Personal Insolvency Law in the Modern Consumer Credit Society: English and Comparative Perspectives

JOSEPH SPOONER, PHD CANDIDATE, UNIVERSITY COLLEGE LONDON

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I, confirm that the work presented in this thesis is my own. Where information has been derived from other sources, I confirm that this has been indicated in the thesis.

Abstract

My project considers the extent to which personal insolvency law has evolved, and should evolve, to meet the conditions of the modern consumer credit society. I illustrate how unprecedented household borrowing has become essential to sustaining macro-economic growth and household living standards, and present economic theories explaining this development, as well as the legal/regulatory norms which facilitated it. Exploring insolvency law theory (particularly ideas from law and economics), I then contrast the law's traditional debt collection objective with the more recently developed fresh start policy in arguing that the circumstances of modern consumer over-indebtedness require a re-orientation of the law to prioritise its debt relief objective.

I explore next factors influencing the development of consumer insolvency law. I contrast the laws of England and Wales, Ireland, France and Belgium, highlighting the extent to which each law is oriented towards the goals of debt collection or debt relief. Using empirical data to question theories which attribute such differences to contrasting legal traditions, social welfare systems or cultural values, I argue that political factors such as interest group influence and shifting policy salience have been more influential in shaping laws, and may occasionally impede the advancement of the fresh start policy.

Next I evaluate the extent to which the realities of consumer over-indebtedness and the fresh start policy have been accepted by English policymakers, administrators and courts. My case studies focus on the conditions for access, scope of debt relief, and sanctions for culpable debtors under English personal insolvency procedures. I argue that in certain aspects English law has not departed sufficiently from its origins in commercial law and its traditional role as a debt collection mechanism. I propose reforms which would allow the law to reflect better its transformation into a *de facto* consumer law and its need to embrace more comprehensively the fresh start policy.

This study reflects the law as it stood, to the best of the author's knowledge, on 15 November 2013, unless otherwise indicated. All website addresses cited were accurate on this date.

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CHAPTER 1: Personal Insolvency Law in the Modern Consumer Credit Society

1.1 Introduction

The central aim of my thesis is to examine the extent to which personal insolvency law has evolved, and should evolve, to meet the conditions of the modern consumer credit society and the new phenomenon of household or consumer over-indebtedness. I focus in particular on the personal insolvency law of England and Wales, which has remained an incrementally-reformed law built upon a slowly evolving centuries-old framework, while socio-economic circumstances relating to personal credit and debt have transformed drastically in recent decades. The "financialisation of society" has seen financial services and the logic of financial markets[1] occupy increasingly significant roles in society, [2] as individuals, companies and public authorities must use financial services to meet a rising number of needs.[3] In recent decades, household credit became widely available to an unprecedented degree, occupying an essential role in financing macro-economic growth, as well as to the improvement and maintenance of household living standards at the micro-economic level. [4] The accompanying new phenomenon of widespread household over-indebtedness has transformed the nature of English personal insolvency law from a commercial law designed to recover investments in a failed business into a consumer debt relief device.[5] These new conditions of the "consumer credit society" call for reconsideration of the principles and policies underlying personal insolvency law, to shape the law to its new context.[6] This chapter presents this context, outlining social, economic and political circumstances which have led to unprecedented household borrowing and the problem of mass over-indebtedness which now confronts personal insolvency law. My primary focus lies on the case of England and Wales (or the wider UK, where appropriate), but much of the analysis is relevant to other European countries also.

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[1] *See e.g.* GERALD F. DAVIS, MANAGED BY THE MARKETS 6 (OUP Oxford, Reprint ed. 2011).

[2] As noted by Lord Turner in 2009, "one of the striking features of the last 15 years has been a dramatic increase across the world in the relative size of wholesale financial services within the real economy." *See* LORD TURNER, TURNER REVIEW 47 (Financial Services Authority 2009); Christoph Deutschmann, *Limits to Financialization*, 52 EUR. J. SOCIOL. ARCH. EUR. SOCIOL. 347 (2011).

[3] GEORGES GLOUKOVIEZOFF, UNDERSTANDING AND COMBATING FINANCIAL EXCLUSION AND OVERINDEBTEDNESS IN IRELAND: A EUROPEAN PERSPECTIVE 14 (Studies in Public Policy, volume 26, The Policy Institute at Trinity College Dublin 2011).

[4] *Id.*, 17.

[5] As I discuss in Chapter 3, these developments led to the enactment of bespoke consumer insolvency laws in other jurisdictions.

[6] *See* Iain Ramsay, *Consumer Credit Society and Consumer Bankruptcy: Reflections on Credit Cards and Bankruptcy in the Informational Economy*, *in* Iain Ramsay, William C. Whitford and Johanna Niemi-Kiesilainen (eds.), Consumer Bankruptcy in Global Perspective 17, 22 (Hart Publishing 2003).

1.2 Consumer/Household Over-Indebtedness and Personal Insolvency Law

A. Household Debt and the Consumer as the Subject of Personal Insolvency Law

The development of the modern consumer credit society and the advent of mass household over-indebtedness require personal insolvency law to occupy a new primary role of addressing the insolvency, not of a commercial actor, but of a *consumer*. The consumer is a concept which the law usually conceptualises as an individual who is acting in a relevant transaction for purposes *outside of her trade or profession*.[7] Therefore my concept of the modern *consumer* credit society involves the circumstances of an unprecedented expansion of borrowing by individuals for non-commercial personal finance purposes, and a departure from the historical position in which credit was primarily used by traders to fund business activities. In certain countries such as France the historical limitation of personal insolvency procedures to business debtors[8] led policymakers to create bespoke consumer insolvency procedures to address the problem of household over-indebtedness, and it is these procedures which fall within my project.[9] Under English personal insolvency law, however, no such distinction between traders and non-traders exists, and procedures have been open to non-traders since the enactment of the *Bankruptcy Act of 1861*.[10] Similarly under Irish law all natural persons are eligible for entry to personal insolvency procedures.[11] My interest lies in how these procedures have evolved to respond to the onset of mass household over-indebtedness.

A legal distinction has traditionally existed between the insolvent trader and consumer due to factors such as the possibility for traders to incorporate and benefit from limited liability in the event of business failure[12] and the law's historical vision of its role as being to support

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[7] This is a widely-used legal definition of "consumer". For example, the 2008 EU Consumer Credit Directive defines a consumer as "a natural person who, in transactions covered by this Directive, is acting for purposes which are outside his trade, business or profession." *See* Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on Credit Agreements for Consumers and Repealing Council Directive 87/102/EEC art. 3(a) (2008); Consumer Credit Act 1974 §16B (1974).

[8] *See* Nicolaas Jacob Herman Huls, Overindebtedness of Consumers in the E.C. Member States 100 (Collection Droit et consommation; Centre de Droit de la Consommation, 1994); Jason J. Kilborn, *Responsabilisation De l'Economie*, 26 Mich. J. Int. Law 619, 628 (2004).

[9] Code de la Consommation, arts. L330–1; 333–3. The exclusion of business debtors with professional debts from the procedures is apparently based on an aim of protecting the security of transactions by preventing an insolvent trader from being able to opt between multiple procedures: *see* Khayat, Droit du surendettement des particuliers 24–6 (LGDJ, 1998).

[10] Bankruptcy Act 1869, s. 69. *See also* Ian F. Fletcher, The Law of Insolvency ¶5.014 (4th Revised edition ed., Sweet & Maxwell, 2009).

[11] Bankruptcy Act 1988, §7(1) (1988); Personal Insolvency Act 2012, §2(1) (2012).

[12] Fletcher (2009), ¶1–022. The benefits of limited liability may be eroded, however, by lender practices requiring business people to waive limited liability and to guarantee loans of their companies: *see e.g.* Law Reform Commission of Ireland,

commercial activity, with little utility recognised in non-business credit.[13] The empirical circumstances of a self-employed small trader who earns a low-to-middle income from her business, however, may not be very different from those of a debtor earning a similar income from her employment.[14] Similar forms of credit may also be used by consumers and business debtors, and in some cases the difficulty in untangling a debtor's obligations in order to categorise her status as trader or consumer may outweigh the benefits of drawing the distinction, which necessarily involves a degree of arbitrariness. Indeed laws applying this test have generated legal uncertainty;[15] while policymakers and law reform bodies in England[16] and Ireland[17] have expressly rejected this nebulous distinction. The similar socio-economic circumstances of low-to-middle income business debtors and consumer debtors mean I include both categories within my study. Therefore while I remain primarily concerned with personal debt incurred outside of the business context, my use of the term "consumer" is more flexible than such a narrow legal definition.[18]

Accordingly, I use the term "consumer credit/debt" largely interchangeably with the term "*household* credit/debt". This latter term captures the socio-economic context of personal finance, as resources are generally shared among members of the household unit, rather than held individually. It also clarifies my inclusion of both secured and unsecured credit in my analysis, a clarification necessary due to the distinction sometimes drawn (legally and otherwise) between consumer credit and secured credit such as mortgage loans.[19] The adoption of the term household credit also intends to indicate my focus on borrowing to fund the full range of household expenses (housing, education, transport, healthcare, other general living costs), so avoiding negative connotations of "consumer" credit as sometimes conceptualised as borrowing

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REPORT ON PERSONAL DEBT MANAGEMENT AND DEBT ENFORCEMENT ¶¶1.340–1.346 (2010). The widespread nature of this practice during Ireland's credit boom of the 2000s led a judge in 2012 to refer to "the usual personal guarantee by directors which is an almost standard obligation of banks loans at this time." ACC Bank plc. v Dillon and Others, [2012] IEHC 474, ¶1.1, per Charleton J.

[13] *See e.g.* Jay Cohen, *The History of Imprisonment for Debt and Its Relation to the Development of Discharge in Bankruptcy∗*, 3 J. LEG. HIST. 153, 161–62 (1982); citing William Blackstone, *Commentaries on the Laws of England* vol. 2 (1765-1769), *473-4.

[14] *See e.g.* ROBERT M. LAWLESS, *Striking Out on Their Own: The Self-Employed in Bankruptcy*, *in* Katherine Porter (ed.) BROKE: HOW DEBT BANKRUPTS THE MIDDLE CLASS 101 (Stanford University Press 2012).

[15] *See e.g.* KHAYAT (1998), 24–6; Lawless (2012), 116.

[16] *See e.g.* HC Deb 14 April 2002 Standing Committee B col. 636, per Miss Johnson M.P.

[17] *See e.g.* LAW REFORM COMMISSION OF IRELAND (2010b), ¶¶ 1.340–1.346.

[18] The UK Consumer Credit Act 1974's exclusion from its regulatory scope of loans which are "entered into by the debtor… wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by him" *only* where the loan provides the debtor with credit exceeding £25,000, is more flexible than the exclusion under the 2008 EU Consumer Credit Directive, and moves closer to my target scope of debtors: CONSUMER CREDIT ACT 1974, (1974 c. 39), §16B. The limit of £25,000 is somewhat low for the purposes of my research inquiry, however.

[19] In a legal context, the UK Consumer Credit Act 1974 and the EU Consumer Credit Directive 2008 draw such a distinction: CONSUMER CREDIT ACT 1974, §16; EU CONSUMER CREDIT DIRECTIVE 2008, art. 2(2)(a). An example of a similar distinction drawn in economic research can be found at: EUROPEAN PARLIAMENT, DIRECTORATE GENERAL FOR INTERNAL POLICIES & ANDREW LILICO, HOUSEHOLD INDEBTEDNESS IN THE EU 4–5 (2010). On the household as the subject of over-indebtedness, see also text to notes 44-46.

for irresponsible spending and "over-consumption".[20] While I use the term "household" when speaking of the socio-economic context of over-indebtedness, nonetheless the household has no legal status, and so I must revert to the term *consumer* (broadly defined) when returning to the legal sphere. Within these terms I intend to include all obligations incurred to fund household costs outside of high-end business activity – including secured mortgage loans and unsecured credit, both fixed and revolving,[21] utility bills and rent arrears,[22] social welfare benefit overpayments,[23] etc. My primary focus, however, is on the secured and unsecured credit supplied by institutional lenders - banks, credit card companies, finance houses, home credit providers and payday lenders – given that these lenders make up the vast bulk of creditors involved in the personal insolvency process.[24]

Ultimately, my study of household or consumer debt and its legal treatment is concerned with insolvency law's approach to the "average" debtor; with the manner in which the law addresses Professors Sullivan, Warren and Westbrook's "Fragile Middle Class".[25] I am less concerned with the cases of high-flying corporate investors,[26] multi-million property speculators,[27] well-resourced "bankruptcy tourists"[28] and riches-to-rags fallen tycoons;[29] the characters who populate both media coverage and Law Reports on personal insolvency law.[30] A more precise legal definition

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[20] *See* Elizabeth Warren, *Over-Consumption Myth and Other Tales of Economics, Law, and Morality, The*, 82 WASH. UNIV. LAW Q. 1485 (2004).

[21] *See e.g.* Broadwick Financial Services Ltd. v Spencer, [2002] 1 ER COMM 446; Mond and Another v MBNA Europe Bank Ltd., [2010] B.P.I.R 1167; Randhawa v Official Receiver, [2006] B.P.I.R. 1435; Southey v Official Receiver, [2009] B.P.I.R. 89.

[22] *See e.g.* Places for People Homes Ltd. v Sharples; A2 Dominion Homes Ltd. v Godfrey, [2011] H.L.R. 45; Harlow District Council v Hall, [2006] 1 W.L.R. 2116.

[23] *See e.g.* Regina (Balding) v Secretary of State for Work and Pensions, [2008] 1 W.L.R. 564; R (Cooper and Payne) v Secretary of State for Work and Pensions, [2011] B.P.I.R. 223 (Court of Appeal), [2012] 2 W.L.R. 1 (Supreme Court).

[24] For example, in a 2010 decision relating to the English Individual Voluntary Arrangement (IVA) procedure, Sir William Blackburne commented that evidence had been presented that mainstream high street lenders who form the British Banking Association "constitute over 90% in value of the creditors in the average 'straightforward consumer' IVA, i.e. an IVA proposed by the ordinary man in the street who gets into debt": *see* MOND (2010), ¶36.

[25] TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT (2000). See also a modern addition to the research inspired by the seminal work of Sullivan, Warren and Westbrook: BROKE: HOW DEBT BANKRUPTS THE MIDDLE CLASS, (Katherine Porter ed., 2011). Due to differences in perception of the term "middle class" in the UK and Europe compared to that prevailing in the USA, this enquiry includes what are commonly understood as both the working and middle classes in this part of the world.

[26] *See* STEPHEN ARIS, GOING BUST: INSIDE THE BANKRUPTCY BUSINESS 155–182 (New edition ed. 1986). *See also* JUKKA KILPI, THE ETHICS OF BANKRUPTCY 141–162 (Routledge, 1998).

[27] *See e.g.* Kemsley v Barclays Bank Plc and Others, [2013] EWHC CH 1274; McConnon v Zurich Bank, [2012] IEHC 587.

[28] *See e.g.* O'Donnell & O'Donnell v The Governor and Company of the Bank of Ireland, 2012 EWHC 3749 (Ch) (2012); ACC Bank Plc. v McCann, [2013] NIMASTER 1.

[29] *See e.g.* Irish Bank Resolution Corporation Limited v Quinn, [2012] NICh 1; Quinn & Others v Irish Bank Resolution Corporation Limited & Others, [2012] IEHC 261; Christoph Paulus, *Shaping the Contours of a Hybrid Concept - Mr Quinn's COMI: Irish Bank Resolution Corporation v Quinn [2012] NICh 1*, 25 INSOLV. INT. 75 (2012).

[30] The presence of these individuals in the Law Reports is most likely because these are the debtors – or the bankruptcy estates - with the means to fund litigation capable of giving rise to reported case law. Cases of "bankruptcy tourism" in particular are likely to be highly resource-intensive: *see e.g.* Adrian Walters & Anton Smith, *'Bankruptcy Tourism' under the EC Regulation on Insolvency Proceedings: A View From England and Wales"*, 19 IIR 181, 186, 193 (2010). For a rare example of a cross-border bankruptcy case involving a debtor of more modest means, *see* Official Receiver v Keelan, [2012] B.P.I.R. 613.

of the scope of my project could be based on all debtors outside of the category of the "high net worth debtor" contained in the UK Consumer Credit Act 1974, a legal definition which excludes from the legislation's regulatory scope certain loans to debtors whose income and assets exceed specified thresholds.[31] To express this legal delineation in the vernacular of our time during the Great Recession, my project focuses on bankruptcy among the ninety-nine percent.[32]

B. Over-Indebtedness and Insolvency

My project examines personal insolvency law from the perspective of the law's means of addressing the modern socio-economic problem of widespread household *over-indebtedness*. I begin from the assumption that the majority of household credit transactions produce beneficial effects for lender and borrower, as well as contributing to wider economic growth.[33] These benefits of household *indebtedness* accrue, however, only so far as a household remains in a position to make repayments. If a household becomes unable to repay, a situation of *over-indebtedness* arises, which as I discuss in Chapter 2 leads to extensive social costs necessitating regulatory intervention through personal insolvency law. "Over-indebtedness" is not a legal term of art, but is commonly used in policy discourse in Europe when discussing the economic and social problem of financially overburdened households.[34] Despite the well-established nature of the concept, no single accepted definition exists.[35] While a range have been proposed,[36] I adopt a definition based on a 2008 European Commission report which

[31] Under the 1974 Act and related secondary legislation, the regulatory regime exempts a loan agreement for a value of more than £60,260 where it includes a declaration made by the debtor and signed by a professional such as an accountant to the effect that the debtor is a "high net worth" individual; on account of her earning no less than £150,000 in the previous year and had throughout the previous year net assets worth at least £500,000: *see* CONSUMER CREDIT ACT 1974, §16A; CONSUMER CREDIT (EXEMPT AGREEMENTS) ORDER 2007/1168, arts. 2–4; Sched. 2 ¶1 (2007).

[32] In 2012, those in the 99th percentile of the income distribution earned an hourly average wage of £61.10, broadly approximating to an annual income of £135,666: REAL WAGES UP 62% ON AVERAGE OVER THE PAST 25 YEARS. OFFICE FOR NATIONAL STATISTICS (2012), http://www.ons.gov.uk/ons/rel/lmac/earnings-in-the-uk-over-the-past-25-years/2012/rpt-earnings-in-the-uk-over-the-past-25-years.html (last visited Mar 21, 2013); Mark King, *Wage inequality rises across the UK*, THE GUARDIAN, November 7, 2012, http://www.guardian.co.uk/money/2012/nov/07/wage-inequality-rises-ons?CMP=twt_gu (last visited Mar 21, 2013). This would place the "high net worth debtor" of the 1974 Act comfortably within the one per cent. On the *Occupy* movement which popularised the concept of the 99%, *see e.g.* NOAM CHOMSKY, OCCUPY (2012).

[33] For a political declaration of this perspective, *see* Council of Europe, Recommendation on Legal Solutions to Debt Problems (2007).

[34] *See e.g.* EUROPEAN COMMISSION ET AL., TOWARDS A COMMON OPERATIONAL EUROPEAN DEFINITION OF OVER-INDEBTEDNESS (2008); DEPARTMENT OF TRADE AND INDUSTRY, OVER-INDEBTEDNESS IN BRITAIN: A DTI REPORT ON THE MORI FINANCIAL SERVICES SURVEY 2004 (2005); DEPARTMENT FOR BUSINESS, INNOVATION AND SKILLS, OVER-INDEBTEDNESS IN BRITAIN: SECOND FOLLOW-UP REPORT (2010). The equivalent French term "surendettement" is used both in legislation as well as in policy documents in France: Cour des Comptes, *La lutte contre le surendettement des particuliers: une politique publique incomplete et insuffisamment pilotée*, *in* RAPPORT PUBLIC ANNUEL 2010 462 (2010); LOI RELATIVE À LA PRÉVENTION ET AU RÈGLEMENT DES DIFFICULTÉS LIÉES AU SURENDETTEMENT DES PARTICULIERS ET DES FAMILLES,, (1989).

[35] *See* EUROPEAN COMMISSION ET AL., OVER-INDEBTEDNESS: NEW EVIDENCE FROM THE EU-SILC SPECIAL MODULE 3 (2010); LAW REFORM COMMISSION OF IRELAND, CONSULTATION PAPER ON PERSONAL DEBT MANAGEMENT AND DEBT ENFORCEMENT ¶1.07 (2009); EUROPEAN COMMISSION ET AL. (2008), 33; RICHARD DISNEY, SARAH BRIDGES & JOHN GATHERGOOD, DRIVERS OF OVER-INDEBTEDNESS 11 (2008); DEPARTMENT OF TRADE AND INDUSTRY (2005), 3.

[36] DEPARTMENT OF TRADE AND INDUSTRY (2005), 3; DISNEY, BRIDGES, AND GATHERGOOD (2008), 13; Council of Europe (2007).

sought to identify common core elements from these various definitions.[37] Therefore I understand over-indebtedness as involving circumstances in which a household is unable to meet recurring expenses under all contracted financial commitments on a structural (i.e. persistent and ongoing, and not temporary) basis without reducing its minimum standard of living, and where the household is unable to remedy the situation through recourse to assets or other financial resources such as further borrowing.[38]

In contrast, personal insolvency law has generally been founded upon the concept of "insolvency". While this concept refers to a factual condition[39] - essentially consisting of "a debtor's ultimate inability to meet his or her financial commitments" – it has effectively become a legally defined (using either the "cash flow" or "balance sheet" tests) term of art.[40] In this sense, the use of the term "insolvency" is intertwined with legal procedures,[41] used interchangeably with the legal term "bankruptcy" in popular usage,[42] and is rarely used in social or economic (as opposed to legal) contexts to describe circumstances of inability to repay obligations. Furthermore, legislative definitions of "insolvency" are based on policy considerations regarding the optimum level of access to legal procedures, and so will not correspond to factual circumstances of debtors' inability to pay. [43] Therefore I use the term "over-indebtedness" to refer to the situation of an inability to meet obligations, confining the use of the term "insolvency" to a formal test prescribed in law (see Figure 20, Appendix). I use the terms "personal insolvency law" and "personal insolvency procedures" to refer to the variety of legal procedures for addressing the situation of an individual's ultimate inability to meet her obligations.

The definition of over-indebtedness differs from typical legal definitions of insolvency in important respects. While the law is concerned with rights and obligations of the natural person or *individual*, this contrasting definition adopts the *household* as its unit of measurement, taking into account the pooling of income and wealth among household members, and the fact that an individual's over-indebtedness has consequences for her dependents.[44] As the legal system does not recognise a legal subject of the "household", an insolvency procedure in contrast must focus on the legal subject of the individual *natural person*. The law in places acknowledges,

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[37] EUROPEAN COMMISSION ET AL. (2008), 37.

[38] *Id.*

[39] It is therefore to be distinguished from a purely legal concept such as "bankruptcy", which is a technical term describing a specific legal process. FLETCHER (2009), ¶ 1–012–13.

[40] *Id.*, ¶ 1–001.

[41] For example, the drafters of a recent World Bank report used the term "insolvency" to encapsulate the ideas both of "the distressed condition of the debtor" *and* "the constellation of potential approaches to treating that condition": WORLD BANK, REPORT ON THE TREATMENT OF THE INSOLVENCY OF NATURAL PERSONS, ¶17 (2013). Therefore the term "insolvency" was used to capture the world's wide range of "various systems offering some combination of collective credit redress and alleviation of the burdens of debt on an insolvent debtor"; thus encompassing systems known by such names as "bankruptcy", "sequestration", "debt relief" or "debt adjustment".

[42] FLETCHER (2009), ¶ 1–012.

[43] *See e.g.* DISNEY, BRIDGES, AND GATHERGOOD (2008), 12.

[44] Also, studies consistently show that financial difficulties are more common among households with children: *see* EUROPEAN COMMISSION ET AL. (2010), 35–6.

however, the factual circumstances of *household* over-indebtedness, for example allowing joint insolvency petitions[45] and providing for asset exemptions which protect a reasonable standard of living not just for the debtor, but also for her partner and dependents.[46]

The temporal dimension of the over-indebtedness definition contrasts with most legal definitions of insolvency, which generally focus on the financial condition of the debtor at a fixed point, usually at the time of the entry of the debtor into the legal procedure.[47] While legal tests of insolvency are generally concerned with a financial calculation, this definition of over-indebtedness adopts a social dimension in considering not just whether a household could meet repayments from income, but whether it could do so without reducing its standard of living below a certain minimum. Finally, the definition of over-indebtedness takes into account the practical reality of the household's financial condition by considering the question of financial exclusion and whether the household can relieve its difficulties by accessing financial resources such as savings or further credit.

Terminology aside, recognition of the distinction between insolvency and over-indebtedness can enhance policymaking in personal insolvency law.[48] Use of the term "over-indebtedness" acknowledges the social and economic context surrounding the law, and the fact that over-indebtedness as a phenomenon exists independently of a legal procedure. This allows policymakers to appreciate that personal insolvency laws regulate existing losses, rather than create new losses for creditors.[49] Furthermore, recognition of the need to measure independently both the levels of over-indebtedness and personal insolvency allows a means of evaluating the extent to which a law is sufficiently serving its public policy objectives. This can move policy debate away from the torturous claims that insolvency filing rates are "too high" and a tendency for personal insolvency law itself to be presented as a problem to be fixed in order to reduce these worrying rates.[50] A focus on over-indebtedness instead allows debate to be shifted to the

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[45] For example, the US Bankruptcy Code provides for joint bankruptcy filings: 11 USC §302. For discussion of the prevalence of joint bankruptcy filings under US law, *see e.g.* Elizabeth Warren, *What is a Women's Issue? Bankruptcy, Commercial Law, and Other Gender-Neutral Topics*, 25 HARV. WOMEN'S L.J. 19, 27–8 (2002); SULLIVAN, WARREN, AND WESTBROOK (2000), 36–7. Joint applications to enter personal insolvency procedures are also possible under Ireland's new law: PERSONAL INSOLVENCY ACT 2012, §§55(3); 89(3)–(4).

[46] INSOLVENCY ACT 1986, §283(2). *See also* FLETCHER (2009), ¶¶8–076 to 8–080.

[47] It should be noted that in some legal systems (such as the new Irish legislation – see Figure 20) a *qualified* insolvency test is adopted, however, which incorporates a longer-term temporal perspective.

[48] A qualification is that in some jurisdictions, such as France, "over-indebtedness" is now a legal term, encapsulated in a legislative definition: Loi relative à la prévention et au règlement des difficultés liées au surendettement des particuliers et des familles. Beyond mere terminology, the use of this word is indicative of a law enacted specifically to respond to the problem of consumer over-indebtedness, primarily in countries in which insolvency procedures were previously only available to traders. This contrasts with English law, which has long been open to both traders and non-traders, but has become more extensively used by consumers as the modern consumer credit society took hold.

[49] WORLD BANK (2013), ¶65.

[50] Jean Braucher, *Theories of Overindebtedness: Interaction of Structure and Culture*, 7 THEORETICAL INQ. L. 323, 328 (2006); Joseph Spooner, *Long Overdue: What the Belated Reform of Irish Personal Insolvency Law tells us about Comparative Consumer Bankruptcy*, 86 AMERICAN BANKRUPTCY LAW JOURNAL 243, 297 (2012). Professors Moss and Johnson argue that "the right question is not whether the number of bankruptcy filings is too high. Even when the number was one-twentieth of its

more constructive position of measuring the law's performance against an objective standard of the level of over-indebtedness in society and the law's success in addressing it. For this reason it is unfortunate that policymakers in many countries fail to distinguish between a legal definition of insolvency and the prevalence of over-indebtedness within their societies.[51]

No consensus exists as to the appropriate method of measuring over-indebtedness,[52] however, with various studies adopting a number of objective and/or subjective indicators of financial difficulty. Objective measures used include such indicators as high aggregate levels of debt-to-income or debts-to-asset ratios,[53] high debt service ratios,[54] arrears in repaying debts and/or bills,[55] write-downs of debt by creditors,[56] and participation in legal personal insolvency or debt collection procedures.[57] Objective measures have the advantage of being readily identifiable and quantifiable, but encounter problems such as the fact that aggregate measures (e.g. debt-to-income ratios) do not reveal the distribution of debt and so may not be reflective of the position at individual household level.[58] Also, there is no widely accepted method for combining these indicators into a composite measure of over-indebtedness,[59] a situation complicated by a lack of overlap between the various indicators' results.[60] Subjective measures use survey responses in which debtors or households identify themselves as experiencing difficulty in repaying obligations,[61] suffering from "financial stress",[62] or finding that keeping up with bills and credit commitments represents a heavy burden.[63] Problems in subjective approaches include dependence upon respondents' varying individual interpretations of terms such as "difficulty".[64] Also, studies repeatedly find that levels of self-reported financial difficulty are higher than the levels suggested by objective indicators such as levels of arrears, as individuals' perception of their financial situation may be worse than it objectively appears to be.[65] Considering these

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current level, critics insisted that consumer filings were out of control…" See David A. Moss & Gibbs A. Johnson, *The Rise of Consumer Bankruptcy: Evolution, Revolution, or Both,* 73 AM. BANKR. L.J. 311, 349 (1999).

51 *See e.g.* EUROPEAN COMMISSION ET AL (2008), 34–6.

52 DEPARTMENT FOR BUSINESS, INNOVATION AND SKILLS, CREDIT, DEBT & FINANCIAL DIFFICULTY IN BRITAIN, 2009/10: A REPORT USING DATA FROM THE YOUGOV DEBTTRACK SURVEY 40 (2011); EUROPEAN COMMISSION ET AL. (2010), 38.

53 ELAINE KEMPSON, OVER-INDEBTEDNESS IN BRITAIN: A REPORT TO THE DEPARTMENT OF TRADE AND INDUSTRY 24, 27–30 (2002), http://www.pfrc.bris.ac.uk/Reports/Overindebtedness_Britain.pdf (last visited Mar 16, 2002); EUROPEAN COMMISSION ET AL. (2008), 30; FINANCIAL INCLUSION CENTRE, REPORT 1: DEBT AND HOUSEHOLD INCOME 19–30 (2011); DTI (2005), 3–4.

54 DTI (2005), 3.

55 *Id.* at 3–4.; BIS (2010A) at 40–2; DISNEY ET AL. (2008) at 41; Burcu Duygan-Bump & Charles Grant, *Household debt repayment behaviour: what role do institutions play?*, 24 ECONOMIC POLICY 107–140, 113 (2009).

56 Amanda E. Dawsey & Lawrence M. Ausubel, *Informal Bankruptcy*, SSRN ELIBRARY (2002); Lawrence M. Ausubel, *Credit Card Defaults, Credit Card Profits, and Bankruptcy*, 71 AM. BANKRUPTCY LAW J. 249 (1997).

57 BIS (2010A), 42–3.

58 EUROPEAN COMMISSION ET AL. (2010), 5; EUROPEAN COMMISSION ET AL. (2008), 40.

59 Gianni Betti et al., *Consumer Over-indebtedness in the EU*, 34 J. ECON. STUD. 136, 142 (2007).

60 DTI (2005), 1.

61 Betti et al. (2007), 144–6.

62 DISNEY ET AL. (2008), 41.

63 BIS (2010A), 45–9.

64 EUROPEAN COMMISSION ET AL. (2010), 4.

65 KEMPSON (2002), 23; BIS (2011A), 51–53; EUROPEAN COMMISSION ET AL. (2008), 49.

methods and their shortcomings, as well as the limited availability of cross-country data, a 2008 study commissioned by the European Commission recommended that data from EU Survey on Income and Living Conditions (EU-SILC) should be used to measure over-indebtedness in the EU, as this data permitted many, although not all, of the elements of this study's definition of over-indebtedness to be measured.[66]

Figure 22 (Appendix, Chapter 1) illustrates the range of over-indebtedness measurements used in a number of (primarily Governmental/Government-commissioned) UK studies and their findings. Subject to the above caveat, one notable result is that while the number of new personal insolvencies in England and Wales (and in other countries)[67] in a given year corresponds to much less than 1% of the population (the 2012 figure was approximately 0.2%), levels of over-indebtedness are much higher according to all methods of measurement.

[66] EUROPEAN COMMISSION ET AL. (2008), 40–7.

[67] Spooner (2012A), 246.

1.3 Explaining the Household Debt Revolution

Since approximately the late 1970s, levels of household borrowing and debt have increased substantially and unprecedentedly in most developed countries;[68] with particularly large growth in the late 1990s and 2000s.[69] On the supply-side of the market, the household debt expansion was facilitated by a number of factors which removed “constraints” on supply. Advanced credit reporting technology has removed the information asymmetry and adverse selection problems of the past[70] which had resulted in “credit rationing”.[71] Technological developments also lowered administrative costs and so enabled lenders to make small consumer loans on a profitable basis.[72] Financial innovation and the development of securitisation practices were, before the financial crisis of the late 2000s, widely understood as having reduced aggregate risk and so facilitated an expansion of mortgage lending.[73] At a macro-economic level, increased lending in Europe in the 2000s was driven by factors such as the introduction of a single currency (which lowered interest rates in countries such as Ireland and Spain), increased financial liberalisation through the Single Market in Financial Services, and a widespread house price boom.[74]

A. The Legal Unleashing of Household Credit

Another important factor has been the extent to which legal norms have facilitated the expansion of household debt.[75] First, at the level of private law, the English courts have shown a favourable attitude towards the new product features and business practices which have facilitated the expansion of household debt. In setting the common law “ground rules” of consumer credit

[68] Aldo Barba & Massimo Pivetti, *Rising Household Debt*, 33 CAMB. J. ECON. 113, 113 (2009). *See also* JASON J. KILBORN, *Two Decades, Three Key Questions, and Evolving Answers in European Consumer Insolvency Law: Responsibility, Discretion, and Sacrifice*, *in* Johann Niemi, Iain Ramsay and William C. Whitford (eds.), CONSUMER CREDIT, DEBT AND BANKRUPTCY: COMPARATIVE AND INTERNATIONAL PERSPECTIVES 307, 308–9 (Hart Publishing 2009).

[69] It should be noted, however, that this is also the only period in respect of which pan-European data is available – see Figure 15, Appendix, Chapter 1). The expansion of household borrowing took place to different extents and at different rates in various countries. By 1995, UK household debt as a percentage of disposable income had already reached levels (99%) which have not yet been reached in France and Belgium: *see e.g.* EUROPEAN COMMISSION ET AL. (2010), 7; Spooner (2012A), 286; Kilborn (2009), 625.

[70] Douglas G. Baird, *Technology, Information, and Bankruptcy*, 2007 UNIV. ILL. LAW REV. 305, 311–14 (2007); Patricia A. McCoy, *Rethinking Disclosure in a World of Risk-Based Pricing*, 44 HARV. J. LEGIS. 123 (2007).

[71] Credit rationing occurred when it was more profitable for lenders to ration lower price credit than to raise prices to reflect true risk levels: *see* Giuseppe Bertola, Richard Disney & Charles Grant, *The Economics of Consumer Demand and Supply*, *in* ECONOMICS OF CONSUMER CREDIT 1–26, 12–4 (2006). For the classic account of household "credit rationing", *see* Joseph E. Stiglitz & Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 THE AMERICAN ECONOMIC REVIEW 393–410 (1981).

[72] Gunnar Trumbull, *Credit Access and Social Welfare The Rise of Consumer Lending in the United States and France*, 40 POLIT. SOC. 9, 25–26 (2012).

[73] TURNER (2009), 42.

[74] LILICO (2010), 10–1.

[75] This discussion focuses on English (UK where relevant) legal and regulatory norms. Similar regimes and policies contemporaneously applied in other European jurisdictions, however.

markets, [76] the English courts have acted consistently with classical contract law and basic neo-classical economics in seeing their role as being to facilitate free exchange and uphold marketplace bargains "neutrally". This has helped to create a "contractual culture" giving maximum freedom to lenders to expand household lending.[77] Courts have approved untested product features such as acceleration clauses[78] and new business models based increasingly on default charges[79] as being compatible with traditional contract law doctrines. In finding that unauthorised overdraft fees on current accounts were charges for services rather than (invalid) penalties for default, Lord Phillips partly based his view on the importance of the charges as sources of bank revenue, in a striking vote of approval by the common law for bank freedom to develop new opportunities for consumer lending profits.[80] Indeed, on occasion courts have malleably dis-applied or moulded long-standing common law doctrines and principles while motivated by the view that it is "important that lenders should feel able to advance money".[81] Even in interpreting consumer protection legislation specifically designed to augment the common law, English courts have adhered to ideas of arm's length bargaining based on trader self-interest and consumer self-reliance,[82] in regarding market forces as the best indicators of the fairness of terms such as interest rates.[83] Furthermore, English courts have held firm to the *caveat emptor* principle in finding that lenders owe no common law duty to consider whether a loan is in a borrower's best interests. [84] This has allowed lenders to feel able to increase the

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[76] Iain Ramsay, *Consumer Credit Law, Distributive Justice and the Welfare State*, 15 OXF. J. LEG. STUD. 177, 177–78 (1995); GERAINT HOWELLS & STEVE WEATHERILL, CONSUMER PROTECTION LAW 3 (Avebury Technical, 2nd Revised edition ed. 2005); ROGER BROWNSWORD, CONTRACT LAW 48–49 (OUP Oxford, 2d ed. 2006).

[77] Ramsay (1995), 178.

[78] Wadham Stringer Finance v Meaney, [1981] 1 W.L.R. 39, 46; discussed in Ramsay (1995), 183.

[79] Office of Fair Trading v Abbey National plc. and Others [2008] EWHC 875 (Comm.) [295]-[324], [2009] UKSC 6, [88], [114].

[80] Lord Phillips stated that "whatever may have been the position in the past, the Banks now rely on the Relevant Charges as an important part of the revenue they generate from the current account services...", Office of Fair Trading v Abbey National plc and Others, [2010] 1 AC 696, [88]. The decision of the UK Supreme Court contrasts both in its ultimate finding and its reasoning with the Australian High Court decision of *Andrews v ANZ Banking,* in which the High Court found similar bank charges could constitute penalties under the common law if excessive. The High Court noted that developments in consumer protection require the common law to evolve from its traditional free market ideology, stating that "this pattern of remedial legislation suggests the need for caution in dealing with the unwritten law as if *laissez faire* notions of an untrammelled 'freedom of contract' provide a universal legal value." *See* Andrews v Australia and New Zealand Banking Group Limited, [2012] HCA 30, [5].

[81] Royal Bank of Scotland Plc v Etridge (No 2) [2001] UKHL 44, [2002] 2 A.C. 773, [2], per Lord Nicholls. This idea is evident in the comments of Lord Hobhouse in the *Etridge* decision that "[t]he law has, in order to accommodate the commercial lenders, adopted a fiction which nullifies the equitable principle [of undue influence] and deprives vulnerable members of the public of the protection which equity gives them." *See Etridge*, [115], per Lord Hobhouse

[82] *See e.g.* Chris Willett, *General Clauses and the Competing Ethics of European Consumer Law in the UK*, 71 CAMB. LAW J. 412 (2012).

[83] Eva Lomnicka, *Unfair Credit Relationships: Five Years On*, [2012] J. BUS. LAW 713, 728.

[84] Joan Wadsley, *Bank Lending and the Family Home: Prudence and Protection*, LLOYDS MARIT. COMMER. LAW Q. 341, 352 (2003). While most cases exploring this issue have involved commercial debtors, there is little to suggest English courts would reach alternative outcomes in respect of consumer credit transactions. In Ireland, where even in the face of disastrous lending which destroyed the Irish banking sector, courts in consumer credit cases have reaffirmed the traditional common law position that "the lender/borrower relationship does not generally impose fiduciary duties on the lender…

supply of credit to consumers without fear of legal recrimination should this result in over-indebtedness.

The financial deregulation of recent decades is widely recognised as fuelling the expansion of household credit and over-indebtedness,[85] with the US Supreme Court decision of *Marquette v First Omaha*[86] often cited as the catalyst for unprecedented consumer lending and soaring bankruptcy filing rates in the USA.[87] Similarly, in recent decades UK regulatory regimes at both prudential and consumer protection levels have facilitated household borrowing. In respect of UK mortgage lending, prudential deregulation included the removal of direct Government controls over building society lending and of restrictions on the powers of these institutions. [88] It also involved the introduction of open competition in mortgage credit markets through the abolition of exchange controls, the "corset" of credit supply limits,[89] building society tax advantages, and a legalised cartel-type arrangement of common interest rates in the building society sector.[90] Reforms in the early 2000s then placed all mortgage lending under the supervision of a single regulator, the Financial Services Authority (FSA).[91] The FSA's initial regulatory policy had been to facilitate an expansion of mortgage lending;[92] and was founded upon a non-interventionist philosophy that markets are in general self-correcting.[93] It imposed prudential capital requirements which it subsequently confessed were exposed by the late 2000s financial crisis as being of insufficient quantity and quality.[94] Similarly, the regulator's approach to consumer protection was also "light-touch" in nature, relying on non-interventionist information disclosure, mere requirements that consumers be provided with information concerning a mortgage product before purchasing it.[95] The regulator rejected more intensive product design regulation, such as limiting the sale of high loan-to-value (LTV) or loan-to-income (LTI) mortgage loans, allowing

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over and above conventional contractual obligations" *See* Irish Life and Permanent plc. v Financial Services Ombudsman, [2012] IEHC 367, [44], per Hogan J.

85 *See e.g.* Trumbull (2012), 13–4; Kevin T. Leicht, *Borrowing to the Brink: Consumer Debt in America*, *in* Porter (ed.) (2012), 195.

86 Marquette Nat. Bank of Minneapolis v First Omaha Service Corp., 439 U.S. 299 (1978).

87 Diane Ellis, *The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and the Personal Bankruptcy Rate*, 98(5) BANK TRENDS, HTTP://WWW.FDIC.GOV/BANK/ANALYTICAL/BANK/BT_9805.HTML; Astrid A. Dick & Andreas Lehnert, *Personal Bankruptcy and Credit Market Competition*, 65 J. FINANCE 655 (2010).

88 Mark Stephens, *Mortgage Market Deregulation and Its Consequences*, 22 HOUS. STUD. 201, 207–8 (2007).

89 *Id.*, 201.

90 *Id.*, 206.

91 FINANCIAL SERVICES AND MARKETS ACT 2000, (2000 C. 8).

92 *See generally,* TURNER (2009); FINANCIAL SERVICES AUTHORITY, MORTGAGE MARKET REVIEW (2009).

93 TURNER (2009), 87.

94 FINANCIAL SERVICES AUTHORITY, MMR (2009), 25–6.

95 A detailed account of regulatory provisions under the Financial Services and Market Act 2000 lies outside the scope of this paper. The regulatory structure consists of a three-tier approach of over-arching principles, explanatory codes and detailed rules relating to licensing, supervision and enforcement. Conduct of business rules relating to mortgage loans are contained in the Mortgage and Home Finance: Conduct of Business Sourcebook (MCOB) section of the FSA Handbook: http://fsahandbook.info/FSA/html/handbook/MCOB. *See* Sarah Nield, *Responsible Lending and Borrowing: Whereto Low-Cost Home Ownership?*, 30 LEG. STUD. 610, 613–14 (2010).

such products to proliferate and facilitate the rapid expansion of mortgage debt in the 2000s.[96] Similarly, the FSA did not prescribe rigorous requirements regarding the affordability assessments which lenders should undertake when lending,[97] leading to lax creditworthiness measurements by lenders and an over-reliance on security rather than on mortgage borrowers' ability to pay, particularly in sub-prime mortgage markets.

Similar trends prevailed in respect of unsecured credit regulation in the UK, under a regime inspired by the Crowther Committee's[98] liberal neo-classical economic paradigm favouring free markets.[99] This Committee expressly prioritised the open supply of credit over consumer protection, considering that the law should not "restrict [the majority's] freedom of access to credit in order to protect the relatively small minority who get into difficulties."[100] The *Consumer Credit Act 1974* was therefore based around market-facilitating, non-interventionist measures such as information disclosure regulation;[101] relying on informed and "confident" consumers, rather than substantive regulatory rules, to drive competitive markets through free exchange.[102] More intensive regulatory approaches,[103] such as price controls limiting interest rates on consumer loans, have been rejected since the *Usury Laws Repeal Act* of 1854,[104] under the classical economic argument[105] that such measures could limit access to credit unduly.[106] Controls of interest rates have been limited to private law mechanisms for over-turning contracts based upon "extortionate" interest rates[107] or "unfair credit relationships".[108] The approach of the English

[96] FSA MMR (2009), 37–49.

[97] *Id.*, 50–55. The "responsible lending" provisions of the MCOB, which included obligations of lenders to take into account a consumer's ability to repay a mortgage loan, were contained in Part II of the Mortgage and Home Finance: Conduct of Business Sourcebook (MCOB) section of the FSA *Handbook of Rules and Guidance*: http://fsahandbook.info/FSA/html/handbook/MCOB

[98] CROWTHER COMMITTEE ON CONSUMER CREDIT, CONSUMER CREDIT: COMMITTEE REPORT, CM 4596 (1971).

[99] For a comparative overview of consumer credit regulatory philosophies in the UK and France, *see* Iain Ramsay, *'To Heap Distress Upon Distress?*, 60 UNIV. TOR. LAW J. 707 (2010).

[100] CROWTHER COMMITTEE ON CONSUMER CREDIT (1971), ¶1.3.5.

[101] In the UK, detailed regulations contain prescriptive rules regarding the form and content of pre-contractual information disclosure by lenders to borrowers: Consumer Credit (Disclosure of Information) Regulations 2004, SI 2004/1481 (UK); Consumer Credit (Agreements) (Amendment) Regulations 2004, SI 2004/1482 (UK). *See* IAIN D.C. RAMSAY, CONSUMER LAW AND POLICY 411-4 (Hart Publishing, 3 ed. 2012). Similar rules exist in respect of advertising information: CONSUMER CREDIT ACT 1974, Part IV.

[102] Iain Ramsay, *From Truth in Lending to Responsible Lending*, *in* Andre Janssen, Reiner Schulze, Geraint Howells (eds.), INFORMATION RIGHTS AND OBLIGATIONS: THE IMPACT ON PARTY AUTONOMY AND CONTRACTUAL FAIRNESS, 48 (Avebury Technical, 2005); RAMSAY (2012a), 533.

[103] Previously existing intensive measures known as control orders have long been abandoned. These orders set rules on terms of such loans as hire-purchase arrangements, stipulating the down payments or deposits required, the finance charges and maximum term of repayment. *See* Sarah Brown, *Using the Law as a Usury Law: Definitions of Usury and Recent Developments in the Regulation of Unfair Charges in Consumer Credit Transactions*, J. BUS. LAW 91, 95 (2011).

[104] Usury Laws Repeal Act (1854).

[105] David Cayne & M.J. Trebilcock, *Market Considerations in the Formulation of Consumer Protection Policy*, 23 UNIV. TOR. LAW J. 396, 411–18 (1973).

[106] Ramsay (2010), 715–7; Brown (2011), 112.

[107] *See* CONSUMER CREDIT ACT 1974, §§137–140; Ramsay (2010), 716.

[108] *See* CONSUMER CREDIT ACT 1974, §§140A–140D; Sarah Brown, *The Unfair Relationship Test, Consumer Credit Transactions and the Long Arm of the Law*, 60 LMCLQ 90 (2009).

courts to such provisions has been non-interventionist, as they have tended to rely on market rates in upholding high interest credit contracts.[109] The lack of legal limitations on interest rates has facilitated the expansion of high-cost consumer credit markets in the UK in recent years, during which time this has been the fastest growing sector of consumer lending.[110]

Just as in the mortgage credit market, product design regulation has been very limited, primarily confined to the general control of unfair terms in consumer contracts under EU law.[111] While this legislation can control some allegedly unfair pricing practices such as credit card default charges[112] and other risky product features,[113] its regulatory power is limited by its inapplicability to "core" terms of consumer credit contracts.[114] Furthermore, it was not until 2006, with the enactment of the *Consumer Credit Act 2006*, that lenders came under a duty to assess a consumer's ability to afford a loan before selling the loan to the consumer;[115] although the banking industry had agreed that such an assessment should form part of the sales process under the voluntary Banking Code.[116]

This introduction of responsible lending requirements in the mid-2000s marked a first step towards more intensive regulation, and following the financial crisis major changes in regulatory philosophy[117] and institutional structures[118] have been taking place in the UK. Nonetheless, this

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[109] Lomnicka (2012), 728.

[110] NATIONAL AUDIT OFFICE, REGULATING CONSUMER CREDIT 8 (The Stationery Office 2012).

[111] EU Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts (1993); Unfair Terms in Consumer Contracts Regulations 1999 (1999).

[112] Charges payable in respect of a credit card missed payment were found to be unfair in the County Court decision of MBNA Bank Ltd. v Thorius, [2010] E.C.C. 8, cited in Brown (2011), 104. Such clauses can be controlled under the UNFAIR TERMS DIRECTIVE, Sched., ¶1(e); and the Office of Fair Trading has set out its regulatory policy for monitoring such charges for fairness: OFFICE OF FAIR TRADING, CALCULATING FAIR DEFAULT CHARGES IN CREDIT CARD CONTRACTS (2006).

[113] For example, the Court of Justice of the European Union indicated in a 2013 decision that a national court could assess the fairness in a mortgage loan contract of an acceleration clause, a default interest rate clause and a clause providing for unilateral quantification of unpaid debt: *see* Mohamed Aziz v Catalunyacaixa, CASE C-41511 (2013).

[114] These limitations were illustrated in the high profile "bank charges" litigation: *see* The Office of Fair Trading v Abbey National plc & Others, [2010] 1 A.C. (UK Supreme Court 2009).

[115] Since 2006, "irresponsible lending" is a ground on which the Office of Fair Trading can revoke a lender's licence: *see* CONSUMER CREDIT ACT 1974 §25(2B). Compliance with the responsible lending duty involves lenders following certain specified procedures in assessing whether a consumer borrower can afford an offered loan: *see* OFFICE OF FAIR TRADING, IRRESPONSIBLE LENDING - OFT GUIDANCE FOR CREDITORS ¶¶4.1–4.33 (2010).

[116] Banking Code ¶¶10.11, 13.1 (2008); Lending Code ¶¶50–56 (2011); Gerard McMeel, *Conduct of Banking Business Brought into the FSA Fold*, 2010 LLOYDS MARIT. COMMER. LAW Q. 431, 434–36. The Banking Code was first issued in 1992, but replaced by the Lending Code in 2009).

[117] TURNER (2009); FINANCIAL SERVICES AUTHORITY, MMR (2009); FINANCIAL SERVICES AUTHORITY, MORTGAGE MARKET REVIEW: PROPOSED PACKAGE OF REFORMS (2011).

[118] A major institutional change involves the transfer (on 1st April 2014) of consumer credit regulatory duties from the Office of Fair Trading to the newly created Financial Conduct Authority: *see* FINANCIAL CONDUCT AUTHORITY, DETAILED PROPOSALS FOR THE FCA REGIME FOR CONSUMER CREDIT (2013). *See also* DEPARTMENT FOR BUSINESS, INNOVATION AND SKILLS, A NEW APPROACH TO FINANCIAL REGULATION: CONSULTATION ON REFORMING THE CONSUMER CREDIT REGIME (2010); HM TREASURY & DEPARTMENT FOR BUSINESS, INNOVATION AND SKILLS, A NEW APPROACH TO FINANCIAL REGULATION: TRANSFERRING CONSUMER CREDIT REGULATION TO THE FINANCIAL CONDUCT AUTHORITY (HM Treasury, Dept. BIS 2013).

follows decades of non-intensive regulation in the UK and elsewhere[119] which undoubtedly provided a welcoming environment for the expansion of household debt and the development of the modern consumer credit society. While for reasons of brevity I have focused on the UK case, similar approaches to household credit regulation can be identified in countries such as Ireland and France.[120]

B. Consumption Smoothing and the Democratisation of Credit

If these factors help to explain the enormous growth in credit *supply* in recent years, the *demand* side of the household debt expansion is more puzzling. Credit for investment purposes, to fund the purchase of a home, durable goods or "human capital" in the form of education, conforms to traditional models of borrowing. It allows assets to be purchased which can ultimately be used to repay the borrowings or to provide security in the event of default.[121] Borrowing to fund present consumption does not follow this traditional logic, however, and historically legal and economic commentators, and apparently general social norms,[122] condemned such borrowing as lying somewhere between folly and fraud.[123] The borrower may be left in financial difficulty without any additional wealth to show for it, while the lack of security offered to lenders exposes them to the full brunt of information asymmetries and adverse selection problems, heightening investment risk[124] and making credit prohibitively expensive.[125] Also, while borrowing for durable investments rationally matches the period of repayment to the period of use of purchased goods;[126] modern forms of revolving credit (credit cards, payday loans, etc.) break this link, while also removing the discipline of a fixed repayment plan.[127]

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[119] EU regulatory rules have also been non-interventionist in nature, and have concentrated primarily on information disclosure rules. See in particular the "maximum harmonization" Consumer Credit Directive 2008.

[120] *See e.g.* Spooner (2012A), 260–62, 284–86; Joseph Spooner, *Fresh Start or Stalemate? European Consumer Insolvency Law Reform and the Politics of Household Debt*, 21(3) EUR. REV. PRIV. LAW 747, 772–74 (2013).

[121] Baird (2007), 307–9; LILICO (2010), 6.

[122] *See e.g.* TERESA A. SULLIVAN, *Debt and the Simulation of Social Class*, *in* Brubaker, Ralph; Lawless, Robert M.; Tabb, Charles J. (eds.), A DEBTOR WORLD: INTERDISCIPLINARY. PERSPECTIVES ON DEBT 49 (Oxford University Press 2012).

[123] *See e.g.* Baird (2007), 309–10; ROSA-MARIA GELPI & FRANCOIS JULIEN-LABRUYERE, THE HISTORY OF CONSUMER CREDIT: DOCTRINES AND PRACTICE 84–9 (Palgrave USA, 2003); ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS ¶II.4.2 (Strahan and Cadell 1778).

[124] *See e.g.* BRUCE G. CARRUTHERS & LAURA ARIOVICH, MONEY AND CREDIT: A SOCIOLOGICAL APPROACH 85–6 (Polity Press, 2010); Stiglitz and Weiss (1981); George A. Akerlof, *The Market for 'Lemons': Quality Uncertainty and the Market Mechanism*, 84 THE QUARTERLY JOURNAL OF ECONOMICS 488–500 (1970).

[125] Trumbull (2012), 25–6.

[126] LILICO (2010), 6.

[127] IAIN RAMSAY, *Consumer Credit Society and Consumer Bankruptcy: Reflections on Credit Cards and Bankruptcy in the Informational Economy*, *in* Ramsay et al. (eds.) CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE 17, 22 (Hart Publishing 2003).

Since the 1950s-1960s the "dominant conceptual framework" for explaining this puzzle has been the "consumption smoothing", "life cycle" or "Permanent Income Hypothesis"[128] neoclassical economic model.[129] This views increased household debt as an economically rational response to uncertain fluctuations of income over time by forward-looking actors seeking to maximise their long-term preferences.[130] As households accumulate and lose wealth at different rates throughout the course of the life cycle,[131] those engaging in utility maximising behaviour should organise their income flows over their lifespan duration to *smooth* consumption, borrowing at times of low income and saving at times of high income so that consumption levels remain constant.[132] Household borrowing thus "can be just as sensible as saving"[133] and raises the welfare of households.[134] The second strand of the "consumption smoothing" theory focuses instead on consumer credit as a form of insurance, a means of maintaining desired levels of consumption in the face of *temporary* "income shocks" or deviations from the long-run income trend.[135] During a time in which a household's income has fallen due to temporary unemployment, for example, it may be economically rational for the household to borrow so as to allow consumption to remain constant in this intermediate low-income period.[136] This reasoning is limited to temporary changes in income, however, as a rational actor would respond to permanent changes by reducing consumption.[137]

This perspective considers that such borrowing behaviour was always economically rational and utility-maximising, but was impossible until the removal of "credit constraints" described above.[138] Some versions of the consumption smoothing thesis view household *over*-indebtedness as arising from borrower behaviour deviating from perfect rationality.[139] Alternative versions, however, explain over-indebtedness as an endemic problem due to the necessary uncertainty of the future[140] and constant potential for adverse shocks to the consumer's expenditure

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[128] Bertola et al. (2006a), 4.

[129] Betti et al. (2007),138.

[130] Barba and Pivetti (2009), 114; Bertola et al. (2006a), 1, 4–5; Baird (2007), 310–1; FH Buckley, *The Debtor as Victim: Book Review*, 87 CORNELL L. REV. 1078, 1081 (2001).

[131] DISNEY ET AL. (2008), 14.

[132] Barba and Pivetti (2009),119; Baird (2007), 310.

[133] Bertola, Disney, and Grant (2006a), 2.

[134] *Id.*,12.

[135] Barba and Pivetti (2009),120.

[136] This model assumes perfect rationality and information on the part of the borrower, so that the likely duration of a temporary income shock can be rationally calculated and priced. As I discuss in Chapter 2, however, the reality of individual decision-making departs from this assumption and factors such as status quo bias, loss aversion and optimism bias may lead to borrowing decisions which are not welfare-enhancing: IAIN RAMSAY,(2012a). Even some accounts relying upon rational choice theory consider short-term borrowing of this kind to be too risky to be welfare-enhancing: DISNEY ET AL. (2008), 15.

[137] Barba & Pivetti (2009), 120.

[138] LILICO (2010), 10.

[139] Barba and Pivetti (2009), 121.

[140] DISNEY ET AL. (2008), 14.

requirements and income streams.[141] Despite the costs for the minority of households who fall into over-indebtedness, the consumption smoothing model ultimately views the household debt expansion as welfare-enhancing on utilitarian grounds. As such, it has a political counterpart in the idea of the "democratisation of credit",[142] a concept "generally spoken of in terms of uplift and advancement... [which] calls for an infusion of democratic values into the private market and a broader sharing of the benefits of the society's economic endowments by a wider spectrum of consumers."[143] When credit is seen as a means of maximising a household's long-term utility by allowing them to smooth consumption and take advantage of economic opportunities, it must be made accessible to as wide a population as possible in order to further enhance democratic, and not just economic, values.[144]

C.Household Debt and Income Inequality

(I) "Loans for Wages"

The life cycle model of consumer debt has been criticised, however, firstly on the grounds of weak empirical evidence supporting the view that saving behaviours differ at different times of life.[145] Furthermore, behavioural economics illustrates that due to the bounded rationality of human behaviour, in contrast to the consumption smoothing theory's rational actor model, an individual's consumption/saving life-cycle plan may be inherently unsustainable.[146] Human decision-making is strongly influenced by context, so that "people lack clear, stable or well-ordered preferences" of the type on which the consumption smoothing model depends.[147] Under the process of *hyperbolic discounting* we demonstrate time-inconsistent preferences,[148] meaning that instead of comparing future and present costs on a constant scale individuals tend to overvalue immediate benefits and discount future costs heavily. This means that households act impatiently in respect of short-term objectives which can be funded by consumer credit, and may borrow at rates which are not optimal as a result.[149] This tendency, along with that of optimism bias,[150] might for example lead households to borrow at times of temporary financial difficulty without considering sufficiently the costs, such as the possibility that perceived short-term

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141 Betti et al. (2007), 140.

142 *See e.g.* Regina Austin, *Of Predatory Lending and the Democratization of Credit*, 53 AM. UNIV. LAW REV. 1217, 1253–57 (2003).

143 *Id.*, 1255.

144 *Id.*

145 Barba and Pivetti (2009), 119.

146 Betti et al. (2007), 141.

147 Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron*, 70 UNIV. CHIC. LAW REV. 1159, 1161 (2003).

148 RAMSAY (2012a), 57.

149 CAROL C. BERTAUT & MICHAEL HALIASSOS, *Credit Cards: Facts and Theories*, *in* Giuseppe Bertola, Richard Disney & Charles Grant (eds.) ECON. CONSUM. CREDIT 182, 227–28 (MIT Press 2004).

150 *See e.g.* Ron Harris & Einat Albin, *Bankruptcy Policy in Light of Manipulation in Credit Advertising*, 7 THEOR. INQ. LAW 431, 434–36 (2006); I. Ramsay (2005), 53.

financial difficulties actually persist over time. While it is an immensely complex task to plan an individual's consumption, borrowing and saving needs at various stages of the life-cycle even within the parameters of perfect information and rationality, this task becomes impossible when bounded rationality and hyperbolic discounting are recognised.[151] It may thus be unrealistic to consider that the expansion of household debt has arisen from perfectly rational long-term economic calculation on the part of households.

Alternatives to the consumption smoothing model have developed, therefore, most notably the "loans for wages" concept. This suggests that increased income inequality (involving the stagnation or slow growth of average real wages, while those of the higher income percentiles have soared) in recent decades has increased the demand for credit among households.[152] Rising household borrowing thus results from the attempts by low and middle income households to maintain both their absolute standards of living and relative standards of consumption[153] and bridge the gap between stagnant wages and rising costs of living.[154] Under this view household credit is only welfare-enhancing in the extent to which it remedies the difficulties created by falling wages and rising living costs. This trend is vividly illustrated by Professor Warren's empirical findings that modern US families "are spending… more on the basics of being middle class" than had been the case in the 1970s.[155] While the extent of this trend varies between countries, indications suggest similar conditions exist in the UK and other parts of Europe.[156] UK average real earnings have risen at approximately half the speed of highest earners over the last 25 years, while productivity growth has outstripped wage increases considerably (Figure 24Figure 25, Appendix).[157] At present, large numbers of European households report an inability to meet unexpected expenses, and difficulties in making ends meet (Figure 28-Figure 29, Appendix), illustrating the fine payday-to-payday margins on which large portions of society now live.[158] In all of the UK (Figure 26, Appendix),[159] Ireland,[160] and France,[161] rising housing costs[162]

[151] Harris & Albin (2006), 441.

[152] PAOLO LUCCHINO & SALVATORE MORELLI, INEQUALITY, DEBT AND GROWTH 2 (Resolution Foundation 2012).

[153] Barba and Pivetti (2009), 122. Thus borrowing at times of low income may reflect not a rational cost-benefit calculation by a household, but rather a desperate attempt by a household to maintain its standard of living, and its social class standing, in the face of financial difficulty: Teresa A. Sullivan (2012), 54.

[154] The social standing attached to certain levels of consumption mean that in the face of reduced income, credit is needed in order to preserve a household's relative position in society and self-worth. Under the "demonstration effect", it is natural for individuals to emulate consumption patterns of slightly wealthier peers, which leads to a spiralling of expenditure. This explanation for increased household borrowing and spending is based directly in income inequality itself, as the spending habits of the wealthy shift expenditure frames of reference for those groups lower in the income distribution. *See* Barba and Pivetti (2009), 124–5.; LUCCHINO AND MORELLI (2012), 2.

[155] Warren (2004), 1502. In the early 1970s the average family spent 54% of its *one* income on the necessities of housing, health insurance, transportation and taxes; expenses which cost the average family 75% of its *two* incomes in the early 2000s.

[156] RESOLUTION FOUNDATION, GAINING FROM GROWTH: THE FINAL REPORT OF THE COMMISSION ON LIVING STANDARDS 30–31 (2013).

[157] *Id.*, 20.

[158] For a discussion of this trend in the American case, *see* JACOB S. HACKER, *The Middle Class at Risk*, *in* PORTER (ED.) (2012), 218.

greatly outstripped income growth in recent years, raising households' mortgage debt burdens.[163] Global commodity prices have also increased by more than average incomes in recent decades (Figure 5). In addition to substituting for wages, household debt also has been substituting for Government debt,[164] as States withdraw social support services, particularly during the age of austerity policies in the late 2000s and 2010s. It appears that the "credit crunch" of this era has seen mainstream sources of credit fail to fulfil this need, and instead the high-interest payday lending industry has grown at an extraordinary rate in the UK, (from a value of £900 million in 2008-9 to a value of £2-2.2 billion in 2011/12[165]), while debt problems arising from payday loans have soared.[166] Thus the financialisation of society has led to a financialisation of welfare, with the market, rather than the State, addressing citizens' social needs,[167] as household credit becomes the "ultimate market-based social welfare programme".[168] One might not now accept quite so readily the once trite judicial statement that a "bank is not to be treated as a branch of the social services agencies." [169]

(II) Political Support for the Household Debt Expansion: "Privatised Keynesianism" or "Let Them Eat Credit"

This substitution of credit for wages in the face of rising income inequality was built upon wide support by policymakers, for reasons of economic policy and political expedience. One perspective describes household credit as solving (temporarily) a fundamental contradiction in capitalism, whereby the system desires the reduction in the cost of labour, but also depends on maintaining high levels of mass consumption among the economy's workers.[170] Consumer spending has been accounting for over half of economic output in most OECD countries since

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159 The ratio of house prices to average income in the UK more than doubled between 1996 and 2007: *see e.g.* Colin Hay, *Good Inflation, Bad Inflation*, 11 BR. J. POLIT. INT. RELATIONS 461, 468 (2009); Waltraud Schelkle, *A Crisis of What?*, 40 POLIT. SOC. 59, 62 (2012).

160 Irish house prices increased by 185% between 1997 and 2005: Hay (2009), 463; Morgan Kelly, *The Irish Credit Bubble*, (Discussion Paper, Geary Institute, University College Dublin, 2009), 2, http://www.ucd.ie/t4cms/wp09.32.pdf.

161 It is not widely recognized that the late 1990s and 2000s also saw a mortgage bubble develop in France, with the measure of house prices against average income raising by 65% between 1996 and 2007: Schelke (2012) at 62.

162 On the role of mortgage lending as a substitute for wealth in the form of both assets and short-term income (via equity release), *see* Monica Prasad, *The Credit/Welfare State Tradeoff*, SSRN ELIBRARY 17 (2010), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1602204.

163 LILICO (2010), 4–5.

164 Barba and Pivetti (2009), 129–31; Prasad (2009).

165 OFFICE OF FAIR TRADING, PAYDAY LENDING: COMPLIANCE REVIEW FINAL REPORT 9 (OFT 2013).

166 The UK debt advice charity CCCS reported a six-fold increase in the number of clients with payday loan debts between 2009 and 2011: CONSUMER CREDIT COUNSELLING SERVICE, CCCS STATISTICAL YEARBOOK 2011 1 (2012). *See also* OFFICE OF FAIR TRADING (2013), 5.

167 GLOUKOVIEZOFF (2011), 44–5.

168 SULLIVAN, WARREN, AND WESTBROOK (2000), 138. *See also* GLOUKOVIEZOFF (2011) at 37; Ramsay (2003A).

169 Banco Exterior Internacional SA v Thomas and Another, [1997] 1 All E.R. 46, 56 (1996), per Sir Richard Scott, V-C.

170 Colin Crouch, *Privatised Keynesianism*, 11 BR. J. POLIT. INT. RELATIONS 382, 384 (2009).

the 1970s, even excluding the costs of home purchasing (Figure 30, Appendix). In the post-war period, Fordist mass production policies in the USA,[171] and Keynesian Welfare State economic policies in countries such as the UK and Scandinavia provided wages and stability for households which allowed them to become mass consumers and so "enable an expansion of markets and profits on an unprecedented scale."[172] Such policies were discontinued following inflation crises in the 1970s, to be replaced with neo-liberal policies based upon a much smaller role for the State in the economy.[173] The accompanying lowering of workers' wages threatened the mass consumer demand which had become crucial for economic growth. This threat was then assuaged by a trend described as "Privatised Keynesianism" - the funding of mass consumption through the extension of credit to low and middle income households.[174] In addition to facilitating consumption, household borrowing also contributed to economic growth via financial sector profits, with a large part of the "value creation" in the financial sector in recent decades coming directly from unprecedented household borrowing.[175] Thus extensive household borrowing made it "possible to bring about the best outcome from the point of view of the capitalist system": low wages coexisting with sustained high levels of aggregate demand, all without the economic "intervention" of the State.[176] While this originally was most probably an organic development rather than a deliberate policy choice; Governments in the UK and elsewhere soon came to realise the importance of household lending to economic growth, and adopted debt-favourable policies.

The expansion of household debt also solved another political problem by placating constituents and stymying the potential for political unrest which could otherwise have been generated by wage stagnation and job insecurity (in the face of increasing wealth among society's elite). So, as part of a political attitude described as "let them eat credit",[177] politicians (whether as a deliberate policy, or as a reactive response to constituent demands[178]), saw household lending as an immediate means of maintaining and improving living standards for the average household without engaging in more long-term reforms (such as expanding access to education),[179] or more politically difficult measures (such as taxation and redistribution).[180] The costs of a bursting credit

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[171] LIZABETH COHEN, A CONSUMERS' REPUBLIC 113–29 (Vintage Books 2004).

[172] Crouch (2009), 386, 384.

[173] *Id.*, 387–88.

[174] *Id.*, 390.

[175] Deutschmann (2011), 351.

[176] Barba and Pivetti (2009), 126–7.

[177] RAGHURAM G. RAJAN, FAULT LINES 21 (Princeton University Press 2011).

[178] Prasad, for one, describes these developments as having been led by demand for easier credit among financially struggling constituents: Prasad (2010).

[179] RAJAN (2011), 8–9.

[180] RAJAN (2011), 9, 31. Taxation and redistribution policies are difficult to implement due to ideological and interest group opposition; while credit expansion appealed to both the left and right, as well as to influential wealthy interest groups who saw consumer lending as a new opportunity for investment: *see* LUCCHINO AND MORELLI (2012), 3.

bubble would be paid for in the long-term, so that contemporary politicians received the benefits of a credit expansion while their successors paid the costs. [181]

These political concerns led UK policymakers to encourage household debt expansion, particularly to facilitate homeownership.[182] Relevant policies included deregulation (see section 3(A) above), financial incentives for mortgage borrowers (such as the "Right-to-Buy" policy of the late 1980s[183] and tax relief for mortgage interest payments[184]), as well as Government supported house price inflation.[185] Similar policies promoting mortgage lending have been identified in the USA,[186] France[187] and Ireland[188] (and helped to fuel financial crises in two of these three countries). The household debt expansion thus has been officially sanctioned by policymakers, as it has become incumbent on households to borrow not just to maintain their own standards of living, but to fulfil a public interest imperative in maintaining economic growth.

1.4 Causes of Over-Indebtedness in the Consumer Credit Society

The preceding analysis has shown the development of a consumer credit society, in which household debt has become essential to maintain macroeconomic growth and microeconomic living standards. Without this expansion of household borrowing, undoubtedly the problem of widespread over-indebtedness would not have ensued. The relationship between the expansion of household debt and the rise of over-indebtedness is complex, however. An aggregate increase in household debt across an economy may not reflect a rise in the number of individual households falling into over-indebtedness, which will depend on the distributions of debt burdens and of income and assets to service such burdens.[189] An increase in outstanding household debt might coincide with an increase in the value of assets (most relevantly, house prices),[190] meaning that household balance sheets may appear no worse off despite rising debt levels.[191] Also, free availability of credit (reflected in high aggregate debt levels) may *reduce* financial difficulties for

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[181] Rajan (2011), 31.
[182] Schelkle (2012),159; Rajan (2011), 32–43.
[183] Schelkle (2012), 64.
[184] FSA MMR (2009),13.
[185] Hay (2009).
[186] Rajan (2011), 36–41; Schelkle (2012), 63.
[187] Schelkle (2012), 68.
[188] OECD, OECD Economic Surveys Ireland 2009. 20 (Organisation for Economic Co-operation and Development, 2009); Patrick Honohan, The Irish Banking Crisis: Regulatory and Financial Stability Policy: A Report to the Minister for Finance by the Governor of the Central Bank (Department of Finance; Central Bank of Ireland 2010); Prn. A10/0700 Klaus Regling & Max Watson, Ireland's Banking Crisis (The Stationary Office 2010).
[189] European Commission et al. (2010), 4-5.
[190] For the example of how house price inflation was fuelled by lax lending standards and a rapid flow of credit into the Irish economy, *see* Kelly (2009). For a discussion of the UK political support for house price inflation, *see* Hay (2009)
[191] European Commission et al. (2010), 5.

some in enabling refinancing to overcome financial emergencies.[192] In this regard it actually may be when aggregate household debt levels *fall*, as credit availability tightens (in a typical "flight to quality" following a credit crunch), that levels of over-indebtedness rise.[193] Given this complexity, it is important to consider further evidence of the *causes* of over-indebtedness.

Studies on this question have generally relied for evidence on debtor self-reporting,[194] qualitative studies based on interviews with stakeholders[195] and/or quantitative analysis of financial indicators (see Figure 21).[196] Irrespective of method, studies have generally found that the primary cause of over-indebtedness is a fall in a leveraged household's income - an "income shock".[197] These shocks are most commonly attributable to such "life accidents" as a loss of employment, a relationship breakdown, or ill health; which render previously manageable commitments unaffordable. At times of economic downturn, income shocks are particularly significant causes of over-indebtedness due to both unemployment rises and deflationary falls in incomes and asset values.[198] In modern conditions most families are dependent on two incomes to sustain their standard of living, and so a drop in one household member's income may be enough to push the household into over-indebtedness.[199] Family relationship breakdowns lead to over-indebtedness for similar reasons, as obligations previously dependent on two incomes must be serviced by one.[200] Ill health can reduce income due to lost employment opportunities and potential inability to work;[201] while mental health problems[202] can contribute to over-indebtedness by adversely affecting a household's money management ability.[203] In countries in which low-cost health insurance is not widely available, the cost of obtaining medical treatment may cause over-indebtedness directly.[204] Large debt burdens borne by average households in the consumer credit society make them constantly vulnerable to an income shock, meaning the possibility of over-indebtedness might be quite close for almost everyone.[205]

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[192] *Id.*, 5.

[193] *See* Professor Lawless' findings of increases in the levels of US bankruptcy filing rates when credit availability reduces: Robert M. Lawless, *Paradox of Consumer Credit, The*, 2007 Univ. Ill. Law Rev. 347 (2007).

[194] *See e.g.* Kempson (2002), 31–2.

[195] Disney et al. (2008), 30–3.

[196] Duygan-Bump and Grant (2009), 119; European Commission et al. (2010), 42–5.

[197] *See e.g.* European Commission et al. (2008), 23–4.

[198] Lilico (2010) at 13–6; European Commission et al. (2010), 4–5, 45. For a description of this process following a credit boom-to-bust in Ireland, *see* Spooner (2012A), 288–90.

[199] Elizabeth Warren & Amelia Warren Tyagi, The Two-Income Trap (Basic Books, export ed ed. 2004).

[200] Disney et al. (2008), 32.

[201] Disney et al. (2008), 32-3.

[202] There is a two-way relationship between mental health difficulties and over-indebtedness, since the stress caused by over-indebtedness can itself lead to ill health for the debtor and/or dependents: Nigel Balmer et al., *Worried Sick: The Experience of Debt Problems and Their Relationship with Health, Illness and Disability*, 5 Social Policy and Society 39–51 (2006); Sarah Emami, *Consumer over-indebtedness and health care costs: how to approach the question from a global perspective*, Background Paper 3 *in* WHO World Health Report (2010) (2010); Duygan-Bump and Grant (2009), 121–3.

[203] *See e.g.* Elaine Kempson & Sharon Collard, Bristol University | School of Geographical Sciences | Managing Multiple Debts 13 (DCA Research Series, volume 01/04, Department for Constitutional Affairs 2004).

[204] Sullivan et al. (2000), 19–20.

[205] European Commission et al. (2008), 24.

While the role of *falling* income in causing debt difficulties appears to be independent of income levels,[206] a second significant cause of over-indebtedness is a household's low income.[207] Again, studies based on debtor self-reporting,[208] qualitative case studies and interviews,[209] and quantitative analysis of aggregate household financial data,[210] show a link between over-indebtedness and the condition of prolonged living on a low income. As households with stagnant incomes rely increasingly on credit to make ends meet, this can result in a pattern of repeated borrowing which becomes unsustainable over time.

Finally, studies also identify a third category of causes of over-indebtedness which can be grouped under the general rubric of household financial mismanagement.[211] These factors are described variously as "over-commitment",[212] "failures of money management"[213] or "financial imprudence".[214] Findings relating to this cause are drawn from debtor self-reporting surveys and interviews with stakeholders. Difficulties in quantifying this factor mean that its role as a cause of over-indebtedness does not have the support of quantitative statistical analysis.[215] The insight gained from these findings is somewhat inconclusive. Firstly, there is limited explanatory value to the tautological assertion that an over-indebted individual, who has by definition borrowed more than she can now afford to repay, has "over-committed". In hindsight, *all* over-indebted households – both the "grasshoppers" and the "ants"[216] - have over-committed or over-spent, even if this level of spending was sustainable at the time of borrowing and would have continued to be so if factors such as income shocks had not intervened.[217] This also raises the question of the influence on qualitative researchers of *hindsight bias*, a concept identified by behavioural economics which identifies a human tendency to exaggerate the degree to which events could have been anticipated in advance.[218] Thus certain studies characterise as financial mismanagement (rather than exogenously caused over-indebtedness) a debtor's failure to reduce expenditure in the face of falling income or rising living costs (one stark example categorises as "financial imprudence" a failure of household to adjust its fuel consumption as oil prices rise[219]).[220] This assumes that households are living at a heightened standard of living

[206] *Id.* at 23–4.; EUROPEAN COMMISSION ET AL. (2010), 45.
[207] EUROPEAN COMMISSION ET AL. (2008), 24–5.
[208] KEMPSON (2002), 30–1.
[209] CHRIS DEARDEN ET AL., CREDIT AND DEBT IN LOW-INCOME FAMILIES | JOSEPH ROWNTREE FOUNDATION (2010).
[210] EUROPEAN COMMISSION ET AL. (2010), 33–4.
[211] EUROPEAN COMMISSION ET AL. (2008), 25–7.
[212] KEMPSON (2002), 32.
[213] KEMPSON AND COLLARD (2004), 11–2.
[214] DISNEY ET AL. (2008), 27–30.
[215] Since a finding of over-indebtedness caused by imprudent over-committed involves a judgment of debtor culpability, this normative element is not quantifiable with a certainty: TERESA SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS 181 (Beard Books,U.S. 1999).
[216] Lynn M. LoPucki, *Common Sense Consumer Bankruptcy*, 71 AM. BANKRUPTCY LAW J. 461 (1997).
[217] Professor LoPucki considers the "moral structure" of consumer bankruptcy to be captured in Aesop's fable of the frivolous spendthrift grasshopper and the hard-working well-organised ant: *Id.*, 463–64.
[218] Ramsay (2003A), 25.
[219] DISNEY ET AL. (2008), 30.

which they can lower as costs rise, a situation divorced from the reality of those households who are already struggling to make ends meet.[221] Such a perspective also veers close to seeing the debtor as a rational economic actor capable of coldly calculating consumption based on income fluctuations. This ignores the human traits of *loss aversion* and *status quo bias*, two cognitive features which mean that all humans – and not just certain "bad planners" – will try to maintain a lifestyle long after an economically rational actor would make changes.[222] Finally, qualitative assessments regarding such vague concepts as whether a debtor has "lived within her means" also necessarily involve a certain level of subjective judgment as to the appropriate spending habits of a household;[223] and so could be open to the criticism of constituting "middle-class moralising dressed up as a technical judgment."[224] In this regard it should be noted that empirical evidence shows that of all income groups, over-indebtedness is most likely among those households who are "materially deprived", in the sense of being unable "to afford some items considered by most people to be desirable or even necessary to lead an adequate life."[225] High debt levels are therefore liable to lead to an inability to afford essential items. [226] This casts further doubt on the "over-consumption myth" that the increase of over-indebtedness in recent decades has been caused by extravagant consumer purchases,[227] an argument which serves the interests of certain groups such as institutional lenders campaigning against policies which would regulate lenders more strictly.[228]

Undoubtedly, financial mismanagement on the part of households plays some role in causing over-indebtedness, and disorganisation or the adoption of an overly relaxed attitude to one's financial affairs contribute to financial difficulties.[229] The evidence seems to suggest, however, that the cases in which over-indebtedness arises due to preventable individual mismanagement seem rare, and that over-indebtedness is a more endemic problem in modern household credit markets. One study which identifies "financial imprudence" as the primary cause of over-indebtedness goes on to describe this concept as being composed of factors (lack of financial literacy and an understanding of product terms among borrowers, leading to "over-borrowing") which can from a different perspective be seen as *market failures* of the kind I discuss in Chapter 2. These factors are indicative of wider market features leading to potential sub-optimal

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[220] DISNEY ET AL. (2008), 30; EUROPEAN COMMISSION ET AL. (2008), 27.

[221] Hacker (2012), 230–4.

[222] Ramsay (2003A), 24.

[223] For discussion of issues of social class related to credit and debt, and in particular for the potential discomfort of higher social classes with the prospect of those in lower classes apparently simulating an elevated social status by using credit to fund their lifestyles, *see* Sullivan (2012), 46–47, 53–54.

[224] Iain Ramsay, *Models of Consumer Bankruptcy*, 20 J. CONSUM. POLICY 269, 275 (1997).

[225] EUROPEAN COMMISSION ET AL. (2010), 33–4. For an explanation of the material deprivation indication under the EU Survey of Income and Living Conditions, see http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Glossary:Severe_material_deprivation_rate.

[226] *Id.*, 34.

[227] Warren (2004).

[228] Sullivan (2012), 53–54.

[229] EUROPEAN COMMISSION ET AL. (2008), 25.

outcomes for *all* borrowers, rather than aberrant financial mismanagement among a particular group of individual borrowers. This point is illustrated by the US consumer bankruptcy project, which over three decades of research has consistently shown that people in bankruptcy "are a typical cross section of the middle class, not a deviant group of chronic failures."[230] Conditions of the modern consumer credit society, in which households have taken on unprecedented high levels of debt, have placed many households in precarious positions in which any, or a combination, of these factors can push a (seemingly random) subset of them into over-indebtedness.[231] The appropriate lesson for policymakers is not to condemn such debtors as somehow lacking or incompetent (see the discussion of the judgment of improvident consumer borrowing in Chapter 6), but to regulate the market appropriately so as to remedy these failures, and subsequent chapters illustrate the role personal insolvency law should play towards this end.

[230] Leicht (2012), 215.
[231] Leicht (2012), 195–217; Hacker (2012).

1.5 Conclusions: Personal Insolvency Law in the Modern Consumer Credit Society

A. The Inevitability of Over-indebtedness in the Modern Consumer Credit Society

Recent decades have seen socio-economic developments supported by official Government policies create a *consumer credit society*, in which household borrowing has become essential both at the micro-economic level of supporting household living standards, and at the macro-economic level in maintaining economic growth. A side-effect of this trend is the development of mass household over-indebtedness and its associated social costs, as the instability of life causes a certain portion of society's heavily debt-burdened households to fall into financial difficulty. While credit provides access to goods, services and opportunities which would otherwise be unavailable to households, it also places them in an unprecedentedly fragile position.[232] The spectre of over-indebtedness stalks a system in which households carry increasingly large debt burdens, and in this context over-indebtedness "can be regarded as a natural phenomenon that inevitably touches a proportion of the population at any time and in any economic circumstance."[233]

This has a number of implications for personal insolvency policy and poses a challenge to traditional ideas and principles developed in a significantly different social and economic context. As I explain in Chapter 2, the law originated as a debt collection device, designed to serve the sole objective of upholding market transactions and maximising returns to creditors. This policy was based on the view that market exchanges between commercial parties acting according to their preferences produce the most efficient allocation of society's resources. The picture of a financialised society[234] presented in this chapter is far from this ideal-type market paradigm. Rather than credit markets being composed of commercial parties venturing into the market voluntarily in the pursuit of profit, they are now constituted by households forced to borrow to maintain reasonable living standards and required by society to do so in order to maintain economic growth. Obligatory participation of households in consumer credit markets susceptible to failures, under the constant threat of adverse life events, leads to inevitable over-indebtedness. Since households, unlike a business, cannot simply be driven from credit markets or "creatively destroyed", externalities and social costs are produced instead of efficient allocations of resources (see Chapter 2). Personal insolvency thus has a new role in regulating these markets and intervening to redistribute risk in an efficient manner and internalise social

[232] This theme is explored comprehensively in SULLIVAN, WARREN, WESTBROOK (2000). *See also* Leicht (2012).
[233] Betti et al. (2007), 141.
[234] *See e.g.* GLOUKOVIEZOFF (2011), 14 et seq; Deutschmann, (2011).

costs. The conditions described in this chapter call for a re-orientation of the law around the fresh start policy and the objective of debt relief.

Pathways into personal insolvency procedure must recognise the limited financial, informational and cognitive resources available to consumer debtors, while also acknowledging that over-indebtedness is an inevitable and widespread occurrence. Further empirical evidence of debtor circumstances is desirable and undoubtedly a certain number of personal insolvency cases involve culpable behaviour. Available evidence suggests, nonetheless, that the law must recognise the unavoidable nature of a certain level of over-indebtedness in a society reliant on personal borrowing, and acknowledge that insolvency arising from condemnable debtor misconduct is exceptional, rather than the standard case. The law should thus provide open and uncomplicated access to debt relief procedures (see Chapter 4). The debt discharge feature of the law should operate in such a manner as to allocate the inevitable losses of credit markets onto the parties best able to bear them, internalising the social costs generated by the market. In Chapters 2 and 5 I explain that in most cases this will involve causing institutional creditors rather than individual household debtors to bear the cost of default through restrictions on their ability to collect debts (Chapter 5).[235] Finally, the law must recognise the necessity of household borrowing in the modern consumer credit society and the inevitability of default. When the Government-mandated household debt burdens inevitably lead to over-indebtedness for a portion of society, these households should be spared the condemnation that personal insolvency law has historically held for debtors,[236] while also being restored to a position in which they can resume economically productive activity. In moving in this direction towards re-allocating responsibility for default, the law can nonetheless continue to guard against abuse of debt relief and undesirable borrowing practices through careful application of the concept of moral hazard (Chapter 6). The conditions of the consumer credit society should also illustrate personal insolvency law's limitations as just one element in a wider economic, social, political and legal environment and particularly the restricted ability of incentives and deterrence contained in the law to influence debtor financial behaviour.

[235] *See e.g.* Lauren E. Willis, *Will the Mortgage Market Correct - How Households and Communities Would Fare If Risk Were Priced Well*, 41 CONNECT. LAW REV. 1177, 1182 (2008); Charles G. Hallinan, *Fresh Start Policy in Consumer Bankruptcy*, 21 UNIV. RICHMOND LAW REV. 49, 118–25 (1986); Richard M. Hynes, *Non-Procrustean Bankruptcy*, 2004 UNIV. ILL. LAW REV. 301, 340–42 (2004).

[236] As Professor Leicht notes in respect of the American case, "many people in bankruptcy are there because they have attempted to engage in activities that American society and culture value, such as pursuing higher education, starting a small business, and owning a single-family home: *see* Leicht (2012), 215.

