# Curb Your Activism: Contracting to Curb Debt Activism in a Post-*Windstream* World

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*ABSTRACT: Corporate law in the United States of America has been shaped and developed on the basic assumption that stakeholders in a firm want the firm to succeed. However, due to the rise of the credit default swaps ("CDS") market and the emergence of decoupling voting and economic interests, this assumption is no longer safe. The relationships between hedge funds and the companies in which they invest have grown tenuous due to the emergence of a new phenomenon: debt activism. Debt activism does incentivize firms to honor debt covenants, but the negative impact of actively destroying firm value outweighs any potential benefits. No case has better illustrated the harmful consequences of debt activism than the 2019 case* U.S. Bank National Association v. Windstream Services, LLC. *The* Windstream *decision signaled open season for hedge funds to seek profit by affirmatively destroying firm value. The decision caused an uproar in the credit markets and cries for the eradication of debt activism immediately grew stronger. This Note, however, argues that debt activism should not be completely eradicated. Complex contract provisions drafted to curb debt activism or reliance upon judicial intervention to protect firms are unreasonable solutions, unlikely, and may actually cause more harm than good. Instead, this Note argues that curbing debt activism by limiting potential remedies for debt activists via default time-bar provisions is a realistic and effective path forward.*

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## I. INTRODUCTION

Corporate law in the United States has been developed on the basic assumption that stakeholders in a firm typically want the firm to succeed.[1] This fundamental assumption governs the way companies conduct business and shapes the basis for relationships between creditors and debtors.[2] However, there are signs that this foundational assumption might not be as true as it once was, causing trust between hedge fund creditors and corporate borrowers to dissipate.[3] A growing phenomenon known as "debt activism"[4] is the cause for

1. Elisabeth de Fontenay, *Windstream and Contract Opportunism* 4 (Duke L. Sch. Pub. L. & Legal Theory Series, Working Paper No. 2020-44, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3603752 [https://perma.cc/W4AA-NEZG].

2. *See id.* ("Corporate law, securities law, financial regulation, and the vast private ordering that has developed in the shadow of such laws, all implicitly assume that investors in a firm seek to maximize the value of the firm . . . .").

3. *See id.*; William D. Cohan, *What Hedge Funds Consider a Win Is a Disaster for Everyone Else*, N.Y. TIMES (May 12, 2019), https://www.nytimes.com/2019/05/12/opinion/windstream-bankruptcy-cds.html?login=smartlock&auth=login-smartlock [https://perma.cc/WRN3-BHAG] (discussing a recent case of alleged debt activism and the problems it has caused for distressed companies trying to trust their creditors).

4. The phenomenon of debt activism is known by many similar names such as: "net-short debt activism"; "hedge fund activism"; "debt default activism"; and "distressed debt activism." For

this unraveling of business principles and it is posing a challenge for corporate lawyers seeking to shield their clients from liability.[5]

Debt activism is the culmination of a perfect storm that has been brewing since the turn of the twenty-first century.[6] Increases in hybrid decoupling[7] and the exponential growth of the credit default swaps market[8] have given opportunistic hedge funds a path to extreme profit through actively decreasing firm value.[9] While some commentators debate debt activism's prevalence or even its existence,[10] a 2019 case of alleged debt activism confirmed many market participants' worst fears about the potential harms of debt activism.[11]

The litigation in *U.S. Bank National Association v. Windstream Services, LLC* arose out of what at first seemed like clever legal maneuvering by a telecommunications provider, Windstream Services ("Windstream").[12] In

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continuity's sake, this Note will refer to the phenomenon all these terms describe as "debt activism."

5. *See generally, e.g.*, Joshua A. Feltman, Emil A. Kleinhaus & John R. Sobolewski, *The Rise of the Net-Short Debt Activist*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 7, 2018) [hereinafter *The Rise of the Net-Short Debt Activist*], https://corpgov.law.harvard.edu/2018/08/07/the-rise-of-the-net-short-debt-activist [https://perma.cc/5XLV-BZGG] (describing a new model of activism involving debt investors); LEONARD KLINGBAUM, DANIEL DURSCHLAG & WESTON T. EGUCHI, WILLKIE FARR & GALLAGHER LLP, CLIENT ALERT: THE RISE OF PROTECTIONS IN CREDIT AGREEMENTS AND INDENTURES AGAINST "NET SHORT" STRATEGIES (June 14, 2019) [hereinafter "NET SHORT"], https://www.willkie.com/-/media/files/publications/2019/06/the_rise_of_protections_in_credit_agreements_and_indentures_against_net_short_strategies.pdf [https://perma.cc/SQ7J-LT7D] (same); JOHN WILLIAMS, JAMES WARBEY, BEN KASTNER & ELIZABETH A. MARTINEZ, MILBANK, CLIENT ALERT: NET SHORT LENDER DISENFRANCHISEMENT: IS THE NEW ANTI-CDS VACCINE SAFE AND EFFECTIVE?: SIRIUS RESPONDS TO "NET SHORT DEBT ACTIVISM" AFTER WINDSTREAM (June 11, 2019) [hereinafter MILBANK MEMO], https://www.milbank.com/images/content/1/1/v2/116063/Client-Alert-6.11.19-Net-Short-Lender-Disenfranchisement.pdf [https://perma.cc/K9QH-UXPD] (same).

6. *See* de Fontenay, *supra* note 1, at 4 (discussing changes in corporate practice "over the last few decades" that have paved the way for debt activism to take place).

7. *See generally* Henry T.C. Hu & Bernard Black, *Debt, Equity and Hybrid Decoupling: Governance and Systemic Risk Implications*, 14 EUROPEAN FIN. MGMT. 663 (2008) [hereinafter *Debt, Equity and Hybrid Decoupling*] (giving an overview of the different types of decoupling and the challenges they pose for modern corporate practice).

8. *See generally* Frank Partnoy & David A. Skeel, Jr., *The Promise and Perils of Credit Derivatives*, 75 U. CIN. L. REV. 1019 (2007) (discussing the rise and dangers of the CDS market in the twenty-first century).

9. de Fontenay, *supra* note 1, at 2–3 (describing the unease of market participants now "that private investment funds in particular can single-handedly cause *decreases* in firm value").

10. *See generally* Vincent S.J. Buccola, Jameson K. Mah & Tai Zhang, *The Myth of Creditor Sabotage*, 87 U. CHI. L. REV. 2029 (2020) (arguing that debt activism is a myth and at the very least the practice is "burning money").

11. *See* de Fontenay, *supra* note 1, at 2 ("[T]he outrage over the *Windstream* decision should be understood primarily as outrage over the hedge fund's naked opportunism and its devastating impact on the other parties."). *See generally* U.S. Bank Nat'l Ass'n v. Windstream Servs., LLC, No. 17-CV-7857, 2019 WL 948120 (S.D.N.Y. Feb. 15, 2019) (holding in favor of an alleged perpetrator of debt activism).

12. *Windstream Servs.*, 2019 WL 948120, at *1.

2017, hedge fund Aurelius Capital Master ("Aurelius") claimed a 2015 transaction violated one of Windstream's indentures and declared a default.[13] In a decision that would lead to outrage, the court decided in favor of Aurelius and awarded damages of over $310 million.[14] To the casual observer, this decision may seem like a strong endorsement of bondholder rights, with Aurelius prevailing over a company blatantly attempting to circumvent its covenants, but that is not how the industry saw it.[15] The industry saw the decision as an endorsement of debt activism due to Aurelius's alleged net-short position in credit default swaps on the bonds.[16] Market participants and commentators immediately signaled alarms that predatory hedge funds could now "force" a solvent company into bankruptcy and make a prodigious profit in the process.[17] After *Windstream*, corporate practitioners began a scramble to understand debt activism and devise the best way to eliminate the practice, or at least protect their clients.

This Note argues that while debt activism is a harmful practice with few benefits, those harms are outweighed by the damage the market as a whole would suffer in an attempt to eradicate the practice completely. Thus, companies should draft contracts with the intention of *curbing* debt activism rather than eliminating it. In Part II, this Note explores the changes in credit instruments and the power of hybrid decoupling that paved the way for debt activism to take place. Then, Part III discusses the *Windstream* decision and explains the industry's negative response while illustrating the ramifications of the decision. Next, in Part IV, this Note argues that not only is the task of eradicating debt activism nearly impossible, but the incentives debt activism creates for companies to honor their covenants justifies stopping short of complete eradication. Part IV then contends that complex contracts limiting creditors' rights will do more harm than good and that judicial intervention protecting the firm is not only unreliable but also unlikely. Finally, in Part V,

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13. *Id.*

14. *Id.* at *24; *see* de Fontenay, *supra* note 1, at 1 ("Few recent cases in finance have attracted as much interest—and vitriol—as [*Windstream Servs.*] . . . .").

15. *See* de Fontenay, *supra* note 1, at 1–3; Cohan, *supra* note 3 ("While that tactic may be perfectly legal, and highly rewarding for the hedge fund, it's a disaster for everyone else: the company and its employees suddenly faced with bankruptcy, other creditors who haven't insured their risk and, of course, the insurers who have to make good on the defaulted debt.").

16. *See* de Fontenay, *supra* note 1, at 2.

17. *See, e.g.*, Cohan, *supra* note 3 ("[H]edge fund managers have been pushing the companies that owe them money into bankruptcy. The hedge funds figure they can make more money from the insurance payoff than they can from getting their principal repaid."); Joshua A. Feltman, Emil A. Kleinhaus & John R. Sobolewski, *Debt Default Activism: After Windstream, the Winds of Change*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 18, 2019) [hereinafter *After Windstream*], https://corpgov.law.harvard.edu/2019/06/18/debt-default-activism-after-windstream-the-winds-of-change [https://perma.cc/E3RJ-5DF7] ("Windstream's 'long-only' debtholders, whose rights were nominally vindicated by the decision, were not happy . . . . With Windstream's bankruptcy, the value of their positions plummeted, illustrating that Debt Default Activism can harm not only corporate borrowers but also their creditors.").

this Note concludes by showing how default time-bar provisions are a viable contracting solution that protects firms without undue limitations on creditor remedies.

