THE LOST PROMISE OF PRIVATE ORDERING

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The agency problem is corporate law's most enduring challenge: when corporate managers spend investors' money, how does the law protect investors from reckless management? Scholars of law, finance, and accounting have suggested that in one corner of corporate law—corporate debt—a powerful tool exists to mitigate the agency problem. Specifically, through loan covenants, lenders can force borrowers to comply with lenders' preferences, thereby mitigating the agency problem in lending.

But loan covenants are disappearing. Over the last decade, loan covenants have become fewer and skinnier, and so called "covenant-lite" or "cov-lite" loans have become dominant. If loan covenants do such a good job of mitigating agency costs, why have lenders willingly parted with them?

This Article attempts to unravel the puzzle of disappearing covenants, and makes three contributions to literatures in law, finance, and accounting. First, using an original, hand-collected, and hand-coded dataset of 7,638 loan agreements spanning the last decade, this Article shows for the first time that financial covenants—the focus of most existing research—are not the only covenants disappearing. Rather, governance covenants, such as those that might give lenders the right to engage with the borrower's board of directors, are also disappearing. This Article coins the term "gov-lite"

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to describe loans that have few governance covenants and shows, for the first time, how prevalent gov-lite loans have become, even in ways that sometimes diverge from the cov-lite trend. Second, this Article draws from original interviews with lawyers working in corporate lending to explain the source and importance of this trend. This qualitative empirical evidence shows that regulation, the structure of the loan industry, and the rise of shadow banking have all contributed to the cov-lite and gov-lite trends. Finally, this Article explores the important theoretical and practical implications of the cov-lite and gov-lite trends. It discusses how the disappearance of covenants exacerbates the agency problem for lenders and shareholders, and how can stakeholders use covenants to advance social interests.

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Introduction

Over a ten-year period, a young CEO raised $700 million from investors[1] and managed a healthcare company that, at its height, was worth over $9 billion.[2] Investors provided little oversight, trusting the CEO's vision and the work of her over 800 employees, many of them scientific luminaries.[3] Their lack of oversight, however, turned out to be a mistake: in 2022, the CEO, Elizabeth Holmes, was found guilty of defrauding her investors.[4]

In corporate law, the question of how to curb managerial malfeasance is evergreen.[5] A key feature of the corporate form is the separation of ownership and control: investors contribute money to a company, but professional managers generally run the day-to-day operations.[6] While this separation has many advantages, its principal shortcoming is that managerial preferences may deviate from investors'.

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1 Press Release, SEC, Theranos, CEO Holmes, and Former President Balwani Charged with Massive Fraud (Mar. 14, 2018), https://www.sec.gov/news/press-release/2018-41 [https://perma.cc/2YGY-E5ET].

2 Roger Parloff, *This CEO Is Out for Blood*, Fortune (June 12, 2014), https://fortune.com/2014/06/12/theranos-blood-holmes/ [https://perma.cc/4EUZ-4CE8].

3 John Carreyrou, *Theranos Lays Off Most of Its Remaining Workforce*, Wall St. J. (Apr. 10, 2018), https://www.wsj.com/articles/theranos-lays-off-most-of-its-remaining-workforce-1523382373 [https://perma.cc/VVX7-WBDS].

4 Press Release, Dep't of Just., Theranos Founder Elizabeth Holmes Found Guilty of Investor Fraud (Jan. 4, 2022), https://www.justice.gov/usao-ndca/pr/theranos-founder-elizabeth-holmes-found-guilty-investor-fraud [https://perma.cc/7NH3-DU97].

5 *See, e.g.*, Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305 (1976) (describing the agency costs that arise from the corporate form's separation of ownership and control); Eugene F. Fama & Michael C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & Econ. 327 (1983) (exploring agency costs in corporate entities and describing how the residual claims of various entity forms can control agency costs); A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 Harv. L. Rev. 1049 (1931) (discussing the power of management as being derived from the shareholders—i.e., managers as agents and shareholders as principals in a principal-agent relationship); Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 Colum. L. Rev. 767, 769 (2017) ("For the last forty years, the problem of agency costs has dominated the study of corporate law and governance."); Leo E. Strine, Jr., *Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance*, 33 J. Corp. L. 1, 6 (2007) (describing corporate law scholars as "fetishiz[ing] the agency costs that flow from the separation of ownership and control").

6 Eugene F. Fama & Michael C. Jensen, *Separation of Ownership & Control*, 26 J.L. & Econ. 301, 301 (1983) (describing the corporate form as characterized by a "separation of decision and risk-bearing functions").

This so-called agency problem is the biggest in corporate law, and has given rise to a variety of statutes, regulations, practices, and contracts all aimed at combating it.[7] Corporate law, for instance, imposes fiduciary duties on corporate managers, requiring them to put investors' interests ahead of their own self-interested ones.[8] Securities laws impose criminal penalties for fraud and self-dealing.[9] Scholars have dedicated reams to ideas designed to curb managers' self-interest, proposing everything from charter and bylaw amendments to shareholder proposals and changes to securities regulation.[10]

This Article contributes to the literature on the agency problem, focusing on one particular method of solving it: loan covenants. Money oils the gears of commerce—and for public companies, no oil is more important than bank loans. In 2022, U.S. corporations raised $99.4 billion by selling their

7 *Id.* at 304 (noting that "[c]ontrol of agency problems in the decision process is important when the decision managers who initiate and implement important decisions are not the major residual claimants and therefore do not bear a major share of the wealth effects of their decisions").

8 Statutes that impose fiduciary duties on directors and officers, for example, are meant to bring managers' actions more in line with owners' incentives. *See The Delaware Way: Deference to the Business Judgment of Directors Who Act Loyally and Carefully*, DELAWARE.GOV, https://corplaw.delaware.gov/delaware-way-business-judgment/ [https://perma.cc/2966-X6Q5].

9 For example, Section 10(b) of the Securities and Exchange Act and SEC Rule 10b-5 prohibit directors, officers, and other corporate insiders from using confidential information to gain profit or avoid loss through trading on a company's stock. Violating the statute and rule may result in criminal sanctions. *See* Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5 (2022).

10 *See, e.g.*, John C. Coffee, Jr., Robert J. Jackson, Jr., Joshua R. Mitts & Robert E. Bishop, *Activist Directors and Agency Costs: What Happens When an Activist Director Goes on the Board?*, 104 CORNELL L. REV. 381, 391 (2019) (testing, empirically, whether activist involvement in companies reduce agency costs); Yaron Nili & Kobi Kastiel, *Competing for Votes*, 10 HARV. BUS. L. REV. 287, 295 (2020) (discussing whether a variety of market forces curb traditional agency cost concerns in public companies); Yaron Nili & Kobi Kastiel, *The Giant Shadow of Corporate Gadflies*, 94 S. CAL. L. REV. 569, 575 (2021) [hereinafter *Gadflies*]; Michal Barzuza, *Inefficient Tailoring: The Private Ordering Paradox in Corporate Law*, 8 HARV. BUS. L. REV. 131, 134 (2018); James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257, 257–92 (2015); Frank H. Easterbrook, *The Race for the Bottom in Corporate Governance*, 95 VA. L. REV 685, 686–87 (2009); Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case Against Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 592–93 (2017); Stephen J. Choi, Jill E. Fisch, Marcel Kahan & Edward B. Rock, *Does Majority Voting Improve Board Accountability?*, 83 U. CHI. L. REV. 1119, 1121–23 (2016) (providing evidence that firms for which majority voting could matter—namely, firms in which shareholders voted against directors in previous elections—resisted majority voting for a while).

own stock.[11] That amount paled in comparison, however, to the amount they raised through borrowing: an eye-popping $510.7 billion.[12]

Lenders, like other corporate stakeholders, worry about the agency problem;[13] specifically, that managers will do a poor job running companies, or take excessive risks, thereby rendering their companies unable to pay back their loans.[14] Through detailed contract provisions—loan covenants—lenders attempt to curb and control managerial behavior and thereby ensure loan repayment.[15]

A rich literature in accounting, finance, and law has shown that covenants are an excellent way to combat the agency problem. For example, George Triantis and Ronald Daniels

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11 SIFMA, 2023 Capital Markets Fact Book 8 (2023), www.sifma.org/wp-content/uploads/2022/07/2023-SIFMA-Capital-Markets-Factbook.pdf [https://perma.cc/6ZTD-NLNT] ("Equity issuance, including common and preferred shares, totaled $99.4 billion in 2022.").

12 Peter Brennan & Umer Khan, *US Corporate Debt Issuance Picked Up in H1 2023*, S&P Global (July 14, 2023), www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-corporate-debt-issuance-picked-up-in-h1-2023-76491899 ("Some $510.67 billion of corporate debt was issued in 2022.").

13 Agency cost can be defined as the "costs of structuring, monitoring, and bonding a set of contracts among agents with conflicting interests." *See* Fama & Jensen, *supra* note 6, at 304.

14 *See* Hyun-Dong Kim, Yura Kim, Tomas Mantecon & Kyojik "Roy" Song, *Short-Term Institutional Investors and Agency Costs of Debt*, 95 J. Bus. Rsch. 195 (2019); Mine Ertugrul & Shantaram Hegde, *Board Compensation Practices and Agency Costs of Debt*, 14 J. Corp. Fin. 512 (2008); Paul Brockman & Emre Unlu, *Dividend Policy, Creditor Rights, and the Agency Costs of Debt*, 92 J. Fin. Econ. 276 (2009); Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 Am. Econ. Rev. 323 (1986).

15 *See* Yong Kyu Gam & Chunbo Liu, Bank Relationship and Contractual Flexibility: Evidence from Covenant Enforcement 9, 9 n.6 (Apr. 28, 2023) (unpublished manuscript) (available at https://ssrn.com/abstract=3486614) (summarizing existing research and stating that creditors gain the right to accelerate debt repayment once "the borrower breaches at least one of the accounting ratios (e.g., Debt-to-EBITDA) that are required to be maintained according to financial covenants specified in loan agreements. Using the threat of payment acceleration upon borrowers' covenant breaching, creditors push for significant changes in various firm policies. By exerting influence on firm policies, creditor control serves as a tool to reduce the agency cost of debt and increase firm value." The firm policies "include but are not limited to changes in capital structure, investment and financing decisions, governance and executive compensation"); *see also* Michael R. Roberts & Amir Sufi, *Renegotiation of Financial Contracts: Evidence from Private Credit Agreements*, 93 J. Fin. Econ. 159, 166 (2009) ("For example, a borrower may wish to increase their capital expenditures, undertake an acquisition, alter their financial policy, increase dividends, liquidate assets, transfer money to subsidiaries, change their financial reporting procedure, alter collateral, consolidate assets, merge with another company, change lines of business, or modify their charter and bylaws. All of these activities may be explicitly restricted by credit agreements.").

have described how lenders reduce a kind of agency costs they term managerial "slack."[16] In their account, debt constrains managers from wasting shareholders' money on perks, empire building, or other wasteful endeavors.[17] Their explanation is that covenant obligations redirect excess cashflow that managers would otherwise have been tempted to use towards wasteful ends (like the proverbial cash burning a hole in someone's pocket) into more value-creating projects.[18] Relatedly, Greg Nini, David Smith, and Amir Sufi have found evidence that when borrowers get into trouble and breach their covenants, subsequent covenant renegotiations are associated with positive changes in firm performance.[19]

The existing literature, however, has two important gaps.

First, existing studies often focus on financial covenants, such as those in which the borrower promises to maintain a particular ratio of assets to debt.[20] They overlook the potential role of covenants that impact borrower governance, including

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16 George G. Triantis & Ronald J. Daniels, *The Role of Debt in Interactive Corporate Governance*, 83 CALIF. L. REV. 1073, 1078 (1995).

17 *See id.*

18 *Id.* ("[O]ther stakeholders know that the imposition of fixed obligations under the loan agreement forces managers to disgorge free cash rather than use it to bankroll forms of managerial slack (for example, managerial perks or empire building)."). Other scholars have written about the effects of lenders on corporate behavior, describing the agency cost benefits of lender control. *See* Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1216–17 (2006) (describing how lenders can help firm managers when they are in distress); Frederick Tung, *Leverage in the Board Room: The Unsung Influence of Private Lenders in Corporate Governance*, 57 UCLA L. REV. 115, 117 (2009) (discussing the lenders' influence when covenants are breached).

19 *See* Greg Nini, David C. Smith & Amir Sufi, *Creditor Control Rights, Corporate Governance, and Firm Value*, 25 REV. FIN. STUD. 1713, 1715 (2012). Other scholars in finance have produced evidence supporting this finding. *See* Matthew T. Billett, Mark J. Flannery & Jon A. Garfinkel, *The Effect of Lender Identity on a Borrowing Firm's Equity Return*, 50 J. FIN. 699, 717 (1995) (finding positive abnormal stock returns to borrowing firms from the disclosure of bank loans from banks perceived as good monitors); Christopher James, *Some Evidence on the Uniqueness of Bank Loans*, 19 J. FIN. ECON. 217, 225–26 (1987) (finding positive stock impacts to borrowers from the announcement of a new bank loan contract); Dianna C. Preece & Donald J. Mullineaux, *Monitoring by Financial Intermediaries: Banks vs. Nonbanks*, 8 J. FIN. SERVS. RSCH. 193, 200-01 (1994) (finding that borrowing companies experience positive abnormal stock returns upon announcement of loan contracts with nonbank lenders).

20 *See, e.g.*, Mitchell Berlin, Greg Nini & Edison G. Yu, *Concentration of Control Rights in Leveraged Loan Syndicates*, 137 J. FIN. ECON. 249, 252–53 (2020) (describing creditor control exclusively in terms of financial covenants); Edison Yu, *Banking Trends: Measuring Cov-Lite Right*, FED. RSRV. BANK OF PHILA. RSCH., no. 3, 2018, at 1, 1–2 (discussing how to measure financial covenants in cov-lite loans); Nini, Smith & Sufi, *supra* note 19, at 1715 (examining the consequences of

those that allow outsiders to have a say on board oversight, potential business decisions, and other issues that do not directly relate to dollars and cents.

Second, existing studies generally rely on incomplete and limited data—either incomplete commercial datasets or relatively limited hand-collected samples. With regard to commercial datasets, much of the literature uses the Dealscan dataset, which is one of the few that is widely available to researchers at reasonable cost.[21] Dealscan's covenant data, however, is woefully incomplete. For many types of covenants, the Dealscan data returns missing values for 90% or more of transactions since 2011 over $100 million.[22] Researchers' own datasets are better, with the most comprehensive of these to date using a dataset of 1,240 leveraged loan credit agreements from 2001 to 2016.[23] But even this larger dataset is incomplete. For example, it contains only 8% of loans in 2011, and 45% of loans in 2014, and in all years is biased towards larger loans.[24] Finally, datasets of both kinds account only for the presence or absence of certain covenants, but do not track or classify the myriad carveouts and exceptions to these provisions that change their impact materially.[25]

This Article fills an important empirical gap by presenting an original, hand-collected, and hand-coded dataset of 7,638 corporate loan agreements spanning from 2011 to 2021. The dataset catalogues a wider range of covenants than previously

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violating financial covenants); Billet, Flannery & Garfinkel, *supra* note 19, at 716–17 (describing bank monitoring in terms of compliance with financial covenants).

21 *See Refinitiv LPC*, REFINITIV, https://www.refinitiv.com/en/financial-data/market-data/lpc-loan-pricing [https://perma.cc/NQW4-DYJX] (stating Refinitiv is the current owner of the product, which is still widely referred to as Dealscan) [hereinafter *Refinitiv LPC*]. Other commercial services exist that have more complete coverage. *See, e.g.*, *Leveraged Commentary and Data*, PITCHBOOK, https://pitchbook.com/leveraged-commentary-data [https://perma.cc/5ZAN-V8N8] (tracking data for leveraged loans). Such services are prohibitively expensive and do not catalogue each kind of covenant that may be important, as we explain below. We have found no research that uses the commercial providers that claim to be the most comprehensive.

22 *See Refinitiv LPC*, *supra* note 21.

23 Victoria Ivashina & Bo Becker, *Weak Credit Covenants* 2 (Nat'l Bureau of Econ. Rsch., Working Paper No. 27316, 2022) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3621821.

24 *Id.* at 14. Other recent studies draw smaller samples. *See, e.g.,* Billett, Flannery & Garfinkel, *supra* note 20, at 253 (using a sample of 946 contracts and looking at one type of covenant).

25 *See, e.g.*, Nini, Smith & Sufi, *supra* note 19, at 1715; Berlin, Nini & Yu, *supra* note 20, at 253.

explored. It also tracks the numerous carveouts and exceptions that meaningfully impact the covenants' effects.

As a result of this deeper dive into covenants, this Article can investigate, for the first time, the potential for governance-related covenants to curb managerial misbehavior. In recent years, there has been a heated debate in both scholarly and practitioner circles about who should get a say in corporate governance. Some have argued for maintaining shareholder primacy—the decades-old norm of prioritizing shareholder interests in corporate decisionmaking.[26] Others, including 160 American CEOs in a highly public statement, have argued for stakeholder theory—a brand of corporate governance that urges corporate decision-making in light of the interests of shareholders, employees, creditors, customers, and other stakeholders.[27] But while much has been said about *who* should participate in governance, relatively little has been said about *how* they should. This Article helps to jump-start that conversation: we show that in addition to shareholders, lenders can readily engage in corporate governance to the benefit of shareholders and other stakeholders alike through the use of governance-related loan covenants.

