NORMATIVE FOUNDATIONS OF CORPORATE INSOLVENCY LAW

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by

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ABSTRACT

This thesis develops a novel framework for normative reflection about corporate insolvency law in terms of distributive justice. It begins by demonstrating that the dominant theoretical approach in this area—known as proceduralism—is incomplete and, in some ways, incoherent, and seeks to build on these failures in arguing for a new approach. It is argued that corporate insolvency law must address at least two connected sets of questions. The first concerns distribution and the second concerns debtor fidelity. The former questions are questions of distributive justice. While no fully specified theory of distributive justice is defended or developed, it is argued that in a society in which distributive shares are mediated by legal rights, individuals must have the capacity to hold and deal with such legal rights on equal terms. Some dealings with such rights will engage the principle of personal responsibility, such that apparent disadvantages for which individuals are responsible need not be condemned by distributive justice. The statutory order of insolvency distribution, as well as its mandatory character, is considered in the light of these arguments. As individuals make use of the capacity to create or deal with legal rights and obligations, they are bound by ordinary moral principles in so doing. The discussion of debtor fidelity, then, considers a range of such principles and pursues their implications for a range of corporate insolvency law doctrines. Debtor fidelity does not, however, offer a justification for the centerpiece transaction avoidance rules prohibiting mere undervalue transactions and mere preferences. These rules, however, may be justified in terms of distributive justice. A normative critique of a range of fraudulent trading and transaction avoidance doctrines is advanced in terms of such principles.

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HCT

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Auf dem Tisch standen Blumen. Ein Brief lag daneben. Er öffnete ihn. Ein Zwanzigmarkschein fiel heraus … Er steckte den Zwanzigmarkschein ein. Jetzt saß die Mutter im Zug, und bald musste sie den anderen Zwanzigmarkschein finden, den er ihr in die Handtasche gelegt hatte. Mathematisch gesehen war das Ergebnis gleich Null. Denn nun besaßen beide dieselbe Summe wie vorher. Aber gute Taten lassen sich nicht stornieren. Die moralische Gleichung verläuft anders als die arithmetische.

—Erich Kästner, *Fabian* (1931)

[There were flowers on the table. A letter was next to them. He opened it. A twenty mark note fell out; … he put it away. By now his mother was sitting in the train. She must shortly find the other twenty mark note, which he had slipped into her handbag. From a mathematical perspective nothing had taken place: each possessed exactly the same sum of money as before. But good deeds do not cancel each other out. Moral arithmetic works differently.]

I INTRODUCTION

1. RATIONALE

This thesis seeks to offer a novel normative account of certain important parts of corporate insolvency law, grounded in principles of distributive justice. Its contribution lies not in seeing the possibility of such an account, but rather in offering a more sustained and worked-out attempt at this task than has hitherto been offered, and one that draws on the resources and methods of analytic jurisprudence and moral and political philosophy.

The thesis is motivated by the observation that existing attempts to directly link insolvency law with the demands of distributive justice have not led to the development of a substantial or coherent theory. At the same time, the most prominent and developed theory of insolvency law—proceduralism—disputes the very relevance of distributive principles in this area. The body of the thesis begins, therefore, by showing that proceduralism fails as a theory. In particular, proceduralism so fails because it assumes answers to questions that only distributive principles can provide. The thesis proceeds by articulating more appropriate distributive and other principles and using these to develop a new account of significant parts of corporate insolvency law.

On the strength of the normative arguments defended, the thesis also offers evaluations of specific features of (positive) insolvency law as it currently exists. While this is pursued principally by reference to English law, many of the features considered are shared by a range of major legal systems in both common- and civil law traditions. A normative critique of at least the following areas of law is offered: the insolvency stay, the ranking of claims for the purposes of distribution, *pari passu* distribution, transaction avoidance and its proper limits, and director responsibility doctrines.

2. METHODOLOGY

2.1. Normative claims, doctrinal claims

This is a thesis in special jurisprudence, or, to put it another way, applied legal philosophy. The key claims of the thesis, outlined below, have whatever appeal they have *as normative claims*, and not in virtue of the extent to which they correspond to the way the law happens to be, or to what judges happen to have said, now or in the past. To the extent that I refer to principles in the thesis, I mean to refer to principles of morality, and not to principles that are latent in, or in some other sense derived from, law.[1]

[1] cf Roy Goode, *Principles of Corporate Insolvency Law* (Kristin van Zwieten ed, 5th edn, Sweet & Maxwell 2018) ch 3; Ronald Dworkin, 'The Model of Rules I' in Ronald Dworkin, *Taking Rights Seriously* (new impression, Duckworth 1978).

I adopt this approach, in part, in order to insist on the distinction between two different kinds of claims that may be made about law. Legal scholars can, without courting controversy, make at least two kinds of claims. The first kind emerges from a purely descriptive exercise, a cataloguing of rules.[2] The second is a normative account of what the law ought to be.[3] Importantly, there is no compromise-position or middle ground here. This is because description and normative argument are not points on a spectrum. Instead, they constitute two distinct possibilities for scholarly reflection. Attempts to draw upon this supposed middle ground typically seek to pursue both fit (ie with legal materials including the decisions of courts) and normative justification in some combination.[4] There are at least two problems with this approach. The first flows from the fact that fit and justification are incommensurable.[5] This means that the idea of combining them is incoherent. The second is that once one departs from the purely descriptive activity I have described then one is no longer describing. And there is no obvious value in a project that is only selectively normative, if it lacks an appealing explanation of its selectivity.[6] Arguments about what a court should do or should have

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[2] eg William Cooke, A Compendious System of the Bankruptcy Laws (Brooke 1785).

[3] eg Alan Schwartz, 'A Normative Theory of Business Bankruptcy' (2005) 91 Virginia Law Review 1199.

[4] This terminology is that used by Ronald Dworkin, *Law's Empire* (Fontana 1986) ch 7.

[5] Attempts have been made to overcome this drawing upon Rawls's notion of reflective equilibrium: Stephen Smith, *Contract Theory* (OUP 2004) 5; drawing, apparently, upon John Rawls, *A Theory of Justice* (Clarendon Press 1972) 42–5; cf Dworkin, *Law's Empire* (n 4) 52; Frederick Wilmot-Smith, 'Reasons? For Restitution?' (2016) 79 Modern Law Review 1122.

[6] Charlie Webb, Reason and Restitution: A Theory of Unjust Enrichment (OUP 2016) 7.

done, or about how the law should be changed, must be normative all the way down if they are to be persuasive. And these are the kinds of arguments that I defend here.

I do not mean to suggest that an account of some principle of law that is wholly normative is one that starts afresh, imagining an ideal society in some sense prior to law. Contingent facts about how the law is, of course, matter, and a substantially stable shared understanding of what the law *is* is the starting point for the normative reflection that this thesis pursues. I take this to be an entirely orthodox way of proceeding: after all, the positive law is much of what this project is about. Sometimes, in what follows, I need to make comments about what the law is. Where this is so, and the positive law is not susceptible to easy restatement, my approach is to acknowledge but not resolve doctrinal controversy to the extent possible. Given that the claims I am seeking to advance are normative, this strategy should not affect the logical force of any argument I defend.[7]

The arguments I advance depend on both moral claims and claims about legal concepts:[8] that it is wrong to deliberately avoid one's obligations is an example of the former; that an obligation is a categorical and protected reason for action is an example of the latter.[9]

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[7] Language like this, which I use throughout the thesis, pre-supposes a version of legal positivism. I adopt such language for ease of exposition and not as a rejection of anti-positivist views of law.

[8] I accept that the word 'concept', in this context, is somewhat unhappy. I have been unable, however, to improve upon it.

[9] Joseph Raz, 'Promises and Obligations' in Joseph Raz and PMS Hacker (eds), *Law, Morality and Society: Essays in Honour of HLA Hart* (Clarendon 1977).

It is sometimes suggested that these kinds of arguments belong in separate jurisprudential silos, those of normative and analytic jurisprudence.[10] Such a view should be rejected. The features of legal concepts have moral implications, some of which I consider in the thesis. Further, it is worthwhile to pursue normative reflection concerning part of a legal system without offering a fundamental critique of every legal concept it employs, even if this is on merely pragmatic grounds.

2.2. Consistency in my approach

The method adopted in chapters 4 and 5 of the thesis may appear to contrast with that pursued in chapters 6 and 7. Chapter 4 begins with the idea of distributive justice, and offers what is intended to be a minimally specified but plausible part-answer to the question of what distributive justice requires. Chapter 5 then pursues the implications of offering an answer in these terms, in particular by developing the idea of an equal legal capacity concerning legal rights. Chapters 6 and 7, on the other hand, start with conceptual claims about obligations, and draw more obviously moral claims from these. I then claim that there are circumstances in which the law should institutionalise these moral norms in some way, and circumstances in which law should refuse to do this, in particular, for reasons of distributive justice.

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[10] Scott Shapiro, *Legality* (Belknap 2011) 2–3.

Despite an apparent contrast in approach, there is no methodological incompatibility between the two parts. This is because chapters 6 and 7 simply pursue the implications of a substantive normative claim defended at the beginning of chapter 5: first, by exploring the implications of what it is to grant an equal capacity to hold and deal with legal rights; and, second, by pursuing the implications of exercises of the capacity in question by which individuals engage their personal responsibility, principally by entering into contracts. Nor is it a deep difference between these parts of the thesis that it is *the state* that I say ought to grant this equal capacity to all, exercises of which lead to obligations arising *among citizens*. For what the state grants to individuals in granting such capacities is, ordinarily, a capacity to deal with other individuals in a distinctive way, in particular by entering into contracts.

2.3. Corporate insolvency and individual bankruptcy law

While the methods chosen for this work could be pursued in an investigation of corporate insolvency law, individual bankruptcy law, or both, this thesis restricts itself to corporate insolvency law and to some doctrines that corporate insolvency law and individual bankruptcy share.[11] This is done partly for pragmatic reasons: an investigation of individual bankruptcy law would have been a larger project than this

[11] UK-law scholarship usually distinguishes between the law of corporate insolvency, on the one hand, and of individual bankruptcy, on the other (even if many bankruptcy doctrines are contained in the Insolvency Act 1986). US usage ordinary refers to either individual or corporate bankruptcy. In the text that follows, either term is meant to refer to corporate insolvency, except where context clearly indicates otherwise.

one. A number of more substantive points also speak in favour of this approach. First, the most developed theoretical literature on insolvency law has been developed in the corporate insolvency law context. I consider this literature in chapter one, and this consideration lays the foundations for the claims that follow. This allows me to make these claims, and to demonstrate their distinctiveness, against a more certain theoretical background. Second, it seems to me that the normative questions corporate insolvency law must confront are a subset of those that individual bankruptcy law must address. In both contexts, puzzles concerning sharing among creditors and debtor fidelity arise. In individual bankruptcy, however, there are further questions about how debtors *qua* individuals should be treated, which questions corporate insolvency law need not confront. It follows, then, that much of the normative case—if not the doctrinal discussion—that I pursue below may be applied quite straightforwardly to individual bankruptcy law. But as a normative account of individual bankruptcy law it would be in important ways incomplete.

3. SUMMARY

Chapter 2 considers the normative theory of insolvency law known as proceduralism, which has been developed by writers including Douglas Baird and Thomas Jackson from the perspective of normative law and economics. Proceduralism holds that insolvency law, best understood, is a procedural device for the cashing out of entitlements of which the law, prior to insolvency proceedings being opened, already takes cognizance. It

should solve the common pool problem that would arise if individual creditor remedies were not suspended and replaced by a collective procedure, and pursue no other goals. In doing so it should respect pre-insolvency entitlements.

I claim that the normative basis for proceduralism is a wealth-maximisation principle, the normative appeal of which cannot be assumed. I argue, further, that the injunction to respect pre-insolvency entitlements is incomplete in a crucial respect—proceduralism does not specify those entitlements which should be most respected when all cannot be. Finally, I claim that proceduralism may be rescued by reading its claims as claims in ideal theory—that is, assuming the justice of all other social arrangements—but at substantial cost to its normative purchase in arguments for law reform, given that social arrangements are not in fact perfectly just.

I conclude by claiming that proceduralism offers three key insights that should be taken forward. First, it properly considers as its starting point the legal rights of claimants on an insolvent estate. Second, it uses those rights as the basis upon which the treatment of different claimants falls to be determined. Third, and finally, it is justifiably hostile to approaches to insolvency law that favour ad hoc, ex post redistribution implemented by way of judicial discretion. I emphasise, however, that such approaches are objectionable because self-defeating, when they are, and not because inefficient.

Chapter 3 seeks to identify, and classify, some of the normative questions to which corporate insolvency law gives rise. I claim that corporate insolvency law can be seen as

raising at least three distinct classes of problems or questions, which I will refer to under the headings of distribution, debtor fidelity, and corporate identity.

Distribution problems are those relevant to determining who should get what, once a company becomes subject to an insolvency procedure. I claim that distribution questions are questions of distributive justice, and must therefore be approached as such. Debtor fidelity problems are those concerning good and bad conduct in matters relevant to the insolvency of a company. As such, these should be understood in terms of defensible principles of interpersonal morality. Finally, corporate identity problems relate to the fact that various stakeholders in corporate insolvency, including but not limited to the debtor, may be companies rather than individuals. I exclude this latter class of questions from the scope of the thesis, as they do not bear upon the arguments to come. These categories are non-exhaustive, and are not intended to be mutually exclusive. I conclude this chapter by explaining the role that the notion of efficiency is to have in my analysis, and by foreshadowing the potential connections between distributional and debtor fidelity questions.

Chapter 4 builds on the claim, defended in chapter two, that the distributional questions raised by corporate insolvency law must be answered in terms of distributive justice. First, I consider what the scope of distributive justice should be. I argue, by reference to what has been called the 'global justice' debate, that justice is owed at least to all those ordinarily subject to the laws of a given political community. In doing so I argue that not only proceduralism, but also certain traditional approaches to insolvency law, have

answered the scope question too narrowly, with important consequences. Second, I consider what it is that should be distributed. I claim, non-exhaustively, that in a market system, the capacity to hold and create legal rights is one such thing, because such a capacity is necessary if the form that material benefits take in a given society is the legal form. Third, I introduce the notion of responsibility, primarily by reference to the work of Ronald Dworkin. I explain how deliberate choices by individuals may generate differences in outcome that distributive justice need not condemn. This line of argument, in particular, is of significance for any consideration of the special position of the adjusting creditors of an insolvent debtor.

Chapter 5 builds upon the key, abstract, claims of chapter 4. In the first part of the chapter I develop my claim that individuals must have certain legal capacities, as a matter of distributive justice, and explain what it means for these capacities to be equal capacities, and why this equality is required. This analysis resonates, to some extent, with an analysis of private law rights and remedies in terms of corrective justice; the equal capacities in question constitute the abstract equality that holds between two parties between whom no relevant injustice has come, and which corrective justice seeks to restore when such injustices do arise. I consider John Gardner's view that corrective justice according to law is not any part of the law's 'imminent rationality', but rather an incomplete legal implementation of underlying moral norms of corrective justice. I claim, with Gardner, that the replication of moral norms of corrective justice by law is only justifiable where distributive principles favour such a replication, and go on to claim that the notion of corrective justice itself is therefore incapable of determining

when it is that corrective justice should be done according to law. I claim that certain attempts to do this by private law scholars, including Robert Stevens, simply beg the question.

In the second part of the chapter I consider how departures from formally equal treatment of legal right-holders can be reconciled with the distributive framework I propose. I show that no part of the argument that I defend prohibits differential treatment of creditors whose entitlements have legally different features. I claim, however, that determining the range of rights that a legal system will recognise is a proper task of mandatory law. This is, in short, because the recognition of new kinds of right is allocative, and questions of allocation must be answered in terms of distributive justice.

In the last part of the chapter I consider what the circumstances of insolvency imply about how these questions of allocation should be answered. I do so by reference to another idea I borrow from the work of Joseph Raz and John Gardner, usually called the continuity thesis. Adapting the continuity thesis, I claim that (1) where insolvency defeats what are otherwise legally protected entitlements, and (2) reasons of distributive justice that underpinned those entitlements are undefeated, then (3) the state should provide for these reasons to be met in other ways. I consider the UK order of distribution (or 'waterfall') against these principles, and comment on the status of secured credit under UK law.

Chapter 6 begins the discussion of the debtor fidelity concerns I argue corporate insolvency law should address. It does so by introducing what I say are three straightforwardly appealing principles of interpersonal morality, and considering them alongside certain substantive doctrines I say these principles appear to embody. The principles are: (1) that it is wrong to deliberately avoid one's obligations, or deliberately obstruct others in their enjoyment of rights correlated to such obligations; (2) that where one has an obligation, that obligation counts against actions that are inconsistent with that obligation, or which would make performance on that obligation less likely; and (3) that it is wrong to create obligations one knows, or ought to know, one has no reasonable prospect of performing.

I argue that principle (1) is substantially reflected in the statutory proscription of transactions in fraud of creditors,[12] fraudulent trading,[13] and certain kinds of presumptively fraudulent re-use of company names.[14] Principle (2) offers normative support to duty-shifting doctrines in English law, according to which directors must have regard to the interests of creditors, and not only shareholders, as a company approaches insolvency,[15] and partial support for director-liability provisions concerning

[12] Insolvency Act 1986 s 423

[13] Insolvency Act 1986 s 213 (see s 246ZA for the equivalent provision in administration).

[14] Insolvency Act 1986 s 216

[15] Companies Act 2006 s 172(3), *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 (CA).

wrongful 'trading';[16] that is, director conduct past the point at which there was no reasonable prospect of avoiding insolvent liquidation (or administration). Principle (3), I claim, should supplement our assessment of the wrongfulness of wrongful trading contrary to sections 214 and 246ZB of the Insolvency Act 1986, and calls for a wider reading of the statute than has emerged from the case-law. I conclude by noting that none of the principles considered in this chapter justify what are perhaps the centrepiece transaction avoidance rules: those addressing transactions at undervalue, and unfair preferences.

Chapter 7 offers a justification for what I call the ordinary transaction avoidance rules: the rules concerning undervalue transactions and unfair preferences.[17] The argument of this chapter is that neither transactions at undervalue nor preferences are in themselves morally wrong as between the parties to them: they need not involve misbehaviour or wrongdoing in the way that the provisions considered in the previous part do. They are, however, objectionable on other grounds. These grounds, I claim, reflect the principles of distributive justice, which are the standard of justification for insolvency law as a whole.

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[16] Insolvency Act 1986 s 214 (see s 246ZB for the equivalent provision in administration). Trading is not in fact required: Goode, *Principles of Corporate Insolvency Law* (n 1) [14-33].

[17] Insolvency Act 1986 ss 238, 239

I begin by attempting to characterise preferences and undervalue transactions as a species of wrongdoing or misbehaviour, and show why this fails, before claiming that the effect of such transactions on (other) creditors gives us reasons of distributive justice not to enforce what might otherwise have been unobjectionable transactions. I then consider whether certain restrictions contained within the ordinary avoidance provisions, including relatively short time-limits, insolvency requirements, and the 'desire to prefer' requirement,[18] can be reconciled with a distributive justice-based account of these rules. I conclude that sections 238 and 239 of the Insolvency Act 1986 do not, in the final analysis, address fidelity concerns at all. Instead, they are provisions required by distributive principles and implied by the mandatory distribution regime, circumscribed, for the most part, by normatively appropriate limits.

4. CONCLUSION

The result is a view of corporate insolvency law as continuous not with the rights conferred by the rest of the legal system, but instead with the reasons of justice that can be seen to underpin and justify the recognition of such rights. Corporate insolvency law stands clearly apart from private law doctrine and from its characteristic justificatory apparatus, which includes notions of intention, good faith and commercial sense. In place of such notions it should consider the vested rights of individuals, the reasons of

[18] Insolvency Act 1986 s 239(4)

justice that underpin them, and the effects of insolvency rules on all those subject to a jurisdiction's laws. To see corporate insolvency law in this way is to offer a novel normative account of this area of law, and a distinctive contribution to a literature dominated by accounts all too eager to eschew questions of distribution, and therefore of distributive justice.

II THE PROCEDURALIST APPROACH TO INSOLVENCY LAW

1. INTRODUCTION

The most prominent and also the most elaborate normative account of insolvency law is that which has come to be known as proceduralism. Proceduralism is a normative theory of insolvency law in that it makes substantive claims about what insolvency law should be like, and claims to offer grounds for criticising certain other normative claims about insolvency law, however described. It is a special—that is, rather than a general—normative theory in that it does not aspire to justify or critique law in a general sense, or all laws. Instead it restricts itself to insolvency law only. By implication, therefore, proceduralism must also be taken to assert that a fully normative theory *can*, without contradiction or incoherence, make claims about what the law should be in some particular domain, abstracted from all the rich context of a particular political community, its laws and its institutions.

Proceduralism has been principally—though not exclusively—defended from within law and economics.[19] By this I mean the body of normative scholarship that has developed since the 1960s around the work of figures such as Posner and Calabresi, as well as the application of insights and concerns drawn from the economic and behavioural sciences—concerns about incentives, ex ante and transaction costs, for example—to problems of law and legal regulation.

I do not mean to suggest that law and economics, or, if this is different, the economic analysis of law, is a single or unified theory, nor that all associated with that label share any particular view on any particular question. As such my comments are necessarily aggregative, and may not be attributable to any particular writer. It will be necessary to the discussion that follows, though, to distinguish between a number of claims that seem

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[19] Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press 1986);Thomas H Jackson and Robert E Scott, 'On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain' (1989) 75 Virginia Law Review 155; Douglas G Baird, 'A World without Bankruptcy' (1987) 50 Law and Contemporary Problems 173; Douglas G Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren' (1987) 54 The University of Chicago Law Review 815; Douglas G Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 The Yale Law Journal 573; Douglas G Baird and Thomas H Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 The University of Chicago Law Review 97; Alan Schwartz, 'A Contract Theory Approach to Business Bankruptcy' (1998) 107 Yale Law Journal 1807; Alan Schwartz, 'A Normative Theory of Business Bankruptcy' (2005) 91 Virginia Law Review 1199; Robert K Rasmussen and David A Jr Skeel, 'The Economic Analysis of Corporate Bankruptcy Law' (1995) 3 American Bankruptcy Institute Law Review 85; Robert K Rasmussen, 'The Ex Ante Effects of Bankruptcy Reform on Investment Incentives' (1994) 72 Washington University Law Quarterly 1159; for an overview see Peter von Wilmowski, 'Insolvency Law: Its Roles and Principles' in Albrecht Cordes and Margrit Schulte Beerbühl (eds), *Dealing with economic failure: between norm and practice (15th to 21st century)* (Peter Lang 2016); Royston Miles Goode, *Principles of Corporate Insolvency Law* (Fifth edition, Sweet & Maxwell 2018) ch 2; cf Robert K Rasmussen, 'An Essay on Optimal Bankruptcy Rules and Social Justice' (1994) 1994 University of Illinois Law Review 1.

to emerge from law and economics scholarship. I shall call these *normative*, *historical* and *positive* law and economics claims. The *normative* claim is that law should be efficient in the wealth-maximising sense of that term. The *historical* claim is that the common law has tended, over time, to deliver efficient solutions, whether or not any particular judge intended this. Finally, the *positive* claim, implicit in the approach of a great deal of recent academic writing on commercial law, is that close attention to the incentives, costs and outcomes produced by certain forms of regulation may inform and enrich our understanding of how regulatory regimes function. Such consideration is closely tied to empirical investigations of the phenomena in question.

As I hope is obvious, what I have called the *normative* claim is a controversial theory with much to defend in the normative domain. A great deal has been written in this connection over a number of decades.[20] Though I shall not argue for this substantive conclusion, I shall proceed on the basis that the normative claim does not succeed; that

[20] This was the focus of a series of lively exchanges, beginning in the late 1970, primarily between Ronald Dworkin and Richard Posner: Richard A Posner, 'Utilitarianism, Economics, and Legal Theory' (1979) 8 The Journal of Legal Studies 103; Richard A Posner, 'The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication' (1979) 8 Hofstra Law Review 487; Richard A Posner, 'A Reply to Some Recent Criticisms of the Efficiency Theory of the Common Law' (1980) 9 Hofstra Law Review 775; Richard A Posner, 'The Value of Wealth: A Comment on Dworkin and Kronman' (1980) 9 The Journal of Legal Studies 243; Guido Calabresi, 'An Exchange: About Law and Economics: A Letter to Ronald Dworkin' (1979) 8 Hofstra Law Review 553; Ronald Dworkin, 'Why Efficiency-A Response to Professors Calabresi and Posner' (1979) 8 Hofstra Law Review 563; Ronald Dworkin, 'Is Wealth a Value?' (1980) 9 Journal of Legal Studies; both Dworkin papers are reprinted in Ronald Dworkin, *A Matter of Principle* (Clarendon Press 1986).

efficiency, understood as wealth-maximisation, is not a normatively desirable overriding goal for this or any other part of the law.[21]

The *historical* claim is beyond the scope of this work and will not be considered further.[22]

The *positive* variety of law and economics, however, is of considerable importance for normative reflection on corporate insolvency law.[23] While normative claims may be advanced that draw upon this kind of analysis, they must find their normative grounding elsewhere. And while this states a methodological limitation for this kind of work, it also shows why insights drawn from positive law and economics can cut across—and thus be useful given—deep normative disagreement. Normative claims informed by this kind of economic analysis can just as easily be made by instrumental legal moralists—those who hold that law should improve our moral situation and employ effective means to this end[24]—as by Posnerian single-value wealth-

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[21] This is usually called 'Kaldor-Hicks' efficiency: Richard A Posner, *Economic Analysis of Law* (Wolters Kluwer Law & Business 2014) [1.2], [2.4]; Nicholas Kaldor, 'Welfare Propositions of Economics and Interpersonal Comparisons of Utility' [1939] The Economic Journal 549; John R Hicks, 'The Foundations of Welfare Economics' (1939) 49 The Economic Journal 696.

[22] Lewis Kornhauser, 'The Economic Analysis of Law' in Edward N Zalta (ed), *The Stanford Encyclopedia of Philosophy* (Fall 2017, Stanford University 2017) s 1.2 <https://plato.stanford.edu/> accessed 10 April 2018.

[23] see generally the introductory discussion in Kornhauser (n 22).

[24] This theory has been developed in criminal law theory: see generally Michael S Moore, *Placing Blame: A General Theory of the Criminal Law* (Clarendon Press 1997); Michael S Moore, 'A Tale of Two Theories' (2009) 28 Criminal Justice Ethics 27; James Edwards, 'An Instrumental Legal Moralism' in Leslie Green, Brian Leiter and John Gardner (eds), *Oxford Studies in Philosophy of Law*, vol 3 (2018).

maximisers—those who hold that that legal system is best which leads to the greatest production of wealth, whatever else it does.[25] John Armour has made the point in these terms:

> [E]ven if the normative premises of welfare economics are not accepted, the law and economics literature on corporate insolvency is still highly relevant to policy makers. To cut to the chase: the answers this literature provides to the 'implementation question' are of interest to anyone seeking to formulate policy prescriptions[.] The law and economics literature … provides insights into how to implement the goals of any given theory. It is this, rather than the inherent normative attractiveness of efficiency, which makes it important to policy-makers.[26]

This describes a proper and defensible way in which such material may be used, and one which does not depend on the viability or appeal of normative law and economics.

In broad outline, the theory of insolvency law known as proceduralism holds as follows. Insolvency law, best understood, is a procedural device for the cashing out of entitlements of which the law, prior to insolvency proceedings being opened, already takes cognizance. (Hence 'proceduralism').[27] In particular, it is a parallel and secondary

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[25] eg Posner, 'A Reply to Some Recent Criticisms of the Efficiency Theory of the Common Law' (n 20) 780; cf Horst Eidenmüller, *Effizienz als Rechtsprinzip: Möglichkeiten und Grenzen der ökonomischen Analyse des Rechts* (4. Auflage., Mohr Siebeck 2015) 169–70.

[26] John Armour, 'The Law and Economics of Corporate Insolvency: A Review' (ESRC Centre for Business Research, University of Cambridge 2001) 197 14–15; cf Horst Eidenmüller, 'Comparative Corporate Insolvency Law' (Social Science Research Network 2016) SSRN Scholarly Paper ID 2799863 4 <https://papers.ssrn.com/abstract=2799863> accessed 17 April 2018.

[27] 'Procedularism' is a term coined in Baird, 'Bankruptcy's Uncontested Axioms' (n 19) 576–80; cf the 'procedure' theory defended in Charles W Mooney Jr, 'A Normative Theory of Bankruptcy Law: Bankruptcy as (Is) Civil Procedure' (2004) 61 Washington & Lee Law Review 931. The word 'procedure'—associated with federal law—sometimes carries with it the implication of standing

system of debt enforcement, the very existence of which creates costs which can only be justified by insolvency law solving what can be understood as a special insolvency problem. This special insolvency problem is the common pool problem—or multi-party prisoners' dilemma—that arises where there are multiple claims against an insolvent estate that is insufficient to meet all of those claims in full, and incentives for claimants to engage in individual enforcement behaviour harmful to the group of claimants taken as a whole. Insolvency law should confine itself to ameliorating this and related common pool problems, and should not pursue other goals.[28] It should, in all other respects, mirror the primary, non-insolvency debt enforcement regime as closely as possible.

Limiting the discussion to corporate insolvency, I shall attempt to set out more fully the central proceduralist positions sketched in the last paragraph (section 2), examine the normative foundations of these claims (section 3), and explain why proceduralism cannot, as ordinarily understood, provide an appealing justification for the claims it makes about the law (section 4). Finally, I attempt show what can be salvaged from the overall failure of the kind of proceduralism that has been defended in the literature (section 5), before concluding.

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in opposition to 'substantive' state law, in the US context. I do not pursue the significance of this here, and do not consider the federalist dimension sometimes invoked in US bankruptcy scholarship: see generally Thomas E Plank, 'Bankruptcy and Federalism' (2002) 71 Fordham Law Review 1063; cf John Armour, 'Who Should Make Corporate Law? EC Legislation versus Regulatory Competition' (2005) 58 Current Legal Problems 369.

[28] Jackson, *The Logic and Limits of Bankruptcy Law* (n 19) 2.

2. PROCEDURALISM

2.1. Three proceduralist claims

The proceduralist view of insolvency law has been most prominently defended by Jackson and Baird. Writing in 1987, Baird framed the issues in this way:

> As far as corporations are concerned, bankruptcy law is a procedure in which the actions of those with rights to the assets of a firm are stayed and the affairs of the firm are sorted out in an orderly way. Two characteristics of this procedure are crucial for present purposes: (1) it is an alternative avenue for vindicating legal rights, in the sense that those with rights to the debtor's assets could, in the absence of the stay, vindicate them elsewhere (albeit perhaps less effectively); and (2) it involves the rights of more than a single player.[29]

Baird goes on to state that '[t]he challenge facing anyone who wants to write about bankruptcy policy is to explain why a distinct bankruptcy law exists at all[, given that i]ntroducing multiple avenues of enforcement is costly.'[30] In what follows, I shall call this the *justification* claim. Baird does not expressly defend the justification claim.

Bankruptcy law, then, calls for normative justification not only in the ways that all laws do—whatever these might be—but also requires special justification because the very fact of having a special bankruptcy law leads inevitably to certain costs being incurred.

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[29] Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy' (n 19) 824.

[30] ibid.

Exactly what these costs are, or who incurs them, or why this is relevant, is not always explained. One plausible reading is that these costs are the costs imposed on all firms, including by the adjustment of credit terms ex ante, by virtue of the availability of a parallel system which suspends individual debt enforcement rights. I return to this below.[31]

Proceduralism sets and then aims to meet the justification claim. It also examines the implications of doing so. Baird and Jackson claim that the special justification for having a bankruptcy law at all depends on bankruptcy law having a distinct function and beneficially pursuing this function.[32] I shall call this the *positive function* claim. They also claim that bankruptcy should law not pursue other possible functions. I shall call this the *residual function* claim. The proper and exclusive function that Baird and Jackson propose for bankruptcy law lies in offering a response to certain common pool problems.

As this short introduction should make clear, the normative claims in play are somewhat compressed, and only partly specified. They are offered by Baird and Jackson as though substantially self-evident, and are therefore left underdeveloped.[33] I shall return to the substance of some of these ambiguities below. For now it is sufficient to present the

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[31] See II.3.3. below

[32] eg Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy' (n 19) 824; Jackson, *The Logic and Limits of Bankruptcy Law* (n 19) 5, 11, 17, 22.

[33] Indeed, Jackson says that 'this role … is largely unquestioned': Jackson, *The Logic and Limits of Bankruptcy Law* (n 19) 11.

proceduralist position, in terms as near as possible to those in which it has been defended, noting the relevant ambiguities as they arise.

I should say at this point that what follows is my attempt to articulate the strongest possible version of proceduralism that I can, based on the manner in which it has been presented and defended in the literature. It is a consequence of this approach that the view that I set out may not in fact be held by any particular scholar. I take this to be an entirely conventional way of proceeding. References to 'proceduralists' should not, therefore, be taken to refer to a particular group of people, nor to imply that any particular group that would, in fact, adopt that label would be of one mind on all questions. The label is no more than a convenient shorthand intended to smooth the foregoing discussion.

2.2. Bankruptcy law's positive function: the common pool problem

Jackson's work has put the idea of a common pool problem at the heart of proceduralist writing about the normative foundations of insolvency law.[34] Insolvency questions arise, Jackson claims, in circumstances in which there is a plurality of claims against a debtor, held by more than one person, against an insufficiency of assets given the extent of those claims.[35] Where either or both of these conditions are not met there is, according to

[34] ibid ch 1.

[35] ibid 8–10.

Jackson's account, simply no insolvency problem to resolve. This is because ordinary, non-insolvency, debt-collection law already provides for the resolution of such cases by way of individual enforcement action. Where these circumstances do obtain, however, Jackson identifies a common pool problem; that is, circumstances in which individual creditors may have incentives to act in a way that would, if unconstrained, be destructive of value. Such behaviour, Jackson claims, could lead to the piecemeal liquidation of firms worth more than the sum of their individual assets, or to the separate sale of assets worth more together than apart.[36] It could also lead to unnecessary and duplicative monitoring and enforcement costs incurred by creditors eager to be able to enforce first in a race for assets, and so be paid in full. And all of this would put upward pressure on the cost of credit.[37] To the extent that bankruptcy law manages to ameliorate such problems, then it goes some way toward justifying the costs of its existence.

Jackson's exposition of the common pool problem is substantially conventional.[38] He takes the example of a lake that could be fished for $100k profit this year (call this option fishnow) leaving nothing for next year, or fished sustainably, into the future, for a yearly profit of $50k (call this option fishalways). He demonstrates that a single owner of (the

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[36] ibid 15–16.

[37] ibid 13–14.

[38] ibid 11; referring to Garrett Hardin, 'The Tragedy of the Commons' (1968) 13 Science 1243; Gary D Libecap and Steven N Wiggins, 'Contractual Responses to the Common Pool: Prorationing of Crude Oil Production' (1984) 74 The American Economic Review 87; Alan E Friedman, 'The Economics of the Common Pool: Property Rights in Exhaustible Resources' (1970) 18 UCLA Law Review 855.

fishing rights to) the lake would, adverting only to her self-interest, prefer fishalways, but that if there were multiple owners, there would be clear incentives for each individual owner to carry out fishnow.[39] The reason fishalways is to be preferred is that it would lead to greater aggregate financial gains for those with rights to the lake taken as a group.

Jackson claims that the role of bankruptcy law lies in solving common pool problems that are strictly analogous to that involving the fish and the lake: bankruptcy law should regulate in such as way as 'to permit the owners of assets [ie a debtor's multiple creditors] to use those assets in a way that is most productive to them as a group in the face of incentives by individual owners to maximise their [individual] positions.'[40] Jackson claims that coercive measures ought to be adopted in order that the preferable option for the creditors taken as a group be pursued. This, he claims, would allow them, as a group, to avoid incurring the costs of competitively monitoring a debtor for the sake of securing an advantageous (individual) position in a race for assets, and also to keep groups of assets together that are worth more together than if sold off piecemeal. Examples of such measures include a stay on individual enforcement action by creditors against an insolvent debtor,[41] and restrictions on preferential payments in the lead-up to

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[39] Jackson, *The Logic and Limits of Bankruptcy Law* (n 19) 12.

[40] ibid 5 (emphasis in original).

[41] eg Insolvency Act 1986 ss 130(2) (companies in liquidation), sch B1 para 43 (companies in administration), 285(3) (individuals in bankruptcy), ibid 17.

the opening of insolvency proceedings.[42] In this way, on Jackson's account, individual creditors are restrained from pursuing their own interests in various ways for the sake of the aggregate financial return of all creditors taken as a group.[43] It is worth noting, at this point, that this does not involve making claims about how these aggregate financial returns should be divided between the creditors.

2.3. Arguments relating to consistency

A second prominent feature of proceduralist accounts of insolvency law may be conveniently cast as an argument from consistency. This argument has been articulated by way of response to a set of prominent objections to proceduralism from writers such as Finch and Warren.[44] It is also intelligible as a free-standing argument in favour of what I have called the residual function claim.[45]

It has been objected that proceduralism fails to provide an appealing account of insolvency law because it fails to take account of the harm to diverse interests that

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[42] see Insolvency Act 1986 s 239, ibid 123–5.

[43] ibid 125.

[44] Vanessa Finch, 'The Measures of Insolvency Law' (1997) 17 Oxford Journal of Legal Studies 227; Elizabeth Warren, 'Bankruptcy Policy' (1987) 54 The University of Chicago Law Review 775.

[45] See II.2.1. above. The residual function claim may well be redundant in the justificatory schema I have claimed proceduralism imposes. But I consider it here because proceduralist scholars including Baird and Jackson appear to defend it on independent grounds.

financial distress and corporate collapse may occasion.[46] These interests include, but are not limited to, the (general) interests of the community around a debtor that fails,[47] the interests of employees in continuing to be employed by the debtor, the interests of suppliers in maintaining valuable contracts or even non-contractual relationships with the debtor, and the interests of the community, or indeed the environment itself, in ensuring that environmental damage caused by the debtor is repaired. Because insolvency is a relevant cause of possible harms under these headings, the objection claims, insolvency ought also to be a forum in which such interests can be negotiated and, to the extent that this is possible, promoted or met.[48]

The proceduralist response to this objection has been to agree that these various interests may be worthy of protection, but to deny that insolvency law is a legitimate or well-adapted means to this end.[49] If the environment should be protected, the argument goes,

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[46] Warren (n 44) 796–7; Finch, 'The Measures of Insolvency Law' (n 44) 236–8 (reviewing what she calls the 'communitarian' vision of insolvency law).

[47] eg Karen Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (Yale University Press 1997) 228–29.

[48] Some accounts also refer to cases in which insolvency courts in fact have appeared to take into account such interests, and on this basis claim that insolvency law does in fact take account of the various interests mentioned above. I have not been able to find a satisfactory explanation of the supposed significance of this observation. If meant in a strictly descriptive way, then it is unobjectionable but also irrelevant to a normative account of this area of law. If meant as offering a reason that insolvency law *should* take account of these interests, then it fails as an argument for want of a normative premise, as Baird has observed in an analogous situation: Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy' (n 19) 817.

[49] ibid.

then why protect it only in circumstances that involve insolvency proceedings?[50] It is also pointed out that protecting some community interests, say, in insolvency would lead to a situation in which the protection that such interests received would depend on whether or not the debtor entered into insolvency proceedings when going out of business, rather than merely putting up shutters and, eventually, being deregistered and so avoiding all the hassle. Put differently, the protection of some interests *in insolvency only* would be arbitrary, and objectionable as such.[51]

The precise contours of this claim about arbitrariness have not been articulated. I see at least two possibilities. The first reason we might have to condemn arbitrariness of the kind I have described might be thought to follow from claims about the absolute (or at least consistent) importance of certain interests, and the claim that the law, in protecting some interest in circumstance X cannot then deny it in circumstance Y, all other things being equal. This latter claim might be understood as a mere appeal to rationality, or as a kind of hypocrisy charge.[52] Alternatively, it might be thought to approximate Ronald Dworkin's view that if the law is to create obligations in a political community, then it must exhibit a kind of principled consistency that he calls integrity, and that when morally significant interests are in play it must, even if mistaken, 'speak with one

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[50] see *Re Celtic Extraction Ltd (In Liquidation)* [2001] Ch 475 (CA) reversing Neuberger J; declining to follow *Re Mineral Resources Ltd* [1999] 1 All ER 746 (Neuberger J)

[51] Rizwaan J Mokal, *Corporate Insolvency Law: Theory and Application* (Oxford University Press 2004) 62–7.

[52] cf Alexandra Whelan and Maggie O'Brien, 'What's Wrong with Hypocrisy?' (2018).

voice'.[53] I do not know if this kind of argument is one that any particular proceduralists would be inclined to accept, on this point or in general.[54] At all events, it is one that would require substantial elaboration. It would also depend on accepting a great deal of (the controversial parts of) Dworkin's theory of law, and in particular his theory of associative obligations.[55] It is also worth noting that it is very likely that condemning arbitrariness in this Dworkinian way cannot be maintained alongside certain kinds of value-maximization claims that some proceduralists may wish to retain. But these matters need not be pursued.

A second possibility would be to understand the charge of arbitrariness against the recognition of some interest *in insolvency only* as claiming that such recognition would be a very poor means of protecting or promoting the interest in question, and that as the law should pursue its chosen goals by effective rather than ineffective means, the use of some putatively ineffective means is objectionable.[56] To put it another way, the concern

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[53] Dworkin, *Law's Empire* (n 4) chs 6-7.

[54] The argument is considered in Mooney Jr (n 27) 973–4; also referring to Denise Réaume, 'Is Integrity a Virtue? Dworkin's Theory of Legal Obligation' (1989) 39 The University of Toronto Law Journal 380; Joseph Raz, 'Speaking with One Voice: On Dworkinian Integrity and Coherence' in Justine Burley (ed), *Dworkin and his Critics* (Blackwell 2004).

[55] Dworkin, *Law's Empire* (n 4) ch 6, esp 195–216; cf Leslie Green, 'Associative Obligations and the State' in Justine Burley (ed), *Dworkin and His Critics* (Blackwell 2004); Joseph Raz, 'The Relevance of Coherence' (1992) 72 Boston University Law Review 273; reprinted in Joseph Raz, *Ethics in the Public Domain: Essays in the Morality of Law and Politics* (Revised edition, Clarendon Press 1994). Associative obligations are obligations that we owe as a consequence of our membership of certain kinds of groups. For Dworkin, these groups can include families, cricket teams, and the right kind of political community, but would never include the National Socialist Party in 1933, say, or the Ku Kux Klan.

[56] Whether or not some means is in fact ill-adapted to the pursuit of some goal may of course depend on a range of empirical questions. I shall not consider the implications of this here, and

could be one about efficacy.[57] To advance a claim of this kind is perhaps less involved than taking the Dworkinian route I have suggested above, but here also further elaboration and clarity is required. While this second characterisation of the charge of arbitrariness has straightforward intuitive appeal, it seems to me that at least part of this appeal flows from an important ambiguity as to the kind of normative claim that proceduralists are making. While I acknowledge that these terms have been used in different ways in related contexts,[58] I shall describe this ambiguity as between claims in ideal and non-ideal theory. As I shall use the terms, a claim in ideal theory assumes ideal background justice. A claim in non-ideal theory makes no such assumption.

The distinction I have in mind is drawn out by considering two possible formulations of the proceduralist statement under consideration. The first would be this:

> (P1) In the best imaginable legal system, with the best imaginable insolvency law, the means of protecting or promoting certain valuable interests should not operate in insolvency only.

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note only that any conjectures we may advance as to the instrumental effectiveness of some rule, etc., is just that: a conjecture. In the terms introduced above, this arbitrariness charge may be understood as directed at a kind of irrationality at the stage of the 'implementation question' considered above: Armour, 'The Law and Economics of Corporate Insolvency' (n 26) 14–15. See II.0 above.

[57] See II.2.5. below

[58] Rawls, for example, employs such terms to refer to ideal compliance with principles chosen by appropriate procedures: Rawls (n 5) passim.

(P1) has intuitive appeal, and is plainly at least as plausible as the shorter version introduced at the top of the last paragraph. However, the statement might also be formulated in the following terms:

> (P2) In actual legal systems, with their flaws and injustices, the means of protecting or promoting certain valuable interests should not operate in insolvency only.

(P2) is altogether different to (P1), and its intuitive appeal is much less certain. I shall return to the implications of this important ambiguity below.[59] For now, it is sufficient to notice that it is not clear whether proceduralism is offered as a set of claims in ideal or non-ideal theory. Clarity is required on this point, for without such clarity, the cogency of proceduralist policy prescriptions cannot be ascertained. This is of particular importance in approaching the different arguments from consistency considered in this sub-section. In ideal circumstances to protect certain interests in insolvency only would be both inconsistent and irrational: if perfect justice is taken care of outside of insolvency law then what further interests could need seeing to? In non-ideal circumstances, however, it may be that to protect certain interests in insolvency only would be inconsistent but not necessarily irrational. For if this means that valuable interests neglected outside of insolvency receive some protection in a legal system rather than none, it is difficult to see why the insolvency provision, and not the lack of provision outside of insolvency, is irrational in the relevant sense. If I am right about this then

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[59] See II.4.3. below

arguments from consistency may have little purchase outside of ideal circumstances. Even in these circumstances, such arguments may appear redundant.

2.4. Arguments regarding forum shopping

Arguments against recognising entitlements in insolvency only based on different kinds of consistency have now been considered. A second set of arguments against recognising such entitlements draws on the idea of objectionable forum shopping.[60] If certain parties have entitlements that are recognised in insolvency only, so the argument goes, then those parties would, pursuing their own interests, be motivated to take steps that would see debtors put into insolvency proceedings, perhaps unnecessarily, in order that certain stakeholders gain access to these special insolvency-only entitlements.

As with the previous arguments I have considered, the question of how to understand this suggestion is not entirely straightforward. It appears to respond to a concern, present in the law and economics literature, that profitable but financially distressed firms—as opposed to bad, economically distressed firms—be put into insolvency proceedings and there risk being broken up, perhaps at the behest of some creditor or

[60] The sense in which forum shopping is to be understood is more obvious in the US, where non-bankrupcy law is state law, to be dealt with in state courts, and bankruptcy law is federal law, to be dealt with in federal courts. The notion is equally applicable, though, as between ordinary non-bankrupcy proceedings on the on hand, and formal insolvency proceedings on the other, even if the court with jurisdiction is, as is sometimes the case in England and Wales, one and the same: see Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy' (n 19) 824–8.

creditors motivated to access some insolvency-only entitlement, despite the overall destruction of value that this would involve.[61] But if this is all there is to the argument from forum shopping, then it is very similar to that concerning the common pool problem discussed above.[62] The concern is about the destruction of some kind of (potential) economic value, and nothing else. If this is so then it adds nothing new to the proceduralist case.

To the extent that it is about increasing the *risk* that firms that are profitable might end up in insolvency proceedings and there be broken up, then it is hard to understand why creditors' incentives of the kind I have described are of any special concern. This is because the conditions for commencing insolvency proceedings are defined by mandatory rules of law, and do not lie in the unconstrained discretion of a creditor or creditors.[63] If the concern relates not to the substance of these rules, but rather to the fact that some creditor(s) may have an incentive to use them in some putatively improper way, then it is difficult to understand how the issue raised is a forum shopping issue, as distinct from a routine civil procedure question about abuse of process or the scope of proper litigation. If, understood differently, the argument is about the costs thrown away by others due to some creditor's ultimately unsuccessful attempt to have a certain

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[61] Jackson, *The Logic and Limits of Bankruptcy Law* (n 19) 26.

[62] see ibid 21, 26. See II.0. above.

[63] This is not to say that the meaning of such rules is uncontroversial, or that the factual matters that must demonstrated under such rules are strightforward: eg *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc* [2013] UKSC 28, [2013] 1 WLR 1408.

of company put into insolvency proceedings, then this is an equally ordinary concern to be met by a given jurisdiction's ordinary law of costs or its analogue: that there may in some circumstances be an incentive to make unmeritorious tort claims seems a poor reason to abolish the law of torts, for example. If the concern relates to the costs thrown away by some creditor in their own ultimately unsuccessful attempt to have some debtor put into insolvency proceedings for an improper purpose, then the concern would embody a peculiar kind of paternalism. In each case, it is difficult to see the distinct normative appeal of these kinds of arguments.

A further case might readily be imagined, in which a profitable but financially distressed firm is put into insolvency proceedings unnecessarily but not broken up. In such a case those assets of the firm worth more together than apart—and, indeed, the firm's business—are kept together, but the firm is still worse off, having incurred direct and indirect costs relating to the unnecessary proceedings.[64] In such a situation, any assessment of the going-concern value of the firm is likely to be affected, and for the worse. This is, however, simply to restate the problem relating to abuse of process or opportunistic litigation considered above. As for the direct costs of the unnecessary procedure, some of these may be recoverable from the relevant petitioner. As for the indirect costs, these should at least partially abate as information as to the company's

[64] Michelle J White, 'The Corporate Bankruptcy Decision' (1989) 3 Journal of Economic Perspectives 129, 146.

true state reaches relevant stakeholders, as it would have had the company successfully defended ordinary civil proceedings.

2.5. The ex ante perspective and the cost of credit

A final set of proceduralist concerns relate to the ex ante effects of insolvency rules.[65] Having considered the suggestion that recognising certain entitlements in insolvency only might be objectionable on grounds of consistency, or that it might encourage a certain kind of forum shopping, we should also consider that the recognition of such entitlements would lead adjusting creditors to charge more for credit. Such adjustments might be provoked in a number of different ways. Consider the following two examples. First, if it were known in advance that certain specified claims would be paid ahead of fixed security, then those offering credit against fixed security would take into account the fact that they would be postponed to the preferred claims to the specified extent. Second, if it were not known that such a preference would be recognised, but that, instead, the assets of an insolvent company would be distributed according to a judge's discretion, then those offering credit would need to charge for the fact that they could

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[65] It has been suggested that these concerns, or some of them, are no so much proceduralist as 'economic', as they are not dealt with expressly, at length, in the body of proceduralist scholarship to which I have referred. To the extent that there is a dispute here, it is a dialectical or taxonomic one, upon which little of importance turns. I associate these ideas with proceduralism because of their consistency with the rest of that theory's orientation and because they tend, in my view, to strengthen proceduralism. To the extent that they are not, or do not, they are severable: cf Rasmussen, 'An Essay on Optimal Bankruptcy Rules and Social Justice' (n 19) 18.

not be sure of the basis on which they claims would be treated; that is to say, the uncertainty would have its own costs.

The latter kinds of costs seem straightforwardly objectionable. The uncertainty costs in question are, on the example, gratuitous. It is more difficult, however, to say much in general terms about the first kind of ex ante adjustment. To say more requires a clearer sense of just why an increase in the cost of credit might be thought undesirable. This might be though to be a direct concern for the cost of credit. This would imply that that insolvency law is best which minimises the cost of credit and pursues no other objectives. Alan Schwartz defends such a view in the following term, on grounds of efficiency:

> A bankruptcy system should function to maximize the return that creditors earn when firms fail. The larger this return is, the lower the interest rate is that creditors demand. A lower interest rate is efficient for two related reasons. First, the set of economically viable and socially desirable projects that firms will pursue becomes larger as the interest rate falls. Second, the effort that firms exert in pursuit of debt-funded projects increases toward the optimal level as the interest rate falls.[66]

This, straightforwardly enough, expresses the normative law and economics claim, and so depends on its normative appeal.[67]

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[66] Schwartz (n 3) 1220; to similar effect Schwartz (n 19).

[67] Schwartz hints at some such difficulties in a footnote: Schwartz (n 19) 1810, 1810n.

A second possible articulation of the concern for the cost of credit is to understand it as a kind of concern about efficacy. This could take at least two forms. The first would be simple inefficacy. An action, measure or theory fails to be efficacious if it fails to achieve some goal to some degree, given, perhaps, what might have been achieved by other means or, in any event, desired.[68] The second would be a concern about self-defeatingness. Some action, measure or theory is self-defeating where its pursuit undermines its stated objective.[69] So understood, the injunction to drive no faster than seventy miles per hour on the motorway would be inefficacious if it did not in fact succeed in having people, or very may people, drive at or below this speed. By contrast, the prohibition of certain drugs would be self-defeating, if the existence of such prohibitions were to lead to *more or worse* such drugs being sold and consumed.[70] (Such a prohibition would also fail to be efficacious.) Concerns of this kind have been expressed by Robert Rasmussen, who gives the following example of a situation in which the lawmaker sought to make the worst-off best-off:

> A general command to the bankruptcy judge to redistribute wealth to the worst-off persons appearing before her would have little to commend it[.] Consider, for example, a bank deciding whether to lend money to a firm. If this potential creditor knows that it will not be the least-advantaged party in the event of bankruptcy, it will expect to receive a reduced amount or even no payout at all if the firm files for bankruptcy. This knowledge will encourage lenders to either raise interest rates or refuse to lend money to

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[68] Horst Eidenmüller calls this the 'lawyer's' conception of efficiency: Eidenmüller, *Effizienz als Rechtsprinzip* (n 25) 55.