## II. THE RISE OF DEBT ACTIVISM

To analyze the growing trend of debt activism and identify how firms should contract to prevent debt activists from harming companies, this Part provides the relevant background on the rise of debt activism and the ways in which it challenges basic assumptions of American corporate law. This Part first identifies shifts in the modern corporate paradigm by explaining debt decoupling[18] and then showing how the popularity of credit default swaps has logically led to a rise in debt activism.[19] This Part then provides an overview of what exactly debt activism is, how the phenomenon occurs, and its consequences, both positive and negative.[20]

### *A. CHALLENGES TO THE CORPORATE PARADIGM*

It is a basic assumption of corporate law that investors in a firm typically want the firm to succeed.[21] However, modern firms can no longer rely on investors to always have the best interests of the firm at heart. To address this shift in the corporate paradigm, Section II.A.1 begins by explaining credit default swaps and how the drawbacks of this derivative have paved the way for opportunistic investors to behave maliciously.[22] Section II.A.2 then explores how hybrid decoupling changes investor incentivization and paints a worrisome picture of what this new trend means for the shift in corporate paradigm from Section II.A.1.[23]

#### 1. Credit Default Swaps and Their Role in Debt Activism

Prior to the twenty-first century, the standard credit instrument of borrowers and lenders was a loan.[24] However, since the turn of the century, credit derivatives, financial contracts used by parties to mitigate risk exposure, have become increasingly important for publicly owned companies.[25] For the purposes of this Note, the derivative that is most important in debt activism is the credit default swap ("CDS"). "[A] credit default swap is a private contract in which private parties bet on a debt issuer's bankruptcy, default, or restructuring."[26] Essentially, a CDS is a contract between a lender and a third

18. *See infra* Section II.A.1.
19. *See infra* Section II.A.2.
20. *See infra* Section II.B.
21. de Fontenay, *supra* note 1, at 4.
22. *See infra* Section II.A.1.
23. *See infra* Section II.A.2.
24. Partnoy & Skeel, *supra* note 8, at 1020.
25. *Id.* at 1020–21.
26. *Id.* at 1021.

party to protect the lender if the underlying borrower defaults.[27] To illustrate, if protection-buyer *X* is a creditor of distressed company *Y*, *X* can go to third-party protection-seller *Z* and enter into a CDS. *X* will pay an annual fee to *Z* in exchange for protection if *Y* defaults during the period of the contract. In the event of *Y*'s default, *X* would likely lose money on the initial loan, but this loss would be offset by the money made on the swap.[28]

CDSs have several benefits such as: (1) allowing creditors to hedge risk; (2) increased liquidity in markets; (3) contract standardization; and (4) providing information to the market about credit risk.[29] CDSs are often analogized to insurance due to their main benefit being helping creditors hedge risk.[30] When used to hedge risk, CDSs appear to be an exceedingly useful contract for creditors. However, CDSs are not without their flaws.

There are two major downsides to CDS protection that pave the way for hedge funds to engage in nefarious behavior.[31] First, the market for CDSs is secretive and relatively opaque.[32] While it is true that the derivatives market has its own trade organization—the International Swaps and Derivatives Association ("ISDA")[33]—that fact does not change the inherently competitive nature of hedge funds. As a result, the details of hedge fund investments are usually a closely guarded secret.[34] Although the transparency of the CDS market was improved by the Dodd–Frank Wall Street Reform and Consumer Protection Act,[35] the market could still be described as foggy, at best. "[N]o information is available on . . . any particular hedge fund's CDS holdings."[36] Thus, hedge funds may play their cards close to the vest and leave the rest of

27. M. Todd Henderson, *Credit Derivatives Are Not "Insurance"*, 16 CONN. INS. L.J. 1, 2 (2009) ("The most basic form of credit derivative . . . a 'credit default swap' (CDS), is simply a contract through which a lender can protect against the risk of default by paying premiums to a third party who agrees to make the lender whole in the event of default by the underlying borrower.").

28. For a similar illustration, see Partnoy & Skeel, *supra* note 8, at 1021–22; *see also* Buccola et al., *supra* note 10, at 2039–40 (illustrating how a CDS can be used).

29. Partnoy & Skeel, *supra* note 8, at 1023–27.

30. *See generally*, Henderson, *supra* note 27 (arguing credit derivatives should not be regulated similarly to insurance, despite the similarities).

31. Partnoy & Skeel, *supra* note 8, at 1034–37.

32. *Id.* at 1036.

33. *Mission Statement*, ISDA, https://www.isda.org/mission-statement [https://perma.cc/FP7R-QUDV] ("ISDA fosters safe and efficient derivatives markets to facilitate effective risk management for all users of derivative products.").

34. *See* Partnoy & Skeel, *supra* note 8, at 1036–37 (describing the opaque nature of the CDS market and noting "ISDA has actively resisted disclosure of credit default swap documentation, insisting that this information is proprietary").

35. *See generally* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (identifying the purpose of the Act as "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system").

36. Henry T.C. Hu, *Corporate Distress, Credit Default Swaps, and Defaults: Information and Traditional, Contingent, and Empty Creditors*, 13 BROOK. J. CORP., FIN. & COM. L. 5, 20 (2018) [hereinafter *Corporate Distress, Credit Default Swaps, and Defaults*].

the market to rely on industry rumblings and media speculation.[37] This opacity becomes far more troublesome considering a CDS can fundamentally alter the standard incentive structure for creditors.

Second, CDSs can incentivize creditors to affirmatively destroy firm value.[38] A creditor protected by a CDS views potential defaults in an entirely different light than otherwise identical creditors with no protection.[39] A conventional creditor who holds more of a firm's debt than CDS protection —one that is "net-long"—wants to see the debtor firm succeed.[40] The same is generally true for creditors whose ownership in debt and CDS protection are equal—"empty creditors."[41] However, creditors whose CDS protection is greater than their ownership of debt—"net-short" creditors—are incentivized to hurt firm value because their potential for financial gain is not directly tied to company success.[42] Obviously, this unique incentive structure for net-short creditors sets them apart from their traditional counterparts. "Very simply, net-short positions give parties the incentive and sometimes *the ability* to cause firms to take value-decreasing actions."[43] In other words, the net-short position means a party is betting on the company's failure, no longer has the incentive to see the firm remain solvent, and now has the ability to vote against the company's best interests, stemming from the sizable voting power acquired by purchasing a blocking position in the firm's debt. The net-short investor thus may be incentivized to force a default, which then causes real-world damage and social harm.[44]

These two dark sides to CDS protection combine to paint a troubling picture in the CDS market. Further, there is an informational deficiency regarding CDS buyers that can be actively incentivized to destroy firm value with their net-short positions.[45] Put simply, firms and industry participants can never confirm with complete accuracy whether a creditor has used CDSs to create a position where it benefits from the firm's economic downfall. Indeed, the lack of public information regarding CDSs often leaves reported examples of debt activism prefaced with qualifiers such as "alleged" due to the unconfirmed nature of the creditor's net-short position.[46]

37. *Id.*

38. Partnoy & Skeel, *supra* note 8, at 1034–35.

39. Buccola et al., *supra* note 10, at 2041–43.

40. *Id.* at 2042.

41. *Id.* at 2043.

42. de Fontenay, *supra* note 1, at 3–4.

43. *Id.* at 4 (emphasis added).

44. *Id.*; *see also* Partnoy & Skeel, *supra* note 8, at 1034–35 (discussing net-short investors' incentives to cause default and providing a real-world example with the 2004 Tower Automotive bankruptcy).

45. *See Corporate Distress, Credit Default Swaps, and Defaults*, *supra* note 36, at 20–21.

46. *See* de Fontenay, *supra* note 1, at 2 ("It was *widely rumored* that . . . [the creditor] held a larger *short* position . . . ." (first emphasis added)); *Corporate Distress, Credit Default Swaps, and Defaults*, *supra* note 36, at 22 (describing GSO Capital Partners as "an alleged *seller* of **short-term**

### 2. An Explanation of Hybrid Decoupling

Investors have long understood that ownership in debt and equity comes with clear "packages of rights and obligations [that] are normally 'bundled' together."[47] These rights and obligations for owners of debt can be "economic rights[,] . . . contractual control rights[,] . . . other legal rights[,] . . . and sometimes disclosure obligations."[48] Equity ownership conveys similar rights in addition to unique ones such as voting rights.[49] The majority of firms are governed by the traditional "one share, one vote" rule that "bundles" equity owners' voting rights with their economic interests.[50] Debt owners' key bundle has traditionally meant their contractual control rights are tied to their "economic rights to interest and principal."[51] These norms have been set under the assumption that these "bundles" operate to incentivize shareholders and bondholders to maximize firm value.[52]

These basic assumptions, however, are no longer reliable due to the proliferation of increasingly complex debt contracts, such as CDSs.[53] Modern practice now allows investors to decouple their formal contractual rights from their economic interests.[54] This "decoupling" is possible whether the ownership interest is in a firm's debt or its equity.[55] "Hybrid decoupling" combines equity and debt decoupling, which creates opportunities for negative economic interest.[56] To illustrate, say hedge fund *X* owns equity in distressed company *Y*. *X*'s equity comes with the standard bundle including voting rights. Now say *X* hedges its position by buying enough CDS protection so that its position is now net-short on company *Y*. *X* has effectively "decoupled" its formal contractual rights from its economic interest —meaning the contractual rights and economic interests are not aligned —and *X* now has a "negative" economic interest. As a result, investor *X* has

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CDS protection and alleged *purchaser* of **longer-term** CDS protection"); Partnoy & Skeel, *supra* note 8, at 1034–35 (describing market chatter of a "widely rumored explanation" as "'[s]ome bankers,' . . . 'believe hedge funds triggered the filing to make their short positions worth more'" (quoting Henny Sender, *Hedge-Fund Lending to Distressed Firms Makes for Gray Rules and Rough Play*, WALL ST. J. (July 18, 2005, 12:01 AM), https://www.wsj.com/articles/SB112164567837987920 [https://perma.cc/S49J-9GCZ])).