B. Personal Insolvency Law and the Reduction of Over-indebtedness

To the extent to which the costs of over-indebtedness have been recognised, it appears that the prevailing policy view in the UK in recent years has been that the over-indebtedness of the minority is a price worth paying for the enhanced welfare brought to the majority by expanded household debt. In the aftermath of the global financial crisis and the continued prolonged shadow of the Great Recession, this view must be questioned.[237] Under a loans for wages model, the prevailing financial market logic of self-interested exchange in a "financialised" society means that what are in effect essential resources are allocated not based on need (either of the individual household or of wider society), but rather only if it is profitable for an intermediary to do so, based upon the expectations of financial markets.[238] Furthermore, even if *access* to credit is granted, commercial self-interest determines the *terms* on which it is offered, meaning that borrowing households may be able to obtain such services only on inappropriate terms which may contribute to their over-indebtedness.[239] Through light-touch regulation and related policies, policymakers may have focused unduly on ensuring *access* to credit, without questioning the *quality* of credit being provided and its *appropriateness* to households' needs, and whether the debt burdens being borne by households would lead to over-indebtedness.[240] In particular, lenders in the credit card[241] and payday lending[242] markets developed business models predicated on the borrower's *default*, meaning that these products' existence depends on a large portion of borrowers' inability to repay and subsequent "roll-over" borrowing. Certain policymakers and commentators nonetheless appear to present persistently a dichotomy between regulation favouring open access to credit (and apparently thus also prosperity and homeownership), and an alternative of financial exclusion or credit constraint and economic deprivation.[243]

This paradigm must now be reconsidered. Not only has the household debt expansion in the late 1990s and early 2000s led to the high cost of over-indebtedness for a (increasingly large) minority of households, but overall welfare may not have improved. The shared macro-economic

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[237] Even under a consumption smoothing model this claim of welfare enhancement via consumer borrowing was subject to certain criticisms: Barba and Pivetti (2009), 120.

[238] GLOUKOVIEZOFF (2011), 18.

[239] *Id.*, 4–5, 29.

[240] *Id.*, 4–5.

[241] The eye-opening work of Professor Mann has exposed the "sweat box" model of credit card lending, in which the majority of lender profit is derived from charges, fees and penalty interest occasioned on the debtor's default, rather than on the debtor repaying the capital sum borrowed with interest: Ronald J. Mann, *Bankruptcy Reform and the Sweat Box of Credit Card Debt*, 2007 UNIV. ILL. LAW REV. 375 (2007).

[242] A 2013 report by the UK Office of Fair Trading found that approximately 50% of income of payday lenders arises from rolled-over loans, i.e. loans provided to debtors who were unable to repay the original loan borrowed and provided further credit to do so. *See* OFFICE OF FAIR TRADING (2013).

[243] As just some examples, *see* Nield (2010), 610; Brown (2011), 91.

gains fuelled by a credit boom have been expensively paid for by losses suffered throughout the Great Recession of the 2000s and 2010s.[244] During this time, malign economic conditions have developed in the context of a falling consumption rate in the developed world, with households paying down large historic debt burdens rather than borrowing to fund consumption.[245] As consumption became financed by credit, interest accrued on everyday expenses, forcing households to work harder and for longer to repay interest on the cost of goods and services which would have been bought from wages in previous decades.[246] Not only does this lower the welfare standards of households, it also creates malleability among labour which might lead to further wage decreases, in a vicious cycle of falling incomes and rising debt.[247] In the most spectacular example of the questionable benefits of the household debt expansion, the boom in mortgage lending in many European countries in the 1990s and 2000s failed in its objective of promoting homeownership, with lower levels of homeownership across Europe at the end of this period than existed in 1995 (Figure 31).[248] In a statement which can also be applied to the UK and other parts of Europe, Professor Trumbull notes that "the financial crisis of 2009 signalled the end of a deeply held ideal of American political economy: that greater market access was welfare enhancing."[249]

Policymakers have responded to these conditions, most notably in the adoption of the regulatory principle of responsible lending, which imposes obligations on lenders to prevent over-indebtedness through prudent lending practices including creditworthiness assessments and product suitability requirements. This concept emerged in the last decade,[250] but has obtained increased attention among policymakers[251] and academics[252] as the "financial crisis [of the late 2000s] has shown that irresponsible behaviour can undermine the foundations of the financial system, leading to… potentially severe social and economic consequences."[253]

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[244] Michael Green, *New Labour: More Debt - The Political Response*, *in* CONSUMER CREDIT, DEBT AND BANKRUPTCY: COMPARATIVE AND INTERNATIONAL PERSPECTIVES 393, 394 (2009); Leicht (2012), 206.

[245] INTERNATIONAL MONETARY FUND, *Dealing with Household Debt*, *in* WORLD ECON. OUTLOOK 2012 1 (IMF 2012).

[246] The Centre for Financial Inclusion, a UK NGO, estimates that £67 billion per year is being paid in interest on household debt alone in the UK: *see* FINANCIAL INCLUSION CENTRE (2011), 1.

[247] Barba & Pivetti (2009), 127.

[248] The UK Financial Services Authority noted in 2011 that the "enormous" increase in mortgage lending and household debt in the previous decade served only to increase house prices, rather than to expand home ownership to wider portions of society: FINANCIAL SERVICES AUTHORITY, MORTGAGE MARKET REVIEW DATA PACK 14 (FSA 2011).

[249] Trumbull (2012), 30.

[250] *See e.g.* I. Ramsay (2005).

[251] *See e.g.* EUROPEAN COMMISSION, INTERNAL MARKET AND SERVICES DG, PUBLIC CONSULTATION ON RESPONSIBLE LENDING AND BORROWING IN THE EU (2009); OFFICE OF FAIR TRADING (2010); FINANCIAL SERVICES AUTHORITY, MORTGAGE MARKET REVIEW: RESPONSIBLE LENDING (FSA 2010).

[252] *See e.g.* Nield (2010); SARAH NIELD, *Mortgage Finance: Who's Responsible?*, *in* James Devenney & Mel Kenny (eds.), CONSUMER CREDIT, DEBT AND INVESTMENT IN EUROPE 160 (Cambridge University Press 2012); KAREN FAIRWEATHER, *The Development of Responsible Lending in the UK Consumer Credit Regime*, *in* Devenney & Kenny (eds.) (2012), 84; John Pottow, *Ability to Pay*, 8 BERKELEY BUS. LAW J. 175 (2011).

[253] European Commission Proposal: Directive on Credit Agreements Relating to Residential Property, ¶3.

Personal insolvency law should recognise its role in the consumer credit society by mirroring these regulatory developments and embracing a role of preventing, rather than merely remedying, over-indebtedness. The traditional approach of the law has been to uphold market exchange passively and maximise returns to creditors in the belief that this would produce an optimal outcome of making as much credit as possible available at the lowest cost, relying on market discipline rather than legislation to provide restraint. The realities of consumer credit markets mean that decisions of debtors obliged to borrow at whatever terms are available, in conditions of uncertainty as to future income shocks, cannot discipline lender conduct. As I explain in Chapter 2, personal insolvency law therefore should play a role in amplifying market signals and instilling market discipline by incentivising creditors to prevent default and so to internalise the social costs of consumer credit markets.[254] In Chapter 4, I argue that this realisation suggests policymakers should no longer design (and direct debtors into) personal insolvency procedures which maximise returns to creditors. I explore how the objective of debt collection, and its important principle of equality of creditors, could be departed from as a means of incorporating principles of lender liability into personal insolvency law,[255] disciplining irresponsible lenders in a manner in which the market fails to do. In Chapter 5, I consider how these considerations for allocating losses could be used to inform the scope of the stay and discharge provided under personal insolvency law. I discuss this objective in the context of moral hazard theory and the sanctions applicable to culpable debtor behaviour in Chapter 6, and illustrate how the relational nature of moral hazard[256] means that a law that is overly punitive of debtors may create incentives for lenders to take greater risks, externalising costs as over-indebtedness increases.

This chapter, together with the theoretical framework presented in Chapter 2, provide the foundation for my argument for re-orienting personal insolvency law around its modern function as a consumer debt relief device, and for the law's embracing of the "fresh start" policy. While personal insolvency law alone cannot rectify wider social inequalities and economic problems, it can at least play a part in addressing the injustices and inefficiencies which fall within its remit by relieving the negative consequences for individual households of the consumer debt explosion and incentivising behaviour which reduces the incidence of over-indebtedness. The principles, policies and underlying ideas of the law must evolve so as to correspond to the function it now plays in the modern consumer credit society.

[254] WORLD BANK (2013), ¶¶88–93.
[255] *See e.g.* John A.E. Pottow, *Private Liability for Reckless Consumer Lending*, 2007 UNIV. ILL. LAW REV. 405 (2007).
[256] Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. LAW REV. 237, 275 (1996).

CHAPTER 2: A Theoretical framework of Consumer Insolvency Law

2.1 Introduction

The developing socio-economic context of personal borrowing and the rise of mass over-indebtedness described in Chapter 1 call for a reconsideration of fundamental assumptions and ideas of personal insolvency law. In this Chapter, I explain how these developments require a shift in emphasis between the two theoretical objectives and justifications of personal insolvency law, and the attribution (at least in the consumer insolvency context) of primacy to the law's debt relief function over its (traditionally dominant) debt collection objective.[257] The origins of personal insolvency law lie in debt collection, the sole objective of a bankruptcy law which saw its role as being to enforce contractual bargains and uphold market expectations. In contrast, in contemporary times "official social/economic policy favours the rehabilitation of debtors… as a legitimate goal of personal insolvency law";[258] to the extent that the discharge of a debtor's obligation may form the "essence"[259] of modern law. Given the traditional orientation of private law around upholding obligations between parties, "[d]ebt relief laws present somewhat of a puzzle",[260] running counter to norms the legal system generally upholds. In this chapter I explore this puzzle's solutions by considering the theoretical foundations of the fresh start policy in order to illustrate why the debt relief function should hold a position of primacy in consumer insolvency policy.

I focus in particular on perspectives drawn from law and economics theory, for a number of reasons. Firstly, in line with the argument throughout that personal insolvency law must evolve to its new role as a *de facto consumer* law, I advocate that lessons from consumer market regulation should be applied to the field of personal insolvency policy. In this regard economic analysis (primarily expressed in terms of *market failure*) has come to dominate regulatory policy-making,[261] to the extent that "those who wish to be taken seriously by governments must frame their proposals within this discourse."[262] This influences my adoption of an economic framework,

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[257] Professor Hallinan explains these two recognised objectives of personal insolvency law in stating that "[o]ne firmly established tenet of time-worn bankruptcy lore holds, of course, that the bankruptcy system serves two functions: the protection and payment of creditors; and the provision of shelter and a 'fresh start' to overburdened debtors: Hallinan (1986), 50

[258] DAVID MILMAN, PERSONAL INSOLVENCY LAW, REGULATION AND POLICY 119 (Ashgate Publishing Limited 2005).

[259] Richard E. Flint, *Bankruptcy Policy*, 48 WASH. LEE LAW REV. 515, 515 (1991).

[260] Hynes (2004), 328.

[261] Tony Prosser, *Regulation and Social Solidarity*, 33 J. LAW SOC. 364, 366–71 (2006).

[262] RAMSAY (2012A), 49.

despite my acknowledgement of criticisms of policymaking based solely on economic perspectives, of the value of alternative approaches (as discussed in Part 2.3 below). Policymakers' reliance on economic approaches is evident in English[263] and Irish[264] personal insolvency law reforms of the last decade, as in the interest in personal insolvency law and the systemic significance of household debt shown in recent years by international organisations such as the IMF,[265] European Commission,[266] European Central Bank[267] and (albeit to a lesser extent) World Bank.[268] Indeed before modern law and economics theory developed, personal insolvency law has long been conceptualised by policymakers as the law of the market and of trade, with economic considerations consistently central.[269] Secondly, some of the most influential academic works in the fields of insolvency and consumer credit regulation are based primarily on economic analysis,[270] while insightful and well-developed theories of the fresh start policy rely on economic frameworks.[271] Key academic debates in the 1990s and 2000s, which were mirrored in legislative debate on US bankruptcy law reform, turned on "a sharp split in the academic literature"[272] between researchers adopting neo-classical, rational choice law-and-

[263] The policy objectives underlying the reform of English bankruptcy law under the Enterprise Act 2002 mirror the functional economic theory of facilitating economic productivity through debt relief, as described below: THE INSOLVENCY SERVICE, BANKRUPTCY: A FRESH START (Insolvency Service 2000); THE INSOLVENCY SERVICE; DEPARTMENT FOR TRADE AND INDUSTRY, PRODUCTIVITY AND ENTERPRISE: INSOLVENCY - A SECOND CHANCE (The Insolvency Service; Department for Trade and Industry, Cm 5234 ed. 2001).

[264] Legislation reforming Irish personal insolvency law describes itself as serving "the need to ameliorate the difficulties experienced by debtors in discharging their indebtedness due to insolvency and *thereby lessen the adverse consequences for economic activity in the State*" (emphasis added): Personal Insolvency Act 2012 (2012), Long Title.

[265] *See e.g.* IMF (2012).

[266] *See* Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Entrepreneurship 2020 Action Plan 17–18 (2013); European Commission, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: A New European Approach to Business Failure and Insolvency (2012).

[267] *See e.g.* Opinion of the European Central Bank of 14 September 2012 on Measures Relating to Personal Insolvency (2012).

[268] WORLD BANK (2013). While this Report's analysis of personal insolvency law draws extensively on economic theory, it also embraces wider perspectives.

[269] For example, 19th Century Parliamentary debates on personal insolvency law reform saw the law as serving trade and economic ends. One politician argued for reforms to remedy deficiencies which meant that "[a]ll who were engaged in commerce shunned the Bankruptcy Court": HC Deb 15 March 1860 vol 157 col. 678, per Mr. Edwin James M.P. Other politicians based their arguments on submissions received from "the principal merchants, bankers and traders of the City of London": HC Deb 21 May 1860 vol 158 col. 1564.

[270] *See e.g.* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (Harvard University Press 1986) (See text to note 329-339 below). The work of Professors Bar-Gill and Warren, based on behavioural economics analysis, influenced the establishment of the US regulatory agency the Consumer Financial Protection Bureau: *see* Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1 (2008).

[271] See e.g. Margaret Howard, *Theory of Discharge in Consumer Bankruptcy, A*, 48 OHIO ST. L.J. 1047 (1987); Hallinan (1986). Some notable well-developed accounts of the fresh start policy based on non-economic frameworks can be identified also: *see e.g.* KAREN GROSS, FAILURE AND FORGIVENESS (Yale University Press 1997); Flint (1991).

[272] DAVID A. SKEEL, DEBT'S DOMINION 199 (Princeton University Press, 2001).

economics on the one hand;[273] and those utilising socio-legal empirical research techniques[274] on the other.[275]

Therefore in order to contribute to both policy debate and academic discussion on personal insolvency law it is important to engage with economic ideas. My theoretical framework is largely founded on economic analysis, albeit in a manner which aims to bridge the divide between traditional neo-classical economic perspectives and socio-legal literature. I integrate insight from information and behavioural economics, as well as the findings of socio-legal researchers, in developing a framework which acknowledges the value of traditional economic analysis but also recognises how the reality of consumer over-indebtedness departs from certain of its assumptions. While traditional neo-classical economic models prescribe that optimal outcomes will be produced by a law which serves a debt collection function and interferes with pre-bankruptcy entitlements as little as possible, insight from behavioural and information economics, understood in the context of the reality of consumer over-indebtedness, argues that optimal outcomes can only be achieved by re-orienting the law towards its debt relief objective and the fresh start policy. Analysis of this type can meet arguments favouring a debt collection perspective on their own terms, and so has an advantage of avoiding unresolvable disputes between parties adopting different normative perspectives and talking past one another unconstructively.[276]

As the previous chapter suggests, personal insolvency law has undergone a profound functional change over time. It originated centuries ago as a commercial law invoked by creditors as a collective debt collection mechanism, which served the objective of maximising returns to creditors from their investments in an ultimately failed business. In contemporary times, it is a consumer law invoked by over-indebted individuals, "[t]he predominant purpose – if not the sole purpose – of [which] is to effect the discharge of debts – to give the debtor a 'fresh start'."[277] This change in the subject and practical function of the law requires an evolution in the legal ideology and theoretical bases of the law, and a questioning of the assumptions of traditional classical law

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273 *See e.g.* Judge Edith H. Jones & Todd J. Zywicki, *It's Time for Means-Testing*, 1999 BYU L. REV. 177 (1999); Todd J. Zywicki, *Economic Analysis of the Consumer Bankruptcy Crisis, An*, 99 NW. U. L. REV. 1463 (2004). One rational choice economics author described a seminal study from the rival socio-legal school as "a curious relic from an earlier age of legal scholarship, when a lack of economic sophistication did not disqualify academics from making policy pronouncements." *See* FH Buckley (2001), 1078.

274 The leading works in this tradition are those of the Consumer Bankruptcy Project: T. SULLIVAN ET AL. (1999); T.A. SULLIVAN ET AL. (2000); Robert M. Lawless et al., *Did Bankruptcy Reform Fail- An Empirical Study of Consumer Debtors*, 82 AM. BANKRUPTCY LAW J. 349 (2008); PORTER (ED.) (2012).

275 For a discussion of these two academic "camps" and the influence of the academic differences of opinion on policy debate, *see e.g.* SKEEL (2001), at 199–202; A. Mechele Dickerson, *Regulating Bankruptcy*, 84 WASH. UNIV. LAW REV. 1861, 1865–74 (2006); Margaret Howard, *Bankruptcy Empiricism: Lighthouse Still No Good*, 17 BANKRUPTCY DEV. J. 425, 440–59 (2000); Iain Ramsay, *Stability and Change in National and Transnational Personal Insolvency Paradigms*, Law and Society Association Annual Meeting, IRC COMPARATIVE PERSPECTIVES ON HOUSEHOLD DEBT AND INSOLVENCY (Conference Paper, on file with author) (Boston Jun. 1, 2013).

276 A. Mechele Dickerson, *Can Shame, Guilt, or Stigma Be Taught*, 32 LOYOLA LOS ANGELES LAW REV. 945, 1871 (1998).

277 Jason J. Kilborn, *Mercy, Rehabilitation, and Quid Pro Quo*, 64 OHIO STATE LAW J. 855, 866 (2003).

of contract and neoclassical economics on which the law's historic debt collection objective was based. While the business-to-business creditor-debtor relations of business insolvency may approximate the ideal market on which such *laissez faire* ideology is founded, the reality of modern consumer insolvency departs dramatically from this paradigm. The fresh start policy's underlying ideas reject such private ordering models of social organisation which see the enforcement of contractual bargains as the organic state of social organisation and departures from this norm as exceptional "interventions";[278] and instead views the law's role as being to correct market failures and redistribute inefficient and unjust market allocations. Under my "active" or "positive" conception of the fresh start policy, debt discharge for insolvent debtors is not "second best" to market allocations (i.e. debts which the law collects),[279] but is an independent socially and economically beneficial institution which serves important public policy objectives. I reject a traditional "passive" or "negative" view of the law's debt relief function, which conceptualises debt relief features of the law as mere limitations (born of sympathy for the debtor) on the otherwise universal norm that the law serves the enforcement of contracts.

[278] For an example of this view of bankruptcy law, *see* Lawrence H. White, *Bankruptcy as an Economic Intervention*, 1 JOURNAL OF LIBERTARIAN STUDIES 281 (1977). For criticism of similar views, *see e.g.* Ramsay (1995), 177; RAMSAY (2012A), 49; Prosser (2006), 371–75.

[279] Prosser (2006), 371.

2.2 The Two Faces of Personal Insolvency Law

A. The Debt Collection Perspective of Personal Insolvency Law

Despite rejecting the primacy of personal insolvency law's debt collection function, I must begin my discussion nonetheless by outlining this objective and its underlying ideas. In jurisdictions such as England and Wales in which the institution of debt discharge is long established, bankruptcy law originated in a collective debt enforcement procedure for the benefit of creditors, with debt discharge and subsequent debt relief policies layered upon this original existing structure. In countries in which new insolvency laws have been introduced in response to modern consumer over-indebtedness (such as Belgium, France and Ireland), policymakers first introducing the idea of debt discharge were confronted with the long-existing conflicting principle of sanctity of contract, and the orientation of existing insolvency (and all private) law around the aim of maximising creditors' recovery of debts. On a wider socio-political plane, the simple social convention that promises ought to be kept and contracts enforced has represented a constant political obstacle to enshrining in law a fresh start policy based upon more conceptually difficult justifications.[280] Therefore arguments for an active fresh start policy to serve the needs of the modern consumer credit society run against not only centuries of legal tradition, but also "common sense"[281] or an unquestioningly accepted social axiom that debts must be repaid.[282] Perhaps these reasons partly explain why some commentators, courts and policymakers (as I explain in subsequent chapters) may afford inadequate recognition to the debt relief function of bankruptcy law, which question these well-established ideas.[283] In the following pages I present ideas of classical contract law and neo-classical economics underpinning the debt collection perspective, before subsequently illustrating their limitations in the context of modern consumer over-indebtedness.

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280 For discussion of political ideological objections to debt relief, see Chapter 3 and Spooner, (2013), 774–76.

281 LoPucki (1997), 464.

282 DAVID GRAEBER, DEBT: THE FIRST 5,000 YEARS 1–4 (Melville House 2012).

283 In the words of Professor Hallinan, in the US context: "[i]ndeed, until well into this century, despite the obvious intent of modern bankruptcy legislation and the empirical realities of consumer bankruptcy filings, respected authorities continued to argue that the protection and payment of creditors was the only legitimate point of permitting legal relief through bankruptcy." See Hallinan (1986), 54, and sources cited therein.

(I) Origins of Bankruptcy Law: A Creditor's Remedy for the Collective Enforcement of Private Law

Bankruptcy law originated in the Middle Ages as a collective debt collection mechanism for the benefit of creditors, at a time when the "only policy issue… was whether the existing means for assisting creditors in collecting their debts were satisfactory."[284] A bankruptcy law was introduced first as a response to the perceived ease with which debtors could evade existing ineffective enforcement mechanisms, providing a particularly effective mechanism to force repayment through procedural devices, close supervision, sanctions and incentives. Secondly, bankruptcy laws responded to the "common pool"[285] or race-to-the-court problem created by the availability of individual enforcement mechanisms to all creditors. This meant that the first creditors to pursue an insolvent debtor generally deprived other creditors of a share of the debtor's limited assets.[286] Therefore the first English bankruptcy laws passed in the 16th Century[287] (developed from the Law Merchant[288]) aimed to provide a means of distributing debtors' assets equitably among creditors, while providing a powerfully coercive mechanism to ensure that creditors could indeed access these assets.[289] The earliest bankruptcy legislation provided not only for the surrender of all debtor assets for the benefit of creditors, [290] but also contained harsh penalties to be used to coerce repayment by debtors (being in the nature of a criminal statute, applicable to fraudulent and absconding debtors).[291] Three key conditions essential to the modern consumer debt relief function of personal insolvency law were absent. No debt discharge was provided to the debtor, with creditors retaining their collection rights after the proceedings had concluded.[292] Only involuntary proceedings brought by creditor petition were possible, while procedures were applicable only to traders or business debtors, rather than consumers.[293]

Debt discharge was established in 1705,[294] before subsequently voluntary bankruptcy was introduced in 1844[295] and finally extended to non-traders in 1861.[296] All the while, however, the law remained firmly oriented towards maximising returns to creditors for the furtherance of

[284] Charles Jordan Tabb, *Historical Evolution of the Bankruptcy Discharge, The*, 65 AM. BANKRUPTCY LAW J. 325, 327 (1991).
[285] JACKSON (1986), 8–11; MICHAEL TREBILCOCK, THE LIMITS OF FREEDOM OF CONTRACT 10–12 (Harvard University Press, New edition ed. 1997).
[286] Tabb (1991), 328.
[287] The first English bankruptcy act was "An Act against such Persons as do make Bankrupts", 34 & 35 Henry 8, c. 4 (1542) (Eng.). *See Id.*, 329; Andrew J. Duncan, *From Dismemberment to Discharge*, 100 COMMER. LAW J. 191, 193 (1995).
[288] IAN F. FLETCHER, LAW OF BANKRUPTCY 6–7 (Legal Topics Series, Macdonald & Evans Ltd 1978).
[289] Hallinan (1986), 54; John M. Czarnetzky, *Individual and Failure*, 32 ARIZ. STATE LAW J. 393, 395 (2000); Kilborn (2003), 862.
[290] Duncan (1995), 194.
[291] *Id.*, 194–95; Tabb (1991), 330–32.
[292] Tabb (1991), 332.
[293] Duncan (1995), 195.
[294] An Act to Prevent Frauds Frequently Committed by Bankrupts 1705, 4 & 5 Anne, c. 17
[295] An Act to amend the Law of Insolvency, Bankruptcy, and Execution, 7 & 8 Vict., c. 96, §41 (1844), Tabb (1991), 353–4.
[296] *See* An Act to amend the law relating to bankruptcy and insolvency in England, 24 & 25 Vict. C. 134; Vern Countryman, *A History of American Bankruptcy Law*, 81 COMMER. LAW J. 226, 229 (1976); SIR KENNETH CORK, INSOLVENCY LAW AND PRACTICE ¶ 42 (Cmnd.8558, H.M.S.O., 1982).

trade.[297] Parliamentary debates on the 1861 legislation show that the primary reasons for extending bankruptcy (and so debt discharge) to non-trading debtors were to reduce the incidence of imprisonment for debt (which remained legal until it was abolished, with some exceptions, in 1869), and in fact to bring more *traders* (who managed to fall outside of the existing definition) within the scope of the procedure[298] in the interests of commercial creditors.[299] Humanitarian concerns informed the legislation to a certain degree, as politicians of the time appeared to demonstrate a genuine desire to reduce imprisonment for debt.[300] Such ideas arose, however, as "an incidental by-product of a system single-mindedly focused on advancing the interests of creditors."[301]

(II) Market Facilitating Logic of Personal Insolvency Law

This traditional perspective of bankruptcy law shares much of its intellectual foundations with classical contract law theory.[302] Both perspectives are based upon the efficient market hypothesis of neo-classical economics and exhibit an underlying ideology or ethic of market individualism[303] or commercial self-interest.[304] This ethic places utmost faith in the ability of unfettered private exchange to deliver efficient outcomes and vindicate personal autonomy,[305] and sees law's role as being to support the market's production of efficient allocations by protecting bargains to the greatest extent possible.

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[297] For discussion of how debt discharge served debt collection aims at this time, see the introduction to Chapter 5.

[298] Duncan (1995), 214–15.

[299] *See e.g.* HC Deb 15 March 1860 vol. 157 col. 678, per Mr Edwin James M.P. Similarly, Mr Thomas Bazley M.P. thanked the Attorney General "on the part of the mercantile and manufacturing portion of the community" for his work in proposing amendments to the law: ibid, col. 681.

[300] Sir Richard Bethell, Attorney General, argued that "[i]mprisonment as a punishment for incurring debt or becoming insolvent without fraud is inconsistent with the dictates of humanity." HC Deb 15 March 1860 vol 157 col. 652-3. On humanitarian motivations in historical English bankruptcy legislation, *see* Tabb (1991), 338–39.

[301] Hallinan (1986), 54.

[302] I focus on the theoretical construct of the "classical law of contract", rather than an era in contract law history occurring in the 18th and 19th century; even thought I acknowledge how this period coincides with key stages in the development of English bankruptcy law. *See* BROWNSWORD (2006), 46–47. For a comprehensive discussion of the classical law of contract, *see* P. S. Atiyah, The Rise and Fall of Freedom of Contract (1979).

[303] John N. Adams & Roger Brownsword, *Ideologies of Contract, The*, 7 LEG. STUD. 205 (1987).

[304] Willett (2012).

[305] TREBILCOCK (1997), 8–9.

(A) Classical Contract Law, Neo-Classical Economics and Bankruptcy as the Law of the Market

The classical law of contract, as opposed to more modern relational[306] and consumer-welfarism[307] conceptions of contract law, holds a robust interpretation of the foundational principle of freedom of contract.[308] Its starting position is that contracting parties, as best judges of their own needs and circumstances, should have complete liberty to decide upon contractual terms (which reflect the parties' wills[309]) and that courts and legislatures should be reluctant to interfere in bargains.[310] This leads to a strong commitment to the idea of the sanctity of contract, that parties be held to their freely made bargains.[311] Most relevantly, contractual excuses should be narrowly construed and the doctrine of frustration or impossibility should not extend to circumstances in which a debtor is unable to repay a contracted debt, or is only able to do so through great hardship.[312] These ideas see contract law as the "law of the market",[313] and are founded upon basic notions of neo-classical economics[314] which promise efficient outcomes from markets free from legal "interventions".

A central idea of neo-classical economics is that resources are allocated more efficiently through the mechanism of voluntary exchange rather than through the collective decision making of State regulation.[315] If two parties enter a voluntary exchange they must both feel that the exchange will further their utility or preferences,[316] and parties inevitably have better information regarding their preferences than a centralised collective decision-making body such as Government.[317] Under this perspective, market exchanges signal individual preferences, and the market becomes the hub of all knowledge of society directed by the "invisible hand" of seller responses to purchaser preferences. This process drives competition and ensures that resources are allocated to those who will use them most efficiently (assuming the absence of transaction costs and the presence

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[306] *See e.g.* JEAN BRAUCHER, JOHN KIDWELL AND WILLIAM C. WHITFORD (EDS.), REVISITING THE CONTRACTS SCHOLARSHIP OF STEWART MACAULAY: ON THE EMPIRICAL AND THE LYRICAL; DAVID CAMPBELL AND PETER VINCENT-JONES (EDS.), CONTRACT AND ECONOMIC ORGANISATION: SOCIO-LEGAL INITIATIVES 40 (Hart Publishing 2013); DAVID CAMPBELL, *The Relational Constitution of the Discrete Contract*, *in* DAVID CAMPBELL AND PETER VINCENT-JONES (EDS.), CONTRACT AND ECONOMIC ORGANISATION: SOCIO-LEGAL INITIATIVES 40 (Dartmouth Publishing Co Ltd 1996); David Campbell & Donald Harris, *Flexibility in Long-Term Contractual Relationships*, 20 J. LAW SOC. 166 (1993).

[307] BROWNSWORD (2006), 137–38; Adams & Brownsword (1987), 314.

[308] BROWNSWORD (2006), 50.

[309] Atiyah (1979), 405–8.

[310] BROWNSWORD (2006), 50–53.

[311] *Id.*, 53–57.

[312] For example, the debtor's unemployment during the course of a contractual relationship will not provide an excuse for non-payment: *see* Ramsay (1995), 183.

[313] P.S. ATIYAH, (1979), 402.

[314] Campbell & Harris (1993) at 166.

[315] TREBILCOCK (1997) at 15–16.

[316] *Id.*, 8.

[317] *Id.*, 8, 16; MAXWELL L. STEARNS & TODD J. ZYWICKI, STEARNS AND ZYWICKI'S PUBLIC CHOICE CONCEPTS AND APPLICATIONS IN LAW 17 (West 2009).

of perfect information).[318] Seller responses to purchaser preferences will lead to mutually beneficial (*Pareto superior*) transactions between sellers and buyers (with at least one party's position improving and no one's deteriorating) until the optimum point of efficiency (*Pareto* optimality)[319] is reached, beyond which no further transactions will benefit one party without causing a loss to another.[320] This reasoning forms "the core of the legitimacy of the market as an allocative mechanism, for it shows allocations reached at general competitive equilibrium to be perfectly efficient" and so to produce positive welfare outcomes.[321]

To this end, the law must support the market mechanism by clearly defining property rights,[322] establishing ground rules[323] which allow these rights to be transferred freely,[324] and enforcing contractual bargains in order to protect the market expectations of parties.[325] The debt collection perspective sees bankruptcy as an extension of contract law, performing a similar role in enforcing bargains and supporting the market, since "[p]ermitting parties to avoid the enforcement of valid contracts invites the dual concerns of creating moral hazard which erodes market confidence[326] and introducing Government interference in the market (which substitutes State preferences for those of market actors)."[327] When market expectations of creditors cannot be realised due to a debtor's insolvency, bankruptcy law must ensure that these expectations remain protected as far as possible, through maximising returns to creditors and promoting creditor freedom to arrange solutions. Professor Jackson's influential "creditors' bargain" account of bankruptcy as a debt collection device encapsulates this perspective in the statement that "the basic role of bankruptcy law is to translate relative values of non-bankruptcy entitlements into bankruptcy's collective forum with as few dislocations as possible."[328]

(B) Neo-Classical Economics and the Collective Nature of Bankruptcy

As suggested by this quotation, the second related manner in which neo-classical economics argues for the efficiency of a personal insolvency law oriented around debt collection lies in the *collective* nature of insolvency procedures. By offering a collective debt collection mechanism, insolvency corresponds to neo-classical economic game theories of the "prisoner's dilemma" and

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318 Stearns & Zywicki (2009), 18–19.

319 *Id.*, 16.

320 *See e.g.* Stearns & Zywicki (2009), 16–17. *See* also, however, the "more relaxed standard for efficiency" of *Kaldor-Hicks* efficiency: Trebilcock (1997), 7; Stearns & Zywicki (2009), 17.

321 Campbell (1996), 52.

322 Trebilcock (1997), 9–15; Stearns & Zywicki (2009), 18.

323 Adams & Brownsword (1987), 206–7.

324 Trebilcock (1997), 9, 15–17.

325 Howells, Weatherill (2005), 8; Czarnetzky (2000), 415.

326 On the concept of moral hazard, see Chapter 6 below.

327 Czarnetzky (2000), 413.

328 Jackson (1986), 253. *See also* Milman (2005), 4.

the "tragedy of the commons".[329] The prisoner's dilemma arises in a situation where a joint welfare maximising solution would be reached for all parties through their cooperation, but where each self-interested party has an incentive to operate in a non-cooperative manner.[330] The solution to the problem is for the "prisoners" to reach a collective decision which produces the joint welfare maximising outcome. The similar "tragedy of the commons" or "common pool" problem operates where joint welfare minimising outcomes (the irreparable depletion of common resources), are produced if each party acts unrestrainedly in their own self-interest by extracting value from the common pool in the hope of gaining greater benefits than the other parties.[331] The primary economic solution to the tragedy of the commons is to allocate the common area to a single owner, so internalising all costs and benefits and aligning marginal private costs with marginal social costs.[332] Influential (creditor-oriented) explanations of insolvency law apply this reasoning, most notably the "creditors' bargain" heuristic, which "dominates scholarship" in corporate insolvency law.[333] These views start from the position that creditor cooperation is desirable to produce the joint welfare maximising outcome, but that the incentives created for each creditor to pursue individual enforcement against a debtor in the hope of full recovery may result in the joint welfare minimising outcome. Individual enforcement efforts may reduce the total value of the debtor's assets (the size of the common pool), and lead to additional costs as creditors compete to collect from the debtor first, including the costs of monitoring both the debtor and competing creditors.[334] Solving the prisoners' dilemma and tragedy of the commons problems, bankruptcy, as a collective and compulsory procedure, provides a method for producing creditor cooperation and making creditors act as one.[335] All creditors benefit from the "creditors' bargain" of the law's stay on individual enforcement efforts, centralised acquisition and sharing of information regarding a debtor's assets, and distribution of these assets among creditors on a *pro rata* basis.[336] *Pro rata* distribution is most appropriate, "because it mimics the value of [creditors'] expected positions immediately before bankruptcy".[337] The law in this way also guarantees a minimum (and predictable) amount of recovery to creditors instead of uncertain outcomes of races-to-court (facilitating business planning and more accurate pricing of credit), while also avoiding wasteful costs of creditor competition.[338] Under this perspective,

[329] JACKSON (1986), 10–14; TREBILCOCK (1997), 10–15.
[330] *See* TREBILCOCK (1997), 11.
[331] JACKSON (1986), 12. The instability of collective action "arises as a direct consequence of the divergent motivations of the [collective] as a whole, on the one hand, and its individual members, on the other." *See* STEARNS & ZYWICKI (2009), 13–4.
[332] TREBILCOCK (1997), 14.
[333] Rizwaan Jameel Mokal, *Authentic Consent Model*, 21 LEG. STUD. 400, 400 (2001).
[334] JACKSON (1986), 16; TREBILCOCK (1997), 12.
[335] JACKSON (1986), 13.
[336] Under the "creditors' bargain" theory of insolvency law, the outcome of joint welfare maximisation means that each (rationally acting) creditor would most likely agree to have its individual enforcement activities curtailed, as long as all other creditors were similarly restrained. *See e.g.* VANESSA FINCH, CORPORATE INSOLVENCY LAW 32–37 (Cambridge University Press, 2d ed. 2009).
[337] *Id.*, 30–1. *See also* KILPI (1998), 14–5.
[338] JACKSON (1996), 14–16.

personal insolvency law thus enhances the welfare of all creditors, leading to the positive welfare outcome of lower cost credit availability.[339]

B. The Debt Relief Perspective of Bankruptcy Law: Theoretical Foundations of the Fresh Start Policy

The modern circumstances of consumer insolvency law, in which the majority of cases involve asset-less consumer debtors voluntarily entering insolvency procedures in order to obtain debt relief (see Figure 1Figure 2 below for the example of England and Wales), mean that the debt relief function of the law now occupies a practical position of primacy, irrespective of the theoretical legal and economic ideas underpinning the law. The debt relief perspective views the law's primary function as lying in its second, younger, function of providing a "fresh start", to the insolvent debtor. According to a seminal statement of this fresh start policy,

> "One of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.'[340] This purpose of the act has been again and again emphasized by the courts as being of public, as well as private, interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt."[341]

The debt relief function requires explanation,[342] since "[d]ischarge of legal obligations is an extraordinary exception to the usual obligation orientation of the law and it must have equally extraordinary justification."[343] This section provides such justification, not as an *apologia* for the departure from traditional contract and bankruptcy law principles represented by debt discharge;[344] but instead to illustrate the societal benefits of the independent policy objective of debt relief. Rather than drawing upon a single central justification, commentators and policymakers have presented a variety of rationales for this policy;[345] which I explain and categorise into their theoretical contexts. As discussed above, I emphasise particularly economic perspectives which expose the inappropriateness of the creditor wealth maximisation perspective in the context of modern household over-indebtedness, while also presenting arguments for a broad fresh start policy founded in considerations of social justice and of ethics or fairness.

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339 *Id.*, 14.
340 *Williams v. U.S. Fidelity & Guaranty Co.,* 236 U. S. 549, 236 U. S. 554-555
341 Local Loan Co. v Hunt, 292 U.S. 234, 244 (1934).
342 Hallinan (1986), 110.
343 Howard (1987), 1047–48.
344 Jason J Kilborn (2003), 861.
345 Howard (1987), 1048; Czarnetzky (2000), 394; Jason J Kilborn (2003), 861; Flint (1991), 519.

The contours of the fresh start policy or the debt relief function of bankruptcy evade precise definition.[346] "Pure" and traditional conceptions of the fresh start provide for rapid "straight" discharge of the debtor's obligations on surrender of her non-essential assets without the condition that the debtor complete a repayment plan of contributions to creditors from her income.[347] Most laws attach further conditions to the debtor's discharge, however. My working conception of the debt relief function involves at least the protection of the debtor from individual creditor enforcement pursuits, as well as the discharge of most of the debtor's obligations, so that the debtor can recommence her financial life with a "clean slate" (see Chapter 5).[348] It also involves the protection from seizure of assets of the debtor necessary for a reasonable standard of living,[349] while other assets are generally liquidated for the benefit of creditors. After these features, debate exists relating to such issues as whether the debtor should be required to make part repayments to creditors (in what might be considered an "earned start" rather than a fresh start[350] - see Chapter 4), undergo a waiting period,[351] or be subjected to other behavioural conditions (such as duty of cooperation and a ban on accessing credit – see Chapter 6)[352] before becoming eligible for debt discharge. Debate also continues as to the extent to which the law should provide for the (elusive concept of the[353]) debtor's "rehabilitation", which might involve providing education to the debtor, for example. Some theoretical perspectives of the fresh start policy provide better answers than others to these questions, but for present purposes it is sufficient to proceed on the basis of this general understanding of the law's debt relief function.

[346] "Despite its ubiquity in the bankruptcy landscape, the fresh start remains an elusive concept": Katherine Porter & Deborah Thorne, *The Failure of Bankruptcy's Fresh Start,* 92 CORNELL LAW REV. 67, 68 (2006).

[347] Jean Braucher, *Fresh Start for Personal Bankruptcy Reform*, 55 AM. UNIV. LAW REV. 1295, 1297 (2005); WORLD BANK (2013) ¶355.

[348] William C. Whitford, *Changing Definitions of Fresh Start in US Bankruptcy Law*, 20 J. CONSUM. POLICY 179, 179 (1997).

[349] Rafael Efrat, *Moral Appeal of Personal Bankruptcy, The*, 20 WHITTIER LAW REV. 141, 141 (1998).

[350] UDO REIFNER ET AL., CONSUMER OVERINDEBTEDNESS AND CONSUMER LAW IN THE EUROPEAN UNION 165–67 (IFS, Erasmus University Rotterdam, University of Helsinki 2003).

[351] INSOL INTERNATIONAL, CONSUMER DEBT REPORT: REPORT OF FINDINGS AND RECOMMENDATIONS 23 (INSOL International 2001).

[352] *Id.*, 22–23.

[353] Howard (1987), 1059–60.

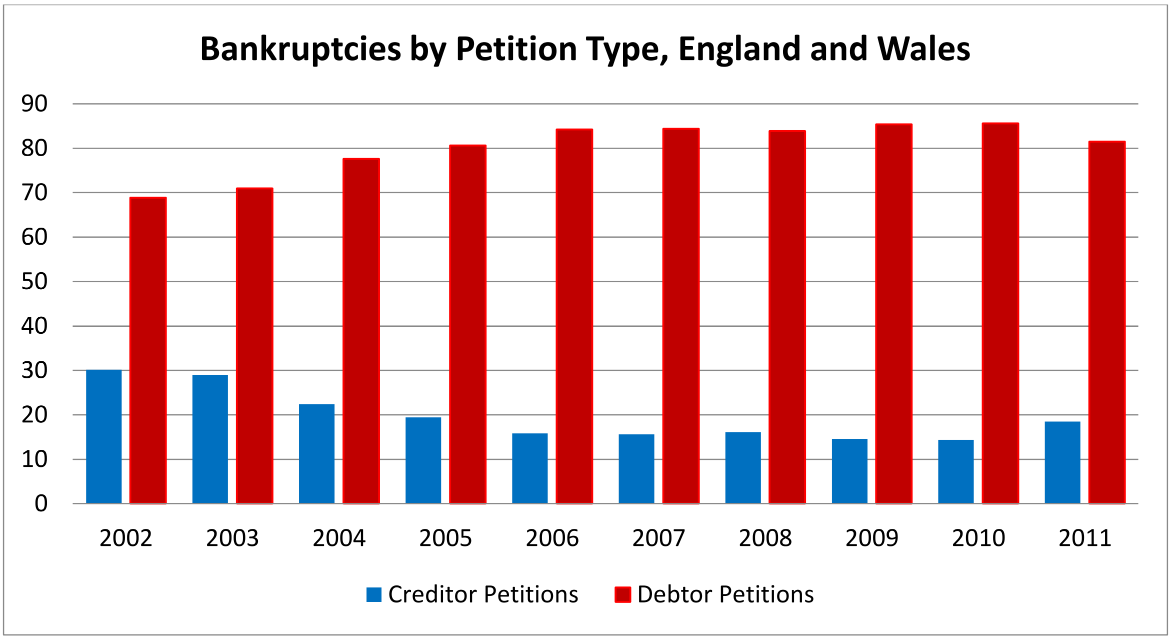

Figure 1: Bankruptcy's development into a debt relief mechanism

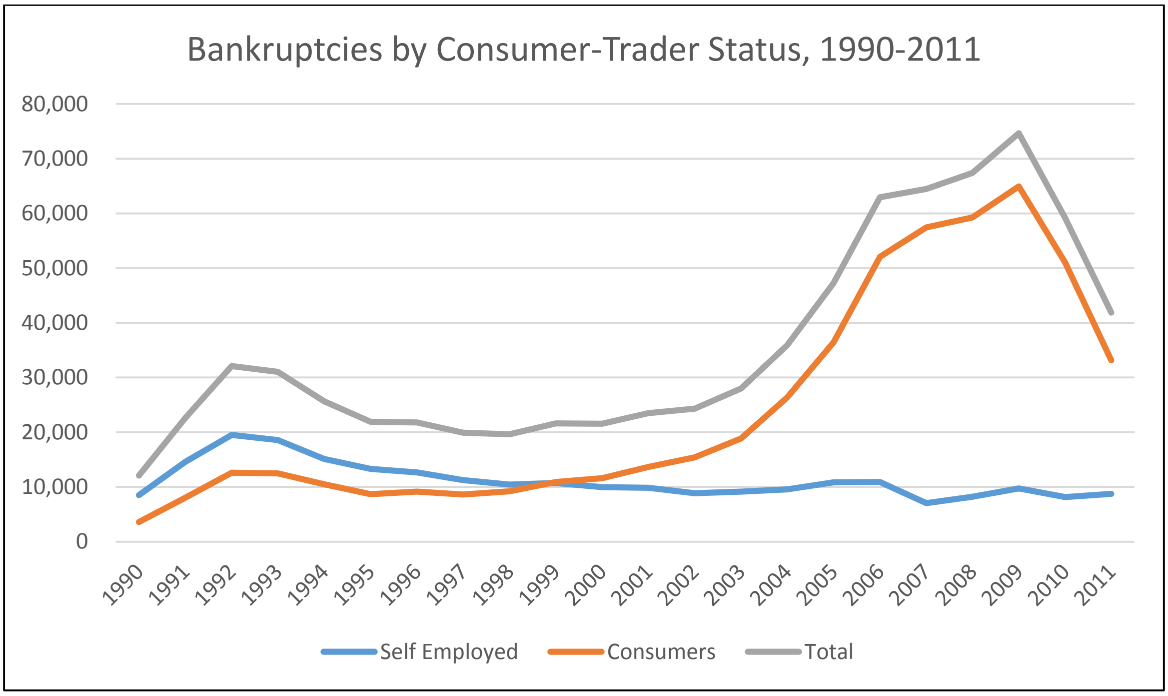

Figure 2: Consumer debtors as majority users of bankruptcy

(I) Imperfections of Consumer Credit Markets

Under the neo-classical economic ideas on which the debt collection perspective of personal insolvency law is based, the classic rationale for the regulation of markets is that of "market failure". A perfectly functioning competitive market (productive of efficient outcomes) requires certain key features, including:

- no barriers to entry and exit for the numerous buyers and sellers in the market;
- no externalities in the sense of costs borne by third parties external to a transaction; and
- perfect information possessed by all market actors.[354]

Where these are not present in practice (which is in fact the norm, rather than the exception[355]), potential "market failures" arise, which regulation must correct if the market is to be returned to efficiency. Consumer credit markets are particularly prone to imperfections and failures, and their departure from the model of the ideal-type market justifies the abandon of *laissez faire* market facilitating approaches to personal insolvency, and the adoption of an active debt relief policy.

1) (Information) Failures in Consumer Credit Markets

First, information failures and information asymmetry abound in consumer credit markets, as lenders possess significantly more information than borrowers in respect of credit products. Information may be particularly expensive to access and process for consumers in credit markets,[356] in which products are complex and a wide range of products are marketed.[357] In addition, consumers' knowledge of product features may be inaccurate due to lenders' ability to change credit products at low cost by simply printing a new form, and their ability to vary even the terms of existing products through contract amendments.[358] Lenders also offer different terms to different consumers, further reducing transparency regarding available products.[359] The "learning effect" said to be a feature of market action is reduced in consumer credit markets, due to the fact that large loan transactions such as mortgages are entered into infrequently by consumers.[360] Also, learning possibilities are limited as people tend to feel uncomfortable discussing financial affairs generally,[361] with those in financial difficulty often experiencing particular shame.[362] Even where consumers are provided with information in advance of borrowing, empirical surveys show that we do not understand well the information provided, and

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[354] *See* RAMSAY (2012A), 42-7; COLIN SCOTT & JULIA BLACK, CRANSTON'S CONSUMERS AND THE LAW 27 (Butterworths, 3d ed. 2000).
[355] SCOTT & BLACK (2000), 30.
[356] *See generally* Joseph E. Stiglitz, *The Contributions of the Economics of Information to Twentieth Century Economics*, 115 THE QUARTERLY JOURNAL OF ECONOMICS 1441, 34 (2000). More specifically, *see* RAMSAY (2012A), 49-54.
[357] Bar-Gill & Warren (2008), 10, 16.
[358] *Id.* at 10. The unilateral variation of consumer contract terms is regulated in the European Union by unfair contract terms legislation, however. *See* Unfair Terms Directive ¶ (j) (1993).
[359] Bar-Gill & Warren (2008), 16.
[360] SCOTT & BLACK (2000), 33; Pete Lunn, Can Policy Improve Our Financial Decision-Making? 9 (Renewal Series, Dublin, Economic and Social Research Institute 2012).
[361] Michiel De Muynck, *Credit Cards, Overdraft Facilities and European Consumer Protection - A Blank Cheque for Unfairness?*, 18 EUR. REV. PRIV. LAW 1181, 1194–95 (2010).
[362] *See e.g.* DEIRDRE O'LOUGHLIN, CREDIT CONSUMPTION AND DEBT ACCUMULATION AMONG LOW-INCOME CONSUMERS : KEY CONSEQUENCES AND INTERVENTION STRATEGIES : AN EXPLORATORY STUDY 45 (Combat Poverty Agency Poverty Research Initiative 2006); PAUL JOYCE, TO NO ONE'S CREDIT 24, 51, 69, 93–94 (Free Legal Advice Centres 2009).

that we tend not to use it.[363] On the rare occasions when consumers in fact incur searching and process costs by using price information to "shop around" for credit products, they usually search based on headline interest rates. This does not prevent a "market for lemons"[364] developing as consumers are less likely to have regard to the quality of products and in particular the presence of certain potentially "risky" product features. Such features could include future interest rate rises as well as charges and penalty interest rates for missed and/or late repayments, all of which can contribute to a consumer falling into over-indebtedness.[365] Lenders do not compete on these charges, since borrowers pay little attention to them at the *ex-ante* purchasing stage, and switching costs render borrowers captive at the *ex post* stage when such charges have been incurred.[366] For these reasons, a voluminous literature illustrates how consumer credit regulatory rules which require the disclosure of information to consumers[367] do not produce optimal outcomes.[368] Consumers have great difficulty identifying whether products meet their preferences, preventing competition from driving lenders to provide loans conforming to preferences. In so far as consumer preferences include the consumer not ultimately falling into financial difficulty, the operation of the market alone is unlikely to achieve efficient outcomes and over-indebtedness will be an inevitable result. The role of bankruptcy in simply maximising creditor returns in facilitating market outcomes therefore must be called into question.

2) Behavioural Economics and Consumer Credit Markets

Behavioural economics provides a further critique of assumptions of the efficient market hypothesis underlying the debt collection perspective. Neo-classical economic theory rests on the fundamental assumption of rational choice: that each individual is motivated by "rational" self-interest, meaning that she will always make decisions which maximise her individual utility (or achieve her preferences).[369] In contrast, behavioural economics shows that human rationality is "bounded" or limited, and that individuals do not always act in furtherance of maximising their preferences.[370] The outcome of people's decisions is influenced strongly by context, such that people's preferences are not clear, stable and organised, and "contextual influences [may even]

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363 ADELE ATKINSON ET AL., LEVELS OF FINANCIAL CAPABILITY IN THE UK: RESULTS OF A BASELINE SURVEY (Financial Services Authority 2006); NUALA O'DONNELL & MARY KEENEY, FINANCIAL CAPABILITY: NEW EVIDENCE FOR IRELAND (Research Technical Paper, volume 1/RT/09, Central Bank and Financial Services Authority of Ireland 2009); ILLUMINAS (FOR THE FSA), DISCLOSURE IN THE PRIME MORTGAGE MARKET (FSA 2008).

364 *See* Akerlof (1970).

365 Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts,* 94 CORNELL LAW REV. 1073, 1096–1102, 1107, 1119–23 (2008); FSA MMR (2009), Annex 2, 4.

366 OFFICE OF FAIR TRADING (2013), 13.

367 *See e.g.* EU Consumer Credit Directive 2008.

368 *See generally inter alia* SUSAN BLOCK-LIEB & RICHARD L. WIENER, *Disclosure as an Imperfect Means for Addressing Over-indebtedness: An Empirical Assessment of Comparative Approaches*, *in* NIEMI ET AL. (2009); Oren Bar-Gill, *Seduction by Plastic*, 98 NORTHWEST. UNIV. LAW REV. 1373 (2003); Bar-Gill (2008).

369 TREBILCOCK (1997), 3–4.

370 *See also* text to notes 145 to 151 above.

render the very meaning of the term 'preferences' unclear."[371] Therefore behavioural economics denies the fundamental assumption of neo-classical economics that market outcomes will be efficient on the very basis that "the model of the rational actor is simply an ideal with no corresponding reality."[372]

Certain findings of behavioural economics are particularly pertinent to consumer credit markets. First, under the process of hyperbolic discounting, individuals exhibit time-inconsistent preferences, in that their preferences and cost-benefit evaluations are not constant over time.[373] Individuals tend to overvalue immediate benefits while discounting heavily future costs.[374] A rational borrower would compare future and present costs using an appropriate and consistent scale, accounting for factors such as future needs and fluctuating interest rates over time. In reality, consumers tend to overvalue the benefit of present access to funds and undervalue future costs, which may include the difficulty of making future repayments and the potentially severe economic, social and health costs of over-indebtedness.[375]

Second, another particularly robustly-confirmed finding in cognitive and social psychology[376] is the "optimism bias" which causes us to adopt an over-optimistic approach to decision-making and to discount unduly the possibility of adverse events occurring.[377] Thus borrowers are likely to over-estimate their ability to repay loans undertaken, and to filter out information regarding risks associated with a product.[378] This problem is compounded by the recognition that the primary causes of over-indebtedness are "life accidents" such as employment loss, ill health or relationship breakdown;[379] incidents of the very type that an optimism bias leads individuals to consider unlikely to occur to them.[380] Even if consumers are informed of potentially "risky" product features such as default or late payment charges, consumers' optimism biases about future ability to meet repayments will lead them to pay such features insufficient attention.[381] Institutional lenders exploit this to gain customers by offering low introductory "teaser" interest rates on mortgage or credit card loans, which attract borrowers holding unrealistically optimistic estimates of future income, rises in home values, interest rates and credit scores.[382] In extreme cases, unexpected charges may create a debt spiral sufficient to trap borrowers in the "sweat box" of negatively amortising revolving credit described by Professor Mann.[383]

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371 Sunstein & Thaler (2003), 1161.
372 SCOTT & BLACK (2000), 34.
373 RAMSAY, (2012A), 57-8.
374 *Id.*
375 Ramsay (2005), 52.
376 *Id.*, 434–36.
377 RAMSAY (2012A), 73; Ramsay (2005), 53; Harris & Albin (2006), 434.
378 Ramsay (2005), 53.
379 See e.g. T.A. SULLIVAN ET AL. (2000); T. SULLIVAN ET AL. (1999); NICOLA DOMINY & ELAINE KEMPSON, CAN'T PAY OR WON'T PAY? : A REVIEW OF CREDITOR AND DEBTOR APPROACHES TO THE NON-PAYMENT OF BILLS (Lord Chancellor's Dept. 2003); KEMPSON (2002).
380 Bar-Gill (2003), 1400.
381 *Id.*, 1402.
382 Lunn (2012), 24–25; Bar-Gill (2008), 1119–21; Bar-Gill & Warren (2008), 34–35; Bar-Gill (2003), 1396–1400.
383 Mann (2007A).

These factors render impossible the rational planning of a household's financial needs throughout a lifetime,[384] and mean that consumer borrowers err systematically in making credit decisions.[385] A certain number of consumer borrowing decisions will be inefficient (in the sense of not being *Pareto superior*), and a portion of consumer borrowers inevitably will fall into over-indebtedness. In these conditions personal insolvency law does not facilitate optimal outcomes by enforcing market exchanges, but rather must, in tandem with *ex ante* consumer credit regulatory regimes, intervene in order to cure the market failures and inefficiencies of consumer borrowing.

3) Externalities in Consumer Credit Markets

A further key assumption of the ideal-type market is the absence of externalities, meaning that all costs and benefits are contained internally within a market transaction, and that a product is priced in a manner which reflects the true cost to society of producing the good in question.[386] If, on the contrary, negative externalities are produced in a market, regulation should respond by requiring market actors to internalise these costs, so to prevent harm to parties outside the market transaction and cause a product's price to reflect its true social cost (thus ensuring efficient resource allocation).[387] Consumer credit markets, particularly in contributing to the socio-economic problem of over-indebtedness, generate considerable negative externalities. Family members of over-indebted individuals suffer severe consequences,[388] while significant costs may be incurred by the State's social welfare system in providing for financially troubled households' basic needs.[389] Indeed, levels of over-indebtedness are higher among households with children than among the general population.[390] Additional burdens may be placed on healthcare systems,[391] as connections between debt difficulties and ill health have been widely recognised in relevant literature.[392] Another externality arises from society's altruistic nature, as altruists in society are saddened to see fellow citizens suffering under the conditions of over-

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[384] Harris & Albin (2006), 441.

[385] While I have focused primarily on failures in the markets for consumer loans, it is clear that the same behavioural traits may lead to problems in respect of other forms of credit, such as arrears of utility bills and rent.

[386] ROBERT BALDWIN, MARTIN CAVE, MARTIN LODGE, UNDERSTANDING REGULATION 18 (OUP Oxford, 2d ed. 2011); RAMSAY (2012A), 42, citing Iain D.C. Ramsay, *Rationales for Intervention in the Consumer Marketplace* (Office of Fair Trading, London, 1984), ¶3.3.

[387] BALDWIN ET AL. (2011), 18.

[388] Bar-Gill & Warren (2008), 59–61; Harris & Albin (2006), 452–54.

[389] REIFNER ET AL. (2003), 62.

[390] EUROPEAN COMMISSION ET AL. (2010), 35–37.

[391] Emami (2010).

[392] Duygan-Bump & Grant (2009); Women, Debt and Health (Dublin, Women's Health Council and MABS ndl 2007); Balmer et al. (2006); Pascoe Pleasence & Nigel J. Balmer, *Mental Health and the Experience of Social Problems Involving Rights*, 16 PSYCHIATRY PSYCHOL. LAW 123 (2009).

indebtedness.[393] It is, however, wider macro-economic externalities or negative systemic consequences of consumer credit markets which provide the “most powerful driving concerns”[394] and form the basis of the two primary economic justifications for an active fresh start policy, as I now discuss.

(II) A Functional Economic Theory of the Fresh Start: Bankruptcy for Productivity

A first externality generated by consumer credit markets is the lost economic productivity resulting from over-indebtedness. The functional economic theory of the fresh start policy therefore views debt relief as an active policy designed “to restore the debtor to economic productivity and viable participation in the open credit economy”,[395] as a means of internalising this social cost. This theory of debt discharge has featured prominently in bankruptcy law and policy discussion. Indeed the US Supreme Court’s seminal statement of the fresh start policy emphasised the public benefit achieved by giving “to the honest but unfortunate debtor... a new opportunity in life and a clear field for future effort”.”[396]

1) Productivity and Employment

First, over-indebtedness may lead to lost economic productivity in the workplace, as individuals in severe debt difficulty may be less productive in their employment. When the product of a debtor’s labour accrues to creditors rather than herself, her incentives to work may be reduced and the debtor may substitute leisure for labour, as leisure is a resource of the debtor which cannot be seized by creditors.[397] The burden of creditor collection efforts may drive the debtor to forgo work entirely to rely on social welfare assistance or on non-taxed cash economy work (the proceeds of which cannot be traced easily by creditors).[398] Externalities then result through a drain on State social welfare resources and/or reduced contributions to tax revenues.[399] While commentators have questioned the reality of the assumption that creditor collection of debtor

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[393] Hynes (2004), 340, citing Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law,* 98 HARV. LAW REV. 1393 (1984), 1420–4.
[394] WORLD BANK (2013), ¶77.
[395] Howard (1987), 1069.
[396] *Local Loan Co.*, 244, per Sutherland J.
[397] JACKSON (1986), 244; Hallinan (1986), 119. In an economic sense, "leisure" refers to time spent on activities other than paid work. While no externalities will result if the debtor's reduced productivity is reflected in reduced wages, the relationship between productivity and wages may not be calculated accurately in such a manner.
[398] Hynes (2004), 342.
[399] WORLD BANK (2013), ¶¶102–5.

income reduces debtors' incentive to work, [400] some empirical evidence shows strong links between households being in arrears and leaving paid employment,[401] while a relationship between long-term unemployment and over-indebtedness has also been recognised.[402] Even allowing for such uncertainty, greater concerns may be based on the reduced *ability* of debtors to work due to the stress and health difficulties associated with over-indebtedness.[403]

Policymakers appear concerned by this social cost, with UK authorities noting that the decline of productivity resulting from over-indebtedness could be conservatively estimated at 30% of salary, approximating 1% of GDP when extrapolated to the over-indebted portion of the population.[404] An active debt relief policy can address these concerns by restoring debtor employment incentives[405] and alleviating the stress and health problems which may compromise a debtor's workplace productivity.[406]

2) Productivity and Entrepreneurship

Similar logic argues that an active fresh start policy can serve economic productivity by facilitating entrepreneurship.[407] From an *ex ante* perspective, the existence of debt discharge can encourage individuals to take the risks necessary to engage in profitable business activity, thus reducing disincentives to economic activity created by the risk of over-indebtedness in a business context in which some failure is inevitable, irrespective of fault. [408] Thus by assuring potential entrepreneurs that misfortune in their ventures will not lead to lifelong indebtedness, the fresh start policy "is a part of the institutional framework vital to fostering entrepreneurship in the market."[409] The debt discharge provided in bankruptcy should be widely accessible, as we cannot identify in advance those members of society who are potential entrepreneurs.[410] The centrality of free market action to entrepreneurship, however, means that bankruptcy law must retain respect for freedom of contract[411] and so may provide for a price to be paid for discharge, consisting at least of the surrender of the debtor's assets for the benefit of her creditors.[412]

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400 Hynes (2004), 323.

401 Elaine Kempson et al., Characteristics of Households in Debt and the Nature of Indebtedness 5 (Department for Work and Pensions; Bristol University Personal Finance Research Centre 2004).

402 Duygan-Bump & Grant (2009), 121–22.

403 Balmer et al. (2006); Chris Fitch et al., Debt and Mental Health: What Do We Know? What Should We Do? (Royal College of Psychiatrists; Money Advice Trust; Rethink; Finance and Leasing Association 2009); Emami (2010).

404 Department of Trade and Industry, Fair, Clear, Competitive 138 (HMSO 2003).

405 Hallinan (1986), 70; World Bank (2013) at ¶¶103-7.

406 Katherine Porter, *The Pretend Solution: An Empirical Study of Bankruptcy Outcomes*, 90 Tex. Law Rev. 103, 142–44 (2011).

407 Czarnetzky (2000); The Insolvency Service; DTI (2001); World Bank (2013), ¶¶106–10.

408 Czarnetzky (2000), 412.

409 *Id.*, 399.

410 *Id.*, 414.

411 *Id.*

412 *Id.*, 422.

From an *ex post* perspective, over-indebtedness may lead to lost economic activity of entrepreneurs who are actually over-burdened with debt due to failed business ventures, and unable to pursue business opportunities for this reason. Over-indebtedness may leave such individuals practically unable to raise credit and obtain business investment, while also reducing incentives for such individuals to pursue economic activity as any benefits may accrue to their creditors. The justification for debt discharge based on the public interest in restoring business people to economic productivity has long proved influential,[413] and notably inspired the liberalisation of English bankruptcy law under the Enterprise Act 2002. Policymakers aimed to use debt discharge to "encourage those who have failed, through no fault of their own, to try again", so that people can risk their capital, energy and time in creating a "dynamic and successful economy".[414]

3) Productivity and Consumer Spending

While the entrepreneurship theory of the fresh start policy is limited to business debtors, in the modern credit economy the (lost) productivity theory of debt discharge also encompasses consumer borrowing. As explained in Chapter 1 (section 3(C)(ii)), consumer spending has become essential to economic growth. While households rely increasingly on credit to maintain reasonable living standards in the absence of significant wage growth, policymakers rely on household credit to sustain this consumer spending necessary for economic growth. Given the necessity of borrowing in the presence of the increased financial instability of liberalised capitalism,[415] traditional ideas of traders being exposed to the vagaries of business apply to households so that "simply engaging in modern economic life is a sort of entrepreneurial risk".[416] Just as debt discharge may encourage entrepreneurship, it also may sustain demand in a society which depends on high levels of consumption for economic prosperity.

At an *ex post* level, externalities arise from the problem of *debt overhang* if large numbers of over-indebted consumers are so burdened with debt as to be unable to engage in the economically productive activity of consumer spending.[417] These households' income is being used to "de-leverage" or repay historic debts, rather than for present consumption. Economic problems are exacerbated by the fact that debt-burdened households are precisely those with a higher marginal propensity to consume than those who are not heavily indebted, so that over-

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[413] See e.g. how Blackstone justified debt discharge as necessary protection against business risk and a means of restoring a failed trader to a "useful member of the Commonwealth." *See* Jay Cohen (1982), 161, citing William Blackstone, *Commentaries on the Laws of England* vol. 2 (1765-1769), *484.

[414] THE INSOLVENCY SERVICE; DTI (2001), 1.

[415] Iain Ramsay, *Comparative Consumer Bankruptcy*, 2007 UNIV. ILL. LAW REV. 241, 244–45 (2007); Hallinan (1986), 66.

[416] WORLD BANK (2013), ¶109.

[417] IMF (2012), 1, 3, 7–8. See also Atif R. Mian et al., Resolving Debt Overhang 9–11 (National Bureau of Economic Research 2012).

indebtedness may deprive an economy of its main spenders.[418] Thus policies focused on reducing debt levels and restoring purchasing ability of consumers can "substantially mitigate the negative effects of household deleveraging on economic activity."[419] This consumer demand/purchasing power thesis operates at an *ex ante* level also, in that the availability of debt relief should persuade consumers to take the risk of borrowing money for consumption purposes, reflecting aims of consumer protection legislation of empowering "confident consumers".[420] As I discuss further in Chapter 6, the *ex-ante* incentives created by debt discharge raise a controversial question of *moral hazard*, in the argument that debt relief creates incentives for consumers to borrow irresponsibly or "over-consume".[421] These reservations, however, fit uneasily with the essential role that consumer borrowing plays in sustaining economic growth, and policymakers' strong encouragement of such borrowing, as discussed in Chapter 1.

(III) The Insurance Theory of Bankruptcy Law: Efficient allocation of risks and losses across the Consumer Credit Society

The society dependent on extensive household leveraging described in Chapter 1 carries a high level of risk, as it lives under the threat of mass over-indebtedness and its imposition of significant losses/costs on households, financial institutions and wider society. This endemic risk was exposed by the financial crisis and consequent Great Depression of the late 2000s, a primary contributor to which was widespread household debt default in the USA.[422] Personal insolvency law and debt discharge play a significant role in allocating these risks of consumer credit markets in an efficient manner which reduces aggregate risk levels and internalises social costs, while also enhancing stability and predictability in the financial system.[423] Perhaps the most comprehensive theory of the fresh start policy, explaining not only the existence of debt discharge but also the design of the law's key features, views bankruptcy as a form of insurance, which allocates the risks and losses of the modern consumer credit society in the most efficient manner.[424] This is achieved by requiring creditors (as insurers) to bear losses of over-

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418 IMF (2012), 9–10.
419 *Id.*, 3.
420 *See e.g.* CONSUMER CREDIT DIRECTIVE 2008, RECITAL 8; *see generally* DEPARTMENT FOR BUSINESS, INNOVATION AND SKILLS, EMPOWERING AND PROTECTING CONSUMERS (2011).
421 Jones & Zywicki (1999), 183, 218; LoPucki (1997), 463–67.
422 WORLD BANK (2013), ¶4. *See generally* ROBERT J. SHILLER, THE SUBPRIME SOLUTION: HOW TODAY'S GLOBAL FINANCIAL CRISIS HAPPENED, AND WHAT TO DO ABOUT IT (2012).
423 WORLD BANK (2013), ¶¶94–98, 111.
424 JACKSON (1986), 229–32; Hallinan (1986), 98–109; Theodore Eisenberg, *Bankruptcy Law in Perspective*, 28 UCLA LAW REV. 953, 981–83 (1980); Hynes (2004), 327–31.

indebtedness through debt discharge, which in turn are paid for by the body of consumer borrowers (the insured) in the form of interest rates (insurance premiums) adjusted to cover aggregate losses.[425]

1) *Debt Discharge and the Efficient Allocation of the Risks of the Consumer Credit Society*

The insurance theory of personal insolvency law promotes an active debt relief policy by illustrating how the law can allocate efficiently the *losses*/*costs* of default in the *ex post* situation of a debtor's over-indebtedness, while also incentivising the efficient allocation of the *risk* of the debtor's future inability to pay in the *ex-ante* creditor-debtor contracting process.[426] A discharge of debt insures the debtor against the costs of over-indebtedness in the event of a change in financial circumstances. This transfers the risk of such occurrence from debtor to creditors, as the superior bearers of risk.[427] Furthermore, insurance involves not merely the transfer of risk from the insured to the insurer, but also the insurer's pooling or spreading of risks,[428] which efficiently reduces overall net risk by substituting several small losses for a single disastrously large loss.[429] Insurance also reduces uncertainty costs by allowing statistical predictions of loss levels among a portfolio of similar risks, converting incalculable uncertainty into actuarial risk.[430] Uncertain losses of a consumer credit economy can be transformed by the insurance function of bankruptcy into certain costs both for debtors (in the "premium" payments they make in the form of interest rates/prices) and for creditors (in the form of predicted losses in personal insolvencies).[431] The premium paid by the insured should reflect the risk she represents, and so through "risk-based pricing"[432] lenders segment borrowers into categories based on their creditworthiness, charging interest rates broadly reflecting risk of non-payment.[433]

As well as promising economic efficiency, the insurance function of personal insolvency has a moral appeal, in providing for the equitable sharing of the consequences of the credit society

[425] Adam Feibelman, *Defining the Social Insurance Function of Consumer Bankruptcy*, 13 AM. BANKRUPTCY INST. LAW REV. 129, 130 (2005). Bankruptcy discharge can also be seen as a functional (as opposed to theoretical) equivalent to insurance, as it provides relief to those who have suffered misfortune of the type against which a social insurance system usually protects.

[426] Hallinan (1986) at 98. While I have described the debtor-creditor relationship as being a contractual one, the same analysis can apply to non-contractual creditor-debtor relationships, such as one arising from a tort committed against the creditor by the debtor: Tom Baker (1996), 272–75.

[427] Hallinan (1986), 100.

[428] *Id.*, 101.

[429] *Id.*; WORLD BANK (2013), ¶95.

[430] L.H. White (1977), 285.

[431] Hallinan (1986), 102.

[432] *See e.g.* Patricia A McCoy (2007).

[433] Hallinan (1986), 106. In practice risk-based pricing may differ from this theoretical explanation, however, as interest rates ostensibly based on repayment risk may in fact be influenced by other factors such as mortgage broker remuneration, discrimination among borrowers, and rent-seeking: McCoy (2007), 127. The high interest rates charged on loans to low-income borrowers may not be based on an elevated risk of default, but rather on profitability concerns arising from high marginal administrative costs of providing loans of small amounts: Gunnar Trumbull (2012), 25–26 (2012).

from which we all benefit. The alternative is to require a small minority of individuals to bear disproportionately severe losses so that the majority who have avoided the misfortune of ill health, unemployment or other adverse life events may benefit from credit.[434]

2) Lenders' Superior Ability to prevent Default

The insurance perspective supports an active debt relief policy firstly because in modern consumer credit markets, creditors are better placed than debtors to prevent over-indebtedness from occurring. If contractual relationships are to allocate resources efficiently, the party best able to prevent a loss from occurring should be required by law to bear the risk of that loss.[435] Traditional views of creditor-debtor relationship consider the debtor to be better placed to prevent default, given that she has greater knowledge and control of her financial circumstances than her creditor.[436] In modern consumer credit markets, this is no longer the case (if ever it was). As discussed above, information asymmetries mean that institutional lenders are significantly better judges than debtors of the nature and effects of complex credit products. Informational disadvantages of creditors which caused adverse selection problems[437] in the past have been overcome by technological advances and advanced credit scoring systems. Consequently institutional creditors are far better equipped than debtors to possess the actuarial and statistical knowledge necessary to make expert predictions of the likelihood of a particular borrower falling into over-indebtedness.[438] This is particularly so given that the primary causes of over-indebtedness are "life accidents" external to the debtor, as described in Chapter 1. The likelihood of such events occurring is an actuarial question which a well-resourced expert lender is better placed than a consumer to judge. Furthermore, cognitive and behavioural biases described above inhibit the ability of consumer borrowers to foresee, predict, and so prevent, default, as opposed to institutional lending firms which approximate far more closely the rational *homo economicus*.[439]

Since lenders are the best judges of the risk involved in a credit transaction, they can adjust their creditworthiness standards accordingly in order to extend credit only where the risk of over-indebtedness is sufficiently small (considering aggregate pooled risk across their lending portfolios).[440] Ideally lenders (if they held perfect information) would price each credit transaction in a manner which accounts for the risk of default involved, in which case there would be no need

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[434] WORLD BANK (2013), ¶95. In this light the insurance conception of personal insolvency law shares ideas with a social justice perspective, in viewing the potential for to redistribute wealth and risks progressively, as discussed further below.
[435] Eisenberg (1980), 981.
[436] *Id.*, 982.
[437] Stiglitz & Weiss (1981).
[438] Howard (1986), 1063. *See also* John A.E. Pottow (2007), 432–34 (2007).
[439] J.A.E. Pottow (2007), 431.
[440] Howard (1987), 1064.

for the legal system to regulate default.[441] In reality, lenders should use the information they hold (which is superior to that held by borrowers) to price transactions based on statistical average risk. Even creditors who are not institutional lenders, such as small retailers or landlords, should include an aggregate estimate of the risk of default in the price of goods or services if they are to survive in efficient markets.[442] A further manner through which creditors are better placed to prevent default lies in the fact that lenders are the designers of credit products and drafters of credit contracts, which consumer borrowers must accept without negotiation. Commentators have identified certain product designs which exploit systematic irrationalities in consumer decision-making, deriving increasingly large portions of profit not from headline interest rates but from less visible default charges and interest, late payment fees and over-limit fees.[443] Other product features which produce consumer behaviour not corresponding to economic rationality include teaser rates and unsolicited increases in credit limits.[444] As these product features may increase the risk of default, and as consumers do not consider them and their potential to contribute to over-indebtedness when borrowing, creditors as designers of credit products are again better placed to prevent default.

Personal insolvency law, therefore, must redistribute the market allocation of the costs of default, by shifting losses away from the debtor and third parties onto creditors. By placing the burden of preventing default on the party best placed to do so, the institution of debt discharge and the fresh start policy bring insolvency law in line with contemporary consumer protection policy in advancing the principle of "responsible lending".[445] In incentivising lenders by inflicting losses on them through debt discharge, personal insolvency law channels the traditional neo-classical economic function of private law litigation in amplifying market signals.[446] Personal insolvency law notifies creditors of insolvent debtors of the need for improved lending practices and more efficient product design, sending a message otherwise stifled by failures of consumer market decisions to reflect their preferences.[447] This signalling function may be a particularly important element of debt discharge, since factors such as securitisation[448] and revenue laws allowing bad debts to be written off against tax mean that lenders may not feel losses imposed by discharge in the manner in which they would in a perfect market.[449] Furthermore, as *de jure* losses in the form of discharged debt may reflect *de facto* losses which have already occurred once a debtor is

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441 Arthur Allen Leff, *Injury, Ignorance and Spite--The Dynamics of Coercive Collection*, 80 YALE LAW J. 1, 26–28 (1970).

442 Howard (1987), 1064.

443 Harris & Albin (2006); Bar-Gill & Warren (2008); Mann (2007A).

444 Ramsay (2005), 53; KEMPSON (2002), 40.

445 See text to notes 251-253 above.

446 RAMSAY (2012A), 103.

447 This signalling function is discussed further in Chapters 4-6.

448 Lois R. Lupica, *The Consumer Debt Crisis and the Reinforcement of Class Position,* 40 LOYOLA UNIV. CHIC. LAW J. 557, 594–99 (2008).

449 Professor Levitin goes so far as to argue that "because of diversification among millions of borrowers, risk-spreading through securitization and insurance, and fee-based profit models, the scope of the bankruptcy discharge has very little impact on the price or availability of credit except at the margins." *See* Adam J. Levitin, *Resolving the Foreclosure Crisis*, 2009 WIS. LAW REV. 565, 648 (2009).

unable to pay, debt discharge's signalling function may in some cases be more significant than its role a *de facto* allocator of losses.[450] Therefore I acknowledge the relevance of factors such as securitisation practices, tax laws and accounting standards (which fall outside of the scope of my project), while nonetheless arguing that the debt discharge can generate incentives for creditor behaviour.

Not only are lenders best placed to prevent default, but they are also much more likely to respond to incentives created by the law than consumer borrowers. Behavioural biases[451] and the lack of consideration of the prospect of default by consumers when borrowing,[452] as well as ignorance of the law [453] mean that consumer borrowing behaviour is in practice unlikely to be influenced by the state of bankruptcy law.[454] In contrast, legally-advised and profit-driven lending businesses[455] can be expected to find incentives in debt discharge to take steps to prevent debt default.[456] Therefore a liberalised debt discharge mechanism, while potentially raising the number of legal insolvencies, should operate to reduce levels of factual over-indebtedness.

3) Lenders as Superior Insurers/Bearers of Loss

An active debt relief policy is also supported by insurance theory on the ground that creditors are best equipped to bear the costs of default and insure against it. Mandatory statutory debt discharge is preferable to the alternative of leaving the debtor the option of purchasing actual insurance, or self-insuring, against the costs of falling into over-indebtedness. First, the same causes of failures in consumer credit markets, such as information asymmetry and financial incapability, would likely lead to failures in markets for over-indebtedness insurance. A significant mis-selling scandal in the UK payment protection insurance market suggests that the potential for such failures are not just theoretical, but very real.[457] Furthermore, behavioural economics suggests that borrowers would underestimate systematically the likelihood of falling into default

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[450] By aligning legal and *de facto* losses, debt discharge can serve to ensure accurate account valuation, impacting significantly on the value of lender's assets. *See* WORLD BANK (2013), ¶¶79–84.

[451] Hallinan (1986), 117.

[452] Lauren E. Willis (2008), 1230.

[453] Surveys in England and Wales show that a majority of bankrupts (approx. 58% and 64% respectively) had not been aware of a major reduction in the waiting period for debt discharge under English law before entering bankruptcy: *see e.g.* THE INSOLVENCY SERVICE, DISCHARGE FROM BANKRUPTCY 7 (Insolvency Service 2006); John Paul Tribe, *Bankruptcy Courts Survey 2005*, (2006), available at: http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/research/personaldocs/BankruptcyCourtsSurvey.pdf. One can assume that knowledge of the change in the law was even lower amongst the general population of borrowers.

[454] The Irish experience of over-indebtedness in the 2000s supports this position, as a draconian bankruptcy law not providing debt relief did not prevent Irish households from becoming among the most indebted in the world. *See generally* Spooner (2012A).

[455] WORLD BANK (2013), ¶52.

[456] Hallinan (1986), 110.

[457] The misselling practices and regulatory response are discussed in the English High Court case of R (British Bankers Association) v The Financial Services Authority and Ors [2011] EWHC 999 (Admin).

or over-indebtedness,[458] and so "debtors would systematically and irrationally tend to substitute self-insurance for the protections… of market insurance or prevention."[459] Debtor self-insurance would in fact most likely involve debtors passing on insurance costs to others in society (family members, social welfare and healthcare systems), thus generating externalities.[460] The jurisdiction of Ireland, where there is effectively no consumer debt discharge system, provides evidence to this effect, with survey evidence showing households' lack of provision for future income reductions or expenses and many pointing to the social welfare system as their only means of dealing with such financial shortfalls.[461] An active debt relief policy acknowledges that creditors are better placed to insure against and bear the losses of over-indebtedness than consumer debtors, thus internalising these externalities. Creditors "can spread, diversify and hedge investments to minimise total portfolio risk" in a manner which is not available to individual debtors,[462] for whom an adverse financial event can prove catastrophic.[463] Lenders can therefore bear more default risk than borrowers and make loans that result in negative outcomes for borrowers and society, but nonetheless are profitable for lenders.[464] The law therefore must shift losses from borrowers to lenders, in order to reduce overall levels of losses by incentivising responsible borrowing, and causing lenders to internalise all of the costs of their activities.

4) Moral Hazard

Conceptualising personal insolvency policy within an insurance framework also provides understanding of the concept of moral hazard.[465] This refers to the tendency of insurance's reimbursement on the occurrence of a relevant risk both to reduce the insured's incentives to take precautions to prevent such an event, and to increase the insured's incentives to exaggerate the extent of a loss which has occurred.[466] In terms of personal insolvency law, moral hazard concerns arise as to the extent to which the discharge, by relieving the debtor of the burden of over-indebtedness, first creates incentives at the *ex post* stage for the debtor to enter an insolvency procedure at the first sign of financial difficulty (potentially in the absence of true need). The availability of discharge similarly raises *ex ante* moral hazard concerns that the debtor may over-borrow in the first place.[467] Just as moral hazard theory illustrates how insurance contracts can be structured so as to reduce and guard against the perverse incentives

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[458] Hallinan (1986), 113–16; JACKSON (1986), 237–41; Hynes (2004), 343–44.
[459] Hallinan (1986), 116.
[460] *Id.*, 118–25; Hynes (2004), 340–42.
[461] O'DONNELL & KEENEY (2009), 45–49.
[462] Willis (2008), 1182.
[463] WORLD BANK (2013), ¶95.
[464] Willis (2008), 1182.
[465] *See generally* Baker (1996).
[466] Hallinan (1986), 84, 92, 103; Hynes (2004), 329; Feibelman (2005), 136–37.
[467] Hallinan (1986), 92.

potentially created by protection against loss, so personal insolvency law incorporates a number of features which are designed to deter and sanction "abuses" of the benefits of debt relief, and these form the subject of Chapter 6. [468]

(IV) Private Law Litigation and Market Discipline: the Problem of Transaction Costs

As mentioned above, under orthodox neo-classical economic theory, private law litigation plays a role not only in protecting market entitlements, but also in instilling market discipline and maintaining an efficient standard of performance by market actors where market sanctions themselves are ineffective.[469] A particularly important and well recognised potential failure in consumer markets lies in the high transaction costs of enforcing private law rights in markets in which general consumer (and wider public) detriment may be large, but harm to an individual consumer may be too small as to make the benefits of litigation justify its costs.[470] The transformation of personal insolvency law from a commercial procedure for regulating business affairs to a *de facto* consumer law, coupled with the necessary scarcity of resources in a case of insolvency, mean that the issue of transaction costs is particularly significant in this area.

While significant sanctions are imposed by markets on defaulting debtors (in the financial, health, and emotional costs of over-indebtedness, plus economic and reputational sanctions imposed through credit reporting[471]), factors such as imperfect information and cognitive biases mean that borrower decisions will not have disciplining effects (in the form of lost custom) on lender behaviour productive of sub-optimal outcomes. Consumer law litigation could potentially perform a disciplining role in the absence of market penalties, by providing means of sanctioning unfair pricing practices[472] or irresponsible lending[473] could be sanctioned. Problems of transaction costs make this unlikely, however. A harmed debtor must incur "search" costs of acquiring information

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[468] See also Figure 45.

[469] RAMSAY (2012A), 103.

[470] *Id.*, 43, citing RAMSAY (1984), ¶¶ 3.8–3.9; William C. Whitford, *Ideal of Individualized Justice*, 68 AM. BANKRUPTCY LAW J. 397, 397–99 (1994); ANTHONY DUGGAN & IAIN RAMSAY, *Front-End Strategies for Improving Consumer Access to Justice*, *in* Michael Trebilcock, Anthony Duggan, Lorne Sossin (eds.), MIDDLE INCOME ACCESS JUSTICE 95, 95 (University of Toronto Press 2012).

[471] On credit reporting, see text to notes 1605-1626 below.

[472] Consumer protection against unfair contract terms is provided by the Unfair Terms Directive, which regulates such issues as default charges in credit card products: *see e.g.* OFT (2006). Due to the imbalance between consumer and supplier and the legislation's objective of protecting consumers in asymmetric transactions, the Court of Justice of the European Union has in a line of cases repeatedly interpreted the Directive as requiring courts to investigate of their own motion whether a contractual term is unfair: *see e.g.* Mostaza Claro v Movil Milenium SL, [2007] 1 C.M.L.R. 22, ¶38 (2006). This position appears to recognise the transaction costs involved for consumers in enforcing their legal rights.

[473] For an example of private litigation involving mortgage loan advice (albeit in the context of an alternative dispute resolution consumer redress regime), *see* Emptage v Financial Services Compensation Scheme Ltd, [2013] (Jun) ALL E.R. (D) 144. Irresponsible or negligent lending does not of itself generate liability under English common law: *see* Wadsley (2003).

on the law before invoking it,[474] while complexity in the law mean that the costs of understanding information obtained ("processing" costs) could create further barriers to private law claims.[475] In those cases where consumers suffer relatively minor economic harm from credit products,[476] the benefits of pursuing any available private law action would most likely not exceed these costs, as well as the obvious cost of funding litigation. If the consumer falls into over-indebtedness, costs may be so large as to justify litigation, but the very financial difficulties involved invariably deprive the consumer of the means of instigating legal proceedings.[477] Litigation carries uncertainty costs and risk of unsuccessful outcomes, which are heightened in the consumer credit context. Unlike consumer disputes in other industries which may involve comparably small traders, the debtor's opponent in adversarial proceedings will usually be a well-resourced "repeat player" in the form of an institutional lender, often backed by other industry members willing and able to contest litigation up to the highest courts in order to obtain favourable rulings and precedents.[478] Various methods exist for reducing transaction costs in consumer litigation, such as avoiding complex/ambiguous rules which increase processing and uncertainty costs, and providing for "self-enforcing" sanctions which can take effect without consumers having to bring litigation.[479] Further measures include the enforcement of consumer law by public authorities rather than through private litigation,[480] and the establishment of low-cost alternative dispute resolution bodies for consumer complaints.[481] These alternative enforcement mechanisms suffer from failings also, being reliant on consumer knowledge of their existence and good faith obedience of rules by lenders unsupervised by courts. They are also vulnerable to the hijacking of agency enforcement strategy by certain interest groups.[482] Furthermore, agency enforcement strategies may not deliver individual justice to consumers who have suffered from market action.[483]

Personal insolvency law can play an important market disciplining role and compensate for these inadequacies, as the insolvency debt discharge operates equivalently to a successful defence to creditors' claims.[484] Discharge on the simple condition of the debtor's insolvency reduces

[474] Jones & Zywicki (1999), 212.
[475] *See e.g.* RAMSAY (2012A), 103.
[476] Bar-Gill & Warren (2008), 56–58.
[477] *See e.g.* Feibelman (2005), 166.
[478] See e.g. the discussion of strategic litigation practices of banks in the field of household credit in HUGH COLLINS, *Regulating Contract Law*, *in* Christine Parker, Colin Scott, Nicola Lacey, John Braithwaite (eds.) REGULATING LAW 13, 21 (2004).
[479] RAMSAY (2012A), 103. See for example the sanction of the unenforceability of consumer credit contracts under the Consumer Credit Act 1974, §§65, 123. See also the requirement that courts investigate the potential unfairness of consumer contract terms of their own motion, note 472 above.
[480] William C. Whitford, *Structuring Consumer Protection Legislation to Maximize Effectiveness*, 1981 WIS. LAW REV. 1018 (1981).
[481] The 2008 EU Consumer Credit Directive explicitly calls on Member States to ensure that adequate and effective out of-court dispute resolution procedures are put in place: Consumer Credit Directive 2008, art. 24. See the examples of the UK Financial Ombudsman Service, established under the Financial Services and Market Act 2000 (2000 c. 8) (UK), Part XVI, Sched. 17; Consumer Credit Act 2006 (2006 c. 14), §59.
[482] RAMSAY (2012A), 108–9.
[483] Whitford (1994), 399.
[484] *Id.*, 401.

information and uncertainty costs, as well as the length and expense of litigation, by providing an unambiguous bright-line rule of consumer protection which applies in respect of (almost) all of the debtor's creditors (as opposed to the need to establish an often complex cause of action against each individual creditor).[485] The development of an industry of insolvency practitioners[486] and both for-profit and non-profit debt advice sectors[487] has reduced information and representation costs for consumers wishing to enter insolvency procedures.[488] Personal insolvency law can provide an appropriate forum and substantive mechanism for consumer protection and market regulation.