[69] Derek Parfit, *Reasons and Persons* (2nd repr. with corrections of 1984 ed., Clarendon Press 1987) pt 1.

[70] Edwards (n 24) 158.

> risky prospects. Similarly, employers would have an incentive to hire those who were comparatively better off and to locate in more prosperous communities. A bankruptcy redistribution to the least advantaged results in nothing more than a tax on those individuals who choose to deal with persons worse off than themselves.[71]

To the extent that this is so, then the arrangements in question are self-defeating as well as inefficacious, and should be condemned as such.

Concerns such as these have clear implications for how objectives should be pursued in law, in corporate insolvency law and in general. But it is also important to note their generality; that is, that they bear no special relationship to proceduralism, and do not say anything about law's proper goals. Efficacy is a limit on the means that may rationally be chosen for the pursuit of some goal. The considerable literature that considers the ex ante effects of insolvency rules can, as such, be understood an offering just the kind of positive economic insight described by Armour, above.[72] In this way, it may inform a lawmaker's choice of appropriate means for the pursuit of some objective. But in doing so it stands apart from proceduralism's overall normative orientation towards value-maximisation, and, if distinct, the normative injunction to reduce the cost of credit.[73]

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[71] Rasmussen, 'An Essay on Optimal Bankruptcy Rules and Social Justice' (n 19) 20.

[72] See II.0. above

[73] It has been suggested that employees may be better protected, ex ante, by a scheme of insolvency law that does not accord them any special treatment ex post, as lower borrowing costs facilitate economic activity, which in turn facilitates greater employment. In short, protecting employees by ex post means can be argued to be self-defeating: Rasmussen, 'An Essay on Optimal Bankruptcy Rules and Social Justice' (n 19). It should be borne in mind, though, that reducing the cost of credit, supposedly for employees' sake, could also be self-defeating, where this was

3. THE NORMATIVE BASIS OF PROCEDURALISM

3.1. The structure of the argument

I have now described the proceduralist account of insolvency law as involving a justification claim, which is putatively met by positive and negative function claims. Proceduralism gives certain content to each of these claims, but must also be taken to make the prior claim that this kind of argumentative schema is the right one to adopt. The schema is this: (1) if insolvency requires special justification in the way described, and (2) it beneficially pursues some proper purpose(s) and (3) does not pursue purposes other than these, (4) then, and only then, is insolvency law justified. Much complexity in what follows flows from the quite different way in which the normative claims of proceduralism have in fact been elaborated. This is explored below. Suffice it to say that the way in which the dialectic has proceeded has obscured the fact that plausible challenges to proceduralism might challenge not only proceduralism's proposed elaboration of either function claim, but also the justification claim itself. To this also, I return below.

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facilitated by the erosion of certain ex post employee protections, if this led employment conditions to deteriorate. This is consistent with the self-defeatingness concern being a general one.

3.2. The Creditors' Bargain distraction

In this section I will consider Jackson's well-known creditors' bargain model (CBM) justification for insolvency law and explain briefly why it fails. I then claim that in spite of its obvious failure, the CBM is substantially irrelevant to a fully normative proceduralist account of insolvency law of the kind considered above.[74] Jackson presents the CBM on a number of separate occasions, and what follows is necessarily a synthesis of these various retellings.[75] The CBM is supposed to justify certain features of insolvency law by showing those features to be among those that creditors would have agreed to, had they bargained ex ante.[76]

Generally speaking, the creditor's bargain is said to 'reflect[] the kind of contract that creditors would agree to if they were able to negotiate with each other before extending credit [and to be] an application of the Rawlsian notion of bargaining in the "original position" behind a "veil of ignorance."'[77] This latter characterisation is misleading. In

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[74] See II.2. above

[75] Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 The Yale Law Journal 857; Jackson and Scott (n 19); Baird and Jackson (n 19); Jackson, *The Logic and Limits of Bankruptcy Law* (n 19).

[76] While Jackson's intentions are not entirely clear on the point, it is possible that putatively consent-driven bargain device is intended to allay liberal concerns that may arise with respect to the imposition of mandatory rules of law that restrict individual creditors' freedom of action in insolvency, and, importantly, impose pro rata distribution on unsecured creditors in spite of their unqualified pre-insolvency entitlement. Given the manifest normative failure of the CBM, these dialectical points are not pursued.

[77] Jackson, *The Logic and Limits of Bankruptcy Law* (n 19) 17n.

fact, as Jackson's writing makes clear, the CBM is the (1) hypothetical agreement, of the (2) real parties that lend to some debtor, (3) at the point of extending credit to that debtor,[78] (4) where those real parties are aware of their own attributes,[79] but (5) uncertain as to whether or not the debtor will default in the future.[80]

The first point to note here relates to the asserted connection to the work of John Rawls.[81] There is little to be gained at this stage from an involved excursion into writings on justice in the Rawlsian tradition. But it is worth noting, however briefly, just how superficial the asserted similarity is. Jackson's CBM is similar to Rawls's ideas regarding choice from the Original Position only in that both are hypothetical—point (1) in the previous paragraph—and that both occur at a notional point in time that precedes the application of the principles that the choice in question would claim to generate—point (3). An analogy on this basis alone is surely unsatisfying. Points (2), (4) and (5) are distinctly non-Rawlsian in their content, and in very obvious ways. This is because each cuts a very large peep-hole through the veil of ignorance that must, on a Rawlsian account, serve to guide the choices to be made by abstract, rational agents.[82]

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[78] Jackson and Scott (n 19) 160.

[79] Jackson, *The Logic and Limits of Bankruptcy Law* (n 19) 15, 30.

[80] This elaboration is consistent with that offered in Mokal, *Corporate Insolvency Law* (n 51) 37–40.

[81] Other attempts to consider insolvency law along Rawlsian lines include: ibid ch 3; Donald R Korobkin, 'Contractarianism and the Normative Foundations of Bankruptcy Law' (1992) 71 Texas Law Review 541.

[82] Rawls (n 5).

It is plausible, however, to read Jackson's references to Rawlsian theories of justice as a matter of rhetoric rather than substance, and if this is so then the obvious failure of the analogy may not detract much from Jackson's account. Jackson's theory must, therefore, be considered on its own terms, which task has been essayed in a thorough and sophisticated fashion by Mokal.

Mokal's charge against Jackson is that while claiming to offer a normative theory of insolvency law drawing in some way on the work of John Rawls, the CBM is, in fact, what he calls a 'mutual advantage' theory, which purports to derive its normative appeal from a particular kind of hypothetical consent: point (1) above. Such a theory, Mokal claims, owes more to Posner and normative law and economics than it does to Rawls.[83] Read carefully, Mokal claims, Jackson's theory does not offer an account of what creditors would have agreed to at some privileged point in the past. Instead, it offers a model of what it would have been rational to for them to agree to, at an arbitrary point in the past, if rationality is understood in a particular way.

In summary, Mokal's objections are these. First, he notices that the notion of consent employed in the CBM cannot be actual consent. This is because no creditors ever had the relevant meeting, nor agreed to any generally applicable insolvency rules.[84] Instead it

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[83] Mokal, *Corporate Insolvency Law* (n 51) 36.

[84] Similarly, it cannot be implied consent, for very much the same reasons: Green (n 55) 267–270.

must be some variety of counterfactual consent, where 'X's "consent" is a fiction[.]'[85] The CBM must therefore be taken to claim 'that [some] policy P ought to be applied to [X] for reasons which have nothing to do with whether he has consented[.]'[86] The reasons Jackson offers amount to noticing that to adopt some policy P *would* have been in some party's interests, *at some point* in the past.[87] These raise further normative questions of (1) why a person ought to be bound to some norm merely because it would have been in their interests to agree to that norm, given that they have not in fact so agreed, and (2) why some particular time, rather than any other, is significant in the making of this determination.[88] Mokal concludes that there is no reason to hold someone to a norm that would merely have been in their interests to have agreed to at some point in the past,[89] and that, further, the CBM fails to identify in a non-arbitrary way any particular privileged point in time at which such a binding determination of antecedent interest could be made.[90] I do not know of any serious objections to these conclusions.

It is also worth noting that even if the CBM did cohere as a justificatory device, there is no reason to think that there would in fact have been unanimous agreement as to any of

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[85] Mokal, *Corporate Insolvency Law* (n 51) 45.

[86] ibid; Ronald Dworkin, 'The Original Position' in Norman Daniels (ed), *Reading Rawls* (Basic Books 1975) 17; Green (n 55) 269; cf David Enoch, 'Hypothetical Consent and the Value(s) of Autonomy' (2017) 128 Ethics 6.

[87] Mokal, *Corporate Insolvency Law* (n 51) 48–9. For present purposes nothing turns on what is meant by 'some party's interests'.

[88] ibid 49.

[89] ibid.

[90] ibid.

the major features of insolvency law that the CBM is supposed to justify.[91] Jackson posits that a stay on individual enforcement, some restrictions upon preferential payments and residual *pari passu* distribution would be agreed to by creditors bargaining ex ante. But he also states that the parties bargaining know their own characteristics: their celerity, their attentiveness, their powers of commercial (or other) persuasion. And armed with such knowledge well placed parties would—according to Jackson—agree to neutralise their known advantages in a negotiation with those in a weaker position.[92] As I hope is obvious, this suggestion is difficult to accept. Indeed, it cannot seriously be maintained. Similarly, it is difficult to see how the CBM can account for the interests of those who do not extend credit by consent, but rather come to be owed money by a debtor who has intruded upon their rights, usually by committing a legal wrong such as a tort or breach of contract. As such creditors do not specifically agree to extend credit in this way, it is hard to see how they could be incorporated into the hypothetical bargaining scenario. Jackson admits as much, noting that 'non-consensual creditors, such as tort creditors, pose special problems to which application of a consensual model seems largely inapplicable'.[93] Even if they could be so included, it would remain to be explained how such parties could be coherently allowed knowledge of the tort to be committed against

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[91] This was first noticed by Carlson: David Gray Carlson, 'Philosophy in Bankruptcy (Review of The Logic and Limits of Bankruptcy Law by Thomas Jackson)' (1987) 85 Michigan Law Review 1341, 1342–5; Mokal, *Corporate Insolvency Law* (n 51) 56–9 ('the CBM as description').

[92] Mokal, *Corporate Insolvency Law* (n 51) 52–55.

[93] Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (n 75) 902–903; Goode, *Principles of Corporate Insolvency Law* (n 1) [2.16]; referring to Rizwaan J Mokal, 'Contractarianism, Contractualism, and the Law of Corporate Insolvency' [2007] Singapore Journal of Legal Studies 51.

them in the future, but denied knowledge of whether or not the debtor would default in the future.

As Mokal has persuasively argued, 'the CBM fails to justify any aspect of insolvency law [and t]he attempt to squeeze out legitimacy from the model fails at every level.'[94] It follows that the CBM should be substantively rejected. It should, in consequence, also to be excised from the dialectic.[95] In the heading to this section I call the CBM a 'distraction'. It is a distraction because its failure does not in fact detract from the enterprise of justifying the claims of proceduralism; a distraction because it was in fact irrelevant from the start. With the CBM out of the way, though, we may now hope to see proceduralism and its normative foundations in sharper relief.

3.3. The true basis for proceduralism

The normative basis of proceduralism is not a kind of hypothetical consent. Instead, it is a kind of objective or external maximisation principle: the same maximisation principle that Jackson must take to be the basis for our intuitive response to his articulation of the common pool problem involving the fish, the lake, and the rights-holders with their individual incentives. This should come as no surprise. After all, proceduralism claims

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[94] Mokal, *Corporate Insolvency Law* (n 51) 37.

[95] The CBM is still regularly referred to as the 'standard understanding': eg Anthony J Casey, 'The Creditors' Bargain and Option-Preservation Priority in Chapter 11' (2011) 78 The University of Chicago Law Review 759.

that the purpose of insolvency law is to solve one or more common pool problems. If this is true, then it might be though to follow that its reasons for doing so are the same reasons that common pool problems should be solved wherever they are to be found. And the most obvious possible reasons for solving such problems can be stated quite briefly.

In order to do so, consider first the common pool problem that Jackson introduces, and the options that I have called fishnow and fishalways in the discussion above. We might regret the pursuit of fishnow because it would mean that there would be no more fish left in the lake after a single year of fishing. But what is the source of this regret? Such regret might be grounded, I suggest, by a concern about the loss of fish (or, if different, the fish population) or the loss of profit from fishing. Either of these concerns would explain the intuition fishalways is to be preferred to fishnow. If we regret the loss of fish we might do so for environmental or aesthetic reasons, or because we think fish are, themselves, proper objects of our moral concern. On the other hand, if we regret the loss of profit from fishing, it cannot be other than because we think that, in the example, *profit* is good and should be maximised; because, all other things being equal, it is always the case that to forego or destroy a potential source of profit is to be regretted.

These concerns do not map onto the circumstances of insolvency as clearly as Jackson appears to suggest. First, it is fairly clear that on the proceduralist view there is no reason to preserve insolvent businesses for their own sake, and thus no analogy to the environmental or aesthetic or other ethical reasons that might lead us to wish for fish to

be preserved for their own sake. Indeed, proceduralist writers including Baird have criticised other writers for seeming to imply such a view.[96] Second, it is also the case that as we move from the fish example to the circumstances of insolvency, the notion of profit is insufficiently general; creditors, instead, seek 'return' with a limited upside. Creditors could, recognising the insufficiency of an insolvent company's assets, quite reasonably wish to minimise their loss or the shortfall on a transaction or event; that is, they might wish to maximise their return. It follows that proceduralism, as defended by Jackson and Baird, depends on the claim that financial returns—that is, monetary wealth, whether profit generating or not—should be maximised, and not on the maximisation of the more specific notion of profit. And as Jackson makes clear, the maximisation to be achieved is that of the aggregate return of the creditors *taken as a group*. The only reason to take them as a group is to maximise returns: to capture a going-concern surplus, say, or avoid monitoring or the duplication of enforcement costs. All of this leaves little room for doubt that the normative basis of proceduralism of the kind under consideration is an imperative to maximise monetary wealth in some group, irrespective the initial or resulting distribution of that wealth within that group.[97]

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[96] eg Douglas G Baird, 'The Uneasy Case for Corporate Reorganizations' (1986) 15 The Journal of Legal Studies 127, 133–4.

[97] Though he does not give reasons, Armour arrives at substantially the same view: Armour, 'The Law and Economics of Corporate Insolvency' (n 26) 8–9; see also Rasmussen, 'An Essay on Optimal Bankruptcy Rules and Social Justice' (n 19) 2–3, 19; Robert K Rasmussen, 'Debtor's Choice: A Menu Approach to Corporate Bankruptcy' (1992) 71 Texas Law Review 51, 67; Finch, 'The Measures of Insolvency Law' (n 44) 231–4.

This analysis straightforwardly explains why proceduralism offers the content it does in elaborating what I have called the positive function claim. It also allows us to specify the justification claim—that as even *having* insolvency law generates costs, insolvency law needs special justification—which is usually offered in vague terms. If the special function of insolvency law is to solve common pool problems, and the reason such problems ought to be solved is because to do so would maximise monetary wealth for creditors taken as a group, then it might be thought that insolvency law's ability to maximise wealth in this way will meet the standard set by the justification claim just in case the costs to the creditors taken as a group are exceeded by the additional return *to those same creditors* taken as a group.

This formulation, at least, seems the most obvious way in which the positive function claim can be made to meet the justification claim. In offering it, though, I have made a refinement to the proceduralist position, by specifying the costs that the justification claim somewhat vaguely invokes, suggesting that they are the costs to the creditors *of some insolvent debtor* taken as a group. But if my characterisation of the true normative basis for proceduralism is correct, then this is not a move in fact available to proceduralists. This is because the very fact of having insolvency law has costs for those who never, in fact, become claimants on the estate of an insolvent debtor. This, after all, was the lesson of the ex ante perspective. What's more, if proceduralists are committed to impersonal wealth maximisation in the way I say they must be, then they cannot point to any distinction between persons—such as that between the creditors of a debtor and

everyone else, for example—that would allow them to disregard these ex ante and systematic costs.

The characterisation of the costs against which the benefits of having insolvency law solve common pool problems must be weighed defines the scope of the empirical question that will ultimately determine if the justification claim is met and thus whether insolvency law turns out to be justified according to the criteria that proceduralism has set. If the relevant costs are those to the creditors taken as a group then the empirical question is this: are total returns to creditors higher or lower if insolvency law is used to solve common pool problems? Here, Jackson gives us reason to expect them to be higher, at least if the direct and indirect costs of the procedure are assumed to be slight. But this is too narrow, because to the extent that there are other costs, proceduralists cannot coherently ignore them. They must instead say that the relevant costs are in fact all costs to all participants in the economy resulting from insolvency law with certain features. Now, the empirical question is one of much wider scope, and less certain answer. It becomes: are all the costs to the economy of even having insolvency law more or less than the increased return to creditors generated by having insolvency law solve certain common pool problems?[98] If such a question is even coherent, and I think there are

[98] Philip Schuchman's work in the 1970s emphasised the significance of what he saw as a severe lack of systematic empirical data relating to all aspects of insolvency proceedings: Philip Schuchman, 'An Attempt at a "Philosophy of Bankruptcy"' (1973) 21 UCLA Law Review 403. While substantial work has been done since then, Schuchman's core contention remains as plausible as ever: that given the complexity of the issues at play, we should be very cautious in trusting our instincts in the absence of robust empirical evidence.

reasons to doubt this, then it is a much more demanding one, and much more challenging to investigate empirically. It is, however, that which proceduralism implies.

4. WHY PROCEDURALISM FAILS

In the previous section I sought to set out and refine the proceduralist position. In this section, I will explain why proceduralism fails as a normative theory of insolvency law.

4.1. Normative law and economics

If my characterisation of proceduralism is correct, and its normative foundation is indeed impersonal value-maximisation, then it follows that proceduralism depends, for its normative appeal, on what I have called the normative law and economics claim. As I explain above,[99] I shall not substantively refute this claim.[100] Instead, I assume that it fails, and shall, in what follows, make the positive case for a normative account of corporate insolvency law that proceeds on a different basis. As such it is sufficient, for present purposes, to note the relationship between proceduralism and this claim, and to

[99] See II.0. above

[100] One reason for this is that such a task has already been adequately performed by others: eg Dworkin, 'Why Efficiency-A Response to Professors Calabresi and Posner' (n 20); Dworkin, 'Is Wealth a Value?' (n 20); Eidenmüller, *Effizienz als Rechtsprinzip* (n 25) pt 3.

point to this as a vulnerability to further very general objections to this theoretical approach.

4.2. The argument from pre-insolvency entitlements

In this section I explain why proceduralism's injunction to respect pre-insolvency entitlements cannot justify any distributive features of an insolvency regime. This argument is related to that which I shall make below regarding the ways in which proceduralism can (and cannot) relate to questions of justice.[101]

Consider the suggestion that the best possible insolvency law respects pre-insolvency entitlements. What, exactly, would this mean? Cast in this way, it could only mean that the best insolvency law would respect *all* pre-insolvency entitlements. This suggestion is clearly confused, for it denies the factual circumstances characteristic of insolvency, where, by hypothesis, an insufficiency of assets means that respecting all pre-insolvency entitlements is excluded from the start.[102] Of course solvent liquidations and administrations do occur, and when they do, there may be complex distributional questions to resolve.[103] But proceduralism does not claim to justify only these, and even

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[101] See II.4.3. below

[102] Of course, the suggestion might be rescued by arguing that such entitlements may be 'respected' otherwise than by being met in full. I am not aware of any proceduralist scholar who has developed this suggestion, which would, in any event, require major revisions to the overall proceduralist case.

[103] eg *Re Lehman Brothers International (Europe) (No 4)* [2017] UKSC 38, [2018] AC 465 (*'Waterfall I'*)

if it did, it would only do so in a redundant way. More precise claims have been made on the strength of the injunction to respect pre-insolvency entitlements, and it is important to understand why these do not succeed.

Such a suggestion might be put in the following way. Given (1) that insolvency law should respect pre-insolvency entitlements, and (2) that secured creditors have security interests outside of insolvency, and (3) unsecured creditors do not have such security interests, then (4) insolvency law should enforce those security interests validly created. It is implicit, here, that the interests of unsecured creditors provide no reason not to give effect to the security interests in question. While such an argument is not without intuitive appeal, I cannot see a way for it to succeed in this form. The conclusions—in particular proposition (4)—simply do not follow from the premises: why should security entitlements rather than some other kind of entitlements—unsecured obligations, for example—be enforced? Its intuitive appeal comes from a kind of rhetorical slippage. The validity of the argument would require that the normative premise 'insolvency law should respect pre-insolvency entitlements' be read as 'insolvency law should respect pre-insolvency *security* (or *proprietary*) entitlements', and such an argument would do no more than assume its conclusion. Whether or not this modified first premise is, in the final analysis, appealing, it is sufficient for present purposes to notice that it cannot be derived from proceduralism of the kind I have described.[104] The reason that such a

[104] A substantial literature considers the justification for secured lending generally, and its role in insolvency proceedings in particular: John Armour, 'The Law and Economics Debate About Secured Lending: Lessons for European Lawmaking?' in Horst Eidenmüller and Eva-Maria

premise cannot be derived from proceduralism is straightforward. If it is the case, as we assume it to be in insolvency, that not all pre-insolvency entitlements (or putative entitlements) can be met, then a choice *must* be made as between rival claims.[105] Proceduralism contains no principle upon which such a choice could be made.[106] If the principle implicitly relied upon is that of wealth-maximisation—normative law and economics—then proceduralism would require an altogether different defence than that which has been offered in the literature. As stated above, I consider that there are significant doubts about the cogency of such an approach, which I do not pursue in this thesis.[107]

Kieninger (eds), *The future of secured credit in Europe* (De Gruyter 2008); John Armour, 'Should We Redistribute in Insolvency?' in Joshua Getzler and Jennifer Payne (eds), *Company charges: Spectrum and beyond* (Oxford University Press 2006); Roy Goode, 'The Case for the Abolition of the Floating Charge' in Joshua Getzler and Jennifer Payne (eds), *Company charges: Spectrum and beyond* (Oxford University Press 2006); Lucian Arye Bebchuk and Jesse M Fried, 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy' (1995) 105 Yale LJ 857; Lucien Arye Bebchuk and Jesse M Fried, 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy: Further Thoughts and a Reply to Critics' 82 Cornell Law Review 1279; Lucien Arye Bebchuk and Jesse M Fried, 'A New Approach to Valuing Secured Claims in Bankruptcy' (2001) 114 Harvard Law Review 2386; Horst Eidenmüller, 'Secured Creditors in Insolvency Proceedings' in Horst Eidenmüller and Eva-Maria Kieninger (eds), *The future of secured credit in Europe* (De Gruyter 2008).

[105] Warren (n 44) 790.

[106] It might be objected here that proceduralism tells us that the law should be 'purely procedural', doing minimum violence to substantive entitlements (or, to put it another way, to change the process by which entitlements are enforced, but not the entitlements themselves), because *inter alia* doing otherwise might change incentives to file, and that this is among the reasons to meet the claims of secured creditors first. Such a claim, however, depends on a particular, undefended conception of 'minimum violence to substantive entitlements', which conception cannot be maintained against the argument I defend in this chapter.

[107] See II.0. above

To notice, as I do, that insolvency distribution unavoidably requires a choice to be made if not all pre-insolvency entitlements can be met is not to make a new contribution to these debates. Indeed, the point is a central plank in the case that Warren makes against proceduralism in her important paper, 'Bankruptcy Policy'.[108] But it is a point that has not been met, probably because it cannot be. The only obvious lines of defence for proceduralism are, here, very unpromising indeed. Faced with the objection that an injunction to respect pre-insolvency entitlements neither describes nor justifies any part of insolvency law's distributive regime, the proceduralist might reply that while it is true that the pre-insolvency entitlements of unsecured creditors are varied, the injunction to respect pre-insolvency entitlements nonetheless explains *some* parts of the distributive regime, including the priority (immunity)[109] of secured claims. Proceduralism explains the treatment of these claims; the treatment of other claims is explained in some other way. Such a response to the objection would plainly be inadequate. This is because a theory that requires that only *some* pre-insolvency entitlements be preserved, at the expense of others, must still explain why it prefers one group of claimants to another, or why the entitlements of that group are the correct starting point, rather than those to come to last.[110] And it must do so in a more subtle way than to merely restate the (descriptive) fact that insolvency law does, as a matter of fact, do this.

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[108] Warren (n 44) 789; Elizabeth Warren, 'Bankruptcy Policymaking in an Imperfect World' (1993) 92 Michigan Law Review 336, 367; referring to Duncan Kennedy, 'Cost-Benefit Analysis of Entitlement Problems: A Critique' (1981) 33 Stanford Law Review 387.

[109] Mokal, *Corporate Insolvency Law* (n 51) 136–8.

[110] It might be put in response to this that secured creditors, for example, were entitled to enforce out of bankruptcy; counting pre-insolvency entitlements should start with their *in rem* interests because they could enforce all along. This argument does not assist in defending proceduralism.

4.3. Ideal and non-ideal theory

I pointed out above that it was unclear whether proceduralism purports to be an ideal or non-ideal theory.[111] That attempts to defend a proceduralist approach to insolvency law are ambiguous as between different kinds of theoretical claim need not, of course, be fatal to the enterprise of articulating a coherent proceduralist theory. But the ambiguity is one that must be resolved if proceduralism is to be made capable of commenting on how legislators should reform insolvency law, how judges should decide cases, and on the state of insolvency law generally. If proceduralism is to be understood as a set of claims in ideal theory in the way I have described, then it is very difficult to see how it is that it could tell us much at all about how the law should be reformed by judges and legislators, for the simple reason that no political community that exists even approximates the ideal circumstances of background justice that such a theory assumes.[112] Consider the following rather blunt examples.

This is because it depends on tacit reliance on a ranking norm—secured (*in rem*) ahead of unsecured (*in personam*)—which is external to proceduralism. Such a norm may or may not be justified. But in neither case does it form part of proceduralism as defended in the literature. Baird, for example, is quite clear that proceduralism does not contain any such norm: eg Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy' (n 19) 823.

[111] See II.2.3. above

[112] This fact has not, of course, prevented it from being used in this way. Baird, for example adverts to what he considers to be the problem of forum shopping, plainly relying on the fact that, as he sees it, the rules determining the conditions for entry into insolvency proceedings are unsatisfactory and open to abuse. He notes also that 'we live in an imperfect world': Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy' (n 19) 820–1.

> *Territory A* does not have a system of unemployment insurance or social security benefits. Insolvency law provides that employees are entitled to a lump sum in priority to both fixed and floating security, as well as priority for claims for unpaid wages.
>
> *Territory B* has a sophisticated system of unemployment insurance and social security benefits. Insolvency law does not provide any benefits to employees analogous to those available in A.

If my characterisation of the ambiguous version of proceduralism is correct, then there is reason, on the strength of this theory and all other things being equal, both to criticise the arrangements in A and to applaud those in B. Further, there is reason to urge those in A to change their law, whether by statute, decree or judicial decision. This would ensure that the insolvency law of A did not address problems (such as employee welfare) that could arise outside of insolvency *as well as* in connection therewith, and thus save (some people) the costs of dealing with them in insolvency only. As I hope is clear, such a claim about law reform cannot be straightforwardly defended on the basis of the proceduralist position I have set out above. It also seems quite likely that a proposal for law reform in A could not be put forward without knowing rather more about social and economic circumstances in that imagined place. It is possible, at least, that its prosperity and labour market conditions would affect the attitude we ought to adopt in respect of its laws, including its insolvency law.

Baird has sought to reject this suggestion, and explains his reasons for doing so in the following passage.

> To say that in a well-conceived legal system, bankruptcy law should begin by looking at nonbankruptcy substantive rights that are enforceable under a nonbankruptcy avenue says nothing about what those substantive rights are under existing law or what they should be. Warren has done nothing to suggest that our model of bankruptcy law is inconsistent with any set of substantive rights. Jackson and I have asked why a parallel debt collection system is desirable at all. The answer, we assert, is the collective action problem. But we then suggest that this reason for a second avenue of enforcement provides no reason for reassessing relative entitlements. Workers should not have a different place in line simply because someone has been able to start a bankruptcy proceeding. All that Jackson and I require is that the differences in the two avenues follow from the reasons for having the two avenues in the first place. We have no objection to differences in multiple avenues of enforcement. We object only to unnecessary differences.[113]

First, Baird suggests that non-insolvency law defines the 'relative entitlements' of claimants on an insolvent estate. But of course this is a nonsense, for part of what it is to be owed a legal obligation outside of insolvency is that it is absolute;[114] that it is not relative at all. This is as true of fixed security holders as it is of unsecured creditors. It is the onset of factual insolvency that brings different claims, and different kinds of claim, into competition with one another, and that forces insolvency law to make a choice.[115]

Second, and more importantly, the passage also claims for proceduralism a kind of neutrality. It amounts to a claim that whatever conditions obtain in some legal system—

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[113] ibid 827–8 (note omitted, emphasis in original).

[114] see generally Ronald Dworkin, 'Taking Rights Seriously' in Ronald Dworkin, *Taking Rights Seriously* (new impression, Duckworth 1978).

[115] Warren (n 44) 790.

whatever the 'set of substantive rights' that it recognises—its insolvency law should have a fixed set of attributes, and that these attributes are those that proceduralism recommends. This, Baird suggests, allows proceduralism to remain neutral on underlying questions of justice (or morality, or legitimacy),[116] and to restrict itself to its own particular and very limited function. But we should reject this claim of neutrality, for it rests on a mistake. The mistake is to imagine, as Baird's argument says we must, that 'neutrality' on underlying questions of justice (or morality, etc.) is somehow different to ignoring such questions; that claiming not to take a view is, in this case, somehow different from endorsing the status quo, however praiseworthy or damnable it be. Baird's approach does not successfully avoid the underlying questions of justice in the way that he claims. Instead, it *assumes* the justice of all law other than insolvency law, and proceeds to make normative claims about how the law should be that depend on this assumption.

One view of such an approach is, of course, to see it as leaving these more systematic questions of justice for others: for other scholars, other departments of the law and the whole task, perhaps, for another day. But even if this is how the proceduralist approach is to be understood grave difficulties remain. First, while it is surely true that questions of justice range widely and beyond the scope of bankruptcy scholarship, it does not follow from this that bankruptcy scholars may ignore, or somehow insulate themselves

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[116] It might also be consistent with Robert Nozick's theory of justice, objecting to any kind of 'patterned' distribution: Robert Nozick, *Anarchy, State and Utopia* (Basil Blackwell 1974) ch 7.

from such questions. Instead, they must surely look to the ways in which questions of justice bear upon their specific domain, and connect with the ideas they develop. Second, such a reading also means that the appeal of proceduralism as a set of law reform proposals depends on how realistic the assumption that others will arrange for there to be justice—elsewhere, at some later time perhaps—turns out to be. In any event the implied claim to neutrality cannot be maintained, principally because the assumption it makes concerning justice does not hold. Nor will it, I conjecture, in the foreseeable future.

To reject this claim of neutrality leaves at least three possibilities. None is promising. The first would be to understand the claim as amounting to the assumption as to circumstances characteristic of a claim in an ideal theory of the kind I have described. This would potentially rescue proceduralism, but limit the use to which it could be put.[117] The second would be to claim in defence of the proceduralist position that insolvency law is not a domain of justice. This could mean either that insolvency law does not need to exhibit any particular features in order to be justice-compliant, or that questions of justice simply do not arise in insolvency. But both of these formulations are very implausible, as the distribution of scarce goods are hallmark features of circumstances in which questions of justice arise.[118] Also, insofar as the legal system and its institutions

[117] If this approach were adopted, proceduralism would still need to make good a number of claims, including empirical claims, concerning society-wide costs: see II.3.3. above.

[118] Rawls refers to circumstances of justice as including those of limited altruism and moderate scarcity: Rawls (n 5) s 22.

are within the domain of justice—and I assume that they are—then it is hard to see how some particular department of law could avoid falling within that domain also. Justice questions arise in insolvency because insolvency determines what certain legal entitlements are. What's more, justice questions particular to insolvency arise where insolvency law accords creditors or other claimants something other than the treatment to which they were entitled outside of insolvency. A third, more involved, possibility would be to claim that insolvency law occupies its own, distinct sphere of justice.[119] But if this is the case, then proceduralism has not specified why this would be, nor what the demands of this special sphere might be. If this were to be pursued, then substantial additions to proceduralism would need to be devised.

5. WHY PRE-INSOLVENCY ENTITLEMENTS MATTER

In the previous section I explained how proceduralism's repeated injunction to respect pre-insolvency entitlements does not justify any feature of the insolvency distribution regime, and why it is not plausible to regard it is an explanation for only part of this regime, without also explaining the lexical priority of the relevant part over all other parts. In this section I will begin my own attempt to set out why it is that pre-insolvency entitlements, and what they represent, matter. My argument as to why such entitlements

[119] This usage borrows from Walzer: Michael Walzer, *Spheres of Justice: A Defense of Pluralism and Equality* (Basic Books 1983). I do not follow Walzer's approach on any substantive matter.

matter draws on my criticism of proceduralism, and the negative arguments that I advanced in connection therewith. As I see it there are three principal reasons that suggest that the common intuition that pre-insolvency entitlements are in some way significant is sound.

First, claimants on an insolvent debtor are making claims based upon legal rights. Part of what it is to have a legal right is that that right cannot ordinarily be overridden or set aside without the consent of the right-holder (save in very exceptional circumstances, including public requisition or a right-holder's own insolvency). Legal rights that a person in fact holds are prima facie conclusions of law about what that person is entitled to. The underlying interests assured by such rights, then, give us reason to seek to respect such pre-insolvency entitlements to the greatest extent possible. Without further elaboration, however, this does not provide guidance as to how the distributive choices that must be made in insolvency should be made.[120]

Second, I have noted above that insolvency law is a domain in which questions of justice arise. I have also suggested that there is no reason to think that insolvency law occupies a sphere of justice distinct from that which applies to public institutions and law generally (and, on some views, to individuals).[121] In sophisticated legal systems the law,

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[120] See V.2.4. below

[121] eg Liam Murphy, 'Institutions and the Demands of Justice' in David A Reidy (ed), *John Rawls* (Ashgate 2008).

and the institutions that it establishes, makes a great many distributions—distributions that purport to be distributions owed in justice—in the form of rights. To the extent that such rights are not met, there is, from the point of view of the legal system, a lack of justice. When insolvency law distributes this *manque à gagner*, it is plausible to suggest that it must do so having regard to what was initially owed. This would reflect the fact that insolvency distribution is a kind of secondary distribution: an occasion for distributions to be made, governed by principles of justice, but among those to whom distributions in justice have already been made. A fuller consideration of this line of inquiry will require some consideration of exactly what form these primary distributions in justice take, and the way in which legal rights embody entitlements in justice. I take this up in chapters 4 and 5.

Third, and less directly, a theory of insolvency law that attaches importance to pre-insolvency entitlements is one that seems unlikely to favour distribution made 'afresh' (as opposed to in the secondary fashion mentioned in the last paragraph) in the exercise of potentially wide judicial discretion.[122] And discretionary distribution of this could be thought objectionable for various reasons: there might be legitimacy concerns about judges making such choices; the courts might be thought unlikely to be able to make appropriate decisions in the light of the epistemic or other confines of the adversary system; this might be thought to create considerable ex ante uncertainly costs which

[122] cf Donald R Korobkin, 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1991) 91 Columbia Law Review 717, 762–772; Gross (n 47) 235–243; Matthew Bruckner, 'The Virtue in Bankruptcy' (2013) 45 Loyola University Chicago Law Journal 233.

would have other undesirable consequences, some of which have been alluded to above. There is no need to consider the detail of these and related objections at this point. It is sufficient to note that they cannot be rejected out of hand. Indeed, I argue elsewhere that some such concerns are, in some considerable degree, sound. While it is not the case that rejecting proceduralism of the kind under consideration need lead one to favour such an approach, it is nonetheless true that rejecting proceduralism does, dialectically at least, appear to re-open this possibility. And this, I conjecture, may raise the spectre of serious objections such as those I have mentioned, the claims of which a normative theory of insolvency law will need to confront. I explore each of these lines of reflection in advancing my own account of insolvency law below. I note only, for now, that this may explain some part of the rhetorical appeal of respecting pre-insolvency entitlements, or, in the terminology I shall go on to prefer, honouring persisting claims in distributive justice.

6. CONCLUSION

This chapter has sought to reconstruct the normative theory of insolvency law known as proceduralism, and to demonstrate its nature and limitations. Best understood, and stripped of certain important ambiguities, proceduralism is the application of an impersonal value maximisation principle to common pool problems that arise in circumstances where multiple claims of multiple claimants are to be met by an insufficient insolvent estate. Proceduralism fails for a variety of reasons. The most

important are these. First, to the extent that it makes normative claims, these are grounded by the supposed normative appeal of an impersonal wealth maximisation principle. The appeal of this principle is controversial, and in any case cannot be assumed. Next, proceduralism's injunction to respect pre-insolvency entitlements fails to provide coherent guidance as to how insolvency distribution should be conducted. Finally, proceduralism is best understood as a set of prescriptions in ideal theory. This means that in circumstances where the scheme of distributions made by law other than insolvency law is justice-deficient, the prescriptions of proceduralism will lack normative appeal. The failures of proceduralism as a normative account of insolvency law are considerable. Its failure provides, however, important clues as to the direction in which the path to a more robust and persuasive theory may lie.

III IDENTITY, FIDELITY, DISTRIBUTION

1. INTRODUCTION

In the previous chapter I considered what I took to be the most sophisticated and developed theory of insolvency law—usually called proceduralism—and argued that it was, in different ways, incomplete and incoherent. For these and other reasons it failed to provide a justification for any part of insolvency law that did not collapse into an unappealing wealth-maximisation principle. I also identified certain concerns present in the proceduralist literature that deserved to be taken forward in the development of a novel normative account of this part of the law. With this much in place, I will now attempt to give some structure to the context from which the normative claims I shall go on to advance will emerge, and to classify some of the normative questions to which corporate insolvency law gives rise. In doing so I also attempt to defend an approach that departs, in some ways, from some other literature, and to pre-empt some objections.

In this chapter I argue that corporate insolvency law can be seen as raising at least three distinct classes of problems or questions, which I will refer to under the headings of corporate identity, debtor fidelity and distribution. Corporate identity problems relate to the fact that various stakeholders in corporate insolvency, including but not limited to the debtor, may be companies rather than individuals. Debtor fidelity problems are

those concerning good and bad conduct in matters relevant to the insolvency of a company. Distribution problems are those relevant to determining who should get what, once a company becomes subject to an insolvency procedure. These categories are non-exhaustive, and are not intended to be mutually exclusive (section 2). I then argue that distribution questions should be dealt with as questions of distributive justice, comment on the role efficiency is to play in the argument to come, and consider one way in which distributive principles may not be applied to corporate insolvency law (section 3).

2. THREE GROUPS OF ISSUES

In this section I will explain my division of corporate insolvency law into what I shall call corporate identity, debtor fidelity and distribution questions.

2.1. Corporate identity

The first limb of the division that I am proposing concerns corporate identity issues. These issues concern the fact that the debtor and certain creditors and other stakeholders in corporate insolvency law are (or may be) companies rather than individuals. The purpose of this section is, principally, to highlight several important ways in which companies are like individuals, and one significant way in which they are not. While there are various corporate structures available under English or other law, what follows

is principally concerned with companies that enjoy limited liability, whatever their other characteristics might be.

Where creditors or other stakeholders happen to be companies I will not, in what follows, draw a sharp distinction between their interests, and therefore the treatment they should be accorded, and those of natural persons. In some cases, of course, questions arise in respect of real people that cannot arise in respect of companies: companies can be neither physically injured nor subjected to imprisonment, for example. So suggestions about compensating for the former or bringing about the latter cannot coherently be articulated (without resort to particular and presently irrelevant doctrines like subrogation or attribution). But where companies and individuals both hold claims against a debtor, and those claims are of a kind that both companies and individuals *can* hold, then it seems that there is no reason deriving from the corporate identity of one claim-holder to urge differential treatment, though of course differential treatment might be justified on other grounds.

The approach that I propose is partly an attempt to avoid further questions about the interests of individuals and the interests of groups that they may comprise. It may well be an open question whether, generally speaking, groups—families, nations and churches, but also companies—can have interests apart from those of their members, and, if they do, what they are and how they should be articulated in normative terms. I do not intend to say anything about these kind of general questions. It seems sufficient to note, for present purposes, that English law provides several routes to the dissolution

of a solvent company, without limitation as to the reasons for dissolution.[123] This suggests that English law does not regard a company as having distinct interests of its own.[124] And as companies are creations of law—a company just is a cluster of legal relations to which law gives rise—I do not see a clear path to defending the contrary view.[125] Similarly, it would be surprising if an argument that companies should take some different form than they currently do were to be advanced in a form that relied on the distinct interests of companies *as companies*. I do not see a route to rendering such interests in an intelligible way.

Corporate debtors—the preoccupation of *corporate* insolvency law—are a different case. Here, there are important differences between the situation of a human person who is insolvent and that of a limited liability company. First, it may be the case that certain

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[123] In particular, provisions concerning the voluntary dissolution of companies are contained in the Companies Act 2006 pt 31, esp ss 1003-1011; and a company may similarly be dissolved following a members' voluntary liquidation, which, in spite on the name of the act in which the provisions are contained, may involve no insolvency: Insolvency Act 1986 ss 84-96. The approach I take to this question is the same as that taken elsewhere by Felix Steffek: Felix Steffek, 'Skizzen Einer Gerechtigkeitstheorie Für Das Privatrecht-Individuen, Interessen, Kohärenz, Konsens Und Ausgleich', *Gedächtnisschrift für Hannes Unberath* (CH Beck 2015) 425. More cautiously, it might be suggested that the law may regard companies as having interests of their own, but that such interests may never predominate. Nothing turns on the difference between this formulation and that offered in the main text for present purposes.

[124] A clear exception to this is the ongoing right of businesses to vote in elections concerning the City of London Corporation: City of London (Ward Elections) Act 2002, amending the City of London (Various Powers) Act 1957.

[125] To avoid doubt, I do not mean to suggest that limited liability companies of the kind I consider in this thesis are a 'nexus of contracts', on which idea see generally Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1996); cf Wesley Newcomb Hohfeld, 'The Nature of Stockholders' Individual Liability for Corporation Debts' (1909) 9 Columbia Law Review 285.

values only make claims in respect of human individuals. While we may, at times, owe mercy or charity or justice, for example, to other (human) people,[126] whose human failings we might equally wish to relieve,[127] it seems likely that we cannot *owe* mercy or charity or justice to an artificial person like a company.[128] It follows that to the extent that values such as these underpin certain features of the law of individual bankruptcy then they ought not to shape corporate insolvency law.

Second, while it is a concern of personal bankruptcy law that the bankrupt person will, and should, continue with his or her life subject to certain restrictions—bankrupts should certainly not be killed, for example—there is no such concern in the case of any particular corporate entity. There is simply no reason to wish that some particular merely legal person not be dissolved or dismembered or otherwise altered that can point to the mere fact of the existence of that particular corporate entity.[129] Indeed, dissolution is the envisioned end point of the liquidation procedure, which may be voluntarily

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[126] Heidi M Hurd and Ralph Brubaker, *Debts and the Demands of Conscience: The Virtue of Bankruptcy* (OUP forthcoming). I thank Heidi Hurd for making some of this material available to me in advance of publication.

[127] Thomas H Jackson, 'The Fresh-Start Policy in Bankruptcy Law' (1984) 98 Harvard Law Review 1393.

[128] One might, perhaps, *practice* mercy towards a company, but my contention is that this could not be *owed*. Similarly, it is consistent with this way of viewing things that one might, for example, give money to a company or other merely legal person because reasons of mercy arising in respect of individuals required it. To avoid doubt, this means that A could have a moral obligation, grounded in the value of charity, to give money to B Co, where this payment to B Co would assist certain people. Such an obligation would not, however, be owed *to* B Co.

[129] I do not pursue the approach to corporate personhood defended in Peter A French, 'The Corporation as a Moral Person' (1979) 16 American Philosophical Quarterly 207.

engaged. This does not, however, imply anything about how and/or whether the company's business should be carried on. But it does suggest that our reasons for wishing to rescue human insolvents will likely be different to the reasons we might have for 'rescuing' companies unable to pay their debts. And these latter reasons should be indifferent to the ongoing existence of any particular corporate entity in question. As Baird notes: 'There is nothing to be sentimental about. Corporations and people are not the same.'[130]

Third, it is clearly the case that corporate action and corporate management raise particular concerns that the actions of individuals cannot.[131] There is no question, for example, of an individual's 'owners'' and 'managers'' incentives being differently aligned. This is because to the extent that individuals have owners and managers, they are embodied in one and the same human person: the individual in question. Companies are obviously not like this. They are constituted by law and divide powers, rights, duties and liabilities between different offices and constituencies according to law. This means that for an insolvent company, it makes sense to ask both *what* the company did before becoming insolvent, and also *how* it was internally run, leading up to its insolvency. Where individuals are concerned, and excluding cases of insanity and the like, only the first question makes sense.

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[130] Baird, 'A World without Bankruptcy' (n 19) 183; Korobkin, 'Contractarianism and the Normative Foundations of Bankruptcy Law' (n 81) 545–546.

[131] The position of an individual running a business on her own account may be different.

General questions about how companies should be run, and how companies are internally structured, including in terms of the obligations of those who manage them, are, for the most part, beyond the scope of this work.

What I have called corporate identity questions will not receive further detailed consideration in the discussion that follows for a number of reasons. First, certain of the questions to which I have adverted—those concerning the punishment of companies for crimes, for example—do not raise questions specific to corporate insolvency law, but instead raise difficult general questions of considerable scope. More important, however, is the fact that the matters concerning corporate identity mentioned in this section point to the ways in which the normative questions that arise in individual and corporate insolvency law are related. Often, corporate insolvency law will raise only a subset of the questions that individual insolvency law must confront. As such these matters concerning corporate identity, without requiring further elaboration, implicitly structure the discussion to come.

2.2. Debtor fidelity

A second category of questions concerns what I will call debtor fidelity. Debtor fidelity questions are those questions concerning good and bad conduct in matters relevant to the insolvency of a company. Such fidelity questions that arise in respect of corporate insolvency law may take different forms, and not all of these are relevant to a theory of

corporate insolvency law of the kind I shall go on to propose. In this section I explain why certain questions should be excised from the scope of the discussion to come, and others retained.

One way of framing fidelity questions in respect of insolvency law would involve seeking to establish the normative character of the failure to pay one's debts, or otherwise meet one's obligations. While such questions may open a rich field for normative, historical, literary or other reflection, it seems to me that little can be said about them, for present purposes, by framing them in this way.[132] Faced with general questions like, 'Should debts be repaid?' or 'Is the failure to pay debts wicked?' it seems relevant that the law does regard a debt as grounding an obligation to pay—this is just what a debt is—and doesn't ordinarily seek to answer to the question about wickedness, following the statutory abolition of the various 'acts of bankruptcy'.[133] Nothing more can be said in general terms. The mere fact of failing to repay a debt (in insolvency, because one in unable to do so), or to meet an obligation (in insolvency, because what is required

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[132] eg David Graeber, *Debt: The First 5,000 Years* (Updated and expanded edition, Melville House 2014); David A Skeel, *Debt's Dominion: A History of Bankruptcy Law in America* (Princeton University Press 2001); Margaret Atwood, *Payback: Debt and the Shadow Side of Wealth* (Bloomsbury 2008); Honoré de Balzac, *Histoire de La Grandeur et de La Décadence de César Birotteau* (Charles-Béchet 1837).

[133] Acts of bankruptcy were described by the Cork Committee as 'obsolete or obsolescent' and abolished on the Committee's recommendation: House of Commons, *Report of the Review Committee: Insolvency Law and Practice* (Cmnd 8558, 1981) [529]-[531]; see generally Israel Treiman, 'Acts of Bankruptcy: A Medieval Concept in Modern Bankruptcy Law' (1938) 52 Harvard Law Review 189.

is beyond one's power), does not, without more, describe a situation in enough detail to allow us to say anything at all about what should follow or how law should respond.

Considering the way in which law does, in fact, respond to such failures, reveals attention being paid to a wider range of circumstances. Legally speaking, the failure to pay a debt is a usually a civil wrong—ordinarily but not invariably a breach of contract—but nothing more. The picture is complicated somewhat where a company becomes insolvent. In such cases, specific provisions of the English insolvency legislation make a range of conduct wrongful (or at least sufficient to ground an order unwinding a transaction or that a concerned individual pay money) that would not be wrongful if insolvency had never occurred. Transaction avoidance doctrines provide for certain transaction entered into in the lead-up to insolvency,[134] or purporting to take effect on or in insolvency,[135] to be unwound or without legal effect. Section 423 of the Insolvency Act 1986 provides for such orders in respect of transactions defrauding creditors. The effect of this section is, generally speaking, to stigmatise 'putting assets beyond the reach of a person who is making, or may at some time make, a claim' by those who enter into

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[134] Insolvency Act 1986 ss 238-239

[135] This is the effect of a judge-made rules known as the anti-deprivation and 'pari passu' principles: eg *Money Markets Ltd v London Stock Exchange* [2002] 1 WLR 1150 (HC); *Belmont Park Investments v BNY Corporate Trustee Services Ltd* [2011] UKSC 38, [2012] 1 AC 383 (anti-deprivation principle); *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 1 WLR 758 (HL) ('*pari passu*' principle). To avoid confusion, it should be pointed out that the so-called '*pari passu*' principle has little to do with *pari passu* distribution: see Rizwaan J Mokal, 'Priority as Pathology: The Pari Passu Myth' (2001) 60 The Cambridge Law Journal 581; Mokal, *Corporate Insolvency Law* (n 51) ch 4.

transactions giving consideration below market value.[136] Sections 213 and 246ZA of the Insolvency Act 1986 stigmatise fraudulent trading by those carrying on the business of a company that goes into insolvent liquidation or administration. Similar conduct is made a criminal offence under the Companies Act 2006.[137] In a similar vein, sections 214 and 246ZB of the Insolvency Act 1986 stigmatise the carrying on of business to the disadvantage of creditors past the point at which the directors of a company know or ought to know that the company has no reasonable prospect of avoiding insolvent liquidation or administration. Section 12 of the Fraud Act 2006 makes those who connive at fraud offences committed by a company guilty of those offences themselves, and such offences are defined to include deliberately inflicting losses in various ways.[138] Section 212 of the Insolvency Act 1986 provides a liquidator with a summary procedure to enforce, among others, directors' duties of care, their fiduciary duties and their duties to promote the success of the company.[139]

Read together, these provisions suggest that outside of ordinary civil recovery mechanisms, the law is indeed concerned with the non-payment of debts, as it is with the infliction of other kinds of losses or harms. It also suggests, though, that particular redress is provided for only in certain special circumstances: where incompetent, or

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[136] Insolvency Act 1986 s 423(3)(a)

[137] Companies Act 2006 s 993; see also Fraud Act 2006 s 9 (relating to the businesses of sole traders).

[138] Fraud Act 2006 s 5

[139] These duties are now specified in the Companies Act 2006 ss 171-177.

dishonest or presumptively suspicious conduct by natural persons contributes to the inability to pay, for example. In each of the circumstances mentioned this inability to pay will have rendered ordinary civil recovery mechanisms nugatory, even before they are foreclosed as a matter of law on the making of a winding-up order or the making of certain applications in respect of administration, for example.[140] But in each case the fact of a company being left in a state in which it is incapable of paying its debts or otherwise meeting its obligations is a necessary but not sufficient condition for the law to take a special interest in this state of affairs.

The provisions to which I have made reference above come from different departments of the law and, on being engaged, have different legal consequences, ranging from that of a purported contractual term being without effect to a finding of guilt in respect of a criminal offence. Some, but not all, are relevant to a theory of insolvency law of the kind I shall propose. To the extent that provisions such as those considered in this section concern the general criminal-law and corporate-law regulatory concern to respond to fraudulent behaviour, then they do not raise any issues specific to insolvency law, and are not the kinds of provisions that such a theory would need to engage. The fact that running a company into the ground is one quite specific way of behaving fraudulently does not detract from this, and I exclude such provisions from what follows on this basis.

[140] Insolvency Act 1986 s 130 (liquidation), sch B1 para 43(6) (administration)

To the extent that provisions such as those considered in this section concern the general corporate-regulatory concern to respond to incompetent or negligent behaviour in the running of companies, they also do not usually raise any issues specific to insolvency law, even though a company becoming insolvent may be a consequence of incompetence or negligence. I mostly exclude these provisions as well, subject to two important qualifications.

