







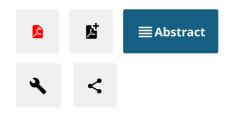
The Journal of Law and Economics > Volume 37, Number 2



**NEXT ARTICLE** >

## Agency Problems of Debt, Convertible Securities, and Deviations from Absolute Priority in Bankruptcy

Michael Frierman and P. V. Viswanath



= More

## **Abstract**

It has been suggested that convertible debt can be used to reduce the tendency toward excessive risk taking in a firm that includes debt in its capital structure. We show that the ability of convertible debt to perform this function is greatly reduced if stakeholders can trade in derivative securities with payoffs contingent on the cash flows of the firm. We show, further, that bankruptcy courts can ensure the same result precisely by deviating from absolute priority. Our model explains two real-world phenomena; one, why bankruptcy law seems to be structured in such a way as to favor equity holders and facilitate deviations from absolute priority, and two, why small firms are more likely to use convertible debt.



## THE UNIVERSITY OF CHICAGO PRESS JOURNALS

The University of Chicago Press Books

Chicago Distribution Center

The University of Chicago

Accessibility

Open access at Chicago

Permissions

Statement of Publication Ethics

The Pillars of Diversity and Inclusion at the University of Chicago Press

Contact us

Terms and Conditions

Privacy Notice

Media and advertising requests



