CONFRONTING THE CERTAINTY IMPERATIVE
IN CORPORATE FINANCE JURISPRUDENCE

BY

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ABSTRACT

Turbulent economic periods leave many enduring legacies. This Article identifies and examines a jurisprudential vestige of the economic instability of the 1970s and 1980s: what I call the "certainty imperative." The imperative is a pervasive rhetoric that infuses the specific goal of stability in financial markets into the broader and more deeply entrenched normative theme of legal certainty. As this persistent theme has evolved across decades of case law and legislative enactments, the imperative has profoundly altered judicial decision-making paradigms in lending and finance by embracing strict interpretive norms and rejecting more expansive contextual analyses. Over time, the imperative's methodological constraints have become far more limiting than more typical notions of judicial restraint; the imperative has become a paralyzing force upon the judiciary, preventing it from engaging in law reform. In essence, the state of lending and finance jurisprudence can be summarized thusly: deference, in the very broadest sense, is shown to the legal status quo.

The methodological constraints imposed by the imperative must be overcome. As modern corporate financing arrangements grow more complex, moral hazards arise when contractual language vests substantive rights and remedies in a manner that does not align with present-day economic interests. This Article suggests several possibilities for expanding the scope of judicial inquiries in the corporate financing realm so that the judiciary may resolve disputes through an interpretive methodology that considers economic substance over contractual form.

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I. INTRODUCTION

Historically overlooked by legal scholars, the field of corporate finance has been the subject of vigorous public interest, critical documentary and forceful editorializing in the wake of the recent financial crisis. Consider, for instance, the myriad headline news stories throughout the crisis and ensuing recession, detailing commercial loan defaults and workouts, high profile corporate bankruptcies, devastating bank failures and startling fire sales of entrenched Wall Street firms. Debt financing in particular has

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


4 See, e.g., Chris Isidore, General Motors bankruptcy: End of an era, CNNMONEY.COM, June 2, 2009; Hugh Son, AIG Falls After Failing to Give Plan to Save Rating, BLOOMBERG, Sep. 15, 2008; Andrew Ross Sorkin, Lehman Files for Bankruptcy; Merrill Is Sold, N.Y. TIMES, Sep. 14, 2008, at A1; James Saft, Bear Stearns's fall prompts a search for faith in banking and markets, N.Y. TIMES, Mar. 18, 2008. For a lively
attracted considerable attention, as a range of debt obligations were subjected to securitization and unregulated derivative trading considered by many to be a cause of the crisis and recession.\footnote{For an overview of the causes of the financial crisis, \textit{see}, \textit{e.g.}, \textsc{Andrew Ross Sorkin}, \textit{Too Big to Fail: The Inside Story of How Wall Street and Washington Fought to Save the Financial System -- and Themselves} (2010); \textit{see also} \textsc{William Poole}, \textit{Causes and Consequences of the Financial Crisis of 2007–2009}, 33 Harv. J. L. & Pub. Pol'y 421 (2010). For a brief discussion of the role of securitization and derivatives, \textit{see} \textsc{Shannon D. Harrington & Abigail Moses}, \textit{Credit Swap Disclosure Obscures True Financial Risk}, Bloomberg, Nov. 6, 2008.}

Even setting aside technical explanations as to the relationship between any given corporate financial practice and broader market disruptions, the financial crisis has made it abundantly clear that where private financing arrangements overlap to create a sufficiently large and complex web of interconnected transactions, the consequences of default can become quite public and wide-spanning. For instance, in one of the most dramatic weeks of the recession, forceful remarks by President Obama underscored the relationship between corporate financing and the fate of established and iconic companies. When unanimous consent to a proposed settlement could not be obtained from Chrysler LLC's corporate lenders, the company was forced to file for Chapter 11 bankruptcy protection.\footnote{\textsc{Amanda Ruggeri}, \textit{Obama Points to New Villain in Chrysler Bankruptcy: Hedge Funds}, U.S. News, May 1, 2009.} Of the lenders refusing consent, President Obama remarked: "They were hoping that everybody else would make sacrifices, and they would have to make none...I don't stand with them."\footnote{\textit{Id.}}

In response to polarizing events of this sort, many market participants and observers believe that the experiences of the last few years suggest a need for greater involvement by governmental institutions in financial markets.\footnote{Calls for increased governmental oversight were a primary motivation for the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), signed into law in the summer of 2010, and to be codified at \textsc{7} U.S.C. \textsc{\$}2. Pub. L. 111-517, Stat.} Law reform is actively
underway and likely to continue as new insights are gained from ongoing empirical research into the causes of the financial crisis and recession, as well as from evolving conceptions as to the role of law, institutions and public policy in financial markets. Careful attention of the legal academy is deeply needed to facilitate the emerging public debate. At best, the verdict on the saliency of the prevailing legal paradigm in corporate finance is still out, patiently awaiting the contributions of legal scholars.

To be sure, in spite of these generalized calls for deeper governmental involvement, in reality each of the judicial, legislative and executive branches of government performs different functions in the formation and execution of financial law and policy. For the most part, reform efforts have been focused on the goal of bringing increased regulatory oversight to the financial services industry, either by imposing regulations upon specific types of financial institutions, or by recharacterizing certain transactions so that they are covered by existing statutory frameworks. In the latter case, such recharacterizations effectively elevate particular instruments from a baseline status as


10 A recent issue of the Brigham Young University Law Review explored a number of these questions. See 9 B.Y.U. L. Rev. (2010).

11 For instance, under existing laws, Financial Holding Companies are regulated by the Federal Reserve. The Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve regulate commercial banks. State insurance commissions regulate insurance companies. More recently, the Bank and Savings Association Holding Company and Depository Institution Regulatory Improvements Act of 2010, H.R. 4173, § 601, imposes additional regulations on certain financial institutions.

private contracts into a more specialized category of instruments subject to regulation under securities or commodities laws.

Yet long before a financial crisis unfolds, and long before Congress and executive agencies have the occasion to revamp statutory and regulatory frameworks, financing arrangements are not outside of the law. Rather, they remain subject to a range of broadly-applicable legal principles, such as those governing contracts generally. Further, where parties seek legal redress, financing arrangements are subject to the jurisdiction of courts. Thus, as these broader debates turn, one question must loom particularly large among legal scholars: what role do courts play in the realm of corporate finance? Moreover, what role should courts play? As history has revealed in other areas of the law, judicial decisions can have profound effects, both in terms of resolving disputes or granting relief and, more broadly, by stimulating legislation that alters the direction of reform efforts. Even more, the availability of an effective judicial process can serve as an important foundation for business activity. In fact, emerging theories demonstrate positive correlations between common law

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13 Recent attention has focused on "derivatives" which include a variety of privately-negotiated contracts, such as interest rate swaps, credit default swaps, equity swaps and commodity price swaps; these transactions are designed to manage risk and enhance profits. Although the financial engineering behind these products can be highly complex, the transaction is effectuated by a contract, often executed using a relatively brief, standardized form. See, e.g., JPMorgan Chase Bank, N.A. v. Controladora Comercial Mexicana S.A.B. DE C.V., 2010 NY Slip Op 52066U (N.Y. Misc. 2010); Lehman Brothers Special Financing Inc. v. BNY Corporate Trustee Services Ltd., 422 B.R. 407 (Bankr. S.D.N.Y. 2010); Fin. One Pub. Co. v. Lehman Bros. Special Fin., Inc., 414 F.3d 325 (2nd Cir. 2005) (each case analyzing claims arising under derivatives contracts under state contract law without reference to laws governing specialized financial instruments).

14 For example, on the role of courts in education finance reform, see Matthew H. Bosworth, Courts as Catalysts: State Supreme Courts and Public School Finance Equity 1-26 (2001).

legal systems and strong financial markets, as courts are better able to provide flexible and responsive redress for investor claims.\textsuperscript{16}

Given that the vast majority of corporate financing activity occurs pursuant to private transactions between highly sophisticated parties, any reflection on the role of courts in this area necessarily touches upon broader notions as to the efficacy of judicial involvement in economic affairs, and the interconnections among law reform, commercial certainty, systemic risk and market efficiency. Perhaps the basic question, then, is what sort of judicial involvement in the realm of corporate finance is even feasible under existing jurisprudential norms?

Even the most cursory review of the present milieu reveals minimal lawmaking by courts in this realm.\textsuperscript{17} With limited exception,\textsuperscript{18} courts presiding over corporate finance cases circumvent more expansive interpretive analyses when identifying substantive rights and obligations or procedural remedies, even declining to extend many common law doctrines that broadly overlie all contracts.\textsuperscript{19} At first blush, this tendency appears to

\textsuperscript{16} The interdisciplinary subfield "law and finance" has brought questions of this sort to the forefront. See, e.g., Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, \textit{Law and Finance}, 106 J. OF POL. ECON. 1113 (1998) (advancing the hypothesis that common law countries provide enhanced protection of minority shareholders).

\textsuperscript{17} Judicial lawmaking, or "judge-made law," finds its roots in The Federalist No. 78, at 492 (Alexander Hamilton) (1961) and the landmark case, Marbury v. Madison, 5 U.S. (1 Cranch) 137, 176 (1803) ("[i]t is emphatically, the province and duty of the judicial department, to say what the law is"). However, the notion of judge-made law has long been controversial, with early courts questioning its constitutional foundation. See, e.g., U.S. v. Wong Kim Ark, 169 U.S. 649 (1898) ("[o]ur duty is to execute the law, not to make it"); see also CHRISTOPHER WOLFE, \textit{THE RISE OF MODERN JUDICIAL REVIEW: FROM JUDICIAL INTERPRETATION TO JUDGE-MADE LAW} (1994).

\textsuperscript{18} See infra Part III for a discussion of expansive analyses in securities law.

\textsuperscript{19} Most jurisdictions recognize an implied covenant of good faith and fair dealing in contracts. \textit{RESTATEMENT (SECOND) OF CONTRACTS} § 205 (1981); Steven J. Burton, \textit{Breach of Contract and the Common Law Duty to Perform in Good Faith}, 94 HARV. L. REV. 369 (1980). However, because most courts decline to recognize a fiduciary duty of a lender to a borrower or the borrower's related parties, the expansion of implied covenants in the realm of corporate finance has been effectively curtailed. See, e.g., ADT Operations, Inc. v. Chase Manhattan Bank, 173 Misc.2d 959, 963-64 (N.Y. Sup. Ct. 1997) (the relationship between a customer and a bank is an arm's length, debtor-creditor relationship which does not, without more, create a fiduciary
reflect a textualist interpretive paradigm dominating American jurisprudence in recent years.\footnote{Textualism is an interpretive regime pursuant to which courts apply objective methodology, such as construing language in accordance with plain meaning. In the context of statutory interpretation, Justice Scalia has described and defended this approach. \textit{See ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 18–25 (1997)} (describing textualist statutory interpretation); \textit{see also} ANTONIN SCALIA, \textit{Judicial Deference to Administrative Interpretations of Law}, DUKE L. J 511 (1989). Textualism has become infused in contract interpretation methodology, fueled by a reemergence of formalism in modern contract law. \textit{See Michael P. Van Alstine, Of Textualism, Party Autonomy, and Good Faith}, 40 WM. & MARY L. REV. 1223 (1999).} However, as I will demonstrate, finance and lending jurisprudence has forged a unique path, and many areas of corporate finance have persistently eluded the rigorous judicial analyses that corporate, transactional\footnote{Contracts relating to business transactions (other than financing arrangements) often include Delaware choice-of-law and forum selection clauses; additionally, most major firms are incorporated under Delaware law. As a result, there is a rich body of corporate jurisprudence in Delaware. The Delaware Court of Chancery has been active in developing common law doctrine, particularly in areas such as fiduciary duties and the roles of managers and shareholders. \textit{See ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW} 39-40 (1993) \textit{[hereinafter ROMANO, GENIUS OF AMERICAN CORPORATE LAW]; see also} Lucian A. Bebchuk & Assaf Hamdani, \textit{Federal Corporate Law: Lessons from History}, 106 COLUM. L. REV. 1793, 1817 (2006) \textit{["[o]ne of the noteworthy features of Delaware law is its heavy reliance on judge-made standards to regulate corporate affairs"])}; Henry Hansmann & Reinier Kraakman, \textit{The End of History for Corporate Law}, 89 GEO. L.J. 439, 459 (2001) (noting, primarily in reference to Delaware corporate jurisprudence, extensive judge-made standards with respect to the fiduciary duties of loyalty and care); Robert A. Ragazzo, \textit{Toward a Delaware Common Law of Closely Held Corporations}, 77 WASH. U. L.Q. 1099 (1999) (detailing the evolution of judicially-crafted standards of shareholder responsibilities). \textit{See infra Part II.A.}} and bankruptcy\footnote{\textit{See Adam Levitin, Toward a Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime}, 80 AM. BANKR. L.J. 1 (2006) (analyzing judicial lawmaking rooted in both legal and equitable grounds in the bankruptcy realm).} law have endured. It seems, then, that there are deeper historical and philosophical forces at work.

Indeed, the decisional paradigm in corporate finance finds its roots in what I call the “certainty imperative,” which is a pervasive rhetoric that infuses the goal of stability in financial markets into the more deeply entrenched normative theme of legal certainty.\footnote{\textit{See infra Part II.A.}}
Specifically, the imperative asserts that stable financial markets are preserved in an environment of "legal certainty," which, in the realm of lending and finance, is judged largely from the subjective standpoint of financial institutions. A jurisprudential legacy of the turbulent 1970s and 1980s, the imperative posits that legal certainty and market stability are best preserved when courts exercise considerable restraint, narrowly tailoring opinions to strict construction and passive enforcement of contracts.24 To this end, the imperative advances strict interpretive methodologies. A frequent theme echoed by banking industry lobbyists,25 the imperative has also prompted legislative enactments that further curtail judicial lawmaking. Yet despite its considerable impact, it is not a positive legal doctrine; in fact, it is the reason for the relatively empty space where corporate finance jurisprudence ought to be. In spite of the imperative's lack of academic treatment, the implications are of plain consequence: modern courts are effectively barred from participating in financial law reform by a decisional paradigm that rejects contextual analyses with respect to the rights, interests and obligations at the heart of financing arrangements.

I will argue that the methodological constraints of the imperative have abandoned the underlying normative goals of certainty and stability in financial markets, and a new paradigm designed to allocate rights and remedies in accordance with the economic substance of arrangements would better preserve certainty and stability. This Article proceeds as follows. Part II begins by articulating the jurisprudential underpinnings of the imperative. In Part III, I examine the economic analysis reflected

24 In contrast to the phrase "judicial restraint," "judicial activism" is often used as political rhetoric; however, when divorced from normative assumptions, the term essentially refers to the legitimacy of judicial decision-making. By "legitimacy" it is meant that a court has properly deferred to some other actor that is better suited to analyze the issue (such as Congress, the executive branch, or the states), but also that it has not blindly deferred such that a decision is divorced from legal precedent or the present realities. See Kermit Roosevelt, III, THE MYTH OF JUDICIAL ACTIVISM: MAKING SENSE OF SUPREME COURT DECISIONS (2008).

25 See, e.g., infra note 154.
in imperative-driven decisions, as well as the interpretive methodology that has evolved across a range of judicial decisions and legislative enactments. In Part IV, I introduce a recent case that exemplifies the current state of corporate finance jurisprudence. I also provide a brief overview of the methods by which courts typically construe financing agreements under strict interpretive norms. I then critically analyze the case, and in Part V I proffer an alternative decisional paradigm and discuss whether a more expansive approach may be more apt to preserve stability and efficiency in financial markets. Part VI concludes.

II: THE CERTAINTY IMPERATIVE

To some extent, the scarcity of doctrinal law with respect to rights and obligations of parties to financing transactions reflects the limited involvement of courts in this area. As a general matter, most of the judiciary’s recent forays into finance and banking have been limited to questions of federal preemption of state laws\textsuperscript{26} and regulations\textsuperscript{27} or controversies in respect of consumer credit and

\textsuperscript{26} For example, a line of cases have considered conflicts between the federal Trust Indenture Act of 1939, codified at 15 U.S.C. § 77aaa, et seq., which supplements the Securities Act of 1933 in respect of debt securities, with various provisions of state securities laws. See, e.g., Bluebird Partners, L.P. v. First Fid. Bank, 85 F.3d 970, 974 (2d Cir. 1996) ("[t]he Trust Indenture Act was enacted because previous abuses by indenture trustees had adversely affected the national public interest and the interest of investors in notes, bonds [and] debentures,’ and Congress sought to address this national problem in a uniform way’"); Zeffiro v. First Pa. Banking & Trust Co., 623 F.2d 290, 299 (3d Cir. 1980) ("[i]t is hard to believe that Congress would have established uniform standards to govern indentures and then paradoxically have allowed the application of those standards to depend on the law of the state of the suit’"). For a discussion of federal preemption of state laws in the area of consumer lending, see Adam J. Levitin, \textit{Hydraulic Regulation: Regulating Credit Markets}, 26 YALE J. ON REG. 143 (2009) [hereinafter Levitin, \textit{Hydraulic Regulation}] (evidencing a pronounced trend toward increased federal preemption of state laws).

\textsuperscript{27} The Supreme Court has grappled with the role of states in regulating the activities of federally-chartered banks. See, e.g., Watters v. Wachovia Bank, N.A., 550 U.S. 1 (2007) (the National Bank Act, codified at 12 U.S.C. §§ 21-43, preempts state licensing, registration and inspection requirements as applied to national banks and their operating subsidiaries).
residential mortgage lending.\footnote{For a summary of law reform in these areas, see Jo Carrillo, Dangerous Loans: Consumer Challenges to Adjustable Rate Mortgages, 5 BERKELEY BUS. L.J. 1 (2008).} This is not to say that disputes arising under sophisticated financing transactions do not ultimately find their way into court. In fact, as such arrangements grow larger and more complex, the claims that arise generate substantial litigation. Cases of this sort tend to arrive in federal courts (including bankruptcy courts) and the state courts of New York.\footnote{The State of New York is overwhelmingly selected in choice-of-law provisions of sophisticated credit agreements, likely due to New York City’s prominence as a global financial center. See Theodore Eisenberg & Geoffrey P. Miller, The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies’ Contracts, 30 CARDOZO L. REV. 1475 (2009).} However, as the following sections demonstrate, finance and lending jurisprudence, including cases extending into the related areas of consumer finance and public finance, reveals a number of insights into the judiciary’s perceptions of its own limited role in financial matters.