The first concerns section 212 of the Insolvency Act 1986, and in particular the duty to consider creditors' interests—rather than just shareholders'—in the manner established in England by the decision of the Court of Appeal in *West Mercia Safetywear Ltd v Dodd*.[141] The extent to which the prospect of insolvency gives content to general law directors' duties does seem to raise specific questions for a theory of corporate insolvency law. Second, section 423 of the Insolvency Act 1986 cannot be straightforwardly excluded from consideration either. This is because, together with other provisions and transaction avoidance doctrines,[142] it can provide for the unwinding of certain transactions that would not, had insolvency not supervened, be liable to being unwound.[143] It seems likely that if such a provision is justified, it will be for reasons relating to the objectives of insolvency law. This draws section 423 closer to the final

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[141] *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 (CA); *Kinsela v Russell Kinsela Ltd* [1986] 4 NSWLR 722 (NSWSC).

[142] See, in particular, the transaction avoidance provisions in the Insolvency Act 1986 ss 238, 239, 274ZA, 274ZB; the judge-made anti-deprivation and '*pari passu*' principles.

[143] To avoid doubt, I do not mean to suggest that s 423 may only be used where a debtor has become insolvent, or entered an insolvency procedure.

group of provisions mentioned above that clearly must be considered by a theory of insolvency law; that is, the group of transaction avoidance doctrines to which I have referred.

2.3. Distribution

The final set of issues with which I take corporate insolvency law to be concerned are those relating to distribution. Distribution problems concern the way in which insolvency law determines rights and other entitlements when not all of these that exist outside of an insolvency procedure can be met in full, as well as the normative implications of these specific determinations (to the extent that there are any). More precisely, distribution questions concern the identity of the pool of assets that are to be made subject to claims upon the insolvent estate, which they constitute; the kinds of claims that may be made against an insolvent estate; how and in what order those claims are to be met from those assets; and, where relevant, how non-repayment is to be shared among claimants on the estate. Finally, they include the normative consequences of any specific determination of rights that insolvency law may make, to the extent that there are any such consequences.

Two distinctions from the literature ought to be borne in mind when approaching distribution questions on the broad basis that I do. The first such distinction is usually

called the immunity/priority distinction (or, more tendentiously, 'fallacy').[144] Mokal suggests that it is a mistake to consider the prohibition on gaining *immunity* from the collective regime—that is, the fact that the collective insolvency regime is compulsory[145]—as having any implications for the way in which questions of *priority* among creditors—that is, concerning the order of distribution—should be answered.[146] For Mokal, individual enforcement action may have undesirable, value-destructive, consequences and should be prevented. That this is so does not, he claims, imply anything at all as to just how the assets should be distributed once any value-destructive race has been averted. He explains:

> The individualistic pre-insolvency debt-collection regime is a mad race to the asset pool. Since that race is undesirable, the collective insolvency system steps in to stop it. The creditors are now forced to *queue up* to have access to the pool. Voidable preferences and post-petition dispositions of assets, etc.

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[144] Mokal, *Corporate Insolvency Law* (n 51) 102–106; Mokal, 'Priority as Pathology' (n 135) 591–594; referring to Thomas H Jackson and Douglas G Baird, *Cases, Problems, and Materials on Security Interests in Personal Property* (Foundation 1987) 67; Douglas G Baird and Robert K Rasmussen, 'Control Rights, Priority Rights, and the Conceptual Foundations of Corporate Reorganizations' (2001) 87 Virginia Law Review 921. I shall avoid the language of fallacy for it misleadingly suggests a contradiction (that is, rather than a merely unmotivated inference).

[145] As a matter of substantive English law, however, that the prohibition is only partial: creditors with fixed security do not enjoy 'priority' in an insolvent liquidation. Instead, their security is unaffected by the opening of a collective insolvency procedure. In this way, immunity is achieved. The position of creditors with claims secured by a floating charge is somewhat different: see V.4. below.

[146] He identifies failures to observe the distinction in Goode, *Principles of Corporate Insolvency Law* (n 1) [8-02] (Mokal's reference is to the 2nd edn); Andrew Keay and Peter Walton, 'The Preferential Debts Regime in Liquidation Law: In the Public Interest?' (1999) 3 Company Financial and Insolvency Law Review 84, 95; Vanessa Finch, 'Is Pari Passu Passé?' (2000) 5 Insolvency Lawyer 194, 194; Andrew Keay, *Avoidance Provisions in Insolvency Law* (LBC Information Services 1997) 40–49; Vanessa Finch and Sarah Worthington, 'The Pari Passu Principle and Ranking of Restitutionary Rights' in Francis Rose (ed), *Restitution and Insolvency* (Mansfield 2000) 2–3.

> can now be seen as attempts by some creditors to bypass this queue. In other words, they represent efforts to gain *immunity* from the collective system. Insolvency law deploys various mechanisms to deny them this immunity [such as transaction avoidance doctrines]. So long as there is no race to the pool, no one succeeds in stealing a drink from it, and creditors await their turn to have access to the debtor's resources; decisions can be made systematically and in the common interest. Crucially, though, note that ensuring that creditors take their place in the queue is one thing. *The order in which they line up* is, in general, quite another.[147]

There is little to object to here if the passage is considered merely on its own terms. But in the final line of the quotation Mokal moves to generalise without explaining why this is appropriate. A generalisation of this kind cannot, however, be maintained. This is because while the mandatory nature of the insolvency regime, on the one hand, and some set of ex post distributive rules of insolvency law, on the other, may be distinct, there is no reason to categorically exclude the possibility that the justification for one may have implications concerning the other. That Mokal fails to notice this merely reflects the fact that his (and Jackson's and Baird's)[148] preferred justification for the mandatory regime—preventing a value-destructive race for assets—does not imply a particular scheme of distribution. But there is no reason, at this stage, to foreclose the possibilities (1) that the underlying reason to make creditors queue is something else, or inextricably tied up with coordination-type reasons, which reasons may well have

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[147] Mokal, *Corporate Insolvency Law* (n 51) 104 (emphasis in original, citations omitted).

[148] Baird, 'The Uneasy Case for Corporate Reorganizations' (n 96) 131; referring to Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (n 75); Douglas G Baird and Thomas H Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 The University of Chicago Law Review 35.

implications for the order to be established in that queue and (2) that the justification for a particular ex post distributive scheme may itself also justify its mandatory imposition. I shall explore this second possibility below, and argue that distributive principles require both the imposition of a collective regime, and, prima facie, *pari passu* distribution.[149] That there are reasons to make the insolvency regime collective *need* not imply anything about how sharing should go ahead in the collective regime. But the point cannot be put any more strongly than this.

The second distinction that my category of distribution questions might be said to obscure is usually called the deployment/distribution distinction.[150] As Baird has shown, one feature of collective insolvency proceedings is that they allow questions of who is to be paid what to be kept entirely apart from questions concerning the use to which some asset or group of assets is to be put. I follow Baird in thinking that keeping this distinction in mind may head off important confusions in this area. And nothing that follows is intended to contradict any of Baird's suggestions in this connection. I note by way of clarification, however, that there is no reason to think that a normative argument primarily concerning who-gets-what distibutional questions could not make claims about the proper deployment of assets, at least while the assets or their proceeds remain part of the estate or in the debtor's hands. Indeed, it would be surprising if such an

[149] See V.3. below

[150] Douglas Baird, 'Loss Distribution, Forum Shopping and Bankruptcy: A Reply to Warren' (1987) 54 University of Chicago Law Review 815, 820.

argument did not have such implications. If an argument required that the value of the pool of assets constituting the insolvent estate be maximised for instrumental reasons—that is, not because value-maximisation is an end in itself, but rather, say, because it would have good consequences for some group—this would require that assets be deployed in such a way as to maximise value. Of course this does not say anything about just what this optimal asset deployment might be. The underlying normative connection is, however, very clear.

3. DISTRIBUTIVE JUSTICE

Having begun by dividing up the normative questions to which I say corporate insolvency law gives rise, I must now consider how at least some of these might be answered. In this section I argue that the distribution questions I identified above should be answered in terms of distributive justice. I then explain the role that efficiency is to have in the argument to come. Finally, I foreswear a deeply mistaken approach to the application of distributive principles to corporate insolvency law.

3.1. Distribution questions are questions of distributive justice

While the claim may well be controversial, it seems to me that questions of insolvency law in general, but those questions I have called distribution questions in particular,

raise what are obviously and paradigmatically questions of distributive justice. Warren fames the matter in the following way:

> Bankruptcy disputes do not share the debtor-versus-creditor orientation of [ordinary] collection law. In bankruptcy, with an inadequate pie to divide and the looming discharge of unpaid debts, the disputes center on who is entitled to shares of the debtor's assets and how these shares are to be divided. Distribution among creditors is not incidental to other concerns; it is the center of the bankruptcy scheme. Accordingly, bankruptcy disputes are better characterized as creditor-versus-creditor, with competing creditors struggling to push the losses of default onto others. [151]

If the distribution to be made according to bankruptcy law is to be defensible, then it must be referable to sound distributional principles. And sound distributional principles, I suggest, just are principles of distributive justice. Now questions of justice are not the only normative questions that arise, and distributive justice may compete with the demands of other values or kinds of justice.[152] Similarly, different conceptions of distributive justice will imply different schemes of insolvency law. But I see no plausible route to denying the relevance of *some* such conception. This is because if distributive justice is about anything, it is about the distribution of benefits and burdens in or across communities. To the extent that insolvency law distributes such benefits and burdens—and on this point I follow Warren in holding that it must[153]—it is susceptible

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[151] Warren (n 44) 785.

[152] The relationship between distributive justice and corrective justice in this area is considered below: see V.2 below.

[153] Warren (n 44) 785–789.

to justification or critique in terms of what distributive justice, properly understood, requires.

In offering the Creditors' Bargain Model as justification for proceduralism, Jackson must be taken to accept at least this much.[154] His reference to Rawls in *Logic and Limits* leaves little room for doubt on this point,[155] even if the use to which Jackson then puts Rawls's work is both eccentric and unpersuasive.[156] Rasmussen is prepared to assume for the sake of argument that what he calls social justice, which is not relevantly different from what I am calling distributive justice, is relevant to the evaluation of insolvency law. Those I have associated with the label 'traditionalism' are, to the extent that they see arriving at defensible answers to questions of distribution as a core task of insolvency law and theory, clearly advancing claims about distributive justice, whether or not they understand themselves to be so doing.[157]

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[154] Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (n 75); Jackson and Scott (n 19).

[155] Jackson, *The Logic and Limits of Bankruptcy Law* (n 19) 17.

[156] See II.3.2. above. For alternative critiques see Mokal, *Corporate Insolvency Law* (n 51) ch 2; Carlson (n 91); Jan Felix Hoffmann, *Prioritätsgrundsatz und Gläubigergleichbehandlung* (Mohr Siebeck 2016) 204.

[157] eg Warren (n 44); Warren (n 108); Korobkin, 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (n 122); Donald R Korobkin, 'The Role of Normative Theory in Bankruptcy Debates' (1996) 82 Iowa Law Review 75, 88–103; Finch, 'The Measures of Insolvency Law' (n 44); Vanessa Finch, 'Security, Insolvency and Risk: Who Pays the Price?' (1999) 62 Modern Law Review 633; Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (Cambridge University Press 2017) chs 1, 2.

Third, and finally, it is significant that I refer throughout the thesis to distribution, and not to *re*distribution.[158] Insolvency law involves distribution because part of what insolvency law does is answer questions about who gets what: it *determines* legal entitlements in certain circumstances. It does not, as talk of redistribution would imply, take things held rightfully by some, legally speaking, and give them to others over the prior holder's rightful claim.[159] Put differently, state-dependent entitlements are redistributive—rather than merely distributive—only if one possible state is assumed to be ordinary and so presumptively determinative. To the extent that control or other interests in valuable property move pursuant to insolvency law, they move because the legal grounds for the enjoyment of such interests change. And these must change, for it is typical of situations governed by insolvency law that all interests cannot be respected. The form such changes should to take is a matter for argument. But it is not the case, as talk of redistribution also implies, that there is a presumptively neutral starting point for such arguments from which one can point only to the fact of having held legally recognised pre-insolvency interests.

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[158] cf Rasmussen, 'An Essay on Optimal Bankruptcy Rules and Social Justice' (n 19) 20.

[159] For a similar argument made with reference to taxation and the nature of one's entitlement to pre-tax income see Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford University Press 2004).

3.2. The role of efficiency

That this limited and schematic claim is (or could be) controversial seems to reflect a deep but elementary confusion. This confusion is approximately to suppose that justice and efficiency (in the Kaldor-Hicks or wealth-maximisation sense) are notions that compete with each other directly.[160] Put differently, it is to assume that they compete with each other in the way poker players at a table compete with one another: there are a certain number of normative chips to be fought over, and each ultimately won over to efficiency is one less that justice might take home at the end of the game. Such a view of things is difficult to understand, and difficult to accept. This is because it asks us to accept that there is some reason apart from reasons of justice to wish that value be maximised across some group.[161] The better view is that efficiency of this kind is a candidate answer, or part-answer, to the question: 'What does distributive justice require?' albeit, on its own, a very implausible one. This, at least, begins to rank the supposed ideals in the appropriate way, and leads us to consider efficiency alongside other possible suggestions as to what distributive justice requires, whether this be flat

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[160] Dworkin describes this kind of efficiency in the following way, which is consistent with my use of it throughout this thesis: 'Wealth maximization … is achieved when goods and other resources are in the hands of those who value them most, and someone values a good more only if he is both willing and able to pay in money (or in the equivalent of money) to have it. An individual maximizes his own wealth when he increases the value of the resources he owns[.] Society maximizes its wealth when all the resources of that society are so distributed that the sum of all such individual valuations is as high as possible.' Ronald Dworkin, 'Is Wealth a Value?', *A Matter of Principle* (Clarendon 1985) 237.

[161] This states the difference between what is sometimes called a 'compromise' and 'recipe' relationship: Ronald Dworkin, 'Why Efficiency?', *A Matter of Principle* (Clarendon 1985) 267–269.

equality of resources, the results of consensual transfers away from some naturally just baseline in the sense advocated by Robert Nozick,[162] or, as is manifestly more plausible, something else.

My approach in this work is, in part, consistent with that adopted by Mokal in his *Corporate Insolvency Law: Theory and Application*. In explaining the role considerations of efficiency are to have in his own theory, he considers that there are reasons to think that neither wealth-maximisation/Kaldor-Hicks efficiency, nor Pareto-optimal states ought to be pursued as what he calls *substantive* goals of schemes of legal regulation.[163] Instead, he claims that what he calls transaction-cost efficiency can, nonetheless, be properly pursued as a *procedural* goal, where a procedural goal is one that allows alternative methods of pursuing substantive goals to be compared and therefore evaluated. He explains this in the following way:

> [E]fficiency can never be a substantive goal of the law. It can never by itself confer justification on any part of it. However, efficiency—understood properly—is quite indispensable as a procedural goal. Once a set of substantive goals has been exogenously specified (eg using a theory of justice), efficiency can be used to judge between various proposed schemes for implementing it.[164]

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[162] Nozick (n 116) ch 7.

[163] I do not say anything here about his objections to these theories, which notice that a prior, unjust, distribution of resources will shape the preferences to which these nominated versions of efficiency respond: Mokal, *Corporate Insolvency Law* (n 51) 22–24.

[164] ibid 25.

A similar notion is described by Eidenmüller, who describes a 'lawyerly' concept of efficiency distinct from that usually employed by law and economics scholars:

> Wenn Juristen von „Effizienz" sprechen, dann meinen sie damit in der Regel, daß irgendein vorgegebenes Ziel mit einem möglichst geringen Aufwand oder daß mit einem gegebenen Aufwand ein bestimmtes Ziel in möglichst hohem Maße erfüllt wird... Diesem Effizienzbegriff liegt eine Zweck/Mittel-Relation zugrunde. Es ist in der Ökonomik gebräuchliche und von den Juristen übernommene Effizienzbegriff der *Wirtschaftlichkeit*. ... So kann man als politisches Ziel ebenso die Kolonisierung des Mars wie auch die Erhaltung des Weltfriedens oder die Führung eines Kriegs festlegen und dann dieses Ziel mit einem effizienten Mitteleinsatz verfolgen. Was effizient ist, ist insoweit immer abhängig von dem vorgegebenen Ziel, dessen Erreichung angestrebt wird.[165]

> [When lawyers speak of 'efficiency', then what they are usually referring to is that some given goal may be reached with the slightest possible outlay, or that some goal may be fulfilled to the greatest possible extent with some particular outlay… This conception of efficiency depends upon on a relationship between end and means. It is commonly adopted in economics and by lawyers as a conception of efficiency as *cost-effectiveness* [Wirtschaftlichkeit]. One may just as easily adopt the political goal of colonising Mars, maintaining world peace or waging a war, and then pursue this goal by efficient means. What would be efficient, in such cases, depends on the particular goal in question.][166]

The concept of efficiency described in this passage is that of a tool for evaluating different means for the pursuit of certain goals. In this way it is similar to the ordinary language notion of effectiveness (or cost-effectiveness, if costs are understood broadly). Some scheme for the pursuit of some goal is superior to others in the relevant way if it allows

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[165] Eidenmüller, *Effizienz als Rechtsprinzip* (n 25) 55 (emphasis in original, citation omitted).

[166] ibid (my trans)

for the fuller realisation of the relevant goal, or, if different schemes would realise the goal to a similar extent, if it does so at a lesser cost (once again, if costs are understood broadly).

I follow Mokal in thinking that what he calls the substantive goals of insolvency law should be determined by what (distributive) justice requires. But I reject his implicit suggestion that it makes sense to speak of two possible schemes of insolvency law, each equally just, but one manifestly more efficient than the other, however either concept is to be cashed out. This is to suggest that justice and efficiency are independent values, and that questions of justice have lexical priority over questions of efficiency. This, I claim, misunderstands the relationship between these two notions. On my account, justice and efficiency are not independent values. Instead, efficiency—of whatever kind—is to be pursued if and to the extent that it is what justice requires in some circumstances. It does not, in consequence, make sense to speak of equally just but differentially efficient schemes of insolvency law. This is because a want of efficiency, where efficiency is what justice requires, just is, on my account, a want of justice.

The point can be made by way of an example. Consider two very similar insolvency regimes, each pursuing what Mokal would call the same substantive goals. Under one regime the direct costs of the collective insolvency procedure (court, lawyers' and practitioners' fees, etc.) are, needlessly, much higher than in the other. Under that regime creditors recover less money than in the other, and there is, therefore, somewhat less money available to be lent in the economy, given that these higher costs are a feature of

every case in that system.[167] My claim is that in cases like this, it makes sense to say that the first regime is not just less efficient than the other, but that it could also be less just. Mokal's account seems to foreclose this possibility.

I have already said that I think that efficiency, if understood to require the implementation of an impersonal value-maximising principle, would amount to a very implausible single response to the question of what justice requires. It would lead us to prefer, for reasons of justice, a community of tycoons surrounded by many more paupers to a community of uniformly but moderately prosperous people if the tycoons were rich enough. This is to say that it would imply a version of what Derek Parfit called the 'repugnant conclusion'.[168] This, I think, should lead us to reject such a principle. This is not, however, to say that justice will never require that economic value, monetary or otherwise, be maximised across some group. Indeed, it is almost certainly true that where insolvency is concerned, as with any other distribution of rivalrous and scarce resources, value maximisation across some group really is what justice requires for some purposes. Rather, it is simply to say that justice does not always require the maximisation of economic value *tout court*, or without attention to the hands into which it falls.

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[167] I ignore the possibility that the courts, lawyers and practitioners, etc., are owed their higher fees in justice, and also the possibility that such people immediately put all the money they receive back into the economy. On the justice of high professional fees Frederick Wilmot-Smith, 'Necessity or Ideology?' *London Review of Books* (6 November 2014) 15.

[168] Parfit, *Reasons and Persons* (n 69) 387–390.

If this is so then the notion of efficiency that should feature in a compelling theory of insolvency law will be both more complex than the 'lawyers'' notion identified by Eidenmüller, but also something short of full-blown wealth maximisation of the kind I have described. Its demands will flow from the values that it seeks, in different ways, to implement: principally, from the demands of justice.

3.3. A false start: doing justice directly

I have suggested above that distribution questions in insolvency law involve questions of justice. As I have argued that this is so substantially by definition, I have not needed to say anything about what justice really does require, or how the demands of justice might relate to insolvency law. In this section I consider whether it makes sense to seek to apply certain principles of justice to insolvency law directly, and claim that it does not. I then suggest that an indirect conception of how justice applies to insolvency law be developed in order that the difficulties encountered by the direct approach may be avoided.

Both Mokal and Rasmussen advance theories which seek to apply principles of justice directly to insolvency law. In the passage extracted above, Mokal speaks of what he calls the substantive goals—as opposed to rules or anything else—of insolvency law being exogenously specified by a theory of justice. That a theory of justice could specify the

goals of insolvency law implies that it could directly determine these goals.[169] This might or might not be objectionable, depending on the way in which the goals were formulated, both as to their content and level of abstraction.

Rasmussen goes further. Seeking to apply Rawls's *Theory of Justice* to insolvency law, and noting that on Rawls's account, principles of justice apply only to the 'basic structure' of society, he seeks to apply principles of justice directly to insolvency law—that is, rather than to its goals. He makes the argument for doing so in the following way: 'Bankruptcy law,' he claims, 'determines the fate of the financially troubled firm and allocates who gets what when there are not enough assets to go around … [and it] is thus part and parcel of the nation's economy.'[170] The 'structure of the economy' falls 'within Rawls's definition of the basic structure of society.'[171] Therefore '[b]ankruptcy law as it operates in a market-based economy is … rightly considered part of society's basic structure.'[172]

Rasmussen's argument is highly compressed and so worth considering more closely. We should agree that bankruptcy law does indeed, among other things, determine 'the fate

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[169] It might be objected that this implication does not flow directly from the passage in question. While I accept that other readings of this passage—if considered alone—may be available, the reading I propose is required by the way in which Mokal develops his theory of insolvency directly from a Rawlsian choice position: Mokal, *Corporate Insolvency Law* (n 51) ch 3.

[170] Rasmussen, 'An Essay on Optimal Bankruptcy Rules and Social Justice' (n 19) 10.

[171] ibid.

[172] ibid 11.

of the financially troubled firm'[173] and the distribution of its assets, if a distribution is to be made. That it does so is merely a reflection of the fact that it must contend with what I have called distribution questions. As such it is an element that does, in part, delineate the economic structure of a society that has bankruptcy law. At the very least, it will determine how certain goods are allocated, and how actors in that economy will expect them to be allocated. (The total absence of any specific bankruptcy law could also, in part, delineate the economic structure of a society in very much the same way, and give rise to different allocations.) Rasmussen's next premise is scarcely more controversial, for we can readily accept that the economic structure of society is part of the basic structure, noting of course that Rasmussen does not say anything very precise about exactly what this might be thought to include. The difficulty, then, is not in accepting the premises, but rather in inferring that bankruptcy law is not only an element of the economic structure of society but also of the basic structure of which that economic structure is an element. Rasmussen does not offer anything more by way of an argument as to why this might be so. An argument is, however, plainly required. It is at the very least an open question whether the relevant relation of transitivity—bankruptcy law to economic structure, economic structure to basic structure—does indeed obtain, and there may be good reasons to think that it does not.

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[173] ibid 10.

I will now explain why it seems to me that bankruptcy law cannot be part of the basic structure of society for the purposes of a Rawlsian theory of justice, which I take to include a theory such as Mokal's, or, in more general terms, why the structure of bankruptcy law is not the kind of thing that can be directly specified by a theory of justice. This is best shown by considering certain ways in which Rasmussen's work fails to identify what could plausibly be said to amount to just outcomes in a Rawlsian framework.

Rawls's *Theory of Justice* is strongly egalitarian. It tolerates inequality, however, where such inequality is permitted by Rawls's second principle of justice, also called the 'difference principle' or 'maximin principle'. This principle permits inequalities of certain kinds if and only if the inequality has the effect of making the worst off under an unequal distribution better off than they otherwise would have been, absent the inequality.[174]

Rasmussen summarises his argument in this way:

> When Rawls's difference principle is applied to the competing bankruptcy theories, [an] economic approach proves itself more capable of protecting the interests of the least advantaged. While it may be difficult to identify with certainty which members of society are the "least fortunate" for the purposes of bankruptcy law, all groups which might possibly qualify as the least

[174] Rawls (n 5) 75–83. Rasmussen does not notice all relevant features of this principle, but nothing turns on this for present purposes.

> fortunate fare better under the economic approach to bankruptcy law than under the traditional theory.[175]

This passage reveals the serious difficulties inherent in Rasmussen's method, which I say flow from his mistaken suggestion that bankruptcy law is part of the basic structure of society. In seeking to apply the difference principle directly to some scheme of insolvency law, Rasmussen immediately encounters the difficulty of determining just who the worst off might be, under some scheme. And instead of seeking to establish the identity of those who would be worst off, he seeks to establish who would be worst off *for the purposes of bankruptcy law*. This is a significant slip, both because the those worst off for the purposes of insolvency law may not be badly off at all—they could be princesses and kleptocrats, for all we know and depending on what the rest of the economic structure of society may be like—and also because it leads Rasmussen into a further confusion.

This further step is that of considering, in a very particular way, whether or not the lot of some class of stake-holders in insolvency—employees, trade creditors, unsecured creditors, etc.—might be better under some set of arrangements than under another. His approach to this task involves taking one such group, considering their lot as a group under one scheme, considering their lot as a group under another, and if their lot is better under his preferred scheme, suggesting that *if* this group is the worst off under the

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[175] Rasmussen, 'An Essay on Optimal Bankruptcy Rules and Social Justice' (n 19) 4.

favoured arrangements, then the difference principle is satisfied in respect of the preferred scheme.

Such an approach is highly suspect. This is because the classes of stakeholders Rasmussen considers cannot be similarly constituted on the two sides of the comparison he is asking us to make. This fact undermines the intuition we are supposed to share: that more jobs under favoured arrangements reflects a better insolvency law *because* it is the maximin, *if* employees turn out to be the worst off group. The suggestion is in fact incoherent. If under some scheme of insolvency law there are 100,000 people employed on X conditions, and under some other scheme there are 130,000 people employed on Y conditions, it is not clear, without more, that we have reason to prefer the second scheme to the first.[176] Y conditions, for example, might be truly ghastly; there are other possibilities. More particularly, there is no reason to think that such a comparison between differently constituted groups shows that those people who make up the 130,000 employees on Y conditions are *themselves* better off than they would otherwise have been, and this is surely the question to which the difference principle, properly understood, directs our attention. The comparison simply does not give us any information at all as to what the lives of these 130,000 were like under the disfavoured arrangements. And if, in support of the proposed comparison, it were to be said that the 130,000 on Y conditions were the 100,000 on X conditions, plus 30,000 more, then it

[176] We would of course have reason to prefer this if our goal were to maximise the number of jobs. I do not consider this possibility further.

would need to be shown that the substance of the schemes of insolvency law under consideration would *in fact* have brought about this very unlikely result. It seems doubtful that this could be done.

Rasmussen's claim that bankruptcy law forms part of the basic structure of society, and is susceptible to evaluation in terms of the difference principle, can thus be seen to fail because it is not possible, confining oneself to insolvency law, to carry out the kind of comparison that the difference principle requires: that of identifying the worst off—not by reference to a class with variable membership, but rather in terms of individuals affected—and asking if they would be better off under one set of arrangements rather than another. Rasmussen's evaluative claims in respect of insolvency law should therefore be rejected.

The argument I have advanced against Rasmussen implies not only that it doesn't make sense to compare, in abstract terms, different possible insolvency regimes in terms of Rawls's second principle of justice, but also that abstract comparisons of different insolvency regimes cannot be made in terms of individual lives. That this is so has important implications for the ways in which the demands of various theories of justice can be brought to bear against insolvency law.

It should also lead us to expel an important confusion that is carried and perhaps sustained by certain forms of words that are sometimes used in the kinds of normative discussions with which I am concerned. In advancing his argument that what he calls

the 'economic' approach to insolvency law conforms to Rawls's second principle of justice, Rasmussen claims that his approach would lead to a situation that would be, among other things, better *for employees*. As I have now explained, this incoherently suggests that insolvency law alone can identify comparison classes of the right kind, the lot of which can be considered and therefore compared in two different, though in many ways similar, possible worlds. In fact, insolvency law alone does not equip us to make any such comparison.

The suggestion that some set of arrangements could, evaluated in this way, be better *for employees* is therefore misleading, and may well obscure the normative claim to which appeal is in fact being made. It may be appropriate to compare different schemes of insolvency law in otherwise similar possible worlds in terms of employment. These evaluations would depend, at the very least, on the number of jobs under each relevant scheme, the conditions attached to those jobs, and what life was like in certain respects for those who did not have jobs under the relevant scheme. And evaluations such as these may have important normative implications. But it is a nonsense to say that some matters relating to the employment of some set of workers being better in some ways than they might otherwise have been for some other set of workers means that that first set of workers are *themselves* better off than under some alternative regime. We would be more faithful to this kind of argument if, instead and very simply, we were to say that we prefer one regime to another for reasons relating to employment. As has been shown, however, the normative appeal of arguments such as these cannot be established by

direct recourse to Rawls's second principle of justice, or a principle of that kind; the normative appeal of such a claim, if there is any, must be established in some other way.

This clarification also points to an important tension that I will, later, seek to reduce if not entirely resolve: that between forward- and backward-looking aspects of insolvency rules, or, more precisely, the fact that some scheme of insolvency law will have effects both in that it applies in insolvencies that do arise (ex post effects) and in that it affects the incentives and behaviour of those actors who bargain on the basis that they may come to be affected by such a scheme (ex ante effects).[177]

In the last part I considered an argument advanced by Rasmussen concerning Rawls's second principle of justice. This was a particular argument, dealing with a particular theory of justice. In what follows, however, I shall not commit to the theory of justice advanced by Rawls. This is possible as the primary conclusions from the last part are readily generalizable. In this section I claimed, first, that the consideration of insolvency law, without more, does not allow us to know enough about those whose interests are affected by to allow us to evaluate their situation in terms of distributive justice. Second, I claimed that we cannot purport to compare alternative schemes of insolvency law, and thus prefer one to the other, in terms of the very lives affected. This is because the legally determined classes of insolvency stakeholders—employees, unsecured or secured

[177] See IV.2. below

creditors, etc.—would be differently constituted on either side of the purported comparison.

I shall go on to claim that substantial progress can be made towards answering the distribution and other questions that arise in respect of insolvency law by approaching these as questions of distributive justice. This may not be the first attempt to articulate a normative account of insolvency law in this way. On one view, at least, Mokal's theory is just such an attempt, albeit one that pursues a more specified theory of distributive justice, elaborated by reference to the value of equality.[178] For Mokal, equality is a constructive attribute of free and reasonable individuals. In virtue of this constructive attribute individuals are, consistently with views expressed elsewhere in more general terms by Ronald Dworkin, entitled to have 'their interests … accorded equal care and respect in the choice of principles' of insolvency law.[179] Importantly, this means that equality is not a call for flat equality of resources, for example. It is, instead, a value to be realised in terms of more abstract comparisons; more particularly, in terms of individuals' interests being taken into account in a particular kind of way in an idealised choice position.[180] As will become clear, this is not the approach to connecting

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[178] This is only one possible view, for the characterisation of Mokal's view is not entirely straightforward. This is because the justification of his approach—called the 'Authentic Consent Model'—is a combination of elements that draws upon work by Rawls and Dworkin. And while the Rawlsian elements are undoubtedly elements of a (Rawlsian) theory of distributive justice, is it less clear that the Dworkinian elements are of this kind: see Mokal, *Corporate Insolvency Law* (n 51) 4–16, ch 3.

[179] ibid 10; Dworkin, 'Taking Rights Seriously' (n 114) 180.

[180] Mokal, *Corporate Insolvency Law* (n 51) ch 3.

distributive justice and insolvency law that I pursue. But as there is, I think, plausibility in Mokal's approach, and as I do not offer key parts of my own theory against, so much as alongside Mokal's, it is worth explaining why I do not pursue it as such.

It is no part of the project that I pursue here to develop or defend a full-blown theory of distributive justice. This is already the preoccupation of a dense and subtle literature in moral and political philosophy. But it is also the case that I take insolvency law to raise what are paradigmatically questions of justice. So whereas Mokal takes a particular account of the value of equality as his starting point, drawing on Rawls and Dworkin, I avoid making such an initial stipulation. In doing so, I hope to avoid taking positions—and, more importantly, having subsequent claims I advance depend on positions—on difficult and controversial questions in moral and political philosophy, save when strictly necessary for the arguments that I will defend. A consequence of this is that rather than offering a theory of justice, I will make certain specific claims about what justice requires, whatever *else* justice requires, in certain kinds of legal systems.

A second set of concerns is more substantive. My own approach seeks to keep alive what I take to be important questions about corporate insolvency law, considered *as part of a legal system* rather than taken on its own. Mokal's starting point, I suggest, forecloses this possibility for reasons that partly reflect the distinct goals of his project. It allows him, for example, to show that the application of a Rawlsian framework to this area of law does not lead where Jackson says it does in his elaboration of the creditors' bargain

model.[181] By contrast, while I may, on my own approach, notice difficulties with Jackson's argument, I will not be able to reach anything like the kind of positive conclusions that emerge from Mokal's work.[182] My approach does, however, preserve access to a distinct set of questions which, it is also important to note, concern what I have characterised as core proceduralist claims concerning rights held outside of insolvency, and what these imply about the form insolvency rules should take.

4. CONCLUSION

In this chapter I have proposed to sort the normative questions raised by corporate insolvency law into categories under the headings of corporate identity, debtor fidelity and distribution. I signaled that corporate identity questions would not receive further express consideration, leaving questions of debtor fidelity and distribution to be pursued in the rest of the thesis. I then argued that in spite of certain complications, distribution questions fell to be answered by reference to an account of distributive justice, explaining the role efficiency is to play in this account, and noting that the application of distributive principles to this area of the law should not be direct.

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[181] See II.3.2. above

[182] Mokal, *Corporate Insolvency Law* (n 51) ch 2.

I have not yet said anything about the values or ideals that (ought to) determine the shape and scope of normative reflection on these questions of debtor fidelity, which, as I have explained, will concern at least *West Mercia* duty-shifting and transaction avoidance, broadly understood. It is an important feature of both groups of doctrines that the law only offers a remedy where a corporate debtor has in fact become insolvent. This means that if there are no circumstances requiring the resolution of insolvency-related distribution questions, in some particular case, then the law does not regard any fidelity question as arising either. This is not, of course, the end of the matter; what the law happens to provide cannot determine the normative question. But it offers as a line of inquiry, which I pursue, that an appealing articulation of at least some corporate fidelity questions may, at least in part, depend on how distribution problems fall to be answered in terms of distributive justice. It is to this task that I now turn.

IV DISTRIBUTIVE FOUNDATIONS FOR INSOLVENCY LAW

1. INTRODUCTION

In this chapter I begin to offer a normative account of the distributional questions to which corporate insolvency law gives rise. As I have already explained, this account will be offered in terms of distributive justice.[183] I will not, however, commit to a particular conception of distributive justice in defending the positive argument to come. This chapter begins by considering a question that any theory of distributive justice must answer: that of who is owed distributive justice, and why. This is usually called the scope question (section 2). I then introduce an assumption concerning the legal and economic systems the insolvency law of which this thesis seeks to investigate. This assumption is that these systems are capitalist or social-democratic market economies, in which access to a range of goods, services and advantages is mediated by exchangeable legal rights. Having made this assumption, I claim that any conception of distributive justice capable of applying to such systems requires individuals to be accorded, among other things, the capacity to hold such rights (section 3). I then consider, drawing upon work by Ronald Dworkin, the idea of personal responsibility. I claim that in systems of the kind

[183] See ch II above

under consideration, individuals should, as a matter of distributive justice, be able to deal with legal rights as they see fit, and that apparent disadvantages to them that arise from such dealings do not, for this reason alone, call for redress as a matter of distributive justice (section 4).

2. THE SCOPE QUESTION

In this section I consider the domain over which justice applies. I shall call this the scope question. I shall call what an individual is owed as a matter of distributive justice a distributive share. Whatever distributive justice requires is required only to the extent that it falls with the scope of distributive justice. While I do not offer a fully specified argument in answer to the scope question, I suggest that the relevant scope must be at least as wide as those within a state—and not some more specific group—and also include those persons ordinarily governed by that state's laws. This means that where corporate insolvency law is concerned, the relevant scope covers all those whose interests are or could be affected by corporate insolvency law. A theory of corporate insolvency law cannot avoid offering an answer to the scope question, whether or not it does so explicitly. This is because the scope question is none other than the question of whose interests should count in thinking about corporate insolvency law.

In abstract terms, then, the scope of distributive justice has important implications for the kinds of measures that distributive justice will permit or proscribe. For example, if

the state must treat only its citizens justly, among themselves, then, from the point of view of such a theory, it may be free to impose burdens on others: whether by assassinating supposed terrorists abroad, or importing foreign workers without affording them labour law protections that other local workers have, or by excluding non-citizens from public healthcare provision, for example. That any of these measures might be consistent with a theory of justice may sit uncomfortably with an intuition that treatment of this kind may sometimes be very wrong indeed.

This intuition may be explained—or explained away—in at least three ways. The first would be to admit that burdening foreigners in some way might be wrong, but to deny that it is unjust. Killing supposed terrorists abroad is wrong because killing anyone is wrong, whether or not anyone else may be killed as a matter of (positive) law, and not for any other reason; exploiting workers is wrong regardless of whether all or merely some workers are exploited, and not for any other reason. On this view, there is no role left for justice to play, and no inconsistency between the state action in questions and the justice that the state action must express. The second explanation would be to admit that such measures are the kinds of things that could amount to injustices, but to claim that those so burdened stand outside the class of those to whom justice applies; ie those within its scope. On this view, on the examples I have given, the distinction between citizen and non-citizen is a morally relevant one, and a proper basis for differential treatment by the state. The third explanation would assert the specific injustice that the first view denies, and deny the moral relevance of the distinction between citizen and

non-citizen offered by the second view. These, I think, are the most obvious available moves.

The moral relevance of the distinction between citizen and non-citizen may be controversial, and I shall not pursue it here. I am able to do this because the corporate insolvency law conflict that I wish to explain in terms of the scope of the moral requirement that state action accord with justice does not arise at the level of this particular distinction. Instead, it arises between groups who could well all be citizens of the state in question, but who may be differently situated, legally speaking, when it comes to some particular insolvency procedure.[184] This conflict captures the central and unresolved disagreement between traditionalist and proceduralist or cost-of-credit theories of insolvency law, which conflict may now be restated in the following way.

Traditionalism must be taken to offer a narrow answer to the scope question.[185] Those whose interests should be taken into account in some particular insolvency procedure, pursuant to normatively satisfactory insolvency law, are those whose interests are at stake in that very procedure, whether or not those interests are recognised by the law inside or outside of insolvency proceedings.[186] Such a group will often be very small, or in any case small in terms of the population of a country. Proceduralists and cost-of-

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[184] Whether or not they ever are is an empirical question that I do not consider.

[185] I comment on this feature of traditional insolvency law scholarship above: see II.2.4. above.

[186] The usual example taken is that of 'community' interests, which are assumed not to take the form of legal rights, and not to be held by any specific legal entity: Gross (n 47) ch 12.

credit theorists take a wider view on this scoping question. On the wider view, those whose interests should be considered by corporate insolvency law are not only those whose legally cognizable interests are at stake in some particular insolvency procedure, but also those who might become so involved in the future, including all participants in the market for credit, whether or not any particular insolvency ever, in fact, eventuates. Put differently, the interests must at least include those of the whole universe of debtors, as any adjustments to credit terms, made by lenders ex ante, will ultimately be borne by such debtors.[187]

The narrow answer that traditionalist scholars implicitly give to the scope question must be rejected. To see why, it will be useful to say something about how political philosophers have treated the questions concerning the grounds and scope of justice. Such questions have been of particular relevance in considering whether or not the demands of justice transcend national boundaries. This is not exactly the scope question that we face in laying the groundwork for a defensible normative account of corporate insolvency law. However, a brief consideration of this material will show that the possible answers to this question suggest that the distinction traditionalists implicitly urge—that we distinguish between the interest of parties to a particular procedure and those of all others—cannot be maintained.

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[187] 'Participants in the market for credit' could be understood more or less inclusively. It might be restricted, say, to those deliberately providing or taking credit, or those who ought to be taken to have done so. This might exclude certain tort creditors from this class, as in the theory put forward in Schwartz (n 3) 1212–1213. The argument that follows excludes such a move for the purposes of the scoping question under consideration.

The different contributions to the global justice literature considered below each suggest that the scope of distributive justice must be no narrower than to include the citizens of the state of which the justice is being considered. As such, it will not be necessary to commit to any particular account of the grounds of justice, within a state or otherwise, for on this question the alternative theories I consider converge. If the scope of distributive justice is at least as wide as the state, then it follows that those *actually affected* by some particular insolvency proceedings, whether directly or indirectly, have standing to demand distributive justice on the same grounds; that is, as those to whom justice is owed.

If this is so then traditionalists cannot maintain the distinction that they require, for the direct and indirect effects of insolvency law concern a group much larger than that of the parties to a particular insolvency procedure. I have argued already that distribution questions in corporate insolvency law—questions about who gets what when a company becomes insolvent—just are questions of distributive justice. But these are not the only such questions to which insolvency law gives rise. Insolvency law determines who gets what in other, less direct, ways, and these too raise distributional questions. In addition to the distributions insolvency law makes to stakeholders in particular cases insolvency law also affects the chances that any particular debtor will default, and so the risk of non-repayment that creditors bear. This kind of risk is distributed throughout the economy in a wide, if in some respects diffuse, way. Such risk is not, of course, a good to be distributed in the way that money or other advantages might be: no theory would

seek to maximise everyone's risk of non-repayment, say, or ensure that everyone in a country had 'enough' of it. But the way in which such risk is distributed will affect people's lives, and their life prospects, in myriad indirect ways, and it seems very likely that it is unjust if some people or groups of people live, for example, inherently riskier lives than others. To the extent that these indirect effects of insolvency touch upon people's important interests, then an argument would be required to show that these effects are to be excluded from consideration as less important than the interests of those more directly affected. No such argument has, however, been forthcoming.

An implication of this view of things is that the indirect, system-level effects of corporate insolvency law raise questions of distributive justice in just the same way that those more immediate distributions made in specific insolvency proceedings do. An important subset of these effects will concern the cost and availability of credit. This is not to say that maximising the availability of credit, or some particular kind of credit, by minimising its cost, through insolvency law or by other means, should be the overriding objective of this or some other department of the law. This would be to make the opposite mistake to that made by traditionalists; as above, an argument would be required if this line of thought were to be pursued, and I do not know of an appealing one. The point is, rather, that questions of distribution, susceptible to analysis in terms of distributive justice, arise whether one starts by considering insolvency law from an ex post perspective and specific distributions actually made, or by considering the effects of such distributions on parties bargaining ex ante. This is a matter of great importance. It suggests an underlying unity in the issues at stake, and a route toward offering a

normative account of at least some of them. This suggestion of unity, however, has not been pursued in the literature.[188] Instead, scholars have preferred to assert the primacy of one perspective—ex post or ex ante—over the other, often by mere implication. Once drawn out, however, the argument for unity is compelling. It shows the relationship between the ex post and the ex ante perspectives, and connects the justice against which corporate insolvency law is to be evaluated with demands of distributive justice, within that notion's more general scope.

The point regarding the grounds and scope of justice may be stated relatively briefly, and by starting with a distinction that has been stated by A J Julius. Without seeking to be exhaustive, Julius distinguishes *allocative* and *associative* theories of justice:[189] 'On an *allocative conception* of justice, justice is fundamentally a standard for evaluating people's responses to allocation problems. These problems materialize wherever you notice the possibility of adding to or subtracting from people's holdings of goods.' As almost all problems of legal regulation or decision-making are of this kind, the scope of such conceptions must be very wide. Associative conceptions are narrower: 'An *associative conception* of justice takes it to be a standard for evaluating histories of people's interaction. Interaction of specific kinds gives rise to unusual moral demands that are

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[188] It might be suggested that proceduralist scholarship does in fact draw the connection that I assert here: that proceduralists see ex post outcomes as important because they have ex ante consequences for the relevant universe of firms. This is not, however, the claim I make here. I do not claim merely that both ex post and ex ante perspectives matter *in some way*, which suggestion I think few would deny. Instead, I claim that both perspectives matter *for the same reasons*. As such, neither matters *because* of the other, as proceduralists might assert.

[189] AJ Julius, 'Nagel's Atlas' (2006) 34 Philosophy & Public Affairs 176.

partly met by ensuring that the interaction tends to generate special distributions of goods.'[190] On an associative conception, it is open to argue that A is owed justice by a state, but that B is not, in virtue of some relevant lack of interaction or connectedness.[191]

Just which kinds of connections should count here is controversial. In defending what Julius calls an associative conception, according to which relevant justice relationships arise primarily within states, Thomas Nagel claims that the right kind of connection

> comes from a special involvement of agency or the will that is inseparable from membership in a political society. Not the will to become or remain a member … but the engagement of the will that is essential to life inside a society, in the dual role each member plays both as one of the society's subjects and as one of those in whose name its authority is exercised.[192]

Also advancing an associative conception, Julius himself makes the suggestion that the relevant connection arises in circumstances involving the 'coercive imposition of terms of interaction,'[193] and notes that governments regularly implement such terms in respect of foreigners as well as citizens and other residents.[194] Thomas Pogge has suggested that the systematised institutional interactions brought about through the process of

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[190] ibid 177 (emphasis in original).

[191] It is clear that this is not intended to exclude other values like charity, or obligations to relieve extreme hardship, which are owed to humanity at large.

[192] Thomas Nagel, 'The Problem of Global Justice' (2005) 33 Philosophy & Public Affairs 113, 128.

[193] In a related context Dworkin refers to 'official coercion': Dworkin, *Law's Empire* (n 4) 190.

[194] Julius (n 189) 184.

globalisation, and the disadvantages they have brought to some, give rise to such connections.[195] This too is an associative conception.

Of these three options—there are of course others—Nagel's draws the line most narrowly. In suggesting that justice arises in virtue of 'the dual role each member plays both as one of the society's subjects and as one … in whose name its authority is exercised', citizens seem to qualify, but no one else does. Altogether more are covered if the connection involves the 'coercive imposition of terms of interaction', which applies to all residents of a state's territory, and plenty of non-residents as well. This also avoids some difficult questions about what it is to be one of those in whose name state power is exercised. Even more again are covered if systematic institutional interaction is what counts.

We do not need to look more closely at these conceptions of the grounds of justice. It is sufficient, for present purposes, to observe that even on Nagel's view, both those affected by some particular insolvency procedure, and those who are participants in the economy of the state in question, will qualify for justice from the state in question. They will be either citizens, ersatz citizens like companies, or those who are not citizens, but could have been and are in an indistinguishable position from that in which they would have had they been citizens.[196] It is true a fortiori on Julius's or Pogge's conceptions. If

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[195] Thomas Pogge, *Realizing Rawls* (Cornell University Press 1989) 240–80.

[196] These different accounts each point to both certain foreign nationals and foreign companies coming within the scope of justice, though for different reasons. On Julius or Pogge's view, there

obligations of justice arise in respect of, at the very least, citizens of a state, then it follows that both the stakeholders in some particular insolvency, and those whose interests are affected by the insolvency law that is in force fall within the scope of that justice.

It is, however, worth considering somewhat more closely what these abstract conclusions imply. For it is, in a sense, hardly surprising to conclude that any part of mandatory law should be justifiable in terms of the interests of all who are subject to it or, if preferred, all who participate in it. This is as true of contract law, or the law of trusts, as it is of criminal law or corporate insolvency law. The way in which litigation proceeds, however, and the way in which cases are argued, with litigants front and centre (in common-law systems at least), risks obscuring this important fact in certain cases. There are cases in which this is in no sense problematic, and we may offer a narrow answer to the scope question, restricting our concern to the immediate parties to some relationship. Certain contractual disputes will be of this kind, and in morality the same may be true concerning some ordinary promises. The question of what A promised B, or that of what X's contract with Y means and what X must therefore pay may well concern only those parties, and where this is so our concern may stop with them. The

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is a sufficient connection where relevantly coercive terms of interaction are imposed by a state, or where economic interaction is present. As such foreign nationals qualify for concern, and, derivatively, foreign companies must too. On Nagel's view too we may reach the same result, albeit less directly, for it is not the case that a state acts *in the name of* those who are not citizens. As such, foreign nationals do not themselves qualify for such concern. But if rules must show the relevant concern to citizens, not *as* citizens but as debtors or creditors, then the concern for citizens in such contexts will require that non-citizen debtors or creditors are treated as citizen creditors or debtors would be. To do otherwise would undermine the conceptual stability but also the exchangeability of legal rights. This is considered at greater length below: see V.2.2. below.

only parties subject *to that contract* are those before the court. But where such a contractual dispute will in fact determine the outcome of a distributive contest between a party and a non-party, this will clearly not be so, and many questions raised in insolvency proceedings are of this kind.

Other examples are possible. It is not seriously arguable, for example, that criminal law, or some particular criminal trial, concerns only the victim of certain offending, and the accused.[197] A wider range of interests than just those of the victim and the accused are in play, some of which are represented by the public prosecutor. The same is true when a court considers the limits of the capacity of individuals to craft obligations by contract: that part of contract law which is mandatory, at least for those who would make contracts, and so has clear system-wide effects, which will be taken into account by well-informed parties bargaining ex ante. A court considers such questions when it considers, for example, the contractual penalties doctrine,[198] the anti-deprivation principle,[199] or the

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[197] The canonical statement is that of Blackstone: William Blackstone, *Commentaries on the Laws of England*, vol 4, ch 1; cf RA Duff and SE Marshall, 'Public and Private Wrongs' in James Chalmers and Fiona Leverick (eds), *Essays in Criminal Law in Honour of Sir Gerald Gordon* (Edinburgh University Press 2010).

[198] *Cavendish Square Holdings BV v Makdessi* [2015] UKSC 57, [2016] AC 1172; cf Caspar Bartscherer, 'The Primary/Secondary Chimera' (2018).

[199] *Revenue and Customs Commissioners v Football League Ltd* [2012] EWHC 1372 (Ch); *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2011] UKSC 38, [2012] 1 AC 383.

alienability of blood or babies by contract,[200] each of which has a public character.[201] Insolvency proceedings are of this second kind.

There is much still to be done in specifying just what it is that distributive justice requires, and much of this is beyond the scope of this thesis. The argument of this section, however, is sufficient to establish the conclusion I foreshadowed above: that there is an underlying unity to our concern for both the ex post and ex ante distributions that insolvency law makes, and their effects.

3. RIGHTS AND CAPACITIES

In the last section the scope of distributive justice was considered, and in particular, the consequences of those debates for the questions raised in this thesis. With this in place we must begin to approach the question of what exactly it is that distributive justice offers to those lucky enough to fall within its scope. In this section I shall claim that in a market economy, distributive justice requires individuals to have the capacity to hold and create certain legal rights or enter into certain legal relationships. In the next section

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[200] Margaret Jane Radin, 'Market-Inalienability' (1987) 100 Harvard Law Review 1849.

[201] Concerning the privatisation of certain public (and protective) functions of contract and fiduciary law see Margaret Jane Radin, 'The Deformation of Contract in the Information Society' (2017) 37 Oxford Journal of Legal Studies 505; Alexandra Whelan, 'Status, Relationship, Contract' (2019); cf James J Edelman, 'When Do Fiduciary Duties Arise?' (2010) 126 Law Quarterly Review 302.

I shall argue that in such systems individuals should be able to engage their personal responsibility in particular ways. As foreshadowed above, I do not defend a particular conception of distributive justice, nor argue for a particular *equalisandum*, as certain egalitarian conceptions of distributive justice would require.[202]

Circumstances of insolvency are circumstances in which legal and other interests conflict. This is because, by definition, there are insufficient resources to meet the claims upon the debtor. Corporate insolvency law aims, where necessary, to resolve these conflicts by providing that certain legal entitlements be qualified or reduced in certain circumstances. Actual insolvency procedures involve, principally, those with legally cognizable claims against an insolvent debtor. As has already been seen, such claimants are not the only ones whose interests insolvency law ought to consider. The arguments that I have advanced suggest, however, that such wider consideration should flow primarily from the overall scheme of insolvency law in force in a place, and not just from distributive choices made in some particular procedure.[203] Those holding legal rights against an insolvent debtor are, however, an important group of insolvency stakeholders, whose position a theory of insolvency law must explain.

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[202] This is sometimes called the 'currency' question. This language is taken from the work of G A Cohen, and 'Equality of What?' is the title of Amartya Sen's 1979 Tanner Lecture: Amartya Sen, 'Equality of What?' in S McMurrin (ed), *Tanner Lectures on Human Values, Volume 1* (Cambridge University Press 1980); GA Cohen, 'On the Currency of Egalitarian Justice' (1989) 99 Ethics 906.

[203] This much is consistent with proceduralism, according to which these matters ought to be seen as inseparable: see II.2.5 above.

