

TOO SMALL TO FAIL: STATE BAILOUTS AND CAPTURE BY MARKET UNDERDOGS

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ABSTRACT

Bailouts have become a pervasive phenomenon, particularly around the 2008 global financial crisis, as states came to the rescue of financial institutions considered Too Big to Fail (TBTF) faced with imminent bankruptcy. While TBTF bailouts are officially designed to prevent catastrophic domino effects in markets, critics view these bailouts as a result of industry manipulations of regulators and state officials, leading to regulatory capture. Scholars describe regulatory capture as a situation where regulators favor the private interests of regulated firms over public interests, in exchange for legally-dubious gains such as political capital, monetary support, or lucrative future employment opportunities. While the phenomenon of regulatory capture by large and resourceful firms is well researched by economists, jurists, and political scientists, a new unexplained phenomenon, yet to be addressed in academic literature, is emerging in modern economies: the bailout of small firms. Due to the relatively insignificant size and influence of those firms, they cannot be considered economically too big to fail and are usually unable to provide regulators with sufficient incentives to secure bailouts through classic capture. Aiming to explain this phenomenon, this paper develops a Too Small to Fail (TSTF) approach, asserting that small firms adopt an underdog rhetoric designed to facilitate regulatory capture. TSTF firms capture regulatory decision-making for lucrative bailouts by blaming regulation, regulators, global and local catastrophes, or by pleading for special consideration due to social importance. The case studies examined in this paper include U.S.-owned firms in both health and media sectors operating in Israel under Israeli regulation. This is an extremely useful arena for examining the underdog

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rhetoric of small firms because of its unique geopolitical characteristics and disposition to capture, stemming from an absence of comprehensive regulation policies. The paper concludes with normative suggestions for overcoming TSTF capture by imposing new legal duties on the regulatory decision-making process of administrative agencies.

I. INTRODUCTION

Bailouts have become a pervasive phenomenon, particularly around the 2008 global financial crisis and states' rescue of major financial institutions considered Too Big to Fail (TBTF).¹ The TBTF approach intends to prevent catastrophic market domino effects due to the collapse of interconnected firms, through state subsidies. Critics who object to state bailouts of financially troubled firms point at manipulations that regulated institutions perform on regulators and state officials, who become captured by industries interested in state aid via the exchange of legally-dubious favors.²

While the phenomenon of regulatory capture by large and resourceful firms is well researched by economists, jurists, and political scientists,³ a new unexplained phenomenon, yet to be addressed in academic literature, is emerging in modern economies: the bailout of small firms. Due to the relatively insignificant size and resources of those firms, the economic logic of TBTF and regulatory capture does not account for their bailout. Attempting to explain this phenomenon, this Article proposes a Too Small to Fail (TSTF) bailout theory in which small firms capture regulatory decision-making to obtain lucrative bailouts by employing an underdog rhetoric: blaming regulation, regulators, global and local catastrophes, or by pleading for special consideration due to social importance.⁴ The case studies examined in this Article include U.S.-owned firms in both health and media sectors operating in Israel under Israeli regulation.⁵ This is an

¹ For a general explanation of the idea of Too Big to Fail *see infra* part III.A. For the emergence and development of the term and policy in U.S. financial history, *see* Jonathan R. Macey & James P. Holdcroft, Jr., *Failure is an Option: An Ersatz-Antitrust Approach to Financial Regulation*, 120 YALE L.J. 1368, 1376–78 (2011).

² For the general idea of capture *see, e.g.*, DANIEL CARPENTER & DAVID A. MOSS, *Introduction*, in PREVENTING REGULATORY CAPTURE: SPECIAL INTEREST INFLUENCE AND HOW TO LIMIT IT 1, 13 (Daniel Carpenter & David A. Moss eds., 2013) [hereinafter PREVENTING CAPTURE]; George Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3, 4 (1971).

³ *See infra* Part III.A.

⁴ *See infra* Part III.B.

⁵ *See infra* Part II.

extremely useful arena for examining the underdog rhetoric of small firms because of its unique geopolitical characteristics and disposition to capture,⁶ stemming from an absence of comprehensive regulation policies.

While Israeli government administration relies heavily on regulating private sectors, it has only recently started developing general regulation guidelines and procedures, following Israel's acceptance to the Organization for Economic Cooperation and Development (OECD) in 2010. Israeli market regulatory and administrative procedure flaws are especially evident, making it a good backdrop for legal analysis of regulatory capture.

In 2008, one of history's biggest financial crises erupted in the United States and then spread worldwide. Similar to other countries, the U.S. financial crisis was eventually resolved through government subsidies—state bailouts of major commercial and investment banks that were considered too big to fail, such as JPMorgan Chase, Citigroup, Bank of America, Bear Stearns, and large insurance companies like AIG. However, this bailout practice, seemingly serving the public's interest in financial stability, was not immune to regulatory capture, as critics have since pointed out.

Regulatory capture refers to regulatory agencies that prioritize the interests of private regulated firms at the expense of the public interest they are supposed to uphold.⁷ Private regulated firms steer regulators away from their public duties, encouraging regulators to act in those firms' favor when promoting legislation or taking regulatory action. These TBTF firms use their vast resources to secure future posts for retired regulators, influence political outcomes to favor regulators who seek reelection, or refrain from media campaigns against regulators that might harm regulatory reputation.⁸ For example, a bank regulator may be considered captured when he refrains from imposing strict regulation on the bank he expects to chair after his retirement or extends regulatory favors when the regulated bank has the power to publicly shame him or help his political campaign.

Research pertaining to the global financial crisis shows that while financial institutions were bailed out under the TBTF paradigm, bailouts were in fact a result of regulatory capture of administrative entities such as the SEC, the Federal Reserve Bank, and the Department of Treasury.⁹

⁶ See, e.g., Manuel Puppis, *Media Regulation in Small States*, 71 INTERNATIONAL COMMUNICATION GAZETTE 7, 9 (2009).

⁷ See *supra* notes 148–51 and accompanying text.

⁸ PREVENTING CAPTURE, *supra* note 2.

⁹ See, e.g., Arthur E. Wilmarth, Jr., *Turning a Blind Eye: Why Washington Keeps Giving in to Wall Street?*, 81 U. CIN. L. REV. 1283, 1363–1428 (2013).

However, bailouts of small firms do not fit the common description of regulatory capture. Small firms cannot promise government officials substantial political support or highly lucrative jobs; their bailouts are not even economically justified because they are not big enough to systemically affect markets.

Consider the case of a small, private hospital; one that is poorly managed, experiences financial difficulties, and is on the brink of collapse. The government then chooses to bail out the hospital's private owners with public money, though should it fail, no systemic effect is expected for the health market. This example describes a true chain of events that took place in Israel in 2014, when the Israeli government bailed out the American-owned Hadassah Medical Center with \$250 million in public funds.¹⁰ Why is a relatively small institution, and others like it, being saved at great public expense? What theory can explain this regulatory action?

A new theory of regulatory capture is developed in this Article to explain small firm bailouts. The Article's main assertion is that on top of regulators' capture by strong corporate entities, another type of capture occurs when small and weak corporations hijack regulatory administrative discretion.¹¹ This Article characterizes this capture-by-the-weak phenomenon and argues that companies can manipulate regulation and regulators both when they are big and strategically placed in the market, and when they are small and systemically insignificant.¹²

Based on this premise, the Article then aims to understand why and when capture-by-the-weak occurs and how it differs from capture-by-the-strong.¹³ Part II of the Article presents two case studies to demonstrate state bailouts of small firms that do not correlate with common explanations for bailout.¹⁴ Part III begins by describing the economic premise of TBTF and its role in the 2008 global financial crisis, and proceeds to suggest a new theory of Too Small to Fail, discussed from two perspectives: that of the failed industry and the rhetoric it employs in its favor, and that of captured regulators.¹⁵ Part IV points to legal administrative and regulatory duties that may be imposed in order to curtail TSTF capture.¹⁶

¹⁰ See *infra* Part II.A.

¹¹ See *infra* Part III.B.

¹² See *infra* Part III.B.

¹³ See *infra* Part III.B.

¹⁴ See *infra* Parts II.A–II.B.

¹⁵ See *infra* Part III.

¹⁶ See *infra* Part IV.

II. FAILED AMERICAN FIRMS UNDER ISRAELI REGULATION

A. *Hadassah Medical Center*

Presently, Israel's administration is deeply involved in regulation,¹⁷ not unlike many modern administrations around the world. The massive privatization of services and production that took place in the 1980s and 1990s enabled private firms to enter the arena that was once state-controlled.¹⁸ The previously Positive State, characterized as central and nationalized, has turned into a privatized state in need of extensive regulation. Israel today is a regulatory state,¹⁹ as it encompasses almost 100 regulatory institutional functions that issue almost 1,000 regulations each year.²⁰ In stark contrast to its vast regulatory volumes, the Israeli Government is yet to develop comprehensive regulatory policies or laws regarding regulatory administrative processes.

This part of the Article consists of two case studies depicting American-owned companies operating under Israeli regulation to illustrate the phenomenon of small firm bailouts. The term "regulation" generally refers to state intervention in steering the economy, mainly via specialized agencies that promulgate, monitor, and enforce regulations applicable to private firms.²¹ Though some consider bailouts as merely executive-

¹⁷ See, e.g., ITZHAK GALNOOR, PUBLIC MANAGEMENT IN ISRAEL: DEVELOPMENT, STRUCTURE, FUNCTIONS AND REFORMS, 58–59 (2010).

¹⁸ See, e.g., Daphne Barak-Erez, *The Private Prison Controversy and the Privatization Continuum*, 5 L. & ETHICS HUM. RTS. 138, 139–40 (2011) (providing a description of Israel's privatization process).

¹⁹ See Giadomenico Majone, *From the Positive to the Regulatory State: Causes and Consequences of Changes in the Mode of Governance*, 17 J. PUB. POL'Y 139, 139 (1997).

²⁰ OECD, *Regulatory Management Indicators, Israel 2011* 20 (2011), available at <http://www.oecd.org/gov/regulatory-policy/47827319.pdf>. Regulatory institutions count according to Israeli Prime Minister's Office, Regulation Team. *Government Book of Regulators* (June 1, 2015), <http://www.pmo.gov.il/policyplanning/Regulation/Documents/regu260715.pdf>. Bear in mind that Israel currently has a population of approximately 8 million.

²¹ The term regulation has many definitions and some are much broader than regulatory agency's activity. See, e.g., ROBERT BALDWIN ET AL., UNDERSTANDING REGULATION: THEORY, STRATEGY, AND PRACTICE 2–3 (2d ed. 2012) [Hereinafter BALDWIN ET AL., 2012]; DAVID LEVI-FAUR, HANDBOOK ON THE POLITICS OF REGULATION 3 (David Levi-Faur ed. 2011); BRONWEN MORGAN & KAREN YEUNG, AN INTRODUCTION TO LAW AND REGULATION 3 (2007); ROBERT BALDWIN ET AL., A READER ON REGULATION 3 (Robert Baldwin et al. eds., 1998) [hereinafter BALDWIN ET AL., 1998].

political funding acts by government entities,²² bailouts are, in fact, a form of regulation. They typically consist of many regulatory aspects such as regulatory standards' relief, waiver of enforcement, or abating debts to the regulator (sometimes the firm has to pay something to be allowed to operate in a market).²³

Furthermore, regulators are usually key players in reshaping the regulatory scheme applied to insolvent companies so as to ensure their post-bailout financial stability (demanding a less expensive standard of behavior) and placing new safeguards that are meant to prevent the recurrence of insolvency (for example, newly imposed corporate governance rules).²⁴ In addition, as this Article illustrates, regulators often become the firms' advocates in funding-authorities forums (i.e. the Federal Reserve System), in hearings before legislative institutions (if a law is required to allow the bailout), and official investigative committees appointed to address a relevant crisis in an industry and suggest regulatory reforms.²⁵

The chosen case studies are particularly useful for the purpose of this Article because Israel is extremely prone to capture.²⁶ This inclination is the result of both the absence of a developed regulatory doctrine and the deep historical relations between the government and industry tycoons.²⁷ When Israel joined the OECD, it was obligated to develop a comprehensive

²² In this Article, I use the term bailouts to describe financial government support and regulatory leniency extended to private companies that face serious financial difficulties or even bankruptcy. Bailouts can be realized through the simple transfer of subsidies; government purchase of company shares; government or regulatory leniency or forbearance of company debts to state or regulators; convenient government loans, asset purchase, and guarantee programs; or in the financial support of mergers or buyouts.

²³ Often by means of informal regulatory negotiations. For instance, during the 2008 financial crisis, U.S. regulators stated they would not impose regulatory sanction on large banks that were bailed out—even though these sanction were non-discretionary in nature—under the Prompt Corrective Action Law. 12 U.S.C. §1831o (2012) (mandating penalties against banks that do not hold sufficient capital ratios). Instead, they opted for private and confidential memoranda of understandings with these banks. See Wilmarth, Jr., *supra* note 9, at 1346–48. See also *infra* notes 30, 90–91 and accompanying text.

²⁴ See, e.g., Usha Rodrigues, *Corporate Governance in an Age of Separation of Ownership from Owner*, 95 MINN. L. REV. 1822, 1839–40 (discussing corporate governance provisions in bailout legislation).

²⁵ See *infra* part III.

²⁶ See, e.g., Galnoor, *supra* note 17, at 59.

