FLOATING CHARGES AND MORAL HAZARD: FINDING FAIRNESS FOR INVOLUNTARY AND VULNERABLE STAKEHOLDERS

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A INTRODUCTION

Insolvency and bankruptcy are words that tend to conjure disappointment, fear, and blame in most corners of the globe, with the notable exception of the United States, which has the aura of rewarding risk-taking entrepreneurs by frequent do-overs. The same cannot be said for most of the rest of the world, particularly within the United Kingdom, which until quite recently has ever been hesitant to introduce insolvency or restructuring procedures that allow the debtor company's management to remain in control of the ailing firm. Along with these procedures, whether debtor in possession or otherwise, come adjustments to the rights and entitlements of creditors and other stakeholders associated with the company in financial distress. This includes, whether directly or indirectly, an impact on employees who are essentially involuntary creditors to an insolvency process entered by their corporate employer, along with other vulnerable and involuntary creditors such as franchisees and tort (or delict) claimants. Although there are a number of firebreaks that provide a buffer for employees under such circumstances in most countries, the underlying paradigm of the insolvency process resembles a re-commoditisation of labour as one of a number of stakeholders who become categorised in terms of preference, priority, and payment as creditors, reducing employees to the value of what they are owed for their labour.

While insolvency and restructuring have a significant impact on a debtor company's employees, there are also devices that may indirectly interfere with the full complement of employee rights, whether statutory or contractual. The UK also provides a device that gives a significant amount of power to a debtor company to continue to deal with its assets, despite those same assets being subject to the extensive charge of a lender: on the wind the floating charge arrives. Typically considered a common law device that is difficult to square with the law of security rights in civil law countries, the floating charge is a somewhat unusual device that is fairly unique in its form, scope, and function to the UK, although other common law jurisdictions have versions of the same concept. However, differences do appear between the English and the Scottish versions of the device, which are discussed elsewhere in this book.[1]

The floating charge as a concept undoubtedly affords a considerable amount of preference and control to the creditor who holds it and to the debtor which can continue to deal with the charged assets, and to potentially dissipate them in the normal course of business. Such power may overshadow any preferences and priorities available to vulnerable stakeholders, such as employees, and certainly over involuntary creditors such as tort victims, as there is no limitation on how such charged assets can be dealt with until and unless the collective format of insolvency and restructuring are put into place at a time of financial distress. The purpose of this Chapter is to explore the socio-legal aspects of the floating charge as it affects employees as vulnerable and involuntary stakeholders specifically, and asks the question as to whether it is possible to achieve fairness by an employee preference and set priority position over the floating charge, or whether it could be open to abuse due to moral hazards created by the power inherent in the floating charge device however and wherever a line is drawn.

B CONTEXT AND METHODOLOGY

(1) The Impact of Control and Scope of the Scottish Floating Charge

It must be admitted at the beginning that this author is not a Scots lawyer nor a Scottish legal academic, therefore the content of this Chapter will inevitably have a foundation in English law, but contrasts will be drawn wherever prudent and relevant. The concept of the floating charge is, however, fairly similar between the two jurisdictions and its creation in Scots law under the broadly worded statutory

[1] See M Raczynska, "An English Perspective on the Scots Law Floating Charge", ch xx.

formulation[2] means it is substantially the same as the common law position in English law.[3] As employment law of both jurisdictions is the same as it relates to employees in insolvency given that most of these specific regulations are derived from EU law, the protections and entitlements available are essentially equivalent as employment law within *Great Britain* (England, Scotland, and Wales) is not devolved from Westminster.[4] Further, English and Scots law often overlap and in the commercial law sphere they are frequently identical.[5]

There are, however, certain key differences in the enforcement of floating charges in England and Scotland that could have a different bearing on how employees are affected. In particular, the Scots floating charge attaches only to specific assets upon the appointment of a receiver, the commencement of liquidation, an administrator providing notice that there are insufficient assets to satisfy all creditors in full, or the court giving an administrator permission to make a payment that is neither secured or preferential, which differs from the English version which can crystallise much earlier and with a greater potential for covering a broad range of assets of the company in existence from time to time. The Scots floating charge also cannot convert into a fixed charge automatically, rather there is a bond indicated in the documentation that refers to the charger's undertaking to pay the underlying debt.[6] The Scottish floating charge is also statutory in nature as is the crystallization process. As a result, certain characteristics of the English floating charge are lacking, such as the ability to draft the device in a document that allows for automatic crystallisation upon the occurrence of certain events or to include the ability for a creditor to provide notice of crystallisation under certain circumstances. Thus there are already limitations that may prevent the high level of freedom exercised by English floating charge holders as compared to those in Scotland, which will already reduce the risk of abuse. That said, there is still a great deal of scope for creditors offering floating charge security to get quite a large bite of the estate apple when it comes to the insolvency of a debtor owing a loan secured by a floating charge.

The floating charge has certainly raised controversy in Scotland, being described as "utterly repugnant"[7] and unlike the English floating charge, remains covered by the Companies Act 1985 section 462(1).[8] It has been severely criticised as "not fitting into the framework of Scottish security law"[9] and has been described as a blunt instrument, if an effective one.[10] The Scottish floating charge effectively puts the lender benefitting from the charge granted by a company in control of an insolvency process entered into by the company owing the debt under the charge. Because the holder of a floating charge can appoint an administrator without the need for application to a court[11] and can essentially overrule

[2] See Companies Act 1985 s 462.
[3] J Hardman, "Some Legal Determinants of External Finance in Scotland: A Response to Lord Hodge" (2017) 21(1) Edin L Rev 30at 49 citing the example of *Re Panama, New Zealand and Australian Royal Mail Co* (1870) 5 Ch App 318.
[4] L Furber, "Employment Law in the United Kingdom – What Differences are there?" (Crunch 1st February 2020) available at *https://www.crunch.co.uk/knowledge/employment/employment-law-in-the-united-kingdom-what-differences-are-there/*.
[5] Hardman (n 3) at 40
[6] R Edgar and S Cooley, 'Taking Security: Some Key Differences between Scotland and England & Wales' (Shoosmiths, 29 November 2019) *https://www.shoosmiths.co.uk/insights/articles/taking-security-some-key-differences-between-scotland-and-england-and-wales#:~:text=In%20Scotland%20there%20is%20no,'bond%20and%20floating%20charge'*.
[7] So described in *Carse v Coppen* 1952 SC 233 at 239, as cited in Jonathan Hardman, *A Practical Guide to Granting Corporate Security in Scotland* (2018) para 6-03. See also A D J MacPherson, "The Pre-History of Floating Charges in Scotland", Ch xx.
[8] Hardman, *Practical Guide* (n 7) para 6-04.
[9] Ibid para 6-06.
[10] Ibid para 6-06; and see also on the academic debate around the Scottish floating charge: G L Gretton, "What Went Wrong with the Floating Charge?" (1984) SLT (News) 172 and "Should Floating Charges Be Abolished?" (1986) SLT (News) 325; D Cabrelli, "The Case against the Floating Charge in Scotland" (2005) 9(3) Edin L Rev 407; R Jack, "The Coming of the Floating Charge to Scotland: An Account and an Assessment" in D J Cuisine (ed), *A Scots Conveyancing Miscellany: Essays in Honour of Professor J M Halliday* (1987) 45-46; Hardman (n 3).
[11] Insolvency Act 1986, Sch B1 para 14. See also D McKenzie Skene, "The Floating Charge and Insolvency Law", ch xx.

winding up petitions,[12] they retain a significant amount of control of the appointments and the process. As an administrator is appointed by the floating charge holder in such circumstances, there have been unsurprising allegations that such a practitioner may have conflicts upon appointment with some loyalty paid to the entity that appoints them.[13]

A floating charge can also cover all or substantially all of the assets of a company,[14] thus not only is the control of the floating charge holder significant, but so is the scope of its reach in terms of the assets available to it for realisation to satisfy the debt. The administrator is also able to deal with the floating charge property as if it were not charged at all whereas fixed security charged property would require a court order in the absence of consent or discharge.[15] Thus, there is nothing apart from traditional corporate and securities law to protect against what would otherwise be perceived as an appropriate asset dissipation, but which could have a significant impact on returns to less powerful or vulnerable creditors in the event of an insolvency due to distributional priorities that favour security holders.

The floating charge holder also has an advantage when claiming from the insolvent estate as it will be entitled to returns before the body of unsecured creditors,[16] with some notable exceptions.[17] Fixed security, however, will rank prior in distribution to floating charges, unless there is an earlier floating charge with a negative pledge.[18] Although the "prescribed part" was introduced under the Enterprise Act 2002, which ringfences up to (now) £800,000 of the assets covered by a floating charge,[19] this amount can look quite small if one considers the level of debts of some of the more recent large insolvencies, such as Nortel and The Lehman Brothers and even more recently, companies such as Carillion, British Home Stores, and Thomas Cook. This prescribed part will be shared between not only standard unsecured creditors, but also employee wages that are not included in the employee preference or the state guarantee funds.[20] Given the level of debt that will be owed to employees as opposed to suppliers and banks, and the fact that such debts are paid by *pari passu* distributions to all those who participate in the prescribed part, employees are unlikely to benefit much from the prescribed part. The floating charge is therefore a powerful tool but, as queried by Hardman, "why should society accept the concept of one creditor receiving a preferential return as a result of this private bargain."[21] Although there are currently protections that aim to hedge against the impact of this preference on employees and other less powerful stakeholders, it is arguable that these do not go far enough given the invaluable contribution that employees make to a company that goes beyond the typical commoditisation of the value of their labour under the employment contract.

(2) Current Provisions Mitigating the Impact of the Floating Charge

(a) Super-priority/Preferential Creditors

In the UK, the Insolvency Act 1986 provides a certain level of preference for employee claims, including up to eight weeks of unpaid wages and up to six weeks of accrued of holiday pay, along with a basic award for unfair dismissal.[22] Such payments are made by the Secretary of State out of the

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[12] Ibid Sch B1 para 17.
[13] Hardman, *Practical Guide* (n 7) para 6-09.
[14] Ibid para 6-12.
[15] Insolvency Act 1986, Sch B1 paras 70 and 71.
[16] Ibid, Sch B1 para 65(3).
[17] Hardman, *Practical Guide* (n 7) para 6-14.
[18] Companies Act 1985 s 464(1)-(4).
[19] The Insolvency Act 1986 (Prescribed Part) Order 2003, SI 2003/2097, paras 2 and 3, as amended by the Insolvency Act 1986 (Prescribed Part) (Amendment) Order 2020, SI 2020/211 art 2(2).
[20] See V Finch and D Milman, *Corporate Insolvency Law: Perspectives and Principles*, 3rd edn (2017) 513-524.
[21] J Hardman, "Law and Economics of the Floating Charge", ch XX. See also Lynn LoPucki, "The Unsecured Creditor's Bargain" (1994) 80 Virginia law Review 1887 in which the author argues that any form of security is an agreement between A and B that C gets nothing, which runs counter to most contractual principles.
[22] Insolvency Act 1986 s 386 and Sch 6.

