The Effect of Court Override in Creditor Negotiations on Firm Financing Choices

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Abstract

This paper examines the impact of judicial intervention on the financing behavior of listed companies in China. A court override occurs when the court imposes a bankruptcy asset distribution plan on creditors who cannot reach a consensus, bypassing dissenting opinions. We argue that such intervention undermines creditors' interests and forces firms to seek alternative, higher-cost financing methods, such as financial leasing. Using data from listed companies between 2016 and 2022, we empirically analyze the effect of the local court override event on the number of financial leasing contracts. Our results show that court overrides lead to a significant increase in financial leasing activity, particularly through smaller, private leasing companies, while reducing the reliance on traditional sources of financing such as bank loans. Furthermore, we find that firms with higher bankruptcy cost, poorer governance and located in cities with worse market development are more likely to secure leasing contracts following court overrides. Our findings suggest that court overrides have profound implications on the local financing environment, increasing the use of costly and enforceable financial instruments like leasing while undermining the traditional credit market.

Keywords: judicial friction, bankruptcy process, financial leasing, financial constraint.

1. Introduction

For firms, debt is one of the most important financial instruments. A substantial body of research has explored the effect of exogeneous shocks on firms' debt financing, including the changes in the price, size, maturity as well as the type of debt from unsecured to collateralized debt. Our paper provides empirical evidence that when external interventions make it difficult to safeguard the interests of creditors, firms with financing needs may have to choose a higher *priority* (even above preferred creditors) access to finance, i.e., using finance leases, which allow creditors to retain ownership, as an alternative to financing part of a bank loan.

We focus specifically on the impact of a court's mandatory intervention—referred to as a *court override*—on a company's bankruptcy liquidation plan, and its subsequent effect on the firm's use of financial leasing. In this context, a court override refers to the court's interference in the decisions made by creditors during the restructuring or liquidation process of a bankrupt firm. Specifically, during this process, the bankrupt firm must propose a distribution plan for the remaining assets, which is typically led by the bankruptcy administrator. This plan requires private negotiations and a vote by all creditors. If creditors cannot reach a consensus, the court has the authority to impose the asset distribution plan, overriding the objections of dissenting creditors. The original intent of this design was to streamline the bankruptcy process and protect creditors from prolonged delays. However, in the Chinese context, due to the court's lack of independence from local governments, this system has been criticized as a tool for local firms to evade debt obligations. In such cases, courts may collude with the bankrupt firm (and even the local government) to undermine the interests of creditors.

In the presence of such frictions, it becomes difficult for creditors to recover their funds in the event of a firm's bankruptcy. Consistent with theories on debt priority structure (Barclay and Smith,1995; Eisfeldt and Rampini, 2009), we conjecture that when creditors perceive that their interests will not be adequately protected, debtors are forced to turn to higher-cost financing methods. Financial leasing contracts provide a more expensive but feasible alternative: the lessor holds ownership of the leased assets, and in the event of credit risk, the lessor only bears the loss of future rental payments.

To test our hypothesis, we empirically examine the impact of the first court override event on financial leasing by listed companies in the region. First, we gathered all bankruptcy case documents related to "creditor meetings" from China Judgement Online to characterize the features of these court override cases. Our data show that the rate of court overrides in China is significantly higher than in the U.S. (10% vs. 0.16%),

which may suggest an overuse of court overrides or a lack of rigorous scrutiny in these cases. Furthermore, we observe significant regional variation in the occurrence of court overrides: the timing of the first court override event and the average probability of such events varies greatly across provinces. This suggests that the occurrence of court overrides is largely influenced by local judicial execution efficiency.

Given this background, we design a staggered Difference-in-Differences (DID) test. Using data from listed companies between 2016 and 2022, we match this data with the first court override event and leasing events based on the companies' registration cities, controlling for a range of characteristics that may affect leasing behavior by the companies. We examine how corporate loan and financial leasing are impacted following a local court override event that harms creditors' interests. Following the estimation methods for count data suggested by Cohn et al. (2022), we use a Poisson fixed-effects model for our main analysis, and also employ two-way-fixed-effects (TWFE) model that includes industry time trend as robustness check.

Our baseline regression results show that the occurrence of the first court override significantly increases the number of financial leasing contracts entered into by listed companies in the region as lessees. The result remains after controlling form firm features such as size, tangibles ratio and leverage, and macroeconomic characteristics including GDP growth and fiscal expense. Meanwhile, the size of firms' short-term debt (proxied by short-term loans), particularly the size of unsecured loans, declines rapidly in the short term. This confirms our hypothesis that after the first court override event, the bankruptcy law fails to effectively protect creditors’ rights, pushing companies to seek alternative financing methods with stronger enforcement mechanisms, such as financial leasing. Consequently, there is a structural shift in the financing choices of listed companies.

We further explore the sources of this change in leasing contracts in terms of lessor type and extensive margin. First, we categorize leasing companies based on the background of their largest shareholder into bank-affiliated leasing companies, group-affiliated leasing companies, and other leasing companies. We find that the primary source of financing does not rely on traditional leasing companies affiliated with large banks or central state-owned enterprises. Instead, financing shifts toward smaller, private leasing companies, which are typically the highest-cost lessors. Second, we do not find consistent evidence of a significant expansion in the range of firms with leasing contracts, with the increase in financial leasing contracts driven mainly by existing firms that have engaged in leasing. This implies that the financial leasing approach affects only some of the firms that have had experience with leasing. To summarize, the

expansion in number of leasing contract that we document is merely a cushion for firms after the tightening of loan financing channels, and does not form an alternative financing method.

Next, we analyze the heterogeneous effects of court override events on financial leasing by considering firm characteristics and market conditions. First, given that debt seniority is associated with the firm's probability of bankruptcy, the switch of corporate financing from loans to finance leasing should be affected by bankruptcy costs: we find that firms with higher bankruptcy risk and weaker cash flows compared to their industry peers are more likely to use leasing. Moreover, since leasing mostly relies on the transfer of ownership of tangible assets, firms with a higher share of tangible assets are also more able to obtain higher leases.