Here, I shall begin this explanation in terms of a capacity to hold and create such legally cognizable interests; *viz.*, such rights. I distinguish the questions that arise in this connection from those which concern the distribution of material or other benefits, whether or not they take the form of legal rights, or involve particular legal rights. The distinction I have in mind is similar to—but of more limited scope than—one that is central in Rawls's *Theory of Justice*: that between first and second principle questions.[204] Rawls's first principle of justice requires that: 'each person is to have an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberties for others.'[205] The second principle provides that: 'social and economic inequalities are to be arranged so that they are … reasonably expected to be to everyone's advantage[.]'[206] As Rawls explains, 'we distinguish between the aspects of the social system that define and secure the equal basic liberties and the aspects that specify and establish social and economic inequalities.'[207] The distinction I am seeking to draw is that between that which must be granted to all, if they are to be able to access certain benefits within a system, on the one hand, and those benefits which are distributed in a society, whether by law or other means, on the other. These other benefits include the stuff and services that I mentioned, in very general terms, above.

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[204] For the suggestion that different kinds of benefits and burdens fall to be distributed according to different principles see generally Walzer (n 119) ch 1.

[205] John Rawls, *A Theory of Justice* (Rev ed, Belknap 1999) 53.

[206] Rawls (n 205).

[207] ibid.

While this distinction opens up two separate fields of questions, we should see that the mechanics of the way in which some society, acting through its institutions, actually distributes material benefits and burdens will affect just what it is that law—if law is the relevant scheme of social organisation—must arm individuals with in the name of distributive justice. Put differently, what individuals must have, in justice, depends upon what individuals require in order to secure a distributive share (ie that which individuals are owed in justice).

I claim that in a market system, law must grant to each to whom distributive justice is owed the capacity to hold and create certain kinds of legal rights.[208] This is because, in a market system, individuals require the ability to hold or create such rights in order to secure a distributive share.[209] Just what particular distributive share individuals might be owed is of course a separate question that only a substantially more developed conception of distributive justice could answer. But a distributive share in such a system is, in part, constituted by property rights, understood broadly,[210] and the capacity to dispose of them, including by entering into contracts. It is through such rights that

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[208] Such an argument need not be maintained in every case: children, and people with severe disability, for example, are not always granted the kinds of capacities I mention here. My argument is not intended to imply that they always should be, at least where parental or guardianship arrangements are in place through which such persons may access their distributive shares. The details of such arrangements do not raise questions specific to insolvency or corporate insolvency law, and consideration of these is beyond the scope of this thesis. As a qualification to the argument to come it is dropped for ease of exposition.

[209] cf Ronald Dworkin, 'Why Liberals Should Care About Equality', *A Matter of Principle* (Clarendon Press 1985) 207.

[210] I mean to refer to property as defined in the Insolvency Act 1986 s 436.

individuals see to their different needs, and craft lives for themselves. One cannot hold such property rights without the capacity to hold property rights. Similarly, one cannot trade in them, or in one's own labour, without the capacity to contract. And while these are not the only routes to the enjoyment of material advantage in any of the tolerably free, democratic, market economies that might be imagined, they are doubtless, as an empirical matter, significant and probably dominant ones.[211]

The claim that I make here is broadly consistent with one made by Rawls, who, discussing the first principle of justice, lists certain liberties he considered that principle to guarantee: alongside freedom of assembly and freedom of thought, and many others, is the right to hold personal property.[212] Shortly thereafter, he offers a further comment concerning this latter right:

> Of course, liberties not on the list, for example, the right to own *certain kinds* of property (e.g., means of production) and freedom of contract as understood by the doctrine of laissez-faire are not basic; and they are not protected by the priority of the first principle.[213]

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[211] My references to capacities here and below should not be taken to suggest any connection between the arguments I defend and those concerning 'capabilities' associated with work by Martha Nussbaum and Amartya Sen: Martha C Nussbaum, 'Nature, Functioning and Capability: Aristotle on Political Distribution' (1988) 6 Oxford Studies in Ancient Philosophy (Supplementary Volume) 145; Martha C Nussbaum, 'Human Functioning and Social Justice: In Defence of Aristotelian Essentialism' (1992) 20 Political Theory 202; Amartya Sen, 'Capability and Well-Being' in Martha C Nussbaum and Amartya Sen (eds), *The Quality of Life* (Clarendon Press 1993); Amartya Sen, *Development as Freedom* (Oxford University Press 1999); see generally Martha Craven Nussbaum, *Creating Capabilities: The Human Development Approach* (Belknap Press of Harvard University Press 2011).

[212] Rawls (n 205) 53.

[213] ibid 54.

The right to hold property, and the right to own property of certain kinds, are distinguished. The first, it seems, is to be thought of as something fundamental; a necessary attribute for a full participant in the kind of ideal society that Rawls envisages.[214] The second, however, is something altogether more contingent, and which might well take different forms according to the particular institutional choices arrived at by different societies, or different ideal legislatures. And the nature of the first right does little to specify the content of the second. It is something analogous to this first kind of right that I claim must be granted to all, in the name of justice, in a market system. This is because it is this first kind of right that gives an individual the means by which to secure a distributive share in a system in which such shares take the form of legal rights. The second, less fundamental kind of right goes well beyond this. As such, if such rights are to be justified then they fall to be justified on other grounds, and not on the basis that they arm individuals with the ability to secure a distributive share.[215]

Before leaving the question, recall that there may be nothing inevitable in any of this. The necessity to constitute certain persons rights-bearers with certain dispositive

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[214] An argument along these lines might similarly be advanced in Hegelian terms: GFW Hegel, *Philosophy of Right* (1821) ss 41-71; Jeremy Waldron, *The Right to Private Property* (Clarendon Press 1988) ch 10.

[215] I do not consider whether this second class of rights are indeed justified in any particular system. I note, however, that an argument seeking to establish this would face the obvious objection that such rights seem liable to create negative externalities or third-party effects that could not be said to flow from the first kind of right discussed. This is the concern that appears to motivate the well-known 'Lockean proviso': John Locke, *Second Treatise of Government* (1689) ch 5; Nozick (n 116) 178–82.

capacities may well be particular to the kind of political and economic organisation that I have described; that is, a market system governed by law. Pashukanis, for example, following Marx and Engels, thought that '[t]he withering away of the categories of bourgeois law will, under [communism], mean the withering away of law altogether, that is to say the disappearance of the juridical factor from social relations.'[216] If law is not the means by which individuals secure access to those benefits some system distributes, then such legal capacities might well be otiose, whether as crusted-on formal rhetoric—ideology, perhaps—that has survived the demise of its bourgeois creators or in some other way.[217] But those circumstances are not ours, and, relevantly for present purposes, would make corporate insolvency law of the kind this work considers as good as unimaginable. What Pashukanis calls the juridical factor is key to the social relations that insolvency law regulates. The legal right is, in part, constitutive of this juridical relation. And if society is to be organised in such a way, then such rights are properly the objects of normative reflection concerning that system. For the sake of clarity, I note that nothing I say here is supposed to cast doubt on any other sources of rights that individuals do or ought to enjoy in a morally defensible legal system. Such rights might protect individuals' bodily integrity or interests in being heard before coercive action is taken which concerns them. The point is a more limited one: that if distributions *in justice* take the form of rights, then this has normative implications, including that individuals

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[216] Evgeniĭ Bronislavovich Pashukanis, *Law and Marxism: A General Theory* (Ink Links 1978) 61.

[217] Hugh Collins, *Marxism and Law* (Clarendon 1982) 95–6; contra Christine Sypnowich, 'The "Withering Away" of Law' (1987) 33 Studies in Soviet Thought 305.

must have the capacity to hold and deal with such rights. It is also a normative implication of this, as I will explain in the next chapter, that the content of a right should be understood in a way that is wholly abstracted from the identity or characteristics of the holder of such a right.[218] This means that the right and its holder are each able to be understood without necessary reference to the other. And while this may sound abstruse, it is a necessary assumption if the rights-talk of the kind familiar to lawyers and philosophers of law is to make sense. If a right is not so defined, then it cannot be discussed as a legal artefact with constant features susceptible to exchange; if it is not so defined, what is being considered is not a legal right as this language is commonly used but some attribute, juridical or otherwise, of a particular person. Distributions in justice could not coherently be mediated by such attributes.

4. RESPONSIBILITY

In the last section I distinguished between certain rights and capacities, on the one hand, and holdings like money, goods or offices, on the other. The former, I suggested, provided the basis upon which people might receive certain kinds of distributions in justice, if certain further conditions were satisfied. Such rights and capacities are not distributed, as such, as they are neither scarce nor rivalrous. By contrast, money, goods and offices have both of these features, and are proper objects of distribution. Many

[218] See V.2.2. below

things that fall in this category may be consumed or destroyed. They may also be assigned or bequeathed or encumbered by the exercise of the rights and capacities just mentioned. The concept of responsibility, in this context, is concerned with these kinds of choices, and the normative implications of the apparent inequalities to which they give rise.[219] A range of theories of distributive justice hold that a person should not be made to bear the consequences of some disadvantage for which that person is *not* responsible.[220] Both the conditions for ascribing responsibility, and its consequences, raise significant questions of distributive justice. The next two sub-sections consider these in turn, by reference to Dworkin's distinction between brute (unchosen) and option (chosen) luck.[221]

4.1. What are we responsible for?

Where a person holds a distributive share, along with certain capacities to deal with and dispose of that share, deliberate exercises of these capacities are choices for which the

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[219] In what follows I shall be principally concerned with responsibility questions concerning the exercise of these rights and capacities, rather than mere choices to consume. This is because the many of the direct distributions that corporate insolvency law makes are concerning those who have made use of these legal capacities. It is not my intention, though, to deny the applicability of much of what follows to choices concerning mere consumption. But as has been the case in other contexts, restricting the discussion to that context which concerns corporate insolvency law most directly will allow certain deep, but presently irrelevant, controversies to be avoided.

[220] Rawls (n 205); Ronald Dworkin, 'Equality of Resources', *Sovereign Virtue: The Theory and Practice of Equality* (Harvard University Press 2000); Cohen (n 202); Sen, 'Equality of What?' (n 202); Amartya Sen, *The Idea of Justice* (Allen Lane 2009); Nussbaum, *Creating Capabilities* (n 211); cf Elizabeth S Anderson, 'What Is the Point of Equality?' (1999) 109 Ethics 287.

[221] Dworkin, 'Equality of Resources' (n 220) 73.

person in question is responsible. Similarly, it may also be said that certain consequences of such choices are the responsibility of that person. Aspects of a person's circumstances that are a person's responsibility have morally different features to circumstances for which that person is not responsible. Exactly what these differences are is controversial.

Ronald Dworkin has sought to explain the notion in question by distinguishing between what he has called brute and option luck. He explains the distinction between these in the following passage, taken from an influential article in which he sets out his theory of equality of resources:

> Option luck is a matter of how deliberate and calculated gambles turn out—whether someone gains or loses through accepting an isolated risk he or she should have anticipated and might have declined. Brute luck is a matter of how risks fall out that are not in that sense deliberate gambles. If I buy a stock on the exchange that rises, then my option luck is good. If I am hit by a falling meteorite whose course could not have been predicted, then my bad luck is brute (even though I could have moved just before it struck if I had any reason to know where it would strike). Obviously the difference between these two forms of luck can be represented as a matter of degree, and we may be uncertain how to describe a particular piece of bad luck. If someone develops cancer in the course of a normal life, and there is no particular decision to which we can point as a gamble risking the disease, then we will say that he has suffered brute bad luck. But if he smoked cigarettes heavily then we may prefer to say that he took an unsuccessful gamble.[222]

The position of those who take 'deliberate and calculated gambles' is different from that of those who find themselves facing hardships that they have not, in any relevant sense,

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[222] ibid.

chosen. But of course further difficulty attends the task of accounting for the great many unchosen factors that affect our lives, and in seeking to design devices, philosophical or political, to neutralise them in some way. If our talents are unchosen, then what about our tastes, expensive or otherwise?[223] A general theory of equality of the kind Dworkin advances must deal with such questions, and, indeed, Dworkin's attempt to do so is itself the subject of a considerable literature, which stands as a demonstration of the complexity of that task.[224]

It seems, too, that our judgments concerning deliberate gambles and thus also unchosen misfortune will depend on those parts of the economic system that we take to be background, and therefore assume to be fixed. Our judgments about whether an injured person ought to have purchased health insurance, for example, will depend, in part, on whether or not the state in which she lives provides healthcare to all without the need for such insurance. Similarly, our views about deliberate choice will reflect the extent to

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[223] What are known as the problem of expensive or offensive tastes are prominent objections to conceptions of equality that seek to equalise welfare across some group. According to the objections, we should reject certain welfare metrics of equality as they would require that those with such tastes, whether for the infliction of pain on others, or for lavish living, be given substantially more resources than others with more ordinary tastes: Ronald Dworkin, 'Equality of Welfare', *Sovereign Virtue: The Theory and Practice of Equality* (Harvard University Press 2000); Cohen (n 202); Will Kymlicka, *Contemporary Political Philosophy: An Introduction* (Clarendon Press 1990) 40ff; Anderson (n 220) 293.

[224] eg Colin M Macleod, *Liberalism, Justice, and Markets: A Critique of Liberal Equality* (Clarendon 1998); Brian Barry, *Theories of Justice* (University of California Press 1989); Richard J Arneson, 'Equality and Equal Opportunity for Welfare' (1989) 56 Philosophical Studies 77; Cohen (n 202); Sen, 'Equality of What?' (n 202); Philippe van Parijs, *Real Freedom for All: What (If Anything) Can Justify Capitalism?* (Clarendon Press 1995); John Roemer, 'A Pragmatic Theory of Responsibility for the Egalitarian Planner' (1993) 22 Philosophy & Public Affairs 146.

which an unjust economic distribution is assumed to be such a neutral background circumstance. A critique of something like this assumption formed part of the argument against proceduralism defended in an earlier chapter.[225] This has implications not only for our views about justice, which were considered in that context, but also for whether or not the conditions for morally significant choice obtain: where one has few or bad options, the fact that one chooses may not be a matter of any great importance.[226]

The limited domain of corporate insolvency law, however, does not require that all these difficult questions be resolved. Indeed, I wish to suggest that Dworkin's rather abstract distinction between brute and option luck provides a plausible basis for distinguishing between different classes of stakeholders when it comes to corporate insolvency law. If I am right, then it may be enough simply to decide who, among these stakeholders, are 'deliberate gamblers' and who are not. In attempting to do this, it will also be necessary to say something about the nature of the gambles being taken in each case. This is because the nature of the gamble in question will ordinarily determine the range of consequences for which the gambler in question is responsible. If I buy a lottery ticket for €2 and lose my money, I am responsible to the extent of €2 but not further.

Both questions of whether or not some group of corporate insolvency law stakeholders may be said to have gambled, and of the characterisation of the gambles in question fall,

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[225] See II.4 above

[226] Joseph Raz, *The Morality of Freedom* (Clarendon Press 1986) ch 14 esp 373-78.

therefore, to be considered. Using Dworkin's labels, we can distinguish between different occasions for brute or option luck. One such occasion concerns the fact of extending credit to the debtor. Another concerns the terms upon which such credit is extended. One who deliberately extends credit to the debtor, and who deliberately does so on terms she has chosen—a professional lender, for example—has only option luck in respect of the outcome, whether good or bad, from her point of view.[227] One who does not deliberately extend credit to the debtor—a tort creditor, for example—and so does not choose the terms upon which this is taken, has only brute luck at each stage. Whether that brute luck is good or bad depends on the arrangements in place in a given legal system concerning such claims.

The two cases considered in the last paragraph are straightforward. Here are some more difficult ones. First, consider the case of one who deliberately extends credit to the debtor, and who does so on terms that she chooses, which terms are later held by a court to be wholly or partly unlawful or invalid. Here, it seems that there is option luck in respect of the decision to extend credit, but something less than this in respect of the terms.[228] Next, consider the case of one who deliberately extends credit to the debtor, but

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[227] Indeed, it is arguable that such a creditor has only good option luck, whether or not she is repayed, having priced in the risk of default ex ante. While no part of the argument that follows turns on this characterization, I prefer not to embrace it fully. This is because things still seem to have gone better for creditor who is repaid than one who isn't, even where both priced in the relevant risk. And it seems natural to describe the difference between these two situations in terms of luck.

[228] The case of deliberately agreeing contractual terms known to be invalid, or known to be at risk of being held invalid, would, however, seem like deliberate gambling.

does so on terms that he did not read, for example, or did not have any choice in accepting, if he indeed was to extend credit, perhaps in making a sale. Once more, it seems that there is option luck in respect of the decision to extend credit. There may well be option luck in respect of the terms as well, but a richer concept of option luck would be required if such a description is to be offered in a more definite way.

Clearly some further explanation is required in order to account for these easily imaginable, but more challenging, cases. The first case is complicated by a lack of congruence between what the lender intends, and what the law permits. Such a lack of congruence may arise in different ways. A lender might intend to create a kind of security interest that the relevant law does not allow.[229] Similarly, loan documentation might provide for something more seriously unlawful, such as peonage upon a relevant event of default. The second kind of case is complicated by a lack of congruence between what a lender, albeit not a very attentive or powerful one, had in mind, and that intention the law of contract will attribute to her in interpreting the parties' agreement.[230]

Whether these are instances of brute or option luck will depend on whether the outcome—invalidity or certain terms—or, perhaps, the process by which the outcome is

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[229] eg *Ex p Jay* (1880) 14 Ch D 19; *Ex p Newitt* (1881) 16 Ch D 522; *Ex p Mackay* (1863) LR 8 Ch App 643; *Ex p Barter* (1884) 26 Ch D 510; British *Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 1 WLR 758 (HL) (invalidity); *Football Creditors* (n 199), *Re Spectrum Plus* [2005] UKHL 41, [2005] 2 AC 680; *Belmont Park Investments* (n X); *Money Markets Ltd v London Stock Exchange* [2002] 1 WLR 1150 (HC) (validity).

[230] I do not consider the application of rules concerning unfair terms in consumer contracts, and related doctrines.

arrived at, can be regarded as having been chosen. On the examples I have given, we might well wish to know whether the lender in question knew that the relevant security interest was unlawful or was liable to be held to be unlawful by a court. With respect to debt peonage we might be less interested in this, but only because of the very grave wrong in question. And concerning the inattentive lender, or the lender forced to 'take it or leave it' we might wish to know if that lender knew that contracts were usually enforceable according to their terms, even when unread and even when documents are signed without enthusiasm. With the relevant knowledge in place, we should have no hesitation in describing any resulting luck as option luck, and attributing responsibility on this basis.

If such knowledge cannot be established, then it may be that there are still reasons to treat a creditor as responsible in the relevant sense, on the basis that they ought to have been aware of certain matters, in spite of the fact that they may not have been. In such cases we are no longer considering what might be called actual knowledge, but rather constructive knowledge: knowledge that we consider the actor in question ought to have had. There is no scope for a detailed discussion of constructive knowledge or its various legal applications here, not least because the difficult issues in question are in no sense restricted to the domain of insolvency law. The constructive knowledge of which insolvency law must take account is, in the great majority of cases, that attributed by the

detailed rules of contract formation.[231] The law will, in some cases, recognise a contract where one party did not intent that a contract, or a contract on certain terms, arise. This is because a court looks not to a contracting party's subjective intentions in assessing the relevant legal questions, but rather assesses that conduct objectively.[232] The best justification for such rules will not align squarely with the notion of responsibility that is the focus of the current discussion. This is because these rules of contract formation—as rules of mandatory law—plausibly require justification drawing both on the autonomy of the contracting parties and on system-wide justifications for the law of contract, whereas responsibility of the kind under consideration looks only to matters of the former kind: to the moral consequences of the choices individuals make. For present purposes, then, I will do no more than note that responsibility may follow from both actual and constructive choices, but that the argument for regarding any particular occasion as involving constructive choice will depend on the analogy that can be drawn to cases of actual choice.

Before leaving the question of responsibility, I wish to pre-empt an objection that might be made based on a further suggestion that appears in Dworkin's work on equality of resources. Such an objection would point to the role that insurance plays in Dworkin's

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[231] Analogous questions may, however, arise in considering whether first-party insurance might have been taken to guard against some particular risk.

[232] Concerning the interpretation of contractual terms see *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749 (HL); *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 (HL) 912–913 (Lord Hoffmann). Other contexts in which such matters are relevant include offer and acceptance, and the intention to be bound: see generally HG Beale, *Chitty on Contracts* (33rd edn, Sweet and Maxwell 2018) [2-004], [2-171], [13-048].

theory, in particular to the way in which it provides a link between brute and option luck. Dworkin offers the following explanation:

> Insurance, so far as it is available, provides a link between brute and option luck, because the decision to buy or reject catastrophe insurance is a calculated gamble. Of course, insurance does not erase the distinction. Someone who buys medical insurance and is hit by an unexpected meteorite still suffers brute bad luck, because he is worse off than if he had bought insurance and not needed it. But he has had better option luck than if he had not bought the insurance, because his situation is better in virtue of his not having run the gamble of refusing to insure.[233]

If insurance provides a link between brute and option luck, so the objection might be put, then those liable to become tort victims or non-consenting creditors should take out insurance against the possibility that they would be imposed upon by a debtor who was, or subsequently became, insolvent. If this is so then in choosing not to take such steps, those who become creditors in such circumstances suffer as a matter of their poor option luck: they are responsible and ought to have insured. Insolvency and business failure are facts of life, and ones that often shift losses onto creditors.[234]

An objection of this kind rests on an analogy between the circumstances Dworkin describes in his article, and those of participants in a legal system, suffering legally

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[233] Dworkin, 'Equality of Resources' (n 220) 74.

[234] I do not consider whether or not an insurance policy of the kind the objection recommends would in fact be available, or available at any particular point in time. It is sufficient to make sense of the objection that certain first-party health insurance policies, for example, would provide a physical-harm tort victim with certain protection regardless of the solvency of the tortfeasor.

recognised wrongs and entering into legally recognisable contracts. It asserts the equivalence of failing to insure against a catastrophe that is in some sense pre-legal, or perhaps extra-legal—the meteorite strike—and one in respect of which the law has already determined wrongfulness and made a general injunction in favour of compensation. But it seems significant that in this second case one suffers a legal wrong, the failure to pay on a judgment, which judgment was, itself, part of the protection that law offered to all in respect of such wrongs. So the question is once more that with which we began the discussion of responsibility, that of whether that under consideration amounts to deliberately exposing oneself to a risk one 'should have anticipated and might have declined.'[235] And while this question will certainly earn a positive answer in certain cases, it is unlikely to do so always.

This objection and the response I propose point to a more difficulty practical problem in adapting Dworkin's ideas about brute and option luck to more concrete problems, including those concerning corporate insolvency law. In devising his theory of equality of resources, Dworkin uses the device of an imagined, pre-legal situation, in which individuals choose bundles of resources and insurance. Unsurprisingly, the misfortune against which one might insure in such circumstances is also pre-legal. I do not think that this undermines the general appeal of Dworkin's distinction between brute and option luck outside of such ideal circumstances. But it is also true that the distinction

[235] Dworkin, 'Equality of Resources' (n 220) 73.

appears, for present purposes, underdeveloped. I doubt that the distinction can be much further developed in general terms, for the question of whether one *should have insured* seems to me not to have a general answer outside of the particular circumstances in which it is asked. It seems to depend on social and institutional conditions, for a start, and on settled expectations about the consequences of certain events. Similarly, it seems not to depend entirely on the legality (or even criminality) of conduct that caused the loss. Compare, for example, the decision not to insure one's expensive bicycle in Oxford against theft, on the one hand, with the with the decision not to take (first-party) insurance against carelessness by one's doctor or legal advisor, on the other.

4.2. The consequences of responsibility

I have already suggested that responsibility is a morally relevant feature that attaches to certain deliberate choices and their consequences, concerning the person whose deliberate choice the choice in question was.[236]

Consider the following two possible views concerning the consequences of such responsibility, which I shall call *constitutive* and *neutral*:

[236] To emphasise choice in this connection follows GA Cohen's reading of Dworkin: Cohen (n 202).

> *Constitutive*: A person should not be made to bear the consequences of some disadvantage for which they are not responsible. Where they are responsible for some disadvantage, responsibility demands that they bear it.
>
> *Neutral:* A person should not be made to bear the consequences of some disadvantage for which they are not responsible. Where they are responsible for some disadvantage, responsibility gives no reason to relieve this disadvantage.

If Samuel is—in whatever sense is relevant, and following some just distribution to all—responsible for some disadvantage that sees him lose £10k, then the constitutive claim states that Samuel is treated justly in being made to bear that loss. It is not merely that the loss is not to be regretted on grounds of justice; the constitutive claim *requires* that it be suffered. The neutral claim, on the other hand, does not. It leaves room to regret his loss on other grounds, which may themselves provide reasons to relieve against the loss in spite of responsibility.

There are immediate reasons to reject the constitutive claim. The constitutive claim requires that individuals be made to bear losses and disadvantages for which they are responsible, as a requirement of distributive justice (and, on Dworkin's theory, as a requirement of equality). This has—to put it mildly—harsh implications. On this view those who smoke cigarettes, for example, would be treated justly in *not* receiving certain cancer treatment at public expense. Such consequences might be thought to amount to a reductio of the constitutive version of the responsibility that I have introduced in this section. Further, the constitutive claim implies that only those responsible for some loss

should bear it, the correctness of which claim cannot be assumed. The neutral claim has neither of these unappealing implications.

Moreover, the arguments defended so far in this chapter simply do not go as far as implying the constitutive claim. I have argued above that distributive justice requires certain capacities to hold and deal with legal rights to be had by all, in order that all may access a distributive share in a given community where the form that such distributions take is the legal form. Recall that I have left open the deeper questions of what is to be distributed and why. Some exercises of these capacities, and some other circumstances, can be said to engage a person's responsibility, but in many cases, too, it is clear that a person may suffer misfortune or achieve success as a matter of nothing more than brute luck, ie that for which a person is not responsible. It is far from clear that distributive justice, equality, or indeed any other value, requires a person to enjoy or suffer all those consequences for which they are responsible, and no part of the argument I defend in this thesis implies this. Instead, it seems more likely that a person has a claim to protection in cases of misfortune where their responsibility is not engaged, and that responsibility, concomitantly, can negate aspects of the prima facie concern we might have in respect of human misfortune or distributive injustice. And this, of course, just is the neutral claim.

It might be objected at this point that I have been speaking about the notion of responsibility, in this section, without reference to the ideal of equality which Dworkin, at least, argues is its proper ground. But this objection would be too quick, for my

argument simply connects distributive justice and responsibility, without the need to appeal to a further ideal, in part because of the assumption I have made concerning market systems and the way in which a distributive share is mediated by legal rights. If distributive justice requires the capacities I say it does, so that a distributive share may be held and dealt with, then it must also have the resources to explain which departures from a given distribution are justice-preserving and which are not.[237] And while responsibility does not provide anything like a complete answer here, it allows us to identify a subset of each. Generally speaking, those departures from a given distribution that are chosen are, as far as the choosing individual is concerned, justice-preserving. Unchosen departures, on the other hand, are not.

5. CONCLUSION

In this chapter I began by asking whose interests should be considered by corporate insolvency law, if corporate insolvency law is to express defensible principles of distributive justice. I claimed that on a range of prominent views, not just those affected by a particular insolvency procedure but also those who are participants in the economy of the state in question must be taken into account. I then considered the role that legal rights must play in any plausible theory of distributive justice, given certain

[237] The language of 'justice-preserving' steps draws on Robert Nozick: 'A distribution is just if it arises from another just distribution by legitimate means… Whatever arises from a just situation by just means is itself just': Nozick (n 116) 151.

circumstances characteristic of capitalist, market-based economies governed by law. In such systems, I claim, individuals must have, as a matter of distributive justice, the capacity to hold legal rights, and to deal with them in certain ways. Finally, I introduced the notion of responsibility, which, I claim, points to a limit upon our concern over what might appear to be departures from just distributions. According to the principle of responsibility, individual choices made under appropriate conditions, together with their consequences, need not be condemned by principles of distributive justice, even where these lead to a distribution that would otherwise be objectionable on such grounds.

V LEGAL RIGHTS IN INSOLVENCY

1. INTRODUCTION

In the last chapter I introduced the claim that in market systems, individuals owed justice must have the capacity to hold legal rights. The short argument I offered in support of this claim was an instrumental one: given that many distributions in justice in market systems take the form of legal rights, individuals should have the capacity to hold such rights if they are to be able to enjoy such distributions.[238] In the first part of this chapter I shall say more about this capacity, and elaborate and defend the further claim that this capacity is, in important respects, an equal capacity (section 2). I then offer an account of how departures from the equality that this capacity appears to require, other than those arising from personal responsibility, may be understood, and, where appropriate, justified. Finally, I evaluate a number of aspects of the statutory order of insolvency distribution under UK law, and comment on the justifiability of secured credit vis-à-vis certain constituencies (section 3).

[238] See IV.3. above

2. EQUALITY AND RIGHTS

2.1 Theories of (legal) rights

Rights play an important role in what follows, and some general comments are therefore required in order to clear the way for the argument to come. I have not yet said anything about particular rights that individuals might have, nor about what rights are, nor about what might ground them, in law, morality or otherwise. The first of these questions is a question about entitlements. I shall say more about these in the second part of this chapter. The second and third are questions for a theory of rights.

The dominant families of such theories are usually referred to as *interest* theories, on the one hand, and *will* theories, on the other. A well-known interest account is offered by Joseph Raz. Raz explains rights in the following terms:

> X has a right if X can have rights, and, other things being equal, an aspect of X's well-being (his interest) is a sufficient reason for holding some other person(s) to be under a duty.[239]

On Raz's account, then, where A has a right that B perform some action, B has a duty to perform that action. Such a duty is a peremptory reason for action, which is to say that it excludes some, but not necessarily all, other reasons concerning the action in

[239] Raz, *The Morality of Freedom* (n 226) 166.

question.[240] The duty is grounded in A's interests, and it is not a necessary condition for the existence of such a duty that A subjectively wishes that the relevant action be performed.[241]

A version of a will theory of rights is expressed in the following passage from Hart, which also assumes that a right in A is correlated with a duty in B:

> The idea is that of one individual being given by the law exclusive control, more or less extensive, over another person's duty so that in the area of conduct covered by that duty the individual who has the right is a small-scale sovereign to whom the duty is owed. The fullest measure of control comprises three distinguishable elements: (i) the right holder may waive or extinguish the duty or leave it in existence; (ii) after breach or threatened breach of a duty he may leave it 'unenforced' or may 'enforce' it … and (iii) he may waive or extinguish the obligation … to which the breach gives rise.[242]

The conflict between these two approaches to questions concerning rights becomes acute when it comes to questions concerning, for example, who can have rights, or whether all rights can be waived. Will theories, for example, seem to exclude infants and certain disabled persons from the class of rights-holders—such persons might be thought to lack the right kind of will—whereas interest theories do not. On will theories, the way seems

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[240] On peremptory and exclusionary reasons, see generally Joseph Raz, *Practical Reason and Norms* (Hutchinson 1975) 35ff.

[241] There will be many cases where A's wishes are relevant to B's duty: A may release B from performing some promised action, for example. I wish only to highlight that this need not always be so.

[242] HLA Hart, *Essays on Bentham: Studies in Jurisprudence and Political Theory* (Clarendon Press 1982) 183–4 (citations omitted).

clearer to arguing that all rights could indeed be waived, which conclusion some may wish to avoid. These and other related general-philosophical disputes are beyond the scope of this work, and I shall make no attempt to resolve them here. There are several reasons for this. First, my discussion of the rights at stake in corporate insolvency law will restrict itself to discussing *legal* rights, and certain features I say that such rights have or should have. This means that certain questions concerning purely moral rights will not arise.[243] Second, I think it likely that what I have called interest and will theories of rights neither diverge nor conflict over the limited domain that I shall consider. As such, I am able to offer an account that is, I hope, consistent with either theory. In doing so I assume that there are legal rights, and that legal rights and moral rights do not always coincide.[244] I take this approach to be uncontroversial.[245]

My discussion of rights, then, will involve a discussion of the capacity to hold rights, rights themselves, and the content of (particular) rights. The distinction between the latter two notions is, I accept, somewhat artificial, and involves a reification of the

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[243] This should not be confused with a very different claim: that no moral rights flow from the recognition of certain legal rights. Such a claim is very implausible indeed. To the extent that legal rights induce certain expectations, for example, it seems very likely that such expectations can have moral implications, whether or not the underlying legal rights are themselves justified all the way down.

[244] Dworkin, 'Taking Rights Seriously' (n 114) 185.

[245] This casts my account in the terms of some version of legal positivism. This is, however, primarily a matter of terminology. An anti-positivist theory of law such as Dworkin's, pursuant to which legal rights *are* a kind of moral right could be accommodated by recasting certain parts of my argument in different terms, without the need to advance substantively different claims: Dworkin, *Law's Empire* (n 4) 152; Ronald Dworkin, *Justice for Hedgehogs* (Belknap Press of Harvard University Press 2011) ch 19.

concept of a right, which may be more or less unnatural depending on context.[246] It makes little sense to speak of my right to vote in elections pursuant to relevant legislation,[247] or my right to free expression under the European Convention on Human Rights as split in this way:[248] as the holding of a thing, and that thing having a further predicate specifying a guarantee of permitted action, for example. But this is not always so, and such a distinction seems altogether less unnatural when it comes to assignable rights concerning proprietary and contractual entitlements. Here, I suggest, the fact *that I have a right* may be of interest without knowing exactly what that right is *to*.[249] And many of the rights at stake in corporate insolvency law are of just this kind. This distinction is drawn in order to structure the discussion that follows. To the extent that it proves unsustainable in particular cases or in general, it is not my intention to have anything of substance depend on it.

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[246] cf John Oberdiek, *Imposing Risk: A* Normative *Framework* (Oxford University Press 2017) 124.

[247] Representation of the People Act 1983 s 4

[248] Convention for the Protection of Human Rights and Fundamental Freedoms (European Convention on Human Rights, as amended) (ECHR) art 10

[249] To some extent, this reflects a distinction stated by Dworkin—that between 'abstract' and 'concrete' rights—as well as Waldron's idea that certain rights generate 'waves' of more specific duties: Ronald Dworkin, 'Hard Cases' in Ronald Dworkin, *Taking Rights Seriously* (new impression, Duckworth 1978) 93–4; Jeremy Waldron, 'Rights in Conflict' (1989) 99 Ethics 503.

2.2 Capacities and rights

2.2.1 The capacities to hold and deal with rights

In the last part I introduced a distinction, taken from Rawls, between the right to hold property, generally speaking, and the right to hold certain kinds of property. For Rawls, the first was a basic liberty and so protected under the first principle, and the second, something less basic. Rawls's distinction, I suggest, speaks in favour of the possibility of considering the capacity to hold certain rights quite apart from the rights that any person may in fact go on to hold.[250] In the passage quoted above, Raz begins the statement of what it is to have a right with the statement, 'X has a right if X *can* have rights'.[251] If the statement that X has a right is true, this entails that X can hold rights, and, insofar as is relevant, that X is the kind of thing that can hold rights. This much is obvious and, I think, analytically true. And it seems equally so whether the rights in question are moral or legal.[252]

All familiar, developed, liberal-democratic legal systems grant the capacity to hold legal rights broadly. There is no need to be a natural person, far less an English or Welsh one,

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[250] see HLA Hart, 'Rawls on Liberty and Its Priority' in Norman Daniels (ed), *Reading Rawls: critical studies on Rawls' A theory of justice* (Basil Blackwell 1975) 236.

[251] Raz, *The Morality of Freedom* (n 226) 166 (emphasis added).

[252] To avoid doubt, I do not mean to suggest that if X has a legal right then necessarily, X can have moral rights, or vice versa.

nor to enter England or Wales, to create legal rights under the law of England and Wales or to sue in the courts of that jurisdiction. Companies statutes provide for different kinds of artificial legal persons capable of holding rights, suing, and being sued. Doctrines of felony attaint, *mort civile* and outlawry[253]—each historical restrictions upon one's legal personality for all or certain purposes—have long since been abolished.[254] Indeed, it seems likely that the capacity in question is at least coextensive with legal subjecthood, and probably broader, depending on how that latter notion is fleshed out.

Those able to hold legal rights might well be glad of this capacity; after all, this capacity is what is needed if one is to do things with law.[255] Further, in familiar legal systems, our share of the community's resources—understood in the widest terms—is mediated by this capacity, as various components of this share are embodied in legal rights. If individuals are owed a distribution in justice, and the form such distributions usually take is the legal form, ie that of legal rights, then it follows that the capacity to hold such rights is required as a matter of justice. This has important implications. If certain

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[253] John Finnis, *Natural Law and Natural Rights* (Reprinted with corrections, Clarendon Press; Oxford University Press 1982) 189.

[254] The law of attaint created difficulties in the Australian colonies, for example, where it was unclear whether or not emancipated convicts could sue to enforce their rights, or be heard in court: Lauren Benton, *Law and Colonial Cultures: Legal Regimes in World History, 1400-1900* (Cambridge University Press 2002) 188; Bruce Kercher, *Debt, Seduction and Other Disasters: The Birth of Civil Law in Convict New South Wales* (Federation Press 1996) 59–65.

[255] I do not consider whether it is part of law's purpose to allow people to do things. Nor do I consider whether law, in fact, has a purpose. I assume, however, that it may be morally desirable that law permit people to do certain kinds of things, and I shall go on to claim that in certain circumstances, it may be morally required.

apparent departures from equality—however understood—are to be tolerated on the basis of responsibility in the way considered in the last chapter,[256] then a capacity to exchange and modify such rights in agreement with others is required. This is because if individuals are expected to go to the market to obtain what they need in order that certain of their vital interests be met, then they must be able to exchange the rights that they have for rights they would prefer to have, or which better meet their needs: my right to this money for your right to that medicine, for example.[257] I shall argue in the next sub-section that the capacity to exchange rights with others further requires that this capacity to hold and deal in legal rights be equal—that is to say, congruent—as among those who enjoy it.

2.2.2 Equal capacities: the idea

The capacities to hold and dispose of or exchange legal rights are morally significant. This is separate to the way in which the rights any person may in fact hold may be morally significant. The capacity to hold is required, where distributions of the community's resources are held as legal rights, so that a person may hold a share of the

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[256] See IV.4. above

[257] To avoid doubt, the capacity to exchange rights is not intended to map onto the idea of 'freedom of contract as understood by the doctrine of laissez-faire' mentioned in connection with Rawls's work: see IV.3. above. Instead, it is a capacity required, as a matter of distributive justice, in a market system, where distributive shares are mediated by legal rights: ibid. That such a capacity be conferred by law does not, without more, imply anything like an unrestricted (laissez-faire) freedom of contract.

community's resources. This share allows them to hold (part of) what distributive justice entitles them to have. Of course it goes nowhere near ensuring that the person with the capacity will enjoy their full distributive share.

The capacity to exchange is required if people are to determine for themselves how the resources they command are to be used, and be held to the consequences of those determinations, in accordance with the principle of responsibility.[258] It is also required if they are to attend to the wishes and needs of other people, including as different kinds of guardians, trustees and fiduciaries. Formal features of legal rights, including concerning their exchange, require that the relevant capacities are the same for all who have them. Put differently, they must be capacities to *do just the same thing*. This means that A is just as bound to her (validly concluded) contract with B as B is. It also means that A and B are just as bound as W and X are, where W and X are the parties to a contractual relationship to which A and B are not parties. This is because if the rights produced by exercises of different people's capacities were different, rights could not have a face value, or, to put in another way, stable deontic content. This last claim is required, I think, if the notion of an exchange of legal rights is to be made intelligible.[259] If this were not so, then rights could not do much of what they usefully do in legal

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[258] A system might, of course, refuse to confer such a capacity on individuals and leave the task of determining how all resources are to be used to the state. I do not consider such a possibility: Pashukanis (n 216) 61.

[259] Les Green makes a similar observation concerning the application and existence of legal rules: Leslie Green, 'The Germ of Justice' (Social Science Research Network 2010) SSRN Scholarly Paper ID 1703008 2 <https://papers.ssrn.com/abstract=1703008> accessed 7 March 2018.

reasoning, and in the economy; it might mean that legal rights could behave differently, legally speaking, depending on the hand that held them. Contracts and property would stick fast for some but slide from the looser grasp of others. I shall return to some of the special considerations associated with an equal capacity concerning certain kinds of property rights below.[260]

2.2.3 Equal capacities: justification

This is the beginning of a picture of legal rights as holdings in justice, the exigibility of which depends on the legally recognised features *as rights*, and not the features of a particular right-holder. Something like this is invoked by Rawls in the following passage:

> [The] impartial and consistent administration of laws and institutions, whatever their substantive principles, we may call formal justice. If we think of justice as always expressing a kind of equality, then formal justice requires that in their administration laws and institutions should apply equally (that is, in the same way) to those belonging to the classes defined by them. As Sidgwick emphasised, this sort of equality is implied in the very notion of a law or institution, once it is thought of as a scheme of general rules.[261]

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[260] See V.3.1. below

[261] Rawls (n 205) 51; Henry Sidgwick, *The Methods of Ethics* (8th edn, Macmillan 1963) 267.

Both Rawls and Sidgwick suggest that a certain equality—Rawls, among others, calls it 'formal justice'[262]—simply follows from what it is to administer laws or institutions. Both, however, acknowledge that this is a limited equality, and one compatible with very great injustice.[263] Sidgwick writes:

> So much equality, however, is involved in the very notion of a law, if it be couched in general terms: and it is plain that laws may be equally executed and yet unjust: for example, we should consider a law unjust which compelled only red-haired men to serve in the army, even though it were applied with the strictest impartiality to all red-haired men.[264]

And as much is true of the limited argument that I have advanced in this section. If individuals are to have a certain equal capacity to hold and deal with legal rights then this is only one feature of what justice may require that they have. It is a requirement, however, with important implications, not all of which have been widely noticed or explored. And as this equal capacity is justified instrumentally in terms of an individual's ability to hold and control a distributive share—whatever this turns out to be—then it both serves and might yield to more specific demands of distributive justice. This is of significance for the discussion that follows.

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[262] Green (n 259) 10–11; referring to HLA Hart, *The Concept of Law* (1st edn, Clarendon Press 1961) 161; Hans Kelsen, *Introduction to the Problems of Legal Theory* (Clarendon Press 1992) 16; David Lyons, 'On Formal Justice' (1973) 58 Cornell Law Review 833.

[263] The same criticism is offered by Hart against Fuller's 'internal morality' of law: Hart, *The Concept of Law* (n 262) 202; referring to Lon L Fuller, *The Morality of Law* (Rev ed, Yale University Press 1969).

[264] Sidgwick (n 261) 267.

It might be objected at this point that I have, contrary to my stated intentions, come down in favour of a particular conception of distributive justice. In claiming that under certain circumstances distributions take the form of legal rights I might be thought to impliedly adopt a theory of equality of resources, such as Dworkin's,[265] as an answer to this question. But this objection mistakes my limited claim for a wider one. The claim I must commit to here is that the distribution of legal rights—many of them to resources, presumably—matters for justice. I think this is obviously true, and cannot think of a plausible route to denying it, even if distributive justice were thought to require pure equality of welfare, which appears to be a non-resource metric. This is for the simple reason that the distribution of rights—and so resources—affects welfare. I do not claim, however, that legal rights are all that matters. As such, my suggestion remains compatible with a range of accounts of distributive justice, provided always my assumptions as to the way in which rights feature in legal systems hold good.

2.2.4 Equal capacities: the connection to the rule of law

It is also worth noting, at this point, the way in which the claims above reflect some of those considered in literature concerning the principle of the rule of law, or what Lon Fuller called law's 'inner morality'.[266] This literature considers what it is for law to

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[265] Dworkin, 'Equality of Resources' (n 220).

[266] See generally Fuller (n 263); John Gardner, 'The Supposed Formality of the Rule of Law', *Law as a Leap of Faith* (Oxford University Press 2012); Joseph Raz, 'The Rule of Law and Its Virtue', *The Authority of Law: Essays on Law and Morality* (2nd ed., Oxford University Press 2009); Paul P Craig,

succeed *as law*, ie at doing whatever it is that law does.[267] The rule of law requires, among other desiderata, that legal norms be cast with a degree of generality and clarity, that norm-subjects may know them at relevant times, and demands principles for the resolution of (apparent) conflicts between norms. Where the rule of law is honoured, the exercise of public power will, in a meaningful sense, be according to law: according to law, that is, rather than by caprice or lottery or unconstrained discretion.[268]

As should be obvious, that some legal system substantially observes the rule of law, or something like it, may not reveal all that much about the moral character of that legal system. The legal system of South Africa between 1948 and 1991, for example, may well have been tolerably rule-of-law compliant, all the while enforcing an opprobrious regime of apartheid.[269] Certain writers have suggested that rule-of-law compliance may promote, in some degree, some wider form of justice.[270] I do not pursue this possibility

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'Formal and Substantive Conceptions of the Rule of Law: An Analytical Framework' (1997) 21 Public Law 467.

[267] As explained above, I do not take a view on whether or not law has a purpose, or if it does, what that purpose might be: see V.2.2.1. above. I do, however, follow Gardner and Raz in thinking that whatever else law is, it is an instrument, and can, to this extent, be *put* to various purposes: Gardner, 'The Supposed Formality of the Rule of Law' (n 266) 211; Raz, 'The Rule of Law and Its Virtue' (n 266) 214–19.

[268] A distinction between 'formal' and 'substantive' conceptions of the rule of law is often drawn, usually by reference to an article by Paul Craig. I doubt that such a distinction is maintainable, for the reasons John Gardner has given. In any case, nothing turns on the distinction for the purposes of what follows. Craig (n 266); Gardner, 'The Supposed Formality of the Rule of Law' (n 266) 198–205.

[269] David Dyzenhaus, *Judging the Judges, Judging Ourselves: Truth, Reconciliation and the Apartheid Legal Order* (Hart 1998).

[270] HLA Hart, *The Concept of Law* (3rd edn, Oxford University Press 2012) 206.

here. I wish to point out, rather, that certain of these requirements of the rule of law are logically necessary features of law, where law is the chosen mode of government. Put differently, they are required, if law is to do anything for norm subjects.[271] If law is to be used in any way whatever to guide action, then it must have certain features. It must, at minimum, be capable of entering the minds of those whose actions it is supposed to guide at the relevant time, and of being understood. Where legal norms are in force, they will often confer legal rights. And if legal rights are to be of any use in legal reasoning or in the practical reasoning of norm subjects, and thus partake in this way of the rule of law, then they cannot undermine the conferring norm's generality, for the generality of the right is constitutive of the generality of the norm.

To speak of legal rights in this way is to understand such rights substantially in terms proposed by Joseph Raz, for whom '[a]ssertions of rights are typically intermediate conclusions in arguments from ultimate values to duties', or 'points in the argument where many considerations intersect and where the results of their conflicts are summarized to be used with additional premises when need be.'[272] He goes on to explain the advantages of such usage in the following terms:

> The fact that practical arguments proceed through the mediation of intermediate stages [ie through references to rights] so that not every time a

[271] Some writers deny that law need necessarily have such an effect on the practical reasoning of norm subjects: eg Scott Hershovitz, 'The Authority of Law' in Andrei Marmor (ed), *Routledge Companion to* Philosophy *of Law* (Routledge 2011).

[272] Raz, *The Morality of Freedom* (n 226) 181.

> practical question arises does one refer to ultimate values for an answer is … of crucial importance in making social life possible, not only because it saves time and tediousness, but primarily because it enables a common culture to be formed round shared intermediate conclusions, in spite of a great degree of haziness and disagreement concerning ultimate values.[273]

These passages concern rights generally, and in particular moral rights. But they are readily applicable to legal rights, on any broadly positivist view of what legal rights are.[274] If legal rights are not, in this formal sense, congruent, as I say they must be, then it is difficult to see how they could offer the practical advantages, particular that of abbreviation in certain kinds of reasoning, that Raz points to. As it happens, such usage is widespread in legal discourse.

2.3 Corrective Justice

The argument just advanced claims to explain certain very basic features of holding certain rights—contracting, and, by extension, claiming certain remedies in connection with these rights and contracts—in terms of the requirements of justice. It does so, in particular, in terms of distributive justice. This approach shares certain important features with what would appear to be a radically opposed account of the private law of (at least) common law jurisdictions in terms of the Aristotelian idea of corrective

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[273] ibid.

[274] I do not mean to suggest, here, that (positive) legal rights are always intermediate conclusions in the manner described; many are not, including many connected to specific legal norms. An order to pay Jones £2m, for example, is not usually intermediate in this way. This changes, of course, if the company ordered to pay Jones the money enters insolvency proceedings.

justice.[275] A brief consideration of these ideas will bring out the distinctiveness of the claims I am seeking to make.

Writers including Ernest Weinrib have sought to make sense of the law of contract, tort and unjust enrichment, in common law jurisdictions at least, in terms of corrective justice. In book 5 of the *Nicomachean Ethics*, Aristotle explains corrective justice as a form of justice opposed to distributive justice, which restores parties to the position of notional equality which proceeded some wrongful interaction; that is, an injustice.[276] The notion of injustice, on such a theory, does not have any particular content, and simply stands for whatever it is that disturbs the normative baseline that obtained as between the parties, at some point in time, prior to some relevant interaction.[277] As John Gardner explains, '[a] norm of corrective justice is a norm that regulates (by giving a ground for) the reversal of at least some transactions.'[278] Weinrib explains the distinction between corrective and distributive justice in the following terms:

> Corrective and distributive justice embody categorically different structures of justification. Corrective justice links the doer and sufferer of an injustice

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[275] Ernest J Weinrib, *The Idea of Private Law* (Harvard University Press 1995); Ernest J Weinrib, *Corrective Justice* (Oxford University Press 2012); Ernest J Weinrib, 'Corrective Justice in a Nutshell' (2002) 52 The University of Toronto Law Journal 349; Jules L Coleman, *Risks and Wrongs* (Cambridge University Press 1992); cf John Gardner, 'What Is Tort Law For? Part 1. The Place of Corrective Justice' (2011) 30 Law and Philosophy 1.

[276] see generally Gardner, 'What Is Tort Law For?' (n 275) 8–10; Finnis (n 253) 177–184 (referring to 'commutative' justice); Aristotle, *Nichomachean Ethics*, V 2-5 1130al4-1133b.

[277] Robert Stevens, *Torts and Rights* (Oxford University Press 2007) 327; Peter Cane, 'Distributive Justice and Tort Law' [2001] New Zealand Law Review 401.

[278] Gardner, 'What Is Tort Law For?' (n 275) 10.

> in terms of their correlative positions. Distributive justice, on the other hand, deals with the sharing of a benefit or burden; it involves comparing the potential parties to the distribution in terms of a distributive criterion… The consequence of this contrast between corrective and distributive justice is that no distributive consideration can serve as a justification for holding one person liable to another. The correlative structure of liability entails the irrelevance of any factor that is normatively significant only because of its possible role in a distributive comparison. For purposes of justifying a determination of liability, corrective justice is independent of distributive justice.[279]

Understood in this way, corrective justice abstracts from the parties and their circumstances, and considers only those matters concerning the relevant injustice, by which they are related.[280] As such, the facts that a wrongdoer is impecunious and a victim fabulously wealthy are both ruled out of bounds in analysing their interaction in terms of corrective justice. Only relevant is the fact that wrongdoer wronged the victim, which situation must—in somewhat abstract, normative terms—be undone.[281] As much is reflected in the structure of the law of torts in common law systems, for example: the law of torts embodies corrective justice as between parties to a suit in demanding that tortfeasors compensate their victims for the wrong they have suffered. And it is usual to

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[279] Weinrib, 'Corrective Justice in a Nutshell' (n 275) 351.

[280] Distributive justice, of course, also abstracts in this way, and for the same reasons; the only difference is that it abstracts different information. This casts further doubt upon Weinrib's distinction.

[281] I do not mean to suggest that all wrongs can be undone by compensation or court order. Clearly a great many, including death or injury, but also failure to perform on time, cannot. On Weinrib's account, however, an order for compensation redresses the normative—rather than factual—inequality between parties to an injustice, which inequality the injustice introduced. Weinrib writes: 'Just as when the equality of corrective justice is disturbed, one person's gain necessarily entails another's loss, so the doing of injury by one entails the suffering of injury by another. The correlativity of gain and loss supervenes on the correlativity of one person's doing and another's suffering harm.' Weinrib, *The Idea of Private Law* (n 275) 64–5.

explain the relevant wrong in terms of the victim's legal rights—attached to but intelligible quite apart from her legal personality—guaranteed through public institutions and, ultimately, the coercive power of the state, pursuant to which a judgment may be executed or an order enforced. This much, at least, is consistent with the picture of legal rights that I am seeking to develop.

Having briefly explained *how* corrective justice might be done, it is also worth considering why this might be thought desirable, particularly in the light of some puzzling suggestions in the literature. Taking the law of torts as his example, Weinrib enthusiastically resists the imputation of 'external' ends to the regulation of private law relationships, which imputation would be at odds, on his view, with that department of law's instantiation of corrective justice.[282] To argue over private law—and connected legal rights—in terms of distributive justice would be to introduce considerations 'alien' or 'extrinsic' to the 'form of the private law relationship', and should therefore be avoided.[283] A suggestion such as this leaves us with something approximating the vacuous claim that the private law does corrective justice, when it does, because that is what private law is: a mechanism for the doing of corrective justice. This set of claims seems not to state a valid argument: the inference from 'the law does corrective justice', to 'there *ought* to be corrective justice done' is not explained. But I do not wish to pursue this possibility, which may turn on the accuracy of my paraphrase, or on my assumption

[282] ibid 4.

