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INTRODUCTION

The use of Chapter 11 to reorganize General Motors (GM) and Chrysler was undeniably high profile and has led to significant debate, discussion, and criticism from bankruptcy scholars, practitioners, and policymakers. In fact, almost every leading American corporate bankruptcy academic has spoken against these automotive bankruptcy cases.[1] The most common critique has been the all-encompassing accusation that the Chrysler and GM cases undermined the entire Chapter 11 process, as well as the rule of law, in a way that will cause repercussions for debt markets for years to come.[2]

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 Lubben has previously developed.[3] That is, the Chrysler and GM cases did not subvert normal Chapter 11 practice.[4] 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. Instead, we contend that once such a decision has been made, the bankruptcy system is an effective way to implement such a decision. Further, using bankruptcy procedures to effect government funding of a failing industry does not distort the bankruptcy system.

Our starting point is that the difference between the automotive cases and the other Chapter 11 cases is the identity of the debtor-in-possession (DIP) lender—the American and Canadian governments. As Lubben has already observed, while "[t]he identity of the DIP lender [was] novel, . . . what happened [was] routine. And the identity of the lender [was] not a bankruptcy issue."[5] 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-

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1. Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 AM. BANKR. L.J. 531, 531 (2009) [hereinafter *No Big Deal*].
2. *Id.* at 531–32.
3. *Id.* at 538.
4. *Id.*
5. *Id.* at 532–33 (citations omitted).

petition loans to help them emerge from bankruptcy.[6] However, following the credit crisis, it became increasingly difficult to obtain DIP financing, as "[t]he usual lenders . . . [had] exited the market, presumably due to either a lack of liquidity or their own financial struggles."[7] As such, it was necessary to seek out alternative DIP lenders;[8] 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 I provides an overview of the Chrysler and GM cases. Part II considers the criticism and commentary surrounding the use of Chapter 11 in the automotive cases. Part III situates the Chrysler and GM cases in the context of the broader bailout versus bankruptcy debates. Part IV uses the examples of Bear Sterns, AIG, Citibank, and Lehman Brothers (Lehman) to suggest that the use of Chapter 11 over a bailout is supported by American experience beyond the automotive cases. Part V considers the bankruptcy versus bailout approach in the Canadian context and explores a recent Canadian example—the asset-backed commercial paper crisis—to illustrate how bankruptcy has been used over bailouts in the Canadian context. Part V also identifies limitations to expanding this approach across borders. Finally, Part VI concludes.

I. OVERVIEW OF THE CHAPTER 11 AUTOMOTIVE CASES

In 2009, North American automotive manufacturers Chrysler and GM filed Chapter 11 petitions as a result of ongoing financial difficulties that suddenly came to a head as a consequence of the wider economic crisis.[9] These cases involved substantial similarities, and in many respects, Chrysler provided a "test run" for its larger, latter counterpart, GM. For example, both Chrysler's and GM's bankruptcies involved "quick sales" under § 363 of Chapter 11.[10] Under this section, a DIP is permitted, under some conditions, to sell its assets free and clear of any interest in them.[11] 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 when dealing with ongoing

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6. Jarrod B. Martin et al., *Freefalling with a Parachute That May Not Open: Debtor-in-Possession Financing in the Wake of the Great Recession*, 63 U. MIAMI L. REV. 1205, 1205 (2009).

7. *Id.*

8. *Id.*

9. *See* Kevin Krolicki & John Crawley, *GM Files for Bankruptcy, Chrysler Sale Cleared*, REUTERS, June 1, 2009, http://www.reuters.com/article/2009/06/01/us-gm-idUSN3044658620090601.

10. 11 U.S.C. § 363 (2010). For a detailed, comparative discussion of quick sales, *see* Stephanie Ben-Ishai & Stephen J. Lubben, *Sales or Plans: A Comparative Account of the "New" Corporate Reorganization*, 56 MCGILL L.J. 591, 591 (2011).

11. 11 U.S.C. § 363(f).

losses, limited lender funding commitments, and rapidly depleting assets.[12] Once a DIP chooses to dispose of its assets in a quick sale, the typical process involves finding an initial bidder (often known as a "stalking horse," for reasons that mystify many, including the authors) and approving the bidding procedures.[13] The overarching goal of this process is to maximize the value of the estate, thereby increasing creditors' returns.[14]

Although the Chrysler and GM cases followed the basic framework for a quick sale, they were noteworthy for their historic and economic importance, for the speed at which they occurred, and perhaps most significantly, because both corporations received substantial financing from the U.S. and Canadian governments.[15] As one of us describes,

> In both cases, the 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 [United Auto Workers]'s retiree health care trust, called the Voluntary Employee Beneficiary Associations. . . .[16]