A. Preserving Stability in Financial Markets

Finance and lending law reform is often reactionary, developed \textit{ex post} in the wake of an economic downturn. Thus, to find the historical roots of present jurisprudential norms in corporate finance, we must look considerably beyond the most recent economic crisis. Commencing in the 1970s and extending into the 1980s, a range of factors converged to create a tremendous amount of turbulence in the global economy. Upon the collapse of the Bretton Woods system in the early 1970s, major currency exchange rates were permitted to float; initially, this brought extraordinary volatility to capital markets.\footnote{Jacqueline Best, The Limits of Transparency: Ambiguity and the History of International Finance 87-89 (2005).} United States banking and financial sectors were particularly vulnerable to the instability, and also faced additional capitalization risks resulting from newly variable exchange rates.\footnote{George Alexander Walker, International Banking Regulation: Law, Policy, and Practice 24-26 (2001); see also Joseph Gold, Public International Law in} Commodity prices fluctuated wildly.\footnote{George Alexander Walker, International Banking Regulation: Law, Policy, and Practice 24-26 (2001); see also Joseph Gold, Public International Law in}
and interest rates similarly ricocheted as inflationary pressures mounted.\textsuperscript{33} Aggressive anti-inflationary actions taken by the Board of Governors of the Federal Reserve System (the "Board") further exacerbated market volatility.\textsuperscript{34} Bank failures began to increase in the 1970s, and surged in the 1980s.\textsuperscript{35} Indeed, by any measure, the period from the early 1970s until the mid-1980s was a particularly turbulent time in United States history.

Against this backdrop of instability, and largely in response to Keynesian interventionalist measures\textsuperscript{36} taken by the Board in the New Deal era as well as at the peak of the inflationary crisis of the 1970s,\textsuperscript{37} a school of neoclassical economics became preeminent. With roots at the University of Chicago,\textsuperscript{38} these "Chicago School" economists rejected the notion of governmental regulation in most financial affairs, arguing that markets are inherently stable so long as they are permitted to function without excessive governmental interference.\textsuperscript{39}

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\textsuperscript{33} VITO TANZI, TAXATION, INFLATION, AND INTEREST RATES 182-84 (1984).


\textsuperscript{35} FRANKLIN R. EDWARDS, THE NEW FINANCE: REGULATION AND FINANCIAL STABILITY 38 (1996) (graphing the increase in bank failures during these decades).

\textsuperscript{36} Keynesian economic theory assumes that certain governmental economic and fiscal policies can stimulate or restrain market expansion. See generally JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY (1936).

\textsuperscript{37} See supra note 34 and accompanying text.

\textsuperscript{38} The most noted of the Chicago School economists was University of Chicago economics professor Milton Friedman, who received the Nobel Prize in economics in 1976. Milton Friedman, Inflation and Unemployment, Nobel Prize Acceptance Speech (Dec. 13, 1976).

Such history is an essential predicate to understanding the judiciary's modern approach to finance and lending cases, as from this period in history arose venerable precedent in this realm. In 1979, the Third Circuit declined to recognize a common law fiduciary duty of a bank to its borrower, explaining that the "legislature is best suited to consider the delicate financial issues at stake and strike the appropriate balance between sound economics on the one hand, and expectations of loyalty on the other."40 Implicit in the court's rationale is the belief that lending relationships require more delicate legal handling than other economic relationships in the commercial marketplace. These concerns of a particular vulnerability in the banking sector reflect both historical context as well as the libertarian economic theories that were gaining distinction at this juncture.

The notion that courts in particular are ill-equipped to tamper with the lending relationship gained far greater prominence in a 1981 consumer finance decision of the Supreme Court concerning questions arising under one of the most influential pieces of modern banking legislation, the Truth in Lending Act (the "Act").41 In Ford Motor Credit Company v. Milhollin,42 the highest court of the land was tasked with determining whether a creditor must disclose to a borrower its right to accelerate the maturity date of debt obligations. Noting that "caution must temper judicial creativity" when interpreting legislation,43 the Court turned to strict

40 Washington Steel Corp. v. TW Corp., 602 F.2d 594, 601 (3d Cir. 1979) ("even if...sound public policy, it would hardly be the province of this court to say so....First, establishing a Per se common law fiduciary duty of banks to their borrowers seems archetypically within the domain of legislative judgment") overruled on other grounds by Clark v. K-Mart Corp., 979 F.2d 965, 967 n. 4 (3d Cir. 1992).
41 Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. §§ 1601-1667f). To the extent a transaction is subject to the Act, the law mandates certain disclosures by the creditor in respect of the extension of credit. The Act applies only to consumer credit (i.e., credit issued for family or household purposes as opposed to business, commercial, industrial or agricultural purposes) that otherwise meets the requirements set forth in the statute and regulations. See Elwin Griffith, Lenders and Consumers Continue the Search for the Truth in Lending Under the Truth in Lending Act and Regulation Z, 44 SAN DIEGO L. REV. 611 (2007).
43 Id. at 565.
interpretive norms to construe the plain meaning of the Act, finding that an acceleration clause was not a "default, delinquency, or similar charg[e]," and thus not subject to mandatory disclosure under the express statutory language.\(^{44}\) Further, the Court found that the question had been addressed in regulations promulgated under the Act and also in guidance issued by Board staff.\(^{45}\) Given that Congress expressly delegated administrative authority to the Board, the Court found that such explanatory material, unless "demonstrably irrational," is dispositive.\(^{46}\) Consequently, disclosure was not required under the Act.

In terms of its holding, \textit{Milhollin} is not a landmark decision; rather, it is one of many cases that broadly fall within the so-called "deference rule,"\(^ {47}\) whereby courts defer to Congressionally-sanctioned agency interpretations of federal statutes or regulations promulgated under such statutes.\(^ {48}\) Deference is granted notwithstanding the judiciary's constitutional power to construe existing law or "fill[] the interstitial silences within a statute or a regulation."\(^ {49}\) Thus, \textit{Milhollin} contains fairly typical deference rule justifications for judicial restraint: "Congress, in delegating regulatory authority to the Board, has chosen to resolve

\(^{44}\) \textit{Id.} at 562-64.

\(^{45}\) \textit{Id.} at 564 n.8.

\(^{46}\) \textit{Id.} at 565.


\(^{48}\) "If the intent of Congress is clear…the court as well as the agency must give effect to the unambiguously expressed intent of Congress. [I]f the statute is silent or ambiguous with respect to the specific question, the issue for the court is whether the agency's answer is based on a permissible construction of the statute." \textit{Chevron}, 467 U.S. at 842–43.

\(^{49}\) \textit{Milhollin}, 444 U.S. at 565.
interpretive issues under the Act by 'uniform administrative
decision, rather than piecemeal through litigation.'\(^{50}\)

Yet for those interested in lending and finance, Milhollin has
philosophical implications that extend far beyond its contributions
to deference rule jurisprudence or even consumer finance law.
Rendered at the peak of the 1980-82 recession, the decision echoes
the Third Circuit in that it reflects an enormous amount of
apprehension as to the role of courts in the realm of lending and
finance. Yet Milhollin went substantially farther than the Third
Circuit, infusing the goal of stability in financial markets into
the more entrenched normative value of legal certainty, which is a
long-standing theme that has persisted across centuries of common
law.\(^{51}\) Articulating a heightened need for "sure guidance" by
persons engaged in the business of lending and finance, the Court
noted that judicial deference to agency interpretation is especially
appropriate when construing the "highly technical" Act.\(^{52}\) In
essence, the decision recognizes a subjective notion of legal
certainty, referred to as "sure guidance," which turns not upon
objective principles of uniformity and clarity in the law, but rather
upon the impression of financial institutions that the law governing
lending transactions has remained unchanged.

\(^{50}\) Id. at 567-68.

\(^{51}\) "He who destroys the means of certainty does a greater mischief than the
sower of dragon's teeth." BYRON KOSCIUSKO ELLIOTT & WILLIAM FREDERICK ELLIOTT,
THE WORK OF THE ADVOCATE 422 (1888). Legal certainty, as a broader normative societal
goal, is to a large extent synonymous with the phrase "rule of law." In the transactional
and commercial realm, certainty is often associated with uniformity, as precision in the
law is believed to allow parties to more efficiently structure transactions and order
(1943) ("[t]he issuance of commercial paper...is on a vast scale and transactions in that
paper from issuance to payment will commonly occur in several states. The application
of state law...would subject the rights and duties of the United States to exceptional
uncertainty. It would lead to great diversity in results by making identical transactions
subject to the vagaries of the laws of the several states. The desirability of a uniform rule
is plain"); Indiana & I.C.R. Co. v. Sprague, 103 U.S. 756, 761-62 (1880) ("[t]o hold that
the moment an unpaid coupon is left on a bond its character and negotiability are changed
would greatly embarrass the traffic in such securities and lead to endless uncertainty and
confusion").

\(^{52}\) Milhollin, 444 U.S. at 565-68.
More recent cases have reiterated Milhollin’s holding and policy rationale in the context of judicial deference to agency interpretations of the Act. More importantly, the infusion of financial market stability into the theme of legal certainty has continued across a range of cases. Thus emerged what I call the “certainty imperative”: a pervasive rhetoric that manifests in the finance and lending realm, and that, over time, has profoundly altered judicial decision-making methodology. The imperative frequently emerges in judicial opinions, in the form of policy arguments, dicta, or as strong cautionary words to lower courts. It is often used as justification for judicial inaction. Conversely, in the rare case that a court applies a more expansive paradigm to resolve a controversy arising under a financing arrangement, the imperative might appear as assurance that the decision does not go so far as to constitute judicial activism.

Generally focused on the needs of banking and financial institutions rather than borrowers, the imperative promotes

54 See, e.g., In re Symons Frozen Foods Inc., 432 B.R. 290, 300 (Bkrtcy.W.D.Wash. 2010) (resolving a conflict of laws question pertaining to statutory liens based in part upon the court’s belief that “the application of Washington law...is supported by its effect of...creating certainty in the market.”); Pinter v. Dahl, 486 U.S. 622, 652 (1988) (the securities market “demands certainty and predictability”).
55 Seemingly innocuous at first blush, judicial dicta can have profound and even unintended effects. See Michael Abramowicz & Maxwell Stearns, Defining Dicta, 57 Stan. L. Rev. 953 (2005). Much of the language quoted from the cases discussed in this section can be described as either dicta or as policy rationale. In either case, such language reveals important insights into underlying motivations of the court.
56 See infra notes 121-125 and accompanying text.
57 See infra notes 117-120 and accompanying text
58 For example, in a 1997 case finding successor liability based on an asset purchase at a foreclosure sale, the United States District Court for the Western District of New York noted, “[t]he court's holding in this case will not disrupt the credit markets, because the facts are unique.” State of N.Y. v. Westwood-Squibb Pharmaceutical Co., Inc., 981 F.Supp. 768, 791 (W.D.N.Y. 1997).
59 Courts have denounced consideration of the consequential effects resulting from a ruling adverse to a borrower. See, e.g., A.I. Credit Corp. v. Government of Jamaica, 666 F. Supp. 629, 633 (S.D.N.Y. 1987) (“our holding could have a devastating financial impact...due to [cross-default provisions across several financing agreements]. But it is not the function of a federal court...to evaluate the consequences to the debtor of
bright-line rules that provide "all prospective lenders the certainty that is so important to the effective operation of markets," or that deliver "guiding principle[s] for those whose daily activities must be limited and instructed by [securities laws and regulations]." The theme is often invoked as a rationale for maintaining the legal status quo, as courts lament a seemingly inequitable outcome under current law, but decline to engage in law reform out of concern that any deviation from the imputed expectations of lenders might disrupt financial markets. To this end, courts invoke forceful language, expressing fear that a decision might "throw credit markets into confusion and destabilize this area of law," or "disrupt orderly credit markets." The Fourth Circuit went so far as to suggest a slippery slope of sorts, whereby a ruling adverse to the expectations of lenders might send tremors through the industry, causing "untold and unknown consequences that cannot now be fully foreseen," "undefinable instability" and even its inability to pay nor the foreign policy or other repercussions...Such considerations are properly the concern of other governmental institutions").

60 In re Bulson, 327 B.R. 830, 845 (Bkrtcy.W.D.Mich. 2005) ("some line must be drawn so that the lenders generally can make rational decisions when underwriting loans....The outcome...is at least one that a lender could have anticipated and adjusted for accordingly").


62 Bulson, 327 B.R. at 845 ("[w]hile the definition...may not accomplish the equitable perfection sought by those courts that champion a case-by-case or totality of the circumstances approach, the exclusion of a few lenders...seems a small price to pay for the certainty afforded by a more precise definition").

63 At times, courts search for and defer to any efficiency argument that supports maintenance of the legal status quo. See Freeman v. Decio, 584 F.2d 186, 190, 196 (7th Cir. 1978) (declining to recognize derivative action under Indiana securities laws for profits of insider trading, in part because insider trading promotes efficient financial markets by signaling price information).

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

65 Algemene Bank Nederland, N.V. v. Hallwood Industries, Inc., 133 B.R. 176, 180-181 (W.D.Pa. 1991) (under a loan assumption agreement, the assignor remained liable to the holder after the holder was unable to recover from the assignee because of involuntary bankruptcy petition filed against the assignee; to find otherwise "would not only be unwarranted but would also disrupt orderly credit markets").
"widespread confusion."\textsuperscript{66} Other times, the imperative is expressed in vague terms, as if to imply some universal understanding that markets are profoundly sensitive to judicial decisions that modify existing law; thus courts have referred to undefined "ripple effects,"\textsuperscript{67} and the simply-stated policy concern: "credit markets may be affected."\textsuperscript{68} When considered in its historical context, the imperative is not a reasoned judicial philosophy, but rather a consequence of a shaken economy and a synthesis of academic theories that seemed to offer new direction for maintaining stability. The following section explores the additional goal of uniformity that tends to accompany the imperative.

\textbf{B. Promoting Uniformity in Contract Terms}

In disputes that turn on contractual agreements, the imperative frequently espouses the additional goal of uniformity, which is heralded as a proxy for legal certainty. Much like the notion of legal certainty reflected in the imperative, the value of uniformity is measured from the subjective standpoint of lenders and financial institutions analyzed as a homogenous group. For instance, in \textit{Broad v. Rockwell International Corp.},\textsuperscript{69} the Fifth Circuit sought to construe indenture language, including provisions that were common boilerplate in the industry. The court downplayed variations in the terms of any particular indenture, noting that such provisions are intended to reach uniform results: "[Boilerplate provisions] have been stated in many different ways in various indentures. Since there is seldom any difference in the intended meaning, such provisions are susceptible of standardized

\begin{footnotes}
\item[66] Cetto v. LaSalle Bank Nat'l Ass'n, 518 F.3d 263, 277 (4th Cir. 2008).
\item[68] See, e.g., In re Fracasso, 210 B.R. 221, 228 (Bankr. D. Mass. 1997), rev'd 222 B.R. 400 (Bankr. 1st Cir. 1998), aff'd 187 F.3d 621 (1st Cir. 1999) (declining to afford debtors a blanket exemption for the equity in their primary residences, because “[t]here are serious state policy issues at play; for example, credit markets may be affected by this revision of the state statute”).
\end{footnotes}
expression."\textsuperscript{70} Granting deference to the imputed expectations of debt holders, the court explained the need for "uniformity" in construing provisions, as such "uniformity...is what makes it possible meaningfully to compare one debenture issue with another, focusing only on the business provisions of the issue and the economic conditions of the issuer, without being misled by peculiarities in the underlying instruments."\textsuperscript{71}

Similarly, in Sharon Steel Corp. \textit{v.} Chase Manhattan Bank,\textsuperscript{72} the Second Circuit succinctly summarized the importance of this subjective brand of uniformity in construing boilerplate provisions: "uniformity in interpretation is important to the efficiency of capital markets."\textsuperscript{73} Further reiterating the \textit{Broad} message of deference to the interpretation assigned by debt holders to boilerplate provisions, the court eloquently articulated the importance of judicial restraint: "the creation of enduring uncertainties...would decrease the value of all debenture issues and greatly impair the efficient working of capital markets. Such uncertainties would vastly increase the risks and, therefore, the costs of borrowing with no offsetting benefits either in the capital market or in the administration of justice."\textsuperscript{74} The court denounced the appellant's "literal approach," choosing to adopt an approach that it believed would advance the utility of debt holders.\textsuperscript{75}

\textsuperscript{70} \textit{Id.} at 942.
\textsuperscript{71} \textit{Id.} at 943.
\textsuperscript{72} 691 F.2d 1039 (2d Cir. 1982).
\textsuperscript{73} \textit{Id.} at 1048.
\textsuperscript{74} \textit{Id.}
\textsuperscript{75} \textit{Id.} at 1049-50. The court explained:

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

The notion that courts ought to defer to prevailing interpretations imputed to lenders collectively has been embraced and reflected in a number of subsequent decisions construing form contracts and boilerplate provisions in the financing realm.\(^7^6\) For example, in a case applying New York law, *Kaiser Aluminum Corp. v. Matheson*,\(^7^7\) the Delaware Supreme Court held that although certificates issued in respect of debt issuances were "hopelessly unclear on the very point at issue," and although courts confronted with ambiguous language normally consider extrinsic evidence in an effort to discern the parties’ intent, it would be inappropriate to do so in the bond financing context.\(^7^8\) Citing *Sharon Steel* and echoing the imperative, the court explained its "reluctan[ce] to risk disuniformity by adverting to evidence of the course of negotiation in a setting in which the same language can be found in many different contracts," as such disuniformity would be detrimental to financial markets.\(^7^9\) To resolve the dispute, the court applied a tie-breaker rule, interpreting the disputed language against the issuer as drafter, thereby upholding the imputed expectations of the investor-creditors. The court’s decision was based in part upon the notion that the current pool of debt holders, although technically parties to the indenture agreements, were not actively engaged in the negotiation process.\(^8^0\) State and federal courts applying New York law have continued to adhere to this

\(^7^6\) Concord Real Estate CDO 2006-1, Ltd. v. Bank of America N.A., 996 A.2d 324, 331 (Del. Ch. 2010) ("[c]ourts strive to give indenture provisions a consistent and uniform meaning because ‘[u]niformity in interpretation is important to the efficiency of capital markets’"); FleetBoston Fin. Corp. Fleet Nat'l Bank v. Advanta Corp., 2003 Del. Ch. LEXIS 8, * 71 (Del. Ch. 2003) (“rules of contract construction require that the term be given the meaning commonly understood in the credit card industry, as established by the record”).

