Incorporating Social Justice Concerns into the New Law and Development Movement: The Importance of Insolvency Law

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**ABSTRACT:** This paper focuses on insolvency law as an underutilized area for incorporating social justice concerns into legal reform projects in developing countries. Insolvency is an area of law that already plays a large role in legal development projects and is especially suited for incorporating social justice concerns because of its ability to redistribute wealth and safeguard vulnerable interests. In arguing that insolvency law should be better exploited by social justice advocates this paper briefly reviews the history and literature surrounding the “Legal Development Movement” (LDM) and discusses the responsibilities of development agencies to incorporate social justice concerns into economically-focused legal development projects. It also discusses the role of insolvency law in the developing world, some of the broad policy choices that reformers can make when drafting insolvency laws, and how current insolvency law reform policies respond to past failings of the LDM. Finally, this paper makes specific policy suggestions for incorporating social justice concerns into insolvency law reform projects. This paper combines two disparate areas of legal scholarship in an effort to further the incorporation of social justice concerns into legal reform projects. While others have written about the importance of incorporating social justice concerns into Law and Development reforms, none have focused on use of insolvency laws to that end. While others have written about how social justice goals can be achieved in the design of insolvency laws, none have focused on how insolvency laws can be better used as an integral part of the LDM. This paper is a first step in a much larger academic project of advocating for greater social justice in legal development reforms.
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Part I: Introduction

The phrase “Law and Development” broadly refers to legal assistance programs in the developing world and the related scholarly literature (Trubek, 2001: 8443; Sherman, 2009: 1258). Scholars in this field declare that the Law and Development Movement (LDM) began in the 1960s, with international legal assistance projects funded by primarily Western development agencies like the World Bank, the International Monetary Fund (IMF) and the United States Agency for International Development (USAID) (Trubek, 2001: 8443; Sherman, 2009: 1260-61). Although the LDM suffered several setbacks and was the subject of extensive academic criticism in its first four decades, the Movement is now in a new phase (Trubek & Galanter, 1974; Trubek & Santos, 2006: 8 FN3). Within this new phase legal development agencies are becoming more interested in the incorporation of social justice concerns into their development projects (Rittich, 2006: 203). This presents social justice scholars with an opportunity to both encourage and shape the current trends in this new phase of the LDM with suggestions for how to integrate social justice policies into economically driven development projects. This paper focuses on insolvency law as an underutilized area for incorporating social justice concerns into legal reform projects. Insolvency is an area of law that already plays a large role in legal development projects and is especially suited for incorporating social justice concerns because of its ability to redistribute wealth and safeguard vulnerable interests.

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There are three expressions that will be limited for the purposes of this paper. The first phrase is “social justice concerns,” which will refer to a broad range of human rights and progressive goals, including but not limited to the rights outlined in multilateral treaties like the International Bill of Human Rights and the International Covenant on Economic, Social and Cultural Rights, especially labor rights, the right to an education and the right to an adequate standard of living (ICESCR, 1966: Arts 8, 11, 13). Secondly, although a great number of bilateral and multilateral donors are engaged in international legal development projects, the “legal development agencies” referenced in this paper will be mainly the World Bank, the IMF, USAID, the United Nations Commission on International Trade Law (UNCITRAL), and those individuals representing these agencies in the field. This paper is limiting the field of agencies involved in international legal assistance to these few because they are the agencies that guide most of the international insolvency law development projects. Finally, when describing “legal development projects” or “legal reform projects” this paper will be referring to a broad range of legal assistance agendas in the developing world, including but not limited to projects that encourage respect for the rule of law, projects that reform judicial systems, projects that design and execute regulatory regimes, and finally projects that design or reform sector specific areas of law like insolvency.

The LDM has endured decades of criticism from academic scholars in the development field for what this paper refers to as its first two phases, but the LDM nevertheless remains a well-financed and often studied area. Critics like David Trubek, one of the original scholars questioning the normative foundations of legal development, saw “serious problems with the strategy of transplanting foreign legal models through and elite-driven approach that did not coincide with the cultural, social, and political contexts of the developing countries” (Trubek,
2001: 8443). Still, in the face of consistent challenges to the theoretical and practical goals of the LDM, the Movement has persisted, and today is not only thriving but has entered into a third phase of implementation (Id.: 8445; Sherman, 2009: 1257-58; Davis & Trebilcock, 2008: 896). The twenty-first century has seen an increase in the number of legal reform projects being undertaken and funded by development agencies (Sherman, 2009: 1257-58). In this third phase it is unlikely that the LDM will adopt any entirely new strategies or benefit from a major overhaul of legal development’s normative foundations, but the third phase does open the door for better integration of social justice concerns into legal development policies.

The LDM is lacking scholarship that links social justice literature with economically-focused legal reform projects (Rittich, 2006: FN44). There is a long-recognized tension between legal reforms that promote democracy and social justice versus creating market-friendly environments attractive to foreign investment (Trubek, 2001: 8446). Market driven legal reform has been criticized as only offering “universalist” solutions that don’t fit the social and political contexts in every developing country, the result being reforms that only benefit an economically elite minority, or only serve the investment interests of Western donor countries (Rittich, 2006: 238). If scholars and development agencies want the third phase of the LDM to respond to these criticisms they cannot rely on the same “one-size-fits-all” formulations, or ignore the social and political realities of different legal contexts (Ginsburg, 2009: 164-67). This work will examine the tension between social justice concerns and economic growth, and offer sector-specific suggestions for incorporating social justice concerns into legal reform in the area of insolvency law.

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Rittich goes on to explain this divide: “social justice critics have often avoided deep engagement with questions of market design” Rittich argues there is a division of labor among academic disciplines, a discomfort with the language or analytic tools of economists, and finally, a tendency for social justice critics to only rely on human rights and constitutional norms as the vehicles of transformative legal change.
Part II will briefly review the history and literature surrounding the LDM leading up to the third phase that the Movement is in today. Part III will discuss the responsibilities of development agencies to respond to past criticisms and new opportunities for incorporating social justice concerns into economically-focused legal development projects. Part IV will move into a general discussion of insolvency law in the developing world, its role as a redistribution institution, and some of the broad policy choices that reformers can make when drafting insolvency laws. Part V looks at the role insolvency law is playing in the third phase of the LDM and discuss how some current insolvency law reform policies respond to changes in the LDM and criticisms from the academy. Finally, Part VI will make specific policy suggestions for incorporating social justice concerns into insolvency law reform projects. Scholars in this field have already expressed their belief that fairer and more equitable approaches to legal development are achievable (Trubek & Santos, 2006: 18). Today the majority of scholars and development agencies believe social justice concerns are compatible with the legal development agenda and no longer see social justice as a distraction from economic growth (Rittich, 2006: 208). The third phase of the LDM is creating the opportunity for scholars to make specific suggestions on how to incorporate social justice concerns into legal development policies.
Part II: The Law and Development Movement

A. Brief History of The Law and Development Movement

Although this paper will eventually focus on the role of insolvency law in legal development, it is important to discuss the history of the first two phases of the LDM in order to give context to the current trends taking place in the Movement. The phrase “Law and Development” encompasses a broad spectrum of academic literature exploring the theory and practice of promoting economic and social development through legal reform (Trubek, 2001: 8443; Sherman, 2009: 1258). Even though efforts by Western countries to reform foreign legal institutions began after WWII, the LDM is generally agreed to have begun in the 1960s, with international projects funded by various legal assistance and development agencies (Trubek, 2001: 8443; Sherman, 2009: 1260-61). Several scholars agree that the LDM can be separated into three distinct “phases” which will be described in detail below (Trubek, 2006: 2-3; Sherman, 2009: 1260-66; Santos, 2006: 267). Understanding the history of the policies that drove the early phases of the LDM will be important in the discussion of contemporary practices (Sherman, 2009: 1260).

The first phase began in the 1950s and 1960s with overseas projects financed by various international development agencies focused on the role of the state in transforming the economy and society (Sherman, 2009: 1260-66). The state-centric first phase of the LDM was rooted in Modernization Theory and was primarily focused on Latin America, Africa and Asia (Trubek, 2001: 8443; Sherman, 2009: 1261). Drawing on Weberian theories about the rise of capitalism, the first phase of the LDM presumed that economic development in these countries would be able to replicate economic and political experiences in the West (Trubek, 2001: 8443; Sherman,
Law was seen as an instrument that could be used to modernize the developing world, and lawyers and judges were seen as the engineers who could spur progressive political and economic changes (Trubek, 2001: 8443). The “Classic Development State” needed new laws and legal institutions that would allow it to plan industrial policies, own major utilities and control economic behavior (Sherman, 2009: 1261-62). Legal transplants became an important tool for development agencies, and they began transplanting modern Western legal institutions that emphasized economic growth and respect for the rule of law into developing countries, mostly in Latin America (Sherman, 2009: 1262-63). In the 1960s legal scholars developed the theory of “liberal legalism” to promote use of law as an instrument to modernize society (Trubek, 2001: 8443). Development agencies emphasized economic legal transplants because it was thought that social and political development would follow from economic growth (Trubek, 2006: 75-77). It was thought that human rights and social justice concerns would spill over from economic development.