More specifically, in the Chrysler case,

> [I]ts two largest creditors were secured creditors owed $6.9 billion and an unsecured employee benefit plan, owed $10 billion. [Chrysler] also owed trade creditors $5.3 billion, and it had warranty and dealer obligations of several billion dollars.
>
> [To address these issues,] [t]he government created and funded a shell company [(New Chrysler)] that, through a § 363 sale from Chrysler, bought substantially all of Chrysler's assets for $2 billion, giving the secured creditors a return of 29 cents on the dollar. FIAT was brought in to manage the new firm and was given a slice of the new company's stock. New Chrysler . . . then assumed the old company's debts to the [union] retirees, most dealers, and trade creditors. The $10 billion of unsecured claims owed to the retirees' benefits plan were replaced with a new $4.6 billion note as well as 55 percent of the new company's stock.[17]

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12. J. Vincent Aug et al., *The Plan of Reorganization: A Thing of the Past?*, 13 J. BANKR. L. & PRAC. 3, 4–5 (2004).

13. *No Big Deal*, *supra* note 1, at 534; *see also* Ben-Ishai & Lubben, *supra* note 10.

14. *No Big Deal*, *supra* note 1, at 535.

15. *Id.* at 536–37.

16. *Id.*

17. Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 733 (2010).

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.[18] 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.[19]

As with Chrysler, GM had both secured and unsecured debt, owing $19.4 billion in pre-petition debt to the U.S. Treasury and 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 JPMorgan Chase ($1.5 billion), Export Development Bank Canada ($400 million), and Gelco Corporation ($125 million).[20] Additionally, GM had $117 billion in unsecured debt to creditors such as the United Auto Workers (UAW) Trust (the UAW Trust).[21] 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.[22]

In terms of the GM agreement, its structure was quite similar to the Chrysler agreement. As with Chrysler, a new entity was formed (New GM), which purchased all of the substantial operating assets of the old company (Old GM) and also assumed some of its key liabilities, such as those owed to the UAW Trust.[23] In exchange, Old GM "receiv[ed] 10% of the equity in the reorganized company, plus warrants to purchase up to 15% more equity under certain conditions."[24] The U.S. and Canadian governments, who were 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.[25]

In the end, "[t]he first-priority secured lenders of Old GM (other than the U.S. Treasury and the Canadian government) were repaid their $6 billion in full by New GM. The unsecured lenders received . . . [the aforementioned 10 percent equity stake in New GM]. The shareholders of

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18. *No Big Deal*, *supra* note 1, at 537. This is significant, as "courts have developed rules to prevent the imposition of a reorganization plan through the § 363 sale process. This is known as the rule against '*sub rosa*' plans." *Id.* at 533.

19. *Id.* at 537. *See also In re* Chrysler, 405 B.R. 84, 92 (Bankr. S.D.N.Y. 2009), *aff'd*, 576 F.3d 108 (2d Cir. 2009), *vacated as moot*, Ind. State Police Pension Trust v. Chrysler, 130 U.S. 1015 (2009).

20. A. Joseph Warburton, *Understanding the Bankruptcies of Chrysler and General Motors: A Primer*, 60 SYRACUSE L. REV. 531, 537 (2010).

21. *Id.*

22. *Id.*

23. *Id.* at 537–38. *See also In re* Gen. Motors Corp., 407 B.R. 463 (Bankr. S.D.N.Y. 2009).

24. *No Big Deal*, *supra* note 1, at 538.

25. Warburton, *supra* note 20, at 538. Under the U.S. 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 the cancelling of indebtedness in the amount of the bid. 11 U.S.C. § 363(k) (2010).

Old GM received nothing."[26] It is worth noting that, "[a]s it did with Chrysler, the UAW [made] concessions to New GM on employee compensation and benefits and on retiree healthcare."[27] The UAW received common stock (with warrants to purchase more), preferred stock, and an additional $2.5 billion note in exchange for their compromise.[28]

II. CRITICISM AND COMMENTARY ON THE AUTOMOTIVE CASES

Barry Adler's allegation, that "[t]he descent of Chrysler and [GM] into bankruptcy threatens the Chapter 11 reorganization process itself[,]"[29] 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."[30] Essentially, Adler posits that the manner in which the automotive bankruptcies were carried out favored 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 threat of insolvency will increase the cost of capital in an economy where affordable credit is sorely needed."[31]

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.[32] 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 "underpriced" is often difficult to discern.

More importantly, although many critics believe that these cases involved a "precedent-setting distortion of bankruptcy priorities,"[33] this is not necessarily the case. Rather, these cases simply reflected the standard U.S. 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

26. Warburton, *supra* note 20, at 538.
27. *Id.* at 538.
28. *See id.*
29. Barry E. Adler, *A Reassessment of Bankruptcy Reorganization After Chrysler and General Motors*, 18 AM. BANKR. INST. L. REV 305, 305 (2010).
30. *Id.*
31. *Id.*
32. *When Fortune Frowned*, THE ECONOMIST, Oct. 9, 2008, at S3.
33. Warburton, *supra* note 20, at 532.

the creditor control normally exercised by private lenders."[34] Or, as one of us less politely explained, "[i]n the past decade lenders have learned how to play the chapter 11 game. . . . [W]hen I see these same institutional investors acting like Captain Renault, I'm skeptical."[35]

