

INVOLUNTARY BANKRUPTCY AS DEBT COLLECTION: MULTI-JURISDICTIONAL LESSONS IN CHOOSING THE RIGHT TOOL FOR THE JOB

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Abstract: *This paper contrasts the usage of creditor-initiated or “involuntary” bankruptcy in England, the Netherlands and the United States, and it presents empirical evidence to reveal and explain stark divergences among these three otherwise very similar systems. U.S. practice is consistent with the hypothesis that involuntary bankruptcy should represent a rare exception to the ordinary process of individual claims enforcement. Elevated levels of involuntary bankruptcy in England and the Netherlands pose a theoretical and practical conundrum. Analysis of empirical data suggests that involuntary bankruptcy is commonly used in England and the Netherlands for deleterious purposes inconsistent with the modern goals of bankruptcy. These discoveries suggest that policymakers should consider restricting involuntary bankruptcy in a variety of ways, especially against individual, natural person debtors.*

We often realize a weakness or oddity in an aspect of our own legal system only by comparing it to others. A case in point is the well-accepted and quite common use in England of creditor-initiated bankruptcy as a means of collecting ordinary claims. What for English lawyers appears a self-evidently appropriate use of bankruptcy turns out to present a theoretical and practical conundrum from a comparative perspective, especially for a U.S. observer.

Theoretically, the key characteristic of a bankruptcy procedure¹ is that it provides not an option for collection of individual claims, but rather a *collective* remedy for *all* creditors of a debtor incapable of satisfying all claimants in full.² Individual creditors should be expected to press their claims in the individual enforcement system in the first and usually exclusive instance. Only in rare cases should the law allow, much less encourage, individual creditors to engage the bankruptcy system, and then only to provide an ultimate backstop to limit and equitably allocate the losses that a debtor’s insolvency causes to all creditors.

Moreover, as a practical matter, individual creditors face powerful disincentives to resorting to a collective remedy, even against a clearly insolvent debtor. For creditors who pursue individual enforcement actions, such as warrants of execution to seize assets or the

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¹ “Bankruptcy” is used here generically to encompass not only “bankruptcy” proceedings proper, involving individual debtors, but also winding-up proceedings, involving company debtors. While the primary normative thrust of this article is on individual bankruptcy, many of the same issues apply to company winding-up proceedings.

² See, e.g., THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 7, 10-13 (1986); BOB WESSELS, BRUCE A. MARKELL & JASON J. KILBORN, INTERNATIONAL COOPERATION IN BANKRUPTCY AND INSOLVENCY MATTERS 14-15 (2009).

especially powerful tool of attachment of the debtor's future earnings, the fruits of such pursuits redound to the sole and exclusive benefit of the pursuing creditor. Moreover, these benefits can continue indefinitely as long as the debtor continues to acquire assets or earnings (and as long as the debtor does not lodge his or her own bankruptcy petition). A creditor who engages a bankruptcy proceeding, in contrast, makes an apparently foolish strategic choice to share the debtor's insufficient available assets with all of the debtor's other free-riding creditors.³ Not only that, but most bankruptcy cases today end with the debtor being fully discharged, a conclusive termination of the very rights that a petitioning creditor is ostensibly seeking to advance.

Theoretically and practically, then, one would expect individual enforcement efforts would dominate, and a creditor-initiated bankruptcy would represent a rare exception, arising only in response to a truly collective problem, such as the debtor's creating or deepening insolvency by wasting assets or alienating them through fraudulent conveyances. This hypothesis is consistent with long-standing experience in the United States. Creditor-initiated bankruptcies, so-called "involuntary" cases in the U.S.,⁴ have represented less than one-tenth of one percent of all U.S. liquidation bankruptcy cases for over a decade. Of an average one million liquidation bankruptcy cases in the U.S. each year from 2000 to 2010, an average of just under 600 each year were involuntary cases initiated upon creditor petitions.⁵

A strikingly different picture emerges from recent data from England and Wales.⁶ In the decade between 1998 and 2008, nearly half of all bankruptcy petitions against individuals were presented by creditors; in absolute terms, a steady average of over 18,000 creditor petitions each year. Though the rate of creditor petitions had steadily declined from a high of nearly 70 percent in the mid-1990s, it remained at about 28 percent in 2007 and 2008.⁷ Indeed, creditor usage has remained remarkably constant over time.⁸ The rate of conversion of these petitions into bankruptcy orders, as well as other key data, will be explored below.

³ Priorities outside the bankruptcy system are generally preserved in bankruptcy, so creditors generally have no incentive to seek bankruptcy as a means of re-ordering ordinary priorities. A creditor might pursue involuntary bankruptcy as a means of preventing other unsecured creditors from improving their priority positions by establishing liens on the debtor's property, and this "distributional" motivation is endorsed in section III.A. below.

⁴ 11 U.S.C. § 303.

⁵ Admin. Office of U.S. Courts, *Judicial Facts and Figures 2010*, tbl. 7.2 (2011), online at www.uscourts.gov/uscourts/Statistics/JudicialFactsAndFigures/2010/Table702.pdf; Admin. Office of U.S. Courts, *Judicial Facts and Figures 2005*, tbl. 7.2 (2006), online at www.uscourts.gov/uscourts/Statistics/JudicialFactsAndFigures/2005/Table702.pdf. In the U.S., individuals, partnerships and corporations are all "persons" eligible to enter a liquidation bankruptcy under Chapter 7 of the Bankruptcy Code. 11 U.S.C. §§ 109(b), 101(41). Various entities including railroads, insurance companies and banks are ineligible. *Id.* § 109(b)(1)-(3).

⁶ Although the United Kingdom is a unitary state, it is currently made up of three distinct "law districts": England and Wales, Scotland, and Northern Ireland. For ease and economy (and with no offence intended to the Welsh) we will use "England"/"English" hereafter as shorthand for "England and Wales"/"English and Welsh."

⁷ The Insolvency Service, *A study of creditors petitioning for bankruptcy up to 2008*, app. 1 (2008), online at www.bis.gov.uk/insolvency/evaluation-reports-pubs.

⁸*Id.* Although the rate of creditor petitions declined between 1998 and 2008, the trend in absolute numbers was upwards. The declining rate is explained by the exponential growth in voluntary petitions filed by consumers, especially in the second half of the decade. See The Insolvency Service, *Enterprise Act 2002 – the Personal Insolvency Provisions: Final Evaluation Report*, 27-31 (2007), online at <http://bit.ly/PtXlvK>.