By the mid-1970s articles criticizing the movement began reflecting a growing unease among scholars about the assumptions underlying liberal legalism (Trubek, 2001: 8443).

“What passed for law and development theory was a somewhat idealized projection of the self-understanding of US and other developed country lawyers, concerning the role of law in their societies. This was combined with a simplistic model of history that presupposed causal and linear relationships between the evolution of a ‘modern’ legal system and market democracy. Needless to say, no empirical evidence was ever produced to support this theory which was little more than a romantic and ethnocentric projection of a developed country legal culture’s ideal of itself. It became clear to some that the movement suffered from an entrenched ethnocentrism and naïveté.” (Trubek, 2001: 8443-44; Trubek and Galanter, 1974).

Disillusionment in the academy reflecting disappointing results from legal transplantation combined with a sensitivity in the US during the Vietnam War protests to criticism about “meddling in foreign countries” ground the Law and Development movement to a halt.
Although some law reform activities continued through the 1980s, like USAID judicial assistance programs, the larger LDM was presumed dead by scholars (Trubek 2001: 8444; Trubek, 2006: 78).

By the 1990s it was clear that the movement had not in fact died. With the fall of the Soviet Union there was a global shift back to free market thinking, leading to and a new set of development policy prescriptions that became known as the “Washington Consensus.” This change revived the LDM (Trubek, 2001: 8444; Sherman, 2009: 1263-65; Cao, 2007: 362). Neoliberal policies coming from Washington-based development agencies shifted the LDM agenda from state-oriented to market-oriented economics and advocated free markets through privatization, deregulation and liberalization (Sherman, 2009: 1263). The Washington Consensus was that entirely new legal frameworks and legal institutions were needed to allow the market to function freely and protect private property and contract rights (Sherman, 2009: 1264). The growth of more internationally oriented corporate law firms in developing countries helped spread the newly accepted belief about law’s role in development. This added to the growing interest of development agencies in legal reform, which led to more funding for reform projects (Trubek, 2006: 83-84).

In this post-Cold-War phase of the LDM, two broad forces influenced development policies. The first, which Trubek calls “the project for democracy” came out of the human rights movement in the 1980s, when the international community made great strides creating institutions to address and enforce human rights norms in many countries (Trubek, 2001: 8444).

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3 This term was coined in 1989 by John Williamson in the background paper for a conference. When the term was first used it referred to a list of ten policies that Williamson thought “more or less everyone in Washington would agree were needed everywhere in Latin America.” Use of the term became the center of a fierce ideological controversy about whether reforms were being imposed upon developing countries by Washington, or whether countries were adopting reforms on their own volition. (Williamson, 2009).
The second focused on economic reforms in which the state plays a largely passive role and the law provides the “legal foundations of capitalism” and creates the necessary “good governance” for attracting foreign and domestic sources of private investment, especially in former command economies (Trubek, 2001: 8444-45). The first phase of the LDM had taught reformers that human rights and social justice concerns would not spill over from economic growth alone; there needed to be a separate goal within the LDM, and domestic institutions needed to become a strong counterpart reflecting international human rights approaches (Trubek, 2006: 84). A new emphasis on the rule of law became the bridge between these two forces: shared projects could focus on the need for efficiently functioning courts with an independent judiciary, and increased access to social justice through alternative dispute resolutions (Trubek, 2006: 85-86).

Unfortunately the second phase of the LDM was unable to avoid the same criticisms of the first: It was ethnocentric and imperialistic in nature, relying entirely on top-down reforms mostly based in universalistic legal transplants (Trubek, 2001: 8445; Trubek, 2006: 86-89; Sherman, 2009:1265). Overreliance on technical legal assistance and legal transplants neglected the domestic political and cultural environments that shape legal and economic systems (Trubek, 2001: 8445). Legal institutions and frameworks were transplanted en masse into the developing world, despite the “complex and disappointing history of legal transplants” and criticism that there is no single model that can be copied in every jurisdiction (Sherman, 2009: 1265; Trubek, 2006: 87). Trubek believes that “billions of dollars have been spent on reforms that are guided more by intuition and hope than by any systematic knowledge or empirical evidence” (Trubek, 2001: 8445).
B. Law and Development is Here to Stay: New Trends and Big Business

There is now evidence that the LDM has entered a third phase, one that Sherman calls “Comprehensive Development” (Sherman, 2009: 1265). There is hope that contemporary legal development practices are finally changing in response to decades of criticism from scholars and the various failings ascribed to the market-centric legal reforms and legal transplants of earlier phases (Sherman, 2009: 1265). Even though the Washington Consensus claimed to be interested in equitable growth and social justice concerns, it has only been in the third phase of the LDM that legal reform policies have started to substantially change (Sherman, 2009: 1264-65).

Notable changes are taking place in the third phase of the LDM, specifically in the legal reform policies of development agencies. According to Alvaro Santos, the third phase of the LDM was inaugurated by World Bank President James Wolfhenson’s strategy of a “Comprehensive Development Framework” (CDF) (Santos, 2006: 268). Santos says “CDF seeks to re-conceptualize development by going beyond its macroeconomic and financial aspects to focus on structural, social and human concerns. The quest is for a stable, equitable and sustainable development” (Santos, 2006: 268). The World Bank’s new strategy is reflected in evidence of a new awareness among development agencies that legal reform needs to be incorporated into context-specific projects based on consultation with domestic leadership and “stakeholders” (Trubek, 2006: 92). Development agencies are recognizing the need to add social justice concerns such as labor rights, women’s rights and environmental protection to a development strategy that still focuses on contract and property rights protections (Trubek, 2006: 92). Strict adherence by development agencies to Neoliberalism and market-shock therapy created severe economic crises in the developing world. Unrestricted markets were often
inefficient, leading to high transaction costs and market information asymmetries (Trubek & Santos, 2006: 6). Some scholars believe that in contrast to previous development policies, the third phase of Law and Development rejects the “one size fits all” strategies, and encourages policy innovation through learning, experimentation, and a substantial degree of collaboration between the state, market, and private actors (Sherman, 2009: 1268-69).

Several prominent LDM scholars have now described and analyzed the changes taking place in the third phase of the Movement. After taking a survey of the World Bank and IMF’s own publications Trubek agrees there have been “shifts in views about development” and cracks in “the original rule of law orthodoxy.” Trubek suggests this means that “critics of the Washington Consensus . . . have succeeded in opening up the discourse” (Trubek, 2006: 93). Kerry Rittich also agrees that there has been a marked shift in the framing of development policy and priorities in the third phase of the LDM (Rittich, 2006: 203). Optimistic about the prospects of this new phase, F. Charles Sherman writes:

“its emergence represents a very positive progression in contemporary Law and Development thinking, i.e. a shift away from universal formulae toward more sophisticated and nuanced yet practical and results-oriented consideration of how to effect economic development” (Sherman, 2009: 1272).

This new era in legal development allows for regulatory law and state intervention to correct market failure and increase participation of stakeholders in developing countries (Trubek, 2006: 12, 89-90, 92). These scholars have found that legal reform projects still play a major role in the LDM, but where such reform projects were once seen as only crucial for economic growth, they are now also endorsed as important for social justice concerns (Santos, 2006: 253; Trubek, 2006: 92). For example, legal development projects play an important role in reforming judicial systems to both enforce private contracts, but also to enforce labor rights. Additionally, legal
development projects that encourage respect for the rule of law help protect property rights as well as respecting antidiscrimination norms.

Although there is agreement among scholars that we are in a third phase of the LDM, there remains criticism about contemporary development projects. Some scholars believe developers continue to use a much idealized Western model of the rule of law, the core of which is the belief in an independent judiciary applying neutral rules in an objective manner, and that the creation of such an institution will be able to “directly and unproblematically accomplish a wide range of goals” from economic growth to human rights enforcement (Trubek, 2006: 92-93). Other scholars add that even though social justice concerns have been introduced in the third phase, it appears that “neither the basic institutional architecture nor the substantive content of the core legal reform agenda has appreciably changed” (Rittich, 2006: 205). The third phase of the LDM continues the neoliberal project of primarily private law development (Trubek, 2006: 8). A final criticism from scholars of the current development phase is that development agencies continue to present private law as neutral, while public or regulatory law is seen as coercive. This continues even with critics showing that private law is just as capable as public law to alter behavioral incentives and resource distribution in society (Trubek & Santos, 2006: 14-15).