\(^7^7\) 681 A.2d 392, 397-98 (Del. Supr. 1996).

\(^7^8\) *Id.* at 397.

\(^7^9\) *Id.* at 398.

\(^8^0\) *Id.* at 398-99.
rule in the context of debt securities, and have expanded it to include a wider range of financing contracts.\footnote{Under New York law, when interpreting an indenture or contract, the words and phrases used by the parties must be given their plain meanings. If the contract is ambiguous, it should be resolved against the party who prepared or presented the document.” Whitebox Convertible Arbitrage Partners, L.P. v. IVAX Corp., 482 F.3d 1018, 1021 (8th Cir. 2007); see also Acuity Capital Management, LLC v. MGI Pharma, Inc., Slip Copy, 2009 WL 2461719 (D.Minn. 2009) (expressing the rule when applying New York law).}

### III: THE ECONOMIC ASSUMPTIONS AND PREVAILING METHODOLOGIES OF THE CERTAINTY IMPERATIVE

Beneath the rhetoric, the imperative is fundamentally a normative viewpoint that is based upon relatively thin conceptions of neoclassical economic analysis of law.\footnote{See Richard A. Posner, Economic Analysis of Law (1972) (the common law largely reflects a goal of advancing economic efficiency); George L. Priest, The Common Law Process and the Selection of Efficient Rules, 6 J. of LEG. STUDIES 65 (1977) (further exploring Posner’s arguments).} Imperative-driven rulings are rooted in the belief that financial markets are vital to the national interest, and therefore judges ought to decide cases in this realm in a manner that advances broad economic efficiency goals.\footnote{The allure of economic analysis in areas of vital importance is noted in Jody S. Kraus, Transparency and Determinacy in Common Law Adjudication: A Philosophical Defense of Explanatory Economic Analysis, 93 Va. L. Rev. 287, 357 (2007) (“economic analysis provides traction on countless doctrinal puzzles on which other theories—and deontic moral theories in particular—provide little traction”).}

A basic assumption of the prevailing neoclassical economic model is that persons largely behave egocentrically and rationally, that they weigh costs and benefits and make choices that maximize expected utility.\footnote{Kenneth J. Arrow, Economic Theory and the Hypothesis of Rationality, in The New Palgrave: Utility and Probability 25-39 (1990).} Utility maximization can be measured on an individual or aggregate basis, with aggregate models considering the welfare of all market participants taken together.\footnote{The welfare economics school of thought has become inextricably linked with redistributive goals, but the earliest works are also responsible for identifying macro-level utility that is a function of the individual utilities of a society’s members. See Arthur C. Pigou, Wealth and Welfare (1912).}
and finance jurisprudence, as in other areas of law that share a strong nexus with economic affairs, courts appear to be striving to advance market efficiency and stability, not only from a strict market-oriented perspective, but also from a more utilitarian view of societal welfare enhancement. In other words, cases in this realm reflect a prevailing view that social welfare is ultimately improved when market efficiency is preserved.

In economic terms, the essential predicate to an efficient market is a competitive market, free from excessive regulation and other potential externalities. Under prevailing theory, markets are inherently efficient to the extent each underlying transaction is efficient. Contracts freely negotiated by sophisticated parties in competitive markets are deemed to be complete and therefore efficient to the extent they represent perfect information at the time of execution and, by their terms, account for all possible

86 A collective notion of social welfare has also figured prominently in antitrust jurisprudence, with origins in the same historical period: "U.S. courts have repeatedly spoken of the goal of antitrust law in terms of promoting 'consumer welfare.' And much, if not most, judicial references to 'consumer welfare' as the underlying goal of antitrust law are traceable to Robert Bork's use of that phrase in his influential Antitrust Paradox of 1978." Daniel J. Gifford & Robert T. Kudrle, Rhetoric and Reality in the Merger Standards of the United States, Canada, and the European Union, 72 ANTITRUST L.J. 423, 430 (2005).

87 A report from the European Investors' Working Group provides a clear statement of the perceived connection between market efficiency and social welfare: "The efficient functioning of financial markets allows easier and cheaper access to capital for firms, in order to boost employment and growth. Investors play a crucial role in promoting efficiency, through the provision of liquidity that can be fuelled towards welfare-increasing activities. Investment alternatives, easy access to capital and investor protection may stimulate market efficiency and provide more opportunities to increase social welfare." Restoring Investor Confidence in European Capital Markets, Final Report of the European Investors' Working Group 11 (March 2010).

88 The natural efficiency of a free market is the famous "invisible hand" argument of Adam Smith: "As every individual...endeavours as much as he can to both employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value, every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the publick interest, nor knows how much he is promoting it....He intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention." ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 456 (1776).
contingencies that may interfere with performance.\textsuperscript{89} Even seemingly inefficient terms are efficient to the extent they reflect a degree of risk that the parties considered appropriate relative to the overall transaction.\textsuperscript{90} Accordingly, any externally-imposed deviation from contract terms reduces overall efficiency as among the parties, and in theory, judicial revision of even the most egregious contract terms is unnecessary: any inefficient allocation mandated by the terms would be renegotiated by the parties to the extent transaction costs are less than the utility loss.\textsuperscript{91}

Governmental regulation of any sort can introduce market inefficiencies; such concerns are particularly heightened in the finance and lending realm, where regulation is generally protective of borrowers or consumers.\textsuperscript{92} In light of this, and because financial institutions are perceived to be intermediaries of market risks, the imputed expectations of lenders and financial institutions appear to be viewed by courts as proxies for market equilibrium in the absence of regulation. Thus, the tendency to preserve lenders' expectations stems not from a bias towards financial institutions, but rather from the logical assumption that the gap between such institutions' expectations and any interpretation rendered by the court is a measure of market regulation introduced by the decision.\textsuperscript{93}

\textsuperscript{89} In securities law, courts have incorporated the principle of completeness thusly: the “two core requirements for an efficient market: ‘large numbers of rational and intelligent investors,’ and ‘important current information’ that is ‘almost freely available to all participants.’” In re Initial Public Offering Securities Litigation, 260 F.R.D. 81, 94 (S.D.N.Y. 2009). On the completeness of contracts generally, see THOMAS J. MICELI, THE ECONOMIC APPROACH TO LAW 90 (2009); BERNARD SALANIE, THE ECONOMICS OF CONTRACTS: A PRIMER 161-90 (2005).

\textsuperscript{90} As the Delaware Court of Chancery noted, when negotiating transactions, sophisticated parties “make their own judgments about the risk they should bear.” Abry P’rs V, L.P. v. F & W Acq. LLC, 891 A.2d 1032, 1061 (Del. Ch. 2006).

\textsuperscript{91} On the importance of considering transaction costs, see Oliver E. Williamson, Transaction-Cost Economics: The Governance of Contractual Relations, 22 J. OF L. AND ECON. 233 (1979).

\textsuperscript{92} See Levitin, Hydraulic Regulation, supra note 26.

\textsuperscript{93} This is implicit in the language used by courts when deferring to the expectations of lenders. See, e.g., infra note 166, and sources cited therein.
Also implicit in finance and lending jurisprudence is an assumption that no other interests, such as those rooted in equitable principles, are sufficient to overcome potential reduction in market efficiency. Even more, a court may recognize inherent inequities in an allocation achieved under a competitive market exchange, but may decline to intervene out of fear that any such intervention will have consequences far beyond the parties before the court. Consequently, a court adhering to the imperative makes the decision that law reform or expansive analysis of any sort will impair economic efficiency. In this manner, judicial decisions in the financial realm are viewed as a dangerous externality rather than as a source of utility-maximization, and are narrowly tailored to strict construction and passive enforcement of contracts.

Just as the rhetoric of the imperative can be more readily understood in its historical context, so, too, can its underlying assumptions be more readily understood in the context of the leading economic theories of the 1970s and 1980s. Essentially, the imperative strongly reflects precepts of the Chicago School, with imperative-driven courts doing their part to avoid excessive governmental intervention in financial transactions. In the broadest terms, the imperative seeks to preserve freedom of contract, which is central to the libertarian ideal of an unregulated, competitive market.

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94 See supra note 62.
95 In cases outside of the finance realm, the Supreme Court has addressed the relationship between judicial construction and enforcement of contracts, on the one hand, and market efficiency, on the other hand. In an airline antitrust case, the Court explained the importance of federal airline deregulation laws in promoting “maximum reliance on competitive market forces.” American Airlines, Inc. v. Wolens, 513 U.S. 219, 230 (1995). However, in ruling that the federal laws did not preempt application of state contract law to claims arising in respect of agreements entered into between the airlines and customers, the Court explained, “market efficiency requires effective means to enforce private agreements.” Id. “The stability and efficiency of the market depend fundamentally on the enforcement of agreements freely made, based on needs perceived by the contracting parties at the time.” Id.
96 See supra notes 36 through 39 and accompanying text.
97 Preservation of free markets was the primary normative goal of the Chicago School. See supra notes 36 through 39 and accompanying text.
governmental intervention, including via judicial decisions, markets are in their natural state inherently stable; instability, it was believed, must be injected from external sources, and once so injected, may bring dangerous consequences. Further, each contract or transaction represents a complete and perfectly efficient exchange; in light of the interconnectedness of such transactions, externally-injected inefficiencies even with respect to one discrete transaction are believed capable of causing a dangerous ripple effect. In contrast, judicial decisions that seek only to construe and enforce a contract are thought to comply with libertarian economic thought; indeed, even in Robert Nozick's classical conception of the "minimal state," enforcement of freely-entered contracts was viewed as an acceptable level of governmental involvement in societal affairs. To this end, the imperative-abiding court merely assists the invisible hand.

Of course, the normative goal of efficiency in financial markets may, at times, conflict with other societal goals; for instance, strong public outcries in the wake of financial crises may necessitate judicial intervention. As a result, in certain subfields of corporate finance, the imperative has grown to serve as an ideological presumption that must compete with traditional goals of equity and fairness. In such cases, the assumptions of the rational actor model have led to a more expansive decisional approach, pursuant to which courts strive to promote more equitable results. Such analyses are typically rooted in Pareto efficiency, whereby an allocation of resources is said to be "Pareto superior" to another allocation "if and only if no person is disadvantaged by it and the lot of at least one person is improved." In most cases, the modified, Kaldor-Hicks efficiency or "potential Pareto superiority" model is applied, whereby an

98 Classic works have argued that interventionist fiscal policy, far from being neutral, causes uncertainty and instability in financial markets. See Ludwig von Mises, The Theory of Money and Credit (1934).
99 Nozick, Anarchy, supra note 39.
outcome is deemed to be more efficient if those who are improved are theoretically able to compensate those who are disadvantaged. Under approaches of this sort, judges strive to reallocate rights and remedies among parties to a contract, transaction or other exchange, thereby achieving allocative efficiency between conflicting interests while offsetting a market allocation that is deemed to be inequitable.

For instance, in the area of securities law, which is a subfield of corporate finance, flickers of the imperative are frequently extinguished by modern courts and the judiciary has, over time, assumed a more active role in law reform. Evidencing an evolving balancing approach, the Third Circuit acknowledged a legitimate argument against class certification in a securities case, but proceeded to certify the class on the grounds that judicial action was needed to remedy an injustice. The court explained:

The Securities Industry Association contends we should be wary of extending class certification to cases where the court will in effect set market standards (such as "best execution") and, by doing so, affect the certainty of capital

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104 Allocative efficiency is a core concern in the area of microeconomic theory. See, e.g., Harvey Leibenstein, *Allocative Efficiency vs. "X-Efficiency,“ 56 Am. Econ. Rev. 392 (1966).

105 See, e.g., Chris-Craft Indus. v. Piper Aircraft Corp., 480 F.2d 341, 357 (2d Cir. 1973) (“securities laws seek to prevent restrictions which distort the market's estimate of value. Considering the weighty interests at stake, Congress and the courts justifiably have outlawed all unfair and deceptive practices related to the trading of securities and have encouraged private damage actions to implement the enforcement of the federal securities laws”); see also U.S. DEPT. OF THE TREASURY, PUBLIC POLICY FOR AMERICAN CAPITAL MARKETS 3 (1974) (securities law is intended to advance efficiency and stability in financial markets).
markets. Generally, it is desirable for these types of changes to occur through rule making by the appropriate agency. But courts should not hesitate to provide remedies for litigants injured by unlawful conduct that may not clearly violate regulatory standards.\textsuperscript{106}

Additional cases in the realm of securities law have demonstrated a similar analysis,\textsuperscript{107} whereby a court acknowledges arguments resting upon the imperative, but notes that it must apply a more expansive interpretive regime due to the nature of the controversy and the concomitant need for judicial action to promote interests of fairness or equity.\textsuperscript{108} Outcomes of this sort are reached even in the face of powerful imperative-driven dissenting arguments.\textsuperscript{109} While such decisions acknowledge that law reform might impair utility maximization in financial markets, they ultimately find that other normative goals, such as investor protection, are sufficiently compelling to offset any consequences.

Even more, securities jurisprudence challenges a fundamental assumption of the imperative: that markets are inherently efficient. In fact, courts have even developed facts-intensive, standards-based doctrine to evaluate market efficiency, with factors

\begin{footnotesize}
\textsuperscript{106} Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 259 F.3d 154, 166 n.7 (3rd Cir. 2001).
\textsuperscript{108} See, e.g., In re Adler, Coleman Clearing Corp., 247 B.R. 51, 127 (Bkrtcy.S.D.N.Y. 1999) (“we will not permit the Claimants to reap the benefits of the fraud of Hanover and its agents”).
\textsuperscript{109} Dissenting to a rebuttable presumption supported by fraud-on-the-market theory of reliance, Justice White noted: "Congress, with its superior resources and expertise, is far better equipped than the federal courts for the task of determining how modern economic theory and global financial markets require that established legal notions of fraud be modified. In choosing to make these decisions itself, the Court...embarks on a course that it does not genuinely understand, giving rise to consequences it cannot foresee." Basic, 485 U.S. at 254 (White, J., concurring in part and dissenting in part). Justice White further notes "the dangers when economic theories replace legal rules as the basis for recovery." Id. Justice White concludes, "I cannot join the Court in its effort to reconfigure the securities laws, based on recent economic theories, to better fit what it perceives to be the new realities of financial markets." Id. at 255.
\end{footnotesize}
considering both quantitative and qualitative indicia of market dynamics.\textsuperscript{110} Where inefficiencies are identified, courts strive to render decisions that correct any resulting sub-optimal, inefficient or inequitable allocations.\textsuperscript{111} As a result, courts have ultimately come to reject the wisdom of passive, imperative-driven paradigms in the realm of securities law, and have proceeded to grapple with financial and economic questions from the bench. Moreover, although federal securities laws are largely statutory in nature, with an extensive regulatory framework to which the deference rule applies, the judiciary has taken an active role in establishing doctrine to construe complex statutory provisions or to address circumstances where there is no rule on point.\textsuperscript{112} For instance, very recent securities controversies present further opportunities to apply contextual interpretive paradigms in the securities realm. For instance, at the time of this writing, courts are currently grappling with the question of whether to compensate investment fraud claimants on the basis of their original principal investment, or on

\textsuperscript{110} The test for market efficiency set forth in Cammer v. Bloom, 711 F.Supp. 1264 (D.N.J. 1989) has been applied in a number of recent cases. See, e.g., In re American Intern. Group, Inc. Securities Litigation, 265 F.R.D. 157, 175-81 (S.D.N.Y. 2010); In re Initial Public Offering Securities Litigation, 260 F.R.D. 81, 94-95 (S.D.N.Y. 2009). *Cammer* sets forth a five-prong inquiry for determining whether the market for a particular security is efficient, including, *inter alia*, trading volume, the number of analysts tracking the security, and the nature of the relationship between unexpected events and the security's price. 711 F.Supp. at 1286-87. Additional factors are at times considered alongside those included in the *Cammer* test. See, e.g., Krogman v. Sterritt, 202 F.R.D. 467, 478 (N.D.Tex.2001).

\textsuperscript{111} Allocative efficiency is also a fundamental goal of statutory law in the securities realm. Mandatory disclosure reflects the normative belief that market efficiency is achieved when information is optimally allocated for use by all market participants. See George Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961).

