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Towards a Principled Approach for Bailouts of COVID-Distressed Critical/Systemic Firms

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TOWARDS A PRINCIPLED APPROACH FOR BAILOUTS OF COVID-DISTRESSED CRITICAL/SYSTEMIC FIRMS

Horst Eidenmüller* & Javier Paz Valbuena**ψ

In this Article, we propose a principled approach for government bailouts of critical/systemic firms who find themselves in COVID-19-induced financial distress. We also demonstrate why bankruptcy is the wrong tool to address these firms' problems.

The current pandemic threatens lives and livelihoods across the world. A key difference compared to previous market shocks is that lockdowns and related measures have, in certain instances, made it impossible for businesses to conduct their operations. This has resulted in a very specific type of distress—one that bankruptcy is not in the best position to address effectively. If there are no revenues, the design of bankruptcy laws makes them an inadequate tool, and the sheer volume of companies going through the process may put severe stress on the system. The difficulties that the vast majority of companies are encountering may be better solved using different tools: bailouts, bail-ins, or a combination thereof, deployed by the government in wide-ranging statutory schemes.

However, these schemes may not adequately address the issues of all companies; and the preservation of some of them—those that we refer to as critical/systemic—may be of such significant value to society that more intense assistance from the government is justified. We engage with the characteristics of firms that should be considered critical/systemic and the principles that should guide ad hoc rescues of those companies by the government. Firms are critical/systemic if their failure imposes significant negative externalities on the economy (or, conversely, their preservation generates significant positive externalities) or if they provide the public with an “infrastructure” not otherwise provided by the private sector. If firms are critical/systemic, the government should have the ability to bail them out, going beyond

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applicable statutory schemes and ensuring that the relevant externalities are considered when deciding whether to keep these companies as going concerns. The bankruptcy process is not designed to vindicate such public considerations.

Government bailouts, however, should be governed by principles, as any government intervention in the economy, and its associated efficiency and distributional effects must be considered with care. The guiding principles that we propose and elaborate on are (i) proportionality, (ii) efficiency, (iii) equity, and (iv) transparency. The application of these principles should ensure that, if the government takes ownership of a private firm through an ad hoc bailout, this is a tool of last resort, and not more than temporary—and that the pre-distress investors properly contribute to the necessary measures.

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I. INTRODUCTION

The COVID-19 pandemic threatens lives and livelihoods across the world. The necessary healthcare measures adopted by governments across the globe, from social distancing to strict lockdowns, disrupt the business models of a large number of companies.¹ Scholars on both sides of the Atlantic have gone to significant lengths to establish the best way to meet the challenge of massive numbers of businesses simultaneously in distress across vast parts of the economy.² Policymakers are committing public rescue funds to assist struggling firms on an unprecedented scale.³ However, irrespective of how well

1. Luc Laeven, *COVID-19 and the Effects of Social Distancing on the Economy*, VOX: CTR. FOR ECON. POL'Y RSCH (Aug. 31, 2020), <https://voxeu.org/article/covid-19-and-effects-social-distancing-economy> [<https://perma.cc/QGP5-VZQM>].

2. See Kristen van Zwieten et al., *Bail-outs and Bail-ins are Better than Bankruptcy: A Comparative Assessment of Public Policy Responses to COVID-19 Distress* 4 (Eur. Corp. Governance Inst., Working Paper No. 535, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3669541 [<https://perma.cc/3AUV-F8BB>]; Jared A. Ellias & George Triantis, *Congress is Ignoring the Best Solution for Troubled Companies: Bankruptcy*, FORTUNE: COMMENTARY (May 14, 2020, 7:00 PM), <https://fortune.com/2020/05/14/bankruptcy-cares-act-aid-coronavirus/> [<https://perma.cc/A5JW-ZPMD>]; Edward R. Morrison & Andrea C. Saavedra, *Bankruptcy's Role in the COVID-19 Crisis* 2 (Colum. L. & Econ. Working Paper, Paper No. 624, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3567127 [<https://perma.cc/8UU7-FNWQ>]; DAVID SKEEL, BROOKINGS ECON. STUD., *BANKRUPTCY AND THE CORONAVIRUS* 4 (2020) [hereinafter *BANKRUPTCY AND THE CORONAVIRUS, PART I*]; DAVID SKEEL, BROOKINGS ECON. STUD., *BANKRUPTCY AND THE CORONAVIRUS, PART II* 3 (2020) [hereinafter *BANKRUPTCY AND THE CORONAVIRUS, PART II*]; Peter Coy, *Stiglitz Calls for 'Super Chapter 11' to Avoid Systemic Collapse*, BLOOMBERG BUSINESSWEEK (Apr. 9, 2020, 4:00 AM), <https://www.bloomberg.com/news/articles/2020-04-09/could-super-chapter-11-help-an-economy-avoid-systemic-collapse> [<https://perma.cc/9QUZ-D8ZL>]; Todd Baker & Kathryn Judge, *How to Help Small Businesses Survive COVID-19* 2 (Colum. L. Sch. Ctr. L. & Econ. Stud. Working Paper, Paper No. 620, 2020), https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=3643&context=faculty_scholarship [<https://perma.cc/6TVN-PEJB>].

3. See Lauren Fedor & James Politi, *House of Representatives Passes \$1.9tn Covid Stimulus Package*, FIN. TIMES (Feb. 27, 2021), <https://www.ft.com/content/21c4bdb4-41eb-4c57-b4af-630da956a950> [<https://perma.cc/VK7S-FQGM>], for stimulus package announcements in the United States. See George Parker, *Sunak to Give £5bn Boost to Covid-Hit Companies in Budget*, FIN. TIMES (Feb. 28, 2021), <https://www.ft.com/content/9c6e7088-5577-4b17-ade1-502bfd33a76> [<https://perma.cc/GE3X-HASN>], for grant scheme announcements in the United Kingdom. One report indicated that during the Summer of 2020, the size of the economic stimulus deployed by Western democracies significantly exceeded, in terms of percentage of GDP, the stimulus advanced during the Great Recession. See ZIYAD CASSIM ET AL., MCKINSEY & CO., *THE \$10 TRILLION RESCUE: HOW GOVERNMENTS CAN DELIVER IMPACT* 2 (2020). We can see steep increases across the globe: 4.9% to 12.1% in the U.S.; 1.5% to 14.5% in the U.K.; 2.2% to 21.0% in Japan; and 3.5% to 33.0% in Germany. *Id.* at 3 Exhibit 1. Another significant reference point is that the United States fiscal response for the stimulus packages approved in December 2020 exceeds \$5 trillion, far surpassing the size of the response to the Great Recession in terms of GDP. *The Fiscal Response to COVID-19 Will be Larger than the Great Recession Response*, COMM. FOR RESPONSIBLE FED. BUDGET (Dec. 22, 2020), <https://www.crfb.org/blogs/fiscal-response-covid-19-will-be-larger-great-recession-response> [<https://perma.cc/6BHE-BH2X>]. These significant responses to the pandemic (addressed at both businesses and households) are, in principle, intended to stabilize the economy—and not to affect the

constructed and implemented the general policy response may be, it will not be sufficient in all cases.

Since the outbreak of the COVID-19 pandemic, a number of companies have emerged as potential candidates for special treatment by their respective governments in an attempt to keep them operating outside bankruptcy.⁴ We have already witnessed headline-grabbing bailouts, such as the German government's rescue of flag carrier Lufthansa⁵ and tour operator TUI,⁶ France's assistance to Eurostar⁷ and Renault⁸ (and carmakers generally),⁹ and the U.S.

allocation of resources or redistribute them. However, if stabilization is the only objective, well-respected scholars are starting to voice their concerns that the stimulus size may be too large and may well lead to the creation of some serious undesirable side effects (essentially inflationary pressures and an overheated economy). See James Politi, *Democrats Hit Back at Summers After Criticism of Stimulus Bill*, FIN. TIMES (Feb. 6, 2021), <https://www.ft.com/content/2ed793d2-fb65-4ec7-9b4c-5851b2c780f3> [https://perma.cc/YU3Q-CRZ5], for an overview of references to the views espoused by Lawrence Summers and Oliver Blanchard; see also Lawrence H. Summers, *Opinion: My Column on the Stimulus Sparked a Lot of Questions. Here Are My Answers.*, WASH. POST (Feb. 7, 2021, 7:00 AM), <https://www.washingtonpost.com/opinions/2021/02/07/my-column-stimulus-sparked-lot-questions-here-are-my-answers/> [https://perma.cc/UM2J-NR8L] (discussing the potential pitfalls of such large stimulus packages).

4. See Antonia Juhasz, *Bailout: Billions of Dollars of Federal COVID-19 Relief Money Flow to the Oil Industry*, SIERRA CLUB MAG. (Aug. 26, 2020), <https://www.sierraclub.org/sierra/bailout-billions-dollars-federal-covid-19-relief-money-flow-oil-industry> [https://perma.cc/GV9H-LGJW].

5. Joe Miller & Laurence Fletcher, *Lufthansa Shareholders Back €9bn Bailout Package*, FIN. TIMES (June 25, 2020), <https://www.ft.com/content/e7f87a03-e77f-46cc-933e-95cd50a60640> [https://perma.cc/43PG-FS42].

6. See Bryce Elder, *Two-Tier Ownership Is Tui's Passport to Nowhere*, FIN. TIMES: LOMBARD (Dec. 10, 2020), <https://www.ft.com/content/d96b4551-e235-4096-93a7-932dff4a5230> [https://perma.cc/9PPG-XZBT].

7. David Keohane & Jim Pickard, *Eurostar Lands Bailout from Investors and French State*, FIN. TIMES (May 18, 2021), <https://www.ft.com/content/08f283fd-adca-4337-a9cb-da5cdf58aa4a> [https://perma.cc/X9V6-YUGP]. Note that Eurostar, the railroad operator, is different from Getlink/Eurotunnel, which owns the railroad infrastructure. Interestingly, Getlink has its own storied relationship with bankruptcy. See Michael Harrison, *Eurotunnel Blames Deutsche as It Files for Bankruptcy Protection*, INDEP. (Apr. 1, 2009), <https://www.independent.co.uk/news/business/news/eurotunnel-blames-deutsche-as-it-files-for-bankruptcy-protection-6095464.html> [https://perma.cc/9BYH-GLCE]. It is important to consider that in this case the French Government already holds a 55% equity stake in the company through state-owned SNCF. Rachael Kennedy, *COVID-19 Eurostar on the Railroad to Ruin. But Should the UK Help Save the French-Owned Company?*, EURONEWS (Jan. 27, 2021), <https://www.euronews.com/2021/01/26/coronavirus-has-eurostar-on-the-edge-of-ruin-but-should-the-uk-help-save-the-french-owned-> [https://perma.cc/Z8WF-7NZD]. Other states hold or held significant stakes: Belgium owns 5% through state-owned SNCB, and the U.K. owned 40% until 2015. *Id.*

8. *France's Renault Reaches Deal on 5 Billion Euro State-Backed Loan: Sources*, REUTERS (May 19, 2020, 12:08 PM), <https://www.reuters.com/article/health-coronavirus-renault-loan/frances-renault-reaches-deal-on-5-bl-eur-state-backed-loan-sources-idUSP6N2BQ03U> [https://perma.cc/NRW8-6SFD]; *Renault Finalizes \$5.6B Credit Facility French State*, REUTERS (June 3, 2020, 2:34 AM), <https://www.reuters.com/article/idUSL8N2DG13E> [https://perma.cc/NDZ3-FX9Z]. Note that before this bailout (a €5bn facility), the French government already owned 15% of the carmaker (and had been the sole owner until its privatization in 1996). *Id.*

9. Katy Dartford & Craig Crowther, *France Promises €8bn to Bail Out Struggling Car Industry*, EURONEWS (May 27, 2020), <https://www.euronews.com/2020/05/27/france-promises-8bn-to-bail-out-struggling-car-industry> [https://perma.cc/RX6E-2PER].

Treasury's bailout of defense contractor YRC Worldwide.¹⁰ Similar ad hoc bailouts will undoubtedly follow as the economic impact of the COVID-19 pandemic continues to slash the financial resources of companies across the globe. At the same time, given the magnitude of public funds involved, government interventions will increasingly come under enhanced scrutiny, such as with Franco-Dutch airline Air France-KLM.¹¹

We will refer to a narrow subset of businesses, such as the ones mentioned in the previous paragraph, as “critical/systemic.” Arguably, these businesses, if financially distressed, warrant an ad hoc, tailored response—both because their situation cannot be effectively remedied with all-encompassing measures and general stimuli to the economy and because their particular characteristics call for such a heightened effort.

This Article intends to make two key contributions in this respect. The first is to explain why it is not a good idea to let critical/systemic businesses go through bankruptcy proceedings. The key point here is that the bankruptcy process is not designed to take into account the positive or negative externalities typically associated with the continued operation or liquidation of critical/systemic firms. The second intended contribution is to detail the principles that should be followed when implementing alternative proceedings designed to deal with the distress of those critical/systemic businesses, which we will generally refer to as “non-statutory, ad hoc bailouts.”

We begin in Part II by explaining why the current wave of COVID-distressed firms is special, and why bankruptcy laws may not be the right tool to deal with these firms. We subscribe to the view that the appropriate way to manage the cohort of distressed businesses resulting from the pandemic is primarily through statutory schemes of government-led bailouts or government-mandated bail-ins.¹² In Part III we discuss which characteristics are required for a business to be considered critical/systemic and thus be a potential subject of a

10. James Politi & Sujeet Indap, *US Treasury Takes Stake in Trucking Company with \$700m Bailout*, FIN. TIMES (July 1, 2020), <https://www.ft.com/content/3d614d3f-6b58-4df5-9e25-e2894de2c479> [https://perma.cc/T5RS-A2F8].