In these cases, the governments, as DIP lenders, used their power as lenders to force a separation of the good and bad assets of the companies.[36] 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.[37] Whether secured lender domination of the Chapter 11 process is a good thing is open to debate, and 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.[38] Moreover, these dissenters also have highlighted the fact that in Chrysler, secured creditors received twenty-nine cents on the dollar, and general unsecured creditors received nothing.[39] In GM, secured creditors were paid in full, and unsecured creditors received a partial payment.[40] That looks a lot like the application of the absolute priority rule.[41]

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."[42] Yet, determining which creditors should be preferred is a matter of policy, and despite arguments that these cases

34. Edward R. Morrison, *Chrysler, GM and the Future of Chapter 11* (Ctr. for L. & Econ. Stud. at Colum., Working Paper No. 365, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1529734.

35. Stephen Lubben, *Shocked, Shocked*, CREDIT SLIPS (June 5, 2009, 8:15 AM), http://www.creditslips.org/creditslips/2009/06/shocked-shocked-1.html.

36. Morrison, *supra* note 34**,** at 4.

37. *Id.* at 1.

38. Richard A. Epstein, *The Deadly Sins of the Chrysler Bankruptcy: Why Mortgage Priorities Matter*, FORBES, May 12, 2009, http://www.forbes.com/2009/05/11/chrysler-bankruptcy-mortgage-opinions-columnists-epstein.html.

39. *See* Fred N. David, *Interpreting the Supreme Court's Treatment of the Chrysler Bankruptcy and its Impact on Future Business Reorganizations*, 27 EMORY BANKR. DEV. J. 25, 32 (2010).

40. *See* Eric Morath, *GM Creditors Sue U.S. over $1.5 Billion Dispute*, MARKETWATCH (June 8, 2011, 3:27 PM), http://www.marketwatch.com/story/gm-creditors-sue-usover-15-billion-dispute-2011-06-08; Linda Sandler, Jeff Green & Mike Ramsey, *GM Bankruptcy Seen as Tale of Best, Worst of Assets*, BLOOMBERG, May 29, 2009, http://www.bloomberg.com/apps/news?pid=21070001&sid=av48.BJYaJbU.

41. The absolute priority rule provides that creditors of a higher priority must get paid in full before the lower ranked creditors (or shareholders) get anything. For example, secured creditors are paid before unsecured creditors, who must be paid before shareholders. 11 USC § 1129(b)(2)(B) (2006). *See also* Case v. L.A. Lumber Prod. Co., 308 U.S. 106, 116 (1939); Wilkow v. Forbes, Inc., 241 F.3d 552, 554 (7th Cir. 2001).

42. *No Big Deal*, *supra* note 1, at 531.

violated the "rule of law," "the rule of law is not violated by a policy disagreement."[43]

Complaints about the amount received by secured creditors under the quick sale are also perplexing, as thirty cents on the dollar is a relatively average recovery rate during a bankruptcy. As Nouriel Roubini notes, "in the past seven months, completed [Credit Default Swap] . . . auctions resulted in a recovery rate of 30 cents on the dollar for loans and about 15 cents on the dollar for bonds,"[44] 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.[45] Yet, much like the recovery rate of thirty cents on the dollar for secured creditors, this too is not unusual. Claims by shareholders for the return of equity do not rank as high as the claims of creditors in bankruptcy.[46] Consequently, under bankruptcy law, shareholders do not recover anything unless the claims of all creditors are satisfied.[47] As such, one 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."[48] This argument is significant insofar as courts have developed rules to curb the imposition of reorganization plans under the § 363 sales process.[49] A ready response to this argument, however, has already been made that in light of the dearth of alternative bidders in the automotive cases, bidding procedures are entirely irrelevant.[50] Specifically, given the state of credit markets, "those who take for granted the existence of unknown or theoretical bidders have some obligation to

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43. *Id.*

44. Nouriel Roubini, *The Impact of Chrysler's Bankruptcy: Lessons for GM—and for the Rest of Us*, FORBES, May 5, 2009, http://forbeslife.nl/2009/05/06/chrysler-gm-fiat-bankruptcy-opinions-columnists-nouriel-roubini.html.

45. David, *supra* note 39, at 32.

46. Allen v. Geneva Steel Co. (*In re* Geneva Steel Co.), 281 F.3d 1173, 1180 n.4 (10th Cir. 2002); *see also* Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 202 (1988); Grp. of Inst. Investors v. Chi., Milwaukee, St. Paul & Pac. R.R. Co., 318 U.S. 523, 565–66 (1943).

47. *In re* Armstrong World Indus., Inc., 432 F.3d 507, 512 (3d Cir. 2005). *See* Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 140.1. 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.

48. *No Big Deal*, *supra* note 1, at 532.

49. *Id*. at 533.

50. *Id.* at 532.

explain how such a bidder would have bought GM, a company with $27 billion of secured debt."[51]

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 United States and Canada would have happily washed their hands of the entire matter.

