Stockholm School of Economics
Master's Thesis
Course 3350
Department of Accounting and Financial Management
Spring 2016

# Debt Restructuring from a Transaction Cost Economics Perspective

## A Comparison between Norway and England

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**Abstract**

This study describes and compares the civil law jurisdiction of Norway and the common law jurisdiction of England's informal and formal debt restructuring processes. Empirically, we gather evidence by interviewing 15 practitioners, with various expertise and experience from either Norwegian and or English debt restructuring. Theoretically, by applying Williamson's (1981; 1985; 1990; 1991; 1999) framework for transaction cost economics (TCE), we compare the efficiency of the two jurisdictions' debt restructuring processes by focusing on value destructive transaction costs. Firstly, our findings indicate that there are similarities between the two jurisdictions' informal debt restructuring processes, while their respective formal processes have several differences. From a TCE perspective, social and legal administrative controls work intertwined in both Norway and England to minimise transaction costs. Secondly, the debt restructuring processes can be separated in governance structures with different types of transaction costs associated with them dependent on their adaptation capacity, although Norway's governance structures' adaptation capacity is seemingly maladapted to debt restructurings. Moreover, our study supports Gilson's (2012) findings, that actors should weigh benefits to costs when choosing an informal or formal debt restructuring process. Thirdly, our findings indicate that social administrative controls have been underpinned by a new governance structure in England, due to changes in the capital environment. Thus, to find a proper adaptation capacity that minimises transaction costs, a debt restructuring procedure should be considered in relation to a jurisdiction's environment.

**Key words:** Transaction cost economics, debt restructuring, opportunistic behaviour, governance structure, firm value

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# 1. Introduction

In "The Nature of the Firm" (1937), Ronald Coase attempts to answer the question to why there are firms in the economy instead of only independent actors that contract with each other. Furthermore, he investigates why and under what conditions firms are expected to emerge. Similarly, researchers within the field of law, economics and finance have asked themselves why there are in-court (formal) debt restructuring procedures instead of only out-of-court (informal) market solutions. For example, in the shadow of the recent financial crisis the U.S. courts encountered corporate debt restructurings using Chapter 11 with a magnitude not seen before. Shortly after the crisis, there was little evidence of "mass liquidations*"* in the U.S.*,* indicating that a majority of the distressed firms had been restructured successfully and there was evidence that corporate profitability and economic values had recovered. Thus, the formal debt restructuring procedure is ostensibly used to a great extent in practice (Gilson, 2012).

Analysing the efficiency of formal debt restructuring procedures that enhances a financially distressed firm's value, has been investigated by several researchers within the existing literature (Jackson, 1982; Baird, 1998; Berkovitch & Israel, 1999; Chatterjee et al., 1996; Payne, 2014, Gilson, 2012; Armour & Deakin, 2001; Haugen & Senbet, 1978, 1988; Schwartz, 1993; Acharya & Subramanian, 2009; Franks et al., 1996; Ayotte & Yun, 2007; Ravid & Sundgren, 1998; LoPucki, 1999). A first stream of literature focused on trying to find optimal insolvency laws in order to solve the prisoner's dilemma, which creditors of financially distressed firm are exposed to when individual creditors seek to enforce their claims in-court via litigation. In contrast to the first stream of the extant literature, by applying the Coase theorem, the second stream of literature emphasises that creditors should pursue informal debt restructurings, as this incur less transaction costs (Haugen & Senbet, 1978, 1988; Schwartz, 1993; Gilson, 1990). Jensen (1989) referred to this as the "privatization of bankruptcy". However, based on the success story of U.S. Chapter 11, researchers question this assumption (Gilson, 2012). The choice of whether one should restructure the debt informally or formally should be based on a comparison between the insolvency options' benefits and costs. One should choose the option that provides the lowest transaction costs and, thereby, maximises the value for the financially distressed firm (Gilson, 2012).

Thus, based on the two streams of literature we see the necessity of thoroughly weighing benefits to costs when deciding upon whether to pursue an informal or formal debt restructuring. Whereas the latter is associated with direct transaction costs, such as administrative and legal fees (Haugen & Senbet, 1978, 1988; Schwartz, 1993; Gilson, 1990), the former can also yield transaction costs that stem from opportunistic behaviour (Roe, 1987; Armour & Deakin, 2001; Gilson, 2012). This indicates that when one only considering the direct transaction costs of a specific debt restructuring process, the picture of the total costs may be inaccurate (Becker & Strömberg, 2012; Gilson, 2012).

Previous research has focused on how social norms in England can substitute legal rules in governing opportunistic behaviour and minimising the total transaction costs (Armour & Deakin, 2001; Finch, 2008). These social norms are often referred to as the "London Approach". Yet, the substitution of legal rules by social norms does not seem to be complete. The social norms in England seem to work intertwined with the legal environment in reducing opportunistic behaviour and, thereby, transaction costs in the informal debt restructuring procedure (Armour & Deakin, 2001; Finch, 2008, 2012). Moreover, there is little known in regards to how the globalisation of capital influences the social norms in England and,

thereby, potentially reducing their ability to govern for opportunism (Armour & Deakin, 2001; Finch, 2008). However, there are few comparative studies in the extant literature that investigate how social norms and legal rules influence the transaction costs of different debt restructuring processes in other jurisdictions than the English. In addition, previous research has found that common law countries rely more on private contracting, whereas civil law countries rely more on government regulation. Consequently, how the social norms and legal rules work intertwined in debt restructurings in a civil law country can be expected to differ from a common law country (Armour & Deakin, 2001; La Porta et al., 2008; Djankov et al., 2007).

Drawing upon interviews with debt restructuring practitioners, we obtain empirical evidence for a contrasting comparison of the debt restructuring procedures between the common law country England and the civil law country Norway. The insolvency jurisdiction in Norway is of particular interest, due to the recent surge in high-yield bonds that stand out in comparison to other Scandinavian countries and implies riskiness in the market (Eyerman et al., 2014). Importantly, debt restructuring practitioners particularly recommended us to contrast the two countries, due to their inherent differences and timely relevance. Against this background, this paper has three objectives.

First, by using the theory of transaction cost economics (TCE) we aim to understand how the interrelationship between social norms and legal rules shape the outcome of debt restructuring processes in Norway, a jurisdiction that has not been previously investigated in the extant literature and is different in its characteristics than the English.

Second, although previous literature has used the theory of TCE in researching the transaction costs of debt restructurings, the literature has not clearly distinguished and compared different governance structures that govern against undesirable debt restructuring outcomes. As such, based on the theoretical logic of TCE, we investigate under what conditions a formal debt restructuring would be more beneficial to an informal and vice versa (Williamson, 1991, 1999). Hence, we provide insights to an extended analysis on the drivers of transaction costs in the informal and formal debt restructuring procedures (Williamson, 1981, 1990, 1999; Gilson, 2012; Becker & Strömberg, 2012). For example, Becker and Strömberg (2012, p.1936) noted: "Unfortunately, these agency costs are hard to identify, and their importance – and even existence – is not well established".

Third, we answer the call for empirical evidence on how the evolution of social norms in England might have changed given the global capital environment. For example, Armour and Deakin (2001, p.51) noted: "The globalisation of financial services … may therefore endanger the stability of the London Approach …" By using the conceptual logic of TCE, this paper investigates how changes in the capital environment may affect the social norms in the debt restructuring procedures.

The paper is structured as follows. Section two provides a review of the literature within law, economics and finance. It describes the conceptual logic of TCE and provides an analogue application of TCE in a debt restructuring context. Section three describes the research method, and section four provides a description and analysis of the debt restructuring processes in Norway and England, which is followed by discussions in section five. Finally, our conclusions are described in section six.

## 2. Theoretical development

### 2.1 Debt restructuring to maximise a financially distressed firm's value

In the stream of literature related to insolvency, there is a distinction between how a country's insolvency law can be used to maximise the value for a certain stakeholder group of a firm or to maximise the value for the entire firm (Gilson, 2012). The latter is the focus of this study, as we believe further findings in this area will be of use to larger groups of actors. This perspective has been thoroughly investigated by several researchers (Acharya & Subramanian, 2009; Adler et al., 2012; Ayotte & Yun, 2007; Baird, 1998; Berkovitch & Israel, 1999; Chatterjee et al., 1996; Franks et al., 1996; Jackson, 1982). A well-known early analysis within this field is the one of Jackson (1982). As the creditors of a defaulting firm are able to collect on their debt by the use of litigation in-court, there is a "race to collect" the debt. This is a classical prisoner's dilemma where the result, can be a sub-optimal liquidation of the firm's assets in piecemeal. In this scenario, there is a need for a forced legal collective insolvency process for the creditors, where there is an statutory standstill on debt collecting procedures while the firm and its creditors renegotiate the terms of the lending agreements in order to provide essential liquidity to the firm (Jackson, 1982).

Based on Jackson's (1982) findings, researchers have used the characteristics of a country's jurisdiction to analyse the efficiency of the legal insolvency procedures, i.e. their ability to minimise costs, over time. More specifically, previous research has analysed the efficiency of the legal insolvency procedures bearing in mind the distinction between creditor friendly and debtor friendly insolvency codes. The former is associated with common law countries, i.e. where precedents, which have a precedential effect on future cases, determine the law. Debtor friendly codes are associated with civil law countries, i.e. countries that have a code of rules that are to guide a judge's decision in-court (La Porta et al., 1998; Merryman, 1969). In two extreme cases, a country is creditor friendly when creditors have all control rights of a firm, whereas shareholders receive all control rights under a debtor friendly code (Acharya & Subramanian, 2009).

One important aspect related to the efficiency of legal insolvency procedures is the ability of these proceedings to distinguish between economically and financially distressed firms. This aspect is discussed in the extant literature (Baird, 1998; Berkovitch & Israel, 1999; Chatterjee et al., 1996; Jackson, 1982). When there is a possibility for the firm to have a positive operating cash flow there might be a business worth saving. Consequently, a financially distressed firm is defined as having prospects to receive a sufficiently large operating cash flow that enables the firm to generate a going concern value for its stakeholders that is higher than the cash flows generated from liquidating the company. In financial distress, the funding of the company has been too optimistic and the firm is now unable to repay its outstanding debt, i.e. cash flow from financing activities, with the current level of operating cash flow (Payne, 2014; Chatterjee et al., 1996).

The legal insolvency codes affect the pre-insolvency incentives for the management of a firm and its stakeholders that makes investment decisions. The insolvency code should be designed so that the firm and its stakeholders are incentivised by the law to make the most economically beneficial investment decision for the firm. Berkovitch & Israel (1999) give a normative description on how an insolvency code should be written in a certain jurisdiction in order to liquidate value destructive firms while preserving value enhancing ones. The authors emphasise that managers of inefficient firms should be incentivised by the insolvency code to

liquidate these firms. The insolvency code should make creditors feel confident to provide funds for firms so that a constrained debt capacity will not impede possible positive net present value projects. Furthermore, Ravid & Sundgren (1998) problematise this issue, by discussing how the U.S.'s debtor friendly Chapter 11 insolvency code on the one hand facilitates economically distressed firms to file for Chapter 11, when they arguably should file for liquidation. On the other hand, it incentivises debtors to file for Chapter 11 earlier and, thereby, preserves value by preventing time consuming and value destructive activities for financially distressed firms.

Besides the in-court (formal) procedure, the literature has discussed insolvency in an out-of-court (informal) context as well. Applying the Coase theorem, which means that parties naturally choose the most beneficial outcome in maximising firm value, stakeholders should use an informal insolvency procedure when the costs of this alternative are lower than that of a formal procedure (Haugen & Senbet, 1978; Schwartz, 1993; Gilson, 2012). In this scenario, the informal alternative should Pareto dominates the formal one, since the costly formal insolvency procedure should incentivise the firm and its stakeholder to choose the informal alternative. Informal insolvency procedures are, indeed, evident in the U.S. (Gilson et al., 1990; Gertner & Scharfstein, 1991). However, data on informal judicial processes regardless of judicial area indicate that over 90% of these are resolved informally, while data on informal insolvency procedures indicate that 50% of these are resolved (Schwartz, 1993; Gertner and Scharfstein, 1991). Hence, these results indicate that there might be issues involved reaching a solution linked to informal insolvency procedures in particular.

