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Transnational Fiduciary Law in Bond Markets: A Case Study

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Centering on a case study, this Article discusses the legal aspects of “net-short debt investing” on global bond markets through the lens of transnational fiduciary law. The aim of the Article is twofold. On the one hand, it is a comparative study on the potential and limitations of 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. On the other hand, the Article focuses on the specific challenges of fiduciary law in transnational settings. In particular, it analyses the influence of transnational private ordering on the establishment of fiduciary duties in state law. The Article makes the case that the concept of fiduciary duties should be interpreted with a view to facilitating mechanisms of private ordering.

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I. INTRODUCTION

The aim of this Article is twofold. On the one hand, it is a comparative study on the potential benefits and limitations of 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. On the other hand, the Article focuses on the specific challenges of fiduciary law in transnational settings. 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 Article 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 decreases. Net-short debt investing is an increasingly popular investment strategy which 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 (infra II). The strategy raises the question whether the net-short investor has a fiduciary duty of loyalty towards (1) the issuer of the bond, (2) other bondholders and (3) the counterparty of the credit default swap (infra III). This legal question has a transnational dimension: large-scale bond sales do not only involve a number of different jurisdictions; they also heavily build on mechanisms of private ordering (infra IV).

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

II. CASE STUDY: NET-SHORT DEBT INVESTING

The problems of net-short debt investing have recently received considerable media attention: the *Financial Times* sees *USA Inc.* 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

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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).

investing? The phenomenon is well illustrated by the much-discussed *Windstream v. Aurelius* case, which has recently been decided by a New York District Court.³ In short, 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 that Windstream transfers 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 %, would have been entitled to declare an “event of default” after a 60-day cure period and demand immediate repayment of the bonds (acceleration).⁵

However, the bondholders took no action after Windstream violated the covenant. This inactivity 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 (infra IV). In this regard, the *Windstream v. Aurelius* dispute is special. Aurelius, a US hedge fund, bought 25 % of the Windstream bonds in 2017, i.e. 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? According to unproven market rumors, Aurelius had simultaneously built a net-short position on Windstream’s debt by buying credit default swaps (CDS) worth 10 times the amount of its bond exposure. 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.

For Aurelius, this strategy certainly made business sense. Whether it made sense from a broader economic perspective seems rather questionable, given that

3. U.S. 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, U.S. Bank National Association, on behalf of the bondholders. The trusteeship arrangement between U.S. Bank National Association and the bondholders raises no issues of fiduciary law in the case at hand.

4. 3 PHILIP R. WOOD, INTERNATIONAL LOANS, BONDS, GUARANTEES, LEGAL OPINIONS § 5-001, at 69 (2d ed. 2007).

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.”

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. On the other hand, one could argue that broader market benefits in the form of deterrence effects for potential covenant violators achieved through Aurelius' "policing" role outweigh these individual losses. As a matter of law, the question is what duties Aurelius had towards other market participants (*infra* III). 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 (*infra* IV). This Article argues that fiduciary law can play an important role in translating market structures and expectations into legal categories.

III. 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: the relationships between bondholder and issuer (*infra* 1), within the group of bondholders (*infra* 2) as well as between bondholder, and CDS counterparty (*infra* 3). To each of these relationships, different laws may apply under conflict-of-laws rules. The legal framing of the relationships might particularly differ between common law and civil law jurisdictions.

A. 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 common 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 (*infra* IV).

1. Common Law

Under New York law, Windstream seemed to have no effective defense against Aurelius' strategy. In the District Court's conclusions of law, Judge Furman elaborates that the court's "sole task is to enforce the Indenture's plain terms."⁶ From a common law perspective, this approach seems justified in principle. 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."⁷ 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 whatever reason one

6. U.S. Bank Nat'l Association, 2019 WL 948120, at 23.

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

wishes.”⁸ These general considerations, however, are of limited import in the field of business law, where the Uniform Commercial Code (U.C.C.) as the model code for commercial transactions expressly incorporates the principle of good faith.

