The Creditor's Guide to Chapter 11 Bankruptcy Outcomes and Recovery Implications

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When first confronted with a Chapter 11 Bankruptcy case, it is not uncommon for every Creditor involved to wonder: how will this case eventually play out and when can I expect a payout on my bankruptcy claim? To explore these questions, we’ve compiled an in-depth guide to help Creditors navigate the possible scenarios in their road to recovery.

A company typically undergoes Ch. 11 Bankruptcy because it is experiencing significant financial distress and is saddled with outsized debts and liabilities. By filing for Ch.11 Bankruptcy protection, the company, referred to as the Debtor, is given the opportunity to stabilize its finances and restructure its debts with the goal of re-emerging as a financially sound and sustainable business.

Named for the U.S. Bankruptcy Code 11, Ch.11 Bankruptcy allows businesses to continue operating while they work with the bankruptcy court and other parties at stake to formulate a plan to restructure and satisfy debt obligations. As a result of a complicated and lengthy legal process, there are different outcomes that a Debtor can achieve through Ch.11 Bankruptcy. While Creditors hope to recover their outstanding claims against the Debtor, not all bankruptcy claims result in a full payout.

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Outcomes of Chapter 11 Bankruptcy

For a financially distressed Debtor, the primary purpose of fling for Chapter 11 Bankruptcy is to restructure into a stable, healthy business. The long and arduous legal process of Ch.11 however, may not always pan out in favor of the Debtor's goals. There are 3 possible outcomes that can happen to a Debtor as a result of Ch.11 bankruptcy court proceedings:

1. Reorganization
2. Sale as a Going Concern
3. Liquidation

When a Debtor Succeeds in Reorganizing

A Debtor successfully exits Chapter 11 by obtaining court confirmation on the Plan of Reorganization, and proceeds to enact its restructuring. For the Debtor's business that was previously struggling, this is the best-case scenario. The long and strenuous legal proceedings are concluded and the Debtor has finally reached an agreement with the court and its Creditors. The Debtor has finally resolved its disagreements, reduced its liabilities, and is able to provide fair and equitable remediation to its Creditors.

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Moving forward with its approved Plan of Reorganization, the Debtor begins paying of its debts owed to Creditors or arranging and settling agreements that fufill these debt obligations in the future. The business can now re-emerge in a healthier position to increase its value and become profitable again. The objective and intent of the Ch.11 Bankruptcy procedure is to allow the Debtor “breathing space” from litigation and corrective action and the right to a just, legal process through which it can restructure its assets, operations and financial affairs for a viable future. By achieving this outcome of reorganization, the Debtor has succeeded on the basis of Chapter 11.

When a Debtor Fails to Reorganize

Bankruptcy does not always result in the Debtor making a heroic come-back as a healthy, stable organization. With the complexity of Chapter 11 Bankruptcy and the unpredictable factors that can transpire, a Debtor may be unsuccessful in its efforts to rehabilitate its operations. Debtors that fail to reorganize under the Ch.11 process encounter two possibilities: sale as a going concern or liquidation.

Sale as a Going Concern

In an initial attempt to pursue its best interests as a company and for its owners, the Debtor may file for Chapter 11 Bankruptcy to gain stability. Through Ch.11, it is able to rehabilitate its financial position and sustain business operations indefinitely. However, the Debtor fails to obtain Creditor approval and court confirmation on its Plan of Reorganization. Ultimately, the process results in the Debtor putting its business up for sale.

A Debtor may choose to divest its ownership in the future of its business through what is called a Going Concern sale or may be forced to do so by Creditor objections and court rulings. This entails the Debtor pursuing a strategic or financial buyer to purchase the business — often at a lower valuation given the Debtor's limited negotiation leverage due to Ch.11. The Debtor realizes its value through the M&A process to new ownership instead of reemergence to grow its own value as a restructured company.

Liquidation

The Ch.11 process goes awry for the Debtor when it is unable to stabilize its financial position and have its Plan of Reorganization accepted. Instead, Creditors' committees or the case trustee demands that the court dismisses the Plan of Reorganization and motions for the Chapter 11 case to be converted to a Chapter 7 Liquidation Bankruptcy. As a result, the Debtor liquidates all of its assets piece-by-piece at discounted values, divest its interests, and utilizes the proceeds to provide recovery to satisfy the debt obligations of its Creditors' claims.

