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The Resolution of Claims in Financial Distress the Case of Massey Ferguson

CARLISS Y. BALDWIN and SCOTT P. MASON*

WHEN A FIRM'S BUSINESS DETERIORATES to the point where it cannot meet its financial obligations, the firm is said to have entered the state of 'financial distress'. The first signals of distress are usually violations of debt covenants coupled with the omission or reduction of dividends. Some financially distressed firms eventually go bankrupt; others recover or manage to settle the claims against them out of court.¹

The behavior of firms in financial distress is interesting for two reasons. First the 'costs of financial distress' are an important element in capital structure theory. In many models,² these costs are hypothesized to counteract the tax benefits of leverage, and lead to an internal optimum for the capital structure of the firm. Second, financial distress has come to be recognized as a state in which contractual claims are incompletely specified. Standard terms of the debt-equity contract are violated when the firm enters financial distress, and claimants may then decide not to act according to previously agreed upon rules or legal formulas.

Recent history has provided a number of examples of firms in financial distress, including Massey Ferguson, International Harvester, Chrysler and Braniff. The resolution of claims in these situations often differs from what is predicted by legal rules or standard theoretical models. This paper examines the actual resolution of claims in the reorganization of Massey Ferguson Ltd. In Part I, we use time series data on daily stock returns to test different specifications of priority rules for debt and equity claims. In Part II, we consider whether Massey Ferguson avoided deadweight costs of financial distress through the restructuring of claims negotiated among creditors during the winter of 1980-81.

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¹ Much research has focused on the event of bankruptcy as a means of identifying firms in financial distress (see, for example, Clark and Weinstein (6) and White (15)). However, many firms, particularly large firms, endure extended periods of distress, leading to liquidation of assets and recontracting of debts, without ever going formally bankrupt. The restriction of samples to legally bankrupt firms thus introduces a potential selection bias. The bias is especially troubling in cases where an attempt is made to infer the magnitude of the costs of financial distress, since many such costs may be incurred in the process of avoiding formal bankruptcy.

² See, for example, the models of Scott (12), Kim (8) and Brennan and Schwartz (4).

I. Priority Rules and the State of Financial Distress

Warner (13) and others have noted that in actual bankruptcy, the me-first rules which give debt strict priority over equity are not absolutely enforced. In this section, contingent claims analysis as developed by Black and Scholes (3) and Merton (10), is used to derive predictions of stock price behavior under different specifications of the effective priority rules. These predictions are then tested against the actual behavior of Massey Ferguson stock before and during the firm's period of financial distress. The results are not consistent with the assumption, made in most models of debt and equity valuation,³ that absolute priority rules are in force. Instead the evidence suggests that the market expects debt and equity claims to be recontracted before the equity claim is wiped out.

A. The Model

Assume that the dynamics for the value of the firm, V , is described by a lognormal diffusion process,

$$dV = (\alpha V - P(\tau)) d\tau + \sigma_v V dz \quad (1)$$

where α is the expected return on the firm, $P(\tau)$ is the known schedule of fixed financial commitments, σ_v is the standard deviation of returns on the firm and dz is a Gauss-Wiener process.

The assumptions of contingent claims analysis permit the value of any of the firm's securities to be described by a partial differential equation. The securities of a firm are distinguished from each other by priority rules, which enter the model in the form of boundary conditions. For example, defining $E(V, \tau)$ as the value of equity, the assumption of perfect me-first priority yields the following boundary condition for equity:

$$E(P(\tau), \tau) = 0 \quad (2)$$

Should the value of the firm drop to or below the currently due financial commitment, $P(\tau)$, then the value of equity is zero.

The statistical parameters of the stochastic processes for firm value and firm equity are related by:⁴

$$\sigma_e = \sigma_v VE_v/E \quad (3)$$

$$\beta_e = \beta_v VE_v/E \quad (4)$$

where σ_e and σ_v are respectively the standard deviation of the return on equity and on the firm as a whole: β_e and β_v denote the 'beta' of the equity and of the

³ The assumption of absolute priority is made in Merton's paper on the pricing of corporate debt (11) and in Black and Cox's (2) subsequent paper on indentures and safety covenants. Most analyses of optimal capital structure (e.g. Scott (12), Kim (8) etc.) also make use of the assumption.