²⁷ See *infra* notes 31–32.

regulation policy.²⁸ However, Israel does not yet have such policy, nor did it develop case law rulings regarding regulatory legal issues.²⁹ For the large part, Israeli regulation is made by consensus, informally at times, and often via regulatory contracts.³⁰ Many local regulators try to learn the issue as they go since there is no manual for regulatory decision-making process.

These practices are not surprising when taking into account Israeli government's known close connections with industry tycoons.³¹ The phenomenon is so deeply rooted and widespread in Israel that it was given a name—*Hon-Shilton* (Hebrew for Capital-Government)—bearing a similar meaning as Crony Capitalism.³² Close connections between Israel's regulators and controlling shareholders of regulated firms, combined with no local regulatory tradition to speak of, produced a special environment in which capture can prosper. Israeli capture presents itself in an extreme case, ideal for theoretical development of current approaches to state and administrative regulatory rulemaking. As this Article will show, the unique history and geopolitical environment of Israel also played an important part in TSTF capture.³³

This part begins by describing the bailout of Hadassah Medical Center (the Hospital) in Jerusalem and continues to the second case study, Israel's TV Channel 10 and its state bailouts. The theory of Too Small to Fail, developed in the following part of the Article against the background of

²⁸ See generally OECD, ENHANCING MARKET OPENNESS, INTELLECTUAL PROPERTY RIGHTS, AND COMPLIANCE THROUGH REGULATORY REFORM IN ISRAEL (2011) (explaining Israel's lack of regulatory doctrine, theory, and procedures), available at <http://www.oecd.org/israel/48262991.pdf>.

²⁹ *Regulatory Policy by Country*, OECD, www.oecd.org/gov/regulatory-policy/by-country.htm (last visited Mar. 25, 2015). Notice Israel has not yet provided OECD with its regulatory policy. *Id.*

³⁰ See, e.g., Sharon Yadin, *Regulatory Contracts in Israeli Financial Markets*, 35 TEL AVIV U. L. REV. 447 (2012).

³¹ See, e.g., *Is Israel Inc. Too Powerful?*, YNETNEWS.COM (Jan. 8, 2011) <http://www.ynetnews.com/articles/0,7340,L-4101788,00.html> (“[T]he country has one of the highest concentrations of corporate power in the developed world. A scathing parliamentary report from June last year found that 10 large business groups control 30% of the market value of public companies, while 16 control half the money in the entire country.”).

³² See, e.g., Daniel Doron, *Crony Capitalism in Israel*, WALL ST. J., Oct. 9, 2010, at A13 (“Israel’s economy remains dominated by about 20 politically-connected families that own much of the country’s assets, which they acquired from the government and labor unions in a privatization process with credit provided by nationalized banks.”).

³³ See *infra* part III.B.

these American-Israeli case studies, can later be implemented in other countries, with appropriate changes.

Medical care in Israel is available to nearly 100% of the population who are members of the four health funds.³⁴ The health insurance scheme in Israel is mandatory and mostly public.³⁵ Citizens are free to choose from these competing, non-profit healthcare plans, which are obligated by law to provide its members with health benefits packages.³⁶ Income-based insurance premiums are shared by employers who pay a compulsory payroll tax and households that pay income-based membership fees.³⁷ Health insurance for needy segments of the population is paid by government through the National Insurance Institute and so, de-facto, Israel holds a universal public health system, with subsidized medications and medical services for all citizens.³⁸

Medical care financing and provision in Israel is institutionally tangled, involving a variety of public, quasi-public, and private institutions.³⁹ Unlike most hospitals in the country, which are government owned, Hadassah is private and provides private medical services.⁴⁰ This relatively small hospital, situated in Jerusalem,⁴¹ was established by Hadassah—the Women's

³⁴ Dov Chernichovsky and David Chinitz, *The Political Economy of Health System Reform in Israel*, 4 HEALTH ECON. 127, 127 (1995).

³⁵ *Id.*

³⁶ See, e.g., Bruce Rosen & Hadar Samuel, *Israel: Health System Review*, HEALTH SYSS.TRANSITION, vol. 11, no. 2, 2009, at 11, available at <http://www.euro.who.int/document/e92608.pdf>.

³⁷ *Id.* at 43.

³⁸ See, e.g., Guy I. Seidman, *Is a Flat-Line a Good Thing?: On the Privatization of Israel's Healthcare System*, 36 AM. J.L. & MED. 452, 470 (2010). The Government distributes NHI funds among the health plans according to a capitation formula that takes into account the number and age mix of members in each plan. See Rosen & Samuel, *supra* note 36, at 43.

³⁹ Chernichovsky and Chinitz, *supra* note 34, at 128.

⁴⁰ For details, see Private Medicine, HADASSAH MEDICAL CENTER, www.hadassah-med.com/private-medicine/sharap.aspx (last visited Mar. 25, 2015). Jerusalem residents enjoy health services from the following hospitals: Hadassah Mount Scopus, Hadassah Ein Kerem, Shaare Zedek Medical Center, Bikur Holim, Al-Makassed, St. Joseph, and Augusta Victoria. See *Medical Information*, CONSULATE GENERAL OF THE UNITED STATES JERUSALEM, http://jerusalem.usconsulate.gov/medical_information2.html (last visited Oct. 13, 2015).

⁴¹ The Hospital was ranked number nine in Dun & Bradstreet Israeli rank for 2009, holding approximately 1,000 beds and serving 1 million patients a year (Israeli population is about 8 million; Jerusalem population is 1 million). In the latest ranking available (2013)

Zionist Organization of America (HWZOA) in 1939 (before the establishment of the State of Israel in 1948).⁴² HWZOA claims it is the largest volunteer organization and the largest women's organization in America, and that it is one of the most prominent groups in American-Jewish communal life, playing a key role in the relationship between that community and Israel.⁴³ The Board of Hadassah comprises fifteen members: one-third consists of Women of Hadassah Organization, another third is manned by American public figures, and another third by Israeli public figures.⁴⁴ The Hospital is considered the flagship of the Organization, a symbol of Zionist success.⁴⁵

In 2008, the Hospital suffered extreme financial deficits stemming from the Women's Organization losses and inability to cover the Hospital's expenses as before, due to the global financial crisis and bad investments made with the Madoff Fund.⁴⁶ By 2014, the Hospital reached a monumental deficit of \$332 million.⁴⁷ The Hospital then asked the District Liquidation Court to approve a recovery plan and settlements with debtors, including Hospital employees, based on a state bailout scheme.⁴⁸ The recovery plan

Hadassah was ranked #5 with 969 beds and an income of 1.6 billion Israeli Shekels (approximately \$410 million). *Rankings of Hospitals*, DUN's 100, <http://duns100.globes.co.il/en/rating?did=1000869855> (last visited Mar. 25, 2015).

⁴² In fact, Hadassah Medical Organization started operating in Israel as early as 1913 by establishing the *Tipat Halav* system (mother and baby clinics), and in 1918 began establishing hospitals in Jerusalem, Safed, and Tiberias. See Rosen & Samuel, *supra* note 36, at 12–13.

⁴³ *What Does Israel's Hadassah Crisis Mean for the Country's Health Sector?*, KNOWLEDGE@WHARTON (Feb. 21, 2014), <http://knowledge.wharton.upenn.edu/article/israels-hadassah-crisis-mean-countrys-health-sector>.

⁴⁴ See MINISTRY OF HEALTH, GABAY COMMITTEE REPORT FOR THE EXAMINATION OF THE HADASSAH CRISIS 8 (2014), available at www.health.gov.il/PublicationsFiles/Hadassah-crisis.pdf.

⁴⁵ See Asher Schechter, *Obamacare in Israel, and the People are Horrified*, HAARETZ (Feb. 20, 2014), <http://www.haaretz.com/news/features/1.575265>.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ Jerusalem Liquidation Court 14554-02-14, *Hadassah Medical Union v. Hadassah Women's Organization of America Inc.* (February 11, 2014) (on file with author); MINISTRY OF HEALTH, *supra* note 44, at 12–13. The state bailout is based on The Companies Law, 5759-1999 (Isr.), § 350(12) which allows the court to approve a company in stay of proceedings to take additional credit to finance its ongoing activities, and on The Budget Foundations Act of 1985, § 3a, authorizing the government to financially support a private entity that serves purposes such as education, culture, religion, science, art, welfare, health, sports, or similar other purposes.

was previously initiated by the Hospital and the Israeli Ministry of Health (MOH), which advocated for it and then negotiated with the Israeli Ministry of Treasury (MOT), finally reaching an agreement concerning financial aid to the Hospital.⁴⁹

In these proceedings, Israeli District Liquidation Court's Judge Mintz stated, in connection with Hadassah's expected bailout, that

the claim that some of the blame for the current condition lies with the State, which shall eventually pay the Applicant's debt no matter what, cannot stand not only because the Applicant is a private firm but also because its practical implications are burdening the entire public with the Applicant's financial recovery. That cannot be justified.⁵⁰

Justified or not, the Hospital managed to secure a lucrative bailout.

The bailout agreement stipulates that the state and HWZOA shall both transfer funds to the Hospital, based on a matching model, in a seven-year course, until 2020.⁵¹

Whereas the Hadassah Women will provide the Hospital with \$19 million annually and take out a loan of \$25 million, the state will give the Hospital an annual grant of \$7.5 million, transfer some \$100 million, and purchase Hadassah's real estate.⁵² On top of this generous financial aid, Israel relieved its regulatory restrictions regarding the HMO cap and increased it by \$30 million, following the MOH recommendations.⁵³

The bailout agreement was accompanied by new Israeli regulatory supervision and enforced structural changes in the hospital's management,

⁴⁹ See KNOWLEDGE@WHARTON, *supra* note 43.

⁵⁰ Hadassah v. Hadassah, *supra* note 48, ¶ 18. See also Haim Bior and Ronny Linder-Ganz, *Hadassah Nurses and Administrative Staff Step Up Sanctions*, HAARETZ (Feb 12, 2014 9:36 AM), <http://www.haaretz.com/business/.premium-1.573784>.

⁵¹ Hadassah v. Hadassah, *supra* note 48. See also JTA, *Hadassah Retains Control of Hospital in Recovery Deal*, TIMES OF ISRAEL (June 30, 2014 5:25 AM), <http://www.timesofisrael.com/hadassah-retains-control-of-hospital-in-recovery-deal>.

⁵² Hadassah v. Hadassah, *supra* note 48. See also Warren Adler, *Hadassah Bailout Frays Amid Accusations of Mismanagement*, HAARETZ (Nov. 5, 2014), <http://www.haaretz.com/business/.premium-1.624739>.

⁵³ Hadassah v. Hadassah, *supra* note 48. See also Ronny Linder-Ganz, *Don't Blame Hadassah Women for the Hospital's Money Ills*, HAARETZ (Feb 17, 2014, 10:08 AM), <http://www.haaretz.com/news/features/.premium-1.574555>.

though they are not very rigorous.⁵⁴ For instance, the Accountant General in the Israeli Ministry of Finance will have supervisory authority over the Israeli-American Board and the Hospital management, and the Israeli Ombudsman will have supervisory powers over the Hospital.⁵⁵ Additionally, the MOH recommended in its special report to enact a legislation that allows immediate bailout should the collapse of Hadassah Medical Center become imminent in the future, not unlike the US TARP legislation.⁵⁶ Overall, a huge bailout was given to the Hospital by the State of Israel, with regulatory encouragement and advocacy, and without any real strings attached. How did that happen?

During their bailout negotiations, the Hospital officials argued that burdensome regulatory supervision was the main cause of its failure.⁵⁷ Speaking in the liquidation proceedings, the Hospital contended that its poor financial status was a result of the MOH regulatory policy of placing strict price caps on the cost of services that the Hospital was allowed to charge the HMO's.⁵⁸ This, according to the Hospital, has harmed its profits causing it to de-facto subsidize the public health system and shoulder huge social responsibility.⁵⁹

The general understanding of the health regulatory scheme in Israel, however, is quite the opposite. In fact, a prominent lack of financial regulation prevails in private hospitals in Israel, including Hadassah.⁶⁰ In the Hadassah case, the popular concept was the widespread regulatory evasion by the management of HWZOA.⁶¹ While the Hospital is subject to

⁵⁴ Hadassah v. Hadassah, *supra* note 48, at ¶ 10. See also Ronny Linder-Ganz, *Hospital Crisis Nears End as Hadassah, State Edge Toward \$870 Million Recovery Plan*, HAARETZ (May 11, 2014 3:30 AM), <http://www.haaretz.com/business/.premium-1.589892>.

⁵⁵ Hadassah v. Hadassah, *supra* note 48. See also Ronny Linder-Ganz, *Government Panel: Take Hospital from Hadassah Women*, HAARETZ (Apr. 9, 2014 3:01 AM), <http://www.haaretz.com/news/israel/.premium-1.584618>.

⁵⁶ See MINISTRY OF HEALTH, *supra* note 44, at 32. For a brief summary of the report see Linder-Ganz, *supra* note 55.

⁵⁷ See, e.g., Ronny Linder-Ganz, *Court Gives Hadassah More Time to Produce Rescue Plan*, HAARETZ (Apr. 15, 2014 3:10 PM), <http://www.haaretz.com/news/israel/1.585564>. This point will be further elaborated later. See *infra* part III.B.

⁵⁸ Hadassah v. Hadassah, *supra* note 48. See also Linder-Ganz, *supra* note 53; *infra* note 199 and accompanying text.

⁵⁹ See *infra* note 199; Hadassah v. Hadassah, *supra* note 48.

