Public interest in bankruptcy: bailouts and effective regulation

Javier PAZ VALBUENA
University of Oxford

Abstract

There is significant renewed interest among bankruptcy scholars regarding the use of Chapter 11 to address issues that affect the public interest. Two instances have been the subject of most attention when considering the use of the tools of bankruptcy; one favourable to the public interest and the other not. Both depend on someone (being able to take part and also) being present in the proceedings when the relevant decisions are made. The first type of situations (value-preserving situations) covers those cases when a party in the proceedings can act for the benefit of certain stakeholders that are somehow represented in the proceedings (e.g., EPA is a party as regulator of the debtor and protects the general interest of the citizenship in a clean environment). The second type (cost-externalising situations) refers to situations where the players participating in the proceedings take decisions to the detriment of those not present or represented, even if their actions are approved by the bankruptcy judge (e.g., Texas two-step to shed liabilities that the debtor was forced to internalise by regulation; regulatory fines as monetary claims). This paper suggests a theoretical framework to deal with both situations.

From Ellias & Triantis (2021, 2023) to Lipson & Skeel (forthcoming Stan. L. Rev.) the focus has been to provide governmental agencies with the tools to protect the public interest (or, at least, the "limited" public interest that the agency represents) within the bankruptcy proceedings, once it is clear that bankruptcy judges will protect their jurisdiction and the government/regulator will not be able to avoid the automatic stay. This requires governmental agencies to participate (if they are entitled to) in the bankruptcy proceedings in a similar standing as other "private" stakeholders, and to accept the bankruptcy judge as the actor most appropriate to be the arbiter of issues that affect the public interest (social value). That this participation may be beneficial for the public interest may be used to justify that accepting the results of cost-externalising situations is somehow its flip side and thus necessary, or to somehow minimize the need for reform—though others such as Macey & Salovaara (2019) focus on the perversion of regulatory regimes conducted in this way.

This paper claims that, theoretically, those two types of situations must be addressed in different ways—not simply by encouraging participation in the bankruptcy proceedings. By integrating the prescriptions regarding value-preserving situations within the framework of my research on bailouts (Eidenmüller & Paz Valbuena, 2021), I highlight that many of these governmental interventions in Chapter 11 proceedings ought to be considered as bailouts (be it as injections of new money or as regulatory forbearance) and therefore should be subject to certain principles, controls and limitations, including the need to impose consequences on the other stakeholders. The ability to provide new funds in Chapter 11 conditional on certain obligations tied to the protection of social value/the public interest is nothing different from what can be done in a bailout, implemented either within or outside of the bankruptcy proceedings. On the other hand, in cost-externalising situations the possibility to shed (for a specific debtor) regulatory obligations that have been put in place for social value must be excluded even in the event of bankruptcy, as otherwise it prevents the regulatory efforts from achieving their valuable aims—for the benefit of those parties who are now considering a restructuring. The social value protected by the general regulation trumps bankruptcy (micro)efficiency.

In both cases, the preferred decisionmaker to preserve the public interest should be the government (as residual holder of social value), rather than a bankruptcy judge or other parties participating in the bankruptcy proceedings (who only have a partial understanding of the different "values" involved). Furthermore, the specific form in which these two situations arise in bankruptcy proceedings (with no party expressly or fully protecting the overall public interest/social value against the other stakeholders) results in a process where the adversarial discovery of the value at play by the bankruptcy judge is not particularly reliable as holders of relevant interests may not have had a chance to voice their opinion and/or enforce their rights.

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Introduction

The public interest[1] is an issue that has always permeated discussions about the economy and the government's ability to intervene. It has also informed discussions about economic legislation and the objectives that we should be (directly and indirectly) pursuing.

In the area of bankruptcy law[2], there has long been a dialogue regarding the proper scope of bankruptcy law between proceduralists and traditionalists. Whether bankruptcy law should only be concerned with solving a common pool problem and the maximization of recoveries by the creditors[3] or also consider matters relating to other stakeholders and the public interest[4] is a debate that remains well alive—even if for some time it seemed that a good share of the bankruptcy scholars, particularly those with a law & economics focus, had settled on the proceduralist camp.

Separate to scholar debate, it cannot be denied that, particularly during (and in the aftermath of) recent crises, governments have played an active role intervening in the economy when certain firms were in difficulties. This assistance, though always predicated on the "public interest" or "common good", has also brought increased scrutiny by the citizenry, which in many cases saw these interventions more as examples of "crony capitalism" than of protection of social value and the interests of the public.

Pressure has also increased on any use of public funds. As budgetary constraints, political polarization and increasing inequality have taken a preeminent place in political discourse and the citizens' minds across the globe, the use of public funds to rescue wealthy corporations and investors becomes more and more suspicious. And in certain jurisdictions, legislators and regulators have gone as far as to declare the banning of bailouts.

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[1] Also referred to as the public good (note that here we are using the term as a philosophical one, and not in the narrow economic sense of non-rival, non-excludable goods), the common good or the social good.

[2] It is important to note from the beginning a matter of nomenclature. When I refer to bankruptcy law in this paper, I am referring to what US law scholars would understand as corporate bankruptcy law and what English law scholars would call corporate insolvency laws. It is important to also note that what I mean in this context by bankruptcy laws is all laws and regulations dealing with the financial distress of corporations, covering US Chapter 11, E&W corporate insolvency laws and other related bodies of law and regulation, such as those affecting private workouts and restructurings that happen in the shadow of the formal insolvency proceedings, which serve as a backstop and anchor for any private negotiations.

[3] See, eg, Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press 1986), 16-17; or Douglas G Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren' (1987) 54 The University of Chicago Law Review 815.

[4] See Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 The University of Chicago Law Review 775.

However, reality dictates that we will always be confronted with situations where we need to react to crises once they happen, and where the costs of inaction appear to be significant and avoidable through intervention. This intervention will thus take place, and it may do so within or outside formal bankruptcy proceedings. But irrespective of the way it happens, it will be an intervention aimed at preserving the "public interest" or "common good" in the form of externalities (ie, value that resides with "external" stakeholders that are not decision-makers)—otherwise the government would not need to intervene and could rely on the relevant stakeholders acting on their own interest.

It is on this basis that Section 1 will discuss my research on bailouts of private[5] firms and the externalities associated to these situations.

In Section 1.1 I discuss the concept of bailout and why it is an important tool in relation to certain types of companies characterised for the presence of externalities (ie, they affect social value elsewhere), which I call "critical firms". In Section 1.2 I go on to discuss in some more detail the concept of "externalities", so that then in Section 1.3 I can explain how the presence of those externalities results in corporate bankruptcy laws not being the optimal tool for their preservation because of their design. I then end this first part in Section 1.4 with the introduction of my proposed tool for the preservation of social value, the ad hoc, ex post bailout, explaining the four principles that should guide its implementation in practice.

Once the framework of my research is explained I move into Section 2, where I discuss the recent treatment of "public interest" in bankruptcy law in the US scholarship. In Section 2.1 I discuss what this recent scholarship has in mind when referring to "public interest", contrasting it with the scope of the externalities in my framework. Section 2.2 then goes on to discuss the protection of the public interest by having the government participate as a private actor in bankruptcy proceedings. It contrasts such intervention with the ad hoc, ex post bailout, considering the differences in scope and the party making the decisions. Both Section 2.1 (particularly) and Section 2.2 deal with situations where the value of the public interest is preserved by the participation in one or other way of the government or another "representative" of the relevant stakeholders (the "**Value-Preserving Situations**").

Section 2.3 goes in a slightly different direction and considers what happens when certain aspects of the bankruptcy laws make it possible for the "public interest" to be attacked, even with the presence of the government in the proceedings and the other checks and balances in play. In these cases, bankruptcy acts a tool allowing the externalisation of costs (the "**Cost-Externalising Situations**"), which is absolutely contrary to the public interest.

In the Conclusion I explain (i) why, in the case of Value-Preserving Situations, bailouts should be a preferred alternative and why some of the interventions discussed should be considered bailouts (and therefore subject to the principles and guidelines that I suggest); and (ii) why, in the case of Cost-Externalising Situations, the solution comes not through government participation in the system but through regulatory reform that ensures that

[5] I will be using the term "private firm" throughout this paper to refer to non-state-owned firms, rather than in opposition to firms which securities are traded in public markets.

the bankruptcy system, and in particular certain institutions thereof, is not (inappropriately) used to achieve goals that are contrary to the overall legal and regulatory system.

1. Critical firms, externalities, corporate bankruptcy laws and bailouts

In this Section 1, I discuss the framework that I have been developing in my doctoral research and a few co-authored publications with Horst Eidenmüller[6]. The reason is that the focus of my research in bailouts and the associated limits of bankruptcy laws constitutes a different attempt at dealing with the problem of preservation and advance of the public interest affected by the financial distress of a private firm.

1.1. Critical firms and bailouts in practice

The concept of bailouts that I use derives from the classical exposition by Casey & Posner, whereby bailouts comprise "government … payments (including loans, loan guarantees, cash, and other types of consideration) to a liquidity-constrained private agent in order to enable that agent to pay its creditors and counterparties, when the agent is not entitled to those payments under a statutory scheme …"[7].

A key element of the bailout is then that it is a response to a specific situation that is already ongoing and to which the government needs to respond. As noted in a previous paper[8], I differentiate for the purposes of my research between statue-based (or general scheme) bailouts[9] and ad hoc bailouts. Both of them are ex post[10], a response to a situation of distress—more or less generalised, more or less specific. But what characterizes the

[6] See Horst Eidenmüller and Javier Paz Valbuena, 'Towards a Principled Approach for Bailouts of COVID-Distressed Critical/Systemic Firms' (2021) 73 South Carolina Law Review 501; Javier Paz Valbuena and Horst Eidenmüller, 'Bailout Blues: The Write-Down of the AT1 Bonds in the Credit Suisse Bailout' (2023) 24 European Business Organization Law Review 409; and Horst Eidenmüller and Javier Paz Valbuena, 'Taxes Blown in the Wind? The Siemens Gamesa Bailout' (2023) 50 Zeitschrift für Wirtschaftsrecht (ZIP) 2601.

[7] See Anthony J Casey and Eric A Posner, 'A Framework for Bailout Regulation' (2015) 91 Notre Dame Law Review 479, p. 480-481.

[8] See Eidenmüller and Paz Valbuena, 'Towards a Principled Approach for Bailouts of COVID-Distressed Critical/Systemic Firms', 511-512.

[9] For instance, the many general schemes that we saw all across Europe allowing firms to access public funds if they were to meet certain requirements clearly stated in the statutory basis for the scheme such as, in the UK, the Bounce Back Loan Scheme or the Coronavirus Large Business Interruption Scheme. These are different from situations where there are pre-existing entitlements that the firms can draw upon based on something else than their situation of financial distress and the government's will to assist in the prevention of such situation. See also Kristin Van Zwieten, Horst Eidenmüller and Oren Sussman, 'Bail-outs and Bail-ins Are Better than Bankruptcy: A Comparative Assessment of Public Policy Responses to COVID-19 Distress' (2021) 15 Virginia Law Review 199, p. 203-204, 219-220.

[10] Also noted as a key element of bailouts by Casey & Posner. See Casey and Posner, 'A Framework for Bailout Regulation', p. 481.

bailouts in my framework is that they are focused on the rescue of a specific firm because of its very particular characteristics (ie, the presence of externalities) and situation.

Another fundamental element of the bailout is that it can adopt different forms. It can be implemented by making a transfer of funds, by waving credits, via regulatory forbearance or through the provision of guarantees. All that is required is that a private company receives assistance from the government to prevent its financial distress and failure that, before that very specific intervention, it was not entitled to demand. So government makes a decision, based on the situation of the company (and maybe also of the economy generally) and its expected or actual financial distress, to use public funds to prevent the failure of that specific company (or cohort of companies).

We have seen examples of this type of government intervention in the economy play out in practice many times over the past 15 years, particularly during situations of generalised crisis such as the Great Financial Crisis of 2008 (and its aftermath) (the "**GFC**") or the covid-19 pandemic (the "**Covid Pandemic**"). And we have also seen significant political pressure being exerted over governments across the globe over the perceived excesses of their interventions during those times. As there were no clear laws or blueprints for the implementation of these bailouts, governments acted in what sometimes might have looked like a haphazard manner, in the way that they thought more appropriate in the midst of the situation. Sometimes that resulted in inconsistent treatment of firms. Sometimes it resulted in the use of public funds to rescue firms that the general public was not particularly keen on assisting with public funds. Most of the time it resulted in heavy criticism; sometimes warranted, some others not.

And all of this was happening in a context of growing inequality, budgetary pressure and political polarization where the use of public funds needs to be as unquestionable as possible to cement the legitimacy of the interventions.

