Bankruptcy Resolution: Direct Costs and Violation of Priority Claims

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Lawrence A. Weiss

Fletcher School of Law & Diplo…

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Bankruptcy resolution

Direct costs and violation of priority of claims

Lawrence A. Weiss*
Tulane University, New Orleans, LA 70118-5669, USA

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I present new evidence on the direct costs of bankruptcy and violation of priority of claims. In a sample of 37 New York and American Stock Exchange firms that filed for bankruptcy between November 1979 and December 1986, direct costs average 3.1% of the book value of debt plus the market value of equity, and priority of claims is violated in 29 cases. The breakdown in priority of claims occur primarily among the unsecured creditors and between the unsecured creditors and equity holders. Secured creditors' contracts are generally upheld.

1. Introduction

This paper examines the resolution of bankruptcy for 37 New York Stock Exchange (NYSE) and American Stock Exchange (AMEX) firms that filed petitions under the 1979 Bankruptcy Code (hereafter 'the Code') between November 1979 and December 1986. New evidence is provided on the direct costs of bankruptcy and the violation of priority of claims.

The costs of bankruptcy have long between viewed as a potential determinant of the pricing of a firm's debt and of its capital structure. Bankruptcy costs are direct and indirect. Direct costs encompass the legal and administrative fees, including the costs of lawyers, accountants, and other profession-

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als involved in the bankruptcy filling. Indirect costs include a wide range of unobservable opportunity costs.

Prior studies report direct costs of bankruptcy ranging from 4% to 25%. This study is the first to examine direct costs under the new Code and to cover a broad range of industrial firms. For the firms examined, direct costs average 3.1% of the book value of debt plus the market value of equity at the end of the fiscal year preceding bankruptcy. As Warner (1977a) demonstrates, such small direct costs have virtually no impact on the pricing of claims and capital structure prior to bankruptcy.

The firm's cost of capital and its capital structure may also be affected if priority of claims is not maintained in bankruptcy. Priority of claims is violated when senior claimants' are not fully satisfied before junior claimants receive any payment. Economists have long argued that bankruptcy courts mistakenly fail to uphold priority of claims. Meckling (1977) asserts: 'The courts, the Congress, and the Securities and Exchange Commission refuse to relegate stockholders to the status of purely residual claimants.' Miller (1977) states: 'Permitting stockholders to claim court protection and thereby retain control of a corporation in default would amount to giving them a call option at the expense of the creditors.'

Priority of claims is violated for 29 of the 37 firms studied, consistent with prior research.[1] The breakdown of priority occurs primarily between the unsecured creditors and equity holders and among the unsecured creditors. Priority of claims holds for only 1 of the 18 cases filed in New York, but for 7 of the 19 cases filed outside New York. Secured creditors' contracts are upheld in 34 of the 37 cases.

The following section reviews the sample of bankrupt firms. This is followed by sections on the costs of bankruptcy and violations of priority, and a brief conclusion. Explanations of the Code and its impact on recontracting within bankruptcy appear throughout the paper.

2. Sample selection

On October 1, 1979, passage of a new bankruptcy code substantially revised bankruptcy administration. The number of businesses filing for bankruptcy skyrocketed from 44,000 in 1980 to 81,000 in 1986. I compile a list of NYSE and AMEX firms declaring bankruptcy from November 1979 to December 1986 by examining: (1) the Securities and Exchange Commission's (SEC's) annual report to Congress, which contains a listing of all presentations by the SEC to bankruptcy courts; (2) the *Wall Street Journal Index* (WSJI) listing of all firms that declare bankruptcy; (3) *Compustat's* Research File listing of all firms that are dropped because of bankruptcy filings; and

[1]See Franks and Torous (1989) and Eberhart, Moore, and Roenfeldt (1990).

Table 1

NYSE and AMEX industrial firm bankruptcies, by year and jurisdiction, November 1979 to December 1986.

Exchange	1980	1981	1982	1983	1984	1985	1986	Total
NYSE	2	2	9	1	3	6	3	26
AMEX	9[a]	9	10	9	13	10	13	73
Total	11	11	19	10	16	16	16	99

Jurisdiction	Number
Alabama	1
Arizona	1
California	8
Colorado	4
Washington, DC	1
Delaware	1
Florida	5
Georgia	1
Iowa	1
Illinois	5
Indiana	2
Massachusetts	4
Maryland	1
Michigan	1
Minnesota	2
Missouri	1
New Jersey	3
New York	30
Ohio	6
Oklahoma	2
Pennsylvania	3
Texas	12
Utah	1
Virginia	2
West Virginia	1
Total	99

[a]Only one firm in the sample filed between the time the new bankruptcy code went into effect, on November 15, 1979, and the end of 1979. The firm, Tenna Corporation, filed on December 5, 1979, and is included in the total for 1980.

(4) firms listed as suspended or deleted from the Center for Research in Security Prices (CRSP) tapes. Financial institutions are excluded because they are not subject to the standard provisions of the bankruptcy code. The initial sample consists of 99 firms that filed for bankruptcy in 32 jurisdictions – an average of 14 firms per year, or 0.7% of the roughly 2,000 firms listed on the two exchanges. Table 1 classifies the sample by stock exchange, the year bankruptcy was filed, and the location of filing.

Court documents are available only at the federal court where the bankruptcy petition is filed, and there may be several jurisdictions or districts within an individual state. Because of budget and time constraints, data collection was confined to the following seven jurisdictions:

Central District of California
Southern District of Florida
Northern District of Illinois
District of Massachusetts
Northern District of Michigan
Southern District of New York
Northern District of Ohio

These locations have a total of 51 filings, or just over half of the initial sample. An additional 14 firms were excluded because their bankruptcies were not resolved by May 31, 1989; their data were being used by a bankruptcy judge and hence were not available for study; or their data had been removed from the court to an archive.

The final sample contains 37 firms. Information on each is provided in the appendix. The average time from filing of the bankruptcy petition to resolution is 2.5 years, with a standard deviation of 1.4 years. The shortest bankruptcy took just under 8 months; the longest, more than 8.3 years. This is much less than the time required by Warner's (1977a) sample of railroad firms, which has a mean of 12.5 years. The shortest bankruptcy in Warner's sample took four years to complete. Franks and Torous (1989) report an average of 4.5 years for 16 firms filing before the Code took effect, and 2.7 years for 14 firms filing afterward (of these 14 firms, 10 are part of the current study).

The sample firms' ratio of debt to total assets is 77%, which is 50% higher than the 51% average for all nonbankrupt firms listed on *Compustat* between 1979 and 1986. For a complete discussion of the difference in financial ratios between bankrupt and nonbankrupt firms, see Weiss (1990).

3. The direct costs of bankruptcy

The direct costs of bankruptcy are the legal and other professional and administrative fees associated with the bankruptcy filing; they represent the measurable part of all bankruptcy costs. The indirect bankruptcy costs are the unmeasurable opportunity costs, including:

1. Lost sales and a decline in the value of inventory. Customers may become concerned about assured supply or warranties. In certain industries (e.g., financial services) these costs can completely destroy the value of the firm (e.g., Drexel Burnham Lambert).