47. *Corporate Distress, Credit Default Swaps, and Defaults*, *supra* note 36, at 17.

48. *Id.*

49. *Id.*

50. Henry T.C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 156 U. PA. L. REV. 625, 632 (2008).

51. *Corporate Distress, Credit Default Swaps, and Defaults*, *supra* note 36, at 17.

52. de Fontenay, *supra* note 1, at 4.

53. *Corporate Distress, Credit Default Swaps, and Defaults*, *supra* note 36, at 17–18 ("These foundational conceptions no longer hold. Today, through the use of derivatives and other means, debt holders and equity holders can, if they wish, easily separate components of these [bundles].").

54. *Id.*

55. *Debt, Equity and Hybrid Decoupling*, *supra* note 7, at 688.

56. *Id.* at 689.

greater value in a company's *failure* than its growth. The resultant environment is perfect for predatory debt activism; not only does *X* benefit from the failure of the company in which it owns equity, but *X* can accelerate that failure due to its voting rights.[57]

### B. *What Is Debt Activism?*

Now that this Note has explained what makes debt activism possible, this Section next explores the phenomenon itself. Debt activism, a term created by the law firm Wachtell, Lipton, Rosen & Katz, refers to a new trend of debt investors that behave differently than a typical investor would according to traditional models of investing.[58] As previously illustrated, with the rise of the CDS market and hybrid decoupling, one can no longer rely on traditional assumptions. This Section begins by explaining what the steps in the process of debt activism look like.[59] Next, it illustrates some of the benefits of debt activism while providing defenses offered by certain hedge funds known for engaging in the practice.[60] Finally, it provides a look at the troublesome real-world impact debt activism can have on distressed companies and their shareholders.[61]

#### 1. How Does Debt Activism Work?

To begin, it is necessary to understand how debt activism works. The debt activist has both a "long" position in a firm's debt and a larger "short" position[62]—hence, "net-short debt activism."[63] The "long" position allows the debt activist, typically an opportunistic hedge fund, to assert defaults against the firm, which leads to the activist profiting on its "short" position.[64] However, this net-short position is no coincidence. Debt activists have a clear "playbook" to reach this strategic net-short position and strike.[65]

There are two standard forms of net-short sabotage.[66] The goal of both

57. de Fontenay, *supra* note 1, at 4–5.

58. *The Rise of the Net-Short Debt Activist*, *supra* note 5; *see also* Eric M. Rosof, Gregory E. Pessin, Michael S. Benn, Tijana J. Dvornic & John R. Sobolewski, *Wachtell Lipton Looks at Acquisition Financing in 2017 and the Year Ahead*, CLS BLUE SKY BLOG (Jan. 17, 2018), https://clsbluesky.law.columbia.edu/2018/01/17/wachtell-lipton-looks-at-acquisition-financing-in-2017-and-the-year-ahead [https://perma.cc/W9NC-5R2C] (describing a troubling trend in the debt markets under the title "Attack of the Net-Short Debt Investor"); *After Windstream*, *supra* note 17 (explaining "'Debt Default Activism'").

59. *See infra* Section II.B.1.

60. *See infra* Section II.B.2.

61. *See infra* Section II.B.3.

62. *See supra* Section II.A.2.

63. *The Rise of the Net-Short Debt Activist*, *supra* note 5.

64. *See id.*

65. *See id.* (referring to the "playbook" of the net-short debt activist and arguing that the pattern has been followed enough to create a pattern).

66. Buccola et al., *supra* note 10, at 2044 ("Two tactics are discussed in the literature

forms is to force a default from which the debt activist profits.[67] The first form is a more passive approach and involves the debt activist frustrating a debtor's attempt at restructuring its balance sheet.[68] Often, this form of activism leads to "engineered defaults" where the distressed company will purposefully breach a contract to cause a default in exchange for favorable financing.[69] This Note does not expand on this more passive brand of debt activism because it is possible that engineered defaults may even be beneficial for both the distressed company and the investor.[70] Rather, it focuses on the second means of sabotage, which involves litigation.[71]

Under this second form, investors seeking to participate in debt activism typically start by scouring the contracts of distressed company transactions.[72] The investor is looking for a covenant violation in a transaction of a distressed company's debt documents.[73] The more difficult it is to cure the covenant violation, the better.[74] It does not matter how long ago the violation occurred; often, the breach has occurred years prior.[75] Once the transaction is located, the investor purchases enough of whatever class of bonds is necessary to obtain a blocking position, meaning a large enough position to prevent certain value-saving actions such as waiving defaults.[76] The investor then buys a larger position in CDSs to establish a net short position.[77] Now, the investor uses the bond votes to assert a technical fault, often using a public letter giving notice to the world of the alleged default.[78] With this large position and voting power, the debt activist is then likely to block any proposed waiver of the default offered to shareholders.[79] Litigation ensues with the burden of

. . . . [B]oth require the activist to assemble a relatively large position in at least one tranche of the target's bonds or notes.").

67. *See id.* at 2044–47.

68. *See id.* at 2046.

69. Carl N. Wedoff & Michael K. Ballew, Jr., *Outrageous Fortune: Making Money by Engineering Defaults*, 38 AM. BANKR. INST. J. 36, 37 (2019).

70. *See Corporate Distress, Credit Default Swaps, and Defaults*, *supra* note 36, at 26–27 (discussing Hovnanian's manufactured default); Mary Childs, *Solus Made Money from that CDS Litigation*, BARRON'S (June 20, 2018, 1:03 PM) [hereinafter *Solus Made Money from that CDS Litigation*], https://www.barrons.com/articles/solus-made-money-from-that-cds-litigation-1529514208 [https://perma.cc/JZ3B-QVTN]. *See generally* Wedoff & Ballew, Jr., *supra* note 69 (comparing benefits of engineered defaults with potential societal harms with examples).

71. Buccola et al., *supra* note 10, at 2047–48.

72. *See The Rise of the Net-Short Debt Activist*, *supra* note 5.

73. *Id.*; Buccola et al., *supra* note 10, at 2046–47.

74. Buccola et al., *supra* note 10, at 2046.

75. *The Rise of the Net-Short Debt Activist*, *supra* note 5.

76. de Fontenay, *supra* note 1, at 3; *The Rise of the Net-Short Debt Activist*, *supra* note 5 (establishing "25 percent of a bond tranche" to be the target amount purchased to serve a default notice).

77. de Fontenay, *supra* note 1, at 3.

78. *The Rise of the Net-Short Debt Activist*, *supra* note 5.

79. de Fontenay, *supra* note 1, at 3.

proving no default has occurred on the distressed company.[80] Once the default is confirmed, the gains from the CDSs offset any losses the investor had from its long position, and the creditor comes out ahead.[81]

### 2. The Benefits of Debt Activism

In the abstract, this strategy does not seem too malevolent. By definition, the distressed company is the party that has breached a covenant and committed some sort of "wrong" in doing so. From this perspective, these hedge funds are not "predators" but rather an equalizing force, ensuring firms are staying true to their covenants. While arguing that companies should be held in check, Mark Brodsky, founder and chairman of Aurelius—a fund not afraid to litigate over debt—argued "[t]here's nothing new about lenders enforcing bond contracts. What has changed is the aggressiveness with which corporate borrowers have been circumventing or ignoring key financial covenants."[82] Brodsky's view has his fund operating as a sort of market police force, keeping firms in line.[83]

There is some truth to the sentiment that an aggressive firm cleverly holding companies to their covenants is a good thing. Modern companies are large, powerful, and intelligent. Having credit market police like Aurelius or GSO Capital Partners does put these firms on notice that they have to play fair. Accordingly, this Note does not argue that debt activism should be eradicated entirely; it agrees that firms should honor their covenants. The next Section, however, addresses the more dubious implications of debt activism and the real-world effect it can have.[84]

### 3. The Problems with Debt Activism

The view of hedge funds as market police forces altruistically keeping companies on their best behavior paints too rosy a picture of the real

80. *The Rise of the Net-Short Debt Activist*, *supra* note 5.

81. de Fontenay, *supra* note 1, at 3 ("As long as the position is net short, by definition the gains on the CDS position from the borrower's default will more than offset the losses on the bonds from this behavior."); *The Rise of the Net-Short Debt Activist*, *supra* note 5 ("[T]his investor buys 'long' positions in corporate debt not to make money on those positions, but instead to assert defaults that will enable the investor to profit on a larger 'short' position.").

82. Sujeet Indap, *USA Inc Faces Growing Threat from Activist Debt Investors*, FIN. TIMES (Sept. 17, 2018), https://www.ft.com/content/98fd33c8-b93d-11e8-94b2-17176fbf93f5 [https://perma.cc/T5AJ-UJK8].

83. Mary Childs, *Windstream Dispute Highlights Aurelius' Role as a Hedge-Fund Debt Cop*, BARRON'S (Aug. 31, 2018, 5:23 PM) [hereinafter Childs, *Hedge-Fund Debt Cop*], https://www.barrons.com/articles/windstream-dispute-highlights-aurelius-role-as-a-hedge-fund-debt-cop-1535750611 [https://perma.cc/NWL5-F5DW]; *see* Mary Childs, *Windstream Loses Legal Case Against Hedge Fund Aurelius, and Now Is Stuck with a Huge Bill*, BARRON'S (Feb. 16, 2019, 7:05 AM) [hereinafter Childs, *Windstream Loses Legal Case Against Hedge Fund Aurelius*], https://www.barrons.com/articles/windstream-loses-legal-case-against-hedge-fund-aurelius-and-now-is-stuck-with-a-huge-bill-51550318739 [https://perma.cc/TB8Z-KV8S].