III. 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 United States 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 Board's (the Fed) and the U.S. Treasury's differing treatment of Bear Sterns, which was bailed out, Lehman, which went bankrupt, and then AIG, which was also 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. government put forth a bailout plan with the dual purpose of saving the banks while also encouraging them to lend, thus saving the broader economy.[52] 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."[53] These banks were essentially deemed "too big to fail," especially when failures were apt to come in bunches. Implicit in this argument is the belief that failing—or going bankrupt—in this case, would be catastrophic. Accordingly, the central "benefit" of a bailout was that it was not bankruptcy.

Indeed, one of the key arguments often advanced in favor of bailouts is the ability to sidestep "supposedly severe consequences that would follow" from a bankruptcy.[54] 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."[55] These concerns are characterized as "firm-specific risks."[56] Second, critics

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51. *Id.* (emphasis omitted).
52. Jeffrey A. Miron, *Bailout or Bankruptcy?*, 29 CATO J. 1, 11 (Winter 2009), *available at* http://www.cato.org/pubs/journal/cj29n1/cj29n1-1.pdf.
53. *Id.*
54. Kenneth Ayotte & David A. Skeel, Jr., *Bankruptcy or Bailouts?*, 35 J. CORP. L. 469, 470 (2010).
55. *Id.*
56. *Id.* (emphasis omitted).

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 derivative counterparties) have direct claims on the firm, while others hold contracts whose value is tied to the distressed firm."[57] The premise of this argument is that a bankruptcy filing has "spillover effects," such that the bankruptcy of one firm will adversely affect several others, and possibly the economy as a whole.[58]

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."[59] They argue:

> 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 costs, over and above the direct and substantial cost to the taxpayer of rescue funding.[60]

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,"[61] 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."[62]Ayotte and Skeel acknowledge that there is no perfect solution; when a firm is failing, someone always loses. They contend:

> 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.[63]

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

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57. *Id.* at 471.
58. *See* Hal S. Scott, *The Reduction of Systemic Risk in the United States Financial System*, 33 HARV. J. L. & PUB. POL'Y 671, 673 (2010).
59. Ayotte & Skeel, *supra* note 54, at 471.
60. *Id.*
61. *Id.*
62. *Id.* at 471–72.
63. *Id.* at 472 (citations omitted).

that forces counterparties to bear losses when there are not enough assets to satisfy all counterparty claims."[64] Jeffrey Miron concurs, claiming that "U.S. policymakers should have allowed the standard process of bankruptcy to operate."[65] Miron contends 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."[66]

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 a result of the actual bankruptcy, or the fact that a major business is in financial distress.[67] Accordingly, the contention that filing for bankruptcy, in and of itself, initiates some kind economic domino effect remains to be 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."[68]

IV. BEAR STERNS, AIG, AND CITIBANK VERSUS LEHMAN

While in the automotive context the American government consistently utilized the Bankruptcy Code, its choice of process with respect to financial institutions can be charitably described as erratic.[69] During the financial crisis, three investment 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 finally, through another 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

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64. *Id.*

65. Miron, *supra* note 52, at 2 (noting that the term bankruptcy indicates "any official reorganization or liquidation procedure").

66. *Id.*

67. Stephen J. Lubben, *Systemic Risk & Chapter 11*, 82 TEMP. L. REV. 433, 437 (2009) [hereinafter *Systemic Risk & Chapter 11*].

68. Miron, *supra* note 52, at 12.

69. This was also the finding of the report released by the Financial Crisis Inquiry Commission (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." FINANCIAL CRISIS INQUIRY COMMISSION, CONCLUSIONS OF THE FINANCIAL CRISIS INQUIRY COMMISSION xxi (2011), *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_conclusions.pdf. We speak here of nonbank financial institutions. In both the United States and Canada, banks are subject to a separate insolvency system. *See* Stephanie Ben-Ishai, *Bank Bankruptcy in Canada: A Comparative Perspective*, 25 BANKING & FIN. L. REV. 59 (2009).

even lesser degree of transparency than the already opaque publicly acknowledged bailouts.[70]

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.[71] However, it ran with the flock when it decided to place a hefty, leveraged bet on the weak end of the U.S. mortgage market.[72]

Specifically, in summer 2007, Bear Stearns Asset Management, a hedge fund subsidiary of Bear Sterns, "reported 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 virtually all of its investor capital."[73] At one point, the "Structured Credit Fund had around $1 billion, while the Enhanced Leveraged Fund, which was less than a year old, had nearly $600 million in investor capital."[74] The two funds were heavily invested in mortgage-backed securities, both directly and via synthetic structures that used derivatives to replicate the effects of mortgage-backed loans.[75] After this announcement, the next year saw Bear Stearns disclose similar losses in its own trading, and the development of a general run on Bear Sterns began, causing investors in the two funds to become increasingly disgruntled.[76] The New York Federal Reserve Bank (the N.Y. Fed) decided to loan money to support the purchase of Bear Sterns by JPMorgan Chase (Chase).[77] Additionally, the N.Y. 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 N.Y. Fed.[78]

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70. Shahien Nasiripour, *Citigroup Was on the Verge of Failure, New Report Finds; Rescue Was Based on 'Gut Instinct,'* HUFFINGTON POST (updated May 25, 2011, 7 :25 PM), http://www.huffingtonpost.com/2011/01/13/citigroup-was-on-the-verg_n_808721.html.