National Insurance Fund.[23] Insurance funds such as this can reduce the burden of the unemployed on the state during any interim period of unemployment that may require social protection following redundancy occurring as a result of a restructuring or insolvency.[24] The fund will cover unpaid wages and holiday pay as well as unfair dismissal settlements, redundancy payments, and pay-outs for failure to consult in the event of collective redundancies or transfers of undertakings. The National Insurance Fund is then subrogated to the rights of employees against the debtor company including their right as preferential creditors.[25] It should also be noted, however, that the payments made as a result of this preference is capped in terms of both the period covered and the amounts that can be claimed. The limits are adjusted from time to time by statutory instrument.[26] Employee claims beyond the preferred portion rank equally to those of other unsecured creditors.

In addition, certain pension contributions are also preferential. Unpaid employee contributions are preferential insofar as sums have been deducted but not yet paid into the pension scheme four months prior to the time of insolvency, with no ceiling on the amount of pension contributions that can be considered preferential under this category. Unpaid employer contributions to an occupational pension scheme are preferred but limited to 12 months prior to insolvency and connected to the amount of the national insurance rebate that is applicable. The pension preference is therefore limited to a percentage of the relevant earnings.[27] Preferential payments are payable out of the available assets of a company prior to ordinary *unsecured* claims, but also prior to the claims owed to floating charge holders once regular secured claims and administrative expenses have been paid.[28] Thus on the face of it, it would appear that the preference already takes into account the issues of floating charge holders grabbing assets prior to other creditors. However, given the discussion in section B about the reality of value ascribed to floating charge holders, much of the asset value may have already been absorbed by paying out the secured creditors in priority.

(b) The "Prescribed Part"

The Enterprise Act 2002 provided what could arguably be described as a buffer against the commodification of debt that the last several decades has seen evolve. The Act was the first of the UK's statutory shifts towards a corporate rescue ideology, reducing the power of the floating charge holder's power to commence a self-interested receivership to a clear favouring of the more communal, entity-based administration. It also introduced a mechanism aimed to mitigate the extent of losses that are generally borne by unsecured creditors.

The "prescribed part" inserted into the Insolvency Act 1986 s 176A "applies where a floating charge relates to the property of a company which has gone into liquidation, administration, provisional liquidation, or receivership" and requires that the insolvency practitioner ringfences a portion of the company's assets available in order to satisfy a certain proportion of unsecured debt.[29] The quantum is established by the order of a statutory instrument and in 2020 was raised to £800,000 from £600,000.[30] Although a government paper noted in 2018 that "the prescribed part payments very rarely reach the current cap" it is notable that the Government also observed that in those cases where the cap is reached,

[23] Enacted under the Employment Rights Act 1996 ss 166-170 and 182-190 as an implementation of Council Directive 80/987/EEC OJ 1980 L283.

[24] G W Johnson, "Insolvency and the Social Protection: Employee Entitlements in the Event of Employer Insolvency" (2006) Report written after the Fifth Forum for Asian Insolvency Reform 27-28 April 2006 in Beijing, China 7.

[25] Finch and Milman, *Corporate Insolvency Law* (n 20) 648.

[26] The Employment Rights (Increase of Limits) Order 2021 SI 2021 no 208. See also Finch and Milman, *Corporate Insolvency Law* (n 20) 522-523.

[27] D Pollard and I Carruthers, "Pensions as a Preferential Debt" (2004) 17 Insolvency Intelligence 65.

[28] Finch and Milman, *Corporate Insolvency Law* (n 20) 647.

[29] V Finch, "Corporate Rescue in a World of Debt" (2008) 8 JBL 756 at 764-766.

[30] The Insolvency Act 1986 (Prescribed Part) (Amendment) Order 2020, SI 2020/211 art 2(2) amending the Insolvency Act 1986 (Prescribed Part) Order 2003.

the raise will be to the benefit of unsecured creditors,[31] which will include most vulnerable creditors such as employees whose full claims were not covered in an alternative way along with tort and environmental claimants.

Empirical evidence has also demonstrated some interesting facts about the realisation of floating charges during an insolvency and the impact this has had on the creation of a prescribed part, as well as how relevant it is in terms of mitigating the adverse impact on unsecured creditors. In research conducted between 2006 and 2011 on 2,129 companies entering insolvency, 1,160 of these companies had given floating charge security with 704 of those companies granting floating charges following the enactment of the Enterprise Act 2002. Only 95 out of the 704 post-Enterprise Act insolvency procedures surveyed saw the creation of a prescribed part by insolvency office holders.[32] This was mainly because of the fragmented capital structure of the companies surveyed rather than any failure on the part of the office holder. Rather, the floating charge was used as a sweep-up security where other instruments were relied upon for most of the realisations instead. Where secured creditors' debts were fully repaid through exercising their rights under fixed charges, the floating charge was superfluous and no longer carried any value in terms of debt owed,[33] thus the prescribed part would have no value in such a case. Rather, as noted by Akintola, "where the fragmentation of a company's capital structure prevents the operation of the prescribed part provision, it would seem that the redistributive policy under the Insolvency Act is self-defeating."[34] The question of the floating charge's impact on vulnerable creditors in such a case is moot; rather, the whole modern debt financing apparatus needs to be considered insofar as it unfairly impacts vulnerable stakeholders. Although the Scottish floating charge may not be used in the same way, the England's experience with the relative effectiveness of the prescribed part in mitigating the losses of unsecured creditors may be instructive.

(c) The Effect of Insolvency on Employees and Other Vulnerable Stakeholders

There is no denying that an employer's insolvency can have a dramatic impact on its employees, whether this is due to a liquidation in which the company is wound up and all jobs are lost, or a restructuring or reorganisation, which may lead to uncertainties and redundancies as well as various insidious means of taking advantage of an employee's bargaining position as leverage to seek better terms that favour the position of the employing company. Although there are certain protections that may offer some solace to employees and allow them to mitigate their risk somewhat, employers will often account for the costs of failing to comply with employment obligations, such as consultation in the event of a collective redundancy,[35] which effectively monetises the rights of employees and leaves with them with the responsibility to press their rights in an employment tribunal. For example, Thomas Cook failed in their consultation duties during a collective redundancy process, which led to 1,500 employees filing a claim that would amount to eight weeks pay, though this could only be claimed from the National Insurance Fund and capped given the lack of assets left in the company.[36] Such payments also do not attract a super-priority as wages and holiday pay do.

The recent demise of Debenhams brought a unique problem to the company's administrators. The insolvency occurred during the COVID-19 pandemic during which many of the Debenhams workers were furloughed.[37] Administrators have 14 days within which to confirm they are adopting

[31] Department for Business Energy and Industrial Strategy, 'Insolvency and Corporate Governance: Government Response' (26 August 2018) available at*https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG_-_Government_response_doc_-_24_Aug_clean_version__with_Minister_s_photo_and_signature__AC.pdf*.

[32] K Akintola, "What is Left of the Floating Charge? An Empirical Outlook" (2015) JIBFL 404 at 404.

[33] K Akintola, "What is Left of the Floating Charge? An Empirical Outlook" (2015) JIBFL 404 at 406.

[34] Ibid.

[35] Trade Union and Labour Relations (Consolidation) Act 1992 Ch 2 Procedure for Handling Redundancies.

[36] A McCulloch, "Up to 1500 Former Thomas Cook Employees Win Payout" (*Personnel Today* 2021) *https://www.personneltoday.com/hr/up-to-1500-former-thomas-cook-employees-win-payouts/*.

[37] Coronavirus Act 2020 ss 71 and 76 provided the competence to create the Coronavirus Job Retention Scheme, the details of which can be found here: *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/879484/200414_CJRS_DIRECTION_-_33_FINAL_Signed.pdf*.

employment contracts, after which adoption is automatic. The employment contracts for the employees on furlough were incidentally adopted by administrators who continued to pay the them beyond the 14 days within which the decision to adopt their contracts had to be made. As a result, their salaries would be accorded the super-priority along with the employees that were intentionally retained. Salaries of adopted contracts would be counted as expenses of administration, which would accord those payments a super-priority over all other debts. With that said, by mid-August 2020, 6,500 employees had been made redundant, including those already furloughed and many who had continued to work during the pandemic. The administrators admitted openly that a full statutory consultation was not feasible in an insolvency situation "where the options available are limited and the administrators must consider their own duty to creditors."[38] Protective awards for failure to consult are paid preferentially in an administration, so will affect the distributions available to other creditors as well, which raises a whole other issue in terms of the fairness of employee entitlements and tribunal awards in such situations. As summarised by Chris Laughton, "…employees feel injustice, employment tribunals impose penalties which fall on innocent creditors, and administrators seek to treat all creditors fairly."[39]

There is ample evidence of the effect that powerful creditors and their security can have on the more vulnerable stakeholders of a company. The liquidation of British Home Stores (BHS) included questions around a floating charge held in the name of Phillip Green, which would have entitled him to get essentially all of his money back from the proceeds of the insolvency process. The Pension Protection Fund (PPF) was the biggest creditor of BHS, which demonstrates just how extensive the social impact can be for a company with a large number of employees. Were the floating charge held to be valid, it would have meant £35 million would not be available to satisfy the claims of the PPF. As it stood, unsecured creditors were only going to get a maximum of 8 pence on the pound of what they were owed.[40] This group would include involuntary creditors such as tort claimants and any additional claims of employees that were not covered by the preference.[41]

Another well-known insolvency in the recent past also relied on its pension schemes to mitigate some effects of its financial distress. The Carillion collapse highlighted the bad behaviour of directors and shareholders insofar as choices were made to pay out more in dividends than the company generated in cash, despite an increase in borrowing and a growing pension deficit.[42] The company financed its debt by borrowing against the value of the pension scheme itself.[43] The pension scheme was left without £2.6 billion that it was owed by Carillion. It also owed £2 billion to 30,000 suppliers, sub-contractors and other short-term and unsecured creditors, who would not be likely to get very much at all in a liquidation.[44] To add insult to injury, Carillion often paid late or otherwise stretched payment terms while encouraging supply chain finance.