\textsuperscript{112} See, e.g., Newton, 135 F.3d at 274 (“there is no statute, rule, regulation, or interpretation, by the SEC or by a court, that [would remedy the dispute]. This absence of precedent did not, however, absolve the district court of the duty to resolve the plaintiffs’ securities fraud claim once it was presented in this suit”). See also James J. Park, *Rule 10B-5 and the Rise of the Unjust Enrichment Principal*, 60 DUKE L.J. 345 (2010) (describing the evolution of common law unjust enrichment theories in securities jurisprudence); Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 VAND. L. REV. 1639 (2004) (discussing the role of the judiciary in developing legal standards for the duty to disclose).
the basis of the value of their ownership interest as recorded on investment instruments just before the fraud was discovered, which such amount likely includes compounded fraudulent earnings, and may also be net of distributions already taken by the claimant far in excess of the original principal investment.\(^{113}\) Fundamentally, the tension is between form and substance, with conflicting arguments guided by strong equitable undercurrents.

Yet notwithstanding these developments in securities law, more expansive analyses, including allocative efficiency models, have been largely unable to take root in other areas of finance. The imperative continues to discourage distributive interventions in free markets, and further warns that such methodologies carry substantial risk: any failed attempt at allocative efficiency may contribute to market failure.\(^{114}\) Thus, in areas of finance and lending beyond securities law, the imperative's underlying market efficiency goals continue to be paramount and no other normative goals have been advanced at their expense. Even more, the basic assumption of perfectly efficient markets has remained dominant. The following sections explore how these assumptions translate into specific judicial methodologies in the finance and lending realm.

A. A Methodology of Restraint and Deference

The imperative advances a methodology of restraint and deference. To some extent, this methodological association is derived from the imperative's early intertwining with deference rule jurisprudence.\(^{115}\) To be sure, in many cases that invoke the


\(^{114}\) Courts take notice of such ripple effects in the context of cases concerning alleged harm to lenders. Tijani v. Holder, 2010 U.S. App. LEXIS 24840, 14-15 (9th Cir. 2010) (“[t]he current economic crisis highlights the full impact of the misrepresentation of risk in the credit market. The impact is on creditors, consumers, and on the economy. When creditors take on too many risky contracts, whether due to their own carelessness or the misrepresentations of their customers, they are likely to suffer enormous economic harm, and the resulting effects on society can be devastating”).

\(^{115}\) See supra Part II.A.
imperative, judicial deference is supported by recognized principles that apply to cases far beyond the finance and lending realm.116 Yet other times, language used by the court hints at a type of deference that is not dictated by familiar doctrine, but rather elected by the court in an effort to avoid disrupting the legal status quo. For instance, the Seventh Circuit was tasked with determining whether regulations promulgated under the Act barred a credit card issuer’s imposition of penalty rates that were otherwise permissible under the cardholder agreement.117 The court acknowledged that the applicable regulation and comment were both ambiguous, and, with little guidance as to its reasoning, proceeded to enforce the cardholder agreement.118 In concluding remarks, the court noted its reliance on horizontal stare decisis with respect to nonbinding coordinate and lower court decisions: "one court of appeals and at least six district courts have interpreted the ambiguous [regulation and comment]. All have held, as our district court did, that banks may apply higher, penalty rates of interest to the entire billing cycle in which the consumer’s default occurs. These decisions are sensible, and we agree with them.”119 Similarly, in a twist on federal preemption doctrine, the Third Circuit supported a ruling in part by asserting that any per se rule recognizing a fiduciary duty of banks to their commercial borrowers would likely be preempted by a subsequent act of Congress.120

Essentially, judicial deference and restraint, as well as strict interpretive norms, appear to be rooted in pragmatic concerns that the judiciary is ill-equipped to assess financial and economic information. For instance, in Household Credit Services, Inc. v. Pfennig,121 the Supreme Court noted that the decision of the Sixth Circuit, if permitted to stand, “would prove unworkable to

116 See supra Section II.A., discussing deference rule jurisprudence.
117 Swanson v. Bank of America, N.A., 559 F.3d 653 (7th Cir. 2009).
118 Id. at 654-55.
119 Id. at 656.
120 Washington Steel, 602 F.2d at 601 (“[g]iven the need for uniform rules in an area so vital to our national economy as banking, any state common law rule that we might imply would likely give way to the preemptive force of federal law”).
creditors and, more importantly, lead to significant confusion for consumers."\(^{122}\) The Court admonished the lower court for adopting a "case-by-case approach" pursuant to doctrinal analysis that the Court found to lack "textual support."\(^{123}\) In particular, the Court criticized the Sixth Circuit's decision that language in Regulation Z conflicted with the Act, asserting that the court "ignored [the] warning that 'judges ought to refrain from substituting their own interstitial lawmaking for that of the [Board].'"\(^{124}\) The Court suggested that the Sixth Circuit's error was caused by a "fundamental misunderstanding of the workings of the credit card industry," and that, in light of such complexities, it is important to apply strict interpretive norms and defer to agency guidance.\(^{125}\) Thus, deference is a form of risk aversion by courts handling cases in this area.

To be sure, such concerns have appeared in cases beyond the finance and lending realm. For instance, the Supreme Court articulated a similar form of risk aversion in a decision in respect of a Commerce Clause challenge to a sales and use tax structure favoring local distribution companies.\(^{126}\) Declining to meddle with existing statutory framework, the Court explained it was "institutionally unsuited to gather the facts upon which economic predictions can be made, and professionally untrained to make them."\(^{127}\) The Court further explained that the judicial branch should abstain from lawmaking in this realm and defer any necessary reform to the legislative branch, since "Congress has the capacity to investigate and analyze facts beyond anything the Judiciary could match...to run economic risks that the Judiciary should confront only when the constitutional or statutory mandate

\(^{122}\) Id. The language reflects arguments raised in support of the credit card issuers: "lenders operating nationwide or regional credit programs would be paralyzed by judicial rulemaking, which might impose different disclosure requirements from jurisdiction to jurisdiction." Brief for the United States as Amicus Curiae, p. 13, Household Credit Services, Inc. v. Pfennig, 541 U.S. 232 (2004).

\(^{123}\) Pfennig, 541 U.S. at 244.

\(^{124}\) Id.

\(^{125}\) Id. at 244-45.

\(^{126}\) General Motors Corp. v. Tracy, 519 U.S. 278 (1997).

\(^{127}\) Id. at 308.
for judicial choice is clear.”128 In the financial realm, concerns of this sort are heightened by the sheer magnitude and complexity of the transactions at stake. In essence, the world of finance and lending is to some extent a perfect storm to the judiciary, and when cases arise with greater frequency following an economic crisis, the imperative provides welcome justification for minimal judicial involvement.

B. Statutory Restrictions on More Expansive Interpretive Analyses

In addition to its continued influence on judicial methodology in the finance and lending realm, the imperative has also sparked legislative reforms that have directly or indirectly disempowered courts by further restricting judicial methodology.129 Indeed, such laws at least partially explain why decision-making paradigms in most areas of finance and lending have not evolved to the degree that they have in the realm of securities law; these statutory enactments essentially freeze corporate finance jurisprudence by locking courts into a highly restrictive decisional paradigm.

At the federal level, a number of enactments that were primarily intended to limit application of statutory and regulatory rules to certain financing arrangements have had the indirect consequence of limiting opportunities for courts to apply more expansive interpretive norms. For instance, in 1990, revisions to the Bankruptcy Code caused a range of commercial financing agreements to be expressly excluded from most provisions of the Code, and thus the broad legal and equitable purview of bankruptcy courts.130 In 2005, these provisions were updated to

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128 Id. at 309. Congress “may inform itself through factfinding procedures such as hearings that are not available to the courts.” Id. at 309 (citing Bush v. Lucas, 462 U.S. 367, 389 (1983)).

129 The imperative's rhetoric is so pervasive that legislation in the lending and finance realm at times includes the phrase “legal certainty” in its title or headings. See Legal Certainty for Bank Products Act of 2000, 7 U.S.C. §§ 27; see also § 739 of the Dodd-Frank Act, "Legal Certainty for Swaps."

excludes a wider range of instruments. As the legislative history of these amendments reveals, the imperative was a primary force. For instance, the 1990 amendments were motivated by a desire to prevent impairment of market stability resulting from "uncertainties regarding the treatment of...financial instruments under the Bankruptcy Code." Similar imperative-rooted concerns are reflected in the legislative history of the 2005 amendments. As a result of these provisions, most financing arrangements other than traditional loans are excluded from the effects of the automatic stay, and counterparties are able to exercise claims on collateral notwithstanding the debtor's bankruptcy filing. More importantly, such provisions effectively remove sweeping categories of financial agreements from the jurisdiction of bankruptcy courts, as well as from the flexible and contextual standards commonly applied by such courts.

Likewise, provisions of the Gramm-Leach-Bliley Act of 1999 excluded from the definition of "securities" under federal securities laws a range of financing arrangements, and therefore

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134 The automatic stay imposed by § 362 of the Bankruptcy Code mandates that, as of the time a bankruptcy case is filed, virtually all acts and proceedings against the debtor or interests and assets of the estate, including the termination of a contract or the exercise of setoff rights, are halted and subject to the court's determination.

135 Giblin, Financial Markets, supra note 130 at 302-04. See also Local Loan Co. v. Hunt, 292 U.S. 234, 240 (1934) (bankruptcy courts are "invested 'with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings'"); Pepper v. Litton, 308 U.S. 295, 304-05 (1939) ("[t]he bankruptcy courts have exercised these equitable powers....to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done"); Mark D. Rosen, Nonformalistic Law in Time and Space, 66 U. CHI. L. REV. 622, 631 (1999) (arguing that the Bankruptcy Code's heavy reliance on standards-based analyses allows courts flexibility to apply local law).

rendered such agreements beyond Securities and Exchange Commission regulation. A similar result was achieved under the Legal Certainty for Bank Products Act of 2000\textsuperscript{137} with respect to the statutory reach of federal commodities laws. While these enactments were largely focused on limiting regulatory oversight with respect to certain instruments that take the form of private contracts, they also caused an indirect curtailment of judicial interpretive authority, as financial instruments expressly excluded from these laws would not be subjected to broader judicial doctrines developed under securities and commodities jurisprudence. More fundamentally, these legislative enactments had the indirect effect of removing a range of instruments from potential exposure to a growing body of securities jurisprudence in which the imperative's efficiency goals are trumped by goals rooted in fairness, equity and investor protection, and where courts actively grapple with the underlying economic substance of the underlying arrangements to resolve disputes.\textsuperscript{138}

With respect to an even wider range of financing arrangements, a wave of credit-specific statutes of frauds\textsuperscript{139} passed in the 1980s and 1990s even further restrict interpretive methodology.\textsuperscript{140}


\textsuperscript{138} See supra Section III.B.


\textsuperscript{140} Bruce A. Kolbezen & Samuel A. Evig, The Colorado Credit Agreements Act and its Impact on Lenders and Borrowers, 36 COLO. LAW. 31, 31 (2007) ("[t]he Colorado legislature enacted the Statute in 1989, at the end of a financial institution crisis that included rising interest rates, changes to federal tax law, and an overextension of credit, all of which contributed to instability in the lending industry").
Consider, for instance, the language of the Minnesota credit-specific statute of frauds: "A debtor may not maintain an action on a credit agreement unless the agreement is in writing, expresses consideration, sets forth the relevant terms and conditions, and is signed by the creditor and the debtor."\textsuperscript{141} While at first blush this language appears only to advance the ordinary purpose of a statute of frauds to bar enforcement of oral agreements, the statute goes significantly farther insofar as it prevents recognition of any relationship between lenders and borrowers with respect to financing arrangements other than the relationship set forth in a written contract. The statute provides: "The following actions do not give rise to a claim that a new credit agreement is created, unless the agreement satisfies the requirements of subdivision 2: (1) the rendering of financial advice by a creditor to a debtor; (2) the consultation by a creditor with a debtor; or (3) the agreement by a creditor to take certain actions, such as entering into a new credit agreement, forbearing from exercising remedies under prior credit agreements, or extending installments due under prior credit agreements."\textsuperscript{142} Finally, it concludes: "A credit agreement may not be implied from the relationship, fiduciary or otherwise, of the creditor and the debtor."\textsuperscript{143} Similar language in the Illinois credit-specific statute of frauds\textsuperscript{144} has been construed to bar all actions that relate to the alleged credit agreement, whether those actions sound in contract or in tort.\textsuperscript{145} Courts in other states have reached a similar result,\textsuperscript{146} finding that the credit-specific statute of frauds

\textsuperscript{141}Minn. Stat. § 513.33(2).
\textsuperscript{142}§ 513.33(3)(a).
\textsuperscript{143}§ 513.33(3)(b).
\textsuperscript{144}Il. St. Ch. 815 §160/2.
\textsuperscript{145}First Nat'l Bank in Staunton v. McBride Chevrolet, Inc., 642 N.E.2d 138 (Ill. 4th Dist. 1994) (Illinois credit-specific statute of frauds bars all actions that relate to an oral agreement, so long as such claims in any way relate to a credit agreement; further, a bank's oral promise to hold a check until Monday so that the customer could deposit additional funds was essentially a credit agreement and therefore required a written agreement).
\textsuperscript{146}See, e.g., Hewitt v. Pitkin County Bank & Trust Co., 931 P.2d 456, 459 (Colo.App. 1995) (the statutory language is not limited to contract claims or to only those tort claims which seek the enforcement of a credit agreement).
bars claims such as unjust enrichment, breach of fiduciary duty, interference with prospective business advantage and negligent misrepresentation.

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

Credit-specific statutes of frauds are undoubtedly rooted in the certainty imperative. As the legislative history in many states

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150 See, e.g., Chies v. Highland Bank, No. C8-00-1630, 2001 WL 214693 at *2 (Minn. Ct. App. 2001) (a bank's agreement to subordinate its own security interest to another bank's interest constituted a "financial accommodation" within the meaning of the credit-specific statute of frauds); Rural Am. Bank of Greenwald v. Herickhoff, 485 N.W.2d 702 (Minn. 1992) (a promise regarding the ordering of payments under two loan facilities constituted a financial accommodation, and therefore a credit agreement under the Minnesota credit-specific statute of frauds).
151 See, e.g., Bank One, Springfield v. Roscetti, 723 N.E.2d 755, 763 (Ill. App. Ct. 1999) (oral modification of a guarantee fell within the Illinois credit-specific statute of frauds because the guarantee constituted part of a comprehensive credit agreement); Univex Int'l., Inc. v. Orix Credit Alliance, Inc., 914 P.2d 1355, 1358 (Colo. 1996) (Colorado's credit-specific statute of frauds "does not apply only to claims involving transactions which are characterized exclusively as credit agreements, but also...to claims which merely relate to credit agreements"). But see Keenan v. Donaldson Lufkin & Jenrette, Inc., 529 F.3d 569, 579 (5th Cir. 2008) ("[t]he situation of two lenders entering an accommodation as to a third-party borrower is beyond the purposes of the [Louisiana credit-specific statute of frauds]").
152 King v. Parish Nat'l Bank, 885 So. 2d 540, 546 (La. 2004) ("[t]he primary legislative purpose of these statutes was to establish certainty as to the contractual liability of financial institutions, which would in turn limit lender liability lawsuits based on oral agreements"); Brown v. Founders Bank and Trust Co., 1994 OK 130, 890 P.2d 855, 862 (Okla. 1994) (the Oklahoma credit-specific statute of frauds is "intended to discourage lender liability litigation and to promote certainty into credit agreements"). See also Todd C. Pearson, Limiting Lender Liability: The Trend Toward Written Credit Agreement Statutes, 76 Minn. L. Rev. 295, 299-300 (1991) ("the general goal behind
reveals, such statutes were adopted in response to lobbying efforts by banking interests, who argued that a credit-specific statute of frauds might advance certainty in the law governing financial transactions. To be sure, courts have not resisted the infringement, as countless decisions have emphasized that these statutes are extremely broad and ought to be applied as written, even though the results of that application may at times seem harsh. Even more, some variations of these statutes, such as the Colorado credit-specific statute of frauds, expressly bar claims such as part performance and promissory estoppel, thereby further restricting the ability of courts to develop common law exceptions to the statutory requirements.

Many such statutes also curtail judicial consideration of facts and circumstances relating to a written financing agreement. The Ohio credit-specific statute of frauds provides: “The terms of a loan agreement subject to this section, including the rights and

these credit agreement statutes is to increase the certainty in contractual liability in order to reduce lender liability litigation”).

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

154 Counsel for the Colorado Bankers Association testified: “[claims are barred] to make it absolutely certain that there are no exceptions to the statute of frauds as to $25,000...loan agreements and above from financial institutions.” Recordings of the House Business Affairs Committee on H.B. 11-16-1989, January 19, 1989, 57th General Assembly.

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

156 Colo. Rev. Stat. § 38-10-124(3). See Stephanie J. Shafer, Limiting Lender Liability Through the Statute of Frauds, 18 COLO. LAW. 1725, 1725 (1989). See also Classic Cheesecake v. JPMorgan Chase, 546 F.3d 839 (7th Cir. 2008) (reviewing a claim of promissory estoppel in respect of an oral promise for commercial financing, finding that “the case turns out to be a routine promissory estoppel case, and that is not enough in Indiana to defeat a defense of statute of frauds”).
obligations of the parties to the loan agreement, shall be
determined solely from the written loan agreement, and shall not
be varied by any oral agreements that are made or discussions that
occur before or contemporaneously with the execution of the loan
agreement." In many jurisdictions, similar language has been
used to bar claims in respect of oral agreements that in any way
relate to an existing financing agreement. Such laws effectively
ensure that commercial financing disputes are analyzed under strict
interpretive norms, consisting primarily of the rules of contract
interpretation, without the influence of doctrinal contract and tort
law, equitable principles or, in certain cases, evidence of
surrounding facts and circumstances.