Given that our exogenous event stems from potential debt evasion, changes in firms' financing methods may also be related to the probability of encroachment: similar to tunneling, when firms have more centralized control, or relatively worse governance, firms are more likely to transfer high-quality assets and then declare bankruptcy, making it difficult for minority creditors to defend their interests. The majority shareholder may be a specialized institutional investor, or a state-owned enterprise with political power (or even the ability to collude with the courts). Our findings confirm this phenomenon: when firms have a higher concentration of shares, a larger share of institutional investors, or are SOEs, firms are more likely to shift their financing from loans to finance leases.

The potential intervention of the court against creditors should also be related to the impact of the local market environment. If the local market-oriented environment is better, then the cost of court intervention will be higher when the firm goes bankrupt. Our findings confirm that firms are less likely to rely on leasing for financing when the marketization index is higher, especially when government intervention is weaker.

Finally, we examine the real effects of the first court override event on listed companies. Our results show that after the first court override, listed companies in the region experience significant declines in liquidity, and profitability. They also suffer from a 0.1% higher probability of insolvency. Given that listed companies are generally perceived as having financing advantages, our findings likely understate the negative effects. These results highlight that court intervention in creditor negotiations has caused substantial negative shocks to the financing environment for local firms.

The findings of this study complement existing research on the factors influencing firms' capital structure, particularly debt structure. In earlier studies on debt prioritization structure (Krishnan and Moyer, 1994; Barclay and Smith, 1995; Yan 2006;

Eisfeldt and Rampini, 2009; Rampini and Viswanathan, 2013), leasing is considered the highest-priority form of debt. The biggest advantage of leasing over collateralized debt is that the lessor is able to retain ownership of the property, and therefore provides higher debt capacity. These researches point out that the choice of corporate debt priority is heavily influenced by bankruptcy costs, measured by as credit ratings, information costs etc. (Kisgen, 2006; Rauh and Sufi, 2010), and it has also been proposed that the development of financial markets can enable firms to rely less on secured debt (Benmelech et al., 2024). Our study provides empirical evidence of changes in debt priorities from debt to leases, pointing to exogenous factors, i.e., negative external shocks to creditors, especially senior creditors, due to bankruptcy interventions, that can lead to an increase in firms' debt priorities. Most relevant to our study, Chang et al. (2022) find, based on the behavior of finance leasing by Chinese listed firms, that banks' regulatory avoidance leads them to substitute bank loans with finance leasing by their subsidiaries. In contrast to their creditor/lessor perspective findings, our conclusions find that in a deteriorating financing environment, listed firms are not even able to obtain financing from bank-based leasing firms and have to turn to smaller leasing firms with less stringent terms but higher fees.

We also add to the research on the impact of legal enforcement on financing constraints from the perspective of the spillover effects of intervening in creditor negotiations. Studies based on Brazil and the United States have found that when the court’s workload decreases, the efficiency of bankruptcy case adjudication improves, which corresponds to improvements in local corporate financing and facilitates investment and expansion (Ponticelli and Alencar, 2016; Müller, 2022). Gopalan et al. (2016) used the establishment of debt recovery courts in India as a quasi-natural experiment and found that a reduction in debt enforcement costs lowered borrowing costs and extended loan durations, with a more pronounced effect on small firms. Similarly, Li and Ponticelli (2022) highlighted that the establishment of bankruptcy courts in China significantly reduced the time spent on bankruptcy case trials, thus promoting local capital accumulation. Our contribution to this literature is twofold. First, we are the first to use court override events as a quasi-natural experiment to explore their effects on local listed companies at a micro level. Second, we consider the spillovers to local non-bankrupt publicly firms, thus providing new economic insight on the efficiency of law enforcement affecting firm financing.

2. Institutional background

2.1 Going bankrupt in China and court override

China reformed its corporate bankruptcy law in 2006 with the goals of improving bankruptcy efficiency, strengthening creditor protection, and standardizing bankruptcy procedures, transitioning from an administrative-driven model to a more market-oriented one. The new law adopts procedures similar to those of developed countries such as the U.S., allowing companies to choose from reorganization, liquidation, or settlement, with a bankruptcy administrator overseeing asset management, creditor claims, and creditor meetings. The court override mechanism discussed in this paper is specifically relevant during the reorganization or liquidation stages. If creditors fail to approve a distribution plan after two rounds of voting, the court has the authority to impose the plan based on relevant criteria. While this reform was intended to marketize the process, it has not entirely removed elements of administrative control and stability maintenance. For example, bankruptcy administrators are appointed by the court, rather than elected by creditors (as in the U.S. and Germany), thus weakening the process's independence.

This paper focuses on the court override mechanism, introduced to enhance bankruptcy efficiency by ensuring the smooth progression of bankruptcy proceedings, preventing delays caused by disagreements among creditors or "prisoner's dilemma" negotiations. However, this mechanism is based on the assumption that courts are more effective than creditors in managing bankruptcies, given the presumption that judges possess comprehensive information about the firm's value and creditor claims, and a deeper understanding of the firm's operations and future prospects. In China, however, companies undergoing bankruptcy reorganization are typically special treatment (ST) firms, which tend to have lower market appeal, making their valuation difficult. Moreover, judges often lack business expertise, and even with expert input, limited information presents significant challenges in assessing the firm's future performance and market viability.

There are also several issues related to the legal design and judicial practice of the court override mechanism. In terms of legal design, China's adoption of this system has been incomplete and lacks clear boundaries for its application. For example, the Chinese version of the law only partially incorporates provisions from Section 1129 of the U.S. Bankruptcy Code, omitting key elements of the "consent approval" clause, which undermines the internal logic and effectiveness of the rule. Additionally, Article 87 of the Chinese Bankruptcy Law, which outlines the criteria for using court overrides, is

vague and lacks specific operational guidance, leading to potential misuse in judicial practice and increased uncertainty in bankruptcy proceedings. This uncertainty may, in turn, infringe upon the legitimate rights of creditors.

