The Problematic Forgotten Buyback

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Abstract

Totaling in excess of $100 billion dollars in transactions annually, debt buybacks allow a company to repurchase bonds from investors, rewriting bargains and stripping away creditor control rights in the process. This Article shows that regulation systematically underprotects bondholders in the context of debt buybacks. It makes three points. First, bondholders confront information asymmetries that enable issuers to buy back creditor claims cheaply. Regulation imposes near negligible requirements on issuers to disclose information about the transaction. Lacking fiduciary protection, bondholder interests are vulnerable to being extinguished by issuers in the interests of promoting those of shareholders and managers. Second, buybacks diminish the power of creditor control rights. Alongside information asymmetries, bondholders confront coordination costs and tight deadlines within which to evaluate the terms of a buyback and changes to bondholder control rights. Owing to these costs, issuers can systematically underprice control rights. Bondholders will not act where the gains of agitation will be less than the cost of information gathering, coordination, and action. By strategically underpricing a buyback by an amount approximating these transaction costs, an issuer can pocket the difference between the price paid for the claim and that which should have been paid to bondholders for their bargain. Third, debt buybacks can allow one set of creditors—notably, banks—to extract value from bondholders. By pushing an issuer to buy back bond claims cheaply, banks—usually with greater individual exposure through loans—can increase their chances of being repaid. They can also acquire a more powerful voice in the issuer's internal governance by muting that of bondholders. In highlighting regulation's forgotten but problematic buyback, this Article offers two proposals to bolster bondholder protection, advocating for greater disclosure and contractual fixes to safeguard the value of claims. These proposals help to preserve the welfare of investors and protect their longer-term confidence in debt capital allocation.

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Introduction

As COVID-19 devastated markets in March 2020, the then $9.6 trillion corporate bond market found itself facing a rough landing.[1] Having enjoyed a buoyant decade of easy credit, with a sizable por-

[1] *See* J. Nellie Liang, *Corporate Bond Market Dysfunction During COVID-19 and Lessons from the Fed's Response* 3–4 (Hutchins Ctr., Working Paper No. 69, 2020), https://www.brookings.edu/research/corporate-bond-market-dysfunction-during-covid-19-and-lessons-from-the-feds-response/ [https://perma.cc/7W6U-CBU6] (detailing the prevailing conditions in the corporate bond market leading up to March 2020); Paul Wiseman, Bernard Condon & Cathy Bussewitz, *Corporate Debt Loads a Rising Risk as Virus Hits Economy*, AP News (Mar. 11, 2020, 4:40 PM), https://apnews.com/article/virus-outbreak-financial-markets-united-states-business-ap-top-news-7cd0108d79c6b4f1ee2e6ec5fc3a2275 [https://perma.cc/M2RQ-MPRE].

tion of borrowing focused in riskier sectors, the pandemic initially took a catastrophic toll on corporate bonds.[2] The price of bonds issued by noninvestment grade ("junk") borrowers plunged at the fastest pace ever recorded, as investors cashed out.[3] Chaos mounted.[4] But amid this unraveling, the conditions also held out a surprising possibility of relief: crashing bond prices and panicking investors meant that issuer companies could buy their bonds back at a bargain. Bond buybacks would reduce the amount of debt an issuer owed. They would also create a win for the books. Companies could record a gain in the difference between the face value of the bond and the purchase price paid to bondholders.[5] For example, the makers of the eponymous food storage containers Tupperware Brands announced a tender offer in May 2020 to buy back approximately one-third of a $600 million bond issue, offering investors forty-five cents on the dollar for tendered bonds.[6] Tupperware planned to spend $79 million dollars to buy back and retire debt totaling $175 million dollars in face value.[7] Highly leveraged and hurt by the pandemic, Tupperware's tender was

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2 *See* Liang, *supra* note 1, at 3–5.

3 *See* Serena Ng & Xie Yu, *Investors, Fearing Defaults, Rush Out of Junk Bonds*, WALL ST. J. (Mar. 26, 2020, 6:38 PM), https://www.wsj.com/articles/investors-fearing-defaults-rush-out-of-junk-bonds-11585215004 [https://perma.cc/X4CQ-WQH9]; *see also* Jessica DiNapoli & Mike Spector, *Exclusive: Macy's Taps Lazard to Bolster Finances as Coronavirus Saps Sales—Sources*, REUTERS (Apr. 11, 2020, 5:35 PM), https://www.reuters.com/article/us-macy-s-lazard-exclusive/exclusive-macys-taps-lazard-to-bolster-finances-as-coronavirus-saps-sales-sources-idUSKCN21T0V7 [https://perma.cc/7XZL-BTAP]; Alexander Gladstone & Suzanne Kapner, *J.C. Penney Skips Bond Payment, Starting Bankruptcy Clock*, WALL ST. J. (Apr. 15, 2020, 4:26 PM), https://www.wsj.com/articles/j-c-penney-skips-bond-payment-starting-bankruptcy-clock-11586979911 [https://perma.cc/7ZHG-ZQU9]; Andrew Edgecliffe-Johnson, Peggy Hollinger, Joe Rennison & Robrt Smith, *Will the Coronavirus Trigger a Corporate Debt Crisis?*, L.A. TIMES (Mar. 15, 2020, 6:00 AM), https://www.latimes.com/business/story/2020-03-15/coronavirus-corporate-debt-crisis [https://perma.cc/39ZU-S6H8].

4 *See* Liang, *supra* note 1, at 25; Ng & Yu, *supra* note 3.

5 Leading law firms released bulletins on debt buybacks and their usefulness as COVID-19 panic hit bond markets in March 2020. *See*, *e.g.*, *COVID-19: Debt Buyback Considerations*, CRAVATH, SWAINE & MOORE LLP (Mar. 30, 2020), https://www.cravath.com/news/covid-19-debt-buyback-considerations.html [https://perma.cc/98PR-LURM]; Memorandum from Paul, Weiss, Rifkind, Wharton & Garrison LLP on COVID-19: Debt Buyback Considerations to clients (Mar. 13, 2020), https://www.paulweiss.com/practices/transactional/finance/publications/covid-19-debt-buyback-considerations?id=30857 [https://perma.cc/4CJ6-9YUC]; *Debt Buyback and Liability Management Considerations*, SHEARMAN & STERLING (Mar. 27, 2020), https://www.shearman.com/en/perspectives/2020/03/debt-buyback-and-liability-management-considerations-covid-19 [https://perma.cc/P7UV-P99F].

6 *See* Tupperware Brands Corp., *Tupperware Brands Corporation Commences Cash Tender Offer for up to $175 Million Aggregate Principal Amount of its Outstanding 4.750% Senior Notes Due 2021*, TUPPERWARE (May 26, 2020, 9:00 PM), https://ir.tupperwarebrands.com/news-and-events/press-releases/2020/05-26-2020-140248422 [https://perma.cc/L5QZ-NGZL].

7 Matt Wirz & Micah Maidenberg, *Tupperware Tries to Contain Financial Woes with Debt*

a chance to improve the health of the firm's finances by cheaply buying back bonds that had been trading at 100 cents on the dollar just a few months earlier in December 2019.[8]

Debt buybacks allow borrowers to repurchase outstanding debt—usually bonds—as a step toward extinguishing this liability from their books.[9] Through a buyback, issuers can rewrite the bargain with creditors by buying them out early and, in many instances, also removing their ability to wield the power formalized in covenants and events of default in the bond agreement.[10] Buybacks enable issuers to accomplish a variety of aims: (1) reduce their debt, (2) eliminate creditor power, and (3) simplify capital structure.[11] As with Tupperware, companies can repurchase debt when it is trading at a discount. If a bond representing a debt of $100 is trading for less, the issuer can achieve its goals while recording a notional windfall on its books.[12] Between 2004 and 2017, approximately $1.89 trillion worth of corporate debt was subject to a debt buyback.[13] In 2010, following the Financial Crisis, buybacks removed over $85 billion worth of credit from company balance sheets.[14]

Share buybacks—when companies repurchase equity claims from existing shareholders—have generated extensive research and contro-

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Deal, WALL ST. J. (May 26, 2020, 4:38 PM), https://www.wsj.com/articles/tupperware-tries-to-contain-financial-woes-with-debt-deal-11590499695 [https://perma.cc/9K73-XDEA].

8 *See id.*

9 *See* discussion *infra* Section II.A. For an overview on the practice, see Lei Mao & Yuri Tserlukevich, *Repurchasing Debt*, 61 MGMT. SCI., 1648 (2015). In this Article, the term "debt buyback" refers broadly to buying back debt both in the open market and using a debt tender offer. The Article later distinguishes and discusses the implications of each method.

10 *See* discussion *infra* Section II.A.

11 *See* discussion *infra* Section II.A; *see also* Mao & Tserlukevich, *supra* note 9, at 1650 (noting the benefits of debt buybacks).

12 *See* discussion *infra* Section II.A; *see also*, Serena Ng, *Firms Move to Scoop Up Own Debt*, WALL ST. J. (Aug. 24, 2009, 12:01 AM), https://www.wsj.com/articles/SB125080949684547827 [https://perma.cc/BJ3H-A48D]. The bond may trade at a discount for a variety of reasons such as changes in the interest rate environment as well as heightened risk attaching to the borrower. *See How Do Rates Affect Bond Performance?*, PIMCO, https://www.pimco.com/en-us/marketintelligence/navigating-interest-rates/how-do-rates-affect-bond-performance/ [https://perma.cc/9QAT-AYLB].

13 This figure is based on data from the Fixed Income Securities Database, and on an approximate read of both open market and tender repurchases conducted by nongovernmental corporations between 2004 and 2017. *See* Wharton Rsch. Data Servs., *Mergent Inc.*, WHARTON UNIV. OF PA., https://wrds-www.wharton.upenn.edu/pages/about/data-vendors/vendor-partner-mergent-inc/ [https://perma.cc/XD32-VMT9].

14 Hagit Levy & Ron Shalev, *Bond Repurchase Objectives and the Repurchase Method Choice*, 63 J. Acct. & Econ. 385, 385 (2017); Brandon Julio, *Corporate Investment and the Option to Repurchase Debt* 1 (Aug. 2013) (unpublished working paper) (on file with author) (noting that the average debt buyback transaction size is large at $151 million dollars).

versy.[15] By contrast, debt buybacks have attracted only glancing attention despite their ability to reshape a company's capital structure.[16] This Article fills the gap by developing an account of debt buybacks and demonstrating how current regulatory design systematically fails to protect bondholders and their control rights. By incentivizing issuers to buy back claims cheaply, regulatory policy forces investors to internalize the high costs of protecting themselves and receiving fair value for claims.

Weak protection for bondholders ultimately forces losses on everyday mom-and-pop investors that cannot cheaply hedge against them. Although bondholders are presented as institutional and sophisticated—in contrast to mom-and-pop shareholders—this standard account is dated and inaccurate.[17] For a start, the U.S. equity market has

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15 *See, e.g.*, Jesse M. Fried & Charles C.Y. Wang, *Short-Termism and Capital Flows*, 8 REV. CORP. FIN. STUD. 207, 210 (2019) (noting that concerns about excessive reliance on share buybacks are overblown and that firm's use of share buybacks does not indicate short-termism and a lack of interest in investment and growth); Alberto Manconi, Urs Peyer & Theo Vermaelen, *Are Buybacks Good for Long-Term Shareholder Value? Evidence from Buybacks Around the World* (Eur. Corp. Governance Inst. Fin. Working Paper No. 436/2014, 2018) (noting a positive effect of buybacks on short-term and long-term excess returns). On policy, see Robert Jackson Jr., Comm'r, SEC, Speech: Stock Buybacks and Corporate Cashouts (Jun. 11, 2018), https://www.sec.gov/news/speech/speech-jackson-061118#_ftnref25 [https://perma.cc/N6CX-8U36] (denying use of Rule 10b-18 safe harbors to companies with executives that cash out after a buyback).

16 *But see* Hadiye Aslan, Madhu Kalimipalli, Praveen Kumar & Buvaneshwaran Venugopal, Mergers and Acquisitions and Debt Recontracting: Evidence from Bond Covenants (2022) (unpublished working paper) (on file with author) (detailing reduction in mergers and acquisitions following a debt repurchase). In the legal literature, a handful of articles examined buybacks in the context of the leveraged buyout boom in the 1980s. *See, e.g.*, Victor Brudney, *Corporate Bondholders and Debtor Opportunism: In Bad Times and Good*, 105 HARV. L. REV. 1821 (1992); John C. Coffee & William A. Klein, *Bondholder Coercion: The Problem of Constrained Choice in Debt Tender Offers and Recapitalizations*, 58 U. CHI. L. REV. 1207 (1991); Andrew Laurance Bab, Note, *Debt Tender Offer Techniques and the Problem of Coercion*, 91 COLUM. L. REV. 846 (1991); Lewis S. Peterson, Note, *Who's Being Greedy? A Theoretical and Empirical Examination of Holdouts and Coercion in Debt Tender and Exchange Offers*, 103 YALE L.J. 505 (1993). On distressed debt exchanges, see William W. Bratton & Adam J. Levitin, *The New Bond Workouts*, 166 U. PA. L. REV. 1597 (2018). On the limited literature in finance scholarship, see Julio, *supra* note 14. Some scholars have written on sovereign buybacks. *See, e.g.*, Jeremy Bulow & Kenneth Rogoff, *The Buyback Boondoggle*, 2 BROOKINGS PAPERS ON ECON. ACTIVITY 675 (1988); Lee C. Buchheit & G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, 48 UCLA. L. REV. 59 (2000) (discussing covenant amendments for sovereign bonds); Mitu Gulati, *Buybacks as a Sovereign Debt Restructuring Strategy: Why the Disfavor?* CREDIT SLIPS (Jan 19, 2020, 2:48 PM), https://www.creditslips.org/creditslips/2020/01/buybacks-as-a-sovereign-debt-restructuring-strategy-why-the-disfavor.html [https://perma.cc/Q3JG-9KMV].

17 *See, e.g.*, Steven L. Schwarcz & Gregory M. Sergi, *Bond Defaults and the Dilemma of the Indenture Trustee*, 59 ALA. L. REV. 1037, 1038–39 (2008); Press Release, SEC, SEC Proposes Amendments to Enhance Retail Investor Protections (Sept. 26, 2019) (available at https://

institutionalized over the last fifty years, fueled by the rise of indexed mutual funds that pool, manage, and invest retail savings stocks.[18] Crucially, the bond market, too, comprises firms that pool and invest Main Street, mom-and-pop capital. Mutual funds, pension funds, and insurance companies predominate as bond investors, reflected in the surging popularity of indexed bond funds and exchange-traded funds.[19] In bond markets, institutionalization and sophistication have long justified a regulatory posture in favor of letting bondholders take care of themselves using their contract with the issuer.[20] By contrast, institutionalization in equity markets has not led to a general reduction of regulatory protections for investors except in discrete, well-known contexts.[21] To be sure, equity and bond claims represent distinct types of risk. But the self-reliance expected of bondholders requires rethinking to determine whether the protective mechanisms at their disposal can substitute for the robust public regulation seen in equity markets. This Article examines the implications of this question for debt buybacks to show that bondholders are insufficiently pro-

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www.sec.gov/news/press-release/2019-189 [https://perma.cc/LQ39-EXXN]). On the rise of institutional bond ownership, see Bratton & Levitin, *supra* note 16, at 1640–41.

18 *See* Dawn Lim, *Index Funds Are the New Kings of Wall Street*, WALL ST. J. (Sept. 18, 2019, 5:30 AM), https://www.wsj.com/articles/index-funds-are-the-new-kings-of-wall-street-11568799004 [https://perma.cc/9XZK-LD6D].

19 *See* Lizzy Gurdus, *The $1 Trillion in Fixed-Income ETFs Will Double in the Next 5 Years, Says iShares America Chief*, CNBC (Sept. 23, 2019, 4:26 PM), https://www.cnbc.com/2019/09/23/ishares-sees-1-trillion-in-fixed-income-etfs-doubling-in-5-years.html [https://perma.cc/DPE6-ACNZ]; Fang Cai, Song Han, Dan Li & Yi Li, *Institutional Herding and its Price Impact: Evidence from the Bond Market*, 131 J. FIN. ECON. 139 (2019); Brooke Masters, *Billions Pouring into Bond ETFs Are Bright Spot for BlackRock*, FIN. TIMES (Feb. 17, 2023), https://www.ft.com/content/231524e2-fe76-412c-ac84-dbfc365879af [https://perma.cc/SK6P-PFFW] (highlighting increased flows into bond exchange-traded funds, despite reduced inflows in the context of other assets); Katherine Greifeld, *The Era of the Bond ETF Has Finally Arrived*, BLOOMBERG (Nov. 17, 2022, 9:46 AM), https://www.bloomberg.com/news/articles/2022-11-17/the-era-of-the-bond-etf-has-finally-arrived-as-mutual-funds-wilt?sref=2qugYeNO [https://perma.cc/R3VR-7NJW] (highlighting entry into bond exchange-traded funds).

20 *See* Clifford W. Smith & Jerold B. Warner, *On Financial Contracting: An Analysis of Bond Covenants*, 7 J. FIN. ECON. 117, 152–53 (1979); Mitu Gulati & George Triantis, *Contracts Without Law: Sovereign Versus Corporate Debt*, 75 U. CIN. L REV. 977 (2007) (highlighting the contractual basis of bondholder protections). For a detailed discussion of the evolution of bondholder contract protections, see William W. Bratton, *Bond Covenants and Creditor Protection: Economics and Law, Theory and Practice, Substance and Process*, 7 EUR. BUS. ORG. L. REV. 39 (2006).

21 *See, e.g.*, Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 342–51 (2013) (outlining the history of limited shareholder protections in private equity markets); Elizabeth Pollman, *Private Company Lies*, 109 GEO. L.J. 353 (2020) (detailing the limited application of Rule 10b-5 to private markets).

tected by regulation as well as contract, with Main Street savers ultimately on the line to bear the costs of the deficiency.[22]

This Article highlights three factors that systematically diminish bond investors' rights: (1) costs associated with information asymmetry and the need for dispersed bondholders to coordinate and negotiate, which are not mitigated by regulation or by the contract between issuer and bondholder, (2) strategic underpayment for bond claims by issuers because bondholders will not litigate if the costs approximate the transaction costs of action, and (3) opportunistic and coercive buybacks pushed by more powerful creditors within a firm's capital structure.

First, bondholders confront a slew of transaction costs that cannot be mitigated by their contract with the issuer.[23] Scholars are familiar with the difficulties of putting a price on a loan and estimating how likely an issuer is to default.[24] An exercise in forecasting, lenders must estimate factors such as the borrower's cash flows for the life of the loan, the quality of management, the worth of its assets and so on. To fix a rate reflecting this default risk, lenders need to come up with hard numbers for nebulous and probabilistic risks affecting the business far into the future.[25] Extending debt is routinely preceded by detailed transfers of information from the borrower to the lender to facilitate a more accurate understanding of the borrower's credit risk. In the case of bank loans, such flows of data can afford lenders precise access into a borrower's affairs.[26] Public bondholders, despite being more distant from the boardroom, still receive disclosures when the bonds are first issued and reporting afterwards.[27]

This transparency when debt is originated stands in stark contrast to its virtual absence when the debt is repurchased. Regulation gov-

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22 On the insufficiency of bondholder investor protection through contract and trading, see generally Jonathan Brogaard & Yesha Yadav, The Broken Bond Market (2022) (working paper) (available at https://ssrn.com/abstract=3941941 [https://perma.cc/AXJ5-GCGC]).

23 On the informational disadvantage faced by bondholders, see *Brudney*, *supra* note 16. On the benefits of mandatory disclosure, see *infra* note 279.

24 *See* Aswath Damodaran, Valuing Declining and Distressed Companies (2009) (working paper) (available at http://dx.doi.org/10.2139/ssrn.1428022 [https://perma.cc/LC79-BG8D]).

25 Lenders need to fix the risk-adjusted "discount rate" to capture the riskiness of the borrower. *See infra* Sections I.A–.B.

26 *See* Frederick Tung, *Leverage in the Board Room: The Unsung Influence of Private Lenders in Corporate Governance*, 57 UCLA L. REV. 115, 125 (2009); *see also infra* Section I.B.

27 *See infra* Sections II.A.1–.2. On private bondholders and their relatively greater negotiating power than public bondholders, see Marcel Kahan & Bruce Tuckman, *Do Bondholders Lose from Junk Bond Covenant Changes?* 66 J. BUS. 499 (1993), and Michael Bradley & Michael R. Roberts, *The Structure and Pricing of Corporate Debt Covenants*, 5 Q.J. FIN., no. 1550001, 2015, at 3.

erning the repurchase of a bond issue by tender offer imposes minimal requirements—confined to providing a notice of terms and ensuring that information that issuers convey is not fraudulent or misleading.[28] Unlike equity tender offers that require fuller, more standardized disclosures, debt buybacks can take place with little formal transparency and no need for the issuer to make a public filing after the transaction with the Securities and Exchange Commission ("SEC").[29] Indeed debt buybacks can avoid even these mild prescriptions. By choosing to repurchase slivers of their debt on the open market—i.e., like any other investor—issuers are absolved from making any prior notification or following up with a specific disclosure outside of what must be provided as part of usual periodic filings and annual report.[30]

This lack of information transfer is striking given what is at stake for bondholders in a buyback. For one, they lose out on the expected bargain of receiving future cash flows—interest and principal payments—and often also lose out on the control rights attached to the debt. Importantly, issuers are ideally placed to utilize their information advantage to optimally time a buyback in ways that shortchange investors.[31] Jesse Fried advances a similar argument in the context of equity repurchases.[32] However, its applicability to debt is pernicious. Managers do not owe a fiduciary duty to their bondholders. This reduces the need to take bondholder interests into account. It also encourages managers to extract gains from bondholders in favor of shareholders as a matter of corporate duty. Bondholders become vulnerable to insiders trading against them in possession of private information, resulting in buybacks taking place when the debt is trading most cheaply. Hagit Levy and Ron Shalev observe that managers strategically time their debt buybacks, taking advantage of their insider information.[33] They find that open market purchases tend to favor uncertain and volatile conditions.[34] Unless they are willing to spend on information, analysis and coordination with other investors, bondholders are on the back foot in a debt buyback. For a tender offer, these costs help the issuer to lowball any tender premium offered to

28 *See* 17 C.F.R. § 240.14e-1 (2022); *see also infra* Part II.

