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THE ADMINISTRATIVE STATE IN BANKRUPTCY

Jared A. Ellias and George Triantis***

This Essay analyzes and assesses the approach of governmental entities to the bankruptcy filings of large, regulated companies. Regulated firms often enter Chapter 11 seeking to exploit bankruptcy law provisions that allow them to take actions that their regulators could block outside of bankruptcy, thereby undermining regulatory enforcement and oversight. As a result, governmental entities often react defensively to a bankruptcy filing, asserting that bankruptcy law does not displace their power over the regulated firm. This tactic is often unsuccessful, as we show by describing the doomed efforts of the Federal Energy Regulatory Commission (FERC) to maintain their statutory authority over Chapter 11 firms. We argue that governments would fare better – and the public interest would be better served – if they participated in, instead of resisting, the bankruptcy process, including by acquiring expertise in bankruptcy law and providing financial support to distressed companies. We illustrate this argument with a case study contrasting the approaches of the California State Attorney General's Office and the County of Santa Clara to the 2019 bankruptcy filing of a hospital system, Verity Health System of California. The County of Santa Clara succeeded in achieving its policy goals where the California Attorney General (like FERC) failed, because the County retained bankruptcy lawyers and took bankruptcy law on its own terms, acting in bankruptcy instead of against bankruptcy.

Bankruptcy law in the United States recognizes and pursues multiple goals within a relatively comprehensive institutional framework. While its goal of maximizing going concern value has achieved prominence in academic discourse and judicial opinions, bankruptcy law also shares the broader goal of promoting the public interest.[1] Of

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1. Bankruptcy courts often consider the public interests of workers or customers and their communities. For example, in rejecting a motion to dismiss the bankruptcy of a landlord of residential apartments, a bankruptcy court observed that "the properties have been allowed to languish at a 'mere survival level' while in receivership . . . . [N]o one . . . has even acknowledged the existence of thousands of residents living in these buildings, some of which have indisputably

course, public interest goals guide the work of other institutions of government, including administrative agencies.[2] Therefore, to the degree that there are conflicts between bankruptcy and the executive branch of government, it is not as much one of competing objectives as one of clashing institutions.[3] In a recent opinion, for example, the Fifth Circuit Court of Appeals began by stating that "the question at the heart of this case . . . concerns a clash of two congressionally constructed titans, FERC [the Federal Energy Regulatory Commission] and the bankruptcy courts."[4]

This competitive institutional framing dominates both the academic analysis and the real-world approach of administrative agencies. Commentators have debated whether bankruptcy court or administrative agencies are superior in protecting the public interest.[5] Meanwhile, in practice, the executive branch largely views bankruptcy as a forum for collecting taxes and fines, and otherwise seeks to remove itself and administrative proceedings from the reach of the bankruptcy stay.[6]

In this Essay, we argue that administrative agencies are missing opportunities to leverage the bankruptcy process to achieve policy goals.[7] As we explain below, administrative agencies typically react to

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fallen into disrepair." *In re* Kingston Square Assocs, 214 Bankr. 713, 738–39 (Bankr. S.D.N.Y. 1997). Some scholars have argued that the academic literature has not paid enough attention to the public interest. *See* Melissa B. Jacoby, Corporate Bankruptcy Hybridity, 166 U. PA. L. REV. 1715 (2018); Jay Lawrence Westbrook, *Commercial Law and the Public Interest*, 4 PA. ST. J.L. & INT'L AFF. 445, 450 (2015). Elizabeth Warren pointed out that the current bankruptcy code eliminated provisions from the Bankruptcy Act of 1898 that permitted judges to reject bankruptcy plans and contract rejection motions when approving them raised public policy concerns. *See* Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 356 n. 47 (1993). Nonetheless, bankruptcy law does take the public interest into account in a myriad of ways and the administration of bankruptcy law often changes based on social needs. *See, e.g.*, Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862 (2014) (discussing the rise of quick sales that allow, in theory, firms to avoid liquidation).

2. *See, e.g.*, Fed. Commc'ns Comm'n v. Prometheus Radio Project, 141 S. Ct. 1150, 1152 (2021) (noting that the Federal Communications Commission has "broad authority to regulate broadcast media in the public interest.").

3. In some cases, the clash is not one of expertise and processes but also institutional priorities. The notion that administrative agencies and public entities with limited mandates embrace parochial concerns is obviously a familiar one to administrative law scholars. *See, e.g.*, Rufus E. Miles, Jr., *The Origin and Meaning of Miles' Law*, 38 PUB. ADMIN. REV. 399 (1978). This may also have been at play in the conflict between the California Attorney General and the County of Santa Clara in the Verity Health Systems case discussed in Section V, *infra*.

4. *In re* Ultra Petroleum Corp., 28 F.4th 629, 635 (5th Cir. 2022).

5. *See infra* Section II.

6. *See infra* Section III.

7. This strategic approach can be contrasted with leveraging regulatory authority in bankruptcy to improve the recovery of agency claims for unpaid fines, penalties, or other liabilities. This phenomenon is discussed in Lindsey Simon, *Chapter 11 Shapeshifters*, 68 ADMIN. L. REV. 233, 244–263 (2016) (providing as examples conditioning the approval of the transfer of a license

a bankruptcy filing by taking a defensive posture, and move to limit the authority of bankruptcy law over regulatory matters. This is misguided for three sets of reasons. First, these motions are often unsuccessful in bankruptcy and appellate courts. Second, the agencies miss opportunities to better promote their policy objectives by participating in the bankruptcy hearings and negotiations, especially if they also bring financial support to the table. We discuss these opportunities in Section III.

Third, and perhaps most importantly, the agencies' defensive approach reflects a fundamental misunderstanding of bankruptcy. Bankruptcy is a collective process, designed to engage all stakeholders in a financially distressed debtor with a view to preventing the liquidation of viable operations that would occur if each stakeholder enforced their rights individually.[8] In Chapter 11, creditors and other parties are successful in achieving this goal when they provide a debtor with solutions to their financial distress, often by contributing new value.[9] The legal framework of bankruptcy increases the space for dealmaking that could not otherwise happen outside of bankruptcy and parties serve their collective purpose when they enlarge that space and contribute to a deal. This ideal applies to the stake of the public interest promoted by administrative agencies as much as the stake of commercial or individual creditors.[10] In other words, the pursuit of regulatory goals without regard to either the financial distress of the debtor or the collective bankruptcy process threatens the survival of the going concern and thereby the success of the regulatory goals themselves.[11]

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to a transferee in a bankruptcy sale on the payment of a claim or piercing the corporate veil to collect from an individual owner of the debtor).

8. *See* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (2001).

9. While this is custom in practice, it has also been long-understood by the judiciary writ large. *See, e.g.*, N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984) ("The Bankruptcy Code does not authorize freewheeling consideration of every conceivable equity, but rather only how the equities relate to the success of the reorganization.").

10. *See, e.g.*, *In re* Extraction Oil & Gas, 622 B.R. 608, 627 (Bankr. D. Del. 2020) (rejecting the Federal Energy Regulatory Commission's request for consideration of its policy goals, noting that "[a provision of the Bankruptcy Code] does not mandate that the Court consider public policy or public interest . . . allowing [ ] for companies in bankruptcy to reorganize *is in the public interest*.").

11. Indeed, some of the most successful contemporary activist investing strategies win by positioning the activist as the party steering the company out of bankruptcy and the activist's opponent as obstructionists. *See* Jared A. Ellias & Robert J. Stark, *Bankruptcy Hardball,* 108 CAL. L. REV. 745 (June 2020); Lindsey D. Simon, *Bankruptcy Grifters*, 131 YALE L.J. 1154 (2022). Melissa Jacoby, among others, have rued the rise of the "transaction" paradigm in bankruptcy practice. *See* Melissa B. Jacoby, *Fast, Cheap, and Creditor-Controlled: Is Corporate Reorganization Failing?*, 54 BUFF. L. REV. 401, 430 (July 2006).

Accordingly, we urge government regulators to prefer the strategy of voice over exit from bankruptcy cases.[12] Indeed, there are many tools that governmental entities can exploit to have influence in Chapter 11. For example, governments can contribute new money to aid the debtor's reorganization efforts, such as money for a bankruptcy loan or funds to buy the company's assets out of bankruptcy, as we explained in an earlier article describing the federal government's strategy in the bankruptcies of Chrysler and General Motors, and the California government's central role in the bankruptcy of Pacific Gas & Electric.[13] Value can go beyond money, though, and private parties routinely contribute technical expertise, advocacy, and business savvy.[14] Administrative agencies have an additional potential form of currency by relieving the debtor of burdensome regulation. We argue that governments will fare better in bankruptcy if they seek to "speak bankruptcy" – either by hiring bankruptcy lawyers or by retaining outside counsel – and approaching Chapter 11 cases as opportunities instead of jurisdictional challenges, working to make deals possible rather than imposing roadblocks that ultimately undermine the success of not only the bankruptcy but also the regulatory goals themselves.[15]

Our Essay proceeds as follows. In Section I, we briefly outline the framing of the relationship between the administrative state and bankruptcy as a jurisdictional clash of institutions. This framing engenders what we have termed the "defensive" strategy of agencies in bankruptcy in which they object to the bankruptcy court's jurisdiction, instead of engaging actively with it. The agencies do so by arguing that

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12. Invoking, at least rhetorically, the classic distinction in ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY (1970).

13. Jared A. Ellias & George Triantis, *Government Activism in Bankruptcy*, 37 EMORY BANKR. DEV. J. 509 (2021).

14. *See* Jared A. Ellias, *Do Activist Investors Constrain Managerial Moral Hazard in Chapter 11?: Evidence from Junior Activist Investing*, 8 J. LEGAL ANALYSIS 493–547 (2016); Michelle M. Harner et. al, *Activist Investors, Distressed Companies, and Value Uncertainty*, 22 AM. BANKR. INST. L. REV. 167 (2014); Wei Jiang et al., *Hedge Funds and Chapter 11*, 67 J. FIN. 513, 556 (2012).

15. The bankruptcy system has become something of its own world, with a deep ecosystem of repeat players, policy goals and customs that shape bankruptcy outcomes. *See* Jared A. Ellias, *The Law and Economics of Investing in Bankruptcy in the United States*, SSRN (Feb. 10, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3578170. Bankruptcy lawyers constantly work to innovate within this framework to accomplish goals for their clients. *See, e.g.*, Jared A. Ellias et al., *The Rise of Bankruptcy Directors*, 95 S. CAL. L. REV. (forthcoming 2022). For an argument that these innovations often subvert bankruptcy policy goals, *see* Lynn M. LoPucki, *Chapter 11's Descent into Lawlessness*, 96 AM. BANKR. L. J. (June 2022); Adam J. Levitin, *Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 TEX. L. REV. (forthcoming 2022).

their actions are protected by statutory exceptions to the automatic stay or that the bankruptcy court may not grant orders conflicting with the agencies' processes and prerogatives. In this Section, we also discuss the normative scholarly debate concerning the clash that focuses on comparative institutional competence.

In Section II, we describe the experience of the Federal Energy Regulatory Commission (FERC), a frequent player in bankruptcy given the number of companies from the energy sector that have passed through bankruptcy. FERC's strategy has been largely to seek to escape the clutches of bankruptcy. This approach, however, has resulted mostly in defeats that are punctuated by subsequent requests by FERC's counsel to vacate adverse judicial opinions, in order to limit the perceived adverse impact on the agency.

In Section III, we briefly outline the provisions in bankruptcy law that provide tools to regulatory agencies that are unavailable outside, especially when the government comes with financial assistance for the distressed debtor. Bankruptcy offers regulatory bodies (i) greater transparency into the affairs of the debtor through enhanced disclosure requirements, (ii) an expedited process for adjudication and settlement, (iii) the ability to engage with all stakeholders in the debtor in a single forum, (iv) greater capacity – for example, through the power of majority voting rules and cram down in confirming a Chapter 11 plan, assumption or rejection of contracts or conditioning new financial assistance – to transform the debtor's relationships with all its stakeholders (investors, employees, contract partners, etc.). Outside of bankruptcy, agencies might choose to proceed through rulemaking or adjudication.[16] Engaging in the bankruptcy process provides additional options that are enhanced when combined with financial assistance to the distressed debtor.