Judicial practice in China indicates that the use of court overrides is significantly higher than in other countries, which may be linked to local protectionism, the stability-maintenance mindset of courts, and judges' insufficient expertise. Local governments, driven by political motivations, often prefer to delay liquidation and support inefficient, insolvent companies in order to maintain social stability, reduce unemployment, and promote local economic growth (Faccio et al., 2006). Introducing specialized courts could help mitigate these issues by strengthening judicial independence (Li and Ponticelli, 2022). However, in practice, local government interference frequently leads to the disregard of creditors' rights during court overrides, resulting in abuse of the system. Additionally, judges often lack industry-specific expertise, which may influence their decisions, particularly when under political pressure or local interests, further undermining creditor protection.

A notable example of such issues is the 2016 bankruptcy case of Jiangxi Sway Group. Despite the restructuring plan failing to gain approval from the general creditor group, the court enforced it, ultimately causing a loss of approximately 23 billion RMB for 12 banks. The collusion between the court and local government was particularly evident: banks had provided Sway with 25 billion RMB in credit under government backing as early as 2011. During the 2008 financial crisis, the local government also set up a special fund, injecting 2 billion RMB and offering loans at below-market interest rates. Moreover, during the first creditor meeting, when the creditor group anticipated the possibility of a court override to enforce the plan, several creditors remarked that "the chances of adjustments to the plan were minimal, and even if the second round of voting failed, the court would still impose the plan." Furthermore, the timing and frequency of court overrides vary significantly between provinces, suggesting that their occurrence is heavily influenced by local judicial enforcement efficiency.

2.2 Financial leasing

The inefficiency of court-enforced cram-downs places creditors at a significant disadvantage, motivating them to seek more effective enforcement methods to mitigate such inefficiencies. One promising alternative is financial leasing, which relies on property rights enforcement rather than debt contract enforcement.

Financial leasing, also known as equipment leasing or capital leasing, is an arrangement

where a company or individual (the lessee) gains access to tangible assets—such as equipment, machinery, vehicles, or real estate—by leasing them from a leasing company (the lessor) in exchange for periodic lease payments over a defined period. This arrangement is primarily business-oriented, allowing companies to acquire necessary assets without bearing the full upfront cost of purchasing them. In a financial leasing agreement, the lessor purchases the asset on behalf of the lessee and retains ownership throughout the lease term. The lessee, in return, has the right to use the asset by making regular lease payments, typically monthly or quarterly, which include both interest charges and a portion of the principal.

Financial leasing offers several key benefits. It enables businesses to acquire essential equipment or assets without committing substantial capital or assuming significant debt, thus preserving cash flow and enhancing resource allocation. Leasing also provides flexibility, allowing the lessee to tailor the lease term and payment schedule to align with the asset's useful life or the company's specific needs. In addition, leasing may offer certain tax advantages, such as the ability to deduct lease payments as an operating expense. Furthermore, compared to traditional debt contracts, financial leasing presents lower risk for the lessor. As long as the lease payments are not completed, ownership of the asset remains with the lessor, providing significant protection. In contrast to securing funds through loans, financial leasing offers enhanced security for the parties involved.

In summary, financial leasing reduces information asymmetry between the parties, thereby lowering transaction and credit risks. As the global economy becomes increasingly interconnected, financial leasing has emerged as a distinctive and widely adopted form of non-bank financing in the international financial sector. In China, it is recognized as the fifth pillar of special financial services, alongside insurance, banking, securities, and trusts. Its role in driving economic development has become progressively more significant.

3. Hypothesis development

The court override mechanism in bankruptcy proceedings grants courts the authority to enforce a bankruptcy asset distribution plan when creditors fail to reach a consensus. However, limited judicial independence may result in court rulings favoring business continuity over creditor interests (Li and Ponticelli, 2022; Faccio et al., 2006). Moreover, due to constraints in judicial resources and a lack of industry expertise among judges, court override decisions are susceptible to administrative influence and non-market factors, further increasing uncertainty for creditors.

Under the classic debt priority structure framework, corporate debt financing decisions are influenced by the seniority of claims in bankruptcy proceedings (Barclay and Smith, 1995). Specifically, in the presence of external shocks, information asymmetry, or mismatched debt structures, firms typically prefer higher-priority debt, such as secured loans, to mitigate creditor concerns about incentive misalignment and to enhance their debt capacity (Hollander and Verriest, 2016; Degryse et al., 2021). However, when courts intervene in bankruptcy proceedings through court overrides, even secured debt faces significant uncertainty, potentially failing to provide the expected protection and recovery.

In such a scenario, merely adjusting debt contract terms or enforcing priority rules may not effectively mitigate the conflicts of interest and risk exposure between debtors and creditors. Consequently, firms may be compelled to seek alternative financing channels as a substitute for traditional bank loans. Financial leasing, which relies on property rights enforcement rather than debt contract enforcement, offers a costlier yet viable alternative (Chang et al., 2022). The key advantage of leasing is that the lessor retains ownership of the leased asset, ensuring stronger asset recovery rights in bankruptcy proceedings (Barclay and Smith, 1995; Eisfeldt and Rampini, 2009), with losses typically limited to unpaid future lease payments. Thus, as bankruptcy resolution uncertainty rises, firms may increasingly turn to financial leasing to ease financing constraints, reduce enforcement risks, and secure access to essential productive assets despite legal interventions.

Although financial leasing can circumvent some of the limitations of traditional debt contract enforcement, its effectiveness may still be affected by court override rulings. For instance, courts may allow bankrupt firms to continue using leased assets, weakening the inherent advantages of financial leasing, particularly in restructuring plans. Based on this premise, we formulate our first hypothesis:
H1: The first court override event causes listed companies in the affected city to increase their use of financial leasing contracts.

