Bankruptcy & Bailouts, Subsidies & Stimulus: The Government Toolset for Responding to Market Distress

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In the spring of 2020, as the COVID-19 pandemic shut down economies around the world, pressure arose for governments to respond to the growing threat of pandemic-related market distress.[1] In addition to responding to the direct public health emergency, governments were expected to stabilize markets—both financial and economic—and provide relief to those harmed by the pandemic's market effects.

In the United States,[2] the initial proposals for government action varied in nature and focus. Some proposals targeted the financial system,[3] while some targeted small businesses[4] and individuals.[5] Others

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1 I use the term "market distress" as a general term that includes both economic and financial distress. The distinction between financial and economic distress, and its importance, is discussed throughout this article.

2 I focus on the United States. While the analysis applies more generally, the specifics with regard to institutions, existing laws, proposals, and government actions differ across jurisdictions.

3 *See, e.g.*, Kevin P. Gallagher et al., *Safety First: Expanding the Global Financial Safety Net in Response to COVID-19*, 12 GLOBAL POL'Y 140 (2021), https://onlinelibrary.wiley.com/doi/10.1111/1758-5899.12871 [https://perma.cc/AA33-M9FG].

4 *See, e.g.*, Shaun Shuxun Wang, *Government Support for SMEs in Response to COVID-19: Theoretical Model Using Wang Transform* (Swiss Fin. Inst. Res. Paper Series, Working Paper No. 20-59, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3608646 [https://perma.cc/K3AS-6YHC]; Hal Scott, *The Fed Needs to Move Faster*, WALL ST. J. (Apr. 10, 2020), https://www.wsj.com/articles/the-fed-needs-to-move-faster-11586557721 [https://perma.cc/ASH9-VCQZ].

5 *See, e.g.*, Phil Lord, *Incentivising Employment During the COVID-19 Pandemic*, 8 THEORY & PRAC. LEGIS. 355 (2020), https://doi.org/10.1080/20508840.2020.1792635 [https://perma.cc/UU9J-XZDW]; Peter Conti-Brown & David Skeel, *Bankruptcy and the Discount Window* (Nov. 15, 2020) (preliminary draft).

were intended to bail out large businesses[6] and specific industries.[7] Still other proposals took a more institutional focus.[8] In the context of bankruptcy law, many imagined building up the bankruptcy system as a primary bulwark against a seemingly imminent wave of economic and financial distress.[9]

With the exception of measures related to financial markets, the actual responses formed a chaotic mix of disconnected half measures that neither stabilized the economy nor provided meaningful relief to those most affected.[10] While that failure may be attributed in part to general government dysfunction and legislative gridlock, a large part of the problem arises from the lack of a clearly identified purpose and framework to guide government responses.

To prepare for the next crisis, we must use this failure to better understand the toolset available to governments dealing with economic and financial threats. The main lessons to take away are that the choice of tools deployed by governments to alleviate a crisis should depend on the nature of the specific problem at hand and that scattershot approaches are unlikely to work.

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[6] *See, e.g.*, Ken Judd & Karl Schmedders, *Why the U.S. Government Needs a New Corporate Bailout Structure—One That Doesn't Rely on Loans*, FORTUNE (Apr. 16, 2020), https://fortune.com/2020/04/16/coronavirus-economic-impact-government-bailout-business-loans-preferred-stock/ [https://perma.cc/45FP-PGEY].

[7] *See, e.g.*, Megersa Abate et al., *Government Support to Airlines in the Aftermath of the COVID-19 Pandemic*, 89 J. AIR TRANSPORT MGMT. 101931 (2020), https://www.sciencedirect.com/science/article/pii/S0969699720305147 [https://perma.cc/2EC9-UB5W] (endorsing government support for the airlines industry); *see also* Fabian Stephany et al., *The Corisk-Index: A Data-Mining Approach to Identify Industry-Specific Risk Assessments Related to COVID-19 in Real-Time* (Working Paper No. 2003.12432v3, 2020), https://ideas.repec.org/p/arx/papers/2003.12432.html [https://perma.cc/NY5S-V9VB] (creating an online index to identify industries most in need of government support due to economic shocks from COVID-19).

[8] *See, e.g.*, Philip Rocco et al., *Stuck In Neutral? Federalism, Policy Instruments, And Counter-Cyclical Responses to COVID-19 in the United States*, 39 POL'Y & SOC'Y 458 (2020), https://www.tandfonline.com/doi/full/10.1080/14494035.2020.1783793 [https://perma.cc/6JT8-4PWU]; Stuti Khemani, *An Opportunity to Build Legitimacy and Trust in Public Institutions in the Time of COVID-19* (World Bank: Rsch & Pol'y, Brief No. 148256, 2020), https://ssrn.com/abstract=3602352 [https://perma.cc/DJL9-Z6FQ].

[9] *See, e.g.*, Benjamin Iverson et al., *Estimating the Need for Additional Bankruptcy Judges in Light of the COVID-19 Pandemic*, 11 HARV. BUS. L. REV. ONLINE (2020), https://www.hblr.org/wp-content/uploads/sites/18/2021/01/HBLR-Estimating-the-Need-for-Additional-Bankruptcy-Judges-Proof_2.pdf [https://perma.cc/9T2J-PFUQ]; *see also* Robin Greenwood et al., *Sizing up Corporate Restructuring in the COVID Crisis* (Nat'l Bureau of Econ. Rsch., Working Paper No. 28104, 2020), https://ssrn.com/abstract=3731274 [https://perma.cc/TAQ7-C62G]; Edward Morrison & Andrea C. Saavedra, *Bankruptcy's Role in the COVID-19 Crisis* (Colum. L. & Econ., Working Paper No. 624, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3567127 [https://perma.cc/JRE4-KEHR].

[10] I focus on the events and actions taken in 2020 at the beginning of the pandemic. The narrative of these events will necessarily become incomplete as the pandemic continues and further government measures are adopted. For example, in 2021, the American Rescue Plan Act of 2021 provided an additional $1.9 trillion in stimulus and relief funding. But the broader lessons and framework will remain valid.

As obvious as those lessons may seem, they were largely ignored in 2020. Much of the confusion in pandemic responses is attributable to attempts to use the wrong tools and to implementation of measures that lacked any clear purpose. In particular, governments and commentators lost sight of two important distinctions in deciding how to act. First is the distinction between tools appropriate for addressing economic distress and those appropriate for addressing financial distress. Second is the distinction between a systemic crisis where distress is spreading and an instance of firm-specific distress where the harm—though perhaps large—is contained.

These distinctions present four types of market distress: specific economic, systemic economic, specific financial, and systemic financial. Each type is distinct from the others, and for each there is a category of appropriate government responses (respectively): direct subsidies, general stimulus, bankruptcy proceedings, and financial bailouts. We thus have this matrix:

TABLE 1

	Specific	Systemic
Economic	Direct Subsidies	General Stimulus
Financial	Bankruptcy Proceedings (Chapter 11)	Financial Bailouts

The importance of understanding these classifications is most evident in the flawed proposals for pandemic-related fixes to bankruptcy law and in the lack of a centralized economic plan to support failing small businesses around the country.

This Article is an attempt to clarify the appropriate (and the inappropriate) government tools for responding to different forms of market distress. In Part I, I provide a brief review of the market-related responses to the pandemic. I discuss actions the United States government has taken,[11] various proposals that have been considered, and some of the economic and financial effects that have resulted. In Part II, I lay out a framework for thinking about government responses to market distress. I describe the four types of distress and explain the fit of each type with a specific category of tools. In Part III, I provide a closer look at and place special emphasis on the interaction between pandemic responses and bankruptcy law because bankruptcy's role has

[11] Some relevant responses in the United States came from state governments, largely in the form of measures to halt evictions. I discuss those briefly along the way.

been the most obviously misunderstood and provides the starkest example of confused analysis.

I. THE RESPONSES AND THE RESULTS (SO FAR)

In the early days of the pandemic, robust debates arose about government relief for markets. Proposals were floated from all directions and suggested all sorts of relief. For good reason—markets were cratering,[12] unemployment was soaring,[13] and uncertainty was extreme[14]—experts were racing to get ideas into the public debate.[15] While many of

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[12] Fred Imbert, *Dow Drops Nearly 3,000 Points, as Coronavirus Collapse Continues; Worst Day Since '87*, CNBC (Mar. 15, 2020), https://www.cnbc.com/2020/03/15/traders-await-futures-open-after-fed-cuts-rates-launches-easing-program.html [https://perma.cc/J3WU-5VH9]; Gunjan Banerji et al., *Stocks Decline as Investors Digest Collapse in Jobs Market*, WALL. ST. J. (Apr. 3, 2020), https://www.wsj.com/articles/global-stock-markets-dow-update-4-3-2020-11585887307 [https://perma.cc/32RL-HBNP].

[13] In March 2020, the unemployment rate increased by 0.9 percentage points to 4.4 percent; in April 2020, the unemployment rate increased by 10.3 percentage points to 14.7 percent. The United States Bureau of Labor Statistics reported that this increase represented "the highest rate and the largest over-the-month increase in the history of the series [beginning in January 1948]." *Employment Situation—March 2020*, U.S. BUREAU OF LAB. STATS. (Apr. 3, 2020), https://www.bls.gov/news.release/archives/empsit_04032020.htm [https://perma.cc/RF6H-DP4P]; *Employment Situation—April 2020*, U.S. BUREAU OF LAB. STATS. (May 8, 2020), https://www.bls.gov/news.release/archives/empsit_05082020.htm [https://perma.cc/Z922-64M5].

[14] *See, e.g.*, Robin Wigglesworth, *Coronavirus Creates Biggest Economic Uncertainty in Decades*, FIN. TIMES (Apr. 19, 2020), https://www.ft.com/content/4d77ab77-0ff0-46ff-b30e-ae712c582457 [https://perma.cc/6WVC-J3EA] (reporting that the "global economic outlook is the murkiest in modern history, with uncertainty over the coronavirus outbreak's ultimate impact causing wild divergences between analysts' forecasts").