2. Increased operating costs. Firms may lose key employees or have to pay more to keep them from abandoning a troubled firm. Suppliers may refuse to ship on favorable credit terms, and the firm's costs of capital may increase.

3. A reduction in the firm's competitiveness. Management attention is focused on the bankruptcy, increasing the firm's vulnerability to competitors.

The Code requires the court to list all fees paid, making possible an examination of the direct costs of bankruptcy. Judges often include a summary of the fees paid in their final order on fees. Unfortunately, access to these data is not guaranteed: the court record may be incomplete or unavailable; many courts interpret the rules concerning preparation of the list as mandatory only when a trustee has been appointed; and other courts simply do not prepare the list because of staffing constraints. Despite these limitations, data for this part of the study are available for 31 of the 37 firms examined.

Three measures are used to assess the magnitude of the direct costs of bankruptcy: (1) market value of equity, (2) book value of debt plus the market value of equity, and (3) book value of total assets, all measured at the fiscal year-end prior to the bankruptcy filing. The market value of debt is not used because only a few firms in the sample (mainly the larger ones) had any publicly traded debt, and publicly traded debt represents only a fraction of total debt. Book value of debt is readily available and is used as a proxy for the market value of equity. The book value of total assets is used to ensure the results are not overstated by the large drop in market value of equity that occurs before the bankruptcy filing, as demonstrated by Weiss (1989).

On average, the direct costs of bankruptcy are 20.6% of the market value of equity (ranging from 2.0% to 63.6%), 3.1% of the book value of debt plus the market value of equity (ranging from 1.0% to 6.6%), and 2.8% of the book value of total assets (ranging from 0.9% to 7.0%). Table 2 displays data on the costs of bankruptcy as a percentage of different measures of firm size, the results of this study in comparison with prior research, and the relationship between firm size and costs.

Both Stanley and Girth (1971) and Ang, Chua, and McConnell (1982) use much smaller firms on average and find much higher fees as a percentage of firm size (25% and 7.5%, respectively) than those of Warner (1977a) and this study. Ang et al. (1982) also find the scale effect hypothesized by Warner (1977a). This study does not find a similar effect. From the results of the ordinary-least-squares regressions presented in table 2, the direct costs of bankruptcy appear highly correlated with total assets but do not fit a concave function (i.e., costs as a percentage of total assets do not decline as the size of the firm increases). The difference between Warner's finding and the

Table 2

Direct costs of bankruptcy and their relationship to firm size.

	Summary statistics				Number of firms	Time period
	Mean	Median	High	Low		
Current study						
Costs[a]/MVE[b]	20.6%	16.7%	63.6%	2.0%	31	1980–1986
Costs/D & E[c]	3.1%	2.6%	6.6%	1.0%	31	1980–1986
Costs/TA[d]	2.8%	2.5%	7.0%	0.9%	31	1980–1986
Prior studies						
Stanley & Girth[e]	24.9%	n/a	n/a	n/a	90	1964
Warner[f]	4.0%	n/a	9.8%	1.1%	11	1933–1955
Ang et al.[g]	7.5%	1.7%	100%	0.01%	55	1963–1978

Regression results (t-statistics in parentheses)

$$\text{Costs} = \underset{(0.1)}{-0.9} + \underset{(11.9)}{0.028} * \text{TA} \qquad R^2 = 0.83, \text{ Number of firms} = 31$$

$$\text{Costs} = \underset{(0.5)}{2.6} + \underset{(1.0)}{0.005} * \text{TA} + \underset{(5.5)}{0.00001} * \text{TA}^2 \qquad R^2 = 0.90, \text{ Number of firms} = 31$$

[a]Costs = legal and other professional fees associated with the bankruptcy filing.
[b]MVE = market value of equity at the fiscal year-end prior to the bankruptcy filing.
[c]D & E = book value of debt plus the market value of equity at the fiscal year-end prior to bankruptcy.
[d]TA = book value of total assets at the fiscal year-end prior to bankruptcy.
[e]Stanley and Girth (1971) use total assets (book value) from the last financial statement filed prior to bankruptcy.
[f]Warner (1977a) uses market value of debt + market value of equity immediately prior to bankruptcy.
[g]Ang et al. (1982) use the liquidated value of the firms at the end of the bankruptcy process.

findings of this study may be explained by noting that Warner's cases are heavily regulated railroads with many more classes of debt than the cases in this study; the changes in the bankruptcy rules and new financing techniques may also play a part.

4. Priority of claims under the new bankruptcy code

This section is divided into four subsections. The first describes how the Code allows priority of claims to be violated. The second presents the method used to investigate violation of priority of claims. The third analyzes the frequency of overall deviations from strict priority of claims, and the fourth examines patterns of deviations.

4.1. The new bankruptcy code and priority of claims

Two types of bankruptcy filings are available to corporations: Chapter 7 and Chapter 11 (these titles refer to chapters of the Code). Chapter 7 provides for the orderly liquidation of a firm's assets by a court-appointed trustee, and payment to claimants in order of priority is always maintained. Only 2 of the 37 firms examined filed under Chapter 7. Chapter 11 provides for reorganization of a firm. Participants in a Chapter 11 filing must approve a plan of reorganization, leaving room for negotiations among the various parties and for violation of priority of claims. In a Chapter 11 bankruptcy the debtor's management operates the firm and works out the reorganization or liquidation unless an interested party can prove management is either incompetent or has committed a fraud, and then the court appoints a trustee. Bankruptcy terminology for management's remaining in control is 'debtor-in-possession'. The law also provides for conversion from one type of filing to the other. Thirty of the 35 firms examined that filed under Chapter 11 were reorganized, and 5 were liquidated. One firm, Cook United, initially filed under Chapter 11 and within a year of its reorganization filed under Chapter 7.[2]

Bankruptcy law alters the creditors' contracts by giving junior creditors and residual claimants the ability to delay the final resolution and to force the firm to incur additional costs – powers junior claimants do not have outside bankruptcy. The first restriction on creditors is the difficulty they face in presenting their own plan for reorganization. The debtor-in-possession or trustee is automatically given a 120-day period to formulate a plan, and during that period no one else can propose a plan. The bankruptcy judge can extend the initial exclusive period, and often does. A creditor can propose a reorganization plan if the exclusive period is over and a debtor's plan has not been accepted within 180 days of the bankruptcy filing. Creditors, unlike debtors, must support their evaluation of the firm's asset values by means of appraisals, a costly process. All this makes credit plans for reorganization rare (there was only one case among the 37 firms examined by this study).

The voting procedure further restricts creditors. Unimpaired creditors – those who receive payment in full with interest or who have had their claims reinstated in full with any defaults cured – do not vote on the reorganization plan. All other creditors are deemed impaired. A majority in number and at least two-thirds by amount owed to the creditors who vote in each class of impaired creditors must approve the reorganization plan before it can be confirmed by the bankruptcy court. Equity holders must also approve the plan by a two-thirds majority, giving them leverage over creditors.