We then present in Section IV new empirical evidence from a survey of observed governmental bankruptcy litigation from the large Chapter 11 bankruptcies 2004-2019 showing that it was predominantly focused on claim collection or attempts to avoid bankruptcy jurisdiction. In our sample, public entities seem to seek to harness the heightened powers given to debtors by bankruptcy law only about 3.5% of the time. This suggests that there is much scope for more activist use of the bankruptcy process by governments than exemplified by the defensive strategy of FERC in Section II.

16. SEC v. Chenery Corp., 332 U.S. 194, 202–03 (1947) (holding that it is primarily in the discretion of agencies to decide whether to proceed via rulemaking or adjudication).

A longer treatment of this phenomenon would examine the use of bankruptcy to pursue goals across a range of regulatory policies, such as labor, environment, housing, and energy. In this shorter Essay, we provide in Section V an illustration by contrasting the strategy of the California State Attorney General and that of the County of Santa Clara in the 2019 bankruptcy of Verity Health Systems. The County was notably more successful in achieving its public health objectives by working with bankruptcy instead of against it. Such government activism represents a view of the administrative state *in* bankruptcy instead of *against* bankruptcy.

We then conclude with a few normative comments about the wisdom of the bankruptcy process as a tool of the administrative state. If taken, the path of regulatory agencies from a predominantly defensive to activist posture resembles that experienced by secured creditors over the past several decades. In the 1980s, secured creditors in bankruptcy were characterized in the literature as being at the mercy of the debtors, in whom the Bankruptcy Code had vested control. Today, secured lenders and activist investors are more often viewed as controlling the process. To many commentators, these parties exploit their control in their self-interest, thus raising doubts as to whether the bankruptcy process has improved as a result. One could ask in the same vein whether the bankruptcy process might give savvy agencies too much influence, beyond that justifiable in United States democracy.

I. Bankruptcy Doctrine and Commentary on the Jurisdictional Clash

The Bankruptcy Code anticipates the clash between the jurisdiction of regulators and bankruptcy courts. Bankruptcy is a forum in which parties' legal rights are modified, sometimes without all the consent otherwise required, for the collective good that is often encapsulated in the preservation of going concern value.[17] One set of distinctive features of bankruptcy consists of gatekeeping provisions that determine who is included, who is excluded and who has the option to stay or exit the bankruptcy forum. With respect to debtors who file, the bankruptcy court may deny them access to the bankruptcy system if

17. *See, e.g.*, Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 Yale L.J. 857, 861–68 (1982).

they have filed in bad faith: for example, if their purpose is to avoid adverse regulation without being in financial distress.[18]

Non-debtor parties, such as administrative agencies, are compelled to participate in the debtor's bankruptcy by operation of the automatic stay under Section 362.[19] Government units often contend that they fall under an exception to the automatic stay in Section 362(b)(4) because their roles as regulator are different from that of a creditor with pecuniary interest, or they may seek relief from the stay for cause.[20] If bound by the stay, the non-debtor party then focuses its attention on whether and how its rights will be affected by the resolution of the bankruptcy. There are three principal ways in which an agency might be affected: (i) the debtor can assume a regulated contract that it breached or reject a contract and convert it into an unsecured claim for damages;[21] (ii) the debtor's assets can be sold free and clear of the agency's claims and interests in the property;[22] and (iii) the debtor can bind the agency to a reorganization plan under the majority voting rules of Chapter 11 or through the determination of the bankruptcy judge under the cramdown provision, that the plan is fair and equitable.[23] The reorganization plan may go so far as to contemplate a transaction that would remove assets from the jurisdiction of a regulator.[24]

Under these rules, a regulatory agency's defensive playbook is fairly straightforward, particularly in cases where part of the debtor's motivation in filing is to mitigate the impact of regulation. The strategy starts by avoiding the grasp of the automatic stay and, if unsuccessful, pivots to fighting against modification of its rights by objecting to the

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18. *See, e.g.*, Jake Bleiberg & Michael R. Sisak, *Judge dismisses NRA bankruptcy case in blow to gun group*, Associated Press (May 11, 2021), https://apnews.com/article/nra-bankruptcy-dismissed-a281b888b64d391374f24539a820d60f.

19. 11 U.S.C.A. § 525(a) (2021) also prohibits the government from discriminating against the debtor solely because of the debtor's bankruptcy filing or financial condition.

20. *See* 11 U.S.C.A. § 362(b)(4) (2020); *see, e.g.*, *In re* Berg, 230 F.3d 1165, 1167 (9th Cir. 2000) (discussing the statutory exemption for governmental entities exercising police power from the automatic stay); O'Brien v. Fischel, 74 B.R. 546, 550 (Bankr. D. Hawaii 1987) (the exemption "prevent[s] the bankruptcy court from becoming a haven for wrongdoers."). In some cases, the agency is both a regulator of the debtor's activities in the public interest and an unsecured creditor and this conflict of interest should be monitored by the bankruptcy court. *See* Simon, *Shapeshifters*, *supra* note 7.

21. *See* 11 U.S.C.A. § 365(a) (2020).

22. *See* 11 U.S.C.A. § 363(f). We discuss this provision in Section V, in the context of the case of Verity Health Systems.

23. *See* 11 U.S.C.A. § 1129 (2010).

24. *See, e.g.*, OGJ Online Staff, *California PUC accuses PG&E of 'regulatory jailbreak,'* Oil & Gas J. (Nov. 28, 2001), https://www.ogj.com/home/article/17261337/california-puc-accuses-pge-of-regulatory-jailbreak.

debtor's adverse treatment of executory contracts, the free-and-clear sale of assets or the confirmation of a reorganization plan.[25] As we describe in Section IV, much of the activity of agencies falls under these categories and we provide illustrative examples using the strategy of the Federal Energy Regulatory Commission in Section II.

The doctrine under Section 362(b)(4) is representative. It provides that the filing of a petition does not operate as a stay on the commencement or continuation of an action or proceeding by a governmental unit "to enforce such governmental unit's . . . police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained . . . to enforce such . . . police or regulatory power."[26] The judicial interpretation of this provision distinguishes between retrospective regulation, that seeks to impose a punishment for past misconduct, and prospective regulation, that bears on future conduct. Under the federal statute governing the judiciary and judicial procedure, the debtor can be compelled to comply prospectively with non-bankruptcy laws and regulations[27] and this type of prospective enforcement is typically exempt under Section 362(b)(4).[28] Monetary sanctions for prebankruptcy violations are treated as claims and subject to bankruptcy jurisdiction. This distinction, however, is more clearly stated than applied.[29] As we discuss in the next Section, the bankruptcy treatment of executory contracts subject to government regulation has features of both categories.

Although the Bankruptcy Code addresses the overlapping jurisdictions of regulatory agencies and bankruptcy courts, the code leaves considerable discretion to the bankruptcy courts and the relationship between the two institutions is uneasy. Some scholars have questioned whether the code and the courts are resolving the clash in the optimal manner. In their normative analysis, these scholars focus on the institutional features of the two sets of lawmaking institutions.

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25. There is limited specific protection of the agency's jurisdiction with respect to agencies that regulate the rates of the debtor. *See* 11 U.S.C. § 1129(a)(6) (2010). This strategy is often aimed at protecting the regulatory jurisdiction but in some cases might be used offensively to improve recovery on the agency's unsecured claim against the debtor. *Supra* note 23.

26. *See* 11 U.S.C. § 362(b)(4) (2020).

27. *See* 28 U.S.C. § 959.

28. *See, e.g.*, Ohio v. Kovacs, 469 U.S. 274, 285 (1985); Midlantic Nat'l. Bank v., N.J. Dept. of Env't. Prot., 474 U.S. 494 (1986).

29. If the nonbankruptcy law limits the agency to injunctive remedies, this enforcement is not stayed. *See, e.g.*, United States v. Apex Oil Co., Inc., 579 F.3d 734 (7th Cir. 2009). Agencies may be exempt with respect to monetary claims to the extent that they seek to fix the amount of penalties or damages liability of their debtor in state or federal courts, but their collection efforts are stayed. *See, e.g.*, Solis v. SCA Rest. Corp., 463 B.R. 248 (Bankr. E.D.N.Y. 2011); United States v. Nicolet, Inc., 857 F.2d 202 (3d Cir. 1988).

Over three decades ago, two articles presented competing perspectives on the institutional advantages of administrative agencies and the bankruptcy courts. Theodore Eisenberg emphasized the framework for broader representation of stakeholders in bankruptcy and noted in particular that nonmanagement interests within a regulated company are often not heard in administrative proceedings.[30] Eisenberg saw bankruptcy as an antidote to regulatory capture by dominant interest groups.[31] Drawing on examples of rate increases authorized for electric utilities, Eisenberg observed that "bankruptcy court may absorb some of the political heat that would otherwise focus solely on the regulators."[32] He saw the political independence of bankruptcy courts as being a virtue, given that the flip side of the political accountability of administrative agencies is the potential capture of the regulatory process by concentrated and politically powerful industries.[33]

A few years later, Robert Rasmussen argued that regulatory enforcement should take place mostly outside of bankruptcy because of the expertise of these agencies.[34] He advocated for a more expansive application of the police and regulatory power exception from the automatic stay in §362(b)(4).[35] Given the significance he placed on com-

30. Theodore Eisenberg, *Bankruptcy in the Administrative State*, 50 LAW & CONTEMP. PROBS. 3 (1987) (discussing bankruptcy implications for regulated industries such as electric utilities and railroads, especially at the intersection of rate setting and financial distress). "For example, the decision to construct or complete a power plant is not always within the jurisdiction of the regulatory agency . . . . In bankruptcy, such construction or completion decisions can be reviewed by nonmanagement interests even if the regulatory authority would lack jurisdiction. Such decisions would have to be incorporated into a reorganization plan, where they could be voted upon, and comments upon the decisions could be solicited from all interested parties, including ratepayers." *Id.* at 26.

31. "A bankruptcy court may consider that the regulatory authority is itself an interest capable of advocate-like behavior. The court can provide a check on this vital interest group. Outside bankruptcy, such a check can be obtained only after substantial delay and expense, subject to standards of judicial review of administrative action, and on the basis of a record constructed by the agency itself." *Id.* at 25. He goes on to suggest that "Bankruptcy can again be thought of as extended regulation patching a representational flaw in the basic regulatory framework." *Id.* at 28.

32. *Id.* at n.97.

33. Theodore Eisenberg, *Bankruptcy in the Administrative State*, 50 LAW & CONTEMP. PROBS. 3 (1987).

34. *See generally* Robert Kenneth Rasmussen, *Bankruptcy and the Administrative State*, 42 HASTINGS L.J. 1567 (1991).

35. *See* Robert Kenneth Rasmussen, *Bankruptcy and the Administrative State*, 42 HASTINGS L.J. 1567 (1991).

> The modern conception of agencies is that they are superior to courts because of their expertise and political accountability. Transferring the dispute from the administrative forum to the bankruptcy arena results in a loss of the agency's expertise . . . . The bankruptcy court simply is not equipped to replicate the agency's ability to weigh competing policy concerns.

parative institutional competence, he criticized the reliance of the courts, and supported by the legislative history, on the distinction between regulatory actions that protect public health and safety prospectively and those that protect the governmental unit's pecuniary interest in property of the debtor.[36]

Other commentators have echoed Rasmussen's position and have been troubled by instances where the bankruptcy process may be used in effect as an appeal from, and forum for overruling, regulatory decisions.[37] Indeed, a couple of authors have gone further to suggest that in some respects, the executive branch of government is a superior forum for implementing even the goals of bankruptcy itself, because of its advantages of expertise, political accountability, public participation, flexibility, and certainty.[38]

While this literature frames the issue as one of a choice between two jurisdictions, we suggest that the administrative state could harness the special mechanisms available in bankruptcy to further regulatory policy goals. The domain expertise of regulatory agencies need not be lost but in fact, can be enhanced in the bankruptcy process. This integration of institutional expertise was encouraged, for example, by the Fifth Circuit Court of Appeals in recent cases (discussed in Section II) that address the bankruptcy court's authority to permit the rejection of energy contracts that, outside of bankruptcy, could only be modified by the Federal Energy Regulatory Commission (FERC).[39] While the Fifth Circuit upheld the bankruptcy court's jurisdiction to authorize the rejection of these contracts, it also required that the bankruptcy courts consider carefully the impact of rejection upon the public interest and invite FERC to participate in the bankruptcy hearing as a party-in-interest.

