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Transnational Fiduciary Law in Bond Markets

A *Case Study*

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5.1 INTRODUCTION

The aim of this chapter is twofold. First, it is a comparative study on the potential benefits and limitations of applying fiduciary law in a "hard case." This analysis is inductive in nature. It aims at contributing to a better understanding of fiduciary law doctrines in both common and civil law jurisdictions. Second, the chapter focuses on specific transnational processes that may shape fiduciary norms. In particular, it analyzes the influence of transnational private ordering on the establishment of fiduciary duties in state law.

Centering on a case study, the chapter discusses the legal aspects of "net-short debt investing" on global bond markets through the lens of transnational fiduciary law. Generally, the term "net-short" refers to the positioning of an investor who benefits as the price of a specific financial asset falls. Net-short debt investing is an increasingly popular investment strategy that enables bondholders (i.e., holders of a company's debt) to cash in on the default of the bond-issuing company by building up a net-short position in credit default swaps (Section 5.2). The strategy raises the question whether the net-short investor has a fiduciary duty of loyalty toward (1) the issuer of the bond, (2) other bondholders, and (3) the counterparty of the credit default swap (CDS) (Section 5.3). This legal question has a transnational dimension: large-scale bond sales do not only involve a number of different jurisdictions, but also heavily build on mechanisms of private ordering (Section 5.4).

The chapter argues that any legal conceptualization of net-short debt investing must consider this transnational dimension (Section 5.5). Specifically, the chapter will make the case that the concept of fiduciary duties should be interpreted with a view to facilitating mechanisms of transnational private ordering.

To make this argument, this chapter assesses a case study – the *Windstream v. Aurelius* dispute involving net-short debt investing – one that, at first glance, seems an unlikely candidate for the application of fiduciary norms. One thing is

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clear: The practice of net-short debt investing may have adverse effects on issuers of bonds, other bondholders, and credit default swap counterparties. Yet "hard" fiduciary law – that is, the domestic legal norms of common law and civil law countries that fiduciary theorists typically focus upon – is unlikely to apply fiduciary duties to net-short debt investing, leaving market participants largely without viable remedies. The picture may change, however, if we take seriously the transnational dimension of bond market cases such as *Windstream v. Aurelius*. Transnational bond markets are a prime example of transnational private ordering, one with a fiduciary dimension, as this chapter argues.

5.2 CASE STUDY: NET-SHORT DEBT INVESTING

The problems of net-short debt investing have received considerable media attention: the *Financial Times* opines that US companies face "a growing threat from activist investors," whereas others critically discuss the role of "hedge-fund debt cops."[1] Even more pointedly, an opinion piece in the *New York Times* claims, "What Hedge Funds Consider a Win Is a Disaster for Everyone Else."[2] What, then, is net-short debt investing? The phenomenon is well illustrated by the much-discussed *Windstream v. Aurelius* case, which was decided by a federal trial court in New York.[3]

The (stylized) facts of the case are as follows. In 2013, Windstream, a telecoms company, issued bonds in order to finance its operations. As is standard market practice, the bond documentation contained a number of so-called covenants. Bond covenants, as an instrument of creditor protection, are clauses that oblige the bond issuer to comply with certain financial ratios, such as a specific debt-to-earnings ratio, and to refrain from risky financial activities.[4] One of the bond covenants prohibited Windstream from transferring any assets to affiliated companies. Windstream violated this prohibition when it transferred a considerable number of its network services to a holding company in 2015, allegedly for regulatory purposes. Given this violation of a covenant, the bondholders, with a quorum of 25 percent,

[1] Sujeet Indap, *USA Inc. Faces Growing Threat from Activist Debt Investors*, FINANCIAL TIMES, Sept. 18, 2018, at 13; Mary Childs, *Windstream Dispute Highlights Aurelius' Role as a Hedge-Fund Debt Cop*, BARRON'S (Aug. 31, 2018), https://www.barrons.com/articles/windstream-dispute-highlights-aurelius-role-as-a-hedge-fund-debt-cop-1535750611.

[2] William D. Cohan, *What Hedge Funds Consider a Win Is a Disaster for Everyone Else*, N. Y. TIMES, May 12, 2019, at 19.

[3] US Bank Nat'l Association v. Windstream Services, LLC, No. 12-CV-7857 (JMF), 2019 WL 948120 (S.D.N.Y. Feb. 15, 2019). The case was brought by the indenture trustee, US Bank National Association, on behalf of the bondholders. The trusteeship arrangement between US Bank National Association and the bondholders raises no issues of fiduciary law in the case at hand.

[4] PHILIP R. WOOD, INTERNATIONAL LOANS, BONDS, GUARANTEES, LEGAL OPINIONS 69 (2d ed. 2007).

would have been entitled to declare an "event of default" after a sixty-day cure period and demand immediate repayment of the bonds (acceleration).[5]

However, the bondholders took no action after Windstream violated the covenant. Their decision not to act was in line with common bond market practice. Triggering an event of default and accelerating repayment of the bond is considered the bondholders' "nuclear option," as it almost invariably leads to the bankruptcy of the bond issuer. Thus, bondholders mostly use covenant violations as bargaining chips for adjusting the financial conditions of the bond and restructuring the company's debt rather than enforce the clauses by demanding immediate repayment (Section 5.4).

In this regard, the facts leading to the *Windstream v. Aurelius* dispute were unusual. Aurelius, a US hedge fund, bought 25 percent of the Windstream bonds in 2017 – that is, well after the covenant violation. It then took swift action by declaring an event of default and demanding immediate repayment of the bond, causing Windstream to fall into bankruptcy. Why did Aurelius act this way? It is hard to know from publicly available information. On one account, one based upon unproven market rumors, Aurelius had built a net-short position on Windstream's debt by buying credit default swaps worth ten times the amount of its bond exposure.[6] Thus, Windstream's default – which Aurelius had triggered itself (a so-called manufactured default) – allowed Aurelius to cash in on the credit default swaps. Aurelius effectively relied on the letter of the bond covenant in order to benefit from Windstream's bankruptcy.

Perhaps Aurelius was acting strategically in this way. Perhaps not. The most that one can say – and all that needs to be said for this chapter's argument – is that for Aurelius, such a strategy certainly would have made business sense. Whether it made sense from a broader economic perspective seems rather questionable, given that Windstream as the bond issuer (as well as its shareholders and employees), other bondholders and the counterparty of Aurelius' credit default swaps all stood to lose.[7] On the other hand, one could argue that broader market benefits in the form of deterrence effects for potential covenant violators achieved through Aurelius'

[5] Section 6.02 of the bond indenture provided that if an event of default occurs, "the Trustee or the Holders of at least 25% in principal amount of the then outstanding Notes may declare all the Notes to be due and payable immediately by notice in writing to the Issuers specifying the Event of Default."

[6] *See* Vincent S. J. Buccola, Jameson K. Mah, & Tai Zhang, *The Myth of Creditor Sabotage*, 81 U. Chi. L. Rev. 2029, 2072–80 (2020) (discussing market rumors and expressing reasonable doubts as to their veracity as well as to the plausibility of Aurelius' alleged "net-short" strategy).

