

# Bankruptcy and Economic Recovery

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# Roadmap

- 1) What is corporate bankruptcy for?
- 2) An overview of key rules
- 3) The problem of delayed commencement
- 4) Bankruptcy and jobs
  - Chrysler
  - Reconciling sales & chapter 11

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*"Ladies and gentlemen,  
is there a bankruptcy attorney on board?"*



# 1) What is Corporate Bankruptcy for?

- 1) Solves collective action problem
- Grab race in the absence of bankruptcy
- Bankruptcy provides collective proceeding (economic vs. financial distress)
- Johns Manville as example
- Jackson (1982); Jackson (1986)

- 2) Shifts control rights to creditors
  - Voting rights
  - Creditors end up with equity
- Less successful with 2) after 1978 Bankruptcy Code enacted

# An additional factor: liquidity

- Bankruptcy's liquidity producing rules
- Ayotte-Skeel (2012)

## 2) Key rules of US Bankruptcy

- Automatic stay
- Preference rules (to discourage opt-out)
- Executory contracts
- DIP/managers continue to run business
- Vote
- Absolute Priority = baseline

### 3) A Key Problem: Late Commencement

- Equity has incentive to resist filing
- DIP reduces but does not remove managers' resistance
  - General Motors: Rick Waggoner
- New lenders are the ones who push for bankruptcy

# How might we encourage earlier commencement?

- Living wills for public firms
- Expand involuntary bankruptcy
- Authorize regulators to file
- Incentives
  - Bounty for equity or filing creditors
  - Penalize creditors if “actual intent to avoid an imminent BR proceeding”
- Remove special treatment of QFCs

# 4) Using Bankruptcy to Protect Jobs

- The Post 1978 environment
  - Reorg as preserving jobs
  - Extending exclusivity
  - Special protections: 1113, 1114
- Creditors' response
  - Tight constraints in DIP financing
  - Performance based pay
  - Sales

# The Chrysler Wildcard

- Used a standard technique in unlikely context
- The abuse: closed auction
- What would have happened if the government hadn't micromanaged?

# Lessons of Chrysler for BR sales

- Hidden costs of using bankruptcy to “save jobs”
- Benefits of streamlining Chapter 11
- Require Chapter 11 if most shareholders/creditors will participate in the new entity?

# Conclusion

- Bankruptcy actually works quite well
- We've suggested a few adjustments