[15] *See supra* notes 3–9 and accompanying text; *see also* Letter from the Nat'l Bankr. Conference to Reps. Pelosi and McCarthy and Sens. McConnell and Schumer, regarding Economic Crisis Caused by SARS-CoV-2 Virus (Mar. 22, 2020), https://drive.google.com/file/d/1oyWbkJgFj3Y_jKr4mRVJpQduXvqGzl1H/view [https://perma.cc/FC8K-SRNS]; Letter from the Nat'l Bankr. Conference to Reps. Pelosi and McCarthy and Sens. McConnell and Schumer, regarding Further Economic Assistance for Individuals and Businesses in Financial Distress as a Result of Crisis Caused by SARS-CoV-2 Virus (Apr. 14, 2020), https://drive.google.com/file/d/1OSA_Yhft3eMn3aqv3bRTcLZeQWXSA8Om/view [https://perma.cc/KK9L-JP79]; Kenneth Ayotte & David Skeel, *Bankruptcy Law Needs a Boost for Coronavirus*, WALL. ST. J. (Mar. 30, 2020), https://www.wsj.com/articles/bankruptcy-law-needs-a-boost-for-coronavirus-11585608800 [https://perma.cc/ZB3Y-GDRG]; Morrison & Saavedra, *supra* note 9; Adam Levitin & Satyam Khanna, *How to Get Money to Small Businesses Fast*, N.Y. TIMES (Mar. 24, 2020), https://www.nytimes.com/2020/03/24/opinion/coronavirus-small-businesses.html [https://perma.cc/8ZHZ-VATM]; Letter from Brook Gotberg, Chair, Bankr. & COVID-19 Working Grp., to Reps. Pelosi and McCarthy and Sens. McConnell and Schumer (May 26, 2020), http://blogs.harvard.edu/bankruptcyroundtable/files/2020/06/Small-Business-Letter-Final-5.26.20-pm.pdf [https://perma.cc/8A67-PCQW]; Letter from Jared A. Ellias, Chair, Large Corps. Comm. of Bankr. & COVID-19 Working Grp., to Reps. Pelosi and McCarthy and Sens. McConnell and Schumer (May 20, 2020), http://blogs.harvard.edu/bankruptcyroundtable/files/2020/05/xLarge-Corporate-Committee_05.18.2020.pdf [https://perma.cc/X47X-VF9T]; Letter from Jared A. Ellias, Chair, Large Corps. Comm. of Bankr. & COVID-19 Working Grp., to Reps. Pelosi and McCarthy and Sens. McConnell and Schumer (June 10, 2020), https://considerchapter13.org/wp-content/uploads/2017/09/Letter-to-Congress-re-Number-of-Bankruptcy-Judges-6.10.20-FINAL.pdf [https://perma.cc/VXD2-43CG] (attaching memorandum authored by Benjamin Iverson et al.); Pamela Foohey et al., *The Debt*

the proposals had individual merit, few were part of anything resembling a cohesive approach.

It is not surprising then that the initial response in the United States—which took the form of legislation and administrative action at both the federal and state levels—was mostly a hodgepodge of measures that provided disconnected patches of relief. Thus, for example, the CARES Act, signed into law on March 27, 2020,[16] made $50 billion available for relief to large airlines, and $17 billion to Boeing,[17] while providing nothing to elderly and disabled adults. As Professor Daniel Hemel put it, "The result is that the largest aid package in U.S. history—intended to afford relief from the consequences of COVID-19—gives nothing at all to millions of people in the population segment most vulnerable to the novel coronavirus."[18]

The most significant economic relief in the CARES Act—and the closest to getting things right—was the Paycheck Protection Program (PPP).[19] Under that program, small businesses were offered direct relief. But the rollout was chaotic,[20] large portions of funds went to large companies and wealthy law firms that did not need relief,[21] and some of

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Collection Pandemic, 11 CAL. L. REV. ONLINE 222 (2020), https://www.californialawreview.org/debt-collection-pandemic/ [https://perma.cc/474W-QXFL]; Morgan Ricks & Lev Menand, *Let's Pay the Stimulus in Digital Dollars*, BLOOMBERG (Mar. 24, 2020), https://www.bloomberg.com/opinion/articles/2020-03-24/coronavirus-stimulus-let-s-pay-it-in-digital-dollars [https://perma.cc/B4NL-3XGJ]; *How Far Could the Fed Go in Responding to COVID-19?*, KNOWLEDGE@WHARTON (Mar. 23, 2020), https://knowledge.wharton.upenn.edu/article/conti-brown-fed-actions/ [https://perma.cc/W59T-APE2].

16 Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. No. 116-136, 134 Stat. 281 (2020).

17 Ultimately, Boeing never accessed the funds. Yeganeh Torbati & Aaron Gregg, *How a $17 Billion Bailout Fund Intended for Boeing Ended Up in Very Different Hands*, WASH. POST (Nov. 25, 2020), https://www.washingtonpost.com/business/2020/11/25/boeing-national-security-bailout-loans/ [https://perma.cc/X8CR-J8H4] ("Aircraft manufacturers including Boeing were the fund's intended recipients but balked at the terms and did not apply.").

18 Daniel Hemel, *Stiffed by the Senate Stimulus: The Surprising Group Left Out of the Coronavirus Rescue Bill*, N.Y. DAILY NEWS (Mar. 26, 2020), https://www.nydailynews.com/opinion/ny-oped-stiffed-by-the-senate-stimulus-20200326-624qm3qnvbhw7py2unylqpd6iy-story.html [https://perma.cc/L6TT-YJMX].

19 For a summary of the PPP, see Ilya Beylin, *The Ignominious Life of the Paycheck Protection Program*, 23 N.Y.U. J. LEG. & PUB. POL'Y (forthcoming 2021).

20 Stacy Cowley et al., *Small-Business Loan Program, Chaotic From Start, Gets 2nd Round*, N.Y. TIMES (Apr. 26, 2020), https://www.nytimes.com/2020/04/26/business/ppp-small-business-loans.html [https://perma.cc/X5RY-FN4S]; Stacy Cowley, *Small-Business Loans Will Be Forgiven, but Don't Ask How*, N.Y. TIMES (Oct. 9, 2020), https://www.nytimes.com/2020/10/09/business/small-business-ppp-loans-forgiveness.html [https://perma.cc/HK5W-BFBF]; *see also* Beylin, *supra* note 19 (collecting and analyzing the merits of various criticisms of the PPP).

21 Erik Sherman, *Many Public Companies That Got PPP Loans Had Lots in the Bank*, FORBES (Apr. 24, 2020), https://www.forbes.com/sites/eriksherman/2020/04/24/public-companies-ppp-loans-money/?sh=4a7e162640d2 [https://perma.cc/EX6Q-WRHD] (noting that despite Treasury guidance—which suggested that public companies with substantial market value should be able to obtain credit elsewhere—hundreds of high-revenue public companies accessed PPP funds); Stacy Cowley & Ella Koeze, *1 Percent of P.P.P. Borrowers Got Over One-Quarter of the Loan Money*,

the firms that most needed it were denied relief because of rules preventing firms in bankruptcy from accessing the program.[22]

States and administrative agencies also provided other forms of economic relief. For example, most states temporarily halted evictions to some degree through executive or legislative action, and others provided similar relief through judicial measures.[23] And on September 4, 2020, the Centers for Disease Control and Prevention (CDC) and the Department of Health and Human Services (HHS) released an agency order that temporarily halted certain residential evictions in all fifty states, the District of Columbia, and most U.S. territories.[24]

N.Y. TIMES (Dec. 2, 2020), https://www.nytimes.com/2020/12/02/business/paycheck-protection-program-coronavirus.html [https://perma.cc/7DAD-TUXR] (reporting that "powerful law firms like Boies Schiller Flexner, restaurants like the steakhouse chain started by Ted Turner, as well as the operator of New York's biggest horse tracks" were among the 600 businesses that received the maximum loan amount of $10 million); *see also* Zachary Warmbrodt, *SBA Presses Big Businesses to Justify Aid, Sparking Uproar*, POLITICO (Oct. 30, 2020), https://www.politico.com/news/2020/10/30/sba-big-businesses-ppp-loans-433736 [https://perma.cc/62HM-47Q5] (stating that the Small Business Administration's ("SBA's") effort to scrutinize large businesses that obtained PPP loans have rattled banks and PPP borrowers alike).

Notably, the new PPP provisions authorized by H.R. 133, the Consolidated Appropriations Act, 2021 (enacted on December 27, 2020, as Public Law 116-260) prohibit publicly-traded companies with securities listed on a national securities exchange from accessing PPP funds. *See* Interim Final Rule, Business Loan Program Temporary Changes; Paycheck Protection Program Second Draw Loans, 86 Fed. Reg. 3712 (Jan. 14, 2021).

[22] PPP funds were administered by the Small Business Administration. Based on its reading of its existing statutory authority and the authority granted to it by the CARES Act, the SBA made PPP relief available only to borrowers not presently in bankruptcy. While some bankruptcy courts tried to get around this rule, the Fifth and Eleventh Circuit Courts held that bankruptcy courts may not compel the SBA to make PPP loans available to debtors in bankruptcy. *See In re* Gateway Radiology Consultants, P.A., 983 F.3d 1239 (11th Cir. 2020); *see also* Ronald A. Spinner et al., *Eleventh Circuit Joins Fifth in Holding That the SBA May Deny Paycheck Protection Program Loans to Debtors in Bankruptcy*, NAT'L L. REV. (Dec. 23, 2020), https://www.natlawreview.com/article/eleventh-circuit-joins-fifth-holding-sba-may-deny-paycheck-protection-program-loans [https://perma.cc/TGG8-8DXS].

In its newest round of PPP authorization, Congress provided that—subject to the SBA Administrator's approval—certain debtors in bankruptcy may be eligible for PPP loans. The SBA, however, has withheld such approval. In its interim final rules, the SBA expressly stated that debtors in bankruptcy are ineligible for PPP loans. *See* Ronald A. Spinner et al., *Congress Permits SBA to Make PPP Loans to Debtors in Bankruptcy, SBA Says "No"*, NAT'L L. REV. (Jan. 15, 2021), https://www.natlawreview.com/article/congress-permits-sba-to-make-ppp-loans-to-debtors-bankruptcy-sba-says-no [https://perma.cc/5W55-X73L].

[23] *See* Practical Law Real Estate, *COVID-19: Commercial and Residential Tenant Eviction Moratoriums Select State and Local Laws Tracker (US)*, WESTLAW (last updated June 4, 2021).