84. *See infra* Section II.B.3.

phenomenon. That investors are interested in keeping a firm solvent and growing its value has been foundational to economic theories of the public corporation.[85] This foundation fostered a basic level of trust between businesses and lenders. As one former investment banker remarked, "[o]nce upon a time . . . when banks or investors lent money to a company . . . [i]f the business did well, the lenders were paid back on time and made money. So they wanted the company to succeed."[86] That is still generally true. Debt activism, however, has provided a means for lenders to make profits while removing the incentive to see the firm succeed. This trend is particularly problematic when the entire corporate legal system has developed behind the notion that investors want the firm to succeed.[87] "Corporate law[s] . . . all implicitly assume that investors . . . seek to maximize the value of their respective interests in the firm . . . at *all* times."[88] While this assumption is not without exception,[89] it is intuitive that those with an interest in a firm will generally want that firm to succeed and prosper.

Although it is no doubt troubling to see debt activism undermine basic assumptions of corporate laws, the real-world consequences that arise from debt activism can be even more controversial. A recent case has exacerbated these already-negative consequences. In the 2016 case of *Wilmington Savings Fund Society, FSB v. Cash America International, Inc.*, the United States District Court for the Southern District of New York was forced to decide whether Cash America breached a covenant, but more importantly, what remedy Cash America's creditors were entitled to.[90] The court held that Cash America's decision to spin-off a major subsidiary breached a covenant and resulted in a covenant default.[91] While this particular breach did not explicitly involve debt activism, the court's ruling on the remedy available to noteholders is significant. The court held that the noteholders were "entitled to payment of the make-whole premium."[92] Typically, covenant violations that cause a default give rise to the remedy of acceleration, which is "the payment of the

85. *Debt, Equity and Hybrid Decoupling*, *supra* note 7, at 664 ("It is assumed in particular that creditors are normally interested in keeping a solvent firm out of bankruptcy and (intercreditor conflicts aside) in maximising [sic] the value of an insolvent firm.").

86. Cohan, *supra* note 3.

87. de Fontenay, *supra* note 1, at 4.

88. *Id.*

89. Shareholders may occasionally take unnecessary risks or act as though they have nothing to lose to cope with a firm experiencing severe financial distress. However, debt covenants tend to reduce this value-decreasing behavior. *See generally* Clifford W. Smith, Jr. & Jerold B. Warner, *On Financial Contracting: An Analysis of Bond Covenants*, 7 J. FIN. ECON. 117 (1979) (arguing that privately negotiated debt covenants are an efficient means of incentivizing stockholders to maximize firm value).

90. Wilmington Sav. Fund Soc'y, FSB v. Cash Am. Int'l, Inc., No. 15-CV-5027, 2016 WL 5092594, at *1 (S.D.N.Y. Sept. 19, 2016).

91. *Id.* at *8.

92. *Id.*

obligations at par."[93] However, the court here ruled that the creditors were entitled to the amount owed if Cash America had chosen early redemption of the bond.[94] This means the creditors were entitled to a far greater sum than they would have been entitled to under an acceleration analysis. The provisions involved in *Cash America International* are very common indentures.[95] This change in remedy when these common indentures are broken has given rise to "premium hunting," where the goal is to exploit comparable indentures to those in *Cash America International* and profit off of covenant violations.[96] With this increase in premiums, there is greater incentivization for debt activism and some firms are even willing to gain a potentially negative reputation for debt activism.[97]

Admittedly, it is difficult to confirm that debt activism is widespread due to the opaque nature of the CDS market.[98] Frequently, cases of debt activism are identified solely based on industry hearsay or reasoning that a net-short position is the only explanation for a creditor's behavior.[99] What is more, some commentators claim debt activism is not a real concern.[100] But, as the old saying goes, "[i]f it looks like a duck, swims like a duck, and quacks like a duck, then it's probably a duck."[101] If a creditor is rumored to have a net-short

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93. Marcel Kahan & Mitu Gulati, *Cash America and the Structure of Bondholder Remedies*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 9, 2018), https://corpgov.law.harvard.edu/2018/08/09/cash-america-and-the-structure-of-bondholder-remedies [https://perma.cc/U7GW-4P8Y].

94. *Id.*

95. MATTHEW A. FELDMAN, JOSEPH G. MINIAS, WESTON T. EGUCHI & JASON D. ST. JOHN, WILLKIE FARR & GALLAGHER LLP, CLIENT MEMORANDUM: COURT HOLDS ISSUER LIABLE FOR A MAKE-WHOLE BASED ON ITS VOLUNTARY BREACH OF AN INDENTURE 2 (Oct. 6, 2016), https://www.willkie.com/~/media/Files/Publications/2016/10/Court_Holds_Issuer_Liable_for_a_Make_Whole_Based_on_Its_Voluntary_Breach.pdf [https://perma.cc/EJ7G-JDUE].

96. *After Windstream*, *supra* note 17; *see also* Mark Darley & Zoe Cooper Sutton, *Net-Short Debt Activism*, FINANCIER WORLDWIDE (Oct. 2019), https://www.financierworldwide.com/net-short-debt-activism#.YVZRnEbMLoq [https://perma.cc/G62J-N6FJ] (noting *Cash America* incentivizes debt activists to accelerate debt).

97. *See* de Fontenay, *supra* note 1, at 9 ("The stakes are too high and the rewards from opportunistic behavior too great. This is . . . true when the parties are not constrained by reputational concerns . . . ."); *see also* Childs, *Hedge-Fund Debt Cop*, *supra* note 83 ("[This particular hedge-fund] is known for insisting on the black-and-white promises in a contract. It enforces the nuances of bond indentures . . . .").

98. *See supra* Section II.A.1.

99. *See* de Fontenay, *supra* note 1, at 3–4 (noting a court in an alleged debt activism case never inquired about a short position because "one would be hard-pressed to explain [the creditor's] behavior in the dispute otherwise"); *Corporate Distress, Credit Default Swaps, and Defaults*, *supra* note 36, at 22–23 ("Although later press reports mentioned the possible role of CDS sellers, the absence of verifiable quantitative information . . . limited the value of those reports."). For a commonly cited case example, see generally TELUS Corporation (Re) 2012 BCSC 1919 (Can.) (U.S. hedge fund shorted TELUS and then exercised voting rights in a way that benefited the hedge fund but harmed other shareholders.).

100. *See generally* Buccola et al., *supra* note 10 (arguing creditor sabotage is a myth).

101. *Duck Test*, FARLEX DICTIONARY IDIOMS, https://idioms.thefreedictionary.com/duck+test [https://perma.cc/NL7Y-E72K].

position and engages is opportunistic firm-value-decreasing behavior, it is entirely reasonable to attribute that behavior to debt activism. As Part III explains, the costs of debt activism are also very real. Indeed, the most recent touchstone case of alleged debt activism illustrates the real-world consequences of creditors seeking to accelerate default—including, but not limited to, a firm filing for bankruptcy and thousands of people losing jobs or services.[102]

## III. THE *WINDSTREAM* DECISION AND THE INDUSTRY'S RESPONSE

Debt activism has been considered a rising trend in the corporate world but, until recently, was most often discussed as a theoretical possibility.[103] However, the phenomenon of debt activism showed its more alarming implications after the case of *U.S. Bank National Association v. Windstream Services, LLC* in 2019.[104] This Part begins, in Section III.A, with a brief overview of the facts that led to the *Windstream* litigation.[105] Next, Section III.B explores the alleged breach involving a sale-leaseback transaction that caused the litigation between telecommunications provider Windstream and Aurelius. Section III.C then analyzes how the court reached its conclusion giving Aurelius a substantial remedy that likely led to Windstream filing for Chapter 11 bankruptcy.[106] Finally, Section III.D addresses the industry's reaction to the decision, including Aurelius's alleged net-short position, while attempting to explain the substantial backlash the ruling received.[107]

### *A. FACTUAL BACKGROUND*

While *Windstream*'s outcome caused a vitriolic response, the litigation arose out of what was originally considered clever legal maneuvering by Windstream.[108] In 2013, Windstream began considering spinning off certain real estate assets into a separate company.[109] The goal was to form a real estate investment trust ("REIT") called Uniti Group, Inc. ("Uniti") that could hold

102. *See infra* Part III.

103. *See generally The Rise of the Net-Short Debt Activist*, *supra* note 5 (describing the trend while noting a current dispute between Windstream and Aurelius would be a prominent example decided soon).

104. U.S. Bank Nat'l Ass'n v. Windstream Servs., LLC, No. 17-CV-7857, 2019 WL 948120 (S.D.N.Y. Feb. 15, 2019); *see supra* note 5 and accompanying text.

105. *See infra* Section III.A.

106. *See infra* Section III.C. This Note operates on the assumption that the large sum of money ordered to be paid to Aurelius was the cause of Windstream's bankruptcy. While it is true that Windstream was already a company in financial distress, it is likely that bankruptcy would have been avoided had the Court ruled in Windstream's favor. *See* de Fontenay, *supra* note 1, at 2.

107. *See infra* Section III.D.

108. *Windstream Servs.*, 2019 WL 948120, at *1. This Note has often referenced the "vitriolic" response to the *Windstream* decision, but it must be noted that even if this is the majority, the opinion is not all-encompassing. Proponents of debt activism, namely hedge funds, view this decision as a court's strong endorsement of their rights, albeit with dollar signs in their eyes.

