The Choice Among Traditional Chapter 11, Prepackaged Bankruptcy, and Out-of-Court Restructuring

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Abstract

I examine how financially distressed firms choose among three alternatives: traditional Chapter 11 bankruptcy, prepackaged bankruptcy, and out-of-court restructuring. In doing so, I investigate firm performance and capital structure, as well as the previously undocumented role of managerial discretion. My sample consists of 198 observations and 174 poorly performing firms that start restructuring between 1988 and 1999 using one of these three alternatives. Results suggest that the primary determinant of the restructuring choice is firm performance. Specifically, logit regressions show that firms are significantly more likely to restructure out-of-court rather than in traditional Chapter 11 bankruptcy when they come from industries with higher median market-to-book ratios and when they have a higher ratio of operating income to total assets in the year before the onset of financial distress. On the other hand, firms restructuring out-of-court also exhibit a significantly greater number of long-term debt contracts per dollar of total debt in the year before distress and a significantly greater increase in the ratio of long-term debt to total assets over the two years prior to distress, compared to firms entering traditional Chapter 11 bankruptcy. There is no evidence to suggest that managerial ownership and monitoring by the board of directors and unaffiliated equity blockholders play a significant role in the restructuring decision.

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1. Introduction

Financially distressed firms have three options available to them to continue independent operations: traditional Chapter 11 bankruptcy, prepackaged bankruptcy[1], and out-of-court restructuring. In this study, I empirically examine how firms choose among these three methods of restructuring and the role of management in that decision.

One hypothesis is that the restructuring decision is based on firm performance and liquidity. To the extent that firms with greater performance and firms from industries with greater performance are, ex ante, more likely to generate future cash flows to service debt and are less likely to become distressed in the future, these firms are more likely to successfully complete an out-of-court restructuring. Firms that are more liquid and less financially distressed are also more likely to successfully restructure out-of-court. On the other hand, sudden liquidity constraints or severe financial distress might increase the likelihood that firms choose traditional Chapter 11 because of Chapter 11's automatic stay feature, prohibiting creditors and others from collecting claims against the firm.

Another hypothesis is that a firm's capital structure determines the restructuring method chosen. For example, firms with a large number of creditors face a creditor coordination problem. If traditional Chapter 11 mitigates creditor coordination problems by forming creditor classes, which allows for negotiations with groups of creditors holding claims of similar seniority

[1] Prepackaged bankruptcy is a hybrid form of restructuring, combining the features of both traditional Chapter 11 and out-of-court restructuring. Firms resolving financial distress through a prepackaged bankruptcy file a plan of reorganization at the same time as their Chapter 11 bankruptcy petition. Voting for approval of the plan occurs either before or after filing. Although prepackaged bankruptcy requires a formal petition to be filed under the Bankruptcy Code and formal court proceedings, the restructuring plan is negotiated out-of-court and the time spent in court is significantly less than traditional Chapter 11 restructurings. For these reasons, I distinguish prepackaged

and risk, then firms likely to be constrained by the creditor coordination problem are more likely to choose traditional Chapter 11 to resolve their distress. Similarly, firms likely to suffer from creditor holdout problems, in which a minority of claimholders refuse to accept a restructuring plan, are better off restructuring under the less stringent voting requirements of traditional Chapter 11 or prepackaged bankruptcy than an out-of-court workout.

A third view is that self-serving managers choose the method of restructuring that best serves their needs, without regard for value maximization. In other words, agency conflicts between managers and other claimholders exist, permitting managers to choose a restructuring alternative other than the optimal, least-cost method for the firm. Traditional Chapter 11 allows managers to remain in control of their firm while providing them the exclusive right, at least temporarily, to propose a reorganization plan. If managers are concerned about their own employment, and to the extent that traditional Chapter 11 insulates managers from being terminated, self-serving managers will choose traditional Chapter 11 over alternative, and perhaps less costly, restructuring methods. Because of the control granted to incumbent managers by the Bankruptcy Code and it's automatic stay provision, self-serving managers might choose traditional Chapter 11 over alternative methods of restructuring in order to continue unprofitable operating strategies or pet projects.

Previous empirical research on how firms choose among available restructuring alternatives is limited. Gilson, John, and Lang (1990) study the characteristics of firms that resolve financial distress through private workouts rather than traditional Chapter 11. However, their analysis does not include prepackaged bankruptcy, nor does it consider the role of managerial discretion in the restructuring decision. In addition, their sample is constructed from

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bankruptcies from other Chapter 11 filings by referring to the latter as traditional Chapter 11 restructurings. See McConnell and Servaes (1991) and Tashjian, Lease, and McConnell (1996).

firms with extremely low stock returns. To the extent that stock returns incorporate information about future restructuring decisions and consequences, their results may be specific to firms with the poorest restructuring outcomes. Chatterjee, Dhillon, and Ramírez (1996) examine the cross-sectional determinants of restructuring choices, including prepackaged bankruptcy, over the short horizon from 1989 to 1992. However, they also do not consider the role of managerial discretion in the restructuring decision. In addition, they sample from a variety of unrelated sources, including the sampling methodology of Gilson, John, and Lang (1990) based on poor stock returns. Results of cross-sectional tests using an inconsistent sampling methodology possibly just reflect the different types of firms covered by different data sources rather than true determinants of restructuring decisions.

In this study, I examine how financially distressed firms choose among traditional Chapter 11 bankruptcy, prepackaged bankruptcy, and out-of-court restructuring. In doing so, I investigate the previously undocumented role of managerial discretion in the choice among restructuring alternatives. In addition, I implement a sampling methodology that mitigates three potential problems of previous studies. First, I sample firms experiencing a sharp decline in earnings, rather than poor stock price performance, mitigating a potential sampling bias towards firms with the poorest restructuring outcomes. Second, I sample firms over a longer period of time, including firms that start restructuring between 1988 to 1999. Third, I sample firms that restructure under each alternative using a uniform sampling methodology, mitigating noise associated from using multiple and unrelated sources.

For my sample of 198 observations and 174 firms that restructure under traditional Chapter 11 bankruptcy, prepackaged bankruptcy, or out-of-court, there exists no evidence of significant differences in managerial ownership or levels of monitoring by directors or

unaffiliated equity blockholders among firms choosing one alternative over another. However, multinomial logistic regressions show that firm performance is a significant factor in determining restructuring alternatives. Firms from industries with a higher median market-to-book ratio and firms with a higher ratio of operating income to total assets in the year before the onset of distress are more likely to restructure out-of-court than through traditional Chapter 11 bankruptcy. Firms restructuring out-of-court also exhibit a significantly greater number of long-term debt contracts per dollar of total debt in the year before distress, suggesting that the firms with the greatest probability of creditor coordination or creditor holdout problems are not more likely to restructure in traditional Chapter 11. In addition, out-of-court firms have a significantly greater increase in the ratio of long-term debt to total assets over the two years prior to distress, compared to firms restructuring in traditional Chapter 11 bankruptcy.

The remainder of this paper is organized as follows. Section 2 further develops the hypotheses of how firms choose among the various restructuring alternatives and reviews existing empirical evidence. Section 3 discusses the sampling methodology and provides descriptive statistics. Univariate results are analyzed in section 4 and multivariate results are discussed in section 5. Section 6 concludes.

2. Theory and Prior Evidence on the Restructuring Decision

This study explores three perspectives on how firms choose among available restructuring alternatives. The first is that the restructuring decision is determined by liquidity and firm performance. The second is that the decision is based on the firm's capital structure. The third is that agency conflicts between managers and other claimholders provide an opportunity for managers to choose a restructuring method that is self-serving, without regard for

value maximization. This section outlines the benefits available under the Bankruptcy Code and develops these three views and their testable hypotheses.

