

Recovery Rates and the Absolute Priority Rule

The paper analyses the relationship between expected recovery rates in bankruptcy and the claim's standing within the capital structure of the debtor. According to the absolute priority rule (APR), the claims in bankruptcy should be always repaid in certain order, i.e. each claim can be satisfied only if all relatively senior claims have been repaid in full. But since the APR is often violated in practice, the actual recoveries may differ significantly from the scenario based on the assumption of adherence to the APR.

The extent of the APR violations depends highly on the creditors' position in the bankruptcy proceedings within each particular legal system. The paper investigates the characteristics of bankruptcy codes that allow APR violations as well as both ex-post and ex-ante effect of these violations. In this context, we also analyse the New Czech Insolvency Act which will enter into force on 1st January 2008. The paper aims to provide a step towards understanding the problematic relationship between the recovery rates and the creditors' rights protection within particular legal framework.