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## **CORPORATE DEBT AND WORKFORCE PROTECTION: LEGAL CHALLENGES IN FINANCIAL RESTRUCTURING**

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### **ABSTRACT**

By virtue of its contention and difficulty, the issues of corporate debt and worker protection fallen in the realm of financial restructuring become immediate emotions during a corporate debt restructuring among the debtors and creditors on one hand, trying to secure monetary recovery under restructured forms, while on the other hand trying to protect the remaining employee rights guaranteed under the operating statutes. Under extreme financial hardship, it becomes paramount to initiate a restructuring of the instruments, such as debt-for-equity exchanges, creditor negotiations, insolvency proceedings, and so forth. However, these acts usually cast a blind eye to social justice or the rights of workers. This essay, by discussing the implementation legislation surrounding corporate debt restructuring and labour protection, presents the undergoing conflict between these two interests-the labour rights and the creditors. This study's objective will be to suggest mutually agreed equitable legal mechanisms to arrive at a compromise between the business sustainability interests of the company and the interests of the employees. The study analyzes existing literature, case law, and international best practices.

## INTRODUCTION/BACKGROUND

Today every company engages in an international business and faces many financial problems, which in turn affect the sustainability of their operations. Market fluctuations, economic downturns, and the like suddenly lead to an unfortunate suspension and then compel the company into corporate creditors debt restructuring for tactical purposes. The alternative corporate debt restructuring strategy which can be pursued to increase liquidity and avoid insolvency is to renegotiate debt commitments outstanding. This allows the corporation to continue to operate as though everything was going as normal because, although its main aim is typically to satisfy the creditors' demands and regain financial stability, the knock-on effects on the workforce are very profound and far-reaching.<sup>1</sup>

Corporate debt restructuring employs several strategies, including debt-for-equity conversion, refinancing, rescheduling, and issuance of new securities. These processes are meant to align a company's financial structure with the current economic realities in order to provide for its viability in the long run.<sup>2</sup>

In the short run, the company could relieve its financial difficulties by attempting to extend the debt period or decrease interest rates on its loan with lenders. Debt-for-equity swaps reduce leverage ratios, thus improving the company's balance sheet and hopefully restoring investor confidence. These short accounting remedies may carry operational implications that directly affect employees.

The restructuring to achieve this objective often leads to layoffs, pay reductions, altered working conditions, and benefit cutbacks for employees. These actions, aimed at reducing costs and optimizing operational efficiency, may put employees through severe socioeconomic problems like financial insecurity and job uncertainty.<sup>3</sup> There's just this: the changes in psychology may affect not just of the morale and productivity of employees, but also the performance of the company at a critical period in the recovery.<sup>4</sup>

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<sup>1</sup> John Armour & David A. Skeel, Jr., Who Writes the Rules for Hostile Takeovers, and Why?, 96 Harv. L. Rev. 1727 (2007).

<sup>2</sup> Stuart C. Gilson, Kose John & Larry H. P. Lang, Troubled Debt Restructurings: An Empirical Study of Private Reorganization of Firms in Default, 27 J. Fin. Econ. 315 (1990).

<sup>3</sup> Harry Rajak, Insolvency Law and Employee Rights: A Comparative Analysis (2018).

<sup>4</sup> Shubham Ghosh, Corporate Insolvency Law: The Impact on Employees, J. Bus. L. 23 (2019).

Though different jurisdictions maintain different laws regarding corporate debt restructuring, in each case creditors, not employees, have priority. Employee claims for back wages and benefits are usually very low priority under most legal regimes compared to secured creditors, who are given priority claims against the company's assets. Most likely, this adverse hierarchy will worsen the financial state of employees by allowing them little or no pay during the insolvency proceedings. For instance, insolvency laws in some countries allow businesses to recapitalize outstanding debts while considerably reducing the liability of employee benefits, thus slashing employee rights. This creates an intricate legal dilemma in view of the clash between workers' rights and the preservation of creditors' interests. Creditors, as funders, thus want to minimize their loss and recover their investments by proposing actions that include divesting from the asset, or drastic cost-cutting measures. While on the other side, employees put in their time and effort, count on those jobs for their very existence and livelihood, and assert that there are penalties against discrimination or dismissal without cause. Thus, to reconcile these competing objectives would require a balancing act that takes into consideration corporate restructuring's ethical, legal, and economic aspects.