[24] Centers for Disease Control and Prevention, Temporary Halt in Residential Evictions to Prevent the Further Spread of COVID-19, 85 Fed. Reg. 55292 (Sept. 4, 2020), https://www.federalregister.gov/documents/2020/09/04/2020-19654/temporary-halt-in-residential-evictions-to-prevent-the-further-spread-of-covid-19 [https://perma.cc/S63B-WVFL]. That order was set to expire on December 31, 2020 but was extended to January 31, 2021 by the December relief legislation. Jemima McEvoy, *Stimulus Bill Extends Eviction Moratorium by One Month—Experts Worry What Comes After*, FORBES (Dec. 22, 2020), https://www.forbes.com/sites/jemimamcevoy/2020/12/22/stimulus-bill-extends-eviction-moratorium-by-one-month-experts-worry-what-comes-after/?sh=9d2a77c493c5 [https://perma.cc/Z534-QQFJ]. On January 20, 2021, at President Biden's urging, the CDC extended the eviction moratorium again until at least March 31, 2021. Media Statement, Ctrs. For Disease Control & Prevention, CDC Director Rochelle P. Walensky, MD, MPH, on

One exception to the chaos was the financial response. Centralized in the hands of the Federal Reserve and Treasury Department, the financial relief was swift and comprehensive, with some of the core programs going into effect before any legislation was enacted. Thus, on March 17 and 18, 2020, the Federal Reserve announced three major lending facilities to be established pursuant to its authority under Section 13(3) of the Federal Reserve Act.[25] These facilities had the effect of providing massive liquidity support to the financial system and reversed an unprecedented liquidity disruption that was unfolding the week of March 16.[26] These measures were later supplemented by additional credit facilities, such as the Primary Market Corporate Credit Facility and the Secondary Market Corporate Credit Facility, and by other funding and programs authorized under the CARES Act.[27]

There are various possible explanations for the exceptional and swift nature of the financial response. Likely, the independent and centralized authority of the Federal Reserve, the quick legislative grant of funding and authority to support the facilities,[28] and experience from

Extending the Eviction Moratorium (Jan. 20, 2021), https://www.cdc.gov/media/releases/2021/s0121-eviction-moratorium.html [https://perma.cc/5YA6-SKU5]. One court has held that the CDC exceeded the federal governments constitutional power in issuing the moratorium. Terkel v. Ctrs. for Disease Control and Prevention, No. 6:20-CV-00564, 2021 WL 742877, at *1 (E.D. Tex. Feb. 25, 2021), *appeal filed*, No. 21-40137 (5th Cir. Mar. 3, 2021). An appeal of that case is currently pending.

[25] The three facilities were the Money Market Mutual Fund Liquidity Facility, the Primary Dealer Credit Facility, and the Commercial Paper Funding Facility. Press Release, Fed. Rsrv., Federal Reserve Board Announces Establishment of a Primary Dealer Credit Facility (PDCF) to Support the Credit Needs of Households and Businesses (Mar. 17, 2020), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200317b.htm [https://perma.cc/7L6G-RY86]; *Money Market Mutual Fund Liquidity Facility*, FED. RSRV., https://www.federalreserve.gov/monetarypolicy/mmlf.htm [https://perma.cc/99JU-FRCK] (last updated May 10, 2021); Press Release, Fed. Rsrv., Federal Reserve Board Announces Establishment of a Commercial Paper Funding Facility (CPFF) to Support the Flow of Credit to Households and Businesses (Mar. 17, 2020), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200317a.htm [https://perma.cc/JV8T-RXFK]; Justin Muzinich, Deputy Secretary, U.S. Dep't of Treasury, Remarks at the 2020 U.S. Treasury Market Conference (Sep. 29, 2020), https://home.treasury.gov/news/press-releases/sm1138 [https://perma.cc/RX53-QSBV]; *see also* Lorie K. Logan, Executive Vice President, Fed. Rsrv. Bank of N.Y., Speech on Treasury Market Liquidity and Early Lessons from the Pandemic Shock (Oct. 23, 2020), https://www.newyorkfed.org/newsevents/speeches/2020/log201023 [https://perma.cc/RXF3-9CKK].

[26] *See* Muzinich, *supra* note 25.

[27] *See* Thomas Wade, *Timeline: The Federal Reserve Responds to the Threat of Coronavirus*, AM. ACTION F. (Oct. 1, 2020), https://www.americanactionforum.org/insight/timeline-the-federal-reserve-responds-to-the-threat-of-coronavirus/ [https://perma.cc/BRS7-ND8Y]. For a brief overview of the Federal Reserve's activities with regards to its outstanding lending facilities, see FED. RSRV., PERIODIC REPORT: UPDATE ON OUTSTANDING LENDING FACILITIES AUTHORIZED BY THE BOARD UNDER SECTION 13(3) OF THE FEDERAL RESERVE ACT (Jan. 9, 2021), https://www.federalreserve.gov/publications/files/pdcf-mmlf-cpff-pmccf-smccf-talf-mlf-ppplf-msnlf-mself-msplf-nonlf-noelf-01-11-21.pdf [https://perma.cc/CT8T-XKHN].

[28] The Deputy Secretary of the Treasury noted, "[I]t is reassuring to know that faced with the first significant shock since the Dodd-Frank reforms, policy makers were able to act swiftly and forcefully to produce a bipartisan and successful result." Muzinich, *supra* note 25.

the 2008 financial crisis all played a role. It is also possible that major financial players were organized to quickly advise (or lobby) the government on cohesive responses, or that the relative opacity of financial measures shields them from the controversy and political bickering that plague measures such as direct payments to individuals.

The comparative success of the Federal Reserve in implementing financial relief as compared to purely legislative measures is consistent with the idea—which I argued for after the 2008 financial crisis—that financial bailouts are best accomplished outside the legislative process: "Generally speaking, a regulator [as opposed to the legislature] should engage in bailouts for the same reason that regulators typically engage in executive action—they can act more quickly and flexibly than Congress can, and are less likely to be influenced by irrelevant political factors."[29]

Notable in all of this is that bankruptcy provisions were almost nonexistent. Most bankruptcy experts thought bankruptcy law and bankruptcy courts would play a large role in dealing with the economic effects of the pandemic.[30] There were broad calls for bankruptcy relief measures and a worry that without such measures catastrophe could hit. Indeed, in the bankruptcy context, a consensus had emerged on one prediction: an unprecedented wave of Chapter 11 bankruptcy cases was on its way.[31]

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29 Anthony Casey & Eric Posner, *A Framework for Bailout Regulation*, 91 NOTRE DAME L. REV. 479, 533–34 (2015).

30 *See infra* note 31.

31 *See, e.g.*, Mary Williams Walsh, *A Tidal Wave of Bankruptcies is Coming*, N.Y. TIMES (June 18, 2020), https://www.nytimes.com/2020/06/18/business/corporate-bankruptcy-coronavirus.html [https://perma.cc/82XG-PFE6]; Iverson et al., *supra* note 9; Letter from Jared A. Ellias (June 10, 2020), *supra* note 15; 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/ [https://perma.cc/4XA5-Y3B9]; Geoff Colvin, *Pandemic Fallout Is About to Overwhelm the Bankruptcy System—And Hit Small Businesses Hardest*, FORTUNE (Nov. 24, 2020), https://fortune.com/2020/11/24/bankruptcy-covid-economy-small-business/ [https://perma.cc/K8BK-5P62]; Dina Gerdeman, *Coronavirus Could Create a 'Bankruptcy Pandemic'*, HARV. BUS. SCH.: WORKING KNOWLEDGE (May 28, 2020), https://hbswk.hbs.edu/item/coronavirus-could-create-a-bankruptcy-pandemic [https://perma.cc/X2AV-8PAY]. Some expressed doubt about the size of the wave. *See* Phil Ciciora, *What Effect Will COVID-19 Have on Consumer Bankruptcies?*, ILL. NEWS BUREAU (Apr. 29, 2020), https://news.illinois.edu/view/6367/808303 [https://perma.cc/EF4Z-AY53] (interviewing Professor Robert M. Lawless); Mark Henricks & Daphne Foreman, *After the Covid-19 Deluge, a Bankruptcy Tidal Wave?*, FORBES (Sep. 23, 2020), https://www.forbes.com/sites/advisor/2020/09/23/after-the-covid-19-deluge-a-bankruptcy-tidal-wave/?sh=2980d49f4aba [https://perma.cc/5MLG-8HKT] (quoting Professor Lawless); David Skeel, *Bankruptcy and the Coronavirus: Part II*, ECON. STUD. AT BROOKINGS (July 2020), https://www.brookings.edu/wp-content/uploads/2020/07/ES-6.6.20-Skeel-1.pdf [https://perma.cc/XT99-USJC]. But the vast majority of experts were predicting the wave.

To respond to this deluge, some called for the appointment of more bankruptcy judges and the funding of other resources.[32] Others proposed various measures that would change bankruptcy rules, such as a program of "pre-packaged bankruptcies for small firms,"[33] the extension of various deadlines for certain payments and actions by debtor,[34] or measures to provide funding to debtors, such as the creation of a government financed Debtor-in-Possession Financing Facility.[35]

In the end, the only provisions in the CARES Act related to bankruptcy were a provision temporarily expanding eligibility for small business proceedings intended to ease bankruptcy,[36] a provision temporarily excluding relief payments from income for individuals in Chapter 13 bankruptcy proceedings,[37] and a provision temporarily allowing individuals to request a modification to a Chapter 13 plan if they experienced hardship related to the pandemic.[38] The Act also had the highly criticized effect of denying PPP funds to firms in bankruptcy.[39]

Subsequent relief legislation in 2020 had a similar whack-a-mole feel to it. The December legislation included additional individual stimulus payments that once again excluded adult dependents, a few small bankruptcy provisions,[40] and additional PPP funding that may or may not be available to firms in bankruptcy.[41]

Given the dynamics discussed above, it is not surprising that the financial crisis has so far been averted while the economic crisis remains. There has not been a liquidity crisis, nor has there been any real lack of capital available to businesses. The same cannot be said of the economic situation. Small business revenues have declined across all industries with variations in severity. Estimates suggest that small

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32 Letter from Jared A. Ellias (June 10, 2020), *supra* note 15; *see also* Iverson et al., *supra* note 9.

33 Greenwood et al., *supra* note 9.

34 Letter from Brook Gotberg, *supra* note 15.

35 *See* Peter DeMarzo et al., *Debtor-in-Possession Financing Facility (DIPFF) Proposal* (June 20, 2020), https://www.gsb.stanford.edu/sites/default/files/publication-pdf/dipff.pdf [https://perma.cc/37JU-RNEY].

36 Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. No. 116-136, Sec. 1113; 11 U.S.C. § 1182, 134 Stat. 281 (2020).

37 *Id.* at Sec. 1113; 11 U.S.C. § 1325, 134 Stat. 281 (2020).

38 *Id.* at Sec. 1113; 11 U.S.C. § 1329, 134 Stat. 281 (2020).

39 *Supra* note 22.