[7] András Danis & Andrea Gamba, *Dark Knights: The Rise in Firm Intervention by CDS Investors*, WBS Finance Group Research Paper No. 265, argue that firm value is even enhanced by CDS investor intervention – at least to the extent that the CDS seller is induced to inject equity capital into the distressed firm.

"policing" role outweighed these individual losses.[8] As a matter of law, the question is what duties Aurelius had toward other market participants (Section 5.3). Both the economic and the legal assessment of the case, however, are contingent upon the structure of transnational bond markets and the reasonable expectations of market participants (Section 5.4). This chapter now turns to those topics, arguing that fiduciary law can play an important role in translating market structures and expectations into legal categories.

5.3 FIDUCIARY DUTIES: A COMPARATIVE ANALYSIS

As the *Windstream v. Aurelius* dispute shows, the legal implications of net-short debt investing concern at least three different relationships: those between bondholder and issuer, relationships within the group of bondholders, and relationships between bondholder and CDS counterparty. Different laws may apply to each of these relationships under conflict-of-laws rules. The legal framing of the relationships might particularly differ between common law and civil law jurisdictions.

5.3.1 *Between Bondholder and Issuer*

In the *Windstream v. Aurelius* dispute, the bonds were issued under New York law. Depending on the nationality of the issuer and the relevant market, bonds are subject to different applicable laws. For German companies, for example, it is not uncommon that bonds are issued under German law, even if the majority of investors is domiciled in other jurisdictions. In any case, the bond covenants will likely be based on transnational standard documentation.

5.3.1.1 Common Law

Under New York law, Windstream seemed to have no effective defense against Aurelius' action. In the New York Federal District Court's conclusions of law, Judge Furman reasoned that the court's "sole task is to enforce the Indenture's plain terms."[9] From a common law perspective, this approach was justified as a matter of general principles. Under the common law of contracts, "good faith does not envision loyalty to the contractual counterparty but rather faithfulness to the scope, purpose, and terms of the parties' contract."[10] There is no general doctrine of abuse of rights, but "if one has a right to do an act, then one can, in general, do it for

[8] On this mechanism, *see* Marcel Kahan & Edward Rock, *Hedge Fund Activism in the Enforcement of Bondholders Rights*, 103 NORTHWESTERN UNIVERSITY LAW REVIEW 281 (2009).

[9] US Bank Nat'l Association, 2019 WL 948120, at 23.

[10] ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC., 50 A.3d 434, 430–31 (Del. Ch. 2012).

whatever reason one wishes."[11] These general common law principles, however, do not control in the field of business law, where the Uniform Commercial Code (UCC), the model code for commercial transactions, expressly incorporates the principle of good faith.[12]

Thus, some courts and commentators have relied on the UCC's principle of good faith in order to establish lender liability in a wide array of banking law cases. In several decisions, US federal and state courts have held that a lender's right to accelerate or terminate a loan may only be exercised in good faith.[13] These decisions were mostly based on the state-law adoptions of section 1-309 of the UCC.[14] Under these standards, courts tend to allow the use of acceleration and termination provisions in loan contracts only as a "shield" rather than as a "sword."[15] Violations of good faith duties by the lender can give rise to contract claims for damages or potentially also tort-based lender liability.[16] Substantively, the duty of good faith imposes a standard of "commercial reasonableness" on the lender.[17] It seems highly questionable, however, whether such a standard would have prevented Aurelius from accelerating the repayment of the bond in our case. If we merely look at Windstream and Aurelius as two parties in a lending relationship, Aurelius did have a legitimate interest in enforcing the covenant after it was breached by Windstream.

[11] Jack Beatson, *Public Law Influences in Contract Law*, *in* Good Faith and Fault in Contract Law 266–67 (Jack Beatson & Daniel Friedmann eds., 1995) (quoting Allen v. Flood [1891] AC 1).

[12] On the doctrine of good faith under the UCC and its origins, *see* Imad D. Abyad, *Commercial Reasonableness in Karl Llewellyn's Uniform Commercial Code Jurisprudence*, 83 Virginia Law Review 429 (1997); Richard Danzig, *A Comment on the Jurisprudence of the Uniform Commercial Code*, 27 Stanford Law Review 621 (1974–75); Mitchell Franklin, *On the Legal Method of the Uniform Commercial Code*, 16 Law & Contemporary Problems 330 (1951); Moritz Renner, *From "The Study of Nature" to Systems Theory: Sociological Approaches in Commercial Law*, Ancilla Iuris 41, 50–51 (2020); James Whitman, *Commercial Law and the American Volk*, 97 Yale Law Journal 156 (1987).

[13] *See, e.g.*, State Nat'l Bank v. Farah Mfg. Co., 678 S.W.2d 661 (Tex. Ct. App. 1984); K.M.C. Co. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985).

[14] Tex. Bus. & Com. Code Ann. § 1.309 (West 2003) ("A term providing that one party or that party's successor in interest may accelerate payment or performance or require collateral or additional collateral 'at will' or when the party 'deems itself insecure,' or words of similar import, means that the party has power to do so only if that party in good faith believes that the prospect of payment or performance is impaired.").

[15] Brown v. Avemco Inv. Corp., 603 F.2d 1367 (9th Cir. 1979); *cf.* Cheryl Anderson, *Breach of Good Faith in Lending and Related Theories*, 64 N. D. L. Rev. 273, 313 (1988).

[16] Alan A. Blakeboro & Rex Heesemann, *Good Faith Duties and Tort Remedies in Lender Liability Litigation*, 15 W. St. U. L. Rev. 617 (1988); James Mabry Vickery, *A Special Relationship: The Use of the Duty of Good Faith and Fair Dealing to Impose Tort Damages in Contracts between Lender and Borrower*, 9 Rev. of Litig. 93 (1990). For a purely contracts-based solution, *see* Sandra Chutorian, *Tort Remedies for Breach of Contract: The Expansion of Tortious Breach of the Implied Covenant of Good Faith and Fair Dealing into the Commercial Realm*, 86 Colum. L. Rev. 377, 402–06 (1986).

[17] Jonathan K. Van Patten, *Lender Liability: Changing or Enforcing the Ground Rules*, 33 S. D. L. Rev. 387, 407 (1988).

Beyond the principle of good faith,[18] far-reaching duties of loyalty may be imposed on the parties when there is a fiduciary relationship between them[19] – that is, when one of the parties is a fiduciary and therefore "is under a duty to act for or give advice for the benefit of another upon matters within the scope of the relation."[20] In such a relationship, the fiduciary has specific obligations to the extent that the beneficiary "would be justified in expecting loyal conduct."[21] From this perspective, the legal conceptualization of the *Windstream v. Aurelius* dispute hinges on the question whether Aurelius was a fiduciary of Windstream and whether it had a fiduciary duty of loyalty to refrain from enforcing the bond covenant.

The particular question of bondholders' fiduciary duties toward an issuer has apparently not been discussed in banking law literature. The most relevant articles focus on the inverse situation. They ask – mostly from a corporate governance perspective – whether the management of the issuer has fiduciary duties toward bondholders.[22] *Windstream v. Aurelius*, however, seems much more closely related to relationships where fiduciary duties are imposed on a bank or other debt investors based on their particular role as a lender.