The remainder of this Article proceeds as follows. Part I sets the stage by providing a brief overview of the agency problem—far and away the most important and enduring problem in corporate law. In particular, this Part pulls together studies in law, accounting, and finance, which universally herald loan covenants as an effective way to align lender interests with management interests, thereby curbing the agency problem. Part II dives into this Article's empirical core. Using original quantitative data, it shows that not only are there fewer financial covenants over time (a trend that the industry calls "cov-lite"), but there are also fewer governance covenants over time (which this Article called "gov-lite"). This Part poses a question about

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26 *See, e.g.*, Lisa M. Fairfax, *The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms*, 31 J. Corp. L. 675, 676 (2006) ("For the past few decades, corporate scholars have agreed almost universally that the shareholder primacy norm most accurately captures the corporation's personality and purpose."); Andrew Keay, *Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?*, 7 Eur. Co. & Fin. Rev. 369, 370 (2010) ("The dominant theory in Anglo-American jurisdictions, as far as determining the objective of large public corporations, has been, certainly since the 1970s, the shareholder primacy theory, also known as 'shareholder value' or 'shareholder wealth maximisation.'").

27 *See Statement on the Purpose of a Corporation*, Bus. Roundtable (Aug. 19, 2019), https://opportunity.businessroundtable.org/ourcommitment/ [https://perma.cc/HG7U-AKG8].

the diminution in covenants: if covenants are such good tools for curbing agency costs, why are they disappearing? Part III then turns to qualitative empirical evidence to probe the puzzle. Original interviews with deal lawyers who work on debt matters shows that loan market competition and the structure of the loan market contribute to the cov-lite and gov-lite trends. Finally, Part IV turns to theoretical and practical implications of the Article.

I
The Agency Problem and the Cov-Lite Puzzle

In a paper cited nearly 30,000 times, Eugene Fama and Michael Jensen coined the term "the separation of ownership and control" to describe the structure of corporations.[28] They note that in large corporations, investors do not control the day-to-day operations of the corporation.[29] Rather, hired managers, many of whom have their own preferences and incentives, take the reins—even though these managers, as a default, bear little financial risk.[30]

A rich literature has grown around the Fama and Jensen paper. Much of this work has focused on the agency problem, in which an agent (in the case of corporations, the managers) might have incentives different from those of the principal (in this case, the shareholders).[31] A robust system of laws, regulations, norms, and contracts has also grown to curb the agency problem.[32]

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[28] Fama & Jensen, *supra* note 6, at 323.

[29] *See id.* at 307–09.

[30] *See id.* at 304.

[31] *See, e.g.*, Stephen M. Bainbridge, The New Corporate Governance in Theory and Practice 160 (2008) (detailing the role of the board in reducing agency costs by monitoring management); Jonathan R. Macey, Corporate Governance: Promises Kept, Promises Broken 50 (2008) (listing major corporate governance mechanisms intended to control agency costs for U.S. public companies); Matthew R. Denes, Jonathan M. Karpoff & Victoria B. McWilliams, *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 J. Corp. Fin. 405, 406 (2017) (synthesizing the results from seventy-three studies that examine the consequences of shareholder activism for controlling agency costs); Stuart L. Gillan & Laura T. Starks, *The Evolution of Shareholder Activism in the United States*, 19 J. Applied Corp. Fin. 55, 68–69 (2007) (describing shareholder activism and its impact on agency costs).

[32] *See* Fama & Jensen, *supra* note 6, at 301–02 (explaining that corporations are characterized by the "separation of 'ownership' and 'control'"—that is, shareholders own the corporation but hire managers to manage it, and their interests are often in tension); *see also* Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 Harv. L. Rev. 1735, 1735 (2006) ("[T]he extent

In the lending context, loan covenants are widely heralded as an effective way to curb the agency problem.[33] Covenants mitigate the agency problem in two ways. First, they solve the agency problem that exists between lenders and borrowers: through covenants, lenders keep an eye on borrowers, making sure borrowers are behaving in a way that ensures that they can pay lenders back.[34] Second, covenants also help solve the problem between borrowing companies and their shareholders. Lenders are interested in limiting corporate waste, and shareholders want the same., Thus, by pushing for their own interests through covenants, lenders are also lending a hand to shareholders.[35]

But despite the promise of loan covenants, financial covenants are disappearing from loan agreements. "Covenant-lite" or "cov-lite" loans have become the norm.[36] This presents a puzzle: if loan covenants are such good ways to mitigate agency issues, why are they disappearing from loan agreements?

In later Parts, this Article shows that not only are financial covenants disappearing, but so are covenants relating to corporate governance.[37] Later Parts of this Article also shows how structural and market-based reasons that have caused cov-lite loans to gain popularity.[38]

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to which corporate law is stacked against shareholder 'intervention power' goes beyond just the housekeeping rules; much of business law acts to limit shareholder involvement in corporate governance."); Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. Pa. L. Rev. 1907, 1910 (2013) (noting that "managers and directors today largely 'think like shareholders'").

33 *See* Baird & Rasmussen, *supra* note 18, at 1216 (describing the power that creditors have to discipline companies when they violate covenants); Nini, Smith & Sufi, *supra* note 19, at 1717 (discussing how creditors discipline managers when covenants are violated); Tung, *supra* note 18, at 117 (explaining the disciplining force that creditors bring to bear on borrowers).

34 *See* Nini, Smith & Sufi, *supra* note 19, at 1721 (describing how lenders monitor borrowers' financial health with the goal of ensuring the loan is repaid).

35 *See* Triantis & Daniels, *supra* note 16, at 1078 (explaining how loan contracts bolster shareholders' interests at the same time as protecting creditors' interests).

36 *See* Yu, *supra* note 20, at 1–2. The shift matches the model set out by Professors Choi and Triantis, who argued that an increased supply of credit would lead to more borrower friendly terms. *See* Albert Choi & George Triantis, *Market Conditions and Contract Design: Variations in Debt Contracting*, 88 N.Y.U. L. Rev. 51, 53–56 (2013). Professors Choi and Triantis argue that the shift is driven, at least in part, by a decrease in adverse selection of borrowers, and less moral hazard when macroeconomic conditions are good. *Id.* at 56.

37 *See infra* Part II.

38 *See infra* Part III.

This Part sets the stage. Part I.A provides a brief overview of the agency problem and the many ways available to curb it in the corporate context. It focuses, in particular, on the promise of loan covenants, showing that researchers in law, finance, and accounting agree that loan covenants can reduce agency issues. Part I.B. then shows that loan covenants are disappearing.

A. The Agency Problem

The balance of power between shareholders and management is perhaps the most important issue in corporate law.[39] Corporations are distinguished by the separation of ownership and control—that is, shareholders, who own the corporation, do not play a role in the day-to-day control of the corporation. Instead, hired guns—managers—run the corporation on behalf of shareholders.[40]

This bifurcation creates a classic agency problem, wherein the incentives of the managers are not always aligned with that of the shareholders. For example, it is well understood that managers might prefer to maximize their own compensation at the expense of shareholders' best interests, which are, generally, to maximize value to shareholders themselves.[41] In an *Atlantic* article, for example, Frank Partnoy and Steven Davidoff Solomon memorably describe their brief stint as activist shareholders of a real estate company: "[the company's] revenue in 2014 was miniscule for a public company: just $52 million. Profits were just $5.7 million. Meanwhile, the managers were feasting: Bielli, the CEO, made $2.7 million in 2014; his CFO and second-in-command, Allen Lyda, made $1.2 million."[42]

A variety of mechanisms have been devised to curb managers' acts of self-interest. Among those are statutory and common-law fiduciary duties, which dictate, for example, that managers must use due care in making decisions on behalf of the corporation.[43] Managers that fail to discharge their duties can be the target of shareholder derivative lawsuits, which may

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39 *See supra* note 5 and accompanying text.

40 *See* Fama & Jensen, *supra* note 6, at 312.

41 *See* Frank Partnoy & Steven Davidoff Solomon, *Frank and Steven's Excellent Corporate-Raiding Adventure*, THE ATLANTIC (May 2017), https://www.theatlantic.com/magazine/archive/2017/05/frank-and-stevens-excellent-corporate-raiding-adventure/521436/ [https://perma.cc/GUB6-55BF].

42 *Id.*

43 *See, e.g.*, Auriga Cap. Corp. v. Gatz Props., 40 A.3d 839, 843 (Del. Ch. 2012).

threaten the corporation's pocketbooks and the director's personal ones.[44]

In addition to the law, a variety of semi-private, semi-contractual mechanisms also influence the relationship between shareholders and managers. Incentive-aligning compensation structures, such as stock options, are one well-understood way: managers are paid in part-ownership of the company, so that their financial fate is tied to that of the company.[45]

Organizational documents like charters and bylaws are also an important battleground for the push-and-pull between shareholders and managers.[46] Theoretically, charters are an organization's constitution, and set forth important rights for shareholders: for example, shareholders are both statutorily and by charter required to vote on fundamental transactions such as mergers and acquisitions, and charters set forth when and how shareholders can vote on the members of the board of directors.[47] Organizational documents also set forth the shareholder proposal process, which is an important avenue for shareholder engagement.[48] Through them, shareholders are able to propose and have other shareholders vote on a wide variety of proposals. For example, shareholders have, in recent years, used the shareholder proposal process to force management to make more disclosures about campaign finance contributions or environmental initiatives.[49]

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44 *See* Jessica Erickson, *The Lost Lessons of Shareholder Derivative Suits*, 77 Wash. & Lee L. Rev. 1131, 1184 (2020) (noting that most Delaware fiduciary suits are for breaches of the duty of loyalty, conflicts of interest, and the like); *see also* Jennifer Arlen, *The Story of Allis-Chalmers, Caremark, & Stone: Directors' Evolving Duty to Monitor* 16 (N.Y.U. L. & Econ. Rsch. Paper Series, Working Paper No. 08-57, 2008), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1304272 (describing DGCL § 102(b)(7), which allows corporations to include charter provisions that insulate directors from personal liability for duty of care breaches).

45 But despite the good intentions, options have been widely criticized in academic literature. *See* Janice Kay McClendon, *Bringing the Bulls to Bear: Regulating Executive Compensation to Realign Management and Shareholders' Interests and Promote Corporate Long-Term Productivity*, 39 Wake Forest L. Rev. 971, 1027–28 (2004) (arguing that traditional equity incentives for managers do not adequately align management and shareholders' interests); Lucian Bebchuk & Jesse Fried, Pay Without Performance: The Unfulfilled Promise of Executive Compensation 7 (2004) (arguing that executives' pay is not adequately correlated with performance).

46 *See* Jens Frankenreiter, Cathy Hwang, Yaron Nili & Eric Talley, *Cleaning Corporate Governance*, 170 U. Pa. L. Rev. 1, 32–33 (2021) (discussing the important role of corporate charters in corporate governance).

47 *Id.*

48 *Id.*

49 *See* Cathy Hwang & Yaron Nili, *Shareholder-Driven Stakeholderism*, U. Chi. L. Rev. Online, Apr. 15, 2020, at 1, 4 (arguing that many of the corporate initiatives and changes commonly deemed stakeholder-friendly, such as those that

But organizational documents are also a place for management to push back on shareholder influence.[50] For example, charters might include classified or staggered board provisions, dividing a board of directors into several "classes," only one of which is up for election every year.[51] Classified boards make it harder for insurgent shareholders to take over a company, because it might take shareholders two or three years to elect enough directors of their own choosing, since only a half or third of the board is up for election every year. Other organizational document provisions, such as provisions that allow most lawsuits to be filed in management-friendly Delaware courts,[52] or provisions called "poison pills" that dilute shareholders' ownership when they launch hostile takeovers,[53] are also tactics that are meant to shut shareholders out of management decision-making.

Just as in the management-shareholder relationship, there are significant agency costs in the lender-borrower relationship. Lenders are concerned that self-interested borrowers might choose to maximize their own interest while putting the lenders' claims at risk. For example, borrowers might try to transfer assets from the corporate borrower in the form of large dividends, share repurchase or asset sales, thereby leaving the corporation unable to repay lenders. Sometimes, shareholders and management might also be incentivized to pursue extra risky projects, since failure will be borne by lenders while success will mostly benefit the shareholders.[54] As the next sub-Part

promise more environmentally-friendly practices, are driven by shareholder proposals); Yaron Nili & Cathy Hwang, *Shadow Governance*, 108 CALIF. L. REV. 1097, 1116 (2020) (showing empirically that shareholders have proposed a variety of initiatives in recent years, including initiatives about campaign finance, the environment, and others).

50 *See, e.g.*, Albert H. Choi & Geeyoung Min, *Contractarian Theory and Unilateral Bylaw Amendments*, 104 IOWA L. REV. 1, 3 (2018) (describing directors' use of unilateral bylaw amendments to combat shareholder activism and shareholder litigation).

51 Lucian A. Bebchuk, Alma Cohen & Allen Ferrell, *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783, 791 (2009).

52 *See* Joseph Grundfest, *The History and Evolution of Intra-Corporate Forum Selection Clauses: An Empirical Analysis*, 37 DEL. J. CORP. L. 333, 335–37 (2012).

53 *See* Ofer Eldar & Michale Wittry, *Crisis Poison Pills*, 10 REV. CORP. FIN. STUD. 204, 211 (2021); Marcel Kahan & Edward Rock, *Anti-Activist Poison Pills*, 99 B.U. L. REV. 915, 921 (2019).

54 *See* Jeremy McClane, *Reconsidering Creditor Governance in a Time of Financial Alchemy*, 2020 COLUM. BUS. L. REV. 192, 208–09 (describing situations in which the interests of shareholders and creditors diverge); *see also* Gary Gorton & James Kahn, *The Design of Bank Loan Contracts*, 13 REV. FIN. STUD. 331, 342 (2000) (noting that when borrowing companies' equity value is low enough relative to its debt, "the borrower may have an incentive to switch projects to add risk").

describes, however, loan covenants play a key role in mitigating the agency cost of debt.

B. The Promise of Loan Covenants and the Cov-Lite Puzzle

Of the many mechanisms that have developed to reduce agency costs, loan covenants are among the most promising.

Lenders wield incredible influence over borrowers, largely because of how much borrowers rely on them for capital. In 2020, U.S corporations borrowed $2.3 trillion from lenders to fund their activities; companies' record-setting $390 billion in sales of equity to shareholders the same year pales by comparison.[55] As one investment manager put it, "companies don't go bankrupt as the stock price falls, but [they do] when they cannot refinance or when the cost of capital gets too high."[56]

To control borrowers' behavior, lenders rely on contracts. For example, they might require periodic reports from borrowers, limits how much future debt a borrower can take on, require that borrowers seek lender permission before acquiring stakes in other companies, or require that borrowers seek lender permission to make large capital expenditures.[57] When a borrower violates a covenant, the lender may have the right to accelerate the.[58] In reality, lenders rarely accelerate.[59] Instead, lenders typically waive covenant violations in exchange for corrective action by the borrower.[60] This practice of waiving covenant violations and renegotiation of loans gives lenders substantial influence in company decision making.[61]

The promise of covenants has been theorized, modeled, and shown empirically by many researchers. For example, George Triantis and Ronald Daniels have argued, compellingly, that lenders share a common interest with shareholders in containing agency costs generated by the separation of managers and owners.[62] As they note, all stakeholders benefit from mechanisms that discipline management to be financially responsible,

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55 SIFMA, *supra* note 11 at 49.

56 Alice Gledhill, *Credit Market Throws Weight Behind Shareholder ESG Activism*, BLOOMBERG (Feb. 1, 2021), https://www.bloomberg.com/news/articles/2021-02-01/credit-investors-throw-weight-behind-shareholder-esg-activism [https://perma.cc/8QSE-U2TR].

57 *See* Choi & Triantis, *supra* note 36, at 49–60.

58 *Id.* at 54, 57–58.

59 *See* Nini, Smith & Sufi, *supra* note 19, at 1715.

60 *Id.*

61 *Id.*; *see also* Baird & Rasmussen, *supra* note 18, at 1210–11.

62 *See* Triantis & Daniels, *supra* note 17, at 1082–90.

take appropriate (but not outsized) risks, and restrict wastefulness, or in other words, to reduce managerial "slack."[63] In a similar vein, a chorus of other scholars have noted that lenders have expertise with regard to debt management, and fiscal responsibility, and they bring their proficiency to bear when interacting with internal corporate stakeholders.[64]

In addition, lenders might theoretically have more incentive to care about the long-term performance of a corporate borrower due to relationship and reputational concerns.[65] Unlike public company shareholders who can exit their relationships with a corporation at any time by selling their shares, bank lenders have historically had long-term repeat-player relationships with corporate borrowers and thus have had a stake in borrowers' long-term success.[66] This is a particularly powerful argument in the modern area, when there is an ever-growing concern that investors are seeking short-term returns rather than investing in the long-term growth of the companies in which they hold shares.[67]

Frank Easterbrook and Daniel Fischel have argued that lender intervention is particularly important in widely-held companies, because those shareholders are particularly susceptible to the collective action problems that limit their ability to monitor and constrain management.[68] Lenders, in contrast, have more incentive to monitor management, and can do so at

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63 *Id.* at 1074, 1077–78; *see also* Nini, Smith & Sufi, *supra* note 19, at 1716–17.