11. See Valentina Pop & Philip Georgiadis, *Ryanair Scores First Wins in EU Court Against State-Propped Flag Carriers*, FIN. TIMES (May 19, 2021), <https://www.ft.com/content/e3e6b8e7-977f-4b66-8b1f-0faf240e90d4> [https://perma.cc/2GZU-KVVE]; Foo Yun Chee, *EU Regulators Okay KLM Bailout, Tweaks Decision After Court Veto*, REUTERS (July 19, 2021, 11:11 AM), <https://www.reuters.com/business/aerospace-defense/eu-regulators-okay-klm-bailout-tweaks-decision-after-court-veto-2021-07-19/> [https://perma.cc/2TQ5-KJGY]. Importantly, in the case of Air France-KLM (as well as Euorostar), the governments that were called to bail out the company already held an equity stake: France and Netherlands each owned 14% of Air France-KLM prior to the bailout. Tara Patel, *French State Tightens Grip on Air France-KLM with 29% Stake*, BLOOMBERG (Apr. 20, 2021, 3:23 AM), <https://www.bloomberg.com/news/articles/2021-04-19/air-france-klm-raises-1-25-billion-giving-france-a-28-6-stake> [https://perma.cc/2QUL-QV48]. The distribution of the contributions and the relevant international spillovers are the subject of ongoing policy discussions (as in the case of Eurostar). See *id.*

12. See van Zwieten et al., *supra* note 2, at 23.

“non-statutory, ad hoc bailout” as well as why those characteristics make bankruptcy an especially poor tool to deal with this type of businesses. Part IV then builds on the concept of non-statutory, ad hoc bailouts and the characteristics of critical/systemic businesses to establish the guiding principles for the implementation of such bailouts. These are public interventions with public money to pursue public objectives. It is crucial that the rights of everyone involved (from the shareholders of the companies to the governments and the taxpayers) are properly safeguarded and the intervention does not have unintended and adverse consequences for public welfare.

II. BAIL-INS, BAILOUTS AND BANKRUPTCY: A COMPARATIVE ASSESSMENT

With every shock or crisis, there is always the temptation to justify what is unique about it and why our past models do not work. Yet most of the time, there is nothing that new.¹³ However, the COVID-19 pandemic has indeed created a quite peculiar situation for many businesses. The public health measures adopted by governments across the globe have resulted in a very specific situation affecting vast numbers of businesses across most industries: economically viable and financially sound businesses have seen their revenues evaporate overnight.¹⁴ In addition, these circumstances often combine with other issues pre-dating the COVID-19 pandemic, such as very high levels of debt in the capital structures of companies across both sides of the Atlantic¹⁵

13. See BANKRUPTCY AND THE CORONAVIRUS, PART I, *supra* note 2, at 4.

14. Ben Unglesbee, *Which Retailers Have Taken the Hardest Financial Hits from COVID-19?*, RETAIL DIVE (July 27, 2020), <https://www.retaildive.com/news/which-retailers-have-taken-the-hardest-financial-hits-from-covid-19/582133/> [<https://perma.cc/C47E-F5DX>]. To give some reference points, in the U.K., the number of businesses in significant financial distress without government support has been steadily increasing from an estimated 500,000 in Q1 of 2020 to more than 630,000 in Q4 of 2020. See Daniel Thomas, *More than 500,000 UK Companies in Financial Distress as Support Ends*, FIN. TIMES (Oct. 28, 2020), <https://www.ft.com/content/1bf6edab-0744-4dac-8334-d56b29bf6c3d> [<https://perma.cc/ZUQ9-VPQA>]; Julie Palmer, *630,000 UK Businesses Now in Significant Financial Distress as New Lockdown Comes into Effect*, BEGBIES TRAYNOR: BUS. HEALTH STATS. (Jan. 21, 2021), <https://www.begbies-traynorgroup.com/news/business-health-statistics/news/firm-news/630000-uk-businesses-now-in-significant-financial-distress-as-new-lockdown-comes-into-effect> [<https://perma.cc/7W32-RGTD>]. A number of experts and practitioners note that the situation is expected to further escalate as governmental support in the U.K. is discontinued in July 2021. Daniel Thomas, *End of Government Covid Support Set to Cause Further Corporate Distress*, FIN. TIMES (June 14, 2021), <https://www.ft.com/content/19bb9e98-b167-4778-9ae7-ccb22c5d14a4> [<https://perma.cc/EX3X-XS9N>].

15. For Europe, see Robert Smith, *Debt-Laden Borrowers Revel in Europe's Buyout Boom*, FIN. TIMES (Feb. 5, 2019), <https://www.ft.com/content/0fa9a75e-1b0e-11e9-9e64-d150b3105d21> [<https://perma.cc/G399-RPEC>]. For the U.S., see Joe Rennison & Colby Smith, *Debt Machine: Are Risks Piling up in Leveraged Loans?*, FIN. TIMES: THE BIG READ (Jan. 21, 2019), <https://www.ft.com/content/64c9665e-1814-11e9-9e64-d150b3105d21> [<https://perma.cc/TV57-Z235>].

and a tally of “zombie” companies¹⁶ far exceeding that seen during the Great Recession.¹⁷

Bankruptcy law is a useful tool to reorganize businesses in normal times, whether in the growing or contracting phase of a regular business cycle.¹⁸ The bankruptcy process is governed by legal rules providing certainty and predictability.¹⁹ Many jurisdictions around the world have one or more dedicated “restructuring proceedings” on their statute book.²⁰ In jurisdictions such as the United States and the United Kingdom, there is a long history of fine-tuning of this type of law.²¹ A sophisticated ecosystem of judges, lawyers, bankers and other bankruptcy practitioners has been optimized for a certain “normal,” which includes anticipated downturns in the business cycle.²²

However, the design features of bankruptcy procedures are inapt to handle the massive influx of COVID-distressed businesses. Bankruptcy is complicated

16. See Ryan Banerjee & Boris Hofmann, *The Rise of Zombie Firms: Causes and Consequences*, BIS Q. REV. 67, 67 (Sept. 2018), https://www.bis.org/publ/qtrpdf/r_qt1809g.pdf [<https://perma.cc/263U-E3WA>] (Zombie firms are defined as “firms that are unable to cover debt servicing costs from current profits over an extended period . . .”).

17. TOBIAS HELMERSSON ET AL., EURO CENT. BANK, FIN. STABILITY REV: CORPORATE ZOMBIFICATION: POST-PANDEMIC RISKS IN THE EURO AREA 95 (2021); Valentina Pop, *Europe’s Zombie Problem Has Only Gotten Worse*, FIN. TIMES: EUR. EXPRESS (May 19, 2021), <https://www.ft.com/content/13918a23-db39-48fd-b812-4fe9c1d82698> [<https://perma.cc/W8Q9-UBYG>]. See also Joe Rennison, *Pandemic Debt Binge Creates New Generation of ‘Zombie’ Companies*, FIN. TIMES (Sept. 13, 2020), <https://www.ft.com/content/9b304e20-49cf-4fba-81a0-4d06f930d7a1> [<https://perma.cc/4WCD-XHLW>] (discussing the re-emergence of Zombie companies in the United States); Eric Platt, *Distressed Debt Specialist Howard Marks Warns on Corporate Borrowing Burden*, FIN. TIMES (Jan. 5, 2021), <https://www.ft.com/content/5585b123-7b9d-40fe-8f63-95f7491e8193> [<https://perma.cc/UY53-FQPT>] (explaining potentially negative consequences for companies’ capital structures and viability once COVID-19 abates).

18. See Edward R. Morrison, *Is the Bankruptcy Code an Adequate Mechanism for Resolving the Distress of Systemically Important Institutions*, 82 TEMP. L. REV. 449, 450–51 (2009).

19. Lia Metreveli, *Toward Standardized Enforcement of Cross-Border Insolvency*, 51 COLUM. J. L. & SOC. PROBS. 315, 316 (2017).

20. See COMPARATIVE GUIDE TO RESTRUCTURING PROCEDURES, WEIL RESTRUCTURING (2012), <https://eurorestructuring.weil.com/wp-content/uploads/2013/02/Comparative-Guide.pdf> [<https://perma.cc/2FGS-CBE7>], for a comparison of various restructuring laws around the world, from Chapter 11 in the U.S. to proceedings such as the scheme of arrangement, the restructuring plan or the company voluntary arrangement under English law, the *procédure de sauvegarde* in France, the *Schutzschirmverfahren* in Germany, the *concordato preventivo* or the *accordi per la ristrutturazione dei debiti* in Italy, or the *concurso de acreedores* in Spain.

21. See, e.g., Small Business Reorganization Act of 2019, Pub. L. No. 116-54, 133 Stat. 424, which included a new Subchapter V and brought about the largest reform of small business bankruptcy in more than a decade.

22. See, e.g., Morrison, *supra* note 18, at 460–62 (discussing skepticism amongst scholars regarding permanent changes to the bankruptcy code to deal with out-of-the-ordinary situations). Furthermore, the efficiency implications of the existing regimes are reasonably well understood; for instance, there is evidence supporting the hypothesis that bankruptcy does a good job in filtering between companies that should be liquidated or reorganized, thus ensuring a proper allocation of assets to their best and highest-value use. See Edward R. Morrison, *Bankruptcy Decision Making: An Empirical Study of Continuation Bias in Small-Business Bankruptcy*, 50 J.L. & ECON. 381, 382–83 (2007).

and costly.²³ A procedure such as Chapter 11 of the Bankruptcy Code in the United States is geared towards an encompassing financial and possibly also economic restructuring of a distressed firm.²⁴ The firm's finances are rescheduled, and management gets some "breathing space" for an operational restructuring through a lengthy process that could last more than a year.²⁵ However, this benefit comes at a cost: the direct and indirect costs of bankruptcy can eat up as much as 10-20% or more of a firm's value.²⁶

The overwhelming majority of COVID-distressed firms do not need such a process, nor are these firms in a position to afford the bankruptcy costs previously mentioned. These firms do not require a substantial financial and/or economic restructuring. Rather, they are experiencing a temporary cash-flow problem because of lockdown-induced trading disruptions. What these firms need is temporary and limited financial assistance. That is not what bankruptcy is designed to provide.²⁷

Hence, bankruptcy is not a good solution to COVID-induced financial distress.²⁸ This deficiency is not primarily a problem of lack of resources.²⁹

23. See Van Zwieten et al., *supra* note 2, at 19.

24. See Morrison & Saavedra, *supra* note 2, at 4-5.

25. See *id.*; see also Edith H. Jones, *Chapter 11: A Death Penalty for Debtor and Creditor Interests*, 77 CORNELL L. REV. 1088, 1088 (1992) (explaining how Chapter 11 reorganization gives companies "breathing-space" so that they can restructure their debts).

26. For indirect costs, a 1998 paper by Andrade and Kaplan pointed to 10-20% for large, leveraged companies. See Gregor Andrade & Steven N. Kaplan, *How Costly is Financial (Not Economic) Distress? Evidence from Highly Leveraged Transactions that Became Distressed*, 53 J. FIN. 1443, 1443 (1998). Direct costs for large companies are assessed at around 2%. E.g., Lynn M. LoPucki & Joseph W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases*, 1 J. EMPIRICAL LEGAL STUD. 111, 113 (2004). *But see* Lynn M. LoPucki & Joseph W. Doherty, *Professional Overcharging in Large Bankruptcy Reorganization Cases*, 5 J. EMPIRICAL LEGAL STUD. 983, 1003 (2008) (arguing after further examination that because of the pronounced impact of firm size on this ratio, "the reporting and use of single percentages to reflect studies in which the subject companies were of varying size is misleading."). Though the level of direct costs seems to be relatively settled in the literature, the same cannot be said about indirect costs. For small and medium-sized businesses, costs may be as high as 30%. See BANKRUPTCY AND THE CORONAVIRUS, PART I, *supra* note 2, at 5. For a recent survey of research on direct and indirect costs of bankruptcy, see EDWARD I. ALTMAN, EDITH HOTCHKISS AND WEI WANG, CORPORATE FINANCIAL DISTRESS, RESTRUCTURING AND BANKRUPTCY 71-81 (4th ed. 2020). See also STEPHEN J. LUBBEN, *The Costs of Corporate Bankruptcy: How Little We Know*, in RESEARCH HANDBOOK ON CORPORATE BANKRUPTCY LAW 275, 283-91 (Barry E. Adler ed., 2020), for another review of recent research on bankruptcy costs and insights on internal institutional issues that may be affecting the magnitude of these costs, particularly direct costs.

27. See Van Zwieten et al., *supra* note 2, at 5.

28. See *id.*

29. Some have argued that the proper solution is for "Congress to appoint additional temporary bankruptcy judges and to increase the budgets of our existing bankruptcy courts." Letter from Jared A. Ellias, Chair Large Corp. Comm. of the Bankr. & COVID-19 Working Grp., to Nancy Pelosi, Kevin McCarthy, Mitch McConnell, & Charles Schumer (May 7, 2020) <https://www.uchastings.edu/wp-content/uploads/2020/05/Large-Corporate-Committee-of-Bankruptcy-Scholars-Letter-to-Congress-5.7.20.pdf> [<https://perma.cc/CTB2-87AN>]. We are not of the opinion this would address the primary problem, that bankruptcy is not the correct tool for the situation. The additional resources will assist in

Bankruptcy's failure to adequately address the special features of COVID-distress is *structural* and not so much one of scale.³⁰ The bankruptcy process does not provide the fix that the overwhelming majority of COVID-distressed firms need.