Recent happenings across the globe have clarified that these issues need to be addressed. For instance, as economic fallout from the COVID-19 pandemic marched across the world, so did a wave of company restructure. Record financial problems necessitated businesses across the board to renegotiate debt obligations and explore ways of cutting costs. In most cases, these actions would entail massive layoffs and alterations to employment contracts, which brought the matter of employee protection during financial restructuring to the fore of legal and policy discussions. In the Indian scenario, the Insolvency and Bankruptcy Code (IBC)<sup>5</sup> of 2016 was passed with the aim of liberalizing the insolvency process and safeguarding the rights of creditors. Regardless, the employees are worried about the adverse impact of the IBC since it has always played an important role in resolving stressed assets and enhancing the ease of doing business. The code has just a few provisions giving specific treatment to employee claims; it generally aims to maximise the value for creditors. This has led to requests for changes to the code that give a more equitable consideration to employee welfare as opposed to creditor recoveries, so that employee rights are not unfairly compromised during the insolvency proceedings.

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<sup>5</sup> Insolvency and Bankruptcy Code, No. 31 of 2016, INDIA CODE (2016).

Different approaches have been adopted the world over to address the issue. For instance, the European Union's Directive on Preventive Restructuring Frameworks<sup>6</sup> places emphasis on the fact that member states should adopt measures to safeguard employees in the event of restructuring. This includes clauses for protecting the rights of employees in cases of underpayment and for informing and consulting them. A social and economic aspect of business insolvencies is the creation of frameworks for encouraging a more just alignment of creditors' and employees' interests. There are, in the end, numerous complicated legal considerations that require a fine balancing act between corporate debt restructuring and employee protection. Companies are forced to weigh the obligation to protect employee rights alongside the critical need of settling creditors' claims while handling financial difficulties. Legal definitions should provide a balance between these interests to promote social cohesion and economic sustain-ability throughout recovery and stability.

## REVIEW OF LITERATURE

An enormous amount of research on labour protection and corporate debt restructuring has been conducted in the fields of law and economics. This overview condenses several key academic works, concentrating particularly on the legal conundrums that arise in balancing employee protection and creditors' interests in financial restructuring.

### Corporate Debt Restructuring Mechanisms

Corporate debt restructuring comprises debt rescheduling, debt refinancing, and debt-equity swaps considered to combat financial distress. Among the debt restructuring processes, the IMF identifies insolvency laws as being very important to orderly debt restructuring. Even though legal frameworks are very important, they may not be sufficient without the intervention of the state at certain instances, especially during financial crises<sup>7</sup>. Grigorian and Raei (2013) also emphasize the important role of the government in intervening in the restructuring of corporate debt, given that across-the-board connections with the corporate milieu necessitating enforceable restructuring for curb bank lending restrain with respect to

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<sup>6</sup> Directive 2019/1023, of the European Parliament and of the Council of 20 June 2019 on Preventive Restructuring Frameworks, 2019 O.J. (L 172) 18.

<sup>7</sup> International Monetary Fund, The Design of Insolvency Regimes Across Countries, IMF Staff Position Note, SPN/10/02 (2010), <https://www.imf.org/external/pubs/ft/spn/2010/spn1002.pdf>.

credit.<sup>8</sup>

### **Legal Frameworks and Employee Protections**

Since the regulatory framework governing corporate restructuring frequently favors creditors' interests, employee rights risk being marginalized. The UK insolvency laws afford only limited preferential status to employee wages and pensions, which one might argue may be inadequate in insolvency proceedings<sup>9</sup>. Similarly, Mathew (2021) contends that India's 2016 Insolvency and Bankruptcy Code (IBC) may weaken employee safeguards during restructuring and is creditor-favoring.<sup>10</sup>

### **Governmental and Policy Interventions**

In order to counter the legal issues lying between labour protection and corporate debt restructuring, policy action is imperative. As the Financial Stability Board (2020) states, even where most countries do not have serious legal barriers to out-of-court debt restructuring, there are still problems with recapitalizing distressed companies.<sup>11</sup> For instance, recent policy discussions in Australia have focused on improving legal protection for workers by discouraging business actions that exploit workers' rights during insolvency.<sup>12</sup>

### **Balancing Creditor and Employee Interests**

The literature highlights how difficult it is to strike a balance between the interests of creditors and employees during financial restructuring. According to Shin (2017), who discusses the macroeconomic effects of company restructuring, the economy may suffer if employee well-being is neglected when creditor recoveries are required.<sup>13</sup> The IMF (2010) also notes that

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<sup>8</sup> David A. Grigorian & Faezeh Raei, Government Involvement in Corporate Debt Restructuring: Case Studies from the Great Recession, 4 Mod. Econ. 29102 (2013), <https://www.scirp.org/journal/paperinformation?paperid=29102>.