Id. at 1591–92.

36. *Id.* at 1598.

37. *E.g.*, Adam Feibelman, *Federal Bankruptcy Law and State Sovereign Immunity*, 81 Tex. L. Rev. 1381, 1384–85 (2003) (while focusing on sovereign immunity of state governments, makes the broader case that "[a]s a general rule, bankruptcy law and bankruptcy courts should not interfere with the regulatory activities of governmental entities – federal, state, or local.").

38. Rafael I. Pardo & Kathryn A. Watts, *The Structural Exceptionalism of Bankruptcy Administration*, 60 UCLA L. Rev. 384 (2012) (questioning whether Congress should have left the interpretation of the Bankruptcy Code to bankruptcy courts and Article III courts). Pardo and Watts suggest that the policy considerations implicated in the interpretation of the Bankruptcy Code would benefit from the expertise and political accountability of administrative agencies, as well as the forward-looking processes of notice-and-comment regulation that invite public participation. *Id.* at 434–35.

39. *In re* Mirant Corp., 378 F.3d 511 (5th Cir. 2004) (electricity purchase); *In re* Ultra Petroleum Corp., 28 F.4th 629 , 634, 636–37 (5th Cir. 2022) (natural gas shipping contract).

In an earlier Article, *Government Activism in Bankruptcy*,[40] we gave two examples of cases in which the executive branch used bankruptcy proactively to advance its policy goals: the federal government in the Chrysler and GM bankruptcies and the California state government in the bankruptcy of Pacific Gas & Electric. In both examples, the governments also brought much needed financial support – new debt financing in the cases of Chrysler and GM and critical wildfire insurance support in the case of PG&E – and leveraged it to gain a dominant role in the restructuring of the debtors. They applied that influence to promote policy goals of energy sustainability, as well as the protection of workers and wildfire victims.[41] Indeed, the United States government saw the bankruptcy process as instrumentally essential to the financial rescue and restructure of the two auto manufacturers and therefore required those companies to file for bankruptcy. However, as we demonstrate in our review of the FERC experience and our empirical observations of motions and objections brought by regulatory agencies, these instances seem to be exceptions to the usual defensive approaches of governments. Armed with a more activist playbook, government agencies might not only refrain from resisting bankruptcy filings, but may indeed even encourage them in some instances, as the federal government did in Chrysler and GM.[42]

Indeed, in some ways, the evolution of the role of secured creditors in Chapter 11 may provide a roadmap for how governments can become more prominent in bankruptcy practice. In the 1980s, secured creditors were widely perceived by commentators as being profoundly disadvantaged by a bankruptcy regime that appeared to favor shareholders at the expense of senior creditors.[43] Today, in sharp contrast,

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40. *See* Jared A. Ellias & George Triantis, *Government Activism in Bankruptcy*, 37 Emory Bankr. Dev. J. 509 (2021).

41. One could reasonably see the strategy of the federal Department of Justice, state attorneys general and local governments in the Purdue Pharma bankruptcy as leveraging the bankruptcy forum to address policy goals more effectively in dealing with Purdue and the Sackler family owners. *See id*., at 549–60.

42. Adam Feibelman argues that government financial regulators should play a more active role in bankruptcies, observing that "bankruptcy law [is] itself a species of financial regulation, a component of the overall framework regulating a modern financial system." Adam Feibelman, *Bankruptcy and the State*, 38 Emory Bankr. Dev. J. 1, 9 (2022). He notes that "government actors do not contravene bankruptcy policy when they employ the system to advance non-bankruptcy policies within their authority, even when doing so enables the government to take actions and achieve goals that it could not outside of the system." *Id.* at 49.

43. *E.g.*, Lynn M. LoPucki, *The Debtor in Full Control – Systems Failure under Chapter 11 of the Bankruptcy Code? (First Installment)* 57 Am. Bankr. L.J. 99, 99–100, 111–12, 116 (1983); Jerome R. Kerkman, *The Debtor in Full Control: A Case for Adoption of the Trustee System*, 70 Marq. L. Rev. 159, 161, 166, 182–83 (1987).

secured lenders are widely seen to control most large Chapter 11 cases.[44] This is a consequence of secured creditors' (and their attorneys') building a new set of tools for achieving goals in Chapter 11, most importantly restrictive debtor-in-possession financing agreements that constrain the debtor's discretion in the bankruptcy process. The federal government pursued a similar strategy to influence the fate of Chrysler and GM during the 2009 great recession.[45] At the beginning of the pandemic-induced recession, there were several proposals that government support for companies impacted by the pandemic should be steered toward debtors in bankruptcy.[46] Governments could impose conditions that would increase their influence in the bankruptcy proceedings, much as secured lenders have done.[47] One would hope that the transparency of the bankruptcy process keeps government accountable for its use of this mechanism, even if the required notice and hearing in bankruptcy falls short.[48] We return to this use of activist investor strategies in Section III, below, and in our Conclusion.

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44. Elizabeth Warren & Jay Lawrence Westbrook, *Secured Party in Possession*, 22 AM. BANKR. INST. L. REV. 12, 12 (2003); Kenneth Ayotte & Jared A. Ellias, *Bankruptcy Process for Sale*, 39 YALE J. REGUL. 1, 1, 3–4, 6 (2022); Frederick Tung, *Financing Failure: Bankruptcy Lending, Credit Market Conditions, and the Financial Crisis*, 37 YALE J. REGUL. 651, 651, 655–57, 659 (2020); Barry E. Adler et al., *Value Destruction in the New Era of Chapter 11*, 29 J.L. ECON. & ORG. 461, 461–62 (2013); Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 784 (2002); David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 919 (2003); Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 514 (2009). For an argument that the secured lender control story is over-stated in today's bankruptcy world, *see* Vince S.J. Buccola, *Sponsor Control: A New Paradigm for Corporate Reorganization,* 90 U. CHI. L. REV. 1 (2022).

45. *See, e.g.*, Mark J. Roe & David A. Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 747–48, 761 (2010). While many commentators at the time viewed the government's intervention as exceptional, others saw the government as stepping into the familiar "lender control" paradigm that had become unremarkable in Chapter 11. *See, e.g.*, Edward Morrison, *Chrysler, GM and the Future of Chapter 11* 1–2, 8, 747–48, 761 (Colum. Univ. Sch. of L., Ctr. for L. & Econ. Stud., Working Paper No. 365, 2009).

46. *See, e.g.*, Peter M. DeMarzo et al., *Debtor-in-Possession Financing Facility (DIPFF) Proposal*, STAN. GRAD. SCH. BUS. (June 20, 2020), https://www.gsb.stanford.edu/sites/default/files/publication-pdf/dipff.pdf. For an argument that these proposals were not necessary or misguided, *see* Anthony J. Casey, *Bankruptcy & Bailouts, Subsidies & Stimulus: The Government Toolset for Responding to Market Distress*, U. CHI. L. F. 63, 63–65 (2021). https://www.gsb/stanford.edu/sites/default/files/publication-pdf/dipff.pdf. For an argument that these proposals were not necessary or misguided, *see* Anthony J. Casey, *Bankruptcy & Bailouts, Subsidies & Stimulus: The Government Toolset for Responding to Market Distress*, U. CHI. L. F. 63 (2021).

47. Feibelman notes that if the Federal Reserve provided DIP lending, it "would engage in some kind of steering or conditioning the behavior of DIP lenders in the bankruptcies." Feibelman, *supra*, note 42, at 48.

48. *See, e.g.*, Jared A. Ellias & George Triantis, *Congress is ignoring the best solution for troubled companies: bankruptcy*, FORTUNE (May 14, 2020), https://fortune.com/2020/05/14/bankruptcy-cares-act-aid-coronavirus/.

II. The Federal Energy Regulatory Commission's Losing War with the Bankruptcy System

In this Section, we briefly discuss how the Federal Energy Regulatory Commission (FERC) has incurred a string of judicial losses in its ongoing fight against bankruptcy law. FERC's strategic mistake stems from the paradigm through which the agency views bankruptcy as a route by which companies undermine its jurisdiction and a threat to its mandate, rather than a forum within which to accomplish its policy goals.

FERC's regulatory mandate creates tension with bankruptcy law when regulated firms file for Chapter 11.[49] The Natural Gas Act (NGA) and the Federal Power Act (FPA) require that regulated firms seek FERC's approval of rates in both new and existing contracts.[50] FERC must review these gas and power contracts to ensure they are "just and reasonable," not "unduly discriminatory or preferential," and in line with the respective statutes' public policy considerations.[51] This statutory framework comes into tension with the exceptional power bankruptcy law gives to debtors over their executory contracts. Compared to state contract law, debtors have an enhanced right to cure their breaches and reinstate ("assume") contracts that they like. Debtors may also discard ("reject") unprofitable contracts and relegate the rights of their counterparty to unsecured claims in bankruptcy.[52] The bankruptcy judge presiding over the case must approve the debtor's requests to assume or reject contracts, but the standard of review is deferential to the debtor's business judgment.[53] Many debtors file for bankruptcy in order to use this provision to assume contracts they have breached but wish to keep, and to discard or renegotiate contracts that are no longer valuable. In the energy sector,

49. *See, e.g.*, *In re* Ultra Petroleum Corp., 28 F.4th 629, 635 (5th Cir. 2022) ("That question concerns a clash of two congressionally constructed titans, FERC and the bankruptcy courts. Congress has imbued each entity with a significant wellspring of authority.").

50. *See* 15 U.S.C.A. § 717c(d) (West 2005) ("Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public."); 16 U.S.C.A. § 824d(d) (West 2018) ("Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public.").

51. 15 U.S.C. § 717c; 16 U.S.C. § 824d.

52. Under Section 365 of the Bankruptcy Code, a debtor may assume, assume and assign, or reject executory contracts and unexpired leases; *see* Kenneth Ayotte*, An Empirical Investigation of Leases and Executory Contracts in Chapter 11*, (Jan. 2014), https://economics.uwo.ca/news_docs/2014/AyottePaper.pdf.

53. *See, e.g.*, *In re* Phila. Newspapers, LLC, 424 B.R. 178, 181–82 (Bankr. E.D. Pa. 2010).

debtors are attracted to this bankruptcy feature that allows them to discard gas or electricity contracts that would require FERC's stricter permission outside of bankruptcy. The policy implications of contract rejection are very significant: wholesale gas and power contracts are key pieces of long-term energy planning, especially for policy goals of affordable consumer pricing, reliable grids, and the transition to clean energy.[54]

FERC's response to such filings has been to affirm its statutory authority and argue that the bankruptcy court must defer to FERC's administration of these contracts by requiring FERC consent to the rejection of any regulated energy contract.[55] In most cases, FERC is acting in concert with the debtor's contract counterparty, who prefers the existing contract terms and hopes FERC's more stringent standard of review will better protect their contract rights.[56] When its regulatory authority is implicated, FERC typically argues that it has either exclusive or concurrent jurisdiction with bankruptcy courts to oversee the alteration or rejection of any regulated contract, using FERC's own reasonableness standard that incorporates the public policy concerns of the NGA or the FPA.[57] If bankruptcy and their appellate courts were to accept this argument, a debtor would only be able to reject a FERC contract only if FERC itself approved the rejection under its own statutory standards.

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54. *See* Hugh M. McDonald & Neil H. Butterklee, *FERC vs. Bankruptcy Courts—The Battle over Jurisdiction Continues*, 17 Pratt's J. Bankr. L. 68, 68 (2022) (listing FERC's policy interests in contract jurisdiction).