Given the perceived risks of these governmental interventions, after the GFC certain jurisdictions decided to try to preclude through legislative action the possibility of the government carrying out bailouts[11]. However, a key question to ask is whether this is something that is feasible in practice. And situations such as the bailouts of Silicon Valley Bank or Credit Suisse in Spring 2023[12] seem to be evidence that outlawing bailouts is not something that works in practice.

But there are "good" bailouts and there are "bad" bailouts[13]. And given that, irrespective of the reasons behind the government's intervention, the optimal decision ex post (eg to bail out) may not need to coincide with the optimal decision ex ante (eg not to bail out), I

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[11] See, eg, John Armour and others, *Principles of Financial Regulation* (Oxford University Press 2016), 348-349, in relation to how Dodd-Frank and the Orderly Liquidation Authority fundamentally restricted the possibility of bailing out financial institutions without further Congressional authorization.

[12] See, for instance, in relation to the Credit Suisse-UBS bailout, Paz Valbuena and Eidenmüller, 'Bailout Blues: The Write-Down of the AT1 Bonds in the Credit Suisse Bailout'.

[13] See, for instance, Michael G Smith, 'Three Essays on the Political Economy of Corporate Bailouts' (PhD dissertation, Columbia University 2014), 9-17.

think that establishing a clear framework that can serve as a blueprint for when a bailout may be appropriate and how to implement it is of the outmost importance.

When referring to "good" and "bad" bailouts in the previous paragraph I am essentially thinking on the two main rationales that lie behind a government intervention in the economy. The "good" rationale is to prevent the failure of firms that have some kind of "social value": government intervenes to ensure that value (the externalities) is preserved. The "bad" one is to make transfer of rents to connected parties[14]: government uses an excuse to funnel public funds to "connected" private parties that are not creating or preserving social value..

In a previous paper[15], I explore that "good" rationale on the basis of what is it that makes government intervene in a situation of crisis to ensure the survival of a certain firms or types of firms on an ad hoc basis. My conclusion is that the rationale that drives the "good" bailouts is that the continuation (liquidation) of the firm results in significant positive (negative) externalities, affecting society at large or a sufficiently wide group that is not represented within the stakeholders that are in a position to protect their interests in bankruptcy[16]". And the firms so characterised are what I call a "critical firm".

1.2. Externalities and a "wider" concept of efficiency

Building on the discussion on the previous section, the "original" rationale for the intervention is purely one of economic efficiency. If, at the point that the firm in financial distress needs the intervention from the government, the benefits of the intervention are higher than the costs, governments should intervene—provided that the other parties that could intervene (ie, those that are part of the formal bankruptcy process, namely, shareholders, creditors, managers or a judge) are not considering the full picture (the full social value affected by the situation of financial distress) and therefore their decisions may be suboptimal.

This disparity in assessment of the efficiency of the situation (eg, whether to reorganise or to liquidate) may come from the difference in the "value" being considered by the parties. From "narrow" considerations of microeconomic efficiency assessing only the effects on the value that is appropriated by those participating or represented in the

[14] See ibid, 12-14.

[15] See Eidenmüller and Paz Valbuena, 'Towards a Principled Approach for Bailouts of COVID-Distressed Critical/Systemic Firms', 520-521. In this paper my coauthor and I get to the concept of "critical firm" by continuously refining what we see in practice (what firms are bailed out, what types of firms benefit from regulatory regimes that aim to protect them, what types of firms benefit from exceptions to restrictive regulations) and what we think is appropriate from a theoretical standpoint—see, generally, pages 512-521.

[16] Whether directly or through their ability to direct or influence the actions of the firm. If they were in a position to protect their interests (whether because insolvency laws provide for protection of certain rights of external stakeholders or because corporate laws required the managers and/or directors of the debtor to consider the welfare of external parties), the relevance of externalities would be reduced as the relevant parties would be entitled to exercise their rights and capture at least part of that value.

bankruptcy process, to a "wider" conception of "social" value that can be captured or preserved in the process and that may affect other "external" stakeholders[17].

Once we extend the scope of the economic efficiency that is traditionally considered for these purposes, we get to see the important "social value" that may be present and that constitutes a key justification for the intervention of the government. This extension of efficiency to a "wider" concept of value (ie, social value) brings with it the understanding that the parties that are participating (or duly represented) in the bankruptcy process are making their decisions on the basis of their "narrower" consideration of value and without having to think about the impact of their decisions on other stakeholders that are not (directly or indirectly) a part of the process, which brings us directly into the scope of externalities.

In my research I discuss four general categories of externalities[18] that may be present and, if so, must be considered when dealing with the financial distress of critical firms. These categories differ on how the externalities come to exist, how immediate their relationship is with those benefiting from (or affected by) them and how certain we are that their preservation (avoidance) will bring a net benefit.

The first category considers the loss of positive externalities where critical firms provide a public good[19] or an infrastructure good[20], and they cease to provide it with no adequate alternative being available[21]. In this category ("Type-1" externalities) one can find, for example, the externalities generated by the goods/services provided by healthcare operators, logistics carriers, or internet service providers[22].

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[17] I will use the term "external stakeholders" to refer to those parties that see some social value that affects them being affected by the distressed firm and the bankruptcy process to which it is being subject, but that are not normally represented within the stakeholders that are in a position to protect (directly or indirectly) their interests in bankruptcy.

[18] For a different exposition on externalities on the bankruptcy process, see Jonathan C Lipson and David A Skeel, 'FTX'd: Conflicting Public and Private Interests in Chapter 11' (2025) 77 Stanford Law Review (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4760736). In this paper, Lipson & Skeel refer to the "public interest" being represented by three different interests that in many ways we can (re-)characterise as externalities: (1) the integrity of the judicial process, (2) other public interests (eg, prosecuting crime), and, finally, a bankruptcy-specific one (3) maximization of value (efficiency). I will discuss in Section 2.1 how this fits with my framework discussed in this Section 1.2.

[19] A standard definition in the economics literature is that "[a] public good is a commodity for which use of a unit of the good by one agent does not preclude its use by other agents". Because of those characteristics, theoretically, their provision by a private firm is inefficient (mainly because of free-riding). See Andreu Mas-Colell, Michael D Whinston and Jerry R Green, *Microeconomic Theory* (Oxford University Press 1995), 351, 359-60. When these goods are provided, they create positive externalities for the benefit of all those who use the public good.

[20] See the definition in K Sabeel Rahman, 'Infrastructural Regulation and the New Utilities' (2018) 35 Yale Journal on Regulation 911, 926-27.

[21] These are similar to the externalities discussed as "situational monopolies" for "essential social functions" in Shlomit Azgad-Tromer, 'Too Important to Fail: Bankruptcy versus Bailout of Socially Important Non-Financial Institutions' (2017) 7 Harvard Business Law Review 159, 164-65, 169-73.

[22] Or even payment services if one were considering financial institutions.

"Type-2" externalities are negative externalities imposed on customers, suppliers and other firms in the industry via (counterparty and informational) contagion. The financial distress is passed on to other parties as a consequence of the default by the distressed critical firms (i) resulting in a loss that brings their counterparties into financial distress of its own or (ii) causing third parties to react to a perceived deterioration of the economy or the specific industry by altering, reducing or halting their trading[23]. A clear example would be that of the externalities imposed by automakers on their concentrated suppliers when they cease trading and the businesses of the latter plummet.

"Type-3" externalities are negative externalities imposed on Governments via effects on labour markets and their associated costs in the form of social security and unemployment-related benefits/payments[24]. An example here would be the externalities created by the liquidation (or significant downsizing) of a dominant regional employer at a time when the supply of alternative employment for the laid-off employees is significantly constrained in the relevant market, resulting in much higher than expected benefits to be funded by the Government.

"Type-4" externalities go one step further by considering the more diffuse benefits to be gained through the stabilisation of the economy in certain situations, resulting in the avoidance of significant widespread costs to the economy[25]. An example of these externalities would be the significant macroeconomic costs imposed on the economy by prolonged recessions which could be mitigated by the quick stimulation of aggregate demand by preserving significant levels of employment or maintaining corporations in a position to undertake further investments[26].

In my framework, I consider the presence of significant externalities as a necessary condition for a firm to be considered a critical firm (ie, a firm that, should it encounter financial distress, would be a strong candidate for a bailout). But that alone will not be

[23] These are the types of externalities discussed in Adam J Levitin, 'In Defense of Bailouts' (2011) 99 Georgetown Law Journal 435, 455-61; Casey and Posner, 'A Framework for Bailout Regulation', 522-23, 528-29; Shai Bernstein and others, 'Bankruptcy Spillovers' (2019) 133 Journal of Financial Economics 608, 624-627; Daron Acemoglu, Asuman Ozdaglar and Alireza Tahbaz-Salehi, 'Microeconomic Origins of Macroeconomic Tail Risks' (2017) 107 American Economic Review 54, 83-85; or Xavier Gabaix, 'The Granular Origins of Aggregate Fluctuations' (2011) 79 Econometrica 733, 764.

[24] These are considered, though under a different lens, in Zachary Liscow, 'Counter-Cyclical Bankruptcy Law: An Efficiency Argument for Employment-Preserving Bankruptcy Rules' (2016) 116 Columbia Law Review 1461. Also, Bernstein and others, 'Bankruptcy Spillovers' (n 23), 627. A somehow related view is exposed in Jonathan S Masur and Eric A Posner, 'Regualtion, Unemployment, and Cost-Benefit Analysis' (2012) 98 Virginia Law Review 579.

[25] These are the macroeconomic externalities that may result from kickstarting the economy and avoiding significant outputs and the resulting hysteresis, as discussed in Yair Listokin, *Law and Macroeconomics: Legal Remedies to Recessions* (Harvard University Press 2019) – in principle I am including here the effect of the Keynesian multiplier in labour markets as a separate effect from the direct effect of liquidation on the labour market. Note that this is a significant step as we move to use the insolvency framework to implement a stabilisation economic policy. Also of interest are Acemoglu, Ozdaglar and Tahbaz-Salehi, 'Microeconomic Origins of Macroeconomic Tail Risks', 83-85; or Gabaix, 'The Granular Origins of Aggregate Fluctuations', 764.

[26] On the costs of prolonged recessions and hysteresis, see Listokin, *Law and Macroeconomics: Legal Remedies to Recessions*, 70-71. Also, in relation to hysteresis in the specific context of shocks to the labour market, see David Romer, *Advanced Macroeconomics* (4th edn, McGraw-Hill Irwin 2012), 484-86.

sufficient. The relevant polity needs to consider that, as a result of the presence of those externalities connected with the continuation of the firm, the consequences of the failure of the firm[27] are not acceptable[28]. In some other cases the (temporary) disruptions in the normal functioning of the economy will be considered unavoidable occurrences that society is willing to accept and that do not merit the use of significant public funds for their prevention.

1.3. The limits of bankruptcy laws

What I mean in this context by bankruptcy laws is all laws and regulations dealing with the financial distress of corporations, covering US Chapter 11, E&W corporate insolvency laws and other related bodies of law and regulation, such as those affecting private workouts and restructurings that happen in the shadow of the formal insolvency proceedings, which serve as a backstop and anchor for any private negotiations.

I have already noted that the primary element of what I call "critical firms" is the presence of significant externalities dependent on their continued operation[29]. It is particularly this characteristic of critical firms that makes formal bankruptcy proceedings an inadequate tool to deal with their (financial) distress.

The existence of these externalities creates a gap between social efficiency and the "local" efficiency assessed by the parties involved in the bankruptcy proceedings. Since there is value that is not considered in the process[30] and may be lost as result of the decisions taken there, (social) welfare is not maximised.

The existence of this gap is possible because there is no party who can claim a clearly defined property right to that "social" value embodied in the externalities discussed in Section 1.2 above. In my research I claim that this social value, a type of "residual" value, could and should be captured by the government as representative of the interests of society, who is the "residual" claimant for all value in society[31]. These claims are initially

[27] And, fundamentally, the consideration that corresponding allocation of losses in accordance with the provisions of the corporate insolvency framework are not acceptable. See Levitin, 'In Defense of Bailouts', 438: 'systemic risk is the risk that individual firms' failures will result in a socially unacceptable impact on the broader economy'.

[28] Ibid, 446-47 ('socially unacceptable macroeconomic contraction'), 508 ('opt out of the loss allocation that would result from the default bankruptcy resolution'). Also, see Azgad-Tromer, 'Too Important to Fail: Bankruptcy versus Bailout of Socially Important Non-Financial Institutions', 176.

[29] As a general reference on the issue of externalities, see Jonathan Gruber, *Public Finance and Public Policy* (5th edn, Macmillan Education 2016), 125ff; Mas-Colell, Whinston and Green, *Microeconomic Theory*, 350ff; Hal R Varian, *Microeconomic Analysis* (3rd edn, W.W. Norton & Company 1992), 432-39.