This discussion should also highlight the significant problem posed by the transaction costs involved in personal insolvency procedures also, however. Administrative[489] and practitioner fees are considerable costs to over-indebted individuals, while search costs remain high.[490] Complexity and ambiguity persist in personal insolvency legislative provisions, which increase the level of advice required and so the costs of debtor applications.[491] Complex provisions also create potential for such costly litigation as to require debtors (even those with representation) to accept creditor-favouring compromises rather than litigate for an interpretation of legislative provisions which protects their interests.[492] Policymakers should recognize the reality of consumer over-indebtedness and the potential for transaction costs to frustrate personal insolvency law's ability to protect consumers and facilitate the optimum operation of consumer credit markets. When calibrating the law and deciding upon the necessary conditions attached to debt discharge to address moral hazard concerns, policymakers must consider the total sum of transaction costs and substantive costs, to ensure that their combined effect is not to restrict debt relief to the point of defeating the purposes of the institution of debt discharge. If over-indebted individuals are artificially excluded from insolvency procedures, inaccurate market signals are sent to lenders.

Apart from transaction costs, other limitations apply to personal insolvency as a consumer protection and market perfecting device. Most notably, the principle of equality of creditors has

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485 *See* RAMSAY (2012A), 103. Consumer bankruptcy can in this regard substitute for deficiencies in other consumer protection laws: UDO REIFNER ET AL., OVERINDEBTEDNESS IN EUROPEAN CONSUMER LAW 50–51 (Books on Demand Gmbh 2010).

486 Adrian Walters, *Individual Voluntary Arrangements*, 18 INT. INSOLV. REV. 5, 25–27 (2009).

487 PATRICE MULLER ET AL., DEBT ADVICE IN THE UK: FINAL REPORT FOR THE MONEY ADVICE SERVICE (London Economics 2012).

488 Jones & Zywicki (1999), 212. In England and Wales, this is true at least of the "managed" IVA and DRO procedures, which make up an increasingly large portion of total personal insolvencies: CCCS (2012), 7. See my discussion in Chapter 4 of concerns arising in the personal insolvency "market".

489 On these costs' effect of restricting access to debt relief in England and Wales, see Chapter 4. See e.g. Sue Edwards, *Too Poor to Go Bankrupt*, EVID. CITIZENS ADVICE SOC. POLICY PUBL. 8 (2012).

490 Only a small proportion of the English population with debt difficulties seeks advice and is aware of available solutions to their problems: Alexy Buck, Pascoe Pleasence, et al., *Do Citizens Know How to Deal with Legal Issues? Some Empirical Insights*, 37 JOURNAL OF SOCIAL POLICY 661, 670–4 (2008). Debtors accessing bankruptcy seem to rely heavily on word of mouth to receive information: Tribe (2006), 40–1. This may be problematic due to the effect of stigma in preventing information disseminating widely via this means.

491 *See e.g.* Jean Braucher, *Increasing Uniformity in Consumer Bankruptcy*, 6 AM. BANKRUPTCY INST. LAW REV. 1, 10 (1998).

492 *Id.*, 11. *See also* text to notes 1172-1175 below.

the consequence of imposing losses on and sending signals to all creditors, irrespective of the responsibility of their conduct in the marketplace and culpability in contributing to the debtor's insolvency.[493] Furthermore, while a private law judgment against a creditor sends a clear message that it is not meeting the market preferences of its customers, a debtor's insolvency may not be directly attributed by a creditor to its inappropriate lending practices.[494] While these considerations are problematic in an individual case, they are less so when an aggregate of a large volume of cases is considered, as high levels of personal insolvencies among a creditor's portfolio should send signals regarding lending practices. These considerations nonetheless argue for a departure from the principle of equality of creditors, as I discuss in Chapter 4.

C. Conclusions on the Theoretical underpinnings of Personal Insolvency Law

Insolvency law's debt collection and debt relief objectives are well recognised.[495] While I have presented the contrast between these objectives as one between a historical debt collection perspective and a modern debt relief philosophy, the view persists that personal insolvency law should serve a primary aim of debt collection, and so involve as little interference in market exchange as possible. Even under English law, which possesses a liberal debt discharge regime, courts occasionally refer approvingly to the use of insolvency law as a debt collection mechanism,[496] mirroring comments of judges applying Ireland's creditor-focused bankruptcy law with comparatively draconian discharge provisions (see Chapter 3).[497] As late as 1994, even insolvency law experts of the UK legal NGO Justice stated that "[t]he insolvency process, whilst incidentally giving relief to the debtor, is essentially collective by nature for the benefit of creditors."[498] The influential creditors' bargain theory also sees insolvency law solely as a collective debt collection device, stating that the "basic problem that bankruptcy law is designed to handle, both as a normative matter and as a positive matter, is that the system of individual creditor remedies may be bad *for the creditors* as a group when there are not enough assets to go around"[499] (emphasis added). The historical debt collection perspective persists in views (founded in ideas of classical contract law and basic neo-classical economics) of the role of

[493] Whitford (1994), 401.
[494] *Id.*, 403.
[495] *See* note 257 *supra*.
[496] Re Taylor's Industrial Flooring Ltd., [1990] B.C.C. 44, 51 (1989).
[497] *See* e.g. D. -v- D. [2008] IEHC 435, 9; and the decision of *Y v X*, in which Abbott J refers to the "mandate of the bankruptcy code to protect creditors": Y. -v- X. [2010] IEHC 440 ¶ 16. On Ireland's bankruptcy law, which arguably only adopted elements of a fresh start policy in 2012, see Spooner (2012A), 249–56.
[498] JUSTICE, INSOLVENCY LAW ¶ 3.1 (Justice 1994).
[499] JACKSON (1986), 10–11.

personal insolvency law as being to protect market entitlements and allocations,[500] under the assumption that market exchange, rather than State judgment, will produce optimal outcomes – that is, the greatest supply of credit at the lowest cost.[501] Insolvency is therefore seen as a private matter, with the State's role being merely to vindicate market entitlements by coercing debtors to honour market bargains and creditors to act collectively in a welfare-maximising manner (the "creditors' bargain"). This creditor wealth maximisation perspective reflects an underlying legal ideology, ethic or paradigm of *market individualism* or *commercial self-interest*; a set of assumptions involving strong faith in the ability of private exchange, between self-interested parties acting competitively, to produce efficient outcomes.[502]

Rather than merely upholding market bargains, the fresh start policy recognises that consumer credit markets are subject to failures and productive of externalities, and so sees a public interest in restoring debtors to economically productive and socially included members of society. This perspective is founded upon an underlying legal ideology or ethic of *consumer protection* or *collective public interest*,[503] which assumes that State regulation is necessary as the reality of consumer contracting departs from paradigmatic assumptions of ideal markets, so that private ordering may produce inefficient outcomes and externalities.

Ideas of the fresh start policy and of the law's debt relief objective have been introduced into a system originally designed to serve the aim of debt collection, and which many continue to perceive as serving this objective. These two conflicting functions of personal insolvency law bear no necessary relationship and could have been pursued by entirely distinct laws.[504] Since "discharge policy historically has been embodied in bankruptcy law, we sometimes lose sight of the distinction between the law of discharge and the law relating to the creditor-oriented collection function of bankruptcy."[505] In so doing, courts, administrators and policymakers risk failing to recognise that debt relief is "a separate and distinct policy objective… which should not be intertwined with the policies relating to the creditor-oriented debt collection… function of the law."[506]

The presence of two opposing policy objectives in one law leads to significant tensions, which arise along certain fault lines of disagreement between the competing respective underlying legal ideologies (market individualism/commercial self-interest v consumer protection/public interest regulation) and assumptions (commercial v consumer bargaining dynamics) which inform the debt collection and debt relief perspectives. First, as I discuss in Chapter 4, policymakers across time and jurisdictions have disagreed as to the extent to which debt relief should be conditional

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[500] *Id.*, 7 et seq.

[501] *See e.g.* Hallinan (1986), 80; Mary Jo Wiggins, *Conservative Economics and Optimal Consumer Bankruptcy Policy*, 7 THEOR. INQ. LAW 347, 358 (2006).

[502] Adams & Brownsword (1987); Willett (2012).

[503] *Id.*

[504] JACKSON (1986), 226–27.

[505] *Id.*, 226.

[506] Flint (1991), 529.

on creditor consent or at least a certain level of return to creditors (measured monetarily or temporally in terms of years of debtor income contributions), in a debate which reflects “a dispute over the appropriate strength of bankruptcy’s collection function”.[507] Secondly, questions of the scope and extent of the stay of enforcement and the debt discharge as discussed in Chapter 5 ultimately turn on whether the law should disturb pre-bankruptcy entitlements only to the extent required to facilitate maximum creditor recovery, or rather intervene more readily to correct (sub-optimal) market allocations via debt relief. Finally, the law’s attribution of responsibility and sanction/punishment for default varies based on whether it should lean towards reflecting market discipline and allocations of risk/responsibility, or rather adjust these allocations in the public interest. This question is explored in relation to the principle of moral hazard and the sanctioning of debtor (mis)conduct in Chapter 6.

In the preceding pages I present arguments in favour of the fresh start policy and the re-orientation of personal insolvency law as it applies to consumers towards the debt relief objective. Failures in consumer credit markets and the externalities these markets produce mean that personal insolvency law must move from a position which passively upholds market allocations, towards one which shifts risk from debtors (and ultimately third parties) onto creditors in the aim of internalising social costs and instilling market discipline on irresponsible lenders. In Chapters 4 to 6, I apply this theoretical framework to the issues of controversy I have identified above, so assessing the extent to which English personal insolvency law has adopted the fresh start policy and evolved to meet the conditions of the modern consumer credit society.

[507] Howard (1987), 1082.

2.3 Alternative Perspectives on the Fresh Start Policy

Economic and market failure analysis is not the only justification for regulation and State involvement in markets, and "the world is full of examples of state intervention on social grounds."[508] Therefore while I adopt primarily an economic analysis, I now advance additional justifications for the fresh start policy which augment the case for the re-orientation of modern consumer insolvency law around the objective of debt relief.

A. Social Justice and Solidarity

The discharge of obligations of over-indebted households can also serve social justice aims of redistributing society's resources in an equitable manner and so reducing social and economic inequality, particularly that generated by consumer credit markets themselves.[509] Debt discharge is supported by the principle of maximising the distributive entitlements of society's least well-off members, a category into which fall debtors in insolvency proceedings, who are in financial difficulty and subject to a range of legal restrictions and social exclusions.[510] The debt collection perspective which sees the law's duty as being to uphold pre-bankruptcy market allocations[511] does not question the appropriateness of existing resource allocations. Rather, this view assumes under Coasian[512] logic that through bargaining resources will reach the hands of those who value them most highly and will use them most efficiently.[513] The central claim of neo-classical economics and private law orthodoxy - that the market exchange process will reach equilibrium at an optimal outcome,[514] - says nothing of the equity of resource distribution at any given equilibrium.[515] A competitive market equilibrium can only be legitimate if it results from a social choice regarding the appropriateness of initial allocations, however.[516] In this way a bankruptcy law focused on debt collection and upholding market allocations could perpetuate distributionally unjust results even if these markets were immune from failures (which I have shown above not to be the case).

[508] Prosser (2006), 366.
[509] Ramsay (1995).
[510] KILPI (1998), 73–74.
[511] JACKSON (1986) 32.
[512] R.H. Coase, *The Problem of Social Cost,* 3 J. LAW ECON. 1 (1960).
[513] HOWELLS & WEATHERILL (2005), 10.
[514] Campbell (1996), 52.
[515] *Id.*
[516] *Id.*

Moreover, commentators have in fact illustrated that consumer credit markets actually exacerbate unjust allocations by distributing wealth regressively.[517] Through features such as cross-subsidisation and risk-based pricing, credit markets may generate conditions under which "the poor pay more" for access to credit, adding an inequality of value to the original inequality of income suffered by society's poorer members.[518] Low income debtors are often segmented into high-interest pricing categories, while pricing structures on products such as credit cards often involve the extraction of extra fees and charges from those debtors already struggling financially, culminating in the "sweat box" of credit card lending identified by Professor Mann.[519] Credit card pricing systems mean that more financially comfortable consumers, the "convenience users" rather than credit card borrowers, obtain services at little to no cost, subsidised by those in financial difficulty.[520] While all individuals are subject to biases in decision-making, survey data[521] supports the theoretical assumption that educated consumers are more financially capable and less likely to make inappropriate credit product choices than those with less education.[522] Higher-income consumers who capable of hiring advisors similarly are expected to make more optimal borrowing decisions.[523] As less-educated, poorer customers exhibit reduced ability to identify undesirable and expensive product features (e.g. late payment fees, over-limit fees, default charges, etc.), market forces will not drive such features from low-income segments. In this regard, in the US subprime mortgage market of the 2000s inferior quality and more expensive mortgage loans were more common among low-income borrowers, ethnic minorities and women.[524] Marginal costs are also higher for low-income consumers due to their greater need of access to funds outside of income to pay for life's necessities.[525]

While neo-classical theory views market participation and exchange as the product of party choice, the process of the "financialisation" of society[526] in recent decades in the presence of increased living costs and stagnant wages has rendered credit market participation essential for most households, as "poverty curtails freedom of choice… [which is] denied to those without the resources to buy their entry ticket through the many turnstiles our society sets up at the entry points to social activity."[527] Thus those unable to access credit fall victim to "financial exclusion"

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[517] On the – often concealed – regressive redistributive effect of a passive and ostensibly neutral judicial application of private law, see Ramsay (1995).

[518] RAMSAY (2012A), 70-7.

[519] Mann (2007A), 385–87.

[520] *Id.*, 384. See also for example the discussion of similar cross-subsidisation in relation to the UK bank overdraft charges regime in the *Abbey National* case, in which Lord Walker noted that some "would regard the United Kingdom system as being, in some sense at least, obviously unfair", but that banks "vigorously disputed" a suggestion by Lord Mance that the system amounted to "a sort of 'reverse Robin Hood exercise'": *Abbey National* (UKSC), ¶2, per Lord Walker.

[521] O'DONNELL & KEENEY (2009), 98–99.

[522] Bar-Gill & Warren (2008), 64.

[523] *Id.*

[524] Bar-Gill (2008), 1138–39.

[525] Bar-Gill & Warren (2008), 64.

[526] GLOUKOVIEZOFF (2011), xv.

[527] Peter Golding, EXCLUDING THE POOR x–xi (Child Poverty Action Group 1987), cited in RAMSAY (2012A), 76-7.

and are isolated from normal life in their societies.[528] Debt discharge allows personal insolvency law to alleviate poverty and deprivation among the inevitable financial failed households[529] and safeguard the basic needs of all society members,[530] while removing households from financial exclusion by providing a fresh start.

The potential redistributive effects of bankruptcy are contested, however, on the basis that private law is ineffective compared to taxation and welfare state policies for addressing wider problems of inequitable wealth distribution,[531] and that distributive efforts may be frustrated by creditors simply passing on any losses sustained from debt discharge to consumers in the form of higher interest rates.[532] Some commentators even argue that debt discharge can result in a *regressive* distribution of wealth, as low-income consumers will be forced to pay higher interest rates to cover the costs of discharged debts of higher income households.[533] Ultimately these arguments require empirical proof, and until such evidence emerges the value of this social justice perspective of bankruptcy for practical policymaking may be limited. Furthermore, the link between household debt and inequality (see Chapter 1) undoubtedly raises wider socio-economic and political questions incapable of resolution through personal insolvency policy alone.

Social justice analysis may therefore provide less precise guidance to policymakers than more well developed economic perspectives. Social justice approaches also raise ideological conflicts which may render reforms based on such motivations politically difficult to implement.[534] My theoretical framework and subsequent analysis in Chapters 4-6 therefore rely less these considerations, but recognise the important social arguments in favour of debt relief which may not be adequately appreciated under an economic approach. In particular, these considerations illustrate clearly that personal insolvency law is not purely a private matter between debtor and creditors, but raises "public problems regarding the distribution and redistribution of wealth with

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[528] *See generally* GLOUKOVIEZOFF (2011).

[529] SULLIVAN ET AL. (2000), 3.

[530] Flint (1991), 537.

[531] Ramsay (1995), 178; Hynes (2004), 328.

[532] Hallinan (1986), 80. This passing on can only occur if credit markets are uncompetitive, and the extent to which these markets can be described as such is contested: *see e.g.* Braucher (1998), 9. See Professor Ausubel's research which suggests that the supra-normal profits earned in the US credit card market cast doubt on its competitiveness: Lawrence M Ausubel, Credit Card Defaults, Credit Card Profits, and Bankruptcy, 71 Am. Bankr. L.J. 249 (1997). Professor Mann's model of the "sweat box" of credit card lending further suggests competitive failures exist in credit card markets: see Mann (2007A).

[533] Buckley (2001), 1090.

[534] Nonetheless French consumer insolvency reforms were successfully introduced (with the support of politicians from both Right and Left) based on the objective of combatting social exclusion: *see* Projet de loi d'orientation relative à la lutte contre les exclusions, Projet de loi (n° 1055), Expose des motifs, 3; Projet de loi d'orientation et de programmation pour la ville et la renovation urbaine, Projet de loi n° 950: 4; Iain Ramsay, *A Tale of Two Debtors*, 75 MOD. LAW REV. 212, 215, 222, 226–28 (2012). While this question requires further research, it could be asked whether the achievement of this consensus was facilitated by, or is evidence of, French private law being less based upon a free market paradigm than its English equivalent.

all that means to persons in a society in which life's very needs are the subject of commerce by means of money".[535]

B. Humanitarian Justifications and Human Rights

Humanitarian concerns and the protection of human rights further argue in favour of an active debt relief policy and a departure from personal insolvency law's debt collection origins. The philosophy of early personal insolvency law - which pre-dates the widespread recognition of human rights - was concerned solely with the rights of creditors and the upholding of market exchanges, and inflicted harshly coercive measures on the debtor to this end.[536] Personal insolvency law's commercial law nature has traditionally served to conceal somewhat the humanity of the debtor, in its emphasis of contractual rights, referral to the debtor as "A Debtor" or "A Bankrupt" and concern with the metaphysical entity of the "bankruptcy estate", a phrase which converts the debtor's very livelihood into abstract concepts of assets and claims.[537] Creditor wealth maximisation theories of insolvency law's "common pool" or "tragedy of the commons" problem conceal the true human tragedy of over-indebtedness, reducing the livelihood of a debtor and her dependents to a common grazing ground of assets and "human capital" to be divided among creditors.[538] Debt collection perspectives of the law thus raise a general criticism of neo-classical economics: that it involves a dehumanising commoditisation of important human values, so that anything which people are willing to sell and buy should be the subject of free market exchange.[539]

Even if a law based on the debt collection perspective produced efficient outcomes (which I contest), such a purely utilitarian approach would be an insufficient basis for policymaking if we accept that individuals possess certain inalienable rights, the infringement of which are not mere costs to be outweighed by countervailing benefits.[540] Thus another ground for re-orienting consumer insolvency law around the fresh start policy is the recognition of the debtor's human dignity, and the protection of her right to earn a livelihood, maintain a reasonable standard of living, and retain her self-determination and liberty.[541] This reasoning is in fact evident in the US Supreme Court's seminal statement of the fresh start policy,[542] with public interest justifications joined by the duty to protect (via relief from excessively burdensome debt) the debtor's right to

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535 Philip Shuchman, *An Attempt at a 'Philosophy of Bankruptcy'*, 21 UCLA LAW REV. 403, 439 (1973).
536 *See e.g.* Duncan (1995).
537 Shuchman (1973), 420.
538 *See e.g.* JACKSON (1986), 225 et seq.
539 TREBILCOCK (1997), 23–24.
540 RAMSAY (2012A), 77-9; BALDWIN ET AL. (2011), 22–23.
541 Flint (1991), 536.
542 *Local Loan Co. v Hunt,* 292 US 234 (1934).

earn a livelihood, a “personal liberty”[543] and “fundamental private necessity” of the “utmost importance”.[544] This reasoning supports an active or positive fresh start policy, in which an expansive provision of debt relief is not merely an advisable policy choice, but necessary to vindicate of human rights.

It must be noted, however, that apart from some notable exceptions,[545] this rights-based prong of the court’s reasoning seems to have been less widely accepted in policy, judicial decisions and academic discourse on bankruptcy’s debt relief function. Both the US[546] and English[547] courts have held that there is no human right to access debt discharge in bankruptcy. Even the European Court of Human Rights, when justifying the interference with creditors’ property rights involved in debt discharge, conceptualised the issue as one of balancing creditors’ rights against the “legitimate social and economic policies” served by the law, rather than against debtors’ personal rights.[548] Human rights law’s impact has generally been limited to condemning the more extremely coercive and punitive elements of personal insolvency law’s debt collection function, many of which are historical residues from pre-human rights eras.[549] For example, the European Court of Human Rights has condemned multiple punitive and coercive aspects of Italian bankruptcy law, while also highlighting potential human rights contraventions in English law.[550] Challenges to elements of English bankruptcy law under the Human Rights Act 1998 have generally, however, upheld these provisions as legitimate and proportionate restrictions on debtors’ rights, necessary to protect creditors’ rights and achieve public interest objectives.[551] These decisions set limits upon the extent to which bankruptcy laws may punish and coerce the

[543] *Id.*, 245, per Sutherland J.
[544] *Id.,* 244.
[545] See the human rights argument of Professor Vern Countryman, a member of the Commission on the Bankruptcy Laws of the United States in the 1970s, that requiring debtors to engage in mandatory repayment plans rather than offering immediate debt discharge would amount to a form of involuntary servitude and so violate the Thirteenth Amendment of the US Constitution: SKEEL (2001), 195. While Professor Skeel and others (*see* Eisenberg (1980), 988) note that this interpretation may not be supported by US case law, other academic commentators have referred to the debtor's liberty in more recent times when arguing against mandatory repayment plans: *see* Karen Gross, *Debtor as Modern Day Peon: A Problem of Unconstitutional Conditions*, 65 NOTRE DAME L. REV. 165 (1989).
[546] United States v Kras, 409 U.S. 434 (1973).
[547] R v Lord Chancellor, Ex Parte Lightfoot, [2000] QB 597.
[548] Back v Finland, 2005 BPIR 1, ¶¶ 52–71 (2004).
[549] Elements of Italian law condemned by the European court include the overly long duration of bankruptcy proceedings (leading to a disproportionate interference with debtors’ property rights), as well as prohibitions on debtors voting and exercising certain roles and professions throughout bankruptcy: *see* Lourdo v Italy, Application No. 32190/96 (European Court of Human Rights 2003); Campagnano v Italy, (2009) 48 European Human Rights Review 43. The Court has similarly held that the interception of a debtor's correspondence could potentially violate the debtor's privacy rights if it extended for an unduly long period: Foxley v The United Kingdom, Application no. 33274/96 (European Court of Human Rights 2000).
[550] *Lourdo*, ¶70.
[551] *See e.g.* DAVID MILMAN, *The Challenge of Modern Bankruptcy Policy*, *in* Sarah Worthington (ed.), COMMERCIAL LAW & COMMERCIAL PRACTICE 373, 390–91 (Hart Publishing 2003); Sir Gavin Lightman, *Attitudes and Values 2*, 14 INSOLV. INT. 65, 69–70 (2001). Despite considerable doubts regarding the compatibility of certain features of Ireland's draconian bankruptcy law with the Constitution of Ireland and ECHR (*see* Joseph Spooner, *Sympathy for the Debtor? The Modernisation of Irish Personal Insolvency Law*, 25 INSOLV. INT. 97, 98 (2012)), challenges to the law have also been unsuccessful: Quinn & Others v Irish Bank Resolution Corporation Limited & Others, [2012] IEHC 261 (2012); Grace v Ireland & Anor, [2007] IEHC 90 (2007).

debtor in furtherance of the law's debt collection function, but merely require offending aspects to be removed from laws which remain oriented around debt collection. Human rights standards therefore appear not to demand an active debt relief policy and the reconfiguration of the law's fundamental perspective to fit the modern consumer credit society.[552]

More expansive humanitarian approaches have been advocated on some occasions, however. In 2012 the United Nations Committee on Economic, Social and Cultural Rights recommended the write-down of principal sums owed under "negative equity" mortgages as a solution to widespread mortgage debt problems in Spain.[553] Furthermore, in Belgium the Constitutional Court effectively mandated the creation of a "no income, no assets" consumer insolvency procedure for low income debtors, in finding that the equality guarantee under the Belgian constitution prevented the law from making debt discharge conditional on the completion of a repayment plan.[554] Overall, however, these more expansion interpretations of the level of debt relief necessitated by humanitarian considerations are rare. This does not, however, prevent such considerations outside of legalistic definitions of human rights requirements from justifying a re-orientation of personal insolvency law around the fresh start policy. Human rights ideas remain important in exposing the limits of cold economic analysis of a law with deeply significant consequences for the personal life of the debtor and her dependents, and help to highlight the discrete identity of *personal* insolvency law as distinct from corporate insolvency.[555]

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[552] In this sense, such judgments bear similarities to decisions condemning coercive aspects of judgment enforcement procedures. *See e.g.* McCann v Judge of Monaghan District Court and Others, [2009] 4 IR. REPORTS 200 (2009); LAW REFORM COMMISSION (2009), ¶¶2.25–2.28; Joseph Spooner, *Enforcement of Court Orders (Amendment) Act 2009*, IR. CURR. LAW STATUT. ANNOT. 2009 09 (2010).

[553] UNITED NATIONS ECONOMIC AND SOCIAL COUNCIL, CONCLUDING OBSERVATIONS OF THE COMMITTEE ON ECONOMIC, SOCIAL AND CULTURAL RIGHTS: SPAIN ¶¶21–2 (2012).

[554] Cour d'arbitrage (now la Cour constitutionelle de Belgique), Arrêt n° 38/2003 du 3 avril 2003. *See also* Jason J. Kilborn, *Continuity, Change and Innovation in Emerging Consumer Bankruptcy Systems*, 14 AM. BANKRUPTCY INST. LAW REV. 69, 94 (2006); SERVICE PUBLIC FÉDÉRAL ECONOMICE, PME, CLASSES MOYENNES ET ENERGIE, LE RÈGLEMENT COLLECTIF DES DETTES 93 (2009).

[555] WORLD BANK (2013), 50–52.

C.Considerations of Morality, Equity and Fairness

A moral or ethical case for the fresh start policy can also be presented.[556] This position is sometimes obscured, however, given that on first appearances the debt collection perspective appears to serve ages-old societal views of the role of contracts"[557] and "a virtually universal ethical precept"[558] in the value of honouring obligations and promise-keeping (accepting the premise that the idea of *promise* lies at the heart of contract law[559]). The enforcement of contracts in insolvency law, coupled with coercive and punitive aspects of bankruptcy laws and criminal law sanctions applicable to culpable debtors, serve a hortatory or deterrent function by incentivising promise-keeping and deterring default.[560] Furthermore, the upholding of pre-bankruptcy market entitlements and lack of State intervention in privately struck bargains is seen as protecting values of individual autonomy and personal liberty inherent in the principle of freedom of contract. [561] As discussed in Chapters 3 and (particularly) 6, policymakers frequently appeal to these moral arguments in favour of the sanctity of contract in opposing lenient debt relief or when proposing limitations on debt discharge.[562]

Given these suggestions that "moral philosophy tells us that we should stick to our promises... it may be surprising to discover that from different sources springs a widespread unanimity favouring the release of insolvents" via debt discharge.[563] Most fundamentally, debt discharge cannot offend the principle of promise-keeping in cases of insolvency where the debtor's financial circumstances mean she cannot repay, as it would be absurd to place a person under a moral duty to do the impossible.[564] In this regard, a moral enquiry into debt discharge in bankruptcy becomes an empirical question to be settled by evidence of the financial circumstances of debtors entering insolvency procedures;[565] while conditioning entry to insolvency procedures on the debtor's insolvency should assuage moral objections to debt discharge.[566] This does not resolve all ethical issues, however, as questions remain regarding the appropriate level of part

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556 *See e.g.* KILPI (1998); Flint (1991).

557 Kilborn (2003), 861.

558 Hallinan (1986), 140.

559 C. FRIED, CONTRACT AS PROMISE (Harvard University Press, New edition ed. 1990).

560 BROWNSWORD (2006), 49, citing P. S. ATIYAH, ESSAYS ON CONTRACT 15 (Clarendon Press, 1986); KILPI (1998), 102–25. On these features of personal insolvency law, see Parts 3.2 and 6.1 below.

561 TREBILCOCK (1997), 8–9.

562 Spooner (2013), 765–67; text to notes 772-793 below.

563 KILPI (1998), 67.

564 *Id.*, 68–9. Even contract law itself, founded upon the norm of promise-keeping, does not require contractual performance where it is impossible, and there is "no moral dimension" to non-performance in such cases: Czarnetzky (2000), 451.

565 For a discussion of the financial dire straits of debtors entering bankruptcy in the USA, *see e.g.* SULLIVAN ET AL., (1999); SULLIVAN ET AL. (2000); Lawless et al.(2008).

566 Hallinan (1986), 140. The exceptional position of USA law, in not making entry to bankruptcy conditional on the debtor's insolvency, is relevant to this debate. The absence of this condition may have obscured the vulnerability of the moral argument against debt discharge in a situation of the debtor's insolvency.

repayment which a debtor should be required to make, the sacrifice or costs to be undertaken in return for debt relief, and whether the circumstances which led to full repayment becoming impossible involved morally upright conduct on the part of the debtor. These issues are discussed further in Chapter 6 (albeit within the economic framework of moral hazard theory, rather than from an ethical perspective).

Moral arguments in favour of the enforcement of contracts as the upholding of quasi-sacred promise-keeping norms are also based upon paradigms ill-fitting to the empirical reality of modern consumer credit markets. Professor Radin draws a contrast between the modern world of mass consumer contracting and the paradigmatic world of freely negotiated, agreed and understood contractual agreements between equally well-informed parties of equal bargaining power.[567] This paradigmatic world, in which those advancing simple arguments that debts ought to be repaid appear to dwell, is far from the reality of consumer credit markets. Here standard form contracts containing one-sided terms are drafted by financial institutions[568] and accepted with little choice by cognitively biased consumers lacking financial literacy skills and knowledge of credit agreements' details, who may be under pressure to borrow to afford reasonable life requirements.[569] It is a truism to claim that individuals should repay their debts. Deeper enquiry is required, however, before stating that a consumer is morally bound to repay sums arising from default charges of which a consumer was unaware and could not understand,[570] from loans which lenders know borrowers will struggle to repay but which are profitable,[571] or from "negative equity" on an unsustainable mortgage loan advanced on the lender's (incorrect) projection of the future value of security, despite the borrower's potential inability to repay.[572] Institutional lenders are in a position to use their "economic, intellectual or psychological superiority" to impose onerous contractual terms on consumer borrowers, exploiting the vulnerability of a weaker party for financial gain.[573] This inequality of bargaining power has been long recognised by policymakers, featuring, for example, in the recommendations of the Crowther Committee on consumer credit;[574] while also influencing US bankruptcy policy debate (particularly in the 1960s and 1970s).[575] Rather than promoting freedom and autonomy, therefore, modern circumstances

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567 MARGARET JANE RADIN, BOILERPLATE, 3-18 (Princeton University Press 2012).

568 *See e.g.* RONALD J. MANN, *'Contracting' for Credit*, *in* Omri Ben-Shahar (ed.) BOILERPLATE: THE FOUNDATION OF MARKET CONTRACTS 106 (Cambridge University Press 2007); Bar-Gill (2003); Harris & Albin (2006).

569 As Professors Howells and Weatherill note"[t]he expectation in commercial contract law that the courts will do no more than act as conscientious protectors of the parties' negotiated bargain has no necessary place in the absence of such negotiation." HOWELLS & WEATHERILL (2005), 21.

570 For discussion of business models based on deriving considerable profits from such unexpected charges, see Ronald J Mann (2007A); Bar-Gill (2003); Bar-Gill (2008).

571 The UK Office of Fair Trading found in 2013 that 50% of income in the payday lending industry arises from rolled-over loans, i.e. loans advanced to an existing customer unable to repay an original loan: OFT (2013).

572 For discussion of such asset-based mortgage lending practices, see EUROPEAN COMMISSION (2009A), 7–8.

573 Michael Schillig, *Inequality of Bargaining Power Versus Market for Lemons: Legal Paradigm Change and the Court of Justice's Jurisprudence on Directive 93/13 on Unfair Contract Terms*, EUR. LAW REV. 336, 338 (2008).

574 CROWTHER (1971), ¶6.1.12.

575 Hallinan (1986), 67–68, 73–80.

of mass consumer contracting on creditors' standard terms may leave the debtor's freedom "totally subordinate to her creditors' interest."[576] Therefore debt discharge may be a means of preserving individual autonomy in an era of "private legislation" by standard form contracts.

While the existence of a moral duty to keep a promise in the first "world" described above (potentially a promise among peers or friends) may be universally accepted, no similar level of interpersonal duty exists in the context of loans made by expert institutional lenders "as part of a calculated impersonal undertaking involving large numbers of similar 'investments' all made for profit".[577] In this sense, the law's formal treatment of all debts and creditors as equal excludes "the vital and important realities" that distinguish types of debts and so cause us "to disregard what may be of greatest moral concern".[578] Since an expert lender, with access to advanced credit scoring facilities, calculates interest rates based on the risk of non-payment, "the moral foundation of the creditor's claim to payment is somewhat dubious... as he has already been paid."[579] Also, moral arguments against debt discharge tend to exhibit a moral asymmetry in failing to apply moral standards to creditors, who are permitted to act solely in accordance with the tenets of profit maximisation.[580] As Professor Shuchman asks "[i]s it not immoral for the creditor to enforce payment though he or it knows (and on moral grounds should inquire) that the debtor's family will suffer thereby?"[581]

A further moral argument in favour of debt relief is that such an approach is demanded by the societal virtue of forgiveness,[582] part of an altruism not often recognised in law, but whose "moral value is a principle almost as widely accepted as the moral duty of payment."[583] In particular, Professor Gross argues that forgiveness is an important societal value capable of having positive restorative effects,[584] allowing creditors to feel that the imbalance caused by wrongdoing has been partially restored, while allowing the debtor "to regain self-esteem and become once again a productive member of society".[585]

The main value of forgiveness for Professor Gross appears to be in facilitation of rehabilitation, an idea familiar from the economic perspective above which involves the restoration of the debtor

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576 KILPI (1998), 77.

577 Shuchman (1973), 429.

578 *Id.*, 432.

579 Hallinan (1986), 141.

580 Brent T. White, *Underwater and Not Walking Away*, 45 WAKE FOR. LAW REV. 971, 1007–9 (2010). I discuss the two-way relational nature of moral hazard in Chapter 6.

581 Shuchman (1973), 435.

582 GROSS (1997), 91–134.

583 Hallinan (1986), 140.

584 GROSS (1997), 94. Professor Hurd similarly argues that "our practices of debt forgiveness are not about maximising aggregate welfare, or about protecting individual rights, or about spreading wealth so as to achieve a more just distribution across society. Rather, they are about achieving and expressing personal virtue – not that of creditors or of debtors (although theirs is not irrelevant) but of our own, as citizens of a just and wealthy society." *See* Hurd, *The Virture of Consumer Bankruptcy*, in Brubaker et al. (eds.) (2012), 217-8.

585 *Id.*

to economic productivity.[586] She also relies on humanitarian and social justice concerns, seeing the forgiveness of debtors as "part of the responsibility to treat members of society humanely."[587] For these reasons, it is questionable whether this forgiveness theory of the fresh start adds to existing perspectives outlined above. Furthermore, its starting assumption that by entering an insolvency procedure a debtor commits a wrong runs contrary to ethical perspectives presented in this section and evidence both of the often innocent causes of over-indebtedness (see Chapter 1). Perhaps most importantly, forgiveness as a moral concept requires that the forgiving agent contributes to the act of forgiveness and is a subjective attitude "based on the sympathetic will of the person excusing". [588] In contrast, any debt discharge founded in a legal institution creates and enforces rights which apply uniformly to all, irrespective of their attitudes.[589] Therefore Professor Gross' theory would appear to allow debt discharge conditional only on creditor consent, and to conceptualise personal insolvency law as a private matter between debtor and creditors. Such a perspective neglects the important public interests served by the fresh start policy.

While a moral case exists for a departure from the debt collection orientation of personal insolvency law towards an active debt relief objective, difficulties arise in deciding upon and applying moral standards to consumer insolvency (see Chapter 6). Due to subjective standards and differences of opinion regarding the probity of debtor and creditor conduct, and the strong ideological conflicts such debate generates, moral questions may be less capable of being answered than questions of what is required to reduce the externalities caused by over-indebtedness, or even to give effect to agreed levels of wealth redistribution. Furthermore, many questions regarding the appropriateness of debtor and creditor conduct can be addressed in a more structured manner through the insurance theory framework and the concept of moral hazard (see Chapter 6). This framework has the additional advantages of focusing on systemic issues to be addressed by a bankruptcy system, rather than the preoccupation with justice *inter partes* which lies behind a moralist approach. While such considerations should be taken into account, particularly to refute simplistic arguments that debt discharge offends the idea of *pacta sunt servanda*, an ethical or moral perspective of personal insolvency law may provide only limited guidance to policymakers.

[586] *Id.*, 99–100.
[587] *Id.*, 102.
[588] KILPI (1998), 67–68.
[589] *Id.*, 68.

2.4 Conclusion

This Chapter argues the case for the re-orientation of personal insolvency law, at least as it applies to *consumers*,[590] around the fresh start policy. It calls for a recognition of debt relief as an independent and fundamental public policy objective of personal insolvency law, thus rejecting the view that debt relief is merely a means of assisting the law's debt collection objective, or a limitation on the law's enforcement function imposed as a concession to the debtor's humanity. In modern consumer credit markets the assumptions underlying the law's debt collection perspective no longer hold, meaning that a law which seeks to maximize returns to creditors may produce sub-optimal outcomes, rather than the efficient resource allocations promised by this aim. Rather, due to the externalities arising from these markets, more efficient outcomes may be produced by the law's imposition of losses on creditors in the event of consumer over-indebtedness. Personal insolvency law thus operates as an insurance mechanism which re-allocates the risks of the consumer credit society in an efficient and equitable manner, internalizing social costs. The fresh start policy argues that in the consumer over-indebtedness context, personal insolvency law's *primary* goal should be to relieve over-indebtedness via protection from enforcement and debt discharge. The policy recognizes, however, the concerns of moral hazard which this position creates, and so requires that costs be imposed on the debtor so as not to incentivize debt default and insolvency. Debtors should be required to surrender assets and income to creditors for this reason, but this requirement should be recognized as ultimately serving a debt relief objective rather than one of maximising creditor returns. Repayment to creditors should not be seen as an end in itself, but rather as a safeguard to ensure that the fresh start policy is not abused and that debt relief is provided only where it is in the public interest.

In this regard the law obviously must continue to uphold private law obligations outside of cases of over-indebtedness, as in such cases externalities are unlikely to arise and optimal outcomes are more likely to be achieved by upholding contractual bargains. Since insolvency law's debt collection function has partly arisen (at least under English law) from deficiencies in the system for the enforcement of debts outside of insolvency procedures,[591] a strong case exists for strengthening mechanisms for the enforcement of judgment debts against solvent debtors as a

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[590] In the sense in which this concept is used in Chapter 1 to refer to non-high net worth debtors (both employed and self-employed).

[591] English bankruptcy law arose as a response to deficiencies in debt enforcement procedures, and was originally neither a *collective* procedure, nor one conditional on the debtor's *insolvency*: Jason Kilborn & Adrian Walters, Involuntary Bankruptcy as Debt Collection 5–7 (Rochester, NY, Social Science Research Network 2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2171441. While the absence of an insolvency condition was related to the presence of the (now abolished) "acts of bankruptcy" system, it remains the case that a debtor can be adjudicated bankrupt under a creditor petition without being insolvent "in the absolute sense" of balance sheet insolvency: IAN F. FLETCHER (2009), ¶¶1–013.

counterpoint to the recognition that consumer insolvency law must be re-oriented around debt relief. English judgment enforcement procedures have been described as “piecemeal at best and ramshackle at worst”,[592] while harsher criticisms state that their deficiencies represent a “fundamental crisis in civil justice.”[593] Despite a long period of policy review in the 2000s and even the enactment of legislation (which has yet to be fully commenced),[594] a proposed overhaul of the system has been abandoned in favour of more modest reforms.[595] Similarly, though the Law Reform Commission of Ireland proposed a comprehensive reform of Ireland’s judgment enforcement law alongside the establishment of a new personal insolvency system,[596] only reforms in the latter area have been implemented.[597] The reform of the law’s debt collection procedures would be an appropriate means of identifying and delineating the distinct policy objectives of debt collection (in cases of debtor solvency where no externalities arise) and debt relief (in insolvency). It would also clarify further how personal insolvency law (at least in the consumer over-indebtedness context) has come to adopt the fresh start policy and attribute primacy to its public policy objective of relieving debts of over-indebted consumers.

[592] MILMAN (2005), 15.

[593] John Baldwin & Ralph Cunnington, *The Enforcement of Judgments in Undefended Claims in the Civil Courts in England and Wales*, 23 CIV. JUSTICE Q. 354, 355 (2004).

[594] Tribunals, Courts and Enforcement Act 2007, Parts 3-4 (2007 c. 15).

[595] John Baldwin & Ralph Cunnington, *The Abandonment of Civil Justice Reform*, 29 CIV. JUSTICE Q. 159 (2010).

[596] LAW REFORM COMMISSION (2009); LAW REFORM COMMISSION OF IRELAND, INTERIM REPORT (Law Reform Commission 2010); LAW REFORM COMMISSION OF IRELAND (2010A).

[597] Spooner (2012B), 100.

CHAPTER 3: Consumer Insolvency Law Reform and the Politics of Household Debt[598]

3.1 Introduction: Personal Insolvency Law in the Consumer Credit Society

As described in Chapter 1, the expansion of household lending and its new vital significance at macro- and micro-economic levels has led to the development of the modern consumer credit society and a by-product of widespread household over-indebtedness. The financial turmoil wreaked upon debt-laden European households by the Great Recession[599] offers a vivid reminder of this trend and has led to a series of consumer insolvency law reforms in some of Europe's most profoundly affected countries. Similar less severe crises have also occurred in recent decades and demanded policy responses, including an initial wave of consumer insolvency law reform in several European countries in the late 1980s and 1990s.[600] As I argue in Chapters 1 and 2, the advent of the consumer credit society and widespread household over-indebtedness calls for personal insolvency law to embrace the fresh start policy and to adapt its features (such as those discussed in Chapters 4-6) to serve the goal of debt relief rather than maximising returns to creditors, subject to protecting against moral hazard (see Chapter 6). This Chapter focuses on the legislative process involved in reforming the law in this manner, using a comparison of national laws to explore potential explanations of their differences, and particularly the respective extent to which they are oriented towards the goals of debt collection or debt relief. Through this process, I identify factors which influence the nature and extent of change in personal insolvency law and so suggest reasons as to why legislation fails to evolve to embrace the fresh start policy and respond to the conditions of the consumer credit society. These factors are largely drawn from the political sphere, as I conclude that certain political science concepts appear to explain the development of consumer insolvency laws in the selected countries, while illustrating the complexity of law reform in this area.

I reach this conclusion after questioning in Part 3 the prominent view amongst policymakers and certain academic commentators that insolvency law is an area of law which is the product of

598 This chapter draws on material published in Spooner (2013) and Spooner (2012A).

599 *See e.g.* Mary Cussen, Brídín O'Leary, Donal Smith, *The Impact of the Financial Turmoil on Households: A Cross Country Comparison*, CENTRAL BANK QUARTERLY BULLETIN 78 (2012) (Ir.).

600 *See e.g.* Johanna Niemi-Kiesilainen, *Consumer Bankruptcy in Comparison*, 37 OSGOODE HALL LAW J. 473 (1999); RAMSAY ET AL. (eds.) (2003); NIEMI ET AL. (eds.) (2009).

inherently *national* legal, economic, social and cultural factors.[601] More specifically, differences in national consumer insolvency laws are attributed to variances in such factors as domestic social welfare systems,[602] consumer credit market structures,[603] and "deeply ingrained cultural differences on the moral imperative of debt incurrence and repayment". [604] Early comparative consumer insolvency literature also widely assumes that there is a significant philosophical split between approaches to consumer insolvency law in Continental European civil law and common law ("Anglo-Saxon") systems. To address these hypotheses, I expand my previous research on the differences between Irish and English laws[605] and consider the consumer insolvency laws of France and Belgium. This allows me both to test the external validity of my original findings and to assess the veracity of the argument that civil law countries demonstrate "a common socializing philosophy based on the sanctity of contractual obligations that sharply distinguishes the European approach from the market-oriented Anglo-Saxon fresh start policy".[606] The choice of these jurisdictions also follows recommendations that comparative legal studies should focus on countries sharing many similarities, so that reasons for differences in their laws can be isolated.[607] Also, commentators have proposed various methods of categorising personal insolvency laws,[608] and these jurisdictions are representative of different categories whether one adopts a qualification system based on "legal families",[609] shared common features of the laws,[610] a sliding scale from "conservative" to "liberal" regimes,[611] or conceptual underpinnings of the law.[612] The location of all countries within the European Union also means that this study

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[601] *See e.g.* Charles J. Tabb, *Lessons from the Globalization of Consumer Bankruptcy*, 30 LAW SOC. INQ. 763, 775–77 (2005); Rafael Efrat, *Global Trends*, 76 AM. BANKRUPTCY LAW J. 81 (2002); JACOB S. ZIEGEL, COMPARATIVE CONSUMER INSOLVENCY REGIMES 8 (Hart Publishing, illustrated edition ed. 2003).

[602] *See e.g.* Robert J Landry III, Amy K Yarbrough, *A Struggling Social Safety Net: Global Lessons from Bankruptcy and Healthcare Reforms in the United States, France and England* in Michelle Kelly-Louw, James Nehf, Peter Rott (eds.)THE FUTURE OF CONSUMER CREDIT REGULATION: CREATIVE APPROACHES TO EMERGING PROBLEMS 165 (Ashgate Publishing, 2008); Efrat (2002), 96–8.

[603] Efrat (2002), 92–6.

[604] Tabb (2005), 778. *See also* Nathalie Martin, *Role of History and Culture in Developing Bankruptcy and Insolvency Systems*, 28 BOSTON COLL. INT. COMP. LAW REV. 1 (2005); ZIEGEL (2003), 8–9; Tabb (2005), 775–77.

[605] Spooner (2012).

[606] Jacob Ziegel, *Facts on the Ground and Reconciliation of Divergent Consumer Insolvency Philosophies*, 7 THEOR. INQ. LAW 299, 303–4 (2006).

[607] Tabb (2005), 770; Ramsay (2007), 258.

[608] Johanna Niemi, *Consumer Insolvency in the European Legal Context*, 35 J. CONSUM. POLICY 443, 445 (2012).

[609] JASON J. KILBORN, COMPARATIVE CONSUMER BANKRUPTCY (Carolina Academic Pr 2007).

[610] EUROPEAN COMMISSION ET AL. (2008) at 89.

[611] Efrat (2002).

[612] I. Ramsay (1997); Iain Ramsay, *Between Neo-Liberalism and the Social Market*, 35 J. CONSUM. POLICY 421, 427–34 (2012); Niemi-Kiesilainen (1999).

adds to the discussion of common European policy in areas of personal insolvency,[613] cross-border insolvency[614] and consumer credit regulation[615] policies.

3.2 Overview of National Laws

In this section I now present a brief overview of the laws of the four countries considered. As a comprehensive discussion of each law lies far outside the scope of this Chapter, I focus on key elements of the laws, which largely mirror the features of English law examined in Chapters 4-6. First I consider the conditions for accessing personal insolvency procedures and particularly the extent of creditor control of access, i.e. whether procedures consist of consensual renegotiation or a statutorily mandated procedure. I also examine the extent of debt relief offered, including the conditions attached, as well as the law's treatment of moral hazard concerns through debtor prohibitions, restrictions and sanctions. Given that my current analysis is focused on the development of consumer insolvency *legislation*, it is a study of "law on the books",[616] and I consider wider issues such as national debt counselling systems elsewhere.[617]

(I) France

The availability of insolvency procedures to consumers is a recent development in France, since prior personal insolvency laws were only applicable to "commercants" or traders [618] The exception was the "faillite civile" procedure under the law of the region of Alsace and Moselle which has long provided summary debt discharge to both business and consumer debtors residing in that area.[619] The first consumer insolvency legislation of general application was passed in 1989,[620] and has subsequently been amended several times until as recently as 2010.[621] The 1989 law established a unique institutional structure, building the system not

[613] *See e.g.* European Commission (2012); European Commission, Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions: Overcoming the Stigma of Business Failure - for a Second Chance Policy (2007); Council of Europe (2007).

[614] *See e.g.* Council Regulation (EC) No. 1346/2000 of 29 May 2000 on Insolvency Proceedings, OJ 1601 1 (2000); Proposal for a Regulation of the European Parliament and of the Council Amending Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings; Niemi (2012); Walters & Smith (2010).

[615] *See e.g.* Consumer Credit Directive 2008; Mortgage Credit Directive Proposal.

[616] In designing this study, I acknowledge comments of Professors Carruthers and Halliday, in the context of corporate insolvency law, that socio-legal scholars have neglected somewhat the making of statutory law, while focusing research on "law in action": see BRUCE G. CARRUTHERS & TERENCE C. HALLIDAY, RESCUING BUSINESS 5, 45–46 (Clarendon Press 1998).

[617] For information on debt counselling in Ireland and England and Wales, see Spooner (2012A), 262–6, and the discussion in Chapter 4.

[618] HULS (1994), 100; Kilborn (2004), 628.

[619] Dominique Dagorne, *La faillité civile en Alsace et Moselle*, in Michel Gardaz LE SURRENDETTEMENT DES PARTICULIERS 39 (1997); Kilborn (2004), 656; Ramsay (2012B), 217–8 (2012).

[620] "Loi surendettement".

[621] Loi n° 2010-737 du 1er juillet 2010 portant réforme du crédit à la consommation.

around courts, but rather a series of administrative bodies (one in each of the 117 *départements*) called “commissions on individual over-indebtedness” (*commissions de surendettement des particuliers*).[622] These are composed of eight members, with the lynchpin of each commission being its secretary, who is a representative of the French Central Bank (Banque de France).[623] The other members are delegates of local government and tax authorities, representatives of the credit industry and consumer associations, as well as a lawyer and social worker (as non-voting members). A debtor applies to one of these commissions, rather than to a court, in order to enter the consumer insolvency procedure. Access conditions require that the debtor be “over-indebted”, a condition characterised by the manifest impossibility for the “good faith” debtor to meet the entirety of her non-professional debts currently due and which will fall due.[624] Once a debtor applies to a commission, the body takes control of the case and directs it along one of three possible tracks or options (although overlap is possible between the tracks).

The first track, which under the original 1989 law was the only option available to debtors, involves the non-interventionist measure of the commission rescheduling the debtor’s obligations into a repayment plan, with considerable flexibility as to the rescheduling arrangements.[625] Payment plans generally may last for no longer than eight years, but may extend for longer when they involve the repayment of home mortgage loans. The legislation originally required creditor consent to a plan for it to come into effect. Since reforms introduced in 1999,[626] however, while commissions continue to seek to achieve a consensual plan in the first instance, they are empowered to *impose* a plan on creditors if agreement cannot be voluntarily reached.[627] These imposed plans may provide for alternative tracks of “ordinary” or “extraordinary” measures, depending on the commission’s view of the severity of the debtor’s financial difficulties.[628] The “ordinary” measures involve limited concessions and modifications to the debtor’s loans such as debt rescheduling and interest rate reductions. Again, repayment plans containing ordinary measures can endure for no longer than 8 years unless they involve the rescheduling of a home loan. The “extraordinary” measures can be recommended by the commission as “special and justified” proposals, and include the discharge of any residual obligation after the sale of the debtor’s home in a situation of “negative equity”; as well as the partial or complete discharge of debt following a two-year moratorium on enforcement and subsequent evaluation of the debtor’s circumstances.[629] Measures recommended by the commission come into effect on their confirmation by a court.[630]

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[622] Code de la Consommation art. L331-1.

[623] Jean-Luc Vatin, *Traitement Du Surendettement: Nouvelles Perspectives*, BULL. BANQ. FR. 101, 101 (1996).

[624] Code de la Consommation art. L330-1.

[625] Code de la Consommation art. L331-6.

[626] Loi No. 98-657, art. 99; Decree No. 99-65 of Feb. 1, 1999, J.O., Feb. 2, 1999, JCP 1999, III, 20038.

[627] Code de la Consommation art. L331-7.

[628] Code de la Consommation art. L331-7 and L331-7-1.

[629] Code de la Consommation art. L331-7-1.

[630] Code de la Consommation art. L332-1.

Finally, the *rétablissement personnel* procedure, introduced in 2003, provides an immediate discharge of the debtor's obligations (albeit excluding debts such as family maintenance obligations) [631] in return for a liquidation of the debtor's assets, in a manner similar to the English or US conception of bankruptcy. Its access conditions, however, limit the procedure to only debtors whose financial circumstances are "irremediably compromised".[632] The commission can recommend *rétablissement personnel* without a judicial liquidation of the debtor's assets where it finds that the debtor possesses no assets of significance.[633] This will be the position in most cases, in which the court merely confirms the commission's recommendations.[634]
In addition to limiting access to consumer insolvency procedures only to debtors acting in "good faith", French law further guards against moral hazard and controls debtor conduct by denying the benefits of the legislation to those found to have committed wrongful conduct such as fraud, asset concealment or the aggravation of insolvency by new borrowings.[635]

(II) Belgium

While Belgian consumer insolvency law bears many similarities to the French system, by which Belgian policymakers were greatly influenced, it took almost a decade from the time of the first French reforms for the Belgian law to be enacted in 1998.[636] The Belgian *loi relative au règlement collectif de dettes*, contained in the civil procedure code, is organised around a judicial, rather than administrative, structure. Every natural person (non-trader) domiciled in Belgium who is not in a position to pay her debts in a sustainable manner, and who has not manifestly orchestrated her own insolvency, may apply to court to enter the process.[637] On deeming the application admissible, the judge names a debt mediator (or debt counsellor),[638] and both the debtor's dealing with her property, and creditors' enforcement efforts, are suspended.[639]
Like in the French system, the first phase of the Belgian debt settlement procedure involves a non-interventionist process of structured renegotiation between debtor and creditors in a non-judicial setting. The debt mediator draws up a repayment plan and proposes it to creditors, guided only by the requirement that it satisfy the legislation's objective of re-establishing the debtor's financial situation, balancing debt repayment with the preservation of the debtor's

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631 Code de la Consommation, art. L332-9; L333-1.
632 See also Ramsay (2012B), 226–8; Kilborn (2004), 655–6.
633 Code de la Consommation, art. L330-1. The court plays a role either in confirming the commission's recommendation or in hearing an objection from creditors: Code de la Consommation, art. L332-5; art. L332-5-1.
634 For the applicable court procedure where assets are available for liquidation, see Code de la Consommation, art. L332-5 et seq.
635 Code de la Consommation, art. L333-2, 1º, 2º, 3º.
636 Kilborn (2006), 70–72.
637 Code judiciaire, Art. 1675/2, 1675/6.
638 SPF Economie (2009), 9; Kilborn (2006), 81–2.
639 Code judiciaire, Art. 1675/7, §§1-2.

human dignity.[640] The duration of the plan (since 2012 reforms[641]) may not exceed seven years (unless the debtor requests a longer plan, for example to repay a mortgage debt).[642] All voting creditors must accept the proposal for it to be approved, at which point it is confirmed by the court.[643] As in France, if no agreement can be reached, the court can impose a plan on creditors.[644] The repayment plan imposed by the court may involve the rescheduling of debts (capital, interest and charges), the reduction of interest rates and the total or partial discharge of interest, costs and charges. No discharge of capital is available to debtors under this track. The repayment plan may not exceed five years in duration.

Much like under the French system, additional "extraordinary" measures are available to the Belgian judge if the debtor's case involves more extreme financial difficulty. Thus the judge can grant a partial debt discharge if the "ordinary" concessions described above would not restore the debtor's financial situation and if all of the debtor's seizable goods have been sold at the initiative of the debt mediator for *pro rata* distribution to creditors.[645] Even then, the debtor will only obtain a partial debt discharge on completion of a repayment plan lasting 3-5 years, and on condition that the debtor's financial situation does not "return to better fortune" before the plan's end.[646] Finally, since 2005 a procedure for the total discharge of debts has been available in "no income, no assets" cases. If the mediator considers that no repayment plan (consensual or court-imposed) is possible due to the debtor's insufficient resources, the mediator may apply to court for the total discharge of the debtor's obligations.[647] The court can then grant a full discharge without a repayment plan, provided the debtor's assets (including the debtor's home if she/he is a homeowner[648]) have been liquidated and the proceeds distributed to creditors.[649] The debtor may be required to engage in education or social assistance for a period of five years,[650] and the discharge becomes final only provided the debtor does not enter "better fortune" during this period.[651] In an important contrast with the French system, this total discharge procedure was not introduced at the initiative of policymakers, but rather was provoked by a decision of the Belgian Constitutional Court holding that the constitution's equality guarantee prohibited a rule which excluded from debt relief those debtors unable to repay a substantial portion of their debts.[652]

[640] Code judiciaire, Art. 1675/3, Art. 1675/10, §2.
[641] Loi modifiant le Code judiciaire en ce qui concerne le règlement collectif de dettes, Art. 2, 26 mars 2012. (Belg,)
[642] Code judiciaire, Art. 1675/10, §6.
[643] Code judiciaire, Art. 1675/10, §4.
[644] Code judiciaire, Art. 1675/11, §§1-3.
[645] Code judiciaire, Art. 1675/13, §1.
[646] Code judiciaire, Art. 1675/13, §§1-2. For debts excluded from discharge, see Art. 1675/13, §3, Art. 1675/13bis, §1.
[647] Code judiciaire, Art. 1675/13bis, §1.
[648] SPF ECONOMIE (2009), 43.
[649] Code judiciaire, Art. 1675/13bis, §2.
[650] SPF ECONOMIE (2009), 41–3.
[651] Code judiciaire, Art. 1675/13bis, §4.
[652] Cour d'arbitrage (now la Cour constitutionelle de Belgique), Arrêt n° 38/2003 du 3 avril 2003. See also Kilborn, (2006), 94; SPF ECONOMIE (2009), 93.

Under all "tracks" of debt relief, the court may reject or terminate a debtor's application in the event of debtor fraud, on the application of the mediator or a creditor.[653] Any abusive conduct by the debtor within a period of five years after discharge can also lead to the revocation of the discharge.

(III) England and Wales

Access to personal insolvency procedures has been open to consumers in England and Wales since the abolition of the law's distinction between traders and non-traders in 1861.[654] The law in this jurisdiction again consists of a series of procedures offering varying levels of debt relief and bearing different access conditions, as I consider more deeply in Chapter 4. A key difference in the English system, however, is that the choice of procedure is left to the debtor rather than a court or administrative body (subject to narrow access conditions for the "no income, no assets" Debt Relief Order procedure).[655] First, an Individual Voluntary Arrangement (IVA) is a statutory agreement entered into by a debtor with her creditors for the settlement of her debts.[656] Under this procedure, the debtor proposes a repayment plan to creditors through a licensed Insolvency Practitioner (usually an accountant or lawyer).[657] The IVA is contractual in nature,[658] and so the concessions offered to debtors depend on the consent of 75% (in value) of creditors. [659] Nonetheless standard terms of IVA agreements have been created between creditors and the "industry" of Insolvency Practitioners,[660] along with a Protocol for treating standard consumer IVA cases. [661] Guidelines regarding appropriate' living expenses are drafted at regular intervals, although these are available to industry stakeholders only and are not publicly accessible.[662] IVAs generally involve a repayment plan of approximately five years in full settlement of the debtor's obligations,[663] although plan durations appear to be growing longer (see Chapter 4). Some control over debtor conduct and safeguards against moral hazard are evident in the criminal liability which can accrue for IVA debtors who make false representations or commit

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653 Code judiciaire, Art. 1675/15, §1-2.

654 BANKRUPTCY ACT 1861.

655 I omit a discussion of the County Court Administration Order procedure, as it has fallen largely into disuse. For information on this procedure, *see*: Donna McKenzie Skene, Adrian Walters, *Consumer Bankruptcy Law Reform in Great Britain*, 80 AM. BANKR. L.J. 477, 487–8 (2006); Iain Ramsay, *Bankruptcy in Transition: The Case of England and Wales - The Neo-Liberal Cuckoo in the European Bankruptcy Nest?*, in RAMSAY ET AL. (eds.) (2003), 205, 212–3.

656 See Insolvency Act, 1986, c. 45, part VIII (U.K.); Walters (2009).

657 Insolvency Act, 1986, c. 45, §256A et seq., Part XIII (U.K.)

658 See Johnson and Anr v Davies and Anr [1999] 3 WLR 1299; [1999] Ch. 117; Milman (2003), 397.

659 Insolvency Act, 1986, c. 45, §§257, 260 (U.K.); Insolvency Rules, 1986 S.I. 1986/1925, r. 5.23(2) (U.K).

660 Standard Conditions for Individual Voluntary Arrangements (Revised April 2012).

661 *IVA Protocol: Straightforward Consumer Individual Voluntary Arrangement* (2008), available on the Insolvency Service website, insolvency.gov.uk.

662 See the website of the Common Financial Statement: http://www.cfs.moneyadvicetrust.org/faqs.asp?page_id=30.

663 *IVA Protocol: Straightfoward Consumer Individual Voluntary Arrangement* (2008), at 9.1; Walters (2009) at 18.

some other fraud.[664] As I discuss in Chapter 4 (section 4(C)(ii)), English policymakers sought unsuccessfully[665] in the mid-2000s to introduce legislation reforming the IVA procedure in order to establish it as the primary consumer debtor remedy and to facilitate greater concessions by creditors.[666]

English debtors unable to pay their debts may instead opt to enter bankruptcy, with limited legal access conditions attached to this procedure.[667] Debtors may apply to their local courts, and since 2002 there has been no requirement for a mandatory court hearing in every case, meaning that bankruptcy can now potentially be a one-day process.[668] It appears, however, that in some parts of the country debtors face delays of up to three months between first court contact and the making of a bankruptcy order.[669] Legislation enacted in 2013 provides for the removal of the court from what will become an administrative debtor petition procedure.[670] While legal access conditions are not onerous, there is a substantial financial obstacle to debtor access, however, in the form of a requirement to pay a deposit and fees amounting to approximately £700 (as discussed in Chapter 4). Once in bankruptcy, a debtor is provided with wide-ranging and comparatively generous debt relief, with automatic discharge taking place within 12 months to release her from her debts (except for the small number of excluded debts).[671] There are counterweights to this debt relief however. Debtors can be (and approximately 20% are[672]) made subject to an Income Payments Order or Undertaking, requiring repayments to creditors for a period of up to three years.[673] All of the debtor's property (except for specified exempt property,[674] which includes approved pension funds[675]) is liquidated for the benefit of creditors.[676] A debtor's discharge may be suspended where the debtor fails to comply with the duty of cooperation under the bankruptcy legislation[677] (although suspensions occurred in only 2.5% to

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664 Insolvency Act, 1986, c. 45, §262A (U.K.)

665 Insolvency Service, Withdrawal of Plans to Introduce Simplified IVAs and Authorised Persons - Question and Answers (Nov. 2008), http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/policychange/foum2007/plenarymeeting.htm.

666 Insolvency Service, Consultation on IVA Regime (Insolvency Service 2007).

667 However, see Insolvency Act, 1986, c. 45, §§266(3), 273-4 (U.K.).

668 *See e.g.* Walters & Smith (2010), 192.

669 INSOLVENCY SERVICE, CONSULTATION: REFORMING DEBTOR PETITION BANKRUPTCY AND EARLY DISCHARGE FROM BANKRUPTCY 10 (Insolvency Service 2009).

670 Enterprise and Regulatory Reform Act 2013 §71, Sched. 18–9; *inserting* Insolvency Act 1986 §§263H–263O, 398A, and making consequential amendments. *See also* INSOLVENCY SERVICE, REFORM OF THE PROCESS TO APPLY FOR BANKRUPTCY AND COMPULSORY WINDING UP (Insolvency Service 2011).

671 Insolvency Act, 1986, c. 45, §§279-281 (U.K.). Discharge does not release the debtor from any fraudulently incurred debt or from any criminal fine.

672 INSOLVENCY SERVICE, OFFICIAL STATISTICS TABLE 2B: BANKRUPTCY ORDERS RESULTING IN AN INCOME PAYMENTS ORDER OR AGREEMENT, 2003-2012, http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201311/table2b.pdf.

673 Insolvency Act, 1986, c. 45, §§310-310A (U.K.)

674 Insolvency Act, 1986, c. 45, §§283(2), 308(U.K.).

675 Welfare Reform and Pensions Act, 1999, c. 30, §11 (U.K.). The protection of assets exempt from liquidation also includes a car necessary to the debtor in her employment: Insolvency Act 1986, §283(2).

676 Insolvency Act, 1986, c. 45, §§306, 322-332 (U.K.)

677 Insolvency Act, 1986, c. 45, §§279(3)-(4), 333 (U.K.)

4% of cases from 2005-6 to 2012-13).[678] Reforms introduced in 2002 removed many of the restrictions that previously applied automatically to all debtors entering bankruptcy, and instead established a system of Bankruptcy Restrictions Orders and Undertakings (BROs and BRUs) to sanction only debtors found to have acted irresponsibly or dishonestly (see Chapter 6).[679] Again the number of cases in which such sanctions are imposed is small, amounting to approximately 1.5% to 3% of cases from 2005 to 2012.[680] In addition, a range of bankruptcy offences apply to debtors in bankruptcy, covering for example the concealment of property, borrowing without revealing the debtor's status as a bankrupt, and the making of false statements.[681]

The final personal insolvency procedure available under English law is the Debt Relief Order (DRO), which came into effect in 2009.[682] Under this "no income, no assets" administrative procedure, insolvent debtors whose income, assets and obligations fall below certain thresholds[683] are eligible to apply to the Official Receiver (a public official responsible for administering bankruptcy cases) through an approved intermediary (a designated debt counselling agency) to enter the procedure.[684] A debtor may not apply however if she has availed of the DRO procedure in the previous six years.[685] Additional conditions based on the debtor's conduct also guard access, and so debtors are excluded if they have entered an undervalued transaction or given a preference to a creditor before applying for a DRO.[686] Once in the procedure, the debtor is protected from enforcement for a period of 12 months, at which point she is released from her obligations unless the discharge is suspended or DRO rescinded due to the debtor's lack of cooperation or specified misconduct.[687] A range of offences and Debt Relief Restrictions Orders similar to those applicable to debtors in bankruptcy exist to police further the debtor's conduct and to prevent abuse.[688]

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678 See e.g. INSOLVENCY SERVICE, THE INSOLVENCY SERVICE ANNUAL REPORT AND ACCOUNTS 2005-6 TO 2011-12; INSOLVENCY SERVICE, OFFICIAL STATISTICS PERFORMANCE ANNEX, http://www.bis.gov.uk/insolvency/About-us/our-performance-statistics

679 Insolvency Act, 1986, c. 45, §§281A, 426A and Sch. 4A (U.K.). See also INSOLVENCY SERVICE, DTI (2000), 1; FLETCHER (2009), 372 et seq.

680 INSOLVENCY SERVICE ANNUAL REPORTS, 2005-6 TO 2011-12.

681 Insolvency Act, 1986, §§350-360 (U.K.).

682 Tribunals, Courts and Enforcement Act, 2007, c. 15, §108 (U.K.), inserting Insolvency Act, 1986, c. 45, §251A-251X (U.K). *See also* THE INSOLVENCY SERVICE, RELIEF FOR THE INDEBTED - AN ALTERNATIVE TO BANKRUPTCY (The Insolvency Service 2005); INSOLVENCY SERVICE, A CHOICE OF PATHS: BETTER OPTIONS TO MANAGE OVER-INDEBTEDNESS AND MULTIPLE DEBT (Department of Constitutional Affairs 2004).

683 At present, for entry to the procedure, a debtor's debts must not exceed £15,000; her assets may not exceed £300 in value, and her monthly surplus income may not exceed £50: Insolvency Act 1986, Sched. 4ZA (6)–(8); Insolvency Proceedings (Monetary Limits) Order 1986/1996.

684 Insolvency Act, 1986, c. 45, §§251A-251B (U.K).

685 Insolvency Act, 1986, c. 45, §251B, Sch. 4ZA, ¶ 5 (U.K).

686 Insolvency Act, 1986, c. 45, Sch. 4ZA, ¶ 9-10 (U.K).

687 Insolvency Act, 1986, c. 45, §§251G-I, 251K-N, 251J (U.K).

688 Insolvency Act, 1986, c. 45, §§251O-T, Sch. 4ZB (U.K).

(IV) Ireland

Contemporary Irish personal insolvency law is so outdated and rarely used[689] that it can be said, at least until later in 2013, that Ireland effectively has no consumer insolvency law.[690] Irish bankruptcy proceedings involve several hearings in the Irish High Court (Ireland's second most senior court), meaning expensive monetary costs in terms of legal fees (no legal aid is available), and significant reputational costs due to the high-profile public nature of the proceedings. In addition, the debtor must provide a deposit of €650 and hold assets capable of raising €1900.[691] Even those few debtors who could meet these access conditions are discouraged from entering bankruptcy due to the lack of debt relief offered. The only real benefit afforded to debtors is protection from individual enforcement efforts of creditors.[692] The debtor must wait a period of 12 years to be automatically discharged from bankruptcy, and while a conditional discharge is in theory available after five years, the conditions attached - including the payment in full of all costs of the proceedings and all priority (including tax) debts - mean that it is almost impossible to obtain.[693] In addition, Irish law is also severe in its automatic imposition of stringent restrictions and disqualifications on all bankrupts, without any enquiry into their culpability.[694] An alternative to petitioning for bankruptcy for Irish debtors had been to avail of a statutory scheme of arrangement procedure.[695] This procedure was very rarely used (with only two arrangements in 2012),[696] however, as it suffers from similar flaws to that of bankruptcy, in that it is an extremely costly, procedurally complicated and onerous procedure. Legislation passed in 2013 ended the application of this procedure.[697]

Irish law has been reformed in the context of severe economic crisis and the crystallisation of heavy household borrowing into an over-indebtedness epidemic.[698] The Personal Insolvency Act 2012[699] amends the bankruptcy procedure while also establishing three new procedures which are largely administrative, albeit subject to judicial oversight. The primary emphasis is on the negotiation of consensual repayment arrangements between debtor and creditors and the

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[689] There were only 35 bankruptcies in 2012: COURTS SERVICE, COURTS SERVICE ANNUAL REPORT 2012, 44 (Courts Service of Ireland 2013).

[690] Spooner (2012A), 245–7; LAW REFORM COMMISSION (2009), ¶ 3.143 et seq (2009).

[691] See Bankruptcy Act, 1988 (Act No. 27/1988), §15 (Ir.); Rules of the Superior Courts, 1986 (S.I. No. 15/1986), ord. 76 r. 29(1) (Ir.).

[692] Bankruptcy Act, 1988 (Act No. 27/1988), §136 (Ir.)

[693] Bankruptcy Act, 1988 (Act No. 27/1988), §85 (Ir.). *See also* Spooner (2012), 252–3.

[694] *Id.*, 254–56.

[695] LAW REFORM COMMISSION (2009), ¶ 3.156–3.158.

[696] COURTS SERVICE (2013), 44.

[697] Bankruptcy Act 1988 §86A (1988), *inserted by* Courts and Civil Law (Miscellaneous Provisions) Act 2013, §35.

[698] Spooner (2012A), 294–6; Spooner (2012B).

[699] PERSONAL INSOLVENCY ACT 2012 (NO. 44/2012) (IRL.). For commencement dates of various parts of the Act, see also Personal Insolvency Act 2012 (Commencement) (No. 2) Order 2013 (S.I. No. 63 of 2013); Personal Insolvency Act 2012 (Commencement) (No. 3) Order 2013 (S.I. No. 285 of 2013).

avoidance of bankruptcy, rather than the embracing of a more liberal debt discharge.[700] Under the Debt Settlement Arrangement (DSA) procedure, a debtor who satisfies a qualified insolvency test may, via a statutorily qualified personal insolvency practitioner, negotiate a repayment arrangement with her unsecured creditors under court protection.[701] If 65% in value of creditors agree to the debtor's proposal, it comes into effect as a Debt Settlement Arrangement on court approval,[702] with the repayment terms to be decided by the parties, subject to certain statutory mandatory terms.[703] Repayment levels must afford the debtor a reasonable standard of living (taking into account statutory guidelines issued by the Insolvency Service of Ireland),[704] and repayment plans can last for no longer than six years, at the end of which the debtor's remaining obligations are discharged. Priority creditors and secured creditors are to be protected, while at least procedural, if not substantive, protection is afforded to the debtor's home through requirements (see sections 69 and 104 of the Act) that a personal insolvency practitioner will prepare an arrangement on such terms as will not require a debtor to leave her residence, insofar as reasonably practicable. The debtor is under a duty to cooperate with the process and act in good faith throughout, on pain of criminal sanction or termination of the arrangement.[705] The Personal Insolvency Arrangement (PIA) procedure is largely similar, subject to the following differences. Access conditions are more onerous (for example, debtors applying must show six months' cooperation with creditors in respect of rescheduled mortgage loans[706]); while the 65% creditor approval must include the support of over 50% of unsecured creditors and over 50% of secured creditors.[707] Most importantly, the PIA procedure allows for both secured and unsecured debt to be renegotiated, but only where the requisite creditor consent is forthcoming. Secured creditors are protected further by provisions allowing any principal write-downs to be "clawed back" should the property in question be sold at a higher value any time within a twenty year period.[708] While all non-excluded unsecured debts are discharged on completion of a repayment plan enduring for a maximum of seven years, secured debts are only discharged to the extent specified in the arrangement.[709]

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[700] PERSONAL INSOLVENCY ACT 2012, Long Title.
[701] *Id.* §§54–88.
[702] *Id.* §§73(6), 78–9.
[703] *Id.* §§67–69.
[704] Insolvency Service of Ireland, Reasonable Living Expenses Guidelines (Jun. 2013), http://www.isi.gov.ie/en/ISI/Pages/Reasonable_living_expenses.
[705] Personal Insolvency Act 2012, §§81, 83, 87, 126–30.
[706] In effect, this means that debtors must comply with duties under the Central Bank of Ireland's *Code of Conduct on Mortgage Arrears*: http://www.centralbank.ie/publicinformation/Documents/2013%20CCMA.pdf. For a discussion of the interaction of this Code with Irish personal insolvency procedures, see my submission to the Central Bank's Review of the Code, which can be found at: http://academia.edu/3255708/Submission_to_the_Central_Bank_of_Ireland_Review_of_the_Code_of_Conduct_on_Mortgage_Arrears
[707] Personal Insolvency Act 2012, §§91, 111.
[708] *Id.* §103.
[709] *Id.* §§99, 125.

The third new procedure introduced by the legislation is a "no income, no assets" procedure known as the Debt Relief Notice (DRN), which is similar to the English DRO procedure, apart from certain key points which limit the extent of debt relief offered. Access is controlled by a qualified insolvency test and certain debtor conduct requirements as well as income, asset and debt thresholds.[710] The waiting period for discharge is fixed at three years, rather than the one year period under the English DRO procedure.[711] The procedure is largely administrative (albeit subject to court supervision), with the debtor to apply for a DRN to the newly established Insolvency Service of Ireland, via an approved intermediary (most likely a debt counsellor). Duties of good faith and cooperation apply to the debtor throughout, with the postponement or denial of discharge serving as sanctions.[712]

Finally, provisions of the Irish legislation yet to be commenced amend the Bankruptcy Act 1988, liberalising the regime by reducing the waiting period for automatic discharge from twelve to three years;[713] and by increasing property exemption levels (including providing new protection of the debtor's pension).[714] Despite these measures, the system remains quite onerous and oriented around debt collection rather than debt relief, however. Archaic doctrines of "fraudulent" preferences and "acts of bankruptcy"[715] persist, while the wide range of restrictions and sanctions imposed on debtors remain, despite their questionable compatibility with human rights standards.[716] New provisions can require debtors to make repayments to creditors for up to five years (even after discharge), meaning that a debtor potentially could be making repayments up to eight years after first petitioning for bankruptcy.[717] The length of the pre-bankruptcy period during which a debtor's conduct may be investigated is extended from one year to three.[718] Finally, not only does the new legislation fail to remedy the problems with accessing bankruptcy procedures under the current law,[719] it in fact creates new obstacles to access. Before applying for bankruptcy, debtors first must make "reasonable efforts" to negotiate a rescheduling agreement with creditors by first applying for a Debt Settlement Arrangement or Personal Insolvency Arrangement where possible.[720] While these reforms represent a clear advancement, they continue to leave Irish personal insolvency law behind its European counterparts in the

[710] *Id.* §§26, 34, 46.

[711] *Id.* §34.

[712] *Id.* §§34, 36, 43, 44.

[713] *Id.* §157. The waiting period for discharge can be extended to up to eight years in the event of the debtor's lack of cooperation, however.

[714] *Id.* §§150–51.

[715] This persistence of the "acts of bankruptcy" doctrine occurs despite its condemnation as "medieval" as long ago as 1938: Israel Treiman, *Acts of Bankruptcy*, 52 HARV. LAW REV. 189 (1938).

[716] The European Court of Human Right's has condemned similar provisions of Italian law: Lourdo v Italy, Application No. 32190/96 (European Court of Human Rights 2003); *Campagnano v Italy*, (2009) 48 European Human Rights Review 43.

[717] Personal Insolvency Act 2012, §157.

[718] *Id.* §§151–54, 158.

[719] Although one access condition requiring the debtor to make assets worth at least €1,900 available to creditors has been removed: *Id.* §148.

[720] *Id.* §§145–47.

extent to which it has embraced the modern “fresh start” policy of debt relief. This is surprising, given the comparatively high levels of household over-indebtedness in Ireland.

(V) A Framework for Comparison

In order to summarise graphically my descriptions of the surveyed laws’ key features, I have prepared a simple framework of comparison which places each law on a scale based on the extent to which it is oriented towards the two ideal-types of personal insolvency law’s debt collection and debt relief objectives discussed in Chapter 2. This simple ranking system identifies key features of each law (based on a survey of recommendations, reports and articles[721]), and assigns to each feature a score from 1 to 5 (where 1 represents a legislative provision following closely the debt relief function of personal insolvency, and 5 representing a provision based purely on the debt collection function). By combining and averaging these scores for each procedure, and in turn for each national law, this simple approach allows me to represent in a graphical form the detailed comparison I have presented above of these laws (Figure 3), while also tracking how the descriptions have changed over time (Figure 4).[722]

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[721] WORLD BANK (2013); Council of Europe (2007); HULS (2004); INSOL INTERNATIONAL (2001); REIFNER ET AL., (2003); EUROPEAN COMMISSION, ENTERPRISE DIRECTORATE GENERAL, BEST PROJECT ON RESTRUCTURING, BANKRUPTCY AND A FRESH START - FINAL REPORT OF THE EXPERT GROUP (2003); LAW REFORM COMMISSION (2009); Jason J. Kilborn, *Expert Recommendations and the Evolution of European Best Practices for the Treatment of Overindebtedness, 1984-2010*, *available at SSRN:* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1663108 (2010); Adrian Walters, Donna McKenzie Skene, *Consuming Passions: Benchmarking Consumer Bankruptcy Law Systems*, in Paul J. Omar (ed.), INSOLVENCY LAW: ISSUES, THEMES AND PERSPECTIVES (2008).

[722] For studies adopting more sophisticated quantitative methods of analysis in comparative personal insolvency law, *see e.g*. John Armour & Douglas Cumming, *Bankruptcy Law and Entrepreneurship*, 10 AM. LAW ECON. REV. 303 (2008); John Armour, *Personal Insolvency Law and the Demand for Venture Capital*, 5 EUR. BUS. ORGAN. LAW REV. 87 (2004).

DEBT COLLECTION

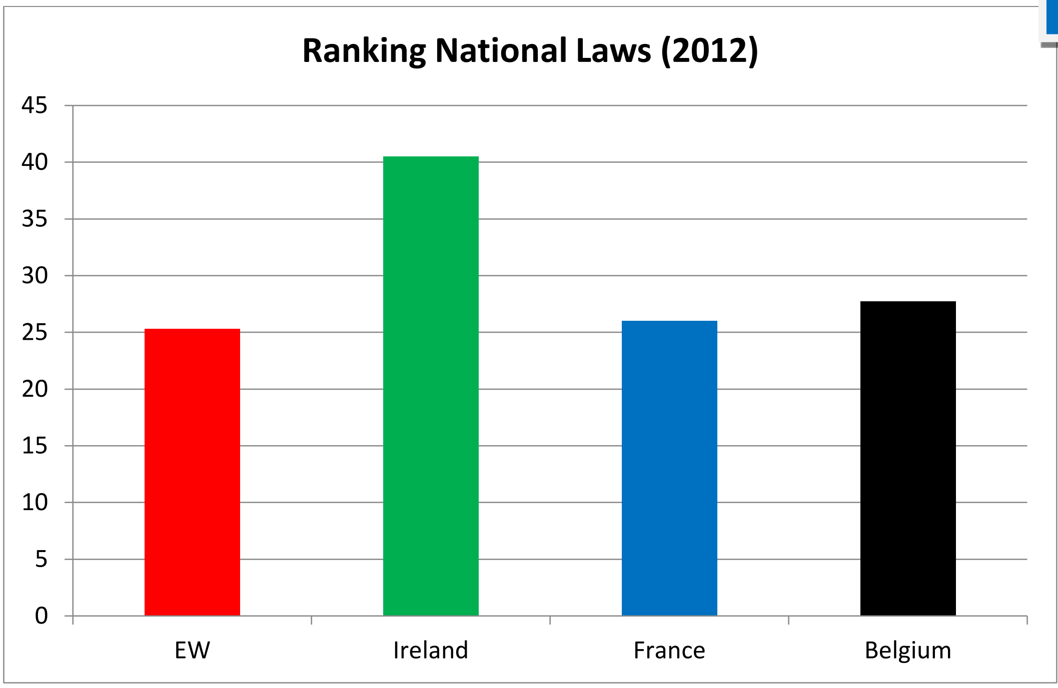

Figure 3: Ranking Consumer Insolvency Laws based on "creditor protection" or "debt relief" ideal-types, 2012 (averaged aggregate of all national procedures)

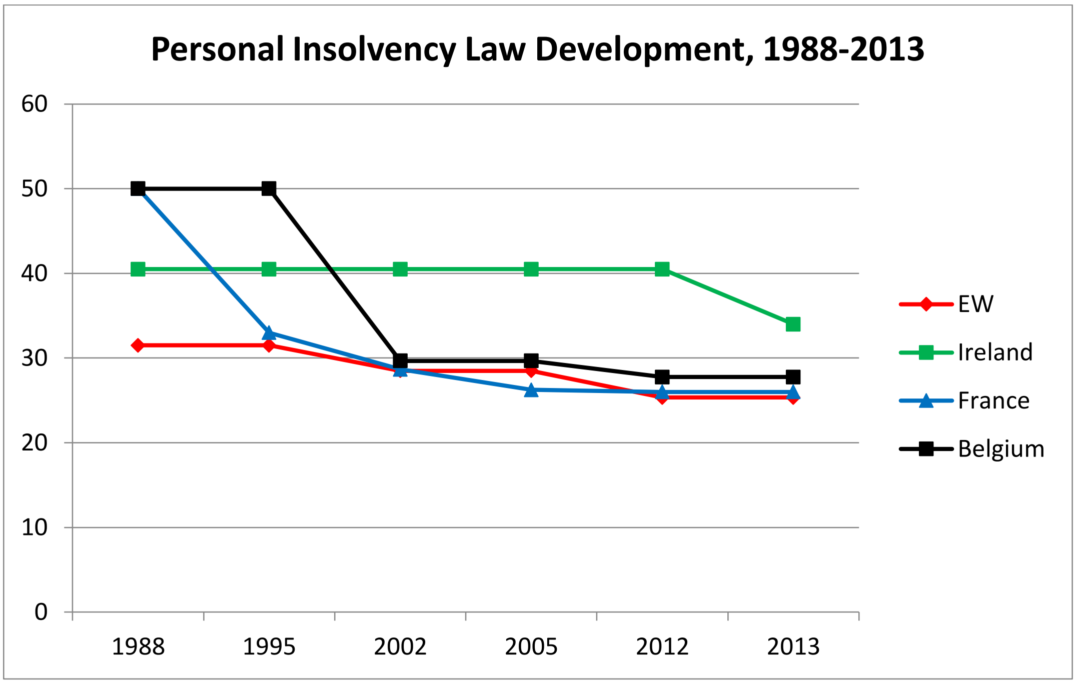

Figure 4: Ranking the extent of Debt Relief Provided by Consumer Insolvency Laws over time, 1988-2013 (averaged aggregate of all national procedures)

DEBT RELIEF

3.3 Potential Explanations of Differences in National Personal Insolvency Laws

Building on the above analysis, I now consider potential explanations for the differences in national laws advanced in comparative consumer insolvency literature.

A. Legal Traditions and the Common Law vs. Civil Law Divide

I address first the argument that common law and civil law legal systems exhibit fundamentally different philosophies in the area of personal insolvency. Early comparative consumer insolvency literature widely assumes a philosophical divide in relation to consumer insolvency between "civil law" or "Continental" jurisdictions of Europe, and "Anglo-Saxon", "Anglo-American", "Commonwealth" or "common law" jurisdictions.[723] Common law jurisdictions are seen as having long provided debt discharge to over-indebted consumers via the "fresh start" policy, while civil law countries either excluded consumers from debt relief entirely, or (from the late 1980s onwards) provided debt discharge only on the debtor's completion of a long repayment plan.[724]

The account of national laws described above shows clearly that divergences in the selected national laws do not arise along the common law vs. civil law axis, however. Firstly, the categories of common law and civil law countries cannot be considered as forming monolithic blocks.[725] This is obvious in respect of the chasm of contrast between Irish and English law, which has even led to a (limited) recent practice of insolvency-motivated migration or "bankruptcy tourism" between the two jurisdictions.[726] Even if the divergences between the civilian laws of France and Belgium are less obvious, key differences exist in the respective institutional frameworks (administrative v judicial), extent of discharge provided, and openness of policymakers to choosing (rather than being mandated by a court) to grant debt relief free from the "price" of a corresponding debt repayment plan.