29 *See infra* Part II.

30 *See infra* Part II.

31 *See* Mao & Tserlukevich, *supra* note 9, at 1658 (modeling the risks of managers using informational advantage in a buyback).

32 *See* Jesse M. Fried, *Insider Trading via the Corporation*, 162 U. PA. L. REV. 801, 814–15 (2014).

33 *See* Levy & Shalev, *supra* note 14, at 398–99.

34 *See id.* at 385 (but noting that higher information quality can mitigate mispricing).

investors to induce them into surrendering their claims. Where the likely gains are lower than the costs of research and negotiation, added to the uncertainty surrounding the valuation of the claim post-tender, investors have little reason to protest the offer. If these investors fail to contest the buyback, issuers pocket the difference between the amount paid to investors and the optimal premium that should have been paid for relinquishing the bargain.

Second, debt buybacks encourage issuers to opportunistically repurchase creditor control rights. Lenders, according to scholarship on this issue, impose covenants to discipline borrowers and reduce the risk that managers and shareholders use lender money self-interestedly to take excessive risks.[35] Scholarship has begun to highlight creditor power in corporate governance, including the emergence of a more activist trend that upends historic bondholder apathy.[36]

Debt repurchases are often accompanied by "consent solicitations" that ask bondholders to agree to amendments of bond covenants and events of default.[37] For all nonpayment-related terms, the law allows the terms of the bond to be changed if the borrower can secure the consent of a majority, sometimes two-thirds of bondholders.[38] Investors are under heavy pressure to accept: if over fifty percent of them agree to changes, e.g. to permit more borrowing, sell assets, conclude a takeover, within a tight deadline—usually twenty business days—the terms of the bond are permanently altered and holdouts are left without a premium and possessing a claim that is emptied of power. Bondholders must wager whether others will accept. Without information sharing and coordination, these uncertainties create coercive pressure to relent, accept the deal, and give up control.[39]

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35 *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 337–38 (1976); Stewart C. Myers, *Determinants of Corporate Borrowing*, 5 J. FIN. ECON. 147, 161–62 (1977).

36 *See* discussion *infra* Section II.B.

37 *See* discussion *infra* Section II.B.2.

38 *See* discussion *infra* Section II.B.2.

39 *See, e.g.*, Verizon, *Verizon Announces Tender Offers/Consent Solicitations for 31 Series of Verizon and Certain of Its Subsidiaries' Notes*, PR NEWSWIRE (Nov. 15, 2017, 21:44), https://www.prnewswire.com/news-releases/verizon-announces-tender-offers--consent-solicitations-for-31-series-of-verizon-and-certain-of-its-subsidiaries-notes-300557404.html [https://perma.cc/43AF-TS2K]; *see also* discussion *infra* Part III; Sris Chatterjee, Upinder S. Dhillon & Gabriel G. Ramírez, *Coercive Tender and Exchange Offers in Distressed High-yield Debt Restructurings: An Empirical Analysis*, 38 J. FIN. ECON. 333, 334 (1995); Kahan & Tuckman, *supra* note 27, at 500.

Marcel Kahan and Bruce Tuckman observe that it can be appropriate for issuers to buy back their debt to lighten creditor oversight.[40] Covenants that might have been necessary at debt's origination may no longer be useful as the company grows less risky. Nevertheless, it is equally plausible that issuers will rationally want to overcorrect and strip out as many contractual fetters as they can.[41] To maximally benefit, issuers will wish to pay as low a premium as they can while removing as many covenants as possible to restore control to shareholders and managers.

Bondholders confront structural deficits when seeking to oppose consent solicitations and protect control rights.[42] A lack of meaningful disclosure impedes an understanding of what these rights are worth. Working out whether the borrower is likely to violate covenants in the future, e.g., by taking on more debt, requires investigation, analysis, and coordination with investors and experts. Governance rights thus present thorny questions for valuation, requiring consensus on how bondholders might use them, with what effectiveness and overall outcome. This raises the transaction costs of investor action and gives borrowers a cushion by which to underpay for bondholder consent.[43] Importantly, the ability of an issuer to cheaply buy out future creditor activism raises the risk that control rights lose their disciplinary edge—prompting lenders to be more circumspect in activism if the consequence is that their claims become subject to an opportunistic buyback.

Third, debt repurchases open the door for certain creditors to extract value from others. They provide an ideal mechanism by which bank creditors can buttress their own position by pushing borrowers to repurchase bonds cheaply. Where certain bonds can be purchased at low cost, banks—usually carrying greater individual exposure—can enhance their own power and economic stature in the process.[44] Fol-

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40 *See* Kahan & Tuckman, *supra* note 27, at 503–04.

41 *See id.*

42 *See* Brudney, *supra* note 16, at 1823–25.

43 *See infra* Section III.A.

44 *See* discussion *infra* Section III.C. The literature on the differences between bank and bond debt is extensive. *See generally* Stuart C. Gilson & Jerold B. Warner, Private Versus Public Debt: Evidence from Firms that Replace Bank Loans with Junk Bonds (Oct. 22, 1998) (unpublished working paper). Although this Article uses bank debt as convenient shorthand to refer to providers of loans, increasingly numerous types of firms can function as loan providers, such as hedge funds. *See, e.g.*, Hannah George & Kelsey Butler, *Why Direct Lending Is a Booming Part of Private Debt*, BLOOMBERG (Mar. 6, 2019, 12:00 AM), https://www.bloomberg.com/news/articles/2019-03-06/who-needs-a-bank-why-direct-lending-is-surging-quicktake-q-a [https://perma.cc/9TH3-LHQR].

lowing the repurchase, the bank might have a better chance of being repaid. Crucially it can gain a stronger voice in debt governance without frictions from competing bondholders. This may be salient for firms facing financial distress, where reducing bondholders and potentially removing noisy activists offers a way to facilitate informal restructuring. Banks possess unique structural advantages in persuading borrowers. They are generally better informed and enjoy access to issuer boardrooms.[45] In addition, they face lighter coordination costs.[46] Unlike dispersed bondholders, banks can organize more easily.[47] While banks may be loath to pay off bondholders before themselves, the ability to repurchase this debt at low cost allows them to extract value whose long-term significance can exceed the near-term outlay of cash.

For completeness, it is worth noting that bonds often formally prescribe how issuers and investors can terminate the relationship early.[48] Specifically, bond agreements commonly offer issuers a contractual way to end the bargain prior to maturity, permitting an issuer to "call"—prepay and retire—the bonds at a predetermined price.[49] Exercising these so-called callability options, however, can represent an expensive proposition for an issuer when they are designed to ensure that bondholders are fully "made whole" for prepayment, as is increasingly the case in practice.[50] Formal contractual flexibility can

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45 *See infra* Section I.B.

46 *See* Randall S. Kroszner & Philip E. Strahan, *Throwing Good Money After Bad? Board Connections and Conflicts in Bank Lending* (John M. Olin L. & Econ., Working Paper No. 139, 2001).

47 *See* Edward I. Altman, Amar Gande & Anthony Saunders, *Bank Debt Versus Bond Debt: Evidence from Secondary Market Prices*, 42 J. MONEY, CREDIT, & BANKING 755, 760 (2010).

48 *See* WILLIAM W. BRATTON, CORPORATE FINANCE: CASES AND MATERIALS 547 (8th ed. 2016); *Callable or Redeemable Bonds*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/callable-or-redeemable-bonds#:~:text=Callable%20or%20redeemable%20bonds%20are,point%2C%20stops%20making%20interest%20payments [https://perma.cc/4QX6-CGZ3].

49 *See* MOORAD CHOUDHRY, CORPORATE BOND MARKETS: INSTRUMENTS AND APPLICATIONS 156–60 (2006) (describing the basics of callable bonds). Bonds can also be "putable," meaning that bondholders have an option to sell the bond back to the issuer at a set price in the contract. *See id.* at 160.

50 Amora Elsaify & Nikolai Roussanov, Why Do Firms Issue Callable Bonds? (Nov. 15, 2016) (working paper) (available at https://repository.upenn.edu/items/44fc20c5-37ce-49f4-98e9-d689cbaea042 [https://perma.cc/788G-6J9D]) (noting the sharp rise in the use of "call provisions" in nonfinancial corporate bonds). Elsaify and Roussanov also highlight that call options trend toward being "make-whole" call options that are commonly "out of the money" for the issuer. This means that the "make-whole" call "strike" price is higher than the market value of the

thus be largely illusory because the costs involved in calling bonds are too high to represent a viable option.

Buybacks constitute especially powerful tools for issuers because they create a cost-effective way to work around expensive formal call provisions. Unless explicitly forbidden, bond contracts can be bought back using an open market transaction or tender offer.[51] Contract law helps to shield the value of bondholder claims in the case of formal calls. However, information deficits, coordination costs, and coercive negotiation tactics diminish the effectiveness of contract as a safeguard for bondholders in a debt buyback. Because contract fails to properly protect bondholders in buybacks, policymakers ought to develop tools to enhance contractual power or more directly supplement public protections for bondholders to protect their interests.

This Article offers two proposals to strengthen protections for bondholders in the context of a buyback. First, regulation can facilitate coordination and reduce transaction costs by equalizing the disclosure requirements for equity and bond buybacks to ensure bondholders also receive notification, standard disclosure, and see a regulatory filing. Fuller disclosure helps bondholders to better assess the value of their claims as well as understand the purposes driving the buyback. Moreover, greater parity between equity and bond markets acknowledges the overall importance of investor protection and the reality that both markets comprise a mix of institutional and retail interests. Second, to the extent that regulation falls short, or requires time to be implemented, this Article sets out contractual fixes to encourage fuller information sharing between the issuer and the investor. These are designed to nudge both sides to negotiate for specific disclosures, timings, and conditions for buybacks using the usual contractual paradigm for bonds. Finally, this Article moots the possibility of imposing a discrete fiduciary duty in favor of bondholders during buybacks. Such a duty could encourage greater disclosure as well as create a cost on managers looking to exploit bondholder vulnerability. A discrete fiduciary duty has advantages. However, limited judicial appetite for creating one and the difficulty of squaring a fiduciary standard within the contractual nature of bond entitlements renders such a solution highly improbable in reality.

A final word on the significance of prioritizing long forgotten debt buybacks within regulation. Importantly, problems raised in this

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bond. *See id.*; Scott Brown & Eric Powers, *The Life Cycle of Make-Whole Call Provisions*, 65 J. CORP. FIN. Dec. 2000, at 1, n.2.

51 *See* CRAVATH, SWAINE & MOORE LLP, *supra* note 5.

Article have gained urgency in the wake of COVID-19 and the subsequent surge in corporate indebtedness. Nonfinancial issuers added around $1.7 trillion in borrowing in 2020, an increase of $600 billion over the previous highest annual total.[52] Almost $153.5 billion of debt was added to the balance sheets of companies and financial institutions in the United States in January 2022 alone as firms sought to take advantage of easy credit ahead of anticipated increasing interest rates.[53] The long horizon effect of high debt on corporate balance sheets will eventually need a solution, especially if risky issuers lose their footing within a challenging macroeconomic environment of rising interest rates, inflation and disrupted supply chains.[54] Debt buybacks will offer a well-trodden pathway to revivify sluggish, struggling balance sheets. For investors, however, they represent a systematic threat to existing bargains that can be opportunistically and thoroughly dismantled on the cheap.

This Article proceeds as follows. Part I outlines the challenges of contracting in debt capital markets, requiring transfers of information and control to lenders. Part II describes the goals and regulation of debt buybacks, with Part III analyzing the implications of their design for dismantling bondholder rights and Part IV outlining pathways for reform.

I. The Power of Corporate Debt

Debt reshapes a company's corporate structure and its internal governance.[55] By taking on debt, businesses can amplify returns.[56]

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52 *See* Sam Goldfarb, *Pandemic Hangover: $11 Trillion in Corporate Debt*, Wall St. J. (June 14, 2021, 10:40 AM), https://www.wsj.com/articles/pandemic-supercharged-corporate-debt-boom-record-11623681511 [https://perma.cc/9S6A-WJUC].

53 *See* Yoruk Bahceli, *Companies Raise Over Half a Trillion Dollars of Debt in Record Jan—Refinitiv*, Reuters (Feb. 1, 2022, 2:28 PM), https://www.reuters.com/business/companies-raise-over-half-trillion-dollars-debt-record-jan-refinitiv-2022-02-01/ [https://perma.cc/GG3U-78BD].

54 *See* Paula Seligson, *Corporate America Is Choking on Debt and Imperiling the Recovery*, Bloomberg (Aug. 21, 2020, 6:00 AM), https://news.bloomberglaw.com/mergers-and-acquisitions/corporate-america-is-choking-on-debt-and-imperiling-the-recovery [https://perma.cc/UXP2-6RZY]; Allison McNeely, *Default Threatens Companies Reeling from Frayed Supply Chains*, Bloomberg (Nov. 19, 2021, 7:00 AM), https://news.bloomberglaw.com/bankruptcy-law/default-threatens-companies-reeling-from-frayed-supply-chains [https://perma.cc/59HJ-4BV4].

55 *See generally* Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. Pa. L. Rev. 1209, 1211–20 (2006) (examining the impact of creditors as decisionmakers in corporations); George G. Triantis & Ronald J. Daniels, *The Role of Debt in Interactive Corporate Governance*, 83 Calif. L. Rev. 1073 (1995) (noting the significance of debt in corporate governance); Tung, *supra* note 26 (analyzing the impact of lenders in corporate decision making).

They also become subject to constraints. For one, debt must be repaid. In addition, lenders routinely impose a suite of restrictions on a company's activities—ostensibly to ensure repayment—but with the result that the company's business independence is curtailed.[57] In the worst case, failure to comply with lender demands pushes an issuer toward distress, bankruptcy, and liquidation.[58]

This Part outlines the power of debt for a company's capital structure and governance. It makes three points. First, borrowers and lenders must determine what an optimal balance sheet ought to look like and how to evaluate the issuer's cost of capital. If an issuer can comfortably repay its debt, it can look forward to returns higher than what it would have achieved by relying on cash reserves alone. On the other hand, the cost of failure is catastrophic. Second, these uncertainties set the stage for a complex and long-term negotiation as both sides tussle over how much information and control an issuer must concede to a creditor.[59] Creditors need information to decide how risky a borrower is and how to price the debt. Creditor controls also give lenders tools to prevent the issuer from taking outsize risks.[60] Third, these dynamics explain the importance of debt buybacks. If a company feels more comfortable financially, it becomes less willing to cede control and information to creditors, necessitating a mechanism that can help quickly extinguish the company's debt from its books.

A. The Transformative Impact of Debt

Broadly, debt represents an arrangement where one party with capital allows another to borrow this money for a period on the understanding that these sums will be repaid. In return for the temporary use of its cash, a lender requires that the borrower pay interest—set at a level high enough to compensate the lender for the risk that the borrower fails to pay, lost opportunities to invest in other ven-

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56 The literature in this area is extensive. *See, e.g.*, Patrick Bolton & David S. Scharfstein, *Optimal Debt Structure and the Number of Creditors*, 104 J. POL. ECON. 1, 2–3 (1996).

57 *See* Baird & Rasmussen, *supra* note 55, at 1209–15; *see generally* Tung, *supra* note 26 (providing examples of lenders using bond covenants to restrict a debtor's internal governance).

58 *See* Tung, *supra* note 26, at 156–60; George G. Triantis, *The Interplay Between Liquidation and Reorganization in Bankruptcy: The Role of Screens, Gatekeepers, and Guillotines*, 16 INT'L REV. L. & ECON. 101, 104–08 (1996) (discussing the intensity of lender power over issuers in the event of covenant breaches); *see also* Bolton & Scharfstein, *supra* note 56, at 2–3 (analyzing optimal contracting conditions to discourage default).

59 *See* Tung, *supra* note 26, at 142 (highlighting a transfer of power from borrower to lender when the former violates a loan covenant).

60 *See id.* at 159–60.

tures, as well as larger macroeconomic concerns like inflation.[61] Usually the lender does not acquire ownership rights, nor does it care about the company for a period longer than the maturity of its loan.[62]

The familiarity of debt's design obscures its significance for reshaping a company and how it behaves. At its best, the decision to borrow can jump start a firm's returns and enhance value for shareholders.[63] Rather than use $200 of equity to invest in a new venture, a company could borrow $100 and use $100 of its own money. Assuming a 10% annual rate of return from this endeavor and a 5% interest rate on the loan, the ability to borrow allows shareholders to reap greater returns when a firm borrows rather than relying on equity alone. By using only equity, the company enjoys a straight 10% gain on its investment, $220. However, when using a mix of debt and equity, shareholders deal in a different calculus: a liability of $105 at the end of the year on total wealth of $220, creating $115 worth of equity value. In other words, by using both debt and equity, shareholders see a gain of 15% rather than just 10%. Provided management can choose projects that are value generating over what needs to be paid out to creditors, debt can promote faster growth than what might have been possible otherwise.[64] Unsurprisingly, theory points to shareholders seeking out debt as a means of supercharging the value of their equity.[65]

At its worst, however, debt can irreparably damage the company by forcing it into distress, asset sales, and possibly liquidation. Return to the above example of a company with $100 loan on its books and $100 in equity. Rather than seeing 10% returns, however, the company suffers a 10% end-of-year loss on its projects. As before, the company confronts a liability of $105 on the loan. Instead of $220 in

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61 For bonds, this is called the "coupon rate." *See* RICHARD A. BREALEY, STEWART C. MYERS & FRANKLIN ALLEN, PRINCIPLES OF CORPORATE FINANCE 46–47, 585–638 (11th ed. 2014) (describing how rate calculations incorporate risk and the centrality of debt in corporate finance); *Bond Basics*, FIN. INDUS. REGUL. AUTH., https://www.finra.org/investors/bond-basics [https://perma.cc/S44J-RYDR].

62 *See Corporate Bonds*, PIMCO, https://global.pimco.com/en-gbl/resources/education/understanding-corporate-bonds [https://perma.cc/FZE2-KHRV].

63 *See* BREALEY ET AL., *supr*a note 61, at 439.

64 *See id.* at 44851. On the allocative and monitoring roles of capital markets, see generally, Solomon Tadesse, *The Allocation and Monitoring Role of Capital Markets: Theory and International Evidence*, 39 J. FIN. & QUANTITATIVE ANALYSIS 701(2004).

65 *See* Richard Squire, *Shareholder Opportunism in a World of Risky Debt*, 123 HARV. L. REV. 1151, 118285 (2010); Richard Squire, *Strategic Liability in the Corporate Group*, 78 U. CHI. L. REV. 605, 622 (2011) (describing the tendency of shareholders to exhibit opportunistic risk taking at the expense of creditors).

wealth, however, the company now has only $180 in value at the end-of-year. Shareholder equity is worth just $75, the difference between $180 and $105, a percentage drop of 25%, rather than the 10% that would have been lost had management relied on equity alone. This illustration is simplified, but it serves to highlight the existential burden facing companies that suffer multiple years of incremental losses, or a single year of large losses, when carrying debt on their books. Imagine that the company's project delivered losses of 30% over the year. Under such conditions, shareholder equity ends up being worth a meager $35, the difference between $140 and $105, a percentage drop of 65%. If its assets lose 47.5% in value, the company's shareholders are wiped out as their equity interest winds up being worth nothing.

The power and perils of debt underscore the significance of firms being able to choose the most optimal capital structure. Where this task is successful—and the company can pay its debt—the gains to shareholder value can be exponential. By contrast, mistakes can be extremely costly, as illustrated above. Not only do shareholders suffer losses on the value of their own equity, but they also face the prospect of paying regular principal and interest on an ever-dwindling set of incoming cash flows.[66]

It is all too easy for lenders and borrowers to arrive at mistaken calculations about how much debt a company can handle.[67] Critically, parties must provide answers to questions that require consensus on states of future existence, the exact permutations of which are often impossible to gauge accurately.[68] For example, a bank and a company seeking to arrange a $10 million loan, designed to be repaid over ten years, must work out whether the company will actually be able to pay back this money over the period. This transaction demands that parties be able to predict factors such as the cash flows the company is likely to produce a decade into the future, sources of risk that might threaten them, the changing value of the company's assets, and how easily this value can be liquidated for cash. Parties might be too optimistic in their assumptions. They may overestimate the durability of the issuer's successes or fail to account for the slate of possible risks that could disrupt its business. Valuation experts can offer intelligent estimates. But the forward-looking, predictive nature of the exercise

66 *See* BREALEY ET AL., *supra* note 61, at 431–35.

67 *See* Damodaran, *supra* note 24, at 7–8.

68 *See* BREALEY ET AL., *supra* note 61, at 356–58.

means a high likelihood that parties will vary in their perspectives and that the "right" answers will be elusive.[69]

The chances of miscalculation are greatest when parties can least afford the error. As a company becomes distressed, estimating its value and default risk represents a particularly thorny task. Under such conditions, Aswath Damodaran notes, conventional valuation strategies break down.[70] Evidence of past performance no longer offers a reliable guide to future operations. Loss-making assets struggle to produce the economic value they once did.[71] The common practice of looking to similar businesses for guidance can lack usefulness where the issuer's business suffers idiosyncratic reasons for failing.[72] Management may behave unpredictably or maliciously to salvage what they can.[73] This difficulty underscores the need for parties to craft measures that can help increase control, constraint, and predictability for lenders long before a company runs into financial distress.[74]

B. Information Transfers in Lending

Lenders need information about a borrower in order to price its riskiness. When compared with dealings in tangible assets like cars or houses that carry some inherent value, pricing the riskiness of ephemeral prospective cash flows poses unique problems.[75] Corporate finance scholarship has developed an extensive body of research designed to clarify the best methods for pricing risk.[76] Still, the fundamental task of estimating future performance means that lenders must ascribe hard values to what is a highly predictive exercise.[77]

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69 For further discussion on the difficulties of valuation in Chapter 11 bankruptcy, see Anthony J. Casey & Julia Simon-Kerr, *A Simple Theory of Complex Valuation*, 113 MICH. L. REV. 1175 (2015).