Despite critiques, contemporary legal development projects are a big business. In the 1990s increased interest in legal reform’s role in economic and political development led to increased funding (Santos, 2006: 253). For instance, in 2009 the United States announced a $1.5 billion aid package to support development projects in Afghanistan and Pakistan (Sherman, 2009: 1257). Also in 2009 the G20 agreed to make $850 billion available through various development agencies like the IMF to support growth in developing countries (Sherman, 2009: 1257).
The World Bank reports that it has spent over $3 billion on hundreds of legal reform projects since the 1990s (Santos, 2006:253; World Bank, 2010). Since the end of the Cold War, international economic institutions like the World Bank, the IMF, the World Trade Organization (WTO) and USAID have played a dominant role in legal reform projects (Salomon, 2007: 12). Those enthusiastic about legal reform of markets and rule of law projects are not only numerous, but include organizations that “do not ordinarily form part of a common allegiance, such as development NGOs, business, human rights groups, and the UN” (Cao, 2007: 366). Even though billions of dollars in aid have been invested into Law and Development projects, many scholars agree that these projects have been regarded more as failures than successes (Cao, 2007: 369). Legal and judicial reform projects are booming, and are seemingly immune to continued criticism and to what some scholars declare is “increasing evidence of scant success” (Santos, 2006: 255).

There are several reasons why the third phase of the LDM is not shrinking at the criticism that brought it to its knees in the 1970s. One is that development projects have taken on an increased urgency since the terrorist attacks of September 11, 2001 (Cao, 2007: 362). Lan Cao argues that since 2001, international security experts view development as necessary in terrorism prevention, and he argues that the connection between security and development has been embraced by scholars, governments and aid agencies alike (Cao, 2007: 362-63). The US in particular is taking a new approach on terrorism that involves addressing some of the perceived underlying reasons for terrorist recruitment (high unemployment, low GDP growth and lack of access to free and stable financial markets) with support for economic development and political change (Cao, 2007: 362-63).

Another reason contemporary legal development projects are booming is that the
“beauty of the ‘law and development’ ideal and the ‘rule of law’ ideal is that hardly any body can disagree with the goal of building a neutral and universally accessible institutional framework that is meant to benefit all people irrespective of race, gender, social status, or membership in a particular clan or group” (Pistor, 2009: 168).

Everyone agrees that an efficient and independent judiciary is a good thing, even if the model of an independent judiciary that most proponents have in mind is probably what Trubek calls an “idealized projection of self-understanding” (Trubek, 2001, 844). An efficient and independent judiciary is something the Western countries themselves are still striving to achieve.

It is clear that the LDM is here to stay this time. Legal reform projects are big international business and the academy is not losing interest. Does this mean progress for social justice concerns in the developing world? There are some signs that the social dimension of legal reform has been brought into the third phase of the LDM (Rittich, 2006: 203). One big sign of this change is the World Bank’s Comprehensive Development Framework. Even though the macroeconomic and financial aspects of economic growth are still a strong priority for the World Bank’s legal reform projects, the “social, structural and human dimensions” of reform are now also being emphasized (Rittich, 2006: 203-204). Rittich believes this change is not just a response to earlier criticisms of the movement, but part of a broader movement elevating human rights to the status of development ends and objectives in their own right, as opposed to simply a desirable spillover from economic growth (Rittich, 2006: 207).

The next step is for scholars to encourage development agencies to continue this trend into the future of the LDM. Rittich argues there is a void in scholarly engagement of social justice concerns in the context of market growth reforms. Although some authors have begun to bridge this gap⁴, there is still room to establish a normative vision for the third phase of the LDM

⁴ Kerry Rittich, in her articles “The Future of Law and Development: Second-Generation Reforms and the Incorporation of the Social” and “Recharacterizing Restructuring: Law, Distribution and Gender in the Structure of
and to challenge legal development agencies to continue the current trend of incorporating social justice concerns into legal reform projects. This paper will join Rittich in an effort to link social justice concerns with economically-focused legal reform projects.

Market Reform” addresses the questions of how IFIs are managing the incorporation of social justice into the development agenda. Additionally Darren Rosenblum in “Feminizing Capital: A Corporate Imperative” and Margaret Chon in “Intellectual Property and the Development Divide” are challenging the dichotomy between private law and social welfare concerns.
Part III: The Incorporation of Social Concerns into Legal Reform Projects

A. Why Development Agencies Should Care about Incorporating Social Justice Concerns into Legal Development Projects

Big development agencies like the World Bank have an important role to play continuing the new trend of incorporating social justice concerns into development projects. There are several arguments why development agencies should care about continuing this trend, including legal and instrumental arguments.

The first argument that development agencies should care about continuing the trend of incorporating social justice concerns into development projects is that the incredible power they wield to impact social justice concerns in the developing world gives them some responsibility. Development agencies have argued that they have no formal obligation to realize social justice concerns. Rittich says that development agencies “maintain that they have no independent, free-floating mandate to act as human rights enforcers; they are strictly limited in their decisions to considerations that demonstrably further economic development” (Rittich, 2006: 240). Margot Salomon agrees that the development agencies’ mandates are not focused on social justice concerns, but she argues globalization has created a new set of social justice “duty-bearers,” especially in the area of social and economic rights in developing countries (Salomon, 2007: 3). Ensuring economic growth and responding to social justice concerns are no longer the exclusive responsibility of the states and are now shared with international organizations, transnational corporations, and multilateral aid agencies (Salomon, 2007: 3). She argues that social justice concerns are not addressed automatically with development, but applying these concerns to the development process can provide the operational link between social justice concerns and the
development practice (Salomon, 2007: 9). A social-justice-oriented approach to development provides a legal and normative foundation for the implementation of legal development policies (Salomon, 2007: 9).

The UN has made similar assertions about the burden of realizing social justice concerns on non-state actors like development agencies. For example, in 2001 the UN Economic and Social Council released a statement concluding that “non-state actors, including international organizations . . . and private businesses also have heavy responsibilities in the struggle against poverty” (CESCR, 2001: ¶20). The UN Charter emphasizes how social justice is linked to a stable economic order which requires international cooperation among states (Salomon, 2007:11). Subsequent legal sources have also implied that powerful members of the international community, which would today include development agencies, have not only a role but also a “responsibility in contributing to the progressive realization of socioeconomic rights” (Salomon, 2007:11-12).

“Just as the economic growth of any given country is no longer considered separately from the role, and impact of, the outside world and its engagement with it, so the outside world can no longer be considered irrelevant for the realization of human rights elsewhere. The impact on the enjoyment of human rights of . . . IFIs . . . and their influential role in the economic order and in the exercise of human rights abroad, is such that their various human rights responsibilities cannot be ignored” (Salomon, 2007: 12).

Another argument why development agencies should continue incorporating social justice concerns into their development projects is that greater attention to social issues (like

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5 Legal sources listed as footnotes 26-27 in Salomon, 2007. See ICESCR, Art.2(1): ‘Each State Party to the present Covenant undertakes to take steps, individually and through international assistance and co-operation, especially economic and technical, to the maximum of its available resources, with a view to achieving progressively the full realization of the rights recognized in the present Covenant by all appropriate means, including particularly the adoption of legislative measures’; and Arts. 11(1), 11(2), 15(4), 22 and 23; see Convention on the Rights of the Child (1989), GA res A/RES/44/25, annex 44, UN GAOR Supp. (No. 49), at 167, UN Doc. A/44/49. CRC, Art. 4: ‘ With regard to economic social and cultural rights, State Parties shall undertake such measures to the maximum extent of their available resources and, where needed within the framework of international co-operation.’
gender equality) enhances human capital, the cultivation of which has now been identified as crucial to economic success in emerging economies (Rittich, 2006: 207). Rittich argues that social issues have now been accepted as both objectives of legal reform in themselves, and also as important factors to achieving economic growth (Rittich, 2006: 207). Social justice concerns and human rights not only contribute directly to economic outcomes, they form part of the political climate necessary to attract investment and ensure growth (Rittich, 2006: 225). Rittich writes that social concerns can have a demonstrable impact on market and economic development, and that development agencies are already shifting reform policies to incorporate them. The World Bank’s own empirical research and policy reports increasingly suggest a connection between the demands of social justice and economic growth (Rittich, 2006: 229). For example, antidiscrimination rules increase market access and economic participation for previously disadvantaged groups, which enhances economic growth as well as social inclusion (Rittich, 2006: 225). Another example is when development agencies include more popular participation in formulating their legal reform policies; this both reinforces democratic values as well as ensures greater success for legal reforms in countries where top-down legal transplants have mostly failed (Rittich, 2006: 232).

The final argument for why development agencies should care about incorporating social justice concerns into development projects is a normative argument. In this third phase of the LDM, development agencies are in a powerful position to influence social justice realization. In 2006 Trubek concluded that the values of “human dignity, equality and fairness are already embedded in contemporary understanding of the rule of law,” and even though existing legal systems do not necessarily embody these values, legal reform is an arena where struggle for such values can go on in a bloodless way (Trubek, 2006: 93-94). He continues to argue, along with
many other LDM scholars, that social justice concerns are compatible with legal reform, and that “development projects [can] be shaped to serve the whole population, not just the economic elite” (Trubek, 2006: 94). This normative vision of legal reform should encourage development agencies to continue incorporating social justice concerns into future development projects. The next section will discuss in more detail how development agencies are already increasingly incorporating social justice concerns into legal reform projects.