Secondly, the reluctance to depart from the principle of sanctity of contract said to be typical of civil law can also be seen in the common law jurisdictions examined.[727] Commentators have said

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723 ZIEGEL (2003), 9.

724 *See further e.g.* Niemi-Kiesilainen (1999); Johanna Niemi-Kiesiläinen, *Collective or Individual? Constructions of Debtors and Creditors in Consumer Bankruptcy*, in RAMSAY ET AL. (2003), 41.

725 *See e.g.* Ramsay (2012C), 429.

726 *See e.g.* Walters & Smith (2010); Paulus (2012). For some high profile recent examples, *see IBRC v Quinn*; O'Donnell v Governor and Company of the Bank of Ireland, [2012] EWHC 3749 (Ch).

727 See text to fn606 above.

that sanctity of contract is a principle of "foundational importance" in the French legal system,[728] as evidenced by the attribution of the force of law to contractual bargains by the French Civil Code.[729] It must be remembered, however, that contractual bargains also hold supra-legal status as protected property rights in the common law jurisdictions of Ireland[730] and England,[731] as well as throughout Europe under the European Convention on Human Rights.[732] The principle of sanctity of contract is valued highly in common law systems also, which is particularly evident in English and Irish *consumer* insolvency policy. The IVA negotiated repayment plan procedure has developed into a core consumer remedy in England and Wales, overtaking the rapid discharge procedure of bankruptcy as the most widely used personal insolvency procedure.[733] It has also been chosen by policymakers as the default consumer insolvency procedure.[734] Irish law until 2013 exhibited a very traditional conception of the sanctity of contract in its onerous bankruptcy law, while even the new law is firmly oriented around consensual renegotiations between debtors and creditors, adhering to contractual principles even more than civilian jurisdictions. Unlike in France and Belgium, neither the English nor Irish arrangement procedures allow an authority to "cram-down" a repayment plan against creditor wishes, leaving expensive bankruptcy procedures as the only solution for debtors whose proposals are rejected. Furthermore, even in bankruptcy increasingly large portions of English debtors must make payments to creditors for three years under Income Payment Orders,[735] while the new Irish bankruptcy procedure will also allow for debtor repayments for up to five years. Therefore at least in *consumer* insolvency policy (and with the exception of "no income, no assets" cases) common law systems, in line with their Francophone counterparts,[736] are oriented around contractual principles and the consensual renegotiation of an over-indebted individual's obligations. Indeed, given the attitudes of policymakers once they began to consider independently the problem of consumer insolvency, one can conclude that had 19th Century legislation not removed the distinction between traders and non-traders, policymakers in the UK "would have been very reluctant to introduce a bankruptcy discharge for consumers."[737] If this realisation is not enough to refute the idea of

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728 Gunnar Trumbull, *Consumer Protection in French and British Credit Markets*, Joint Center for Housing Studies, Harvard University UUC08-17, 23, available at: http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/ucc08-17_trumbull.pdf. (2008).

729 Code Civil, art. 1134. *See* Ramsay (2012B), 233.

730 *See e.g.* LAW REFORM COMMISSION (2009), ¶¶ 2.16–2.22.

731 *See e.g.* Wilson v First County Trust Ltd. (No. 2), [2003] 3 WLR 568.

732 Contractual rights are protected as possessions under ECHR Protocol 1, art. 1. The European Court has held that personal insolvency laws involving the discharge of debt constitute an interference with this protection, and so must serve a legitimate public interest objective in a proportionate manner: *Back v Finland*, [2005] BPIR 1.

733 *See* Figure 7: Personal Insolvency Filing Rates in England and Wales, 1985-2012.

734 Insolvency Service (2007A).

735 In 2005-6, 9,605 Income Payment Orders/Agreements were issued during a year in which there were 53,386 new bankruptcies: INSOLVENCY SERVICE (2006B) at 5,13. By 2011-12, 10,158 orders and agreements were obtained at a time of just 38,469 new bankruptcies: INSOLVENCY SERVICE, THE INSOLVENCY SERVICE ANNUAL REPORTS AND ACCOUNTS 2011-12 15–6 (2012).

736 Niemi (2012) at 446.

737 Ramsay (2012B), 248.

fundamentally opposed ideologies of consumer insolvency in common law and civil law jurisdictions, the belated introduction of extensive debt discharge in France and Belgium in 2004 and 2005 respectively adds further evidence.

Finally, the above discussion highlights a fundamental tension in a claim that the alleged "Anglo-Saxon" fresh start policy is more "market-based" than a civilian approach adhering closely to the principle of sanctity of contract.[738] As discussed in Chapter 2, the neo-classical economic ideal of the market is based on freedom of contract and the principle that private exchange is the most efficient means of allocating resources.[739] From this perspective, statutorily imposed debt discharge is a State intervention in the operation of the market;[740] while the consensual renegotiation of obligations or "market-based debt resolution"[741] is a facilitative process which better protects market expectations (see further Chapter 4's exposition of the "personal insolvency marketplace" under English law). This realisation illustrates the inconsistency in a view that Anglo-Saxon systems are both more open to debt discharge and more market-oriented than a category of civilian jurisdictions.

B. National Social Welfare Systems

The second potential explanation for divergences in national laws is based on the varying levels of social protection in different countries. Literature identifies national social welfare systems as influencing national personal insolvency laws in two ways.[742] Firstly, where a country provides a comparatively low level of social protection, its citizens must incur greater risk of over-indebtedness by borrowing to pay for necessities such as education, healthcare and housing. This creates a need for open access to extensive debt relief. Secondly, limited social protection means that households are more vulnerable to the ill effects of unexpected "life accidents" such as job loss, ill health or relationship breakdown.[743] This increases the likelihood of such events causing households to fall into over-indebtedness and so necessitates generous debt relief laws.[744] This theory has an initial appeal when applied to the USA, a country traditionally considered as having both a limited social safety net and a famously generous consumer bankruptcy law. For example, the restrictive coverage of the public healthcare system in the USA

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[738] Ziegel (2006), 303–4.

[739] *See e.g.* TREBILCOCK (1997), 15–16; STEARNS & ZYWICKI (2009), 18–19.

[740] *See e.g.* L.H. White (1977).

[741] IMF (2012), 14.

[742] *See e.g.* Efrat (2002), 96–98; Landry III & Yarbrough (2008). The link between these factors is questioned by Professor Kilborn: Kilborn (2007).

[743] Feibelman (2005), 130–31.

[744] *See e.g.* SULLIVAN ET AL. (2000), 14–22; LAW REFORM COMMISSION (2009), ¶¶ 1.30–1.36.

has been identified as a significant contributing factor to the high bankruptcy rates in that country.[745]

To test these hypotheses, I examine general social spending and public healthcare expenditure rates in the countries surveyed using comparative data published by the Organisation for Economic Cooperation and Development (OECD). I also compare national income replacement rates, as the "income shock" of unemployment plays a significant role in causing over-indebtedness.[746] If theories linking social safety nets to consumer bankruptcy laws are accurate, one would expect levels of social protection in each country to rank inversely to the ranking of each country on the "debt relief" to "debt collection" scale, with the countries offering the least extensive debt relief (e.g. Ireland) compensating by providing generous social protection (See Figure 5).

"Social Safety Net" Variable	**Expected Results, given a National Personal Insolvency Law's Relative Proximity to the "Creditor Protection" or "Debt Relief" Perspectives**	
	"Debt Collection"	**"Debt Relief"**
Social spending as % GDP	High	Low
Social health spending as % GDP	High	Low
Private sector healthcare expenditure as % total healthcare expenditure	Low	High
Social spending per capita	High	Low
Public health spending per capita	High	Low
Income Replacement Rates	High	Low

Figure 5: Results predicted by the theory that extensive debt relief laws are used to compensate for narrow social safety nets.

The available data on social welfare provision in these countries do not serve to explain differences in national laws, however, as presented in my results in Figure 32-Figure 34 (see Appendix). No pattern of correspondence appears between the relative rankings of national laws along the debt relief to creditor protection scale and the relative levels of social protection in the countries surveyed. This brief analysis questions the link between national social welfare systems and consumer insolvency laws, and suggests that researchers and policymakers should be cautious in assuming that consumer insolvency laws are necessarily influenced by domestic social welfare systems. Pending more extensive analysis, I argue that this evidence therefore supports Professor Kilborn's critique of the theory that the development of consumer insolvency laws in Europe arose as a response to a shrinking of the Welfare State.[747]

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[745] SULLIVAN ET AL. (2000), 155–56.
[746] See e.g. *Id.*, 14–18.
[747] Kilborn (2007).

C.Cultural Factors

Another explanation advanced for the differences in consumer insolvency laws points to contrasting national attitudes or “deeply ingrained cultural differences on the moral imperative of debt incurrence and repayment”.[748] This view argues that debt laws are products of cultural preferences, prevailing religious attitudes,[749] or even illustrative of a “national psyche”.[750] The presence of this view in academic community also seems to be mirrored among policymakers. For example, a 2006 report of the French Advisory Council on the Financial Sector opined that the “Anglo-Saxon world” is very different to “Continental Europe” in the area of attitudes relating to credit.[751] Similarly, UK politicians opposed to the liberalisation of personal insolvency law were sceptical “of politicians... going to the USA, seeing something that looks superficially good but is embedded in a particular nation’s business culture and believing that it can be transposed into a different culture and country.”[752] In discussing its personal insolvency law reforms, the Irish Government again cited the aim of seeking “to uphold Ireland’s strong payment culture”.[753] If national laws are linked to cultural attitudes, this could pose an obstacle to law reform and the dissemination of international best practices. It is important therefore to understand whether this is truly the case, or rather whether such pleas to cultural traditions are merely rhetorical tools used by opponents of reforms which would bring the law in line with conditions of the modern consumer credit society.

I compare available data from pan-European Eurobarometer public opinion surveys in order to search for links between diverging consumer insolvency laws and national attitudes concerning insolvency and indebtedness, credit, risk and poverty. These surveys cover a wide range of topics, and so I selected only certain questions and responses which literature suggests are relevant to this discussion. Firstly, in Figure 36 I present evidence of national attitudes towards insolvent companies or persons,[754] while Figure 37 presents evidence of opinions regarding the risks and responsibilities of credit use (see Appendix).[755] Secondly, following links drawn in

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[748] Tabb (2005), 778. *See also* ZIEGEL (2003), 8.

[749] MARIA MANUEL LEITAO MARQUES & CATARINA FRADE, *Searching for an Over-indebtedness Regulatory System for Portugal and the European Union*, *in* RAMSAY ET AL. (2003) 121, 122.

[750] Karen Gross, *Demonizing Debtors*, 37 OSGOODE HALL LAW J. 263, 269 (1999).

[751] ANDRÉ BABEAU & COMITÉ CONSULTATIF DU SECTEUR FINANCIER, LA DEMANDE DES MÉNAGES EN MATIÈRE DE CRÉDIT À LA CONSOMMATION ET LES AJUSTEMENTS NÉCESSAIRES POUR Y RÉPONDRE 44 (2006). *See also* Ramsay (2010), 729; Alain Chatriot, *Protéger Le Consommateur Contre Lui-même*, nº 91 VINGTIÈME SIÈCLE REV. HIST. 95, 95 (2006).

[752] HC Deb 14 April 2002 Standing Committee B col. 633, per Mr. Ken Purchase M.P. (U.K.)

[753] GOVERNMENT OF IRELAND, *Ireland: Memorandum of Economic and Financial Policies*, *in* European Commission, ECONOMIC ADJUSTMENT PROGRAMME FOR IRELAND, WINTER 2011 REV. 54, ¶ 13 (2011).

[754] EOS GALLUP EUROPE, FLASH EUROBAROMETER 134: ENTREPRENEURSHIP (2002). See also EUROPEAN COMMISSION, ENTERPRISE DG (2003), 24, Annex III.

[755] EUROPEAN UNION RESEARCH GROUP EEIG & EUROPEAN COMMISSION, DG HEALTH AND CONSUMER PROTECTION DIRECTORATE-GENERAL, PUBLIC OPINION IN EUROPE: FINANCIAL SERVICES REPORT B 99, 109, 112 (Standard Eurobarometer 205, Wave 60.2, 2004).

literature and policy documents regarding the relevance of these factors to personal insolvency law,[756] I present evidence of national attitudes regarding entrepreneurship (Figure 38)[757] and issues of wealth redistribution[758] and policies for the alleviation of poverty and inequality (Figure 39).[759] The following figure shows the outcomes predicted by the hypothesis linking national cultural attitudes to personal insolvency laws.

Cultural/Attitudinal Issue	**"Debt Collection" Perspective**	**"Debt Relief" Perspective**
Opinion on insolvent debtors (Figure 36)	Little support for "second chance" for debtors, risk-taking etc.	Support for "second chance" for debtors; risk-taking etc.
Risks of Credit (Figure 37)	Credit, if used correctly and responsibly by debtors, is useful and not dangerous.	Credit holds risks for borrowers and over-indebtedness is unavoidable; creditors should share responsibility.
Entrepreneurship and Risk-Taking (Figure 38)	Suspicious of entrepreneurship, business risk and "second chance" culture.	Favourable view of entrepreneurs, business risk, "second chance" culture.
Wealth Redistribution (Figure 39)	Less concerned by poverty, inequality. Opposed to wealth redistribution, high taxation. Favours individual responsibility	Concerned by poverty, inequality Supports wealth redistribution, high taxation. Favours collective/Government responsibility

Figure 6: Relationship between national personal insolvency law and cultural attitudes

The available data on public opinion in these countries, as presented in Figure 36Figure 39, shows that the aforementioned expectations are not realised. Firstly, the rankings of national public opinion responses in respect of the issues surveyed show no clear pattern of correspondence with the relative orientations of national laws towards debt collection or debt relief. Secondly, the survey responses reveal inconsistent and sometimes ambiguous national attitudes. This ambivalence relating to issues of personal financial circumstances suggests that differences of opinion prevail on this complex subject even within national boundaries (as my discussion in Part 3.4 below illustrates). Thus one cannot confidently argue that a law which veers towards the "debt collection" end of the scale represents a clear national attitude of suspicion and condemnation regarding credit and debt, as evidenced by Ireland's draconian

[756] Armour & Cumming, (2008); INSOLVENCY SERVICE; DT I (2001).

[757] EUROBAROMETER (2002); THE GALLUP ORGANISATION, ENTREPRENEURSHIP IN THE EU AND BEYOND: ANALYTICAL REPORT (European Commission, DG Enterprise and Industry 2009).

[758] Gross (1999), 270.

[759] TNS OPINION AND SOCIAL, EUROBAROMETER POVERTY AND SOCIAL EXCLUSION REPORT 41, 115, 210 (European Commission, DG Employment, Social Affairs and Equal Opportunities 2010).

bankruptcy law and world-leading levels of household indebtedness.[760] The cultural dimensions of this issue are more nuanced than such a simplistic perspective would allow,[761] and national laws combine competing ideas and attitudes to the extent that it may be unrealistic to assume that a law reflects a national cultural attitude which is "pro" or "anti" credit or bankruptcy. Furthermore, policies enacted in legislation may influence public attitudes, adding complexity to the interaction of these factors.

As well as the fact that "cross-border cultural explanations are inherently nebulous",[762] a further limitation of this analysis is that the survey data I have used was not collected specifically to answer the questions I pose. Furthermore, some of the survey questions and responses lead to ambiguous implications regarding public opinion on consumer insolvency laws. For example, a view that credit is more useful than dangerous could suggest either a generous bankruptcy law which incentivises debtors to borrow despite the risk involved, or a severe bankruptcy law due to policymakers' failure to recognise any danger in credit use. Similarly, a public generally favouring wealth redistribution may prefer to do so through taxation and the social safety net rather than through private law mechanisms such as bankruptcy. Finally, the surveys represent a snapshot of national opinion at a particular temporal point, and do not illustrate changes in national attitudes over time; an insight which would be useful in examining forces behind policy change. Despite these limitations, my analysis nonetheless certainly suggests that commentators must exercise caution when assuming that national laws reflect national cultural preferences and so supports the tentative scepticism of the link between national consumer insolvency laws and national culture evident in the writings of Professor Ramsay.[763]

D. Conclusions on Explanations for Differences in National Laws

To gain a greater perspective of the extent to which personal insolvency laws are the product of inherently national factors, a more comprehensive study could encompass other variables. For example, in my previous work I have found that differences in national procedures for the enforcement of judgment debts, and national debt counselling systems, appear to have little influence on the divergences between Irish and English bankruptcy law.[764] While outside the scope of this current project, it would be useful to expand such analysis to France and Belgium. Another factor appropriate for analysis is the respective consumer credit regulatory systems in each jurisdiction, given the links drawn in literature between the deregulation of consumer credit

760 OECD (2009), 20.
761 Braucher (2006), 334–41.
762 RONALD J. MANN, *Making Sense of Nation-Level Bankruptcy Filing Rates*, *in* NIEMI ET AL. (EDS.) (2009) 225, at 238.
763 Ramsay (2007), 265–73; Ramsay (2012B), 248.
764 Spooner (2012A), 262–9.

markets, rising over-indebtedness and the introduction or reform of consumer insolvency laws.[765] Limitations on interest rates on consumer loans have been cited as being particularly influential to rates of over-indebtedness;[766] but yet an examination of regulatory approaches in the studied countries does not suggest an influence over consumer insolvency law. While Ireland and England and Wales adopt very similar approaches to interest rate regulation, their personal insolvency laws contrast starkly.[767] French and Belgium consumer insolvency regimes diverge less, but the differences which exist appear to have no relation to interest rate regulatory regimes, which are similar in both regime design[768] and the permitted maximum interest rates (Figure 35, Appendix). A closer comparison of the consumer credit regulatory regimes of these jurisdictions would aid in confirming these initial observations.

At this point, however, I argue that there is sufficient evidence at least to suggest that policymakers and commentators should be slow to assume that national personal insolvency laws are necessarily the product of national structural factors or cultural idiosyncrasies, which could pose obstacles to law reform in response to changing socio-economic conditions.[769] To be clear, I do not dispute that general issues of household over-indebtedness in a society are influenced by a wide and complex range of structural and cultural factors.[770] I accept that personal insolvency laws are thus merely one part of a much wider constellation of legislation, policies, practices and attitudes relevant to over-indebtedness. My paper argues nonetheless that in the narrow field of personal insolvency legislation in the countries studied, the law may not correspond to relevant structural and cultural factors to the extent assumed among some commentators and policymakers. Opposition to law reform based on national legal traditions, structural institutions or cultural preferences may therefore need to be examined closely before being accepted at face value.

[765] Efrat (2002), 92–6.

[766] Ellis (1998); Dick & Lehnert (2010). These studies consider the effects of interest rate deregulation on the use of existing bankruptcy laws, rather than on law reform. Due to the extent to which increased over-indebtedness creates a demand for personal insolvency law reform, however, these works' argument remains relevant to the current discussion.

[767] Spooner (2012A), 260–2.

[768] In respect of French law, see Code de la Consommation, Art. L.313-3. See also I. Ramsay (2010) at 725; UDO REIFNER ET AL., STUDY ON INTEREST RATE RESTRICTIONS IN THE EU 66–67 (Institut für Finanzdienstleistungen e.V. (iff); Zentrum für Europäische Wirtschaftsforschung GmbH (ZEW, Mannheim) 2010). In respect of Belgian law, see Reifner et al *Id.*, 68–70.

[769] While consumer insolvency law may carry much more social significance than the law of civil procedure, one might appreciate in this context the sentiment behind the comment of Bingham LJ (as he then was) that "procedural idiosyncrasy is not (like national costume or regional cuisine) to be nurtured for its own sake..." Court of Appeal, England and Wales, Dresser UK Ltd and Others v Falcongate Freight Management Ltd. and Others, [1992] QB 502, 522 (1991).

[770] *See e.g.* Braucher (2006).

3.4 Political Development of National Consumer Insolvency Laws

I contend that a more insightful means of understanding the development of national personal insolvency laws is to consider the political processes behind law reforms. Personal insolvency law, unlike other aspects of private law in which judicial development has been more significant, is a "creation of statute", and so of politics, in all of the countries surveyed.[771] In this regard, concepts drawn from political science can assist in identifying forces that shaped consumer insolvency laws. This illustrates how legislation in this field is an outcome of circumstances, conflict and compromise, rather than an inevitable organic product of inherently national structural and cultural features. This means that while the fresh start policy may be a universally sound public policy direction in all the surveyed jurisdictions, political factors may obstruct the adoption of this policy.

A. Consumer Debt Relief and Political Ideology

While most areas of private law contain political content,[772] personal insolvency law raises particularly vivid considerations of ideology[773] which are likely to produce political discord.[774] In short, "debt is social dynamite and always has been."[775] First, Government "intervention" in market bargains via debt discharge raises eternal Left-Right debates regarding the respective roles of the State and the Market (and of personal and collective responsibility) in economic and social life.[776] Personal debt law has "historically registered, and been part of, conflict between wider class antagonisms";[777] and continues to raise politically divisive issues in its ability to distribute power and resources progressively between financially weakest debtors and the creditor class or financial elite.[778] Political conflict is also driven by questions of morality and

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[771] Elizabeth Warren, *Changing Politics of American Bankruptcy Reform, The*, 37 OSGOODE HALL L. J. 189, 189–90 (1999). For a consideration of the role court decisions have played in developing English law, however, see also Milman (2003).

[772] *See e.g.* Duncan Kennedy, *The Political Stakes in 'Merely Technical' Issues of Contract Law*, 10 EUR. REV. PRIV. LAW 7 (2002).

[773] On the difficulty of defining precisely the term "ideology", *see* Dickerson (2006), 1885–88. I use the term generally to refer to an outlook or set of assumptions and beliefs regarding the public interest which politicians and/or voters use to reach decisions in relation to political questions.

[774] *See e.g.* Gross (1999), 267.

[775] SULLIVAN ET AL. (1999), 334.

[776] *See e.g.* Atif Mian, Amir Sufi, Francesco Trebbi, *The Political Economy of the US Mortgage Default Crisis*, 100 AM. ECON. REV. 1967, 1969 (2010).

[777] Ramsay (1995), 177.

[778] *Id.*, 181. Some advocates of strict consumer bankruptcy laws oppose debt discharge due to their perception of it as "just another governmental benefit or bailout": Dickerson (2006), 1869.

individual responsibility.[779] Some fear that "the sky will fall"[780] and society will slide into moral ruin if the law allows departure from the unquestioningly accepted social axiom that debts should be repaid.[781] On the other hand, advocates of lenient debt relief equally present moral arguments founded on humanitarian justifications and the injustice of requiring households to suffer from exploitative lending practices.[782] Opponents of generous debt discharge hold an "ideological conviction that personal responsibility explains most financial misfortune",[783] and such attitudes create the potential for a "moral panic" condemning "irresponsible" borrowers.[784] This perspective remains unflinching even in the face of empirical evidence of the desperate financial circumstances of debtors in personal insolvency procedures, and of the role that factors external to debtors play in causing over-indebtedness.[785] While many of these debates have a long lineage, political conflict is even fiercer in contemporary times due to the centrality of money to modern life[786] and recent decades' "financialisation of society" (see Chapter 1).[787]

Examples of these ideological clashes emerge from multiple jurisdictions. It is undoubtedly true that policymakers in civil law jurisdictions were strongly concerned about the moral appropriateness of legislating for the discharge of consumer debt, and this is seen in political discussion of initial reforms which did not depart far from traditional ideas of sanctity of contract.[788] UK politicians opposed to granting generous debt relief for consumers as a by-product of business insolvency law reforms also cautioned against the dangers of providing consumers with an easy "escape clause from... responsibilities".[789] These political concerns appear to have been taken into account by the UK Insolvency Service, who cited arguments founded upon the sanctity of contract and the promotion of repayment morality when proposing the IVA repayment plan procedure over bankruptcy's rapid debt discharge as its preferred consumer debt remedy.[790] English politicians also raised redistributive concerns in debates during the 2000s, cautioning that more generous debt discharge legislation could transfer wealth from the morally upstanding regularly repaying borrowers to irresponsible defaulters, [791] or reduce the supply of credit to the economy.[792] Irish policymakers proposing 2012 legislative reforms similarly questioned why a borrower repaying his/her debts "should pay for the

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779 *See e.g.* Dickerson (2006), 1891–92.

780 Kenneth N. Klee, *Restructuring Individual Debts*, 71 AM. BANKRUPTCY LAW J. 431, 432 (1997); Lupica (2008), 604.

781 *See e.g.* GRAEBER (2012), 1–4.

782 Ramsay (1995), 190–91.

783 Warren (2004), 1509–10.

784 *See e.g.* Matthew Watson, *Headlong into the Polanyian Dilemma*, 11 BR. J. POLIT. INT. RELATIONS 422 (2009).

785 Howard (2000), 459. See the discussion of empirical studies on the causes of over-indebtedness in Chapter 1.

786 Gross (1999), 271–72.

787 GLOUKOVIEZOFF (2011), xiv–xv.

788 For examples of these points being raised in legislative discussions, see Kilborn (2004), 656; Kilborn (2006), 92.

789 See e.g. HC Deb 14 April 2002 Standing Committee B col. 632-3, per Mr. Mark Field M.P. and Mr. Ken Purchase M.P. (U.K.)

790 Insolvency Service (2007A), 44.

791 See e.g. HC Deb 14 April 2002 Standing Committee B col. 629, 644-5, per Mr. Simon Waterson M.P. (U.K.)

792 See e.g. HC Deb 14 April 2002 Standing Committee B col. 645, per Mr. Simon Waterson M.P. (U.K.)

indulgence of others and why he or she should bail them out."[793] These universal ideological conflicts inevitably raised by consumer insolvency law, which show little evidence of being based on national lines, illustrate the difficulty in achieving the political consensus required to introduce reforms in this field.

B. Public Opinion and Policy Salience

A second political factor particularly relevant to consumer insolvency law development is that of public opinion, which political scientists generally agree influences public policy.[794] The strength of such influence increases with the salience of an issue to the public, as politicians realise that decisions in relation to salient issues will be noted by the public and impact upon the electorate's view of decision-makers.[795] A "highly salient issue is one that affects a large number of people in a significant way",[796] and policymaking will be salient when it involves factors such as a threat to a necessity (e.g. environmental risks, fuel scarcities, etc.), a threat to standards of living (e.g. housing issues), or an affront to community values (e.g. moral issues such as pornography regulation).[797] In contrast, public opinion will be less influential in respect of technically complex issues, which raise "factual questions that cannot be answered by generalists or laypersons".[798] The timing of consumer insolvency law reform in various countries will vary with the salience of the issue of household over-indebtedness.

Household over-indebtedness lends itself to high salience, given the threat to living standards it represents, particularly where mortgage debt difficulties place homeownership at risk.[799] Its salience is heightened at particular times, such as when the "large distributional shifts [resulting from] a debt-induced financial crisis raise the stakes for everyone in the political process."[800] Political scientists have thus shown that US politicians have been very responsive to the prevalence of mortgage debt default among their constituents in recent years, for example.[801] The current mortgage debt crises of Ireland and Spain have spurred the mobilisation of interest groups advocating for law reforms to provide relief to over-indebted households and prevent home repossessions and forced evictions.[802] These ideas also seem to correspond to the

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[793] Dáil Éireann Debate 18 July 2012, Vol. 772 No. 2, per Minister Alan Shatter T.D. (Irl.).

[794] Paul Burstein, *The Impact of Public Opinion on Public Policy*, 56 POLIT. RES. Q. 29, 29 (2003).

[795] *Id.*, 30; Benjamin I. Page & Robert Y. Shapiro, *Effects of Public Opinion on Policy*, 77 AM. POLIT. SCI. REV. 175, 181–83 (1983).

[796] William T. Gormley, *Regulatory Issue Networks in a Federal System*, 18 POLITY 595, 598 (1986).

[797] *Id.*, 600–601.

[798] *Id.*, 598.

[799] *Id.*, 601.

[800] Mian et al. (2012), 6.

[801] Mian et al. (2010).

[802] For an Irish example, see the evidence presented to a Parliamentary hearing on personal insolvency legislation by advocacy group New Beginning, which was founded in response to Ireland's mortgage debt crisis: HOUSES OF THE OIREACHTAS, JOINT COMMITTEE ON JUSTICE, DEFENCE AND EQUALITY, REPORT ON HEARINGS IN RELATION TO THE SCHEME OF THE PERSONAL INSOLVENCY BILL

development of consumer insolvency law in European countries. The "explosion"[803] of European consumer insolvency laws such as that of France in the 1990s and 2000s coincided with a "trigger" [804] of new public interest in this traditionally technical area of law due to "facts on the ground" of a mass consumer over-indebtedness crisis.[805] In France, new forays into consumer lending by banks in the 1980s in the context of banking deregulation, technological advances and Government support of mortgage credit led to a surge of consumer lending, which crystallised into mass household over-indebtedness once macro-economic conditions deteriorated and a credit crunch ensued.[806] As the over-indebtedness problem grew, public opinion led to political consensus in favour of policy intervention.[807] This cycle is now repeating itself in the introduction or reform of consumer insolvency laws in several European countries during the Great Recession;[808] particularly in the Irish case in which the collapse of the "Celtic Tiger" economy has led to a public demand for reform of the country's long-ignored archaic personal insolvency law.[809] When European laws were being developed in the late 1980s and 1990s, consumer insolvency was not an issue of public salience in Ireland as levels of consumer credit remained very low, due to Irish banks' reliance on deposits to fund lending.[810] During the 2000s, unprecedented access of Irish banks to international wholesale markets, Government policies supporting mortgage borrowing,[811] sub-standard internal risk management systems and inadequate "light-touch" regulation[812] led to a flood of credit into the Irish economy (and soaring home prices).[813] The onset of the economic crisis and credit crunch[814] in 2008 crystallised world-leading levels of household leveraging[815] into over-indebtedness, as soaring unemployment and

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(Houses of the Oireachtas 2012), 12. For reports of mobilisation against evictions in Spain, *see e.g.* Fiona Govan, *Spanish homeowners rally together to fight evictions by banks*, THE TELEGRAPH, May 2, 2012, http://www.telegraph.co.uk/finance/financialcrisis/9241430/Spanish-homeowners-rally-together-to-fight-evictions-by-banks.html (accessed October 18 2013).

803 Kent Anderson, *The Explosive Global Growth of Personal Insolvency and the Concomitant Birth of the Study of Comparative Consumer Bankruptcy,* 42 OSGOODE HALL LAW J. 661 (2004).

804 TERENCE C. HALLIDAY & BRUCE G. CARRUTHERS, BANKRUPT: GLOBAL LAWMAKING AND SYSTEMATIC FINANCIAL CRISIS 368–69 (Stanford University Press 2009).

805 *See e.g.* Ziegel (2006); Kilborn (2009) at 309–10.

806 *See e.g.* DANIELLE SALOMON, *Quand Une Politique Publique En Cache Une Autre...*, *in* Gardaz (1997), 13; DANIELLE SALOMON, *Changing Performance Standards in the French Banking System*, *in* Sigrid Quack, Glenn Morgan, Richard Whitley (eds.), NATIONAL CAPITALISM, GLOBAL COMPETITION AND ECONOMIC PERFORMANCE 159 (John Benjamins Publishing Company 2000); Gunnar Trumbull, Harvard Business School Working Paper 11-047 (2010), *http://hbswk.hbs.edu/item/6579.html*; Ramsay (2012B); Jason J Kilborn (2004).

807 Salomon (1997), 14.

808 For other examples, see the new Estonian consumer insolvency law: INTERNATIONAL MONETARY FUND, REPUBLIC OF ESTONIA: STAFF REPORT FOR THE 2010 ARTICLE IV CONSULTATION 15 (IMF 2011). Information on the new Greek law can be found at: http://www.flac.ie/getinvolved/campaigns/current/21st-century-law-needed-for-21st-century-overindebtedness/.

809 Spooner (2012), 288–90.

810 Kelly (2009), 4–6, 17.

811 OECD (2009), 20; REGLING & WATSON (2010), 6.

812 REGLING & WATSON (2010), 28–29; HONOHAN (2010).

813 Kelly (2009), 9–12.

814 On how reduced supply of consumer credit pushes households into debt difficulty, *see* Robert M Lawless (2007).

815 OECD (2009), 20.

plummeting household wealth levels led to widespread repayment difficulties.[816] As a mortgage debt crisis developed in the country (with over 20% and counting of residential mortgages in serious difficulty by mid-2013), household over-indebtedness transformed from a "poor person's problem"[817] to a very salient issue for large numbers of voters,[818] causing the Irish Government to overhaul personal insolvency law.[819]

The concept of policy salience can perhaps also provide insight as to why policymakers in England and Wales consistently focused on business debtors when reforming personal insolvency law, and long neglected to introduce consumer-specific insolvency procedures, even as consumers became the primary users of these procedures in the 2000s. The existence of a business bankruptcy law which incidentally offered relatively forgiving debt relief to consumers meant that solutions already existed at times of economic recession in the 1990s and 2000s. This potentially prevented build-up of demand for debt relief among households, meaning that consumer insolvency law reform did not gain the salience in England and Wales that it held in other countries.

C. Interest Group Influence

While the idea of policy salience helps to explain how consumer insolvency law is added to policymakers' agendas in various jurisdictions, theories of interest group influence offer important insight into the varying content of substantive laws.[820] Personal insolvency legislation often represents "a compromise between organised creditor groups and the countervailing pressures of populism and other pro-debtor movements."[821] Under classic principles of collective action, in competitions between interest groups (all of whom are assumed to maximise their utility[822]), the groups most likely to be successful in influencing policy are those consisting of a small number of politically organised actors with harmonious, cohesive and intense interests.[823] The banking industry fits this description very closely.[824] The financial sector also holds influence over Government due to its increasingly large share of economic output in a society which has

[816] Spooner (2012), 283–6.

[817] Stuart Stamp, *The Impact of Debt Advice as a Response to Financial Difficulties in Ireland*, 11 Soc. Policy Soc. 93, 93–94, 101 (2012).

[818] 2010 Eurobarometer survey data show an above-average sense of vulnerability to debt difficulties among the Irish population, despite contemporaneous dismal economic conditions throughout the EU: Eurobarometer (2010), 39–46.

[819] The latest Irish mortgage arrears statistics can be found at: Central Bank of Ireland, *Residential Mortgage Arrears and Repossession Statistics: Q2 2013*, Central Bank of Ireland (Aug. 23, 2013), http://www.centralbank.ie/polstats/stats/mortgagearrears/Documents/2013q2_ie_mortgage_arrears_statistics.pdf.

[820] *See e.g.* George J. Stigler, *The Theory of Economic Regulation*, 2 Bell J. Econ. Manag. Sci. 3 (1971); M. Olson, The Logic of Collective Action (Harvard University Press, Revised ed. 1974).

[821] Skeel (2001), 16.

[822] Eric A. Posner, *Political Economy of the Bankruptcy Reform Act of 1978, The*, 96 Mich. Law Rev. 47, 59–60 (1997). The preferences of debtors, creditors and practitioners are to seek legislation which transfers wealth to them, while politicians seek re-election and administrative officials seek prestige and workloads appropriate to their resources.

[823] Olson (1974); Mian et al. (2012), 21.

[824] Carruthers & Halliday (1998), 72.

become progressively more "financialised" in recent decades.[825] Governments may be disposed towards adopting policies favourable to this sector as a means of attracting and keeping financial industry business,[826] and of encouraging banking sector cooperation in Government economic policies.[827] Financial institutions also hold the resources both to contribute to political funding and to influence public and political opinion via public relations campaigns.[828]

Government agencies and departments form another category of interested parties which plays an important role in law reform,[829] particularly in relation to highly salient but also complex issues when these actors must provide "a solution that is both technically and politically defensible."[830] In contrast, consumers generally form a large, diffuse group with diverging interests, and an important division exists between financially troubled consumers who favour lenient consumer insolvency laws and the financially stable consumers who oppose such laws due to fears that they will lead to more expensive credit.[831] Furthermore, large numbers of the population are investors in debt via pension funds and similar investment vehicles (or via taxpayer bail-outs of banks), meaning the interests of these households may conflict with those of over-indebted households.[832] Future debtors are an unidentifiable group,[833] and factors such as the unforeseen nature of future debt difficulty and discomfort or stigma of identifying oneself with a debtor class dissuade individuals from mobilising to promote debt relief laws.[834] Debtor influence has been notably absent even in corporate insolvency policymaking,[835] while in the personal insolvency context the obvious paucity of resources among the over-indebted population makes lobbying efforts practically impossible.[836] Therefore while debtors represent "a large enough electoral constituency to obtain policy recognition", they are not likely to be "a sufficiently cohesive force" to influence the detail of personal insolvency legislation in their favour.[837]

This is especially the case since consumer insolvency law is complex as well as salient. Once politicians have taken the initial decision to reform consumer insolvency law, the influence of public opinion (via politicians' actions) is likely to decline, as most citizens may be unable to

[825] Deutschmann (2011), 353–54.

[826] For the example of Irish Government policies aiming to attract financial sector investment, *see* NIAMH HARDIMAN, *Introduction: Profiling Irish Governance*, *in* Niamh Hardiman (ed.), IRISH GOVERNANCE IN CRISIS 1, 3, 12 (Manchester University Press 2012).

[827] For the example of the French Central Bank's and Finance Ministry's alignment with the financial sector in the process of the enactment of France's first consumer insolvency law, *see* Salomon (1997), 22.

[828] Dickerson (2006), 1877–78.

[829] Spooner (2012A), 278.

[830] Gormley (1986), 605.

[831] Spooner (2012A), 281–1; SKEEL (2001), 243; Posner (1997), 54.

[832] Sullivan (2012), 51.

[833] Dickerson (2006), 1878.

[834] Spooner (2012A), 282.

[835] TERENCE C. HALLIDAY ET AL., *Missing Debtors: National Lawmaking and Global Norm-Making of Corporate Bankruptcy Regimes*, *in* BRUBAKER ET AL (EDS.) (2012), 236.

[836] Dickerson (2006), 1879.

[837] Mian et al. (2012), 20.

ascertain whether the law's details correspond to their interests.[838] Consequently, the complexity involved means that the detail of the law is to be developed by bureaucratic actors (Government department and Central Bank officials, etc.), industry representatives and professionals.[839] Thus in relation to the high salience, high complexity issue of consumer insolvency law, "[a]lthough citizens help to define the problem, experts are normally allowed to find a solution."[840]

In this regard studies have identified interest group politics as playing an important role in shaping both corporate and consumer insolvency law reform in several jurisdictions such as the US, UK, France and Canada.[841] A classic example of the influence of interest groups in the consumer bankruptcy law-making process lies in the enactment of the pro-creditor *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* (BAPCPA) in the US.[842] Examples can be drawn from European countries also, and a useful focus for identifying such influence is the extent to which consumer insolvency laws have been oriented around voluntary rescheduling and repayment plans, rather than more interventionist legislatively imposed debt discharge (see Chapter 4). Danielle Salomon's account of the development of France's first consumer insolvency law in 1989 shows how the rejection of an immediate debt discharge procedure represented a triumph of the aligned strong interests of the consumer credit industry, the Banque de France and the Ministries of Finance and Justice over less influential actors. The Secretary of State for Consumers, with the support of consumer associations and local politicians, had in fact proposed to expand the *faillite civile* immediate debt discharge procedure existing in the region of Alsace-Moselle to the remainder of the country.[843] This proposal was rejected in favour of a law built around consensual debt rescheduling, however, when the credit industry won the sympathy of a Ministry of Finance and a *Banque de France* in need of financial sector cooperation to support economic policy, and a Ministry of Justice opposed to the increased burden on the courts system represented by a new debt discharge procedure.

Similarly, the increased primacy of the IVA repayment plan procedure as a consumer debt remedy under English law should be understood in the context of the extent to which use of this

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[838] Burstein (2003), 30.

[839] The public salience of the overall policy area may limit the influence of industry groups, or at least cause politicians seeking re-election or bureaucratic actors who wish to preserve accountability to disguise transfers to such groups: *see* Gormley (1986), 613–14; E.A. Posner (1997), 59. More generally on the roles of these actors in law reform, *see* Spooner (2012A), 276–283; Posner (1997), 56–8; CARRUTHERS, HALLIDAY (1998), 72–6.

[840] Gormley (1986), 618.

[841] CARRUTHERS, HALLIDAY (1998); Iain Ramsay, *Functionalism and Political Economy in the Comparative Study of Consumer Insolvency: An Unfinished Story from England and Wales*, 7 JOURNAL OF THEORETICAL INQUIRIES IN LAW 625 (2006); Ramsay (2012B); SKEEL (2001).

[842] Many commentators "view the BAPCPA story as a classic example of vote-buying by the consumer credit industry": Dickerson (2006), 1875. The lobbying which led to the 2005 legislation has been dramatically described by one commentator as "one of the most shameful chapters in the history of American business": GERALD THAIN, *Consumers*, *in* Peter Cane, Mark Tushnet (eds.), THE OXFORD HANDBOOK OF LEGAL STUDIES 536, 555 (Oxford University Press 2005). *See also* Mary Jo Wiggins (2006), 349; Warren (1999); Elizabeth Warren, *The Market for Data*, 2002 WIS. L. REV. 1 (2002).

[843] Salomon (1997), 18.

procedure, rather than bankruptcy, favours the interests of creditors, practitioners and Government departments/agencies. Consumer association campaigns for the removal of financial obstacles to accessing the alternative bankruptcy procedure (see Chapter 4)[844] have been rejected on the grounds that Government did not wish to impose the costs of bankruptcy on creditors,[845] a position supportive of credit industry preferences. The perennial competition between departments for limited public resources,[846] has led to opposition to proposed consumer-specific insolvency reforms[847] by the Ministry of Justice,[848] due to concerns of increased burdens on the courts system.[849] Similarly, the Insolvency Service's preferences would not involve the burden of administering thousands more bankruptcy cases.[850] Furthermore, a large industry of private sector actors has developed consumer debt solutions from the IVA procedure (originally designed for business debtors), thus creating an interest group with a considerable stake in preserving the legal status quo.[851] As most debtors in the bankruptcy procedure are unrepresented (and so unproductive of practitioner income), practitioners have little incentive to advocate consumer-friendly bankruptcy.[852] The smothering, on the grounds of "adverse implications for creditor groups" of the Insolvency Service's proposed reforms to re-balance the IVA procedure in favour of debtors in the mid-2000s provides further evidence of interest group influence.[853] The alternative policy compromise, the publication of a voluntary protocol by IVA providers and creditors,[854] allowed these groups to pursue their interests directly as they replaced the legislature as drafters of consumer IVA rules. Creditors were particularly protected by the freedom retained even to depart from their own rules due to the voluntary nature of the Protocol.[855] At this time of economic prosperity, consumer debt issues were less salient than they were to become during the Great Recession;[856] and it can be assumed that this factor facilitated extensive interest group influence.[857]

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[844] *See* Edwards (2012). See also the arguments in the House of Commons debates on the Enterprise Bill 2001: HC Deb 10 April 2002 vol 383 col. 69 (Ms. Joan Walley M.P.); HC Deb 14 April 2002 Standing Committee B col. 643, 691 (Mr Simon Waterson M.P.) (U.K.)

[845] The Government also indicated that it did "not believe that general taxation should pay for people to enter bankruptcy when they may have taken on debts irresponsibly"; a statement which is dubious in that it runs contrary to one of the 2002 legislation's chief aims of removing the presumption of irresponsibility associated with bankruptcy. *See* HC Deb 14 April 2002 Standing Committee B col. 693, per Ms Melanie Johnson M.P. (U.K.)

[846] Carruthers, Halliday (1998), 143; Ramsay (2012B), 246.

[847] Cork (1982) ¶¶272–73. See, however, Courts and Legal Services Act 1990 (1990 c. 41), §13 (U.K.).

[848] This Ministry also has been known at various times as the Lord Chancellor's Department and the Department for Constitutional Affairs.

[849] Ramsay (2012B), 246.

[850] *Id.*, 239.

[851] Walters (2009), 8, 23–9; Ramsay (2012B), 246–7.

[852] Skeel (2001), 82.

[853] Insolvency Service (2008A). See further discussion at text to notes 1047-1062 below.

[854] IVA Protocol: Straightforward Consumer Individual Voluntary Arrangement (2008).

[855] Mond and Another v MBNA Europe Bank Ltd. [2010] EWHC 1710 (Ch); [2010] BPIR 1167.

[856] As one simple illustration of the varying salience of these topics, a Nexis UK search of major mentions of the term "individual voluntary arrangement" in UK newspapers produces 473 hits for the six year period from January 1st 2007 to December 31st 2012, but only 224 hits for the six years from January 1st 2001 to December 31st 2006. This is relevant as

I have illustrated in my previous work how interest group analysis helps to explain how Irish personal insolvency law remained in its archaic state until 2013, despite growing levels of consumer indebtedness.[858] I plan a full study of the political economy of the Irish Personal Insolvency Act 2012 as a future research project. For now, however, it is relevant to note that a project initially presented by politicians to the public as having its foundations in humanitarian aims of debt relief,[859] subsequently became oriented around creditor protection during the technical process of drafting complex legislation.[860] Positions adopted by politicians in high-profile public hearings made proposals which would have provided more extensive debt relief;[861] but these were not incorporated into the final version of the legislation as prepared by the Department of Justice. The legislation also departs from the detailed technical recommendations of the Law Reform Commission of Ireland[862] in respect of certain notable features, with the proposals moving closer to a debt collection paradigm as the legislative process developed.[863] This is consistent with the theoretical predictions and evidence from other jurisdictions above, as an initial pro-debtor orientation of reform proposals seems to fade as the substantive content of the law is developed. Finally, a unique aspect of the Irish position to be considered is the country's participation in a financial assistance programme of the "Troika" of the European Union, European Central Bank (ECB) and International Monetary Fund (IMF). The interests of these institutions in ensuring the prudential solidity of Ireland's previously Government bailed-out banks point towards their support for the law's debt collection orientation.[864]

Pending further analysis, I note that the high salience, high complexity nature of this issue in Ireland leads to theoretical predictions that creditor groups, but particularly practitioners and Government officials, would act as chief influencers of the legislation.[865] In this context an important further consideration is that there will necessarily be a lack of expertise present in a jurisdiction such as Ireland which is introducing a consumer insolvency law for the first time. This, firstly, may open a space for interest groups to exert greater influence than may otherwise be the

media interest is a reasonable proxy for issue salience: Matthew Eshbaugh-Soha, *The Conditioning Effects of Policy Salience and Complexity on American Political Institutions*, 34 POLICY STUD. J. 223, 230 (2006); Gormley (1986), 604.

857 Gormley (1986), 605–6.

858 Spooner (2012A), 276–83.

859 See the quotes from Irish politicians cited at *Id.*, 290.

860 On the influence of "selective social and economic pressures" on Irish policy responses to social need, *see* Hardiman (2012), 5.

861 Houses of the Oireachtas (2012).

862 LAW REFORM COMMISSION (2009); LAW REFORM COMMISSION (2010B); LAW REFORM COMMISSION OF IRELAND, REPORT (2010A).

863 See the comparison of Government proposals with the Commission's recommendations in Spooner (2012B).

864 This position is illustrated by the European Commission's support of legislation provisions aimed at "tightening eligibility criteria, reducing the scope for opportunistic borrower behaviour, and protecting secured creditors' rights", as well as its call for "additional safeguards against moral hazard". *See* EUROPEAN COMMISSION, DG ECONOMIC AND FINANCIAL AFFAIRS, EUROPEAN ECONOMY: ECONOMIC ADJUSTMENT PROGRAMME FOR IRELAND, SUMMER 2012 REVIEW 28–29 (Occasional Papers 115, European Commission 2012); ECB (2012).

865 Gormley (1986), 605.

case in relation to high salience legislation.[866] Secondly, since consumer law generally, and consumer insolvency law in particular, involve a departure from the private ordering paradigms which inform areas of banking and commercial law, it is unlikely that professionals drawn from such areas will advance the "fresh start" policy of debt relief to as great an extent as would be required to achieve the policy's public interest objectives. Therefore these factors may limit the degree to which new consumer insolvency laws embrace the fresh start policy as recommended by Chapter 2's normative discussion. In conclusion, examinations of interest group influence on consumer debt relief laws in France[867] and Ireland, as well as recent studies in the USA (albeit not directly related to consumer insolvency law),[868] tend in common to illustrate how reforms designed to meet an urgent public demand and to achieve important public policy objectives can be compromised considerably by interest group influence.[869]

D. The Interplay of Ideology, Public Opinion, and Interest Groups

In political science literature, public opinion and interest group power are traditionally treated as competing influencers of policy;[870] while a similar contrast is drawn between political ideology and interest group influence.[871] Alternative perspectives, however, reveal further layers of complexity in the political process of consumer insolvency reform by illustrating the interrelationship of these factors.[872] In a first interaction, the above discussion already shows how public opinion and interest group influence vary based on conditions of policy salience and complexity. Furthermore, public opinion may be susceptible to manipulation by interest group influence through information dissemination campaigns,[873] and mechanisms such as the "rhetorical capture" of policymakers.[874] A classic example may be found in the US consumer credit industry media campaign to the effect that generous debt relief under US bankruptcy law costs every American family $400 per year in raised interest rates, which was subsequently comprehensively debunked.[875] Additionally, given that public opinion is less influential in relation

[866] For the role academic experts and non-profit consumer bankruptcy lawyers in opposing interest group arguments in US policy debates, *see* Dickerson (2006), 1870–71; Skeel (2001), 191–97.
[867] Salomon (1997), 31–37.
[868] Despite the fact that in the context of a debt overhang following a financial crisis, "[n]ormative analyses suggest that this problem necessitates debtor relief", commentators have identified creditor opposition as causing US mortgage debt relief legislation to be a "miserable failure": Mian et al. (2012), 6–10, 18–19.
[869] *Id.*, 23.
[870] Burstein (2003), 30.
[871] See e.g. Daniel A. Farber, Law and Public Choice 23–33 (University of Chicago Press 1991).
[872] *See e.g.* Dickerson (2006), 1900–1905.
[873] Page & Shapiro (1983), 189; Burstein (2003), 30–31.
[874] Margaret Jane Radin, *Rhetorical Capture*, 54 Ariz. Law Rev. 457 (2012).
[875] Warren (2002), 13–20.

to complex technical issues,[876] interest groups may also aim to hide the political interests at stake in personal insolvency law "behind a cloak of technical expertise"[877] in order to dissuade the public from forming strong opinions on an issue.[878] Personal insolvency law's reputation as a technical, legalistic subject[879] has allowed the substantive content of the law to be shaped considerably by interest groups – primarily practitioners historically, but increasingly creditors.[880] A further factor is the interrelationship between interest group influence and political ideology, as seemingly ideological debates may be based upon self-serving arguments fed into the political discourse by interest groups.[881] Creditors in most jurisdictions are frequently heard to argue that the law must uphold moral values of promise-keeping and send "responsible messages" regarding credit use.[882] As just one example, English politicians in parliamentary debates on the Enterprise Act 2002 openly cited from credit industry briefings in arguing that the extension of more generous debt relief to consumers would reduce the stigma of bankruptcy and "undermine the concept of personal responsibility."[883] Concerns regarding the redistributive effects of consumer debt relief are also raised by creditors in most jurisdictions, as they argue typically that the "sky will fall" and "credit will dry up"[884] if consumer debt relief laws are liberalised.[885] A particularly egregious example emanates from the same 2002 UK debates, as a credit-industry briefed politician cited the abovementioned "$400 per year" myth.[886] This line of argument regarding the consequences of debt relief can be particularly effective, as it raises Government concerns that debt discharge might reduce the supply of credit necessary for economic growth (see Chapter 1).[887] It also constitutes a "winning strategy"[888] to divide the already weak consumer credit lobby between defaulting debtors and non-defaulting borrowers.[889] It also disguises credit industry interests by presenting creditors as benign guardians of their customers' interests in low cost credit, rather than self-interested parties advancing their preferences. Finally, political science literature also recognises a relationship between policy issue salience and political ideology. For example, ideological positions may tend to become particularly polarised following

[876] Burstein (2003), 30.
[877] Gormley (1986), 608.
[878] CARRUTHERS & HALLIDAY (1998), 74.
[879] SKEEL (2001), 141; CARRUTHERS & HALLIDAY (1998), 74; Ramsay (2012B), 240–42.
[880] *See e.g.* Warren (1999).
[881] Edward L. Rubin, *Rational Choice and Rat Choice*, 80 CHIC.-KENT LAW REV. 1091, 1117 (2005).
[882] *See e.g.* comments of the Irish Banking Federation, Oireachtas Joint Committee on Justice, Defence and Equality Debate, Personal Insolvency Bill: Discussion (15 February 2012), per Ms. Eimer O'Rourke, available at: http://debates.oireachtas.ie/JUJ/2012/02/15/00003.asp and HOUSES OF THE OIREACHTAS (2012) at 28.
[883] HC Deb 14 April 2002 Standing Committee B col. 647, per Mr. Simon Waterson M.P. (U.K.).
[884] Lupica (2008), 604.
[885] For an example from contemporary Irish political debate, see Oireachtas Joint Committee on Justice, Defence and Equality Debate, Personal Insolvency Bill: Discussion (15 February 2012), per Ms. Eimer O'Rourke, available at: http://debates.oireachtas.ie/JUJ/2012/02/15/00003.asp and HOUSES OF THE OIREACHTAS (2012), 27.
[886] HC Deb 14 April 2002 Standing Committee B col. 645, per Mr. Simon Waterson M.P. (U.K.)
[887] Salomon (1997), 18.
[888] Sullivan (2012), 53.
[889] SKEEL (2001), 80–82.

a financial crisis, increasing political conflict and the difficulty of enacting reforms during such times.[890]

A feature of consumer insolvency policy is that when forming opinions policymakers, commentators and voters appear to rely on familiar narratives and stereotypical characterisations or constructions of debtors, rather than empirically informed viewpoints.[891] Narratives, myths and fictions allow people to perceive complex issues as more predictable, understandable and controllable than they actually are. Thus "master plots" based on "common knowledge" assumptions[892] and composed of conventional narratives and characters may inform policymaking by lending "a generic shape or outline to organise bewildering experience into an intelligible story."[893] Historical punitive bankruptcy laws viewed the debtor as a dishonest character,[894] while more modern policies view the debtor as a risk-taking economically productive entrepreneur,[895] or an unfortunate victim of external circumstances. Narratives formed around rising consumer bankruptcy rates lament the demise of a mythical "golden age of thrift"[896] and foresee the downfall of the bankruptcy system[897] in the increased presence of the character of the debt relief abuser.[898] The extent to which any narrative or characterisation becomes a guiding force in policymaking may be a function of factors such as political ideology, policy salience and interest group influence discussed above. Thus English reforms in 2002 based on the paradigm of the debtor entrepreneur, despite the fact that the majority of bankruptcy debtors were non-trading consumers, were influenced by political visions of building an enterprise-oriented economy.[899] French policymakers' much-criticised[900] reliance on the characterisation of

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890 Mian et al. (2012).

891 *See e.g.* Ramsay (2012C), 425–27.

892 PAUL ROCK, MAKING PEOPLE PAY 14 et seq. (Routledge & Kegan Paul Books, 1st Edition. ed. 1973).

893 SCOTT A. SANDAGE, BORN LOSERS 48–50 (Harvard University Press 2005).

894 The Budd Committee, the report of whom influenced the drafting of the Irish Bankruptcy Act 1988, based its recommendations for severe discharge conditions and debtor restrictions regime on the view that most bankrupts are dishonest and deserving of punishment, and that the community should be protected from them: MR. JUSTICE FREDERICK O. BUDD, BUDD REPORT ¶38.5.2 (Government of Ireland 1973).

895 For examples from English personal insolvency policy, see INSOLVENCY SERVICE (2000A); INSOLVENCY SERVICE; DTI (2001). See also the reference to this paradigm by the US Supreme Court in *Local Loan Co.*; and a wider discussion of the paradigm in US bankruptcy policy in Hallinan (1986), 56.

896 LENDOL CALDER, FINANCING THE AMERICAN DREAM 22–26 (Princeton University Press, New Ed ed. 2001).

897 Moss & Johnson (1999), 321.

898 Dickerson (2006), 1905. President George W. Bush justified the legislation in the following terms:

> "In recent years, too many people have abused the bankruptcy laws. They've walked away from debts even when they had the ability to repay them. This has made credit less affordable and less accessible, especially for low-income workers who already face financial obstacles."

"President Signs Bankruptcy Abuse Prevention, Consumer Protection Act", *The White House (President George W. Bush Archives)*, 20 April 2005, http://georgewbush-whitehouse.archives.gov/news/releases/2005/04/20050420-5.html.

899 Adrian Walters, *Personal Insolvency Law After the Enterprise Act*, 5 J. CORP. LAW STUD. 65, 65–67 (2005).

900 Ramsay (2012C), 426; Ramsay (2012B), 225.

the “passive” [901] debtor victim may be attributable more to interest group influence than empirical reality, as creditor and debtor interest groups supported this characterisation which absolved both of responsibility for over-indebtedness.[902] Furthermore, the widespread presence of “bankruptcy abusers” in the US bankruptcy system was cast into serious doubt by empirical evidence, but yet was accepted by policymakers in the presence of interest group arguments to this effect.[903]

3.5 Conclusions on the Politics of Consumer Insolvency Law Reform

As part of my wider argument in favour of re-orienting personal insolvency law towards its debt relief objective, in this Chapter I dispute perspectives which argue that this area of the law is intrinsically part of a “national psyche” [904] and which object to the fresh start policy as being incompatible with national legal traditions, social structures and cultural preferences. I argue instead that my study suggests consumer insolvency laws are the outcome of complex political conflicts and compromises. Pleas to national traditions and values may simply be instrumental arguments furthering ideological or interest group preferences, particularly where they call for the preservation of the status quo and the rejection of “foreign” models for reform. While credit-industry briefed UK politicians opposing consumer bankruptcy reform appealed to the distinct nature of national cultural values,[905] French consumer associations saw no cultural objections to relying on examples of lenient consumer insolvency systems of the USA and Canada.[906] My paper is not an argument for widespread legal transplants, however. Where evidence exists of legitimate national idiosyncrasies and social/cultural/institutional differences, then these factors should be taken into account in policymaking.[907] I suggest nonetheless that commentators and policymakers should not hastily accept in an unquestioning manner the alluring argument that national personal insolvency laws are inevitably the product of distinctly national factors.

The political complexity of consumer insolvency appears to be very influential n shaping national laws, and leads to considerable difficulties in modernising the law to embrace the “fresh start” policy. Even where shifting public opinion leads legislators to accept the need to introduce

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901 *See e.g.* Vatin (1996), 107; PHILIPPE HOUILLON, AVIS SUE LE TITRE III (PROCÉDURE DE RÉTABLISSEMENT PERSONNEL) DU PROJET DE LOI (950) D’ORIENTATION ET DE PROGRAMMATION POUR LA VILLE ET LA RÉNOVATION URBAINE 10–12 (Assemblée nationale, Commission des lois constitutionnelles, de la législation et de l’administration générale de la République 2003); Ramsay (2012C), 425–26.

902 Ramsay (2012B), 225.

903 Dickerson (2006), 1870–71.

904 Gross (1999), 269.

905 HC Deb 14 April 2002 Standing Committee B col. 633, per Mr. Ken Purchase M.P. (U.K.)

906 Salomon (1997), 23.

907 My study in this chapter has focused on the laws of neighbouring countries sharing many similarities. I acknowledge that inherently national factors may explain differences in personal insolvency law to a greater extent if a more diverse selection of countries is examined.

consumer insolvency laws (e.g. in France and Ireland), political ideology and interest group influence have tended to dilute the reforms ultimately introduced, often compromising the new legislation's ability to achieve its objectives. This is true even in the distinguishable case of England and Wales, where the liberal debt discharge traditionally available to consumers can be partly explained by the fortuitous fact that business bankruptcy laws have been open to non-traders since the Bankruptcy Act of 1861. Incremental law reforms have been insulated from political controversy by their uncontroversial aims of supporting business enterprise, rather than the more contentious objective of relieving consumer debt. Politicians supporting business bankruptcy reform indeed have been uncomfortable in defending the independent merits of debt discharge for consumers, providing justifications for this institution's retention founded only in pragmatism and path dependency.[908] As Chapter 4 discusses, opposition to lenient bankruptcy discharge is most likely tempered by the fact that creditors and practitioners feel adequately protected by a system which allows them to direct debtors into procedures other than bankruptcy. In turn, when policymakers addressed consumer insolvency specifically, reform efforts have been less successful, as evidenced by the abandonment of Insolvency Service proposals for legislation to reform the IVA procedure for consumer debtors. The introduction of a "no income, no assets" procedure as an evidence-based response to a public interest need, at a time when consumer over-indebtedness was less salient in the mid-2000s, appears to run contrary to this assertion.[909] This reform, however, was perhaps facilitated by the lack of creditor and practitioner concerns of lost income due to the "can't pay" nature of the target group;[910] and the fact that the sharing of the administrative burden of the non-judicial procedure between the Insolvency Service and debt advice agencies (who were to be remunerated for their services) was compatible both with the interests of these parties and of the Ministry of Justice.

Consumer insolvency laws are therefore the product of a complex interaction of political factors, and a range of competing and interacting factors must align for reforms to be implemented. This perhaps provides the most convincing explanation of why European consumer insolvency laws have come to embody the fresh start policy neither to the extent seen in other legal systems such as the USA, nor to that suggested by the theoretical prescriptions of Chapter 2. In the following chapters, I illustrate that even when the political process has facilitated the adoption of legislation aligning more closely to the fresh start policy, as appears to be the case under English law at least in respect of the bankruptcy and DRO procedures, significant difficulties arise nonetheless in ensuring that such legislation is interpreted and applied consistently with the fresh start policy.

[908] See e.g. HL Deb 30 July 2002 vol 638 col. 824, per Lord Sainsbury of Turville.; HC Deb 14 April 2002 Standing Committee B col. 629, 644-5, per Mr. Simon Waterson M.P. (U.K.) On path dependence generally, *see* Paul Pierson, *Increasing Returns, Path Dependence, and the Study of Politics*, 94 AM. POLIT. SCI. REV. 251 (2000).

[909] INSOLVENCY SERVICE (2005A), citing DOMINY & KEMPSON (2003); KEMPSON & COLLARD (2004).

[910] DCA, INSOLVENCY SERVICE (2005).

CHAPTER 4: The Consumer Insolvency Marketplace

4.1 Introduction: The Competing Philosophies of Personal Insolvency Law

In the following Chapters, I argue that English personal insolvency law, not conforming to the position advocated in Chapter 2, has inadequately embraced the fresh start policy and insufficiently adjusted to the demands of the consumer credit society, instead remaining overly oriented around the commercial debt collection function which the law originally served. The tension between the competing goals of personal insolvency law is evident along a number of "fault lines" or contentious points of policy debate. This Chapter raises one such discussion, concerning the conditions of access to debt relief for consumers and in particular the question of whether debt relief should take the form of (voluntarily negotiated) repayment plans or statutorily mandated liquidation-and-discharge procedures. I argue that English policymakers, and particularly courts, have adopted a conceptualisation of personal insolvency as a marketplace, which is based on underlying ideas of individualistic self-interested rational behaviour and the assumption that optimal outcomes are produced via debtor and creditor choice as represented in market exchange.[911] While this approach may be appropriate to commercial insolvencies involving well advised and resourced business actors, it is inappropriate in the consumer insolvency context in which factors such as information asymmetries and behavioural biases, as well as a simple lack of resources, mean that debtors are unlikely to achieve bargaining outcomes which reflect their best interests. The consequences are failures in the personal insolvency "market", imposing externalities on third parties. This reality calls for legal intervention and a reorientation of the law towards the fresh start policy, and a departure from the goal of protecting market expectations and creditor returns which the debt collection perspective of the law serves.

Modern English personal insolvency law is the result of incremental reforms over many centuries of a law originally designed to serve as a coercive collective *debt collection* device for the enforcement of an insolvent *trader's commercial* obligations. As the debt relief objective has been added to a law designed to serve the aim of debt collection, there have developed "different

[911] *See e.g.* HOWELLS & WEATHERILL (2005), 8 et seq.; TREBILCOCK (1997), 15–17.

and perhaps competing philosophical bases for the one legal process”.[912] New rules, principles and ideas based upon the function of debt relief have been added to the law,[913] but “certain fundamental principles, and considerations of policy, remain unaltered by the transformations in law and procedure brought about by the Insolvency Act 1986, and by subsequent legislative reforms including those effected by the Insolvency Act 2000 and the Enterprise Act 2002.”[914] This has led to difficulty in applying the modern law, as the debt collection function is seen “as embodying an independent policy concern for creditor payment that must be ‘balanced’ against the ‘fresh start’ policy to determine the extent of particular… rights.”[915] Since the “legislation contains no hierarchical system of priorities”,[916] modern and historical principles of debt collection and debt relief jostle to attract the attention of judges seeking to interpret ambiguous legislative provisions. Policymakers too have at times lacked clarity as to the function of personal insolvency law in the credit system.[917]

This has led to insufficient recognition of the modern conditions of consumer insolvency and of the appropriateness of the fresh start policy as a regulatory response. Policymakers and particularly courts have been overly influenced by the law’s historical aim of facilitating debt collection, despite the fact that the vast majority of bankruptcies are initiated by (consumer) debtors rather than creditors, and large portions of this population have few or no assets available for liquidation and distribution to creditors (Figure 41-Figure 42, Appendix). Irrespective of the theoretical role of bankruptcy, in practice it serves the function of debt relief rather than debt collection. This is less so in the case of the IVA procedure which necessarily involves part repayment of creditors, but still under this procedure all arrangements are initiated by (primarily consumer) debtors with the aim of obtaining debt relief (Figure 44).

Further tension is created by the fact that policymakers and courts have also been overly influenced by the law’s historical commercial orientation, despite the fact that the law is now primarily used by *consumer* debtors (Figure 43-Figure 44). Policymakers in other European countries developed bespoke procedures designed to remedy the specific problem of mass consumer over-indebtedness in the 1980s and 1990s.[918] In England and Wales, however, apart from the limited Debt Relief Order procedure introduced in 2009, personal insolvency policy has been based around the paradigm of the business debtor or trader.[919] Legislative failure to alter the law creates a dissonance between the context in which the law originated and that in which it now operates, requiring judicial recognition of new policy bases and empirical realities when

[912] Shuchman (1973), 414.
[913] CORK (1982); INSOLVENCY SERVICE & DTI (2001).
[914] FLETCHER, (2009), 77.
[915] Hallinan (1986), 144.
[916] Milman (2003), 396.
[917] Hallinan (1986), 52.
[918] See e.g. Kilborn (2009).
[919] Consumers had been permitted to access personal insolvency procedures since 1861, but these procedures had never been designed to address this problem.

applying the law.[920] I argue that such a judicial response has not been forthcoming, however, as a commercial paradigm of free market bargaining has been inappropriately applied to the conditions of modern consumer over-indebtedness.

The tension between the two perspectives of personal insolvency is evident in certain key policy debates. One notable example is the question of whether personal insolvency legislation should provide debtors with access to debt discharge merely on the liquidation of the debtor's non-essential assets (if any), or rather only on completion of a repayment plan of several years' duration.[921] I focus on the related debate of whether personal insolvency procedures should consist of legally imposed debt discharge, or rather whether they should involve the voluntary rescheduling of debts between debtor and creditors.[922] Voluntary renegotiation has prevailed over debt discharge in the laws of countries such as France and Belgium, as well as in Ireland's new personal insolvency law.[923] The creditor wealth maximisation perspective, founded in basic ideas of neo-classical economics, favours such voluntary renegotiation - "market-based debt resolution"[924] - over a State imposed solution. After all, under the creditor's bargain theory, bankruptcy law is merely a means of achieving creditor cooperation, and if this can be achieved at lower transaction costs outside of legal procedures, a non-judicial outcome is preferable.[925] This is consistent with a view of insolvency law's role as being to protect market expectations to the greatest extent possible[926] in the view that private exchange between self-interested parties will produce *Pareto* optimal outcomes (the most efficient allocations of resources, i.e. credit availability at a lower price).[927] Adherents to these private ordering perspectives of bankruptcy argue that "interventionist" legally mandated insolvency solutions (particularly involving substantial debt write-downs) can lead to "strategic defaults" by financially sound households, as well as weakening confidence regarding respect for private contracts and creditor rights.[928] Bargaining for rescheduling terms is seen as producing more efficient market outcomes because the extent and costs of default, and the interest rates required to compensate, can be determined

[920] Hallinan (1986), 69.
[921] For an example of the debate in the US over whether consumer debtors should be freely permitted to choose to enter the Chapter 7 liquidation-and-discharge procedure, or rather should be required to enter the Chapter 13 repayment plan procedure where they possess the means to make repayments, see e.g. Wiggins (2006); Braucher (2005); Jason J. Kilborn, *Still Chasing Chimeras but Finally Slaying Some Dragons in the Quest for Consumer Bankruptcy Reform*, 25 LOYOLA CONSUM. LAW REV. 1 (2012). For general discussion of the policy of requiring debtors to undertake repayment plans before discharge, *see* Kilborn (2003).
[922] WORLD BANK (2013) ¶¶127–36.
[923] See *e.g.* Spooner (2013), 751–62; Chapter 3 above.
[924] IMF (2012), 14.
[925] Barry E. Adler, *Bankruptcy Primitives*, 12 AM. BANKRUPTCY INST. LAW REV. 219, 235–36 (2004); JACKSON (1986), 17.
[926] JACKSON (1986), 7 et seq.
[927] STEARNS & ZYWICKI (2009), 18–19; TREBILCOCK (1997), 15–16.
[928] IMF (2012), 19–22.

by market actors' preferences, all while avoiding the legal procedures' transaction costs. This should in theory allow credit to be supplied most widely at the lowest possible cost.[929]

I argue in this Chapter that English law largely corresponds to this framework, as a combination of legislative and court decisions have created an overall perspective which views personal insolvency as a marketplace in which debtors and creditors are given maximum freedom to resolve their cases as they choose. This perspective contrasts with the fresh start policy, which considers that legislatively imposed discharge of insolvent debtors' obligations produces optimal outcomes, correcting inevitable failures in consumer credit markets and internalising social costs.

4.2 Debtor Choice in English Personal Insolvency Law

As described in Chapter 3, English personal insolvency law is composed of three procedures.[930] Due to the limited access conditions for the Debt Relief Order procedure, I focus in this Chapter on the two mainstream procedures of bankruptcy[931] and Individual Voluntary Arrangements (IVA).[932] Bankruptcy involves the liquidation of any non-exempt assets of the debtor, and the discharge of her debts at the end of a 12 month waiting period. Meanwhile, the IVA procedure involves the debtor's submission of a proposal to her unsecured[933] creditors via a licensed Insolvency Practitioner (usually an accountant or, less frequently, a lawyer), which becomes an arrangement if approved by 75% in value of creditors.[934] As I discuss below, the terms of an IVA are determined by debtor-creditor negotiations, but standard terms have been developed between the consumer credit and Insolvency Practitioner industries, including a usual repayment plan of 5-6 years (but see Figure 12 below) in full settlement of the debtor's obligations.[935] Unlike the US Chapter 13,[936] or the consumer debt settlement laws of France[937] and Belgium,[938] no "cram-down" mechanism exists under English law for the imposition of a repayment plan on creditors by a court or administrative authority where more than 25% object. Legally debtors largely have a free choice as to whether to enter the IVA or bankruptcy procedure. Some

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[929] Wiggins (2006), 398.

[930] I disregard the County Court Administration Order procedure, which is now very rarely used: *see e.g.* McKenzie-Skene & Walters (2006), 487–88; Ramsay (2003B), 212–13.

[931] FLETCHER (2009), ch. 5–13.

[932] *See Id.* ch. 4((I)(1); Walters (2009).

[933] An IVA cannot affect the right of secured creditor to enforce its security: Insolvency Act 1986, §258(4).

[934] *Id.*, §260; Insolvency Rules 1986/1925 reg. 5.23(2).

[935] Standard Conditions for Individual Voluntary Arrangements (Revised April 2012).

[936] Under Chapter 13 of the US Bankruptcy Code, a repayment plan comes into effect on confirmation by a court, rather than via creditor agreement: 11 U.S.C. §1327(a); Porter (2011), 116–19.

[937] Code de la Consommation, art. L331–7.

[938] Code Judiciaire (Belgium) art. 1675/11.

limitation to this choice exists as the bankruptcy debtor petition procedure requires a court, in cases in which the debtor's asset and debt values fall within certain boundaries (more than £4,000 and less than £40,000 respectively),[939] to consider whether bankruptcy proceedings should be stayed to allow the debtor to enter into an IVA.[940] This procedure appears to be very rarely used, and the condition that a debtor's available assets be worth at least £4,000 limits its relevance to only a minority of consumer debt cases (see Figure 42, Appendix).

The English position contrasts with the laws of other European countries. In France and Belgium, debtors are steered into discrete "streams" of debt relief by a court or administrative authority based on the latter's assessment of the severity of the debtor's financial difficulties.[941] The first stage of all cases involves the proposal of a repayment plan to creditors.[942] If creditors reject this proposal, a plan can be "crammed-down" by an administrative authority/court, and other more aggressive debt relief measures can be imposed if the debtor's circumstances so warrant. Irish legislation coming into force in 2013 expresses policymakers' aim of allowing indebtedness to be resolved "without recourse to bankruptcy",[943] and similarly requires debtors to attempt to reach voluntary arrangements with creditors before availing of the discharge procedure of bankruptcy.[944] In the policy debate relating to "rational sorting"[945] and the question of whether debtor choice or decision-maker adjudication should determine access to each of the various available procedures (particularly voluntary rescheduling arrangements or liquidation-and-discharge),[946] English law falls more on the side of debtor choice than its neighbouring jurisdictions.

939 Insolvency Act 1986 §273(1); Insolvency Proceedings (Monetary Limits) Order 1986/1996.

940 Insolvency Act 1986, §§273–4; FLETCHER (2009), ¶¶6.123–6.125.

941 Spooner (2013), 751–55.

942 Code de la Consommation, art. L331–6,331–7; Code judiciaire (Belgium), art.1675/3, 1675/10.

943 Personal Insolvency Act 2012, Long Title.

944 *Id.* §§91(1)(g), 145(4), 148; Bankruptcy Act 1988, §§11, 15.

945 JEAN BRAUCHER, *A Law-in-Action Approach to Comparative Study of Repayment Forms of Consumer Bankruptcy*, *in* NIEMI ET AL. (EDS.) (2009), 347–55.

946 WORLD BANK (2013), ¶¶199–203.

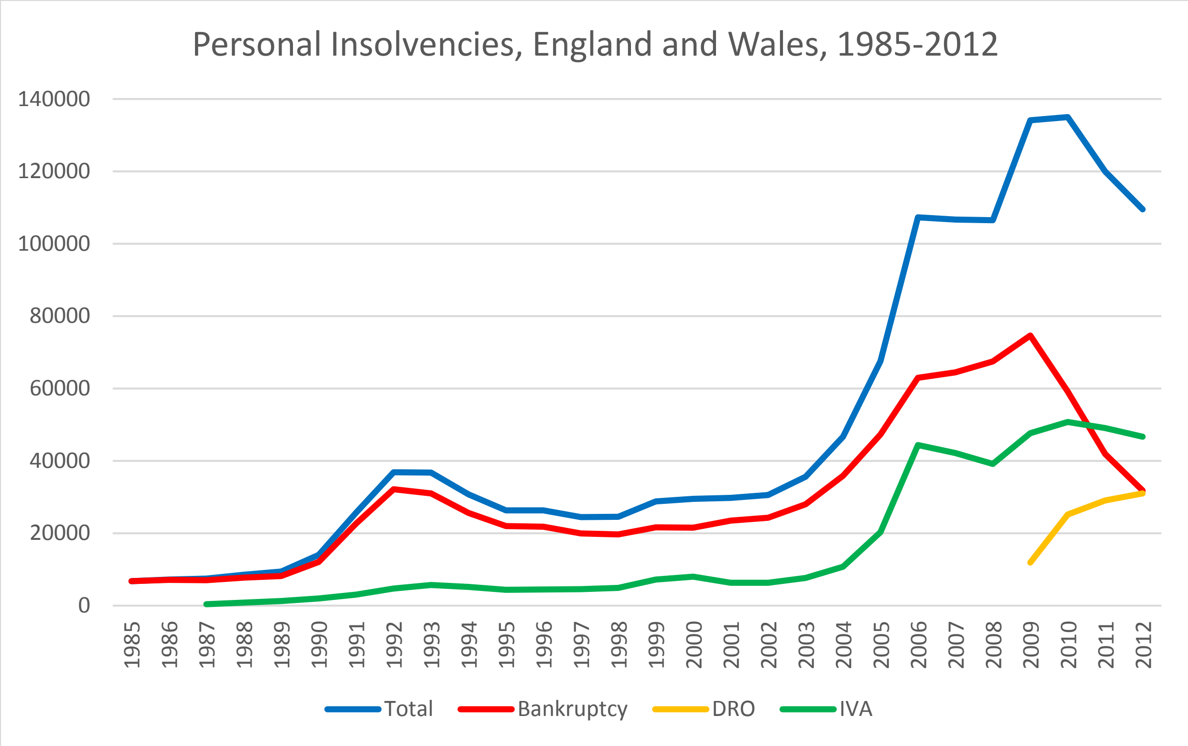

Figure 7: Personal Insolvency Filing Rates in England and Wales, 1985-2012.

Source: The Insolvency Service

In addition to these statutory procedures, a range of alternatives are available for English debtors to address their financial difficulties outside of legal insolvency mechanisms. Unlike countries such as France (in which fee-charging private debt counselling services are prohibited[947]) or Ireland (where state-funded debt counselling services dominate the sector[948]), a well-developed industry of private and third sector debt counselling services exists in the UK.[949] In 2010, an official report identified approximately 56,000 debt advice agencies licensed by the UK Office of Fair Trading,[950] the regulatory body with authority for supervising providers of "ancillary credit businesses".[951] These services range from money management advice and budget planning, to negotiating with creditors, to the formal solutions of either statutory insolvency procedures or non-statutory Debt Management Plans (DMPs).[952] A DMP consists of a (generally non-binding) agreement between a debtor and her creditors to reschedule her debts over an extended repayment period, based on the making of a monthly payment by the debtor to an advice

[947] Code de la Consommation, art. L321–1.

[948] *See e.g.* Spooner (2012A), 262–66. In Belgium, Debt mediators can be appointed from the ranks of (since 2012 specially trained) lawyers and other specified legal officials, as well as public or private licensed debt counselling agencies: Code Judiciaire (Belgium) art. 1675/17. Debt mediator services have existed since 1994 in Belgium, and are provided both by the public social services and by private sector providers. A network of state-licensed debt counselling services exists throughout the country of Belgium. *See e.g*. SPF Economie (2009), 9; Kilborn (2006), 81–82.

[949] Muller et al. (2012).

[950] Comptroller and Auditor General, Helping Over-indebted Consumers 26 (The Stationary Office 2010).

[951] An "ancillary credit business" is a business comprising or relating to a range of activities, including for present purposes "debt-adjusting", "debt-counselling" and "debt-collecting": Consumer Credit Act 1974, §§21, 145.

[952] Muller et al. (2012), 52.

agency, which is then distributed on a *pro rata* basis among creditors.[953] There is generally no debt write-down under a DMP, and various reports estimate long repayment periods of more than 10[954] or 20 years.[955] While data on this sector is limited, the Insolvency Service estimated that 72,500 DMPs were entered into in 2004;[956] while a 2009 UK Government report estimated that between 100,000 and 150,000 debtors enter into new DMPs per year, a figure which would exceed the annual number of personal insolvencies in England and Wales.[957] A 2009 Insolvency Service survey found that among those companies providing both IVAs and DMPs, approximately 4-5 DMPs were being "sold" for every one IVA proposed to creditors.[958] A Government survey based on data obtained in 2009-10 similarly found that while only 1% of the representative sample of the general population were in bankruptcy or IVA procedures, 5% were in DMPs.[959]

Additional means by which debtors seek to address their financial difficulties include negotiating payment plans bilaterally with creditors directly, outside of a formal DMP (and without the assistance of an intermediary), obtaining consolidation loans (usually secured over a residence), or re-mortgaging. These latter two options are available at times of rises in house values,[960] but are less viable following a fall in house prices when households fall into "negative equity". Limited available data show that most debtors in bankruptcy primarily considered the alternative options of DMPs and more informal rescheduling arrangements with creditors (even more so than they considered an IVA) before choosing bankruptcy.[961] An Insolvency Service report found consolidation loans to be the most popular alternative type of debt relief actually sought by debtors in IVAs before they entered the procedure during the years 2005-7.[962] The number of surveyed IVA debtors who had previously entered a DMP was found to be 16% in 2007-8 and 33% in 2008-9, while almost 80% of debtors had been through one or more alternative debt relief solutions before entering the IVA procedure.[963] Further insight into the breakdown of consumer debt solutions is provided by the following information regarding options recommended to clients

[953] SHARON COLLARD, AN INDEPENDENT REVIEW OF THE FEE-CHARGING DEBT MANAGEMENT INDUSTRY 2 (Money Advice Trust and Personal Finance Research Centre, University of Bristol 2009).

[954] Insolvency Service (2007A), 43.

[955] Insolvency Service, Improving Individual Voluntary Arrangements ¶24 (2005). It should be noted that this view is contested, however, with Stepchange (a leading free-to-client advice provider, formerly known as CCCS) stating that the average duration of a DMP is approximately five years: StepChange Debt Charity, *The Truth About DMPs*, STEPCHANGE.ORG, http://www.stepchange.org/Infographics/ThetruthaboutDMPs.aspx. Little information is available to indicate whether Stepchange's position is representative of that of other providers, and in particular standards may vary in DMPs negotiated directly with creditors or via fee-charging intermediaries.

[956] Insolvency Service (2005B), ¶24.

[957] MINISTRY OF JUSTICE ET AL., DEBT MANAGEMENT SCHEMES - DELIVERING EFFECTIVE AND BALANCED SOLUTIONS FOR DEBTORS AND CREDITORS 14 (2009); COLLARD (2009), 3.

[958] INSOLVENCY SERVICE, REVIEW OF THE IMPACT OF THE IVA PROTOCOL 27 (Insolvency Service 2009).

[959] BIS (2011A), 43.

[960] PriceWaterhouseCoopers, Living on Tick: The 21st Century Debtor 7 (2006).

[961] *See* INSOLVENCY SERVICE, SURVEY OF DEBTORS PETITIONING FOR BANKRUPTCY 15 (Insolvency Service 2007); Tribe (2006), 36.

[962] *See* INSOLVENCY SERVICE, SURVEY OF DEBTORS AND SUPERVISORS OF INDIVIDUAL VOLUNTARY ARRANGEMENTS 14 (2008).

[963] INSOLVENCY SERVICE (2009B), 10.

by a leading non-fee-charging provider which occupies 21% of the overall debt advice market (including both fee-chargers and non-fee-chargers):[964]

	2009 % of Clients	2010 % of Clients	2011 % of Clients
Income Maximisation	31.7	32	28.7
DMP	25.8	28	29.3
Bankruptcy	11.9	9.6	9.3
Meets actual payments	8.9	8.9	10.1
IVA	6.8	6.4	5.1
DRO	4.1	4.9	6.0
Token Payments	4/6	4.3	5
Realise Assets	1.6	2	2.2
Equity Release	0.4	0.4	0.5
Other	4.2	3.3	3.8

Figure 8: Solutions recommended by the Consumer Credit Counselling Service (now known as Stepchange) to its debtor clients, 2009-2011[965]

[964] MULLER ET AL. (2012), 39.

[965] CCCS (2012), 41. It should be noted that the option of the debtor entering a more informal debt repayment arrangement directly with a creditor (without intermediation) would not appear in the range of options proposed by an intermediary such as the CCCS.

4.3 Buying Bankruptcy Services in the Personal Insolvency Market

The first *de facto* limitation on debtors' *de jure* insolvency options is that bankruptcy is an expensive procedure in England and Wales, as debtors presenting a bankruptcy petition must pay a court fee of £175[966] and a deposit of £525[967] to cover (partly) the cost of administering the bankruptcy procedure. In response to the growing number of asset-less consumer bankruptcies (which do not provide sufficient proceeds to pay administrative costs) in recent decades, secondary legislation has increased the size of the deposit payable at almost yearly intervals, with a particularly large increase in 2010.[968] These costs represent a significant practical obstacle for debtors seeking to access bankruptcy, as illustrated in Figure 9-Figure 10, and Insolvency Service and debt advice agency reports indicate that debtors rely heavily on borrowing and/or charity in order to raise the necessary funds.[969]

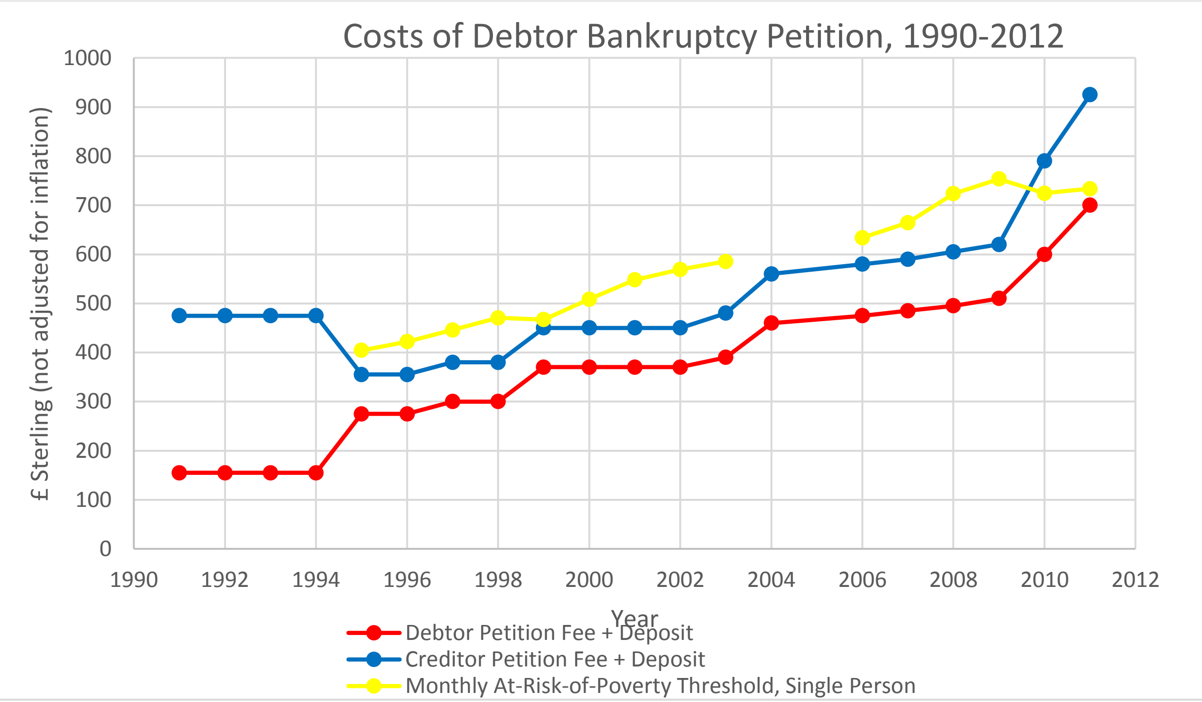

Figure 9: Costs to debtors of accessing bankruptcy, relative to creditor costs and the monthly at-risk-of-poverty threshold

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966 Civil Proceedings Fees Order 2008/1053, Sched. 1; as amended by Civil Proceedings Fees (Amendment) Order 2011 2011/586.

