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CREDITORS STRIKE BACK: THE RETURN OF THE COOPERATION AGREEMENT

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ABSTRACT

In the low interest rate environment that followed the Great Recession, a fanatical demand for high-yield investments provided private equity firms an opportunity. Newfound borrower leverage facilitated credit documents with few creditor safeguards and various loopholes. Borrowers subject to these "sponsor-favorable" terms now had options in times of financial distress. More specifically, they had the option to strike first.

Utilization of coercive exchanges began in earnest around 2015 and has since flourished. Unmonitored portfolio companies experiencing financial distress now regularly rely on questionable interpretations of ambiguous contractual provisions to surreptitiously move assets away from creditors' collateral baskets and subordinate lenders. These unprecedented acts of financial war are pure, self-interested behavior designed to seize and redistribute value. Creditors in this multiplayer prisoner's dilemma have two choices: (i) cooperate with its creditor group and attempt to prevail by securing a majority coalition, or (ii) defect and work with the borrower who promises to share some of the spoils of victory.

Scholars have thoroughly detailed private equity's plan of attack. But what is missing is an exploration of creditor countermeasures to these new coercive exchanges. This Essay attempts to conceptualize the

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decision to coordinate and analyze the benefits and costs of cooperation. Further, this Essay explores the prevalent terms and basic design of cooperation agreements based on my unique review of a number of private disputes.

The possibility of opportunistic behavior casts a long shadow in these battles of financial titans. The benefits of a coordinated response are clear, but there still exist many obstacles, including threats of free riding. And borrowers have myriad weapons in their arsenal to splinter adversary groups. In choosing between cooperation and defection, creditors know there may be no honor among thieves.

> *"The first principle of Economics is that every agent is actuated only by self-interest. [But invariably an agent must choose to act] without, or with, the consent of others affected by his actions. In [a] wide sense[], the first species of actions may be called war; the second contract."*[1]

INTRODUCTION

Shortly after World War II, RAND Corporation—the original think tank —was formed to answer one simple question: How would a nuclear war with Russia play out?[2] RAND researchers were asked to think the unthinkable.[3] At that time, the two-person, zero-sum game was the quintessential model that guided strategy exercises. In fact, Al Tucker developed the most famous game-theory exercise, the Prisoner's Dilemma, at RAND to help illustrate bargaining dynamics.[4] Despite their prominence, these noncooperative games of "pure conflict"[5] were a poor fit for negotiation and military strategy.[6] RAND

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1. F.Y. EDGEWORTH, MATHEMATICAL PSYCHICS: AN ESSAY ON THE APPLICATION OF MATHEMATICS TO THE MORAL SCIENCES 16–17 (C. Kegan Paul 1881) (emphasis omitted).

2. *See* SYLVIA NASAR, A BEAUTIFUL MIND 105 (1998).

3. *See id.* (citing HERMAN KAHN, ON THERMONUCLEAR WAR (1960) (crediting Kahn as the source of the famous phrase)).

4. *See* John Cassidy, *How Game Theory Explains the Leaks in the Trump White House*, THE NEW YORKER (May 15, 2018), https://www.newyorker.com/news/our-columnists/how-game-theory-explains-the-leaks-in-the-trump-white-house [https://perma.cc/XYP5-27E4] ("In 1950, Albert Tucker, a mathematician at Princeton, gave a talk to a group of Stanford psychologists about the rapidly developing science known as game theory.").

5. NASAR, *supra* note 2, at 115; *see generally* JOHN VON NEUMANN & OSKAR MORGENSTERN, THE THEORY OF GAMES AND ECONOMIC BEHAVIOR (1944) (explaining non-zero-sum games).

6. *See* NASAR, *supra* note 2, at 96 ("[T]wo-person zero-sum games have virtually no relevance to the real world. Even in war there is almost always something to be gained from cooperation.").

exercises failed to account for the effect of additional players and the potential for alliances and cooperation even with an adversary.[7]

By the middle of the 20th century, economists were exploring the idea of cooperative, non-zero sum games,[8] but the theory remained underdeveloped. Jonathan Nash altered the landscape with his essay, *The Bargaining Problem*.[9] Nash explained that market actors are not purely competitive in all transactions. Self-interest is oftentimes best served by collaborating and cooperating with others. Cooperative games allow players to make enforceable agreements with other players and be bound by a specific strategy.[10] Consequently, defection would not always be the dominant strategy in the world Nash envisioned. This idea offered a unique rebuttal to the Prisoner's Dilemma.

Though not exhibiting the same level of intensity as the Cold War, the recent coercive exchanges involving private equity sponsors and their portfolio companies, on one hand, and unsuspecting lenders and noteholders, on the other, have created a bleak financial battlefield.[11] The low interest rate environment that persisted over the last thirteen years drove demand for high-yield investments.[12] This dynamic allowed

7. *See id.*

8. *See, e.g.*, VON NEUMANN & MORGENSTERN, *supra* note 5, at 504 ("Our considerations have reached the stage at which it is possible to drop the zero-sum restriction for games.").

9. *See* John F. Nash, Jr., *The Bargaining Problem*, 18 ECONOMETRICA 155, 155–62 (Apr. 1950) (describing a bargaining situation where mutual benefit is possible but not achieved).

10. NASAR, *supra* note 2, at 96.

11. Private equity firms, including Apollo Global Management and The Blackstone Group, are asset managers whose business model involves acquiring companies—referred to as "portfolio companies"—with an eye to improving operations and cash flow before either selling the company or taking it public. *See* Samir D. Parikh, *Saving Fraudulent Transfer Law*, 86 AM. BANK. L.J. 305, 311–12 (2012) [hereinafter Parikh, *Saving Fraudulent Transfer Law*] (describing a typical leveraged buyout process in which private equity firms acquire target companies). When discussing a portfolio company, its private equity owner is often described as a "private equity sponsor" or simply "sponsor." Private equity sponsors acquire portfolio companies through leveraged buyouts, which involve using the target company's assets as collateral for the significant amount of debt necessary to effectuate the acquisition. *See id*. A variety of agreements—referred to as "credit agreements" or "debt instruments"—memorialize the lending relationship between the target company—also known as the "borrower"—and the group of lenders that provided the necessary funding. These lenders are creditors of the company, as are the parties who purchased the bonds or "notes" issued by the company. Noteholders can be secured or unsecured but even secured noteholders tend to be in a junior lien position as to the company's collateral and enjoy less influence than the company's senior secured lenders.

12. *See* Samir D. Parikh, *Financial Disequilibrium*, 171 U. PA. L. REV. (forthcoming 2023) (manuscript at 4), https://ssrn.com/abstract=4323945 [https://perma.cc/4L9A-PDUK] [hereinafter Parikh, *Financial Disequilibrium*] (explaining that "miniscule interest rates" contributed to "a fanatical demand for high-yield investments").

private equity sponsors to forcibly evolve debt instruments and insert woefully ambiguous provisions and limited covenants. In the last few years, borrowers facing minimal monitoring have used their first-mover advantage to exploit contractual provisions to seize value from creditors. Dropdown[13] and uptier[14] transactions became common place and the practice of layering coercive measures quickly followed.[15]

Game theory lies at the heart of borrower strategies designed to splinter creditors and prevent them from coordinating to preclude coercive measures. In the typical scenario, a borrower experiencing financial distress will pull levers intentionally buried in key debt instruments.[16] Affected creditors invariably bring suit but, as litigation lingers, borrowers offer sweeteners to individual creditors in the hopes of splintering the group.[17] The choice for the left out creditors is simple: defect and accept the borrower's offer, receiving benefits that soften the blow of the coercive measures; or cooperate with the other disfavored creditors and hope that they will prevail in court. This latter choice comes with the understanding that financial positions will be decimated if the group suffers too many defections.

One could argue that coercive exchanges are value additive, benefitting the company and its shareholders by providing access to new capital and thereby minimizing bankruptcy risk. I think that characterization is inaccurate. The maneuver is essentially a money grab that provides the borrower a little additional runway but does nothing to address the structural and operational issues that invariably played a large role in creating the distressed situation in the first place. What often results from coercion is a zombie company that generates

13. *See id.* at 25–27 (demonstrating by example that a "dropdown transaction" generally involves a borrower exploiting ambiguous terms in applicable debt instruments to move assets out of a lender groups' collateral basket and into an unrestricted subsidiary in order to allow the borrower to use the asset to access new capital).

14. *See id.* at 30–31 (demonstrating by example that an "uptier" transaction generally involves a borrower convincing a majority group within a lender syndicate to vote to alter various provisions of the lending agreement that effectively seize value from the minority group and redistribute that value to benefit the private equity sponsor, the borrower, and the majority lender group).

15. The maneuvers at the heart of this essay are described as "coercive" because they appear to disrupt key parties' ex ante expectations of the business relationship and rights at issue. Borrower action is arguably premised on baseless interpretations of contractual provisions and is seen as exploitive by creditors. *See generally* Parikh, *Financial Disequilibrium*, *supra* note 12.

16. *See generally id.* (presenting six detailed case studies for coercive exchanges that have occurred in the last eight years).

17. *See, e.g.*, *id.* at 30 (outlining the sweeteners employed by J.Crew during pending litigation).

only enough revenue to service its debt, limping along until there is very little left to salvage.[18] Indeed, many of the companies that have implemented coercive exchanges recently have failed to recover. Envision, Incora, iHeart, J.Crew, and Serta Simmons all filed for bankruptcy.[19] The borrower's maneuvers—which caused significant disruption and a resource drain—may have helped the sponsor secure more fees and improve its position in a bankruptcy, but that appears to be the primary benefit.