As there is no general doctrine of fiduciary duties in banking law, courts and commentators tend to assume fiduciary duties of banks only in two scenarios: if the bank acted as an agent or trustee, or if there is some "special circumstance" warranting an ad hoc application of fiduciary norms.[23] In the lending business, "special circumstances" typically refers to situations that deviate from the model of an arm's-length relationship between creditor and debtor.[24] Thus, banks as lenders have fiduciary duties toward the borrower if they have "control or an informational advantage over the borrower."[25] Most examples involve cases where banks acted outside of their usual lending role, for example, by giving advice that the borrower relied upon.[26]

[18] This complementarity reflects the origins of fiduciary law in equity. On this aspect, *see* Cecil J. Hunt, *The Price of Trust: An Examination of Fiduciary Duty and the Lender–Borrower Relationship*, 29 Wake Forest L. Rev. 719, 728–29 (1994).

[19] Beatson, *supra* note 11, at 267.

[20] Restatement (Second) of Torts, § 874 cmt. a (Am Law Inst. 1979).

[21] Deborah A. DeMott, *Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences*, 48 Ariz. L. Rev. 925, 936 (2006).

[22] *Cf.*, *e.g.*, David M. W. Harvey, *Bondholders' Rights and the Case for a Fiduciary Duty*, 65 St. John's L. Rev. 1023 (1991); George S. Corey, M. W. Marr Jr. & Michael F. Spivey, *Are Bondholders Owed a Fiduciary Duty?*, 18 Fla. St. Univ. L. Rev. 971 (1991).

[23] Andrew F. Tuch, *Fiduciary Principles in Banking*, *in* The Oxford Handbook of Fiduciary Law 125, 127 (Evan J. Criddle et al. eds., 2019); Hunt, *supra* note 19, at 739–50. However, there is an argument to be made that the lender-borrower relationship necessarily has fiduciary elements that give rise to corresponding duties, *cf.* Hunt, *supra* note 19, at 723–27.

[24] Tuch, *supra* note 24, at 127.

[25] *Id.* at 127–28.

[26] *See*, *e.g.*, Morris v. Resolution Trust Corp., 622 A.2d 708 (Me. 1993); Buxcel v. First Fidelity Bank, 601 N.W.2d 593 (S.D. 1999).

Does the *Windstream v. Aurelius* dispute fall under this category of cases? Arguably, yes. It might be a "special circumstance" that Aurelius, by virtue of holding 25 percent of the bonds, had particular leverage over Windstream, as it was able to trigger an event of default at will. On the other hand, however, Windstream itself had violated the bond covenant. Aurelius did not overstep the contractual boundaries of its role as a lender. To the contrary, it availed itself of a contractual right that expressly aimed at safeguarding its financial interests. Thus, under the common law, the case for establishing a fiduciary duty that would enjoin Aurelius from triggering a default seems rather weak. Even those who argue for a broad application of fiduciary duties in lending relationships do not discuss a restriction of the lender's termination rights.[27]

5.3.1.2 Civil Law

Had Windstream issued the bond under German law, the legal situation would have been quite different at the outset. As in most civil law jurisdictions, there is no elaborate doctrine of fiduciary duties in German law.[28] However, there are functional equivalents to such duties with a potentially much broader range of application. Like many civil law jurisdictions,[29] German law establishes a principle of "good faith and fair dealings" (section 242 *Bürgerliches Gesetzbuch*) for all contracts. Legal acts that run counter to this principle are void. At the same time, the law of contracts establishes a general duty to protect the other party's rights and interests in section 241(2) *Bürgerliches Gesetzbuch*. Violations of this duty can give rise to contractual claims for damages. These general clauses are open to different interpretations and are mostly given concrete substance on a case-by-case basis.

It is widely agreed, however, that the principle of good faith implies a far-reaching prohibition of the abuse of rights.[30] The prohibition is interpreted in a context-specific manner. For instance, relationships of agency and trust give rise to a strong duty of loyalty. By contrast, there are only minimal requirements of consistent behavior for transactional contracts.[31] Given its adaptability, the abuse-of-rights doctrine potentially has a very wide range of applications.

[27] Most notably Hunt, *supra* note 19, at 775–78.

[28] Thilo Kuntz, *Das Recht der Interessenwahrungsverhältnisse und Perspektiven von Fiduciary Law in Deutschland- zugleich ein Beitrag zum Verhältnis von öffentlichem Recht und Privatrecht am Beispiel der wertpapierhandelsrechtlichen Wohlverhaltenspflichten und der Geschäftsleiterhaftung*, *in* Festschrift für Karsten Schmidt zum 80. Geburtstag 761 (Katharina Boele-Woelki et al. eds., 2019).

[29] On the civil tradition of "good faith" and its role as a "legal irritant" in common law jurisdictions, *see* Gunther Teubner, *Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences*, 61 Mod. L. Rev. 11 (1998).

[30] *Cf.*, *e.g.*, Claudia Schubert, *§ 242*, *in* Münchener Kommentar zum Bürgerlichen Gesetzbuch paras. 199–202 (Franz Jürgen Säcker & Roland Rixecker eds., 9th ed. 2019).

[31] Christoph Kumpan, Der Interessenkonflikt im deutschen Privatrecht 100–03 (2014); Schubert, *supra* note 31, paras. 236–38 (2019). The details of the interrelation of

In banking law, it has specifically been discussed in the scholarly literature whether the principle of "good faith and fair dealings" can effectively enjoin a lender from demanding repayment in certain situations. This problem is often expressly framed as a question of the "fiduciary duties" (*Treuepflichten*) of the lender.[32] The doctrinal foundation of this argument differs from the common law approach to the extent that fiduciary duties are understood as a mere concretion of the general principle of good faith. In substance, however, many of the same considerations apply.

Most commentators agree that even a relationship bank – that is, a bank that has a long-standing business relationship with its customer – is free to terminate the credit line of its customer if the latter is in financial distress.[33] However, the special "fiduciary" role of the bank limits this freedom in two distinct ways. On the one hand, an outright abuse of rights is prohibited: A bank may not terminate a loan if the debtor can still be saved by an extension of the credit line, and if the termination does not even advance the bank's financial interests.[34] On the other hand, the bank may not behave in a self-contradictory way: If – based on past behavior – a debtor can reasonably expect his relationship bank to extend existing credit lines, these can only be terminated for compelling reasons.[35]

The *Windstream v. Aurelius* dispute falls under neither category. The termination of the bond by Aurelius was not outright abusive, as it did make business sense for Aurelius to terminate. Furthermore, Aurelius' behavior was not prima facie contradictory, as – individually – Aurelius did nothing to cause a legitimate expectation on Windstream's side that the bond covenant would not be enforced. Thus, a civil law perspective on the constellation will likely lead to the same results as the common law analysis.

5.3.2 *Within the Group of Bondholders*

It is more plausible that, by enforcing the bond covenant, Aurelius violated a fiduciary duty toward other bondholders. In both common law and civil law jurisdictions, the content and reach of mutual duties between lenders or

general contract law and the law of agency and trust are much disputed in detail. Its existence in principle, however, is widely accepted.

