part II.C.
328. *See supra* Part II.A.; *see also supra* Part II.C.
329. 716 F. Supp. 1504 (S.D.N.Y. 1989).
330. *Id.* at 1518; *see supra* note 163 and accompanying text.

for each party within the class, and does not prevent the subordination of the class as a whole.[331] If parties wanted an antisubordination provision, they should have bargained for one rather than try to read it into pro rata sharing.[332] Many parties have adopted antisubordination language to guard against this possibility.[333]

3. The Implied Covenant of Good Faith and Fair Dealing Is Nearly Irrelevant in Commercial Disputes

The implied covenant of good faith and fair dealing has been hamstrung in New York commercial disputes.[334] The legacy of *RJR Nabisco* instructs that if the parties do not negotiate an express provision protecting their interests, courts should not insert one under any implied obligation.[335] Instead, this omission is taken as an affirmative agreement that no limitation exists other than those delineated in the contract's express terms.[336] This inherent tension has come to realize then-Judge Scalia's warning: the implied covenant has been read into near irrelevance.[337]

The courts in both *Trimark* and *Serta* explained that if the participating lenders were within their rights to amend the original credit agreement, the implied covenant could not impose restrictions going beyond what is outlined in the contract.[338] Alternatively, if the plaintiffs prevail on the contract claims, the implied covenant claim is duplicative because they arise from the same operative facts.[339] Thus, in the view of these courts, there is little room for any implied covenant claim in the context of an intercreditor dispute.

B. The Case for a Limited Expansion of Implied Contractual Good Faith

Uptier transactions certainly have the potential to be abusive, and in the current state of play, any such abuse may only be remedied under the written terms of the parties' agreement. This Note suggests that a subset[340] of cases

331. *See supra* note 257 and accompanying text.
332. *See supra* note 263 and accompanying text.
333. The LSTA has published recommended antisubordination language for inclusion in credit agreements. *See* Marsh, *supra* note 15 (detailing the recommended language: "[No amendment, waiver or consent shall] without the prior written consent of each Lender directly affected thereby, (i) subordinate, or have the effect of subordinating, the Obligations hereunder to any other Indebtedness, (ii) subordinate, or have the effect of subordinating, the Liens securing the Obligations to Liens securing any other Indebtedness, or (iii) modify Section [include pro rata sharing, pro rata treatment, post default waterfall an borrower/affiliate buyback mechanics if appropriate] or any other provision hereof in a manner that would have the effect of altering the ratable reduction of Commitments or the pro rata sharing of payments otherwise required hereunder.").
334. *See supra* Part I.D.3.b.
335. *See supra* note 155 and accompanying text.
336. *See supra* note 157 and accompanying text.
337. *See supra* note 133 and accompanying text.
338. *See supra* Part II.A; *see also supra* Part II.C.
339. *See supra* Part II.A; *see also supra* Part II.C.
340. This Note stops short of advocating for a broad application of the implied covenant of good faith and fair dealing to all liability-management transactions. Concededly these

exists where the implied covenant could be expanded to prevent abusive transactions. Courts should recenter the focus of the restructuring market on increasing the long-term viability of debtors and preventing value destroying transactions. Part III.B.1 explains that because of the New York State Court of Appeals's stated goals in contract construction, it is unlikely to adopt contextualist principles. One such principle is increasing the degree of play in the joints of contractual good faith.[341] Part III.B.2 contends that notwithstanding New York's textualist regime, some courts have recently expressed willingness to enforce good faith claims when an agreement is silent about the conduct and the conduct is commercially unreasonable. Part III.B.3 argues that New York courts should consider a limited expansion to contractual good faith in uptier transactions with particular focus on the reasonable expectation of the parties and commercial reasonableness of a proposed transaction.