70 *See* Damodaran, *supra* note 24, at 6.

71 *See id.*

72 *See id.* at 10–11.

73 *See generally id.* at 6.

74 *See, e.g.*, Casey & Simon-Kerr, *supra* note 69, at 1212, 1218 (advocating for more judicial fact-finding on these questions in bankruptcy and related disputes). On the valuation heuristics commonly deployed by managers, see John R. Graham & Campbell R. Harvey, *The Theory and Practice of Corporate Finance: Evidence from the Field*, 60 J. FIN. ECON. 187 (2001).

75 Secured debt can help mitigate these problems but still faces issues concerning valuing the underlying risk.

76 *See, e.g.*, DARRELL DUFFIE & KENNETH J. SINGLETON, CREDIT RISK: PRICING, MEASUREMENT, AND MANAGEMENT 13 (2003) (outlining "quantitative models for measuring and pricing risk").

77 *See* Damodaran, *supra* note 24, at 3 ("As human beings, we are hard wired for optimism and reflect that with positive growth rates and higher cash flows in the future for the companies

Lending relationships generally entail an intensive transfer of information between the borrower and lender.[78] Such disclosures tend to be far more granular than what shareholders receive by way of routine securities disclosures and the company's corporate governance obligations.[79] The access to data that lenders are afforded—particularly in the context of bank loans—can rival that of a borrower's own board members.[80] Loan agreements offer the most obvious mechanism by which lenders demand data about an issuer's risk of default.[81] However, institutional lenders can also lean on softer relationships, such as interpersonal dealings or board seats, as a way to glean information that might not be obvious on paper. Randall Kroszner and Philip Strahan found that banks possess an extensive network of linkages into the boardroom of nonfinancial companies, with bank executives being prolific on corporate boards.[82] These directorships allow banks to build relationships and actively engage in on-the-ground monitoring at their borrower firms.[83]

These intensive transfers of information are more attenuated in bond markets, especially where bonds are issued publicly.[84] However, they are still important. Bill Bratton observes that bondholders place heavy reliance on the bond indenture—the contract governing the relation between bondholder and issuer—as a means of self-protection, enforcement, and monitoring.[85] In addition, bond investors count on a

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that we value. When valuing declining firms, we have to go against the grain and estimate cash flows for the future that may be lower than cash flows today.").

78 *See* Tung, *supra* note 26, at 125–31 (discussing "crossmonitoring" between lenders and borrowers).

79 *See* Securities Act of 1933, Pub. L. No. 73-22 §§ 5(a), 5(b)(2), 48 Stat. 74, 77 (codified as amended at 15 U.S.C. § 77) (requiring production of detailed disclosure document before a company can issue and effect sales in securities to the public); *see also* Securities Exchange Act of 1934, Pub. L. No. 73-291 § 13, 48 Stat. 881, 894 (codified as amended at 15 U.S.C. § 78) (codifying similar disclosure requirements).

80 *See* Tung, *supra* note 26, at 125–29 (noting that borrower shareholders and lenders monitor to different extents).

81 *See id.* at 135–40 (discussing "trip wire" mechanisms in financial covenants that trigger lender scrutiny).

82 *See* Kroszner & Strahan, *supra* note 46, at 12.

83 *See id.* Banks are subject to restrictions that forbid lending to their bank executives, director, or a company controlled by a bank official. *Compliance Guide to Small Entities*, FED. RSRV. (Mar. 1, 2017), https://www.federalreserve.gov/supervisionreg/regocg.htm [https://perma.cc/6FFH-D74P]. A full discussion of these restrictions is outside the scope of this Article.

84 *See* Brudney, *supra* note 16, at 1853–55 (discussing the informational disadvantages for bondholders relative to bank creditors). On the greater influence of bondholders in private markets, see Marcel Kahan & Bruce Tuckman, *Private vs. Public Lending: Evidence from Covenants* 11–13 (1993).

85 *See* Bratton, *supra* note 20, at 41–45 (noting that the protectiveness of the indenture

regular supply of mandatory periodic reporting under securities laws.[86] With more activist bondholders gaining influence, Ed Rock and Marcel Kahan highlight violations of financial reporting obligations as a common trigger for bondholder scrutiny and action.[87]

Scholars underscore the significance of disclosure as a mechanism by which firms looking for funds can reduce their cost of capital.[88] Examining the impact of accounting disclosures, Richard Lambert Christian Leuz and Robert E. Verrecchia observe that companies providing more extensive disclosure enjoy a lower cost of capital relative to those that do not.[89] Transparent capital seekers help investors to close the gap between expectations and the reality of a company's cash flows. They soften the entrenched informational advantages that directors enjoy.[90] By equipping investors to arrive at more nuanced estimations about the company's worth, transparent issuers become more attractive than those that are less open and liable to suffer from mismanagement.[91]

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tends to vary by the riskiness of the borrower); *see also* Yakov Amihud, Kenneth Garbade & Marcel Kahan, *A New Governance Structure for Corporate Bonds*, 51 STAN. L. REV. 447, 469–70 (1999) (proposing the creation of a supertrustee for bond indentures that can intensively monitor and enforce covenant breaches on behalf of dispersed bondholders).

86 *See* Securities Exchange Act of 1934 Pub. L. No. 73-291 § 13, 48 Stat. 881, 894 (codified as amended at 15 U.S.C. § 78). For a review of the arguments and literature on disclosure regimes generally, see Michael D. Guttentag, *An Argument for Imposing Disclosure Requirements on Public Companies*, 32 FLA. ST. U. L. REV. 123, 13342 (2004).

87 *See* Marcel Kahan & Edward Rock, *Hedge Fund Activism in the Enforcement of Bondholder Rights*, 103 Nw. U. L. REV. 281, 290–91 (2009); *see also*, Yu Gao, Abbie Smith & Xue Wang, *Do Hedge Funds Undertake Activism in the Bond Market? Evidence from Bondholders' Responses to Delay in Financial Reporting*, 39 CONTEMP. ACCT. RSCH. 1542, 1543–44 (2022).

88 *See* Arthur Levitt, Chairman, SEC, Remarks at the Inter-American Development Bank: The Importance of High Quality Accounting Standards (Sept. 29, 1997) ("[H]igh quality accounting standards . . . improve[] liquidity [and] reduce[] capital costs.").

89 *See* Richard A. Lambert, Christian Leuz & Robert E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, 45 J. ACCT. RSCH. 385, 410–11 (2007); *see also*, Mary E. Barth, Yaniv Konchitchki & Wayne R. Landsman, *Cost of Capital and Earnings Transparency*, 55 J. ACCT. & ECON. 206 (2013) (showing that firms with better earnings transparency enjoy a lower cost of capital).

90 *See, e.g.*, Victor Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 334–35 (1979) (noting that disclosure rules promote investor faith and eliminate the cost of risk premiums paid to investors).

91 *See* Wayne R. Guay & Robert E. Verrecchia, *Conservative Disclosure*, 3 J. Fin. Reporting 73, 81–82 (2018) (noting that firms that commit to "conservative disclosure," in other words, disclosing negative news, experience higher firm prices); *see also* Robert E. Verrecchia & Joseph Weber, *Redacted Disclosure*, 44 J. ACCT. RSCH. 791, 813 (2006) (showing that firms that engaged in more redaction of proprietary terms in filings experienced deterioration on certain liquidity measures—e.g., a higher bid-ask spread).

The significance of disclosure as a means of reducing capital costs takes on added meaning for companies that find themselves in distress.[92] The ability of debt to trigger an effective death spiral elevates the importance of information as a protective tool for lenders to gauge the company's riskiness.[93] Differences of opinion on valuation between lenders as well as between lenders and shareholders puts disclosure at the heart of negotiations designed to clarify the uncertainty.[94] This is especially relevant for struggling companies facing the added complication that conventional valuation methodologies are vulnerable to misfiring.[95]

C. Creditor Control Rights as Risk Mitigation

Lenders also exercise control over a borrower's internal affairs to safeguard their exposure.[96] Understanding creditor power has long come in second place when compared to the literature that has grown around capturing the role of shareholders. However, lenders can be impactful in ways that far exceed the influence of shareholders on a company's granular decision making and everyday performance.[97]

Creditor governance, particularly in the context of bank debt, can be highly influential.[98] Formally, bank lenders look to the loan agreement to craft contractual levers that can severely limit a borrower's

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92 *See* Stuart C. Gilson, Edith S. Hotchkiss & Richard S. Ruback, *Valuation of Bankrupt Firms*, 13 REV. FIN. STUD. 43, 44–45 (2000) (highlighting the ways that bankruptcy can limit the quality and quantity of information available about a firm's cash flows).

93 *See id.* at 55.

94 *See id.* at 44–45 (discussing the importance of information for creditors during valuation battles). On voluntary disclosure, cost of capital and capital structure choices, see Jeremy Bertomeu, Anne Beyer & Ronald A. Dye, *Capital Structure, Cost of Capital, and Voluntary Disclosures*, 86 ACCT. REV. 857 (2011).

95 Damodaran, *supra* note 24, at 5–6.

96 *See* sources cited *supra* note 55.

97 *See* Baird & Rasmussen, *supra* note 55, at 1212–23; Tung, *supra* note 26, at 117–29. *But see* Jared A. Ellias & Robert J. Stark, *Bankruptcy Hardball*, 108 CALIF. L. REV. 745 (2020) (analyzing the increasingly opportunistic behavior by issuers against creditors in situations of financial stress like Chapter 11 bankruptcy, designed to help certain stakeholders over others).

98 *See, e.g.*, Christopher James, *Some Evidence on the Uniqueness of Bank Loans*, 19 J. FIN. ECON. 217, 226 (1987) (finding that bank lending results in a boost to share prices, whereas private placements can produce negative returns); Steven Ongena, Viorel Rosçovan, Wei-Ling Song & Bas J.M. Werker, *Banks and Bonds: The Impact of Bank Loan Announcements on Bond and Equity Prices*, 2 J. FIN. MGMT. & INSTS. 131, 148 (2014) (noting that bond credit spreads showed a marked decrease in risk following the announcement of a bank loan); Steven Ongena & Viorel Roscovan, *Bank Loan Announcements and Borrower Stock Returns: Does Bank Origin Matter?*, 13 INT'L REV. FIN. 137, 157 (2013) (noting that stock returns vary depending on the kind of bank that lends to a borrower, with higher stock returns where lending is undertaken by foreign banks and local banks). *But see* Matthew T. Billett, Mark J. Flannery & Jon A. Garfinkel, *Are Bank Loans Special? Evidence on the Post-Announcement Performance of Bank Bor-*

room to maneuver.[99] With detailed information and access to the boardroom, lenders are able to surveil a borrower and limit its expenditures, investments, dividend declarations, changes of control, and additional debt.[100] Violations of bond indenture terms can result in harsh consequences, with lenders dictating firings of senior managers and ensuring creditor-approved replacements.[101] Indeed, scholars note that the loan agreement constitutes an organic document that is under constant renegotiation and updating.[102] Terms and conditions are drafted precisely in order to be breached; the terms are designed to trigger periodic scrutiny and opportunities for lenders to impose discipline as well as to extract lucrative private gains in the form of fees and products sold to the borrower.[103] According to one study on covenant violations by Michael Roberts and Amir Sufi, only about 4% of all covenant violations led to a lender ending its relationship with the borrower.[104] Rather, the default opened the door to a renegotiation between the parties on revised, creditor-approved terms.[105]

These instances of lender engagement are not limited to bank lenders. Increasingly, bondholders have sometimes shown themselves to be active in pursuing violations of indenture terms.[106] In general, it

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rowers, 41 J. FIN. & QUANTITATIVE ANALYSIS 733, 749 (2006) (suggesting that a boost to equity returns may be very short-term in nature). The literature on this topic is extensive.

99 *See, e.g.*, Baird & Rasmussen, *supra* note 55, 1212–23; Tung, *supra* note 26, 117–29.

100 *See* Baird & Rasmussen, *supra* note 55, 1212–23; Tung, *supra* note 26, 117–29.

101 *See* Tung, *supra* note 26, 117–29.

102 *See* George Triantis, *Exploring the Limits of Contract Design in Debt Financing*, 161 U. PA. L. REV. 2041, 2047–48 (2013) [hereinafter *Limits of Contract Design*] (noting the shift of power to creditors); George G. Triantis, *Debt Financing, Corporate Decision Making and Security Design*, 26 CAN. BUS. L.J. 93, 101–04 (1996) [hereinafter *Debt Financing*] (analyzing the importance of default as a trigger for renegotiation); *see also* Barry E. Adler & Marcel Kahan, *The Technology of Creditor Protection*, 161 U. PA. L. REV. 1773, 1778–79 (2013) (noting that contracts governing the relationship between creditors and debtors can be changed more easily than laws); Charles K. Whitehead, *The Evolution of Debt: Covenants, the Credit Market, and Corporate Governance*, 34 J. CORP. L. 641, 650–54 (2009) (analyzing the varying intensity of covenants); Albert Choi & George Triantis, *Market Conditions and Contract Design: Variations in Debt Contracting*, 88 N.Y.U. L. REV. 51, 61 (2013) (noting the capacity of covenant adjustment in response to changes to shifts in credit availability). Where borrowers violate loans in a past lending, it can lead to higher spreads in a new loan. *See* Felix Freudenberg, Björn Imbierowicz, Anthony Saunders & Sascha Steffen, *Covenant Violations and Dynamic Loan Contracting*, 45 J. CORP. FIN. 540, 540–42 (2017).

103 *Limits of Contract Design*, *supra* note 102, at 2047–48.

104 Michael R. Roberts & Amir Sufi, *Control Rights and Capital Structure: An Empirical Investigation*, 64 J. FIN. 1657, 1660 (2009).

105 *See id.* at 1666; Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 537–39 (2009) (on the significance of creditor control in the periods preceding and during bankruptcy).

106 *See* Kahan & Rock, *supra* note 87, at 282–83 (noting limited incentives for indenture

makes sense that bondholders would be passive actors in debt governance—leaving indenture terms to go underenforced. Collective action costs and relatively weaker covenants in public bond debt can consign creditor control by bondholders to a theoretical afterthought.[107] However, activist hedge funds have steadily made their mark in bond markets, reviving neglected covenants by organizing and agitating against issuers, deploying their sophistication and resources, and taking advantage of regulatory flexibility to pursue actions and punish indenture defaults.[108] Kahan and Rock identify key triggers for bondholder action: interpretative discrepancies in the bond, proposed changes of control, and failures to file timely reports with the SEC can unleash intervention.[109] Activists have been able to extract value in the form of fees for waiving default violations, securing full or greater than full payment on the bonds, tighter covenants, and a subsequent increase in the market price of the traded bonds.[110] Their incentives to act have also enjoyed a boost through recent judicial decision making. Approving generous remedies for bond defaults, courts have crafted lucrative carrots for bondholders who can successfully press their claim.[111]

This "default activism" has reverberated across major Main Street, motivating issuers to seek settlements with agitators.[112] Albert-

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trustees to monitor and act on violations of the indenture agreement). In public markets, bond issues are administered by an indenture trustee, designated, in theory, to protect bondholder interests. However, it is well recognized that trustees are poorly incentivized and can lack authority and duty to protect bondholders. *See* Schwarcz & Sergi, *supra* note 17, at 1040–42 (noting that trustees are not subject to a stringent standard of care in protecting bondholders); Amihud et al., *supra* note 85, at 469–70 (detailing the need for a "supertrustee" to enhance bondholder discipline).

107 *See* Kahan & Rock, *supra* note 87, at 283. In the context of private debt markets, see Kahan & Tuckman, *supra* note 84, at 11–13; Bratton, *supra* note 20, at 63–65; Amihud et al., *supra* note 85, at 457–65.

108 *See* Kahan & Rock, *supra* note 87, at 283.

109 *See id.*, at 284–92; *see also* Gao et al., *supra* note 87, at 1543–44 (analyzing the characteristics of hedge fund versus non-hedge fund driven enforcement).

110 *See* Kahan & Rock, *supra* note 87, at 284–92 (detailing specific instances of bondholder activism).

111 *See, e.g.*, Wilmington Sav. Fund Soc'y, FSB v. Cash Am. Int'l, Inc., No. 15-CV-5027, 2016 WL 5092594 (S.D.N.Y. Sept. 19, 2016). The court allowed the payment of a "make-whole" premium to investors alleging a default of indenture terms, in addition to the amount that the issuer would have owed them had it chosen to redeem early. *See id.* For discussion, see Mitu Gulati & Marcel Kahan, Cash America *and the Structure of Bondholder Remedies*, 13 Cap. Mkts. L.J. 570 (2018) (discussing *Cash America*); Matt Levine, *Bond Covenants and Skeptic Skepticism*, Bloomberg L. (Jan. 12, 2017, 9:23 AM), https://www.bloomberg.com/opinion/articles/2017-01-12/bond-covenants-and-skeptic-skepticism#xj4y7vzkg [https://perma.cc/5XEH-8VQX] (discussing *Cash America* and "make-whole" premium payments).

112 *See* Steven Cohen, Emil A. Kleinhaus & John R. Sobolewski, *Default Activism in the Debt Market*, Harv. L. Sch. F. on Corp. Governance (Dec. 4, 2018), https://

sons, the supermarket giant, paid $330 million to Safeway bondholders to deal with accusations that Albertsons's then four-year-old takeover of Safeway had violated several indenture terms.[113] Albertsons used this $330 million to buy back certain bonds at par as well as to pay unpaid and accrued interest on this debt with the understanding that doing so would free the company to move forward.[114] Similarly PetSmart, the pet supplies company and owner of Chewy.com, has been embroiled in litigation with creditors holding PetSmart loans and bonds.[115] PetSmart transferred Chewy's equity to its parent company and a subsidiary, putting this asset out of reach of creditors and violating terms of loan and bond agreements.[116] Though PetSmart managed to settle the dispute with some creditors, it did not satisfy all its bondholders.[117] One firm, holding $80 million in loan exposure and $600 million of bond debt, continued to litigate, prompting other bondholders to consider action.[118]

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corpgov.law.harvard.edu/2018/12/04/default-activism-in-the-debt-market/ [https://perma.cc/4A3U-69Y8].

113 *See Albertsons Buys Disputed Safeway Bonds*, WINSIGHT GROCERY BUS. (Nov. 30, 2018), https://www.winsightgrocerybusiness.com/retailers/albertsons-buys-disputed-safeway-bonds [https://perma.cc/Q4C6-29LE].

114 *See* Katherine Doherty, *Albertsons' Safeway Buys Back Notes to End Default Claim*, BLOOMBERG (Nov. 29, 2018, 5:19 PM), https://www.bloomberg.com/news/articles/2018-11-29/albertsons-buys-back-safeway-notes-to-end-default-dispute#xj4y7vzkg [https://perma.cc/C9LE-DTMX]. For more background on this dispute, see Alexandra Scaggs, Opinion, *Schrödinger's Default*, FIN. TIMES (July 25, 2018), https://www.ft.com/content/f82088fa-b44a-30f5-bbc7-6ee8446b5282 [https://perma.cc/8LXG-PK2P] and Letter from Lawrence Lee, Couns. for Bondholders, Paul, Weiss, Rifkind, Wharton & Garrison LLP, to Counsel for Safeway as Issuer of the Debentures (Jul. 19, 2018) (on file with the Geo. Wash. L. Rev.).

115 *See* Eliza Ronalds-Hannon & Katherine Doherty, *CapRe Seeks to Take Over PetSmart Lawsuit That Lenders Dropped*, BLOOMBERG L. (Apr. 5, 2019, 1:50 PM), https://www.bloomberg.com/news/articles/2019-04-05/capre-seeks-to-take-over-petsmart-lawsuit-that-lenders-dropped [https://perma.cc/SR8K-WNLT].

116 Soma Biswas, *PetSmart Defends Chewey.com Share Transfers*, WALL ST. J. (Sept. 17, 2018, 1:48 PM), https://www.wsj.com/articles/petsmart-defends-chewy-com-share-transfers-1537206523 [https://perma.cc/G4SB-7GEF].

117 *See* Ronalds-Hannon & Doherty, *supra* note 115.

118 *See id.* For a discussion of the noteholder agitation against J. Crew, iHeart, and Claire's, see, for example, David W. Morse, *Lenders Beware: Expectations and Unintended Consequences—It's Not Just Financial Covenants!*, THE SECURED LENDER 34 (Nov. 2018), https://www.otterbourg.com/assets/htmldocuments/Lenders%20Beware%20Covenants%20Secured%20Lender%20Nov.%202018.pdf [https://perma.cc/M69V-BQL2]. In the distressed debt context, see Michelle M. Harner, *Trends in Distressed Debt Investing: An Empirical Study of Investors' Objectives*, 16 AM. BANKR. INST. L. REV. 69, 84–90 (2008) (detailing the strategies used by distressed debt investor specialists); Michelle M. Harner, *The Corporate Governance and Public Policy Implications of Distressed Debt Investing*, 77 FORDHAM L. REV. 703, 73537 (2008) (on the success in so-called "loan-to-own" strategies).