40 In separate legislation, Congress extended existing bankruptcy judgeships and enacted minor changes to the distribution of bankruptcy fees to the United States Trustee. Bankruptcy Administration Improvement Act of 2020, Pub. L. No. 116-325, 134 Stat. 5086 (2021). This does not represent an expansion of the bankruptcy bench. Rather it is just a continuation of the pre-pandemic status quo—a far cry from adding dozens or hundreds of new judges that some called for—and it likely would have happened regardless of the crisis.

41 *Supra* note 22. Notably, the American Rescue Plan Act of 2021 contained $1.9 trillion in broader relief especially for individuals.

business revenues declined between 30 percent and 70 percent in large cities;[42] still other figures indicate that by mid-April 2020, revenue for a typical small business engaged in personal services had declined over 80 percent.[43]

Perhaps most surprising, though, is how wrong the bankruptcy predictions have been. The wave never materialized.[44] Despite the widespread economic distress, bankruptcy filings have not swelled to anything like what was predicted, and courts have not been overwhelmed. The rate of bankruptcy filings for small businesses (and individuals) has actually fallen quite dramatically, and the rate of large corporate bankruptcies—while it has increased—has not reached anywhere near a level that would cripple bankruptcy courts.[45] To be sure, we are still in the midst of the pandemic, and a day of economic reckoning is on the horizon. But it is less clear today that this reckoning will take place in bankruptcy courtrooms. This distinguishes 2020 from 2008, which—despite massive government bailouts and subsidies—saw a steep increase in bankruptcy filings.[46]

Part of this might be explained by interventions such as the PPP. But many of the predictions in April and May had already factored those programs into the analysis. There is likely more to the story, and

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[42] Scholars examining the differential impact of the crisis in affluent and economically depressed regions found that "[s]mall business revenues in the highest-income and highest-rent ZIP codes . . . fell by more than 65% between March and mid-April, compared with 30% in the least affluent ZIP codes." Raj Chetty et al., *The Economic Impacts of COVID-19: Evidence from a New Public Database Built from Private Sector Data 3* (Nat'l Bureau of Econ. Rsch., Working Paper No. 27431, 2020).

[43] *Small Business Financial Outcomes During the Onset of COVID-19*, JPMORGAN CHASE (June 2020), https://www.jpmorganchase.com/institute/research/small-business/small-business-financial-outcomes-during-the-onset-of-covid-19#finding-3 [https://perma.cc/D269-P3ZW].

[44] While commercial bankruptcies were up 29 percent in 2020, individual bankruptcy filings plummeted. In total, bankruptcy filings in 2020 actually experienced one of the largest drops in history, falling 30 percent compared to 2019. Press Release, Am. Bankr. Inst., Total Bankruptcy Filings Drop 30 Percent in Calendar Year 2020, Commercial Chapter 11s Up 29 Percent (Jan. 6, 2021), https://www.abi.org/newsroom/press-releases/total-bankruptcy-filings-drop-30-percent-in-calendar-year-2020-commercial [https://perma.cc/HXJ3-EHHN].

[45] Rachel Layne, *COVID Was Supposed to Increase Bankruptcies. Instead, They've Gone Down*, HARV. BUS. SCH.: WORKING KNOWLEDGE (Nov. 23, 2020), https://hbswk.hbs.edu/item/covid-was-supposed-to-increase-bankruptcies-instead-theyve-gone-down [https://perma.cc/EHE7-VQSZ] (asserting that the increase in Chapter 11 filings was driven by corporations with more than $50 million in assets; filings for small businesses during this same period actually dropped); *see also Annual Bankruptcy Filings Fall 29.7 Percent*, U.S. COURTS (Jan. 28, 2021), https://www.uscourts.gov/news/2021/01/28/annual-bankruptcy-filings-fall-297-percent [https://perma.cc/5NBL-QU74] ("Bankruptcy filings fell sharply for the 12-month period ending Dec. 31, 2020. . . . Only one category saw an increase in filings. Chapter 11 reorganizations rose 18.7 percent . . . .").

[46] During the 2008 crisis, business bankruptcies increased by 54 percent (with public company bankruptcies up 74 percent), and total bankruptcy filings increased 31 percent, from 850,912 total filings in 2007 to 1,117,771 filings in 2008. *US Bankruptcy Filings Up 31 Pct in 2008-Court Data*, REUTERS (Mar. 5, 2009), https://www.reuters.com/article/usa-bankruptcy-filings/us-bankruptcy-filings-up-31-pct-in-2008-court-data-idUSN0533332920090305 [https://perma.cc/CL5D-JVBJ].

it may have to do with a misunderstanding of the exact challenges that a global pandemic presents and what—if anything—the bankruptcy system can do to address those challenges (more on this in Part II). Indeed, part of the story is that we—bankruptcy lawyers and scholars[47]—had lost sight for a moment of the real limitations of corporate bankruptcy law and the distinction between financial and economic distress.

The fact that bankruptcy courts were not hit by a torrent of filings does not, however, mean there wasn't great distress. Unemployment numbers skyrocketed and then vacillated throughout the year, and small businesses were decimated. We should find no comfort in the absence of a wave.

II. THE FRAMEWORK

To choose the appropriate form of government intervention in response to market distress resulting from a crisis or disaster, one must determine the nature of the distress and the purpose for the intervention. Markets might be faced with a banking crisis—as they were in 2008—that threatens financial liquidity, or an economic crisis that could leave over twenty million people unemployed as in 2020.[48] The appropriate response will be different for each type of distress posed by a crisis.

In identifying the nature of market distress, the distress can be classified across two dimensions. First, the distress can be economic or financial. Second, it can be systemic or specific. These dimensions prescribe the appropriate response. A government's goals and the tools to achieve those goals will be very different when the government is responding to specific distress as compared to when it is responding to systemic distress. Similarly, the tools appropriate to relieve financial distress are very different from those appropriate to relieve economic

[47] I must count myself in this group as I too signed a letter urging an expansion of the bankruptcy bench. Letter from Jared A. Ellias (June 10, 2020), *supra* note 15. In retrospect, that letter was premature and, for the reasons discussed in this article, the proposed remedy has proven to be unnecessary. A few scholars expressed mild skepticism. *See* Skeel, *supra* note 31; Ciciora, *supra* note 31; Henricks, *supra* note 31. Interestingly, the one group that seemed least worried about the wave was the bankruptcy judges themselves. During conversations and panels, I have heard many bankruptcy judges note that they are not particularly concerned about a crippling wave of cases and some strongly reject the idea that more judges should be appointed.

[48] In April 2020 the number of unemployed persons in the United States increased by 15.9 million to reach 23.1 million unemployed. *Employment Situation—April 2020*, *supra* note 13. Although this figure had decreased to 10.7 million unemployed by December 2020, this figure is nearly twice the pre-pandemic level of unemployment in February 2020. *Employment Situation—December 2020*, U.S. BUREAU OF LAB. STAT. (Jan. 8, 2021), https://www.bls.gov/news.release/archives/empsit_01082021.htm [https://perma.cc/2XFE-3H2S].

distress. For example, bankruptcy law is a tool not well suited to resolving systemic financial distress or any form of economic distress.[49]

In this Part, I first examine the dimensions of distress. From there, I present each toolset and its suitability for the relevant category of distress.

A. Catgories and Dimensions of Market Distress

1. Economic vs. financial

Economic and financial distress are two distinct problems.[50] The distinction is familiar to bankruptcy lawyers.[51]

Economic distress occurs when a firm struggles in the marketplace. The core problem is usually that the firm can no longer sell its goods or services at a price that justifies the cost of producing them. Demand for the firm's product may fall for various reasons including new competition, failed marketing campaigns, and shifts in consumer preferences. Or the firm's cost of producing the goods may rise for reasons including shortages in the supply of production inputs, increases in the cost of labor, and failed operations. As we will see, such shifts in demand and production costs may also result from an exogenous shock like the COVID-19 pandemic.[52]

In contrast, financial distress occurs when a firm struggles with its capital structures. The core problem here is usually that the firm is burdened by its past debts and cannot finance new projects, even when those projects are profitable. Financial distress can exist even when a firm is economically sound. There may be demand for its products at prices that exceed the cost of production, but the firm cannot borrow money to finance the projects because of its prior debts. This problem—known as debt overhang—arises because the existing creditors already have claims on revenue that will come from the future project or because the markets are not liquid enough to provide financing for the project.[53]

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[49] *See* discussion *infra* Section II.B.4 (Bankruptcy proceedings for specific financial distress).

[50] Economic and financial distress can occur simultaneously and often one can cause the other. But they need not be coupled, and even when they are each type calls for a distinct government response.

[51] BARRY E. ADLER ET AL., BANKRUPTCY: CASES, PROBLEMS, AND MATERIALS 27 (3d ed. 2000) ("Understanding that financial and economic distress are conceptually distinct from each other is fundamental to understanding Chapter 11 of the Bankruptcy Code.").

[52] The effects of the pandemic might manifest in direct changes to consumer preferences or in government ordered changes to consumption or supply.

[53] *See generally* Kenneth Ayotte & David A. Skeel, *Bankruptcy or Bailouts?*, 35 J. CORP. L. 469 (2010) (explaining debt overhang and market liquidity as causes of financial distress).

2. Specific vs. systemic

Some forms of distress are specific to one firm, while other forms are systemic in that they threaten to spread throughout the economic or financial system. When a single firm fails because its products are inferior, that is an example of specific economic distress. Similarly, if a single firm cannot finance its operations because it took on too much debt, that is an example of specific financial distress. Notably, specific distress—economic or financial—is not a crisis in the sense that the harm is not spreading.

Systemic distress, on the other hand, can be thought of as distress that can spread and produce macroeconomic costs.[54] Systemic financial distress occurs when the distress of financial institutions is spreading from firm to firm and ultimately into the real economy. Likewise, systemic economic distress occurs when one firm's economic collapse threatens the viability of other firms. The key is that distress is spreading.

Because it is spreading, any systemic crisis will likely present with both economic and financial distress. That is to say, financial distress can lead to economic distress—as it did in 2008—and economic distress can lead to financial distress—as many worried it would during the pandemic.[55] But the relative severity and importance of addressing each type will differ across crises.

It is also worth noting that systemic distress is distinct from specific distress that is merely common. Specific distress can afflict many firms without actively spreading. This can occur, for example, in the wake of a disaster or crisis that has run its course where many firms are in distress, but the distress is contained. Conversely, the distress of one large firm might be systemic if it threatens to spread because of the importance or size of that firm.