55. *In re Ultra Petroleum*, F.4th 629 at 635; *In re* FirstEnergy Sols. Corp., 945 F.3d 431, 438 (6th Cir. 2019); *In re* Mirant Corp., 378 F.3d 511, 515 (5th Cir. 2004); *In re* PG&E Corp., 603 B.R. 471, 476 (Bankr. N.D. Cal. 2019), *order vacated, appeal dismissed sub nom.* Pac. Gas & Elec. Co. v. FERC, 829 F. App'x 751 (9th Cir. 2020); *In re* Boston Generating, LLC, No. 10 CIV 6528(DLC), 2010 WL 4288171 *3–4 (S.D.N.Y. Nov. 1, 2010); *In re* Calpine Corp., 337 B.R. 27. 30–31 (Bankr. S.D.N.Y. 2006); *In re* Extraction Oil & Gas, 622 B.R. 608, 625–26 (Bankr. D. Del. 2020), *motion to certify appeal granted sub nom.* Extraction Oil & Gas, Inc., No. 20-11548 (CSS), 2021 WL 3722229 (D. Del. Aug. 23, 2021); *In re* Chesapeake Energy Corp., 622 B.R. 274 (Bankr. S.D. Tex. 2020); Gulfport Energy Corp. v. FERC, 41 F.4th 667, 671–72 (5th Cir. 2022).

56. *See, e.g.*, *In re PG&E*, 603 B.R. at 477:

> [Contract counterparties] were concerned that Debtors would try to reject [electricity contracts] in their forthcoming bankruptcy. As a result, they asked FERC to rule that the bankruptcy court and FERC both must approve rejection of a [contract] for rejection to have effect. Promptly thereafter . . . FERC ruled "that this Commission and the bankruptcy courts have concurrent jurisdiction to review and address the disposition of wholesale power contracts sought to be rejected through bankruptcy."

Id.

57. *See, e.g.*, *In re Mirant Corp.*, 378 F.3d at 515 (FERC argued "because the Federal Power Act . . . grants FERC the exclusive authority to regulate the wholesale rates in contracts for the interstate sale of electric power, any rejection of those contracts must occur in a FERC administrative proceeding.").

In fact, FERC has lost repeatedly in federal courts. In the 2004 case of *In re Mirant*, the Fifth Circuit held that a Chapter 11 firm could reject FERC-regulated contracts without FERC's consent.[58] In that case, FERC objected to the attempts by Mirant Corporation ("Mirant") to reject its regulated contracts as a "collateral attack" on FERC's regulatory jurisdiction.[59] The Fifth Circuit sided with the bankruptcy court, holding that that "there is nothing within the Bankruptcy Code itself that limits a public utility's ability to choose to reject an executory contract subject to FERC regulation as part of its reorganization process."[60] However, the Fifth Circuit also said that the bankruptcy court should, in the case of a request to reject a FERC-regulated contract, give the rejection request "heightened scrutiny" to assess its impact on the public interest and that FERC should have a chance to participate in the bankruptcy court hearing.[61]

Since *Mirant*, FERC has repeatedly and unsuccessfully challenged the rationale in that opinion.[62] In 2019, FERC sought to block California utility PG&E–who had not yet filed for bankruptcy–from using Chapter 11 to reject its regulated contracts.[63] In response to petitions from FERC-regulated contract counterparties, the agency issued ad-

58. *Id.* at 524. *But see In re Calpine*, 337 B.R. 27. Contrary to other circuits, the Southern District of New York has previously refused to rule on rejection motions in bankruptcy prior to a determination by FERC, essentially granting the agency exclusive jurisdiction over FERC-regulated contracts. *See id.* at 33. The *Calpine* decision emphasized that a bankruptcy court was the incorrect body to balance the public policy considerations FERC must consider in any contract changes. *See id.* at 38 ("By holding that FERC has exclusive jurisdiction to modify or terminate the Power Agreements in this case, an issue of great public interest will be heard in a branch accountable to the electorate in a forum that specializes in considering the public interest.").

59. *In re Mirant Corp.*, 378 F.3d at 520. FERC attempted to rely on the filed-rate doctrine in this argument, which holds "[t]he reasonableness of rates and agreements regulated by FERC may not be collaterally attacked in state or federal courts. The only appropriate forum for such a challenge is before the Commission or a court reviewing the Commission's order." Miss. Power & Light Co. v. Miss. ex rel. Moore, 487 U.S. 354, 375 (1988).

60. *In re Mirant Corp.*, 378 F.3d at 522.

61. *Id.* at 525.

62. In the most recent Fifth Circuit opinion on this issue in 2022, the court described FERC's response to *Miran*t, "At first, FERC acknowledged *Mirant.* But three years ago, FERC decided that *Mirant* need not be followed . . . FERC's decrees pressed the rationale that *Mirant* repudiated: namely, that rejection 'modif[ies] or abrogate[s]' a filed-rate contract [which must, by statute, be approved by FERC]. *Gulfport Energy Corp.*, 41 F.4th at 673.

63. *See* NextEra Energy, Inc. & NextEra Energy Partners, L.P. v. Pac. Gas & Elec. Co., 166 FERC P 61049 (F.E.R.C.), 2019 WL 350693 *1 (F.E.R.C. 2019), *review dismissed, decision vacated sub nom.* Pac. Gas & Elec. Co. v. FERC, 829 Fed. Appx. 751 (9th Cir. 2020), *and vacated sub nom.* Nextera Energy, Inc. & Nextera Energy Partners, L.P. v. Pac. Gas & Elec. Co. Exelon Corp., 177 FERC ¶ 61,162 (F.E.R.C. 2021). FERC's lack of success in *PG&E* should be contrasted with the successful approach of the California State Government and Governor Gavin Newsom, who used an insurance arrangement and state law to score a number of policy wins in the PG&E bankruptcy. *See* Jared A. Ellias & George Triantis, *Government Activism in Bankruptcy*, 37 EMORY BANKR. DEV. J. 509, 536–37, 541 (2021).

ministrative rulings that declared, pre-emptively, that it had "concurrent jurisdiction" with any bankruptcy court to decide whether PG&E could reject a FERC-regulated contract.[64] After filing for bankruptcy, PG&E immediately sought an order from the bankruptcy judge that the agency lacked jurisdiction over PG&E's ability to reject FERC-regulated contracts in bankruptcy.[65] The bankruptcy judge agreed, issuing a declaratory judgment that "(1) FERC d[id] not have concurrent jurisdiction over its decision to permit Debtors to reject (or assume) executory contracts under Section 365; and (2) that the FERC . . . rulings . . . [were] of no force and effect and [were] not binding on Debtors in these cases."[66] When PG&E later decided not to reject the contracts, FERC sought to avoid the adverse future precedential impact of its litigation defeat by asking the Ninth Circuit to vacate the order, and the appellate court agreed to do so.[67]

In 2022, the Fifth Circuit affirmed a bankruptcy court ruling that followed the *Mirant* holding on very similar facts. In *In re Ultra Petroleum*, FERC once again argued that the Fifth Circuit should revisit aspects of the *Mirant* decision to avoid subjecting FERC-regulated contracts to the exclusive jurisdiction of the bankruptcy court.[68] The Fifth Circuit declined to do so, noting that "what FERC casts as a pitched battle [between FERC and the bankruptcy court] is actually a settled truce . . . [w]e are not permitted to stray from *Mirant*'s holding even if we were so inclined (which we are not)."[69] The panel noted that FERC-regulated contracts do require "a higher standard" than the typical contract rejection fact pattern, in line with *Mirant*'s "consideration of the public interest."[70] FERC, the Fifth Circuit said, must be invited to participate in bankruptcy court litigation.[71] Government

64. *NextEra Energy & NextEra Energy Partners*, 2019 WL 350693 at *7–8.

65. *In re PG&E Corp.*, 603 B.R. at 476.

66. *Id.* at 490.

67. Pac. Gas & Elec. Co. v. FERC, 829 F. App'x 751, 755 (9th Cir. 2020). However, the Ninth Circuit also vacated FERC's previous orders regarding PG&E's FERC-regulated contracts, removing their precedential power as well. *Id.* at 755–56.

68. In *In re Ultra Petroleum*, FERC did not dispute the portion of the *Mirant* holding that said that a bankruptcy court can approve a debtor's request to reject a FERC-regulated contract. *See In re Ultra Petroleum Corp.*, 28 F.4th at 639. FERC did, however, take issue with the "the statement [in *Mirant*] that FERC could not enforce full performance and payment under a rejected contract" if the bankruptcy court allowed rejection. *See id.* FERC argued this language in the *Mirant* panel's decision was dicta. *See id*. The Fifth Circuit decided that the challenged statements were, in fact, not dicta. *See id* at 639–40.

69. *Id.* at 639.

70. *In re Ultra Petroleum Corp.*, 28 F.4th at 642. The Fifth Circuit said that any bankruptcy court considering contract rejection must "'ensure that rejection does not have cause any disruption in the supply of electricity.'" *Id.*

71. *Id*. at 642–43.

agencies are always welcome to participate in bankruptcy cases as a "party-in-interest" under bankruptcy law. So, the effect of this line of cases is to compel FERC to participate in the bankruptcy process instead of proceeding under its separate administrative authority.[72]

FERC returned to the Fifth Circuit that same year in the bankruptcy of Gulfport Energy Corporation.[73] When Gulfport was in financial distress but had yet to file for bankruptcy, FERC passed preemptive orders on request of a contract counterparty (Rover Pipeline) affirming that the public interest does not require any modification or abrogation of the transportation agreements with Rover and that the debtor would need FERC approval before rejecting in bankruptcy.[74] Gulfport subsequently filed for bankruptcy, moved to reject its agreements with Rover, and petitioned the Fifth Circuit Court of Appeals for review of FERC's earlier orders. After noting that the NGA gives FERC authority over attempts to modify or abrogate covered contracts, the Fifth Circuit held that "rejection is just a breach; it does not modify or abrogate the filed rate, which is used to calculate the counterparty's damages. So, FERC cannot prevent rejection. It cannot bind a debtor to continue paying the filed rate after rejection. And it cannot usurp the bankruptcy court's power to decide Gulfport's rejection motions." The Fifth Circuit then vacated the challenged FERC orders.[75]

In sum, FERC's bankruptcy strategy has led to a somewhat predictable dance. A company that wishes to reject or modify a FERC-regulated contract files for bankruptcy and FERC responds by taking action – as in PG&E, sometimes pre-emptively – to try to keep the bankruptcy court from serving as the forum for modifying a FERC-regulated contract.[76] FERC appears in the bankruptcy court to argue that the bankruptcy court is limited to, at best, "concurrent" jurisdiction.[77] FERC loses this argument and and often loses again on its appeals.[78] And, as the PG&E example suggests, FERC is motivated to ask courts to vacate the orders against the agency to avoid the precedential impact of the loss, which then allows FERC to make an argument that these issues have not been decided when the next FERC

72. 11 U.S.C. § 1109.

73. Gulfport Energy Corp. v. FERC, 41 F.4th 667 (5th Cir. 2022).

74. The court in *Gulfport* notes that "FERC asserted 'parallel, exclusive jurisdiction' over the filed-rate contracts. *Id.* at 673–74.

75. *Id.* at 685–86.

76. *See supra* note 64 and accompanying text.

77. *See supra* notes 58, 65, 69 and accompanying text.

78. *See supra* notes 61, 67, 70 and accompanying text.

regulated firm files for bankruptcy.[79] The public interest is likely to be better served if FERC were to leave behind its historically single-minded defense of its jurisdiction, retain bankruptcy lawyers, and actively engage in the bankruptcy hearings and negotiations.

The subordination of the authority of administrative agencies such as FERC over contracts to the bankruptcy process is often the socially optimal institutional decision that, as we explain in this paper, can serve the goals of the administrative agency. FERC's defensive strategy impedes the collective efforts in bankruptcy, and the contribution of bankruptcy judges, to save the going concern of distressed but viable companies. The prices and other terms of FERC-regulated contracts are often central to the resolution of the economic and financial distress of debtors in the energy sector.[80] In turn, the agency's goals cannot be achieved through business entities that are insolvent or financially distressed. This mutual dependence – under which bankruptcy needs the participation of FERC while the regulator needs the bankruptcy process – reflects the core collective nature of bankruptcy that is undermined when an agency prefers exit over voice.