[283] ibid 75; Stevens (n 277) 325.

that such an argument is intended. It is sufficient to observe that even if this or some similar argument could stand on its own terms, it would give no guidance at all as to when corrective justice should be done and what its proper domain might be. Put against those in favour of a New-Zealand-style accident compensation scheme that might replace part the law of torts in England and Wales,[284] or anywhere else, the claim that the new compensation scheme just wouldn't be corrective justice would seem entirely without purchase.[285]

2.4 Corrective justice: the continuity thesis

An alternative to Weinrib's view is proposed by John Gardner.[286] Instead of conceiving of legal norms of corrective justice in terms of their own 'immanent rationality',[287] Gardner suggests that a justification of such legal norms may be offered in terms of similarly structured moral norms of corrective justice.[288] Gardner seeks to demonstrate the structure of such moral norms by reference to a number of prosaic examples: a catalogue of sometimes mundane but morally significant daily failures that seem, in each case, to ground obligations of repair. These are the parent's obligation, say, to take his

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[284] Accident Compensation Act 1972 (NZ), Accident Compensation Act 2001 (NZ).

[285] Weinrib must, therefore, be driven to concede that there is no reason at all, and certainly no reason of justice, to do or secure corrective justice in such cases: cf Matthew Kramer, 'Justice as Constancy' (1997) 16 Law and Philosophy 561.

[286] Gardner, 'What Is Tort Law For?' (n 275).

[287] Weinrib, *The Idea of Private Law* (n 275) 206.

[288] Gardner, 'What Is Tort Law For?' (n 275) 25.

child for a substitute treat when a promised outing is missed, however good the excuse.[289] The relationship between the relevant failure and the resulting repair obligations is cast in terms of what is called the 'continuity thesis'.[290] According to the continuity thesis, reasons to perform a primary obligation—to perform on a promise, the duty to provide for one's child, to express friendship to one's friends, or whatever—may survive one's failure to perform that obligation, and in doing so give reasons to provide next-best satisfaction—a secondary obligation.[291] Reasons, here, are normative considerations counting in favour of, or against some action, that may be compared in terms of their weight.[292] As Gardner explains:

> [The relevant] reasons, not having been satisfied by performance of the primary obligation, are still with us awaiting satisfaction and since they cannot now be satisfied by performance of that obligation, they call for

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[289] An excuse, here, is meant to contrast with a justification. On this distinction see John Gardner, 'Justifications and Reasons', *Offences and Defences: Selected Essays in the Philosophy of Criminal Law* (Oxford University Press 2007).

[290] Gardner, 'What Is Tort Law For?' (n 275) 33; see generally Joseph Raz, 'Personal Practical Conflicts' in Peter Baumann and Monika Betzler (eds), *Practical Conflicts: New Philosophical Essays* (Cambridge 2004).

[291] In unpublished work Frederick Schauer suggests that courts do not attend to this 'moral residue' of unmet reasons to any significant extent, at least in cases involving deprivations of Hohfeldian liberties (such as the 'rights' to speak freely, or to associate freely, and so on). He notes that there seems to be an exception in cases involving the deprivation of property rights by the state. This argument does not directly challenge the claims I make in this chapter. This is because most of the rights of which I consider the deprivation in an insolvency context are not Hohfeldian liberties, but rather Hohfeldian rights in the strict sense: claims upon others concerning some action, usually the payment of a sum of money. As such they are directly analogous to the property cases Schauer considers: Frederick Schauer, 'Rightful Deprivations of Rights' (2019).

[292] Reasons, in this discussion, may be understood simply as considerations that count in favour of something, or against it: Thomas Scanlon, *What We Owe to Each Other* (Belknap Press of Harvard University Press 1998) 17; Derek Parfit, *On What Matters* (Oxford University Press 2011) vol 1 pt 1.

> satisfaction in some other way. They call for next-best satisfaction, the closest to full satisfaction that is still available. We need to know the rationale of the obligation, of course, so that we can work out what counts as next best. But once we have it we also have the rationale, all else being equal, for a secondary obligation, which is an obligation to do the next-best thing.[293]

The idea, here, is offered in very general terms, and it seems likely that rather than a single continuity thesis, a range of continuity theses might be formulated, fastening on different aspects of a relevant situation that can be said to continue in the relevant sense. In unpublished work, Sandy Steel considers three such theses, which he calls *duty*, *reason* and *right* continuity, in connection with compensatory duties in private law. Where A culpably harms B, duty continuity posits that A must compensate B because A is, in some sense, still bound by the duty not to harm B. Reason continuity posits 'that the reasons which grounded the duty breached continue to demand conformity post-breach and that compensation is often the next-best way of conforming to those reasons.'[294] Finally, right continuity would ground A's compensatory obligation on B's right not to have been injured as he was.[295] The version of the continuity thesis I shall make use of below is nearest to what Steel calls reason continuity. As I shall explain, however, duty or right continuity might be used just as easily, for certain complications that arise in the context of private law compensatory obligations, or indeed concerning merely moral obligations of compensation, do not arise in the insolvency law context.[296]

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[293] Gardner, 'What Is Tort Law For?' (n 275) 33.

[294] Sandy Steel, 'Compensation and Continuity' (2019).

[295] ibid. On a Hohfeldian view, duty and right continuity are of course opposite sides of the same coin.

[296] These are the focus of Steel's paper: Steel (n 294).

The idea I require for the argument to come is a straightforward one: that certain reasons survive specific instances of non-conformity and in so doing continue to call for satisfaction. Plainly not all reasons are like this, in particular those which, due to the passage of time or the occurrence of some event, are no longer susceptible to conformity. My reason to attend a particular concert last Tuesday does not persist if I fail to attend the concert,[297] for there is no longer any concert to attend. Some of the more abstract reasons that, as a prior matter, gave me the reason to attend the concert may of course persist in the relevant sense. My interest in and the pleasure I and my family take from the music of Björk or Dvořák may give me relatively precise reasons to seek out and attend another concert even once the day of a possible outing has passed, for these more general reasons may be satisfied by a wider range of actions, commensurate with their generality. This much is sufficient for the argument to come.

Whatever the particulars of the most appealing version of the continuity thesis, it is clear that the law may express, specify, or reinforce the moral norms of corrective justice that the continuity thesis prescribes. But, as Gardner argues, there is nothing automatic or direct about this relationship. Legal norms of corrective justice, even where they coincide with moral norms, in no sense simply follow directly from such norms. This is because even in the light of relevant moral norms, there remain questions of whether to subject

[297] The same is true if I do attend the concert.

the relevant domain to regulation by law; if so, of what kind or regulatory response to prefer; if this response is to erect legal norms of corrective justice, then of the form such norms should take, given the interests at stake and the cost of administering corrective justice according to law. And some of these factors give rise to their own, particular, allocative, problems that are themselves problems of distributive justice.[298]

2.5 Corrective justice as legal justification

The combination of a corrective-justice-derived account of private law has been enthusiastically embraced by some private lawyers. It is, for example, the basis of certain arguments advanced by Robert Stevens.[299] In his *Torts and Rights*, Stevens explains the relationship between rights and remedies in these terms. Specifically, he considers why it is that that courts, very often, do not enforce primary rights; they offer, instead, something secondary or second-best:

> The usual reason why the remedy the claimant seeks is not specific enforcement of the primary right is temporal: it is too late. After a careless driver has run me over, it is too late to grant an injunction. The wrong generates a new right exigible only against the wrongdoer… In theory, the law could adopt almost any secondary obligation as a response to the wrong. A trespasser could have his hands cut off, or a slanderer could be required to be locked in stocks and publicly humiliated. We would today consider these responses to be inappropriate. The 'best' thing to have occurred would have been for the right not to have been infringed at all. Where the wrong

[298] John Gardner, 'What Is Tort Law For? Part 2. The Place of Distributive Justice' in John Oberdiek (ed), *Philosophical foundations of the law of torts* (Oxford University Press 2014).

[299] Stevens (n 277) ch 4.

> has been committed, the secondary obligation to pay money imposed upon the wrongdoer can be seen as the law's attempt to reach the 'next best' position to the wrong not having been committed by him in the first place.[300]

It is the continuity thesis that explains why the pillory or mutilation would be an inappropriate response *in tort*, and why paying (special) damages would be better.[301] On any plausible account of the reasons for the law's recognition of rights to bodily integrity protected by the law of torts, these persisting reasons are better met, after the tort has been committed, by ameliorating the harm the tort has occasioned, than by inflicting gratuitous punishment on the tortfeasor. (There may, of course, be other departments of the law that do this; many torts are, or can be, criminal offences or grounds for professional disciplinary action.)

Stevens does not consider the range of distributive considerations to which Gardner draws attention. Instead, he takes as his starting point certain (legal) rights that the law does recognise, and restricts himself to considering how the law does and should protect those rights. Having embraced the continuity thesis, he does not offer an answer to the question: 'when should corrective justice be done *by law*?' And he is right not to, for the answer to this question can only be offered in terms of values external to corrective justice, distributive justice among them.[302] By not offering an answer to this question, however, he cannot say whether or to what extent corrective justice should be done once

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[300] ibid 59 (citations omitted).

[301] I do not consider any issues concerning general damages.

[302] Gardner, 'What Is Tort Law For? Part 2. The Place of Distributive Justice' (n 298) 339.

one party to an injustice is insolvent and also subject to other claims. Nonetheless, in an article considering proprietary remedies in the law of restitution, Stevens offers the following explanation of the persistence of (formally) proprietary rights where a debtor enters insolvency proceedings:

> Say I forgetfully leave my umbrella on the premises of a business. The next day I discover that the business has gone into bankruptcy. I return and ask for my umbrella back. The trustee refuses to hand it over, claiming that it is valuable and must be sold with the proceeds distributed to the general body of creditors. Does this raise a question of priorities? No. It is my umbrella. I have better title to it than does the business… Colloquially, the umbrella is mine, and that is the end of it.[303]

It is, of course, technically true that there is no question of priorities here. This is because proprietary interests, as a matter of English liquidation law, do not have priority in insolvency proceedings, but rather stand outside of them.[304] This being so, Stevens's umbrella theory is no more than an explanation of what it is that the law happens to do, and does not give any reason to favour such arrangements. The nearest Stevens comes to offering such reasons comes in the following passage:

> Where the defendant is in bankruptcy proceedings … allowing the judge to create rights that will afford the plaintiff priority when the plaintiff had no such entitlement beforehand is profoundly wrong. Legislatures have laid down codes for the distribution of a bankrupt's assets. These codes allow for the protection of certain kinds of creditors… It runs flatly contrary to principle to allow judges to arrogate the power to create by court order new

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[303] Robert Stevens, 'When and Why Does Unjustified Enrichment Justify the Recognition of Proprietary Rights?' (2012) 92 Boston University Law Review 919, 935 (citation omitted).

[304] See II.2.3. above

> rights for the protection of particular creditors upon bankruptcy – *rights that did not exist before*.[305]

If the reason to respect umbrella rights is that they existed prior to the commencement of insolvency proceedings, then it is difficult to see how umbrella rights are different to other rights to be paid. Such rights almost always pre-date the opening of insolvency proceedings and may be vulnerable to legal challenge if they do not. Indeed, the law is hostile to attempts to create new rights on or after the commencement of insolvency proceedings.[306] On this reading, the umbrella theory is vulnerable to the same scheme of objections—especially those concerning incompleteness—put in response to proceduralism above.[307]

2.6 The place of distributive justice

Some aspects of the theory are, however, of more general significance. While quick, the broad thrust of Stevens's argument is familiar. Certain reasons are appropriate for judges to rely upon, and others are not. These limits are usually said to be justified in terms of some or all of the following matters: the lack of democratic accountability of

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[305] Stevens (n 303) 934 (citations omitted, emphasis added).

[306] eg *Ex p Mackay* (1863) LR 8 Ch App 643; *Ex p Jay* (1880) 14 Ch D 19; *Ex p Newitt* (1881) 16 Ch D 522; *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 1 WLR 758 (HL); *Mayhew v King* [2011] EWCA Civ 328; *Belmont Park Investments v BNY Corporate Trustee Services Ltd* [2011] UKSC 38, [2012] 1 AC 383. See generally HC Tait, *The Anti-Deprivation Principle* (MPhil thesis, University of Oxford, 2016).

[307] See II.4.2. above

judges, the position of courts vis-à-vis the legislature in a constitutional order, the epistemic or technical limitations of common-law adversarial procedures, or judges' lack of public-policy or moral expertise. I do not offer a view on the strength of any of these suggestions, which are in any case very general ones.[308] I note only that even taken at their strongest, they do not, first, propose to limit legislatures as to the scheme of insolvency (bankruptcy) law that might be arrived at, nor do they, second, offer guidance to judges who must resolve 'hard cases' whether they wish to or not. Stevens and others making such arguments presumably see that there could be no objection to the legislature pursuing distributive justice in designing such rules. But they fail to notice, as John Finnis has observed, that 'the submission of an issue to the judge itself creates a kind of *common* subject matter, the *lis inter partes*, which must be allocated between the parties'.[309] Such allocation, of course, just is a matter of distributive justice, and is in all cases unavoidable.

Finnis writes, of such decisions, that '[t]he biased or careless judge violates distributive justice by using an irrelevant criterion (or by inappropriately using a relevant criterion) in apportioning the merits'.[310] I wish to advance two claims, consistent with Finnis's observations. The first is that corrective justice according to law is sometimes what distributive justice requires. This is little more than a reframing of the argument

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[308] eg Jeff King, *Judging Social Rights* (Cambridge University Press 2012) pt 2.

[309] Finnis (n 253) 179.

[310] ibid.

defended earlier, pursuant to which an account of distributive justice, sensitive to personal responsibility, may authorise apparent or ex post inequalities. Where not only the holding of a distributive share but also personal responsibility is institutionalised by way of a system of legal rights, then dealing in rights can only make sense if these rights can be considered in a manner that abstracts from those who hold them and whatever their a priori claims in distributive justice might be. If part of what individuals are owed in justice is the capacity to make themselves responsible by dealing with legal rights in particular ways, then the mechanisms of such exercises of responsibility—the mechanisms of enforcing deals, correcting abuses within contractual relationships, and so on—should not be such as to render individual decisions without consequence. And this would be the effect if each dispute brought before a court were treated as an occasion for doing distributive justice afresh. On this basis we may support a system of regulating certain kinds of interactions between individuals, substantially in terms of corrective justice. So if a judge were to decide, in circumstances where A and B are responsible for some transaction in the relevant sense, that A, because poorer than B, need not pay B as agreed, it would be arguable that the judge had acted in a distributively unjust manner in failing to do corrective justice.

The second claim is that corrective justice provides no account of how to resolve genuine conflicts between competing legal rights. And so it is equally true that, 'the biased or careless judge violates distributive justice' in doing corrective justice outside of circumstances in which this is what distributive justice requires. In referring to competing legal rights I mean to refer to only a subset of what is sometimes called the

'problem of entitlement'.[311] The problem of entitlement concerns the allocation of legal rights in the light of directly competing interests: the interest in quietly enjoying one's flat and another's interest in operating noisy industrial machinery in the workshop downstairs, for example.[312] Here, upstairs and downstairs have competing interests, which conflict the law must settle: the law must determine whether and to what extent there is an injustice in play. Such problems may be analysed in terms of distributive justice, but are not of present concern. The conflicts I wish to consider, rather, are those where there are multiple *parallel* claims upon a finite resource, which claims exceed that resource's value or are inconsistent with its nature. Claims upon an insolvent estate exceeding that estate's value involve such conflicts. So too, do competing claims to trust property where property subject to different trusts has been combined and also depleted by an insolvent trustee.

What, then, is the normative structure of such conflicts? Where the ordinary 'entitlement' problem sketched above involved the setting of a normative baseline in respect of which corrective justice might be done between A and B, the conflicts under consideration involve not the determination of the relationship between C and the debtor or defalcating trustee—C has an acknowledged right to be paid (or to the performance of the trust)—but the determination of C's relationship with X, who also

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311 Guido Calabresi and A Douglas Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85 Harvard Law Review 1089, 1090.

312 Such problems are considered in RH Coase, 'The Problem of Social Cost' (1960) 3 The Journal of Law and Economics 1.

has a right to be paid (or to the performance of the trust). C and X are not parties to one and the same injustice. Neither owes anything to the other in terms of the debt or trust obligations in question. The corrective injustices, here, are contained within the individual relationship each has with the defaulting debtor or trustee. As such, the conflict between the rights of C and X, to the extent that it arises, falls to be resolved by some other principle or principles of distributive justice. Finnis has suggested that 'the whole idea of bankruptcy law is to make … an adjustment between commutative [ie corrective] and distributive justice in the peculiar circumstances of insolvency.'[313] I do not wish to put the claim as strongly as this. But Finnis's observation directly identifies a vitally important question: that of the proper basis for making such adjustments.

Finnis does not, unfortunately, consider this question at any length. He does, however, provide a number of suggestions. In a part of *Natural Law and Natural Rights* that takes bankruptcy law as case study for the application of principles of justice, he writes:

> [B]ankruptcy law both gives effect to the commutatively just claims of the insolvent's creditors and at the same time subjects all those claims to a principle of distributive justice[.] Bankruptcy law pools all the claims, and … thus departs radically from the fundamental principle of Robert Nozick's 'historical entitlement' theory of justice[.] For if a creditor enforces his commutatively just claim … and thereby swallows up the wherewithal for satisfying any of the equally just claims of other creditors, the situation that has 'arisen' cannot … be properly regarded as 'itself just'.[314]

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[313] Finnis (n 253) 191.

[314] ibid 188 (citations omitted).

He goes on to give the following account of *pari passu* distribution among general creditors:

> [A]s between all the ordinary [ie general] creditors … 'equity is equality'. The debts they prove are paid to them *pari passu*… This is, then, another instance of the 'geometrical' equality which, as apposed to 'arithmetical' equality, is (as Aristotle said) characteristic of distributive justice. In other words, within this class of creditors, the criterion of distributive justice is: 'to each according to his (legally recognized) claim upon the debtor in commutative justice'.[315]

What count, then, for the purposes of a distribution that is to be made in insolvency, are the underlying legal claims (arising as a matter of corrective justice or otherwise) held against a debtor. And when the legal nature of such claims is equivalent, then so too is the treatment they ought to be accorded in an insolvency distribution, according to Finnis's argument. I have argued as much already, in terms of distributive justice. However, differential treatment *may* be warranted where different kinds of legal entitlements are in competition, as is the case when a secured creditor and general creditors compete for the same pool of value. This I consider in the next section, where I claim that, consistent with my argument thus far, this, too, should be considered in terms of the demands of distributive justice.

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[315] ibid 190 (emphasis in original).

3. DIFFERENTIAL TREATMENT

In the first part of the chapter I sought to explain and justify an entitlement to equal treatment on the basis of equivalent legal rights, and to situate this within the minimal schema of distributive justice through which my argument has been brought. In this section I seek to offer a normative framework that will allow differential treatment to be considered, this too in terms of distributive justice. By differential treatment I mean instances where the law treats different groups of claimants on an insolvent estate in a manner that is not the same. There is differential treatment, for example, as between secured and unsecured creditors, and as between unsecured creditors the law treats as preferential and those it does not. In seeking a justification for differential treatment I consider those circumstances in which this may be normatively desirable. A final section, below, will briefly consider parts of the insolvency 'waterfall';[316] that is, the distribution rules that rank claims where distributions are to be made under English corporate insolvency law.

In beginning to consider the appropriateness of the differential treatment of claims by insolvency law by reference to the framework I propose, the first thing to notice is that no argument I have made concerning distributive justice prohibits differential treatment of creditors whose entitlements have legally different features. What it prohibits, rather,

[316] See V.4. below

is comparing claims in respects unconnected to legal rights. The different kinds of legal rights or interests that can be created in a legal system depend on the positive law of that legal system, and systems vary considerably in the kinds of interests that they recognise. Until relatively recently, for example, many common law jurisdictions differed from many civilian jurisdictions in that they facilitated the holding of legal title to property for the benefit of another or for a charitable purpose without this arrangement requiring the creation of a new legal entity; that is, they provided for the legal form known as the trust.[317] I doubt that anything general can be said about the abstract justice of such differences.

3.1 Allocation and the *numerus clausus* principle

In determining whether some legal system should recognise or give effect to some particular kind of property right—whether an 'inalienable fee simple',[318] a proprietary right to the proceeds of a bribe received in breach of fiduciary duty,[319] or to a novel

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[317] There is now a developing civilian law of 'trusts': Maurizio Lupoi, 'The Civil Law Trust' (1999) 32 Vanderbilt Journal of Transnational Law 967; Marius J de Waal, 'A European Law of Trusts' in Antoni Vaquer Aloy and Reinhard Zimmermann (eds), *European Private Law Beyond the Common Frame of Reference: Essays in Honour of Reinhard Zimmermann* (Europa Law 2008); Alexandra Braun, 'The Framing of a European Law of Trusts' in Lionel Smith (ed), *The Worlds of the Trust* (Cambridge University Press 2013).

[318] Edward Jenks, 'An Inalienable Fee Simple?' (1917) 33 Law Quarterly Review 11.

[319] Katy Barnett, 'Distributive Justice and Proprietary Remedies Over Bribes' (2015) 35 Legal Studies 302.

security arrangement[320]—considerations of distributive justice fall to be considered. This is because such a determination is allocative. More concretely, this reflects the fact that rights recognised within a legal system as formally proprietary are of much wider exigibility than many other merely personal or contractual rights; they are, it is usually said, exigible against the world at large.[321]

That the recognition of new kinds of rights gives rise to questions of distributive justice is, if not positively recognised, at least consistent with the way in which such questions are approached in certain jurisdictions as a matter of positive law. It is common for legal systems to restrict individuals' ability to craft novel kinds of interests, especially where the creation of such interests may bind or affect third parties. Interests are most likely to bind or affect strangers to their creation where they are formally proprietary in nature; that is, where they arise in connection with some particular thing or collection of rights. In Germany and France, for example, rights *in rem* are said to be restricted to a closed

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[320] Sarah Worthington, 'Making Sense of Arguments about the Anti-Deprivation Rule' (2010) 8 International Corporate Rescue 26; Sarah Worthington, 'Insolvency Deprivation, Public Policy and Priority Flip Clauses' (2010) 7 International Corporate Rescue 28; Sarah Worthington, 'Good Faith, Flawed Assets and the Emasculation of the UK Anti-Deprivation Rule' (2012) 75 The Modern Law Review 112.

[321] The question of what makes a right, in whatever sense, *proprietary*, will not be considered here. It is, however, the subject of a considerable literature: eg AM Honoré, 'Ownership' in A Guest (ed), *Oxford Essays in Jurisprudence, First Series* (OUP 1961); AM Honoré, 'Rights of Exclusion and Immunities against Divesting' (1959) 34 Tulane Law Review 453; JW Harris, *Property and Justice* (Clarendon Press 1996) 139–162, 169–71; James E Penner, 'The Bundle of Rights Picture of Property' (1995) 43 UCLA Law Review 711; Henry E Smith, 'Property as the Law of Things' (2012) 125 Harvard Law Review 1691; Thomas W Merrill, 'Property and the Right to Exclude' (1998) 77 Nebraska Law Review 730; Simon Douglas and Ben McFarlane, 'Defining Property Rights' in James Penner and Henry Smith (eds), *Philosophical Foundations of* Property *Law* (OUP 2013).

list—a *numerus clausus*—as they were in Roman law.[322] This restriction is known as the numerus clausus principle (NCP). And while no such formal principle is to be found in the positive law of England and Wales, some writers have argued that certain restrictive tendencies in English property law are best explained and justified on this basis, at least when it comes to legal rather than equitable proprietary rights.[323]

A range of possible justifications for some kind of NCP have been advanced in the literature, and these express the concern for the effects of new kinds of property rights on third parties in different ways. Thomas Merrill and Henry Smith argue, from an economic perspective, that:

> [I]diosyncratic property rights create a common pool problem. The marginal benefits of the idiosyncrasy are fully internalized to the owner of the property rights, but the owner bears only a fraction of the general measurement costs thereby created… Consequently, since an individual's interest in creating the non-standard right … is less than the additional measurement costs imposed on the other market participants, there is a rationale for the law to prohibit the creation of this kind of idiosyncratic right.[324]

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[322] See generally Bram Akkermans, *The Principle of Numerus Clausus in European Property Law* (Intersentia 2008). Concerning the law of France, some doubt on this point has been expressed following the decision of the third civil chamber of the Cour de Cassation in the *Maison de Poésie* decision (28 January 2015). However, while that decision arguably does recognise a novel kind of right *in rem*, the Court expressly does so 'sous réserve des règles d'ordre public' ('subject to rules of public policy'). This being so, the numerus clausus principle (NCP) argument holds, albeit in a weaker form. Concerning the law of Germany, a similar argument is available given the provisions in the Federal Constitution concerning property: see Grundgesetz (Germany) art 14.

[323] eg Ben McFarlane, 'The Numerus Clausus Principle and Covenants Relating to Land' in Sue Bright (ed), *Modern Studies in Property Law: Volume 6* (Hart 2011).

[324] Thomas W Merrill and Henry E Smith, 'Optimal Standardization in the Law of Property: The Numerus Clausus Principle' (2000) 110 Yale Law Journal 1, 32–3.

They go on to conclude that 'the *numerus clausus* strikes a rough balance between the extremes of complete regimentation and complete freedom of customization'.[325] Ben McFarlane has argued, from a more conventionally doctrinal perspective, that some form of NCP limits common law (ie rather than equitable) property rights, and that this position may be defended on liberal grounds.[326] He argues that this is because the creation of new property rights—and, by extension, new kinds of property rights—imposes new duties on all persons,[327] and that the imposition of new duties on others—and, I extrapolate, the possibility of so doing—is destructive of freedom when it occurs without the consent of the duty-bearer.[328] For present purposes, there is no need to consider the detail of these arguments concerning the NCP. It is sufficient to note these writers' focus upon the system-wide consequences of the recognition of particular kinds of property rights, which is consistent with my claim that such determinations should be made as a matter of distributive justice.

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[325] ibid 40; for alternative argument, also from an economic perspective and also emphasising certain third party costs, see Henry Hansmann and Reinier Kraakman, 'Property, Contract and Verification: The Numerus Clausus Problem and the Divisibility of Rights' (2002) 31 Journal of Legal Studies S373, 384.

[326] McFarlane (n 323); for a libertarian alternative see Richard A Epstein, 'Notice and Freedom of Contract in the Law of Servitudes' (1981) 55 Southern California Law Review 1353.

[327] McFarlane uses the terms 'rights' and 'duties' as set out in Wesley N Hohfeld, 'Some Fundamental Conceptions as Applied in Legal Reasoning' (1913) 23 Yale Law Journal 16.

[328] McFarlane (n 323) 313–17. While McFarlane does not commit to a particular conception of liberty, the freedom from the *possibility* that others unilaterally create new duties seems to share the orientation with Philip Pettit's 'republican' conception of liberty: Philip Pettit, *Republicanism: A Theory of Freedom and Government* (Oxford University Press 1999) ch 3.

The upshot of this brief excursion into property theory is the straightforward and intuitively plausible insight that deciding which kinds of rights the law should recognise should be determined by the demands of distributive justice. Questions of property rights and priority rights concerning insolvency therefore fall to be justified in just the same way, as their distributive impact in insolvency is identical.[329] As much is made clear by the way in which they may both feature in a recitation of the insolvency distribution 'waterfall': expenses first, then fixed security, then the prescribed part,[330] and so on. The questions of whether some particular kind of entitlement should be permitted, on the one hand, and where such an entitlement should rank in the waterfall, on the other, are sometimes separable. This may be because of doctrinally distinct but functionally similar routes to some outcome. Whether certain accrued employee claims should have statutory preference, for example, is a question concerning only the ranking of such claims, the underlying validity of which is properly assumed. Whether some particular arrangement should be regarded as giving rise to a proprietary interest, principally raises questions going to the validity (or effectiveness, given some goal, or party intentions) of the underlying arrangement, and whether it obtains the legal status of property in the formal or *in rem* sense. If such an arrangement did give rise to rights *in*

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[329] Of course, a novel property right recognised by judges will attract the (functional) ranking of property, whereas a new priority recognised by legislation may specify a more precise position in the waterfall. Nothing in the present discussion turns on this distinction. Similarly, I do not mean to suggest that the only distributively-relevant features of these rights are their insolvency effects.

[330] The 'prescribed part' is a small fund made available to general (unsecured) creditors out of assets subject to a floating charge pursuant to the Insolvency Act 1986 s 176A and the Insolvency Act 1986 (Prescribed Part) Order 2003.

rem, then it is usually assumed that certain consequences would follow; this is the insight captured by Stevens's umbrella example. Certain legal structures that purport to craft entire obligations, or withdraw the ongoing benefit of executory contracts, in a way that may affect third parties in circumstances of insolvency should also answer to these same demands, where their purported effect is to limit or reduce the pool of assets from which other creditors are to be paid.[331] Consider the following examples.

> *Priority:* A statute provides that accrued employee claims are to be paid out of the proceeds of the sale of assets subject to a fixed charge.[332]

> *Property:* The Supreme Court decides that a bribed fiduciary's principal owns—and is not merely owed—the proceeds of a bribe.[333]

> *Contract:* The High Court decides that parties to a particular commercial relationship may provide that one party only earns its entitlement to payment arising from the relationship on completion of an entire year's work.[334]

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[331] *Sumpter v Hedges* [1898] 1 QB 673; US Bankruptcy Code § 365(e); *Whitmore v Mason* (1861) 2 J & H 204, 70 ER 1031; *Belmont* (n 306); *Revenue and Customs Commissioners v Football League Ltd* [2012] EWHC 1372 (Ch) ('*Football Creditors*'); Ben McFarlane and Robert Stevens, 'In Defence of Sumpter v Hedges' (2002) 118 Law Quarterly Review 569.

[332] This is in fact the law in France: Code de commerce (France) art L625-7, Code du travail (France) art L3253-2; see Federico M Mucciarelli, 'Employee Insolvency Priorities and Employment Protection in France, Germany, and the United Kingdom' (2017) 44 Journal of Law and Society 255, 268–9.

[333] *Attorney-General (Hong Kong) v Reid* [1994] 1 AC 324 (PC); *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2015] AC 250.

[334] *Football Creditors* (n 331); *Sumpter* (n 331).

It is my contention that, where insolvency law is concerned, the key normative question in each of these examples is the same, as in insolvency each arrangement has the same effect. That question is whether the preference, entitlement or structure is justified as a matter of distributive justice.

3.2 The demands of distributive justice: the continuity thesis returns

Distributive justice has now been introduced to the discussion in three distinct ways. First, a market system in which distributive shares are secured by legal rights requires an equal capacity to hold such rights, for reasons of distributive justice. Second, drawing on the discussion of John Gardner's work above, I have argued that the recognition of certain claims—the legal determination that corrective justice should be done—should be justifiable in terms of distributive justice, and that this is the case even if no insolvency issues are to be considered. Third, I have now claimed that any decisions that, functionally speaking, rank claims for the purposes of an insolvency distribution are also in need of justification in terms of distributive justice. This includes deciding whether certain legal arrangements succeed in creating *in rem* property rights, and deciding what kinds of *in rem* property rights there can be. This also concerns certain limits upon the power of parties to contract for certain effects or outcomes. The determination that certain classes of claim rank equally is, of course, as much a ranking decision as one that provides for differential treatment. The way in which the demands of distributive justice bear upon each of these issues is distinct. More now needs to be said about how these distinctive demands can be brought together.

I have already said that I do not commit to a theory of justice, and that to develop or defend a theory of justice is beyond the scope of this work. That this is so necessarily limits the prescriptive claims that may be offered in reliance upon my theory alone. Assessing her own discussion of bankruptcy policy, Elizabeth Warren claimed to have 'offered a dirty, complex, elastic, interconnected view of bankruptcy from which [we] can neither predict outcomes nor even necessarily fully articulate all the factors relevant to a policy decision.'[335] While it would be difficult to deny that bankruptcy is, in different ways, 'dirty, complex, elastic,' and its parts 'interconnected', we should stop short of concluding that the same need necessarily be true of bankruptcy theory. Warren defended her approach in the following terms:

> I call attention to the difficult distributional issues in bankruptcy, and I identify factors that influence how those distributional issues are resolved. Perhaps more importantly, I advocate a process of framing and refining questions, considering both their normative and empirical elements, to give content to the bankruptcy debate.[336]

Theoretical reflection should do or facilitate all of these things. In pursuing such reflection, however, we should be able to hope for more than merely to point out where questions of distribution may arise. As should be clear, to say that some decision should be justifiable in terms of distributive justice is not to say that it should be considered in

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[335] Warren (n 44) 811.

[336] ibid.

isolation, nor that a 'fresh' distribution should be made according to some generally applicable criterion. To do so would be to make a number of serious missteps. In this section I shall suggest that Gardner's argument for the continuity thesis suggests a way to begin bringing these different arguments from the demands of a minimally specified conception of distributive justice together.

The continuity thesis asserts that where there is a failure to conform to reasons, some reasons may persist, and call for satisfaction by substitute, next-best-possible performance. Just what substitute performance is required depends on the reasons in question. I wish to propose a similar schema: (1) Where insolvency qualifies or reduces what are otherwise legally protected entitlements; and (2) reasons of distributive justice that underpinned those entitlements are undefeated; then (3) the state should provide for these reasons to be met in other ways.[337] This view of things emphasises that where the state institutionalises norms of corrective justice, it does so as part of what is required in order to give individuals part of what they are entitled to as a matter of distributive justice.

Consider the following examples.

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[337] As foreshadowed above, this is most similar to what Steel calls reason continuity: see V.2.4. above. I use this terminology here because it seems natural, and also because it allows me to avoid the questions of what rights individuals have, against the state, as a matter of distributive justice, and which of the reasons of distributive justice concerning state action, if any, amount to duties or obligations. If such questions were resolved, it seems likely that view I defend here could be put in terms of duty or right continuity.

> *Bodily integrity*: Grant that the state guarantees the bodily integrity of citizens, in part, by forcing those who (carelessly) injure others to pay for the medical care their victims require. A Co's product grievously injures B and B obtains a judgment against A Co. Shortly thereafter, a winding-up order is made in respect of A Co. B's claim is unsecured.

> *Freedom to contract*: Grant that the state accords citizens the right to enter into contracts of their choosing and provides enforcement mechanisms. A Co borrows £1m from B Co. Shortly thereafter, a winding-up order is made in respect of A Co. B Co's claim is unsecured.

In the first of these examples, we see that B risks receiving only a small amount of the face value of her judgment in A Co's insolvency. In the second, B Co risks receiving only a small amount of the sum owing on the loan. My intuition is that the first case calls for redress and that the second may not. The reasons for this may be explored by reference to the schema I propose.

First, in both cases the circumstances of insolvency make it the case that neither B nor B Co are likely to be paid the face value of their claims. This is not due to any particular provision of insolvency law, but rather due to the fact that the assets the debtor commands are insufficient to meet all claims. Were no insolvency to have supervened, no question would arise here: each claim would be paid at its face value.

Second, the reasons for recognising the claims in each case must be considered. In the *bodily integrity* case, I think it clear enough that whatever reasons there were to support the right to be paid compensation in certain cases persist, the debtor's inability to pay

notwithstanding. In such a case, the state has provided, for reasons of distributive justice, that (1) a right not to suffer certain injuries and be indemnified in respect of any actually suffered be recognised, and that (2) legal norms of corrective justice should serve this end. As has been seen above, different means might have been chosen. If we assume, for the sake of argument, that distributive justice requires that bodily integrity be protected in some way, nothing considered hitherto requires that this concern be addressed by the institutionalisation of legal norms of corrective justice, nor implies that the underlying reasons of distributive justice are met where those norms of corrective justice fail to provide an injured party with the promised indemnity. In such cases, it may be that further action is required.

The *freedom to contract* case is quite different. Here, it is far from clear that the reasons to institutionally enforce promises—that is, the reasons to allow *law* to be used for this purpose—survive an insolvent debtor's inability to pay. This is because the reasons of distributive justice in question go only as far as providing for the institutionalisation of certain norms of corrective justice. There is no underlying distributive claim as between the state and the promisee apart from that of affording all an equal capacity to contract and hold property. Where law does enforce promises, but does not look to resources other than those of the defaulting debtor in so doing, no underlying claim of distributive justice seems unmet. The capacity to contract is not undermined; what's more, the disappointed contractor may have adjusted her bargain in anticipation of such a possibility and, to this extent, be met with a situation that was anticipated as part of a

chosen course of conduct. This would, of course, be an example of the kind of responsibility which, as I have argued above, is compatible with distributive justice.[338]

Third, and finally, I claim that it is for the state (rather than for specific individuals) to provide for any persisting reasons of distributive justice to be met. I think this is so because reasons of distributive justice are reasons that apply principally to institutions and institutional design.[339] This is not to say that the state must, itself, meet these reasons directly, as with a direct payment, for example. Rather, it is to say that the state should provide for a system in which such reasons are met, just as it provides, for reasons of distributive justice, for the administration of private law substantially in terms of corrective justice when the debtor is solvent. Various such systems are imaginable.

3.3 Implications and objections

Before concluding this section, I shall note some of the implications of the view that I have set out, and seek to pre-empt certain objections that might be put against it.

The argument I have put in this chapter may appear deflationary: it may seem, on the strength of what I have argued above, that there is little that is special about corporate

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[338] See IV.4. above

[339] Whether such reasons apply to others—individuals, for example—is controversial, and need not be resolved here: Rawls (n 5) 54–55; Thomas Nagel, *Equality and Partiality* (Oxford University Press 1991) chs 6, 9; cf Murphy (n 121).

insolvency law in terms of its goals and purpose. If I am right, then the ultimate purpose of corporate insolvency law is not to maximise value,[340] or promote virtue by demonstrating forgiveness,[341] for example, but rather to support—express, that is, and not undermine—the scheme of distributive justice that the legal system as a whole expresses and determines. While this may sound abstract, it is not any more abstract than the Posnerian injunction to maximise value,[342] or the (incomplete) proceduralist mantra that pre-insolvency legal claims should be respected.[343] Proceduralists have been right, of course, to notice that whatever insolvency law should attend to should be something that arose prior to the onset of insolvency proceedings. But this something is what is owed to all in distributive justice, and not particular legal rights, even if rights will provide a good deal of information about what those justice entitlements are though to be, in the relevant legal system. What my model notices is that insolvency raises a series of distributive justice questions that do not arise elsewhere, and also renders nugatory certain ordinary remedies that the state provides as a matter of distributive justice, as in the *bodily integrity* example above. Where this is so insolvency law should complement rather than replicate the rights recognised by the rest of the law. And this complementarity is explained by the continuity of the underlying reasons of distributive

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[340] See ch II above

[341] This argument is usually made in the (personal) bankruptcy law context, where it is manifestly plausible: see Gross (n 47) 93; Hurd and Brubaker (n 126).

[342] See generally Posner, 'Utilitarianism, Economics, and Legal Theory' (n 20).

[343] See II.4.2. above

justice, and justified to the extent that those underlying reasons are themselves defensible.

It might be objected at this point that I have done no more than restate proceduralism, dressing up its ideas in some clothes borrowed from analytic legal philosophy. This claim should be rejected, for the model I propose and proceduralism share no more than the insight that insolvency law should be in some way continuous with the rest of the law. They diverge is specifying just what it is that continues—what mediates the continuity—and also in arguing for why this is desirable. If my general argument against proceduralism succeeds, then it is also true that proceduralism is not a coherent theory of insolvency law.[344] If, instead, the objection is no more than that my model develops elements of proceduralism, then there is probably nothing given up in conceding it. The point of such an objection would, however, be unclear.

It might also be objected that I have failed to address a key plank of proceduralist writing on this subject by failing to take seriously the ex ante—principally cost-of-credit—effects of 'new' entitlements that are called into being by the commencement of insolvency proceedings. As has been discussed, such concerns feature prominently in the work of writers including Alan Schwartz and Douglas Baird.[345] But that objection rests on imputing a careless practical naïveté to defenders of the continuity thesis, which

[344] See II.4. above

[345] See II.2.5. above

imputation is not maintainable. In the version defended by Gardner, the continuity thesis, where it applies, requires next-best action or substitute performance following the failure to meet some obligation; that is, to respond to some reasons in a particular fashion. Next-best performance is that which would meet the still-existing reasons that meant, at some previous point in time, that there was an obligation in the first place. Substitute performance that was to any significant degree self-defeating,[346] would simply fail to meet those persisting reasons. As such, it would not be required by the continuity thesis, whether on Gardner's account, or on the slightly adapted version I defend.

It might further be objected that I have failed to address another important line of proceduralist argument, concerning value-destructive forum shopping for entitlements only available in insolvency proceedings.[347] This, too, reflects a misunderstanding. There is a general concern in law about what are sometimes called cases of 'abuse of process', '*abus de droit*', 'abuse of law' or 'abuse of rights'. I assume that the objection does not merely refer to such concerns, which are in no sense particular to insolvency; any litigation whatever may be begun for a collateral, improper or otherwise deviant purpose. Instead, it envisages insolvency rules that allow certain stakeholders to improve their positions vis-à-vis others by an entry into insolvency proceedings.[348] At

[346] ibid.

[347] See II.2.4. above

[348] ibid.

least three points should be made in response to this suggestion. First, most insolvency stakeholders do not have a position vis-à-vis others before the onset of insolvency. As much emerged from the discussion, above, which considered how parallel claims in corrective justice came to compete with one another. This casts doubt on the cogency of the proceduralist claim. Second, there is no reason to think that all insolvency-specific entitlements do in fact have the effect of altering the relative position of claimaints on an insolvent estate. Some 'new' entitlements take the form of a right to access state guarantees: access to the National Insurance Fund, or the Pension Protection fund, for example, with a relevant scheme representative subrogated to an unaltered claim on the insolvent estate.[349] Finally, to the extent that 'new' insolvency entitlements meet interests that are met outside of insolvency in different ways, then the incentive to seek the insolvency route to some advantage—being paid one's wages, for example—arises only when the non-insolvency route to that benefit comes to appear unpromising. It may be that the recognition of some specific entitlements in insolvency only could be self-defeating or create perverse incentives in certain circumstances. I do not intend to offer a general defence of such cases, and would not wish to. But I think it is tolerably clear that such instances cannot be assumed to be the general case and as such it is sufficient to show, for present purposes, that the recognition of new rights in insolvency is unlikely always to be like this.

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[349] *Trustees of the Olympic Airlines SA Pension & Life Insurance Scheme v Olympic Airlines SA* [2015] UKSC 27, [2015] 1 WLR 2399 (Lord Sumption); cf the prescribed part of assets made available to general (unsecured) creditors out of assets subject to a floating charge pursuant to the Insolvency Act 1986 s 176A and Insolvency Act 1986 (Prescribed Part) Order 2003.

4. A VIEW OF THE WATERFALL

In the last section I considered the way in which departures from formally equal treatment fell to be justified in corporate insolvency law according to the normative account that I defend. In this section I will briefly set out what this theory implies for certain specific questions that have been considered at great length in the corporate insolvency law literature. In doing so I note the specific implications of my arguments and the avenues of enquiry that they open; I neither hope nor attempt to do justice to the considerable and subtle literature that concerns each matter raised. I consider the justification, if there is one, for giving priority to secured credit, before considering the position of employees, small trade creditors and tort victims under UK law.

The argument I have defended thus far shows that there are prima facie reasons of distributive justice to favour *pari passu* distribution in insolvency proceedings, but that departures from this kind of distribution may be justified, consistent with the demands of distributive justice. It also suggests that where the law sanctions such differential treatment this may give rise to reasons of justice that count in favour of certain other kinds of state action.

4.1 The UK waterfall in summary

Under UK law certain property held by a company for or subject to the interests of others does not form part of the 'property of the company' and so does 'not compete in the priority stakes.'[350] This includes property held on trust, or subject to a fixed security interest: a mortgage or fixed charge, for example. As such the trust beneficiary, charge holder, vendor with retention of title, etc., may look to the relevant property directly to meet their claims (subject to a stay in administration).[351] A creditor holding a floating charge may also seek recovery from the property subject to the floating charge subject to certain carve-outs.[352]

As far as is relevant, claims are then met in the following order from the property of the company. First come the expenses of the liquidation, and then preferential debts. Where these cannot be met from the assets not subject to a floating charge, they are paid from these assets.[353] Preferential debts include, most relevantly, certain limited employee entitlements and unpaid contributions to occupational pension schemes.[354] Where there are insufficient assets to meet the claims of general unsecured creditors the liquidator

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[350] Goode, *Principles of Corporate Insolvency Law* (n 1) [8-59].

[351] Insolvency Act 1986 sch B1 para 43

[352] Note that different rules apply to floating charges created before 15 September 2003. In what follows this qualification is dropped for ease of exposition.

[353] Insolvency Act 1986 s 175(2)(b) (preferential debts)

[354] Insolvency Act 1986 s 386, sch 6

must also deduct a relatively modest ring-fenced fund from the property otherwise subject to the floating charge, known as the 'prescribed part'.[355] General unsecured creditors are then paid *pari passu* among themselves. After these creditors come post-liquidation interest, deferred claims and non-provable liabilities, which will not be further considered here,[356] though it is worth mentioning that such claims have been recently considered in detail by the Supreme Court.[357]

4.2 The priority of secured credit

To accord functional priority to secured credit is to provide, by law, for differential treatment as between secured creditors and others, and for the legal treatment of secured creditors to be more favourable than that received by those not so secured. I have claimed above that such differential treatment is justified when it is required as a matter of distributive justice. This is an abstract claim, but one that may be made more concrete without great difficulty. It is worth, however, noting what even this abstract claim entails, and, in particular, the kinds of candidate justifications that it rules out. Foremost among these are arguments based on the consent or intentions of the parties to some candidate security arrangement. This is because it is not defensible, as a matter of distributive justice, that an agreement between A and B distribute as between A, B and

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[355] Insolvency Act 1986 s 176A, Insolvency Act 1986 (Prescribed Part) Order 2003 (SI 2003/2097). See generally Goode, *Principles of Corporate Insolvency Law* (n 1) [6-37].

[356] This summary paraphrases ibid [8-59].

[357] *Re Lehman Bros International Europe (No 4)* [2017] UKSC 38, [2018] AC 465 ('Waterfall I')

C to C's disadvantage.[358] Nor is it defensible that the state provide a legal mechanism by which A and B distribute to themselves at C's expense, for the sake of A and B's private interests. This is not to resolve the question against the recognition and enforcement of consensual security, but rather to say that the justification for such recognition and enforcement is to be sought elsewhere.

Justifications consistent with the argument I advance here have been offered in the law and economics literature.[359] John Armour summarises what he takes to be the most plausible such possibility in the following terms:

> [T]he ability of corporate debtors to grant security has the potential to yield social benefits extending beyond the parties to the security agreement (that is, "positive externalities").[360] *Ex ante*, by facilitating bonding and monitoring activity, security lowers the probability that the debtor will engage in wealth-reducing transactions, and helps to reduce the probability of default. This increases the value of all creditors' claims. *Ex post*, by facilitating efficient enforcement, it can increase the overall "size of the pie" for distribution.[361]

The detail of this position, and of other more or less plausible alternatives, need not be pursued. Whether security does in fact have any generally beneficial effects—such as

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[358] Hence the oft-quoted observation that '[s]ecurity is an agreement between A and B that C takes nothing': Lynn M LoPucki, 'The Unsecured Creditor's Bargain' (1994) 80 Virginia Law Review 1887, 1899.

[359] See John Armour, 'The Law and Economics Debate about Secured Lending: Lessons for European Lawmaking' (2008) 5 European Company and Financial Law Review 3, 1–10.

[360] See George G Triantis, 'Secured Debt under Conditions of Imperfect Information' (1992) 21 The Journal of Legal Studies 225; Steven L Schwarcz, 'The Easy Case for the Priority of Secured Claims in Bankruptcy' (1997) 47 Duke LJ 425; Rizwaan J Mokal, 'The Search for Someone to Save: A Defensive Case for the Priority of Secured Credit' (2002) 22 Oxford Journal of Legal Studies 687.

[361] Armour, 'The Law and Economics Debate about Secured Lending' (n 359) 8–9.

these positive externalities—is an empirical matter, and as such is not considered here. Let us grant, however, for the sake of argument, that security does have some such beneficial effects, in order to pursue the implications of my argument.

Where some legal form or institution creates general benefits of some kind, then there is no obvious objection to the establishment of that form or institution, all else being equal. Such a move would be a Pareto-improvement upon the previous state of affairs: some people would be better off, and no one would be worse off.[362] Difficulties arise, however, where it appears that the form or institution in question, while having certain acknowledged benefits, may also make some individuals worse off than they would otherwise have been, which must in nearly every distributional determination be the case. A justification for security runs into just these kinds of difficulties. The question then becomes that of how law might justifiably pursue policies of general benefit, without depriving individuals of that to which they are entitled as a matter of distributive justice. In order to offer an answer to this question, it is necessary to consider just how it is that security might be thought to make certain creditors worse off, and the conditions under which this would be justifiable.

[362] This is not to say that the resulting state of affairs is unobjectionable. It might, for example, have bad consequences, or have been arrived at by objectionable procedures. Objections to inequality along these lines are considered in TM Scanlon, *Why Does Inequality Matter?* (Oxford University Press 2018) chs 2, 6, 7, 9.

4.3 Does security make general creditors worse off?

The legal recognition of security interests makes unsecured creditors prima facie worse off, at least if their situation is considered ex post. This is because where an insolvent debtor has given security, over a particular assets, thereby removing it from the pool, unsecured creditors will have recourse to a smaller pool of assets, and thus receive a smaller return than they would have received, had there been no such security.

This prima facie judgment should, however, be qualified in certain important respects by considering the position of certain creditors ex ante. First, where an unsecured creditor both had notice of a security interest, and decided to extend credit at a given interest rate in any event, then such a creditor suffers, when they do, as a result of a risk willingly run, and do not miss out on anything owed to them by the state as a matter of distributive justice. In the terminology introduced in the last chapter, such a creditor suffers as a matter of bad option luck; that is, in a way for which they are responsible.[363] This judgment, I think, depends on three things being present: notice, voluntariness in extending credit, and an ability to determine the rate of interest at which that credit is extended. Where one or more of these features is absent, then our view of the creditor's position changes. Where there is no notice of the security interest, it cannot be said that the creditor is worse off ex post as a result of a risk willingly run, for the extent of the

[363] See IV.4. above

risk was not known. Where voluntariness is absent the creditor's will is not engaged at all, and so their responsibility cannot be either. And where the creditor is not able to set an appropriate interest rate because non- or only weakly-adjusting,[364] then we may similarly be concerned that the entirety of the risk in question has not been willingly assumed. In each such case—and in combinations thereof—the creditor is indeed worse off.

Legal strategies may address some of these concerns quite straightforwardly, and provisions concerning the registration of company charges, for example, are a clear attempt to address the concerns about notice mentioned here. A range of company charges, if not registered within 21 days, [365] are void against the liquidator, administrator or creditors of an insolvency company.[366] And with such a system of recordation in place, certain instances of disadvantage may be avoided. [367] No such strategy is in place, though, concerning voluntary but weakly adjusting creditors, and involuntary creditors.

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[364] Non-adjusting creditors are those who are unable to influence the terms on which they lend, whereas weakly-adjusting creditors are those able to influence the terms on which they lend only slightly. This terminology comes from Bebchuk and Fried, 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy' (n 104) 864.

[365] Companies Act 2006 ss 859A, 859B

[366] Companies Act 2006 s 859H(3)

[367] English law does, however, allow for a range of legal forms, functionally equivalent to security interests, that are not subject to this registration regime: see discussion in Goode, *Principles of Corporate Insolvency Law* (n 1) [2-27]-[2-28].

4.4 Employees and small trade creditors

Voluntary but weakly-adjusting creditors are creditors who deliberately extend credit, but who may lack the bargaining power to determine the terms on which they do so. Employees paid in arrears are, generally speaking, creditors of this kind, and their particular situation is discussed in more detail in the subsection below. Small trade creditors may find themselves in this position too.[368] Generally speaking, then, in recognising and allowing the enforcement of security interests, and in *not* making special provision for voluntary but non- or only weakly-adjusting creditors, does the state leave those creditors without something that they are owed in distributive justice? That this will sometimes be so becomes clear if we consider the situation of employees, which Goode describes in these terms:

> There can be no doubt that employees do deserve special protection. Very often their wages or salaries are their sole source of income. The loss of employment can thus have a devastating effect on them and their families, an effect exacerbated by their employer's non-payment of their entitlements. The relationship between employee and employer is a continuing relationship requiring mutual trust and confidence and it is a relationship in which the employee is very clearly the subordinate. Moreover, without the work of the employees, the employer's business would not function and creditors would not get paid.[369]

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[368] ibid [8-21].