Data from the Netherlands, a useful third reference point from Continental Europe,⁹ present a similar challenge to the creditor-bankruptcy hypothesis. The Dutch bankruptcy system is divided into two segments: bankruptcy (*faillissement*) and personal debt adjustment for individuals (the so-called “*Wsnp*”¹⁰). Data on petitions for opening both sorts of proceedings are available only for 2005, 2008, 2009 and 2010, but in those four years, creditor petitions represented an average of one-third of all filings.¹¹ Only debtors may petition for personal insolvency relief in the *Wsnp* system,¹² so including these petitions misleadingly depresses the ratio of creditor petitions to the total. Limiting the analysis to bankruptcy (*faillissement*) filings, the average over 9000 creditor petitions each year represent a staggering 60 percent of total bankruptcy petitions between 2009 and 2011. Remarkably, this represents a sharp decline from the average 75 percent of bankruptcy petitions between 2000 and 2008.

This paper seeks to explain the stark contrast between U.S. and English and Dutch practice with respect to the paradox of creditor-initiated or “involuntary” bankruptcy. These three bankruptcy systems have all evolved over the past several decades to offer powerful relief to overindebted individual debtors on relatively generous terms, so the rapidly rising tide of debtor-initiated bankruptcies is to be expected.¹³ These systems seem to offer very little in the way of enticements for *creditors*, however. If the English and Dutch bankruptcy systems are being used in a way consistent with the theoretical and practical implications of their intended design, it seems self-defeating and illogical for English and Dutch creditors to be initiating so many bankruptcy cases, especially against individuals with few or no available assets.

Somewhat troubling suggestions emerge from closer examination of available Dutch and English data. In many if not most cases, creditors seem to be using the threat of bankruptcy to achieve goals that are inconsistent with and, indeed, in opposition to the intended effects of a

⁹ Unfortunately, it is not possible to conduct meaningful comparisons with other Continental jurisdictions with large-volume, robust bankruptcy systems. The German statistical agency’s otherwise excellent data reporting on the integrated German business and personal insolvency system does not include data on petitions filed by creditors, as opposed to debtor filings. See Statistisches Bundesamt, *Insolvenzen*, www.destatis.de/DE/ZahlenFakten/GesamtwirtschaftUmwelt/UnternehmenHandwerk/Insolvenzen/Insolvenzen.html. The French bankruptcy system is rigidly divided into two segments, one available only to commercial actors, the other to address personal insolvency (*surendettement des particuliers*). The latter does not allow for creditor petitions at all. *Code de la consommation* art. L331-3 (“La procédure est engagée devant la commission à la demande du débiteur ...” [The procedure is engaged before the commission at the demand of the debtor]). Moreover, the French system aggregates a wide variety of differing degrees of consumer financial distress, making “bankruptcy” comparisons all but impossible. For an overview of the French system of personal debt relief, see Jason J. Kilborn, *La Responsabilisation de l’Economie: What the United States Can Learn From the New French Law on Consumer Overindebtedness*, 26 MICH. J. INT’L L. 619 (2005).

¹⁰ For a general description of the history and operation of this parallel personal bankruptcy system, see Jason J. Kilborn, *The Hidden Life of Consumer Bankruptcy Reform: Danger Signs for the New U.S. Law From Unexpected Parallels in the Netherlands*, 39 VANDERBILT J. TRANSNATIONAL L. 77 (2006).

¹¹ This figure is based on a combination of data compiled from the Dutch Central Statistical Bureau’s online database of bankruptcy statistics (*faillissementen en schuldsaneringen*), www.cbs.nl/nl-NL/menu/themas/veiligheid-recht/cijfers/default.htm, and the most recent annual review of the personal insolvency system, Lia Combrink-Kuiters & Vinodh Lalta, Raad voor Rechtsbijstand, *Monitor Wsnp: Zevende meting over het jaar 2010*, 14, tbl. 3.1 (2011), online at www.wsnp.rvr.org/pdf/Monitor%20Wsnp%202010_TP.pdf.

¹² *Faillissementswet* art. 284(1) (“Een natuurlijke persoon kan ... verzoeken de toepassing van de schuldsaneringsregeling uit te spreken” [A natural person can ... request the application of debt restructuring]).

¹³ In the English context, see Adrian Walters, *Individual Voluntary Arrangements: A Fresh Start for Salaried Consumer Debtors in England and Wales?*, 18 INT’L INSOL. REV. 5 (2009).

modern bankruptcy system. That is, rather than seeking collective resolution, creditors most often use bankruptcy as a means of enforcement and collection of individual claims, leveraging debtors' fear of the stigma of bankruptcy and harassing impecunious debtors to make an example of them to others even if no recovery is expected. In most cases, creditors do not (or cannot) carry through with their threat to see the bankruptcy process through to its conclusion; rather, the court dismisses the case as patently unproductive or the creditor-petitioner abandons the case once the threat produces the desired *in terrorem* effect and the debtor pays. Either event places an improper burden on the bankruptcy administration system, and the coercion-and-abandonment strategy undermines the rights of other, more patient and cooperative creditors, in addition to the protections for the debtor that a proper unfolding of the formal system would likely provide.

These tentative conclusions lead directly to a normative question of increasing importance: Are creditor petitions justified in light of the goals of twenty-first century debt-relief systems and the purposes to which creditor petitions seem to have been put in the past? As the World Bank and other institutions endeavor to provide guidance for developing insolvency regimes for individuals,¹⁴ this article suggests that established and emerging bankruptcy systems (particularly for individuals) should restrict creditor petitions to avoid abuse and waste and to confine this tactic to instances where creditor-initiated measures can reasonably be expected to provide a meaningful remedy for a collective harm. Involuntary bankruptcy seems to represent a tool originally designed to solve a problem that has all but disappeared today, though the tool continues to be used for other, deleterious purposes.

Part I reviews the historical development of creditor-initiated bankruptcy and the specific problems this remedy was designed to solve. It traces these roots through to the three most prominent groups of modern rules regulating creditors' initiation of involuntary bankruptcy. Part II augments the theoretical-doctrinal discussion by focusing on the specific way in which creditors are actually using bankruptcy as a tool to leverage individual debt collection. This part presents quantitative and qualitative data on the results of creditor-initiated bankruptcy petitions in the Netherlands and England, the creditors who make the most use of this remedy in England, and their strategies and thought processes in doing so. Based on these revelations, Part III proposes three potential reforms to achieve a more theoretically and practically sound policy for restricting involuntary bankruptcy to situations where it is suitable for addressing the collective problems for which bankruptcy was designed.