B. How Development Agencies are Incorporating Social Justice Concerns into Legal Reform Projects

There are several mindful changes that development agencies have been making in the third phase of the LDM that demonstrate greater incorporation of social justice concerns into reform projects. The first important change that legal development agencies have been making in recent years is a direct response to harsh criticism from LDM scholars about the use of universalist legal transplants and almost single-minded focus on market growth, without regard for the social, cultural or political dimensions of development (Trubek, 2001; Trubek & Santos, 2006:6, 89; Salomon, 2007: 9,11; Rittich, 2006: 208,213). In response to these criticisms development agencies have been redesigning legal reform policies to be more flexible and context-oriented (Sherman, 2009: 1271). Legal reforms projects are getting better at adapting to existing legal frameworks and are more open to being reworked by local actors as opposed to simply being transplanted into different countries’ legal statutes “as-is” (Rittich, 2006: 206, 211).

Another change in the way development agencies conduct legal reforms is a greater expansion of the types of actors participating in legal development. More and more regulatory tasks that were once the sole realm of the state are now being handed to civil society
organizations like voluntary associations or non-governmental organizations (Rittich, 2006: 223). These different groups can provide development agencies with valuable sources of social capital, local information and democratic preferences (Rittich, 2006: 223). Greater involvement of different groups in development projects can even increase demand on the state for institutional change, which may create more cooperation of the state in implementing legal reform projects (Rittich, 2006: 223).

Another change that can be seen in recent LDM reform projects is the adoption of more “soft law” policies. These are informal and voluntary initiatives that take place on the ground level in developing countries instead of strict formalistic rulemaking (Rittich, 2006: 223). Soft laws can provide a useful tool for incorporating social justice concerns into development projects. An example of this is to encourage gender equality and labor rights through workplace codes of conduct, as opposed to new legislation (Rittich, 2006: 224). Rittich argues that these soft laws are often generated by the affected parties themselves on the ground level (Rittich, 2006: 224).

A final change to the legal reform policies of development agencies is the greater recognition of non-legal resources, social networks and culture. Rittich insists that this marks a “significant shift in the regulatory approach” of development agencies (Rittich, 2006: 224). She says:

“While the justification for formal law remains centered on its role in attracting investment and promoting growth, culture and society have now been partially rehabilitated and there is a new interest in the role of informal norms in furthering efficiency as well as growth” (Rittich, 2006: 224).
Informal rules are being used to complement formal law to facilitate business transactions (Rittich, 2006: 224). Cao agrees that addressing the cultural foundations of legal reform projects is a critical step in the third phase of LDM (Cao, 2007: 365).

Rittich argues that the above changes indicate a growing trend of “instrumentalization of social justice claims” where “social objectives are embraced not only because they are human rights or are socially desirable, but because they enhance growth” (Rittich, 2006: 233). Worker’s rights and gender equality advocates have started lobbying agendas in terms of their contribution to the economy (Rittich, 2006: 233), and social goals that most directly enhance market participation like education, worker training, or collective bargaining are taking priority over social goals that aren’t seen as similarly conducive to increasing human capital (Rittich, 2006: 233).

Even though these changes indicate a progressive step towards greater incorporation of social justice concerns into development projects, they have not been free from criticism. Changes to how social justice issues are being framed have been criticized by scholars who would rather keep the emphasis on collective rights instead of individualized benefits (Rittich, 2006: 233). There is also the danger that development agencies are not only incorporating social concerns into market reform projects, but they are changing them in the process (Rittich, 2006: 246).

“By articulating their relationship to economic growth and managing the processes by which [social concerns] are incorporated, the IFIs are effectively ranking and ordering the importance of different social objectives and alternatively legitimizing and delegitimizing the means and strategies by which they can be pursued” (Rittich, 2006: 247).

Regardless of these critiques, what is generally agreed upon is that in the third phase of LDM market and social reforms are on the table together (Trubek, 2006: FN3; Rittich, 2006:...
Rittich warns legal scholars that they cannot simply accept any automatic collapse of social justice concerns into economic projects (Rittich, 2006: 248-52). On the other hand, those insisting that social justice concerns can only be tackled through the formal institutionalization of human rights should open up to the idea that progressive outcomes can be furthered in a variety of ways, some of which include incorporation into economic reform projects (Rittich, 2006: 248-52).

Legal development agencies have begun incorporating social justice concerns into development projects, and legal scholars are now well positioned to encourage this trend by suggesting new forms of social and economic policy integration. This paper will take this next step by focusing on the role of insolvency law in legal development and by making suggestions for greater incorporation of social justice concerns into insolvency law policy.
Part IV: Insolvency Law in the Developing World

A. The Importance and Relevance of an Effective Insolvency Law

Insolvency law is one of the few subjects outside of criminal law and civil liberties that invites a social justice approach (Gearty, 1998: 6). This presents a special analytical challenge to social justice advocates. This is because although it is predominantly a business subject, involving the regulation of failed commercial ventures, it also directly affects the economic well-being of individual people like community members, company directors, employees and other business owners (Gearty, 1998: 5). Insolvency law is one of the few private or financial law subjects that can look beyond the sanctity of private contracts and be redistributive by nature. This is why it is an important area to focus on for incorporating social justice concerns into legal reform projects.

Economic and development scholars generally agree that market growth and economic development are greatly facilitated by stable and predictable finance markets and access to credit (Sloman, 2006: 720-48; Muir, 2009: 1). The World Bank asserts that “Capital and credit, in their myriad forms, are the lifeblood of modern commerce” (World Bank, 2011: 2). Individuals need credit to finance housing, education, and healthcare and thereby raise their standard of living. Agricultural workers and manufacturers need credit for capital equipment investments and to expand operations. Finally, credit and financing are especially important to entrepreneurs who need it to fund new business proposals which will increase competition in the economy (Muir,

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6 This paper will focus on corporate or business insolvency law, and not personal bankruptcies. Although laws that regulate personal insolvencies have a lot of social justice repercussions and can influence entrepreneurship, they make up a different body of law than corporate insolvency law, and they will not be discussed here.
Access to credit is therefore an important part of a developing economy, and plays an important role in legal development projects.

Closely related to the importance of credit in legal development projects, insolvency or bankruptcy law is increasingly recognized as a fundamental legal institution necessary for economic growth and entrepreneurship (Ayotte, 2009: 2; Davies, 2004: 296). The adoption of laws that protect creditors’ rights and ensure a stable and attractive investment climate are a “precondition to participation in the global economic order” (Rittch, 2006: 211). The World Bank believes “insolvency and creditor’s rights laws can contribute to the economic health of countries by providing a safety valve in the event of financial distress, reducing asset deterioration, and restoring balance to commercial relationships” (World Bank, GILD website). The UN adds that insolvency laws and institutions are critical to enabling countries to achieve the benefits and avoid the pitfalls of integrating their national financial systems with international financial systems (UNCITRAL, 2004: 12).

Insolvency law at its most basic is a legal framework regulating business failure. In any credit-based economy, there is a risk to creditors that individual companies will not be successful enough to repay all of their debts. When default occurs in a large company that owes money to multiple creditors, and there is no functioning insolvency law in place, creditors will race to reclaim the money they are owed (Finch, 2009: 9, Jackson, 1986). This “free-for-all” generally results in high litigation costs, business stagnation, inefficiencies and unfairness to weak or vulnerable creditors (Finch, 2009: 9). Effective insolvency laws allow for the fair and orderly distribution of assets by either dissolving businesses that are not viable or by saving businesses that have a chance at becoming sustainable (BizCLIR, Bankruptcy website). Not only does a clear and enforceable insolvency law prevent the costly and inequitable race amongst creditors to
the assets, but it plays an important role in creating predictable and manageable business relations in a developing economy (BizCLIR, Bankruptcy website). Without an effective insolvency law in place, creditors interested in financing businesses in developing countries cannot be sure how their investments will be treated in the event of default. This not only scares away investment, but it creates high interest costs and perverse incentives for creditors to aggressively reclaim their assets at the first sign of financial difficulty in the company.

There is a range of legal issues that are affected by insolvency law. Elizabeth Warren, one of the leading scholars on the American bankruptcy system, argues that it is impossible to avoid rules that deal with the consequences of business failure (Warren, 1993: 343). There will have to be some laws in place that deal with contract rights, tort victims, banks, employees, suppliers, and anyone else affected by a failed business (Warren, 1993: 343). Insolvency laws have the ability to resolve all of these different claims and interests in one place and provide certainty in the market and promote economic stability and growth (UNCITRAL, 2004: 12). Insolvency procedures affect economic incentives not only at the time of business distress, but even when investors enter contracts with a company while it is still profitable (Wihlborg, 2002: 6). These issues reinforce the argument that insolvency law has a powerful impact on economic development. Because of this impact, and because of the wide range of interested parties, or “stakeholders” that are affected in this area of law, insolvency is an important legal sector to focus on when incorporating social justice concerns into development projects. The way that development agencies reform existing or design new insolvency laws will be critical to the incorporation of social justice concerns.