[32] Most notably, Claus-Wilhelm Canaris, *Kreditkündigung und Kreditverweigerung*, 143 ZHR 113, 116 (1979); more restrictively, Klaus Hopt, *Rechtspflichten der Kreditinstitute zur Kreditversorgung, Kreditbelassung und Sanierung von Unternehmen. Wirtschafts–und bankrechtliche Überlegungen zum deutschen und französischen Recht*, 143 ZHR 139, 159 (1979). On the further discussion, *see* Bankvertragsrecht, Vierter Teil paras. 137–39 (Stefan Grundmann & Moritz Renner eds., 5th ed. 2014).

[33] *Cf.* Bankvertragsrecht, *supra* note 33, para. 137.

[34] Hopt, *supra* note 33, at 162–63 (1979); Claus-Wilhelm Canaris, Bankvertragsrecht para. 1266 (2d ed. 1981).

[35] Canaris, *supra* note 35, at 125 (1979).

bondholders is highly controversial. Much depends on the conception of the legal relationship constituted by a group of investors: Is it merely contractual, or does a group of investors amount to some form of legal association? In the latter case, individual investors are more likely to be bound by specific fiduciary duties.

5.3.2.1 Common Law

In common law jurisdictions, it is widely held that investors do not form any kind of legal association that would give rise to specific mutual duties. The question has been discussed for syndicated lending in particular, where a number of lenders contribute individual shares to a large-scale corporate loan. Although earlier court decisions have not been unequivocal in this matter,[36] most commentators agree that – even in such cases – the arrangement between the lenders is "not a partnership, joint venture, or other association."[37] A fortiori, this also holds true for the relationship between bondholders, where the degree of cooperation between investors is usually much lower than in a syndicated loan. The market standard agreement issued by the International Capital Markets Association (ICMA) expressly provides – for the underwriting banks ("managers") – that "[n]one of the provisions of this Agreement or any other agreement relating to the Securities shall constitute or be deemed to constitute a partnership or joint venture between the Managers or any of them."[38]

Nevertheless, there are situations in which a lender or bondholder might have fiduciary duties toward other investors. This is most evident when the lender or bondholder acts as an agent or trustee of the other investors, a common practice for administering the outstanding debt and facilitating its repayment. Standard loan documentation often contains a disclaimer of fiduciary responsibilities for these functions.[39] The validity of such disclaimers is subject to dispute (Section 5.4).

With a view to the *Windstream v. Aurelius* dispute, however, it is worth noting that courts have discussed the existence of fiduciary duties between investors well beyond relationships of trusteeship and agency. Most notably, the English High Court in the *Redwood* case[40] discussed whether a majority of lenders has a fiduciary duty not to take a debt restructuring decision that would harm a minority of the lenders. The

[36] *See* Crédit Français Intl., S.A. v. Sociedad Financiera de Comercio, C.A., 128 Misc.2d 564, 581 (1985) (holding that a consortium of lenders constitutes a joint venture under New York law).

[37] Agasha Mugasha, The Law of Multi-Bank Financing. Syndicated Loans and the Secondary Loan Market para. 5.09 (2007) (with further references).

[38] Int'l Capital Mkt. Ass'n. *Standard Form Agreement Between Managers*, § 9 (Dec. 2018).

[39] *See, e.g.*, Loan Mkt. Ass'n., *Facility Agreement*, para. 28.5, provides that "[n]othing in any Finance Document constitutes the Agent or the Arranger as a trustee or fiduciary of any other person."

[40] Redwood Master Fund Ltd v. TD Bank Europe Ltd. [2006] 1 BCLC 149.

High Court held that this may, in fact, be the case – but only to the extent that the majority acts in bad faith and thus abuses the powers conferred to it.

Applied to *Windstream v. Aurelius*, the result of this "abuse of powers" standard is far from clear. When Aurelius used its 25 percent share of the bonds to declare an event of default and thus triggered Windstream's bankruptcy, other bondholders that had not sufficiently hedged their exposure were disadvantaged. But Aurelius' decision to do so was not taken with the purpose of disadvantaging other creditors. Without this subjective element, there is generally no abuse of powers – and thus no breach of a fiduciary duty.

5.3.2.2 Civil Law

In contrast to the common law approach, civil law jurisdictions like Germany consider a lenders' consortium to be a partnership.[41] As a result, they transpose the corporate law doctrine of fiduciary duties to the relationship between lenders.[42] However, most commentators clearly differentiate between loans and bonds. Whereas lenders contributing to a syndicated loan are widely regarded as forming a partnership, bondholders are not.[43] Therefore, fiduciary duties between bondholders do not reach beyond the minimum standard prohibiting an abuse of rights or self-contradictory behavior. As a result, Aurelius' behavior is to be judged much along the same lines as under the common law approach – and cannot be considered in breach of a fiduciary duty.

5.3.3 *Between Bondholder and CDS Counterparty*

CDS contracts are usually made under New York or English law, based on standard documentation by the International Swaps and Derivatives Association (ISDA).

[41] For German law, *see* Carsten Schäfer, *Vorb.* § 705, *in* Münchener Kommentar zum Bürgerlichen Gesetzbuch para. 58 (Franz Jürgen Säcker & Roland Rixecker eds., 7th ed. 2017); Andreas Diem & Christian Jahn, Akquisitionsfinanzierungen – Kredite für Unternehmenskäufe § 31 para 2 seq (4th ed. 2019); Kai Andreas Schaffelhuber & Frank Sölch, *in* Münchener Handbuch des Gesellschaftsrechts § 31 para. 9 (Hans Gummert & Lutz Weipert eds., 5th ed. 2019); Jens Wenzel, Rechtsfragen internationaler Konsortialkreditverträge 256 et seq. (2006). The question is highly disputed in French and Spanish law.

[42] For a critical account of the pertinent German law, *see* Moritz Renner, *Treupflichten beim grenzüberschreitenden Konsortialkredit*, Zeitschrift für Bankrecht und Bankwirtschaft 278, 285–87 (2018).

[43] *See, e.g.*, Christian Hofmann & Christoph Keller, *Collective Action Clauses*, 2011 ZHR 684, 718 (2011); Florian Leber, Der Schutz und die Organisation der Obligationäre nach dem Schuldverschreibungsgesetz 254 (2012). For a rare exception, *see* Philip Liebenow, Das Schuldverschreibungsgesetz als Anleiheorganisationsrecht und Gesellschaftsrecht § 14 (Jörn Axel Kämmerer et al. eds., 2016).

In the ISDA Master Agreement under English law, each party expressly represents that "[t]he other party is not acting as a fiduciary for or an adviser to it in respect of the Transaction."[44] This is in line with the typical risk allocation of a swap contract, where the parties clearly delineate their respective responsibilities. There is nothing to suggest that this disclaimer of fiduciary duties would be held unenforceable (see Section 5.4), either in a common or a civil law court.

In March 2019, the ISDA published a proposal to the ISDA Credit Derivatives Definitions that aimed to preclude "manufactured defaults" allowing investors to benefit from events of default.[45] However, these definitions only capture defaults that have been "manufactured" through a collusion of investor and issuer – another increasingly common practice spooking market participants.[46] It does not encompass defaults brought about by strategies of net-short debt investing such as the one employed by Aurelius.