I. THEORY: BANKRUPTCY AS COLLECTIVE REMEDY FOR INSOLVENCY

In its very earliest form, bankruptcy was indeed designed as an unrestricted collection mechanism for individual creditors. Proto-bankruptcy procedures developed in the Roman Empire at the beginning of the Common Era to fill a void in the absence of specific individual remedies for unpaid creditors. By the beginning of the second century, however, Roman law had already developed a distinction between individual claims enforcement against *solvent* debtors

¹⁴ See, e.g., Jason Kilborn et al, World Bank, *Report on the Treatment of the Insolvency of Natural Persons* (2013), http://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport_01_11_13.pdf; INSOL INTERNATIONAL, *CONSUMER DEBT REPORT II: REPORT OF FINDINGS AND RECOMMENDATIONS* (2011); Council of Europe, *Recommendation CM/Rec(2007)8 of the Committee of Ministers to member states on legal solutions to debt problems* (2007).

(*pignus in causa iudicati captum*), and collective, liquidation bankruptcy-type remedies reserved for *insolvent* debtors (*bonorum distractio*).¹⁵

Built on these Roman foundations, bankruptcy in the modern sense began to emerge much later, around the turn of the fourteenth century in the northern Italian merchant cities.¹⁶ Functioning alongside, and as a restricted adjunct to, individual enforcement procedures, bankruptcy remained confined to a relatively narrow response to problems affecting all creditors collectively. In England, however, the law came full circle first in the seventeenth century and then later again in reforms in the mid-eighteenth, mid-nineteenth and late-twentieth centuries, which extrapolated a peculiar presumption of collective default based on any one individual unsatisfied demand. As a result, individual enforcement remedies were rendered all but superfluous as they were supplanted by the unique English model of expansive deemed insolvency, a model followed to a greater or lesser degree in several other countries.¹⁷

A. The Original Purpose and Function of Creditor-initiated Bankruptcy

Until the mid-1800s, throughout much of Europe and then eventually in early U.S. law, bankruptcy would remain an exclusively creditor-driven remedy, but it was consistently designed not as a general collection device, but as a response to a narrow range of specific problems. On the continent, the specific problem remained insolvency, the debtor's general inability to satisfy all creditors with available assets. Under the continuing influence of the early Italian statutes and the much later French codification, bankruptcy laws consistently restricted creditors to engaging this remedy only upon a showing of the debtor's insolvency (or other collective harm). These statutes emerged in response to calls from creditors for government-supported mechanisms for "enforced creditor collective action" to prevent powerful or sophisticated creditors from taking all of the debtor's available wealth and leaving other creditors with nothing.¹⁸ Continental laws eventually coalesced around the original Italian indicator of insolvency; that is, the debtor's general and non-transitory "cessation of payments."¹⁹ Once a debtor stopped making payments on its debts to all creditors, and that situation appeared likely to persist, the need for a collective remedy was established, and bankruptcy could properly supersede individual pursuit of claims.

In England, in contrast, the original problem to be solved was not a *condition*, but an *action*—the debtor's active evasion of any one creditor's attempts to collect a debt. In early English bankruptcy law, one did not *become* a bankrupt; rather, one *made* bankrupt by engaging in behavior—so-called acts of bankruptcy—designed to undermine the efforts of creditors to enforce their claims using ordinary, individual collection remedies. The first English bankruptcy statutes were designed to solve the dual problems of inherent limitations on common law writs of judgment execution and debtors who hid either themselves or their property from ordinary individual enforcement efforts.

¹⁵ JAN H. DALHUISEN, DALHUISEN ON INTERNATIONAL INSOLVENCY AND BANKRUPTCY, vol. 1, pt. 1, § 1.01 (1986).

¹⁶ *Id.* §§ 1.01, 2.01[2], 2.02[1].

¹⁷ As far as we are aware, all of the other countries with a bankruptcy trigger resembling the English individual-default "statutory demand" are Commonwealth countries or countries where legal evolution has otherwise been directly influenced by English law. For references to congruent structures in the law of Australia, Israel, and South Africa, see *infra*, note 63.

¹⁸ Emily Kadens, *The Myth of the Customary Law Merchant*, 90 TEXAS L. REV. 1153, 1175 (2012).

¹⁹ DALHUISEN, *supra* note 15, §§ 2.02[1]-[7], 3.02-07.

While the early common law provided individual means of enforcing money judgments, it subjected these means to substantial hindrances that frustrated effective individual enforcement. First, inherent limitations powerfully suppressed the effectiveness of the two primary execution writs. The ancient writ of *feri facias* made the debtor's goods and chattels subject to seizure and forced sale, but not the primary source of value in early modern times—land. Even though the writ of *elegit*, introduced by the Statute of Westminster of 1285,²⁰ provided a means of enforcement against land, it offered creditors only a moiety (half) interest in the rents and profits produced by the debtor's lands during a limited term tenancy, not fee simple ownership.²¹ Second, clever debtors could impose external limits on the operation of these two writs by alienating their property, perhaps in combination with another evasion tactic: fleeing England entirely as an outlaw and allowing their property remaining in England to escheat to the Crown. Third, in an evasion strategy unique to England, debtors could keep their creditors at bay by “keeping house”; that is, simply staying with their lavish personal property inside their homes, since no execution could occur inside the debtor's residential sanctum.²²

Bankruptcy in England developed to offer creditors mechanisms to overcome these hindrances. Introduced in 1543,²³ the first English bankruptcy statute²⁴ set English law on a course that would consistently, and increasingly over time, contrast with Continental practice. That statute inaugurated an English approach to bankruptcy not as a collective remedy against insolvent debtors to distribute losses equitably among creditors, but rather as a mechanism to provide individual creditors with remedies “against such persons as do make Bankrupt.”²⁵ Without regard to the debtor's solvency, English bankruptcy statutes offered a way around the restrictions on the scope of enforcement writs (bankruptcy proceedings encompassed the entirety of a debtor's estate) and curtailed the creditor-evasion techniques mentioned above. This first Act was directed against debtors who “flee to parts unknown or keep their houses.”²⁶ Rather than forcing the property of an absconding debtor to escheat to the Crown, this statute provided for ratable distribution of the fugitive outlaw's entire property among creditors, and this and later statutes created an exception to the “sanctity of the home” principle when it was used to hinder or frustrate creditors.²⁷

Later developments sharpened this English focus on bankruptcy as a means of countering the common law hindrances to ordinary debt collection, against solvent and insolvent debtors alike. Only a few decades later in 1571, the next major English bankruptcy statute²⁸ expanded the range of creditor-evasion techniques to be countered via bankruptcy petition, to include the

²⁰ 13 Edw. 1.

²¹ See Stephan A. Riesenfeld, *Collection of Money Judgments in American Law—A Historical Inventory and a Prospectus*, 42 IOWA L. REV. 155, 157-58 (1957).