Scholars have thoroughly detailed private equity's plan of attack.[20] What is missing is an exploration of the creditor response to these tactics. This Essay spotlights the (i) countermeasures to private equity's new coercive exchanges and unpacks the intricacies of the creditor decision to coordinate, (ii) terms of cooperation agreements, and (iii) significant obstacles that exist to an effective contractual solution in these financial battles. In Part I, I conceptualize the decision-making framework for creditors. This part assesses coercive measures from a creditor perspective and through a game-theory lens, a vantage point missing in the current literature. Part II explains how financial war has erupted and details private equity's balkanization

18. *See* Vince Sullivan, *"Zombie" Retailers Like Bed Bath & Beyond Face a Reckoning*, LAW360 (Jan. 26, 2023, 2:50 PM) ("Retailers like Bed Bath & Beyond . . . have now become 'zombie companies' that can only make enough revenue to service their debt.").

19. *See* Erin Hudson, Rachel Butt & Eliza Ronalds-Hannon, *KKR's Envision Files for Bankruptcy To Cut $5.6 Billion Debt*, BLOOMBERG L. (Mar. 30, 2023, 1:38 PM), https://news.bloomberglaw.com/bankruptcy-law/kkrs-envision-files-bankruptcy-after-creditor-talks-fail [https://perma.cc/K3YS-NWP5]; Simon Lee, *Incora Files for Chapter 11 with Over $300m in DIP Financing*, BLOOMBERG L. (May 31, 2023), https://news.bloomberglaw.com/bankruptcy-law/incora-files-for-chapter-11-with-over-300m-in-dip-financing [https://perma.cc/QMP4-LDYN]; Tom Hals, *Largest U.S. Radio Company iHeartMedia Files for Bankruptcy*, REUTERS (Mar. 14, 2018, 10:19 PM), https://www.reuters.com/article/us-iheartmedia-bankruptcy/largest-u-s-radio-company-iheartmedia-files-for-bankruptcy-idUSKCN1GR0GB [https://perma.cc/N27J-PQR6]; Vince Sullivan, *J.Crew Just First In Expected Flood of Retail Bankruptcies*, LAW360 (May 4, 2020, 9:24 PM), https://www.law360.com/articles/1270220/j-crew-just-first-in-expected-flood-of-retailbankruptcies [https://perma.cc/F3LS-7X8W]; Amelia Pollard and Luca Casiraghi, *Serta Simmons Files for Bankruptcy Amid Financing Controversy*, BLOOMBERG (Jan. 23, 2023, 11:54 AM), https://www.bloomberg.com/news/articles/2023-01-24/mattress-maker-serta-simmons-files-for-chapter-11-bankruptcy [https://perma.cc/Q82D-SC3L].

20. *See, e.g.*, Parikh, *Financial Disequilibrium*, *supra* note 12, at 9–10 ("The story starts with private equity's acquisition model."); Kenneth Ayotte & Christina Scully, *J.Crew, Nine West, and the Complexities of Financial Distress*, 131 YALE L.J. F. 363, 366 (2021); Diane Lordes Dick, *Hostile Restructurings*, 96 U. WASH. L. REV. 1333, 1365 (2021); Jared Ellias & Robert Stark, *Bankruptcy Hardball*, 108 CALIF. L. REV. 745, 752–57 (2020); *see also* Mark J. Roe, *The Trust Indenture Act of 1939 In Congress and the Courts in 2016: Bringing the SEC to the Table*, 129 HARV. L. REV. F. 360, 363–69 (2016) (describing several "problems" resulting from judicial applications of Depression-era securities law).

measures designed to redistribute value from creditors to the borrower and sponsor. This part also offers the PetSmart dispute as a case study on how coordination without some binding cooperation agreement can be an ineffective countermeasure. In Part III, I detail the return of the cooperation agreement as a means to deter defection. This part unpacks key terms and objectives underlying cooperation agreements and how this is the paramount coordinated creditor response. Creditors who cooperate minimize the possibility of exploitive coercive exchanges and—at least in their estimation—force the borrower to abide by the original deal terms. But the fear of opportunistic behavior plagues creditor ranks. I also explore the key practical and legal obstacles to coordination, including free riding, precarious majorities, and the crossholder's luxury.

Coercive exchanges create disequilibrium in distressed debt markets.[21] These acts of financial war have been presented as attempts to rejuvenate a distressed company but appear to have done little more than afford private equity sponsors additional fees and an improved position in the ultimate bankruptcy case.[22] This Essay explores the revival of cooperation agreements as a countermeasure that could offer sanctuary to disfavored creditors. Despite the promise of protection, however, various obstacles to cooperation exist and each round of these financial games unveils new weaponry.[23]

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21. As I noted in an earlier article:

> [t]o the extent the leveraged-loan market offers retail products through mutual funds and other vehicles, public confidence is essential to the growth of these markets. A vibrant public market for debt securities relies on various measures to police exploitation. But public confidence is eviscerated if borrowers are allowed to target specific investors from whom to appropriate value and ostensibly pick winners and losers in times of financial distress.

Parikh, *Financial Disequilibrium*, *supra* note 12, at 39.

22. *See id.* at 20–21 (identifying examples of private equity sponsors taking advantage of ambiguous contractual provisions and favorable market conditions to "take value from lenders and noteholders" in times of distress).

23. *See* Max Frumes & Lavanya Nair, *Special Situations Insight: Sabre Upsized, Amended New $700M Loan Terms Includes Concessions from Centerbridge Lender Group as Part of Tricky LME*, LEVFIN INSIGHTS, June 9, 2023 (on file with author) (describing "double dip" borrowing maneuver that could be a new type of liability management exercise).

I. PRIVATE EQUITY AND THE MULTIPLAYER PRISONER'S DILEMMA

As a consultant at RAND[24] in the 1940s, Albert Tucker developed the Prisoner's Dilemma as an exercise to manifest game theory.[25] Tucker imagined a scenario where two criminals are arrested for a crime they have jointly committed and promptly placed in different rooms.[26] A key assumption is that the criminals have no means of communicating with each other and no access to legal counsel. The prosecutor does not have sufficient evidence to convict the criminals.[27] Therefore, she presents the following offer to each criminal: If they both deny committing the crime, they will be charged with a minor offense that will almost assuredly to lead to a one-year prison sentence.[28] If they both confess, then each will likely receive a five-year prison sentence. And if one criminal denies committing the crime but the other confesses, then the criminal who confesses will receive no prison time, but the other will receive a ten-year prison sentence.[29]

In assessing what the players should do, the initial reaction is that the players should cooperate and remain silent. But in determining how an individual player should behave, it is clear that the player should confess regardless of what her partner does.[30] Indeed, if criminal 1 confesses and thereby defects, then criminal 2's best course is to also confess. If criminal 1 remains silent, criminals 2's best course is still to confess, because she would prefer to have no prison time as opposed to a one-year sentence. Defection is the dominant strategy, but if both defect they receive a less desirable outcome.

The Prisoner's Dilemma offers insight into game theory through the lens of a two-person, zero-sum game. But few game theoretic

24. RAND is a think tank that was borne after World War II. *See* NASAR, *supra* note 2, at 106 (describing the creation of RAND). The atomic bomb had played a decisive role in ending the war, and the scientists and mathematicians in the Manhattan Project had earned academics a new-found respect from military leaders. *See id.* The end of the war did not alleviate the need to explore military problems. The resolution of an active global conflict had merely created an inactive one. By 1950, both the US and the Soviet Union had atomic weapons, and RAND scientists explored the game theoretic aspects of nuclear war. *See id.*

25. *See* R. DUNCAN LUCE & HOWARD RAIFFA, GAMES AND DECISIONS 94 (1957) (attributing Prisoner's Dilemma to Tucker).

26. *See* NASAR, *supra* note 2, at 118 ("As Tucker told the story, the police arrest two suspects and question them in separate rooms.").

27. LUCE & RAIFFA, *supra* note 25, at 95.

28. *Id.*

29. *Id.*

30. *See id.* (charting potential outcomes for the prisoners based on their ultimate choices).

situations in the real world align with this model.[31] The typical scenario invariably involves a group of people or institutions who must decide whether to cooperate or defect; most often, each individual is better off defecting, regardless of what the others do. If all defected, however, they would be worse off than if they had cooperated.[32] The Prisoner's Dilemma and similar exercises offered limited utility to the researchers at RAND and similarly fail to provide meaningful insight into most modern, real-world disputes.[33]

Therefore, imagine a derivation of the traditional Prisoner's Dilemma. There is a group of gang members who have been informed that they are about to be arrested for a crime. The prosecutor knows that all suspects have collaborated in perpetuating the crime, but she does not have sufficient evidence to convict them. These individuals understand that the prosecutor is going to bring the group into the police station, separate them, and then make an offer to some—but not all—of the individuals to provide evidence against the others. Assume none are able to access legal counsel and, even if they could, it would not change the decision they must make. We can think of the decision to provide evidence as defecting from the group. The individuals do not know who may receive an offer, but—unlike the Prisoner's

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31. For example, Luce and Raiffa proposed this n-person analogy to the Prisoner's Dilemma:

> [C]onsider the case of many wheat farmers where each farmer has . . . two strategies: 'restricted production' and 'full production.' If all farmers use restricted production the price is high and individually they fare rather well; if all use full production the price is low and individually they fare rather poorly. The strategy of a given farmer, however, does not significantly affect the price level . . . so that regardless of the strategies of the other farmers, he is better off in all circumstances with full production. Thus full production dominates restricted production; yet if each acts rationally they all fare poorly.

Id. at 97.

32. The tragedy of the commons captures a multiplayer dilemma. *See* ELINOR OSTROM, GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION 2 (1990) ("'[T]he tragedy of the commons' has come to symbolize the degradation of the environment to be expected whenever many individuals use a scare resource in common."). Furthermore, as I have previously written:

> The tragedy arises when a group of individuals have ostensibly unfettered privileges to use a scarce resource. No single individual in the group is allowed to exclude another from using the resource, nor can the group coordinate efforts to restrict access to the resource. Each individual benefits directly from consumption and this benefit is greater than the delayed harm stemming from depletion risk, which is distributed evenly among the group. Consequently, the individuals in the group do not internalize all the costs of their conduct. In other words, each individual acting rationally in their own self-interest will create collective action that results in the overconsumption—and, in many cases, the entire depletion—of the scarce resource.

