A Comparative Study of Bankruptcy as Bailout

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The use of Chapter 11 to reorganize Chrysler and General Motors ("GM") was undeniably high profile and has led to significant debate, discussion and criticism from bankruptcy scholars, practitioners and policy makers. In fact, almost every leading American corporate bankruptcy academic has spoken against the automotive bankruptcy cases. The most common critique went along the lines of the all-encompassing accusation that the Chrysler and GM cases undermined the entire Chapter 11 process, and even the rule of law, in a way that would have repercussions for debt markets for years to come.

In this article, using a comparative approach (Canadian versus American and automotive versus financial sectors), we build on the defense of the Chapter 11 automotive cases that one of us has already put forward elsewhere. That is, the Chrysler and GM cases did not subvert normal Chapter 11 practice.[1] Rather, we argue that the automotive cases are a good case study of how governments can provide money to a failing but significant industry in a consistent and transparent manner. This article is not about whether governments *should* fund failing industries. Rather, we argue that once such a decision has been made, the bankruptcy system is an effective way to implement such a decision. Further, using the bankruptcy system to effect government funding of a failing industry does not distort the bankruptcy system.

Our starting point is that what was different in the automotive as compared to other Chapter 11 cases was the identity of the debtor-in-possession ("DIP") lender—the American and Canadian governments. As one of us has already observed, while the "identity of the DIP lender is novel what happened is routine. And the identity of the lender is not a bankruptcy issue."[2] In the automotive cases, the identity of the DIP lender was a question of economic reality. Obtaining DIP financing is an essential element of a successful Chapter 11 reorganization, as it allows debtors to maintain sufficient liquidity during the reorganization and obtain post-petition loans to help them emerge from bankruptcy.[3] However, following the credit crisis, it became increasingly difficult to obtain DIP financing, as "the usual lenders … have exited the market, presumably due to either a lack of liquidity or their own financial struggles."[4] As such, it was necessary to

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1 Lubben, Stephen J. “No Big Deal: The Chrysler and GM Cases in Context” (2009) 83 Am. Bankr. L.J., online <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1467862> 101 at 105 [Lubben, “No Big Deal”]

2 Lubben, "No Big Deal," *ibid*. at 103.

3 Martin, Jarrod B. et al. "Freefalling with a Parachute That May Not Open: Debtor-in-Possession Financing in the Wake of the Great Recession", online < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1430566 > 1 [Martin].

4 Martin, *ibid*.

seek out alternative DIP lenders;[5] in the case of Chrysler and especially GM, where the DIP loan was the largest ever obtained by a debtor, the U.S. and Canadian governments filled this void.

Part II provides an overview of the Chrysler and GM Cases. Part III considers the criticism and commentary surrounding the use of Chapter 11 in the automotive cases. Part IV situates the Chrysler and GM cases in the context of the broader bailout versus bankruptcy debates. Part V uses the examples of Bear Sterns, AIG, Citibank and Lehman Brothers to suggests that the use of Chapter 11 over a bailout is supported by American experience beyond the automotive cases. And Part VI considers the bankruptcy versus bailout approach in the Canadian context and explores a recent Canadian example – the Asset Back Commercial Paper Crisis (ABCP) – to illustrate how bankruptcy has been used over bailout in the Canadian context and the limits to expanding this approach across borders. Part VII concludes.

II. Overview of the Chapter 11 Automotive Cases

In 2009, North American automotive manufacturers Chrysler and GM filed Chapter 11 cases as a result of ongoing financial difficulties that suddenly came to a head as a result of the wider economic crisis. These cases involved substantial similarities, and in many respects Chrysler provided a kind of "test run" for its larger, latter counterpart. For example, both Chrysler and GM's bankruptcies involved "quick sales" under section 363 of Chapter 11.[6] Under this section, a DIP is permitted, under some conditions, to sell their assets free and clear of any interest in them. The benefit of a sale under §363 is that it tends to be much faster than a detailed Chapter 11 plan under §§1123 and 1129. By providing for a faster sale, §363 sales are usually the best option in dealing with ongoing losses, limited lender funding commitments, and rapidly depleting assets.[7] Once a DIP chooses to dispose of its assets in a quick sale, the typical process entails finding an initial bidder (often known as a "stalking horse," for reasons that mystify many, including the authors) and approval of bidding procedures.[8] The overarching goal of this process is to maximize the value of the estate, thereby increasing creditors' returns.[9]

Although the Chrysler and GM cases followed the basic framework for a quick sale, they were noteworthy for their historical and economic importance, the speed at which they occurred, and perhaps most significantly, because both corporations received substantial financing from the U.S. and Canadian governments.[10] As one of us describes:

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5 Martin, *ibid*.

6 For a detailed comparative discussion of quick sales see Stephanie Ben-Ishai and Stephen Lubben, "Sales or Plans: A Comparative Account of the "New" Corporate Reorganization" (forthcoming Spring 2011, McGill Law Journal, Volume 56) online: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1541265> [Ben-Ishai & Lubben, "Sales or Plans"].

7 J. Vincent Aug et al., "The Plan of Reorganization: A Thing of the Past? (2004) 13 J. Bankr.L. &Prac.3 at 4-5.

8 Lubben, "No Big Deal," *supra* 1 at 105. *See also* Ben-Ishai & Lubben, "Sales or Plans," supra note 6.

9 *Ibid*.

10 *Ibid.*

> In both cases, U.S. Treasury and the governments of Canada and Ontario agreed to provide the automakers with DIP financing on the condition that a sale of each debtor's assets occur on an expedited basis so as to preserve the value of the business, restore consumer confidence, and avoid the costs of a lengthy chapter 11 process. In both cases the purchaser of the assets was a newly created entity, funded by the North American governments. In exchange for wage cuts that brought the automakers in line with their foreign competitors, and the union's promise not to strike for several years, the purchasers agreed to give equity stakes in the reorganized company to the UAW's retiree health care trust, called the Voluntary Employee Beneficiary Associations (VEBA). [11]

More specifically, in the Chrysler case, its two largest creditors were secured creditors owed $6.9 billion and an unsecured employee benefit plan, owed $10 billion. It owed trade creditors $5.3 billion, and it had a warranty and dealer obligations of several billion dollars. To address these issues, the various governments created and funded a shell company ("New Chrysler"), which, through a § 363 sale, bought substantially all of Chrysler's assets for $2 billion. This gave the secured creditors a return of 29 cents on the dollar. Fiat was then brought in to manage the new firm and was given twenty percent of the purchaser's equity, with rights to obtain a majority stake in the future upon payment of governmental claims. New Chrysler assumed the old company's debts to the union retirees, most dealers and trade creditors. The unsecured claims of the retirees' benefits plans were replaced with a new $4.6 billion note as well as 55 percent of the new company's stock.[12]

Although the majority of Chrysler's senior lenders approved of the government's plan with Fiat, certain distressed debt buyers, primarily two Indiana pension funds, raised several objections, including the claim that the quick sale was essentially a plan in disguise.[13] However, the pension funds' arguments were rejected by the bankruptcy court, which added that—having contractually given up their right to independent action—the funds also lacked standing to bring their objections.[14]

As with Chrysler, GM had both secured and unsecured debt, owing $19.4 billion on pre-petition debt to the U.S. Treasury and a billions more to a range of secured lenders, including a syndicate of lenders led by Citicorp US, Inc. ($3.9 billion); a syndicate of lenders led by JP Morgan Chase ($1.5 billion); Export Development Bank Canada ($400 million); and Gelco Corporation ($125 million).[15] Additionally, GM had $117 billion in unsecured debt to creditors such as the United

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[11] *Ibid*. at 107.