At the same time, capital market regulators from different jurisdictions have discussed the issues of net-short debt investing and "manufactured defaults" as potential instances of market manipulation.[47] So far, their inquiries have not led to tangible results. Yet, it might prove to be an interesting test case for the idea of public fiduciary duties of capital market investors.

5.3.3.1 Interim Conclusion

Judged against general principles of common law and civil law, the *Windstream v. Aurelius* dispute is an unlikely case for applying fiduciary duties. Although the practice of net-short debt investing might have adverse effects on a range of market participants – the issuer of the bond, other bondholders, CDS counterparties – neither common law nor civil law consider it a breach of the investor's fiduciary duties. This leaves affected market participants largely without viable remedies against the practice.

5.4 THE TRANSNATIONAL DIMENSION OF FIDUCIARY LAW

This chapter suggests that we might reach a different conclusion if we take the transnational dimension of the case seriously. It argues that the bond market is a

[44] Int'l. Swaps & Derivatives Ass'n., *Master Agreement and Schedule*, Part 4 (m)(3) (2002).

[45] Int'l. Swaps & Derivatives Ass'n., *Proposed Amendments to the 2014 ISDA Credit Derivatives Definitions Relating to Narrowly Tailored Credit Events* (2019), https://www.isda.org/a/nyKME/20190306-NTCE-consultation-doc-complete.pdf (last accessed July 20, 2019).

[46] Joe Rennison, *Hovnanian Misses Bond Payment in Controversial "Manufactured Default,"* Financial Times (May 2018), https://www.ft.com/content/56c729b4-4da4-11e8-8a8e-22951a2d8493 (last accessed July 20, 2019).

[47] US Sec. & Exch. Comm'n [SEC], Press Release, *Joint Statement on Opportunistic Strategies in the Credit Derivatives Market* (June 24, 2019), https://www.sec.gov/news/press-release/2019-106 (last accessed July 7, 2019).

prime example for transnational private ordering. Against this background, it outlines a transnational approach to fiduciary law. Following this approach, it takes a fresh look at the justification and scope of fiduciary duties in both common and civil law jurisdictions. Specifically, it examines the potential of fiduciary law to "enable and bolster social norms"[48] formed in a transnational context.

5.4.1 *Transnational Ordering in the Bond Market*

5.4.1.1 Transnational Legal Orders

The concept of transnational law has always been contested. Until today, the discussion is dominated by two opposing camps – to the extent that the existence of transnational law is accepted at all.[49] On the one hand, there are authors in the tradition of Jessup who aim at developing a functional conception of transnational law as "all law which regulates actions or events that transcend national frontiers."[50] On the other hand, there are authors who make the case for a more rigorous definition of transnational law, often taking the ancient *lex mercatoria* as an example.[51]

The "wars of faith"[52] over the existence and nature of the medieval law merchant and its potential successors shall not be revisited in this chapter. For the chapter's purposes, it will suffice to acknowledge that there is a cornucopia of mechanisms of legal ordering – with differing degrees of public sector involvement – that are not limited to one national jurisdiction. For this chapter's purposes, several features of these phenomena are worth highlighting. First, a legal order is transnational when it transcends the boundaries between national and international law, such as when it is neither a creature of purely domestic or purely public international law, but rather interstate law that has effects within multiple states. Second, such ordering is transnational if it transcends the boundary between unity and fragmentation; that is, it does not form a self-sufficient legal order comparable to national legal systems. Finally, transnational legal orders (TLOs) may transcend the boundary between

[48] Matthew Harding, *Fiduciary Law and Social Norms*, *in* Criddle et al., *supra* note 24, 798.

[49] It is disputed, *e.g.*, by F. A. Mann, *Lex Facit Arbitrum*, *in* International Arbitration Liber Amicorum for Martin Domke 157 (Pieter Sanders ed., 1976); Michael Mustill, *The New Lex Mercatoria: The First Twenty-Five Years*, *in* Liber Amicorum for the Rt. Hon. Lord Wilberforce 149 (Maarten Bos & Ian Brownlie eds., 1987).

[50] Philip C. Jessup, Transnational Law 2 (1956); similarly Gralf-Peter Calliess & Moritz Renner, *Between Law and Social Norms: The Evolution of Global Governance*, 22 Ratio Juris 260 (2009); Gregory Shaffer, *Theorizing Transnational Legal Ordering*, 12 Ann. Rev. L. & Soc'y 231 (2016).

[51] Clive M. Schmitthoff, *International Business Law: A New Law Merchant*, *in* 2 Current Law and Social Problems 129 (1961); Berthold Goldman, *Frontières du droit et "lex mercatoria"*, 9 Archives de philosophie du droit 177 (1964).

[52] Gunther Teubner, *"Global Bukowina": Legal Pluralism in the World Society*, *in* Global Law without a State 3, 8 (Gunther Teubner ed., 1997).

public and private ordering; that is, they may involve mechanisms of private ordering that often rely on public enforcement mechanisms – for example, litigation in state courts.[53]

The elements of such orders are well captured by Halliday's and Shaffer's concept of transnational legal orders (TLOs).[54] TLOs constitute functional equivalents to state law in the dimensions of rulemaking, adjudication, and enforcement.[55] In these three dimensions, they involve legal norms, produced by or with legal bodies that transcend nation-states and are engaged with legal bodies within multiple nation-states..[56]

5.4.1.2 Ordering the Bond Market

(A) Formalized TLO Global bond markets are largely structured as a TLO in this sense. Bond issues heavily rely on standard documentation that is developed by industry associations such as the US-based Securities Industry and Financial and Markets Association (SIFMA) and the Zurich-based ICMA, as well as by globally active law firms. Whereas the SIFMA plays an important role in the market for bonds denominated in US dollar, the ICMA is the leading standard-setter for Euro-denominated bonds. The associations often work together, for example, on interest-rate benchmarks[57] and on standard agreements for the repo market.[58] The structure and function of both associations is similar; their membership is constituted by financial institutions from around the world.[59] The following remarks focus on the example of the ICMA.

Members of the ICMA, mostly banks and other market participants from more than sixty countries, work together in a number of committees in order to set standards for global primary and secondary bond markets. The ICMA's Legal and

[53] Moritz Renner, Zwingendes transnationales Recht: Zur Struktur der Wirtschaftsverfassung jenseits des Staates 215–28 (2011).

[54] Terence C. Halliday & Gregory Shaffer, *Transnational Legal Orders*, *in* Transnational Legal Orders 3 (Terence C. Halliday & Gregory Shaffer eds., 2015).

[55] Gralf-Peter Calliess et al., *Transformations of Commercial Law: New Forms of Legal Certainty for Globalized Exchange Processes?*, *in* Transforming the Golden Age Nation State 83 (Achim Hurrelmann et al. eds., 2007).

[56] Halliday & Shaffer, *supra* note 54, at 12–17. Who, however, seem to limit their definition to "formalized" legal "texts"; *see infra* note 61.

[57] Sec. Indus. & Fin. Markets Ass'n., *ISDA, AFME, ICMA, SIFMA and SIFMA AMG Launch Benchmark Transition Roadmap* (Feb. 1, 2018), https://www.sifma.org/resources/news/156924/ (last accessed Sept. 28, 2019).