⁴ These relationships follow from an application of Itô's Lemma. They hold independently of boundary conditions, although the boundary assumptions will affect values of E and E_v . Note that the parameters α , σ_v and ρ_{vm} (hence β_v) need not be constant, but may be (nonstochastic) functions of a state variable. Thus, the underlying characteristics of the firm may be changing over time, and relationships (3) and (4) will still hold instantaneously.

firm, and E_v is the partial derivative of E with respect to V . Under absolute first priority rules (equation (2)), as the value of the firm $V(\tau)$ approaches the currently-due commitment $P(\tau)$, the standard deviation of equity σ_e increases without bound.⁵ This is implied by the fact that VE_v/E (the elasticity of E with respect to V) increases without bound as $V(\tau)$ approaches the limiting value. Equation (4) indicates that β_e behaves similarly, that is, it is predicted to increase without bound as V approaches the value of currently due fixed commitments $P(\tau)$.

B. Introducing Different Priority Rules

The specification of different priority rules implies different behavior for σ_e and β_e as the firm approaches the point of default. For example, suppose that, if the value of the firm falls to a point V^* , claims against the firm are renegotiated, and that, in the recontracting, equity will receive a fixed fraction of the firm's assets. In this case, as the value of the firm approaches the recontracting point V^* , β_e and σ_e will approach β_v and σ_v , the beta and standard deviation of the underlying assets. However, in actual refinancings, equityholders do not typically receive shares in an unlevered firm. Instead, they receive equity in a recapitalized, levered firm, (although their holdings may be heavily diluted). If this outcome is anticipated, then as V approaches V^* , we would expect σ_e and β_e respectively to approach the standard deviation and beta of the recapitalized firm.

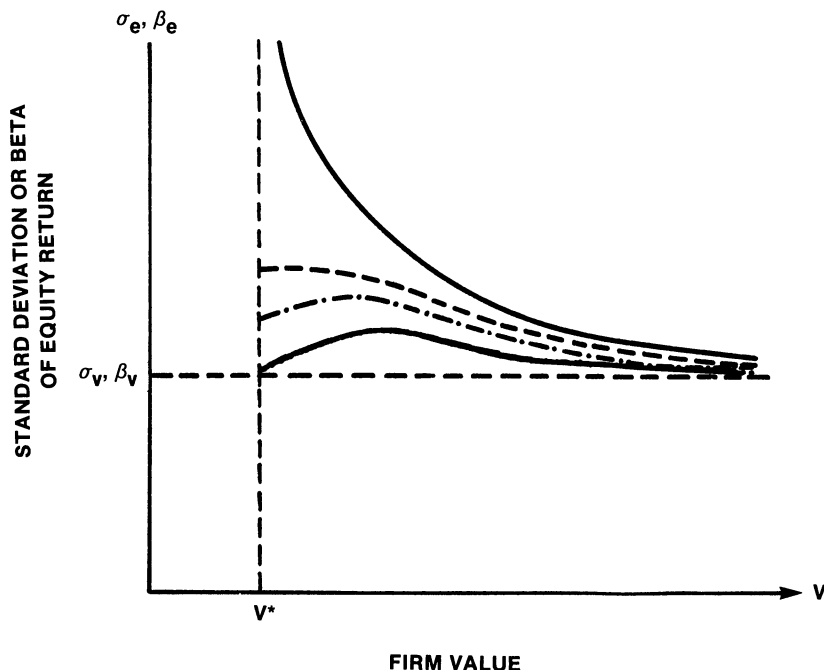
Our empirical tests of alternative priority rules (below) are necessarily joint tests of the assumed return dynamics as well as the boundary specifications. In particular, the assumption that equity and asset returns follow a continuous lognormal diffusion process implies that the beta and the standard deviation of equity always have the same ratio as the beta and standard deviation of the underlying assets.