Upon completion of the Chapter 7 Bankruptcy and liquidation process, the Debtor's business becomes insolvent, ceasing to exist. From a Chapter 11 standpoint, this outcome is the worst scenario for a Debtor that not only failed to overcome its struggles by restructuring, but also failed to keep its business alive.

The Chances of a Successful Reorganization

How prevalent are each of these three Chapter 11 outcomes exactly? Considering the goal of reorganization as intended within Chapter 11 of the US Bankruptcy Code, one would expect the vast majority of Chapter 11 cases to succeed in Debtor reemergence through court-confirmed restructuring.

Based on an empirical analysis comprising 136 Ch.11 cases involving over 70,000 total creditors between 1998-2009[1], less than half of the cases (only 45.5%) succeeded in emerging from reorganization. Of the other cases, almost a quarter (22.4%) ended up as a Going Concern sale —with 9.7% of the cases being acquired by financial buyers and 12.7% of the cases being acquired by strategic buyers. And finally, liquidation resulted in almost a third (32.1%) of the study's 136 Chapter 11 Bankruptcy cases.

How Often Does Chapter 11 Result in a Successful Reorganization?

Succeeded

Less than half of the cases (only 45.5%) succeeded in emerging from reorganization.

45.5%

32.1%

Going Concern

Of the other cases, almost a quarter (22.4%) ended up as a "Going Concern" sale with 9.7% of the cases being acquired by financial buyers and 12.7% of the cases being acquired by strategic buyers.

22.4%

Liquidation

And finally, liquidation resulted in almost a third (32.1%) of the study's 136 total Ch.11 Bankruptcy cases.

Failed

These results are surprising because more than half of the total cases observed (54.5%) resulted in Ch.11 failure—unable to reorganize—and thus the Debtors sold the business or liquidated its assets entirely.

54.5%

59%

Liquidation

Of those cases that failed to reorganize, 59% of the time they ended up in liquidation

41%

Concern Sales

As the more predominant outcome compared to 41% of cases that ended up as going concern sales.

Data Source:
Ivashina, Victoria and Iverson, Benjamin Charles and Smith, David Carl, "The Ownership and Trading of Debt Claims in Chapter 11 Restructurings" (June 5, 2015). Journal of Financial Economics (JFE), 119 (2), 316-335, 2015

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These results are surprising

Because more than half of the total cases observed (54.5%) resulted in Ch.11 failure—unable to reorganize—and thus the Debtors sold the business or liquidated its assets entirely. Of those cases that failed to reorganize, 59% ended up in liquidation as the more predominant outcome, compared to 41% of cases that ended up as Going Concern sales. In other words, when a Debtor fails to successfully reorganize, it has a tendency to become insolvent altogether.

Implications for Claim Recovery

For Creditors, who are left with unpaid bills and invoices caused by a Debtor's Chapter 11 Bankruptcy, the unpredictable outcomes that can result from such a lengthy and grueling process can be cause for great financial uncertainty.

Given the conclusions drawn above, we'd like to offer Creditors some clarity as to how these different scenarios might impact their claims in terms of:

1. Recovery Likelihood
2. Recovery Timing
3. Recover Rate

Creditor Recovery Likelihood

While no one has a crystal ball, Creditors can speculate the outcome probability of their Ch.11 case by examining historical case data. The most probable outcome for Ch.11 cases is a successful Debtor reorganization at 45.5%, followed by a conversion to Ch.7 liquidation at 32.1%, and finally Going Concern sale at 22.4%.

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For Debtors that successfully restructure via Ch.11, this common outcome frequently involves negotiating concessions with Creditors on reduced payout of their claim value, especially for classes of Unsecured Claims. For an Unsecured Creditor, this means a full recovery on Claim value can be possible, but a partial recovery on Claim value is more the likely result. If a successful reorganization is the best Ch.11 outcome in terms of the Debtor’s resulting financial health, then the other unsuccessful outcomes could yield even less favorable results for Creditors.