Nor is it a good idea to try to adapt bankruptcy laws to better deal with the requirements of the pandemic, as many jurisdictions have tried.³¹ A tested instrument, which works well for most firms in normal times, should not be modified to deal with extraordinary situations such as COVID-19 or other unforeseen pandemics. Whatever tweaks may serve to make bankruptcy law marginally better at dealing with COVID-19-related distress will also move the legislation and its application from its current equilibrium to a less optimal situation in the long run.

Accordingly, we posit³² that the best option is an approach based on providing financial assistance to the businesses affected by significant but temporary decreases in revenue, avoiding the need to file for formal bankruptcy protection at least until the current COVID-19 situation has been brought under

dealing with some of the issues exposed by the COVID-19 pandemic (the overload of the system due to increased numbers of companies requiring bankruptcy protection) but will prove insufficient to deal with other critical matters discussed in this Article unless combined with a bailout or a bail-in.

30. At the same time, we acknowledge that the pressure on resources results in large numbers of simultaneous petitions having to be shepherded through the system, and that there is evidence that the system itself behaves in a different (not optimal) way when overloaded. *Cf.* Benjamin Iverson, *Get in Line: Chapter 11 Restructuring in Crowded Bankruptcy Courts*, 64 MGMT. SCI. 5370, 5370 (2018) (arguing that the level of caseloads in a bankruptcy court affects the nature of firm restructuring).

31. Some jurisdictions have established temporary changes to deal with the first shock of the pandemic until lockdowns are no longer required. Insofar as these changes do indeed remain temporary, they do not warrant too much criticism. Some examples of such temporary tweaks include the suspension of duties to file for bankruptcy (France, Germany, Italy, Spain), the suspension of wrongful trading provisions (UK), the suspension of equitable subordination for shareholder loans made available during the suspension period (Germany, Italy), the limitation of avoidance actions in relation to the transactions made during the suspension period (Germany), or the stay of liquidations due to breach of a previous insolvency agreement if an alternative plan is provided (Spain). *See* Aurelio Gurrea-Martinez, *Insolvency Law in Times of COVID-19* 8–11 (Ibero-Am. Inst. for Law & Fin., Working Paper 2/2020, 2020) (surveying legal responses to the COVID-19 pandemic). Some jurisdictions have taken the chance to also introduce permanent changes to their bankruptcy laws. These changes have been particularly relevant in the United Kingdom, though it has to be acknowledged that these amendments had been in the making well before the start of the COVID-19 pandemic. In particular, British law now has established a standalone moratorium, Corporate Insolvency and Governance Act, 2020, c. 12 (UK), <https://www.legislation.gov.uk/ukpga/1986/45/part/A1> [<https://perma.cc/D8L3-JEGL>], a prohibition of *ipso facto* termination rules for the supply of goods and services, Insolvency Act 1986, c. 45 § 233B(3)–(5) (UK), <https://www.legislation.gov.uk/ukpga/1986/45/section/233B> [<https://perma.cc/JRD3-XCQJ>], and a new tool, the restructuring plan, which allows for the carrying out of cross-class cramdowns, Companies Act 2006, c. 46 § 901F (UK), <https://www.legislation.gov.uk/ukpga/2006/46/part/26A/2020-06-26> [<https://perma.cc/8K6U-EXMJ>].

32. In this recommendation, we follow Van Zwieten, Eidenmüller and Sussman. *See* van Zwieten et al., *supra* note 2, at 39.

control and these businesses are in a position to resume normal trading.³³ Such relief can be effected by the relevant governments in two main ways (or different combinations thereof), namely bailouts and bail-ins. In a bailout, it is the state or other public institution who funds the relief; in a bail-in, it is private stakeholders.³⁴ The difference is in the *source* of the relief funds.³⁵ The *size* of these funds is not decisive when characterizing a measure as a bailout or bail-in.³⁶

Both bailouts and bail-ins have the same goal, namely, to provide financial breathing space to a distressed company when bankruptcy seems to be the only other option. 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.”³⁷ Bail-ins serve a similar function, i.e., to provide some breathing room to businesses until trading can resume.³⁸ However, they do so by pausing or reducing claims at the expense of counterparties rather than taxpayers.³⁹ One can define bail-ins as a government mandate to “in a ‘one time’ way, outside of formal reorganization law . . . [provide] some degree of forgiveness by creditors or counterparties.”⁴⁰

In the current COVID-19 crisis, one of the first types of government response came in the form of deploying statutory bailout and bail-in schemes that were already in place pre-pandemic.⁴¹ In addition, dedicated (new) COVID-19 schemes were created and implemented to combat the economic effects of the pandemic.⁴² Finally, instead of being based on a general statutory

33. Special consideration of the impact of the costs of shutdowns (e.g., layoffs, physical shutdown of capital) is also warranted, as their relative effects may impact the appropriate response to the situation of a specific firm. *See id.* at 24–26.

34. *See id.* at 23.

35. *See id.*

36. *See generally id.* (explaining the differences between bailouts and bail-ins).

37. Anthony J. Casey & Eric A. Posner, *A Framework for Bailout Regulation*, 91 NOTRE DAME L. REV. 479, 481 (2016).

38. *See* Van Zwieten et al., *supra* note 2, at 7.

39. *See id.*

40. *Id.* at 23.

41. For example, short-term work schemes (furlough schemes) are designed to bail out companies in difficulties by providing temporary support to preserve employment. These schemes have been used in previous crises and also during “normal” times. *See* PIERRE CAHUC ET AL., INST. OF LAB. ECON., IZA DP NO. 11673, WHEN SHORT-TIME WORK WORKS 1 (2018); *see also* GIULIA GIUPPONI & CAMILLE LANDAIS, CTR. FOR ECON. POL’Y RSCH., CEP DISCUSSION PAPER NO. 1585, SUBSIDIZING LABOR HOARDING IN RECESSIONS 2 (2018). Examples of short-term programs include the German *Kurzarbeit*, the Italian *cassa integrazione guadagni straordinaria*, and the French *chômage partiel*. Another form of government response is what Professor Block refers to as “special fund bailouts.” *See* Cheryl D. Block, *Overt and Covert Bailouts: Developing a Public Bailout Policy*, 67 IND. L.J. 951, 963–64 (1992).

42. *See*, for example, the Coronavirus Business Interruption Loan Scheme (CBILS) in the UK, European Commission Press Release IP/20/527, State Aid: Commission Approves UK Schemes to Support SMEs Affected by Coronavirus Outbreak (March 25, 2020); the Spanish Solvency Support Fund,

scheme, which applies to a larger group of firms, a bailout can also be effected ad hoc to rescue an individual firm or a small group of firms.⁴³ If private stakeholders bail out the firm, we have a private workout (see Table 1).

TABLE 1			
<i>Source of Funds/Type of Scheme</i>	<i>Statutory Scheme, Pre-Pandemic</i>	<i>Statutory Scheme, Post-Pandemic</i>	<i>Ad hoc Intervention</i>
<i>Public</i>	Statute-Based Bailout	Statute-Based Bailout	Ad hoc Bailout
<i>Private</i>	Statute-Based Bail-In	Statute-Based Bail-In	Private Workout

Politically, bailouts are more popular than bail-ins.⁴⁴ Bailouts shift the financial burden to future generations, and they spread this burden over the whole population—there are clear winners and no clear losers.⁴⁵ By comparison, bail-ins target a select group of private stakeholders who are impacted

European Commission Press Release IP/20/1426, State Aid: Commission Approves € 10 Billion Spanish Fund to Provide Debt and Capital Support to Companies Affected by the Coronavirus Outbreak (July 31, 2020); a French scheme providing state guarantees on commercial loans to enterprises with up to 5,000 employees through the public investment bank Bpifrance, European Commission Press Release IP/20/503, State Aid: Commission Approves French Schemes to Support Economy in Coronavirus Outbreak (March 21, 2020); the establishment of the Economic Stabilization Fund in Germany, European Commission Press Release IP/20/1280, State Aid: Commission Approves German Fund to Enable up to €500 Billion of Liquidity and Capital Support to Enterprises Affected by the Coronavirus Outbreak (July 8, 2020); or the CARES Act in the United States, *About the CARES Act and the Consolidated Appropriations Act*, U.S. DEP'T OF THE TREASURY, <https://home.treasury.gov/policy-issues/coronavirus/about-the-cares-act> [<https://perma.cc/MSE6-FCGC>], including for instance, the Paycheck Protection Program managed by the U.S. Small Business Administration, see *Paycheck Protection Program*, U.S. DEP'T OF THE TREASURY, <https://home.treasury.gov/policy-issues/coronavirus/assistance-for-small-businesses/paycheck-protection-program> [<https://perma.cc/8N8R-MEZB>].

43. When Casey and Posner, *supra* note 37, at 481, define a bailout as “when the government makes payments . . . to a . . . private agent . . . when the agent is not entitled to those payments under a statutory scheme,” we understand that said statutory scheme is the type of scheme that we are referring to as “pre-pandemic,” i.e., one that was in place before the relevant “trigger situation” occurs.

44. Van Zwieten et al., *supra* note 2, at 33 (explaining that bailouts are politically attractive because they shift losses to future generations and spread losses rather than impose them on a specific group of stakeholders, as is the case with bail-ins); see also ALLEN N. BERGER & RALUCA A. ROMAN, *TARP AND OTHER BANK BAILOUTS AND BAIL-INS AROUND THE WORLD 13* (2020) (explaining that bailouts are attractive to government officials because “they can usually be put together relatively quickly and do not require the advance cooperation of private-sector agents that bail-ins often do.”); *id.* at 19 (discussing the pros and cons of bailouts and bail-ins).

45. See Van Zwieten et al., *supra* note 2, at 33.

immediately.⁴⁶ From a fairness perspective, both approaches have at least some merit: the pandemic affects us all, hence financial aid should come from taxpayers' resources; on the other hand, stakeholders of private firms have voluntarily assumed specific risks, including, in particular, bankruptcy risks.

COVID-related statutory bailout schemes in many jurisdictions help prevent a mass influx of distressed businesses into their respective bankruptcy systems.⁴⁷ However, sometimes these statutory schemes do not provide sufficient resources to successfully allow certain (large) critical/systemic companies to remain viable without requiring further arrangements.⁴⁸ At the same time, bankruptcy proceedings remain an unattractive option, for reasons we explore in the next Part.

Hence, in the following Part, our focus is specifically on the bailouts in the upper-right corner of Table 1: those that constitute non-statutory ad hoc interventions.

III. SPECIFIC PROBLEMS OF CRITICAL/SYSTEMIC FIRMS

A. *A Definition of Critical/Systemic Firms*

Which companies are critical/systemic, and what are the characteristics that allow us—and the relevant governments—to identify them? This is one of the key questions that we set out to address with this Article, since the characteristics of those firms permit us to tackle two very important issues: what are the reasons that justify firms being subject to an ad hoc bailout, if needed, and why are regular bankruptcy proceedings not the most appropriate tool to deal with such firms.

A first approach at defining critical/systemic firms may aim to understand what types of companies (and in what sectors) different governments across the world have considered important enough to directly intervene in a situation of crisis on an ad hoc basis to ensure their survival. Analysing *what* firms have been rescued by governments across the globe in ad hoc bailouts, and *why* they have been rescued, may provide us with a starting point to formulate our proposed definition.

46. See Abigail S. Boyd, *Bail-ins—Just Another Self-Fulfilling Prophecy?*, 27 BANKING & FIN. L. REV. 599, 601 (2012); see also Emiliios Avgouleas & Charles Goodhart, *Critical Reflections on Bank Bail-ins*, J. FIN. REGUL. 3, 4 (2015) (explaining that bail-ins impose the burden of losses on private stakeholders).

47. See Van Zwieten et al., *supra* note 2, at 39.

48. See MARC LABONTE, CONG. RSCH. SERV., R42150, SYSTEMATICALLY IMPORTANT OR “TOO BIG TO FAIL” FINANCIAL INSTITUTIONS 7 (2018) (explaining that the use of more than one policy approach to combat the failure of critical/systemic companies can be more effective than the use of one approach in isolation).

According to empirical research conducted in the aftermath of the Great Recession, ad hoc bailouts that are conducted by governments in practice exhibit a series of commonalities.⁴⁹ First, governments tend to bail out firms that present a “systemic risk.”⁵⁰ Second, the political orientation of governments seems to have an effect on the type of firms that receive support.⁵¹ Left-of-center governments tend to rescue more firms and firms with larger numbers of employees,⁵² while right-of-center governments tend to rescue fewer firms, but those tend to be more significantly concentrated around capital-intensive businesses.⁵³ Third, the presence of strong special interests that would be harmed by the failure of the firm also appears to have an effect on the likelihood of a bailout.⁵⁴

Most relevant among these findings, for our purposes, are the scope of the definition of “systemic” and a better understanding of the underlying circumstances favored by governments of different political orientation in their decisions on bailouts. On the definition of “systemic,” the industries where a higher share of distressed firms tend to be bailed out are finance, transportation, and utilities.⁵⁵ The main reason being that “out of concern for aggregate welfare

49. See Michael Graham Smith, *Three Essays on the Political Economy of Corporate Bailouts* 3–4, 18–20, 70 (2014) (Ph.D. dissertation, Columbia University), <https://doi.org/10.7916/D8QZ283M>. Smith conducted empirical research on two samples of government bailouts. The first one (the “General Dataset”) contained a dataset of “631 firms that approached bankruptcy between the years of 1987 and 2011 and that span 17 industries and 50 countries,” *id.* at 3, which was constructed using media keyword searches that yielded a total of 747 instances of distressed firms in the period, *id.* at 20. The second one (the “EEA Dataset”) was a dataset containing all bailouts in the European Economic Area (EEA) for the period 1999–2011, as they must be reported by the Member States in compliance with the regulations on state aid. *Id.* at 70.