Figure 1 shows the predicted behavior of β_e and σ_e under alternative boundary conditions. The solid lines indicate outcomes for the two extreme alternatives: If absolute priority rules are enforced and equity is wiped out in a reorganization, then as the value of the firm approaches the recontracting point V^* , β_e and σ_e should increase dramatically. If, on the other hand, equityholders expect to receive a fixed fraction of the firm's assets in reorganization, then as V approaches the recontracting point, β_e and σ_e should approach the β_v and σ_v characteristic of the firm's assets. Finally, the dotted lines indicate potential intermediate outcomes. If, in a reorganization, equityholders expect to receive shares in a relevered firm, then β_e and σ_e will approach values somewhere between the asset β_v and σ_v and infinity.

C. Empirical Results

We collected daily stock market return data on Massey Ferguson for the period January 1976 to December 1981. We estimated β_e by regressing Massey's returns (adjusted for dividends) on the returns of the CRSP value weighted market portfolio and a proxy for industry performance. Given the assumptions of the

⁵ This result is found in Merton (10) and Black and Cox (2).

Figure 1. Predicted β_e and σ_e Under Alternative Boundary Conditions^a

^a β_e : equity beta, σ_e : equity standard deviation, β_v : asset beta, σ_v : asset standard deviation, V : firm value, V^* : recontracting point. Under absolute priority rules, as firm value approaches the recontracting point, β_e and σ_e increase without bound. But if the market expects claims to be recontracted, and equity receives shares in the reorganized firm, then as V falls, β_e and σ_e will converge to finite values. In the extreme case where equity receives a fraction of the firm's assets, β_e and σ_e will approach the beta and standard deviation of the unlevered firm, β_v and σ_v .

contingent claims model, and in particular the functional form of (3) and (4), this is a misspecified regression. However, the specification errors are less severe if the data are divided into subsamples within which V does not change too significantly. Thus, the regressions were run on nonoverlapping samples of one and two years of data (253 and 506 observations respectively).⁶ An F -test of the null hypotheses that the three two-year regressions were homogeneous rejected the hypothesis at the 99% confidence level. However, a similar test applied to the one-year subsets indicated that going from 506 to 253 observations brought no significant improvement in the explanatory power of the regressions.⁷

We also estimated the standard deviation of equity returns (σ_e) for the same

⁶ The value of Massey Ferguson shares decreased consistently in the period 1976–1981, thus subdivision of the sample by time is essentially equivalent to a stratification by V .

⁷ Other than subdividing the sample, we made no other adjustments for misspecification. The principal source of misspecification is the fact that the β_e 's and σ_e 's we estimate are obtained from linear approximations of underlying nonlinear functions (see Figure 1). We do not believe that the nonlinearity is severe enough to bias results seriously within subperiods but, our tests indicate that the results for the sample as a whole are simply a mixture of behavior over very heterogeneous subperiods. The specification errors also imply that standard confidence bounds on coefficients are potentially misleading.

one- and two-year periods that equity betas were estimated. Table 1 reports our estimates of Massey's β_e and σ_e as well as the company's market value of equity, price per common share, and debt-equity ratio at the end of each year (1976–1981). Figure 2 plots Massey's β_e and σ_e for the three two-year subperiods and also shows corresponding equity betas and standard deviations for John Deere and Company, a company in the same industry which was not in financial distress.

Table 1
Massey Ferguson Ltd.—Summary Statistics
1976–1981

		1976	1977	1978	1979	1980	1981
Equity Beta	(a)	1.44		1.16		0.83	
	(b)	1.55	1.26	1.13	1.19	0.79	0.94
Equity Standard Deviation	(a)	.021		.025		.035	
	(b)	.021	.020	.026	.024	.031	.038
Market Value of Common and Preferred Stock	(c)	505.5	374.6	229.3	266.0	100.2	104.0 (d)
Closing Price per Common Share		21%	14%	8%	10%	3%	1%
Closing Debt/Equity	()	1.2	2.1	3.3	2.6	6.2	9.9

(a) Based on two-year subperiods.