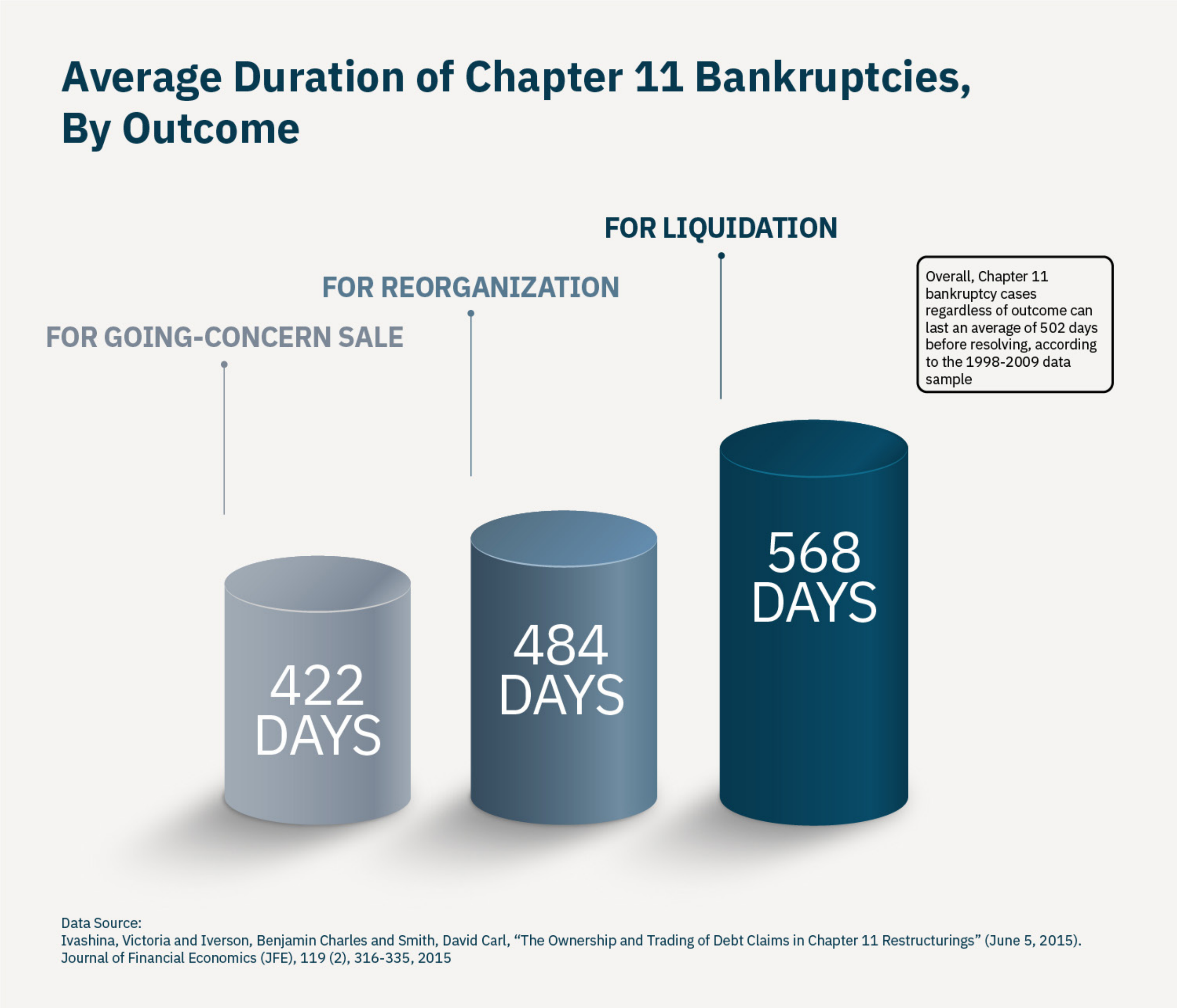
For Going Concern sales, these Debtors have been stabilized financially to make enough revenue to meet their payment obligations and continue operations. However, the future outlook is unclear and indefinite. The change in ownership through a last-ditch acquisition can present further complications or hurt the Creditors’ chances in realizing a full recovery of their claim values. With the Debtor’s acquisition price unknown, and the acquirer’s cash position uncertain, a Creditor’s likelihood of a full recovery on their claim value is up in the air.

Given these factors, Creditors can generally expect a reduced likelihood of claim recovery relative to reorganization scenarios. However, Going Concern sales are the least likely bankruptcy outcome to occur and Creditors should take this into account.

For liquidation outcomes — which are second most common — the goal is to offload assets (usually at deep discounts) so that the Debtor can use the value received on their asset sales to pay off debts. Conceivably, reduced prices on asset sales would result in reduced funds for the Debtor to pay off debts. For an Unsecured Creditor, this means a full recovery on Claim value is highly unlikely. In the aforementioned 1998-2009 study, liquidations resulted in the lowest enterprise valuations for insolvent Debtors, on average, and Creditors can expect this to correlate with their ability to recover on their claims.