[2]The second bankruptcy filing was outside the period under study, so only the resolution of the Chapter 11 filing is included here.

If the bankruptcy judge does not believe agreement will be reached, he or she can force acceptance of a plan by using a procedure termed a cram-down. Before applying a cram-down the judge must order costly valuation hearings to ensure that any dissenting class of impaired creditors receives at least as much under the plan as it would in a liquidation. The prospect of such hearing is often enough to make creditors approve a plan in which their priority is violated.

Creditors may also be willing to allow a violation of priority to obtain their proceeds in a timely manner. Initially, the trustee, management, or an outside consultant ascertains whether a class of claimants is impaired or unimpaired, and whether each class will receive more from the plan than it would if the firm were liquidated. Any claimant who disagrees with any part of the plan is allowed to argue that position in court, further delaying the resolution. If the bankruptcy judge, after hearing arguments from dissenting claimants, determines that the estimated values and status of claimants contained in the plan are unfair (the judge decides what constitutes fairness), a vote cannot be taken, and a new plan must be prepared.

Secured creditors, whose collateral is worth less than the principal plus accrued interest, may give up part of their claims to avoid losing additional interest. Bankruptcy law has traditionally been vague about whether secured creditors receive interest on their claims over the bankruptcy period. The Supreme Court has recently clarified this issue in *United Savings Association of Texas* v. *Timbers of Inwood Forest Associates, Ltd.* According to an opinion written by Justice Scalia, secured creditors receive interest on their loans at the rate specified up to the value of their secured interest. Once that maximum is reached, no further interest is allowed.

Secured creditors may also be willing to violate priority to reduce the risk of decay in the value of their collateral. Bankruptcy law instructs the trustee or debtor-in-possession to protect the interests of the secured creditors so they will receive, at a minimum, what they would have received if the bankruptcy petition had not been filed. Unfortunately, providing such protection is not an exact science. Numerous cases have tried to determine what constitutes adequate protection for secured creditors but the answer is still vague.

Finally, tax laws influence bankruptcy resolutions. Under current tax law, cooperation of the equity holders is essential to maintain the corporate shell and preserve tax-loss carryforwards. Equity holders may receive a distribution of funds from an insolvent firm in return for their cooperation.

4.2. Method

To determine the extent to which priority of claims is violated, this study uses the figures reported in the reorganization plan confirmed by the bankruptcy court. The plan must designate and describe each class of creditors, say how each class will be treated, and provide adequate means of implementation. It specifies the cash and securities each class will receive, when it will receive them, and whether a particular class is unimpaired or impaired. The plan also says whether a given class will receive at least as much as it would receive in a liquidation. Most plans do not formally set out the estimated amount each class would receive in a liquidation but merely state that the plan provides more.

Most plans report the percentage of claims to be repaid to each class, and where this number is not provided it usually can be calculated from other court documents. When the reorganization plan contains estimated market values for securities given to creditors in compensation for their claims, I use those market values; otherwise, I use the face value of the securities. If the final distribution is contingent on future events and the plan presents a range of possible values for what each group of claimants will receive, this study uses the median value. Whenever possible, I spoke with the lawyers involved about the negotiation process.[3]

The reorganization plan indicates whether priority of claims is violated when agreement among the parties is reached. Gains or losses because of unpredictable changes in the company and the economy between the time of the agreement and final payment to the creditors are separate from whether the claimants agree to uphold or violate priority. Further, most of the reorganized firm's securities do not trade in a public market and the only evidence of their value is the value provided in the reorganization plan.

The values in the plan are confirmed by an impartial judge, who is central to the decision-making process and has the benefit of all the evidence and testimony. Use of these values has several limitations, however. First, the amount of a creditor's claim is the amount allowed by the court, and the court accepts management valuations unless a creditor establishes a different value through costly hearings. Second, the court may understate the amount of the claim by failing to provide appropriate interest. Finally, the court will accept management's view of whether creditors are impaired, and creditors may decide it is not worth the effort and expense to prove otherwise. According to the lawyers interviewed, it is rare for a reorganization plan to incorrectly classify a group as unimpaired. Despite these limitations, the plan of reorganization remains the most timely and objective source of information about what each claimant expects to receive from the bankruptcy process.

For the purpose of this study, priority of claims is upheld when, according to the reorganization plan, secured creditors are satisfied first, then various

[3]Fourteen lawyers were contacted, half by phone and half in person. Most of the lawyers had worked on several of the cases under study.

grades of subordinated debt, and equity holders last. I also determine whether priority of claims is violated for both secured and unsecured creditors or for unsecured creditors alone.

4.3. Deviations from strict priority of claims

Strict priority of claims is violated in 78% (29/37) of the cases. Table 3 summarizes violation of priority for the firms examined, and the appendix provides additional information on each firm, with a brief summary of the bankruptcy filing.

Shareholders received nothing in only seven (19%) cases – five cases in which priority of claims is maintained and two cases in which it is violated. In three (8%) cases, shareholders receive a cash settlement ranging from \$233,000 to \$1,500,000, or \$0.03 to \$0.10 per share. In 15 (41%) cases, shareholders receive a small portion (25% or less), and in 12 (32%) cases, shareholders received a substantial portion (more than 25%) of the equity of the reorganized company.

In six cases, shareholders retain virtually all (99% or 100%) of the reorganized firm's equity. In two of these cases (Bobbie Brooks and Branch Industries) the firms' fortunes recovered sufficiently to repay the creditors fully. In two other cases (Lionel Corporation and Salant Corporation) the secured creditors are paid fully and the unsecured creditors receive over 90% of their claims. In the remaining two cases (Imperial Industries and Richton International) the secured creditors are paid in full, but the unsecured creditors receive only 37% and 60% of their claims, respectively. One lawyer argued: 'Shareholders were tossed a bone, crumbs off the table, to get the deal done and save any tax-loss carryforwards.' It still remains a clear breach of the debt contracts for shareholders to retain anything when creditors are not fully paid.

Within the various classes of unsecured creditors (e.g., senior and subordinated debentures), strict priority of claims rarely holds. For example, in the White Motor reorganization plan, the senior unsecured bondholders received 61% of their claims; the senior unsecured creditors, 55%; the general unsecured creditors, 51%; and the subordinated unsecured bondholders, 14%. The lawyers interviewed either did not know or were unwilling to provide any insight into why the senior unsecured creditors were not fully repaid before the junior unsecured creditors received anything. The lawyers agreed that priority was largely ignored within the group of unsecured creditors but insisted the consensual settlements made everyone better off.

Priority of claims for the secured creditors is maintained in 92% (34/37) of the cases in my sample. The three cases of violation are Crompton, Evans Products, and Stevcoknit. Crompton, a textile mill that produced corduroy and velveteen products, filed for bankruptcy in New York on October 23,

Table 3

Summary of claims resolution for 37 exchange-listed firms filing for bankruptcy between 1980 and 1986.