1. New York Is Opposed to Contextualism in Contract Disputes Between Commercial Parties

New York is not likely to adopt a more contextual approach to enforce commercial norms in uptier transactions. First, commercial transactions between sophisticated parties are where New York is most committed to textualism.[342] Textualism provides certainty, predictability, and finality.[343] New York courts choose a textualist regime to secure the benefits of being the preferred forum for contractual disputes.[344] Commercial parties choose New York law as the governing law for their agreements precisely because the interpretive regime is a known quantity.[345] Understanding the looseness of many credit documents and the lack of willingness of courts to supply any other protections, parties can capture value by participating in the majority group of an uptier transaction.[346] Minority parties have little incentive to change this system if they participate in these transactions and sometimes find themselves in the majority.[347] The upshot of this is that moving away from textualism would drive parties away from New York courts, a result that New York is decidedly against.[348]

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transactions are highly technical and courts are not in the business of second-guessing the judgment of transacting parties as to whether a transaction is in the company's best interest. *See, e.g.*, Kamin v. American Express Co., 383 N.Y.S.2d 807 (Sup. Ct. 1976).

341. *See supra* Part I.D.2.

342. *See supra* note 148 and accompanying text.

343. *See supra* note 147 and accompanying text.

344. *See supra* note 148 and accompanying text.

345. *See supra* note 149 and accompanying text.

346. *See, e.g.*, Part II.A.

347. In the *Serta* litigation, Apollo-controlled funds were in the minority, while they are in the majority in the *Mitel* litigation. *Compare* N. Star Debt Holdings, L.P., v. Serta Simmons Bedding, LLC, No. 652243/2020, 2020 WL 3411267, at *1 (N.Y. Sup. Ct. June 19, 2020), *with* Mitel Complaint, *supra* note 19, at 5.

348. *See supra* note 148 and accompanying text.

Put simply, transactors are left to their bargain in New York, and judges do not have much room to disrupt private arrangements.[349] The hard parol evidence rule, plain meaning rule, and demise of contractual good faith all contribute to this reality.[350] These core tenets were adopted in New York precisely to secure its status as the preferred forum for commercial contract disputes.[351] However, without intervention, New York runs the risk of allowing liability-management transactions to become more aggressive and potentially abusive. Distressed companies and their advisors are endlessly inventive in structuring arrangements that satisfy the letter of their agreement but not the spirit.[352] Courts should avoid reading contractual good faith into irrelevance and provide some guidance to the restructuring market by enforcing good faith claims where the transactions do not provide a meaningful reduction of leverage or otherwise increase the long-term viability of the company.

2. Some Courts Expressed Willingness to Enforce Good Faith in Intercreditor Disputes

Notwithstanding New York's predilection for textualism in contractual construction, there have been recent applications of the implied covenant of good faith and fair dealing to intercreditor disputes.[353] Concededly, the recent applications of the implied covenant to certain intercreditor disputes are not controlling. Instead, this Note suggests that the application can be instructive in policing the boundaries of lender conduct in uptier transactions.

In *AEA Middle Market Debt Funding LLC*, the implied covenant was employed to prevent a majority coalition of lenders from purchasing and recapitalizing the borrower to the detriment of the minority.[354] This recapitalization purported to allow only minority lenders to exchange their existing loans for unsecured loans while the majority exchanged for first-priority loans.[355] In rejecting this transaction, the court emphasized the parties' reasonable expectations.[356] The court focused on conduct outside of the contract, specifically the concealment and commercial unreasonableness of the transaction.[357] Given this, it was reasonable for the minority group of

349. *See supra* note 155 and accompanying text.

350. *See supra* Part III.A.

351. *See supra* note 148 and accompanying text.

352. Parties have continually developed liability-management transactions. In 2023, the market saw an increase of "double dip" transactions. Shankar Ramakrishnan, *Investors Turn Risk-On for Some Junk Debt but Not All*, REUTERS (Nov. 7, 2023 3:22PM), https://www.reuters.com/markets/rates-bonds/investors-turn-risk-on-some-junk-debt-not-all-2023-11-07/ [https://perma.cc/S739-XRR2] (noting that in a double dip, "debt is issued by a subsidiary, with guarantees from the parent and other subsidiaries. The subsidiary then gives a loan to the parent which then becomes collateral for the new debt"). The effect of the double dip, as the name might suggest, is to create two claims in a single financing.

353. *See supra* Part I.D.3.b.

354. *See supra* Part I.D.3.b.

355. *See supra* note 174 and accompanying text.