III. The Exceptional Tools Available in Bankruptcy

We have argued that FERC and other agencies would, in many cases, be better able to promote their regulatory goals by working in bankruptcy than seeking to escape it. At a high level, we have explained this by emphasizing the mutual dependence that often exists between the success in meeting policy goals and the resolution of the financial distress of regulated companies. We also argue that bankruptcy is designed as a collective process to serve such interdependent interests and that, in many cases, administrative agencies can leverage the special features of this process to better serve their policy objectives. In this Section, we briefly identify more specifically some of

79. *See* Pac. Gas & Elec. Co. v. FERC, 829 F. App'x 751, 755–56 (9th Cir. 2020). Other agencies follow a similar strategy to FERC's. *See, e.g., In re* Spansion, Inc., 418 B.R. 84 (Bankr. D. Del. 2009), *order enforced sub nom; In re* Spansion Inc., No. 09-10690 (KJC), 2009 WL 3386816 (Bankr. D. Del. Oct. 15, 2009), *vacated sub nom;* Samsung Elecs. Co. v. Ad Hoc Consortium of Floating Rate Noteholders, No. CIV. 09-0835, 2010 WL 2636115 (D. Del. June 29, 2010), and *vacated sub nom;* Samsung Elecs. Co. v. Ad Hoc Consortium of Floating Rate Noteholders, No. CIV. 09-0835, 2010 WL 2636115 (D. Del. June 29, 2010) (subjecting the International Trade Commission to bankruptcy law's automatic stay).

80. In Section I, we noted that in applying the exemption to the automatic stay in 362(b)(4), bankruptcy courts distinguish between regulatory action to punish pre-filing infractions and regulatory action to enforce rules against post-filing activity. *See supra* notes 26–29 and accompanying text. Executory contracts,whether regulated or not,have elements of both categories: they are burdensome liabilities undertaken before bankruptcy that can impede the survival of viable commercial debtors.

those bankruptcy tools that might be used by agencies and are either unavailable or less effective outside of bankruptcy.

The first potential benefit of bankruptcy is the more significant transparency and disclosures of the debtor than are typically available to regulators outside of bankruptcy. Of course, legislation or regulation can require companies to provide information to their regulators. The environmental protection agency, for example, has access to information under CERCLA, RCRA and the Clean Water Act. Without getting into details, we note here that bankruptcy law requires the debtor to file schedules and statements that disclose its assets and liabilities, current income and expenditures, all its executory contracts and unexpired leases and a statement of financial affairs. More information may be obtained from the proofs of claims filed by the various creditors. In addition, Section 343 of the code requires the debtor to attend the first meeting of creditors and to submit to examination under oath at such meeting. In addition, under Federal Rule of Bankruptcy Procedure 2004, the court may allow examination of any entity to obtain information relating to the debtor's acts, conduct, property of the debtor, or its liabilities or financial condition or any matter that may affect the administration of the bankruptcy estate.[81] More generally, by participating in the case, the administrative agency can interact and receive information by participating in or with the creditors' committees.

As a party in interest, a government unit can request the appointment of an examiner to investigate the affairs of the debtor.[82] Whether requested by a government agency or a creditor, the court may order the appointment of an examiner in any case in which the debtor has unsecured liabilities of more than $5 million.[83] While the court has discretion to define the scope of the examiner's investigation,[84] it is potentially very broad: "[to] investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation

81. Fed. R. Bankr. P. 2004.

82. "[A]fter notice and a hearing, the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor . . . if (1) such appointment is in the interests of creditors . . . or (2) the debtor's . . . unsecured debts . . . exceed $5,000,000." 11 U.S.C. § 1104(c).

83. *Id.* at § 1104(c)(2). Note that many bankruptcy courts have interpreted the "mandatory" nature of the examiner statute as still providing the judge with discretion to deny requests to appoint examiners. *See* Jonathan C. Lipson, *Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies,* 84 AM. BANKR. L. J. 1, 3–4 (2010).

84. *See, e.g.*, *In re* Revco D.S., Inc., 898 F.2d 498, 501 (6th Cir. 1990) ("the bankruptcy court retains broad discretion to direct the examiner's investigation, including its nature, extent, and duration.").

of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan."[85] The examiner produces a report that is made available to the creditors' committees and to any other entity as the court designates.[86] Although the focus of the examiner's investigation is unlikely to be directly related to the behavior regulated by the administrative agency, it may well provide relevant circumstantial evidence that assists the agency, such as an examination of prebankruptcy misconduct or financial transactions between affiliated companies.

An interesting case study arising as this Essay goes to press, is the motion by the U.S. Trustee to appoint an independent examiner in the Chapter 11 case of FTX Trading Ltd.[87] It may indicate the limits to government using the tool of the bankruptcy examiner to obtain information needed to achieve policy goals. Many states and financial regulators joined in the motion, arguing that the scale and complexity of potential wrongdoing in FTX implicate wide public interest.[88] The debtor and the Official Committee of Unsecured Creditors opposed the motion largely on the grounds that the cost of an examiner would greatly outweigh benefits to the recovery of the creditors of the company.[89] These parties argued that the public interest is not valid grounds for the appointment of an examiner and that it should be served by government investigations outside bankruptcy, such as those conducted by the SEC, CFTC, Department of Justice.[90] The

85. 11 U.S.C. § 1106(a)(3).

86. 11 U.S.C. § 1106(a)(4)(B).

87. Motion of the United States Trustee for Entry of an Order Directing the Appointment of an Examiner at 1-3, *In re* FTX Trading Ltd., Case No. 22-11068 (Bankr. D. Del. Dec. 1, 2022) [hereinafter *FTX U.S. Trustee Examiner Motion*].

88. State of Wisconsin's Joinder to the Motion of the United States Trustee for Entry of an Order Directing the Appointment of an Examiner at 1, *In re* FTX Trading Ltd., Case No. 22-11068 (Bankr. D. Del. Dec. 21, 2022); The Vermont Department of Financial Regulation's Joinder to Motion for Entry of an Order Directing the Appointment of an Examiner at 1, *In re* FTX Trading Ltd., Case No. 22-11068 (Bankr. D. Del. Jan. 3, 2023); Joinder of the Texas State Securities Board and Texas Department of Banking to the Motions of the United States Trustee, State of Wisconsin, and Vermont Department of Financial Regulation for Entry of an Order Directing the Appointment of an Examiner at 1-3 [hereinafter *FTX Texas Examiner Motion*], *In re* FTX Trading Ltd., Case No. 22-11068 (Bankr. D. Del. Feb. 1, 2023) (also attaching letters of support from government agencies in Alaska, Arkansas, California, Florida, Hawaii, Idaho, Illinois, Kentucky, Maine, Maryland, New Hampshire, New Jersey, North Carolina, Oklahoma, Tennessee, and Washington DC).

89. Debtors' Objection to Motion of the United States Trustee for Entry of Order Directing the Appointment of an Examiner ¶ 6 [hereinafter *FTX Debtors' Objection to Examiner*]; Objection of the Official Committee of Unsecured Creditors to Motion of the United States Trustee for Entry of an Order Directing the Appointment of an Examiner ¶ 13, *In re* FTX Trading Ltd., Case No. 22-11068 (Bankr. D. Del. Jan. 25, 2023).

90. *FTX Debtors' Objection to Examiner* ¶ 11-12.

CEO of FTX, John J. Ray III, added that "[t]his is just too fragile an environment for me to accept yet another seat at the table".[91] In February 2023, Bankruptcy Judge John Dorsey orally denied the government's motion to appoint an examiner, noting that an examiner would likely cost more than $100 million to the estate and, irrespective of its value to government enforcement agencies, it would not be in the interests of the creditors.[92]

The second benefit of the bankruptcy process is that it provides the administrative agency with various avenues along which to participate in judicial decisions affecting the debtor. The agency can benefit from the provision for expedited processes in bankruptcy for the adjudication and settlement of disputes. Beyond its narrow regulatory focus, the administrative agency can pursue its goals also in the broader adjustment or rights and obligations through the bankruptcy process. It is a party in interest and thereby has standing to object to key motions such as the confirmation of a plan or the sale of assets outside the ordinary course of business.[93] If the debtor also owes the agency a monetary obligation, it is a claimholder with rights to vote on the debtor's plan as well as to object to debtor motions.[94] Moreover, Bankruptcy Rule 2018(a) gives the court even broader discretion to permit "an interested entity to intervene generally or with respect to any specified matter." There is a range of matters relating to the continued operations of the company that are brought before the court for authorization and the regulator can be heard at these hearings, even if the matter at hand is tangentially related to the purpose of the regulation. Moreover, given the regulator's expertise in the industry of the debtor, its input through effective advocacy may well be given considerable weight in the context of determinations at the core of the survival of the debtor's going concern.

As a third benefit, the agency who remains engaged in bankruptcy would have a seat at the bargaining table as the debtor and its key stakeholders negotiate a resolution of its financial distress, whether it involves a reorganization plan, a global settlement of disputed claims,

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91. *Id.*

92. Dietrich Knauth, *FTX Bankruptcy Judge Rejects Call for New Investigation into Crypto Exchange's Collapse*, Reuters (Feb. 15, 2023), https://www.reuters.com/legal/ftx-bankruptcy-judge-rejects-call-new-investigation-into-crypto-exchanges-2023-02-15/; Steven Church, *FTX Judge Declines to Tap Bankruptcy Examiner to Probe Collapse*, BL (Feb. 15, 2023), https://news.bloomberglaw.com/bankruptcy-law/ftx-judge-declines-to-tap-bankruptcy-examiner-to-probe-collapse.

93. 11 U.S.C. § 1128(b). Another example is that the agency can object and be heard at a hearing on the approval of the disclosure statement. 11 U.S.C. § 1125(b).

94. A conflict of interest may arise when the agency is responsible both for regulating the debtor's prospective activities and collecting on a prebankruptcy claim. *Supra* note 7.

the assumption and/or rejection of executory contracts and leases, or the free-and-clear sale of assets. Bargaining outside bankruptcy would more likely be a bilateral exercise between the agency and the regulated company. In bankruptcy, the deal space and bargaining options provide for a much richer set of possible solutions. The cost of regulation can be allocated in various ways among the company's various classes of stakeholders. For example, if the debtor company cannot afford the full impact of regulation, the agency can adjust this burden in return for concessions negotiated among the different secured and unsecured creditors. The agency can negotiate directly with individual creditors, including important suppliers and customers of the regulated firm; in contrast, outside of bankruptcy, the agency typically speaks only to the management of the regulated entity. Although the larger number of parties in the negotiation can lead to a greater risk of holdouts, this obstacle is addressed by exploiting or working in the shadow of the rules of class-based majority voting on reorganization plans and the judicial cramdown of plans that the court finds to be "fair and equitable."[95]

The government can enjoy a fourth benefit from bankruptcy if it contributes financial support to the distressed debtor, the support can be conditioned on debtor decisions and bankruptcy events that increase the government's influence over the course of the bankruptcy case. Distressed debtors can obtain fresh funding through debtor-in-possession (DIP) financing under Section 364.[96] These financing arrangements typically come with higher priority debt and are otherwise similar to loans outside of bankruptcy in that they contain covenants and events of default. Private equity firms or hedge funds have been known to provide DIP loans under agreements that support their objective to acquire assets or control of the debtor enterprise.[97] Although the terms of these agreements are subject to judicial scrutiny when the DIP financing arrangement is authorized by the bankruptcy

95. *See* 11 U.S.C. § 1129(a)(8) and 11 U.S.C. § 1129(b)(1).

96. *See* Kenneth Ayotte & David A. Skeel, Jr., *Bankruptcy Law as a Liquidity Provider,* 80 U. Chi. L. Rev. 1557, 1590 (2013); George G. Triantis, *Financial Slack Policy and the Law of Secured Transactions*, 29 J. Legal Stud. 35, 57 (2000); George G. Triantis, *A Theory of the* Regulation *of Debtor-in-Possession* Financing, 46 Vand. L. Rev. 901, 901 (1993).