The solution to an informal insolvency procedure for a financially distressed firm should be one that focuses on rescuing the firm as a going concern, since the liquidation value is lower than the going concern value. When the choice of rescuing the firm is motivated, restructuring the company's debt will be crucial. A successful debt restructuring will enable the firm to regain control over its financial cash flow and, thereby, restore the firm's liquidity in order for it to remain as a going concern (Payne, 2014; Gilson, 2012). [1]

The findings from the extant literature indicate that when a firm faces financial distress, there is an inherent conflict of interest in debt restructurings between and among the financially distressed firm and its stakeholders. This may lead to opportunistic behaviour being conducted by the firm and its stakeholders (Baird & Rasmussen, 2006; Baird & Bernstein, 2006; Armour & Deakin, 2001; Schwartz, 1993). Roe (1987), Gertner & Scharfstein (1991), Baird (1986), Gilson et al. (1990), Asquith et al. (1994), Franks et al. (1994), Chatterjee et al. (1996) and Armour & Deakin (2001) identify a number of possible problems when the firm and its stakeholders try to agree on an informal debt restructuring solution. Two of these problems relate to specific opportunistic behaviours, whereas two relate to factors that increase the possibility for opportunism. First, there is the possibility for a small number of creditors to "free-ride" on the restructuring agreement, i.e. there is a hold-out problem. This means that some creditors do not participate in the agreement, as it is sufficient for the firm to write down the participating creditors' face value of their debts. However, all creditors cannot behave like this, as the debt restructuring then cannot proceed due to lack of participants. Second, creditors may conduct hold-up activities. In this case, they participate in the process, but are not cooperative in the sense that they, first, do not agree to amendments in the lending

[1] As such, the main focus of this paper is on debt restructuring. When this paper hereafter refers to insolvency procedures, debt restructuring as well as liquidation are included. When referring solely to debt restructuring, liquidation is excluded.

agreements or, second, threat to file for liquidation if they do not receive a larger share of the firm's value in the new agreements. This type of opportunistic behaviours is only credible if the actor conducting it is expected to gain by not agreeing. As amendments in the lending agreements are necessary to rescue the financially distressed firm from liquidation, such behaviour can be time consuming and, thereby, value destructive. Third, when creditors' priorities become more heterogeneous it complicates the ability to reach a consensus in the debt restructuring agreement. This is due to the fact that the creditors with heterogeneous priorities have different opinions regarding how to solve disputes. Brunner & Krahnen (2008) investigate the emergence of bank pools that emerge in Germany in the informal debt restructuring procedure. These pools are created with the intent to make the processes more efficient, and the authors find that they are more likely to do so when there are fewer banks cooperating, indicating less heterogeneous priorities. Fourth, information asymmetry increases the likelihood of hold-out and hold-up problems. Information asymmetry aggravates the possibility to reach a consensual agreement, since it becomes harder for the creditors to learn about the financially distressed firm's future prospects, and for the firm and its creditors to learn about each other's positions.

There is evidence that senior creditors design financial contracts ex-ante to reduce the information asymmetry and, thereby, opportunistic behaviour. As a result, the costs of reaching an informal debt restructuring agreement decrease. Senior creditors incorporate covenants in the ex-ante contracts with the aim to keep the firm as a going concern. Hence, the creditors take on a more active role in the firm since they gain a larger control over the financing (Baird & Rasmussen, 2006; Haugen & Senbet, 1988). However, there are issues for a certain creditor to ex-ante "lock-in" a firm to a particular informal debt restructuring procedure, as the firms can choose other creditors as well with different lending contracts that favour another design of the informal debt restructuring procedure (Adler, 1993; LoPucki, 1999). As such, in order to capture ex-ante savings through committing to a particular informal debt restructuring procedure there might be a need for costly ex-post restrictions, such as the liquidation of a company. Albeit the lack of ex-ante contracting, such a restriction incentivises creditors to agree upon a design of an informal solution, since it saves value. Armour and Deakin (2001) investigate how the English "London Approach" convention "lock-in" creditors to a particular informal debt restructuring procedure, where they conclude that social norms can substitute ex-ante contracting. Further, the convention aids creditors to avoid opportunistic behaviour and instead guides them to maximise the joint value of all creditors without the need for ex-ante contracting to govern possible opportunistic actions. Armour and Deakin (2001) further conclude that the legal rules in the formal insolvency procedure play an important part in shaping the social norms. As such, it is important to understand the interrelationship between social norms and legal rules in shaping informal debt restructurings. However, the effectiveness of social norms is a function of their acceptance among the population of creditors. If this population changes, which has happened in England with the inflow of vulture funds, this may lead to a destabilisation of the accepted social norms as a means of governing opportunistic behaviour (Armour & Deakin, 2001; Finch, 2008).

Opportunistic costs may lead to significant costs for the informal debt restructuring process. Hence, actors risk taking economic inefficient decisions when not considering these costs from the formal and informal debt restructuring processes (Becker & Strömberg, 2012). Based on the success story of Chapter 11 in the U.S. after the recent financial crisis, results indicate that the formal debt restructuring procedures sometimes are more efficient than the informal proceedings (Gilson, 2012). Consequently, one must consider both the benefits of

reducing opportunistic costs and other costs that are associated with different debt restructuring alternatives when choosing the most efficient option that maximises the firm value (Gilson, 2012). However, little comparative research has investigated the interrelationship between legal rules and social norms in governing for opportunism in the informal debt restructuring process in a civil law jurisdiction. Hence, in this context, it would be of interest to study how this interrelationship influences firms and stakeholders' actions in maximising firm value during debt restructurings. In addition, there is little research about how accepted social norms that govern for opportunism in the informal debt restructuring process may change, given a shift in creditors participating in the informal processes.

## 2.2 Transaction cost economics

In the extant literature related to efficiency in debt restructuring procedures, researchers have identified that costs are associated with transactions, and thus perceived them as transaction costs. In the literature, it is either an indirect focus on how to minimise transaction costs, (Acharya & Subramanian, 2009; Adler et al., 2012; Franks et al., 1996; Berkovich & Israel, 1999; Ayotte & Yun, 2007; Finch, 2008, 2012; Ravid & Sundgren, 1998) or a more explicit focus (Armour & Deakin, 2001; Brunner & Krahnen, 2008; Schwartz, 1993; Gilson, 2012). Transaction costs have been widely analysed through the theory of transaction cost economics (TCE) (Williamson, 1981, 1990, 1991, 1999). Based on the theory of TCE, transaction costs incur either due to direct costs, i.e. bureaucratic costs, to prevent opportunism or indirectly from opportunistic behaviour when control mechanisms are insufficient to prevent such behaviour, i.e. maladaptation costs (Williamson, 1991, 1999). Since actors should have an interest to minimise transaction costs in their pursuit for the most efficient debt restructuring procedure, there is a need to consider the trade-off between bureaucratic costs and maladaptation costs (Gilson, 2012).

The discriminating alignment hypothesis in the scene of TCE aims to find an economic efficient trade-off. The hypothesis demonstrates that transactions, which differ in their characteristics, should be aligned with a governance structure, with different cost and competencies, in a discriminating manner (Williamson, 1991, 1999). Moreover, the environment should also be considered since it has an impact on transaction costs. For example, if new actors enter the scene with more opportunistic behaviour that ignore potential reputational damage, there is a risk for higher maladaptation costs. As such, there is firstly a need to dimensionalise the transaction characteristics to understand what the potential maladaptation costs that might accrue. Secondly, there is a need to dimensionalise the governance structure given the environment, i.e. the governance structure's ability to decrease potential maladaptation costs, at the expense of higher bureaucratic costs (Williamson, 1991, 1999).

Fundamental assumptions underlying TCE include two behavioural characteristics. These behavioural characteristics explain how governance structures are means to create order, where there is a potential for conflicts that decrease opportunity for mutual economic gains among the actors involved in transactions. Firstly, human agents are subject to bounded rationality (Simon, 1961) and, secondly, some of the agents act opportunistic (Williamson, 1981, 1990, 1991, 1999). With regard to the former, agents act rationally based on the information they possess, i.e. they may lack certain analytical tools that would make them act like an "economic man". Thus, bounded rational agents cannot control for all possible outcomes in a contract, which is why nothing more than an incomplete contract can be achieved. The second behavioural assumption of opportunism increases the costs in

contracting. An opportunistic agent is not only interested in his self-interest, similar to economic man, but could also act deceptively (Williamson, 1981, 1990, 1999).

Adaptation to unforeseen disturbances, i.e. contract breaches in transactions, is the central economic problem of TCE, as different adaptations capacities are needed to different transaction characteristics in order to minimise the total transaction costs. Adaptation can come in different forms, where the polar modes are autonomous and coordinating adaptation (Williamson, 1991, 1999). Williamson (1999) defines a governance structure as a mode of internally consistent contract law regime, incentive intensity and administrative controls with the aim for a desirable adaptation capacity that is aligned with the transaction characteristics. There are three generic forms of governance structures, namely market, hybrid and hierarchy, where the polar modes are market and hierarchy. These generic governance structures have different adaptation capacities. Three aspects mainly define the different capacities: (1) contract law regime (2) incentive intensity, and (3) administrative controls (Williamson, 1991, 1999). Each contract law regime is consistent with different governance structures for which conflicts of interest are most effectively resolved within, when contracts are breached. The governance structures are supported by incentive intensity and administrative controls that are instruments used to solve these conflicts of interest within each governance structure. These two instruments work in opposite directions, when the incentive intensity is high there is no need for administrative controls and vice versa. The three aspects can be combined in various ways to create order, by yielding different adaptation capacities that seek to align transaction characteristics with a governance structure that minimises transaction costs. As a result, the efficacy of governance structure is a function of both the actors' efforts of designing instruments (incentive intensity and administrative controls) and the legal environment (contract law regime) (Williamson, 1991, 1999).

Incomplete contracts require adaptive mechanisms when unforeseen disturbances occur. Disturbances are of three different kinds: inconsequential, consequential and highly consequential. Inconsequential disturbances are when the economic effect of contract deviations is too small to motivate the costs of renegotiating the realignment of the deviations. Consequential disturbances, on the other hand, are sufficiently large deviations where renegotiations are economically motivated. When highly consequential disturbances occur, renegotiations are too costly to administer and there is a need for other types of coordinating activities (Williamson, 1991, 1999).

The contract law regime that is best aligned with the market governance structure is the classical contract law (Williamson, 1991). Classical contract law implies that actors in the market can go their own way at negligible costs to the others. If conflicts of interest should occur, they are managed in a formal legalistic way, i.e. litigation. This is consistent with inconsequential disturbances as there are limited gains from renegotiating the contracts. Consequently, given an inconsequential disturbance each actor has strong economic incentives, i.e. high incentive intensity, to switch contract, as there is a clear linkage between their reduced costs and their individual action of changing the contract. Moreover, other actors cannot be held accountable for losses of another actor when he switches a contract nor can they have legitimate claims on gains. This implies that there is no dependency for a specific actor to other actors in succeeding or failing to generate economic gains (Williamson, 1991). Consequently, the actors are autonomous to each another and there is little dependency. As such, there is no need for any administrative controls that coordinate the actors to renegotiate. Autonomous adaptation is best described by looking at an ideal market,

where contracts are signed and or renewed as a buyer bids the asked price in a spot market (Williamson, 1991, 1999).

Neoclassical contract law is best aligned with a hybrid governance structure, where the actors relieve the contract-breaching actor via an excuse doctrine from strict enforcement when consequential disturbances occur. The actors maintain autonomy to each other, however, there exists a dependency relation. As the actors maintain autonomy there is still some incentive intensity, where the autonomous actor can respond efficiently without consulting the other actors. However, given the dependency relation it can be more beneficial to renegotiate contracts. Renegotiations of contract breaches can be seen as trying to receive mutual economic gains out-of-court by arbitration, where strict enforcement by litigation (as classical contract law and market governance structure would argue for being the best alternative) would have punitive economic consequences for the actors involved, i.e. maladaptation costs. As such, maladaptation costs can be decreased in renegotiations given the ex-post legalistic threat of negative economic consequences for the actors (Williamson, 1991, 1999). Notwithstanding, maladaptation costs can still occur if no appropriate administrative controls that result in a coordinating adaptation, for example by providing for arbitration in the case of when voluntary agreement fails, are in place that facilitates renegotiations when unforeseen consequential disturbances occur. On the other hand, administrative controls come at the cost of lower autonomy, incentive intensity and added bureaucratic costs.

However, when disturbances become highly consequential, neoclassical contract law become limited in its use. In this scenario, as the actors are still to some extent autonomous, they are incentivised to enforce their legal rights instead of renegotiating and continue the relationship as this is seen as the most economically beneficial option for the individual (Williamson, 1991, 1999). In this scenario, the hybrid governance structure results in added transactions costs due to maladaptation and even more coordinating adaptation is called for (Williamson, 1991, 1999). Forbearance is the implicit contract law of the hierarchical governance structure, where internal conflicts of interest are not granted court access but resolved internally. As such, the hierarchy itself is its court of ultimate appeal. Internal conflicts of interest are resolved by the coordinating adaptation capacity of an authority within the hierarchy rather than by arbitration between parties. This saves economic resources, time and reduces information asymmetry, i.e. decreasing maladaptation costs, if there are highly consequential disturbances and it is hard to achieve agreement via arbitration. However, the coordinated adaptation comes at a cost, with reduced incentive intensity and added bureaucratic costs (Williamson, 1991, 1999).

The unit of analysis in transaction cost economics is the transaction itself (Williamson, 1981, 1999). A transaction is defined as a material or immaterial object that is transferred through a technological separable interface. When the transaction is completed it means that one stage of activity ends and a new stage begins. It is the frictions that occur in the transfer between different stages of activity that are called transaction costs (Williamson, 1981). Williamson (1981, 1999) defines three dimensions that describe transactions costs. These are uncertainty and risk, the frequency of a transaction and asset specificity. Opportunistic behaviour is associated with more uncertain and risky transactions that are more asset specific, while both less and more frequent transactions can be associated with opportunistic behaviour. A more thorough explaining of this will be provided in section 2.3.1 (Williamson, 1981, 1991, 1999).

After considering both the dimensions of governance structures and the transaction characteristics we can consider the discriminating alignment hypothesis more thorough.