<sup>9</sup> United Kingdom Insolvency Law, Wikipedia, [https://en.wikipedia.org/wiki/United\\_Kingdom\\_insolvency\\_law](https://en.wikipedia.org/wiki/United_Kingdom_insolvency_law) (last visited Feb. 24, 2025).

<sup>10</sup> Mathew Thomas, Employee Protection and the IBC: Analyzing the Impact on Workers, 10 Nat'l L. Sch. Bus. L. Rev. 62 (2021), <https://repository.nls.ac.in/cgi/viewcontent.cgi?article=1062&context=nlsblr>.

<sup>11</sup> Financial Stability Board, Evaluation of the Effects of Financial Reforms on Corporate Debt Restructuring, FSB Report (2020), <https://www.fsb.org/uploads/P090522.pdf>.

<sup>12</sup> Labor Vows to Crack Down on Corporate Shonks, The Australian, <https://www.theaustralian.com.au/nation/labor-vows-to-crack-down-on-corporate-shonks/news-story/42db842b43f16e0cb2f9a463d0f3c350> (last visited Feb. 24, 2025).

<sup>13</sup> Hyun Song Shin, Bank Capital and Monetary Policy Transmission, IMF Working Paper WP/17/17 (2017), <https://www.imf.org/-/media/Files/Publications/WP/wp1717.ashx>.

although insolvency laws allow for debt restructuring, they may not adequately address the extent of employee suffering during financial crises, indicating the need for more comprehensive legal solutions.

### **Emerging Trends and Future Directions**

Issues with business restructuring are changing as a result of recent occurrences. The Wall Street Journal (2024) reports on a sharp rise in business corporation bankruptcies, citing high interest rates, residual post-pandemic debt affecting crucially important businesses, and legal scrutiny of the restructuring process.<sup>14</sup>

These signs suggest that there is a growing need for legal norms to strike a balance between improved employee rights and economic revitalisation. Overall, the research reveals a persistent tension in the context of corporate debt restructuring between the interests of creditors and employee protection. Although policy interventions and legal frameworks have continued to advance, balancing equity is still a complex legal conundrum that needs ongoing scholarly and policy attention.

### **RESEARCH OBJECTIVES**

- To examine the legal concerns of corporate debt restructuring and how they affect worker protection.
- To assess how well workers' rights are safeguarded by present labour regulations during financial restructuring.
- To examine global best practices and suggest legislative changes that strike a balance between the interests of employees and business sustainability.
- To look into how lawmakers, regulators, and courts handle conflicts between employees and creditors.

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<sup>14</sup> Four Defining Themes in Corporate Restructuring in 2024, The Wall Street Journal, <https://www.wsj.com/articles/four-defining-themes-in-corporate-restructuring-in-2024-64c0828d> (last visited Feb. 24, 2025).

## **RESEARCH QUESTIONS**

- What are the most crucial legal concerns regarding employee protection in corporate debt restructuring?
- How are workers' rights handled during financial restructuring under the present labour laws?
- What can be learnt from global best practices for striking a balance between employee protection and company debt obligations?
- What legislative changes can be recommended to support a more equitable corporate restructuring strategy?

## **METHODOLOGY**

This study examines the legal concerns at the intersection of worker protection and corporate debt restructuring using a multifaceted research methodology. The following are included in the methodology:

- **Doctrinal Legal Analysis:** Examining laws, rules, and court rulings to identify the legal precepts governing employee rights and company reorganisation.
- **Comparative Legal Study:** Examining how different countries balance the interests of creditors and employees in restructuring.
- **Empirical Data Analysis:** Compiling and evaluating information on corporate insolvency cases to gauge the impact on workers, including the number of layoffs and pay changes.
- **Qualitative Information:** To gather in-depth information, stakeholders such as legislators, business executives, labour union representatives, and legal experts participated in focus groups and interviews.
- **Policy and Legal Reform Analysis:** Examining existing regulations and proposing changes to the law to strike a balance between employee protections and business financial success. The research method incorporates ethical considerations including confidentiality and informed consent.

