

Perfectly Incomplete: Holdouts and Efficiency-Enhancing Fiduciary Duties

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ABSTRACT

Distressed debt exchanges increasingly involve preferential treatment of certain creditors at the expense of others, raising concerns about unpredictable disruptions of creditors' rights and potentially increased debt costs. This study examines the impact of *Quadrant*, a ruling that allowed Delaware-incorporated firms to prioritize one creditor over another. I develop a theoretical framework showing that the ability to discriminate among creditors mitigates holdout costs, facilitates renegotiation, and enhances efficiency by reducing bankruptcy-related deadweight losses. Empirical evidence supports this hypothesis: post-*Quadrant*, Delaware firms increase debt utilization, grant greater holdout leverage, and file for Chapter 11 in worse financial condition, without changes in debt prices or quantities. Notably, loan agreements are less likely to contain terms blocking preferential transactions, indicating increased efficiency rather than a mere shift in demand.