[58] Int'l Capital Mkt. Ass'n., *Global Master Repurchase Agreement*, https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/repo-and-collateralmarkets/legal-documentation/global-master-repurchase-agreement-gmra/ (last accessed Sept. 28, 2019).

[59] In the case of the SIFMA and their respective subsidiaries in the United States, *see* Sec. Indus. & Fin. Markets Ass'n., *Member Directory*, https://www.sifma.org/about/member-directory/ (last accessed Sept. 28, 2019).

Documentation Committee consists of the heads and senior members of the legal transaction management teams of member firms. The standard documentation elaborated by the committee is intended as market "best practice." Its real impact on market practice can hardly be overestimated. As bonds are heavily traded on cross-border secondary markets, bond documentation needs to be highly standardized in order to generate a marketable financial instrument that is not limited to a single jurisdiction. Therefore, bond issuers usually stick closely to market standard provisions outlined in the ICMA's *Primary Market Handbook* when drafting the bond indentures.

The indentures will invariably contain a choice-of-law clause subjecting the bond to the jurisdiction of state courts. However, scope and detail of the bond indentures are such that there is usually not much room for resorting to rules of domestic law.

To the extent that fiduciary duties are assumed by one of the parties – for example, by the lead manager of a bond issue – they are expressly spelled out in the contract or a separate trust deed. If there is no mention of fiduciary duties, there is a high probability that market participants did not deem them necessary or conducive to the functioning of the bond market.

(B) Informal Rules in TLOs? At the same time, the practice of bond market participants is not determined by contract language alone. It is also embedded in different layers of relational and social norms.[60] These norms are often informal in nature. They are thus not clearly encompassed by Halliday's and Shaffer's concept of TLOs.[61] Yet such rules may structure whole fields of cross-border transactions. Empirical studies on industries as diverse as the international cotton trade and the global software industry have shown the high significance of informal norms of cooperation.[62]

Most actors in the bond market are repeat players. Global banks cooperate in different settings, as managers of a bond issue or as members of a financing

[60] On the concept of relational norms, *see generally* Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 Am. Soc. Rev. 55 (1963); Ian R. Macneil, *Relational Contract: What We Do and Do Not Know*, 3 Wis. L. Rev. 483 (1985); on the concept of social norms, *see* Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 The Journal of Legal Studies 115, 138 (1992); Robert C. Ellickson, Order Without Law: How Neighbors Settle Disputes (1991).

[61] *Cf.* Halliday & Shaffer, *supra* note 55, at 15–16.

[62] For the cotton trade, *see* Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation through Rules, Norms, and Institutions*, 99 Mich. L. Rev. 1724 (2001). Barak D. Richman, *Ethnic Networks, Extra-Legal Certainty, and Globalization: Peering into the Diamond Industry*, *in* Contractual Certainty in International Trade 31 (Volkmar Gessner ed., 2008); for the software industry, *see* Thomas Dietz, Global Order beyond Law: How Information and Communication Technologies Facilitate Relational Contracting in International Trade (Hugh Collins et al. eds., 2014).

consortium. In the course of cooperation, they form mutual, or relational, expectations of behavior. Many banks active in the primary market are also interested in a stable business relationship with the bond issuer. They know well that "continuity [of cooperation] can be put in jeopardy by defecting from the spirit of cooperation and reverting to the letter [of a formal contract]."[63] Thus, in the words of Ellickson, relational norms constitute an effective means of "second-party control" of behavior.[64]

On a wider scale, market participants feel obliged to a number of unwritten rules that are considered necessary for the functioning of the market as a whole. In Ellickson's taxonomy of private ordering, these norms can be termed mechanisms of "third-party control," as they extend well beyond bilateral relationships between market participants and can be enforced by third parties.[65] Sometimes, market participants comply with the unwritten rules of market practice out of mere self-interest. In most cases, they simply have nothing to gain from disruptive behavior. In other instances, market actors comply with the unwritten rules of the industry for fear of retribution by third parties. As in other industries, "black lists" and "white lists" are widely used in financial markets to exclude noncooperating players from future transactions.

Are there any unwritten rules of market practice that might influence the legal evaluation of the *Windstream v. Aurelius* dispute? Empirical research shows that creditors almost never accelerate a corporate loan or bond in case of a technical event of default.[66] They mostly refrain from doing so for fear of a domino effect: As soon as one creditor demands immediate repayment, others will follow suit and try to take hold of the borrower's assets.[67] Mandatory disclosure of the default will further impair the financial situation of the borrower. Bankruptcy then seems the all-but-inevitable consequence. Therefore, creditors usually coordinate in order to adapt financing conditions when a covenant has been breached, rather than declare an event of default and accelerate the loan or bond.[68] But can this – factual – standard behavior of bond creditors be regarded a transnational legal norm?

This question points to one of the eternal problems of legal theory, the distinction between law and social norms.[69] From a functional perspective, much is to be said for the proposition that behavioral norms become law as soon as they are integrated into the communicative structures of the legal system.[70] For the purposes of this chapter, the question does not need to be answered conclusively. Instead, I suggest

[63] Oliver E. Williamson, *The Economics of Governance*, 95 Am. Econ. Rev. 1, 2 (2005).
[64] On this terminology, *see* Ellickson, *supra* note 61, at 126–32.
[65] *Id.* at 126–32.
[66] Daniela Matri, Covenants and Third-Party Creditors 115–46 (2017).
[67] *Id.* at 130–32.
[68] For empirical evidence, *see id.* at 130–32.
[69] Calliess & Renner, *supra* note 51, at 262.
[70] *Id.* at 267–68.

that behavioral standards in the bond market can and should be reflected in the traditional categories of contract and fiduciary law doctrine (Section 5.4.3).

5.4.2 *Transnational Fiduciary Law*

This approach implies that the TLO that has emerged in the global bond market is not an autonomous legal system of its own that could be chosen as applicable law under conflict-of-laws rules. Instead, it constitutes and defines the legitimate expectations of the parties that form the basis of fiduciary duties in both common and civil law jurisdictions.

5.4.2.1 Transnational Fiduciary Law as Non-state Law

When standard contracts and usages in transnational bond markets are conceptualized as a legal order in its own right, it becomes possible for market participants to choose them as the law applicable to their contractual relations, based on general conflict-of-laws rules. As a consequence, the existence and scope of fiduciary duties would have to be discussed solely within the system of these privately made norms. The parties would be able to opt out of the relevant state law,[71] at least within the boundaries of international public policy.

It is disputed whether a choice of law can point to non-state law at all. In the US and UK literature, the question is hardly discussed at all.[72] In Continental Europe, there has been an intense debate on the matter.[73] However, it has been largely settled by the EU legislator. The wording of the relevant Article 3 Rome I Regulation and related provisions were put in a manner that limits the permissible choice of law to the "law of a country," while earlier drafts of the regulation had expressly allowed for a choice of non-state "rules of law."[74]

[71] *Cf.* Bernstein, *supra* note 61, at 154–57.

