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CONFRONTING THE CERTAINTY IMPERATIVE 
IN CORPORATE FINANCE JURISPRUDENCE

Diane Lourdes Dick

I. INTRODUCTION

The United States’ corporate sector is in the midst of an exceptionally turbulent time. In particular, the field of corporate finance has been the subject of vigorous public interest, critical documentaries and forceful editorials in the wake of the recent financial crisis. Consider the myriad headline news stories throughout the crisis and ensuing recession, detailing commercial loan defaults and workouts.

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2 In transactional practice, the term “corporate finance” encompasses a range of value-maximizing and capital-raising activities. Corporate financing—loosely defined as the capital that funds the formation, operation and expansion of business enterprise—may be comprised of equity or debt, with the latter typically derived from traditional bank loans, syndicated lending arrangements and publicly and privately placed debt securities. See, e.g., JONATHAN BARRON BASKIN & PAUL J. MIRANTI, JR., A HISTORY OF CORPORATE FINANCE 4–7 (1997).

high profile corporate bankruptcies,\textsuperscript{4} devastating bank failures,\textsuperscript{5} and startling fire sales of entrenched Wall Street firms.\textsuperscript{6} Debt financing in particular has attracted considerable attention, as many analysts consider securitized debt obligations and unregulated derivative trading to be a cause of the crisis.\textsuperscript{7}

Even setting aside technical explanations about the relationship between any given corporate financial practice and broader market disruptions, the financial crisis has made it abundantly clear that where private financing arrangements overlap to create a sufficiently large and complex web of interconnected transactions, the consequences of default can be quite public. For instance, during one of the most dramatic weeks of the recession, President Obama made forceful remarks underscoring the relationship between corporate financing decisions and the fate of established and iconic companies.\textsuperscript{8} When Chrysler’s corporate lenders failed to unanimously consent on a proposed settlement, the company was forced to file for Chapter 11 bankruptcy protection.\textsuperscript{9} Of the lenders refusing consent, President Obama remarked: “They were hoping that everybody else would make sacrifices, and they would have to make none . . . I don’t stand with them.”\textsuperscript{10}

\textsuperscript{6} E.g., James Saft, Bear Stearns’s Fall Prompts a Search for Faith in Banking and Markets, N.Y. TIMES (Mar. 18, 2008), http://www.nytimes.com/2008/03/18/business/worldbusiness/18iht-rtoc119.1.11209658.html; Hugh Son, AIG Falls After Failing to Give Plan to Save Rating (Update4), BLOOMBERG.COM (Sept. 15, 2008), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=agiwl45qTgY; see also Chris Isidore, General Motors Bankruptcy: End of an Era, CNNMONEY.COM (June 2, 2009), http://money.cnn.com/2009/06/01/news/companies/gm_bankruptcy (reporting on General Motors’ bankruptcy, including their removal from the Dow Jones industrial average which has included General Motors since 1925). For a lively account of events leading up to the crisis, see ANDREW ROSS SORKIN, TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM—AND THEMSELVES (2010).
\textsuperscript{9} Id.
\textsuperscript{10} Id.
As with most turbulent economic eras, this period of strife will leave many enduring legacies. In particular, some market participants and observers are demanding greater involvement by governmental institutions in financial markets. Legal reform is underway and is likely to continue as new insights emerge from ongoing empirical research as to the role of law, institutions and public policy in financial markets. Careful attention from the legal academy is needed to facilitate the emerging public debate. At best, the verdict is still out on the efficacy of the prevailing legal paradigm in corporate finance.

For the most part, reform efforts have been focused on increasing oversight of the financial services industry, either by imposing new laws and regulations upon specific types of financial institutions, or by recharacterizing certain transactions so that existing statutory and regulatory frameworks cover them. In the latter

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11 Calls for increased governmental oversight were a significant motivation for the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), Pub. L. No. 111-203, 124 Stat. 1376 (to be codified in scattered sections of 7, 12 & 15 U.S.C.), which was signed into law on July 21, 2010. See Damian Paletta, U.S. Lawmakers Reach Accord on New Finance Rules, WALL ST. J. (June 25, 2010), http://online.wsj.com/article/SB10001424052748703615104575328020013164184.html (noting the influence of public opinion and advocacy groups on the passage of the Dodd-Frank Act).


13 A recent issue of the Brigham Young University Law Review explored a number of these questions. Symposium, Evaluating Legal Origins Theory, 2009 BYU L. REV. 1413 (including several articles on the topic of law and finance).

14 For instance, under existing laws, the Federal Reserve Board regulates financial holding companies. See Bank Holding Company Act of 1956, 12 U.S.C. §§ 1841–1852 (2006). Depending upon the institution’s charter, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve and state agencies may regulate commercial banks. See Federal Deposit Insurance Act, 12 U.S.C. §§ 1811–1835a (2006) (providing statutory authority for the Federal Deposit Insurance Corporation’s regulatory oversight of banking institutions); id. § 1842 (providing regulatory authority for the Federal Reserve); 12 C.F.R. §§ 1–197.21 (or 1.1–1.8) (2010) (providing the rules and regulations of the Office of the Comptroller of the Currency); Adam J. Levitin, Hydraulic Regulation: Regulating Credit Markets Upstream, 26 YALE J. ON REG. 143, 149 (2009) (“If a bank has a state charter and is neither federally insured nor a member of the Federal Reserve system, its primary regulator for consumer protection will be the state banking regulator and/or the state attorney general.”). More recently, Congress imposed additional regulations on certain financial institutions. See Bank and Savings Association Holding Company and Depository Institution Regulatory Improvements Act of 2010, Dodd-Frank Act §§ 601–628.

15 See David J. Gilberg, Regulation of New Financial Instruments Under the Federal Securities and Commodities Laws, 39 VAND. L. REV. 1599 (1986) (providing a historical context for understanding the regulation of commodities and securities by the Commodity Futures Trading Commission and the Securities Exchange Commission); see also Commodity Futures Trading Comm’n v. G7 Advisory Servs., LLC, 406 F. Supp. 2d 1289,
case, such recharacterizations effectively elevate particular instruments from a baseline status as private contracts into a more specialized category of instruments subject to regulation under securities or commodities laws.

Yet long before a financial crisis unfolds, and long before Congress has the occasion to revamp statutory frameworks, even the most innovative financing arrangements are within the law’s reach. For instance, they remain subject to a range of broadly applicable legal principles, such as those governing contracts generally. Further, where parties seek legal redress, financing arrangements are subject to the jurisdiction of courts. Thus, as these broader debates turn, one question must loom particularly large among legal scholars: What role do courts play in the formation and execution of financial law and policy? Moreover, what role should courts play? As history has revealed with respect to other areas of the law, judicial decisions can have profound effects, both in terms of resolving disputes or granting relief and, more broadly, by stimulating legislation that alters the direction of reform efforts. Moreover, the availability of an effective judicial process can serve as an important foundation for commercial and financial activity.

1292–95 (S.D. Fla. 2005) (providing an overview of the history of expanded regulatory reach, particularly in the context of commodities trading).

16 Recent attention has focused on “derivatives,” which is a category of financial instruments that includes a variety of privately negotiated contracts, such as interest rate swaps, credit default swaps, equity swaps and commodity price swaps. These transactions are designed to manage risk and enhance profits. Although the financial engineering behind these products can be complex, the transaction is carried out by a contract, often executed using a relatively brief, standardized form. See, e.g., Fin. One Pub. Co. v. Lehman Bros. Special Fin., Inc., 414 F.3d 325, 338–40 (2d Cir. 2005) (analyzing claims arising under derivatives contracts using state contract law without reference to laws governing specialized financial instruments); JP Morgan Chase Bank, N.A. v. Controladora Comercial Mexicana S.A.B. De C.V., No. 603215/08, 2010 WL 4868142, at *6–7 (N.Y. Sup. Ct. Mar. 16, 2010) (same).

17 See supra note 16.

18 Financing arrangements are contracts, and as such are subject to the jurisdiction of courts; extensive rules of civil procedure determine which court(s) have jurisdiction. See Burger King Corp. v. Rudzewicz, 471 U.S. 462, 474–78 (1985) (describing in detail the minimum contacts necessary for personal jurisdiction in a suit involving contract claims).


20 The interdisciplinary subfield “law and finance” has brought questions of this sort to the forefront. These studies claim positive correlations between common law legal systems and strong financial markets, presumably because courts are better able to provide flexible and responsive redress for investor claims. See, e.g., Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, Law and Finance, 106 J. Pol. Econ. 1113, 1115–17 (1998) (advancing the hypothesis that financial markets tend to flourish in common law countries partly because such systems provide enhanced protection for investors).
Nevertheless, even the most cursory review reveals minimal lawmaking by courts in the area of corporate finance. With limited exception, courts presiding over cases in this realm tend to circumvent more expansive interpretive analyses when identifying substantive rights and obligations or procedural remedies. Some courts even decline to extend common law doctrines that broadly overlie all contracts. At first blush, this tendency appears to reflect the textualist interpretive paradigm dominating American jurisprudence in recent years. However, as this
Article will demonstrate, finance and lending jurisprudence has forged a unique path, and many areas of corporate finance have persistently eluded the rigorous judicial analyses that corporate, transactional, and bankruptcy law have endured. It seems, then, that there are deeper historical and philosophical forces at work.

Indeed, the prevailing judicial decision-making approach in corporate finance finds its roots in what this Article calls the "Certainty Imperative," which is a decisional paradigm that infuses the goal of stability in financial markets into the deeply entrenched normative theme of legal certainty. Specifically, the Imperative asserts that stable financial markets are achieved in an environment of "legal certainty," which, in the realm of finance and lending, is best preserved when courts exercise considerable restraint, narrowly tailoring opinions to strict construction and passive enforcement of contracts. Imperative-driven rulings are rooted in the belief that financial markets are vital to the national interest, and therefore judges ought to decide cases in this realm in a manner that advances broad economic efficiency goals. As it has evolved across decades of case law and legislative enactments, the Imperative has profoundly altered judicial decision-making in finance and lending.

Yet despite the Imperative's considerable impact, it is not a positive legal doctrine; rather, it is simply the reason for the relatively empty space where

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Faith, 40 WM. & MARY L. REV. 1223, 1223–30 (1999) (studying the effects of formalism upon the contractual duty of good faith).

See infra notes 221–223 and accompanying text (describing judicial lawmaking by Delaware courts in the area of corporate law).

Contracts relating to business transactions (other than financing arrangements) often include Delaware choice-of-law and/or forum selection clauses. Additionally, most major firms are incorporated under Delaware law. The Delaware Court of Chancery has been active in developing common law doctrine in the areas of corporate and transactional law, particularly with respect to fiduciary duties and the roles of managers and shareholders. E.g., ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 39–40 (1993); see also Lucian A. Bebchuk & Assaf Hamdani, Federal Corporate Law: Lessons from History, 106 COLUM. L. REV. 1793, 1817 (2006) ("One of the noteworthy features of Delaware law is its heavy reliance on judge-made standards to regulate corporate affairs."); Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, 89 GEO. L.J. 439, 459 (2001) (noting, primarily in reference to Delaware corporate jurisprudence, judge-made standards with respect to the fiduciary duties of loyalty and care); Robert A. Ragazzo, Toward a Delaware Common Law of Closely Held Corporations, 77 WASH. U. L. REV. 1099, 1100–02 (1999) (detailing the evolution of judicially-crafted standards of shareholder responsibilities).

See Adam J. Levitin, Toward a Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime, 80 AM. BANKR. L.J. 1, 85 (2006) ("As a normative matter, judicial lawmaking in bankruptcy should be called and analyzed in terms of federal common law, not equity. Federal common lawmaking is already happening, but no one recognizes it as such.");

See infra Part II.A.
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Corporate finance jurisprudence ought to be. In spite of the Imperative’s lack of academic treatment, the paradigm’s implications are of plain consequence. The Imperative’s methodological constraints have become a paralyzing force upon the judiciary, preventing the courts from participating in financial law reform. In essence, the state of finance and lending jurisprudence can be summarized thusly: deference, in the very broadest sense, is shown to the legal status quo.

This Article argues that the methodological constraints of the Imperative have abandoned its underlying goals of certainty and stability in financial markets. Therefore, a new paradigm is needed that will enable courts to allocate rights and remedies in accordance with the economic substance of arrangements, and thus better enhance market stability. This Article proceeds as follows: Part II articulates the jurisprudential underpinnings of the Imperative. Part III examines the economic theory and assumptions reflected in Imperative-driven decisions, as well as the interpretive methodology that has evolved across a range of judicial decisions and legislative enactments. Part IV introduces a recent case that exemplifies the current state of corporate finance jurisprudence under Imperative-driven methodologies, and provides a brief overview of the methods by which courts typically construe financing agreements under strict interpretive norms. Part V proffers an alternative decisional paradigm that is designed both to enable courts to engage in a more expansive analysis and also to empower courts to allocate legal rights and remedies in a manner that is consistent with the actual economic arrangement of the parties. Part VI concludes with a recommendation that this more expansive approach may be more apt to enhance stability in financial markets.

II. THE CERTAINTY IMPERATIVE

The scarcity of doctrinal law with respect to rights and obligations of parties to financing transactions reflects, to some extent, the limited involvement of courts in this area. As a general matter, most of the judiciary’s recent forays into finance and banking have been limited to questions of federal preemption of state laws.

29 For example, a line of cases considers conflict between the federal Trust Indenture Act of 1939, codified at 15 U.S.C. §§ 77aaa–bbbb (2006), which supplements the Securities Act of 1933, codified at 15 U.S.C. §§ 77a–aa (2006), and various state securities laws. See, e.g., Bluebird Partners, L.P. v. First Fid. Bank, N.A., 85 F.3d 970, 974 (2d Cir. 1996) (“The Trust Indenture Act was enacted because previous abuses by indenture trustees had adversely affected ‘the national public interest and the interest of investors in notes, bonds [and] debentures,’ and Congress sought to address this national problem in a uniform way . . . .” (citations omitted) (quoting 15 U.S.C. § 77bbb(a) (1994))); Zeffiro v. First Pa. Banking & Trust Co., 623 F.2d 290, 299 (3d Cir. 1980) (“It is hard to believe that Congress would have established uniform standards to govern indentures and then paradoxically have allowed the application of those standards to depend on the law of the state of the suit.”). On federal preemption of state law in the area of consumer lending, see Levitin, supra note 27, at 145–47, 158 (describing federal preemption in the area of
and regulations or controversies over consumer credit and residential mortgage lending. This is not to say that disputes arising under sophisticated corporate financing transactions do not ultimately find their way into court. In fact, as these arrangements grow larger and more complex, the claims that arise generate ample litigation. Cases of this sort tend to arrive in federal courts (including bankruptcy courts) and the state courts of New York. However, as I argue in the following sections, finance and lending jurisprudence, including cases extending into the related areas of consumer finance and public finance, reveals a number of insights into the judiciary’s limited role in financial matters.

A. Preserving Stability in Financial Markets

Finance and lending law reform is often reactionary, developed ex post in the wake of an economic downturn. Thus, to find the historical roots of present jurisprudential norms in corporate finance, we must look considerably beyond the most recent economic crisis. Commencing in the 1970s and extending into the 1980s, a range of factors converged to create a tremendous amount of turbulence in the global economy. Upon the collapse of the Bretton Woods system in the early banking regulation but suggesting that a state’s ability to regulate secondary consumer debt markets has not yet been preempted).

30 The Supreme Court has grappled with the role of states in regulating the activities of federally chartered banks. See, e.g., Watters v. Wachovia Bank, N.A., 550 U.S. 1, 6–7 (2007) (holding that the National Bank Act, codified at 12 U.S.C. § 1 et seq., preempts state licensing, registration and inspection requirements as applied to national banks and their operating subsidiaries).

31 See generally Jo Carrillo, Dangerous Loans: Consumer Challenges to Adjustable Rate Mortgages, 5 BERKELEY BUS. L.J. 1, 3 (2008) (discussing litigation-based reform efforts in the context of the mortgage market).


1970s, major currency exchange rates were permitted to float; initially, this brought extraordinary volatility to capital markets. United States banking and financial sectors were particularly vulnerable to the instability, and faced additional capitalization risks resulting from newly variable exchange rates. Commodity prices fluctuated wildly and interest rates ricocheted as inflationary pressures mounted. Aggressive anti-inflationary actions taken by the Board of Governors of the Federal Reserve System (the “Board”) further exacerbated market volatility. Bank failures began to increase in the 1970s, and surged in the 1980s. Indeed, by any measure, the period from the early 1970s until the mid-1980s was a particularly turbulent time in United States economic history.

Against this backdrop of instability, and largely in response to Keynesian interventionist measures taken by the Board in the New Deal era as well as at the peak of the inflationary crisis of the 1970s, a school of neoclassical economics

41 Keynesian economic theory assumes that certain governmental economic and fiscal policies can stimulate or restrain market expansion; these interventions are necessary because, although free markets are believed to be self-balancing, the point of equilibrium features socially undesirable characteristics. For instance, unemployment may remain high. See generally JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY (1936).
42 See supra note 39 and accompanying text.
became preeminent. With roots at the University of Chicago, these “Chicago School” economists rejected the notion of governmental regulation in most financial affairs, arguing that markets are perfectly competitive, inherently stable, and entirely efficient so long as they are permitted to function without excessive governmental interference.

Such history is an essential predicate to understanding the judiciary’s modern approach to finance and lending cases. Indeed, as Professor Gilmore predicted in his 1977 seminal work on American jurisprudence, starting in the late 1970s courts began to move away from the “interventionist, egalitarian contract jurisprudence of the 1960s and 70s,” in favor of a market-based approach that underscored freedom of contract. Cases involving corporate finance agreements particularly reflect these evolving sentiments. In 1979, the Third Circuit declined to recognize a common law fiduciary duty of a bank to its borrower, explaining that the “legislature is best suited to consider the delicate financial issues at stake and strike the appropriate balance between sound economics on the one hand, and expectations of loyalty on the other.” Implicit in the court’s reasoning is the

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43 The most noted of the Chicago School economists was University of Chicago economics professor Milton Friedman, who received the Nobel Prize in economics in 1976. See Milton Friedman, *Inflation and Unemployment*, Nobel Prize Acceptance Speech (Dec. 13, 1976).


48 Wash. Steel Corp. v. TW Corp., 602 F.2d 594, 601 (3d Cir. 1979) (“[E]ven if... sound public policy, it would hardly be the province of this court to say so... . . . First, establishing a *per se* common law fiduciary duty of banks to their borrowers seems
belief that lending relationships require more delicate legal handling than other economic relationships in the commercial marketplace. These concerns about vulnerability in the banking sector reflect the historical context as well as the libertarian economic theories gaining renewed interest in the 1970s.

The notion that courts are ill-equipped to tamper with the lending relationship gained far greater prominence in a 1980 Supreme Court consumer finance decision concerning questions arising under one of the most influential pieces of modern banking legislation, the Truth in Lending Act (the “Act”). In *Ford Motor Credit Co. v. Milhollin*, the Court considered whether a creditor must disclose to a borrower its right to accelerate the maturity date of debt obligations. Noting that “caution must temper judicial creativity” when interpreting legislation, the Court turned to strict interpretive norms to construe the plain meaning of the Act. Given that Congress expressly delegated administrative authority to the Board, the Court found that such explanatory material, unless “demonstrably irrational,” is dispositive. Consequently, disclosure was not required under the Act.

In terms of its holding, *Milhollin* is not a landmark decision; rather, it is one of many cases that broadly fall within the so-called deference rule, whereby archetypically within the domain of legislative judgment.”), overruled on other grounds by *Clark v. K-Mart Corp.*, 979 F.2d 965, 967 n.4 (3d Cir. 1992).

*Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. §§ 1601–1667f (2006)). The Act applies only to consumer credit (i.e., credit issued for family or household purposes as opposed to business, commercial, industrial or agricultural purposes). §1603. To the extent a transaction is subject to the Act, the law mandates certain disclosures by the creditor with respect to the extension of credit. See Elwin Griffith, *Lenders and Consumers Continue the Search for the Truth in Lending Under the Truth in Lending Act and Regulation Z*, 44 SAN DIEGO L. REV. 611, 612 (2007).*

*444 U.S. 555 (1980).*

*Id. at 565.*

*Id. at 562–64. Specifically, the Court found that an acceleration clause was not a “default, delinquency, or similar charg[e],” and thus not subject to mandatory disclosure under the express statutory language. Id. at 562.*

courts defer to congressionally sanctioned agency interpretations of federal statutes or regulations.\textsuperscript{56} Deference is granted notwithstanding the judiciary’s constitutional power to construe existing law or “fill[] the interstitial silences within a statute or a regulation.”\textsuperscript{57} Thus, Milhollin references fairly typical deference rule justifications for judicial restraint: “Congress, in delegating regulatory authority to the Board, has chosen to resolve interpretive issues under [the Act] by ‘uniform administrative decision, rather than piecemeal through litigation.’”\textsuperscript{58}

Yet for those interested in finance and lending, Milhollin has philosophical implications that extend far beyond its contributions to deference rule jurisprudence or even consumer finance law in general. Rendered at the peak of the 1980–82 recession, the decision echoes the Third Circuit\textsuperscript{59} by reflecting an enormous amount of apprehension as to the role of courts in the realm of finance and lending. In fact, Milhollin ventures substantially farther than the Third Circuit, infusing the goal of stability in financial markets into the more entrenched normative value of \textit{legal certainty}, which is a long-standing theme that has persisted across centuries of common law.\textsuperscript{60} Articulating a heightened need for of the statutes it is authorized to implement reflects a sensitivity to the proper roles of the political and judicial branches.”).}

\textsuperscript{56} If the intent of Congress is clear . . . the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. . . . [I]f the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency’s answer is based on a permissible construction of the statute.

\textit{Chevron}, 467 U.S. at 842–43.\textsuperscript{57} Ford Motor Credit Co. v. Milhollin, 444 U.S. 555, 565 (1980).\textsuperscript{58} Hess v. Citibank, 459 F.3d 837, 843 (8th Cir. 2006) (quoting Milhollin, 444 U.S. at 567–68).\textsuperscript{59} Wash. Steel Corp. v. TW Corp., 602 F.2d 594, 601 (3d Cir. 1979), discussed \textit{supra} note 48 and accompanying text.\textsuperscript{60} “He who destroys the means of certainty does a greater mischief than the sower of dragon’s teeth.” \textsc{Byron K. Elliott} & \textsc{William F. Elliott}, The Work of the Advocate 422 (2d ed. 1911). Legal certainty, as a broader normative goal, is to a large extent synonymous with the phrase “rule of law.” In the transactional and commercial realm, certainty is often associated with uniformity, as precision in the law is believed to allow parties to more efficiently structure transactions and order commercial expectations. A core value of the earliest \textit{lex mercatoria}, the goal of legal certainty continues to be articulated in cases that touch upon finance and lending. \textit{See, e.g.}, Celia Wasserstein Fassberg, \textit{Lex Mercatoria—Hoist with Its Own Petard?}, 5 CHI. J. INT’L L. 67, 77 (2004); see also Clearfield Trust Co. v. United States, 318 U.S. 363, 366–67 (1943) (“The issuance of commercial paper . . . is on a vast scale . . . The application of state law . . . would subject the rights and duties of the United States to exceptional uncertainty. It would lead to great diversity in results by making identical transactions subject to the vagaries of the laws of the several states. The desirability of a uniform rule is plain.”); Ry. Co. v. Sprague, 103 U.S. 756, 761–62 (1880) (“To hold that the moment an unpaid coupon is left on a bond its
“sure guidance” by persons engaged in the business of finance and lending, the Court notes that judicial deference to agency interpretation is especially appropriate when construing this particular “highly technical” Act.61 In essence, the decision recognizes a subjective notion of legal certainty, referred to as “sure guidance,” which does not turn upon objective principles of uniformity and clarity in the law, but rather upon the desire for financial institutions to sense that the law governing lending transactions has remained unchanged.

More recent cases have reiterated Milhollin’s holding and policy rationale in the context of judicial deference to agency interpretations of the Act.62 More importantly, the infusion of financial market stability into the theme of legal certainty has continued across a range of cases.63 Thus emerged what this Article calls the “Certainty Imperative”: a judicial paradigm that has taken root in the finance and lending realm, and that, over time, has profoundly altered judicial decision-making methodology. The Imperative tends to manifest as a pervasive rhetoric in judicial opinions, which takes the form of policy arguments,64 dicta,65 or as strong cautionary words to lower courts.66 It often serves as justification for judicial inaction.67 Conversely, in the rare case that a court applies a more

character and negotiability are changed would greatly embarrass the traffic in such securities and lead to endless uncertainty and confusion.”). As I argue in this Article, the goal of legal certainty has come to dominate judicial decision-making in the realm of finance and lending in recent decades.

61 Milhollin, 444 U.S. at 565–68.
62 See, e.g., Hess, 459 F.3d at 843 (quoting Milhollin and explaining, “Creditors need ‘sure guidance through the highly technical Truth in Lending Act,’ and Congress, in delegating regulatory authority to the Board, has chosen to resolve interpretive issues under the TILA by ‘uniform administrative decision, rather than piecemeal through litigation.’”); Gaydos v. Huntington Nat’l Bank, 941 F. Supp. 669, 672–73, 677 (N.D. Ohio 1996) (quoting Milhollin and concluding that “caution must temper judicial creativity in the face of legislative or regulatory silence”).
63 See infra note 64.
64 E.g., Pinter v. Dahl, 486 U.S. 622, 652 (1988) (explaining that the securities market “demands certainty and predictability”); In re Symons Frozen Foods Inc., 432 B.R. 290, 300 (Bankr. W.D. Wash. 2010) (resolving a conflict of laws question pertaining to statutory liens based in part upon the court’s belief that “the application of Washington law . . . is supported by its effect of . . . creating certainty in the market.”).
65 Judicial dicta, though seemingly innocuous at first blush, can have profound and even unintended effects. See generally Michael Abramowicz & Maxwell Stearns, Defining Dicta, 57 STAN. L. REV. 953 (2005) (providing a thorough analysis of dicta in legal opinions). Much of the language quoted from cases discussed in this section can be described as either dicta or as policy rationale. In either case, such language reveals important insights into underlying motivations of the court.
66 See infra notes 137–141 and accompanying text.
67 See infra notes 133–136 and accompanying text.
expansive paradigm to resolve a controversy arising over a financing arrangement, the Imperative might appear as assurance that the decision does not go too far. 68

Generally focused on the needs of banking and financial institutions rather than borrowers, 69 the Imperative promotes bright-line rules that provide “all prospective lenders the certainty that is so important to the effective operation of markets,” 70 or that deliver “guiding principle[s] for those whose daily activities must be limited and instructed” by laws and regulations governing commercial transactions. 71 The theme is often invoked as a rationale for maintaining the legal status quo, as courts lament a seemingly inequitable outcome under current law, 72 but decline to engage in law reform out of concern that any deviation from the expectations imputed to lenders collectively might disrupt financial markets. 73 To this end, courts invoke forceful language, expressing fear that a decision might “throw credit markets into confusion and destabilize this area of law,” 74 or “disrupt orderly credit markets.” 75

68 For example, in a 1997 case finding successor liability based on an asset purchase at a foreclosure sale, the United States District Court for the Western District of New York noted, “[t]he court’s holding in this case will not disrupt the credit markets, because the facts are unique.” New York v. Westwood-Squibb Pharm. Co., 981 F. Supp. 768, 791 (W.D.N.Y. 1997).

69 Courts have denounced consideration of the consequential effects resulting from a ruling adverse to a borrower. E.g., A.I. Credit Corp. v. Jamaica, 666 F. Supp. 629, 633 (S.D.N.Y. 1987) (“[O]ur holding could have a devastating financial impact . . . due to [cross-default provisions across several financing agreements]. But it is not the function of a federal district court . . . to evaluate the consequences to the debtor of its inability to pay nor the foreign policy or other repercussions . . . . Such considerations are properly the concern of other governmental institutions.”).

70 In re Bulson, 327 B.R. 830, 844 (Bankr. W.D. Mich. 2005) (“[S]ome line must be drawn so that the lenders generally can make rational decisions when underwriting loans . . . . [T]he outcome . . . is at least one that a lender could have anticipated and adjusted for accordingly.”).


72 Bulson, 327 B.R. at 844–45 (“While the definition . . . may not accomplish the equitable perfection sought by those courts that champion a case-by-case or totality of the circumstances approach, the exclusion of a few lenders . . . seems a small price to pay for the certainty afforded by a more precise definition.”).

73 See infra notes 76–79 and accompanying text.

74 Smith v. Anderson, 801 F.2d 661, 665 (4th Cir. 1986) (“[T]he loan transaction here complied with the careful requirements of state and federal law. To supplement those requirements with ones of our own devising would throw credit markets into confusion and destabilize this area of law.”).

75 Algemene Bank Nederland v. Hallwood Indus., Inc., 133 B.R. 176, 180–81 (W.D. Pa. 1991) (explaining that under a loan assumption agreement, the assignor remained liable to the holder after the holder was unable to recover from the assignee because of involuntary bankruptcy; to find otherwise “would not only be unwarranted but would also disrupt orderly credit markets”).
The Fourth Circuit went so far as to suggest a slippery slope of sorts, whereby a ruling adverse to the expectations of lenders might send tremors through the industry, causing "untold and unknown consequences that cannot now be fully foreseen," "undefinable instability" and even "widespread confusion." Other times, courts express this Imperative in vague terms, as if to imply some universal understanding that markets are profoundly sensitive to judicial decisions that modify existing law. For instance, courts have referred to undefined "ripple effects," and the simply stated policy concern: "credit markets may be affected." When we consider such expressive verbiage in its historical context, the Imperative does not seem to be a reasoned judicial philosophy, but rather a consequence of a shaken economy and a loose synthesis of emerging academic theories that seemed to offer new direction for maintaining stability. The following section explores the additional goal of uniformity that tends to accompany the Imperative.

B. Promoting Uniformity in Contract Terms

In disputes that turn on contractual agreements, the Imperative frequently espouses the additional goal of uniformity—a goal heralded as a proxy for legal certainty. Much like the notion of legal certainty reflected in the Imperative, the value of uniformity is measured from the subjective standpoint of lenders and financial institutions analyzed as a homogenous group. For instance, in *Broad v. Rockwell International Corp.*, the Fifth Circuit sought to construe language in a bond indenture agreement, including provisions that were common boilerplate in the debt securities industry. The court downplayed variations in the terms of any particular indenture, noting that such provisions are intended to reach uniform results: "[Boilerplate provisions] have been stated in many different ways in various indentures. Since there is seldom any difference in the intended meaning, such provisions are susceptible of standardized expression." Deferring to the

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76 Where the expectation of lenders is reasonable and based on an agency interpretation in a particularly complex field of law. *Cetto v. LaSalle Bank Nat'l Ass'n*, 518 F.3d 263, 277 (4th Cir. 2008).

77 *Id.*

78 *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 189 (1994) (stating that in the federal securities law, "uncertainty and excessive litigation can have ripple effects").

79 *E.g.*, *In re Fracasso*, 210 B.R. 221, 228 (Bankr. D. Mass. 1997) (declining to afford debtors a blanket exemption for the equity in their primary residences, because "[t]here are serious state policy issues at play; for example, credit markets may be affected by this revision of the state statute"), *rev'd*, 222 B.R. 400 (Bankr. 1st Cir. 1998), *aff'd per curiam*, 187 F.3d 621 (1st Cir. 1999).

80 642 F.2d 929 (5th Cir. 1981).

81 *Id.* at 943.

82 *Id.* at 942.
imputed expectations of debt holders, the court explained the need for “uniformity” in construing provisions, as such “uniformity . . . is what makes it possible meaningfully to compare one debenture issue with another, focusing only on the business provisions of the issue . . . and the economic conditions of the issuer, without being misled by peculiarities in the underlying instruments.”

Similarly, in Sharon Steel Corp. v. Chase Manhattan Bank, the Second Circuit succinctly summarized the importance of uniformity in construing boilerplate provisions: “uniformity in interpretation is important to the efficiency of capital markets.” Further reiterating the Broad message of deference to the interpretation assigned by debt holders to boilerplate provisions, the court eloquently articulated the importance of judicial restraint:

[T]he creation of enduring uncertainties . . . would decrease the value of all debenture issues and greatly impair the efficient working of capital markets. Such uncertainties would vastly increase the risks and, therefore, the costs of borrowing with no offsetting benefits either in the capital market or in the administration of justice.

The court denounced the appellant’s “literal approach,” choosing instead to adopt an approach that it believed would advance the principal interests of debt holders at the expense of what the court believed was of marginal interest to the issuer.

A number of subsequent decisions in the financing realm construing form contracts and boilerplate provisions have embraced the notion that courts ought to defer to prevailing interpretations imputed to lenders collectively. One example is

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83 Id. at 943.
84 691 F.2d 1039 (2d Cir. 1982).
85 Id. at 1048.
86 Id.
87 Id. at 1049–50. The court explained:

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


88 Concord Real Estate CDO 2006-1, Ltd. v. Bank of Am., 996 A.2d 324, 331 (Del. Ch. 2010) (“Courts strive to give indenture provisions a consistent and uniform meaning because ‘[u]niformity in interpretation is important to the efficiency of capital markets.’”
Confronting the Certainty Imperative

Kaiser Aluminum Corp. v. Matheson,89 a Delaware Supreme Court case applying New York law.90 The court held that, although certificates issued with respect to debt issuances were “hopelessly unclear on the very point at issue,” and although courts confronted with ambiguous language normally consider extrinsic evidence in an effort to discern the parties’ intent, it would nevertheless be inappropriate to do so in the bond financing context.91 Citing Sharon Steel and echoing the Imperative, the court explained its “reluctan[ce] to risk disuniformity by adverting to evidence of the course of negotiation in a setting in which the same language can be found in many different contracts,” because disuniformity would be detrimental to financial markets.92 To resolve the dispute, the court applied a tiebreaker rule, interpreting the disputed language against the issuer as drafter, thereby upholding the imputed expectations of the debt holders. The court’s decision relied, in part, upon the notion that the current pool of debt holders—although technically parties to the indenture agreements—were not actively engaged in the negotiation process.93 State and federal courts applying New York law continue to adhere to this rule in the context of debt securities, and have expanded it to include a range of financing contracts.94

As the preceding sections reveal, the Imperative is a dominant paradigm in the jurisprudence of finance and lending. Because of this Imperative, judicial decision-making in the finance and lending realm reflects a number of normative assumptions regarding the role of courts in financial and economic affairs. As a result, certain highly conservative interpretive methodologies reign supreme. The following section explores the underlying economic theory and assumptions reflected in Imperative-driven decisions.

(Alteration in original); FleetBoston Fin. Corp. Fleet Nat’l Bank v. Advanta Corp., No. 16912-NC, 2003 Del. Ch. LEXIS 8, at *71 (Del. Ch. Jan. 22, 2003) (“[R]ules of contract construction require that the term be given the meaning commonly understood in the credit card industry, as established by the record.”).

89 681 A.2d 392 (Del. 1996).
90 Id. at 397–98.
91 Id.
92 Id. at 398.
93 Id. at 398–99.
94 “Under New York law, when interpreting an indenture or contract . . . [i]f the contract is ambiguous, it should be resolved against the party who prepared or presented the document.” Whitebox Convertible Arbitrage Partners, L.P. v. IVAX Corp., 482 F.3d 1018, 1021 (8th Cir. 2007); see also Acuity Capital Management, LLC v. MGI Pharma, Inc., Civil No. 08-5434, 2009 WL 2461719, at *2 (D. Minn. Aug. 10, 2009) (expressing the same rule when applying New York law).
III. THE ECONOMIC ASSUMPTIONS AND PREVAILING METHODOLOGIES OF THE CERTAINTY IMPERATIVE

Beneath the rhetoric, the Imperative is fundamentally a normative viewpoint based upon relatively thin conceptions of neoclassical economic analysis of law. Imperative-driven rulings are rooted in the belief that financial markets are vital to the national interest, and therefore judges ought to decide cases in this realm in a manner that advances broad economic efficiency goals.

A basic assumption of the prevailing neoclassical economic model is that persons largely behave egocentrically and rationally, that they collect relevant information, weigh costs and benefits, and make choices in accordance with preferences designed to maximize expected utility. Economists measure “utility maximization” on an individual or aggregate basis, with aggregate models considering the welfare of all market participants taken together. In finance and lending jurisprudence, as in other areas of law that share a strong nexus with economic affairs, courts strive to advance market efficiency and stability. This

95 On neoclassical economic analysis generally, see sources cited infra note 97. On the effect of neoclassical thought on legal analysis, see RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW (1972) (explaining that the common law largely reflects a goal of advancing economic efficiency); George L. Priest, The Common Law Process and the Selection of Efficient Rules, 6 J. LEGAL STUD. 65 (1977) (exploring Posner’s arguments further).

96 The allure of economic analysis in areas of vital importance is noted in Jody S. Kraus, Transparency and Determinacy in Common Law Adjudication: A Philosophical Defense of Explanatory Economic Analysis, 93 VA. L. REV. 287, 357 (2007) (“Economic analysis provides traction on countless doctrinal puzzles on which other theories—and deontic moral theories in particular—provide little purchase.”).

97 The prevailing neoclassical model can be traced to Adam Smith and David Ricardo, who analyzed the interworkings of free markets from the decision-making perspective of individual economic actors. See ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (6th ed. 1892); DAVID RICARDO, ON THE PRINCIPLES OF POLITICAL ECONOMY AND TAXATION (1817). Additional refinements were made by a number of subsequent theorists. See, e.g., W. STANLEY JEVONS, THE THEORY OF POLITICAL ECONOMY (1871) (exploring Smith’s and Ricardo’s arguments through formal, mathematical analysis); CARL MENGER, PRINCIPLES OF ECONOMICS (James Dingwall & Bert F. Hoselitz trans., 1976) (1871) (building upon Smith’s and Ricardo’s theories as to the nature of individual decision in the marketplace, and establishing the Austrian school of economics).


99 The welfare economics school of thought has become inextricably linked with redistributive goals, but the earliest works are also responsible for identifying macro-level utility that is a function of the individual utility-seeking decisions of a society’s members. See ARTHUR C. PIGOU, WEALTH AND WELFARE (1912).

100 Social welfare also figures prominently in antitrust jurisprudence: “U.S. courts have repeatedly spoken of the goal of antitrust law in terms of promoting ‘consumer
stems not only from a strict market-oriented perspective, but also from a more utilitarian view of societal welfare enhancement. In other words, cases in this realm reflect a prevailing view that social welfare ultimately improves when market efficiency improves.\(^1\)

In economic terms, the essential predicate to an efficient market is a competitive market—free from excessive regulation and potential externalities.\(^2\) Under the prevailing theory, markets are competitive when each underlying transaction is efficient.\(^3\) Contracts freely negotiated by sophisticated parties are deemed to be complete and efficient to the extent they represent perfect information at the time of execution and, by their terms, account for all possible contingencies that may interfere with performance.\(^4\)

1. A report from the European Investors’ Working Group articulates the perceived connection between market efficiency and social welfare:

   The efficient functioning of financial markets allows easier and cheaper access to capital for firms, in order to boost employment and growth. Investors play a crucial role in promoting efficiency, through the provision of liquidity that can be fuelled towards welfare-increasing activities. Investment alternatives, easy access to capital and investor protection may stimulate market efficiency and provide more opportunities to increase social welfare.


2. Belief in the natural efficiency of a free market is articulated in the famous “invisible hand” metaphor of Adam Smith:

   As every individual . . . endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. . . . [H]e intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.

   SMITH, supra note 97, at 455–56.