[369] ibid [8-21] (citations omitted).

This passage identifies three reasons for special concern as to the situation of employees: their vulnerability to their employer in respect of their livelihood, the quality of the employment relationship, and the close connection between the employees' labour and the company's functions. The latter two concerns may be set aside, as they are in no sense restricted to non- or weakly-adjusting creditors.[370] The concern as to employees' vulnerability concerning their unpaid entitlements and also their ongoing employment, however, is of considerable importance. This is because, I suggest, employees who do not receive accrued pay and entitlements, and who are not assisted through a period of unemployment, miss out on part of what they are owed by the state as a matter of distributive justice.

I have argued above that the state must grant to each individual the capacity to hold and deal with legal rights and that this capacity is, in a meaningful sense, an equal capacity. The reason that this capacity is required is that in market systems, such a capacity is required if individuals are to secure to themselves a distributive share, whatever specific form that takes. In such market systems, one of the most usual ways to secure resources to meet one's vital interests is through employment, which relationship is framed, legally speaking, by an exercise of the capacity in question (specifically, the capacity to contract and thereby sell one's labour). Where this capacity does not in fact secure to an employee the resources with which to meet her vital interests, the capacity is not

[370] They are also not appealing principles of distributive justice.

delivering to her what it is supposed to as a matter of distributive justice. Those reasons of distributive justice, then, that supported the recognition of the capacity in the first place are unmet, and so persist and call for substitute satisfaction. And this will be so whether the employee is to miss out because the employer is hopelessly insolvent, or merely somewhat insolvent but with such assets as there are subject to extensive security. It is therefore permissible that the law provide for distribution of the assets of an insolvent company to secured creditors only if alternative arrangements for employees are in place. The detail of some such arrangements are considered briefly in the next subsection.

As it happens, English law does establish such alternative arrangements. English law, partly by way of implementation of European Union law, protects certain employee entitlements where an employer company enters insolvency proceedings. Certain unpaid contributions to occupational pension schemes enjoy statutory preference, as do up to four months' unpaid wages and holiday pay up to an (unchanged since 1976)[371] £800 limit.[372] Employees may prove for these entitlements in the employer's insolvency, or pursue a parallel claim upon the National Insurance Fund,[373] which is obliged to pay up to eight weeks' wages and six weeks' unused holiday pay at a maximum of £464 per

[371] Insolvency Act 1976 sch 1 pt 1; Mucciarelli (n 332) 272.

[372] Insolvency Act 1986 sch 6

[373] Employment Rights Act 1996 ss 166ff

week, as well as statutory redundancy and unfair dismissal payments.[374] As such the state guarantees these entitlements, albeit at a rate considerably below median national earnings, which the Office for National Statistics found to be £569 per week in 2018.[375] To the extent that such alternative arrangements secure to employees what the state owes them, as a matter of distributive justice, then any ex post disadvantage they may suffer as a result not only of the legal recognition of security but also due to the mere fact of their employer's inability to pay their claims may be said to be outweighed, at least as between the state and the employee.

It is worth pausing, here, to notice how specific this argument is to the particular position of employees, and that it is not obviously able to be modified in favour of other kinds of creditor, including small trade creditors, for example. Trade creditors may, of course, be vulnerable to a particular debtor. But the connection between what the state owes (the individuals behind the corporate personality of) a trade creditor as a matter of distributive justice and what is secured through that creditor's relationship with the debtor is far less clear. Those individuals employed by a trade creditor are employees, and so ought to be protected in the trade creditor's own possible insolvency. The position of those who are not employees—sole traders and the self-employed,[376]

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[374] Where an employee receives a payment from the National Insurance Fund the Secretary of State is subrogated to the employee's claim against the employer to the extent of the payment: Employment Rights Act 1996 s 167(3)(a).

[375] *Statistical Bulletin: Employee Earnings in the UK* (Office for National Statistics 2018).

[376] Those whose self-employment is a sham and who are, properly understood, workers or employeers of the insovent debtor should, on my argument, be assimilated to the position of employees. On the phenomenon of sham self-employment in the UK see generally J Clark and

unincorporated or incorporated, and so on—is a matter for further investigation, which cannot be pursued here, and will depend on whether the debtor's non-payment deprives them of something owed to them, by the state, as a matter of distributive justice.

4.5 Involuntary creditors (tort victims)

I have not yet said anything about the special position of involuntary creditors of an insolvent debtor, those who never sought to extend credit, but who may have been victims of the debtor's torts, for example. Clearly, such creditors are worse off, ex post, where a debtor is insolvent and has given security; they are liable to receive a lower dividend then they would have had such security not been granted if required to prove as general creditors. Further, not having chosen to extend credit to the debtor, there is no natural sense in which such creditors' responsibility is engaged.

A similar argument may be made here as was offered in respect of employees. In legal systems where certain vital interests are protected through the law of civil responsibility—in most common law systems the law of torts—this part of the law helps to compensate for harm resulting from violations of an individual's rights. Where the law does not manage to secure a tort victim such compensation, as will be the case where

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Lord Wedderburn, 'Modern Labour Law: Problems, Functions, and Policies' in Lord Wedderburn, R Lewis and J Clark (eds), *Labour Law and Industrial Relations: Building on Kahn-Freund* (OUP 1983); ACL Davies, 'Sensible Thinking About Sham Transactions' (2009) 38 Industrial Law Journal 318; Alan L Bogg, 'Sham Self-Employment in the Supreme Court' (2012) 41 Industrial Law Journal 328.

a tortfeasor is insolvent, the law may fail to deliver to the tort victim what they are owed by the state as a matter of distributive justice.[377] Reasons of distributive justice, then, may remain unmet, and so persist and call for substitute satisfaction. It is therefore permissible that the law provide for distribution of the assets of an insolvent company to secured and preferential creditors ahead of tort victims only if alternative arrangements for such tort victims are in place.

In this case too does English law provide for such arrangements. The Third Parties (Rights Against Insurers) Act 2010 provides for claimants to be subrogated to the rights of insolvent defendants as against a defendant's liability insurer. This means that where a claimant has been the victim of a tort committed by the now-insolvent defendant, and that defendant's liability gave rise to a right of indemnity under an insurance policy, the claimant may recover that indemnity directly from the insurer without having to prove for it in the defendant's liquidation, and thus share it with other general creditors.[378] The importance of this provision becomes clear only with a sense of the range of instances in which liability insurance is mandated by law. Under UK law liability insurance is

[377] I do not wish to suggest that all torts protect interests that the state must assure to individuals as a matter of distributive justice. I assume, however, that an individual's right to bodily integrity, for example, is such an interest. Consider, by contrast, the status of property torts.

[378] Where the liability exceeds the quantum of the right to indemnity, then the claimant may prove for the difference as a general creditor.

compulsory for motorists,[379] employers (concerning certain employee claims),[380] and for a range of regulated professions, including doctors, accountants, financial advisors, solicitors and barristers. Further, even if not required to hold such insurance by law, many organisations will choose to hold such insurance for prudential reasons; ie for reasons concerning the ongoing success of the organisation. This is not to say that all tort victims will have recourse to an insurer in cases where a relevant tortfeasor is insolvent. Some tortfeasors will be uninsured. But this will be most frequently the case outside of contexts in which insurance is compulsory, and areas in which insurance is compulsory are those in which it has been determined that the vital interests of individuals require special protection, consequent upon this special provision being made by the state. To the extent that measures such as the Third Parties (Rights Against Insurers) Act 2010 provide for reasons of distributive justice unmet by an insolvent tortfeasor's obligation to pay compensation to be met by alternative means, then it forms part of a defensible scheme of insolvency distribution in which tort victims are treated as general creditors only.

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[379] Road Traffic Act 1988 ss 143-156. Section 153 specifically addresses the position of motorists who become bankrupt, and the effect of the Third Parties (Rights Against Insurers) Act 2010 in such cases.

[380] Employers' Liability (Compulsory Insurance) Act 1969

5. CONCLUSION

This chapter began by considering certain formal characteristics of legal rights in a legal system where shares in distributive justice take the form of such rights. I claimed that an equal capacity to hold rights, and to contract, is required in such a system, and that legally similar rights created in the exercise of such a capacity must be treated impartially. Such a conclusion resonates both with certain demands of the rule of law, and with certain formal requirements of rules, if such rules are to offer practical guidance. I then considered the way in which the idea of corrective justice has been used to explain certain kinds of legal claim, and noted the inability of such accounts to explain or justify insolvency distribution. Drawing on work by John Gardner, I argued that corrective justice should only be done where, at least, distributive justice requires it. I argued that differential treatment in insolvency fell to be justified in terms of distributive justice. This led me to claim that where insolvency defeats what are otherwise legally protected entitlements, and the reasons of distributive justice that underpinned those entitlements are undefeated, then the state should provide for these reasons to be met in other ways. Finally, I considered the implications of these arguments including for the legal status of secured credit, employee entitlements and the claims of tort victims against an insolvent debtor.

VI THREE PRINCIPLES IN THE MORALITY OF OBLIGATIONS

1. INTRODUCTION

In chapter 3 I sought to classify some of the normative questions to which corporate insolvency law gives rise. I proposed to distinguish between corporate identity, debtor fidelity and distribution questions. In this chapter I begin considering those debtor fidelity questions more closely, and seek to consider just what should count as bad conduct in matters relevant to the insolvency of a company.

In introducing this class of fidelity questions, I noted that the category label, left unexplained, risked being both over- and under-inclusive. If understood to refer to the evaluation of all matters of good and bad conduct by companies, or stakeholders in companies, then it would stretch far too wide, and certainly beyond the scope of this project. If understood to refer to the wrongfulness inherent in a company *coming to be* factually insolvent, or unable to pay one or more debts, or even simply failing to pay one or more debts, then it would seem to miss the point. This is because corporate insolvency law does not take any special interest a company that merely fails to meet its obligations, without something more being present in the factual matrix: the law looks to the *inability*,

rather than the mere *failure* to pay.[381] Further, talk of wrongfulness is in some ways inapposite, as it forecloses, without good reason, the possibility that some insolvency law doctrines—certain transaction-avoidance rules, for example—may target transactions that need not be wrongful transactions. I will return to such cases in the next chapter, but do not consider them further here.

Rather than responding to the wrongfulness of non-repayment, then, corporate insolvency law responds to the fact that a company is unable to pay its debts or otherwise meet its obligations.[382] This does not mean that whenever a company is factually insolvent, corporate insolvency law will automatically respond. But it does mean that whenever corporate insolvency law is involved, one of the things that it responds to is a company's insolvency or presumed insolvency. It provides, for example, for an orderly liquidation and distribution of the company's assets to those with claims

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[381] The failure to pay without explanation, however, is deemed to indicate an inability to pay: *Cornhill Insurance plc v Improvement Services Ltd* [1986] BCLC 26, 28-29.

[382] Two qualifications to this are, strictly speaking, required. The first reflects the fact that the members of a company may voluntarily wind up that company using the members' voluntary winding-up procedure provided for in the Insolvency Act 1986 pt IV esp chs 2, 3. There should be no actual insolvency in such cases, and section 89(4) of the Act provides for criminal liability for directors who make statutory declarations of solvency without proper grounds for doing so, where such declarations are required. Such members' voluntary windings-up will not be considered further. The second qualification reflects the fact that a company placed into insolvent liquidation may turn out, after further and perhaps lengthy examination, to have assets sufficient to meet its liabilities. This was so in *Waterfall I* (n 103). This class of cases does not cause any particular difficulty for the framework I set out in this chapter. This is because even if, as in *Waterfall I*, a debtor made subject to insolvency proceedings turns out to be solvent, the law approaches the debtor, and becomes involved in its affairs, on the basis that it is not. This will, on occasion, allow the law to perform a residual debt enforcement function, as in the case of recalcitrant but solvent debtors.

to them, as and to the extent required by law, under the supervision of a liquidator or similar official. And it does this whether the company in question was run honestly but fell on hard times—the small-time manufacturer of floppy disks and video cassettes, say—or a scandalous fraud on almost everyone—the Bank of Credit and Commerce International, for example.[383]

But of course while insolvency may arise without any wrongdoing over and above that represented by the mere fact of breaches of its obligations, it is equally true that the law in this area is concerned with certain kinds of wrongdoing, and that wrongdoing may come hand in hand with a company's entry into insolvency proceedings. What's more, financial distress or the opening of insolvency proceedings may give rise to incentives for wrongdoing that do not arise outside of such circumstances. Similarly, an end-game scenario for certain stakeholders may make new kinds of wrongdoing possible,[384] or see

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[383] See generally TH Bingham, *Return to an Address of the Honourable the House of Commons Dated 22 October 1992 for the Inquiry into the Supervision of the Bank of Credit and Commerce International* (HMSO 1992).

[384] Whatever particular concept of wrongdoing is adopted, the law undoubtedly takes this view. Misconduct both prior to, and during, a winding-up is addressed by offences created by the Insolvency Act 1986 ss 206-11. These concern specific instances of fraud in anticipation of winding-up (s 206), transactions in fraud of creditors (s 207), misconduct by company officers in the course of a winding-up including as concerns the delivery-up of records and property to the liquidator (s 208), the falsification or destruction of books or records (s 209), material omissions in a statement of the company's affairs (s 210) and false representations to creditors intended to procure their consent concerning the affairs of the company (s 211). Certain of these offences cover matters that might be dealt with as other, more general, offences, or constitute such offences regardless the company's solvency. Certain others, however, could only arise in insolvency: those concerning delivery-up and statements to the liquidator, for example (ss 208-10), or misleading creditors (s 211).

the *dénouement* of a fraudulent scheme set in place well in advance.[385] When the law considers such wrongdoing, it looks beyond the mere fact that some debts have not been repaid or that an insolvency procedure has been opened. It looks to the management of the company, to its obligations, to the ways in which they were incurred, to the way its affairs were structured, and to certain dispositions made in the period leading up to the company's demise.

It is not surprising, then, that insolvency law and doctrines the operation of which is not restricted to insolvency appear to overlap to some extent. But we should be cautious not to make too much of the apparent overlap. Where pre-insolvency matters are scrutinised by the law, this scrutiny is carried out according to norms not all of which operate in insolvency only.[386] I consider some of these below. There is nothing surprising about this fact. Indeed, if pre-insolvency entitlements are to matter in insolvency at all, then they must matter, in part, in virtue of the significance that not-only-insolvency doctrines give them. Companies have no existence but by law; their directors have no powers but by law; and the law constitutes and scrutinises their affairs in myriad ways, in good financial times and in bad. Some overlap, here, is inevitable, and it is far from clear that this is undesirable.

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[385] This was the case in *Hill v Spread Trustee Co Ltd* [2006] EWCA Civ 542, [2007] 1 WLR 2404.

[386] I refer to 'norms' here in order to avoid raising questions of 'procedure' and 'substance' in this connection, which do not bear upon the present discussion.

General talk of debtor fidelity concerning companies must be made more precise for present purposes. There is a sense in which everything from corporate criminal liability generally, to corporate social responsibility, to the law of corporate defamation could be said to give rise to fidelity questions: each concerns questions of good and bad conduct concerning companies. The corporate fidelity questions I wish to consider, however, are more circumscribed. They are limited to those questions of good and bad conduct by and in the management of companies that are in some way related to corporate insolvency. I do not include all questions of good and bad conduct concerning a company that has in fact become insolvent. Further, I do not consider cases where the court disregards a company's separate legal personality and pierces the so-called corporate veil, if such questions are thought to amount to a distinct doctrinal category.[387] Not every doctrine I consider is confined in its operation to insolvency proceedings, nor uniquely concerned with insolvency.[388] Each, however, engages the fidelity questions with which this chapter is concerned.

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[387] I do not mean to exclude consideration of fidelity questions concerning a company that might be found to be *behind* a corporate veil; only the company whose separate legal personality is being called into question. Nor do I mean to deny that a version of a veil-piercing doctrine might be functionally equivalent to some of the doctrines that I consider in this chapter. As a matter of English substantive law, however, it seems that the better view is that there is no doctrine according to which members of a limited company, in their capacity as members, are made responsible for the debts of the company: *Prest v Petrodel Resources Ltd* [2013] UKSC 34, [2013] 2 AC 415, *Adams v Cape Industries* [1990] 2 WLR 657, 749-763 (HL) [1990] Ch 433, 532-549 (CA); *Yukong Lines Ltd v Rendsburg Investments Corporation* [1998] 1 WLR 294, [1998] 2 BCLC 485 (Toulson J). Instead of adopting this strategy, English law provides for director liability, including according to the doctrines considered in this chapter, as well as transaction avoidance doctrines, including those considered in this chapter and the next.

[388] As will be seen, the rationale for certain insolvency doctrines may be engaged where there is no insolvency procedure in play, and so spill outward into the generally applicable law: *Hill* (n 385); *Dornoch Ltd v Westminster International BV ('The WD Fairway') (No 1)* [2009] EWHC 889 (Admlty), [2009] 2 Lloyd's Rep 191 (Tomlinson J); *Dornoch Ltd v Westminster International BV ('The*

In this chapter I shall sometimes use the language of *corporate* fidelity, rather than the more general language of debtor fidelity. This is not meant to suggest that those principles I consider are of relevance to companies only. Indeed, quite the opposite is true: all of the principles considered in this chapter are principles of interpersonal morality and practical reasoning that very clearly do apply to natural persons, perhaps even first and foremost. My attention to corporate fidelity matters reflects, rather, the focus of this project. To the extent that the discussions that follow have implications beyond this focus, these implications cannot be pursued here.

I shall also refer, throughout this chapter, to the way obligations figure in practical reasoning. By practical reasoning I mean to refer to an idealised and simplified account of the weighing of reasons for action, or a kind of deliberation.[389] This might usefully be contrasted with theoretical reasoning, a similar process concerning reasons for belief. On the account I adopt, which draws heavily on work by Joseph Raz, any occasion of practical reasoning—deciding whether or not to φ—involves a weighing of reasons for and against φ-ing. By reasons for φ-ing I mean considerations that count in favour of φ-ing, and by reasons against, considerations that count in favour of not-φ-ing. I discuss reasons on the assumption that they have a dimension of weight.[390] As such, reasons

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WD Fairway') (No 2) [2009] EWHC 1792 (Admlty) (Tomlinson J); David Osborne, Graeme Bowtle and Charles Buss, *The Law of Ship Mortgages* (2nd edn, Informa 2016) 97–104. See also VI.2.1 below.

[389] This is consistent with Finnis (n 253) 12.

[390] Raz, *Practical Reason and Norms* (n 240) 25–28.

must be weighed against one another and cannot simply prevail by force of numbers.[391] As I shall explain below, it is plausible to suggest that obligations can both *be* reasons for action in their own right, and also *give* reasons for other actions. If I have an obligation to pay Jones £1m by tomorrow afternoon, this obligation is a reason to pay Jones the money by the appointed time. Put differently, the obligation itself is a reason to perform an action that corresponds to the deontic content of the obligation. My obligation to pay Jones also gives reasons concerning other actions. On this straightforward example, my obligation gives me reason to instruct my bank to arrange the payment, or to write a cheque, or to collect debts owed to me such that shall be able to pay Jones by tomorrow afternoon. Concomitantly, I shall argue, it gives me reason not to gamble the £1m away the night before the payment is due, however good my intentions in so doing.

The next three sections articulate, defend, and apply three straightforward and, on my argument, appealing moral principles, and explain how these principles appear to offer justifications for certain substantive doctrines. It is no part of my argument that these principles are inherent in the law, come from the law, or are derived from the law in some way.[392] Instead, I claim that these are moral principles, to which the law should

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[391] See generally ibid 15–35, ch 1.

[392] These are not principles such as those considered by Ronald Dworkin: Dworkin, 'The Model of Rules I' (n 1); Dworkin, *Law's Empire* (n 4) ch 1; Reinhard Bork, *Principles of Cross-Border Insolvency Law* (Intersentia 2017); HC Tait, 'Review of Principles of Corporate Insolvency Law by Reinhard Bork' 133 Law Quarterly Review 685.

give effect. I then consider the extent to which English law does this, point out inconsistencies and lacunae, and offer suggestions as how this might be improved.

The principles I defend are these:

(1) It is wrong to deliberately avoid one's obligations, or deliberately obstruct others in their enjoyment of rights correlated to such obligations.

(2) Where one has an obligation, that obligation counts against actions that are inconsistent with that obligation, or which would make performance on that obligation less likely.

(3) It is wrong to create obligations one knows, or ought to know, one has no reasonable prospect of performing.

In this chapter I claim that provisions targeting transactions in fraud of creditors, fraudulent trading, and the 'phoenix syndrome' are explicable in terms of principle (1) (section 2). Principle (2) is a weaker version of principle (1), which offers a normative explanation of so-called duty shifting doctrines, and, in part, the statutory provisions targeting wrongful trading (section 3). Principle (3) completes the normative explanation of the wrongful trading rules, as well as the fraudulent trading rules (section 4). I conclude by noticing what these principles do not proscribe—mere preferences, good-

faith undervalue transactions, and deprivation provisions, among others—fuller consideration of which is held over to the next part.[393]

There is a further principle that I should mention at this point that I do not defend or give further express consideration below. This is the principle that it is wrong to breach an obligation, which I shall call principle O. Nothing that follows is intended to cast doubt on the soundness of principle O; indeed, much of the appeal of the principles I do defend depends upon it. But as stated already, mere breaches of principle O are not the concern of insolvency law, for insolvency law presupposes multiple breaches of obligations—breaches of contract, mostly—which failures are symptomatic of an insolvent debtor's inability to pay. Wrongdoing in terms of principle O is amply present in every insolvency. But it is wrongdoing that, without more, insolvency law disregards.

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[393] Deprivation provisions now fall to be considered in the light of the decision of the Supreme Court in *Belmont Park Investments v BNY Corporate Trustee Services Ltd* [2011] UKSC 38, [2012] 1 AC 383, which decision contains references to subjective questions of 'good faith' and 'commercial sense': [75] (Lord Collins). This might appear to assimilate the Anti-Deprivation Principle to those doctrines considered alongside principle (1). However, the ADP cannot be considered in this way. This is because a vulnerable deprivation does not share the correlative structure of these doctrines: the putative beneficiary of a deprivation provision does not wrong the creditors made worse off if the deprivation is upheld. This is because there is no relationship of obligation between that putative beneficiary and those creditors. An argument of a similar structure is defended concerning preferences in the next chapter: see VII.3. below.

2. PRINCIPLE (1)

The first principle I defend in the most straightforward. It is the principle that it is wrong to deliberately avoid one's obligations, or deliberately obstruct others in their enjoyment of rights correlated to such obligations. Principle (1) is an elaborated version of principle O strengthened by a requirement of deliberateness. Examples of wrongdoing in terms of principle (1) from ordinary life abound. If I have an obligation to support my children, then I act wrongly in deliberately seeking to avoid providing such support. In the same way, if I promise to help my friend move house, I act wrongly if I then deliberately fail to show up at the appointed time and place.

Such a principle as principle (1) does not require a lengthy defence. This is because such a principle (or principles) flows directly from the nature of obligation. What it is for an obligation to oblige is that it makes some action mandatory. Put differently, an obligation to φ is a categorical or peremptory reason to φ, which reason will usually exclude at least some reasons for not-φ-ing.[394] Where one is obliged to φ, this means that one should φ or ought to φ, and if one fails to then one breaches that obligation. If one ought to φ, it follows that one has reason to take steps towards φ-ing. If I have an obligation to meet

[394] The extent that this is so will depend on just how the obligation in question came to be owed, and upon the proper (philosophical) analysis of the relevant means of procuring obligations (ie of promising or legitimate authority, eg). These difficult questions do not bear upon the present discussion and will not be considered further. For an explanation of what it means for reasons to be *excluded* by other reasons see Raz, *Practical Reason and Norms* (n 240) 40–48; cf Christopher Essert, 'A Dilemma for Protected Reasons' (2012) 31 Law and Philosophy 49.

my friend at 7pm and I live 30 minutes from the agreed meeting place, then I have reason to set off, and reason to do so by 6.30pm.

This is not to say that where one has an obligation to φ one ought in every case—or, if preferred, all things considered—to φ, or to take the steps that would lead towards φ-ing. This is because there might be compelling reasons against φ-ing that either cancel or outweigh the obligation to φ without being excluded by it. This is to say that obligations, as they will be discussed here, have a provisional or *pro tanto* quality. In failing to φ when one is so obliged, it is always true that one breaches one's obligation. It is not true, however, that in breaching an obligations one always acts wrongly.

Consider the case in which I promised to help my friend move house. Were I deliberately to fail to show up at the appointed time I would clearly act wrongly. But where I accidentally break both my legs the day before the move, it seems clear that I do not. Here, though, it is equally clear that I fail to perform the obligation I created in promising. In such circumstances my friend may release me from my promise, upon learning of my accident. I might also, in some circumstances and if I am able, be obliged to arrange for substitute performance of some kind.[395] But in either case it is clear that while I fail to perform on my obligation I do not always act wrongly in failing to do so.

[395] See V.2.4. above

The cases in which I most obviously act wrongly are those in which I deliberately avoid doing that which I am obliged to do.

Where I am obliged to φ, it will sometimes be the case that someone else has the right that I φ.[396] In Hohfeldian terms, my *duty* to φ is correlated to another person's *right*.[397] Where obligations—or Hohfeldian duties—and rights are correlated in this way it is analytically true that when I fail to perform on an obligation I fail to give the right-holder that to which she had a right. This means that the difference between deliberately failing to perform, or deliberately seeking to avoid performance, and deliberately frustrating another in the enjoyment of their rights will sometimes amount to the same kind of wrongdoing.

The law has long been concerned with intentional wrongdoing connected to bankruptcy. The statute 13 Eliz c 5 provided:

> For the avoiding of feigned, covinous and fraudulent feoffments, gifts, grants, alienations, bonds, suits, judgments and executions, as well of lands and in tenements, as of goods and chattels … devised and contrived of malice, fraud, covin, collusion or guile to the end, purpose and intent to delay, hinder or defraud creditors and others of their just and lawful actions, suits, debts, etc; [as these were] not only to the let or hindrance of the due

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[396] This will always be the case in the context of corporate obligations to pay creditors, for example. I say that this will 'sometimes' be the case here in order to avoid the unnecessary and strong claim that the Hohfeldian schema is a proper basis for describing, or a definition of, all rights. Similarly, it leaves open a possible reading of sections 214 and 246ZB of the Insolvency Act 1986 that does not conceive of these sections in strictly correlative terms.

[397] see generally Hohfeld (n 327).

> course and execution of law and justice, but also to the overthrow of all true and plain dealing, bargaining and chevisance between man and man[.]

The statute is widely, but efficiently, drafted. First, it refers to a number of improper attitudes: malice, fraud, covin, collusion and guile. It then points to prohibited conduct: delaying, hindering or defrauding creditors, or others, of their lawful debts or actions. The statute then provides that certain dispositions, whether in writing or not, shall be of no effect against any person so delayed, hindered or defrauded, where the disposition was made with any of the improper attitudes mentioned, or with an intention to engage in the prohibited mode of conduct.

The Statute of Elizabeth addressed more than intentional wrongdoing, not least because equitable fraud need not—then as now—have involved subjective dishonesty. As the editors of Snell's Equity note:

> [T]he term 'fraud' [extends] beyond actual fraud to include, by a fiction, conduct that involves no deceit or dishonesty... The equitable concept of fraud does not stop at 'moral fraud in the ordinary sense' but also takes account of 'any breach of the sort of obligation which is enforced by a court that from the beginning regarded itself as a court of conscience.'[398]

But the statute does make clear that 'actual' wrongdoing, too, has long been a concern in this area. Statute, supplemented by the common law, now regulates good and bad

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[398] John McGhee and others, *Snell's Equity* (33rd edn, Sweet & Maxwell 2015) [8-002] (citations omitted). *Belmont* (n 13) [151] (Lord Mance).

conduct in corporate insolvency law. But I shall argue in this chapter that much of its normative motivation is the same.[399]

If I am right, then the key to understand the fidelity concern in corporate insolvency law lies in understanding the implications of existing obligations in practical reasoning. In the insolvency context, concerns about fidelity are not engaged by the mere failure to pay. This, instead, is the concern of the general law of debtors and creditors; that is, ordinary debt enforcement law. Instead, such concerns are engaged by the steps (purportedly) taken to avoid paying, or paying as much, or being made to pay on one's own obligations, in spite of the validity of some underlying obligation requiring payment, which obligation has implications for what we should do. (This also explains why it is not wrong to cause a company to incur a debt, knowing one will not ordinarily be called on to meet it from one's personal assets: the obligation, in such a case, is never one's own.)[400]

What I have called principle (1) has straightforward appeal. Deliberate conduct of the kind I have described *concerning insolvency* is simply a particular case of this general mode of wrongdoing. In the great majority of cases where insolvency is concerned, the obligation is to perform one's own contracts and meet one's own obligations, including

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[399] See Robert Charles Clark, 'The Duties of the Corporate Debtor to Its Creditors' (1976) 90 Harvard Law Review 505.

[400] *Prest* (n 387) [34] (Lord Sumption)

to revenue authorities. Outside of insolvency, a wider range of regulatory and other obligations may be relevant. Of course this is not to say that there will not be more challenging cases in which questions may arise as to whether one really does have an obligation, or as to the deontic content of an acknowledged obligation, and so, *mutatis mutandis*, for a right held by another. But it is equally clear that this is no objection to principle (1) as such.[401]

The rest of this section considers specific statutory provisions for which, I claim, principle (1) provides a plausible normative explanation.

2.1. Transactions in fraud of creditors (s 423)

I begin with section 423 of the Insolvency Act 1986.[402] Sections 423 to 425 of the Insolvency Act 1986 are, in part, referable to the statute of Elizabeth.[403] Pursuant to these sections, a court is given a wide discretion to make orders where transactions are entered into gratuitously, in consideration of marriage, or at undervalue, for the purpose: '(a) of

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[401] It might be suggested, at this point, that to analyse this part of the law in terms of principle (1) requires insolvency law to offer a special response to 'efficient' breaches of contract (ie breaches of contract by a party deliberately electing to breach and pay damages because this course is more advantageous to that party than performance would be). This is a mistake. An efficient breach includes an election to pay damages according to the law of contract. As such it does not involve an attempt to avoid an obligation in the sense under consideration here.

[402] cf Law of Property Act 1925 s 172 (rep)

[403] This history is traced in John Armour, 'Transactions Defrauding Creditors' in John Armour and Howard N Bennett (eds), *Vulnerable transactions in corporate insolvency* (Hart 2003) [3.6]-[3.17].

putting assets beyond the reach of a person who is making, or may at some time make, a claim against him, or (b) of otherwise prejudicing the interests of such a person in relation to the claim which he is making or may make.'[404] Though somewhat tighter in their wording, sections 423 to 425 target similar wrongdoing as the statute of Elizabeth, narrower only in that prejudicial transactions for fair value would not be caught.[405] It is arguable that what might be called factual preferences—that is, payments or grants of security that have the effect of placing an existing creditor in a better position than they would have been in in a subsequent liquidation *without* the desire to prefer required by section 239 of the Insolvency Act 1986—meet the description of a prejudicial transaction for fair value. Whether or not this is so is disputed at the level of doctrine.[406] I do not comment on that doctrinal dispute here, both because no matter of present relevance turns on its resolution, and because it is not clear that the dispute is a pure question of law susceptible to resolution by doctrinal argument. Suffice it to say that where fair value is given, the scope for prejudice is substantially less.

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[404] Insolvency Act 1986 s 423(3)

[405] Such transactions might be liable to challenge pursuant to s 239 (preferences), or, if regarding specific or unique items, recoverable pursuant to equitable doctrines.

[406] On one view, a company paying a preference receives a reduction of its obligations in the amount of the preference, which is, from the company's perspective, fair value: *Re MC Bacon Ltd (No 1)* [1990] BCLC 324 (Millett J). A different approach to this question is advocated by Arden LJ in *Hill* (n 385) [92]-[99]. This doctrinal dispute has certain parallels with one that was dealt with in *Phillips v Brewin Dolphin Bell Lawrie Ltd* [2001] UKHL 2; [2001] 1 WLR 143, concerning, in part, the valuation of the grant of an unauthorised sub-lease, whose head lease was subsequently terminated: Mokal, *Corporate Insolvency Law* (n 51) 323–326.

Section 423 does not require insolvency or insolvency proceedings to have been opened, and applies without limitation as to time.[407] Contravention of the section does not require dishonesty of motivation, but merely the substantial purpose 'of putting assets beyond the reach of a person who is making, or may at some time make, a claim' as per the statutory language.[408] To act with this purpose is to act so as to deliberately avoid having the company perform its obligations, and to obstruct others in their enjoyment of rights correlated to such obligations. As such, section 423 is straightforwardly explicable in terms of principle (1), and defensible as such.

2.2. Fraudulent trading (s 213/246ZA)

Sections 213 and 236ZA of the Insolvency Act 1986 address fraudulent trading.[409] Fraudulent trading is defined as trading in circumstances where 'it appears that any business of the company [is] carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose'.[410] In order to make a

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[407] See *Hill* (n 385) (bankruptcy); cf *Inland Revenue Commissioners v Hashmi* [2002] 2 BCLC 489, [2002] EWCA Civ 981 (no insolvency); *Dornoch Ltd v Westminster International BV ('The WD Fairway') (No 1)* [2009] EWHC 889 (Admlty), [2009] 2 Lloyd's Rep 191 (Tomlinson J); *Dornoch Ltd v Westminster International BV ('The WD Fairway') (No 2)* [2009] EWHC 1792 (Admlty) (Tomlinson J) (no insolvency). While the look-back period is unlimited, ordinary limitation applies in the ordinary way.

[408] *Arbuthnot Leasing International Ltd v Havelet Leasing Ltd (No 2)* [1990] BCC 636; *Hashmi* (n 407) [25] (Arden LJ); *Random House UK v Allason* [2008] EWHC 2854 (Ch) [52] (David Richards J).

[409] References to s 246ZA, which concern companies in administration, are dropped below for ease of exposition. A separate offence of fraudulent trading, defined without reference to insolvency, exists: Companies Act 2006 s 993(2).

[410] Insolvency Act 1986 s 213(1)

person liable for fraudulent trading under section 213, it must be shown that the business of the company was carried on in this way, and that the person to be made liable participated in the carrying on of the business with knowledge of some fraud or fraudulent purpose; that is, that they were 'knowingly party' to it.[411] A person need not have held a formal office within a company to be made liable under section 213,[412] but where the business of the company has not been carried on with intend to defraud creditors, no liability for an outsider can arise.[413] The 'intent to defraud' that must be demonstrated to ground liability under section 213 is that of actual dishonesty, judged objectively, and not according to particular standards that a respondent may happen to have adopted in the conduct of their affairs.[414] 'Blind-eye knowledge' of fraud, or 'a suspicion that the relevant facts do exist and a deliberate decision to avoid confirming that they exist' will be sufficient, at least where the suspicion is 'firmly grounded and targeted on specific facts'.[415]

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[411] see Goode, *Principles of Corporate Insolvency Law* (n 1) [14-25]-[14-26].

[412] *Re Gerald Cooper (Chemicals) Ltd* [1978] Ch 262

[413] *Morphitis v Bernasconi* [2003] EWCA Civ 289, [2003] Ch 552

[414] *Barlow Clowes International Ltd v Eurotrust Ltd* [2005] UKPC 37, [2006] 1 WLR 1476 [10] (Lord Hoffmann); *Abou-Ramah v Abacha* [2007] 1 Lloyds Rep 115. In *Barlow Clowes* the Privy Council departed, in substance, from the earlier decision of the House of Lords in *Twinsectra Ltd v Yardley* [2002] UKHL 12, [2002] 2 AC 164, by way of what has been described as a 'masterpiece of verbal manipulation': Goode, *Principles of Corporate Insolvency Law* (n 1) [14-25]. The Supreme Court recently approved and applied the observations of Lord Hoffmann in *Barlow Clowes* in *Ivey v Genting Casinos (UK) Ltd* [2017] UKSC 67, [2018] AC 391.

[415] *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd* [2003] 1 AC 469 [116] (Lord Scott); accepted as the appropriate test for s 213 actions in *Bank of India v Morris* [2005] EWCA Civ 693, [2005] BCC 739, [14]; affirming *Morris v State Bank of India* [2003] EWHC 1868 (Ch), [2003] BCC 735 [11] (Patten J).

This schema is straightforwardly explicable in terms of principle (1). The business of a company is carried on with intent to defraud creditors just in case the company is managed in such a way as to *deliberately* defraud its creditors, according to an objective standard. And as the main, if not only, interest creditors have is that their debts be paid, it follows that the natural way to defraud creditors is by not paying. Principle (1), therefore, gives a clear justification for such a rule as is contained in section 213, as interpreted by the courts.

2.3. Unlawful phoenix activity (s 216)

Sections 216 and 217 of the Insolvency Act 1986 address what is commonly known as illegitimate 'phoenixing' activity, or the 'pheonix syndrome'.[416] Such activity occurs where a person conducts business through a succession of similarly named companies, each of which become insolvent. In such cases, these sections provide for criminal liability—with a fine or imprisonment or both—and personal liability for certain company debts. This mode of proscribed conduct abstracts one level from the fraudulent trading I have already mentioned. If that trading was at the level of a single company, illegitimate phoenix activity is at the level of one or more directors or shadow directors conducting business through a succession of companies with identical or substantially similar names. In such cases, the liquidation followed by the creation of a new corporate

[416] Note that detailed qualifications to these rules, known as 'excepted cases', appear in the Insolvency (England and Wales) Rules 2016 rr 22.4, 22.6, 22.7.

vehicle is dealt with on the basis that the intervening liquidation has been used to merely free a continuing business of its acknowledged debts, to the hindrance of creditors. Creditors of the insolvent company may have lost the benefit of that company's goodwill, which may, in effect, have been transferred gratuitously to the phoenix company. Similarly, those who deal with the phoenix company may be misled as to its standing and creditworthiness, though this is not, of course, of relevance to an analysis in terms of principle (1).[417] As such, these provisions address the kind of fidelity concerns under consideration, and are equally explicable in terms of principle (1), and justifiable in the same way.

3. PRINCIPLE (2)

The second principle I defend is that the fact of an obligation counts against actions that are inconsistent with that obligation, or which would make the performance of that obligation less likely. In the corporate insolvency law context, wrongdoing in terms of principle (2) involves a failure to consider insolvency in a particular way in circumstances where it should be considered. Such conduct involves the failure to consider certain stakeholders' interests in the period leading up to insolvency, and may coincide with wrongdoing in terms of principle (1).

[417] These points were noted in *Penrose v Official Receiver* [1996] 1 BCLC 389, 397-8 (Chadwick J).

Contraventions of principle (2) involve lesser wrongdoing than contraventions of principle (1), though in many instances where principle (2) is engaged, so too is principle (1). Principle (1) could be accepted without accepting principle (2). However, if principle (2) is accepted, principle (1) must be accepted as well, a fortiori. Like principle (1), principle (2) makes claims about the way in which existing obligations are reasons for action, and give reasons for and against other, related, actions.

An obligation is a categorical or peremptory reason for the obligee to take some action:[418] in this case, a reason to pay each creditor the amount owed. As has already been put in principle (1), one acts wrongly when one deliberately seeks to avoid performing one's obligations. This is, in part, because having an obligation to φ narrows the range of permitted actions, and is analytically inconsistent with not-φ-ing. Further, if one has an obligation to φ then it is also true that the obligation is a reason for actions that would lead to φ-ing and against actions that would lead one towards not-φ-ing or which make φ-ing less likely. The weight of this reason will depend on just how much more or less likely φ-ing would be, given the action in question.

If I am obliged to make a pilgrimage to Lourdes then I have reason to apply for a passport, if I do not have one, and to make arrangements for travel. (I may also be obliged to do some or all of these things, which possibility I do not consider here.)

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[418] Raz, 'Promises and Obligations' (n 9); Joseph Raz, *The Authority of Law: Essays on Law and Morality* (2nd ed., Oxford University Press 2009) ch 12; Gardner, 'What Is Tort Law For?' (n 275) 31.

Similarly, I have reason not to arrange to be in Sydney at the time I am obliged to make the pilgrimage. Simple legal examples are possible as well. If I have to pay my gas bill tomorrow I have reason not to spend the money I need to pay that bill on a holiday today. At the same time, I have reason to put money aside such that I may meet that obligation when it matures.

All this lends support to principle (2) expressed in the following terms:

> (2) Where one has an obligation, the fact of that obligation counts against actions that are inconsistent with that obligation, or which would make performance on that obligation less likely.

In the corporate insolvency law context this becomes the following:

> (2*) Where a company has an obligation, the fact of that obligation counts against actions by its managers that are inconsistent with that obligation, or which would make performance on that obligation less likely.

Principle (2) implies principle (2*), and is therefore sufficient to explain the duty of managers of companies to have regard to the interests of creditors as the company's financial health deteriorates.[419] I shall also argue that the principle offers a partial explanation of the wrongful trading remedy contained in the Insolvency Act 1986.

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[419] It might be objected that (2*) does not follow from (2). Such an inference, it might be said, arises only from an impermissible slip from the obligations to creditors owed by the company, to reasons that would affect managers. An objection along these lines is misconceived. Even if one were to grant that the practical reasoning of a company is something other than the practical

3.1. Directors' duties

Where managers fail to have regard to a company's obligations in the way I have described, in terms of principles (1) and (2), they may be made accountable by the law in a number of different ways. Section 212 of the Insolvency Act 1986 empowers a liquidator to pursue breaches of directors' general law duties to the company. Those duties are owed in virtue of the Companies Act 2006. In particular, section 172(1) provides that '[a] director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole…' This is qualified by section 172(3), which provides that all directors' duties under the act apply subject to 'any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.' The section 172 duty is sometimes referred to as a 'fiduciary' duty.[420] The

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reasoning of its managers, or some of them, there is no reason to doubt that some obligation owed by one person may have implications for the practical reason of another person. This is sufficient to show that such an objection must fail. An argument of this kind does, however, raise the further question of just which managers should be affected. Detailed consideration on this point is beyond the scope of this chapter. It is sufficient for present purposes to note that nothing in the argument I defend here would require accountability based on principle (2*) to be restricted to those formally holding office as directors. This is not to say that limits based upon some other principle might not be appropriate.

[420] Such language appears, eg, thoughout the judgments in *Bilta (UK) Ltd v Nazir* [2015] UKSC 23, [2016] AC 1. Further, the section 172 duty is enforceable in the manner of other fiduciary duties: Companies Act 2006 s 178. On the identification of those duties that are specifically fiduciary see Matthew Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Hart 2011) esp ch 3.

intended significance of this label is not always made clear, and the attribution of the label may be read in a number of different ways.[421]

Directors' duties in the period leading up to insolvency are sometimes discussed in the law and economics literature in terms of agency costs.[422] Such an analysis notices that as a company nears insolvency, the creditors of the company depend on the agency of company's management for the payment of their claims. This is because management controls the assets of the company, and retains the power to deploy or dispose of these. Management, in exercising these powers may fail to behave as the creditors might wish, for a range of reasons.[423] Such agency costs are analogous to those that may arise in a healthy company, as between shareholders and managers, where these groups are differently composed.[424] That this terminology be adopted, or not, does not affect the normative argument to come.

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[421] It has recently been suggested that developments in non-corporate fiduciary law, including the decision of the Supreme Court in *AIB Group (UK) plc v Mark Redler & Co Solicitors* [2014] UKSC 58, [2015] AC 1503 may have implications for the scope of the 'fiduciary' duties provided for by the Companies Act 2006: Kristin van Zwieten, 'Director Liability in Insolvency and Its Vicinity' (2018) 38 Oxford Journal of Legal Studies 382, 403. This suggestion is yet to receive sustained academic or judicial consideration, and its doctrinal standing should not be assumed. Such doctrinal questions are in any event beyond the scope of this work.

[422] Rizwaan J Mokal, 'An Agency Cost Analysis of the Wrongful Trading Provisions: Redistribution, Perverse Incentives and the Creditors' Bargain' (2000) 59 The Cambridge Law Journal 335; Richard Williams, 'What Can We Expect to Gain from Reforming the Insolvent Trading Remedy?' (2015) 78 The Modern Law Review 55; Armour, 'The Law and Economics of Corporate Insolvency' (n 26) 16–17.

[423] Their reasons for doing so are not presently relevant, and the discussion that follows does not require any assumptions as to managers' motivations, incentives or behaviour.

[424] Reinier H Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, Oxford University Press 2017) ch 2.

Some flesh must be put onto the bones of the agency costs analysis, though, as it is not yet clear why we would wish to regulate managers' behaviour in the light of creditors' interests.[425] After all, it is usually not the case that one must forebear from adversely affecting the interests—especially the commercial interests—of another. In ordinary circumstances one is free to negotiate for hard bargains or to drive commercial rivals out of business by competition.[426] In each case, it would be surprising to think that the law might intervene to prevent this, all other things being equal. The difference between these examples and the case of a near-insolvent debtor, is that the latter has pre-existing obligations to creditors, the (future) performance of which is impaired by the actions under consideration.[427] This is what is captured by principle (2).

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[425] This task is taken up in ibid 113–117.

[426] I do not consider the implications of competition law here, which, in any event, should be understood to serve wider interests than those of a particular market participant: John B Kirkwood and Robert H Lande, 'The Fundamental Goal of Antitrust: Protecting Consumers, Not Increasing Efficiency' (2008) 84 Notre Dame Law Review 191; Renato Nazzini, 'Welfare Objective and Enforcement Standard in Competition Law' in Ariel Ezrachi and Ulf Bernitz (eds), *Private Labels, Brands, and Competition Policy: The Changing Landscape of Retail Competition* (Oxford University Press 2009); Okeoghene Odudu, 'The Wider Concerns of Competition Law' (2010) 30 Oxford Journal of Legal Studies 599.

[427] This is the basis for Hohfeld's well-known criticism of Lord Lindley's speech in *Quinn v Leathem* [1901] AC 495, 534. See Hohfeld (n 327) 36–37.

3.1.1. The *West Mercia* doctrine

One rule of law, qualifying the general position concerning directors' duties as envisaged by section 172(3), is that established by the Court of Appeal in *West Mercia Safetywear Ltd (in liq) v Dodd*.[428] In that case Dillon LJ, with whom Croom-Johnson LJ and Caulfield J agreed, approved and applied the following passage from the judgment of Street CJ of the New South Wales Court of Appeal in *Kinsela v Russell Kinsela Pty Ltd (in liq)*:

> In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration.[429]

While a number of doctrinal uncertainties of some significance remain, the general *West Mercia* doctrine has been affirmed and refined in subsequent cases.[430] This means that in some circumstances, a failure by directors to consider the interests of creditors will

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[428] *West Mercia* (n 141)

[429] *Kinsela* (n 141) 730

[430] For a recent treatment see van Zwieten (n 421).

expose those directors to a liquidating court's jurisdiction to order the repayment of money to the company with interest, the restoration of property to the company, or to order a contribution to the assets of the company.[431]

Such a rule is, in general terms, consistent with the analysis I have advanced in this chapter. Where a company owes certain obligations and is in financial difficulties, its managers have reasons, flowing from those obligations, that count against any action that would make meeting those obligations less likely than it would otherwise have been. Put differently, they have reasons in terms of principle (2). If this is so, then a normative critique of such provisions would need to deny the wrongfulness of taking action inconsistent with acting on an obligation, or claim that the need to address such wrongdoing is outweighed by some other considerations.

The way principle (2) is cast draws attention to the fact that certain actions are made impermissible by the obligations a company has. If my argument succeeds, this shows that a *West Mercia*-type doctrine may justifiably prohibit certain actions; that is, impose a negative prescription concerning action by management. It is, however, arguable that such doctrines go beyond establishing negative prescriptions, and in fact require directors to take positive steps in having regard to creditors' interests. Such positive prescriptions are not required by principle (2). Their justification is, however,

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[431] Insolvency Act 1986 s 212(3)

straightforward. Where a company has obligations to creditors, these obligations are reasons for action. Commonly, though not in every case, the action in question will be a positive action. The payment of a debt is an example of such a case. A company has such reasons whether or not insolvency proceedings are underway.[432] The positive side of the *West Mercia* doctrine, then, merely reflects this fact, as well as the fact, considered in the discussion above, that obligations are not only themselves reasons for action, but also give reasons for further, related actions.[433] As I have explained, in this way, an obligation to go on a lengthy pilgrimage is a reason to obtain the right kind of shoes. I do not defend this as a further principle in this chapter, because I take it to follow very closely indeed from what an obligation is.[434]

Some scholars, in considering the *West Mercia* doctrine and its analogues, refer to the doctrine as involving a kind of 'duty-shifting'.[435] There is a sense in which this description is appropriate. The doctrine involves a shift from considering the interests of a company's 'members as a whole'—that is, its shareholders—to considering

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[432] Outside of insolvency proceedings, the action required by an obligation to pay a debt is that the debt be paid. Once insolvency proceedings are opened, the obligation can no longer be to pay the debt, as this is no longer possible, *ex hypothesi*. In such cases, the obligation will be next-best performance: concretely, to see to it that the debt is paid to the greatest extent possible. This is consistent with the analysis in terms of the continuity thesis defended in an earlier chapter: see V.2.4., V.3. above.

[433] See VI.3 above.

[434] Related questions concerning positive action are considered in the discussion of the wrongful trading remedy: see VI.3.2 below.

[435] eg *Credit Lyonnais Bank Nederland NV v Pathé Communications Corp* (Delaware Chancery, 30 December 1991); *In re Buckhead America Corporation* 178 BR 956 (Delaware 1994) 968; *In re Hechinger Investment Co* 274 BR 71 (Delaware 2002) 89.

creditors' interests in some way, beyond some threshold.[436] But the significance of this should not be overstated, and the label should not, in particular, be taken to suggest that the creditors' interests in the assets of the company spring up afresh, *deus ex machina*, at some critical point. As I have explained, the normative pull of these interests arises for the same reasons that the debts in question came to be owed. Sometimes, though not always, this will flow from the voluntary action of the debtor. This is the case, at least, where the debt owed is contractual. This insight is sufficient to show why certain objections to duty-shifting doctrines do not, and also cannot, succeed.

3.1.2.Objections to duty shifting

In an article addressing the Delaware case of *North American Catholic Educational Programming Foundation v Gheewalla*,[437] Hu and Westbrook have sought to challenge the suggestion 'that a company's financial condition should trigger changes in duty.'[438] In doing so, they argue that legal requirements for managers to have regard to the interests of creditors prior to the opening of insolvency proceedings, should be abolished. They do so on the grounds that 'duty shifting imposes creditor-oriented tasks on a corporate

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[436] As a matter of English law, duty shifting language is also inappropriate. Strictly speaking, the directors' duty remains the same: it is owed to the company, to consider the company's interests. It is into the context of these 'interests' that the creditors' interests intrude in the vicinity of insolvency.

[437] *North American Catholic Educational Programming Foundation v Gheewalla* 930 A 2d 92 (Delaware 2007)

[438] Henry TC Hu and Jay Lawrence Westbrook, 'Abolition of the Corporate Duty to Creditors' (2007) 107 Columbia Law Review 1321, 1324.

governance system that is designed to serve the interests of shareholders … [which] leads to unacceptable mismatches in ends and means.'[439] They also claim that 'duty shifting fails to consider the foundational structure of either shareholder ownership rights or private property generally.'[440] Stated in this way both of these claims requires significant specification, but a more straightforward gloss is possible in each case.

The first claim is that there are two corporate governance systems in US law: the first, operating as a matter of state law, is oriented towards companies being run in the interests of their shareholders. The second, operating as a matter of federal law through the US Bankruptcy Code, is oriented towards companies being run in the interests of creditors. Duty shifting, Hu and Westbrook argue, is an illegitimate intrusion of the federal, creditor-focused orientation into the state-law corporate governance system.

This claim may be dealt with quite quickly. As I have explained above,[441] arguments concerning aspects of US federalism are often made in the normative bankruptcy literature. These arguments, whether persuasive or not, do not have clear implications outside of a strongly federal context, as exists in the United States.[442] To the extent that this first claim is maintained without its federalist motivation—to claim that there are

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[439] ibid.

[440] ibid.

[441] See II.1. above.

[442] I do not consider the implications of such arguments in a system like Australia, for example, where insolvency law is also dealt with pursuant to Federal legislation.

two distinct corporate governance regimes, and that they should be kept apart because they are separate—it does no more than beg the question.

The second claim is that it follows from the nature of shareholders' rights that the managers of a company should consider only shareholders' interests if that company is not in fact in an insolvency procedure:

> It is elementary that principals can choose their agents and, accordingly, [shareholders' rights to vote are] the legal centerpiece of the governance system. These matters go beyond the instrumental. Absent accountability to shareholders, the power vested in directors has no legitimacy. From the very beginning of the modern corporation, to be a shareholder has necessarily involved possession of voting, inspection, and other embedded rights. Although shareholders can continue to vote, inspect, and sue, the shifting of duties from shareholders to creditors renders such embedded rights meaningless. Nothing short of the fundamental destruction of core shareholders ownership rights is at stake in the application of the duty shifting doctrines.[443]

This claim is puzzling for a number of reasons, and fails to explain why a mismatch between shareholder rights to vote and inspect company records, and so on, on the one hand, and creditor-oriented duties, on the other, should be regarded as a matter of any particular concern. First, it is far from obvious that principals can always choose their agents or that, when they can, this choice is a matter of any particular importance. At the very least, this is not true of trustees, nor of guardians, nor necessarily of lawyers.