Any time new laws are being drafted or reforms to existing laws are being suggested it is important to be clear about the goals and the values that will be furthered by those laws (Finch,
In her text on corporate insolvency law, Vanessa Finch is adamant that laws in this area must be developed with a sense of purpose, because when the purpose is unclear laws will be riddled with inconsistencies of reasoning and failures of policy (Finch, 2009:1). Different countries take different approaches to which key objectives an insolvency regime should aim to achieve depending on each country’s different legal and social values (UNCITRAL, 2004: 11). The basic aims and objectives of insolvency law have been a subject of fierce debate since its inception (Finch, 2009: chs. 1-2; see also Flessner, 1994; Warren, 1987; Jackson, 1986). Although there are a great number of potentially competing objectives for an insolvency regime, the main debate among scholars has centered on whether insolvency law should aim only to maximize creditor wealth, or whether other interests (like those of employees, or the general public) should play a bigger role in insolvency law policy (Keay & Walton, 2003: 24).

Proponents of the “creditor wealth maximization” approach believe the main objective insolvency rules and policies should be designed to achieve is maximize the amount of wealth that goes to creditors, and distribute that wealth according to the bargains that each creditor made before the business failed (Finch, 2009: 33; Jackson, 1986). This approach has been strongly criticized as a “dangerous over-simplification of the nature and purpose of the bankruptcy process” (Goode, 2005: 43, describing Warren, 1987). An exclusive concentration on maximizing returns to creditors is unfair to small or nonconsensual creditors who were unable to

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7 The following is a list of the key objectives for an insolvency regime identified by scholars and practitioners: Provide certainty in the market to promote economic stability and growth; Maximize the value of returns to creditors; Provide timely, efficient and impartial resolution to business failure; Treat business difficulty at an early stage; Distribute proceeds to creditors fairly and equitably; Administer insolvency process honestly and competently; Investigate and punish bad business conduct when necessary to encourage commercial morality; Recognize existing creditor rights and establish clear rules for ranking priority of claims; Recognize and safeguard interests of society/community affected by insolvency; Rescue viable commercial enterprises; Preserve future expectations for shareholders; Safeguard interests of the workforce by preserving investment of labor, expertise and loyalty; And recognize community interests in the continuance of a business or in pollution clean-up costs (Finch, 2009: 27-65; Cork, 1982: Para. 198; Goode, 2005: 39-49; UNCITRAL, 2004: 11-15).
make a good bargain before the business failure (like tort victims, or small creditors), and this approach is based on untested assumptions about what creditors want before default is contemplated (Goode, 2005; Warren, 1987: 787-88; Finch 2009: 33-34).

Alternative approaches to insolvency law take a broader spectrum of interests into account when planning for the collection and distribution of assets after business failure (Korobkin, 1991: 721; Warren, 1987; Finch, 2009: 38-48). Although she doesn’t go as far as Warren who takes a “dirty, complex, inter-connected” multiple-values approach to insolvency policy, Finch does argue that certain values (expertise, accountability, efficiency, and fairness) can be generally accepted by everyone and can more holistically guide an inclusive approach to insolvency policy than an approach based solely on economic interests (Finch, 2009: 52-63).

Certain parties are acutely affected in insolvency law that are not considered in the creditor wealth maximization approach, like employees that lose their jobs, taxing authorities who lose ratable property, suppliers who lose customers, customers that are forced to go elsewhere, and the community as a whole (Warren, 1993: 354-55). Finch argues that insolvency law should serve a series of values beyond a single economic rationale (Finch, 2009: 45). The next section examines how insolvency law can be redistributive and sensitive to broader issues of social justice.

**B. Insolvency Law as a System of Redistribution**

Insolvency law can take account of values and interests beyond just the economically rational because it is designed to have significant distributional power (Warren, 1993: 352). When a company fails and there are inevitably not enough assets to repay all of its debts, insolvency law resolves disputes between competing claims by altering certain legal rights and
creating priorities of repayment (Warren, 1993: 352). The purpose of insolvency law is not to ensure that all creditors will be paid in full, or to ensure that all interests are completely protected, but to provide a fair and predictable distribution scheme after striking a balance between the many parties’ interests and the economic, political and social considerations at stake when a company fails (UN Guide: 11, 23). Warren argues that insolvency law represents a deliberate decision on the part of lawmakers to pursue different distributional objectives from the de facto scheme of debt collection (Warren, 1993: 353). Since insolvency law benefits creditors by replacing the costly and chaotic race for assets with an orderly and efficient method of collection and distribution, insolvency is a forum in which everyone agrees to part with some rights in order to participate in a process that works for the collective good (Warren, 1993: 361). This allows insolvency regimes to distribute wealth in ways that protect vulnerable members of society from the dangers of business failure (Warren, 1993: 356).

Insolvency law can help safeguard interests that have no other protection when a company goes under. One example is to safeguard the interests of customers who can’t easily access similar goods, or a community that may lose a major source of economic industry. Another example of insolvency law safeguarding unprotected interests is that insolvency law can anticipate the consequences of default on future claimants like future tort claimants who have not even discovered their injuries yet, or government agencies that may discover pollution sites and demand clean-up costs (Warren, 1987: 786-87). There will be competing normative goals in any insolvency regime, and a well-designed law can achieve a balance of different objectives and interests by reapportioning the risks of business failure in ways that suit a society’s economic, political and social goals (Warren, 1993:338; UN Guide: 15). Royston Goode argues that just
because certain interests are subordinate to other more powerful interests, is not grounds for denying them some place in the distribution scheme (Goode, 2005: 45).

Designing insolvency law to redistribute wealth is not simply a hypothetical policy approach; almost every legal system that has insolvency procedures has developed rules where certain weaker or unprotected interests get priority over more powerful creditors (Goode, 2005: 46). When legal reformers are designing new insolvency laws there are several factors that are relevant in determining the appropriate method of distribution in an insolvency scheme. One factor is a party’s ability to prepare for or anticipate the business’s default (Cantlie, 1994: 420-21). Did the party have access to all of the relevant information when it was contracting with the company? For example, small creditors (trade creditors, suppliers or service providers) might not have the bargaining power to demand certain information at the time of transaction, or the transaction might be too small to warrant a lot of investigation into the finances of the company (Finch, 2009: 632). These small creditors might need extra protection in an insolvency distribution scheme, because larger creditors would have an unfair advantage.

Even if the party did have enough information to anticipate business difficulty, did the party have enough bargaining power to broker a fair deal? Parties with very low bargaining power or a limited ability to demand timely payment of debts suffer more than large creditors (like banks) that can secure timely payment before the business is having difficulty (Finch, 2009: 165-71).

Another factor that is relevant in determining wealth redistribution in an insolvency scheme is a party’s ability to handle the risk of default (Finch, 2009: 607-09; Villiers, 1999). Certain creditors are harmed more than others when a company defaults. Large creditors, like
banks, can spread the risk of default across many investments, while small creditors like suppliers who have given the company a grace period for repayment, or employees who are owed wages or pension payments have very little ability to spread the risk. When a business fails to pay an employee’s wages, it is often the employee’s only source of income, and even if the employee is owed much less than a larger creditor is owed, he or she will be harmed disproportionately (Finch, 2009: 608).

Unlike many other private and financial legal regimes, insolvency laws can be designed from the outset as a system of redistribution (Warren, 1993). Insolvency law is an area of law that is already focused on a great deal in development projects because of its importance to creating stable economic growth. However, it is underutilized as an area of law for incorporating social justice outcomes. Legal development agencies designing insolvency regimes in the developing world can utilize insolvency’s redistributitional power to incorporate social justice concerns into legal reform projects. Part V will look more specifically at how insolvency law is being used by development agencies in the third phase of the LDM.
Part V: Insolvency Law in the Third Phase of Law and Development

A. Development Agencies Current Use of Insolvency Law

Insolvency law plays a major role in contemporary LDM projects. Several big development agencies including USAID, the UN, the IMF and the World Bank, have specifically targeted insolvency law as an area for focused reform and development\(^8\). The IMF and World Bank focus on insolvency and creditors’ rights law because they see it as a critical element of financial system stability (World Bank, GILD website). In the third phase of the LDM these development agencies are executing insolvency law reform projects mostly through the use of ‘Best Practices’ models and legislative reform models. The two most prominent models for reform projects are the UN’s “Legislative Guide on Insolvency Law” (Guide) and the World Bank’s “Principles for Effective Insolvency and Creditor Rights Systems” (Principles) (UNCITRAL, 2004; World Bank, 2011). These models have been developed to aid both the evaluation of existing insolvency laws and development assistance of new insolvency laws around the globe. The World Bank and IMF argue that “these two complementary texts represent the international consensus on best practices and set forth a unified standard for Insolvency and Creditors’ Rights (ICR) systems. In addition, these texts serve as reference points for evaluating and strengthening countries’ ICR systems” (World Bank, GILD website).