²² See Israel Treiman, *Escaping the Creditor in the Middle Ages*, 43 L.Q. REV. 230, 233-34 (1927) (describing other early creditor-evasion techniques, including seeking sanctuary at spacious locations such as Westminster).

²³ Though this statute is traditionally assigned to the year 1542, it was in fact passed in 1543. For a useful explanation of the dating conventions in early English statutes, see Emily Kadens, *The Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law*, 59 DUKE L.J. 1229, 1236-37 (2010).

²⁴ 34 & 35 Henry VIII c. 4.

²⁵ See Louis Edward Levinthal, *The Early History of English Bankruptcy* 67 UNIV. PENN. L. REV. 1, 14 (1919).

²⁶ *Id.* at 14.

²⁷ Treiman, *supra* note 22, at 236-7.

²⁸ 13 Eliz. I c. 7.

intentional hindering of a creditor's collection efforts.²⁹ Conclusively departing from the continental model of insolvency-based collective redress, English law would from this point forward require creditors initiating bankruptcy proceedings to prove not the debtor's insolvency requiring collective action, but rather any one of these "acts of bankruptcy" intended to frustrate individual collection.

Within a few more decades, the notion of evading creditor collections was expanded to include passive forms of "evasion," including in the most extreme case simple nonpayment of a single debt. Stretching the notion of an "act of bankruptcy" this far allowed the exception of bankruptcy to swallow the rule of ordinary debt collection, creating problems and an early reform. In 1623, a statute "for the Description of the Banckrupt and Releife of Credytors"³⁰ added to the list of acts of bankruptcy the simple failure to respond to collection efforts and "pay or otherwise compound for" a debt of at least £100 within six months after the maturity date of the debt.³¹ As simple nonpayment of a single debt became a sufficient basis for bankruptcy, individual enforcement remedies were rendered all but superfluous. At the very least, the theoretical line between individual enforcement and collective bankruptcy was blurred beyond recognition. The serious problems of this approach emerged over the ensuing several decades, as it was "found by Experience that many and great Mischiefs and Inconveniences have happened ... to Trade and Credit in general" due to this expansive definition of a bankrupt.³² Therefore, almost exactly 300 years ago, effective 20 April 1712, this specific provision was repealed.³³ It would reappear in slightly different guise later,³⁴ however, and the "many and great mischiefs and inconveniences" of its modern application will be explored below.

B. Modern Statutes Reflect Dual-Track Historical Development of Involuntary Bankruptcy

Although "keeping house" and other creditor-evasion techniques were eventually curtailed, and individual enforcement remedies expanded in effectiveness in England and elsewhere, the force of inertia had set English bankruptcy policy on a path from which it would not diverge until the late twentieth century. Even after English law aligned itself with European and U.S. theories by predicating creditor-initiated bankruptcy on the debtor's general inability to pay, the acts-of-bankruptcy heritage persisted in the form of strong presumptions of inability to pay that hark back to the maligned 1623 statute allowing creditors to seek bankruptcy as a response to simple failure by the debtor to respond to individual collection efforts. The introduction of debtor-initiated *voluntary* bankruptcy in England and the U.S. in the mid-1800s,

²⁹ Israel Treiman, *Acts of Bankruptcy: A Medieval Concept in Modern Bankruptcy Law*, 52 HARV. L. REV. 189, 194 (1938). In that same year, a general statute "against Fraudulent Conveyances" (13 Eliz. I c. 5) was passed to give judgment creditors a more direct response to a debtor's fraudulent alienation of property, *see* Riesenfeld, *supra* note 21, at 161, though a fraudulent conveyance of property would be specifically defined as an act of bankruptcy only in the next major bankruptcy statute in 1604, 1 Jac. I c. 15.

³⁰ 21 Jac. I c. 19.

³¹ *See also* Treiman, *supra*, note 29, at 196.

³² 10 Ann c. 25.

³³ *Id.*

³⁴ Preceding the current "statutory demand" process described below, *see, e.g.*, 4 Geo. III c. 33 (1764) (making it an act of bankruptcy to fail to "pay, secure, or compound for" a debt of £100 "to the satisfaction of [the] creditor" within two months of service of legal process on a "merchant [etc.] having privilege of parliament"); 32 & 33 Vict. c. 71 § 6(6) (1869) (expanding acts of bankruptcy to include failure by any trader or non-trader to "pay ... secure or compound for" a debt of £50 within seven days (traders) or three weeks (non-traders) after service of summons).

especially the extension of this protection to non-merchants in the late 1800s, further complicated the tenuous theoretical and practical position of involuntary bankruptcy as a sensible creditor remedy.

1. Hybrid development in United States

When the United States began to experiment with bankruptcy law in the nineteenth century, it followed English example, as in most other areas of the law. The list of acts of bankruptcy under U.S. law was shorter than the corresponding English list,³⁵ however, and courts, commentators and soon lawmakers resisted the notion of pressing a solvent debtor into bankruptcy on the simple basis that one isolated act of bankruptcy had been established.³⁶ After early experience with an insolvency requirement revealed serious practical and procedural difficulties for creditors, policymakers sought to ease access to involuntary bankruptcy in the major reform of U.S. bankruptcy law in 1978, so that today, a European-style “cessation of payments” standard applies to creditors’ attempts to invoke bankruptcy.³⁷

Ironically, in practice, the 1978 reforms have not eased the process of involuntary bankruptcy. Instead, a combination of factors has reduced involuntary bankruptcy to the rarest of exceptions in U.S. practice. First, the U.S. bankruptcy courts have placed considerable hurdles in the path of creditors attempting to establish that a debtor is “generally not paying [its] debts as such debts become due.”³⁸ Second, only creditors holding non-contingent, undisputed, unsecured claims of at least \$14,425 may lodge a petition, and unless the debtor has fewer than twelve such creditors, an involuntary petition must be presented jointly by at least three creditors.³⁹ Third, the law threatens creditors with serious sanctions if their efforts at initiating an involuntary bankruptcy case fail, especially if the court finds that such efforts were undertaken in “bad faith.”⁴⁰ Several courts have suggested that a single creditor using bankruptcy as a collection mechanism, even against an insolvent debtor, is potentially not acting in good faith.⁴¹

Finally, especially after the 1978 liberalization of the debtor-relief provisions of U.S. bankruptcy law, creditors face what might be called, drawing on a popular African-American folk story, the “Brer Rabbit Problem.” In one of the famous Uncle Remus tales, the trickster Brer Rabbit is trapped by Brer Fox, who wonders aloud about the torturous death to which he should put his trapped prey. Brer Rabbit pleads, “Oh please, Brer Fox, whatever you do, please don’t throw me into the briar patch.” When Brer Fox throws Brer Rabbit into the briar patch, expecting the rabbit to meet a miserable end, Brer Rabbit quickly hops out of the patch and

³⁵ See THOMAS COOPER, *THE BANKRUPT LAW OF AMERICA, COMPARED WITH THE BANKRUPT LAW OF ENGLAND* 134-57 (1801).