⁶⁰ See MINISTRY OF HEALTH, *supra* note 44, at 8.

⁶¹ See, e.g., Meirav Arlosoroff, *Hadassah: Too Big to Fail*, HAARETZ (Feb. 13, 2014, 3:11 PM), <http://www.haaretz.com/business/business-opinion/.premium-1.573906>.

health-services quality and pricing regulations imposed by the MOH, there is little to no supervision concerning the Hospital's financial stability or management.⁶² As a private hospital, Hadassah was free to spend money on whatever it desired—buildings, technologies, or highly paid personnel—there was no de-facto regulation regarding those activities by the MOH or any other Israeli regulator.⁶³ The cap restrictions on HMO's that referred their patients to receive public medical care in the hospital were not central at all in this private services oriented hospital.

The regulatory deficit concerning Hadassah and the uninterrupted control management hold over its operations is further exemplified in the following illustration. Generally, the MOH financial regulation of private hospitals is characterized by regulatory contract making rather than a strict system of mandatory rules.⁶⁴ The boards of directors of State hospitals are usually reluctant to cooperate with regulatory requests, so the MOH waits for the hospital to make some request from the regulator, when it can secure a deal in which the request is positively considered in exchange for information disclosure regarding the management of the hospital (which is subject to regulatory disclosure de-jure).⁶⁵ Under these conditions, it is clear that small private hospitals can manipulate regulators into favorable treatment.

The capture of the MOH and other regulatory officials to secure a bailout deal was evident from the hearings' protocols and final reports that were issued by the regulator's special committee, which was appointed to review the situation of the Hospital.⁶⁶ For instance, considering possible regulatory responses to the crisis—including turning the Hospital public (selling it to the State) and imposing stringent financial regulation—the report stressed

⁶² See MINISTRY OF HEALTH, *supra* note 44, at 8. See also Rosen & Samuel, *supra* note 36, at 70–71 (“[T]he Government regulates hospital licensure and oversees the authorization process for opening a new hospital or department. Furthermore, the number of hospital beds is regulated, along with their distribution in terms of ownership, specialty and location, as are major capital expenditures, such as the acquisition of magnetic resonance imaging (MRI) scanners and other expensive equipment. In Israel, monitoring of nonmedical components of quality takes place through a system of inspections and other types of reviews.”).

⁶³ The supervision of hospitals in Israel is based on a 1940 order of the pre-state British Mandatory government that gives no financial oversight authority to the MOH. See Public Health Ordinance, 1940.

⁶⁴ For regulatory contracts made by The Second Authority for Television & Radio see *infra*, notes 87–91 and accompanying text.

⁶⁵ See Schechter, *supra* note 45.

⁶⁶ See MINISTRY OF HEALTH, *supra* note 44.

that Israeli officials view HWZOA as a most important ally and supporter of Israel.⁶⁷

While the Hospital was actually becoming insolvent, Health regulators were most supportive of the private interests of its shareholders. It was clear to the regulators, without a doubt, that the Hospital must be saved without properly considering other options: “The state will have to give money. I have no doubt about it whatsoever. The state of Israel will have to give money to save the [Hospital in its] current situation and support it on an ongoing basis to help it get back on its feet.”⁶⁸

B. Television Channel 10

During the last few days of 2014, Israeli TV Channel 10, one of only three main Israeli broadcast channels, and its 400 employees, were waiting in alert anticipation to the regulator’s decision regarding their future: Will they receive a regulatory bailout, or will they have to stop airing and close the station due to serious deficit?⁶⁹ The Channel’s regulator had been presented with the same dilemma regarding the future of Channel 10 several times over the past decade, ever since it first issued a tender for a commercial television station in 2002 to compete with the existing monopoly in commercial television at the time.⁷⁰ On December 31, 2014, the very last day of the franchise period, the regulator again decided to renew the Channel 10’s regulatory franchise under substantial regulatory reliefs and debt waivers to the tune of almost \$40 million, thus saving it from bankruptcy and foreclosure.⁷¹ What caused the regulator to be so captured in Channel

⁶⁷ *Id.* at 23.

⁶⁸ See Transcript of Gabay Committee, Minister German, at 8 (2014), available at <http://www.health.gov.il/Services/Committee/gabai/Documents/p02042014.pdf>. The Gabay Committee was appointed to examine the Hadassah Medical Center crisis. See generally Linder-Ganz, *supra* note 55.

⁶⁹ See, e.g., Debra Kamin, *Arnon Milchan’s Israeli Network Saved by Last-Minute Government Reprieve*, VARIETY (Dec. 31, 2014, 7:39 AM), <https://variety.com/2014/tv/news/arnon-milchans-israeli-network-saved-by-last-minute-government-reprieve-1201390022>.

⁷⁰ See, e.g., Marissa Newman and Lazar Berman, *President, ex-finance minister back Channel 10 bailout*, START-UP ISRAEL, DEC. 29, 2014, <http://www.timesofisrael.com/president-ex-finance-minister-back-channel-10-bailout/>.

⁷¹ See The Second Authority for Television & Radio Law, 5750-2015, amendment No. 39; 7470 ISR. Admin. Regs. 559 (2014) [hereinafter The Second Authority Law]. See also Li-or Averbach, *Attorney General Saves Channel 10*, GLOBES ENGLISH (Dec. 31, 2014, 9:56 AM), <http://www.globes.co.il/en/article-attorney-general-saves-channel-10-1000997319>

10's self-preservation interests through state funding and regulatory relief that it was willing to overlook massive recurrent regulatory infringements? How can we explain regulatory bailout negotiations conducted against the written letter of applicable law?

Israel's television history is short.⁷² In the late 1960's, Israel's first public television broadcaster, Channel 1, started broadcasting.⁷³ It was not until 1993 that Channel 1's monopoly ended with the establishment and insertion of Channel 2, Israel's first commercial broadcaster.⁷⁴ Not only was there finally a competition between TV stations over Israeli viewers, but also the era of public television was in many ways over and succeeded by the era of commercial television.⁷⁵ In 2002, Israel's third television channel, commercial broadcaster 'Israel Ten', started broadcasting as Channel 10—an Israeli TV station owned by two American businessmen, Arnon Milchan and Ron Lauder, (holding 49% combined) and one Israeli controlling shareholder.⁷⁶ While Channel 2 had completely changed television for local viewers, breaking away from public television's failures,⁷⁷ Channel 10 was not as big of a success, running as a distant second to Channel 2 in rating

("Weinstein's decision comes just 24 hours before Channel 10's franchise was due to expire and the TV station would have been compelled to close down. The ruling comes after a day of hectic discussions between Second Television and Radio Authority board members and Deputy Attorney General Avi Licht.").

⁷² See OREN SOFFER, *MASS COMMUNICATION IN ISRAEL: NATIONALISM, GLOBALIZATION, AND SEGMENTATION* 117–66 (2014) (illustrating a comprehensive depiction of Israel's television history).

⁷³ Israel was declared a sovereign state in 1948. *U.S. Relations with Israel*, U.S. DEP'T OF STATE (Mar. 10, 2014), <http://www.state.gov/r/pa/ei/bgn/3581.htm>.

⁷⁴ *The Establishment of Channel 2*, SECOND TELEVISION & RADIO AUTHORITY, http://www.rashut2.org.il/english_regulating_ch2.asp (last visited Apr. 7, 2015).

⁷⁵ Today, alongside the state-run Channel 1, there is the Knesset Channel, which is devoted to the Israeli parliament (Channel 99); and Channel 33, which mainly focused on Arabic speakers. Paid commercial content is offered to Israeli homes via cable and satellite channels, provided by Hot Telecom and Yes respectively. See Kamin, *supra* note 69.

⁷⁶ Israeli Yosi Meiman. In 2013, Lauder decided to sell his share of the company. The controlling shareholder of Channel 10 is now RGE Group, led by Len Blavatnik.

⁷⁷ Interestingly, state-owned and operated public TV Channel 1 also suffered financial difficulties over the past several years, with a growing deficit and entering a liquidation process. The Channel is now being reformed and is expected to be replaced by a new entity, the Public Broadcasting Corporation (PBC), after the Israel Broadcasting Authority (IBA) went into receivership in 2014 ahead of massive layoffs and the sale of property. See, e.g., JPost Editorial, *Save the IBA's English news*, Aug. 28, 2014, THE JERUSALEM POST <http://www.jpost.com/Opinion/Columnists/Save-the-IBAs-English-news-372690>.

terms.⁷⁸ In fact, many believe Channel 10 has failed to achieve its intended regulatory purposes; namely, competition in content and in advertising, and in creating original content.⁷⁹

Israeli television franchisers are regulated by an independent authority dedicated to commercial television and radio broadcasts supervision.⁸⁰ Recently, there was some talk of establishing a central telecommunications regulator, an institution similar to the British Ofcom and U.S. FCC.⁸¹ However, this regulatory reform is yet to take place and Israel's regulatory institutional design is still quite decentralized, as follows: The Ministry of Communication regulates fixed line telecom companies, mobile phone companies, Internet service providers, postal services, and radio broadcasters, supervising their spectrum management and frequency licensing.⁸² Another regulator operates under the Minister of Communication—the Council for Cable and Satellite Broadcasting.⁸³ The public Channel 1 is separately regulated by the Israel Broadcasting Authority, which is also responsible for public radio broadcasting.⁸⁴ Another regulator—the Second Authority for Television and Radio (the Second Authority)—regulates Channel 2 and Channel 10 (as well as commercial radio stations).⁸⁵ The Second Authority acts by power of the Second Authority for Television & Radio Law of 1990 (Second Authority

⁷⁸ See, e.g., Nati Tucker, *Television Ratings Rise, but Ad Revenues Decline*, HAARETZ (July 3, 2012), <http://www.haaretz.com/business/television-ratings-rise-but-ad-revenues-decline-1.448417>.

⁷⁹ *Id.* See, e.g., Tamar Libes, *Who Needs Channel 10?*, THE SEVENTH EYE (July 7, 2009), <http://www.the7eye.org.il/21393>.

⁸⁰ Though formally independent in substantive matters of media regulation, the authority is administratively subject to the minister of communication, who appoints the Authority Council and approves the authority's employee's salaries. See The Second Authority Law §§ 7, 25, 29–31.

⁸¹ See, e.g., Nati Tucker, *Panel Recommends Independent Media Regulator for Israel*, HAARETZ (Sep 18, 2015 5:00 AM), <http://www.haaretz.com/business/.premium-1.676544>.

⁸² *Ministry Overview*, THE STATE OF ISRAEL MINISTRY OF COMMUNICATIONS (2015), <http://www.moc.gov.il/135-en/MOC.aspx>.

⁸³ *Council for Cable TV and Satellite Broadcasting*, THE STATE OF ISRAEL MINISTRY OF COMMUNICATIONS (2015), www.moc.gov.il/367-en/MOC.aspx.

⁸⁴ See Soffer, *supra* note 72 at 85–87.

⁸⁵ *About Us*, THE SECOND AUTHORITY FOR TELEVISION & RADIO, www.rashut2.org.il/english_index.asp.

Law), administers broadcasts through franchise and license holders, and supervises them.⁸⁶

Israel's television regulation presents an interesting dissonance between its formal institutions and its de-facto institutional arrangements, making room for regulatory capture. On the one hand, Israeli television franchisers are governed by a detailed legislative scheme comprising primary law, secondary laws, and regulations (mainly rules).⁸⁷ These law and regulatory norms define regulatory obligations imposed on television franchisers in detail, seemingly without leaving much room for regulatory discretion in regulating broadcasts. For example, the Second Authority Law states that at least 40% of television broadcasts must comprise local Israeli productions, and that franchisees have to meet a certain quota of quality genre programs (drama, documentaries, and special programs—all local productions) to broadcast each year.⁸⁸ On the other hand, alongside this 'command-and-control' style regulation, the main portion of television regulation is made of regulatory agreements negotiated with the franchisees,⁸⁹ often conditioning the binding regulations, the provisions of the Second Authority Law, and the franchise agreements, creating a form of regulatory bailout.⁹⁰

⁸⁶ *Id.* See also *Our Role*, THE SECOND AUTHORITY FOR TELEVISION AND RADIO, www.rashut2.org.il/english_role.asp; 1304 Israel Registry 59. A law amendment was introduced a few years ago to enable a regulatory reform-shifting from broadcast franchises to licenses. See The Second Authority Law, *supra* note 71, § 30.

⁸⁷ *Legislation – Laws & Regulations*, THE SECOND AUTHORITY FOR TELEVISION AND RADIO, available at http://www.rashut2.org.il/critic_judge.asp?refCatId=115.

⁸⁸ The Second Authority Law, *supra* note 71, first schedule §§ 1–2; The Second Authority for Television and Radio Rules (broadcasting television programs by a franchise owner), 5770–2009, available at <http://www.rashut2.org.il/editor/UpLoadLow/b-116.pdf>. See also Jonathan Cohen, *Global and Local Viewing Experiences in the Age of Multichannel Television: The Israeli Experience*, 15 COMM'C'N THEORY 437, 446 (2005), available at <http://hevra.haifa.ac.il/~comm/he/files/yoni/CT-global.pdf>.

⁸⁹ These agreements are incorporate in Law. See The Second Authority Law, *supra* note 71, §§ 37c, 59a, 102a.