64 *See* Nini, Smith & Sufi, *supra* note 19, at 1716–17; *see also* Joanna M. Shepherd, Frederick Tung & Albert H. Yoon, *What Else Matters for Corporate Governance?: The Case of Bank Monitoring*, 88 B.U. L. Rev. 991, 994–96, 1002 ("The detailed reporting obligations and contract constraints imposed by the loan agreement, as well as the bank's ability to control the borrower's cash, enable the bank literally to control the firm.").

65 *See* Triantis & Daniels, *supra* note 16, at 1092.

66 *See id.* at 1079–80, 1104–07 ("In this sense, the interactive theory is true to the contractual vision of the firm and yields a system that is in fact far more effective in disciplining and correcting managerial slack than the traditionally conceived model in which shareholders act as the sole principals for management.").

67 *See* Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. Corp. L. 493, 502 (2018).

68 *See* Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 169–70 (1996). Collective action problems arise when the value of shareholders' stakes is smaller than the cost of coordination, such that if shareholders do not like what management is doing, it is less costly simply to sell the stock. *See id.*

a relatively lower cost than shareholders through contractual covenants.[69]

Empirical research also supports the theory that lenders interact with borrowing companies to improve their performance in a way that is often consistent with the interests of other corporate stakeholders.[70] Several studies have found that lender monitoring and intervention leads to positive changes in firm performance.[71] Matthew T. Billett, Mark J. Flannery, and Jon A. Garfinkel showed that, contrary to intuition, corporate debt is not a bad thing: rather, taking on debt actually significantly *increases* firm performance.[72] They surmise that this abnormal return can be attributed in part to the fact that lenders monitor their borrowers, thereby closing the agency gap.[73] Other scholars have similarly shown, empirically, that borrowing can increase firm performance, perhaps directly though monitoring of agency costs and perhaps indirectly because the market perceives that a seasoned lender is at the helm monitoring those costs.[74]

Moreover, there is scant evidence that lender intervention leads to increased conflicts of interest with shareholders, or at least, conflicts in which the agency costs outweigh the positive benefits of intervention.[75] To the contrary, the research suggests that lenders play an important role in disciplining management when other governance mechanisms cannot.[76]

Although covenants have been wildly heralded by scholars, however, they have lost popularity in recent years. Rather, in

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69 *See* Triantis & Daniels, *supra* note 17, at 1087–88; *see also* Nini, Smith & Sufi, *supra* note 19, at 1715–16.

70 *See* Nini, Smith & Sufi, *supra* note 19, at 1716–17, 1747–58.

71 *See, e.g.*, *id.* at 1716–17; *see also* Billett, Flannery & Garfinkel, *supra* note 19, at 717 (finding positive abnormal stock returns to borrowing firms from the disclosure of bank loans from banks perceived as good monitors).

72 *See* Billett, Flannery & Garfinkel, *supra* note 19, at 699.

73 *Id.* at 699–700.

74 *See* James, *supra* note 19, at 219; Preece & Mullineaux, *supra* note 18, at 200–01 (finding that borrowing companies experience positive abnormal stock returns upon announcement of loan contracts with nonbank lenders).

75 *See* Nini, Smith & Sufi, *supra* note 19, at 1716–17; *see also* Shepherd, Tung & Yoon, *supra* note 64, at 1027–39. Nonetheless, one recent study has found evidence that lenders refrain from intervening to reduce borrowers' debt load or investment expenditure when the lenders also happen to be shareholders, suggesting a possible tradeoff between equity and debtholder interests. *See* Sudheer Chava, Rui Wang & Hong Zou, *Covenants, Creditors' Simultaneous Equity Holdings, and Firm Investment Policies*, 54 J. FIN. & QUANT. ANALYSIS 481, 481–83 (2019).

76 *See* Triantis & Daniels, *supra* note 16, at 1079, 1091, 1082–88.

the last decade and a half, the market has, in fits and starts, shifted toward more borrower-friendly loan terms. Most notably, there has been a move toward cov-lite loans.[77] Between October 2015 and October 2018, the proportion of leveraged loans that were cov-lite is estimated to have grown from just under 65% to almost 80% of the syndicated loan market.[78]

The most commonly described feature of cov-lite loans is their lack of ongoing financial monitoring covenants.[79] In such loans, borrower financial health metrics like leverage ratios and minimum coverage ratios are not tested continuously as they are in the traditional "covenant heavy" loans.[80] Rather, in cov-lite loans, the borrower's compliance with financial ratios is tested, if at all, only when a borrower undertakes certain transactions such as issuing new debt or making a major acquisition.[81] The looser covenants leave borrowers freer to manage their finances.[82] However, because the ongoing monitoring function of traditional covenants is missing, the loans do not have the same power to influence borrower behavior on an ongoing basis. To the extent financial ratios are incorporated into other loan provisions, they have become more lenient over time.[83]

The rise of cov-lite loans presents a puzzle. If covenants do such a good job of mitigating agency problems, why do lenders not insist on them? Lenders have every reason to want more monitoring through covenants. And, as much research has

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77 *See* Yu, Choi & Triantis, *supra* note 36 and accompanying text.

78 *See Leveraged Loans: Covenant-Lite Issuance Levels Off, Though Remains Strong*, S&P Glob. Mkt. Intel. (Nov. 9, 2018), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/leveraged-loan-news/leveraged-loans-covenant-lite-issuance-levels-off-though-remains-strong [https://perma.cc/HE2K-DGN7].

79 *See* Meyer C. Dworkin & Monica Holland, *Recent Trends in U.S. Term Loan B*, *in* The International Comparative Legal Guide to Lending & Secured Finance 26, 26–27 (Thomas Mellor et al. eds., 2d ed. 2014).

80 *See id.* I note that there are a number of other features of cov-lite loans, and that these permutations vary from deal to deal. *Id.* The move to incurrence covenants is commonly cited. *See id.* at 26.

81 *See id.* at 27–28.

82 *See id.* at 27.

83 One prominent example of this is a more borrower-friendly definition of EBITDA, of which there are many variations. *See id.*; *see also* Adam B. Badawi, Scott D. Dyreng, Elisabeth de Fontenay & Robert W. Hills, *Contractual Complexity in Debt Agreements: The Case of EBITDA* 1–7 (Duke L. Sch. Pub. L. & Legal Theory Series, Working Paper No. 2019-67, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3455497 (identifying previously unexamined variety in the definitions of EBITDA).

shown, shareholders and lenders often have similar incentives, so shareholders should champion lender oversight.[84]

Later Parts of this Article attempt to explain this puzzle. Scholars have largely focused on *financial* covenants, including the relatively recent disappearance of financial covenants in cov-lite lending. These studies overlook *governance* covenants. Unlike financial covenants, which require borrowers to meet certain financial metrics, governance covenants more directly allow lenders to get involved in running the borrower's company. A requirement that the borrower maintain a particular financial ratio, for example, is a financial covenant, while a covenant that allows the lender to have a board seat or a board observer seat on the borrower's board of directors is a governance one. As Part II shows through original empirical evidence, *governance* covenants have also been disappearing, further deepening the cov-lite puzzle. Then, Part III explains, using qualitative empirical evidence, why both financial and governance covenants are disappearing.

II
The Rise of Gov-Lite Loans

This Part shows, for the first time, that governance covenants are also disappearing from loan agreements. Part II.A briefly discusses the distinction between financial covenants and governance covenants. Part II.B turns to a first look at the empirical evidence. Using a novel, hand-coded dataset of 7,600 credit agreements representing ten years' worth of loans to public companies, the subpart shows exactly what lenders care about when lending. Just as there has been a trend toward cov-lite loans, there is also a previously undocumented trend toward loan agreements with few or weak governance covenants. This Article calls this latter category of loans "gov-lite" loans.

A. Financial and Governance Covenants Defined

Financial covenants, which is the focus of the existing research, restrict companies through a financial metric such as a debt-to-equity ratio, or sometimes through a requirement to keep a certain amount of liquidity. For example, lenders to the

84 *See infra* Part IV.B for a discussion of shareholders conflicting views regarding creditor covenants, explaining why shareholders may refrain from supporting more covenants.

Tropicana Casino in Las Vegas (perhaps not wanting to gamble on being repaid), included a covenant that the casino "shall not permit . . . cash on hand . . . to be less than $2,000,000" at any time.[85] A later loan's covenant imposed a ratio-based restriction, making the casino promise that it would not take on debt that would more than 3.25 times the value of its equity else be in breach.[86] These financial covenants tie the hands of managers, but do not directly deal with agency costs, or issues that are important to corporate stakeholders.

Other such covenants restrict major financial transactions. Delta Airlines is an example of one such firm whose management is significantly impacted by various negative covenants included in its credit agreement. Their loan agreement with JPMorgan Chase Bank restricts the company's ability to enter into a merger, make certain payments and investments, and enter into a business "materially different from those conducted by [the Company] on the Closing Date [of the credit agreement]."[87] Like the Tropicana financial covenants, the restrictions in Delta's debt agreements are common and have been the focus a prior corporate law theoretical work.[88] However, these provisions only affect corporate governance indirectly, and then only upon the occurrence of major events, such as financial distress, or a fundamental transactions.

Governance provisions, by contrast, influence corporate agency costs on an ongoing basis. For example, the Tropicana loan agreement referenced above contains a covenant stating that it would not "sell, lease, transfer or otherwise dispose of any of its Real Property or assets to . . . any Affiliate" without the lenders' approval.[89] This provision is intended to stop company insiders from giving themselves sweetheart deals, a corporate governance problem because it amounts to company

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[85] Amended & Restated Loan Agreement Among Tropicana Las Vegas, Inc. and Wells Fargo Principal Lending, LLC, et al., at 82 (Dec. 21, 2012), https://www.sec.gov/Archives/edgar/data/1479046/000143774912013128/ex10-20.htm [https://perma.cc/NCJ8-GXD9].

[86] Credit Agreement Among Tropicana Entm't Inc. and Credit Suisse AG, Cayman Islands Branch et al., at 64 (Nov. 27, 2013), https://www.sec.gov/Archives/edgar/data/1476246/000144530513003085/a2013-11x268kex101.htm [https://perma.cc/573V-8SNQ].

[87] Credit and Guaranty Agreement Among Delta Airlines, Inc. and JPMorgan Chase Bank, N.A., et al., at 100 (Aug. 24, 2015), https://www.sec.gov/Archives/edgar/data/27904/000002790415000013/dal9302015ex101.htm [https://perma.cc/BBQ5-N7HU].

[88] Tung, *supra* note 18, at 117.

[89] Amended & Restated Loan Agreement Among Tropicana Las Vegas, Inc. and Wells Fargo Principal Lending, LLC, et al., *supra* note 85, at 81.

managers taking value from other company stakeholders.[90] An example of a governance covenant of a different type is one in which SilverBow Resources, Inc. agrees to notify its lenders of any "Material Environmental and Social Incident," defined as an incident in which the borrower does anything to materially harm the environment, the health and safety of it workers, or if its workers protest or express a "prolonged community grievance" and work with the lender to remedy it.[91] Silverbow also agrees to "collaboration and mutual feedback on greenhouse gas emission reduction," delivery to the lenders of an "ESG survey," and joining the lender in a "partnership to evaluate pilot vendors on identifying greenhouse gas emission reduction opportunities."[92] Covenants such as this have an ongoing impact on how the corporation is managed, with an eye towards reducing agency costs: in the past, corporate managers have had incentives to ignore or understate the impact of the environment or social issues because doing so was better for the managers in the short run, even if they reduced company value and cost shareholders in the long run.[93] Increasingly, loan covenants such as Silverbow's seek to limit these agency costs in a way that is beneficial for stakeholders as well. As this Article describes below, these provisions impact corporate governance and stakeholder engagement without reference to financial ratios or whether a party is in default. The results in this Article show why these previously overlooked sources of corporate governance are important, and how they force a rethinking of the commonly accepted story about lender governance and cov-lite.

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90 *See* Simon Johnson, Rafael La Porta, Florencio Lopoez-de-Silanes & Andrei Shleifer, *Tunneling*, 90 Am. Econ. Rev. 22 (2000) (describing the agency costs arising when company insiders take cash or assets out of the company through facially legitimate transactions at non-market prices that favor the insider).

91 *See* SilverBow Res., Inc., Amended Credit Agreement (Form 8-K) (Nov. 12, 2021), https://d18rn0p25nwr6d.cloudfront.net/CIK-0000351817/7fad2147-9a7b-425d-8e3a-09fcd32c9d32.pdf [https://perma.cc/J5VP-K5KF].

92 *See id.*

93 For example, Exxon has been accused of downplaying for decades the impact of its fossil fuel products on climate change as well as the value of its own assets in an effort to boost short term stock price at the expense of the company's long-term value. *See* Appellant's Brief, Exxon Mobil Corp. v. Massachusetts, No. 2021-P-0860 (Mass. App. Ct. filed Nov. 8, 2021); *see also* Jonathan Stempel, *Exxon Must Face Massachusetts Lawsuit Alleging Climate Change Deceit*, Reuters (June 23, 2021), https://www.reuters.com/business/exxon-must-face-massachusetts-lawsuit-alleging-climate-change-deceit-2021-06-23/ [https://perma.cc/A23M-R3D6].

B. The Gov-Lite Trend

This Article uncovers, for the first time, a trend toward gov-lite loan agreements: loan agreements that, like cov-lite loan agreements, have fewer or weaker governance covenants. To do so, this Article relies on a hand-collected original dataset of 7,638 loan documents. This represents the complete universe of corporate loans made by bank lenders to public companies above $50 million, made between 2011 and 2021. This subpart begins with a brief note on methodology. It then shows how gov-lite loans have become a trend over the last ten years.

1. *Methodology*

This data was collected from the U.S. Securities and Exchange Commission's electronic database, EDGAR, between 2011 and 2021. Then, the authors and a team of research assistants reviewed each contract, extracting basic information, including information about lender identity, sponsor identity, administrative agent identity, borrower identity, loan type, and loan purpose.

The team then extracted the text of all the covenants. The team coded the covenants and grouped them into broad categories, before further breaking them down with respect to their sub-provisions, as discussed further below. In order to ensure that covenant-like provisions were not missed, the team read both the covenant sections and searched the rest of the loan documents for relevant provisions. To ensure consistency in coding, we had approximately 10% of each coder's loans overlap with other coders, allowing us to verify we maintained constant coding. In total, the data set includes all covenant provisions that occur at least ten times for corporate loans with respect to 3,182 companies over the course of ten years.

In order to investigate trends with respect to how loan covenant volume might relate to company characteristics such as the company's size, the team also extracted financial data on the borrowers from Compustat and merged them with the loan data. Tables A and B in Appendix A, *infra*, present summary statistics of the loan sample and borrowers, respectively.

2. *Affiliated-party Covenants*

One important governance covenant is the affiliated-party covenant, also called a conflict-of-interest covenant. During the period studied, these covenants have become rarer—and where they exist, they have become less stringent.

The affiliated-party or conflict-of-interest covenant addresses lender concerns that, left to their own devices, borrower's management might engage in "tunneling"—the practice of directing resources from the borrower to another company in which the managers have some kind of financial interest.[94] In particular, these covenants impose heightened standards for approval of affiliated or conflict-of-interest transactions, beyond what is required under Delaware law.[95]

These covenants come in different varieties. Some require the lender's approval for any self-dealing transaction. For instance, the Tropicana loan agreement referenced above contained a covenant stating that it would not "sell, lease, transfer or otherwise dispose of any of its Real Property or assets to, or purchase any property or assets from, or enter into or make or amend any transaction, contract, agreement, understanding, loan, advance or guarantee with . . . any Affiliate" without the lenders' approval.[96] Others are less stringent; for example, Family Dollar Stores, Inc. can make deals with insiders if they are on the same terms as "would be obtainable in a comparable

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94 *See* Johnson, La Porta, Lopoez-de-Silanes & Shleifer, *supra* note 90, at 22 (stating that although tunneling can occur through theft or fraud that directly moves cash or assets out of the company, it more commonly occurs through facially legitimate transactions at non-market prices that favor the tunneling recipient). For example, Elon Musk controls the publicly held company SpaceEx, but also controls and has cashflow rights in the private digging and drilling firm, The Boring Company. In a well-publicized incident, Musk tested The Boring company's drilling equipment on SpaceEx land free of charge, knowing full well that any other landowner dealing at arm's-length would have demanded payment for use of the land (and likely insisted on indemnification and a host of other contractual protections as well). Shareholders of SpaceEx brought a lawsuit alleging that Musks' literal tunneling, was also metaphorically "tunneling" because it appropriated value that should have gone to SpaceEx, and by extension, SpaceEx shareholders. *See* Rob Copeland, *Elon Musk's New Boring Co. Faced Questions Over SpaceX Financial Ties*, WALL ST. J., (Dec. 17, 2018), https://www.wsj.com/articles/elon-musks-new-boring-co-faced-questions-over-spacex-financial-ties-11545078371# [https://perma.cc/D7WA-ZMRK].