109. *Id.* at *2.

and lease some of Windstream's critical assets "to improve the company's financial flexibility, attract investment, and improve tax and cash flow efficiency."[110] Windstream would be able to transfer real estate assets to the REIT but also enter into a lease with the REIT allowing Windstream to continue to use the assets.[111] Effectively, Windstream would formally separate the company's assets but be able to functionally keep them together. This allows a company in distress, such as Windstream, to maintain control over critical assets while appealing to investors with a new entity. There was a major hurdle, however, standing in Windstream's path: Windstream's debt contracts contained a provision ("the Indenture") forbidding this exact kind of sale and leaseback transaction.[112]

### *B.* WINDSTREAM'S *BREACH AND ENSUING LITIGATION*

To overcome this hurdle, instead of initially seeking a waiver from noteholders, Windstream devised a clever plan that would mimic a sale and leaseback while formally satisfying the terms of the Indenture. Windstream's plan for a spin-off transaction (the "2015 Transaction") involved three steps that obtained the same results of a sale-leaseback transaction while plausibly keeping the company's debt indentures intact.[113] The process can be simplified as follows: (1) Windstream would transfer the real estate assets to Uniti; (2) Uniti would then lease the assets to a newly formed holdings company, Windstream Holdings ("Holdings"); then (3) Windstream would pay Holdings for the rights to use the assets leased from Uniti.[114] The spin-off transaction closed in 2015.[115] Importantly, no party objected to the 2015 Transaction for two years, until 2017.[116]

In the summer of 2017, the hedge fund Aurelius acquired enough senior unsecured notes to obtain a blocking position.[117] Aurelius then directed U.S. Bank National Association (the "Trustee") as trustee to call a default on

110. *Id.*; *see id.* at *4 n.3.

111. *Id.* at *4–5.

112. *Id.* at *2.

113. *See id.* at *3–5.

114. *See id.*; Buccola et al., *supra* note 10, at 2063–64 (providing a similar simplified summary of the sale-leaseback workaround).

115. *Windstream Servs.*, 2019 WL 948120, at *4–5.

116. *Id.* at *6–7. ("Under Section 6.01(a)(v) of the Indenture, a Noteholder representing twenty-five percent or more of the aggregate principal amount of Notes . . . may give written notice of a failure of [Windstream] or any of its Restricted Subsidiaries to comply with Indenture Sections 4.07 or 4.19. If Services or the Restricted Subsidiaries continue in their failure to comply for sixty days after such notice, an Event of Default will occur . . . ." (citations omitted)).

117. de Fontenay, *supra* note 1, at 1. A "blocking position" in a debt tranche is a position large enough for the holder to impose their will and control any votes regarding a company's debt issuances. Michelle Harner, *Opportunities in Distressed Debt*, CONGLOMERATE (Nov. 19, 2008), https://www.theconglomerate.org/2008/11/opportunities-i.html [https://perma.cc/YJ8Y-NAL3].

Windstream.[118] On September 21, 2017, "Aurelius gave written notice to [Windstream] that Aurelius believed the 2015 Transaction breached the Indenture in multiple ways,"[119] primarily contending that the 2015 Transaction breached the bond indenture that prohibited "Sale and Leaseback Transactions."[120] Four days after the written notice, Windstream publicly disclosed the Notice of Default while maintaining the "allegations were 'without merit' and 'intended to manipulate the price of the Notes and other securities.'"[121]

Windstream then filed suit against the Trustee in Delaware Chancery Court, which the Trustee then removed to the Southern District of New York.[122] After litigation commenced, Windstream attempted to moot Aurelius's claim altogether by diluting the hedge fund's voting rights and acquiring a waiver of default.[123] Windstream sought to have "friendly noteholders" exchange into the six and three-eighths percent class of Notes in order to dilute Aurelius's voting power while also concurrently consenting to waive the default.[124] Put simply, Windstream offered to exchange the debt of existing creditors for additional notes in Aurelius's class so the hedge fund could not block any attempted waiver of default.[125] While Windstream's plan appeared to have worked, Aurelius argued the terms of the Indenture made the new noteholders' consent invalid.[126]

### *C. The Court's Decision*

The case came down to two legal issues: (1) whether the 2015 Transaction was a Sale and Leaseback Transaction; and (2) if so, whether Windstream avoided liability by obtaining a valid waiver. The judge was unsympathetic to Windstream and found for Aurelius on both issues.[127] The court, unpersuaded by clever legal maneuvers, held "that [Windstream's] financial maneuvers—and many of its arguments here—[we]re too cute by

118. de Fontenay, *supra* note 1, at 1.

119. *Windstream Servs.*, 2019 WL 948120, at *6.

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.* at *7–9 ("Perhaps skeptical of the strength of its legal position, [Windstream] began pursuing a business solution to the problems posed by Aurelius's Notice of Default even as it was seeking relief in court. With the assistance of its bankers, the company began devising a plan 'to neutralize Aurelius' . . . ."); *see* Buccola et al., *supra* note 10, at 2065–67 (addressing how Windstream attempted to moot the claim by acquiring a waiver); *see also* de Fontenay, *supra* note 1, at 1 ("[T]he company attempted simultaneously to dilute Aurelius's voting rights and to obtain valid creditor consent for the default waiver.").

124. *Windstream Servs.*, 2019 WL 948120, at *7–8.

125. de Fontenay, *supra* note 1, at 1.

126. *Id.* at 2; *Windstream Servs.*, 2019 WL 948120, at *19.

127. *Windstream Servs.*, 2019 WL 948120, at *23.

half."[128] The 2015 Transaction was considered a Sale and Leaseback Transaction "in substance" and the additional notes offered by Windstream to dilute Aurelius's power were invalid under the letter of the Indenture.[129]

On February 15, 2019, the court awarded Aurelius the full principal amount of its notes "with all accrued and unpaid interest."[130] All told, Aurelius was entitled to over $310 million in damages. Only ten days later, Windstream filed for bankruptcy.[131] While it is true that Windstream was already a distressed company—the notes in question were already being traded at a discount—it is likely that a judgment in Windstream's favor would have prevented the firm's financial ruin.[132] Windstream had previously stated that coming up with the money following an adverse decision would be catastrophic.[133] The company's CEO, Tony Thomas, stated the judgment cut off the company's liquidity and the board was left with no other option but Chapter 11 bankruptcy.[134]

### D. *The Industry's Response to the* Windstream *Decision*

At first blush, the *Windstream* decision seems like nothing more than a strong endorsement of bondholder rights and a victory of substance over form in debt contracts; such an auspicious attitude toward the court's opinion, however, was far from the industry's interpretation. Numerous commentators have been up in arms about a court giving its blessing to apparent predatory debt activism.[135] It must be noted, however, that Aurelius's net-short position is only alleged, not confirmed. Although the word "alleged" seems to be doing a lot of heavy lifting in that sentence, as this Note previously discussed, a net-short position is notoriously challenging to confirm.[136] A net-short position is

128. *Id.*

129. *Id.* ("[T]he 2015 Transaction qualifies as a Sale and Leaseback Transaction because, in substance, the Transferor Subsidiaries sold the Transferred Assets and then, either directly or indirectly, leased them back; making Holdings the sole signatory on the Master Lease did not change those facts.").

130. *Id.* at *24.

131. Voluntary Petition for Windstream Holdings, Inc., *In re* Windstream Holdings, Inc., No. 19-22312 (Bankr. S.D.N.Y. Feb. 25, 2019), ECF No. 1.

132. de Fontenay, *supra* note 1, at 1–2.

133. Childs, *Windstream Loses Legal Case Against Hedge Fund Aurelius*, *supra* note 83 ("Windstream has said coming up with that money would bankrupt it . . . . Windstream provides cable in 18 rural American states. For 20% of its areas of operation, Windstream is the only option. So this might be a bit of a bummer for society.").

134. Declaration of Tony Thomas, Chief Executive Officer and President of Windstream Holdings, Inc., (I) in Support of Debtors' Chapter 11 Petitions and First Day Motions and (II) Pursuant to Local Bankruptcy Rule 1007-2, at ¶¶ 11–12, at 6, ¶¶ 39–43, at 11–12, *In re* Windstream Holdings, Inc., No. 19-22312 (Bankr. S.D.N.Y. Feb. 25, 2019), ECF No. 27.

135. *See, e.g.*, de Fontenay, *supra* note 1, at 2 ("Judge Furman's decision caused a furor among bond investors."); Cohan, *supra* note 3 (criticizing the Windstream decision—the article is titled "*What Hedge Funds Consider a Win Is a Disaster for Everyone Else*"); *After Windstream,* supra note 17.

136. *See supra* Section II.A.1.

the only likely explanation for why a hedge fund would intentionally decrease firm value.[137] It is clear to the industry that this was predatory behavior. Thus, the industry believed Aurelius purposefully sought to profit from CDS protection by causing a company's bankruptcy and viewed the harm to other bondholders and stakeholders, not the least of which being Windstream employees, as nothing more than collateral damage.[138]

The industry's contempt was not only directed at Aurelius, but also at the district court itself. A substantial amount of anger towards the *Windstream* decision stems from the notion that the court should have used its equitable powers to prevent this "naked opportunism" from bankrupting a colossal company.[139] Frustration also stemmed from the judge's "asymmetric approach," which rewarded Aurelius for following the letter of the Indenture but penalized Windstream for using the 2015 Transaction to put substance over form.[140]

Further frustration was felt by industry participants who believe the duty of good faith and fair dealing prevents value-decreasing moves.[141] The opinion that net-short activism breaches the duty of good faith is understandable; after all, intentionally harming a company's value does seem contradictory to fair dealing.[142] However, when one considers Windstream's blatant attempt to circumvent its own debt covenants, this good faith and fair dealing argument loses its shine. It does seem peculiar that a case where both parties were arguably operating at less than good faith would draw substantial ire in this way. At bottom, the outrage should be understood as fear of the harm an opportunistic hedge fund can have on others.[143]

Following the *Windstream* decision, a surge of law firm client memos was released regarding protection from hedge funds wishing to participate in debt activism.[144] It was clear that the decision set off alarms for investors and firms alike, stemming from three core concerns. First, investors and firms could no longer assume that all investors would seek to maximize firm value at all

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137. While a net-short position is difficult to confirm, it is often considered confirmed due to the understanding that any hedge fund who is not net-short would have no incentive to actively destroy firm value in this manner. *See* de Fontenay, *supra* note 1, at 2.