Importantly, bondholder governance can impact a company outside of covenant violations. Sandrine Docgne shows that indenture terms impact firm management independently of enforcement by bondholders.[119] In her study of public bonds, restrictions on investment in bond indentures resulted in a fall in investment in the two years following the bond issue.[120] Such firms undertook fewer capital expenditures relative to those that were not subject to such covenants.[121] Perhaps unsurprisingly, this trend was especially true for firms that were financially distressed.[122]

Creditor control can enhance capital allocation. It provides a check on the risk that managers and shareholders will be careless and greedy in looking after creditor money.[123] That lenders can be ruthlessly efficient at accomplishing this is suggested by Greg Nini, David C. Smith, and Amir Sufi who observed forced manager turnover to be 60% higher than usual in the quarter a covenant violation occurs.[124] Work by Sadi Ozelge and Anthony Saunders shows this figure to be much higher, with underperforming firms in violation of loan terms experiencing a 68–92% higher probability of forced manager change.[125] Additionally, lender vigilance can help cure distorted shareholder incentives that might lead shareholders to unduly enrich themselves at creditor expense. Loan and indenture agreements explicitly scrutinize dividend declarations.[126] In the PetSmart litigation, for example, creditors sued alleging that value was unfairly diverted to its parent, effectively declaring a dividend for the parent and depriving creditors of key collateral.[127] Unsurprisingly, Linda Allen and others find that dividend payouts decline under bank monitoring.[128] That

119 *See* Sandrine P. Docgne, Bond Covenants and Investment Policy (Feb. 14, 2019) (working paper).

120 *See id.* at 13–14.

121 *See id.* at 2–3.

122 *See id.*

123 *See, e.g.*, *Limits of Contract Design*, *supra* note 102, at 2047–48; Smith & Warner, *supra* note 20; Michael C. Jensen, *The Agency Costs of Free Cash Flow, Corporate Finance & Takeovers*, 76 AM. ECON. REV. 323, 324 (1986).

124 Greg Nini, David C. Smith & Amir Sufi, *Creditor Control Rights, Corporate Governance, and Firm Value*, 25 Rev. Fin. Stud. 1713, 1716 (2012) (showing that CEO turnover is sixty percent higher following a covenant violation); *see also* Sadi Ozelge & Anthony Saunders, *The Role of Lending Banks in Forced CEO Turnovers*, 44 J. MONEY, CREDIT & BANKING 631 (2012) (noting higher CEO turnover where companies are more dependent on debt).

125 Ozelge & Saunders, *supra* note 124, at 631.

126 *See* Tung, *supra* note 26, at 145.

127 *See* sources cited *supra* note 118.

128 *See* Linda Allen, Aron Gottesman, Anthony Saunders & Yi Tang, *The Role of Banks in Dividend Policy*, 41 FIN. MGMT. 591 (2012).

lender oversight can yield real welfare pay-offs is made clear by the benefits that can accrue to companies following a default. In a study of 3,500 covenant violations, Nini and others show that companies see gains in their equity valuation, reduced expenditure, fewer dividends, better performance, and abnormal returns of around 5%.[129]

But creditor oversight comes with costs. For one, the borrower must regularly service its debt. Failure to do so results in default and a cascade of disciplinary measures.[130] To afford payment, companies might have to forgo investment in risky projects or projects that will only produce profit far into the future.[131] Additionally, lenders may focus only on monitoring their own interest even if it conflicts with that of other creditors.[132] They may make poor decisions and fail to consider the effect of their efforts on others.[133] Finally, lender monitoring can be a nuisance. It can give rise to expensive negotiations, and outcomes may not always benefit the company. In one empirical study of bondholder activism by hedge funds, the authors find that interventions can result in wealth transfers from shareholders and nonintervening bondholders to hedge fund activists.[134] The authors note that such intervention is motivated primarily by short-term, profit-based considerations and the benefits accrue mainly to the activists, rather than to the company.[135]

To summarize, debt requires parties to estimate the issuer's chances of meeting its payment obligations. The uncertainty means that lenders need tools that can help to properly price default risk and techniques—like taking security over a borrower's assets—that can cushion its impact. Importantly, ceding information and control to lenders can vastly ease a borrower's path to obtaining credit, but is also problematic. Managers and shareholders can face limits on deci-

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129 Nini et al., *supra* note 124, at 1715–17; *see also* Victoria Ivashina, Vinay B. Nair, Anthony Saunders, Nadia Massoud & Roger Stover, *Bank Debt and Corporate Governance*, 22 REV. FIN. STUD. 41, 42 (2009) (showing that lenders governance can contribute to making borrowers more attractive takeover targets).

130 *See* Freudenberg et al., *supra* note 102, at 541.

131 *See* Baird & Rasmussen, *supra* note 55, at 1245–46.

132 *See* George G. Triantis, *Secured Debt Under Conditions of Imperfect Information*, 21 J. LEGAL STUD. 225, 24147 (1992); *see also, e.g.*, Anthony J. Casey, *The Creditors' Bargain and Option-Preservation Priority in Chapter 11*, 78 U. CHI. L. REV. 759, 761–62 (2011) (describing tensions between junior and senior creditors and impact on creditor incentives).

133 *See* Baird & Rasmussen, *supra* note 55, at 1245–46.

134 *See* Gao et al., *supra* note 87, at 1546.

135 *See id.* at 1575; *see also* Kahan & Rock, *supra* note 87 (observing that hedge funds are strategic and tactical in pursuing only those covenant violations that result in actual profit for the fund).

sion making. Lenders can become a costly nuisance, locking borrowers into a long-term system of formal and softer constraints that can seem excessively limiting.

II. An Introduction to Debt Buybacks

Debt buybacks involve borrowers using available cash to reduce or extinguish their debt by buying back their own debt on the open market or through a tender offer.[136] They operate as part of a spectrum of techniques used by bondholders and issuers to renegotiate and terminate their agreement prior to maturity.[137]

Debt buybacks are a powerful tool for borrowers, helping companies to recalibrate their capital structure and reset the balance of control between themselves and lenders.[138] Buybacks are also significant for intercreditor relationships. Those whose debt is bought back lose their standing within the hierarchy of lenders. For some, this can be welcome, allowing them to recover some of their money and to end their relationship with a faltering company.[139] For others, however, debt buybacks can result in lenders unwillingly losing future cash flows and creditor control rights.[140] Despite their significance, however, the literature on debt buybacks is surprisingly thin, reflecting a phenomenon that appears forgotten by policy and operating under the regulatory radar.[141] This Part introduces debt buybacks, their importance for investor bargains, and their regulation.

136 Here the word "buyback" is used to refer to both open market repurchases and tender offers. *See* Brandon Julio, *supra* note 14 ("Although debt retirement by open market repurchases and tender offers are rather common, very little is understood about the market for debt repurchases . . . . ").

137 *See supra* note 49.

138 *See, e.g.*, Julio, *supra* note 14, at 29–30; Julio J. Rotemberg, *Sovereign Debt Buybacks Can Lower Bargaining Costs*, 10 J. Int'l Money & Fin. 330, 331–32 (1991).

139 *Cf.* Rotemberg, *supra* note 138, at 332.

140 *See* Brudney, *supra* note 16, at 1822.

141 *See* Julio, *supra* note 14, at 4 ("The literature on debt repurchases is surprisingly fairly small and young.").

A. The Rationale for Debt Buybacks

Debt buybacks provide borrowers with a means to adjust their balance sheets by repurchasing outstanding debt claims,[142] usually accompanied by amendments to their terms and conditions.[143]

Share buybacks function as a channel to compensate shareholders. In addition to dividends, equity buybacks constitute a form of payout to shareholders.[144] Such buybacks leave shareholders whose securities are not repurchased with a proportionately larger claim to the remaining pie.[145] According to Jesse Fried and Charles Wang, equity buybacks are usually viewed favorably by investors.[146] Activist campaigns routinely seek to pressure management to return value to shareholders through dividends and equity buybacks.[147] Fried and Yang observe that between 2007 and 2016, S&P 500 firms distributed around $7 trillion to shareholders in the form of either dividends or buybacks.[148] Per finance theory, equity buybacks help reduce managerial misbehavior by limiting the amount of free cash left in the hands of incompetent managers.[149] Such payouts are also necessary for capital markets. If shareholders cannot count on regular returns, whether these occur by way of buybacks or dividends, there is little reason to invest.[150]

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142 Loans can also be repurchased by a company in the open market. *See* Levy & Shalev, *supra* note 14, at 385–86. However, this is less common and also does not implicate securities regulation because loans are not generally included as "securities" within the definition of section 2(a)(1) of the Securities Act of 1933. *See* Carmine Boccuzzi, Meme Peponis & Jared Gerber, *New Ruling May Aid Syndicated Loan Market Amid Pandemic*, LAW360 (June 8, 2020, 6:43 PM), https://www.law360.com/articles/1278124 [https://perma.cc/2X5B-TKU2].

143 *See* Brudney, *supra* note 16, at 1821. This Article does not examine callable bonds that expressly provide provisions for the debt to be "called" or prepaid in advance of the maturity date. On discussion of callable bonds, see Qiping Xu, *Kicking Maturity Down the Road*: *Early Refinancing and Maturity Management in the Corporate Bond Market*, 31 REV. FIN. STUD. 3061 (2018) (describing the tendency for issuers to be sensitive to macroeconomic shifts).

144 *See* William F. Maxwell & Clifford P. Stephens, *The Wealth Effects of Repurchases on Bondholders*, 58 J. FIN. 895, 896–98 (2003).

145 *See id.* at 897–98.

146 *See* Fried & Wang, *supra* note 15, at 208; *see also* Gustavo Grullon & Roni Michaely, *The Information Content of Share Repurchase Programs*, 59 J. FIN. 651, 653–54 (2004) (noting that news of share repurchases tends to point to a reduction in systematic risk and a lowering of cost of capital relative to firms that are nonrepurchasing).

147 *See, e.g.*, Erin McCarthy, *Icahn Letter Pushes Apple to Buy Back More Shares*, WALL ST. J. (Oct. 9, 2014, 10:53 AM) https://www.wsj.com/articles/icahn-pushes-apple-to-buy-back-more-stock-1412860351 [https://perma.cc/8QTT-2RRH].

148 Fried & Wang, *supra* note 15, at 212; *see also* William Lazonick, *Profits Without Prosperity*, HARV. BUS. REV., Sept. 2014 (suggesting that share buybacks increase short-termism). Fried and Yang offer a rebuttal to this thesis. *See* Fried & Wang, *supra* note 15, at 208–10.

149 *See* Grullon & Michaely, *supra* note 146, at 653.

150 For the classic account, see Jensen, *supra* note 123, at 326.

But the purpose of buying back debt has little to do with winning selling creditors' approval and returning value to them. Despite a shared nomenclature, debt buybacks serve a distinct economic purpose from equity repurchases. Whereas shareholders depend on stock buybacks as a source of returns on investment, debt repurchases seek to extinguish the bargain originally reached with a creditor. Debt repurchases can deprive creditors of the expected value of their investment and limit the cash flows and contractual rights to which bondholders are otherwise contractually entitled.[151] Unless forbidden by the bond agreement, they also provide a way around express contractual provisions that deal with calling and retiring a bond issue.[152] Between 2004 and 2017, companies have repurchased approximately $1.89 trillion worth of debt in the open market and through tender offers.[153]

Broadly, debt buybacks can be carried out to satisfy four major purposes: (1) moving the company toward a more optimal balance between debt and equity, (2) amending or eliminating covenants in the credit agreement, (3) informally restructuring bondholder claims during periods of financial distress, and (4) bypassing contractual callability options.

1. Cleaning Up the Balance Sheet

Debt buybacks can reduce leverage on balance sheets, bringing the company's capital structure closer to an optimal mix of debt and equity.[154] It makes sense that companies would want to buy back their own debt. For a start, lenders and borrowers might have misjudged the borrower's default risk at origination resulting in the debt burden becoming untenable. Lenders may have locked a borrower into an ex-

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151 *See* Brudney, *supra* note 16, at 1822.

152 *See id.* This is especially true for debt tender offers. *See id.* at 1833–35. For open market repurchases, issuers can repurchase from bondholders at an undervalue. *See id.* at 1832 (critiquing the practice as issuer opportunism). On debt buybacks as a way to negotiate around hard contractual constraints, see Julio, *supra* note 14, at 3–5. On opportunism, see James Greene, Monica M. Holden, Stuart Matty, Melissa Butler, Richard Pogrel, & Jonathan Rogers, *Bond Repurchases—an Issuer's Guide to Questions to Ask and Points to Consider (March 2020 Update)*, White & Case (Mar. 30, 2020), https://www.whitecase.com/insight-alert/bond-repurchases-issuers-guide-questions-ask-and-points-consider-march-2020-update [https://perma.cc/GB2H-ZEF8].

153 *See supra* note 13 and accompanying text.

154 *See* Timothy Kruse, Tom Nohel & Steven K. Todd, *The Decision to Repurchase Debt*, 26 J. Applied Corp. Fin. 85, 88 (2014) (discussing reasons for buying back debt, including deleveraging); Julio, *supra* note 14, at 19 (showing that debt repurchase decisions are driven by the need to address distortions from optimal capital structure).

pensive set of payment obligations relative to riskiness, causing it to divert unnecessarily large amounts of cash to service its debt.[155] For example, shifting macroeconomic conditions can mean that acceptable terms for debt issued in one year become burdensome in another.[156] This became apparent in the years following the 2008 Financial Crisis when the availability of cheap debt increased after the Federal Reserve lowered interest rates.[157] Buybacks quickly took off and, in 2010, reached $88 billion in repurchased publicly traded debt.[158] Empirical study shows that issuers are sensitive to shifting macroeconomic climates when deciding to prepay or refinance their debt.[159] Debt repurchases thus allow borrowers to buy back expensive debt and take out cheaper credit in response to favorable economic conditions.

This rationale is powerful in the case of smaller, less creditworthy companies. Such businesses usually have little slack, riskier cash flows, and a possible history of past defaults. Debt repurchases offer these borrowers an opportunity to use resources strategically to buyback and refinance their debt and avoid expensive violations and bankruptcy. As discussed in Part I, companies experiencing losses risk rapidly putting the value of their equity in jeopardy. Struggling companies are closer to the precipice of insolvency and likely to have a higher debt burden than they can service.

Unsurprisingly, scholars note that debt repurchases are particularly popular with riskier companies, such as those with a credit rating of BBB or below.[160] These debt levels place constraints on investment choices, reducing a firm's capacity to respond to new opportunities.[161] Brandon Julio empirically observes that companies conducting

155 *See* Julio, *supra* note 14, at 29 (noting that debt buybacks offer a form of debt renegotiation). For a discussion of covenants, discussed below, see Kahan & Tuckman, *supra* note 27 (highlighting that covenants may not always be optimal for the length of the loan).

156 *See, e.g.*, Sam Goldfarb & Avantika Chilkoti, *Regulators, Investors Zero in on Corporate Debt Market*, WALL ST. J. (May 28, 2019, 10:14 AM), https://www.wsj.com/articles/regulators-investors-zero-in-on-corporate-debt-market-11558958401 [https://perma.cc/E85Y-7MTU] (describing how evolving macroeconomic conditions made borrowing less burdensome during the period in question).

157 For explanation of the Federal Reserve's approach to lowering interest rates and the impact on the corporate bond market, see William D. Cohan, Opinion, *The Big, Dangerous Bubble in Corporate Debt*, N.Y. TIMES (Aug. 9, 2018), https://www.nytimes.com/2018/08/09/opinion/corporate-debt-bubble-next-recession.html [https://perma.cc/3L9W-WY4A].

158 Julio, *supra* note 14, at 1.

159 *See* Xu, *supra* note 143, at 3062.

160 *See* Kruse et al., *supra* note 154, at 86–88 (observing that companies who engaged in buybacks were more likely to have weak operating returns, less cash, more long-term debt, trade at a discount, and have more assets).

161 *See id.* at 85; Julio, *supra* note 14, at 1.

buybacks were highly indebted, both in absolute terms as well as relative to competitors.[162] In addition, firms repurchasing debt showed vulnerability to default.[163] In the two months preceding the repurchase, bond credit ratings fell sharply following a period of decline in company finances.[164] Further underscoring this point, Julio reports that surveyed companies saw an average drop of 55% in their cash flows over the three years preceding the buyback.[165]

Anecdotally, a slew of prominent investment grade, or slightly less than investment grade, Main Street companies bought back their debt in recent years in a bid to revive their balance sheets. Like Tupperware, Macy's and Kohl's, the retail giants, both recently repurchased their debt.[166] Similarly, BBB-rated companies like Verizon and Viacom also resorted to repurchasing their debt to reduce debt servicing costs.[167] By improving the look of their books, this strategy helped BBB-rated companies see better performance relative to more creditworthy peers.[168]

It is debatable whether buybacks are an unquestioned positive for issuers. Recall that debt can promote good governance.[169] Lenders scrutinize managers and shareholders and prevent them from using company resources for undue self-enrichment.[170] Repurchases by issuers, particularly those with a propensity toward riskiness, may be bad news for capital allocation in the long-term. Ultimately, judgments on the rightness or otherwise of buybacks for debt reduction turn on determinations of what constitutes an optimal capital structure for a particular company.[171] The "correct" amount and composition of debt can provide a boost for firm value by offering cost-effective investment capital and sound monitoring. Studies show that equity value rises, albeit modestly, after a repurchase. In their study of 208 buybacks by 189 companies, Kruse, Nohel, and Todd noted that the transactions

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162 *See* Julio, *supra* note 14, at 16.

163 *See id.* at 17.

164 *See id.* at 16–17.

165 *See id.* at 17.

166 Alexandra Scaggs, *Debt Buybacks Could be the New Stock Buybacks*, BARRON'S (Jan. 8, 2019, 7:00 AM), https://www.barrons.com/articles/stock-buybacks-debt-buybacks-51546891480 [https://perma.cc/D9EK-RJZD] [hereinafter Scaggs, *Debt Buybacks*].

167 *See id.*

168 *See id.*

169 *See supra* Section I.C.

170 *See supra* Section I.C.

171 *See, e.g.*, Bolton & Scharfstein, *supra* note 56, at 20 (finding that optimal capital structure balances default deterrence and cost mitigation of unavoidable defaults).

studied yielded average cumulative equity returns of 1.47%.[172] Repurchases funded by equity failed to generate any gains.[173] Those that were financed using asset sales were more successful, increasing cumulative equity gains by an average of 3.77%.[174] These findings point to a relatively mixed picture where short-term, average gains for a company's bottom line are ultimately eroded by a lasting hit to the quality of internal discipline and creditor control.

2. *Extinguishing Creditor Control*

Debt buybacks provide a way for borrowers to extinguish creditor control rights. In repurchasing debt, borrowers can eliminate covenants that are problematic or likely to trigger future activism.[175]

That companies might want to do away with tough covenants is understandable. Marcel Kahan and Bruce Tuckman point out that a fixed set of covenants can be a poor fit for the changing riskiness of a long-term lending relationship.[176] Restrictions on borrowing, capital expenditure, or dividend declarations may become stifling for an issuer whose riskiness has changed.[177] Overly limiting covenants can transfer value from a company's shareholders to its creditors.[178] Where creditors enforce ill-fitting covenants, discipline becomes costly and not useful to reduce riskiness.

Under the Trust Indenture Act, modifying terms relating to payment demands essentially unanimous consent from bondholders—rendering such amendments practically impossible.[179] But companies routinely buy back their debt to modify the application of nonpayment related covenants and events of default.[180] Here, changes can be achieved by securing the consent of the majority or, sometimes, two-thirds of all bondholders.[181] In one study, covenant removal was cited

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172 Kruse et al., *supra* note 154, at 88.

173 *Id.*

174 *Id.*

175 *See* Jamie A. Anderson-Parson, Terrill R. Keasler & Robin T. Byerly, *Bond Indenture Consent Solicitations as a Debt Management Tool*, 3 INT'L J. FIN STUD. 230, 231–33 (2015).

176 *See* Kahan & Tuckman, *supra* note 27, at 499.

177 *See id.* at 499–503; *see also* Chatterjee et al., *supra* note 39, at 334 (noting the benefits for lenders of covenant alterations to enable workouts); Cohen et al., *supra* note 112 (noting how restrictive covenants can limit an issuer's options).

178 *See* Anderson-Parson et al., *supra* note 175, at 233–34.

179 The Trust Indenture Act of 1939 mandates that amendments to payment terms receive unanimous consent, effectively precluding any realistic chance of an informal bond workout. *See* 15 U.S.C. § 77ppp(b).

180 *See* Kahan & Tuckman, *supra* note 27, at 502–04.

181 *Id.* at 501–02.

as the reason for conducting almost 20% of the buybacks in the sample.[182] In 2017, Verizon, the telecoms giant, paid $1 billion to buy back bonds on behalf of itself and numerous subsidiaries while also removing various limiting covenants.[183] Albertsons handed over $330 million to repurchase bond debt from investors contesting its takeover of Safeway, blunting the power of activists.[184]

As discussed earlier, issuers can also buy back restrictive debt to take advantage of a permissive lending environment. The availability of cheap credit—particularly post-2008—has helped issuers to bargain for lighter loan and indenture terms.[185] In such circumstances, it makes little sense for issuers to be hamstrung by debt carrying highly restrictive covenants. Instead, they can use debt repurchases to relieve their compliance burden, prior to refinancing on more relaxed terms.

This approach has advantages. A borrower should face fewer costs from covenant violations, like a ratings downgrade.[186] Activist debtholders end up with a more limited arsenal of levers with which to agitate against a company. According to one view, more relaxed debt terms mean fewer defaults precisely because management has greater leeway to act and is not impacted by aggressive investors.[187] Research by Standard and Poor's showed that "cov-lite" loans rated BB- had a default rate of zero, compared with a rate of 6.7% for similarly rated debt that contained the usual set of covenants.[188] With fewer covenant

182 Kruse et al., *supra* note 154, at 87.

183 Verizon, *supra* note 39.

184 *See* Doherty, *supra* note 114.