97. Jared A. Ellias & Kenneth Ayotte, *Bankruptcy Process for Sale*, 39 Yale J. Reg. 1, 3 (2022); Michelle M. Harner et al., *Activist Investors, Distressed Companies, and Value Uncertainty*, 22 Am. Bankr. Inst. L. Rev. 167, 167 (2014); Kai Li & Wei Wang, *Debtor-in-possession financing, loan-to-loan, and loan-to-own*, 39 J. Corp. Fin. 121, 121 (2016); Kenneth Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. Legal Analysis 511, 513 (2009); David A. Skeel, Jr., *The Past, Present and Future of Debtor-in-Possession Financing*, 25 Cardozo L. Rev. 1905, 1905–06 (2004); David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 Pa. L. Rev. 917, 923 (2003).

court, considerable concern has been expressed about the undue influence they can give to the DIP lenders. The Commission of the American Bankruptcy Institute charged with studying reforms to Chapter 11 articulated such a concern over milestones and deadlines in DIP loan agreements, "that relate in a material or significant way to the debtor's operations . . . or to the resolution of the case," such as setting deadlines for the holding of an auction, closing of a sale or proposing a plan and filing of a disclosure statement in connection with a plan.[98] These loan covenants can accelerate asset sales and lead to loss of value that would have been realized through either reorganization or an extended sale process.[99]

There is no categorical reason why a government agency could not provide DIP loans under agreements that promote policy instead of financial investment objectives. An interesting analogous arrangement was the recent use of so-called Blue Bonds in the restructuring of Belize's sovereign debt. The support of the U.S. International Development Corporation was conditioned on covenants that promoted several important conservation goals. Belize agreed to take measures to protect approximately 30% of its ocean, including coral reefs, mangroves and fish spawning sites.[100] In the case of PG&E, California state legislation provided a fund that relieved the utility from the prospect of future liability from wildfires associated with its activities but conditioned it on a reorganization plan that was consistent with the state's climate goals.[101] Given that this support was essential to the survival of PG&E, the conditions gave the Governor and the state very significant leverage over the terms of the reorganization of the utility.[102] We have discussed elsewhere the federal government's use of DIP financing to steer the reorganization of Chrysler and GM in a direction that served the Obama Administration's environmental and

98. COMMISSION TO STUDY THE REFORM OF CHAPTER 11: 2012-2014 FINAL REPORT AND RECOMMENDATIONS, AMERICAN BANKRUPTCY INSTITUTE 80 (2014).

99. *Id.* The Commission did not propose a ban on milestones and deadlines in DIP loan covenants but instead recommended (a) caution in refraining from authorizing them in an interim order and (b) imposing a sixty-day moratorium from the petition date on the effective date of such covenants. *Id.* at 79–80, 83.

100. Clemence Landers & Nancy Lee, *Belize's Big Blue Debt Deal: At Last, A Scalable Model?,* CTR. GLOB. DEV. (Nov. 10, 2021), https://www.cgdev.org/blog/belizes-big-blue-debt-deal-last-scalable-model; *The Government of Belize Partners with The Nature Conservancy to Conserve 30% of its Ocean Through Debt Conversion,* NATURE CONSERVANCY (Nov. 5, 2021), https://www.nature.org/en-us/newsroom/blue-bonds-belize-conserve-thirty-percent-of-ocean-through-debt-conversion/. Notably, the Nature Conservancy would be involved in monitoring compliance *Id*.

101. *See* Ellias & Triantis, *supra,* note 40, at 536–39.

102. *Id.* at 541–42.

labor priorities.[103] In other cases, a government may condition its financial support of a debtor in such a way as to guide the sale of assets into the hands of a buyer that is more desirable to the regulators. Indeed, the government unit may come to the bankruptcy case with the funds to purchase assets of the regulated entity itself, as illustrated by the strategy of the County of Santa Clara in the Verity Health Systems bankruptcy, described in Part V.

IV. Empirical Study of the Bankruptcy Litigation Strategy of Agencies

In this Section, we present the results of an empirical study of bankruptcy litigation between governmental entities and large Chapter 11 firms. While the FERC's defensive strategy described in Section II *supra* is relatively well-known because of the amount of appellate litigation, much less is known about how representative it is and how often public entities and administrative agencies appear as litigants in bankruptcy court. No comprehensive dataset currently exists of such interactions between public entities and corporate debtors in bankruptcy.

Accordingly, we built a new dataset by hand. We began with the list of all large companies that filed for bankruptcy between 2004 and 2019 with more than $250 million in assets or liabilities from Next Generation Research and we downloaded the docket text from each case, to create a dataset that consists of 1,422,819 docket entries from 699 court dockets. We then ran a series of searches to identify all the docket entries that appeared to involve a public entity or administrative entity.[104]

We provide some initial caveats to our analysis, although we do not believe that any of them undermine the generalizability of our conclusions *infra*. First, we are only able to observe regulatory interactions that led to agencies and public entities filing documents with the bankruptcy court. That means we are missing information on the entire universe of interactions which occur less formally, such as over phone calls or through regulatory processes that continued outside bankruptcy even though the firm was in Chapter 11. Second, our search

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103. *Id.* at 525–28.

104. We ran two searches, both of which are broad and underinclusive. We first limited the corpus of 1.4 million docket entries to the 602,127 entries that contained "motion" or "objection." For federal agencies, we then searched for the list of state agencies on the Library of Congress' website (https://www.loc.gov/rr/news/fedgov.html). For state agencies, we returned to the list of motions and objections and searched for "Department" and we then omitted the entries with "Tax," "Revenue," "Finance" or "Financial" as those were almost certainly agencies seeking to collect debts.

terms are not perfect or all-encompassing, and we are likely missing significant numbers of entities, especially administrative agencies below the state level. Since we started our analysis with automated searches instead of manual review of the court dockets, we are also missing a substantial number of observations. As such, we consider this to be an exploratory analysis that provides some high-level insights and sets the table for future research.

With those caveats in mind, our automated searches identified a dataset of 1,026 docket entries.[105] We inspected each of these rows, which identified 540 interactions between a regulator and a Chapter 11 firm, where each interaction had, on average, 1.9 docket entries corresponding to it. For example, a dispute between a given debtor and the Securities and Exchange Commission might appear in our data as two docket entries: one involving a motion from the debtor that mentioned the agency by name and the other involving an objection from the agency. Of the 540 interactions, 318 involved federal administrative entities, 229 involved state entities, 9 involved both federal and state entities and 21 involved local entities (such as the Department of Airports Division of the City of Los Angeles). The 540 interactions involved 711 different public entities. Table 1 lists the agencies with ten or more appearances in the sample.

105. The searches originally identified 1,057 docket entries, thirty-one of which were false positives on manual inspection of the docket text.

Table 1. Agencies with Ten or More Interactions with Chapter 11 Debtor Between 2004 and 2019.

Agency	Number of Appearances
Federal Deposit Insurance Corporation	52
Department of the Interior	46
Environmental Protection Agency	37
Department of Labor	34
Department of Justice	32
Securities and Exchange Commission	19
Ohio Environmental Protection Agency	13
California Department of Toxic Substances Control	12
Department of Health and Human Services	12
Bureau of Land Management	12
Department of Energy	11

To learn more about these regulatory interactions, we read the underlying court filings to learn as much as we could about the nature of the regulator's involvement in the bankruptcy case. To reiterate, we are limited in this exercise in learning what the debtor and the regulator and other parties decided to say in written form on the court docket. After reviewing a random sample, we created a list of six non-mutually exclusive categories that we used to code each interaction. Table 2 below summarizes the categories and the proportion of the sample that falls into the category.

TABLE 2. DESCRIPTION AND SUMMARY OF OBSERVED REGULATOR/CHAPTER 11 DEBTOR INTERACTION.

Category	Description	Proportion of Sample
Regulator Seeks to Collect Debt	Regulator is behaving like a creditor and seeking to get paid money it is owed.	55.2%
Regulator Seeks to Avoid Discharge	Regulator is seeking, either through court order or debtor election, to receive assurance that its debts will not be altered by any bankruptcy plan of reorganization.	5.6%
Regulator Seeks to Continue its Enforcement Action (other than money damages)	Regulator is seeking to continue exercising enforcement power against the debtor, such as by seeking a ruling from the judge that it is exempt from the automatic stay.	44.1%
Regulator Seeks to Protect an Aligned Third Party	Regulator is appearing on behalf of a third party, such as pension beneficiaries or tort victims.	11%
Regulator Seeks to Make Use of Bankruptcy Powers to Expand Regulatory Powers	The Regulator seeks to use tools unavailable outside of bankruptcy, such as motions for the appointment of an examiner or taking advantage of the ability to sell assets "free and clear" of existing interests.	3.5%
Other		13.3%

As the data show, the public entities in our sample are much more likely to appear in court as a creditor seeking payment of a debt (55.2%) or seeking a court order confirming that the regulator's relationship with the debtor is unaffected by the bankruptcy filing and that it can continue enforcement actions (44.1%). Government entities rarely appear in our sample seeking (3.5%) to make use of the expanded powers of bankruptcy law. One example of a more proactive than defensive action by government is the SEC's request for the appointment of an examiner in the bankruptcy of Metropolitan Mort-

gage & Securities Co., that would help the Commission get greater visibility into the financial affairs of the company and at a cost that would be shared by the company's creditors.[106] Another example is the objection of the California Department of Toxic Substances Control and other state agencies to the issuance of a protective order that would shield from public view documents related to PG&E's tort creditors.[107] It is not clear that such information would have been publicly disclosed without a bankruptcy case.

V. Contrasting Governmental Strategies in the Case of Verity Health Systems

This Essay contrasts two approaches that public entities can take to Chapter 11. The first is an institutional contest. From this perspective, the strategy of regulatory agencies is to escape the bankruptcy court's jurisdiction by objecting to the automatic stay and to asset sales or reorganization plans that frustrate the usual course of regulatory action. The second, an activist approach, engages with the bankruptcy process and exploits its advantages to further public policy goals: for example, by engaging in a global settlement or reorganization of disputed claims against an insolvent debtor.[108] In Section II, we described the experience of FERC, who repeatedly and unsuccessfully sought to win the clash with bankruptcy courts. Health care is another regulated sector that has experienced substantial financial distress and bankruptcies, which have been characterized by similar conflicts with regulators.[109] Health care providers are regulated by multiple government agencies at the federal, state and local levels, who enjoy significant authority in granting or revoking licenses, paying for services to patients and policing the quality of care provided.[110] Debtors in bankruptcy often rebuff the jurisdiction of these regulators and the govern-

106. *See* Motion for Order Directing Appointment Of Examiner By Securities and Exchange Commission; Memorandum In Support Thereof, [Docket No. 80], *In re* Metro. Mort. & Sec. Co., Inc., (Bankr. E.D. Wash. Feb. 9, 2004).

107. *See* Objection of the California State Agencies to Motion of the Official Committee of Tort Claimants for Entry of a Protective Order, Docket No. 2634, Case No. 19-30088, *In re* PG&E Corp. (Bankr. N.D. Cal. June 19, 2019).

108. *See, e.g.*, Ellias & Triantis, *supra* note 40.

109. The conflicts between health care regulators and bankruptcy courts are described in Laura N. Coordes, *Reorganizing Healthcare Bankruptcy*, 61 B.C. L. Rev. 419 (2020). Professor Coordes argues for significant reform of the Bankruptcy Code to better accommodate the complexities of healthcare debtors, including the interests of the regulators and patients that may conflict with the financial interests of the debtor and creditors.

110. *E.g.*, the Department of Health and Human Services, the Centers for Disease Control, Center for Medicare and Medicaid Services, the Veterans Administration, the Food and Drug Administration, the Agency for Healthcare Research and Quality. *Id.* at 430–31.

ment agencies usually respond by defending their authority from incursion by bankruptcy courts, whether the debtor purports to reorganize, sell its assets to another entity, or shut down operations.[111]

The 2018 bankruptcy of the non-profit Verity Health Systems ("Verity") illustrates the two alternative approaches to the jurisdictional clash by contrasting the strategies of two government bodies with mutual policy goals of protecting the supply of health care in California. The California State Attorney General (the "California AG") has the discretion to approve and to condition approval of sales of nonprofit hospitals or other healthcare assets.[112] The California AG uses this regulatory authority over nonprofit healthcare entities to condition sales to for-profit buyers to ensure that they do not reduce the supply of quality healthcare, especially to vulnerable constituents in the state.[113] In a practice that accelerated under then-Attorney General Kamala Harris, the California AG often conditioned approval of a sale on the buyer's commitment to maintain levels of services, such as in trauma center or skilled nursing services.[114] In some cases, the conditions were so onerous and restrictive that prospective purchasers abandoned their transactions.[115]

The California AG imposed such terms in approving the sale of Verity in 2015 to a private equity firm, BlueMountain Capital Management.[116] These conditions (which we will refer to as "AG's 2015 conditions") exacerbated the financial distress that Verity had been experiencing for years, which ultimately led to its bankruptcy filing in 2018.[117] At that time, Verity operated six hospitals throughout California,[118] served more than 500,000 patients in 2017[119] and employed

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111. The regulators also may have financial interests at stake. For example, they argue that provider agreements are executory contracts and not assets to ensure that if the agreements are assumed or assigned, all overpayments must be returned in full to satisfy the cure requirement. *Id.* at 439.