## DISCUSSION/ANALYSIS

### Conflicting Interests in Financial Restructuring

In the case of corporate financial restructuring, creditors' and employees' interests often conflict. For example, creditors, which are banks or bond holders or institutional investors that loaned money to the corporation, are more concerned with what will make them money and not out of pocket, and therefore they want to recover debt, and make sure they have collateral to do so or that the restructured entity will be able to carry its commitments. In order to accomplish these goals, creditors may seek that their charges are met through such activities as asset sales, cost cutting, and organisational restructuring.<sup>15</sup>

But workers don't have much of a concern for the next employer. Financial restructuring can result in employee personal and working condition reductions, as well as in termination of employment contracts. Not only do these have economic consequences for the workers' standard of living, but also economic consequences of wider socioeconomic impact in terms of increased unemployment and lower consumer spending. It is over the ranking of claims within the framework of insolvency procedures that the disagreement resides. The pyramid of hierarchy in which secured creditors stand at the top and are given precedence when distribution of insolvent company's assets takes place, is the norm in most jurisdictions. Workers' claims are usually scored lower, which means largely or in parts these obligations are delayed or postponed. This asymmetric treatment does not appear just or fair in the context where employees tend to hold undiversified risks and are more exposed to financial damage than financial creditors. This conflict must be resolved by the kind of prudent strategy which balances the interests of employees on the one side with the genuine apprehensions of creditors on the other. Since these interests are in conflict, legal remedies, legislative changes, and innovative restructuring options must be looked for to reconcile these different interests while securing social justice and economic efficiency.

### Shortcomings of Insolvency Frameworks

The insolvency frameworks are developed for a structured remedy with respect to financial problems. Employee rights in the context of restructuring processes remain very poorly

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<sup>15</sup> Jay L. Westbrook, Priority Conflicts as a Barrier to Economic Recovery, 46 Tex. Int'l L. J. 521 (2011).



safeguarded by such insolvency systems in the processes of their execution.

- **Claim Prioritization:** A common limitation is the hierarchical arrangement of claims, where the rights of employees are ranked lower than those of secured creditors. Such an order of priority subordinates the interest of workers in the form of lesser amounts of pension benefits and paid or unpaid wages or other payments. In certain jurisdictions, for example, the employees thus lose the complete potentiality recovery during insolvency as they are assigned the status of unsecured creditors.
- **Recourse Inadequate Legal Protection:** Employee Protection Strong measures to protect employees from harm during company restructuring do not feature in the statutory frameworks of many legal systems. Sudden dismissals and a lack of earned entitlement losses can ensue in the absence of such protections, which includes inadequate notice periods. Long-winded and complicated procedures finally add to employee anguish and create a situation of having no quick solutions.
- **Variation Among Jurisdictions:** Some countries grant preferential treatment to employee claims while some have systems that just protect them to a limited extent. Differences could then lead to some outrageous inequality when insolvency proceedings are transnational, as different employee groups across countries may encounter unequal treatment in terms of protection.

**Case Example:** The European Union's insolvency regulation<sup>16</sup> aims to bring standard methods into all nations participating. But their interrelationship with state regulation will probably have unexpected consequences that will undermine employee, in fact, protection. For example, the provisions of the regulation could possibly lead to delayed or reduced settlements for lower-level employees under conflict with domestic guarantee programs. This demonstrates a need for harmonized policies, directing national labor standards toward international ones, including comprehensive reform stressing rights of workers in bankruptcy cases. Some possible measures would include certain advocacy on the importance of workers' rights, setting up wage assurance funds for continuous updates for employees during the restructuring process among others; all towards a balanced approach between employee rights and creditor interests.

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<sup>16</sup> World Bank, Resolving Insolvency: Strengthening Employee Protections, World Bank Doing Business Report (2019), <https://www.doingbusiness.org/en/reports/global-reports/doing-business-2019>.

## **Role of Trade Unions and Collective Bargaining**

Trade unions and collective bargaining mechanisms are very relevant and useful in protecting workers' interests in corporate financial restructuring. They influence the restructuring outcome in many respects, more importantly in retaining job conditions and just compensation.