71. *See* RICHARD A. POSNER, A FAILURE OF CAPITALISM: THE CRISIS OF '08 AND THE DESCENT INTO DEPRESSION 252 (2009).

72. Matthew Goldstein & David Henry, *Bear Stearns' Hunt for Big Cash*, BLOOMBERG BUSINESSWEEK, June 13, 2007, http://www.businessweek.com/bwdaily/dnflash/content/jun2007/db20070613_321601.htm; *The $2 Bail-Out*, THE ECONOMIST, Mar. 22, 2008, http://www.economist.com/node/10881453.

73. *In re* Bear Stearns Cos. Sec., Derivative, & ERISA Litig., 763 F. Supp. 2d 423, 558 (S.D.N.Y. 2011).

74. *Id.*

75. *Id.* at 448; Michael C. Macchiarola, *Beware of Risk Everywhere: An Important Lesson from the Current Credit Crisis*, 5 HASTINGS BUS. L.J. 267, 271–72 (2009).

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

77. 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.

78. *Bear Stearns, JPMorgan Chase, and Maiden Lane LLC*, BD. OF GOVERNORS OF THE FED. RESERVE SYS., http://www.federalreserve.gov/newsevents/reform_bearstearns.htm (last updated Dec. 15, 2011).

Despite these heavy investments by the N.Y. Fed, Bear Sterns shareholders received $10 per share from Chase.[79] 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 this 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.[80]

Seeing that Bear Sterns was not the last bank that would fail, and facing the possibility that the U.S. government would eventually have to bail out 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. Instead, 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 Fed 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 § 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.

Lehman stands most in contrast to AIG, which failed almost immediately after Lehman.[81] 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.[82]

The Fed first bailed out AIG in September 2008 with an $85 billion loan, part of a total of $150 billion lent to the company.[83] The N.Y. Fed also

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79. *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, 719 (2009).

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

81. *See* William K. Sjostrom, Jr., *The AIG Bailout*, 66 WASH. & LEE L. REV. 943, 943 (2009).

82. *See* James B. Stewart, *Eight Days: The Battle to Save the American Financial System*, THE NEW YORKER, Sept. 21, 2009, at 59.

83. Joe Nocera, *Propping Up a House of Cards*, N.Y. TIMES, Feb. 28, 2009, at B1.

led a controversial plan in late 2008 to help AIG cancel over $50 billion in credit derivative swap contracts with U.S. and European banks by paying the banks in full for their contracts with AIG.[84]

In the latter instance, both the Fed and the U.S. Treasury resisted efforts by reporters to discover who these banks were.[85] 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.[86] The latter information demonstrated how the Fed 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 2008, Citibank neared its own failure, even after it had already taken $25 billion in Troubled Asset Relief Program (TARP) funds from the U.S. Treasury to shore up its capital.[87] Ultimately, Citibank would require $45 billion in bailout funds and a ten-year government-backed insurance policy on more than $300 billion of mortgages and other related securities before it stabilized.[88] 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 later.[89]

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.[90] Bondholders in these companies were spared any losses whatsoever.[91] This stands in stark contrast to Lehman, where shareholders were apt to be wiped out and bondholders would 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 Sachs was favored by government officials and that TARP recipients were pressured to support administrative policy, including the automotive bankruptcy cases. Many of

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84. Michael Simkovic, *Secret Liens and the Financial Crisis of 2008*, 83 AM. BANKR. L.J. 253, 284 n.157 (2009); Yomarie Silva, *The "Too Big to Fail" Doctrine and the Credit Crisis*, 28 REV. BANKING & FIN. L. 115, 125 (2009).

85. Declan McCullagh, *Fed Under Pressure to Reveal AIG Bailout Recipients*, CBS MONEY WATCH (Mar. 9, 2009), http://www.cbsnews.com/8301-503983_162-4854959-503983.html.

86. *Systemic Risk & Chapter 11*, *supra* note 67, at 438–39.

87. Eric Dash, *Citigroup to Halt Dividend and Curb Pay*, N.Y. TIMES, Nov. 23, 2008, http://www.nytimes.com/2008/11/24/business/24citibank.html.

88. Nasiripour, *supra* note 70.

89. *Id.*

90. Joe Nocera, *Sheila Bair's Bank Shot*, N.Y. TIMES MAGAZINE, July 9, 2011, at 25.

91. *Id.*

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 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 distressed financial institutions.