4. On the completeness of contracts generally, see THOMAS J. MICELI, THE ECONOMIC APPROACH TO LAW 90 (2d ed. 2009); BERNARD SALANIÉ, THE ECONOMICS OF CONTRACTS: A PRIMER 161–90 (2d ed. 2005). In securities law, courts have incorporated
seemingly ineffective terms are deemed complete and efficient when they reflect a degree of satisficing or assumption of risk that the parties considered appropriate relative to the overall transaction. Accordingly, any externally imposed deviation from contract terms reduces overall efficiency. Thus, at least in theory, judicial revision of even the most egregious contract terms is unnecessary—any inefficient allocation mandated by the terms would be renegotiated by the parties to the extent the overall utility loss exceeds the transaction costs of renegotiating the terms.

Because of these assumptions, governmental regulation of any sort is believed to introduce market inefficiencies; these concerns are particularly heightened in the finance and lending realm, where regulation is generally perceived to be one-sided and protective of borrowers or consumers. In essence, the imputed expectations of lenders and financial institutions are looked upon as proxies for market equilibrium in the absence of regulation. In the context of judicial decision-making, the gap between these institutions' expectations and any interpretation rendered by a court provides a rough measure of market regulation introduced by the decision. In light of these prevailing views, and because financial institutions serve as intermediaries of market risk, it is easy to understand why courts are reticent to exercise the full range of judicial authority in this arena.

Also implicit in finance and lending jurisprudence is an assumption that no other interests—such as those rooted in equitable principles—are sufficient to overcome any potential reduction in market efficiency. Furthermore, a court may recognize that an allocation under a competitive market exchange might not advance interests of fairness and equity, but may still decline to intervene out of fear that intervention will have consequences far beyond the particular controversy. Consequently, a court adhering to the Imperative adopts a presumption that law reform or expansive analysis of any sort will impair market

the principle of completeness thusly: “[t]here are two core requirements for an efficient market: ‘large numbers of rational and intelligent investors,’ and ‘important current information’ that is ‘almost freely available to all participants.’” In re Initial Pub. Offering Sec. Litig., 260 F.R.D. 81, 94 (S.D.N.Y. 2009) (quoting Paolo Cioppa, The Efficient Capital Market Hypothesis Revisited: Implications of the Economic Model for the United States Regulator, 5 GLOBAL JURIST ADVANCES 1, 5–6 (2005)).

As the Delaware Court of Chancery noted, when negotiating transactions, sophisticated parties “make their own judgments about the risk they should bear.” Abry Partners V, L.P. v. F & W Acq. LLC, 891 A.2d 1032, 1061 (Del. Ch. 2006).

This is essentially the Coase theorem, which is explored infra note 326 and accompanying text. For further discussion of transaction costs, see Oliver E. Williamson, Transaction-Cost Economics: The Governance of Contractual Relations, 22 J.L. & ECON. 233 (1979).

See Levitin, supra note 27.

This is implicit in the language used by courts when deferring to the expectations of lenders. See, e.g., sources cited infra note 186.

See supra note 72.
efficiency. Under this perspective, judicial decision-making in the financial realm poses a potentially dangerous externality. Thus, judicial decisions are narrowly tailored to strict construction and passive enforcement of contracts.\footnote{110}

Just as the rhetoric of the Imperative can be more readily understood in its historical context, so, too, can its underlying theoretical assumptions be more readily understood in the context of the leading economic theories of the 1970s and 1980s. Essentially, the Imperative strongly reflects precepts of the Chicago School, with Imperative-driven courts doing their part to avoid excessive governmental intervention in financial transactions.\footnote{111} In the broadest terms, the Imperative seeks to preserve freedom of contract, which is central to the libertarian ideal of an unregulated, competitive market.\footnote{112} The Imperative also hints at fundamental assumptions of this era: markets are inherently stable absent governmental intervention of any form, including via judicial decisions. Instability, it was believed, can be injected only from external sources, and once injected, may bring dangerous consequences.\footnote{113} Furthermore, each contract or transaction represents a complete and perfectly efficient exchange. In light of the interconnectedness of these transactions, externally injected inefficiencies—even with respect to just one discrete transaction—are capable of causing a dangerous ripple effect.\footnote{114}

\footnote{110} In cases outside of the finance realm, the Supreme Court has addressed the relationship between judicial construction and enforcement of contracts, on the one hand, and market efficiency, on the other hand. In an airline antitrust case, the Court explained the importance of federal airline deregulation laws in promoting “maximum reliance on competitive market forces.” Am. Airlines, Inc. v. Wolens, 513 U.S. 219, 229–30 (1995). However, in ruling that the federal laws did not preempt application of state contract law to claims arising under agreements entered between the airlines and customers, the Court explained, “market efficiency requires effective means to enforce private agreements.” Id. “The stability and efficiency of the market depend fundamentally on the enforcement of agreements freely made, based on needs perceived by the contracting parties at the time.” Id.

\footnote{111} See supra notes 41, 43, 44 and accompanying text.

\footnote{112} Preservation of free markets was the primary normative goal of the Chicago School. See supra notes 41, 43, 44 and accompanying text.

\footnote{113} Classic works have argued that interventionist fiscal policy, far from being neutral, causes uncertainty and instability in financial markets. See LUDWIG VON MISES, THE THEORY OF MONEY AND CREDIT (H.E. Baston trans., Liberty Classics 1980) (1934).

\footnote{114} Courts take particular notice of such ripple effects in the context of cases concerning alleged harm to lenders. Tijani v. Holder, 628 F.3d 1071, 1077 (9th Cir. 2010) (“The current economic crisis highlights the full impact of the misrepresentation of risk in the credit market. The impact is on creditors, consumers, and on the economy. When creditors take on too many risky contracts, whether due to their own carelessness or the misrepresentations of their customers, they are likely to suffer enormous economic harm, and the resulting effects on society can be devastating.”). But see A.I. Credit Corp. v. Jamaica, 666 F. Supp. 629, 633 (S.D.N.Y. 1987) (noting the potentially devastating economic, financial, and foreign policy consequences of a ruling on the foreign-borrower,
In contrast, this perspective assumes that judicial decisions that seek only to construe and enforce a contract comply with libertarian economic thought. Indeed, even Robert Nozick’s classical conception of the “minimal state” deemed the enforcement of freely entered contracts to be an acceptable level of governmental involvement in societal affairs.\footnote{Nozick, supra note 44, at 26.} To this end, the Imperative-abiding court does nothing more than silently assist the invisible hand.

Of course, the normative goal of efficiency in financial markets may, at times, conflict with other societal goals. For instance, strong public outcries in the wake of financial crises may necessitate judicial intervention. As a result, in certain subfields of corporate finance, such as securities law, the Imperative has grown to serve as an ideological presumption that must compete with other traditional goals, like equity and fairness. In these cases, assumptions of the rational actor model have led to a more expansive decisional approach. These analyses are typically rooted in the Pareto measure of efficiency,\footnote{See Richard Leftwich, The Price System and Resource Allocation 11, 94, 382 (Dryden Press 6th ed. 1976). An exchange is deemed to be “Pareto optimal” if there is no other exchange that makes at least one participant better off and every participant at least as well off. In other words, a Pareto optimal outcome cannot be improved upon without impairing at least one participant. See id. at 11.} whereby an allocation of resources is said to be “Pareto superior” to another allocation “if and only if no person is disadvantaged by it and the lot of at least one person is improved.”\footnote{Jules L. Coleman, Markets, Morals and the Law 72 (1988).} In most cases, economists apply the modified, Kaldor-Hicks efficiency or “potential Pareto superiority” model, whereby an outcome is deemed more efficient if those who benefit are theoretically able to compensate those who are disadvantaged.\footnote{Nicholas Kaldor, Welfare Propositions of Economics and Interpersonal Comparisons of Utility, 49 Econ. J. 549, 550 (1939) (“[W]here a certain policy leads to an increase in physical productivity, and thus of aggregate real income, the economist’s case for the policy is quite unaffected by the question of the comparability of individual satisfactions . . . ”); see also J. R. Hicks, The Foundations of Welfare Economics, 49 Econ. J. 696 (1939) (advancing a theory of general equilibrium that takes into consideration individual compensation to reach efficient market exchanges); Brian N. Wasankari et al., Of Distributive Justice in Economic Efficiency: An Integrated Theory of the Common Law, in 19 Res. L. & Econ., 139, 142–53 (Richard O. Zerbe, Jr. & William Kovacic eds., 2000) (providing thorough discussion of the Kaldor-Hicks efficiency model).} Under approaches like this, judges strive to reallocate rights and remedies among parties to a contract, transaction, or other exchange,\footnote{See Omri Ben-Shahar, A Bargaining Power Theory of Default Rules, 109 Colum. L. Rev. 396, 401–04 (2009) (describing the surplus-maximization principle in commercial gap-filling cases).} thereby achieving allocative

\begin{itemize}
\item but finding that consideration of such consequences are beyond the scope of the federal district court.
\item \footnote{Nozick, supra note 44, at 26.}
\item \footnote{See Richard Leftwich, The Price System and Resource Allocation 11, 94, 382 (Dryden Press 6th ed. 1976). An exchange is deemed to be “Pareto optimal” if there is no other exchange that makes at least one participant better off and every participant at least as well off. In other words, a Pareto optimal outcome cannot be improved upon without impairing at least one participant. See id. at 11.}
\item \footnote{Jules L. Coleman, Markets, Morals and the Law 72 (1988).}
\item \footnote{Nicholas Kaldor, Welfare Propositions of Economics and Interpersonal Comparisons of Utility, 49 Econ. J. 549, 550 (1939) (“[W]here a certain policy leads to an increase in physical productivity, and thus of aggregate real income, the economist’s case for the policy is quite unaffected by the question of the comparability of individual satisfactions . . . ”); see also J. R. Hicks, The Foundations of Welfare Economics, 49 Econ. J. 696 (1939) (advancing a theory of general equilibrium that takes into consideration individual compensation to reach efficient market exchanges); Brian N. Wasankari et al., Of Distributive Justice in Economic Efficiency: An Integrated Theory of the Common Law, in 19 Res. L. & Econ., 139, 142–53 (Richard O. Zerbe, Jr. & William Kovacic eds., 2000) (providing thorough discussion of the Kaldor-Hicks efficiency model).}
\item \footnote{See Omri Ben-Shahar, A Bargaining Power Theory of Default Rules, 109 Colum. L. Rev. 396, 401–04 (2009) (describing the surplus-maximization principle in commercial gap-filling cases).}
\end{itemize}
efficiency between conflicting interests while offsetting an inequitable market allocation.\textsuperscript{120}

Most notably, in the area of securities law, which is a subfield of corporate finance, modern courts frequently extinguish flickers of the Imperative. Thus, the judiciary has, over time, assumed a more active role in law reform.\textsuperscript{121} An example of the evolving balancing approach is the Third Circuit’s decision in \textit{Newton v. Merrill Lynch}. The court acknowledged a legitimate argument against class certification in a securities case, but proceeded to certify the class because judicial action was needed to remedy an injustice. The court explained:

\[\text{[T]}\]he Securities Industry Association contends we should be wary of extending class certification to cases where the court will in effect set market standards (such as “best execution”) and, by doing so, affect the certainty of capital markets. Generally, it is desirable for these types of changes to occur through rule making by the appropriate agency. But courts should not hesitate to provide remedies for litigants injured by unlawful conduct that may not clearly violate regulatory standards.\textsuperscript{122}

Additional cases in the realm of securities law have demonstrated a similar analysis,\textsuperscript{123} whereby a court acknowledges arguments resting upon the Imperative, but then notes that it must proceed under a more expansive interpretive regime due to the nature of the controversy and the concomitant need for judicial action to promote interests of fairness and equity.\textsuperscript{124} Courts reach outcomes of this sort even in the face of powerful Imperative-driven dissenting arguments.\textsuperscript{125} These decisions

\textsuperscript{120} Allocative efficiency is a core concern of microeconomic theory. \textit{See, e.g.}, Harvey Leibenstein, \textit{Allocative Efficiency vs. “X-Efficiency,”} 56 AM. ECON. REV. 392 (1966) (introducing a theory of “X-efficiency” with respect to production output, which depends upon allocative efficiency).

\textsuperscript{121} \textit{See, e.g.}, Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341, 357 (2d Cir. 1973) (“The securities laws seek to prevent restrictions which distort the market’s estimate of value. . . . Congress and the courts justifiably have outlawed all unfair and deceptive practices related to the trading of securities and have encouraged private damage actions to implement the enforcement of the federal securities laws.”); \textit{see also} JAMES H. LORIE, U.S. DEPT. OF THE TREASURY, PUBLIC POLICY FOR AMERICAN CAPITAL MARKETS 3 (1974) (explaining that securities law is intended to advance efficiency and stability in financial markets).

\textsuperscript{122} \textit{Newton v. Merrill Lynch}, 259 F.3d 154, 165–66 n.7 (3d Cir. 2001).

\textsuperscript{123} \textit{See, e.g.}, \textit{Basic Inc. v. Levinson}, 485 U.S. 224, 254 (1988) (White, J., concurring in part and dissenting in part) (recognizing a fraud-on-the-market theory of reliance by investors on allegedly material misrepresentations).

\textsuperscript{124} \textit{See, e.g.}, \textit{In re Adler}, 247 B.R. 51, 127 (Bankr. S.D.N.Y. 1999) (“[W]e will not permit the Claimants to reap the benefits of the fraud of Hanover and its agents.”).

\textsuperscript{125} Dissenting to a rebuttable presumption supported by a fraud-on-the-market theory of reliance, Justice White noted:
acknowledge that law reform might impair utility maximization in financial markets. However, they ultimately find that other normative goals, such as investor protection, are sufficiently compelling to offset any consequences.

Securities jurisprudence—much like antitrust jurisprudence—challenges the Imperative’s core belief that markets are inherently efficient. Perfect competition is a basic tenet of market efficiency, and perfect competition relies upon the assumption that there are enough participants and commodities in the commercial marketplace that no single market participant may influence price. Yet courts presiding over securities cases see ample evidence to refute these idealized academic assumptions. As a result, courts have developed a fact-intensive, standards-based doctrine to evaluate market efficiency, with factors considering both quantitative and qualitative indicia of market dynamics.126 Where courts identify inefficiencies, they strive to render decisions that correct sub-optimal, inefficient, or inequitable allocations.127

As a result, courts reject the wisdom of passive, Imperative-driven paradigms in the realm of securities law, and grapple with financial and economic questions

Congress, with its superior resources and expertise, is far better equipped than the federal courts for the task of determining how modern economic theory and global financial markets require that established legal notions of fraud be modified. In choosing to make these decisions itself, the Court . . . embarks on a course that it does not genuinely understand, giving rise to consequences it cannot foresee.

Basic Inc., 485 U.S. at 254 (White, J., concurring in part and dissenting in part). Justice White further notes “the dangers when economic theories replace legal rules as the basis for recovery.” Id. at 253. Justice White concludes, “I cannot join the Court in its effort to reconfigure the securities laws, based on recent economic theories, to better fit what it perceives to be the new realities of financial markets.” Id. at 255.

126 The test for market efficiency set forth in Cammer v. Bloom, 711 F. Supp. 1264, 1286–87 (D.N.J. 1989), has been applied in a number of recent cases. See, e.g., In re Am. Int’l. Grp., Inc. Sec. Litig., 265 F.R.D. 157, 175–81 (S.D.N.Y. 2010) (applying the Cammer test to determine whether the market for certain debt securities was efficient); In re Initial Pub. Offering Sec. Litig., 260 F.R.D. 81, 94–95 (S.D.N.Y. 2009) (applying the Cammer test to determine whether the market for certain equity securities was efficient). Cammer sets forth a five-prong inquiry for determining whether the market for a particular security is efficient, including, inter alia, trading volume, the number of analysts tracking the security, and the nature of the relationship between unexpected events and the security’s price. 711 F. Supp. at 1286–87. Additional factors are at times considered alongside those included in the Cammer test. See, e.g., Krogman v. Sterritt, 202 F.R.D. 467, 478 (N.D. Tex. 2001) (exploring additional factors suggestive of market efficiency, such as market capitalization, bid-ask spread, and float).

127 Allocative efficiency is a fundamental goal of statutory law in the securities realm. Mandatory disclosure reflects the normative belief that market efficiency is achieved when information is optimally allocated for use by all market participants. See George J. Stigler, The Economics of Information, 69 J. Pol. Econ. 213 (1961).
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from the bench. Moreover, although federal securities laws are largely statutory in nature (with an extensive regulatory framework to which the deference rule applies) the judiciary has taken an active role in establishing doctrine to construe complex statutory provisions\textsuperscript{128} or to address circumstances where there is no rule on point.\textsuperscript{129}

Yet notwithstanding these developments in securities law, more expansive analyses, like allocative efficiency models, have been largely unable to take root in other areas of corporate finance. Given that the vast majority of corporate financing activity occurs pursuant to private transactions between highly sophisticated parties, theoretical assumptions regarding a perfectly competitive and inherently efficient market continue to prevail. Against this backdrop, any discussion of the judiciary’s role in financial transactions necessarily touches on broader notions of efficacy of judicial involvement in economic affairs. It also illuminates the interconnections among law reform, commercial certainty, systemic risk, and market efficiency.

As a result, the Imperative continues to discourage judicial interventions in free markets, and further warns that more expansive methodologies carry substantial risk: any failed attempt to redistribute economic surplus or legal rights and obligations may contribute to market failure. Thus, in areas of finance and lending beyond securities law, the Imperative’s underlying market stability goals continue to be paramount and no other normative goals have been advanced at their expense. Furthermore, the basic assumption of a perfectly competitive and inherently efficient market has remained dominant. The following sections explore how these assumptions translate into specific judicial methodologies in the finance and lending realm.

\section*{A. Restraint and Deference}

The Imperative advances a methodology of restraint and deference.\textsuperscript{130} To some extent, this methodological association is derived from the Imperative’s early


\textsuperscript{129} See, e.g., Newton v. Merrill Lynch, 135 F.3d 266, 274 (3d Cir. 1998) (“[T]here is no statute, rule, regulation, or interpretation, by the SEC or by a court, that [would remedy the dispute]. This absence of precedent did not, however, absolve the district court of the duty to resolve the plaintiffs’ securities fraud claim once it was presented in this suit.”).

\textsuperscript{130} In contrast to the phrase “judicial restraint,” “judicial activism” is often used as political rhetoric; however, when divorced from normative assumptions, the term essentially refers to the legitimacy of judicial decision-making. By “legitimacy” it is meant that a court has properly deferred to some other actor that is better suited to analyze the issue (such as Congress, the executive branch, or the states), but also that it has not blindly
intertwining with deference rule jurisprudence.\textsuperscript{131} To be sure, in the many cases that invoke the Imperative, judicial deference has roots in recognized principles that apply to cases unrelated to the finance and lending realm.\textsuperscript{132} Yet other times, courts’ language hints at a brand of deference that is not dictated by familiar doctrine, but rather elected to avoid disrupting the legal status quo.

For instance, the Seventh Circuit considered whether regulations promulgated under the Truth in Lending Act (the “Act”) barred a credit card issuer’s imposition of penalty rates that were otherwise permissible under the cardholder agreement.\textsuperscript{133} The court acknowledged that the applicable regulation and comment were both ambiguous, and, with little explanation of its reasoning, proceeded to enforce the cardholder agreement.\textsuperscript{134} In concluding remarks, the court noted its reliance on horizontal \textit{stare decisis} with respect to nonbinding coordinate and lower court decisions:

\begin{quote}
[O]ne court of appeals and at least six district courts have interpreted the ambiguous [regulation and comment]. All have held, as our district court did, that banks may apply higher, penalty rates of interest to the entire billing cycle in which the consumer’s default occurs. These decisions are sensible, and we agree with them.\textsuperscript{135}
\end{quote}

Similarly, in a twist on federal preemption doctrine, the Third Circuit supported a ruling in part by asserting that any \textit{per se} rule recognizing a fiduciary duty of banks to their commercial borrowers would likely be preempted by a subsequent act of Congress.\textsuperscript{136}

Essentially, judicial deference and restraint—as well as strict, textualist interpretive norms—appear to be rooted in pragmatic concerns that the judiciary is ill-equipped to assess financial and economic information. For instance, in \textit{Household Credit Services, Inc. v. Pfennig},\textsuperscript{137} the Supreme Court noted if the Sixth Circuit’s decision was upheld, it “would prove unworkable to creditors and, more
defered such that a decision is divorced from legal precedent or the present realities. \textit{See Kermit Roosevelt III, The Myth of Judicial Activism: Making Sense of Supreme Court Decisions} (2008).