³⁶ See, e.g., Treiman, *supra* note 29; John C. McCoid II, *The Occasion for Involuntary Bankruptcy*, 61 AM. BANKR. L.J. 195, 196-212 (1987) (noting the introduction of insolvency as a requisite of most of the acts of bankruptcy in the first permanent U.S. Bankruptcy Act of 1898).

³⁷ 11 U.S.C. section 303(h)(1) (“generally not paying ... debts as such debts become due”).

³⁸ See 2 COLLIER ON BANKRUPTCY § 303.31 (Alan N. Resnick & Henry J. Sommer, eds., 16th ed. 2012); Susan Block-Lieb, *Why Creditors File So Few Involuntary Petitions and Why the Number Is Not Too Small*, 57 BROOKLYN L. REV. 803 (1991).

³⁹ 11 U.S.C. § 303(b). The minimum claim amount is indexed for inflation triennially. 11 U.S.C. § 104.

⁴⁰ 11 U.S.C. § 303(i).

⁴¹ See, e.g., Block-Lieb, *supra* note 38, at 830 n. 140; COLLIER, *supra* note 38, at 303-48 n. 22, 303-58 n. 28.

smugly reveals his complete comfort, as he was “[b]orn and bred in the briar patch.”⁴² While U.S. debtors are not “born and bred in bankruptcy court,” the current U.S. Bankruptcy Code hardly represents a miserable place that debtors avoid at all costs. A quite common response to an involuntary bankruptcy petition—perhaps *the most* common response—is a motion by the debtor to convert the case to a voluntary one under the control of and for the benefit of the debtor.⁴³ Not surprisingly, then, involuntary bankruptcies have long constituted only a very small fraction of all U.S. bankruptcy cases, falling to consistently below one percent of all cases beginning in 1964 and below one-half of one percent beginning in 1980.⁴⁴

2. Historical European “cessation of payments” standard in the Netherlands

The current Dutch law on creditor-initiated bankruptcy is representative of other Continental laws, reflecting the early Roman and Italian roots of bankruptcy as a device for *collective* creditor action in the face of the debtor’s general “cessation of payments.” The Dutch Bankruptcy Act leaves significant discretion for the court to determine whether the debtor has, in fact, generally “ceased to pay” its debts.⁴⁵ This is very similar to the involuntary bankruptcy test under other modern Continental bankruptcy laws,⁴⁶ though German⁴⁷ and French⁴⁸ law emphasize that the cessation of payments must be the result of the debtor’s *inability* to pay, not simply *unwillingness*, while Belgian law emphasizes that the cessation must be permanent and adds a curious proviso that the debtor must no longer be able to obtain credit.⁴⁹ In a provision unique to Dutch law, the collective nature of the proceedings is emphasized by an explicit requirement of a *concursum creditorum*; that is, it must be established that the debtor has more than one creditor with outstanding unpaid claims.⁵⁰

One would expect the Brer Rabbit Problem⁵¹ to exclude many individuals from bankruptcy in the Netherlands, as the law requires the court clerk to send a letter to all natural person debtors who are the subjects of a creditor’s bankruptcy petition, reminding them that they can seek voluntary relief under the personal debt adjustment law if they are willing to meet its

⁴² For an easily accessible version of one of many retellings of this tale, see S.E. Schlosser, *Brer Rabbit and the Tar Baby*, http://americanfolklore.net/folklore/2010/07/brer_rabbit_meets_a_tar_baby.html.

⁴³ COLLIER, *supra* note 38, § 303.03A.

⁴⁴ See Bradley Hansen, *Bankruptcy Law in the United States*, tbl 4, in EH.NET ENCYCLOPEDIA (Robert Whaples, ed., 14 Aug. 2001), <http://eh.net/encyclopedia/article/hansen.bankruptcy.law.us>.

⁴⁵ *Faillissementswet* art. 6[3] (“de schuldenaar in den toestand verkeert dat hij heeft opgehouden te betalen” [the debtor has ceased to pay]); Dennis Faber & Niels Vermunt, *National Report for the Netherlands*, in COMMENCEMENT OF INSOLVENCY PROCEEDINGS (Dennis Faber et al., eds., 2012) 425, 435-36.

⁴⁶ See, e.g., DALHUISEN, *supra* note 15, vol 1, pt II, § 1.02[4][c]-[g].

⁴⁷ *Insolvenzordnung* art. 17; Christoph G. Paulus & Matthias Berberich, *National Report for Germany*, in COMMENCEMENT OF INSOLVENCY PROCEEDINGS (Dennis Faber et al., eds., 2012) 313, 324-25 (noting that illiquidity is presumed if the debtor cannot meet 10 percent of its matured debts in three weeks by applying assets that can be readily liquidated).

⁴⁸ *Code de commerce* arts. L631-1, L640-1; Cécile Dupoux & Carole Nerguararian, *National Report for France*, in COMMENCEMENT OF INSOLVENCY PROCEEDINGS (Dennis Faber et al., eds., 2012) 284, 292.

⁴⁹ *Faillissementswet/Loi sur les faillites* art. 2; Eric Dirix & Roel Fransis, *National Report for Belgium*, in COMMENCEMENT OF INSOLVENCY PROCEEDINGS (Dennis Faber et al., eds., 2012) 42, 49.

⁵⁰ Faber & Vermunt, *supra* note 45, at 435-36.

⁵¹ See *supra* note 42 and accompanying text.

somewhat stringent demands.⁵² Nonetheless, as will be examined below, creditor petitions for bankruptcy against individual Dutch debtors remain a common phenomenon. Also as revealed below, the results of these petitions are difficult to explain if one assumes Dutch creditors are using involuntary bankruptcy with the expectation that the process itself—as opposed to the mere threat of process—will produce a favorable outcome for them. Unless creditors suffer from rampant ignorance or strategic foolishness, this tactic must evidence some other strategy focused outside the formal bankruptcy process.

3. Deemed inability to pay in England & Wales

Only in England does the law invite individual creditors to initiate bankruptcy proceedings in response to a debtor’s failure to pay a single small debt when demanded. Ostensibly, the “acts of bankruptcy” were abandoned in the major reform of English bankruptcy law that unified personal bankruptcy and business insolvency practice under the Insolvency Act 1986.⁵³ Nonetheless, one particular act of bankruptcy continues under modern English law under the euphemism of a conclusive presumption.