Priority of claims holds when secured creditors are satisfied first, then various grades of subordinated debt, and equity holders last.

Firm name	Percentage or description of claims paid		
	Secured creditors	Unsecured creditors	Equity holders
		Priority held	
Bobbie Brooks	100%	100%	100%
Branch Inds	100%	100%	100%
Brody (B) St	100%	51%	0
Flanigan's	100%	100%	0
Garland Corp	100%	100%	> 0
Ronco Telepd	100%	Balance	0
Tenna Corp	74%	0	0
U.N.A. Corp	100%	1 CS[a] per $1 claim	0
		Priority violated for unsecured creditors only	
AM Intl	100%	94%	47%
Anglo Energy	100%	58%	25%
Beker Inds	100%	< 20%	38%
Berry Inds	100%	Cash & PS[b]	60%
Combustion	100%	49% to 82%	$316,000
Cook United	100%	93% of CS	7%
Goldblatt	100%	24%	53%
HRT Inds	100%	75%	25%
Imperial Inds	100%	37%	100%
KDT Inds	100%	36%	$1,500,000
Lionel Corp	100%	Up to 100%	100%
Manville	100%	Up to 100%	5%
McLouth Stl	100%	90% of CS	10%
Morton Cos	100%	33%	$233,000
Penn-Dixie	100%	45% of claim + 50% CS	50%
Revere Copper	100%	65%	77%
Richton Intl	100%	60%	100%
Salant Corp	100%	97%	99%
Saxon Inds	100%	From 33% to 49%	PS
Seatrain Ln	100%	CS	Warrants
Shelter Res	100%	5% of CS	5%
Spencer Cos	100%	30% of claim + 60% CS	17%
Tacoma Boat	100%	96% of CS	4%
Towle Mfg	100%	60%	7%
White Motor	100%	51%	10%
Wickes Cos	100%	From 59% to 92%	19%
		Priority violated for secured creditors	
Crompton Co	85%	20%	0
Evans Pds	76%	87%	0
Stevcoknit	37% to 77%	33%	12%

[a]CS = common stock.
[b]PS = preferred stock.

1984; its reorganization plan was confirmed 1,423 days later, on September 15, 1988. Priority broke down because of litigation by the unsecured creditors against the secured creditors. The unsecured creditors argued that the secure creditors were not entitled to payment from the surplus in Crompton's pension plan and Crompton's holdings of export-related commercial paper. After prolonged negotiations, a settlement was reached whereby the secured creditors received 85% of their claims, the unsecured creditors received 20% of their claims, and the equity holders received nothing.

Evans Products, a supplier of building materials and home mortgages, was the first major case in which a creditor-initiated reorganization plan was confirmed by the court. Evans Products filed for bankruptcy in Florida on March 11, 1985, and its reorganization plan was confirmed 478 days later, on July 2, 1986. Lawyers involved with the case assert that secured creditors decided to go forward with the effort and expense of a creditor plan when they were unable to reach a settlement with Victor Posner, a Miami-based reclusive acquirer and buyout specialist, who held a controlling interest in the company's stock. The plan froze out the equity holders, but to ensure its success, the secured creditors offered the unsecured creditors a sweetened deal. Unsecured creditors actually received a higher percentage of their claims (87%) than secured creditors (76%); their total claims, however, amounted to less than one-fourth of the secured creditors' claims. Many of the lawyers involved now believe that the secured creditors gave the unsecured creditors substantially more than was necessary to get the deal done.

Stevcoknit, a producer of knitted fabrics for sportswear, filed for bankruptcy in New York on November 16, 1981, and had its reorganization plan confirmed 424 days later, on January 14, 1983. According to lawyers involved in the case, the secured creditors accepted 57% of their claims because the market value of their collateral had fallen far below the value of their claims. Unsecured creditors received 33% of their claims, and equity holders were given an 11% share of the reorganized firm.

4.4. How priority of claims is violated

Discussions with lawyers indicate that two factors, firm size and location of bankruptcy, are important in predicting whether priority of claims will be violated. According to the lawyers, the larger, more complicated bankruptcies present more opportunities for equity holders and small groups of unsecured creditors to extract concessions from other creditors. Anecdotal evidence supports the lawyers' claim that different jurisdictions treat debtors differently, and debtors respond by filing in the district they think will be most favorable to them. A February 6, 1989 *Miami Review* article describes how the Southern District of Florida's chief bankruptcy judge is much tougher on debtors than judges in some other districts.

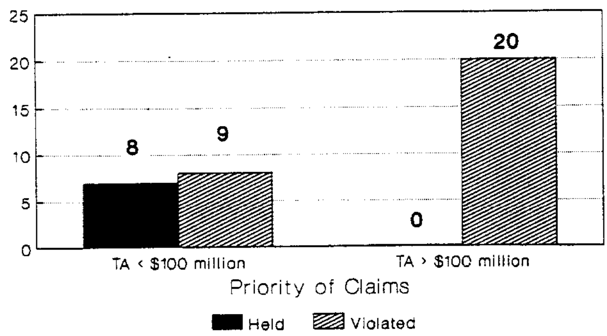

Fig. 1. Priority of claims and bankruptcy resolutions, by firm size, for 37 firms filing for bankruptcy between 1980 and 1986. TA = book value of total assets at the fiscal year-end prior to bankruptcy.

Bankruptcy falls under federal law and, except for certain state-law issues, should be uniform across the United States. To receive bankruptcy protection, a firm must file with the bankruptcy clerk in the United States court district where the firm had its principal place of business for the preceding 180 days, or where most of the firm's assets are located, or in a district that facilitates negotiations with creditors. Corporations with assets and operations in several jurisdictions have some latitude in deciding where to file.

Figs. 1 and 2 illustrate, by firm size and location of bankruptcy filing, violation of priority of claims in the sample of bankruptcy resolutions. The larger firms and firms filing in New York are more likely to violate strict priority of claims. Strict priority is violated for all 20 firms having total assets over $100 million, 14 of which filed in New York. For firms with less than

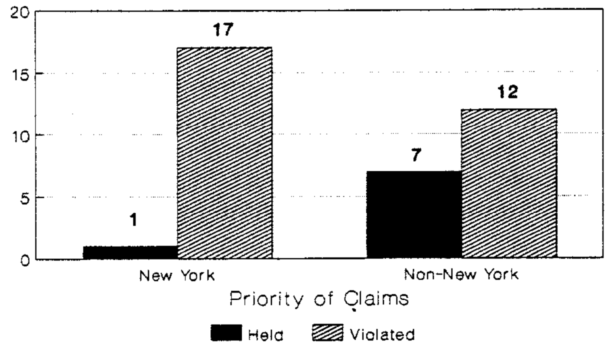

Fig. 2. Priority of claims and bankruptcy resolutions, by location of filing, for 37 firms filing for bankruptcy between 1980 and 1986.