Williamson (1999) illustrates the nature of the discriminating alignment hypothesis in TCE, by developing a simple contractual schema (see fig. 1), where Williamson defines administrative controls as safeguards (Williamson, 1999). In the first step, there can either be a dependency relation (Node B, where k>0) or not (Node A, where k=0). In the case of no dependency, one can reach an ideal market transaction, i.e. a complete autonomous adaptation of the governance structure. Node A resembles a market governance structure, where there is a high incentive intensity and no dependency between the actors. However, when dependency increases (k>0) one will reach Node B as transaction costs increases due to potential maladaptation costs if no safeguards are put in place (s=0). If safeguards, however, are provided (s>0) and thereby increasing the coordinating adaptation of the governance structure, one can reach either Node C or Node D. Thereby, the opportunistic costs stemming from a maladaptation between the set of transaction and the governance structure is decreased. Node C resembles a hybrid governance structure. Node D resembles a hierarchical governance structure where increased coordinating adaptation come with additional bureaucratic costs and decreased incentives. Yet, additional bureaucratic costs may be offset by decreased maladaptation costs when transferring the set of transactions from the hybrid to the hierarchical governance structure. This implies that transactions costs for a set of transactions vary with different governance structures. Node D can be argued to be "the organisation form of last resort […] when all else fails […]". (Williamson 1999, p. 1091).

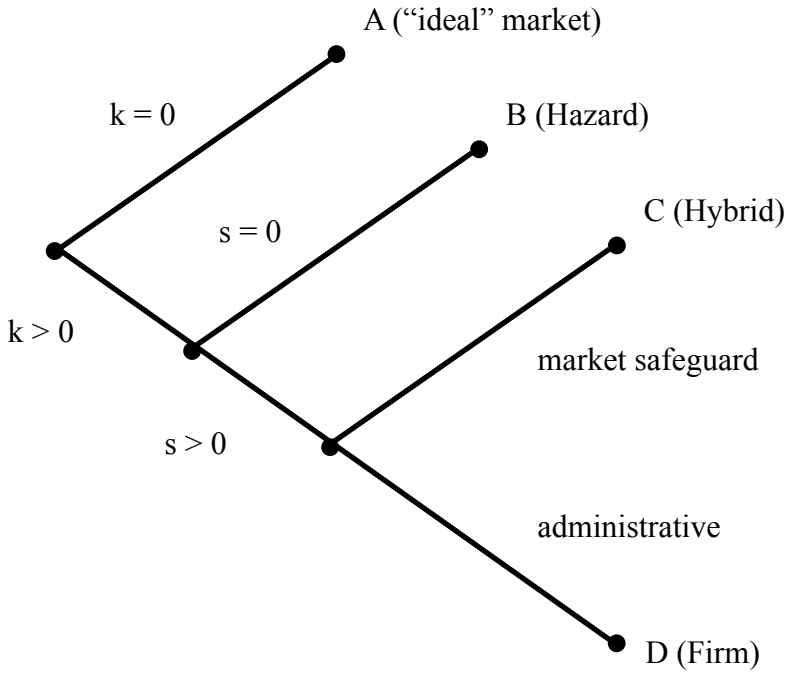


*Figure 1. A simple contracting scheme (Williamson, 1999).*

## 2.3 Transaction cost economics in debt restructuring

Building on the insights from TCE, the informal and formal debt restructuring procedures discussed in the extant literature can be seen as different governance structures (Haugen & Senbet, 1978, Schwartz, 1993; Gilson, 2012; Williamson, 1991, 1999). Through the theoretical lens of TCE, actors should choose a debt restructuring governance structure with an adaptation capacity that is aligned with the debt restructuring transaction characteristics in a way that it can minimise the total transaction costs the most and thereby maximise the firm value (Williamson, 1991, 1999). Thus, the theoretical scope elaborates on the rationale actors

should have when choosing either an informal or formal debt restructuring governance structure as a means of maximising firm value.

### 2.3.1 Transaction characteristics in debt restructuring and opportunism

Given Williamson's definition of a transaction, a transaction in debt restructurings occurs when one stage of activities in the debt restructuring process change. For example in the informal debt restructuring procedure, Armour and Deakin (2001) found two stages of activities, i.e. first, the notification stage and, second, the negotiation phase. Consequently, a transaction occurs, for example, when the notification phase ends and the activities move from the notification to the negotiation phase. Of course, by dividing the process in only two stages we receive a simplistic picture. In theory, one could divide each stage in even smaller ones and by adding the costs associated with the transition between each of these smaller stages, we receive the total transaction costs associated with these two stages. Actors should consider whether to pursue the stages of activities associated with a debt restructuring in an informal or formal debt restructuring process. Although the notification stage arguably occurs before a firm can enter a formal debt restructuring procedure, negotiations can occur either informally or formally.

As previously discussed, the dimensions of transaction characteristics (asset specificity, uncertainty and risk and frequency), affect the risk for opportunistic behaviour and, thereby, the total transaction costs (Williamson, 1981, 1999). First, it is important to understand the concept of asset specificity in debt restructuring procedures as this can increase the dependency between actors involved and call for a need of coordinated adaptation (Williamson, 1991, 1999). In a debt restructuring there is a dependency relation between the creditors in order to support the financially distressed firm. The amortisation, interest rates or face value of the debt instruments need to be amended to trade the firm out of its precarious situation. Moreover, the financially distressed situation can also be solved through new funds (Payne, 2014). Arguably, asset specificity decreases in a liquid market where debt instruments are frequently traded and a debtholder can trade out of its participation in the debt restructuring process (Armour & Deakin, 2001; Finch 2008), leading to lower dependency. However regardless of whether the debt instrument is traded or not, the debt instrument's face value and covenants remains the same after a trade for the firm and the debt instrument's potentially new owner, i.e. there is no change in the lending agreement. Hence, there is still a need for restructuring the debt between the firm and the creditor in order to provide sufficient liquidity leeway to get the financially distressed firm out of its financial problems (Payne, 2014). Consequently, there will exist a dependency between the firm and the owner of the debt instrument until the firm's liquidity increases, since the firm's survival is still dependent on the restructuring of the debt.

Second, uncertainty and risk aggravate the ability to restructure the debt. With increased liquidity in the debt instruments there is also an increase in heterogeneous priorities among the creditors. This potentially increases opportunistic behaviour, due to the fact that speculative traders of distressed debt have strong preferences to make quick recoveries by enforcing or threating to enforce their claims (Armour & Deakin, 2001; Finch 2008), which also attenuates incentives to restructure the debt (Williamson, 1991, 1999). If enough creditors enforce their claims, the enforcement can lead to a value destructive liquidation. Moreover, heterogeneous priorities can be argued to increase the information asymmetry as more and sometimes unknown creditors are involved in the debt restructuring process, making it harder to communicate (Jackson, 1982; Armour & Deakin, 2001; Finch, 2008). There is

evidence in the extant literature that when creditors believe they have an information disadvantage they are more likely to conduct opportunistic hold-up or hold-out activities (Armour & Deakin, 2001; Gilson 2012). In addition, when the firm has an information advantage, the risk for opportunism from the firm increases as they withhold information from creditors, which potentially prolongs the process and destroys value in the debt restructuring (Schwartz, 1993). Another issue related to uncertainty and risk is the relation between the accumulated experience and knowledge in regards to the debt restructuring processes and the number of times management, other stakeholders and the court have been in these situations (Gilson, 2012). When the debt is traded to people with experience in debt restructurings, one effect is that transaction costs can be reduced as actors become more accustomed to the procedures and behave more efficiently (Gilson, 2012). A court with experience is more expected to perform firm value preserving decisions. Hence, actors' behaviour become more predictable and thus decreases the perceived risk.

The third aspect, frequency, concerns how often a debt restructuring is performed. Debt restructurings are arguably non-standardised due to their firm specific nature, thus although several debt restructurings have been performed in many jurisdictions, they are idiosyncratic transactions. Hence, the frequency of these is low, which makes each transaction costly. Another aspect relates to frequency of disturbances. The more frequent consequential and highly consequential disturbances there are in terms of e.g. opportunism in a debt restructuring, the better a hierarchical governance structure is suited. Finally, the more frequent transaction occurs with similar actors, the more certain is the fact that the actors involved do not act opportunistic, since actors easier can build a relationship with one another that enhances their trustworthiness (Armour & Deakin, 2001; Williamson, 1981, 1985, 1991, 1999).

### 2.3.2 Debt restructuring governance structures and adaptation capacities

There is a need to create an adaptation capacity in the formal and informal debt restructuring procedure that lead actors to act for mutual economic gain by reducing opportunistic behaviour. In the formal debt restructuring procedure, it is initially important to distinguish between the court and the procedures themselves. The formal debt restructuring procedure is subordinated to the court. However, the court can appoint this procedure for particular cases, which delimits the ability for individual creditors in those cases to access court litigation for enforcement of claims. Instead, the cases are handled through the discretion of the formal debt restructuring procedure (Jackson, 1982). While the court makes the final decision of a discrete formal process, the debt restructuring procedure has different designs in different jurisdictions. Importantly, from a TCE perspective the formal debt restructuring procedure is a governance structure of its own, which have been designed with its own hierarchy to resolve a debt restructuring internally without the intention for autonomous creditors to access court by enforcing their claims in potentially secured assets via litigation. Thus, it is consistent with the contract law of forbearance, as it should operate as its own ultimate court of appeal with complete discretion in some areas within debt restructuring (Williamson, 1991, 1999). For instance, in order to avoid enforcement of claims, previous literature illustrates how administrative controls are put in place in terms of a statutory standstill (Jackson, 1982). Occasionally, there are arbitrators with various degrees of authority that coordinate the process and thereby attenuate incentives for actors and discourage them to act autonomously. On the other hand, the arbitrators make the process more efficient by preventing opportunistic behaviour (Payne, 2014). Although formal procedures arguably have strong resemblances to a

hierarchical governance structure, their design vary and a more thorough description will be provided later in this study.

The extant literature and the insights from TCE support the fact that the informal debt restructuring procedures resembles a hybrid governance structure (Armour & Deakin, 2001; Gilson, 2012; Payne, 2014; Schwartz, 1993), subordinated to formal governance structures and the ultimate court. The informal procedure is consistent with the reasoning of neoclassical contract law (Williamson, 1991, 1999). Actors have incentives to cooperate, but also to act opportunistically. There is a dependency relation between actors and an interest to restructure the debt, since the formal alternative often is perceived as a more costly alternative. However, debt restructurings sometimes collapse into court litigation, which tend to lead to liquidation when actors ignore dependency relations and act autonomously, by behaving opportunistic and enforcing their claims. When a single creditor prefers litigation to collective arbitration it yields additional maladaptation costs, as it either takes time and resources to convince this creditor to agree on a debt restructuring or that when creditors collect their secured assets via litigation this decreases the going concern value of the firm. Moreover, when too many creditors enforce their claims this ultimately leads to liquidation. As the liquidation value is lower than the going concern value for a financially distressed firm this can also be seen as a maladaptation cost. Thus, the literature indicates that creditors create administrative controls in terms of ex-ante adapted lending agreements and social norms, with the aim to more efficiently handle debt restructurings through arbitration. Arbitration enables actors to still act autonomously, but also coordinates actors to find a solution (Armour & Deakin, 2001; Baird & Rasmussen, 2006; Gilson, 2012; Williamson, 1991, 1999). However, there are issues in regards to the efficacy of these ex-ante contracts, which supports the incomplete contract assumption of TCE and indicates a difficultness to contract for successful arbitrations (LoPucki, 1999).

### 2.3.3 A simple contractual schema for debt restructuring governance structures

Given Williamson's (1999) illustration of a simple contractual schema, a similar can be generated for debt restructuring governance structures (see fig. 2). In an ideal market (A) there is no dependency and an ideal solution could be found with a complete autonomous adaptation of the governance structure. In such a scenario the total going concern value of the firm is not impaired by transaction costs associated with the debt restructuring governance structures. However, as shown in the extant literature there is, arguably, always a dependency ($k>0$) in the transactions between the debtor and its creditors and between the different creditor classes (Armour & Deakin, 2001). Thus, there is a need to resolve the financially distressed situation through debt restructuring governance structures when disturbances occur. If no administrative controls are put in place in such a situation ($s_1=0$) the hazards (B) stemming from the behavioural characteristics can potentially lead to maladaptation costs, for example lengthy debt restructurings, reputational damage and losses incurred by liquidating the firm. If the increased maladaptation costs are larger than the bureaucratic costs added by setting different administrative controls in place, a more efficient choice would thus be to create administrative controls ($s_1>0$) and a governance structure with a desired adaptation capacity. There is evidence in the extant literature that administrative controls (Baird & Rasmussen, 2006), social norms (Armour & Deakin, 2001) and the threat for ex-post costly restrictions (Jackson, 1982; LoPucki, 1999) are used to guard against opportunistic behaviour in the informal debt restructuring governance structure (C). Additional administrative controls in the formal debt restructuring governance structures (D) can be used ($s_2 > s_1$) if the informal administrative controls are insufficient to decrease maladaptation costs, at the expense of

additional bureaucratic costs. As such, the formal debt restructuring governance structures is chosen if "all else fails" (Williamson, 1999, p. 1091).