95 Delaware law allows them as long as the conflicts are disclosed, and the deals are approved by either a majority of disinterested directors or a majority of disinterested shareholders. DEL. CODE ANN. tit. 8, § 144(a) (2010). However, lenders recognize that the approval of disinterested directors can be hollow, in part because director disinterest is hard to identify with certainty. *See* Beam *ex rel.* Martha Stewart Living Omnimedia, Inc. v. Stewart, 833 A.2d 961, 976–84 (Del. Ch. 2003) (analyzing whether certain directors of Martha Stewart Omnimedia were sufficiently disinterested given their various personal connections to Martha Stewart).

96 Amended & Restated Loan Agreement Among Tropicana Las Vegas, Inc. and Wells Fargo Principal Lending, LLC, *supra* note 85, at 81.

arm's-length transaction" with an unaffiliated third party.[97] More relaxed still is the standard in Green Plains Bluffton LLC's covenant stating that any arm's-length transaction is allowed if made "in the ordinary course of . . . business."[98] Still others, such as a loan entered into by set out laundry lists of transactions that are presumptively allowable, but insist a heightened standard for everything else. Some set a threshold dollar amount for transactions that are subject to heightened review. And still other prescribe detailed procedures for determining if a transaction passes muster, complete with board votes and requirements that management deliver certified statement that the transaction mirrors an arm's-length one. For example, Hawaiian Airlines' 2014 credit agreement covenanted that any transactions with affiliates above a given threshold require "an opinion as to the fairness . . . of such [a]ffiliate [t]ransaction from a financial point of view issued by an accounting, appraisal or investment banking firm of national standing."[99]

Although these provisions provide an important way for lenders to prevent tunneling by management, they have been gradually fading from loans. Figure 1 shows this trend. The number of affiliated-party covenants has steadily decreased over the ten years studied. As a result, the percentage of borrowers subject to such provisions has also decreased steadily. In 2011, 60% of borrowers were subject to restrictions on self-dealing. By 2021, the number was just above 20%.

Even in loan agreements that continue to include these affiliated-party provisions, standards have become laxer, giving much more freedom to the borrower's management.

Affiliated-party provisions generally include a variety of sub-provisions that can make the provision more or less restrictive for borrowers. Dollar thresholds (allowing affiliated-party transactions under a certain dollar amount), auditor verification requirements (requiring the borrower to obtain an

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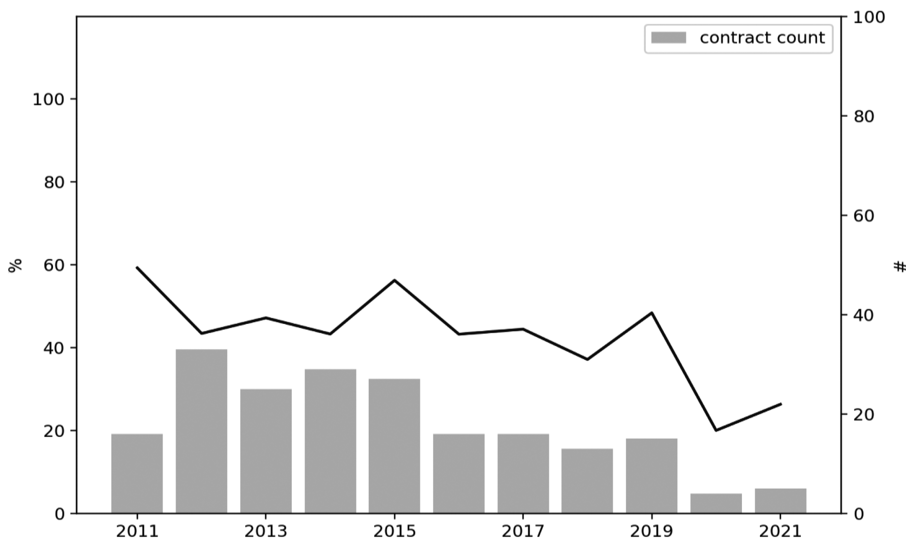
[97] Credit Agreement Among Family Dollar Stores, Inc. and Wells Fargo Bank, Nat'l Ass'n et al., at 62 (Aug. 17, 2011), https://www.sec.gov/Archives/edgar/data/34408/000119312511279946/d208764dex1031.htm [https://perma.cc/3ZY5-CKWZ].

[98] *See* Amended & Restated Master Loan Agreement Among Green Plains Bluffton LLC and Agstar Fin. Servs., PCA, at 31 (Sept. 30, 2011) https://www.sec.gov/Archives/edgar/data/1309402/000119312511290872/d250606dex106.htm [https://perma.cc/QG6C-X38F].

[99] *See* Credit & Guaranty Agreement Among Hawaiian Airlines, Inc. and Citibank, N.A. et al., at 126 (Nov. 7, 2014), https://www.sec.gov/Archives/edgar/data/1172222/000117222215000012/exhibit1081.htm [https://perma.cc/VJ5D-LCRU].

FIGURE 1: Affiliated-Party/Conflict-of-Interest Covenants

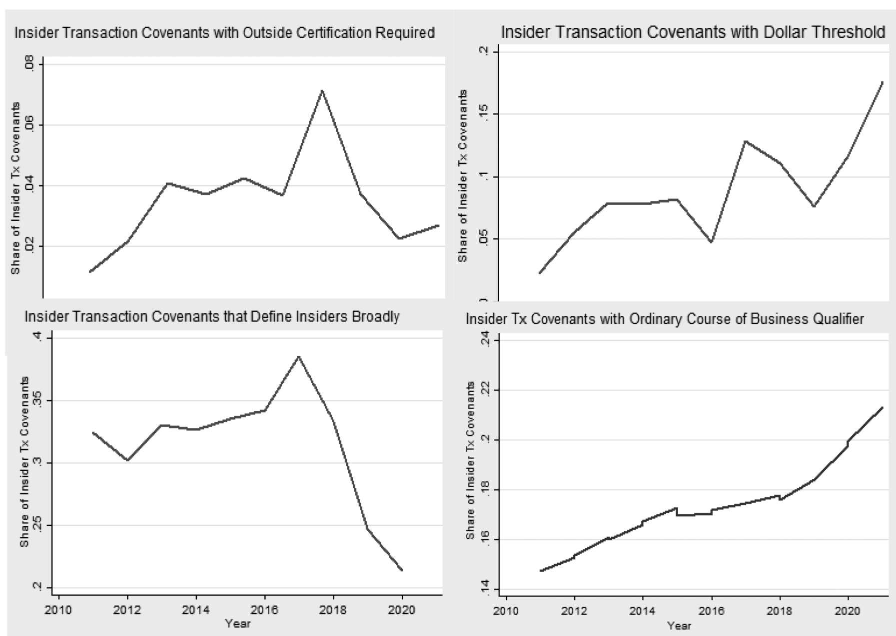


independent auditor's certification that transactions are done at arm's-length), and covered party definitions (listing officers, directors, and others who might be considered insiders) can all be adjusted, affecting the restrictiveness of the loan. Moreover, many affiliated-party provisions also exclude transactions done "in the ordinary course of business" from the restrictions on insider dealings.[100] Given how broadly the "ordinary course of business" can be construed, this provision allows borrowers a substantial amount of freedom despite the existence of the insider transaction clause.

The data shows that each of these carve-outs from affiliated-party covenants have become more lenient for borrowers in recent years. Figure 2 below shows the prevalence of several provisions, as a percentage of the loans that still contain any restriction on conflict-of-interest transactions. In particular, the Figure shows how covenants that reduce oversight and make it easier for corporate insiders to engage in self-dealing have increased, while restrictions on such behavior have decreased. Qualifiers for dealing in the ordinary course of business—a large loophole—have increased from 14.5% to 21%. Dollar thresholds under which no transactions will be questioned,

[100] A similar exclusion from disclosure of related party transactions was considered and rejected by the SEC. *See* Executive Compensation and Related Person Disclosure, SEC Release No. 33-8732A, 88 SEC Docket 2353 (Aug. 29, 2006).

FIGURE 2: Affiliated-Party/Conflict-of-Interest Covenants Carveouts



another large loophole, have gone from 3% to inclusion in 17% of deals. The reach of these covenants has also narrowed: provisions governing interested transactions for a broad swath of officers, directors and major shareholders peaked at 48% of deals in 2017, but have fallen to 22% as of 2021, resulting in far fewer corporate actors being covered. Outside certifications for potential conflict transactions likewise have gone from inclusion in 7% of transactions to 2%. These are important changes. Some of percentage difference may appear relatively small, but taken together and in light of the decline of insider transaction covenants overall, they represent significant weakening of agency cost control.

Another important governance covenant grants lenders so-called "meeting rights"—access to directors and officers. Some argue that the meeting right is the key to activist shareholders' success in many situations, even where they do not have enough of a stake to control the company.[101]

[101] The importance of face-to-face contact and soft power has been described in the context of activist hedge funds and shareholders. *See, e.g.*, Martijn Cremers, Saura Masconale & Simone M. Sepe, *Activist Hedge Funds and the Corporation*,

Meeting rights covenants come in a variety of forms. Some covenants contain the ability for lenders to show up at any time, as many times as they want, and to have face-to-face access to any management personnel or outside consultants or auditors as they see fit.[102] Others agree to a limited number of meetings at scheduled intervals to discuss financial results shortly after they are released.[103] The weakest version of this covenant dispenses with the meeting requirement altogether if the company holds telephone conference with their shareholders.[104] And still others have a shifting set of meeting rights, depending on the condition of the borrower.[105] A particularly invasive, and powerful, form of the meeting rights covenant provides a board observer right: these kinds of covenants

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94 WASH. U. L. REV. 261 (2016) (describing activist hedge funds' ability to meet with management as a form of soft power); Jeffrey N. Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, 94 COLUM. L. REV. 124, 129 (1994) (discussing institutional investors' influence through meetings with management). Regarding lenders, scholars have described the impact of meetings with lenders, especially after covenants are breached. *See* Baird & Rasmussen, *supra* note 18, at 1216–17.

102 For example, PerkinElmer's lenders in 2019 had the right "to discuss [the company's] affairs, finances and accounts with [the company's] directors, officers and independent public accountants all at the expense of the company and at such reasonable times during normal business hours and as often as may be reasonably desired." Credit Agreement Among PerkinElmer, Inc. and Bank of Am., N.A., et al., at 96 (Sept. 17, 2019), https://www.sec.gov/Archives/edgar/data/31791/000119312519246865/d804222dex101.htm [https://perma.cc/25YS-CKTS].

103 In one such more borrower-friendly example, Cheniere Energy, Inc. agrees only to allow access to the company's officers and accountants (but not directors) and stipulates that absent a default "such visits and inspections shall be limited to once in each calendar year and shall be at the sole cost and expense of . . .the applicable [l]ender." *See* Credit Agreement Among Cheniere Energy, Inc. and Société Générale, et al., at 85 (June 18, 2020), https://www.sec.gov/Archives/edgar/data/3570/000119312520173340/d949394dex101.htm [https://perma.cc/8JKQ-DLCL].

104 In a typical example, Fiesta Restaurant Group's lenders agree that any meeting rights "may be satisfied by the holding of any quarterly earnings call with public equityholders." *See* Credit Agreement Among Fiesta Restaurant Group, Inc. and Jeffries Fin. LLC, at 74 (Nov. 23, 2020), https://www.sec.gov/Archives/edgar/data/0001534992/000121390020039958/ea130552ex10-1_fiesta.htm [https://perma.cc/B3XJ-KF3Q].

105 For instance, Allison Transmission agrees to allow visits only once per year, unless the company is in default in which case lenders can visit "as often as may reasonably be desired." *See* Second Amended and Restated Credit Agreement Among Allison Transmission, Inc. and Citibank, N.A., et al., at 117 (Mar. 29, 2019), https://www.sec.gov/Archives/edgar/data/1411207/000119312519092833/d714412dex101.htm [https://perma.cc/J4VH-PT7U].

allow lenders to appoint non-voting observers to the borrower's board of directors.[106]

The *rate* at which meeting rights covenants appear in loan agreements has remained relatively stable over time, as some form of meeting or inspection right appears in nearly all contracts. However, looking at the details of these provisions tells a different story. The provisions themselves have weakened over the past ten years, as broad lender access and the unfettered right to meet with management has given way to limited and restricted meeting rights. These trends are also demonstrated by Figure 3 below showing the inclusion over time of subclauses that curb access.

Specifically, provision allowing an unfettered right for lenders to meet anytime with borrowers has declined from 23% to 14% of borrowers in the sample. Conversely, provisions restricting lenders' meetings to once per year rose from 13% in 2013 to a high of 29% in 2017, before falling again to 23% as of 2021. Provisions forcing lenders to bear all of the costs of meetings with management, a soft deterrent to meeting but a deterrent nonetheless, increased from 58% to 65% by 2021. Provisions vitiating lenders' meeting rights if the borrower holds a conference call with public shareholders—something that public companies routinely do anyway—rise from 51% to 60% by 2021. All of these changes together point to an erosion of meetings rights despite the continued existence of meeting covenants.

By contrast, board observer rights are much less common. From 2011 until the end of 2020 there were only fifteen borrowers subject to such provisions in publicly disclosed documents in our sample. However, in 2021, fourteen more borrowers agreed to allow lenders to appoint non-voting members to their boards of directors. This generally goes against the gov-lite trend because it gives lenders more governance rights.[107] However, the small numbers make it difficult to draw any firm conclusions about whether this is a trend.

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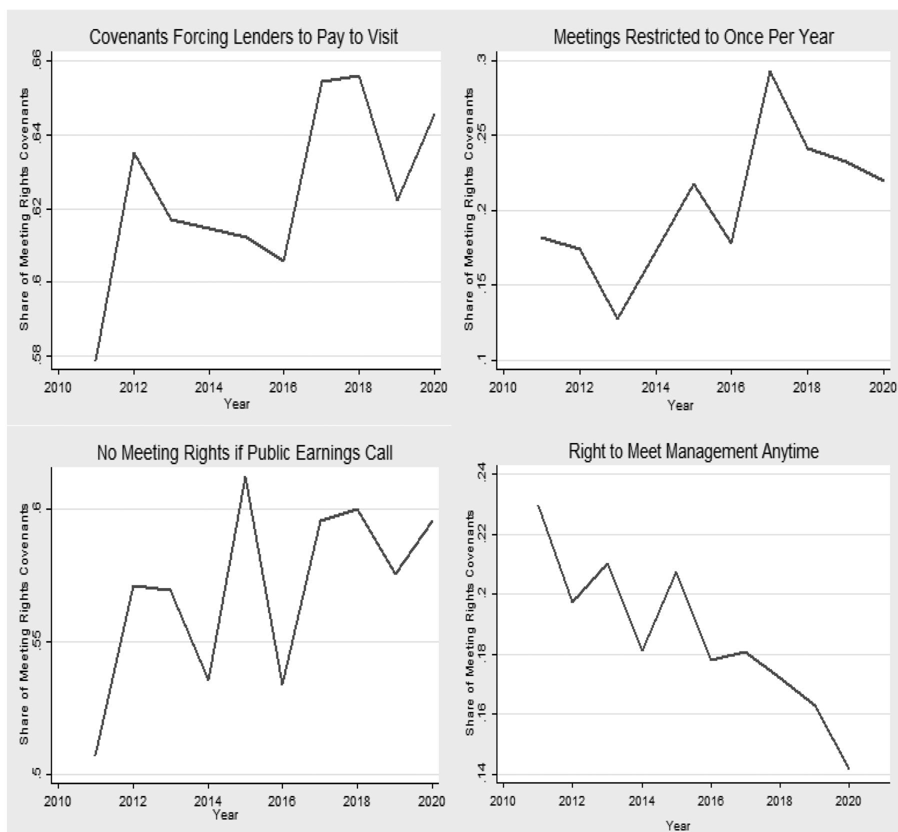
106 For example, ESports Technologies agrees that:

> Lender shall have the right to designate a non-voting representative to attend all meetings of the Board of Directors of the Borrower and any committees thereof . . . and will receive all information related to those meetings (including any reports or documents, if any, that are prepared for review by the Board at the same time as any members of the Board receive such documents).

Credit Agreement Among ESports Techs., Inc. and CP BF Lending, LLC, at 40 (Nov. 29, 2021), https://www.sec.gov/Archives/edgar/data/1829966/000168316821006036/esports_ex1002.htm [https://perma.cc/H3QD-55YJ].

107 *See* Telephone Interview with Interview Participant #2 (Dec. 17, 2021).