50. *Id.* at 3. Of course, what is meant by systemic risk is the key issue at hand. Smith, *supra* note 49, finds (on the basis of the General Dataset) that the largest firms and those operating in the financial industry are more likely to receive a bailout, considering that a good proxy for systemic risk. *Id.* Most of the literature has focused on the type of systemic risk brought about by financial institutions, that is, a contagion risk that destabilizes the banking system and the capital markets; see, for reference, Morrison, *supra* note 22, at 450; the analysis in Adam J. Levitin, *In Defense of Bailouts*, 99 *GEO. L.J.* 435 (2011), at 438, extends the concept and considers a wider approach based on the political relevance of the consequences (“the risk that individual firms’ failures will result in a socially unacceptable impact on the broader economy”). Our view, further explained in this Section, is that a firm is critical/systemic when its continuation (failure) results in significant positive (negative) externalities for the economy. Smith, *supra* note 49 at 438.

51. Levitin, *supra* note 50, at 492.

52. Smith, *supra* note 49, at 36, 40–43. Smith finds (on the basis of his General Dataset) that left-leaning governments are 11.5% more likely to bail out a business, and this effect increases with the number of employees of the firm. *Id.* at xvi.

53. *Id.* Smith finds (on the basis of his EEA Dataset) that left-leaning governments bail out labor-intensive businesses roughly 1.6 times more than others, while right-wing governments bail out companies in capital-intensive sectors roughly 2.5 times more than others. *Id.*

54. Smith, *supra* note 49, *passim*.

55. See *id.* at 160 tbl.A.2. These industries (as determined by NAICS codes 52, 48 and 22, respectively) are the only ones in the General Dataset where bailouts exceed 30% of the instances of

costs, governments might be more likely to provide bailouts to firms that pose the threat of systemic risk to the broader economy.”⁵⁶ As to the circumstances that appear to play a role depending on the political orientation of the government, the key difference seems to be the relevance and threshold of “subsidiarity”—i.e., the point at which the type and gravity of the effects appears to warrant state intervention.⁵⁷ The presence of strong special interests does not have an effect on our characterization of critical/systemic firms, but it will certainly play a role in the design of the principles governing bailout interventions, as described below.

A taxonomy of actual government bailout practices regarding presumptively critical/systemic firms is a helpful starting point. However, it is not sufficient for constructing a “normative” view of what these firms should be, or which of their characteristics justifies government intervention to rescue them. For these purposes, and before developing our own view, we discuss other instances of actual or proposed governmental and/or regulatory protection of certain types of firms and justifications for such interventions. We analyze (i) the restrictions on foreign direct investment (FDI) within the OECD, (ii) the EU regulations on state aid, (iii) the concepts of “infrastructure” and “public utilities” as applied in the theory and practice of regulation,⁵⁸ and (iv) the scope of activity of state-owned enterprises (including the EU caselaw on “golden shares”). We use these regulations as a proxy to understand which types of firms policymakers and public officials consider being of pivotal relevance to the economy, and why.

1. *Restrictions to FDI*

The first proxy that we consider relates to instances in which states exercise their jurisdictional power to limit the “access” of foreigners to their markets. For a long time, the OECD has monitored the ways in which both its members and third countries have established such restrictions.⁵⁹ One of the most

bailed out to distressed firms. *Id.* The data in Table A.2 also shows a large absolute number of bailouts in the manufacturing industry (NAICS code 31). *Id.*

56. *Id.* at xx.

57. *Id.* at 12-14; *see infra*, Part IV. Governments will only intervene when there is a sufficiently large risk, and this perception of risk seems to be well aligned with partisan lines. *See* Smith, *supra*, note 49 at 4.

58. K. Sabeel Rahman, *Infrastructural Regulation and the New Utilities*, 35 YALE J. ON REG. 911, 911, 918 (2018) (discussing the significance of industries being recognized as public utilities). In particular, we are interested in the scholarship on governmental action designed at the turn of the 20th century, between the Civil War and the New Deal, *i.e.*, during the Brandeisian era of the “public utility” or “public service corporation,” which has been revived by the law & political economy scholarship. *See, e.g., id.*; Morgan Ricks, *Money as Infrastructure*, 2018 COLUM. BUS. L. REV. 757, 768 (highlighting the new recognition of the banking industry and infrastructure as public utilities); WILLIAM NOVAK, *THE CORPORATION AND AMERICAN DEMOCRACY* 139 (Naomi R. Lamoreux & William J. Novak eds. 2017).

59. Smith, *supra* note 49, at 3.

comprehensive studies available in this regard was conducted at the turn of the century.⁶⁰ However, in recent years, governments have been extending the scope of these restrictions.⁶¹ This trend has only intensified since the start of the COVID-19 pandemic.⁶² As specific examples of the current scope of these limitations, we focus on restrictions in the United States⁶³ and the United Kingdom.⁶⁴ In the United States, foreign investors willing to invest in “any person engaged in interstate commerce” may need to deal with CFIUS (the Committee on Foreign Investment in the United States) if the proposed control transaction could affect U.S. “national security” (though the scheme also refers to national defense and critical infrastructure).⁶⁵ The core industries and types of firms affected by CFIUS regulations are defense, infrastructure, semiconductors and sensitive technologies, telecommunications, financial

60. Stephen S. Golub, *Measures of Restriction on Inward Foreign Direct Investment for OECD Countries*, (OECD Economics Department, Working Paper No. 357, 2003) (generalizing how the policies toward capital flows are constantly changing), https://www.oecd-ilibrary.org/economics/measures-of-restrictions-on-inward-foreign-direct-investment-for-oecd-countries_335043060125 [<https://perma.cc/CF83-LU69>].

61. For example, the EU established a regime for foreign direct investments in 2019. Regulation (EU) 2019/452, O.J. 2019 (L 79I) 3, 2, & 13 (March 21, 2019) [hereinafter FDI Screening Regulation].

62. Didier Martin, *Protectionism is Back on the French Economic Menu*, FIN. TIMES (Feb. 17, 2021), <https://www.ft.com/content/7a3e0b84-9387-4425-8d05-ffb4f09f70a4> (last visited Nov. 22, 2021). A number of these provisions are meant to be temporary measures to address the COVID-19 pandemic, but others had been under discussion before the start of the pandemic. For example, France recently blocked the acquisition of retailer Carrefour by a Canadian group on the grounds of “food sovereignty,” a reason added to the foreign investment restriction regime in April 2020 as an addition to a substantial reform conducted in May 2019. *See id.* Additionally, Italy changed its FDI regime, extending the scope of the restrictions to additional strategic sectors and lowering the thresholds for intervention. Decreto-Legge 8 aprile 2020, n. 23, G.U. Apr. 8, 2020 n. 94 (It.). Spain has similarly changed its FDI provisions twice extending the scope of affected sectors and affected investors as well as lowering the applicable thresholds. Real Decreto-Ley, Art. 16 (1)(b) (B.O.E. Aug. 8, 2020, 73) (Spain). The EU overall has also issued guidance with the FDI Screening Regulation, *supra* note 61.

63. Essentially, this is the Committee on Foreign Investment in the US (CFIUS) regime, although other agencies such as the Defense Counterintelligence and Security Agency also have the ability to restrict certain types of foreign investment. *See* FOCI MITIGATION AGREEMENTS, <https://www.dcsa.mil/mc/ctp/foci/mitigation/> [<https://perma.cc/9ASD-JQPG>]. The CFIUS regime is established under Section 721 of the Defense Production Act, Executive Order 11858, and the regulations at Chapter VIII of Title 31 of the Code of Federal Regulations. US Department of the Treasury, *CFIUS Laws and Guidance*, <https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-laws-and-guidance> [<https://perma.cc/AH36-TSWF>].

64. National Security and Investment Act 2021, § 5 (UK) <https://www.legislation.gov.uk/ukpga/2021/25/contents/enacted> [<https://perma.cc/LR84-5A7G>].

65. 31 C.F.R. § 800.101(a), (b) (2021). Part 800.248 of Title 31 of the US Code of Federal Regulations defines a “TID U.S. Business” as one dealing with “critical technologies,” which includes national defense-related goods and services, “covered investment critical infrastructure,” or “sensitive personal data.” 31 C.F.R. § 800.248 (2021); *see also* JAMES K. JACKSON, THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS), 16 nn.36–37 (identifying the 27 “critical sectors” and 28 “critical infrastructure areas”). Involvement with a TID U.S. Business triggers a CFIUS declaration.

institutions, and information technologies.⁶⁶ In the United Kingdom, the historical practice was not to restrict foreign investment in any material way.⁶⁷ Under the recently enacted National Security and Investment Act 2021, the United Kingdom has established its first⁶⁸ stand-alone foreign investment regime.⁶⁹ The Act directly subjects a number of key sectors to this new regime, supplemented by a general reference to “national security.”⁷⁰ These sectors include defense, energy, communications, data infrastructure, critical suppliers to government and emergency services, computer hardware, robotics, quantum technologies, and biological engineering.⁷¹

2. *State Aid*

Another interesting proxy comes from state aid regulations, a quintessential expression of European Union (EU) substantive laws and political economy. The EU strives to implement a “single market” within its borders, and a number of tools are in place so that this objective is achieved.⁷² Among those measures, the regulation of state aid is enshrined in Articles 107-109 of the Treaty on the Functioning of the European Union (TFEU).⁷³ The general rule is that state aid is incompatible with the internal market and thus forbidden.⁷⁴ However, in certain cases (which include assistance to firms in certain industries⁷⁵ or regions or rescuing and restructuring certain types of firms), the EU rules provide an exception because of the particular relevance of the special interests that are present.⁷⁶ And it is these exceptions that may help us in developing our concept of critical/systemic firms. The exceptions most relevant for our purposes are

66. COMM. ON FOREIGN INV. IN THE UNITED STATES, ANNUAL REPORT TO CONGRESS CY 2019, at iii-v (2020), <https://home.treasury.gov/system/files/206/CFIUS-Public-Annual-Report-CY-2019.pdf> [<https://perma.cc/9ACE-2JFG>].

67. Alex Potter and Kaidy Long, *The Foreign Investment Regulation Review: United Kingdom*, L. REVS. (Oct. 17, 2021) <https://thelawreviews.co.uk/title/the-foreign-investment-regulation-review/united-kingdom> [<https://perma.cc/6XEE-A4LN>].

68. Apart from the government’s ability to issue public interest intervention notices under the Enterprise Act 2002. There were emergency reforms to this regime in July 2020 to address the COVID-19 pandemic.

69. National Security and Investment Act 2021 (UK) <https://www.legislation.gov.uk/ukpga/2021/25/contents/enacted> [<https://perma.cc/LR84-5A7G>].

70. *Id.* at c. 2, 7.

71. *Id.*

72. See generally SINGLE MARKET AND STANDARDS, https://ec.europa.eu/growth/single-market_en [<https://perma.cc/2DHP-FL5J>].

73. 2012 O.J. (C 326) arts. 107-09.

74. *Id.* at art. 107.

75. Sectoral aid is based on exemptions to state aid based on specific treatment accorded to those sectors by the TFEU itself: agriculture and fisheries, *id.* at art. 42, transport, *id.* at art. 93, or production of (and trading in) arms, munitions and war material in relation to essential interests of the state’s security, *id.* at art. 346(1)(b). Furthermore, in application of the procedure in Article 107(3)(e) TFEU, coal and shipbuilding are also subject to a special regime in this regard. *id.* at art. 107(3)(e).

76. *Id.* at arts. 107-09.

those included in the European Commission's Guidelines on state aid for rescuing and restructuring non-financial undertakings in difficulty.⁷⁷ These Guidelines focus on seven different "compatibility criteria" that need to be met for the specific state aid being permitted.⁷⁸ Of these, the one that is particularly important is the need for the relevant aid to pursue "an objective of common interest, in that it aims to prevent social hardship or address market failure by restoring the long-term viability of the undertaking."⁷⁹ According to the Guidelines, this objective is present when there are significant "externalities," such as when the effects on employment are particularly severe or where an important service would be interrupted without any clear alternatives.⁸⁰ Effects on employment and the provision of important services might generally be subsumed under the rubric of "externalities," but they present some specific facets (and are so salient in the public's mind) that it may be worth describing them as separate from (but closely related to) the more general "externalities."

