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Shareholder Litigation, Shareholder-Creditor Conflict, and the Cost of Bank Loans

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Shareholder Litigation, Shareholder-Creditor Conflict, 
and the Cost of Bank Loans

Yongqiang Chu*

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Abstract

I study how shareholder litigation affects the cost of bank loans via its impact on the 
distribution of bankruptcy estate and the conflict of interests between shareholders and 
creditors. Using a natural experiment based on a ruling by the Ninth Circuit Court 
of Appeals, I find that increasing the difficulty of class action suits decreases loan 
spreads. The effect is stronger for firms with higher institutional ownership, which is 
consistent with the argument that class actions suits help shareholders extract wealth 
from creditors when the firm is in bankruptcy. Further analysis shows that the effect 
is weaker for firms with stronger creditor protection in bankruptcy.

Keywords: Shareholder Litigation, Shareholder-Creditor Conflict, Bankruptcy, Value 
Destruction

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