[12] Mark J. Roe and David Skeel, "Assessing the Chrysler Bankruptcy" (12 August 2009), online: <http://ssrn.com/absract=1426530> 1 at ["Chrysler Bankruptcy"] at 3.

[13] Lubben, "No Big Deal," *supra* note 1 at 108. This is significant, as courts have developed rules to prevent the imposition of a reorganization plan through the section 363 sale process. This is known as known as the rule against "*sub rosa*" plans. *Ibid*. at 104.

[14] *Ibid*. at 108. See also, *In re Chrysler*, 405 B.R. 84, 92 (Bankr. S.D.N.Y.), *aff'd*, 576 F.3d 108 (2nd Cir. 2009) (vacated as moot by the U.S. Supreme Court).

[15] Warburton, A. Joseph. "Understanding the Bankruptcies of Chrysler and General Motors: A Primer" (2010) 60 Syracuse L. Rev. 531, online <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1532562> 531 at 537 [Warburton].

Auto Workers Trust (UAW Trust).[16] After GM filed for Chapter 11, $30.1 billion in DIP financing was given by the U.S. Treasury and $3.2 billion was provided by the Canadian government, with another $6 billion to be provided later.[17]

In terms of the GM agreement, its structure was quite similar to Chrysler's. As with Chrysler, a new entity was formed ("New GM"), which purchased all of the substantial operating assets of the Old GM and also assumed some of its key liabilities, such as those owed to the UAW Trust.[18] In exchange, Old GM received ten percent of the equity in the reorganized company, in addition to warrants to buy up to fifteen percent more equity in certain circumstances.[19] The U.S. and Canadian governments, owed $50 billion in combined pre- and post-petition financing, assigned their loans to new GM, which credit bid for the assets of Old GM.[20]

In the end, the "first-priority secured lenders of Old GM (other than the U.S. Treasury and the Canadian government) were repaid their claims in full by New GM. The unsecured lenders received … [the aforementioned equity stake in New GM]. The shareholders of Old GM received nothing."[21] It is worth noting that as with Chrysler, the UAW made concessions with the New GM with respect to employee compensation and benefits, receiving common stock (with warrants to purchase more), preferred stock and an additional $2.5 billion dollar note in exchange for their compromise.[22]

III. Criticism and Commentary on the Automotive Cases

Barry Adler's allegation that the "descent of Chrysler and General Motors into bankruptcy threatens the Chapter 11 reorganization process itself,"[23] is representative of the bulk of the commentary on the automotive cases. Although Adler concedes that these cases were successful insofar as they "quickly removed assets from the burden of unmanageable debt amidst a global recession," he adds that the "price of this achievement was unnecessarily high because the cases established or buttressed precedent for the disregard of creditor rights."[24] Essentially, Adler posits that the manner in which the automotive bankruptcies were carried out favoured certain creditors, while denying the rights of others. Accordingly, Adler and other proponents of this perspective argue that the Chrysler and GM cases "may usher in a period where the spectre of

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16 Warburton, *ibid*.

17 Warburton, *ibid*.

18 Warburton, *ibid*.at 538. See also *In re Gen. Motors Corp.*, 407 B.R. 463 (Bankr. S.D.N.Y. 2009).

19 Lubben, "No Big Deal,"*supra* note 1 at 104.

20 Warburton, *supra* note 15 at 538. Under the US Bankruptcy Code creditors can bid up to the full amount of their secured debt claim to acquire the assets to which their lien is attached in exchange for cancelling of indebtedness in the amount of the bid.

21 Warburton, *ibid*.

22 Warburton, *ibid*.

23 Adler, Barry E. "A Reassessment of Bankruptcy Reorganization After Chrysler and General Motors"(2010), online: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1530011> at 1 [Adler].

24 Adler, *ibid*.

insolvency will increase the cost of capital in an economy where affordable credit is sorely needed."[25]

A number of responses can and have been put forward. First, the over-availability of credit is partially responsible for the recent credit crisis in the first place. Accordingly, it is open to debate whether affordable credit is actually what this economy needs and what "affordable" should mean. The difference between “affordable” and “under priced” is often difficult to discern.

More importantly, although many critics believe that these cases involved a "precedent-setting distortion of bankruptcy priorities,"[26] this is not necessarily the case. Rather, that these cases simply reflected the standard US regime, as it has existed for at least a decade. As Edward Morrison argues, these cases "exposed the reality that Chapter 11 offers secured creditors—especially those that supply financing during the bankruptcy case—control over the fate of distressed firms. Because the federal government supplied financing in the Chrysler and GM cases, it possessed the creditor control normally exercised by private lenders."[27] Or, as one of us less politely explained, “In the past decade lenders have learned how to play the chapter 11 game . . . when I see these same institutional investors acting like Captain Renault, I'm skeptical.”[28]

Specifically, in these cases, the U.S. and Canadian governments used their power as DIP lender to "influence management, force a sale of good assets and favored debts (to the UAW) to a government-owned entity, and let the court distribute remaining assets to creditors left behind in the bankruptcy estate."[29] Accordingly, the Chrysler and GM bankruptcies did not "break new ground" by altering priority rules; instead, they relied on the procedures commonly used in Chapter 11 reorganizations.[30] Whether secured lender domination of the Chapter 11 process is a good thing is open to debate, but is not limited to the automotive cases.

In addition to the argument that the Chrysler and GM cases subverted traditional priority rules, critics have argued—along similar lines—that in these cases bankruptcy courts failed to honor the entitlement for which creditors contract. Moreover, these dissenters also highlighted the fact that in Chrysler secured creditors received 29 cents on the dollar, and general unsecured creditors received nothing.[31]

In GM secured creditors were paid in full and unsecured creditors received a partial payment. That looks a lot like application of the absolute priority rule.

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[25] Adler, *ibid*.

[26] Warburton, *supra* note 15 at 532.

[27] Morrison, Edward R. "Chrysler, GM and the Future of Chapter 11" (5 January 2010), online: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1529734 > 1 [Morrison].

[28] http://www.creditslips.org/creditslips/2009/06/shocked-shocked-1.html

[29] Morrison, *ibid*.at 2.

[30] Morrison, *ibid*.

[31] See, for example, David, Fred N. "Interpreting the Supreme Court's Treatment of the Chrysler Bankruptcy and its Impact on Future Business Reorganizations" (2010) 27 Emory Bankruptcy Development J. 1, online: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1621757> 1 at 7 [David].