Corporate financing decisions are significantly influenced by firm characteristics, making it essential to examine how different firms adjust their financing strategies under judicial intervention. Given that court overrides can impact creditor recovery rates, we focus on two key sources of heterogeneity: bankruptcy costs and evasion risk.

First, we hypothesize that firms with high bankruptcy costs are more likely to increase their use of leasing after a court override event. Bankruptcy costs refer to both direct

and indirect costs incurred when a firm enters bankruptcy, including asset liquidation losses, reputational damage, and opportunity costs due to operational uncertainty. Higher bankruptcy costs can weaken a firm's refinancing ability, leading to more severe financial constraints. Prior studies suggest that financially constrained firms value financial leasing for its additional debt capacity, making them more inclined to lease capital assets compared to less constrained firms (Barclay and Smith, 1995; Eisfeldt and Rampini, 2009).

Second, firms with a higher risk of debt evasion may also increase their reliance on leasing. Evasion risk refers to a firm's strategic actions aimed at reducing creditor recoveries, such as asset transfers, debt concealment, or opaque transactions before bankruptcy. These behaviors are more common in firms with weak corporate governance, concentrated ownership, or state ownership (Liu and Gary, 2012). In particular, state-owned enterprises (SOEs) may leverage political influence or even collude with courts (Li and Ponticelli, 2022). Such debt evasion tactics make traditional lenders more cautious, often leading to higher borrowing costs or outright credit rationing, exacerbating firms' financing constraints. Consequently, firms facing difficulties in obtaining traditional loans may be forced to seek alternative financing through leasing. Therefore, we propose the following hypothesis:

H2: The association between court override events and the volume of financial leasing is more pronounced in firms with high bankruptcy costs or high evasion risks.

At the regional level, marketization plays a crucial role in shaping corporate financing decisions. In less market-oriented regions, financial markets are underdeveloped, information transparency is low, and government intervention is more prevalent. Under such conditions, firms' borrowing behavior and debt repayment capacity become less predictable, exposing creditors to higher uncertainty. As a result, creditors in these regions may place greater reliance on financing methods that offer stronger asset security, such as financial leasing. In these regions, legal uncertainty and disruptions in debt enforcement caused by court override events are more likely to push firms toward leasing as a means of reassuring creditors about asset recovery prospects. Therefore, we propose the following hypothesis:

H3: The association between court override events and the volume of financial leasing is more pronounced in regions with lower levels of marketization.

4. Data and variables

4.1 Court override and bankruptcy cases

We downloaded all bankruptcy case documents from China Judgement Online, which include 1,966 cases spanning from 1994 to 2021. Of these, 54.4% (1,070 cases) were reorganization cases, while 45.6% (896 cases) were liquidation cases. From these case documents, we manually extracted detailed information, including the name of the bankrupt company, the court handling the case, the reorganization administrator, the trial date, asset-liability values, the number of creditor meetings, recovery rates, attendance at meetings, modifications to the proposed plans, and court rulings.

Our analysis of these case details reveals two interesting insights. First, the proportion of court override in China is relatively high, accounting for about 10% of total bankruptcy cases (with 11% of reorganization cases and 8% of liquidation cases). This percentage is notably higher than in developed countries like the U.S. and Germany, suggesting the overuse of forced rulings or a lack of strict scrutiny in their application in China's bankruptcy proceedings. Second, there is significant regional variation in the use of court override. The timing of the first court override event differs substantially across provinces, and the average probability also varies greatly between regions. This suggests that the occurrence of court override is strongly related to local judicial execution efficiency. These cases, spanning from 2009 to 2021, cover 17 provinces. We identified the timing of the first forced ruling event in 65 prefecture-level cities as a quasi-natural experiment, enabling us to analyze how such judicial enforcement measures impact the financing situation of listed companies.

4.2 Financial leasing and debt

Data on financing leases, debt, and loans of Chinese listed companies are obtained from the China Stock Market & Accounting Research Database (CSMAR). For leasing events, we retained those where the listed company was the lessee and excluded samples with missing key variables such as the duration of leasing contract. Ultimately, we analyzed 768 financing lease transactions that occurred between May 2016 and May 2023. We aggregated the number of financing lease events, debt, and loan amounts for each company per year, creating a firm-year panel dataset for the empirical regression analysis. Due to the significant number of missing values in the lease amount data, we focused the analysis on the number of financing lease events.

Furthermore, we categorized leasing companies based on the background of their

largest shareholder, classifying them as either bank-affiliated leasing companies or group-affiliated leasing companies. Specifically, there are 47 bank-affiliated leasing companies, with 170 leasing events, accounting for 22.14% of the total. There are 401 group-affiliated leasing companies, with 335 leasing events, accounting for 43.62%. Based on these categories, we similarly aggregated the annual number of leasing events for each listed company, enabling further analysis of the sources of financing leases.

4.3 Control variables

Following Chang et al. (2022), this paper controls for a range of variables that may influence a company's financing leasing behavior, including the logarithm of total sales (lnSales), return on equity (ROE), total debt-to-sales ratio (Leverage), and the ratio of fixed assets to total assets (Tangibles). Additionally, we define two dummy variables based on the ultimate controlling shareholder: whether the company is a state-owned enterprise (SOE) and whether it is a foreign-owned enterprise (Foreign-owned). We also control for local economic characteristics including GDP per capita (GDPpp), GDP growth and fiscal expense scaled by fiscal income. All variables are sourced from the CSMAR database.

We match firm data with the court override event data based on the registration city of the listed company. Given the time span of company debt and bankruptcy court override data, the sample includes observations from 2016 to 2022. Moreover, we exclude companies in the financial sector, as well as firms that are classified as ST (Special Treatment) or delisted. The final sample consists of 48,958 company observations. Appendix Table 1 presents the summary statistics of main variables.