⁹⁰ These are also known as regulatory contracts. See GREGORY SIDAK & DANIEL F. SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES 4 (1997); David A. Dana, *The New “Contractarian” Paradigm in Environmental Regulation*, 2000 U. Ill. L. Rev. 35, 36 (1999); Jody Freeman, *The Contracting State*, 28 FLA. ST. U.L. REV. 155, 156 (2000). See also *supra* note 23 and accompanying text; Yadin, *supra* note 30. A crude distinction is commonly accepted in the regulatory literature between command-and-control and 'soft law' tools. Whereas command-and-control aims at obligating firms with certain norms and standards of activity with binding legal sanction, softer tools such as agreements, voluntary

These regulatory bailout contracts, also found in the previous Hadassah case study, were typically introduced to correct franchise infringements without having to terminate the franchise itself. This regulatory design left the franchisers with plenty of influence on state regulation implementation, enforcement, and promulgation, thus further inducing future infringements.⁹¹ It seems that Channel 10 enjoys regulatory easements and state loans allow it to keep broadcasting. The regulator did not want to consider other market options and kept repeating the same bailout patterns.

Channel 10 was originally designed in the image of British Television Channel 4, a public-commercial broadcaster established in 1982 as the successful contender of the BBC.⁹² Channel 10 was characterized as both public and commercial.⁹³ Governed by strict content regulation, it was supposed to produce quality programming on the one hand, while carrying commercials and seeking profit maximization as a business model, on the other.⁹⁴ Channel 10 was obliged to pay the Second Authority some 4% of the station's annual income in royalties (an annually changing sum in regulations) and nearly \$5 million in franchise fees.⁹⁵ However, these strict regulatory requirements were never met by Channel 10 during its twelve years of broadcasting.⁹⁶ The end of each franchise period raised the need to re-evaluate a possible extension.⁹⁷ These caused several crises for the channel—in 2003, 2009, 2011, 2013 and recently, in 2014.⁹⁸

programs, disclosure rules, and self-regulation rely on the encouragement of the regulated entity to induce behavioral changes so as to steer the regulated industry in the desired direction. See JOHN BRAITHWAITE, *TO PUNISH OR PERSUADE: ENFORCEMENT OF COAL MINE SAFETY* 4 (1985); AYRES AND BRAITHWAITE, *infra* note 200, at 4; BALDWIN ET AL., 2012, *supra* note 21, at 111.

⁹¹ See, e.g., MORGAN & YEUNG, *supra* note 21, at 79–150; Daniel A. Farber, *Taking Slippage Seriously: Noncompliance and Creative Compliance in Environmental Law*, 23 HARV. ENVTL. L. REV. 297, 318–19 (1999) (stating that regulatory negotiations of violations can encourage further regulatory infringements, especially when the regulatory contract is enacted in legislation or other formal regulation).

⁹² As reflected in Knesset deliberations at the time. See Transcript of 15th Knesset Finance Committee Meeting No. 77 (Jan. 5, 2000) (on file with author).

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ See The Second Authority Law, *supra* note 71, §§ 99, 100.

⁹⁶ See, e.g., *The Establishment of Channel 10*, THE SECOND AUTHORITY FOR TELEVISION AND RADIO, http://www.rashut2.org.il/english_regulating_ch10.asp.

⁹⁷ *Id.*

⁹⁸ *Id.*

In each of these decision-making intersections, the Second Authority chose to refrain from publishing a tender for a new franchiser, as the law stipulates,⁹⁹ and instead, having no explicit authority to do so, negotiated with Channel 10 a new franchise agreement.¹⁰⁰ This regulatory contract practice eroded the public interests that were supposed to be achieved through current regulation, as they included more lenient content requirements and financial obligations towards the regulator, de facto bailing out the station from foreclosure. In 2010, when eight years of franchise ended for Channel 10, it was time to reconsider its legally-dubious recurring bailout practice by the Second Authority,¹⁰¹ but this was not exactly how things eventually turned out for Channel 10.

By the end of 2009, Channel 10 had already accumulated substantial regulatory violations: It was \$5 million short in obliged investments in film productions; it owed \$12 million in regulatory royalties and franchise fees; and it was \$25 million behind in investments in drama and documentary productions obliged by the Second Authority Law.¹⁰² The station had also managed to accumulate a great deficit and was infringing on the duty to broadcast news from Jerusalem, the state's capital, as required by the Second Authority Law.¹⁰³ Though the Second Authority Law at the time did not allow a franchise extension in case of major regulatory violations, Channel 10 filed an application with the regulator asking to be allowed to continue

⁹⁹ See The Second Authority Law, *supra* note 71, §§ 37B, 38.

¹⁰⁰ See The Second Authority Law, *supra* note 71; Opinion of the Legal Counsel of the Second Authority for Television and Radio, *Television Broadcast License Extension In The Third Channel - Channel Ten* (Aug. 13, 2009), www.rashut2.org.il/daily.asp?catId=125&pgId=54087; ISRAELI COMPTROLLER, 61B ANNUAL REPORT FOR 2009 506–10 (2010) [hereinafter ISRAELI COMPTROLLER].

¹⁰¹ ISRAELI COMPTROLLER, *supra* note 100.

¹⁰² See The Second Authority for Television and Radio, Annual Report (2010); ISRAELI COMPTROLLER, *supra* note 100. See also Transcript of the 18th Knesset, Joint Education-Economic Committee Meeting No. 150 (Jan. 5, 2010) (on file with author).

¹⁰³ *Id.*

broadcasting until 2012.¹⁰⁴ In response, the regulator agreed to negotiate a debt and content settlement mechanism.¹⁰⁵

At the same time, the Second Authority asked the Minister of Communication and the MOT to promote a bill for Channel 10 that would enable franchise extension.¹⁰⁶ Such a bill was necessary because the regulator lacked sufficient authority to renew the franchise of a breaching franchiser.¹⁰⁷

The negotiations on regulatory relief for the sustainment of Channel 10 between the regulator and the station's top management then served as the foundations of the Knesset bill.¹⁰⁸ The minutes of the nine meetings of Knesset Committee for Economy and Society (held over five months) reflect that the regulator strongly advocated Channel 10's case for franchise renewal.¹⁰⁹ Indeed, the regulator was so keen on securing Channel 10's

¹⁰⁴ §37 of the Second Authority Law states that a broadcast franchise will expire at the end of its stipulated duration; accordingly, §38 of the Law mandates that a tender must be published by the regulator. The Second Authority Law, *supra* note 71, §§ 37–38. The Law also forbids franchise extension in cases franchisees breach their franchise conditions, regulations, and the Law. *Id.*

¹⁰⁵ See decision No. 7, the Second Authority Council, meeting No. 85, Nov. 27, 2008 (on file with author).

¹⁰⁶ As reflected in the Knesset deliberations at the time. See Transcript of 18th Knesset Education-Economic Committee Meeting No. 1 (Oct. 26, 2009) (on file with the author). See also Transcript of 18th Knesset Education-Economic Committee Meeting No. 2 (Oct. 27, 2009) (on file with author).

¹⁰⁷ The Authority's discretion was bounded by Law. See The Second Authority Law, *supra* note 71, § 37.

¹⁰⁸ See *e.g.* Transcript of the 18th Knesset, Joint Education-Economic Committee Meeting No. 150, *supra*, note 102.

¹⁰⁹ See, *e.g.*, *id.* This advocacy was extremely difficult in light of a claimed covert objection of Prime Minister Benjamin Netanyahu to the channel's news section, which in the past conducted several exposés against the prime minister and his wife. See, *e.g.*, Lahav Harkov & Greer Fay Cashman, *Bill to Extend Channel 10 Broadcast Franchise Clears Hurdle*, JERUSALEM POST (Jan. 5, 2015), <http://www.jpost.com/Israel-News/Politics-And-Diplomacy/Bill-to-extend-Channel-10-broadcast-franchise-clears-hurdle-386707>; Center, *Left Hit PM for 'Intervening' to Shut Ch. 10*, JERUSALEM POST (Dec. 16, 2012), <http://www.jpost.com/Diplomacy-and-Politics/Center-Left-hit-PM-for-intervening-to-shut-Ch-10>. It should be noted that in 2014, the 19th Knesset dissolved, the government was reshuffled, and the prime minister assumed the Communication Portfolio, which made him the main authority in the bailout matter. See, *e.g.*, Jonathan Lis, *Netanyahu ally Gilad Erdan Accepts Interior Ministry, Gives Up Offered UN Post*, HAARETZ (Nov. 4, 2014), <http://www.haaretz.com/news/national/premium-1.624665>.

continuous standing on the television market that he was willing to overlook all regulatory infringements, however far reaching they were.¹¹⁰ Amendment 32 of the Second Authority Law, introduced in 2010, concluded the regulatory-parliamentary-industry negotiations and enacted the regulatory bailout scheme.¹¹¹ The bailout allowed for some \$10 million in regulatory relief for Channel 10.¹¹² These funds did not last long. In 2012,¹¹³ and again in 2014, more regulatory bailouts were made through legislation.¹¹⁴

During the bailout negotiations, Channel 10 made a myriad of claims (that will be discussed in the next part). It argued that shutting down the station would harm the public as it would have to consume media content from only one commercial channel (Channel 2);¹¹⁵ that Channel 2 would de-facto have total control of opinions and the political agenda of the media;¹¹⁶

¹¹⁰ *Id.*

¹¹¹ The Second Authority Law, *supra* note 71, amendment No. 32.

¹¹² See *supra* note 102 and accompanying text.

¹¹³ In the 2012 arrangement, on top of regulatory content waivers, a state loan of \$16 million was extended to Channel 10 to cover its debts to the regulator. See The Second Authority Law, *supra* note 71, amendment No. 37.

¹¹⁴ See *id.* See also *supra* note 102 and accompanying text. It should be noted that the bailout of late 2014 came in conjunction with the general elections, which made closing down one of the two leading Israel TV news stations highly problematic in terms of democratic values. See, e.g., Nati Tucker, *Labor MK Proposes Legislation to Rescue Israel's Channel 10*, HARETZ (Dec. 30, 2014, 11:03 AM), <http://www.haaretz.com/news/israel/premium-1.634403>. A few months later, in mid-2015, the Channel received another bailout, including regulatory easements manifested in a license given for 15 years (instead of another franchise extension). See *Media News, History in Israeli Television: The Second Authority granted Channel 10 a 15 years' license*, THE SECOND AUTHORITY FOR TELEVISION AND RADIO (June 28, 2015), http://www.rashut2.org.il/news_inner.asp?catid=58&pgid=105363&ShowPage=5&from=HomePage&stts=0.

¹¹⁵ See Tucker, *supra* note 114.

¹¹⁶ See Transcript of the 18th Knesset, Joint Education-Economic Committee Meeting No. 112 (Nov. 25, 2009) (on file with author); Transcript of the 18th Knesset, Joint Education-Economic Committee Meeting No. 150, *supra* note 102. See also Gili Izikovich, *Ministries Move to Save Cash-Strapped Channel 10*, HARETZ (Oct. 19, 2009), <http://www.haaretz.com/print-edition/news/ministries-move-to-save-cash-strapped-channel-10-1.5884> (“Channel 10 warned that the country could find itself with a TV monopoly.”). Channel 10’s petition filed with the Supreme Court in 2012 stated that the petition against closing the station is not only about saving employees from dismissal but also “saving Israeli democracy” and freedom of speech. Jasmin Gueta, *Channel 10 Petitions to The Supreme*

that on the whole, less content would be created for television in Israel, and the local culture and original content production will be severely harmed;¹¹⁷ that the regulation obliging it to invest \$70 million annually in news and content caused its continuing deficit;¹¹⁸ that war and military operations were the reason for its failure to produce ratings;¹¹⁹ that the upcoming general elections made the Channel's survival crucial for Israeli democracy;¹²⁰ that Channel 10 staffers and their families would suffer greatly from unjust dismissals; and that politicians whose images were tarnished by the Channel's news department's exposés were routing for the Channel's demise.¹²¹

The regulators portrayed the Channel 10 and Hadassah bailouts as TBTF cases of institutions that were rescued because they were “too important to fail.” The next part will show, however, that these were actually rather small firms, but they managed to capture regulatory sympathy using the unique manipulation that small underdog firms employ vis-à-vis state regulators to receive undeserved financial benefits and arguing they were, in fact, very important.¹²²

Based on these case studies, the TSTF theory is presented in the next part of the Article as follows: first, the theory of, TBTF and its main practices are presented in the prism of the financial global crisis of 2008. Then, a theory of TSTF is suggested and discussed, focusing on the narratives adopted to create TSTF capture.

Court Trying to Prevent Screen Blackout, THE MARKER, (Dec. 16, 2012), <http://www.themarker.com/law/1.1886880>.

¹¹⁷ See, e.g., Transcript of the 18th Knesset, Joint Education-Economic Committee Meeting No. 112, *supra* note 116.

¹¹⁸ See *id.* (quoting Channel 10's CEO); Nati Tucker, *Minister of Treasury to Channel 10 Executives: It's Up to You to Get Out of This Crisis*, THE MARKER (Dec. 12, 2012), <http://www.themarker.com/advertising/1.1879031> (quoting Channel 10's Chairman of the Board).

¹¹⁹ See, e.g., Ofir Dor, *Commercial Television Channels Ask for Assistance in Funding Costs of Special Broadcasting*, CALCALIST (Jul. 20, 2014), <http://www.calcalist.co.il/articles/0,7340,L-3636472,00.html>.

¹²⁰ See *supra* notes 71, 114.

¹²¹ See *supra* note 109 and accompanying text.

¹²² See *infra* Part III.B.