In response to the broader point, one of us has already argued that it essentially amounts to a "statement that the government should prefer investors over unions."[32] Yet, determining which creditors should be preferred is a matter of policy, and despite arguments that these cases violated the "rule of law," the "rule of law is not violated by a policy disagreement."[33]

With respect to complaints about the amount received by secured creditors under the quick sale, these are also perplexing, as 30 cents on the dollar is a relatively average recovery rate during a bankruptcy. As Nouriel Roubini notes "in the past seven months, completed Credit Delivery Swap ("CDS") auctions results in a recovery rate of 30 cents on the dollar for loans and 15 cents on the dollar for bonds,"[34] despite better results in the past.

Similarly, critics of the Chrysler and GM Chapter 11 cases underscore the fact that shareholders received nothing for their equity positions.[35] However, much like the recovery rate of 30 cents on the dollar for secured creditors, this too is not unusual. Rather, claims by shareholders for the return of equity do not rank as claims of creditors in bankruptcy. Accordingly, under bankruptcy law, shareholders do not recover anything unless the claims of all creditors are satisfied.[36] As such, it is curious why critics would question these particular elements of the Chrysler and GM cases.

In addition to the general criticisms outlined above, academics also took issue with specific elements of the Chrysler and GM cases. For example, testifying before Congress, Douglas Baird claimed that the bidding procedures approved by the courts in the Chrysler and GM quick sales "amounted to an impermissible, stealth reorganization plan because bidders were required to treat the unions in the same manner as the initial, government-sponsored bidder."[37] This argument is significant insofar as courts have developed rules to curb the imposition of reorganization plans under the §363 sales process.[38] However, a ready response to this argument has already been made that in light of the dearth of alternative bidders in the automotive cases, bidding procedures are entirely irrelevant.[39] Specifically, given the state of credit markets, "those who take for granted the existence of unknown or theoretical bidders have some

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32 Lubben, "No Big Deal,"*supra* note 1 at 101.

33 Lubben, "No Big Deal,"*ibid*.at 102.

34 NourielRoubini, "The Impact of Chrysler's Bankruptcy: Lessons for GM—and For the Rest of US" (Forbes, 5 May 2009), online < http://forbeslife.nl/2009/05/06/chrysler-gm-fiat-bankruptcy-opinions-columnists-nouriel-roubini.html>.

35 David, Fred N. "Interpreting the Supreme Court's Treatment of the Chrysler Bankruptcy and its Impact on Future Business Reorganizations" (2010) 27 Emory Bankruptcy Development J. 1, online: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1621757> 1.

36 See, for example, the *Bankruptcy and Insolvency Act*, R.S. 1985, c. B-3 at s.140.1 [BIA]. Following the 2009 amendments, a creditor is not entitled to a dividend in respect of an equity claim until all claims that are not equity clams have been satisfied.

37 Lubben, "No Big Deal,"*supra* note 1 at 102.

38 Lubben, "No Big Deal,"*ibid*.at 104.

39 Lubben, "No Big Deal,"*ibid*.at 102.

obligation to explain how such a bidder would have bought GM, a company with $27 billion of secured debt."[40]

As mentioned above, in an economic climate where DIP financing is scarce, it bears questioning whether there were truly any better options for GM and Chrysler. If there were better options, one can easily surmise that the governments of the US and Canada would have happily washed their hands of the entire matter.

IV. The Bankruptcy versus Bailout Debate

Following the onset of the 2008 financial crisis and the unveiling of the U.S. Treasury's 2008 bailout plan, there has been considerable debate in the U.S. as to whether bankruptcy or bailouts produce more desirable results for failing companies and for the economy as a whole. In particular, the Federal Reserve and the U.S. Treasury's differing treatment of Bear Sterns, which was bailed out, and Lehman Brothers, which went bankrupt, and then AIG, which was bailed out, are at the forefront of this discussion. These cases are compared and discussed in more detail in the next section, illustrating that our argument for bankruptcy over bailout extends beyond the automotive cases.

In 2008, the U.S. Treasury's bailout plan was enacted, in an attempt to improve bank balance sheets and, consequently, to spur bank lending.[41] Among the justifications offered was the fact that "as of early September 2008, major banks were facing imminent failure because their mortgage-backed assets had declined rapidly in value."[42] These banks, essentially, were deemed too big to fail, especially when failures were apt to come in bunches. Implicit in this argument is the sense that failing—or going bankrupt—in this case, would be catastrophic. Accordingly, the central "benefit" of a bailout in this case was that it is not bankruptcy.

Indeed, one of the key arguments often advanced in favor of bailouts is the ability to sidestep supposedly severe consequences that follow from a bankruptcy.[43] Proponents of this approach focus on two particular "shortcomings" of bankruptcy. First, critics emphasize the impact of bankruptcy "on the value of the distressed firm itself. Bankruptcy, the reasoning goes would severely dissipate the value of the firm's assets."[44] These concerns are characterized as "firm-specific risks."[45] Second, critics of bankruptcy cite the negative consequences of a bankruptcy filing outside the firm, as "bankruptcy filing directly affects the firm's contractual counterparties, some of whom, such as lenders and derivatives counterparties, have direct claims on the firms, while others hold contracts whose value is tied to the distressed firm."[46] The premise of this

40 Lubben, "No Big Deal,"*ibid*.

41 Jeffrey A. Miron, "Bankruptcy or Bailout?" (2009) 29 Cato J. 1 at 11, online: <http://www.cato.org/pubs/journal/cj29n1/cj29n1-1.pdf> [Miron].

42 Miron, *ibid*.

43 Ayotte, Kenneth & David A. Skeel, Jr. "Bankruptcy or Bailouts?" 35 J. Corp. Law 470, online: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1362639< [Ayotte and Skeel].

44 Ayotte and Skeel, *ibid*. at 471.

45 Ayotte and Skeel, *ibid*.

46 Ayotte and Skeel, *ibid.*

argument is that a bankruptcy filing has "spillover effects," such that on the bankruptcy of one firm, several others and possibly the economy as a whole are adversely affected.