3. Infrastructure/Public Utilities

The concept of "public utility" or "public service corporation" in the Brandeisian tradition is based on the idea that there are certain economic activities that are "affected with a public interest" that should therefore be subject to a specific regime.⁸¹ The reason that these corporations conducting

77. Communication from the Commission – Guidelines on State Aid for Rescuing and Restructuring Non-Financial Undertakings in Difficulty, 2014 O.J. (C 249) 1 [hereinafter Guidelines]. An updated version of the Guidelines is now overdue, as they were supposed to cover the 2014-2020 period. Furthermore, the European Commission issued a Temporary Framework to guide state aid during the pandemic, allowing for specific assistance in addition to that available under the Guidelines. 2020 O.J. C 0911 [hereinafter Temporary Framework]; *see also* Communication from the Commission C(2020) 1863 final of March 19, 2020. It applies to bailouts less than EUR 1.8 million and which comply with some other terms and conditions. The Framework has been amended several times, last by 2021 C 34. Its term has also been extended and it is currently in force through 2021. The aid in the Guidelines is understood to be allowed under the scope of Article 107(3)(c) TFEU and is subject to the "one time, last time" principle as per paragraph 8 of the Guidelines, *supra* (*i.e.*, aid can generally only be received once within a 10-year period). The Temporary Framework provides for different types of state aid that would be compatible with previous aid received under Article 107(3)(c) TFEU: the compensation of direct damages suffered under exceptional circumstances allowed under Article 107(2)(b) TFEU and the additional temporary state aid measures approved under Article 107(3)(b) when there is a serious disturbance of the economy of a Member State (a situation that, according to the European Commission, applies to the COVID-19 pandemic). The Temporary Framework also contains provisions that, although less helpful in assisting with the definition of critical/systemic firms, provide interesting insights as to the principles that should guide the treatment of bailouts of these firms. This issue will be discussed in Part III below.

78. *Id.* at 3; *see also* Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application Articles 107 and 108 of the Treaty, O.J. L 187 of 26.6.2014 p.1 (highlighting the guidelines for the exemption regulation for member states).

79. The Guidelines, *supra* note 77, at para. 43.

80. *Id.* at para. 44.

81. *See* NOVAK, *supra* note 58, at 140.

such specific economic activities are considered special is because they affect “*juris publici*,” i.e., rights belonging to the public at large.⁸² This approach, developed in the United States at the turn of the 20th century, was construed from traditional English common law principles, particularly those relating to “public” or “common callings” (the most famous of which was the “common carrier”). To this, additional layers were added as the states built their general “police power” and established the first corporate regulations in the state charters of incorporation.⁸³ During the first decades of the last century, this “public utility” regulation had a prominent position in U.S. legislation and public policy.⁸⁴ But after the New Deal, it disappeared from policy discourse and lawmaking.⁸⁵

However, in the past few years, the approach has been experiencing a strong revival thanks to influential voices within the law and political economy scholarship.⁸⁶ The proponents of this tradition of the “public utility” have updated the original framework to our current world, and the focus now is on the concept of “infrastructural goods and services.”⁸⁷ The main characteristics of what constitutes such “infrastructural goods and services,” which are candidates to be subject to a special regulatory regime (as the public utilities were at the turn of the 20th century), will also prove helpful to us when delineating the contours of critical/systemic firms in this article. These characteristics are (i) the existence of economies of scale for the production/provision of the goods or services, (ii) the position of the company as point-of-access to a wide range of downstream uses, and (iii) the vulnerability of the social infrastructure to private power or domination.⁸⁸ We are thus talking of firms which are involved in the production and provision of public goods that are a gateway for other goods and services generally needed by citizens to conduct their normal lives⁸⁹ and that, absent regulation, are susceptible to some form of private control because certain operators are capable of reaching a privileged position due to the scale of such firms.

82. *Id.* at 146.

83. *Id.* at 143, 145. See *id.* at 154, for further details on the historical genesis of the “public utility” concept.

84. See *id.* at 141.

85. See *id.* at 142.

86. See Rahman, *supra* note 58, at 914.

87. See *id.* at 926.

88. *Id.* at 926–27.

89. This characterization is similar to that used by Shlomit Azgad-Tromer when she defines “socially important” institutions as *ex ante* candidates for bailouts and requires a “situational monopol[y] of an essential industry.” Shlomit Azgad-Tromer, *Too Important to Fail: Bankruptcy Versus Bailout of Socially Important Non-Financial Institutions*, 7 HARV. BUS. L. REV. 159, 162 (2017).

4. *State-owned Enterprises (SOEs) and “Golden Shares”*

State-owned enterprises normally respond to the need for the government to directly intervene in the market economy for very specific reasons, mainly to support national interests (*e.g.*, to generate income through natural monopolies, protect a nascent industry, or provide certain goods or services in competition with the private sector) or to address market failures (provision of public and common goods, externalities).⁹⁰ In the EU context, there is a clear focus on “network” industries, such as energy, railways or telecommunications, as the natural fit for SOEs.⁹¹ These are industries characterized by the existence of significant externalities and the provision of public goods.⁹²

“Golden shares” represent an evolution from government’s direct ownership of critical enterprises.⁹³ When EU governments started privatization processes in the late 1990s with a view to achieving the fiscal requirements established for access to the monetary union, they decided that, given the relevance of these companies and the services they provided, they should retain some degree of control despite parting with all (or most) of their economic ownership interests.⁹⁴ In some cases, this control was established through corporate protections or ownership of special classes of shares and in many other cases through regimes established under the relevant public laws of the respective jurisdiction before or concurrently with the privatization of the relevant companies.⁹⁵ The powers through which such “golden shares” were exercised were essentially limits to voting rights, the establishment of certain veto rights, or special powers to appoint a certain number of members of the board of directors of the privatized company.⁹⁶ The companies that remained “protected” through this regime despite their privatization tended to be involved in utilities/energy (*e.g.*, EDP—Energias de Portugal, Endesa, SNEA—Société Nationale Elf Aquitaine (now Total)), infrastructure and transportation (*e.g.*, BAA (now Heathrow Airport Holdings)), telecommunications (*e.g.*, Portugal Telecom, Telefónica), defense-related activities (*e.g.*, Rolls-Royce, BAE Systems), or (allegedly) critical manufacturing (*e.g.*, Volkswagen).⁹⁷ Though

90. See ORG. FOR ECON. COOP. AND DEV., OWNERSHIP AND GOVERNANCE OF STATE-OWNED ENTERPRISES 19 (2018); see also ORG. FOR ECON. COOP. AND DEV., OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES 17–21 (2015).

91. Directorate-General for Economic and Financial Affairs, *State-Owned Enterprises in the EU: Lessons Learnt and Ways Forward in a Post-Crisis Context*, Institutional Paper 031, at 1–2, 7 (July 2016).

92. See *id.* at 6.

93. See Andrea Biondi, *When the State is the Owner – Some Further Comments on the Court of Justice ‘Golden Shares’ Strategy*, in COMPANY LAW AND ECONOMIC PROTECTIONISM 95, 96 (Ulf U. Bernitz & Wolf-Georg Ringe eds., 1st ed. 2010).

94. See Jonathan Rickford, *Protectionism, Capital Freedom, and the Internal Market*, in COMPANY LAW AND ECONOMIC PROTECTIONISM, *supra* note 93, at 54, 56.

95. See *id.*

96. *Id.* at 58.

97. *Id.* at 58 nn.16, 59–63, 66–67.

the challenge of these regimes before the Court of Justice of the European Union is an extremely important topic affecting the (legally permissible) structuring of ownership interests resulting from a bailout,⁹⁸ for our purposes in this Section, that is secondary to the specific types of companies that the EU Member States' governments made subject to the respective regime in the first place.⁹⁹

* * *

When considering all these types of regulation together, the following principle emerges: continuation (liquidation) of critical/systemic firms 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, and thus the loss allocation as per the bankruptcy laws is not socially acceptable. These externalities manifest themselves mainly because critical/systemic firms provide society with a public good (including essential services that would otherwise not be provided) or an “infrastructure” which is necessary for the functioning of the economy. At the same time, this characterization of critical/systemic firms includes enterprises important for the stabilization of the economy and the limitation of the macroeconomic costs that would be imposed on the social security system (and on individuals) as a result of a significant shock to the labor market resulting from the liquidation of this type of firm.¹⁰⁰ There are other manifestations of externalities in the context of critical/systemic firms, namely ripple effects resulting for the economy as a consequence of their failure.¹⁰¹

Very few other characterizations have been attempted in the literature,¹⁰² but the phenomenon of (non-financial) critical firms is sometimes discussed, even without attempting to characterize them, from a purely practical perspective.¹⁰³ Concepts such as “situational monopoly,”¹⁰⁴ despite the

98. See discussion *infra* Section IV.A.

99. To our knowledge, no case decided before the European Court of Justice on these matters has allowed a differential treatment based on the characteristics of the company subject to the “golden share.” There are different groups of cases based on the type of mechanism that implements the “golden share” but not on the type of company. See Rickford, *supra* note 94, at 59.

100. Hence, both the allocation and stabilization aspects of government intervention must be considered. See Azgad-Tromer, *supra* note 89, at 160–61. Bailouts do not seem to be the adequate tool to conduct distributional intervention. Cf. Louis Kaplow & Steven Shavell, *Why the Legal System is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667, 667–68 (1994) (arguing that legal rules are a worse tool for redistribution than income taxes). On the goals of the economic intervention of the state in economic policy, see generally AGNÈS BÉNASSY-QUÉRÉ ET AL., *ECONOMIC POLICY* 17–32 (2d ed. 2019).

101. See Azgad-Tromer, *supra* note 89, at 162.

102. See *id.* at 181.

103. See Oscar Couwenberg & Stephen J. Lubben, *Not a Bank, Not a SIFI; Still Too Big to Fail*, 35 EMORY BANKR. DEV. J. 53, 55 (2019).

104. See Azgad-Tromer, *supra* note 89, at 165, 171–73 (discussing the “situational monopoly” concept in the context of urgent healthcare).

differences with our framework, seem to be hinting at similar issues that can be captured more precisely with the concept of externalities, as developed in this Article.

At the same time, it is important to note that what counts as a relevant positive or negative externality in a particular jurisdiction is jurisdiction-specific, reflecting the collective preferences in that jurisdiction. Hence, a company which may be critical/systemic in one jurisdiction may not be critical/systemic in another.

B. The Bankruptcy Process and Public Interests

Against the background of the described externalities as the key element (or property) of a critical/systemic firm, the next step is to assess whether bankruptcy is a good option or not for such a firm. We discussed the suitability of bankruptcy generally in Part II, but we are now considering a very specific and much narrower subset of firms, and thus, we must address some other important issues.

First, there are far fewer businesses in this cohort. Hence, the argument against bankruptcy based on the negative effects caused by system overload does not apply with equal force to critical/systemic firms. However, the impaired ability of bankruptcy systems to work effectively under the conditions of the pandemic might also negatively affect its usefulness as a crisis tool for critical/systemic firms. A large truck will not find a place in a large garage if it is already full with many small cars.

More importantly, the expected bankruptcy costs are higher for critical/systemic firms compared to other firms—both in absolute and possibly also in relative terms.¹⁰⁵ Critical/systemic firms are not only large but often also publicly traded.¹⁰⁶ Hence, they are hit by changing market perceptions as to the firm's future and loss of trust much more severely than other firms.¹⁰⁷ In addition, the need for a swift resolution is stronger because of the correlation between time spent in bankruptcy proceedings and bankruptcy costs.¹⁰⁸

105. See EDWARD I. ALTMAN ET AL., *supra* note 26, at 71–81, discussing the inconclusive evidence on the indirect costs of bankruptcy. However, there is research focusing on specific aspects affecting the level of indirect costs in certain industries that would increase with size. See, e.g., Ali Hortaçsu et al., *Indirect Costs of Financial Distress in Durable Goods Industries: The Case of Auto Manufacturers*, 26 REV. OF FIN. STUD. 1248, 1249 (2013); see also Morrison, *supra* note 18, at 461–62 (noting that “[t]he current regime is just more costly for taxpayers when systemically important institutions fail than one that permits immediate federal takeover” which he links to the swiftness and expertise of the regulators (as compared with bankruptcy judges) to minimize such indirect costs).

106. See Morrison, *supra* note 18, at 449.

107. Azgad-Tromer, *supra* note 89, at 174.

108. Lynn M. LoPucki & Joseph W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases*, *supra* note 26, at 114 (“Firm size and case duration were the principal

Second, the most important issue is the presence of the aforementioned externalities. By definition, such externalities fall on parties external to the companies which would be subject to a bankruptcy process. In key Western jurisdictions (such as the United States and the United Kingdom), these parties have no or only a very limited say in any decisions to be made during the proceedings.¹⁰⁹ In other jurisdictions, bankruptcy laws and proceedings grant to those external stakeholders certain (direct) rights or (indirect) protections, through third parties that are actually a party to the bankruptcy proceedings.¹¹⁰ This results in a narrower scope for government intervention through bailouts, as some of the externalities are appropriately internalized through the exercise of the aforementioned rights and protections. But a large share of these externalities remain unaddressed under “regular” bankruptcy provisions even in those jurisdictions.

Bankruptcy is a public process attending mostly to private interests of those participating in it and in which the debtor and its creditors attempt to sort out the debtor’s financial problems.¹¹¹ The process is not designed to vindicate public interests going beyond those of the stakeholders in the private entity which finds itself in bankruptcy.¹¹² It is highly unlikely that the benefits (costs) of positive (negative) externalities are taken into account fully when deciding on the optimal course of action in the proceedings. This may result in a significant destruction of social value even if the actors involved (creditors, shareholders and management) act in a perfectly rational way.

A different process led by the government, such as an ad hoc bailout, creates or safeguards (social) value by ensuring that, for example, the effects of

determinants of [fees.]”); see also Lynn M. LoPucki & Joseph W. Doherty, *Professional Overcharging in Large Bankruptcy Reorganization Cases*, *supra* note 26, at 1010–12 (arguing that case duration was a substantial factor in fees because “professionals have the *opportunity* to bill more in . . . longer cases . . .”).

109. See Azgad-Tromer, *supra* note 89, at 178 (arguing that investors in socially important non-financial institutions are rationally not attempting to preserve positive social externalities during bankruptcy proceedings).