Carillion owed more than £1.3 billion to banks when it entered compulsory liquidation and only had £29 million in cash at the time.[45] Banks with security would, of course, be able to exercise their enforcement rights against the assets charged. [46] In addition, The GLAS Trust Corporation, which had facilitated the advancement of a series of loans to Carillion, held fixed and floating charges over the

[38] Chris Laughton, 'Debenhams: What the Insolvency Process Means for Employees' (*Personnel Today* 2020) *https://www.personneltoday.com/hr/debenhams-what-the-insolvency-process-means-for-employees/*.
[39] Ibid.
[40] Zoe Wood, 'BHS Placed into Liquidation after Pressure from Biggest Creditor' (*Guardian* 2016) *https://www.theguardian.com/business/2016/dec/02/bhs-liquidation-pressure-biggest-creditor-ppf-philip-green-frank-field*.
[41] For more on the BHS insolvency, see for example I Clark, "The British Home Stores Pension Scheme: Privatised Looting?" (2019) 50(4) *Industrial Relations Journal* 331 and N Safari and M Gelter, "British Home Stores Collapse: the Case for an Employee Derivative Claim' (2018) 19(1) Journal of Corporate Law Studies 43.
[42] House of Commons Business Energy and Industrial Strategy and Work and Pensions Committees, *Carillion* (16 May 2018) 7.
[43] Clark, (n41) at 335.
[44] House of Commons Business Energy and Industrial Strategy and Work and Pensions Committees, *Carillion* (n 42) 7.
[45] F Mor et al, "The Collapse of Carillion" (Briefing Paper No 8206, House of Commons Library 2018) 9.
[46] Ibid 13.

company's assets and would be paid first in priority to unsecured creditors.[47] The overleveraging of Carillion and the way that its financing was structured resulted in the directors and shareholders both being the overall "winners" in the failure, while unpaid traders and suppliers as well as employees would lose out. As noted in the House of Commons:

> The consequences of the collapse of Carillion are a familiar story. The Company's employees, its suppliers, and their employees face at best an uncertain future. Pension scheme members will see their entitlements cut, their reduced pensions subsidised by levies on other pension schemes….
> But this sorry tale is not without winners. Carillion's directors took huge salaries and bonuses which, for all their professed contrition in evidence before us, they show no sign of relinquishing….
> Carillion was not just a failure of a company, it was a failure of a system of corporate accountability which too often leaves those responsible at the top – and ever-present firms that surround them – as winners, while everyone else loses out.[48]

There are clearly many issues that can cause unfairness in an insolvency, as indicated by the above examples. However, for the purpose of this Chapter, the floating charge and security in general and the priority afforded to them during an insolvency will be the focus. While employees in particular are granted a certain level of priority and preference over that of the floating charge holder, creditors with fixed charges will still be able to fully exercise their rights in most circumstances. Given the nature of employment as part of the human condition, this Chapter will query whether it is fair to place them within the realm of a factor of production once an insolvency has been commenced. Employees and involuntary creditors such as tort and environmental claimants, carry a certain vulnerability as they do not have the power or capacity to mitigate the risk that is taken when entering into a relationship with a company. To a lesser extent, many unsecured creditors are beset by information asymmetries and an imbalance in bargaining power as compared to banks and venture capitalists which makes their position also difficult to mitigate in terms of the risk they undertake. This Chapter will argue that these vulnerabilities should be taken into account when considering the fairness of security instruments, and in particular the floating charge. In order to derive a justification for this position, a theoretical framework will be introduced in the next sub-section relying on the application of vulnerability theory as developed by Martha Fineman.

(3) Theoretical Framework

One aim of this Chapter is to examine the issue of the floating charge and its fairness relative to vulnerable and involuntary stakeholders from a socio-legal perspective, rather than the typical efficiency perspective so often embraced by company and commercial law scholars. This means treading a line that attempts to balance two often conflicting areas of law and society: the need for a regulatory framework that allows businesses to thrive by attracting investment and another often-competing regulatory framework that provides a buffer for more vulnerable corporate stakeholders against the impact of unbridled self-interested capitalism, such as was so acute during the early Industrial Revolution in the United Kingdom and the United States in particular. The special nature of labour has often been a focus of democratic-socialists, labour politicians, religious leaders, and social activists. The key tenet of the International Labour Organisation that "labour is not a commodity"[49] echoes through the writings of Karl Marx[50] and Robert Owen.[51] The Encyclical *Rerum Novarum* "The

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[47] "Carillion Company Liquidation Case" (*Business Rescue Expert) https://www.businessrescueexpert.co.uk/carillion-compulsory-liquidation-contracts-employees/*

[48] House of Commons Business Energy and Industrial Strategy and Work and Pensions Committees, *Carillion* (n 42) 93 (para 39).

[49] Declaration of Philadelphia, Constitution of the International Labour Organisation (1992) 22.

[50] See for example, K Marx, *Das Kapital* (1867) *https://www.marxists.org/archive/marx/works/1867-c1/.*

[51] See R Owen, *A New View of Society Or, Essays on the Principle of the Formation of the Human Character and*

Workers Charter" written by Pope Leo XIII in 1950 also places the value of labour in connection with natural justice rather than that of the "invisible hand" of the market, as described by Adam Smith[52]:

> Let the working man and the employer make free agreements, and in particular let them agree freely as to the wages; nevertheless, there underlies a dictate of natural justice more imperious and ancient than any bargain between man and man, namely, that wages ought not to be insufficient to support a frugal and well-behaved wage-earner.[53]

Fundamentally, a person's labour cannot be fairly valued without consideration of the wider implications of what that value must go on to support. The employee is not simply selling his or her labour, they are earning a livelihood that must be applied to daily needs and also put by for the unforeseen and for old age.[54] In addition, regardless of the choice that it has been said that workers have in accepting employment, particularly clear in the "employment-at-will" doctrine still prevalent in the United States, employees really have little choice when accepting and maintaining employment. This lack of choice makes them vulnerable to the uncertainties caused by an employer's financial distress. Even when given a voice, insolvency processes tend to give the most power and the loudest voice to the creditor possessing the largest proportions of the debt owed. This would place individual employees on the bottom rung of the ladder. Even as a group, their voices are unlikely to be heard over the finance creditors holding floating charges over substantial assets of the employing company.

Given the clear vulnerability of employees in the context of an employer's financial distress and the clear uniqueness of employees as a group of creditors and stakeholders, a different approach to assessing fairness in their treatment during insolvency may add a new perspective on how their position should perhaps be reconsidered and how processes and devices such as the floating charge should be reconsidered as they impact these essential components of business. Such a perspective requires the consideration of values that cannot so easily be monetised and while modern law has gone some way to incorporating some non-economic values, it tends to be piecemeal dependent upon the particular fields of law in question. Thus, "values may provide some of law's content but are typically subordinated to the formal rational qualities that dominate it."[55]

A theoretical framework is therefore needed that considers the choices of all stakeholders affected by the decisions of a corporate entity. Law and economics considerations, and by extension the Jacksonian adherence to creditor wealth maximisation as the underpinning rational for insolvency procedures, is exclusionary.[56] It depends on legal ties connected to the law of contract. It does not allow for a balancing of the vulnerabilities caused by involuntary parties and information asymmetries inherent in processes instigated at the behest of a large creditor who may hold a floating charge. In fact, the efficiency metrics (Kaldor Hicks) used in law and economics calculations tend to benefit one party while harming the other over and over again. A socio-legal perspective, however, allows for an analysis of current legal structures in such a way that is directly linked with the social situation to which the law applies,[57] thereby allowing for a focus on the impact on stakeholders who may be involuntary parties to an insolvency and unable to adjust their level of risk accordingly.

One of the key underlying precepts of collective insolvency procedures globally is that of equal treatment,[58] although there are so many priority carveouts that it is arguable whether this remains the

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the Application of the Principle to Practice (first published 1816, Political Economy Reference Archive) *https://www.marxists.org/reference/subject/economics/owen/index.htm*.

[52] See A Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (first published 1776, 1993).

[53] Leo XIII, *The Workers' Charter: The Encyclical Rerum Novarum* (1950).

[54] See for example P O'Higgins, '"Labour is not a Commodity"-an Irish Contribution to International Labour Law' (1997) 26 ILJ 227.

[55] R Cotterrell, "Theory and Values in Socio-legal Studies" (2017) 44(S1) Journal of Law and Society 19 at 26.

[56] See T H Jackson, *The Logic and Limits of Bankruptcy Law* (1986).

[57] D N Schiff, "Socio-Legal Theory: Social Structure and Law" (1976) 39(3) MLR 287 at 287.

[58] The *pari passu* principle is said to be the "foremost principle in the law of insolvency around the world." See

case.[59] Martha Fineman notes, in respect to equality of treatment between individuals, that where equality is "reduced to sameness of treatment or a prohibition on discrimination, this has proved an inadequate tool to resist or upset persistent forms of subordination or domination."[60] Further:

> This version of equality is similarly weak in its ability to address and correct the disparities in economic and social wellbeing among various groups in our society. Formal equality leaves undisturbed- and may even serve to validate – existing institutional arrangements that privilege some and disadvantage others.[61]

Although the treatment of creditors already carries with it the obligations that were in place under contract for the repayment of debts due, the nature of debts for goods and services or for loans is different in nature from the obligations owed to employees under an employment contract. While there are certainly debts in terms of wages for work undertaken, the relationship is far more complex and far-reaching in terms of social implications. Equal treatment in such circumstances is not necessarily fair treatment given the varying degrees of power that different categories of stakeholders will have in an insolvency process. This is also why so many carveouts already exist to this so-called fundamental principle, such as the categorisation of preferential debts that is often applied to employee claims.[62] It should be noted that in the United Kingdom context this preference is extremely limited in terms of what is likely to be owed to employees, any excess of which would either have to rank as an unsecured debt or to be paid through the National Insurance Fund.

Although Martha Fineman's vulnerability theory was constructed with the very human dependencies associated with social and cultural discrimination that have not been mitigated fully by the models of equal protection that currently underpin civil rights law and discourse, with some adjustment it can also provide a new lens through which to view legitimately vulnerable stakeholders to a corporate insolvency. Equality may even be an unjust measure when it is applied to "situations of inescapable or inevitable inequality where differing levels of authority and power are appropriate" such as in an employer/employee relationship.[63] Extending this to insolvency situations, it can serve to recalibrate fairness between the clearly differential power structure among the various stakeholders due to the rights attached to security and regulatory priorities where applicable.

Fineman observes that the term "vulnerable" can be used to describe:

> …a universal, inevitable, enduring aspect of the human condition that must be at the heart of our concept of social and state responsibility. Vulnerability thus freed from its limited and negative associations is a powerful conceptual tool with the potential to define an obligation for the state to ensure a richer and more robust guarantee of equality than is currently afforded under the equal protection model.[64]

Fineman goes on to explain that "the concept of vulnerability can act as a heuristic device, pulling us back to examine hidden assumptions and biases that shaped its original social and cultural meanings."[65] Vulnerability can then provide a valuable context within which critical perspectives on political, societal, and legal institutions can be constructed.[66] A focus on vulnerability goes beyond the normative claims for equality generally, whether formal or substantive, and suggests the interrogation of what may be "just and appropriate mechanisms to structure the terms and practices of inequality."[67] Currently,

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A Keay and P Walton, "The Preferential Debts Regime in Liquidation Law: in the Public Interest" (1999) CfiLR 84 at 85 as cited in R J Mokal, "Priority as Pathology: the *Pari Passu* Principle" (2001) 60(3) CLJ 581.

[59] For a full discussion on the realities of *pari passu* in the context of regulatory priorities, see Mokal 1 (n 59).

[60] M Fineman, "The Vulnerable Subject: Anchoring Equality in the Human Condition" (2008) 20(1) Yale Journal of Law and Feminism 1 at 3.

[61] Ibid.

[62] Mokal (n 58) at 584.

[63] M Fineman, "Vulnerability and Inevitable Inequality" (2017) 4(3) Oslo Law Review 133 at 135.

[64] Fineman (n60) at 8-9.

[65] Ibid at 9.

[66] Ibid at 9.

[67] Fineman (n63) at 134.

insolvency procedures continue to be guided by economic paradigms, principally due to its association with corporate law which continues to be shielded to some extent in the United Kingdom, and to a larger extent in the United States, by the continued reliance on the free-market of Western capitalism.[68] However, given the social implications of corporate insolvency, an adjusted perspective that takes in these non-economic features is overdue.