V. BANKRUPTCY VERSUS BAILOUT IN CANADA: THE ASSET-BACKED COMMERCIAL PAPER CRISIS

In this section, we further develop our thesis that the automotive cases are a good case study for the effective use of bankruptcy over bailout. We have argued that the comparison of the Lehman 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 demonstrates 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)[92] allows a debtor to make use of a quick sale procedure similar to the Chapter 11 procedure.[93] In Canada, however, 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 its 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 a proceeding, whereas Chapter 11 does not.[94] 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.[95] 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 United States, it is quite clear that Chapter 11 can be used for liquidation.[96]

We have shown that questions of speed and certainty mark the biggest difference between these two jurisdictions, as the CCAA is more than sufficiently flexible to account for simple procedural differences. It is likely that this combination of factors—speed and certainty—is the most plausible explanation for the failure to use the CCAA in the automotive cases. It is

92. Companies Creditors' Arrangement Act, R.S.C. 1985, c. C-36.
93. Ben-Ishai & Lubben, *supra* note 10, at 599.
94. 11 U.S.C. § 109(d) (2010).
95. Ben-Ishai & Lubben, *supra* note 10, at 599.
96. Stephen J. Lubben, *Business Liquidation*, 81 AM. BANKR. L.J. 65, 65 (2007).

also possible, however, that the Canadian governmental actors involved in the automotive cases preferred to act in the U.S. forum, which may have been less transparent to a Canadian observer and thus, less likely to result in political consequences at home.

Setting aside the question of the advantages and disadvantages 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 and the automotive cases. While the government clearly had a role in the CCAA process, this example is not identical to the American cases as it is unclear what was provided by 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] purchases of assets that back-up the ABCP and generate cash flow."[97] 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.[98] 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."[99] The repayment of maturing ABCP is accomplished via the cash

> generated by an issuer trust's underlying asset portfolio and the issuance of new ABCP. In addition, to provide ABCP trusts with a back-up source

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97. Jay M. Hoffman & Jeffrey C. Carhart, Miller Thomson LLP, Canadian Asset-Backed Commercial Paper Crisis (Oct. 3, 2007), http://www.millerthomson.com/assets/files/newsletter_attachments/issues/eSecurities_Notes_October_3_2007.pdf. *See also* Viral V. Acharya & Phillip Schabl, *Do Global Banks Spread Global Imbalances? Asset-Backed Commercial Paper During the Financial Crisis of 2007–09*, 58 IMF ECON. REV. 37 (2010), *available at* http://www.imf.org/external/np/res/seminars/2009/arc/pdf/acharya.pdf; Jeffrey Carhart & Jay Hoffman, *Canada's Asset Backed Commercial Paper Restructuring: 2007–2009*, 25 BANKR. & FIN. L. REV. 35, 36 (2009); Daniel M. Covitz, Nellie Liang & Gustavo A. Suarez, *The Evolution of a Financial Crisis: Panic in the Asset-Backed Commercial Paper Market* (Fed. Reserve Bd. Divs. of Research & Statistics, & Monetary Affairs, Staff Working Paper 2009-36), *available at* http://www.federalreserve.gov/pubs/feds/2009/200936/200936pap.pdf; Fred Myers & Alexa Abiscott, *Asset Backed Commercial Paper: Why the Courts Got It Right*, 25 BANKR. & FIN. L. REV. 5 (2009).

98. Stephen J. Lubben, *The Bankruptcy Code Without Safe Harbors*, 84 AM. BANKR. L.J. 123, 139 (2010).

99. Hoffman & Carhart, *supra* note 97.

> 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' . . . .[100]

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;[101] on the other, there is ABCP issued by trusts which are not sponsored or managed by banks.[102]

In 2007, on the heels of the sub-prime mortgage crisis in the United States, a liquidity crisis began to threaten the ABCP market in Canada.[103] 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.[104] 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 (e.g., 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.[105] During the credit crisis, many investors stopped buying ABCP and rolling over their notes. Instead, they sought to redeem them. Yet, as a result of the timing mismatch, most funds were unable to pay holders of maturing ABCP, which created a liquidity crisis for holders.[106] In short, something similar to 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

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100. *Id.*

101. *See* Schedule I Banks, Canadian Bankers Ass'n, http://www.cba.ca/en/banks-in-canada/61-banks-operating-in-canada/110-schedule-i-banks (last modified May 30, 2011). 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. Following the implementation of Bill C-38 in 2001, however, 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 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, Globalisation, Deregulation and Financial Services Reform in Canada: Legislating Canada's "Superbanks" (Summer 2006) (unpublished Ph.D. thesis), *available at* www.summit.sfu.ca/system/files/iritems1/2952/etd2366.pdf).

102. Hoffman & Carhart, *supra* note 97.

103. *Id.* at 2.

104. ATB Fin. v. Metcalfe & Mansfield Alt. Inv. II Corp., 2008 ONCA 587, para. 1, *available at* http://www.ontariocourts.on.ca/decisions/2008/august/2008ONCA0587.htm [hereinafter Metcalfe & Mansfield Court of Appeal].