110. For instance, Italian law contains provisions on the forced continuation of a large enterprise resulting in a preservation of employment at the expense of the creditors. Legge 27 ottobre 2008, n.166, in G.U. 28 Oct. 28, 2008, n.252 (the amended Marzano law); decreto legislativo 8 luglio 1999, n.270, in G.U., Aug. 9, 1999, n. 185. (the Prodi-bis law). France makes maintaining employment a factor in judicial reorganization proceedings. CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] art. L631-1. Spain similarly allows the court to take into consideration the preservation of jobs to agree to a lower offer in an auction for the company. B.O.E. 2021, 219. Chinese law offers much stronger protections for stakeholders that Western jurisdictions do not ordinarily consider by requiring resettlement of employees. NATALIE MROCKOVA, *CORPORATE BANKRUPTCY LAW IN CHINA* 74 (2021).

111. See Morrison, *supra* note 18, at 450 (arguing that when a debtor enters bankruptcy, non-debtor counterparties exercise “safe harbors”).

112. See *id.* at 450–51 (arguing that bankruptcy’s safe harbors help counterparties but do not manage market risk).

contagion¹¹³ and on the labor market¹¹⁴ are considered when deciding whether the critical/systemic firms should continue operating or not, and how it might best be restructured. This could not happen within a “regular” bankruptcy process, and therefore the relevant actors might decide on a liquidation which destroys social value.¹¹⁵ In order to avoid this, these firms need to be kept outside of the bankruptcy process.¹¹⁶

Bailouts and bankruptcy are not mutually exclusive. Both are solutions to financial distress that result from separate decisions.¹¹⁷ And it cannot be ruled out that a bailout may be needed after an unsuccessful attempt at solving the firm’s issues in bankruptcy. Alternatively, a firm may be bailed out but somehow cannot continue to operate profitably after the assistance and needs to seek bankruptcy protection. Bailouts and bankruptcy are both tools with different characteristics, and the specific situation at hand may present necessities that are better catered to by one or the other at different points in time.

IV. A PRINCIPLED APPROACH TO BAILING OUT CRITICAL/SYSTEMIC FIRMS

So far, we have discussed why traditional bankruptcy laws may not be the best tool to address the problems of COVID-distressed companies in general. In addition, we have taken a further step considering the same issue in relation to what we have called critical/systemic companies. This is a subset of companies that, because of their very specific characteristics, may warrant a direct intervention of the government to allow them to survive.

We have mentioned “systemic risk” as one of the key rationales for the use of bailouts by governments. Particularly since the Great Recession (and especially in the realm of financial institutions), a significant regulatory effort has been made in relation to what has been called “macroprudential” regulation; that is, establishing a number of rules and provisions that, *ex ante*, allow us to reduce the level of risk in the economy.¹¹⁸ However, this *ex ante* regulation will not be sufficient in every case to prevent the occurrence of “systemic risk,” which is a specific manifestation of the existence of important externalities

113. Levitin, *supra* note 50, at 455.

114. Zachary Liscow, *Counter-Cyclical Bankruptcy Law: An Efficiency Argument for Employment-Preserving Bankruptcy Rules*, 116 COLUM. L. REV. 1461, 1464 (2016).

115. Azgad-Tromer, *supra* note 89, at 177–78.

116. In a similar vein, scholars have noted that “using bankruptcy to resolve systemically important firms risks the over-politicization of the bankruptcy process and the debasement of its rule of law virtues.” See Levitin, *supra* note 50, at 487.

117. See, e.g., Diane Lourdes Dick, *Bankruptcy, Bailout, or Bust: Early Corporate Responses to the Business and Financial Challenges of COVID-19*, BANKR. L. LETTER, July 2020, at 1–2 (2020).

118. Levitin, *supra* note 50, at 475.

affecting the wider economy.¹¹⁹ Hence, we will always be confronted, to some degree, with the need to react to crises *ex post*. However, being able to react flexibly to address issues that had not been anticipated should not be an excuse for arbitrary interventions.

The stakes may be high, and the parties involved quite important, but the negative consequences of an unconstrained use by states of their ability to bail out critical/systemic firms could be significant. Hence, principles or standards need to be established beforehand to help guide the actions of governments and their officials in these cases. Further, such actions need to be subject to judicial control (ideally after the fact) in accordance with provisions that provide the government with sufficient flexibility to address difficult issues with limited information and under a pressing timeline.¹²⁰

Historically, it was economist and journalist Walter Bagehot in nineteenth-century England who first formulated guiding principles for bailouts.¹²¹ This first attempt at devising the principles that should guide a bailout of financial institutions in a banking crisis, with the government functioning as a “lender of last resort,” was still in the mind of policymakers in the United States when considering the rescue of automakers in 2008.¹²² According to Bagehot, every intervention of the “lender of last resort”¹²³ should be characterized by three key

119. For similar perspectives, see Jeffrey Manns, *Building Better Bailouts: The Case for a Long-Term Investment Approach*, 63 FLA. L. REV. 1349, 1352 (2011); Levitin, *supra* note 50, at 438, 462; Iman Anabtawi & Steven L. Schwarcz, *Regulating Ex Post: How Law Can Address the Inevitability of Financial Failure*, 92 TEX. L. REV. 75, 96 (2013) (in the bailouts context).

120. See, e.g., Pop & Georgiadis, *supra* note 11 (reporting recent judicial interventions in relation to controversial bailouts by EU governments of the French-Dutch airline Air France-KLM (dealt with at the EU level); see also Ramon Muñoz, *Un juez desbloquea el rescate de Plus Ultra al no apreciar “por ahora” ningún delito* [A Judge Unlocks the Plus Ultra Bailout by Not Appreciating Any Crime “For Now”], EL PAIS (August 9, 2021), <https://elpais.com/economia/2021-08-09/un-juez-desbloquea-el-rescate-de-plus-ultra-al-no-apreciar-por-ahora-ningun-delito.html> [<https://perma.cc/5CRS-752P>].

121. WALTER BAGEHOT, *LOMBARD STREET: A DESCRIPTION OF THE MONEY MARKET* (Great Britain, Henry S. King & Co. 1873).

122. See ERIC A. POSNER, *LAST RESORT: THE FINANCIAL CRISIS AND THE FUTURE OF BAILOUTS* 46–50, 126 (2018); see also STEVEN RATTNER, *OVERHAUL: AN INSIDER’S ACCOUNT OF THE OBAMA ADMINISTRATION’S EMERGENCY RESCUE OF THE AUTO INDUSTRY* (2010). The auto team led by Mr. Rattner thought that “further government funding should come only in exchange for fundamental restructuring that made automakers truly viable” and “all stakeholders... ought to share the pain of such an overhaul.” *Id.* at 53. Republican senator Bob Corker proposed the “Corker’s covenants,” which centered around the requirement for a substantial contribution by creditors, unions and employees. *Id.* at 37.

123. The literature discussing bailouts has traditionally focused on the rescue of financial institutions within the context of a financial crisis. In this context, the government authority bailing out the financial institution is normally referred to as the “lender of last resort,” as the primary way to implement the bail-out in these circumstances was through extending funding that was not available in the market (normally liquidity issues were the core problems affecting the financial institutions). See, e.g., Xavier Freixas et al. *The Lender of Last Resort: A 21st Century Approach* 5 (Eur. Cent. Bank, Working Paper No. 298, 2003), https://papers.ssm.com/sol3/papers.cfm?abstract_id=487484 [<https://perma.cc/B862-99DJ>]; cf. Manns, *supra* note 119, at 1352, 1383–94 (proposing an “investor of last resort” independent federal agency in charge of bailouts).

features: (i) lend as widely as possible, (ii) against good collateral and (iii) at a high rate of interest.¹²⁴ These principles were established to address a specific type of bailout for a narrow subset of companies,¹²⁵ but they have been used in practice by policymakers to frame responses for other more intrusive interventions and to be applied to firms in other sectors.¹²⁶ As such, we think that they are a good starting point for the discussion of the principles that we are proposing in this Part.

In our view, the following four principles ought to guide the actions of government when considering (or implementing) an ad hoc bailout of a critical/systemic firm: proportionality, efficiency, equity, and transparency. These principles are essential to establish the legitimacy of the government intervention, which is crucial if we aspire to justify it as an appropriate use of government power.¹²⁷ If government is conducting a public intervention with public money to pursue public objectives, it follows that, at the very least, we need to ensure that such intervention is perceived as legitimate by society.

A. *Proportionality*

The first principle concerns the proportionality of the intervention. Given the significant uncertainties of the situation—for example, absence of a counterfactual, difficulty in establishing the costs and benefits of the intervention—it is fundamental that the government only intervenes when necessary to achieve its objectives, such as the preservation (minimization) of positive (negative) externalities by ensuring the continuation of the firm as a going concern, and that such intervention is conducted in the least intrusive way possible. This generally means that the government should only take equity stakes in private companies when there is no other feasible alternative to preserve (avoid) the positive (negative) externalities associated with the rescue operation. Further, if it is deemed indispensable to take an equity stake in the company, it must be a temporary one with a clear exit path.¹²⁸

124. See BAGEHOT, *supra* note 121, at 56–57, 65. These criteria have been incorporated to some extent in current regimes such as The Guidelines, *supra* note 77, at paras. 58, 60, which deal with the requirement regarding the “high rate of interest” (expected to be conducive to an early repayment of the funds advanced by the governments). They concern the terms and conditions of the bailouts, making them harsh enough to incentivize repayment of any instruments held by the relevant government as soon as practicable.

125. *I.e.*, a widespread financial crisis, where the government is normally dealing with illiquid but ultimately solvent financial institutions.

126. The main concern of policymakers while applying these principles was addressing moral hazard and minimizing the risk for taxpayers’ funds. However, the way in which this has been historically implemented is problematic, as it is based on what Manns, *supra* note 119, at 1368, calls a “break even” approach, where the government fails to extract an adequate risk-adjusted return.

127. See Levitin, *supra* note 50, at 491–92, 514.

128. See, e.g., The Guidelines, *supra* note 77, at paras. 56–58.

Governments must consider which specific tools they will use to ensure the continued viability of the struggling firm. If provision of a guarantee is sufficient to achieve that end, no funds should be advanced. If funds can be advanced under a loan with sufficient collateral, there is no justification for taking an equity interest, i.e., to commit more risky capital. The government should be operating in the market in a way similar to a private party to avoid market distortions to the extent possible. If the government intervention strengthens the equity position of the firm, the government must be entitled to a commensurate return.¹²⁹

Proportionality requires that, even in such dire circumstances, market distortions¹³⁰ are minimized and that companies are allowed to continue operating without unnecessary meddling from a shareholder that is not particularly adept at running a private business.¹³¹ If the government is required to provide an equity (or equity-like) investment to reinstate and maintain the solvency of the company, there are different ways to structure such an investment so that it is adequately remunerated, maintaining sufficient influence to protect taxpayers' interests without exercising day-to-day control of the operations of the company.¹³² In practice, this should result in governments being reluctant to take positions in ordinary fully voting shares and ensuring that any such participations are restricted in terms of both scope and time.¹³³ An interesting example is provided by the bailout by the German government of Lufthansa in June 2020.¹³⁴ The government ended up with 20% of the equity in the company after a €9 billion investment across the capital structure.¹³⁵ That 20% made the German government the largest shareholder in Lufthansa.¹³⁶

129. See Manns, *supra* note 119, at 1386–87. Similarly, Bagehot advised a “high interest rate,” but this was to ensure a proper return on the risk assumed by the government with the taxpayers’ money, not to incentivize the quick return of funds to minimize moral hazard. BAGEHOT, *supra* note 121, at 15.

130. See, e.g., The Guidelines, *supra* note 77, at paras. 55, 71.

131. This is probably especially the case under the COVID-19 pandemic, as many of the companies requiring bailouts are not in such position because of poor management of the business; therefore, continuation of their current management teams with their industry expertise is most likely the best way to lead to recovery when normal times resume. See generally Directorate-General for Economic and Financial Affairs, *supra* note 91, at 23 (“In the new Member States the return on equity in private firms is in most cases substantially higher than in SOEs”).

132. These interests could go from purely economic, receiving a commensurate return for the risk undertaken with the bailout, to other general policy objectives that are valuable to the government and taxpayers and that could be included as prerequisites or conditions for the rescue. For example, “good citizenship” requirements such as not to pay dividends or repurchase shares until certain milestones are achieved or to achieve certain levels of “green” investments in the business.

133. This is consistent with The Guidelines, *supra* note 77, at para. 49.

134. Lufthansa is the country’s flag carrier airline that was privatized in 1997. See, e.g., Joshua Posaner, *German Government Takes Controls at Lufthansa with Bailout*, POLITICO (May 25, 2020), <https://www.politico.com/news/2020/05/25/german-government-agrees-to-lufthansa-bailout-279392> [<https://perma.cc/E7ER-QWX5>].