On its face, the English Insolvency Act seems to have moved in the direction of Continental practice by requiring creditors to establish the debtor’s inability to pay as a predicate to an involuntary bankruptcy.⁵⁴ The old orientation of English bankruptcy around individual debt collection remains present, however, in subtle and not-so-subtle forms. The subtle form is that inability to pay in England is gauged in terms of any single debt, not a general inability to pay and cessation of payment, as elsewhere in Europe and the United States. A single creditor can present a bankruptcy petition against an individual debtor in England “in respect of *a debt* or debts”⁵⁵—meaning that a single unsecured debt will suffice—so long as that debt is not subject to serious dispute and amounts to at least £750 and the debtor “appears ... to be unable to pay.”⁵⁶ The provisions relating to individual debtors were remodeled on the then extant provisions for creditor’s winding-up petitions against corporate debtors. These corporate provisions, now found in sections 122(1)(f) and 123(1)(a), (2) of the Insolvency Act, and which are the same in all material respects as the provisions relating to individual debtors, have remained on the statute book, more or less unchanged, since they were first enacted during the Victorian era.⁵⁷ It is clear from legislative history that, as regards involuntary petitions against individual debtors, English law reformers made a deliberate policy choice in the 1980s to couple the abolition of acts of bankruptcy with the extension of the corporate model to all debtors whether individual or corporate.⁵⁸ The irony is that Victorian corporate insolvency law was an adaptation of individual bankruptcy law and so the vestiges of the earlier notion that failure to pay a single debt could comprise an act of bankruptcy⁵⁹ still remain in the current law.

⁵² *Faillissementswet* art. 3[1]. See *supra* notes 9-10 and accompanying text on the divisions within Dutch insolvency law.

⁵³ Prefaced by the extensive deliberations of the Cork Committee, see REPORT OF THE REVIEW COMMITTEE, INSOLVENCY LAW AND PRACTICE (Cmnd 8558, 1982).

⁵⁴ Insolvency Act 1986 § 267(2)(c).

⁵⁵ *Id.* § 267(2) (emphasis added).

⁵⁶ *Id.* §§ 267(2)(a), (2)(c), (4).

⁵⁷ The Companies Act, 1862 §§ 79-80.

⁵⁸ REPORT OF THE REVIEW COMMITTEE, *supra* note 53, ¶¶ 529-30.

⁵⁹ See *supra* notes 30-34 and accompanying text.

The not-so-subtle English exceptionalism here lies in the statutory definition of “inability to pay,” which amounts to a resurrection of the maligned 1623 Act that opened the gateway to creditor-initiated bankruptcy based upon the debtor’s simple failure to pay a single debt on demand. Much as under the 1623 law, a creditor today can conclusively establish that a debtor is “unable to pay” a current debt by serving a so-called “statutory demand” on the debtor using a simple prescribed form.⁶⁰ If the debtor fails to “pay the debt or secure or compound for it to the satisfaction of the creditor” within three weeks of service of the demand, the debtor is irrefutably presumed to be “unable to pay,” laying the foundation for a creditor’s bankruptcy petition.⁶¹ English courts have steadfastly refused to set aside this presumption of inability to pay even in the face of clear demonstration of the debtor’s solvency.⁶² Many other countries with historical ties to England have adopted a version of this “statutory demand” presumed basis for involuntary bankruptcy, though commonly it applies only to companies, while a judgment and a so-called “bankruptcy notice” or “bankruptcy warning” are required against individual debtors.⁶³

In any event, the notion that the collective remedy of bankruptcy should follow on the simple basis that the debtor has failed to pay one creditor’s debt of £750 is strikingly at odds with the general theory of bankruptcy, as well as practice in much of the rest of the world. One U.S. commentator noted, in criticizing the then-U.S. law regarding acts of bankruptcy, the incongruity with bankruptcy theory of allowing “perfectly solvent debtors to be thrown into bankruptcy against [their] will.”⁶⁴ In the face of “so absurd a consequence,” this commentator took comfort that “such an eventuality [was] unlikely to occur.”⁶⁵ Subsequent practice in England reveals that exactly such a consequence is not at all unlikely. Modern English lawmakers have evidently forgotten Parliament’s conclusion of three centuries ago that such a basis for bankruptcy causes “many and great Mischiefs and Inconveniences.”⁶⁶ As the following section reveals, such mischiefs and inconveniences flow not only from creditors’ carrying through with initiating involuntary bankruptcies on the simple basis that a debtor has refused to pay a single debt, but also—and perhaps more so—from the mere *threat* of initiating a case on such basis. Threats like this appear to have become a standard tactic in ordinary debt collection in England.

⁶⁰ See Insolvency Rules 1986, SI 1986/1925, rules 4.4-4.6, 6.1-6.2; The Insolvency Service, *Statutory Demands: A written request from someone who is owed for payment of a debt* (2012), online at www.bis.gov.uk/assets/bispartners/insolvency/docs/publication-word/12-635-statutory-demands.

⁶¹ The creditor is not required to reduce the debt to judgment before presenting a statutory demand. Non-payment on a judgment provides a separate ground for deemed inability to pay debts. See Insolvency Act 1986 §§ 123(1)(b), 268 (1) (also establishing inability to pay when “execution or other process” is issued in respect of a judgment and “has been returned unsatisfied in whole or in part”).

⁶² See, e.g., *Cornhill Insurance Plc v. Improvement Services Ltd* (1986) 1 WLR 114 (Ch); *Taylor’s Industrial Flooring Ltd v M&H Plant Hire (Manchester) Ltd* (1990) BCC 44 (CA).

⁶³ See, e.g., Christopher F. Symes, *National Report for Australia*, in COMMENCEMENT OF INSOLVENCY PROCEEDINGS (Dennis Faber et al., eds., 2012) 1, 7-10 (noting the bankruptcy notice procedure is the basis for 95 percent of involuntary bankruptcy against individuals, but this requires an unpaid judgment not for the statutory demand level of \$2000, but the bankruptcy notice level of \$5000, as amended in 2010); David Hahn, *National Report for Israel*, in COMMENCEMENT OF INSOLVENCY PROCEEDINGS (Dennis Faber et al., eds., 2012) 365, 375-76; Kathleen van der Linde, *National Report for South Africa*, in COMMENCEMENT OF INSOLVENCY PROCEEDINGS (Dennis Faber et al., eds., 2012) 521, 534, 537 (emphasizing that, in contrast to the statutory demand presumption applicable to companies, inability to pay must be established against individuals, not simple unwillingness).

⁶⁴ Treiman, *supra* note 29, at 206.

⁶⁵ *Id.*

⁶⁶ See *supra* note 32 and accompanying text.