The first UNCITRAL insolvency publication was the Model Law on Cross-Border Insolvency with Guide to Enactment (Model Law), which was first adopted by the UN in 1997

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as an innovative approach to creating a workable solution to cross-border insolvencies (Fletcher, 2006: 86). Prior to the Model Law, attempts to enact international treaties in the area of insolvency and creditors’ rights law had failed because of irreconcilable differences between national laws and policies (Fletcher, 2006: 86). The Model Law instead was created as a flexible example of a limited, but functionally important, series of provisions that could be adopted into different countries’ laws, either as a whole or in parts (Fletcher, 2006: 86-87; UNCITRAL, 1997). It was hoped that most countries would adopt the Model Law without much alteration, leading to “a coherent set of provisions for cross-border co-operation [that] would progressively enter into force in the laws of many countries throughout the world, generating a de facto framework for international assistance in insolvency matters” (Fletcher, 2006: 87). From 1997 to 2010 at least nineteen countries have announced already their adoption of some or all of the Model Law (UNCITRAL, Status website). In June, 2004 UNCITRAL adopted the Legislative Guide on Insolvency Law as a complement to the Model Law. UNCITRAL was taking a step away from providing countries with a universalist model for insolvency law and instead offered a guide for how to implement more context-specific insolvency policies. The Guide was intended to be used as a reference by legal reformers and national legislative bodies when preparing new laws or reviewing the adequacy of existing ones (UNCITRAL, 2004: 3). The Guide was developed with the goal of encouraging the adoption of effective corporate insolvency regimes in countries where there was either a dysfunctional insolvency regime, or no insolvency law at all, and it has been hailed by the International Bar Association as a “comprehensive work of real

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9 Australia, Canada, Columbia, Eritrea, Greece, Japan, Mauritius, Mexico, Montenegro, New Zealand, Poland, Republic of Korea, Romania, Serbia, Slovenia, South Africa, UK/Northern Ireland, British Virgin Islands, and the USA. According to the UNCITRAL Model Law Stats website “Since States enacting legislation based upon a model law have the flexibility to depart from the text, the above list is only indicative of the enactments that were made known to the UNCITRAL Secretariat.” http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html
practical value” (World Bank, GILD website; IBA website). Together the Model Law and the Guide are currently used to assist both development agencies and national authorities to design new insolvency laws as well as reform old ones.

World Bank first began developing the Principles in 1999 at a time when there were no internationally recognized standards to evaluate the effectiveness of different countries’ insolvency laws (World Bank, 2011: 1). The Principles were originally vetted in five separate regional conferences, with the input of experts from 75 different countries; drafts were placed on the World Bank’s website for public comment, and were finally approved and adopted in 2001 (World Bank, 2011: 1). From 2001 to 2004, the Principles were used to assess insolvency systems in 24 different countries in all regions of the world before they were revised and republished in 2005 and then again in 2011 (World Bank, 2011: 1). The World Bank asserts that “assessments using the Principles have been instrumental to the Bank’s developmental and operational work and in providing assistance to member countries. These assessments have yielded a wealth of experience and enabled the Bank to test the sufficiency of the Principles as a flexible benchmark in a wide range of country systems” (World Bank, 2011: 1).

During the development and revision of the Principles, the World Bank worked alongside UNCITRAL staff and experts to ensure consistency between the Principles and the UN’s Legislative Guide (World Bank, 2011: 2). The following section will discuss some of the possible criticism for the current use of insolvency law in legal reform projects.

**B. Potential Criticism of Current Insolvency Law Development Projects**

There are several potential criticisms of the development and use of the Guide and Principles. These are very similar to criticisms from scholars in the first two phases of the LDM.
The first potential criticism of insolvency law development projects is that the development and use of the Guide and Principles is just another example of naïve believe in universalist transplants that can be relocated to any jurisdiction and stimulate market growth in varied legal environments. Trubek’s strongest plea for the third phase of Law and Development is to replace the “one-size-fits-all” formula that guided the practices of the past, and abandon the hope of one big universal scheme that will solve a variety of development challenges (Trubek, 2007: 241). He argues that the greatest weakness and the greatest appeal of the schemes of the last phases of the LDM were that they were based on universalism (Trubek, 2007: 237). New legal reform projects instead need to master the complexity and heterogeneity of all the different and distinct legal systems, and use less general formulas, best practices and pre-packed reforms (Trubek, 2007: 238). There are signs that this is taking place in insolvency development projects.

Although the support among developers for ‘best practices’ models remains strong, IFIs no longer tout them as universalist solutions. Both UNCITRAL and the World Bank are adamant that their models are not intended to be used as legal transplants, but are designed to be flexible references that can assist reformers and national authorities develop insolvency laws that form an integrated part of the legal institutions that are already in place (World Bank, 2011: 1-3; UNCITRAL, 2004: 3). Publications from development agencies involved in insolvency law reform say that to be effective, “the content and implementation of an insolvency law must be compatible and coordinated with other aspects of a country’s legal system” (BizCLIR, bankruptcy website). There is no universal solution to the design of an insolvency law because countries vary significantly in their needs (UNCITRAL, 2004: 15). Other laws that effect insolvency practice (like contract enforcement, property rights, enforcement of remedies, etc.)
vary between countries, and the effective implementation of a new insolvency law will need to adapt to those differences (UNCITRAL, 2004: 15). Even though development agencies are using pre-designed models to assist legal reform projects, they seem to be giving up on the “one-size-fits-all” strategies and instead taking more account of the disparities between different countries (Sherman, 2009: 1269). They are responding to the criticism that context matters and adapting development policy to be more attuned to the particular conditions on the ground (Sherman, 2009: 1271). This is a promising change for social justice advocates who are working to incorporate more progressive social reform into legal development projects. By being more attuned to the different legal, political and environmental contexts of developing countries, IFIs will be more aware of the different social concerns as well.

Another potential criticism from past legal reform practices is that legal reforms based on “best practices” models are undemocratic, top-down initiatives that left out local leaders and various interested parties (Rittich, 2006: 234-35). Trubek argues that legal development policies instead should be constructed through experimentation and collaboration (Trubek, 2009: 9). Broad participation by stakeholders, beyond just the state and business actors, would add more transparency and legitimacy to legal reform projects (Trubek, 2009: 22-23; Sherman, 2009: 1271; EPIQ II, 2007: 9-13). In this area Trubek agrees that development agencies are paying more attention to local participation in the design and implementation of legal reforms (Trubek, 2006: 7; EPIQ II, 2007: 9-13). Rittich adds that “country ownership” of reform is a hallmark of the third phase of the LDM (Rittich, 2006: 206, 211). The World Bank asserts that a seminal aspect of its ‘Insolvency Initiative’ is its active engagement with different parties in various “global and regional forums that have brought together key international experts and relevant regional practitioners” (World Bank – GILD, 2011). In order to develop the Guide and
Principles, both the World Bank and UNCITRAL conducted extensive consultation with the international insolvency community (World Bank, 2011: 1-3; UNCITRAL, 2004: iii).

Development agencies also encourage a great deal of “stakeholder” participation in the development and review of insolvency regimes in each country (EPIQ II, 2007: 9-13). USAID published a guide to economic policy reform in 2007 that strongly encourages the involvement of a wide variety of interested parties including local decision-makers, civil society, implementing ministries, the private sector, NGOs and other development agencies (EPIQ II, 2007:2). Broad participation in reform projects is not only more democratic, but it allows more social concerns to be addressed during the design of new laws and ensures greater success for new policies once they are implemented (EPIQ II, 2007: 2). For example, if a broad group of interested parties is able to discuss the design of a new insolvency regime, the development agencies organizing the project can be more aware of the different groups that might be harmed in the event of business failure and design protective schemes into the new law accordingly.

A third potential criticism from LDM scholars that can be applied to current insolvency projects is that despite changes in the third phase of the LDM, legal reform projects have still been too rigid. The needs of specific industries and regions can be better ascertained and addressed if the third phase of the LDM is both stable and flexible (Trubek, 2009: 20). Development agencies should be seeking new ideas and exploring new paths toward successful legal reform (Trubek, 2009: 20). Insolvency laws seek to maintain stability and predictability in order to attract investors, but new insolvency laws should also be revised from time to time to ensure they are meeting local requirements (see EPIQ II, 2007). UNCITRAL agrees, and says because “society is constantly evolving, insolvency law cannot be static, but requires reappraisal at regular intervals to ensure it meets current social needs” (UNCITRAL, 2004: 16). The World
Bank’s Principles express a similar interest in flexibility: “As legal systems and business and commerce are evolutionary in nature, so too are the Principles, and we anticipate that these will continue to be reviewed going forward to take account of significant changes and developments” (World Bank, 2011: 3). Flexible legal regimes are an important part of incorporating social justice concerns into legal reform projects. Since social justice concerns will be different in each jurisdiction, and because such concerns are likely to change over time, legal regimes need to be flexible in order to adapt to new social challenges and priorities, while still maintaining the stability that makes an effective insolvency law so important to economic growth.