2.1 The Benefits of Chapter 11

Ideally, value maximizing firms should choose the restructuring alternative that results in the least costly resolution of financial distress. Prior evidence suggests that traditional Chapter 11 bankruptcy results in higher direct costs (e.g., legal and administrative fees) and potentially higher indirect costs (e.g., the value of lost sales and managers' time) than prepackaged bankruptcy and out-of-court restructuring, with prepackaged bankruptcy falling between the other two.[2] Given that traditional Chapter 11 is still a frequently used method of resolving financial distress, and assuming that not all of these firms are choosing inefficiently, it must either be the case that traditional Chapter 11 is less costly for some firms than restructuring out-of-court or that Chapter 11 provides unique benefits to filing firms, of which firms restructuring out-of-court cannot take advantage. These benefits include an automatic stay from creditors and a less restrictive approval process for the plan or reorganization.

After filing a bankruptcy petition under Chapter 11 of the U. S. Bankruptcy Code, the firm is protected by an automatic stay.[3] Unless waived by the court, this automatic stay remains in effect until the firm emerges from bankruptcy. While protected from creditors, managers propose and seek acceptance of a reorganization plan. Acceptance of the plan occurs through a voting process requiring approval from a majority (two-thirds in value and one-half in number) of each impaired class of claimholders. In addition, the bankruptcy judge reserves the right to

[2] See, for example, Tashjian, Lease, and McConnell (1996), Gilson, John, and Lang (1990), Betker (1997), and Franks and Torous (1994).

[3] §362 of the U. S. Bankruptcy Code.

cram down a fair and reasonable plan on dissenting parties. In contrast, firms in an out-of-court restructuring must seek approval from all participating claimholders.[4]

Firms that choose prepackaged bankruptcy inherently waive the benefits of the automatic stay provision by negotiating and seeking approval of a reorganization plan prior to filing. In addition, because firms using prepackaged bankruptcy are under court protection for significantly less time than traditional Chapter 11 firms, and thus protected from creditors for significantly less time, the accrued benefits of an automatic stay are likely to be significantly less. However, because the voting requirements under the Bankruptcy Code are the same for both prepackaged bankruptcy and traditional Chapter 11, firms choosing either of these two restructuring alternatives benefit from not having to seek unanimous consent. Therefore, traditional Chapter 11 is more likely the least-cost restructuring alternative for those firms seeking the benefit of an automatic stay. Either prepackaged bankruptcy or traditional Chapter 11 is more likely the least-cost alternative for those firms benefiting from the less restrictive voting requirements that the Bankruptcy Code provides.

Finally, the Bankruptcy Code provides three benefits, in addition to an automatic stay and less restrictive voting, which possibly make traditional Chapter 11 and prepackaged bankruptcy less costly than out-of-court restructuring. These include the tax liability on cancellation of indebtedness income, the use of net operating loss carryforwards, and the valuation of post-restructuring claims. If a firm restructures out-of-court and exchanges debt with a higher face value for debt with a lower face value, the difference between the face values is considered taxable income. Similarly, if a firm restructures out-of-court and offers equity to debtholders,

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[4] The Trust Indenture Act of 1939 requires that all individual debtholders consent to changes to a bond indenture, such as the interest rate, maturity, or principal. Alternatively, firms can propose an exchange offer, but each bondholder has the option not to participate.

and if ownership by existing shareholders becomes less than 50% of their original ownership, the firm forfeits it's accumulated net operating loss carryforwards.[5] Both the tax liability on cancellation of indebtedness income and the forfeiture of net operating loss carryforwards only apply to out-of-court restructuring. Therefore, firms seeking these benefits are more likely to restructure through traditional Chapter 11 or prepackaged bankruptcy. Related to the creditor holdout problem, some firms may seek Bankruptcy Code protection in order to preserve the value of restructured claims [McConnell and Servaes (1991)]. In 1990, Judge Lifland ruled that debtholders who participated in a previous out-of-court debt restructuring of LTV Corporation and accepted securities at a discount from their face value could only value their securities for the purpose of a bankruptcy claim at the discounted market value. Firms can secure all of these benefits using prepackaged bankruptcy or traditional Chapter 11. To the extent that traditional Chapter 11 involves higher direct and indirect costs than prepackaged bankruptcy, prepackaged bankruptcy is more likely to be the least-cost alternative for firms seeking these benefits, but otherwise capable of restructuring out-of-court.

2.2 Liquidity and Firm Performance

The restructuring decision may depend on liquidity and firm performance. Firms suffering from a lack of liquidity are most in need of an automatic stay from creditors, a benefit not provided (or utilized) by prepackaged bankruptcy or out-of-court restructuring. Thus, to the extent that firms choose the least-cost restructuring alternative, I hypothesize that firms choosing

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[5] Betker (1995) documents that no prepackaged bankruptcy in his sample would have lost net operating loss carryforwards had it restructured out-of-court. However, the benefit of prepackaged bankruptcy is in the more flexible allowed use of the net operating loss carryforwards.

traditional Chapter 11 have more severe liquidity problems than firms choosing alternative methods of restructuring.

Similarly, firms in more severe financial distress are likely to require a more complex reorganization. If, as Gilson (1997) suggests, traditional Chapter 11 reduces transaction costs, this cost saving is greater for firms requiring more extensive restructuring. In addition, firms in Chapter 11 can receive debtor-in-possession financing with superpriority status. For these reasons, traditional Chapter 11 is more likely the least-cost alternative for firms in more severe financial distress. Firms in less severe financial distress are more likely to restructure out-of-court, with prepackaged bankruptcy serving those firms in the middle. In the same way, firms with greater performance and firms from stronger industries are more likely to successfully restructure out-of-court. Stronger firm and industry performance in the period prior to restructuring increases the expected ability of the firm to generate future cash flows to service debt and decreases the probability of future financial distress.

2.3 Capital Structure

Another determinant of restructuring may be capital structure. Firms prone to creditor coordination or creditor holdout problems are more likely to benefit from the Bankruptcy Code's less stringent voting requirements. Therefore, either traditional Chapter 11 or prepackaged bankruptcy is more likely to be the least-cost alternative for these firms, as opposed to out-of-court restructuring. The creditor coordination problem occurs when large numbers of creditors holding heterogeneous claims make it difficult for the firm to negotiate with all individual claimholders. This problem is mitigated by the Bankruptcy Code in two ways. First, the Bankruptcy Code groups claimholders into classes based on the similarity of claims, allowing the

firm to negotiate with a fewer number of creditor classes than individual claimholders. Second, and perhaps more important, the Bankruptcy Code only requires approval from a majority (two-thirds in value and one-half in number) of the creditors in each impaired class. Thus, coordination is further simplified by only needing a majority of support from each class. However, prepackaged bankruptcy requires creditors to voluntarily accept being placed into creditor classes in out-of-court, pre-filing negotiations. Therefore, it is expected that traditional Chapter 11 is more likely the least-cost alternative for firms negotiating with a larger number of creditors, while out-of-court restructuring is more likely the least-cost alternative for firms negotiating with relatively fewer creditors. Prepackaged bankruptcy likely serves those firms in the middle.[6]

Similar to problems arising from creditor coordination, creditor holdout occurs when an individual creditor refuses to accept a plan of reorganization that reduces his claim, even though it is beneficial to the firm as a whole. These conflicts are more likely in firms with a larger number of creditors and a more complex capital structure (i.e., more heterogeneous claims). The creditor holdout problem is mitigated by the less stringent voting requirements of traditional Chapter 11 and prepackaged bankruptcy. Therefore, these restructuring alternatives are more likely than out-of-court restructuring to be the least-cost method for firms with larger numbers of creditors and more complex capital structures.