967 Insolvency Proceedings (Fees) Order 2004/593, art. 6; as amended by Insolvency Proceedings (Fees) (Amendment) Order 2011/1167 art. 2(b).

968 See e.g. comments of Richard Judge, Chief Executive of the Insolvency Service, in: The Insolvency Service: Oral Evidence Taken Before the Business, Innovation and Skills Committee (House of Commons, Hansard 2012).

969 INSOLVENCY SERVICE (2007B), 27; Citizens Advice Bureau, Reforming Debtor Petition Bankruptcy and Early Discharge From Bankruptcy: Citizens Advice Response to the Insolvency Service 5–9 (2010); Citizens Advice Bureau, Reform of the Process to Apply for Bankruptcy and Compulsory Winding Up: Response by Citizens Advice to the Insolvency Service 4–7 (2012).

	2005	2006	2007	2008	2009	2010	2011
% Population unable to meet unexpected expense	30.8	28.5	26.6	28.6	31.1	34.7	**36.7**
Amount of this expense (£)[970]	633.92	664.50	723.50	753.42	724.42	733.66	**743.67**
Amount of Bankruptcy Fee + Deposit (£)	460	475	485	495	510	600	**700**

Figure 10: Cost of bankruptcy, relative to ability of population to meet unexpected financial expense

While the remission of the court fee in cases of low-income debtors[971] mean that half of debtors do not pay this portion of the cost,[972] the deposit of £525 cannot be waived in any case. The rigidity of this condition in cases of low income debtors was challenged on human rights grounds in the case of *Regina v Lord Chancellor, ex parte Lightfoot*;[973] a decision which is insightful in its conceptualisation of bankruptcy as a service to be purchased by the debtor. Here the applicant argued that the requirement to pay a non-waivable deposit infringed the debtor's common law constitutional right of access to justice, and the human right to a fair hearing in the determination of an individual's civil rights and obligations.[974] The English Court of Appeal rejected this claim, finding that these rights apply only to disputes the outcome of which will decide rights and obligations.[975] The English courts stated that a debtor petitions for bankruptcy not to have her liabilities determined, but ultimately to be relieved of them.[976] Bankruptcy is thus "a benign administration system to make fair and practical sense" of insolvent debtors' cases, "designed both for the fair treatment of creditors and the relief of debtors", not involving concerns of access

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[970] This figure is based on a question asked in the European Union Survey on Income and Living Conditions as to whether a household can afford an unexpected expense of a specified amount. The amount in question is 1/12th of the national at-risk-of-poverty annual income threshold, which in turn is calculated at 60% of the national median annual income: *see* MÉLINA ANTUOFERMO & EMILIO DI MEGLIO, EUROSTAT STATISTICS IN FOCUS: POPULATION AND SOCIAL CONDITIONS 7 (2012).

[971] Civil Proceedings Fees Order 2008/1053, Sched. 2.

[972] INSOLVENCY SERVICE (2007B), 5; Insolvency Service Technical Policy, Impact Assessment of a Reform to the Debtor Petition Bankruptcy Process 9 (2007).

[973] *Lightfoot*, [2000] QB 597.

[974] European Convention on Human Rights, article 6(1).

[975] *Lightfoot*, 629, per Simon Brown LJ.

[976] *Id.*, 622, per Simon Brown LJ.

to justice.[977] Parliament could have provided for a similar system to be provided administratively without judicial involvement;[978] and it was equally legitimate for Parliament to decide "to make the scheme for the rehabilitation of debtors available only at a price."[979] Although finding that access to debt relief is not a human rights imperative, the Court of Appeal nonetheless expressed concern that a large numbers of debtors are excluded from bankruptcy in this manner, with Simon Brown LJ noting that "[i]t is… apparently for this reason that the great majority of those wishing to petition for bankruptcy do not in fact do so. To them, therefore, is denied… 'the importance of the rehabilitation of the individual insolvent.' They face instead a lifetime of unrelieved indebtedness."[980]

The decision and reasoning of the courts are instructive for a number of reasons. First, they exhibit many elements of the debt collection conception of the law. While the court recognises the debt relief or "rehabilitation" provided by the law, this provision is not seen as an independent objective of the law. Debt relief is not seen as a right, but as a privilege to be bestowed on the debtor out of some sense of "compassion",[981] under a law otherwise concerned with debt collection. The courts' reasoning displays the idea typical of the debt collection perspective of the law that the benefit of debt relief should only be extended to the debtor "at a price", as a *quid pro quo* for her benefitting creditors by surrendering her estate, and paying the costs of the process which makes her assets available for creditors.[982] Indeed, the courts' decision seems to have been influenced by the fact that, historically, bankruptcy law has long required such a deposit to be paid by a petitioning debtor.[983] The law was originally designed purely to serve the end of debt collection, however, and so also contained features such as conditioning debtor access on providing minimum dividends to creditors.[984] Therefore the court's reliance on the historical existence of features of the law exhibits a failure to recognise that the law's objectives have moved beyond the sole aim of facilitating debt collection. In viewing debt relief as a benefit to be bought by the debtor in exchange for making her assets available to creditors, this perspective also fails to acknowledge the benefits to *society*, rather than merely these private parties, in debtor rehabilitation. This contrasts with the classic understanding of the fresh start policy provided by the US Supreme Court, which stressed that debt discharge's preservation of the

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[977] *Id.*, 609, per Laws J (High Court), cited by Simon Brown LJ in the Court of Appeal, 629.

[978] *Id.*, 609, per Laws J.

[979] *Lightfoot*, 628, per Simon Brown LJ.

[980] *Id.,* 617, per Simon Brown LJ.

[981] This perspective can be seen in the comments of Simon Brown LJ that

> "it is not difficult to recognise the hardship and worry that many will suffer through their financial exclusion from the undoubted benefits of this rehabilitation scheme and, *in the more compassionate times in which we now live*, it may be hoped that the competing interests will be considered anew and perhaps a fresh balance struck" (emphasis added).

Id., 631, per Simon Brown LJ.

[982] "In short, the debtor obtains the protection of a bankruptcy order on terms that he delivers up his estate for administration for the benefit of his creditors..." *Id.*, 631, per Chadwick LJ.

[983] *Id.*, 609. 625. 631.

[984] John D. Honsberger, *Philosophy and Design of Modern Fresh Start Policies*, 37 OSGOODE HALL LAW J. 171, 175 (1999).

debtor's ability to earn a livelihood "is of the utmost importance not only because it is a fundamental private necessity, but because it is a matter of great public concern."[985]

In line with a creditor wealth maximisation perspective, the court's reasoning displays an underlying legal ethic or ideology of *market individualism* founded in assumptions of classical contract law and neo-classical economics.[986] This is most obvious in the Court's conclusion that "the mandatory deposit is not for access to the court but rather towards the costs of *services* being provided by others for the petitioner's benefit" (my emphasis).[987] Bankruptcy here is conceptualised as a service on offer in a personal insolvency marketplace, and like other potential options or services available to the insolvent debtor, it comes at a price. Courts expect over-indebted individuals (presumably considered to be commercial-minded, well-informed rational economic actors) to conduct a cost-benefit analysis of bankruptcy and only purchase this service if so doing would realise their preferences. The *individualism* of this approach is evident in the expectation that the debtor internalise the costs of her participation in the credit market, rather than sharing this cost among society or forcing creditors to contribute.[988] The position of requiring debtors to pay for access to bankruptcy also suggests an underlying belief in the efficiency of private ordering in its Coasian[989] lack of concern for the law's distributional effects and the fact that this condition will impact the poorest debtors disproportionately.[990] The court's finding that bankruptcy does not involve the determination or distribution of rights and obligations mirrors Professor Jackson's view of insolvency law's proper role as being to replicate and uphold market entitlements and the distributions of pre-bankruptcy rights and obligations which have taken place in the marketplace.[991] This is a view which English courts have expounded on further occasions, often in ways which assimilate corporate and personal insolvency reasoning, as evidenced in Lord Hoffmann's statement that the "important part is that bankruptcy, whether personal or corporate, is a collective proceeding to enforce rights and not to establish them."[992]

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[985] *Local Loan Co.*, 244. Note, however, that the US Supreme Court has decided that there is no constitutional right to discharge from debts via bankruptcy: see the decision of United States v Kras 409 US 434 (1973), cited in Gross (1989), 168.
[986] On the concept of *market individualism*, see Adams & Brownsword (1987).
[987] [2000] QB 597, 623, per Simon Brown LJ.
[988] *See e.g.* Wiggins (2006), 355–56. Note the comments of the Government in defending the existence of this obstacle to accessing bankruptcy: "we do not believe that general taxation should pay for people to enter bankruptcy when they may have taken on debts irresponsibly." [988] HC Deb 14 April 2002 Standing Committee B col. 693, per Ms. Melanie Johnson M.P. This statement is somewhat puzzling, given the chief rationale of the reforms being introduced at that time was that debtors in bankruptcy should no longer be automatically presumed to be dishonest or irresponsible.
[989] Coase (1960).
[990] On the extent to which the efficient market hypothesis is unconcerned by distributional issues, *see e.g.* HOWELLS & WEATHERILL (2005), 10.
[991] JACKSON (1986), 253.
[992] Cambridge Gas Transport Corp V. Official Committee of Unsecured Creditors (of Navigator Holdings PLC and Others) (Isle of Man) [2006] UKPC 26, [2007] 1 A.C. 508, ¶15 (2006).

4.4 Individual Voluntary Arrangements: Contractual Insolvency

The Individual Voluntary Arrangement procedure can also be seen to be based on a paradigm of commercial free market contracting. This mechanism was originally envisaged as a method for creditors and sophisticated, well-advised and well-resourced debtors to reach flexible mutually beneficial arrangements in the event of the failure of the debtor's business activities, in a manner analogous to a corporate insolvency "work-out". As the procedure developed to become primarily used by consumer debtors, its foundations in commercial law and the paradigm of maximum contractual freedom which judicial interpretations have instilled in the procedure have become problematic.

A. Policy History of the IVA

The IVA procedure originated in the Insolvency Acts of 1985[993] and 1986.[994] While this legislation was introduced following the publication of the Cork Committee recommendations,[995] it did not adopt the Committee's views on the appropriate response to "the emergence of the consumer debtor, a commonplace today, but virtually unknown in the Nineteenth Century".[996] Recognising a "sharp distinction" between consumer and business debtors, the Committee was in "no doubt… that the most urgent need of all is for the introduction of a simple, accessible and inexpensive procedure for dealing with the ordinary consumer debtor."[997] It thus recommended the introduction of a court-ordered repayment plan procedure,[998] as well as a fast-track liquidation procedure for uncomplicated cases "where the failure is the result of imprudence or extravagance rather than fraud or misconduct, and where full investigation is not required."[999] In contrast, the Committee's recommendations for the establishment of the IVA were firmly based in the realm of commercial insolvency. They were modelled on the corporate insolvency mechanism of creditors' voluntary winding up[1000] and presented as one of two consensual "work-

[993] Insolvency Act 1985, §§110–18 (1985).

[994] Insolvency Act 1986, §§252–263G.

[995] CORK (1982), ¶22. For a history of arrangement and composition procedures existing prior to the introduction of the IVA, *see* FLETCHER (2009), ¶4–003.

[996] CORK (1982), ¶16.

[997] *Id.*, ¶¶201, 272.

[998] This procedure was to be called the Debts Arrangement Order: *Id.* at 272–349. The Committee also proposed that in cases in which the debtor has no significant realisable assets and no disposable income, an Enforcement Restriction Order could be made by a court to prevent the enforcement of judgments against the debtor without leave of the court.

[999] *Id.* ¶¶549, 585–88.

[1000] *Id.* ¶363.

out" procedures for both individual/personal and corporate insolvency.[1001] The procedure was for use not by consumers, but by well-advised commercial debtors, including company directors, professionals and unincorporated traders.[1002] Even within this commercial context, the Cork Committee did not envisage a purely consensual model of arrangement and proposed some mandatory terms, for example to provide for debt discharge after a maximum repayment plan duration of three years.[1003] Furthermore, the Committee recommended that the acceptance of a debtor's proposal by a simple majority (in value) of creditors would be sufficient to bind all creditors.[1004]

In its response to the Cork Committee report, the Government published a White Paper which was primarily concerned with corporate insolvency.[1005] The personal insolvency reform proposals were limited to reforming the bankruptcy procedure as part of a general reform of insolvency court procedures, and introducing the IVA as part of a policy of establishing voluntary arrangement procedures for both corporate and individual debtors.[1006] The Paper considered that a voluntary arrangement would suffice as a solution for small bankruptcy cases, rejecting the Cork Committee's proposals for more interventionist judicial remedies.[1007] In subsequent legislative debate there was little interest in consumer debt issues,[1008] and ultimately the personal insolvency law created by the Insolvency Acts of 1985 and 1986 was that foreseen in the White Paper. The IVA procedure introduced was even more oriented towards the paradigm of private ordering than had been recommended by Cork, with a super majority of 75% required for an arrangement to come into effect, for example. While I discuss ideological issues arising in the politics of consumer insolvency elsewhere,[1009] one must consider the legislative response to the Cork Report in the context of the Thatcher Administration's aim of reducing State involvement in the insolvency process.[1010] This was evident in a prior Green Paper described as "dominated by the determination to reduce civil service manpower above all other considerations",[1011] as part of general Government policies of favouring renewed reliance on private ordering in such other areas as consumer, employment, and landlord-tenant law.[1012]

[1001] *Id.* ch. 7.
[1002] *Id.* ¶365.
[1003] *Id.*, ¶¶387, 396–97.
[1004] *Id.,* ¶381.
[1005] DEPARTMENT OF TRADE AND INDUSTRY, A REVISED FRAMEWORK FOR INSOLVENCY LAW (Stationery Office Books 1984).
[1006] *Id.*, ¶¶57–139.
[1007] *Id.*, ¶¶120–25.
[1008] The primary consumer issue discussed during the legislative debates preceding the legislation concerned consumers in their capacity as *creditors*, as consumer associations campaigned for protection for consumers who had made prepayments/deposits for goods and services to a company which subsequently entered an insolvency procedure: CARRUTHERS & HALLIDAY (1998), 346–53.
[1009] Spooner (2013), 765-7. See also Part 3.4(A) above.
[1010] DTI (1984), ¶17.
[1011] Ian Fletcher, *Bankruptcy Law Reform*, 44 MOD. LAW REV. 77, 77, 81 (1981).
[1012] HOWELLS & WEATHERILL (2005), 21–2; 80–5.

B. The Contractual Basis of the IVA: Judicial Development

Following its legislative establishment, "[w]ith only tenuous statutory guidance [the courts] have constructed a foundation for the IVA which is firmly based in contract."[1013] In *Johnson v Davies,*[1014] the Court of Appeal held that the answer to the contested issue of whether an IVA granting debt discharge to a participating debtor also discharged a solvent co-debtor lay not in the legislative text, but rather in the arrangement's terms themselves. The Court rejected the argument (based on case law under prior legislation) that the co-debtor should be discharged by operation of law;[1015] and found that the terms of the IVA in question indicated creditors' contrary intention that no such discharge of the co-debtor be granted.[1016] This finding was part of a firm assertion by the Court of Appeal of the IVA's contractual nature. It stated that the omission by the legislature of statements made in prior legislation regarding the discharge of a co-debtor under an arrangement "was the result of a deliberate decision" that voluntary arrangements should be treated as consensual in nature, rather than being composed of terms mandated by law.[1017] While a minority of 25% of dissenting creditors can be bound by the majority's approval of a proposal, the Court considered that dissenting creditors do not have the arrangement imposed on them by law, but rather are "bound by the arrangement as the result of a statutory hypothesis. The statutory hypothesis requires [dissenting creditors] to be treated as if they had consented to the arrangement."[1018]

In its reasoning, the court adopts a legal ethos or ideology under which private ordering and contractual agreement between self-interested actors form "the general law", a natural order of "neutral and rational principles" which always exists unless legislative intervention clearly indicates the contrary.[1019] Consistent with this approach, the court felt reluctant to imply any terms into the arrangement which had not been expressly included, except in accordance with basic principles of contract law. Therefore under the Court's interpretation of the IVA even the discharge of debt, the "predominant purpose – if not the sole purpose – of individual bankruptcy today",[1020] "depends entirely on the terms of the arrangement. One must look at the arrangement, and nothing else, in order to find the terms (if any) under which the debtor is discharged".[1021] Consistent with ideas of classical contract law and basic neo-classical

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[1013] Milman (2003), 397.
[1014] Johnson and Another v Davies and Another, [1999] CH. 117 (1998).
[1015] *Id.*, 131-2.
[1016] *Id.*, 127-8.
[1017] *Id.,* at 131.
[1018] *Id.*, 138.
[1019] For critical discussions of reasoning of this kind, *see e.g.* Ramsay (1995), 196; HOWELLS & WEATHERILL (2005), 8–10, 78–80.
[1020] Kilborn (2003), 866. *See also* INSOL INTERNATIONAL (2001), 22 et seq.
[1021] *Johnson*, 138.

economics, the court placed faith in the power of market bargaining between self-interested private actors to achieve optimal outcomes, considering a voluntary consensual framework was in both the debtor and creditors' best interests. This framework helped the debtor by not mandating terms so debtor-protective as to make IVAs unattractive to creditors, while still promoting "the interests of the debtor that he should be able to propose a scheme under which he will obtain a complete release from his liabilities…"[1022] This reasoning mirrors that applied by authors and judges such as Circuit Judge Posner in relation to contracts involving weaker parties, in the argument that rules providing protection to weaker parties against hard bargains may not benefit such parties, but instead may merely dissuade businesses from offering to contract with such parties.[1023] Chadwick LJ's reasoning based on a "statutory hypothesis" of consensual insolvency brings to mind Professor Jackson's "creditors' bargain" theory,[1024] as well as Professor Adler's proposal for "self-authored insolvency"[1025] or the IMF's "market-based debt resolution".[1026] All of these approaches follow neo-classical economic fundamentals in considering that voluntary bargaining between debtor and creditors will produce flexible solutions which better serve both debtor and creditor interests than Government-mandated outcomes,[1027] as well as serving general welfare by allocating resources efficiently (allowing credit to be available at the lowest cost).

This view of courts' role as being to facilitate private exchange is continued in the court's apparent conceptualisation of creditor wealth maximisation as the primary aim of insolvency law. Despite the ostensibly neutral and literalist interpretative approach of the court, it adopted certain elements of a purposive approach, but significantly only to further the purpose of debt collection. Thus the court implied into the arrangement a term it deemed necessary to its operation providing that creditors could not exercise individual remedies during the term of the arrangement. The court saw this moratorium on individual enforcement as essential to the law's collective debt collection function and the principle of equality of creditors.[1028] This contrasts with the court's rejection of the view that debt discharge must be implied as a necessary element of a personal insolvency procedure. In subjecting debt discharge to creditor control, the reasoning reverts to the position of historical bankruptcy laws under which the debtor's discharge was not automatic, but rather depended on creditor assent.[1029] This denial of automatic discharge represents a repudiation of debt relief as a legitimate independent objective of personal

[1022] *Id.*
[1023] Amoco Oil v Ashcraft, 791 F 2D 519, ¶ 10 (1986).
[1024] JACKSON (1986), 253.
[1025] Adler (2004), 235–36.
[1026] IMF (2012), 14.
[1027] WORLD BANK (2013), ¶129(e).
[1028] Thus when asked what are necessary terms of the "statutory hypothesis", the court produced the same answer as offered by Professor Jackson's hypothetical "creditors' bargain": all creditors would hypothetically agree to halt individual enforcement actions and cooperate in collectively sharing the debtor's resources among them: JACKSON (1986) at 10 et seq.
[1029] *See e.g.* Shuchman (1973), 451; Charles Jordan Tabb (1991), 337.

insolvency law,[1030] and a judicial position oriented around creditor protection which conflicts with policy developments in respect of the bankruptcy and DRO procedures.[1031]

Similar positions are evident in further case law interpreting the nature of the IVA procedure. In *Raja v Rubin*, the Court of Appeal rejected the argument that the binding effect of an IVA derives from statute rather than from contract.[1032] Instead it again applied normal contractual principles in holding that under an IVA "the position is no different from that which obtains under the general law" in respect of the question of whether an IVA can be varied through the agreement of the parties to it.[1033] Furthermore, in the *NT Gallagher* case, the Court of Appeal held that the same principles apply to both IVAs and Company Voluntary Arrangements in respect of questions of the relationship between voluntary arrangements and court liquidation (i.e. bankruptcy) procedures. In considering both the IVA and CVA "statutory contract" procedures to be based upon the same assumptions and principles, the Court effectively held that an identical approach should be applied in household debt cases as in those, for example, involving the insolvency of a mining company forming part of a group owing debts of £4.4 billion.[1034]

C. The IVA as a *Consumer* Insolvency Procedure

(I) Rising and Falling Rates of Consumer IVAs

Despite its origins in commercial law, the gap left by legislative failure to introduce bespoke consumer insolvency procedures led the IVA procedure to be used widely by *consumer* debtors as the socio-economic phenomenon of mass household over-indebtedness developed. The limited available information shows that by the mid-2000s a huge majority of debtors using the procedure were consumers as opposed to traders (Figure 44, Appendix).[1035] During the early 2000s, the rate of IVAs increased rapidly (Figure 7) and even outstripped rises in bankruptcies, despite increased consumer use of a bankruptcy procedure liberalised under the Enterprise Act 2002.[1036] This rapid growth has been primarily attributed to high levels of household debt[1037] and entrepreneurial activities of IVA providers;[1038] as well as procedural simplifications introduced by the Insolvency Act 2000.[1039]

[1030] Hallinan (2005), 60.

[1031] *See e.g.* Insolvency Service, DTI (2001); Insolvency Service (2005A).

[1032] Raja v Rubin and Another, [2000] Ch. 274, 285.

[1033] *Id.*, 287; Milman (2005), 132–34.

[1034] Tucker v Gold Fields Mining LCC, [2010] B.C.C. 544 (2009).

[1035] Since 1994, the trend has been for approximately less than 5-10% of IVAs to involve commercial debt: Insolvency Service (2005B), ¶27.

[1036] This trend ran contrary to expectations that the reform of bankruptcy discharge rules would reduce IVA use by debtors: *see* Milman (2005), 136–37.

[1037] Walters (2009), 23; Green (2009), 410.

[1038] Walters (2009), 25–27; Green (2009), 410.

One of the features of a voluntary debt renegotiation regime of course is that parties can decline to enter into an arrangement. Creditor desire to maximise returns, as well as the "holdout" or "anticommons" problem[1040] created by the 75% majority rule, create incentives for creditors to reject debtor proposals (see further Part 4.5(A) below). The rapid growth in consumer IVAs ended abruptly in the mid-2000s as creditors developed new opposition to IVAs (Figure 11),[1041] in "a determined attempt by creditors through their intermediaries to stiffen the criteria on which they were prepared to vote in favour of IVAs."[1042] This led to the introduction by major creditors of "hurdle rates" (minimum projected dividends) of approximately 40% for the acceptance of IVA proposals, a sharp departure from the historical practice of accepting proposals offering approximately 15-25% dividend.[1043] Where such hurdles were not reached, creditors often rejected debtors' proposals without individual consideration of their merits, with Green estimating that in 2007 approximately 15,000-20,000 debtors who would previously have been accepted into the IVA procedure were excluded.[1044] These conditions also placed new pressure on debtors to agree to onerous, and perhaps unsustainable, terms in order to win creditor approval.[1045] Excluded debtors could then be driven into processes over which creditors have more control and which offer better financial outcomes for creditors, such as direct (non-intermediated) debt repayment plans (see discussion in Part 4.6(A) below).[1046] Bankruptcy was left as the only safe haven for these rejected debtors, but as I have shown above, this option was not available to all consumer debtors due to its costs.

[1039] Insolvency Service (2005B), ¶12. The Insolvency Service indicated that the additional cost and time involved in the Interim Order procedural step "varies between providers but ranges from an extra hour's work to several weeks' delay and up to £1,000 in fees": Insolvency Service (2007A), ¶ 28.

[1040] *See e.g.* Rolef J. de Weijs, *Harmonisation of European Insolvency Law and the Need to Tackle Two Common Problems*, 21 INT. INSOLV. REV. 67 (2012).

[1041] A particular problem is the rejection of low-debt IVA proposals, due to creditors' perception that the low returns do not justify the process' costs: Insolvency Service (2005B), ¶30.

[1042] Walters (2009), 30.

[1043] Green (2009), 408.

[1044] *Id.*, 409.

[1045] Walters (2009), 30–1; Green (2009), 413.

[1046] Professor Walters suggests that one aim of the creditors was *disintermediation*: breaking down the relationships that were developing between debtors and their advisors (IVA providers) in order to reassert direct control over their over-indebted customers. This control would allow creditors either to pursue the debtor for the full amount owed, or to cross-sell other debt resolution options such as (non-intermediated) DMPs or loan consolidations: Walters (2009), 31. Michael Green similarly suggests that creditors aimed to reduce the write-offs of historical retail credit lending by such strategies as moving debtors into DMPs rather than IVAs; offering consolidation loans (secured on the debtor's home) to distressed debtors; or selling distressed debt to collection agencies or other third parties: Green (2009), 408. Adopting a relational contract theory perspective, Professor Block-Lieb suggests that a creditor may prefer non-legal informal debt resolution arrangements as this may facilitate the continuation of an ongoing business relationship between creditor and debtors: Susan Block-Lieb, Why Creditors File so few Involuntary Petitions and Why the Number is not too Small, 57 Brooklyn Law Review 803, 851 (1991-2).

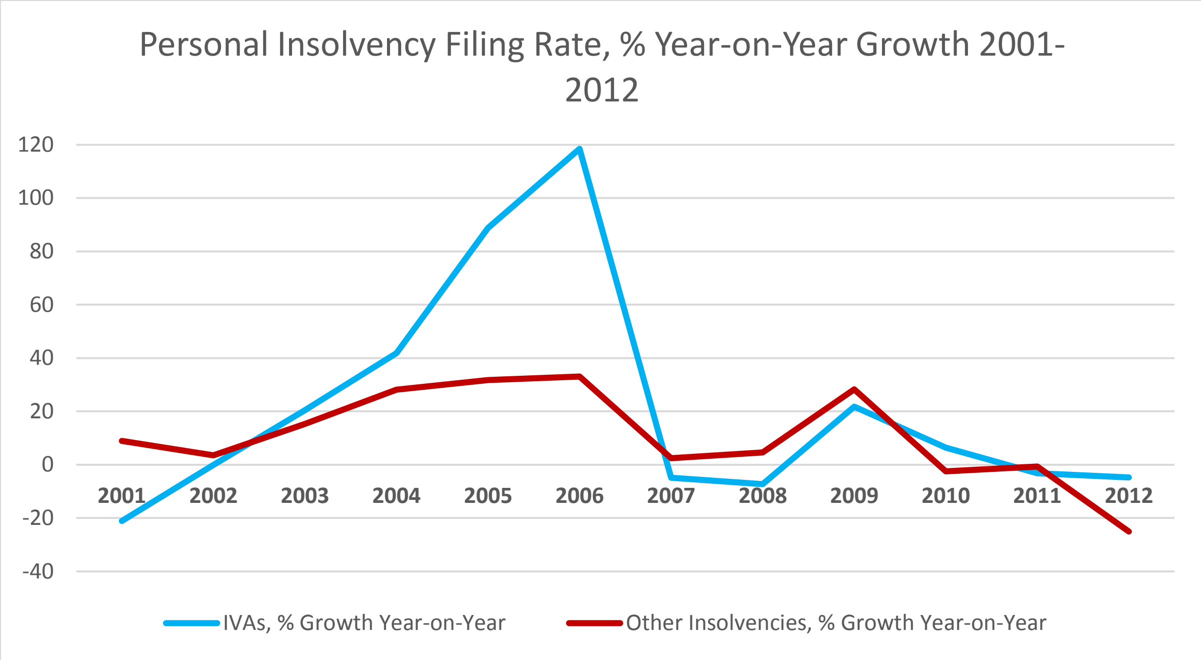

Figure 11: Personal insolvency % year-on-year growth, 2001-2012.
Source: The Insolvency Service

(II) Policy Responses

The Insolvency Service responded to this problem of debtor exclusion from the IVA procedure by proposing legislative reforms in the mid-2000s.[1047] In this first consideration of *consumer* insolvency by English policymakers (the Enterprise Act 2002 reforms having been designed with business debtors in mind), the Service considered that the IVA was the most appropriate consumer debt remedy, conceptualising it as “the best product in the market for both debtors and creditors.”[1048] The agency recognised that despite huge increases in consumer IVAs, “the regime still needs to be modified to further assist over indebted individuals to access a debt resolution solution that is proportionate and appropriate to their circumstances.”[1049] The Service first aimed to remove procedural complexity.[1050] Secondly it sought to address the voting system which allowed individual creditors to influence outcomes unduly and reject valid proposals;[1051] as well as to force debtors into overly onerous and unsustainable IVAs.[1052] Concerns arose that consumers excluded from IVAs were resorting to less appropriate alternative “products” such as debt consolidation, re-mortgaging, voluntary debt management plans or bankruptcy.[1053] The Service was particularly worried that creditor holdouts were pushing debtors into unsuitable DMPs, which have a number of “shortcomings”: namely the failure to bind creditors or provide

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1047 Insolvency Service (2005B); Insolvency Service (2007A).
1048 Insolvency Service (2005B), ¶21.
1049 Insolvency Service (2007A), ¶4.
1050 *Id.* ¶2.
1051 Insolvency Service (2005B), ¶¶30–34; Insolvency Service (2007A), 43.
1052 Insolvency Service (2005B), 74, 80.
1053 Insolvency Service (2007A), 44.

debt forgiveness, and their long duration which "can deny a debtor full access to credit for a significant period of time which may not help his rehabilitation."[1054] The Service saw greater potential for financial rehabilitation under the "finite resolution process" of the IVA.[1055] Therefore in 2005 it proposed the introduction of two administratively streamlined Simplified IVA (SIVA) procedures, one of which would have removed creditors' power to refuse a proposal at all in low-value cases. The second would have reduced the number of votes needed to pass proposals in all other cases to a simple majority (while also removing creditors' powers to modify debtor proposals).[1056]

The reform proposals were scaled down during a consultation process, with the "cram-down" model for low-value cases rejected entirely.[1057] Instead, the Insolvency Service returned in 2007 with proposals concentrating on reducing procedural formalities, requiring approval of only a simple majority of creditors for an IVA to come into effect, and removing creditors' power to propose modifications.[1058] Importantly, however, these proposals were also ultimately abandoned, due to the Insolvency Service's opinion that many of the problems which the proposals would address had been resolved by voluntary industry action.[1059] This action involved the introduction of the IVA Protocol: "a voluntary agreement, which provides an agreed standard framework for dealing with straightforward consumer IVAs and applies to both IVA providers and creditors."[1060] The reform proposals' abandonment came despite the Insolvency Service's earlier view that a non-binding code of practice of this type would be an insufficient policy response.[1061] The rejection of reform plans appears to have been influenced by strong creditor opposition, and insight on this factor's relevance may be obtained from my discussion of interest group influence on consumer insolvency reform.[1062]

(III) Reassertion of the Contractual Paradigm: *Mond v MBNA Europe Bank Ltd*.

The consequences of these policy developments were explored in subsequent litigation regarding the legal status of the IVA Protocol. In *Mond v MBNA Europe Bank Ltd.*,[1063] an IVA provider and his company sought declarations that the defendant credit card lender, a member of the British Bankers Association (BBA), had breached provisions of the Protocol when voting to

[1054] *Id.*, 43.
[1055] *Id.*, 48.
[1056] Insolvency Service (2005B), ¶¶26–37.
[1057] Improving Individual Voluntary Arrangements: Summary of Responses and Government Reply (2006).
[1058] Insolvency Service (2007A).
[1059] Insolvency Service (2008A).
[1060] IVA Protocol: Straightfoward Consumer Individual Voluntary Arrangement (2008), ¶2.1.
[1061] Insolvency Service (2007A), 45, 48.
[1062] *See* Part 3.4(C) above. *See also* Spooner (2013), 781-2.
[1063] *Mond and Another v MBNA Europe Bank Ltd.*, [2010] B.P.I.R 1167 (2010).

reject a protocol-compliant debtor proposal. The defendant, who held more than 25% in value of the debts and so effectively possessed a veto, rejected the proposal on grounds including "high fees" and "disposable income available for a DMP", and so effectively forced the debtor into a bilateral DMP.[1064] The claimant complained that this was an inappropriate solution as the debtor would have to make full repayments to the defendant over an "excessive and irrational" period of ten years, and so would receive no debt relief or "fresh start".[1065] The claimant argued that the Protocol created a legal obligation (of a contractual nature) on the part of the defendant to vote in favour of a Protocol-compliant proposal unless good reasons for rejecting the proposal were disclosed.[1066] The defendant allegedly breached this obligation in voting "entirely in its own interests without regard to [the debtor's] financial position and the interests of the general body of… creditors."[1067] According to the claimant, these actions represented a standard "mechanical approach" adopted by that lender in cases in which it holds veto power, in rejecting IVA proposals unless they guarantee a certain minimum projected dividend.[1068] The claimant argued that this process of setting indiscriminate hurdle rates was subversive of the purpose of the Protocol, detrimental to the "IVA market" and harmful to the general body of debtors.[1069] He also claimed that the defendant's conduct was allegedly limiting the number of IVAs being offered, and so frustrating IVA providers in their aim of fulfilling "the valid public policy objective of providing debt relief for individuals in financial distress."[1070]

The High Court rejected the claimants' arguments, firstly holding that the Protocol was to be regarded as a "voluntary industry standard or a code of best practice", creating no legal obligations.[1071] The document was of an "imprecise and aspirational" nature, which according to the court "does not… seek to set out the terms of any contract by which the IVA provider and the creditors, electing to operate the Protocol, are to be bound in law."[1072] Secondly, the court considered that the Protocol's wording did not limit the ability of creditors to vote against a proposal to circumstances in which there are good reasons for so voting.[1073] While the Protocol

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[1064] The judge described a DMP as in substance "a non-binding agreement between a debtor and his creditor for the payment of the debtor's debt over a longer period than that provided by the terms of the underlying indebtedness", *Id.*, ¶6.

[1065] *Id.*, ¶73.

[1066] Key clauses of the Protocol on which the claimants placed particular reliance included the following:

> "13.1 It is understood that one of the aims of the Protocol is to improve efficiency in the IVA process and to this extent creditors and IVA providers will avoid the need for modifications of an IVA proposal wherever possible. This does not affect the right of creditors to vote for or against an IVA proposal.
>
> 13.2 Where a creditor or their agent on their behalf votes against a protocol compliant IVA proposal, their reason for so doing should be disclosed to the IVA provider."

See *Id.*, ¶¶28, 31-3.

[1067] *Id.*, ¶32.

[1068] *Id.*, ¶73.

[1069] *Id.*, ¶¶43-4.

[1070] *Id.*, ¶44.

[1071] *Id.*, ¶¶18, 29.

[1072] *Id.*, ¶29.

[1073] *Id.*, ¶60.

required creditors to give reasons for rejecting a proposal, this merely served aims of transparency and co-operation, and did not require reasons conforming to any standards.[1074] In any event, Sir William Blackburn found nothing unreasonable in the defendant's approach to IVA proposals,[1075] and considered that a creditor "is entitled, in my view, to have regard to its own self-interest."[1076] The judge could see "no intrinsic reason why a [Protocol-compliant proposal should] not be rejected because the creditor considers that a DMP is preferable."[1077] The judge recognised, however, the undesirable consequences of this position in excluding debtors and so inhibiting the aim of debtor rehabilitation, but concluded that "the remedy lies in modifying the terms of the proposal or in persuading Parliament to amend the legislation governing IVAs."[1078]

Again in the court's decision one can discern an underlying paradigm of market bargaining between self-interested rational actors, despite the ostensibly literalist and "neutral" approach to interpreting the Protocol adopted by the court. The court perceived private ordering and debtor-creditor bargaining as the natural order, and considered that express statements in the Protocol, or even legislation, would be required to cause the court to consider even limited restrictions on parties' bargaining freedom. The court interpreted the Protocol without regard to the policy context from which it arose, and the public interest in preventing creditor holdouts from defeating reasonable debtor proposals. Instead the judge saw personal insolvency law in purely private law terms, as raising an inevitable conflict between the interests of debtor and creditors, in which all parties are expected to act in their own self-interest. The court's approach of giving maximum freedom to creditors in debt renegotiation reflects the traditional position under general English private law doctrine, under which creditor concessions are not legally binding.[1079] While there has been some advance on this position in recent cases,[1080] wide freedom remains for creditors to enforce an original agreement even in the event of renegotiation.

Certain elements of a purposive approach are evident in the court's ostensibly literalist method of interpreting the Protocol, but – as in *Johnson* – these recognise only the debt collection purpose of personal insolvency law. In offering an opinion that the creditor's conduct was reasonable, the

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[1074] *Id.*, ¶67.
[1075] *Id.*, ¶74.
[1076] *Id.*, ¶74.
[1077] *Id.*, ¶74.
[1078] *Id.*, ¶80.
[1079] *See e.g.* Broadwick Financial Services Ltd. v Spencer, [2002] 1 All ER (COMM) 446; Re Selectmove, [1995] 1 W.L.R. 474 (1995). For a discussion of the "Pinnel's case" doctrine, under which "a lesser sum of money, paid on or after the due date, is not satisfaction for a debt", *see* Richard Austen-Baker, *A Strange Sort of Survival for Pinnel's Case*, 71 MOD. LAW REV. 611 (2008).
[1080] In some cases the courts have held that the principle of promissory estoppel may mean that a lender's commitment not to take enforcement action on the condition of the debtor complying with a rescheduled payment plan may prevent the creditor from subsequently enforcing the original agreement: Collier v P & MJ Wright (Holdings) Limited, [2007] (Dec) All ER 233; Royal Bank of Scotland v Luwum, [2008] All ER 202; Austen-Baker (2008). It should be noted that Professors Adams and Browsword see the development of the principle of promissory estoppel as a move toward a partial shift from an ideology of market individualism to one of consumer protection in courts' application of the law of contract: *see* Adams & Brownsword (1987), 210.

court acknowledged that a DMP would not provide the debtor with debt relief. The court appeared more strongly influenced, however, by the fact that the creditor's conduct was "not unfair towards other creditors"[1081] and so did not violate the principle of *equality of creditors* central to the debt collection perspective of the law. While a debtor's conduct would be seen as unreasonable if contrary to this principle of the creditor wealth maximisation objective, conduct contrary to the law's debt relief aim nonetheless could be considered reasonable. In interpreting the Protocol in accordance with a view of insolvency procedures as a creditors' bargain to be struck in the personal insolvency marketplace, the High Court validated creditor holdout practices which run contrary to the Insolvency Service's stated policy of preferring IVAs over alternatives such as DMPs for consumer debtors,[1082] and which are inconsistent with the debt relief objective evident in official policy relating to bankruptcy and Debt Relief Orders. The court perpetuated the potential for the public policy aims of the personal insolvency system to be "defeated by powerful commercial interests who have no democratic mandate."[1083]

[1081] *Mond*, ¶74.
[1082] Insolvency Service (2007A), 44.
[1083] Green (2009), 409.

4.5 The Limits of Contractual Consumer Insolvency

The above discussion has shown a general trend in court decisions, and even by the Insolvency Service in its IVA proposals, to conceptualise personal insolvency procedures as "products" in a marketplace, for which parties should have maximum freedom to bargain. The Insolvency Service acknowledged a role for "product regulation"[1084] of the IVA in this marketplace so as to guarantee its quality and its suitability for the purposes it serves, as well as to create incentives for parties to select this option over what it considered lower quality alternatives of bankruptcy, DMPs, or consolidation loans. The substitution of a voluntary protocol for regulation, and the court's bestowal of its imprimatur to creditors' freedom to depart from the protocol, however, means that the market is largely unregulated.

Not only does this free market perspective fail to encompass important distributive, humanitarian and moral considerations raised by personal insolvency law, but it is also flawed in its own economic premise of achieving optimal resource allocations. While complete contractual freedom may facilitate efficient outcomes in commercial contexts where parties negotiate symmetrically at arm's length, it is a basic premise of consumer law that unregulated market exchange between producers and consumers generally will not produce optimal results.[1085] Failures are inevitable in consumer markets, which necessitate regulatory intervention.

A. The Consumer Over-Indebtedness Market

A free market in personal insolvency is problematic as significant market failures arise in the *ex post* market in debt restructuring, just as they arise in the *ex-ante* consumer credit market (see Parts 2.2(B) and Part 4.6(B) above). The debt resolution market consists of a range of "products" which are "sold" by creditors to debtors (via intermediaries in some, but not all, cases).[1086] One can conceptualise the products as packages of various levels of debt relief or forbearance, sold by creditors at various prices (the debtor's surrender of income and/or assets, completion of a long-term repayment plan, etc.). While creditors do not voluntarily "sell" the level of debt relief provided in bankruptcy, they are required by law to offer it in the event of the debtor's petition. Creditors can nonetheless compete with bankruptcy by offering debtors alternative debt

[1084] For a discussion of the regulatory technique of setting product standards, see e.g. RAMSAY (2012A), 104.

[1085] *See e.g.* HOWELLS & WEATHERILL (2005), 10–11.

[1086] I base the following analysis on a market consisting of a debtor and her body of creditors, with debt relief of various "quality" (i.e. the extent of debt relief), being "sold" by creditors at various "prices" (level of repayments, duration of repayment plan). Thus I do not consider the role of the intermediary in the process, and issues (such as principal-agent problems) might arise do to the intermediaries' involvement.

resolution products of IVAs and DMPs.[1087] As a central assumption of the efficient market ideal is that market actors behave according to their preferences and constantly seek to maximise their utility,[1088] I now establish the parties' bargaining positions by outlining assumed debtor and creditor preferences.

(I) Debtor Preferences

Over-indebted consumers can be assumed to seek to maximise their utility by purchasing the most extensive debt relief at the lowest (financial and non-financial) cost. Bankruptcy provides the greatest debt relief to debtors, in that all of the debtor's non-exempt debts are discharged after a waiting period of just one year, on the liquidation of the debtor's non-essential assets (if any – see Figure 42, Appendix). Approximately 25% of debtors must make contributions from income for a three year period.[1089] The IVA procedure generally provides for debt discharge after a debtor has completed a repayment plan enduring for approximately 5-6 years,[1090] although evidence suggests a recent trend of increasingly longer repayment periods (see Figure 12 below). The usual debt write-down obtained at the IVA's end usually amounts to approximately 60% of the debtor's obligations.[1091] Under a DMP, a debtor will make rescheduled repayments to creditors for a period estimated by the Insolvency Service to endure for more than 10 or even 20 years.[1092] No debt discharge/forgiveness is generally provided under a DMP.

Apart from these considerations, the treatment of the debtor's home is a significant factor in deciding which procedure meets a debtor's preferences, and is crucial to the related choice faced by American consumer debtors between Chapters 7 and 13 of the US Bankruptcy Code.[1093] In bankruptcy, a home-owning debtor will generally be required to surrender her home, subject to a one year "grace period" during which she and her family may continue to live there,[1094] and the condition that the property be sold only where the debtor's interest is worth more than £1,000.[1095] Therefore for debtors in "negative equity", whether the debtor may keep her home is a matter between her and her mortgage lender.[1096] An IVA generally deals solely with unsecured debt, and the arrangement reached cannot affect the right of a secured creditor to enforce its

[1087] Another alternative debt solution is the consolidation loan, but as this product differs from other debt resolution mechanisms in significant ways, it is not a directly substitutable product and I omit it from the analysis.
[1088] TREBILCOCK (1997), 3–4.
[1089] Insolvency Act 1986, §§310–310A. *See* Spooner (2013), 766.
[1090] IVA Protocol: Straightfoward Consumer Individual Voluntary Arrangement (2008), ¶9.1.
[1091] INSOLVENCY SERVICE (2009B), 18; PWC (2006), 3.
[1092] Insolvency Service (2007A), 43; Insolvency Service (2005B), ¶24. See footnote 955, however.
[1093] Porter (2011), 135–37; MARIANNE B. CULHANE, *No Forwarding Address*, *in* Porter (ed,) (2012) 119, 122 et seq.
[1094] Insolvency Act 1986, §§336–38; FLETCHER (2009), ¶8–002.
[1095] Insolvency Act 1986, §313A and Insolvency Proceedings (Monetary Limits) (Amendment) Order 2004/547; FLETCHER (2009), ¶8–032.
[1096] *See* Insolvency Rules 1986/1925, rules. 6.93, 6.109; FLETCHER (2009), ¶9–073.

security.[1097] An IVA offers certain advantages to home-owning debtors,[1098] as it will generally not oblige the sale of the debtor's home, but will require the debtor to release a portion of any home equity she holds.[1099] The protection of the debtor's home does not appear to be as influential in the choice between bankruptcy and IVA as in the Chapter 7 v 13 decision in the US, however. While data is limited, 8-14% of debtors in bankruptcy during the years 2003-2008 were property owners, with this figure increasing steadily throughout this period.[1100] In 2009, only 36% of IVA debtors were homeowners, while only 25% of debtors held equity in their properties.[1101] In contrast, approximately 75% of US debtors under the Chapter 13 procedure are homeowners.[1102] While the wish to keep one's home is the primary motivation for American debtors selecting Chapter 13,[1103] this motivation ranks much lower down the list of English debtors' reasons for choosing an IVA, which is understandable given their lower level of home ownership.[1104] For a large majority of IVA debtors, the ability to keep one's home thus is irrelevant to the choice of an IVA over bankruptcy.

While debt relief clearly provides financial benefits in the removal of a debtor's legal liabilities, it can also provide other non-financial benefits in terms of the relief from stress and health difficulties related to over-indebtedness, etc.[1105] Formal legal procedures such as bankruptcy and an IVA, both of which end creditor enforcement action via an automatic stay/moratorium, are likely to provide these benefits to a much greater extent than a non-binding informal repayment arrangement with creditors.[1106] Given the difficulties of keeping to a tight budget for a prolonged period of time, it is likely that bankruptcy, with its shorter duration, provides greater relief from anxiety than the IVA procedure. A repayment period in excess of five years provides plenty of time for financial difficulties to re-emerge, putting further stress on a debtor seeking to maintain repayments, as she has a one-in-three chance of her IVA failing (see Figure 12 below).

Similarly, the debtor may recognise certain non-financial costs as attaching to each procedure, such as the debtor's sense of shame or moral concerns regarding her failure to repay her debts.[1107] These costs are obviously more difficult to measure objectively. Satisfaction of the moral/social norm of debt repayment appears to be valued by IVA debtors, as the wish to repay creditors is the most commonly cited reason for selecting this option. [1108] Again, this contrasts

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1097 Insolvency Act 1986, §258.

1098 Walters (2009), 20–21.

1099 IVA Protocol: Straightfoward Consumer Individual Voluntary Arrangement (2008), ¶9.1 et seq.

1100 Insolvency Service, Profiles of Bankrupts 2005/6-2007/8 (2009); Insolvency Service, Profiles of Bankrupts 2-003/4-2005/6 (2007).

1101 INSOLVENCY SERVICE (2009B), 18.

1102 Porter (2011), 121.

1103 *Id.*, 134.

1104 INSOLVENCY SERVICE (2008B), 17.

1105 *See e.g.* Ronald Mann & Katherine Porter, Saving Up for Bankruptcy 313–18 (SSRN Library 2010), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1540216; Porter (2011), 142–44.

1106 Walters (2009), 19–20.

1107 Hallinan (1986), 141–42; Jones & Zywicki (1999), 215–21.

1108 INSOLVENCY SERVICE (2008B), 17.

with the US position, where the desire to repay as much debt as possible is a less important goal of debtors.[1109] It should be recalled, however, that the Income Payment Order/Agreement mechanism allows debtors to make repayments to creditors in bankruptcy also. Avoiding the stigma of bankruptcy could be a further motivating factor for choosing an IVA,[1110] and this is another top reason cited by debtors for choosing an IVA.[1111]

In presenting the IVA as "the best product in the market" for both debtors and creditors, the Insolvency Service listed additional perceived advantages to debtors of IVAs over bankruptcy. The Insolvency Service notes that the IVA offers "more control of the process" than bankruptcy.[1112] One might question, however, the level of control held by an IVA debtor who must pass all income bar that required for a minimal standard of living to an Insolvency Practitioner for five years or more. The Service continues to state that the IVA "provides certainty in both repayment levels and duration, together with the opportunity for debt forgiveness."[1113] All of these elements are also provided to a much greater extent by bankruptcy, however. While the duration of bankruptcy is fixed in law (subject to the rare occurrence of a suspension of discharge), and income contributions are fixed by a neutral administrator, under the IVA procedure the "certainty" of these elements is subject to the wishes of creditors. Finally, the Service argues that an IVA "is less punitive on the debtor (in terms of the restrictions imposed) than bankruptcy".[1114] Reforms under the Enterprise Act of 2002, however, have removed many of the restrictions previously applicable to debtors in bankruptcy.[1115] While it has been argued that certain professionals benefit from an IVA due to the negative impact of bankruptcy on their ability to practice under professional regulatory norms,[1116] the limited data available suggests that only a small minority of IVA debtors are professionals, with only 5% present among a 2006 survey's sample of 5,850.[1117] Furthermore, it appears at least some regulatory bodies have relaxed their rules on the impact of a member's bankruptcy on her ability to practice, while participation in an IVA may also have consequences for professional practice. Culpable bankruptcy debtors can be investigated and made subject to additional costs in the form of

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1109 Porter (2011), 134.

1110 Walters (2009), 20. Some cases studies suggest, however, that some individuals may not distinguish between IVAs and bankruptcy in relation to the stigma involved: *see* PWC (2006), 15.

1111 INSOLVENCY SERVICE (2008B), 17.

1112 *Id.* ¶21. The wish to retain control over their finances nonetheless appears to influence debtors' choice of the IVA procedure. It is unclear whether survey responses to this effect indicate that debtors consider they have more control over their finances under the IVA procedure than in bankruptcy, or rather whether it means that a desire to re-balance one's financial situation was a reason for choosing *any* debt solution. Survey evidence shows that the wish to retain control over assets is not an influential factor in debtors' choice of the IVA: INSOLVENCY SERVICE (2008B), 17.

1113 Insolvency Service (2005B), ¶21.

1114 Insolvency Service (2007A), ¶3.

1115 *See e.g.* Walters (2005), 82–85.

1116 Walters (2009), 20.

1117 PWC (2006), 17.

Bankruptcy Restrictions Orders/Undertakings and bankruptcy offences,[1118] but the avoidance of these sanctions lies within the debtor's control.[1119]

Perhaps most importantly, all procedures have varying direct financial costs. As discussed above, bankruptcy debtors must overcome the considerable obstacle of paying a fee and deposit amounting to £700. In contrast, a 2008 Insolvency Service survey found that approximately 80% of debtors in IVAs spread fees over the course of an IVA rather than paying upfront, suggesting that initial ("up-front") financial costs are a much lesser obstacle to IVA access.[1120] While a 2009 survey differed in finding this figure to be closer to 50%, since 20% of respondents did not know if they had paid an initial fee it is likely that significantly more than half avoided up-front costs (although the lack of debtor knowledge of costs is concerning).[1121] Debt Management Plans are either provided by non-fee-charging advice services, or are funded by deductions from the debtor's monthly repayments to creditors. This means that again the debtor pays no up-front fees on entering into a DMP. Many fee-charging firms deduct the entirety of the debtor's first monthly repayments in order to cover fees, however, meaning that while the firm is paid promptly, the debtor's financial difficulties may not be fully addressed for several months.[1122] Given the greater debt relief offered by bankruptcy, and the capacity of Income Payment Orders/Agreements to serve debtors' moral desire to repay debts, the obstacle posed by the cost of accessing bankruptcy may therefore be a significant factor in directing debtors away from the benefits of bankruptcy towards the IVA procedure or DMPs. This was recognised by the Insolvency Service in recent evidence presented to Parliament.[1123]

(II) Creditor Incentives

Creditors, in turn, can be assumed to seek to minimise losses and recover as much of the unpaid debt from the debtor as possible. The options to be weighed by creditors in the event of a debtor's default include:

- Seeking to collect sums owed from the debtor via dunning and other non-judicial methods;
- Suing the debtor and seeking to enforce a court judgment;
- Petitioning for the debtor's bankruptcy (or not preventing a debtor from petitioning for her bankruptcy);

[1118] For an example of a debtor attempting to switch a case from bankruptcy to an IVA in order to avoid investigation of suspect conduct, *see* Bramston v Haut [2012] EWCA Civ 1637, [2013] 1 W.L.R. 1720 (2012).

[1119] Spooner (2012), 255; Walters (2005), 85–100.

[1120] INSOLVENCY SERVICE (2008B), 9–10.

[1121] INSOLVENCY SERVICE (2009B), 13–14.

[1122] Office of Fair Trading, Debt Management Guidance Compliance Review ¶ 1.22 (2010). The OFT found even more abusive conduct among firms who advertise their services as free while later charging a fee.

[1123] House of Commons, Business, Innovation and Skills Committee, The Insolvency Service ¶ 42 (Westminster, House of Commons 2013).

- Negotiating an IVA with the debtor;
- Negotiating a DMP with the debtor.[1124]

The costs of judicially enforcing debt claims are likely to be so high relative to the value of assets or income recoverable from an insolvent consumer that creditors may have little incentive to pursue individual enforcement action.[1125] Informal debt collection efforts are likely to be less expensive, and so may be a preferred option for creditors. The creditors' bargain theory, however, holds that insolvency plays the role of enhancing general creditor welfare by solving collective action problems and forcing co-operation in order to maximise debt recovery for creditors as a group, while avoiding the value destruction and wasted costs of creditor competition in individual enforcement.[1126] This suggests that creditors may prefer a collective repayment arrangement to individual enforcement action, and prefer a non-judicial procedure with lower transaction costs than a judicial procedure. This assumption underlies the Insolvency Service's consideration that its lower costs and higher returns make the IVA a preferable consumer insolvency procedure for creditors than bankruptcy.[1127] Irrespective of transaction costs, the extensive debt relief provided by bankruptcy means that unless a debtor has substantial realisable assets it will represent the worst outcome for creditors. Therefore creditors have incentives to opt for a collective procedure other than bankruptcy, such as an IVA. Subject to standardised industry practices,[1128] creditors are incentivised to negotiate an arrangement involving the highest repayment levels for the longest duration.[1129] The IVA voting rules establish conditions for a classic "holdout" problem,[1130] as a creditor holding veto power is in a position to extract disproportionate value by using the threat of frustrating the debtor's proposal (as seen from the *Johnson* and *Mond* cases).[1131]

The industry standardisation of IVA terms, however, means that IVAs generally have some *de facto* outer limits of repayment levels and plan duration. Thus, as seen in the *Mond v MBNA* case, a creditor holding sufficient voting power has an incentive to reject debtor proposals altogether where greater returns can be achieved by directing the debtor into a long term DMP. This may involve the vetoing creditor sharing debtor contributions in a manner which maximise

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[1124] Other options available to the creditor lie outside the scope of my study, such as selling a consolidation loan to the debtor or selling defaulted debt to a debt buying/collecting firm: see e.g. Green (2009), 408.

[1125] WORLD BANK (2013) ¶¶59–68; Bertola et al. (2006A), 14, 18.

[1126] JACKSON (1986), 10–14.

[1127] Insolvency Service (2005B), ¶22.

[1128] This standardisation does not unduly restrain the freedom of creditors in the IVA bargaining process, since creditors have already negotiated for this standardisation under a "meta-bargaining" process: *see e.g.* CARRUTHERS & HALLIDAY (1998), 15 et seq.

[1129] This is subject to recognition by creditors that subjecting debtors to overly long repayment periods may be counter-productive in that may reduce debtor productivity and so the amount of income available for repayments to creditors: WORLD BANK (2013), ¶62. Dr Pond's empirical studies of IVAs have shown that creditor modifications requiring increased monthly contributions from debtors increase the risk of the IVA failing: Keith Pond, *Creditor Strategy in Individual Insolvency*, 28 MANAG. FINANCE 46, 57 (2002).

[1130] *See e.g.* STEARNS & ZYWICKI (2009), 17–18.

[1131] Moss & Johnson (1999), 318–19.

returns to *all* creditors (but frustrates the debt relief objective),[1132] or "cheating" in collecting more from the debtor unilaterally than would be recovered under an IVA or *pari passu* DMP.[1133] Favourable accounting treatment of DMPs over IVAs may also further incentivise creditors holding sufficient votes to direct a debtor into a DMP.[1134] Therefore a potential anticommons or holdout situation exists under which creditors are incentivised to reject IVA proposals outright in order to obtain greater returns via non-statutory insolvency or debt collection procedures.

A further consideration for creditors is whether the administrative costs of IVAs and DMPs are justified by the amounts received in repayments. Extended durations of repayments plans, which increase returns to creditors, also raise transaction costs in monitoring and processing dividends.[1135] Transaction costs may be lower for a bilateral DMP negotiated directly between one creditor and debtor, rather than one negotiated via an intermediary remunerated from the debtor's limited funds (as is always the case in IVAs). Survey evidence suggests that creditors consistently seek to reduce fees charged by Insolvency Practitioners under IVAs as a means of reducing transaction costs and increasing returns.[1136] Certain fixed IVA administrative costs will be disproportionately high in low value cases, in which creditor rejection rates are high.[1137]

Additional costs accruing due to the debt relief involved in the IVA procedure take the form of "self-cure" risk and "re-default" risk.[1138] There is a risk that a debtor's financial difficulties are temporary, so that the debtor will "cure" and return to full repayments in time. To accede to debt relief under such borrowers' proposals "would be to throw away money."[1139] By forbearing enforcement and "selling" a DMP of long duration to the debtor, a creditor can guard against this risk, and remains free to depart from the non-binding DMP to obtain full repayments should the debtor's income increase. This exemplifies how creditors place value on maintaining *control* of a case, as they do under an unregulated procedure such as a direct DMP.[1140] Classically a creditor dislikes losing control over a case, since an unfavourable outcome may result.[1141] The "re-default" risk refers to creditor fears that debtors offered reduced repayment under an IVA may subsequently default in making repayments (and potentially enter bankruptcy), meaning that the

[1132] This provides the novel solution to the "common pool" problem of simply enlarging the pool, albeit while flooding the surrounding area (by creating externalities borne by third parties).

[1133] For a discussion of the individual's incentive to "cheat" in a collective agreement, see STEARNS & ZYWICKI (2009), 13–14.

[1134] Walters (2009), 32.

[1135] Pond (2002), 53.

[1136] INSOLVENCY SERVICE (2009B), 18, 27.

[1137] PWC (2006), 11; Pond (2002), 55.

[1138] Manuel Adelino et al., Why Don't Lenders Renegotiate More Home Mortgages? 7 (National Bureau of Economic Research 2009), http://www.nber.org/papers/w15159.

[1139] B. White (2010), 1010.

[1140] *See also* note 1046 *supra.*

[1141] This position is explained in Professor Rock's classic study of the sociology of debt collection:

> "The transfer of control from the creditor to another institution is always attended by risks. The creditor not only loses his ability to manipulate the debtor, the debtor himself may be reappraised…. One of the chief difficulties facing a creditor is [the] likelihood that a debtor will be redefined and consequently treated with what is thought to be excessive leniency."

See ROCK (1973), 68.

creditor's costs in negotiating and processing the IVA have been wasted.[1142] This cost is increased by concerns of moral hazard and adverse selection, which may lead to creditor scepticism as to the debtor's potential to comply with an IVA repayment plan.[1143] By seeking to place a debtor into a non-statutory DMP, and preferably a bilateral non-intermediated DMP, the creditor can retain maximum control over the case. Finally, some creditors may reject an IVA proposal due to a simple refusal to accept a reduction in their claim out of principle, a problem experienced in voluntary renegotiation systems in other countries.[1144]

B. Failures in the Consumer Insolvency Market

Under the efficient market hypothesis, an optimal outcome in the debt resolution market would involve debtors buying and creditors selling debt relief products which best meet their mutual preferences, in a manner which internalises all costs and produces optimal outcomes. For the reasons I now explore, however, failures in the debt resolution market mean that debtors do not choose products which best maximise their utility, leading to sub-optimal outcomes in which creditors can maximise gains while externalising costs.

(I) A Captive Market

Firstly, a basic precondition for an efficient market is that all parties can enter and exit the market freely.[1145] This may not be the case for over-indebted consumers, who may effectively be forced into "purchasing" *some* debt resolution mechanism due to actions such as the pressure of creditor collection efforts and judicial enforcement actions. Therefore if a debtor considers that no debt resolution "product" suits her preferences, it is difficult for her simply to leave the market. The closest a debtor can come to so doing is to petition for bankruptcy, as this represents a rejection of debt relief concessions offered by creditors. The costs of accessing bankruptcy, however, mean that this is not a realistic option for many debtors. A debtor who finds her creditors unwilling to offer favourable terms in an IVA or a DMP cannot "shop around" and decide to negotiate with an alternative set of creditors who are more open to such terms. Furthermore, there are no competitive pressures which could encourage creditors to offer more favourable renegotiation terms.[1146]

[1142] Adelino et al. (2009), 7; B. White (2010), 1010.

[1143] Pond (2002), 49.

[1144] World Bank (2013, ¶131.

[1145] Ramsay (2012A), 42, citing Ramsay (1984), ¶3.3; Scott & Black (2000), 27.

[1146] It is true that creditors may hold concerns that their reputation may be tarnished if their harsh treatment of defaulters generates bad will and jeopardises custom: *see* Leff (1970), 35. These concerns can be alleviated, however, by minimising the outward flow of information regarding IVA/DMP negotiations (see the discussion of information asymmetry), or by

(II) Information Failures

Secondly, an efficient market requires that all actors in the market possess perfect information,[1147] which is not the case as significant information asymmetries exist between creditors and consumer debtors in the market for debt restructuring.[1148] Creditors are "repeat players" in this market, while a consumer debtor is likely to be experiencing it for the first time. This means that a debtor will not benefit from the "learning effect" which is a theoretical feature of efficient markets.[1149] Further, learning possibilities are limited as people tend to feel uncomfortable discussing financial affairs generally,[1150] with those in financial difficulty often experiencing particular shame.[1151] This means that debtors who have been through debt solutions are unlikely to communicate their experiences widely, furthering reducing information flow. Consumer debtors are also likely to be uninformed regarding the range of "products" in the market due to their lack of knowledge of often complex insolvency legislation.[1152] Information regarding the "going rate" of debt write-down typically offered by creditors is most likely inaccessible to debtors, as this information is uniquely within creditors' control. Creditors may place the debtor at an even greater informational disadvantage by avoiding standardisation of debt forgiveness policies;[1153] and by restricting public knowledge of debt write-downs (for example, the "trigger figures" under the UK Common Financial Statement used to calculate appropriate levels of debtor repayment are not publicly available).[1154] IVA providers have identified a problem of inconsistency in IVA negotiations.[1155] Creditors hold further informational advantages in their proprietary credit scoring systems, which mean that each creditor has unique information regarding the impact of entering a particular debt solution will have on the debtor's

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using debt collection agencies and other third parties to recover their funds. Adverse selection concerns mean that lenders are unlikely to wish to market themselves as default-friendly, lest they attract unwanted high risk borrowers.

[1147] *See* RAMSAY (2012A), 49-54. *See generally* Stiglitz (2000).

[1148] *See e.g.* Whitford (1994), 403.

[1149] SCOTT & BLACK (2000), 33; Lunn (2012), 9.

[1150] *See e.g.* De Muynck (2010), 1194–95.

[1151] *See e.g.* O'LOUGHLIN (2006), 45; JOYCE (2009), 24, 51, 69, 93–94.

[1152] Surveys conducted in England and Wales show that a majority of bankrupts (approx. 58% and 64% respectively) had not been aware of a major change in the leniency of the debt discharge regime under English law before entering bankruptcy: INSOLVENCY SERVICE (2006A), 67–68. *See also* ANGELA LITTWIN, *The Do-It-Yourself Mirage: Complexity in the Bankruptcy System*, *in* PORTER (ED.) (2012) 157.

[1153] I argue that a lack of standardisation may serve to empower creditors and disempower debtors in restructuring negotiations: *see* Spooner (2012), 265.

[1154] See http://www.cfs.moneyadvicetrust.org/faqs.asp?page_id=37. See also Irish Parliamentary debates in which concerns were raised regarding the creditor practice of requiring debtors entering mortgage restructuring negotiations to sign non-disclosure agreements: Dáil Éireann Debates, Leader's Questions, 14th March 2013, question of Mr Pearse Doherty, T.D. See also *Sinn Féin Urges End to Bank Secrecy on Mortgage Restructuring*, IR., http://www.irishtimes.com/news/politics/sinn-f%C3%A9in-urges-end-to-bank-secrecy-on-mortgage-restructuring-1.1320982; Joseph Spooner, Review of the Code of Conduct on Mortgage Arrears: Submission to the Central Bank of Ireland 6 (2013), available at: http://www.centralbank.ie/regulation/poldocs/consultation-papers/Pages/closed.aspx?PagingID=2.

[1155] INSOLVENCY SERVICE (2009A), ¶5.12.

future access to credit. This allows creditors to use unverifiable threats of adverse consequences for the debtor's credit history to convince debtors to agree to a rescheduling arrangement which is more in the creditor's interest than the debtor's.[1156] A classic debt collection tactic is to withhold the precise details of the consequences of debtor non-cooperation by threatening an unspecified sanction.[1157] Debtors may enter into unfavourable repayment arrangements under fear of alternative consequences more severe than those which would actually arise.[1158]

(III) Bounded Rational Behaviour

Another serious obstacle to the efficient operation of the "market" for debt resolution is that consumer debtor behaviour does not correspond to the rational choice model on which the efficient market hypothesis is based. Therefore, aside from information failures which inhibit welfare-enhancing choices, behavioural economics teaches us to be cautious in assuming that even well-informed debtors can *identify* what is in their best interests. [1159] Rather than negotiating an optimal IVA or DMP with creditors (or recognising that other alternatives such as bankruptcy might better maximise welfare), optimism bias may lead consumer debtors to over-estimate their ability to comply with a rigorous repayment plan over a number of years, thus leading them into an unsustainable or overly onerous arrangement.[1160] Time-inconsistent preferences[1161] mean that individuals value present benefits much more highly than they should in relation to future costs, which they undervalue significantly.[1162] Therefore desperate consumer debtors eager to end the stress of over-indebtedness[1163] may value the present benefits of immediate protection from enforcement over the underestimated costs of following an onerous repayment plan for several years into the future.[1164] In the IVA context the potential for a debtor to sign up to an overly onerous plan is increased by the fact that creditors often wait until the morning of the creditors' meeting to propose modifications,[1165] meaning that the debtor may have only minutes in which to assess the extent to which a modified proposal meets her future preferences. Thus

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1156 B. White (2010), 1011.

1157 "Ambiguous threats are a… feature of [debt] collection. Enforcement would be discredited if it contained falsifiable predictions about action." ROCK (1973), 71–72.

1158 *See e.g.* B. White (2010), 995–96.

1159 Charles J. Tabb, *Of Contractarians and Bankruptcy Reform*, 12 AM. BANKRUPTCY INST. LAW REV. 259, 263–66 (2004).

1160 See e.g. the sources cited by Tabb (2004), 263–64.

1161 Ramsay (2005), 52.

1162 *See e.g.* Jason J. Kilborn, *Behavioral Economics, Overindebtedness & (and) Comparative Consumer Bankruptcy*, 22 EMORY BANKRUPTCY DEV. J. 13, 21 (2005).

1163 For a discussion of the negative health effects of over-indebtedness, see LAW REFORM COMMISSION (2009), ¶¶1.11–1.15; Emami (2010); Balmer et al., (2006).

1164 This problem is particularly pronounced in the context of a consumer in financial difficulty, as her creditors hold the power actually to raise the consumer's valuation of the present benefit of stress relief by increasing the pressure they apply on the debtor through their collection activities.

1165 INSOLVENCY SERVICE (2009B), 27–28.

even if consumers had the bargaining leverage and information to negotiate arrangements competitively with creditors, these biases may lead them to agree to sub-optimal terms.[1166]

In addition, emotional factors may move consumer debtor behaviour away from the paradigm of economically rational choice. Debtors may wish to avoid the most financially beneficial solutions (such as bankruptcy) due to a sense of shame or guilt, and a desire not to be seen as immoral or irresponsible.[1167] The amount of this cost can be increased by creditors at the micro-level through pleas to the debtor's moral obligations to repay, and at the macro-level by purveying messages of "payment morality" in the media and public debate.[1168] These factors may further lead to debtors choosing sub-optimal debt solutions, while increasing creditors' chances of obtaining favourable outcomes.

(IV) Inability of Intermediaries to Cure Failures in Debtor Choice

While the actions of intermediaries in negotiating IVAs and/or DMPs on the part of debtors potentially could counter-act these failings, this may not be the case in practice.[1169] In fact, information asymmetries may be exacerbated by widespread misleading advertising in the debt management market, as identified by the Office of Fair Trading.[1170] The OFT similarly found that advisors employed by debt management firms "generally lack sufficient competence and are providing consumers with poor advice based on inadequate information."[1171] The regulator further found that firms were directing debtors into the most profitable procedures, irrespective of the debtor's needs. It should also be considered that legally under an IVA an intermediary's duty is not just to advise the debtor,[1172] and that practically her interests (in directing debtors to more

1166 See e.g. Walters (2009), 31.
1167 B. White (2010), 992–94.
1168 *Id.*, 996–1007.
1169 For example, behavioural economics literature suggests it is extremely difficult for intermediaries to correct clients' cognitive biases. *See* Stephanos Bibas, *Plea Bargaining Outside the Shadow of Trial*, 117 HARV. LAW REV. 2464, 2522 (2003).
1170 OFT (2010B), 7.
1171 *Id.*
1172 The Insolvency Practitioner's role as a nominee in proposing an IVA extends beyond advising a debtor, and also involves a duty to creditors and the court: see e.g. Statement of Insolvency Practice 3 (SIP3), Joint Insolvency Committee, 2007, ¶1.5. The Insolvency Service policy review of the IVA made it clear that the Insolvency Practitioner owes a duty to produce outcomes favourable to creditors: Insolvency Service (2005B), ¶¶32–35. The IP's duties were described by HHJ Roger Cooke in the following terms:

> "There must be a duty to the debtor at least up to the point when the proposal is accepted… However once the scheme is approved in the ordinary way his duties to the debtor would cease as he then becomes the supervisor of the arrangement. As such his duties can only be his public duties to the creditors with which any private duty to the debtor would be inconsistent."

Pitt v Mond [2001] BPIR 624, cited in Milman (2005), 79.

profitable "products";[1173] and/or maintaining good business relations with creditors[1174]) may conflict with those of the debtor. Due to the need to maintain low costs, intermediaries are also incentivised to propose the option most likely to be accepted by creditors in order to save resources, rather than "fighting" to negotiate the most appropriate remedy for the individual debtor.[1175] Most importantly perhaps, intermediaries lack any financial incentive to recommend that a debtor opt for the "unmanaged"[1176] solution of bankruptcy, from which no fees can be earned.[1177] Concerns arise that rather than choosing options which best meet their preferences – the key feature of a market – many consumer debtors are steered or forced into overly onerous repayment plans, when the alternative of bankruptcy may not only provide a preferential outcome for the debtor, but also reduce externalities.[1178]

(V) Externalities

Classic market failure theory acknowledges the need for regulatory intervention where the market leads to negative externalities being imposed on parties other than those contracting.[1179] Consumer insolvency is a situation in which extensive negative externalities abound, as discussed in Chapter 2. Personal insolvency law internalises these costs by restoring debtors (through debt discharge) to positions of economic productivity, and incentivising creditors (as the parties best placed to prevent default and to insure against it) to internalise these social costs by adopting more responsible lending practices (see Part 4.6(B) below). If an insolvency procedure or non-statutory arrangement requires a debtor to participate in a prolonged repayment plan in which a large portion of her income is paid to creditors, externalities continue to accrue, as the debtor's low consumption and productivity levels persist and she may remain in such financial difficulty as to require support from social welfare systems and health services.[1180] Debtors will most likely already have spent a long period in financial difficulty before taking the step of

[1173] An Office of Fair Trading review of the debt management industry "found significant and widespread examples of unfair and improper business practices. Firms are not giving the advice or offering the solution that is in the best interests of the consumer but instead that which is most profitable to them." *See* OFT (2010B), ¶1.20.

[1174] For evidence of this problem in the market for *corporate* insolvency practitioners, see e.g. Office of Fair Trading, The Market for Corporate Insolvency Practitioners: A Market Study (OFT 2010).

[1175] Whitford (1994), 401.

[1176] For a discussion of the rising relative levels of "managed" insolvencies compared to bankruptcies, see CCCS (2012), 7–8.

[1177] Walters (2009), 34.

[1178] See Professor Whitford's concerns regarding similar circumstances in the US consumer bankruptcy system: Whitford (1994), 415.

[1179] Tabb (2004), 260, 266.

[1180] The support of the debtor via social assistance systems creates incentives for lenders to continue to extend credit even in cases in which the debtor may have difficulty in making repayments from her own resources. *See e.g.* Hynes (2004), 340–41.

seeking to enter a DMP/IVA.[1181] Similar externalities arise when debtors are excluded from collective arrangements entirely and individual collection efforts persist.

C.Empirical Picture of IVA Contracting Failures

Consistent with the above analysis, the limited number of studies of the operation of IVA bargaining show "general agreement that IVA terms are currently overly dictated by creditor groups"[1182] and that "the debtor is effectively powerless".[1183] The introduction of the IVA Protocol does not appear to have remedied these problems.

First, evidence suggests that certain creditors hold policies of invariably rejecting IVA proposals in order to direct debtors into debt solutions involving lesser losses. The sharp decline in the growth rate of IVAs described above has been accompanied by rises in numbers of intermediated DMPs and, presumably, also of non-intermediated direct DMPs and informal repayment arrangements. In a 2009 Insolvency Service survey, IVA providers described large increases in the numbers of DMPs compared with IVAs, indicating that they negotiated 4-5 DMPs for every IVA proposed.[1184] Providers indicated that regularly they did not propose IVAs even in suitable cases, due to knowledge that certain creditors automatically reject proposals when they possess more than 25% of voting rights.[1185] Evidence suggests creditors act in the manner suggested by the model presented above, rejecting debtor proposals outright where it is in their economic self-interest, but not in the public interest.

Researchers and policymakers must not make the error of assuming that creditors' acceptance of a proposal necessarily represents a successful outcome, however. An agreed arrangement involving very onerous repayment terms or an overly extended duration may not internalise the social costs of over-indebtedness, and may indeed exacerbate externalities. Policymakers must consider closely the *quality* of debt rescheduling arrangements, rather than just their quantity. While increased data is much needed, there is sufficient evidence to raise concerns that creditors have used the power handed to them by English law to impose arrangements on debtors which may be frustrating the fresh start policy. A first significant victory on the part of creditors was the extension of repayment periods for arrangements. While now the standard duration is approximately 5-5½ years, in the IVA procedure's early years about half of arrangements

[1181] For consideration of the financial difficulties endured by debtors before seeking a formal remedy, *see e.g.* Mann & Porter (2010), 313.
[1182] Sue Morgan, Causes of Early Failures in Individual Voluntary Arrangements 41 (Kingston University 2008).
[1183] Michael Green, Individual Voluntary Arrangements Over-Indebtedness and the Insolvency Regime: Short Form Report 8 (Bangor, University of Wales 2002).
[1184] INSOLVENCY SERVICE (2009B), 28.
[1185] *Id.*, 29.

typically endured for less than one year,[1186] while others tended to last for a period of up to three years.[1187] This mirrored the three year waiting period for automatic discharge from bankruptcy at the time (and the current maximum duration of repayments under a bankruptcy Income Payment Order/Agreement), and also reflected the recommendations of the Cork Committee.[1188] Since the early 1990s, the durations of repayment periods have increased steadily, in a trend driven by creditors' desire to increase returns.[1189] This trend appears to be continuing: while in 2006 only 10% of IVAs lasted for more than 6 years, by September 2012 27% of IVAs first registered in 2006 (i.e. IVAs enduring for at least six years), and over 10% of those registered in 2005 (i.e. enduring for at least seven years) remained ongoing (see Figure 12). This is quite worrying, since repayment periods of such long duration compromise the fresh start policy considerably and conflict with efforts to incorporate further this policy into bankruptcy law by liberalising discharge conditions.

In addition, creditors seek to increase the level of income contributions required of IVA debtors, and refuse to accept a debtor's initial proposal without requiring modifications in a large majority (between 70-97%) of cases.[1190] Most modifications relate to dividends and distribution of repayments, the fees of the intermediary, and the levels of debtor contributions or the repayment plans' duration. A 2009 Insolvency Service survey found that the average projected rate of returns to creditors in debtor proposals pre-modification was 35p in the £, but that this rose to 41p after modifications.[1191] Arrangements requiring such high contributions risk becoming unsustainable, and surveys consistently identify unsustainable contributions as a primary reported cause of IVA failures.[1192] Failure rates have risen considerably since the early 2000s, and the apparent increasing number of longer-term IVAs may exacerbate this trend (Figure 12). Even some debtors who succeeded in completing an IVA considered that the contributions they had been making were too high,[1193] further illustrating that participation in an IVA does not necessarily reveal a debtor's preference for this mechanism. IVA providers surveyed in 2009 considered that the Protocol has had a limited impact on reducing the number of modifications proposed by creditors.[1194] In the absence of more detailed evidence, one is left to conclude provisionally that, as in other jurisdictions which provide for consumer choice in personal insolvency, large numbers of debtors are entering repayment plans that provide for much greater repayment to creditors than would be made under the alternative procedure of bankruptcy.[1195] A

[1186] Pond (2002), 56.
[1187] Morgan (2008), 11.
[1188] CORK (1982), ¶387.
[1189] Morgan (2008), 11.
[1190] INSOLVENCY SERVICE (2008B), 30–34; INSOLVENCY SERVICE (2009B), 18, 27.
[1191] INSOLVENCY SERVICE (2009B), 18.
[1192] Morgan (2008), 42; INSOLVENCY SERVICE (2008B), 12; INSOLVENCY SERVICE (2009B), 18.
[1193] Morgan (2008), 42.
[1194] INSOLVENCY SERVICE (2009B), 28. Providers did welcome the fact that some creditors had removed the "hurdle" rates which they had been setting as a condition for the approval of an IVA.
[1195] Whitford (1994), 412–13.

useful research project would involve study of the circumstances of debtors in IVAs in order to assess their productivity, reliance on third party financial support, and consumption levels, thus measuring the social costs generated by creditors' insistence on higher repayments over longer periods of time.

Individual Voluntary Arrangements (IVAs) registered in England & Wales
Status as at: September 2012

	COMPLETED		ONGOING		TERMINATED		TOTAL[3]
YEAR	Number of Cases	% of Total	Number of Cases	% of Total	Number of Cases	% of Total	Number of Cases
1990	1,379	71.5%	0	0.0%	549	28.5%	1,928
1991	2,128	69.4%	0	0.0%	937	30.6%	3,065
1992	3,326	70.9%	0	0.0%	1,364	29.1%	4,690
1993	3,879	68.8%	0	0.0%	1,755	31.2%	5,634
1994	3,442	67.7%	0	0.0%	1,639	32.3%	5,081
1995	2,917	66.8%	0	0.0%	1,453	33.2%	4,370
1996	3,082	68.9%	1	0.0%	1,387	31.0%	4,470
1997	3,090	68.6%	0	0.0%	1,417	31.4%	4,507
1998	3,378	69.0%	5	0.1%	1,510	30.9%	4,893
1999	5,107	71.1%	0	0.0%	2,075	28.9%	7,182
2000	5,646	71.0%	2	0.0%	2,304	29.0%	7,952
2001	4,510	71.9%	6	0.1%	1,758	28.0%	6,274
2002	4,402	70.1%	6	0.1%	1,873	29.8%	6,281
2003	4,969	65.6%	42	0.6%	2,562	33.8%	7,573
2004	6,550	61.1%	342	3.2%	3,833	35.7%	10,725
2005	11,133	55.0%	2,117	10.5%	7,005	34.6%	20,255
2006	15,996	36.3%	11,920	27.0%	16,168	36.7%	44,084
2007	6,037	14.4%	20,383	48.6%	15,507	37.0%	41,927
2008	2,675	6.9%	23,781	61.2%	12,398	31.9%	38,854
2009	2,324	4.9%	34,723	73.0%	10,522	22.1%	47,569
2010	1,499	3.0%	42,612	84.1%	6,543	12.9%	50,654
2011	757	1.5%	45,941	93.7%	2,341	4.8%	49,039

Figure 12: IVAs Completed, Terminated and Ongoing as at September 2012.
Source: The Insolvency Service.

4.6 Conclusions and Policy Recommendations

English personal insolvency law originated centuries ago as a collective debt collection device used to maximise returns to creditors by allocating among them the assets of a failed business based on their respective levels of investment in the debtor's commercial project. The law now serves as a mechanism invoked by over-indebted consumers of limited income and assets who have fallen into difficulty in their personal finances in order to obtain relief from the burdens (financial and otherwise) of over-indebtedness. Consistent with the commercial orientation of the law, policymakers and courts in England and Wales have conceptualised personal insolvency as a marketplace, and have trusted the efficient operation of the system to consumer choice and free bargaining.

A. The *Ex Post* Consumer Insolvency Market

While such an approach may facilitate optimal outcomes in the context of commercial insolvency, it is inappropriate now that personal insolvency law has developed into a *de facto* consumer law.[1196] The law has long recognised the need to move beyond principles of freedom of contract and private ordering at the *ex-ante* stage of consumer credit contracting (see discussion of consumer credit regulation in Chapter 1).[1197] It nonetheless contrarily trusts that pure contractual bargaining will produce optimal outcomes at the *ex post* stage of a consumer's insolvency, when the debtor is likely to be in a more vulnerable, emotionally drained, less well-resourced and less informed position.[1198] As noted in the recent World Bank report, where a debtor's situation has deteriorated to the point where she is seeking formal insolvency relief, "natural market forces and free negotiation are no longer sufficient safeguards of the public health and welfare."[1199] Support for this position derives not just from the IVA experience, but also from the "dismal failure" of the US Home Affordable Modification Program (HAMP).[1200] This is another high-profile illustration of the tendency of voluntary household debt restructuring to lead to the twin problems of excluding suitable debtors from relief, while also offering to others relief composed of insufficient creditor concessions to achieve the public policy objectives of alleviating over-indebtedness.

The above discussion suggests free contracting in personal insolvency contributes to exclusion of over-indebted individuals from personal insolvency procedures. Such exclusion levels appear to be high, with a 2011 UK Government study estimating that between 12% and 19% of the population could be considered to be over-indebted, and yet only approximately 2% were in personal insolvency procedures (IVAs and bankruptcy), while 5% were in DMPs.[1201] These results mirror previous UK studies of over-indebtedness, all of which suggest that levels of over-indebtedness in society exceed greatly the population reached by the personal insolvency system (see Figure 22). As neither creditors nor these households bear the entire costs of over-indebtedness, society must carry the cost of the exclusion of financially troubled households from the personal insolvency market. Externalities also accrue when over-indebted individuals enter inappropriate repayment arrangements involving excessive income contributions for unduly long

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[1196] Whitford (2004), 401–3.

[1197] *See generally* RAMSAY (2012A), 361 et seq.

[1198] "Consumers in difficulty often seek immediate debt advice in desperation": OFT (2010B), 4. On the emotional distress experienced by debtors at the time of making a decision to seek a debt relief remedy, *see* Mann & Porter (2010), 313–18.

[1199] WORLD BANK (2013), ¶209.

[1200] Porter (2011), 114–16; *See also* IMF (2012), 22–25; Alan M. White, *Deleveraging the American Homeowner*, 41 CONNECT. LAW REV. 1107 (2008); Patricia A. McCoy, The Home Mortgage Foreclosure Crisis (Harvard Joint Centre for Housing Studies Working Paper, 2013, http://www.jchs.harvard.edu/research/publications).

[1201] BIS (2011A), 40–53.

periods. The extent to which IVAs and particularly DMPs outnumber bankruptcies thus poses concerns regarding the potential imposition of further social costs onto third parties.

Apart from these considerations of externalities, the market conception of personal insolvency also ignores important social justice and distributive concerns, in that it impacts the poorest debtors disproportionately.[1202] The conceptualisation of bankruptcy's extensive debt relief as a service to be purchased means that debtors who cannot afford the substantial upfront bankruptcy costs are pushed towards alternative "services" such as DMPs by necessity rather than choice. The introduction of the lower cost Debt Relief Order procedure is a welcome improvement on this position, but its narrow entry conditions mean that many low income debtors are excluded from this procedure and yet cannot afford to enter bankruptcy.[1203] The conceptualisation of bankruptcy as a market-based service raises another typical criticism that market-based ideas of social ordering lead to a commodification of human values and insufficient recognition of humanitarian concerns.[1204] Bankruptcy law's technicality has a tendency to de-personalise the procedure, [1205] and creditor wealth maximisation, "common pool" theories of insolvency law risk de-humanising the debtor further.[1206] In this regard the decisions of courts described above, particularly that of *Lightfoot*, contrast strongly, for example, with the Belgian constitutional court's determination that constitutional guarantees of equality[1207] required that debt relief be made available to all debtors irrespective of their resources.[1208] This led Belgian legislators to introduce a "no income, no assets" debt discharge procedure.

Recent proposals to allow the debtor petition deposit to be paid via instalments are welcome, as this should improve access to bankruptcy considerably.[1209] It should be noted, however, that these proposals are accompanied by a plan to increase the deposit amount, on the *quid pro quo* market logic that debtors should be willing to pay more highly for the "premium" debt relief obtainable through bankruptcy compared to other insolvency products.[1210] Policymakers continue to overlook the *public* interest objectives of the fresh start policy and fail to realise that market logic will not achieve these aims.

[1202] On the extent to which the efficient market hypothesis, and theories based on the assumption that unregulated markets will produce efficient outcomes, are unconcerned by distributional issues, *see e.g.* HOWELLS & WEATHERILL (2005), 10.

[1203] Edwards (2012); CAB (2012).

[1204] *See e.g.* TREBILCOCK (1997), 23–24.

[1205] Shuchman (1973), 420.

[1206] See text to notes 537 to 539 above.

[1207] Article 10 of the Constitution of Belgian provides that "Belgians are equal before the law" and that "no class distinctions exist in the State"; while Article 11 states that "enjoyment of the rights and freedoms recognised for Belgians must be provided without discrimination."