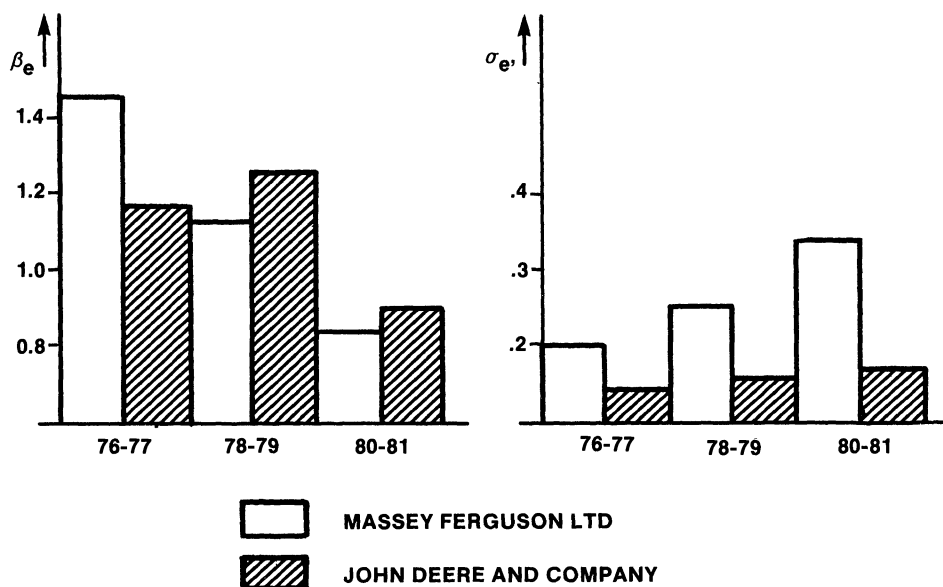
(b) Based on one-year subperiods.

(c) In millions of U.S. dollars.

(d) Reflects issuance of 25 million (approximately) new common shares in 1981.

(e) Book value of debt/market value of equity. Equity includes preferred shares.

Figure 2. Estimated β_e and σ_e for Massey Ferguson Ltd. and John Deere and Company 1976–1981



The results do not by and large support the hypothesis that the market believes absolute priority rules will be enforced. Although Massey's standard deviation of equity rose dramatically from 1976 to 1981, the firm's equity beta actually declined over the same time period. The fact that John Deere's beta also declined suggests that some of the downward trend in Massey's β_e could have been the result of changes in the fundamental risk of the farm equipment industry. However the decline in Massey's β_e is more pronounced than John Deere's and also occurred simultaneously with a large decline in the market value of Massey's equity and large increases in Massey's leverage.⁸ The behavior of Massey's β_e is thus difficult to reconcile with the prediction, given perfect *me-first* priority rules, that the beta of equity increases without limit as the value of the firm and the equity fall.

Figure 2 also shows that Massey's β_e and σ_e moved in opposite directions and did not maintain a constant ratio over the period of financial distress. Since John Deere also showed a decreasing β_e and increasing σ_e during the period, this movement may have reflected changes in the systematic and unsystematic risks of the underlying assets. However, the changes in Massey's statistics were more dramatic than Deere's, and thus appear to require further explanation.

There are three potential explanations for the contradictory movement of Massey Ferguson's β_e and σ_e . First, the behavior may be due to peculiarity of the company or of the farm equipment industry during this period, and hence not generally representative of firms in financial distress. Second, our estimates of β_e and σ_e may be biased because of some estimation problem. Third, the stochastic process generating stock returns may be different from the lognormal diffusion process we assume.