5. Empirical analysis

5.1 Empirical specification

In the baseline regression, we examine the impact of the first court override event on the financing lease amount of local listed companies. To do this, we take advantage of the staggered timing of the first court override events across regions and combine it with company-level information. We estimate the following relationship using a fixed-effects Poisson regression model:

$$E(\mathrm{N}(\text{Total lease})_{it}|\mathrm{X}_{it}, \mathrm{FE}) = \mathrm{esp}(\alpha + \beta \mathrm{Post}_{it} + \gamma \mathrm{X}_{it} + \mu_i + \theta_t)$$

$N(\text{Total lease})_{it}$ represents the financing lease amount of firm i in year t, and Post_{it} is a dummy variable indicating whether the first court override event has occurred. X_{it} is a set of control variables, including the firm's size, profitability, leverage, asset structure, and ownership attributes. The model includes firm fixed effects μ_i and year fixed effects θ_t to control for unobservable firm-level heterogeneity and macroeconomic factors that vary over time. To obtain robust standard errors, we adjust them using the bootstrapping method.

5.2 Baseline analysis

Table 1 presents the baseline estimates on the changes in the number of financial leasing contracts following a court override event. Columns (1)–(3) use a Poisson regression with fixed effects, reporting coefficients as incidence rate ratios (IRR) with bootstrap standard errors in parentheses. Column (1) presents the results without any controls, providing a simple look at the effect of the Court Override event on leasing behavior. In Column (2), we include firm-level controls, such as firm size, profitability, and leverage, to account for heterogeneity in firm characteristics that may influence leasing decisions independently of the Court Override. By adding these controls, we can isolate the effect of the Court Override event from potential confounders. Column (3) extends the analysis by adding city-level controls, capturing regional factors such as local economic conditions and legal environments that may also influence leasing activity. The Poisson regressions consistently show a significant increase in the number of leasing contracts post-override, suggesting that Court Override events prompt firms to seek alternative financing options in response to heightened creditor caution and a changing financial environment.

Columns (4) – (6) present estimates using two-way fixed effects (TWFE) OLS regressions to further examine the robustness of the results. Column (4) provides the basic OLS estimates with no controls, and in Column (5), we introduce firm and city-level controls to account for firm-specific factors and regional variations that might influence the results. These additional controls help refine the estimates by reducing omitted variable bias and ensuring that observed changes in leasing behavior are more likely due to the Court Override itself rather than external factors. Finally, Column (6) adds industry-year fixed effects, which help account for time-varying industry-wide trends that might affect all firms within a particular sector. This specification ensures that our estimates reflect only the within-industry variation over time, providing even more precise evidence of the impact of Court Override events. Across all specifications, the results show a consistent and significant increase in leasing contracts, supporting the conclusion that the occurrence of a Court Override event drives firms to seek

alternative financing mechanisms as they adapt to a more uncertain and risk-averse environment.

Appendix Table 2 presents the robustness tests for the baseline estimates to assess the reliability of the results. First, we address potential bias arising from the staggered Difference-in-Differences (DID) setting, which can be influenced by the negative weighting issue. In Column (1), we employ the method proposed by Callaway and Sant'Anna (2021) to correct for this issue, which adjusts for the heterogeneity in treatment timing across units. In Column (2), we further refine the sample by excluding both always treated and never treated firms, focusing only on provinces that experience a change in treatment status. This allows us to estimate the effect of the Court Override events without the confounding influence of permanent treatment status, and we still find that the results hold.

Second, we consider the potential endogeneity of treatment status, as it may be correlated with provincial characteristics. To mitigate this concern, Columns (3) and (4) focus on subsamples that exclude municipalities directly under central government control and include only the eastern provinces, which are typically more developed and may face different dynamics in terms of judicial enforcement. By restricting the sample to these regions, we reduce potential biases that could arise from underlying differences in regional characteristics. The results from these alternative specifications remain robust, further supporting the validity of the baseline findings and indicating that our results are not driven by regional characteristics or the choice of treatment assignment.

5.3 Source of changes in leasing contracts

We further explore the source of changes in firms' leasing contracts. First, we delve into the types of lessors that drive such increase. Columns (1) – (4) of Table 2 provide the results for leasing with different lessors, using the total number of leases with bank-affiliated leasing companies, group-affiliated leasing companies, and other lessors as dependent variables. The results reveal that there is no significant change in the number of leases with bank-affiliated and group-affiliated leasing companies. This finding differs from those of Chang et al. (2022), who concluded that banks and other financial institutions use financial leasing as alternative financing to their customers to avoid regulatory requirements. In contrast, our findings show that companies are more likely to directly exit the financing process. On the other hand, the number of leasing contracts with non-bank-affiliated or group-affiliated leasing companies increased by an average of about 70.8%.

Second, given that the current estimate gives an overall change of contract number, we move on to examine whether more listed firms are applying this way of financing. Table 3 presents the changes in the extensive margin of firms' financial leasing contracts, where the dependent variable is a dummy indicating whether a firm has engaged in a leasing contract. We employ both logit and OLS regressions to examine the effect. The results from logit regression in Column (1) show that the coefficient is insignificant, suggesting that there is no clear evidence that the likelihood of a firm engaging in leasing contracts changes after a Court Override event. Similarly, the coefficient in Column (2) is only marginally significant, indicating weak evidence of a change in the extensive margin of firms' leasing behavior. Overall, these results suggest that the Court Override event may not significantly affect the decision of firms to engage in financial leasing, at least not in terms of the extensive margin. This implies that while firms may increase the intensity or volume of leasing contracts (as seen in the number of contracts in previous tables), the decision to engage in leasing in the first place may not be as strongly influenced by the occurrence of a Court Override event.