135. *Id.*

136. *Id.*

Despite that, the government did not exercise their voting rights on a day-to-day to basis, took only two seats in the twenty-member supervisory board¹³⁷ of the company, and is only keeping the right to convert some of its hybrid-debt investment into an additional 5% equity stake in the event of a hostile takeover.¹³⁸

Similarly, proportionality also requires (together with efficiency and fairness) that the government only assists to the extent necessary, after the pre-existing investors in the firm have done all that is possible to remedy or at least mitigate the situation of distress. In order to assess what this means in practice, it will be helpful to consider two principles with long-standing tradition in EU state aid rules for restructuring aid: “significant own contribution”¹³⁹ and “adequate burden sharing.”¹⁴⁰ Similar requirements have been included in other formulations of key principles applicable to bailout practice in the United States.¹⁴¹ The investors in the firm that is being rescued need to contribute to the rescue of the firm if they are to retain any interest, i.e., they need to absorb at least part of the relevant losses to the extent necessary for the firm to be able to continue operating.¹⁴² Such contribution or sharing is fundamental to ensure that moral hazard is kept to reasonable levels and to maintain the degree of equity necessary to ensure the legitimacy of a bailout. This means that, in practice, ad hoc bailouts will contain an element of ad hoc bail-ins. It is through this ad hoc decision as to which stakeholders and/or counterparties need to participate through the bail-in that government exercises a flexibility not available elsewhere to overcome the risks and issues connected to critical/systemic firms suffering from COVID-induced financial distress.¹⁴³

137. *Id.* In German stock corporations, there is a two-tiered board of directors composed of a supervisory board (*Aufsichtsrat*) and an executive board (*Vorstand*). See, e.g., DELOITTE, THE GERMAN SUPERVISORY BOARD: A PRACTICAL INTRODUCTION FOR US PUBLIC COMPANY DIRECTORS 4 (2021), <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Risk/gx-german-supervisory-board-publication.pdf> [<https://perma.cc/DF7Z-FWLQ>].

138. See *Lufthansa: Thanks for the Support*, FIN. TIMES (June 25, 2021), <https://www.ft.com/content/e05ce98b-2a46-430b-a2eb-b3fd5daf5e69> [<https://perma.cc/PV6A-2PTK>] (on the final rescue package and its volume); Joe Miller, *Lufthansa Board Refuses to Approve Bailout Due to Brussels Demands*, FIN. TIMES (May 27, 2020), <https://www.ft.com/content/cadfcc82-f58c-492a-a881-f9df624de1a7> [<https://perma.cc/JV6U-YE56>] (describing rights attached to the government position). Note that the 25% stake is a statutory threshold under German law that would allow government to block an unwanted takeover attempt. Miller, *supra* note 138.

139. The Guidelines, *supra* note 77, paras. 62–64.

140. *Id.* at paras. 65–69. These requirements are, however, not included in the Temporary Framework, *supra* note 77.

141. RATTNER, *supra* note 122, at 37–38 (referencing the bailout principles for the General Motors and Chrysler bailouts/bankruptcies proposed by the team led by Steven Rattner and Senator Corker).

142. This is one of the two “key structural issues” of bailouts discussed by Levitin, *supra* note 50, at 490–91, where it is referred to as a “haircut.”

143. An important decision to make is whether there should be a benchmark/backstop in the form of the results of liquidation, so stakeholders who receive less than that need to be compensated as part of

Designing a rescue package for critical/systemic firms, which involves a combination of ad hoc bailout and bail-in measures, involves intricate negotiations. Governments cannot simply dictate a bail-in with respect to such firms, allocating a cost to a specific party in a way that is not provided for in ordinary legislation and for which the government does not have an immediate legal authority. Forcing a bail-in outside bankruptcy creates significant problems such as the expropriation of private rights (including the Takings Clause in the United States).¹⁴⁴ But bail-ins are needed, among other reasons, to deal with moral hazard (as explained above, and also related to efficiency considerations), to reduce costs and to ensure fairness in the distribution of the costs and benefits resulting from the bailout.¹⁴⁵

Hence, in the absence of legislative support to simply mandate a bail-in, and if “hijacking” the bankruptcy process to conduct a bailout is not a sensible option,¹⁴⁶ the main practical mode of implementing a bailout of a critical/systemic firm is to structure it so that a (partial) bail-in can be achieved. This should be relatively straightforward in the case of shareholders. Allocating costs to them is simply done by taking an equity participation that dilutes pre-existing shareholders. The matter becomes much more difficult when dealing with creditors or other stakeholders. What has happened in practice is that the need for the (partial) bail-in as a precondition for the bailout has forced creditors to “voluntarily” accept the bail-in—or risk a liquidation where their rights would be worth far less.¹⁴⁷ However, requiring bail-ins creates far too much tension and delays processes to the point where avoidable losses are incurred because of the delay.¹⁴⁸ In other situations, despite the need for a (partial) bail-in for the aforementioned reasons, exacting it at the time would be counter-

their interest that has been expropriated. In accordance with the principle of proportionality, we understand such compensation should be in place to minimize breaches of the pre-existing rights of the parties.

144. See Matthew Berger, *Biting the Hand that Feeds: The Takings Clause and AIG*, 12 J. INT’L BUS. & L., 341, 345–46 (2013) (discussing the U.S. government’s bail-in of AIG and ensuing lawsuit by AIG’s largest shareholder alleging a violation of the Takings Clause).

145. See *infra* Sections IV.B, IV.C.

146. See Levitin, *supra* note 50, at 485. Such “hijacking” of the bankruptcy process is what many scholars claim happened with the General Motors and Chrysler bailouts/bankruptcies of 2009. See Todd J. Zywicki, *The Chrysler and General Motors Bankruptcies*, in RESEARCH HANDBOOK ON CORPORATE BANKRUPTCY LAW, *supra* note 26, at 303; RATTNER, *supra* note 122, at 180–81. We believe that “hijacking” the bankruptcy process to achieve objectives that are not normally expected to be achieved through them (for example, by government exercising its exorbitant powers 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).

147. See, e.g., RATTNER, *supra* note 122, at 172–78 (relating to the auto bailout and creditors holding out). This issue is discussed on a more theoretical level in Yair Listokin & Inho Andrew Mun, *Rethinking Corporate Law during a Financial Crisis*, 8 HARV. BUS. L. REV. 349, 366–80 (2018). See *id.* at 374–78 (referring to the AIG case as an example of shareholders and directors holding out); *id.* at 378–80 (referring to the Lehman Brothers case).

148. See, e.g., RATTNER, *supra* note 122, at 173–76.

productive to the objectives of the bailout.¹⁴⁹ In such a case, it is important to have a tool that allows for the bail-in to be effected at some time in the future when affected creditors are no longer at risk of facing financial distress as a consequence of the bail-in.¹⁵⁰

B. Efficiency

A public intervention by the government to carry out an ad hoc bailout of a critical/systemic firm should also be assessed against the measuring rod of economic efficiency in the sense of the Kaldor-Hicks principle or of cost-benefit analysis. A number of arguments¹⁵¹ may be made against using efficiency in this sense as normative goal, but despite its shortcomings, it still is the most widely used benchmark in public policy.¹⁵²

Since we discuss externalities as a key motivation for the intervention to rescue critical/systemic firms via ad hoc bailouts, it is of the utmost importance that the aforementioned measures of efficiency, when applied to the bailout, properly account for all the relevant costs and benefits that need to be internalized. Some of these externalities may have time-varying characteristics, with their value changing throughout the economic cycle.¹⁵³

Even accepting that the assessment of those externalities will be tentative, it is clear that government needs to conduct the analysis to ascertain the adequacy of the intervention. The fact that there is uncertainty surrounding the exact benefits of the intervention should be an additional supporting argument for proportionality (in the sense of subsidiarity, as discussed above);¹⁵⁴ only when the benefit is clear should we feel comfortable with the significant use of public resources that an ad hoc bailout of a critical/systemic firm entails.

But, even when we are reasonably certain about the increased social value resulting from the preservation (avoidance) of positive (negative) externalities in a specific case, government needs to be acutely aware of the important costs that could result from the intervention, namely in the form of market

149. See Levitin, *supra* note 50, at 440.

150. The simplest practical implementation of such a bail-in is through so-called “force-placed” investments, where the creditor who benefits from the bailout of its debtor issues an instrument to the government in consideration for those benefits. *Id.* at 510–11. The amount to be repaid to the government through the amortization of that investment is then the bail-in. *Id.* This is what Levitin refers to as a “gavage” investment. *Id.* at 510. Levitin claims that an example of such a bail-in measure during the Great Recession was the “forced” equity investment of the U.S. government in Goldman Sachs (a large creditor of AIG who benefitted enormously from its bailout), which “bears strong similarity” to a “gavage” investment even though “the federal government never articulated a connection between forced capital injections and haircuts.” *Id.* at 512.

151. See, e.g., HORST EIDENMÜLLER, EFFIZIENZ ALS RECHSTPRINZIP (4th ed. 2015).

152. See *id.* at 41–57.

153. See, e.g., YAIR LISTOKIN, LAW AND MACROECONOMICS: LEGAL REMEDIES TO RECESSIONS 140–42 (2019).

154. See discussion *supra* Section III.A.

distortions,¹⁵⁵ the creation of moral hazard, or suboptimal governance structures, especially if the state takes a controlling stake in the distressed firm.¹⁵⁶ It is important that no intervention causes material long-term distortions to efficient private bargains.

In general, COVID-distressed firms should only be bailed out if their business model is sound or can at least be re-engineered to make it sound (again).¹⁵⁷ This consideration applies of course to critical/systemic firms as well: any public intervention should be calibrated such that the scope and mode of operation of the critical/systemic firm is adjusted to make it as efficient as possible under the circumstances.¹⁵⁸

In the end, a bailout is a way to allocate costs resulting from a shock.¹⁵⁹ Governments need to make sure that the cost is effectively borne by society in the best possible way.¹⁶⁰ That means that the result needs to make economic sense (normally through a cost-benefit analysis). But it also needs to be acceptable to the polity.¹⁶¹ Accordingly, the way in which the decision-making process surrounding the bailout is organized and its distributive effects (and the fairness thereof) are critical.

C. Equity

By definition, an ad hoc bailout of a critical/systemic firm will consist of a significant transfer of resources from the government (funded by the generality of taxpayers) to a very specific company and/or its counterparties.¹⁶² Such a transfer poses *per se* a number of questions as to the fairness of the intervention and its effects on different people. The government, using public funds for a public purpose, needs to ensure that its public intervention does not unjustifiably favor one constituency over another.

A first issue here is what can be done to further the public purpose. A key element was discussed in Section IV.A above, when we mentioned the need for the government to ensure that it would retain a sufficient influence over a bailed-out firm to protect the taxpayers' interests and that incumbent stakeholders

155. See The Guidelines, *supra* note 77, at paras. 55, 71, 87 (stating the need for rescue aid to satisfy certain conditions).

156. See Levitin, *supra* note 50, at 489–90, 511.

157. See, e.g., CLEMENS FUEST, WIE WIR UNSERE WIRTSCHAFT RETTEN: DER WEG AUS DER CORONA-KRISE [HOW WE SAVE OUR ECONOMY: THE WAY OUT OF THE CORONA-CRISIS 57 (2020).

158. See The Guidelines, *supra* note 77, at para. 55.

159. See SMITH, *supra* note 49, at 8–9.

160. See Block, *supra* note 41, at 992–93, 1002 (detailing the difficulties that the “more dispersed” public will have in opposing unpopular bailouts and asserting that governments should seek to ensure that bailouts do not impose costs on sectors of the public that do not in turn receive a benefit).

161. See *supra* text accompanying note 127.

162. See Manns, *supra* note 119, at 1364; see also Anabtawi & Schwarcz, *supra* note 119, at 105, 109 (describing the manner in which the United States' government employed ad hoc bailouts during the 2008 Financial Crisis).

should contribute to the rescue via a (partial) bail-in.¹⁶³ Another task is to ensure that the intervention is efficient (as discussed in Section IV.B above) and that the relevant externalities¹⁶⁴ are appropriately addressed.

A further question is whether the government should leverage its position as provider of much-needed resources to advance specific policy goals. For instance, if the government is providing resources to a company that is considered to be critical/systemic because of labor market considerations, it is only natural that it will exercise its power to ensure that the company maintains certain employment levels. Similarly, establishing restrictions to the use of funds¹⁶⁵ made available to ensure the viability of the firm—*e.g.*, not using the funds to pay out a dividend or conduct a share repurchase program—would be unobjectionable.¹⁶⁶ Advancing other policy goals that do not directly affect the preservation of the firm—such as “green” goals beyond what is required under “normal” legislation—is certainly subject to debate.¹⁶⁷ It is our view that advancing these other relevant policy goals would be an appropriate and legitimate use of the government’s power in deciding whether to use public funds to rescue a critical/systemic business.¹⁶⁸ Public opinion seems to agree

163. See Levitin, *supra* note 50, at 508–09, 512; see also *supra* text accompanying note 132.

164. There is of course a certain degree of jurisdiction specificity here. The concept of a critical/systemic firm is subject to the collective preferences underlying the economic policy of a particular jurisdiction. See discussion *supra* Section IV.A.

165. Funds should be limited to those necessary to ensure both the viability of the firm and the preservation (avoidance) of the associated positive (negative) externalities, in accordance with the earlier-referenced proportionality principle. See discussion *supra* Section IV.A.

166. Such restrictions are part of the Lufthansa bailout package. European Commission Press Release IP/20/1179, State Aid: Commission Approves €6 Billion German Measure to Recapitalize Lufthansa (June 25, 2020).

167. See, *e.g.*, Temporary Framework, *supra* note 77, at para. 10 (referencing the “green and digital twin transitions” in the EU as important objectives that need to be pursued).