Samir D. Parikh, *The New Mass Torts Bargain*, 91 FORDHAM L. REV. 447, 460 (2022) [hereinafter Parikh, *New Mass Torts*].

33. *See* NASAR, *supra* note 2, at 115–16.

Dilemma—they do know that not all of them can defect. Assume that if none of the suspects defect, then there is a high probability that prosecutor will charge them all with a lesser crime and each suspect will receive a one-year sentence. A suspect's choice to cooperate with the group and refuse to provide evidence to the prosecutor creates positive externality to all other players' welfare. However, if more than one suspect agrees to provide evidence against the others, then the non-defectors will receive a minimum 10-year sentence. One defector is not by herself sufficient to secure convictions against non-defectors. A suspect that defects is eligible to receive probation and the possibility of taking over the territory of any non-defector, but at least one other suspect must defect to allow the defectors to secure this prize.

Unlike the traditional Prisoner's Dilemma, in this modified dilemma, defecting is not always the "rational" choice. Let's assume that a suspect that defects faces a limited risk of retribution if at least two gang members defect and the non-defectors are imprisoned; however, the risk of retribution is material if one gang member defects but others do not and the prosecutor is unable to convict the non-defectors.

One significant wrinkle in this modified version of the game is that the gang members do not know who is going to receive an offer to provide evidence against the others. They simply know that not all will be able to defect. They also understand that more than one defector is necessary for the prosecutor to build her case. In our modified dilemma, the gang members have the opportunity to coordinate and implement some form of cooperation prior to being arrested.

As detailed in Part II below, this modified version of the Prisoner's Dilemma more accurately captures the game-theoretic aspects of how private equity sponsors and their portfolio companies interact with creditor groups in many liability management exercises that ultimately lead to coercive exchanges.

II. WAR

Various actions have coalesced to undermine creditor positions in recent liability management exercises.[34] As Professor Edgeworth noted,[35] these initial actions can best be described as financial war—

34. I detail much of this in my article, *Financial Disequilibrium*. *See* Parikh, *Financial Disequilibrium*, *supra* note 12.

35. *See supra* note 1 and accompanying text.

purely self-interested behavior designed to seize and redistribute value.

A. Liability Management Exercises

Private equity firms invariably acquire target entities through leveraged buyouts, an acquisition model funded by significant debt secured by the assets of the acquired company.[36] Unfortunately, aggressive debt layering places the post-acquisition target in a precarious financial position. These companies are often "balancing on the edge of bankruptcy for many years after the LBO."[37] During the Great Recession, sponsors sought to provide portfolio companies[38] the means to avoid bankruptcy in times of financial distress.

The debt instruments[39] governing lending and investing relationships were the starting point for this ambitious plan. These agreements were historically filled with restrictive covenants that provided lenders and other creditors significant monitoring benefits.[40] However, the turn of the last decade ushered in an extended period of ultra-low interest rates coupled with quantitative easing.[41] These dynamics caused investors to desperately chase high-yield

36. For an explanation of leveraged buyouts, see Parikh, *Saving Fraudulent Transfer Law*, *supra* note 11, at 312–13. As the article explains:

> [In a leveraged buyout,] the buying group creates a shell company strictly for the purpose of the acquisition . . . . The buying group then obtains approximately 60 to 90 percent of the sale price through debt and infuses 10 to 30 percent in the form of equity . . . . At the closing of the sale, the borrowed funds are transferred to the shell . . . . The shell uses these funds to purchase the shares of the target from the shareholders . . . . Within the senior debt tranche, there may be loans of varying terms, maturities, payment schedules, seniorities, and amortization . . . . The target often issues junk bonds to provide additional subordinated financing.

Id.

37. Parikh, *Financial Disequilibrium*, *supra* note 12, at 18. Naturally, bankruptcy poses the risk that the sponsor's equity position will be wiped out.

38. See *supra* note 11 for an explanation of "portfolio company" and associated terms.

39. *See id.* (explaining that these agreements are what memorialize the relationship between the borrower and the lender).

40. *See* Parikh, *Financial Disequilibrium*, *supra* note 12, at 18 (noting that these loan contracts "contained robust maintenance and incurrence covenants that allowed lenders to actively monitor and police borrowers").

41. *See* Anna-Louis Jackson, *Quantitative Easing Explained*, FORBES ADVISOR (Mar. 18, 2023), https://www.forbes.com/advisor/investing/quantitative-easing-qe [https://perma.cc/FQG9-2F8L] ("Quantitative easing—QE for short—is a monetary policy strategy used by central banks like the Federal Reserve. With QE, a central bank purchases securities in an attempt to reduce interest rates, increase the supply of money and drive more lending to consumers and businesses.").

investments.[42] With too many lenders and investors chasing a limited number of deals, sponsors engaged in unprecedented contractual engineering.[43]

Borrowers—in most cases, at the direction of private equity sponsors—demanded debt instruments with few covenants.[44] Further, sponsors relied on the practice called "sponsor-designated counsel" to appoint and pay for the law firms that represented lenders funding their deals.[45] The offer seemed like a perk to lenders but actually served to fray the attorney-client relationship for these parties. Indeed, lender counsel in these cases were in a difficult position because failure to be compliant in negotiations with the borrower could result in that law firm not being appointed in subsequent deals.[46] This helped sponsors enjoy unique influence over negotiations, "[l]oose covenants replaced stringent ones[,] and many covenants disappeared entirely."[47] Further, sponsors redrafted contractual provisions that had historically served to constrain borrower conduct and "imbued them with ambiguity and vagaries that created loopholes and trapdoors."[48]

Without robust covenants, creditors did not have the monitoring powers and ability to police conduct in the ways they once did.[49] And

42. *See* MAX FRUMES & SUJEET INDAP, THE CAESARS PALACE COUP 34 (2021) ("Debt investors were hungry for high-yielding loans and bonds in the mid-2000s. [It was a] seller's market . . . .").

43. *See* Parikh, *Financial Disequilibrium*, *supra* note 12, at 4, 21 ("Blurry-eyed investing allowed sponsors to undertake unprecedented contractual planning. Borrowers . . . were able to demand debt instruments that left investors with few legal protections.").

44. *See id.* ("This seller's market meant that the contracts under which Harrah's debt was going to be sold would contain few restrictions . . . .").

45. *See* Silas Brown, Will Louch & Laura Benitez, *The Powerful City Lawyer at the Center of a Private Equity Storm*, BLOOMBERG (Feb. 16, 2023), https://www.bloomberg.com/news/articles/2023-02-16/the-powerful-city-lawyer-at-the-center-of-a-private-equity-storm [https://perma.cc/E3TV-KUH9] ("The widely-used designated counsel arrangement] allows private equity firms, guided by their lawyers, to appoint and pay for the law firms that represent the lenders funding their deals.").

46. *See id.* ("Being on the wrong side of [the borrower] can result in law firms being frozen out of future deals . . . . 'It is very difficult to feel you have independence when the other firm sitting across the table may have played a role in getting you your job . . . .'").

47. Parikh, *Financial Disequilibrium*, *supra* note 12, at 21; *see also* Daniel B. Kamensky, *The Rise of the Sponsor-in-Possession and Implications for Sponsor (Mis)behavior*, 171 U. PA L. REV. ONLINE (forthcoming 2023) (on file with author).

48. Parikh, *Financial Disequilibrium*, *supra* note 12, at 23.

49. *See id.* at 22 ("Creditors lack the means to effectively monitor the borrower. The opportunity for creditor intervention is limited . . . ."). *But see* Frederick Tung, *Do Lenders Still Monitor? Leveraged Lending and the Search for Covenants*, 47 J. CORP. L. 153, 156, 157 (2021) (arguing that "lending practices have evolved" to address concerns that "covenant-lite" debt relationships will reduce monitoring).

without meaningful oversight, borrowers enjoyed a first-mover advantage to exploit the ambiguous provisions that sponsors had planted.

War began in earnest around 2015 as distress forced companies to start executing the emergency plans they had created years before.[50] One of the primary maneuvers is the "dropdown" transaction. The dropdown can be described as a series of transfers undertaken by a borrower based on an unorthodox interpretation of governing debt instruments designed to move assets out of lenders' collateral basket to an unrestricted subsidiary. As seen in Figure 1 below, a borrower would invoke the seemingly harmless "investment" provision that appears in many term loan agreements and other debt instruments[51] to execute a multi-stage transfer of assets and funds out of a restricted subsidiary to an unrestricted subsidiary not subject to covenant or term loan obligations. Once complete, these now unencumbered assets can be used to secure additional capital or address existing debt obligations.

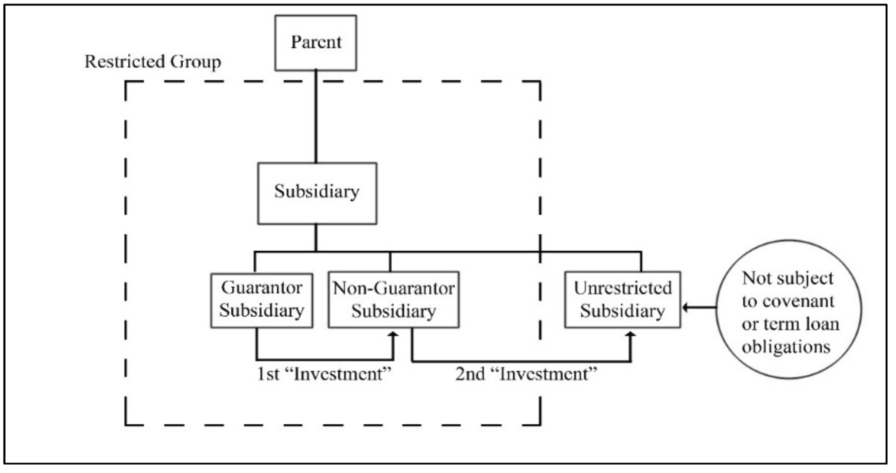

Figure 1. A "dropdown" transaction.