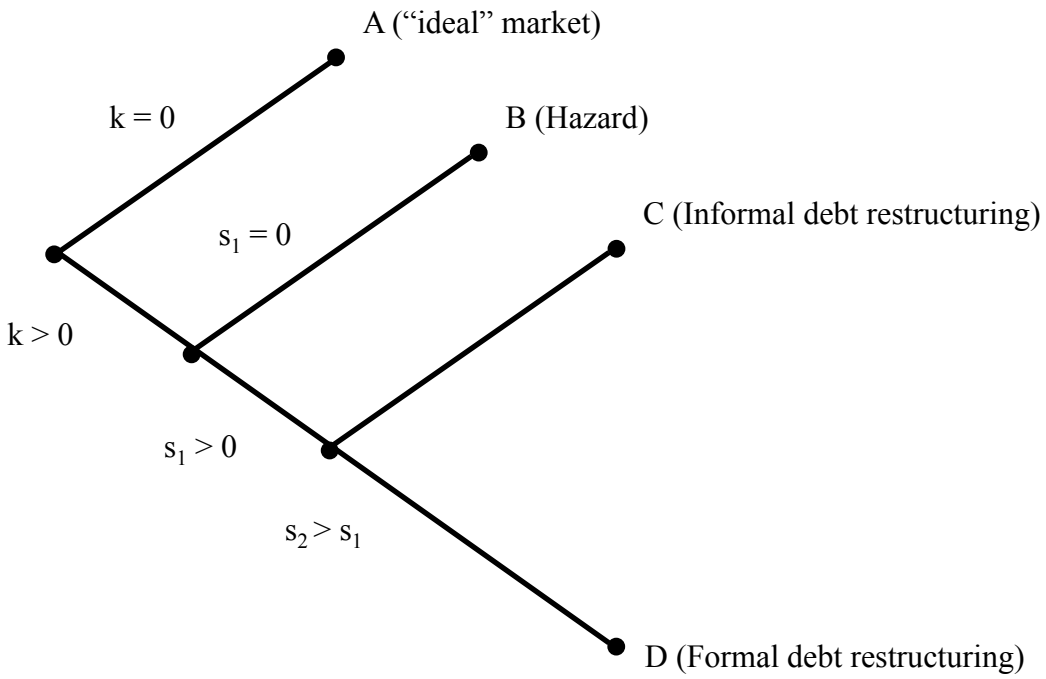


*Figure 2. A simple contracting scheme applied in a debt restructuring context.*

# 3. Method

## 3.1 Research design – a contrasting comparison between Norway and England

In this paper we, firstly, portray and compare the formal and informal debt restructuring processes for Norway and England, by gathering empirical evidence from debt restructuring practitioners. We thereafter compare the efficiency of Norway to England's processes by using the theory of TCE. Secondly, we compare the English debt restructuring processes based on our findings to findings on England in previous literature, to study whether potential environmental changes may have had an impact on the debt restructuring processes, and if so, how. The Norwegian and English debt restructuring processes are seen as two separate cases in this paper. Consequently, the research is designed as a multiple case study for which the cases of Norway and England are presented and contrasted. Using contrasting cases is deemed as favourable in order to develop the theory as different settings can provide validity to the a priori constructs if the cases confirm the hypotheses or provide opportunity to develop the theory further if disconfirming evidence is found (Eisenhardt, 1989).

Basing our choice of the two cases on theoretical sampling (Eisenhardt, 1989), the choice of examining and contrasting Norwegian and English debt restructuring processes was primarily made for two reasons. First, Norwegian and English laws stem from different origins. The latter has its origins in the common law tradition, whereas the former stems from the civil law tradition. The civil law tradition is the oldest and originates from the Roman law. It orders the law based on statutes and codes and relies on legal scholars to formulate these laws (Merryman, 1969). In contrast to the civil law, the common law relies on the expertise of judges to solve disputes and shape the law. Instead of statutes and codes, former judicial outcomes formulate the law (La Porta et al., 1998). One can see the common law as "dispute

resolving" and the civil law as "policy implementing" (Damaska, 1986). Consequently, these judicial differences can be expected to have an impact on each country's debt restructuring processes, where a comparison might provide interesting findings.

Secondly, due to practical reasons in terms of easier access to interviewees and data, we decided to compare England with a Scandinavian country. Further there has been a recent surge in high-yield bonds in Norway, higher than in other Scandinavian countries, which implies an increased riskiness in the market (Eyerman et al., 2014). Which actors that are involved in a debt restructuring procedure are largely determined by how the financially distressed firm is financed. For example, an important financer to a firm is the bondholder. In regards to the bondholders, there are differences between the English and Norwegian high-yield bond market. The latter is associated with lighter documentation requirements and originating processes than the former. As such, it can be argued that this will impact the debt restructurings procedures in respective country. In Norway the issuing company must not undergo any financial, legal due diligence performed by an investment bank. Hence, in contrast to the English high-yield bond market, the Norwegian enjoys a less costly process of issuance but suffer from lower credit ratings and lower secondary market liquidity. The Norwegian high-yield market, however, provides the investor with higher returns in comparison to its English counterpart. Thus, in search for higher yields, the Norwegian high-yield bond market has attained interest from international investors. This raises challenges for the Norwegian high-yield bond market as the templates developed with the associated lax documentation requirements are structured to suit a concentrated bond ownership market with private buy-and-hold investors (Eyerman et al., 2014). Debt restructuring practitioners also indicated that the Norwegian market was of high interest, du to a recent increase in business opportunities in the area. However, practitioners agreed upon that a contrasting comparison of efficiency between England and Norway could provide interesting findings, since England has a long experience within the debt restructuring industry (Armour & Deakin, 2001) while Norway is relatively more nascent.

The scope of this study is to investigate debt restructurings that involve the largest financers with arguably the largest impact on firm value in the debt restructuring processes, which primarily are banks and bondholders (Becker & Josephson, 2016). This scope provides us with two interesting aspects. First, in order to be able to capture the dynamics of a changing capital environment there is a need to study debt restructurings when there are different types of banks and bondholders in the process. This deepens our understanding of how potential new challenges, that are associated with these changes, are dealt with. Second, as the extant literature has shown, it is likely that transaction costs are greater when there are more heterogeneous creditors involved. Consequently, this scope provides us with insights in what type of transaction costs these are and how to manage them. Importantly, we exclude financial institutions, since these companies operate within a different legal environment. Hence, they can be argued to not fit in the debt restructuring processes we describe.

Further, we qualitatively attach transaction costs to the debt restructuring processes and analyse the efficiency of the Norwegian and English processes. By not quantifying these aspects, it is difficult to say whether one of the Norwegian or the English processes is more efficient than the other. However, if one were to quantify the transaction costs in the restructuring process and a process was found to have lower costs in one country than in the other, the results would likely be inconclusive. It would still be difficult to say whether the more efficient approach would be as efficient in the other jurisdiction due to environmental differences. Instead, the aim is to understand the drivers of transaction costs in the

restructuring processes and to see how the informal and formal debt restructuring procedures in each country succeed in maximising firm value. In addition, this approach has been favoured in previous research (Armour & Deakin, 2001; Gilson, 2012).

## 3.2 Data collection

The data was gathered between February and April in 2016. In total, 15 semi-structured interviews were made, of which 13 different persons were interviewed (see table 1). Consequently, some of the interviewees were interviewed more than once. The major rationale for interviewing some persons more than once was to untangle the data by asking more focused questions in order to understand the debt restructuring processes sufficiently deep. This facilitated our process to assess and attach transaction costs to the debt restructuring processes in Norway and England, respectively. The typical length of an interview was approximately one hour. With the exception of two interviews, all interviews were tape-recorded in order to be sure of what specific interviewees said and most of the recordings were transcribed. In addition, notes were taken during all of the interviews. Some of the interviews were conducted over telephone, in cases where interviewees were located at a different geographical location, i.e. in England.

As the unit of analysis are the transactions within the debt restructuring processes, we interviewed stakeholders with experience from the processes in both countries. Furthermore, as a debt restructuring is associated with conflicting interests between and among stakeholder groups, it is likely that the stakeholders will perceive the debt restructuring processes differently. Hence, a vital part of our study was to interview stakeholders with different experiences, as we were able to triangulate the data from one stakeholder with data found from another. This approach has also been recognised as favourable by other academic scholars and performed in previous literature related to our field of study (Eisenhardt, 1989; Armour & Deakin, 2001).

An a priori decision was made based on extant literature to interview the following stakeholders: Financial advisors, legal advisors, banks and an academic scholar. The reason to why debtors and bondholder were not interviewed directly is mainly due to the fact that debt restructurings are a sensitive matter for debtors and bondholders and, as a consequence, it proved difficult to get access to these stakeholders. Instead, advisors to debtors and bondholders and bond trustees were used as a proxy for their viewpoints. In fact, conflicts of interest can arguably be better observed from a third-party's viewpoint, since they can observe these conflicts more unbiased. Yet, we acknowledge that there might be some issues a third-party proxy can omit in debt restructurings. In addition, the majority of the interviews were conducted with financial advisors, since we perceived them to be main drivers of the informal debt restructurings processes. Moreover, some of the interviewees were not limited to a specific stakeholder group. For example, some of the financial and legal advisors had experience from working both with debtors and creditors. As such, the stakeholder perspective from these groups is indirectly accounted for in the interviews. In addition, several informants were experienced in both the Norwegian and English debt restructuring procedures. Hence, they provided us with more direct answers on contrasting features between the countries. We acknowledge that it would be more objective to assess the contrasting aspects of the debt restructuring processes ourselves, however, we found it beneficial to let the informants provide us with their viewpoint on contrasting aspects as well, due to their more extensive experience they have from working with debt restructurings.

We performed semi-structured interviews, where we prepared a set of questions, which we used during each interview (see Appendix – Semi-structured interview questions). Each interview began by asking the interviewees what their role in the debt restructuring processes was. Then, we asked the interviewees more specific questions about their experience of debt restructuring processes. However, we departed from the ex-ante prepared questions if the interviewee's role and experience was deemed to not fit the structure of the questions. For example, if an interviewee was a priori found to mainly be involved with negotiations in the debt restructuring process, we asked questions related to this theme. Given the lack of research about Norwegian informal debt restructuring processes and the effect the changed bondholder ownership structure has had in England, we performed the early interviews in a way to understand how the Norwegian and English processes currently look.

We primarily conducted the interviews to understand the informal part of the debt restructuring process, as there is limited research about this. The informal process was also complemented by gathering data of the formal process, which we did through interviews and an examination of the literature that covers the law. In addition, we interviewed an academic scholar in order to grasp the full picture of the formal processes and the influence that the law has on the informal processes. In regards to the informal debt restructuring process some of the interviewees were asked if they could provide us with documentation about their role in order to complement the data from the interviews. For example, some interviewees provided us with documentation that described the debt restructuring processes from their viewpoint.

## 3.3 Data analysis

The research was conducted with an abductive approach (Dubois & Gadde, 2002). This implies an iterative development between the data collection, data analysis and theory. After reading the extant literature, we created a theoretical framework that relies on an analogous application of TCE in order to provide a foundation for the data analysis. This provides the research with focus and a foundation on which the study can be grounded (Eisenhardt, 1989).

Important issues in our data analysis were to identify the governance structures, their type of adaptation capacity and what type of transaction costs that are associated with the different governance structures. Firstly, we used our theoretical framework based on Williamson's (1991) definition of a governance structure to identify the governance structures in Norway and England, respectively. Specifically, we studied our data in combination with previous research findings, in order to map these accumulated findings with our theoretical framework. As such, empirics were mapped in accordance with the contract law regime, incentive intensity and administrative controls and we concluded whether these aspects work in an internally consistent manner in order to achieve a desirable adaptation capacity to constitute a governance structure. We also investigated what type of contract law regime it is and how strong the incentive intensity and administration controls are, to determine whether the governance structures resemble a market, a hybrid or a hierarchical mode. Secondly, we identified transaction costs and investigated whether they stemmed from maladaptation costs or bureaucratic costs. We distinguished between these two cost groups by asking ourselves whether the cost stemmed from indicators that are associated with opportunistic behaviour from actors (maladaptation costs), or whether they stemmed from attempts to prevent opportunistic behaviour, i.e. administrative controls (bureaucratic costs). We categorised the maladaptation costs based on these two drivers of opportunistic behaviour, i.e. information asymmetry and heterogeneous priorities. Hence, higher degree of information asymmetry and heterogeneous priorities are associated with more opportunistic behaviour. Finally, we

categorised the transaction costs according to which transaction characteristic dimension and governance structure they best aligned with.

| No. | Date | Length | Stakeholder role | Geographic expertise | Transcript |
|---|---|---|---|---|---|
| **1** | 29-02-2016 | 60 min | Financial advisor bank | Norway | N |
| **2** | 07-03-2016 | 110 min | Financial advisor bank | England | N |
| **3** | 08-03-2016 | 105 min | Financial advisor bank | England | N |
| **4** | 10-03-2016 | 105 min | Bond Trustee | Norway | N |
| **5** | 15-03-2016 | 60 min | Financial advisor bank | England | Y |
| **6** | 17-03-2016 | 70 min | Financial advisor bank | Norway/England | Y |
| **7** | 17-03-2016 | 50 min | Financial advisor debtor | Norway/England | Y |
| **8** | 22-03-2016 | 65 min | Bank | Norway/England | Y |
| **9** | 22-03-2016 | 60 min | Financial advisor bondholder | Norway | Y |
| **10** | 23-03-2016 | 60 min | Bank | Norway | Y |
| **11** | 05-04-2016 | 70 min | Financial advisor debtor | Norway/England | Y |
| **12** | 05-04-2016 | 70 min | Bond Trustee | Norway | Y |
| **13** | 15-04-2016 | 20 min | Academic scholar | Norway/England | N |
| **14** | 18-04-2016 | 40 min | Legal advisor debtor/bank | Norway/England | N |
| **15** | 20-04-2016 | 60 min | Financial advisor bank | England | N |

*Table 1. Interviewee list. N = No, Y = Yes*

Another central issue of the data analysis was to analyse what potential impact the changed environment in England has had on the London Approach's social norms. Thus, we initially searched for potentially newly incurred maladaptation costs in the informal debt restructuring procedure in England. However, our data indicated that there were no significant increases in the maladaptation costs, thus the London Approach was deemed to still be robust. As such,

we analysed whether there had been any changes in the adaptation capacity for the English debt restructuring governance structures.

