

Solution:

(1)

The priority order gives the following claims:

$$\text{Mortgage bonds} = \$11 \text{ million}$$

The rest \$5.4 million is to be split equally amongst the creditors (accounts payable) and the debenture bond holders.

Thus, we get

$$\text{Accounts Payable} = \$2.4 \text{ million}, \text{Debenture Bond Holders} = \$3 \text{ million}$$

(2)

(a) If debentures are subordinated, then their priority is lower than the creditors. Thus, we get:

$$\text{Mortgage bonds} = \$11 \text{ million}, \text{Accounts Payable} = \$4 \text{ million}$$

$$\text{Debenture (subordinated) bonds} = \$1.4 \text{ million}$$

(b) If there was only \$12.5 million, then we get the following:

$$\text{Mortgage bonds} = \$11 \text{ million}, \text{Accounts Payable} = \$1.5 \text{ million}$$

Debenture ones will receive nothing.