III. THE TOO SMALL TO FAIL THEORY

A. *The Too Big to Fail Theory*

‘Too big to fail’ (TBTF) became a popular catch phrase in American homes during the 2008 financial crisis.¹²³ In simple terms, TBTF reflects the idea that some financial institutions are too interconnected to other institutions to allow the failing firm to go under because this might create a national (or international) financial crisis in a domino effect, and therefore it is more efficient to rescue it with a governmental bailout.¹²⁴

Reacting to losses of more than \$1 trillion by banks and insurance companies around the world between 2007 and 2009, central banks and governments in the United States, United Kingdom, and Europe provided nearly \$9 trillion to support the industry with emergency liquidity assistance, capital infusions, asset purchase programs, and financial guarantees.¹²⁵ U.S. federal agencies extended about half of that support.¹²⁶ During that time, between mid-2006 and the end of 2008, a major American crisis emerged (known as the *subprime mortgage loan crisis*), slicing the value of U.S. homes by an estimated \$6 trillion.¹²⁷

The problem of TBTF institutions still occupies economies around the world and is not outdated. Only recently, in response to the Russian ruble crisis in which it lost some 45% against the dollar in 2014, the Russian Central Bank announced it would provide up to \$540 million to rescue National Trust Bank.¹²⁸ In the European Union, one of Portugal’s largest

¹²³ See Macey & Holdcroft, *supra* note 1.

¹²⁴ For an idea of TBTF see generally Arthur E. Wilmarth, Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963, 968 (2009).

¹²⁵ See *id.*

¹²⁶ *Id.* In 2008, financial assistance was given by US regulators and Government to 19 of the largest U.S. banks (each with more than \$100 billion of assets) and AIG, collectively extending \$290 billion in capital assistance. The United Kingdom and European nations similarly provided their financial institutions with more than \$4 trillion in financial support by the end of 2009. See Wilmarth, Jr., *supra* note 9, at 1345.

¹²⁷ See Wilmarth, Jr., *supra* note 124, at 966–67.

¹²⁸ See Andrey Ostroukh & Alexander Kolyandr, *Russian Regulators Take Over Retail Bank as Depositors Take Fright*, WALL ST. J. (Dec. 22, 2014), <http://www.wsj.com/articles/russia-central-bank-to-bail-out-private-lender-trust-bank-1419248842>.

financial institutions was recently bailed out with 4.4 billion Euros by Portugal's regulators with the European Commission's approval.¹²⁹

State bailouts have been the miracle cure prescribed worldwide in recent years to mostly-failed financial institutions that threaten to undermine financial stability. It is considered by many the most honest, moral, and efficient response to TBTF private institutions' mismanagement. In the aftermath of the global financial crisis, many view the bailouts as a public policy success and politicians often flaunt their support of industry bailouts as an achievement.¹³⁰

As the subject is still at the heart of rigorous political debate, many in the political arena object to state bailouts. In 2014, the U.S. Congress passed a revision to the "prohibition against federal government bailouts of swaps entities" bill.¹³¹ This revision, again, allows for Wall Street institutions' bailouts by reversing the Dodd-Frank Wall Street Reform and the Consumer Protection Act, which were enacted after the 2008 financial crisis to restrict future bailouts.¹³² Referring to this pro-bailout amendment, to the nearly half a trillion dollars in bailout money received by multinational bank Citigroup in recent years, and the financial institutions' influence on the amendment's introduction, Senator Elizabeth Warren stated that "Congress passes yet another provision that was written by lobbyists for the biggest recipient of bailout money in the history of the country A financial institution has become so big and so powerful that it can hold the entire country hostage."¹³³

The TBTF approach and its bailout solution have been criticized as ineffective and too lenient towards the financial industry. It appears that the

¹²⁹ Jack Ewing & Chad Bray, *Banco Espírito Santo to Be Split Up in Rescue by Portugal*, INT'L BUS. (Aug. 3, 2014), <http://www.nytimes.com/2014/08/04/business/international/banco-espirito-santo-of-portugal-appears-headed-for-a-bailout.html>.

¹³⁰ See, e.g., Keith Laing, *Obama: Auto Bailout 'was the right thing to do'*, HILL (Jan. 7, 2015, 5:48 PM), <http://thehill.com/policy/transportation/228836-obama-auto-bailout-was-the-right-thing-to-do>.

¹³¹ 15 U.S.C. § 8305 (amending the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1648 (2010)) (amended by Consolidated and Further Continuing Appropriations Act, Pub. L. No. 113-235, 128 Stat. 2130 (2014)).

¹³² Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

¹³³ Wonkblog Staff, *'Enough is Enough': Elizabeth Warren Launches Fiery Attack After Congress Weakens Wall Street Regs*, WASH. POST (Dec. 12, 2014), <http://www.washingtonpost.com/blogs/wonkblog/wp/2014/12/12/enough-is-enough-elizabeth-warrens-fiery-attack-comes-after-congress-weakens-wall-street-regulations>.

terms of the regulation and bailout plans are open to substantial influence from industry. For instance, economists argued that the TBTF policy gives private institutions an incentive to assume unwanted risks in their business affairs while growing to be large enough to be rescued by the government when the time comes.¹³⁴ Reliance on this type of regulatory response to industry failures creates negative incentives for major firms to become more prudent and minimize risks, and thus they become more risk-taking and prone to financial failure.¹³⁵

Other TBTF critics focus on the part big firms played in negotiating the terms of government bailouts and new regulatory schemes such as the Dodd-Frank Act. While the Act was designed to prevent the recurrence of such financial failures, it was deeply influenced by lobbying performed by Wall Street institutions, which led to soft and lenient implementation.¹³⁶ In other words, the TBTF policy is often understood as the result of industry manipulation of regulatory bodies and policymakers, designed to secure government subsidies and bailouts, consequently making those regulators captured in preserving the interests of the distressed private sector.¹³⁷

Recent research regarding the aftermath and post mortem of the financial industry crisis in the United States associates government bailouts and regulatory reforms and reliefs with a form of regulatory capture.¹³⁸ In this depiction, regulators are “captured” by powerful financial industry players who allocate substantial resources to influencing policy legislation

¹³⁴ See, e.g., NASSIM TALEB & CHARLES S. TAPIERO, *TOO BIG TO FAIL, HIDDEN RISKS, AND THE FALLACY OF LARGE INSTITUTIONS* (2009), available at <http://ssrn.com/abstract=1398102>.

¹³⁵ See Nassim Taleb & Charles S. Tapiero, *Risk Externalities and Too Big to Fail*, 389 PHYSICA A: STAT. MECHANICS AND ITS APPLICATIONS 3503, 3503–07 (2009).

¹³⁶ See DAVID A. SKEEL, JR., *THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES* (2010) available at <http://ssrn.com/abstract=1690979>; Wilmarth Jr., *supra* note 124. Eventually, bailouts were legislated in a \$700-billion program known as the Troubled Asset Relief Program (TARP) by President Bush in 2008. Wilmarth, Jr., *supra* note 9, at 1365–66.

¹³⁷ See, e.g., a recent definition for capture in the law and business literature: “Regulatory capture is the result or process by which regulation, in law or application, is consistently or repeatedly directed away from the public interest and toward the interests of the regulated industry, by the intent and action of the industry itself.” PREVENTING CAPTURE, *supra* note 2 at 1, 13.

¹³⁸ See James Kwak, *Cultural Capture and the Financial Crisis*, in PREVENTING CAPTURE 71, 72 (Daniel Carpenter and David A. Moss eds., 2013); Lynn A. Stout, *Derivatives and the Legal Origin of the 2008 Credit Crisis*, 1 HARV. BUS. L. REV. 1, 18–20 (2011); Wilmarth, Jr., *supra* note 9.

that pertains to the financial industry with campaigns and lobbying.¹³⁹ In fact, research has shown that financial companies received approximately \$500 of government bailout money for every dollar they spent on lobbying during the 5 years prior to the bailouts under TARP legislation.¹⁴⁰

Additionally, the financial industry has managed to maintain regulatory capture by facilitating the “revolving doors” technique—a phenomenon in which regulators are offered lucrative jobs in the regulated private sector after their retirement, consequently causing them to become extra lenient towards those firms during their official terms.¹⁴¹ This strong influence has been linked by scholars both to lax, pre-crisis financial regulation and to generous, post-crisis bailouts and weak implementation of new legislation intended to enhance financial supervision.¹⁴² As Law Professor Arthur Wilmarth, Jr. describes: “Large financial institutions responded to the crisis by appealing for and obtaining government bailouts. Political influence played a key role in determining which firms received bailouts and how much help they secured.”¹⁴³

B. The Too Small to Fail Theory

In his influential 1971 article, *The Theory of Economic Regulation*,¹⁴⁴ Nobel Laureate George Stigler framed the “problem of regulation” as “the problem of discovering when and why an industry . . . is able to use the state for its purposes.”¹⁴⁵ In this part, I wish to follow Stigler’s mission statement and expand the study of regulatory capture. In brief, this is my thesis: small firms play the card of underdogs subject to all kinds of misfortunes and disadvantages to obtain regulatory benefits in times of crisis. In response, regulators tend to refrain from imposing command & control enforcement on firms they should regulate (i.e., license revocation, criminal and administrative sanctions) and instead appear as saviors and push for bailouts as a form of capture.

This TSTF capture is a necessary addition to capture literature, which until now focused on strong industries (i.e. monopolies) and their material

¹³⁹ See Wilmarth, Jr., *supra* note 9, at 1363.

¹⁴⁰ See *id.* at 1365–56 (citing BENJAMIN M. BLAU ET AL., CORPORATE LOBBYING, POLITICAL CONNECTIONS, AND THE 2008 TROUBLED ASSET RELIEF PROGRAM 4, *available at* <http://ssrn.com/abstract=1878653>).

¹⁴¹ *Id.* at 1366.

¹⁴² *Id.* at 1311, 1366–67.

¹⁴³ *Id.* at 1365.

¹⁴⁴ Stigler, *supra* note 2.

¹⁴⁵ *Id.* at 4.

hold on regulators.¹⁴⁶ The analysis offered in this Article reveals a new set of regulatory bias yet to be thoroughly considered in the capture and administrative law research.¹⁴⁷

Stigler's 1970's theory of capture came in stark contrast to the prevailing view of regulation in administrative law as well as in political science as an instrument used by regulatory agencies for the maximization and pursuit of public interest (the Public Interest Theory).¹⁴⁸ According to the Public Interest Theory, economic regulation in the form of retention of monopolistic power of firms, price regulation, quality and safety regulation, as well as social regulation for the protection of equality and other rights of consumers is executed to maximize social welfare.¹⁴⁹

In contrast to this idealist depiction of administration, Stigler described regulation in terms of supply and demand—a market in which regulation is acquired by the industry and is designed and operated primarily for its benefit—for example, an industry that pushes for price fixing, entry control, or quota regulation to eliminate competition by other firms.¹⁵⁰ The regulation-seeking industry can pay regulators with campaign contributions or lucrative jobs to party members.¹⁵¹ This behavior contradicts most premises of administrative law theory and doctrines.

According to Stigler, the costs of the desired legislation (or regulation) increase with the size of the industry: the larger the industry, the more expensive are the regulatory plans that it needs to eliminate competition and therefore, the persuasion power it needs to employ on politicians has to be stronger.¹⁵² What happens with regulators of smaller firms that seek favorable regulation? So far, this question remains mostly unanswered and undeveloped. Stigler contended briefly that smaller firms are excluded from

¹⁴⁶ See, e.g., Ernesto Dal Bó, *Regulatory Capture: A Review*, 22 OXF. REV. ECON. POL. 203, 203–25 (2006) (providing a description of the research done in the regulatory capture field).

¹⁴⁷ See also Stigler, *supra* note 2 ; *infra* note 153 and accompanying text.

¹⁴⁸ See Stigler, *supra* note 2 (discussing public interest theory of regulation). See also Richard Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335, 335 (1974). For economic versus social justifications and purposes of regulation, see *infra* note 164.

¹⁴⁹ Posner, *supra* note 148; Stigler, *supra* note 2.

¹⁵⁰ Stigler, *supra* note 2 at 3.

¹⁵¹ *Id.* at 12.

¹⁵² *Id.* at 12.

the political process of capture since they have nothing to bargain with.¹⁵³ Furthermore, most of the capture theory literature has traditionally focused on markets of natural utility monopolies in which only one firm is allowed to operate (i.e., major firms).¹⁵⁴

My thesis is that regulators act not merely on pure Stiglerian economic tradeoffs or motivations, but are subject to manipulations that small industries (and other players) use to their benefit when seeking favorable regulation.¹⁵⁵ In this new model, regulated entities intentionally influence regulators' cognition in their favor, thus capturing them.¹⁵⁶

Economic capture, sometimes referred to as institutional corruption,¹⁵⁷ manifests in many forms that are thoroughly discussed in public-choice literature, including the appointment of regulators to high management positions in the regulated industry after they complete their tours as

¹⁵³ *Id.* It is important to note, however, that Stigler expanded on the interest group theory of the early 20th century political scientist and Marx's view that big business control institutions, from monopolies to firms operating in competitive markets. See Jean-Jacques Laffont & Jean Tirole, *The Politics of Government Decision-Making: A Theory of Regulatory Capture*, 106 THE QUARTERLY JOURNAL OF ECONOMICS, 1089, 1089 (1991).

¹⁵⁴ See Bó, *supra* note 146.