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[443] Hu and Westbrook (n 438) 1385.

Second, it is not clear that the powers of directors need legitimacy—a desideratum for the exercise of specifically political power or authority—rather than ordinary justification—a desideratum for laws or legal structures generally.[444] A company is not a democracy, but rather operates and is constituted according to laws providing for its operation and constituting it in a particular way. It is difficult to see this, without more, as objectionable. These laws provide for the selection of directors, and directors hold office properly in such a company just when the procedures for their selection have been properly followed. The level at which justification is to be considered is that of the company: in particular, the kind of company where directors are selected in the relevant way. It may turn out that to permit such companies is, in the final analysis, objectionable. This could be for a range of reasons. But where this is so it will not be because their directors do not enjoy democratic legitimacy in the exercise of their powers.

Third, it is unclear what importance is to be attached to the fact that shareholders have 'always' held certain 'embedded' rights, alongside the right that the company be run in their interests. Granting the empirical claim—however implausibly—Hu and Westbrook need to show that there are good reasons to see these rights are necessarily—rather than merely contingently—coincident. They do not, however, offer an argument to this effect, leaving the reader to assume, perhaps, that such changes should be made

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[444] see generally Fabienne Peter, *Democratic Legitimacy* (Routledge 2009); cf Usha Rodrigues, 'The Seductive Comparison of Shareholder and Civic Democracy' (2006) 63 Washington and Lee Law Review 1389; Colleen A Dunlavy, 'Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights' (2006) 63 Washington and Lee Law Review 1347.

for the sake of a certain view of conceptual tidiness, or superficial neatness of doctrine.[445] To the extent that the authors' argument would seek to justify adverse effects on creditors, it would need to point to more than the mere fact of shareholder interest, for it is no justification for A to take B's money that A's interests would be advanced by such a taking.[446] What would be required would be some system-level justification for just such a bundling of shareholder rights as Hu and Westbrook say is required.[447] But the authors offer neither a compelling nor a sustained response to the suggestion that shareholders' property rights—if formally proprietary—are merely coextensive with those incidents of ownership that the law in fact gives them. And so we see that the argument assumes what it purports to demonstrate: duty shifting would be contrary to the nature of shareholder interests only if shareholders' interests have the nature the authors assume. It is, however, far from clear that they do. The authors' claims therefore fall well short of making a compelling case for law reform of the kind they advocate.

Hu and Westbrook claim in the introduction to their paper that '[r]egardless of financial condition, a corporation and its directors should never owe a duty to creditors, apart

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[445] Fidelis Oditah, 'Wrongful Trading' (1990) 218 Lloyd's Maritime and Commercial Law Quarterly 218; quoting RI Tricker, *Corporate Governance* (Gower 1984) 13.

[446] Dworkin, 'Taking Rights Seriously' (n 114); Nozick (n 116) chs 3, 4; Richard A Epstein, 'One Step beyond Nozick's Minimal State: The Role of Forced Exchanges in Political Theory' (2005) 22 Social Philosophy and Policy 286.

[447] The notion that proprietary rights are a 'bundle' of 'incidents' belongs to Tony Honoré: Honoré, 'Ownership' (n 321); see generally Thomas W Merrill and Henry E Smith, 'What Happened to Property in Law and Economics' (2001) 111 Yale LJ 357, 360–366.

from constraints arising in contract and tort.'[448] These latter constraints, they admit, are appropriate. (In a footnote, they also exclude any detailed consideration of fraudulent behaviour.)[449] But what they fail to notice is that, properly understood, the duty to consider the interests of creditors *is* itself a constraint arising from the company's obligations, of which many will have arisen in contract or tort. This is to say that the reason managers should have regard to creditors' interests is that the obligations owed to creditors affect the range of permissible actions that may subsequently be taken in the management of the company, including in the specific ways considered in this section. In one sense, the duties upon managers, via the company, do not change: there is a duty to pay the creditors both inside and outside insolvency proceedings. Outside of insolvency proceedings and when the company's financial health is good, a great many actions by management will be consistent with this obligation to pay creditors and otherwise see to it that the company perform its obligations. In such circumstances, creditors' and shareholders' interests do not require different action. As the company's financial health deteriorates, however, fewer actions will be consistent with the company's obligations, and the reasons given by those obligations. Some courses of action that some shareholders might prefer, including those involving taking on higher

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[448] Hu and Westbrook (n 438) 1324. I assume that the references to 'contract and tort' should be read to include all law that applies generally to companies. I do not take Hu and Westbrook to imply that a company should look to the interests of creditors to the extent required by the law of contract, say, but not where the obligation arose due to the operation of a statute.

[449] ibid 1324 n 5.

risks in the hope of high returns, may be morally impermissible given a company's existing obligations. Hu and Westbrook, however, do not consider this possibility.[450]

The objections to so-called duty shifting I have considered do nothing to cast doubt on the normative appeal of principle (2), and do not amount to an appealing positive case for the shareholder rights Hu and Westbrook say the law should provide. Principle (2), on the other hand, provides a straightforward normative explanation of the *West Mercia* doctrine and its analogues.

3.2. Wrongful trading (ss 214/246ZB)

A second route to making directors responsible for similar wrongdoing is contained in sections 214 and 246ZB of the Insolvency Act 1986.[451] Section 214 concerns wrongful trading, and is engaged where a company has entered insolvent liquidation and:

> [A]t some time before the commencement of the winding up of the company, [a director] knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and … [failed to take] every step with a view to minimising the potential loss to the company's creditors as … he ought to have taken.[452]

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[450] One reason for this is that the authors take as their subject widely held companies, where directors would be expected to have less incentive to pursue such activity than in closely held ones.

[451] References to s 246ZB, concerning companies in administration, are dropped below for ease of exposition.

[452] Insolvency Act 1986 s 214

The knowledge attributable a director whose conduct is being examined is that which the director in fact has, as well as 'the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company'.[453] Where a director has engaged in wrongful trading '[t]he court … may declare that that person is to be liable to make such contributions (if any) to the company's assets as the court thinks proper.'[454]

As was the case concerning the *West Mercia* doctrine above,[455] it appears on the face of section 214 that not only a negative prescription but also a positive prescription. The language of the statute requires managers to take 'every step with a view to minimising the potential loss to … creditors', past the point at which there is no reasonable prospect that the company will avoid insolvency proceedings. This, it might be thought, is a positive prescription, and on this basis escape the kind of justification in terms of principle (2) that I defend in this section.[456] The better view is that the difficulty here is more apparent than real. This is because anything other than the taking of every step with a view to minimising losses to creditors must be condemned by principle (2), apart

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[453] Insolvency Act 1986 s 214(4)

[454] Insolvency Act 1986 s 214(1). Note that this remedial provision is in the same terms as 213(2), concerning fraudulent trading.

[455] See VI.3.1 above.

[456] One possible route to denying that section 214(3) creates a positive obligation would be to claim, at the level of doctrine, that section 214(3) is properly characterised as a defence, rather than an element of the statutory wrong of wrongful trading. I do not consider this possibility here.

from a decision by managers to put the company into an insolvency procedure at the critical point, which decision I assume to be proper.[457] It follows, then, that no further justification is required for the apparently positive side of the duty to avoid wrongful trading.[458]

In recommending the introduction of the wrongful trading remedy the Cork Committee wrote:

> [W]e propose that a company shall be trading wrongfully if, being insolvent or unable to pay its debts as they fall due, it incurs liabilities to other persons without a reasonable prospect of meeting them in full; and that a person who was a party to the carrying on of the company's trading may be made personally liable for the debts of the company if he knew or, as an officer, ought to have known that the trading was wrongful.[459]

The Committee continued:

> We intend our proposals to apply, not only to the company which is unable to pay its debts as they fall due, but also to the company which is insolvent, that is to say, whose liabilities exceed its assets. Such a company is able to pay existing debts only by incurring fresh obligations. The essence of wrongful trading is the incurring of liabilities with no reasonable prospect of meeting them; whether by incurring debts with no reasonable prospect of paying them, or by taking payment in advance for goods to be supplied with no reasonable prospect of being able to supply them or return to the money in default.[460]

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[457] Such a decision might well be inconsistent with minimising losses to creditors.

[458] If such a justification were required, it could be offered in the way considered above by reference to the *West Mercia* doctrine, *mutatis mutandis*: see VI.3.1 above.

[459] House of Commons (n 133) [1781].

[460] ibid [1784].

Quite clearly, part of what the committee had in mind was 'incurring debts with no reasonable prospect of meeting them',[461] and this is reflected in the draft wrongful trading clause included in the Report.[462] This was subsequently confirmed in a White Paper,[463] and while the rule finally enacted was significantly different to that proposed by the Committee, a concern about the incurring of new debts in this way is consistent with the plain meaning of what is now section 214 of the Insolvency Act 1986.[464]

The wrongful trading remedy has not, however, been consistently applied in a manner sensitive to these concerns. The decided cases on section 214 have given the section a somewhat restricted reading, as is conveniently demonstrated by the recent case of *Ralls Builders*.[465] In *Re Ralls Builders* Snowdon J refused to make orders against directors he found to have engaged in wrongful trading contrary to section 214 of the Insolvency Act 1986, because the wrongful trading in question had not increased the net amount of the company's debts.[466] While new creditors had been taken on who were unlikely to be paid, or paid much, some previous creditors had been paid such that the company's balance sheet was in no worse a position that it would have been but for the wrongful

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[461] ibid.

[462] ibid [1806].

[463] Department of Trade, *A Revised Framework for Insolvency Law* (Cmnd 9175, 1984) [4].

[464] Gabriel Moss, 'No Compensation for Wrongful Trading - Where Did It All Go Wrong?' (2017) 30 Insolvency Intelligence 49, 50; Gabriel Moss, 'Addendum' (2017) 30 Insolvency Intelligence 88.

[465] *Re Ralls Builders* [2016] EWHC 243 (Ch), [2016] BCC 293 (Snowdon J)

[466] van Zwieten (n 421) 384.

trading that had occurred. The directors had incurred new debts past the critical point, but the company's net position was no worse than it would otherwise have been. Losses resulting from the deficiency would, however, be borne differently.

In a recent article Gabriel Moss has argued that Snowdon J's decision may be open to doubt on strictly doctrinal grounds.[467] While the doctrinal correctness of *Ralls Builders* is not a matter of primary concern for the purposes of my analysis of the wrongful trading remedy, it should be pointed out that Snowdon J's approach is consistent with previous cases on section 214, even if none of those decisions was strictly binding on him.[468] In *In re Purpoint Ltd*, for example, Vinelott J said:

> The court, in making an order under section 214, is concerned to ensure that any depletion in the assets of the company attributable to the period after the moment when the directors knew or ought to have known that there was no reasonable prospect of avoiding an insolvent winding up—in effect, while the company's business was being carried on at the risk of creditors—is made good. The purpose is to recoup the loss to the company so as to benefit the creditors as a whole. The court has no jurisdiction to direct payment to creditors or to direct that moneys paid to the company should be applied in payment of one class of creditors in preference to another. Moreover, creditors whose debts are incurred after the critical date in fact have no stronger claim than those whose debts were incurred before that date. The former class also suffers to the extent that the assets of the company are depleted by wrongful trading.[469]

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[467] Moss, 'No Compensation for Wrongful Trading - Where Did It All Go Wrong?' (n 464).

[468] *Re Purpoint Ltd* [1991] BCC 121; *Re Continental Assurance Co of London plc (in liq) (No 4)* [2007] 2 BCLC 287

[469] *Re Purpoint Ltd* (n 468) 129 (Vinelott J) (citation omitted). The passage is cited by Snowdon J: *Ralls* (n 465) [237].

Similarly, in *Re Continental Assurance Co of London plc*, Park J held wrongful trading in contravention of section 214 'must make the company's position worse before it becomes appropriate for the court to order the directors to make a contribution.'[470]

Whatever the better view of the doctrine, I wish to suggest that a more careful consideration of just what is wrong with wrongful trading lends support to a wider remedy than the decisions in *Purpoint*, *Continental Assurance*, and *Ralls Builders* appear to allow for. Properly identifying this wrongfulness is, however, a matter of some complexity.

The approach to wrongful trading favoured by Snowdon J identifies its wrongfulness as carrying on past the time at which it is known (or ought to be) that there is no reasonable prospect of avoiding insolvent liquidation, and in failing to take every step with a view to minimising the loss to the company. A remedy will therefore be awarded where trading causes the company's net deficiency vis-à-vis its body of creditors to increase. While I shall suggest that conduct that would lead to the grant of a remedy according to this approach is plainly wrongful, I shall also claim that certain conduct not meeting this threshold is wrongful as well. This, I claim, provides support for a wider reading of section 214 than the authorities considered above require. I wish to suggest that this established approach identifies, but misunderstands, the distinction between two kinds

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[470] *Re Continental Assurance* (n 468) 296 (Park J). The passage is cited by Snowdon J: *Ralls* (n 465) [238].

of cases. That difference, I claim, is the difference between the following examples, of which the latter approximates *Ralls Builders*:

> *Drowning:* A Co's directors know that A Co has no reasonable prospect of avoiding insolvent liquidation. A Co's directors trade on, substantially increasing A Co's net deficiency. A winding-up order is made in respect of A Co.

> *Treading water:* A Co's directors know that A Co has no reasonable prospect of avoiding insolvency liquidation. A Co's directors trade on, paying off old debts with new credit, leaving the net deficiency constant. A winding-up order is made in respect of A Co.

On Snowdon J's approach, *Drowning* involves wrongful trading and *Treading water* does not.[471] In *Drowning*, the business of A Co has been carried on without proper regard for the interests of creditors, who held rights against the company and whom the company owed corresponding obligations. This is an application of the straightforward principle I defend above. Given that the deficiency vis-à-vis the creditors of A Co has increased, there is no need to consider precisely what the interests of creditors are. However these interests are understood, the existing obligations of the company will have counted against actions that would have led to decreased conformity in respect of those same obligations. And so the case is straightforward.

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[471] This is a gloss. More precisely, on Snowdon J's approach, *Drowning* involves wrongful trading for which a remedy should be ordered, whereas *Treading water* involves wrongful trading for which no remedy should be ordered. For present purposes nothing turns on the distinction between Snowdon J's terms, and the gloss I use in the text above.

Treading water is more difficult for at least two reasons. The first is that it does not fall foul of the principle I used to explain the wrongfulness in *Drowning*. This is because the fact of an obligation to X does not count against borrowing money from Y so that X may be paid; instead, it likely counts in favour of such an action. The second appears from the approach taken by Snowdon J, who held that the case did not involve wrongful trading because the creditors *as a whole*—or, if preferred, the company—did not suffer any loss. (Unpaid individual creditors, of course, did suffer loss.) On this view of things there would be no wrong to remedy, and thus no wrongful trading.

To conclude that creditors *as a whole* have not suffered any loss involves the interests of creditors being characterised in a particular way; that is, as the interests of all creditors, whoever these creditors are, taken as an undifferentiated group. If this approach is adopted, then it seems that it is no worse that A Co owe £1m to X, Y, and Z at time *t*, than that A Co owe £1m to W, X and Y at time *t* + 1. This approach leads to the denial of a remedy in a case such as *Ralls Builders*.

There are reasons to doubt this approach to creditors' interests. First, it does not reflect the normative basis of the corporate fidelity concerns I describe in principles (1) and (2) above: that of particular legal obligations owed—not the mere fact of having obligations—having consequences for the practical reasoning of companies through their managers. Second, it involves considering creditors as a group, and seeking to make comparisons between differently constituted groups, at different times, which operation risks moral incoherence, even if such comparisons are made through the

apparently convenient proxy of the net asset position of the company.[472] Third, there is no obvious reason that the moral norm regulating this kind of trading should be insensitive to the distribution of losses in this way.

While *Treading water* is not wrong in the way that *Drowning* is wrong, nor does Snowdon J's approach in *Ralls Builders* persuasively establish the propriety of borrowing from Y to pay pre-existing debts to X, where there is no reasonable prospect of Y being repaid. If wrongfulness is to be established in this case, then, it must be in terms of some further principle.

4. PRINCIPLE (3)

4.1. Wrongful trading (s 214) (continued)

Thus far I have argued that it is wrong to deliberately seek to avoid one's obligations, and that the fact of one's existing obligations give reasons against actions that would make performing one's obligations less likely. The third principle I defend is similarly schematic, and may be stated in the following terms.

[472] This is a particular case of what Derek Parfit called the Non-Identity Problem: Parfit, *Reasons and Persons* (n 69) ch 16; Derek Parfit, 'Future People, the Non-Identity Problem, and Person-Affecting Principles' (2017) 45 Philosophy & Public Affairs 118.

(3) It is wrong to create obligations one knows, or ought to know, one has no reasonable prospect of performing.

I will consider this with reference to an example from ordinary life, before considering it in the corporate insolvency law context, at which point I will state some important qualifications. Consider the following:

> A promises B that he will collect B's child from school tomorrow, in Wales.
> A lives in Australia, and could not reach Wales by tomorrow.

Assume that valid promises create prima facie moral obligations for the promisor.[473] Assume, further, that A's promise is valid. If this is so then A has an obligation to collect B's child from school in Wales tomorrow, despite the fact that A cannot possibly reach Wales by the required time. A is wrong to make such a promise where he knew or ought to have known that there is no reasonable prospect of performing the obligation he voluntarily undertakes at the time he undertakes it.

Such behaviour is wrong for a number of reasons. First, to promise something one has no reasonable prospect of doing involves a kind of untruthfulness. Second, this is a kind of untruthfulness that may, in some cases, deceive. Third, where such a promise does deceive, it may lead to harm to a promisee who acts in reliance on the promise. Fourth, to create promissory obligations in this way may damage the practise of promising to

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[473] This assumption is not strictly necessary for my argument, but rather smooths the presentation of the example. The example need not involve promising, and would be equally workable with another kind of voluntary obligation.

the disadvantage of all: it would take us nearer to a situation in which there was simply no point in promising in the first place, or, if preferred, a situation in which the locution 'I promise' would not bear any particular information. In making this argument I do not need to defend an account of promising. I have assumed, instead, that valid promises just do create obligations. While this view does not enjoy universal assent,[474] it does accommodate the leading theories of promising, including those associated with Joseph Raz, TM Scanlon and Neil MacCormick.[475]

Further examples allow these principles to be better adapted to the corporate insolvency law context, and show the necessity of at least one important qualification. Consider the following cases.

> K Co holds only a moderately successful but distinctly illiquid Austrian real estate portfolio. K Co is obliged to pay £10m to Bankia by tomorrow. K Co has only £7.5m available to pay Bankia, but will receive £10m in historically overpaid VAT from HMRC next week. K Co borrows £2.5m from RBS to pay Bankia. Shortly thereafter, all K Co's properties are destroyed by an earthquake and a rogue employee absconds with the £10m received from HMRC. A winding-up order is made on RBS's application.

> L Co holds only a worthless Austrian real estate portfolio. L Co is obliged to pay £10m to Bankia by tomorrow. L Co has only £7.5m available to pay Bankia, but its directors hope to win £100m in the Euromillions next week. L

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[474] Heidi M Hurd, 'Promises Schmomises' (2017) 36 Law and Philosophy 279.

[475] Raz, 'Promises and Obligations' (n 9); Joseph Raz, 'Is There a Reason to Keep Promises?' (Social Science Research Network 2012) SSRN Scholarly Paper ID 2162656; Neil MacCormick, 'Voluntary Obligations and Normative Powers I' (1972) 46 Proceedings of the Aristotelian Society, Supplementary Volumes 59; Thomas Scanlon, 'Promises and Practices' (1990) 19 Philosophy & Public Affairs 199.

> Co borrows £2.5m from RBS, pays Bankia, and no one wins the Euromillions. L Co's situation does not improve and a winding-up order is made on the application of RBS.

Clearly, there is no cause for complaint against the managers of K Co, given any of the principles I am defending. K Co neither sought to avoid its obligations, nor took steps making it less likely to be able to perform, nor undertook obligations it could not reasonably have hoped to perform. There was no reason, we assume, to anticipate the natural disaster or the embezzlement. The case of L Co is quite different. Here, it is quite clear that L Co undertook an obligation that it could not reasonably have hoped to perform. Clearly, any hope of performance was most unreasonable; indeed, it was less than speculative. But are these facts sufficient to make the managers of L Co's conduct wrongful, as it clearly is?

In a recent article Heidi Hurd defends a similar principle to that which I defend here. In a discussion of the circumstances in which promise-breaking is wrongful, Hurd claims:

> [I]t may be that one's promise … culpably gives rise to adverse reliance because, while one had such reliance as one's purpose at t1 and deliberately uttered one's words so as to induce such reliance, *one should not have done so because one was at least consciously aware at t1 that one might well thwart that reliance at t2*. Thus, if someone is consciously aware of the risk that when payment comes due, her bank account will be empty, she makes a culpable promise in agreeing to pay later for what she takes away from an owner today. When her debt comes due at t2, she cannot claim that she is without blame for failing to pay it, for she acted recklessly in making the promise at

> t1, and she thus culpably induced and then thwarted nonculpable reliance interests so as to leave the object's owner worse off.[476]

In the example in the passage, the promise in question is wrongful to the extent that the promisor, when making the promise, has the prospect of non-performance in mind—call this the intention condition—and the vendor, without culpability, relies upon the promise to his disadvantage—call this the reliance condition. On this view, some kind of reliance is constitutive of the wrongfulness in question, which wrongfulness can only arise, with such reliance, at some time after the promise is made. Concomitantly, where there is no such reliance, there is no wrongfulness in terms of Hurd's principle.

This passage concerns promising, and Hurd's view that the raw fact of promising does not create obligations is controversial. As such, adapting such a discussion to the legal context requires certain straightforward adjustments, not least because contractual obligations, at least, are produced by the parties' actions triggering general norms of the law of contract, and not by one party's reliance on professed intentions of a counterparty. Yet the fact that the recipient of a putatively wrongful promise—one where the intention condition only is satisfied—does *not* rely upon the performance of the promise does seem significant. And something like this significance is apparent in the legal context as well.

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[476] Hurd (n 474) 313 (emphasis added).

In the example above involving L Co, where there was no increase in the net deficiency, but a new creditor taken on who had no reasonable prospect of being paid, we did not know anything about the attitudes, knowledge or diligence of that creditor. Consider versions of the example in which the new creditor extended credit on the basis that it would be repaid, there being—we assume—no reason to think otherwise; or extended credit, knowing it was unlikely to be paid (or paid in full).

The principle that it is wrong to voluntarily create obligations one has no reasonable prospect of meeting—principle (3)—condemns either version of the example. But it also seems that a creditor who extends credit, at interest, knowing that repayment is unlikely, has little to complain about when she is not repaid. She, after all, got what she bargained for, and on the assumption that the net deficiency is not increased, there is no compelling case to offer a remedy—in addition, that is, to the right to participate in pro rata distribution in insolvency proceedings—in response to the debtor's conduct vis-à-vis such a creditor.[477] If I am right about this Hurd's emphasis on the reliance interest in the philosophy of promising points towards a proper limit we should observe in delineating the wrongfulness of incurring obligations that may exceed our capacities.

Just how this limit should be characterised is a matter of some complexity. Consistent with the methods adopted throughout this thesis, my approach is to treat principle (3)

[477] Sometimes, claims that some party 'took the risk' of not being repaid assume (or merely assert) a conclusion of law. This is not such a case: see Frederick Wilmot-Smith, 'Replacing Risk-Taking Reasoning' (2011) 127 Law Quarterly Review 610.

as a moral principle of prima facie wrongdoing, concerning moral obligations. All other things being equal, it is wrong to create a moral obligation that one knows or ought to know one has no reasonable prospect of performing. If we are to qualify principle (3) as I say we should, in order to accommodate the intuition that those who accept promises fully aware of certain facts occupy a special position, we might do so in at least two possible ways. The first would be to see this kind of non-reliance (or partial non-reliance) ab initio as negating any wrongdoing in terms of principle (3). The second would be to maintain that the promisor does wrong in terms of principle (3) in making such a promise, but that the promisee, if she accepts the promise, lacks standing to complain about its having been made because of her knowledge of certain facts. I do not need to choose between these possibilities for the purposes of the argument I defend in this section; both would qualify principle (3) in the manner required. But I cannot quite leave matters here, because the example I am seeking to address concerns the creation of legal rather than moral obligations that a debtor at risk of insolvency may be unable to meet.

The application of principle (3) to the creation of legal obligations, rather than moral obligations, raises further difficulties. Some of these reflect general, structural differences between promising and contracting, which I cannot consider here.[478]

[478] see generally Charles Fried, *Contract as Promise: A Theory of Contractual Obligation* (Harvard University Press 1981); Joseph Raz, 'Promises in Morality and Law' (1982) 95 Harvard Law Review 916; Dori Kimel, *From Promise to Contract: Towards a Liberal Theory of Contract* (Bloomsbury Publishing 2003); Seana Valentine Shiffrin, 'The Divergence of Contract and Promise' (2006) 120 Harvard Law Review 708; Seana Valentine Shiffrin, 'Are Contracts Promises?' in Andrei Marmor (ed), *The Routledge Companion to Philosophy of Law* (Routledge 2012).

Acknowledging these difficulties I claim, somewhat provisionally, that the application of principle (3) in this area may be explained in the following terms. Where a debtor at risk of insolvency enters into a contract with a lender, the legal obligations the debtor creates—to pay the amount owed unconditionally—may be more stringent than the underlying promises made: to try and repay, for example, perhaps in good faith, but at a high interest rate. This means that there will be circumstances in which a debtor at risk of insolvency creates legal obligations that exceed her capacities but does not breach principle (3). In such circumstances the lender has not been wronged, morally speaking.[479] As such, insolvency law need not offer a special response to such lending.

Before leaving this point a further example may usefully be considered, one which illustrates the implications of principle (3). Consider the following:

> *Heading for shore:* A Co's directors know that A Co has no reasonable prospect of avoiding insolvent liquidation. A Co's directors trade on, taking on new credit but substantially reducing A Co's net deficiency. A winding-up order is made in respect of A Co.

On my argument, principle (2) does not condemn the example. Principle (3), however, quite plainly does. This was also the case concerning *treading water*, considered above. The only difference between *treading water* and *heading for shore* is that in the latter case,

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[479] There will also be limits upon the ability to craft legal obligations more stringent than the underlying exchange of promises for otherwise this would open the way to sham transactions and to fraud on other creditors. Such arrangements have been struck down as shams and 'fraud on the bankruptcy laws': *Re Johns* [1928] Ch 737; *Ex p Williams* (1877) 7 Ch D 138.

new credit is taken on and a better job is done of paying the existing creditors. It is still a case of robbing Peter to pay Paul, just one where the directors have done an altogether better job. It might be objected that in condemning *heading for shore*, principle (3) discourages efforts at corporate rescue, and will lead to lower recoveries for creditors overall; put differently, it would lead us to 'shrink the pie'. This might, on some views, be thought to permit the rejection of principle (3) by reductio.

Such an objection is misdirected. From the beginning of this work I have expressly disavowed adopting Kaldor-Hicks efficiency as the purpose or objective of corporate insolvency—or indeed any other part of—law. This means that the failure of some principle to require action that maximises value in some particular circumstances does not, without more, amount to an objection to that principle. This being so, to object to principle (3) on the grounds that it fails to maximise value is not really to object to principle (3) at all. Instead, it is to object to the entire normative project that this thesis pursues. And objections at this level are more properly pursued in more general terms.

There are reasons, however, to doubt the force of the objection, even if taken on its own terms, and these become more obvious when the 'critical point' envisaged by section 214 is considered a little more closely. This critical point is the point at which the company in question has no reasonable prospect of avoiding insolvent liquidation. This will depend on the state of the company's own finances, of course, but also on the support of its lenders. This means that even if a company is cash-flow insolvent, it will nonetheless retain a reasonable prospect of avoiding insolvent liquidation while it retains the

support of, say, its bank. When, then, would the bank be inclined to offer such support? Presumably, this would be in cases where a rescue appears viable, given what the bank knows about the company in question. If this is true then principle (3) seems only to discourage rescue in cases where senior lenders have also chosen not to support such an effort. And if this is so then the value-destructive consequences of principle (3) may be very slight indeed.

At the end of this discussion we see that wrongful trading may take at least two forms, and that a normative explanation of the doctrine may be offered in terms of two principles rather than just one. The first is that the fact of existing obligations counts against actions that would lead to worse conformity with such obligations. This is principle (2). The second is that it may be wrongful to voluntarily create an obligation where there is no reasonable prospect of conformity. This is principle (3). Wrongfulness in terms of this latter principle may be qualified or negated, as explained above, where the obligee knows of the obligor's circumstances, and accepts the obligation regardless. There is no reason to think that such knowledge should negate wrongfulness in terms of the former principle.

The former principle will capture all cases in which the net deficiency vis-à-vis creditors increases after the critical point, whether by deploying assets improvidently or running up further debt with existing creditors. The second principle covers cases in which directors continue to trade, but avoid increasing the deficiency by 'robbing Peter to pay Paul.' Both kinds of trading are, I claim, morally wrongful. If I am right about this, then

this provides a plausible moral foundation for the wrongful trading remedy, as well as grounds for criticising the regrettable manner in which the law on section 214 has developed, and thus the outcome in *Ralls Builders*. Additionally, albeit for different reasons, it vindicates a view taken by the Cork Committee in 1982.

4.2. Fraudulent trading (s 213) (reprise)

Not only does principle (3) complete a defensible normative account of wrongful trading, it bolsters the account of the law of fraudulent trading offered above.[480] There, the fraudulent trading remedy was argued to be referable to principle (1): in particular, to the proposition that it is wrong to deliberately avoid one's obligations. Quite clearly, however, principle (3) is relevant here as well. This is because fraudulent trading might be carried on not only with respect to existing obligations, owed to existing creditors, but also with respect to those who *become* creditors as a consequence of the trading in question, their money taken in circumstances where the debtor knows there is no reasonable prospect that they will be paid, or even intends that they not be paid. If an appealing moral argument identifies wrongful trading in terms of principle (3), then it follows that fraudulent trading may be established in an analogous fashion, *a fortiori*.

[480] See VI.2.2 above.

5. CONCLUSION

In this chapter I have offered three principles of corporate debtor fidelity, and sought to explain a range of insolvency law doctrines in terms of these principles. The principles are as follows.

(1) It is wrong to deliberately avoid one's obligations, or deliberately obstruct others in their enjoyment of rights correlated to such obligations.

(2) Where one has an obligation, the fact of that obligation counts against actions that are inconsistent with that obligation, or which would make performance on that obligation less likely.

(3) It is wrong to create obligations one knows, or ought to know, one has no reasonable prospect of performing.

Principle (1) provides support for doctrines including those targeting transactions in fraud of creditors, fraudulent trading, and the 'phoenix syndrome'. Principle (2) is a weaker version of principle (1), and explains so-called duty shifting doctrines, and, in part, the statutory provisions targeting wrongful trading. Principle (3) completes my normative explanation of the wrongful and fraudulent trading rules.

There is much, however, that has not yet been explained: in particular, the long-standing provisions that allow preferential payments or transactions at undervalue to be

unwound.[481] These provisions have yet to be explained because the actions that they target are not always wrongful in terms of the principles that I have set out in this chapter: the recipient of a preferential payment is not wronged by the receipt of that payment, and, what's more, there is often a reason flowing from a particular legal obligation *to* make a preferential payment.[482] The same may be said concerning undervalue transactions. As such, the normative explanation of these doctrines, if one is to be found, will need to draw on more than the principles set out in this chapter. I consider these matters next.

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[481] Insolvency Act 1986 ss 238-9

[482] Deliberate preferences to connected parties may, of course, fall foul of the principles discussed in this chapter, as may certain undervalue transactions, as appeared from the consideration of s 423. While this will not always be always be the case, where it is, the transactions are likely to contravene certain of the doctrines considered in this chapter in addition to being vulnerable pursuant to the ordinary provisions concerning preferences and undervalue transactions considered in the next (ie Insolvency Act 1986 ss 238, 239).

VII TRANSACTION AVOIDANCE AND DISTRIBUTIVE JUSTICE

1. INTRODUCTION

In the last chapter I considered certain kinds of wrongdoing, and considered certain insolvency law doctrines as responses to this. In particular, I suggested that rules on fraudulent trading, transactions in fraud of creditors, phoenix activity, wrongful trading and so-called duty shifting doctrines could be seen as responses to conduct that is morally wrong, in terms of the rights and duties that people have, and that the law, to some extent, mirrors. That conduct, I claimed, was wrongful in that it (1) involved deliberate attempts to avoid existing obligations, or (2) taking steps that make meeting one's obligations less likely, or (3) undertaking obligations knowing that there is no reasonable chance that they be met.

This explanation left a good deal of what is usually called transaction avoidance law unexplained, including the centrepiece provisions in this area: those providing for undervalue transactions and preferential payments to be unwound. An explanation in terms of the three principles defended in the last chapter was not possible principally

because transaction avoidance doctrines target the recipient of the preference, payment or disposition of property, and not the debtor. Further, it seems that while certain transactions that fall to be unwound as preferences or as transactions at undervalue might be captured by the three principles (and associated debtor fidelity doctrines of positive English law), not all will be.[483] In these cases, it is worth considering why what may well be correctively just arrangements should be unwound. These puzzles, then, motivate this chapter.

In this chapter I shall refer to the group of substantive doctrines I consider as the ordinary transaction avoidance rules. This is in contrast to the fraudulent or wrongful trading rules that were considered in the last chapter. This terminology points to the important differences in justification that the arguments defended in this chapter and the last demonstrate. This is not, of course, to suggest that facts that trigger these ordinary transaction avoidance rules might not also trigger the fraudulent or wrongful trading provisions.[484] Rather, it is to make clear that such facts need not involve any fraud or wrong. This is simply to say that, in many instances, transactions entered into in contravention of the fraudulent trading rules may be vulnerable pursuant to the

[483] A deliberate transaction at undervalue will engage principle (1) (and Insolvency Act 1986 s 423); an unintentional transaction at undervalue might engage principle (2) (and the *West Mercia* rule); an intentional preference will engage principle (1), in each case as against the debtor (or a manager thereof).

[484] See VII.3 below

ordinary transaction avoidance rules as well. But, as stated above, the target of these actions will be different.

This chapter begins by introducing the ordinary transaction avoidance rules in English law (section 2). I then argue that neither transactions at undervalue nor preferences are in themselves morally wrong as between the parties to them: they need not involve misbehaviour or wrongdoing in the way that the provisions considered in the previous part do (section 3). They are, however, objectionable on other grounds (section 4). These grounds, I claim, reflect the principles of distributive justice which, as I have already claimed, are the standard of justification for insolvency law as a whole. These principles count in favour of transaction avoidance doctrines, but also show how such doctrines may be defensibly restricted (section 5). I then offer an evaluation of sections 238 and 239 of the Insolvency Act 1986 in terms of the argument of this chapter (section 6), before offering some comparative context against which my conclusions may usefully be read (section 7).

2. THE ORDINARY TRANSACTION AVOIDANCE RULES

2.1. Undervalue transactions (s 238)

Section 238 of the Insolvency Act 1986 provides for certain transactions at undervalue to be unwound, where a company enters administration or liquidation.[485] The section applies where a company enters into a 'transaction with any person at an undervalue' at a 'relevant time'.[486] A 'transaction … at an undervalue' is one that is gratuitous, or in which the company receives consideration worth 'significantly less than the value, in money or money's worth, of the consideration provided by the company'.[487]

A 'relevant time' is any time in the two years preceding the opening of the relevant administration or liquidation,[488] at which time the company was unable to pay its debts or became unable to pay its debts as a result of the transaction at undervalue.[489] These insolvency conditions are assumed to be satisfied, unless the contrary is shown, where the transaction is with a person connected to the company otherwise than as its employee.[490]

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[485] Insolvency Act 1986 s 238(1)

[486] Insolvency Act 1986 s 238(2)

[487] Insolvency Act 1986 s 238(4)

[488] Insolvency Act 1986 ss 240(1), 240(3)

[489] Insolvency Act 1986 s 240(2)

[490] Insolvency Act 1986 s 240(2)

Where the section is engaged, a court may 'make such [an] order as it thinks fit for restoring the position to what it would have been if the company had not entered into [the] transaction.'[491] However, '[t]he court [should] not make an order under this section in respect of a transaction at an undervalue if it is satisfied—(a) that the company which entered into the transaction did so in good faith and for the purpose of carrying on its business, and (b) that at the time it did so there were reasonable grounds for believing that the transaction would benefit the company.'[492]

In some respects, section 238 is drawn more restrictively than section 423, which provision was considered in the last chapter. Section 423 does not require a transaction to have been entered into at a 'relevant time', for example. However, liability under section 238 may be established without reference to the intention of the disponor. This means that the intention of the disponor is not relevant to whether or not the transaction in question is liable to being unwound pursuant to section 238. What's more, where a transaction is entered into in good faith, and there are reasonable grounds for believing that the transaction would benefit the company, it should not be unwound pursuant to section 238. As such, if the ordinary business of a company really does benefit that company, then it is difficult to see how transactions entered into in the ordinary course of business could be unwound.

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[491] Insolvency Act 1986 s 238(3)

[492] Insolvency Act 1986 s 238(5)

Section 238 of the Insolvency Act 1986 requires a particular kind of 'transaction'.[493] Such a transaction requires 'some degree of mutuality of intent',[494] and cases including *Re Taylor Sinclair (Capital) Ltd* and *Clarkson v Clarkson* provided support for this requirement,[495] which has been repeated in more recent cases.[496] The doctrinal status of the requirement is, however, very unclear, not least because a 'transaction' may include a gift.[497] In the decision of the House of Lords in *Phillips v Brewin Dolphin Bell Lawrie*,[498] the speech of Lord Scott, with which Lords Steyn, Hutton, Hobhouse and Millett agreed, supports the view that the requirement of a 'transaction', simply requires the court to consider the value given by the company, and the amount it received in exchange, whether by way of a single contract or a more complex set of arrangements.[499] But in that case there was no lack of mutuality on the facts, and there is no specific mention of mutuality in Lord Scott's speech. More recently, the Court of Appeal considered the

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[493] The same language appears in the Insolvency Act 1986 s 423.

[494] John Armour, 'Transactions at an Undervalue' in John Armour and Howard N Bennett (eds), *Vulnerable transactions in corporate insolvency* (Hart 2003) 56.

[495] *Re Taylor Sinclair (Capital) Ltd* [2001] 2 BCLC 176 (Englehart QC); *Clarkson v Clarkson* [1994] BCLC 921 (Weeks QC).

[496] *Re Kiss Cards Ltd* [2016] EWHC 2176 (Ch); *Re HHO Licensing Ltd* [2017] EWHC 2953 (Ch)

[497] Insolvency Act 1986 s 436(1)

[498] *Phillips v Brewin Dolphin Bell Lawrie* [2001] UKHL 2, [2001] 1 WLR 143; see Mokal, *Corporate Insolvency Law* (n 51) 312–323; Rizwaan J Mokal and Look Chan Ho, 'Consideration, Characterisation, Evaluation: Transactions at an Undervalue after Phillips v Brewin Dolphin' (2001) 1 Journal of Corporate Law Studies 359.

[499] Mokal, *Corporate Insolvency Law* (n 51) 319.

matter in the case of *BTI 2014 LLC v Sequana SA*,[500] a case in which the 'transaction' for the purposes of section 423 of the Insolvency Act 1986 was the payment of a dividend.[501] David Richards LJ, with whom Longmore and Henderson LJJ agreed, declined to read the statutory 'transaction' requirement as extending only to transactions that were in some way bilateral.[502] But this passage too is *obiter*, as the dividend in question was not held to have been unilateral. Acknowledging this doctrinal uncertainty, I proceed on the basis that a 'transaction' for the purposes of section 238 (and 423) of the Insolvency Act 1986 is almost any transfer of value or valuable property, and that there may well be no additional, more demanding requirement of mutuality mandated by these provisions.[503]

2.2. Preferences (s 239)

Section 239 of the Insolvency Act 1986 provides for certain preferences given to be unwound, where a company enters administration or liquidation.[504] The section applies where a company has 'given a preference to any person', 'at a relevant time'.[505] A company gives a preference to a person where: 'that person is one of the company's

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[500] *BTI 2014 LLC v Sequana SA* [2019] EWCA Civ 112 (Longmore, David Richards and Henderson LJJ)

[501] *Sequana* (n 500) [51]-[64] (David Richards LJ)

[502] *Sequana* (n 500) [58], [60] (David Richards LJ)

[503] This is consistent with the implications of the normative argument I defend below, which would, similarly, offer grounds upon which a stronger adherence to mutuality by the courts might be criticised.

[504] Insolvency Act 1986 s 239

[505] Insolvency Act 1986 s 239(2)

creditors or a surety or guarantor [and] the company does anything or suffers anything to be done which … has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done.'[506] Additionally, it must be shown that the 'company which gave the preference was influenced in deciding to give it by a desire … to produce … the effect.'[507]

A 'relevant time' is any time in the six months preceding the opening of the relevant administration or liquidation—or two years where the preference is given to a connected party[508]—at which time the company was unable to pay its debts or became unable to pay its debts in giving the preference.[509]

Unlike section 238, section 239 includes an element of subjectivity: the need to show a 'desire to prefer'.[510] And whereas section 238 has a defence for transactions made in good faith for the benefit of the company in the ordinary course of business, there is no such provision in section 239.

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[506] Insolvency Act 1986 s 239(4)

[507] Insolvency Act 1986 s 239(5)

[508] Insolvency Act 1986 ss 240(1), 240(3)

[509] Insolvency Act 1986 s 240(1)

[510] Recall that it does have an analogue in the Insolvency Act 1986 s 423 prohibition on transactions in fraud of creditors; see VI.2.1. above.

3. MISBEHAVIOUR

The ordinary transaction avoidance rules contained in sections 238 and 239, which target transactions at undervalue and preferences, are sometimes explained as legal responses to certain kinds of misbehaviour, whether by a debtor, a creditor, or perhaps both. In this section I will briefly set out some such views, and state why they should be rejected.

Before I do so it is worth heading off what might be called a pragmatic objection to my approach. It might be objected that the interpretation that follows does not take account of an important function of the ordinary transaction avoidance rules: that of unwinding fraudulent transactions in situations where the fraudulent trading rules (ie those considered in the previous chapter) could not be satisfied,[511] whether for want of evidence or for excess of cost; or were not used because recovery under an insurance policy might be excluded if formal allegations of fraud be made, for example. Understanding the ordinary transaction avoidance rules in this way ties them—the objection proceeds—to just the kind of misbehaviour considered in the last part, and so the argument I make below is misconceived from the start.

As I have said, such an approach to the ordinary transaction rules sees these rules as targeting just the kind of misbehaviour considered in the last part, albeit indirectly.

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[511] See ch VI above

Instead of requiring the proof of a disponor's state of mind, or fraudulent design, the ordinary transaction avoidance rules simply unwind certain transactions taken to bear certain marks of presumptive fraud. But as the fraud is only presumptive—short of proven dishonesty in any event—the remedial response is civil and, in many cases, restitutionary, rather than penal.[512] This leaves the victims of the supposed fraud materially better off, and the procedure is, in theory at least, cheaper than one in which actual fraud, say, must be shown.

No part of my argument precludes using the ordinary transaction avoidance rules in this way; indeed, quite the contrary is true. This is because to the extent that there are reasons to relax the requirements of the fraudulent trading rules, these reasons are reasons that go not to the evaluation of some impugned conduct, but rather to beneficial effects of such a relaxation in general. These beneficial effects must be, primarily, increased recoveries for creditors.[513] To the extent that this is desirable it is desirable for reasons of distributive justice. This being so, the argument that follows as to the logic and limits of the ordinary transaction rules applies whether they are used to pursue fraud indirectly, or to unwind transactions regardless of fraud. As shall become clear, there is no deep normative difference between these two cases.

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[512] The language of 'causative events' that entrain 'remedial responses' is that of Peter Birks: Peter Birks, *Unjust Enrichment* (2nd edn, Oxford University Press 2005).

[513] I do not consider the possibility that such rules might also beneficially deter fraudulent conduct. Whether or not this is so is a matter for empirical investigation.

3.1. Creditor misbehaviour

In this section I explain why creditor misbehaviour cannot coherently be thought to be a necessary feature of transactions targeted by the ordinary transaction avoidance rules. Such an approach may usefully be considered with reference to the decision of Millett J in *Re MC Bacon (No 1)*.[514]

In that case, a company, MC Bacon Ltd, owing its bank some £300,000 on an unsecured overdraft facility, lost its main customer. Around the same time, two senior directors retired from active management of the company. Upon learning of this, the bank, believing the company to be insolvent but capable of trading out of its difficulties, demanded security as a condition of its continued support. The company gave security, but shortly after this went into administrative receivership.[515] In the receivership, the security given to the bank was challenged, relevantly as a preference contrary to section 239 of the Insolvency Act 1986. Millett J upheld the grant of security. In doing so, he considered ways in which section 239 differed from the previous provision concerning preferences. [516] He considered the difference between the 'dominant intention' requirement, which had been a feature of the old law, and the fact that the then-new section 239 referred to the influence of a 'desire to prefer'. According to Millett J:

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[514] *Re MC Bacon Ltd (No 1)* [1990] BCLC 324 (HC)

[515] Adminstrative receivership was (with prospective effect only) abolished by the Enterprise Act 2002.

[516] Bankruptcy Act 1914 s 44(1) (rep)

> A man is taken to intend the necessary consequences of his actions, so that an intention to grant a security to a creditor necessarily involves an intention to prefer that creditor in the event of insolvency. The need to establish that such intention was dominant was essential under the old law to prevent perfectly proper transactions from being struck down. With the abolition of that requirement intention could not remain the relevant test. Desire has been substituted. That is a very different matter. Intention is objective, desire is subjective. A man can choose the lesser of two evils without desiring either.
>
> It is not, however, sufficient to establish a desire to make the payment or grant the security which it is sought to avoid. There must have been a desire to produce the effect mentioned in the subsection, that is to say, to improve the creditor's position in the event of an insolvent liquidation. A man is not to be taken as *desiring* all the necessary consequences of his actions. Some consequences may be of advantage to him and be desired by him; others may not affect him and be matters of indifference to him; while still others may be positively disadvantageous to him and not be desired by him, but be regarded by him as the unavoidable price of obtaining the desired advantages. It will still be possible to provide assistance to a company in financial difficulties provided that the company is actuated only by proper commercial considerations. Under the new regime a transaction will not be set aside as a voidable preference unless the company positively wished to improve the creditor's position in the event of its own insolvent liquidation.
>
> There is, of course, no need for there to be direct evidence of the requisite desire. Its existence may be inferred from the circumstances of the case just as the dominant intention could be inferred under the old law. But the mere presence of the requisite desire will not be sufficient by itself. It must have influenced the decision to enter into the transaction.[517]

The decision of Millett J in *Re MC Bacon* has been widely criticised.[518] The decision, in particular, gives creditors reason to press most strongly for preferences if they are able,

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[517] *Re MC Bacon* (n 514) 335-6

[518] Goode, *Principles of Corporate Insolvency Law* (n 1) [13-138]; Mokal, *Corporate Insolvency Law* (n 51) 332–338; Andrew Keay, 'Preferences in Liquidation Law: Time for a Change' [1998] Company Financial and Insolvency Law Review 198; Ian F Fletcher, 'Voidable Transactions in Bankruptcy'

so as to improve upon the lot that would otherwise have been theirs in a subsequent liquidation.[519] Millett J was able to reach the decision he did in the case by holding that the pressure the bank was able to apply negated the 'desire' requirement of section 239: MC Bacon was not, in Millett J's view, influenced by a desire to prefer because of the pressure it was under. Put differently, it had no choice. It follows, then, that had the pressure been less, it would have been more likely that the charge in that case would have been held to be a preference in contravention of section 239. This is presumably because there is more room for desire where one's choices are less constrained.

I do not consider objections to Millett J's decision in *Re MC Bacon* on purely doctrinal grounds. Instead, I wish to suggest that the outcome in the case shows why a subjective element such as that found in section 239 has no place in a normatively coherent prohibition on the granting of preferences. In short, the reason that such an element has no place here is that the intention or desire of the grantor of a merely preferential payment does not make any moral difference as between the debtor and its creditors. Intention does matter to the extent that the intention is a fraudulent intention, but such

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in Jacob S Ziegel (ed), *Current Developments in International and Comparative Corporate Insolvency Law* (Clarendon Press 1994) 309.

[519] Where directors make the payment in breach of duty and the dominant creditor dishonestly assists in breach of that duty, they may be liable as an accessory to that breach of duty. Similarly, there is scope for a domanint creditor to be held to be a shadow director, and liable as such: *Westpac Banking Corporation v Bell Group Ltd (No 3)* [2012] WASCA 157, (2012) 89 ACSR 1; van Zwieten (n 421) 405–408.

intentions should be—and, for the most part, are[520]—already addressed by the fraudulent or wrongful transaction rules considered in the last part.[521]

Central to Millett J's analysis is that transactions entered into by companies acting pursuant to 'proper commercial concerns' should not be unwound.[522] Just what 'proper commercial concerns' are is not explained. But the passage cited above does suggest that it will be proper for a company to seek or maintain finance in order to seek to trade its way out of financial difficulties, or perhaps to restructure its finances. Even if this is accepted, however, difficulties remain. First, this would invite a distinction between a case in which a company acted pursuant to such proper commercial considerations, and also desired to improve the lot of the relevant creditor in the event of a liquidation, and one in which a company acted similarly without so desiring. On this approach, only the first case would see a transaction unwound pursuant to section 239.

The second difficulty, however, runs deeper, and reflects the fact that the intention of the grantor of a preference is simply not relevant to any principle of corrective justice that operates as between the debtor and the preferred creditor, the debtor and the non-

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[520] Recall that the decision in *Ralls* (n 465) means that there will be some cases where such an intention may be present but where there may be no remedy, as the net deficiency has not increased. I offer a normative critique of this above: see VI.3.2., VI.4.1. above.

[521] See VII.3. above

[522] *Re MC Bacon* (n 514) 336

preferred creditors, or the preferred creditor and the non-preferred creditors. Instead, it raises questions of distribution: that is, questions of distributive justice.[523]

Consider the following example, which corresponds to the situation in *Re MC Bacon*:

> Q Co is in financial difficulties, with £1m in assets. It has a £1m overdraft with its bank, repayable on demand, as well as further unsecured debts of £1m. The bank threatens to call in the overdraft unless Q Co charges its property for the bank's benefit. Q Co grants the charge.

It is my contention that to seek to analyse an example such as this in terms of misbehaviour would be to miss the point. This is because, on these facts, there is no misbehaviour to speak of. To see debtor misbehaviour here would be to see the directors of Q Co as doing something wrong in seeking to keep their accounts open and to respond to the heavy pressure that was being applied to them. To see creditor misbehaviour here would be to see the bank as acting wrongly in making use of its advantageous position. And to argue in this way would require defending principles pursuant to which a right-holder should, in determining how to act, disregard features of some advantageous position in which she may find herself, and pursuant to which a failure to disregard such features should be considered wrongful. Put differently, it would require the identification of principles that would require a right holder to restrain herself in spite of a correctively just entitlement to take some action. Evaluation in terms of such

[523] See III.3.1. above

principles might then require that the particular right-holder's motivations be considered in each particular case.[524]

Such an analysis is most unpromising. On such an approach, creditor misbehaviour is most obviously to be understood to mean that the bank has wronged the debtor in some way, if we stay with our example. Such a wrong would, then, cry out to be undone or reversed. But how could this be? The debtor itself is no worse off; indeed, it is better off than it would have been had the charge not been given.[525] There is no corrective injustice as between the creditor and the debtor, for the creditor has simply done what she had the right to do, and the debtor had no right that the creditor not take such action. What's more, there is no distributional issue as between creditor and debtor, for the right of the creditor to be paid and the amount of the debtor's debts remains unchanged.[526] As such, we return from the search for misbehaviour empty-handed, at least if we restrict ourselves to the rights and duties that exist as between the debtor and its creditors.

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[524] cf Rawls (n 205) 119.

[525] I do not mean to suggest that no grant of security could leave a debtor worse off. Such a grant might restrict the debtor's future conduct—its ability to raise new finance, for example, or to deal with assets that would not otherwise have been encumbered—in such a way as to leave its chances of avoiding insolvent liquidation altogether worse.

[526] This would also be true in the case of a preferential payment, rather than the putatively preferential grant of a charge. In such a case, the debtor's debt is reduced by the amount of the payment, and the net position as between creditor and debtor remains unchanged. It should be acknowledged that other approaches to valuing debts owed to insolvent companies may be imagined. This face-value or balance sheet approach, however, is established in the case-law: *Re Continental Assurance Co of London* [2001] BPIR 733; *Re Marinari Ltd* [2004] BCC 172 and adopted in the literature: van Zwieten (n 421) 384; Goode, *Principles of Corporate Insolvency Law* (n 1) [14-54]-[14-55]; Roy Goode, *Principles of Corporate Insolvency Law* (4th edn, Sweet & Maxwell 2011) [14-52]-[14-53].