Third, we supplement findings on financial leasing with changes in firms' short-term debt. Appendix Table 3 presents the changes in firms' short-term debt following a Court Override event. The dependent variables in Columns (1)–(4) represent the natural logarithms of different types of short-term debt: ordinary loans, secured loans, short-term loans, and total short-term debt. The significant negative coefficients across all specifications suggest that the occurrence of a Court Override event is associated with a reduction in firms' reliance on short-term debt. This pattern may reflect increased creditor caution and a heightened perception of risk following the forced ruling, leading creditors to be more reluctant to extend short-term credit.

The negative relationship between Court Override events and short-term debt can be interpreted in the context of financial market reactions to increased uncertainty in the bankruptcy process. With the implementation of Court Overrides, creditors may perceive a greater likelihood of judicial intervention in the event of default, prompting them to tighten lending standards and reduce exposure to short-term loans, which are typically riskier in uncertain environments. The consistent negative effect across different types of short-term debt provides robust evidence that such events disrupt firms' access to short-term financing, potentially exacerbating liquidity constraints and influencing the broader financing environment.

5.4 Heterogeneity analysis

5.4.1 Firm bankruptcy cost

We first examine several characteristics that may influence firms' bankruptcy cost, which may in turn influence firms' access to leasing. Table 4 investigates how bankruptcy costs influence the switch from debt financing to financial leasing. Given that debt seniority is associated with a firm's probability of bankruptcy, we expect that firms facing higher bankruptcy costs would be more inclined to shift their financing from loans to leasing arrangements. To explore this, we split the sample based on three different bankruptcy cost indicators: O-score, operating cash flow to assets, and tangibles-to-assets ratio. For each indicator, we categorize firms as having higher values than their industry peers or not.

The results suggest that firms with higher O-scores, lower cash flow to asset ratios, and higher tangibles-to-assets ratios are more likely to engage in financial leasing. This pattern aligns with the idea that firms facing higher bankruptcy costs, which are more vulnerable to financial distress, may prefer leasing as an alternative to debt financing. Leasing allows these firms to reduce the direct financial burden of debt while still acquiring essential assets. These findings highlight the importance of bankruptcy costs in shaping a firm's financing decisions, reinforcing the view that financial leasing can be a strategic tool for firms seeking to mitigate the risks associated with debt.

5.4.2 Debt evasion risk

Given that court override is likely linked to debt evasion, such risk can influence firms' financing decisions, particularly the shift from loans to financial leasing. Debt evasion, similar to tunneling, often occurs when firms with more centralized control or weaker governance structures engage in transferring high-quality assets before declaring bankruptcy, making it difficult for minority creditors to protect their interests. This behavior is more likely in firms with majority shareholders who may be institutional investors or state-owned enterprises (SOEs), potentially with political influence or even the ability to collude with courts.

To examine this, we divide the sample based on firms' risk of debt evasion, proxied by the concentration of shares (percentage held by the top 3 shareholders), the percentage of institutional ownership, and whether the firm is state-owned. A firm is considered "high" in each indicator if its value exceeds the sample median.

The results, presented in Table 5, confirms our conjecture: firms with higher share concentration, a greater proportion of institutional ownership, or those that are state-

owned are more likely to switch from debt financing to financial leasing. These firms may be more inclined to use leasing as a financing method to protect assets and avoid the scrutiny associated with traditional debt contracts, given their higher potential for encroachment or debt evasion. The findings suggest that firms with more concentrated ownership or political connections may strategically shift financing methods to reduce the risks of creditor claims during bankruptcy, highlighting the role of governance structures in shaping financing decisions.

5.4.3 Marketization

Furthermore, the impact of court override events on local listed companies' leasing activity may vary depending on the market environment. A higher degree of marketization typically indicates better market mechanisms, regulatory conditions, and less government intervention. In such environments, creditors are less likely to need to exercise caution, as company financial behaviors and debt repayments are more transparent and predictable. Therefore, in regions with higher marketization, the demand for leasing may not significantly increase following a court override event, and the overall financing behavior of firms may remain largely unaffected. To assess the influence of marketization, we analyzed the impact of the market index on leasing events. The regression results presented in Table 6 suggest that in regions with higher marketization, the number of leasing events for local listed companies did not show a significant increase following the initial court override. This finding supports our hypothesis that, in highly marketized regions, the financing environment is more stable, and creditors are less reliant on leasing as a financing option.

5.5 Economic consequences

The analysis above indicates that following the first court override event, local creditors became more cautious, leading to a structural decline in firms' financing priority. As a result, companies were forced to turn to smaller leasing companies with looser conditions for financing. We further examine whether this shift in financing behavior has adverse effects on firms. Table 7 presents the impact of the first court override event on a range of financial indicators for local listed companies.

Column (1) shows the changes in companies' debt repayment capacity: after the first court override event, the liquid ratio of listed companies decreased significantly. This suggests that in an environment of inefficient debt enforcement, creditors raised their lending requirements, making it more difficult for companies to secure new financing or extend credit terms. Column (2) illustrates the changes in profitability: the court override event led to a 1.8% increase in the probability of negative net income,

indicating lower efficiency in utilizing shareholder capital and overall worsening performance. Furthermore, column (3) reports an 0.1% increase in probability of firm being insolvent. Despite the margin is low in economic scale, the result suggests potential bankruptcy spillover risk triggered by court intervention in the previous bankruptcy process.

These results suggest that the external shock from judicial enforcement led to significant deterioration in firms' liquidity, profitability, and insolvency risk, resulting in considerable economic costs.

6. Conclusions

This study explores the impact of court override events on local firms' financing choices. We find that the occurrence of a first-time forced ruling in a region significantly increases the number of leasing transactions among local listed companies. When creditors become more cautious, firms are forced to turn to smaller, less-regulated leasing companies that offer more lenient terms. The shift is more pronounced among firms with higher bankruptcy cost, worse governance and those located in cities with worse marketization. Our findings highlight on the importance of judicial processes in shaping corporate financing environments.