138. *Id.*

139. *Id.* at 5. The "naked opportunism" refers to the ruthless nature with which hedge funds will assert default. The phrase seems to convey the industry's opinion that this behavior is brazen, but the profits seem to outweigh any reputational concerns a hedge fund might have. While it is true that "naked opportunism" does seem to fit Aurelius's behavior, one could also describe Windstream's clever attempt at bypassing its covenants as "naked opportunism."

140. *Id.* at 6.

141. *Id.*

142. *Id.*

143. *Id.* at 2–3 (arguing that outrage over the *Windstream* decision should be understood as outrage towards Aurelius's brazen behavior that was able to have a "devastating impact" on almost every other party involved).

144. *See, e.g.*, *After Windstream*, *supra* note 17; "NET SHORT", *supra* note 5, at 2–3 (discussing trends in *Windstream* provisions); MILBANK MEMO, *supra* note 5, at 5 (discussing "the negative effects of net short" lender provisions as an anti-*Windstream* provision).

times.[145] *Windstream* served as a clear example of a court supporting a hedge fund engaging in value-decreasing behavior.[146] Second, and in the same vein, hedge funds now saw a clear path to profit by single-handedly decreasing firm value.[147] Aurelius had made over $310 million by holding Windstream to its covenants and sending the firm into bankruptcy.[148] Finally, and arguably most frustrating, it is difficult to contract against debt activism, and there is not a clear solution.[149] Market participants have offered potential solutions that this Note addresses later, but none have emerged yet as a path forward to protect investors while still appeasing hedge funds seeking to hold firms to their covenants.[150]

Even with the growing unease surrounding the concerns amplified by *Windstream*, the industry did not view this problem as one entirely without redress. Commentators offer the principles of equitable subordination as a means for curbing creditors' inequitable, but "technically legal," conduct.[151] Equitable subordination protects the investors not engaging in debt activism who may be caught in the crossfire of a hedge fund decreasing firm value.[152] However, relying on equitable subordination is unreliable since it is unclear what level of "inequitable" conduct is necessary and pursuing this claim may still only provide "nuisance value" to investors.[153] Another suggested solution is requiring courts to take an iterative approach, where the court considers the various possible meanings of the contractual terms and then choses the most logical interpretation to cut down on debt activism in the CDS market.[154] However, as *Windstream* illustrated, relying on judges to interpret contracts is unpredictable and still provides an avenue for hedge funds to exploit the letter of bond indentures. Sophisticated minds can differ on the "logical" interpretation of contract terms, after all.

145. *See* de Fontenay, *supra* note 1, at 2–3.

146. *Id.*

147. *Id.*

148. U.S. Bank Nat'l Ass'n v. Windstream Servs., LLC, No. 17-CV-7857, 2019 WL 948120, at *22 (S.D.N.Y. Feb. 15, 2019).

149. *See* de Fontenay, *supra* note 1, at 2–3.

150. *See After Windstream*, *supra* note 17.

151. Wedoff & Ballew, *supra* note 69, at 70 (arguing the *Windstream* decision does not foreclose equitable subordination claims in response to debt activism moving forward).

152. *Id.* ("[A] bankruptcy court may subordinate all or part of a claim 'under principles of equitable subordination.' . . . Even if a creditor's conduct is technically legal, sufficiently inequitable conduct can give rise to equitable subordination." (quoting 11 U.S.C. § 510(c)(1) (2018)) (footnote omitted)).

153. *Id.* ("The [interested party] would effectively have 'option value' to litigate those claims and extract at least nuisance value. . . . Although these transactions have been criticized on various grounds, the current guidance from the courts is too limited to draw definite conclusions about future court challenges.").

154. *See generally* Robert K. Rasmussen & Michael Simkovic, *Bounties for Errors: Market Testing Contracts*, 10 HARV. BUS. L. REV. 117 (2020) (championing an iterative approach to reduce the benefits of exploiting errors in contracts in the CDS market).

Further, instead of letting courts decide what the contracts meant, practitioners were quick to devise so-called "anti-*Windstream*" provisions designed to shield clients from debt activism via contract.[155] However, as this Note will discuss, drafting increasingly complex financial contracts may actually exacerbate the problem, rather than solve it.[156] At bottom, with no clear solution emerging, the immediate reaction caused by *Windstream* is one of uncertainty. Debt activism upset basic assumptions about corporate law and how bondholders are incentivized.[157] Traditional debt contracts do not protect against debt activism, and judicial intervention following the *Windstream* decision seems increasingly unlikely.

Despite the inherent problems with debt activism, this Note does not argue that it should be eradicated completely. There is undoubtedly a benefit to incentivizing firms to honor their covenants, and complete eradication accomplishes the opposite. Rather, this Note argues the best path forward is to substantially curb debt activism by using simple contract provisions to limit the remedies available to debt activists for affirmatively decreasing firm value.

## IV. MOVING FORWARD TO CURB DEBT ACTIVISM

This Note has established that debt activism is an immediate problem with considerable consequences to firms and their stakeholders. What remains is finding a solution. To begin, Section IV.A explains why debt activism should not be eradicated completely but rather curbed to limit the instances where social harms are likely.[158] Sections IV.B and IV.C then argue that complex contract drafting[159] and judicial intervention[160] will not solve the problems posed by predatory hedge funds. Finally, Section IV.D provides a rationale for why simple, bargained-for default time-bar provisions are a workable means of effectively curbing debt activism.[161]

### A. *DEBT ACTIVISM SHOULD NOT BE COMPLETELY ERADICATED*

While this Note has illustrated the problems with debt activism, it does not argue that the practice should be entirely prevented. Allowing firms to skirt their covenants simply because creditors may decrease value is not sound policy. In fact, the most surefire way for a company to prevent debt activism is by honoring its covenants and drafting them in a manner that does not give rise to "technical" breaches.[162] Moreover, the "activism" is more readily achieved

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155. *See After Windstream*, *supra* note 17 (discussing potential contracting fixes post-*Windstream*).

156. *See infra* Section IV.B.

157. *See supra* Section II.A.1.

158. *See infra* Section IV.A.

159. *See infra* Section IV.B.

160. *See infra* Section IV.C.

161. *See infra* Section IV.D.

162. *See The Rise of the Net-Short Debt Activist*, *supra* note 5 ("[C]ompanies are well-advised to avoid covenants that lend themselves to 'technical' breaches based on notice and delivery obligations and

in equity markets than the market for corporate debt, and the vast majority of bondholders hope "without any action on their part, the company will meet its obligations, including payment in full at maturity."[163] As long as the majority of market participants are acting in good faith, it is not clear that debt activism requires complete eradication via legislation, judicially created doctrine, or other means.

Some commentators have gone even further and argued that debt activism is not a real problem in the credit market.[164] While this Note takes the position that debt activism is a real phenomenon with troubling consequences, there is not necessarily a consensus regarding the real-world implications. For example, the hedge funds that have gained a reputation for the practice would surely dispute that they have done anything wrong.[165] Indeed, it is possible in certain instances that debt activists may be seen as providing a service to the credit market.[166] Forcing major corporations to honor their covenants ensures both parties' contractual obligations are being fulfilled. Finally, certain cases of alleged debt activism have actually benefited *both* creditor and lender.[167] For all these reasons, complete eradication goes a step too far. The most reasonable path forward is to allow firms to contract to limit debt activism, if they so choose, to a degree at which they feel protected and creditors are still willing to loan. However, these contractual solutions should be simple and concise to prevent the challenges posed by increasingly complex contractual provisions.

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to draft covenants as precisely as possible, with due regard for anticipated transaction structures."). It should also be noted that simply "not breaching" may be easier said than done. After all, Windstream did not *formally* breach the covenant prohibiting sale-leaseback transactions but rather crafted a transaction that was *substantively* the same as the proscribed transaction. *Id.*

163. *Id.* (emphasis omitted) ("The market for corporate debt does not immediately lend itself to the same kind of 'activism' found in equity markets. Bondholders, unlike shareholders, do not elect a company's board or vote on major transactions. Rather, their relationship . . . is governed primarily by contract.").

164. *See generally* Buccola et al., *supra* note 10 (arguing "that the net-short creditor saboteur is an urban legend . . . widely circulated but lacking a substantial basis in fact.").

165. *See* Childs, *Hedge-Fund Debt Cop*, *supra* note 83 ("Aurelius isn't alone: Elliott Management is also known as a stringent contract enforcer, and Blackstone Group's GSO Capital Partners has joined the down-and-dirty, better-do-your-homework weight class. Write bond documents at your own risk, and pray they don't call you."). *But see id.* ("Society is not a hedge fund client. Sometimes the effects of a fund's actions do not serve the public good. . . . But, if we accept the tenets of this system we built, it means hedge funds can kill our cable and our toys.").

166. *See id.* ("[I]t's comforting there's someone out there enforcing bond indentures, keeping us safe.").

167. *See Solus Made Money from that CDS Litigation*, *supra* note 70 (discussing the favorable financing resulting from a dispute between GSO Capital Partners and Hovnanian Enterprises, "[i]t's rare to find a game where everyone is a winner, but, apparently, this overly belabored Rube Goldberg machine did the trick"); *Corporate Distress, Credit Default Swaps, and Defaults*, *supra* note 36, at 27 ("It was a win-win for Hovnanian and GSO: below-market financing for the former and a CDS payout for the latter.").

### B. *Increasingly Complex Contracts Are Not a Viable Solution to Debt Activism*

With complete eradication being unreasonable, a natural reaction to try and solve a contracts issue is to attempt drafting *better* contracts. After all, debt activism is, at its core, a contractual issue. The problem with this approach, however, is the ease with which contracts can become complex and, ironically, create more loopholes for parties to exploit.[168] This approach becomes even more challenging when trying to prevent opportunism ex ante because there is a tendency to try and guard against all possible negative outcomes.[169] Highly formalistic contract drafting and strict interpretation together give rise to ex post opportunism.[170] Hedge funds have already proven their skill at exploiting complex contractual language—providing more complex provisions may simply provide hedge funds additional loopholes to pursue.