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

157 Oh. St. § 1335.02(C).
158 Colorado courts have applied the statute to bar a guarantor's claims arising
from an oral agreement discharging obligations under the original credit agreement. See
159 Even transactions without any substantial nexus to the state may select New
York law to govern commercial agreements, and this choice-of-law will be respected
based upon a New York statute providing that parties to any contract involving
consideration of $250,000 or more “may agree that the law of this state shall govern their
rights and duties in whole or in part, whether or not such contract, agreement or
undertaking bears a reasonable relation to this state.” N.Y. Gen. Oblig. Law § 5-1401.
160 N.Y. Gen. Oblig. Law § 5-701 provides: “[e]very agreement, promise or
undertaking is void, unless it or some note or memorandum thereof be in writing, and
subscribed by the party to be charged therewith, or by his lawful agent, if such
agreement, promise or undertaking...by its terms is not to be performed within one year.
have ruled that this provision applies to bar oral agreements in respect of financing arrangements for which repayment extends beyond one year.\(^{161}\) Furthermore, New York courts tend not to enforce rights or obligations unless clearly evidenced by a written agreement.\(^{162}\) In fact, such courts are known for employing formalist,\(^{163}\) textual analyses,\(^{164}\) pursuant to an approach that has been summarized thusly: "New York’s contract jurisprudence is formalistic, literalistic, nonjudgmental, and deferential to the freedom of parties to bargain for mutual advantage."\(^{165}\)

The certainty imperative also appears to be firmly rooted in New York commercial law. The Supreme Court for New York County articulated the imperative in a decision declining to extend common law fiduciary duties in the context of a commercial bank financing the hostile takeover of its corporate customer, noting that "a per se rule might unduly restrict banks in providing credit to competing customers, and might thus unduly reduce the pool of available credit."\(^{166}\) Further, the imperative comports with important interests of the state. The Court of Appeals of New York, in resolving a conflict of laws question pertaining to a


\(^{163}\) See, e.g., Jordan Panel Sys. Corp. v. Turner Constr. Co., 841 N.Y.S.2d 561, 573 (N.Y. App. Div. 2007) (explaining that even where principles of equity invite an alternative result, the contract at issue must be enforced as written: "we did not write those rules of engagement, and we are not empowered either to ignore or rewrite them").

\(^{164}\) Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926, n.1-2 and accompanying text (2010) (identifying New York as a jurisdiction that relies on textualist decision-making); Miller, *Bargains Bicoastal*, supra note 162 at 1478 ("New York judges are formalists. Especially in commercial cases, they have little tolerance for attempts to re-write contracts to make them fairer or more equitable, and they look to the written agreement as the definitive source of interpretation").

\(^{165}\) Miller, *Bargains Bicoastal*, supra note 162 at 1522.

\(^{166}\) *ADT Operations*, 173 Misc.2d at 967. The court explained, "Chase is a bank which has a national presence. Any rule which might have such a broad impact should be considered by the Legislature or appropriate administrative or oversight agencies." *Id.*
commercial lending agreement, explained: "New York...is a financial capital of the world, serving as an international clearinghouse and market place for a plethora of international transactions....In order to maintain its preeminent financial position, it is important that the justified expectations of the parties to the contract be protected." Subsequent cases by state and federal courts applying New York law have echoed these policy concerns. In fact, the Second Circuit succinctly summarized New York law’s purpose as "promoting certainty in international financial markets.”

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

C. The Present State of the Imperative

The imperative has moved quietly but steadily through the judicial and legislative processes, and in so doing this

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167 J. Zeevi and Sons, Ltd. v. Grindlays Bank (Uganda) Limited, 371 N.Y.S.2d 892, 898 (N.Y. 1975). Further, "[a] vast amount of international letter of credit business is customarily handled by certain New York banks whose facilities and foreign connections are particularly adaptable to this field of operation...The parties, by listing United States dollars as the form of payment, impliedly accepted these facts and set up procedures to implement their trust in our policies." Id.


170 The imperative has moved quietly in that is has not been identified as an overarching jurisprudential norm; however, the use of this rhetoric has not escaped notice of those within the industry. See, e.g., Growth and Development of the Derivatives Market: Hearing Before the Sen. Comm. on Banking, Housing and Urban Affairs, 109th
jurisprudential vestige of the economic turmoil of the 1970s and 1980s has profoundly altered judicial decision-making paradigms in corporate finance. The imperative’s normative goals of subjectively-nuanced legal certainty and uniformity have become intertwined with judicial restraint and deference. As a result, the state of corporate finance jurisprudence in the United States can be summarized thusly: deference, in the very broadest sense, is shown to the legal status quo. Even more, the imperative is not confined to the American judicial landscape, but has also taken root in the United Kingdom, where more expansive interpretive regimes are likewise viewed as a threat to London-based financial markets.\footnote{171}

While ostensibly a prevailing view, the imperative is not without its discontents. Demonstrating some emerging doubts as to the proper paradigm in lending and finance cases, the imperative was the subject of a lively debate between the majority and dissenting opinions in a 2008 decision of the Supreme Court. In \textit{Department of Revenue of Ky. v. Davis},\footnote{172} the Court considered whether the Commonwealth of Kentucky’s income tax structure violated the dormant Commerce Clause to the extent it exempted from state income tax the interest on bonds issued by Kentucky or

\footnote{171 See \textit{FINANCIAL MARKETS LAW COMMITTEE, ISSUE 97 – EUROPEAN CONTRACT LAW} (2010) (a response prepared by a United Kingdom independent legal reform board for submission to the UK Government Call for Evidence and Views to Inform its Response in respect of adopting European contract law, which utilizes a substantially more contextual and expansive interpretive regime versus the United Kingdom and United States). In the report, prepared by members affiliated with banking and lending behemoths Goldman Sachs and Deutsche Bank, among others, articulates the dangers to legal certainty that arise from judicial lawmaking or more expansive interpretive regimes in respect of contract disputes. For instance, the report notes that concepts such as good faith, reasonableness and fair dealing, “may be expected to achieve substantively fair results, [but are] less likely to achieve certainty of outcomes.” \textit{Ibid.} at 10.}

\footnote{172 553 U.S. 328 (2008).}
its subdivisions, but taxed the interest on debt securities from other states. The Court held that the income tax structure did not run afoul of the dormant Commerce Clause, since the tax exemption favored a traditional governmental function (the issuance of debt securities to pay for public projects) without any differential treatment favoring local entities over substantially similar out-of-state interests.\footnote{Id. at 353-56.}

Conceding that the relevant provisions of the Commonwealth's tax code were enacted with an eye toward ensuring the marketability of local bonds, the Court noted an important interest in market stability: when the Commonwealth "issues [its bonds] for sale in the bond market, it relies on that tax code, and seller and purchaser treat the bonds and the tax rate as joined...intimately."\footnote{Id. at 348.} Addressing the Respondents' request that the Court apply the \textit{Pike} balancing test to determine whether the income tax structure imposed an excessive burden on commerce,\footnote{The test was originally articulated in \textit{Pike v. Bruce Church, Inc.}, 397 U.S. 137 (1970). "Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." \textit{Id.} at 142. Respondents in \textit{Davis} asserted a number of excessive burdens on commerce. \textit{See Davis}, 553 U.S. at 353-54.} the Court advanced the imperative's message of judicial restraint: "even on the assumption that a \textit{Pike} examination might generally be in order in this type of case, the current record and scholarly material convince us that the Judicial Branch is not institutionally suited to draw reliable conclusions of the kind that would be necessary for the [Respondents] to satisfy a \textit{Pike} burden in this particular case."\footnote{553 U.S. at 354.} because such conclusions turn on "cost-benefit questions"\footnote{Id. at 355.} of a financial and economic nature, with respect to

\begin{quote}
Is any court in a position to evaluate the advantage of the current market for bonds issued by the smaller municipalities...? Consider that any attempt to place a definite value on this feature of the
\end{quote}
which a striking feature is "not even the difficulty of answering them or the inevitable uncertainty of the predictions that might be made in trying to come up with answers, but the unsuitability of the judicial process...for making whatever predictions and reaching whatever answers are possible at all." 178

The Court declined to strike down the differential taxation scheme, even declining to consider more expansive analysis of the doctrinal issues in the case, noting in a subtle play on words that any other decision "to a certainty would upset the market in bonds and the settled expectations of their issuers based on the experience of nearly a century." 179 Finally, the Court expressed the root of its unwillingness to engage in law reform: "While it is not our business to suggest that the current system be reconsidered, if it is to be placed in question...an elected legislature is the preferable institution for incurring the economic risks of any alteration in the way things have traditionally been done." 180 Shedding additional light on the normative assumption that law reform is damaging to financial markets, the majority explained: "risk is the essence of what the [Respondents] are urging here. It would miss the mark to think that...courts...are being invited merely to tinker with details of a tax scheme; we are being asked to apply a federal rule to throw out the system of financing municipal improvements." 181

Existing system would have to confront the what-if questions. If termination of the differential tax scheme jeopardized or eliminated most single-state funds...would some new source of capital take their place? Would the interstate markets accommodate the small issuers..., or would the financing in question be replaced by current local taxation for long-term projects..., or would state governments assume responsibility through their own bonds or by state taxation? Or would capital...dry up, eliminating a class of municipal improvements....[And] what would the effect be on interstate capital flows?

Id. at 354-55.

178 Id.

179 Id. at 356.

180 Id.

181 Id.
Any such reforms would "expose the States to the uncertainties of...economic experimentation." 182

The Court's concerns reflect the imperative's key underlying assumption: that any deviation from the legal status quo introduces systemic risk to an otherwise perfectly efficient market. In contrast, a dissenting opinion by Justice Kennedy, with whom Justice Alito joined, questioned the majority's support for a decision that runs contrary to important precedent in the area of the Commerce Clause. 183 Extending an invitation to expose these underlying assumptions to judicial analysis, Justice Kennedy explained:

> Throughout the Court's argument is the concern that, were this law to be invalidated, the national market for bonds would be disrupted....The concern is legitimate, but if it is to be the controlling rationale the Court should cast its decision in those terms. The Court could say there needs to be a sui generis exception, noting that the interstate discrimination has been entrenched in many States and for a considerable time. That rationale would prompt my own statement of disagreement as a matter of principle and economic consequences, but it would be preferable to a decision that misinterprets the Court's precedents. Instead, today the Court weakens the preventative force of the Commerce Clause and invites other protectionist laws, thus risking further dislocations and market inefficiencies based on the origin of products and commodities that should be traded nationwide and without local trade barriers. 184

In essence, the dissent argues that the certainty imperative must not be used to support decisions that are divorced from the very rules and precedent they purport to be based upon. By generating decisions that are so perplexing, the judiciary indeed disrupts legal certainty -- not the subjective form that has evolved in the lending and finance context, but rather the far more entrenched legal certainty that has deep foundations in the common law. A

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182 Id.
183 553 U.S. at 362-74 (Kennedy, J., dissenting).
184 Id. at 375-76 (Kennedy, J., dissenting) (internal citations omitted).
disruption of the latter can have consequences far beyond financial markets. This is a damning critique, as even setting aside deeper normative questions, if imperative-driven decisions damage legal certainty, then the continued paralysis of the judiciary is misguided, unnecessary and potentially far more harmful than reasoned judicial analysis.

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

Further analyses of these and related questions are deeply needed. For one thing, it is not entirely clear that the concept of "legal certainty," as it has come to rest in finance jurisprudence as a subjectively-nuanced narrative, can be a means of promoting long-term stability in financial markets. Clearly, the preservation of legal certainty minimizes risk in transactional dealings generally; excessive risk of midstream unenforceability or recharacterization of transactions is disruptive to free markets. However, if the ultimate goal is market stability, then emerging theories suggest that some degree of outcome-based uncertainty in transactional law might actually reduce excessive risk-taking and moral hazard effects that produce great instability from within.

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


187 See ROGER MCCORMICK, LEGAL RISK IN THE FINANCIAL MARKETS (2011).
financial markets.\textsuperscript{188} Similarly, it is not clear that judicial involvement is a \textit{per se} impediment to market stability. As evidenced by the recent crisis, systemic risk in financial markets can result from internal forces.\textsuperscript{189} Markets are inherently cyclical, and to the extent a natural contraction causes parties to default on interconnected financing arrangements, the resultant confidence erosion, reduced liquidity and cross-default contagion can introduce substantial instability.\textsuperscript{190} In such instances, courts may be an important intermediary, possessing sufficiently broad legal and equitable powers to manage complex and facts-intensive disputes.

While arguments of this sort require careful interdisciplinary analysis, we can at this juncture ascertain one obvious failing of the imperative: it remains steeped in rhetoric that has not evolved despite decades of increased understanding of financial and economic principles. One commentator, writing on United Kingdom financial law reform, summarized the dangers thusly: "[a] number of risks are inherent in a crude reliance on the power of unanalysed value-concepts such as legal certainty...[T]here is the obvious danger that the concept of ‘legal certainty’ becomes fetishized, and stands in the way of any real evaluation of the merits of law reform."\textsuperscript{191}

The imperative seems to have reached such a perilous point. Underscoring the dangers of a rhetoric that relies upon untested assumptions, consider 2005 congressional testimony urging that swaps continue to be construed as private agreements rather than as futures contracts, as the latter designation would have rendered

\textsuperscript{190} “Systemic risk is fundamentally a contracting problem that arises when a large number of parties cannot honor their commitments.” Margaret M. Polski, \textit{Systemic Risk and the U.S. Financial System}, MERCATUS ON POLICY, No. 53 (2009).
\textsuperscript{191} See Perkins, \textit{Legal Certainty}, supra note 170 at 163.
these instruments subject to extensive regulations. Noting the financial industry's fear that the judiciary or legislature might impair the legal status quo through an adverse opinion as to the characterization of credit default swaps, the testimony heralded the "legal certainty" achieved by Congress's decision not to bring these financial instruments under the regulatory framework applicable to futures contracts: "privately negotiated derivatives have continued to thrive and produce innovation [that] has proceeded unabated. Even more importantly, thanks in no small part to derivatives, the markets have been able to withstand significant shocks to the financial system. The legal certainty provided by the [broad exclusions and exemptions from the Commodities Exchange Act] has been an important part of this success."

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

IV: TESTING THE EFFICACY OF THE CERTAINTY IMPERATIVE'S PREVAILING METHODOLOGIES

193 Id.
194 Professor Greenberger explained: "[b]y removing the multi-trillion dollar swaps market from the traditional norms of market regulation, a highly speculative derivative bubble was created that was opaque to federal regulators and market observers alike." Testimony Before the Financial Crisis Inquiry Commission Hearing on the Financial Crisis (2010) (statement of Michael Greenberger, Law School Professor, University of Maryland School of Law). As a result, "the swaps market permitted trillions of dollars of financial commitments to be made with no assurance that those commitments could be fulfilled beyond the highly illusory AAA ratings of the counterparties in question." Id. The failings of the legal system are summarized as follows: "[h]ad the norms of market regulation been applicable, these swaps transactions would have been adequately capitalized by traditional clearing norms; and the dangers building up in these markets would otherwise have been observable by the transparency and price discipline that accompanies exchange trading." Id.
Strict interpretive norms might do little to preserve certainty and stability in financial markets. For one thing, the assumption that markets are perfectly efficient and stable may be misguided; further, to the extent instability arises from within financial markets, strict interpretive norms in many cases blind courts to economic realities and prevent meaningful resolution of claims. Simply put, imperative-driven methodologies might not provide a sufficiently intricate framework to assess the complexities of dynamic financing arrangements. In fact, there is a strong efficiency argument for adopting a more expansive interpretive regime in corporate finance jurisprudence.

To some extent, the continued imperative-driven reliance on strict interpretive norms in complex finance and lending jurisprudence may also reflect the relative infancy of judicial law in this realm. Consider, for instance, the parallel realm of corporate law, which is also comprised of sophisticated and complex private contracts. Delaware’s body of judge-made law has evolved considerably in the last century, and has been characterized as an "investment in legal capital" by corporate law scholar Roberta Romano. While Delaware law strives to promote many of the same normative goals as the imperative, including freedom of contract, Delaware courts recognize the value of contextual analyses in transactional matters, and further note the balancing of interests that is so often required to resolve disputes in this realm. Referring to these tensions, the Court of Chancery explained, "there are many circumstances in which the high priority our society places on the enforcement of contracts between private parties gives way to even more important concerns." 197

195 ROMANO, GENIUS OF AMERICAN CORPORATE LAW, supra note 21 at 40; Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 J. of LAW, ECONOMICS, AND ORGANIZATION 225, 258–75 (1985).
196 NACCO Indus., Inc. v. Applica Inc., 997 A.2d 1, 35 (Del. Ch. 2009) (“Delaware upholds the freedom of contract and enforces as a matter of fundamental public policy the voluntary agreements of sophisticated parties”).
197 ACE Ltd. v. Capital Re Corp., 747 A.2d 95, 194 (Del. Ch. 1999).
Research suggests that rather than causing unpredictable judicial discretion, expansive analyses in transactional affairs can be a source of certainty.\(^{198}\) Indeed, the persistent preference for Delaware as a state of incorporation\(^ {199}\) as governing law for sophisticated merger and acquisition agreements\(^ {200}\) and as a forum for corporate litigation\(^ {201}\) is perhaps empirical evidence of the utility-maximizing potential of more expansive analyses. These observations are theoretically consistent with legal scholarship asserting that a more reasoned approach often emerges as a dominant and favored method of resolving disputes that arise in respect of complex commercial dealings.\(^ {202}\)

To the extent courts are willing to confront the certainty imperative and move beyond its methodological constraints, corporate finance jurisprudence may ultimately follow a similar course. In the following section, I explore the hypothesis that more expansive methodologies may be more apt to promote efficiency,

\(^{198}\) See supra note 195 and sources cited therein.