105. Myers & Abiscott, *supra* note 97, at 7.

106. Hoffman & Carhart, *supra* note 97, at 2.

rarely had any idea about the specific assets supporting their notes, and this further added to investors' lack of confidence.[107]

As a result of the impending crisis, in August 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,

> these 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 governing 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.[108]

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.[109]

Following the Montreal Proposal, an investor committee, chaired by Purdy Crawford, was formed to oversee the restructuring of the ABCP market.[110] This committee became known as the Pan-Canadian Investors Committee, or the Crawford Committee. Although their plan was "highly complex and involve[d] many parties,"[111] its essence was this: to "convert the [n]oteholders' paper—which has been frozen and therefore effectively worthless for many months—into new, long-term notes that would trade freely, but with a discounted face value."[112] In an attempt to deal with the transparency issues that precipitated the crisis in the first place, investors would be informed about the assets supporting their notes.[113] The plan also aimed to "address[] the timing mismatch between the notes and the [underlying] assets by adjusting the maturity provisions and interest rates on the new notes. Further, the [p]lan adjusts some of the underlying credit

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107. Myers & Abiscott, *supra* note 97.

108. Hoffman & Carhart, *supra* note 97.

109. Metcalfe & Mansfield Court of Appeal, 2008 ONCA 587, para. 2.

110. Hoffman & Carhart, *supra* note 97, at 2. Mr. Crawford is a leading figure among Canadian corporate lawyers. *See also* Daryl-Lynn Carlson, *Purdy Crawford: Doing it All*, CANADIAN LAWYER (Nov. 2009), http://www.canadianlawyermag.com/Purdy-Crawford-Doing-it-all.html; Jim Middlemiss, *A Second Chance at ABCP Justice*, FIN. POST, Oct. 6, 2010, at FP.1; *Biography of Purdy Crawford*, OSLER.COM, http://www.osler.com/ourpeople/Profile.aspx?id=1069 (last visited Dec. 31, 2011); *Purdy Crawford Named One of Canada's 25 Most Influential Lawyers*, OSLER.COM (Aug. 2010), http://www.osler.com/NewsResources/Details.aspx?id=2666.

111. Metcalfe & Mansfield Court of Appeal, 2008 ONCA 587, para. 24.

112. *Id.* at para. 24.

113. *Id.* at para. 25.

default swap contracts by increasing the thresholds for default . . . ."[114] Additionally, in order to make the notes more secure, the plan would pool the majority of assets underlying ABCP into two master vehicles.[115]

The plan also included third-party releases from any liability associated with the ABCP. Thus, noteholders would have to give up their claims, which were mostly tort claims alleging negligence, misrepresentation, negligent misrepresentation, failure to act prudently as a dealer/advisor, and acting in conflict of interest.[116] Specifically, the plan called for "the release of Canadian banks, Dealers, Noteholders, Asset Providers, Issuer Trustees, Liquidity Providers, and other market participants – in Crawford's words, 'virtually all participants in the Canadian ABCP market' – from any liability associated with ABCP . . . ."[117] 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 margin funding facilities designed to make the notes more secure. It also required sponsors to give up their existing contracts, banks to provide below-cost financing for the margin funding facility, and other parties to make various contributions to the plan.[118] 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.[119]

Yet, 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.[120] Specifically, the Dissident Noteholders felt that their chances of receiving value under the plan were not sufficient to surrender their right to litigate.[121] Moreover, the Dissenting Noteholders took issue with the releases granted under the plan. In particular, the Dissenting Noteholders questioned whether the court could 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.[122]

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114. *Id.*

115. *Id.* at para. 26.

116. *Id.* at para. 29. There were also allegations of breach of fiduciary duty and claims for other equitable relief. *Id.*

117. *Id.*

118. *Id.* at para. 31, 32.

119. *Id.* at para. 36.

120. Myers & Abiscott, *supra* note 97, at 10.

121. *Id.* at 10.

122. Metcalfe & Mansfield Court of Appeal, 2008 ONCA 587, 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 United States on the permissibility of such releases.

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.[123] 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:

> 1. Are the parties to be released necessary and essential to the restructuring of the debtor?
> 2. Are the claims to be released rationally related to the purpose of the Plan and necessary for it?
> 3. Can the Court be satisfied that without the releases the Plan cannot succeed?
> 4. Are the parties who will have claims against them released contributing in a tangible and realistic way to the Plan?
> 5. Is the Plan one that will benefit not only the debtor but creditor Noteholders generally?
> 6. Have the voting creditors approved the Plan with knowledge of the nature and effect of the releases?
> 7. Is the Court satisfied that in the circumstances the releases [were] fair and reasonable in the sense that they were not overly broad and not offensive to public policy?[124]

Ultimately, in holding that the plan—including the third-party releases—was fair and reasonable,[125] Justice Campbell dismissed the claims of the Dissenting Noteholders, characterizing their desire to defeat the plan as a "tyranny by the minority."[126] 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."[127]

This decision was then appealed to the Court of Appeal for Ontario, where the court was required to determine the permissible scope of a restructuring under the CCAA.[128] Furthermore, on appeal, the dissenting creditors proposed that if the court can indeed sanction such a plan, then the

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123. ATB Fin. v. Metcalfe & Mansfield Alt. Inv. II Corp., 2008 CanLII 27820 (ONSC), para. 157, *aff'd*, Metcalfe & Mansfield Court of Appeal, 2008 ONCA 587, *available at* http://www.bfrs.ca/PDF/Turner/Metcalfe_&_Mansfield_Alternative_Investments_II_Corp._(Re),_2008_CanLII_27820_(ON_S.C.).pdf.