356. *See supra* note 189 and accompanying text.

357. *See supra* note 186 and accompanying text.

lenders to expect a proportional share of proceeds, and this reasonable expectation was disappointed.[358]

3. New York Should Consider a Limited Expansion of Contractual Good Faith to Prevent Abuse

In evaluating the reasonable expectation of a minority group in an uptier, courts should consider whether a particular transaction is commercially unreasonable and thus violates the implied covenant of good faith. *AEA Middle Market Debt Funding LLC* is instructive on this point.[359] First, courts should consider whether it was reasonable for a party to expect proportional treatment. In this inquiry, it may be that timing is a dispositive factor. If the loan was issued before any sort of liability-management transaction emerged in the market, it might be reasonable to assume that these parties should not have expected that some form of liability-management transaction might occur. Conversely, if a loan was issued more recently when these transactions and the corresponding litigation have received national attention, it might be reasonable to assume that these parties should have expected some variety of liability-management transactions to occur and, therefore, would have had ample incentive and ability to contract around it.

After determining that a transaction may violate the reasonable expectations of the parties, courts should evaluate the commercial reasonableness of the transaction. One factor in assessing the commercial reasonableness of a transaction is whether it was concealed from some lenders in a syndicate. Most lenders were aware of the competing proposals in *Serta*.[360] The debtor conducted an auction-like process wherein competing lender coalitions submitted liability-management proposals.[361] The debtor was then in the position of selecting the proposal that captured the most value and provided the most significant increase to its long-term viability.[362] In this case, the publicity of the transaction may defeat any sort of notion of concealment of the transaction until it could be revealed as a fait accompli. Courts should find that a bona fide auction-like process cuts in favor of upholding the transaction.

One final consideration should allow a court to weigh the benefit provided to the company by a given transaction. Courts should find that transactions structured to maximize benefit for the company are reasonable, whereas the transactions that merely shift value from one lender group to another without capturing meaningful value for the company are unreasonable. Consider a comparison of *Serta* and *Trimark*.[363] In *Serta*, the lenders exchanged at a

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358. *See supra* note 189 and accompanying text.

359. *See supra* Part I.D.3.b.

360. *See supra* note 281 and accompanying text.

361. *See* Serta Simmons Bedding, LLC v. AG Centre St. P'ship (*In re* Serta Simmons Bedding, LLC), Ch. 11 Case No. 23-90020, Adv. No. 23-9001, 2023 WL 3855820, at *4–5 (Bankr. S.D. Tex. June 6, 2023).

362. *See id.*

363. *See supra* Part II.A; *see also supra* Part II.C.

discount, reducing the company's leverage by over $200 million.[364] In *Trimark*, the majority lenders exchanged their loans at face value while they were trading at a discount.[365] This transaction netted the majority lenders, rather than the company, nearly $70 million.[366] The transaction that provides much-needed liquidity to the company should be seen as commercially reasonable, whereas a sort of cash grab by majority lenders, more similar to *Trimark*, is commercially unreasonable and should be subject to heightened scrutiny.

As a general matter, the boundaries of uptier transactions can be policed with the implied covenant. Specifically, courts should find *AEA Middle Market Debt Funding LLC* instructive and evaluate the reasonable expectation of parties, focusing on the commercial reasonableness of a transaction.

CONCLUSION

Liability-management transactions have rapidly developed in the wake of the COVID-19 pandemic. Lenders and borrowers have continuously pushed the bounds of their agreements and invented dynamic transaction structures. This Note identifies New York law as a motivating factor in the development of these transactions. Because the text has become the only consideration, and liability-management transactions are designed to comply with the letter but not the spirit of their agreement, lenders are left with little recourse.

This Note argues that courts applying New York law should expand the implied covenant of good faith and fair dealing to police the boundaries of uptier transactions and prevent value-destroying transactions. These transactions surely run the risk of becoming abusive. Courts should protect the reasonable expectation of parties and evaluate whether the concealment and commercial reasonableness of the proposed transaction violate this expectation.

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364. *See supra* note 279 and accompanying text.
365. *See supra* note 210 and accompanying text.
366. *See supra* note 211 and accompanying text.