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Tables and Figures

Table 1. Baseline estimates: increase in financial leasing contracts

Dependent variable	Number of leasing contracts					
Model	Fixed-effects Poisson			Two-way fixed effects		
	(1)	(2)	(3)	(4)	(5)	(6)
Post	1.696***	1.770**	2.510***	1.029**	1.033**	1.036**
	(0.315)	(0.424)	(0.678)	(0.011)	(0.014)	(0.015)
lnSales		0.968	1.009		1.002	1.001
		(0.181)	(0.182)		(0.005)	(0.005)
ROE		1.597*	1.626*		1.024	1.023
		(0.385)	(0.423)		(0.019)	(0.018)
Leverage		2.995	3.799		1.052*	1.051*
		(3.385)	(3.439)		(0.029)	(0.029)
Tangibles/Assets		1.944	1.704		1.015	1.029
		(2.863)	(2.581)		(0.119)	(0.122)
lnLoan		1.028	1.021		1.000	1.000
		(0.023)	(0.018)		(0.000)	(0.000)
1[SOE]		1.163	1.221		1.010	1.011
		(0.315)	(0.317)		(0.015)	(0.015)
1[Foreign-owned]		0.738	0.796		0.990	0.989
		(0.231)	(0.225)		(0.021)	(0.022)
GDPpp			0.871***		0.998	0.999
			(0.042)		(0.001)	(0.001)
GDPgrowth			1.049*		0.999	0.999
			(0.026)		(0.001)	(0.001)
FiscalExpense/Income			0.515**		0.989	0.987*
			(0.158)		(0.007)	(0.006)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	
Industry * Year FE						Yes
Observations	1,824	1,380	1,380	25,794	18,707	18,707
Number of firms	308	282	282			
R-squared				0.421	0.471	0.475

Notes: This table presents the baseline estimates on changes in the number of financial leasing contracts. The dependent variables are the number of financial leasing contracts. *Post* is a dummy variable indicating whether the firm's city has experienced a Court Override event. Columns (1) — (3) use a Poisson regression with fixed effects, and coefficients are reported as IRR ratio with bootstrap standard errors reported in parentheses. Columns (4) — (6) use TWFE OLS estimates, and the standard errors are clustered by province and reported below the coefficients. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

Table2. Types of financial leasing contracts

Dependent variable:	#of Contracts from Bank-affiliated Lessors	#of Contracts from Corporate-affiliated Lessors	#of Contracts from Other Lessors
	(1)	(2)	(3)
Post	1.715	1.747	3.343***
	(1.012)	(0.920)	(1.153)
Controls	Yes	Yes	Yes
FE: Firm, Year	Yes	Yes	Yes
Observations	335	554	825
# of firms	68	113	169

Notes: This table presents the estimates on changes in the number of different financial leasing contracts. The dependent variables in Columns (1) – (3) are the number of financial leasing contracts by bank-affiliated lessors, corporate group-affiliated lessors, and other lessors, respectively. *Post* is a dummy variable indicating whether the firm's city has experienced a Court Override event. Coefficients are estimated from Poisson regressions with fixed effects, and are reported as IRR ratio with bootstrap standard errors reported in parentheses. All regressions include control variables as in Column (3) in Table 1. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

Table3. Extensive margin

Dependent variable:	1[Firm has leasing contract]	
Model	Logit	TWFE
	(1)	(2)
Post	1.797	1.013*
	(0.651)	(0.007)
Controls	Yes	Yes
FE: Firm, Year	Yes	Yes
Observations	1,370	18,707
# of firms	280	
R-squared		0.413

Notes: This table presents changes in extensive margin of firms' financial leasing contracts. The dependent variable is a dummy variable defined as whether the firm has leasing contract. *Post* is a dummy variable indicating whether the firm's city has experienced a Court Override event. Columns (1) uses logit regression with fixed effects, and bootstrap standard errors are reported in parentheses. Column (2) uses TWFE OLS estimates, and the standard errors are clustered by province and reported below the coefficients. All regressions include control variables as in Column (3) in Table 1. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

Table 4. Heterogeneity analysis: bankruptcy cost

Indicator:	O-Score		OCF/Assets		Tangibles/Assets	
Subsample	High	Low	High	Low	High	Low
	(1)	(2)	(3)	(4)	(5)	(6)
Post	2.210**	1.164	4.814	2.514***	3.637***	2.220**
	(0.770)	(0.539)	(5.633)	(0.735)	(1.161)	(0.815)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
FE: Firm, Year	Yes	Yes	Yes	Yes	Yes	Yes
Observations	791	367	399	630	685	535
# of firms	185	95	114	174	155	132

Notes: This table presents the heterogeneous analysis based on subsample divided by firms' bankruptcy cost, proxied by O-score, operating cash flow and tangibles ratio, respectively. High in Indicator is defined as having a value higher than industry mean. The dependent variables are the number of financial leasing contracts. *Post* is a dummy variable indicating whether the firm's city has experienced a Court Override event. Coefficients are estimated from Poisson regressions with fixed effects, and are reported as IRR ratio with bootstrap standard errors reported in parentheses. All regressions include control variables as in Column (3) in Table 1. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

Table 5. Heterogeneity analysis: risk of debt evasion

Indicator:	Share Concentration		Institutional Ownership		SOE	
Subsample	High	Low	High	Low	=1	=0
	(1)	(2)	(3)	(4)	(5)	(6)
Post	3.928***	1.137	3.417***	1.792	3.583***	1.997**
	(1.202)	(0.420)	(1.038)	(0.664)	(1.427)	(0.626)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
FE: Firm, Year	Yes	Yes	Yes	Yes	Yes	Yes
Observations	616	674	657	628	459	825
# of firms	138	148	145	139	107	183

Notes: This table presents the heterogeneous analysis based on subsample divided by firms' risk of debt evasion, proxied by share concentration (Percentage of share held by top 3 shareholders), percentage of institutional ownership, and whether the firm is state-owned, respectively. High in Indicator is defined as having a value higher than sample median. The dependent variables are the number of financial leasing contracts. *Post* is a dummy variable indicating whether the firm's city has experienced a Court Override event. Coefficients are estimated from Poisson regressions with fixed effects, and are reported as IRR ratio with bootstrap standard errors reported in parentheses. All regressions include control variables as in Column (3) in Table 1. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