In summary, traditional Chapter 11 is hypothesized to more likely be the least-cost alternative for firms with less liquidity, firms in greater financial distress, firms with poorer

[6] McConnell and Servaes (1991) point out that the large number of trade creditors, their relative unsophistication, and the heterogeneity of their claims make it less likely for firms with large amounts of trade credit to successfully restructure through a prepackaged bankruptcy. However, Betker (1995) documents that 41 of 49 sample firms undergoing prepackaged bankruptcy continued to pay trade creditors, thus waiving an automatic stay from that class and leaving them unimpaired.

performance, firms from industries with poorer performance, firms with greater expected creditor coordination problems, and firms with a greater possibility of creditor holdout. Out-of-court restructuring is more likely the least-cost alternative for firms with greater liquidity, firms in less financial distress, firms with stronger performance, firms from stronger industries, firms with fewer expected creditor coordination problems, and firms with a smaller possibility of creditor holdout. Prepackaged bankruptcy is hypothesized to serve those firms in the middle.

2.4 The Role of Managerial Discretion

Agency theory predicts that managers might not always act in the best interest of shareholders [Jensen and Meckling (1976)]. If agency conflicts exist in financially distressed firms, then the possibility exists for managers to make restructuring decisions out of self-interest rather than concern for value maximization. Corporate governance and monitoring mechanisms exist to mitigate these agency conflicts. These mechanisms include independent outside directors (directors with no other business or family ties to the firm) and unaffiliated equity blockholders (equityholders owning at least 5% of the firm and having no business or family ties to the firm). In addition, equity holdings by managers and directors are used to align their interests with those of shareholders, although evidence suggests that excessive managerial holdings lead to managerial entrenchment, potentially exacerbating agency problems.[7]

In addition to the automatic stay from creditors granted by the Bankruptcy Code upon filing a formal petition, managers of the firm are guaranteed 120 days to propose a plan of reorganization and an additional 60 days to have the plan approved by each impaired creditor class. However, this period is generally extended, and often, it is continuously extended until a

[7] See Stulz (1988), Morck, Shleifer, and Vishny (1988), McConnell and Servaes (1990), and Demsetz and Lehn (1985).

reorganization plan is accepted. Thus, the incumbent management remains in control of the firm's operations and influences the reorganization process. Although the court can replace incumbent management with a trustee, the Bankruptcy Code reserves this for situations of "fraud, dishonesty, incompetence, or gross mismanagement."[8] LoPucki and Whitford (1993) show that shareholders of traditional Chapter 11 firms do not always have the same ability to call shareholder meetings for the purpose of replacing directors and managers in traditional Chapter 11 as they do out-of-court.

Because traditional Chapter 11 offers managers the exclusive right to propose an initial plan of reorganization and the ability to continue managing the firm's operations, Bradley and Rosenzweig (1992, 1995) argue that incumbent managers are granted excessive power over the firm's reorganization and that traditional Chapter 11 provides a safe haven for managers, protecting them from disciplinary forces. To the extent that this is true, self-serving managers might choose a traditional Chapter 11 restructuring, even if it is more costly for the firm. For example, managers of financially distressed firms concerned about their own employment might file for traditional Chapter 11 in order to remain employed and in control of the firm, rather than attempt a less costly restructuring alternative unprotected from disciplinary forces. Bradley and Rosenzweig (1992) suggest that managers with pet projects or self-serving operating strategies will choose traditional Chapter 11 since that alternative provides managers with the freedom to continue such value reducing projects and strategies. Weiss and Wruck (1998) document asset-stripping to fund unprofitable operations in the Chapter 11 case of Eastern Airlines. LoPucki and Whitford (1993) suggest managers of marginally solvent firms may engage in high risk

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[8] §1104 of the U.S. Bankruptcy Code. The Bankruptcy Code also allows for the appointment of a trustee for similar causes to those mentioned, and if such appointment is "in the interests of creditors, any equity security

investments. In doing so, the majority of the risk is borne by creditors, while shareholders potentially benefit.

If traditional Chapter 11 is relatively more costly and facilitates these self-serving activities and interests, and to the extent that managers do not always choose the least-cost restructuring method, it is likely that self-serving managers choosing traditional Chapter 11, rather than a less costly alternative, face weaker monitoring and governance structures. I hypothesize that firms restructuring through traditional Chapter 11 suffer from weaker monitoring from the board of directors and outside equity blockholders. In addition, management likely has either insufficient equity holdings to align their interest with shareholders or is entrenched by excessive ownership.

2.5 Prior Evidence on the Restructuring Decision

Two empirical studies examine the characteristics of firms choosing among the various restructuring alternatives. Gilson, John, and Lang (1990) investigate the incentives that firms in financial distress have to restructure out-of-court rather than through traditional Chapter 11. Their sample is comprised of New York Stock Exchange and American Stock Exchange listed firms over the period 1978 to 1987, with three-year unadjusted common stock returns among the bottom five percent. They find that firms are more likely to successfully restructure their debt privately when they have relatively more intangible assets, as measured by the ratio of the market value of assets to their replacement cost, when they owe more of their debt to banks, and when they owe fewer creditors, as measured by the ratio of the number of long-term debt contracts to the book value of total liabilities. They argue that traditional Chapter 11 is more

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holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor."

costly for firms with relatively more intangible assets because, as assets are sold in bankruptcy to pay down debts and remedy default, the destruction of going-concern value is greater for these firms. Their results also suggest that the holdout problem is mitigated when firms negotiate with fewer lenders, especially banks. At the time of their study, prepackaged bankruptcy was not a frequently used alternative.[9] Because they sample on poor stock returns, their sample is potentially biased towards firms with poorer restructuring outcomes, and their results may not apply to a broader sample of financially distressed firms.

The cross-sectional characteristics of firms choosing each of the three restructuring alternatives are studied by Chatterjee, Dhillon, and Ramírez (1996), who hypothesize that the decision depends on the firm's liquidity, the degree of leverage, the level of economic distress, and the creditor coordination problem. They use a sample of firms from a variety of sources that restructure through traditional Chapter 11, prepackaged bankruptcy, or out-of-court during the 1989-1992 period. In terms of liquidity, they find that firms using prepackaged bankruptcy have a significantly higher ratio of current debt due to total assets in the year prior to filing than firms reorganizing out-of-court or through traditional Chapter 11 bankruptcy. Their measure of current debt due includes the value of defaulted loans, possibly measuring the likelihood of actual default rather than the level of current obligations not already in default. In terms of leverage, traditional Chapter 11 firms are found to have a significantly lower ratio of total liabilities to total assets than prepackaged bankruptcy or public workout firms, and public workout firms have a significantly higher proportion of long-term debt than firms using any of the other alternatives.

[9] The first high-profile firm to use prepackaged bankruptcy was Crystal Oil Company in 1986 [McConnell and Servaes (1991)], although smaller companies are believed to have used it prior to 1986 [Tashjian, Lease, and McConnell (1996)].

Chatterjee, Dhillon, and Ramírez (1996) measure the level of economic distress as the ratio of earnings to total assets and find firms filing traditional Chapter 11 are significantly more economically distressed than firms using prepackaged bankruptcy, and firms using prepackaged bankruptcy are more economically distressed than firms restructuring out-of-court. They suggest this evidence is consistent with higher quality firms choosing to restructure out-of-court and lower quality firms filing traditional Chapter 11, with prepackaged bankruptcy serving those firms in the middle. Consistent with the hypothesis that a greater proportion of trade credit exacerbates the creditor coordination problem, Chapter 11 firms have a significantly greater proportion of trade credit than firms using alternative methods of restructuring. Traditional Chapter 11 firms have a significantly higher proportion of bank debt to long-term debt than firms using prepackaged bankruptcy or workouts. However, these results only focus on the short period between 1989-1992. In addition, Chatterjee, Dhillon, and Ramírez use a variety of unrelated sampling sources, including the methodology of Gilson, John, and Lang (1990). This leaves open the possibility that cross-sectional results reflect the characteristics of firms covered by each sampling source rather than true determinants of restructuring decisions. I am aware of no existing empirical study that explores the role of managerial discretion in the restructuring decision.

3. Sample Selection and Description

The objective of this study is to investigate how managers choose to resolve financial distress and to examine the monitoring mechanisms in place when managers make those decisions. My sample consists of 198 observations of financially distressed firms that start

restructuring either through traditional Chapter 11, prepackaged bankruptcy, or out-of-court between 1988 and 1999.

I employ a two-step sampling methodology similar to Gilson (1989, 1990) and Gilson, John, and Lang (1990). For each year between 1990 and 1997, I calculate the three-year change in the ratio of operating income to total assets for all firms on the Compustat Industrial Annual, Full Coverage, and Research tapes with at least $100 million in total assets in the first of the three years. Requiring $100 million in initial total assets increases the likelihood that the firm's financial distress is covered by the press, but allows for the fact that some firms may sell assets during the period of declining operating income. I focus on those firms whose three-year change in the ratio of operating income to total assets is in the bottom five percent for that sampling year. Over the period 1990 to 1997, this results in 1,103 potential observations for 708 firms. Next, I search the Dow Jones News Service newswire for the five years surrounding the sampling year for each potential observation for evidence of traditional Chapter 11, prepackaged bankruptcy, or out-of-court restructuring.[10] My final sample consists of 198 observations for 174 financially distressed firms restructuring in one of these three ways. Additional information on when restructuring was initiated and concluded is obtained from the Wall Street Journal, the Dow Jones Newswires, the Press Release Wires, Reuters English News Service, and the Associated Press Newswires.[11]

This sampling methodology has two principal advantages. First, I sample based on earnings declines rather than poor stock returns. To the extent that stock prices and stock returns

[10] Search terms include: covenant, bankrupt, bankruptcy, chapter 11, chapter 7, liquidate, liquidation, default, reorganize, reorganization, restructure, restructuring, distress, creditor, bondholder, negotiate, negotiations, renegotiate, renegotiation, prepack, prepackaged bankruptcy, and prearranged bankruptcy.

[11] Dow Jones Newswires include Dow Jones News Service and Federal Filings Newswires, among others. Press Release Wires include Business Wire and PR Newswire, among others.

incorporate the probability of future events, such as the method of restructuring and the likelihood of successfully resolving financial distress, focusing on only those firms with the lowest stock returns potentially causes one to sample a disproportionate amount of firms in severe financial (or economic) distress, thus resulting in a sample of firms with the worst expected future restructuring outcomes. Second, I use the same sampling methodology to sample all firms, rather than sampling firms undergoing each of the restructuring alternatives from separate and unrelated sources. To the extent that different sources cover firms with different characteristics, using a different source to sample firms choosing each restructuring alternative potentially leads one to incorrectly conclude the cross-sectional variables important in restructuring decisions. In other words, if firms restructuring by traditional Chapter 11 are sampled from one source and firms restructuring out-of-court are sampled from another source, evidence suggesting the importance of a firm characteristic in the choice between traditional Chapter 11 and an out-of-court restructuring could possibly just be evidence that the firms covered by one source are different than the firms covered by another.

Because my sample consists of only firms experiencing significant declines in operating income, it is less likely that I include highly levered firms whose financial distress is triggered without such significant performance declines. However, Asquith, Gertner, and Scharfstein (1994) document firm performance and industry performance as being the primary causes of financial distress for their sample of junk-bond issuers. Leverage was the primary cause for only 9% of their sample. If highly levered firms are more likely to restructure out-of-court, as Jensen (1989) suggests, and if my sampling methodology biases me away from including these firms, one would expect the proportion of out-of-court restructurings in my sample to be smaller than other studies. This does not appear to be the case.

Information on board structure, board ownership, management, and managerial ownership are obtained from proxy statements. All information on the capital structure and leverage of firms come from Compustat, with the exception of the number of long-term debt contracts outstanding, which comes from Moody's Industrial Manuals. Following convention, I distinguish between inside, independent outside, and affiliated outside directors. Inside directors are those who are also employees of the firm. Affiliated outside directors include former employees, family members of employees, and those with business ties to the firm. Independent outside directors include all others. The same convention is used to distinguish between affiliated and unaffiliated equity blockholders who are not officers or directors of the firm. All data come from the fiscal year-end or proxy date most recent before the start of restructuring.

Table 1 describes the distribution of the sample. Panel A shows the distribution across years (according to when the firm starts restructuring) and types of restructuring. Examining the sample year-by-year reveals some clustering in the 1991 to 1992 and 1995 to 1996 periods. Greater dispersion is found among the types of restructuring. Only twenty incidences of prepackaged bankruptcy appear in the sample. Traditional Chapter 11 bankruptcies account for 41.92% of the sample and out-of-court restructurings account for the remaining 47.98%. Panel B shows the distribution of the sample across industries, by one-digit SIC code. Over half of the sample firms are classified as manufacturing or trade.

Financial, ownership, and board characteristics for the sample are provided in table 2. Panel A presents the financial characteristics of the sample. The mean (median) book value of total assets for the sample is $739 million ($324 million). These poorly performing, financially distressed firms experienced a decline in their market-to-book ratios, as well as declines in the median market-to-book ratios in their industries. In addition, since the sample is constructed

from firms that exhibited extreme declines in operating income to total assets over a three-year period, it is no surprise that the sample firms have significant declines in this ratio over the one and two years prior to restructuring. Poor performance is also illustrated by the significant increase in the ratio of net operating loss carryforwards to total assets.

The sample firms also exhibit a significant increase in leverage. Over the one and two years prior to restructuring, sample firms significantly increased their current liabilities to total assets, long-term debt to total assets, and total liabilities to total assets. For the average firm, total liabilities account for 87% of total assets in the year before restructuring. Current liabilities comprise 39% of total assets and long-term debt makes up 37%.

Panel B of table 2 reports descriptive statistics for the equity ownership by officers, directors, and blockholders. Three measures of ownership by management are reported: ownership by the chief executive officer (CEO); ownership by the top three officers, which includes the CEO, chairman of the board, and president; and ownership by all officers and directors. In the year before restructuring, the average (median) CEO owns 11.46% (2.27%) of the firm's voting rights, and over the two years preceding restructuring, ownership by the CEO significantly decreases. In addition, during the one and two years prior to restructuring, ownership by the top three officers and all officers and directors significantly declines, while both the number of and ownership by unaffiliated blockholders significantly increases. These results are consistent with Gilson (1990), who documents an increase in ownership by unaffiliated equity blockholders and a decrease in ownership by the CEO and all officers and directors from the year before to the year after the start of restructuring. If the restructuring decision involves potential conflicts of interest between managers and shareholders, one would expect an increase in monitoring by unaffiliated equity blockholders during financial distress.

Changes in the composition of the board of directors are reported in panel C. The median board size is eight directors and does not significantly change prior to restructuring. Similarly, the composition of the board does not change. The average board is comprised of 35% inside directors, 47% independent outside directors, and 18% affiliated outside directors. These results suggest that, even as operating income is significantly declining and the firm is nearing financial distress, the composition of the board does not change to increase its monitoring effectiveness.

4. Univariate Analysis

The objective of this study is to examine how mangers choose one restructuring alternative over another, and what monitoring and governance mechanisms are in place when managers choose each alternative. Table 3 documents the financial, equity ownership, and board characteristics of firms for each method of restructuring. In addition, the table reports test statistics for differences in means and medians among the three types of restructuring.

Panel A reports financial variables for the fiscal year-end prior to the start of restructuring. Similar to previous studies, the sample shows several significant differences in the financial characteristics of firms choosing one restructuring alternative over another. Firms restructuring through a prepackaged bankruptcy are larger than firms restructuring through traditional Chapter 11 or out-of-court, although only median book values are significantly different. The sample consists of larger traditional Chapter 11 and prepackaged bankruptcies, but smaller out-of-court restructurings, than Chatterjee, Dhillon, and Ramírez (1996), and larger traditional Chapter 11 bankruptcies and out-of-court restructurings than Gilson, John, and Lang (1990).

The results also suggest differences in the performance of firms choosing one alternative over another. Consistent with Gilson, John, and Lang (1990), firms restructuring out-of-court have higher market-to-book ratios than those filing a traditional Chapter 11 bankruptcy petition. However, this difference is not significant. Firms restructuring out-of-court come from industries with significantly higher median market-to-book ratios than firms filing a traditional Chapter 11 bankruptcy petition. In addition, firms restructuring out-of-court have significantly higher ratios of operating income to total assets than traditional Chapter 11 firms. Prepackaged bankruptcy firms have a significantly lower ratio of net operating loss carryforwards to total assets than either traditional Chapter 11 or out-of-court firms. This is inconsistent with the theory that firms might choose a prepackaged bankruptcy over an out-of-court restructuring to preserve the value of their net operating loss carryforwards. Overall, firms that restructure out-of-court appear to have greater performance in the year before restructuring than firms turning to traditional Chapter 11 bankruptcy.

There also exist differences in the capital structure of firms choosing among these three restructuring alternatives. Current liabilities to total assets is significantly greater for firms resolving financial distress in traditional Chapter 11 than for firms restructuring out-of-court. This is consistent with traditional Chapter 11 firms being relatively more illiquid. In fact, traditional Chapter 11 firms increase their ratio of current liabilities to total assets significantly more than do out-of-court firms over the two years prior to the start of restructuring (not reported in the table). Other measures of short-term debt do not differ significantly among the three types of restructuring. Long-term debt to total assets in the year prior to restructuring is not significantly different among these firms. However, firms restructuring out-of-court increase their ratio of long-term debt to total assets significantly more than do traditional Chapter 11

bankruptcy firms in both the one and two years prior to the start of restructuring (also not reported in the table). Finally, firm entering traditional Chapter 11 bankruptcy are significantly more levered than firms restructuring out-of-court, as measured by the ratio of total liabilities to total assets. These results show that, although traditional Chapter 11 firms have more total debt, this is driven by a greater dependence on current debt, which significantly increases in the period before distress. Firms restructuring out-of-court rely more heavily on long-term debt, which also significantly increases in the period before distress.

Complexity of the firm's capital structure is measured by the number of long-term debt contracts and the ratio of long-term debt contracts to total liabilities. Although there is no significant difference in the number of long-term debt contracts among these firms, there are differences in the number of debt contracts per dollar of total debt. Firms restructuring out-of-court have significantly more long-term debt contracts per dollar of total debt than do firms restructuring in either traditional Chapter 11 or prepackaged bankruptcy. This suggests that firms for which the probability of creditor coordination and creditor holdout problems is highest are the firms which restructure out-of-court, not in traditional Chapter 11. This inconsistent with the results of Gilson, John, and Lang (1990).

Next, I examine the role of managerial discretion in the choice among methods of restructuring. Panel B of table 3 reports the equity ownership for managers and blockholders. Overall, analysis of univariate results suggests that equity ownership by managers, all officers and directors, and equity blockholders do not significantly differ among the three restructuring alternatives. To the extent that equity ownership by managers provides an incentive for them to work in shareholders' interests, and if equity blockholders are effective monitors, then there is

little difference in the incentives of managers and monitoring by equity blockholders among the three restructuring alternatives.

Finally, univariate analysis of the board of directors is presented in Panel C of table 3. Independent outside directors are hypothesized to be the most effective monitors on the board, due to their lack of any personal or business ties to management. Inside directors are hypothesized to be the least effective monitors. Similar to equity ownership, there are no significant differences in board size or composition among firms restructuring in traditional Chapter 11, prepackaged bankruptcy, or out-of-court.

5. Multivariate Analysis

Univariate results suggest that some performance and capital structure variables may play a significant role in the choice among restructuring alternatives for this sample of poorly performing firms. However, managerial ownership and board composition do not appear to be significant determinants. Table 4 presents multinomial logit analyses comparing firms restructuring in prepackaged bankruptcy and out-of-court to those restructuring in traditional Chapter 11.

Panel A of table 4 contains the results of logistic regressions estimating the probability that a firm chooses a prepackaged bankruptcy or an out-of-court restructuring, rather than a traditional Chapter 11 bankruptcy. Model 1 includes measures of industry performance, firm performance, liquidity, long-term debt, and creditor coordination in the year prior to the start of restructuring. The multivariate results are consistent with the univariate results. Specifically, firms restructuring out-of-court have significantly higher industry median market-to-book ratios and ratios of operating income to total assets, as well as a greater number of long-term debt

contracts per dollar of total debt than firms restructuring in traditional Chapter 11 bankruptcy. This is consistent with the hypothesis that firms with greater performance and firms from industries with greater investment opportunities are more likely to successfully restructure out-of-court. Firms from weaker industries and firms with poorer performance are more likely to seek traditional Chapter 11 bankruptcy. However, to the extent that the ratio of the number of long-term debt contracts to total liabilities measures the likelihood of creditor coordination or creditor holdout problems, the results are inconsistent with the notion that firms subject to these negotiating hurdles are more likely to enter traditional Chapter 11 bankruptcy. The marginal importance of these variables is not significant when comparing firms restructuring via prepacks to those using traditional Chapter 11 bankruptcy.

In addition to firm performance and capital structure, model 2 examines the role of managerial ownership and monitoring in the restructuring decision by including the percentage of equity ownership by the CEO, the percentage of equity ownership by all unaffiliated equity blockholders, and the proportion of independent outside directors on the board. According to the evidence, and consistent with the univariate results, the levels of managerial ownership and monitoring by unaffiliated equity blockholders and the board of directors are not significant predictors of restructuring choice.[12] The results continue to show that firms with greater performance are more likely to restructuring out-of-court rather than through traditional Chapter 11, although industry performance does not continue to play a significant role. In addition, the ratio of long-term debt contracts per dollar of total debt remains significant, though not in the same direction as was hypothesized. Finally, model 2 shows that firms with a greater ratio of

[12] In a model with just CEO ownership, ownership by unaffiliated equity blockholders, and proportion of independent outside directors on the board as the independent variables, these measure of incentives and monitoring still showed no significant predictive power.

long-term debt to total assets are significantly more likely to restructure out-of-court rather than through traditional Chapter 11.

Panel B of table 4 presents the multinomial logit models using the changes in the firm performance, capital structure, and ownership and monitor variables over the two years prior to the start of restructuring. After controlling for changes in firm performance, liquidity, and capital structure, firms in industries that experience large declines in investment opportunities, as measured by the industry median market-to-book ratio, are significantly more likely to restructure through a prepackaged bankruptcy rather than through a traditional Chapter 11. In addition, model 3 suggests that firms experiencing less of a decline in operating income to total assets in the period before distress are more likely to choose a prepack rather than a traditional Chapter 11 bankruptcy. In other words, firms restructuring via prepackaged bankruptcy appear to be relatively better performing firms in suddenly distressed industries.

Similar to the univariate results discussed in the previous section, firms with the greatest increases in the ratio of long-term debt to total assets are significantly more likely to restructure out-of-court than in traditional Chapter 11. Neither changes in equity ownership by the CEO or unaffiliated equity blockholders, nor changes in the proportion of independent outside directors on the board are significant determinants of restructuring choice. Finally, the results in both panel A and panel B table 4 are nearly identical when the models include a control for firm size.

