

# **Debt, “Debt Governance,” and the Decoupling Framework: “Empty Creditors,” “Hidden Non-Interests,” and the Matter of Evidence**

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Discussion: Alan D. Morrison, University of Oxford

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- DEBT DECOUPLING. Host legal systems could relate to the going-concern, or to bankruptcy law. An “empty creditor” pre-bankruptcy can vote but has transferred economic interest via (e.g.) CDS market, or (“hybrid” decoupling) derivatives on shares. Equally, a “hidden non-interest” arises when a vote is cast by an agent with no economic interest, or even a negative interest

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- There is new evidence from the 2007-2009 financial crisis of decoupling. Moreover, when decoupling happens bankruptcy is more likely

- Very nice paper
- Elegant taxonomy of problems; nice summary of evidence
- It is hard to pick holes in this material

# WE HAVE BEEN HERE BEFORE



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A.A. Berle and G.C. Means, *THE MODERN CORPORATION AND PRIVATE PROPERTY*  
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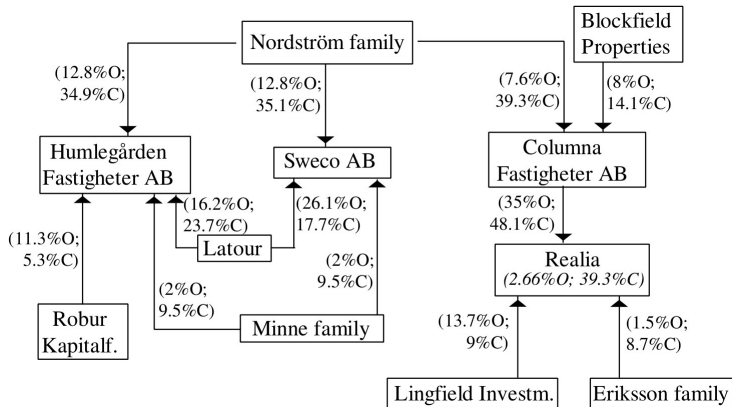
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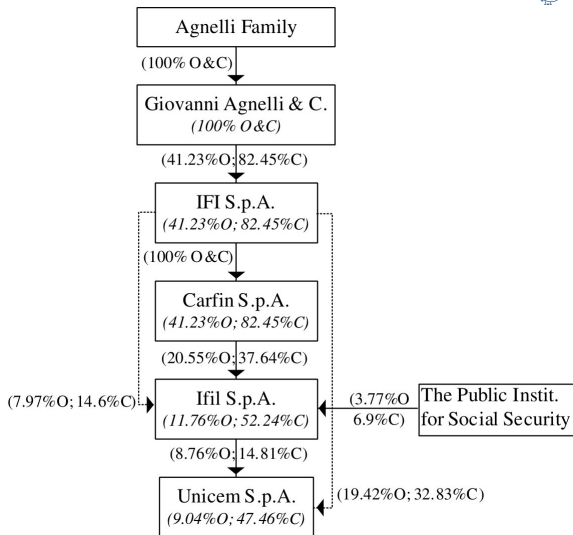
*if all profits are earmarked for the security holder, where is the inducement for those in control to manage the enterprise efficiently?*

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# EUROPEANS ARE FAMILIAR WITH HIDDEN INTERESTS

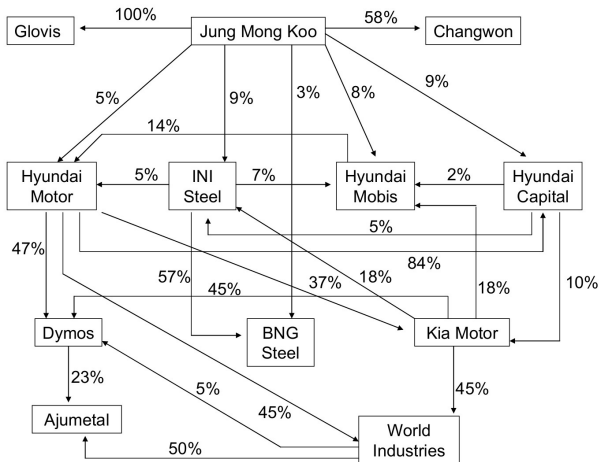


Mara Faccioa, Larry H.P. Lang, *The ultimate ownership of Western European corporations* 65  
J. FIN. ECON. 365 (2002)

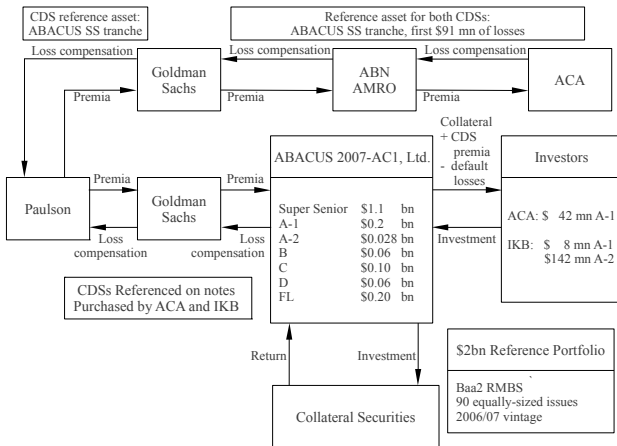


*Id.*

# ... SO ARE KOREANS



Heitor Almeida, Sang Yong Park, Marti Subrahmanyam, Daniel Wolfenzon, *Valuation and performance of firms in complex ownership structures: An application to Korean chaebols* (2007)



Steven M. Davidoff, Alan D. Morrison, William J. Wilhelm, Jr, *The SEC v. Goldman Sachs: Reputation, Trust, and Fiduciary Duties in Investment Banking* 37 J. CORP. L. 529



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- Ownership innovations emerged because they served a purpose. Each involves a contract that alters the division of ownership and control rights
  - Institutions evolved to support the purpose. Prices changed (possibly slowly) to reflect the changes

# EQUILIBRIUM EFFECTS





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- If A sells the debt for £80 then, of course, he *has* to vote the debt into bankruptcy to break even
- It is hardly surprising that CDS trade predicts bankruptcy. But the bankruptcy generates no benefits for agent A: he sold something for £80 whose value conditional upon bankruptcy was £80

# CANDIDATE EXPLANATIONS



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3. Agent A and agent B are colluding against someone else. Not a good thing





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    - ▶ Renegotiation is cheaper; covenants can be broader and more inclusive

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- Ownership and the contractual terms of debt are likely to evolve in response to these changes. If markets reflect value then agents will be guided in their choices by an invisible hand
- Fraud is a bad thing. Transparency is a good thing.
- Could we also facilitate commitments not to engage in some of these trades? The easiest way to do this might be to allow for the issuance of non-protectable debt and equity

# CONCLUSION



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- This happened when the private corporation was invented, and it was a force for good
- But good things are more likely to happen when the right institutional scaffolding exists