FIGURE 3: Meeting Rights Covenants Sub-provisions



3. *Sustainability and Environmentalism*

In recent years, lenders have expressed interest in promoting sustainability and other environmentally oriented causes. For example, Barclays touts its "commitment to managing the environmental and social risks associated with its lending and financing activities" and claims that "[a]s well as managing potential risks to our own business, as a financier we have an important role to play in ensuring society's energy needs are met whilst helping to limit the threat that climate change poses to our planet."[108] They describe two categories of environmental lending risk: direct, which arises when the bank takes land

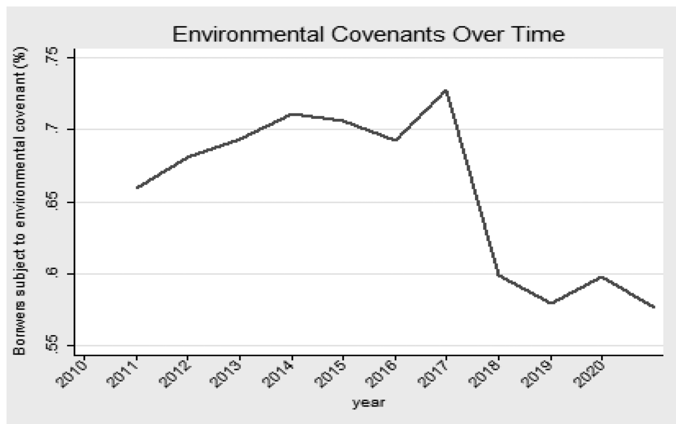
108 ZOSO DAVIES, CHARLOTTE EDWARDS, MAGGIE O'NEAL & HIRAL PATEL, BARCLAYS, EXPANDING ESG COVERAGE IN BARCLAYS RESEARCH (2020), https://www.investmentbank.barclays.com/content/dam/barclaysmicrosites/ibpublic/documents/our-insights/ESGResearch/ESG_WhitePaper_Public.pdf [https://perma.cc/3VCR-JN2F].

as collateral that might be impacted by climate change, and indirect, which environmental issues may impact the creditworthiness of the borrower.[109]

Loan agreements contain two kinds of provisions that allow lenders to promote sustainability. One is a sustainability covenant, a relatively new kind of covenant that allows borrowers to pay lower interest if they meet pre-agreed environmental friendliness benchmarks. A different type of more standard covenant provides that borrowers will notify lenders of environmental problems and ensure compliance with environmental laws. Perhaps more importantly, many of these clauses go beyond mere compliance with the law, mandating procedures that force companies to audit their environmental policies and, in some cases, forcing borrowers to monitor third parties with whom they do business for environmental compliance as well.

Given that fact, and the support lenders have shown for ESG, one would expect that such environmental clauses would strengthen. However, the story is mixed. Environmental compliance covenants generally decline beginning in 2017. The trend is shown in Figures 4 below.

FIGURE 4: Overall Change in Environmental Covenants over Time

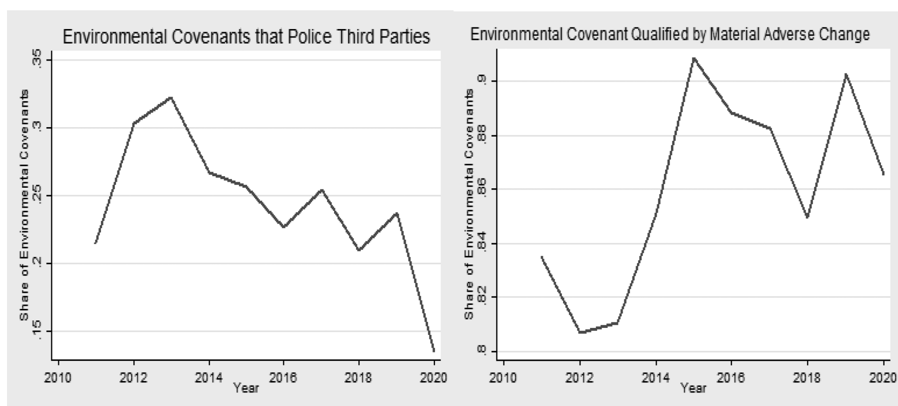


From 2017 to 2021, the presence of these covenants declined. Environmental regulation covenants were present in 622 new loan agreements entered into in 2012. By 2021, only 274 new agreements contained such provisions. As a percentage of all loans, this represents a decline in the inclusion

[109] *Id.*

of such provisions from 73% of all loans to just under 57%. Moreover, even where such covenants continue to be included, they are becoming less onerous, as shown in Figure 4a below. They are less likely to mandate that a borrower monitor third parties, a provision which would otherwise expand the scope of the borrower's environmental monitoring and compliance. Such provisions fell from being included for 34% of borrowers in 2013 to 13% by 2021. Environmental covenants are also increasingly likely to be limited by reference to materiality. This means that environmental liabilities will only breach the loan agreement if they rise to the level of something that impacts the firm in a significant way, a qualification that has the effect of making the covenant difficult to enforce. These covenants to cover 81% to 91% of borrowers by 2021, but bearing in mind greatly reduced number of borrowers with any such covenants at all, this change effectively guts most of these provisions.

FIGURE 4A: Environmental covenant sub-clauses



Sustainability covenants provide a countervailing trend, but they are still small in number. Prior to 2021, twenty-six borrowers had included a sustainability covenant in their loans. In 2021 alone, an additional seventy-two borrowers had agreed to such provisions.

4. *Disclosure Covenants*

Another type of covenant that influences borrower governance is the disclosure covenant. Through these covenants, lenders require firms to regularly furnish financial and operating reports in order to track the firm's compliance with the

terms of the debt agreement.[110] Firms ordinarily must disclose this information more frequently, and in more detail, than they otherwise do with scheduled public disclosures.[111]

For instance, pursuant to the credit agreement between AmerisourceBergen Corporation and Wells Fargo Bank, AmerisourceBergen must disclose to the bank, within fifty days after each of the first three fiscal quarters of the Company, an unaudited balance sheet, statement of operations, and cash flow, in addition to promptly furnishing any other documentation reasonably requested by the bank.[112] The additional disclosure requirements imposed by lenders likely have the effect of keeping management in check and on track to meet the firm's financial goals and deadlines. In some ways, a debt agreement can be more binding on management than even its own charter, as it is policed by a third party and requires that party's consent for any modifications or exceptions.[113]

The prevalence of disclosure covenants has remained stable over time with such covenants appearing in nearly all agreements. However, a closer look at the covenants reveals that they have become weaker in terms of the timing and amount of information required to be disclosed. The most important way in which this has happened concern the disclosure of significant new debt obligations that dramatically change the company's free cashflow. The trigger for such disclosure is determined by the company's EBITDA (earnings before interest taxation depreciation and amortization), which is a measure of earnings available for things like paying debt or taking on new projects.[114] While not a standard accounting measure, EBITDA has been calculated relatively consistently for most companies in the past.[115] The current trend, however, is to provide individualized definitions of EBITDA, including "add backs," or items that can be used to make EBITDA seem larger than would be the case for a company using a standard definition.[116]

110 Tung, *supra* note 18, at 123–25.

111 *Id.*

112 Term Credit Agreement Among AmerisourceBergen Corp. and Wells Fargo Bank, Nat'l Ass'n, at 46 (Oct. 31, 2018), https://www.sec.gov/Archives/edgar/data/1140859/000114085918000046/exhibit102termcreditagreem.htm [https://perma.cc/TWZ5-D3YV].

113 *See* Triantis & Daniels, *supra* note 16; *see also* Tung, *supra* note 18, at 125–26.

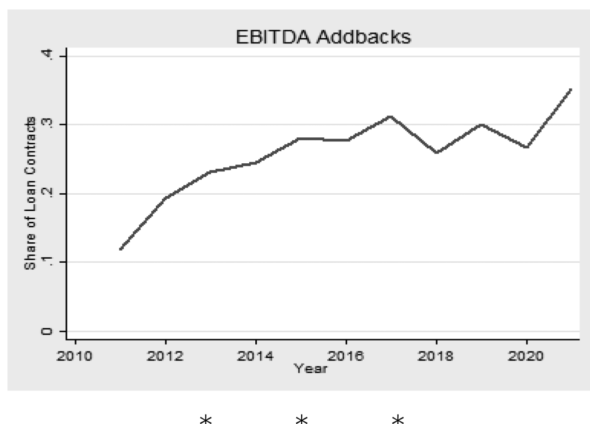
114 For a discussion of EBITDA complexity and tailoring see, for example, Badawi, Dyreng, de Fontenay & Hills, *supra* note 83.

115 *Id.*

116 *Id.*

In short, the add back makes it easier to look healthy and avoid having to disclose its financial situations to its lenders.[117] Add backs have increased dramatically in recent years, from being included for just over 10% of borrowers to being present in one third (33%) of new loans, as shown in Figure 5 below.

FIGURE 5: EBITDA Addbacks That Limit Disclosure Threshold



* * *

As documented in this Part, governance covenants, just like financial covenants, are declining over time. The gov-lite trend deepens the cov-lite puzzle: if the dominant theory and evidence are correct and covenants are vehicles for restraining agency costs, what explains their decline? The next Part turns to qualitative empirical evidence—original interviews with practicing lawyers—to crack the mystery.

III
EXPLAINING COV-LITE AND GOV-LITE

As previous Parts noted, the cov-lite and gov-lite trends present a puzzle: why have lenders relinquished control over borrowers? We turned to original interviews with practicing lawyers to solve the mystery. These lawyers provided two explanations: structure and competition in the existing syndicated loan market, and the rise of direct lending. Each of these is discussed in turn here.

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117 *Id.*

A. Competition and Syndication

Interview participants consistently reported that competition among lenders has given borrowers more bargaining power, which means they can dictate better terms.[118] When asked why lender competition has heated up to the point that many were forced to drop valued protections in the first place, interview participants presented a story of the unintended consequences of regulation.

In 2013, with the 2008 financial crisis still fresh in mind, the Federal Reserve, which regulates bank holding companies (a category that includes traditional banks such as Chase, Bank of America, and now many entities that were formerly investment banks like Goldman Sachs and Morgan Stanley), issued guidelines meant to reduce credit risk in the financial system.[119] The Fed issued the guidance with the intention of ensuring that regulated lenders maintained adequate monitoring and control of their borrowers and the credit risk they represented.[120] The banks, as naturally risk-averse corporate entities, interpreted the guidance as a restraint on their ability to allow any wiggle room in their loan documentation. This produced two significant consequences.

The first is that some lenders simply stopped extending credit to riskier borrowers whom they thought needed monitoring.[121] Ironically, this gave an opening to non-regulated entities such as private equity funds, hedge funds and securitization vehicles to begin competing by offering loans with fewer of the very covenant restraints the Fed intended to shore up.[122] In 2017, the Fed's guidelines were effectively nullified by the new

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118 *See Frequently Asked Questions (FAQ) for Implementing March 2013 Interagency Guidance on Leveraged Lending*, Bd. Governors Fed. Rsrv. Sys. (Nov. 7, 2014), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20141107a3.pdf [https://perma.cc/BUC4-YJC2].

119 *Id.*

120 *Id.*

121 Telephone Interview with Interview Participant #2 (Dec. 17, 2021); *see also* Sooji Kim, Matthew C. Plosser & João A. C. Santos, Fed. Rsrv. Bank N.Y., Macroprudential Policy and the Revolving Door of Risk: Lessons from Leveraged Lending Guidance (2017) https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr815.pdf [https://perma.cc/J4FA-H6RV].

122 *Id.*; *see also* Frank Martin-Buck, *Leveraged Lending and Corporate Borrowing: Increased Reliance on Capital Markets, With Important Bank Links*, 13 FDIC Q. 41, 41 (2019) ("The migration of lending activity away from the regulated banking sector has increased competition for loans and facilitated looser underwriting standards and risky lending practices . . . ."); Telephone Interview with Interview Participant #1 (Dec. 17, 2021).

administration, but by that point it was too late for the market to go back.[123] Unregulated lenders had acquired a foothold, and now even some of the smaller regulated lenders need to lower their standards and cut out covenants to compete.[124]

The second significant consequence of the regulatory change is that it increased the practice of loan syndication which further undermined banks' concern with corporate governance covenants.[125] In a syndicated loan, the borrower appoints a bank, (called the "lead arranger") which negotiates the loan contract and finds a group of other institutions (the "syndicate") willing to become co-lenders by acquiring participations in the loan.[126] The lead arranger performs due diligence on the borrower, analyzes the borrower's credit and negotiates the covenants.[127] The lead arranger acts as an agent for the lending syndicate, policing violations of the loan covenants and monitoring the borrower for signs of deterioration in its financial condition.[128]

Loan participations in a typical syndicated loan are illiquid compared to debt securities like bonds, because transferring an interest in the loan requires assigning rights under the contract, a process that requires the borrower's consent.[129] This worked in traditional lending situations because the lenders maintained long-term relationships with borrowers, monitoring them, advising them and providing more capital if needed throughout the life of the loan.[130] The lending paradigm in

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123 *See* Kim, Plosser & Santos, *supra* note 121; *see also* Christopher Auguste, et al., *Trump Administration Proposes Rule to Thwart Resurrection of Leveraged Lending Guidance*, JD Supra (Nov. 20, 2020), https://www.jdsupra.com/legalnews/trump-administration-proposes-rule-to-30097/ [https://perma.cc/5BR6-EJBV].

124 *See* sources cited *supra* note 123; *see also* Telephone Interview with Interview Participant #4 (Dec. 27, 2021).

125 *See* Telephone Interview with Interview Participant #2 (Dec. 17, 2021); *see also* Kim, Plosser & Santos, *supra* note 121.

126 *See* Elizabeth de Fontenay, *Do the Securities Law Matter? The Rise of the Leveraged Loan Market*, 39 J. Corp. L. 725, 740 (2014) ("With loan syndication, a major bank referred to as the lead arranger negotiates the key terms of the loan with the borrowing company, and then organizes a syndicate of lenders to fund it.").

127 *See* Katerina Simons, *Why Do Banks Syndicate Loans?*, 1993 New Eng. Econ. Rev. 45, 46 (explaining that the "lead bank[] acts as syndicate manager, recruiting a sufficient number of other banks to make the loan, negotiating details of the agreement, and preparing documentation").

128 *See* de Fontenay, *supra* note 126, at 740.

129 *Id.*

130 *Id.*

which lenders retain an interest in the loan throughout its life is called the "originate-to-hold" model.[131]

The non-bank investors entering the market have come to be referred to collectively as "shadow banks" due to the fact that they provided funding like bank lenders but are not regulated by the Federal Reserve as are banks.[132] Unlike banks, these unregulated non-bank lenders have no interest in maintaining a monitoring relationship with borrowers, instead preferring to be able to trade loan interests in a liquid market.[133] They are thus content with simpler contracts containing fewer covenants, because such contracts are more uniform, fungible and ultimately tradeable.[134] The net result has been that traditional banks have come to hold a shrinking amount of the loans they originate, leading the market away from borrower-lender relationships characterized by familiarity and repeat play, to a market in which non-bank lenders invest in tradable loans at arm's-length, as they might do with bonds or other securities.[135] The shadow banks have thus catalyzed the rise of a new lending paradigm, the "originate-to-distribute" model.[136] That matters for corporate governance because a large portion of syndicated loans are either arranged by shadow banks or ends up in the hands of shadow banks who have no interest in covenants or monitoring borrowers.[137]

Finally, syndication also reduces the risk that each lender in the syndicated group bears with respect to potential default of the loan and therefore enables each lender to agree to more lenient loan protections.[138] This stands in contrast with the direct lending model this Article discusses below, where the lender bears the full cost of default and therefore is incentivized to monitor the company through more stringent covenants.[139]

This Article's data are consistent with that explanation. The decline in loans is not uniform among lenders and in fact reveals a fragmented market. This Article separates the top twenty lenders by deal value. These lenders also happen to be regulated banks lenders, from all smaller lenders, the majority

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131 *Id.*

132 Martin-Buck, *supra* note 122, at 42.

133 *See* de Fontenay, *supra* note 126, at 740.

134 Martin-Buck, *supra* note 122, at 42.

135 *Id.*

136 *Id.*; *see also* McClane, *supra* note 54, at 220–21.

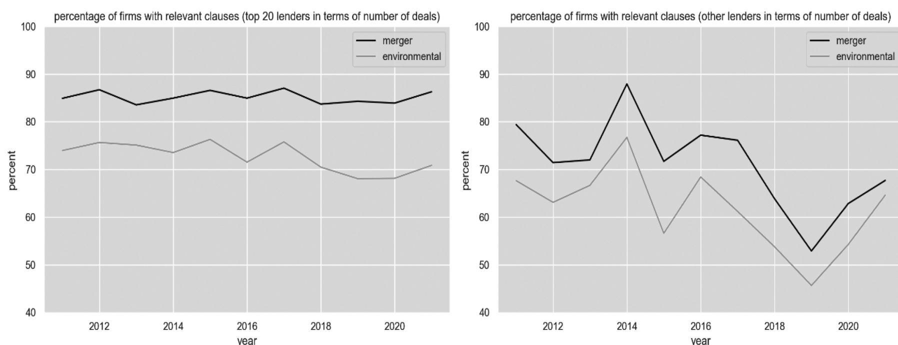
137 Martin-Buck, *supra* note 122, at 42.