[1208] See text to note 652 above.

[1209] Insolvency Service (2011B), 18; House of Commons (2013), 15.

[1210] "At present, individual debtor bankrupts have to pay an upfront fee of £525. *Given the level of debt relief they can receive*, we agree with the Insolvency Service that it would not be unreasonable to increase that fee, possibly on a sliding scale" (emphasis added), ¶43.

B. Consumer Insolvency and *Ex Ante* Consumer Credit Markets: Beyond Creditor Wealth Maximisation

This leads to a wider discussion of the need for a re-orientation of English personal insolvency law around the fresh start policy in order to spread the risks of the consumer credit society in an efficient and fair manner.[1211] The creditor wealth maximisation perspective and its preference for voluntary restructuring aims to protect market expectations/entitlements to the greatest extent possible. This is an appropriate aim if policymakers are confident that market exchanges produce optimal outcomes. In the context of *ex ante* modern consumer credit markets, just as in the *ex post* personal insolvency markets, factors such as information asymmetries and behavioural biases mean that consumer credit markets may not produce optimal outcomes, and create externalities in the form of over-indebtedness (see Chapter 2). This was made particularly evident by the global financial crisis of the late 2000s. Policymakers and regulators have recognised that under-regulated consumer credit markets will not produce efficient outcomes, and have departed from the traditional assumption that "well managed firms will not develop products which are excessively risky and… well informed consumers will only choose products which serve their needs."[1212] Instead, regulators and policymakers have proposed significant reforms of consumer credit market regulation, including the re-orientation of the law around the principle of responsible lending.[1213] The fresh start policy requires that personal insolvency law follow by correcting market failures and attempting to cause social costs to be internalised, rather than passively facilitating market outcomes.

The traditional approach of bankruptcy, in the limited extent to which it has recognised and sought to reduce externalities, has been to require the *debtor* to internalise such costs, on the understanding that she is responsible for her insolvency and is best placed to prevent it.[1214] This potentially explains English law's policy of requiring debtors to pay the costs of administering their affairs in bankruptcy, and the much faster increase in debtor petition costs compared to creditor petitions in recent decades (see Figure 9 above). The Insolvency Service also attributes blame for default on debtors in claiming an advantage of the IVA procedure is its ability to teach debtors how to manage money responsibly.[1215]

[1211] *See e.g.* Hallinan (1986), 98–109; Eisenberg (1980), 981–83; JACKSON (1986), 229–32; Hynes (2004), 327–31; WORLD BANK (2013), ¶¶94–98.

[1212] FSA MMR (2009), ¶4.2; FSA (2011A); EUROPEAN COMMISSION (2009A); Mortgage Credit Directive Proposal (2011).

[1213] On the principle of responsible lending, see text to notes 250-253.

[1214] Eisenberg (1980), 982.

[1215] Insolvency Service (2007A), 45–46.

In modern consumer credit markets, however, it is the lender who is best placed both to prevent default from occurring and to bear the losses of default, as explained in Chapter 2. Personal insolvency law's role therefore should be to cause institutional creditors to internalise the social costs of consumer credit markets. The fresh start policy demands the debtor's restoration to productivity at the expense of her creditors, so that creditors can be incentivised by the losses suffered in bankruptcy to adopt more responsible lending policies and so prevent future over-indebtedness. This has the important ramification for consumer insolvency policy that the maximisation of creditor returns should no longer be considered a primary aim of the law, if it remains a worthy aim *at all*. Insolvency Service proposals which sought to establish the IVA as the primary consumer insolvency remedy were strongly influenced by the consideration that the IVA is likely to produce larger returns to creditors than bankruptcy;[1216] and so represents "the best deal possible for creditors."[1217] By designing insolvency law to maximise creditor returns, however, the law cushions creditors from the effects of the market and weakens market discipline, allowing creditors to save on the resources spent on monitoring creditworthiness of borrowers and to externalise the costs of their unsustainable lending.[1218] The principle of equality of creditors exacerbates this moral hazard problem, as all creditors - both reckless and responsible - are guaranteed *pro rata* returns in insolvency proceedings, irrespective of their role in causing the individual's over-indebtedness.[1219] As I discuss in Chapter 6, moral hazard is a two-way relational issue, and policymakers must remain vigilant to safeguard against perverse incentives created for both debtors and creditors. While policymakers have generally recognised the issue of moral hazard as it relates to debtor conduct, greater acknowledgement of the risk of creditor moral hazard is required. The amount of creditor returns should therefore not be a measure of the success of the law; indeed high returns might signify the law's failure. Rather, policymakers should assess the extent to which the law internalises the social costs of consumer credit markets. To measure the law's effectiveness, it is more appropriate to compare the levels of over-indebtedness in society with the numbers of individuals in personal insolvency remedies, and to assess the extent to which these remedies are facilitating the objective of restoring the financially troubled to positions of economic productivity and social inclusion.

[1216] Insolvency Service (2005B), ¶¶22, 30, 33, 35.
[1217] *Id.* ¶¶33, 35.
[1218] WORLD BANK (2013), ¶¶91–92. As argued by Professor LoPucki, "[e]fforts at squeezing the last nickel out of bankrupts may be counter-productive. By making bad loans good, the system reduces consumer lenders' losses, and thereby encourages their poor lending practices." *See* LoPucki (1997), 465.
[1219] Whitford (1994), 401.

C.Consequences for Consumer Insolvency Policy

The conception of personal insolvency as a marketplace has created an area governed by a "tyranny of choice"[1220] and a new consumer protection problem,[1221] in which large numbers of debtors appear to be entering into debt solutions which may be neither in the debtors', nor society's, best interests. English policymakers and courts have generally been satisfied to allow free market contractual principles to regulate this new space, a response which is insufficient for the reasons outlined above. Alternative approaches are available, positive signs of which are visible for example in the 2013 Court of Appeal decision in *Consolidated Finance Ltd. v Collins*, holding that loans (secured on the debtor's home) extended for the purposes of annulling a debtor's bankruptcy were not exempt from relevant consumer protection legislation.[1222] While Sir Stanley Burnton based his judgment on a literal legislative interpretation, the judge also recognised the transaction's socio-economic context and expressed concerns regarding the lender's potentially irresponsible and exploitative wider business practices.[1223] This decision provides a useful demonstration of the required move beyond abstract principles of free contracting and ideal-type efficient markets, towards recognition of the consumer protection problems of the *ex post* personal insolvency marketplace, and of personal insolvency law's new context as a *de facto* consumer law. Contractual approaches, founded upon the misleading promise of consumer choice, are ill-suited to rectifying inequalities since contract law can only refuse to enforce contracts in limited circumstances and "cannot compel the making of contracts on terms favourable to one party".[1224] In contrast, a core feature of personal insolvency law is its ability to impose solutions on parties via legislative bankruptcy rules and "cram-down" mechanisms.

It appears appropriate, therefore, to introduce policy reforms which restrict consumer choice in departing from a free market-based conception of personal insolvency. Proposals from US commentators for the creation of a single consumer insolvency portal appear equally attractive in the English context,[1225] and strong consideration should be given to *simplifying* the insolvency regime by establishing a single consumer insolvency procedure.[1226] This follows the logic of *ex ante* regulatory rules obliging lenders to provide "plain vanilla" credit products in response to sub-

[1220] Porter (2011), 113.

[1221] Whitford (1994), 403.

[1222] Consolidated Finance Ltd. v Collins and Others, [2013] (May) ER 111 (2013).

[1223] *Id.* ¶¶56–57.

[1224] *Amoco Oil*, ¶10, per Posner C.J.

[1225] Braucher (2005); Whitford (1994); Porter (2011), 154–56.

[1226] The idea of designing simplified consumer insolvency procedures was a recommendation of the Cork Committee, which also proposed a "single portal" of sorts, albeit with multiple procedures potentially available after a common initial screening process, "under which the court will have considerable latitude to decide upon the most appropriate method for dealing with the debtor's affairs": CORK (1982), ¶550. *See more widely* ¶¶272 et seq.; ¶¶545-65.

optimal outcomes caused by information asymmetries and behavioural biases. [1227]The Debt Relief Order (DRO) appears the most appropriate vehicle, as the only English procedure designed specifically to address consumer over-indebtedness, and one which has been judicially recognised as serving the purpose of "unadulterated debt relief".[1228] It is a low-cost and procedurally uncomplicated procedure, minimising transaction costs and artificial barriers to entry which exclude "low net worth" debtors whose financial situations nonetheless are liable to trigger externalities.[1229] This procedure may carry less stigma than bankruptcy, being free from the latter procedure's long-standing negative connotations. It is also distanced from the historical legacy of a commercial law designed to maximise returns on creditor investments, which means that courts and administrative officials may be less inclined to apply historical and commercial ideas and principles which may be inappropriate to the modern conditions of consumer debt. Therefore the most appropriate reform may be the expansion of this procedure beyond its current limited "no income, no assets" remit to all personal insolvencies below a category of high net worth debtors, the insolvencies of whom may require more sophisticated procedures.[1230] As illustrated in this Chapter and Chapters 1 and 2, the most pertinent distinction for the law to draw is between debtors with and without the means to access information and representation, rather than the consumer/trader distinction more typically adopted.

Asset exemptions and the Income Payment Order/Agreement mechanism applicable in bankruptcy could simply be carried over to the expanded DRO procedure. Importantly, the level of repayments would be calculated by a neutral administrative official with regard to the fresh start policy, rather than by creditors with the aim of maximising their returns (as is the case under the IVA). The approach should be "less a matter of defining a predetermined benefit for creditors than of defining a predetermined level of sacrifice for debtors" necessary to address moral hazard concerns (see Chapter 6).[1231] Policymakers should thus reconsider strongly the role of voluntary debt rescheduling and the IVA procedure, and whether this procedure serves any additional purpose which could not be achieved via an expanded Debt Relief Order procedure, complete with repayments from income. The IVA may retain value for some categories of individuals, such as the approximately 35% of IVA debtors who are homeowners; or high net worth debtors who are so well-advised, and whose affairs are sufficiently complicated, as to

[1227] *See e.g.* Lunn (2012), 24–28. See also Professor Mann's proposals for the mandatory adoption of standardised terms in credit card contracts: Mann (2007B), 116-9.

[1228] *Cooper and Payne (EWCA)*, ¶85, per Toulson LJ.

[1229] Hallinan (1986), 130; World Bank (2013), ¶195; IMF (2012), 24–25, 27.

[1230] I adopt the concept of "high net worth" debtor from the UK Consumer Credit Act, which exempts from its regulatory protection any loan agreement for a value of more than £60,260 where it includes a debtor's declaration signed by an advisor such as an accountant to the effect that the debtor is a "high net worth" individual, meaning that she earned no less than £150,000 and had net assets valued at £500,000 or more throughout the previous year. It might be appropriate to adjust these levels, particularly to allow the realisation in bankruptcy of substantial assets worth less than £500,000. *See* Consumer Credit Act 1974, §16A; Consumer Credit (Exempt Agreements) Order 2007/1168, rules 2–4; Sched. 2 ¶1.

[1231] World Bank (2013), ¶274.

prefer flexibility in addressing an insolvency. Outside of these limited categories, the added value of the IVA procedure in consumer insolvency appears limited.

Chapter 3 illustrates the influence of administrative costs of insolvency procedures to the State in shaping policy decisions, and I recognise that the expansion of the DRO procedure could increase such costs. While a detailed cost and impact assessment lies outside the scope of my project, I suggest nonetheless that policymakers should consider calling upon creditors to bear increased costs as part of their internalisation of consumer credit market externalities. [1232] Once the goal of creditor wealth maximisation and the related principle of equality of creditors are recognised as no longer of primary importance in consumer insolvency, new options can be explored such as attributing greater losses to those creditors most responsible for facilitating the debtor's insolvency. In order for personal insolvency law to perform its market correcting function,[1233] it should be more precise in the signals it sends regarding the (in)appropriateness of creditors' lending practices.[1234] A sharper method of disciplining consumer lending practices via personal insolvency law might allow only those creditors who could demonstrate that they had followed appropriate regulatory norms of responsible lending[1235] to claim dividends from debtor income contributions.[1236] Returns denied to creditors failing to comply with these standards could contribute to administering the consumer insolvency system. Limiting the benefits of insolvency procedures only to creditors who can demonstrate their worthiness could announce the law's re-orientation towards the fresh start policy and constitute a radical, but appropriate, restatement of personal insolvency law's *quid pro quo*.

[1232] *See e.g.* the levy imposed by Belgian law on consumer lenders based on the portion of their loan books in default in a given year : Loi (du 19 avril 2002) modifiant la loi du 5 juillet 1998 relative au règlement collectif de dettes et à la possibilité de vente de gré à gré des biens immeubles saisis (M.B. du 07/06/2002, p. 26229), art. 2 (Belgium). See also Kilborn (2012), 105.

[1233] *See also* Parts 1.5(B), 2.2(C) above, Part 6.5(B) below.

[1234] Whitford (1994), 403.

[1235] *See e.g.* OFT (2010). As not all relevant creditors are regulated by Office of Fair Trading or Financial Conduct Authority, further general guidance on responsible lending could be issued by the Insolvency Service or other appropriate regulatory authorities to establish minimum standards of prudent lending in other sectors.

[1236] Here I draw on proposals previously advanced by commentators: *see e.g.* Pottow (2007), 456 et seq; Kilborn (2004), 669–71; Vern Countryman, *Improvident Credit Extension: A New Legal Concept Aborning?*, 27 MAINE LAW REV. 1 (1975).

CHAPTER 5: Intersection of Debt Collection and Debt Relief: Scope and Extent of Stay of Enforcement and Discharge

5.1 Introduction

In this Chapter I examine a further fault line along which tension between competing perspectives of personal insolvency law arises, in relation to the law's features of the stay of creditor enforcement actions;[1237] and the discharge of the debtor's obligations on the completion of the insolvency process.[1238] These two fundamental elements, long recognised as linked,[1239] form the core of the law's debt relief function, but also lie at the intersection of this function with the law's traditional debt collection aims.

Under creditor returns maximisation perspectives of the law such as Professor Jackson's "creditors' bargain" theory, the key feature of personal insolvency law as a debt collection mechanism is its *collective* nature.[1240] Creditors benefit as a whole when insolvency law provides a mechanism which solves collective action problems by producing creditor coordination and cooperation. As collective arrangements are constantly susceptible to individual incentives to "cheat",[1241] a key role of insolvency law is to compel cooperation among creditors.[1242] The *stay* of individual enforcement actions or *moratorium* produces this outcome, preventing individual advantage-taking by creditors and preserving the principle of *pari passu* distribution or *equality of creditors*. Also, all creditors benefit from the stay's facilitation of the maximisation of the debtor's assets' value, particularly of any going-concern value.[1243] While now central to the law's debt relief aims or "fresh start" policy, the debt *discharge* under personal insolvency law too originated in a (1705) law designed to serve the sole aim of maximising returns to creditors.[1244] Debt discharge formed a carrot to 18th Century legislation's stick of severe enforcement remedies,[1245]

[1237] See Insolvency Act 1986, §285

[1238] Insolvency Act 1986 §281(1) provides that "where a bankrupt is discharged, the discharge releases him from all the bankruptcy debts." On the centrality of debt discharge to modern personal insolvency law and the "fresh start" policy, *see e.g.* INSOL INTERNATIONAL (2001), 14–15, 22–24.

[1239] *See e.g.* FLETCHER (2009), 175, citing Re Blake (1875) 10 Ch. App. 652 and Re Hutton [1969] 2 Ch. 1.

[1240] *See* JACKSON (1986), 7-19; 253.

[1241] STEARNS & ZYWICKI (2009), 13–14.

[1242] JACKSON (1986), 17.

[1243] Susan Block-Lieb, *Fishing in Muddy Waters*, 42 AM. UNIV. LAW REV. 337, 387–88 (1992).

[1244] Tabb (2001), 333–39; note 294 above.

[1245] The law even provided for the death penalty for fraudulent debtors, showing its punitive and coercive nature. *See* Duncan (1995), 198–99.

and was conditional on the debtor undertaking specified actions designed to enhance creditor returns.[1246] Subsequent legislative amendments further limited the discharge by making it subject to creditors' consent,[1247] with the law conceptualising debt discharge not as a public interest imperative, but rather a private decision for creditors to release a debtor from her obligations only when satisfied they had extracted all they could.[1248] Under this perspective, questions regarding the scope of the stay and discharge and the exemption of certain debts are answered by reference to whether they enhance overall creditor welfare and fairness *inter* creditors, with little regard to debtor rehabilitation.

Not until subsequent laws introduced automatic discharge could it be said that "[b]y thus severing the previously existing link between payment and discharge, the authors of [modern bankruptcy law] had necessarily adopted a view of debtor relief as a legitimate independent objective..."[1249] Under this objective, the stay of enforcement and debt discharge are conceptualised as the core elements of the fresh start policy.[1250] In the modern law, "one of the principal purposes of an insolvency system for natural persons is to re-establish the debtor's economic capability, in other words, *economic rehabilitation*."[1251] As argued in Chapter 2, the rehabilitation of the debtor under the fresh start policy serves the public interest by allocating the risks of a credit-based economy in an efficient and just manner. The stay of enforcement advances this purpose by stopping collection efforts against the debtor, which otherwise may reduce her resources to such a level as to create externalities.[1252] This protection from enforcement and "breathing space"[1253] is a chief attraction for debtors entering personal insolvency procedures (distinguishing them from informal arrangements such as Debt Management Plans[1254]), offering temporary respite before the debt discharge on completion of the process ultimately provides long-term relief.[1255] In thus facilitating the debtor's rehabilitation, the stay of enforcement is "the linchpin of bankruptcy

[1246] Tabb (1991), 337.
[1247] Duncan (1995), 199; Tabb (1991), 337.
[1248] Shuchman (1973), 450–51; Hallinan (1986), 60.
[1249] Hallinan (1986), 60; The requirement of creditor consent was eliminated in England in 1842 (5 & 6 Vict., c. 122, §39 (1842)), only to be reintroduced in 1869 (32 & 33 Vict., c. 71, §48 (1869)). It was finally eliminated in 1883, but a system of limited, conditional and suspended debt discharges applied from this time instead: Tabb (1991), 354. Automatic discharge was introduced into English law for the first time in 1976: Insolvency Act, 1976, c. 60, §§7-8 (UK), *see* FLETCHER (1978), 308–9.
[1250] WORLD BANK (2013), ¶354.
[1251] *Id.*
[1252] For example, where a stay of enforcement prevents the debtor from losing her home, this reduces the imposition of costs on the debtor's family or on wider society through forced evictions. *See e.g.* Bar-Gill (2008), 1135–37; Levitin (2009), 568–69.
[1253] REIFNER ET AL. (2010A), 277. This reduces the stress caused to the debtor via collection activities. which potentially lead to externalities through health problems, family relationship difficulties and reduced workplace productivity: *See e.g.* Porter (2011), 142–44.
[1254] Insolvency Service (2005B), ¶24.
[1255] Howard (1987), 1063.

relief."[1256] The principle of equality of creditors takes on an alternative, subordinate, status under the debt relief perspective of the law, focusing not on maximising creditor wealth but on the idea that the losses which the law imposes on creditors should be shared fairly *inter* creditors.[1257] Conditions attached to discharge and the stay of enforcement, and requirements for the debtor to surrender income and assets, are necessary to address moral hazard concerns (see Chapter 6), rather than to further an objective of maximising returns to creditors.[1258] Similarly, exceptions to the stay and discharge should be limited and should only exist where necessary to address moral hazard concerns or to serve other important policy objectives. The question this perspective of the law asks is whether the exemption of certain categories of debts risks inhibiting the debtor's fresh start.[1259]

As I argue throughout, the law has undergone a functional transformation in recent years which necessitates its re-orientation around the primacy of the fresh start policy. In many modern consumer *bankruptcies* at least, in which little or no assets are distributed to creditors, the aim of protecting the debtor from enforcement in order to facilitate his/her rehabilitation may be the *only* practical purpose served by the stay of enforcement and discharge.[1260] Due to the development in the law's function over time, certain commentators (albeit those based in the USA) now refer to debt discharge as the "essence" of modern personal insolvency law,[1261] and comment that the "predominant purpose - if not the sole purpose - of individual bankruptcy today is to effect the discharge of debts - to give the debtor a 'fresh start'".[1262] Such comments are not confined to the US context, as seen in the World Bank's 2013 wide geographical survey of personal insolvency laws, in which the public policy benefits of such laws identified are actually almost all benefits of debt discharge and the suspension of debt enforcement.[1263] Similarly, INSOL's 2001 Consumer Debt Report describes the discharge of debt as "a key-element of any consumer debtor insolvency law…"[1264]

By examining policymakers' and courts' treatment of issues relating to the discharge and stay of enforcement, [1265] I assess the extent to which English law has evolved to re-orient itself in the

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[1256] Kilborn (2003), 893.
[1257] Hallinan (1986), 144–45. See my comments in Chapter 4, however, on the doubt which must be cast on the principle of equality of creditors if personal insolvency law is to send market disciplinary signals to creditors who have engaged in inappropriate lending practices.
[1258] *Id.*, 144.
[1259] INSOL (2001), 23.
[1260] While the prevention of individual enforcement efforts continues to serve creditor interests by preserving debtor income for distribution to creditors, the importance of this consequence may be outweighed by the stay of enforcement's protective and social cost reducing effects, as any contributions from income are likely to fall well short of full repayment.
[1261] Flint (1991), 515.
[1262] Kilborn (2003), 866.
[1263] World Bank (2013), ¶¶76–111.
[1264] INSOL (2001), 22.
[1265] In this Chapter, I focus on these features under the bankruptcy and Debt Relief Order procedures. I discuss the IVA procedure in detail in Chapter 4, arguing that the development of this procedure has not evolved to embrace the debt relief or "fresh start" policy of personal insolvency law; instead remaining oriented overly towards debt collection aims.

manner suggested by the law's new functional role and by theoretical policy prescriptions. In respect of bankruptcy, legislative developments have recognised the justifications for affording debt discharge a central role, albeit while failing to acknowledge the law's departure from a commercial to a consumer contextual setting.[1266] The Enterprise Act 2002's reforms contained a balance of liberalised debt discharge (reducing the waiting period for automatic discharge from three years to one)[1267] and the replacement of automatic restrictions for all bankrupts[1268] with a new system of targeted sanctions to address moral hazard concerns.[1269] These reforms recognised the externalities of lost economic productivity caused by personal over-indebtedness and debt overhang, and so following the fresh start policy sought to use debt discharge to lessen the adverse consequences of financial failure and so facilitate entrepreneurial risk-taking.[1270] The focus of policymakers remained exclusively on commercial debtors, however, overlooking the fact that consumer debtors were bankruptcy's majority users. Earlier bankruptcy reforms had similarly acknowledged the importance of debt discharge to personal insolvency policy. While the Insolvency Act 1976 introduced an automatic discharge for the first time,[1271] the Insolvency Act 1986 reduced the debtor's waiting period for such discharge to just three years.[1272] The 1986 legislation followed the Cork Committee report, which recognised the significant public policy importance of the fresh start principle and identified it as a basic objective of insolvency law.[1273] The Committee's highlighting of the urgent need to respond to unprecedented levels of *consumer* insolvency was less closely followed by the legislature, however.[1274]

The Debt Relief Order procedure's introduction (coming into effect in 2009)[1275] represents a more complete evolution, recognising both the centrality of debt discharge as personal insolvency law's core feature, and that the law now functionally serves as a consumer law. The DRO pursues no debt collection objective, with no contributions to creditors from the debtor's assets/income. In response to the empirical reality that bankruptcy had become primarily used by non-business debtors of limited assets and means,[1276] the DRO is a simplified administrative insolvency procedure for "no income, no assets" cases, under which a debtor obtains initial protection from enforcement during a one year moratorium period, followed by a full discharge of all non-excluded debts.[1277]

[1266] *See e.g.* INSOLVENCY SERVICE (2000); INSOLVENCY SERVICE; DTI (2001).
[1267] Enterprise Act 2002 §256, substituting Insolvency Act 1986 §279 (1986).
[1268] Enterprise Act 2002, §§265–68.
[1269] *Id.* §257, Schd. 20, inserting Insolvency Act 1986, §281A, Schd. 4A.
[1270] INSOLVENCY SERVICE, DTI (2001).
[1271] Insolvency Act 1976 §§7–8; FLETCHER (1978), 308–9.
[1272] Insolvency Act 1986, §279.
[1273] CORK (1982), ¶192.
[1274] *Id.* ¶16.
[1275] *See e.g.* INSOLVENCY SERVICE (2005A); INSOLVENCY SERVICE, DCA (2004).
[1276] INSOLVENCY SERVICE (2005A), 16.
[1277] Subject to the suspension of discharge and/or imposition of sanctions in the event of the debtor's misconduct (see Chapter 6 below).

Despite these legislative developments, I illustrate in this Chapter that English court decisions in relation to the nature, scope and extent of the stay of enforcement and discharge exhibit a persistent conceptualisation of personal insolvency law as serving the debt collection objective. I consider the adverse public policy consequences of a series of important superior court interpretations of ambiguous legislative provisions by reference to a debt collection paradigm, using the example of the *Sharples* case concerning personal insolvency law's protection from eviction of over-indebted tenants. I have selected cases based upon their relevance to the debt collection/debt relief fault line arising in relation to the moratorium and discharge, and also with the intention of examining more recent case law in order to investigate superior courts' perspectives on legislative moves towards the fresh start policy in the past decade, in bankruptcy and DRO reforms implemented in 2004 and 2009 respectively. I show how these judgments (and in one case, the Government response) exhibit a failure to embrace the fresh start policy to the extent one might expect from policy developments, and to the extent demanded by theoretical assessments of the function of personal insolvency law in the modern consumer credit society.

5.2 "The importance of the rehabilitation of the individual insolvent..."

Before analysing court considerations of more recent policy developments, it is useful to examine the House of Lords' early views on the first shift towards the fresh start policy represented by the Insolvency Act 1986. An early post-1986 judicial consideration of the nature of the bankruptcy stay of enforcement arose in the House of Lords decision of *Smith v Braintree DC*.[1278] Here the House found that the power given to courts to "stay any action, execution or other legal process against the property or person of the debtor"[1279] extended to proceedings for the committal of a debtor under statutory powers for the collection of certain taxes.[1280] In the court's judgment, Lord Jauncey first interpreted in a teleological manner the wording of the 1986 Act and found that "[t]he purpose of [the stay of enforcement in] section 285 is to protect the estate for the whole body of creditors and to prevent unsecured creditors… from taking steps by putting pressure on

1278 Smith (A Bankrupt) v Braintree District Council [1989] 3 WLR 1317, [1990] 2 AC 215.

1279 Insolvency Act 1986, §285(1). In addition to this provision, section 285(3) provides for an automatic stay, stating that during bankruptcy:

> "no person who is a creditor of the bankrupt in respect of a debt provable in the bankruptcy shall (a) have any remedy against the property or person of the bankrupt in respect of that debt, or (b) before the discharge of the bankrupt, commence any action or other legal proceedings against the bankrupt except with the leave of the court and on such terms as the court may impose."

1280 General Rate Act 1967, §102.

the debtor to obtain advantages over other creditors."[1281] Lord Jauncey stated that the moratorium had to be interpreted in light of this collective debt collection objective. Secondly, the judge considered the nature of the committal proceedings and whether they fell within the scope of the stay, given this purpose. The judge rejected pre-1986 case law which had decided that such proceedings were punitive or quasi-criminal in nature (thus falling outside the scope of the stay),[1282] stating that the 1986 Act marked a new departure in English insolvency law, requiring novel re-interpretation.[1283] The new principles introduced by the legislation reflect changing attitudes to the morality of debt default, and "the legislation now emphasises the importance of the rehabilitation of the individual insolvent". For these reasons, the judge felt justified in construing the 1986 Act "as a piece of new legislation without regard to 19th century authorities or similar provisions of repealed Bankruptcy Acts..."[1284] The court decided that, free from such precedents' constraints, the dominant consideration should be the stay's purpose in ensuring creditors act collectively, which did not permit an exception for tax claims of the kind at issue.

Professor Milman appropriately describes this decision as exemplifying "heady days" in which the English courts adopted a progressive approach in advancing the reforming legislation's transformative aims.[1285] While the judge applied new ideas of debt relief in extending bankruptcy's protection from enforcement to committal proceedings, Lord Jauncey's interpretation of the stay of enforcement's purpose, however, reflected the traditional view of bankruptcy as a collective debt collection device. The judge provided a classic statement of the function of the stay as being to facilitate collective debt collection, consistent with the creditors' bargain theory. While the judge recognised how the new legislation "emphasises the importance of the rehabilitation of the individual insolvent", Lord Jauncey did not perceive the moratorium as a mechanism through which the law pursues this policy. This is despite the fact that the fresh start policy would have provided strong justification for interpreting the moratorium widely to prevent the debtor's imprisonment.

[1281] *Smith*, 229-230.
[1282] In Re Edgcome [1902] 2 KB 403.
[1283] *Smith,* 237.
[1284] *Id.*, 237-8.
[1285] Milman (2003), 379–80.

5.3 Twenty-First Century Decisions on the Scope of the Stay of Enforcement and Discharge

(i) Regina (Balding) v Secretary of State for Work and Pensions

The interaction of the debt collection and debt relief conceptions of bankruptcy law is also evident in the more recent cases of *Regina (Balding) v Secretary of State for Work and Pensions*[1286] and *Regina (Cooper and Payne) v Secretary of State for Work and Pensions*.[1287] *Balding* concerned both bankruptcy's stay of enforcement and debt discharge, as the High Court and Court of Appeal agreed that a debtor's liability to repay overpaid social welfare payments (which were being collected via deductions from ongoing Government welfare payments to the debtor), was discharged by bankruptcy. The courts held that the social welfare legislation gave the relevant Government Department a right to recover an amount of benefits determined to have been overpaid, and created a corresponding "liability to pay money under an enactment" on the debtor's part. This could be considered a bankruptcy debt,[1288] whether collected via court proceedings or deductions from future payments.

As the Court of Appeal agreed with the "comprehensive judgment" of Davis J (as he then was),[1289] I focus my discussion on this High Court decision. In deciding the case, Davis J was bound by decisions under both antecedent English bankruptcy legislation[1290] and the present regime[1291] which had found that the stay of enforcement did not affect the Government's right to make deductions from welfare payments to the bankrupt debtor. These decisions did not clarify the effect of the bankruptcy discharge on this right, however. Davis J was thus free to decide that welfare overpayments were discharged in bankruptcy, but to do so the judge had to distinguish the purpose of the stay of enforcement from that of the debt discharge.[1292] The judge described the policy underpinning the discharge as being "to wipe the slate clean and, broadly speaking,

[1286] [2007] EWHC 759 (Admin) (High Court); [2007] EWCA Civ 1327, [2008] 1 W.L.R. 564 (Court of Appeal).

[1287] [2010] EWCA Civ 1431, [2011] BPIR 223 (Court of Appeal); [2011] UKSC 60, [2012] 2 W.L.R. 1 (Supreme Court)

[1288] Insolvency Act 1986, §382(1) defines the term "bankruptcy debt" as including "any debt or liability to which [the debtor] is subject at the commencement of the bankruptcy." Section 382(4) in turn states that "liability" means "a liability to pay money or money's worth, including *any liability under an enactment*, any liability for breach of trust, any liability in contract, tort or bailment and any liability arising out of an obligation to make restitution" (my emphasis).

[1289] *Balding* (EWCA), [24].

[1290] Bradley-Hole v Cusen [1953] 1 QB 300.

[1291] Regina v Secretary for Social Security ex parte Taylor and Chapman [1997] BPIR 505. Davis J also considered a House of Lords opinion on Scottish bankruptcy law: Mulvey v Secretary of State for Social Security 1997 SC (HL) 105, 1997 SLT 753.

[1292] *Balding* (EWHC), [40].

enable the bankrupt to make a fresh start."[1293] The unacceptable vista of a debtor who was to be given a fresh start remaining subject to enforcement in respect of pre-bankruptcy liabilities would "simply compel a conclusion" that the liability to repay the benefits must be discharged.[1294] Therefore Davis J's reasoning affirms strongly the fresh start, recognising the modern policy view that the "more debts that are excluded from the effect of the discharge, the less effective the insolvency regime can be in achieving the debtor's rehabilitation and the many related goals".[1295] Davis J next turned to the purpose behind the enforcement moratorium, and in contrast to the approach in *Smith*, found that the stay served *both* the debt collection and debt relief objectives. The judge recognised that the orderly administration of the bankruptcy, through the protection of the debtor's estate for the benefit of creditors, "of course" constitutes one rationale for the moratorium. Davis J proceeded, however, to recognise the stay's debt relief function in identifying another rationale of the protection of the debtor from proceedings.[1296] The approach of Davis J differs from that in *Smith*, in recognising that the stay of enforcement's traditional function has been joined by a new role. This recognition did not influence the outcome as the case related only to the debt discharge, and prior authority constrained the High Court's views on the scope of the stay. One might speculate, however, that had the question of the moratorium's scope been at issue, the importance Davis J attributes to the fresh start principle could have led to an expansive interpretation.

(ii) Regina (Cooper and Payne) v Secretary of State for Work and Pensions

This question ultimately arose in the related case of *Regina (Cooper and Payne) v Secretary of State for Work and Pensions*.[1297] Here the UK Supreme Court decided that the moratorium on enforcement under both the DRO and bankruptcy procedures extended to deductions from a debtor's ongoing welfare benefit payments to recover past benefit overpayments and social fund loan repayments.[1298] The Court overruled precedents that had prevented lower courts (as in *Balding*) from interpreting the bankruptcy moratorium's scope widely enough to include such claims.[1299] These authorities had required the Court of Appeal in *Payne and Cooper* to

[1293] *Id.,* [41].
[1294] *Id.,* [49].
[1295] WORLD BANK (2013) ¶367.
[1296] *Balding* (EWHC), [52]. He also noted that a rationale of debtor protection "may play a part in the discharge provisions", illustrating how the moratorium and discharge combine to serve the debt relief aim characteristic of modern bankruptcy law.
[1297] *Cooper and Payne*.
[1298] Insolvency Act 1986 §251G(2) provides that during the moratorium, a creditor has no remedy in respect of the debt, and may not commence a bankruptcy petition, or any action or other legal proceedings against the debtor, except with the court's permission.
[1299] *Bradley-Hole* (1953); *ex parte Taylor* (1997); *Mulvey* (1997).

distinguish the DRO procedure from bankruptcy in order to find that social welfare payment deductions were suspended by the DRO moratorium. [1300] The Court of Appeal majority thus identified the stay as serving two discrete functions under the two mechanisms. Following Lord Jauncey in *Smith*, Smith LJ explained that its purpose in bankruptcy is “to preserve the bankrupt’s assets in order that they should be available for fair distribution”[1301] to creditors, as part of the administration of the debtor’s estate. In contrast, the judge saw the DRO moratorium’s purpose as simply providing “immediate debt relief, but with a period for investigation [before final debt discharge] during which the order may be set aside.”[1302] Toulson LJ clarified that “the purpose of the DRO scheme is unadulterated debt relief, and it is entirely consistent with the nature of the scheme that from the making of the DRO a creditor to whom a specified qualifying debt is owed should have no 'remedy in respect of the debt'.”[1303] Therefore the Court of Appeal saw the moratorium as serving a pure debt relief objective under the DRO procedure, but a debt collection aim in bankruptcy. These contrasting objectives were seen as justifying an extension of the moratorium under the DRO beyond the limits precedent had established in bankruptcy.

The Supreme Court departed from the constraining prior authorities[1304] and reached the view that deductions from benefit payments fell under both the moratorium and discharge, in both the bankruptcy and DRO procedures.[1305] While Baroness Hale JSC accepted the Court of Appeal’s logic that there is “a major difference between the purpose of the waiting periods in each scheme”,[1306] she and her court did “not see any reason to distinguish the DRO scheme and bankruptcy” in respect of the scope of the stay under the two regimes.[1307] The court therefore held *Balding* to be correctly decided and applied its findings equally to the DRO regime as to bankruptcy.[1308] Lord Brown JSC particularly was keen to avoid the Court “creating or reinforcing absurd and anomalous distinctions both between the DRO and bankruptcy regimes and between the debtor’s situation respectively before and after the end of the moratorium period/discharge from bankruptcy.”[1309]

[1300] *See e.g. Cooper and Payne (EWCA)*, [54], per Smith LJ. Even Mummery LJ’s dissent, which applied the bankruptcy precedents to the DRO procedure, distinguished between the two procedures: see ¶30.

[1301] Cooper and Payne (EWCA), [85].

[1302] *Id.*, [77].

[1303] *Id.*, [85].

[1304] The court considered the *Taylor* decision, which held that social welfare payment deductions fell outside the bankruptcy moratorium, wrongly decided: *ex parte Taylor* (1997).

[1305] [2011] UKSC 60, [2012] 2 W.L.R. 1.

[1306] Ibid.

[1307] *Cooper and Payne (UKSC)*, [23], per Baroness Hale JSC. Lord Mance JSC also commented that there “is... no real reason to distinguish between the provisions applicable in [the context of bankruptcy] and in the present context of a debt relief order.”

[1308] Cooper and Payne (UKSC), [26].

[1309] *Id.*, [28]. There is a clear tension between this statement and that of Toulson LJ in the Court of Appeal that “I do not believe that the solution to this case lies in searching for an unattainable symmetry between schemes which, despite their similarities, in some respects have different purposes and are expressed in different language”: *Cooper and Payne (EWCA)*, [54]. The role of existing precedent in preventing such a symmetry from being achieved in Toulson LJ’s decision should be recognised, however.

The Supreme Court's freedom to depart from authority meant its decision was based more on a literal meaning of the statutory language rather than the purposive approach of the Court of Appeal. The uniformity it brought to the bankruptcy and DRO procedures was not the result of a view that both procedures, and so the feature of the moratorium under both procedures, have come to serve the same debt relief objective. Rather, the Court seemed to support the Court of Appeal's view that the purposes of the moratoria are significantly different, and so by extension this appears to represent (non-binding) Supreme Court support for the view that the sole purpose of the moratorium in bankruptcy is the protection of the debtor's assets for the benefit of her creditors. While the courts were willing to see how the stay of enforcement serves the fresh start policy of debt relief in the DRO context, this role of the stay was not recognised in bankruptcy. This view contrasts with the more nuanced view of the stay's dualistic functions adopted by Davis J in *Balding*, who acknowledged that its traditional function has been joined by another rationale of relieving the debtor from creditor enforcement, and so together with the discharge the moratorium serves the aim of debtor rehabilitation under the fresh start policy.

5.4 Finding a Home for the Fresh Start Policy in Bankruptcy Law

The tension between the debt collection and debt relief perspectives of personal insolvency law led to significant practical consequences in the cases of *Harlow District Council v Hall*,[1310] and *Places for People Homes Ltd. v Sharples*,[1311] in respect of the question of whether a moratorium on enforcement serves to protect from eviction a debtor tenant owing rent arrears. While the fresh start policy would support the debtor's protection on the grounds that her eviction would jeopardise substantially her rehabilitation, the Court of Appeal in *Sharples* (the decision on which I focus for reasons of brevity) held that neither the bankruptcy nor DRO stays of enforcement prevent an order for possession being made to remove a debtor tenant from her home. The Court, relying on precedent,[1312] held that a possession order made on the ground of rent arrears under a secured tenancy[1313] is not a remedy in respect of the debt constituted by the rent arrears, but rather "is a remedy which restores to the landlord full propriety rights, including rights

[1310] *Harlow District Council v Hall*, [2006] 1 W.L.R. 2116.

[1311] *Places for People Homes Ltd. v Sharples; A2 Dominion Homes Ltd. v Godfrey*, [2011] H.L.R. 45.

[1312] Ezekiel v Orakpo [1977] QB 260; *Harlow DC*.

[1313] The tenancies in question in this decision were protected tenancies of a type known as "assured tenancies", in respect of which a court cannot make an order for possession except under certain specified grounds, some of which are mandatory, while others are discretionary and allow a court to refrain from making an order where unreasonable to do so. The relevant grounds in this decision were the discretionary ground of arrears of rent and the mandatory ground of at least eight weeks' rent unpaid. See Housing Act 1988 (1988 c. 50), §7 and Sch. 2.

of occupation and letting, in respect of the property."[1314] Etherton LJ rejected the debtors' arguments that the object of a claim for possession is to secure payment of rent arrears, instead finding that such a claim aims to protect a property right and "restore to the landlord the right to full possession and enjoyment of the landlord's property."[1315] The Court held, however, that the status of rent arrears as a bankruptcy debt means that courts are prevented by the moratorium from entering judgment for the arrears, and from making a suspended possession order conditional on arrears repayment. Thus while the debtors in this case received discharge of their rent arrears liabilities, their fresh starts were constrained by the loss of their homes.

As well as adopting a literal approach to interpreting sections 285 and 251G of the 1986 Act in reaching this decision, Etherton LJ also relied on the purpose of the stay of enforcement.[1316] The judge clearly adopted a debt collection perspective in identifying the objective as being to protect the debtor's estate and prevent one creditor from obtaining an improper advantage over another.[1317] Etherton LJ held that since an assured tenancy does not form part of the bankruptcy estate,[1318] this purpose would not be frustrated by allowing a landlord to obtain a possession order, as other creditors would not be disadvantaged by such an order. Secondly, even if the threat of a possession order caused a debtor to make repayments to the landlord, this would not have a negative impact on other creditors, since the debtor's income – from which such repayments would be made – also does not form part of the bankruptcy estate.[1319] The court adopted a debt collection-oriented interpretation of the stay, seeing this mechanism as designed to preserve equality of creditors and maximise assets available for distribution to creditors as a group, rather than part of the tools used to give effect to the rehabilitative fresh start policy. Enforcement should only be stayed where it would cause detriment to creditors, and if possession orders only affect property unavailable to other creditors, there is no function for the stay to fulfil.[1320] This is despite the aims of debtor protection and rehabilitation expressed by legislators when enacting (without opposition) the provisions to exclude tenancies from the bankruptcy estate, explained in the following terms:

> "I believe that a bankrupt tenant whose tenancy has no financial value is put in an even more unfortunate position if he should lose his tenancy too. If he loses his home, he is not going to be in a position to sort out his affairs..."[1321]

Etherton LJ relied on case law predating the Insolvency Acts 1985-6 and the Enterprise Act 2002,[1322] and did not see fit to re-evaluate such case law based on the increased emphasis on

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[1314] *Sharples*, [63].
[1315] *Id.*, [65].
[1316] *Id.*, [70].
[1317] *Id.*, [30], [70].
[1318] Insolvency Act 1986, §283(3A), (inserted by Housing Act 1988 (c.50), §117(1)).
[1319] *Sharples*, [70].
[1320] The second aspect of this reasoning appears particularly inappropriate in the context of modern household over-indebtedness in which debtors hold few valuable assets, meaning that the debtor's income is the sole resource for which creditors (including landlords alongside other creditors) compete.
[1321] HL Deb 11 October 1988 vol 500, 725, per Lord Malcolm Sinclair, Earl of Caithness.

debt relief in the policies underlying the 2002 reforms and the DRO procedure. Even when considering the DRO procedure (which recognises no concept of the debtor's "estate"), the judge rejected the idea that these principles call for a re-evaluation of the scope of the moratorium. Even while acknowledging the "broad policy point that the object of a DRO is the relief from debt of those with limited means and limited debts",[1323] the judgment abandoned a purposive approach in the DRO context and instead reverted to a literalist interpretation which would avoid giving "an artificial meaning" to the wording of the relevant legislative provision.[1324] As seen above in relation to IVA case law (Part 4.4(B)), the court was comfortable in adopting a purposive approach in respect of the debt collection purpose, but inconsistently was unwilling to allow the debt relief policy objective determine questions of legislative interpretation.

That said, when deciding the final issue that a court could not make a suspended possession order requiring repayments of arrears against a bankrupt or DRO debtor, Etherton LJ indeed returned to a purposive interpretation technique. Acknowledging that "the DRO regime (and bankruptcy) is designed to restrict the recovery of debt and, when the process is complete, to eliminate it,"[1325] the judge concluded that permitting the recovery of the debt through a conditional possession order "would be contrary to that policy". Thus here Etherton LJ was willing to give a wide interpretation to the *debt discharge* under both procedures, but did not consider that the policy objectives justifying this interpretation also called for an expansive interpretation of the *moratorium*. Therefore the harmony between these features of the law achieved in *Cooper and Payne* was not replicated in *Sharples.*

5.5 Adverse Consequences: the Case Study of *Sharples* and the Protection of Tenants in Personal Insolvency

The decision in *Sharples* was followed subsequently by the Court of Appeal in *Irwell Valley Housing Association Limited v Docherty,*[1326] a decision in which Lewison LJ noted the decision's undesirable potential consequence that a tenant who pays the current rent, but fails to contribute towards (the subsequently discharged) arrears as required in a pre-DRO conditionally suspended possession order, may suffer eviction despite the DRO.[1327] This observation brings into focus the negative consequences of the *Sharples* decision, which I now present as a case

[1322] *Ezekiel*.
[1323] *Sharples*, [77].
[1324] Insolvency Act 1986, §251G.
[1325] *Sharples*, [81].
[1326] Irwell Valley Housing Association Limited v Docherty, EWCA Civ 704 (2012).
[1327] *Id.*, [17].

study of problems generated by English courts' lack of appreciation of the modern policy objectives of personal insolvency law (as represented in the normative framework established in Chapter 2 above). An interpretative approach that sees the stay of enforcement as playing no role in the fresh start policy, but as merely serving the aim of maximising returns to creditors, may defeat the rehabilitative aims of modern personal insolvency law. The decisions in *Smith, Balding* and *Payne and Cooper*, while illustrative of the tension between the debt collection and debt relief perspectives of the law, ultimately were cases in which the two perspectives largely pointed to the same conclusions. This is not the case for *Sharples*, making this decision and the issue of the protection from eviction of tenant debtors particularly illustrative of the adverse consequences of English courts' insufficient recognition of the fresh start policy.

A. Socio-Economic Significance of Tenant Over-indebtedness

The *Sharples* decision is particularly significant given the socio-economic context of the growing policy problem of rent arrears. While historically the question of the treatment in bankruptcy of the family home of a home-owning debtor has consistently been a topic for policy consideration,[1328] little attention has been given to the protection from eviction afforded to tenant debtors under personal insolvency law. This is despite tenants making up the large majority of debtors entering the personal insolvency system. While data is limited, only 8-14% of debtors in bankruptcy during the years 2003-2008 were property owners, albeit with this figure increasing steadily throughout the period.[1329] In 2009, only 36% of IVA debtors were homeowners, while only 25% of debtors held equity in their properties.[1330] Similarly, quantitative empirical analysis of over-indebtedness suggests that residence in rented accommodation is associated with an increased probability of financial difficulty, most likely due to relatively lower incomes and higher marginal housing costs of renters as opposed to homeowners.[1331] Rent arrears also appears to be a growing problem, with a leading UK debt advice charity[1332] reporting considerable rises in client rent difficulties in recent years.[1333] Arrears difficulties appear more prominent in the private rented sector than among social housing tenants, which is particularly significant due to the current and projected continued growth of this sector, as mortgage-financed home ownership

[1328] *See e.g.* CORK (1982), ¶¶1114–31; INSOLVENCY SERVICE, THE BANKRUPT'S HOME - BEFORE AND AFTER THE ENTERPRISE ACT 2002 (2008); FLETCHER (2009), ¶¶8–022 to 8–023.

[1329] Insolvency Service (2009C); Insolvency Service (2007D).

[1330] INSOLVENCY SERVICE (2009B), 18.

[1331] EUROPEAN COMMISSION ET AL. (2010), 38–40.

[1332] See text to note 964 above.

[1333] CCCS (2012) 21, 24–25; STEPCHANGE DEBT CHARITY, STATISTICAL YEARBOOK 2012, 22 (2012).

and social renting both fall.[1334] Data relating to statutory homelessness also suggests increased financial difficulty among renters. While levels of homelessness caused directly by rent arrears remain consistently low, there has been a noted increase in the number of cases of homes lost due to the end of an assured shorthold tenancy.[1335] The short term of most tenancies and procedural advantages for landlords of waiting until a tenancy's end to seek possession[1336] may explain the prevalence of tenancy expiry over rent arrears as a cause of homelessness, while nonetheless suggesting increased financial difficulty among renters. While the reasoning of the court in *Sharples* may have been influenced by the status of the creditors as social landlords,[1337] the legal consequences of the decision extend to all main forms of tenancy, including the assured shorthold tenancy which is standard in both the social and private sectors.[1338] Therefore the decision carries significant socio-economic implications.

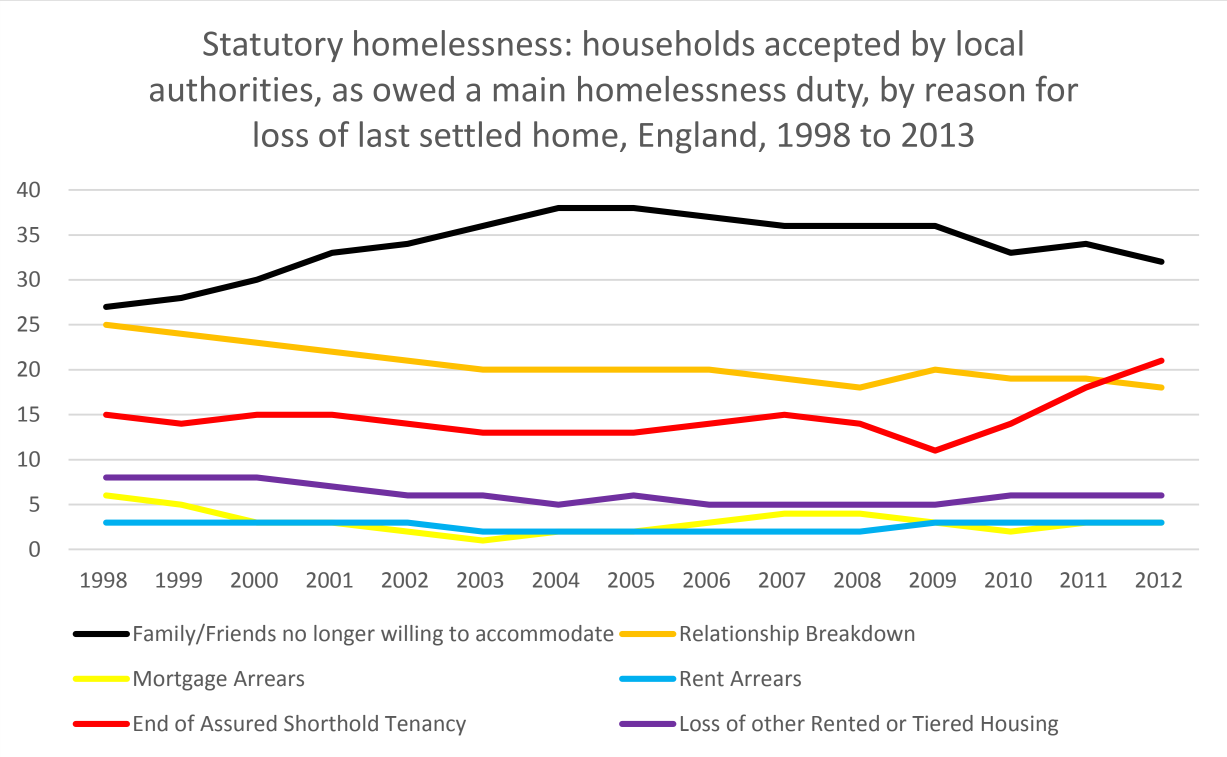

Figure 13: Statutory Homelessness Data: Reasons for Loss of Last Home, 1998-2013

[1334] *See e.g.* CHRISTINE WHITEHEAD ET AL., HOUSING IN TRANSITION: UNDERSTANDING THE DYNAMICS OF TENURE CHANGE (A REPORT FOR THE RESOLUTION FOUNDATION AND SHELTER) 8–9, 22–32 (Cambridge Centre for Housing and Planning Research 2012).

[1335] *See* Department for Communities and Local Government, Homelessness Statistics, https://www.gov.uk/government/organisations/department-for-communities-and-local-government/series/homelessness-statistics. Assured shorthold tenancies are the standard form of tenancy in England and Wales: *see Insolvency Service Technical Manual, Part 4: Tenancies*, ¶¶30.65–30.65A (Jul. 18, 2012), http://www.insolvencydirect.bis.gov.uk/freedomofinformation/technical/technicalmanual/ch25-36/Chapter30/Part%204/Part%204.htm#30.62A.

[1336] SHELTER, EVICTION RISK MONITOR 2012, 8–9 (2012).

[1337] David Milman, *Debt Relief Orders: Mixed Messages from the Courts and Policymakers*, 25 INSOLV. INTELL. 104, 105–6 (2012).

[1338] *See Insolvency Service Technical Manual, Part 4: Tenancies*, ¶30.70; Insolvency Act 1986, §283(3A).

B. Social Costs of Eviction: Economic Perspectives and the Social Insurance Function of Personal Insolvency Law

The eviction of over-indebted tenants not only obviously causes considerable hardship to debtors themselves, but also leads to externalities which pose public policy concerns. The debtor will face adverse consequences in the form of transaction costs of relocating to alternative accommodation.[1339] These include the costs of finding somewhere new to live (which may or may not be wholly suitable for the household's needs), transporting belongings and abandoning items too expensive to transport or unsuitable for any new accommodation.[1340] Investments in community networks may be lost, while substantial emotional and psychological costs may accrue in the form of embarrassment or shame accompanying eviction.[1341] An evicted bankruptcy/DRO debtor may encounter considerable difficulty in obtaining a new tenancy due to the adverse impact of insolvency and an eviction order on the debtor's credit history.[1342] These additional costs and hardships of eviction therefore push the debtor further from the law's rehabilitative aims.

If the debtor has a family, eviction may also impose considerable losses on these third parties, with adverse consequences including potential detriment to education and development for relocated children.[1343] Significantly, if the debtor is unable to find alternative accommodation in the private market or social lending sector, a duty may fall on the State under housing legislation to provide accommodation.[1344] The data outlined above (Figure 13) indicates that the departure of tenants from rented accommodation is placing an increased burden on public funds. The unnecessary eviction of tenants and creation of transaction costs through their exit from and re-entry into the housing market may also cause inefficient distortions of this market.

The fresh start policy, which aims to allocate the risks of the consumer credit society in an efficient and equitable manner, would argue that these externalities can be best internalised by preventing the eviction of debtors in bankruptcy and DRO procedures as part of a process of financial rehabilitation. While perhaps not quite as well placed as institutional consumer credit lenders, landlords remain better placed than individual debtors to bear the costs of tenant default and also to prevent against such default. Marginal costs of eviction are likely to be much smaller

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1339 Bar-Gill (2008), 1137.

1340 Culhane (2012), 129.

1341 Culhane (2012).

1342 On the steps followed by landlords when checking potential tenants' credit histories, see housing charity Shelter's account:
http://england.shelter.org.uk/get_advice/private_renting/renting_privately/how_private_landlords_check_tenants.

1343 Culhane (2012), 130–32.

1344 *See* UK Government, "Homelessness Data", https://www.gov.uk/homelessness-data-notes-and-definitions.

and bearable for landlords than the potentially devastatingly high costs of eviction for a debtor.[1345] Indeed, once *Sharples* confirmed that arrears of rent are in any case lost through bankruptcy/DRO discharge, landlords suffer no additional financial losses by being unable to evict a debtor. The stay of all other collection actions against the debtor (and ultimate discharge of debts) means that a debtor in these procedures should have more income than ever available for the payment of rent, so *enhancing*, rather than reducing, the landlord's likelihood of receiving repayment. The effect of *Sharples* therefore is the eviction of a tenant for non-payment of rent at the very moment when she enters a rehabilitative process which should facilitate enabling her to pay rent in future.[1346] A landlord may actually suffer losses if a property is left unoccupied for a period following an eviction,[1347] while transaction costs are incurred in finding a new tenant. Therefore the additional losses suffered to landlords if the moratorium extended to possession orders may be non-financial and limited to the loss of a legal right to possession of the property. The eviction of a tenant in a bankruptcy/DRO procedure may simply be an opportunistic tactic by a landlord seeking to obtain a new tenant willing to pay higher rent in a rising market.

Even if we focus on the loss of this right as a cost, housing associations and holders of property portfolios are better placed to bear these costs than debtors are to bear their corresponding losses, as they include losses due to default in calculating rents charged across their range of tenants. While this process is difficult for smaller landlords, those engaging in the commercial activity of renting property for profit must bear accompanying risks and price accordingly, as traders who do not understand their businesses have no right to remain artificially in the market.[1348] While landlords may be less well equipped than institutional consumer credit lenders to prevent default through informed credit extension practices (and to engage in risk-based pricing), UK landlords benefit from access to credit reference systems and remain better placed than individual tenants to conduct complex creditworthiness and risk assessments. Undoubtedly these considerations must be adjusted somewhat in the context of social housing markets, as housing associations do not lend purely for profit and serve charitable aims of access to housing which do not allow for strict creditworthiness assessments and market discipline. These associations nonetheless bear a capacity to spread losses in a manner which may be efficient. Ultimately a difficult policy choice may arise as to whether non-commercial social landlords warrant special treatment in personal insolvency, but it is clear that considerations of the fresh start policy neglected in the *Sharples* decision have a significant role to play in making such a choice.

[1345] WORLD BANK (2013), ¶95.

[1346] This reasoning regarding the debtor's future ability to repay also alleviates concerns of permitting continuously defaulting occupants of social housing to remain in residence despite long lists of other potential tenants: Milman (2012), 105–6.

[1347] Unoccupied premises also represent externality costs for society generally: Bar-Gill (2008), 1136.

[1348] Howard (1987), 1064.

The fresh start policy views personal insolvency law as performing the role of re-allocating the risks of the consumer credit society in a more efficient manner than can be achieved through consumer markets prone to failures and imperfections. While the case is less clear cut than in respect of consumer credit transactions involving institutional lenders, an application of this reasoning to the issue of the protection from eviction of over-indebted tenants suggests that personal insolvency should shift costs away from the debtor and from wider society and on to landlords by preventing eviction while an enforcement moratorium is in force. The decision in *Sharples* worryingly fails to recognise these considerations. Rather than recognising the benefits of distributing risk efficiently onto those best capable of bearing it, Etherton LJ appeared to call into question the legitimacy of consumer debt relief by emphasising the "financially catastrophic" consequences for landlords if they were unable to evict "persistent non-payers". This view of bankruptcy/DRO debtors as "persistent non-payers" whom landlords should write-off and evict contrasts strikingly with the fresh start policy of rehabilitation (and the theme of the Enterprise Act 2002 reforms), under which the debtor is to be restored to a position of economic productivity and financial independence free from past financial difficulties.

As I discuss in Chapter 6, the insurance perspective of personal insolvency law recognises the problem of moral hazard and the potential for insurance against losses to reduce incentives to prevent such losses. Concerns of *ex post* moral hazard (that a debtor may exaggerate her need for debt relief) arise in the present context, as protection against eviction might create incentives for a debtor not to make all reasonable efforts to pay her rent. This potential for abuse of a stay of eviction has been recognised by commentators on the American bankruptcy code.[1349] Moral hazard reasoning does not suggest that insurance should not be provided where it creates perverse incentives, however, but rather that it should be structured in a manner to reduce such incentives. Thus an eviction moratorium could be structured to alleviate these concerns, for example by permitting eviction on the grounds of non-payment in cases in which an insolvent debtor would be solvent but for her rent arrears (suggesting the debtor was deliberately withholding rent while able to afford other repayments). Eviction on grounds other than non-payment of rent could also be permitted, and lessons could be learned from 2005 amendments to the US Bankruptcy Code which introduced exceptions to the stay on eviction in bankruptcy.[1350] Allowance could also be made for cases in which a change in the debtor's circumstances means her rent will be unaffordable even after her rehabilitation and the discharge of her other debts. *Ex ante* moral hazard concerns of irresponsible borrowing and over-consumption are less significant in the context of rented properties, since housing is a basic necessary expense, rather than a

[1349] *See e.g.* Warren (1997), 502–3; Alan M. Ahart, *The Inefficacy of the New Eviction Exceptions to the Automatic Stay,* 80 AM. BANKRUPTCY LAW J. 125, 126–27 (2006).

[1350] 11 U.S.C. §362(b)(22), (23) (introduced by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005). *See generally* Ahart (2006). These exceptions permit the eviction of a debtor-tenant where the landlord has obtained a judgment for possession which pre-dates the bankruptcy petition, and where possession proceedings are brought on the grounds that the property is endangered or that illegal use of controlled substances is taking place there.

luxury or impulse purchase of the type made by a "spendthrift" debtor (see Chapter 6 below).[1351] While the possibility remains of individuals renting properties beyond their means, the risk is much reduced when compared to alternative credit forms, particularly revolving credit.

The case of the protection from eviction of over-indebted tenants in personal insolvency procedures raises difficult questions, both within the framework of the fresh start policy and bankruptcy's insurance function, and in the context of wider housing policies. While I acknowledge that the latter considerations falling outside the scope of my analysis could be dominant policy factors, the former suggest that ultimately the weight of argument leans towards the public interest being best served by extending the enforcement moratorium to protect debtor-tenants from eviction. At the very least, it is clear that a more sophisticated policy analysis is called for than that undertaken in the *Sharples* decision, and that the goals of modern personal insolvency law and the objectives of the fresh start policy should be comprehensively integrated into such analysis.

C.Distributional and Humanitarian Concerns

The outcome in *Sharples* is also problematic from distributional and humanitarian perspectives of the fresh start policy (see Chapter 2). Debt relief can be seen as a form of equitable redistribution of wealth, correcting the regressive wealth distributions created by credit markets and ensuring a minimum standard of living for the most financially troubled. Modern conceptions of personal insolvency law have moved away from Professor Jackson's debt collection view that insolvency law should involve "as few dislocations as possible" from pre-bankruptcy distributions of resources.[1352] Rather, "[v]iewed in its proper context… the law of personal insolvency functions as a mechanism of redistribution",[1353] under which creditors and other more well-resourced groups absorb the losses of stricken debtors so that the costs of a credit society can be more equitably shared. Yet the court in *Sharples* appeared to reject these fundamental premises of personal insolvency law. Etherton LJ noted that default in paying rent leads to negative consequences for "non-defaulting tenants who may have to pay higher rents to compensate for the landlord's lost revenue."[1354] The judge apparently considered this position, central to both the social insurance and redistributive functions of personal insolvency law, as being undesirable. Despite the aim of rehabilitating debtors who enter insolvency procedures, the judge could see "no reason why bankrupt assured tenants who owe arrears of rent should... be placed in a more advantageous position as regards possession proceedings than other assured tenants who owe

[1351] LoPucki (1997) 462-4; Warren (2004).
[1352] JACKSON (1986), 253.
[1353] FLETCHER (2009), ¶3–002.
[1354] *Sharples*, [5].

arrears of rent."[1355] Similar objections to the redistributive effects of consumer debt relief were expressed by members of the Supreme Court in *Payne and Cooper*, as Lord Mance JSC queried whether the effects of the bankruptcy and DRO procedures, in providing more favourable treatment to debtors than non-bankruptcy/DRO social welfare recipients, were "sensible or desirable".[1356] If the very fundamental premises of risk sharing and distribution upon which the fresh start policy are based are not recognised by English judges, it is inevitable that the courts will not acknowledge the policy's appropriate position as the primary objective of consumer insolvency law.

Finally, judicial reasoning in cases such as *Sharples* can be criticised as failing to appreciate the humanitarian justifications underlying the fresh start policy. Bankruptcy law's technicality has a tendency to de-personalise the procedure, [1357] conceptualising liquidation proceedings against "a bankrupt" as a distribution of the metaphysical entity of the "bankruptcy estate", rather than the sharing out of a household's livelihood.[1358] The decision regarding personal insolvency's protection from eviction potentially raises issues relating to the debtor's human right to respect for her private and family life, home and correspondence.[1359] Similarly, the issue in question could have implications for the right to an adequate standard of living, including housing;[1360] a right which the United Nations Committee on Economic, Social and Cultural rights has considered to justify debt relief laws supporting households in mortgage debt difficulty.[1361] The decision contains no suggestion that it was informed by these considerations, however, and while I do not argue that the judgment contravenes such rights, reflection upon these humanitarian concerns would undoubtedly have provided relevant insight. Instead the decision was based on a rather technical distinction between a remedy in respect of a debt and a remedy advancing a property right, which potentially ignores the human reality of household over-indebtedness and the practical outcomes which modern personal insolvency law aims to achieve.

[1355] *Id.*, [72].
[1356] *Payne and Cooper (UKSC)*, [44].
[1357] Shuchman (1973), 420.
[1358] *Id.*
[1359] See Article 8 of the European Convention on Human Rights. *See generally* JAN VAN APELDOORN, HUMAN RIGHTS IN INSOLVENCY PROCEEDINGS. (Kluwer B.V. 2012).
[1360] *See* Article 11 of the International Covenant on Economic, Social and Cultural Rights.
[1361] UN ECOSOC (2012), ¶¶21–22.

5.6 Conclusions

In discussing the difficulty of reconciling historical ideas and objectives of personal insolvency law with the modern "rehabilitative philosophy with which they are supposed to co-exist", Professor Fletcher notes that the modern aims of the law are "not very widely appreciated".[1362] In this chapter, I have sought to illustrate that to a certain extent English courts share this lack of appreciation of the law's more modern ideas and the fresh start policy around which the law normatively should be, and positively increasingly is, oriented. I have focused on judicial decisions relating to the enforcement moratorium and debt discharge, but examples of the judicial attribution of primacy to personal insolvency law's debt collection function over its debt relief objective can be drawn from other decisions relating to such questions as debtor asset exemptions and the extent of protection of the debtor's pension in bankruptcy,[1363] and even matters of private international law.[1364]

In judicial reasoning, the modern rehabilitative aims of the law have not taken root and outgrown more longstanding conceptions of personal insolvency law as a passive tool for upholding market exchanges. Courts' reluctance to embrace the market-correcting and redistributive aspects of fresh start policy again reflect a judicial attitude associated with traditional conceptions of commercial private law of the courts' role as being to facilitate market bargaining between self-interested actors,[1365] as described in Chapter 4. Courts are often reluctant to see themselves as intervening in the market and engaging in resource redistribution, but rather prefer to see their work as involving the apolitical reduction of transaction costs and facilitation of efficient resource allocation through private exchange.[1366] A central tenet of the fresh start policy, however, is that failures in consumer credit markets, will produce neither efficient resource allocations nor distributionally just results, and so personal insolvency law has a role to play in achieving the public policy outcomes which the market cannot. It is worrying that the primacy placed on debt relief goals by the reform of bankruptcy under the Enterprise Act 2002 and the introduction of the DRO procedure has not been recognised by courts in decisions which revert to historic conceptions of the law. More explicit policy pronouncements may be desirable to increase

[1362] FLETCHER (2009) ¶3–003. Professor Fletcher's comments contrast the rehabilitation of the debtor and the punitive treatment afforded to the debtor both under historical and contemporary bankruptcy law, as discussed further in Chapter 6. The comments are equally relevant, however, to the contrast between the law's debt collection and debt relief/fresh start aims.

[1363] Raithatha (as Trustee in Bankruptcy of Michael Roy Williamson) v Williamson, [2012] 1 W.L.R. 3559 (2012). *See* John Briggs, *The Recent Court Decision in Raithatha v Williamson: Creditors' Right to an IPO/IPA over More Than the Debtor's 'Pension in Payment'*, 25 INSOLV. INTELL. 65 (2012).

[1364] The High Court recently considered the preservation of the "creditors' bargain" principle of equality of creditors as being of sufficient public policy importance to justify an English court's grant of an anti-suit injunction, but was unwilling to accept the protection of a debtor's discharge under English bankruptcy law as adequate grounds for such a remedy: *Kemsley v Barclays Bank Plc and Others*, [2013] EWHC Ch 1274 (2013).

[1365] *See e.g.* Adams & Brownsword (1987).

[1366] Ramsay (1995), 179.

judicial acceptance of modern policy goals, as may be judicial training in the modern law's objectives. Ultimately, the best solution most likely involves the expansion of the Debt Relief Order procedure to become the default consumer insolvency remedy, as courts have demonstrated an increased willingness to acknowledge the new objectives of debt relief served by this procedure. Responses to the decisions discussed in this Chapter pose concerns regarding the continued commitment to the fresh start policy even amongst policymakers, however. The urgent response to the decision in *Payne and Cooper* was legislation which excludes social fund debts from the protection of enforcement moratoria and discharge, despite the extent to which such a measure conflicts with the fresh start policy.[1367] No similarly urgent response arose in respect of the *Sharples* decision, despite this Chapter's illustration of how the fresh start policy advocates such a reaction.

[1367] Insolvency (Amendment) Rules 2012 (2012). *See also* Milman (2012), 105.

CHAPTER 6: Consumer Debt Relief and Moral Hazard

6.1 Introduction

In Chapter 2, I argue that personal insolvency law is best conceptualised as a form of insurance, which reduces and allocates the risks and costs of a consumer credit society in an efficient manner. An advantage of this insurance framework is the insight it provides into the problem of *moral hazard*, the risk that by providing extensive debt relief under the fresh start policy, the law may create incentives for debtors to petition for debt relief when not in true financial difficulty, or to engage in borrowing practices which increase over-indebtedness. Therefore this Chapter considers, within the framework of insurance theory and the economic concept of moral hazard,[1368] how English law guards against abuse of debt relief.[1369] The chapter focuses in particular on the system of Bankruptcy Restrictions Orders (BROs) and Bankruptcy Restrictions Undertakings (BRUs) introduced by the Enterprise Act 2002 as a counterweight to more lenient debt discharge. This is an important subject due to the traditional importance of the maintenance of credit morality as a primary "basic objective" [1370] of English personal insolvency law, and the manner in which this issue again raises tension between the law's debt collection and debt relief objectives, as well as between its historical origins and modern context.

The debt collection perspective of personal insolvency law compels debtor repayment and holds debtors responsible for default, thus upholding market bargains. Under this view, to permit debtors to avoid their obligations easily would erode confidence in market exchange.[1371] The debtor, traditionally seen as the party best able to prevent default from occurring, should be required by law to bear responsibility for a loss occurring on default – thus internalising costs of her participation in the market, and becoming incentivised to avoid default - so that an efficient allocation of resources can be achieved via market exchange.[1372] In contrast, the debt relief or

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[1368] At times policymakers invoke the economic concept of moral hazard in a non-technical sense when discussing countervailing forces opposing debt relief policies, meaning that the distinction between the technical and political/ideological is not always clear. *See e.g.* the commitment of the Irish Government to reform personal insolvency law "with the objective of increasing the speed and efficiency of proceedings *while at the same time mitigating moral hazard and maintaining credit discipline*" as part of Ireland's financial assistance programme: EUROPEAN COMMISSION (2012B), 61. The question of moral hazard has featured prominently in public and political debates on issues such as employee protection laws, social welfare provision and health care: Baker (1996), 238–40.

[1369] I do not conduct an inquiry into the ethics and moral philosophy of personal insolvency law, and analyses of this type can be found elsewhere: *e.g.* KILPI (1998). I note that much social science has moved beyond the idea of debt as a moral issue, as household debt and over-indebtedness have become an accepted reality in the modern socio-economic conditions I describe in Chapter 1: *see* CALDER (2001), 20.

[1370] CORK (1982), ¶191.

[1371] Czarnetzky (2000), 413.

[1372] Eisenberg (1980), 981.

fresh start perspective of the law considers that in the modern consumer credit society the institutional creditor is better placed than the consumer debtor to prevent default and bear its costs, as explained in Chapter 2 and Part 6.5 below. Therefore more efficient outcomes (productive of fewer externalities) can be generated by the law placing costs of default on lenders and incentivising *lenders* to prevent default. Rather than sanctioning debtor default in the hope of incentivising contractual performance, this view sees a credit level of insolvency as inevitable and condemns abuse of the debt relief provided under the law, rather than the mere fact of the debtor's default. More targeted costs and sanctions are necessary, however, to ensure debt relief is only provided in circumstances which serve the public interest (i.e. cases in which negative externalities would otherwise accrue). If a debtor who can bear the costs of default seeks to enter an insolvency procedure dishonestly, or if default was caused by the debtor's fraud, then the public interest in the debtor's discharge subsides. Further, allowing a debtor to profit from the law's debt relief could incentivise over-indebtedness. The debtor's good faith is thus fundamental to the fresh start policy, which has always limited debt relief to the "honest but unfortunate" debtor,[1373] as evident in the US Supreme Court's seminal statement in *Local Loan Co. v Hunt*.[1374] At a political level, the fresh start policy requires a system for disciplining debtor conduct and preventing abuse to legitimise it in the face of widespread and intense political opposition to debt relief[1375] (see Part 3.4(A) above[1376]), even if empirical evidence shows minimal debtor "abuse" of the system (see Figure 14 below).[1377] Therefore while both perspectives of personal insolvency recognise a role for the law in addressing concerns of moral hazard and sanctioning inappropriate debtor conduct, their respective views of this aspect of the law vary considerably, leading to difficulties in the law's application.

The issue of debtor misconduct also divides historical and modern perspectives of personal insolvency law. Early bankruptcy laws were quasi-criminal in nature,[1378] and as well as facilitating debt collection sought to uphold standards of fair dealing in commerce by punishing perceived debtor deviancy.[1379] For this reason, "commercial morality, and respect for the rule of law, may be said to constitute the very bedrock upon which the law of bankruptcy is founded."[1380] The law's very subject matter of unhonoured obligations traditionally raised initial suspicions of

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1373 Lawrence Ponoroff & F. Stephen Knippenberg, *Debtors Who Convert Their Assets on the Eve of Bankruptcy: Villains or Victims of the Fresh Start?*, 70 NYU LAW REV. 235, 243 (1995). Professor Howard similarly expresses the purpose of consumer insolvency law as being "to give a fresh start to the 'honest but unfortunate debtor'": Howard (1987), 1047.

1374 *Local Loan Co.*, 244.

1375 WORLD BANK (2013), ¶113.

1376 *See also* Spooner (2013), 774–75.

1377 *See e.g.* Teresa A. Sullivan et al., *Less Stigma or More Financial Distress*, 59 STANFORD LAW REV. 213 (2006); SULLIVAN ET AL.(2000); SULLIVAN ET AL.(1999); WORLD BANK (2013), ¶118.

1378 Tabb (1991), 330; Duncan (1995), 192 et seq.

1379 CORK (1982), ¶38.

1380 FLETCHER (2009), ¶6–032.

misconduct,[1381] and harsh sanctions were historically applicable to all bankrupts, with particularly punitive treatment afforded to fraudulent debtors.[1382] As 18th and 19th Century laws accepted the importance of credit to trade[1383] (although mainstream legal[1384] and economic[1385] thought continued to condemn *consumer* credit[1386]) and became progressively more lenient, they nonetheless retained a penal element in imposing a range of restrictions and incapacities on all bankrupts, and retaining severe punishments for culpable debtors.

As late as the 1980s, the Cork Committee saw an important "public interest" in the investigation of the causes of the debtor's insolvency and the punishment of misconduct.[1387] The Committee nonetheless recommended that most personal insolvency cases could be processed with little investigation, reserving a more severe procedure for cases involving debtor dishonesty or obstructiveness.[1388] While the *Insolvency Acts 1985-1986* did not enact these recommendations, they reduced the law's stigmatising effects somewhat by no longer requiring a bankrupt's public examination in all cases, for example.[1389] The Enterprise Act 2002 shifted policy further, expressly aiming to make bankruptcy less punitive and stigmatising.[1390] Policymakers recognised the lack of misconduct in most cases,[1391] and aimed to facilitate entrepreneurship by lowering the costs of business failure. Legislation reduced the waiting period for debt discharge and replaced the restrictions/incapacities previously applicable to all undischarged bankrupts with the Bankruptcy Restriction Orders/Undertakings system of punishments for solely culpable debtors (see Part 6.3). This marked a new approach of encouraging, rather than deterring, credit risk and ultimately recourse to debt relief procedures. Debt default was no longer seen as condemnable conduct of itself, and the law departed from the historical one-size-fits-all approach, which had treated all insolvent individuals as wrongdoers or "social menaces".[1392] In principle these changes marked a new departure, but their introduction into a longstanding personal insolvency

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[1381] This view persists among some modern commentators, as seen in the following remarks of Professor Zywicki and Judge Jones: "Bankruptcy represents a repudiation of one's promises… It is… not surprising that society punishes and stigmatizes an individual's failure to keep his promises." Jones & Zywicki (1999), 215.

[1382] *See e.g.* John Paul Tribe, *Bankruptcy and Capital Punishment in the 18th and 19th Centuries*, SSRN ELIBRARY 1, available at SSRN: http://ssrn.com/abstract=1329067 or http://dx.doi.org/10.2139/ssrn.1329067 (2009); An Act for the Better Relief of Creditors against such as shall become Bankrupts 1604, 1 Jac. C. 15; An Act for the Further description of a Bankrupt and relief of creditors against such as shall become bankrupts and for inflicting corporal punishment upon the bankrupts in some special cases 1623, 21 Jac. 1, c.19. An Act to Prevent Frauds Frequently Committed by Bankrupts 1705, 4 & 5 Anne, c. 17. See Rafael Efrat, *The Evolution of Bankruptcy Stigma*, 7 THEOR. INQ. LAW 373 (2006); Tribe (2009), 1.

[1383] CORK (1982), ¶34.

[1384] *See e.g.* Jay Cohen (1982), 161–62, citing William Blackstone, *Commentaries on the Laws of England* vol. 2 (1765-1769), *473-4.

[1385] SMITH (1778), 426.

[1386] Non-traders were excluded from bankruptcy law until 1861: Bankruptcy Act of 1861, §69. *See e.g.* FLETCHER (2009), ¶5.014.

[1387] CORK (1982), ¶¶1734–74.

[1388] *Id.* ¶¶545–54.

[1389] Insolvency Act 1986, §290(1).

[1390] INSOLVENCY SERVICE, DTI (2001); INSOLVENCY SERVICE (2000).

[1391] INSOLVENCY SERVICE (2000), ¶¶2.1, 7.1.

[1392] Walters (2005), 83.

framework based around historical ideas of debtor culpability means that the re-orientation of the law around modern debt relief objectives has not been wholly achieved.

6.2 Moral Hazard, Debtor Misconduct and Bankruptcy "Abuse"

A. The Nature of Moral Hazard

The insurance theory of personal insolvency views the law, through its key institution of debt discharge, as a means of allocating the risks of the consumer credit society in an efficient manner, minimising overall risk by making losses more predictable and incentivising *lending* practices which *reduce* levels of default.[1393] The perspective also acknowledges the corresponding problem of *moral hazard*, however, and the risk that the availability of debt relief may create incentives for *borrowing* practices which *increase* levels default and over-indebtedness. The classic concept of moral hazard refers to the "tendency for insurance against loss to reduce incentives to prevent or minimise the cost of loss."[1394] Reduced incentives to prevent the cost of loss are conceptualised as *ex ante* moral hazard, while *ex post* moral hazard is the theoretical tendency for insurance to reduce incentives to minimise costs of recovering from loss.[1395] Applied to personal insolvency law, moral hazard concerns firstly arise as to the extent to which the discharge, by relieving the debtor of over-indebtedness, creates incentives (at the *ex post* stage) for the debtor to enter an insolvency procedure at the first sign of financial difficulty without a true need for debt relief. At the ex ante stage, similar concerns arise regarding debt relief's tendency to create incentives for consumers to over-borrow in the first place (at the *ex-ante* stage).[1396] For neo-classical economic theorists, the law must take serious account of both of these sets of incentives. Those working with the findings of behavioural economics and/or empirical evidence of consumer decision-making are more concerned only with the *ex post*

[1393] Personal insolvency policy is but one of many issues which, through insurance theory, "can best be understood as an institutional adaptation to the problems of risks and incentives". *See* Joseph E. Stiglitz, *Risk, Incentives and Insurance*, 8 GENEVA PAP. RISK INSUR. - ISSUES PR. 4, 4 (1983).

[1394] Baker (1996), 239; Hallinan (1986), 84, 92, 103; Hynes (2004), 329. Problems of moral hazard are generated when there is information asymmetry between the insured and insurer, limiting the insurer's ability to monitor the insured's conduct and insert contractual provisions which foresee and control the insured's actions: Stiglitz (1983), 5.

[1395] Baker (1996), 270.

[1396] Hallinan (1986), 92.

incentives,[1397] as they argue that assumptions of moral hazard theory required to generate *ex ante* concerns do not hold in consumer over-indebtedness' empirical reality (see Part 6.5 below). The assumptions of moral hazard theory include:

1) Money (the reduction in a debtor's liability in the case of personal insolvency law) compensates for loss;
2) People are rational economic actors (including rational loss minimizers);
3) Taking care to prevent loss requires effort;
4) Taking care is effective;
5) The insured has control over herself, her property and her financial circumstances; and
6) Insurance payments are not conditioned on a given standard of care on the part of the insured.[1398]

A further insight for personal insolvency law is the relational nature of moral hazard, [1399] meaning that every legal amendment addressing the risk of debtor moral hazard may increases incentives for lenders to increase risk levels in their lending practices. One of the notable achievements of economists' explorations of moral hazard is to illustrate how "insurance" is not simply a product provided by insurance companies as traditionally understood, but relates to any case in which the actions of one party have consequences for the risk of loss carried by another.[1400] The issue of moral hazard is a two-way phenomenon, and any reduction in the debt relief provided under the law means that debtors (and ultimately wider society) are providing increased insurance to creditors in respect of their unsuccessful lending decisions. As I argue at multiple points in this dissertation, personal insolvency law should play a market disciplining role in incentivising creditors to lend responsibly and internalise the social costs of credit markets. Therefore measures addressing debtor moral hazard must guard against creating a moral hazard problem on the lender side of the market.

[1397] *Id.* Some commentators even dismiss concern regarding *ex post* moral hazard as "more an economists' fantasy than an empirically grounded reflection of [debtors'] behaviour. Most bankruptcy filers are seriously financially strapped and bankruptcy is a last-resort option." *See* Levitin (2009), 644.
[1398] Baker (1996), 276.
[1399] *Id.*, 275.
[1400] *Id.*, 272.

B. From the "Honest but Unfortunate" Debtor to the "Amoral Calculator"

(I) Categorising Debtors: Honest, Dishonest and Improvident

Due to the wide range of possible debtor conduct,[1401] difficulties arise in designing features of the law to guard against moral hazard. Thus courts, policymakers and commentators have frequently relied on paradigmatic characterisations of the debtor to assist in deciding on appropriate measures.[1402] Authoritative statements of the fresh start policy indicate that its benefits should be provided to the "*honest but unfortunate*" debtor, there being little dispute as to the appropriateness of debt relief in such cases.[1403] This image of the debtor, unfortunate due to her financial difficulties and honest due to these difficulties' external causes,[1404] are readily identifiable in sources such as case studies presented by debt advice and poverty charities.[1405] Next there are *dishonest* debtors, the "amoral calculators",[1406] who lied to creditors or to courts/administrative officials, hid assets, or disposed of assets subject to security.[1407] Such debtors are recognisable in Insolvency Service case studies of debtors subjected to bankruptcy restrictions for obtaining credit fraudulently, or whose discharge was suspended for failing to disclose funds.[1408] Again, few difficult policy questions arise in relation to such debtors, with most disagreement based solely on the appropriate punishment (e.g. denial of discharge, imposition of restrictions/incapacities, criminal liability – see Part 6.3). [1409]

Greatest controversy arises in the intermediate category of the "spendthrift"[1410] or "*improvident*"[1411] consumer debtor, in some cases an "incurably naïve optimist".[1412] This

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[1401] LoPucki (1997), 477.

[1402] *See e.g.* GROSS (1997), 104–14. See further discussion in Part 3.4(D) above.

[1403] Hallinan (1986), 65–66; LoPucki (1997), 461 et seq.

[1404] Ponoroff & Knippenberg (1995), 293.

[1405] *See e.g.* STEPCHANGE (2012), 13; DEARDEN ET AL. (2010), 22–26; CAB (2010), 6–7.

[1406] FLETCHER (2009), ¶11–007.

[1407] LoPucki (1997), 461; Howard (1987), 1053–54.

[1408] INSOLVENCY SERVICE (2012A), 35.

[1409] The distinction between dishonest and honest debtors has also influenced French consumer insolvency policy, with policymakers deploying a categorisation of "active" and "passive" over-indebtedness. Those debtors falling into the category of active over-indebtedness are characterised as intentional insolvents who profit from every opportunity to live beyond their means, without worrying of ever repaying. In contrast, debtors falling into the latter category include those who have overestimated their resources, and are victims of their own low budgets and/or the temptations of advertising and consumer culture. *See* ISABELLE COUTURIER, *La Condition De Bonne Foi Pour Le Reglement Des Difficultés Liées Au Surendettement Des Particuliers*, *in* GARDAZ (ED.) (1997), 81.

[1410] LoPucki (1997), 461, 464.

[1411] Hallinan (1986), 66–71.

characterisation involves an individual whose financial difficulties result from high levels of credit-funded consumption and misjudgements about her capacity to repay, rather than purely external events.[1413] Often this character is described as strongly intending to honour her large unpayable debts, not realising the extent of her financial difficulty.[1414] Examples of this category can again be found in empirical survey case studies.[1415] Technical and political support for sanctions, and opposition to lenient debt discharge, here comes from a view that over-indebtedness could be avoided by these debtors, and that borrowing in these cases lacks social utility, in contrast to business debt (see Part 6.5).[1416] Unless some sanctions apply, *ex ante* moral hazard concerns arise, as simply allowing this category of debtors to benefit from debt relief may encourage irresponsible borrowing.[1417]

The case for sanctioning such debtors is complicated, however, by concerns that legal disincentives would be futile in the case of such *improvident* or incurably naïve borrowers, as well as the law's need to respect consumer spending's central role in producing economic growth (Part 1.3 above).[1418] Furthermore, empirical uncertainty abounds as to the role played by such improvident borrowing in causing over-indebtedness (see Part 1.3(D)), and difficult distinctions between over-spending caused by extravagance, and over-spending to cope with an income shock such as redundancy.[1419] Empirical data regarding debtors in insolvency procedures can alleviate concerns of *ex post* moral hazard by showing that debtors are indeed severely financially troubled, but are less effective in proving whether or not lenient laws facilitated financial difficulty by *encouraging* excessive borrowing.[1420] More basically, while these characterisations of debtor behaviour are useful in providing general indications as to the kinds of perverse incentives the law should remove, such paradigmatic examples do not generate workable legal definitions.[1421]

(II) Substantive v Procedural Misconduct

In terms of measures designed to address moral hazard, Professor Howard draws a useful distinction between *substantive* misconduct and *procedural* misconduct.[1422] Procedural (dis)honesty refers to the debtor's misconduct in the insolvency procedure itself, such as a failure

1412 Howard (1987), 1054.
1413 Hallinan (1986), 66.
1414 LoPucki (1997), 461.
1415 PWC (2006), 15.
1416 Hallinan (1986), 66.
1417 Jones & Zywicki (1999), 183, 218; LoPucki (1997), 463–67.
1418 LoPucki (1997), 464–65.
1419 Dickerson (2006), 1873.
1420 *Id.*, 1872.
1421 *Id.* See also Professors Ponoroff and Knippenberg's discussion of the difficulty in defining the concept of the "honest but unfortunate" debtor: Ponoroff & Knippenberg (1995), 293–99.
1422 Howard (1987), 1053–57.

to cooperate in the procedure and to disclose honestly all income and assets. Little opposition arises to the sanctioning of debtors behaving in this manner. In contrast, substantive dishonesty refers to conduct outside of the insolvency procedure itself, but relating to claims made in the procedure.[1423] Most controversy arises in the realm of substantive misconduct, in which the debtor's pre-insolvency borrowing behaviour becomes subject to scrutiny. Here the full spectrum of debtors described above is present, from the responsible but unfortunate victim of external income shocks to the wilfully fraudulent debtor, along with the intermediate category of reckless or negligent improvident debtors.[1424] Therefore it is in respect of the category of *substantive* misconduct and the characterisation of *improvident* debtors that the most difficult policy choices arise (see Figure 45, Appendix).