The controversial J.Crew dispute offers an example. In that case, the borrower invoked the ambiguous "investment" provision that

50. *See* Parikh, *Financial Disequilibrium*, *supra* note 12, at 26–28 (describing the 2015 coercive exchange by iHeart Media).

51. *See* Ayotte & Scully, *supra* note 20, at 369 (explaining that this provision was intended to serve the limited purpose of enabling a borrower "to invest in overseas businesses while shielding them from U.S. taxation").

appeared in its term loan agreements.[52] J.Crew construed the provision to allow a restricted subsidiary to make an investment up to $150 million in another corporate affiliate as long as the transferor was not a party to the term loan.[53] This construction became weaponized when it was coupled with another provision in the term loan agreement that seemingly authorized a restricted subsidiary not subject to the term loan to make an investment in an unrestricted subsidiary.[54] J.Crew believed that this second provision allowed it to make a separate transfer of up to $100 million.[55]

To effectuate the dropdown, J.Crew transferred a subset of its trademarks valued at $250 million—which was the applicable cap based on its reading of the debt instruments—to a restricted subsidiary that was not a party to the term loan agreement.[56] The next step was to have this entity transfer the trademarks to a newly formed unrestricted subsidiary.[57] Assets held by unrestricted subsidiaries are not subject to the covenants and debt obligations that bind restricted subsidiaries.[58] The transfer to a subsidiary outside the credit group resulted in the automatic release of all liens on the trademarks. As a result, J.Crew had arguably turned the trademarks into an unencumbered asset that could be used to secure additional capital or help restructure existing

52. *See* Parikh, *Financial Disequilibrium*, *supra* note 12, at 29 ("The company's term loan agreement permitted a convoluted, multi-stage process by which assets could be moved out of the term lenders' collateral package.").

53. Ayotte & Scully, *supra* note 20, at 369.

54. *See id.* at 368–69 ("[The Term Loan Agreement] specifically permitted 'Investments made by any Restricted Subsidiary that is not a Loan Party to the extent to such Investments are financed with the proceeds received by such Restricted Subsidiary from an Investment in such Restricted Subsidiary . . . .'").

55. *See id.* at 369 (explaining that J.Crew determined that a restricted subsidiary not subject to the agreement was able to make investments in an unrestricted subsidiary as long as the investments were financed with proceeds received by the restricted subsidiary from an investment in such entity).

56. *See* Complaint at 19, Eaton Vance Mgmt. v. Wilmington Sav. Fund Soc'y, No. 654397/2017, 19 (N.Y. Sup. Ct. 2017).

57. *See id.*

58. *See* Ayotte & Scully, *supra* note 20, at 369 ("J. Crew transferred ('invested') the trademarks into a newly formed unrestricted subsidiary, freeing them from both the covenants and the debt obligations.").

debt obligations.[59] This transfer was naturally terrible for lenders whose collateral package had been significantly depleted.[60]

"Uptiering" is perhaps a more aggressive coercive measure. In an "uptier" transaction a group of creditors provide additional financing in exchange for a super-priority position achieved by altering the original term loan. The two key aspects of the maneuver are (1) securing a majority of lenders who can then vote to amend the applicable debt instruments to subordinate the liens and/or claims of existing lenders, often described as "exit consents"; and (2) the borrower allowing the majority lenders to exchange their existing debt for new debt not subject to the onerous new subordination.[61] Figure 2 below presents a graphical representation of a typical uptier transaction.

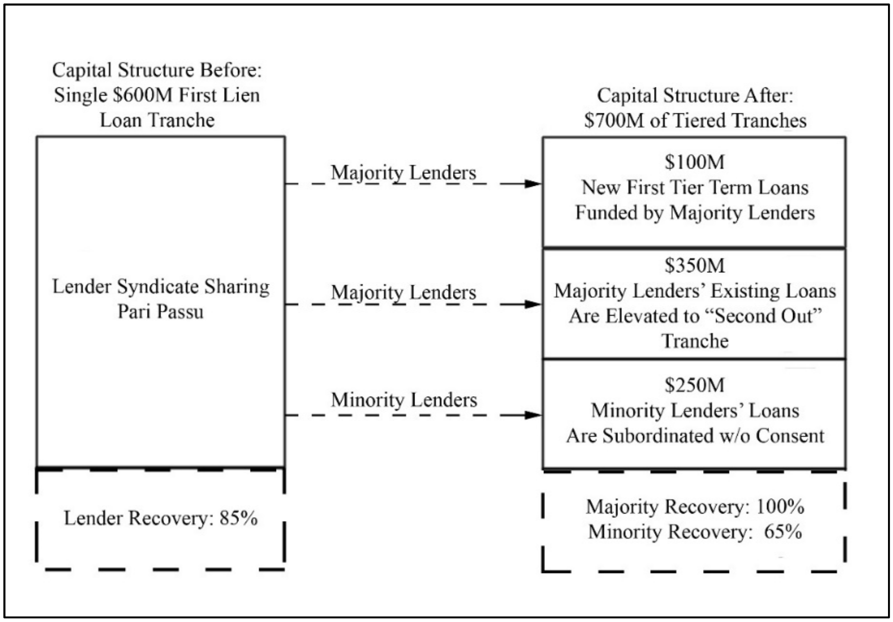

Figure 2. An "uptier" transaction.

59. *See id.* at 368 ("[I]ts term-loan documents permitted it to move $250 million in trademark collateral to a new subsidiary for the benefit of refinancing the PIK notes.").

60. *See id.* at 369 (noting that, while a company's restricted-subsidiary status protects lenders by subjecting them "to the covenants in the loan documents," J.Crew's transfer "formed [an] unrestricted subsidiary, freeing them from both the covenants and the debt obligations").

61. *See, e.g.*, Decision + Order on Motion at 4, N. Star Debt Holdings, L.P. v. Serta Simmons Bedding, LLC, 2020 N.Y. Slip. Op. 31954(U) (N.Y. Sup. Ct. 2020) (No. 652243/2020).

The Trimark dispute offers an example. In that case, Trimark and its private equity sponsor worked with lenders that held a majority of the borrower's debt.[62] The majority group agreed to various "exit consents" and would ultimately vote to alter key provisions in the credit agreement, including pushing out the repayment schedule, subordinating the collateral position of the group, eliminating covenants, and broadening the scope of the "no-action" clause.[63] The majority only agreed to these alterations because once the changes took effect, the borrower issued new "first out" debt to the majority lenders secured by the collateral that had secured the original debt. This act provided this group with a super-priority position.[64] The borrower then issued "second out" debt to the majority lenders in a dollar-for-dollar exchange for the debt they originally held, allowing the lenders to exit their current position and no longer be subject to the terrible terms the group had approved.[65] The majority lenders' original debt was then retired, and the "no-action" clause restricted the minority lenders from bringing a suit contesting the maneuvers.[66] In effect, the majority had eviscerated the lender groups' financial position before exiting the group and foreclosing any attempt by the minority lenders to address this behavior through litigation.

In the last few years, borrowers have become more aggressive by layering coercive measures and soliciting defectors in order to seize value from creditors and redistribute it to the company, its private equity sponsor, and a subset of creditors who had defected to effectuate the attack.[67]

62. *See* Plaintiffs' Consolidated Opposition to Defendants' Motion to Dismiss at 6, Audax Credit Opportunities Offshore Ltd. v. TMK Hawk Parent, Corp., No. 565123/202, 2021 WL 4706582, at *21 (N.Y. Sup. Apr. 6, 2021) [hereinafter Audax Plaintiff's Opposition] ("Centerbridge and Blackstone acquired 59.8% and 26.8% equity interests, respectively, in TriMark . . . in a leveraged buyout financed by [a loan] issued to TriMark by several large financial institutions.").

63. *See* Parikh, *Financial Disequilibrium*, *supra* note 12, at 30–31 (explaining that a "no-action" clause can eviscerate lender rights by allowing only the administrative agent to bring suit for any potential claims based on harm to the lender consortium).

64. Audax Plaintiff's Opposition, *supra* note 62, at 12.

65. *See id.* ("Defendant Lenders instantly benefit[ted] by increasing the value of their loans in this exchange . . . .").

66. *See id.* at 14 ("Defendants purportedly rewrote narrow constraints on the First Lien Lenders' ability to sue directly to cover every conceivable cause of action . . . ."). Naturally, there are various derivations of an uptier transaction.

67. *See* Parikh, *Financial Disequilibrium*, *supra* note 12, at 24–25 ("coupled with equity sponsors' new aggression . . ."); *see* Kamensky, *supra* note 47, at 1 ("These case studies show how the unchecked incentives of private equity sponsors have resulted in increasingly aggressive

B. The PetSmart Supergame

The PetSmart restructuring is just one of many coercive exchanges that have taken place since 2015.[68] The dispute captures many of the material aspects of the modified multiplayer prisoner's dilemma described in Part I.

In 2018, PetSmart was drowning in debt from an $8.5 billion leveraged buyout[69] coordinated by its private equity sponsor, BC Partners, and a $3 billion acquisition of Chewy.com.[70] A bankruptcy filing could have wiped out BC Partners' equity investment and represented an entirely unacceptable outcome just three years after the acquisition. The PetSmart board decided to get aggressive.[71]

PetSmart construed its term loan agreement (the "PetSmart Term Loan Agreement") to allow the borrower to make various "restricted payments" to affiliated entities.[72] More specifically, the loan agreement arguably allowed PetSmart to make payments up to the sum of $200 million plus any funds that could be categorized as "Available Equity Amount"—a term that included capital contributions received by PetSmart after the closing of the PetSmart Term Loan Agreement.[73] PetSmart asserted that it could distribute up to $1.2 billion because it had received $1 billion in capital contributions in connection with its acquisition of Chewy.com.[74] PetSmart executed a dropdown by relying on the "investment" exception that appeared in its credit agreement. PetSmart formed a new, wholly owned unrestricted subsidiary and then—based on a questionable interpretation of the credit

tactics . . ."). However, the practice appears to be limited to the United States. *See* Giulia Morpurgo, *Europe Too "Polite" for Firms To Stir Creditor-on-Creditor Chaos*, BLOOMBERG L. (May 9, 2023, 6:50 AM), https://news.bloomberglaw.com/bankruptcy-law/europe-too-polite-for-firms-to-stir-creditor-on-creditor -chaos [https://perma.cc/V4HH-QJST] ("[C]reditor-on-creditor violence . . . [is] running into resistance in Europe.").