¹⁵⁵ The first signs of this notion are beginning to show in capture literature. For tangent research suggesting that capture might reflect a cognitive state of mind that does not originate in rent-seeking, see Jon D. Hanson & David G. Yosifon, *The Situation: An Introduction to the Situational Character, Critical Realism, Power Economics, and Deep Capture*, U. PA. L. REV. 152, 218 (2003) (referring to 'deep capture' as the disproportionate and self-serving influence that industries exert over external and internal elements of governmental and non-governmental agents, such as the media); SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 104–05 (Pantheon Books, 1st ed. 2010) (asserting that regulators adopted the idea that unregulated financial activity is always good for society as a form of 'cultural capture' because of the prestige it confers onto regulators); Kwak, *supra* note 138 (asserting that 'cultural capture' occurs when regulators feel they share common interests with a similar group of people in their level or above it).

¹⁵⁶ For a definition of capture that emphasizes the manipulative intentions of regulated entities, see Carpenter & Moss, *supra* note 137.

¹⁵⁷ See generally FRÉDÉRIC BOEHM, REGULATORY CAPTURE REVISITED – LESSONS FROM ECONOMICS OF CORRUPTION, INTERNET CENTER FOR CORRUPTION RESEARCH (2007), available at <http://www.icgg.org/downloads/Boehm%20-%20Regulatory%20Capture%20Revisited.pdf>.

regulators (a phenomenon known as Revolving Doors¹⁵⁸); refraining from publically criticizing regulators or filing suit against them, and so on.¹⁵⁹

While large firms are sometimes associated with capture stemming from institutional rent seeking that they have the resources to offer (and small regulated entities do not), small firms have to capture regulators in other ways. That is not to say that TSTF-captured regulators are not influenced by some interests of self-preservation (more regulated entities means more regulatory prestige and funding), self-benefits, and political popularity considerations when saving small, financially distressed firms.¹⁶⁰ Case studies show, however, that the primary motivation and cause of regulatory bailout of the small firms is not consistent with classic capture.

When small, regulated firms undergo financial difficulties, regulators often adopt a TSTF approach based on underdog type arguments by those firms. Frequently stressed in these arguments is the importance of protecting employment security for the workers of the firm or factory that might go under.¹⁶¹ Small regulated entities also try to build on general state issues as their reason for failure, citing national financial crises, market size, regulatory schemes, or national security crises—thus presenting their poor condition as national liabilities and moving from private to public rhetoric.

¹⁵⁸ For an extensive work on the revolving door practice *see, e.g.*, MARK V. NADEL, CORPORATIONS AND POLITICAL ACCOUNTABILITY 75 (1976); Jeffrey E. Cohen, *The Dynamics of the "Revolving Door" on the FCC*, 30 AM. J. POL. SCI. 689, 689 (1986); Mark T. Law and Cheryl X. Long, *Revolving Door Laws and State Public Utility Commissioners*, 5 REG. & GOVERNANCE 405, 405 (2011); Edna Earle Vass Johnson, *Agency "Capture": The "Revolving Door" Between Regulated Industries and Their Regulating Agencies*, 18 U. RICH. L. REV. 95, 95 (1983); Toni Makkai & John Braithwaite, *In and Out of the Revolving Door: Making Sense of Regulatory Capture*, 12 J. PUBL. POL'Y 61, 67 (1992).

¹⁵⁹ *See* Laffont & Tirole, *supra* note 153, at 1091.

¹⁶⁰ For instance, numerous reputational considerations pertaining to political capital were in play in the case of the Channel 10 bailout, as many politicians tried to win electoral support by standing by a failed TV station in the name of democracy. *See, e.g.*, Nati Tucker, *Labor MK Proposes Legislation to Rescue Israel's Channel 10*, HAARETZ (Dec. 30, 2014) <http://www.haaretz.com/news/national/premium-1.634403>. But *see supra* note 109 and accompanying text (explaining the prime minister's objection to the bailout for different political reasons). Another example pertains to the Hadassah case-study in which the local press claimed that the regulator, the MOH, was captured by the Hospital's Board of Directors because the regulator might need favors such as receiving quick quality health care for the regulator or his family (or people who can politically help the regulator). *See* Arlosoroff, *supra* note 61.

¹⁶¹ *See supra* note 116.

TSTF firms may also insist that they are essential to society in a manner that justifies a bailout (even if they are not). For example, a hospital, even a small one, can be especially important because it adds to the basic social right to health; an underdog television channel may be important because it diversifies viewers' content, promotes democracy and the pluralism of opinions, and supervises the government.¹⁶² These arguments are usually accompanied by intimidation rhetoric regarding what would happen the day after the firms' collapse, citing apocalyptic social and market scenarios.¹⁶³

This TSTF capture correlates with justifications of market regulation in the first place, and small firms facing bankruptcy play right in to those original rationales. In general, regulatory theory provides that government intervention is justified when market failures need correction (economic regulation) or when there is a need to protect social rights such as equality or the right to education (social regulation).¹⁶⁴ Whenever TSTF firms are built mainly on a social and not an economic promise, the frame of mind attached to their activities can be manipulated to their advantage.

In certain markets, regulation is mostly in place for the protection of civil rights in fields such as health, education, culture, sports, knowledge, freedom of information and opinions, freedom of speech, and other democratic values.¹⁶⁵ Arguing for their continuing existence, small firms tend to capture their regulators with arguments based on such social logic, and thus secure a bailout.¹⁶⁶ In light of the social justifications that prevail

¹⁶² It also provides "social glue" associated with public goods that benefit the public more when consumed together by a large group of people who can share the experience, known as "solidarity goods." See Cass R. Sunstein & Edna Ullmann-Margalit, *Solidarity Goods*, 9 J. POL. PHIL. 129, 132 (2001).

¹⁶³ See, e.g., Lazar Berman, *Cash-strapped Channel 10 says it will close down on Wednesday*, TIMES OF ISRAEL (December 29, 2014, 1:30 am), <http://www.timesofisrael.com/cash-strapped-channel-10-says-it-will-close-down-on-Wednesday>; Ofir Dor, *Michael Golan to Ministry of Communications: Hold me Back*, CALCALIST (July 27, 2015, 09:14 AM), <http://www.calcalist.co.il/marketing/articles/0,7340,L-3665369,00.html>.

¹⁶⁴ See, e.g., BALDWIN ET AL., 2012, *supra* note 21, at 15–23; MORGAN & YEUNG, *supra* note 21, at 26–36.

¹⁶⁵ See, e.g., BALDWIN ET AL., 1998, *supra* note 21, at 16.

¹⁶⁶ Another explanation for regulatory bailouts of small firms can be that it is easier and safer to stay on an existing and well-trodden regulatory path than to change it. This form of bias, known as path dependence, occurs when organizational, mental, reputational or financial assets (i.e. startup money already invested in a firm) have already been invested in a certain chosen path, making it psychologically difficult to alter a chosen course even when it ceases to be the optimal course of action. See, e.g., Paul A. David, *Why are Institutions the 'Carriers of History'? Path Dependence and the Evolution of Conventions, Organizations*

in TSTF type of cases (though always somewhat interrelated with market failures)¹⁶⁷ and the rhetoric accompanying the rescue efforts, the TSTF theory is not an economic but a social theory.

The public interest in saving these regulated firms is simple: if the institution in question is socially important enough to be regulated, then it should be saved by the state and receive regulatory relief and state aid. Note that this statement may seem, at first sight, as being always true: if a firm is important enough to be regulated *ex-ante* for the assurance of some social right, then it must be important enough to be saved *ex-post*. For instance, television is regulated in order to satisfy a quota of high-quality programs to be aired to the public. The contribution of an additional TV content provider to the market can be extremely enriching to the viewers since regulation will make it produce more original content. Its disappearance from the content arena, on the other hand, can be accordingly perceived as extremely damaging for the development of culture and political criticism in the state.¹⁶⁸ This logic applies especially, though not exclusively, to cases where market regulation is the reason for introducing new market players through state franchises or other types of state licensing in the first place and in cases of regulation of bodies that serve a social purpose that is bigger than making profit.¹⁶⁹

Yet, if this is the case and regulators merely bail out small firms because their existence as additional players is socially better for the market as a whole, why do regulators not try to find new players to replace failed players and let them expire? Why should the costs of bailouts be borne by the regulators and the public when new players can take their places (assuming there are other potential players)? The answer is that regulators are captured by these self-proclaimed socially important underdog firms.

and Institutions, 5 STRUCTURAL CHANGE & ECON. DYNAMICS 205, 208–209 (1994); Peter A. Hall & Rosemary C. R. Taylor, *Political Science and the Three New Institutionalisms*, 44 POL. STUD. 936, 938 (2006).

¹⁶⁷ For instance, a claim was recently made by Channel 10 employees' representative, economic journalist Matan Hodorov, that Channel 10 should be saved so as to correct a market failure in which Israeli journalists do not have enough jobs due to the small number of operating TV channels in the country. See Transcript of the 19th Knesset, Economy-Society Committee Meeting No. 1 (Dec. 10, 2014) (on file with author).

¹⁶⁸ This is not always true, of course, but the social nature of the subject might distort analytical regulatory considerations.

¹⁶⁹ For a contradiction of the common perception that small firms carry special significance for market and society, see Mirit Eyal-Cohen, *Down-Sizing the "Little Guy" Myth in Legal Definitions*, 98 IOWA L. REV. 1041 (2013).

Under TSTF capture, the regulator—with the encouragement of the regulated entity in need—feels responsible for and sympathizes with the regulated entity's poor financial condition. The state of mind that the regulator then develops has to do with guilt, a sense of responsibility, and a desire to rise to the role of a rescuing white knight.¹⁷⁰ This role, entangled with a kind of Messiah complex, further empowers the regulatory institutional cognition as a vital powerful force in society and business alike.¹⁷¹ The type of guilt and responsibility that leads to this bias is illustrated in the MOH representative's testimony before the Committee in the Hadassah case: "I felt it was my responsibility to establish an internal investigation committee to understand how this happened What were the regulatory measures we could have taken and didn't."¹⁷² A stark sense of regulatory responsibility was also evident in the remarks of the Second Authority's chairperson regarding the insolvent Channel 10: "Even if we were wrong about Channel 10—that was our position as a public council. We sent them to do these productions. We did that."¹⁷³

Under TSTF capture, the regulator naturally assumes responsibility for securing a bailout without rationalizing it too much, as the MOH stated before her appointed committee: "It was clear that in some way or another

¹⁷⁰ The term "white knight" is borrowed from the world of business and corporate law, referring to a friendly investor that acquires a corporation at a fair consideration with the support of the board of directors, usually during a period of a possible hostile takeover by another potential acquirer (black knight) or when the company faces bankruptcy. See, e.g., Cathy M. Niden, *An Empirical Examination of White Knight Corporate Takeovers: Synergy and Overbidding*, 22 *Financial Management* 28, 28 (1993).

¹⁷¹ A Messiah Complex is a state of mind in which an individual believes he or she is destined to become a savior. *What is Messiah Complex?*, PSYCHOLOGY DICTIONARY, <http://psychologydictionary.org/messiah-complex> (last visited Mar. 27, 2015). This idea resonated in a statement that former Chairwomen of Hadassah's Board of Directors made before the Gabay Committee, describing state official's desire to create a crisis in order to become the industry's savior. See Transcript of Gabay Committee appointed to examine the Hadassah Medical Center crisis, testimony of Esther Dominicinni at 46 (Feb. 26, 2014), available at <http://www.health.gov.il/Services/Committee/gabai/Documents/p26022014.pdf>.

¹⁷² See Transcript of Gabay Committee appointed to examine the Hadassah Medical Center crisis, Ministry of Health, Minister German testimony at 7–8 (Apr. 2, 2014), available at <http://www.health.gov.il/Services/Committee/gabai/Documents/p02042014.pdf> [hereinafter Transcript of Gabay Committee].

¹⁷³ See Transcript of the 18th Knesset, Joint Education-Economic Committee Meeting No. 150, *supra*, note 102.

we would help [Hadassah Hospital] above and beyond; that means sticking our hands in our pockets and giving.”¹⁷⁴

A review of the regulatory rhetoric in the minutes of legislative proceedings, court rulings, and regulatory reports pertaining to the Hadassah and the Channel 10 case studies revealed a social capture and an adoption of a social-importance rhetoric employed by the industry. Here are a few examples: In liquidation court, government regulators said, “[T]he state rescued the Applicant [Hadassah Hospital] out of public responsibility and due to the institution’s vitality.”¹⁷⁵ Regulators also described the Hospital in the Knesset as a “national asset serving over one-million residents of Jerusalem and its area.”¹⁷⁶ In fact, the mere thought of allowing the Hospital to fail and making room for new players to enter the market was almost foreign to the regulators: “It goes without saying that the [Hadassah] hospice will not close and that the psychiatric ward will not close . . . these things are unheard of.”¹⁷⁷

Under the TBTF theory, firms usually turn to economic arguments that correlate with the regulatory rationale for monitoring their activity in the first place. Accordingly, banks and other financial institutions are usually regulated for purposes such as assuring financial stability and avoiding possible risks to customers due to sudden institutional insolvency that might result in the institutions’ inability to pay back customers deposits.¹⁷⁸ Banks and other financial institutions are indifferent to the risks they pose to the public and therefore create negative externalities in their risk-taking activity.¹⁷⁹ The other main regulatory rationale for intervention in financial markets is information asymmetry.¹⁸⁰ Given that banks usually have an

¹⁷⁴ See Transcript of Gabay Committee, *supra* note 172, at 3. Similar statements by the Minister can also be found in the Transcript of the 19th Knesset, Finance Committee Meeting No. 335 (May 13, 2014) (on file with author).