# 4. Case findings: Debt restructuring procedures in Norway and England

In this section, firstly, we portray the actors involved and the environment in which debt restructurings are performed to further understand the possible conflicts of interest between the actors. Secondly, we describe and compare the formal debt restructuring procedures in Norway to England. Thereafter, we do the same for the informal debt restructuring procedures.

## 4.1 Actors and the capital environment in debt restructuring procedures

Although the actors involved in debt restructuring procedures vary for each case, the major groups of actors that are involved to various extents in debt restructuring procedures in both England and Norway include (1) the debtor (the company itself) and creditors, i.e. (2) banks, (3) bondholders and (4) suppliers. There are also (5) shareholders, (6) financial and (7) legal advisors that support the debtor and the creditors and, finally, some sort of (8) intermediary agent that facilitates communication between the bondholders and the company.

By the law there is a priority order for each capital instrument on the firm's balance sheet, on which creditors and shareholders have a secured or unsecured claim on when the firm is insolvent. As such, ideally it should be clear how the cash flows should be divided among the actors without implications. Actors with higher priority rights should receive payment first and those with lower should be paid last. Although, a creditor with a low priority still has a first claim on an asset if he has a security. To simplify, bank creditors are most often more prioritised than other creditor groups. Bonds tend to be high-yield and thus lack security, hence, they are subordinated next to bank debt. However, as the extant literature as well as our empirics indicates, there are deviations from the absolute priority order due to opportunistic behaviour.

Two financers to the financially distressed firm are the shareholders and suppliers, if they sell on credit. Shareholders' equity share in the company is according to the law in both jurisdictions the most subordinated in a debt restructuring, hence they have a residual claim. However, they can potentially have an impact on more senior creditors in debt restructurings if their approval is needed in order to issue new equity instruments that can help to solve liquidity issues for the financially distressed firm. If shareholders oppose an informal debt restructuring solution, they usually receive a small share of the total value of the firm (often around 5%), in order to cooperate in order for the more senior creditors to avoid prolonged or interrupted negotiations. Suppliers are also far down in the priority order in both jurisdictions. Suppliers, on the other hand, tend not to have a particularly large role in debt restructurings. In order to keep operations going and avoid that too much information about the debt restructuring leaks to the public, suppliers are managed separately and often receive full payment for what they have delivered to the distressed firm.

The often most economic important groups of actors in debt restructurings are the banks and bondholders, as these two creditor groups often stand for the largest amount of financing to the firm and are often the most senior creditor groups. Importantly, they also have the right to enforce their claims, which can lead to liquidation. As the company is in need for financial leeway to remain as going concern, these two creditor groups need to do sacrifices with

respect to face values, coupons, maturities and interest rates to push the financially distressed firm in the right direction. The conflicts and potential opportunistic behaviour usually involve issues around how large the sacrifices should be from each of these creditor groups but also between the individual creditors within the groups.

The bank creditors can either lend on a stand-alone basis to a company, or in a bank syndicate, which is a loan that is done in collaboration with other banks. Consequently, the conflict of interest within the group of bank creditors can vary dependent on what type of loan that is outstanding. Bondholders can be of various kinds, from more experienced hedge funds to institutional investors whose competences vary. Bondholders' intention of owing the bonds can vary, where some have a short-term and other have long-term perspective. Dependent on the type of bondholder, the conflict of interest can be augmented if there are more heterogeneous priorities. The bond agent's role is to represent the voice of the bondholders that are gathered in a bondholder's committee to reach some sort of consensus among the bondholders.

A factor that greatly influences the conflict of interest between and among creditors is the capital environment. Both countries have experienced changes in its capital environment, where there is a trend towards increased global capital flows. Relationship lending is a key feature of Norway's financial system, which is due to the country's "little club of banks", i.e. a label an interviewee used to refer to the country's relatively few banks. This has the effect that there is an environment where ones reputation quickly spreads. Lately, however, due to the increase in international high-yield bonds, international capital has flown in the country from investors that are less accustomed to the Norwegian lending culture. Norwegian companies that want to take on new loans, but for different reasons cannot receive a loan from the bank, often find high-yield bonds an attractive alternative. However, these companies have little or no experience from doing business with international investors that usually are professional and have a high transactional, rather than relational, interest in doing business. International actors also behave more confrontational and less consensual. There have also been changes in the English capital market during the recent years. The high-yield bond market has soared in England as well, increasing the variety of actors. There are also more alternative capital providers than banks, where the capital structure among firms have become more complex by actors that have different agendas. This poses threats to the norm driven London Approach, where one of the most important social norms is the relational aspect, i.e. the threat of being excluded from future business (Armour & Deakin, 2001). However, the London Approach is still to a large extent the normative approach that creditors follow in the informal process in England and it helps in avoiding costly conflicts of interests. As one financial advisor based in London put it: "It should be fair, and it is fair if everybody follows what they should be entitled to under law".

## 4.2 The formal debt restructuring procedures

Financially distressed firms need an effective way to restructure their debt. This can be accommodated through formal debt restructuring procedures. Next, the Norwegian and English formal debt restructuring procedures will be described and compared with respect to their ability to perform an effective debt restructuring.

### 4.2.1 The Norwegian formal debt restructuring procedures

There is one formal debt restructuring procedure in Norway, which is gjeldsforhandling. Only the debtor can apply for a gjeldsforhandling. The purpose of gjeldsforhandling is to give the debtor time to negotiate with its creditors. An administrator is appointed by the court, which has the leading role in this procedure to coordinate creditors in order to find a solution to the debt restructuring. The negotiations may proceed for three months, in which they are granted a statutory standstill, and the length of this statutory standstill may be prolonged if approved by court. Gjeldsforhandling is not made public before the process leads to an application of a compulsory composition, i.e. cramdown mechanism, or a voluntary composition. However, secured creditors cannot be cram downed. Another feature relates to the fact that new liquidity is not granted super priority, making it harder to bring in new finance to the company during the procedure (Mellqvist, 2015). Interestingly, although there is a formal debt restructuring procedure in Norway, several financial advisors seem to be unaware of its existence, illustrated by how a financial advisor firmly denied its existence when asked about it. A legal advisor was aware of its existence, but could not mention a single case when it had been used.

### 4.2.2 The English formal debt restructuring procedures

The English insolvency procedures contain many differences in comparison to Norway. In English law, there is primarily three formal debt restructuring procedures, namely (1) a Company Voluntary Agreement (CVA), (2) schemes of arrangement and (3) administration. In practice, number two and three are sometimes combined to form a fourth additional option, namely (4) a scheme twinned with administration.

A *CVA* can be used before a firm becomes insolvent, to restructure a firm's debts and rescue the company in an early stage. The purpose of the CVA is to enable the debtor to find compromises with its creditors. However, if it is in administration, an administrator can initiate the procedure and be in charge of the company's operations. Otherwise, the company's directors can initiate the procedure as well. A debt restructuring practitioner will often be involved as a nominee and thereafter as a supervisor of the CVA, but there is still a state of debtor in possession, meaning that the company remain control throughout the CVA process. The creditors are summoned to a meeting that does not have to be approved by all creditors. Hence, the CVA has a cramdown possibility. However, a CVA cannot bind secured creditor without their consent. The creditors are not divided into classes and it is only one meeting. If the proposal is approved, it is binding for the company and the creditors who had the possibility to vote on the meeting. However, there is also minority protection through the role of the nominee and the ability of the minority to challenge the proposal in-court if it is seen as unfair. In addition, there is a lack of statutory standstill when trying to put a CVA in place.

*Schemes of arrangement* can be used regardless of whether the company is solvent or insolvent, similar to the CVA, thus enabling creditors to act early. The schemes procedure is structured in three stages. The first requires the company and its members or creditors to propose a compromise or arrangement. The company's board will then usually propose the scheme, and an application is thereafter sent to court. Secondly, members and creditors meet in their respective classes to vote on the scheme. If some creditors disagree to the scheme, there is a cramdown possibility to get it approved. It can also bind secured creditors, thereby removing or modifying securities. However, one cannot cramdown a whole class of creditors, i.e. secured creditors cannot bind subordinated creditors, which on the other hand can be

circumvented through a twinned schemes with administration. Importantly, the company can decide whom to bring to the scheme and if a certain group is considered to not be affected, that group's approval has not to be sought. Thirdly, the court must sanction the scheme.

The downside of this procedure include the fact that it is cumbersome, partially explained by that the class meetings are complex and often difficult, where the firm must produce extensive statements. There is also a protection to minority interests by the court. Moreover, there is no statutory standstill between the formulation of the scheme and when it becomes effective. Hence, during this period each individual creditor can exercise its rights and remedies they have towards the firm. This means that a creditor can enforce its rights during this period, without considering the majority of creditors.

*Administration* is in contrast to the CVA and schemes of arrangement a procedure targeted for insolvent companies. Further, there are cramdown possibilities, but there are none that can cram down secured debt. It is also no debtor-in-possession proceeding, which the other two mentioned procedures are. Rather, in an administration, an administrator (i.e. external manager) is appointed by the court to manage the firm. The administrator can trade freely, and dispose of the firm's assets. The administrator must serve the interests of all the company's creditors. The company can also agree upon a pre-pack, meaning that it reaches an agreement prior to going into administration, where it agrees to sale its business or all its assets. This option is made with the agreement of an insolvency practitioner and the firm's creditors. Often, it can be sold back to its existing management or senior lenders. This enables a rapid sale, which preserves value and goodwill. The administration procedure includes a statutory standstill for the enforcement of claims.

Another option that has become more frequently used lately is *schemes twinned with administration*, i.e. when a scheme of arrangement is combined with a pre-pack administration. A few of the features that schemes provide, namely its cramdown possibilities for secured as well as unsecured creditors can be combined with features that administration provides, e.g. the statutory standstill. Although schemes cannot cram down creditors across classes, this combined option provides a solution to this issue. Thus, this option can be used when out of the money creditors with a low legal priority act opportunistic, for instance adopting a hold-up behaviour. To explain this procedure, the MyTravel Group Plc case serves as a good example. MyTravel was insolvent, but instead of entering liquidation, the group's business was sold to a new company owned by the senior lenders, using a pre-pack. The senior lenders' debt was restructured via a scheme. This could be achieved without involving the junior creditors, as they were out of the money (the company's assets were not even able to pay the debts of the senior lenders). The schemes procedure enables the company to exclude creditors whose rights are unaffected by the scheme. The junior creditors were thereby left behind in the old company with their claims that in essence were worth nothing, since the assets had been transferred to the new company. The junior creditors were thus not part of the scheme and could not vote against it. The threat of this scheme in the described case was enough to encourage bondholders to agree to a consensual debt restructuring. The method has, however, not been thoroughly tested. There are other cases, including the one described above that have not been fully approved by court (Payne, 2014).

### 4.2.3 Differences between Norway and England's formal debt restructuring procedures

There are primarily two differences between Norway and England's formal debt restructuring processes. The first relate to the fact that gjeldsforhandling is seldom used, which leads to that

judges and administrators are potentially less experienced of working with debt restructurings. Hence, this increases uncertainty among actors with regard to how the outcome of the process will look like. The second aspect relates to that there are fewer cramdown mechanisms in Norway. This is partially due to the fact that only the debtor applies for it, implying that creditors cannot use the formal cramdown mechanisms unless an agreement to apply for a gjeldsforhandling is done between the creditors and the debtor. England also has a larger variety of formal debt restructuring procedures with different types of cramdowns. As the literature indicates, the English procedures are even more flexible in the sense that new types of debt restructuring procedures have emerged that allow creditors to combine cramdowns in ways that cannot be done in Norway.

The formal debt restructuring procedure in Norway is less nuanced in its design in contrast to England. The differences between Norway and England's formal procedures have, however, an impact on the informal procedure, considering how social norms and legal rules work intertwined in the informal process as previous literature has indicated.

## 4.3 The informal debt restructuring procedures

When considering the informal debt restructuring procedures, both jurisdictions' procedures have some similarities. The informal debt restructuring procedure can be outlined in the following three stages of activity (see fig. 3): It starts with a *financial event*, followed by a *company analysis* and ends with *negotiations* where actors either find a solution to the debt restructuring or are forced to enter a formal debt restructuring procedure or to liquidate the company. Due to the structural similarities, we will first describe the informal debt restructuring procedures in which there are coherences between Norway and England. Then, we will point out differences between the jurisdictions informal debt restructuring procedures.

A *financial event* occurs when a bank or bond covenant is breached in the lending agreements with the firm. If not already aware, a company's more prioritised creditors, i.e. bank lenders and or bondholders, realise that a company may be under financial distress when this happens. The initiative to commence further analysis of the situation is thus taken from a creditor. In these cases, the creditors take on a more active role and try to evaluate whether this is a one-time event or a symptom that the company is expected to become even more financially fragile. If the case is the former, the situation can often be managed in a consensually manner between the creditor(s) and the company. If it is the latter, financial and legal advisors are often involved to analyse the company's financial and operational situation, and the second phase of the informal debt restructuring commences.