124. *Id.* at para. 143.

125. *Id.* at para. 144.

126. *Id.* at para. 138.

127. *Id.* at para. 155.

128. Metcalfe & Mansfield Court of Appeal, 2008 ONCA 587, para. 3.

applications (i.e., trial) judge erred in holding that this particular plan was fair and reasonable.[129]

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.[130] The Court of Appeal for Ontario added that "[a]n interpretation of the CCAA that recognizes its broader socioeconomic purposes and objects is apt in this case. As the application judge pointed out, the restructuring underpins the financial viability of the Canadian ABCP market itself."[131] Accordingly, in order to facilitate the broader socioeconomic purposes underlying the CCAA, the court established that third-party releases are indeed permissible where they are reasonably connected to the restructuring at hand. Justice Blair summarized this rule:

> 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."[132]

Ultimately, the court saw no reason why a release in favor of a third-party, negotiated as part of a package between a debtor and creditor and reasonably relating to the proposed restructuring, cannot fall within this framework.[133] The court also held that the releases were reasonably justified as part of the compromise between the debtors 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 for Ontario 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."[134]

Finally, in rendering his decision for the Court of Appeal for Ontario, Justice Blair stressed the importance of this compromise to the ABCP

129. *Id.*
130. *Id.* at para. 44.
131. *Id.* at para. 53.
132. *Id.* at para. 61.
133. *Id.*
134. *Id.* at para. 112.

market as a whole. Situating this case within the broader context of restructuring proceedings, Justice Blair posited:

> 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.[135]

Interestingly, unlike the American critique of the automotive cases, which focused on the allegation that the Chapter 11 process was subverted, the Canadian response, having been 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 on which to make an informed decision.[136] Similarly, in the same article, Peter Brown, Chairman and Founder of Canaccord Capital Group, claimed that "some big investment firms sold ABCP in July [2007] knowing that some issuers were facing challenges. In an interview, Mr. Brown said that [relevant] information was not available to the general market."[137]

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:

> The banks operate in a highly regulated environment and one of the regulators -- 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

135. *Id.* at para. 117.
136. *Redcorp Ventures Criticizes ABCP Bailout Plan*, FINANCIAL POST (CANADA), Aug. 24, 2007, http://www.financialpost.com/story.html?id=c83bc705-35e0-4169-95eb-f61633bfeea9&k=69266.
137. *Id.*

> interest, certainly in the interests of the functioning of the financial markets, and all participants are expected to do their share . . . .[138]

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 of Canada never considered using public funds to bail out the country's $35 billion non-ABCP market.[139]

Outlining why public funds would not be used to bail out the ABCP market, Carney stated that financial market participants who "took [ABCP], . . . [were] sophisticated . . . . Th[is] is not the place to put taxpayers' dollars or the balance sheet of the Bank of Canada."[140] Rather than bail out 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.[141]

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 eighteen months following the plan's implementation. During this period, collateral calls on certain credit default swaps were forbidden, and "an additional $3.45 billion senior ranking 'back stop' margin funding facility [was] 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 the other margin facilities [were] exhausted."[142] 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.[143]

CONCLUSION

This Article began by setting aside notions that governments always act unfairly, whether it makes sense to save an industry at all, and by discussing the causes of the financial failure of the automotive and financial industries.

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138. Barry Critchley, *TD May Join ABCP Bailout*, FINANCIAL POST (CANADA), Dec. 19, 2007, http://www.financialpost.com/opinion/story.html?id=d7eefab7-9dc6-44c4-93e5-b6b5ee3761f8.

139. *Bank of Canada Didn't Consider ABCP Bailout–Carney*, REUTERS, Feb. 18, 2008, http://uk.reuters.com/article/idUKN1820571220080218.

140. *Id.*

141. *Id.*

142. Carhart & Hoffman, *supra* note 97, at 58.

143. Myers & Abiscott, *supra* note 97, at 5; *see also* William A. Scott & Philip J. Henderson, *Restructuring Canada's ABCP: A Unique, Successful, Private Restructuring*, 28 INT'L FIN. L. REV. 30, 30 (2009).

With that, we 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 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 government intervention and how various stakeholders will make out, bankruptcy as bailout is a less effective option. Only with transparency can a bankruptcy-bailout mechanism hope to achieve political legitimacy.