68. *See generally* Parikh, *Financial Disequilibrium*, *supra* note 12 (providing case studies for six different coercive exchanges).

69. A leveraged buyout is an acquisition financed with a significant amount of debt secured by the assets of the acquired company. Parikh, *Saving Fraudulent Transfer Law*, *supra* note 11, at 311.

70. Counterclaims, Answer, and Affirmative Defenses at 10–11, Argos Holdings, Inc. and PetSmart, Inc. v. Wilmington Trust, Nat'l Ass'n, (No. 18-cv-5773), (S.D.N.Y. Sept. 6, 2018), 2019 WL 1397150 [hereinafter "PetSmart Answer"].

71. *See* Parikh, *Financial Disequilibrium*, *supra* note 12, at 22–24 (detailing PetSmart's coercive maneuvers and the purported legal bases for them).

72. Complaint at 15, Argos Holdings, Inc. v. Wilmington Trust, Nat'l Ass'n, (No. 18-cv-5773), (S.D.N.Y. June 26, 2018), 2019 WL 1397150.

73. *Id.*

74. *Id.* at 2, 15–16.

agreement—transferred Chewy.com stock valued at over $900 million to the unrestricted subsidiary controlled by BC Partners.[75] The administrative agent charged with managing the lending relationship on behalf of the consortium disputed the validity of these actions.[76] PetSmart sought declaratory relief and loan holders argued that the maneuvers breached key contract provision.

With litigation pending, Chewy.com began experiencing strong performance. By 2018, it had $3.5 billion in revenue, up from less than $500 million just three years earlier.[77] Chewy.com's prosperity—which I argue arose despite the coercive exchange, not because of it—raised the possibility of taking the company public. But Chewy could not be taken public with lingering questions regarding the transfers of company stock.[78] BC Partners needed to bring an end to the dispute.

BC Partners offered loan holders the opportunity to improve their current position, receiving (i) a small consent fee, (ii) an increased interest rate on its debt, and (iii) a commitment from the company to aggressively reduce the outstanding balance owed.[79] The catch was that if BC Partners was able to secure a majority of the loan group, it would have that group vote[80] to cease the pending litigation, meaning that those outside of the majority could not resort to the courts to seek legal redress for the coercive maneuvers. Further, not all loan holders could accept the offer.[81] PetSmart promised to withdraw the offer once a majority of holders had accepted and could vote to halt all litigation.[82]

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75. *See* PetSmart Answer, *supra* note 70, at 15. PetSmart ultimately issued a dividend to BC Partners in the form of 20 percent of Chewy stock, which PetSmart valued at $908.5 million, *see id.*, and it is unclear if the term loan agreement contemplated a "restricted payment" being in a form other than cash. Once again, ambiguity in the agreement—which I argue was by design—benefitted the equity sponsor.

76. *See id.* at 12 ("[A]dvisors for PetSmart had three calls with the Agent's advisors . . . [to] explain how the Transactions are permitted under the Credit Agreement.").

77. Sujeet Indap, Opinion, *Pet Supplies IPO Follows Dog-Eat-Dog Battle for Debtholders*, FIN. TIMES (May 6, 2019), https://on.ft.com/44txhry [https://perma.cc/Q9DT-AJ7Q] ("Chewy itself was prospering . . . . In 2018, its revenues reached $3.5 [billion], eight times higher than in 2015 . . . . But there could be no listing of Chewy with litigation over its ownership outstanding.").

78. *See id.* ("But there could be no listing of Chewy with litigation over its ownership outstanding.").

79. *See id.*

80. BC Partners needed approval of only lenders holding more than 50 percent of the outstanding loan amount in order to terminate the litigation. *See* Katherine Doherty, *PetSmart Offers Loan Amendment To Quash Asset Dispute*, BLOOMBERG (Mar. 25, 2019, 12:50 PM), https://www.bloomberg.com/news/articles/2019-03-25/petsmart-is-said-to-offer-loan-amendment-to-quash-asset-dispute [https://perma.cc/PLT7-QNY7].

81. *See* Indap, *supra* note 77.

82. *Id.*

BC Partners' exploding offer was open for 24 hours or until a majority was secured. An individual loan holder faced four outcomes: 1) defect before BC Partners secured a majority and receive an incrementally improved position, 2) defect and watch BC Partners fail to secure the necessary majority; 3) cooperate with the group and hopefully thwart BC Partners' plan—without a majority, BC Partners would be forced to consider settlement or continue with the litigation that could very well lead to a finding that PetSmart's actions breached key terms—and 4) cooperate with the group only to watch BC Partners secure enough defections to end the litigation; in this scenario, the cooperating group would be in a significantly worse position.[83]

Disfavored loan holders were communicating with each other throughout this process and were able to reach an informal agreement that none would accept BC Partner's offer. There were many reasons for loan holders to reach an informal agreement, including the idea of avoiding temporal traps—instances where short-term interests (for example, protecting one investment) can conflict with long-term interests (for example, preventing this type of exploitation in subsequent deals).[84]

Creditors in these positions can be described as players in an iterated prisoner's dilemma. In other words, gains are not static; if creditors keep defecting in these situations, the payoffs will decrease over time, all other things being equal.[85] There are many restructuring cases like this one, and PetSmart can be seen as one of many rounds of negotiation. A defection may create a premium in one case, but could be seen as a tacit approval of coercive measures—meaning that the offer in the next game may be decidedly worse. If a loan holder defected but no other loan holders did so, BC Partners would not have the necessary majority and the defecting loan holder could face retaliation. Further, repeat players create reputations and a player with a reputation for defecting may not be included in future alliances, membership to which may be necessary to capture a premium in a

83. Unlike the traditional two-player game, the harm caused by a creditor defection in PetSmart is distributed across a group of sophisticated parties. This could have the psychological effect of encouraging defection.

84. *See* HAROLD H. KELLEY, JOHN G. HOLMES, NORBERT L. KERR, HARRY T. REIS, CARYL E. RUSBULT & PAUL A.M. VAN LANGE, AN ATLAS OF INTERPERSONAL SITUATIONS 418 (2003).

85. *See* MICHAEL TAYLOR, THE POSSIBILITY OF COOPERATION 107 (1987) (describing how, in reality as opposed to the Prisoners' Dilemma supergame, repetitive exploitive choices may lead to decreasing payoffs).

subsequent case.[86] This threat may be sufficient to motivate a creditor to select cooperation.

The loan holder group informed PetSmart that none of them would defect and accept the offer. This announcement was intended to bind the group, but there was no binding agreement actually preventing defection. Unfortunately, once BC Partners made its offer, the disfavored loan holders did not have sufficient time to comprehensively coordinate their efforts.

The lack of a binding agreement proved to be fatal. At the eleventh hour, just hours before the expiration of the 24-hour response window, Apollo accepted the offer and defected.[87] As word of this defection spread, other loan holders attempted to follow suit.[88] Apollo's defection instigated other defections. True to its word, PetSmart withdrew the offer once it had secured a majority of the loan debt.[89] The defector group voted to dismiss the litigation shortly thereafter, which they were entitled to do under the governing documents.[90] The remaining loan holders were left in a woefully compromised position with ostensibly no recourse.

Below is a way to look at the game from a loan holder viewpoint:

86. Akira Okada, *The Possibility of Cooperation in an N-Person Prisoners' Dilemma with Institutional Arrangements*, 77 PUB. CHOICE, no. 3, 1993, at 630 (explaining that "[t]he mechanism of attaining cooperation is the mutual punishment that every individual incorporates into his behavior plan (strategy) in the repeated prisoners' dilemma game. If the defection by some individual is monitored, then all other individuals punish him by selecting defection during sufficiently many future repetitions of the game."); *see also* Max Frumes, *Special Situations Insight: The Subtle Art of the Cooperation Agreement*, LEVFIN INSIGHTS, Mar. 9, 2023 [hereinafter Frumes, *Subtle Art of the Cooperation Agreement*] (on file with author) (explaining potential consequences to free riders).

87. *See* Indap, *supra* note 77.

88. *See id.* ("Immediately a mad rush of hedge funds stampeded to get their consents in, some not even reading the precise terms of what they were agreeing to.").

89. *See id.* (noting that PetSmart used "some very sharp sticks" to persuade debtholders to abandon litigation).

90. *See id.* (observing that the threat of litigation had been "apparently removed").

	Alternative 1: If some defect but not enough to secure a majority	Alternative 2: If some defect and it is enough to secure a majority	Alternative 3: If all attempt to defect	Alternative 4: If none defect
Loan Holders' Preference	Cooperation over Defection	Defection over Cooperation	Defection over Cooperation	Cooperation over Defection

Table 1. The prisoner's dilemma from a loan holder's point of view.

More succinctly, the preference can be characterized as defection over cooperation where the defectors are able to create a majority group and cooperation over defection where the defectors—if any—are unable to create a majority group. There was no institution that bound the loan holders' decision in this case. I argue that defection is not the "rational" choice in all situations, and we can assume that individual loan holders preferred universal cooperation to attempted universal defection. A loan holder's gain or loss in this situation was dictated by her own strategy in the game and by the number of other loan holders who chose to cooperate. Therefore, those seriously considering defection were actually incentivized to coordinate with each other.

The PetSmart dispute crystallized the allure of defection in a multiplayer game. The loan holders that cooperated with the creditor group and did not work with the borrower were ultimately forced to accept the borrower's unique interpretation of the PetSmart Term Loan Agreement. Further, they did not receive the fees and other sweeteners that the defectors received. As the victor, BC Partners and its portfolio company were entitled to the spoils. But acts of war rarely go unaddressed.