$100 million in assets, strict priority holds in eight of 17 cases, only one of which filed in New York. There appears to be a strong link between firm size and priority of claims.

The results on the treatment of creditors in different locations are less clear. Lawyers in both Florida and Illinois assert that judges and lawyers in their jurisdictions are more willing to freeze out equity holders than are judges and lawyers in New York. One lawyer interviewed about the Evans Products case stressed how New York lawyers involved in the case were willing to give the equity holders a sizeable piece of the reorganized company. Only after the New York lawyers became frustrated by Victor Posner's demands were the Florida lawyers able to persuade their New York colleagues to propose a creditor plan and freeze out the shareholders. Priority of claims held for only one of the 18 cases filed in New York, and in that case the firm's fortunes turned around during the bankruptcy so there were sufficient funds to repay all creditors in full. Priority of claims held for seven of the 19 cases filed outside of New York.

Lawyers in New York acknowledge the high number of filings there and the favorable treatment of debtors. They say there is less fighting among parties in New York because of the greater sophistication of the creditors, the professional actions of the bankruptcy lawyers, and a willingness by creditors to compromise priority to settle the case quickly. No evidence, however, supports the lawyers' assertion that New York cases are resolved faster than cases filed in other parts of the country. The average time needed to resolve the New York cases is 974 days, compared with 850 days for the cases outside New York. The New York cases take longer than non-New York cases whether the cases examined are large or small (total assets of more or less than $100 million before the bankruptcy filing).[4]

The process of assigning judges to New York cases does not appear to be random as claimed by the court. As of August 1990, five bankruptcy judges (Abram, Buschman, Blackshear, Brozman, and Lifland) preside over all bankruptcy cases in the Southern District of New York. Of the 18 New York cases examined, six (33%) were handled by the Honorable Burtan R. Lifland; the Honorable Prudence Abram and the Honorable Edward J. Ryan each handled three cases (17% each); the Honorable Howard C. Buschman III and the Honorable John J. Galgay each handled two cases (11% each); and the Honorable Cornelius Blackshear and the Honorable Joel Lewittes each handled one case. Too few cases were examined in each of the other districts

[4]The larger New York cases (average total assets of $457 million) spend an average of 988 days from the filing of the bankruptcy petition to the court's confirmation of a reorganization plan, compared with 873 days for non-New York cases (average total assets of $691 million). The smaller New York cases (average total assets of $61 million) average 925 days in bankruptcy, compared with 818 days for non-New York cases (average total assets of $34 million).

for me to determine whether any particular judge dominated the larger cases filed there.

All the non-New York cases were filed in the jurisdiction where the firm's headquarters or principal place of business was located. Six of the 18 firms filing in New York (Beker, HRT, KDT, Manville, Tacoma Boatbuilding, and Towle) did not have their headquarters or principal place of business in New York. The available evidence is insufficient to show why New York attracts a disproportionate share of the bankruptcy filings. New York may have more lawyers and judges with the expertise to work on large cases; it may be a convenient location for the firm and its creditors; it may happen to be the location of the firm's headquarters and/or principal place of business; or New York judges may have different biases than judges in other districts. Whatever the reason, equity holders appear to receive better treatment in New York.

5. Conclusion

Bankruptcy represents a legal framework for recontracting when various interested parties cannot reach an accord following a firm's default on a debt contract. If either the direct costs of resolving a bankruptcy are high or creditors cannot be confident that priority of claims will be honored, creditors will require somewhat higher interest rates, raising the cost of corporate borrowing and altering the firm's capital structure. This paper presents new evidence on the direct costs of bankruptcy and the degree to which priority of claims is violated in bankruptcy proceedings of NYSE and AMEX firms.

I find lower direct costs of bankruptcy than previous researchers, a finding that may be explained by differences in the size and type of firms studied, the methods used to calculate firm size, the time periods considered, or changes in the bankruptcy law. On average, direct costs of bankruptcy are 3.1% of the book value of debt plus the market value of equity at the fiscal year end prior to the bankruptcy filing, with a range from 1% to 6.6%. These low direct costs, as demonstrated by Warner (1977a), will have little or no impact on the pricing of claims prior to bankruptcy.

Priority of claims is violated in 29 of the 37 cases examined. Unsecured creditors are frequently denied priority over both equity holders and lower-ranked unsecured creditors. Secured creditors receive their full claim in all but three of the 37 cases. Creditors are likely to demand higher interest rates to compensate them for the violation of priority of claims that occurs in bankruptcy.

Equity holders of larger firms appear to fare better than their smaller-firm counterparts, probably because junior claimants are better able to delay the resolution in the larger, more complex cases, and to threaten the loss of tax loss carryforwards. The disproportionate number of cases in which equity holders in New York receive some compensation in violation of priority of claims, combined with the disproportionate number of cases filed there, seems to indicate that debtors may shop around for the best place to file – and correctly choose New York. Of all the cases where priority of claims held, only one was in New York. Because New York is the headquarters for a majority of the larger firms studied, however, it may simply be a proxy for firm size and complexity of capital structure.

Olson (1965) declares that 'unless the number of individuals in a group is quite small, or unless there is coercion or some other special device to make individuals act in their common interest, rational, self-interested individuals will not act to achieve their common or group interest.' Bankruptcy is a social institution designed to deal with just such a collective-action problem by: (1) preserving the value of the firm and preventing premature liquidation after the firm has defaulted on its debt, and (2) enforcing creditors' rights. Bankruptcy has always sought to prevent creditors from racing to grab assets; however, there is no reason it could not deliver the reorganized firm into the hands of the creditors and keep the stockholders in their place as residual claimants. A lack of belief in markets may be the underlying reason the law perceives it necessary to allow violation of priority of claims.

Appendix

Table 4

Summary of firms examined.

AM International *Business graphics equipment and systems*

04/14/82, bankruptcy petition filed in Illinois
09/11/84, plan confirmed
881 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = $14,765,000
Total assets prior to bankruptcy = $546,213,000
Direct costs/total assets = 2.70%
Debt/total assets prior to bankruptcy = 97.5%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received an average of 94% of their claims. Equity holders retained 47% of the common stock of the reorganized company.

The firm had a $203 million write-down of assets, and the SEC charged Price Waterhouse and three of its partners with violating security laws. The firm blamed its bankruptcy on poor planning, sloppy management, and inadequate financing.

Anglo Energy *Oil and gas extraction*

11/04/83, bankruptcy petition filed in New York
07/14/86, plan confirmed
983 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = $9,066,000
Total assets prior to bankruptcy = $229,596,000
Direct costs/total assets = 3.94%
Debt/total assets prior to bankruptcy = 85.1%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received 50% of their claims in cash and notes, and 8% in common shares and warrants. Equity holders retained 25% of the common stock of the reorganized company.

The firm blamed its bankruptcy on the decline in the oil and gas business in 1982.