¹⁷⁵ See Jerusalem Liquidation Court 14554-02-14 *Hadassah Medical Union v. Hadassah Women’s Organization of America Inc.*, Para. 10 (Feb. 11, 2014).

¹⁷⁶ Transcript of the 19th Knesset, Finance Committee Meeting No. 335, *supra* note 174.

¹⁷⁷ *Id.* (containing statements by Siman-Tov, Ministry of Finance referent).

¹⁷⁸ See, e.g. Peter O. Mulbert, *Managing Risk in the Financial System*, in THE OXFORD HANDBOOK OF FINANCIAL REGULATION 364, 390 (Eilís Niamh Moloney & Jennifer Payne Ferran eds., 2015).

¹⁷⁹ See, e.g. *Introduction*, THE OXFORD HANDBOOK OF FINANCIAL REGULATION 1, 4 (Eilís Niamh Moloney & Jennifer Payne Ferran eds., 2015).

¹⁸⁰ See, e.g. Frank Partnoy, *Financial Systems, Crisis, and Regulation*, in THE OXFORD HANDBOOK OF FINANCIAL REGULATION 68, 75 (Eilís Niamh Moloney & Jennifer Payne Ferran eds., 2015).

advantage over their customers regarding the terms of their contracts, the concern is that the bank will use this informational gap to its advantage at the expense of the customers.¹⁸¹ Therefore, regulation is placed on banks to coerce them to confer certain crucial information to customers that could even the playfield a little.¹⁸²

While these rationales for regulating big banks hold some social implications (supplying sufficient banking services in an equal and just manner, for instance), the main justification for their regulation is market failures.¹⁸³ In contrast, regulation imposed on hospitals, schools, or the media is centered in the idea of social protection; namely, the right to health, the right to education and the promotion of cultural and democratic values (these of course can also be justified in economic terms but that would be an imprecise depiction).¹⁸⁴

Building on social justifications for regulating markets, small businesses often make social arguments in their pleas for state bailouts, claiming that democracy might suffer or that some social right might be infringed if they cease to exist.¹⁸⁵ They assert that since their mere existence promotes (under regulations) certain rights and social values, the regulator should have a direct interest in their survival.¹⁸⁶ Even when contending that a monopoly might be formed in their absence, the concern they point to is not of rising prices (not directly anyway) but of harming some vague social value such as lack of opinion pluralism. The logical flaw of the assertions of too-small-but-important entities is that the institutions in question are never important enough to justify state bailouts with extremely high sums of public money. For example, Israeli Channel 10 claimed that shutting down the station would harm the public because only one television channel will control broadcast and that local culture and original content productions will be severely affected as a result.¹⁸⁷ In reality, however, this dire prediction is not necessarily accurate and is definitely solvable, as depicted in the

¹⁸¹ See, e.g., Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 8-9 (2008).

¹⁸² *Id.* at 84.

¹⁸³ See, e.g. *Introduction*, THE OXFORD HANDBOOK OF FINANCIAL REGULATION, *supra* note 179, at 4.

¹⁸⁴ See *supra* note 164; BALDWIN ET AL., 2012, *supra* note 21, at 23 (addressing the difference and correlation between social and economic regulation).

¹⁸⁵ See *supra* notes 161–63 and accompanying text.

¹⁸⁶ On social rights as a regulatory justification See BALDWIN ET AL., 2012, *supra* note 21 at 22–24.

¹⁸⁷ See *supra* notes 116–17 and accompanying text.

Ministry of Communication draft bill that was prepared in case no bailout is approved for Channel 10.¹⁸⁸ According to the bill, which eventually did not pass, TV Channel 2, currently operated by two franchisers broadcasting on different weekdays, was to be split into two separate channels that compete against each other and would be obliged to buy local content in similar proportions as television broadcasters used before the structural market change takes place.¹⁸⁹

Furthermore, a reform on the Israeli television market is currently underway that might make the Channel 10 bailout redundant.¹⁹⁰ As it turns out, the Israeli television regulator estimated that a move from franchise to license, if accompanied by content investment reduction, could open the market to up to five players.¹⁹¹ All of the aforementioned policy alternatives will prevent the local television market from becoming concentrated to a degree that might harm social values relating to pluralism, culture, and freedom of speech.

Of course, the blurriness of the values in question (i.e. health, housing, education) and the problem of quantifying their social values enabled regulators, the public, and the financially distressed firms to over-estimate and over-stress their real value. This capture is further entrenched when the public and the regulators attach special meaning to the existence of an institution that is hard to define in quantitative terms referring to issues such as the historic, emotional, or symbolic value of long-lasting institutions—for example, Hadassah Medical Center was established before the State was;¹⁹² and many people are used to watching Channel 10. For similar reasons, the State of South Carolina recently bailed out South Carolina State University, the state's historical black public college, with \$12 million.¹⁹³

A big part of the manipulation small firms perform on regulators is rooted in blame allocating and guilt-assigning narratives. As mentioned

¹⁸⁸ See Draft Bill amendment to The Second Authority Law (2014) (on file with author). See also Li-or Averbach, *Erdan Proposes Splitting Channel 2*, GLOBES (Sep. 2, 2014, 10:48 PM), <http://www.globes.co.il/en/article-erdan-proposes-splitting-channel-2-1000968454>.

¹⁸⁹ *Id.*

¹⁹⁰ See Transcript of the 19th Knesset, Economy-Society Committee Meeting No. 1, *supra* note 167, at 14 (statement by the regulator, Shay Babed, the Second Authority's CEO). For the Law amendment see *supra* note 86.

¹⁹¹ See *supra* note 86.

¹⁹² See *supra* Part II.A.

¹⁹³ Cynthia Roldan, *State to Dig into Emergency Cash for S.C. State Bailout*, POST & COURIER (Dec. 8, 2014, 9:39 PM), <http://www.postandcourier.com/article/20141208/PC1603/141209507>.

earlier, small, financially distressed institutions often blame regulation for their failures and financial hardships.¹⁹⁴ One could argue that regulators are actually at fault because they had imposed too much regulation on small, private firms in the first place, causing them to go bankrupt, and then respond to the crisis with a reduction proposal that equals the regulation imposed on the firm—as in the chicken and the egg problem. Under this premise, since financial difficulties of private regulated firms are sometimes the result of heavy regulation, bailout in the form of regulatory relief and advocacy is a mere correction of that administrative miscalculation.

Nevertheless, the case studies do not support this theory since shifting blame from failed private management to public regulators occurs both in heavily regulated industries (the Channel 10 case)¹⁹⁵ as well as in under-regulated industries (the Hadassah case)¹⁹⁶. Hadassah Medical Center is an example of regulatory default in supervising the Hospital's financial stability and funds management by the HWZOA. At the time, much criticism focused on the absence of the MOT's regulatory involvement in the exceptionally high salaries the Hospital paid its personnel.¹⁹⁷ In fact, the Ministry of Health itself claimed that it first learned there was even a problem with the Hospital's financial statements from the media.¹⁹⁸ Addressing Liquidation Court, however, the Hospital argued that its "poor financial state stems from the regulatory health system, which forced the hospital to offer services at HMO in prices as defined by the Ministry of Health," blaming regulators of over-regulating the Hospital out of business.¹⁹⁹

¹⁹⁴ See *supra* notes 118, 183 and accompanying text.

¹⁹⁵ Local TV stations argued that Israeli regulators and legislators introduced one of the world's most restricting regulatory models. See, e.g., Yisrael Medad & Eli Pollak, *Media Comment: Is Media Regulation Necessary?*, JERUSALEM POST (Oct. 9, 2014), <http://www.jpost.com/Opinion/Media-comment-Is-media-regulation-necessary-374998>.

¹⁹⁶ See *supra* Part II.A.

¹⁹⁷ See KNOWLEDGE@WHARTON, *supra* note 43.

¹⁹⁸ See Transcript of Gabay Committee appointed to examine the Hadassah Medical Center crisis, Ministry of Health, Minister German, at 3 (Apr. 9, 2014), available at <http://www.health.gov.il/Services/Committee/gabai/Documents/p02042014.pdf>. See also Miki Peled, *CEO of Ministry of Health Roni Gamzo had Learned of the Hadassah Crisis from the Newspaper*, CALCALIST (June 19, 2014, 7:18 AM), <http://www.calcalist.co.il/local/articles/0,7340,L-3633087,00.html>.

¹⁹⁹ See Jerusalem Liquidation Court 14554-02-14, *Hadassah Medical Union v. Hadassah Women's Organization of America Inc.*, para. 3 (Feb. 11, 2014).

IV. REGULATORY BAILOUT IMPACT ASSESSMENT

In recent years, regulation has become the most promising and dominant school of thought in administrative law.²⁰⁰ It encompasses the activities and interactions of state agencies entrusted with supervising and navigating private firms market activities via myriad legal norms and enforcement tools.²⁰¹ In this research field, issues such as regulatory scope of discretion, regulatory decision-making process, and regulatory exposure to influence from private regulated bodies and interest groups are at the center of attention in legal scholarship.²⁰²

I propose to correct the regulatory TSTF capture described in this Article through administrative law mechanisms that inform regulators of cost and benefit considerations that stem from each possible regulatory course of action, instead of allowing biases towards small industry players enter the decision-making process. In doing so, the agency must first consider, and subsequently present to the government different alternatives of action regarding regulatory intervention in cases of financially distressed firms, as opposed to concentrating its entire regulatory efforts on advocating for those firms.

Due to the significant role regulators play in bailing out of financially distressed firms, particularly small ones, this Article analyzes bailouts from a regulatory perspective. Though the analysis presented in this Article can be applied to both state executive-political functions and state professional regulatory functions involved in bailouts (functions that sometimes operate under the same administrative body, i.e. U.S. Department of Treasury), the Article focuses on regulatory capture to secure a bailout. Accordingly, this

²⁰⁰ See, e.g., IAN AYRES AND JOHN BRAITHWAITE, *RESPONSIVE REGULATION – TRANSCENDING THE DEREGULATION DEBATE* 7 (1992); JERRY MARSHAW, *GREED, CHAOS AND GOVERNANCE: USING PUBLIC CHOICE TO IMPROVE PUBLIC LAW* (1997); MORGAN & YEUNG, *supra* note 21.

²⁰¹ See, e.g., Jerry Marshaw, *Public Law and Public Choice: Critique and Rapprochement*, in *RESEARCH HANDBOOK ON PUBLIC CHOICE AND PUBLIC LAW* 19 (Daniel A. Farber and Anne Joseph O’Connell eds., 2010); JIM ROSSI, *REGULATORY BARGAINING AND PUBLIC LAW* (2005); *THE REGULATORY STATE: CONSTITUTIONAL IMPLICATIONS* (Dawn Oliver, Tony Prosser and Richard Rawlings eds., 2010).

²⁰² See, e.g., BALDWIN ET AL., 2012, *supra* note 21; STEVEN P. CROLEY, *REGULATION AND PUBLIC INTERESTS: THE POSSIBILITY OF GOOD REGULATORY GOVERNMENT* (2008); CASS R. SUNSTEIN, *AFTER THE RIGHTS REVOLUTION: RECONCEIVING THE REGULATORY STATE* (1993); CASS R. SUNSTEIN, *THE COST-BENEFIT STATE: THE FUTURE OF REGULATORY PROTECTION* (2002).

part proposes to impose legal duties on regulators who consider TSTF bailouts, using regulatory impact analysis.

Regulatory Impact Analysis (sometimes referred to as Regulatory Impact Assessment or RIA) is a policy and a supporting regulatory tool designed to help regulatory decision-makers to properly consider costs and benefits stemming from a proposed regulation (or de-regulation).²⁰³ Developed in the 1990's and 2000's in Europe and the United States,²⁰⁴ the current guidelines for RIA are general and do not address specific regulatory problems.²⁰⁵ These RIA policies are intended to apply to both economic and social regulations, but generally do not elaborate on the required regulatory considerations for different types of regulatory action (or inaction), especially not 'social' considerations.

In addition, RIA policies do not explicitly refer to the RIA process as a de-biasing tool against capture for regulators. Even scholars consider it primarily a tool for correcting regulatory decisions by regulators who knowingly or negligently choose poorly-designed regulations, neglect social goals, ignore the adverse impacts of regulation, serve small interest-groups, and wish to magnify their own power or replace one risk with another.²⁰⁶ Scholars further describe RIA as a tool designed for overcoming problems of informational asymmetries and omission of the voices of those affected by the regulation.²⁰⁷ The potential of RIA as a de-capturing tool in regulatory decision-making is ignored. This Article aims to fill this gap and propose a new policy for regulators to implement when regulatory bailout is considered.

The proposed considerations below should be part of a regulatory impact assessment process (*Regulatory Bailout Impact Assessment*) executed to overcome the TSTF capture described previously.²⁰⁸ The new proposed process can also be implemented in cases of banks and other financial institutions that fall within the TBTF paradigm,²⁰⁹ following in the footsteps

²⁰³ See Jonathan B. Wiener & Alberto Alemanno, *Comparing Regulatory Oversight Bodies Across the Atlantic: The Office of Information and Regulatory Affairs in the US and the Impact Assessment Board in the EU*, in *COMPARATIVE ADMINISTRATIVE LAW* 309, 309 (Susan Rose-Ackerman & Peter Lindseth eds., 2010).