III. CONTRACT

The previous Part detailed the reasons that private equity enjoys unique bargaining leverage and how this leverage produces radical outcomes in various distressed situations, including the PetSmart dispute. Creditors have attempted some incremental steps to limit the possibility of these types of outcomes in the future.[91] This Part explores

91. *See generally* Vincent S.J. Buccola & Greg Nini, *The Loan Market Response to Dropdown and Uptier Transactions* (forthcoming 2023), https://papers.ssrn.com/abstract=4143928

how creditors have begun relying on cooperation agreements to defuse liability management exercises. But despite the value of these agreements, various obstacles exist to coordination.

A. *The Current State of Play*

The obvious starting point for creditors seeking to counteract liability management exercises is to revise key provisions in debt instruments. This process is already underway and is easier to effectuate because borrowers have far less negotiating power in the current interest-rate environment. In a new paper, Professors Buccola and Nini explain that, based on a robust sample of more than 600 syndicated term loan contracts: (i) the number of contracts that ostensibly eliminate uptiering in its current form nearly doubled in the year after the practice became popularized in the dispute involving Serta Simmons and its creditors; and (ii) beginning in 2020, so-called "dropdown blockers" became prevalent restricting the dropdown of intellectual property.[92] Facilitating these changes and others like them is the fact that creditors have begun eliminating the practice of sponsor-designated counsel and avoiding law firms that had perhaps been too compliant to borrower demands in previous negotiations.[93] New dynamics and the current credit environment will invariably lead to more robust covenants and monitoring options, which should limit borrowers' first-mover advantage.[94]

Creditors may also respond by being more aggressive in identifying and attempting to hold parties responsible for financial malfeasance. For example, in the last decade, officers and directors of portfolio companies have relied on questionable valuations to transfer

[https://perma.cc/JXX6-N39X] (discussing some of the ways in which creditors block "dropdowns" and "uptiers.").

92. *See id.* at 1, 6 ("In the year following the Serta transaction, the frequency of loans that block uptiers increased from about 40% to about 75% . . . . [W]e do find evidence that contracts entered since 2020 have become more likely to prohibit the dropping down of intellectual property . . . assets specifically.").

93. *See* Silas Brown, Will Louch & Laura Benitez, *The Powerful City Lawyer at the Center of a Private Equity Storm*, BLOOMBERG L. (Feb. 16, 2023, 12:00 AM) https://news.bloomberglaw.com/bankruptcy-law/the-powerful-city-lawyer-at-the-center-of-a-private-equity-storm [perma.cc/E3TV-KUH9] ("[R]ecent moves by creditors to hire their own counsel and actively avoid working with certain law firms . . . .").

94. I have also argued for legal changes. I have argued that creditors should be entitled to bring direct breach of fiduciary duty claims against directors and officers of insolvent firm who orchestrate these maneuvers and target creditors to whom fiduciary duties are owed. *See* Parikh, *Financial Disequilibrium*, *supra* note 12, at 46–47.

assets for less than reasonably equivalent value in an attempt to protect the financial interests of their private equity sponsor.[95] In the Caesars Entertainment bankruptcy case, the examiner found a basis for intentional fraudulent transfer claims against various directors and officers.[96] Creditors willing to pursue these claims have significant leverage, because many D&O insurance policies do not cover damages stemming from fraudulent or constructively fraudulent conduct; in other words, if liability is found, the wrongdoer's personal assets can be used to satisfy a judgment.[97] Further, the reputational harm to an individual found to have committed fraud cannot be overlooked.

No one expected creditors to sit idle in the midst of financial war. But none of the steps outlined above help creditors subject to existing debt instruments with sponsor-favorable terms. How do creditors improve outcomes in these scenarios?

B. Cooperation

Contract follows initial acts of war. Indeed, cooperation is often necessary for creditors to prevent coercive measures in the private equity multiplayer prisoner's dilemma.[98] And, as outlined above, a creditor's choice to cooperate creates positive externality to all other players' welfare. Bankruptcy addresses the fact that coordination costs often times prevent creditors from collaborating and formulating an orderly restructuring process outside of court. In liability management exercises, sponsors rely on these obstacles in order to press their advantage. Creditors have various means of striking back, including attempting to modify debt instruments to bolster monitoring and

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95. *See* FRUMES & INDAP, *supra* note 42, at 83 ("Shawn Tumulty . . . wrote an email to the Caesars investor relations account, writing, 'Several of the recent asset sales have taken place at EXTREMELY questionable valuations . . . ."). The same authors note that:

> Evercore's final fairness opinion used financial projections that were nearly a year old. Evercore had then failed to account for [new, significant] cash flows in an attempt to quickly close the deal. . . .Perella Weinberg had twisted itself into a pretzel to sign off on the transfer out of OpCo of the Linq and Octavius Tower for peanuts. And in the Four Properties sale, Centerview had used the downwardly revised projections in its analysis to complete the deal at a cheap valuation.

Id. at 232.

96. *See id.* at 228–29.

97. *See id.*; *see also* Abraham Gross & Daniel Tay, *Fox's Dominion Settlement Exposes Coverage Risks*, LAW360 (April 19, 2023, 10:53 PM) https://www.law360.com/insurance-authority/articles/1599103/fox-s-dominion-settlement-exposes-coverage-risks [https://perma.cc/6F7D-B3DU] (explaining that dishonest acts are often excluded from coverage under D&O policies).

98. *See* Okada, *supra* note 86, at 630 ("One of the important problems of the prisoners' dilemma is whether or not and how individuals can achieve cooperation.").

eliminate trapdoors and loopholes, but these steps fail to mitigate the risk of coercive measures based on debt instruments that are already in the market.

1. *The Cooperation Agreement's Value Add*.[99] Cooperation agreements were likely first introduced in the 1990s, but have been used sparingly since the turn of the century.[100] The last two years have seen a rejuvenation.[101] Cooperation agreements have been signed in distress situations involving BrandSafway, Caesars Entertainment, Carvana, Mitel, Rackspace Technologies, and Travelport.[102] Various market factors have played a role in this renewed prominence, including "unhedged [corporate] floating-rate debt in" a rapidly "rising-interest-rate environment."[103] But sponsor-backed firms' aggressive use of coercive measures is the primary driver.

As explored in Part II.B, the primary starting point in evaluating the utility of a cooperation agreement is assessment by disfavored creditors—or those who believe they will soon become disfavored—whether their potential outcomes improve by engaging in collective decision making.[104] Coalitions come about in unique ways. In some

99. In January and March 2023, the author interviewed separately five preeminent creditor attorneys to understand the intricacies of these private agreements. Additionally, the author personally reviewed three private cooperation agreements. *See* Telephone Interview with Creditor Attorney 1 (Jan. 12, 2023) (on file with author); Telephone Interview with Creditor Attorney 2 (Mar. 31, 2023) (on file with author); Telephone Interview with Creditor Attorney 3 (Mar. 30, 2023) (on file with author); Telephone Interview with Creditor Attorney 4 (Mar. 30, 2023) (on file with author); Private Cooperation Agreements (on file with author).

100. *See* Interview with Creditor Attorney 2, *supra* note 99.

101. *See* Frumes, *Subtle Art of the Cooperation Agreement*, *supra* note 86 ("While the earliest co-op agreement goes back decades, their use has exploded over the past two years . . . .").

102. *See id.* (listing "notable co-op agreements" that have occurred in distress situations in recent years).

103. *Id.*

104. Most of the affected institutions are CLO funds, special purpose vehicles that primarily invest in syndicated loans. A recent article explains CLOs:

> CLOs repackage corporate loans into securities of varying risk and size that are then sold to other investors. Historically about 90% of new CLOs each year buy debt from larger companies in the form of leveraged loans . . . . [T]ypical CLO managers buy debt from the liquid leveraged loan market, where the loans can be underwritten by Wall Street banks and then sold to a large group of institutional investors . . . .

Carmen Arroyo, Paula Seligson & Lisa Lee, *Private Credit Is So Big That It's Changing Part of CLO Market*, BLOOMBERG (July 6, 2023), https://www.bloomberg.com/news/articles/2023-07-06/private-credit-is-so-big-that-it-s-changing-part-of-clo-market [https://perma.cc/YA3Y-HP64]. Another problem for CLOs is that they cannot participate in many forms of LMEs due to the structure of the fund. For example, they are often restricted from providing direct liquidity to a borrower or DIP financing if a borrower accesses bankruptcy.

cases, a law firm may identify a borrower that is experiencing financial distress and determine that its debt instruments allow one coercive measure or another.[105] This law firm will reach out to affected creditors and attempt to organize the group to fend off an attack.[106] In other cases, affected creditors themselves may sense war[107] and engage counsel to review the applicable credit agreements and determine the need for a coordinated response.[108]

Once a group is formed, it must consider enforcement mechanisms to ensure cooperation. In some cases, the coordination occurs in advance of any coercive measures being implemented. In others, acts of war may have already occurred and litigation against the borrower is pending. In this latter scenario, members of an organized group can begin negotiating with each other and formulating the best form cooperation can take to resist borrower initiatives for defection. A particularly cohesive group with long-standing relationships may eschew a formal agreement and rely on general points of understanding.[109] However, in most current cases, a cooperation agreement of some sort will be executed.[110] After an agreement restricting defection is signed, creditors then play the game hoping that their cooperation and pending litigation put pressure on the borrower. Counsel for the group must worry about possible defections and how they will be policed.

Cooperation agreements provide three predominant benefits. Primarily, the agreement warns the borrower that implementing coercive measures may prove extremely difficult.[111] As explored in depth in Part III.B.2, *infra*, the agreements I reviewed had robust covenants and aggressive enforcement provisions. A creditor that signs the agreement may have to relinquish its defection option for the term the agreement is in effect. Further, the agreement—which is invariably publicized once signed—sends a strong signal of solidarity to the

105. *See* Interview with Creditor Attorney 3, *supra* note 99.