Beker Industries *Chemicals (concentrated phosphate)*

10/21/85, bankruptcy petition filed in New York
10/06/88, plan confirmed
1,081 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = $5,042,000
Total assets prior to bankruptcy = $341,087,000
Direct costs/total assets = 1.57%
Debt/total assets prior to bankruptcy = 61.1%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received a variety of assets (from land to different forms of equities) representing less than 20% of their claims. Equity holders retained 38% of the reorganized firm.

The firm blamed its bankruptcy on the decline in the market price of its principal product.

Berry Industries *Oil and gas extraction equipment and service*

10/05/84, bankruptcy petition filed in California
11/16/87, plan confirmed
1,137 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = $620,000
Total assets prior to bankruptcy = $39,608,000
Direct costs/total assets = 1.57%
Debt/total assets prior to bankruptcy = 59.2%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received the balance of cash from one of the subsidiaries and a new class of preferred stock, and could vote for two of the five members on the board of directors. Equity holders retained their shares.

The firm blamed its bankruptcy on the decline in the oil market.

Bobbie Brooks *Manufacture sportswear and swimwear*

01/15/82, bankruptcy petition filed in Ohio
02/15/83, plan confirmed
397 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = $1,537,000
Total assets prior to bankruptcy = $87,005,000
Direct costs/total assets = 1.76%
Debt/total assets prior to bankruptcy = 65.9%

Priority of claims held – Firms reorganized.

Secured and unsecured creditors were paid in full and equity holders retained their interest in the company.

The firm blamed its bankruptcy on unprofitable operations.

Branch Industries *Trucking and warehousing*

08/16/84, bankruptcy petition filed in New York
03/31/88, case dismissed
1,323 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = $1,229,000
Total assets prior to bankruptcy = $52,458,000
Direct costs/total assets = 2.34%
Debt/total assets prior to bankruptcy = 86.3%

Priority of claims held – Firm reorganized.

Secured and unsecured creditors were fully paid and the company's bankruptcy petition was dismissed.

The firm blamed its bankruptcy on the increased competition and rate cutting that followed deregulation of the trucking industry.

Brody (B) Seating *Manufacture furniture*

02/04/80, bankruptcy petition filed in Illinois
01/09/81, plan confirmed
340 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = $224,000
Total assets prior to bankruptcy = $3,823,000
Direct costs/total assets = 5.85%
Debt/total assets prior to bankruptcy = 65.7%

Priority of claims held – Firm liquidated under Chapter 11.

Secured creditors received 100% of their claims. Unsecured creditors received 51% of their claims. Equity holders received nothing.

The firm blamed its bankruptcy on a general softening of the furniture market combined with increasing interest rates.

Combustion Equipment *Air pollution and agricultural equipment*

10/20/80, bankruptcy petition filed in New York
12/21/83, plan confirmed
1,157 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = \$2,123,000
Total assets prior to bankruptcy = \$177,991,000
Direct costs/total assets = 1.19%
Debt/total assets prior to bankruptcy = 74.4%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Senior unsecured creditors received cash for 82% of their claims plus stock, and subordinated creditors received 49% of their claims plus stock. Equity holders were paid \$316,000.

The firm blamed its bankruptcy on cost overruns, strikes, and a failure to obtain necessary operating permits.

Cook United *General merchandise discount department stores*

10/01/84, bankruptcy petition filed in Ohio
09/30/86, plan confirmed
729 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = \$4,926,000
Total assets prior to bankruptcy = \$166,161,000
Direct costs/total assets = 2.96%
Debt/total assets prior to bankruptcy = 95.5%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received 92% of the common stock of the new company, the union received 1%, and equity holders received 7%.

Within a year after the plan of reorganization was confirmed, the company refiled a Chapter 7 bankruptcy petition, the company was liquidated, and strict priority of claims held. The results of the first bankruptcy, where priority held for the secured creditors only, are used for this study.

The firm blamed its bankruptcy on insufficient sales and excess inventory.

Crompton Co. *Textile mill (corduroy and velveteen) products*

10/23/84, bankruptcy petition filed in New York
09/15/88, plan confirmed
1,423 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = \$922,000
Total assets prior to bankruptcy = \$97,064,000
Direct costs/total assets = 0.94%
Debt/total assets prior to bankruptcy = 60.0%

Priority violated for secured creditors – Firm liquidated under Chapter 11.

Secured creditors received approximately 85% of their claims. Unsecured creditors received approximately 20% of their claims. Equity holders received nothing.

The firm blamed its bankruptcy on competition from Far Eastern textile producers and a weak domestic market.

Evans Products *Building materials and home mortgages*

03/11/85, bankruptcy petition filed in Florida
07/02/86, plan confirmed
478 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = $12,347,000
Total assets prior to bankruptcy = $803,228,000
Direct costs/total assets = 1.53%
Debt/total assets prior to bankruptcy = 86.0%

Priority violated for secured creditors – Firm reorganized.

Secured creditors received 76% of their claims. Unsecured creditors received 87% of their claims. Equity holders received nothing.

Evans was the first major case in which the creditor plan of reorganization was confirmed by the court. When the creditors and Victor Posner – who held a controlling interest in Evans – could not agree, the secured creditors decided to go forward with the expense of a creditor plan and freeze out the equity holders. To ensure success of the plan, the secured creditors offered the unsecured creditors a sweetened deal that many lawyers today believe was unnecessary.

The firm blamed its bankruptcy on the increase in interest rates that occurred after it extended fixed-rate mortgages while borrowing at rates tied to prime.

Flanigan's Enterprises *Retail liquor stores*

11/04/85, bankruptcy petition filed in Florida
05/07/87, plan confirmed
549 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = not available
Total costs of bankruptcy = $26,779,000
Direct costs/total assets = not available
Debt/total assets prior to bankruptcy = 83.5%

Priority of claims held – Firm liquidated.

Secured creditors received 100% of their claims. Unsecured creditors received the balance, which was estimated to be 100% of the face value of the claims but was paid over one and a half years. Equity holders received nothing.

The firm blamed its bankruptcy on significant rental increases on leases (tied to the consumer price index) and declining sales.

Garland Corp *Knitted textile products*

04/29/80, bankruptcy petition filed in Massachusetts
12/22/80, plan confirmed
237 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = $805,000
Total assets prior to bankruptcy = $25,423,000
Direct costs/total assets = 3.16%
Debt/total assets prior to bankruptcy = 55.2%

Priority of claims held – Firm liquidated.

Secured and unsecured creditors were paid in full, with funds left over for shareholders.

After management walked out, a trustee turned the company around by completing work in progress and manufacturing more goods.

The firm blamed its bankruptcy on five years of substantial losses.

Goldblatt Brothers *General merchandise department stores*

06/16/81, bankruptcy petition filed in Illinois
10/14/83, plan confirmed
850 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = $2,736,000
Total assets prior to bankruptcy = $67,601,000
Direct costs/total assets = 4.04%
Debt/total assets prior to bankruptcy = 85.3%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received 24% of their claims. Equity holders received 52.5% of the common stock of the reorganized company. The value of the equity was very low, considering that another firm received the remaining 47.5% of the common stock for providing a loan of $3 million.