Problems with this approach regarding CDSs are illustrated in the 2019 acquisition of Sirius Computer Solutions ("Sirius") by the private equity firm Clayton, Dubilier & Rice ("CD&R").[171] This transaction closed only months after the *Windstream* decision, and it is clear potential debt activism was a concern; language in the financing of the deal "prohibit[ed] lenders that own[ed] derivative positions from voting on company matters," while carving out an exception for banks.[172] Effectively, Sirius was attempting to cabin the voting rights of potential hedge fund debt activists to only those matters concerning the loan itself.[173] While Sirius deserves credit for attempting to shield itself from debt activists, the provision has its shortcomings.[174] The provision does not explain how "net-short" will be defined or whether affiliates of investors are considered when determining the position; both leave room for exploitation.[175] With the variety of ways in which a discerning hedge fund may reach a net-short position, there is room for debt activists to operate and reach a result similar to that illustrated in *Windstream*.[176] The Sirius provision thus does not prevent debt activism and illustrates the notion

168. *See* de Fontenay, *supra* note 1, at 6.

169. *See id.*

170. *See* Robert E. Scott & George G. Triantis, *Incomplete Contracts and the Theory of Contract Design*, 56 CASE W. RSRV. L. REV. 187, 190–92 (2005).

171. Press Release, Sirius Comput. Sols., Inc., Sirius to Enter Equity Partnership with Clayton, Dubilier & Rice (Apr. 5, 2019), https://www.siriuscom.com/2019/04/sirius-to-enter-equity-partnership-with-clayton-dubilier-rice [https://perma.cc/FE9A-RNB6].

172. Kristen Haunss, *Sirius Computer Moves to Block Derivatives Holders from Speculation*, REUTERS (May 22, 2019, 12:03 PM), https://www.reuters.com/article/sirius-cds/sirius-computer-moves-to-block-derivatives-holders-from-speculation-idUSL2N22Y0EF [https://perma.cc/VMN6-ER2F].

173. MILBANK MEMO, *supra* note 5, at 1–3.

174. *Id.* at 1–4.

175. *Id.* at 3–4.

176. Clever positioning and creative legal arguments can be made based on this provision. As shown in *Windstream*, even disagreements over something as basic as what constitutes a breach can provide room for debt activists to operate. *See supra* Section III.B and accompanying footnotes.

that the lengthier and more complex the contract, the more room for loopholes and disagreement surrounding terms.[177]

Beyond the Sirius example, a litany of questions accompanies any net-short lender provision: How do you define a "net-short" position?[178] Does this prohibition include lenders with affiliates who have net-short positions?[179] At what point does the net-short provision become so broad that no lenders are interested?[180] Increasingly complex contracts with blanket rule-like provisions do not prevent ex post exploitation.[181] The questions that come with provisions like Sirius's do nothing to eradicate the eternal "cat-and-mouse game" in which hedge funds and distressed firms engage.[182]

In fact, these complex contract provisions may be more likely to *hurt* the credit market as a whole or even pave the way for *greater* opportunistic behavior from hedge funds.[183] For example, contracting to reduce the effectiveness of certain covenants generally serves to make those covenants less effective over time, which eventually may raise the cost of borrowing.[184] Any provision that makes a party consider the financial positions it has along with its affiliates is likely to decrease liquidity to some degree.[185] Additionally, the reward from debt activism is too high for hedge funds to simply stop trying to find loopholes, no matter how complex the contract is.[186] This incentive for hedge funds may be increased considering their high self-regard as "market police" keeping companies in line.[187]

The desire for complex contracts to save the day is understandable, if ill-

177. *See generally* MILBANK MEMO, *supra* note 5 (discussing the shortcomings of net-short lender provisions).

178. *See id.* at 3–4.

179. *See id.* at 4.

180. *See id.*

181. de Fontenay, *supra* note 1, at 9.

182. *Id.*

183. *Id.* at 3 ("Ironically, the contemporary move toward ever longer, more detailed contracts is likely to foster *more* opportunistic enforcement by hedge funds and others, rather than to help eliminate it.").

184. *See* MILBANK MEMO, *supra* note 5, at 5 ("[C]ovenants are included in bond indentures . . . to induce lenders to lend, . . . improving the borrower's access to credit and lowering its cost. Any market development that . . . dilute[s] the effectiveness of covenants generally . . . reduce[s] the range of . . . tools available to borrowers and their creditors to strike an appropriately priced arrangement.").

185. *Id.* ("Because any net short lender provision will require a potential lender to consider its other financial positions (and possibly those of its affiliates) before proceeding to take on the loan, any loan that includes such provisions will be at least somewhat less liquid.").

186. de Fontenay, *supra* note 1, at 9.

187. *See* Childs, *Hedge-Fund Debt Cop*, *supra* note 83 ("Aurelius is known for insisting on the black-and-white promises in a contract. It enforces the nuances of bond indentures, stitching up loopholes and manually hammering out standardization in terminology and meaning. Its exactitude makes money but also serves a purpose: It's keeping order. Someone has to do it."); *see also supra* notes 82–83 and accompanying text (discussing the increase in aggressiveness by corporate borrowers and attempts to keep them in-line).

advised. This Note advocates use of a contractual provision, although of a simpler ilk, to curb debt activism. Nevertheless, it is clear that lengthy, complex contracts cannot solve the difficulty of defining (and proscribing) all of the ways a company can be net-short or prevent the loophole cat-and-mouse game between lenders and borrowers. Moreover, corporate practitioners are hesitant to allow a generalist judge to use their discretion in interpreting complex transactions.[188] As the next Section illustrates, the problems with complex drafting and the industry's wariness to allow judges to interpret simpler contracts leaves parties to corporate transactions between the proverbial rock and hard place.

### *C. Judicial Intervention to Prevent Debt Activism Is Unreliable and Unlikely*

With financial contracts seemingly growing more complex by the day, and the potential for judicial error always a concern in the back of drafters' minds, asking the courts to intervene is a tall order, ripe with significant enforcement costs.[189] Asking courts to decide these cases based on implied covenants such as the duty of good faith and fair dealing provides little guidance, as well. How is a judge to reach an "equitable" solution when *both* parties are arguably acting in bad faith? One need not go any further than the *Windstream* decision to find such a case. With Windstream circumventing its covenants and Aurelius actively attempting to destroy firm value, both sides arguably fell short of the duty of good faith.[190] Indeed, the court was loath to reward a company for a "cute" maneuver attempting to side-step its covenants.[191] It does not strain the imagination to see the problems in asking courts to forgive one company's bad faith because a hedge fund had *worse* faith. That simply is not a workable rule.

What is more, it is far from axiomatic that a net-short debt activist is acting in bad faith. Regarding the duty of good faith and fair dealing, "[a] party to a contract is allowed to act in its own self-interest consistent with its rights under the contract."[192] These hedge funds have the right to call defaults, and "'if one has a right to do an act, then one can, in general, do it for whatever reason one wishes.'"[193] Moreover, the ISDA Master Agreement allows parties to

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188. de Fontenay, *supra* note 1, at 8.

189. *See id.*

190. *See supra* Section III.D.

191. U.S. Bank Nat'l Ass'n v. Windstream Servs., LLC, No. 17-CV-7857, 2019 WL 948120, at *23–24 (S.D.N.Y. Feb. 15, 2019).

192. Citibank, N.A. v. United Subcontractors, Inc., 581 F. Supp. 2d 640, 646 (S.D.N.Y. 2008), *aff'd*, 355 F. App'x 507 (2d Cir. 2009).

193. Moritz Renner, *Transnational Fiduciary Law in Bond Markets: A Case Study*, 5 U.C. IRVINE J. INT'L, TRANSNAT'L & COMPAR. L. 113, 116–17 (2020) (quoting Jack Beatson, *Public Law Influences in Contract Law*, *in* GOOD FAITH AND FAULT IN CONTRACT LAW 266, 266–67 (Jack Beatson & Daniel Friedmann eds., 1995)).

engage in transactions "including 'any action which might constitute or give rise to a Credit Event,'" such as a default.[194] In other words, there is nothing *technically* wrong with the actions of Aurelius and other hedge funds participating in debt activism.

### D. *Default Time-Bar Provisions Are a Viable Means of Curbing Debt Activism*

Thus far, this Note has shown that complex contracts purporting to sever the voting rights of net-short bondholders and judicial intervention via the doctrine of good faith and fair dealing are not viable solutions for parties wishing to prevent net-short debt activism. This Note has further shown that attempting to completely eradicate debt activism would signal open season for borrowers to breach their covenants with impunity. The proper balance is to allow parties to contract to limit the *instances* in which creditors may use their rights to decrease firm value via judicial remedy. To that end, default time-bar provisions are an effective means of reasonably limiting remedies for hedge funds when they are considering affirmatively destroying firm value.[195]

In addition to the eradication of debt activism being ill-advised, contracting to eliminate it entirely is difficult, if not *impossible*.[196] Overly restrictive net-short lender provisions can have negative effects on credit markets generally.[197] These negative effects include, inter alia: (1) ensuring that covenants become less effective by reducing incentives for creditors to enforce those covenants; (2) reducing liquidity of credit instruments will likely make it increasingly costly for creditors to lend; and (3) specifically targeting the CDS market with net-short lender provisions is likely to make all creditors hesitant to use CDSs.[198] Thus, the default time-bar provisions illustrated in this Section focus less on eliminating debt activism and more on a bargained-for compromise that allows debtors to feel secure without harming the credit market as a whole.