B. Appropriate Tools for Each Category

We can thus analyze market distress to which government action might be targeted in four categories, each of which is best addressed by a particular type of government action. Targeted subsidies are for specific economic distress;[56] general stimulus programs are the toolset for

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[54] Casey & Posner, *supra* note 29, at 523.

[55] Muzinich, *supra* note 25 ("The 2008 crisis had moved from Wall Street to Main Street. This crisis, on the other hand, started with Main Street businesses shutting down as required by the pandemic, and the concern the week of March 16 became that a financial market crisis would also develop, creating further instability for so many Main Street businesses that rely on financing.").

[56] This category may be properly understood as a form of humanitarian relief or political favoritism rather than a crisis response. *See* Casey & Posner, *supra* note 29, at 490 n.47.

systemic economic crisis;[57] bailouts are for systemic financial crisis; and bankruptcy proceedings are for specific financial distress. (See Table 1 from the introduction.) This subpart explains the connection between each category and the appropriate type of government actions.

1. Subsidies for specific economic distress

Subsidies are transfers, often in the form of loans or direct payments, to alleviate the economic distress of a particular individual, firm, or industry.[58] These transfers may be attempts to provide humanitarian relief to individuals or to save a particular firm or industry from failure, often for political or moral reasons.[59] They are not intended to stop the spread of distress but rather to relieve or reverse distress that has already occurred. In this way, they are the appropriate tool for responding to specific economic distress.

Because specific economic distress is not spreading, the relevant considerations for a proper government response are different from those discussed below for systemic distress. Individual businesses fail all the time, but there are no efficiency arguments supporting direct government intervention to reverse the contained economic failure of one business or industry. When governments provide humanitarian relief to alleviate the harsh effects of unforeseen events or abrupt economic transitions or to save a particular firm or industry from failure,

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[57] "Bail-ins" proposed by Van Zwieten et al. would also fall in this category. *See infra* note 94. These can be thought of as government mandated private stimulus. *See also* Zachary Liscow, *Counter-Cyclical Bankruptcy Law: An Efficiency Argument for Employment-Preserving Bankruptcy Rules*, 116 COLUM. L. REV. 1461 (2014).

[58] One might alternatively call these payments "direct relief." That term may imply some moral desert and seems particularly appropriate where the payments go to individuals where moral considerations argue in their favor. But with failing firms and businesses, a transfer to prevent that failure is a subsidy and economically indistinguishable from a subsidy in any other context.

[59] Casey & Posner, *supra* note 29, at 490, 505. Professor Dauber has demonstrated that relief payments to disaster sufferers are a longstanding feature of American legal and political history. The September 11th Victim Compensation Fund of 2001 is one prominent example of relief packages throughout American history. Direct compensation has been provided since the founding days of the Republic, including through a Claims Commission following the War of 1812, as well as statutory relief for victims of an 1827 Virginia fire and victims of the Whiskey Rebellion. Moreover, "between 1860 and 1930 alone, there were more than ninety separate relief measures for various fires, floods, droughts, and famines." These measures included millions expended for southern relief after the Civil War. Dauber, *infra* note 60, at 290–95; *see also* MICHELE L. DAUBER, THE SYMPATHETIC STATE: DISASTER RELIEF AND THE ORIGINS OF THE AMERICAN WELFARE STATE (2012).

the argument for such relief rests instead on moral grounds[60] or political considerations (or lobbying).[61]

The moral and political considerations at play when providing such relief are not much different in a pandemic than they are in other contexts. The moral questions about who deserves relief and the risks of political abuse in granting that relief are much the same after this pandemic as they were after prior disasters, such as earthquakes, hurricanes, fires, the terrorist attacks of September 11, and even the War of 1812 and the Whiskey Rebellion.[62]

Still, one fact might distinguish the political and moral calculus here. Few events in recent history have had such a direct effect on so many people around the world. It is not clear which way that cuts. On the one hand, ubiquity may create a strong political appetite for relief. On the other hand, it may spark especially vigorous objections to any relief targeted at specific firms or industries, especially if those firms or industries are viewed as political favorites.[63]

2. Stimulus for systemic economic distress

In some cases, economic distress can be systemic. These cases often call for transfers intended to stimulate systemic economic activity. Because these transfers are intended to jump-start economic activity and stop the spread of economic distress, they usually should be targeted at a broad market or industry rather than at specific firms or individuals. And the argument for using broad measures (directed at all small and

[60] *See* Michele L. Dauber, *The War of 1812, September 11th, and the Politics of Compensation*, 53 DEPAUL L. REV. 289, 354 (2013) (discussing the "moral economy" involved in such transfers which often "requires that claimants represent themselves as blameless victims of forces entirely beyond their own control").

[61] Airlines have been particularly successful at this type of lobbying, receiving special relief after the terrorist attacks of September 11 and during the pandemic. Margaret M. Blair, *The Economics of Post-September 11 Financial Aid to Airlines*, 36 IND. L. REV. 367, 367–70 (2003); *see also* Jonathan Lewinsohn, Note, *Bailing Out Congress: An Assessment and Defense of the Air Transportation Safety and System Stabilization Act of 2001*, 115 YALE L.J. 438, 457 (2005) ("The ultimate goal of the ATSSSA was to avoid the symbolic cataclysm of multiple carriers declaring bankruptcy a short time after September 11."); Air Transportation Safety and System Stabilization Act, Pub. L. No. 107-42, § 101(a)(2), 115 Stat. 230 (2001) (codified at 49 U.S.C. § 40101 (2012)). Consistent with this trend, the airline industry secured billions in a bailout and loan package in the initial months of the pandemic. Alan Rappeport & Niraj Chokshi, *Crippled Airline Industry to Get $25 Billion Bailout, Part of It as Loans*, N.Y. TIMES (Apr. 14, 2020), https://www.nytimes.com/2020/04/14/business/coronavirus-airlines-bailout-treasury-department.html [https://perma.cc/G7YF-7UZ9].

[62] Dauber, *supra* note 60.

[63] Of course, all disaster relief measures prompt *some* fairness objections. *See id.* at 347 (quoting a woman objecting to relief after September 11 for treating those victims differently from victims of natural disasters and asking, "[W]hy do those people deserve to become millionaires more th[a]n any other surviving family member of any other disaster?"). Those objections might be louder when virtually everyone has some grounds to claim entitlement to relief.

medium businesses) rather than targeted measures is even stronger during a pandemic.

The systemic costs of economic distress are most obvious when the effects of a single firm's or industry's[64] shutdown spreads broadly to other businesses and consumers, ultimately causing the failure of otherwise economically viable firms. If markets function perfectly, firms with economic value will survive the failure of firms without economic value, and there will be no social costs. But when transition costs are high and it is difficult to differentiate good from bad firms, and when markets are slow to adjust to changes in aggregate supply and demand, economic distress may spread and create system-wide deadweight loss.[65] In that case, it may be in everyone's interest to prevent the first domino from falling or to stop the spread as soon as possible when the market does not produce the necessary coordination to do so on its own.[66]

This coordination problem and the spread of economic distress are particularly likely to accompany a global pandemic, but with added complications. Given the scope, speed, and variation of the economic shocks produced by the pandemic, efficient market adjustments and coordination were impossible. In March and April, certain industries experienced an abrupt and severe reduction in demand for their goods and services across all firms. Consumers stopped paying to fly on planes, stay in hotels, eat in restaurants, and go to movie theaters or fitness centers. In light of the rapidly changing circumstances, it would have been naïve to expect markets to swiftly and costlessly adjust. Instead, the market produced dramatic business closings and record-setting unemployment.

Responding to such a shock is complicated in part because many conventional government policies won't work in a pandemic setting. For instance, in a non-pandemic economic crisis, the government might provide direct stimulus funding to jump-start economic activity. If reduced demand for restaurants poses systemic economic risk—because restaurant failures lead to food distributor failures, which lead to catering failures, and so on—the government might provide stimulus funds directly

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[64] In reality, few economic firms are large enough to qualify as that "first domino." But certainly, if an entire industry or community shut down, the risk of systemic spread would be real.

[65] For a fuller but accessible treatment of these macroeconomic concepts and how they relate to law, see Yair Listokin, *A Theoretical Framework for Law and Macroeconomics*, 21 AM. L. & ECON. REV. 46 (2019).

[66] *Id.* at 47 (noting that a recession produced by inadequate aggregate demand "represents a coordination failure"); *see also* N. Gregory Mankiw, *New Keynesian Economics*, CONCISE ENCYCLOPEDIA OF ECON., http://www.econlib.org/library/Enc1/NewKeynesianEconomics.html [https://perma.cc/V9GF-2FMB].

to the restaurant industry or to potential diners. The first solution allows the restaurants to cover their production costs and lower prices. The second allows the diners to offset some of the price and dine more. Either way, the result is an increase in economic activity for the restaurants.

That approach would fail in a pandemic. If restaurants are closed because of a government order or because of consumer precautions, payments to stimulate dining will either fail or—even worse—work against public health policy. There is no sense in giving diners money to spend at restaurants that cannot open. And while a transfer to a restaurant may save that restaurant, it won't stop the systemic spread if the restaurant doesn't have any reason to spend the money on supplies or workers. For that reason, the government action would need to be broader, directed at the restaurants and all their suppliers as well as all other systemically affected industries.[67]

A further complication arises because of the temporal nature of the pandemic. It may be that the restaurants' suppliers can survive while the restaurants are shut down but only as long as the restaurants are expected to return after the pandemic. In those cases, the key to stemming the spread of systemic distress is not spurring on economic activity, but rather preserving the restaurants as going concerns until the pandemic recedes. This is done not for the sake of the restaurants, but for the sake of those other businesses who depend on the existence of the restaurants.

This problem arises because the permanent closures of restaurants have ripple effects. As restaurants shut down, food distributors, landlords, and workers now have to redeploy their resources in the economy.[68] Food distributors may adapt their businesses to produce for new markets. That adaptation is costly to do (and undo). Or they may shut down. And so the result of the restaurant closure might be the waste of these switching costs, or the restaurants *and the food distributors* might be lost for good.

Similarly, employees who are laid off will incur costs in adjusting to new labor markets. In the depth of the pandemic, Amazon may go on an unprecedented hiring spree—because its services are in more demand—providing jobs for unemployed restaurant workers.[69] But

[67] Alternatively, the government might require the restaurant to spend the money on supplies (and employees) it doesn't need or use. This is obviously wasteful but could be cost justified if it resulted in significant savings in the cost of administering the program.

[68] Firms may also default on bank loans causing systemic economic distress to spread into the financial sector. This might cause liquidity issues to spread.