Overall, the results in table 4 are consistent with the hypothesis that traditional Chapter 11 serves those firms with relatively weaker performance.[13] There is no evidence that traditional Chapter 11 also serves those firms with higher potential creditor coordination and creditor

[13] There is some evidence that liquidity is important. In models that remove the ratio of operating income to total assets, the ratio of current liabilities to total assets, a measure of firm liquidity, becomes significant (not currently reported in a table). More liquid firms choose to restructure out-of-court. Less liquid firms are more likely to restructure in traditional Chapter 11 bankruptcy.

holdout problems. The results also provide no evidence that firms with higher managerial incentives, in the form of CEO equity ownership, and higher monitoring by the board of directors are more likely to restructure out-of-court rather than through a traditional Chapter 11 bankruptcy.

6. Conclusion

Using a sample of 198 observations from 174 firms that experienced significant declines in earnings over a three year period, resulting in financial distress, I examine how firms choose among three restructuring alternatives: traditional Chapter 11 bankruptcy, prepackaged bankruptcy, and out-of-court restructuring. In addition to analyzing performance, liquidity, and capital structure, I investigate the role of managerial discretion in this choice.

Results suggest that firm performance plays a significant role in determining whether firms choose one restructuring alternative over another. Multinomial logistic regressions show that firms with a higher ratio of operating income to total assets are significantly more likely to restructure out-of-court rather than through traditional Chapter 11 bankruptcy. Similarly, there is some evidence that firms from industries with higher industry median market-to-book ratios are more likely to restructure out-of-court rather than via traditional Chapter 11. Compared to traditional Chapter 11 firms, firms using prepackaged bankruptcy appear to have improving performance, illustrated by significant increases in the ratio of operating income to total assets, but come from industries experiencing significant declines in their median market-to-book ratio, a measure of investment opportunities.

The capital structure of firms is also a significant determinant of restructuring choice, though not as hypothesized. Firms restructuring out-of-court have both a significantly higher

level of long-term debt to total assets and a significantly greater increase in that ratio in the two years prior to the start of restructuring. Using the ratio of the number of long-term debt contracts to total liabilities to measure the likelihood of creditor coordination and creditor holdout problems, firms that are more likely to encounter these negotiating obstacles are also significantly more likely to restructure out-of-court rather than in traditional Chapter 11. In contrast to measures of performance and capital structure, measures of managerial incentives and the monitoring effectiveness of the board of directors are not significantly related to the firm's restructuring decision.

This paper provides some evidence that managers choose the least-cost restructuring alternative to resolve financial distress, rather than acting out of their own self-interest. If traditional Chapter 11 bankruptcy is a relatively more costly restructuring alternative, either because of direct legal costs or by facilitating self-serving behavior by managers, these results are inconsistent with the idea that more effective monitoring and better alignment of managers' interests with those of shareholders will reduce the likelihood that managers choose traditional Chapter 11 bankruptcy.

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Table 1

Distribution of the sample across years, types of restructuring, and industries. The data consist of 198 observations and 174 firms that resolved financial distress through a traditional Chapter 11 bankruptcy, prepackaged bankruptcy (prepack), or out-of-court restructuring. Twenty-two firms appear in the sample twice, having restructured on two occasions with more than one year between the ending data of the first occasion and beginning date of the second. One firm appears three times. The starting date is the date of the first news article identifying that the firm is near bankruptcy, or is in default, possible default, or negotiations with creditors. For three observations, the starting date is the date of the firm's Chapter 11 filing. For five observations, the starting date is the same as the ending date of an out-of-court restructuring.

Panel A: Distribution of Sample Across Years and Types of Restructuring

Year	Chapter 11	Prepack	Out-of-Court	Total	Percent of Sample
1988	3	0	0	3	1.52
1989	5	2	3	10	5.05
1990	12	3	6	21	10.61
1991	15	4	13	32	16.16
1992	4	3	16	23	11.62
1993	6	0	6	12	6.06
1994	6	1	7	14	7.07
1995	8	2	12	22	11.11
1996	9	2	18	29	14.65
1997	6	2	7	15	7.58
1998	6	1	7	14	7.07
1999	3	0	0	3	1.52
	83 (41.92%)	20 (10.10%)	95 (47.98%)	198 (100.00%)	100.00%

Table 1 (continued)

Panel B: Distribution of Sample Across Industries

One-Digit SIC	Industry Description	Frequency*	Percent of Sample
1	Mining and Construction	20	11.05
2	Manufacturing	23	12.71
3	Manufacturing	51	28.18
4	Transportation and Utilities	10	5.52
5	Wholesale and Retail Trade	37	20.44
6	Finance, Insurance, and Real Estate	20	11.05
7	Services	12	6.63
8	Services	6	3.31
9	Public Administration	2	1.10

* SIC codes are missing for 17 observations.

Table 2

Descriptive statistics. The data consist of 198 observations and 174 firms that resolved financial distress through a traditional Chapter 11 bankruptcy, prepackaged bankruptcy (prepack), or out-of-court restructuring. Twenty-two firms appear in the sample twice, having restructured on two occasions with more than one year between the ending data of the first occasion and beginning date of the second. One firm appears three times. The starting date is the date of the first news article identifying that the firm is near bankruptcy, or is in default, possible default, or negotiations with creditors. For three observations, the starting date is the date of the firm's Chapter 11 filing. For five observations, the starting date is the same as the ending date of an out-of-court restructuring. All financial data are fiscal year-end data for the most recent fiscal year ending prior to the start of restructuring. All proxy data come from the proxy statement most recently prepared before the start of restructuring. The number of long-term debt contracts comes from Moody's Manuals. Top three officers include the CEO, Chairman of the board, and President. Equity blockholders are those holding 5% or more of the firm's common equity. Affiliated blockholders are Employee Stock Ownership Plans and those with business ties to the firm. Inside directors are officers of the firm. Affiliated outside directors include former officers of the firm, family members of current officers, or those with business ties to the firm. All other directors are considered independent outside directors. For one- and two-year changes, ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

Panel A: Financial Characteristics

	N	Mean	Median
Book Value of Assets (in $ millions)	180	739.1792	324.3900
Two-Year Change	176	175.0302***	21.2860***
One-Year Change	180	77.9378**	0.3390
Market Value of Assets (in $ millions)	163	841.0988	353.5105
Two-Year Change	151	140.4267**	-15.0691
One-Year Change	158	69.4298	-3.7164
Market-to-Book Ratio	163	1.4819	1.1019
Two-Year Change	151	-0.0577	-0.0620***
One-Year Change	158	0.0106	-0.0286
Industry Median Market-to-Book Ratio	180	1.3921	1.2530
Two-Year Change	179	-0.0168	-0.0098
One-Year Change	179	-0.0312	-0.0333***
Operating Income / Total Assets	180	0.0031	0.0372
Two-Year Change	176	-0.1112***	-0.0899***
One-Year Change	180	-0.0684***	-0.0411***
Net Operating Loss Carryforwards / TA	124	0.2797	0.0145
Two-Year Change	110	0.1932***	0.0000***
One-Year Change	117	0.1318***	0.0000***
Current Liabilities / Total Assets	159	0.3935	0.3041
Two-Year Change	155	0.0831***	0.0307***
One-Year Change	158	0.0784***	0.0206***