185 The term "cov-lite" is usually applied to bank loans. *See* Michael N. Reczek, An Examination of the Value of Covenant Lite Debt to Issuing Companies 4 (Apr. 1, 2010) (working paper), http://web-docs.stern.nyu.edu/glucksman/docs/Reczek2010.pdf [https://perma.cc/5HE5-JXJQ]. However, there has been a deterioration in covenant quality for bonds as well as loans. For discussion on the increasing "bond-like" quality of the leveraged loan market, see generally Maura E. O'Sullivan & Benjamin M. Cheng, *Term Loans and High Yield Bonds: Tracking the Convergence*, THOMSON REUTERS PRACTICAL L. (July 1, 2012), https://1.next.westlaw.com/Document/I03f4d6a0eee311e28578f7ccc38dcbee/View/FullText.html?transitionType=default&contextData=(sc.Default) [https://perma.cc/9Y76-GFN3]; Alexandra Scaggs, *Hope Floats*, FIN. TIMES (May 16, 2018), https://www.ft.com/content/89178cc4-5188-3fb5-9e77-fed4b7494307 [https://perma.cc/7VQM-UDXY].

186 *See* Reczek, *supra* note 185.

187 *See id.* at 10–11.

188 Kadhim Shubber, *Concern Over Waning Use of Covenants in Debt Markets*, FIN. TIMES (Aug 27, 2015), https://www.ft.com/content/44030cb2-4690-11e5-b3b2-1672f710807b [https://perma.cc/3S7P-CT88]; *see also* Stephen Foley, *Cov-Lite Loans Lose Stigma in Yield Hunt*, FIN. TIMES (May 31, 2013), https://www.ft.com/content/e7d2ac10-ca11-11e2-8f55-00144feab7de [https://perma.cc/2JRZ-HM6U] (noting that cov-lite loans are not less likely to default that traditional loans). According to this study, the sample of cov-lite loans rated B- had a default rate of 13%, 5.4% lower than comparable debt with normal covenants. Shubber, *supra.* This view, that

violations, the issuer can delay or minimize negotiations with its lenders where routine defaults do not occur as regularly.[189] Carrying a lighter load of covenants, shareholders and managers can maintain greater control and transfer value from lenders to themselves.

The steady weakening of covenant strength post-2008 provides compelling incentives for issuers to consider repurchases.[190] According to Moody's Investors Service, the restrictiveness of covenants for high-yield bonds fell to a record low in July 2015.[191] In their measure for covenant quality, where a grade of "1" signals highest protection and "5" the lowest, the average covenant quality for such bonds stood at 4.6.[192] In mid-2018, its quality score for the North American bond market as a whole stood at 4.41, with the best scoring bond issues achieving grades of just 3.65 and 3.99—grades considered to be weak by Moody's standards.[193] Commentators have observed that indentures are being drafted to be more permissive in their financial covenants—increasing, for example, the amount of debt a company can incur relative to its earnings.[194] In addition, generous carveouts, opaque drafting, and contractual "loopholes" all give issuers plenty of wiggle room where they would likely not have enjoyed it beforehand.[195]

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cov-lite loans are less likely to default, is not shared universally. *Id.* The fact of limited default, critics suggest, is a matter of contractual luck, rather than a sign of a sounder credit profile. *See id.*

189 *See* Foley, *supra* note 188.

190 On the trade-off between cash flow and creditor control rights within low interest-rate environments, see Michael R. Roberts & Michael Schwert, *Interest Rates and the Design of Financial Contracts* (Nat'l Bureau of Econ. Rsch., Working Paper No. 27195, 2022).

191 Shubber, *supra* note 188.

192 *Id.*

193 *Bond Covenant Protections Weaken as Private Equity Scores Hit Record-Worst*, MOODY'S INVS. SERV. (June 12, 2018), https://www.moodys.com/research/Moodys-Bond-covenant-protections-weaken-as-private-equity-scores-hit—PR_385129 [https://perma.cc/JR2H-3P39]. On rock bottom scores for loan covenants, see *North American Loan Covenant Quality Hits New Record-Worst in Q3 2018*, MOODY'S INVS. SERV. (Jan. 24, 2019), https://www.moodys.com/research/Moodys-North-American-loan-covenant-quality-hits-new-record-worst—PR_394213 [https://perma.cc/Y5F3-4KNC]; *see also* Mary Childs, *And the Most Aggressive Private-Equity Deal Sponsor Is . . .* , BARRON'S, (Aug 21, 2019, 3:10 PM), https://www.barrons.com/articles/ranking-the-most-aggressive-private-equity-deal-sponsors-51566414643 [https://perma.cc/B39Y-RDD8] (discussing covenant quality in private equity deals).

194 *See, e.g.*, Alexandra Scaggs, *'Some of the Worst Loan Covenants That We've Ever Seen,'* FIN. TIMES (May 22, 2018), https://www.ft.com/content/21d6b2f7-f3a3-3ecc-b479-f11c3c7645bd [https://perma.cc/H37P-VFSJ].

195 *See id.*; *see also* Scaggs, *supra* note 185. However, investors are pushing back on weakening terms, particularly in egregious cases. *See, e.g.*, Scaggs, *supra* note 194.

Debt repurchases to restore managerial control for borrowers raises questions. Flexibility in shrugging off covenants—while beneficial in some cases—can be costly where borrowers are opportunistic and tactical in pursuing well-timed buybacks. Fewer covenants, weak monitoring, limited activism, and delayed negotiations might encourage managerial and shareholder risk-taking. Where managers take on more leverage than optimal—without the protection of covenants to keep risk-taking in check—lenders bear the risk of fallout.[196]

3. Resolving Financial Distress

For completeness, it is worth briefly noting that debt repurchases, specifically debt exchanges, play an important role in helping distressed companies to restructure their business, especially outside of the formal Chapter 11 bankruptcy process.[197] Companies that have taken on bond debt can find themselves in a tough position when it comes to dealing with an inability to pay off their liabilities. To avoid a Chapter 11 reorganization, privately negotiated debt "workouts" can offer a preferred first option for issuers.[198] A dispersed set of bondholders in a complex capital structure create long odds for a workout to succeed.[199]

Debt buybacks provide a mechanism to facilitate an out-of-court restructuring by allowing bond issues to be repurchased, removing them from the borrower's capital structure and easing negotiation. Much more often, rather than an outright repurchase, existing bonds can be exchanged as part of an offer to swap the old debt for new credit but on revised terms. Because the Trust Indenture Act requires unanimous consent to amend the payment-related terms of a bond, workouts require the original bonds to be exchanged for new ones that reflect an amended bargain on repayment.[200]

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196 *See* Kahan & Rock, *supra* note 87, at 304; Gao et al., *supra* note 87. On valuation questions in the context of covenants in junk bonds, see generally Kahan & Tuckman, *supra* note 27.

197 *See* WACHTELL, LIPTON, ROSEN & KATZ, DISTRESSED MERGERS AND ACQUISITIONS 19–26 (2013), https://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.22377.13.pdf [https://perma.cc/9MQP-YSUA] (discussing the role of debt repurchases for distressed companies attempting to avoid Chapter 11 proceedings).

198 *See* Stuart C. Gilson, Kose John & Larry H.P. Lang, *Troubled Debt Restructurings: An Empirical Study of Private Reorganization of Firms in Default*, 27 J. FIN. ECON. 315, 345–46 (1990) (finding that distressed companies see private debt work-arounds as an "attractive" alternative to formal reorganization). On the tradeoffs underlying workouts versus formal proceedings, see generally Alan Schwartz, *Bankruptcy Workouts and Debt Contracts*, 36 J.L. & ECON. 595 (1993).

199 *See* Bratton & Levitin, *supra* note 16, at 1600–01.

200 *See* 15 U.S.C. § 77ppp(b); *see also* Mark J. Roe, *The Voting Prohibition in Bond Work-*

Exchanging old bonds for new ones provides issuers with a route out of situations that would most likely end up in Chapter 11.[201] Successful exchange offers can offer real economic gains. According to Edward Altman and Brenda Karlin, exchanges have yielded stronger recoveries for bondholders when compared with formal restructuring.[202] Looking at exchange offers between 1984 to 2009, they show that exchanges produced an average recovery of 50.9 cents per dollar invested compared to just 37.5 cents for other kinds of default.[203] Exchange offers also tend to be much cheaper than formal bankruptcies.[204]

Nevertheless, exchange offers are often plagued by failure, conflict, opportunism, and rent-seeking.[205] Creditors hold out: dissenting creditors can see the value of their bonds increase by being uncooperative.[206] Issuers, too, can behave destructively, seeking to strong-arm creditors into accepting bad deals.[207] This dynamic can blunt the appeal and workability of exchange offers even if they offer the most likely avenue for an out-of-court bond workout.

A full discussion of bond workouts and debt exchanges is outside the scope of this Article. But they sit along the spectrum of strategies enabled by the basic theory and economics of debt renegotiation and repurchase.[208] That this technique can facilitate progress in situations of financial distress is reflected in the positive note sounded by Bill

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outs, 97 YALE L.J. 232, 232 (1987) (noting that recapitalization of existing bond obligations requires consent from the bondholders). In response, industry has developed exchange offers as a means to progress out-of-court bond workouts. *See* Bratton & Levitin, *supra* note 16, at 1600–02, 1631–32 (describing the history and real-life effects of the Trust Indenture Act). For seminal treatment on Section 316(b) of the Trust Indenture Act, making a case for removing the section, see Roe, *supra*, at 234–45 (arguing that Section 316(b) promoted wasteful negotiation and minimized the chances for successful exchange-offer based workouts); *see also*, Brudney, *supra* note 16, at 1876–78.

201 *See* Bratton & Levitin, *supra* note 16, at 1600–02.

202 *See* Edward I. Altman & Brenda Karlin, *The Re-Emergence of Distressed Exchanges in Corporate Restructurings*, 5 J. CREDIT RISK 43, 49 (2009).

203 *Id.* at 50, tbl.2.

204 *See* Bratton & Levitin, *supra* note 16, at 1630–31.

205 Scholars have developed a thoughtful literature into the issues surrounding section 316(b). *See* Roe, *supra* note 200; Bratton & Levitin, *supra* note 16.

206 This can happen because uncooperative creditors retain the "old" bond with the original terms (e.g., a high interest rate), whereas those that agree to an exchange receive a bond that carries a lower rate. *See* Bratton & Levitin, *supra* note 16, at 1607–08. After the exchange is completed, holdouts profit instead of those that worked with the issuer as the value of their bond increases. *See id.*

207 *See id.* at 1608–11.

208 *See generally* Anna Pinedo & Remmelt Reigersman, Morrison & Foerster, Presentation: Debt Repurchases & Exchanges (Nov. 8, 2012).

Bratton and Adam Levitin in their study of postcrisis exchange-based bond workouts. While underscoring the inherent difficulty, this last decade has seen workouts become more successful. The authors show that around twenty percent of all restructurings have moved from bankruptcy courts to workouts facilitated by bond exchange offers.[209] With institutional investors warming to exchanges and working efficiently to enable them, repurchases and exchanges are showing their usefulness in the marketplace.

4. Enhancing Contractual Flexibility

Debt buybacks offer flexibility for issuers seeking to negotiate around contractual terms on redeeming and retiring bonds. Bond indentures commonly include callability provisions that permit issuers to redeem and retire the bonds at a pre-agreed price. Issuers often have an option to "call" the bonds so long as they are willing to pay for it.[210] When interest rates decline, for example, the issuer might find it cheaper to call an existing set of bonds and issue new ones at favorable rates.[211] The "call" or "strike" price is specified as a percentage of the bond's face value—that is, the amount that issuers agree to pay investors.[212] This price can be a percentage of face value or one that varies according to a schedule over time.[213] Investors generally demand a higher return for holding a callable bond versus a noncallable equivalent.[214] With a callability option, investors risk losing the benefit of their investment earlier than the bond's stated maturity date. Also, the price of the bond will rarely appreciate beyond the call price, in effect, creating a growth ceiling for the value of the security.[215]

Standard callability options provide issuers with a contractually prescribed and workable means to exit the investment. But recent trends in market practice hint at a more complex signaling function for certain types of calls. Scholars point to a sharp increase in the use of "make-whole" call options that are designed to financially punish

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209 Bratton & Levitin, *supra* note 16, at 1601.

210 *See* CHOUDHRY, *supra* note 49, at 156–161, 263–65.

211 *See id.* at 262–65. Other options within a bond contract can include putability as well as sinking funds that set aside a pool of funds to repay or redeem bonds over the terms of the indenture. *See id.* at 160, 162.

212 *See id.* at 262–65.

213 *See id.* at 156–159; *see also* Elsaify & Roussanov, *supra* note 50, at 5, 7–9.

214 *See* CHOUDHRY, *supra* note 49, at 157.

215 *See id.* at 156–59.

issuers that exercise the option of paying off debt early.[216] In other words, make-wholes describe a subset of calls whose strike price is calculated in a way that makes it deliberately expensive and uneconomic for the issuer to use the option.[217]

The rise of make-wholes in bond agreements underscores their power as signaling devices. Knowing that an issuer will most likely never exercise the option, investors can be reassured that they will be repaid in accordance with bond covenant's terms. Their inclusion, particularly by riskier issuers, can help lower the cost of the debt for a firm owing to the improbability of the bond being redeemed and retired early.[218]

Debt buybacks, however, offer issuers a means of working around expensive contract restrictions on calling and retiring the debt. Where they are not expressly forbidden under the bond contract, buybacks can give an issuer the choice to either buy its debt back or to use a contractually prescribed call provision, whichever is cheaper and more convenient.[219] An issuer bound to a make-whole call provision, designed to ensure that the debt can only be retired by overcompensating an investor, will likely find a buyback to be an especially attractive avenue for retiring outstanding debt.

The expense of make-whole options means that debt buybacks occupy an especially significant place within the spectrum of techniques enabling issuers and investors to renegotiate their deal.[220] Crucially, the make-whole provision advantages an issuer seeking to undertake a cheap buyback. For one, by agreeing to an overly high compensatory amount, it becomes more likely that the issuer will not be able to pay for the call.[221] If an issuer is in financial trouble, then a bondholder may be willing to agree to a buyback rather than waiting

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216 *See* Elsaify & Roussanov, *supra* note 50, at 2 (showing the marked growth of make-whole provisions in bond indentures in recent years).

217 Make-whole provisions are generally designed to provide investors with the present value of future cash flows owed under the bond calculated in accordance with a rate benchmarked to the risk-free Treasury rate and containing a premium settlement spread to overcompensate the investor. *See id.* at 5–9; Brown & Powers, *supra* note 50, at 1 n.1.

218 *See* Elsaify & Roussanov, *supra* note 50, at 7–9.

219 *See* Brown & Powers, *supra* note 50, at 1–3.

220 *See* Julie Harrison & Mitchell Benson, *Make-Whole Provisions: Impact of the* Hertz *and* Ultra Petroleum *Decisions in US Chapter 11 Cases*, INT'L RESTRUCTURING NEWSWIRE, Q1 2023, at 13, 15 (noting the expensive cost of enforcing make-whole provisions in light of recent judicial opinions). The Author thanks Prof. Bill Bratton for this insight.

221 On the enforceability of make-whole provisions in bankruptcy, see *In re* 1141 Realty Owner LLC, 598 B.R. 534, 544 (Bankr. S.D.N.Y. 2019); *In re* MPM Silicones, L.L.C., 874 F.3d 787 (2d Cir. 2017); *In re* AMR Corp., 730 F.3d 88 (2d Cir. 2013).

to see if the issuer's fortunes improve. Additionally, the existence of a standard call or make-whole reduces the holdout power that a bondholder may have. Those that fail to agree to a buyback can always see their claims called and retired at a prefixed, albeit high, price. In this way, the bondholders—as those granting an option to an issuer—give up a source of power and control that the issuer can wield.

B. The Mechanics of Debt Buybacks

Debt buybacks can proceed using either an open market repurchase or a formal tender offer. If an issuer wishes to remove covenants attaching to a bond issue, it conducts a "consent solicitation" as part of a tender offer. Open market repurchases cannot remove or modify covenants. The discussion below highlights the permissive and opaque regulatory regime that applies to buybacks and consent solicitations, giving rise to information deficits and coordination hurdles for investors that are costly to overcome.[222]

1. Open Market Repurchases

The most straight-forward way to conduct a buyback is for the company to simply repurchase its own debt in the open market or through a private negotiation with select bondholders.[223] The advantage of this approach lies in its simplicity, speed, and secrecy. The company is not required to disclose its intention to purchase its debt.[224] It can keep news of the buyback to itself.[225] This can make it

222 There is some legal literature examining buybacks. *See, e.g.*, Bab, *supra* note 16; Brudney, *supra* note 16; Coffee & Klein, *supra* note 16, at 1212 (noting that issuers conducting bond repurchases and exchanges can put bondholders in a coercive "prisoner's dilemma"); Schwartz, *supra* note 198 (highlighting the capacity of bondholders to coordinate and avoid oppressive behavior); Ford Lacy & David M. Dolan, *Legal Aspects of Public Debt Restructurings: Exchange Offers, Consent Solicitations and Tender Offers*, 4 DEPAUL BUS. L.J. 49 (1991) (noting distortions in the bargaining process for debt tender offers); Kahan & Tuckman, *supra* note 27; Peterson, *supra* note 16 (arguing that issuer coercion can push for "good" choices).

223 *See* Levy & Shalev, *supra* note 14, at 385–386.

224 *See id.* at 387. The company would be mindful of ensuring that it does not trade in possession of material nonpublic information, triggering scrutiny under the prohibition against insider trading, under Rule 10b-5 of the Exchange Act of 1934. *But see* discussion, *infra* Section III.A, regarding the applicability to bond purchases; *see also* Eric Sibbitt & Adam Ajlouni, *Opportunities for Strategic Debt Disclosures*, O'MELVENY (Feb. 15, 2017), https://www.omm.com/resources/alerts-and-publications/alerts/opportunities-for-strategic-debt-repurchases2/ [https://perma.cc/8KR9-X6JU] (noting ways that companies repurchasing debt can mitigate potential Rule 10b-5 liability). On insider trading and stock repurchases, see generally Fried, *supra* note 32.

225 The company can successfully undertake a privately negotiated or open market purchase if it does not trigger a "creeping tender," a tender offer in substance which would be subject to disclosure requirements. *See* Jill Concannon, Rob Matthews, James Greene, Colin

less likely that opportunistic investors hear about a buyback and jump into the market to buy up the debt and then sell it back to the company at a higher price, diminishing the likelihood that bond prices move against the company just as it is looking to repurchase its debt.[226]

The logical time for a company to undertake a transaction like this is when its debt is trading at a discount to its real value. In the aftermath of the 2008 crisis, for example, several companies sought to buy back their own debt when it was trading for pennies on the dollar.[227] In one quarter of 2009, chemical producer Hexion spent $26 million to repurchase bonds with a face value of $196 million, paying the bargain sum of 13 cents on the dollar.[228] Rather than owe a liability of $196 million, the company spent $26 million to retire it, booking a gain of $170 million.[229]

Helpfully, the regulatory constraints attaching to open market repurchases are minimal. Whereas equity open market buybacks are preceded by an announcement as well as postacquisition disclosure, open market debt buybacks are only disclosed indirectly as part of the company's annual report and periodic filings. Presale disclosure is not required.[230]

Chang, Gary Kashar, Jonathan Michels & Tommaso Tosi, *Bond Repurchases—An Issuer's Guide to Questions to Ask and Points to Consider*, WHITE & CASE (Oct. 2018), https://www.whitecase.com/sites/whitecase/files/files/download/publications/bond-repurchases-an-issuers-guide-to-questions-to-ask-and-points-to-consider.pdf [https://perma.cc/463W-FFFN]. Guidance on what constitutes a possible tender offer is set out in *Wellman v. Dickinson*, 475 F. Supp. 783, 823–24 (S.D.N.Y. 1979). This balancing test looks for a tender offer where some of the following factors are present: (1) the offer is disseminated in a public manner, (2) the offer provides a premium to the market price, (3) the company offers no opportunity to negotiate, (4) the offer extends to a substantial portion of the issue, (5) the offer is time limited, (6) there is pressure on offer recipients to respond to the offer, and (7) the offer is contingent on the tender of a fixed number of shares, often subject to a fixed maximum number to be purchased. *Id.*; *see also* SEC v. Carter Hawley Hale Stores, Inc., 760 F.2d 945, 950 (9th Cir. 1985).

226 *See* Ng, *supra* note 12 (noting that conducting debt repurchases "quietly" can help prevent price increases).

227 *See id.*

228 *Id.*

229 *Id.*

230 Equity repurchases are generally preceded and followed by an announcement of the proposed buyback under exchange rules as well as under the safe-harbor Rule 10b-18 and Rule 10b-5. In addition, Item 703 of Regulation S-K and Forms 10Q, 10-K and 20-F stipulate disclosure of equity repurchases. 17 C.F.R. § 229.703 (2022) (covering "[p]urchases of equity securities by the issuer and [others]"). For debt repurchases, such specific obligatory requirements are missing, though issuers may provide disclosure under Regulation Fair Disclosure (to avoid giving nonpublic information to select investors) as well as under regulatory filings like the Form 8-K, 10-K, and annual report. For further discussion on the regulatory reporting obligations for equity buybacks, see Fried, *supra* note 32, 814–15.

The major purpose of the open-market buyback lies in helping borrowers pay down a small portion of their debt cheaply. This strategy can clean up the company's balance sheet. But it cannot retire a major portion of an outstanding bond issue. Crucially, it does not strip away difficult covenants that may be limiting a company's ability to maneuver. Although this strategy is easy and convenient, its utility is generally limited.