[1423] *Id.,* 1054.
[1424] *Id.*

6.3 Addressing Moral Hazard under English Law

A. The Cost of Debt Relief: Designing Incentives

In both academic and political debates in which moral hazard is invoked, the point is sometimes underappreciated that the concept's value lies "not in the recognition that insurance could have undesirable consequences… but rather in the claim that the undesirable consequences could be controlled."[1425] Insurance theory illustrates a number of ways in which personal insolvency law can address moral hazard, largely mirroring means through which insurance contracts can be structured to reduce perverse incentives. This provides more precise guidance to policymakers than the categories outlined above. Ultimately the guiding principle of moral hazard is that the costs and benefits of insurance must be calculated so that an insured cannot profit from a loss. English law thus demonstrates a wide range of measures designed to structure insolvency debt relief in such a manner that a debtor conducting a cost benefit analysis is not incentivised to over-borrow or otherwise fail to avoid over-indebtedness. The system relies on imposing such costs so that the procedures are attractive only to debtors carrying severe burdens of over-indebtedness, "for whom the possibility of externalizations of those burdens are correspondingly large."[1426]

First, English personal insolvency law causes all debtors entering procedures to bear part of the costs of their default, just as an insurance contract may require the insured to pay a deductible or co-payment.[1427] The law achieves this first by conditioning access on the debtor's insolvency,[1428] meaning that the debtor herself will have to bear the considerable costs (loss of income/assets, stress and health difficulties, shame of financial failure, etc.) incurred from the onset of initial default until her insolvency. Furthermore, English law requires a debtor in bankruptcy to surrender her non-exempt[1429] assets for liquidation,[1430] while the debtor may also be required to contribute excess income to creditors under an Income Payments Order/Agreement.[1431] Under the insurance theory of the fresh start policy, these features of personal insolvency law address moral hazard concerns even though they differ from features traditionally seen as sanctioning misconduct, such as restrictions/incapacities and criminal law penalties. Under the traditional

[1425] Baker (1996), 240.
[1426] Hallinan (1986), 131.
[1427] *Id.*, 103.
[1428] The insolvency condition for accessing the Debt Relief Order, Individual Voluntary Arrangement and bankruptcy procedures all require that the debtor must "unable to pay her debts" when applying to enter the procedure, as stated in Insolvency Act 1986, §§251A, 255(1) and 256A(3), 272(1) (respectively). See Figure 20.
[1429] *Id.* §282(2).
[1430] On the distribution of the debtor's assets, see FLETCHER (2009), ch. 10.
[1431] Insolvency Act 1986, §§310, 310A.

debt collection perspective of personal insolvency law, these features are not conceptualised as serving aims of preventing undesirable debtor behaviour, but as serving the law's purpose of maximising returns to creditors (with the debt collection perspective requiring additional sanctions to deter irresponsible borrowing and default). Thus an insolvency condition is seen as necessary for defining the point at which a common pool problem arises which necessitates a collective debt collection remedy, rather than leaving creditors to enforce their contracts individually.[1432] Surrender of the debtor's income and assets is seen as the key feature of a law serving a debt collection goal, with other features such as debt discharge and the stay of enforcement (see Chapter 5) merely auxiliary facilitators of the maximisation of assets/income available to creditors.

The question always remains as to whether the costs attached to debt relief are sufficient to prevent over-borrowing and subsequent insolvency from becoming utility-maximising behaviour. These concerns arise particularly in relation to the one-year waiting period for discharge in bankruptcy[1433] introduced under the Enterprise Act 2002 as an express policy choice to reduce bankruptcy's costs.[1434] The law recognises that in addition to these costs additional safeguards are necessary to monitor and prohibit certain debtor conduct, so to remove incentives for actions which could reduce the costs of debt relief for that debtor and so afford her the benefits of credit and subsequent debt relief without the accompanying costs.[1435] The law thus prohibits (and sanctions through the BRO/U regime and criminal penalties) the concealment, removal, or fraudulent disposal of, or fraudulent dealing with, property by the debtor, as well as failures in the debtor's accounting processes, prior to the commencement of bankruptcy.[1436] Similarly, restrictions on the debtor's ability to borrow and trade during the bankruptcy[1437] and Debt Relief Order[1438] moratorium further perform *ex post* and *ex ante* monitoring functions.[1439] *Ex post* monitoring of the debtor's true need for relief is facilitated by the insolvency access condition, investigation of the debtor's affairs and the duty imposed on the debtor to co-operate in the insolvency proceedings,[1440] (the latter of which is punishable severely by the suspension of

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[1432] Block-Lieb (1992), 406 et seq. Court decisions can be found to support this reasoning, in rejecting debtor petitions for bankruptcy as abusive where no common pool issue arises. In the case of *The Debtor v Allen* the debtor owed only a single debt which he was unable to pay immediately in full, but could pay via instalments over time, leading to court to find the debtor did not meet the insolvency condition of inability to pay one's debts. *See* Re A Debtor (No.17 of 1966), Ex Parte the Debtor v Allen [1967] Ch. 590, [1967] 2 W.L.R. 1528. Re A Debtor (No.17 of 1966), Ex Parte the Debtor v Allen [1967] Ch. 590, [1967] 2 W.L.R. 1528; FLETCHER (2009), ¶5–004.

[1433] Insolvency Act 1986, §279.

[1434] *See e.g.* FLETCHER (2009), ¶11–007; MILMAN (2005), 123, 154.

[1435] *See* FLETCHER (2009), ¶13–002.

[1436] *See Id.*, ¶¶13–008 to 13–029.

[1437] See the range of prohibitions and offences outlined in the Insolvency Act 1986, Insolvency Act 1986, §§353–60, 390; FLETCHER (2009), ¶¶11–021, 13–001 et seq.

[1438] Insolvency Act 1986, §§251K, 251N–251S.

[1439] Certain of these prohibitions, such as on the debtor obtaining credit above a prescribed amount without disclosing her status as a bankrupt, or on engaging in business under a different name, facilitate *ex ante* monitoring of future borrowing by the debtor's creditors.

[1440] Insolvency Act 1986, §§251J, 290–1, 312.

discharge,[1441] BRO/Us and criminal liability).[1442] *Ex ante* monitoring of the insured by the insurer at the borrowing stage is facilitated by excluding from debt discharge (and so from insurance coverage) debts incurred by fraud,[1443] since such fraud inhibits lenders from conducting accurate creditworthiness assessments (and setting interest rates or "premiums" to match risk levels).

Where a risk falls within an insured's endogenous control so that the insured can cause the relevant loss intentionally, the only response of insurance markets may be to deny coverage, as a premium accurately covering the risk would be prohibitively expensive.[1444] Such acts may also be socially undesirable, so that insurance should not encourage their committal.[1445] This reasoning provides another explanation for the exclusion from discharge of fraudulently incurred debts, as well as justifying the exclusion of criminal law fines and debts arising from tortious acts.[1446]

Conditions for accessing personal insolvency procedures also exclude certain debtors from debt relief coverage. A court may dismiss a bankruptcy case where a petition constitutes an abuse of process, or annul a bankruptcy order where it ought not to have been granted.[1447] Courts for example have used this power to dismiss a petition of a debtor who has entered bankruptcy multiple times while repeatedly obtaining credit with no intention of repayment,[1448] in a manner consistent with moral hazard theory. Policymakers setting the debt relief cost-balance have access to less information than debtors regarding their preferences and the price they are willing to pay for debt relief. If a debtor, by entering bankruptcy multiple times, reveals that her subjective preferences do not value the costs of bankruptcy as being too high to reduce incentives to become over-indebted (even if these costs would dissuade most debtors), then moral hazard theory justifies denying debt relief to such debtor. Outright denial of insurance coverage is only rarely appropriate, however, again based on the premise that moral hazard theory does not require the denial of insurance where perverse incentives exist, but rather the structuring of insurance in a manner to reduce or remove these incentives.[1449] Consistent with this position, English courts rarely exclude a debtor from accessing bankruptcy debt relief

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[1441] *Id.* §279(1); FLETCHER (2009), ¶¶11–004 to 11–005.

[1442] FLETCHER (2009), ¶13–030.

[1443] Insolvency Act 1986, §§251I(3), 281(3).

[1444] Hallinan (1986), 103; Feibelman (2005), 137.

[1445] On the link between insurance and the encouragement of undesirable conduct, *see* Baker (1996), 259–60.

[1446] Insolvency Act 1986, §§251A(4), 281(4)–(5); Insolvency Rules 1986/1925 rule 5A.2. An alternative explanation suggests tortious debts are excluded because these involuntary creditor claims do not fit in the insurance model of debt relief at all, since such creditors do not have the opportunity of assessing the risk of non-payment by the debtor, and of charging an appropriate risk-adjusted premium/interest rate: see e.g. Hallinan (1986), 107–8. English law appears to support this latter explanation in the extent to which the wide exclusion of tortious debts from discharge in bankruptcy extends beyond claims arising from deliberate acts, to include those arising from the debtor's negligence. Also, this may explain the law's exclusion of family maintenance debts from discharge.

[1447] Insolvency Act 1986, §§264)(2), 266(3), 282(1)(a); FLETCHER (2009), ¶¶6–083 to 6–088.

[1448] In Re Betts, [1901] 2 K.B. 39 (1901).

[1449] Baker (1996), 240.

entirely.[1450] English law's approach of relatively open access to debt discharge, followed by rigorous scrutiny of the debtor after her entry into the procedure, is more compatible with the fresh start policy than approaches in some jurisdictions which screen debtors closely for misconduct at the point of entry.[1451] Exclusion from debt relief may be an effective safeguard against abusive behaviour, but it may not necessarily lead to greater repayments to creditors from over-indebted debtors,[1452] whose over-indebtedness meanwhile may generate externalities.[1453]

Apart from the structural features described thus far, insurance contracts may also guard against moral hazard by obliging the insured to take certain steps to avoid a risk. Similarly, English law imposes obligations on a debtor not to be careless in increasing the risk of insolvency, by sanctioning the incurrence of debt without reasonable likelihood of repayment under the Bankruptcy Restrictions Orders/Undertakings regime. This is a particularly significant feature of English law, as it relates to the categories of *substantive misconduct* and *improvident borrowing,* the most controversial policy issues in this area.

B. Bankruptcy Restriction Orders/Undertakings

The reduction of debt relief costs effected by the bankruptcy law reform and the introduction of the Debt Relief Order procedure was counterbalanced by the introduction of the system of Bankruptcy Restriction Orders and Undertakings (BROs/BRUs) and Debt Relief Restrictions Orders and Undertakings (DRROs/DRRUs).[1454] In prescribing certain types of conduct as giving rise to sanctions, the BRO/U system imposes additional obligations on debtors to take steps to reduce the risk of over-indebtedness, as well as not to take actions which could inhibit monitoring of the debtor, exaggerate her need for assistance, or generally skew the cost-benefit balance. A Bankruptcy Restrictions Order must be made by a court where the court thinks it appropriate having regard to the bankrupt's conduct both before and after the making of the bankruptcy order

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[1450] FLETCHER (2009), ¶¶6–086 to 6–087. Stricter access conditions attach to the DRO procedure, however, as a debtor may be excluded due to her previous participation in an insolvency procedure, or her giving of a preference or making of an undervalued transaction: Insolvency Act 1986, Sch. 4Z. Fewer limitations attach to access to the IVA procedure, and an IVA debtor is subject to fewer restrictions and sanctions during the procedure, most likely because under this procedure creditors are given final say as to whether the costs of debt relief in a particular IVA are set sufficiently highly. See, however, the criminal liability imposed on fraudulent debtors under §262A of the 1986 Act.

[1451] *See e.g.* WORLD BANK (2013), ¶189.

[1452] LoPucki (1997), 464–66.

[1453] Hallinan (1986), 130; WORLD BANK (2013), ¶197; IMF (2012), 24–25, 27.

[1454] INSOLVENCY SERVICE, DTI (2001), ¶¶1.25–1.45. While BROs/DDROs are court-imposed sanctions, BRUs/DRRUs consist of debtors entering into an agreement with the Official Receiver or Insolvency Service whereby debtors undertake not to engage in any of the activities that would be restricted had a court order been made. BROs/BRUs were introduced by §257 and Sch. 20 of the Enterprise Act 2002, inserting §281A and Schedule 4A into the Insolvency Act 1986. An almost identical system of Debt Relief Restrictions Orders/Undertakings were introduced when the DRO procedure came into force in 2009. *See* Tribunals, Courts and Enforcement Act 2007 (2007 c. 15), Sch. 19 ¶1, inserting Insolvency Act 1986 Sch. 4ZB. Unless otherwise stated, references to the BRO/BRU system also include the DRRO/DRRU regime.

(thus encompassing both substantive and procedural misconduct).[1455] The court is required to take into particular account a range of specified "kinds of behaviour" on the part of the bankrupt,[1456] which are discussed below. The system therefore responds to concerns that, even though the cost-benefit balance of debt relief may be appropriate in most cases, certain actions of calculating debtors can reduce the costs of debt relief so that over-borrowing or exaggerating the need for debt relief become profitable.

A BRO/U operates to impose incapacities on a debtor preventing her (on pain of criminal penalty), for a period of between 2 and 15 years,[1457] from holding positions including the following:[1458]

- Company director (unless authorised by a court);[1459]
- Insolvency practitioner[1460] or receiver/manager of a company's property;[1461]
- Member of Parliament;[1462]
- Member of a local authority.[1463]

Perhaps more relevantly to the average consumer debtor, a BRO/U also prohibits a debtor from obtaining credit above a prescribed amount without disclosing her status.[1464] Most importantly, details of any debtor subjected to post-discharge restrictions are entered into a public register maintained by the Secretary of State.[1465] In this way, the BRO/U sanction primarily imposes costs on the debtor in her future credit market participation by damaging her credit reputation,[1466] rather than increasing immediate costs of debt relief, as the debtor's discharge remains unaffected. [1467]

I focus on the BRO/U regime as a means of examining English law's treatment of the issue of moral hazard in consumer insolvency policy for a number of reasons. This system is central to English law's control of debtor (mis)conduct, and is comparatively distinctive since this control is exercised via a series of restrictions rather than through entry conditions, denial of discharge or criminal penalties.[1468] The regime's abandonment of the policy of restricting all debtors signifies an important shift towards the fresh start policy, acknowledging that in most insolvency cases

[1455] Insolvency Act 1986 Sch. 4A, ¶2(1).
[1456] Insolvency Act 1986 Sch. 4A, ¶¶2(2)- 2(3).
[1457] Insolvency Act 1986, Sch. 4A, ¶¶4(2), 9(2).
[1458] Walters (2005), 87.
[1459] Companies Director Disqualification Act 1986, 11(1).
[1460] Insolvency Act 1986, §390(5).
[1461] *Id.* §31.
[1462] *Id.* §426A.
[1463] Local Government Act 1972 (1972 c. 70), §81(1)(b).
[1464] Insolvency Act 1986, §§251S(3)(b), 360(5).
[1465] *Id.* Sch. 4A; ¶12.
[1466] See Parts 6.4, 6.6 below. On the difficulty of setting a premium to reflect a potential insured's risk in the absence of full information, *see* Hallinan (1986), 102.
[1467] Walters (2005), 77.
[1468] *See e.g.* WORLD BANK (2013), ¶114. Contrast with the limitations on access and discharge designed to address debtor misconduct in the laws of France, Belgium and Ireland: *see* Part 3.2 above and Spooner (2013), 751–62.

recourse to debt relief should be encouraged rather than deterred. Furthermore, the new system provides a means for English law to address the controversial *ex ante* moral hazard cases of *substantive* debtor misconduct and "*improvident*" consumer debtors, through the inclusion of borrowing with reasonable expectation of repayment as a condemnable type of behaviour. In fact, this has been the most common ground for BRO/Us until recently (Figure 15). Aside from its frequent invocation, this ground is particularly significant since it potentially provides some legal means of setting standards at the most controversial frontier of appropriate modern consumer borrowing behaviour, and of distinguishing between "the unemployed steelworker [and] the grasshopper hedonist";[1469] between the borrower making ends meet and the one who abuses credit cards to buy exotic holidays, designer goods and recreational drugs.[1470] This ground therefore provides more fruitful material for examination than other grounds involving clear-cut examples of conduct universally considered worthy of sanction.[1471]

By comparative consumer insolvency law standards English law in this way is unusual in investigating the reasonableness of the debtor's *ex ante* borrowing. [1472] US law has traditionally not examined the debtor's pre-bankruptcy conduct (with the exception of intentional misconduct and fraud),[1473] and prohibitions on irresponsible or reckless over-borrowing are much more limited in scope than English law's questioning of the reasonableness of the debtor's expectation of payment.[1474] Similarly, while French law's "good faith" access condition extends somewhat further into an examination of borrowing conduct,[1475] the French courts have confirmed that mere negligence on the part of the debtor does not amount to bad faith so as to exclude her from accessing debt relief.[1476] All of these factors identify this ground for the making/obtaining of BRO/Us as appropriate for examination.

1469 SULLIVAN ET AL. (1999), 8.

1470 This example is taken from an Insolvency Service case study of a debtor subjected to a BRO: *see* THE INSOLVENCY SERVICE, THE INSOLVENCY SERVICE ANNUAL REPORT AND ACCOUNTS 2006-07, 19 (The Stationary Office 2007).

1471 For cases involving less contested debtor conduct, *see e.g.* Official Receiver v Pyman, [2007] All ER 25 (2007) (debtor transferring assets to son prior to bankruptcy); Official Receiver v Bathurst, [2008] EWHC CH 1724 (2008) (removing assets from estate while insolvent, failing to declare funds to Official Receiver, transferring assets to family); Official Receiver v May, [2008] EWHC CH 1778 (2008) (selling an asset which was subject to security).

1472 The 2013 World Bank Report on the insolvency of natural persons notes difficulties in assessing negligence or imprudence in borrowing behaviour, and that "most systems have adopted a lower standard of intentional fraud or of the concept of honesty." *See* WORLD BANK (2013), ¶195.

1473 Hallinan (1986), 126; LoPucki (1997), 462.

1474 Certain consumer debts are presumed by US law to be non-dischargeable on the grounds of being incurred by false pretences or fraud, including consumer debts of more than $500 owed to a single creditor for luxury goods/services incurred within 90 days before bankruptcy; and cash advances under an open ended consumer credit plan exceeding $750 in value obtained within 70 days before bankruptcy: *See* USC Title 11 - Bankruptcy, USC §523(a)(2)(C)(i)–(ii). While these categories examine the borrowing conduct of the debtor, they in effect police deliberate borrowing with the intention of entering bankruptcy; rather than merely unreasonable or improvident over-borrowing.

1475 *See e.g.* Couturier (1997), 77–82.

1476 Ramsay (2012B), 229.

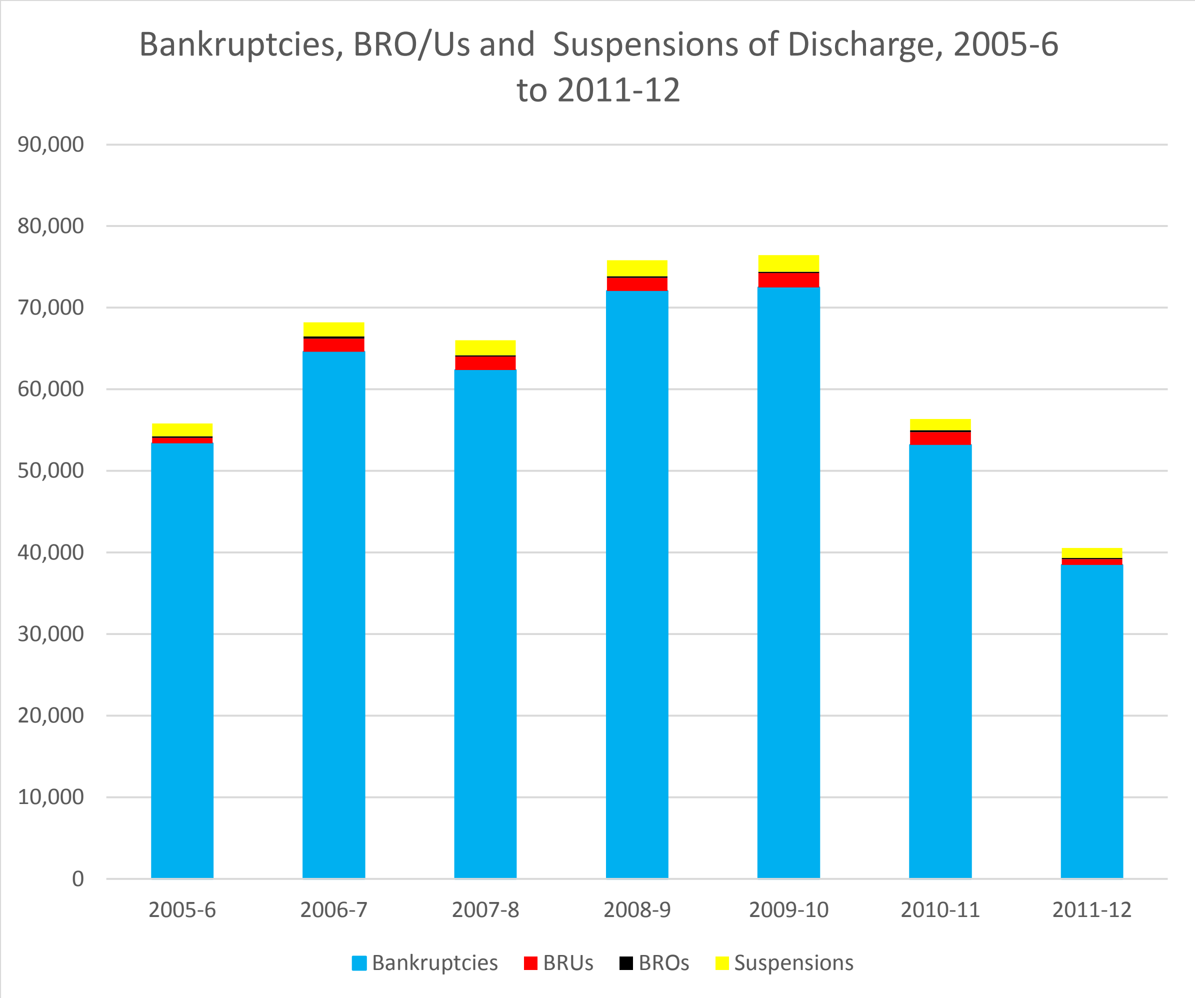

Figure 14: Bankruptcy restriction orders and undertakings, suspensions of discharge and total numbers of bankruptcies, April 2005 to March 2010.

Sources: *The Insolvency Service Annual Reports and Accounts*, 2005-06 to 2011-12.

6.4 Evaluating the Bankruptcy Restriction Order/Undertaking System as a Response to Moral Hazard in Consumer Insolvency

A. Objectives of the System

I now outline the objectives of the BRO/U system, before discussing how the regime's operation illustrates that in certain ways it is not well suited to the modern conditions of consumer over-indebtedness, leading to difficulties in achieving these goals.

(I) Protection of the Public

A traditional aim of bankruptcy law has been to protect the public from the potentially harmful actions of a dishonest debtor.[1477] This is a key objective of the BRO/U regime, as seen from the Insolvency Service's identification of the system as being primarily "designed to provide protection for the public."[1478] The nature of the most significant sanctions under the regime mean that it adopts a form of protection based on information disclosure, sending messages to credit markets regarding the heightened credit risk represented by culpable, as opposed to honest, debtors.[1479] To place this objective within an economic theoretical framework, the law effectively aims to sort debtors in order to alleviate information asymmetries and adverse selection problems in consumer credit markets,[1480] facilitating more accurate creditor lending decisions (and more accurate pricing of risk via interest rates).[1481] The personal insolvency system,[1482] and particularly the BRO/U regime, thus represents an information-based regulatory response to market failure, mirroring information disclosure rules which have dominated consumer credit regulatory policy on the opposite side of the market in recent decades (see Chapter 1).

[1477] On the objective of personal insolvency of protecting the public in this manner, *see e.g.* CORK (1982), ¶1734 et seq.; FLETCHER (2009), ¶¶11–031.

[1478] INSOLVENCY SERVICE, A STUDY OF THE BANKRUPTCY ENFORCEMENT REGIME BEFORE AND AFTER THE ENTERPRISE ACT 2002, at 18 (Insolvency Service 2007).

[1479] Walters (2005), 86.

[1480] *See e.g.* Hallinan (1986), 102; Stiglitz (1983), 5.

[1481] *See e.g.* Hallinan (1986), 102. As explained by Professor Leff, if "information about a person's reputation were prefect, there would be no such thing as a collection problem. The sole "collection" practice would be precise pricing of the initial transaction." *See* Leff (1970), 28.

[1482] Under a creditor protection perspective, personal insolvency law and its debt discharge can be seen as a means of reducing wasteful collection costs by providing "a device by which creditors could efficiently discover that their debtors' financial circumstances rendered further collection efforts pointless." *See* Hallinan (1986), 82.

Professor Walters noted on the enactment of the 2002 reforms that the aims of de-stigmatising bankruptcy in furtherance of the fresh start policy would only be achieved if the legislation caused lenders to distinguish between culpable and non-culpable debtors when offering credit.[1483] The limited available evidence from an Insolvency Service evaluation thus casts doubt on the BRO/U regime's efficacy, as it found that lenders, despite awareness the regime, they do not distinguish between the two categories in their lending practices.[1484]

(II) Removing Incentives for Over-borrowing and abuse of Debt Relief Procedures

Another primary aim of the BRO/U regime is to address concerns of *ex ante* and *ex post* moral hazard generated by the availability of debt relief, as discussed throughout the preceding analysis. This role of deterring irresponsible over-borrowing and abusive recourse to insolvency debt relief has been recognised by the courts. Thus in the *Randhawa* decision, the court commented that while "the main object of making a BRO must undoubtedly be the protection of the public", the "jurisdiction is also intended to have a deterrent effect."[1485] Parliament thus "intended to impose a substantial sanction in any case where the bankrupt's conduct was shown to have fallen below the appropriate standard". This aim of deterrence has been repeated in other judgments.[1486] Considered in the framework of moral hazard, this objective of the BRO/U is to monitor debtor conduct and provide for additional costs for debtors who would be inclined to evade moral hazard controls and re-tilt in their favour the legislative cost-benefit balance of debt relief. It is difficult to measure the extent to which the system achieves this objective, but the low levels of BRO/Us imposed relative to the number of bankruptcies could perhaps be attributed to the deterrent effect (see Figure 14 above).

(III) Political legitimacy of debt relief

A third aim of the BRO/U system is to increase public confidence in personal insolvency procedures, and so to legitimise the institution of debt discharge in the face of political opposition. Again available evidence casts doubt on the system's efficacy in achieving this aim, with Insolvency Service evaluations in 2006 and 2007 finding that less than a third of the public surveyed agreed that the insolvency regime protected the public from dishonest or reckless

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[1483] Walters (2005), 86.

[1484] INSOLVENCY SERVICE, ENTERPRISE ACT 2002 - THE PERSONAL INSOLVENCY PROVISIONS: FINAL EVALUATION REPORT NOVEMBER 2007, 98 (2007).

[1485] *Id.*, [69].

[1486] *See Official Receiver v May*, [24]; *Bathurst*, [30]-[31].

bankrupts, while approximately half of respondents were undecided on this question.[1487] Evaluations showed a large lack of awareness of the regime, as while only 17-21% of respondents thought they had heard of BRO/Us, no respondents were able to describe them accurately.

B. Applying a Historical Commercial System to Modern Consumer Debtors

An initial examination of the BRO/U regime reveals a number of concerns regarding its appropriateness to address the circumstances of modern consumer over-indebtedness, which may limit its ability to achieve its objectives. The first problem is a symptom of the law's development through the introduction of new ideas of the fresh start policy into a longstanding personal insolvency framework originally designed to serve the sole aim of debt collection. The "kinds of behaviour" which a court must take into account in deciding whether a Bankruptcy Restrictions Order is appropriate[1488] were not developed based on considerations of modern conditions of consumer credit use of the type described in Chapter 1. Rather these standards replicate the types of conduct that the Bankruptcy Act of 1914 required a court to take into account when assessing whether to discharge a debtor under that statute's conditional discharge system (see Figure 46, Appendix).[1489] Rather than being shaped "in the light of experience and developing commercial circumstances",[1490] the BRO/U regime is based on standards of behaviour expected under a historical law which regarded a debtor as guilty of misconduct by her mere insolvency, and which placed her under a duty to maximise returns to creditors.[1491] In simply applying century-old standards to the radically altered socio-economic context of household debt, this aspect of the BRO/U regime is inconsistent with policy efforts to modernise personal insolvency law and fails to recognise that "not only has the legislative approach to individual bankruptcy altered since the mid-19th century, but social views as to what conduct involves delinquency, as to punishment... have drastically changed..."[1492] In this way, the legislature effectively opted out of the debate relating to what might constitute acceptable household credit behaviour in modern society. This is likely to lead to difficulty in applying these standards to modern consumer debtors and risks producing outcomes which conflict with the fresh start policy.

1487 INSOLVENCY SERVICE (2007F), 21.

1488 Insolvency Act 1986 Sch. 4A, §2(1)-(3).

1489 Bankruptcy Act 1914 (4 & 5 Geo. 5), §26. See also CORK (1982), ¶¶1854–57.

1490 CORK (1982), ¶1858.

1491 For a consideration of how a debt collection/creditor wealth maximisation perspective of personal insolvency law might lead to certain debtor conduct being judged as culpable, *see* Ponoroff & Knippenberg, (1995), 301–4.

1492 Smith (A Bankrupt) v Braintree District Council, [1990] 2 A.C. 215, 237–38 (1989), per Lord Jauncey.

Secondly, the BRO/U regime is symptomatic of a second wider flaw in English law: the application of commercial standards to what is now a *de facto* consumer law. Introduced in a policy initiative designed to promote entrepreneurship, the BRO/U regime is rooted in the context of business insolvency. Indeed it is expressly modelled on the system for the disqualification of company directors under English law, adopting the same standards of conduct and sanctions with only slight modifications (see Figure 15). Again, the standards applicable are not designed to the circumstances of modern consumer borrowing. It is difficult and inappropriate to apply corporate governance standards, designed to judge the conduct of those assuming the duties of a company director, to the circumstances of consumers who borrow money for the purposes of funding their personal lives, often to pay for basic living expenses (see Chapter 1).[1493]

CDDA	Bankruptcy Restriction Orders
Failure to supply any goods or services which have been paid for in whole or in part	Failure to supply any goods or services which have been paid for in whole or in part
Failing to ensure that the company kept accounting records	Failure to maintain business accounting records
Responsibility for company entering into undervalue or preference transactions	Entering into undervalue transactions or giving preferences
Failure to co-operate with the insolvency officeholder	Failure to co-operate with the Official Receiver or trustee

Figure 15: Grounds for making of Bankruptcy Restrictions Orders, Company Directors Disqualification Orders[1494]

Case law on the BRO/U regime illustrates the difficulty of applying standards developed in the corporate governance context to circumstances of household borrowing. In the leading case of *Randhawa v Official Receiver*, Sir Launcelot Henderson QC drew from the policy documents preceding the introduction of BRO/Us a "predisposition" to construe the relevant provisions in a manner analogous to corresponding provisions relating to company director disqualifications. The judge therefore followed director disqualification cases in deciding on the level of judicial discretion available under BRO jurisdiction and on the method of calculating appropriate BRO duration.[1495] He was nonetheless "alert to… the inherent differences in [the] subject matter" of corporate and personal insolvency.[1496] The judge identified difficulty in applying corporate governance standards "concerned only with conduct as a director… of a company, which is of course a separate legal person to which directors stand in a fiduciary relationship", to a debtor's "own financial affairs [which do not] involve a fiduciary relationship" and which involve

[1493] *See also* Walters (2005), 89.

[1494] Insolvency Service, DTI (2001), ¶1.30.

[1495] [2006] BPIR 1435, [70]-[74], citing Hoffmann LJ in Re Grayan Building Services (In Liquidation) [1995] Ch 241; [87], in turn citing Re Sevenoaks Stationers (Retail) Ltd. [1991] Ch 164.

[1496] *Randhawa*, ¶68. *See also* Walters (2005), 89.

circumstances "of almost infinite variety."[1497] While the list of types of conduct to be considered by the judge are not exhaustive,[1498] the court noted that it cannot "carry out a roving inquiry into the bankrupt's conduct, but will instead have to focus on specific allegations of misconduct and decide whether they are made out on the evidence."[1499] Therefore the entire lifestyle and financial affairs of the debtor should not be on trial, but an enquiry into the appropriateness of a consumer's conduct in her private financial affairs remains quite distinct from investigating a company director's compliance with specific freely assumed duties, and calls for different standards. A stark contrast exists between a director who accepts the highest behavioural standards of a fiduciary and a household borrower funding personal expenditure via credit offered (often aggressively advertised) by an institutional creditor who holds significantly superior information and ability to prevent default and bear its costs.[1500]

C. Procedural Dimensions: the Limits of Consumer Plea Bargaining

The restrictions regime might also lead to inappropriate outcomes in the consumer context due to the fact that the vast majority of restrictions are actually imposed by BRUs rather than BROs. The existence of BRUs can be seen as indicative of English law's tendency to apply ideas of self-interested market bargaining to personal insolvency (see Chapter 4), as even the sanctioning of the debtor becomes a commodity for which parties should bargain. The debtor is expected to price the risk and costs of challenging the Official Receiver's allegations in contested BRO proceedings, before reaching an arrangement that enhances both (rational economic) parties' welfare by sharing the saved costs of litigation.[1501] Such a bargain, apparently reflecting the parties' best interests, is assumed to produce an efficient outcome benefitting the public interest.

This free-market contractual approach may be appropriate to its original commercial context, where company directors or business debtors may have sufficient information and access to professional advice as to negotiate an undertaking which protects their interests and so represents a genuine consensus between director/debtor and Official Receiver. In the consumer debtor context, however, substantial information asymmetries exist between debtors and Official Receivers, particularly regarding the content of personal insolvency law and its consequences for the debtor. While a large majority of debtors obtain advice *before* entering bankruptcy, [1502] in only

[1497] *Randhawa,* [62].
[1498] *Id.*, [66].
[1499] *Id.,* [67].
[1500] On the point that debtors are not fiduciaries for their creditors, see e.g. Ponoroff & Knippenberg (1995), 277–78.
[1501] In this regard the assumptions underlying the BRU regime are similar to those relating to the negotiation of settlements in civil litigation and plea bargaining in criminal law proceedings: *see e.g.* Bibas (2003), 2464.
[1502] Insolvency Service (2007B), 10.

a small number of cases is *legal* advice received, and no advice is available in respect of post-bankruptcy decisions in what the debt advice industry considers to be an "unmanaged" remedy.[1503] This raises concerns regarding debtors' ability to challenge the Official Receiver's allegations of wrongdoing (including the official's interpretation of legislation), or alternatively to negotiate an optimal arrangement. As debtors feel morally at fault for,[1504] and stigmatised by,[1505] their bankruptcies, this shame[1506] and sense of personal failure[1507] attached to debt default are likely to convince uninformed debtors easily that they have committed wrongdoing.

Furthermore, ideas of behavioural economics (see Parts 2.2(B)(I) and 4.5(B)(III) above) also render dubious the assumption that parties are rational economic actors who agree only to undertakings in their best interests. On the one hand, optimism bias may lead some debtors unadvisedly to challenge allegations of wrongdoing in cases in which a BRO court determination will be unfavourable.[1508] On the other hand, however, time inconsistent preferences may lead a debtor to accept an undertaking which avoids immediate costs (temporal, financial, emotional) of court proceedings, but which has detrimental long-term consequences.[1509] Risk aversion also means that debtors (whose financial failure particularly limits their willingness to take future risks) are likely to accept what is offered in an undertaking rather than risk a more severe punishment via a court-ordered BRO, even where a court challenge holds the potential gain of lesser or no punishment.[1510]

Corporate directors or business debtors, on the other hand, are more likely to have had access not only to *ex ante* advice in the management of their pre-insolvency financial affairs (reducing the likelihood of unintentional/negligent misconduct), but also *ex post* advice in relation to insolvency proceedings.[1511] Advised commercial actors will have superior information regarding their legal entitlements, and may benefit from advice's effect of reducing cognitive biases.[1512] Even if a consumer debtor can identify that an undertaking is not in her interests, or wishes to contest the misconduct allegations, her lack of resources to fund legal proceedings mean that she may have no option but to accept the Official Receiver's position.[1513] In support of these

[1503] CCCS (2012), 7.

[1504] Tribe (2006), 111–15.

[1505] INSOLVENCY SERVICE, ATTITUDES TO BANKRUPTCY 2009 8 (Insolvency Service 2009).

[1506] For evidence of the extent to which debtors feel ashamed and sitgmatised due to their financial difficulties, even outside of a formal statutory insolvency procedure, see sources in note 1151 *supra.*

[1507] *See e.g.*Gross (1999), 271–72; On the sense of personal failure attached to financial failure, see generally SANDAGE (2005).

[1508] On the application of this idea in the related area of plea bargaining in criminal law, see Bibas (2003), 2498–2502.

[1509] *Id.*, 2504–7.

[1510] *Id.*, 2507–12.

[1511] WORLD BANK (2013), ¶52.

[1512] Bibas (2003), 2527.

[1513] Just as debtors in bankruptcy often have to accept even dubious creditor claims as they lack the resources to fund litigation vindicating their rights: Braucher (1998), 11. In the *Randhawa* decision, the debtor had previously entered into a company director disqualification undertaking despite contesting his culpability, as he lacked the resources to pay the legal costs of defending himself against the allegations put forward: *Randhawa*, [17].

theoretical predictions, not only do BRUs outnumber BROs considerably, but the BRUs:BROs ratio is consistently higher than the corresponding CDDUs:CDDOs figure, suggesting fewer bankrupt debtors than company directors take court proceedings to contest allegations of misconduct (Figure 16). There is a risk that BRUs are obtained not on the basis of the system's objectives, but instead are influenced by socio-economic circumstances and personal characteristics (such as intelligence and confidence).[1514] The BRU system thus not only raises doubts regarding whether optimal undertakings are reached, but also raises distributional concerns, as the least well-resourced debtors may be more likely to enter into (more onerous) undertakings than their wealthier counterparts. Humanitarian concerns also arise, as a debtor's rights of access to justice and to a good name may be compromised where she lacks the means to challenge an Official Receiver's assertion of wrongdoing. [1515]

One must assume that Official Receivers act in good faith and with expert knowledge both of personal insolvency law and of the empirical reality of consumer over-indebtedness. Nonetheless concerns arise regarding the *potential* for inappropriate outcomes under the BRU system, and mere suspicion of such may undermine the regime's legitimacy and its ability to hold public and market confidence. This potential may be increased by institutional factors, such as the pressures[1516] to obtain BRUs exerted on Official Receivers by annual enforcement targets.[1517] While enforcement officials may decide to "get the most bang for their buck" by focusing on the most egregiously culpable debtors,[1518] enforcement targets in the presence of limited resources may incentivise officials to obtain undertakings in a certain number of "easy" cases of weak resistance to a BRU.

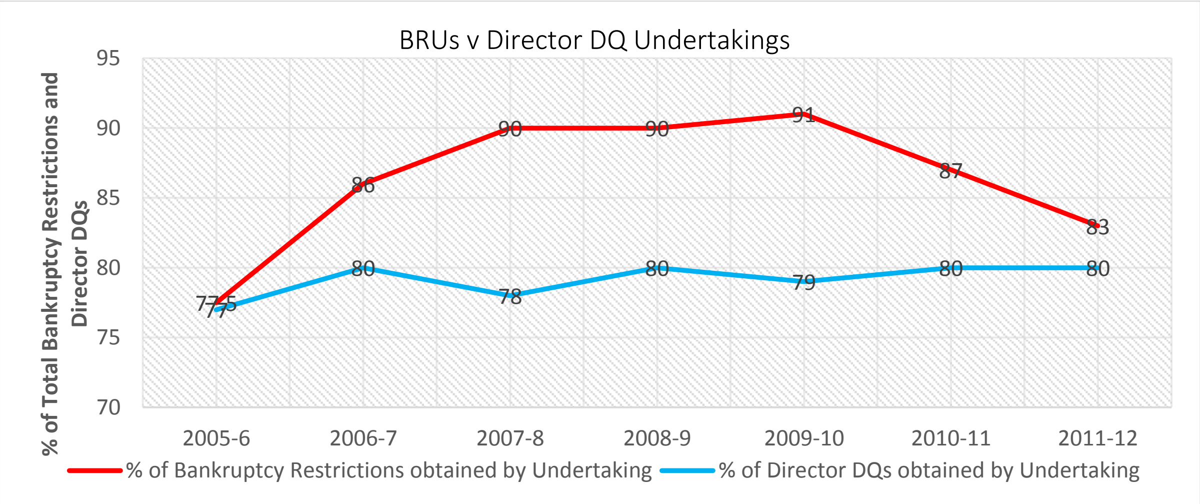

Figure 16: Respective percentages of Bankruptcy Restrictions and Director Disqualifications obtained via undertakings.

1514 Bibas (2003), 2468.

1515 See European Convention on Human Rights, arts. 6, 8.

1516 *See e.g.* House of Commons (2013), 16–20.

1517 These enforcement targets are specified in the Insolvency Service's annual reports: see e.g. INSOLVENCY SERVICE (2010A), 4.

1518 Bibas (2003), 2466.

Source: Insolvency Service Annual Reports, 2005-6 to 2011-12.

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Bankruptcy Restrictions Orders and Undertakings - Allegation Types						
• Incurring debt without reasonable expectation of payment	890	713	517	351	136	77
• Preferences or transactions at undervalue	331	474	519	470	285	155
• Gambling, rash and hazardous speculation or unreasonable extravagance	296	150	140	101	40	30
• Other	157	152	Not recorded	0	0	0
• Dissipation of assets	127	120	194	144	86	87
• Failure to account for loss	99	72	68	3	5	1
• Neglect of business affairs contributing to the bankruptcy	80	140	367	443	331	238
• Prosecutable matters	54	67	68	68	36	18
• Failure to keep or preserve proper accounting records	34	40	42	30	18	13
• Trading at a time when knowingly or unknowingly insolvent	21	17	11	10	1	8
• Failure to supply goods or services	10	13	71	14	9	7
• Second bankruptcy	8	6	9	5	2	0
• Non co-operation	6	13	42	11	12	3
• Excessive pension contributions	5	14	5	0	0	1
• Fraud	Not recorded	67	81	105	102	52
• Non-disclosure of assets	Not recorded	N/A	N/A	43	63	51
• Disposal of goods subject to hire purchase agreements	Not recorded	N/A	N/A	24	20	19
• **Total**	**2150**	**2058**	**2134**	**1822**	**1146**	**760**

Figure 17: Allegation types on which BRO/Us obtained, 2007-8 to 2012-13.[1519]

[1519] INSOLVENCY SERVICE (2012A), 34; INSOLVENCY SERVICE OFFICIAL STATISTICS PERFORMANCE ANNEX (2013), HTTP://WWW.BIS.GOV.UK/INSOLVENCY/ABOUT-US/OUR-PERFORMANCE-STATISTICS.

D.Determining *reasonable* borrowing behaviour

A further difficulty for the BRO/U regime in achieving its objectives, which is symptomatic of the failings identified above, is that the standards of debtor behaviour established in the legislation are indeterminate and susceptible to generating contrasting subjective judgments. There is scope for considerable inconsistency in judging the responsibility of consumer borrowing behaviour, as one person's high-flyer or spendthrift[1520] is another's unfortunate victim of volatile economic conditions and a "credit culture".[1521] Contested spaces at the margins of empirical studies of over-indebtedness suggest a complexity of credit use that renders individual judgments difficult.[1522] Furthermore, judges and Official Receivers, like debtors, may be subject to behavioural biases such as hindsight bias, under which people tend to over-estimate what could have been anticipated in foresight.[1523] A classic response of policymakers to fears of debt relief abuse is to attribute subjective powers to decision-makers under vague standards.[1524] This risks inappropriate outcomes, however, as well as inconsistency and problems of "local legal culture", where there is "a coherent and persistent variation in the application of laws."[1525] Potential for inconsistency exists particularly in the application of the law by Official Receivers in obtaining BRUs. Data for the year 2010-11 provided by the Insolvency Service shows limited regional variation in raw rates of BRO/Us, but further research is required to explore such variation over time (Figure 18).

On the introduction of the BRO/U system, doubts regarding the practical ability of the law to distinguish between honest and culpable debtors were met with the Government's response that "case law will develop over time and previous judgments will provide guidance on what constitutes culpability."[1526] The fact that approximately 80-90% of restrictions are obtained by BRUs rather than court order[1527] means that this expectation has not been fulfilled and that private determinations of Official Receivers, rather than public court decisions, set standards of debtor culpability.[1528] Even the minority of cases which are litigated (and the smaller number

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1520 It might be useful to heed Professor Ramsay's warning that "[t]here is the danger that criticism of bankrupts as 'bad planners' may simply be middle-class moralising dressed up as a technical judgment." See Ramsay (1997), 275.

1521 Ramsay (2007), 245.

1522 Ramsay (2003A), 25.

1523 *Id.*

1524 Jay Lawrence Westbrook, *Local Legal Culture and the Fear of Abuse*, 6 AM. BANKRUPTCY INST. LAW REV. 25 (1998).

1525 *Id.*

1526 HC Deb 14 April 2002 Standing Committee B col. 638, per Ms. Johnson M.P.

1527 Figures compiled from Insolvency Service annual reports throughout these years: see e.g. THE INSOLVENCY SERVICE (2006B), 17; INSOLVENCY SERVICE (2010A), 20.

1528 While the relevant legislation (Insolvency Act 1986, Sch. 4A, §7) states that a debtor may *offer* a bankruptcy restrictions undertaking to the Secretary of State, it appears clear in practice a BRU involves an Official Receiver presenting the debtor with allegations of misconduct, which a debtor then accepts and agrees to an undertaking for an appropriate period: see INSOLVENCY SERVICE (2010A), 20. Some insight into the BRU process can be gleamed from case studies published in the Insolvency Service's annual reports. The number of case studies provided is small however, and the representativeness of reported) are not likely to be representative.[1529] For reasons outlined above, difficulties arise for consumer debtors in challenging BRU offers through BRO proceedings, and so litigated cases are likely to be unrepresentative of standard consumer insolvency cases (or even standard cases involving alleged misconduct). High value and complex cases are likely to be overrepresented, which arguably hold the greatest potential for strategic and opportunistic behaviour. Furthermore, Official Receivers may choose to litigate only the most serious cases of misconduct in order to maximise resources.[1530] This may influence the perceptions of judges and other stakeholders, giving a misleading impression as to the proportion of bankruptcy cases involving such complex financial arrangements requiring close scrutiny. Concrete standards for "normal" consumer borrowing are unlikely to emerge from this process.

Courts and Official Receivers therefore have not had great success in sharpening the historical and commercial norms outlined in legislation into concrete standards of behaviour for modern consumer debtors. In the leading case of *Randhawa v Official Receiver,*[1531] Sir Launcelot Henderson QC (sitting as a Deputy High Court judge) attempted to lay down general standards for the making of BROs. The judge noted that no express guidance is given as to the applicable standards, but that all of the listed grounds "involve some element of misconduct or neglect or financial irresponsibility",[1532] amounting to "a failure in some significant respect to live up to proper standards of competence or probity in the conduct of one's financial affairs."[1533] In this case, the judge condemned the debtor's conduct, "a self-confessed act of folly"[1534] as "reckless and irresponsible",[1535] and so justifying the making of a BRO.

The guidance provided in this decision is limited, and leaves potential for indeterminacy and inconsistency. These problems are illustrated in the consumer insolvency case of *Official Receiver v Southey*,[1536] in which the court disagreed with the relevant Official Receiver's opinion that the debtor had borrowed without reasonable expectation of repayment. Here the debtor actor borrowed substantial sums of money while in financial difficulty and casual employment, expecting to repay when his employment began on the second series of a TV show, the debtor having played a prominent role in the first series. Subsequently the entire cast of the TV show was changed for the second series, meaning the debtor was left without employment. The Official Receiver sought a BRO on the basis that the debtor's expectation of repayment was not reasonable, as there was no guarantee that actors in a TV show would be retained for a

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these examples must be queried before general conclusions can be drawn into the methodology of Official Receivers in obtaining BRUs.

[1529] *See e.g.* Shuchman (1973), 406.

[1530] Bibas (2003), 2466.

[1531] Randhawa v Official Receiver [2006] BPIR 1435.

[1532] *Id.*, [66].

[1533] *Id.*, [68].

[1534] *Id.*, [79].

[1535] *Id.*, [78]-[79].

[1536] Official Receiver v Southey [2009] BPIR 89.

subsequent series.[1537] Chief Registrar Baister rejected the application for a BRO in finding that on the evidence, the debtor's prospect of repayment was reasonable.[1538] Firstly, the Chief Registrar noted that the law does not require certainty regarding repayment and that here the prospect "was not so remote that no reasonable person could have concluded that the extra indebtedness could never be repaid."[1539] In contrast, a series of factors pointed towards the reasonableness of the expectation, including the debtor's history of living a similar lifestyle for the past decade and ability to meet his monthly repayments until close to bankruptcy, and the fact that his acting career, though not secure, was progressing positively.[1540] Registrar Baister then cited both *Randhawa* and the directors' disqualification case of *Re Bath Glass Ltd.* as establishing "a relatively high test" for the making of a BRO. Despite the debtor's admission that he borrowed without "sufficient thought"[1541] and that he was "slightly naïve" in assuming he would be re-employed for a second series, such errors of judgment (mirroring characterisations of the *improvident* consumer debtor) did not satisfy the standard of misconduct required for a restriction. The Registrar summarised his judgment of the debtor's conduct as follows:

> "Putting it at its highest, the respondent misjudged his ability to repay. Putting it at its lowest, he was doing nothing wrong in managing his modest affairs as best he could."

The divergence of opinion between Official Receiver and court in this case demonstrates the potential for contrasting subjective standards to be applied in judging consumer debtor culpability. [1542] This is an important divergence, since the number of BRO/Us based on this once most common ground has fallen dramatically since 2008-9. [1543] The causes of this trend are unclear, but if it is the case that the *Southey* decision has had a corrective effect in illustrating that BRUs should not be made in analogous cases, this worryingly suggests that BRUs were being made inappropriately for several years in cases similar to *Southey*.[1544] The indeterminacy of the legislative standards may therefore have led to serious practical consequences of inappropriate BRUs being issued.

[1537] *Southey*, [8].
[1538] *Id.*, [23].
[1539] *Id.*, [23].
[1540] *Id.*, [23].
[1541] *Id.*, [11].
[1542] For a discussion of the difficulties and inconsistencies arising in judicial decision-making based on vague standards Ponoroff & Knippenberg (1995), 292.
[1543] See Figure 17, Figure 19**.**
[1544] It is plausible that the economic crisis of the late 2000s led to more personal insolvency cases clearly caused by factors external to the debtor, or even changed Official Receiver perceptions regarding the (un)reasonableness of borrowing behaviour. A further possible explanation might lie in the fact that the period since 2008-9 coincides with the introduction of the Debt Relief Order procedure, although it would be troubling if the demographic of low-income debtors entering the DRO procedure had previously been widely subjected to BRUs on the ground of unreasonable borrowing.

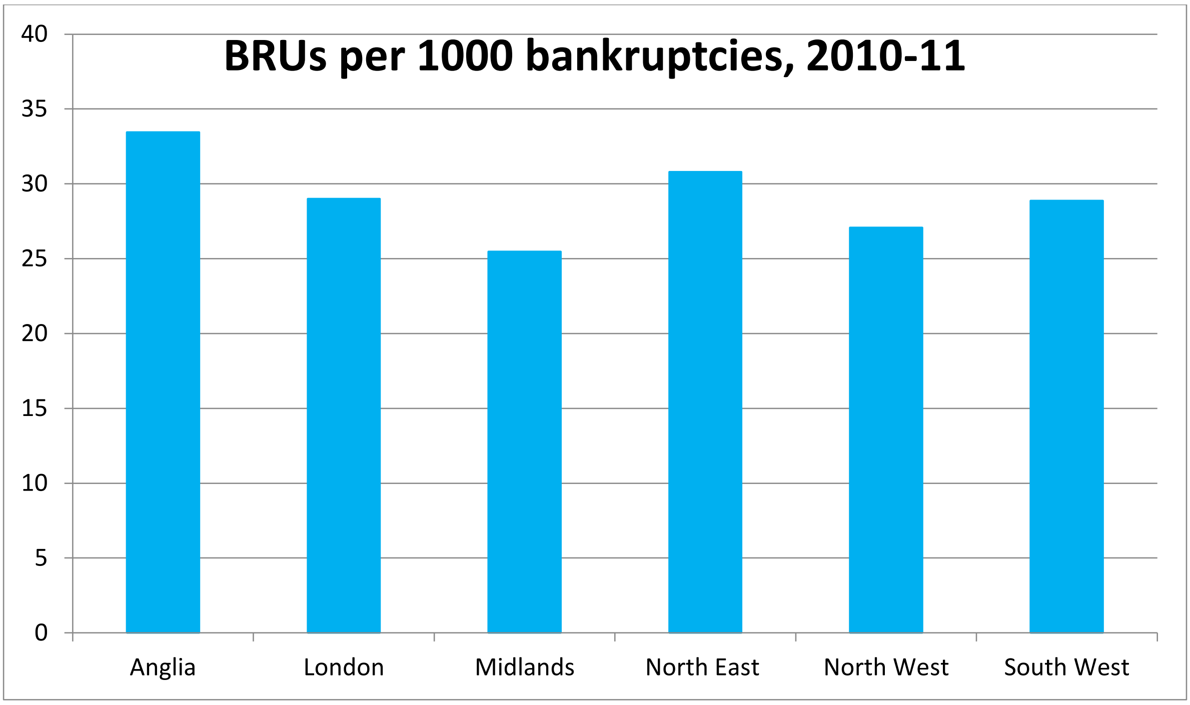

Figure 18: Bankruptcy Restriction Undertakings in 2010-11 as a % of Bankruptcies in 2010-11, by Region. Data supplied to author by the Insolvency Service.

6.5 Judging the Reasonableness of Consumer Borrowing Behaviour

If the BRO/U system is genuinely to set standards of modern consumer credit conduct and to isolate the extravagant credit abuser from the unfortunate reasonable debtor, legislators should provide judges and Official Receivers with more precise guidance regarding the conduct to be sanctioned. The question then arises as to how such appropriate standards could be formulated. Conscious that "any individualised attempt in bankruptcy law to sort behaviour into *ex post* simple categories of fault/no fault is likely to be fraught with difficulty",[1545] in this section I raise nonetheless a number of considerations which could inform the development of a framework for judging the reasonableness of consumer borrowing behaviour. I frame my analysis around the *Southey* decision, which serves as a test case of sorts regarding the application to consumer insolvency of the BRO/U ground of borrowing without reasonable expectation of repayment.

A. Placing the Law into Context: the Role of Household Debt in the Consumer Credit Economy

Firstly, the reasonableness of the debtor's borrowing should be judged in the overall context of the modern purposes of household credit and conditions of consumer over-indebtedness. This is important given the (post Enterprise Act 2002 and DRO introduction) law's aim of imposing sanctions only in marginal cases involving misconduct, while ensuring that debtors are not sanctioned or discouraged from entering insolvency procedures in "normal" cases. For policymakers concerned with *abuse* of credit and debt relief, a preliminary task is to determine appropriate uses of credit.[1546] In this regard, the *Southey* case resembles a typical case of household borrowing which conforms both to conventional explanations of the purposes for household borrowing and standard accounts of causes of over-indebtedness. As discussed in Chapter 1, empirical studies repeatedly identify "income shocks" as significant causes of over-indebtedness, including the debtor's unemployment, income reduction, or inability to work due to ill health. Even the most orthodox "consumption smoothing" neoclassical economic model of consumer credit would explain Mr Southey's conduct as a standard case of short-term consumption smoothing, with credit being used rationally as a form of insurance during a

[1545] Ramsay (2003A), 25.
[1546] Hynes (2004), 360.

temporary "income shock" or deviation from the long-run trend of income.[1547] Even departing from the criticised assumption of rational choice which underlies the "consumption smoothing" model, behavioural economics in contrast might explain a financially troubled debtor's borrowing in the ultimately misplaced expectation of future employment as a standard example of a decision influenced by optimism bias and time-inconsistent preferences. Ultimately inopportune household borrowing to supplement "modest means" in the face of volatile low-earning employment also represents a standard case under the alternative "loans for wages" model of household debt, rather than an example of exceptional abusive conduct. Legislation establishing standards of consumer borrowing behaviour should adopt the purposes and functions of household credit as a starting point, and should ensure that behaviour conforming to standard uses of credit in the modern consumer credit society should not be impugned.

Borrower behaviour, and the incentives created by the law, must also be assessed in light of the macro-economic function performed by household borrowing in sustaining the demand and consumer spending necessary for economic growth, particularly at times of stagnant incomes for much of society (see Chapters 1 and 2). Arguments that more stringent control of borrower behaviour is necessary to ensure that lenient personal insolvency laws do not allow debtors to enjoy the benefits of credit without paying the costs[1548] may understate the point that wider society, and not just consumer borrowers, benefits from economic growth associated with increased consumer spending. While the social utility of promoting risk-taking among entrepreneurs is widely recognised, policymakers are less ready to see that current economic growth structures require households to borrow at unprecedented levels despite high employment volatility,[1549] and so to take risks which would in the past have been treated as excessively dangerous or reckless.[1550] The law thus must accept the perhaps uncomfortable reality that the people closest to the category of the improvident over-borrowing debtor may also represent those households with a higher marginal propensity to consume and contribute to economic growth.[1551] Personal insolvency law now effectively operates as a consumer law, and like other consumer protection legislation must perform a role of empowering confident consumers,[1552] and so encouraging welfare-enhancing economic activity, even if (and indeed because) such activity is inherently risky. This requires extending greater leeway to borrowers in assessing whether their borrowing decisions were reasonable than would have been the case when past personal insolvency laws were enacted, so that debtors (such as Mr Southey) should not be deterred by future employment risk from engaging in economically productive activity.[1553]

[1547] *See e.g.* Barba & Pivetti (2009), 120.
[1548] *See e.g.* Jones & Zywicki (1999), 183, 218.
[1549] *See e.g.* MATTHEW PENNYCOOK ET AL., A MATTER OF TIME: THE RISE OF ZERO-HOUR CONTRACTS (Resolution Foundation 2013).
[1550] Hallinan (1986), 66–67.
[1551] IMF (2012), 9–10.
[1552] EU Consumer Credit Directive 2008, Recital 8.
[1553] WORLD BANK (2013), ¶109.

B. Moral Hazard and the Allocation of Responsibility for Consumer Insolvency

In this socio-economic context of consumer debt, certain key assumptions of moral hazard theory are particularly significant. Firstly, theory assumes the sufficiency of *financial* compensation for loss, which would require that the financial benefits of debt relief compensate the debtor for any losses incurred up to the point of receiving a debt discharge. An individual's over-indebtedness may lead to costs which cannot be compensated by the reduction in the individual's debt burden alone, however, such as stress and health difficulties, strained family relationships, and/or a sense of stigma or shame due to financial failure.[1554] The debtor's sense of moral obligation may lead to non-financial costs of entering an insolvency procedure,[1555] while the loss of a debtor's home involves many costs which cannot be compensated by improvement to a balance-sheet.[1556] Secondly, for a classic moral hazard situation to arise, the insured's person, property or financial circumstances must lie within her control, and that taking care must be effective in preventing loss. As noted above, however, primary causes of over-indebtedness include factors external to the debtor and against which taking care will not protect, such as unemployment/income reduction, ill-health and relationship breakdown (Chapter 1). As argued in a 2013 World Bank Report, "no matter how carefully and responsibly one manages one's finances, one can never be sure when financial distress will strike unexpectedly as a result of distant and perhaps unexpected forces." [1557] Therefore certain conditions necessary to a classic situation of moral hazard are not present in a case such as *Southey* of the allegedly unreasonable insolvent consumer borrower.

These factors illustrate a certain inevitability of default and indeed the desirability of risk of default, if economic activity is to be maximised. The insurance theory of the fresh start policy therefore identifies personal insolvency law as a means of allocating this risk efficiently, through rules requiring risk to be borne by the party best placed to prevent default from occurring and to bear the costs of default should it occur.[1558] Traditional perspectives considered borrowers to have superior ability to prevent default due to their unique knowledge about their own propensity to repay.[1559] In current conditions, however, technological advances mean that institutional consumer lenders possess sophisticated means of determining the likelihood of repayment

[1554] Porter (2011), 142–44.
[1555] Hallinan (1986), 141–42.
[1556] Culhane (2012), 129–34.
[1557] World Bank (2013), ¶96.
[1558] In this section I focus on the factors making the institutional lender better positioned to prevent default than the consumer debtor. For a discussion of why the institutional lender is better placed to bear the costs of default, see Part 2.2(B)(III) above.
[1559] Eisenberg (1980), 983.

through processes such as credit scoring.[1560] In *Southey,* the Official Receiver argued that the employment prospects in the debtor's industry are such that it was unreasonable for the debtor to believe he had a realistic prospect of repaying, a position which places responsibility for such assessments on the debtor.[1561] In a calculation of industry-wide employment prospects, however, "the knowledge needed to assess the risk of default is actuarial, not individual".[1562] The calculations necessary to determine accurately whether the benefits of a loan outweigh the costs "are intractable for even the most sophisticated, diligent, and unbiased of decision-makers",[1563] and are particularly beyond the grasp of unadvised household borrowers of limited financial capability.[1564] It is therefore more efficient to impose the costs of evaluating the debtor's employment prospects on the institutional lender, so that the expert professional risk assessor, rather than a household debtor, is responsible for conducting the necessary actuarial analysis to assess a credit transaction's risk.

While debtors must bear responsibility for unreasonable borrowing, any efforts of personal insolvency law to modify consumer borrower behaviour are likely to be unsuccessful. Generally very low levels of financial literacy and understanding of credit contracts amongst the general population, coupled with behavioural biases in decision-making, mean that even if consumers were strongly incentivised to make optimal borrowing decisions, they would be unable to do so. Furthermore, it is unlikely that personal insolvency law could ever have such an incentivising effect on borrowing behaviour. Consumers tend to ignore the possibility of default (and so the content of bankruptcy law) when making borrowing decisions, while even if they attempt to account for the risk of default, decision-making biases cause them to undervalue this risk (and so the likelihood of the law ever applying to them).[1565] Knowledge of personal insolvency law is low even among debtors in the system, not to mention among the general borrowing population.[1566] It might in theory be desirable to provide sufficient levels of education and de-biasing training to convert the general population into better borrowers and subsequently hold them to higher standards of behaviour.[1567] Undoubtedly the support of policymakers for financial education initiatives is a welcome development.[1568] The effectiveness of such programmes has been strongly questioned,[1569] however, and from a policymaking perspective the aim of educating the

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1560 *See e.g.* Pottow (2007), 432–34; Baird (2007), 311–14; McCoy (2007); Niemi-Kiesilainen (1999), 477.

1561 *Southey*, [19].

1562 Howard (1987), 1063.

1563 Willis (2008), 1230.

1564 FINANCIAL SERVICES AUTHORITY, CONSUMER RESPONSIBILITY (Discussion Paper, volume DP08/5, 2008); ATKINSON ET AL. (2006).

1565 Willis (2008), 1230.

1566 Surveys conducted in England and Wales show that a majority of bankrupts (approx. 58% and 64% respectively) had not been aware of a major change in the English debt discharge regime's leniency before entering bankruptcy: *see e.g.* INSOLVENCY SERVICE (2006A), 7; Tribe (2006), 67–68.

1567 Support for the need for debtor education can be found at: INSOL (2001), Recommendation 8, 28; MILMAN (2005), 154–55.

1568 *See e.g.* European Commission, Communication from the Commission - Financial Education; EUROPEAN COMMISSION, REVIEW OF THE INITIATIVES OF THE EUROPEAN COMMISSION IN THE AREA OF FINANCIAL EDUCATION (STAFF WORKING DOCUMENT) (2011).

1569 Lauren E. Willis, *Against Financial-Literacy Education*, 94 IOWA LAW REV. 197 (2008).

entire borrowing population to act as economically rational responsible borrowers is likely to be expensive and limited in effect, and ultimately an impractical means of promoting reasonable borrowing behaviour. Any pragmatic policymaker must realise that "creditors are likely to be more fruitful regulatory targets for reforming behaviour."[1570]

This raises the next consideration of the relational nature of moral hazard theory, and the multiple moral hazard problem raised by creditor-debtor relationships.[1571] Where the law holds a debtor liable for the consequences of her over-indebtedness, this reduces creditors' incentives to prevent over-indebtedness.[1572] If the BRO/U regime has the effect of deterring debtors from entering insolvency procedures, this raises moral hazard concerns that lenders may be left free to lend profitably and lower their monitoring costs by reducing the quality of creditworthiness assessments, while not being obliged to write off losses in insolvency procedures.[1573] These monitoring costs can be externalised and borne by other parties (e.g. the State's welfare system, the debtor's family, other creditors, and society in general).[1574] Indeed, concerns of creditor moral hazard may be more significant than that of debtor moral hazard, since well-advised financial services firms are aware of incentives created by the law,[1575] respond to financial incentives,[1576] and are judged by their ability to produce profits rather than being held to moral standards[1577] (thus having no moral costs of the kinds which might restrain individual debtors from engaging in opportunistic behaviour).[1578] Through the BRO/U system, personal insolvency law seeks to sanction borrowers who have acted unreasonably, while providing for no equivalent sanction for unreasonable or irresponsible lending. This is concerning given the role of personal insolvency law, and the aim of the BRO/U regime, of reinforcing market discipline and so correcting market failures.[1579] If a BRO/U signals debtor culpability in a case in which lenders have taken insufficient care to prevent default, the market message of the inappropriateness of a lender's conduct is suppressed. Therefore if policymakers wish to prevent loan transactions from taking place in circumstances involving unreasonable prospects of repayment, it may be more effective to place responsibility on the lender, rather than the consumer borrower, to avoid such a transaction; and to sanction a lender where credit is unreasonably advanced.

The BRO/U regime's asymmetric view of moral hazard shows personal insolvency law to continue to follow traditional private law norms, founded on principles of market individualism[1580]

[1570] Pottow (2007), 430.
[1571] Baker (1996), 274.
[1572] *Id.*
[1573] LoPucki (1997), 466.
[1574] WORLD BANK (2013), ¶¶91–92.
[1575] *Id.* ¶52.
[1576] LoPucki (1997), 466; Hallinan (1986), 110.
[1577] B. White (2010), 972, 1009.
[1578] For example, debtors using the IVA procedure in INSOLVENCY SERVICE (2009B), 15.
[1579] Whitford (1994), 403.
[1580] Adams & Brownsword (1987).

and *caveat emptor*,[1581] which view departures from creditor contractual freedom to lend and subsequently enforce market bargains as extraordinary "redistributions" to be avoided by courts.[1582] Despite its development into a *de facto* consumer law, personal insolvency law has not followed consumer credit regulatory norms in embracing the principle of lender responsibility.[1583] Much of the analysis in this section is drawn from ideas of consumer behaviour which have become well established in consumer protection policy, but which have not been taken into account in the BRO/U regime which is built upon corporate governance and early 20th century business insolvency standards, and which adheres to traditional commercial private law ideas.

C.Additional Grounds for Concern

My focus thus far has been on the BRO/U ground of borrowing without reasonable expectation of repayment, and of how this ground should be re-evaluated in the context of modern consumer credit markets. The fact that BRUs on this ground may have been common in appropriate cases before the decision in *Southey* raises concerns that inappropriate BRUs are made on other grounds too, however. For example, the making of preferences or undervalued transactions has been the second most common allegation upon which BRO/Us are based (Figure 17, Figure 19). While undoubtedly these scenarios can involve abusive behaviour which the law should deter,[1584] "[i]n many cases, however, transactions designed to prefer particular creditors have been inspired by motives which, according to ordinary notions, would not be thought to be deserving of moral censure."[1585] Traditionally, the law renders preferential payments capable of being set aside because such a transaction runs contrary to the principle of equality of creditors and the *pari passu* distribution of the debtor's estate.[1586] Undoing the transfer thus aids the objective of maximising returns to creditors as a group.[1587] While such a transaction traditionally has been vulnerable, the law has not traditionally sanctioned the debtor for the act of giving a

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[1581] For example, on the lack of liability for irresponsible or unreasonable lending under English law, *see e.g.* Wadsley (2003).

[1582] *See* Baker (1996), 275. On the distinction between "normal" market-facilitating contract law and "redistributive" regulatory rules, *see generally* Ramsay (1995); HOWELLS & WEATHERILL (2005), 8 et seq.

[1583] See text to notes 250-253 above.

[1584] For cases in which preferences were given by debtors to family members in order to place assets out of the reach of creditors (and so reduce bankruptcy costs for the debtor), see e.g. *Official Receiver v Bathurst*; *Official Receiver v May*. Note in this regard that the Insolvency Act 1986 treats specially cases in which the creditor preferred is an associate of the debtor, in which case an intention to prefer the creditor is presumed: Insolvency Act 1986, §340(4)–(5). Professor Walters suggests that a BRO/U could be made on the basis of conduct which does not establish all of the conditions necessary for an application to overturn a transaction as a preference: Walters (2005), 91. I consider that this would be an undesirable position, and that if a debtor is to be found to have acted culpably, then the requirements of section 340 should at least be established, perhaps alongside some culpable intent on the part of the debtor.

[1585] CORK (2002) ¶1243.

[1586] FLETCHER (2009), 272–73.

[1587] Ponoroff & Knippenberg (1995), 301–4.

preference. Indeed, reforms based on the Cork Report abandoned the historical terminology of "fraudulent preferences" in favour of the simple term "preferences",[1588] since "the insinuation of dishonesty has ceased to be an integral aspect of this ground for recovery of payments."[1589] In finding a debtor culpable where she makes a repayment to a creditor before entering an insolvency procedure (effectively obliging the debtor to act in the best interests of creditors), the BRO/U regime edges closer to placing the debtor in a role similar to a fiduciary,[1590] a position rejected by the court in *Randhawa*. When the centrality of the law's debt relief function is recognised, the mere fact that creditors are worse off as a result of the debtor's action should not be as conclusive of debtor culpability as might have been the case when the law served the sole purpose of debt collection. The realities of modern consumer over-indebtedness suggest a need for caution in assuming that a preferential transfer necessarily amounts to wrongdoing. Vulnerable debtors may be subjected to considerable creditor pressure to make repayment, rendering a finding of culpability inappropriate where a debtor merely failed to resist such collection efforts. Furthermore, it is standard practice in money advice/debt counselling[1591] and even in creditors' arrears management protocols to treat certain debts as "priority" payments which the debtor is permitted and encouraged to pay ahead of other obligations.[1592] Overly strict sanctioning of preferences might afford insufficient recognition to the realities of consumer debt, as well as the fresh start policy. There is little available evidence of the standards applied in making BRO/Us on this ground, but the lack of transparency at least raises concerns of inappropriate standards. Therefore while my primary focus has been on re-balancing debtor and creditor responsibility for unreasonable credit transactions leading to over-indebtedness, other BRO/U grounds could also require re-evaluation in the context of modern consumer over-indebtedness.

[1588] Insolvency Act 1986, §340.

[1589] FLETCHER (2009), 274.

[1590] Ponoroff & Knippenberg (1995), 277–78.

[1591] *See e.g.* STEPCHANGE (2012), 3, 20; Citizens Advice Bureau, Citizens Advice - How to Sort Out Your Debts, http://www.adviceguide.org.uk/england/debt_e/debt_help_with_debt_e/how_to_sort_out_your_debts.htm.

[1592] The British Bankers' Association Lending Code provides that a bank should not ask a debtor to make repayments of debts from income until provision has been made for the payment of priority debts, with debts considered to hold priority status where failure to pay could lead directly to the loss of the debtor's home, liberty, utility supplies or essential goods/services. *See* British Bankers Association *Lending Code*, ¶218.

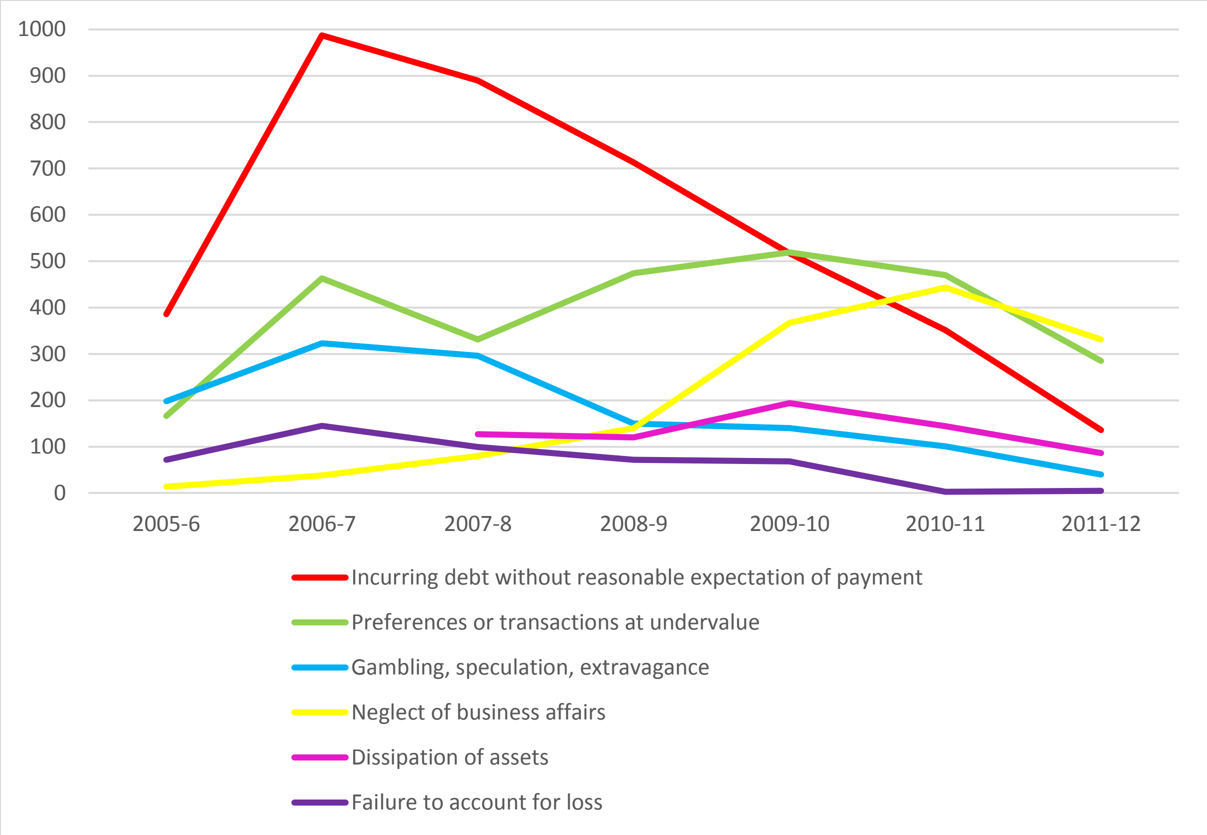

Figure 19: Types of misconduct alleged in BRO/U cases.

Source: Insolvency Service Annual Reports, 2005-6 to 2011-12

D.Conclusions and Policy Considerations

In order to address moral hazard concerns, inform credit markets and legitimate debt relief in the public eye, a system such as the BRO/U regime must take into account the purposes of household credit in the modern consumer credit society and recognise the realities of consumer credit markets. It should incorporate insight from consumer protection policy in relation to issues such as information asymmetries and behavioural biases, while also recognising the limited resources of over-indebted consumers and the fact that significant practical obstacles to accessing insolvency procedures exist alongside any substantive costs imposed specifically to deter moral hazard. These costs, which combine with substantive costs of debt relief to create potentially exclusionary effects, include the "premium" of a risk-based interest rate already paid by a debtor (which may lead to the "poor paying more", as seen in Chapter 2), and the financial costs of accessing personal insolvency procedures (see Chapter 4). Personal insolvency law should also recognise the relational nature of moral hazard, and accept that lenders' superior ability than that of consumer borrowers to prevent default and bear its costs mean that the law must guard against creating creditor moral hazard concerns by incentivising irresponsible lending.[1593] These factors suggest that the law indeed may have no role to play in sanctioning the "*improvident*" debtor, who commits *substantive misconduct* by over-borrowing in an unreasonable manner. Rather, the optimal policy approach may be to incentivise creditors to lend more responsibly so that this improvident debtor never has the opportunity to over-borrow, consistent with the overall re-orientation of the law towards the fresh start policy, to reduce externalities and provide discipline which imperfect markets fail to produce.

This is not to suggest that personal insolvency law has no role to play in disciplining debtors. Where debtor conduct demonstrates a deliberate intention to evade the costs of debt relief and upset the legislature's cost-benefit balance, the law should deter such conduct. The fresh start policy is justified by the assumption that creditors are better placed than consumer debtors to prevent default and bear its costs. Where a *debtor* is best placed to prevent default (where the debtor has intentionally over-borrowed) or to bear losses (where the debtor has hidden assets which could cushion default, or has otherwise intentionally exaggerated her need for default), debtor responsibility is justified. Therefore aspects of the BRO/U regime which address *intentional* debtor misconduct remain justified in a manner in which those aspects sanctioning *unreasonable* but unintentional debtor behaviour are not.

All of these considerations suggest that a system for sanctioning consumer debtor conduct must be more transparent and less based upon a private ordering framework than is the case under the current system, which is heavily reliant on BRUs rather than court-issued BROs. More comprehensive data could be made available than the limited case studies provided in

[1593] Moss & Johnson (1999), 343.

Insolvency Service annual reports, the representativeness of which is unclear. Auditing and reporting of BRUs could be carried out by the Insolvency Service to ensure that BRUs are being issued consistently and appropriately in consumer cases.

6.6 The Limits of Personal Insolvency Law

Policymakers' concerns with ensuring that the benefits of debt relief are counterbalanced with sufficient costs to address moral hazard and uphold repayment morality should not exaggerate the law's influence in encouraging/compelling debtors to honour their obligations, to the neglect of the role of social and market factors.[1594] These factors include ethical and social imperatives favouring the repayment of debts, but also the borrower's rational response to economic coercion represented by potential exclusion from credit transactions consequent upon an individual developing a reputation for non-payment.[1595] Recognising these points, personal insolvency law's ability to encourage responsibility in credit use while promoting the fresh start policy may be overshadowed by non-legal factors.

A. Social/Psychological Incentives

Social psychological perspectives of law suggest that emotional factors such as shame, guilt and fear may cause debtors to act in a manner which does not match the incentives offered by the legal system.[1596] People are unlikely to default on their obligations, even when in their economic interests to do so, if such action would cause them to feel like immoral or irresponsible actors, or in particular to feel they will be perceived as such by others.[1597] Similarly, fear of the consequences of default – including loss of financial resources and damage to credit histories - can influence debtor behaviour powerfully.[1598] Debtors' limited knowledge of default's consequences (including the impact on proprietary credit scoring systems) and of available legal protections[1599] may heighten this sense of fear. The influence of these emotions may be enhanced by the dissemination in public discourse of reinforcing messages by social and economic institutions holding interests in encouraging debtor repayment.[1600] Politicians acting

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[1594] Leff (1970), 27. Indeed, legal enforcement mechanisms are criticised as largely ineffective: *see e.g.* Baldwin & Cunnington (2004).
[1595] Leff (1970), 27.
[1596] B. White (2010).
[1597] *Id.*, 992.
[1598] *Id.*, 995, 1001–5.
[1599] *See e.g.* FLETCHER (2009), ¶3–003.
[1600] B. White (2010), 996–1007.

upon ideological or voter preferences, and/or interest group influence (see Chapter 3), may publicly condemn default and laud the virtue of honouring obligations. This conflict or game to set macro-level norms which then influence micro-level bargains operates similarly to the more well-recognised process of "meta-bargaining" in the "market for regulation"[1601] to shape the content of legislation which in turn shapes bargains in individual cases.[1602] Both processes involve attempts by interested parties to increase the costs - legal or otherwise - imposed on their bargaining counterparties in order to achieve outcomes best reflecting their preferences. The insight for policymakers is that socially imposed moral standards – contributing to the much-discussed "stigma" of bankruptcy[1603] - raise the costs of debt relief for the debtor, elevating the threshold at which the debtor will find accessing insolvency procedures sufficiently beneficial as to outweigh such costs.[1604] Policymakers should take these considerations into account when calibrating legal safeguards to address moral hazard concerns.

B. Credit Reporting and Reputation as Security

A second, perhaps more tangible, means by which "the law plays a subordinate role in lender-borrower relations"[1605] is through the modern credit reporting system.[1606] Credit reporting systems address moral hazard concerns at both the *ex-ante* and *ex post* levels by raising substantially the costs of default for debtors. Indeed, the BRO/U regime seems to recognise this, since a primary sanction (particularly for consumer debtors, who may not be affected by, say, a prohibition on acting as a company director) is the publication of the BRO/U in the relevant register, with the implication of negative impact on a debtor's credit history.

A debtor's credit history determines her future ability to access credit (as well as to rent an apartment, access utility facilities, make purchases consistent with her economic and social status,[1607] and even in some cases to gain employment[1608]).[1609] Exclusion from credit markets is a severe sanction, particularly in a financialised society in which credit plays an important role for

[1601] Baldwin et al. (2011), 43–44; Stigler (1983).
[1602] Carruthers & Halliday (1998), 15.
[1603] Sullivan et al. (2006); Jones & Zywicki (1999); Efrat (2006); European Commission (2007).
[1604] Hallinan (1986), 142.
[1605] B. White (2010), 1006.
[1606] *See e.g.* Nicola Jentzsch, Financial Privacy: An International Comparison of Credit Reporting Systems (Springer, 2nd ed. ed. 2010).
[1607] Rashmi Dyal-Chand, *Human Worth as Collateral*, 38 Rutgers Law J. 793, 811 (2006).
[1608] McGuffick v Royal Bank of Scotland Plc, [2009] EWHC Comm 2386, ¶29 (2009).
[1609] Claimants in suits against lenders and credit reference agencies in respect of alleged misreporting of credit history data provide evidence of considerable costs of negative credit reports, including the loss of businesses and homes: *see e.g.* Gatt v Barclays Bank Plc, Mark Williams, [2013] EWHC 2, ¶2 (2013); Smeaton v Equifax Plc, [2013] EWCA Civ 108, 3, 36 (2013).

much of the population in funding essential purchases (Chapter 1). Technological advances mean that lenders can now compile and circulate unprecedentedly large amounts of information, increasing their control over debtors' reputations.[1610] Since reputation is an asset of the debtor, subject to value fluctuation via the communication of relevant information,[1611] this means that lenders even of unsecured credit can be conceptualised as holding something equivalent to security in the form of the debtor's credit history.[1612] While credit reporting originated as a means of overcoming information asymmetries and adverse selection problems in lending decisions, it also plays an additional role in encouraging debtor repayment and responsible borrowing by sanctioning a defaulting debtor through the destruction of value held in her credit history asset.[1613] Indeed, the small value of consumer debts mean that legal enforcement proceedings may be disproportionately expensive in some cases, leaving credit reporting as a primary enforcement mechanism.[1614] The costs imposed on a defaulting debtor by the credit reporting system may exceed any costs imposed by personal insolvency law, and this must be recognised by policymakers when calibrating the costs and benefits of legal debt relief regimes. Policymakers' calculations lack precision when indeterminate costs can be imposed on debtors by private actors outside of the law.[1615]

[1610] Leff (1970), 31. As argued by Professor Dyal-Chand, "[t]he omnipresence of the credit reporting system is the key to its power as a mechanism for behavior modification": Dyal-Chand (2006), 809–10 (2006).

[1611] Leff (1970), 26–33. Professor Leff defines "reputation" for the purposes of analysing debt collection and insolvency as "a measure of a particular person's positive or negative predicted deviation from the other party's average predicted [transaction costs] of collecting from him." A person's reputation or credit history may also have a less tangible, but nonetheless important value to an individual as a representation of the individual's character: B. White (2010), 1005.

[1612] Dyal-Chand (2006). In economic terms, a borrower's credit history shares many of the key characteristics of security, including most significantly the ability of lenders to eliminate the asset (the threat of which motivates repayment) and to monitor the asset easily, as well as the asset's ability to appreciate and be of meaning to the borrower: *Id.* at 814–17.

[1613] Dyal-Chand (2006), 808. In the English High Court case of *McGuffick v RBS,* a consumer debtor's representatives argued that credit reporting is "overtly a tool of enforcement. Indeed… it enable[s] a creditor to enforce an agreement in the most effective way, by threatening the debtor that if he [does] not pay… the default would be reported to [Credit Reference Agencies]": *McGuffick*, ¶28. Such use of credit reporting as security in an equivalent manner to a threat of repossession of a mortgaged property can be seen for example in the case of Royal Bank of Scotland v Luwum, [2008] ER 202, ¶5.

[1614] Bertola et al. (2006A), 14, 18.

[1615] A further cost imposed on insolvent debtors by the market is the denial of a bank account. Only one high street bank (as well as some credit unions) offers basic bank accounts to undischarged bankrupts, and a large majority of debtors lose their bank accounts on entering bankruptcy. *See* INSOLVENCY SERVICE, BANK ACCOUNTS FOR BANKRUPTS: GOVERNMENT RESPONSE (2012). *See e.g.* Rosie Murray-West, *Co-op Shuts Out New Bankrupt Customers*, TELEGRAPH.CO.UK, Sep. 17, 2012, http://www.telegraph.co.uk/finance/personalfinance/9548472/Co-op-shuts-out-new-bankrupt-customers.html. To further the fresh start and financial inclusion policies by promoting the supply of bank accounts to bankrupts (INSOLVENCY SERVICE, BANK ACCOUNTS FOR BANKRUPTS: A CONSULTATION 8–9 (2011)), the Insolvency Service and Government have proposed legislative reforms removing banks' potential liability to a trustee in circumstances in which after-acquired property has passed through a bankrupt's account (INSOLVENCY SERVICE (2012B), 5–6. *See also* Insolvency Act, §307). These policymakers admitted, however, that this reform may be ineffective, since it is not the (almost negligible) risk of such a potential claim, but rather commercial considerations of risk and profitability, which motivate market practices of refusing these customers (INSOLVENCY SERVICE (2011C), ¶¶33-6; INSOLVENCY SERVICE (2012B), 5).