138 *Id.*

139 *See infra* Part II.B.

of which are unregulated lenders and relatively small banks. When isolating the top twenty lenders, covenant inclusion remains fairly constant: the decline seen in the aggregate data disappears. By contrast, the decline in covenants among lenders outside the top twenty—a group dominated by unregulated non-banks—is readily apparent. The contrast can be seen below for the covenants we have just described in the preceding section. For the sake of comparison, the figures below also show the differing trends for investment-related covenants that have been the focus of other research. All of these differing trends are apparent from the graphs in Figure 6 below.

FIGURE 6A. Change in Clauses: Top 20 versus other lenders: environmental covenants



These different trends are consistent with the hypothesis that much of the trend toward fewer covenants is driven by competition for business among smaller unregulated lenders. These lenders have fewer long-term or repeat-player relationships and therefore have less interest in negotiating aggressively to maintain covenants in corporate loan agreements. The largest, best-established lenders, however, continue to do so. The trend can be seen for a number of other covenants that have implications for governance. In particular, trends are markedly more pronounced for lenders with less market share with respect to the insider transaction clauses discussed above (aggregate trends and non-top twenty trends shown in Figure 6b). The same is true for the visitation and inspection right clauses discussed above (aggregate trends and non-top twenty trends shown in Figure 6c). By contrast, covenants that deal with restrictions on borrower investment remain more stable, with less difference for lenders outside the top twenty than for the sample as a whole (shown in Figure 6d).

FIGURE 6B Change in Clauses: Top 20 versus other lenders: insider transaction covenants

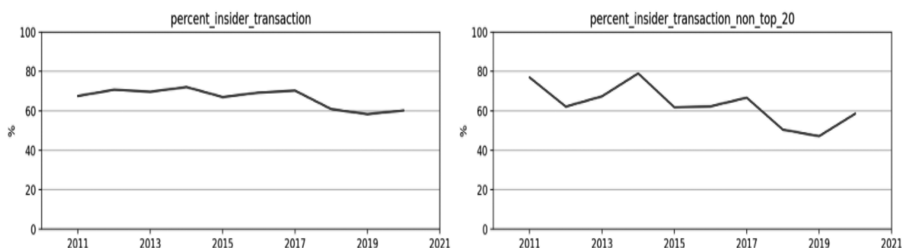


FIGURE 6C Change in Clauses: Top 20 versus other lenders: inspection/visitation right covenants

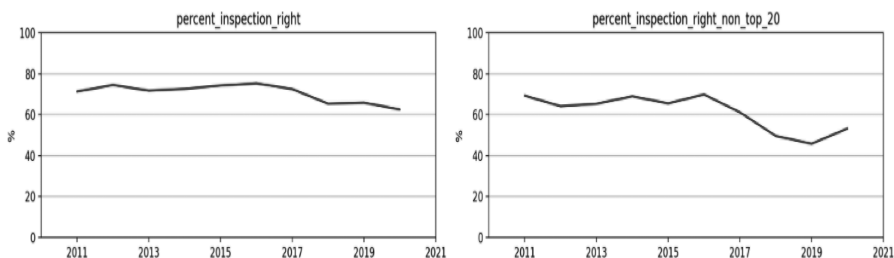
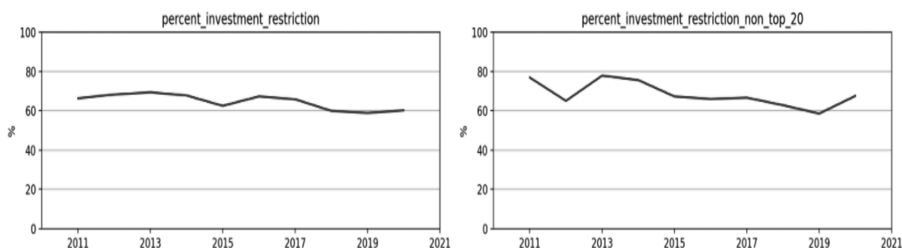


FIGURE 6D Change in Clauses: Top 20 versus other lenders: investment covenants



The decline in governance covenants thus demonstrates how corporate governance, and the control of agency costs is linked to markets, which in turn are affected by government intervention in sometimes unpredictable ways. However, as this Article explains in the next section, market fragmentation

has not been all bad. A portion of the market has emerged that engages in direct lending, in which lenders continue to monitor agency costs, to the benefit of all corporate stakeholders.

B. Direct Lending

The evidence that we have gathered shows that governance covenants are being used less frequently as constraints on agency costs in public companies. However, with respect to private company borrowers, the lending market is different. Recent years have seen the emergence of so-called direct lending. Indeed, in recent years, the credit markets have incorporated direct lending in increasing frequency, particularly in sectors like the oil and gas and infrastructure.[140]

Direct lending involves a private credit fund using capital raised from investors[141] without having to syndicate the loan out to the institutional loan market.[142] Similar to banks earning money by lending capital, direct lenders use their balance sheet (assets under management or "AUM") to extend loans and obtain a return on the capital loaned. Common features of direct lending involves a unitranched deal structure (meaning that the loan is not divided between multiple lenders),[143]

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140 Brandon R. Anderson et al., *Expert Q&A on Direct Lending*, LATHAM & WATKINS LLP, (June 27, 2017), Practical Law Article No. W-008-4586; Elena Maria Millerman & Derrik Sweeney, *Lending & Secured Finance Laws and Regulations Developments in Midstream Oil and Gas Finance in the United States 2022-2023*, ICLG (July 4, 2022), https://iclg.com/practice-areas/lending-and-secured-finance-laws-and-regulations/20-developments-in-midstream-oil-and-gas-finance-in-the-united-states [https://perma.cc/RV5N-BN3E].

141 Direct lenders can be institutional investors such as traditional investment managers, insurance companies, or pension funds and endowments, or other alternative credit funds such as private equity funds and private equity investors as individuals. Anderson et al., *supra* note 140.

142 Anderson et al., *supra* note 140.

143 Ben Mohr, *Supercharged Fixed Income – Direct Lending*, MARQ. ASSOCS. INV. PERSP., Oct. 2016, at 1, 4, https://www.marquetteassociates.com/wp-content/uploads/2016/10/Supercharged-Fixed-Income-Direct-Lending.pdf [https://perma.cc/R4EY-Z4WK]; *see also* Anderson et al., *supra* note 140; Tod Trabocco, *Tracing the Rise of Direct Lending: The Importance of Rates and Loan Structure*, CAMBRIDGE ASSOCS. (June 2017), https://www.cambridgeassociates.com/insight/tracing-the-rise-of-direct-lending-the-importance-of-rates-and-loan-structure/ [https://perma.cc/2TA4-TFPE].

no syndication,[144] faster deal execution,[145] limited or no pricing flex,[146] unrated by credit ratings agencies,[147] and an overall greater certainty of deal execution between a small number of parties.[148] Additionally, the average term to maturity on such loans is between five to six years and the loan is highly illiquid, given there is not a liquid secondary market where lenders can easily trade these private loans to other lenders.[149]

Direct lenders usually act as the sole lender to a business which gives them unique advantages. One of the benefits of direct lending is that such private credit funds are unregulated non-financial institutions, and thus do not have to adhere to leveraged lending guidelines or any regulatory capital requirements.[150] Additionally, the unitranche structure allows borrowers to secure financing from one source.[151] Direct lending also solved the yield problem for the investors by blending senior and subordinated debt together into a single unitranche loan, which provides a more attractive investment opportunity for private credit funds.[152] However, the direct lender must undergo its own credit analysis of the opportunity since it bears all of the credit risk on extending a loan. In contrast, syndicated loans have groups of lenders with the opportunity to lend to middle-market and large size businesses.[153] Syndicated lending usually finances larger loans for M&A and private equity buyout while also diversifying the individual loan risk across a larger number of lenders and investors.[154] The loans focus on lending to larger and more established businesses and di-

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144 However, club deals with other direct lenders can still happen, depending on aggregate deal size, but are not common. Trabocco, *supra* note 143; *see also* William Haggard, Dr. Raphaela Schröder, Martin Hook & Martin Rotherman, *Wealth Management: Instant Insights – Syndicated and Direct Lending Strategies*, Rothschild & Co. (Feb. 25, 2020), https://www.rothschildandco.com/en/newsroom/insights/2020/02/syndicated-and-direct-lending-strategies/ [https://perma.cc/AH82-UMT6].

145 Anderson et al., *supra* note 140.

146 *Id.*

147 *Id.*; Armen Panossian, Raj Makam & Clark Koury, *Direct Lending: Benefits, Risks, and Opportunities*, Oaktree Cap. Mgmt. (May 13, 2021), https://www.oaktreecapital.com/insights/insight-commentary/education/direct-lending [https://perma.cc/8BCY-4GWL].

148 Anderson et al., *supra* note 140.

149 Panossian, Makam & Koury, *supra* note 147.

150 Anderson et al., *supra* note 140.

151 Trabocco, *supra* note 143.

152 *Id.*

153 Haggard, Schröder, Hook & Rotherman, *supra* note 144.

154 *Id.*

versify the credit risk over a number of investors.[155] However, since each investor owns a smaller percentage of each loan, the return investors can expect from a syndicated loan strategy is less than the expected return from a direct lending strategy. Further, since syndicated loans are often credit-rated and held by other investors, there is usually a relatively liquid secondary market for such loans.

While for decades, commercial banks were the primary lenders to small and middle-market companies; since the financial crisis in 2008-2009, banks significantly reduced lending due to balance sheet capital constraints, and private credit funds stepped in to largely fill the capital void.[156] As a result, direct lending has seen unprecedented growth in deal volume and assets under management.[157] And, private lenders have had no shortage of deployment opportunities for their available capital or "dry powder."[158] The direct lending market has become an increasingly important part of the overall loan market and significant amounts of private capital have been raised to meet the demand. In some cases, this has led to a handful of risks, such as a loosening in underwriting standards as direct lenders make accommodative decisions to increase their ability to participate in multiple deals.[159] However, direct lending also gives the lender the incentive and leverage to tailor its own protections in each investment opportunity. Direct lenders can structure the loan to give them high seniority and security in the capital structure of the firm, as well as have increased visibility to the company's operations and increased access to management through various more rigorous governance covenants.[160]

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155 *Id.*

156 *See supra* note 144 and accompanying text.

157 *Id.*; *see* DYLAN COX & KYLE STANFORD, PITCHBOOK DATA, H1 2021 GLOBAL PRIVATE DEBT REPORT (2021) (stating direct lending has become an increasingly important part of the lending environment, and significant private capital has been raised to meet the demand. Over $150 billion of private debt has been fundraised each year since 2016. Further, in H1 2021 direct lending continued to be the standout strategy within the private debt market, accounting for 34.6% of the capital raised).

158 *See id.* at 4; KELLY THOMPSON, DIRECT LENDING DEALS, FULL YEAR 2021 INSIGHTS & OUTLOOK REPORT (2022) (on file with authors) (showing $103.5 billion worth of U.S. sponsored direct lending originations. However, given that nearly all direct lending deals are privately funded and contain, at maximum, a small group of numbers, such data is privately and anonymously reported).

159 *Positioning Portfolios for Late Cycle Dynamics: Direct Lending*, BLACKROCK, https://www.blackrock.com/institutions/en-us/insights/investment-actions/direct-lending (last visited Feb. 11, 2022) [https://perma.cc/ZV4R-ELYX].

160 Panossian, Makam & Koury, *supra* note 147.

Since in most direct lending, the borrowers are private companies, there is no public disclosure on these loans and therefore we cannot directly quantity the governance covenants in these loans. However, we gathered information from interviews with practitioners as well as a data service that aggregates news reports about these deals to develop a rough estimate of their importance for corporate governance.

Although were unable to obtain the covenants for these loans given their private nature, we did obtain data on the size of the market as well as general covenant trends. As of the end of 2021, the direct lending market was sizable, with nearly $1 trillion in outstanding loans.[161] The lenders are non-regulated entities (as opposed to banks that are regulated by the Federal Reserve). They are overwhelmingly credit funds that specialize in direct lending, private equity firms, or business development corporations (a company that specializes in lending to smaller companies).[162] They make loans as large as $3 billion, rivaling even some of the regulated bank loans seen among public borrowers.[163]

Direct lenders buck the trend seen among public borrowers and regulated banks.[164] Cov-lite is reportedly not the standard in direct loans, meaning that they retain financial covenants.[165] Attorneys we interviewed for this project universally mentioned direct lending as an area in which lenders maintain ongoing governance rights over borrowers as well. As one attorney put it, the direct lenders "view themselves as a partner to the business."[166] They require robust information rights, meeting and visitation rights, as well as the right to appoint board observers.[167] As another attorney who has negotiated loan deals for twenty years stated, "part of [direct lenders'] investment committee's thesis is that they want to be more active in governance . . . their investment committee requires more board oversight."[168] These companies will negotiate for a

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161 *See* THOMPSON, *supra* note 158.

162 *See id.* at 27.

163 *Id.*

164 *See* Telephone Interview with Interview Participant #5 (Dec. 7, 2021); Telephone Interview with Interview Participant #3 (Dec. 23, 2021); Telephone Interview with Interview Participant #5 (Jan. 18, 2022).

165 *See id.*

166 Telephone Interview with Participant #1 (Dec. 17, 2021).

167 *Id.*; *see also*, Telephone Interview with Participant #2 (Dec. 17, 2021) (stating that board observer rights may have "more prevalence" in private companies).

168 *See* Telephone Interview with Participant #2 (Dec. 17, 2021).

"a non-voting observer right at any and all board meetings, and sometimes committee meetings."[169] Borrowers tend to resist the inclusion of board observer rights because they do not want monitoring or interference, but they are common nonetheless.[170] According to one attorney, certain lenders in this space insist on board observer rights in all of their deals as a condition of extending the loan.[171]

Direct lenders are also likely to insist on limitations on insider transactions. This is especially the case for founder-run companies.[172] Lenders also insist upon this for deals in which there is another private equity firm sponsoring the transaction, to limit their taking advantage of influence with insider to give themselves excessive advisory fees.[173]

IV
Implications

This Part discusses the theoretical and practical implications of cov-lite and gov-lite. Agency costs and the efforts to mitigate them have been at the core of corporate law discourse for close to a century, with a rich literature exploring the ways through which markets, regulations, and shareholders can mitigate them. This literature and the previous Parts of this paper show that covenants in loan agreements should play an important role in mitigating agency costs—but both financial and governance covenants are disappearing due to competition and syndication.

This Part explores the theoretical and practical implications of these cov-lite and gov-lite trends. Part IV.A describes the theoretical implications. In particular, it argues that in the modern era, where both shareholders and stakeholders are concerned with a variety of environmental, social, and governance ("ESG") issues, loan covenants provide a powerful way for corporate outsiders to gain a say in how corporate decisions are made. Part IV.B then moves to highlight the practical implications of outside governance by credit agreements.

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169 *See id.*

170 Telephone Interview with Participant #1 (Dec. 17, 2021).

171 *See* Telephone Interview with Interview Participant #2 (Dec. 17, 2021).

172 *See* Telephone Interview with Participant #3 (Dec. 23, 2021).

173 *See* Telephone Interview with Participant #3 (Dec. 23, 2021); Telephone Interview with Participant #4 (Dec. 27, 2021).

A. Theoretical Implications

1. *Understanding the Boundaries of Governance*

One of this Article's most important contributions is that it brings to light the existence of governance covenants. For some time, scholars have looked to corporate organizational documents—charters and bylaws—for information about corporate governance. Only a few studies have expanded beyond that, looking at, for instance, how ancillary corporate policies can also house important governance provisions,[174] or how shareholder proposals affect governance.[175]

Moreover, lenders' influence on corporate governance had been relatively under-theorized—legal research provided little empirical evidence of lenders' governance impact, and finance and accounting research provided little evidence outside of lenders' financial impact.[176]

By highlighting the role of lenders in shaping corporate governance, this Article shows how even documents that do not govern internal affairs—i.e., documents other than charters, bylaws, committee charters, internal governance documents and the like—can and do have an impact on corporate governance.

An understanding of the existence and scope of external corporate governance mechanisms, such as governance interjected through debt agreements, is an important first step toward developing better, more complete theories of governance and the relationship between managers and shareholders.[177] For example, without an understanding of the full universe of

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174 Nili & Hwang, *supra* note 49 (showing that a variety of governance policies are contained with non-charter, non-bylaw documents, such as committee charters).

175 Sarah C. Haan, *Shareholder Proposal Settlements and the Private Ordering of Public Elections*, 126 YALE L.J. 262, 269, 272, 290 (2016); *see generally* Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315 (2008) (documenting the developing role of public pension funds).

176 *See supra* Part I.