The firm blamed its bankruptcy on competitive pressures, changing trends, higher operating costs, and increased interest rates.

HRT Industries *General merchandise discount department stores*

11/23/83, bankruptcy filed in New York
02/10/84, plan confirmed
444 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = $6,158,000
Total assets prior to bankruptcy = $211,146,000
Direct costs/total assets = 2.91%
Debt/total assets prior to bankruptcy = 73.5%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received an average of 75% of their claims (in various combinations of cash and stock). Equity holders received one new share for every four old shares.

The firm blamed its bankruptcy on declining sales caused by general economic conditions.

Imperial Industries *Stone, clay, and glass products*

09/29/86, bankruptcy petition filed in Florida
06/02/87, plan confirmed
246 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = not available
Total assets prior to bankruptcy = $19,315,000
Direct costs/total assets = not available
Debt/total assets prior to bankruptcy = 120.0%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received 37% of their claims. Equity holders retained their equity interest.

The firm blamed its bankruptcy on declining sales caused by general economic conditions.

KDT Industries *General merchandise discount department stores*

08/05/82, bankruptcy petition filed in New York
03/24/84, plan confirmed
597 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = \$3,460,000
Total assets prior to bankruptcy = \$239,555,000
Direct costs/total assets = 1.44%
Debt/total assets prior to bankruptcy = 82.9%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Senior unsecured creditors received an initial distribution of stock plus cash for 36% of their claims and the potential for a future cash distribution of up to 17% of their claims. Subordinated unsecured creditors received similar treatment with a smaller percentage of their claims. Equity holders received Ames common stock (Ames took over KDT) worth \$1.5 million and the potential for an additional distribution of up to \$0.10 per share (or an additional \$500,000).

The firm blamed its bankruptcy on changing consumer spending habits, competition from other chains, high interest rates, and a prolonged recession.

Lionel Corp. *Retail toy and leisure products*

02/19/82, bankruptcy petition filed in New York
09/12/85, plan confirmed
1,301 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = \$5,466,000
Total assets prior to bankruptcy = \$221,619,000
Direct costs/total assets = 2.40%
Debt/total assets prior to bankruptcy = 85.1%

Priority violated for junior unsecured creditors – Firm reorganized.

Secured creditors and senior unsecured creditors received 100% of their claims. General unsecured creditors received some cash and common stock. Equity holders retained their old shares and received warrants to purchase new shares.

The firm blamed its bankruptcy on high interest rates and energy costs, combined with a poor 1981 Christmas season.

Manville Corp. *Asbestos products*

08/26/82, bankruptcy petition filed in New York
12/15/85, plan confirmed
1,207 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = \$82,475,000
Total assets prior to bankruptcy = \$297,814,000
Direct costs/total assets = 3.58%
Debt/total assets prior to bankruptcy = 35.9%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received 76% of their claims in cash and debentures, and equity for the balance (essentially losing some accrued interest). Tort asbestos claimants received cash and shares valued at \$2.3 to \$2.6 billion. Shareholders received approximately 5% of shares of the reorganized firm.

The firm blamed its bankruptcy on thousands of product-liability lawsuits.

McLouth Steel *Steel manufacture and motor carrier*

12/08/81, bankruptcy petition filed in Michigan
12/11/84, plan confirmed
1,099 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = not available
Total assets prior to bankruptcy = \$446,085,000
Direct costs/total assets = not available
Debt/total assets prior to bankruptcy = 72.7%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received slightly over 90% of the common stock of the reorganized firm, with equity holders receiving the balance.

The firm blamed its bankruptcy on a dramatic rise in labor and energy costs, combined with increased foreign competition.

Morton Shoe *Manufacture and retail footwear*

01/05/82, bankruptcy petition filed in Massachusetts
08/15/83, plan confirmed
587 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = \$708,000
Total assets prior to bankruptcy = \$30,818,000
Direct costs/total assets = 2.32%
Debt/total assets prior to bankruptcy = 93.6%

Priority violated for unsecured creditors – Firm liquidated under Chapter 11.

Secured creditors received 100% of their claims. Unsecured creditors received an average of 33% of their claims. Equity holders received \$233,000, or just under 10% of the amount paid to the unsecured creditors.

The firm blamed its bankruptcy on continuing losses.

Penn Dixie *Manufacture steel and cement*

04/07/80, bankruptcy petition filed in New York
03/04/82, plan confirmed
696 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = \$3,760,000
Total assets prior to bankruptcy = \$176,728,000
Direct costs/total assets = 2.12%
Debt/total assets prior to bankruptcy = 68.7%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received cash for 45% of their claims and slightly less than 50% of the common stock of the reorganized firm. Equity holders received slightly over 50% of the common stock of the reorganized firm. The judge awarded the lawyers involved a 10% premium on their fees for their expeditious handling of the case.

The firm blamed its bankruptcy on the wasteful and fraudulent investments made by the firm's CEO, Jerome Castle.

Revere Copper and Brass *Manufacture metals and metal products*

10/27/82, bankruptcy petition filed in New York
07/29/85, plan confirmed
1,066 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = $7,560,000
Total assets prior to bankruptcy = $473,756,000
Direct costs/total assets = 1.59%
Debt/total assets prior to bankruptcy = 60.2%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received an average of 65% of their claims (cash value). Equity holders retained their shares (diluted to 77% of total outstanding).

The firm blamed its bankruptcy on its inability to expand production and reduce the unit cost at its rolling mill and reduction plant.

Richton International *Manufacture jewelery and sportswear*

03/18/80, bankruptcy petition filed in New York
08/26/81, plan confirmed
526 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = $1,076,000
Total assets prior to bankruptcy = $53,477,000
Direct costs/total assets = 2.01%
Debt/total assets prior to bankruptcy = 50.2%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received 60% of their claims. Equity holders were unimpaired and retained their equity position.

The firm blamed its bankruptcy on losses in both its jewelery and sportswear businesses.

Ronco Teleproducts *Wholesale miscellaneous durable goods*

02/02/84, bankruptcy petition filed in Illinois
04/28/87, converted to Chapter 7
1,181 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = not available
Total assets prior to bankruptcy = $20,543,000
Direct costs/total assets = not available
Debt/total assets prior to bankruptcy = 70.0%

Priority of claims held – Firm liquidated under Chapter 7.

Secured creditors were fully paid, and the unsecured creditors received the balance.

The firm blamed its bankruptcy on an optimistic expansion combined with a decline in sales.

Salant Corp. *Apparel and other textile products*

02/22/85, bankruptcy petition filed in New York
05/19/87, plan confirmed
816 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = $7,003,000
Total assets prior to bankruptcy = $110,439,000
Direct costs/total assets = 6.34%
Debt/total assets prior to bankruptcy = 77.4%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received approximately 97% of their claims (45% in cash, 50% in debentures, and 2% in common shares). Equity holders were unimpaired except for a slight dilution of their holdings.