\textsuperscript{131} \textit{See supra} Part II.A.
\textsuperscript{132} \textit{See supra} Section II.A (discussing deference rule jurisprudence).
\textsuperscript{133} Swanson v. Bank of Am., N.A., 559 F.3d 653 (7th Cir. 2009).
\textsuperscript{134} \textit{Id.} at 654–56.
\textsuperscript{135} \textit{Id.} at 656 (citations omitted).
\textsuperscript{136} Wash. Steel Corp. v. TW Corp., 602 F.2d 594, 601 (3d Cir. 1979) (“Given the need for uniform rules in an area so vital to our national economy as banking, any state common law rule that we might imply would likely give way to the preemptive force of federal law.”).
\textsuperscript{137} 541 U.S. 232 (2004).
importantly, lead to significant confusion for consumers.” The Court admonished the lower court for adopting a “case-by-case approach” pursuant to doctrinal analysis that the Court found to lack “textual support.” In particular, the Court criticized the Sixth Circuit’s decision that certain regulatory language conflicted with the Act, asserting that the court “ignored [the] warning that ‘judges ought to refrain from substituting their own interstitial lawmaking for that of the [Board].’” The Court suggested that the Sixth Circuit’s error was caused by a “fundamental misunderstanding of the workings of the credit card industry,” and that, in light of such complexities, it is important to apply strict interpretive norms and defer to agency guidance. Thus, in the Supreme Court’s view, deference is a form of risk aversion.

To be sure, these concerns have appeared in cases beyond the finance and lending realm. For instance, the Supreme Court articulated a similar form of risk aversion in a decision regarding a Commerce Clause challenge to a sales and use tax structure favoring local distribution companies. Declining to meddle with the existing statutory framework, the Court explained it was “institutionally unsuited to gather the facts upon which economic predictions can be made, and professionally untrained to make them.” The Court further explained that the judicial branch should abstain from lawmaking in this realm and defer any necessary reform to the legislative branch. “Congress has the capacity to investigate and analyze facts beyond anything the Judiciary could match . . . to run economic risks that the Judiciary should confront only when the constitutional or statutory mandate for judicial choice is clear.” In the financial realm, the sheer magnitude and complexity of the transactions at stake heighten these sorts of concerns. In essence, the world of finance and lending is, to some extent, a perfect storm to the judiciary—when cases arise with greater frequency following an economic crisis, the Imperative provides welcome justification for minimal judicial involvement.

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138 Id. The language reflects arguments raised in support of the credit card issuers: “lenders operating nationwide or regional credit programs would be paralyzed by judicial rulemaking, which might impose different disclosure requirements from jurisdiction to jurisdiction.” Brief for the United States as Amicus Curiae at 6 Household Credit Servs., Inc. v. Pfennig, 541 U.S. 232 (2004) (No. 02-857).
139 Household Credit Servs., Inc. v. Pfennig, 541 U.S. 232, 244 (2004).
140 Id.
141 Id. at 244–45.
142 Gen. Motors Corp. v. Tracy, 519 U.S. 278 (1997).
143 Id. at 308.
144 Id. at 309. Congress “may inform itself through factfinding procedures such as hearings that are not available to the courts.” Id. at 309 (citing Bush v. Lucas, 462 U.S. 367, 389 (1983)).
B. Statutory Restrictions on More Expansive Interpretive Analyses

In addition to its continued influence on judicial methodology in the finance and lending realm, the Imperative has also sparked legislative reforms that have further disempowered courts.\(^\text{145}\) Indeed, such laws at least partially explain why approaches to judicial decision-making in other areas of finance and lending have not evolved to the degree that they have in securities law; these statutes essentially lock courts into a highly restrictive decisional model.

At the federal level, many enactments that were primarily intended to limit application of statutory and regulatory rules to certain financing arrangements had the indirect consequence of limiting opportunities for courts to apply more expansive interpretive norms. For instance, in 1990, revisions to the Bankruptcy Code expressly excluded a range of commercial financing agreements from most provisions of the Code, and thus from the broad legal and equitable purview of bankruptcy courts.\(^\text{146}\) In 2005, Congress updated these provisions to exclude a wider range of instruments.\(^\text{147}\) As the legislative history of these amendments reveals, the Imperative was a primary force. For instance, the 1990 amendments were motivated by a desire to prevent impairment of market stability resulting from “uncertainties regarding the treatment of . . . financial instruments under the Bankruptcy Code.”\(^\text{148}\) Similar Imperative-rooted concerns are reflected in the legislative history of the 2005 amendments.\(^\text{149}\) As a result of these provisions, most financing arrangements, other than traditional loans, are excluded from the effects of the automatic stay.\(^\text{150}\) More importantly, these provisions effectively remove

\(^{145}\) Indeed, the Imperative’s rhetoric is so pervasive that legislation in the finance and lending realm at times includes the phrase “legal certainty” in its title or headings. See Legal Certainty for Bank Products Act of 2000, 7 U.S.C. § 27a–f (2006) (providing that no over-the-counter derivative contract shall be unenforceable under any federal or state law based on a failure to comply with the Commodity Exchange Act); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 739, 124 Stat. 1379, 1729 (2010) (providing for regulatory authority with respect to swap arrangements).

\(^{146}\) The excluded agreements are defined in section 101 of the Bankruptcy Code, as further amended in 2005. For a thorough discussion, see Thomas J. Giblin, Financial Markets in Bankruptcy Court: How Much Uncertainty Remains After BAPCPA?, 2009 COLUM. BUS. L. REV. 284 (2009).


\(^{149}\) See Giblin, supra note 146, at 290–91 (quoting and discussing legislative history found in H.R. REP. NO. 109-31, pt. 1, at 20 n.78 (2005)).

\(^{150}\) The automatic stay imposed by 11 U.S.C. § 362 (2006) of the Bankruptcy Code mandates that, as of the time a bankruptcy case is filed, virtually all acts and proceedings against the debtor or against any assets of the estate, including the termination of a contract or the exercise of setoff rights, are halted and subject to the court’s determination.
sweeping categories of financial agreements from the jurisdiction of the bankruptcy bench, as well as from the flexible and contextual standards commonly applied by these courts. These enactments largely focused on limiting regulatory oversight with respect to certain instruments that take the form of private contracts. However, they also caused an indirect curtailment of judicial interpretive authority, as financial instruments expressly excluded from these laws would not be subject to many of the broader doctrines developed under securities and commodities jurisprudence. More fundamentally, these legislative enactments have the indirect effect of removing a range of instruments from potential exposure to a growing body of judge-made securities law. In this jurisprudence the Imperative’s efficiency goals are trumped by interests like

151 Giblin, supra note 146, at 302-04; see also Pepper v. Litton, 308 U.S. 295, 304-05 (1939) (“The bankruptcy courts have exercised these equitable powers . . . to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done.”); Loc. Loan Co. v. Hunt, 292 U.S. 234, 240 (1934) (stating that bankruptcy courts are “invested with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings”); Mark D. Rosen, Nonformalistic Law in Time and Space, 66 U. CHI. L. REV. 622, 631 (1999) (arguing that the Bankruptcy Code’s heavy reliance on standards-based analyses allows courts flexibility to apply local law).


154 However, it is important to note one important area where securities jurisprudence continues to apply to swap agreements. Under the Legal Certainty for Bank Products Act of 2000, “security-based swap agreements” remain subject to specific fraud, manipulation, and insider trading prohibitions contained in the Securities Act of 1933 and Securities Exchange Act of 1934, including judicial decisions promulgated with respect to such statutes, to the same extent that such laws are applicable to securities. See 7 U.S.C. § 1a(47)(A)(v) (Supp. II 2010) (defining “security-based swap agreement” as a swap agreement of which “a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, including any interest therein”).
fairness, equity, and investor protection, and courts actively grapple with the economic substance of arrangements.\textsuperscript{155}

With respect to an even wider range of financing arrangements, a wave of credit-specific statutes of frauds\textsuperscript{156} passed in the 1980s and 1990s further restricting judicial interpretive methodology.\textsuperscript{157} Consider, for instance, the language of the Minnesota credit-specific statute of frauds: "A debtor may not maintain an action on a credit agreement unless the agreement is in writing, expresses consideration, sets forth the relevant terms and conditions, and is signed by the creditor and the debtor."\textsuperscript{158} At first blush this language appears only to advance the ordinary purpose of a statute of frauds: to bar enforcement of oral agreements. However, the statute goes significantly farther. It prevents recognition of any relationship between lenders and borrowers with respect to financing arrangements other than those forth in a written contract.

The statute provides:

The following actions do not give rise to a claim that a new credit agreement is created, unless the agreement satisfies the requirements of subdivision 2: (1) the rendering of financial advice by a creditor to a debtor; (2) the consultation by a creditor with a debtor; or (3) the agreement by a creditor to take certain actions, such as entering into a new credit agreement, forbearing from exercising remedies under prior credit agreements, or extending installments due under prior credit agreements.\textsuperscript{159}

\begin{footnotes}
\item[155] See supra Section III.B.
\item[157] Bruce A. Kolbezen & Samuel A. Evig, The Colorado Credit Agreements Act and Its Impact on Lenders and Borrowers, 36 COLO. L. W. 31, 31 (2007) ("The Colorado legislature enacted the Statute in 1989, at the end of a financial institution crisis that included rising interest rates, changes to federal tax law, and an overextension of credit, all of which contributed to instability in the lending industry.").
\item[158] MINN. STAT. § 513.33(2) (2010).
\item[159] Id. § 513.33(3)(a).
\end{footnotes}
Finally, it concludes: "A credit agreement may not be implied from the relationship, fiduciary or otherwise, of the creditor and the debtor." Courts have construed similar language in the Illinois credit-specific statute of frauds to bar all actions that relate to the alleged credit agreement, whether those actions sound in contract or in tort. Courts in other states have reached similar results, finding that the credit-specific statute of frauds bars claims such as unjust enrichment, breach of fiduciary duty, interference with prospective business advantage, and negligent misrepresentation.

These statutes have considerable impact across a range of financing activities. For instance, the Minnesota credit-specific statute of frauds is construed to apply to financial accommodations of any sort, and not merely traditional loans. Courts in a variety of jurisdictions have applied their respective credit-specific statutes of frauds to a range of financial transactions, as well as to financial accommodations that relate to an existing credit agreement.

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160 Id. § 513.33(3)(b).
162 First Nat’l Bank in Staunton v. McBride Chevrolet, Inc., 642 N.E.2d 138, 140-43 (Ill. App. Ct. 1994) (holding that a bank’s oral promise to hold a check until Monday so that the customer could deposit additional funds was essentially a credit agreement and therefore required a written agreement to be enforceable under the Illinois credit-specific statute of frauds).
163 See, e.g., Hewitt v. Pitkin Cnty. Bank & Trust Co., 931 P.2d 456, 458–59 (Colo. App. 1995) (explaining the Colorado credit-specific statute of frauds is not limited to contract claims or to those tort claims which seek the enforcement of a credit agreement).
165 Hewitt, 931 P.2d at 459–60.
167 See, e.g., Rural Am. Bank of Greenwald v. Herickhoff, 485 N.W.2d 702, 706 (Minn. 1992) (holding that a promise regarding the ordering of payments under two loan facilities constituted a financial accommodation, and therefore a credit agreement, under the Minnesota credit-specific statute of frauds); Chies v. Highland Bank, No. C8-00-1630, 2001 WL 214693, at *2 (Minn. Ct. App. 2001) (instructing that a bank’s agreement to subordinate its own security interest to another bank’s interest constituted a “financial accommodation” within the meaning of the Minnesota credit-specific statute of frauds).
168 See, e.g., Univex Int’l., Inc. v. Orix Credit Alliance, Inc., 914 P.2d 1355, 1358 (Colo. 1996) (en banc) (finding Colorado’s credit-specific statute of frauds “does not apply only to claims involving transactions which are characterized exclusively as credit agreements, but also . . . to claims which merely relate to credit agreements”); Bank One, Springfield v. Roscetti, 723 N.E.2d 755, 763 (Ill. App. Ct. 1999) (concluding that the oral modification of a guarantee fell within the Illinois credit-specific statute of frauds because the guarantee constituted part of a comprehensive credit agreement). But see Keenan v. Donaldson Lufkin & Jenrette, Inc., 529 F.3d 569, 579 (5th Cir. 2008) (“The situation of two lenders entering an accommodation as to a third-party borrower” is outside the scope of the Louisiana credit-specific statute of frauds).
Credit-specific statutes of frauds are undoubtedly rooted in the Certainty Imperative.\(^{169}\) As the legislative histories of many states reveal,\(^{170}\) these statutes were adopted in response to lobbying efforts by banking interests, who argued that a credit-specific statute of frauds might advance certainty in the law governing financial transactions.\(^{171}\) Courts have not resisted the infringement imposed by these statutes on judicial decision-making autonomy, as countless decisions have emphasized that these laws are extremely broad and ought to be applied as written, even though the results of that application may at times seem harsh.\(^{172}\) Furthermore, some variations of these statutes, such as the Colorado credit-specific statute of frauds, expressly bar claims such as part performance and promissory estoppel, further restricting the ability of courts to develop common law exceptions to the statutory requirements.\(^{173}\)

\(^{169}\) King v. Parish Nat’l Bank, 885 So. 2d 540, 546 (La. 2004) (“The primary legislative purpose of these statutes was ‘to establish certainty as to the contractual liability of financial institutions,’ which would in turn limit lender liability lawsuits based on oral agreements.” (quoting Whitney Nat’l Bank v. Rockwell, 661 So. 2d 1325, 1329 (La. 1995))); Brown v. Founders Bank & Trust Co., 890 P.2d 855, 862 (Okla. 1994) (stating the Oklahoma credit-specific statute of frauds “is intended to discourage lender liability litigation and to promote certainty into credit agreements”); see also Todd C. Pearson, Limiting Lender Liability: The Trend Toward Written Credit Agreement Statutes, 76 MINN. L. REV. 295, 299 (1991) (“[T]he general goal behind these credit agreement statutes is to increase certainty in contractual liability in order to reduce lender liability litigation.”).

\(^{170}\) See, e.g., Bill Analysis of H.B. 704 Before the S. Judicial Proceedings Comm., Gen. Assembly of Md. (1989) (providing that with respect to a bill introducing the Maryland credit-specific statute of frauds, “The intent of this bill is to . . . make[] certain credit agreements . . . unenforceable unless they are in writing,” as well as “protect lenders against claims that the lender made a verbal promise to loan money and then refused to do so, or that the lender verbally agreed to extend the terms of a loan,” and that such goals were commanded in part by an environment in which “multimillion dollar lawsuits [were] being filed and recovery [was] being made based on alleged verbal promises to lend and based on modifications of existing loan agreements”).


\(^{172}\) See, e.g., Mach. Transps. of Ill. v. Morton Cmty. Bank, 687 N.E.2d 533, 535–36 (Ill. App. Ct. 1997) (“[A]ll actions relying on an oral agreement are barred by the Act. We reluctantly agree with [established precedent]. Our reluctance stems from our acute awareness that strict application of this statute can easily lead to disastrous consequences in the hands of unscrupulous lenders.”).

\(^{173}\) COLO. REV. STAT. § 38-10-124(3) (2011); see Stephanie J. Shafer, Limiting Lender Liability Through the Statute of Frauds, 18 COLO. LAW. 1725, 1725–26 (1989); see also Classic Cheesecake Co. v. JPMorgan Chase Bank, N.A., 546 F.3d 839, 847 (7th Cir. 2008) (reviewing a claim of promissory estoppel with respect to an oral promise for commercial financing, finding that the “case turns out to be a routine promissory estoppel case, and that is not enough in Indiana to defeat a defense of statute of frauds”).
Many of these statutes also curtail judicial consideration of facts and circumstances relating to a written financing agreement. The Ohio credit-specific statute of frauds provides:

The terms of a loan agreement subject to this section, including the rights and obligations of the parties to the loan agreement, shall be determined solely from the written loan agreement, and shall not be varied by any oral agreements that are made or discussions that occur before or contemporaneously with the execution of the loan agreement.\textsuperscript{174}

In many jurisdictions, similar language has been used to bar claims arising under oral agreements that relate, in any way, to an existing financing agreement.\textsuperscript{175}

When broadly construed, these laws effectively ensure that commercial financing disputes are analyzed under strict interpretive norms. These norms consist primarily of the rules of contract interpretation, without the influence of doctrinal contract and tort law, equitable principles or, in certain cases, evidence of surrounding facts and circumstances.

The pervasiveness of credit-specific statutes of frauds—and the fairly uniform tendency for courts to strictly apply them—speaks volumes for the enduring strength of the Imperative. However, the impact of these statutes in the commercial marketplace is limited to a large degree by jurisdictional concentration. New York law governs the vast majority of sophisticated corporate financing arrangements in the United States, as well as a large portion of cross-border financing arrangements.\textsuperscript{176} Although New York has not adopted a credit-specific statute of frauds, New York's general statute of frauds is broad enough to cover most financing arrangements, since it applies to contracts with a duration of more than one year.\textsuperscript{177} State courts in New York have ruled that this provision applies to bar

\textsuperscript{174} \textit{Ohio Rev. Code Ann.} § 1335.02(C) (2006).
\textsuperscript{175} For example, Colorado courts have applied the statute to bar a guarantor's claims arising from an oral agreement discharging obligations under the original credit agreement. \textit{See} Pima Fin. Serv. Corp. v. Selby, 820 P.2d 1124, 1128 (Colo. App. 1991).
\textsuperscript{176} Even transactions without any substantial nexus to the state may select New York law to govern commercial agreements, pursuant to a New York statute providing that parties to any contract involving consideration of $250,000 or more "may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not such contract, agreement or undertaking bears a reasonable relation to this state." \textit{N.Y. Gen. Oblig. Law} § 5-1401 (McKinney 2010).
\textsuperscript{177} \textit{N.Y. Gen. Oblig. Law} § 5-701 (McKinney 2001) provides:

Every agreement, promise or undertaking is void, unless it or some note or memorandum thereof be in writing, and subscribed by the party to be charged therewith, or by his lawful agent, if such agreement, promise or undertaking . . . [b]y its terms is not to be performed within
oral agreements regarding financing arrangements for which repayment extends beyond one year.\textsuperscript{178} Furthermore, New York courts generally do not enforce contractual rights or obligations unless clearly evidenced by a written agreement.\textsuperscript{179} In fact, these courts are known for employing formalist,\textsuperscript{180} textual analyses,\textsuperscript{181} pursuant to an approach that has been described as: "formalistic, literalistic, nonjudgmental, and deferential to the freedom of parties to bargain for mutual advantage."\textsuperscript{182}

Moreover, the normative goals of the Certainty Imperative are firmly rooted in New York commercial law. The Court of Appeals of New York, in resolving a conflict of laws question pertaining to a commercial lending agreement, explained:

New York . . . is a financial capital of the world, serving as an international clearinghouse and market place for a plethora of international transactions . . . . In order to maintain its pre-eminent financial position, it is important that the justified expectations of the parties to the contract be protected.\textsuperscript{183}

\textsuperscript{178} See, e.g., NES Energy Inc. v Mazzarro, No. 51,910, at *3 (Suffolk Cnty. Ct, Oct. 21, 2010) (applying New York's general statute of frauds to a loan agreement).

\textsuperscript{179} Geoffrey P. Miller, \textit{Bargains Bicoastal: New Light on Contract Theory}, 31 \textit{CARDozo L. REV.} 1475, 1502 (2010) ("New York, with its strong preference for written agreements, more stringently enforces the statute's requirements.").

\textsuperscript{180} See, e.g., Jordan Panel Sys. Corp. v. Turner Constr. Co., 841 N.Y.S.2d 561, 573 (N.Y. App. Div. 2007) (explaining that even where principles of equity invite an alternative result, the contract at issue must be enforced as written: "we did not write those rules of engagement, and we are not empowered either to ignore or rewrite them").