[30] By those who are present or duly represented in the proceedings (the "internal" stakeholders), who may not care or not even be aware of the effects on social value that may affect the "external" stakeholders.

[31] This is a claim that requires further research, but I have found preliminary support in certain jurisdictions that I will be analysing in detail, such as in provisions regarding the social function of property and the subordination of any wealth in the country to the "general interest" in the Spanish (article 128.1) and Italian (articles 41-47) constitutions, or in the English doctrine of eminent domain. Somewhat related arguments, from a moral/political philosophy standpoint, may be found in Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford University Press 2002), 176.

built on the premises that the corporation is managed for the benefit of their shareholders (and sometimes, in certain jurisdictions, its creditors[32]) and corporate insolvency laws contain very limited effective general requirements to consider external parties, if any[33]. But, if we were to relax any of these assumptions, the need to consider (at least some of) these externalities would be reduced[34].

1.4. My proposal: the ad hoc, ex post bailout

My analysis, as briefly summarised in the preceding Sections, reclaims, for the purposes of economic efficiency, further space for the government (as "agent" for social value held by "external" stakeholders) in relation to the (financial) distress of critical firms.

The government (as the legitimate depository of social interests)[35] is the agent adequately positioned to fully internalise all the costs and benefits of specific situations when they spill over the immediate stakeholders of a corporation (ie those to whom the law gives a direct, actionable right to impose, or at the very least voice, their will in relation to the conduct of the affairs of a company and its journey through insolvency) [36].

According to my research, the best way to operationalise the intervention of the government in these situations is by using a tool that allows the government to force the internalisation of all relevant costs and benefits: the ad hoc, ex post bailout.

This will not be a tool to substitute bankruptcy proceedings. It is an additional instrument in the government toolkit that may be effectively deployed when the social costs of not considering the relevant externalities are so important that the government feels comfortable in their assessment that the benefits of intervention will exceed the costs

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[32] It is interesting to note the diverging evolution in this regard in the US (see NACEF v. Gheewalla, 930 A.2d 92 (Del. 2007)) and the UK (see West Mercia Safetywear Ltd. v. Dodd [1988] BCLC 250; BTI 2004 v. Sequana S.A. [2019] EWCA Civ 112; and s.172(3) Companies Act 2006).

[33] For instance, in the US and England & Wales there is nothing like the provisions in the Chinese insolvency framework relating to the resettlement of employees (articles 8 and 11 of the Enterprise Bankruptcy Law). See Natalie Mrockova, *Corporate Bankruptcy in China: Principles, Limitations and Options for Reform* (Hart Publishing 2021), 74. Though continental European jurisdictions contain, eg, provisions on the forced continuation of a large enterprise resulting in a preservation of employment at the expense of the creditors within the extraordinary administration (*amministrazione straordinaria*) under *legge* no. 166 of 27 October 2008 (the amended Marzano law) and *decreto legislativo* no. 270 of 8 July 1999 (the so-called Prodi-bis law) in Italy; the consideration of saving jobs as an objective of the judicial reorganisation proceedings (*redressement judiciaire*) under article L631-1 of the Commercial Code in France; or the ability of the court to take into consideration the preservation of jobs to agree to a lower offer in an auction for the company or a business unit under article 219 of the *Texto Refundido de la Ley Concursal* in Spain.

[34] Because if property rights were properly granted to third parties, these would be entitled to directly enforce their rights over the relevant value (which would then enter into the decision-making process properly) and we would not need to resort to government to protect that value via internalisation.

[35] Similar arguments have been considered in the literature regarding the potential positive effects of horizontal ownership by widely diversified/market-portfolio-holding institutional investors.

[36] The problems posed by international spillovers (eg, consider the discussions between the British and French Governments regarding the rescue of Eurostar) add a significant layer of complexity to the problem.

(monetary and distortionary) of intervening to capture them. The government may decide to deploy this tool in conjunction with bankruptcy proceedings as well as outside of them[37].

Understanding that ad hoc, ex post bailouts are unavoidable as sometimes they are the best tool that governments have to preserve social value, takes us to the next step: ensuring that whenever government intervenes in this fashion, it is doing so in a way that reflects proper understanding of the situation and its responsibilities vis-à-vis its citizens for the use of (increasingly scarcer) public funds.

For this reason, in a previous paper[38] discussing the use of ad hoc, ex post bailouts in the context of the Covid Pandemic, we proposed a principled approach to the use of bailouts to protect critical firms (and the relevant externalities). The underlying idea is to establish certain principles or guidelines that assist us in ensuring that any implementation of a government intervention in the economy via a bailout will be a legitimate use of public funds. These principles, guidelines or blueprints[39] are developed on the basis of the theoretical insight feeding into my analysis (mostly of economic nature), as well as drawing (by way of inductive reasoning) from model laws, regulations and other instruments that in practice deal with similar situations.

1.4.1. Efficiency

The first of these principles (which may even be considered a prerequisite for a bailout to take place) is that of efficiency. As discussed in Section 1.2, the reason justifying the use of funds for a bailout is that there is an argument of (economic) efficiency to be made for the intervention. The government needs to be comfortable in the assessment that the value preserved with the intervention is larger than the costs associated. A key element, as has been discussed, is to make sure that, when the efficiency assessment[40] is conducted, it properly takes into consideration not only the value that can be appropriated by those parties that participate in the bankruptcy process but also the other "social" value that may be present in the relevant scenario.

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[37] If inside formal bankruptcy proceedings, care should be taken to ensure that we are not "hijacking" the bankruptcy process. In this respect, I have already noted in a previous article that "*hijacking* the bankruptcy process to achieve objectives that are not normally expected to be achieved through them (eg, by government exercising its exorbitant powers in practice within the context of *normal* insolvency proceedings) is not an appropriate way to deal with issues that require different solutions (and safeguards for all parties involved)". See Eidenmüller and Paz Valbuena, 'Towards a Principled Approach for Bailouts of COVID-Distressed Critical/Systemic Firms', 528 and footnote 146.

[38] See ibid, 523-535.

[39] The discussion of the principles in Sub-Sections 1.4.1 to 1.4.4 is a summarized version of the detail in ibid, 523-535.

[40] The idea is to conduct a cost/benefit analysis (as implementation of the Kaldor-Hicks principle) that widely considers the available sources of value. As noted in ibid, 529, although "a number of arguments may be made against using efficiency in this sense as a normative goal, … despite its shortcomings it still is the most widely used benchmark in public policy".

Given the limited information available and the need to react quickly, in certain cases the assessment of efficiency of the intervention by the government may be tentative. Only when, acknowledging the previous limitations, the government is safe in assessing that there is a net gain to be achieved by intervening should this principle be considered to have been adhered to. And this assessment ought to be always subject to proper understanding of the important costs that may arise from the intervention—among other potential issues, it is important that no intervention causes material long-term distortions to efficient private bargains.

Using a bailout is only acceptable when the government is preventing the failure of a financially-distressed firm[41] in situations where the allocation of costs that would result from not intervening is not deemed acceptable (as there is a loss of social value that can be avoided).

1.4.2. Subsidiarity

A closely related principle to efficiency is that of subsidiarity (that we can also consider in terms of proportionality).

Given the extraordinary nature of the bailout and the use of public funds to rescue a private firm (and its stakeholders), the scope of these interventions should be limited to that absolutely necessary to achieve its proper goal: the preservation of the social value in the form of externalities that are secured by the continuation of the firm being rescued. The conservation of the firm as a going concern needs to be secured in the least intrusive way, avoiding the creation of any market distortions.

This principle also requires something that is fundamental in my framework: the assistance by the government ought to be the minimum required once "the pre-existing investors in the firm have done all that is possible to remedy or at least mitigate the situation of distress"[42]. If these pre-existing investors want to retain any interest in the firm post-bailout, "they need to absorb at least part of the relevant losses to the extent necessary for the firm to be able to continue operating"[43]. In this way, in my framework all bailouts require that there is an element of bail-in. Without this contribution, the government intervention is not proportional, and the bailout should not take place.

This is an essential requirement to ensure that moral hazard is mitigated and equity investors, creditors and, when applicable, management are held accountable and exposed to the risks of their respective positions.

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[41] A bailout should never be implemented for the purposes of assisting an economically-distressed firm, as in that case it would be clearly inefficient and value-destructing. This is not to say that government should never intervene in a different way; it simply notes that the specific tool of a bailout should only be used to rescue firms who have a sound business and that will create a net positive value after the government's intervention sorts out the financial problems affecting the firm.

[42] See Eidenmüller and Paz Valbuena, 'Towards a Principled Approach for Bailouts of COVID-Distressed Critical/Systemic Firms', 527.

[43] See ibid.

1.4.3. Equity

Equity (or fairness) is an important principle as bailouts normally represent significant amounts of public funds being deployed or put at risk. This requires a few things.

That the funds are used to pursue a public purpose, the furtherance of a public interest that is appreciated as such by the polity. Within this framework, this may be somehow covered by application of the principle of efficiency. If the bailout only happens when social value in the form of externalities is present, then we will be progressing the public interest by preserving those externalities.

This also brings us to the question as to whether government is entitled to leverage its position as provider of assistance to require certain behaviours from the bailed-out firm[44]. If the behaviours are directly linked to the reason why the company requires to be bailed out and they are addressed at ensuring that the relevant issues are sorted and that the government is repaid, there is not much to question. Similarly, no problem seems to arise if the requirements are directly attached to ensure that whatever externality was the reason for the intervention is effectively preserved. What might be open for discussion is what happens when the provision of assistance is conditional on advancing other policy goals of the government that are not directly linked to the more direct issues, for instance, asking an airline that is being rescued because of the externalities present in the preservation of employment within the company and its providers to limit their short-haul journeys (even if that may not be financially advisable or will result in a reduction in employment)[45].

A different side of this principle deals with the effects on the other market participants in the industry of the bailed-out firm. They should not be negatively affected. Government should aim at avoiding the creation of distortions in the market when intervening, and institutional safeguards should be in place to ensure that the interests of the competitors not receiving assistance are also taken into consideration.

This principle is also about establishing procedures that guarantee equity and fairness by ensuring consistency in the way that decisions about whether to provide assistance or not via a bailout are made. This is a big part of establishing the legitimacy of these interventions. And it is further assisted by the final principle, transparency.

1.4.4. Transparency

Transparency requires that the citizens, as ultimate beneficiaries of the intervention, are provided with the key details necessary to judge the legitimacy of any bailouts being conducted. After all, the intervention requires the use of significant amounts of taxpayers'

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[44] Further discussed in relation to government's leverage in bankruptcy in Section 2.2.2.

[45] This will be discussed again in Section 2.2.2 when we talk about the participation of the government as DIP Jared A Ellias and George G Triantis, 'Government Activism in Bankruptcy' (2021) 37 Emory Bankruptcy Developments Journal 509 lender in the bankruptcy process and what some authors suggest that we can get from that. See Jared A Ellias and George G Triantis, 'The Administrative State in Bankruptcy' (2023) 72 De Paul Law Review 323, at 344-345, 361; or Ellias and Triantis, 'Government Activism in Bankruptcy', at 518-519.

funds, will have important distributional effects, and is said to be conducted for the public good (or at least to benefit a certain subset of the general population that a majority thereof should feel is warranted).

Given the specific nature of these interventions, and the fact that at times the nature of the situation will require some level of confidentiality to avoid creating a bigger problem, this requirement for transparency is not absolute and will need to be operationalized. But even if circumstances may require some adjustments while the intervention is being planned and carried out, "full material disclosure ought to be made as soon as possible"[46]. And in any case, full decisions regarding the bailout and its implementation should be subject, in the way that they adjust to appropriate guidelines, to ex post judicial control[47].

* * *

The importance of these principles is to ensure that whenever there is a use of public funds to bail out a firm, this is implemented with certain protections that are not otherwise available. Protections that are not only for the benefit of the taxpayer but also for the benefit of those other stakeholders that might be affected by the government's intervention.

The main protection to the general public (and thus, in a way, to the public interest) comes from the efficiency and transparency principles, as they ensure that the funds are put to a "good" use and the taxpayers have a way to monitor and supervise the actions of the government. That the government intervenes legitimately in a way that is economically efficient appropriately addresses many of the potential concerns derived from such an intervention in the economy using taxpayers' funds.

2. The US scholarship on public interest in Chapter 11

There is significant renewed interest among bankruptcy scholars regarding the use of the bankruptcy process (and particularly Chapter 11) to address issues that affect the public interest[48]. Two instances have been the subject of most attention when considering the use of the tools of bankruptcy; one favourable to the public interest and the other not. Both depend on someone (being able to take part and also) being present in the proceedings when the relevant decisions are made.