By placing vulnerability at the centre of the social policies that have come to influence the preferences and entitlements for employees in insolvency law, it is possible to re-evaluate current approaches and to also consider the vulnerability of the institutions themselves. As has been evident in the age of COVID-19, some institutions will fail in the face of market fluctuations caused by sudden economic shocks such as lockdowns. By focusing on stakeholder vulnerability, it is also possible to uncover the weaknesses of the institutions in place that were intended to respond to that vulnerability, such as in the case of UK insolvency law, the prescribed part or certain preferences for employees.[69]

Vulnerability theory provides a different perspective from which the treatment of employees (and other vulnerable and involuntary creditors) can be viewed that considers the broader social implications of their role in society and the impact upon this that an insolvency of their employer may have, along with how they may be affected by the exercise of rights held by more powerful creditors, such as floating charge holders. Achieving a balance between the contractual obligations implicated and affected by security and the economic needs of the availability of security and the social impact that the control and priority of security provides, particularly in a situation of insolvency, is inherently value laden. Although commentators and scholars of corporate and insolvency law often prefer to avoid the determination of social value in a corporate or commercial context as will be discussed in the section C, there can be no denying that the social impact remains and should therefore at least be considered in the context of achieving fairness in the balance between social and business interests. As noted by Fineman, as "law should recognise, respond to, and, perhaps, redirect unjustified inequality, the critical issue must be whether the balance of power struck by the law was warranted."[70] Although she generally refers to equality between individuals, given the differences between powerful creditors and those who are involuntary creditors to an insolvency as well as the value-laden characteristics of some of the more vulnerable involuntary creditors, a rethinking of the equalities ascribed to insolvency procedures is also worth undertaking.

(4) Presentation of the Chapter

This Chapter will be examining the potential moral hazard associated with the power of floating charge holders and other security interests when considered in the context of vulnerable and involuntary stakeholders, primarily employees. Section B will present a number of theoretical perspectives that will help to contextualise the associated issues of debt, insolvency and financial regulation and the values ascribed thereto. The Chapter will then discuss the theoretical justification for the interference with pre-insolvency entitlements that the priorities and preferences ascribed to employees present. The fairness of floating charges and other security devices to involuntary and non-adjusting creditors and stakeholders during an insolvency will then be considered within the context of the oft-conflicting priorities of capital versus labour. Finally, the chapter will return to vulnerability theory with a view to suggesting certain adjustments in perspective and approach that will account for the inherent vulnerability of employees in an employers' insolvency and whether the current framework of protection is adequate under the circumstances, which will be followed by a conclusion considering the current changes to law and society over the last few years and the potential impact this has had or will have on the need to protect vulnerable insolvency stakeholders going forward.

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[68] Fineman (n60) at 5.
[69] Ibid at 12-13.
[70] Fineman (n 3) at 142.

C PERSPECTIVES ON DEBT, INSOLVENCY, AND MORAL HAZARD

(1) The Moral Dimension of Debt

Debt used to have an intrinsic moral dimension tied to the human condition. While early banks could only advance loans against the deposits held within the bank, this is no longer the banking norm. Today dispensing with debt has become a financial decision as institutions tend to treat individual debt obligations as profit-making and capital freeing instruments. Granted, in order for banks to lend to individuals, they must first have capital to provide to borrowers and capital can only be freed if banks can also free themselves from the debt of their borrowers, often by selling it on through the complex securitization transactions, such as those that were at least partially indicted by assessments of the financial crisis of 2007/08. However, the extent to which debts can now be separated from the individual who owes them is reflective of fundamental changes in how debt is perceived in the modern financial context, particularly when compared to the anthropological origins of debt as a concept. Modern securities such as the floating charge are examples of how far debt has evolved from its early conception.

Debt and credit have an extraordinarily long history lying well outside their current financial aspects. It has been said that the origin of modern debt and credit lies in a sense of human community, mutual obligations, and morality.[71] It has been viewed as a product of humanity's existential condition owed by virtue of the natural mutual protections afforded by living in a society or, from a metaphysical perspective, the existential debt owed to a supreme being.[72] Those living proper and moral lives are obliged to constantly repay the existential debts owed to one another. This evolved into a social obligation over time related to a reputation for honesty and charity,[73] something that can be traced to the early developments of social contract theory as well.

Over time, this connection between debt and morality has changed fundamentally. The impersonal market and state regulation replaced moralistic social networks. The legalisation of lending with interest has allowed for the growth of the finance industry as it is known today.[74] While today debts and credits have taken on an impersonal and purely financial character within a specific legal framework, their derivation is in good faith, socially acceptable behaviour and reputation that create the "credit" of an individual in society.[75]

It is rare today to find an individual or a company that does not live in a perpetual state of financial debt: it is the accepted status quo of the human condition and the conditions of the free market and capitalism, which has essentially commoditised the value of debt into something that has been separated from its moral roots and which also leads to the fragmentation of credit and invention of clever debt instruments such as the floating charge, which allows large creditors to further mitigate the risk of their lending.[76] It has become abstracted from any proprietary interest that a debtor may have had over it; banks do not ask a mortgagor if they can sell their "IOU" on to hedge funds, insurance companies, or other financial institutions, despite that by all appearances, debt has a proprietary nature. It also does not matter that security can be granted over non-specific assts and in relation to unspecified or generalised financial needs as is done by the granting of a floating charge.

(2) Financial Regulation and Economic Efficiency

The financial sector has long benefitted from a neo-liberal economic approach to its regulation. This has allowed innovation in investment and profit-making, creating new and different debt instruments

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[71] D Graeber, *Debt: The First 5000 Years* (2011) 1-19.

[72] This is a primordial debt "owed by the living to the continuity and durability of the society that secures their individual existence" from G Ingham, *The Nature of Money* (2004) 90.

[73] D Graeber (n 71) and J H Munro, "The Medieval Origins of the Financial Revolution: Usury, Rentes and Negotiability" (2003) 25(3) The International History Review 505-562, 506.

[74] Graeber, *Debt* (n 71)332-333.

[75]Ibid 56-57; according to Munro (n 733) at 506, usury is defined as the exaction of interest or of any specified return beyond the principal value of a loan.

[76] Finch (n 29) at 765.

and ways of selling and packaging them in order to increase bank liquidity, permitting more and greater lending to individuals and businesses. However, much lending now lacks the moral underpinning that has traditionally characterised debt and credit, which raises the question of how abuse can be avoided without engaging in morally hazardous activities that may place more vulnerable and involuntary creditors of a company at greater risk of higher losses in an insolvency due to the power that debt instruments such as floating charges afford to both the secured creditor and the lender. It must be queried, then, if a purely economic approach to regulation of the financial market is adequate, particularly given the distance that has evolved between debt and the human element of it and the ease by which it is now disposed.

The principles of law and economics provide an analytical framework within which a balance between social and commercial interests is sought. The basis of an economic approach to legal rules assumes that the people involved in a legal system will act rationally to maximise their own satisfaction.[77] In an economic analysis of the law, if two opposing sides of an issue behave rationally, they will find a balance that maximises the benefits/happiness of each side when an outcome is uncertain at the outset.[78] Rational maximisation within a legal system suggests that by putting a conceptual price on legal rights and remedies, it will be possible to create legal rules that maximise effectiveness by finding the perfect balance of economic efficiency between competing aims.[79]

Law and economics define a good legal system as one that keeps the profitability of businesses and the welfare of people aligned, so that the pursuit of profit also benefits the public. This is somewhat reflective of the ideals of utilitarianism, a fairly hedonistic and secular political theory that places the overall pleasure or perhaps satisfaction of humanity as the defining characteristic of what is "right" for humanity in terms of political and legal structure.[80] However, while classical utilitarianism seeks to maximise the sum of all individuals' functions in terms of utility, law and economics aims to try to maximise social wealth rather than social utility. Goods should be awarded to those individuals who are willing to pay the most, not to those for whom those goods will have the highest utility. Fines and sanctions then become a deterrent if they are set at a level that people are unwilling to "pay the price" for doing the unwanted behaviour. The trick is to set the price at a level that deters the behaviour but does not deter one from engaging in some risk, particularly if applied to economic activity.[81] While true that sanctions may prevent unwanted and costly behaviour, it would be economically inefficient in terms of regulating the financial market to set those sanctions at such a level that no one would want to lend, invest, or follow entrepreneurial ideas. Thus, a balance needs to be struck to find the point that deters enough behaviour to retain some order in the market, while not discouraging some risk in the market.

One problem with the law and economics theoretical framework is that it has been perceived as being of a specifically free-market, capitalistic ideology and even an apology for conservatism. While it is not intended to paint capitalism as "evil", it must also be acknowledged that it does not often consider those elements of society that fall outside of the markets and profit, or that are impacted by imbalances in the power of choice, such as employees and other involuntary creditors in an insolvency situation. If economic efficiency depends on what people are willing to pay, then by association, a person's willingness to pay is directly connected to what they are able to afford. Thus, the more wealth one has, the more likely it is that it can be increased in a system built on models of pure economic efficiency. Its precept tends to support unequal income distribution and can also be exemplified in the power differential between those holding little of the debt proportion in an insolvency and those that hold substantially all of the assets hostage as could be the case for a floating charge holder, which may have a detrimental effect upon the insolvency outcomes for other stakeholders.

Ronald Coase's theory, developed in the 1960s, on social costs posits that in circumstances where two activities conflict, the costs should be assessed as the combination of both activities. For example, where a train passing by a farmers' field causes crop damage, there should be a compensation

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[77] R A Posner, "Utilitarianism, Economics and Legal Theory" (1979) 8(1) JLS 104.
[78] R A Posner, "Observation: The Economic Approach to Law" (1974) 53 Tex L Rev 761.
[79] Ibid at 764.
[80] M Freeman, *Lloyd's Introduction to Jurisprudence*, 9th edn (2014) chs 2 and 3; B Bix, *Jurisprudence: Theory and Context*, 6th edn (2012) ch 3.
[81] U Gneezy and A Rustichini, "A Fine is a Price" (2000) 29(1) JLS 1.

that balances the requirements of supply and demand for the services of both the farmer and the railway. Both the train and the farmer provide a social benefit that can be quantified economically, which can make it difficult to assess where the compensatory obligation should lie in perfectly economic terms. A balanced approach would allocate the costs to both farmers and railways and allow for both to continue to co-exist and provide their benefits to society as a whole.[82] This analysis, however, tends to ignore transaction costs. Without such costs parties would tend to negotiate on an equal footing to achieve a mutually beneficial transaction while internalising the social costs. This does not reflect reality, however.

Applying Coase's theory to the need to achieve a balance between social costs and the highly complex and depersonalised characteristic of modern financial regulation does not necessarily amount to a true balance of fairness between society and economy. It does not consider external obstacles and influences or the inherent imbalance in bargaining power between the various parties. Regulation has been created to control industrial pollution, noise and other noxious or anti-social effects of industry, but the commoditisation of debt presents an entirely different social cost. If debt is fundamentally an obligation or promise, what happens when that promise is mixed with other promises, amalgamated, divided, sold and dispersed to the point that it can no longer be identified in connection with the goods or services to which it was originally connected? Granted, debt is itself only a concept having no true physical existence, at least not since the un-pegging of major currencies from the gold standard, and even then money only represented a promise to pay something else of equivalent value, accepted only because it is assumed that others will also accept it as valuable in exchange.[83] That said, if debt is to remain a promise, surely the person who made that promise should remain connected to it in some way.