	N	Mean	Median
Accounts Payable / Total Assets	180	0.1275	0.0963
Two-Year Change	176	0.0065	0.0018
One-Year Change	180	0.0091**	0.0024*
Debt Due in One Year / Total Assets	170	0.0590	0.0087
Two-Year Change	164	0.0244***	0.0006**
One-Year Change	168	0.0194*	0.0001*
Long-Term Debt / Total Assets	180	0.3742	0.2814
Two-Year Change	176	0.0642***	0.0175***
One-Year Change	180	0.0296**	0.0083***
Total Liabilities / Total Assets	180	0.8713	0.7770
Two-Year Change	176	0.1742***	0.1011***
One-Year Change	180	0.1361***	0.0593***
Number of Long-Term Debt Contracts	165	4.8121	4.0000
Two-Year Change	145	0.2276	0.0000
One-Year Change	155	0.0000	0.0000
Long-Term Debt Contracts / Total Liab.	165	0.0286	0.0156
Two-Year Change	145	-0.0083***	-0.0022***
One-Year Change	155	-0.0054***	-0.0006***

Table 2 (continued)

Panel B: Equity Ownership

	N	Mean	Median
Ownership by Chief Executive Officer	163	0.1146	0.0227
Two-Year Change	125	-0.0191**	-0.0001**
One-Year Change	142	-0.0072	0.0000
Ownership by Top Three Officers	163	0.1796	0.0520
Two-Year Change	125	-0.0307***	-0.0027***
One-Year Change	142	-0.0114**	-0.0001**
Ownership by All Officers and Directors	163	0.2796	0.1951
Two-Year Change	125	-0.0285**	-0.0090***
One-Year Change	142	-0.0026	-0.0011*
Number of Unaffiliated Blockholders	163	1.7239	1.0000
Two-Year Change	125	0.2960**	0.0000**
One-Year Change	142	0.1620*	0.0000*
Ownership by Unaffiliated Blockholders	163	0.1896	0.1244
Two-Year Change	125	0.0501***	0.0000***
One-Year Change	142	0.0255***	0.0000**
Number of Affiliated Blockholders	163	0.1840	0.0000
Two-Year Change	125	-0.0160	0.0000
One-Year Change	142	-0.0141	0.0000
Ownership by Affiliated Blockholders	163	0.0426	0.0000
Two-Year Change	125	-0.0017	0.0000
One-Year Change	142	0.0046	0.0000

Table 2 (continued)

Panel C: Board of Directors

	N	Mean	Median
Total Number of Directors	162	8.0247	8.0000
Two-Year Change	124	-0.1048	0.0000
One-Year Change	141	0.0213	0.0000
Proportion of Inside Directors	162	0.3499	0.3333
Two-Year Change	124	-0.0120	0.0000
One-Year Change	141	-0.0052	0.0000
Proportion of Independent Outside Directors	162	0.4723	0.5000
Two-Year Change	124	0.0205	0.0000
One-Year Change	141	0.0222**	0.0000
Proportion of Affiliated Outside Directors	162	0.1786	0.1667
Two-Year Change	124	-0.0073	0.0000
One-Year Change	141	-0.0161	0.0000

Table 3

Firm characteristics by type of restructuring and differences between methods of restructuring. The data consist of 198 observations and 174 firms that resolved financial distress through a traditional Chapter 11 bankruptcy, prepackaged bankruptcy (prepack), or out-of-court restructuring. Twenty-two firms appear in the sample twice, having restructured on two occasions with more than one year between the ending data of the first occasion and beginning date of the second. One firm appears three times. The starting date is the date of the first news article identifying that the firm is near bankruptcy, or is in default, possible default, or negotiations with creditors. For three observations, the starting date is the date of the firm's Chapter 11 filing. For five observations, the starting date is the same as the ending date of an out-of-court restructuring. All financial data are fiscal year-end data for the most recent fiscal year ending prior to the start of restructuring. All proxy data come from the proxy statement most recently prepared before the start of restructuring. The number of long-term debt contracts comes from Moody's Manuals. Top three officers include the CEO, Chairman of the board, and President. Equity blockholders are those holding 5% or more of the firm's common equity. Affiliated blockholders are Employee Stock Ownership Plans and those with business ties to the firm. Inside directors are officers of the firm. Affiliated outside directors include former officers of the firm, family members of current officers, or those with business ties to the firm. All other directors are considered independent outside directors. The first column identifies the variable. Columns 2 through 4 provide means (medians) and number of observations for each restructuring alternative. Columns 5 through 7 provide the t-statistic (Z-statistic) for differences in mean (median) between restructuring alternatives. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

Panel A: Financial Characteristics

(1)	(2)	(3)	(4)	Tests of Differences (5)	(6)	(7)
	Chapter 11	Prepack	Out-of-Court	Chapter 11/ Prepack	Chapter 11/ Out-of-Court	Prepack/ Out-of-Court
Book Value of Assets (in $ millions)	862.1570	890.7428	602.1343	-0.10	1.23	-1.14
	(346.3695)	(583.2500)	(209.5200)	(2.11^{**})	(1.24)	(2.80^{***})
	n = 76	n = 17	n = 87			
Market Value of Assets (in $ millions)	920.4192	935.7311	764.1302	-0.04	0.67	-0.54
	(350.9463)	(501.4280)	(351.7453)	(1.26)	(0.15)	(1.32)
	n = 66	n = 13	n = 84			

(1)	(2)	(3)	(4)	Tests of Differences (5)	(6)	(7)
	Chapter 11	Prepack	Out-of-Court	Chapter 11/ Prepack	Chapter 11/ Out-of-Court	Prepack/ Out-of-Court
Market-to-Book Ratio	1.2879 (1.0825) n = 66	1.1930 (1.0667) n = 13	1.6790 (1.1312) n = 84	0.51 (-0.24)	-1.55 (-0.91)	1.83* (-0.89)
Industry Median Market-to-Book Ratio	1.2986 (1.2034) n = 75	1.3585 (1.1837) n = 18	1.4797 (1.3004) n = 87	-0.50 (-0.02)	-2.62*** (-2.01**)	0.87 (-1.16)
Operating Income / Total Assets	-0.0296 (0.0216) n = 76	0.0478 (0.0503) n = 17	0.0229 (0.0503) n = 87	-1.50 (1.06)	-1.89* (-2.11**)	-0.63 (-0.18)
Net Operating Loss Carryforwards / TA	0.2336 (0.0046) n = 57	0.0626 (0.0000) n = 11	0.3693 (0.0247) n = 56	1.68* (-0.80)	-0.72 (0.78)	1.78* (-1.38)
Current Liabilities / Total Assets	0.4516 (0.3263) n = 65	0.3395 (0.2612) n = 14	0.3558 (0.2638) n = 80	1.46 (-1.38)	1.63 (2.40**)	0.20 (-0.04)
Accounts Payable / Total Assets	0.1385 (0.1045) n = 76	0.1016 (0.0848) n = 17	0.1230 (0.0944) n = 87	1.30 (-1.18)	0.87 (1.00)	0.94 (-0.71)
Debt Due in One Year / Total Assets	0.0604 (0.0064) n = 71	0.0384 (0.0206) n = 15	0.0614 (0.0099) n = 84	0.95 (0.97)	-0.04 (-1.10)	0.94 (0.47)

(1)	(2)	(3)	(4)	Tests of Differences (5)	(6)	(7)
	Chapter 11	Prepack	Out-of-Court	Chapter 11/ Prepack	Chapter 11/ Out-of-Court	Prepack/ Out-of-Court
Long-Term Debt / Total Assets	0.3249 (0.2832) n = 76	0.4371 (0.4271) n = 17	0.4049 (0.2771) n = 87	-1.50 (1.27)	-1.20 (-0.22)	-0.33 (1.06)
Total Liabilities / Total Assets	0.9002 (0.8311) n = 76	0.8498 (0.7992) n = 17	0.8502 (0.7249) n = 87	0.62 (0.14)	0.56 (2.25***)	0.00 (1.45)
Number of Long-Term Debt Contracts	5.0000 (4.0000) n = 72	4.3889 (4.5000) n = 18	4.7333 (4.0000) n = 75	0.72 (-0.14)	0.48 (0.49)	0.41 (0.10)
Long-Term Debt Contracts / Total Liab.	0.0231 (0.0120) n = 66	0.0138 (0.0134) n = 15	0.0369 (0.0200) n = 70	1.91* (-1.19)	-1.68* (-1.65)	2.96*** (-1.98**)