In response, proponents of the bankruptcy process posit that there are significant drawbacks to relying on bailouts. For example, Kenneth Ayotte and David Skeel characterize bailouts as "ad-hoc" and "last minute rescue efforts."[47] They argue that

> The rescue loan approach favored in the financial crisis increased uncertainty, increased the costs of moral hazard and dampened the incentive of private actors to resolve distress before a desperate 'day of reckoning' arose. These forces created substantial cost to the taxpayer of rescue funding.[48]

Ayotte and Skeel also tackle the specific two-pronged argument of bailout enthusiasts. With respect to the issue of firm-specific risks, they state that the "firm specific risks of Chapter 11 are overstated," adding that "the law gives distressed firms several advantages in bankruptcy that are unavailable outside of bankruptcy. These advantages help preserve firm value, allocate control rights to residual claimants, and do a more effective job of handling moral hazard concerns than taxpayer-funded rescue loans on the eve of bankruptcy."[49]Ayotte and Skeel acknowledge that there is no perfect solution—when a firm is failing, someone always loses. They contend that:

> The distress of financial firms thus poses an inescapable choice: regulators must either allow counterparties to take losses, and thus confront the possibility of systemic effects, or they must use taxpayer money to prevent the losses from being realized. Bankruptcy has proven to be an adequate mechanism for handling the former choice, and it is flexible enough to accommodate the latter.[50]

With respect to the alleged systemic risks of bankruptcy, it is questionable whether they are restricted to bankruptcy proceedings alone. Indeed, "[s]ome of these systemic costs … would arise in any procedure that forces counterparties to bear losses when there are not enough to satisfy all counterparty claims."[51]Jeffrey Miron concurs, claiming that "U.S. policymakers should have allowed the standard process of bankruptcy to operate."[52] Miron claims that although bankruptcy "would not have avoided all the costs of the crisis … it would plausibly have moderated those costs relative to a bailout. Even more, the bankruptcy approach would have reduced rather than enhanced the likelihood of future crises."[53]

Additionally, with respect to systemic risks, it is difficult to determine whether the "crisis of confidence" that occurs when a large firm goes bankrupt is as a result of the actual bankruptcy,

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47 Ayotte and Skeel, *ibid*.

48 Ayotte and Skeel, *ibid*.

49 Ayotte and Skeel, *ibid* at 471-72.

50 Ayotte and Skeel, *ibid*. at 472.

51 Ayotte and Skeel, *ibid*.

52 Miron, *supra* note 40 at 2.

53 Miron, *ibid*.

or the fact that a major business is in financial distress. Accordingly, the contention that filing for bankruptcy, in and of itself, initiates some kind economic domino effect remains to proven.

Moreover, for some, bankruptcy is not merely the "lesser of two evils." Rather, it is a beneficial choice. For example, Miron notes that "[f]ailure is an essential aspect of capitalism. It provides information about good and bad investments, and it releases resources from bad projects to more productive ones."[54]

V. Bear Sterns, AIG, Citibank v. Lehman Brothers

While in the automotive context the American government consistently utilized the Bankruptcy Code, with regard to financial institutions its choice of process could be charitably described as erratic.[55] During the financial crisis three financial firms were known to have faced financial distress, and the U.S. government chose to resolve the distress first by a bailout, then by a chapter 11 case, and then by a bailout. Moreover, it is now apparent that Citibank was in more trouble than previously acknowledged, and it too was bailed out during the crisis, although with an even lesser degree of transparency than the already opaque publicly acknowledged bailouts.[56]

Bear Stearns, the fifth-largest U.S. investment bank, was founded in 1923 and had managed to survive shocks from the Great Depression through the September 11th attacks, but it ran with the flock when it decided to place a hefty, leveraged bet on the weak end of the U.S. mortgage market.[57]

Specifically, in the summer of 2007 Bear Stearns Asset Management, a hedge fund subsidiary of Bear Sterns, reported to its investors that its Bear Stearns High-Grade Structured Credit Fund had lost more than 90% of its value, while the Bear Stearns High-Grade Structured Credit Enhanced Leveraged Fund had lost almost all of its investor capital. At one point, the Structured Credit Fund had around $1 billion in capital, while the Enhanced Leveraged Fund, which was less than a year old, had nearly $600 million in investor capital. Both funds were heavily invested in mortgage back securities, both directly and via synthetic structures that used derivatives to replicate the effects of mortgage-backed loans.[58]

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54 Miron, *supra* note 40 at 12.

55 This was also the finding of the report released by the Financial Crisis Inquiry Commission (the "FCIC") on January 27, 2011. The FCIC concluded that "the government was ill prepared for the crisis and its inconsistent response added to the uncertainty and panic in the financial markets." See www.fcic.gov. We speak here of non-bank financial institutions. In both the United States and Canada banks are subject to a separate insolvency system. Stephanie Ben-Ishai, *Bank Bankruptcy in Canada: A Comparative Perspective*, 25 Bank. & Fin. L. Rev. 59 (2009).

56 http://www.huffingtonpost.com/2011/01/13/citigroup-was-on-the-verg_n_808721.html

57 Stephen J. Lubben, *Systemic Risk & Chapter 11*, 82 Temp. L. Rev. 433 (2009).

58 Michael C. Macchiarola, *Beware Of Risk Everywhere: An Important Lesson From The Current Credit Crisis*, 5 Hastings Bus. L.J. 267, 301(2009).

After this announcement, the next year saw Bear disclose similar losses in its own trading and the development of a general run on Bear Sterns began, along with a flood of litigation by disgruntled investors in the two funds.[59] The New York Federal Reserve Bank initially contemplated acting as DIP lender to Bear Sterns to resolve the situation, but soon the NY Fed decided its loan would instead support the purchase of Bear Sterns by JP Morgan Chase.[60] Additionally, the NY Fed agreed to take over certain risky assets that Chase refused to purchase; and these assets eventually found a home in an LLC owned by the NY Fed.

Despite these heavy investments by the New York Fed, Bear Sterns shareholders received $10 a share from Chase.[61] In short, Bear Sterns' creditors were spared from incurring any losses and its shareholders likely received $10 per share more than they would have in a chapter 11 case.

If the U.S. government thought that saving this one bank had ended the problem, they were quickly disabused of that notion as the markets increasingly reflected the belief that Lehman was next. At the same time, although the fact was apparently less widely understood, both AIG and Citibank were heading toward the precipice as Bear Sterns' collapse drove down the value of real estate related assets.[62]

Seeing that Bear Sterns was not the last bank that would fail, and facing the possibility that the US government would eventually have to bailout multiple financial institutions, the government urged the financial industry to formulate a plan to save Lehman. When that effort failed, Lehman decided to file a bankruptcy petition.

Unfortunately, it seems that neither banking regulators nor Lehman management appreciated that filing a large corporate bankruptcy case involves a good deal of advanced planning. Rather, both parties treated the matter more like a homeowner seeking to use bankruptcy on the day of the foreclosure sale – Lehman's bankruptcy counsel was only alerted on the day of the proposed filing. This has sometimes led banking regulators and others to draw faulty conclusions from the Lehman case – essentially arguing that Lehman shows that Chapter 11 is unsuitable for financial institutions.

Nonetheless, with the aid of continued lending from the Federal Reserve to Lehman's broker-dealer subsidiary, Lehman was able to quickly sell its assets to Barclays. Thus, along with the automotive cases, Lehman represents the third significant use of section 363 during the financial crisis. Unlike the financial firm bailouts that came before and after it, Lehman's resolution would take place in a courtroom, with a transcript.

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59 Karl S. Okamoto, *After the Bailout: Regulating Systemic Moral Hazard*, 57 UCLA L. Rev. 183, 197 (2009).

60 Robin Sidel, Dennis K. Berman & Kate Kelly, J.P. Morgan Buys Bear in Fire Sale, As Fed Widens Credit to Avert Crisis, Wall St. J., Mar. 17, 2008, at A1.