(3) Justifying Priority for Secured Debt and Floating Charges

There are many rationales for the protection of the rights of creditors who bargain for security over their lending. There has long been a fairly widespread consensus among both legal scholars and economists that "according full priority to secured creditors is desirable because it promotes economic efficiency."[84] The accordance of a priority in repayment in respect of a secured loan, which is common in many legal systems, may not result in secured creditors obtaining the full value of their claims, but they still tend to be substantially advantaged over unsecured creditors or other more vulnerable involuntary (non-adjusting) stakeholders. Unsecured creditors will only have a claim to those assets that are left after the secured creditors have taken their share,[85] effectively subordinating the claims of unsecured and non-adjusting creditors to the creditor with security without their consent, which is theoretically contrary to the mandatory rules of insolvency that do not allow for the circumvention of distribution rules by way of subordination.[86]

In the case of England and Scotland, unsecured and non-adjusting creditors may only be left with what has been circumscribed by the prescribed part out of a floating charge, which as has been described above, may not even exist if the same creditor retains a fixed charge that has already satisfied the fullness of their debt, leaving the floating charge valueless. In circumstances where vulnerable or involuntary creditors do not have the same kind of support or power that even the median group of unsecured creditors do, this could have an even more significant impact. See, for example, the discussion of British Home Stores in section A.

The consensus supported by these many rationales fall back on the premise supported by well-known insolvency law theorists such as Thomas Jackson and Douglas Baird that "[b]ankruptcy law

[82] R H Coase, "The Problem of Social Cost" (1960) 3 Journal of Law and Economics 1. See further discussion in Hardman (n 21).
[83] Graeber, *Debt* (n71) 47.
[84] L A Bebchuk and J M Fried, "The Uneasy Case for Priority of Secured Claims in Bankruptcy" (1996) 105 Yale LJ 857 at 859.
[85] Ibid at 861.
[86] Ibid at 857-858.

should change a substantive non bankruptcy rule only when doing so preserves the value of assets for the group of investors holding rights in them."[87] Further, Baird and Jackson have asserted that:

> Protecting the value of a secured creditor's non-bankruptcy rights – whatever they might be – actually reinforces the bankruptcy policy of putting the firm's assets to their best use by placing the costs of trying to keep the assets of a firm together on those who stand to benefit from such an effort.[88]

Although the "bankruptcy policy" referred to in the quote above is specifically United States' policy, many jurisdictions reflect a similar approach to secured credit, offering protection to the point that they are excluded from the collective procedure in some cases. This leaves secured creditors in some jurisdictions free from the restrictions of a stay or moratorium and able to enforce their security despite the company being subject to a collective insolvency procedure. In addition, the Scottish floating charge has been described as an insolvency tool, rather than a traditional real right in security, which grants an additional level of security and risk mitigation for creditors holding such charges.[89] These priorities are based on the bargains made between debtor and creditor; however, only larger and powerful creditors tend to be able to afford the high level of risk mitigation provided by a floating charge. It therefore creates a higher level of priority that is justified as having been paid for by the secured creditor. This approach embraces the application of a law and economics approach to insolvency and restructuring law, which tends to follow the creditors' bargain theory in many respects still today.

The creditors' bargain theory supported the view that the objective of insolvency law was to provide a collective debt mechanism for the creditors of an insolvent entity and therefore, the legitimacy of an insolvency procedure depended on its ability to maximise the value of the debtor's estate for distributions.[90] This theory also claimed that pre-insolvency entitlements should only be impaired in insolvency when necessary to maximise the net asset distribution to the collective of creditors and never to accomplish strictly distributional goals.[91] Thus insolvency laws influenced by this theory tended to be hostile toward the redistribution of wealth post-insolvency.[92]

There have only been limited successful explorations of alternative theories of insolvency law that take in the many social, involuntary and non-financial stakeholder interests that are inextricably associated with business and corporate failure. This is particularly true given that the creditors' bargain model is fraught with problems, not the least of which being that it was created to explain a process that has existed in some form for two millennia and longer in some ancient civilisations (for example, the Hammurabi dynasty in Babylon, 2250 BC)[93] and was developed as a reaction to pre-existing conditions relating to debt. Rather, bankruptcy is not "the logical outcome of ethical principles consciously adopted and consistently applied by perfectly rational legislators; it is instead the product of social exigency, moral conflict, and political compromise."[94] In short, the result of over indebtedness and financial failure is messy and it is the messiness that collective procedural frameworks have been created to control and improve for the benefit of all creditors and, more recently, stakeholders in the future of the

[87] D G Baird and T H Jackson, "Corporate Reorganisations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy" (1984) 51(1) U Chi L Rev 97 at 99.

[88] Ibid at 101. "Insolvency" and "bankruptcy" will be used interchangeably in this section due to the discussion of American theorists. "Bankruptcy" refers to both corporate and personal insolvency in the United States, whereas "bankruptcy" traditionally refers to personal insolvency in the UK.

[89] See J Hardman, "Hohfeld and the Scottish Floating Charge" and Chapter 6 in A McPhearson, *The Floating Charge* (2020).

[90] Jackson, *Logic and Limits* (n 56) 2-3.

[91] R E Scott, "Through Insolvency with the Creditors' Bargain Heuristic" (1986) 53 U Chi L Rev 690 at 692.

[92] D G Carlson, "Bankruptcy Theory and the Creditors' Bargain" (1992) 61 U Cin L Rev 453 at 457.

[93] See L Levinthal, "The Early History of Bankruptcy Law" (1918) U Pa L Rev 223; for a detailed history of bankruptcy law over the last two millennia, see P Omar, *European Insolvency Law* (2004).

[94] D G Carlson, "Philosophy in Bankruptcy" (1987) 85(5/6) Mich L Rev 1341 at 1389 as summarised by D R Korobkin, "Contractarianism and the Normative Foundations of Insolvency Law" (1993) 71 Tex L Rev 541 at 543.

company.[95] Add to that the pull of social policy issues that include vulnerable stakeholders who are unable to adjust their financial risks, and the issues becomes tortuous.

Some theorists have tried to depart from the creditors' bargain. For example, Donald Korobkin presents an "insolvency choice" theory,[96] a value-based account that attempts to explain insolvency law,[97] which was necessary in his view because previous theories were "limited by the economic account's vision of insolvency law as a mechanism for achieving superior economic returns",[98] which in turn, limited choices to economic outcomes only.[99] Essentially, Korobkin viewed the economic accounts as being "incapable of recognising noneconomic values essential to a vindicating explanation of corporate reorganisation".[100] Indeed, insolvency law has emerged as a system with varied contours and dimensions that satisfy interests that go well beyond simple wealth maximisation.[101]

Korobkin's view recognises that the outcomes of financial distress, such as a foreclosure by a secured creditor or sale of assets to satisfy a floating charge holder, have more than just an economic impact on the company, rather it involves a range of issues such as loss of employment and economic activity. Furthermore, given the higher level of procedural complexity that reorganisation and restructuring present, which tend to be the current aims of most insolvency procedures, a purely economic account does not fully explain or justify their use. Rather than liquidate a company, reorganisations and restructurings aim to rehabilitate it with the success of such a procedure predicated on the corporation surviving as a going concern or at least existing long enough to maximise distributions to creditors.[102]

It is not only creditors that participate in Korobkin's model but rather all that are impacted by an insolvency within a society.[103] The aim is to define a "procedure of choice that satisfies basic notions of fairness" while ensuring that the principles do not "offend our most strongly considered judgments about how society ought to respond to the problem of financial distress".[104] Where a solution that exclusively focuses on creditor wealth maximisation would often lead to the liquidation of the business to distribute proceeds to creditors, such an outcome would not necessarily satisfy the needs of employees or their dependents. For example, the application of creditor wealth maximisation would require that the business of a financially distressed company be sold whenever it would result in the largest distribution in money to creditors, despite the fact that the business might still be viable and also support numerous employees relying on it as their exclusive source of income.[105] Plainly, the preferential treatment of some parties in insolvency frameworks is a departure from normal priorities, but meets a social need to protect more vulnerable parties. While this concept does not fit neatly within the definition of collective principles of insolvency law, it does allow such a framework to satisfy a broader set of needs than the strict adherence to contractual entitlements and priorities.

Elizabeth Warren has also challenged the creditors' bargain theory as a premise for insolvency law. She recognised that the distributional issues arising in insolvency have an inherent give-and-take character; for example, when a secured creditor enforces against an insolvent estate, this often defeats, at least partially, the collective rights of unsecured creditors who will not get their full contractual due.[106] Warren challenged the creditors' bargain theory, redefining it as an argument about economic rationality in which the aim of the policies underpinning insolvency law were to make sure that assets

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[95] See for example G-J Boon, "Harmonising European Insolvency Law: The Emerging Role of Stakeholders" (2018) 27 International Insolvency Review 150.

[96] A similar communitarian approach to the Creditors' Bargain Theory based on a hypothetical situation in which the principles of an insolvency system are selected by participants. An explanation of the Creditors' Bargain Theory will follow in this section.

[97] D R Korobkin, "Rehabilitating Values: A Jurisprudence of Insolvency" (1991) 91(4) Colum L Rev 717 at 721.

[98] Ibid at 737.

[99] Ibid at 738.

[100] Ibid at 740.

[101] Ibid at 739.

[102] M J Roe, "Insolvency and Debt: A New Approach to Corporate Reorganisation" (1983) Colum L Rev 527 at 534-536.

[103] Korobkin (n 94) at 554.

[104] Ibid at 553-553.

[105] Ibid at 579.

[106] E Warren, "Insolvency Policy" (1987) 54(3) U Chi L Rev 755 at 789-790.

were managed to achieve the highest value in their use.[107] She also argued that the central job of insolvency law should be to apportion the losses of the debtor's default, and that "a variety of factors impinge on the difficult policy decision of where to let those losses fall".[108] Warren also claimed that neither the simple nor enhanced creditors' bargain could justify or account for corporate rehabilitation, restructuring, and rescue.

What has been apparent to Warren, Korobkin and others is that a more nuanced and thoughtful approach is more appropriate than a purely economic framework provided by the creditors' bargain theory, given the many competing interests in a rescue or restructuring procedure. Warren's approach promoted a design of an insolvency framework that would keep viable businesses running while allowing for the consideration of "non normal" creditors such as employees.[109] With the focus on restructuring in today's global insolvency policy an insolvency framework should also provide for rescue, rehabilitation, and restructuring where the business is viable, in order to protect the greater interests of the company and its stakeholders. Maximising value for the collective also means reducing strategic behaviour associated with individual creditors and debtors pressing whatever advantage they may have in the process, creating "prisoners' dilemmas" by the exploitation of superior information or greater bargaining power.[110] Although insolvency systems tend to be designed to reduce the risk of such dilemmas, the power afforded to secured creditors including floating charge holders undoubtedly continues to influence insolvency outcomes.

The argument for interfering with pre-insolvency rights and entitlements in order to respond to the social problems caused by insolvency has frequently been met with outright rejection to varying degrees of acceptance with caveats. It has been said that it should not be within insolvency or bankruptcy law that issues of social policy should be resolved.[111] Given the theoretical framework underpinning this discussion, the position of theorists such as Baird and Jackson within the paradigm of law and economics supporting wealth maximisation for contractual creditors cannot survive. It leaves aside the vulnerabilities inherent in the employment relationship and the involuntariness of other stakeholders who have suffered detriment and are owed recompense of some description by the company in financial distress, whereas the position of theorists such as Warren and Korobkin tend to support this paradigm shift. These are obligations owed by the company itself, the assets of which tend to be preserved first for creditors holding security and then unsecured creditors, covering a variety of vulnerable and involuntary stakeholders, who may (if they are fortunate) achieve a few pence on the pound of what they are owed. The obligations go beyond the debt itself in many cases, although they have been quantified in the only way that the typical capitalist system is able to do, which ranks them as an equivalent unsecured claim to be answered in the relevant order of priority.