168. See *supra* text accompanying note 132. As the government is using public funds to advance public objectives, it seems appropriate in terms of fairness and proportionality that more forward-thinking policies be employed in these situations, even if their wider roll-out in the economy is not yet a possibility. Notably, with underlying environmental or “green” issues, as in the case of critical/systemic firms, there are huge externalities (and very important international spillover effects), and thus bailouts might be an appropriate place to address them. Public opinion (as proxy for the desires of the taxpayers funding these interventions) is increasingly supportive of conditionality or “good citizenship” requirements, and there have been calls for such measures to be taken in relation to some of the bailed-out companies. See Katherine Dunn, *Climate Conditions on Airline Government Bailouts are Rare – and the Coronavirus Likely Won’t be an Exception*, FORTUNE (June 26, 2020, 11:15 AM), <https://fortune.com/2020/06/26/airline-bailouts-climate-conditions-coronavirus> [<https://perma.cc/BR95-8NSZ>]; see also Sam Morgan, *Spain Underpins Car Sector Bailout with Green Goals*, EURACTIV (June 15, 2020), <https://www.euractiv.com/section/transport/news/spain-underpins-car-sector-bailout-with-green-goals/> [<https://perma.cc/Y53H-PTLJ>] (providing examples of “green strings” being attached to the Spanish government’s recent bailout of automakers); David Meyer, *Germany’s Auto Industry Could Get Billions in Funding to Go Green*, FORTUNE (Nov. 2, 2020, 10:51 AM), <https://fortune.com/2020/11/02/germany-auto-industry-subsidies-green-self-driving-cars-eco-friendly/> [<https://perma.cc/UY2N-HTUK>].

with this approach,¹⁶⁹ and recent research shows that there is higher support for government bailouts among the polity when the rescued companies are perceived to be acting in a proper way in relation to the power they hold and prominent role they play in society, such as by exhibiting good environmental behavior.¹⁷⁰

Thus far, we have discussed the ways in which bailouts can benefit not just the bailed-out firm but also the public broadly. Now we need to turn to the issue of ensuring that the intervention does not bring about negative effects or that, if it does, these are limited and appropriately dealt with. The more general issue in this regard is that of the potential creation of distortions in the market.¹⁷¹ Certainly, there should be sufficient safeguards to ensure that the interests of competitors of the bailed-out firm that do not receive government assistance are taken into account. In this regard, EU state aid regulations provide a good example of institutional safeguards,¹⁷² established to provide fairness and transparency to the process and scope of bailouts and to ensure that competitors that may have claims in relation to their fair (or unfair) treatment are duly heard.¹⁷³

A related area of concern is that of “specially connected” firms that may receive more beneficial treatment. Research on state intervention in the economy and, more specifically, on the political economy of bailouts suggests that there are indeed certain types of firms that are more likely to receive a favorable governmental intervention because of their preexisting relationship with government officials.¹⁷⁴ However, it seems that institutional safeguards in democratic states manage to keep this kind of problem under control.

169. See Camilla Hodgson, *G7 Criticised for Covid Bailouts with No ‘Green Strings’ Attached*, FIN. TIMES (June 2, 2021), <https://www.ft.com/content/fdae5476-28b8-4a81-96b7-55a660f24558> [<https://perma.cc/5VVF-QWEV>].

170. See Emanuele Colonnelli & Niels J. Gormsen, *Selfish Corporations* 11, 22, 39–40 (Chicago Booth Rsch. Paper No. 20-51, 2020), <https://www.chicagobooth.edu/-/media/research/stigler/pdfs/workingpapers/305selfishcorporations.pdf> [<https://perma.cc/2MWT-76VE>].

171. See Joe Miller & Peggy Hollinger, *Lufthansa Chief Says €9bn Bailout Larger than Needed for Survival*, FIN. TIMES (June 3, 2020), <https://www.ft.com/content/5c32cd83-e639-4421-9ae2-8165ecdd5097> [<https://perma.cc/82Q5-N6U7>] (quoting Lufthansa’s CEO, who said the company’s bailout package was “focused on how [the company] can maintain its position as a German global champion, not just how it can avoid insolvency”).

172. The Guidelines include tools such as the structural measures, The Guidelines, *supra* note 77, at paras. 78–79, the market opening measures, *id.* at para. 86, and other procedures aimed at limiting market distortions, *id.* at para. 80. These tools, particularly the structural ones, tend to be a topic of contentious discussions and negotiations between the bailed-out company, the competent national government, the European Commission, and the competitors of the bailed-out company. See Joe Miller, *Lufthansa Accuses EU of Damaging its Business Model*, FIN. TIMES (July 14, 2020), <https://www.ft.com/content/99617bce-73ed-45cb-94c4-f28fd95325be> [<https://perma.cc/GA7C-RGH8>] (discussing the controversial safeguards employed in the Lufthansa bailout).

173. See The Guidelines, *supra* note 77, at paras. 85, 96.

174. See SMITH, *supra* note 49, at 12–14; see also Mara Faccio et al., *Political Connections and Corporate Bailouts*, 61 J. FIN. 2597, 2627–29 (2006).

Finally, equity also manifests itself in procedural safeguards to ensure that the interests of shareholders and creditors are preserved in accordance with established guidelines. This use of safeguards closely relates to our earlier discussion of bail-ins and whether they should be required of creditors as a condition of a bailout.¹⁷⁵ A first question to consider is whether it is fair for government to decide that a specific stakeholder is to suffer a loss on their interest. A second issue is whether there is sufficient justification for the discriminatory treatment of stakeholders when imposing a bail-in on some while not on others. The first issue presents a number of important problems, particularly in relation to the protection of private rights against expropriation. Without attempting to provide a comprehensive answer to this problem, we think it is critical to identify several potentially applicable protections against expropriation in a specific case and to establish the relevant benchmark in reference to which the government should evaluate stakeholders' rights. As to the latter, we think there is a good case to be made for the use of liquidation as the relevant benchmark, because the company would not be viable without the government's intervention in such a case. The second issue is a matter of considering which stakeholders are in a position to best absorb the relevant losses without creating the type of negative externalities that the bailout is trying to avoid.

A key element to ensure equity and fairness involves establishing procedures that guarantee consistency in the decision-making of the government and its officials in a way that is transparent and can be reviewed after the fact by reference to pre-specified criteria or standards.

D. Transparency

Bailouts are an exercise of the "power of the purse" by governments in a way that may have significant distributional effects.¹⁷⁶ Hence, it is vital that the bailout of a critical/systemic firm is conducted for the right reasons, and the public accepts (at least implicitly) as legitimate the use of the funds. The only way in which this can be ensured, in a context in which government (or its agencies implementing the plan) has a high degree of flexibility and discretion

175. See discussion *supra* Section IV.A.

176. See Levitin, *supra* note 50, at 481, 507–08.

to act, is by ensuring that the bailout is conducted by the government¹⁷⁷ publicly and transparently.¹⁷⁸

This general principle, though, needs to be adequately operationalized.¹⁷⁹ In the first instance, this means that relevant and detailed information justifying the intervention and its scope must be disclosed to the public. This transparency with the public should include a comprehensive discussion of the relevant normative criteria applied in the decision to bail out a critical/systemic firm. Such thorough transparency is essential in securing the legitimacy of a government's decision to implement a particular bailout.

This need for material transparency might be difficult to satisfy in real time, particularly if a bailout requires discretion regarding a businesses' inner workings or requires the government to act especially quickly. Even though such circumstances may justify some temporary adjustments to the principle of maximum transparency, full material disclosure ought to be made as soon as possible.

In any event, all decisions relating to the bailout will eventually become transparent because they are subject to *ex post* judicial control.¹⁸⁰ As has already been mentioned, officials should be given sufficient flexibility and discretion in carrying out any necessary interventions, as their time-sensitive nature means that swift decisions must be made to effectively react to new-found circumstances. Importantly, decisions relating to a bailout are typically made in

177. Note that in this article, we have not engaged with a critical question regarding the implementation of bailouts, which is who specifically should have the actual authority to undertake them (e.g., Parliament, the Cabinet, an agency). This is not an oversight nor an indication of this not being a relevant issue. Given the comparative/normative approach that we are following in this article, duly engaging with this matter would far exceed the article's scope. We consider this a critical issue in relation to the legitimacy of the bailout process. For a survey of the main issues and considerations in this regard from a United States perspective, see Levitin, *supra* note 50, at 491; see also Manns, *supra* note 119, at 1384–87.

178. See Van Zwielen et al., *supra* note 2, at 38–39. For a discussion of the relevance of the process level for negotiation and conflict management, see Horst Eidenmüller & Andreas Hacke, *The PPP Negotiation Model: Problem, People, and Process*, OXFORD BUSINESS LAW BLOG (Mar. 17, 2017), <https://www.law.ox.ac.uk/business-law-blog/blog/2017/03/ppp-negotiation-model-problem-people-and-process> [<https://perma.cc/C6BP-UNU6>]. It is also interesting to consider in this regard the publicity regime established in the EU in relation to state aid under Article 108(3) TFEU. See CONOR QUIGLEY, *EUROPEAN STATE AID LAW AND POLICY* 404 (3d ed. 2015).

179. This *ex ante* operationalization will, together with the transparency of the process, provide for the strong legitimacy that these types of interventions require. See Levitin, *supra* note 50, at 491 (“Unless the structure and process of bailouts are clear and maximize political accountability, bailouts’ political legitimacy will suffer . . .”).

180. It is a different question whether bailout decisions are currently open to sufficient judicial control. No explicit reference is included, for instance, in the EU consolidated Temporary Framework. For a discussion of the limited causes of action which exist in the absence of a bailout framework, see Casey & Posner, *supra* note 37, at 535–36. 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.

light of very limited information and working against a counterfactual about which we do not have any certainty.

As previously discussed, bailouts are *ex post* responses to a critical situation and thus are not the best place to utilize specific rules formulated *ex ante*. However, governments can engage in effective *ex ante* action by establishing sufficiently abstract guiding principles which provide policymakers with a framework for decision-making, to ensure that the ultimately-implemented bailout is one that is satisfactory to the public and possesses the required legitimacy. Judicial control, *ex post*, of how the actions of the government and its officials meet such *ex ante* guiding principles is therefore a necessity.¹⁸¹

V. CONCLUSION

The COVID-19 pandemic continues to threaten lives and livelihoods across the world in a dimension not seen since the influenza pandemic of 1918–1920 and the Great Depression of the 1930s.¹⁸² Scholars and policymakers are struggling to identify how best to respond to the financial distress of millions of businesses suffering from the sudden and unprecedented loss of revenues caused by lockdowns.¹⁸³ No consensus has yet emerged on whether bailouts, bail-ins, bankruptcy, or a combination thereof is best suited to contain the pandemic-induced economic damage to firms and the economy as a whole.

In this Article, we have investigated an issue in this context which, so far, has received little attention in scholarly and public debate: namely, whether the general considerations relevant to the policy question on bailouts, bail-ins, and bankruptcy apply equally to what we define as critical/systemic firms. We characterize a firm as critical/systemic if continuation of the firm is associated with significant positive externalities and, conversely, discontinuation with significant negative externalities. Critical/systemic firms often are involved in the provision of public goods in a jurisdiction.

181. See, e.g., Posner, *supra* note 122, at 85–91, 179 (noting that during a crisis, the courts typically defer to the judgement of the government/regulator). Such deference avoids a second-guessing that would delay the intervention and cause harm. See *id.* at 183. However, Posner asserts that there should be a clear procedure through which to assert a claim against the government for their actions conducted for the purposes of the bailout. See *id.* at 179–80. Further, where appropriate, there should be a general *ex post* analysis of the situation by independent government agencies. See *id.*

182. See Lenny Bernstein, *Covid-19 Death Toll Rivals Fatality Rate During 1918 Flu Epidemic, Researchers Say*, WASH. POST (Aug. 13, 2020), https://www.washingtonpost.com/health/covid-19-death-toll-rivals-fatality-rate-during-1918-flu-epidemic-researchers-say/2020/08/13/48e1dbf2-dd01-11ea-b205-ff838e15a9a6_story.html [<https://perma.cc/4A24-8XH6>]; see also Nara Schoenberg, *Comparing COVID-19 with Previous National Crises Such As Vietnam War, Spanish Flu: Historians Weigh in on the Similarities and Differences*, CHI. TRIB., (Sept. 10, 2020), <https://www.chicagotribune.com/lifestyles/ct-life-covid-compare-national-crises-09092020-20200910-ovkxyg36fje6bkfr45k3fr4jta-story.html> [<https://perma.cc/43WK-AJR9>].

183. See discussion *supra* Part I.

We demonstrate how bankruptcy is particularly ill-suited to handle the financial distress of such firms. This is because bankruptcy is a process in which the debtor and its creditors seek to resolve the debtor's financial distress by readjusting the involved stakeholders' claims on the debtor's assets. Central to the bankruptcy process are *private* rights. The process is not designed to vindicate *public* concerns and interests other than the debtor's narrow financial interests.¹⁸⁴ A bankruptcy court is not a forum to adjudicate on positive or negative externalities associated with the financial failure and possible preservation of a critical/systemic firm.¹⁸⁵ This consideration differs from the arguments against the suitability of bankruptcy to handle COVID-induced financial distress of millions of small and medium-sized or even large, but not critical/systemic enterprises.

Hence, bailing out such enterprises often will be a sensible and sometimes even an inevitable decision. However, given the scale of the financial and non-financial interests at stake in such a bailout, it is all the more important that decisions are taken in a principled manner. Therefore, we suggest four principles, which should guide policymakers who have to decide on and implement bailouts of critical/systemic firms: proportionality, efficiency, equity, and transparency. Observing these principles should help policymakers navigate the tricky normative terrain of large-scale bailouts, which will maximize the perceived legitimacy of the government's actions while simultaneously preserving the necessary flexibility and discretion.

184. See Morrison, *supra* note 18, at 450–52; see also discussion *supra* Section III.B.

185. See discussion *supra* Section III.B.