English law does not appear, however, to acknowledge this role of credit reporting as a *de facto* debt enforcement mechanism.[1616] In a case in which consumer protection legislation rendered the relevant credit agreement unenforceable, the English High Court rejected as "somewhat pejorative" "any suggestion that the bank is using… its continued reporting of the state of the claimant's account to [Credit Reference Agencies, "CRAs"]… as a coercive tool to persuade the claimant to pay the outstanding amount of the loan".[1617] Rather, according to the court, "the reporting has been for the legitimate purposes… of sharing credit performance data with other financial institutions through the CRAs to promote responsible lending."[1618] The court took a legal-centric view of what constitutes enforcement, rejecting the idea that dunning practices, the solicitation of a debt collection agency, or even commencing legal proceedings could amount to "enforcement" for the purposes of consumer credit legislation.[1619] Arguably therefore the law has not adequately recognised the role of credit reporting systems in regulating debtor behaviour and supplementing, or even replacing, the legal system as a means of enforcing obligations. The credit reporting system remains largely autonomous, as evidenced in lenders' tendency not to follow the distinctions drawn between honest and culpable debtors in the BRO/U system.

For policymakers' aim of addressing moral hazard concerns, by distinguishing between categories of debtors in terms of debt relief costs, to be given effect (and the administrative costs of the distinguishing process to be justified), the treatment of these categories in credit reporting systems must be regulated.[1620] Such regulatory control of credit reporting practices may conflict, however, with the accuracy of lenders' creditworthiness assessments and the autonomy of lenders in fulfilling important legal duties of responsible lending. In this regard tension arises between the objectives of addressing moral hazard concerns and of "protecting the public" or

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[1616] Note, however, that certain actions such as reporting/threatening to report that a consumer owes a debt which in fact was not owed or which represents only a claim for unliquidated damages are regulated under English law's control of unfair commercial practices: Office of Fair Trading v Ashbourne Management Services Ltd., [2011] EWHC 1237 (Ch) (2011).

[1617] *McGuffick*, ¶36.

[1618] *Id.*

[1619] *Id.* ¶¶79–82. The court did not specify the actions which would amount to enforcement, but noted that certain legislative provisions could be interpreted as suggesting a number of specified enforcement actions, including recovering possession of goods/land, demanding early repayment of a loan, and enforcing security: see Consumer Credit Act 1974, §§76–77, 87.

[1620] Currently credit reference agencies are licensed and supervised (Consumer Credit Act 1974 §§21, 25), while the law requires accuracy in credit history reporting (Data Protection Act 1998 (1998 c. 29) §§4, 9, 10, 13, 14; Consumer Credit Act 1974, §§157–59). Furthermore, lenders are obliged to conduct creditworthiness assessments as part of their responsible lending duties, by consulting credit reference files where necessary (Consumer Credit Act 1974, §§55B(3)(b); Financial Conduct Authority *Handbook of Rules and Guidance*, Mortgage and Home Finance: Conduct of Business Sourcebook (MCOB), MCOB 11.3.) Practices in using credit reference information are not regulated, however, to such an extent as to prevent the potential financial exclusion of bankrupts in a manner contrary to the fresh start policy. It is interesting in this regard to note that the Insolvency Service consultation on bank accounts did not even consider obliging banks legislatively to make basic bank accounts available to undischarged bankrupts. This contrasts with European Union proposals for a legislative right to a basic bank account: European Commission, Recommendation of 18 July 2011 on Access to a Basic Payment Account, OFF. J. EUR. UNION (2011). The English position can be contrasted with US Bankruptcy Code, which prohibits discrimination by both Government units and private employers against debtors who have entered/completed bankruptcy: see 11 USC §525; Milman (2005), 95.

providing more accurate information to credit markets concerning debtors' financial difficulties. The benefits of a regime such as the BRO/U system as a response to information failures in credit markets include its ability to provide information in an efficient, reliable and centralised manner.[1621] In this purpose, however, the law can again be criticised as having been superseded by market developments. Technological advancements and the development of sophisticated credit reference/scoring systems mean that lenders can conduct accurate creditworthiness assessments themselves, without the need for the information provided through the BRO/U regime.[1622] The fact that lenders appear not to be distinguishing between "ordinary" and restricted bankrupts suggests that creditors already possess better information than that produced by the BRO/U process.[1623] In this way creditors appear to be rejecting the "protection" offered by the law. Again, basic premises of consumer protection policy - the asymmetry of information, rationality and bargaining power between business and consumer - seem not to have been recognised by personal insolvency law, which sees the need for the law to protect lenders against debtors, despite lenders being in the stronger position.

If the law was to intervene and *require* lenders to distinguish between honest debtors and those subjected to a BRO/U (both as a means of addressing moral hazard by ensuring policymakers' intended sanctions apply to debtors, and to ensure that what in policymakers' view is "better" information is communicated to the market), this would risk the substitution of the judgment of courts and Official Receivers for that of lenders in creditworthiness assessments. This might lead to sub-optimal outcomes due to the informational disadvantages faced by such State actors,[1624] and may conflict with regulatory norms which seek to put creditors' superior information to work in the public interest by placing legal responsibility on lenders to conduct adequate creditworthiness assessments. Thus in providing information to credit markets, the BRO/U regime risks both doing too little or too much. The law cannot take control of the creditworthiness assessment process while simultaneously imposing legal responsibility on lenders to undertake expert assessments. It also cannot serve an aim of protecting creditors while also reducing their protection by interfering in lending decisions and exposing them to lending practices which potentially may conflict with commercial best judgment. Therefore policymakers must decide upon the right balance of regulatory intervention and lender responsibility in determining how the twin tools of preventative regulation of lending decisions and curative debt relief (with adequate protection against moral hazard) can best operate to achieve the objectives of reducing the externalities of over-indebtedness.

[1621] LoPucki (1997), 477–78.

[1622] Baird (2007), 311–14; Ronald J. Mann, *Information Technology and Non-Legal Sanctions in Financing Transactions*, 54 VANDERBILT LAW REV. 1625 (2001).

[1623] One recent case provides an example of the bankruptcy system providing misleading information to credit markets, in its failure (now cured) to publish information regarding the rescission of bankruptcy orders: *Smeaton*.

[1624] Czarnetzky (2000), 461.

The third goal of ensuring the public legitimacy of the personal insolvency system is also compromised by market developments' overshadowing of the law. The BRO/U regime promises to provide legitimacy (or "economic justice"[1625]) to debt relief mechanisms by investigating debtor conduct and sanctioning culpable behaviour, identifying dishonest debtors while exonerating all others as honest but unfortunate. The law's legitimating ability is compromised, however, when the more significant debtor distinctions are drawn, and more relevant sanctions are imposed, by credit reporting systems rather than by courts and administrative officials. This privately operated system of investigation and reporting lacks the transparency necessary to provide legitimacy, as credit scoring practices and lender decision-making remain within the confines of proprietary information.[1626] The underlying objective of the credit reporting system of serving lenders' commercial objectives also means that categorisations of borrowers may not correspond to those which would be achieved in a system motivated by concerns of justice and equity among borrowers. Therefore if the benefits of the personal insolvency system are provided by law, but costs imposed by the market, policymakers' power to ensure a legitimate balance of these costs and benefits is limited.

[1625] LoPucki (1997), 477 et seq.
[1626] *Id.*, 478.

CHAPTER 7: Concluding Thoughts

I have argued that English personal insolvency law, at least in the context of "consumer" debtors falling outside of the high net worth category, should re-orient itself around the fresh start policy, departing from a perspective which views the law as primarily serving the aim of debt collection, and instead recognising the law's debt relief function as its primary objective. This involves the reform of the law to reflect better its status as a *de facto* consumer law, departing from commercial assumptions of the efficiency of free contracting, and facilitating access to the debt relief which forms the core of the modern law's operation. While English law embraces the fresh start policy to a greater extent than that of many European countries, in certain ways it remains rooted in historical debt collection/creditor wealth maximisation perspectives, despite dramatic changes in the social, economic and political contexts of personal indebtedness in recent decades. This is evident in courts' and policymakers' conceptualisation of the personal insolvency system as a marketplace organised around free contracting principles (Chapter 4), despite contracting failures in consumer transactions being a basic premise of consumer law and policy. It is also apparent in courts' failure to recognise wholly the law's protective effect (Chapter 5) and in legislation's continued application of historical and commercial/corporate standards of debtor conduct to an entirely contemporary challenge of judging the appropriateness of household borrowing behaviour in modern consumer credit markets. The above chapters both diagnose the law's failure to recognise the demands of its new consumer focus and identify certain negative consequences of this position, but further research exploring the practical adverse results of this position is desirable. An important research step would be the collection of empirical data relating to the circumstances of debtors participating in long-term IVAs and DMPs, in order to compare with those of debtors benefitting from the more immediate and extensive debt relief provided in bankruptcy.

I argue that the best means of addressing the legislative shortcomings identified is to expand the Debt Relief Order procedure so that it affords access to all debtors falling outside of the high net worth category, thus establishing this procedure as a *consumer* insolvency law.[1627] Unlike alternative procedures, this procedure was born of the consumer credit society, and carries neither the historical debt collection objectives nor the commercial law assumptions which remain attached to bankruptcy and IVA procedures, despite attempted, and even successful, efforts to reform legislative provisions governing these procedures. The politics of consumer debt mean that this proposed reform will not be easily accomplished, however, as political factors such as ideology, interest group influence and temporal shifts in public policy salience may obstruct law reform. This is suggested by the lessons both from past attempts to reform the IVA procedure

[1627] See text to notes 1225 to 1236.

and the more recent Irish personal insolvency legislation, which illustrates how obstacles to reform may be heightened in an era of the consumer credit society heavily influenced by the financial crisis of the late 2000s and the increased impact of globalisation (as evidenced in European institutions and the IMF's influence on Irish policy). Further research could increase understanding of the political economy of consumer insolvency law reform, and insight could be obtained from examining the role of factors such as path dependence[1628] and the effectiveness of anti-reform rhetoric[1629] on the development of English personal insolvency legislation over time, alongside the other elements considered in Chapter 3.

As well as examining policy development of the law and administrative data regarding its application, I also examine case law to gain further insight into the extent to which the operation of personal insolvency law corresponds to theoretical prescriptions. This technique has been somewhat neglected in the comparative consumer insolvency literature to date.[1630] The lack of analysis of judicial decision making in this field is a significant omission, since an investigation of the English experience shows courts to be particularly unresponsive to the fresh start policy. It appears from the studied cases that consumer law remains seen as an exceptional aberration or intervention into private law by English judges,[1631] or at least has not been accepted by English courts as appropriate for informing reasoning in cases involving areas of the law traditionally viewed as commercial in nature. In consumer cases which do not fall within the boundaries of specific consumer protection legislation, courts appear to apply orthodox private law founded upon assumptions of commercial self-interested bargaining, as evident in the discussion in Chapters 4 to 6.[1632] The reasons for this judicial approach are more difficult to explain than legislative inertia, and could be accurately identified only through a comprehensive study in its own right. Explanations may include, for example, the content of legal training and education, which usually affords core status to doctrinal private law, but more regularly omits consideration of consumer law's questioning of such doctrine. Socio-political factors may also play a role, as the judges like others hold political ideological leanings,[1633] which may align with perspectives favouring free contracting based upon commercial self-interest over regulatory intervention and redistribution of market allocations. The background and experience of judges in the courts system must also be considered, as judges drawn from the ranks of successful barristers are more likely to have spent their pre-judicial days in the world of commercial law than in litigating low-value consumer law cases. Similarly, the transaction costs of consumer litigation[1634] mean that once on the bench, judges, and particularly those in superior courts, are unlikely to be

[1628] *See e.g.* Pierson (2000).
[1629] *See e.g.* ALBERT O. HIRSCHMAN, THE RHETORIC OF REACTION: PERVERSITY, FUTILITY, JEOPARDY (1991).
[1630] Anderson (2004), 675-6.
[1631] *See e.g.* Ramsay (1995), 177-8.
[1632] *See also* the cases outside of the insolvency context discussed in text to notes 76-84 above.
[1633] *See e.g.* J.A.G. Griffith, *The Politics of the Judiciary*, (Fontana Press, 5th ed., 2010).
[1634] See text to notes 469-483 above.

exposed to many consumer law disputes and the departure from standard commercial law assumptions which such cases require. The practicalities of consumer litigation also mean that, particularly in the household credit sector, businesses can mobilise to fund litigation and ensure that the cases founded upon commercial and market-based perspectives put forward by financial institutions are substantially better resourced than consumer advocacy of a departure from such norms.[1635] In a financialised world, litigation may be just another game – alongside meta-level competitions for legislation and public opinion (both discussed in Chapter 3) and micro-level individual debt restructuring bargains (Chapter 4) - in which financial institutions hold the best hands, with successive victories in the legislative, litigation and private bargaining spheres multiplying the extent to which outcomes favour creditors.[1636] These ideas require further consideration, but irrespective of the causes of judicial unwillingness to deploy the fresh start policy, the isolation of consumer insolvency from the historical and commercial contexts associated with the bankruptcy and IVA procedures - by placing it into an expanded DRO mechanism - may leave less judicial flexibility to interpret the law in a manner inconsistent with the fresh start policy. As the analysis throughout suggests, however, any such legislative reforms should be accompanied by a wider recognition among policymakers, administrative officials and judges of the law's new role in the context of the modern consumer credit society, and the embracing of the fresh start policy by all actors within the system.

[1635] *See* note 478 above.
[1636] See text to notes 1601-1602 above.

Appendix: Figures, Data Charts and Graphs

Chapter 1: Consumer Credit Society

Country	General Liquidation and Discharge Procedure(s)	Repayment Plan Procedures	"No Income, No Assets" Liquidation and Discharge Procedures
Belgium Single point of access: - non-trading natural person not in a position to pay debts in sustainable manner (provided that has not manifestly orchestrated own insolvency).[1637]		• Consensual Renegotiation • Repayment Plan w/o Capital Discharge • Repayment Plan w/Capital Discharge	Immediate discharge procedure
England and Wales	Bankruptcy - Debtor "unable to pay her debts"[1638] - Court interpretation: cash-flow test[1639]	Individual Voluntary Arrangement - Must meet conditions for accessing bankruptcy[1640]	Debt Relief Order - Debtor "unable to pay her debts"[1641]
France Single point of access: manifest impossibility for ("good faith") debtor to meet the		• Consensual Renegotiation • Ordinary Measures • Extraordinary Measures	Procédure de rétablissement personnel

[1637] Code judiciaire, art. 1675/2, 1675/6.
[1638] INSOLVENCY ACT 1986, §272(1) (1986).
[1639] FLETCHER (2009), ¶ 6–088, citing Re Coney, [1998] B.P.I.R. 333 (1998).
[1640] INSOLVENCY ACT 1986, §§255(1), 256A(3).
[1641] INSOLVENCY ACT 1986, §251A.

entirety of her non-professional debts currently due and which will fall due.[1642]			
Ireland	Bankruptcy - Debtor unable to meet engagements with creditors[1643]	• Debt Settlement Arrangement • Personal Insolvency Arrangement - "Insolvent" = unable to pay debts in full as they fall due, *and* has no likelihood of becoming solvent within a period of five years, while also maintaining a reasonable standard of living.[1644]	Debt Relief Notice - "Insolvent"= unable to pay debts in full as they fall due, *and* has no likelihood of becoming solvent within a period of three years, while also maintaining a reasonable standard of living.[1645]

Figure 20: Personal Insolvency Procedures Falling within the scope of my study, and insolvency tests under each procedure

1642 Code de la Consommation Art. L330-1.

1643 BANKRUPTCY ACT 1988, §15.

1644 PERSONAL INSOLVENCY ACT 2012, §§1(2), 26(2)(e).

1645 PERSONAL INSOLVENCY ACT 2012, §§1(2), 26(2)(e).

Study	Method	Primary Relationship with Over-indebtedness (Ranked in order of significance)	Secondary Relationship with Over-indebtedness	Tertiary Relationship with Over-indebtedness
Kempson 2002[1646]	Surveyed debtors self-reporting	Income shock - Redundancy - Relationship breakdown - Sickness/disability - Other loss of income	Low income	"Over-commitment"
Disney et al 2008[1647]	Qualitative, interviews with industry stakeholders	"Financial imprudence" - Over-borrowing - Under-insurance - Relative price shocks	Income shocks - Loss of employment - Family breakdown or divorce - Ill health	Macro-economic shocks - Interest rate rises - Restrictions on credit ("credit crunch")
European Commission 2008[1648]	Meta-analysis of previous studies	Loss of income	Low income	Money management, over-commitment and over-spending
Duygan-Bump et al 2009[1649]	Quantitative analysis of household survey data	Income shocks - Unemployment - Health shock - Income drop		
European Commission 2010[1650]	Quantitative analysis of household survey data	Income shocks	Family relationship breakdown (divorce or separation)	Low income

[1646] Kempson (2002), 32.
[1647] Disney et al. (2008), 27–36.
[1648] European Commission et al. (2008), 22–28.
[1649] Duygan-Bump and Grant (2009), 119.
[1650] European Commission et al. (2010), 30–46.

Figure 21: Causes of Over-Indebtedness, Survey of Major Studies

Survey	Indicator	Indicator Result as % UK Population
Kempson 2002[1651]	*Household* reports "financial difficulties"	20
	Household Financial difficulties, no arrears	7
	Household In arrears (average: arrears on 1.9 commitments)	13
	Household constantly struggles or is falling behind on commitments	11
DTI MORI 2004-5[1652] (data collected 2004)	*Individuals* spending more than 25% of gross monthly income on unsecured repayments	8
	Individuals spending more than 50% of gross monthly income on total borrowing repayments (secured and unsecured)	9
	Individuals with 4 or more credit commitments	6
	Individuals in arrears on a credit commitment and/or domestic bill for >3 months (average amount: £868)	4
	Individuals declaring household's borrowing "heavy burden"	4
Disney et al 2008[1653] (data 1999/2005)	*Families* behind on at least one credit arrangement	5.5/2.1
	Families behind on at least one loan	7.1/3.2
	Families with mortgage/rent arrears	12/6.8
	Families behind with at least 1 utility bill	36.5/22.4
BIS 2010[1654]	*Households* spending more than 30% of gross monthly income on servicing unsecured loans	10 (of households who provided complete information in survey response)
	Households spending more than 20% of gross monthly income on servicing unsecured loans	17 (approx.) (of households who provided complete information in survey

1651 Kempson (2002)
1652 DTI (2005).
1653 Disney et al. (2008)
1654 BIS (2010A).

		response)	
	Households with 4 or more credit commitments	18	
	Household in arrears on a credit commitment and/or domestic bill for >3 months ("structural" arrears)	9	
	Households declaring keeping up with bills and credit commitments to be a "heavy burden"	15	
BIS/YOUGOV 2011[1655]	*Household* arrears: one or more months behind	13	Composite objective indicators: **12%** (*either* structural arrears *or* participation in an insolvency/debt enforcement procedure)
	Household arrears: more than three months behind ("structural" arrears)	9	
	Households structural arrears, behind on three or more payments	2	
	Respondent declared bankrupt within last 2 years	1	
	Respondent participating in an IVA	1	
	Respondent participating in a Debt Management Plan	5	
	Respondent has had County Court Judgment or other legal proceedings for non-payment in last 2 years	3	
	Household feels keeping up with bills is "heavy burden"	14	Composite subjective indicators: - 19% households responded positively to at least two questions - 30% responded positively to at least one
	Household constantly struggles to keep up, or is falling behind, with bills/payments/commitments	23	
	Household struggles to last to next pay day more often than not	21	
	Household constantly or usually overdrawn on bank current account	21	
	Household uses credit for day-to-day living expenses "all the time"	11	

Figure 22: Indicators of Over-Indebtedness

1655 BIS (2011A).

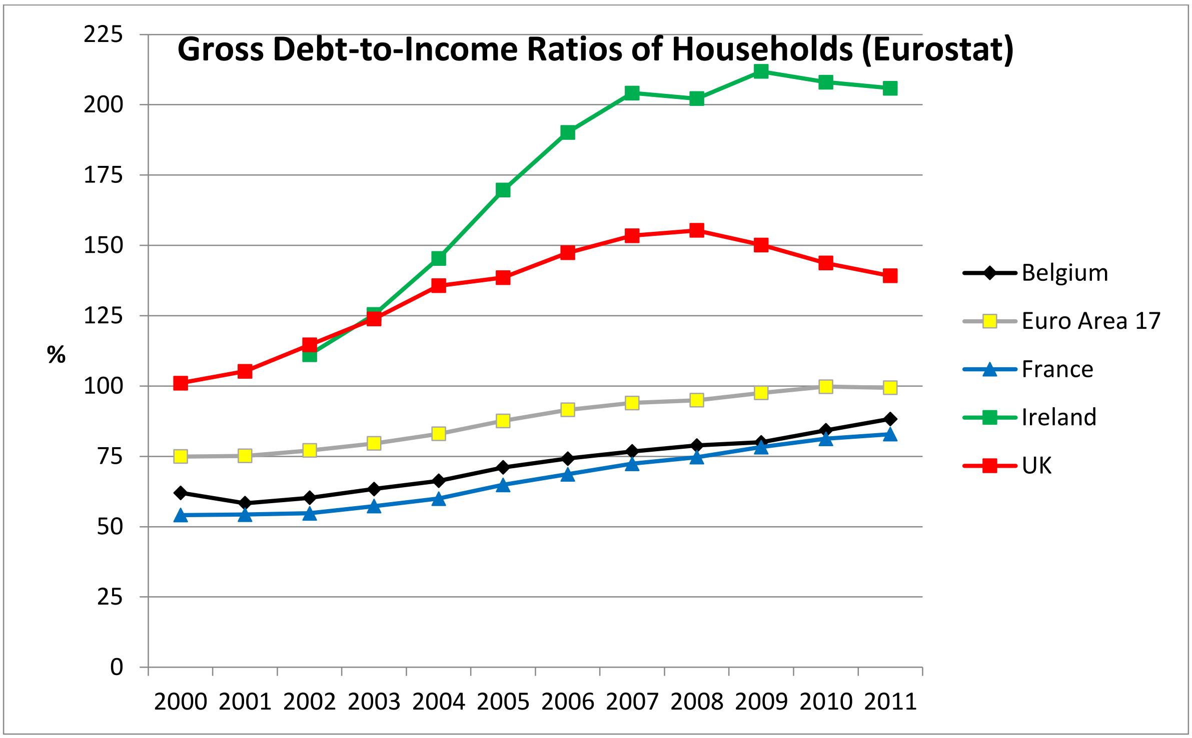

Figure 23: Eurostat Data on Gross Debt-to-Income Ratios of Households.

(Gross disposable income adjusted for change in net equity of households in pension funds reserves)

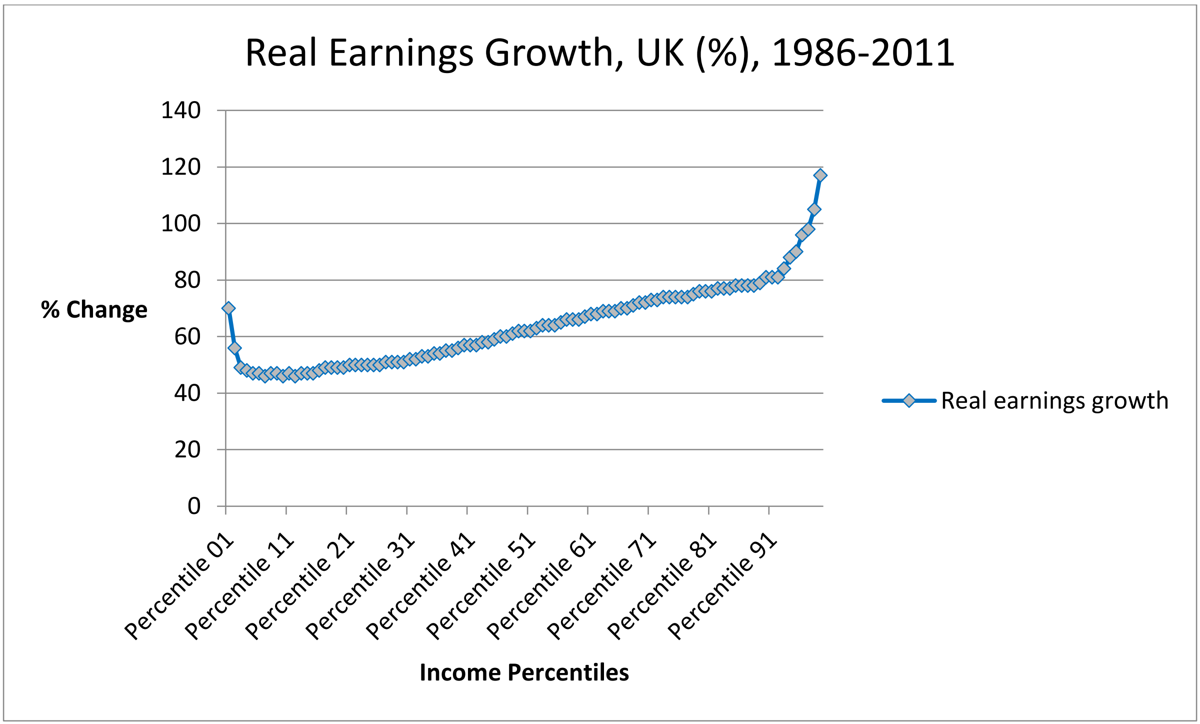

Figure 24: Real Earnings Growth, UK (%), 1986-2011

Source: Office for National Statistics, "Real Wages up 63% on Average over the Past 25 Years"

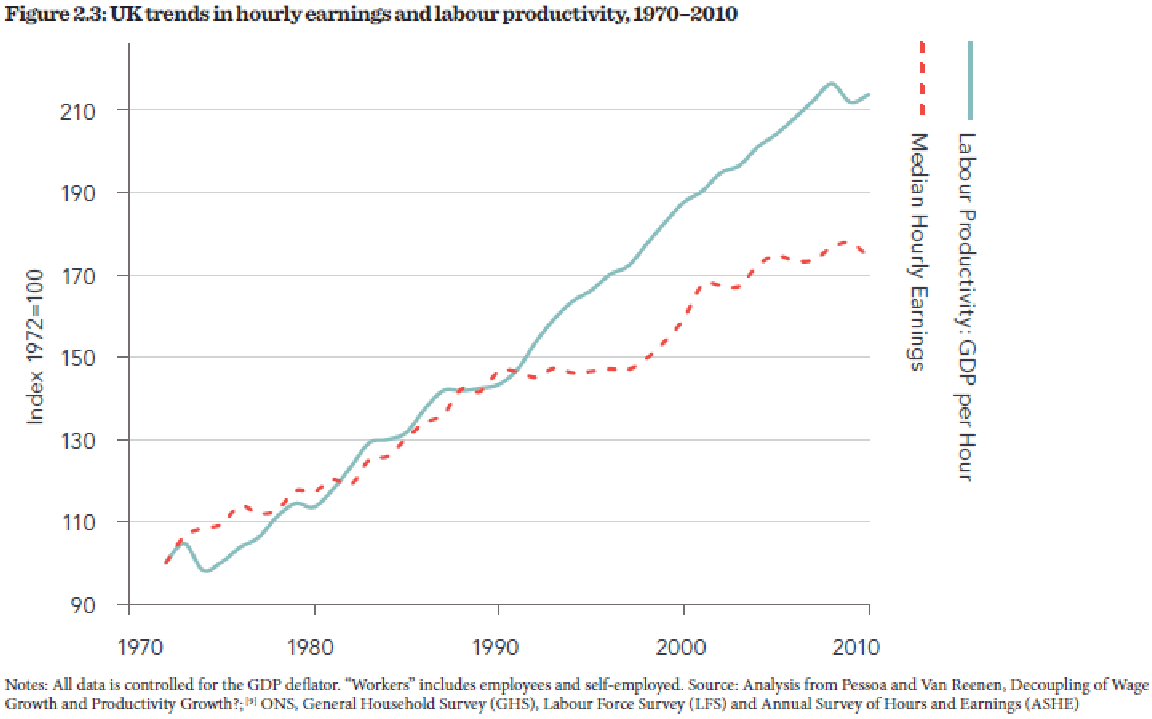

Figure 25: UK trends in hourly earnings and labour productivity, 1970-2010

Source: Resolution Foundation Commission on Living Standards (2013), at 20

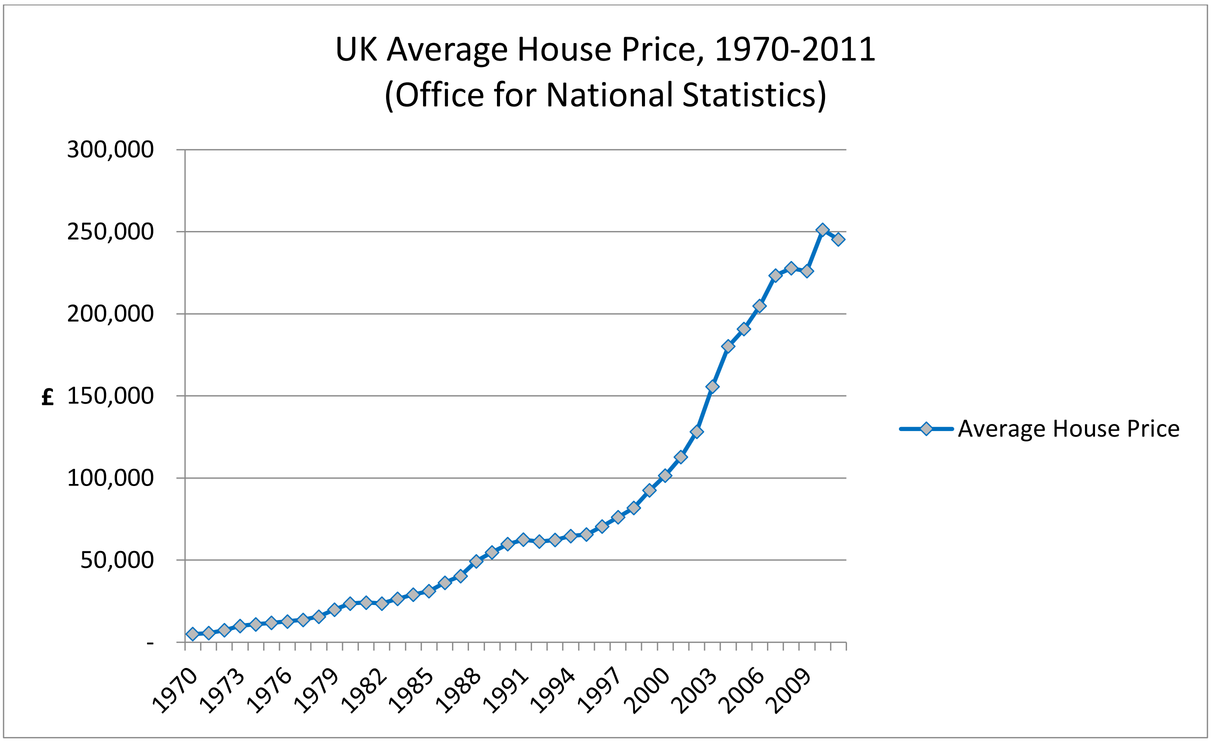

Figure 26: UK Average House Price Inflation, 1970-2011 (Office for National Statistics)

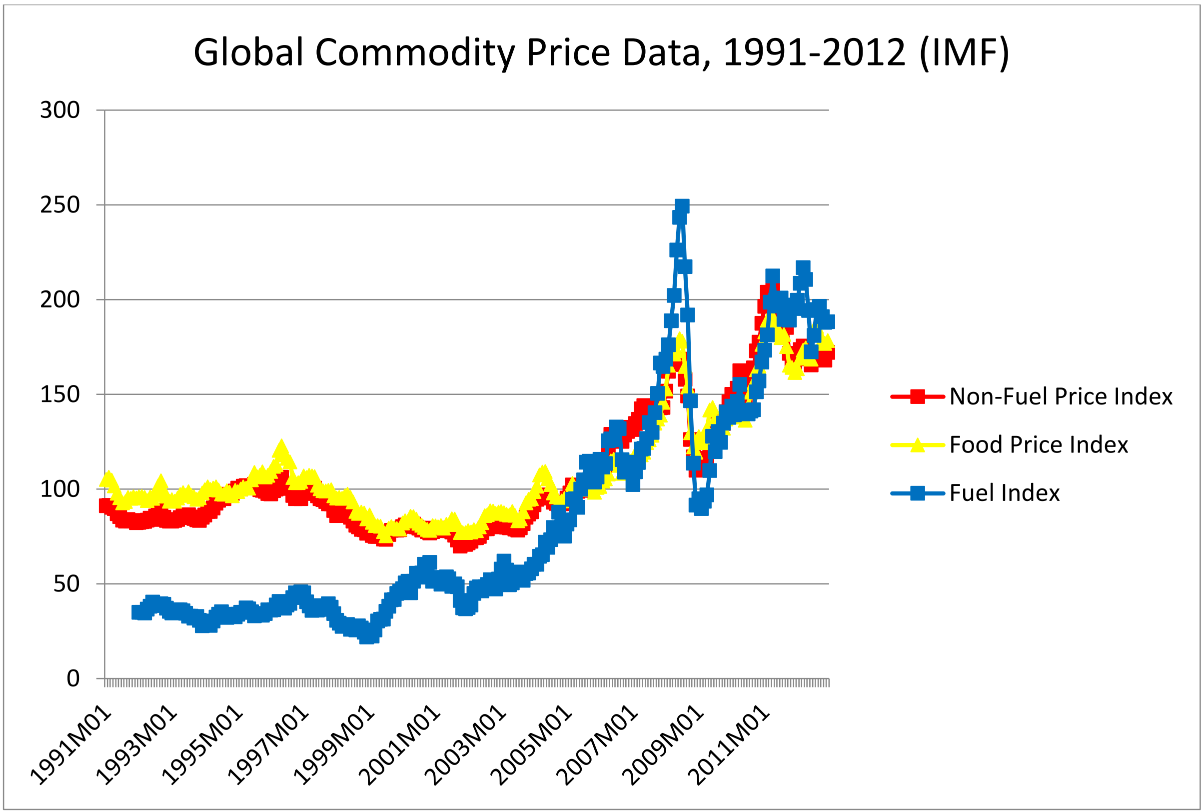

Figure 27: IMF Global Commodity Price Data, 1991-2012

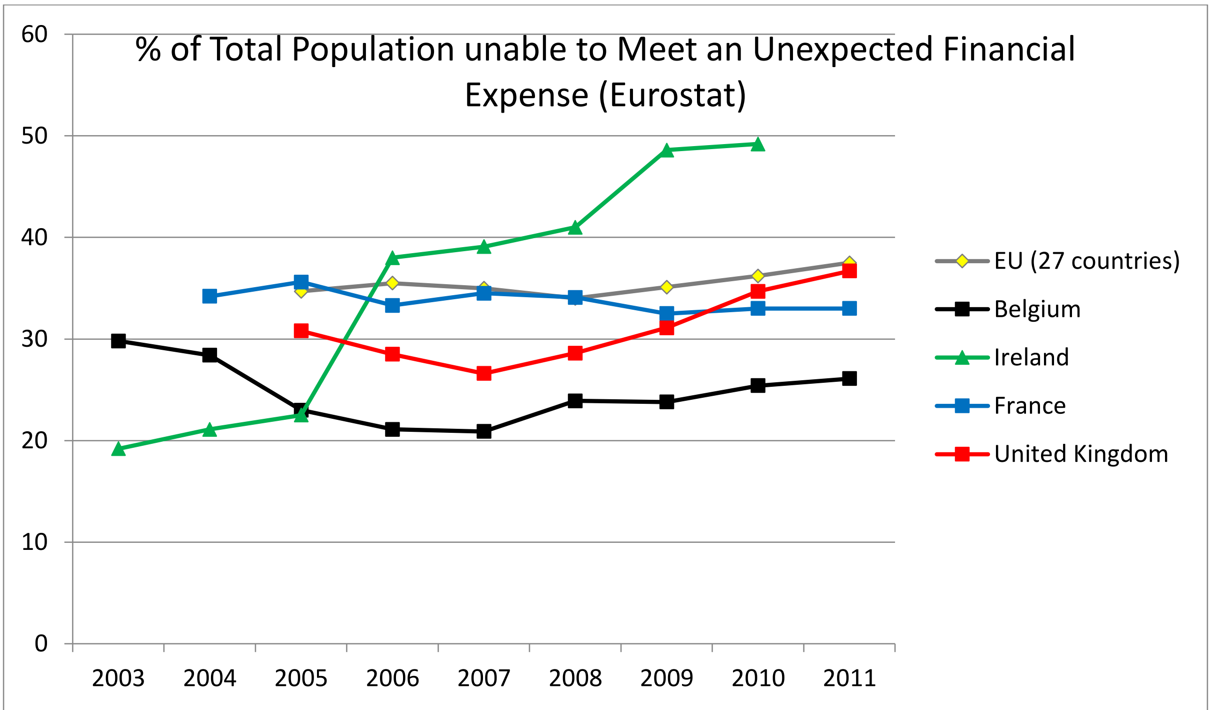

Figure 28: % of Total Population unable to meet Unexpected Financial Expense

Source: Eurostat, European Survey on Income and Living Conditions (SILC). The amount of the unexpected financial expense in question is the same as the "at risk of poverty" threshold in each country, which is calculated as 60% of the national monthly median equivalised disposable income in each country. In the UK, this represented an amount of approximately £735.

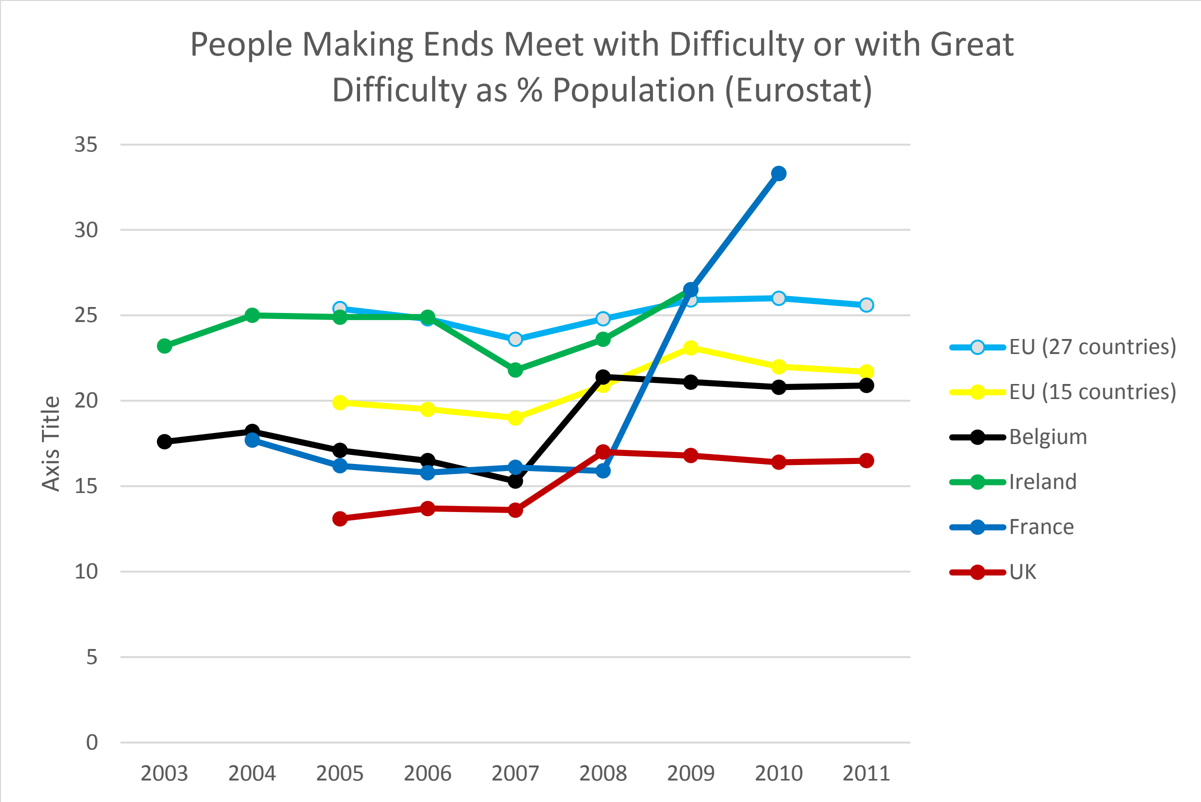

Figure 29: Percentage of population making ends meet with difficulty or with great difficulty
Source: Eurostat

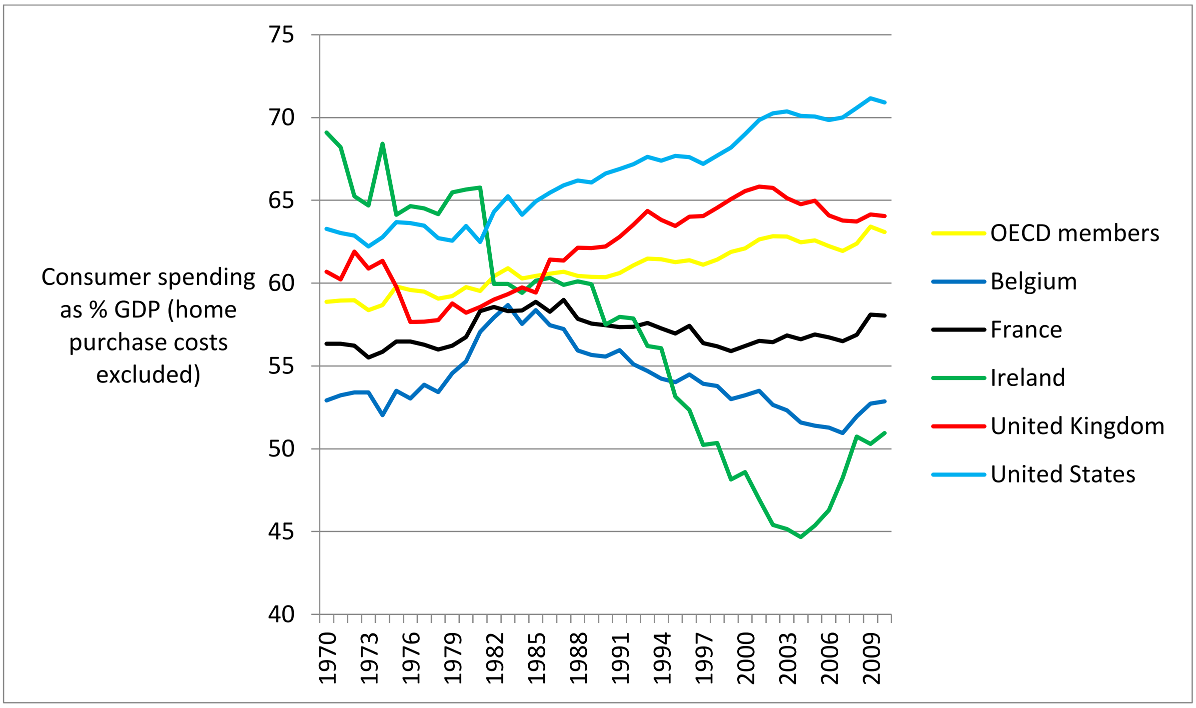

Figure 30: Consumer Spending as % GDP

Home purchase costs excluded. Source: World Bank.

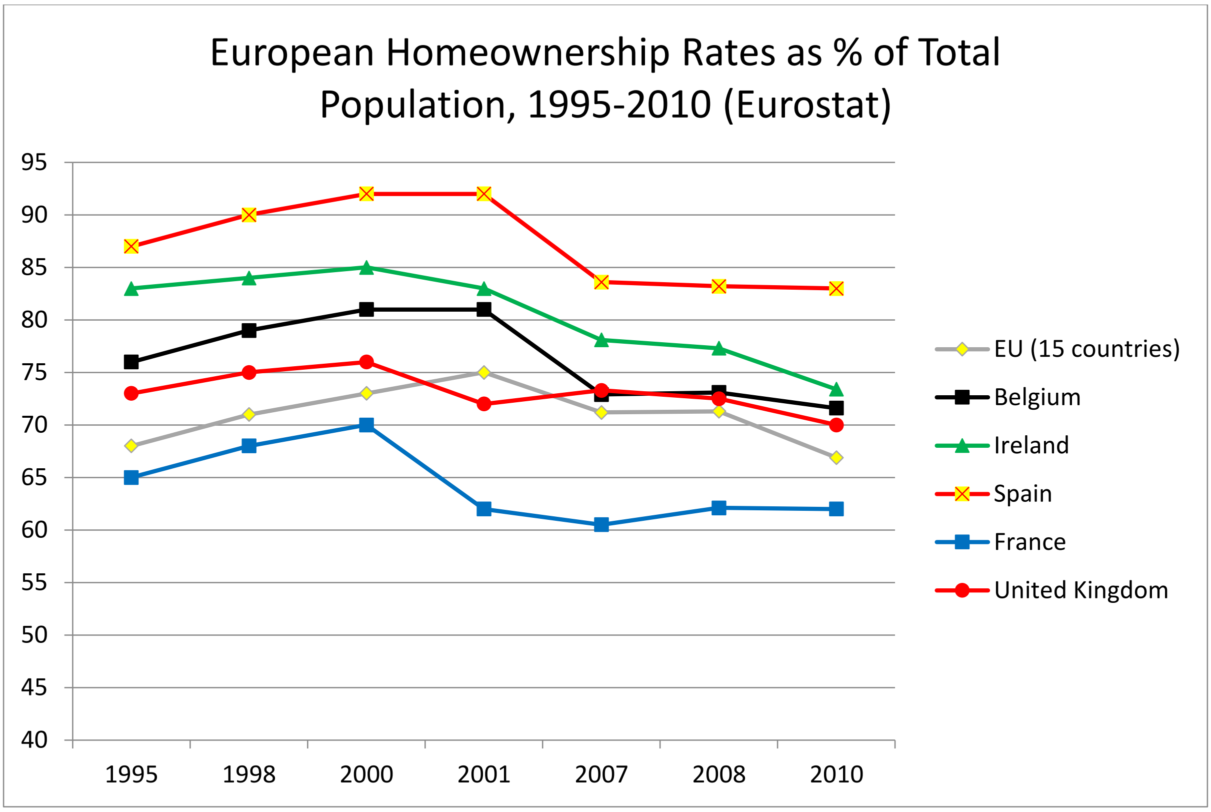

Figure 31: European Homeownership Rates, 1995-2010

Source: Eurostat

Chapter 3: Data Graphs

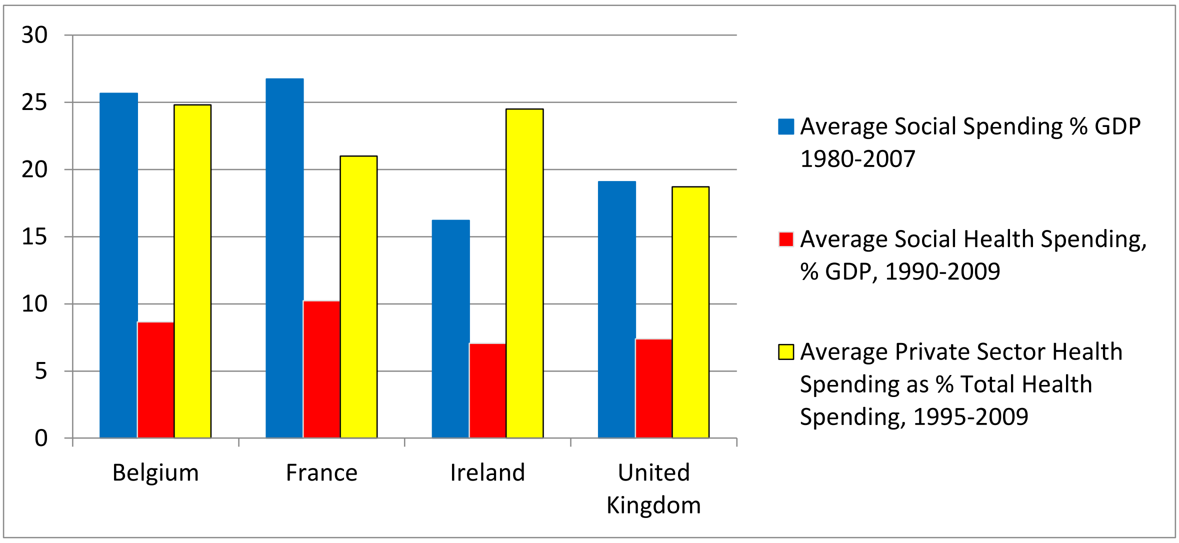

Figure 32: Social Expenditure in Belgium, France, Ireland, UK

Source: OECD, Available at: http://stats.oecd.org/Index.aspx?DataSetCode=SOCX_AGG, OECD StatExtracts, available at: http://stats.oecd.org/#

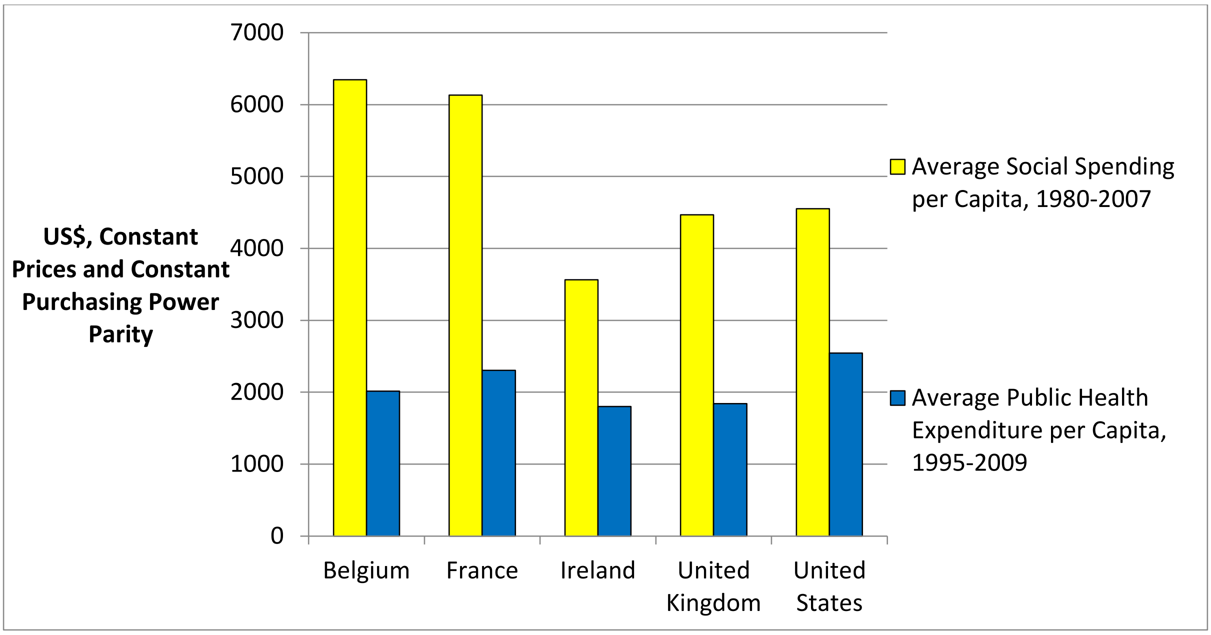

Figure 33: Average Social Spending and Public Health Expenditure per Capita, Belgium, France, Ireland, UK, USA. Available at: http://stats.oecd.org/Index.aspx?DataSetCode=SOCX_AGG

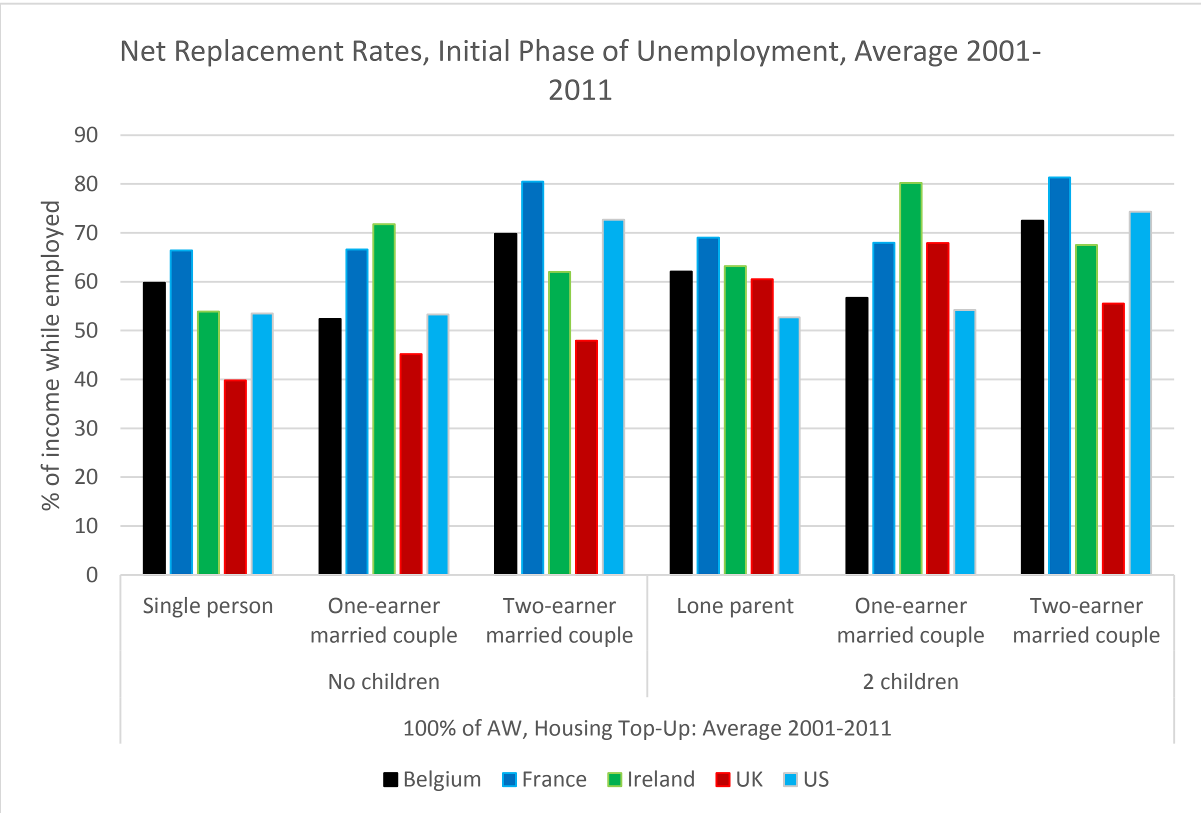

Figure 34: Net Replacement Rates, Initial Phase of Unemployment, Average 2001-2011

Source: OECD *Benefits and Wages: Statistics*, http://www.oecd.org/els/benefitsandwagesstatistics.htm (accessed 12th September 2013)

Notes: Six family types, all families qualifying for housing assistance or social assistance “top ups”, where available. Data is based on cases in which the relevant person(s) earned 100% of the average wage prior to unemployment. Data relates to the initial period of unemployment, but after any required waiting period.

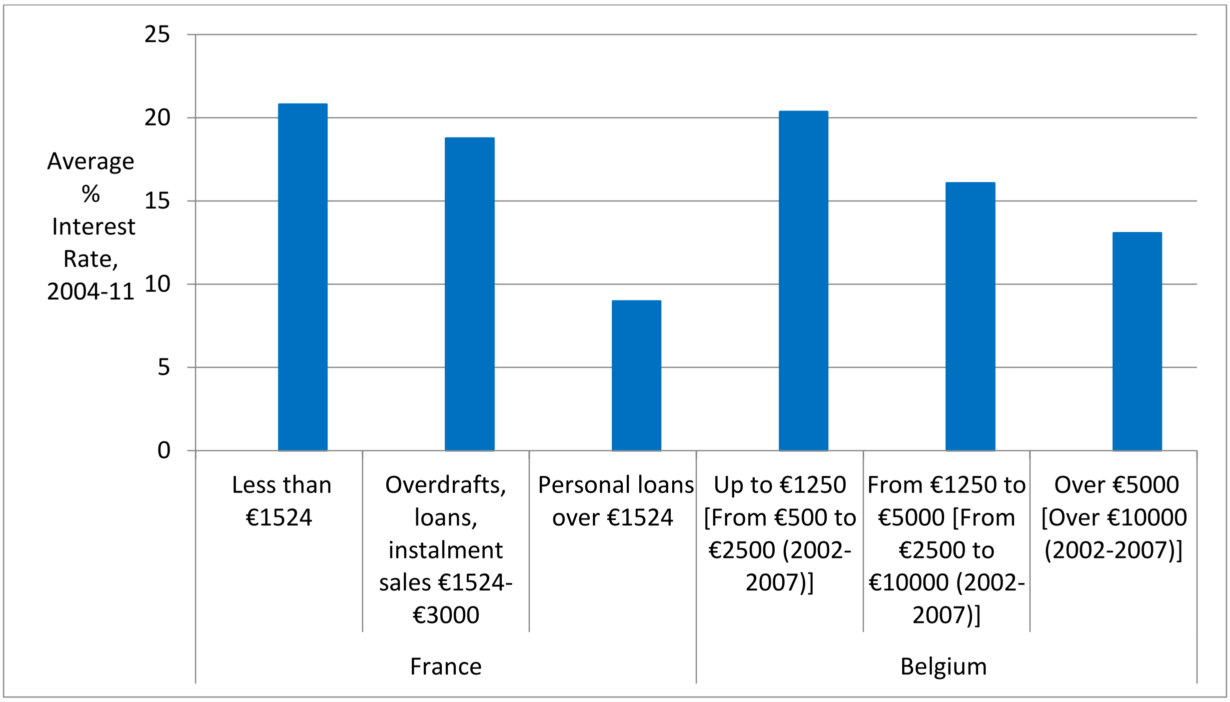

Figure 35 Average interest rate limits in France and Belgium, 2004-2011.

Source: ***Journal Officiel de la République Française; SPF Économie, P.M.E. Classes moyennes et Energie*** **(Belg.)**

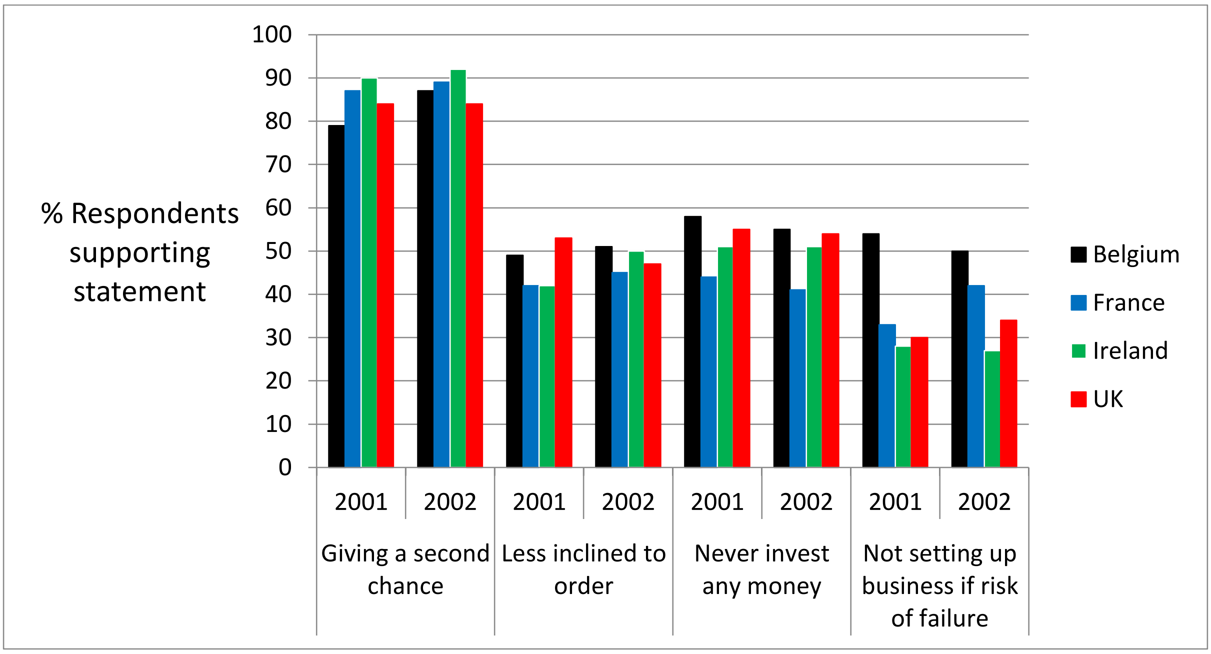

Figure 36: Public attitudes towards insolvent companies/persons, Eurobarometer (2002).

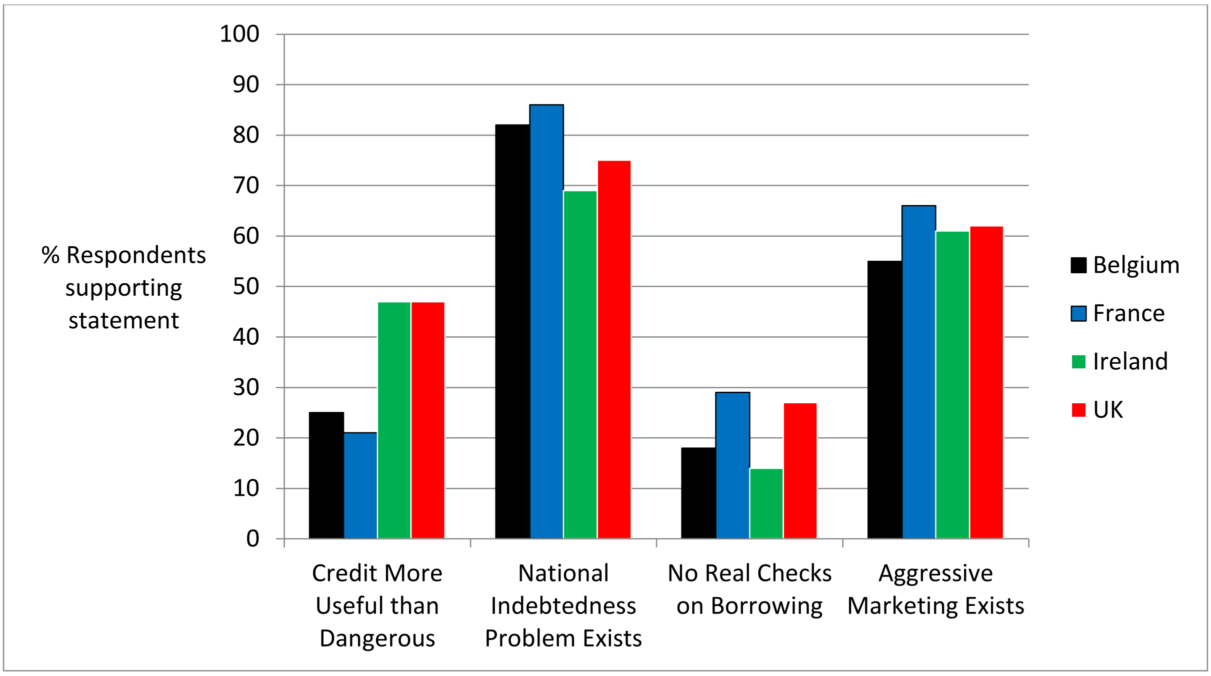

Figure 37: Public attitudes towards credit, Eurobarometer (2004).

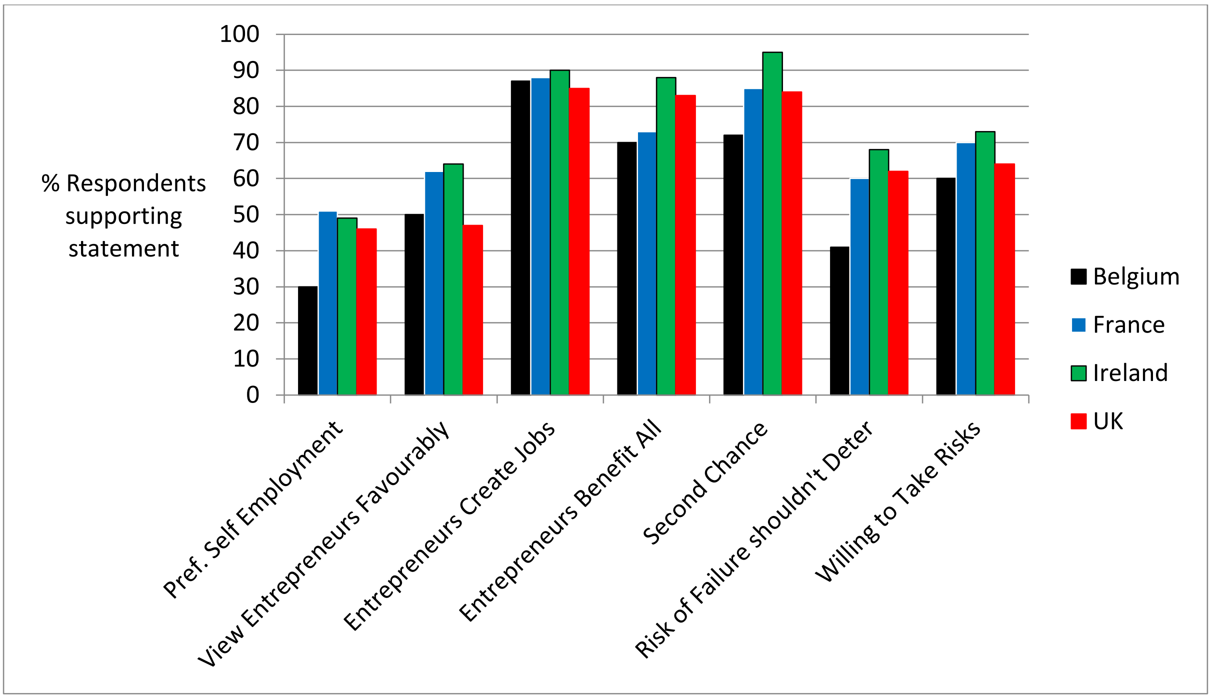

Figure 38: Public attitudes regarding entrepreneurship and business failure.

SOURCE: EUROBAROMETER ANALYTICAL REPORT (2009).

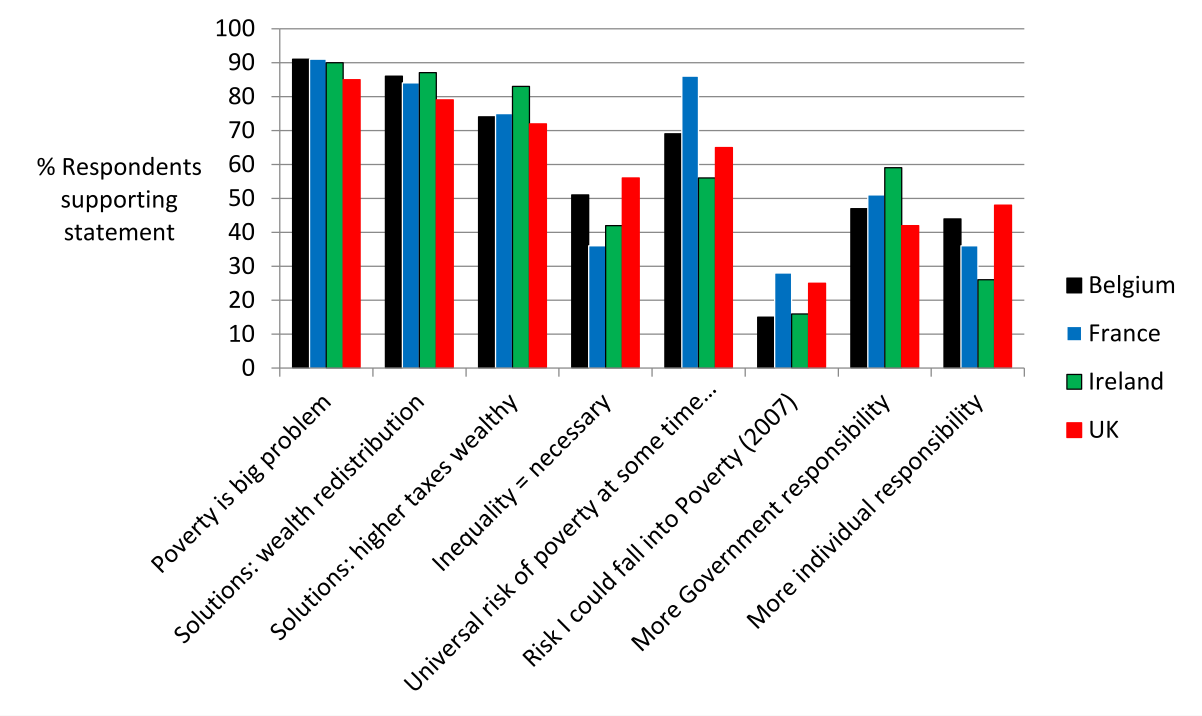

Figure 39: Public attitudes regarding poverty, inequality and wealth redistribution.

Sources: Eurobarometer (2010); TNS Opinion and Social, Special Eurobarometer - European Social Reality 62 (2007).

Chapter 3: Ranking National Laws: Data Tables

KEY FEATURES of PERSONAL INSOLVENCY LAW	POINTS RANKINGS
Access: Cost	1 = Free to Debtor plus free State-funded debt counselling; 2 = Insolvency procedure free to Debtor; 3 = Debtor pays trustee fee if sufficient income; 4 = Debtor must pay trustee in all cases; 5 = Minimum assets requirement *and/or* Debtor to pay deposit
Access: Other Conditions (apart from insolvency)	1 = None; 2 = Petition not abusive; 3 = economic conditions (e.g. qualified insolvency/means testing); 4 = Good faith/examinations of causes of insolvency, etc.; 5 = Good faith + exceptional economic conditions
Institution	1 = administrative (trustee) 2 = administrative (formal institution) 3 = administrative with court confirmation; 4 = court proceedings; 5 = several court appearances
Measures voluntary (i.e. subject to creditor veto) or imposed on creditors by an institution.	1 = imposed by court/agency; 2= 51% Creditor approval; 3 = 60% C approval; 4 = 75% C approval 5 = unanimous C approval
When is a repayment plan required?	1 = no repayment required; 2 = repayment where excess income; 3 = partial repayment in all cases, set by institution; 4 = partial repayment in all cases, set by creditors 5 = full/almost complete repayment in all cases
Property Exemptions (excluding protection of debtor's home, due to difficulty of ranking accurately the various approaches)	1 = no asset liquidation; 2 = reasonable items plus pension; 3 = uncapped reasonable items/judgments execution law exemptions; 4 = reasonable items capped at monetary value;

	5 = creditor discretion
Income Exemptions	1 = all income exempt *or* legal minimum budgetary standards; 2 = general civil judgment execution procedures thresholds; 3 = institutional discretion; 4 = creditor discretion with voluntary/guideline minimum budgetary standards; 5 = creditor discretion only
Discharge (assuming all systems provide for some non-dischargeable debts)	1= full in all cases; 2= full discharge in some cases; 3= partial discharge in all cases; 4= partial discharge in some cases 5 = no legal right to discharge/creditor approved/discharge of interest but not capital/10+ years of waiting
Waiting Period	1= immediate; 2= 12 months-3 years; 3 =C approval with statutory cap/3-5 years; 4 = 6-10 years legal maximum/depends on C approval/minimum repayment; 5 = 10 years legal minimum; 10+ years max.
Moral Judgments	1 = none; 2= denial of discharge or restrictions where fraud; 3 = good faith access; 4= good faith access + denial of discharge or restrictions where fraud; 5 = long-term restrictions/incapacities on all Debtors

Figure 40: Key features of national laws: coding conditions

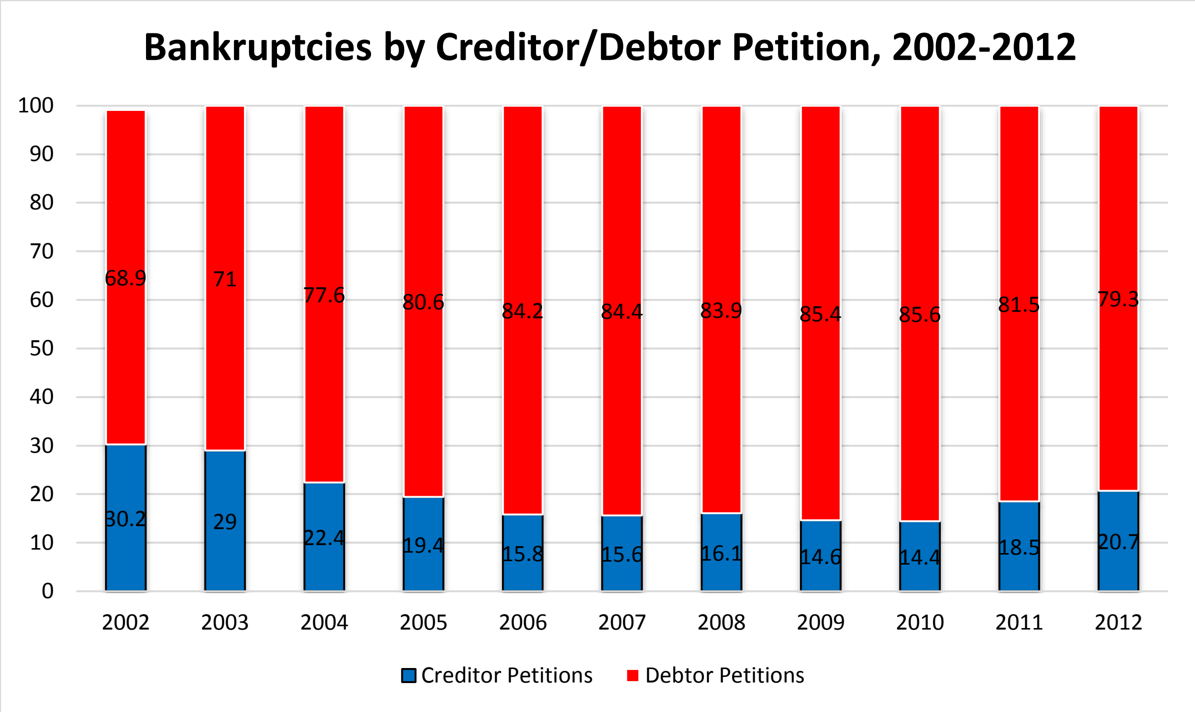

Figure 41: Bankruptcies by Creditor/Debtor Petition, England and Wales, 2002-2012
In England and Wales, Bankruptcies have increasingly become a debt relief mechanism, initiated by debtors rather than creditors. Source: The Insolvency Service

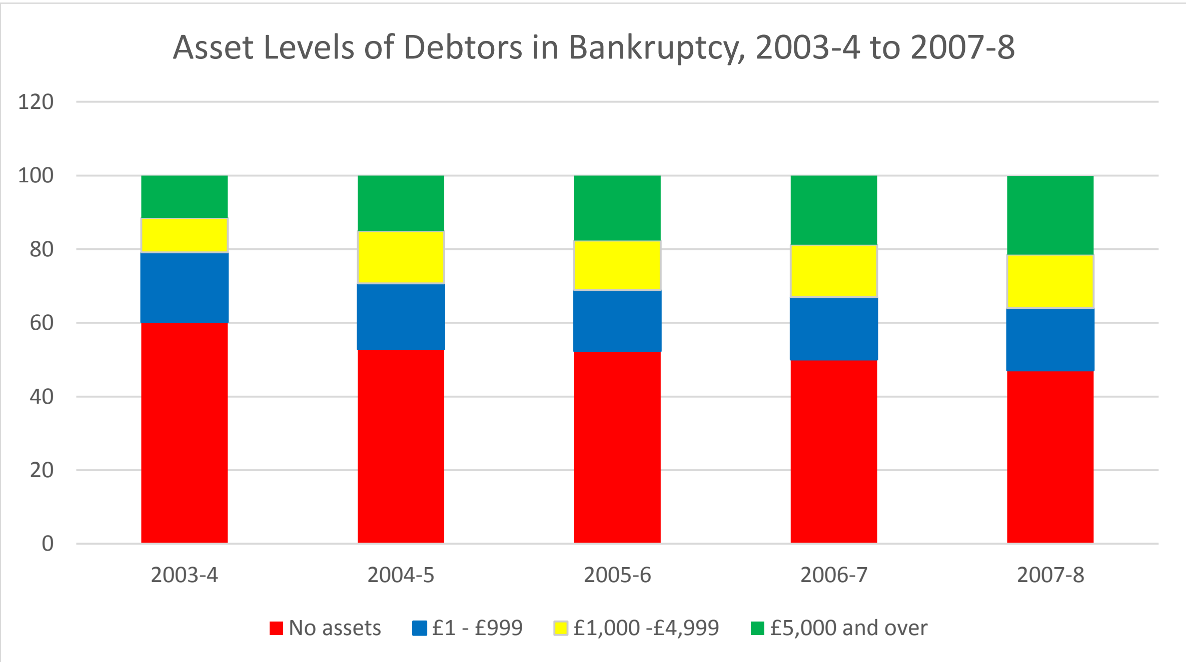

Figure 42: Asset Levels of Debtors in Bankruptcy, England and Wales, 2003-4 to 2007-8
Source: The Insolvency Service

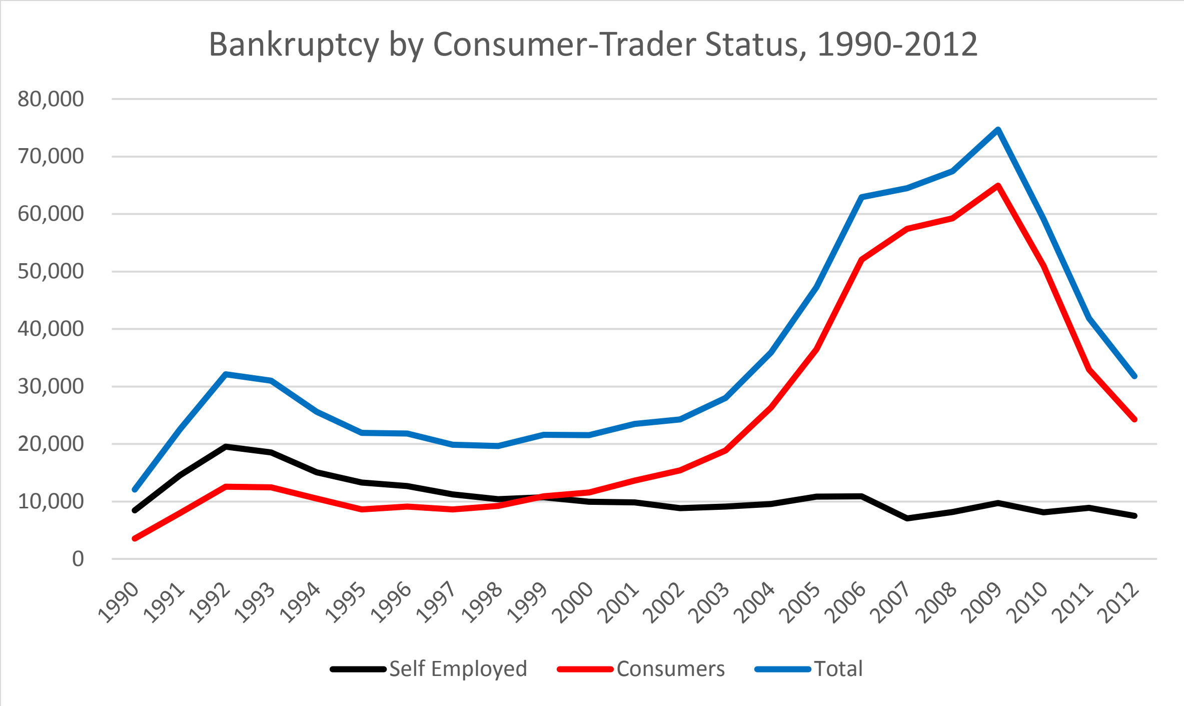

Figure 43: Bankruptcy by Consumer-Trader Status, England and Wales, 1990-2012

Sources: The Insolvency Service

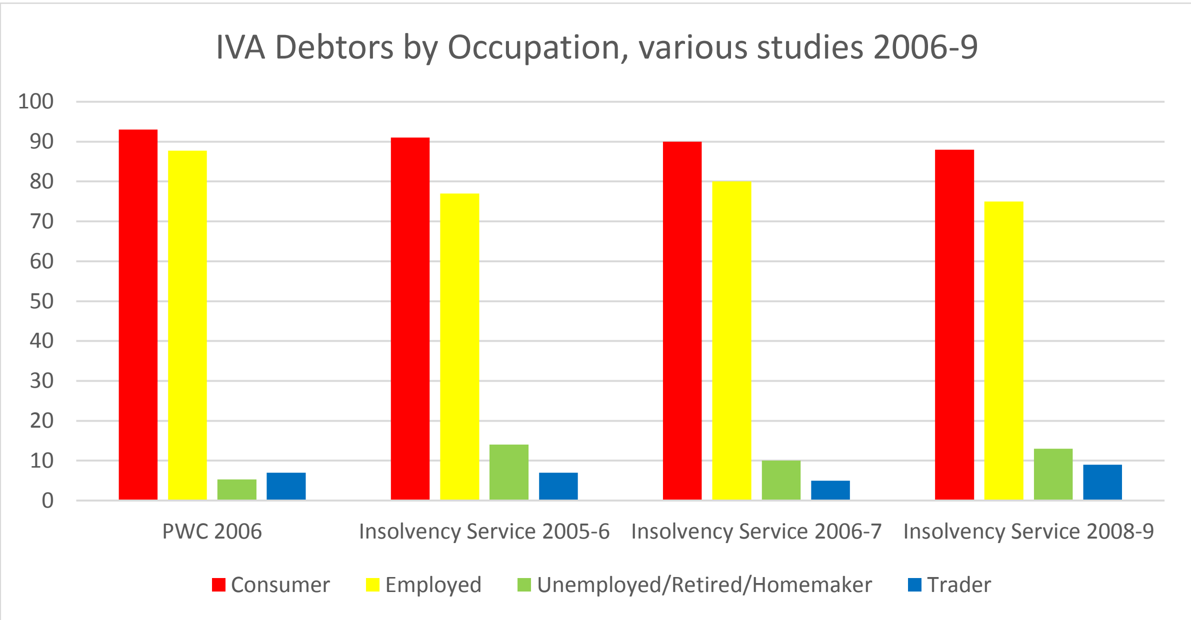

Figure 44: IVA Debtors by Occupation, various studies 2006-9

A large majority of debtors using the IVA procedure are consumers.[1656]

1656 PWC (2006); INSOLVENCY SERVICE (2008B); INSOLVENCY SERVICE (2009B).

(Mis)Conduct	**Insurance concept**	**Procedural v Substantive**	**Moral hazard: *ex ante* v *ex post***	**Debtor Characterisation**	**Treatment under English law**
Mere insolvency; no misconduct	Deductible/ co-payment	N/A	Both	All	Surrender of non-exempt assets; contributions to creditors from income; insolvency condition
Applying for debt relief while not insolvent	Exaggerating need for assistance	Procedural	Ex post	Dishonest	Insolvency condition
Lack of co-operation, full disclosure within procedure	Ex post monitoring: prevent exaggerated claim of need for relief	Procedural	Ex post	Dishonest	Suspension of discharge; BRO/U
Fraudulently incurring credit	Prevents creditor monitoring Risk entirely within insured's control	Substantive	Ex ante	Dishonest	Debt excluded from discharge; BRO/U
Criminal law fines, tort liability debts	Exclusion from coverage of risks wholly within debtor's	Substantive	Ex ante	Dishonest (except for certain excluded debts, e.g. family law obligations)	Debt excluded from discharge

	control; these creditors not "insurers" of debtor				
Transactions at undervalue; preferences Disposal of assets, etc.	Exaggerating need for relief, deliberately reducing costs of debt relief/evading moral hazard controls	Substantive	Ex post (action taken while debtor insolvent)	Dishonest	Debtor excluded from accessing DRO; BRO/U.
Borrowing without reasonable expectation of repayment	Duty on debtor to take actions avoiding risk	Substantive	*Ex ante*	Improvident	BRO/U

Figure 45: Means through which English personal insolvency law addresses debtor moral hazard concerns
(Apart from general costs of debt relief, i.e. surrender of assets/income, waiting period for discharge).

2002 Enterprise Act, Sch.4A(2)-(3)	**§§26-27 Bankruptcy Act 1914**
(a) failing to keep records which account for a loss of property by the bankrupt...; (b) failing to produce records of that kind on demand by the official receiver or the trustee;	(c) Failure to keep proper books of account within the three years prior to bankruptcy
(c) entering into a transaction at an undervalue...;	

(d) giving a preference...;[1657]	(i) giving a fraudulent preference within three months of the bankruptcy
(e) making an excessive pension contribution;	
(f) failure to supply goods or services which were wholly or partly paid for which gave rise to a claim provable in the bankruptcy;	
(g) trading at a time before commencement of the bankruptcy when the bankrupt knew or ought to have known that he was himself to be unable to pay his debts;	(c) continuing to trade by the bankrupt after knowing himself to be insolvent
(h) incurring, before commencement of the bankruptcy, a debt which the bankrupt had no reasonable expectation of being able to pay;	(d) contracting a provable debt without having at the time any reasonable expectation of being able to pay it
(i) failing to account satisfactorily to the court, the official receiver or the trustee for a loss of property or for an insufficiency of property to meet bankruptcy debts;	(e) failure to account satisfactorily for any loss of assets
(j) carrying on any gambling, rash and hazardous speculation or unreasonable extravagance which may have materially contributed to or increased the extent of the bankruptcy...	(f) bringing on or contributing to the bankruptcy by rash and hazardous speculations, and unjustifiable extravagance in living, gambling...
(k) neglect of business affairs of a kind which may have materially contributed to or increased the extent of the bankruptcy;	(f) bringing on or contributing to the bankruptcy by... any culpable neglect of business affairs
(l) fraudulent breach of trust	(l) the bankrupt being guilty of any fraud or fraudulent breach of trust
(m) failing to cooperate with the official receiver or the trustee.	
(§3) the bankrupt was an undischarged bankrupt at some time during the period of six years	(k) having previously been made bankrupt or made a composition or arrangement with his creditors

[1657] This should be read in accordance with the conditions for defining a preference in Insolvency Act 1986, §310.

ending with the date of the bankruptcy to which the application relates	
	(a) bankrupt's assets will not produce a dividend of 50p in the £ unless this is due to circumstances for which he cannot justly be held responsible
	(g) putting any creditor to unnecessary expense by frivolous or vexatious defence to any action properly brought against him
	(h) contributing to his bankruptcy by incurring unjustifiable expense in bringing a frivolous or vexatious action
	(j) incurring liabilities within three months of the bankruptcy with a view to making his assets equal to 50p in the £ on the amount of his unsecured liabilities
	(§26(2)) the bankrupt has committed any misdemeanour or felony connected with his bankruptcy
	§27 bankrupt has made settlement before and in consideration of marriage when unable to pay debts; or made covenant/contract before and in consideration of marriage for the future settlement on wife/children of any money/property in which he had not at date of marriage any estate or interest; with a view to defeat or delay creditors.

Figure 46: Standards of Debtor Behaviour in 2002 and 1914

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