Table 3 (continued)

Panel B: Equity Ownership

(1)	(2) Chapter 11	(3) Prepack	(4) Out-of-Court	Tests of Differences (5) Chapter 11/ Prepack	(6) Chapter 11/ Out-of-Court	(7) Prepack/ Out-of-Court
Ownership by Chief Executive Officer	0.1293 (0.0224) n = 66	0.1052 (0.0298) n = 16	0.1045 (0.0219) n = 81	0.42 (0.36)	0.71 (0.02)	-0.01 (0.41)
Ownership by Top Three Officers	0.2040 (0.0594) n = 66	0.2242 (0.1806) n = 16	0.1509 (0.0411) n = 81	-0.29 (0.75)	0.71 (1.22)	-1.15 (1.76*)
Ownership by All Officers and Directors	0.3012 (0.2341) n = 66	0.3069 (0.2609) n = 16	0.2566 (0.1472) n = 81	-0.08 (0.22)	1.00 (0.68)	-0.70 (0.89)
Number of Unaffiliated Blockholders	1.8333 (1.0000) n = 66	1.3125 (1.0000) n = 16	1.7160 (2.0000) n = 81	1.17 (-1.02)	0.43 (0.35)	0.95 (-0.84)
Ownership by Unaffiliated Blockholders	0.1946 (0.1164) n = 66	0.1905 (0.1101) n = 16	0.1854 (0.1344) n = 81	0.06 (-0.37)	0.27 (-0.18)	-0.09 (-0.55)
Number of Affiliated Blockholders	0.1818 (0.0000) n = 66	0.1250 (0.0000) n = 16	0.1975 (0.0000) n = 81	0.50 (-0.42)	-0.22 (-0.28)	0.63 (-0.58)
Ownership by Affiliated Blockholders	0.0415 (0.0000) n = 66	0.0081 (0.0000) n = 16	0.0503 (0.0000) n = 81	1.78* (-0.54)	-0.36 (-0.34)	2.41** (-0.76)

Table 3 (continued)

Panel C: Board of Directors				Tests of Differences		
(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Chapter 11	Prepack	Out-of-Court	Chapter 11/ Prepack	Chapter 11/ Out-of-Court	Prepack/ Out-of-Court
Total Number of Directors	8.0769 (8.0000) n = 65	7.9375 (8.5000) n = 16	8.0000 (8.0000) n = 81	0.19 (0.09)	0.17 (0.12)	0.09 (0.36)
Proportion of Inside Directors	0.3491 (0.3333) n = 65	0.3121 (0.2222) n = 16	0.3581 (0.3333) n = 81	0.84 (-1.30)	-0.36 (-0.15)	1.05 (-1.43)
Proportion of Independent Outside Directors	0.4724 (0.4444) n = 65	0.5168 (0.5000) n = 16	0.4634 (0.5000) n = 81	-0.72 (0.71)	0.28 (0.44)	-0.77 (0.75)
Proportion of Affiliated Outside Directors	0.1785 (0.1429) n = 65	0.1710 (0.2000) n = 16	0.1802 (0.1667) n = 81	0.17 (0.11)	-0.07 (-0.32)	0.23 (0.00)

Table 4

Multinomial logistic regressions, relative to firms restructuring in traditional Chapter 11 bankruptcy. The data consist of 198 observations and 174 firms that resolved financial distress through a traditional Chapter 11 bankruptcy, prepackaged bankruptcy (prepack), or out-of-court restructuring. Twenty-two firms appear in the sample twice, having restructured on two occasions with more than one year between the ending data of the first occasion and beginning date of the second. One firm appears three times. The starting date is the date of the first news article identifying that the firm is near bankruptcy, or is in default, possible default, or negotiations with creditors. For three observations, the starting date is the date of the firm's Chapter 11 filing. For five observations, the starting date is the same as the ending date of an out-of-court restructuring. All financial data are fiscal year-end data for the most recent fiscal year ending prior to the start of restructuring. All proxy data come from the proxy statement most recently prepared before the start of restructuring. The number of long-term debt contracts comes from Moody's Manuals. Top three officers include the CEO, Chairman of the board, and President. Equity blockholders are those holding 5% or more of the firm's common equity. Affiliated blockholders are Employee Stock Ownership Plans and those with business ties to the firm. Inside directors are officers of the firm. Affiliated outside directors include former officers of the firm, family members of current officers, or those with business ties to the firm. All other directors are considered independent outside directors. The table provides the parameter estimate, as well as the Wald Chi-Square statistic in parentheses. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

Panel A: Financial and Governance Variables

Variable	Prepack		Out-of-Court	
	Model 1	Model 2	Model 1	Model 2
Intercept	-1.9096	-2.9092	-1.7058	-0.7706
	(1.56)	(1.91)	(3.63*)	(0.37)
Industry Median Market-to-Book Ratio	0.3391	0.4576	1.0102	0.4452
	(0.17)	(0.28)	(4.18**)	(0.55)
Operating Income / Total Assets	3.3248	4.0630	3.0413	3.2032
	(1.63)	(1.93)	(4.14**)	(3.63*)
Current Liabilities / Total Assets	0.1338	0.6620	-0.6729	-0.9232
	(0.01)	(0.16)	(0.88)	(1.06)
Long-Term Debt / Total Assets	0.8971	0.9921	0.9309	1.4904
	(0.64)	(0.50)	(1.87)	(3.30*)
# Long-Term Debt Contracts / Total Liab.	-26.7314	-17.1153	14.6382	16.3321
	(1.27)	(0.51)	(3.90**)	(3.62*)
Ownership by Chief Executive Officer		-0.8721		-0.0978
		(0.14)		(0.01)
Ownership by Unaffiliated Blockholders		0.0285		-0.3076
		(0.00)		(0.09)
Proportion of Independent Outside Directors		1.2075		-0.3805
		(0.41)		(0.11)

Table 4 (continued)

Panel B: Two-Year Changes in Financial and Governance Variables

Variable	Prepack		Out-of-Court	
	Model 3	Model 4	Model 3	Model 4
Intercept	-0.8957	-1.2102	0.3622	0.6545
	(2.71*)	(2.40)	(1.23)	(2.49)
Δ Industry Median Market-to-Book Ratio	-2.3083	-3.6310	-0.0133	-0.1869
	(3.33*)	(4.44**)	(0.00)	(0.06)
Δ Operating Income / Total Assets	8.0768	6.8114	1.4633	3.1943
	(3.25*)	(1.47)	(0.57)	(1.21)
Δ Current Liabilities / Total Assets	0.2568	-0.1103	-1.4784	-1.5415
	(0.02)	(0.00)	(1.94)	(0.84)
Δ Long-Term Debt / Total Assets	-0.2892	-3.1109	3.3899	5.8893
	(0.01)	(0.60)	(7.41***)	(9.19***)
Δ # Long-Term Debt Contracts / Total Liab.	21.6536	24.4893	4.1766	10.7021
	(1.67)	(1.10)	(0.22)	(0.94)
Δ Ownership by Chief Executive Officer		-0.6427		-0.1025
		(0.02)		(0.00)
Δ Ownership by Unaffiliated Blockholders		-0.5000		-1.5767
		(0.03)		(0.96)
Δ Proportion of Independent Outside Directors		-1.2960		0.2637
		(0.16)		(0.03)