Creditor Recovery Timing

Another aspect to consider is the timing of each Chapter 11 Bankruptcy outcome, and how it might affect a Creditor's timeline on receiving repayment or equitable distribution from the Debtor at the conclusion of the case.



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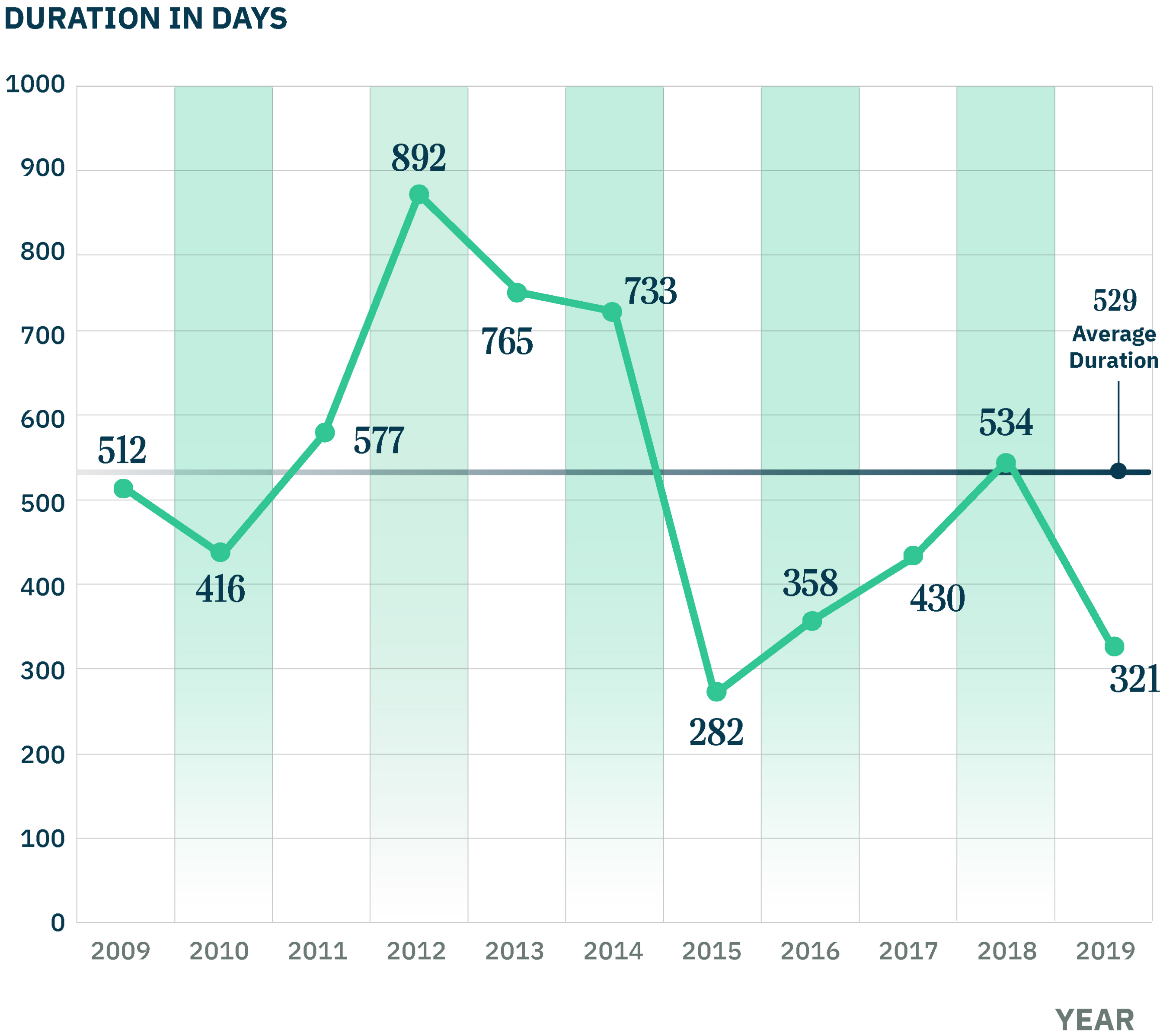
In the event a case results in a Going Concern sale, this outcome appears to resolve two months faster than a successful reorganization, on average. Liquidations appear to last the longest, on average taking almost three months longer to resolve relative to reorganizations. A likely explanation is that further court proceedings are needed when converting to Ch.7 from Ch.11, as well as the time to orchestrate and complete the sale of individual Debtor assets. Therefore, Creditors may have to wait longer in this scenario to recover payment distributions.