\(^{200}\) Adam B. Badawi, *Interpretive Preferences and the Limits of the New Formalism*, 6 BERKELEY BUS. L.J. 1, 40-41 (2009) ("[t]hough it is difficult to obtain precise numbers, many merger agreements choose Delaware courts as the forum to resolve any disputes; a choice presumably influenced by the substantial experience that Delaware courts have with corporate law"); Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VAND. L. REV. 1975 (2006) (parties to corporate mergers prefer Delaware law over all other states).


certainty and stability in financial markets. I elaborate on these recommendations by introducing a case study in which a court decided a commercial lending controversy pursuant to strict interpretive norms. After considering the court’s traditional, imperative-driven decisional paradigm, I focus on a hypothetical consideration of the case using more expansive analysis. This exercise permits us to capture both the reasons why it is necessary for modern courts to move beyond the constraints of the imperative as well as the problems that arise when strict interpretive norms are applied to highly complex arrangements.

A. Case Study: Beal and its Discontents

A recent corporate finance case, Beal Savings Bank v. Sommer, and the critical response it generated within the practice community, demonstrates the fundamental weakness of imperative-driven methodologies in promoting stability and certainty in financial markets. The dispute in Beal pertained to consent mechanisms and enforcement rights of minority lenders in a syndicated loan agreement: the very issue that arose in the failed Chrysler debt restructuring negotiations discussed above. The case is particularly instrumental in that it demonstrates the limits of strict interpretive norms in framing the issues that arise under complex financing arrangements and identifying the economic substance of claims, particularly where the dispute involves questions beyond the fact or extent of borrower default.

In Beal, the New York Court of Appeals held that an individual lender participating in a syndicated loan did not have standing to sue a guarantor unilaterally, as such agreements “intended for collective action” with respect to the enforcement of remedies against any of the borrower parties. The lending syndicate was, at the time of litigation, comprised of thirty-seven lenders and an administrative agent, and all but one of the lenders (Beal Savings Bank) had entered into a forbearance arrangement with the

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203 8 N.Y.3d 318 (NY 2007).
204 See supra notes 6 and 7 and accompanying text.
205 Id. at 332.
borrower parties. In denying Beal Savings Bank's claim, the court found that a supermajority vote (sufficient to meet the "required lenders" threshold of at least 2/3 of the outstanding principal balance of the loan) was needed to enforce remedies under the credit documents.\(^{206}\)

The court decided the case by applying strict, imperative-driven interpretive norms to the underlying credit documents. Specifically, the court commenced its analysis by application of rules of contract interpretation to the underlying credit documents. Under established principles that are fairly identical in every jurisdiction, the pivotal question in construing a contract is whether the terms are clear and unambiguous.\(^{207}\) Ambiguity does not exist as a matter of law merely because the parties offer contradictory interpretations.\(^{208}\) Rather, under the "four corners" rule, courts attempt to discern the original intent of parties based upon language in the agreement.\(^{209}\) Courts generally strive to "construe the agreements so as to give full meaning and effect to material provisions."\(^{210}\) Courts typically consider very little extrinsic evidence to construe contract terms, with the exception of occasional reference to dictionary meanings or, under the

\(^{206}\) Id.

\(^{207}\) The detection of ambiguity in drafted language can be a matter of varying judicial opinion and methodology. See, e.g., Jerald D. Stubbs, The Federal Circuit and Contract Interpretation: May Extrinsic Evidence Ever be Used to Show Unambiguous Language is Ambiguous?, 39 PUB. CONTR. L.J. 785 (2010).

\(^{208}\) "An 'ambiguous' word or phrase is one capable of more than one meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages and terminology as generally understood in the particular trade or business." Walk-In Med. Ctrs., Inc. v. Breuer Capital Corp., 818 F.2d 260, 263 (2d Cir. 1987).

\(^{209}\) See, e.g., U.S. v. Moorman, 338 U.S. 457 (1950); Vermont Teddy Bear Co., Inc. v. 538 Madison Realty Co., 1 N.Y.3d 470, 475 (N.Y. 2004) ("[i]n the absence of any ambiguity, we look solely to the language used by the parties to discern the contract's meaning"). But see Richard A. Posner, The Law and Economics of Contract Interpretation, 83 TEX. L. REV. 1581, 1597 (2005) [hereinafter Posner, Contract Interpretation] (criticizing the value of the rule thusly: "If the contract is clear, there is no need to interpret it. If it is unclear, the rule provides no guidance to extracting its meaning").

Restatement view, the technical meaning of technical terms.\textsuperscript{211} Where there are inconsistent terms, all provisions are reconciled, if possible.\textsuperscript{212} Specific provisions are enforced over conflicting miscellaneous or otherwise general provisions.\textsuperscript{213}

In \textit{Beal}, no document explicitly prohibited the enforcement of remedies by individual lenders. In fact, the court acknowledged the lack of unequivocal language: "Here...neither the Credit Agreement nor the [keep-well agreement] contain an explicit provision stating that a Lender may -- or may not -- take individual action in the event of default."\textsuperscript{214} Furthermore, the keep-well agreement, which was the document setting forth obligations of the guarantors, provided that it was "enforceable...by each Lender."\textsuperscript{215} Also suggesting the availability of individual enforcement, the credit agreement provided, in pertinent part: ",[n]o right or remedy conferred upon the Administrative Agent or the Lenders in this Agreement is intended to be exclusive" and "every such right and remedy shall be cumulative...to every other right or remedy contained in the Loan Documents."\textsuperscript{216} Finally, suggesting that the forbearance arrangement could not proceed without unanimous consent of the lenders, the keep-well agreement stated: "no amendment, modification or waiver can be made to the Loan Documents so as to 'release the [guarantors] under the Keep-Well Agreement...without the consent of all Lenders,'" and that the guarantors "shall not be released from their obligations...because of...[a]ny...forbearance...or other act or omission of the Administrative Agent or the Lenders."\textsuperscript{217} Thus, the credit documents appeared to preserve individual enforcement rights.

In contrast, the credit agreement contained language suggesting collective action pursuant to a supermajority consent mechanism:

\textsuperscript{211} \textit{Restatement (2nd) of Contracts} § 202, p.3b (1981).
\textsuperscript{214} 8 N.Y.3d at 326.
\textsuperscript{215} \textit{Id}.
\textsuperscript{216} 8 N.Y.3d at 322.
\textsuperscript{217} \textit{Id}. at 330.
the "Administrative Agent, at the direction of the Required Lenders, may 'exercise any or all rights and remedies at law or in equity,' including the right to recover judgment on the Keep-Well Agreement." Finally, the keep-well agreement provided that it was a "Loan Document executed pursuant to the Credit Agreement and shall (unless otherwise expressly indicated herein) be construed, administered and applied in accordance with the terms and provisions thereof." Thus, the credit documents appeared to contemplate collective action of some sort, and it was unclear how such a mechanism should be reconciled with individual enforcement rights.

After a lengthy attempt to reconcile the conflicting language, the court held that the agreements were unambiguous as a matter of law with respect to a lender's individual standing to enforce the agreements. The court rested its holding on the rule that "[a] reading of the contract should not render any portion meaningless," and, in the court's view, the interpretation advanced by Beal Savings Bank would render meaningless the provision authorizing the agent to act upon the direction of the required lenders. Further, in accordance with the rule that "a contract should be 'read as a whole, and every part...interpreted with reference to the whole...as to give effect to its general purpose," the court concluded that the credit documents "explicitly and implicitly" precluded unilateral action by any lender and suggested an "unequivocal collective design."

218 Id. at 322.
219 Id. at 322-23.
220 The court held: "The specific, unambiguous language of several provisions, read in the context of the agreements as a whole, convinces us that, in this instance, the lenders intended to act collectively in the event of the borrower's default and to preclude an individual lender from disrupting the scheme of the agreements at issue." Id. at 321.
221 Id. at 324.
222 Id.
223 Id.
224 Id. The court relied on Credit Francais International, S.A. v. Sociedad Financiera de Comercio, C.A., 490 N.Y.S.2d 670 (N.Y.Sup. 1985). However, the documents at issue contained more explicit and pervasive language vesting rights in the administrative agent to act on behalf of the lenders collectively, and only one general provision supported individual enforcement.
Yet the reverse outcome could have been reached by application of the same rules of interpretation. For instance, a court could conclude that the credit documents must not be read so as to render meaningless those portions asserting that the agent's rights were not exclusive, and that each lender maintains an individual right of enforcement. Indeed, as the dissenting opinion argues, absent plain language that "no suit will be brought unless a majority or supermajority of the lenders agree to take action," preclusion of a lender's enforcement rights runs contrary to fundamental principles guiding the relationship between a lender and borrower, since "[a] bank that lends money to a borrower and is not repaid is entitled to sue to get its money back." Further, a court could find that each lender maintained traditional enforcement rights that may be exercised in each lender's individual capacity, and that the language granting rights to the agent was intended to vest the agent with standing to proceed in the event that a supermajority of lenders agree to collective action, but solely with respect to such lenders' collective rights.

Ironically, while the court’s imperative-driven methodology was met with considerable criticism from within the corporate finance practice community, most critics conclude that the decisional outcome is not inconsistent with industry norms. The

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225 This interpretation was advanced in Commercial Bank of Kuwait v. Rafidian Bank, 15 F.3d 238, 243 (2nd Cir. 1994) ("While the participation agreement...authorizes the 'Confirming Bank' to sue 'only if requested to do so by the Majority Banks,' this provision does not abrogate the rights of participating banks to sue on their own. Indeed, the agreement points the other way, providing that the rights of the parties 'under the general law' are expressly reserved").

226 8 N.Y.3d at 332 (Smith, J., dissenting).

227 See, e.g., Joshua Stein, Model Intercreditor Agreement (Among A Lenders, B Lenders, and Swap Counterparty), 575 PLI/Real 431, 445 (2010) ("[t]he result in Beal conformed to industry expectations, as the author understands them. Given some of the language in the Beal loan documents, though, the court perhaps did the lending industry a favor to some degree"); Keith H. Wofford, Lender 'Collective Action' Doctrine Provokes Controversy: Against: A Violation of New York Law and Good Policy, 12/14/2009 N.Y.L.J. 9, (col. 5) ("[t]he Beal Court took the position that, even where a credit agreement accords rights to individual lenders or provides that certain acts require unanimous lender consent, those provisions should be read narrowly (even to the point of having no meaning), in order that the collective design of the credit agreement may prevail"); Paul J. Epstein, Beal v. Sommer: Did Decision on Collective Action in Exercise
trouble with Beal lies not in the court’s holding, but rather in that the ruling seems divorced from the text construed, and although the ruling ultimately aligns with industry customs, the opinion does not reveal any consideration of such contextual factors. As the dissenting opinion articulates, the majority reaches a “pragmatically appealing result,” given that only one of the thirty-seven lenders sought to enforce remedies, but such a result was achieved by “read[ing] into the loan documents language that would compel results far less appealing.” Even more, the holding is inconsistent with precedent asserting that similar language granting enforcement rights to administrative agents so that they may proceed on behalf of a majority of lenders do not override express rights of lenders to proceed individually. Thus, even where a decisional outcome is acceptable in the industry, as the Davis dissent warned, murky analysis injects substantial uncertainty.

Perhaps the most perplexing aspect of the decision is the court's finding that the agreements were unambiguous. In this regard, the New York Court of Appeals is not alone. In general, courts deciding corporate finance cases seem reluctant to identify ambiguity, presumably because any such declaration would

of Lenders' Remedies Reflect Contracting Parties' Intent?, 125 BANKING L.J. 240 (2008) ("[a]s a matter of equity, the Court's decision...seems to be the correct one....[However,] the Court seems to have cut some corners as a matter of contract interpretation...[The conclusion of the contract interpretation analysis] is not clearly supported by the terms of the contracts themselves").

228 8 N.Y.3d at 335 (Smith, J., dissenting).

229 See supra note 225.

230 Commentators have attempted to summarize the import of Beal: “New York law further provides that the typical credit agreement language that authorizes the administrative agent, acting upon the instructions of lenders holding a certain percentage of the debt, to declare the loan accelerated and pursue remedies against the borrower in the event of default, precludes individual creditor action” (emphasis added). Randall Klein & Danielle Juhle, Majority Rules: Non-Cash Bids and the Reorganization Sale, 84 AM. BANKR. L.J. 297 (2010). Yet the court ruled in part based upon specific clauses, and in part based upon a summary view of the entire set of loan documents; thus, without public access to such agreements, it is impossible to know whether the ruling was based upon “typical credit agreement language.”

231 See, e.g., In re QuVIS, Inc., Not Reported in B.R., 2010 WL 2228246 (Bkrtcy.D.Kan. 2010) (a loan agreement was “less than precise in its treatment of the
require a more expansive interpretative analysis and therefore potentially run afoul of the imperative.\textsuperscript{232} For instance, had the \textit{Beal} court acknowledged ambiguity, it could have reached the same decisional outcome, but it would have been obligated to engage in more rigorous interpretive analysis\textsuperscript{233} or, more boldly, advance a theory of collective action grounded in law or equity.

For instance, a court confronted with an ambiguous agreement might attempt to discern what the parties originally intended. Such analyses are premised upon the assumption that the parties addressed the issue during negotiations, but did not articulate the resolution in their written agreements. If necessary, a court may look to extrinsic evidence to discern intent.\textsuperscript{234} If evidence does not reveal the actual intent of the parties, the court might attempt to determine what the parties would have agreed had the question arisen during negotiations. This is, in fact, the most widely-employed approach to gap-filling incomplete commercial contracts.\textsuperscript{235} To discern hypothetical intent, a court might look to surrounding circumstances at the time the agreement was executed,

\textsuperscript{232} In a rare example of a court finding that a material provision of a corporate financing agreement is ambiguous, a United States District Court found a material adverse change clause to be ambiguous, thereby prompting a review of extrinsic evidence as well as an analysis of the foreseeability of the adverse events. Capitol Justice LLC v. Wachovia Bank, N.A., 706 F.Supp.2d 23 (D.D.C. 2009). \textit{See also} BKC\textit{AP}, LLC v. CA\textit{PT}E\textit{C} Franchise Trust 2000-1, 572 F.3d 353 (7th Cir. 2009) (finding a commercial loan agreement ambiguous as a matter of law, and remanding the case for a trial to determine the parties' intent).


\textsuperscript{234} See PNC Bank v. GPL Outlots, LP, Slip Copy, 2010 WL 2696344 (S.D.Ind. 2010) (permitting discovery of the drafting history of a Master Loan Agreement that the borrower asserted to be ambiguous).

\textsuperscript{235} \textit{See} Ben-Shahar, \textit{Default Rules}, supra note 103 at 396 ("[t]he most broadly accepted principle of gap filling is that courts should 'mimic the parties' will'").
customary usage of language in the agreement,\textsuperscript{236} or even terms that the marketplace would dictate for deals similar in scope.\textsuperscript{237}

In other cases, ambiguities are resolved pursuant to a tie-breaker rule. Perhaps the most frequently-cited example of such a rule, \textit{contra proferentem}, provides that ambiguous language should be interpreted against the drafting party.\textsuperscript{238} This rule is often applied in the context of insurance agreements,\textsuperscript{239} and has been exported to the financing realm.\textsuperscript{240} In the area of lending and finance, another tie-breaker rule has been adopted in some states, whereby guaranty agreements are strictly construed in favor of the guarantor.\textsuperscript{241} There is wide variation in how, when and to what

\textsuperscript{236} Wells Fargo Asia, 612 F.Supp. 351 (recommending review of evidence relating to customary practice in the Eurodollar market).

\textsuperscript{237} This approach was taken in the commercial gap-filling case, Oglebay Norton Co. v. Armco, Inc., 556 N.E.2d 515, 519-20 (Ohio 1990) (supplanting contract price terms with market prices). While this approach is more readily applied to pricing terms, in the realm of corporate finance the court could look to one of the many surveys summarizing terms employed in commercial financing agreements.

\textsuperscript{238} The Restatement suggests that construing a contract against the drafter is justified when the drafter is in a better position to know of uncertainties or when the drafting party has the stronger bargaining position. \textit{Restatement (2nd) of Contracts} § 206 com. a (1981).


\textsuperscript{241} “A guarantor is entitled to have his agreement strictly construed so that it is limited to his undertakings, and it will not be extended by construction or implication,” and thus a court should adopt “a construction which is most favorable to the guarantor.” Coker v. Coker, 650 S.W.2d 391, 394 n.1 (Tex. 1983); see also Mazur v. Young, 507 F.3d 1013, 1021-22 (6th Cir. 2007) (courts should “apply the principle of strict interpretation to the construction of [a guaranty] contract"); Wells Fargo Bank, NA v. MPC Investors, LLC, 705 F.Supp.2d 728, 736 (E.D.Mich. 2010) (Michigan precedent
extent such tie-breaker rules are applied. For instance, some courts seek to avoid application of contra proferentem by determining whether, of alternative interpretations, only one is reasonable.\textsuperscript{242} In such cases, courts test reasonableness based upon an analysis of hypothetical intent of the parties at the time the contract was entered into,\textsuperscript{243} or based upon the overall utility maximization of each interpretation.\textsuperscript{244} Other courts have limited application of this rule by applying it only where actual intent cannot be determined upon review of extrinsic evidence.\textsuperscript{245}

As a final alternative, courts at times apply economic analysis to aid in discerning whether one interpretation is more reasonable. Economic analysis is particularly useful given the similarities between the process of balancing conflicting contract interpretations and cost-benefit analysis — a decisional approach rooted in principles of economic efficiency. For the most part, such analyses look to the economic utilities as they existed at the time

\textsuperscript{242} Lohnes v. Level 3 Communications, Inc., 272 F.3d 49, 59 (1st Cir. 2001) (referring, in an equity financing case, to the rule of contra proferentum as a "hoary aphorism" and noting that the appellant's "reliance is mislaid. In order to invoke this principle, the proponent first must demonstrate that there is an ambiguity...Here, the appellant has failed to show that the interpretation which he urges is, 'under all the circumstances, a reasonable and practical one'"; Cappellini v. Mellon Mortgage Co., 991 F.Supp. 31, 39-40 (D.Mass. 1997) (declining to apply contra proferentum because the alternative interpretation was unreasonable).