61 *See generally* Marcel Kahan & Edward Rock, *How to Prevent Hard Cases From Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 Emory L.J. 713 (2009).

62 *See generally* ANDREW ROSS SORKIN, TOO BIG TO FAIL (2009).

Lehman stands most in contrast to AIG, which failed almost immediately after Lehman.[63] Indeed, given the parallel tracks the two companies were on in the fall of 2008, it is somewhat surprising that federal regulators did not anticipate the effects that the failure of Lehman would have on AIG.[64]

The Fed first bailed out AIG in September 2008 with an $85 billion loan, which restructured myriad times as some of the company's obligations were shifted to the U.S. Treasury.[65] The New York Fed also led a controversial plan in late 2008 to help AIG cancel over $60 billion in credit derivative swap contracts with U.S. and European banks by paying the banks in full for their contracts with AIG.[66]

In the latter instance, both the Fed and the Treasury resisted efforts by reporters to discover who these banks were. Ultimately the information was released, and revealed that the Fed had not only saved several large American financial institutions from distress, but also key German and French financial institutions. The latter information revealed how the Federal Reserve had taken on the role of saving not just the U.S. economy, but also that of saving most of the larger Western economic system.

Then in November of 2008, Citibank neared its own failure, even after it had already taken some $25 billion in Troubled Asset Relief Program ("TARP") funds from the U.S. Treasury to shore up its capital. Ultimately Citibank would require $45 billion of bailout funds and a ten-year government-backed insurance policy on more than $300 billion of mortgages and other related securities before it stabilized. The extent to which Citibank was nearly taken over by the government and the full extent of its problems were not widely understood until more than two years latter.

Notably, in all three of the bailouts shareholders in the failed financial institutions managed to retain their stakes in the companies, avoiding the need to take immediate losses and participating in a government funded revitalization of the financial institutions. Bondholders in these companies were spared any losses whatsoever. This stands in stark contrast to Lehman, where shareholders are apt to be wiped out and bondholders will suffer significant losses.

More broadly, and as noted earlier, Lehman offers a degree of transparency, resulting from the use of the traditional bankruptcy system, which was totally lacking in the other financial institution cases. The opacity of the bailouts contributed to the growth of conspiracy theories during the crisis, including claims that Goldman was favored by government officials and that TARP recipients were pressured to support administration policy, including the automotive bankruptcy cases. Many of these conspiracy theories were embraced by academics and others, and have buttressed a general claim of "lawlessness." Moreover, while Lehman was able to proceed according to previously established rules set forth in the Bankruptcy Code and

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63 *See* William K. Sjostrom, Jr., *The AIG Bailout*, 66 Wash. & Lee L. Rev. 943, 943 (2009).

64 *See* James B. Stewart, *Eight Days*, New Yorker, Sept. 21, 2009, at 58.

65 Joe Nocera, *Propping Up a House of Cards*, N.Y. TIMES, Feb. 28, 2009, at B1 (discussing AIG).

66 Yomarie Silva, Recent Development, *The "Too Big to Fail" Doctrine and the Credit Crisis*, 28 Rev. Banking & Fin. L. 115, 125 (2009)

established by prior chapter 11 cases, the bailouts contributed to the feeling that the government was acting in an arbitrary and ill considered manner with regard to the distressed financial institutions.

VI. Bankruptcy versus Bailout in Canada: The Asset Backed Commercial Paper Crisis

In this section we develop further our thesis that the automotive cases are a good case study for the effective use of bankruptcy over bailout. We have argued the comparison of the Lehman Brothers bankruptcy and the Bear Sterns and AIG bailouts illustrates that our thesis extends beyond the automotive sector. Here we argue that a comparable, but not identical, regime in Canada further illustrates that our thesis may also extend across borders where the bankruptcy system is transparent and clear.

As we have shown elsewhere, the Canadian *Companies Creditors Arrangements Act* ("CCAA")[67] allows a debtor to make use of a quick sale procedure similar to the Chapter 11 procedure.[68] However, in Canada the debtor has less ability to "cleanse" assets through the sale process. Particularly with regard to employee claims, a pre-plan sale under the CCAA is not apt to be quite as "free and clear" as it American counterpart.

The jurisdictions also differ on the point at which the reorganization procedures – and the sale process – can be invoked. Canada, like most other jurisdictions, has an insolvency prerequisite for commencing proceeding, whereas Chapter 11 does not. And the Canadian sale process is tied to the oversight of cases by the monitor: without the monitor's consent, it is unlikely that a Canadian court would approve a pre-plan asset sale.[69] In the United States, on the other hand, there is no such position. Accordingly, a debtor can seek almost immediate approval of a sale upon filing. Finally, there remains some doubt and conflicting case law in Canada about the use of the CCAA in circumstances that amount to liquidation, particularly following an asset sale. In the U.S., it is quite clear that Chapter 11 can be used for liquidation.[70]

We have shown that it is questions of speed and certainty that marks the biggest difference between the two jurisdictions, as the CCAA is more than sufficiently flexible to account for simple procedural differences. It is likely this combination of latter factors that is the most plausible explanation for the failure to use the CCAA in the automotive cases, although it is also possible that the Canadian governmental actors involved in the automotive cases preferred to act in the United States forum, which may have been less transparent to a Canadian observer and thus less likely to result in political consequences at home.

However, setting aside the question of the advantages and disadvantage of Canada's slower moving and at times less transparent quick sale process under the CCAA, the CCAA has been used to effect a bailout of an industry – the Asset Backed Commercial Paper industry – as was done in Lehman Brothers and the automotive cases. While the government clearly had a role in

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67 *Companies Creditors' Arrangement Act*, R.S., 1985, c. C-36 [CCAA].

68 Ben-Ishai & Lubben, "Sales or Plans", *supra* note 6.

69 *Ibid.*

70 Stephen J. Lubben, "Business Liquidation"(2007) 81 Am. Bankr. L.J. 65.

the CCAA process, this example is not identical to the American case as it is unclear what was provided in the way of funding.

Within the recent credit crisis, the asset-backed commercial paper ("ABCP") stood out as one of the key issues in Canada. Simply put, ABCP is a short term form of investment that is asset-backed. It is a secured debt obligation issued by a limited purpose trust to fund the purchase of assets that back-up the ABCP and generate cash flow.[71] In the United States, ABCP were commonly referred to as "conduits," and were widely used before the financial crisis to move assets off a financial institution's balance sheet.[72] As such, ABCP or conduit structures were primarily motivated by regulatory arbitrage.