Overall, Chapter 11 Bankruptcy cases regardless of outcome can last an average of 502 days before resolving, according to the 1998-2009 data sample. In a separate analysis of large, public Chapter 11 cases that concluded between 2009-2019, the average duration was 529 [3] days before resolution. Judging from these two studies, Ch.11 Cases that are not pre-negotiated or pre-packaged, can take between 16 to 17 months on average to conclude. More complex cases often take longer to resolve, while others may be more expedient in proceedings and take less time. As a Creditor, one can expect to wait a minimum of a year (but more likely, closer to a year and a half) before distributions are issued on Claims at the conclusion of a Case (and assuming a Bankruptcy Claim is not subject to be discharged without a payout).



Data Source:
UCLA-LoPucki Bankruptcy Research Database

Creditor Recovery Rate
At the end of the day, besides the issues of likelihood and timing, a Creditor's foremost concern is the issue of repayment amount. The claim amount to which a Creditor can recover from the Debtor's bankruptcy estate is impacted by many factors throughout the bankruptcy process. Below are two factors that can serve as a reference on assessing bankruptcy claim recovery amounts.

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Recovery Rate by Bankruptcy Outcome

Based on the 136 Ch.11 cases observed in the 1998-2009 study[1], the 70,000+ Creditors involved were found to achieve a mean recovery rate of 50.4% upon case conclusion. In other words, Creditors generally recovered half of their original claim value on an average basis.

When dissecting the study's results further by the type of Bankruptcy outcome, we observe the following recovery rates as a percentage of the original liability amounts at petition filing:

- Reorganization = 57.4% mean recovery rate
- Going Concern Sale = 46.8% mean recovery rate
- Liquidation = 45.1% mean recovery rate

Creditors were able to recover an average of 57.4% on their claims from Debtors who successfully emerged from Ch.11 through court-confirmed reorganization.

For those cases that did not result in Debtor reorganization, claim values of less than half were recovered by Creditors who encountered these alternative outcomes. Cases with Going Concern sales recovered an average of 46.8% as a percentage of original debts, while liquidation cases recovered 45.1% as a percentage of original debts.

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This should not come as a surprise given that a Debtor's failed attempts to reorganize under Ch.11 give rise to alternative scenarios that realize the enterprise value left in its business. From a best case scenario of exiting Ch.11 through successful restructuring, to a worst case scenario of converting to Ch.7 liquidation, a Debtor finds itself in increasingly desperate circumstances. The resulting valuations paint a picture of the Debtor's financial health and recovery ability for Creditor claims upon exit of each bankruptcy outcome.

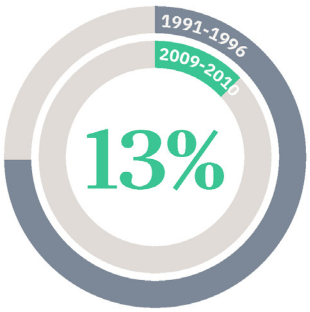
Recovery Rate by Creditor Class
While it is impossible to predict how a Chapter 11 Bankruptcy case will ultimately conclude for the Debtor, a Creditor can examine their potential for recovery by considering the type of claim they hold against the Debtor. During the Creditor Prioritization process within Ch.11 proceedings, a Debtor assesses and classifies each allowed claim into separate Creditor classes, according to their similarity in repayment rights.