\textsuperscript{181} Miller, \textit{supra} note 179, at 1478 ("New York judges are formalists. Especially in commercial cases, they have little tolerance for attempts to re-write contracts to make them fairer or more equitable, and they look to the written agreement as the definitive source of interpretation."); Alan Schwartz & Robert E. Scott, \textit{Contract Interpretation Redux}, 119 \textit{YALE L.J.} 926, 928 nn.1-2 (2010) (identifying New York as a jurisdiction that relies on textualist decision-making).

\textsuperscript{182} Miller, \textit{supra} note 179, at 1522.

\textsuperscript{183} J. Zeevi and Sons, Ltd. v. Grindlays Bank (Uganda) Ltd., 333 N.E.2d 168, 172-73 (N.Y. 1975). Further,

[a] vast amount of international letter of credit business is customarily handled by certain New York banks whose facilities and foreign connections are particularly adaptable to this field of operation. The parties, by listing United States dollars as the form of payment, impliedly accepted these facts and set up procedures to implement their trust in our policies.

\textit{Id.}
Subsequent cases applying New York law in state and federal courts have echoed these policy concerns. The Second Circuit succinctly summarized New York law’s purpose as “promot[ing] certainty in international financial markets.” In light of these interests, New York courts are mindful of the effect of their decisions on financial markets. For instance, the Supreme Court for New York County articulated the Imperative in a decision declining to extend common law fiduciary duties in the context of a commercial bank financing the hostile takeover of its corporate customer, noting that “a per se rule might unduly restrict banks in providing credit to competing customers, and might thus unduly reduce the pool of available credit.”

The convergence of state and federal statutory enactments with evolving judicial norms means that the judiciary handles virtually all cases arising under corporate financing arrangements lightly. Where controversies must be resolved, they are decided under strict interpretive norms; namely, the rules of contract interpretation. These rules essentially ensure that courts restrict their involvement to strict construction and passive enforcement of financing contracts that are deemed to be complete and perfectly efficient.

C. The Present State of the Imperative

The Imperative has moved quietly, but steadily through the judicial and legislative processes, and in so doing this jurisprudential vestige of the economic

186 ADT Operations, Inc. v. Chase Manhattan Bank, 662 N.Y.S.2d 190, 195 (1997). The court further explained, “Chase is a bank which has a national presence. Any rule which might have such a broad impact should be considered by the legislature or appropriate administrative or oversight agencies.” Id.
187 The Imperative has moved quietly in that it has not previously been identified as an overarching jurisprudential norm; however, the use of this rhetoric has not escaped notice of those within the industry. See, e.g., Growth and Development of the Derivatives Market: Hearing Before the Subcomm. on Int’l Trade & Fin. of the S. Comm. on Banking, Hous. & Urban Affairs, 109th Cong. 5–6 (2005) (statement of Joseph P. Bauman, CEO, JB Risk Consulting, LLC) (emphasizing the importance of legal certainty as a rationale for declining to extend regulations in the derivatives market, noting, “[i]n a way, market discipline and legal certainty are a check and balance on the effective functioning and growth of any market”); see also Joanna Perkins, Legal Certainty and the Role of the Financial Markets Law Committee, 2 CAP. MARKETS L.J. 155, 155–56 (2007) (detailing the mission of a United Kingdom legal reform board, which seeks to guide courts and legislative bodies so that “legal certainty” is protected).
turmoil of the 1970s and 1980s has profoundly altered judicial decision-making approaches in corporate finance. The Imperative's normative goals of subjectively nuanced legal certainty and uniformity have become intertwined with judicial restraint and deference. As a result, the state of corporate finance jurisprudence in the United States can be summarized thusly: deference, in the very broadest sense, is shown not only to the freedom of parties to contract, but also to the legal status quo.

The Imperative is not confined to the American judicial landscape. It has also taken root in the United Kingdom, where more expansive interpretive regimes are likewise viewed as a threat to London-based financial markets. Yet, while ostensibly a prevailing view, the Imperative is not without its discontents. Demonstrating some emerging doubts as to the proper paradigm in finance and lending cases, the Imperative was the subject of a lively debate between the majority and dissenting opinions in a 2008 decision of the Supreme Court. In Department of Revenue of Kentucky v. Davis, the Court considered whether the Commonwealth of Kentucky's income tax structure violated the dormant Commerce Clause to the extent it exempted from state income tax the interest on bonds issued by Kentucky or its subdivisions, while taxing the interest on debt securities from other states. The Court held that the income tax structure did not run afoul of the dormant Commerce Clause, since the tax exemption favored a traditional governmental function (the issuance of debt securities to pay for public projects) without any differential treatment favoring local entities over substantially similar out-of-state interests.

Conceding that the relevant provisions of the Commonwealth's tax code were enacted with an eye toward ensuring the marketability of local bonds, the Court noted an important interest in market stability: when the Commonwealth "issues [its bonds] for sale in the bond market, it relies on that tax code, and seller and purchaser treat the bonds and the tax rate as joined . . . intimately." The Respondents asked the Court to apply the Pike balancing test to determine whether

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188 See generally FINANCIAL MARKETS LAW COMMITTEE, ISSUE 97 - EUROPEAN CONTRACT LAW (2010). This is a report prepared by a United Kingdom independent legal reform board for submission to the UK Government Call for Evidence and Views to Inform its Response with respect to adopting European contract law, which utilizes a substantially more contextual and expansive interpretive regime than the United Kingdom and United States. The report, prepared by members affiliated with banking and lending behemoths Goldman Sachs and Deutsche Bank, among others, articulates the dangers to legal certainty that arise from judicial lawmaking or more expansive interpretive regimes as applied to contract disputes. For instance, the report notes that concepts such as good faith, reasonableness and fair dealing, "may be expected to achieve substantively fair results, [but are] less likely to achieve certainty of outcomes." Id. at 10.
190 Id.
191 Id. at 352-53.
192 Id. at 348.
the income tax structure imposed an excessive burden on commerce.\textsuperscript{193} Addressing this request, the Court advanced the Imperative's message of judicial restraint:

\[\text{[E]ven on the assumption that a \textit{Pike} examination might generally be in order in this type of case, the current record and scholarly material convince us that the Judicial Branch is not institutionally suited to draw reliable conclusions of the kind that would be necessary for the [Respondents] to satisfy a \textit{Pike} burden in this particular case.}^\textsuperscript{194} . . . \text{[Because such conclusions turn on] cost-benefit questions}^\textsuperscript{195} [of a financial and economic nature, with respect to which a striking feature is] not even the difficulty of answering them or the inevitable uncertainty of the predictions that might be made in trying to come up with answers, but the unsuitability of the judicial process . . . for making whatever predictions and reaching whatever answers are possible at all.\textsuperscript{196}

The Court declined to strike down the differential taxation scheme, even declining to consider more expansive analysis of the issues in the case, noting that any other decision "to a certainty would upset the market in bonds and the settled expectations of their issuers based on the experience of nearly a century."\textsuperscript{197} Finally, the Court expressed the root of its unwillingness to engage in law reform:

\textsuperscript{193} \textit{Id.} at 353. The test was originally articulated in \textit{Pike v. Bruce Church, Inc.}, 397 U.S. 137 (1970). "Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." \textit{Id.} at 142. Respondents in \textit{Davis} asserted a number of excessive burdens on commerce. See \textit{Davis}, 553 U.S. at 353–54.

\textsuperscript{194} \textit{Davis}, 553 U.S. at 353.

\textsuperscript{195} \textit{Id.} at 355. The Court explained such cost-benefit questions and the role of the judiciary thusly:

Is any court in a position to evaluate the advantage of the current market for bonds issued by the smaller municipalities . . . ? Consider that any attempt to place a definite value on this feature of the existing system would have to confront the what-if questions. If termination of the differential tax scheme jeopardized or eliminated most single-state funds . . . would some new source of capital take their place? Would the interstate markets accommodate the small issuers . . . or would the financing in question be replaced by current local taxation for long-term projects . . . or would state governments assume responsibility through their own bonds or state taxation? Or would capital . . . dry up, eliminating a class of municipal improvements. . . . [And] what would the effect be on interstate capital flows?

\textit{Id.} at 354–55.

\textsuperscript{196} \textit{Id.} at 355.

\textsuperscript{197} \textit{Id.} at 356.
"While it is not our business to suggest that the current system be reconsidered, if it is to be placed in question . . . an elected legislature is the preferable institution for incurring the economic risks of any alteration in the way things have traditionally been done."\(^{198}\) Shedding additional light on the normative assumption that law reform is damaging to financial markets, the majority explained:

\[\text{[R]isk is the essence of what the [Respondents] are urging here. It would miss the mark to think that . . . courts . . . are being invited merely to tinker with details of a tax scheme; we are being asked to apply a federal rule to throw out the system of financing municipal improvements.}\]\(^{199}\)

Any such reforms would "expose the States to the uncertainties of . . . economic experimentation."\(^{200}\)

The Court’s concerns reflect the Imperative’s key underlying assumption: that any deviation from the legal status quo introduces systemic risk and instability to an otherwise perfectly efficient market. Yet ironically, the majority in \textit{Davis} calls upon the Imperative to support a state practice that is arguably rooted in protectionist economic policy: the early antithesis of neoclassical economic thought.\(^{201}\) In this manner, the decision reveals just how entrenched the Imperative has become—it dominates judicial decision-making irrespective of the underlying economic principles at stake. Thus, although the Imperative was initially intertwined with free market ideals, its methodology has become so pervasive that it is applied even in support of protectionist policies. In essence, the Imperative is no longer used chiefly as a means of advancing a particular nuanced economic perspective, but rather to restrict courts from intervening \textit{at all} in financial affairs.

In contrast, a dissenting opinion by Justice Kennedy, with whom Justice Alito joins, questions the majority’s support for a decision that runs contrary to important precedent in Commerce Clause jurisprudence.\(^{202}\) Extending an invitation to expose these underlying assumptions to further judicial analysis, Justice Kennedy explains:

\begin{quote}
Throughout the Court’s argument is the concern that, were this law to be invalidated, the national market for bonds would be disrupted. The concern is legitimate, but if it is to be the controlling rationale the Court should cast its decision in those terms. The Court could say there needs
\end{quote}

\(^{198}\) \textit{Id.}  \\
\(^{199}\) \textit{Id.}  \\
\(^{200}\) \textit{Id.}  \\
\(^{201}\) Protectionism is often associated with classical mercantilism, which flourished in the sixteenth to nineteenth centuries. Mercantilist thought focused upon the role of the state in harnessing individual impulses to promote public welfare. \textit{See generally} ELI F. HECKSCHER, MERCANTILISM (E. F. Soderlund ed., 1955) (providing a thorough account of protectionism and mercantilism).  \\
\(^{202}\) \textit{Davis}, 553 U.S. at 362–74 (Kennedy, J., dissenting).
to be a *sui generis* exception, noting that the interstate discrimination has been entrenched in many States and for a considerable time. That rationale would prompt my own statement of disagreement as a matter of principle and economic consequences, but it would be preferable to a decision that misinterprets the Court’s precedents. Instead, today the Court weakens the preventative force of the Commerce Clause and invites other protectionist laws, thus risking further dislocations and market inefficiencies based on the origin of products and commodities that should be traded nationwide and without local trade barriers.203

In essence, the dissent argues that the Certainty Imperative must not be used to support decisions that are divorced from the very rules and precedent they purport to be based upon. By generating decisions that are so perplexing, the judiciary indeed disrupts legal certainty—not the subjective form that has evolved in the finance and lending context, but rather the far more entrenched legal certainty that has deep foundations in the common law. A disruption of the latter can have consequences far beyond financial markets. This is a damning critique. Setting aside deeper normative questions, if Imperative-driven decisions in fact do little to promote legal certainty204 then the continued paralysis of the judiciary is misguided, unnecessary, and potentially destructive.

Justice Kennedy’s dissenting opinion also calls into question the wisdom of passive decision-making paradigms in cases that touch upon financial matters, suggesting that concerns of market disruption should be articulated in decisions and subjected to judicial consideration of the actual interplay between law reform and economic consequences.205 This exposure has the added benefit of testing the soundness and resilience of the connection between any particular law reform and stability in financial markets. Rather than seeking abstention, the dissent reveals a willingness to grapple with financial and economic questions from the bench.

Further analyses of these and related questions are deeply needed. For one thing, it is not entirely clear that the concept of “legal certainty,” as it has come to rest in corporate finance jurisprudence as a subjectively nuanced narrative, can be a means of promoting long-term stability in financial markets.206 Clearly, the preservation of legal certainty minimizes risk in transactional dealings generally. Excessive risk of midstream enforeability or re-characterization of transactions

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203 *Id.* at 375–76 (Kennedy, J., dissenting).

204 See Ofer Raban, *The Fallacy of Legal Certainty: Why Vague Legal Standards May Be Better for Capitalism and Liberalism*, 19 B.U. PUB. INT. L.J. 175, 176–77 (2010) (examining “claims that clear legal rules produce the legal certainty and predictability required by capitalism and liberalism,” and finding that “the fallacy consists in identifying people’s ability to predict the consequences of their actions with lawyers’ ability to predict the consequences of applying the law”).

205 *Davis*, 553 U.S. at 375–76 (Kennedy, J., dissenting).

is disruptive to free markets. However, if the ultimate goal is market stability, then emerging theories suggest that some degree of outcome-based uncertainty in transactional law might actually reduce excessive risk-taking and moral hazard effects that produce great instability from within financial markets. Similarly, contrary to widespread presumptions, it is not clear that markets actually are inherently efficient, or that judicial involvement is per se an impediment to market stability. As the recent financial crisis illustrates, systemic risk in financial markets can result from internal forces. Markets are inherently cyclical, and to the extent a natural contraction causes parties to default on interconnected financing arrangements, the resultant confidence erosion, reduced liquidity, and cross-default contagion can introduce substantial instability. In these instances, courts may serve as an important intermediary, possessing sufficiently broad legal and equitable powers to manage complex and fact-intensive disputes.

While arguments of this sort require careful interdisciplinary analysis, we can ascertain one obvious failing of the Imperative: it remains steeped in rhetoric that has not evolved despite decades of advancements in our understanding of financial and economic activity. One commentator, writing on financial law reform in the United Kingdom, summarized the dangers:

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208 Moral hazards arise where a party is insulated from certain risks that it would otherwise normally bear; as a result, the insulated party is incentivized to behave differently from how it would in the absence of insulation from the risk. See, e.g., Kenneth Arrow, Essays in the Theory of Risk-Bearing 142–43 (1971) (exploring moral hazard in the context of insurance policies).


210 The efficient market hypothesis has recently come under attack, most notably by behavioral economics and behavioral finance theorists. See, e.g., Andrei Shleifer, Inefficient Markets: An Introduction to Behavioral Finance 10–12 (2000) (discussing emergent psychological evidence to refute the assumptions of investor rationality).

211 "Systemic risk is fundamentally a contracting problem that arises when a large number of parties cannot honor their commitments." Margaret M. Polski, Systemic Risk and the U.S. Financial System, Mercatus on Pol'y, May 2009, at 1, 3.


213 On the scientific and philosophical evolution of knowledge in finance and economics, see generally James R. Hackney, Jr., The Enlightenment and the Financial
A number of risks are inherent in a crude reliance on the power of unanalyzed value-concepts such as legal certainty. . . . [T]here is the obvious danger that the concept of 'legal certainty' becomes fetishized, and stands in the way of any real evaluation of the merits of law reform.  

The Imperative seems to have reached just such a perilous point. Underscoring the dangers of a rhetoric that relies upon untested assumptions, consider congressional testimony in 2005 urging that credit default swaps continue to be construed as private agreements rather than as futures contracts—the latter designation would have rendered these instruments subject to extensive regulations. The testimony noted the financial industry's fear that the judiciary or legislature might impair the legal status quo through an adverse opinion as to the characterization of swaps. It heralded the "legal certainty" achieved by Congress's decision not to bring these financial instruments under the regulatory framework applicable to futures contracts:

[P]rivately negotiated derivatives have continues [sic] to thrive and product innovation has proceeded unabated. Even more importantly, thanks in no small part to derivatives, the markets have been able to withstand significant shocks to the financial system. The legal certainty provided by the [broad exclusions and exemptions from the Commodities Exchange Act] has been an important part of this success.

Indeed, given the suspected role of excessive trading and poor risk management with respect to unregulated derivatives in the recent financial crisis, these arguments underscore the power of the Imperative's rhetoric. Perhaps the
Imperative is less a call for legal certainty than a call for legal complacency—effectuated in part by tying the hands of the judiciary—and therein lies the true danger to stability in modern financial markets.

IV. TESTING THE EFFICACY OF THE CERTAINTY IMPERATIVE’S PREVAILING METHODOLOGIES

Strict Imperative-driven interpretive methodologies might do little to promote efficiency, stability, and certainty in financial markets. For one thing, the assumption that markets are perfectly efficient and inherently stable may be misguided. Furthermore, to the extent instability arises from within financial markets, strict interpretive norms blind courts to economic realities and prevent meaningful resolution of claims. Simply put, Imperative-driven methodologies might not provide a sufficiently intricate framework to assess the complexities of dynamic financing arrangements. In fact, there is a strong efficiency argument for adopting a more expansive interpretive regime in corporate finance jurisprudence.

To some extent, the continued Imperative-driven reliance on strict interpretive norms in finance and lending jurisprudence may reflect the relative infancy of judicial law in this realm. Consider, for instance, the parallel jurisprudence of corporate transactional law, which is also comprised of sophisticated and complex private contracts. In particular, Delaware’s body of judge-made law has evolved considerably in the last century, and has been characterized as an “investment in legal capital” by corporate law scholar Roberta Romano. While Delaware law strives to promote many of the same normative goals as the Imperative, including freedom of contract, Delaware courts recognize the value of contextual analyses in transactional matters and further note the balancing of interests that is so often required to resolve disputes. Referring to these tensions, the Court of Chancery explained, “there are many circumstances in which the high priority our society places on the enforcement of contracts between private parties gives way to even more important concerns.”

question.” *Id.* at 21. The failings of the legal system are summarized as follows: “[h]ad the norms of market regulation been applicable, these swaps transactions would have been adequately capitalized by traditional clearing norms; and the dangers building up in these markets would otherwise have been observable by the transparency and price discipline that accompanies exchange trading.” *Id.*

218 See sources cited supra notes 211–212.

219 ROMANO, supra note 26, at 40; see also Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 258–75 (1985) (noting the unique contributions of Delaware courts in the area of corporate law).

220 NACCO Indus., Inc. v. Applica Inc., 997 A.2d 1, 35 (Del. Ch. 2009) (“Delaware upholds the freedom of contract and enforces as a matter of fundamental public policy the voluntary agreements of sophisticated parties.”).

221 ACE Ltd. v. Capital Re Corp., 747 A.2d 95, 104 (Del. Ch. 1999).
Research suggests that rather than causing unpredictable judicial discretion, expansive analyses in transactional affairs can be a source of certainty. Indeed, the persistent preference for Delaware as a state of incorporation, as governing law for sophisticated merger and acquisition agreements, and as a forum for corporate litigation, may signal the utility-maximizing potential of more expansive analyses. This evidence is also theoretically consistent with legal scholarship asserting that a more reasoned approach often emerges as a dominant and favored method of resolving disputes that arise in complex commercial dealings.

To the extent courts are willing to confront the flaws inherent in the Certainty Imperative and move beyond its methodological constraints, corporate finance jurisprudence may ultimately follow a similar course. The following section explores the hypothesis that more expansive methodologies may be more apt to enhance efficiency, certainty, and stability in financial markets. This section elaborates on these recommendations by introducing a case study in which a court decided a corporate finance controversy pursuant to strict interpretive norms.

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222 Cf. sources cited supra note 219.
225 See, e.g., Adam B. Badawi, Interpretive Preferences and the Limits of the New Formalism, 6 BERKELEY BUS. L.J. 1, 40–41 (2009) (“Though it is difficult to obtain precise numbers, many merger agreements choose Delaware courts as the forum to resolve any disputes; a choice presumably influenced by the substantial experience that Delaware courts have with corporate law.”); Jens Dammann & Henry Hansmann, Globalizing Commercial Litigation, 94 CORNELL L. REV. 1, 13 (2008) (Delaware is “the preferred forum for cases involving publicly traded corporations”); Stephen J. Massey, Chancellor Allen’s Jurisprudence and the Theory of Corporate Law, 17 DEL. J. CORP. L. 683, 704 (1992) (noting the Chancery Court’s prominence as a “forum for the adjudication of corporate law issues”).
226 See, e.g., U.C.C § 1-103 (setting forth a foundational principle of the Uniform Commercial Code (the “Code”): “[The Code] must be liberally construed and applied to promote its underlying purposes and policies”); id. § 1-103 official cmt. ¶ 1 (further explaining that courts should apply a contextual interpretive paradigm to cases arising under the Code); John Braithwaite, Rules and Principles: A Theory of Legal Certainty, 27 AUSTL. J. LEGAL PHIL. 47, 47 (2002) (describing that, as regulated phenomena become more complex, principles deliver more consistency than rules); Myron T. Steele & J.W. Verret, Delaware’s Guidance: Ensuring Equity for the Modern Witenagemot, 2 VA. L. & BUS. REV. 189, 192 (2007) (explaining, in the context of Delaware corporate law, that while rigid rules can advance predictability in the law, more flexible standards are often needed to generate more efficient and responsive outcomes).
considering the court’s traditional, Imperative-driven decisional approach, this
Article provides a hypothetical consideration of the same case using more
expansive analysis. This exercise demonstrates why it is necessary for modern
courts to move beyond the constraints of the Imperative. It also illustrates
problems that arise when strict interpretive norms are applied to highly complex
arrangements in the modern transactional landscape.

A. Case Study: Beal and Its Discontents

A recent corporate finance case, Beal Savings Bank v. Sommer,\(^2\) demonstrates the limitations of Imperative-driven judicial decision-making
approaches in identifying the economic substance of claims, particularly where a
dispute involves questions beyond the fact, or extent, of borrower default. In Beal,
the New York Court of Appeals held that an individual lender participating in a
syndicated corporate loan did not have standing to sue a guarantor unilaterally, as
the credit documents “intended for collective action” with respect to the
enforcement of remedies against the borrower or any guarantor.\(^2\)

The lending syndicate was, at the time of litigation, comprised of thirty-seven
lenders and an administrative agent, and all but one of the lenders (Beal Savings
Bank) had entered into a forbearance arrangement with the borrower and
guarantors.\(^2\) In denying Beal Savings Bank’s claim to proceed individually
against a guarantor, the court found that a supermajority vote (sufficient to meet
the “required lenders” threshold of lenders holding at least two-thirds of the
outstanding principal balance of the loan) was needed to enforce remedies under
the credit documents.\(^2\)

The court decided the case by applying strict Imperative-driven interpretive
norms. Specifically, the court applied rules of contract interpretation to the
underlying credit documents. Under established principles that are virtually
identical in every jurisdiction, the pivotal question in construing a contract is
whether the terms are clear and unambiguous.\(^2\) Ambiguity does not exist as a
matter of law merely because the parties offer contradictory interpretations.\(^2\)

\(^2\) 8 N.Y.3d 318 (2007). The dispute in Beal pertained to consent mechanisms and
enforcement rights of minority lenders in a syndicated loan agreement: the very issues that
arose in the failed Chrysler debt restructuring negotiations referenced in the introductory
paragraphs of this Article. See supra notes 9–10 and accompanying text.

\(^2\) Id. at 332.

\(^2\) Id. at 321–23.

\(^2\) Id. at 332.

\(^2\) The detection of ambiguity in drafted language can be a matter of varying judicial
opinion and methodology. See generally Jerald D. Stubbs, The Federal Circuit and
Contract Interpretation: May Extrinsic Evidence Ever Be Used to Show Unambiguous
Language Is Ambiguous?, 39 PUB. CONT. L.J. 785 (2010) (considering the use of extrinsic
evidence in construing contract language).

\(^2\) The Second Circuit wrote:
Rather, under the “four corners” rule, courts attempt to discern the original intent of the parties based upon the unequivocal language of their written agreement.\textsuperscript{233} Courts generally strive to “construe . . . agreements so as to give full meaning and effect to material provisions.”\textsuperscript{234} Judges typically consider very little extrinsic evidence when interpreting contract terms, with the exception of occasional reference to dictionary meanings or, according to the Restatement, the meaning of technical terms.\textsuperscript{235} Where there are inconsistent terms in an agreement, all provisions are reconciled, if possible.\textsuperscript{236} To this end, courts apply ordering rules of sorts—for instance, specific provisions are enforced over conflicting miscellaneous or otherwise general provisions.\textsuperscript{237}

In \textit{Beal}, no document explicitly prohibited enforcement of remedies by individual lenders. In fact, the court acknowledged the lack of clarity in the credit documents: “Here . . . neither the Credit Agreement nor the [keep-well agreement] contains an explicit provision stating that a Lender may—or may not—take individual action in the event of default . . . .”\textsuperscript{238} Furthermore, the keep-well agreement, which set forth obligations of the guarantors, provided that it was “enforceable by . . . each Lender.”\textsuperscript{239} Also suggesting the availability of individual lender enforcement, the credit agreement provided, in pertinent part: “No right or remedy conferred upon the Administrative Agent or the Lenders in this Agreement is intended to be exclusive”\textsuperscript{240} and “every such right and remedy shall be

An “ambiguous” word or phrase is one capable of 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.


\textsuperscript{233} See, e.g., United States v. Moorman, 338 U.S. 457, 463 (1950) (construing the express language of an agreement and declining to consider evidence as to the parties’ subjective intent); Vermont Teddy Bear Co. v. 538 Madison Realty Co., 807 N.E.2d 876, 879 (N.Y. 2004) (“In the absence of any ambiguity, we look solely to the language used by the parties to discern the contract’s meaning.”). \textit{But see} Richard A. Posner, \textit{The Law and Economics of Contract Interpretation}, 83 TEX. L. REV. 1581, 1597 (2005) (“If the contract is clear, there is no need to interpret it. If it is unclear, the [four corners] rule provides no guidance to extracting its meaning.”).


\textsuperscript{235} \textit{RESTATEMENT (SECOND) OF CONTRACTS} § 202(3)(b) (1979).


\textsuperscript{238} 8 N.Y.3d 318, 326 (2007).

\textsuperscript{239} \textit{Id.} at 323.

\textsuperscript{240} \textit{Id.} at 322.
cumulative . . . to every other right or remedy contained in the other Loan Documents . . . .\textsuperscript{241}

Finally, suggesting that the forbearance arrangement could not proceed without unanimous consent of the lenders, the keep-well agreement stated: "[N]o amendment, modification or waiver can be made to the Loan Documents so as to 'release the [guarantors] under the Keep-Well Agreement . . . without the consent of all Lenders.'\textsuperscript{242} Furthermore, the guarantors "shall not be released from their obligations . . . because of . . . [a]ny . . . forbearance . . . or other act or omission of the Administrative Agent or the Lenders . . . ."\textsuperscript{243} Thus, the credit documents appeared to preserve individual enforcement rights, particularly in the event of forbearance or other material modification of the loan terms.

In contrast, the credit agreement contained language suggesting collective action pursuant to a supermajority consent mechanism: "the Administrative Agent, at the direction of the Required Lenders, may 'exercise any or all rights and remedies at law or in equity,' including the right to recover judgment on the Keep-Well [Agreement]."\textsuperscript{244} Moreover, the keep-well agreement provided that it was a "Loan Document executed pursuant to the Credit Agreement and shall (unless otherwise expressly indicated herein) be construed, administered and applied in accordance with the terms and provisions thereof."\textsuperscript{245} Thus, the credit documents appeared to contemplate collective action of some sort, but it was unclear how such a mechanism should be reconciled with each lender's individual enforcement rights.

In the spirit of Imperative-driven judicial decision-making, the court constrained its analysis to strict interpretive norms and applied rules of contract interpretation to the underlying credit documents, holding that the agreements unambiguously barred enforcement by individual lenders.\textsuperscript{246} The court rested its holding on the rule that "[a] reading of the contract should not render any portion meaningless."\textsuperscript{247} In the court's view, recognition of a right of individual enforcement by each lender would render meaningless the provision authorizing the agent to act upon the direction of the required lenders.\textsuperscript{248} Furthermore, in accordance with the rule that "a contract should be 'read as a whole, and every part . . . interpreted with reference to the whole . . . as to give effect to its general

\textsuperscript{241} Id.
\textsuperscript{242} Id. at 330.
\textsuperscript{243} Id.
\textsuperscript{244} Id. at 322.
\textsuperscript{245} Id. at 322–23.
\textsuperscript{246} Id. at 321 ("The specific, unambiguous language of several provisions, read in the context of the agreements as a whole, convinces us that, in this instance, the lenders intended to act collectively in the event of the borrower's default and to preclude an individual lender from disrupting the scheme of the agreements at issue.").
\textsuperscript{247} Id. at 324.
\textsuperscript{248} Id. at 328.
CONFRONTING THE CERTAINTY IMPERATIVE

purpose," the court concluded that the credit documents as a whole "explicitly and implicitly" precluded unilateral action by any lender and suggested an "unequivocal collective design." Yet the reverse outcome could have been reached by application of the very same rules of contract interpretation. A court could, for instance, conclude that the credit documents must not be read so as to render meaningless those portions asserting that the agent's rights were nonexclusive, and that each lender maintains an individual right of enforcement. Indeed, absent plain language that "no suit will be brought unless a majority or supermajority of the lenders agree to take action," preclusion of a lender's enforcement rights runs contrary to fundamental principles guiding the relationship between a lender and borrower. As the dissent succinctly stated: "A bank that lends money to a borrower and is not repaid is entitled to sue to get its money back." In light of the Imperative's promise of legal certainty, it is ironic that judges experienced in commercial law reach such opposing interpretations of the credit documents. As the following section articulates, deeper consideration of Beal reveals additional shortcomings of Imperative-driven methodologies in resolving controversies that arise in the modern corporate financing realm.

B. Critical Analysis of Beal

Beal demonstrates that, in cases arising under complex financing arrangements, present-day economic realities often no longer align with the risks

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249 Id. at 324–25 (citing Westmoreland Coal Co. v Entech, Inc., 100 N.Y.2d 352, 358 (2003)).
250 Id. at 324.
251 Id. at 326. The court relied on Credit Francais Int'l, S.A. v. Sociedad Financiera de Comercio, C.A., 490 N.Y.S.2d 670 (Sup. Ct. 1985). However, the documents at issue in Credit Francais contained more explicit and pervasive language vesting rights in the administrative agent to act on behalf of the lenders collectively, with only one general provision supporting individual enforcement.
252 For instance, a court could find that each lender maintained traditional enforcement rights that may be exercised in each lender's individual capacity, and that the language granting rights to the agent was intended to vest the agent with standing to proceed solely with respect to the rights of lenders choosing to participate in the collective action. A similar interpretation was advanced in Commercial Bank of Kuwait v. Rafidain Bank, 15 F.3d 238, 243 (2d Cir. 1994) ("While the participation agreement . . . authorizes the 'Confirming Bank' to sue 'only if requested to do so by the Majority Banks,' this provision does not abrogate the rights of participating banks to sue on their own. Indeed, the agreement points the other way, providing that the rights of the parties 'under the general law' are expressly reserved.").
253 Beal, 8 N.Y.3d at 332 (Smith, J., dissenting).
254 Id.
or bargaining power present during negotiation of the underlying credit documents. For one thing, by the time litigation is advanced, the facts and circumstances of a financing arrangement are often far removed from those that existed when the underlying credit documents were executed. Indeed, at the time of the court's decision in Beal, the borrower had been insolvent for almost six years and was undergoing liquidation. The dispute among the parties did not pertain to the borrower's default. However, the fact that circumstances had moved so far beyond the spirit and scope of the underlying credit documents that the parties were not even debating the borrower's obligations suggests a profound disconnect between present-day economic realities and those depicted in the underlying documents. Yet the court focused exclusively upon these documents in deciding the case.

In addition, Beal Savings Bank was not a party to the original loan, but rather acquired its interest. This fact highlights a very important reality of the modern financing realm: lenders buy and sell loan interests on the secondary loan market with great frequency. Furthermore, some speculative investors specifically acquire distressed debt from other lenders, often for a mere fraction of the outstanding principal. Although, with proper documentation, such acquirers step into the shoes of the original lender, these transfers raise questions as to the propriety of applying rules of contract interpretation that impute the intent and bargaining power of the original parties to present-day holders.

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255 Ben-Shahar, supra note 119, at 417 (discussing the importance of relative bargaining power and its centrality to the advanced arguments).

256 A similar concern has been articulated with respect to bankruptcy consent requirements: "Bankruptcy law's reliance on the consent of proxies, successors, or others similarly situated has become especially problematic in recent years as consent rights increasingly have been divorced from economic rights through modern financial engineering." Daniel J. Bussel & Kenneth N. Klee, Recalibrating Consent in Bankruptcy, 83 AM. BANKR. L.J. 663, 733 (2009).

257 See id. at 323 (noting that the borrower sought bankruptcy protection on September 11, 2001). Additionally, under virtually all lending agreements, a borrower's insolvency is a default, terminating the lender's commitment to make any additional advances of loan proceeds. See, e.g., 1 MORTON MOSKIN, COMMERCIAL CONTRACTS: STRATEGIES FOR DRAFTING AND NEGOTIATING § 16.04(j) (2003) (describing a provision of this sort in an unsecured credit agreement).

258 Beal, 8 N.Y.3d at 323 ("Neither plaintiff-appellate Beal nor its assignore, BFC Capital, Inc., was an original Lender, and neither held any interest in the loan when the Borrower petitioned for bankruptcy protection. BFC acquired a 4.5% interest in the bank debt after the Borrower filed for bankruptcy.")


260 See, e.g., Kaiser Aluminum Corp. v. Matheson, 681 A.2d 392, 397 (Del. 1996) ("When a contract is ambiguous, a court normally relies upon extrinsic evidence of the parties' intent . . . . [However in this case, s]uch an investigation would reveal information
the case of an acquisition for a mere fraction of the outstanding principal, there is a significant incentive for the acquirer to take an adversarial position in restructuring discussions purely because any concession, settlement or judgment to be obtained might enable the lender to profit from its investment.\(^{261}\)

To be sure, the underlying credit documents are essential in defining the obligations of the parties, including the extent of the originally outstanding indebtedness; but conceptually speaking, the financing relationship is an organic arrangement that evolves over time, much as a corporation grows and evolves. Indeed, sophisticated corporate financing arrangements often entail revolving lines of credit and other standing commitments and contractual arrangements,\(^{262}\) and as such are referred to in the industry as credit “facilities” created pursuant to underlying credit documents. This nomenclature, which is to some degree analogous to the distinction between a corporation and its formation documents, is perhaps a subtle recognition of the dynamic nature of the relationships created by credit documents. Furthermore, as financing arrangements have grown to include heterogeneous lender groups, and as securitization and derivative transactions have created additional layers to existing arrangements, the Imperative’s goal—the promotion of certainty and uniformity premised upon the imputed expectations of financial institutions—has become nearly impossible to meet.

\(^{261}\) A problem of this sort also arises in the bankruptcy context. For instance, U.S. Bankruptcy Judge Robert Gerber, at a hearing on the issue of reforming Bankruptcy Rule 2019 (which mandates disclosure of certain creditors’ economic interests in claims), purportedly recounted a situation in the General Motors Corp. bankruptcy, whereby “a group told him it represented 1,500 bondholders who bought their debt at around par using pension money. When he requested disclosure under rule 2019 he learned the group consisted of three people who bought their debt at pennies on the dollar.” Tiffany Kary, *Federal Judge Says Rules Needed to Bar Bankruptcy Failure Bets*, BLOOMBERG (Feb. 05, 2010), http://www.bloomberg.co.jp/apps/news?pid=90970900&sid=apaU32ZSweGY. Judge Gerber also noted that “distressed investors ‘have their own agendas, which not infrequently consist of simply maximizing returns for themselves, in the shortest possible time horizon.’” Id.

\(^{262}\) See, e.g., *O’Reilly Automotive, Inc. successfully completes debt refinancing*, AFTERMARKET BUS. (Jan. 25, 2011), http://aftermarketbusiness.search-autoparts.com/aftermarketbusiness/Distribution/OReilly-Automotive-Inc-successfully-completes-debt/ArticleStandard/Article/detail/703975 (reporting the closing of a $750 million credit facility, including a $200 million facility for letters of credit and a $75 million swing-line facility); *Parkway Closes New Revolving Credit Facility*, PRNEWSWIRE (Jan. 31, 2011), http://www.prnewswire.com/news-releases/parkway-closes-new-revolving-credit-facility-114979914.html (reporting the closing of a $200 million credit facility, including a $190 million unsecured revolving line of credit and a $10 million working capital revolving line of credit, pursuant to which the borrower also maintains a $100 million interest rate swap).
C. Confronting Ambiguity in Beal

Ironically, while the Beal court's Imperative-driven approach has been met with considerable criticism from within the corporate finance practice community,263 most observers conclude that the court ultimately assigned legal rights and remedies in a manner that is consistent with industry expectations.264 Based solely upon the outcome of the case, strong arguments can be made that the court sought to advance equitable interests or confirm standard practices in the industry. Yet the opinion does not reveal consideration of these factors.265 Rather, the decision evidences only a struggle to declare highly incongruous documents "unambiguous as a matter of law" by operation of some of the most nebulous rules of contract interpretation.266 For this reason, the trouble with Beal lies not in the

263 See sources cited infra note 264.
264 See, e.g., Paul J. Epstein, Beal v. Sommer: Did Decision on Collective Action in Exercise of Lenders' Remedies Reflect Contracting Parties' Intent?, 125 BANKING L.J. 240, 240–41, 246–47 (2008) ("As a matter of equity, the Court's decision . . . seems to be the correct one. . . . However, the Court seems to have cut some corners as a matter of contract interpretation. . . . [The conclusion of the contract interpretation analysis] is not clearly supported by the terms of the contracts themselves . . . ."); Joshua Stein, Model Intercreditor Agreement (Among A Lenders, B Lenders, and Swap Counterparty), in COMMERCIAL REAL ESTATE FIN. 2010: HOW TO HANDLE DEFAULTS, DISTRESS, MATURITIES, AND STACKS OF DEBT 445 (PLI Real Estate Law and Practice Course Handbook Series, PLI Order No. 23198, 2010) ("The result in Beal conformed to industry expectations, as the author understands them. Given some of the language in the Beal loan documents, though, the court perhaps did the lending industry a favor to some degree."); Keith H. Wofford, Lender 'Collective Action' Doctrine Provokes Controversy; Against: A Violation of New York Law and Good Policy, N.Y. L.J., Dec. 14, 2009, at 9 col. 5 ("The Beal Court took the position that, even where a credit agreement accords rights to individual lenders or provides that certain acts require unanimous lender consent, those provisions should be read narrowly (even to the point of having no meaning), in order that the collective design of the credit agreement may prevail.").
265 Although the majority opinion includes several citations to a single secondary source, written nearly twenty years earlier, such review can hardly be considered a thorough investigation of customary practice. Beal Sav. Bank v. Sommer, 8 N.Y.3d 320, 330–32 (2007).
266 In general, courts presiding over corporate finance controversies are reluctant to identify ambiguity, presumably because any such declaration would require a more expansive interpretative analysis and therefore potentially run afoot of the Imperative. See, e.g., In re QuVIS, Inc., No. 09–10706, 2010 WL 2228246, at *6 (Bankr. D. Kan. June 1, 2010) ("[The loan agreement was] less than precise in its treatment of the secured creditors and their rights vis-à-vis another, but nonetheless unambiguous as a matter of law on this very issue."). In a rare example of a court finding that a material provision of a corporate financing agreement is ambiguous, a United States District Court found a material adverse change clause to be ambiguous, thereby prompting a review of extrinsic evidence as well as an analysis of the foreseeability of adverse events. Capitol Justice LLC v. Wachovia Bank, N.A., 706 F. Supp. 2d 23, 30–29 (D.D.C. 2009); see also BKCAP, LLC
decisional outcome, but in the fact that the ruling purports to be based upon textual analysis and is arguably divorced from the construction of the text itself.