The firm blamed its bankruptcy on the combination of a costly failed engineering attempt to reduce manufacturing costs and a reduction in the general demand for jeans and slacks.

Saxon Industries *Paper and allied products*

04/15/82, bankruptcy petition filed in New York
03/22/85, plan confirmed
1,072 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = $14,216,000
Total assets prior to bankruptcy = $486,617,000
Direct costs/total assets = 2.90%
Debt/total assets prior to bankruptcy = 74.0%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Senior unsecured creditors received between 45% and 49% of their claims. General creditors received 37% of their claims. Debenture holders received 33% of their claims. Equity holders exchanged their shares for preferred shares.

The firm blamed its bankruptcy on a dramatic downturn in the oil business combined with increased costs.

Seatrain Lines *Water transportation (vessel chartering)*

02/11/81, bankruptcy petition filed in New York
03/27/87, plan confirmed
2,235 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = $15,422,000
Total assets prior to bankruptcy = $913,414,000
Direct costs/total assets = 1.68%
Debt/total assets prior to bankruptcy = 101.4%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received new common shares. Equity holders received new Seatrain warrants.

The firm blamed its bankruptcy on the increase in oil prices through the 1970s, which halted construction of new vessels.

Shelter Resources *Wood buildings and consumer products*

09/09/82, bankruptcy petition filed in Ohio
07/26/85, plan confirmed
1,051 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = $2,638,000
Total assets prior to bankruptcy = $37,728,000
Direct costs/total assets = 6.99%
Debt/total assets prior to bankruptcy = 103.3%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received a small amount of cash and 5% of the common stock of the reorganized firm. Equity holders received 5% of the common stock of the reorganized firm. The balance of the common stock was sold to an outsider.

The firm blamed its bankruptcy on increasing interest rates and reduced housing starts.

Spencer Companies *Manufacture and retail apparel*

11/19/86, bankruptcy petition filed in Massachusetts
11/30/88, plan confirmed
742 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = $1,789,000
Total assets prior to bankruptcy = $34,554,000
Direct costs/total assets = 5.17%
Debt/total assets prior to bankruptcy = 60.7%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received a cash payment for 10% of their claims and 60% of new Spencer common stock. They also received notes for 20% of their claims and warrants for the purchase of 2 million additional shares. Equity interests retained their common shares, which accounted for 17% of the total outstanding.

The firm blamed its bankruptcy on losses in businesses other than the retail sales of footwear.

Stevcoknit *Textile mill products*

11/16/81, bankruptcy petition filed in New York
01/14/83, plan confirmed
424 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = $1,279,000
Total assets prior to bankruptcy = $39,297,000
Direct costs/total assets = 3.25%
Debt/total assets prior to bankruptcy = 67.0%

Priority of claims violated – Firm reorganized.

Secured creditors received between 37% and 77% of their claims. Unsecured creditors received 33% of their claims. Equity holders received 11.5% of the reorganized firm's stock. Lawyers interviewed declared that the secured creditors accepted less than 100% because the value of their collateral had fallen far below the value of their claims.

The firm blamed its bankruptcy on poor economic conditions in the textile industry.

Tacoma Boatbuilding *Ship building and repair*

09/23/85, bankruptcy petition filed in New York
08/17/87, plan confirmed
693 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = not available
Total assets prior to bankruptcy = $277,954,000
Direct costs/total assets = not available
Debt/total assets prior to bankruptcy = 103.3%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received 96% of new common stock. Equity holders received 4% of new common stock.

The firm blamed its bankruptcy on a ten-week strike in 1983 that caused a loss of skilled workers, disrupted schedules, and hurt efficiency, and on no new contracts in 1985.

Tenna Corp. *Electronic and other electrical equipment*

12/05/79, bankruptcy petition filed in Ohio
04/06/88, case closed
3,045 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = $472,000
Total assets prior to bankruptcy = $29,130,000
Direct costs/total assets = 1.62%
Debt/total assets prior to bankruptcy = 62.0%

Priority of claims held – Firm liquidated under Chapter 7.

Secured creditors received 74% of their claims. Unsecured creditors and equity holders received nothing. This was a Chapter 7 bankruptcy filing.

The firm blamed its bankruptcy on declining sales due to a sharp reduction in shipments to automakers.

Towle Manufacturing *Manufacture silverware and giftware*

03/24/86, bankruptcy petition filed in New York
09/30/87, plan confirmed
555 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = $7,519,000
Total assets prior to bankruptcy = $239,627,000
Direct costs/total assets = 3.13%
Debt/total assets prior to bankruptcy = 73.0%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received 60% of their claims (12% in cash, 31% in debentures, and 17% in new common stock). Old preferred shareholders received 6.6% of new common stock, and old common shareholders received 3.3% of new common stock.

The firm blamed its bankruptcy on reorganization of its distribution facilities, which caused late deliveries and canceled orders.

U.N.A. Corp. *Wholesale durable goods*

12/01/86, bankruptcy petition filed in Massachusetts
06/17/88, plan confirmed
564 days in bankruptcy
Listed on AMEX
Direct costs of bankruptcy = not available
Total assets prior to bankruptcy = $18,217,000
Direct costs/total assets = not available
Debt/total assets prior to bankruptcy = 98.5%

Priority of claims held – Firm reorganized.

Secured creditors were fully paid. Unsecured creditors received one common share for each dollar of claim. Equity holders received nothing.

The firm blamed its bankruptcy on continued losses.

White Motor *Motor vehicles and equipment*

09/04/80, bankruptcy petition filed in Ohio
11/18/83, plan confirmed
1,170 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = $21,168,000
Total assets prior to bankruptcy = $630,150,000
Direct costs/total assets = 3.35%
Debt/total assets prior to bankruptcy = 63.4%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Unsecured creditors received an average of 51% of their claims with over 90% in cash and the balance in shares. Equity holders retained a 10% interest in the common stock of the reorganized firm.

The firm blamed its bankruptcy on volatility of demand for heavy-duty trucks and farm equipment, combined with a substantial level of borrowing pegged to an increasing prime rate.

Wickes Companies *Building materials and supplies*

04/24/82, bankruptcy petition filed in California
09/21/84, plan confirmed
881 days in bankruptcy
Listed on NYSE
Direct costs of bankruptcy = $20,345,000
Total assets prior to bankruptcy = $551,509,000
Direct costs/total assets = 1.31%
Debt/total assets prior to bankruptcy = 98.5%

Priority violated for unsecured creditors – Firm reorganized.

Secured creditors received 100% of their claims. Senior unsecured creditors received 74.5% of their claims in cash and another 17.5% in common stock (53% of the total outstanding) of the reorganized firm. Subordinated creditors received 50.9% of their claims in cash and 6.1% in common stock (28% of the total outstanding) of the reorganized firm. Equity holders received 19% of the common stock of the reorganized firm (4% to the old preferred shareholders and 15% to the old common shareholders).

The firm blamed its bankruptcy on a decline in earnings, combined with an increase in interest rates after it incurred approximately $1.7 billion of debt to pay for acquisitions.

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