We might, however, understand the complaint about creditor misbehaviour differently. Rather than looking for a wrong by the creditor against the debtor, instead, we might consider whether the putatively preferred creditor has wronged other unsecured creditors of the debtor in some way. This is more plausible than the first suggestion, as here, at least, it is clear that those creditors are indeed worse off as a consequence of the charge having been granted. But this too is beset with difficulties. First, it is not the bank that grants the charge, but rather the debtor. This means that the immediate legal cause of the harm is not any action by the bank at all, but that of the debtor. This points to debtor misbehaviour in the granting of the charge, rather than misbehaviour by the bank. Second, the bank and the other creditors need not have any relationship with each other apart from the fact that their respective, and we assume correctively just, claims against the debtor fall to be met from the same pool of assets. This being so, it is difficult to see how the bank wrongs the other creditors, although it is clearly the case that the pressure brought to bear in obtaining the charge makes the other creditors worse off. The unsecured creditors have no right that the bank not apply pressure to the debtor, nor does the bank owe the particular creditors any duty. If I am right about this then the creditor who would solicit a preference does not necessarily do wrong in so doing.

There is a final sense in which it would be mistaken to assert that the putatively preferred creditor wrongs other creditors; that is, in knowingly assisting the debtor to make a

preferential payment.[527] Such assistance could, of course, only be wrongful if the making of the preferential payment is itself wrongful. This question is considered in the next section, but let us proceed for now on the basis that this is so.[528] If the debtor acts wrongly in giving a preference, so the argument would go, then any other party that assists the debtor in doing also acts wrongly, perhaps depending on their knowledge of the debtor's situation or the extent to which they themselves benefit from the relevant acts. The argument may be put, somewhat more tightly, in the following way:

(1) If D wrongs X in doing some action; and
(2) C assists D to do this; and
(3) C knows D's action wrongs X; and/or
(4) C benefits from the wrong to X; then
(5) C also acts wrongly; and
(6) C also wrongs X.

Let us assume the validity of the inference from (1)-(4) to (5), and that neither (3) nor (4) is redundant. It is clear enough that in certain circumstances such an argument will seem valid. If Trustee holds £1m on trust for Beneficiary, and Rogue helps Trustee to embezzle the money so the two of them can buy a house and abscond it seems clear that not only has Trustee acted wrongly but that Rogue has as well. What's more, in this example, it

[527] I offer this suggestion by way of analogy to the doctrines concerning knowing receipt of trust property, or its proceeds, or knowing assistance in a breach of trust: *Barnes v Addy* (1874) LR 9 Ch App 244; *Westpac Banking Corporation* (n 519); van Zwieten (n 421) 405–408.

[528] I argue below that this is not so: see VII.3.2. below.

also seems natural to suggest that both Trustee and Rogue have wronged Beneficiary. But this, I think, follows from special features of the example and, in particular, the law of trusts. Rogue wrongs Beneficiary in knowingly assisting in Trustee's embezzlement of the trust property. The trust property—the £1m—is that to which Beneficiary was beneficially entitled. Put differently, Rogue wrongs Beneficiary because she has knowingly assisted Trustee to deprive Beneficiary of that very property to which Beneficiary had a legal entitlement, whatever the precise nature of that entitlement be.[529] Furthermore, Rogue never had any right, on the facts of the example, that Trustee purchase a property in order that they might abscond together. If this is true, then there is no valid inference, on the above schema alone, from the premises (1)-(4) to the conclusion at (6), because, on our example, additional special features of the case are responsible for the intuition.

We must consider, then, whether such additional features are present when it comes to knowing or dishonest assistance in the making of what we are assuming to be a wrongful preference. It is clear, I suggest, that no such feature is present. When D gives C a

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[529] I use the language of legal entitlement here—rather than the language of rights—as an acknowledgement of the challenging scholarly debates concerning the 'nature' of the beneficiary's interest in trust property. I do not take a position in these debates, nor upon the prior question of whether or not the beneficial interest under a trust in fact has a nature. See generally Ben McFarlane and Robert Stevens, 'The Nature of Equitable Property' (2010) 4 Journal of Equity 1; Simon Gardner, '"Persistent Rights" Appraised' in N Hopkins (ed), *Modern Studies in Property Law, Volume 7* (OUP 2013); Richard C Nolan, 'Equitable Property' (2006) 122 Law Quarterly Review 232; James J Edelman, 'Two Fundamental Questions for The Law of Trusts' (2013) 129 Law Quarterly Review 66; JW Harris, 'Trust, Power and Duty' (1971) 87 Law Quarterly Review 31; Lionel Smith, 'Massively Discretionary Trusts' (2017) 70 Current Legal Problems 17.

preference, nothing to which any other party had a specific right is misappropriated,[530] and C will have had a right to the relevant payment, or to the payment a preferential grant of security secures. When the preference is given, the fund from which all general creditors are to be paid is depleted.[531] But it makes no sense at all to speak of wronging *all* such creditors, for all such creditors, taken together, are not a person, legal or otherwise,[532] and neither collectively nor individually did such creditors have a right that C or D pay them from the fund specifically, or that that the fund not be depleted. This is important because a wrong, if it is to be capable of analysis in terms of corrective justice, needs to wrong someone; to interfere with something to which that party was entitled *from the wrongdoer*. And there is no such entitlement here.

Absent fraudulent intention, a creditor who presses a debtor for a preference does not necessarily, in doing so, commit any wrong susceptible to analysis in terms of corrective justice. Such a creditor does not wrong the debtor, nor do they wrong other creditors, whether as a principal or as a party knowingly assisting the debtor in some (assumed) wrongdoing. Such arguments apply equally to undervalue transactions. A counterparty who presses for a hard bargain in dealing with a debtor in difficulty does no wrong to

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[530] Were any such misappropriation present on the facts, it could be addressed pursuant to ordinary trust law, equitable principles or the law of property.

[531] Preferred creditors could also be affected. This qualification is dropped in the interests of clarity.

[532] Mokal notes that 'focusing on the interests of creditors as a group … in the present context merely obscures from view the principles actually at play': Mokal, *Corporate Insolvency Law* (n 51) 308. I do not mean to deny that certain formal insolvency and restructuring procedures do constitute committees of (classes of) creditors for certain purposes.

that debtor, who has no right to a deal on any particular terms. That counterparty owes no duty to the debtor's other creditors, and nor would that counterparty wrong identifiable right holders in knowingly assisting an insolvent debtor to enter into a disadvantageous transaction. This will be the case whether the transaction is one for slight or insufficient consideration, or for no consideration at all, as in the case of a gift, for it is not within the power of a counterparty to force a gift from the debtor company.[533] Of course this analysis does not apply in cases that involve a specific misappropriation of property, as where a creditor presses for payment from property held on trust, for example, or otherwise not property of the debtor. For these reasons an analysis of the ordinary transaction avoidance rules in terms of necessary creditor misbehaviour must be rejected.

3.2. Debtor misbehavior

It remains to consider, then, whether the debtor who would give a preference need necessarily do wrong in so doing. Here, once again, I claim that the search for debtor misbehaviour is misguided. The reasons for this may be stated relatively briefly. When

[533] It may be within a creditor's power to press a director to have a company confer a gift on that creditor. Should the director succumb to such pressure this will straightforwardly amount to a breach of her duties to the company. Whether the creditor acts wrongly will depend on the character of the pressure applied. If the creditor has a legal right to take the action threatened, it is difficult to see how this could be wrongful. However, it may be that certain threats to do what would otherwise be lawful acts may amount to 'illegitimate' threats that could lead to the restitution of unjust enrichment: Beale (n 232) [8-046]; Graham Virgo, *The Principles of the Law of Restitution* (3rd edn, OUP 2015) 215–218; cf Paul S Davies and William Day, '"Lawful Act" Duress' (2018) 134 Law Quarterly Review 5.

a debtor gives a preference, she gives a creditor with an acknowledged claim some advantage that other creditors do not receive. This advantage is either the payment of money owed, or an improvement in the creditor's position which improvement is realised in money in a subsequent receivership, liquidation or distributing administration. An insolvent debtor is one unable to pay its debts within the meaning of section 123 of the Insolvency Act 1986; that is, unable to meet its obligations. But each of these obligations remains a peremptory, categorical reason that counts in favour of the debtor taking the action that the obligation requires: usually the payment of a debt. As has been suggested,[534] the fact of such obligations may, in certain circumstances, count against incurring new ones. But it is difficult to see how the fact of practically competing obligations,[535] or indeed logically inconsistent obligations, can provide any guidance to the *debtor*.[536] Instead, as I have argued, such conflicts suggest the need for law to resolve the conflict, in a manner consistent with the reasons of justice that led to the recognition of the relevant legal obligations in the first place.[537]

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[534] See ch VI above

[535] See generally Matthew H Kramer, *Objectivity and the Rule of Law* (Cambridge University Press 2007) 125–130; Matthew H Kramer, 'Rights without Trimmings' in Matthew H Kramer, NE Simmonds and Hillel Steiner (eds), *A Debate Over Rights: Philosophical Enquiries* (OUP 2000) fn 7.

[536] This is what is known as deontic 'explosion'; that is, where the logic of inconsistent obligations formally implies that all action is mandatory (ie to just the same extent): see Lou Goble, 'Normative Conflicts and The Logic of "Ought"' (2009) 43 Noûs 450, 459; Graham Priest, 'Paraconsistent Logic' in DM Gabbay and F Guenthner (eds), *Handbook of Philosophical Logic*, vol 6 (2nd edn, Springer 2002) 343; cf Andrew Currie, 'Conflict and Explosion' (2018).

[537] See V.3.2. above

If I owe £5 to A and £5 to B, but have only £5 to my name, my obligation to A gives me reason to pay A and not to take actions which would make paying A less likely, such as paying B, and my obligation to B gives me precisely opposite reasons. The mere fact of my obligations, here, gives me no practical guidance at all. This being so, it seems natural that in such a situation I would be left to decide based on reasons apart from my obligations: my affection for the creditor, my need to keep them happy for the purposes of future deals, their respective reputations for violence, or anything else. If I choose to pay A, and in doing so to meet one of my obligations, then I do not wrong B except to the extent that I fail to conform to my other obligation, and this, as I have explained, is not the kind of wrongfulness with which insolvency law is concerned.[538] If I am obliged to pay £5 to B and instead pay my last £5 to A, to whom I also owe this amount, I do not do anything, in paying A, that B had a right that I not do.

The limited claim I am making here should not be mistaken for a broader one: that preferences are never objectionable for any reason or wrongful in any sense. Such a claim is clearly mistaken, and I shall explain why this is so in the next section.[539] What I claim above and in the last section, however, is more limited than this. My claim is that while a preference may make certain creditors worse off than they would have been had the preference not been given, such creditors are not wronged by the debtor or the preferred

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[538] See VI.1. above

[539] Jackson states that '[p]references … are bad only in light of a collective proceeding': Jackson, *The Logic and Limits of Bankruptcy Law* (n 19) 138.

creditor, in any relevant sense, when the debtor gives the preference. As I shall explain below, there are better and more straightforward principles—principles of distributive justice—pursuant to which preferences and other vulnerable transactions may be shown to be objectionable.

4. JUSTIFYING THE RULES

In this section I explain the problem with preferences and undervalue transactions, and the proper grounds upon which criticism of them may stand. I explain how the ordinary transaction avoidance rules may defensibly target transactions that involve no wrongdoing whatever, but that cases of presumptive wrongdoing may warrant a less restrictive approach. This, as it happens, is reflected in section 239 of the Insolvency Act 1986. Sometimes the grant of a preference or a gratuitous alienation, for example, may be fraudulent in the most severe sense. In such a case, the transaction may constitute a criminal offence, or ground personal liability pursuant to the fraudulent trading rules. In this section, however, I claim that even where this is so, there may be independently sufficient grounds to unwind such transactions simply in virtue of their outcome or effect.

In the last section I argued that there was no specific wrong in the grant of a preference, in terms of the respective rights and duties of a debtor and its several creditors, and that the same was true of an undervalue transaction. The reason for this was, in each case,

the same: in each case the party putatively committing the wrong in question was found, on closer analysis, to owe no duty to those who would be made worse off by the conduct in question, and those to be made worse off were found to have no right that the putative wrongdoer do anything at all. This meant that, in terms of corrective justice at least, there was no corrective injustice as between identifiable parties: the particular parties were not in any relationship delineated by bonds of obligation.

This much has frequently been noted in the literature, although it is worth noting that the terminology used by certain writers has been apt to mislead. Rather than being for the sake of certain creditors, it has often been said that the ordinary transaction avoidance rules serve the '*pari passu* principle'. Unfortunately this principle has often been used in argument with neither a clear definition nor appropriate qualifications. It is most implausible to read references to the *pari passu* principle, in this context, as references to the inherent importance of *pari passu* distribution. Instead, references to the principle should be read as references to that scheme of distribution established pursuant to mandatory rules of law, of which *pari passu* distribution is a normatively significant component, irrespective of its empirical prevalence.[540] This, in any event, is

[540] As Kristin van Zwieten has recently put the matter, eminent judges and innumerable writers 'have simply invoked the *pari passu* rule as a form of shorthand to describe what is in fact the general statutory rule of distribution[.] This does not mean that references to the principle are hollow, for judges have also recognised that the general rule of distribution—that unsecured creditors must share pro rata in the company's free assets—performs an equality function.' Goode, *Principles of Corporate Insolvency Law* (n 1) [3-07] (citations omitted); cf Goode, *Principles of Corporate Insolvency Law* (n 526) [3-07]; Mokal, 'Priority as Pathology' (n 135) 591.

the approach I adopt, consistent with the arguments defended in earlier chapters.[541] With this is place, the route to a justification for the ordinary transaction avoidance rules is much clearer; indeed, the structural role of the ordinary transaction avoidance rules is almost blindingly clear.

The ordinary transaction avoidance rules support the mandatory insolvency distribution scheme established by the law. This is for the simple reason that some procedure cannot properly be said to be mandatory if those lucky enough to have a good view of things or other advance notice of its implementation are able to opt out of it without consequence. The ordinary transaction avoidance rules, then, support the goals of compulsory, collective insolvency proceedings and the distributions that are made in such proceedings. As Jackson has written, 'the idea of preference law is part and parcel of the substitution of collective remedies for individual remedies.'[542] That these rules support the pursuit of certain goals is to say that they share these goals. This is as true on Jackson's view, stated in the *Logic and Limits*, as it is on that which I defend here.[543] According to Jackson:

> Preference law is best viewed as a solution to [a] replication of the common pool problem that results from strategic planning in the prebankruptcy

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[541] See V.2.2. above

[542] Jackson, *The Logic and Limits of Bankruptcy Law* (n 19) 124.

[543] On Jackson's view, however, the same is not true concerning undervalue transactions. This is because such transactions do not give rise to a common pool problem. As such, on Jackson's view, such transactions should be dealt with by non-bankruptcy law. The argument I defend in chapter 1 requires that Jackson's view on this point be rejected: ibid 146–150.

> period. Preference law, therefore, is essentially a transitional rule designed to prevent individual creditors from opting out of the collective proceeding once that event becomes likely. It is part of the attempt to ameliorate the effects of a common pool problem that justifies a collective proceeding in the first place.[544]

Mokal makes the same point, albeit with reference to a different set of goals:

> [T]he statutory scheme for the distribution of the insolvent estate enshrines Parliament's decision about how to allocate the loss flowing from the insolvency. Attempts to gain immunity subvert this scheme, causing payments to be made to some creditors … to the detriment of others.[545]

The sense in which such conduct subverts—rather than merely avoids—the scheme is that such conduct undermines the goals and purposes of having such a scheme in the first place. My failure to join, say, a political party or a sports club does not undermine either organisation, for such organisations are based on, at least, a community of conviction or interest. My failure to pay tax, on the other hand, subverts the system of public provision because it is a purpose of taxation that it be levied on all such that contributions to public provision may be made pursuant to a scheme that applies to all:[546] my behaviour in opting out cannot but impose costs on others who have no choice but to contribute, and could, in certain circumstances, even make the system of taxation for

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[544] ibid 125 (citation omitted).

[545] Mokal, *Corporate Insolvency Law* (n 51) 309.

[546] Murphy and Nagel (n 159) ch 4.

public provision pointless.[547] This is also true as among creditors in a collective insolvency procedure.

The kind of conduct that will undermine the objectives of compulsory, collective insolvency proceedings will of course depend upon just what the goals of such proceedings are taken to be. We might consider, with Jackson, that the goals of such proceedings are to minimise wasteful and duplicative monitoring costs and to avoid a situation where, in a race for assets, assets worth more together are sold piecemeal. If this is accepted then laws that facilitate or encourage any kind of racing undermine the objectives of the procedure.[548]

On the approach that I defend here, the goals of collective insolvency procedures are to be understood differently. As such, the question is not whether the bank wrongs the other creditors in pursuing its correctively just claims against the debtors—quite clearly it does not. Instead, the question to consider is that of how the law should resolve the conflict between the correctively just claims of the bank, and the correctively just claims of the other creditors, given that not all claims can be paid in full. This question is, in terms of the classification of questions I have defended, one of the distributional

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[547] Such a situation may be analysed as a coordination problem: see Joseph Raz, 'The Problem of Authority: Revisiting the Service Conception' (2005) 90 Minnesota Law Review 1003, 1016, 1036. This is how Jackson himself analyses it.

[548] Jackson, *The Logic and Limits of Bankruptcy Law* (n 19) ch 6. Racing, of course, is a creditor-focused phenomenon, and Jackson's view should be taken to see vulnerable transactions of the kind under consideration as a species of creditor misbehaviour. As explained above, such a view should be rejected.

questions that insolvency law must answer. This is because it requires a determination of entitlements. And distributional questions, as I have explained, must be answered in terms of sound distributive principles; that is, in terms of distributive justice. Where some correctively just arrangement between certain parties affects the interests of non-parties then this, I have suggested, may count against the legal enforcement of arrangements even if and in spite of the fact that the arrangements in question are correctively just.[549] This may be so even where the reasons for which the law might otherwise have given effect to those correctively just arrangements are themselves reasons of distributive justice, as will often be the case. I take it to be obvious that it is not a sound principle of distributive justice that the debtor simply decide the resolution of this conflict of obligations in its unconstrained discretion.

Undervalue transactions and preferences are both objectionable on similar grounds. In each case, arrangements between the debtor and a counterparty—the preferred party or the counterparty to the undervalue—are unwound which, apart from the debtor's insolvency, may be unobjectionable.[550]

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[549] To avoid doubt, such third party effects would also count against the enforcements of arrangements that are not correctively just, *a fortiori*. It is likely that some transactions that fall to be unwound pursuant to s 238 are not correctively just. This possibility need not, however, be pursued for the purposes of the argument I defend here.

[550] Disadvantageous transactions might lead to action by members of a company against a director, by derivative action, where those transactions involved breaches of that director's duties: Companies Act 2006 ss 170-177. However, such action would not affect the validity of the transactions themselves.

The equality of treatment within legally established categories that insolvency law mandates is part of what is owed to individual rights-bearers as a corollary of their capacity to hold and dispose of the legal rights through which a distributive share can be held and enjoyed in a market system.[551] Such equality is straightforwardly subverted by preferential payments and grants of security when a debtor is insolvent, or becomes insolvent as a result of the payment.

The case of undervalue transactions in similarly grounded, though somewhat distinct in its working out. Subject to the ordinary rules concerning the liability of company directors, and the duty of those directors to promote the success of the company,[552] those managing the affairs of companies have wide discretion as to the terms on which they might enter into agreements: they are entitled to bet against the market, and to take on even considerable entrepreneurial risk. That certain directors or managers might make bad deals is unobjectionable to the extent that non-parties to a given transaction are not made worse off in the enjoyment of their legal rights by transactions to which they are not parties.

But in insolvency this is not the case. Here, we assume that there are claims that exceed the value of the insolvent company's assets, and that these claims are protected individually (ie as against the debtor) and also inter se (ie as against other parallel claims

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[551] I defend this proposition above: see V.2.2. above.

[552] Companies Act 2006 s 172

against the debtor) by the law. Whereas a normatively defensible preference provision gives effect to this inter se protection, a normatively defensible provision addressing undervalue transactions gives these existing, vested rights against the debtor some protection against being further impaired by the taking on of new obligations on uncommercial terms, or by the making of gifts. Section 238, then, circumscribes managers' discretion concerning the value of the deals they might enter into far more tightly than does the general law. This is a departure from the ordinary principle of corrective justice according to which agreements, freely entered into, should be enforced. Such a principle, of course, has a particular importance in commercial settings. It is a departure according to which the law restricts managers' permissible action given the vested rights of third parties to some transaction, giving final effect only to those transactions entered into on terms that strangers to the transaction, whose interests are at stake, could be expected to accept. As such, it is a restriction in furtherance of principles of distributive justice.

5. CONTAINING THE RULES

5.1. The finality principle

Thus far I have set out the basis upon which I say ordinary transaction avoidance rules are to be justified, if there are to be justified; that is, in terms of distributive justice. That such rules of law fall to be justified in terms of distributive justice has implications for

the proper limitations and qualifications to which such rules of law may properly be made subject. In this section I consider one such limitation, which I shall call the finality principle. According to the finality principle, it is in some way desirable that transactions be final. Put differently, it is normatively desirable that, once certain requirements are met, transactions may no longer be called into question or unwound pursuant to rules of law, including the ordinary transaction avoidance rules.

The finality principle might be formulated in either of the following ways, both of which purport to consider the position of the parties to some transaction:

(1) Transactions should stand so as not to disturb the legitimate expectations of the parties to them
(2) Transactions should stand so as not to disturb the settled expectations of parties to them

It takes little to show that both of these formulations are unsatisfactory.[553] The first is unsatisfactory because it depends of the definition of a legitimate expectation, which it does not provide. To this extent it begs the question. The second is unsatisfactory because it would lead us to leave undisturbed even very grave injustices merely because of the passage of time. It is unable to distinguish between the settled expectations of a fraudster and that of a bona fide acquirer of the legal estate for value without notice, for

[553] A version of the principle (1) is, however, commonly defended, and sometimes called 'protection of trust': Bork (n 392) [4.55]-[4.66]; Reinhard Bork (ed), *Report on Transactions Avoidance Laws: Clash of Principles: Equal Treatment of Creditors vs. Protection of Trust* (CERIL 2017).

example, upon which distinction we should insist, if what we are considering is an entitlement flowing from some person or other's subjective expectations. What's more, this would put the sections 238 and 239 at odds with section 423, the general equitable rules of accessory liability, and section 21 of the Limitation Act 1980, none of which impose a temporal limitation as to liability.[554] Reasons of consistency and more, then, militate against understanding the finality principle in the second way set out above.

A number of doctrines in English law promote finality and long-held expectations. Limitation statutes—in England the Limitation Act 1980—limit the rights of a would-be claimant once the limitation period set out in that statute expires, and rules of adverse possession extinguish the rights of a former title-holder, 'clearing' the title of the adverse possessor.[555] In the next subsection I derive an appealing version of the finality principle from certain literature concerning the limitation of actions, in particular from work by Richard Epstein.[556] I then consider whether certain limits built into the ordinary transaction avoidance rules, as well as carve-outs from those rules for certain kinds of transaction, promote this version of the finality principle. Such limits include,

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[554] The application of limitation periods to equitable claims is, however, a matter of considerable complexity: see William Swadling, 'Limitation' in Peter Birks and Arianna Pretto-Sakmann (eds), *Breach of Trust* (Hart 2002).

[555] *JA Pye (Oxford) Ltd v Graham* [2002] UKHL 30, [2003] 1 AC 419; *Powell v McFarlane* (1977) 38 P & CR 452; *Buckinghamshire County Council v Moran* [1990] Ch 623 (CA); *Ocean Estates Ltd v Pinder* [1969] 2 AC 19 (PC).

[556] To avoid doubt, I do not mean to suggest that look-back periods and limitation periods are the same. The difference between look-back periods and limitation periods in the strict sense is that the former limit the ability to access the power in question, whereas the latter limit the time by which the power must be used.

concerning undervalue transactions, the temporal element and the insolvency requirement, but are qualified somewhat for connected parties. Concerning preferences such limits include the temporal element, the insolvency requirement, and the intention requirement, which requirements are also qualified somewhat for connected parties. In each case there are protections for certain third parties.

5.2. Finality: the analogy to the limitation of actions

Speaking extra-judicially, Oliver Wendell Holmes Jr once made the following comments concerning limitation provisions:

> The end of such rules is obvious, but what is the justification for depriving a man of his rights, a pure evil as far as it goes, in consequence of the lapse of time? … I should suggest that the foundation of the acquisition of rights by lapse of time is to be looked for in the position of the person who gains them, not in that of the loser. … A thing which you have enjoyed and used as your own for a long time, whether property or an opinion, takes root in your being and cannot be torn away without your resenting the act and trying to defend yourself, however you came by it.[557]

Holmes, in this passage, appears ready to defeat the correctively just claim of one claimant for the sake of the settled feelings or subjective expectations of another, in this case with the help of limitation measures. In doing so he must be taken to understand the finality principle in one of the two ways considered and rejected above. On this approach, the time-barred claimant's correctively just entitlement is defeated because of

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[557] Oliver Wendell Holmes, 'The Path of the Law' (1897) 10 Harvard Law Review 457, 476–477.

the defendant's settled expectation, which, at the expiry of the limitation period, frees the defendant of the duty correlated to the claimant's right.[558] And, what's more, this is done for the sake of the defendant's subjective expectations.

Except in cases where a right-holder has deliberately encouraged or benefited from such expectations, an approach along these lines must be rejected.[559] This is because it purports to offer an account of the limitation measures under consideration in terms of corrective justice, which cannot be articulated without the introduction of a grave confusion. If A has a right that B perform some action, and that entitlement is correctively just, then there are simply no reasons of corrective justice pursuant to which such an entitlement would fall be to be negated at a later time, merely on account of the passage of time.[560] This is because time neither works nor undoes any injustice as between the parties.[561]

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[558] In rare cases will the claimant's right still have certain effects vis-à-vis the defendant, as where, having paid a time-barred debt, a payor seeks restitution: *Moses v Macferlan* (1760) 2 Burr 1005, 1012; 97 ER 677, 681–682 (Lord Mansfield); Charles Mitchell and others, *Goff & Jones: The Law of Unjust Enrichment* (9th edn, Sweet & Maxwell 2016) [2-41]-[2-44].

[559] Such circumstances may be dealt with under the law of fraud, contract, unjust enrichment, or estoppel.

[560] Arguably, the equitable defence of laches does consider the effect of the passage of time as between the parties. I am unable to pursue this matter here: see generally Clare Stanley and Michael J Ashdown, 'Laches and Limitation' (2014) 20 Trusts & Trustees 958.

[561] This observation is made a core element of Robert Nozick's account of justice in transfer (and, arguably, good reason to think that this account cannot but unravel, given the extent of past injustice): Nozick (n 116); Richard A Epstein, 'Past and Future: The Temporal Dimension in the Law of Property' (1986) 64 Washington University Law Review 667, 674.

An alternative account of limitation measures has been offered by Richard Epstein:

> The passage of time is correlated with a wide variety of factors, each of which makes it less likely that a lawsuit will reach the correct outcome. The insistence upon a statute of limitation recognizes that sometimes better overall results are reached by not making individualized inquiries into the facts of each case… Statutes of limitation elevate the temporal element to a categorical role.[562]

In a later article he expands:

> The major cost associated with the passage of time is uncertainty. For risk averse individuals, that uncertainty creates a cost that greater certainty could reduce. In addition, any increase of uncertainty increases the scope of the discretion lodged in both public and private hands. That discretion spurs private litigation that generates high administrative costs and high error rates. The passage of time therefore creates pressures, both public and private, to take steps to ensure that legal rights and duties do not depend on events that are remote from the present[.] … These practical demands often clash with the strict principles of corrective justice, where the passage of time is of no particular consequence in determining the relative rights and duties of all persons. As an abstract principle each violation of individual rights appears to require full redress on a case by case basis. The ungainly structure of legal doctrine is sometimes explained by the difficult task of reconciling these two inconsistent tendencies in a wide range of specific contexts.[563]

Epstein analyses limitation provisions of the kind under consideration as deliberate departures from the administration of interpersonal, corrective justice as between the parties. In doing so he notices, as suggested above, that the passage of time leaves the

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[562] Richard A Epstein, 'The Temporal Dimension in Tort Law' (1986) 53 The University of Chicago Law Review 1175, 1183.

[563] Epstein, 'Past and Future' (n 561) 667–668 (emphasis added).

balance of this purely interpersonal justice unaffected, but that other concerns may justify different action. These other concerns, however, do not touch the parties directly, though to the extent that they generate a legal response they may lead to a modification to their respective positions inter se. Instead, they are system-level considerations. Epstein describes this move in the following way:

> The system of corrective justice provides all individuals with a framework of rights based upon the rules of first possession and voluntary subsequent transfer. The question is whether the removal of some of these rights through general rule can be justified on the ground that the shift in entitlement increases the overall utility of each individual, roughly in proportion to his original holdings.[564]

Now I do not need to accept Epstein's view, stated here, that the ultimate standard of legal justification is that of increasing a particular kind of utility. But I claim, with Epstein, that reasons that fall to be considered at the level of the legal system as a whole may justify departures from individual rights held as a matter of corrective justice, because of the demands of the standard of legal justification, which, I have argued, is that of distributive justice. This is because law should only enforce obligations of corrective justice when this is what distributive justice requires. Where weighty system-level concerns count against the enforcement of correctively just entitlements, this simply states that reasons of distributive justice count against such enforcement. Epstein

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[564] ibid 679 (citation omitted).

and I disagree only, here, on what it is that distributive justice—the standard of legal justification—requires.[565]

What system-level good, then, do restrictions upon the transaction avoidance doctrines work in promoting the finality of transactions? Most obviously, such limitations facilitate the clearance of entitlement, and so reduce uncertainty costs where title or entitlement are in question.[566] In doing so they facilitate voluntary transactions in a market.[567] As Braithwaite and Murphy have argued in a recent review of the legal framework for managing the default of Central Counterparties (CCPs), the financial system benefits both from the ultimate certainty of legal arrangements in place, and from the perception held by market participants that such arrangements will prove resistant to potentially protracted legal challenges,[568] and if this is so then the same must be true

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[565] My treatment of distributive justice in earlier chapters is broad enough that 'maximising utility' can be understood to be a candidate answer to the question of what distributive justice requires. It is not, however, an appealing answer. This does not matter, however, for the purposes of the arguments defended in this chapter: see III.3. above.

[566] To avoid doubt, I do not mean to suggest that the effect of sections 238 or 239 is to render any transaction void ab initio. As such, any limits on the ambit of these provisions does not literally operate so as to clear legal title. An analogy is nonetheless clear: those who fear they may be made to pay money they have received back, pursuant to provisions such as sections 238 or 239, may be affected in just the same way as a person who receives specific property but who cannot be sure it is truly theirs. In this way, limits on these doctrines do have the effect of clearing entitlement, if not, strictly speaking, title.

[567] Epstein, 'Past and Future' (n 561) 668.

[568] Braithwaite and Murphy argue that 'it is not just the fact of legal certainty that is important, but also the perception that a substantive challenge is unlikely to succeed': Jo Braithwaite and David Murphy, 'Got to Be Certain: The Legal Framework for CCP Default Management Processes' (Bank of England 2016) 37 4; Jo Braithwaite and David Murphy, 'Central Counterparties (CCPs) and the Law of Default Management' (2017) 17 Journal of Corporate Law Studies 291, 292.

of transactions.[569] The extent to which provisions such as those under consideration in fact generate these benefits is of course a matter for empirical investigation. A priori, however, the structure of the case is clear. It follows that the finality principle, properly understood, is a proper limit upon the ordinary transaction avoidance rules. It remains to consider, then, whether English law coherently implements the finality principle.

6. EVALUATION

I have argued that, absent fraud, preferences and undervalue transactions are not wrongful in a way that can be coherently cast in terms of corrective justice; that is, in terms of the rights and duties of particular, identifiable parties to the transactions in question. Instead, they are objectionable on grounds of distributive justice. Similarly, absent fraud, no appealing rendering of the principle of finality can be made in terms of corrective justice. Instead, the principle should be understood as one sounding in distributive justice. This means that while distributive justice counts in favour of unwinding certain transactions, it also counts in favour of limiting the extent to which such transactions may be unwound. This, as I have explained, is not for the sake of particular parties to a particular transaction, but rather in support of system-level goals. Such goals include, most importantly, the facilitation of voluntary transactions in markets, which transactions are hindered to the extent that market participants are

[569] This argument also bears upon the carve-outs from the application of the transaction avoidance rules, which matter cannot be pursued here.

unable to know that what they have—and thus might trade with—will not have to be given or paid back to an insolvency office holder or anyone else.[570]

This has implications for the kinds of limits that might rationally be imposed on the ordinary transaction avoidance rules. First, this implies that the limits should be general to transactions, or kinds of transactions, and not reflect the features of particular transactions. Look-back periods are an example of such general restrictions. So too is the general exclusion of certain kinds of transactions from the scope of the ordinary avoidance provisions: exchange contracts, financial collateral, CCP default resolution measures, and the like.[571] The cogency of the arguments in support of these specific carve-outs from the ordinary insolvency regime, however, raises matters of considerable complexity that are beyond the scope of this thesis.[572]

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[570] To avoid doubt, I do not claim that this an appealing first-order distributive principle. Rather, is instrumentally required: see III.3.2. above.

[571] Companies Act 1989 s 165; Goode, *Principles of Corporate Insolvency Law* (n 1) [9-15], [13-137].

[572] The carve-outs from ordinary corporate insolvency law have been introduced in an attempt to contain systemic risk in the financial system. Kristin van Zwieten has recently noted, however, that 'there is a growing body of scholarship maintaining that rules of this kind may in fact increase contagion effects by encouraging creditor counterparties to rush to enforce their rights, [which] may enhance the likelihood of the failure of any individual institution': ibid [1-61], [2-1]; referring to Charles W Mooney Jr, 'The Bankruptcy Code's Safe Harbors for Settlement Payments and Securities Contracts: When Is Safe Too Safe' (2014) 49 Texas International Law Journal 245; Edward R Morrison, 'Is the Bankruptcy Code an Adequate Mechanism for Resolving the Distress of Systemically Important Institutions' (2009) 82 Temple Law Review 449; Edward R Morrison, Mark J Roe and Christopher S Sontchi, 'Rolling Back the Repo Safe Harbors' (2013) 69 Business Lawyer 1015.

By the same token, the differential treatment accorded to voidable transactions entered into with connected parties appears justifiable, and it is difficult to see any objection to the law treating such transactions as presumptively suspect, and so subject to lengthier look-back periods, or to presumptions concerning preferential intent or insolvency.[573] As much is entirely consistent with my argument that ordinary transaction avoidance rules should be restricted for reasons of distributive justice. If the ordinary transaction avoidance rules are qualified and restricted in order to address system-level concerns, then exposing a small class of insiders to wider-reaching rules is entirely consistent with this strategy.

Section 241 of the Insolvency Act 1986 provides that orders made under section 238 and 239: 'shall not prejudice any interest in property which was acquired from a person other than the company and was acquired in good faith and for value, or prejudice any interest deriving from such an interest'.[574] Such a measure promotes the finality of transactions entered into by parties who did not themselves receive the relevant preference or undervalue, and who dealt in good faith and gave value. In its application to transactions with certain general features, it justifiably limits the scope of the ordinary transaction avoidance rules by reference to the finality principle. In not availing those not in good faith, and who do not give value, it excludes from the scope of its protection only those with no maintainable claim to the finality in question.

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[573] Insolvency Act 1986 ss 239(6), 240(1)(a), 240(2).

[574] Insolvency Act 1986 s 241(2)(a)

The approach defended here does, however, provide a basis upon which to criticise features of the existing English law in this area. One such feature is the 'desire' element of section 239,[575] discussed alongside the *MC Bacon* case above. Such a provision serves neither a discernible principle of distributive justice nor legal-cum-commercial certainty.[576] To the extent that it leads to fewer transactions with preferential effects being unwound, it does do in a normatively arbitrary fashion. Such an intention element has no place in a normatively defensible law that governs the unwinding of preferences.[577] As such it is also true that section 238 of the Insolvency Act 1986 quite properly includes no such reference to wholly subjective matters.[578]

Finally, we see that the insolvency requirement that forms a part of both sections 238 and 239 is not defensible in terms of the finality principle, however understood. The insolvency requirement sees to it that only those transactions are vulnerable that do, in fact, set back the interests of other creditors. This goes to the problematic quality of the transaction itself, and not to the particular circumstances in which transactions *of this kind* ought to be unwound. Where a debtor is solvent then preferences and undervalue

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[575] Insolvency Act 1986 s 239(5)

[576] Where the preference in question is made to a connected party the desire to prefer is, however, presumed: Insolvency Act 1986 s 239(6). It is difficult to imagine a case in which this presumption, once raised, might be rebutted.

[577] This conclusion is widely shared by scholars: Goode, *Principles of Corporate Insolvency Law* (n 1) [13-67]; Mokal, *Corporate Insolvency Law* (n 51) 336; Fletcher (n 518) 309; Keay (n 518).

[578] There is a part-subjective 'good faith' element in the Insolvency Act 1986 s 238(5) safe-harbour provision, which is considered above: see VII.2.1. above.

transactions simply do not set back the interests of creditors in the way that they do when the debtor is insolvent. Given the interests of other creditors ground our concern as to the enforcement of undervalue transactions and preferences, it is right to restrict our concern to transactions that in fact have the normatively significant effect with which we are concerned.

7. COMPARISON

Thus far I have offered a normative account of the ordinary transaction avoidance provisions substantially in terms of English law. In this subsection, I will briefly consider analogous provisions in Australian federal insolvency law, German federal insolvency law and French law. Other jurisdictions might have been chosen, but nothing turns on this for present purposes. The purpose of this brief and necessarily selective comparative survey is to show, first, that transaction avoidance rules of the kind I have considered in this chapter—including a preference provision without a subjective element—are extant legal phenomena, albeit not necessarily English ones, and as such candidate objects of study. Second, it is to show that my normative analysis does not, where it diverges from English positive law, diverge in any significant way from the solutions arrived at by other major jurisdictions. This does not affect the logical force or cogency of the principal claims defended in this chapter. It does, however, offer context consistent with the argument of this chapter both as to the purposes these rules serve and their limits. Finally, it suggests that not just the normative argument of this chapter but also the

overall argument of this thesis may have, whatever else they have, a certain broad explanatory appeal.

Provisions analogous to what I have called the ordinary transaction avoidance rules exist in many major legal systems.[579] Australian law provides relief in cases of 'unfair preferences'[580] and 'uncommercial transactions'.[581] In both cases, there are analogous transaction requirements,[582] temporal requirements,[583] and insolvency requirements.[584] Connected party transaction are also singled-out both by specific provisions concerning 'unreasonable director-related transactions', which include transactions involving close associates of directors,[585] and by lengthier look-back periods for transactions involving related entities.[586] There is, however, no intention requirement in respect of unfair

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[579] See generally Bork (n 553); Gerard McCormack and others, *Study on a New Approach to Business Failure and Insolvency: Comparative Legal Analysis of the Member States' Relevant Provisions and Practices* (European Commission 2016).

[580] Corporations Act 2001 (Aus) s 588FA

[581] Corporations Act 2001 (Aus) s 588FB

[582] In the case of unfair preferences, the requirement is that 'the transaction results in the creditor receiving from the company, in respect of an unsecured debt that the company owes to the creditor, more than the creditor would receive from the company in respect of the debt if the transaction were set aside and the creditor were to prove for the debt in a winding up of the company': Corporations Act 2001 (Aus) s 588FA(1)(b). In the case of uncommercial transactions, the requirement is that 'it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction, having regard to: (a) the benefits (if any) to the company of entering into the transaction; and (b) the detriment to the company of entering into the transaction; and (c) the respective benefits to other parties to the transaction of entering into it; and (d) any other relevant matter': Corporations Act 2001 (Aus) s 588FB(1).

[583] Corporations Act 2001 (Aus) s 588FE

[584] Corporations Act 2001 (Aus) s 588FC

[585] Corporations Act 2001 (Aus) s 588FDA

[586] Corporations Act 2001 (Aus) s 588FE(4)

preferences.[587] A defence is available to those transacting in good faith, without reasonable grounds for suspecting the company is insolvent, and who give consideration or change their position.[588]

German law provides for *Insolvenzanfechtung* in analogous cases. Gratuitous transfers made in the four years preceding the entry into insolvency proceedings may be unwound.[589] So too may decisions to give security or satisfaction in the three months preceding the entry into insolvency proceedings, where the debtor was insolvent and the creditor knew of the debtor's insolvency.[590] Payments and grants of security to which a creditor is not entitled are liable to be unwound where they are given in the month preceding the request to enter insolvency proceedings, or in the three months preceding the request if the debtor was insolvent or the creditor knew of the disadvantage to other creditors.[591] Transactions directly prejudicial to insolvency creditors may be unwound where they are entered into in the three months preceding the entry into insolvency proceedings, where the debtor is insolvent and the counterparty knew of the debtor's insolvency.[592] By way of comparison with English law, German law has broadly

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[587] Where such an intention is present, a transaction may be able to be set aside pursuant to the Corporations Act 2001 (Aus) s 588FE(5), which, subject to a 10 year look-back period, is analogous to Insolvency Act 1986 s 423.

[588] Corporations Act 2001 (Aus) s 588FG

[589] Insolvenzordnung (Germany) § 134 ('InsO')

[590] InsO § 130

[591] InsO § 131

[592] InsO § 132

analogous temporal requirements and insolvency requirements (except concerning gratuitous transfers).[593] However, where the English law concerning preferences looks to the intention of the debtor, some analogous provisions in the InsO look to the counterparty's knowledge of the debtor's financial state.

French law provides for the nullity of certain acts taken after the debtor's *cessation des paiements*; that is, the date the court determines the debtor to have been cash-flow insolvent, which date may not be fixed more than 18 months prior to the date of the judgment opening the insolvency procedure.[594] Acts so avoided include, among others: gratuitous alienations of real or personal property; contracts 'dans le[s]quel[s] les obligations du débiteur excèdent notablement celles de l'autre partie'; payments on debts not (yet) due; and grants of security for existing indebtedness.[595]

Even a cursory consideration of this material, then, shows that while provisions targeting certain pre-insolvency transactions are indeed common, and share a similar structure, they are by no means identical.[596] This comparative material establishes that there is a common view that there is *something* objectionable about certain kinds of pre-bankruptcy transactions or dispositions of property. The argument I defend above

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[593] See, to similar effect, Insolvency Act 1986 s 423.

[594] Code de Commerce (France) L631-8

[595] Code de Commerce (France) L632-1

[596] This is also the conclusion of two recent surveys: Bork (n 553); McCormack and others (n 579) ch 4.

provides a plausible account of just what this wrongfulness is, and what it is not, in a way that does not depend on the peculiarities of English positive law.

8. CONCLUSION

This chapter began by introducing what I have called the ordinary transaction avoidance rules, that is, the rules targeting undervalue transactions and preferences under English law. I considered whether these could coherently be understood in terms of wrongdoing, whether by the debtor, a creditor, or by certain third parties, concluding that they could not be, before developing an account of just what makes preferences and undervalue transactions objectionable in terms of distributive justice. This involved explaining why it is that distributive justice can sometimes require that even correctively just arrangements be unwound; that is, because the reasons to give legal effect to correctively just arrangements are themselves reasons of distributive justice, and so to be weighed against other reasons of distributive justice that may be in play. I then considered the proper limits upon the ordinary transaction avoidance rules in terms of a conception of the principle of finality, before offering an evaluation of sections 238 and 239, along with some comparative context. The upshot of all of this is that this discussion of corporate fidelity must conclude in a deflationary fashion. This is because sections 238 and 239 of the Insolvency Act 1986 do not, in the final analysis, address fidelity concerns at all. Instead, they are provisions of a kind—if not in every aspect of their detail—required by

distributive principles, and implied by the mandatory distribution regime. While they are not the only such rules of law, they are some of the most significant.[597]

[597] Others include disclaimer and the avoidance of post-petition dispositions: Insolvency Act 1986 ss 127, 178.

VIII CONCLUSION

1. SUMMARY

Building upon key insights from proceduralist scholarship, this thesis shows that corporate insolvency law raises, among others, distributional and debtor fidelity questions. It offers answers to some such questions, and shows the ways in which these are related.

Questions of who gets what in corporate insolvency law are, paradigmatically, questions of distributive justice. All those within the scope of this justice are entitled to a distributive share. In a community in which access to resources and other advantages is mediated by legal rights, all members of the community must have at least the bare capacity to hold, create and deal with legal rights.

This capacity to hold, create and deal with legal rights must be an equal capacity. It follows from this that the law should, as a starting point, act impartially as between exercises of the capacities in question; that is, the law must treat legally similar rights in a formally equal fashion. Default (and residual) *pari passu* distribution in insolvency proceedings is therefore both explicable and normatively desirable. The law may provide for different classes of legal rights—personal and proprietary, and so on—which

classes have different features and behave differently in insolvency proceedings. That such classes be allowed, however, should be justified in terms of distributive justice, and must be considered right by right. Where some of a debtor's obligations go unmet, whether by reason of the recognition, by law, of different classes of rights, or by the mere fact of the debtor's inability to pay, the state may have undefeated reasons of distributive justice to see that the underlying interests of certain creditors are met in some other way (ie other than from the debtor's estate). Whether or not this is so depends on the nature of these underlying interests.

What have been called the fraudulent trading rules (Insolvency Act 1986 ss 423, 213, 246ZA, 216, 214, 246ZB and the *West-Mercia* doctrine) are justified by reason of the obligations a debtor already owes at relevant times, and also by the further reasons given by those obligations. A wider reading of the wrongful trading remedy (Insolvency Act 1986 ss 214, 246ZB) is required to better express the justification for these provisions defended here.

The rules targeting transactions at undervalue (Insolvency Act 1986 s 238) and unfair preferences (Insolvency Act 1986 s 239) cannot coherently be said to target misbehaviour or moral wrongdoing as between the debtor and the recipient of the preference or undervalue. Attempts to cast these provisions in this light can only lead to the drawing of morally irrelevant distinctions, which may be avoided by offering a justification of these provisions in terms of distributive justice. Distributive justice also provides a sound basis upon which to place limits—including temporal limits—on transaction

avoidance provisions, without the need to argue that fraud should be excused in virtue of certain parties' settled expectations.

2. FURTHER QUESTIONS

There is a great deal that this thesis has not been able to consider. The normative arguments advanced might straightforwardly have been applied to further corporate insolvency law and company law doctrines. The distributive principles considered would, for example, have been sufficient to permit an analysis of the doctrine of disclaimer, pursuant to which an insolvency office-holder may divest the company of 'onerous property'.[598] The debtor fidelity principles, too, might have been considered alongside the law and practice of company director disqualification.[599] Both sets of principles imply claims about the kinds of restructuring procedures that the law should permit, and in particular concerning the conditions under which a restructuring plan may permissibly be imposed upon dissenting creditors or dissenting classes of creditors—the process usually called 'cram-down'.[600] While these are questions of considerable interest and of practical importance, they have not been able to be pursued here.

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[598] Insolvency Act 1986 s 178

[599] Company Directors Disqualification Act 1986

[600] see Jennifer Payne, 'The Role of the Court in Debt Restructuring' (2018) 77 The Cambridge Law Journal 124.

This thesis has considered corporate insolvency law. As I have already explained, certain arguments made here are readily applicable to personal insolvency law. In order to pursue such reflection, however, further work would be required, both in applying the normative arguments defended here to specific personal insolvency doctrines, and in considering the reasons there might be to relieve individuals *qua* individuals from indebtedness they are unable to meet.[601]

A further important direction in which reflection might be pursued would be in respect of cross-border insolvency. A range of instruments aim to regulate this important area,[602] which may operate alongside various domestic law rules of private international law.[603] On one prominent view, cross-border insolvency should be regulated according to what is called the principle of universalism.[604] According to the principle of universalism, insolvency proceedings with an international connection should be dealt with in a single

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[601] Gross (n 47); Hurd and Brubaker (n 126); cf Jackson, 'The Fresh-Start Policy in Bankruptcy Law' (n 127).

[602] eg Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings [2015] OJ L141/19; UNCITRAL Model Law on Cross-Border Insolvency (1997); see generally Ian F Fletcher, *Insolvency in Private International Law: National and International Approaches.* (2nd edn, Clarendon 2005).

[603] eg Insolvency Act 1986 s 426; *Cambridge Gas Transport Corporation v Official Committee of Unsecured Creditors* [2006] UKPC 26, [2007] AC 508; *Rubin v Eurofinance SA* [2012] UKSC 46, [2013] 1 AC 236; *Singularis Holdings Ltd v PricewaterhouseCoopers* [2014] UKPC 36, [2015] 1 AC 1675 (common law principle of universalism); *Re Commercial Bank of South Australia* (1886) 33 Ch D 174; *Re English, Scottish and Australian Chartered Bank* [1893] 3 Ch 357; *Felixstowe Dock and Railway Co v United States Lines Inc* [1989] QB 360 (common law ancillary liquidation doctrine).

[604] see Gerard McCormack, 'Universalism in Insolvency Proceedings and the Common Law' (2012) 32 Oxford Journal of Legal Studies 325; Bork (n 392).

set of (main) proceedings, which have global effect.[605] The normative basis for the principle of universalism has not yet been satisfactorily articulated. At the same time, however, it is strongly advocated by certain scholars. It may be that universalism, as used by certain writers, amounts to a version of efficiency.[606] If this is so, then it is worth figuring out if this is all universalism is, and, if not, what else it might be thought to be. If, as this thesis argues, insolvency law takes its shape from what individuals are owed in distributive justice, then a normative account of cross-border insolvency law should take as its starting point those very same entitlements.

3. ENVOI

The foregoing shows that a normative account of corporate insolvency in terms of distributive justice is both possible and illuminating. There is no good reason to think that corporate insolvency law should not be analysed in terms of distributive justice, and this thesis has shown where such an analysis might lead. In doing so it has shown that a normative account of this kind accommodates certain commonly-held moral intuitions: that there is something unfair about giving preferences, or looking after

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[605] Universalism is usually offered by way of contrast to territorialism, according to which assets of an insolvent debtor local in different jurisdictions, for example, might be dealt with in separate proceedings in those different jurisdictions and perhaps even according to different laws.

[606] This is almost certainly true in Lucian Arye Bebchuk and Andrew T Guzman, 'An Economic Analysis of Transnational Bankruptcies' (1999) 42 The Journal of Law and Economics 775; Irit Mevorach, *The Future of Cross-Border Insolvency: Overcoming Biases and Closing Gaps* (Oxford University Press 2018) ch 1.

shareholders at creditors' expense; or that *pari passi* distribution is in fact a morally sound default rule when it comes to distributing the property of an insolvent debtor, to name a few. Further, it shows an underlying unity in the reasons that may be seen to underlie such intuitions. Not only does this account fit with certain moral intuitions, it also fits with a great deal of English positive law. The mandatory insolvency stay, the mandatory distribution regime, default *pari passu* distribution, the treatment accorded to employees and other vulnerable stakeholders, the fraudulent trading rules and the ordinary transaction avoidance rules have all be shown to be, to a considerable extent, justifiable (albeit, in some cases, on the assumption that certain further empirical premises hold). Arguments in these terms have not previously been made.

The Creditors' Bargain Model of insolvency law must be discarded. The debate—metaphorical or otherwise—between proceduralist and so-called traditional insolvency law scholarship should no longer be pursued. Instead, attention should be directed to the way in which corporate insolvency law articulates with the rest of the particular legal system in which it is to be found, and the important interests of distributive justice that that system ought to protect. To see corporate insolvency law in this way is to emphasise its public, as opposed to private, character. This is of particular importance in a common-law jurisdiction like England and Wales, in which it is usually though that the arguments upon which a court should found its decision should be brought by the parties to a dispute. In such systems it is unlikely that private parties are properly incentivised to look to the public interests at stake. It is equally unlikely that judicial officers are

properly equipped to consider such matters of their own motion. These are matters of some concern.

Corporate insolvency law, then, is less special than it seems. Its normative skeleton takes its shape from the justification for the legal system as a whole; it is neither neutral, nor some separate domain. The justification it requires is therefore no more special than that required for any area of law. But it is nonetheless an integral part of any system of financial capitalism, for in such a system—whatever its merits or demerits—widespread default must be a fact of life. That this is so reflects the way in which the market redirects resources away from less-valued uses and redeploys them. If there is nothing objectionable about a market sanction of this kind falling upon an economically distressed company, the same cannot be said for those individuals who depend on that company in different ways. These individuals are among those to whose interests every aspect of law must, in the final analysis, answer. Normative reflection concerning this relationship may fruitfully be pursued in terms of distributive justice.

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