In a separate empirical study on unsecured creditors involved in large, public Ch.11 [2] Bankruptcy cases, the following average recovery rates were observed for each unsecured creditor class across two time periods:

Creditor Average Recovery Rate by Class

In a separate empirical study on unsecured creditors involved in large, public Ch.11 Bankruptcy cases[2], the following average recovery rates were observed for each unsecured creditor class across two time periods:

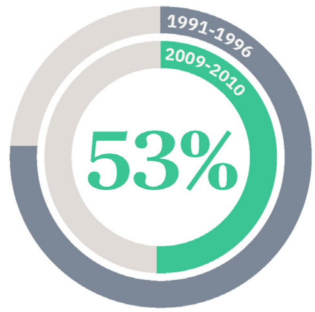
Senior Unsecured



2009-2010 (or **13** cents on the dollar)

1991-1996 (or **74** cents on the dollar)

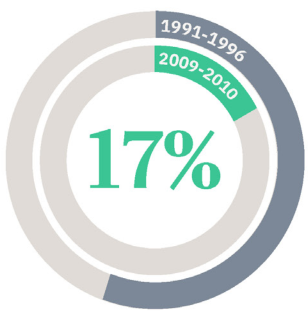
General Unsecured



2009-2010 (or **53** cents on the dollar)

1991-1996 (or **77** cents on the dollar)

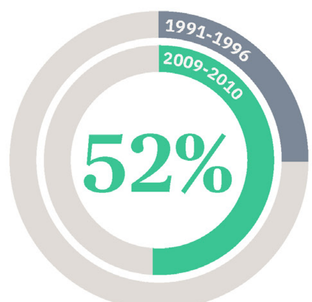
Senior Subordinated



2009-2010 (or **17** cents on the dollar)

1991-1996 (or **56** cents on the dollar)

Junior Subordinated



2009-2010 (or **52** cents on the dollar)

1991-1996 (or **25** cents on the dollar)

Data Source:
Andrew A. Wood, "The Decline of Unsecured Creditor and Shareholder Recoveries in Large Public Company Bankruptcies" (Dec, 2011). American Bankruptcy Law Journal, 85(4), 429-450, 2011

These results uniformly conclude that all subclasses of Unsecured Creditors can expect recovery at substantially less than the full amount of their original claim value. Even when a Debtor successfully reorganizes under Ch.11, as demonstrated above, this data shows that an Unsecured Creditor will not receive a full 100% repayment on their original claim at the conclusion of a case.

When comparing time periods, the recovery trend for unsecured creditors appears less than promising. In fact, the study illustrates that recovery rates have decreased over time. Creditor recovery as a percentage of original claim value descended across the board for all three Unsecured Creditor classes observed. The exception was Junior Subordinated creditors, which happened to increase across time periods — however, the study clarifies that this particular finding of increased recovery rate was not statistically significant. From this data, the study's author concludes that "unsecured creditors and equity [holders] recovered significantly less in 2009-10 than they did in 1991-96 [2]."

At the end of a lengthy legal process, Creditors (especially unsecured and those with equity interests) can generally expect a lower rate of recovery on their claims post-2010s than they would in the mid-90s. As the study concludes, "unsecured creditors can expect to receive very little [2]."

While the study did not examine secured creditor classes, the author points to increasing amounts of secured debt observed in Ch.11 cases — "The explanation for this result is most likely the corresponding significant increase in secured debt between the two 'periods. In 2009-10, median secured debt made up 41% of median assets. In the closest period possible for comparison, 1997-99, median secured debt made up 23% of median assets. When more must be paid to secured creditors, there is less for unsecured creditors and equity [holders] to recover [2]."

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In summary, Creditor Class plays a major factor in rates of recovery on Bankruptcy Claims. Due to the waterfall payment distribution method that's used in the resolution process of Bankruptcy Claims, Secured Creditors maintain a higher repayment priority than Unsecured Creditors. And within Unsecured Creditor classes, their priority rankings can influence their differing recovery rates.

Although these findings are not prescriptive, these two studies [1] [2] illustrate what Creditors can expect in the rate of recovery on their claims under different bankruptcy circumstances and prioritization factors.

The Good News...
Good News for Secured Creditors
Despite the varying Bankruptcy outcomes and average rates of recovery for Creditors, not all Creditor classes and their Claims recover lower values in the Ch.11 process. Secured Claims can typically recover close to 100% of their original Bankruptcy Claim value, which is dependent on the value the Claim is secured against — as guaranteed by collateral or a lien. Additionally, Creditors with Unimpaired Claims are able to recover 100% of their original value.

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This procedural order in Chapter 11 gives Secured Creditors the first right of repayment from the bankruptcy estate’s available funds, and therefore a higher chance of full Claim value recovery.
In addition, Priority Unsecured Claims have a greater possibility of recovering higher values as they too are repaid preferentially and sequentially over Non-Priority Unsecured Creditor Claims.