II. PRACTICE: EMPIRICAL EVALUATION OF BANKRUPTCY THREAT AS COLLECTION LEVERAGE

For “perfectly solvent” debtors, the pernicious effects of using bankruptcy as a debt collection device are manifest. If the system of ordinary judgment enforcement has any meaning, it seems patently unjustified to allow creditors to do an end run around this system and move straight to bankruptcy simply to bludgeon a nonperforming debtor (and inconvenience other creditors and the administration of justice) with the many negative (and unnecessary) consequences of a bankruptcy proceeding. Some of the “Mischiefs and Inconveniences” identified by Parliament three centuries ago⁶⁷ must have related to allowing creditors to foist the many negative externalities of a bankruptcy proceeding on an otherwise solvent debtor, other creditors, justice organs and general society, rather than pursuing ordinary enforcement remedies with unpleasant but confined effects. If bankruptcy is a proper remedy for nonpayment of a single liquidated debt exceeding £750, from the perspective of the public administration of justice, ordinary enforcement proceedings are superfluous and should be eliminated. If ordinary enforcement proceedings have any justification, it must be that they are designed to be applied to solvent debtors, and precise, targeted techniques for investigating and revealing the assets of a debtor—before or after judgment—are the proper tool in such cases, not the blunderbuss of bankruptcy.

One suspects, though, that most debtors against whom involuntary bankruptcy petitions are directed are not, in fact, perfectly solvent. The very lodging of a bankruptcy petition may well undermine or destroy value inherent in a debtor’s business, and it is a truism that the value of any debtor’s assets will inevitably be depressed by the process (or even the mere threatened prospect) of liquidation in bankruptcy. Whether based on general cessation of payment or inability to pay a single debt, an involuntary bankruptcy case can likely be justified against many, many debtors today, especially individuals.

But against an *insolvent* debtor, collective bankruptcy seems to be a self-evidently poor strategic choice for an individual creditor savvy and sophisticated enough to engage the ordinary claims enforcement process. A creditor who initiates a collective bankruptcy proceeding will have to share the debtor’s insufficient assets with all creditors rather than hoarding these assets to its own advantage and beggaring its competitors, and the modern bankruptcy process puts an end to what otherwise could be perpetual enforcement efforts by any given creditor. Granted, the statutory-demand-and-bankruptcy process allows a creditor to avoid the time and expense of obtaining a judgment, and “[a]s a debt collection mechanism, ... may be swifter and, for the individual creditor, less expensive than a claim that may not come to trial for some time.”⁶⁸ These points notwithstanding, surely the kinds of undisputed, liquidated debts that can be collected via a statutory demand would lead inevitably to a relatively quick default judgment in the individual debt collection process and to relatively direct, exclusive, and ongoing access to a debtor’s available assets, including future income. Self-serving ordinary enforcement seems to be the obvious choice for individual creditors savvy enough to understand their options.

⁶⁷ See *supra* note 32 and accompanying text.

⁶⁸ Gerard McCormack, *National Report for England, in* COMMENCEMENT OF INSOLVENCY PROCEEDINGS (Dennis Faber et al., eds., 2012) 234, 245.

Closer examination of the outcomes of involuntary bankruptcy cases in the Netherlands and England reveals that something else must be going on in systems with substantial numbers of involuntary bankruptcy petitions. Abstract thinking about the direct purposes potentially served by involuntary bankruptcy serves only to distract attention from creditors' real motivations. The concrete objective for creditors seeking involuntary bankruptcy must lie elsewhere, not in the bankruptcy process itself. From the petitioning creditors' perspective, involuntary bankruptcy *orders* most likely represent strategic failures. The goal most likely is not a bankruptcy order; rather, the goal is using the threat of a bankruptcy order to coerce payment from the debtor, to the disadvantage of competing creditors and without the protective intermediation of the courts charged with regulating ordinary collections.⁶⁹

Empirical examination of the results of creditor petitions and the strategies pursued by petitioning creditors lays bare the troubling alternative explanation that involuntary bankruptcy is used not as a formal collection device itself, but as a form of super-powerful informal collection leverage. Creditors in most cases likely have neither the actual intention nor even the desire to see a bankruptcy case actually initiated and administered to completion. The majority of petitions are not converted to orders, and the great bulk of orders produce extremely modest or even no returns for creditors, at least as reflected on public records. The story reflected in public statistics seems to be one of strategic failure, bluffs called that produce no real benefits for creditors. The real story here, however, likely lurks in the shadows of pre-bankruptcy collection efforts, in the unknown numbers of private threats of a bankruptcy filing that successfully coerce immediate payment from the debtor. It is not the procedure itself, properly administered to completion, that produces returns, but rather the simple *threat* of such a procedure.

A. Filings, Orders and Results in the Netherlands

Statistics on formal creditor-initiated bankruptcy in the Netherlands expose this device to be a very poor collection method, indeed, at least judging by the part of the story appearing in public reports. Only a small portion of creditor petitions for bankruptcy (*faillissement*) result in an administered case, and public statistics do not indicate how much value this fraction of cases has produced. During the past decade, creditors have lodged an average of about 9400 bankruptcy petitions each year, but only about 4200 bankruptcy cases have resulted in an order opening a case on a creditor's petition. Approximately 43 percent of these opened cases involved individual (natural person) debtors, one-third of whom were sole proprietors of an unincorporated small business.⁷⁰ Though a time lag makes direct comparison of filings and

⁶⁹ The vast majority of civil debt claims for a specified sum fall within the jurisdiction of the county courts in England. Claims for under £5,000 are allocated to the "small claims track." Claims for between £5,000 and £25,000 are allocated to the "fast track." Claims for over £25,000 are allocated to the "multi-track." County courts handle small claims and fast track cases and county courts in large urban areas that are designated as civil trial centers may also deal with multi-track claims. *See generally* Parts 27-29 of the Civil Procedure Rules, online at www.justice.gov.uk/courts/procedure-rules/civil/rules. Simple debt claims for less than £100,000 can be started online in the county courts using Money Claim Online, a central processing portal administered by the Northampton County Court. *Id.*, Practice Direction 7E.