Thus, some courts and commentators have relied on the principle of good faith in order to establish lender liability in a wide array of banking law cases. In several decisions, both federal and state courts have held that a lender’s right to accelerate or terminate a loan may only be exercised in good faith.⁹ These decisions were mostly based on the state-law adoptions of sec. 1-309 U.C.C.¹⁰¹¹ Under these standards, courts tend to allow the use of acceleration and termination provisions in loan contracts only as a “shield” rather than a “sword.”¹² Violations of good faith duties by the lender can give rise to contract claims for damages or potentially also tort-based lender liability.¹³ Substantively, the duty of good faith imposes a standard of “commercial reasonableness” on the lender.¹⁴ It seems highly questionable, however, whether such a standard would have enjoined 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.

Beyond the principle of good faith,¹⁵ far-reaching duties of loyalty may be imposed on the parties when there is a fiduciary relationship between the parties,¹⁶ i.e. when one of the parties “is under a duty to act for or give advice for the benefit of another upon matters within the scope of the relation.”¹⁷ In such a relationship, the fiduciary has specific obligations to the extent that the beneficiary “would be

8. 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).

9. *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).

10. 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.”).

11. *E.g.*, TEX. BUS. & COM. CODE ANN. § 1.208 (West 2003).

12. *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).

13. 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).

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

15. 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).

16. Beatson, *supra* note 8, at 267.

17. RESTATEMENT (SECOND) OF TORTS, § 874 cmt. a (AM LAW INST. 1979).

justified in expecting loyal conduct.”¹⁸ From this perspective, the legal evaluation 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 towards the issuer has apparently not been discussed in banking law literature. Most related articles focus on the inverse situation. They ask—mostly from a corporate governance perspective—whether the management of the issuer has fiduciary duties towards bondholders.¹⁹ Our case, however, seems much more closely related to constellations 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 if either the bank acted as an agent/trustee or under “special circumstances.”²⁰ In the lending business, “special circumstances” mostly refer to situations that deviate from the model of an arm’s length relationship between creditor and debtor.²¹ Thus, banks as lenders have fiduciary duties towards the borrower if they have “control or an informational advantage over the borrower.”²² Most examples in point concern cases where banks acted outside of their usual lending role, e.g. by giving advice that the borrower relied upon.²³

Does the *Windstream v. Aurelius* dispute fall under this category of cases? It might be argued that a “special circumstance” could be that Aurelius, by virtue of holding 25 % of the bonds, had particular leverage over Aurelius 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. Quite to the contrary, it availed itself of a contractual right that expressly aimed at safeguarding its financial interests. Thus, 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.²⁴

18. Deborah A. DeMott, *Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and their Consequences*, 48 ARIZ. L. REV. 925, 936 (2006).

19. *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).

20. 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 15, 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 15, at 723–27.

21. Tuch, *supra* note 20, at 127.

22. *Id.* at 127–28.

23. *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).

24. Most notably Hunt, *supra* note 15, at 775–78.

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.²⁵ However, there are functional equivalents to such duties with a potentially much broader range of application. Like many civil law jurisdictions,²⁶ German law establishes a principle of “good faith and fair dealings” (sec. 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 sec. 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 substantiated 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.²⁷ The prohibition is interpreted in a context-specific manner, so that, e.g. relationships of agency and trust give rise to a strong duty of loyalty, whereas there are only minimal requirements of consistent behavior for transactional contracts.²⁸ On this basis, the abuse-of-rights doctrine potentially has a very wide range of applications.

In banking law, it has specifically been discussed 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.²⁹ 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 is free to terminate the credit line of its customer if the latter is in financial distress.³⁰ However, the

25. 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).

26. 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).

27. Cf. e.g., Claudia Schubert, § 242, in MÜNCHENER KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH paras. 199–202 (Franz Jürgen Säcker & Roland Rixecker eds., Beck 9th ed. 2019).

28. CHRISTOPH KUMPAN, DER INTERESSENKONFLIKT IM DEUTSCHEN PRIVATRECHT 100–03 (Mohr Siebeck ed., 2014); Schubert, *supra* note 27, paras. 236–38 (2019). The details of the interrelation of general contract law and the law of agency and trust are much disputed in detail. Its existence in principle, however, is widely accepted.