Secured creditors are generally very well placed to influence the insolvency outcomes of a company in financial distress. Generally, secured creditors tend to be banks, which are key players who can also contribute to the rescue of a company by deferring payment demands, renegotiating terms, choosing not to exercise their enforcement rights, and supplying rescue funds. They also usually have far more information about the financial situation of a company, so are better placed to make well-informed decisions about the risks of continuing to do business with the company. They also are well resourced with funds, skills, and expertise to exercise their power over the insolvency process, which

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[107] Ibid at 802.
[108] Ibid at 810.
[109] Douglas Baird, for example, agrees that such stakeholders are not always adequately protected, but argues that their protection is something that should sit outside of an insolvency framework. See D G Baird, "Loss Distribution, Forum Shopping, and Insolvency: A Reply to Warren" (1987) 54 U Chi L Rev 815 at 815. The view of workers as "non normal" stakeholders is a particularly American view in contrast to the European view of workers as being central stakeholders in corporate life. See generally I Lynch-Fannon, *Working Within Two Kinds of Capitalism* (2003).
[110] A prisoner's dilemma is a theory that says that rationally acting individuals will not act in a manner that is in their collective interest if they are not able to communicate with each other and co-ordinate their actions. See A Rapoport and A M Chammah, *Prisoner's Dilemma* (1965) and J Hardman, "Law and Economics of Corporate Financial Difficulty" in P Omar and J L L Gant, *Research Handbook on Corporate Restructuring* (Elgar Publishing 2021) 500-512.
[111] D G Baird and T H Jackson (n 87) at 102.

will also be mostly to their ongoing benefit.[112] Employees and other vulnerable stakeholders, in contrast, are plagued by information asymmetries and as their funds are also tied up in the ongoing success of the company in question, will not have anywhere near the same level of resourcing to ensure they get an equal hearing.

The last several decades have also seen a shift in how corporate financing is arranged while the perspective on debt as a concept has changed dramatically from its moralistic roots. This has involved a considerable fragmentation of debt,[113] which has created greater and greater distances between the original debtor and lenders in a credit relationship. Although the floating charge has been around arguably in one form or another for more than a thousand years, it has also been affected by the more modern views on debt, which have created that moral distance between debtor and creditor on the financial markets. The buying and selling of debt have also led to the commodification of debt,[114] which adds further distance from that fundamental moral dimension of repaying what is owed.

Although the Enterprise Act 2002 introduced some mitigation upon the power of the floating charge holder, the existence of the floating charge has been viewed as having an overall positive effect on corporate finance and rescue. It has "played a cardinal role in the provision of debt finance to companies".[115] While it has undergone a number of changes both under legislation such as the Enterprise Act 2002 and through case law, such as *Spectrum Plus,*[116] the instrument remains an important form of security today. As noted by Kayode Akintola, "In spite of insolvency legislation, the floating charge is still capable of performing one of the cardinal functions of security – debt realisation."[117] The facility of the floating charge is particularly useful as a modern debt realisation device due to the nature of smaller companies in particular, which tend to have more current assets than fixed assets, making fixed security less effective in protecting a secured lender.

The floating charge itself also offers a certain level of power to floating charge holders in terms of commencing insolvency and exercising some control over appointments, despite the changes introduced by the Enterprise Act 2002.[118] Though an administration can be commenced by directors or the floating charge holder in many cases, in a high number of those commenced by the company or its directors in the aforementioned study there was also evidence that secured creditors including floating charge holders were also actively involved in appointments under the process, often by applying leverage associated with the continuation or granting of new lending.[119] Thus, while the banks that often hold the floating changes may not take full control by commencing a process and appointing a professional to see it through, they will still exercise significant influence over the process, not the least reason being that they could also be a source of rescue finance should a restructuring be possible.

D JUSTIFYING EMPLOYEE PREFERENCE OVER A FLOATING CHARGE

(1) Employment Regulation and the Free Market

In classic neo-liberal economic tradition, labour was considered a mere factor of production: a commodity to be bought and sold freely on the market.[120] The Industrial Revolution in the UK revealed how much labour could be dehumanised by this *laissez faire* approach. However, once the untenable position of workers during the Industrial Revolution was recognised, it was declared that labour should not be treated as a commodity. Even Adam Smith observed that there was an inequality of bargaining power between employers and employees. He noted that:

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[112] V Finch, "Corporate Rescue: Who is Interested?" (2012) 3 JBL 190 at 195.
[113] Finch (n 29) at 759.
[114] Ibid at 765.
[115] Akintola (n 33) 404.
[116] *Spectrum Plus Ltd v National Westminster Bank Plc* [2005] UKHL 41; [2005] 3 WLR 58.
[117] Akintola (n 33) at 404.
[118] V Finch, "Re-Invigorating Corporate Rescue" (2003) JBL 527 at 541.
[119] Akintola (n 33) at 406.
[120] Smith, *Wealth of Nations* (n 52)36-44.

> [m]any workmen could not subsist a week, few could subsist a month, and scarce any a year without employment. In the long run, the workman may be as necessary to his master as his master is to him; but the necessity is not so immediate.[121]

The following century, Karl Marx described the commoditisation of labour as leading to exploitation of workers and constituting a barrier to free human development.[122] Contrary to this commoditisation premise, labour is unlike any other commodity insofar as it has a distinctly human aspect as individuals can decide how hard they work and with what level of care. The environment in which someone works also affects their behaviour, which affects their decision-making and the work that they provide. It is not as simple as providing work under a contract as employees have other concerns that may limit their choices with regards to the jobs they can take, such as the costs of changing location and other human factors such as the stigma that can be associated with changing jobs regularly.[123] Were labour a mere commodity, as Marx notes, there would be little or no possibility for growth or advancement of individuals once they have taken their first job, which is clearly not how the labour market works in reality.

Eventually workers' vulnerability was confirmed by the International Labour Organisation in the Declaration of Philadelphia.[124] The welfare state gave the plight of workers a central concern, recognising that due to asymmetry of information between employees and employers, perfect competition could not exist in the labour market.[125] Social justice, fair income distribution, and even job security can be linked to the need for the welfare state to preserve and protect human dignity.[126] Labour regulation has also been justified by reference to the stability it can provide to the labour market.[127] The preferential legislative treatment that employees often receive during insolvency procedures and EU Directives that provide protection can be seen as a product of these justifications.

The development of the employment relationship has a long history. In most jurisdictions, it can be characterised by the subordination of an employee to the needs of the employer, who will generally have control over hours, workplace, tools, and work performance. There is an inherent imbalance in employment relationships that historically allowed for the exploitation of employees.[128] Employment law today is concerned with equalising the bargaining power of the employment relationship. This is generally through legislation preventing employers from unfairly exercising their power over employees and protecting employees' right to continued employment. While countries such as the US, with only a few individual state exceptions, continue to embrace the "employment-at-will" doctrine,[129] most countries, including the United Kingdom, have evolved systems that acknowledge the social risks of employment, including the cost of unemployment, and provide some protection to try to prevent the vagaries of a regulation-free labour market.

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[121] Ibid 65.

[122] See K Marx, "Economic and Philosophic Manuscripts" in T B Bottomore (ed), *Early Writings* (first published 1844, 1963) 76, discussed at length in E Tucker, "Renorming Labour Law: Can we Escape Labour Law's Recurring Regulatory Dilemmas?" (2010) 39(2) ILJ 99 at 105-106.

[123] J Stiglitz, 'Employment, Social Justice, and Societal Well-Being' (2002) 141(1-2) International Labour Review 9 at 10

[124] Declaration Concerning the Aims and Purposes of the International Labour Organisation, adopted at the 26th Session of the ILO, Philadelphia, 10 May 1944.

[125] B E Kaufman, "Labor Law and Employment Regulation: Neoclassical and Institutional Perspectives" in K G Dau-Schmidt et al (eds), *Labor and Employment Law and Economics: Volume 2, Encyclopaedia of Law and Economics*, 2nd edn (2009) 4 at 14-16.

[126] See Article 1 of the Charter of Fundamental Rights of the European Union 2012/C 326/02: "Human dignity is inviolable. It must be respected and protected."

[127] Kaufman (n 1255) at 49.

[128] J L L Gant, "Proletarianisation and the Emergence of Labour Regulation in France and Britain"in *Balancing the Protection of Business and Employment in Insolvency: An Anglo-French Perspective* (2017) 33-78.

[129] The employment-at-will doctrine is best articulated by Horace Gray Wood in 1877: "With us the rule is inflexible, that a general or indefinite hiring is *prima facie* a hiring-at-will, and if the servant seeks to make out a yearly hiring, the burden is upon him to establish it by proof…"; S F Befort, "Labor and Employment Law at the Millennium: a Historical Review and Critical Assessment" (2001-2002) 43 Boston College L Rev 351 at 355-356.

Workers provide more than a simple quantifiable service that can be equated to a cost or value. They also provide firm specific skills and expertise that become integrated into the business of a company, which goes far deeper than a nut or bolt, or machinery. Where such human capital is invested, it is reasonable that it should be protected from arbitrary treatment by management along with other guarantees to protect employment.[130] Firm specific human capital can be as important if not more so than the value of equity capital and will often contribute at a higher level to the firm's wealth than its physical assets.[131] Employees contribute to productivity, innovation and firm synergies, along with labour and loyalty over an extended period, all of which will often significantly enhance firm value. These employee investments confer value on the company in return for an implicit or explicit promise of job security,[132] which is of course compromised in the event of an insolvency or restructuring in terms of the certainty of that security and often at the expense of continued employment. In addition, most employees are essentially undiversified, working full time at a single firm, thus their risk is also undiversified if a firm then fails. A job loss and/or loss of compensation can therefore have a devastating effect on both the individual employees, their families, as well as communities and local economies that their wages support.[133]

The time and effort expended by employees on the firm for which they work will often be overlooked when valuing their contribution, for example, when it comes to a redundancy situation resulting from a restructuring. A conservative estimate by Blair suggests that employees who have worked for a long time for a single firm and who are laid off during a corporate restructuring typically will earn 15-20% less in their next position.[134] A substantial part of the investment that the employee has made is therefore lost when they are laid off with no prospect for recovery.[135] As noted by Esterbrook and Fischel, employees "may make formidable investments in the firm (in the sense of irrevocable, specialised commitments of physical or human capital)" but account for this on the basis that employees are equally empowered to bargain for adequate compensation in their employment contract.[136] Although true that a firm will equally invest in an employee, it is impossible to define or quantify the value gained by the company as a result of an employee gaining skills and expertise on the job, an investment by an employee which is lost when they are terminated during a restructuring or otherwise.[137]

The argument for protecting employees with some priority in insolvency stems from various justifications. A reorganisation is generally commenced with the hope that the business will continue, and that by retaining employees, corporate knowledge will also be retained. Also, an employee's wages represent a large part of that person's wealth; they do not enter the relationship consciously factoring in the risk of their employer's default in the way that a trade creditor signing a negotiated contract might. From a business protection point of view, prioritising employee claims may prevent valuable employees from seeking work elsewhere while a reorganisation is taking place.[138]

In relation to the passing of social legislation and a focus on social policy in political agendas, it has historically been argued by proponents of efficiency in the law and economics movement that these are an illegitimate interference with market relations.[139] While freedom, autonomy, liberty, and individualism are central to the benefits perceived in following a neo-classical economic model, giving

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[130] S Deakin and F Wilkinson, "Labour Law and Economic Theory: A Reappraisal" (1998) ESRC Centre for Business Research, University of Cambridge Working Paper No 92, 1.