[69] Karen Weise, *Pushed by Pandemic, Amazon Goes on a Hiring Spree Without Equal*, N.Y. TIMES (Nov. 27, 2020), https://www.nytimes.com/2020/11/27/technology/pushed-by-pandemic-amazon-goes-on-a-hiring-spree-without-equal.html [https://perma.cc/73Q9-FHV5].

matching and training those workers to new jobs is costly and does not happen overnight. And, of course, Amazon may then let all of those workers go when the pandemic ends.

As another example of spreading distress, consider a fitness center that is shut down by the pandemic. Like the restaurant, it has employees and suppliers who will be affected by the shutdown. But there are broader effects as well. The health food store and drive-through coffeeshop located next to the fitness center may be able to remain open, but they will still lose their customer base as the traffic to the fitness center disappears. During the pandemic these adjacent businesses may, themselves, need direct stimulus to survive. But that stimulus alone is not enough; they also need an assurance that the fitness center will be back (or will be replaced by a new fitness center) at the end of the pandemic. Without that assurance, the adjacent businesses may also be forced to close down for good. The government might, therefore, reduce social waste by propping up fitness centers to ensure that coffeeshops and health food stores don't collapse.

At the core, these are all problems about coordination and transition costs. If it is costless to shut down the old gyms (and coffeeshops and health food stores) when the pandemic begins and costless to open up new ones when it ends, then these temporal complications don't matter. Or if the costs are small enough, the government can simply let them fail and then provide stimulus to new replacement businesses after the pandemic is over. But if the costs of transition—including shutdown, reallocation of capital and labor, and rebuilding—exceed the costs of government-funded preservation, then preservation is the better course of action.

This comparative analysis can quickly favor preservation when there is a likelihood that distress will spread. If preserving the restaurant industry also preserves the vendors, landlords, and banks that do business with that industry, the expense of maintaining one business might eliminate the transition costs for five more. When that is true, government intervention on behalf of the restaurants looks even more economically attractive.

These calculations are, however, difficult, and again the pandemic context adds complications and uncertainties, three of which I highlight here. First, unlike the economic distress of a failed firm or industry that has outlived its usefulness (think the horse and buggy industry in the early twentieth century), the economic distress that arises in a pandemic will be temporary for many industries. But no one can know its exact duration.

That muddies the water. The appropriate allocation of economic resources for a pandemic that lasts three months might be quite different from the allocation appropriate for one that lasts over a year. And so, the social cost of providing stimulus funds to maintain the existing allocation relative to the social cost of letting market reallocation play out will depend in large part on what one expects the economy to look like next year. If firms shut down and three months later the demand for their products rebounds, the consumption of resources in shutting them down and then bringing them back is a waste. But what if they won't be back for three years?

Somewhat counterintuitively, the longer one thinks the pandemic will last, the weaker the argument is for systemic economic relief. The cost of preserving a business goes up relative to shut down and (re)startup costs as the period of distress increases. It may make economic sense to prop up a dormant restaurant or fitness center for ten months, but not for five years. (On the other hand, the humanitarian argument for specific relief may move in the opposite direction.)

Second, for some firms and industries, there is uncertainty about whether demand will ever recover. That is, some markets may be permanently altered, while others may not. It hardly makes sense to preserve the movie theater industry as it is if demand for movies in theaters will never fully return to pre-pandemic levels. But until the pandemic ends, one might not be able to distinguish permanent from temporary changes in these markets.

Finally, it may be difficult to differentiate firms and industries that are casualties of the pandemic from those that would have collapsed in the normal course of business.

These uncertainties make it difficult for markets to adjust to the shock of a pandemic. They also present a daunting challenge to governments considering intervention. In some instances—where more firms are expected to be viable after the pandemic and the cost of distinguishing good firms from bad firms is high—the best action may be to keep all firms alive until the pandemic is over. The question is a difficult one of how the expected costs of preserving all dormant businesses compare to the costs of shutting down and restarting (or sometimes altogether losing) the viable businesses. If it is too costly or impossible to answer this question, a government actor might take a blunt market-wide or industry-wide approach to stimulus and do the reckoning when the dust settles.

As a final matter, it is worth noting that systemic economic distress in a pandemic and the various complications discussed are especially acute problems for small and medium businesses. When a local coffeeshop or restaurant cannot pay its debts because its revenues have dried up and its fixed costs remain, there are only two paths forward. Either the creditors forbear—recognizing that there is no other use for these assets while the economy is on pause—or they shut the business down. Other tools like bankruptcy proceedings have little or no role to play here and cannot alter these two paths (more on this later).

The same is not true for most large businesses. The level of uncertainty is not the same. One does not doubt that the major airlines will return to some level of business after the pandemic or that McDonald's and Starbucks will continue to exist. Perhaps those firms will incur new debts to weather the storm, and they may have to reorganize their capital structures or even go through bankruptcy and change ownership, but one is reasonably sure that most of their assets will still be valuably deployed as part of their existing enterprises.

All this suggests that the government has a particular role to play in reducing systemic economic distress for small and medium businesses. To foreshadow later discussion, the appropriate tool for this action is emphatically not bankruptcy law. Bankruptcy law cannot create new economic demand, and it cannot pay the employees of a restaurant that is shut down.[70] Likewise, it cannot solve systemic problems because it functions in only one small corner of the system.[71] Similarly, other proposals that are narrowly targeted or require ad hoc judicial processes are unlikely to provide the necessary systemic relief. Standstill agreements or creditor haircuts provide specific relief to certain firms in financial distress who are worried about prior debts, but they don't go very far in paying the current costs of maintaining a business through a shut down that has lasted for almost a year. Rather, systemic economic distress should be met with a broad and general stimulus program for small and medium businesses.

Looking at what the government actually did in 2020, the PPP was in a sense appropriate as a broad transfer to small businesses, but a broader and more organized relief program would have been better.[72]

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[70] Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 102 (1984) [hereinafter *Corporate Reorganizations and the Treatment of Diverse Interests*] ("The problems brought by business failures are not bankruptcy problems."); *see also* DOUGLAS G. BAIRD & THOMAS H. JACKSON, BANKRUPTCY: CASES, PROBLEMS, AND MATERIALS 27 (3d ed. 2001) ("The legal system can do nothing to solve the problem of economic distress . . . . Laws can do nothing to transform bad restaurants into good ones.").

[71] Baird & Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests*, *supra* note 70, at 102 ("A bankruptcy proceeding should not be the place to implement a policy that society does not enforce outside of bankruptcy and that is unrelated to the preservation of assets for the firm's investor group. Most businesses fail without a bankruptcy petition ever being filed."). Professor Liscow questions this argument, though his analysis does not show that bankruptcy judges have the tools necessary to make firm-specific decisions based on broad macroeconomic calculations. *See* Liscow, *supra* note 57.

[72] Although the PPP has succeeded to some degree in preserving jobs and businesses, there remains significant disagreement as to the program's efficiency and efficacy. David Autor and David Cho found that the PPP increased aggregate employment by 1.4 million to 3.2 million jobs through the first week of June 2020. David Autor et al., *An Evaluation of the Paycheck Protection*

As to the other forms of systemic economic relief in the CARES Act, they were at best disorganized tinkering at the edges and at worst blatant political favoritism.

Consider, for example, the funds provided to the airline industry.[73] The airlines were not at risk of being dismantled. It is true that many airlines were in financial distress.[74] Without relief it was possible that some would have filed for bankruptcy and or ended up being owned by their creditors. But none of that poses an obvious macroeconomic concern. Nor was the relief structured to prevent systemic spread or protect adjacent industries. And to the extent the transfers were intended as relief for airline *employees*, direct payments would have been a more efficient and effective way to achieve that end.

As for the government payments to individuals, they might be defensible as specific relief,[75] but in terms of systemic distress they provided no help to the small businesses that were shutting down. Individual stimulus is a consumer-focused program, but the systemic problem in this crisis was at the small and medium business level. Indeed, to the extent payments to individuals in 2020 stimulated aggregate demand—usually what you want from a stimulus program—they were misdirected because they would have only stimulated demand for products from the wrong firms, those that *were not being shut down* because of the pandemic risk.[76]

Program Using Administrative Payroll Microdata (2020) (preliminary draft), https://economics.mit.edu/files/20094 [https://perma.cc/Q52J-XRR8]. These modest findings have led some economists to argue that the PPP is an inefficient use of funds. Ben Casselman & Jim Tankersley, *$500 Billion in Aid to Small Businesses: How Much Did It Help?*, N.Y. TIMES (Feb. 1, 2021), https://www.nytimes.com/2021/02/01/business/economy/ppp-jobs-small-business.html [https://perma.cc/7N3M-YMZ8]. By contrast, other economists argue that the PPP was beneficial insofar as it saved small businesses in disadvantaged regions. Indeed, a study utilizing survey data from businesses in Oakland, California, estimated that the PPP increased medium-run survival probability by 20.5 percent, although only for microbusinesses. Robert P. Bartlett III & Adair Morse, *Small Business Survival Capabilities and Policy Effectiveness: Evidence from Oakland* (Nat'l Bureau of Econ. Rsch., Working Paper No. 27629, 2020), https://www.nber.org/system/files/working_papers/w27629/w27629.pdf [https://perma.cc/Q6QM-HAUN]; *see also* Beylin, *supra* note 19.

[73] Richard Squire, *Opinion: U.S. Airlines Don't Need a Bailout to Stay in Business*, WASH. POST (Mar. 22, 2020), https://www.washingtonpost.com/opinions/2020/03/22/us-airlines-dont-need-bailout-stay-business/ [https://perma.cc/WV8P-DCYT]; Anthony Casey, *Large Corporations Did Not Need a Bailout*, CLS BLUE SKY BLOG (Apr. 14, 2020), https://clsbluesky.law.columbia.edu/2020/04/14/large-corporations-did-not-need-a-bailout/ [https://perma.cc/W7H9-4HR6].

[74] David Schaper, *United Airlines Reports $1.8 Billion Loss but Looks Ahead to Friendlier Skies*, NPR (Oct. 15, 2020), https://www.npr.org/sections/coronavirus-live-updates/2020/10/15/924225784/united-airlines-reports-1-8-billion-loss-but-looks-ahead-to-friendlier-skies [https://perma.cc/8D8C-TKUF].

[75] While the payments may have been justified on independent grounds as relief for the specific economic distress of those receiving it, it is odd that the payment program excluded those most in need of relief. *See* discussion *supra* note 18.

