

Subordination and the Assets of Widget Company

The assets of Widget Company have just been sold at auction to satisfy the claims of three classes of creditors: a Senior class, a Subordinated class and Trade creditors. The claims are as follows: Senior-\$800; Subordinated-\$600; and Trade-\$400. The Subordinated class is subject to a subordination agreement which provides that, in a bankruptcy of Widget Company, the Subordinated class must turn over any distributions received by it to "Senior Indebtedness" until all "Senior Indebtedness" has been paid in full. You have been told that "Senior Indebtedness" is defined to include all indebtedness for borrowed money that is expressly designated as senior in either an indenture or a loan agreement. Senior class represents obligations issued under an indenture that makes the proper designation. The Trade creditors are owed money on "open account" for provision of goods and services to Widget Company in the ordinary course of business. You have been told that all three classes of creditors are unsecured.

1. Assume that the assets of Widget Company are liquidated for \$900. What is the bankruptcy distribution to each of the Senior, Subordinated and Trade creditor groups prior to recognition of intercreditor agreements?

- a. Senior: \$700; Subordinated: \$200; Trade: \$0.
- b. Senior: \$300; Subordinated: \$300; Trade: \$300.
- c. Senior: \$700; Subordinated: \$0; Trade: \$200. Senior: \$400; Subordinated: \$300; Trade: \$200.
- d. Senior: \$700; Subordinated: \$100; Trade: \$100.

2. Assume that the assets of Widget Company have been liquidated for \$900. What is the dividend paid to each creditor class after giving effect to the subordination language?

- a. Senior \$400; Subordinated \$300; Trade: \$200.
- b. Senior: \$700; Subordinated: \$0; Trade: \$200.
- c. Senior \$800; Subordinated \$60; Trade: \$40. Senior: \$800; Subordinated \$0; Trade: \$100.
- d. Senior \$700; Subordinated \$120; Trade: \$80.

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3. Assume that the assets of Widget Company are liquidated for \$1350. What is the distribution to each creditor class after giving effect to the subordination contract?

- a. Senior \$800; Subordinated: \$330; Trade: \$220.
- b. Senior: \$600; Subordinated: \$450; Trade: \$300.
- c. Senior: \$800; Subordinated: \$250; Trade: \$300.
- d. Senior: \$800; Subordinated: \$450; Trade: \$100.