177 Gabriel Rauterberg, *The Separation of Voting and Control: The Role of Contract in Corporate Governance*, 38 YALE J. ON REGUL. 1124, 1163, 1176 (2021). In its 2019 Statement on the Purpose of the Corporation, the Business Roundtable—an influential group of nearly 200 CEOs of major American companies—openly stated that they "share[d] a fundamental commitment to all of our *stakeholders*," and vowed to run their companies with the welfare of employees, suppliers, communities, *and* shareholders in mind. *Statement on the Purpose of a Corporation*, *supra* note 27 (emphasis added).

governance mechanisms, it has thus far been impossible to understand a corporation's agenda and how it plans to execute that agenda. Social agendas, such as environmental policies, often metastasize in debt agreements rather than in the corporation's internal documents. Even non-social agendas, such as those relating to core governance issues such as director qualifications, stock options, and conflicts of interests, are often developed and defined in these documents.

In short, by shining a light on a broader array of non-internal documents that can influence governance, this Article opens the door to a wide array of new research that can take into account a larger array of documents that might influence the corporation.

2. *Expanding Beyond Shareholders vs. Stakeholders*

Another important theoretical implication is that this Article's findings challenge the conventional understanding of *who* impacts governance, and *how*. The conventional wisdom is that governance is a tug-of-war between shareholders and management. And while scholars, policymakers, and practitioners have shown a growing interest in stakeholder governance in recent years, few have provided any concrete ideas how to engage stakeholders.

Stakeholder theory is the idea that managers ought to make decisions for the benefit of both shareholders and non-shareholder stakeholders, such as employees, the surrounding community, suppliers, and customers.[178] In recent years, this idea has gained substantial momentum and gained support from scholars and practitioners alike. But despite the fact that much ink has been split arguing for or against stakeholder theory, relatively little has been said about how stakeholders might even be able to engage in corporate decision-making.

For example, several scholars have written about stakeholder engagement through activist shareholding.[179] In these situations, activists purchase shares of a company and then use their weight as shareholders to influence corporate behavior. Some of the best-known of these campaigns have made it into corporate-law casebooks. Antiwar activist Charles Pillsbury, for instance, purchased shares of Honeywell in order to convince

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178 Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 103–08 (2020) (describing stakeholder theory).

179 *E.g.*, Haan, *supra* note 175; Choi & Fisch, *supra* note 175.

the company to stop making munitions for the Vietnam War.[180] More recently, an Episcopalian church in Manhattan, Trinity Wall Street, purchased shares of Wal-Mart in an attempt to force the retailer to stop selling automatic weapons.[181] Scholars have written about versions of this, too: campaign finance activists who submit proposals to corporations,[182] shareholders who have successfully pressured corporations to make reams of non-mandated disclosures,[183] and powerful institutional investors who use their clout to urge companies to adopt diverse boards and environmental policies.[184]

Of note, however, stakeholders who buy shares in order to influence corporations are *shareholders*—so these studies provide no roadmap for how a non-shareholder stakeholder might influence decision-making. In fact, with one notable exception,[185] legal scholarship has said little about the specifics of how a pure stakeholder can get involved in decision-making.

This Article is the first to show, concretely, how a non-shareholder stakeholder can and does get involved in corporate governance: that is, lenders can and do influence corporate governance even without becoming shareholders.

One important consequence of recognizing lenders' influence is that it is now clear that debt agreements can obscure the true division of powers between managers and shareholders by granting lenders important say in the governance of the corporation. This lender influence may bolster or curb shareholders' interest. This interjection, that is often done without shareholder input or approval, presents problems for both shareholders trying to assess the corporation's governance checks on management and their own rights, and to researchers trying to measure change in that push-and-pull relationship.[186] For example, in the 1980s and 1990s, it was

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180 Minnesota *ex rel.* Pillsbury v. Honeywell, Inc., 191 N.W.2d 406, 406 (Minn. 1971).

181 Trinity Wall St. v. Wal-Mart Stores, Inc., 792 F.3d 323, 328 (3d Cir. 2015).

182 Haan, *supra* note 175.

183 Hwang & Nili, *supra* note 49.

184 Lund, *supra* note 67; Choi & Fisch, *supra* note 175.

185 Professor Jennifer Fan, for instance, has described the way that employees get involved in corporate decision-making, especially in high-tech industries, where competition for employees is fierce. *See* Jennifer S. Fan, *Employees as Regulators: The New Private Ordering in High Technology Companies*, 2019 UTAH L. REV. 973.

186 Haan, *supra* note 175 (showing that a variety of campaign finance policies were adopted as a result of management's settlements with shareholders, rather than as a result of shareholder vote).

relatively easy to track the increase in takeover defenses being used by corporations, as these defenses were often articulated in core organizational documents.[187] In modern governance, however, numerous parts of the governance relationships are hidden in governance provisions of debt agreements.

B. Practical Implications

This Article's findings also bring to the fore several important practical implications for various groups.

1. *Stakeholders*

In its 2019 Statement on the Purpose of the Corporation, the Business Roundtable—an influential group of nearly 200 CEOs of major American companies—openly stated that they "share[d] a fundamental commitment to all of our *stakeholders*," and vowed to run their companies with the welfare of employees, suppliers, communities, *and* shareholders in mind.

Many scholars, policymakers, and practitioners have also argued that non-shareholder stakeholders *should* participate in corporate governance, but the existing literature has mainly focused on stakeholder participation through shareholder rights[188] and shareholder-backed stakeholderism.[189]

While useful, pushing for stakeholder values via shareholder engagement presents an incomplete solution for stakeholders. For one thing, some stakeholder-driven topics stand in direct contrast with shareholder interests. Where shareholder and stakeholder interests diverge, shareholder rights are likely to prevail, to the detriment of stakeholders.[190] Second, even if some shareholders are allies of specific stakeholderism

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[187] *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 173 (Del. 1986); *see also* Yakov Amihud, Markus Schmid, & Steven Davidoff Solomon, *Settling the Staggered Board Debate*, 166 U. PA. L. REV. 1475 (2018) (addressing the debate over the efficacy of staggered boards and ultimately determining that the effect of staggered boards is firm dependent).

[188] Haan, *supra* note 175.

[189] Hwang & Nili, *supra* note 49.

[190] *See* George Triantis, *Exploring the Limits of Contract Design in Debt Financing*, 161 U. PA. L. REV. 2041, 2042 (2013) (explaining that "as faithful agents of their shareholders, managers are more likely to [take actions adverse to other stakeholders such as] (a) forego lower-risk, profitable projects ('underinvestment'); (b) invest in higher-risk, unprofitable alternatives ('overinvestment' or 'risk alteration'); (c) incur additional debt to further leverage the equity in the firm; and (d) distribute firm value to shareholders in the form of dividends or share repurchases"); *see also* Rock, *supra* note 32, at 1910 (noting that "managers and directors today largely 'think like shareholders'").

topics, there are many barriers to corporate action: for example, shareholders still need to garner sufficient support to make shareholder proposals, and corporations do not always act on shareholder proposals.

This Article is the first to show a path forward for one set of non-shareholder stakeholders: lenders. Through covenants, lenders can have a say in corporate governance, even without becoming shareholders. Indeed, with regard to corporate activism on ESG issues, lenders have been described as an "underutilized resource."[191]—and perhaps it is time for lenders to use their power.

Other non-lender, non-shareholder stakeholders might also engage with the corporation's corporate governance through loan agreements. For example, community members living near a corporate polluter might seek to influence the borrower company's lender bank to include a governance covenant regarding environmental liability rather than through a shareholder proposal. The lender bank could then include a covenant mandating compliance with environmental regulations and regular environmental reports.

Already, some of this type of stakeholderism activism occurs through green bonds—bonds created to fund projects with positive environmental or climate benefits, which have surged in popularity in recent years. A report from Moody's noted that new sustainable bond issuance may top $650 billion in 2021, a 32% jump from last year.[192] Green bonds fall under a larger umbrella of sustainable bonds, with proceeds from investors earmarked by issuers for projects that are good for the environment, sustainability, and social purposes. ESG linked loans have also become a popular tool to increase the link between the debt agreement and companies ESG performance. While the majority of green bond buyers are big pensions, retail investors are also having the chance to participate in the market. The Green Bond Principles, a "best practice" document put out by the International Capital Market Association, sets out guidelines for use of proceeds, project

191 Gledhill, *supra* note 56 (quoting Chris Kaminer, Head of Investment Strategy at Lombard Odier Investment Managers).

192 Andrea Miller, *How the $1 Trillion Market for 'Green' Bonds Is Changing Wall Street*, CNBC (May 28, 2021), https://www.cnbc.com/2021/05/28/how-the-1-trillion-market-for-green-bonds-is-changing-wall-street.html [https://perma.cc/EFU8-6FXX].

evaluation, management of proceeds, and reporting to investors.[193] Green bonds offer a promising example for the potential of governance covenants in loan agreements but with the potential to go beyond environmental topics and into a broader array of social issues.

Alongside green bonds, direct lenders have increasingly integrated environmental, social, and governance criteria into their investment strategy.[194] As an increasing number of direct lenders incorporate ESG criteria into their lending commitments, such lenders can decide whether to lend capital or not based on a company's ESG rating, link a positive ESG score to a reduced interest rate, or encourage other direct lenders to join together to promote incorporation of ESG-criteria in direct lending commitments.[195] Direct lenders in the private debt market who are able to integrate ESG into their portfolios will likely be met with approval from investors globally.[196]

Indeed, the growing usage of direct lending also presents new opportunities for future research. Direct lending may show early signs of a revival of stakeholder interests pushed through debt agreements, rather through traditional shareholder tools. While debt-driven stakeholdersim presents many benefits, such as direct impact, a targeted approach and skin in the game, it also raises concerns. Whereas traditional mechanisms of shareholder-driven stakeholderism are affected in collaboration with shareholders (and often with their explicit approval), debt-driven stakeholderism will frequently bypass shareholder approval all together. This raises important theoretical and

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193 Int'l Cap. Mkt. Ass'n, Green Bond Principles: Voluntary Process Guidelines for Issuing Green Bonds (2021), https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Green-Bond-Principles-June-2021-140621.pdf [https://perma.cc/KTF8-S6ZE].

194 Alex Di Santo & Andrea Lennon, *ESG in Private Debt: Europe's Red Hot Private Debt Market Is Going Green*, Crestbridge (Aug. 2, 2021), https://www.crestbridge.com/insights/esg-private-debt [https://perma.cc/SJU5-U8CP] (stating in 2020, Barings Bank "offered financing which included an annual review of the margin for the credit facility, based on the achievement of five pre-defined ESG criteria. Because the test [was] annual, it require[d] the borrower to be committed to the ESG criteria—and because commitment to the criteria directly correlates to a reduction in the cost of its capital, the firm [was] suitably incentivised to make good on that commitment. The more criteria the company meets, the larger the cost reduction").

195 Alex Di Santo, *Direct Lending: The Opportunity in 2021 and Beyond*, Crestbridge (June 3, 2021), https://www.crestbridge.com/insights/direct-lending-opportunity-2021-and-beyond [https://perma.cc/9NCB-BBL3].

196 Di Santo & Lennon, *supra* note 194.

practical questions, some of which are set out in the next section, and many of which are ripe for future research.

2. *Shareholders*

This Article's findings have significant practical implications for shareholders. For shareholders, a corporation's charter, bylaws, and other corporate documents are the traditional sources of its corporate governance structure. And while financial covenants in loan agreements are more thoroughly tracked and studied, shareholders and investors should be aware of the significant role governance covenants can play in a borrower corporation's governance.

Governance by debt is a double-edged sword for shareholders' interests. On one hand, lenders can provide a valuable service in monitoring and curbing the agency costs that the widely-held corporation presents.[197] In that sense, strong lender-pushed governance rights, particularly those aimed at minimizing managerial slack or excessive risk-taking, would be a valuable tool from a shareholder perspective. Yet, shareholders' and lenders' interests are not always aligned, and at times governance provisions in debt agreements may tie the company's hands in ways that are detrimental to shareholders' interests. For example, restrictions on dividends or M&A transactions may ensure that the corporation would have sufficient assets to repay lenders but may come at a cost of losing significant growth opportunities or return on investment to shareholders.[198] Additionally, the sharp rise in the ability and power shareholders have over management, may negate the need for collaboration with creditors.[199]

The gov-lite and cov-lite trends further complicate shareholders' positions in the corporation. Shareholders may be losing an important ally in the quest to curb managerial entrenchment but may also be benefiting from the removal of governance restrictions that benefited lenders at the expense of

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197 *See supra* Section I.B.

198 *See* William W. Bratton, *Bond and Loan Covenants, Theory and Practice*, 11 Cap. Mkts. L.J. 461, 472 (2016) ("As between a payout to shareholders and reinvestment, any investment yielding a positive cash return, no matter how low, is superior, for even a zero return investment enhances the asset base available to pay the debt. Here, then, it is the lender's side of the debt-equity conflict of interest that threatens inefficient results.").

199 *See, e.g.*, Nili & Kastiel, *Gadflies*, *supra* note 10; Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 Colum. L. Rev. 2563, 2565 (2021).

shareholders. Furthermore, if ESG matters take stronger hold in debt agreements,[200] the push and pull between shareholders and stakeholders is likely to widen.

This delicate balance exemplifies the importance to shareholders of using a nuanced, case-by-case approach for evaluating each situation in which lenders can have significant say in corporate governance. Specifically, shareholders and prospective investors should be more vigilant about covenants in loan agreements as they steadily trend toward cov-lite and gov-lite. Moreover, they should also examine them against the specific governance structure of the company.

Practically speaking, shareholders can request that companies provide a robust disclosure of the interaction of its internal governance policies with its external governance commitments. This is particularly important as shareholders are not asked to approve debt obligations[201]—standing in contrast with the approval of key governance provisions by a shareholder vote—or at the very least the ability to reverse internal governance arrangements through a shareholder-initiated bylaw amendment.

3. *Lenders*

The findings in this Article also have important implications for lenders. In the past, many non-senior lenders could rely on senior lenders to lead the way on monitoring borrowing and mitigating agency costs. This has included lenders buying bonds in the market for corporate debt, worth over one-trillion dollars as of the end of 2021.[202] As discussed earlier, however, the structure of the loan market—in that many loans are originated and then immediately sold via syndication[203]—creates a system in which potentially *no lenders* are monitoring a borrower's governance. This means that, especially for those lenders who previously free-rode on senior lenders, now is the time to take a closer look at borrower governance.

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200 *See supra* Part II.

201 *See* William T. Allen, Reinier Kraakman & Guhan Subramanian, Commentaries and Cases on the Law of Business Organization 460 (4th ed. 2012) (explaining that mergers, sales of substantially all assets, charter amendments, and voluntary dissolutions are the only transactions that require shareholder approval by statute, and noting that corporate charters overwhelmingly do not expand this scope and instead "rely strictly on the provisions of the statutes to allocate power between the board and shareholders").

202 *See* Telephone Interview with Interview Participant #4 (Dec. 27, 2021).

203 *See supra* Part III.

Fortunately for these non-senior lenders, there are several practical avenues through which they can accomplish monitoring. For example, lenders can collaborate more closely with shareholders and stakeholders, thereby reintroducing important governance provisions to loan agreements. Lenders can consider moving away from the syndication structure, in order to keep a closer eye on borrowers' governance. Finally, as previous Parts discussed, many lenders can move toward direct lending, a method of lending that allows more direct lender influence in corporate governance.

4. *Proxy Advisors*

ISS and Glass Lewis, the two major proxy advisors, provide analyses and support to institutional investors in connection with their vote. This role, according to insiders and their advisors, gives proxy advisors significant power and control over many voting decisions in the market.[204] As then-Chief Justice of the Delaware Supreme Court Leo Strine noted: "powerful CEOs come on bended knee to Rockville, Maryland, where ISS resides, to persuade the managers of ISS of the merits of their views about issues like proposed mergers, executive compensation, and poison pills."[205]

Proxy advisors concentrate their assessments on governance metrics rather than exclusively assessing companies' financial performance.[206] One way proxy advisors influence governance is through rating companies along metrics such as the ESG QualityScore.[207] But when reviewing and scoring companies along these metrics, proxy advisors should more seriously and closely consider governance covenants in a company's loan agreements and how those covenants shape up

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[204] Timothy M. Doyle, Am. Council For Cap. Formation, The Conflicted Role of Proxy Advisors 7, 11 (2018), https://accf.org/wp-content/uploads/2018/05/ACCF-The-Conflicted-Role-of-Proxy-Advisor-FINAL.pdf [https://perma.cc/ED97-3R34].

[205] Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 Del. J. Corp. L. 673, 688 (2005); *see also* Asaf Eckstein & Sharon Hannes, *A Long/Short Incentive Scheme for Proxy Advisory Firms*, 53 Wake Forest L. Rev 787, 793–97 (2018) (describing the increasing power of proxy advisors).

[206] Kobi Kastiel & Yaron Nili, *The Corporate Governance Gap*, 131 Yale L.J. 782, 794 (2022).