106. *Id.*

107. Some sponsors—notably Apollo—have demonstrated a willingness to initiate coercive measures. Interview with Creditor Attorney 4, *supra* note 99.

108. *Id.*

109. Economists have found that cooperation is more likely in a small, cohesive group than in a large one. *See, e.g.*, Okada, *supra* note 86, at 632.

110. *See* Interview with Creditor Attorney 4, *supra* note 99.

111. A well-drafted and timely cooperation agreement would be extremely helpful in thwarting many types of liability management exercises, including the PetSmart maneuver. *See infra* Part II.B.

borrower. A united front severely limits borrower options. A cooperation agreement entered into in advance of liability management exercises is particularly valuable. In cases where war is declared before creditors can mobilize, a borrower in need of additional defectors must approach individual creditors with some sort of enticement in order to secure defection. A determined borrower will move methodically through the creditor ranks, seeking defectors and hoping to preclude a blocking position.[112] The cooperation agreement attempts to address this behavior.

The agreement can also provide cover in cases where private equity sponsors attempt to use relational leverage to force settlement. Key executives of disfavored creditors may be inclined to cooperate with the group even without a cooperation agreement, but as stakes rise, other decision makers may intervene. Large private equity sponsors enjoy unique relationships in the industry. As the originators of various investment opportunities, sponsors have the power to exclude potential investors from lucrative deals.[113] We saw this in the Caesars' restructuring. In that case, Apollo—the private equity sponsor in that dispute—encountered difficulty securing the defections it needed to consummate its out-of-court restructuring.[114] The firm's founders began calling owners of the holdout creditors.[115] Marc Rowan and Leon Black called the founders of Oaktree Capital, bypassing Ken Liang who was tasked with overseeing the firm's position. Initial

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112. *See* FRUMES & INDAP, *supra* note 42, at 253 (explaining that, while "the group was cohesive and aligned on strategy and tactics," it was not "a majority, and so the group needed to be sure that there were enough other holders of second-lien bonds who were on their side. Apollo knew the math, too, and were experts at picking off hedge funds here and there to sign on to their settlement.").

113. Frumes and Indap paint a vivid example of such exclusion:

> Executives at Apollo, the equity sponsor of the debtors in the Caesars bankruptcy case,] made calls to [key executives at Oaktree, a creditor in the case who was standing in the way of a settlement Apollo sought.] Apollo ominously reminded them that Oaktree and [other key creditors in the case] depended on deal flow from Apollo that they could be excluded from in the future.

See id. at 122. *Id.* at 71 ("Apollo was a big, powerful institution . . . . And while investment banks had a job to do, they were aware that crossing powerful private equity firms could be expensive in the long run."). CLOs are frequently the investors affected by liability management exercises. *See supra* note 104. In my conversations with prominent attorneys in this space, many noted that CLOs are investors dependent on the debt issued in the deals organized by private equity sponsors. The fear of future retribution for past dealings makes CLOs particularly vulnerable to relational leverage. *See* Interview with Creditor Attorney 3, *supra* note 99.

114. *See* FRUMES & INDAP, *supra* note 42, at 122 (noting that Oaktree, in a meeting with Apollo, signaled "that they were willing to fight" restructuring).

115. *See id.*

cajoling led to an ominous reminder: Oaktree "depended on deal flow from Apollo" and "could be excluded from" future deals.[116] This pressure was enough to force at least one creditor, Canyon Partners, to defect.[117] Signing a binding cooperation agreement may be a way to defuse these types of interventions, especially in situations where the maturity of the paper is less than a year away.[118]

Finally, in certain unique circumstances, a well-drafted cooperation agreement can tighten loose terms in the original credit documents and build back in covenants that were originally excluded.[119] These new provisions could alter simple majority voting schemes found in the original debt instruments and address other suboptimal provisions. For example, the original credit agreement may allow for modification of key rights by a majority vote of debtholders. A cooperation agreement signed by a supermajority of debtholders could impose a provision that restricts such a modification without unanimous consent of the group.[120] This new agreement would ostensibly amend the original permissive term. Further, a cooperation agreement can restrict signatories from voting their debt in certain specific ways that could distort pro-rata distribution—a restriction that may not necessarily appear in a document with sponsor-favorable terms.

2. *Customary Terms And Practical Limitations*. I have had the opportunity to review three recent, private cooperation agreements and discuss general provisions with leading practitioners to gain insight into the prevalent terms and basic structure of these documents.[121] These agreements are intended to be succinct and targeted.[122] And

116. *Id.*; *see also* Parikh, *Financial Disequilibrium*, *supra* note 12, at 20 (describing how sponsors use relational leverage to gain concessions).

117. *See* FRUMES & INDAP, *supra* note 42, at 134 ("And while Canyon had been talking tough in the spring and early summer about taking the fight to Apollo, they'd lost their stomach for a fight . . . . Their relationship with the Apollo co-founders went back [years] and it would be an ugly fight with people they considered friends."). In addition to hedge funds, private equity sponsors enjoy relational leverage with CLO funds and other institutions that purchase syndicated and leveraged loans.

118. *See* Interview with Creditor Attorney 3, *supra* note 99.

119. Interview with Creditor Attorney 3, *supra* note 99; Interview with Creditor Attorney 4, *supra* note 99.

120. Interview with Creditor Attorney 3, *supra* note 99.

121. Private Cooperation Agreements, *supra* note 99.

122. The risk with agreements with limited provisions is that brevity could create the same possibility for opportunistic behavior that existed in the original credit documents. More specifically, group members could theoretically defect after realizing that the decision of staying

though each agreement must be bespoke to address case idiosyncrasies, there are some prominent provisions worth noting.

The agreements to which I was privy had robust restrictions on those creditors ("Cooperating Creditors") who held debt subject to the cooperation agreement. Negative covenants mandated that group members refrain from selling, transferring, pledging, or disposing of any part of their position unless the transferee agreed to sign a joinder agreement and become subject to all aspects of the cooperation agreement (a "Debt Transfer"). Failure of a transferee to timely sign the Joinder Agreement would render the transfer void *ab initio*. And the agreements went further by attempting to address dissension within the ranks. Cooperating Creditors were restricted from taking or encouraging any action that could be materially inconsistent with the applicable cooperation agreement or whose object was to delay, impede, or otherwise interfere with the consummation of the agreement. And a transferee's debt that was not subject to the cooperation agreement prior to a Debt Transfer would be subject to all of the cooperation agreement's terms after the Debt Transfer. Finally, Cooperating Creditors were allowed to purchase borrower debt after signing a cooperation agreement, but that additional debt would automatically be subject to the terms of the agreement. Any Debt Transfer or debt acquisition that did not comply with the applicable cooperation agreement's terms were deemed *void ab initio* and each Cooperating Creditor had the individual right to enforce the voiding of such a transfer or acquisition. New York state law governed.

The provisions I reviewed also compelled Cooperating Creditors to comply where a supermajority of Cooperating Creditors believed some sort of settlement or action—for example, a negotiated debt exchange—was in the best interests of the collective. A dissenting group member did not have the ability to opt out of such a deal or take any action—including litigation—to prevent its consummation.

Cooperating Creditors were also prohibited from communicating with the borrower and its agents. And the agreements forbade any side agreement, understandings, or commitments between a Cooperating Creditor and the borrower or any entity or person affiliated with the borrower involving any debt subject to the terms of the cooperation agreement. Changes to key provisions in the agreement required

in the group was suboptimal. As noted below, the fact that these creditor groups enjoy shared interests and characteristics may deter this kind of behavior more so than the cooperation agreement itself.

consent of all creditors in the group or at least all creditors who originally signed the agreement. To afford the group some flexibility, the agreements had a 60-to-90-day initial duration with an option for the group to extend with consent of a supermajority of the aggregate principal amount of outstanding debt held by the group.[123] A covenant invariably restricted disclosure of this time limit to preclude the borrower from simply waiting out the agreement. Some of the agreements automatically terminated if the group no longer represented at least a majority of the outstanding debt.

An agreement's "remedies provision" is arguably the most important feature. The agreements I reviewed provided exclusively for specific performance and injunctive relief. In other words, a breach of the agreement —perhaps in the form of defecting and providing the borrower the necessary votes to effectuate an uptier transaction or refusing to cooperate with a transaction approved by the group—could not be remedied with money damages.

The robust restrictions outlined above along with the ability to compel an act or unwind a defection provides the creditor group a meaningful counterattack to borrower efforts to impose a coercive exchange or otherwise exploit contractual provisions. But there are still limitations. A cooperation agreement is most impactful when a creditor group is facing an uptier transaction, which is premised on some sort of contractual subordination of a subset of the creditor group and various "exit consents." A timely cooperation agreement could unravel this liability management exercise. A cooperation agreement, however, may have negligible impact on an aggressive borrower interested in pursuing a dropdown transaction, which can be executed without the borrower aligning itself with a majority group of creditors. However, as seen in the PetSmart dispute, a cooperation agreement may not be able to halt a dropdown transaction, but creditor litigation can subsequently negate the borrower's contractual interpretation upon which the transaction was premised. As to this latter threat, a cooperation agreement could be extremely valuable in precluding the borrower from convincing creditors to vote to withdraw litigation in exchange for various fees and sweeteners.

Another fundamental limitation involves enforceability of the specific performance provision. Under New York state law, specific

123. *But see* Frumes, *Subtle Art of the Cooperation Agreement*, *supra* note 86 ("Common co-op length is six months with three-month or six-month extensions, where every three to six months counsel checks again.").

performance is inappropriate where money damages "would be adequate to protect the expectation interest of the injured party."[124] It is unclear if specific performance would be appropriate to address a breach of a cooperation agreement.[125] One could argue that money damages could address the group's expectation interests. I am unaware of any scholarship or court ruling exploring whether specific performance is an appropriate remedy in coercive exchange cases. I suspect no law firm would want to be the first to bring such a suit.[126] This void creates a fair amount of uncertainty as to one of the key features of these agreements. A creditor group seeking specific performance could analogize to restructuring support agreements (RSA). RSAs are used frequently by parties in restructuring and bankruptcy contexts.[127] These agreements are rarely ever breached and courts regularly enforced them.[128] At the same time, even this analogy has limits. There are few opinions dealing with specific performance requests for breaches of RSAs. And opinions that do address the issue indicate that there may be limits to enforceability.[129]

I suspect most parties understand that the specific performance provision is a necessary but insufficient means to ensure fidelity. Going back to the game theoretic principals outlined in Part II.B, iterative games force players to accept that a defection in one game may lead to

124. Sokoloff v. Harriman Estates Dev. Corp., 96 N.Y.2d 409, 415 (App. Ct. 2001) (citing (RESTATEMENT [SECOND] OF CONTS. § 359[1])).