In a recent study, Aharony, Jones and Swary (1) considered the risk characteristics of a large sample of firms that had gone bankrupt. They found that the (equity) betas of bankrupt firms decreased relative to a control sample in the five years prior to bankruptcy, and that standard deviations of equity returns simultaneously increased. These findings indicate that the results for Massey are not a statistical accident nor are they attributable to peculiarities of the farm equipment industry. Instead the results appear representative of the behavior of market returns of financially distressed firms in general.

Part of the relative movement of Massey's β_e and σ_e may have been the result of estimation problems. In the last subperiod (1980–1981), Massey's stock price was quite low and the 'trading-in-eighths' restriction had a noticeable effect on daily returns. If trading takes place only at particular discrete prices, but the underlying true price is continuous, then the sample variance will be biased upward relative to the true variance of the underlying process. Covariances (and betas) will be asymptotically unbiased, although small sample estimates may be biased downward. Thus there is reason to believe that, in the last years of the sample, Massey's β_e and σ_e did not diverge as much as the raw estimates indicate. In particular σ_e should be adjusted downward: this casts further doubt on the

⁸ Measured as the ratio of book value of debt to market value of equity. This ratio overstates Massey's leverage because the market value of debt was less than its book value. However, by any measure, Massey's leverage increased dramatically from 1976–1981.

hypothesis that the market believes absolute priority rules will be enforced if the firm defaults on its financial obligations.

Finally, the stochastic process generating returns may not have been a pure diffusion process. Since Massey entered financial distress, there appear to have been numerous discontinuities, or jumps in the stock price. The jumps can be interpreted as 'information events.' Specifically, the market is receiving and processing information concerning the reorganization of Massey. If information concerning reorganization and the recontracting of claims is not correlated with movements in the market, then the beta observed for the combined jump-diffusion process would be unaltered, but the estimated standard deviation would be higher in periods when the apparent frequency of jumps is high, that is, in 1980-81. Adjusting for an independent jump component would thus reduce the apparent divergence between β_e and σ_e in the raw estimates.

In conclusion, despite various statistical and specification problems, the empirical results do not appear to support the hypothesis that absolute me-first priority rules are in effect. Counter to the prediction of a contingent claims model with absolute priority, Massey's β_e did not increase significantly as the firm approached the point of default: in fact it decreased. Massey's σ_e did increase over this period, but, we have argued, its rise is overstated because of biases introduced by the 'trading-in-eights' restriction and, potentially, by the effect of a jump component in the return generating process. Both of these effects deserve further analysis, but we feel that refinements of theory and methodology will simply strengthen the case against absolute priority as the correct boundary specification.

II. Test of Deadweight Costs of Financial Distress

If it is known that absolute priority rules will be suspended in the event of financial distress, then an upper bound will be placed on the amount a firm can borrow. Thus recontracting is sufficient to explain why firms do not seek maximum leverage. However, the recontracting hypothesis and the deadweight bankruptcy cost hypothesis are not mutually exclusive: both effects may simultaneously influence the firm's capital structure decisions. In this section we shall attempt to test for the existence of deadweight bankruptcy costs during Massey Ferguson's period of financial distress.

Lintner (9) lists the presumed costs of financial distress as: 1) increases in agency and monitoring costs with increasing debt, 2) the loss of 'financial flexibility', 3) the loss of sales due to weakened assurance of delivery, 4) increasing inability to undertake otherwise profitable future investment opportunities, and 5) increasing probabilities of costly violations of restrictive indenture provisions and of incurring deadweight bankruptcy costs. White (14) adds to this list the costs in bankruptcy of liquidating a firm which should be reorganized or reorganizing a firm which should be liquidated.

For our purposes, it is useful to divide these costs into three categories. The first category comprises agency and monitoring costs borne by lenders and passed on to all firms in the form of higher interest charges. Although we believe these

costs to be important, we have no way of measuring them for Massey Ferguson and thus are forced to ignore them.