The first type of situations (what I called "Value-Preserving Situations") covers those cases when a party in the proceedings can act for the benefit of certain "external"

[46] See Eidenmüller and Paz Valbuena, 'Towards a Principled Approach for Bailouts of COVID-Distressed Critical/Systemic Firms', 534.

[47] As I note in ibid, footnote 180, "the ability for the courts to control the implementation of the bailouts ex post should be as broad as possible, provided that bailouts are not second-guessed as long as they comply with the relevant guiding principles".

[48] Ellias & Triantis note that their article "may be thought of as an extension of the classic debate ignited by Elizabeth Warren and Douglas Baird in 1987 on the scope of bankruptcy" (Ellias and Triantis, 'Government Activism in Bankruptcy', 514).

stakeholders that they somehow represent in the proceedings (eg, EPA is a party as regulator of the debtor and protects the general interest of the citizenship in a clean environment). The second type (what I called "Cost-Externalising Situations") refers to situations where the players participating in the proceedings take decisions to the detriment of those not present or represented, even if their actions are approved or monitored by the bankruptcy judge (eg, Texas two-step to shed liabilities that the debtor was forced to internalise by regulation; regulatory fines as monetary claims).

I will discuss first the concept of public interest and how it relates to the externalities at the core of my framework (Section 2.1). Then I will consider, in Section 2.2, the Value-Preserving Situations when the government participates actively in the bankruptcy process, and will contrast them with the situations where my framework allows for the implementation of bailouts. Finally, in Section 2.3, we discuss scenarios where the government intervention happens but the result is (or may be) contrary to the public interest because it allows the externalization of costs that should have internalized by certain economic agents.

2.1. Public interest

The first big question when addressing the potential fit between my framework as described in Section 1 and this new important stream of US bankruptcy scholarship is to understand what is the "public interest" that is being analysed in it[49]—and how that fits with the concept of externalities. The second step is to understand the different "intensities" of public interests being protected, and the nature of the communities that are so affected by them. Finally, I consider which actors are in a position to preserve that public interest in the bankruptcy process[50], to then assess whether they are in a better or worse position that my "residual holder of social value" to do that.

2.1.1. What is a/the public interest?

As a first approximation, a public interest (also common good or general welfare) could be generally understood to be something for the benefit of a large group (a polity), that is shared by them. Similarly, the Stanford Encyclopedia of Philosophy[51] characterizes the "common good" as "those facilities—whether material, cultural or institutional—that the members of a community provide to all members in order to fulfil a relational obligation they all have to care for certain interests they have in common". As such, it is a concept that is closely related to that of externalities described in Section 1.2 above, in that it is social value that is affected by what others (ie, the community) do. It is also closely related

[49] For these purposes I will refer to some of the most recent scholarship by bankruptcy scholars in the US, and in particular Lipson and Skeel, 'FTX'd: Conflicting Public and Private Interests in Chapter 11'; Ellias and Triantis, 'The Administrative State in Bankruptcy'; Ellias and Triantis, 'Government Activism in Bankruptcy'; and Joshua C Macey and Jackson Salovaara, 'Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law' (2019) 71 Stanford Law Review 879.

[50] Note that here we are still considering the appropriateness of bankruptcy laws as they stand. I will only consider the practical implications of government actively intervening once we get to Section 2.2 below.

[51] See https://plato.stanford.edu/entries/common-good/ (last checked on 2 September 2024).

to the economic concept of public goods[52], though it could also be extended to cover common pool or common resource goods (rivalrous but non-excludable; eg, access to fisheries) and even club goods (non-rivalrous but excludable; eg, access to cultural goods).

This is a concept that encompasses something that is beneficial to a group of people but which could be affected by the decisions and actions of specific actors. These decisions and actions of specific parties could then have a significant effect on the welfare of the entire group. The externalities in my framework (as described in Section 1.2) would certainly represent social value that is a public interest.

Let's see, however, how this new branch of scholarship is approaching the issue. Lipson & Skeel[53] point out that there are three main public interests that can be preserved in the bankruptcy process: (i) the integrity of the judicial process, (ii) maximization of value (efficiency) through efficient, consolidated proceedings, and (iii) "other" public interests. Their protection seems to rest in a number of gatekeepers with different mandates and incentives, who may not always be present in the bankruptcy process or who may have conflicting or different goals than some of the other stakeholders that will be affected by what happens in the proceedings.

The first of these public interests, the "integrity of the judicial process", is said to be the overarching interest to be preserved in Lipson & Skeel's framework. It is an interest that, because of its very diffuse character and general relevance outside of bankruptcy and situations of financial distress, is difficult to fit into my framework. It could be some kind of "Type-5" externality, as its benefits are even more diffuse that those considered in Section 1.2. Or it could be considered a public good (and so maybe fit with what I have called "Type-1" externalities).

However, this is not an externality directly caused by the preservation or not of the firm as an operating business. This is a separate good that is affected by the way in which the legal system is used to deal with the financial distress of the firm. It is important. It affects social value in a significant way. But its value does not depend on whether the debtor continues operating or not; it depends on what actions are taken by the legal system to deal with the situation of the debtor.

It is more a pre-requirement for intervention rather than the public interest that the intervention seeks to protect. As such, this is akin to ensuring the legitimacy of the intervention: there is a public interest that we want to preserve, and it needs to be preserved while complying with the relevant rules and regulations.

In my framework, this is something covered by the principles that apply to implementation of bailouts (ie, how should they be conducted) rather than by the scope of the social value and externalities. The key principles involved in preserving the

[52] Non-rivalrous, non-excludable goods. See Section 1.2 and footnote 19.

[53] See Lipson and Skeel, 'FTX'd: Conflicting Public and Private Interests in Chapter 11', 8. Their discussion of the public interest affected in bankruptcy proceedings is anchored on the specific case of FTX, though it is developed with a degree of generality to allow its extension to bankruptcy proceedings generally.

integrity of the judicial process (in a way, a justification of the legitimacy of the intervention) are those of equity (Section 1.4.3) and transparency (Section 1.4.4), though proportionality also plays a role.

So bailouts would not affect this system integrity if they are done properly, according to pre-set guidelines and procedures, such as is the case in my framework.

The second interest, "maximization of value through efficient, consolidated proceedings", is a bankruptcy-specific interest. Efficiency is well accepted as the cornerstone of bankruptcy proceedings. It leads to a maximization of the value of the debtor company that results in a value as large of possible to be distributed among the company's creditors[54]. And it is also an element reflected in my principles for bailouts (see Section 1.4.1).

An important consideration here is that my framework extends the scope of the traditional (micro-) efficiency focus, which only considers the value that is brought to the parties that participate and have a say in the bankruptcy process (or that are otherwise represented by those intervening), to other instances of social value[55]. By considering a wider concept of efficiency, we find the value in the externalities affecting "outside" stakeholders and they now become an important part in the decision-making process.

So "maximization of value through efficient, consolidated proceedings" is also a part of my framework, particularly when we consider the potential externalities that may be affected by the bankruptcy process and the "gap" between the efficiency being considered in the process and the wider social value.

The final set of interests fall under the non-descriptive tag of "others". This "other public interests" category in Lipson & Skeel includes certain public goods or the prosecution and defence of serious crimes[56]. Those interests seem to point into two very different directions for these "other" interests.

If we consider the public goods part first, this seems to go squarely in the direction of my externalities framework. When we have sufficiently relevant pools of value that may get affected in the bankruptcy process, that is part of the public interest. When issues such as the need to protect railroad transportation in the early 20th century come to the forefront, it is because the railroad network is providing a significant amount of value to a community, going beyond the monetary interests that it has for its equity investors and other financial creditors[57]. This is a clear acknowledgement of externalities (in this case, a "Type-1" externality in my framework) as public interests.

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[54] This is key for the "proceduralist" tradition and the "credit bargain theory"—though the "traditionalists" also accept the value of economic efficiency, though tempered in consideration of other valuable goals (less bankruptcy-specific) that may also be achieved.

[55] See Section 1.2.

[56] See Lipson and Skeel, 'FTX'd: Conflicting Public and Private Interests in Chapter 11', 8, 9 and 14.

[57] Note that Lipson & Skeel report that even though system integrity (the integrity of the judicial system) is for them the most important public interest, historically that ranking has been overturned at times when confronted with other public interests that were a pressing concern at that time, such it was the case with

If we consider the second example of "other" interests (ie, the prosecution and defence of serious crimes), we see that we are going into a very different territory, closer to the "integrity of the judicial process" than to the efficiency and externalities issues that we have been just discussing. As noted when discussing "integrity" above, this is not the case of an externality caused by the preservation or not of the firm; it seems to be more of an interest in the proper functioning of the legal system. Once again it is a separate good (or interest) that comes into play in a different way. It is also important and has effects on social value in a significant (but quite diffuse) way. But, as it was the case with "integrity", its value does not depend on whether the debtor continues operating or not—it depends on what actions are taken by the legal system to deal with the relevant situation. The fact that some of those actions can or should take place in bankruptcy proceedings does not make this automatically the same kind of problem as the others that affect the social value that the debtor brings by continuing in operation. As such, this is something that, if appropriate within my framework, is covered by the principles that apply to implementation of bailouts (ie, how they should be conducted)—so that the bailout is not conducted in a way that is going to affect these "other" interests.

So, the public interests under "integrity of the judicial process" and the second leg of the "other interests" discussed in the above paragraph would be, in my framework, more of a procedural requirement that needs to be observed when intervening rather than instances of a social value that requires intervention to be protected.

But these are not the only instances of public interests in Chapter 11 that are discussed in the literature. What are other concepts or examples of public interest that we can turn to for further refining our definition?

For instance, when we look at Ellias & Triantis[58] we can observe a different approach. In their papers it is discussed how government, not being able to subtract itself from the power of the bankruptcy court[59], is in a better position to protect the public interest (that it is entrusted with) if it decides to participate actively in the bankruptcy process. That is, the government is acting as a "private" actor in the proceedings, not as a gatekeeper. Through that participation, Ellias & Triantis argue, a number of "benefits"[60] can be achieved. These benefits are instruments or tools that can then be used to pursue the government's objectives in the bankruptcy process, which are those that should comprise

the use of the receivership strategy in the late 19th and early 20th centuries to protect railroad transportation. See ibid, 7.

[58] See Ellias and Triantis, 'The Administrative State in Bankruptcy'; and Ellias and Triantis, 'Government Activism in Bankruptcy'.

[59] See Ellias and Triantis, 'Government Activism in Bankruptcy', 515-517; or Ellias and Triantis, 'The Administrative State in Bankruptcy', 329-330, 349 and 350ff.

[60] See Ellias and Triantis, 'The Administrative State in Bankruptcy', 340-346. The paper mentions, among other, (i) increased disclosures, (ii) participation in judicial decisions, (iii) bargaining with company and shareholders, and, most saliently, (iv) conditional support. As I will further discuss in Section 2.2.2 below, the conditional support where government leverages its assistance (financial or otherwise) to control or significantly influence the bankruptcy process in order to pursue its own policy goals falls squarely with the definition of bailout that I use in my framework.

the public interests that are being preserved by the intervention[61]: (i) recover money owed to the government[62] and/or (ii) protect social value or promote the public interest[63]. In particular, Ellias & Triantis note that "[b]ankruptcy is a forum in which parties' legal rights are modified, sometimes without all the consent otherwise required, for the collective good that is often encapsulated in the preservation of going concern value"[64].

This "collective good" is the public interest. And in so describing it, this approach is consistent with my frameworks as discussed in Section 1.1 above: the rationale that drives "good" bailouts is that the continuation (liquidation) of a "critical firm" creates significant positive (negative) externalities, affecting society at large or a sufficiently wide group that is not represented within the stakeholders that are in a position to protect their interests in bankruptcy[65].

Thus, when all the foregoing is considered[66], there seems to be a significant overlap between what the US scholarship discussing public interest in Chapter 11 consider to the this "public interest" and the role that externalities play in my framework.

2.1.2. Different "intensities" of the public interest

Connected with the issues discussed in the preceding Section is the scope of the relevant public interest. "How public it is?", so to speak. Because when we are considering the public interests that can be protected (in Chapter 11 through intervention, or via a bailout in my framework), we need to think about who is the group that benefits from them. Let's discuss a few instances of different levels of "intensity" of the affected public interest that

[61] See ibid, 349.

[62] Ibid, 327: "empirical evidence from a survey of observed governmental bankruptcy litigation from the large Chapter 11 bankruptcies 2004-2019 [shows] that it was predominantly focused on claim collection or attempts to avoid bankruptcy jurisdiction".

[63] Ellias & Triantis note that "bankruptcy law does take the public interest into account in a myriad of ways and the administration of bankruptcy law often changes based on social needs". See ibid, 323. Also, Ellias & Triantis refer to "the use of bankruptcy to pursue goals across a range of regulatory policies, such as labor, environment, housing, and energy". See ibid, 328.