Time-bar provisions are a classic means of limiting the remedies available for breach of contract.[199] This brand of provision "provid[es] cost and program[] certainty and transparency."[200] Parties will not always be satisfied with the

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194. *See* Gina-Gail S. Fletcher, *Engineered Credit Default Swaps: Innovative or Manipulative?*, 94 N.Y.U. L. REV. 1073, 1128 (2019) (quoting ISDA CREDIT DERIVATIVE DEFINITIONS § 11.1(b)(iii) (2014)).

195. *See supra* Section III.B.

196. *See* MILBANK MEMO, *supra* note 5, at 2–3 ("[W]e acknowledge at the outset that [drafting a contract provision to prevent debt activism] is difficult (if not impossible) to achieve . . . .").

197. *See id.* at 4–5.

198. *See id.* Thus far, it has appeared that net-short lender provisions increasingly involve the idiosyncratic features of creditors. This contingency on features unique to creditors reduces transferability and thus decreases liquidity which in turn increases cost. *See id.* at 5.

199. *See* Shur-Value Stamps, Inc. v. Phillips Petroleum Co., 50 F.3d 592, 598 (8th Cir. 1995) (discussing materiality of limiting provisions such as time-bar provisions).

200. PAUL GILES & STEVE GIBSON, EVERSHEDS RAISING THE BAR: TIME BARS AND THEIR

background law, such as the statute of limitations on an issue, and this dissatisfaction often leads to the parties negotiating individualized terms.[201] As the value of the contract increases, economic theory suggests that parties find it more worthwhile to negotiate for and implement these individualized terms.[202] With the value of debt contracts increasing, it is reasonable to expect parties to such a contract to solve issues with background law, including ill-fitting statutes of limitation. This is even more likely considering the process of "sitting on" and asserting a technical default after a substantial gap in time is a common strategy in debt activism.[203] In this way, default time-bar provisions can function as a bargained-for "statute of limitations" in debt contracts to curb predatory debt activism that occurs years after the alleged breach.[204]

Indeed, Charter Communications has already attempted this approach in its recent issuance of 5.375 percent Senior Notes.[205] The default time-bar provision in its notes set a limit of two years for notice of default.[206] Under the default time-bar provision:

> [A] Default under clause (iii), (iv), (v) or (vi) of the previous paragraph will not constitute an Event of Default until the trustee or the Holders of at least 30% in principal amount of the outstanding Notes notify the Issuers of the Default and, with respect to clauses (iv) and (vi), the Issuers do not cure such Default within the time specified in clause (iv) or (vi) of this paragraph after receipt of such notice; *provided that a notice of Default may not be given with respect to any action taken, and reported publicly or to Holders, more than two years prior to such notice of Default.*[207]

This provision means that if a creditor wishes to assert a technical default

ENFORCEABILITY IN ENGLISH LAW EPC CONTRACTS 2 (2014), https://www.eversheds-sutherland.com/documents/services/construction/time-bars-in-english-law.pdf [https://perma.cc/F4BR-N28G] (discussing the purpose and benefits of time-bar provisions).

201. Andrew A. Schwartz, *A "Standard Clause Analysis" of the Frustration Doctrine and the Material Adverse Change Clause*, 57 UCLA L. REV. 789, 794–95 (2010) ("[W]hen dealing with complex contracts, parties often negotiate and draft express written terms.").

202. *Id.* at 795 ("High-value contracts are therefore where we should expect to, and do, see the most resources expended on negotiating and drafting.").

203. *See* "NET SHORT", *supra* note 5, at 2–3 (discussing time-bar provisions as a means of preventing an opportunistic hedge fund from asserting a "notice of [d]efault" after a substantial gap in time).

204. *See id.* at 2 ("[Default time-bar] provision[s] effectively impose[] a 'statute of limitations' on creditors' rights to declare defaults . . . thereby preventing creditors from opportunistically 'sitting on' a challenge to a transaction.").

205. *Id.*; *see* CCO Holdings, LLC, First Supplemental Indenture (Form 8-K), at A-10 (May 23, 2019) [hereinafter CCO First Supplemental Indenture] ("Default may not be given with respect to any action taken, and reported publicly or to Holders, more than two years prior to such notice of Default.").

206. *See* CCO First Supplemental Indenture, *supra* note 205, at A-10.

207. *Id.* (emphasis added).

similar to the default in the *Windstream* case, they must do so within two years—a timeframe one-third the length of the statute of limitations for contract claims in New York, for example.[208]

In the same way, if Windstream had included a default time-bar provision in the relevant notes in that case, Aurelius would have been barred from bringing a claim.[209] A recent example of "[a]n even longer gap" was present when Safeway bondholders made an objection to Albertson's acquisition attempt.[210] In that case, there was a four-year delay between the announcement of Albertson's plan to acquire Safeway and when Safeway bondholders objected.[211] The four-year gap present in that case still would not pose a problem under New York law.[212] Practitioners clearly seem dissatisfied with the current gaps that are allowed between the alleged wrongful conduct and bondholders publicly declaring default.[213]

Default time-bar provisions allow creditors and borrowers to bargain for an acceptable time-gap with which both sides are comfortable.[214] It is not important whether the standard for time-bar provisions ultimately lands at six months, two years, or any other reasonable timeframe. The important thing is that market participants will be able to establish a clear standard that strikes a proper balance between the interests of firms and hedge funds. Indeed, one of the most appealing characteristics of default time-bar provisions is that they do not completely eliminate a remedy for creditors.[215] Default time-bar provisions provide a reasonable means of protection from activists while also maintaining creditors' rights to appropriate remedies stemming from their covenants. Thus, default time-bar provisions are an effective means of curbing debt activism

208. N.Y. C.P.L.R. 213 (MCKINNEY 2019) (setting a six-year statute of limitations for claims based on contracts in writing). Though not at issue in the *Windstream* case, the statute of limitations in Delaware for most contracts is three years. 10 DEL. CODE ANN. tit. 10, § 8106 (West 2021).

209. *See After Windstream*, *supra* note 17 (exploring default time-bars as a reaction to the *Windstream* decision and noting "the gap between . . . the challenged spin-off transaction (April 2015) and the time Aurelius actually asserted a default (September 2017)").

210. *See id.* ("An even longer gap applied to the recent objection by Safeway bondholders to the company's acquisition by Albertsons."); Katherine Doherty, *Safeway Bondholders Said to Query Albertsons Debt Maneuvers*, BLOOMBERG L. (June 29, 2018, 1:54 PM), https://www.bloomberglaw.com/document/X3T4L8oCoooooo [https://perma.cc/K7JA-TFCJ] ("Four years after Albertsons Cos. announced it would acquire Safeway . . . bond owners are asking whether the supermarket giant violated terms of their holdings . . . .").

211. Doherty, *supra* note 210.

212. *See* N.Y. C.P.L.R. 213.

213. *After Windstream*, *supra* note 17 ("[I]t is clear that many market participants are not content with the longer limitations periods dictated by state law . . . .").

214. *See id.* (discussing purpose of default-time bars and emphasizing the ability of the market to determine an appropriate standard).

215. It appears clear that eliminating a remedy outright would be a deal-breaker for creditors. *See id.* ("[R]ecent developments suggest that borrowers and lenders may find common ground on contractual provisions that will constrain activists *without unduly limiting creditor remedies*." (emphasis added)).

without unintentionally increasing opportunistic behavior or harming the credit market as a whole.

## V. Conclusion

Since the recent growth of the CDS market in the twenty-first century, there has been a shift in the corporate paradigm. The assumption that all stakeholders act in the best interest of the firm at all times is no longer a basic principle upon which companies may rely. Predatory hedge funds are now able to attempt to actively destroy firm value by calling technical defaults and having greater financial incentives in a firm's failure than its solvency. Debt activism has very real consequences from harming all other bondholders in a company's debt to bankrupting a massive firm and costing thousands of employees their jobs.

No case has exemplified the real-world harms more than the 2019 *Windstream* decision. While a major firm going bankrupt is certainly a dire consequence, the implications the decision has for future behavior are even more alarming. By rewarding Aurelius's naked opportunism, the *Windstream* court signaled to all interested hedge funds that predatory behavior against distressed companies is condoned in the courts. The court effectively gave its blessing for firms to actively destroy firm value while forsaking the interests of all other stakeholders. Although the prevalence of the practice is still disputed, *Windstream* confirmed what many feared: Debt activism is real, dangerous, and difficult to prevent.

It is unreasonable to rely on judicial intervention or increasingly complex contracts that proscribe net-short investors' rights to solve the problems presented by debt activism. Drafting overly complex provisions based on idiosyncrasies of creditors will likely only provide more loopholes for clever hedge funds while harming the liquidity of the credit market. Moreover, as *Windstream* illustrated, courts are disinclined to bail out a company that breached a covenant—even more so when the breach appears deliberate. In that instance, debt activists are likely acting within their rights and a court is unlikely to punish them for doing so. It is difficult, if not impossible, to eradicate debt activism via contract or judicial intervention.

The good news is that debt activism does have some benefits and need not be completely eradicated. Firms now, more than ever, have an incentive to carefully draft their debt contracts and honor their indentures. Companies can and should strive to *curb* rather than eliminate debt activism. To do so, companies can carefully draft covenants in a manner that makes technical breaches unlikely and then carefully follow those covenants. However, most firms likely feel they are already doing just that. Default time-bar provisions provide an extra layer of protection for firms by limiting the instances in which a default may be declared through the effective creation of a bargained-for statute of limitations. This simple extra provision allows the market to still reap the benefits of debt activism while striking a middle ground between protecting firms and avoiding undue limitations on creditor remedies.

In a broader sense, finding a middle ground should always be the goal when drafting debt contracts to protect lenders from debt activists. Limiting remedies, rather than eliminating voting rights altogether, is a more reasonable approach to curb debt activism. As long as creditors do not feel their rights are being unduly burdened, debt activism will be effectively curbed and the credit markets unharmed. Moving forward, default time-bar provisions should be included in debt contracts to curb debt activism by allowing the market to dictate appropriate gaps in time between breaches and defaults.