29. 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., De Gruyter 5th ed. 2014).

30. Cf., BANKVERTRAGSRECHT, *supra* note 29, para. 137.

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.³¹ 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.³²

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.

B. Within the Group of Bondholders

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

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,³³ most commentators agree that –even in such cases– the arrangement between the lenders is “not a partnership, joint venture, or other association.”³⁴ 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

31. Hopt, *supra* note 29, at 162–63 (1979); CLAUD-WILHELM CANARIS, *BANKVERTRAGSRECHT*, para. 1266 (De Gruyter 2d ed. 1981).

32. CANARIS, *supra* note 31, at 125 (1979).

33. 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).

34. AGASHA MUGASHA, *THE LAW OF MULTI-BANK FINANCING. SYNDICATED LOANS AND THE SECONDARY LOAN MARKET* para. 5.09 (Oxford Univ. Press. 2007) (with further references).

constitute or be deemed to constitute a partnership or joint venture between the Managers or any of them.”³⁵

Nevertheless, there are situations in which a lender or bondholder might have fiduciary duties towards 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.³⁶ The validity of such disclaimers is subject to dispute (infra IV).

With a view to the *Windstream v. Aurelius* dispute, however, it is most interesting to note that courts have discussed the existence of fiduciary duties between investors well beyond constellations of trusteeship and agency. Most notably, the English High Court in the *Redwood* case³⁷ discussed whether a majority of lenders is enjoined by fiduciary duties from taking a (debt restructuring) decision that would be harmful to a minority of the lenders. The High Court held that this may in fact be the case – but only if the majority acts in bad faith and thus abuses the powers conferred to it. Applied to our case, the result of this “abuse of powers” standard is far from clear. When Aurelius used its 25 % 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 no abuse of powers – and thus no breach of a fiduciary duty.

2. Civil Law

In contrast to the common law approach, civil law jurisdictions like Germany consider a lenders’ consortium to be a partnership.³⁸ As a result, they transpose the corporate law doctrine of fiduciary duties to the relationship between lenders.³⁹ However, most commentators clearly differentiate between loans and bonds. Whereas lenders contributing to a syndicated loan are widely regarded as forming a

35. Int’l Capital Mkt. Ass’n. *Standard Form Agreement Between Managers*, § 9 (Dec. 2018).

36. For example, 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.”

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

38. For German law, see Carsten Schäfer, in *MÜNCHENER KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH*, Vorbem. § 705 para. 58 (Franz Jürgen Säcker & Roland Rixecker eds., Beck 7th ed. 2017); ANDREAS DIEM & CHRISTIAN JAHN, *AKQUISITIONSFINANZIERUNGEN – KREDITE FÜR UNTERNEHMENSKÄUFE* § 31 para 2 seq (Beck 4th ed. 2019); Kai Andreas Schaffelhuber & Frank Sölch, in *MÜNCHENER HANDBUCH DES GESELLSCHAFTSRECHTS*, § 31 para. 9 (Hans Gummert & Lutz Weipert eds., Beck 5th ed. 2019); JENS WENZEL, *RECHTSFRAGEN INTERNATIONALER KONSORTIALKREDITVERTRÄGE* 256 et seq. (Nomos ed. 2006). The question is highly disputed in French and Spanish law.

39. 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).

partnership, bondholders are not.⁴⁰ 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 to be in breach of a fiduciary duty.

C. 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). 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.”⁴¹ 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 below IV), either in a common or a civil law court.

In March, the ISDA has published a proposal to the ISDA Credit Derivatives Definitions that intends to preclude “manufactured defaults” allowing investors to benefit from events of default.⁴² However, these definitions only capture defaults that have been “manufactured” through a collusion of investor and issuer – another increasingly common practice spooking market participants.⁴³ 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.⁴⁴ 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.

40. 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 (Nomos ed. 2012). For a rare exception, see PHILIP LIEBENOW, *DAS SCHULDVERSCHREIBUNGSGESETZ ALS ANLEIHEORGANISATIONSRECHT UND GESELLSCHAFTSRECHT* § 14 (Jörn Axel Kämmerer et al. eds., Mohr Siebeck ed. 2016).