[64] Ibid, 328, referring to Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 Yale Law Journal 857, at 861-868. The preservation of the company as a going concern is normally considered a proxy for the public interest, and as such there is an embedded continuation bias in the bankruptcy system. These situations, however, have to be subject to further scrutiny to ensure that the continuation is, in effect, efficient. See also Macey and Salovaara, 'Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law', 892 and 942-951.

[65] See also footnote 16.

[66] One could also consider some other legislative definitions of the "public interest" in areas such as bankruptcy, administrative law or even financial regulation. Considering the latter for some comparative law insight, one can look at the European Union Bank Recovery and Resolution Directive, which in its article 32(1)(c) notes that a resolution action shall only be taken to the extent that is necessary in the public interest, which is then embodied in the resolution objectives in article 31. They connect again with public goods and externalities. See Sven Schelo, *Bank Recovery and Resolution* (2nd edn, Wolters Kluwer 2020), 110-112, for further details.

are being discussed in the scholarship to get an understanding about what needs to be protected and who is the right party to protect the public interest:

a. *General regulations*

We can start generally from a public interest that benefits an entire polity. For instance, a general regulation protecting all consumers in a given jurisdiction, or the provision of an essential public good that benefits everyone such as national defence. Or the benefits for the environment and a healthy life that derive from environmental regulation and its enforcement by agencies such as the EPA.

In this way, we can think of situations involving general regulations that establish requirements to conduct an economic activity in order to protect the general public (or a sufficiently wide subset thereof)[67]. This will normally be economic regulation dedicated to make economic actors internalize certain costs that would otherwise be laid on the public. These are rules that should always be met and complied with as a prerequisite for someone to be able to conduct an economic activity that may have effects on others.

These are the more general public interests, affecting a wide spectrum of the citizenry, and therefore they are the ones where the "holder" of value is closer to what, in Section 1.3 above, I referred to as the government as residual holder of social value. In my framework, the government (as embodiment of the state) is characterised as holder of a "residual" claim on social value, which is exercised via the implementation of tools such as the ad hoc, ex post bailout. Government then also becomes a residual decision-maker ex post. That function is needed as it is impossible to properly regulate everything ex ante (for example, because of time inconsistency[68]), and the consequences of not responding ex post may be severe.

When considering certain public interests, we can protect them ex ante through regulation, protecting whatever externalities may be present and forcing economic actors to internalize the costs[69] that they would impose on third parties or the public generally. When this first level fails and the externalities become endangered, we can use a second layer of protection via an ad hoc, ex post bailout. Among other things, because the bankruptcy system poses significant issues to ensure that economic agents effectively comply with certain regulations[70].

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[67] See, for instance, the environmental regulations requiring coal companies to reclaim their mines. Cf Macey and Salovaara, 'Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law', 893ff.

[68] As optimum policies are not consistent across time, ex post and ex ante optimality of policy decisions do not coincide.

[69] To see how this can go wrong in bankruptcy, see Section 2.3.1(a) to understand how these regulatory obligations are being circumvented in practice.

[70] For a more detailed discussion, please refer to Macey and Salovaara, 'Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law', 885-892 and 906ff (particularly 934-942).

b. Parens patriae litigation

A ring down in level of generality from the circumstances discussed in Section 2.1.2(a) above we find those situations where the government decides to act in representation of its citizenship or a defined group thereof to protect their rights in litigation against a private company.

In theory, *parens patriae* litigation is only concerned with a specific public interest that has been affected by a mass tort so widespread that "the sheer number of private wrongs elevates them to a public concern"[71].

However, as Organek[72] notes, "governments use bankruptcy law to pursue policy objectives at the expense of the victims they purport to represent". These opposition of interests may be caused by the fact that in bankruptcy individual claimants may be affected in their claims by the existence of a general *parens patriae* claim brought by the government on behalf of their citizens generally (so that the amounts available for the specific individuals may be affected by the amounts secured by the *parens patriae* claim), or because the governments decide to use bankruptcy to "achieve policy goals that might be impossible outside bankruptcy"[73] and those goals may be more important to the government that the rights of the specific claimants[74].

The use by the government of the bankruptcy to achieve other goals widens the scope of the social value that is being considered. In such a case, we may or may not agree with the use of the bankruptcy proceedings and its institutions to further progress other policy goals, but what is certainly true is that we have an actor, the government, who is (as in Section 2.1.2(a) above) a party in a good position to be considered as holder of a "residual" claim on social value and therefore a good party in principle to assess the relevant social value in play. Courts seem to acknowledge that as "[s]tate attorneys general, as public officials, are typically presumed by courts to be representing the public interest when they bring litigation… [t]his is specially true of… parens patriae litigation, where the state may be the only entity empowered to bring suit"[75].

Additional issues may be further discussed considering potential spillover effects across jurisdictions and the potential conflicts between different AGs, but it seems safe to assume that here we have a "general" representative of the public as holder of value—though in some cases their "real" interests may be narrower.

[71] See William Organek, 'Mass Tort Bankruptcy Goes Public' (2024) 77 Vanderbilt Law Review 723, 729.

[72] See ibid, 727.

[73] See ibid, 730.

[74] See ibid, 727.

[75] Ibid, 742.

c. Narrow interests protected by a specific agency

Different governmental agencies or units have different mandates. When carrying out their activities, agencies are constrained by their mandate and a specific subset of the population that is considered to be the beneficiary of its activity on a certain specific area. They also have limited information beyond there are of interest, as well as limited opportunities to coordinate with other government agencies or units.

If we have an entity that is entrusted with protecting the quality of water from springs in a certain region and that agency is a party to the insolvency of a company which is polluting the water reservoirs in the area, then that is good news for that very specific public interest. The agency will exercise its rights in and outside of bankruptcy to ensure that the pollution is limited and the effects on the individuals and the environment in its jurisdiction are minimized. But it does not care (or it is not aware, or it does not have the possibility or ability to engage) about other potential issues affecting social value. It will not, for instance, be able to consider other costs to the same people that it is protecting (eg loss of employment, contagion to competitors and suppliers), or costs of similar nature to other people that are not within their mandate (eg, a local regulator that does not consider potential spillover effects on another jurisdiction).

As the example above has illustrated, government agencies, even when purporting to protect the public interest, may actually represent a narrow subset because of the scope of their mandate. If that is the case, even if they can fully participate in the bankruptcy process, they will only protect that very narrow subset of the public interest. And, when they do that, they may do so at the expense of other public interests. Without a party that is actually the holder of the overall social value and is aligned with all concurrent interests, the best that we can hope for is that the sum of the actions of the different agencies, by acting to progress their specific mandate (or the interest of their beneficiaries), amounts to an optimal cumulative protection of the public interest.

d. Monetary interests

At the lowest level we find those cases in which a specific agency with a narrow focus and group of beneficiaries acts in furtherance of its mandate, not for the advance of the interests of its beneficiaries but simply for its self-interest in preserving its position and resources to be able to keep conducting its public interest activities[76].

These are the cases of intervention in the bankruptcy process to ensure that any debts owed to the government (eg, taxes) or any of its agencies or units (eg, fines) will be paid. This is in certain way in furtherance of public interests as these entities can only continue carrying out their functions and protecting the public interest if they have sufficient funds to do so. As such, participation of the government in bankruptcy proceedings simply for the purposes of collecting monies owed to it represents a lower level of generality when considering the scope of the public interest being protected.

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[76] See Ellias and Triantis, 'The Administrative State in Bankruptcy', 324 and 327. See also ibid, 349, where it can be easily ascertainable that, by far, the largest use that government does of the bankruptcy process is simply to ensure that it is paid whatever monies it is owed, or to try (mostly unsuccessfully) to enforce non-monetary regulations.

Furthermore, same as in Section 2.1.2(c) above, if we are dealing with an agency or government unit, when they are protecting their narrow monetary interest, they may do so at the expense of other public interests that may be more socially valuable.

* * *

In this Section we have considered the public interest from several different levels. At the more general ones, the actor intervening may be a good protector of social value as it is concerned with a sufficiently wide public interest. In other cases, despite the intervention being a positive development compared to passive non-intervention, there are outstanding issues to consider because of potential conflicts of interest or lack of information., in this Section 2.1.2 I have considered what the government (and its agencies and units) may do in relation to certain "intensities" of the public interest, considering the right levels. In the coming Section 2.1.3 I will consider who protects the public interest in the current configuration of the bankruptcy system.

2.1.3. Who protects the public interest in Chapter 11?

We have now identified the public interest and provided some examples of what party would be the "right" one to take care of it in some different manifestations. The next step is to understand who are the actors that can protect the public interest in the bankruptcy process and see how that compares with the "holders" of the relevant social value, who should be those with the better information and incentives to ensure that the public interest is preserved.

In this Section, I will focus on the institutional "gatekeepers" provided for in bankruptcy legislation—that is, who are the parties that in the current design of the bankruptcy laws would be entrusted with the protection of the public interest. The possibility that the government may intervene as a private actor to preserve the public interest will be discussed in Section 2.2.1 below.

Lipson & Skeel[77] highlight the custodian role played by three different "gatekeepers" in relation to the public interest: (i) the attorneys of the debtor, (ii) the examiner, and (iii) the US Trustee. When we also consider the use of the bankruptcy process to deal with public mass tort litigation[78], another figure must be added, that of the (iv) attorney generals that are entitled to bring the relevant *parens patriae* litigations on behalf of their citizens.

First, we will consider the attorneys of the debtor[79]. They play an important role in dealing with the many interests present within the company and those other participants

[77] See Lipson and Skeel, 'FTX'd: Conflicting Public and Private Interests in Chapter 11', 9.

[78] See Organek, 'Mass Tort Bankruptcy Goes Public', 742.

[79] Similar arguments could be made in relation to any trustees that may be appointed to displace the debtor-in-possession, which is a rare occurrence. See Mark J Roe and Frederick Tung, *Bankruptcy and Corporate Reorganization: Legal and Financial Materials* (University casebook series, 4th edn, Foundation Press 2016), 9, 30-31. Creditors may seek to appoint a trustee instead of management "for cause, including fraud,

in the process. And they should do this while attending to their public professional responsibilities.

This would in my opinion not be an optimal choice even if the noted issues with their public responsibilities and "disinterested" character held[80]. With a debtor in possession and the lawyers being engaged by the company, it is difficult to think how they will effectively consider the interests of external stakeholders and the social value associated therewith.

Second, we consider the examiner. The examiner is a figure that has become a frequent presence in large, high-profile, controversial corporate bankruptcies when the management of the company is suspected of having created the financial distress by committing fraud—though the threshold for appointment should not be too high if an interested party so asks[81].

Examiners would be a better candidate if the scope of their mandate were not so narrow[82]. The Bankruptcy Code[83] notes that it is the function of the examiner, if appointed by the bankruptcy court, to conduct an investigation of the distressed firm, including "an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor". As such, their focus is extremely narrow and focused on ensuring the integrity of the system (to use one of the "types" of public interest noted in Section 2.1.1 above). This is strengthened by the fact that they will be appointed in proceedings if it is "in the interests of creditors, any equity security holders, and other interests of the estate"[84]. It is only this last mention to other interests of the estate that may give some grounds to consider social value not directly accruing to the usual participants in the bankruptcy proceedings. Another positive consideration in relation to their ability to protect "other" interests is that examiners have duties to no one else by the bankruptcy court[85], which could also help in protecting the interests of "external" stakeholders. However, it appears clear that the

dishonesty, incompetence, or gross mismanagement… or if such appointment is in the interest of the creditors" (§1104(a) Bankruptcy Code).

[80] See Lipson and Skeel, 'FTX'd: Conflicting Public and Private Interests in Chapter 11', 34-42 and 66.

[81] See ibid, 43.

[82] Though note that, even though it is extremely infrequent in practice, the Bankruptcy Code seems to widen its scope in §1106(b) (referring to §1106(a)(3) and the duties of trustees), which could include (if the bankruptcy court so decided) "[to] investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan".

[83] See §1104(c) Bankruptcy Code.

[84] §1104(c) Bankruptcy Code. The other scenario calling for the appointment of examiners when debts exceed USD 5mn. However, Lipson & Skeel report an empirical study noting that examiners in Chapter 11 cases were "vanishingly rare" because parties normally do not request their appointment and both the parties and the bankruptcy court worry about their costs and usefulness to achieve the goals of the process. See Lipson and Skeel, 'FTX'd: Conflicting Public and Private Interests in Chapter 11', 44-45.

[85] Ibid, 45.

main focus of the examiners would be to ensure the maximization of creditors' recoveries, and in doing so investigating the existence of any irregularities that may have assisted in the demise of the debtor, rather than trying to preserve any additional social value or public interest (beyond those more procedural in nature)[86]—this is further supported by the fact that the examiner conducts an investigation that is fully "separate from the reorganization process"[87].