\textsuperscript{243} Allstate Life Ins. Co. v. BFA Ltd. Partnership, 948 A.2d 318, 328 (Conn. 2008) (under one interpretation, "the plaintiff would have decreased its protection while...loaing the defendants up to an additional $2 million and extending the maturity date of the loan....We cannot reasonably conclude that the plaintiff would have lessened its indemnification protection in this situation").

\textsuperscript{244} Savedoff v. Access Group, Inc., 524 F.3d 754, 764 (6th Cir. 2008) (considering such a rule in respect of a student loan agreement, but finding that only one interpretation was reasonable).

\textsuperscript{245} Ursery v. Option One Mortg. Corp., 2007 WL 2192657, *10 n20 (Mich.App. 2007) ("contra proferentum...is used only when there is a true ambiguity and the parties' intent cannot be discerned through all conventional means, including extrinsic evidence"); Stephenson v. The Third Co., 2004 WL 383317, *6 (Tenn.Ct.App. 2004) (contra proferentum "does not trump other rules of construction in all situations. Above all, it does not negate the actual intention of the parties, where that can be deduced from other evidence").
the contract was negotiated. To the extent only one interpretation would clearly advance overall utility, or conversely, to the extent one interpretation would yield a perverse outcome, then the more efficient approach is adopted.\footnote{See, e.g., Columbia Gas Transmission Corp. v. New Ulm Gas, Ltd., 940 S.W.2d 587, (Tex. 1996) ("we are to examine all parts of the contract and the circumstances surrounding the formulation of the contract....It is inconceivable that the parties intended such a perverse result in this contract"); see also Fresh Del Monte Produce v. IAT Group, Inc., 836 N.Y.S.2d 160, 164 (N.Y.App.Div. 2007) (contracts should not be interpreted so as to produce unreasonable results).}

Thus, by declaring the credit documents unambiguous as a matter of law, the Beal court ostensibly avoided expansive interpretive analyses. Even more, the court remained well within the boundaries of imperative-driven methodologies, in that it remained focused upon the plain meaning of underlying documents without resorting to extrinsic evidence. To be sure, Beal is not an outlier case, either in terms of its methodology or the questions presented. Even within the bankruptcy context, where courts routinely exercise broad legal and equitable powers, courts continue to restrict their analyses to strict interpretive norms when consent issues arise.\footnote{Bankruptcy courts look to state contract law when matters arise under private agreements and there is no statutory law (such as provisions of the Bankruptcy Code) on point. See HSBC Bank USA v. Branch (In re Bank of New England Corp.), 364 F.3d 355, 363 (1st Cir.), cert. denied, 543 U.S. 926 (2004).} For instance, consent conflicts arise with respect to free and clear sales\footnote{Such sales are conducted under § 363(f) of the Bankruptcy Code.} and credit bidding,\footnote{Credit bidding is conducted under § 363(k) of the Bankruptcy Code.} pursuant to which assets may be acquired from the bankruptcy estate.\footnote{See, e.g., In re GWLS Holdings, Inc., No. 08-12430, 2009 WL 453110 (Bankr. D. Del. 2009); In re Metaldyne Corp., 409 B.R. 671 (Bankr. S.D.N.Y. 2009).} In both circumstances, courts apply prevailing methods of contract interpretation to underlying credit documents to determine consent thresholds and other requisite rights and obligations of the parties before the estate may proceed with the sale. For example, in the Chrysler case,\footnote{See In re Chrysler LLC, 405 B.R. 84 (Bankr. S.D.N.Y. 2009), aff’d In re Chrysler LLC, 576 F.3d 108 (2d Cir. 2009).} lenders holding less than 1% of the outstanding prepetition indebtedness objected to a proposed sale, arguing that
unanimous consent was required.\textsuperscript{252} As in \textit{Beal}, the \textit{Chrysler} court decided the case based upon rules of contract interpretation, finding that the underlying credit documents unambiguously evidenced a collective design, and that the requisite consent threshold was satisfied.\textsuperscript{253}

Yet there are considerable limitations to imperative-driven strict interpretive norms and other "form over substance" approaches to modern financing disputes. As \textit{Beal} evidences, when a decision seems unsupported by the text of the underlying agreements, market participants are left wondering whether some other guiding principle, such as equity or customary practice, motivated the court. Furthermore, such methodologies can lead to decisions that are divorced from underlying economic substance. For instance, in a 2009 ruling, a United States Bankruptcy Court found that even where a majority of note holders consented to a credit bid, the sale could not proceed because the underlying credit documents vested in the indenture trustee the sole discretion to take substantive action.\textsuperscript{254} Given that indenture trustees, in their capacity as such, do not bear the risk of economic loss with respect to a financing arrangement, the outcome vests substantive rights in a manner that does not align with present-day economic interests.\textsuperscript{255} As the following section reveals, perverse outcomes of this sort are increasingly likely when complex financing arrangements are construed under prevailing imperative-driven methodologies.

\textbf{B. A Critical Analysis of \textit{Beal}}

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\begin{itemize}
\item \textsuperscript{252} \textit{Id.} at 93.
\item \textsuperscript{253} \textit{Id.} at 102-04.
\item \textsuperscript{254} In re Electroglas, Inc., 2010 WL 2821868 (Bankr. D. Del. 2009).
\item \textsuperscript{255} Recent analyses demonstrate agency problems, including moral hazards, where a lead arranger does not share in the outstanding indebtedness. These observations can be analogized to the indenture trustee scenario, particularly in a situation of borrower insolvency where the lead arranger's principal goal of maintaining a customer relationship is clearly extinguished. \textit{See} Nada Mora, \textit{Lender Exposure and Effort in the Syndicated Loan Market}, Federal Reserve Bank of Kansas City Working Paper No 10-12 (2010).
\end{itemize}
Imperative-driven methodologies are capable of gross oversimplification of a dispute, as well as an allocation of legal rights and remedies in a manner that is inconsistent with the actual economic arrangement. First, strict interpretive norms focus on the intent of parties that do not necessarily bear the economic benefit or burden of any particular decisional outcome. For instance, while the administrative agent in Beal most likely served as lead drafter of the underlying credit documents, the administrative agent, in its capacity as such, likely had very little economic interest in the outcome of the litigation.256 However, rules of contract interpretation place considerable attention upon the intent, interests, bargaining power and substantive rights of drafting parties, including lead arrangers. Second, Beal demonstrates how, by the time litigation is advanced, facts and circumstances are often far removed from those that existed when the underlying credit documents were executed. For instance, at the time of the Beal decision, the borrower had been insolvent for almost six years, and likely had no ability to make payments of principal or interest. Not to mention, under virtually all lending agreements, a borrower's insolvency is a default, terminating the lender's commitment to make any additional advances of loan proceeds.257 Indeed, the situation in Beal was far beyond that of a distressed borrower; this was an insolvent borrower undergoing liquidation. While the dispute in Beal did not pertain to the borrower's default, the fact that circumstances had moved so far beyond the scope of the credit documents that the parties were not even debating the borrower's obligations suggests a profound disconnect between

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256 By definition, the Administrative Agent is the lead arranger, not a lender. While in practice most lead arrangers serve in a dual capacity, also holding some fractional interest as a lender, there is wide variation and, furthermore, the loan interest might have been sold or reduced through the secondary market. Nada Mora, Lender Exposure and Effort in the Syndicated Loan Market, Federal Reserve Bank of Kansas City Research Working Paper No. 10-12 (2010).

257 See, e.g., MORTON MOSKIN, COMMERCIAL CONTRACTS: STRATEGIES FOR DRAFTING AND NEGOTIATING, VOLUME 1 §16.04 (2003) (describing a provision of this sort in an unsecured bank credit agreement).
present-day economic realities and those depicted in the documents the court focused upon in deciding the case.

To this end, Beal reveals that in cases arising in respect of complex financing arrangements, present-day economic risks often no longer align with the economic risks or bargaining power present during negotiation of the underlying credit documents.\(^{258}\) For example, Beal Savings Bank was not a party to the original loan, but rather acquired its interest pursuant to an assignment by an affiliate, which was an original lender.\(^{259}\) While the assignment was likely pursuant to an internal reorganization rather than a secondary loan market transaction, this fact highlights a very important reality of the modern financing realm. Lenders buy and sell loan interests on the secondary loan market with great frequency.\(^{260}\) Further, some speculative investors specifically acquire distressed debt from other lenders, often for a mere fraction of the outstanding principal. Although, with proper documentation, such acquirers step into the shoes of the original lender, these transfers raise questions as to the utility of applying rules of contract interpretation that impute the intent and bargaining power of the original parties to present-day holders.\(^{262}\) For instance, in the case of an acquisition for a mere fraction of the outstanding principal, there is a significant incentive for the

\(^{258}\) The importance of considering relative bargaining power is central to the arguments advanced in Ben-Shahar, Default Rules, supra note 103.

\(^{259}\) A similar concern was articulated in respect of bankruptcy consent requirements: “Bankruptcy law’s reliance on the consent of proxies, successors, or others similarly situated has become especially problematic in recent years as consent rights increasingly have been divorced from economic rights through modern financial engineering.” Daniel J. Bussel & Kenneth N. Klee, Recalibrating Consent In Bankruptcy, 83 AM. BANKR. L.J. 663, 733 (2009) [hereinafter Bussel & Klee, Recalibrating Consent].

\(^{260}\) An affiliate relationship can be inferred from the facts of Belmont Investments, LLC v. U.S., No. 4:07cv9 (E.D. TX Aug. 2, 2010).


\(^{262}\) See, e.g. Kaiser, 681 A.2d at 397 (“[w]hen a contract is ambiguous, a court normally relies upon extrinsic evidence of the parties’ intent....[However in this case, s]uch an investigation would reveal information about the thoughts and positions of, at most, the issuer and the underwriter” rather than the current debt holders).
acquirer to take an adversarial position in restructuring discussions purely because any concession, settlement or judgment to be obtained might enable such lender to profit from its investment.\footnote{This is similar to the "net winner" problem discussed in respect of the Madoff settlement. See supra note 113 and source cited therein. A similar problem arises in the bankruptcy context. For instance, U.S. Bankruptcy Judge Robert Gerber, at a hearing on the issue of reforming Bankruptcy Rule 2019, which mandates disclosure of certain creditors' economic interests in claims, purportedly recounted a situation in the General Motors Corp. bankruptcy, whereby "a group told him it represented 1,500 bondholders who bought their debt at around par using pension money. When he requested disclosure under rule 2019 he learned the group consisted of three people who bought their debt at pennies on the dollar." Tiffany Kary, Federal Judge Says Rules Needed To Bar Bankruptcy Failure Bets, BLOOMBERG.COM, Feb. 05, 2010. Judge Gerber also noted that "distressed investors have their own agendas, which not infrequently consist of simply maximizing returns for themselves, in the shortest possible time horizon." Id.\footnote{See, e.g., Parkway Closes New Revolving Credit Facility, PRNEWswire, Jan. 31, 2011 (reporting the closing of a $200 million credit facility, including a $190 million unsecured revolving line of credit and a $10 million working capital revolving line of credit, pursuant to which the borrower also maintains a $100 million interest rate swap); O'Reilly Automotive, Inc. successfully completes debt refinancing, AFTERMARKET BUSINESS, Jan. 25, 2011 (reporting the closing of a $750 million credit facility, including a $200 million facility for letters of credit and a $75 million swing-line facility).} To be sure, the underlying credit documents are essential in defining the obligations of the parties, including the extent of outstanding indebtedness; but conceptually speaking, the financing relationship is an organic and multifaceted arrangement that evolves over time, much as a corporation grows and evolves. Sophisticated corporate financing arrangements often entail revolving lines of credit and other standing commitments and contractual arrangements,\footnote{See, e.g., Parkway Closes New Revolving Credit Facility, PRNEWswire, Jan. 31, 2011 (reporting the closing of a $200 million credit facility, including a $190 million unsecured revolving line of credit and a $10 million working capital revolving line of credit, pursuant to which the borrower also maintains a $100 million interest rate swap); O'Reilly Automotive, Inc. successfully completes debt refinancing, AFTERMARKET BUSINESS, Jan. 25, 2011 (reporting the closing of a $750 million credit facility, including a $200 million facility for letters of credit and a $75 million swing-line facility).} and as such are referred to in the industry as credit "facilities" created pursuant to underlying credit documents. Such nomenclature, which is to some degree analogous to the distinction between a corporation and its formation documents, is perhaps a subtle recognition of the dynamic nature of the relationships created by credit documents. Strict interpretive norms expressly deny courts the ability to fully appreciate the dynamics of a fluid and organic credit facility. Furthermore, as financing arrangements have grown to include heterogeneous lender groups, and as securitization and derivative transactions
have created additional layers to existing arrangements, the imperative’s goal of promoting the imputed expectations of financial institutions has become nearly impossible. Not only is there no clear definition of lenders, but disputes are increasingly among financial institutions. For all of these reasons, parties to such arrangements can be expected to increasingly turn to courts to resolve claims; yet courts cannot adequately perform this function to the extent imperative-driven interpretive paradigms result in an allocation of legal rights and remedies in a manner that is inconsistent with the actual economic arrangement of the parties.

C. The Case for a More Expansive Interpretive Methodology

Some may argue that notwithstanding opportunities for misallocation of legal rights and remedies, more rigid interpretive rules are necessary in the finance and lending realm to promote certainty, uniformity and stability in financial markets. Yet ironically, a more expansive analysis may actually do more to promote certainty than continued reliance on purportedly mechanical rules of contract interpretation. Recent evidence suggests that prevailing rules of contract interpretation in fact conceal a number of subjective influences, which quite clearly run afoul of the certainty imperative. For instance, as evidenced by decisions outside of the corporate finance realm, the prevailing approach to contract interpretation is not without its own biases, inconsistencies and limitations. Moreover, given the sheer


266 Karl N. Llewellyn, *Remarks on the Theory of Appellate Decisions and the Rules or Canons About How Statutes are to be Construed*, 3 VAND. L. REV. 395, 401 (1950) (“there are two opposing canons on almost every point”); see also Avery Wiener Katz, *The Economics of Form and Substance in Contract Interpretation*, 104 COLUM. L. REV. 496, 497 (2004) (“many rules of contract law have the effect of privileging or emphasizing certain types of potentially relevant interpretive materials, and discounting or excluding others”).
size, complexity and, at times, internal inconsistencies of the agreements and instruments that govern modern commercial transactions, robust contract interpretation has become increasingly cumbersome and consequently, vulnerable to oversight and error. Yet among the many criticisms that have been levied against rules of contract interpretation, the strongest of all such attacks assert that these rules are mere facades, concealing decisions that are actually rooted in undeclared normative or theoretical persuasions of the court. The realm of corporate finance is no exception to these criticisms; in fact, Beal exemplifies these very concerns, along with those raised in Justice Kennedy's dissenting opinion in Davis. The decision seems divorced from applicable rules and precedent, and from the very text construed. Perhaps in recognition of these limitations, the efficacy of deciding complex disputes on the basis of rules of


268 Credit documents often comprise hundreds or even thousands of pages. A significant portion are negotiated via a flurry of drafts on the eve of closing. Such realities of modern practice can lead to the problems articulated in a recent case construing indenture documents: courts ought to "construe a contract 'in accord with the parties' intent,' and the best evidence of their intent 'is what they say in their writing.' Easy enough to say: but difficult to apply when the parties' writings are as convoluted and opaque as those in this case." Bank of New York v. First Millennium, Inc., 598 F.Supp.2d 550, 568 (S.D.N.Y. 2009). See also HSBC Bank USA, Nat. Ass'n v. Dara Petroleum, Inc., Slip Copy, 2010 WL 2197525 (E.D.Cal. 2010) (a commercial loan agreement providing for interest at a rate of "the 30 Day LIBOR equivalent to the Wall Street Journal Prime," was "unintelligible on its face....Neither defendants' expert, who has worked extensively in the lending industry, nor plaintiff's expert, a professor of economics, had ever seen the specific phrase").


271 Frank C. Newman & Stanley S. Surrey, Legislation—Cases and Materials 654 (1955) (rules of interpretation "are useful only as facades, which for an occasional judge may add luster to an argument persuasive for other reasons").
contract interpretation is generally under pressure. Such criticisms echo deeper normative questions as to the relative efficiencies of judge-made doctrine versus bright-line rules, and further call into question the utility of imperative-driven methodologies in promoting certainty and stability in financial markets. Indeed, if the certainty imperative, as the bedrock goal of corporate finance jurisprudence, reflects a genuine desire on the part of the judiciary to promote certainty and stability in financial markets, then continued reliance on strict interpretive norms without any overt consideration of contextual factors may bring about a crisis of legitimacy in this realm.

V: EXPLORING ALTERNATIVE JUDICIAL METHODOLOGIES

A. Key Modifications to Prevailing Imperative-Driven Methodologies

Assuming the imperative's underlying goals continue to be paramount, this section recommends several possibilities for expanding the scope of judicial inquiries in the financing realm. In particular, I propose two modifications to prevailing imperative-driven interpretive methodologies: first, courts must consider the present-day economic substance of each party's claims; second, courts should be empowered to allocate legal rights and remedies in a manner that is consistent with the actual economic arrangement of the parties, in an effort to replicate the outcomes that the parties would have reached but for any inefficiencies and sub-optimal allocations introduced when contractual terms are applied to present-day economic realities. Further development and evaluation of these recommendations is needed, particularly from an interdisciplinary perspective. In the meantime, the


273 See, e.g., RICHARD A. POSNER, HOW JUDGES THINK (2008); FRIEDRICH A. HAYEK, LAW, LEGISLATION, AND LIBERTY (1973).
suggestions below strive to counter the tendency for imperative-driven methodologies to promote form over substance when applied to complex and dynamic financing arrangements.