[131] M M Blair, "Firm-Specific Human Capital and Theories of the Firm" in M M Blair and M J Roe (eds), *Employees and Corporate Governance* (1999) 58 at 71.

[132] J Sarra, 'Widening the Insolvency Lens: The Treatment of Employee Claims' in Paul J Omar (ed), *International Insolvency Law: Themes and Perspectives* (Ashgate 2008) 295 at 297.

[133] Ibid.

[134] Blair (n 131) at 61.

[135] W Njoya, "Employee Ownership and Efficiency: An Evolutionary Perspective" (2004) 33(3) ILJ 211at 230.

[136] F H Easterbrook and D R Fischel, *The Economic Structure of Corporate Law* (1991) 38 as cited in Njoya (n 135) at 230.

[137] Njoya (n 135) at 230.

[138] D R Korobkin, "Employee Interests in Bankruptcy" (1996) 4 Am Bankr Inst L Rev 5, 6.

[139] S Deakin and F Wilkinson, "Rights vs Efficiency? The Economic Case for Transnational Labour Standards" (1994) 23(4) ILJ 289 at 292.

individuals choices free from constraint and coercion,[140] these positive effects are not always accessible. It is not reflective of the real position of employees in the labour market. In terms of welfare economics, if markets are competitive, information must be perfect in order to reach a true competitive equilibrium. This presumes that government intervention should not be necessary to maintain market efficiency in an optimal competitive situation.[141]

The premise that perfect competition can exist within the labour market is spurious. The labour market is imperfectly competitive due to inequality of bargaining power, unequal access to information and resources, and unequal balance of rights that exist within it as demonstrated in the foregoing sections. While employment regulation often impedes the perceived efficiency of the free market, it is justified as restoring balance to an otherwise exploitative and imbalanced relationship that, without control, would be socially inefficient and unjust due to the unilateral reduction in wages and conditions of labour.[142] Market failures owing to informational problems that cause an inefficient allocation of resources provide a premise for the argument in favour of social policy as a factor for improving that market efficiency.[143] The early days of the industrial revolution throughout Europe exemplify this imbalance in competition. While it could be argued that the same moral conditions do not exist today, it is only necessary to observe the exploitation of workers that occurs in developing countries to realise that such conditions persist.[144]

Fundamentally, the protection of employment rights and labour are justified due to the human element from a moral perspective as well as a human investment perspective. Labour protection and regulation "addresses the idiosyncratic problems that arise in relation to contracts of employment through a mixture of special contract law and market regulation." It also "appeals to considerations of a fair distribution of wealth, power, and other goods in society."[145] The prevalence of labour and employment protection even in places such as the United States where such protection is generally quite limited, indicates the broad recognition that employees and workers should be a special case when considered as a "factor of production." However, when insolvency arises, labour appears to be re-commoditised with employees becoming creditors valued by reference to the debt owed under their employment contracts. Although there are some additional protections and preferences, it is arguable that these do not go far enough to account for the investments made by employees in terms of their time and skill. This is even more relevant in the context of the power wielded by secured creditors including floating charge holders whose priorities effectively subordinate unsecured claims.

(2) Employees in Insolvency: Contradiction of Pre-Insolvency Priority Entitlements

The majority of insolvency scholars and policy makers tend to ignore or eschew non-contractual interests, such as the social policy matters associated with employees, community interests, and other non-adjusting involuntary stakeholders. Rather, most insolvency scholars still tend to view insolvency from a law and economics perspective and focus on creditor wealth maximisation as the main or sole goal for an insolvency or restructuring process.[146] These goals tend to favour the creditors with the most power (holding the highest value of debt with the highest level of priority). Although the argument goes that creditors can choose how to mitigate their risk when entering into contracts and that the information is there for them to do so, the reality is not so black and white as discussed in section B. Some creditors

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[140] Kaufman (n 125) at 6-9.
[141] D Fourage, "Costs of Non-Social Policy: Towards and Economic Framework of Quality Social Policies – and the Costs of not Having them" (Report for the Employment and Social Affairs DG, European Commission, 3 January 2003).
[142] Kaufman (n 125) at 30-41.
[143] D Fourage (n 141).
[144] J L L Gant, "Conflict and Resolution: Path Dependent Influences on the Evolution of Acquired Rights in Corporate Rescue in the UK and France", in *Balancing the Protection of Business and Employment in Insolvency: An Anglo-French Perspective* (2017) 195-208.
[145] H Collins, "Theories of Rights as Justifications for Labour Law" in G Davidov and B Langille (eds), *The Idea of Labour Law* (2011) 137 at 137.
[146] N D Martin, "Noneconomic Interests in Bankruptcy: Standing on the Outside Looking in" (1998) 59 Ohio State L J 428 at 438.

do not have the information, the money, time, or power to adjust to the changing situation, which puts them at a disadvantage to those who can. As observed by Elizabeth Warren, there is clearly nothing simple about insolvency policy or the social issues affected by it. Rather, insolvency is "a dirty, complex, elastic, interconnected view…from which [she] can neither predict outcomes nor even necessarily fully articulate all the factors relevant to a policy decision."[147] Non-contractual interests are, of course, far more difficult to quantify, which explains to some extent why those interests tend to be left out of economic evaluation of insolvency law. However, their existence and importance have a significant value to society, particularly when those non-quantifiable up-front costs then have to be borne by governments and, by extension, tax-payers.[148]

Corporate failure affects more than banks, trade creditors, and shareholders who all have a contractual claim against the assets or value of the company. Clearly, the employees of a company may find themselves jobless and perhaps even pension-less if the company is dissolved. As an employee's purely contractual claim is unsecured, it will have little hope of claiming back lost wages, entitlements, and other benefits unless additional protections are provided under the law.

Most jurisdictions have recognized the social problem associated with this situation and provided some level of priority or preference to ensure that employees will get a commensurately larger bite of the apple, at the expense of both secured and unsecured creditors depending on the jurisdiction. These privileges are supported by international organisations such as the World Bank,[149] UNCITRAL,[150] the International Labour Organisation,[151] and European Union institutions[152] and extend well beyond the protection of direct financial costs in respect of wages. In particular, the EU institutions have laid down Directives that require the approximation of minimum standards for protecting job security and continuity of employment,[153] as well as ensuring fairness for collective economic dismissals.[154]

Employees are afforded greater consideration for a number of reasons. They are often considered "involuntary creditors" as they have little choice but to provide their labour in exchange for their livelihood. However, it could also be argued that an employee can choose whether or not to take a job, but the reality is far more complicated. The capitalist societies of the Western World require as a matter of fundamental importance to society and even the individual identity that people work to support themselves financially. Their labour investment is undiversified so if the firm fails, an employee will likely lose their job with the unavoidable effect on local economies supported by their wages. This can also impact future support through the adverse impact an insolvency may have on employee pensions.[155] It is therefore difficult to accept that there really is a choice in whether a person undertakes work to earn

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[147] E Warren, "Bankruptcy Policy" (1987) 54 U Chi L Rev 775 at 811.

[148] See for example, K Gross, "Taking Community Interests into Account in Bankruptcy: An Essay" (1994) 72 Wash U L Q 1031.

[149] The World Bank, "Principles for Effective Insolvency and Creditor/Debtor Regimes" (World Bank Group 2016) *http://pubdocs.worldbank.org/en/919511468425523509/ICR-Principles-Insolvency-Creditor-Debtor-Regimes-2016.pdf* . Principle C.12.4 calls for special recognition and treatment of labour claims on the basis that "workers are a vital part of an enterprise and careful consideration should be given to balancing the rights of employees with those of other creditors."

[150] UNCITRAL Legislative Guide on Insolvency Law (United Nations 2005) *https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf*. See paras 72 & 73 on pages 287-288 in which the priority for workers claims provided by a majority of states is discussed as well as the guarantee funds that some states provide to cover claims not met by the insolvent estate.

[151] See the International Labour Organisation, C095 Protection of Wages Convention (1949) *https://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100_ILO_CODE:C095*. See Article 11(1): In the event of the bankruptcy or judicial liquidation of an undertaking, the workers employed therein shall be treated as privileged creditors either as regards wages due to them for service rendered during such a period prior to the bankruptcy or judicial liquidation as may be prescribed by national laws or regulations, or as regards wages up to a prescribed amount as may be determined by national laws or regulations. See also International Labour Organisation, C158 Termination of Employment Convention (1982) Article 11 and C173 Protection of Workers Claims (Employer's Insolvency) Convention 1992, Articles 6 and 12.

[152] Directive 2008/94/EC OJ 2008 L283/36.

[153] Directive 2001/23/EC OJ 2001 L82/16.

[154] Directive 98/59/EC OJ 1998 L225/6.

[155] Sarra, (n 132) at 297.

their livelihood, or even a particular job depending on the circumstances of the individual and market conditions at the time.

Employees contribute more than just their labour for livelihood, particularly in today's service economies requiring a high level of skill and intellect. They contribute to "productivity, innovation and firm synergies" which frequently enhance firm value and may have done so over an extended period, exhibiting difficult to quantify values such as loyalty. These confer "value on the corporation on the basis of implicit or explicit promises of job security."[156] Sarra observes further that:

> The promise gives rise to contributions to the firm in the form of time, energy and creativity over and above the current wage/labour exchange. On insolvency, the employees' investments in this respect are not adequately protected by employment contracts or statutory minimum protections as these provisions are aimed solely at fixed capital claims.[157]

Whereas wealth maximization can be justified if humanity is removed from the equation entirely, along with the costs of involuntariness and information asymmetry, when looking at the circumstances of insolvency as a reality and all of its associated impacts on society and global economies, people (and other non-financial stakeholders) must be considered in order to perform a full execution of the social contract to which we are all a party. This includes the corporation, which benefits from legal systems "perpetuated by the government and the public" and should therefore bear some responsibility and accountability to the human beings upon which the corporation is built.[158] The need to consider employees as integral parts of the business has been supported by discussions around firm-specific human capital and the integral part that humans play as a defining feature of a firm itself.[159] A key takeaway of labour theory in this area is that:

> …employee investments in firm-specific human capital cannot be well protected by explicit and complete contracts. Other institutional arrangements are needed, and those arrangement often have the effect of tying the fortunes of the employee together with those of the firm.[160]

The relationship between employee and employer (debtor/company) is therefore far more interrelated and connected than a supplier/debtor relationship as suppliers can choose the terms of the contract and adjust interest rates, for example, to account for insolvency risk. A secured creditor will have an even greater separation as their risk is protected by the ability to exercise their security. Employees have no such choice or flexibility in the role that they play in a firm.