Third, we consider the US Trustee, which presents, for our purposes, characteristics similar to those of the examiners, though it is a permanent presence in bankruptcy proceedings. The US Trustee is charged with protecting the integrity of the system[88]. As such, it has a very important role to play. But, once again, it is a role that does not lend itself easily to the preservation of social value in the circumstances considered in my framework. It is a role that ensures that the operations and circumstances that surround the company are conducted in ways that are appropriate, but it does not go beyond that to ensure the preservation of other social value that may be affected by the interruption in the operations of the company,

Finally, we will consider the attorney generals. They are also widely accepted to represent the public interest when they carry out litigation on behalf of private citizens—which they can do within bankruptcy[89]. In a way, they are the representatives of the government that in my framework is the holder of residual value[90]. My main issue when considering the state AGs as optimal protectors of social value is that their scope may be narrower because of their consideration of only issues that may be litigated (or litigated profitably for their political gain) and the fact that they act on the state level and therefore that may result in conflicts due to spillovers.

In addition to the 3+1 gatekeepers that have been discussed until now, we could also consider the bankruptcy judges, as they are responsible for confirming any reorganization plan and could use their faculties to ensure that the public interest is not affected by the arrangements agreed to by the debtor and its creditors[91]. The reality is that the bankruptcy judge "serves primarily as referee of a process ran by the parties themselves"[92]. With no party expressly or fully protecting the overall public

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[86] See Section 2.1.1 above, particularly in relation to the discussion of Lipson & Skeel's public interests of "integrity of the judicial system" and "other interests". In a similar vein, Lipson & Skeel note that "[t]he Court of Appeals recognized that the stakeholders' economic interests in the outcome are distinct from the need for an independent examination and report in large and notorious cases. In the terms we have used in this Article, it plays a crucial role in assuring the integrity of the system, the first and most important type of public interest". See ibid, 49.

[87] In re FTX Trading Ltd., 91 F.4th (3rd Cir. 2024), at 155, as cited by ibid, 48.

[88] Ibid, 49, mentioning also that some of the key functions that the US Trustee thus performs include policing the bankruptcy system for conflicts of interest, "cronyism" or debtor misconduct.

[89] Organek, 'Mass Tort Bankruptcy Goes Public', 742.

[90] See Section 1.3.

[91] See Ellias and Triantis, 'Government Activism in Bankruptcy', 514.

[92] See Lipson and Skeel, 'FTX'd: Conflicting Public and Private Interests in Chapter 11', 11.

interest/social value against the other stakeholders, this results in a process where the adversarial discovery of the value at play by the bankruptcy judge is not particularly reliable, as holders of relevant interests may not have had a chance to voice their opinion and/or enforce their rights.

When taking all of this into consideration (together with the arguments exposed in relation to the limits of bankruptcy law in Section 1.3 above), my opinion expressed in Section 1.4 above that the government is the residual holder of social value and therefore the party in the better position to assess the presence of externalities and ensure that they are preserved stands. This is also consistent with what has been discussed in the preceding Section 2.1.2.

2.2. Government as an actor in bankruptcy

The presence of the government as an active participant in the bankruptcy process (most likely through an agency or unit) reflects the complex dynamics of today's bankruptcy proceedings, where participants engage in aggressive tactics that not so far ago would have been unheard of (and unsuccessful if attempted)[93].

While in the past the government had been insistent in asserting its privileges to subtract itself from the bankruptcy process and trying to "limit the authority of bankruptcy law over regulatory matters"[94], the consistent reply coming from bankruptcy courts was that they were ready to stand their ground and protect their jurisdiction[95].

As a result, governments and their units and agencies have been increasingly participating in bankruptcy proceedings in similar ways to other private actors, though, as Ellias & Triantis show[96], government is still far from consistently using bankruptcy proceedings to pursue its policy goals. They, however, caution that "If governments begin to adopt this alternative strategy, it will raise new questions as to the desirable limits of such activism"[97].

In this Section 2.2 I will be discussing a number of issues directly related to that intervention of the government in the bankruptcy proceedings, with a view to contrast it with the government intervention at the core of my framework, the bailout.

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93 For a general overview of changes in the restructuring market in this regard, see Jared A Ellias and Robert J Stark, 'Bankruptcy Hardball' (2020) 108 California Law Review 745.

94 Ellias and Triantis, 'The Administrative State in Bankruptcy', 325.

95 Ibid, noting that "these motions ae often unsuccessful in bankruptcy and appellate courts". Ellias & Triantis go further in this direction and note that "[t]he subordination of the authority of the administrative agencies… over contracts to the bankruptcy process is often the socially optimal institutional decision that, as we explain in this paper, can serve the goals of the administrative agency"; see ibid, 340.

96 See, eg, ibid, 349, for a great summary of the frequency and type of intervention of the government in a sample of Chapter 11 proceedings.

97 Ibid, 360. If we consider these interventions (particularly when advancing funds) to be bailouts, then my guidelines outlined in Section 1.4 would serve as those limits.

First, I will be considering what benefits may be derived by this intervention in the bankruptcy proceedings for the public interest, and how that connects with the concept of public interest that has been discussed in Section 2.1.1 above. Then I will consider the scope of the intervention in the bankruptcy process and whether this participation can be extended to outside of the bankruptcy process. After that, I will contrast the benefits of the intervention in the bankruptcy process with the problems that they pose, particularly considering the status of the government as a "private" actor.

2.2.1. Benefits for the public interest

Ellias & Triantis indicate two main benefits for the public interest that derive from government's participation in the bankruptcy process[98].

The first is that, by participating, the government enjoys opportunities to promote its policy objectives before the court and the other creditors—and much more so if the government's participation comes together with the provision of funds (as if it were a DIP lender[99]) or some other form of assistance.

The second is that "[t]he legal framework of bankruptcy increases the space for dealmaking"[100]. That means that having more tools than what are normally available outside bankruptcy, the government has more flexibility to implement its intervention and may be capable of structuring a deal that serves the public interest which might not be achievable without those tools.

What this means in terms of the public interest[101] is that the government can more effectively push its objectives when it actively participates in the bankruptcy proceedings. And it can do that thanks to it being able to resort to the following (otherwise unavailable) tools[102]: (i) enhanced disclosures, (ii) an expedited process for adjudication and settlement[103], (iii) the ability to engage with all stakeholders in a single forum, and, critically, have more room to transform the debtor's relationships with all its stakeholders.

Enhanced disclosures are of significant importance because they allow the decision-maker (in our case the government) to collect more information about the real situation of the distressed firm in order to properly assess the situation and ensure that an intervention is warranted. As I note on Sections 1.4.1 and 1.4.2, two important guidelines

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[98] See ibid, 325.

[99] But, if the government so does, this intervention almost certainly becomes a bailout. See the definition that I use in my framework in Section 1.1 above.

[100] Ellias and Triantis, 'The Administrative State in Bankruptcy', 325.

[101] See Section 2.1.1 above.

[102] See Ellias and Triantis, 'The Administrative State in Bankruptcy', 327.

[103] This will play a significant role in the discussion in Section 2.3.1 below.

in my framework are efficiency and subsidiarity. This implies an appreciation of the limited information on the basis of which governments may need to intervene in certain occasions. Given the limits of what we know about each situation at the moment that the decision needs to take place, governments need to feel comfortable that the intervention is going to have a net positive impact (despite of uncertainties) and that it is only conducted in such circumstances. In such a scenario, the additional information available to the government in bankruptcy[104] may make a significant difference in permitting it to bridge the informational gap to be comfortable with an intervention. Though we should always bear in mind that this is mostly information about the debtor and its business and operations, and in my bailout framework we are looking for the externalities affecting other "external" stakeholders, and it may well be the case that the government is still the best source for that kind of information without having to take part in the bankruptcy process.

The expedited process for adjudication and settlement gives more room for the government to operate. However, it may also be the tool that enables certain Cost-Externalising Situations that will be further discussed in Section 2.3.1 below.

The ability to engage with all stakeholders in a single forum (and, critically, having more room to transform the debtor's relationships with all its stakeholders) is an important instrument for government to be able to coordinate the "internal" stakeholders and take advantage of its leverage in the most efficient way possible to implement whatever plan it deems more appropriate for the firm and the public interest. However, this does not mean that it cannot be achieved outside of the bankruptcy process. In practice, governments have been able to structure and "dictate" terms on interventions outside of bankruptcy by leveraging their position as regulators and providers of support. By providing an alternative to financial distress to the firm and its stakeholders, government can affect their negotiations and guide them through the structures that would allow them to keep as much value as possible[105].

All in all, the idea is that government "activist" intervention in bankruptcy enables it to better and further pursue its policy goals compared with the alternative. The crucial idea is that it allows government to intervene and further preserve and advance its policy goals that are in service of the public interest. By taking advantage of what the bankruptcy process offers to other activists, government can better serve its purpose. This key idea connects with the rationale for bailouts in my framework: the public interest is served by preserving social value, normally in the form of externalities that are created or protected by allowing the distressed firm to continue to operate.

[104] Ellias and Triantis, 'The Administrative State in Bankruptcy', 354: "the debtor's disclosures in bankruptcy and the close scrutiny provided by hearings tend to produce more transparency into the affairs of the debtor than is often available to regulators outside of bankruptcy".

[105] See, for instance, Paz Valbuena and Eidenmüller, 'Bailout Blues: The Write-Down of the AT1 Bonds in the Credit Suisse Bailout', discussing the bailout of Credit Suisse in the Spring of 2023.

2.2.2. Scope of the intervention

In the preceding Section 2.2.1 we have explored what are the advantages to the government (and in an indirect way to the public interest) that result from active participation in the bankruptcy process.

Some of these advantages are solely the result of being an active participant on the bankruptcy process. But some other are catalysed by the government adopting a more active role among the creditors, thus harvesting the benefits that in "regular" proceedings accrue to those creditors that hold a position of "special" relevance[106]. And to this governments can add their additional strengths as regulators.

Ellias & Triantis[107] suggest that the key actions that government can carry out to maximize its influence (and accordingly being able to better push its policy goals—and thus advance and/or preserve the public interest) are (i) the contribution of new money to fund the reorganization à-la DIP lender, and (ii) relieving the debtor of burdensome regulation.

Now, are cash injections and regulatory forbearance not interventions that we would normally consider as falling within the concept of bailout as defined in Section 1.1 above? Is there anything "peculiar" about these interventions or the fact that they happen in bankruptcy proceedings? Otherwise, these may well be bailouts, but without being subject to the heightened scrutiny that they should because of what they entail. That is the reason why the principles and guidelines outlined in Sections 1.4.1 to 1.4.4 should have an important role to play.

As for direct financial support, Ellias & Triantis discuss in a 2021 paper[108] the examples of the bankruptcies of Chrysler, GM and, more recently, Pacific Gas & Electric, instances where the government (whether federal or state) brought much needed financial relief to the companies. This made it possible for the government to play a dominant role in the bankruptcy, which allowed the government to not only preserve the companies as going concerns (thus preserving the public interest) but to also promote its policy goals.

A vital question now is how those policy goals being promoted connect with the specific public interest being preserved. What I mean by this is that, when we consider the policy goals being pursued in connection with a specific distressed firm, we can think about two main categories.

First, we may think of those policy goals that connect directly with the rationale for the intervention. So, imagine the case for the interventions in the bankruptcies of Chrysler and GM. Government decides that if the companies were to fail, the effects in terms of

[106] Ellias and Triantis, 'Government Activism in Bankruptcy', 511-512: "It is well-established that activist investors like hedge funds can gain influence over Chapter 11 firms, chiefly by providing the debtors with post-petition financing conditioned on advancing the investors' goals or by litigating to acquire favorable judicial orders and negotiating settlements in the shadow of that litigation".

[107] See Ellias and Triantis, 'The Administrative State in Bankruptcy', 326.

[108] See Ellias and Triantis, 'Government Activism in Bankruptcy', 523-545.

employment may be massive in the region, causing significant prejudice to the public interest. As such, there is a clear public interest that needs to be protected and that justifies the intervention.

In that context, the promotion of that specific goal in the bankruptcy process appears justified. Government is intervening to preserve the labour force and the implementation of that intervention will seek that labour is preserved. Formulated in a different way, the use of the bankruptcy process by the government (as well as the use of any leverage that it may have in it) to secure the goals that originally motivated the intervention appear, prima facie, as appropriate and legitimate courses of action.

But, second, we may also think of other policy goals[109] that the government may want to pursue given of the additional flexibility that it can achieve in the bankruptcy process, either because of the benefits that bankruptcy brings[110] or the particular leverage that the government has amassed in specific proceedings[111]. In these cases, the appropriateness of the government using its position is not a foregone conclusion, though depending on what those other policy goals are it may result in further legitimacy for the intervention in the form of higher public support[112].