According to Jay Hoffman and Jeffrey Carhart of Miller Thomson LLP, a leading Canadian corporate law firm, the assets underlying Canadian ABCP are traditionally "made-up of mortgages and various types of consumer loans and receivables, but many of the trusts currently hold a significant portion of their assets in the form of credit default swaps, collateralized debt obligations and other leveraged derivatives instruments."[73] The repayment of maturing ABCP is accomplished via the cash "generated by an issuer's trust's underlying asset portfolio and the issuance of new ABCP. In addition, to provide ABCP trusts with a back-up source of liquidity, the trust generally arranges for liquidity support facilities that, subject to satisfying certain conditions, may be drawn by the issuer on the occurrence of a "market disruption" ..."[74] In Canada, the ABCP market is divided in two. On the one hand, there is ABCP issued by trusts and managed by Schedule I banks, which are essentially domestic banks authorized under Canada's *Bank Act* to accept deposits;[75] on the other, there is ABCP issued by trusts which are not sponsored and managed by banks.[76]

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71 Hoffman, Jay M. and Jeffrey C. Carhart. "Canada's Asset Backed Commercial Paper Crisis" (Miller Thompson LLP, 3 October 2007), online: <http://www.millerthomson.com/assets/files/newsletter_attachments/issues/eSecurities_Notes_October_3_2007.pdf.>at 1 [Hoffman]. See also: Acharya, Viral V. and Phillip Schabl. "Do Global Banks Spread Global Imbalances? The Case of Asset-Backed Commercial Paper During the Financial Crisis of 2007-09" (5 April, 2010), online <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1585818>; Carhart, Jeffrey and Jay Hoffman. "Canada's Asset Backed Commercial Paper Restructuring" (2009) 25 Bank.& Fin. L. Rev. 35; Covitz, Daniel, Nellie Liang and Gustavo Suarez. "The Evolution of a Financial Crisis: Panic in the Asset-Backed Commercial Paper Market" (24 August 2009), online: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1364576 >; and Myers, Fred and Alexa Abiscott. "Asset Backed Commercial Paper: Why the Courts Got it Right" (2009) 25 Bank. & Fin. L. Rev. 5.

72 Stephen J. Lubben, *The Bankruptcy Code Without Safe Harbors*, 84 Am. Bankr. L.J. 123, 139 (2010).

73 Hoffman, *ibid*.

74 Hoffman, *ibid*.

75 "Schedule I Banks" (Canadian Bankers Association, 3 June 2010), online: <http://www.cba.ca/en/banks-in-canada/61-banks-operating-in-canada/110-schedule-i-banks>. However, although the term Schedule I bank is still widely used, it is important to note reforms that have taken place in the past decade. In Canada, Schedule I banks were traditionally the largest Canadian-owned banks and were required to be publicly held. In contrast, Schedule II banks were typically smaller banks and were subject to size restrictions. However, following the implementation of Bill C-38 in 2001 the Schedule framework for Canadian banks was replaced with a new regime under which banks with equity of more than $5 billion must be widely held, with no person holding more than 20 percent of voting shares or 30 percent of non-voting shares. In contrast, banks holding between $1 billion and $5 billion in equity may be closely held, as long as there is a

In 2007, on the heels of the sub-prime mortgage crisis in the U.S., a liquidity crisis began to threaten the ABCP market in Canada.[77] This crisis was fuelled by investors' loss of confidence following the news of defaults on sub-prime mortgages and placed Canadian financial markets at risk.[78] Additionally, the ABCP crisis was the result of a timing mismatch—while ABCP is a short-term investment, the assets backing it tended to be long-term assets like mortgages and credit card receivables. As such, there was a timing issue between the cash they generated and the funds needed to repay the maturing notes.[79] During the credit crisis, many investors stopped buying ABCP and rolling over their notes. Instead, they sought to redeem them. However, as a result of the timing mismatch, most funds were unable to pay holders of maturing ABCP, which created a liquidity crisis for holders.[80] In short, something like a bank failure developed at the level of the ABCP trusts. Compounding these problems was the total lack of transparency that characterized the ABCP market: Noteholders rarely had any idea about the specific assets supporting their notes and this further added to investors' lack of confidence.[81]

As a result of the impending crisis, in August of 2007, a group of financial institutions involved in the Canadian ABCP market met to form what is known as the Montreal Proposal. Under this agreement,

> [T]hese institutions (and other holders who later signed on) agreed to a 60 day standstill period during which each party agreed that it would roll-over its non-bank sponsored ABCP on or following its maturity date and would not take any action that would precipitate an event of default under the trust indenture government the ABCP. This agreement include[d] a pledge by asset providers to refrain from making any collateral calls on assets held by the trusts and a pledge by trust sponsors to refrain from calling on any liquidity provider who signed on to the proposal to fund under liquidity facilities. In addition, the participants in the Montreal Proposal agreed in principal to a proposal that would see ABCP eventually converted to rated floating-rate notes with maturities matching the maturities of the underlying assets.[82]

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public float of 35 percent of equity shares. Finally, banks with less than $1 billion in equity have no ownership restrictions apart from a "fit and proper test." *See*, Russell Alan Williams, "Globalization, Deregulation and Financial Services Reform in Canada: Legislating Canada's 'Superbanks'" (Simon Fraser University, Department of Political Science, 2006), online: <http://ir.lib.sfu.ca/retrieve/3719/etd2366.pdf>.

76 Hoffman, *supra* note 66.

77 Hoffman, *ibid*.at 2.

78 Metcalfe & Mansfield Alternative Investments II Corp., (Re), 2008 ONCA 587, 240 O.A.C. 245 at para. 1 [*Metcalfe & Mansfield*], cited to CanLii.

79 Fred Myers and Alexa Abiscott, "Asset Backed Commercial Paper: Why the Courts Got it Right" (2009) 25 Bank. & Fin. Law Rev. 5 at 7 [Myers and Abiscott].

80 Hoffman, *supra* note 66 at 2.

81 Myers and Abiscott, *supra* note 74.

82 Hoffman, *ibid*.

Essentially, the Montreal Proposal was a "standstill" agreement and represented the first of many plans made by key Canadian participants to freeze the $32 billion ABCP market in an attempt to restructure it.[83]

Following the Montreal Proposal, an investor committee, to be chaired by Purdy Crawford, was formed to oversee the restructuring of the ABCP market.[84] This committee became known as the Pan-Canadian Investors Committee or the Crawford Committee. Although their plan was "highly complex and involved many parties,"[85] its essence was this: their plan was to convert the noteholders' paper—which was frozen and worthless—into new, long-term notes that would trade freely, but at a discounted face value.[86] Investors would be informed about the assets supporting their notes, in an attempt to deal with the transparency issues that precipitated the crisis in the first place.[87] The plan also aimed to address the timing mismatch between the notes and the underlying assets by changing the maturity provisions and interest rates on the new notes, as well as adjusting some of the underlying credit default swap contracts by increasing the thresholds for default.[88] Additionally, in order to make the notes more secure, the plan would pool the majority of assets underlying ABCP into two master vehicles.[89]

The plan also included third-party releases from any liability associated with the ABCP, so the Noteholders would have to give up their claims, which were mostly tort claims alleging negligence, misrepresentation, negligent misrepresentation, failure to act prudently as a dealing/advisor, and acting in conflict of interest.[90] Specifically, the plan called for "the release of Canadian banks, Dealers, Noteholders, Asset Providers, Issuer Trustees, Liquidity Providers, and other market participants – in Mr. Crawford's words, "virtually all participants in the Canadian ABCP market" – from any liability associated with ABCP…."[91] These releases were necessary to compensate participants for concessions made to facilitate the plan, which included asset providers assuming an increased risk in their credit default swap contracts, disclosing certain proprietary information in relation to the assets and providing below-cost financing for

83 *Metcalfe & Mansfield*, *supra* note 73 at para. 2.