Good News for Unsecured Creditors
The Chapter 11 Bankruptcy process is certainly unpredictable, lengthy and complicated for the Debtor, but even more so for Creditors who must put their trust in the court process and wait for an indefinite amount of time to learn the fate of their filed Bankruptcy Claims.

With the findings explored throughout this article, it is clear that the odds are stacked against Unsecured Creditors in recovering their Claim values during the Bankruptcy process, regardless of outcome.
Furthermore, recovery rates for Unsecured Creditors appear to have declined in recent years. Having to wait over 16 months for a case to resolve and only receive less than 50% on their original Claim value, Unsecured Creditors don’t have much to look forward to in recovery at the end of lengthy involvement in Bankruptcy proceedings.

However, there is an alternative route to recovery for Creditors outside of the court process that provides the advantage of greater certainty, predictability, control, and expediency.

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Claims Trading as a Recovery Opportunity for Unsecured Creditors

What many Creditors do not know is that there is a robust market for the buying and selling of Chapter 11 Bankruptcy Claims, commonly known as Claims Trading.
The process to list and sell a Bankruptcy Claim takes place entirely outside of the Debtor’s Ch.11 proceedings in court, and regardless of its outcome.

While the Debtor works towards reorganization with the court, Creditors have the option of selling their Bankruptcy Claim (in return for immediate cash) to an external investor who desires a stake in the Ch.11 case or Debtor’s restructured business. Only when a Claim is successfully sold (or traded) does the completed transaction get transferred and registered within the bankruptcy court registrar.

On a volume-weighted basis, 91% of all Claim Trades occur during the first half of a Bankruptcy case [1]. With that being said, if we assume that Ch.11 cases in general take 502 days in average duration (based on the 1998-2009 data sample), than 91% of claims are traded within 251 days (or 8.2 months) of a Ch.11 case.

Based on this, Creditors can assess their own window of opportunity to trade their Claim in relation to their Ch.11 case situation and timing.

Additionally, a disproportionately large number of Claims traded are those that are entitled to vote. Voting Claims are more than 2.5x more likely to trade than a claim that does not entitle its holder to vote [1]. This means Creditors whose claims are entitled to voting rights on the Debtor’s Plan of Reorganization should consider the benefits of selling their Claim via the process of Claims Trading.

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For an Unsecured Creditor in the early stages of a Ch.11 case or who possesses a Claim with voting rights, the opportunity to reap immediate cash by selling your Bankruptcy Claim is a lucrative opportunity that should be seriously considered. It can be the most optimal condition to yield the best and fastest monetary return from motivated Bankruptcy Claims Traders.

After exploring the possible outcomes for a Chapter 11 case, their impact to Claim recovery likelihood, timing, and value, it may be most advantageous for a Creditor to sell and trade their Bankruptcy Claim before the conclusion of their Debtor’s case.

While Debtors must take a chance on reorganization and live with whatever hand they are dealt, Creditors are fortunate to have concurrent options in and out of court. With Claims Trading, immediate cash might be just a conversation away.

Sources:

1. Ivashina, Victoria and Iverson, Benjamin Charles and Smith, David Carl, “The Ownership and Trading of Debt Claims in Chapter 11 Restructurings” (June 5, 2015). Journal of Financial Economics (JFE), 119 (2), 316-335, 2015

2. Andrew A. Wood, “The Decline of Unsecured Creditor and Shareholder Recoveries in Large Public Company Bankruptcies” (Dec, 2011). American Bankruptcy Law Journal, 85(4), 429-450, 2011

3. https://lopucki.law.ucla.edu/tables_and_graphs/Average_case_duration_non-prepack_non-prenegotiated.pdf

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About XCLAIM

XCLAIM is a revolutionary digital marketplace built to trade bankruptcy claims transparently, efficiently, and in real-time. XCLAIM is leading a monumental shift, by unleashing digital efficiencies of scale through an ecosystem of integration partners. XCLAIM provides a turn-key solution that empowers Creditors to unlock and recover value on their illiquid claims, simplifying the trade settlement process and minimizing payment risks. By centralizing the world's largest supply of bankruptcy claims, XCLAIM delivers unprecedented investment opportunities for Buyers to source, value, and trade bankruptcy claims with ease. Founded in 2018 and headquartered in Los Angeles, CA, XCLAIM Inc. most recently closed a $4 million seed round, led by First Round Capital.

For more information, please visit www.x-claim.com.