As I suggest in Section 1.4.4, transparency is a central element in bailouts, as the legitimacy of the intervention requires that the general public can understand the rationale behind the use of public funds. A similar rationale needs to apply for any public interventions that leverage the position of a governmental entity to pursue policy goals that are not explicit and/or lack sufficient legislative support[113].

As it was shown, for instance, in the rescue of Credit Suisse by UBS (with the intervention of the Swiss government)[114], governments can structure bailouts in different ways other than an outright injection of cash or the provision of guarantees. And sometimes an apparently "private" solution may be implemented in practice in the shadow of certain concessions by governments that are the backbone to any potential "private deal" that may happen.

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[109] See, eg, the Blue Bonds mentioned in Ellias and Triantis, 'The Administrative State in Bankruptcy', 345,

[110] See the "benefits" discussed in Section 2.2.1.

[111] Whether because it is bringing financial support or regulatory forbearance, or because of any other reason.

[112] In this regard, an empirical study conducted by Colonnelli & Gormsen points to taxpayers being more amenable to bailouts that have associated "green" conditions. See Emanuele Colonnelli and Niels JC Gormsen, 'Selfish Corporations' (2020) Chicago Booth Research Paper .

[113] Note that Ellias & Triantis indicate that there is an expectation that "the transparency of the bankruptcy process keeps the government accountable for its use of [its leverage]". See Ellias and Triantis, 'The Administrative State in Bankruptcy', 334.

[114] See Paz Valbuena and Eidenmüller, 'Bailout Blues: The Write-Down of the AT1 Bonds in the Credit Suisse Bailout'.

By conditioning the support that may be needed for a potential deal to happen, government can also dictate the structure of any potential deal to pursue whatever policy goals it may deem appropriate. Because of what we have seen in Section 2.2.1, bankruptcy law provides some interesting benefits. But, as I have noted in the preceding paragraphs, there is nothing precluding the government to similarly act outside of bankruptcy to pursue its goals using different tools and leveraging its influence just the same as within formal bankruptcy.

If we look at it this way, from the standpoint of what these interventions are doing functionally, there is nothing really that different from what government is doing in bankruptcy proceedings when providing financial support and pushing for its policy goals and what that same government is doing outside bankruptcy in a "regular" bailout.

But if we do not recognise this similarity (which in my framework would immediately require that the relevant guidelines are applicable to ensure a legitimate and proper intervention), then we permit that these interventions continue to happen without proper safeguards.

2.2.3. Problems derived from participation

Having discussed in the previous Section what governments can do to increase their reach in protecting what they may deem to be the public interest, it is important to now consider the other side of the matter and inquire whether that participation (and any privileges, rights and obligations associated thereto) may be the source of any issues that may affect the public interest[115].

An interesting question is whether these interventions using the exceptional powers available under bankruptcy law strike the right balance between what we hope the government is trying to achieve (ie, protect or advance the public interest) and the compromises that we accept to make it work. For instance, Ellias & Triantis note that "this strategy is specially useful in times of urgency and policy paralysis, when government bankruptcy activism can provide a pathway past veto players in the political system"[116]. Though using it to bypass checks and balances in the system (even if we feel at the moment that it is for the greater good) should give us pause.

Furthermore, the fact that the government is acting as a private actor when it really is not should make us wary of blindly accepting these interventions without considering their effects and implications. In my bailout framework, those concerns are concerned by the principles and guidelines discussed in Section 1.4. In the absence of protections of that type, we need to consider the specific situations. As Ellias & Triantis ponder, "the accountability and transparency that are essential to a democratic system can sometimes be enhanced and at other times impaired in the bankruptcy system… By proceeding through bankruptcy activism, a partisan government may be able to enact policies that would have been blocked otherwise"[117].

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[115] Or the private rights and interests of persons affected by the intervention.

[116] Ellias and Triantis, 'Government Activism in Bankruptcy', 509, 512, 545.

[117] Ibid, 512-513.

If we are to accept government interventions to rescue firms in financial distress (whether in bankruptcy proceedings or via a bailout) it is critical to ensure that, while doing so, governments do not act in a way that would otherwise not be possible—ie, that they are not simply avoiding legal constraints that are in place to control the activity of the executive power. It is the very nature of the government that justifies the existence of administrative law as a way to protect the polity from abuses. And any interventions on the economy that bear with them a significant (even if potential) financial cost should consider legitimacy as an extremely important pre-requisite.

The bankruptcy court exercises an important balance to the power of government in bankruptcy proceedings. When we consider interventions that seek to protect or further the public interest, including social value that is held by "external" stakeholders[118], there are two main problems. The first is that bankruptcy judges are not an optimal choice to be a decision-maker for complex policy debates[119]. The second is that when we consider the participation of the government units or agencies in bankruptcy to protect the public interest we encounter situations where there is no party expressly or fully protecting the overall public interest/social value against the other stakeholders, which results in a process where the adversarial discovery of the value at play by the bankruptcy judge is not particularly reliable as holders of relevant interests may not have had a chance to voice their opinion and/or enforce their rights.

* * *

Up until this point in the argumentation of Section 2, we are discussing situations where the protection of the public interest by intervening in the bankruptcy process is resulting, at least on its face, in improvements. When compared to the alternative situation of trying to abstract from the process while being subject to what is going on in it, it seems clear that this "active" participation of the government and/or its agencies results in increased preservation of social value. And it that respect it should be desirable.

However, this participation in the bankruptcy process to protect the public interest may have some other effects that could be counter-productive if our aim is to make sure that overall social value is preserved.

A key consideration in this regard is that, due to the mechanisms for intervention noted in this Section 2.2, it is not clear that all relevant public interest (ie, all relevant social value) may be appropriately considered and addressed by parties which, despite their interests and actions in furtherance of a certain subset of public interests, are not entrusted with the public interest generally—and lack the information and tools to actually consider the public interest generally beyond their usual narrow scope. For instance, we may feel well that the EPA ensures that a certain interest is well protected but at the same time fail to realize that there is significant social value to be preserved in

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[118] Ie, stakeholders that are not normally present or duly represented in bankruptcy proceedings, and that therefore cannot advance their views.

[119] Ellias and Triantis, 'Government Activism in Bankruptcy', 545.

the potential implications of the liquidation of a company that will send shockwaves to a close community of suppliers that are heavily dependent on the company and represent a significant part of the labour market in a certain region.

Another, more subtle consideration, is that the government, by "playing the game" is implicitly accepting its rules, in certain ways hindering much needed changes[120]. In such a way, this participation in the bankruptcy process without strong opposition to these rules is giving them support. It gives credence to thinking that the bankruptcy process is a finely-tuned and well-balanced system that works well in its current form, and that some of its features (even if not optimal in certain respects) are a part of a whole that should not be changed in isolation.

In practice this could be a significant problem when we consider that there are certain institutions and/or tools within the bankruptcy process that, in the way that they are currently being used, may result in significant damage to the public interest. These are the Cost-Externalising Situations that I will be discussing in the next Section.

2.3. Externalization of costs

In Section 2.1 I have discussed how I think about "public interest" and the major overlap of that concept with that of "externalities", which is the focus of my research. In that vein, I consider that the public interest is effectively protected by preserving the value of externalities that may be present, and by causing economic agents to internalize[121] the costs of their activities.

Thus, any actions conducted by agents with a purpose to avoid the internalization of their costs (particularly when it is so mandated by law or regulation) by forcing them onto the general public (or even a narrower subset thereof) are actions that should be considered contrary to the public interest. Where things get interesting is when we consider that there may be conflicting interests that both purport to be a public interest. They both may be narrower that the general, overall social value, but wide enough to both be considered a public interest.

When a public interest needs to be affected, we need to ensure that it is being done so that a greater public interest is served and that any intervention is being conducted with the necessary guarantees for the protection of the public good.

That is why (frequent) situations like those mentioned by Macey & Salovaara[122] and Organek[123] pose a substantial risk to the preservation of the public interest. They are

[120] See, eg, Macey and Salovaara, 'Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law', 952-957.

[121] This is done through the imposition of regulatory obligations.

[122] See Macey and Salovaara, 'Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law'.

[123] See Organek, 'Mass Tort Bankruptcy Goes Public'.

widespread, and there are some parties that are clear winners in these situations. A strong case can even be made for certain "narrow" efficiency gains being achieved. But it is evident that the public interest (understood as social value in its widest form) is ill-served by this.

2.3.1. Bankruptcy, price regulation and tort liability

In Section 2.2.1 above we were discussing some elements of bankruptcy law that were beneficial for governments to push for their policy goals (and thus specific instances of the public interest) in ways that could not be achieved outside of the bankruptcy setting. That tools such as that are available to the government, other creditors and the company may as well negatively impact the public interest in other occasions.

a. Regulatory obligations

One of the biggest problems that we encounter when we deal with large, regulated firms and bankruptcy laws is that, as it is quite eloquently described by Macey & Salovaara[124], there are a number of tools that can be used by savvy firms to avoid regulatory mandates.

When we were discussing public interest in Section 2.1 above, we saw that one of the ways in which the government seeks to advance and preserve the public interest is via regulations. Those regulations limit the ways in which firms can carry out their operations. One of the ways in which they aim to do so is by ensuring that firms that operate in the economy cannot do so profitably by making other parties bear costs related to their activity.

Regulations in this way protect the public interest by restricting the ways in which companies can carry out activities that impose costs on the general public or other third parties. They can do so essentially in two ways: (i) prohibiting or limiting the conduction of the specific activities that have the aforementioned negative effects, or (ii) forcing the internalisation of those costs by the firm, which will then reduce the quantity to the optimal level in consideration of its economic incentives. The former are also know as command-and-control or quantity regulations, while the latter are known as price or market regulations.

Economists, and policymakers following their advice, tend to follow the view that price regulations are better[125]. They have, however, one big problem. They have a different treatment in bankruptcy that make it relatively easy for them to be avoided.

Thus, we find ourselves in a situation where we are promoting the use of both (i) bankruptcy and (ii) price regulation to advance the public interest, but, when we put both institutions together with a sophisticated private firm with a desire to elude costly obligations, we are actually making it possible for the company to negatively affect the public interest. How did that happen?

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[124] See Macey and Salovaara, 'Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law'.

[125] See, eg, Gruber, *Public Finance and Public Policy*, 139ff.

Macey & Salovaara[126] provide an enlightening and very detailed explanation of how this happens in the coal mining industry. For our purposes, suffice it to say that certain tools and strategies allow shrewd companies to avoid their regulatory obligations. The tools are those widely available to all debtors under bankruptcy laws: (i) the ability to reject executory contracts (§365(a) Bankruptcy Code) and collective bargaining agreements (§1113, 1114); (ii) the right to abandon burdensome property (§363); and (iii) the ability to transfer obligations in a reorganization plan (with limited protection from fraudulent conveyance).

These tools have been used repeatedly by coal mining companies by employing three mutually reinforcing strategies to evade their environmental and retiree liabilities through bankruptcy[127]. First, firms can structure their operations to allow them to not fully internalize costs until as late as possible (eg, by postponing compliance or incurring the necessary costs as much as possible). Second, parent companies can get rid of low-value assets and significant liabilities by continuously divesting itself of those assets, via divestiture or liquidations. Finally, the firm can engage in aggressive accounting with a view to inflate the value of its assets and push liabilities off balance sheet, in order to appear solvent, continue operating and making possible the reorganizations that will allow it to shed its liabilities effectively.

In this way, companies keep isolating themselves from their regulatory obligations. They keep the valuable assets and contracts, while being able to get rid of unvaluable assets (with inflated prospects) to which they attach significant liabilities.

In a way, this is an interesting implementation of something akin to an “asset separation tool” or “bad bank” structure[128], to preserve the operations of the company that gets rid of those bad assets. The problem in this situation is that it is not the government or investors voluntarily taking the bad assets at a price, but some connected party relying on limited liability to enable the company to survive at the expense of those holding the liabilities that take the hit upon disposal. Allowing firms to do this is akin to a bailout by regulatory forbearance, as the government will need to deal with the discarded liabilities to avoid the negative impact to the public interest. So a bailout without protections. But it can even be worse. Government may decide to not care about those liabilities. At that point this would just be a massive distributional transfer from firms that continue to operate to a defenceless subset of the general public.

And this is something that happens when we deal with price regulations (as they are converted into monetary obligations that become general unsecured claims), but not when we deal with command-and-control regulations.

[126] Macey and Salovaara, 'Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law', 935-942.

[127] Ibid, 934.

[128] See, eg, Armour and others, *Principles of Financial Regulation*, 351; Simon Gleeson and Randall D Guynn, *Bank Resolution and Crisi Management: Law and Practice* (Oxford University Press 2016), 227-228; or Schelo, *Bank Recovery and Resolution*, 57-61, 157-160.

