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Hidden Wealth Transfers in Bankruptcy Asset Sales: A Real Option Analysis

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Summary

Under the U.S. Bankruptcy Code, company-debtors can sell assets, out of the ordinary course of business, if there is a “good business reason”, before creditors, shareholders and other claimants have agreed to a plan (§363). Such asset sales are frequently contested amongst claimants. This paper focuses on the conflicts that arise during such assets sales between creditors of different priorities and between creditors and shareholders. We use option theory to describe the payoffs and incentives of the two parties and show, under a limited set of assumptions, how permitting these sales affects the value of parties’ interests. We show large wealth-redistributive effects from early sale that can dwarf the value losses that courts use to justify early asset sales. This brings into question recent decision making and trends in bankruptcy that trade off speed at the expense of shareholders’ rights and safeguards.

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