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

42. 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).

43. Joe Rennison, *Homanian 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).

44. U.S. 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).

D. *Interim Conclusion*

The *Windstream v. Aurelius* dispute is a hard 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.

IV. THE TRANSNATIONAL DIMENSION OF FIDUCIARY LAW

This Article 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 prime example for transnational private ordering (infra 1). Against this background, it outlines a transnational approach to fiduciary law (infra 2). Following this approach, it takes a fresh look at the justification and scope of fiduciary duties in both common and civil law jurisdictions (infra 3). Specifically, it examines the potential of fiduciary law to “enable and bolster social norms”⁴⁵ formed in a transnational context.

A. *Transnational Ordering in the Bond Market*

1. *Transnational Legal Orders*

The concept of transnational law has always been contested. Until today, the discussion is dominated by two opposing camps – as far as the existence of transnational law is accepted at all.⁴⁶ 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.”⁴⁷ 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.⁴⁸

The “wars of faith”⁴⁹ over the existence and nature of the medieval law merchant and its potential successors shall not be revisited in this Article. For the

45. Matthew Harding, *Fiduciary Law and Social Norms*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW 798 (Evan J. Criddle et al. eds., 2019).

46. It is disputed, for example, 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).

47. PHILIP C. JESSUP, *TRANSNATIONAL LAW* 2 (Yale Univ. Press. 1956); similarly Graf-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).

48. 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).

49. Gunther Teubner, *‘Global Bukovina’: Legal Pluralism in the World Society*, in GLOBAL LAW WITHOUT A STATE 3, 8 (Gunther Teubner ed., 1997).

Article's purposes it will suffice to acknowledge that there is a cornucopia of private ordering mechanisms – with differing degrees of public sector involvement – that are not limited to one national jurisdiction. These phenomena can be termed transnational to the extent that they transcend the boundaries

between national and international law: they are neither creatures of domestic nor of public international, i.e. inter-state, law,

between unity and fragmentation: they do not form a self-sufficient legal order comparable to national legal systems, and

between public and private ordering: they are heavily based on mechanisms of private ordering, but often rely on public enforcement mechanisms, e.g. through state courts.⁵⁰

The elements of such orders are well captured by *Halliday's* and *Shaffer's* concept of transnational legal orders (TLO).⁵¹ TLOs constitute functional equivalents to state law in the dimensions of rule-making, adjudication and enforcement.⁵² 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.⁵³

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 Markets Association (SIFMA) and the Zurich-based ICMA. Whereas the SIFMA seems to play 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, e.g. on interest-rate benchmarks⁵⁴ and on standard agreements for the repo market⁵⁵. The structure and function of both associations is similar, their

50. MORITZ RENNER, ZWINGENDES TRANSNATIONALES RECHT. ZUR STRUKTUR DER WIRTSCHAFTSVERFASSUNG JENSEITS DES STAATES 215–28 (Nomos ed. 2011).

51. Terence C. Halliday & Gregory Shaffer, *Transnational Legal Orders*, in TRANSNATIONAL LEGAL ORDERS 3 (Terence C. Halliday & Gregory Shaffer eds., 2015).

52. Graf-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).

53. Halliday & Shaffer, *supra* note 51, at 12–17. Who, however, seem to limit their definition to “formalized” legal “texts,” see *infra* note 58.

54. 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/1569_24/ (last accessed Sept. 28, 2019).

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

membership is constituted by financial institutions from around the world.⁵⁶ The following remarks focus on the example of the ICMA.

Members of the ICMA, mostly banks and other market participants from more than 60 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 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 the market standard provisions outlined in the ICMA "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. Rights and duties of the parties are effectively determined by the transnational rules that are elaborated and continuously updated by the ICMA.

To the extent that fiduciary duties are assumed by one of the parties, e.g. 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 the relevant ICMA committees did not deem them necessary or conducive to the functioning of the bond market.

b. Informal Rules in TLOs?

At the same time, it is important to note that 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.⁵⁷ These norms are often informal in nature. They are thus not clearly encompassed by *Halliday's* and *Shaffer's* concept of TLOs.⁵⁸ Yet such rules may structure whole fields of cross-border transactions. Empirical studies on industries as diverse as the international cotton trade and the

56. 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).