The solution for these issues lies with better laws addressing these situations, rather than with increased participation in the bankruptcy process[129].

Also, when we were discussing what about bankruptcy laws makes them useful for government to better pursue the public interest in, it was mentioned that bankruptcy laws provide an expedited process for adjudication and settlement of disputes. This and other features make it very interesting to use bankruptcy for the purposes of settling tort liability, which is the focus of the next Section. Once again, if this is connected with strategies such as the transfer of regulatory obligations, companies have found a way to keep avoiding their regulatory obligations.

b. Shedding of tort liability and potential conflicts

Also connected with the situations above are those where the government intervenes in what Organek calls public mass tort bankruptcies[130].

Several trends have favoured the increased participation of governments in mass tort litigation. A fundamental consideration is that, it being more difficult to carry out their activities via legislation and regulation due to political considerations, litigation presents a venue that can be exploited to implement certain policies that would be much more difficult to carry out through the legislative or regulatory process. It is a tool that remains effective, particularly because the courts are being amenable to government actions brought on behalf of private citizens. As Organek notes[131], "[s]tate attorneys general, as public officials, are typically presumed by courts to be representing the public interest when they bring litigation—such deference is not typically accorded to private class counsel. Courts also apply permissive standards on standing, causation, and judicial review of the reasonableness of settlement. This is specially true of consumer protection and parens patriae litigation, where the state may be the only entity empowered to bring suit".

This connects with another trend, this time in the bankruptcy arena. Large companies with potential mass tort liabilities have been moving out from multidistrict litigation and into bankruptcy proceedings to resolve these liabilities. The key rationale for this migration rests with the fact that bankruptcy law and the bankruptcy proceedings provide an expedited process for adjudication and settlement[132], which is also fostered by certain provisions that allow for the distressed firm to put forward their best offer for settlement (which are not present in multidistrict litigation)[133].

[129] In that respect, I fully agree with Macey & Salovaara's suggestions. See Macey and Salovaara, 'Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law', 951-956.

[130] See Organek, 'Mass Tort Bankruptcy Goes Public', 729.

[131] Ibid,742.

[132] See Ellias and Triantis, 'The Administrative State in Bankruptcy', 327.

[133] Organek, 'Mass Tort Bankruptcy Goes Public', 735-739.

Some key elements of what can be achieved in this context by using bankruptcy proceedings that are of interest to the tortfeasor[134] in the context of Cost-Externalizing Situations are that (i) bankruptcy permits a permanent discharge of all liabilities of the debtor; (ii) bankruptcy courts can channel all present and future claims to a settlement fund, facilitating the finality of the settlement process; and (iii) most controversially, bankruptcy courts can also grant third parties (eg, shareholders) a release from liability in exchange for making financial contributions to the bankruptcy estate (even over the objections of affected parties that would prefer to litigate with those third parties).

And with the growth of the use of bankruptcy to deal with tort liabilities, we have also experienced the apparition of sophisticated strategies that allow debtor firms to structure their businesses to shed off certain liabilities using the bankruptcy process without being financially distressed. This has been briefly discussed in Section 2.3.1(a).

In the specific cases of "public mass tort bankruptcies", governments take on many different roles that they leverage into better pursuing their specific goals, be them general policy goals or more mundane pecuniary interests.

The key consideration is that, in order to pursue their goals, governments engage with the distressed firm in order to put an end to the tort liability situation by leveraging its position into a favourable settlement after forcing the company into bankruptcy. After the settlement is reached and implemented, there will not be any other funds available to other people affected by the tortious actions of the firm.

In many cases, this means that government's interests in securing and implementing the settlement (and subsequent discharge of the distressed firm and related parties) may conflict with those of certain of its citizens who have been affected by the actions of the firm. And so we have governments playing the role of ultimate protector of the public interest of its citizens and launching claims that purport to protect them, subsequently ending competing with some of its citizens for the scarce resources of the tortious firm.

I agree with Organek[135] that this conflict of interests warrants the establishment of protections that bankruptcy law does not currently possess, as it was not designed with this type of governmental participation in mind.

However, there still is an important question when considering these conflicts between the government (arguably protecting the public interest) and the private citizens being the claims on their own. I appreciate the need for protection of the individual rights. But when we are considering a single, finite pot of money that will be used to compensate all of the victims, should the government not be in the best position to entertain any arguments as to the best distribution of those funds (with the supervision of the court)? Is it not the fact that we have some private citizens claiming while others are covered by the governmental claim somehow akin to a creditor run in a regular bankruptcy, which we all agree is not the best way to share finite resources?

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[134] Ibid, 737-739. With the added benefit that bankruptcy courts welcome the opportunity to deal with these types of proceedings within bankruptcy.

[135] See ibid, 765-766, 773, 782.

A more difficult balance appears when governments are not simply distributing funds among interested parties in relation with one specific policy goal (eg, distributing compensation among all affected by asbestos in relation to one specific firm) but when the government brings into the mix other policy goals[136] that it intends to pursue and conflict with the interests of the parties (eg, government wants compensation for asbestos but also to ensure that the large labour force of the company is not laid off).

Once again, the solution for these issues lies with better laws addressing these situations, rather than with increased participation in the bankruptcy process.

2.3.2. A regulatory forbearance bailout?

If we go back to the definition of bailout that I used in Section 1.1, bailouts are government payments (including any type of consideration) to a liquidity-constrained private agent so that it is able to pay its creditors and counterparties (and continue with its operations), provided that such agent is not otherwise entitled to those payments (eg, under a statutory scheme)[137].

The key element is that there is a transfer of financial capacity from the government to the private company, and that such transfer allows the company to avoid a situation of financial distress and continue with its operations.

This "transfer of financial capacity" can take many forms. The general public may be more familiar with capital injections, loans and guarantees since the GFC and the Covid Pandemic brough with them significant instances of general scheme and ad hoc bailouts that were heavily publicized and scrutinized. But other forms of intervention used to rescue private firms share the same elements and need to also be considered to fall within the above definition of bailouts.

Of the remaining forms to implement a bailout, probably the more relevant is that consisting of a waiver of government rights. By waiving rights to moneys owed or that would be owed in the future (eg, tax rights, tax expenditures and tax breaks) or excluding a specific company from certain regulatory burdens that affect everyone else (eg, discharge of costly obligations or dispensation from complying with certain rules or requirements)[138].

This type of intervention is less transparent than a deployment of funds via an equity injection or the guaranteeing of loans or performance obligations by private corporations. Because of that it may raise fewer challenges from the taxpayers. But that should not be considered a positive development.

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[136] Ibid, 744.

[137] See Casey and Posner, 'A Framework for Bailout Regulation', 480-481.

[138] See, eg, Aaron M Levine and Joshua C. Macey, 'Dodd-Frank Is a Pigouvian Regulation' (2018) 127 Yale Law Journal 1336.

These situations are undoubtedly bailouts, and they should be treated as such. Guidelines and protections outlined in Section 1.4 should apply equally to ex post, ad hoc bailouts conducted as equity injections and to those that are implemented through regulatory forbearance by reducing the costs associated with the activity of the company so that it can be preserved as a going concern.

So, when Macey & Salovaara talk about how regulatory obligations are discharged or avoided or when Organek discusses the government's role facilitating the settlement and discharge of liabilities, we find ourselves before situations that should be considered bailouts, irrespective of the way in which they are conducted. They made it possible for the company to shed important liabilities to continue operating. Sometimes those liabilities are owed to the government (even if for the benefit of society in general or for a defined subgroup thereof); but some other times the government is just an enabler in the shedding of liabilities off specific groups of stakeholders.

As previously noted, in my framework the government is characterised as holder of a "residual" claim on social value, which is exercised via the implementation of tools such as the ad hoc, ex post bailout. Government then also becomes a residual decision-maker ex post. That function is needed as it is impossible to properly regulate everything ex ante — for example, because of time inconsistency —, and the consequences of not responding ex post may be severe.

We have not gotten ridden of bailouts (we cannot, as I have noted elsewhere); we have just gotten better at hiding them. Furthermore, the need to preserve the legitimacy of the government in carrying out these interventions (for the public good) requires that every intervention, among other things, is clearly compliant with the transparency principle discussed in Section 1.4.4. We are using significant amounts of public money to pursue public interests. The polity should be agreeing with it; and, if they are not, there is a significant issue of legitimacy that needs to be properly addressed.

Conclusion

In recent times we have seen a surge in scholarly interest in the public interest aspects of bankruptcy. This renewed interest, in a way, brings to current days the debate between traditionalists and proceduralists originally started by Professors Warren and Baird in the late 80s.

This interest to consider the public interest as a broader set goals within the bankruptcy system, in addition to the fundamental objective to maximize the value of the distressed firm for efficient distribution among its creditors, is the result of a number of situations coming together. An economic environment of growing inequality and budgetary constraints. Ever-increasing (and justified in attention to the public interest) regulation of the economy. Increased saliency of, and popular interest on, certain public goods (such as the environment) and social values.

The public interest needs to be catered for. Outside bankruptcy. And in bankruptcy proceedings. But I mostly subscribe to Professor Baird's position that highlights that what is specific about bankruptcy law is that it deals with a specific common pool problem, and that other public interest issues need to be dealt with in a appropriate way irrespective of whether the firm is in bankruptcy or not.

What I propose in my research is that, normally, we should let private actors do what they do, attend to their private interest while protecting their rights in financial distress. But that there are some types of companies that, given how they affect social value through externalities, require that we pay more attention to them—and for which the bankruptcy system is not appropriate for that very reason (the parties that hold that social value are not present or represented in the bankruptcy proceedings). And that governments act to protect them via a bailout if needed to keep them in operation, as otherwise we could risk that the parties participating in the bankruptcy process do not consider important externalities affecting society.

I appreciate that, after the experiences of the GFC and the Covid Pandemic, many jurisdictions have grown weary of anything that resembles a bailout. Governments have exceeded their mandates in rescuing certain companies at a significant political cost. Interventions have been erratic and criticized by many. To the point that, in those jurisdictions, bailouts are everything but forbidden.

And as a result (and within the context of what Professor Ellias has termed "hardball bankruptcy") we turn to something different. And that something different may be the government acting in self-help by participating in the bankruptcy proceedings to emulate the strategies that have brought so much success to the "activists".

By accessing the toolkit of the activists, and leveraging its position in the bankruptcy process as both regulator and potential provider of funds, governments can steer the workings of the bankruptcy process and steer them towards the achievement of its policy goals. But governments do that in a context where the checks and balances on its actions are limited.

In many cases, these interventions result in a net positive, as they improve on the protection of the public interest when we contrast them with the alternative situation of government trying unsuccessfully to subtract itself from the bankruptcy proceeding and therefore lacking any influence in the outcome of the proceedings. This is when the government's intervention results in the protection of some social value that would otherwise not be protected by the parties participating in the bankruptcy (as this is a value that rests with an "external" stakeholder that does not participate in the proceedings); what I called a "Value-Preserving Situation". But at different times, the specific tools of bankruptcy (and the intervention of government) may result in the destruction of social value, such as in the cases of avoidance of regulatory obligations (using tools such as the rejection of executory contracts, the abandonment of burdensome property and the transfer of regulatory obligations) or in cases where government participates in a settlement of tort liabilities in bankruptcy with the associated discharge and release of third parties. In these cases, the parties participating in the bankruptcy achieve the result that they want, but the public interest is not protected. These are what I called "Cost-Externalising Situations".

My main concerns with the government intervention in the bankruptcy process as a "private actor" to protect and advance the public interest is twofold. First, the government

unit or agency appearing in bankruptcy may be concerned only with a "narrow" public interest, thus failing to protect the wider social value. Second, the participation in bankruptcy for "Value-Preserving Situations" may in some ways serve as justification for the continuing "Cost-Externalising Situations" or reduce pressure to effect the needed legal and regulatory changes required to prevent these "Cost-Externalising Situations" from happening on a frequent basis.
A related point of concern is the lack of adequate protections in bankruptcy laws for these types of interventions by governments, which can exert significant influence leveraging its multiple "hats" into abusing the other participants in the proceedings.

This is particularly the case when we realise that in many of the situations that are being discussed by the authors, government is providing new money or some kind of regulatory forbearance to strengthen its position in the proceedings. It is my contention that in those cases the intervention should be considered a bailout, and therefore be subject to a series of controls to endure that they are a proper and legitimate intervention.

In my framework, if we have a bailout, we need to (i) have a proper consideration of the full social value involved in the situation (and the bankruptcy judge and narrow agencies or government units are not the right decision-makers), (ii) ensure that there is a component of bail-in (so that investors and managers cannot rely on hand-outs by the government on the basis of the externalities affected by their company), and (iii) consider a number of other aspects of the intervention, such as ensuring that it is efficient, proportional, equitable and legitimate.

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