The second category comprises unavoidable losses of business or increases in operating costs during the period of financial distress. Included in this category are the loss of sales due to customers' doubts about the quality of future service and losses of operating efficiency due to decreased financial flexibility. Preliminary tests based on quarterly data indicated a substantial reduction of sales and operating efficiency during Massey's period of financial distress (1978–1981). However, we are faced with an irreducible identification problem: reduced sales and operating inefficiencies may have been brought about by financial distress or by poor management which in turn led the firm deeper into financial distress. The direction for causality cannot be determined without recourse to a more specific model relating the magnitude of lost sales or operating inefficiencies to externally observable firm characteristics, e.g., the nature of its product markets or financial structure.

The third category consists of costs arising from conflicts among claimants. These costs can be avoided if a cooperative arrangement can be reached among the various claimants to the firm. This category includes most of the efficiency losses identified by Bulow and Shoven (5) and White (14): the cost of good investments foregone, the cost of poor investments accepted, the cost of reorganizing a firm that should be liquidated, of liquidating a firm that should be reorganized, etc. Haugen and Senbet (7) have questioned whether such costs can be very large in a market where claims can be freely purchased and recombined. They reason that if such costs are present, it would be in some agent's interest to purchase all of the outstanding claims and make economically efficient choices on behalf of the reorganized firm.

Avoidable deadweight costs might have little or no observable impact, if the costs themselves are small or if the negotiation process is efficient so that the probability of arriving at an inefficient outcome is negligible. However, in the case of Massey Ferguson, there were objective reasons to believe that the costs of resolving claims via normal methods (formal declaration of bankruptcy followed by a court settlement) might be larger than for another company. In 1980, Massey had manufacturing operations in more than 31 countries. Massey's debt was all owed by subsidiaries to local lenders, and denominated in local currencies. Nevertheless, product flows and transfers of credit between subsidiaries were an intrinsic aspect of Massey's business.

In 1980, as Massey approached the point of financial collapse, it was not known (and still is not) if intracompany transfers of goods and credit could have been maintained in the context of multiple parallel bankruptcy proceedings. For example, the flow of diesel engines from the Perkins engine subsidiary in the U.K. to the tractor plant in Ontario—a flow absolutely essential to North American operations—might have been difficult to sustain in bankruptcy without coordination between the British and Canadian bankruptcy courts. Such coordination would have been difficult given the constraints of the legal systems of the two countries. Multinational bankruptcy to this day is uncharted legal territory.

A Massey Ferguson *reorganization* in bankruptcy was probably not possible

because of the coordination problems just described. However, a *liquidation* carried out through court proceedings in many countries was possible, and in 1980 might have been an attractive option to some lenders. In fact, one group of lenders—the Australians—chose to exercise their option: On December 23, 1980 Massey's Australian subsidiary was placed in receivership. (It was rapidly reorganized and emerged from the courts within 90 days.) No other lending group has yet chosen this course: this suggests that, at least in the 1980 and subsequent 1982 rounds of recontracting, the consensus among lenders was that the economic losses associated with a Massey Ferguson liquidation were large and evenly distributed enough to warrant continuing cooperation.