- **Representation and Bargaining:** Any trade union is, in practice, the united voice of workers negotiating with a given employer or creditors. Their collective bargaining power can result in deals that in some situations ameliorate harsh consequences on employees, such as an assurance to take measures to protect jobs, freeze salaries, or offer generous severance packages. Collaboration with compromising trade unions with strong representation, for example, has seen some restructuring proposals develop into signed agreements that include retraining programs and full benefits for affected workers.
- **Legal Support and Advocacy:** In ensuring that employees' rights are protected during insolvency processes, unions may give legal assistance. Unions accomplish that by taking precedence to salary negotiations, contesting unfair dismissals, and fulfilling statutory labor regulations. Where labor laws are weak, unions may be paramount in guarding workers' rights.
- **Challenges of trade unions:** The trade unions are in an important role but have a heavy burden with regard to the financial restructuring and face a number of other challenges :
- **Legal Impediments:** In areas of jurisdiction, for some kinds of collective bargaining, laws may restrict the powers of trade unions to give effect to any impacts of restructure.
- **Reduced Leverage to Bargain:** Under the duress of economic conditions and potential bankruptcy, unions might be pressed to make sacrifices that leave their members poorly protected.
- **Unequal Influence of Unions:** There are differences as to how trade unions affect different industries and regions. Employees from low-density industries or countries may not be adequately represented in the restructuring process.

- Case Example: Case of the North Australian Aboriginal Justice Agency (NAAJA)<sup>17</sup> bore the brunt of intense legal wrangling and economic harm dealt to the company by the wrongful termination of its top executive. The current absence of effective collective bargaining mechanisms indicates the potential weaknesses that workers can suffer during restructuring situations.

## **SUMMARY OF FINDINGS/EXPECTED OUTCOME/AND RESEARCH CONTRIBUTION**

It is an examination of how things get to a more intricate legal scenario in terms of employee protection and debt restructuring in companies. Some key findings and expected outcomes from a more complete investigation including doctrinal legal insights, comparative evaluations, empirical observation analysis, and qualitative discoveries include:

### **1. Shortcomings in Existing Legal Frameworks**

The study has pointed out substantial flaws in the existing legislative frameworks governing corporate debt restructuring, especially concerning the protection of employee rights. In most jurisdictions, creditors' interests are prioritised, at times, even at the cost of employee compensation and job security. The divergence here therefore propounds the idea that maybe some form of legislation is required to roughly balance the interests of employees versus creditors.

### **2. Impact of Restructuring on Employees**

Data has proven to show adverse effects of business restructuring on employees such as: job losses, reduced salaries, and fewer benefits. These effects not only affect an individual in her personal life, but there are also wider socio-economic ramifications on the society such as increased dependency on social welfare programs and reduced purchasing behavior.

### **3. Lessons from International Practices**

Countries that have strong businesses' and employees' protective mechanisms during bankruptcy processes generally end up with more balanced outcomes, according to

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<sup>17</sup> North Australian Aboriginal Justice Agency v. Chief Executive Officer, [2020] NTSC 14 (Austl.).

comparative studies. For example, some European countries require employee representation during restructuring negotiations so that it is considered both long-term viability of the business and the well-being of the workforce.

#### **4. Role of Stakeholders in Restructuring Processes**

The study emphasizes the numerous responsibilities that judges, regulators, legislators, trade unions, and asset management companies have in determining the outcome of any restructuring exercise. Collocating their activities may result in having a balance between the interests of employees and creditors as well as more just outcomes.

#### **5. Policy Recommendations**

In terms of findings, this study provides the following policy recommendations:

- **Enhanced Legal Protection:** Change bankruptcy rules to incorporate explicit clauses safeguarding workers' rights during the reorganisation process.
- **Employee Participation:** To guarantee that their interests are properly taken into account during the restructuring discussions, ensure that there are employee representatives present.
- **Government Intervention:** Establish support systems, sponsored by the government, to assist displaced workers, such as retraining programmes or subsidies.
- **Transparent Processes:** Promote legislative enactment to strengthen transparency in restructuring processes so that all parties may engage effectively. These are some of the policies the study has recommended in light of the findings:
- **Enhanced Legal Protection:** Alter bankruptcy law to include specific clauses that will protect the rights of the employees during the process of reorganisation.

This employee will tag representatives so that their interests may always remain on the discussion of any restructuring that might happen. The State will mitigate the economic challenges which dislocated workers face by establishing government-sponsored support

systems such as retraining programs or subsidies. Make arrangements for process transparency by legislation on clearer and more participative restructuring processes for all involved parties.

### **Research Contributions**

The study adds to a body of work that:

- Synthesising Legal Disciplines: Brings together knowledge from labour and business law to provide a thorough understanding of the problems with debt restructuring.
- Empirical Insights: Bring in empirical data to the policy discussion by providing evidence-based studies that quantify the impact of restructuring on employees."
- Comparative Perspectives: Drawing from international best practices to offer flexible solutions in diverse legal contexts." The study ultimately makes a case for reform legislation to balance employee protection with corporate financial restructuring to further the achievement of social justice and economic stability.

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