[76] It is also possible that stimulus payments even posed a risk of encouraging consumers to spend money on activities we do not want them to engage in during the pandemic. This might

Other measures like the eviction moratoria were certainly important, but none was sufficiently broad to address the full problem that an enormous number of small and medium businesses have closed their doors and will not be here when the pandemic is over.[77]

3. Bailouts for systemic financial distress

Like economic distress, financial distress can be systemic or specific. Systemic financial distress occurs when, because of the interconnected nature of financial systems, distress at financial firms spreads through the financial system and dries up the capital generally available to firms in the real economy. This shock to liquidity will prevent those firms from financing their operations. The government's best response to systemic financial distress is to inject liquidity into the financial system. This injection is a bailout and can take the form of loans, guarantees, cash, or other transfers to private agents.[78]

The government's responses to the financial crisis of 2008 provide examples of such liquidity injections. As the crisis of 2008 spread and brought the near collapse of global financial markets, the United States government responded with massive financial bailout programs largely administered through the Federal Reserve and the Treasury Department. The scope, appropriateness, and efficacy of those programs has been the subject of much debate and a robust academic literature.[79]

suggest that we should more directly and deliberately subsidize the activities we want people to engage in.

[77] Exact figures are difficult to calculate, due in part to "lack of timely and granular data on financial positions" of small and medium sized enterprises in the United States. Pierre-Olivier Gourinchas et al., *COVID-19 and SME Failures* 7 (Nat'l Bureau of Econ. Rsch., Working Paper No. 27877, 2020), https://www.nber.org/system/files/working_papers/w27877/w27877.pdf [https://perma.cc/N2AY-59SB]. That said, available estimates demonstrate that there is a significant influx in small business failures due to the impact of COVID-19. *See Local Economic Impact Report*, YELP: ECON. AVERAGE (Sept. 2020), https://www.yelpeconomicaverage.com/business-closures-update-sep-2020.html [https://perma.cc/69D2-SK7M] (estimating that 97,966 businesses had permanently closed between March and September 2020); Robert W. Fairlie, *The Impact of Covid-19 on Small Business Owners: Evidence of Early-Stage Losses from the April 2020 Current Population Survey* (Nat'l Bureau of Econ. Rsch., Working Paper No. 27309, 2020), https://www.nber.org/papers/w27309 [https://perma.cc/X9W3-N4S7] ("The number of active business owners in the United States plummeted by 3.3 million or 22 percent over the crucial two-month window from February to April 2020."); Alexander W. Bartik et al., *How Are Small Businesses Adjusting to COVID-19? Early Evidence From a Survey* 8 (Nat'l Bureau of Econ. Rsch., Working Paper No. 26989, 2020), https://www.nber.org/papers/w26989 [https://perma.cc/87W8-PLSE] (reporting that in March 2020, 41.4 percent of small business owners had temporarily closed due to COVID-19, while 1.8 percent reported that they had permanently closed due to the pandemic).

[78] *See generally* Casey & Posner, *supra* note 29.

[79] Kate Judge, *Guarantor of Last Resort*, 97 TEX. L. REV. 707 (2019); Kate Judge, *The First Year: The Role of the Modern Lender of Last Resort*, 116 COLUM. L. REV. 843 (2016); Iman Anabtawi & Steven L. Schwarcz, *Regulating Ex Post: How Law Can Address the Inevitability of Financial Failure*, 92 TEX. L. REV. 75 (2013); Adam J. Levitin, *In Defense of Bailouts*, 99 GEO. L.J. 435 (2011); Jeffrey Manns, *Building Better Bailouts: The Case for a Long-Term Investment Approach*, 63 FLA.

While most would agree that the Federal Reserve has a central role to play in responding to a systemic financial crisis,[80] there is less agreement on the appropriate structure and rules that should guide its actions.

Because these arguments are already well rehearsed, I will spend the least time on this category. I have set out my views on this question elsewhere,[81] providing a framework to guide governments in designing financial bailouts. I noted there that the optimal government agents for implementing financial bailouts will usually be regulators in the executive branch and that a balance must be struck between considerations of ex post efficiency, fairness, moral hazard, and administrative costs.[82] Fairness and administrative costs can often be in particular tension because the easiest and most direct way to stabilize financial markets is providing aid to large financial institutions not individuals.

That tension was on display in the 2008 bailouts and the negative public reaction to the "big bank" or "Wall Street" bailouts.[83] The same tension exists with regard to the current crisis. As the Federal Reserve acted quickly to set up its 13(3) facilities in response to the pandemic, again the direct benefits accrued largely to financial institutions. And there have been some familiar complaints that the program favors Wall Street over Main Street.[84] The additional relief provided directly to individuals may temper some of these fairness complaints, though it is too soon to know.

As far as ex post efficiency, the financial measures appear to have been successful. To the extent a financial crisis was looming, it has been averted. Financial markets appear unscathed, and there has been no

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L. REV. 1349 (2011).

80 *See generally* Tamim Bayoumi et al., *Monetary Policy in the New Normal*, INT'L MONETARY FUND (Apr. 2014), https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2016/12/31/Monetary-Policy-in-the-New-Normal-41419 [https://perma.cc/XF68-7FNL].

81 *See generally* Casey & Posner, *supra* note 29.

82 *Id.*

83 *See, e.g.*, Nina Easton, *Main Street Turns Against Wall Street*, CNN MONEY (Sept. 28, 2008), https://money.cnn.com/2008/09/26/news/economy/easton_backlash.fortune/index.htm [https://perma.cc/YZU6-7D2D]; Adam Nagourney, *Bracing for a Backlash Over Wall Street Bailouts*, N.Y. TIMES (Mar. 15, 2009), https://www.nytimes.com/2009/03/16/us/politics/16assess.html [https://perma.cc/BV2N-VSQW]; Ross Douthat, *The Great Bailout Backlash*, N.Y. TIMES (Oct. 5, 2010), https://www.nytimes.com/2010/10/25/opinion/25douthat.html [https://perma.cc/YQ7A-RMQL].

84 *See, e.g.*, Niv Elis & Sylvan Lane, *Anger Mounts after Corporations Tap Small-Business Relief Funds*, HILL (Apr. 20, 2020), https://thehill.com/policy/finance/493759-anger-mounts-after-corporations-tap-small-business-relief-funds [https://perma.cc/KCM3-2VRZ]; Gene Marks, *Shame on Big Banks for Failing to Step up at a Critical Moment: The Covid-19 Pandemic*, GUARDIAN (Apr. 8, 2020), https://www.theguardian.com/business/2020/apr/08/big-banks-coronavirus-critical-moment [https://perma.cc/4BXH-8MX7].

liquidity crisis or lack of capital available to business. Indeed, most reports suggest that capital has been available in abundance.[85]

One might counter that no financial crisis ever loomed. But the spiraling markets in mid-March suggest that the threat was real.[86] The fact that we will never be sure is good news. The best crisis responses will appear unnecessary if they stop the spread before it happens.

4. Bankruptcy proceedings for specific financial distress

Bankruptcy law creates a system of procedures where specific firms and individuals can seek judicial relief for their specific financial distress. Firm-specific financial distress is a familiar concept to all bankruptcy lawyers and scholars. When a firm has too much debt in its capital structure, it may find itself unable to raise new capital to finance projects. This can occur even when financial markets are functioning perfectly.

Bankruptcy law is a system of proceedings designed specifically to alleviate this problem.[87] This is an uncontroversial view that has appeared in casebooks for decades.[88] The importance of this point is in its negative corollary. Bankruptcy law is not a tool for solving economic distress. Bankruptcy does not solve economic problems—it cannot pay future bills and cannot create new demand. If a restaurant has no customers, the bankruptcy process will not create new revenue to pay employees or make rent.

This is evident in the fact that many small businesses that try to use bankruptcy to save their business fail. Indeed, the majority of small and medium businesses who try to reorganize in Chapter 11 fail and

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[85] *See* John Foley, *Breakingviews–Big U.S. Banks Keep Their Powder a Bit Too Dry*, REUTERS (Jan. 15, 2021), https://www.reuters.com/article/us-jpmorgan-results-breakingviews-idUSKBN29K29A [https://perma.cc/79P8-2Z5S] (observing that "[b]ig U.S. banks are awash with capital, trading like it's the end of days, and raising abundant capital for their clients"); Rachel McGovern, *Record Sum of Dry Powder Ready for Pandemic-Hit Firms, ICG Says*, BLOOMBERG (Jan. 8, 2021), https://www.bloomberg.com/news/articles/2021-01-08/record-sum-of-dry-powder-ready-for-pandemic-hit-firms-icg-says [https://perma.cc/9LLV-EZUT]; *Can Private-Equity Firms Turn a Crisis into an Opportunity?*, ECONOMIST (May 30, 2020), https://www.economist.com/finance-and-economics/2020/05/30/can-private-equity-firms-turn-a-crisis-into-an-opportunity [https://perma.cc/VU3R-D73G] (observing that the private equity firm Blackstone has $152 billion in dry powder).

[86] *See* Imbert, *supra* note 12; Banerji et al., *supra* note 12.

[87] *See, e.g.*, Ayotte & Skeel, *supra* note 53 (arguing that bankruptcy is a solution for firms dealing with debt overhang or other liquidity problems).

[88] *See, e.g.*, BAIRD & JACKSON, BANKRUPTCY: CASES, PROBLEMS, AND MATERIALS, *supra* note 70, at 27.

end up liquidating.[89] Moreover, most economically failing firms do not even bother with the process and simply shut down.[90]

It is not so surprising then that small business bankruptcy filings appear to have decreased since the pandemic began. Small firms will either fail or survive. Some have already failed and skipped the bankruptcy process because it had nothing to offer them.[91] Others are likely on the brink. Consider a firm that cannot pay its rent. The landlords may be subject to the eviction moratorium, or they may be waiting things out because—during the pandemic shutdowns—there is no new tenant waiting to replace the current one. But the moment the moratorium is lifted or the moment the new tenant materializes, that will change.

On the other hand, large firm filings have increased.[92] Again, this is not surprising. For these firms, the economic distress is temporary. It will consume assets and equity value, but the bulk of their assets will still be available when the pandemic eases. A small restaurant's creditors may liquidate its assets, while a large airline's creditors might take ownership of the firm and downsize by selling a few airplanes, keeping the bulk of the assets together. The airline resolves its financial distress by shifting ownership to creditors, and that can be accomplished through the bankruptcy process.[93]

Similarly, but less well recognized, bankruptcy law is a particularly bad tool for systemic distress.[94] When distress is spreading through the

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[89] It is estimated that nearly 60 percent of small business that file for bankruptcy under Chapter 11 are ultimately shut down; these filings are alternatively converted to Chapter 7 proceedings or are dismissed so that liquidation may occur under applicable state law. Edward R. Morrison, *Bankruptcy Decision Making: An Empirical Study of Continuation Bias in Small Business Bankruptcies*, 50 J.L. & ECON. 381, 382 (2007).