[207] The ISS QualityScore uses a numeric, decile-based score that indicates a company's governance risk across Governance, Environmental & Social pillars. For a full description see *ESG Ratings & Rankings*, ISS ESG Sols., https://www.issgovernance.com/esg/ratings/ [https://perma.cc/FRW9- C2Q5].

against loan agreements among a company's peers. By incorporating debt governance, including an appropriate focus on gov-lite agreements, proxy advisors' scores, and voting recommendations can better reelect the broader governance landscape, rather than merely focusing on internal governance provisions.

5. *Courts*

Historically, courts protected lenders by imposing liability on managers who abused their powers to prevent repayment to lenders. Managers can transfer assets away from the firm by, for example, distributing them as dividends to shareholders,[208] or placing them in an insulated, limited liability subsidiary.[209] Managers may also choose high risk, costly investments that leave little value in the firm if they do not pay off.[210] Such managerial opportunism is particularly acute when the firm approaches insolvency (sometimes called the "zone of insolvency") because at that point it is often easier or more expeditious for managers to deploy assets in ways that benefit junior claimants like shareholders, than to try to manage the firm out of its precarious position.[211]

Court protections against this kind of managerial opportunism have waned in recent years after a brief period of intense interest from the Delaware courts. This interest stemmed from a steep rise in the use of debt financing in corporate America,[212] as well as a glut of leveraged buyouts throughout the 1980's fueled by that debt. Litigation over leveraged buyouts led the

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208 The protection has primarily taken the form of fiduciary duties since the 1970's. *See, e.g.*, Harff v. Kerkorian, 324 A.2d 215, 222 (Del. Ch. 1974), *aff'd in part, rev'd in part*, 347 A.2d 133 (Del. 1975) (suggesting a duty for the board of a Delaware corporation even without a contractual right in the event of "fraud, insolvency, or a violation of a statute").

209 *See, e.g.*, Eliza Ronalds-Hannon & Katherine Doherty, *PetSmart Moves Part of Chewy.com Out of Creditors' Reach*, BLOOMBERG (June 4, 2018), https://www.bloomberg.com/news/articles/2018-06-04/petsmart-is-said-to-move-chewy-stake-in-j-crew-style-transfer/ [https://perma.cc/4WB4-VBFU].

210 *See* Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp., No. Civ. A. 12150, 1991 WL 277613, at *34 n.55 (Del. Ch. Dec. 30, 1991) ("The possibility of insolvency can do curious things to incentives, exposing creditors to risks of opportunistic behavior and creating complexities for directors.").

211 Jared A. Elias & Robert Stark, *Bankruptcy Hardball*, 108 CALIF. L. REV. 745, 756–57 (2020) (discussing incentives of managers before and during insolvency).

212 The percentage of firm value represented by debt rose from 25% in 1930 to 65% by 1990. *See* John R. Graham, Mark T. Leary & Michael R. Roberts, *A Century of Capital Structure: The Leveraging of Corporate America*, 118 J. FIN. ECON. 658, 659 (2015) (tracing the history of American corporate debt).

Delaware Chancery Court to broaden the set of situations in which boards might owe fiduciary duties to lenders.[213] In the seminal case of *Credit Lyonnais*,[214] the court held that the directors of a company operating "in the vicinity of insolvency" owed fiduciary duties not just to shareholders but also to the entire "corporate enterprise." With the aid of a stylized law and economics example, the opinion made the point that fulfillment of fiduciary duties to the "corporate enterprise" included taking account of the interests of lenders.[215] The decision was met with forceful criticism from academics who charged that fiduciary duties were unnecessary for parties who were perfectly capable of contracting and enforcing their contractual rights in court on their own behalf.[216]

In a series of subsequent cases,[217] the Delaware courts curbed their recognition of lender fiduciary duties. First, in the *Gheewalla* case, the Delaware Supreme Court repudiated *Credit Lyonnais*' pronouncement of lender fiduciary duties in a "zone of insolvency," thus foreclosing lenders' direct claims of breach of duty while a company was still solvent.[218] The court left open the possibility of derivative claims once the company crossed into insolvency. In a later decision, *Quadrant Structured Products*, the court went a step further and declared that

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213 *See* Dianne F. Coffino & Charles H. Jeanfreau, *Delaware Hits the Brakes: The Effect of* Gheewalla *and* Trenwick *on Creditor Claims*, 17 NORTON J. BANKR. L. & PRAC. 63, 63–64 (2008) (recounting the shift toward broader fiduciary duties to creditors and subsequent retrenchment).

214 *See Credit Lyonnais*, 1991 WL 277613, at *34.

215 *Id.*; *see also* Myron M. Sheinfeld & Judy Harris Pippitt, *Fiduciary Duties of Directors of a Corporation in the Vicinity of Insolvency and After Initiation of a Bankruptcy Case*, 60 BUS. LAW. 79, 88 (2004).

216 *See, e.g.*, Jonathan C. Lipson, *Directors' Duties to Creditors: Power Imbalance and the Financially Distressed Corporation*, 50 UCLA L. REV. 1189, 1193 (2003) (arguing that the ability of banks and bondholders to protect themselves and exit bad investments mean that they should be limited to the contractual rights they have negotiated); Frederick Tung, *Gap Filling in the Zone of Insolvency*, 1 J. BUS. & TECH. L. 1201, 1204 (2007) ("[A]t least for commercial creditors, fiduciary duties that include such creditors are unnecessary . . . .").

217 *See* Quadrant Structured Prods. Liab. Co. v. Vertin, 115 A.3d 535, 544 (Del. Ch. 2015). Prior cases had similarly made clear the high burden that creditors would need to overcome to lodge a claim of fiduciary breach. *See, e.g.*, Nelson v. Emerson, No. Civ. A. 2937-VCS, 2008 WL 1961150 (Del. Ch. May 6, 2008) (denying a creditor's claim of fiduciary breach by filing bankruptcy to frustrate creditors' claims).

218 N. Am. Cath. Educ. Programming Found. v. Gheewalla, 930 A.2d 92, 100 (Del. 2007). Prior opinions had already criticized *Credit Lyonnais* and come close to rejecting it. *See, e.g.*, Trenwick Am. Litig. Tr. v. Ernst & Young, L.L.P., 906 A.2d 168, 170–74 (Del. Ch. 2006) (describing the zone of insolvency doctrine as not giving rise to a cause of action).

the board of an insolvent company owes no fiduciary duties to lenders. Nonetheless, the court did state that the board *may* consider lenders when considering their fiduciary duties to the corporation as a whole, but made clear that a board's business judgment to take a risk prejudicial to lenders would be protected by the business judgment rule.[219] Thus, while the Delaware courts briefly moved to recognize fiduciary duties toward lenders in the 1980s and early 1990s, since 2006, they have made a hasty retreat in the opposite direction.[220]

Delaware's reluctance to incorporate lender protection under state corporate law has had significant practical impact. In one recent example, the pet supply retailer PetSmart ran into severe financial trouble following a leveraged buyout and the acquisition of Chewy.com, and faced a mountain of debt owed to bank lenders and bondholders.[221] Instead of attempting to manage the company back to fiscal health or entering a Chapter 11 proceeding to ensure an orderly distribution of assets to lenders, the firm's managers moved $2 billion in Chewy.com's equity out of lenders' reach by distributing $900 million to shareholders and placing $750 million in a subsidiary that was not liable for the debt.[222] A similar move was taken at J.Crew the same year, resulting in the bizarre outcome that junior bondholders were placed ahead of senior bank lenders in priority of repayment.[223] Observers noted that these ag-

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219 *See Quadrant Structured Prods. Liab. Co.*, 115 A.3d at 544.

220 These trends have been insightfully analyzed by Jared Elias and Robert Stark. *See* Elias & Stark, *supra* note 211, at 760–62 (noting that after *Gheewalla*, directors can favor certain creditors over others without breaching their fiduciary duty and have no obligation to run the business for the protection of creditors); *see also* Adam B. Badawi, *Debt Contract Terms and Creditor Control*, 4 J.L. FIN. & ACC. 1 (2019) (examining the impact of the *Gheewalla* decision).

221 *See* Eliza Ronalds-Hannon & Lauren Coleman-Lochner, *The Most Expensive Takeover in Retail Is Drowning in Debt*, BLOOMBERG (Apr. 25, 2018), https://www.bloomberg.com/news/articles/2018-04-25/yielding-21-in-bond-market-the-no-1-retail-lbo-is-in-trouble#xj4y7vzkg [https://perma.cc/8E4Z-BZ3V].

222 Ronalds-Hannon & Doherty, *supra* note 209; *see also* Elias & Stark, *supra* note 211, at 757 (arguing that courts and traditional doctrines such as fraudulent transfer law have become insufficient to prevent such moves).

223 Soma Biswas, *Deal to Save J.Crew from Bankruptcy Angers High-Yield Debt Investors*, WALL ST. J. (Sept. 21, 2017), https://www.wsj.com/articles/deal-to-save-j-crew-from-bankruptcy-angers-high-yield-debt-investors-1506011065 [https://perma.cc/P77X-9HRV] (commenting on the fact that the transaction pushed "junior bondholders to the front of the line of creditors, ahead of term-loan holders, who were in a superior position"). Vincent Buccola has proposed a theory to explain these trends in terms of private equity sponsor power. *See* Vincent S.J. Buccola, *Sponsor Control: A New Paradigm for Corporate Reorganization*, 90 U. CHI. L. REV. 1, 4–7 (2023); *see also* Vincent S.J. Buccola & Greg Nini, *The Loan Market Response to Dropdown and Uptier Transactions* (June 29, 2022)

gressive moves by management in both cases were the result of Delaware's new abrogation of lender fiduciary duties—managers now know they can get away with tactics that would have given rise to liability under *Credit Lyonnias*.[224]

The Delaware courts' now-prevailing rationale sees lenders as capable of bargaining in their own interests, and to the extent their contracts are incomplete, they must be assumed to be intentionally so. However, our findings show that there is reason to question the dominant narrative that lenders can effectively contract for their own interests in all cases. At times, it is clear that lenders can indeed impose certain constraints, perhaps beyond even those of shareholders. But that ability is not uniform among lenders or over time and depends highly on market forces. Thus, the set of covenants courts claim to be the result of privately ordered protection may not reflect the bargain courts assume they do.

If the goal is good corporate governance and minimizing agency costs, then not only should lenders' influence be accounted for, but the extent to which they can influence the company or protect their own interests should also be considered. Thus, lenders' ability to contract is cyclical and dependent on developments that go beyond the simple bilateral arrangement between lender and borrower. And because they bargain in the shadow of market forces, so, analogous to shareholders, their bargains may be incomplete for reasons that are unintentional and inefficient, i.e., because of market failures. Courts' rationales for limiting fiduciary duties to lenders hinge on lenders' ability to bargain, but that in turn implies that this rationale's power shifts as lenders' bargaining power waxes and wanes. This implies that courts should revisit whether fiduciary duties should consider lenders. If such duties exist, there are thorny questions about how to operationalize them.

(unpublished manuscript) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4143928) (describing changes in contract terms in response to hardball tactics).

[224] *See, e.g.*, Elias & Stark, *supra* note 211, at 747; Nathan Vardi, *Leon Black's Apollo Global Management Keeps Winning Battles and Outmaneuvering Creditors*, FORBES (Aug. 28, 2014), https://www.forbes.com/sites/nathanvardi/2014/08/28/leon-blacks-apollo-global-management-keeps-winning-battles-and-outmaneuvering-creditors/?sh=35719f5a785f [https://perma.cc/8HJ7-65Q9] (discussing private equity's rising ability to outmaneuver creditors whose claims are legally senior to shareholders).

Conclusion

This Article addresses two gaps in the literature. First, it is the first to identify and empirically study "gov-lite" loans—bank loans to corporate borrowers that have few or no covenants relating to governance of the borrower. Using an original dataset, this Article is the first to document the rise of gov-lite loans over the last decade. Second, this Article tackles the mystery of the gov-lite trend. Like "cov-lite" loans—loans that are light on financial covenants—gov-lite loans are a puzzle. Reams of theoretical and empirical literature have shown that loan covenants are an excellent way to mitigate the agency problem in lending—yet covenants are on the decline. Using qualitative empirical evidence, this Article shows that the decline is fueled by competition and syndication in the corporate loan market, as well as the rise of a new type of lending: direct lending. Finally, this Article considers the significant theoretical and practical implications of gov-lite for shareholders, corporate stakeholders, and the courts.

Appendix A: Summary Statistics

Summary statistics of the loan sample are presented below in Tables A, and summary statistics relevant to borrowers are set out in Table B.

Table A. Loan Summary Statistics

Loan Purpose	***N***	***Percent of Sample***
Acquisition finance	1,050	13.80%
Dividend recap	130	1.71%
Refinancing	2,687	35.32%
Other/General corporate purposes	4,465	58.69%
Loan Type		
Senior loan	5,527	72.65%
Asset-backed loan	1,278	16.80%
DIP	77	1%
Cov-lite only (no cov-heavy facility)	756	9.94%
Investment grade loans	2,280	29.98%
Leveraged loans	5,326	70.02%
Secured loans	4,194	55.14%
Unsecured loans	3,412	44.86%

Notes: Loans can have more than one purpose and type, allowing statistics to equal more than 100%.

The median loan amount in the sample is $420 million, and median company size in terms of assets $681 million. We coded loans according to their purpose, their seniority, whether they were considered leveraged or investment grade, and whether or not they were secured. We also coded each loan as either "covenant-lite" or covenant heavy based on whether or not financial covenants were present, in accordance with the commonly accepted definition of covenant-lite. For purposes of counting loans as covenant lite, we count the most restrictive covenants in a borrower's loan package at any given time. Borrowers sometimes have multiple active loan agreements at any given time, some of which may be covenant-lite but others of which are covenant heavy. Accordingly, even borrowers with covenant-lite loans will be subject to restrictions if they are obligated under concurrent covenant heavy loan tranches. Since our interest is in the covenants that affect a borrower's corporate governance at any given time, we assume that the most restrictive covenants included in the entire package of a borrower's active agreements in a given time period are the ones that are relevant for each provision that we study.

Table B. Borrower Summary Statistics

	mean	***median***
Loan size ($ millions)	3,030.00	420.00
Borrower total assets ($ millions)	3,099.25	681.80
Borrower total debt ($ millions)	874.00	171.05

Borrower Industries, by 3-digit SIC	***N***	***Percent of Sample***
Aerospace and defense	35	0.46%
Agriculture	28	0.37%
Automobiles, airlines and transportation	420	5.52%
Banking and financial services	430	5.65%
Chemicals	243	3.19%
Computer and electronic equipment	286	3.76%
Construction and materials	186	2.45%
Consumer goods	157	2.06%
Food and beverage	260	3.42%
Forestry and paper	93	93%
Insurance	188	2.47%
Manufacturing and machinery	351	4.61%
Media & entertainment	225	2.96%
Medical devices and healthcare	386	5.07%
Mining and metals	283	3.72%
Oil and gas	539	7.09%
Pharmaceuticals and biotechnology	226	2.97%
Real estate	769	10.11%
Retailers	528	6.94%
Services	865	11.37%
Telecommunications	151	1.99%
Textiles and apparel	90	1.18%
Tobacco	19	0.25%
Travel and leisure	102	1.34%
Utilities	747	9.82%

We catalogued 41 types of covenants that occurred in at least 10 of the agreements over the entire time period. A detailed discussion of each type of covenant is not feasible or

necessary for this Article, but we describe several categories of covenants that impact corporate governance and stakeholder engagement. These are: covenants that deal with insider self-dealing, covenants that give lenders soft power through access, disclosure and information covenants, and covenants related to sustainability or environmental issues.

Appendix B: Interviews & Interview Methodology

The findings in this article are informed by interviews with the following individual interview participants. Interview participants are practicing lawyers who work on bank lending, or, occasionally, areas that are directly adjacent to bank lending.

The interviews were semi-structured. When interviewing participants, we asked a set of open-ended questions, and supplemented those with follow-up questions and requests for clarification. We took notes and transcribed the answers in real time, but did not record the interviews.

For brevity and anonymity, each interview participant is identified within the text of the article by a reference term, which is noted in the chart below.

To identify interview participants, we used a snowball sampling technique, asking each interview participant at the end of the interview if they could introduce me to additional potential participants. The main shortcoming of this method is sampling bias. However, personal introductions helped us gain access to a population that would otherwise not speak to us.

Reference Term	**Interview Date**	**Experience**
Interview Participant 1	December 17, 2021	Senior associate at major law firm working on bank lending
Interview Participant 2	December 17, 2021	Partner at major law firm working on bank lending
Interview Participant 3	December 23, 2021	Partner at major law firm working on bank lending
Interview Participant 4	December 27, 2021	Partner at major law firm working on bank lending
Interview Participant 5	December 27, 2021	Partner at major law firm working on capital markets
Interview Participant 6	January 19, 2022	Partner at major law firm working on bank lending
Interview Participant 7	January 19, 2022	Partner at major law firm working on bank lending
Interview Participant 8	February 13, 2022	Partner at a mid-size law firm working on bank lending
Interview Participant 9	February 14, 2022	Senior associate at major law firm working on bank lending
Interview Participant 10	June 15, 2022	Partner at major law firm working on leveraged finance
Interview Participant 11	June 14, 2022	Partner at major law firm working on bank lending