Indeed, as the dissent argues, the majority in *Beal* reaches a "pragmatically appealing result," given that only one of the thirty-seven lenders sought to enforce remedies. However, this result was achieved by "read[ing] into the loan documents language that would compel results far less appealing." Moreover, the holding is inconsistent with prior decisions, which held that similar language granting enforcement rights to administrative agents does not override express rights of lenders to proceed individually.

Ultimately, as Justice Kennedy's dissenting opinion in *Davis* warns, this murky judicial analysis injects substantial legal uncertainty. Whereas strict interpretive norms may seem, at least theoretically, to advance the Imperative's *laissez faire* ideals, they might in fact permit one of the most disquieting forms of governmental intervention in finance and lending—unbridled judicial discretion. In essence, seemingly mechanical rules of contract interpretation, when applied to exceedingly complex commercial agreements, may serve only to conceal a highly subjective judicial decision-making process.

For instance, as evidenced by decisions outside of the corporate finance realm, the prevailing textualist approach to contract interpretation enables judges to act upon a number of subjective influences and biases, and also invites...
inconsistent\textsuperscript{272} and inadequate analyses.\textsuperscript{273} Moreover, given the sheer size, complexity and, at times, internal inconsistencies of the agreements and instruments that govern modern commercial transactions,\textsuperscript{274} robust contract interpretation has become increasingly cumbersome.\textsuperscript{275} Consequently, it is vulnerable to oversight and error.\textsuperscript{276} Yet among the many criticisms levied against strict interpretive norms, the strongest of all such attacks assert that the rules of contract interpretation are mere facades, concealing decisions that are actually rooted in undeclared normative or theoretical persuasions of the court.\textsuperscript{277} The realm of corporate finance is no exception to these criticisms; \textit{Beal} exemplifies these very concerns.

Much of the criticism of \textit{Beal} stems from the court’s insistence that seemingly internally inconsistent documents are unambiguous.\textsuperscript{278} By declaring the credit

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\textsuperscript{272} Karl N. Llewellyn, \textit{Remarks on the Theory of Appellate Decision and the Rules or Canons About How Statutes Are to Be Construed}, 3 \textit{VAND. L. REV.} 395, 401 (1950) ("[T]here are two opposing canons on almost every point."); \textit{see also} Avery Wiener Katz, \textit{The Economics of Form and Substance in Contract Interpretation}, 104 \textit{COLUM. L. REV.} 496, 497 (2004) ("[M]any rules of contract law have the effect of privileging or emphasizing certain types of potentially relevant interpretive materials, and discounting or excluding others.").

\textsuperscript{273} \textit{See} \textit{STEPHEN BREYER, ACTIVE LIBERTY: INTERPRETING OUR DEMOCRATIC CONSTITUTION} 85 (2005) ("[O]veremphasis on text can lead courts astray, divorcing law from life . . . .").

\textsuperscript{274} Credit documents often comprise hundreds or even thousands of pages. A significant portion is negotiated via a flurry of drafts on the eve of closing. These realities of modern practice can lead to the problems articulated in a recent case construing indenture documents. \textit{Bank of New York v. First Millennium, Inc.} notes that courts ought to "construe a contract 'in accord with the parties' intent,' and [that] the best evidence of their intent 'is what they say in their writing.' Easy enough to say: but difficult to apply when the parties' writings are as convoluted and opaque as those in this case." 598 F. Supp. 2d 550, 568 (S.D.N.Y. 2009) (citing Greenfield v. Philles Records, Inc., 780 N.E.2d 166, 170 (2002)); \textit{see also} HSBC Bank USA, N.A. v. Dara Petroleum, Inc., No. CIV. 2:09-2356, 2010 WL 2197525, at *4 (E.D. Cal. May 28, 2010) ("[T]he phrase 'the 30 Day LIBOR equivalent to the Wall Street Journal Prime,' is unintelligible on its face . . . . Neither defendants' expert, who has worked extensively in the lending industry, nor plaintiff's expert, a professor of economics, had ever seen the specific phrase . . . .").

\textsuperscript{275} \textit{See}, \textit{e.g.}, \textit{In re} Premier Entm't Biloxi LLC, 445 B.R. 582 (Bankr. S.D. Miss. 2010) (providing a thorough interpretation of indenture agreements, resulting in a published opinion of sixty pages).

\textsuperscript{276} \textit{See}, \textit{e.g.}, Randall H. Warner, \textit{All Mixed up About Contract: When Is Contract Interpretation a Legal Question and When Is It a Fact Question?}, 5 VA. L. & BUS. REV. 81 (2010) (describing inconsistencies in the treatment of contract interpretation as a question of fact or of law).

\textsuperscript{277} \textit{FRANK C. NEUMANN & STANLEY S. SURRY, LEGISLATION: CASES AND MATERIALS} 654 (1955) ("[Canons of construction] are useful only as facades, which for an occasional judge may add luster to an argument persuasive for other reasons.").

\textsuperscript{278} \textit{See} sources cited \textit{supra} note 265.
documents unambiguous as a matter of law, the court ostensibly avoided expansive interpretive analyses and remained focused upon the plain meaning of underlying documents in its quest to assign legal rights and obligations. Beal is not an outlier case, either in terms of its methodology or the questions presented. Even within the bankruptcy context, where courts routinely exercise broad legal and equitable powers, courts continue to restrict their analyses to strict interpretive norms when construing the rights and obligations of parties to existing financing arrangements.279

Had the Beal court acknowledged ambiguity in the underlying credit documents, it might have reached an outcome that assigned legal rights and obligations identically to the actual outcome, but it would have been forced to engage in more rigorous interpretive analysis280 or, more boldly, advance a theory of collective action grounded in law or equity.

Generally, a court confronted with an ambiguous agreement is expected to discern the intent of the original parties to the underlying documents.281 These analyses are premised upon the assumption that the parties addressed all pertinent issues during negotiations, but did not articulate the resolution in their written

279 Generally speaking, bankruptcy courts look to state contract law when matters arise under private agreements and there is no statutory law (such as provisions of the Bankruptcy Code) on point. See HSBC Bank USA v. Branch 364 F.3d 355, 363 (1st Cir. 2004). As a result, decision-making norms, such as those that have evolved under the Certainty Imperative, continue to reign supreme. For instance, consent conflicts arise with respect to free and clear sales, which are conducted under § 363(f) of the Bankruptcy Code, and credit bids, which are conducted under § 363(k) of the Bankruptcy Code. See, e.g., In re GWLS Holdings, Inc., No. 08-12430, 2009 WL 453110 (Bankr. D. Del. Feb. 23, 2009) (applying prevailing methods of contract interpretation to underlying credit documents to determine consent thresholds and other requisite rights and obligations of the parties before the estate may proceed with the sale); In re Metaldyne Corp., 409 B.R. 671 (Bankr. S.D.N.Y. 2009). For example, in Chrysler, lenders holding less than 1% of the outstanding prepetition indebtedness objected to a proposed sale, arguing that unanimous consent was required. In re Chrysler LLC, 405 B.R. 84, 103 (Bankr. S.D.N.Y. 2009), aff'd, 576 F.3d 108 (2d Cir. 2009). As in Beal, the Chrysler court decided the case based upon rules of contract interpretation, finding that the underlying credit documents unambiguously evidenced a collective design, and that the requisite consent threshold was satisfied. Id. at 102–04.


281 See generally Arthur L. Corbin, The Interpretation of Words and the Parol Evidence Rule, 50 CORNELL L.Q. 161 (1965) (a foundational work exploring the process of construing ambiguous texts).
agreements. If necessary, a court may look to extrinsic evidence. If evidence does not reveal the actual intent of the original parties, or if evidence reveals that the parties never addressed the issue during negotiations, the court might attempt to determine what the parties would have agreed had the question arisen during negotiations. This is, in fact, the most widely employed approach to gap-filling incomplete commercial contracts. To discern this so-called hypothetical intent, a court might look to surrounding circumstances at the time the agreement was executed, customary usage of language in the agreement, or even terms that the marketplace would dictate for deals similar in scope.

In other cases, ambiguities may be resolved pursuant to a tiebreaker rule. Perhaps the most frequently cited example of such a rule, *contra proferentem*, provides that ambiguous language should be interpreted against the drafting party. Courts often apply this rule in the context of insurance agreements, but it has been exported to the financing realm. In the area of finance and lending,


283 See Ben-Shahar, *supra* note 119, at 396 (“The most broadly accepted principle of gap filling is that courts should ‘mimic the parties’ will.’”).


286 This approach was taken in the commercial gap-filling case, *Oglebay Norton Co. v. Armco, Inc.*, 556 N.E.2d 515, 519-20 (Ohio 1990) (supplanting contract price terms with market prices).

287 The Restatement suggests that construing a contract against the drafter is justified when the drafter is in a better position to predict uncertainties or when the drafting party has the stronger bargaining position. *RESTATEMENT (SECOND) OF CONTRACTS § 206 cmt. a* (1981).


another tiebreaker rule has been adopted in some states, whereby guaranty agreements are strictly construed in favor of the guarantor. There is wide variation in how, when, and to what extent such tiebreaker rules are applied. For instance, some courts seek to avoid application of contra proferentem by determining whether only one of multiple alternative interpretations is reasonable. In these cases, courts test reasonableness based upon an analysis of hypothetical intent at the time the contract was entered into, or based upon the overall utility maximization of each proffered interpretation. Other courts have limited application of this rule by applying it only where actual intent of the parties cannot be determined upon review of extrinsic evidence.

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290 A guarantor is entitled to have his agreement strictly construed so that it is limited to his undertakings, and it will not be extended by construction or implication,” and thus a court should adopt “a construction which is most favorable to the guarantor.” Coker v. Coker, 650 S.W.2d 391, 394 n.1 (Tex. 1983) (citing Reece v. First State Bank of Denton, 566 S.W.2d 296, 297 (Tex. 1978); see also Mazur v. Young, 507 F.3d 1013, 1021 (6th Cir. 2007) (“[C]ourts should ‘apply the principle of strict interpretation to the construction of [a guaranty] contract.’” (citing Bandit Indus. Inc. v. Hobbs Int’l, Inc., 620 N.W.2d 531, 535 (Mich. 2001)); Wells Fargo Bank, NA v. MPC Investors, LLC, 705 F. Supp. 2d 728, 736 (E.D. Mich. 2010) (explaining that Michigan precedent narrowly construes guaranty contracts); Ulreich v. Kreutz, 876 S.W.2d 726, 728 (Mo. Ct. App. 1994) (noting that under Missouri law “liability of a guarantor is to be strictly construed” according to the plain meaning of the agreement).

291 Lohnes v. Level 3 Commc’ns, Inc., 272 F.3d 49, 61 (1st Cir. 2001) (referring, in an equity financing case, to the rule of contra proferentum as a “hoary aphorism” and noting that the appellant’s “reliance is mislaid. In order to invoke this principle, the proponent first must . . . show that the interpretation which he urges is, ‘under all the circumstances, a reasonable and practical one.’”); Cappellini v. Mellon Mortg. Co., 991 F. Supp. 31, 39–40 (D. Mass. 1997) (declining to apply contra proferentum because the alternative interpretation was unreasonable).

292 Allstate Life Ins. Co. v. BFA Ltd. P’ship, 948 A.2d 318, 328 (Conn. 2008) (explaining that under one interpretation, “the plaintiff would have decreased its protection while . . . loaning the defendants up to an additional $2 million and extending the maturity date of the loan. . . . We cannot reasonably conclude that the plaintiff would have lessened its indemnification protection in this situation.”).

293 See Savedoff v. Access Grp., Inc., 524 F.3d 754, 764–68 (6th Cir. 2008) (considering application of such a rule to a student loan agreement, but finding that it was not reasonable for the court to read the contract to prohibit collection of additional interest from monthly payments).

As a final alternative, courts at times apply economic analysis to aid in discerning whether one interpretation of an ambiguous agreement is more reasonable. Economic analysis is particularly useful in this context given the similarities between the process of balancing conflicting contract interpretations and cost-benefit analysis—an approach rooted in principles of economic efficiency. For the most part, these analyses look to the economic utilities as they existed at the time the contract was negotiated. To the extent only one interpretation would clearly advance overall utility, or conversely, to the extent one interpretation would yield an economically perverse outcome, the more efficient approach is adopted.

Yet even these more expansive rules of interpretation may be inadequate in the corporate finance context. For one thing, these rules tend to focus the court's attention upon underlying agreements that do not reveal the intent of parties who bear the present-day economic benefit or burden of any particular outcome. For instance, rules of contract interpretation place considerable attention upon the intent, interests, and bargaining power of the drafting and negotiating parties. However, in a case like Beal that pertains to a syndicated credit facility, the lead drafter was likely the administrative agent who may have very little economic interest in the outcome of the litigation. Indeed, in order to most effectively resolve the controversy among the parties and to generate useful precedent that provides certainty to the corporate finance community, a case like Beal probably requires that which the Certainty Imperative has effectively barred: a judicial decision grounded upon reasoned legal or equitable doctrine.

As Beal evidences, in the continued absence of doctrinal law governing the rights and obligations of parties to corporate financing arrangements, market

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295 See Posner, supra note 233, at 1590.
296 See, e.g., Columbia Gas Transmission Corp. v. New Ulm Gas, Ltd., 940 S.W.2d 587, 591 (Tex. 1996) ("we are to examine all parts of the contract and the circumstances surrounding the formulation of the contract. . . . It is inconceivable that the parties intended such a perverse result in this contract.").
298 The Kaiser Aluminum court acknowledged this limitation of rules of contract interpretation, observing that debt holders, while parties to the underlying contracts, were not engaged in the negotiation and drafting process. Intimating that the issuer, as drafter, had greater power in the negotiation and drafting process, the court applied a tiebreaker rule and construed the contract against the issuer. See supra notes 90–93 and accompanying text.
299 By definition, the Administrative Agent is the lead arranger, not a lender. While in practice most lead arrangers serve in a dual capacity, also holding some fractional interest as a lender, there is wide variation and, furthermore, the loan interest might have been sold or reduced through the secondary market. See Nada Mora, Lender Exposure and Effort in the Syndicated Loan Market (Fed. Reserve Bank of Kansas City Research, Working Paper No. 10–12, 2010).
participants are left grappling with a court’s contract interpretation exercise—wondering whether some other guiding principle, such as equity, efficiency, or customary practice, motivated the court. Furthermore, these methodologies can lead to decisions that are divorced from underlying economic substance. For instance, in a 2009 ruling, a United States Bankruptcy Court found that even where a majority of note holders consented to a credit bid, the sale could not proceed because the underlying credit documents vested in the indenture trustee the sole discretion to take substantive action.\footnote{In re Electroglas, Inc., No. 09-12416(PJW), 2009 WL 8503455 (Bankr. D. Del. Sept. 23, 2009).} Given that indenture trustees do not bear the risk of economic loss with respect to a financing arrangement, the outcome perversely vested substantive rights in a manner that not only does not align with present-day economic interests, but also thwarts present-day economic interests.\footnote{Recent analyses demonstrate agency problems, including moral hazards, that arise when a lead arranger does not share in the outstanding indebtedness. These observations can be analogized to the indenture trustee scenario, particularly in a situation of borrower insolvency where the lead arranger’s principal goal of maintaining a customer relationship is likely to be moot. See Mora, supra note 299, at 5.}

Perhaps in recognition of these limitations, the efficacy of deciding complex disputes based on rules of contract interpretation is generally under pressure.\footnote{Jonathan R. Macey & Geoffrey P. Miller, The Canons of Statutory Construction and Judicial Preferences, 45 VAND. L. REV. 647, 656 (1992) (predicting that societal utility would increase if judges decided cases with guidance from principles of public policy rather than purely on the basis of plain meaning); see also David McLauchlan, Contract Interpretation: What Is It About?, 31 SYDNEY L. REV. 5, 18 (2009) (arguing that the consideration of extrinsic evidence is in fact consistent with the principles behind the plain meaning approach); Posner, supra note 233, at 1587 (exploring the inherent inefficiencies of mechanical rules of contract interpretation).} These criticisms echo deeper normative questions as to the relative efficiencies of judge-made doctrine versus bright-line rules,\footnote{See FRIEDRICH A. HAYEK, LAW, LEGISLATION, AND LIBERTY: A NEW STATEMENT OF THE LIBERAL PRINCIPLES OF JUSTICE AND POLITICAL ECONOMY 121–23 (1973) (articulating benefits of a common law system versus a civil law code).} and further call into question the utility of Imperative-driven methodologies in promoting certainty and stability in financial markets. Indeed, if the Certainty Imperative—as the bedrock goal of corporate finance jurisprudence—reflects a genuine desire on the part of the judiciary to promote certainty and stability in financial markets, then continued reliance on strict interpretive norms may bring about a crisis of legitimacy with respect to the court’s very role as an arbiter of disputes.
V. EXPLORING ALTERNATIVE JUDICIAL METHODOLOGIES

A. Key Modifications to Prevailing Imperative-Driven Methodologies

This section proposes several recommendations to expand the scope of judicial inquiries in lending and finance jurisprudence. In particular, I propose two modifications to prevailing Imperative-driven interpretive methodologies. First, courts should consider the present-day economic substance of each party's claims. Second, courts should be empowered to allocate legal rights and remedies in a manner that is consistent with the actual economic arrangement of the parties. These modifications would allow courts to more closely replicate the outcomes that the parties would have reached but for the inefficiencies and sub-optimal allocations introduced when contractual terms are applied to present-day economic realities. Further development and evaluation of these recommendations is needed, particularly from an interdisciplinary perspective. In the meantime, the suggestions below strive to counter the tendency for Imperative-driven methodologies to promote form over substance when applied to complex and dynamic financing arrangements.

1. Consideration of Present-Day Economic Substance

Courts striving to reach efficient decisions in the financing realm must be empowered to consider the present-day economic substance of each party's claims by determining, in both qualitative and quantitative terms, the nature and extent of each party's actual economic interest at the time of litigation. Consideration of present-day economic substance would essentially involve a factual inquiry, pursuant to a request for disclosure by the parties to a controversy. Specifically, each claimant would be required to file a verified statement with the court, setting forth three elements: (1) the identity of the lender, creditor, or claimant; (2) the nature and amount of this person's interest in the financing arrangement, the dates when acquired and the amounts paid therefor, unless the claim or interest is alleged to have been acquired pursuant to this person's original participation in the financing arrangement as set forth in the credit documents;304 and (3) the nature and amount of this person's actual or prospective losses as a result of any deterioration in the financing arrangement.305 These disclosure obligations should

304 The proposed disclosure requirements set forth in clauses (1) and (2) are a modified version of the language in Bankruptcy Rule 2019, which is intended to foster transparency in the bankruptcy process. See In re Nw. Airlines Corp., et al., 363 B.R. 701, 701–02 (Bankr. S.D.N.Y. 2007).
305 Essentially, this is a test of economic substance, albeit exploring loss potential as opposed to the profit potential that is more frequently examined in tax law. See David P. Hariton, Sorting Out the Tangle of Economic Substance, 52 TAX LAW. 235, 235–36 (1999) (“A transaction only has economic substance . . . if it alters the taxpayer's economic position in a meaningful way (apart from its tax consequences).”).
be applied to each lender represented by an administrative agent, indenture trustee, or other agent serving with respect to a syndicated or participated lending arrangement.\textsuperscript{306} A disclosure requirement of this sort would enable courts to identify the true economic substance of each underlying claim, in what would essentially involve a "substance over form" investigation.\textsuperscript{307} In most cases, these interests will be radically different from those that existed when the credit documents were executed; particularly to the extent interests have been sold on the secondary market.\textsuperscript{308}

Additionally, courts should be empowered to qualitatively assess each person’s claims in a "facts and circumstances" inquiry intended to identify possible rent-seeking motivations. The importance of this inquiry is supported by economic efficiency principles. Indeed, since negotiations often enable parties to avoid litigation, the disputes that advance to litigation (excluding enforcement actions for monetary defaults) are likely to involve situations where present-day economic substance is far removed from contractual language. In this circumstance, parties have highly asymmetric risks and are therefore encouraged to engage in rent seeking\textsuperscript{309} to benefit from the disparities between actual economic interests and

\textsuperscript{306} In this respect, the proposed analytical framework materially departs from Bankruptcy Rule 2019, which was recently amended to clarify that disclosure obligations did not apply to creditors who are otherwise represented by an administrative agent, indenture trustee, or similar covered entity. See Order of the Supreme Court, Amendments to the Federal Rules of Bankruptcy Procedure (2011), available at http://www.supremecourt.gov/orders/courtofficialorders/frbk111.pdf (authorizing certain amendments to the Federal Rules of Bankruptcy Procedure, including Rule 2019, which such amendments shall take effect on December 1, 2011).