57. 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* (Harvard Univ. Press 1991).

58. *Cf.* Halliday & Shaffer, *supra* note 51, at 15–16.

global software industry have shown the high significance of informal norms of cooperation.⁵⁹

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 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].”⁶⁰ Thus, in the words of R. Ellickson, relational norms constitute an effective means of “second-party control” of behavior.⁶¹

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.⁶² 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 non-cooperating 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.⁶³ 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.⁶⁴ 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

59. 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., Hart 2014).

60. Oliver E. Williamson, *The Economics of Governance*, 95 AM. ECON. REV. 1, 2 (2005).

61. On this terminology see ELLICKSON, *supra* note 57, at 126–32.

62. *Id.* at 126–32.

63. DANIELA MATRI, COVENANTS AND THIRD-PARTY CREDITORS 115–46 (Springer Int'l. Publ'g. AG 2017).

64. *Id.* at 130–32.

an event of default and accelerate the loan or bond.⁶⁵ But can this – factual – standard behavior of bond creditors be regarded a transnational legal norm?

This question points to the one of the eternal problems of legal theory, the distinction between law and social norms.⁶⁶ 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.⁶⁷ For the purposes of this Article, the question does not need to be answered conclusively. Instead, I suggest that behavioral standards in the bond market can and should be reflected in the traditional categories of contract and fiduciary law doctrine (*infra* IV.2.b).

B. Transnational Fiduciary Law

This approach implies that the transnational legal order 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 (*infra* a). 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 (*infra* b).

1. Transnational Fiduciary Law as Non-state Law

If standard contracts and usages in transnational bond markets were defined as a legal order in its own right, market participants might conceivably 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,⁶⁸ 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.⁶⁹ In Continental Europe, there has been an intense debate on the matter.⁷⁰ However, it has been largely settled by the EU legislator. The wording of the relevant Art. 3 Rome I Regulation and related provisions were put in a manner that limits the permissible

65. For empirical evidence see *id.* at 130–32.

66. Calliess & Renner, *supra* note 47, at 262.

67. *Id.* at 267–68.

68. *Cf.* Bernstein, *supra* note 57, at 154–57.

69. 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).

70. 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).

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.”⁷¹

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.⁷² A particularly convincing attempt at combining the relevant criteria set out by courts and commentators that shall be explored in this Article has been developed by Paul Finn and further elaborated by Deborah DeMott.⁷³ The approach has recently gained broader support among courts and commentators in Commonwealth countries.⁷⁴

This approach argues, in brief, that fiduciary duties are based on “justifiable expectations of loyalty.”⁷⁵ 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, Paul Finn convincingly argues that it implies an assessment that “cannot be arrived at by any process of strict legal reasoning.”⁷⁶ “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.”⁷⁷

The expectations-based approach is especially fruitful when applied to the “non-conventional, atypical, fact-based, and informal fiduciary relationships”⁷⁸ 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

71. 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).

72. For an overview of the current debate see Paul B. Miller, *The Identification of Fiduciary Relationships*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW (Evan J. Criddle et al. eds., 2019).

73. Paul Finn, *Contract and the Fiduciary Principle*, 12 UNSW L. J. 76 (1989); DeMott, *supra* note 18, 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).

74. Tuch, *supra* note 73, 482; DeMott, *supra* note 18 at 938.

75. DeMott, *supra* note 18, at 934–38.

76. Finn, *supra* note 73, at 83.

77. *Id.* at 87.

78. DeMott, *supra* note 18, at 940.

influence result on the other; the relation can be legal, social, domestic, or merely personal.”⁷⁹

It is rare that fiduciary relationships arise alongside an existing contractual relationship.⁸⁰ Interestingly, however, Paul Finn makes the case that specifically bank-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.⁸¹

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” towards 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.”⁸² *DeMott’s* contribution to the discussion is both exemplary and particularly important because it –maybe unknowingly– indicates how sociological insights can inform the doctrine of fiduciary duties.