2. *Tender Offers and Consent Solicitations*

Tender offers provide more formal and comprehensive approach to buy back a bond issue. They can also be used to remove restrictive and cumbersome covenants by combining the tender offer with a consent solicitation.[231]

A company can benefit by timing the tender offer to take advantage of its bonds trading on the open market at a discount.[232] Unlike the open market repurchase, the company must persuade a swath of bondholders to tender their bonds by offering a premium on the market price. That is, the issuer needs to convince dispersed bondholders to accept its offer by paying enough money to compensate them for their loss of future cash flow and contractual rights.

In turn bondholders need to bet on whether accepting the offer—and tender premium—serves them better than holding out for repayment. They must wager whether fellow bondholders will be tempted to accept the offer. If enough investors sign on, then those that do not accept will lose the premium, be left holding onto bonds that are not easy to trade, and may no longer enjoy the same contractual rights they did previously. Steven Mann and Eric Powers find that for the average tender offer, the tender price is 4.75% greater than the market price and the percentage of bonds tendered is 82.3%.[233] It follows that the more the borrower is willing to pay by way of tender premium, the greater the number of bonds tendered. According to Mann and Powers, a 1% increase in the tender premium results in an approximately 9% rise in the number of bonds tendered.[234]

The choice between whether to do a tender offer or an open market repurchase depends on a firm's precise objectives (e.g., to remove

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231 *See* Sibbitt & Ajlouni, *supra* note 224.

232 *See* Kruse et al., *supra* note 154 (noting that debt usually trades at a discount prior to a debt tender).

233 Steven V. Mann & Eric A. Powers, *Determinants of Bond Tender Premiums and the Percentage Tendered*, 31 J. BANKING & FIN. 547, 557 (2007).

234 *Id.* at 549.

covenants) as well as prevailing market conditions. Hagit Levy and Ron Shalev report that tender offers tend to be common during normal economic conditions—with around one open market purchase for four tender offers.[235] During market turmoil, when investors may be more likely to demand a higher premium for surrendering their bond, the ratios are reversed and open market repurchases become more popular, with four such buybacks for every tender.[236] Often, borrowers use both open market and tenders to soak up as much of their own debt as possible. For example, Kohl's undertook a series of debt buybacks in 2018–2019. Beginning with a tender offer for $500 million in mid-2018, it followed up with a $28 million open market repurchase.[237] A mixed strategy allows the issuer to use open market repurchases to buy back scraps of debt that did not get tendered.[238]

Tender offers take place through a formal process that is governed by a regulatory framework for buying back a large segment of outstanding securities from investors.[239] Under Regulation 14E, issuers must give notice of the offer to all investors and ensure that investors have at least twenty business days to accept it.[240] Although both

235 Hagit Levy & Ron Shalev, The Decision between Tender Offers and Open Market Bond Repurchases: Do Bond Issuers Time the Market? (Aug. 1, 2013) (working paper), https://en-coller.tau.ac.il/sites/nihul_en.tau.ac.il/files/media_server/Recanati/management/seminars/account/hagit.pdf [https://perma.cc/8FMJ-VR9G].

236 Levy & Shalev, *supra* note 235.

237 Adam Levine-Weinberg, *Kohl's Debt Is Disappearing Quickly*, MOTLEY FOOL (Apr. 10, 2019, 11:17 PM), https://www.fool.com/investing/2019/01/03/kohls-debt-is-disappearing-quickly.aspx [https://perma.cc/DC7Y-XR9Y].

238 *See* Coffee & Klein, *supra* note 16, at 1210 (noting that firms often deploy tender offers and open market purchases sequentially).

239 *See* 17 C.F.R. § 240.14d-1(a) (2022) (subjecting debt tenders to Regulation 14E). The main regulation applicable to all tender offers, including debt tenders, is section 14(e) of the Exchange Act of 1934 and SEC Regulation 14E. It requires, among other things, to keep an offer open for 20 business days *Id.* § 240.14e-1(a). Issuers are subject to antifraud rules under Rule 10b-5 and anti-manipulation provisions of Rule 102 of SEC Regulation M. Equity buybacks require compliance with Regulation 14E as well as Rule 13(e)-4 and other regulations such as Rule 10b-5. Regulation limits the ability of equity issuers to "sweeten" the offer, but debt issuers are free to do so. *See* ANNA PINEDO & ALEX SPEYER, LEXIS PRACTICE ADVISOR: TOP 10 PRACTICE TIPS: DEBT TENDER OFFERS (2019). Exchange offers for cash consideration and offers for debt convertible to equity are subject to the more stringent set of rules that apply for equity buybacks. For fuller details, see Morrison & Foerster LLP, *Tender Offer Considerations for Cash Repurchases and Exchange Offers*, JDSUPRA (Jul. 1, 2009), https://www.jdsupra.com/post/documentViewer.aspx?fid=2c1796d3-7ed6-4c20-928f-567b4b65073e [https://perma.cc/98B7-9F32]; DAVID S. BAXTER, RESTRUCTURING DEBT SECURITIES: A PRIMER FOR ISSUER TENDER OFFERS, DEBT EXCHANGE OFFERS, REPURCHASES AND OTHER LIABILITY MANAGEMENT MATTERS (2020); *see also* Kahan & Tuckman, *supra* note 27, 502–03 (on the mechanics of tenders and consent solicitations).

240 17 C.F.R. § 240.14e-1(a) (2022).

equity and debt tenders are subject to the usual antifraud and antimanipulation protections, equity tender offers must include form disclosure, a post-tender regulatory filing with the SEC, dissemination, and limited freedom to amend offers.[241] By contrast, debt tender offers do not stipulate any specific form disclosure, allow room to amend an offer, and do not require a post-tender filing with the SEC.[242]

Tender offers are routinely combined with efforts by issuers to either scrap or amend covenants and events of default. When a company tenders an offer to buy back debt, it can also ask bondholders to append their consent to changes in certain terms attaching to the debt.[243] These "consent solicitations" can only target terms of the indenture that do not relate to payment.[244] More than sixty percent of tender offers include a consent solicitation.[245] The Trust Indenture Act forces unanimous consent to be provided when it comes to changing "sacred" aspects of the bond as its interest rate or maturity.[246] A tender looking to amend a bond's less sacred parts—restrictions on dividends or asset sales, for example—can still be altered by obtaining consent from the majority, or sometimes two-thirds, of holders of the bonds.[247] If a majority of the bondholders can be persuaded to tender their bonds and consent to amendments, the bonds that are left untendered end up carrying much weaker terms. Although the payment terms will remain unchanged, protective covenants as well as events of default will fall away or be materially watered down.[248]

The process can bring extraordinary pressure to bear on bondholders.[249] Cooperating, tendering investors receive tender premia—

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241 *See* Charles T. Haag & Zachary A. Keller, *Honored in the Breach: Issues in the Regulation of Tender Offers for Debt Securities*, 9 NYU J.L. & BUS. 199, 223–34 (2012) (detailing regulations applicable only to equity tender offers); *see generally id.* (detailing and discussing the tender offer process).

242 *See id.* at 224–25 (noting that the disclosure and filing requirements of Regulation 14D do not apply to debt tender offers).

243 *See* BAXTER, *supra* note 239, at 32–34.

244 *See id.* at 34.

245 Kruse et al., *supra* note 154, at 87.

246 *See* BAXTER, *supra* note 238, at 34.

247 *See id.*; *see also* Kahan & Tuckman, *supra* note 27, at 501–02 (discussing consent solicitations generally).

248 *See* Kahan & Tuckman, *supra* note 27, at 501–02.

249 Case law holds that the contractual tender process is subject to the duty of good faith. However, by itself, seeking a consent solicitation and an exit consent to covenant changes by bondholders agreeing to the tender does not violate this duty. *See, e.g.*, Katz v. Oak Indus. Inc., 508 A.2d 873, 881–82 (Del. Ch. 1986).

sometimes higher premia if they tender earlier than the deadline.[250] Those that do not tender their bonds miss out. Tendering bondholders avoid future negotiation costs, distress, and bankruptcy. Those that do not tender can get stuck in lengthy court processes if the issuer defaults.[251] Crucially, the bonds left behind become undesirable following the consent solicitation. They may have trouble finding a market for trading bonds which have been stripped of contractual power.[252] Most consent solicitations are successful given these pressures.[253] Highlighting the coercive potential of consent solicitations in exchange offers, Bratton and Levitin show that consent solicitations accompanied 82.6% of exchanges in their study and were a key mechanism to secure approval for the deal.[254]

Scholars debate whether the consent solicitation process is overly coercive. Kahan and Tuckman, for example, show that consent solicitations can be economically harmful for bondholders—particularly if they struggle to coordinate.[255] But they also note that bondholders experience positive abnormal returns around the time of solicitation, suggesting that, perhaps, bondholders gain an overall net advantage.[256] Others are less sanguine. Chatterjee and others observe that bondholders give up real value to shareholders even though bondholders can avoid the pain of bankruptcies and workouts.[257] In a study of fifty companies doing consent solicitations, Anderson-Parson and others find that it is shareholders that experience strong returns around the announcement while bondholders get a mere "token" payment for the deal.[258] The jury is out on conclusive answers on the question of coercion. Past work examines small data sets of around sixty companies or fewer. Moreover, they do not account for the impact on bondholders

250 *See* Haag & Keller, *supra* note 241, at 246–47.

251 *See* Chatterjee et al., *supra* note 39, at 335–36 (noting the value to creditors of avoiding workouts and insolvency proceedings).

252 *See* Kahan & Tuckman, *supra* note 27, 502–04; Royce de R. Barondes, *An Economic Analysis of the Potential for Coercion in Consent Solicitations for Bonds*, 63 FORDHAM L. REV. 749, 767–68 (1994).

253 *See* Kahan & Tuckman, *supra* note 27, at 502–04.

254 Bratton & Levitin, *supra* note 16, at 1638–39.

255 *See* Kahan & Tuckman, *supra* note 27, at 500, 504–07 (noting that "Section III begins with a game-theoretic analysis of consent solicitations and concludes that there exists a trembling hand perfect (THP) Nash equilibrium in which bondholders who cannot coordinate their actions will consent to covenant changes even when it is not in their collective interest").

256 *See id.* at 501–02, 507–10.

257 *See* Chatterjee et al., *supra* note 39, at 375–58.

258 *See* Anderson-Parson et al., *supra* note 175, at 232.

in an age of greater activism by hedge funds where creditor control rights have been gaining in power and economic significance.

3. Opacity as a Feature of Debt Buybacks

Issuers are not required to provide detailed disclosure concerning debt buybacks. Under SEC Regulation 14E, the borrower must supply a basic notice of the tender, its key terms, and deadlines. Debt repurchases can be undertaken with limited fanfare, requiring no form disclosure and no post-tender SEC filing.[259] The issuer is subject to the antifraud protections of Rule 10b-5 and Regulation 14E. The tender offer cannot contain untruths, omissions and distortions of fact that render it false and misleading.[260] The chance of creating a fraudulent notice can mean companies must disclose more fully.[261] But this limited amount of disclosure makes enforcement unlikely. Small falsehoods may fail to attract attention.

Further, the prohibition against insider trading has limited reach vis-à-vis debt repurchases. In theory, the prohibition against insider trading should prevent those in possession of material nonpublic information from trading without disclosure. This means that the company should worry about undertaking a bond repurchase when it is in possession of material, nonpublic knowledge that might impact the future price of its debt securities—for example, information about a potential or pending takeover.[262]

But the prohibition against insider trading is only weakly protective in this context.[263] For one, companies can always trade on confidential information whose significance falls below the threshold of materiality.[264] Additionally, in the context of equities, delayed disclosure of repurchase transactions limits the extent to which violations can be detected.[265] For bonds repurchases, this difficulty is further magnified given the limited disclosure and procedural requirements of the bond tender offer—and no prior disclosure at all where repurchases are undertaken in the open market. Information on why a borrower conducted a debt repurchase and its anticipated economic

259 *See* Roberts & Schwert, *supra* note 190.

260 17 C.F.R. § 240.10b-5 (2022).

261 *See* Haag & Keller, *supra* note 241, at 222–33.

262 *See* LATHAM & WATKINS, NAVIGATING DEBT REPURCHASES: WHAT YOU NEED TO KNOW 4–5 (2008), https://www.lw.com/en/people/admin/upload/SiteAttachments/Alert%203015.pdf [https://perma.cc/H4PE-3X2Q].

263 On debt repurchases and insider trading, see Levy & Shalev, *supra* note 14, at 398–400.

264 *See* Fried, *supra* note 32, at 823–24.

265 *See id.* at 814–15.

effects usually only emerge later through its periodic disclosures and annual report, leaving regulators with the burden of piecing together a complex causal account about what happened, how it happened, and why it happened.[266] Most important, companies do not owe a fiduciary duty to their bondholders. This means that traditional liability for insider trading does not typically bite. Creditor-borrower relationships are founded on contract and do not generally give rise to fiduciary status.[267] Per the classic account, because the law demands that managers first owe a fiduciary duty to their investors before they become subject to the prohibition against insider trading, the absence of a fiduciary obligation negates the protection the law could offer.[268] The safeguards owed by managers to shareholders, therefore, do not extend to cover banks or to bondholders.[269]

This lack of information availability in debt buybacks is striking and problematic. Bondholders value different types of information than equity holders—such that simply freeriding on equity disclosures is insufficient. For bondholders, data on the changing default risk of the firm is critical—negative information that shows how likely a company is to default. Scholars have noted the tendency of bond markets to pay special attention to information regarding defaults. Mark DeFond and Jieying Zhang show that bond prices demonstrate faster uptake of negative news that would most likely point to default, like shock earnings announcements and changes to a firm's balance sheet.[270] The absence of real disclosure for debt repurchases creates specific information gaps. Insights into why the company is undertak-

266 Rule 14e-3 prohibits insider trading by persons in possession of information related to a tender offer obtained from, inter alia, the issuer of the securities that are subject to the tender. 17 C.F.R. § 240.14e-3.

267 *See, e.g.*, Harff.v. Kerkorian, 324 A.2d 215 (Del. Ch. 1974), *aff'd in part, rev'd in part*, 347 A.2d 133 (Del. 1975) (holding that convertible bondholders did not enjoy fiduciary protection); Katz v. Oak Indus., Inc., 508 A.2d 873, 879 (Del. Ch. 1986) (noting the same); Metro. Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504 (S.D.N.Y. 1989) (same). Fraud or insolvency can give rise to a fiduciary duty. However, the Delaware Supreme Court, in *North American Catholic Education Programming Foundation, Inc. v. Gheewalla*, 930 A.2d 92 (Del. 2007), radically restricted fiduciary protections owed to creditors on the eve of bankruptcy owing to the perceived sophisticated nature of bond investors. *See id.* at 99–103. For further discussion on issuer's fiduciary duties to creditors and bankruptcy, see Ellias & Stark, *supra* note 97.

268 *See* Dirks v. SEC, 463 U.S. 646, 654, 659, 661–62 (1983); Chiarella v. United States, 445 U.S. 222, 225–230 (1980).

269 Some have argued for the creation of a fiduciary duty toward bondholders. *See, e.g.*, William W. Bratton, Jr., *Corporate Debt Relationships: Legal Theory in a Time of Restructuring*, 1989 DUKE L.J. 92, 149–51 (noting that advocates do not see covenants as sufficiently protective); Bab, *supra* note 16, at 855–67; Brudney, *supra* note 16, at 1836–45.

270 *See* Mark L. DeFond & Jieying Zhang, *The Timeliness of the Bond Market Reaction to Bad Earnings News*, 31 CONTEMP. ACCT. RSCH. 911 (2014).

ing the buyback, like its future business plans, are likely to have significance in facilitating a more accurate assessment of a company's default risk and the value of the bond claim and control rights.

In summary, debt buybacks accomplish critical goals: reducing leverage, blunting creditor control, restructuring debt, and providing a workaround formal callability provisions. Issuers can quickly and quietly reshape their relationship with a swath of investors with minimal disclosure and procedural safeguards. The regulatory regime for buybacks creates a burden for investors. Disclosure is minimal. Consent solicitations place intense pressure on investors and strongarm acceptance, creating the risk that bondholders are coerced into giving up their rights cheaply. As high debt levels, COVID-19's economic toll, and macroeconomic challenges make buybacks an essential tool to manage liabilities, addressing their impact on bondholder interests constitutes an urgent task for investor protection.

III. The Problematic Buyback

This Part argues that debt buybacks are deeply problematic for investor protection because they systematically undercompensate bondholders.[271] It makes three claims. First, debt buybacks are characterized by persistent information asymmetries and coordination problems for investors, requiring bondholders to take on costs to protect their interest. Second, these transaction costs mean that issuers enjoy room to underprice the tender premium by an amount roughly approximating these costs. If bondholders do not see net gains from contesting the buyback, they will not push for a better deal, allowing an issuer to benefit from the difference between the price paid for the claim and the optimal price that should have been paid to investors. Third, this Part raises the potential for powerful, coordinated creditors like banks to persuade issuers to conduct coercive buybacks of bond claims in order to boost their own chances of being repaid and to amplify their voice within the issuer's capital structure. Regulatory design thus leaves bondholders vulnerable to being systematically underpaid for their bargain. These vulnerabilities highlight that the bond contract is an insufficient safeguard for investor protection regarding buybacks.

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271 *But see* Chatterjee et al., *supra* note 39, at 357 (for the gains that creditors make, e.g., avoiding bankruptcy).

A. Embedded Information Asymmetries

Built-in information asymmetries create systematic transaction costs for bondholders in debt buyback transactions.[272] Limited disclosures make it harder and more costly for investors to price their claims. Bondholders must analyze complex trade-offs.[273] Does the tender offer—the market price plus the tender premium—give acceptable present value compared to what could be earned from the original set of promised cash flows? What is the value attaching to the covenants and events of default?[274] Importantly, how might other bondholders view the offer? Would a majority or more decide to accept the deal? How much of a discount on any optimal premium would be acceptable to avoid being left with a bond post-tender that is stripped of its covenants? In other words, what is the cost of being a holdout?

Disclosure helps bondholders to navigate uncertainties at the time that credit is first extended. But disclosures are scant when this debt is repurchased by the issuer. Yet in both cases, bondholders are being asked to make hard choices concerning the valuation of an issuer's business, its future default risk, and the present value of promised cash flows. If the issuer is distressed financially, the challenge of putting a price on an issuer's claims becomes even harder.[275] In theory, bondholders should be better informed about an issuer's business at the time of a repurchase than they were when the bond was issued. At the time of the buyback, bondholders should have received years' worth of periodic disclosures, like 10-Ks, and may have engaged with the issuer to advise on changes to management practice and corporate risk-taking. Despite this experience, however, bondholders still confront uncertainty regarding the terms of buyback and the trade-offs concerning whether to accept it and at what price. As tenders seek to repay an entire class of bonds—impacting a swath of investors—limited information to assist in valuation shifts burden from an issuer to a dispersed group of bondholders to pay for this information and analysis.[276]

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272 Brudney, for example, questions the sufficiency of disclosure for bondholders in debt repurchases. Brudney, *supra* note 16, at 1836.

273 *See* Mann & Powers, *supra* note 233, at 550–54 (discussing the complex factors that affect the premium paid to bondholders in a tender offer).

274 *See generally* Kahan & Rock, *supra* note 87.

275 *See generally* Damodaran, *supra* note 24 (discussing the difficulties of evaluating a company's value and future cashflows during financial distress and reorganization).

276 *But see* Kahan & Tuckman, *supra* note 39, at 513.

Managers are also more insulated from charges of insider trading when transacting in the bond market relative to equities.[277] Though hotly debated as a normative question, caselaw has refrained from creating a fiduciary duty owed by managers or issuers to their bondholders—a precondition for insider trading liability under Rule 10b-5.[278] In its absence, there is little need for the issuer and managers to affirmatively disclose confidential insights in explaining the debt buyback's terms.[279] This affords managers an opportunity to devise strategies designed to repurchase debt when it is cheapest and bondholders possess few alternatives by which to oppose the deal. In other words, structural information asymmetries leave bondholders vulnerable to being shortchanged by issuers and managers.[280]

Debt buybacks thus create an uneven playing field for bondholders that they must pay to cure. In addition, investors need to know how others will vote in order to coordinate and bargain with the issuer. The costs of information gathering, investigation, coordination, and negotiation shift the balance of power in favor of the issuer.[281] Where bondholders face high research and coordination costs, they will only be motivated to act when the tender premium meaningfully undervalues their claim. Where they cannot be certain that the issuer's finances will recover, they may choose to remain apathetic and cut

277 *See* Simi Kedia & Xing Zhou, *Informed Trading around Acquisitions: Evidence from Corporate Bonds*, 18 J. FIN. MKTS. 182, 183 (Mar. 2014) (noting the "scant" attention paid to insider trading in corporate bond markets). Several academic studies have empirically observed trading on insider information in the bond market. *See, e.g.*, Note, *Insider Trading in Junk Bonds*, 105 HARV. L. REV. 1720 (1992) (advocating for liability for insider trading in junk bond markets); Laurie P. Cohen & Kevin G. Salwen, *SEC Starts Insider-Trading Probe in Junk-Bond Market*, WALL ST. J., Apr. 10, 1991, at C1; *see also* SEC v. Rorech, 673 F. Supp. 2d 217, 227–28 (S.D.N.Y. 2009) (examining insider trading in bond and credit default swap markets); SEC, *Barclays Bank Pays $10.9 Million to Settle Charges of Insider Trading on Bankruptcy Creditor Committee Information*, SEC Litigation Release No. 20132, 90 S.E.C. 1999 (May 30, 2007) (charges by a bank on a creditor committee using its position to transact in securities); Yesha Yadav, *Insider Trading in the Derivatives Markets*, 103 GEO. L.J. 381 (2015) (detailing propensities for insider trading in credit derivatives).

278 *See supra* note 268 and accompanying text.

279 Scholars have debated the incentives of firms to disclose information. *See, e.g.*, Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335, 1362 (1999); John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 722–730 (1984).