\textsuperscript{307} The substance over form doctrine figures prominently in tax law. See, e.g., Gregory v. Helvering, 293 U.S. 465, 470 (1935).

\textsuperscript{308} For example, in \textit{Beal}, lenders holding approximately 95% of the outstanding indebtedness consented to the forbearance arrangement. At first blush, this suggests that the advancement of Beal Savings Bank's interests at the expense of the remaining lenders carries a price: an amount equal to the present-day value of a forbearance arrangement sufficient to gain the support of lenders who have an economic interest equal to approximately 95% of the outstanding indebtedness. This assumption clearly renders decisional outcomes that advance the interest of such lenders more "pragmatically appealing," as the dissent notes. 8 N.Y.3d 320, 335–36 (N.Y. 2007) (Smith, J., dissenting). Yet suppose disclosures to the court revealed that Beal Savings Bank was the only original lender, and that the holders of the remaining 95% had acquired their interests for mere pennies on the dollar. In such a case, the party with the greatest actual economic interest and greatest relative incurred or prospective losses would be Beal Savings Bank, and an argument can be made that its interests ought to be advanced to the greatest extent by the decisional outcome.

\textsuperscript{309} Rent-seeking is any conduct intended to extract economic benefit by some method other than the adding of value to an enterprise. See generally James M. Buchanan, \textit{Rent Seeking and Profit Seeking}, in \textit{Toward a Theory of the Rent-Seeking Society} 3–4 (James M. Buchanan et al. eds., 1980).
contractual rights. In the context of a deteriorating financing arrangement, where resources are scarce, this behavior represents a particularly egregious form of waste. Rent-seeking parties siphon resources for personal profit, thereby further compounding the loss.

2. Consideration of the "Economic Effect" of Contractual Assignment of Rights and Remedies

Courts should be empowered to engage in distributive and allocative functions that replicate the outcomes the parties would have reached but for the inefficiencies and sub-optimal allocations introduced when strict contractual terms are applied to present-day economic substance. Courts may continue to apply rules of contract interpretation to understand the relationships, rights, and obligations established pursuant to the underlying credit documents; however, before assigning legal rights and remedies or economic surplus in accordance with contractual language, these assignments should be tested for "economic effect."

For an allocation of legal rights, remedies, or economic surplus set forth in the underlying credit documents to have economic effect, it must be consistent with the relative economic benefits and burdens borne by each party. For example, where underlying credit documents vest substantive rights in a party that bears no present-day economic interest in the financing arrangement, and parties with substantial present-day economic interests wish to proceed in a contrary manner, a court would be empowered to reallocate substantive rights accordingly, such that the substantive rights are exercised in a manner that has economic effect. Similarly, any economic surplus would be distributed in accordance with the actual economic interests of parties as disclosed to the court. In essence, an allocative model would remove incentives for rent-seeking behaviors and other forms of waste, thereby distributing scarce resources in accordance with economic substance.

At first blush, application of allocative models in the financing realm may raise concerns of excessive meddling. However, an approach of this sort may in fact serve as a better analogue to the analyses applied from within financial markets. For instance, when parties to corporate financing disputes restructure distressed debts outside of court, the process is not one of strict enforcement or


311 The "economic effect" test is used to determine the proper allocation of partnership items that impact the federal income taxation of partners. See 26 U.S.C. § 704(b) (2006).

312 A more detailed description of the economic effect test as applied in the context of partnership allocations can be found in Treas. Reg. § 1.704-1(b)(2)(ii)(a) (1960).
rearticulation of each party’s imputed expectations in negotiating the credit documents. Rather, the process is one of allocating resources in accordance with the present-day economic substance of each party’s claims. In particular, parties strive to maximize the borrower’s assets or income realization potential so that wealth can be transferred in an orderly manner to lenders in an effort to achieve the greatest satisfaction of outstanding obligations. To the extent any additional surplus can be made available, whether in the form of assets that can be sold or cash that can be freed by reducing expenses, the loan is restructured to allow this realization. If, in contrast, lenders resolved disputes pursuant to strict contract enforcement, then commercial loans would virtually always end in judicial or non-judicial enforcement of remedies (such as foreclosure) rather than consensual workouts.

Indeed, allocative approaches are already used within the bankruptcy context with respect to matters arising beyond the scope of credit documents. Yet within or without bankruptcy court, prevailing Imperative-driven methodologies largely reject any such distributive or allocative models in the finance and lending context. The following section explores how a hypothetical court reconsidering Beal might incorporate these and related analytical constructs into an interpretive methodology that better advances the underlying goals of the Certainty Imperative.

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314 Id.
315 For modeling of utility maximizing behavior by and among lenders, borrowers, and regulators in the course of loan workouts, see Philippe Aghion et al., On the Design of Bank Bailout Policy in Transition Economies, in DESIGNING FINANCIAL SYSTEMS IN TRANSITION ECONOMIES: STRATEGIES FOR REFORM IN CENTRAL AND EASTERN EUROPE 7–36 (Anna Meyendorff & Anjan V. Thakor eds., 2002). Although the model applies specifically to transition economies, it draws upon certain universal tendencies that are relevant in virtually all jurisdictions. For instance, the model reminds us that banks have an incentive to restructure in order to avoid having nonperforming loans in their loan portfolios.
316 “Sound workout programs begin with a complete understanding of all relevant information, as well as a realistic evaluation of the abilities of both the borrower and bank management.” OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMMERCIAL REAL ESTATE AND CONSTRUCTION LENDING 21 (1998).
317 Jun Chen & Yongheng Deng, Commercial Mortgage Workout Strategy and Conditional Default Probability: Evidence from Special-Serviced CMBS Loans 1–7 (Univ. of S. Cal. Lusk Ctr. for Real Estate, Working Paper 2010) (reporting that, out of 217 commercial loans for which consensual workouts were attempted, approximately half resulted in a modification that continued the lending relationship, while only 22% required the lender’s legal enforcement of remedies).
B. Beal Revisited under a More Expansive Interpretive Methodology

A hypothetical court, recognizing that the underlying credit documents are ambiguous with respect to the consent threshold required to bar lenders from proceeding individually, might turn to a more expansive paradigm to reach an economically efficient outcome. Alternatively, to the extent the agreements are found to be unambiguous as a matter of law, a court might proceed to a more expansive analysis where these agreements allocate legal rights, remedies, or economic surplus in a manner that lacks economic effect in the context of the dispute.

Upon identifying the present-day economic substance of each party’s claims, pursuant to disclosures submitted to the court and a facts and circumstances inquiry, a hypothetical court would proceed to identify the potential utility-maximization of each alternative outcome. To this end, the court might evaluate theoretical and empirical insights with respect to various consent mechanisms. For instance, scholarly material analyzing sovereign bond restructurings in the 1990s and early 2000s would be particularly relevant. Work produced in this area generally reveals that, setting aside transaction costs, collective action in multi-lender arrangements allows for more efficient renegotiation and restructuring of a borrower’s obligations. In contrast, without any sort of collective action mechanism, each lender would be required to proceed individually to enforce remedies, thereby draining the borrower’s assets due to the costs and delays associated with defending each suit. However, where a collective action mechanism employs a threshold that is easily satisfied, a moral hazard arises whereby the borrower has incentives to seek restructuring of debts that it might have otherwise satisfied according to original credit terms.

In comparing the utility maximizing potential of unanimous versus supermajority consent mechanisms, literature identifies three broad problems associated with unanimous consent mechanisms in the debt-restructuring context;

319 A rich discussion of consent mechanisms, as well as the particular costs and benefits of each, can be found in classic political economy texts. The most noted example is JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY (1962).


the circumstances in *Beal* present an opportunity for the same problems to arise.\(^3\) First, there can be substantial transaction costs because lenders holding a small fractional interest must be reached, informed of the proposed restructuring, and given an opportunity to respond.\(^3\) Second, in light of the heterogeneity of lender groups,\(^3\) it can be very difficult for any one restructuring arrangement to suit the needs of every lender; ironically, the arrangement that would advance the interests of every lender would most likely not generate relief to a distressed borrower.\(^3\)

Furthermore, when examined in light of Coasian economic theory,\(^3\) unanimous consent mechanisms invite rent-seeking behavior.\(^3\) In particular, there are obvious incentives for holdout by minority lenders, because a single fractional owner is in a position to demand benefits in exchange for consent. These payoffs occur in the financing realm; for instance, the discovery of payments in exchange for minority lender consent was the subject of a 2010 case before the Fifth Circuit.\(^3\) As other lenders become aware of these arrangements, a classic prisoners’ dilemma results, whereby the tendency to hold out creates an equilibrium that leaves all parties in a worse position.\(^3\)

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\(^3\) The three problems described herein are modified from Häser, *supra* note 320, at 91–92.

\(^3\) See id.

\(^3\) Syndicated financing arrangements often include not only traditional banking institutions, but also a range of nontraditional lenders, such as hedge funds, private equity funds, insurance companies, pension funds and investment divisions of large corporations. See, e.g., Mark Brannum, *Hedge Funds Make for Painful Bankruptcies*, 23 *Tex. Law. 21* (2007).


\(^3\) See Highland Crusader Offshore Partners LP v. LifeCare Holdings Inc., 377 F.App’x 422 (5th Cir. 2010) (involving a borrower who offered to pay an increased amendment fee to certain holdout lenders in exchange for consent to a loan modification).

The court would likely find that a supermajority consent mechanism is more apt to achieve the greatest overall net utility maximization. The court would then proceed to test the economic effect of the allocation. Here, the allocation pertains to legal rights and remedies of a zero-sum nature. However, in disputes that involve contractual surplus, the surplus would be allocated in accordance with, and in proportion to, the actual economic interests of the parties in the financing arrangement.\textsuperscript{330} As a final step, the court might test the reasonableness of any outcome by comparing the end result to what would occur in the absence of judicial intervention. Essentially, this final step assures that the court’s intervention does not substantially deviate from the course that is most likely to be taken in the absence of judicial involvement. It merely removes the rent-seeking, contractual arbitrage and other inefficiencies that derive from the disparity between present-day economic realities and strict contractual rights.

Beyond the facts of \textit{Beal}, a more expansive decisional paradigm would have great utility across a range of disputes that are presently decided under strict, Imperative-driven methodologies. For instance, similar disputes arise when a borrower has defaulted on a debt obligation and might avoid bankruptcy if an accommodation can be obtained from lenders.\textsuperscript{331} Indeed, this was precisely the situation in the failed Chrysler debt restructuring negotiations,\textsuperscript{332} in which the company needed unanimous consent of its lenders to a $2 billion cash settlement in satisfaction of approximately $6.9 billion of indebtedness.\textsuperscript{333} The four largest lenders in the financing arrangement, holding approximately seventy percent of the outstanding indebtedness, agreed to the workout terms,\textsuperscript{334} but the remaining lenders refused and the company filed for Chapter 11 bankruptcy protection.\textsuperscript{335}

\textsuperscript{330} Any remaining surplus might be allocated to parties that did not make an economic investment in, and were not party to, the financing arrangement—but have suffered the greatest actual or prospective losses as a result of the deterioration in the financing arrangement. These parties might include other investors, including secured or unsecured debt holders and equity shareholders, as well as customers, pensioners, employees, suppliers, and even more remote parties, such as current or prospective tort claimants. The consequences of defaults and bankruptcies on such parties are explored in the factually outdated but conceptually relevant article, David Welch et al., \textit{What If GM Did Go Bankrupt...}, BLOOMBERG BUSINESSWEEK, Dec. 12, 2005.

\textsuperscript{331} Headlines of loan workouts hint at the frequency of protracted negotiations between borrowers and lender groups. See Jeffrey A. Trachtenberg, \textit{Houghton Owner Restructures Debt}, WALL ST. J., Feb. 22, 2010; General Growth forbearance request deadline passes, WASH. TIMES, Mar. 16, 2009.

\textsuperscript{332} See supra notes 9–10 and accompanying text.


\textsuperscript{334} See id.

\textsuperscript{335} Shefali Anand, \textit{The Chrysler Bankruptcy Plan: Oppenheimer Fund Refused to Budge}, WALL ST. J., May 2, 2009, at A2. Admonishing the lenders who declined to consent, President Obama stated, “I don’t stand with those who held out when everyone else is making sacrifices.” \textit{Id.}
In cases of this sort, borrowers sometimes proceed to Chapter 11 bankruptcy in an effort to obtain a so-called cram down, whereby the bankruptcy court imposes a restructuring plan over the objections of minority lenders if certain requirements are met. Substantial utility maximization might be reached if, in lieu of a bankruptcy filing, a court could reduce a unanimous consent mechanism to that of a supermajority or simple majority consent mechanism, or reduce a supermajority consent mechanism to that of a simple majority. These outcomes would in many cases yield considerable utility-maximization, and simply replicate the consent mechanism that is likely to be imposed on the lenders if the borrower seeks bankruptcy protection.

Even beyond lender consent thresholds, a more expansive analysis would enable courts to more effectively resolve a great number of disputes in the corporate financing realm. For instance, this approach would be instrumental in cases where a borrower is in covenant default rather than monetary default, and the covenants impose obligations that are alleged to be unreasonable or excessively burdensome. Other potential applications include defaults declared under material adverse change or lender insecurity clauses, and cases arising due to a lender or co-venturer refusing to fund advances.

336 Under § 1129(b)(2)(A)(ii) of the Bankruptcy Code, a debtor may under certain circumstances “cram down” a plan notwithstanding rejection by a creditor class. For a thorough discussion of consent mechanisms in the bankruptcy context, see Bussel & Klee, supra note 256.

337 Unanimous consent mechanisms substantially limit restructuring options. For example, a British chemicals company required the unanimous consent of its lenders, and thus a restructuring proposal that garnered the approval of 81% of senior lenders and 90% of junior creditors could not proceed without litigation. Tom Freke, Lenders Poised to Take British Vita Stake-Sources, REUTERS, Mar. 13, 2009.

338 Such a mechanism might have been useful in the situation of retail mall owner General Growth Properties Inc. One major news outlet announced that the company was “struggling to avoid filing for bankruptcy protection,” as “a plan to defray payment on five series of bonds failed to secure sufficient bondholder support, sending its stock down as much as 10%.” Ilaina Jonas, General Growth Fails to Win Bondholder Support, REUTERS, Mar. 30, 2009. The company filed for Chapter 11 bankruptcy protection the following month. See Ilaina Jonas, General Growth Bankruptcy Faces Challenge, REUTERS, June 9, 2009.

339 See supra note 333 and accompanying text.

340 These so-called “technical defaults” are more likely to occur when industry downturns make it difficult for corporate borrowers to comply with financial covenants. See David Hahn, The Roles of Acceleration, 8 DEPAUL BUS. & COM. L.J. 229, 232–35 (2010).

341 “Failure to fund” cases demonstrate the importance of considering present-day economic circumstances, since in many cases it might be economically inefficient to compel lenders to continue to gain risk exposure. In cases of this sort, courts continue to construe the underlying loan documents, drawing upon procedural remedies to compel results dictated by the language. See Destiny USA Holdings, LLC v. Citigroup Global
Outside of the lending realm, this decisional paradigm would have great utility in circumstances where financing arrangements are profoundly interconnected. For instance, at the time of the Lehman Brothers' Chapter 11 filing, the Lehman corporate family was party to more than ten thousand derivative contracts, with more than 1.7 million transactions outstanding. In each case, the underlying contract contained language granting priority of payment in the event of a default, including the filing of a Chapter 11 bankruptcy. To the extent financing transactions are interconnected, the consequences of default are only further magnified, and substantial instability and uncertainty can arise when outcomes allocate rights, remedies and surplus in a manner that fails to comport with economic substance.

Moreover, where economic instability emerges from within markets, the judiciary can serve as an important first-line of defense against further market disruptions by providing flexible and responsive redress as arrangements begin to unravel. Courts that look solely to underlying agreements pursuant to strict, Imperative-driven methodologies miss an opportunity to contribute meaningful reforms to the law governing financial transactions. And, ironically, this restrictive approach does little to preserve market stability.

VI. CONCLUSION

As it has evolved across decades of case law and legislative enactments, the Certainty Imperative has profoundly altered judicial decision-making in finance and lending by encouraging strict interpretive norms and rejecting more expansive contextual analyses. Over time, the Imperative’s methodological constraints have become a paralyzing force upon the judiciary, preventing it from engaging in legal reform. In essence, the law of corporate finance places the highest value upon the status quo. The methodological constraints imposed by the Imperative must be overcome. As modern corporate financing arrangements grow more complex, moral hazards arise when contractual language vests substantive rights and


A case of this sort is pending in New York. An investment management company sued its joint venture partner, asserting that the latter failed to fund its commitments. See Sasha M. Pardy, Coventry Files $500M Lawsuit Against Developers Diversified, COSTAR GRP., Nov. 5, 2009.


See supra note 343.

See supra note 330.
remedies in a manner that does not align with evolving economic interests. Courts must be empowered to apply more expansive analyses designed to allocate legal rights and remedies in a manner that is consistent with the actual economic arrangement of the parties.

Some will disagree with my appraisal. Criticisms of more expansive judicial analyses have been articulated in the related areas of corporate and transactional law. The realm of corporate finance is not beyond the reach of similar arguments, as each substantive area of the law represents yet another showcase for longstanding tensions between legal formalism and realism, and between textual and contextual approaches. The relatively uncharted realm of corporate finance remains fertile ground for these and countless other philosophical tensions. More interdisciplinary scholarly attention is needed in this area, particularly with respect to the relationship between market stability and the underlying normative value of legal certainty, the role of courts in financial markets, and the broader interconnections among legal reform, systemic risk, and market efficiency. However, an undeniable certainty emerges: to the extent this realm is subjected to further analyses, we can expect lively and theoretically compelling discourse in the law of corporate finance.

346 Compare Marcel Kahan & Edward Rock, Symbiotic Federalism and the Structure of Corporate Law, 58 VAND. L. REV. 1573, 1576 (2005) (asserting that Delaware corporate law is a "classical or 19th century common law model of lawmaking" with "some intrinsic limitations, including that legal change is slow, standard-based, and incremental"), and Jonathan R. Macey, Delaware: Home of the World’s Most Expensive Raincoat, 33 HOFSTRA L. REV. 1131, 1132–37 (2005) (claiming that because Delaware law is stable and predictable, powerful interest groups enjoy a dominant position within the culture), and Jonathan R. Macey & Geoffrey P. Miller, Toward an Interest-Group Theory of Delaware Corporate Law, 65 TEX. L. REV. 469 (1987) (claiming that judge-made law that is favorable to corporations encourages corporations to litigate in Delaware, which in turn increases litigation in the state), with Mohsen Manesh, Legal Asymmetry and the End of Corporate Law, 34 DEL. J. CORP. L. 465, 511 (2009) (characterizing Delaware corporate law as “indeterminate” due to its abundance of judicial opinions and heavy reliance on judicial fact-finding and vague standards), and Marcel Kahan & Ehud Kamar, Price Discrimination in the Market for Corporate Law, 86 CORNELL L. REV. 1205, 1235–36 (2001) (arguing that “predictability is wanting” in Delaware due to its excessively intensive litigation culture). See also Ehud Kamar, A Regulatory Competition Theory of Indeterminacy in Corporate Law, 98 COLUM. L. REV. 1908, 1911 (1998) (arguing that Delaware elicits litigation and grants broader judicial discretion, which gives Delaware a competitive advantage over other states in the area of corporate law).
