Creditor Coalitions in Bankruptcy

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Summary

- **Research Question**: What are the causes and consequences of creditor coalition formation in Chapter 11 corporate bankruptcy cases?
- **Motivation**: Ad hoc creditor coalitions have become popular in chapter 11 restructuring cases. Important to understand:
  - What leads to creditor coalition formation
  - How these coalitions affect bankruptcy outcomes
- Stylized model to predict coalition formation
  - Creditors will form a coalition if net benefits benefits of doing so exceed the net benefits of being an independent creditor or purchasing a blocking position
- Empirically test the predictions using novel creditor group membership data from regulatory disclosures

Summary

- Coalition formation depends on
  - Share of debt held by banks ↓
  - Number of creditors ↑
  - Case size (leverage) ↑
  - Price impact (market liquidity) ↑
  - Creditor familiarity ↑
- Effect on bankruptcy outcomes
  - A group may have higher bargaining power than dispersed creditors $\implies$ higher recovery rates
  - Can lead to higher litigation, longer case length, higher creditor-on-creditor violence
- Empirical evidence on bankruptcy outcomes
  - Event study around group formation announcements:
    - Bond prices increase following announcement of group formation — market expectation of higher recovery
  - Diff-in-diff analysis using Peabody ruling: no effect on recovery rates , longer case length, more documents filed, potentially higher creditor-on-creditor violence

Discussion

- Studies an emerging tool in bankruptcy resolution
- Novel data — provides a first look at creditor coalitions and their potential impact
- Comments
  - Group formation: multiple dimensions of group formation
  - Bankruptcy outcomes: identification

Group Formation

Understanding group formation

$$GroupHolding\% = \alpha + \beta X + \beta_0 Controls + FixedEffects$$

$GroupHolding\%$ is the fraction of principal debt held by group members

- Present results on the extensive margin
  - What determines whether a group will exist or not?
- Compare characteristics of cases with and without groups
- The model features activist creditors who offer an option to non-activist creditors to join the group. Explore this in the data more
  - Does the presence of activist creditors increase the likelihood of group formation?
  - Would the presence of more than one activist creditor deter group formation?

Understanding group formation

- To better understand potential effects on bankruptcy, important to understand not only the fraction of debt held by a coalition but also the composition of a coalition
- Group concentration: A high fraction of debt held by a group could be achieved either by a few members holding a large fraction or several members holding roughly similar amounts
- Large vs small groups: A group with too many members may not be as productive as a group with fewer members
- Membership across multiple groups: If a creditor is a member of multiple coalitions, it might affect incentives to exert effort
- Number of groups: What determines whether a case has one ore more groups and how would it affect bankruptcy outcomes?
- Which case characteristics determine the composition of coalitions and how does it subsequently affect bankruptcy outcomes?

Bankruptcy Outcomes

Effect on bankruptcy outcomes

- Group formation is correlated with other case characteristics that could affect bankruptcy outcomes
- Solution: Use the 2017 Peabody ruling that increased the benefits of group participation
- Treated cases are those with high creditor familiarity
- Proceed in two steps:
  - Show that treated groups had higher group formation propensity post Peabody
  - Study bankruptcy outcomes for treated vs control groups post Peabody

Effect on bankruptcy outcomes

	(1) GroupHolding%	(2) GroupHolding%Class	(3) GroupSizeClass	(4) ClassInfluGroup
PostPeabody	0.276***	-0.00996	0.0529***	0.165**
	(0.0561)	(0.0255)	(0.00919)	(0.0605)
TreatmentClose	-0.0115			
	(0.0441)			
PostpeabodyXClose	0.140			
	(0.112)			
TreatmentCloseClass		0.00265	-0.0257**	-0.0138
		(0.0142)	(0.00920)	(0.0515)
PostpeabodyXCloseClass		0.175***	0.0957***	0.228*
		(0.0263)	(0.0143)	(0.0934)
Constant	0.140***	0.344***	0.222***	0.319***
	(0.0238)	(0.0140)	(0.0159)	(0.0344)
Fixed Effect	IndXYear	Class,IndXYear	Class,IndXYear	Class,IndXYear
Cluster	Ind,Year	Ind,Year	Ind,Year	Ind,Year
N	104	351	316	354
R^2	0.364	0.339	0.277	0.340

Effect on bankruptcy outcomes

	(1) LnCaseLength	(2) LnNumOfdkt	(3) VerticalAPR	(4) HorizontalAPR	(5) RecoveryCase	(6) DebtReduc%
PostPeabody	-0.431*	-0.187	-0.000889	-0.0356	-0.0201	0.256
	(0.185)	(0.178)	(0.0987)	(0.0752)	(0.0376)	(0.193)
TreatmentClose	-0.841***	-0.690***	0.311**	-0.163*	0.0322	-0.326**
	(0.113)	(0.0975)	(0.108)	(0.0722)	(0.0308)	(0.109)
PostpeabodyXClose	0.934***	0.776**	-0.222	0.375*	-0.0764	0.500***
	(0.110)	(0.211)	(0.122)	(0.157)	(0.0761)	(0.0976)
LnAssets	0.287***	0.466***	-0.0581*	0.111***	-0.0464	0.0566
	(0.0645)	(0.0737)	(0.0243)	(0.0234)	(0.0313)	(0.0861)
LnNumofClass	-0.00483	0.0996	0.282	0.296**	-0.0388	0.0801
	(0.388)	(0.237)	(0.165)	(0.0788)	(0.0425)	(0.0726)
Constant	3.111***	3.144***	0.517***	-1.002***	1.033***	-0.178
	(0.613)	(0.608)	(0.0758)	(0.210)	(0.255)	(0.725)
Fixed Effect	IndXYear	IndXYear	IndXYear	IndXYear	IndXYear	IndXYear
Cluster	Ind,Year	Ind,Year	Ind,Year	Ind,Year	Ind,Year	Ind,Year
N	104	100	104	104	87	84
R^2	0.412	0.540	0.365	0.289	0.472	0.487

Effect on bankruptcy outcomes

- Creditor familiarity not statistically significant for case-level analysis; hard to interpret results from the second stage
- How do cases with above and below median creditor familiarity differ across other dimensions that affect bankruptcy outcomes?
  - Cases with high creditor familiarity also have more creditors
  - Post Peabody period includes Covid so cases with more creditors took longer to resolve during Covid

Other Comments

- How does Covid affect your results?
- Why do you study only one bankruptcy outcome at the case-class level (Table 13)?
- Results from event study show positive effects on recovery rates but from the diff-in-diff analysis show negative or no effects on recovery rates. Why?
- Do creditors continue to form groups even after seeing lower recovery rates?

Conclusion

- The paper documents interesting facts on creditor coalitions and provides suggestive evidence on its negative effects
- Exploring multiple dimensions of coalitions and strengthening identification can make the paper even stronger