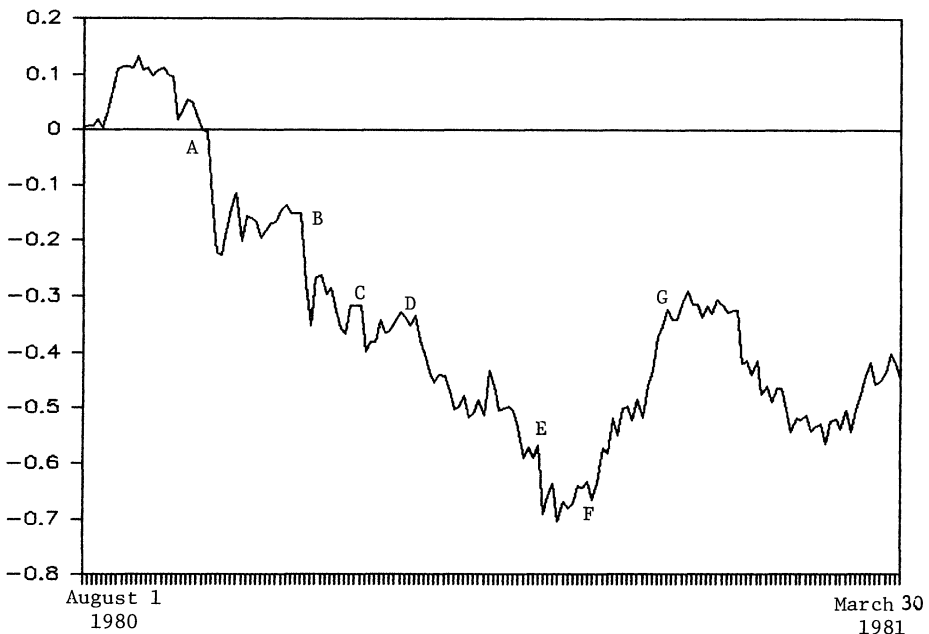
If large deadweight costs will be incurred in the event claimants fail to reach a cooperative agreement, and if equity participates in the final settlement, then information associated with the recontracting process will have an impact on common share prices. The first round of recontracting for Massey Ferguson can be dated (approximately) from September 9, 1980 when the company announced it would be unable to meet debt related obligations, to February 9, 1981, when final government agreement to the terms of the refinancing was secured.

Figure 3 depicts the response of common share prices to firm specific events which took place during the recontracting period. Response is measured by the cumulative daily residuals of Massey's common stock. The residuals were calculated as follows: Massey's stock returns for the previous 506 days were regressed on the market (CRSP value weighted market index), and John Deere's excess returns (defined as Deere's return less the market return). The regression was then applied on a one-step-look-ahead basis to predict Massey's return on the following day. The difference between Massey's predicted and actual return was defined as the residual, and cumulated residuals are graphed in the figure.⁹

The most dramatic single move in the period is the large negative residual (20%) associated with the first announcement (Sept. 9, 1980) that a debt restructuring was imminent. Despite much prior preparation, there seems to have been a substantial amount of surprise at the announcement. Subsequent downward jumps coincided with Argus Corporation, Massey's largest shareholder, donating its shares to the employees' pension fund (October 2–3) and with the Canadian government announcement of the terms of its support (October 20–21). A final significant downward revision (13%) occurred on December 15 with the announcement that Massey's fourth quarter losses were larger than previously thought, and a projection that the company's losses in the first quarter of fiscal 1981 would be in the range of US \$100 million.

Although dramatic, the downward trend in cumulative residuals from September through December 1980 is not necessarily evidence for large potential deadweight costs associated with recontracting. Throughout this period, bad news about the company's performance was arriving concurrently with information about the progress of creditors' negotiations. For example on September 9, Massey reported 1) an unprecedented third quarter loss, 2) debt levels up 54%

⁹ Our procedure essentially amounts to use of a two factor generating model for Massey Ferguson's returns, the factors being the market and an industry factor. An interest rate factor was included in some early runs, but was found to have no effect.

Figure 3. Cumulated Daily Residuals for Massey Ferguson Ltd. August 1, 1980–March 31, 1981

Key dates are: A—September 9, 1980: Firm reports heavy third quarter losses and predicts it will default on certain debts by fiscal year end. Stock drops 20% in two days. B—October 2–3, 1980: Argus Corp. donates its shares to Massey pension funds. Canada says it will “work closely” with the company. Stock drops 20% in two days on reopening. C—October 20–22, 1980: Terms of Canadian preferred stock guarantee announced. D—October 31, 1980: Company fiscal year-end. E—December 13–15, 1980: Massey announces fourth quarter losses were heavier than expected, and first quarter 1981 losses would be in the neighborhood of \$100 million. Agreement in principle reached among some major banks. F,G—January 2–19, 1981: Bankers’ negotiations in London, stock sustains 26% rise over 13 trading days.

from the previous year and 3) that a restructuring of debt would be necessary. Together, these announcements triggered a 20% decline (approximately) in the value of Massey’s stock, but the potential deadweight costs associated with the debt restructuring announcement cannot be disentangled from the effect of the earnings announcement. Similarly, Conrad Black’s donation of Argus’s shares was indicative of his views on the probability of the company’s survival. These views might have been based on knowledge of Massey’s internal condition, forecasts of the future of the farm equipment industry, or pessimism about the feasibility of a negotiated settlement among claimants. We cannot discern from the data which of these influences predominated for Black or for the market.