²⁰⁴ For a historic description of the rise of regulatory impact assessment processes as part of the rise of the regulatory state in the U.S. and in Europe, see *id.* at 313–16.

²⁰⁵ *Id.* at 310.

²⁰⁶ *Id.*

²⁰⁷ *Id.*

²⁰⁸ See *supra* Part III.B.

²⁰⁹ See *supra* Part III.A.

of the European Commission's latest legislative work on preventing and regulating vast bailouts of banks in the European Union.²¹⁰ Similar structuring of the Secretary of Treasury's discretion in approving banks' bailouts was made under the Emergency Economic Stabilization Act of 2008 that prompted the TARP program.²¹¹ The purpose of the regulatory decision-making structuring proposed here is to overcome regulatory TSTF capture.

The RIA process is designed to help regulatory agencies establish whether regulation is necessary and justified to achieve a regulatory objective such as correcting market failure.²¹² After identifying a set of potential regulatory approaches, agencies should conduct a cost-benefit analysis for each approach.²¹³ Though most RIA guidelines concentrate on quantifying cost and benefits associated with new regulations or regulatory action, some reference to non-monetary cost and benefits can be found.

The U.S. RIA Circular states that an agency also needs to evaluate non-quantified and non-monetized benefits and costs of the regulatory

²¹⁰ See EUROPEAN COMMISSION STATEMENT, FINALISING THE BANKING UNION: EUROPEAN PARLIAMENT BACKS COMMISSION'S PROPOSALS (SINGLE RESOLUTION MECHANISM, BANK RECOVERY, RESOLUTION DIRECTIVE, AND DEPOSIT GUARANTEE SCHEMES DIRECTIVE) (2014), available at http://europa.eu/rapid/press-release_STATEMENT-14-119_en.htm?locale=en; Directive 2014/59/EU of the European Parliament and of the Council of 15 May establishing a framework for recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, 57 OFFICIAL J. EUROPEAN UNION 190, 192 (2014), available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0059&from=EN> ("Authorities should take into account the nature of an institution's business, shareholding structure, legal form, risk profile, size, legal status and interconnectedness to other institutions or to the financial system in general, the scope and complexity of its activities.").

²¹¹ Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765. See especially "Considerations" under § 103, 122 Stat. at 3770 ("In exercising the authorities granted in this Act, the Secretary shall take into consideration—(1) protecting the interests of taxpayers by maximizing overall returns and minimizing the impact on the national debt; (2) providing stability and preventing disruption to financial markets in order to limit the impact on the economy and protect American jobs, savings, and retirement security; (3) the need to help families keep their homes and to stabilize communities.").

²¹² See U.S. OFFICE OF INFORMATION AND REGULATORY AFFAIRS, REGULATORY IMPACT ANALYSIS: A PRIMER 2 (2011), available at https://www.whitehouse.gov/sites/default/files/omb/inforeg/regpol/circular-a-4_regulatory-impact-analysis-a-primer.pdf.

²¹³ *Id.* at 3.

alternative, including distributional effects on populations such as low-income groups.²¹⁴ In cases of non-tradable goods like clean air or water, the agency has to value the satisfaction that individuals derive from using the resource, including ‘non-use values’, where individuals value a resource or good even without prospects of use; for example, wildlife in remote areas.²¹⁵ Also recognized in this context are social regulatory goals such as privacy or anti-discrimination acts, as long as they promote “the well-being of the American people.”²¹⁶ In fact, in the latest executive presidential order pertaining to RIA process of American regulatory agencies, social purposes preceded the economic objectives of regulation in general: “Our regulatory system must protect public health, welfare, safety, and our environment while promoting economic growth, innovation, competitiveness, and job creation.”²¹⁷

Regulatory Impact evaluation processes are commonly exercised in OECD countries and in the United States, but not in Israel.²¹⁸ This administrative flaw may be the gap that small firms use to manipulate Israeli regulation in their favor. While RIA is usually employed in OECD countries when promulgating new regulations or assessing existing regulations, this paper suggests that a specific RIA for bailouts be constructed. This bailout analysis procedure should apply to regulators who consider bailing out small companies that are subject to regulation (usually ‘social’ regulation) and seem to carry some social importance. The impact assessment process required in these cases has to do with assessing regulatory action such as regulatory exemptions, royalty relief, or other regulatory aid (including advocating state bailout and legislative proposals to benefit the firm), and not with the construction of a new regulatory scheme considered to be implemented on the bailed out firm in the future. The new regulatory scheme should also be subject to RIA, of course, but will only take place

²¹⁴ *Id.* at 4, 7–8.

²¹⁵ *Id.* at 9.

²¹⁶ Executive Order 12,866 of September 30, 1993, 58 Fed. Reg. 51735 (Oct. 4, 1993).

²¹⁷ Executive Order 13,563 of January 18, 2011, 76 Fed. Reg. 3821 (Jan. 21, 2011).

²¹⁸ See ISRAELI PRIME MINISTER’S OFFICE, GOVERNMENT GUIDE TO REGULATORY IMPACT ASSESSMENT—RIA, DRAFT FOR COMMENTS (2013), available at <http://www.chamber.org.il/images/Files/21597/3.pdf> (containing a draft report for a general plan to incorporate regulatory impact assessment process in the work of regulators in Israel (not referring specifically to regulatory bailouts)). For RIA in the European Union, see, e.g., EUROPEAN COMMISSION, IMPACT ASSESSMENT GUIDELINES 4 (2009), available at http://ec.europa.eu/smart-regulation/impact/commission_guidelines/commission_guidelines_en.htm.

after RIA was executed with regard to the main decision—whether or not to save the firm.

It is proposed that a *Regulatory Bailout Impact Assessment* take place in TSTF cases in which regulators consider, formally and in writing, the social importance of the firm's activity (i.e., whether it promotes educational, occupational, democratic, cultural, or health values, and so on) against regulatory alternatives for the market. In this regard, the regulating agency should consider replacing the firm with another private firm or state function that can play the same social role against the possibility of bailout. Bailouts need to be considered against the possibility of leaving things as they are and letting the firm to go under. In this last course of action (rather, non-action) the regulator must consider the possibility of denying bailout and quantify its implications in terms of civil and social rights protection (assuming there are no major economic market failures to assess).

As hard as it is to define or quantify potential harm to social rights, particularly in light of unexpected future events, the regulator has to try to evaluate what might happen later. If the costs of letting the firm fall outweigh the benefits of a bailout, then the regulator and the state should help the firm get back on its feet. In this context, it is suggested that the regulator consider the cost of the regulatory bailout in terms of money, subsidy, loan or debt write-off; the implications of the bailout on the entire market; the threat of eroding the regulatory standard; the harm to the regulatory public reputation as a defender of the public interest; potential harm to the level of deterrence of other market players; the possibility that the regulator may have to match lenient regulatory terms to other companies;²¹⁹ the possibility that the bailed-out firm might still suffer another financial crisis, and how soon that might happen;²²⁰ the firm's willingness to cooperate with the new regulatory supervision scheme and the kind of obligations it is willing to undertake; other market players' view of the issue; the position of the public and of interest-groups re the considered bailout; the option of another firm that is willing and able to take

²¹⁹ This claim for equality was frequently made by TV Channel 2 with regards to regulatory benefits that were given to its competitor, Channel 10, as a form of bailout. These demands were eventually met by the Second Authority for Television and Radio. See, e.g., HCJ 5872/07 Movie & Television Producers Union of Israel v. Second Auth. for Television & Radio [2010] (Isr.) (on file with author); HCJ 5574/12 Keshet Television Inc. v. Minister of Comm'n [2014] (Isr.) (on file with author).

²²⁰ Note that Channel 10 was bailed out at least three times by its regulator in merely twelve years of its operation under concession, between 2000 and 2014. See *supra* Part II.B.

the financially distressed firm's place;²²¹ the economic feasibility of the considered player on the current market.²²²

The key point to this procedure is that the process of regulatory decision-making becomes more aware and informed and less captured by the industry. This is especially important in cases of social regulation where considerations are sketchy and hard to quantify.

However, cost-benefit analysis is not without fault. *Regulatory Bailout Impact Assessment* might be subject to both general deficiencies of cost-benefit analysis in regulatory process and to specific, new shortcomings pertaining to social cost-benefit analysis made against the background of a proposed bailout. For instance, RIA is inherently subject to legal contention by the industry that might attack the analysis as not thorough enough, not considering all relevant factors, or being biased against industry. In fact, the financial industry's demands for extensive cost benefit analysis studies have become a central tool in the industry's attempts to impede the SEC and Federal Reserve Bank rules designed to implement the Dodd–Frank Act in the United States.²²³

The main concerns in *Regulatory Bailout Impact Assessment* are specific claims against a preordained decision that is influenced by private interests, in line with public choice theory and capture theory; the inability to properly assess social costs and benefits and the ability to crunch the figures in any desired direction; the capture being so deep that no RIA can change it; and public or political pressure to enable or reject a bailout that clouds the professional regulatory decision-making.

These apprehensions are always potentially there, but should not hinder the application of the proposed process. Regulators have to be aware of these obstacles and try to prepare ahead. Imposing a duty on regulators to analyze alternatives and describe their usefulness in resolving a problem in ways that are contrary to or different from the direction of the capture in a detailed report should decrease the small firms' power to manipulate regulators' decision-making in their favor.

²²¹ One may always suggest direct state intervention to fill the void left by a failed private company, but this notion is rather anachronistic in the privatization era.

²²² Market conditions may change over time, causing a firm to naturally be ejected out of a market. This can happen after new private actors enter the market, or in the wake of a technological or a social development (for example, the public deserts print newspapers and favors online newspapers). These cases are especially prone to the regulatory path-dependence bias where regulators tend to reminisce over past glory and the historical heritage of a private firm or organization and avoid necessary changes. See *supra* note 166.

²²³ See Wilmarth, Jr., *supra* note 9, at 1310–11.

V. CONCLUSION

The TSTF approach creates an effect similar to the TBTF approach as they both provide regulators with seemingly solid justifications for the bailout of private sector firms in distress, including granting major regulatory concessions. While TBTF firms are depicted as economically essential, TSTF firms are presented as socially invaluable. Both rationales call for a bailout. A vicious cycle is thus created as firms are being signaled that capture of regulators for possible bailouts is feasible when things go sour, subsequently encouraging them to invest in capturing resources for possible future bailouts.

While financial conglomerates were rewarded for their risk-taking behavior with bailouts after the global financial crisis of 2008, smaller firms found their loophole for achieving regulatory and state bailouts using underdog arguments. Since small firms are not big enough to matter financially to the economy on the grand scale, they typically argue that bailout is necessary to protect social values, and that regulators are responsible for their situation for reasons such as regulatory deficit or over-regulation; regulatory bias against the weak; workers' layoffs; local financial or security crisis; special social importance; and political elections.

Regulators are so important in the securing of bailouts that it can be argued that their mere existence as an administrative function is crucial for firms seeking state bailouts. For instance, one can argue that the second largest Israeli newspaper bankrupted and closed in 2014 partly because it had no regulator to defend its case (newspapers are primarily unregulated entities and have no professional regulator).²²⁴ Without an advocate in government circles, the chances of a firm to receive financial help might substantially decrease.

The outcome of the regulatory bailouts described in this article is problematic. Under the TSTF policy, the state and its regulators grant concessions and licenses to hospitals, schools, and media entities, but these firms are not expected to be good. In fact, they can overspend, refuse compliance with regulations, and generally fail to fulfill their societal purpose, and still be recognized as too important to fail. This cannot be

²²⁴ See, e.g., Roy Greenslade, *Israel's Maariv 'on Verge of Closure'*, GUARDIAN (Oct. 6, 2012), <http://www.theguardian.com/media/greenslade/2012/oct/06/newspapers-israel>. Daily Maariv was sold in 2014 to the Jerusalem Post group and merged with a weekly newspaper named Weekend Maariv. Niv Elis, *Antitrust Authority Approves Maariv Sale to Jerusalem Post Group*, JERUSALEM POST (Apr. 30, 2014), <http://www.jpost.com/Business/Business-News/Antitrust-Authority-approves-sale-of-Makor-Rishon-Maariv-350878>.

considered good regulatory policy as it encourages the perception of the state as the ultimate insurer that firms can always rely on. As Hadassah Hospital Chairman stated, “they [the Hospital management] said Hadassah won’t fall . . . the state won’t let it fall.”²²⁵

Having said that, the TSTF capture portrayed in this Article does not necessarily mean that the regulatory outcome regarding bailout is inefficient or defeats the public interest entirely. In this respect, we can embrace recent capture literature’s distinction between strong capture and weak capture.²²⁶ From this point of view, capture is not existent or non-existent but rather manifests in degrees.²²⁷ While strong capture situations mean that society is better off without regulation entirely, weak capture is unwanted and should be limited, but is not catastrophic to regulation itself.²²⁸

The case studies depicted in this Article show a regulatory tendency to ‘buy’ into the industry’s rhetoric of social importance and the depiction of firms as victims of regulation as well as other misfortunes they endure due to their size. TSTF capture discussed in this paper is not necessarily a form of strong capture and therefore does not mean that it is always disastrous, but rather something to be aware and beware of in the regulatory process. The administrative procedure that the Article suggests—*Regulatory Bailout Impact Assessment*—aims to do just that.

²²⁵ See Dominicinni, *supra* note 171, at 31, 45.

²²⁶ See Carpenter & Moss, *supra* note 137, at 11.

²²⁷ *Id.*

²²⁸ *Id.*