[72] Ralf Michaels, *The Re-State-ment of Non-State Law: The State, Choice of Law, and the Challenge from Global Legal Pluralism*, 51 Wayne Law Review 1209, 1210 et seq. (2005).

[73] Andreas Kappus, *"Lex mercatoria" als Geschäftsstatut vor staatlichen Gerichten im deutschen internationalen Schuldrecht*, IPRax 137(1993); Stefan Leible, *Parteiautonomie im IPR – Allgemeines Anknüpfungsprinzip oder Verlegenheitslösung?*, *in* Festschrift für Erik Jayme zum 70. Geburtstag 485, 490 (Heinz-Peter Mansel et al. eds., 2004); Johannes Christian Wichard, *Die Anwendung der UNIDROIT-Prinzipien für internationale Handelsverträge durch Schiedsgerichte und staatliche Gerichte*, 60 RabelsZ 269, 282 et seq. (1996).

[74] Ulrich Magnus, *Die Rom I-Verordnung*, IPRax 27, 33 (2010); Giesela Rühl, *Rechtswahlfreiheit im europäischen Kollisionsrecht*, *in* Die richtige Ordnung. Festschrift für Jan Kropholler zum 70. Geburtstag 187–89 (Dietmar Baetge ed., 2008); Stefan Leible & Matthias Lehmann, *Die Verordnung über das auf vertragliche Schuldverhältnisse anzuwendende Recht ("Rom I")*, RIW 528, 533 (2008).

5.4.2.2 Transnational Fiduciary Duties in State Law

Thus, even in a field that is largely determined by transnational legal ordering, such as the global bond market, the rights and obligations of market actors, including their fiduciary duties, are subject to state law. Yet, as I will argue, fiduciary duties under both common and civil law must be defined with a view to the transnational dimension of the social field concerned.

(A) Common Law There is no single overarching theory explaining the imposition of fiduciary duties under the common law.[75] A particularly convincing attempt at combining the relevant criteria set out by courts and commentators that shall be explored in this chapter has been developed by Finn and further elaborated by DeMott.[76] The approach has recently gained broader support among courts and commentators in Commonwealth countries.[77]

This approach argues, in brief, that fiduciary duties are based on "justifiable expectations of loyalty."[78] Both the identification of fiduciary relationships and the imposition of distinct fiduciary duties rely on this concept. As to the identification of a fiduciary relationship, Finn convincingly argues that it implies an assessment that "cannot be arrived at by any process of strict legal reasoning"[79]: "A variable mix of legal phenomena, factual phenomena, presumptions, and public policy, guide and structure the judgment made when a character is to be attributed to a relationship."[80]

The expectations-based approach is especially fruitful when applied to the "non-conventional, atypical, fact-based, and informal fiduciary relationships"[81] that might be at play in the *Windstream v. Aurelius* dispute. Conceptually, it ties in with the often-cited entry in Black's Law Dictionary, which defines the fiduciary relation as arising "whenever confidence is reposed on one side, and domination and influence result on the other; the relation can be legal, social, domestic, or merely personal."[82]

It is rare that fiduciary relationships arise alongside an existing contractual relationship.[83] Interestingly, however, Finn makes the case that specifically bank-

[75] For an overview of the current debate, *see* Paul B. Miller, *The Identification of Fiduciary Relationships*, *in* Criddle et al., *supra* note 24.

[76] Paul Finn, *Contract and the Fiduciary Principle*, 12 UNSW L. J. 76 (1989); DeMott, *supra* note 22, at 938. For an application of the approach to the field of investment law, *see* Andrew F. Tuch, *Investment Banks as Fiduciaries*, 29 Melbourne Univ. L. Rev. 478 (2005).

[77] Tuch, *supra* note 77, 482; DeMott, *supra* note 22 at 938.

[78] DeMott, *supra* note 22, at 934–38.

[79] Finn, *supra* note 77, at 83.

[80] *Id.* at 87.

[81] DeMott, *supra* note 22, at 940.

[82] *Fiduciary Relationship*, Black's Law Dictionary (10th ed. 2014). The definition has been considerably expanded in the 11th ed. 2019.

[83] Finn, *supra* note 77, at 94.

borrower relationships are prone to give rise to fiduciary relationships: Banks "are not charitable institutions" – yet, the transformation of bank-customer relationships over time, the complexity of financial transactions, and the social role of banks as performing "vital public services" generate justifiable expectations of behavior that are legally protected as a fiduciary relationship.[84]

These justifiable expectations also form the basis for the specific duties arising out of the fiduciary relationship. DeMott identifies a number of circumstances in which an actor has "justifiable expectations of loyalty" toward a potential fiduciary: Such expectations may arise "in the course of the parties' relationship over time," based on "an actor's evident allegiances," and in case of the beneficiary's "inability to self-protect."[85] Thus, DeMott's contribution points toward how sociological insights can inform the doctrine of fiduciary duties.

This chapter assumes that a sociologically informed approach to legal doctrine is desirable to the extent that it allows for a "reflexive law" – that is, legal norms that provide legal certainty and at the same time adapt to the circumstances of the social field they regulate.[86] DeMott's approach takes an important step in this direction. When she acknowledges the importance of "the course of the parties' relationship over time," this comes very close to sociological accounts of the function of "relational norms."[87] The concept effectively refers to the mutual expectations of behavior formed by the parties of a bilateral relationship that play a crucial role in transnational legal ordering.

These relational norms are often complemented with expectations of behavior that arise not from the bilateral relationship between two parties, but from the common usage of all market participants. A prime example of the effect of social "roles"[88]: When assuming a certain role, professional or otherwise, or when entering into a specific social field, actors are necessarily subject to a number of generalized expectations of behavior. A lawyer, for example, is expected to behave in a way that is loyal to the interests of her client – because she is a lawyer. In a similar manner, bond market participants are subject to a set of behavioral expectations that are formed by market practice. These generalized expectations play a decisive role in the *Windstream v. Aurelius* dispute, as will be shown later.

(B) Civil Law Despite its differing doctrinal framing, the civil law approach to fiduciary duties provides similar "points of entry" for expectations generated in

[84] *Id.* at 95.
[85] DeMott, *supra* note 22, at 941–48.
[86] *See generally* Gunther Teubner, *Substantive and Reflexive Elements in Modern Private Law*, 17 L. & Soc. Rev. 239 (1983). Specifically for transnational law, *see* Gralf-Peter Calliess, *Reflexive Transnational Law: The Privatisation of Civil Law and the Civilisation of Private Law*, 23 ZfRSoz 185 (2002).
[87] On the concept of "relational norms" in sociolegal studies, *see generally* Macaulay, *supra* note 61; MacNeil, *supra* note 61.
[88] DeMott, *supra* note 22 at 938–40.

settings of transnational private ordering.[89] Such a "point of entry" may be found in the prohibition of self-contradictory behavior that forms part of the German concept of fiduciary duties. Similar to the "justifiable expectations" test in the common law approach to fiduciary duties, the principle of consistency may build upon the relational as well as the generalized expectations of behavior held by the actors involved. German commentators expressly refer to the notion of "justifiable expectations" when it comes to spelling out the conditions of the abuse-of-rights doctrine and the prohibition of self-contradictory behavior.[90]

5.4.3 *Fiduciary Duties in the Bond Market Revisited*

What does this mean for the *Windstream v. Aurelius* dispute? How can fiduciary law reflect transnational legal ordering in bond markets? The answer turns on the concept of "justifiable expectations" that arguably forms the basis of the relevant doctrines in both common law and civil law jurisdictions. At the same time, it depends on relationship between formal and informal elements in TLOs. The formal rules in transnational standard documentation clearly imply the existence of – very limited – fiduciary duties of bondholders. They do foresee specific situations in which a bondholder might act as a fiduciary of other bondholders. These situations are limited to instances where a bondholder expressly assumes the role of a fiduciary, for example, when they act as an agent of the underwriting banks. In all other instances, bondholders are restrained by majority thresholds or quorums, not fiduciary duties.