1. Consideration of Present-Day Economic Substance

Courts striving to reach efficient decisions that promote certainty and stability in the financing realm must be empowered to consider the present-day economic substance of each party's claims by determining, in both qualitative and quantitative terms, the nature and extent of each party's actual economic interest at the time of litigation. Consideration of present-day economic substance would essentially involve a factual inquiry, pursuant to a request for disclosure by the parties to a controversy. Specifically, each claimant would be required to file a verified statement with the court, setting forth (1) the identity of such lender, creditor or claimant; (2) the nature and amount of such person's interest in the financing arrangement, the times when acquired and the amounts paid therefor, unless such claim or interest is alleged to have been acquired pursuant to such person's original participation in the financing arrangement as set forth in the credit documents, and (3) the nature and amount of such person's actual or prospective losses as a result of any deterioration in the financing arrangement. A disclosure requirement of this sort would enable courts to identify the true economic substance of claims, in what would essentially involve a "substance over form" investigation. In most cases, such interests will be radically different from those

274 The proposed disclosure requirements set forth in clauses (1) and (2) are a modified version of the language in Bankruptcy Rule 2019, which is intended to foster transparency in the bankruptcy process. See In re Northwest Airlines Corp., et al., 47 BCD 248 (Bankr. S.D.N.Y. 2006).

275 Essentially, this is a test of economic substance, albeit exploring loss potential as opposed to the profit potential that is more frequently examined in tax law. David P. Hariton, Sorting Out the Tangle of Economic Substance, 52 TAX LAW. 235, 235 (1999) ("[a] transaction only has economic substance...if it alters the taxpayer’s economic position in a meaningful way (apart from its tax consequences)").

that existed when the credit documents were executed, particularly to the extent interests have been sold on the secondary market.\footnote{277}

Additionally, courts would be empowered to qualitatively assess each person's claims in a facts and circumstances inquiry intended to identify possible rent-seeking motivations. The importance of this inquiry is supported by economic efficiency principles. Indeed, since negotiations often enable parties to avoid litigation, the disputes that advance to litigation (excluding enforcement actions for monetary defaults) are likely to involve situations where present-day economic substance is so far removed from contractual language that parties have highly asymmetric risks and are therefore encouraged to engage in rent-seeking and other attempts to benefit from the disparities between actual economic interests and contractual rights.\footnote{278} In the context of a deteriorating financing arrangement, where resources are scarce, rent-seeking behavior represents a particularly egregious form of waste, since rent-seeking parties siphon resources for personal profit, thereby further compounding the losses faced by others.

\footnote{277}{For example, in \textit{Beal}, lenders holding approximately 95\% of the outstanding indebtedness consented to the forbearance arrangement. At first blush, this suggests that the advancement of Beal Savings Bank's interests at the expense of the remaining lenders carries a price: an amount equal to the present-day value of a forbearance arrangement sufficient to gain the support of lenders who have an economic interest equal to 95\% of the outstanding indebtedness. This assumption clearly renders decisional outcomes that advance the interest of such lenders more "pragmatically appealing," as the dissenting opinion notes. 8 N.Y.3d at 335 (Smith, J., dissenting). Yet imagine that disclosures to the court revealed that Beal Savings Bank was the only original lender, and that the holders of the remaining 95\% had acquired their interests for mere pennies on the dollar. In such a case, the party with the greatest actual economic interest and greatest relative incurred or prospective losses would be Beal Savings Bank, and an argument can be made that its interests ought to be advanced to the greatest extent by the decisional outcome. The remaining lenders have not suffered actual losses, and their risk of prospective losses (in this case, an amount equal to their actual economic interests) pales in comparison to the actual and prospective losses faced by Beal Savings Bank.}

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

Courts must be empowered to engage in distributive and allocative functions that replicate the outcomes the parties would have reached but for the inefficiencies and sub-optimal allocations introduced when strict contractual terms are applied to present-day economic substance. Courts may continue to apply rules of contract interpretation to understand the relationships, rights and obligations established pursuant to the underlying credit documents; however, before assigning legal rights and remedies or economic surplus in accordance with contractual language, such assignments would be tested for "economic effect." For an allocation of legal rights, remedies or economic surplus set forth in the underlying credit documents to have economic effect, it must be consistent with the relative economic benefits and burdens borne by each party. Thus, for example, where underlying credit documents vest substantive rights in a party that bears no present-day economic interest in the financing arrangement, and parties with substantial present-day economic interests wish to proceed in a contrary manner, a court would be empowered to reallocate substantive rights accordingly, such that the substantive rights are exercised in a manner that has economic effect. Similarly, any economic surplus would be distributed in accordance with the actual economic interests of parties as disclosed to the court. In essence, an allocative model would remove incentives for rent-seeking behaviors and other forms of waste and distribute scarce resources in accordance with economic substance.

At first blush, application of allocative models in the financing realm may raise concerns of excessive meddling in financial affairs. However, an approach of this sort may in fact serve as a

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279 The "economic effect" test is applied in the context of the allocation of partnership items that impact the federal income taxation of partners. See § 704(a) of the Internal Revenue Code.

280 A more detailed description of the economic effect test as applied in the context of partnership allocations can be found in Treas. Reg. § 1.704-1(b)(2)(ii)(a).
better analogue to the analyses applied from within financial markets. For instance, when parties to commercial financing disputes restructure distressed debts outside of court, the process is not one of strict enforcement or rearticulation of each party's imputed expectations as of negotiating the credit documents. Rather, the process is one of allocating resources in accordance with the present-day economic substance of each party's claims. In particular, parties strive to maximize the borrower's income realization potential so that wealth can be transferred in an orderly manner to lenders in an effort to achieve the greatest satisfaction of outstanding obligations. To the extent any additional surplus can be made available, whether in the form of assets that can be sold or cash that can be freed by reducing expenses, then the loan is restructured to allow such income realization. If, in contrast, lenders resolved disputes pursuant to strict contract enforcement, then commercial loans would virtually always end in foreclosure or other judicial enforcement of remedies rather than consensual workouts. Indeed, allocative approaches are already used within the bankruptcy context with respect to matters arising beyond the

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282 For modeling of utility maximizing behavior by and among lenders, borrowers and regulators in the course of loan workouts, see Anna Meyendorff & Anjan V. Thakor, Designing Financial Systems in Transition Economies: Strategies for Reform in Central and Eastern Europe 7-36 (2002). Although the model applies specifically to transition economies, it reveals universal tendencies, such as that banks have an incentive to restructure in order to avoid having nonperforming loans in their loan portfolios.
283 “Sound workout programs begin with a complete understanding of all relevant information, as well as a realistic evaluation of the abilities of both the borrower and bank management.” Commercial Real Estate And Construction Lending Comptroller’s Handbook, OCC (2009).
284 Jun Chen & Yongheng Deng, Commercial Mortgage Workout Strategy and Conditional Default Probability: Evidence from Special Serviced CMBS Loans, University of Southern California Lusk Center for Real Estate Working Papers 6 (2003) (approximately half of commercial mortgage workout attempts result in a modification that continues the lending relationship, with the other half ending in legal enforcement of remedies or the borrower's bankruptcy).
scope of credit documents. Yet prevailing imperative-driven methodologies largely reject any such distributive or allocative models in the finance and lending context. The following section explores how a hypothetical court reconsidering *Beal* might incorporate these and related analytical constructs into an interpretive methodology that better advances the underlying normative goals of the certainty imperative.

**B. Beal Revisited Under a More Expansive Interpretive Methodology**

A hypothetical court, recognizing pursuant to a contract interpretation analysis that the underlying credit documents in *Beal* are ambiguous with respect to the consent threshold required to bar a lender from proceeding individually, might turn to a more expansive paradigm to reach an outcome that is likely to promote economic efficiency in respect of the present-day economic substance of the financing arrangement. Alternatively, to the extent the agreements are found to be unambiguous as a matter of law, a court might proceed to a more expansive analysis where such agreements allocate legal rights, remedies or economic surplus in a manner that lacks economic effect in the context of the dispute.

Upon identifying the present-day economic substance of each party’s claims pursuant to disclosures submitted to the court and a facts and circumstances inquiry, a hypothetical court would proceed to identify the potential utility-maximization of each alternative decisional outcome. To this end, the court might evaluate theoretical and empirical insights with respect to various consent mechanisms. For instance, scholarly material analyzing sovereign bond restructurings in the 1990s and early 2000s would

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286 A rich discussion of consent mechanisms, as well as the particular costs and benefits of each, can be found in classic political economy texts. The most noted example is James M. Buchanan & Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (1962).
be particularly relevant. Work produced in this area generally reveals that, setting aside transaction costs, collective action in multi-lender arrangements allows for more efficient renegotiation and restructuring of a borrower's obligations. In contrast, without any sort of collective action mechanism, each lender would be required to proceed individually to enforce remedies, thereby draining the borrower's assets due to the costs and delays associated with defending each suit. However, where a collective action mechanism employs a threshold that is easily satisfied, a moral hazard arises whereby the borrower has incentives to seek restructuring of debts that it might have otherwise satisfied according to original credit terms.

In comparing the utility maximizing potential of unanimous versus supermajority consent mechanisms, such literature identifies three broad problems associated with unanimous consent mechanisms in the debt restructuring context, which can be applied with some minor adjustment to the circumstances in Beal. First, there can be substantial transaction costs because lenders holding a small fractional interest must be reached, informed of the proposed restructuring and given an opportunity to respond. Second, in light of the heterogeneity of lender groups, it can be very difficult for any one restructuring arrangement to suit the needs of every

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289 The three problems described herein are modified from Haseler, Collective Action Clauses, supra note 287.

290 Syndicated financing arrangements often include not only traditional banking institutions, but also a range of nontraditional lenders, such as hedge funds, private equity funds, insurance companies, pension funds and investment divisions of large corporations. See Mark Brannum, Hedge Funds Make for Painful Bankruptcies, TEXAS LAWYER, Mar. 12, 2007.
lender; ironically, the arrangement which would advance the interests of every lender would most likely not generate relief to a distressed borrower.\(^{291}\) Further, when examined in light of Coasian economic theory,\(^{292}\) unanimous consent mechanisms invite rent-seeking behavior. In particular, there are obvious incentives for holdout by minority lenders, as a single fractional owner is in a position to demand benefits in exchange for consent. Such payoffs occur in the financing realm; for instance, the discovery of payments in exchange for minority lender consent was the subject of a 2010 case before the Fifth Circuit.\(^{293}\) As other lenders become aware of such arrangements, a classic prisoners' dilemma results, whereby the tendency to hold out creates an equilibrium that leaves all parties in a worse position.\(^{294}\)

The court would likely find that a supermajority consent mechanism is more apt to achieve the greatest overall net utility maximization. The court would then proceed to test the economic effect of such allocation. Here, the allocation is in respect of legal rights and remedies which are of a zero-sum nature. However, in disputes that involve contractual surplus, such surplus would be allocated in accordance with and in proportion to the actual economic interests of the parties in the financing arrangement, with any remaining surplus allocated to parties that did not make an economic investment in and were not party to the financing arrangement, but have suffered the greatest actual or prospective losses as a result of the deterioration in the financing arrangement. As a final step, the court might test the reasonableness of any decisional outcome by comparing the end result to that which


\(^{293}\) See Highland Crusader Offshore Partners LP v. LifeCare Holdings Inc., 377 Fed.Appx. 422 (5th Cir. 2010) (a borrower offered to pay an increased amendment fee to certain holdout lenders in exchange for consent to a loan modification).

would occur in the absence of judicial intervention. Essentially, this final step assures that the court's intervention does not substantially deviate from the course that is most likely to occur under an efficient market hypothesis, but merely removes the rent-seeking, contractual arbitrage and other inefficiencies that derive from the disparity between present-day economic realities and strict contractual rights.

Beyond the facts of Beal, this decisional paradigm would have great utility across a range of disputes that are presently decided under imperative-driven methodologies. For instance, similar disputes arise when a borrower has defaulted and might avoid bankruptcy if an accommodation can be obtained from lenders.\(^\text{295}\) Indeed, this was precisely the situation in the failed Chrysler debt restructuring negotiations,\(^\text{296}\) in which the company needed unanimous consent of its lenders to a $2 billion cash settlement in satisfaction of approximately $6.9 billion of indebtedness.\(^\text{297}\) The four largest lenders in the financing arrangement, holding approximately seventy percent of the outstanding indebtedness, agreed to the workout terms,\(^\text{298}\) but the remaining lenders refused and the company filed for Chapter 11 bankruptcy protection.\(^\text{299}\) In cases of this sort, borrowers sometimes proceed to Chapter 11 bankruptcy in an effort to obtain a so-called "cram down," whereby the bankruptcy court imposes a restructuring plan over the objections of minority lenders if certain requirements are met.\(^\text{300}\) Substantial utility maximization might be reached if, in lieu

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\(^{296}\) See supra notes 6 and 7 and accompanying text.


\(^{298}\) See id.

\(^{299}\) Shefali Anand, *Oppenheimer Fund Refused to Budge*, WAll St. J., May 2, 2009. Admonishing the lenders who declined to consent, President Obama stated, "I don't stand with those who held out when everyone else is making sacrifices." Id.

\(^{300}\) Under § 1129(b)(2)(A)(ii) of the Bankruptcy Code, a debtor may under certain circumstances "cram down" a plan notwithstanding rejection by a creditor class.
of a bankruptcy filing, a court could reduce a unanimous consent mechanism to that of a supermajority or simple majority consent mechanism, or reduce a supermajority consent mechanism to that of a simple majority. These outcomes would in many cases yield considerable utility maximization, and simply replicate the consent mechanism that is likely to be imposed on the lenders if the borrower seeks bankruptcy protection.

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

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For a thorough discussion of consent mechanisms in the bankruptcy context, see Bussel & Klee, Recalibrating Consent, supra note 259.

301 Unanimous consent mechanisms substantially limit restructuring options. For example, a British chemicals company required the unanimous consent of its lenders, and thus a restructuring proposal that garnered the approval of 81 percent of senior lenders and 90 percent of junior creditors could not proceed without litigation. Tom Freke, Lenders poised to take British Vita stake-sources, REUTERS, Mar. 13, 2009.

302 Such an outcome might have been useful in the situation of retail mall owner General Growth Properties Inc. One major news outlet announced that the company was "struggling to avoid filing for bankruptcy protection," as "a plan to defray payment on five series of bonds failed to secure sufficient bondholder support, sending its stock down as much as 10 percent." General Growth fails to win bondholder support, REUTERS, Mar. 30, 2009. The company filed for Chapter 11 bankruptcy protection the following month. See Ilaina Jonas, General Growth bankruptcy, REUTERS, June 9, 2009.

303 These so-called "technical defaults" are more likely to occur when industry downturns make it difficult for corporate borrowers to comply with financial covenants. See David Hahn, The Roles of Acceleration, 8 DePaul Bus. & Com. L.J. 229, 232-35 (2010).

304 "Failure to fund" cases demonstrate the importance of considering present-day economic circumstances, since in many cases it might be economically inefficient to compel lenders to continue to gain risk exposure. In cases of this sort, courts continue to construe the underlying loan documents, drawing upon procedural remedies to compel results dictated by the language. See Destiny USA Holdings, LLC v. Citigroup Global Markets Realty Corp., 889 N.Y.S.2d 793 (N.Y. 4th Dept. 2009) (ordering a commercial lender to fund advances to enable a borrower to complete construction).
venturer\textsuperscript{305} refusing to fund advances. Any corporate financial default can have profound implications for investors, including debt holders and equity shareholders, as well as customers, pensioners, employees, suppliers, creditors and even more remote parties, such as current or prospective tort claimants.\textsuperscript{306} Beyond the lending realm, this decisional paradigm would have great utility in circumstances such as the Lehman Brothers Chapter 11 case, in which the Lehman corporate family was party to more than ten thousand derivative contracts at the time of the bankruptcy filing, with more than 1.7 million transactions outstanding.\textsuperscript{307} In each case, the underlying contract contained language granting priority of payment upon the occurrence of an event of default, including the filing of a Chapter 11 bankruptcy.\textsuperscript{308} To the extent financing transactions are so interconnected, the consequences of default are only further magnified, and decisional outcomes that allocate rights, remedies and surplus in a manner that fails to comport with economic substance not only fail to promote stability and certainty in financial markets, but in fact introduce substantial instability and uncertainty.

Even more, in cases of this sort, where instability emerges from within markets, the judiciary can serve as a first line of defense against further market disruptions by providing flexible and responsive redress as arrangements begin to unravel. Courts that look strictly to underlying agreements pursuant to imperative-
driven methodologies miss such opportunities to contribute meaningful reforms to the law governing financial transactions.

VI: CONCLUSION

Existing jurisprudential norms in the financing realm, prompted by a pervasive rhetoric promising certainty and stability in financial markets, do not deliver on their promises and instead unnecessarily bar the judiciary from participating in law reform. The imperative's underlying goals must be divorced from methodological constraints so that richer analyses may be applied.

Some will of course disagree with my appraisal. Criticisms of more expansive judicial analyses have been articulated in the related areas of corporate and transactional law.309 The realm of corporate finance is not beyond the reach of similar arguments, as each substantive area of the law represents yet another showground for longstanding tensions between legal formalism and realism,310 and between contextual and textual approaches. The relatively uncharted realm of corporate finance remains fertile ground for these and countless other philosophical tensions. Additional interdisciplinary scholarly attention is needed in this area, particularly with respect to the relationship between market stability and the underlying normative value of legal certainty, the role of courts in financial markets, and the broader


interconnections among law reform, systemic risk and market efficiency. However, an undeniable certainty emerges: to the extent this realm is subjected to more expansive interpretive analyses, we can expect a lively and theoretically compelling discourse in the law of corporate finance.