The financial event in Norway and England has lately become more triggered by breaches in the bondholder lending agreements, rather than solely by banks. Parts of the bond capital stem from aggressive vultures funds. These funds have bought bonds at a discount and have incentives to start a debt restructuring to increase the value of their investment. On the other hand, bank loans have, in comparison to high-yield bonds, relative strong covenants. The stronger covenants help the banks to start a debt restructuring earlier and thereby proactively decrease the risk for value being destroyed when the firm is under financial distress.

In the *company analysis*, banks meet up early in the process and agree to a standstill to prevent enforcement of claims. They then gather information with the help from financial advisors about the situation for the financially distressed firm and learn about each other's opinions. Usually, there are e.g. two or three lead banks in a syndicate of ten banks that work

as a coordinating group, whose goal is to reach a consensus on what can be done among the creditors within the bank syndicate. The financial advisors, on behalf of creditors, develop an Independent Business Review (IBR) to evaluate whether the company is only financially distressed. If the advisors find this is the case, they go back to a point in time to when the company was profitable and try to understand why the company went distressed and investigate possibilities to solve the situation. The IBR also involves sorting out how liquid the company is, in terms of cash and available credit facilities. It is essential to understand if the firm has enough short-term liquidity to maintain its status as a going concern. Often new funds need to be found. You typically have short-term engagement with creditors to know what sources of liquidity that can be brought in to the company in a short term to fund the process. Funding can include deferral of outstanding repayments or fresh borrowing from current or new creditors. There is an accepted principle that fresh borrowings often are granted super-priority in both countries. In order to determine a sustainable capital structure for the firm, the company's management team in conjunction with financial advisors develops a restructuring plan. The document outlines what the company can do in a period of 1-5 years in the future to get as much profit and cash as possible. It differs from a business plan, since the business plan has an element of opportunism to it. A restructuring plan focuses on things that are under the company's control, such as expected costs. Revenue and margin growth, on the other hand, are determined by less controllable things such as customer sales, which might be associated with the market performance. This plan suggests the level of debt that the company can have, i.e. making it possible for the advisors in collaboration with the creditors and the company to design a capital structure that the company can afford. The plan also portrays the liquidity situation, showing whether the firm is liquid enough to keep maintain its operations. The financial advisors cooperate with legal advisors to understand whether the new capital structure will work legally in terms of the current credit agreements and potentially newly written agreements.

Bondholders' coordination and collaboration during the company analysis are handled via an intermediary bond agent in both jurisdictions. The intermediary bond agent in the Norway is the Nordic Trustee, whereas Law Debenture works as the bond agent in most cases in England. Both agents have an administrative role in gathering information and coordinating the bondholders to reach some sort of consensus on how they assess the situation for the firm. The bond agents' main task is to act as a filter between the debtor and the bondholders.

When a sustainable capital structure for the firm has been proposed, *negotiations* will start. Initially, key assumptions are tested to determine whether the restructuring plan is achievable or not, by having the restructuring plan subjected to a third-party review, by financial and legal advisors to the different creditors involved. In other words, the restructuring plan is the first part of the negotiations, where the firm and creditors try to agree upon which level of cash flow that is expected from the company in the future. After agreeing on a capital structure, negotiations commence that aim to determine how to restructure the debt in order to reach this capital structure. Areas that the creditors in negotiations might have to agree upon include amendments in the maturity of debt, amortisation, interest rates and covenants. The lending agreements for private bank debt stipulate that the first three have to be agreed by all creditors in order to do amendments. Covenants, on the other hand, can be amended if a certain threshold of the banks agrees on it. During negotiations, discussions concerning amendments of covenants are similar in the two jurisdictions. The amendments are based on a view of the future, with a forecast of future expected cash flows and what headroom the company wants on the current covenants. Potentially, the covenants are set up in a way that is deemed appropriate for the business. The company usually wants higher headroom than the

bank wants to provide it with, which serves as a starting point for negotiations. The banks also stress test the covenants, to avoid that the firm breaches them again. In negotiations, creditors usually accept their position as it is defined in law. The company usually share information openly to all creditors. However, value is destroyed when actors that behave opportunistic do not respect these principles.

Similar to the previous literature, our empirics indicate that mainly two aspects increase opportunistic behaviour, i.e. heterogeneous priorities and information asymmetry. Firstly, with regards to heterogeneous priorities, some bondholders hold bonds at par value, while other buy bonds at a discount. Negotiations are more likely to go smooth if all bondholders would either hold their bond at par or at a discount, compared to if there were a mix. The differences in priorities of these two types lead to that they behave differently in negotiations. The former is well aware of that he will receive a relatively small amount of money from a possible liquidation, i.e. the "nuclear option", and is thus more motivated to bargain for a consensual solution that helps everybody, while the latter that bought in cheaply has a relatively higher upside potential from a possible liquidation through enforcement of his claims. As the bondholder that represents the latter is awarded by how much he manages to increase the value of the bond, he will behave more aggressive if he believes this will serve his purpose. Hence, the bondholder as an additional creditor does not only have conflicts within their group, but they also make negotiations more complex, since their interests also differ from bank creditors. Thus, heterogeneous priorities make it harder to come up with a coherent strategy in the negotiations that has to be agreed by and maintained by all.

*If you're at par you want the company rescued. If you're at the discount you look more at getting a short-term gain that is good for you but you don't look at the entire picture. - Financial Advisor*

To avoid the issue of heterogeneous priorities related to early enforcement, standstill agreements are put in place. In both jurisdictions, standstill agreements are often agreed upon between the firm and its creditors to prevent lenders from demanding their claim on the firm, thereby protecting the firm from liquidation while negotiations are ongoing.

Secondly, information asymmetry is evident during negotiations where you in contrast to banks, do not know who the bondholders are. "They are faceless", as an advisor put it. While another creditor can build a long-term relationship with a bank and learn about whether they are aggressive or conservative in negotiations, the same is not as clear with bondholders. It becomes harder to know at which price they bought the bond at and what their agenda is, which causes problems in the negotiations since the other creditors involved in the negotiations are not sure how to tackle them. Bondholders are often offshore tax havens and thus become hard to initiate a conversation with.

There are mechanisms that serve to reduce the information asymmetry. Firstly, the appointed lead banks facilitate the communication with bondholders and the debtor. Bond agents, work as an arbitrator and organiser between bondholders. Thus, the bondholders can easier agree as a group via the bond agent and then start negotiate with bank creditors and the company. The arbitrator is beneficial in the sense that it is good to have a third-party with a broad understanding of the process that also is objective in the negotiations between the bondholders, debtor and bank creditors. Secondly, the relationship that the creditors have with the company is important during negotiations to decrease the information asymmetry and shorten the time used in the negotiations. As two creditors put it, it becomes easier to share

the burden and make the debt restructuring process less time-consuming if you can have an open dialogue with the debtor from the very beginning. Both the creditors and the debtor must make concessions, and this is easier to achieve if you have a friendly rather than a hostile debtor. If the latter is the case, the process might be prolonged since you must ensure yourself that the debtor has no hidden agenda.

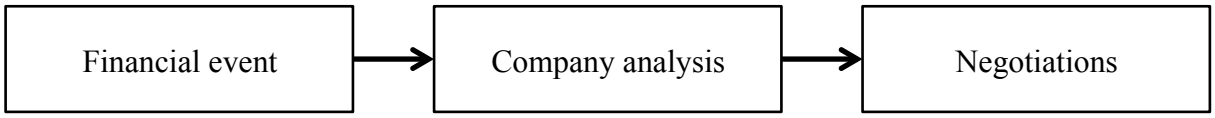


*Figure 3. The informal debt restructuring procedure.*

### 4.3.1 Differences between Norway and England's informal debt restructuring procedures

A comparison of the *financial event* between the jurisdictions provides some interesting findings. The Norwegian high-yield bonds' documentation requirements are more lax in comparison to the high-yield bonds issued in England. The documentation requirements in Norway have been criticised. As more and more international capital has flown in the Norwegian market, the documentation has not caught up. Mistakes were made in the documentation and those mistakes were not always picked up and learnt from, illustrated by the following quote:

*This what we did the last time, let us do exactly the same again – Financial advisor*

Several advisors believe that if more international capital flows into Norway, an overhaul of the current documentation requirements might be necessary. Although international bondholders, in particular hedge funds, enjoy the speed of movement that is associated with the low documentation requirements, they often wonder why certain aspects were not documented if things go wrong. To quote an advisor, "Hindsight is always a good thing, isn't? Act in haste – repent at leisure". Whether you prefer lax or more thorough documentation depends on whom you represents. The banks are more cautious than the hedge funds, whereas the latter is more deal-driven. It is thus no coincidence that so much deal-driven international capital flows into Norway.

During the *company analysis*, although the agreement of a standstill to prevent enforcement of claims exists in both jurisdictions, the standstill is legitimated in different ways. In the case of England, the London Approach supports this explicitly. In Norway it is done more implicitly, where the fairly small capital environment enhances relations between banks and thus work as a substitute for a standstill. Thus, if a bank was not to cooperate, it could hurt its reputation and impede future business.

The information gathering process, in which advisors request information from the debtor is slightly different in Norway compared to England in the company analysis. First, the culture in Norway is more individualistic, illustrated by the following quote:

*If you forcefully instruct an employee in England, then they do what they are told. If you do the same in Norway, employees do something different instead. – Financial Advisor*

This has the implication in Norway that when the relationship between the advisors and the debtor is well functioning, the advisors receive the requested information in time without

remarks. However, in cases where the relationship is not working, the process is prolonged and or advisors are unable to gather the necessary information. In England, more actors are often involved which also prolongs the process, however, you receive the information you request.

In *negotiations*, the empirics indicate that heterogeneous priorities, one of the drivers of opportunistic behaviour, have increased in Norway both among bondholders as well between banks and bondholders. This is firstly evident among bondholders by observing how the increase among international bondholders in the Norwegian high-yield bond market has changed the dynamics in the Norwegian debt restructuring. There are mainly two types of Norwegian bondholders, either the long-term Norwegian retail and institutional type or the short-term international hedge fund type. Although the Norwegian retail and institutional bondholders have become more experienced after the recent financial crisis in 2008, they still have relatively little experience, in contrast to England, about debt restructuring and tend to hold the bonds at par value. On the one hand, they are usually less active and not as tough in negotiations, on the other hand, they are less educated about debt restructuring and have a lower understanding of the dynamics in negotiations than in England. Advisors and other arbitrators in Norway also try to educate less experienced actors about what a debt restructuring is. Although international hedge fund bondholders are more active and confrontational in negotiations, since many have bought the bonds at a discount and have an incentive to increase the bond value, they are also more experienced than Norwegian bondholders and more accustomed to negotiate, which makes the process more efficient.

Norway also has a relatively more illiquid bank debt market in comparison to England, which contributes to increased heterogeneous priorities. This is partially due to the fact that banks in Norway consider it to have a negative impact on their relationships with debtors when selling their loans to other creditors. Banks that hold loans at par have higher incentives to find a consensual solution to preserve as much firm value as possible. Thus, these banks have other priorities than the more confrontational international bondholders, and this risk to increase opportunistic behaviour.

Heterogeneous priorities are in general augmented by the fact that there is a more holistic approach towards the creditors involved in the debt restructurings in Norway compared to England. You have to have all the creditors around the table in Norway to reach a consensus, due to the country's lack of cramdown possibilities. Hence, subordinated bondholders must be more involved in the Norwegian negotiation process. Occasionally, banks have tried to exclude the bondholders from the negotiations in Norway, which have not helped the parties to reach an agreement. According to one Norwegian practitioner, the bondholders are not even interested to hear the proposal if they have not been involved earlier in the negotiations. This dynamic is important, since bondholders have the possibility to enforce their claims, which can lead to a costly liquidation.

There are various tools available to prevent opportunistic behaviour that stems from heterogeneous priorities, where the first is the standstill agreement and the second is the cramdown mechanism. Firstly, similar to the stage of company analysis, the London Approach supports standstills explicitly for both bank and bond debt, while the relational aspect in Norway implicitly supports it. In regards to bondholders, there is a precedent on a no-action clause in the Norwegian bond agreements that work as a standstill agreement. Secondly, in England, formal cramdown mechanisms in the various formal debt restructuring procedures are used as leverage in negotiations. In contrast, Norway has fewer formal

possibilities to cram down creditors, implying that the cramdown mechanisms in isolation are unable to fully prevent opportunistic behaviour. However, the Norwegian bond agreements allow non-cooperative bondholders to be cram downed out-of-court by other bondholders.

As the Norwegian legal system has fewer cramdown possibilities, the company's Centre of Main Interest (COMI) is of relevance. The COMI determines in which jurisdiction a company can undertake a legal insolvency proceeding. Companies and creditors are quite flexible in determining where they have their COMI, meaning that another country's jurisdiction can be used for a group of or for all creditors and the debtor. The loan documentation is also adapted according to Loan Market Association-standard, an international best practice in standard loan documentation, so creditors simply can adapt it to be used under English insolvency law. As a result, the COMI concept has the implication that you cannot analyse a jurisdiction in isolation. Although no case so far has been documented where a Norwegian reorganisation has been done under English insolvency legislation, the mere possibility to change the jurisdiction through the use of the COMI aspect, enables creditors, in particular banks, to use this as leverage in negotiations as a possible contingency outcome. Since English insolvency legislation is more creditor-friendly, in particular for prioritised bank debt, the COMI aspect can be used as a way to deter dissident bondholders to act in an unfavourable way for the bank. COMI is also considered in cases where an agreement on either loan maturity, interest rate or amortization cannot be agreed upon in a bank syndicate, since these factors require unanimous consent in a bank syndicate under the Norwegian jurisdiction.