Fact-finding about the true condition of the company continued through the middle of December when the last revised estimate of Massey’s financial condition was published. Up to that point Massey’s creditors had made few public statements, although rumors circulated about an agreement in principle reached by some of the major banks on December 13. Just after the publication of the final figures, Massey’s Australian creditors caused its subsidiary to go into receivership.

After December 15, the creditors' negotiations continued and culminated in two week-long negotiating sessions at the Dorchester Hotel in London. Representatives of 250 banks attended the second set of meetings ending January 16, 1981. In these sessions the essential terms of the refinancing were hammered out, and more importantly, (since the terms had been circulating since early November, and a preliminary agreement reached in December), essentially all Massey's creditors consented to the refinancing package.

The London negotiations coincided with a 26% rise (approximately) in Massey Ferguson's stock against the market. This rise is the only relatively unambiguous evidence we have that deadweight costs were avoided by the claimants through their agreement to settle claims cooperatively. The rise over the first 13 days of January, coinciding with the negotiation period, has a T-statistic of 2.41, which is significant at the 5% level. Termination of the upward movement occurred at the same time as the public announcement that an agreement had been reached. Over the same period virtually nothing else of significance happened to Massey Ferguson, (nothing, that is, that ever reached the press).

Although large in relative terms, the rise in share price added less than US \$20 million to the market value of Massey's outstanding shares. However, common shareholders did not participate directly in the negotiating process: The equity's share in any gain was thus a by-product of the negotiations—or, perhaps, was a form of compensation for equity's cooperation with certain formalities (votes to increase authorized common shares, etc.) Or, the lenders may have judged that a more massive dilution would trigger hostile shareholder suits or a formal declaration of bankruptcy, which they may have wanted to avoid.

III. Conclusion

This paper examines the actual resolution of claims in the reorganization of Massey Ferguson Ltd. In Part I we used contingent claims analysis to derive predictions of stock price behavior under different effective priority rules. The predictions were then tested against the actual behavior of Massey Ferguson stock in the firm's period of financial distress. On balance, the tests do not support the hypothesis that absolute priority rules are in force, but instead indicate that the market expects debt and equity claims to be recontracted before equity is eradicated.

In Part II, we examined Massey's cumulative daily residuals from September 1980 to March 1981 to determine whether deadweight costs were avoided by the recontracting of claims negotiated over this period. There is weak evidence in the behavior of equity returns that deadweight costs of bankruptcy were avoided by a cooperative settlement. The observed gain of 26% in the value of common shares underestimates the potential deadweight loss, because a probability of success would have been embedded in the stock price going into the recontracting period. Roughly speaking, if the market placed .5 probability on an agreement being reached, then the measured gain would correspond to half of the avoided loss.

Although significant, the absolute magnitude of the gain observed on traded

equity was quite small. This may be explained by the fact that creditors, not common shareholders, were the key participants in the negotiations, and therefore should have been able to appropriate most of the gains from the settlement. A more complete test of the avoidable deadweight cost hypothesis would involve looking at the impact of recontracting on the value of traded debt as well as equity.

The recontracting of claims against large, financially distressed firms is a fairly new phenomenon and the total population of firms that have been through the process is small. Thus, in the near future, empirical work relating to large firms in financial distress may be constrained to the intensive analysis of time series data on particular firms. We have tried to show that such an analysis, if related to existing financial theory, can provide useful insights leading to the refinement of theoretical models as well as to the generation of new testable hypotheses.

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