ALTERNATIVE INVESTING

Effects of Bankruptcy Court Protection on Asset Sales

November 26, 1996

This paper uses a sample of commercial aircraft transactions to examine the effectiveness of bankruptcy court protection in mitigating costs of financial distress associated with asset sales.

The evidence suggests that neither protection under Chapter 11 of the bankruptcy code nor court-supervised liquidation under Chapter 7 of the code are effective at mitigating price discounts. If anything, firms operating under supervision of the court sell assets at even bigger discounts.

Based on these findings, we can conclude that the current bankruptcy code does not preclude rents associated with asset sale discounts from accruing to asset buyers rather than sellers' claimholders. At least in the case of used aircraft sales, buyers appear to pay attractive prices whether or not the distressed seller has the bankruptcy court's protection.

If there is any effect of bankruptcy in minimizing financial distress costs associated with asset sales, it involves limiting the quantity of sales. Firms that file for bankruptcy protection and eventually emerge lose a very small fraction of their fleets. If these firms are only financially distressed (as opposed to being both financially and economically distressed) then bankruptcy protection is value enhancing. If on the other hand these firms are not economically viable, then avoiding or delaying liquidation will destroy value.

Analyses presented in this paper are based on nine bankruptcy filings by major U.S. airlines between 1978 and 1992: Braniff (May 1982), Continental (September 1983), Air Florida (July 1984), Eastern (March 1989), America West (June 1991), Continental (December 1990), Midway (March 1991), Pan Am (January 1991), and TWA (January 1992).