

Public interest in bankruptcy: bailouts and effective regulation

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ABSTRACT

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

From Ellias & Triantis (2021, 2023) to Lipson & Skeel (forthcoming Stan. L. Rev.) the focus has been to provide governmental agencies with the tools to protect the public interest (or, at least, the “limited” public interest that the agency represents) within the bankruptcy proceedings, once it is clear that bankruptcy judges will protect their jurisdiction. This requires governmental agencies to participate (if they are entitled to) in the bankruptcy proceedings in a similar standing as other “private” stakeholders, and to accept the bankruptcy judge as the actor most appropriate to adjudicate on issues that affect the public interest (social value). That this participation may be beneficial for the public interest may be used to justify that accepting the results of cost-externalizing situations is somehow its flip side and thus necessary—though scholars such as Macey & Salovaara (2019) focus on the perversion of regulatory regimes conducted in this way.

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

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