280 *Cf.* William K.S. Wang, *Trading on Material Nonpublic Information on Impersonal Stock Markets: Who Is Harmed, and Who Can Sue Whom Under SEC Rule 10b-5?*, 54 S. CAL. L. REV. 1217, 1220–30 (1981) (describing the harms when informed insiders can systematically win against investors).

281 *See* Brudney, *supra* note 16, at 1834–35.

their losses. Alternatively, they may only take those actions that require cursory investment in information and bargaining.

Coordination between bondholders does not necessarily reset the balance.[282] It represents an imperfect safeguard. Coordination can reduce bargaining costs and research expenses if bondholders pool resources. However, such coordination only reduces the threshold at which a bondholder will be motivated to act—it does not eliminate the underpricing cushion an issuer enjoys regarding the tender premium. Even with proper coordination, bondholders still need to pay for information, analysis, and bargaining with the issuer. Given that bondholders have imperfect levels of information—and the issuer possesses the richest understanding of its own future—the issuer is well placed to set the tender premium at a level that disincentivizes action. The issuer can lowball the tender premium by a sum that reflects (1) uncertainty in valuing the present and future value of the claim and (2) a base level of investigative and coordination costs needed to cure this uncertainty and negotiate for a higher premium. The issuer can thus deploy its informational advantage to set the premium at a level that underprices the debt but not to such a degree that the bondholders are incentivized to contest it actively. In other words, the issuer can underprice the premium to be roughly equal to information and bargaining costs, ensuring that bondholders will not have an incentive to act.

Take a highly simplified example. Company's bonds are trading at $100 per bond, and it proposes to buy these bonds back at a tender price of $60, confident in the knowledge that these bonds might soon be worth $85 per bond. This underpricing represents a self-assured strategy, recognizing that it will cost bondholders money to investigate, coordinate, and agitate for a better offer. Assuming that it costs a bondholder at least $20 per bond in transaction costs, and where the valuation is uncertain (e.g., give or take $5), bondholders have very little incentive to put money into pushing back on this offer. By skillfully underpricing the tender offer, equipped by superior insight into its own affairs, the company can extract value equivalent to around $25 per bond.

Moreover, coordination between bondholders is costly and not always successful. Collective endeavors suffer from the problem of free riders.[283] First movers seeking to bring a group of dispersed actors

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282 *See id.*

283 *See, e.g.*, Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863,

together will internalize a higher cost relative to the other bondholders that follow. Those able to freeride will enjoy fewer transaction costs while still reaping the benefits of an increase in the premium. If investors each look to the other to move first, passivity can prevail. If bondholders fail to coordinate and pool resources, then the transaction costs involved in an intervention against the issuer go up.

To be sure, these dynamics do not always have to be adversarial. In some contexts, issuers may be cooperative and open to voluntary disclosure. For example, an issuer may worry about gaining a bad reputation for hurting bondholders, making it more expensive for it to raise future capital. It may wish to proceed quickly with the tender and agree to pay a higher premium.[284] Institutional investors that are repeat players in bond markets may also be used to cooperating, sharing resources, and bargaining efficiently. For example, Bratton and Levitin have remarked on the increasing ability shown by institutional investors and issuers to cooperate in distressed bond exchanges.[285] But limited disclosure and uncertainty about valuing the terms of a buyback still set the stage for bondholders to confront high transaction and information costs. The expenditure involved provides issuers with an opportunity to underprice the premium by a level reflecting these costs and uncertainty, dissuading bondholders from agitating for a higher premium for themselves. In other words, policy cannot simply assume that investors will be sophisticated and resourced enough to coordinate and police valuation during the buyback.

B. Underpricing Investor Control

Amending covenants and events of default represents a key reason for issuers to conduct a buyback.[286] But buybacks also raise concerns that the issuer will relax restrictions expansively at little cost to itself. The decision to repurchase debt can revive sources of risk between the creditors and the issuer's managers and shareholders where managers and shareholders become less restricted in being able to misuse investor money.

866–80 (2013) (highlighting passivity common to mutual funds that look to activist hedge funds to lead governance interventions).

284 *See* Mann & Powers, *supra* note 233, at 553–54.

285 *See* Bratton & Levitin, *supra* note 199, at 1639.

286 *See* Mann & Powers, *supra* note 233, at 549–50*; see also* Kahan & Tuckman, *supra* note 39; Chatterjee et al., *supra* note 39.

1. Maximum Rollback at Minimum Cost

Regulation gaps create conditions that encourage issuers to underprice bondholder creditor control through a potentially oppressive consent solicitation process.[287] Undercompensating bondholders can provide short-term gains for issuers. Tender premia tend to be higher when there are more restrictive covenants.[288] Logically, issuers must pay more to remove a stricter set of covenants. That an issuer must pay more to reduce a heavier contractual burden, however, is not the same thing as saying that the price will be a fair reflection of the value lost by bondholders.

Issuers have every reason to underprice bondholder control rights. First, paying a lower-than-optimal premium in the consent solicitation helps the issuer appear less risky. Where the tender premium is high, the market should conclude that restrictive covenants hold value to bondholders, presumably because bondholders wish to use them as a disciplinary device against the issuer. A lower tender premium can offer a deceptively optimistic signal that even activists see little value in enforcement.

Secondly, a low tender premium helps the issuer to buy out future violations of its bond contract cheaply. By paying to reduce or eliminate a series of restrictive covenants, the issuer can avoid falling afoul of prospective violations. It buys itself immunity from having to confront activists, litigation, and public interventions by investors designed to challenge management and corporate decision making. Particularly with hedge fund bondholder activism on the rise and recent caselaw awarding generous remedies for covenant defaults, the ability to buy out future violations represents a valuable strategy.[289] By reducing future litigation risk, issuers can divert present-day financial and managerial resources to risky ventures that might otherwise have provoked the ire of bondholders. On the other hand, where the issuer can cheaply neutralize productive bondholder scrutiny and discipline for the foreseeable future, it can extract value for itself and shareholders at the expense of bondholders. But in turn, this increases chances of managerial or shareholder mismanagement. For example, by immunizing itself against likely violations, the company also misses out on the scrutiny and discipline that can follow such defaults. Management

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287 On coercion, see generally Coffee & Klein, *supra* note 222; Bab, *supra* note 16; Brudney, *supra* note 16; Kahan & Tuckman, *supra* note 27.

288 *See* Mann & Powers, *supra* note 233, at 550–51.

289 *See* Gulati & Kahan, *supra* note 111 (discussing the *Cash America* case and "make-whole" remedies for bond defaults).

acquires for itself the latitude to take risks that it would not have otherwise and to heighten the overall risk of failure.

Regulation helps issuers that wish to underpay bondholders for their control rights. Disclosure is limited—requiring bondholders to take the lead in investigation and analysis. Owing to information deficits, investors possess only limited data by which to gauge the economic usefulness of their covenants. Moreover, the absence of a fiduciary duty for bondholders eliminates the obligation managers might have to act in the investors' best interests. Although a duty of good faith nominally applies, courts have blessed the consent solicitation process as being in compliance with this duty.[290] Indeed, managers are motivated to adopt an adversarial posture in supporting the acquisition of shareholder power at the expense of bondholders. The former constitutes a source of long-established legal obligation, the latter exists by dint of a time-limited contract. If this contract can be disposed of cheaply, managers arguably come into closer compliance with their fiduciary obligation to vigorously pursue and defend shareholder interests.

With few legal safeguards, bondholders must coordinate privately to achieve the most optimal price for their contractual rights. Scholars have routinely billed the consent solicitation process as a prisoner's dilemma.[291] However, in game theoretic terms, consent solicitation also requires bondholders to engage in a "coordination game" that promises greatest gain for those that can work together to pursue a collective good. Where participants peel off to follow smaller private victories, opportunities for coordination disappear and so does the possibility of that bigger prize.[292] Critical to such cooperation is, unsurprisingly, the availability of information and channels of communication that can enable investors to achieve consensus on what their rights are worth.[293] In debt buybacks, this kind of assistance does not exist under regulation, putting the costs firmly at the door of bondholders if coordination is to be successful. Given these costs—as well

290 *See* Katz v. Oak Indus. Inc., 508 A.2d 873, 881 (Del. Ch. 1986). In addition, the notion of "good faith" is inherently prone to varying understanding and interpretations, creating limited clarity for the market. *See* Brudney, *supra* note 16, at 1869–70.

291 *See, e.g.*, Coffee & Klein, *supra* note 222, at 1212–13. Although not a subject of this Article, the weak status of the indenture trustee also contributes to bondholder underprotection. On the indenture trustee and its traditional weaknesses, see sources cited *supra* note 106.

292 *See* Douglas G. Baird, Robert H. Gertner & Randal C. Picker, Game Theory and the Law 35–37 (1994). *See generally* Brian Skyrms, The Stag Hunt and the Evolution of Social Structure (2004).

293 *See* Baird et al., *supra* note 292, 40–41.

as the skill needed to coordinate effectively—investors are put firmly on the back foot and must count on an alignment of issuer opportunism seriously underpricing control rights, skillful, deep-pocketed investors, and the existence of independent investors with enough motivation to remain engaged for the length of the negotiation.

This accretion of costs can increase the odds that bondholders might each pursue a cheap exit that limits the accumulation of additional expenses. Moreover, consensus is especially hard to achieve with bondholder control rights. Contractual levers in bond covenants have long gone underenforced. Not until the emergence of hedge fund activists have these rights carried serious firepower.[294] This can contribute to a limited history and expertise by which to determine how to value their exercise. Understandably, investors can diverge on how they value contractual levers given the differing importance that certain control rights might have for certain investors relative to others; for example, risk averse bondholders may place greater value on restrictions like limiting dividends.[295] As building consensus takes time, necessitating discussion and lobbying between investors, bondholders are primed to consent, especially in light of tight deadlines and bad consequences if others have taken the offer.

Considering the above, contractual power offers weak protection to safeguard bondholder control rights. One key rationale justifying the lack of a fiduciary standard in favor of bondholders lies in the protection offered to creditors via contract.[296] Bondholders are supposed to enjoy protection through covenants and events of default, apparently removing the urgency to establish fiduciary protection as safeguard against managerial and shareholder risk-seeking. If consent solicitation and debt buyback processes allow these contractual rights to be cheaply altered without regulatory scrutiny, it raises the normative question of whether the law overestimates bondholder contractual power as a source of investor protection.[297]

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294 *See* Kahan & Rock, *supra* note 87, at 283–84.

295 *See* Cohen et al., *supra* note 112 (describing default activism as "Default Archaeology" where investors with differing interests may acquire already defaulted debt in order to enforce particular contractual provisions).

296 *See* Brudney, *supra* note 16, at 1836–49; Coffee & Klein, *supra* note 16, at 1268 n.184; Lawrence Mitchell, *The Fairness Rights of Corporate Bondholders*, 65 HARV. L. REV. 1165, 1167–68 (1990).

297 *See* Brogaard & Yadav, *supra* note 22, at 22–24. On contract as a prophylactic against the need for fiduciary protection, see, for example, Brudney, *supra* note 16, 1836–45; Henry T.C. Hu & Jay Lawrence Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321, 1330–41 (2007) (discussing the rationales for contractual rather than fiduciary protection for creditors); Frederick Tung, *The New Death of Contract: Creeping Corporate Fiduciary*

2. *Governance Failure and Economic Waste*

Underpricing of bond covenants raises the risk that issuers become vulnerable to agency costs, fostering governance failures and economic waste. The ability of issuers to inexpensively repurchase debt can result in bondholder rights becoming less valued over time as a means of controlling agency costs. Just as recent years have witnessed an uptick in hedge-fund led bondholder activism, opportunistic repurchases may turn the tide in favor of issuers by allowing preemptive buyouts of those issues that are most likely to attract activist advances. In situations where bondholder activists are merely creating a nuisance, buyouts offer a useful mechanism to blunt the impact of a disruptive activist campaigns. However, where bondholders are enforcing covenants designed to prevent excessive risk-taking and rent-seeking, an issuer's ability to deploy a repurchase strategically can reduce the effectiveness of bondholder action and the fear it creates in boardrooms.

Removing covenants through buybacks makes sense as a reaction to this increase in bondholder activism.[298] Equally, it is arguable that it could represent an overcorrection to the problem of overly rigid contract provisions. In removing or amending covenants, the modified bond provides only a weak check on managerial and shareholder rent-seeking.

If covenants can be released cheaply and quickly through a buyback, it makes sense for issuers to push for an expansive relaxation of covenants when the opportunity arises. This allows issuers and shareholders to divert resources to themselves, for example, to pay dividends, to transact with major shareholders, or to borrow more for risky projects.[299] If bondholders are willing to accept the deal, they have little interest to negotiate to keep protections in place or agitate for a higher premium. If bondholders know that they will no longer be involved in a company's capital structure, they are unlikely to spend money to push for keeping tight covenants.

Duties for Creditors, 57 EMORY L.J. 809, 860–69 (2008) (highlighting the protections offered by contract for sophisticated creditors). *But see* Ellias & Stark, *supra* note 100, at 749–50 (noting the insufficiency of contract to safeguard creditor protections on the eve of insolvency); *see also* Smith & Warner, *supra* note 20, at 152 (recognizing the role of contracting to reduce agency costs of debt).

298 *See* Kahan & Rock, *supra* note 87, at 283 (noting that the rise in bondholder activism give companies "excessive" incentive to avoid potential covenant violations).

299 *See* Anderson-Parson et al., *supra* note 175, at 231.

The handful of studies on tender offers and consent solicitations show abnormal gains for shareholders on multiple measures.[300] In many ways, this is to be expected. Managers have a systematic informational advantage. They owe no fiduciary duty to the bondholder. It would be odd if managers were to lavish cash on bondholders to buy back debt without strong expectation that shareholders would enjoy a greater gain following the transaction. As noted earlier, shareholders reap the rewards promised by a cleaner balance sheet. Julio reports that companies see leverage ratios decrease by almost 16%, improved access to external funding, and reduced frictions caused by high levels of lingering debt on the balance sheet.[301] Kruse and others also point to shareholders being rewarded by the market with a post-tender premium, an increase in the company's asset base and better performance overall.[302] News of a possible debt buyback routinely sends share prices soaring.[303] But scholarship has so far failed to empirically address whether—longer term—the episodic elimination of bondholder oversight can also lead to problems as shareholders and managers are less constrained in their ability to pay themselves, borrow more, and to spend the money on riskier investments. Put simply, do attempts to rework covenants through buybacks end up hurting companies in the long run by relaxing covenants too much relative to the firm's governance risk?

An important and related question is whether bondholders receive sufficient value for giving up their governance rights.[304] This inquiry is not simply a matter of ensuring that investors receive a "fair" deal. Rather it speaks to the incentives that regulation creates to encourage bondholders to invest in contracting for and exercising governance power in the first place. If buybacks facilitate a dismantling of bondholder rights without adequate compensation, rational bondholders might be reluctant to invest in negotiating for creditor control levers *ex ante*, creating a permanent worsening of discipline.[305] Credit

300 *See, e.g.*, *id.* at 238–41.

301 Julio, *supra* note 14, at 1.

302 Kruse et al., *supra* note 154, at 85–88.

303 *See, e.g.*, James Shotter & Thomas Hale, *Deutsche Bank to Launch Buyback of Its Bonds*, FIN. TIMES (Feb. 12, 2016), https://www.ft.com/content/b3f3e40c-d18b-11e5-831d-09f7778e7377 [https://perma.cc/D27U-3DHW].

304 *See* Paul Asquith & Thierry A. Wizman, *Event Risk, Covenants, and Bondholder Returns in Leveraged Buyouts*, 27 J. FIN. ECON. 195, 206–10 (1990) (finding that bonds with heavy covenant protection are more likely to see covenants removed though a tender offer following a leveraged buyout).

305 On agency and bonding costs in the corporate structure, see Jensen & Meckling, *supra* note 35, at 308–10.

providers may be drawn only to companies that do not need much active governance—larger, safer firms that are publicly traded, rather than smaller opaque ones that might benefit from creditor monitoring.

One might expect that the market should systematically punish an issuer's decision to strip away bondholder oversight by imposing a higher cost for future capital. But relying on fear of market discipline represents an imperfect strategy. For one, the market faces challenges in putting a price on governance rights and creditor activism. By how much should the issuer's cost of capital increase if it decides to remove restrictive covenants? If an issuer's business has changed such that it no longer needs the same intensity of bondholder control, it should be rewarded with less restrictive debt. But if it has not and consent solicitation is deployed to severely reduce monitoring, the issuer represents a credit risk whose cost of capital ought to increase in lockstep with its over-confident maneuvering.

The market must also consider a complex counterfactual: what would creditors have achieved with the benefit of their control rights in the absence of the consent solicitation? In analyzing this question, it is not enough to just examine the power that creditors possess on paper.[306] Rather a debate about valuing bondholder control must also consider how investors would seek to wield these covenants in practice. On this last question, it is worth reflecting on the outcomes likely to be generated by intervention. Default activism by bondholders can sometimes be opportunistic, focused on creating short-term pay-offs for activist hedge funds.[307] Where an issuer buys out such opportunistic creditors, its repurchase may have only a limited effect on its long-term financial health given that such bondholders are only trying to make a quick buck from litigating technical defaults.[308] On the other side, as detailed by Sandrine Docgne, contractual restrictions can have a more substantive impact on an issuer's decision making in shaping investment policies and spending choices.[309] Studies, looking at only one or two covenant terms, have shown that bond markets can price them.[310] But as Marcel Kahan observes, it is not easy or always possi-

306 *See* MARIAROSA VERDE, LOAN PRESERVER: THE VALUE OF COVENANTS 3–4 (1999) (noting that bond indentures are lacking real value owing to their broad drafting and weak enforcement); *see also* Docgne, *supra* note 119, at 1.

307 *See* Gao et al., *supra* note 87, at 1544.

308 *See* Kahan & Rock, *supra* note 87, at 314.

309 Docgne, *supra* note 119, at 1.

310 *See* Marcel Kahan, *The Qualified Case Against Mandatory Terms in Bonds*, 89 NW. U. L. REV. 565, 572–78 (1996).

ble to know how well the market can price the terms of an entire contact, nor how it will be enforced.[311]

Neither of these questions can be answered easily, if they can be answered at all. Bondholders are on the back foot on account of information asymmetries and limited pressures on managers to provide information. In determining what kind of value is lost through a consent solicitation, creditors lack the advantage of readily available data to dissect an issuer's motivations and why managers choose to undertake a buyback. This disadvantage complicates assessments of an issuer's changing risk.[312] Whether releasing contractual fetters makes sense practically or whether it represents a borrower's attempt to dislodge creditor power opportunistically cannot be assessed in the absence of real disclosure and data.[313]

In addition, even if the market can put a price on bondholders seeing systematic losses in both money and power, issuers might nevertheless decide that this price is worth paying.[314] Issuers may determine that any reputational damage and increase in the cost of capital costs less than the gains likely to be made in the buyback. The superior informational advantages enjoyed by an issuer's management, possible enhancements to a company's balance sheet as well as reduced bondholder monitoring might, together, hold out sufficient motivation for issuers to accept any resulting damage in the market. Where mangers wish to take on risky projects, divert resources to themselves and shareholders or shirk problematic scrutiny into their activities, engaging in strategic repurchases is compelling, despite added costs to a company's future capital.[315] The prospect of debt markets being able to price the risk of buybacks into the cost of credit is not a panacea against bondholder coercion, especially if shareholders and managers decide the costs are worth the returns promised in the buyback.

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311 *Id.* at 595–620; *see also* Peter Feldhütter, *The Same Bond at Different Prices: Identifying Search Frictions and Selling Pressures*, 25 REV. FIN. STUD. 1155 (2012) (noting the value attaching to control rights in bonds).

312 *See* Chatterjee et al., *supra* note 39, at 357.

313 *See* Asquith & Wizman, *supra* note 304. (noting that consent solicitations occur after LBOs to remove tough covenants); Julio, *supra* note 14, at 30.

314 *See, e.g.*, Mao & Tserlukevich, *supra* note 9, at 1651–52 (noting that even despite greater tax liabilities and regulatory burdens, managers may sometimes favor debt buybacks to achieve their objectives).

315 *See* Kruse et al., *supra* note 154, at 87–88.

C. *Intercreditor Coercion*

Buybacks can also provide a mechanism for one set of creditors to seek out coercive advantage at the expense of another. By pushing for certain debt to be repurchased at a discount and for its covenants to be scrapped, remaining creditors can achieve multiple aims.[316]

Importantly, they can help to improve their odds of being repaid. Rather than diverting cash flow to pay off several sets of creditors, a cheap buyback can ensure that cash that comes in goes to pay off a smaller number of outstanding claims. Indeed, a buyback can boost the chances that an issuer achieves greater financial security to repay remaining liabilities.[317] A healthier balance sheet, with better operating performance, more valuable equity, and cheaper financing can permit an issuer to boost cash flows and collateral valuation while reassuring lenders of future performance.[318] According to one model, debt buybacks reduce the overall default risk attaching to a company and improve its credit rating.[319] And anecdotally at least, buying back one set of loans can often impact the outlook for another. When Deutsche Bank announced that it would buy back $5.4 billion worth of senior-ranked, unsecured bonds to shore up its balance sheet, the news was designed to offer reassurance that it could pay its more junior debt.[320] Promising a sounder balance sheet following the buyback, the price of Deutsche Bank's junior unsecured bonds immediately rallied by 2.6%.[321]

While Deutsche Bank bought back one set of bonds to improve the creditworthiness of another, bank loan providers are most likely to have an outsize voice in suggesting strategic buyback of bond debt.[322] Banks might seek out opportunistic bond buybacks when the bonds are transacting at a heavy discount. Those extending loans are likely

316 *See, e.g.*, Coffee & Klein, *supra* note 16, at 1238.

317 *See* Julio, *supra* note 14, at 29; Kruse et al., *supra* note 154, at 86–87.

318 *See* Julio, *supra* note 14, at 16–17.