UNCITRAL and the World Bank promote the practice of designing laws that are the result of careful consideration and conscious policy choices, especially when a new regime is altering legal rights and departing from principles of general law (like disallowing creditors to enforce contracts under a collectivized insolvency system) (UNCITRAL, 2004: 12). Insolvency law reform is an area of the LDM where development agencies and scholars can collaborate to incorporate social justice concerns into development projects. Various social justice concerns like protecting employment or democratic participation are encouraged by allowing interests other than just creditors to be involved at the legal development stage, and by insisting on maximum transparency in legal reform projects (Trubek, 2009: 23). Insolvency reform projects can be designed to both elicit private investment and ensure that legal regimes serve the public interest. Part VI of this paper will explore several specific suggestions for changes that can be made to insolvency law development projects in order to incorporate more social justice concerns.
Part VI: Suggestions for Incorporating Social Justice Concerns into Insolvency Laws

A. Broad Policy Changes

The most important step in developing or reforming an insolvency law is to establish the key values and objectives of the law upfront. Broad policy choices need to be made that balance potentially inimical principles like whether to emphasize saving businesses or liquidating them. Since an effective insolvency regime cannot fully protect the interests of everyone affected by business failure, the design of a new insolvency law should be clear about the balance it is striking between different objectives (UNCITRAL, 2004: 15; Finch, 2009: 52-63). This balance needs to be made up front because predictability in insolvency is crucial to the stability of the system. All parties need to be able to anticipate how their legal rights will be affected in the event of business failure (UNCITRAL, 2004: 15). By having the power to change certain legal rights and redistribute wealth, insolvency law is well-positioned to affect social justice concerns in the developing world. This Part will discuss which insolvency objectives development agencies can emphasize that will take advantage of insolvency law’s redistributive power and thus further the incorporation of social concerns into development projects. There are a number of ways that an effective insolvency law can help incorporate social justice outcomes into legal reform projects. The following suggestions for making insolvency law more social justice oriented require broad policy considerations. More specific changes that might go into future insolvency legislation will be discussed later in the next section.

i. Emphasis on Reorganization

The first broad policy objective that development agencies should choose to emphasize when designing social justice oriented insolvency laws is to try to save businesses whenever
possible. Reorganization or rescue are terms used in insolvency law to refer to a number of
different procedures that are ultimately intended to help a company overcome financial difficulty
and continue running. The end product of reorganization might be the business restored to its
original state before the financial trouble, or it might be a drastically downsized version with new
management and a completely new business plan (Finch, 2009: 244). The goal however, is to
breathe new life back into a viable business, even if that means making major changes. When a
big creditor senses trouble in a company it can stop all business production by foreclosing on
debt and repossessing assets in lieu of payment. In countries where there is no process in place
for saving a business, the premature dismemberment of factory machinery or office equipment
by individual creditors as the collection of their debts damages the economic capacity the
community and directly affects employment opportunities. Adopting a reorganization approach
to insolvency does not mean that all businesses get saved. Businesses that are beyond rescue
should be liquidated as fairly and efficiently as possible, but businesses with a reasonable
prospect for survival should be given a second chance (UNICTRAL, 2004: 16, 23).

   Development agencies that focus only on creditors’ interests will argue that liquidating a
troubled business is less costly than a potentially failed rescue, and it is more efficient to let the
market reallocate resources to more productive businesses. This narrow view reflects LDM
phase one and two thinking and can be criticized the same as the creditor wealth maximization
approach to insolvency discussed earlier. Creditors’ interests are not the only ones that are
affected when a business fails, and insolvency law has the redistributive power to take broader
interests into account. Development agencies should emphasize reorganization over liquidation
in legal reform projects in order to take advantage of insolvency’s unique ability in this area to
incorporate social justice concerns.
Additionally, liquidation is not always the most efficient method of tackling the problem of financial difficulty in business. It is a “basic economic theory that greater value may be obtained from keeping the essential components of a business together, rather than breaking them up and disposing of them in fragments” (UNCITRAL, 2004: 12-13). In fact, business profits and value can be maximized by reorganizing a troubled business (Finch, 2009:245). Reorganization does not guarantee that a business will be completely restored, that all employees will keep their jobs, or that its creditors will be paid in full, but creditors will eventually receive more than if the business was immediately liquidated (Goode, 2005: 45;UNCITRAL, 2004: 23-24). Preventing the mad grab for assets is important if there is any possibility of saving the business or selling it for a higher price as a whole (UNCITRAL, 2004: 14). Selling a business as a going concern maintains employment opportunities and keeps economic activity in the community that would otherwise be eliminated in liquidation.

The UNCITRAL Guide emphasizes reorganization as a key objective in an effective insolvency law because it can serve several different goals: the value of creditor’s claims may be enhanced if the business can be sold as a whole instead of sold off in pieces; keeping a business going gives a second chance to shareholders and management of the business; reorganization incentivizes entrepreneurship; and vulnerable groups like employees and small trade creditors are better protected from the consequences of business failure (UNCITRAL, 2004: 15-16). Reorganizing a business, even if it requires making substantial changes, means that employees get to keep their jobs, suppliers do not lose a client, customers do not have to go elsewhere, and the community where that business is located does not have to suffer the consequences of a failed business. These outcomes might be minor in the case of a small business failure, but they
could be very damaging in a community where the troubled business in question is the main source of employment.

Keeping employees in their jobs is one of the most important social justice concerns that can be incorporated into insolvency law reform projects. Employment considerations have led many countries to favor insolvency laws that try to save businesses whenever possible (Wihlborg, 2002: 6). In businesses where technical know-how or employee loyalty and goodwill are more valuable than any physical assets the business might own, the preservation of human resources and business relations cannot be realized through liquidation (UNCITRAL, 2004: 24).

In an article discussing insolvency laws in Africa, Clas Wihlborg finds that legislation favoring reorganization has generally been implemented after severe economic downturns when the consequences of insolvencies have been felt (Wood, 1995: Wihlborg, 2002: 6). An existing economic crisis can be deepened and prolonged if financially distressed firms are not rehabilitated but are instead forced to shut down (Wihlborg, 2002: 4). Designing an insolvency law that emphasizes reorganization whenever possible not only saves jobs and protects communities, but it keeps functional factories and offices running instead of stopping production at the first sign of trouble (Wilkinson, 2008, 1).

**ii. Additional Broad Policy Changes**

A second social justice concern that can be incorporated into an insolvency law policy is greater encouragement of entrepreneurship (Armour, 2008). Entrepreneurship is not only important for economic growth, it can also be an important factor in increasing a family’s or community’s standard of living. In a developing economy where much of the workforce is
employed by the same industry (like the farming of a particular agricultural crop)
entrepreneurship encourages individuals to develop a broader set of skills or start a side business.
If there is a natural disaster or market change that affects the industry both the individual’s family and community will benefit from the existence of diverse sources of income. Insolvency law encourages entrepreneurship because it protects individuals from crippling debt. “Fear of failure can act as a powerful disincentive to potential entrepreneurs and the actual cost of failure can deter many whose first failure was honest from trying again” (Insolvency Service, 2001: 1).
An insolvency regime that is designed to be more debtor-friendly than creditor-friendly allows individuals to finance innovative new ideas with less overall debt risk (Wihlborg, 2002: 6).
Many insolvency regimes, like bankruptcy in the United States, come with “fresh start” provisions that allow individuals to distribute whatever valuable assets they have after a failed venture, dissolve their remaining debt, and try again. These provisions encourage entrepreneurship by fostering innovation and experimentation in the marketplace, which can lead to successful new businesses and economic growth. Corporate insolvency laws encourage entrepreneurship when in conjunction with laws that respect businesses as separate legal entities. Business managers and directors can run innovative new companies without great personal risk, allowing them to try marketing new products or services.

A third broad policy objective that development agencies can decide to design into an insolvency law is to investigate and punish fraudulent behavior in bad businesses, which fosters a more accountable business culture. Insolvency law can be designed to identify the causes of a company’s failure and to punish individuals who have behaved poorly. Insolvency laws that include sanctions for improper trading and disqualification of business managers from running any new companies protect the public in the future (Goode, 2005: 62-63). Some existing
insolvency laws\textsuperscript{10} even have provisions to shut down businesses before they are in default if they are engaging in practices that defraud customers or take advantage of vulnerable populations (Finch, 2009: 541-48).

Finally, the design of an insolvency law can influence corporate moral behavior and infuse normative principles into business operations. Since insolvency law impacts a great variety of other legal sectors (corporate, employment, tort, environmental, pension and banking law), its design, underlying values and objectives can have far reaching effects (Finch, 2009: 1). When an insolvency law is designed to embody certain progressive values and principles, it can instill those principles into other areas of market practice, like fairness, equality, transparency and accountability (Finch, 2009).

\textbf{B. Specific Statutory Suggestions: Protecting Employees and Vulnerable Creditors}

When designing or reforming insolvency laws, development agencies can ensure greater protections for some of the most vulnerable interests involved in business failure. In a redistributive insolvency regime, creditors' interests in repayment can be protected in conjunction with the wider interests of the community. Goode argues that if it is beneficial for creditors to agree to a collective regime in order to avoid the costs of pursuing their individual claims, then it can be equally beneficial to open that regime up to a wider class of interested

\textsuperscript{10} An example of this is public interest liquidation in the UK, where the Department for Business, Enterprise & Regulatory Reform and the Financial Services Authority have powers to petition the court to wind up a company on ‘just and equitable’ grounds.
parties like employees (Goode, 2005: 45). The following sections make specific suggestions for incorporating social justice concerns into legal development projects.

i. Employee Protection Schemes

Business failure can be stressful to any employee that loses a job or has a claim for unpaid wages, but it can be especially traumatic for employees who have invested years of work, skill and loyalty into a company (Finch, 2009: 754). It is beyond the scope of insolvency law to insulate employees from the prospect of future job loss, but it is not beyond its scope to control the risk of non-payment of wages when a business fails (Cantlie, 1994: 414).