84 Hoffman, *supra* note 66 at 2. Mr. Crawford is a leading figure among Canadian corporate lawyers. *See* Daryl-Lynn Carlson, "Purdy Crawford: Doing it All" (*Canadian Lawyer*, November 2009), online: http://www.canadianlawyermag.com/Purdy-Crawford-Doing-it-all.html; Jim Middlemiss, "A second chance at ABCP Justice" (*Financial Post*, 5 October 2010), online: http://www.nationalpost.com/related/topics/second+chance+ABCP+justice/3628386/story.html; "Our People: Purdy Crawford" (Osler, Hoskin and Harcourt LLP) online: <http://www.osler.com/ourpeople/Profile.aspx?id=1069>; and "Purdy Crawford named on of Canada's 25 Most Influential Lawyers" (Osler, Hoskin and Harcout LLP, August 2010), online: <http://www.osler.com/NewsResources/Details.aspx?id=2666>.

85 *Metcalfe & Mansfield*, *supra* note 73 at para. 24.

86 *Metcalfe & Mansfield*, *ibid*.

87 *Metcalfe & Mansfield*, *ibid*. at para. 25.

88 *Metcalfe & Mansfield*, *ibid*.

89 *Metcalfe & Mansfield*, *ibid*.at para. 26.

90 *Metcalfe & Mansfield*, *ibid*.at para. 29. There were also allegations of breach of fiduciary duty and claims for other equitable relief.

91 *Metcalfe & Mansfield*, *ibid*.

margin funding facilities designed to make the notes more secure; sponsors giving up their existing contracts; banks providing below-cost financing for the margin funding facility; and other parties making various contributions to the plan.[92] Initially, there were concerns over the releases in the plan being too broad; as such, a "fraud carve out" was added to exclude certain fraud claims from the plan's releases.[93]

However, despite the seemingly balanced approach taken in the plan, a small group of Noteholders (the "Dissenting Noteholders"), opposed the plan, preferring instead to retain the option of suing those who had sold them the ABCP.[94] More specifically, the Dissident Noteholders felt that their chances of receiving value under the plan were not sufficient to surrender their right to litigate. Moreover, the Dissenting Noteholders took issue with the releases granted under the plan. In particularly, the Dissenting Noteholders questioned whether the court can sanction a plan that calls for creditors to provide releases to third parties who are in fact solvent and not actually creditors of the debtor company.[95]

Nevertheless, at trial, Justice Campbell, of the Ontario Superior Court of Justice, held that the releases sought under the Plan of Arrangement were fair and reasonable.[96] In attempting to assess the fairness and reasonableness of the plan—post fraud carve out—Justice Campbell posed seven broad questions in order to reach a decision:

> Are the parties to be released necessary and essential to the restructuring of the debtor?
>
> Are the claims to be released rationally related to the purpose of the Plan and necessary for it?
>
> Can the Court be satisfied that without the releases the Plan cannot succeed?
>
> Are the parties who will have claims against them released contributing in a tangible and realistic way to the Plan?
>
> Is the Plan one that will benefit not only the debtor but creditor Noteholders generally?
>
> Have the voting creditors approved the Plan with knowledge of the nature and effect of the releases?

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92 *Metcalfe & Mansfield*, *ibid* at para. 32.

93 *Metcalfe & Mansfield*, *ibid* at para. 29.

94 Myers and Abiscott, *supra* note 74.

95 *Metcalfe & Mansfield*, *ibid.*at para. 3. The issue of "third party releases" has been litigated in several mass-tort cases in the United States, beginning with the Johns-Manville asbestos case in the 1980s.Kane v. Johns-Manville Corp., 843 F.2d 636 (2d Cir.1988). There is presently a circuit split within the US on the permissibility of such releases.

96 *Metclafe & Mansfield Alternative Investments II Corp, (Re),* 2008 CanLII 27820, 47 B.L.R. (4th) 74 [*Metcalfe & Mansfield* Trial Decision].

> Is the Court satisfied in the circumstances the releases were fair and reasonable in the sense that they were not overly broad and not offensive to public policy?[97]

Ultimately, in holding that the plan—including the third party releases—was fair and reasonable,[98] Justice Campbell dismissed the claims of the Dissenting Noteholders, characterizing their desire to defeat the plan as a "tyranny of the minority."[99] Moreover, he also stressed the "big picture" thrust of his decision, stating that the ABCP Crisis was "a unique situation in which it was necessary to look at larger issues than those affecting those who feel strongly that personal redress should predominate."[100]

This decision was then appealed to Court of Appeal for Ontario, where the Court was required to determine the permissible scope of a restructuring under the CCAA.[101] Moreover, on appeal, the dissenting creditors proposed that if the court can indeed sanction such a plan, then the applications judge erred in holding that this particular plan was fair and reasonable.[102]

In response to the dissenting creditors' argument that the CCAA does not permit releases such as those included in the plan, the Court noted that the CCAA is skeletal and flexible; as such courts must play a key role in filling in the gaps in the scheme.[103] The Court of Appeal added that "[a]n interpretation of the CCAA that recognizes its broader socio-economic purposes and objects is apt in this case. As the applications [trial] judge pointed out, the restructuring underpins the financial viability of the Canadian ABCP market itself."[104] Accordingly, in order to facilitate the broader socio-economic purposes underlying the CCAA, the Court established that third party releases are indeed permissible where they are reasonably connected to the restructuring at hand. Blair J.A. summarized this rule, stating that:

> The CCAA is a sketch, an outline, a supporting framework for the resolution of corporate insolvencies in the public interest. Parliament wisely avoided attempting to anticipate the myriad of business deals that could evolve from the fertile and creative minds of negotiators restructuring their financial affairs. It left the shape and details of those deals to be worked out within the framework of the comprehensive and flexible concepts of a "compromise" and "arrangement."[105]

Ultimately, the court saw no reason why a release in favour of a third party, negotiated as part of a package between a debtor and creditor and reasonably relating to the proposed restructuring

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97 *Metcalfe & Mansfield* Trial Decision, *ibid*. at paras. 23, 37, 53, 57, 59, 103-4, 143-4 and 155-7.

98 *Metcalfe & Mansfield* Trial Decision, *ibid*. at para. 144.

99 Myers and Abiscott, *supra* note 76 at 3.

100 *Metcalfe & Mansfield* Trial Decision, *supra* note 91 at para. 155.

101 *Metcalfe & Mansfield*, *supra* note 73.

102 *Metcalfe & Mansfield*, *ibid.*

103 *Metcalfe & Mansfield*, *ibid.*at para. 44.