125. *See id.* ("Specific performance is an appropriate remedy for a breach of contract concerning goods that 'are unique in kind, quality or personal association' where suitable substitutes are unobtainable or unreasonably difficult or inconvenient to procure." (quoting RESTATEMENT [SECOND] OF CONTS. § 360)).

126. As a hedge against a court refusing to accept specific performance as the sole remedy, some firms include liquidated damages provisions in their cooperation agreement. *See* Interview with Creditor Attorney 2, *supra* note 99; Interview with Creditor Attorney 4, *supra* note 99. This could present a problem, though. The key argument for specific performance is that monetary damages cannot be properly assessed or protect the parties' expectation interests. The inclusion of a liquidated damages provision would appear to undermine this argument.

127. *See* David A. Skeel, *Distorted Choice in Corporate Bankruptcy*, 130 YALE L.J. 366, 379 (2020) ("Debtors use RSAs . . . to lock in creditor support for an anticipated reorganization plan.").

128. *See In re* Residential Capital LLC, 2013 WL 3286198, at *18 (Bankr. S.D.N.Y. June 27, 2013) (citing five bankruptcy cases in the Southern District of New York where restructuring support agreements were recognized as being enforceable).

129. See *In re* Latam Airlines Group, S.A., 2022 WL 2206829 at *54 (Bankr. S.D.N.Y. 2022) (citing In re *Station Holding Co., Inc.*, 2004 WL 1857116 (Bankr. D. Del. 2004) and In re *NII Holdings, Inc.*, 536 B.R. 61 (Bankr. S.D.N.Y. 2015) for the proposition that a specific performance provision in an RSA that required a party to vote in favor of a plan of reorganization regardless of plan terms would be unenforceable under Section 1125(b)).

retribution in subsequent games. As noted above, membership in these coalitions can have a material effect on a creditor's recovery. A creditor with a reputation for defecting faces the risk of exclusion in deals where cooperation is essential in salvaging a financial position.[130] Group identification can provide additional deterrence. These creditor groups are often composed of firms that have significantly similar profiles and operations. This affinity could earn a defector a particularly vicious retribution.[131] And a firm that defects *after* signing a cooperation agreement faces the risk of incurring the wrath of the entire creditor community.[132]

Self-interest is still the guiding light in all of these cases, but the dynamics outlined above coupled with strong market norms may help foster solidarity in ways that contractual obligations alone cannot.[133]

A. Obstacles to Cooperation

Creditors encountering liability management exercises must formulate countermeasures. Coordinated response is an obvious starting point but, in addition to the enforcement questions discussed above and the customary transaction costs associated with these types of compacts,[134] significant obstacles to cooperation exist.

1. *Free Riding*. The attractiveness of free riding in this context is clear.[135] In cases where a law firm is attempting to organize a majority creditor group, a free rider enjoys the optionality of allowing the group

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130. *See* Interview with Creditor Attorney 3, *supra* note 99; Interview with Creditor Attorney 4, *supra* note 99.

131. Interview with Creditor Attorney 1, *supra* note 99; Interview with Creditor Attorney 2, *supra* note 99; Interview with Creditor Attorney 4, *supra* note 99.

132. Interview with Creditor Attorney 2, *supra* note 99.

133. *See* LUCE & RAIFFA, *supra* note 25, at 96 ("[W]e may suppose that the effect of breaking a binding agreement is so disastrous that it is not considered.").

134. Coordination in most contexts involves significant transaction costs. In researching this topic, however, I was told repeatedly that traditional transaction costs related to coordination are rarely a deterrent. *See,* e.g., Interview with Creditor Attorney 3, *supra* note 99. Liability management exercises invariably affect a relatively small group of creditors that are familiar with each other. *Id.*

135. *See* Okada, *supra* note 86, at 631–32 (explaining the draw of free riding where a group is unable to exclude non-participating parties from the benefits created by the group; for example, an organization that can preclude sovereign members from committing environmental pollution cannot exclude a non-member from enjoying the benefits of a newly clean international waterway).

to develop strategy and devote time and resources to resolution.[136] The free rider can presumably join the group at a later date and enjoy the fruits of the group's efforts but entertain the borrower's overtures in the meantime. In cases where the group lacks a majority of debtholders, a free rider may be in a unique position to rent seek.

Coordination designers appear focused on carrots—as opposed to sticks —in deterring free riding.[137] This tact may stem from the suspicion that the threat of an informal retaliation for those who attempt to free ride is unlikely to compel a creditor to make what she may believe is an irrational choice. Therefore, in order to defuse this type of opportunism, cooperation agreements contain "initial consenting party" provisions, which provide original signatories to the agreement and those that join within a very limited grace period additional fees and sweeteners that will be withheld from those who join subsequently.[138] The attorneys I spoke to explained that these nudges have been sufficient to secure participation in the current environment.[139] Nevertheless, these attorneys acknowledged that the fear of creditor reluctance could spur them to include a provision that absolutely precluded creditors from joining the group after the effective date of the cooperation agreement.[140]

2. *Exploding Offers and Precarious Majorities.* As seen in PetSmart, a borrower undertaking liability management exercises has a much higher probability of achieving its objectives if it can act before affected creditors coordinate. An exploding offer—usually open for only 24 hours or until a majority of the outstanding debt at issue is secured—is a significant obstacle to cooperation.

136. Attorneys' fees are rarely an issue at an early stage of coordination because many law firms will provide loss-leader services with the understanding that they will become lead counsel and accordingly compensated if financial war breaks out. *See* Interview with Creditor Attorney 2, *supra* note 99.

137. Interview with Creditor Attorney 1, *supra* note 99; Interview with Creditor Attorney 4, *supra* note 99.

138. Interview with Creditor Attorney 4, *supra* note 99.

139. In the current environment, free riding may not be the threat that it customarily is. Insiders I spoke with explained that in most current cases, cooperation is often seen as the most viable way to preserve value and defeat coercive maneuvers. Creditors are invariably anxious to be part of a coordinated creditor response. However, keep in mind that the borrower may also be offering initial defectors a deal, sometimes referred to as "early bird economics." *Id.*; Interview with Creditor Attorney 3, *supra* note 99.

140. *See, e.g.*, Interview with Creditor Attorney 2, *supra* note 99.

To defuse the exploding offer, creditors can prophylactically organize a majority group in advance of any acts of war. But majority positions can be precarious. Coercive debt issuance is another powerful weapon in a borrower's arsenal. Imagine that a borrower subject to permissive debt instruments is believed to be considering liability management exercises. A majority debt holder group begins coordinating and is successful in convincing a slight majority of debt holders to sign a robust cooperation agreement. The war is not necessarily won at this point. The borrower could respond by issuing additional debt to specific defectors to allow this rogue group to clear majority or super-majority thresholds, as necessary. If successful, the borrower can move forward with a coercive exchange and seize value from the disfavored group. This countermeasure—which was used recently in both the Incora[141] and Revlon disputes[142]—could leave creditors hesitant to sign a cooperation agreement in the next iteration of the game.

3. *The Crossholder's Luxury*. Crossholders are creditors who own debt at different levels of the capital structure and may even own equity in the private equity sponsor. These parties can appear to be aligned with a particular group but possess unique incentives. For a crossholder, a suboptimal settlement for one creditor group to which it belongs may be acceptable if it is necessary to secure an oversized return from a different position. This is what I call the crossholder's luxury; a crossholder may lose a battle but still win the war. For example, in the Caesars's dispute, Canyon Capital owned first-lien bonds, second-lien bonds, and equity in the private equity sponsor.[143] Canyon Capital's incentives did not align with the second-lien bondholders, who were the lone holdouts in that case. Canyon was fixated on settlement with Caesars and pushed the second-lien bondholder group to accept offers that were well below what was reasonable under the circumstances.[144] Canyon's fear was a prolonged

141. *See* Parikh, *Financial Disequilibrium*, *supra* note 12, at 44 (noting that "[t]he indenture allowed Incora to issue more debt with few restrictions," since, though "[n]ormally, there would not be a market for debt from a distressed company," here, the company "was not selling to the market at large." Instead, "Incora issued just enough new debt to give Silver Point and PIMCO the super-majority position they needed to alter the applicable indentures and release the existing liens.").

142. *See* Frumes, *Subtle Art of the Cooperation Agreement*, *supra* note 86.

143. *See* FRUMES & INDAP, *supra* note 42, at 253.

144. *See id.* (noting that crossholders "were desperate for a settlement" and that Canyon "was furiously backchanneling" to reach a compromise).

lack of consensus creating chaos that could decimate its other positions.[145]

In some cases, crossholder positions are not fully disclosed or appreciated. This dynamic could undercut the idea that many of these creditor groups allows clandestine maneuvering and influence that could undermine coordination in unforeseen ways.

CONCLUSION

Private equity sponsors have proven adept at finding creative pressure points in distress situations. But coercive exchanges have distorted distressed debt markets and destroyed value by delaying necessary restructurings of struggling firms. This Essay assesses the means by which creditors have begun responding to acts of war and argues that these counterattacks are necessary to restore equilibrium. With the economy moving into a more challenging credit cycle, the outcomes of these financial battles will impact markets and the US economy. Ultimately, the choice between cooperation and defection is one that creditors will be unable to escape in the upcoming years.

145. *See id.*