A final difference between Norway and England relates to the Norwegian process' arbitrator to reduce information asymmetry, the Nordic Trustee. The Nordic Trustee gathers information and tries to find a debt restructuring solution that is fair to all the bondholders, the company and bank creditors. The bond agents' function differ somewhat between England and Norway. Law debenture is more focused on compliance and work mostly as a "post box" between the company, bondholders and bank creditors. Nordic Trustee, on the other hand, has a more pragmatic approach. Nordic Trustee acts more proactively in finding a consensus than its English counterpart among does. However, the bond agents do not participate in negotiations.

# 5. Discussion

## 5.1 Debt restructuring from a TCE-perspective

Evidently, there is firstly a gap in the existing literature in regards to the trade-off of choosing an informal or formal debt restructuring procedure (Gilson 2012; Becker & Strömberg, 2012). Clearly, in order to minimise total transactions one must consider the trade-off between bureaucratic costs versus maladaptation costs in the debt restructuring procedures (Gilson, 2012). As TCE suggests, an economic efficient trade-off can be achieved by choosing a governance structure with a suitable adaptation capacity that is aligned with the transaction characteristics. Secondly, there is a gap in the literature with respect to how social norms and legal rules work intertwined in reducing opportunism in the informal debt restructuring procedure in a civil law jurisdiction (Armour & Deakin, 2001). These social norms and legal rules seem to prevail in both Norway and England. We argue that these aspects resemble administrative controls, in their shared purpose to reduce opportunistic behaviour. Although, we find it practical to emphasise whether they stem from social norms or legal rules as it distinguishes their characteristics. Hence, based on the definition of governance structures, we understand the rationale to how social and legal administrative controls work intertwined, as

their aim is to work internally consistent in order to achieve a desired adaptation capacity in the informal governance structure of debt restructurings.

Our findings provide further insights to the analysis of Armour and Deakin (2001), which structure the stages of activity in the informal debt restructuring procedure in a notification and a negotiation stage, whereas we structured the process in three stages. This categorisation enabled us to more clearly map out each and every transaction cost that stands out in the informal debt restructuring procedures. Moreover, our findings suggest that the trade-off in Norway has had the result that the Norwegian debt restructuring processes are maladapted in some areas. Table 2-3 summarise the main differences in transaction costs and its drivers between Norway and England for both the informal and formal debt restructuring processes, based on the methodology as described in section 3.3. The transaction costs will be more thoroughly discussed in section 5.1.1. Note, however, that only major transaction costs and drivers that stand out in contrast to the other jurisdiction are mentioned.

### 5.1.1 Norway and England's debt restructuring governance structures

In determining whether a certain debt restructuring process is a governance structure, we refer to Williamson's (1991) definition, of whether these administrative controls and incentives work in an internally consistent manner to achieve a desirable adaptation capacity. The financial event due to its nature occurs informally, as actors then choose whether to continue the process informally or to undertake a formal process. On the other hand, actors' choice of governance structure depends on the company analysis and negotiations. The transaction characteristics and the adaptation capacity of the governance structure determine whether these two stages will be effectively performed informally or formally.

Our findings suggest that the debt restructuring processes in Norway is constituted of two governance structures, namely the informal and formal debt restructuring process (gjeldsforhandling). We have identified five governance structures in England, namely one informal and four formal debt restructuring processes. The formal debt restructuring processes are schemes of arrangement, CVA, administration and the recently developed method schemes twinned with administration. Our findings suggest that these governance structures use different social and legal administrative controls to seek an adaptation mode that bests minimises transaction costs.

The informal debt restructuring procedure in Norway resembles a hybrid governance structure. Firstly, there are incentives for all individual creditors to find a debt restructuring agreement, as this will increase the expected share of the firm value for every creditor. For a financially distressed firm, even creditors that are out of the money should be incentivised to restructure the debt, since you still have a chance to receive a share of the future going concern value. However, occasionally, some creditors might have incentives to act suboptimal in order to gain a higher share at the expense of destroyed firm value. Hence, since each creditor's share in the firm's assets is worth less after such behaviour, there is a dependency between the creditors. Secondly, social and legal administrative controls introduce the opportunity to realise mutual gains for all creditors if this opportunistic behaviour can be controlled for and minimised. Legal administrative controls in the Norwegian informal debt restructuring process include Nordic Trustee's cramdown possibility and the no-action clause of bondholders, while social administrative controls include the standstills banks usually initiate when operating in syndicates. Another legal administrative control relates to the low documentation requirements that are prepared when new bonds are issued. In addition, actors

are incentivised to cooperate and to find a mutual understanding due to the social administrative controls of relationships, while those who act deceptively are punished. Thirdly, as the parties involved in the procedure are dependent on one another to find an agreement, coordinating discussions take place. Our findings for the Norwegian informal debt restructuring procedure suggest that there are bilateral discussions between bank syndicates and a bondholder representative. There are also multilateral discussions within each creditor class. A lead bank, an arbitrator appointed based on a social administrative control, often

| **Norway in contrast to England** | **Frequency** | **Uncertainty and risk** | **Asset specificity** |
|---|---|---|---|
| **Financial event** | | **1. MC(N):** Lax documentation requirements lead to information asymmetry, where processes risk being delayed that might destroy firm value. | |
| **Company analysis** | **2. MC(N):** If malfunctioning social administrative controls, individualism increases level of information asymmetry. | | |
| **Negotiations** | | **3. MC(N):** Holistic approach leads to more actors involved, thus more heterogeneous priorities.<br>**5. MC(N):** Fewer formal administrative controls increase the credibility of threats from opportunism.<br>**6. MC(N):** Lax documentation requirements increase information asymmetry, making it harder to know who you negotiate with.<br>**7. BC(E):** Higher documentation requirements are legal administrative controls that increase bureaucratic costs in terms of higher compliance.<br>**8. BC(N):** Legal administrative controls to educate bondholders are costly.<br>**9. BC(N):** The legal administrative control of the Nordic Trustee to coordinate induces bureaucratic costs.<br>**10. MC(E):** The legal administrative control of the Nordic Trustee to coordinate reduces maladaptation costs. | **4. MC(N):** Illiquid bank debt market in combination with more liquid bond market, increases heterogeneous priorities. |

*Table 2. Transaction costs and its drivers in Norway compared to England's informal debt restructuring process. MC = Maladaptation cost, BC = Bureaucratic cost. N = the cost is higher in Norway, E = the cost is higher in England.*

| Norway in contrast to England | Frequency | Uncertainty and risk | Asset specificity |
|---|---|---|---|
| **Formal debt restructuring** | | **1. BC(N):** Seldom used, leading to a lack of experience of judges and administrators making unpredictable and possibly value destructive decisions. **2. BC(E):** More legal administrative controls in terms of cramdown mechanisms increase bureaucratic costs. | |

*Table 3. Transaction costs and its drivers in Norway compared to England's formal debt restructuring process. MC = Maladaptation cost, BC = Bureaucratic cost. N = the cost is higher in Norway, E = the cost is higher in England.*

coordinates discussions in the bank syndicate. The Nordic Trustee, another arbitrator appointed by a legal administrative control, coordinates discussions among bondholders. The precedent on the Trustee's ability to initiate a no-action clause and cramdown possibilities, further enhances its legal authority. Overall, adaptation in the informal debt restructuring governance structure is arguably based on both some coordination aspects as well as on autonomy.

England's informal procedure is arguably a hybrid governance structure as well, although more hierarchical than its Norwegian counterpart. The procedure has logically many similarities to Norway's with regard to incentives, as the creditors are incentivised to avoid a costly liquidation. However, social and legal administrative controls vary. Our findings suggest that there are legal administrative controls in terms of stronger debt documentation requirements in England than in Norway. England's more compliance focused bondholder coordinator is a legal administrative control that rarely crams down opportunistic bondholders. Instead, England's formal procedure works intertwined with the informal and actors often threat to use the legal administrative controls associated with them in negotiations, for instance cramdown mechanisms. Hence, actors account for these legal administrative controls in the informal procedure, when they deliberate to find a strategy and occasionally use them as leverage in negotiations. Further, the ability to coordinate actors, primarily banks and bondholders, is facilitated through the London approach, a social administrative control. This social administrative control encourages bank creditors to appoint a lead bank, an arbitrator, to coordinate other bank creditors. The social administrative control is designed to decrease hold-out behaviour among banks as unanimous consent is required for major changes in the bank debt agreements. If not cooperating, they are threatened from future business. In addition, the social administrative control of the London Approach is also evident amongst bondholders, although not as clearly as for the bank. However, there are also legal administrative controls in terms of cramdown possibilities, in the bondholder agreements. The London Approach also encourages actors to initiate a standstill, in order for the concerned actors to find an agreement. Similar to Norway, adaptation occurs autonomously as well as coordinative. Arguably, the informal process is more coordinative in England than in Norway in the sense that the London Approach is perceived as being more

explicit and more articulated in coordinating actors. Also, England's more creditor friendly insolvency code is beneficial for creditors during the informal process, since they can use this as leverage and thereby gain a stronger coordinative role.

Both the Norwegian and English informal debt restructuring processes are consistent with the neoclassical contract law. However, in contrast to England, there are signs that the governance structure is maladapted on several areas in Norway's informal debt restructuring process, which yields maladaptation costs driven by opportunistic behaviour. Specifically, ten differences in transaction costs have been identified to stand out in Norway (see table 2).

(1) Maladaptation costs can be identified at the financial event. Information asymmetry increases due to lax documentation requirements related to issuance of Norwegian high-yields bonds. This can have several consequences, where the firm, which possesses an informational advantage, might opportunistically withhold information to bondholders about its financial situation. This can have the effect that bondholders are involved in the process later, where, the process can be delayed and firm value is destroyed. (2) During the company analysis, our findings suggest that malfunctioning social administrative controls risk to increase maladaptation costs illustrated by the outcome from bad relationships. In these cases, debtors are discouraged to share information, which increases the information asymmetry between those performing the analysis and the firm. Although bad relationships are arguably value destructive in England as well, the individualistic nature of business in Norway increases the risk of opportunistic behaviour. (3) Norway's holistic approach has the effect that more actors are involved with more heterogeneous priorities. Bondholders' interests differ from banks and from one another, leading to conflicts within as well as between creditor groups, which risk leading to increased opportunistic behaviour.

(4) There is also an issue of heterogeneous priorities, as Norway's illiquid bank debt market potentially can lead to that bank debt holders are of different types, since some have bought debt at a discount while others hold it at face value. On the other hand, this phenomenon can be argued to exist in England as well, since it is likely to assume that some actors hold bank debt at face value, even if the liquidity for bank debt is higher. However, when contrasting the liquidity between bonds and bank debt, there are larger differences in Norway than in England, where the former has a more liquid market for its bonds than for its bank debt. Hence, when comparing bank debt holders to bondholders, actors are more heterogeneous in Norway than in England, which makes it harder to agree upon a consensual solution and thus risks leading to opportunistic behaviour. (5) Fewer legal administrative controls in terms of cramdown possibilities, lead to that the credibility of opportunistic threats by creditors increases. This is due to the fact that opportunistic creditors are more likely to be expected to gain in Norway than in England. (6) Another aspect relates to the lax documentation requirements that lead to higher information asymmetry between the firm and bondholders. Thus, this makes it harder for actors to know their counterpart and whom they are dealing with, which increases the risk of opportunistic behaviour.

(7) Lax documentation requirements also reduce bureaucratic costs in terms of issuing the bonds, since it is easier to be compliant. Hence, the English documentation requirements induce higher bureaucratic costs due to their higher compliance. (8) There are higher bureaucratic costs due to Nordic Trustee's role as a legal administrative control of educating bondholders about debt restructuring. Bondholders in England are more experienced about English debt restructuring from the start. (9, 10) Finally, Nordic Trustee's role to reduce

information asymmetry in Norway by coordinating bondholders increases bureaucratic costs while it reduces maladaptation costs.

Before we discuss the Norwegian and English formal debt restructuring procedures, it is important to distinguish between the court, which has the final legal decision, and formal debt restructuring procedures that has been given various degrees of authority to find a solution to restructure the debt. The court has appointed an administrator to manage a formal debt restructuring procedure and given the administrator a high degree of discretion to solve conflicts of interest if they were to arise. However, if a creditor has objections against the administrator's solution to a conflict, a creditor can use the court to ensure that the administrator follows what is stipulated in the law when managing the formal debt restructuring procedure. The court has the power to elect as well as to remove an administrator. This is similar to when an employee, for example, can use a labour court when he has objections towards his manager in a particular conflict within a firm. Hence, we argue that the formal debt restructuring procedures are governance structures themselves with the aim to through an authority, i.e. administrator, create a more coordinating adaptation capacity.