In our case, the bond indenture permitted Aurelius to act on Windstream's covenant violation because Aurelius held 25 percent of the outstanding bonds. Thus, the formalized bond documentation created no expectation on part of other bondholders that Aurelius would not make use of its right to demand immediate repayment of the bond. To the contrary, the imposition of a fiduciary duty restraining Aurelius from doing so would run counter to the declared intentions of the parties.

Informal rules of transnational ordering make the matter more complicated. As market practice diverges from the black letter of the contract, so might the expectations of the parties. If almost all market participants refrain from enforcing bond covenants almost all of the time, this will necessarily give rise to the expectation that a particular covenant will not be enforced in this particular instance.

Is this expectation justifiable in the sense that it should be legally protected by the imposition of a fiduciary relationship and fiduciary duties of loyalty and/or care?

[89] On general clauses as a means of "socialization of contract," *see* Teubner, *supra* note 87, at 277.

[90] Dirk Olzen & Dirk Looschelders, § 242, *in* J. von Staudingers Kommentar zum Bürgerlichen Gesetzbuch para. 286 (2015).

This normative question cannot be reduced to a moral evaluation of the conflicting claims of the parties. Instead, it must be answered with a view to the functional rationality of the social field concerned.[91] That bondholders generally make use of covenants only in a coordinated manner is not by chance, and it is neither merely in their self-interest. The factual collectivization of acceleration rights also serves a broader purpose: It helps bondholders to overcome the collective action problem posed by the threat of a creditors' race. Only if bondholders refrain from accelerating their bonds individually, a solution that is sustainable for all investors can be found.

Thus, it seems highly plausible that both Windstream and other bondholders had a justifiable expectation that Aurelius would not accelerate the bond and cause Windstream's default. This justifiable expectation should be reflected by fiduciary law doctrine in both common and civil law jurisdictions. Conceptually, it can be framed as a good faith duty to act in accordance with the interests of the bond issuer as well as other bondholders – to the extent that these interests are substantiated in specific expectations of behavior.[92] Imposing a fiduciary duty on Aurelius to refrain from acceleration would also have a positive side effect on the swap market, as it would limit the potential for information arbitrage for CDS-insured bondholders.

However, imposing on Aurelius a fiduciary duty to refrain from accelerating the bond would mean that the informal expectations formed by participants in transnational markets would effectively render ineffective the formal rules laid down in transnational standard contracts. As these contracts aim at conclusively regulating the collective use of default clauses through majority and quorum requirements, they can be considered as a collective opt-out of fiduciary duties. Is such an opt-out permissible?

The question is highly controversial in both common law and civil law countries.[93] In settings of transnational legal ordering, the question needs to be addressed from a somewhat different perspective. If the purpose of fiduciary duties in this context is to preserve the functionality of TLOs, then the bar is set high for justifying the imposition of fiduciary duties on individual market participants. To the extent

[91] Gunther Teubner, *After Privatization? The Many Autonomies of Private Law*, 51 Current Legal Problems 393 (1998).

[92] On the role of the principle of good faith under civil law doctrines of fiduciary law, *see supra* Section 5.3.1.2; On the duty of good faith in the context of the fiduciary duty of loyalty in common law doctrine, *see* Andrew S. Gold, *The Fiduciary Duty of Loyalty*, *in* Criddle et al., *supra* note 24, 390–91.

[93] For US law, *see*, *e.g.*, Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 Stanford L. Rev. 211, 249–51 (1995). For legal comparative overviews of the debate, mostly from the perspective of company law, *see* Holger Fleischer & Lars Harzmeier, *Zur Abdingbarkeit der Treuepflichten bei Personengesellschaft und GmbH*, 18 NZG 1289 (2015); Alexander Hellgardt, *Abdingbarkeit der gesellschaftsrechtlichen Treuepflicht*, *in* Festschrift für Klaus J. Hopt zum 70. Geburtstag am 24. Aug. 2010: Unternehmen, Markt und Verantwortung 89 (Stefan Grundmann et al. eds., 2010); Maximilian Mann, Abdingbarkeit und Gegenstand der Gesellschaftsrechtlichen Treuepflicht 73–92 (Holger Fleischer et al. eds., 2018).

that formal rules of transnational legal ordering, such as standard contracts, are made and adapted in an inclusive and transparent procedure, it can be presumed that all relevant concerns are adequately reflected in the rules.[94] Accordingly, it should be left to the transnational rulemaking process to define the reach of fiduciary duties. If formalized transnational rules are silent on the matter, they may be complemented by informal expectations of behavior as default rules. If, in contrast, they clearly aimed at conclusively regulating the duties of market participants, there is no room for imposing fiduciary duties and, through the formalized rules of the standard contracts, market participants opt out of the default rules.

As a consequence, Windstream's claim against Aurelius would have to be dismissed under both common and civil law rules, as would have to be claims of other bondholders. Even though Windstream and other bondholders had a justifiable expectation based in transnational market practice that the bond would not be accelerated, the relevant transnational standard contracts effectively opt out of the bondholders' fiduciary duties.

5.5 CONCLUSION

Under traditional doctrines of fiduciary law in both common and civil law traditions, the practice of net-short debt investing is hard to capture. However, fiduciary law doctrine accepts that justified expectations giving rise to a fiduciary relationship may be formed not only in the bilateral relation between two parties but also in the wider setting of a market or social field. By translating these expectations into legal rights and obligations, fiduciary law can be a powerful tool for enabling and framing private ordering. In this sense, "transnational fiduciary law" stands for an approach that seeks to reinterpret existing doctrines of fiduciary law in light of the specific problems of cooperation arising in transnational settings. Both formal and informal elements of TLOs are thus reflected in the rules and principles of state law.

Under a transnational fiduciary law approach, strategies of net-short debt investing may amount to violations of the fiduciary duty of loyalty. They run counter to the justifiable expectation of bond issuer and other bondholders alike that default provisions in bond indentures are only enforced for securing or facilitating repayment of the bond. This informal expectation of behavior may complement the formalized rules of transnational standard contracts that structure global bond markets. However, market participants may also use standard contracts for collectively opting out of fiduciary duties.

[94] On the underlying "constitutionalization" of transnational legal orders, *see*, *e.g.*, Moritz Renner, *Occupy the System! Societal Constitutionalism and Transnational Corporate Accounting*, 20 INDIANA J. OF GLOBAL LEGAL STUD. 941 (2013).