E ARE FLOATING CHARGES FAIR TO VULNERABLE STAKEHOLDERS?

Security with priority has been described as fair because (1) it has been freely bargained for; (2) it does not deprive the company of value; and (3) parties are given notice of security arrangements and so

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[156] Ibid at 297.

[157] J Sarra, *Creditor Rights and the Public Interest, Restructuring Insolvent Corporations* (2003) 70 as cited in Sarra (n 132) at 297.

[158] E M Dodd Jr, "For Whom Are Corporate Managers Trustees?" (1932) 45 Harv L Rev 1145 at 1148 as cited in N D Martin, "Noneconomic Interests in Bankruptcy: Standing on the Outside Looking In" (1998) 59 Ohio State L J 429 at 439.

[159] On this discussion, see for example G S Becker, "Human Capital: A Theoretical and Empirical Analysis with Special Reference to Education" (1964) National Bureau of Economic Research; Peter B Doeringer and Michael J Piore, *Internal Labour Markets and Manpower Analysis* (1971); S M Jacoby, "The New Institutionalism: What can it Learn from the Old?" 29(Spring) Industrial Relations 316; M Hashimoto, "Firm-Specific Human Capital as a Shared Investment" (1981) 71(June) American Economic Review 475; and R C Topel, "Specific Capital and Unemployment: Measuring the Costs and Consequences of Job Loss" in A H Meltzer and C I Ploser (eds), *Studies in Labour Economics in Honor of Walter Y Oi* (1990) 181.

[160] M M Blair, "Firm-Specific Human Capital and Theories of the Firm" (2003) Georgetown University Law Centre, Business, Economic and Regulatory Policy Working Paper No 167848, 58, 61.

cannot justifiably complain about it.[161] These arguments are based on the premise that other creditors will be aware of such activities and will be able to adjust their loan rates accordingly. However, this applies rationally only to voluntary contractual parties and even then, the information asymmetries persist, whether voluntary or not. There are vastly differing negotiating positions between banks holding floating charges and trade suppliers extending a line of credit.[162] The bargain argument also does not stand up for those creditors who are truly involuntary nor where the bargain itself effectively lays costs on other creditors without their consent insofar as a floating charge allows for a debtor to increase the insolvency share for a secured creditor, which will inevitably come at the expense of unsecured and involuntary creditors.[163]

The contention that granting security does not deprive the company of value also has difficulties. As new assets are acquired following the granting of a security, more security builds up without the injection of additional value. Finch notes "That creditor enjoys the windfall benefit of diminishing risks of default and the existing interest proves increasingly advantageous to it. New assets do not enter the pool for the potential benefit of unsecured creditors but create such windfalls."[164] The floating charge effectively allows for a charge to be placed on future property without bargaining for that specific security, which seems fundamentally inequitable when it comes to the fairness with regards to unsecured and involuntary creditors. This can have a particularly acute impact on employees given that their future claims are not accounted for in the insolvency waterfall.

Finally, the third argument rests on adequate information for creditors to make adjustments to their loan rates. Although floating charges and other rights in security must be registered, and this is considered as a form of notice, the reality is much different. The register itself is static and will not account for the fluctuations of value within the property of the company over which a charge floats. Furthermore, if a floating charge includes bank overdrafts, these can fluctuate on a daily basis, so no information available on a register will give a full picture of a company's finances at any given point in time. In addition, this information is valueless to involuntary or non-adjusting creditors in any event as they do not have the freedom to mitigate their risks by adjusting their loan rates.[165]

The creation of security in general will divert value from creditors that cannot adjust the size of their claims to take into account the effect of the security held by floating charge and fixed security holders. Any security given will effectively subordinate their unsecured claims without any need to inform them or allow them to mitigate the risks that such actions by a debtor may entail.[166] Essentially, the private contract of the floating charge instrument will have an effect on third parties to their detriment, which under contract law would not normally be acceptable.[167] Such third parties will suffer from information asymmetries, particularly if they are involuntary creditors, and will generally be unable to adjust their terms to account for the increased risk presented by the granting of additional security.[168] There are also creditors whose claims may simply be too small to justify the cost of making additional searches to determine the leveraging of the debtor prior to contracting and will be "rationally uninformed" about the borrower's financial structure.[169] They will thus be disadvantaged by the information asymmetries between themselves and those creditors who are more closely involved with the debtor's financial decision making, such as fixed security and floating charge holders.

Security interests giving full priority essentially make the lender better off by effectively transferring insolvency value from creditors that cannot adjust the size of their claims.[170] As noted by

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[161] J Hudson, "The Case Against Secured Lending" (1995) 15 Int Rev of Law and Econ 47 at 55 and R Goode, "Is the Law too Favourable to Secured Creditors?" (1983-1984) 8 Can Bus Rev 53 as cited in V Finch, "Security, Insolvency and Risk: Who Pays the Price?" (1999) 62(5) MLR 633 at 660.
[162] B Carruthers and T Halliday, *Rescuing Businesses: The Making of Corporate Bankruptcy Law in England and the United States* (1998) 171 and L LoPucki, "The Unsecured Creditors' Bargain" (1994) 80 Va L Rev 1887 at 1896-1898 as cited in Finch (n 161) at 660-661.
[163] Finch (n 161) at 661.
[164] Ibid at 662.
[165] Ibid at 662.
[166] Bebchuk and Fried (n 84) at 964.
[167] J Hardman, "Law and Economics of the Floating Charge", ch xx.
[168] J Hardman, "Law and Economics of the Floating Charge", ch xx.
[169] Bebchuk and Fried (n 84) at 864.
[170] Ibid at 882.

Vanessa Finch, the floating charge in particular is a "mechanism that is particularly conducive to the transfer of insolvency value from unsecured to secured creditors."[171] It allows large lenders to exploit their dominant bargaining position and effectively to arrange for a transfer of value to what would have been distributed to unsecured creditors out of the working capital of a debtor, which is instead tied up by the floating charge.[172] This will clearly harm employees who are owed for their labour and for pension contributions that are contractually guaranteed and fundamentally should also not be adjustable on the basis that employees should not be treated as a commodity that can be valued simply as a factor of production.

If one considers the information asymmetries naturally present between the banks, which generally hold the majority of security, including the floating charges, and the relatively weak position of employees and other involuntary and non-adjusting creditors, there is clearly a power bias toward the entity wielding the security and/or the highest level of debt. Such secured creditors will wield considerably more control over the governance of an insolvency process.[173] Banks are significantly better informed about the financial state of a company to which it is lending due to the due diligence and auditing requirements that are often applied prior to lending a sum of money. They also have access to expertise on corporate funding, which further assists in assessing the risks of lending.[174] In addition, floating charge holders continue to exercise a great deal of power over procedure and appointment, despite the general abolition of administrative receiverships under the Enterprise Act 2002,[175] creating a moral hazard risk of making opportunistic appointments suiting their self-interests while potentially further unbalancing the playing field for less powerful stakeholders in an insolvency. They are aware of the risks to a high level of detail, whereas regular employees will be dependent upon the company fully for livelihood and pension contributions along with the support this provides for families and communities. They will not be privy to the same level of information and even if they were, they are caught in the ubiquitous need for a job without any true instrument or tool to mitigate the risks that continuing to work for their current financially distressed employer. The choice is simply not there.

Floating charges and other forms of security can have a clear and sometimes extreme effect on third parties who are unable to mitigate their risk. A shift in approach to regulation in this area could reorient corporate decision making, whether that is preserving assets, asset value, and entering into financing transactions, such as floating charges, that may subordinate the rights of other stakeholders. Reorienting corporate decision-making towards vulnerabilities would mean reconsidering the corporate governance relationship from the top down. Whereas directors are generally tasked with maximising and growing the value of the corporation's assets, if that role shifts to that of a "trustee," the responsibility shifts from dollar signs to sustaining the corporate assets for the benefit of all those who depend upon it. A trustee in this context replaces the traditional director concept, whose duty is narrower and focused on maximising shareholder value; whereas a director with a trustee type of role would be in charge of a corporation as a social institution rather than an entity created solely through private contracts.[176] Directors then shift from being agents of the shareholders to being trustees of the corporate entity which would include the duty to protect all of the corporation's tangible and intangible assets for the benefit of all stakeholders who depend on the corporation in one way or another.[177]

A shift towards trusteeship rather than an agent/principal type of model that typifies most corporations in England and Scotland would also mean a shift in the way corporate assets are valued as such valuations would have to include characteristics that are far more difficult to monetise. Assets separated from straightforward value maximisation will also include firm specific human capital, the expectations of customers and suppliers, and the company's influence on and importance to the

[171] Finch (n 161) at 658.
[172] Ibid at 658.
[173] E J Janger, "The Logic and Limits of Liens" (2017) Brooklyn Law School Legal Studies Research Papers Accepted Paper Series (No 539) 589, 592.
[174] Finch (n 118) at 541.
[175] Ibid at 540.
[176] T Clarke, "Accounting for Enron: Shareholder Value and Stakeholder Interests" (2005) 13(5) Corporate Governance: An International Review 598 at 606.
[177] J Kay, "The Stakeholder Corporation" in G Kelly, D Kelly, and A Gamble (eds), *Stakeholder Capitalism* (1997) 125- at 135 as cited in T Clarke, "Accounting for Enron: Shareholder Value and Stakeholder Interests" (2005) 13(5) Corporate Governance: An International Review 598 at 606-607.

community within which it exists. Thus, a trustee's duties are not just to the financial interests of its shareholders, but also to the broader purposes of the corporation as a social construct built upon a number of social institutions beyond the financing of banks.[178] This shift requires a consideration of "social capital", described as "the set of resources, tangible or virtual, that accrue to an organisation through social stricture, facilitating the attainment of goals,"[179] all of which are difficult to value in money, but without which no corporation could survive. These are deeper and more complex social relationships based in the reality of how business works within the world, rather than a strict adherence to law and economics limitations that see only contractual relationships and monetary value.[180]

These expanded interests can be justified in insolvency considerations if one looks to the needs of the community as a social construct upon which corporations rest.[181] Without the community within which a corporation exists, a corporation will not exist. It is not merely an entity built on legal contracts and relationships – there are far more considerations, which were first clearly recognised in modern times by leaders of the early labour and social movements of the industrial revolution such as Marx, Owen, and even the Pope. Although "vulnerability theory" may not have been the defining factor of their philosophy, Fineman's theory provides a new paradigm that highlights the fundamental unfairness of security rights that neglect social concerns, some of which are absolutely fundamental to the survival of a corporation beyond the value of their contractual contribution. The human factor must be taken into account if a more equitable global community is to be created in the future. This includes a more nuanced approach to enforcing securities such as floating charges, and the relative priorities ascribed to them during an insolvency.

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[178] J Kay, "The Stakeholder Corporation" in G Kelly, D Kelly, and A Gamble (eds), *Stakeholder Capitalism* (1997) 125- at 135 as cited in T Clarke, "Accounting for Enron: Shareholder Value and Stakeholder Interests" (2005) 13(5) Corporate Governance: An International Review 598 at 607.

[179] R Leenders and S Gabbay, *Corporate Social Capital* (1999) 3 as cited in Clarke (n 178) at 607.

[180] Clarke (n 176) 607.

[181] See K Gross, "Taking Community Interests into Account in Bankruptcy: An Essay" (1994) 72 Wash U L Q 1031.