The Norwegian formal procedures have strong resemblances to hierarchical structures with a cooperative adaptation capacity. Firstly, the procedure cannot be argued to provide incentives to the parties involved to find a consensus as the coordination is handled via stipulations in gjeldsforhandling. The absolute priority rule within gjeldsforhandling distinguishes between parties that are in and out of the money. Hence, parties often have low or none incentives to cooperate, as the share they will receive is determined beforehand by matching the rights in gjeldsforhandling with what kind of debt it is according to the lending agreements. However, creditors can forego the absolute priority rule with the support from legal administrative controls, i.e. cramdowns, by the use of compulsory composition. Hence, in these cases, there are incentives for the concerned parties to cooperate. Secondly, there are other legal administrative controls in the process that can be used to ensure that the creditors do not behave opportunistic. For example, the statutory standstill delimits the individual contracted ability to collect claims. As such, the administrator's authority is based on what is stipulated in gjeldsforhandling and can overrule individual creditors' ex-ante contracted rights for the collective benefits of all creditors, except from cases there are potential compulsory composition agreements. Thus, gjeldsforhandling and its legal administrative controls are largely consistent with the implicit contract law of forbearance within a hierarchy (Williamson, 1991), but due to the fact that arbitration can be facilitated by the cramdown mechanism, it also has resemblances to neoclassical contract law. Hence, as an analogy to Williamson's (1991) application of the transaction cost theory to organisations, the discretion of the administrator is similar to the discretion of the management of a firm. This analogy also holds true for the governance structures in England's formal debt restructuring procedures, which will be described in the next paragraph in terms of how some administrator is in charge.

There are several formal alternatives for debt restructuring in England. Schemes of arrangement is a hybrid governance structure that provides some individual incentives, since the scheme requires parties to find a compromise that can be sent to court. It also provides legal administrative controls by requiring a certain threshold of creditors to approve the scheme and it thereafter binds the remaining minority to the decision. Also, a legal administrative control relates to the fact that there is a state of debtor in possession, where the firm has some discretion in determining if they perceive that a certain actor is affected by the scheme or not, and can choose whether to bring that actor to the scheme. The firm also has

some discretion when they later propose the scheme to court. As the scheme aims to provide the court with a proposal, it cannot override contracts besides in those cases when it can cram down a claim, consequently, the scheme does not provide full authority. The CVA is also a hybrid and similar to schemes of arrangement in the sense that it also provides individual incentives for the participating actors to find an agreement among each other, and provides several legal administrative controls in terms of cramdown mechanisms to force dissident actors to approve the proposal, with secured creditors as an exception. Another legal administrative control concerns the fact that either the debtor or an appointed administrator is in charge of the process. However, similar to schemes of arrangement there is no full authority to override contract law. Thus, both schemes of arrangement and CVA are consistent with characteristics from the neoclassical contract law, although there are arguably more resemblances to the contract law of forbearance in these procedures than an informal process, due to stronger legal administrative controls.

Similar to gjeldsforhandling, administration has resemblances to a hierarchical structure, as there are low incentives for actors to themselves cooperate, given the priority order in the English law that actors have to follow. Legal administrative controls include a statutory standstill that overrides the contracted ability in bond or bank debt to collect their claim. Another legal administrator control is the appointed administrator that follows similar principles to that of its Norwegian counterpart, in the sense that its aim is to preserve firm value and see to the interest of all the creditors, while it has discretion to make decisions on the behalf of creditors. However, there is a legal administrative control in terms of a cramdown mechanism in this procedure, which gives some incentives to creditors to cooperate if it can increase the value of their claims. The analogy of Williamson (1991) applies here as well, since the administrator can override contract law for the collective good. Thus, the process is largely consistent with the contract law of forbearance, although it also bears features in terms of cramdown mechanisms that are consistent with neoclassical contract law, and there is a cooperative adaption mode under this procedure.

The schemes twinned with administration is a hybrid between schemes of arrangement and administration, as the name indicates. In one sense, it provides incentives to creditors, which perceive that they are in the money, to find an agreement. This would help the firm out of its financial difficulties and reach its potential going concern value, which will increase the creditor's individual share of their claims. It includes various legal administrative controls, such as a statutory standstill and cramdown possibilities for both secured and unsecured creditors. Importantly, in contrast to administration in isolation, it includes the legal administrative control to cram down a different creditor class entirely, which can prevent potential opportunistic behaviour from out of the money bondholders. There is a state of debtor in possession, albeit secured creditors hold a key position in negotiations of the firm's new capital structure before entering the formal administration procedure. Hence, legal administrative controls are not as strong as in a 'pure' administration procedure since there is no appointed administrator during negotiations, but there are some lead actors. Thus, the process has consistencies with neoclassical contract law and some features from the contract law of forbearance. Importantly, as the method has not been thoroughly tested, this option can only be perceived as a governance structure as long as actors recognise it as one.

In table 3, it is summarised how (1) the bureaucratic costs are high in the Norwegian formal debt restructuring procedure in contrast to England, as Norwegian judges and administrators have low experience of working with debt restructurings due to their low frequency, and thus risk acting inefficiently. For instance, this leads to that the administrator's plan and how the

court finally interprets the case is unpredictable and hence uncertain in Norway. England's processes are more frequently used and actors can thus more easily predict the outcome by studying previous cases. Creditors also perceive that the uncertainty is higher, since they lose more control in the Norwegian process than they do in England. (2) England has more legal administrative controls in terms of cramdown mechanisms, however, these come at a higher bureaucratic cost as the apparatus related to them is larger.

Given the different governance structures, our data indicates that actors intentionally choose the governance structure they perceive as least costly, supporting the findings of Gilson (2012). However, as evident in the extant literature this seems be based on the bounded rational assumption that the informal debt restructuring procedures always is less costly (Gilson, 2012), especially in Norway. The assessment of whether the going concern value exceeds the liquidation value is performed early on in the debt restructuring, during the company analysis. The IBR and the debt restructuring plan are arguably proxies for determining the going concern value, as this exercise provides the reader with an understanding of the business situation and the firm's potential in a conservative manner. Since the going concern value should be determined higher than the liquidation value, Norway's informal procedure is in most cases considered the first alternative, whereas gjeldsforhandling is hardly considered. However, as previously discussed, one cannot consider Norway's debt restructuring procedure in isolation but has to consider it in connection to the COMI aspect. This expands Norwegian actors' alternatives to also include the formal procedures in England, but actors' are not always aware of this option.

## 5.2 Changes in the capital environment and possible effects on transaction costs

As was mentioned in the introduction of this paper, there was also a gap in the extant literature regarding how changes in the capital environment may affect the social administrative controls in the London Approach (Armour & Deakin, 2001; Finch, 2008). Armour & Deakin's (2001) predict these changes at the end of their study, as they wonder how the existing system with the London Approach will manage them. By using TCE, our findings provide further insights to how changes in the capital environment may affect the most efficient trade-off between bureaucratic costs and maladaptation costs for a debt restructuring. For example, a change in the environment may lead to an increase in opportunistic behaviour as there is a decreased reputational damage from such behaviour in the new environment. Consequently, there might be a need to increase the social and or legal administrative controls in order to counterbalance this effect. These arguments are supported by our findings.

The shift to a more hierarchical governance structure can be observed in England. England has more legal administrative controls than Norway, since its formal procedures are more developed and used more interchangeably with its informal procedure. This is however not surprising, since the capital environment in England is more transactional than in Norway, thus incentives to cooperate are lower, and the country has a longer experience from working with debt restructuring. However, after Armour & Deakin's (2001) study, there have also been changes in the capital environment of England. Capital structures of companies have become more diverse, complex and transactional, which are factors that reduce the incentive intensity even more. Interestingly, the governance structure has adapted in England, as we can observe from the emergence of a new governance structure, the scheme of arrangement twinned with a pre-pack administration. This alternative provides stronger legal administrative controls to more senior creditors, which can be interpreted as a response to the

increased transactional approach with lower incentives to cooperate. This supports Williamson's (1991) notion, of how lower incentives can be supported by having stronger administrative controls.

When considering possible effects in Norway, due to changes in the capital environment, our findings suggest that the transaction costs stem from different sources. Firstly, there are those that arise from teething problems. The lack of Norwegians experience will likely disappear with time, as more Norwegians become educated about the procedures. Although, it may become more complicated to provide judges with more experience, as this would require more companies to file a formal debt restructuring. Secondly, there are transaction costs that stem from cultural aspects in the country, which are less likely to change in a close time horizon. The social administrative controls stemming from the relationship aspect is cultural, and hence more static, which also is the case for Norwegian individualism and Norway's holistic approach, to include everyone in the process. Thirdly, there are transaction costs that possibly could change. If there is a change in the capital environment, if more international capital flows into Norway from investors with a transactional approach, more suboptimal behaviour can be expected and conflicting agendas. This would attenuate incentives to cooperate, since international investors are less relationship-oriented and more transactional. This could possibly undermine social administrative controls, but by strengthening legal administrative controls these can substitute the lower incentives and thereby ensuring a more effective governance structure with lower transaction costs (Williamson, 1991). For example, more transactional lending can increase transaction costs stemming from lax documentation requirements, since transactional investors are arguably associated with a riskier behaviour and would thus enhance the uncertainty associated with information asymmetry. It would also make the lack of legal administrative controls in terms of cramdown possibilities even more clear, since transactional investors can be expected to act more opportunistic. Thus, the governance structure would have to adapt to manage these costs. This adaptation can occur in various ways, but would include more legal administrative controls. For instance, one could reform the formal procedure by linking it more clearly to the informal procedure and provide it with more administrative controls, similar to England's system. Another option would be to reform the informal procedure, e.g. by giving more authority to the Nordic Trustee, which would enhance its role as a legal administrative control. A third way would be for actors to more extensively use the COMI option and consider England's various formal debt restructuring procedures, which offer more legal administrative controls. Either way, this would imply a shift from a hybrid closer to a hierarchical governance structure.

## 6. Conclusion

This paper has made empirical and theoretical contributions to the extant literature on law, economics and finance (Haugen & Senbet, 1978; Williamson, 1981, 1991, 1999; Jackson, 1982; Armour & Deakin, 2001; Finch, 2008; Becker & Strömberg, 2012; Gilson, 2012; Payne, 2014). First, our empirics illustrate similarities between the Norwegian and English informal debt restructuring procedures. Social norms and legal rules work intertwined in both jurisdictions and affect the outcome of debt restructurings by preventing a main driver of transaction costs, opportunistic behaviour. However, the ability to govern for opportunistic behaviour differs, due to jurisdictional differences in the interrelationship between the social norms and legal rules. Theoretically, debt restructuring procedures can be seen as governance structures, with social norms and legal rules as a set of consistent administrative controls. The efficacy of social administrative controls in the informal debt restructuring governance structure is underpinned by a set of legal administrative controls.

Second, the trade-off between the bureaucratic costs, which social and legal administrative controls generate, in relation to maladaptation costs stemming from opportunism, indicates that Norway in contrast to England is maladapted in some areas. This leads to an increase in transaction costs and, ceteris paribus, a reduction of firm value. Thus, this paper supports Gilson's (2012) findings that one ought to weigh benefits to costs when choosing between an informal to a formal debt restructuring governance structure. Our study also provides insights on the linkage between opportunistic behaviour and transactions costs in an empirical relevant context.

Third, as a response to Armour & Deakin (2001) call for evidence, our findings indicate that England's social administrative controls have been underpinned by a new governance structure due to changes in the capital environment. This emphasises the relevance of studying a jurisdiction's capital environment, when one is to develop a debt restructuring governance structure with an adaptation capacity that minimises transaction costs.

This paper raises important issues for practitioners and legislators. First, to minimise transaction costs, it is critical to understand drivers of opportunism and be aware of the effectiveness of social and legal administrative controls to prevent opportunism. Second, legislators should consider the need to increase the coordinating capacity of Norway's governance structures, as the empirics indicate that they are maladapted in some areas. Third, a jurisdiction cannot be analysed in isolation when one is to compare governance structures for formal debt restructurings. The COMI aspect enables actors to choose in which jurisdiction a formal debt restructuring procedure should be conducted, which provides actors with a broader set of alternatives to choose the most efficient trade-off between bureaucratic and maladaptation costs, in order to minimise transaction costs.

Although banks and bondholders are the most active groups of actors in the debt restructuring procedure, it cannot be excluded that other groups of actors such as employees and suppliers influence the outcome of the process. In future research, it is of interest to include the dimension of other stakeholders and their potential impact on firm value. Moreover, this paper has excluded financial institutions, as their debt restructuring procedures are significantly different in nature to non-financial firms. Thus, a similar study as ours on these type of firms can contribute to the extant literature. Finally, the scope of this paper was not to conclude whether one jurisdiction is more efficient than the other, since we performed a qualitative study on two different environments. Hence, we encourage future research to investigate the size and magnitude of transaction costs in these jurisdictions, albeit a quantification of our findings might prove to be a challenging task.

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# Appendix

**Semi-structured interview questions**
*The questions were adapted to the respondents' answers, expertise and experience*

1 Please tell me about your role in the debt restructuring process.

2 Please tell me about the English / Norwegian debt restructuring process.

- Informal? Formal? Which actors are involved? Major obstacles? Are there any outstanding issues between the actors? Which are the most value destructive issues to the firm?

3 Please tell us more about your role in [Financial event; Company analysis; Negotiations]

4 Which are the major differences between Norway and England's debt restructuring processes?

5 Tell us about bank creditors / bondholders' behaviour in the process.

6 Which other stakeholders have a major role in the processes?

7 How has the capital environment changed in England the recent years? How has this change affected debt restructuring?

8 Which other issues/aspects would you like to highlight in this context?