112. *See generally* CAL. CORP. CODE §§ 5914–5917 (requiring any nonprofit corporation that operates or controls a health facility to provide written notice to, and obtain the consent of, the California AG).

113. *See In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283, 294 (Bankr. C.D. Cal. 2018).

114. *See* Complaint at 5, 43–44, Prime Healthcare Serv., Inc. v. Harris, No. 16-00778 (C.D. Cal. Sept. 21, 2015), *appeal dismissed,* 17-56380, 2017 WL 6398069 (9th Cir. Oct. 5, 2017).

115. *See, e.g.*, Prime Healthcare Serv., Inc. v. Harris, No. 16-00778 (C.D. Cal. Sept. 21, 2015), *appeal dismissed,* No.17-56380, 2017 WL 6398069 (9th Cir. Oct. 5, 2017).

116. *See* Declaration of Richard G. Adcock in Support of Emergency First-Day Motions Filed by Debtor Verity Health Sys. of Cal., Inc. at 23–24, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

117. *See id.* at 24–25.

118. Melody Petersen, *Verity Health files for bankruptcy protection. Its six California hospitals will stay open*, L.A. TIMES (Aug. 31, 2018), https://www.latimes.com/business/la-fi-verity-health-bankruptcy-20180831-story.html.

over 5,400 workers.[120] In bankruptcy, Verity sought to break free of the AG's 2015 conditions that required it to provide various costly services to the community, such as neo-natal emergency care, and had precipitated Verity's financial distress and bankruptcy filing.[121] The California AG responded by insisting – unsuccessfully – that the bankruptcy court had no authority over those conditions or any that the AG might impose on asset sales in bankruptcy.

In contrast, the County of Santa Clara ("Santa Clara") believed that the enforcement of these conditions was incompatible with the continuation of the two Verity hospitals in its county of over 2 million residents (including the city of San Jose).[122] Therefore, it sought to work on a sale or restructuring of the debtor – at least the two hospitals in the County – that would maintain services in its community, even at the cost of having fewer specialized services at each of the hospitals than mandated by the AG's 2015 conditions.[123] Indeed, the Verity bankruptcy was striking in that, despite their common policy objectives, the two approaches resulted in adversarial conflict between the two levels of government.

Verity had been struggling for years prior to its bankruptcy filing with losses resulting from rising operating expenses and pension costs and low reimbursement rates.[124] By 2018, the company was deeply insolvent, with about $1 billion in liabilities supported by a mere $147 million in assets.[125] For over a decade, Verity had been looking for buyers and merger partners in an effort to restore financial stability and to overcome operational troubles.[126] It had attempted an affiliation in 2012 with a larger hospital chain, but that failed within two years. A subsequent deal to sell its operations to a for-profit buyer in

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119. *See* Declaration of Richard G. Adcock In Support of Emergency First-Day Motions Filed by Debtor Verity Health Sys. of Cal., Inc. *supra* note 116, at 4.

120. *Id.* at 15.

121. *See id.* at 24.

122. In one of the hospitals, 73% of patients were covered by Medicare and Medi-Cal, Sur-Reply to Response of Cal. Att'y General to Debtors' Bid Procedures Motion; Declaration of Alicia Berry at 8, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

123. John Woolfolk, *Santa Clara County Offers $235 Million for O'Connor, St. Louise Hospitals*, San Jose Mercury News (Oct. 2, 2018), https://www.mercurynews.com/2018/10/02/santa-clara-county-offers-235-million-for-oconnor-st-louise-hospitals/.

124. *Id*. at 22.

125. Transcript of Hearing Re: Debtor's Emergency Motion for Entry of an Order Authorizing the Filing Under Seal of Confidential Patient Information at 17, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

126. Transcript of Hearing Re: Debtor's Emergency Motion for Entry of an Order Authorizing the Filing Under Seal of Confidential Patient Information at 15-16, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

2014 had been effectively blocked by the California AG who insisted on conditions that the buyer found unacceptable.[127]

After many attempts to save the company through sales or mergers, the sale to BlueMountain Capital Management was finally concluded in 2015, subject to strict operating mandates under the AG's 2015 conditions.[128] They required Verity to provide a high and broad level of health services, such as minimum numbers of intensive care beds and minimum annual requirements for charity care.[129] These conditions were expressly binding on all successors and assignees, particularly future purchasers of Verity or its assets.[130] BlueMountain invested over $250 million into the company and then sold it to another buyer in 2017, who put another $100 million into the system.[131]

The burden of the AG's 2015 conditions continued to threaten the feasibility and ultimately the survival of Verity's operations.[132] When Verity filed for bankruptcy in 2018, it was quite possible that some or all of its assets would be liquidated. While the system continued to incur losses as a going concern, there were buyers who were interested in purchasing the hospitals in a bankruptcy liquidation to convert their real estate into housing, offices, or retail space.[133] This outcome would be detrimental to the provision of health care to populations in the hospitals' respective regions, which was a grave concern to both the California AG and the County of Santa Clara.[134]

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127. *Id*. at 16.

128. *See* Declaration of Richard G. Adcock in Support of Emergency First-Day Motions Filed by Debtor Verity Health System of California, Inc. at 28, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

129. *Id.* at 24, 28.

130. *See* Response to Debtors' Motion for Entry of an Order Approving Form of Asset Purchase Agreement for Stalking Horse Bidder, and an Order Authorizing the Sale of Property Free and Clear of All Claims, Liens, and Encumbrances; Memorandum of Points and Authorities in Support Thereof at 3, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

131. Transcript of Hearing Re: Debtor's Emergency Motion for Entry of an Order Authorizing the Filing Under Seal of Confidential Patient Information at 16, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

132. *Id*.

133. As Verity subsequently told the bankruptcy court, "the cumulative effect of the [California AG] conditions was to lock the Debtors into a failing business model, dictating . . . minute details of business operations, as well as denying the Debtors the ability to repurpose facilities [to meet market demand]." *See* Declaration of Richard G. Adcock in Support of Emergency First-Day Motions Filed by Debtor Verity Health Sys. of Cal., Inc. at 28, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

134. In one of the hospitals, 73% of patients were covered by Medicare and Medi-Cal, Sur-Reply to Response of California Attorney General to Debtors' Bid Procedures Motion; Declaration of Alicia Berry at 8, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

Each government body, however, pursued a very different strategy and execution. The California AG played defense by insisting, repeatedly and unsuccessfully, that it had power to enforce the 2015 conditions and exercise its regulatory authority free of interference from the bankruptcy court.[135] Immediately after Verity filed for Chapter 11, the California AG's attorneys filed an objection in bankruptcy court, asserting that bankruptcy law does not pre-empt the AG's power to regulate nonprofit hospitals to "protect the public health or safety," including the imposition of conditions on any sale to for-profit entities.[136] The attorneys demanded that any bankruptcy order – including the use of cash or the borrowing of money – be subject to the AG's 2015 conditions.[137]

The California AG's strategy was problematic in two respects. First, it failed to appreciate the economic reality that Verity – or at least many of its operations – could not continue as a going concern under the 2015 conditions that compelled it to offer services whose cost substantially exceeded revenue.[138] As noted previously, the debtor's disclosures in bankruptcy and the close scrutiny provided by hearings tend to produce more transparency into the affairs of the debtor than is often available to regulators outside of bankruptcy. Outside of bankruptcy, a company might argue to its regulator that its conditions are excessively burdensome and are likely to lead to insolvency and cessation of operations. The regulator, however, has limited capacity to verify this claim and may therefore be skeptical. In contrast, as noted in Section III, bankruptcy gives the regulator not only access to debtor disclosures in the form of schedules and statements, but also various rights to examine the debtor and participate in meetings of creditors. These disclosures in the Verity bankruptcy made it abun-

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135. Attorney General's Initial Limited Objection to Debtor's Emergency First Day Motions; Memorandum of Points and Authorities In Support Thereof, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

136. *Id.* at 4. In making this argument, the California AG relied on the seminal case of *Midlantic Nat'l. Bank v. N.J. Dept. of Env't Prot.,* which the Supreme Court found that a debtor could not use bankruptcy law to abandon property "in contravention of state laws or regulations that are reasonably designed to protect the public's health or safety." Midlantic Nat'l. Bank v. N.J. Dept. of Env't Prot., 474 U.S. 494, 496 (1986). In that opinion, the Supreme Court held that the Bankruptcy Act of 1978 inherited a pre-Bankruptcy Code common law doctrine that limited the trustee's ability to abandon property when doing so would conflict with a valid state or federal interest. *See id.* at 500.

137. *See* Attorney General's Initial Limited Objection to Debtor's Emergency First Day Motions; Memorandum of Points and Authorities In Support Thereof at 6, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

138. *See* Debtors' Reply to Response of California Attorney General to Debtors' Bid Procedures Motion at 13–14, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

dantly clear that the organization could not continue to provide health services under the continuing burden of the AG's 2015 conditions.

Second, the California AG missed the opportunity to be a principal participant in negotiating the terms of the resolution of Verity's distress, whether by reorganization or, as it turned out, by sale of assets. Instead, the bankruptcy judge commented in court that after reading the AG's objection, he did not have "much hope" that Verity would be able to reach a consensual resolution with the AG.[139] Its office did not hire bankruptcy lawyers for the Verity case, relying instead on its in-house attorneys, some of whom had some bankruptcy experience.[140] One can hypothesize a bi-directional causal connection: the California AG did not retain bankruptcy lawyers because it sought to be exempt from bankruptcy but also it did not appreciate the benefits from participating in the bankruptcy because it lacked the expertise to do so. As a result, the AG missed the opportunity to participate – even lead – the creation of a collective economic solution that would optimize the continued availability of health services in the state.

While the County of Santa Clara had a similar policy goal – the availability of quality health care to its population – it had different regulatory leverage over Verity outside of bankruptcy and a different bankruptcy strategy. Santa Clara's main interest was to preserve the operations of the two Verity hospitals located in Santa Clara that were a critical part of the community care infrastructure for county residents.[141] As noted earlier, Verity had been struggling financially while trying to save its operations by merger or affiliation with other groups.[142] Santa Clara had looked into buying the two hospitals for some time prior to the bankruptcy.[143] After the bankruptcy filing, Santa Clara took two steps familiar to activist investors but less commonly associated with County governments. First, it hired a leading

139. Transcript of Hearing Re: Debtor's Emergency Motion for Entry of an Order Authorizing the Filing Under Seal of Confidential Patient Info. at 18, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

140. For comparison's sake, the lawyer for Verity would characterize the attorneys for the California AG as "helpful discussion with attorneys for the charitable trust section and a bankruptcy lawyer or at least someone familiar with bankruptcy law from the Attorney General's Office." *See* Transcript of Hearing re: Debtor's Emergency Motion for Entry of an Order Authorizing the Filing Under Seal of Confidential Patient Info. at 18, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151). He noted that he had had "difficulties" with one of the attorneys in a prior case. *See id.*

141. *See supra* note 134 and accompanying text.

142. *See supra* note 48 and accompanying text.

143. John Woolfolk, *Santa Clara County Offers $235 Million for O'Connor, St. Louise Hospitals*, San Jose Mercury News (Oct. 2, 2018), https://www.mercurynews.com/2018/10/02/santa-clara-county-offers-235-million-for-oconnor-st-louise-hospitals/.

national law firm with seasoned bankruptcy lawyers to represent the County's interests in the bankruptcy case.[144] Second, to ensure the survival of the two Santa Clara hospitals, Santa Clara offered $235 million to buy and continue operating them.[145] The County viewed bankruptcy as a forum for acquiring those assets rather than the jurisdictional threat that the California state government saw it as.