[90] *See* Douglas G. Baird & Edward R. Morrison, *Serial Entrepreneurs and Small Business Bankruptcies*, 105 COLUM. L. REV. 2310, 2317 (2005) ("Perhaps only ten to fifteen percent of all failing businesses ever file a bankruptcy petition.").

[91] Despite the sharp increase of small business failures since the onset of COVID-19, there has been a corresponding decrease of small business bankruptcy filings during this same period. *Compare* sources *supra* note 77, *with* sources *supra* note 45.

[92] *Supra* note 45.

[93] A more technical way to explain this point is that each firm—big and small—has a set going concern value. That is the value that is created by keeping its assets together. The going concern of the large firm will be large in absolute terms. The going concern value of a small firm will be small. Preserving the business and reorganizing its capital structure costs money. These costs eat up value. At some point the costs of recovery are greater than the going concern value. When that happens, the firm will fail. But unlike going concern value, these costs are not necessarily proportional to the size of the firm. Restructuring costs are much higher for small firms than large firms as measured relative to the firm's going concern value. Thus, a large firm is more likely to have enough excess going concern value to cover those costs and avoid true economic distress.

[94] Van Zwieten, Eidenmuller and Sussman make a similar point in noting that bankruptcy is not designed to deal with the "exceptional scale and nature of COVID-19 distress." Kristin van Zwieten et al., *Bail-outs and Bail-ins Are Better Than Bankruptcy: A Comparative Assessment of Public Policy Responses to COVID-19 Distress* (European Corp. Governance Inst., Law Working

system, looking for a solution in a decentralized process that addresses each affected firm separately makes little sense. As a first objection, bankruptcy law provides a case-by-case system where each judge is focused on one debtor. That judge lacks systemic information and is not in a position to collect policy inputs on the state of systemic financial markets.[95] And the appropriate remedy for an individual firm is different from the appropriate remedy for the system as a whole.[96]

Thus, proposals to inject liquidity into the system by providing special loans to bankrupt debtors are flawed.[97] Systemic liquidity problems occur at a macroeconomic level, but bankruptcy is not and has never been a macroeconomic tool.[98] Trying to use it as such would create coordination problems among multiple courts and other policymakers.

To use an analogy to the public health crisis in a pandemic, bankruptcy proceedings are like a doctor treating an individual patient. While they are crucial to resolving that patient's issues, they can do little to address the danger throughout the community. The specific treatment for an individual patient is distinct from the public health measures needed to contain the spread of the disease. And the specific treatment for one firm's financial distress is distinct from the measures necessary to stabilize financial markets as a whole. Just as a systemic health crisis requires coordinated systemic action and not ad hoc individual treatments, a systemic financial crisis requires a coordinated systemic response.[99] The bankruptcy system does not provide that response.

Paper No. 535/2020, 2020), https://ssrn.com/abstract=3669541 [https://perma.cc/3NJQ-Z5Y7].

[95] *But see* Liscow, *supra* note 57.

[96] Triantis and Ellias seem to take a different view. Ellias & Triantis, *supra* note 31 ("Instead of building a new rescue system that operates outside and exclusive of existing bankruptcy law, the government should recognize that it already has a set of experts in financial distress in its bankruptcy judiciary and put that expertise to work."). To the extent they argue that the bankruptcy system will be an important tool for large firms in specific financial distress, I agree. But beyond that they seem to suggest that bankruptcy is the core of a systemic response to the economic and financial crisis. That is where our analysis diverges.

[97] *See* Jason Roderick Donaldson et al., *Restructuring vs. Bankruptcy* (Colum. L. & Econ., Working Paper No. 630, 2020), https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=3710&context=faculty_scholarship [https://perma.cc/BP7P-KUAV]; Peter DeMarzo et al., *supra* note 35.

[98] *But see* Liscow, *supra* note 57, for an argument that bankruptcy court is a good place for counter cyclical measures. Liscow's argument is directed more towards unemployment than crisis. Still, the proposal is undermined by its asymmetry with non-bankruptcy relief, and in a crisis the institutional and coordination concerns are heightened. A bankruptcy judge sitting in a particular district will not be great at assessing the full picture. It makes more sense for that to be done by the executive or legislative branch.

[99] Ellias and Triantis use a different analogy and reach a different conclusion. Ellias & Triantis, *supra* note 31 ("In its strategy to provide relief and stimulus, the government is in effect offering roadside emergency assistance when the infrastructure and expertise of a hospital is easily accessible."). This is an apt analogy for the specific patient. But again, it is not clear how the individual hospital can stop the systemic spread here.

As a second objection, conditioning systemic aid on the filing of bankruptcy will only address the problem for firms that have already started to fail. This often occurs too late in the day to prevent a spread. And bankruptcy remedies will miss firms that never file for bankruptcy—some because bankruptcy offers no solution to their distress, some because bankruptcy is too expensive, and some because they are far beyond saving. In fact, the bulk of the firms in distress never enter the bankruptcy system. And those that do often do not find the relief they need. Thus, any measure that tries to use bankruptcy as the point of entry for systemic relief—such as a provision for automatic funding or a provision forcing creditors to provide relief to the debtor—will be too narrow because it will miss most relevant firms.[100]

As a third objection, relief that is available only in bankruptcy may corrupt the incentives for filing. This is not a new idea. It has long been recognized that systemic relief that is only available in bankruptcy draws firms into bankruptcy that don't belong there.[101] That is particularly worrisome when—as is the case for small businesses—the costs of bankruptcy are significant. Providing relief outside of bankruptcy allows a business to access that relief without incurring the large costs of an unnecessary bankruptcy proceeding.

To be clear, for the same reasons, it is also a mistake to go to the other extreme and condition relief on the absence of a bankruptcy filing or otherwise exclude bankrupt firms from accessing relief. Systemic relief should be bankruptcy neutral. This was one of the most egregious oversights in the original CARES Act. Whether or not that oversight has or will be rectified remains to be seen.[102]

III. FINAL THOUGHTS ON BANKRUPTCY AS A CASUALTY OF THE PANDEMIC

The preceding subpart demonstrates that bankruptcy is not an appropriate tool for responding to systemic financial or economic distress. But a second question remains. Will the bankruptcy system itself be a casualty of the crisis? This is not a question of how the bankruptcy system can remedy the crisis, but of how the crisis will affect the bankruptcy system. Some have raised doubts about the system's ability to continue functioning in its normal way during the crisis.

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[100] Automatic provisions forcing creditors to take haircuts or provide other "bail-ins" also create the risk of transmitting the financial distress from debtors to their creditors. This could exacerbate the problem by moving the systemic risk closer to the core of the financial system.

[101] Baird & Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests*, *supra* note 71, at 99–101.

[102] *See* sources cited *supra* note 22 and accompanying text.

This question arises because systemic financial and economic distress cause individual firms to experience specific financial distress, and those firms may then file for bankruptcy. During a large crisis, the number of firms hit by such specific financial distress may increase.

We have seen this to some degree with large firm filings. But those large firms are not the systemic concern, and the numbers have been manageable. If a system-crippling wave hits, it will do so when small firms and individuals start filing at significantly increased rates, which they haven't. Of course, that might change. Perhaps the wave was postponed by the earlier stimulus programs and will arrive when those programs run out, or perhaps distress will deepen to a level that spurs on small business filings.

If one thinks the wave is still likely, one might think the bankruptcy system needs support—more judges and other resources—to survive. Upon reflection, however, increasing the number of bankruptcy judges in the face of this wave is an odd response. Historically, small businesses don't fare well in bankruptcy. They convert to Chapter 7 and go out of business after wasting their remaining value on the bankruptcy process.[103] And so the prediction is that courts will drown in a wave of bankruptcy cases that the system is bad at handling, that too many debtors with hopeless cases will seek relief in a system that cannot help them.

It is a strange response to that prediction to call for more judges. More judges for what? Processing hopeless cases toward liquidation? If lawmakers have the foresight now to see the wave coming and the political ability to do something about it, why prepare to process that wave rather than prepare to stop it?

Preparing the bankruptcy courts is the wrong solution for this problem. It is also the less politically feasible one. Lawmakers are likely to find it politically easier to stop the wave than to add judges to manage it. The judge question is a fraught one likely to involve local constituencies and political logrolling, and the addition of judges will likely face more political hurdles than would an expensive bailout or stimulus plan.[104]

If the choice is between adding dozens or hundreds more bankruptcy judges[105] or doubling stimulus relief for small businesses, then

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[103] Baird & Morrison, *supra* note 90.

[104] The allocation of bankruptcy judgeships can implicate powerful local interests among legal professionals. To create hundreds of new judgeships is one thing but deciding where to put them is another. Like the decades-old debate about venue reform, that question will be difficult to resolve without major political battles. Indeed, the history of the creation of new bankruptcy judgeships (most of them temporary) has demonstrated that this is a difficult issue on which to get congressional movement.

[105] *See, e.g.*, Iverson et al., *supra* note 9 (estimating that the bankruptcy system could need as

the lawmakers should double stimulus relief. This is a direct example of the main point in this Article. Government action should focus on the right problem with the right set of tools. If the goal is to stop a wave of systemic economic distress, the government should provide stimulus. It should not spend resources to reinforce a remedy for specific financial distress that provides no systemic or economic relief.

IV. CONCLUSION

One cannot understand the right government tools in a crisis until one understands the nature of the crisis and the purpose for government intervention. In a financial crisis, government actors might want to save specific firms that have been affected, or they might want to stabilize financial markets. In an economic crisis, their goal might be to stop the spread of distress. Or the damage might be done, and the government actors just want to compensate firms or people for their losses. Each specific goal will suggest a specific path of action.

The choice of tools in the current crisis has been suboptimal. The government has yet to fully address the systemic economic challenges posed by COVID-19. The appropriate response requires further economic stimulus for small businesses rather than bankruptcy reform. The economic hardship is real and growing. And while the day of reckoning likely won't arrive as a wave of Chapter 11 bankruptcy filings, in the absence of appropriate systemic economic relief, it will materialize in some form.

many as 246 temporary judges); Letter from Jared A. Ellias (June 10, 2020), *supra* note 15 (calling on Congress to appoint at least fifty temporary bankruptcy judges).