Employees are particularly ill-suited to assess and spread the risk of business failure, or to protect themselves from the effect of employer misfortune (Warren, 1993: 357). There are several employment protection schemes that insolvency laws can incorporate to help shield workers from some of the consequences of business failure. The first is to give employee claims preferential status over other creditors. This type of protection would allow employees to collect unpaid wages, accrued holiday pay and unfulfilled pension contributions before other types of creditors that have a greater capacity to weather the consequences of business failure (Finch, 2009: 756). Designing insolvency laws to give preferential status to employee claims will be discussed further in the next section.

Another rule that can be incorporated into an insolvency regime that helps protect employee wages is to give them “super-priority funding” while the business is being reorganized (Finch, 2009: 415-16). When a business is being reorganized tough decisions have to be made about employment. Even if employees are retained, there is a danger that the reorganization will
be unsuccessful and that the employees will devote more time to their jobs and never be fully paid for their work. In developed insolvency regimes, like the United Kingdom, employees that are retained during reorganization are given extra reassurance that their wages will be paid by giving them priority even over the attorney’s costs during the reorganization (Finch, 2009: 415-16). Giving employee wages super-priority funding during the reorganization of a business encourages skillful or highly experienced employees to stay and help see the business through difficult times, and also expresses respect and concern for employee vulnerability.

Another employee protection that is related to super-priority funding for employee wages is rules that encourage the continuation of paid employment. If retaining employees means their claims for unpaid wages rank above the administration costs for reorganization, there is a powerful incentive to retrench current employees and hire new ones that will not qualify for the same protections. Insolvency laws can be designed to protect employees from this risk by forcing employers to pay unfair dismissal claims unless they have a qualified business reason to retrench them\(^\text{11}\). These same rules can be applied to scenarios when the business is being sold as a going concern (as a whole) to a new owner. Current employees will be protected from being replaced with cheap labor unless there is a qualified business reason to do so (Finch, 2009: 756-57). Rules like these reinforce issues of fairness and distributional justice within an insolvency regime.

ii. Priority Status Given to Vulnerable Creditors

The default principle for the distribution of assets in insolvency law is \textit{pari passu} (on equal footing) (Goode, 2005: 175; Finch, 2009: ch. 14). The \textit{pari passu} principle generally refers

\(^{11}\) In the United Kingdom, if an employer lays off employees during an insolvency proceeding, they have to prove that they did so for an economic, technical or organizational reason (ETO defense).
to the distribution of assets ratably among creditors according to their “class.” Creditors in insolvency are separated into classes according to the protections that they bargained for before the business was in default. Creditors that did not bargain for some special protection in the event of business default, like taking mortgages on the business property, will get classified as unsecured creditors, and treated alike during the distribution of assets. A collectivist and redistributional insolvency regime makes exceptions to the *pari passu* principle and approaches post-default distribution in a different way. Instead of all unsecured creditors being treated alike, prior private bargains are adjusted and certain creditors are given priority payment or preferential status for public policy reasons (Finch, 2009: ch. 14; see Warren, 1987; see also Warren, 1993).

There are several reasons why certain interested parties are particularly vulnerable and should be given preferential status in distribution. One is that not all parties are positioned to make a fair bargain with the business before it defaults. Employees are ill-positioned to negotiate higher wages or benefits to protect them from the risk of employer misfortune, either because they lack the information and expertise or because competition for jobs is too intense. Small trade creditors lack the bargaining power to demand higher interest rates on supply shipments that have gone unpaid. Of course, tort victims don’t have a chance to bargain at all, since they are nonconsensual claimants (Finch, 2009: 607-611).

Another reason why some parties should get preferential status is because they bear the cost of business failure disproportionately, and for the purpose of incorporating social justice concerns insolvency regimes can be designed to protect them (Cantlie, 1994: 430). Employees are rarely able to spread default risks to other sources of income and so when their employer fails to pay their wages they will suffer considerable hardship (Finch, 2009: 609). Trade creditors may be able to spread some risks across multiple business relationships, but small suppliers will
suffer disproportionately if a big customer defaults on payment. Small suppliers may even be forced to let go of some of their own employees in the case of a big default, and for social justice reasons such as protecting employment these suppliers can be protected in a collectivist insolvency regime (Finch, 2009: 208).

A final reason to protect vulnerable parties like employees and small unsecured creditors is that unlike powerful creditors like banks, these parties have very little ability to influence or prevent business default (Finch, 2009: 610). Finch argues “if a party is able to intervene and forestall disaster, we may, on fairness grounds, be less inclined to protect them from default risks by giving them priority than we would in the case of someone who has no power to intervene” (Finch, 2009: 610). Small trade creditors and low level employees could potentially threaten to stop working or trading in the face of imminent default, but they will rarely be positioned to influence decision-making so as to limit the danger of business failure. Tort creditors will probably never have any power to affect business defaults or levels of care in business management, especially tort victims who do not yet know they have been harmed (Finch, 2009: 611).

One of the criticisms of the first two phases of the LDM was that reforms that were focused on economic efficiency and market growth tended to place disproportionate burdens and risks on particularly vulnerable groups (Rittich, 2006: 206; see also Rittich, 2002). A socially-conscious insolvency design removes some of the burden on vulnerable groups by giving them preferential status in the distribution of wealth. Cantlie argues that if vulnerable parties cannot tailor their credit terms it is wrong to burden those creditors with risks that they are in no position to recognize, calculate, adjust terms to or protect themselves against (Cantlie, 1994: 419).
Part VII: Conclusion

It is now more than a decade into the Twenty-First century and the Law and Development movement is going strong. International development agencies are investing billions of dollars into legal reform projects in the developing world and new projects are constantly being designed. In the face of continuous criticism about elitist and naïve reform agendas, these projects are not going away. Social justice advocates can continue to criticize these projects, or they can look for new ways to work with them in order to achieve more progressive goals.

This paper has combined two disparate areas of legal scholarship in an effort to further the incorporation of social justice concerns into legal reform projects. While others have written about the importance of incorporating social justice concerns into Law and Development reforms, none have focused on use of insolvency laws to that end. While others have written about how social justice goals can be achieved in the design of insolvency laws, none have focused on how insolvency laws can be better used as an integral part of the LDM.

It is possible that practiced scholars in either human rights and development or insolvency law will not be wholly convinced by this engagement, or by the argument that engagement is necessary at all. There are some weaknesses to this paper’s argument that social justice concerns can be better incorporated into the LDM through the use of insolvency law reforms.

One weakness of this argument is that scholars are not in complete agreement that significant changes have taken place in the LDM. Some argue that the majority of legal reform projects are still oriented toward market-centric laws and social justice concerns are only
peripheral at best. These criticisms only emphasize the need for scholars to encourage and guide changes in the LDM to be more social-justice-oriented. There are still many changes that can be made to legal development projects, and this paper is an example of how scholars can make incremental suggestions for change through focusing on specific sectors of legal reform.

Another potential problem with this paper’s argument to incorporate social justice concerns through insolvency law is that some scholars, like Rittich, point out that even if the LDM is shifting greater attention to social issues, during the process of incorporation development agencies may be transforming social goals in ways that do a better job conforming to development strategies than exacting distributive justice (Trubek & Santos, 2006: 16; Rittich, 2006: 232). This point only further highlights the need for social justice scholars to help guide the current changes in development agency policy. Unless scholars can emphasize which social justice concerns should be incorporated into projects, or how those concerns should be defined, development agencies will be left to implement social policies as they see fit.

Scholars in this field are optimistic about the changes that are taking place in the LDM (Sherman, 2009; Rittich, 2006). This paper argues that the narrative of development agencies is changing to focus on more comprehensive and progressive outcomes, and the way legal reform projects are being executed shows a concerted effort to respond to past criticisms with greater local participation and flexible development policies.

A weakness of this paper from the perspective of insolvency developers may be that an effort to engage insolvency with social justice concerns is seen as a waste of time. Scholars may argue that the purpose of insolvency law is to effectively and efficiently dissolve failed businesses, and incorporating social justice concerns into the broader context of development is
beyond the capacity of insolvency regimes. This paper argues otherwise. Insolvency law is uniquely suited to engage in economic growth as well as distributive justice. Insolvency law’s ability to redefine legal rights and redistribute wealth makes it an important area of legal reform to focus on in the broader project of incorporating social justice concerns into the LDM.

Certainly, much more academic and empirical research is needed before the incorporation of social justice concerns into economically-focused areas of legal reform can be considered a success. This paper has only begun the much larger task of actually integrating social justice concerns into insolvency reform policies, which will involve any number of development agencies, individual legal reformers representing those agencies in the field, local decision-makers and interested parties. But this is an opportunity that should not be missed for the LDM to move on from the criticized policies of its past and to continue taking steps towards the genuine incorporation of social justice concerns into legal reform.
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