On October 1, 2018, about a month after filing for Chapter 11, Verity filed a motion for the court's authorization to sell two hospitals to Santa Clara.[146] While other potential buyers had considered making an offer, Santa Clara was the first to make a formal bid for the hospitals.[147] Other bidders were scared away by Verity's cost of operating under the AG's 2015 conditions.[148] Verity moved for authorization to hold a full auction with Santa Clara's bid as a "stalking horse."[149] An essential part of the motion was that the assets would be sold free and clear of the AG's 2015 conditions. The proposed sale agreement was structured as an overt challenge to the California AG's ability to block the transaction, with a provision in the contract stating that the "approval of the Attorney General of the State of California shall not be

144. Notice of Appearance and Request for Service of Papers, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

145. Declaration of Jeffrey Smith in Support of entry of Order Approving Sale of Certain Assets to Santa Clara County Free and Clear of All Encumbrances at 3, *In re* Verity Health System of California, Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151). There were no other bidders. *See* Transcript of Hearing Re: Motion to Extend Exclusivity Period for Filing a Chapter 11 Plan and Disclosure Statement at 44, 53, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151). Santa Clara could take advantage of a quirk of state health law that provided public hospitals with higher reimbursements than other hospitals for indigent care, which perhaps was the only path to a viable reorganization given that no one was willing to bid against them. *See* Tracey Kaplan, *Santa Clara County Buys Two Financially Struggling Hospitals for $235 Million*, San Jose Mercury News (Dec. 2, 2018), https://www.mercurynews.com/2018/12/10/santa-clara-county-acquires-two-hospitals-winning-auction-by-default/.

146. Response to Debtors' Motion for Entry of an Order Approving Form of Asset Purchase Agreement for Stalking Horse Bidder, and an Order Authorizing the Sale of Property Free and Clear of All Claims, Liens, and Encumbrances; Memorandum of Points and Authorities In Support Thereof at 3, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

147. John Woolfolk, *Santa Clara County Offers $235 Million for O'Connor, St. Louise Hospitals*, San Jose Mercury News (Oct. 2, 2018), https://www.mercurynews.com/2018/10/02/santa-clara-county-offers-235-million-for-oconnor-st-louise-hospitals/.

148. Declaration of James Maloney in Support of Debtors' Notice of Motion and Motion for the Entry of an Order Approving Form of Asset Purchase Agreement for Stalking Horse Bidder and for Prospective Overbidders to Use at 4, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

149. Notice of Motion and Motion for the Entry of an Order Approving Form of Asset Purchase Agreement for Stalking Horse Bidder and for Prospective Overbidders to Use at 107, 131, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

a condition precedent to Purchaser's obligation to close the transactions contemplated by this Agreement."[150]

The California AG filed an objection ten days later, asserting that its jurisdiction to set and enforce conditions on sales of assets by Verity was unaffected by the bankruptcy filing.[151] Specifically, the AG argued that the conditions it had attached to Verity were binding upon all successors and purchasers of the assets, could not be reduced to money damages, and thus could not be washed away the bankruptcy court's free-and-clear authority under Section 363(f).[152] The AG asked the bankruptcy judge to authorize the sale only if the Debtors expressly agreed that the 2015 conditions would remain binding on buyers.[153] Verity responded that the California AG's terms would not be binding in a sale to Santa Clara County because it was a government entity[154] and that if another buyer prevailed instead in the auction, the AG's 2015 conditions could be curtailed by virtue of "the supremacy of bankruptcy law."[155] With respect to the California AG's argument that Section 363(f) does not authorize the sale free and clear of regulatory conditions, Verity asserted that the statutory provision contained no such carve-out.[156] Verity also noted that, at the end of the day, the hospitals could not afford to operate under the California AG's mandates and that "the most likely outcome of the California AG insisting on the continuing requirement of the existing Conditions is that no buyer will come forward to acquire the assets and the hospitals will be closed."[157] Verity also invited the AG to come forward with capital that would enable its hospitals to operate under the California AG's conditions.[158] The California AG responded simply by

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150. *See id*.

151. Response to Debtors' Motion for Entry of an Order Approving Form of Asset Purchase Agreement for Stalking Horse Bidder, and an Order Authorizing the Sale of Property Free and Clear of All Claims, Liens, and Encumbrances; Memorandum of Points and Authorities in Support Thereof at 3, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

152. *Id*. at 10. The AG argued that the conditions it had attached to Verity, which were binding upon all successors and purchasers of the assets, could not be reduced to money damages and thus could not be washed away the bankruptcy court's power under Section 363(f). *See id.* at 10–11.

153. *Id*. at 5.

154. *Id*. at 7.

155. *Id*. at 37.

156. In making this argument, Verity drew inspiration from a recent bankruptcy court decision that had overruled FERC's argument that it should be allowed to shelter behind a "public safety exception" to the automatic stay. *See id.* at 7 (citing *Midatlantic Nat'l Bank*, 474 U.S. 494 (1986)).

157. *Id*. at 14.

158. *Id.* at 13.

disputing that the bankruptcy court had the power to alter its rights but signaled that it was open to negotiating.[159]

While Verity and the California AG attempted to negotiate their dispute, the debtor conducted an open search for other bids for about a month and received none.[160] Other than insisting that the 2015 conditions would follow the sale of the hospitals, the AG did not appear to be interested in monitoring or participating in the auction process. Verity informed the court that after an open search for other bidders, Santa Clara's $235 million offer was the only offer that Verity received for the two Santa Clara hospitals.[161] The California AG informed the judge that, while it supported the sale, it was not willing to waive the 2015 conditions.[162] The bankruptcy judge rules in favor of Santa Clara, however, holding that bankruptcy law allowed the court to issue an order cleansing the assets of the obligations that had been imposed with the 2015 sale.[163]

Notably, the California AG's office committed a series of mistakes in advocacy that undermined their position. A few days before the final hearing on the sale of the hospitals to Santa Clara, the California AG's office filed a statement with the court informing the judge that it "did not object to the sale."[164] Subsequently, at the sale hearing, the California AG informed the judge that this statement was "'inartfully drafted'" and that it did, in fact, object to the sale of the hospitals free and clear of the conditions.[165] The bankruptcy judge held that the statement filed with the court amounted to a waiver of the California

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159. *See generally* Sur-Reply to Debtors' Reply to Response of California Att'y General to Debtors' Bid Procedures Motion; Declaration of Alicia Berry, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

160. Notice That No Auction Shall Be Held Re Debtors' Motion for the Entry of an Order Approving Form of Asset Purchase Agreement for Stalking Horse Bidder and for Prospective Overbidders to Use, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

161. Debtors' Notice of Motion and Motion for the Entry of an Order Approving Form of Asset Purchase Agreement for Stalking Horse Bidder and for Prospective Overbidders to Use, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

162. *Id*. at 37.

163. *See In re* Verity Health Sys. of Cal., Inc., 598 BR 283, 293:

> The Conditions are an 'interest in property' within the meaning of § 363(f). The Conditions provide that any owner of the Hospitals must furnish specified levels of emergency services, intensive care services, cardiac services, and various other services. The required service levels were derived based upon the historical experience of the prior operator. As such, the Conditions are monetary obligations arising from the ownership of property.

Id.

164. *See id.* at 290.

165. *See id.* at 289

AG's ability to prosecute an objection, holding that "[w]hen litigating with a sophisticated party such as the Attorney General, the Debtors, Santa Clara, and other interested parties are entitled to presume that representations made by the Attorney General in papers filed with the Court accurately reflect his position."[166] The judge further held that the California AG was equitably estopped from pursuing any objection to the sale order.[167]

The AG appealed the bankruptcy judge's order to the District Court.[168] Meanwhile, Santa Clara County issued a press release warning that "[s]ince the County was the only party to bid on Verity's hospitals in Santa Clara County, it is likely [that slowing the sale] would cause the closure of O'Connor and St. Louise hospitals . . . . The Attorney General's actions to block the sale of Verity's hospitals to the County is a real threat to the health of our community, our residents and the vulnerable populations the hospitals serve."[169] District Court Judge R. Gary Klausner ruled against the California AG,[170] and the sale of the two hospitals to Santa Clara closed.[171] The California AG would suffer even more significant defeats in the bankruptcy process. Verity continued to look for buyers for its other hospitals and reached an agreement to sell the remaining hospitals to a private equity firm about two months after agreeing to sell the first two hospitals to Santa Clara.[172] No other bidders for the other hospitals emerged, and the for-profit buyer entered into negotiations with the California AG who required significant conditions that went significantly beyond what the buyer was willing to accept.[173] The overall sale price was $610 million and the additional conditions added more than $300 million in costs to the anticipated purchase.[174] Verity and the private equity firm then asked the bankruptcy judge to issue an order declaring that bank-

166. *See In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283, 291.

167. *See id*. at 283, 292.

168. *In re* Verity Health Sys. of Cal., Inc., No. 2:1-cv-00133-RGK, 2019 WL 6520521, at *1 (C.D. Cal. Feb. 22, 2019).

169. Press Release, California Department of Justice Attempts to Block Sale of Verity Hospitals to the County of Santa Clara (Jan. 10, 2019, 12:00 PM) (https://news.sccgov.org/news-release/california-department-justice-attempts-block-sale-verity-hospitals-county-santa-clara).

170. *In re* Verity Health Sys. of Cal., Inc., No. 2:19-cv-00133-RGK, 2019 WL 6520521, at *4–5 (C.D. Cal. Feb. 22, 2019).

171. Jody Meacham, *Santa Clara County's purchase of hospitals and health clinic finally closes*, SILICON VALLEY BUS. J. (Mar. 1, 2019), https://www.bizjournals.com/sanjose/news/2019/03/01/santa-clara-county-verity-hospitals-purchase.html.

172. *In re* Verity Health Sys. of Cal., Inc., No. 2:18-bk-20151-ER, 2019 WL 5585007, at *1 (Bankr. C.D. Cal. Oct. 23, 2019), *vacated,* No. 2:1-bk-20151-ER, 2019 WL 6519342 (Bankr. C.D. Cal. Nov. 13, 2019).

173. *See id*. at *2.

174. *Id*. at *1–2.

ruptcy law could override these conditions and the judge agreed, holding that bankruptcy law allowed the sale of the assets free and clear of any California AG restrictions. In this clash of jurisdictions, therefore, the clear loser was the statutory discretion of the California AG to block or condition the bankruptcy sale of nonprofit hospitals to for-profit buyers.[175]

The bankruptcy judge's decision created a major problem for the California AG. This second sale transaction created a template that any nonprofit hospital could use subsequently to sell assets to a for-profit buyer without the California AG's permission. It threatened to become a road map for evading state regulation. As this decision represented a significant problem for the continuing authority of the California AG over such sales, the AG offered to consent to the sale and waive its right to appeal the bankruptcy judge's order if the bankruptcy judge vacated the opinion.[176] As a lawyer representing the buyer informed the bankruptcy court, "the California AG [sought to limit] the collateral damage from your ruling."[177] The parties then reached agreement, and the order was vacated.[178] This conclusion – failure followed by moving the vacate the adverse order — is reminiscent of the endings in FERC's clashes with the bankruptcy court that we described in Section II.

VI. Conclusion

We have outlined the case for government agencies moving from defensive posture in bankruptcy (seeking to insulate their regulatory jurisdiction from interference by the bankruptcy court) to active engagement in the bankruptcy process. By retaining bankruptcy counsel and being proactive in bankruptcy cases, the agencies can exploit potent tools available under bankruptcy law, especially if they also bring new financial support along with their expertise. If governments begin to adopt this alternative strategy, it will raise new questions as to the desirable limits of such activism. The attractive speed of bankruptcy decision making, for example, comes at the price of abbreviated procedures, which might result in an end-run of the usual administrative law or even legislative processes. We have also flagged the concerns

175. *Id.* at *2.

176. Transcript of Hearing Re: Stipulation by Verity Health Sys. of Cal., Inc. and the Cal. Att'y Gen. Resolving Debtors' Emergency for the Entry of an Order at 10-11, *In re* Verity Health Sys. of Cal., Inc., 598 B.R. 283 (Bankr. C.D. Cal. 2018) (No. 18 Bankr. 20151).

177. *Id.* at 11.

178. *In re* Verity Health Sys. of Cal., Inc., No. 2:18-bk-20151-ER, 2019 WL 6519342, at *1 (Bankr. C.D. Cal. Nov. 13, 2019).

that exist over the use of DIP financing leverage to influence the course of the bankruptcy process: such as whom the debtor's assets are sold to and under what terms. Therefore, important policy and statutory – perhaps even constitutional – questions will need to be addressed if and when the current clashes of regulatory and bankruptcy jurisdictions yield to more of an integration of the two.