This Article assumes that a sociologically informed approach to legal doctrine is desirable to the extent that it allows for a “reflexive law,” i.e. legal norms that provide legal certainty and at the same time adapt to the circumstances of the social field they regulate.⁸³ Professor *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” (supra IV.1.b.2). 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 is the effect of social “roles:”⁸⁴ 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

79. *Fiduciary Relationship*, BLACK’S LAW DICTIONARY (10th ed. 2014). The definition has been considerably expanded in the 11th ed. 2019.

80. Finn, *supra* note 73, at 94.

81. *Id.* at 95.

82. DeMott, *supra* note 18, at 941–48.

83. See generally Gunther Teubner, *Substantive and Reflexive Elements in Modern Private Law*, 17 L. & SOC. REV. 239 (1983). Specifically for transnational law, see Galf-Peter Calliess, *Reflexive Transnational Law. The Privatisation of Civil Law and the Civilisation of Private Law*, 23 ZFRSOZ 185(2002).

84. DeMott, *supra* note 18 at 938–40.

formed by market practice. These generalized expectations play a decisive role in the *Windstream v. Aurelius* dispute, as will be shown below (infra IV.2.b.2).

b. Civil Law

In spite of its differing doctrinal framing, the civil law approach to fiduciary duties provides similar “points of entry” for expectations generated in settings of transnational private ordering.⁸⁵ 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 (supra II.1.b). Similar to the “justifiable expectations” test in the common law approach to fiduciary duties (supra IV.2.b.1), 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.⁸⁶

C. 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 transnational legal orders. The formal rules in transnational standard documentation are rather clear on the existence of 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, e.g. 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 % 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 (supra II). Quite to the contrary, the imposition of a fiduciary duty restraining Aurelius from doing so would run counter to the declared intentions of the parties.

However, matters become more complicated when we take into account the informal rules of transnational ordering that are at play here. 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

85. On general clauses as a means of “socialization of contract” see Teubner, *supra* note 83, at 277.

86. Dirk Olzen & Dirk Looschelders, *in* J. VON STAUDINGERS KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH § 242, para. 286 (De Gruyter ed. 2015).

almost all of the time (supra IV.1.b.2), 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? This normative question cannot be reduced to a –necessarily arbitrary– 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.⁸⁷ 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 has to 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.⁸⁸ However, 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 trump 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 discourse.⁸⁹ In settings of transnational legal ordering, the question needs to be

87. Gunther Teubner, *After Privatization? The Many Autonomies of Private Law*, 51 CURRENT LEGAL PROBLEMS 393 (1998).

88. On the role of the principle of good faith under civil law doctrines of fiduciary law see *supra* III.1.b; 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 THE OXFORD HANDBOOK OF FIDUCIARY LAW 390–91 (Evan J. Criddle et al. eds., 2019).

89. For U.S. law see, for example, 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 Treupflichten bei Personengesellschaft und GmbH*, 18 NZG 1289(2015); Alexander Hellgardt, *Abdingbarkeit der gesellschaftsrechtlichen Treupflicht*, 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 GESEL.

addressed from a somewhat different perspective. If the purpose of fiduciary duties in this context is to preserve the functionality of transnational legal orders, then the bar is set high for justifying the imposition of fiduciary duties on individual market participants. To the extent 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.⁹⁰ 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 has 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.

V. CONCLUSION

Under traditional doctrines of fiduciary law in both the common and the civil law tradition, 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, it can be a powerful tool for enabling and framing private ordering. In this sense, "transnational fiduciary law" stands for an approach that seeks to re-interpret existing doctrines of fiduciary law in light of the specific problems of cooperation arising in transnational settings. Both formal and informal elements of transnational legal orders 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

LSCHAFTSRECHTLICHEN TREUEPFLICHT 73–92 (Holger Fleischer et al. eds., Duncker & Humblot 2018).

⁹⁰ On the underlying "constitutionalization" of transnational legal orders see, for example, Moritz Renner, *Occupy the System! Societal Constitutionalism and Transnational Corporate Accounting*, 20 INDIANA J. OF GLOBAL LEGAL STUD. 941 (2013).

markets. However, market participants may also use standard contracts for collectively opting out of fiduciary duties.