319 *See* Hui Xu, Three Essays on Debt Pricing 80 (Apr. 3, 2018) (Ph.D. dissertation, University of Illinois at Urbana-Champaign).

320 *See* Shotter & Hale, *supra* note 303.

321 *Id.* But, analysts were skeptical that the buyback could improve the credit risk of lower ranked Additional Tier 1 bonds. For discussion, see Alex Chambers & Helene Durand, *Market Questions Long-Term Impact of Deutsche Buyback*, REUTERS (Feb. 12, 2016, 1:31 PM), https://www.reuters.com/article/deutsche-bank-bonds/update-1-market-questions-long-term-impact-of-deutsche-buyback-idUKL8N15R4G0 [https://perma.cc/2L5M-UFDM]; *see also* Paul J. Davies, *Why a Deutsche Bank Bond Buyback Would Help*, WALL ST. J. (Feb. 10, 2016, 10:50 AM), https://www.wsj.com/articles/why-a-deutsche-bank-bond-buyback-would-help-1455119412 [https://perma.cc/LG3J-2WL5].

322 *See, e.g.*, Bratton, *supra* note 20, at 76–77.

to hold greater single exposure to the borrower relative to more dispersed bondholders.[323] This loan debt is harder to sell, making its risk stickier.[324] Banks may have repeat relationships with a borrower as well as lucrative side deals to provide an array of financial products and services.[325]

In addition, removal of problematic bondholders can enlarge the influence of remaining creditors. Repurchases—combined with consent solicitations—can neutralize the ability of bondholder activists to assert themselves in a company's governance. Where such activists create nuisance value—by strategically targeting firms in technical default of their bond contracts, for example—their interference might be viewed as an economic drag on others. If bondholders deploy their power to prevent a company from taking on value-generating activities—for example, a profitable merger—bank lenders have cause to worry about the risk that noteholders pose to a borrower's creditworthiness. Where a company is in distress, negotiating with bondholders to achieve a workout can add time and expense to the restructuring process.[326] Even where the bondholders rank junior to a loan creditor, buying back the bond debt cheaply can allow senior lenders to assert their authority more effectively without facing pushback and costly frictions with assertive junior bondholders.[327]

Banks possess special advantages in pushing for strategic buybacks. They are likely to be better informed than bondholders. Enjoying information and access to boardrooms, bankers garner in-depth insights into the company's workings, enabling a finer assessment of when bond debt might be most undervalued.[328] They may have a better knowledge on prospective projects, be available to offer additional credit, as well as to advise on restructuring. Banks are thus well suited to evaluate the trade-offs involved in a buyback and to push management to take it on at a moment that might best transfer

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323 *See* Kroszner & Strahan, *supra* note 46, at 25.

324 *See* Edward I. Altman, Amar Gande & Anthony Saunders, *Bank Debt Versus Bond Debt: Evidence from Secondary Market Prices*, 42 J. MONEY, CREDIT, & BANKING 755, 756–57 (2010) (noting the recent development of the bank loan markets).

325 *See* Sreedhar T. Bharath, Sandeep Dahiya, Anthony Saunders & Anand Srinivasan, *Lending Relationships and Loan Contract Terms*, 24 REV. FIN. STUD. 1141, 1144 (2011); *see also* Tung, *supra* note 26, at 139–40.

326 *See* Aslan et al., *supra* note 16, at 2–3.

327 On this and conflict between senior and junior bondholders, see generally Casey, *supra* note 132.

328 *See* Altman et al., *supra* note 324 (noting the monitoring advantages of bank creditors relative to bondholders). *See generally* Brudney, *supra* note 16 (analyzing the informational disadvantages of bondholders).

value from bondholders to themselves. The relative superiority of information enjoyed by banks relative to bondholders is made clear by a study comparing the intensity of price changes for loans compared to bonds in response to news of default and bankruptcy. Examining a dataset of loans versus bonds issued by the same company, Edward Altman and others observe that loan prices fall much more prior to a default or bankruptcy relative to bonds—and much less after this news is announced.[329] Owing to the better monitoring and access available to banks, loan prices fell much earlier, signaling rapid awareness.[330] Bondholders, by contrast, reliant on public information, absorbed the news later after it became public.[331]

In addition, bank lenders—likely much fewer in number than bondholders—will confront lower coordination costs. Unlike the difficulties affecting bondholders, banks can share information more easily, develop a strategy, and press their influence with issuers.[332]

Whether banks, in fact, play an active role in promoting buybacks—potentially to the detriment of other creditors—remains a question for empirical analysis. That they have compelling incentives would suggest that this question is one worth pursuing. Inter-creditor machinations can work to keep dispersed, lesser informed lenders at a systematic disadvantage to banks, adding heft to issuer efforts to dismantle bondholder claims.

In summary, this Article makes the argument that debt repurchases systematically and problematically undercompensate bondholders for their claims and creditor control rights. Information asymmetries are codified as a matter of regulatory policy, requiring investors to internalize the costs of investigation, analysis, and coordination. In pricing the tender premium, borrowers have every incentive to push for a maximal easing of covenants and events of default. Information deficits create barriers for investors to negotiate and value governance rights. This affords issuers an opportunity to systematically underprice the bargain by an amount approximating these costs. Finally, debt buybacks open the door for dispersed, lesser informed bondholders to be outmaneuvered by more unified bank lenders looking to improve their changes of repayment and expansion of control. This structurally uneven playing field between issuers and bondhold-

329 *See* Altman et al., *supra* note 324, at 756–57.

330 *See id.* at 763–64.

331 *See id.* at 756.

332 *See* Frederick Tung, *supra* note 26, at 162–66 (highlighting the dynamic of syndicated lenders in debt governance).

ers raises implications for policy. If bondholders always lose out, the current design of policy has failed to create a regulatory framework that protects investors and ensures an efficient allocation of their debt capital.

IV. Fixing Debt Buybacks

This Part outlines ideas for reforms to address the underprotection faced by public bondholders in debt buybacks. These arguments matter for the $11 trillion corporate debt market that has, in the wake of COVID-19, witnessed sharply increased activity.[333] Bondholders, being contractual, dispersed, and time-limited creditors, falling outside the fiduciary duty, are especially vulnerable to seeing their claims be devalued. Ultimately, institutional bondholders, like bond mutual funds, represent the capital of everyday savers looking for reliable, regular returns. If their claims lack sufficiently robust and workable protection from opportunistic issuers, managers, shareholders, or banks, regulation can rightly be criticized for forcing systematic losses on investors that cannot be easily hedged. At a time when the bond market is already shocked and investors are in line to take losses down the line, diminishing faith in the market's ability to protect their interest can extract a long-term price for debt capital allocation.

This Part explores pathways for policy to help even the playing field between investors and issuers. It proposes (1) the creation of greater equality in regulatory treatment between debt and equity buybacks, (2) ideas for contractual fixes to strengthen bondholder protections, and (3) a possible imposition of a discrete fiduciary duty in the context of a repurchase.

A. Equalizing Disclosure in Debt and Equity Buybacks

Debt buybacks need better disclosure to bring their regulation into basic alignment with the rules applicable to equity repurchases. The present discrepancy between equity and debt is difficult to justify, particularly given the increasing popularity of bond funds for everyday savers. Debt markets have been infamous for their opacity. But this posture has been gradually changing. Notably, since 2002, transactions in public and private corporate bonds must be reported and prices disseminated to the marketplace.[334] In other words, the SEC

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333 *See* Goldfarb, *supra* note 52; Joe Rennison, *US Corporate Bond Issuance Hits $1.919tn in 2020, Beating Full-Year Record*, Fin. Times (Sept. 2, 2020), https://www.ft.com/content/a59c2a9d-5e0b-4cbc-b69e-a138de76a776 [https://perma.cc/3HBE-3V9T].

334 *See TRACE Enhanced Historical Data*, Fin. Indus. Regul. Auth. (2017), https://

has devoted resources to enhancing transparency as a means of improving the transaction costs involved in trading bonds.[335]

Recall that debt repurchases lack formal ex ante and ex post reporting requirements.[336] In the case of equity, open-market repurchases require a prior notification and, since 2003, specific post-trade disclosure in the company's regulatory filings.[337] Tender offers in equity mandate form disclosures and a filing after the tender is completed.[338] By contrast, debt repurchases involve negligible formal transparency requirements beyond compliance with Rule 10b-5 antifraud provisions. Prior notification is not required and even tender offer rules do not stipulate a post-offering filing. In the absence of a fiduciary duty for bondholders, the application of the prohibition against insider trading is much weaker in bonds than in equity markets.

Greater transparency constitutes a small but significant first step toward equalizing the playing field between issuers and bond investors. Prior notification before open market debt repurchases alerts investors to the possibility that their securities may be trading at a discount to real value. Notice allows investors to prepare for the possibility that they may be trading their claims with a counterparty that is most informed about its own affairs. This can encourage bondholders to do research, investigation, and to coordinate. They might think about using the control levers available to them to examine the company's financial condition and management. Hagit Levy and Ron Shalev point to the usefulness of disclosure in helping investors.[339] Comparing tender offers with open market debt repurchases, they show that claims acquired through open market trades increase more in price than those bought in a tender offer. This suggests that bond-

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www.finra.org/sites/default/files/TRACE_Enhanced_Historical_Data.pdf [https://perma.cc/G3HU-AQ9G].

335 *See, e.g.*, FIXED INCOME MARKET STRUCTURE ADVISORY COMMITTEE, SEC, RECOMMENDATION FOR THE SEC TO ESTABLISH A NEW ISSUE REFERENCE DATA SERVICE FOR CORPORATE BONDS (2018).

336 *See* discussion *supra* Section II.B.3.

337 *See, e.g.*, NASDAQ, INC., NASDAQ STOCK MARKET RULES § 5250(b)(1) (2012); Michael Simkovic, *The Effect of Mandatory Disclosure on Open-Market Stock Repurchases*, 6 BERKELEY BUS. L.J. 96, 102–09 (2009); Jesse M. Fried, *Informed Trading and False Signaling with Open Market Repurchases*, 93 CALIF. L. REV. 1323, 1340–42 (2005) (describing varying post-trade disclosure regimes and the Rule 10b-18 regime, as well as the rationale for introducing specific disclosure in 2003).

338 *See* 17 C.F.R. § 240.14d-100 (2022).

339 Levy & Shalev, *supra* note 14, at 399–400.

holders that sell their claims in the open market are losing out more heavily.[340]

Ex post reporting by way of a specific notice or filing also offers benefits for investors and regulatory policy. For a start, it can promote a deeper understanding of market activity. How much debt has been bought back, which companies are engaging in these transactions, how often they are engaging in these transactions, and whether their debt buybacks track closely to trades in stock or derivatives markets all constitute questions for which *ex post* disclosure can help develop a more nuanced picture. It affords regulators and researchers a way to connect the dots and gain an understanding of how securities markets are pricing capital, using creditor control rights, and monitoring managerial slack through trades in equity and bond claims. From the standpoint of investor protection and market integrity, data also assists regulators in detecting fraud, misleading statements, and their impact on markets. Moreover, knowing that they will be disclosing information and becoming subject to scrutiny might motivate companies to avoid coercive and unfair practices.

Disclosure is not a panacea. The regulatory regime governing equity buybacks is deficient in many respects. The regime for prior notification can seem flimsy, with companies offering only generalized notices of their *possible* intent to do a buyback. Ex post disclosure can also be ineffective, owing to lengthy delays between concluding a repurchase and reporting it. Jesse Fried recommends shortening the ex post reporting regime to require disclosure within days, not months.[341] Disclosure is also costly on companies, though they are the best and most efficiently placed to produce information about themselves. Most fundamentally, disclosure cannot fix the structural deficiencies that affect bondholders. Managers can time buybacks to divert value most optimally to themselves. Coordination and information sharing is difficult. Tenders can be coercive. Bondholders can be outmaneuvered systematically. Despite limits in its overall efficacy, however, it provides a first step that introduces a similar level of transparency to bond markets as exists in equity with the expectation that this transparency will be refined and enlarged in due course.

B. Making Contracts Workable

The absence of strong public regulation in bond markets heightens the significance of contractual safeguards as the go-to shield for

340 *See id.* at 398.

341 Fried, *supra* note 32, at 834–36 (recommending a two-day reporting time requirement).

bondholders. Additionally, given the contractual foundation of the bond-issuer relationship, it makes sense to consider stronger contract drafting to more fully secure bondholder rights in the context of buybacks.

First, bond contract drafting can be upgraded to include provisions that compel disclosure by issuers regarding both open market repurchases as well as tender offers. Particularly where regulation does not step in to equalize disclosure requirements between debt and equity, contract can fill the gap. Open market repurchases place bondholders at a special disadvantage. Issuers are not required to make any formal notification and post hoc reporting remains indirect—e.g., through an annual report.[342] Without fiduciary obligations, bondholders are vulnerable to seeing their claims be bought up when issuers know they can extract greatest value.[343] In other words, issuers are well placed to repurchase the debt when it is trading at its lowest value relative to the information known to the company.

One potential remedy for this would be to amend bond contracts to require issuers to notify bond markets when they intend to conduct an open market repurchase. This would place bond and equity markets on a more equal footing using contractual rather than just regulatory fixes.[344]

Additionally, indentures can be drafted to stipulate that issuers produce more fulsome disclosure regarding debt tenders. An advantage to the contractual approach lies in the ability of investors and issuers to negotiate what aspects of a borrower's plans and finances should be disclosed prior to a tender offer. Such disclosure may be more detailed with distressed borrowers that pose a tougher valuation challenge. Alternatively, the industry may devise a standard that sets out the types of data that bondholders would wish to receive for tenders in order to understand and price the value of the claim. As discussed in Part II, the growing prevalence of expensive make-whole provisions point to the increasing importance of buybacks as a means of retiring a bond issue.[345] With this in mind, there are strong incentives for industry to collectively deliberate on whether the minimal

342 *See* Levy & Shalev, *supra* note 14, at 387.

343 *See id.* at 387–88.

344 The Author thanks Jonathan Brogaard, Mitu Gulati, and Steven Schwarcz for this suggestion.

345 *See* discussion *supra* Part II. The Author thanks Bill Bratton for insight and discussion on this point.

disclosure required under Regulation 14E is sufficient or whether it ought to be supplemented contractually.

A more dramatic contractual intervention might see indentures place stricter controls on debt buybacks either in the open market or through the tender offer. This could see contracts entirely restrict issuers from conducting debt buybacks through any means or specifying clear conditions, such as price ranges, within which buybacks can occur. Such a solution offers greater control to bondholders. It can also increase the level of consistency between formal call provisions and buybacks.

But such a step requires careful thought. Debt buybacks, as this Article shows, serve an array of useful functions for issuers. From helping move firms toward a more optimal mix of debt and equity or removing unnecessary covenants, buybacks constitute an important risk management device for firms and their creditors.[346] Outright bans or dissuasive controls on debt buybacks—making them as rigid as calls—may end up causing more problems for creditors instead of solving them. Borrowers could find themselves in distressed situations without a workable means of resolution, save for complex renegotiations and Chapter 11 restructuring. Bondholders that would like to exit through a buyback could also end up with limited options to quickly liquidate their claim. Importantly, buybacks offer a critical means by which issuers and investors can renegotiate claims, building flexibility into the term structure of bonds. Where buybacks are heavily curtailed by contract, issuers and bondholders may find themselves constrained into a more fixed arrangement.[347]

Although contractual reforms respect existing paradigms of bondholder investor protection, contractual fixes have a mixed history in bond markets. Contract has not always worked effectively to protect vulnerable investors, and its defects can diminish the power of a solution that relies on private monitoring and discipline.[348] Scholars note longstanding underenforcement of bond terms, investor apathy, a lack of diligence in reading, and negotiating contract terms as curtailing the power of contract.[349] Rising activism may point to changing

346 *See* discussion *supra* Part II.

347 *See* Marcel Kahan & G. Mitu Gulati, *Contracts of Inattention*, CLS BLUE SKY BLOG (Jan. 23, 2020), https://clsbluesky.law.columbia.edu/2020/01/23/contracts-of-inattention/ [https://perma.cc/XJJ3-WEF3].

348 *See id.*

349 *See, e.g.*, *id.* The contract law literature on this point is extensive and a full discussion is outside the scope of this work. *See* Julian Nyarko, *Stickiness and Incomplete Contracts*, 88 U. CHI. L. REV. 1 (2021) (noting the persistence of boilerplates in bond contracts).

trends. However, the dispersed nature of investors, a weak indenture trustee, as well as stickiness and path dependencies offer reasons for continuing caution about the workability of just looking to contract as a safeguard against bondholder coercion.

C. The Possibility—and Impossibility—of Fiduciary Protection

The structural imbalance between issuers and investors revives the question of whether there ought to be greater fiduciary protection for bondholders. This constitutes a well-worn debate in legal scholarship and one whose full discussion is outside the scope of this Article. Importantly, there exist very good reasons for *not* imposing such a duty. Bondholder and shareholder interests can diverge, creating confusion and incoherence in corporate law.[350] Crucially, the interests of bondholders are fundamentally at odds with the property-based paradigm underlying equity ownership relative to the time-limited, contractual nature of bond claims. Shareholders must look to fiduciary duties to guard themselves against managerial misfeasance. Bond investors, by contrast, deploy contract as their sword against agency costs.[351]

For this reason, a general fiduciary duty in favor of bondholders seems impractical. But it is worth asking whether a discrete duty may be imposed in the context of debt repurchases as a means of leveling the playing field and imposing affirmative obligations on managers to take bondholder interests more fully into account.

Scholars have long resisted the incremental expansion of fiduciary protection into credit markets. Fred Tung, for example, offers a persuasive argument for private contracting between shareholders and creditors as a more effective means to bargain around the various risks of opportunism.[352] Given the sophisticated nature of bondholders, imposing fiduciary protections can represent undue meddling into private bargains. Although this faith in contracting has justified a resistance to fiduciary duties in some quarters, others note a troubled reality for creditors on the ground. Jared Ellias and Robert Stark highlight a growing enthusiasm on the part of issuers to deliberately extract value from creditors for the benefit of shareholders during pe-

350 *See* Levy & Shalev, *supra* note 14, at 385 (noting the diverging interests of bondholders and shareholders and the wealth transfer from the former to the latter in the case of open market repurchases).

351 *See* discussion *supra* Section I.C.

352 *See* Tung, *supra* note 297, at 867.

riods of financial distress.[353] Following recent case law that has curtailed the application of a fiduciary duty owed to creditors around insolvency, Ellias and Stark point to an unraveling of norms that have historically precluded issuers from seeking to hurt creditors.[354] Managers and shareholders, they argue, are now engaged in costly games of "bankruptcy hardball" with creditors, who seem ill-placed to protect themselves using contractual bargains and sophistication.[355]

This Article shows there may be several rationales to ground a discrete fiduciary duty in the discrete context of a debt buyback. First, bondholders risk losing their entire bargain with the borrower—and at the latter's discretion. This makes bondholder interests adverse to those of managers and shareholders that seek to buy out the debt and its covenants at the cheapest possible price and with fewest transaction costs. Second, relying on contract alone in this context may not even be practicable, without investors having to spend heavily on information, coordination, and lobbying. Dispersed bondholders already face high hurdles in organizing. Hedge fund activists offer some antidote to this difficulty, but it is far from a complete one. In debt buybacks and consent solicitations, bondholders face the added difficulty of tight deadlines—usually 20 business days—that create fierce urgency to contest the tender. Scholars have pointed to the coercive nature of solicitations.[356] Added to limited information and inertia prompted by collective action costs, relying on simple contract for protection seems optimistic.

However, despite its benefits over other reforms, a discrete fiduciary duty in this context faces long odds in implementation. With bonds founded on contract, courts are likely to view such a duty as radical. Recent Delaware caselaw underscores the lack of judicial enthusiasm for extending fiduciary protections to creditors, even in situations where lender-borrower interests are in conflict.[357] Moreover, it is not clear whether the market would support the creation of such a duty. It forces borrowers to internalize compliance costs at a time when they are struggling financially. The need to act in bondholder interests may limit their negotiating power surrounding the tender

353 *See* Ellias & Stark, *supra* note 97, at 747–49.

354 *See id.* at 748.

355 *See id.* at 748, 762.

356 *See* discussion *supra* Section III.A.

357 The Delaware Supreme Court and the Delaware Court of Chancery have sharply limited the bite of fiduciary protection owed by managers to creditors around insolvency. *See* N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 103 (Del. 2007); Quadrant Structured Prods. Co. v. Vertin, 102 A.3d 155 (Del. Ch. 2014).

premium. From the standpoint of bondholders, fiduciary protections may also lack real power. How should the standard be defined in the context of debt buybacks? What kinds of behaviors might trigger a breach of the duty? Can the wide latitude traditionally encapsulated within the concept of business judgment essentially inoculate managers against a bondholder claim? As a result, it seems improbable that despite the costly structural imbalance of power between bondholders and issuers in the context of debt buybacks, the law will turn toward a fiduciary duty to provide the answer.

Conclusion

Debt buybacks constitute a high-dollar, problematic yet shockingly understudied phenomenon in capital markets. With the expansion of corporate credit over the last decade, prioritizing their study and regulatory import should take on greater urgency. This Article takes a first step to do so, situating debt repurchases within the context of theories exploring the role and power of debt. While highlighting debt's significance, it shows how buybacks represent a potent tool in the hands of borrowers, capable of rewriting the bargain between issuer and creditor in ways that can systematically punish investors. For bond markets, information asymmetries and structural barriers to coordination penalize bondholders. Traditionally protective tools like contract, coordination, and voice lack effectiveness where investors cannot use them without first internalizing high private costs. To mitigate the harm to bondholders, this Article sets out pathways for reform, focusing on disclosure and contract reform. In doing so, it begins a much needed discussion to unravel the significance of debt buybacks for capital allocation, investor welfare and the economy.