104 *Metcalfe & Mansfield*, *ibid.*at para. 53.

105 *Metcalfe & Mansfield*, *ibid.*at para. 61.

cannot fall within the framework.[106] The Court also held that the releases were reasonably justified as part of the compromise between the debtor and creditors, as the plan could not succeed without them and the parties being released from liability made significant contributions to the plan.

With respect to the opposing creditors' argument that the trial judge erred in finding that the plan was fair and reasonable, the Court of Appeal disagreed. Here, the Court refused to go against the trial judge's decision, since he was aware of the merits of all the arguments and negotiated the compromise of the fraud carve out. The Court noted that the trial judge "was alive to the merits of the appellants' submissions…. Implementation of the Plan, in his view, would work to the overall greater benefit of the Noteholders as a whole…. It was his call to make."[107]

Finally, in rendering his decision for the Court of Appeal for Ontario, Justice Blair stressed the importance of this compromise to the ABCP market as a whole. Situating this case within the broader context of restructuring proceedings, Justice Blair posited that:

> In insolvency restructuring proceedings almost everyone loses something. To the extent that creditors are required to compromise their claims, it can always be proclaimed that their rights are being unfairly confiscated and that they are being called upon to make the equivalent of a further financial contribution to the compromise or arrangement. Judges have observed on a number of occasions that CCAA proceedings involve "a balancing of prejudices," inasmuch as everyone is adversely affected in some fashion.[108]

Interestingly, unlike the American critique of the automotive cases, focused on the allegation that the Chapter 11 process was subverted, the Canadian response, which has largely played out in the media rather than in the academy, did not focus on the distortion of the CCAA process. Rather, there was a sense that because the CCAA does not provide enough transparency, the plan and further actions taken in response to the ABCP crisis constituted a "bailout." For example, Terry Chandler, CEO of Redcorp. Ventures Ltd. and a holder of notes required to vote on the plan, was critical of the plan, citing a lack of transparency as to how the plan would unfold and a lack of information based upon which to make an informed decision.[109] Similarly, in the same article, Peter Brown of Canaccord Capital Group claimed that "some big investment firms sold ABCP in July [of 2007] knowing that some issuers were facing challenges. In an interview, Mr. Brown said that information was not available to the general market."

In a 2007 editorial entitled "TD May Join ABCP Bailout," the *Financial Post* outlined the ABCP "bailout," in which the banks, not the taxpayers (in theory) were to be the ones doing the bailing. The article noted that:

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106 *Metcalfe & Mansfield*, *ibid.*

107 *Metcalfe & Mansfield*, *ibid.*at para. 112.

108 *Metcalfe & Mansfield*, *ibid.*at para. 117.

109 *Financial Post*, "Redcorp Ventures criticizes ABCP plan, (*Financial Post*), online: <http://www.financialpost.com/story.html?id=c83bc705-35e0-4169-95eb-f61633bfeea9&k=69266>.

> The banks operate in a highly regulated environment and one of the regulators … [and] the Bank of Canada … wants the problem solved. And it wants help from the banks, the institutions that sold most of the ABCP and which, in some cases, refused to provide back-up liquidity agreements. And David Dodge, governor of the Bank of Canada, wants help from all of them, whether they were directly involved or not. And the central bank has the ultimate power, as well as the power to use moral suasion with a message along these lines: Solving the ABCP problem is in the public interest, certainly in the interests of the functioning of the financial markets, and all participants are expected to do their share …[110]

However, in a 2008 Reuters article, the Bank of Canada defended itself against allegations of bailing out the ABCP market, with David Dodge successor Mark Carney asserting that the Bank never considered using public funds to bailout the country's $35 billion non-asset backed commercial paper market.[111]

Outlining why public funds would not be used to "bailout" the ABCP market, Carney stated that financial market participants "took [ABCP], they are sophisticated … That is not the place to put taxpayers' dollars or the balance sheet of the Bank of Canada."[112] Rather than bailout the industry, Carney insists that the Bank of Canada was "involved in this situation in a very light-touch way" in order to solve the "huge coordination problem," between the market participants involved.[113]

Despite the confusion as to whether a "bailout" occurred as a result of the ABCP crisis, a 2009 article by Miller Thomson's Hoffman and Carhart confirms that government funding played a role in recent enhancements to the Plan. Specifically, they refer to a moratorium period of 18 months following the Plan's implementation, during which collateral calls on certain credit default swaps were forbidden, as well as the "provision of an additional $3.45 billion senior ranking 'back stop' margin funding facility to be provided by a combination of Canadian governments … available to be used for a period of one month following the expiry of the Moratorium Period if other margin facilities are exhausted."[114] Further, despite the opposition and confusion that often accompanies allegations of a bailout, many academics—both domestically and abroad—have lauded the overarching solution achieved during the ABCP crisis. Indeed, Canada's ABCP restructuring has been "hailed as a unique, successful, private restructuring" in response to the credit and sub-prime mortgage crises.[115]

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110 B. Chritchley, "TD may join ABCP bailout" (*Financial Post*), online: <http://www.financialpost.com/opinion/story.html?id=d7eefab7-9dc6-44c4-93e5-b6b5ee3761f8>.

111 Reuters, "Bank of Canada didn't Consider ABCP bailout—Carney" (18 February 2010), online <http://uk.reuters.com/article/idUKN1820571220080218>[Reuters].

112 Reuters, *ibid*.

113 Reuters, *ibid*.

114 Jeffrey Carhart and Jay Hoffman, "Canada's Asset Backed Commercial Paper Restructuring: 2007-2009" (2009) 25 Bank. & Fin. L. Rev.35 at 58.

115 Myers and Abiscott, *supra* note 76 at 5. *See also*, W.A. Scott & P.J. Henderson, "Restructuring Canada's ABCP: A Unique, Successful, Private Restructuring (2009) Int'l Fin. L Rev.

VII. Conclusion

This article began by setting aside the notion that governments always act unfairly or whether it makes sense to save an industry at all or the causes of the financial failure of the automotive or financial industries. We were focused on the point where a government has decided to intervene and the question of how bankruptcy as bailout fares as compared to other bailout options.

Our review of the Chapter 11 automotive cases offers a case study on the effective use of bankruptcy as an alternative to a government bailout. Our thesis is fleshed out by our comparison of the Lehman Brothers and Bear Sterns cases. However, the Canadian experience suggests that a country's bankruptcy reorganization system may only be used as an effective alternative to bailout where the process is transparent and clear.

That is, while both the United States and Canada have highly developed reorganization systems, in the particular context of a government funded bailout, the extra transparency associated with Chapter 11 is an additional asset. By comparison, the Canadian ACBP experience played out through the CCAA, illustrates that bankruptcy is only a better option when the trade offs between various stakeholders are made clear. Where there continues to be ambiguity about the nature of the government's intervention and how various stakeholders made out, bankruptcy as bailout is a less effective option. Only with the transparency can a bankruptcy-bailout mechanism hope to achieve political legitimacy.