Table 6. Heterogeneity analysis: marketization

Indicator	Marketization		Government Intervention		Financial Market Development	
Subsample	High	Low	Low	High	High	Low
	(1)	(2)	(3)	(4)	(5)	(6)
Post	1.660	3.204***	2.041*	3.608***	3.682	2.449***
	(0.615)	(1.113)	(0.766)	(1.235)	(3.370)	(0.740)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
FE: Firm, Year	Yes	Yes	Yes	Yes	Yes	Yes
Observations	524	750	503	824	651	560
# of firms	120	173	110	172	141	126

Notes: This table presents the heterogeneous analysis based on subsample divided by local marketization, proxied by marketization index (from Fan et al., 2010), index of government relationship with the market, as well as financial market development (total loans to deposit ratio), respectively. High in Indicator is defined as having a value higher than sample median. The dependent variables are the number of financial leasing contracts. *Post* is a dummy variable indicating whether the firm's city has experienced a Court Override event. Coefficients are estimated from Poisson regressions with fixed effects, and are reported as IRR ratio with bootstrap standard errors reported in parentheses. All regressions include control variables as in Column (3) in Table 1. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

Table 7. Economic consequences of court override

Dependent variable:	Liquidity	1[Loss in profit]	1[Distress]
	(1)	(2)	(3)
Post	-0.203***	0.018**	0.001***
	(0.049)	(0.009)	(0.000)
Controls	Yes	Yes	Yes
FE: Firm, Industry * Year	Yes	Yes	Yes
Observations	18,505	18,707	18,707
R-squared	0.779	0.636	0.460

Notes: This table presents the economic consequences of court override event. The dependent variables in Columns (1) – (3) are firms' liquidity ratio, whether the firm has a negative profit, and whether the firm is insolvent, respectively. Post is a dummy variable indicating whether the firm's city has experienced a Court Override event. The estimation model uses a TWFE regression. All regressions include control variables as well as firm and industry-by-year fixed effects as in Column (6) in Table 1. Standard errors are clustered by province and are reported in parentheses below the coefficients. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

Appendix

Appendix Table1. Summary Statistics

Variables	Observations	Mean	Std. Dev.	Min	Median	Max
Panel A. Court Override Event						
Post	25,794	0.866	0.341	0	1	1
Panel B. Financial Leasing, Debt and Loan						
Number of leasing contracts	25,794	0.0313	0.277	0	0	12
#of Contracts from Bank-affliated Lessors	25,794	0.00605	0.0926	0	0	4
#of Contracts from Corporate-affliated Lessors	25,794	0.00969	0.124	0	0	5
#of Contracts from Other Lessors	25,794	0.0157	0.194	0	0	12
Ordinary Loan	19,105	10.87	9.713	0	16.52	26.46
Secured Loan	19,105	12.59	9.387	0	17.91	26.38
Short-term Loan	19,105	15.77	7.966	0	19.15	25.63
Short-term Debt	23,021	16.51	7.305	0	19.25	25.63
Panel C. Control Variables						
lnSales	25,771	21.45	1.617	8.429	21.32	28.81
ROE	25,592	0.0371	0.221	-1.341	0.0713	0.375
Leverage	25,794	0.427	0.221	0.0533	0.409	1.161
Fixed/Assets	25,698	0.186	0.152	0	0.154	0.954
lnLoan	19,105	17.15	7.314	0	19.70	26.83
1[SOE]	25,794	0.299	0.458	0	0	1
1[Foreign-owned]	25,794	0.225	0.417	0	0	1
GDPpp	20,507	11.62	4.491	1.063	12.04	66.18
GDPgrowth	20,569	6.348	2.544	-20.63	6.800	16.80
FiscalExpense/Income	20,560	1.638	0.965	0.698	1.318	17.08

Appendix Table2. Robustness checks

Model	CSDID	Fixed-effects Poisson		
Sample		Treatment year = 2018	Excluding municipalities	Eastern region
	(1)	(2)	(3)	(4)
Post	1.236*	2.854***	2.198**	2.054**
	(0.144)	(0.911)	(0.723)	(0.649)
Controls	Yes	Yes	Yes	Yes
FE: Firm, Year	Yes	Yes	Yes	Yes
Observations	6,455	468	1,073	636
# of firms		96	220	131

Notes: This table presents the robustness tests of the baseline estimates. Column (1) presents ATT estimates with method proposed by Callaway and Sant'Anna (2021). Columns (2) — (4) presents estimates reported as IRR ratio from Poisson regressions with fixed effects, with bootstrap standard errors reported in parentheses. All regressions include control variables as in Column (3) in Table 1. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

Appendix Table 3. Decrease in firm debt

Dependent variable:	Ordinary Loan	Secured Loan	Short-term Loan	Short-term Debt
	(1)	(2)	(3)	(4)
Post	-0.414**	-0.346*	-0.295***	-0.210***
	(0.190)	(0.203)	(0.073)	(0.064)
Controls	Yes	Yes	Yes	Yes
FE: Firm, Industry * Year	Yes	Yes	Yes	Yes
Observations	18,707	18,707	18,707	18,707
R-squared	0.772	0.779	0.893	0.864

Notes: This table presents the changes in firm's short-term debt. The dependent variables in Columns (1) – (4) are the natural logarithm of firms' ordinary loan, secured loan, short-term loan and short-term debt, respectively. Post is a dummy variable indicating whether the firm's city has experienced a Court Override event. The estimation model uses a TWFE regression. All regressions include control variables as well as firm and industry-by-year fixed effects as in Column (6) in Table 1. Standard errors are clustered by province and are reported in parentheses below the coefficients. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively.