Not a Bank, Not a SIFI; Still Too Big to Fail

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ABSTRACT

Many have wrestled with too big to fail firms, with the attention predominantly focused on banks, especially the so-called systemically important ones, i.e. SIFI's ("Systematically Important Financial Institutions"). In this Article we look at too big to fail firms. We focus on cases of large firms that are not banks but were considered too big to fail when in financial distress. We look at a diverse set of multi-jurisdictional, internationally active, and nationally very important large firms, analyze their outcomes and whether and in what way they were supported by their respective governments. This analysis reveals that all these firms can be categorized in one of four types of resolution frames: a standard bankruptcy procedure, a bankruptcy procedure with funding support from the state, an ad hoc solution, and a full bailout by the government. We argue that only the first two types are needed for resolving financial distress, with the latter two inefficient. We provide arguments for the efficiency of the government support via the bankruptcy procedure in a jurisdiction and we discuss how this fits our cases. We conclude that for large firms the moral hazard associated with the too big to fail argument can be mitigated, but that it at least implies a bankruptcy procedure that is able to handle such large cases.

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INTRODUCTION

The notion that some corporations (and even sovereigns) are simply "too big to fail" is a well-known concept in the financial sector.[1] But what about financial distress among giant corporate groups that are not banks? Are these companies also too big to fail, or does the extant bankruptcy or insolvency system work for them?

That is, are very large, or "jumbo" corporate bankruptcy or insolvency cases inherently different from normal cases? When a jurisdiction faces the prospect of a national champion on the brink of failure, do the normal rules apply or does the government scramble to fashion an ad hoc solution?

This is, of course, a version of the too big to fail question, but our focus here is not on financial institutions, but rather "real economy" firms. In that context, we ask the basic question of "bankruptcy or bailout?"

To get at this question, we consider the biggest corporate failures from a range of developed economies. The temptation is to focus on the United States ("U.S."), since that provides a single, large economy, with a single source of law—almost as if the European Union ("EU") had adopted an EU level bankruptcy law, with EU bankruptcy courts.

But we resist that temptation, because we suspect that at least in part law does matter. In particular, it seems likely that the restructuring tools offered by a particular jurisdiction—assuming that there is a restructuring option available—will at least partially answer the questions we ask. Namely, we hypothesize that having a well-developed reorganization system may reduce the pressure for a bailout, or any other intervention by political authorities.

Conversely, a country might be motivated to adopt a modern bankruptcy system only when the pressure of a national champion comes into play. Parmalat's bankruptcy represented 1.5 percent of Italian GNP, much more like Lehman than Enron or other well-known U.S. corporate bankruptcies when considered as a percentage of U.S. GNP. It is thus perhaps unsurprising that the Italian government was unwilling to test out the "normal" Italian bankruptcy system with a firm of such local significance.

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[1] *E.g.*, Stephen J. Choi & G. Mitu Gulati, *Innovation in Boilerplate Contracts: An Empirical Examination of Sovereign Bonds*, 53 EMORY L.J. 929, 989 (2004); Helen A. Garten, *Banking on the Market: Relying on Depositors to Control Bank Risks,* 4 YALE J. ON REG. 129, 146 (1986); Peter P. Swire, *Bank Insolvency Law Now That It Matters Again*, 42 DUKE L.J. 469, 514 (1992).

But insolvency law is not the only factor at play. Law can reduce the pressure for a bailout, but not eliminate it altogether.[2] The background state of the economy matters very much too. Thus, the American government can risk using "normal" chapter 11 procedures when Texaco[3] or Pacific Gas and Electric files for bankruptcy during relatively normal times, even if PG&E is the primary utility company in the largest state in the nation it will be allowed to use chapter 11, but might hesitate to do so when General Motors faces bankruptcy in the midst of a global financial crisis.[4]

In this Article we examine our group of extremely large corporate insolvency cases from around the world to tell the story of the "too big to fail" bankruptcy outside the financial industry context.

We develop a matrix of four basic approaches to the failure or potential failure of a national champion. Using this matrix, we argue that bailouts, and the problems associated therewith, can be best avoided by governmental support of the traditional bankruptcy process in times of systemic crisis. We conversely argue that ad hoc statutory solutions too often reflect neglected legal reform efforts that would be better addressed ex ante, before a crisis hits.

In a model world, all firms, no matter what size, would be resolved under the same bankruptcy or insolvency process. But in times of market failure, including times when needed funding of the reorganization process are unavailable, this may not be a realistic option.[5] The choice at this point is no longer between reorganization and bailout, but instead between liquidation and bailout.[6] We submit that under these circumstances, government assistance can put the reorganization option back on the table.[7]

Thus, we conclude that good reorganization laws are but a first step toward avoiding bailouts, and the moral hazard attendant with such. In addition to a

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2 *See* Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 367 (1993).

3 We do not cover Texaco in this Article, but accounts of the case can be found in Lynn M. LoPucki & Walter O. Weyrauch, *A Theory of Legal Strategy*, 49 DUKE L.J. 1405, 1421–22 (2000) and Robert H. Mnookin & Robert B. Wilson, *Rational Bargaining and Market Efficiency: Understanding Pennzoil v. Texaco*, 75 VA. L. REV. 295 (1989).

4 *See* Kenneth Ayotte & David A. Skeel, Jr., *Bankruptcy or Bailouts?,* 35 J. CORP. L. 469, 478 (2010).

5 *See* Stavros Gadinis, *From Independence to Politics in Financial Regulation*, 101 CAL. L. REV. 327, 374 (2013).

6 *Cf.* Jonathan C. Lipson, *Against Regulatory Displacement: An Institutional Analysis of Financial Crises*, 17 U. PA. J. BUS. L. 673, 705 (2015).

7 *See* Jeffrey Manns, *Building Better Bailouts: The Case for A Long-Term Investment Approach*, 63 FLA. L. REV. 1349, 1361 (2011).

workable statute, which includes a workable insolvency process, the state must be able and willing to intervene in connection with specific market failures.[8] An ability to do so will reduce the need to intervene in a more general sense.

A. Too Big to Fail, In Brief

The "too big to fail" concept, although long in gestation, burst into public view in 1984, when the United States House Banking Committee held hearings on the $4.5 billion bailout of Continental Illinois National Bank & Trust Co. of Chicago.[9] At that hearing, the Comptroller of the Currency told Congress that the United States government would not allow any of the nation's largest banks to fail.[10] The Comptroller thus verbalized a preexisting reality, a reality that continues to exist in some jurisdictions.[11]

The idea is that certain of the largest financial institutions, the "too big to fail" firms, will not be allowed to fail.[12] As a result, these financial institutions expect a governmental bailout, and will engage in extra risky behavior.[13] "Too big to fail" financial institutions effectively operate with the benefit of a government guarantee, which protects shareholders from the normal consequences of taking on excessive risk.[14] As a result, these financial institutions will incur moral hazard.[15]

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[8] *See* Antonio E. Bernardo et. al., *Designing Corporate Bailouts*, 59 J.L. & ECON. 75, 78 (2016).

[9] Arthur E. Wilmarth, Jr., *Too Good to Be True? The Unfulfilled Promises Behind Big Bank Mergers*, 2 STAN. J.L. BUS. & FIN. 1, 44 (1995); *see also* Marsha Hymanson, *Borrower Beware: D'oench, Duhme and Section 1823 Overprotect the Insurer When Banks Fail*, 62 S. CAL. L. REV. 253, 262 (1988).

[10] Jonathan R. Macey & Geoffrey, *Bank Failures, Risk Monitoring, and the Market for Bank Control*, 88 COLUM. L. REV. 1153, 1181 (1988).

[11] As an example, take the case of Canada where six banks are deemed "too big to fail," according to the Office of the Superintendent of Financial Institutions; *see Canada's Big 6 Are Too Big to Fail, Regulator Says,* THE CANADIAN PRESS (Mar. 26, 2013, 10:57 AM), http://www.cbc.ca/news/business/canada-s-big-6-banks-are-too-big-to-fail-regulator-says-1.1334560 (accessed Apr. 15, 2017).

[12] Adam J. Levitin, *In Defense of Bailouts*, 99 GEO. L.J. 435, 452 (2011).

[13] Daniel R. Fischel & Andrew M. Robert, *The Regulation of Banks and Bank Holding Companies*, 73 VA. L. REV. 301, 315 (1987); Karl S. Okamoto, *After the Bailout: Regulating Systemic Moral Hazard*, 57 UCLA L. REV. 183, 205 (2009); Saule T. Omarova, *Wall Street as Community of Fate: Toward Financial Industry Self-Regulation*, 159 U. PA. L. REV. 411, 420 (2011).

[14] *See* Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L.J. 247, 266 (2010); Mark J. Roe, *The Derivatives Market's Payment Priorities as Financial Crisis Accelerator*, 63 STAN. L. REV. 539, 545 (2011).

[15] Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193, 231 (2008); *see also* Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1815 (2011); Adam J. Levitin & Susan M. Wachter, *Explaining the Housing Bubble*, 100 GEO. L.J. 1177, 1189 (2012).

Moreover, a "too big to fail" institution enjoys a form of subsidy not realized by traditional firms, because investors face a sharply reduced risk of loss upon default.[16] As Arthur E. Wilmarth, Jr. summarized:

> Studies have shown that, compared to smaller banks, the largest banks operate with lower capital ratios, higher percentages of uninsured deposits, lower levels of core deposits, higher percentages of loans, and lower levels of cash and marketable securities. While some analysts argue that the financial markets permit big banks to operate with more leverage and less liquidity because of their greater asset diversification, others contend that TBTF [Too Big To Fail] status creates a large implicit subsidy that causes the financial markets to tolerate a higher risk profile for big banks.[17]

As a result, these investors will demand a lower return from "too big to fail" institutions, as compared with regular firms.[18]

While the concept is typically applied to large banks, or financial institutions more generally, there is no reason why it could not apply to other types of firms as well. Thus, more than a decade ago John Coffee suggested that the four remaining global accounting firms might be "too big to fail."[19] Just before the recent financial crisis, one author argued that a financial product—asset securitization—had become "too big to fail," in the sense that courts would never undermine the dubious legal theories that supported this increasingly important form of finance.[20]

Management of national champions have every reason to accept otherwise too-large risks in their firms: If the risk pays off, shareholders gain and those same managers get big bonuses. If the risk turns out badly, then shareholders and other financiers of the firm are unhappy, but the government will bail them

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[16] Nizan Geslevich Packin, *Supersize Them? Large Banks, Taxpayers and the Subsidies That Lay Between*, 35 NW. J. INT'L L. & BUS. 229, 244–52 (2015); Thomas W. Joo, *A Comparison of Liquidation Regimes: Dodd-Frank's Orderly Liquidation Authority and the Securities Investor Protection Act*, 6 BROOK. J. CORP. FIN. & COM. L. 47, 50 (2011). *See also* David Reiss, *The Federal Government's Implied Guarantee of Fannie Mae and Freddie Mac's Obligations: Uncle Sam Will Pick Up the Tab*, 42 GA. L. REV. 1019, 1025 (2008).

[17] Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975–2000: Competition, Consolidation, and Increased Risks*, 2002 U. Ill. L. REV. 215, 300–01 (footnotes omitted).

[18] *See* Patricia A. McCoy et. al., *Systemic Risk Through Securitization: The Result of Deregulation and Regulatory Failure*, 41 CONN. L. REV. 1327, 1373 (2009).

[19] John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 345 (2004); *see also* Lawrence A. Cunningham, *Too Big to Fail: Moral Hazard in Auditing and the Need to Restructure the Industry Before it Unravels*, 106 COLUM. L. REV. 1698 (2006).

[20] Kenneth C. Kettering, *Securitization and Its Discontents: The Dynamics of Financial Product Development*, 29 CARDOZO L. REV. 1553, 1633 (2008).

out.[21] This makes the downside for a "too big to fail" firm not as unpleasant as it would be for a typical firm, which would have to file for bankruptcy, and possibly liquidate, when a major risk turns out badly.[22]

In short, if a firm is "too big to fail" it will never experience bankruptcy, or at least never experience bankruptcy in the traditional way. This distorts the normal market incentives and gives these firms a competitive advantage.[23]

B. A Story of Global Corporate Failure

In this section, we describe the material that will form the basis of our theoretical discussion in the next section of the Article. Although the resolution of each of the following cases follows different paths, all involve "national champions," companies that were of substantial size relative to the local economy. We proceed in chronological order.

1. Lockheed Aircraft, United States[24]

In 1971, seven years before the present American Bankruptcy Code was enacted, Lockheed faced bankruptcy after cost overruns and delays building its new TriStar passenger jet.[25] Lockheed's problems in part stemmed from the earlier bankruptcy of Rolls-Royce, the British engine maker. The company pleaded with the federal government, claiming that 60,000 American jobs were on the line, and ultimately obtained $250 million (approximately $1.5 billion in 2016) in loan guarantees from Congress.

The bailout helped Lockheed bring the TriStar to market in 1972, but the jumbo jet failed to compete effectively with jets produced by McDonnell Douglas and Boeing. Production ended in 1983, marking the end of Lockheed's sales of commercial jets.

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21 Manns, *supra* note 7, at 1368. *See also* Franklin R. Edwards & Edward R. Morrison, *Derivatives and the Bankruptcy Code: Why the Special Treatment?*, 22 YALE J. ON REG. 91, 99–100 (2005).

22 Anat R. Admati, Peter Conti-Brown, & Paul Pfleiderer, *Liability Holding Companies*, 59 UCLA L. REV. 852, 861 (2012).

23 Lissa Lamkin Broome, *The Dodd-Frank Act: Tarp Bailout Backlash and Too Big to Fail*, 15 N.C. BANKING INST. 69, 73 (2011) (quoting Arthur E. Wilmarth, Jr., *The Dodd-Frank Act: A Flawed and Inadequate Response to the Too-Big-To-Fail Problem*, 89 OR. L REV. 951 (2011)).

24 Appeal of Lockheed Shipbuilding & Const. Co., ASBCA No. 18460, 75-1 B.C.A. (CCH) ¶ 11246 (May 13, 1975); *Lockheed Loan Backed* (Sept. 8, 1972) https://www.nytimes.com/1972/09/08/archives/lockheed-loan-backed-rail-loans-voted-by-senate-body.html (last viewed Nov. 18, 2018); Jesus Sanchez, *The Lockheed-Martin Merger: Lockheed's Flight Plan* (Aug. 31, 1994) http://articles.latimes.com/1994-08-31/business/fi-33310_1_lockhead-corp (last viewed Nov. 18, 2018).

25 The Lockheed bailout is reviewed in greater detail in Appeal of Lockheed Shipbuilding & Const. Co., ASBCA No. 18460, 75-1 B.C.A. (CCH) ¶ 11246 (May 13, 1975).

Lockheed remained one of the nation's biggest defense contractors; it merged with Martin Marietta in 1995 to form Lockheed Martin.[26]

2. *Chrysler Automotive, United States*[27]

At the end of the 1970s, Chrysler, the third largest automaker in the United States, was in a difficult position, and during 1978 working capital fell from $959 million to $356 million.[28] Rising gasoline cost, changing consumer tastes, and fuel-efficiency standards contributed to Chrysler's troubles, because it had steadfastly refused to change its production to compete with Japanese imports directly.[29]

Following a $1 billion loss in 1979, Chrysler faced the possibility of filing under the then newly enacted chapter 11.[30] Instead, Congress guaranteed $1.5 billion ($4.5 billion in 2016) in loans to bail Chrysler out and protect auto industry jobs. The controversial move followed heavy lobbying by Chrysler Chairman Lee Iacocca.

The bailout act, signed into law by President Jimmy Carter on January 6, 1980, required Chrysler to raise $2 billion on its own through concessions from workers and suppliers, along with other aid.[31] Chrysler returned to profitability and finished repaying the loan in 1983.

Chrysler was rescued again in 2009 in a state supported bankruptcy case[32] that tracked the procedure used for GM, discussed below. It presently operates as the North American subsidiary of Fiat.

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[26] Mark D. Whitener & Susan S. Desanti, *Vertical Restraints And Vertical Mergers: Recent Developments In FTC Enforcement*, Remarks of the F.T.C. (1995).

[27] An Act to authorize loan guarantees to the CHRYSLER Corporation, 15 U.S.C. § 1861 (1980); *In re* Chrysler, LLC, et. al., 2009 U.S. Dist. LEXIS 44833 (S.D.N.Y. 2009); *Chrysler's Woes*, N.Y. TIMES (Aug. 5, 1979), http://www.nytimes.com/1979/08/05/archives/chryslers-woes.html (last viewed Nov. 18, 2018); William H. Jones, *The Bottom-Line Details Of the Chrysler Bailout* (Nov. 4, 1979) https://www.washingtonpost.com/archive/business/1979/11/04/the-bottom-line-details-of-the-chrysler-bailout/a7175793-ac11-4b4f-bbce-3cfbf620f77c/?utm_term=.4b7b60f1e5e6 (last viewed Nov. 18, 2018); *Examining Chrysler's 1979 Rescue* (Nov. 12, 2008, 4:00 PM) https://www.npr.org/templates/story/story.php?storyId=96922222.

[28] *See generally* Anthony J. Casey & Eric A. Posner, *A Framework for Bailout Regulation*, 91 NOTRE DAME L. REV. 479, 499–500 (2015).

[29] H.R. REP. NO. 96-690, at 13 (1979), *reprinted in* 1979 U.S.C.C.A.N. 2787, 2793 ("In brief, this industry will have [spent] some $80 billion over the next five years ($13.6 billion by Chrysler) to completely remake its product line, as a consequence of the world energy problem.").

[30] 1978 sales: $13.6 billion.

[31] An Act to authorize loan guarantees to the CHRYSLER Corporation, 15 U.S.C. § 1861 (1980).

[32] *See In re* Chrysler, LLC, et. al., 2009 U.S. Dist. LEXIS 44833.

3. *Philipp Holzmann, Germany*[33]

Philipp Holzmann was once the largest German construction company, with 23,000 employees at the end of the 1990 decade in 600 subsidiaries worldwide. Due to an economic downturn, managerial overstretch, and risky project developments, Holzmann became severely financially distressed in 1999, also the year of its 150th birthday.

In November 1999, Holzmann announced losses of €1.3 billion, due to operational losses and revaluations of projects. Its annual report showed total assets of €4.8 billion and negative equity of €818 million.[34] At the end of that month, after negotiations failed with banks, Holzmann petitioned for bankruptcy.

The then German chancellor, Gerhard Schröder, initiated a bailout package to rescue Holzmann from bankruptcy. It involved new lines of credit for €511 million, and a federal guarantee of €128 million. Only after the lines of credit would have been exhausted would this guarantee become effective.

In the next few weeks, a consortium of nineteen banks agreed to a restructuring and refinancing plan that, apart from including the above, specified additional equity capital, an exchange of claims in convertible securities, for a total package of €2.2 billion. Employment was already down to around 28,000 in 1999 and was further reduced to 11,000 jobs by early 2002.

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[33] Phillip Holzmann, *Annual Report 2000*, Global Reports (2000) http://quote.morningstar.com/stock-filing/Annual-Report/2000/1/1/t.aspx?t=XDUS:HOZ&ft=&d=db92c0b5577b2a2a; *Chronologie: Holzmanns Überlebenskampf [Chronology: Holzmann's Struggle for Survival]*, MANAGER MAGAZIN (Mar. 21, 2002), http://www.manager-magazin.de/unternehmen/artikel/a-188341.html.; *KONZERNE:Gigantische Täuschung [Companies: Gigantic deception]*, SPIEGEL ONLINE (Aug. 14, 2000), http://www.spiegel.de/spiegel/print/d-17114454.html; *Phillip Holzmann*: *Bye, bye J.A. Jones*, MANAGER MAGAZIN (Sept. 18, 2018); *Holzmann: Aus zwei mach drei [Turn two into three]*, MANAGER MAGAZIN (Apr. 07, 2002); Corrina Budras, *Holzmann-Konzern wird zur Dauerbaustelle [Holzmann Group Becomes Permanent Construction Site]* FRANKFURTER ALLGEMEINE (June 10, 2010), http://www.faz.net/aktuell/wirtschaft/unternehmen/insolvente-baufirma-holzmann-konzern-wird-zur-dauerbaustelle-11055930.html; *Holzmann: Bund zahlt nichts [The Federal Government Pays Nothing]*, SPIEGEL ONLINE (June 17, 2002), http://www.spiegel.de/spiegel/print/d-22896166.html; *Holzmann: Insolvenz angemeldet [Bankruptcy Filed]*, MANAGER MAGAZIN (Mar. 21, 2002) http://www.manager-magazin.de/unternehmen/artikel/a-188248-2.html; *Holzmann: Brüssel genehmigt Geldspritze [Brussels Approves Cash Injection]*, MANAGER MAGAZIN (Apr. 27, 2001) http://www.manager-magazin.de/unternehmen/artikel/a-130608.html; *13 JAHRE NACH INSOLVENZ: Holzmann-Pleite wird abgeschlossen [13 Years of Insolvency: Holzmann Bankruptcy is Completed*], FRANKFURTER ALLGEMEINE (Nov. 11, 2015) http://www.faz.net/aktuell/wirtschaft/13-jahre-nach-insolvenz-holzmann-pleite-wird-abgeschlossen-13922646.html. Figures in DM converted to € at €/DM = 0.51.

[34] Annual Report 2000, supra note 33, at 76.

With this package Holzmann was able to extend its lease on life till 2002. But after announcing a loss of €122 million on €6.4 billion of sales, it was the biggest European bankruptcy in 2002.

The banks were not prepared to lend to Holzmann again and the German government would not intervene a second time. Bankruptcy was declared on March 21, 2002. Holzmann owed its banks approximately €767 million, and total debts amounted to approximately €1.5 billion. The bankruptcy included firms in Austria, the United States, China, Saudi Arabia and Malaysia.

Once in bankruptcy, many of the ongoing construction projects were continued till completion. Holzmann subsidiaries were sold to various buyers in Germany and elsewhere; among those was the U.S. subsidiary J.A. Jones. Around 80% of jobs in Germany were saved. The bankruptcy proceedings closed in 2015 with a total payout of approximately €313 million to creditors.

4. Pacific Gas & Electric Company, United States[35]

The Pacific Gas and Electric Company ("PG&E"), California's largest utility company, filed for bankruptcy protection in early 2001. It filed its chapter 11 petition after incurring more than $9 billion in wholesale energy debt. It had more than 18,000 employees, and assets were listed at just over $30 billion.

The cost of wholesale electricity had soared beyond the retail prices established under a state power deregulation plan enacted in 1998.[36] The situation was allegedly exacerbated by the aggressive, and perhaps even illegal, actions of Enron and other energy traders.[37]

Wholesale power prices then began to decline, and in 2004 the company's reorganization plan was approved.[38] Under the plan, PG&E was to pay creditors in full by selling $8 billion in bonds and charging customers $2.2 billion.

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[35] *In re* Pac. Gas & Elec. Co., 304 B.R. 395, 398 (Bankr. N.D. Cal. 2004); Norman A. Pedersen, *Power Play*, L.A. LAW., Apr. 2002, at 24; *Judge Approves PG&E Bailout*, WALL ST. J. (Dec. 23, 2003 12:01 AM) https://www.wsj.com/articles/SB107214516968910000; *PG&E May Be About to Close Its Chapter 11*, L.A. TIMES (Dec. 17, 2003) http://articles.latimes.com/2003/dec/17/business/fi-pge17; Bob Egelko, *PG&E bailout puts burden on consumers / Judge approves plan – state has final says*, S.F. GATE (Dec. 13, 2003 4 AM) https://www.sfgate.com/news/article/PG-E-bailout-puts-burden-on-consumers-Judge-2508803.php.

[36] Pedersen, *supra* note 35, at 24.

[37] *Feds Add 10 Counts to Enron Manager's Power-Fraud Indictment United States v. Forney*, 15 ANDREWS UTIL. INDUS. LITIG. REP. 8 (2004).

[38] *In re* Pac. Gas & Elec. Co., 304 B.R. at 398.

5. *Swissair, Switzerland*[39]

The Swiss flag carrier, Swissair, was abruptly grounded on October 2, 2001, after months of financial problems left it unable to pay for fuel and landing fees. Tens of thousands of passengers were stranded worldwide. An aggressive acquisition strategy of smaller airline groups at the end of the 1990s, large operational losses, together with the September 11th attacks in the United States and an earlier crash off the coast of Novo Scotia, caused an already impending liquidity crisis to spiral out of control. Swissair had total assets of CHF 17.9 billion (€11.2 billion), CHF 13.4 billion (€8.4 billion) debts, sales of CHF 13 billion (€8.1 billion) and 68,000 employees.

Swissair's collapse reverberated around Europe and beyond. In Belgium, flag carrier Sabena filed for bankruptcy protection after Swissair failed to make a promised payment to its Belgian affiliate.

Swissair itself received bridge loans up to CHF 450 million (€281 million) from the Swiss federal government to operate in the days after filing for bankruptcy in order to prevent losing slots and gates at airports, save jobs, help travelers, and keep Switzerland connected with the wider world.

In the next few weeks following the bankruptcy, the federal government together with UBS and Credit Suisse provided funding for Crossair Ltd. Co., the short-haul flight subsidiary of the debtor, to take over the parent company's operations. In 2005, Crossair (renamed Swiss International Airlines) was itself taken over by Germany's Lufthansa for CHF 340 million (€212 million).

The original debtor-entity remains in liquidation in Switzerland.

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[39] SAirGroup, *Annual Report 2002*, http://www.sr692.com/misc/printed/reports/pdf/SWR20002.pdf; Alistair Osborne, *Swissair files for bankruptcy*, THE TELEGRAPH (Oct. 2, 2001 12:01 AM) https://www.telegraph.co.uk/finance/2735944/Swissair-files-for-bankruptcy.html; *Swissair grounds all flights*, BBC NEWS, (Oct. 2, 2001 10:19 PM) http://news.bbc.co.uk/2/hi/business/1574658.stm; Andreas Keiser, *Swissair collapse still reverberates* (Sept. 30, 2011 1:13 PM) https://www.swissinfo.ch/eng/swissair-collapse-still-reverberates/31250752; Mark Milner, *Syndicate agrees to bail out Swissair*, THE GUARDIAN (Oct. 23, 2001 23 October 2001 6:11 PM) https://www.theguardian.com/technology/2001/oct/23/internetnews.business2; THE LIQUIDATOR OF SWISSAIR, http://www.liquidator-swissair.ch/en/latest/weekly-situation-report.htm (last visited on November 18, 2018). Please note that the firm was called SAirGroup, using the brandname Swissair. Swiss francs are converted at an exchange rate of €/CHF = 0.625.

6. *Alstom, France*[40]

Alstom is a large multinational industrial manufacturing firm active in the marine, power, and transport market.[41] Alstom manufactures well-known trains such as AGV, TGV, and Eurostar, and more traditional commuter train equipment used worldwide.

In 2003, Alstom became severely financially distressed.[42] Losses in that year (as of March 31, 2003) amounted to €1.4 billion on total sales of €21 billion.[43] Alstom was carrying €6.3 billion of financial debts, with equity of €700 million and total assets of €24.8 billion at fiscal year-end. Alstom's problems were due to the takeover of ABB's turbine operations in 2000 which, due to technical failures, gave rise to serious damage claims of approximately €4 billion.[44] In addition, the firm was hit by several bankruptcies of shipping companies which had ordered cruise ships.

Worldwide, Alstom employed 110,000 people (FTE), with approximately 78,000 (FTE) in Europe. The rescue plan that was drawn up in 2003 initially amounted to a total of €3.2 billion of state and bank funds, but the final package in 2004 was €2.5 billion.[45] It also specified several subsidiaries that had to be sold, with a total expected value of €800 million.[46]

This plan was accepted by the European Competition authorities under conditions of selling assets and assigning shares to the French government for a fixed term. The plan called for the conversion of subordinated bonds held by the French government into an 18.5% equity stake. Also a €1 billion rights issue

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40 *Company Overview of Alstom SA*, BLOOMBERG, https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=387473 (last visited Oct. 22, 2018); Maurice Braud, *Alstom Rescue Plan Agreed*, Eurofound, http://www.eurofound.europa.eu/observatories/eurwork/articles/alstom-rescue-plan-agreed (last visited Apr. 15, 2017); Alstom, Annual Report (Form 20-F) (Oct. 15, 2003), https://www.sec.gov/Archives/edgar/data/1062066/000119312503062461/d20f.htm#tx516_7; *Commission Authorizes Restructuring Aid to Alstom Under Conditions*, COMPETITION POL'Y NEWSL. 3, http://ec.europa.eu/competition/publications/cpn/2004_3_13.pdf; Greg Keller & Steve de Bonvoisin, *Alston Garners EU Approval For Bailout Plan*, WALL ST. J., (July 8, 2004) http://www.wsj.com/articles/SB108923262876457652 (last viewed Apr. 15, 2017); Ania Nussbaum, *France Rejects 6.6 Million-Euro Pay Deal for Alstom Ex-CEO*, BLOOMBERG, https://www.bloomberg.com/news/articles/2016-07-05/alstom-investors-reject-6-6-million-euro-pay-deal-for-former-ceo (last viewed Apr. 15, 2017).

41 *Company Overview of Alstom*, *supra* note 40.

42 Braud, *supra* note 40.

43 Alstom, Annual Report (Form 20-F), *supra* note 40.

44 *Commission Authorizes Restructuring Aid to Alstom Under Conditions*, *supra* note 40; Keller & de Bonvoisin, *supra* note 40.

45 *EU Gives Alstom Bailout Backing*, BBC NEWS, http://news.bbc.co.uk/2/hi/3873149.stm (last viewed Apr. 15, 2017).

46 Alstom, Annual Report (Form 20-F), *supra* note 40.

was expected to help improve Alstom's dwindling reserves.[47] The French equity stake may have risen to as much as 31.5% at the time.[48]

The French government continues to own about 20% of Alstom, making it the largest single shareholder.[49]

7. *Air Canada, Canada*[50]

In 2000, Air Canada merged with its main competitor, Canadian Airlines, and seemingly enjoyed a near monopoly on Canadian air travel. By the turn of the century, it had a seventy percent share of the Canadian market, and had more extensive operations in the United States than any other foreign carrier. But the integration of the two companies did not go smoothly, and demand for air travel was hit first by the terror attacks of September 11th, and then by the SARS outbreak in 2003, when Toronto, Air Canada's hub and Canada's business center, was one of the cities hardest hit.[51]

In 2003, Air Canada filed for protection under the Companies' Creditors Arrangement Act ("CCAA"), perhaps the closest analog to chapter 11 in the United States. It listed debts of more than $9.7 billion (USD), assets $7.8 billion, and had about 35,000 employees.[52]

It emerged from bankruptcy the following year as ACE Aviation.[53] Air Canada became the main operating subsidiary of ACE.[54]

The company had obtained more than $1 billion in wage and benefit concessions from Air Canada's various unions in order to secure $1.1 billion in

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[47] Agreement Among The French State, Alstom, and Its Main Banks Dated 17 May 2004 (May 27, 2004), https://www.sec.gov/Archives/edgar/data/1062066/000119312504104568/dex411.htm (last viewed Apr. 15, 2017).

[48] Alstom, Annual Report (Form 20-F), *supra* note 40.

[49] Nussbaum, *supra* note 40.

[50] Joel Baglole, *Airlines in Turmoil: Air Canada Files for Protection From Creditors*, WALL ST. J. (Apr. 2, 2003) http://www.wsj.com/articles/SB104922208595545500 (last visited Apr. 15, 2017); Scott Deveau, *As ACE Aviation Winds Down, Questions Linger Over Lasting Effects on Air Canada*, FIN. POST (Apr. 20, 2012 9:48 PM) https://business.financialpost.com/transportation/as-ace-winds-down-questions-linger-over-lasting-effects-on-air-canada (last visit Apr. 15, 2017); *Judge approves Air Canada restructuring plan* (Aug. 23, 2004 3:09 PM) https://www.cbc.ca/news/business/judge-approves-air-canada-restructuring-plan-1.479670.

[51] Baglole, *supra* note 50.

[52] InterVISTAS Consulting, Inc., *Restructuring Air Canada*, INTERVISTAS (Apr. 6 2003) http://www.intervistas.com/downloads/CAIR/issues/2003/04_apr2003.pdf at 2.

[53] Deveau, *supra* note 50.

[54] *Judge approves Air Canada restructuring plan*, *supra* note 50.

financing from a consortium led by Deutsche Bank AG. Creditors were converted into shareholders, reducing outstanding debt to just under $3 billion.

8. Parmalat, Italy[55]

Parmalat, a multinational Italian dairy and food corporation, was active in thirty countries, employing around 30,000 people. Representing just under 1% of Italian GDP in 2003, with revenues of more than $7 billion, it was quoted on the Milan stock exchange and clearly was one of Italy's biggest corporations.

But then Bank of America accused Parmalat of having a non-existing $3.9 billion account.[56] And on December 24, 2003, the company was forced to declare bankruptcy. Debts were ultimately reported at €14.3 billion, about eight times higher than originally reported on the books of the company.

After the bankruptcy declaration of Parmalat, a number of large banks, among those Bank of America, Citicorp, Morgan Stanley, UBS, Deutsche Bank, investors, creditors, and auditor Grant Thornton, became involved in litigation in various U.S. and Italian courts for fraudulent behavior and claims for damages. The founder of Parmalat was sentenced to ten years in prison for fraud in 2008. Other executives settled out of court, while several executives were acquitted.

The Italian government devised emergency legislation, the Marzano Decree, to help Parmalat restructure as this was deemed impossible under the then existing Italian bankruptcy law to protect Parmalat's going-concern value. In January 2004, the government appointed Enrico Bondi as administrator with the aim to restructure the firm.

Under the reorganization plan, Parmalat was restructured into sixteen companies with total revenues in 2004 (pro forma) of €3.7 billion, half the size

[55] *Italian Dairy Boss Gets 10 Years*, BBC NEWS (Dec. 18, 2008) http://news.bbc.co.uk/2/hi/business/7790803.stm (last visit Apr. 15, 2017); *Parmalat In Bankruptcy Protection*, BBC NEWS (Dec. 24, 2003) http://news.bbc.co.uk/2/hi/business/3345735.stm (last visit Apr. 15, 2017); *Europe's Biggest Bankruptcy Remembered*, EUROPEANCEO (Mar. 23, 2012) https://www.europeanceo.com/finance/europes-biggest-bankruptcy-remembered/ (last visit Apr. 15, 2017); *Suing Over Spilt Milk: the Parmalat Scandal*, WORLD FINANCE, http://www.worldfinance.com/home/special-reports-home/the-parmalat-scandal (last visit Apr. 15, 2017); *Newsletters on Parmalat Group*, WBG (July 29, 2004) http://siteresources.worldbank.org/GILD/Resources/Parmalat_Newsletters_(July&Aug2004).pdf; *Parmalat Presentation*, PARMALAT, http://www.parmalat.com/attach/content/55/Presentazione%20Parmalat%2006-10-05.pdf (last visit Apr. 15, 2017); Lorenzo Segato, *A Comparative Analysis of Shareholder Protections in Italy and the United States: Parmalat as a Case Study*, 26, NW. J. INT'L & BUS. 373, 375 (2006); Wolfgang Munchau, *Parmalat Affair Has Plenty of Blame to Go Round*, FIN. TIMES, Dec. 29, 2003, at 15.

[56] Parmalat In Bankruptcy Protection, *supra* note 55.

of the firm prior to bankruptcy. This group of firms had assets worth €2.5 billion, equity of €1.4 billion, and 16,400 employees.[57] Specifically, the plan detailed an acquisition of assets and restructured liabilities by a new company, with existing creditors receiving shares in that company. The plan, including a debt-for-equity swap, was put to a vote in 2005.

Creditors agreed in August and the court approved the plan in October 2005. Parmalat was relisted on the Milan stock exchange that month. Remaining firms in the Parmalat empire were liquidated via normal bankruptcy procedures.

9. Alitalia Airlines, Italy[58]

In 2008, Alitalia was reportedly losing €1 million a day.[59] Its net debt stood at €1.28 billion, and it had been previously rescued by a heavily criticized European Commission bailout and restructuring plan in 2004.

The Italian government stepped in with an emergency €300 million "loan" that was never recovered when the airline was ultimately sold to a group of local investors. Indeed, the loan was eventually termed illegal aid by EU regulators.[60] The government, which owned 49.9% of Alitalia, blocked a foreign take-over and instead put the airline into bankruptcy as a temporary measure.

The new owners quickly made some changes, and sold 25% of their new airline to Air France-KLM, reportedly for a 40% premium over what the owners had paid to buy the airline out of bankruptcy just a month before.[61] But the airline continued to bleed cash.

Then, in 2013, the airline was again saved by a rights offer, in which the Italian postal system (Poste Italiane) purchased shares in the company for €75 million as part of a €300 million offering, otherwise taken up by existing

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[57] Parmalat Presentation, PARMALAT (Oct. 6, 2005) http://www.parmalat.com/attach/content/55/Presentazione%20Parmalat%2006-10-05.pdf at 7, 34.

[58] *Illegal State Aid?: EU Questions Italy's Loan for Moribund Alitalia*, SPIEGEL ONLINE, http://www.spiegel.de/international/business/illegal-state-aid-eu-questions-italy-s-loan-for-moribund-alitalia-a-549683.html (last visited Apr. 15, 2017); Nicola Clark & Elisabetta Povoledo, *Shareholders Voting on Alitalia Bailout Plan*, The New York Times, http://www.nytimes.com/2013/10/15/business/international/shareholder-vote-due-on-alitalia-bailout.html (last visited Apr. 15, 2017); Agnieszka Flak, *Alitalia to cut 2,037 jobs, reduce flight crew pay in latest revamp: unions* REUTERS (Mar.17, 2017) https;//www.reuters.com/article/us-alitalia-restructuring/alitalia-to-cut-2037-jobs-reduce-flight-crew-pay-in-latest-revamp-unions-idUSKBN1601T9.

[59] *Illegal State Aid?: EU Questions Italy's Loan for Moribund Alitalia*, *supra* note 58.

[60] Guy Dinmore & Joshua Chaffin, *Bidders Released from Repaying Alitalia Aid*, FIN. TIMES https://next.ft.com/content/9c6b134a-b0e7-11dd-8915-0000779fd18c (last visited Apr. 15, 2017).

[61] Guy Dinmore et al., *Air France-KLM Buys 25% of Altalia*, FIN. TIMES https://next.ft.com/content/776c5c2c-e0ce-11dd-b0e8-000077b07658 (last visited Apr. 15, 2017).

shareholders.[62] As a result of this move, Poste Italiane became the second largest individual shareholder in the airline. Yet the company continued to struggle.

Then, in 2014, with significant government involvement in the negotiations, Alitalia agreed to an extensive workout with its shareholders and creditors. Italian banks wrote off old debts and agreed to extend new lending to the airline. Abu Dhabi-based Etihad Airways paid €387.5 million for a 49% stake in Alitalia, while other shareholders contributed €300 million in fresh funds.[63] Alitalia's workforce was cut by nearly 16%.[64]

In 2017 another restructuring was announced, which included layoffs of more than 2,000 ground personnel and salary cuts of flight personnel by twenty-five to thirty-five percent. The plan was met with outrage by the unions, and the resulting strike threatened the airline's future viability. As this Article goes to press, the airline had received a bridge loan from the government and was being marketed for sale to rivals.[65] How the new, more nationalist, Italian government will proceed is uncertain.

10. General Motors, United States[66]

It was long known that General Motors (GM), the largest auto manufacturer in the United States, and at one point one of the biggest corporations in the world, suffered from fundamental problems.[67] These lingering issues came to a head as a result of the 2008 global financial crisis.

The company had just over $100 billion in assets, and more than 240,000 employees worldwide at the time of its collapse.

In late 2008, the company requested government support along the lines of that offered to American banks. The George W. Bush administration, then in its final months, agreed to support all of the American automakers for a few

62 Clark & Povoledo, *supra* note 58.

63 Shereen El Gazzar, *Etihad completes acquisition of 49% stake at Alitalia* THE NATIONAL (Dec. 23, 2014) https://www.thenational.ae/business/etihad-completes-acquisition-of-49-stake-at-alitalia-1.452102 (last visited Nov. 18, 2018).

64 Flak, *supra* note 58.

65 Christopher Jasper & Chiara Alabnese, *Alitalia Attracts EasyJet, Delta Bids in New Attempt at Sale* BLOOMBERG (Nov. 1, 2018 5:23 AM) https://www.bloomberg.com/news/articles/2018-11-01/alitalia-attracts-easyjet-delta-bids-in-latest-attempt-at-sale.

66 Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases In Context*, 83 AM. BANKR. L.J. 531 (2009).

67 Levine v. Smith, 591 A.2d 194, 198 (Del. 1991).

months—essentially long enough for the new administration to take office and make a decision about their fate.

The new Obama administration decided that it would provide funding to help save General Motors, conditional on the firm filing a bankruptcy petition to achieve a quick restructuring of its operations. Controversially, the administration also required that General Motors negotiate a deal with its primary labor union to ensure that the reorganized company would also benefit from "labor peace."[68] The end result of that negotiation was General Motors' assumption of certain unsecured obligations to the union's retirement fund, whereas other unsecured creditors were not so fortunate.[69] In exchange the union agreed to a new two-tiered labor structure, whereby new employees would not receive as generous benefits as existing employees, and the union also promised that no strikes would occur within a specified period of time after bankruptcy.

General Motors entered bankruptcy, and immediately proposed a sale to a newly created limited liability company that was backed by the U.S. and Canadian governments. The sale, as is typical in American bankruptcy practice, was subject to "higher and better" offers, but in the midst of a financial crisis such offers were not forthcoming.[70]

The new company purchased the "good" assets of General Motors, while the other assets remained behind in the bankruptcy estate. The new firm quickly changed its name to General Motors, while the old firm became known as Motors Liquidation, Inc. and began the process of liquidating its estate under a chapter 11 plan. The entire bankruptcy process was funded by a government provided "DIP loan" under § 364 of the Bankruptcy Code.[71]

The new General Motors has since conducted an IPO, and its two sovereign backers have sold their stakes in the firm as part of that process.

11. Arcandor, Germany[72]

Arcandor was one of Germany's largest companies with well-known subsidiaries such as Karstadt, Primondo, Quelle, online mail order companies,

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[68] Richard Brean, The General Motors And Chrysler Bankruptcies: Understanding The Transactions And The Underlying Legal Issues, ABA SEC. OF LAB. AND EMP. L. 3RD ANN. CLE CONF., at 15 (Nov. 4–7, 2009).

[69] Casey & Posner, *supra* note 28, at 518.

[70] *See* 11 U.S.C. § 363 (2018).

[71] 11 U.S.C. §§ 364, 1101(1).

[72] *TIMELINE - Arcandor's path to insolvency*, REUTERS U.K. (June 9, 2009 12:56 PM) https://uk.reuters.com/article/uk-arcandor-timeline-sb/timeline-arcandors-path-to-insolvency-idUKTRE5584JC20090609: Arcandor AG, *2007–08 Annual Report of the Group* (2008), http://www.quicktake.morningstar.com/stocknet/

and Thomas Cook, the well-known travel agency. Arcandor declared bankruptcy on June 9, 2009 and is considered the largest bankruptcy in Germany. Around 56,000 employees were involved.

The bankruptcy included the holding Arcandor and some subsidiaries, but not Thomas Cook, KarstadtQuelle Bank and online mail order business HSE24. Although Arcandor made several requests for aid in order to help solve its problems in the year of its bankruptcy, the state as well as the federal government rejected the calls. At the end of its accounting year 2007-2008, the annual report showed total equity of €1.2 billion, interest bearing debts of approximately €5 billion and total assets of €14 billion. The year showed a loss of €746 million.[73]

Once in bankruptcy, Thomas Cook was sold as a going concern, but Quelle had to be sold piecemeal. Several Karstadt stores were sold to competitors, others were closed. The bankruptcy proceeding is still ongoing, with some stores open for business and others for sale. Arcandor's CEO Thomas Middelhof filed for personal bankruptcy in 2015, following fraud charges.[74]

12. Nortel Networks, Canada[75]

At its height from 1999 to 2000, Nortel was worth nearly $300 billion (CAD), employed more than 90,000 people globally and was regarded as one of Canada's most valuable tech companies. It operated with 130 subsidiaries located in more than 100 countries and dating back to the founding of the Bell Telephone company at the close of the 19th century, the predecessor to Northern Telecom, or Nortel.[76]

The global financial crisis contributed to Nortel's decision to file for protection in both Delaware and its hometown, Toronto, in 2009. The company's problems really began in 2001, however, when it was hit by the technology stock collapse and then became mired in an accounting scandal that led to criminal

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secdocuments.aspx?symbol=aro&country=deu (last visited Oct. 16 2018); Julia Finch, *Thomas Cook's majority owner Arcandor files for bankruptcy*, THE GUARDIAN (June 9, 2009 12:19 PM) https://www.theguardian.com/business/2009/jun/09/thomas-cook-arcandor-bankruptcy.

73 Arcandor AG, 2007–08 Annual Report of the Group (2008), supra note 72.

74 Jack Ewing, *Thomas Middelhoff, Ex-Chief of Bertelsmann, Gets 3-Year Prison Team Over Misuse of Funds*, N.Y. TIMES (Nov. 14, 2014) https://www.nytimes.com/2014/11/15/business/international/thomas-middelhoff-ex-chief-of-bertelsmann-gets-3-year-prison-sentence.html (last visited Nov. 18, 2018).

75 *In re* Nortel Networks, Inc., 669 F.3d 128 (3d Cir. 2011); Ian Austen, *Nortel Seeks Bankruptcy Portection*, N.Y. TIMES (Jan. 14, 2009) https://www.nytimes.com/2009/01/15/technology/companies/15nortel.html; Lauren L. Peacock, *A Tale of Two Courts: The Novel Cross-Border Bankruptcy Trial*, 23 AM. BANKR. INST. L. REV. 543 (2015).

76 *In re* Nortel Networks, Inc., 669 F.3d at 131.

charges against three of its former executives.[77] At the same time, other technology firms began taking away the firm's market share.

Since seeking court protection in 2009,[78] Nortel has sold all of its major assets, raising around $9 billion, capped off by the $4.5 billion sale of its patent portfolio to a consortium including Apple, Inc. and Microsoft Corp.[79] Both the federal and provincial governments resisted calls to intervene in the bankruptcy.[80]

In early 2015, judges in Delaware and Canada approved a plan to pay more than $7 billion to creditors of Nortel Networks, thus ending years of litigation over the former telecommunications company that filed for bankruptcy in 2009.[81]

C. Common Threads

All of the firms addressed in the prior section were severely financially distressed. For all of them the threat of bankruptcy loomed large.

1. Paths to Resolution

For instance, Swissair's failed acquisition strategy and the losses throughout its empire left it in a weak financial condition. The September 11th attacks were more than it could handle at that moment in time. With stranded travelers, grounded aircrafts and staff, it needed swift action and funds to get its business back on track. The Swiss government first helped the firm restore operations immediately after the grounding, and then, via a going-concern sale in bankruptcy, the assets were lifted out of the insolvent company.

With Parmalat a going-concern sale was combined with a financial restructuring. When news came that executives of Parmalat had hidden large

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77 Wojtek Dabrowski, *Former Nortel executives hit with criminal charges*, REUTERS (June 19, 2008 10:19 AM) https://www.reuters.com/article/us-nortel-charges/former-nortel-executives-hit-with-criminal-charges-idUSWNA616320080619 (last visited Nov. 18, 2018).

78 Canada-based Nortel filed insolvency proceedings in Canada, and the High Court of Justice in England placed affiliate Nortel Networks U.K. Ltd. in insolvency administration. Nortel's U.S. affiliate, Nortel Networks Inc., and several related companies filed chapter 11 petitions in the U.S. Bankruptcy Court for the District of Delaware. *In re* Nortel Networks, Inc., 669 F.3d at 131.

79 Anthony Duggan & Norman Siebrasse, *The Protection of Intellectual Property Licenses in Insolvency: Lessons from the Nortel Case*, 4 PENN ST. J.L. & INT'L AFF. 489, 504 (2015).

80 Allan L. Gropper, *The Arbitration of Cross-Border Insolvencies*, 86 AM. BANKR. L.J. 201, 224–27 (2012).

81 *In re* Nortel Networks, Inc., 532 B.R. 494, 561 (Bankr. D. Del. 2015); Peacock, *supra* note 75, at 544–46.

debts, it threatened to paralyze the whole firm. With the fraud looming large over its—presumably profitable—business, the Italian government intervened to save these activities from dissolving with a concomitantly disastrous effect on many (small) Italian farmers. Here the intervention called for a whole new piece of legislation in order to keep the firm in operation and quarantine the consequences of the fraud. Next, the profitable businesses were transferred out of the bankrupt company into a new company in which creditors were allocated new securities.

For Alstom, the French government simply did not want to wait for bankruptcy and intervened directly with funds to keep Alstom afloat. It might be attributable to the specifics of French bankruptcy law that the Swissair route was not easily taken. In a seemingly similar vein, although further back in time, the bailouts of Lockheed and Chrysler (1980) had the American federal government finance a rescue package for both firms. Given later cases—General Motors and Chrysler (2009)—such a bailout would probably not happen now, but the route via bankruptcy and an asset sale would likely be taken, with some doubts whether the federal government would be involved at all.[82]

Alitalia qualifies for multiple interpretations as it was first to receive bailout funds from the Italian government, but then via bankruptcy sold to investors. This latter recipe, though without bankruptcy, was repeated in 2013 and 2014 without any financial aid, but important indirect government involvement. One wonders why Alitalia did not use the same rules by which Parmalat was restructured.

Philipp Holzmann was intended to be bailed out by banks and government funds, but this could not be maintained. Holzmann's problem, due to a bad market, managerial overstretch, and unprofitable project developments activities were too much to stomach for banks in the end and presumably too much for the German federal government. For both Arcandor and, in the second instance, Holzmann, bankruptcy meant (ultimately) liquidation. Due to the fact that these two companies were very large, the procedures have taken years to sell, close and dissolve the respective companies.

Other "standard" uses of bankruptcy procedure are Nortel Networks, Air Canada and PG&E. Nortel didn't receive any aid from government, but was sold in parts to other investors like the German cases. Air Canada and PG&E

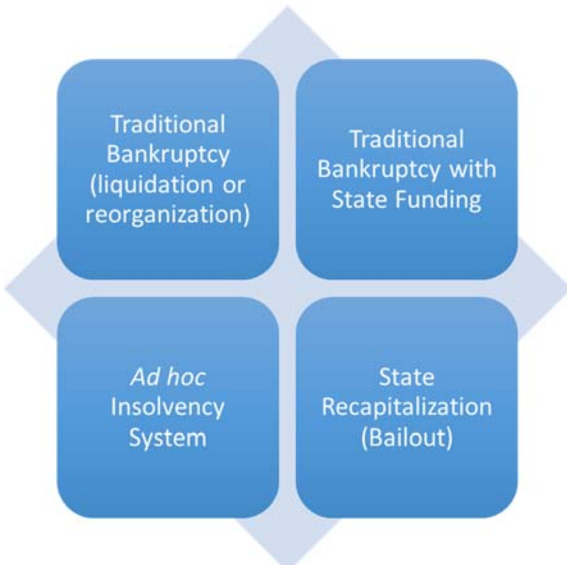
[82] Alternatively, the federal government might help coordinate a private response by large, money-center banks.

restructured their liabilities and were able to continue their operations. In that sense they differed from the liquidation-oriented cases.

General Motors is akin to Swissair—unmistakably bigger in absolute terms, but similar in relative scale and outcome—in that the Obama government intervened to keep the firm operative in the first few months, and then was instrumental in coordinating and financing a going-concern deal to move the assets out of insolvency. Reasons for this are also to be found in the economic downturn and the wish to prevent the American auto sector, and its many parts manufacturers and dealers, from collapsing.

2. A Matrix of Endings

Based on our broad review of the cases, we conclude that the pattern of large company corporate failure tends to sort into four main categories. These categories are shown on the figure set forth below.



One question that comes up when discussing these cases together is why they differ that much in outcome. All firms did face severe financial difficulties, and all were big enough to send shockwaves to various markets, be it labor markets, stock and credit markets, or supplier markets. And, presumably, in all cases management might look forward to the helping hand of a government. Why save GM and Swissair via a going-concern sale, but not Arcandor or

Holzmann (in second instance); why save Alstom outside bankruptcy, but restructure and save Parmalat and GM? And why leave Nortel to liquidate in the midst of a financial crisis?

The fact that some bankruptcy systems are geared much more to reorganization than others would imply that GM and Chrysler (2009) could have been left to chapter 11 (without any government support), while Arcandor and Holzmann—given the lack of reorganization experience in Germany under its bankruptcy law (Insolvenzordnung)[83]—would imply a forthcoming attitude of German governments. It was not to be so.

For France, its bankruptcy system is noted for its employment perspective and emphasis on saving firms, but less generous in severing financial ties between the bankrupt estate and buyer. Might this be so problematic that bankruptcy needs to be prevented? Alstom might be proof of this, although there is also a tendency in French governments to help firms survive financial dire straits.

The Parmalat case suggests that reforms were overdue with regard to Italian business bankruptcy law—as such problems might have been easy to resolve under a regime akin to chapter 11. But then Italian bankruptcy law never had the possibility to practice on such a large case. If a large Italian firm would become distressed, a solution akin to Germany's might come to pass, or as a second possibility a (French-style) government support action. Alitalia suggests that the Italian government (generally) wants to prevent liquidations, and instead has often opted to look to other investors. So might there be no general encompassing answer to these questions?

To begin to answer this question, in the next figure we sort the cases we reviewed in the prior part of this Article by the four categories set forth above. Many of the cases we have reviewed, and many more that we could have reviewed, lie in the two categories along the diagonal from the top left corner: *bankruptcy* or *bailouts*.

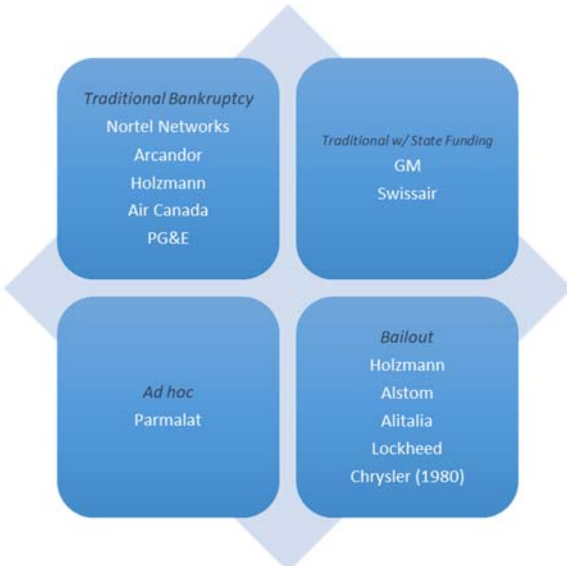
We argue that it would be preferable if cases instead occupied the categories in the top row only.

83 INSOLVENZORDNUG [INSO] [INSOLVENCY ACT], Oct. 5, 1994, BUNDESGESETZBLATT [BGBI.], as amended on Jan. 1, 2002, *translation at* https://germanlawarchive.iuscomp.org/?p=773.

3. *Flattening the Matrix*

In an ideal world, the kind of world most academic theories inhabit, all cases would be resolved under the traditional bankruptcy process. All firms, no matter how large they may be or when they might experience financial distress, would be subjected to the same statutory process. This would avoid the subsidy to bigger firms that is inherent in the "too big to fail" concept.[84]

Unfortunately, the political costs of a ridged adherence to academic orthodoxy will often be too large for even the heartiest policymaker. Austerity is fine when it does not affect your own ability to get reelected.[85]



[84] *See* Jodie A. Kirshner, *The Bankruptcy Safe Harbor in Light of Government Bailouts: Reifying the Significance of Bankruptcy As A Backstop to Financial Risk*, 18 N.Y.U. J. LEGIS. & PUB. POL'Y 795 (2015).

[85] *See* Walter Adams & James W. Brock, *Antitrust, Ideology, and the Arabesques of Economic Theory*, 66 U. COLO. L. REV. 257, 270 (1995). *Cf.* Anna Gelpern & G. Mitu Gulati, *Foreword: Of Lawyers, Leaders, and Returning Riddles in Sovereign Debt*, 73 L. & CONTEMP. PROBS., i, xi (2010).

As such, it will sometimes be necessary to consider a backup or "second best" solution. We submit that the second best solution in these circumstances is to use the normal bankruptcy procedure, with the government stepping in to provide for any gaps in the funding market.

As an initial matter, use of the normal bankruptcy framework is apt to provide an outcome that is largely consistent with investor expectations.[86] This in turn promotes market discipline and reduces the moral hazard that results from ad hoc interventions in the firm's financial health.[87]

Likewise, in many jurisdictions use of the traditional bankruptcy process is the only means of imposing real losses on shareholders. If moral hazard is to be avoided, and market discipline promoted, it must begin with shareholders losing some or all of their investment when the firm experiences serious financial distress. And involuntary conversion of junior debt into equity is similarly a vital feature of any functional reorganization system that hopes to defeat the "too big to fail" phenomenon.[88]

Most importantly, use of the general bankruptcy or restructuring process is more apt to address the problems that cause financial distress in the firm. Injecting money via a governmental sponsored bailout into the firm's capital structure, on the other hand, simply buys the firm more time. The firm might restructure its operations, but often it is quite difficult to do that outside of insolvency. For example, in the United States many retail companies, and many airlines, find it preferable to reject leases for stores or airplanes in a systematic and wholesale way under the Bankruptcy Code.[89] Revamping leases under non-bankruptcy law requires bargaining with individual counterparties, resulting in the inevitable holdout problem.

Of course, the challenge of implementing this second best solution—a government supported bankruptcy case—rests in the key question of when to use it. If used too often, the second best solution becomes a kind of substitute bailout, replacing the normal bankruptcy process in virtually all cases.

We suggest that the ideal rule would start with a strong presumption that the normal rules apply. Absent extreme circumstances, the normal bankruptcy

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86 Michael Huemer, *The True Costs of Government Bailouts*, 11 GEO. J.L. & PUB. POL'Y 335, 339 (2013).

87 David Zaring, *A Lack of Resolution*, 60 EMORY L.J. 97, 104–05 (2010).

88 *See* Oscar Couwenberg & Stephen J. Lubben, *Essential Corporate Bankruptcy*, 16 EUR. BUS. ORG. L. REV. 39, 55 (2015).

89 Eric Jedrychowski, *The Post-September 11 U.S. and European Airline Industries: Navigating Through the Bailouts, Bankruptcies, Liquidations and Mergers*, 28 CONN. J. Int'l L. 177, 193 (2012).

system should be invoked and the firm, no matter how large or locally important, resolved thereunder. This would mean that cases like Alitalia, Alstom, Parmalat, Lockheed and Chrysler (1980) should have been taken into a bankruptcy procedure, like Swissair, Arcandor, General Motors, Holzmann, Nortel Networks, Air Canada and Pacific Gas & Electric have been. At least these latter cases show that it is entirely possible to use a bankruptcy procedure, thus forcing the argument that if a bankruptcy procedure is not to be used, why then a different route has to be taken.

In only two instances should a government sponsored bankruptcy process be used in place of the default process. First, if the lending markets are severely disrupted, we argue that government lending, or guarantees, in support of the bankruptcy process is warranted. Such loans should be made on (undisturbed) market terms. This would imply that for cases like General Motors and Chrysler (2009) such support might have been needed as lending markets were severely disrupted.

Presumably, an argument can also be made that Swissair and Parmalat, due to the surrounding uncertainty in their operations, might have been unable to secure funding in the first few weeks of sorting out their messes. A less strong argument can be made for Holzmann, although the German government provided guarantees only. While for some firms governmental support was forthcoming, they would not qualify under this rule: Alitalia, Alstom, Lockheed and Chrysler (1980).

Second, if the broader economy is in distress, such that all potential asset buyers are apt to leave the market for the debtor's assets, governmental support for an asset purchase is also warranted. Under this category cases like (again) General Motors, Chrysler (2009) and Swissair, would qualify, while Alitalia, Alstom, Lockheed would not.

As in the financial institution context, we argue that it is critically important that "'funding' ought to be in the form of liquidity provisions at a time when private sources are closed to the resolving bank, not a bailout."[90] We first consider General Motors and Swissair in more detail as two cases that line up best with these criteria, then we look at the others.

In the case of General Motors, the United States government provided $30 billion to fund the bankruptcy case, in addition to the $20 billion previously

[90] Jeffrey N. Gordon & Wolf-Georg Ringe, *Bank Resolution in the European Banking Union: A Transatlantic Perspective on What It Would Take*, 115 COLUM. L. REV. 1297, 1353 (2015).

provided by the Bush administration, in exchange for just over 60% of the reorganized company's equity. The Canadian government, which provided $9.5 billion, received almost 12% of the stock, while the autoworkers union received 17.5%, and the old bondholders 10%. In exchange, the company used the bankruptcy process to shed $79 billion in debt and close fourteen obsolete factories.

The SwissAir bankruptcy was similar, in that the Swiss government provided the airline funding to maintain its operations until they could be sold to a new entity, in this case its former subsidiary Crossair. The Swiss federal government also provided CHF 1 billion to keep Swissair going through March, 2002. It then bought a 19.2% stake in Crossair for CHF 600 million. UBS and Credit Suisse together invested CHF 350 million for a 19.5% stake. Regional governments and business interests invested another CHF 2.1 billion.

The General Motors bankruptcy occurred in the midst of the global financial crisis, while the SwissAir bankruptcy occurred shortly after the September 11th attacks, which resulted in an approximate 30% decline in air travel. In short, both occurred in extreme circumstances, which warranted special governmental support of the normal bankruptcy process.[91] To be sure, both companies had financial problems that predated their respective crises, and which made the firms fragile and unable to withstand the unexpected challenges they faced.

Nonetheless, the decision to conduct a traditional bankruptcy with government support ensured that shareholders in both companies faced the consequences of their firms' failures.[92] Creditors too suffered substantial losses. In both cases, investors were thus compelled to face the risks that they had previously been compensated for. In a bailout, taxpayers would have instead handed these investors a windfall, and have set misaligned incentives for years to come.[93]

Another key question is why Nortel was left to liquidate, despite its failure at roughly the same time that General Motors collapsed. Certainly the Canadian government, which was an active participant in the American bailouts of both GM and Chrysler (2009), could have provided similar assistance to Nortel,

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[91] Adam J. Levitin, *Safe Banking: Finance and Democracy*, 83 U. CHI. L. REV. 357, 448 (2016).

[92] Tara Branum & Susanna Dokupil, *Security Takeovers and Bailouts: Aviation and the Return of Big Government*, 6 TEX. REV. L. & POL. 431, 482 (2002).

[93] Ann Graham, *Bringing to Heel the Elephants in the Economy: The Case for Ending "Too Big to Fail"*, 8 PIERCE L. REV. 117, 147 (2010).

which was at least as significant from a Canadian perspective as either of the automakers.[94]

One Canadian newspaper answered that question succinctly:

> The Harper government refused to offer a bailout for struggling Nortel Networks Corp. after concluding it was just a badly managed company without a viable business plan, rather than a linchpin to a key industry.[95]

Thus, while both GM and Nortel had significant internal business problems, GM benefited from its connections to a broader industry. Nortel, on the other hand, had in some sense fallen behind in the competitive tech industry.

This does make clear, however, that GM still benefited from its "too big to fail" status. Its investors experienced market discipline, but the firm remained intact. If it had filed a fully traditional chapter 11 case—our top left box—it likely would have been sold in "chunks," as Nortel has been sold. Inevitably, a second best solution will never provide all of the benefits of the ideal solution.[96]

And despite the residual "too big to fail" elements at play in General Motors, and even in Chrysler's parallel 2009 bankruptcy case, we submit that this case is clearly preferable to the outcomes in the many other bailouts we have reviewed, stretching from Lockheed in the early 1970s to Alitalia in recent years. In all of these cases creditors, and often even shareholders, maintained their stakes in the debtor-companies, while taxpayers footed the bills.[97]

At the same time, it is important to note that none of the bailouts we have reviewed occurred during times that would have warranted even a state-supported bankruptcy case, along the lines of General Motors or SwissAir. Alitalia, Alstom, Chrysler (1980) and Holzmann were obviously severely distressed, but not facing a financial system in disarray, nor necessarily a lack of potential buyers.[98] Perhaps the bailout of Lockheed could be defended in the specific context of a major defense contractor, operating during the midst of the

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[94] *See* Stephanie Ben-Ishai & Stephen J. Lubben, *A Comparative Study of Bankruptcy As Bailout*, 6 BROOK. J. CORP. FIN. & COM. L. 79, 92 (2011).

[95] Shawn McCarthy & Campbell Clark, *Why Ottawa Turned Its Back on Nortel*, THE GLOBE AND MAIL (July 23, 2009) https://www.theglobeandmail.com/report-on-business/why-ottawa-turned-its-back-on-nortel/article4279987/ (last viewed Nov. 18, 2018).

[96] *See* Cheryl D. Block, *Overt and Covert Bailouts: Developing A Public Bailout Policy*, 67 IND. L.J. 951, 990 (1992).

[97] Michael Simkovic, *Competition and Crisis in Mortgage Securitization*, 88 IND. L.J. 213, 251 (2013).

[98] Although for Alstom this is hard to prove, as the French government did not wait for such buyers to come forward.

Cold War. That essentially moves the bailout out of the economic sphere, into something more sovereign.

Strategic or national security considerations are clearly a slippery slope.[99] While Lockheed was one of many defense contractors, arguably Alstom played an even more critical role in European infrastructure.

Ultimately, Lockheed and Chrysler in 1979 simply encountered financial distress before the United States had adopted a modern corporate bankruptcy procedure. But in both cases, along with those of Holzmann, Alstom, Alitalia, the facts reveal fundamental problems with the firms in question. Of course, the same could be said for General Motors. The key difference being that it was fortunate to survive until background economic conditions provided some justification for the government to support its insolvency process.

Before we close, we stop to address the question of Parmalat and the enactment of an ad hoc insolvency measure that addresses national champions. Essentially, we view this move as suboptimal in that it represents an admission that the laws currently in place are not fit for purpose.[100]

Legislative reform is clearly better done with ample time for consideration and reflection. Moreover, the inherently retroactive nature of such legislation opens up the process to litigation risk that is not present when the normal channels are used.[101]

CONCLUSION

The natural tendency is to deal with the failure of a national champion by going to the extremes: bankruptcy or bailout.[102] The bankruptcy option has primarily been used in jurisdictions with well-developed bankruptcy systems, but it makes an appearance in other locales (e.g., Germany) that cannot easily be placed in that category.

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[99] *Cf.* Ana Swanson, *U.S. to Put Tariffs on Its Key Allies, Risking Reprisal*, N.Y. TIMES, June 1, 2018, at A1.

[100] *See* David Hahn, *The Financial Crisis of 2009–Have Reorganization Proceedings in Emerging Markets Gone Bankrupt? Israel As A Case Study*, 12 U. PA. J. BUS. L. 731, 771 (2010).

[101] A good example of this can be seen in the ongoing litigation related to the American government's decision to place Fannie Mae and Freddie Mac, key components in the American home mortgage market, into a conservatorship in late 2008, under a law passed just days before. Stephen J. Lubben, *Failure of the Clearinghouse: Dodd-Frank's Fatal Flaw?*, 10 VA. J.L. & BUS. REV. 127, 156 (2015).

[102] Jonathan Lewinsohn, *Bailing Out Congress: An Assessment and Defense of the Air Transportation Safety and System Stabilization Act of 2001*, 115 YALE L.J. 438, 476 (2005).

Instead, the real question appears to be whether background market conditions warrant deviation from "normal" bankruptcy procedures.[103] We argue any such deviations should take the form of government backed or even government provided funding or asset purchases in the normal bankruptcy process.

Such a "second best" solution removes the pressure to conduct a full-scale bailout, while still imposing some degree of market discipline on investors.[104]

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[103] *See* Robert K. Rasmussen & David A. Skeel, Jr., *Governmental Intervention in an Economic Crisis*, 19 U. PA. J. BUS. L. 7, 11 (2016).

[104] Hahn, *supra* note 100, at 770.