⁷⁰ Public statistics do not indicate what percentage of creditor *petitions* were lodged against individual debtors, as opposed to companies, and what percentage of these specific petitions ultimately led to opened cases.

opening orders at least mildly misleading, a rough comparison of filings to orders over the past decade reveals an average creditor-petition-to-order conversion rate of only about 45 percent.⁷¹

An even more disheartening statistic is the rate of dismissal of opened cases. The Dutch courts have closed an average of just under 7000 bankruptcy cases each year over the past decade, and of these, an average of about 4800 each year were dismissed—70 percent of all closed cases—most likely for lack of assets to cover administrative expenses, particularly the trustee’s remuneration.⁷² It is not clear from public reports what percentage of cases opened on creditor petitions (as opposed to debtor petitions) are dismissed, or what percentage of dismissed cases involved natural person debtors (as opposed to companies), but creditor-initiated cases represent an average of 70 percent of all bankruptcy filings and 55 percent of all opened cases over the past decade, so at least half of the dismissed cases were likely initiated by creditors. Since individuals are more likely to lack administrable assets, the dismissal rate for cases initiated against individual debtors is likely even higher. Another 460 bankruptcy cases on average each year—about 7 percent of closed cases—are voluntarily converted by individual debtors to personal debt adjustment cases (*Wsnp*).

Thus, adding these converted cases to the cases that are dismissed outright produces a total official “failure” rate of nearly 60 percent for bankruptcy cases opened on a creditor petition (and again, likely much higher for cases involving individual debtors). Here again, it is not possible to trace cases directly from filing to order to closing, but in rough figures, if only 45 percent of creditor petitions resulted in an opening order, and about 60 percent of these orders were dismissed, this represents a fairly dismal rate of official “success.” Moreover, it is not clear that even the cases that survived the gauntlet through opening and past dismissal produced any significant return for creditors above and beyond the substantial expenses of administration.

Whatever picture public statistics might paint of the success rate for cases that make their way into the formal bankruptcy system, anecdotal evidence suggests that the *unofficial* rate of *informal* success is much higher. Dutch creditors threaten to push debtors into bankruptcy with the expectation that debtors will respond by making extraordinary efforts to pay in order to avoid the stigma and other ill effects of a bankruptcy case. As a means of coercing payment from debtors, this tactic is reportedly both common and extremely effective.⁷³ In order to make the threat of bankruptcy more credible, creditors likely file many bankruptcy petitions with no expectation of “success” in the formal system, simply as a means of demonstrating their seriousness to other debtors who might question creditors’ fortitude. As the following section relates, these anecdotal accounts and strategic speculation about creditor use of bankruptcy in the Netherlands are consistent with closer and more textured empirical examination of similar practice in England.

⁷¹ Figures on file with authors, compiled from the Central Statistical Bureau’s online database of bankruptcy statistics (*faillissementen en schuldsaneringen*), www.cbs.nl/nl-NL/menu/themas/veiligheid-recht/cijfers/default.htm.

⁷² See Kerstholt Bedrijfsadviseurs, *Opheffing wegens gebrek aan baten*, www.faillissement.nl/nl/faillissement/fasen-van-het-faillissement/opheffing-wegens-gebrek-aan-baten/ (reporting that lack of assets to cover administrative expense is the most common basis for bankruptcy dismissal).

⁷³ See, e.g., Kerstholt Bedrijfsadviseurs, *Faillissementsaanvraag als incassomiddel*, www.faillissement.nl/nl/faillissement/faillissementsaanvraag-als-incassomiddel/.

B. Creditor-initiated Bankruptcy in England: Usage, Users and Motivations

The published statistical data on creditor-initiated bankruptcy in England is limited in scope. The Insolvency Service counts bankruptcy and company winding-up process; the Court Service housed in the Ministry of Justice counts court process, including bankruptcy and company winding-up petitions and orders. We have been able to supplement what can be gleaned from public statistics by further data obtained under freedom of information from the Insolvency Service and some limited aggregate data for the calendar year 2011 which counts advertisements of bankruptcy orders and winding-up petitions appearing in the London Gazette.⁷⁴ We have further supplemented this patchy descriptive statistical data with some limited qualitative data derived from a small sample of elite interviews with key actors.⁷⁵ The purpose of the interviews was to seek explanations of trends within the statistical data and to provide some account of creditor motivations with a view to verifying or falsifying the second-named author's impressions of practice derived from his first-hand experience of the debt collection and bankruptcy system in England.⁷⁶

The general impression derived from the public statistics supports our story of the persistence of creditor-initiated bankruptcy in England. In the last decade or so the proportion of corporate liquidations that were involuntary has consistently been at around 30-40 percent of all liquidations, voluntary and involuntary.⁷⁷ The proportion goes down to under 30 percent if we factor in other types of formal insolvency process, namely administrations and company voluntary arrangements, which corporate debtors can initiate voluntarily, albeit invariably with the assistance of a professional insolvency practitioner. Nevertheless, this is not small beer, especially when compared to the U.S., and the absolute numbers and proportion of involuntary corporate liquidations has been remarkably stable over time. Not surprisingly, given the boom in consumer bankruptcies since the turn of the century,⁷⁸ creditor-initiated bankruptcy orders are now dwarfed by bankruptcy orders self-initiated by debtors. However, the absolute numbers of creditor-initiated bankruptcy orders against individuals has remained constant over the last decade within a range between around 7,000 and 11,000 per annum.⁷⁹ Just after the turn of the century, they accounted for more than 30 percent of all bankruptcies; nowadays, with the uptick in debtor-initiated consumer bankruptcies they account for between 14-20 percent of all

⁷⁴ Data on file with authors. All bankruptcy orders must be gazetted. See Insolvency Rules 1986, SI 1986/1925, rules 6.34(2), 6.46(2). Creditor winding-up petitions must be gazetted before the court hears the petition and makes a winding-up order. *Id.*, rule 4.11.

⁷⁵ Interviews were conducted with a senior policy maker, a leading London solicitor who specializes in debtor-creditor and insolvency law, a creditor representative and a High Court bankruptcy registrar. The solicitor and creditor representative did not speak for, but directly represented to us, the views and perceptions of the Institute of Credit Management, a leading UK trade association for credit managers. On elite interviewing generally, see, e.g., David Richards, *Elite Interviewing: Approaches and Pitfalls*, 16 *POLITICS* 199 (1996).

⁷⁶ The second-named author trained and qualified as a solicitor, working in private practice in the East Midlands between 1991 and 1994. He also had opportunities to observe the workings of the bankruptcy system in practice while serving as a consultant to the Business Recovery and Insolvency department of the law firm Geldards LLP between 2005 and 2011.

⁷⁷ See the Insolvency Service's Quarterly Statistics Releases, online at <http://bit.ly/OAx13i>. Each quarterly release reproduces historical aggregate data for purposes of comparison. For company liquidations in England, see Table 1.

⁷⁸ Walters, *supra* note 13.

⁷⁹ *Id.* The historical aggregate data on bankruptcies of individuals is in Tables 2 and 2a of the quarterly releases.

bankruptcies.⁸⁰ Notwithstanding the relative decrease in creditor-initiated individual bankruptcies, the contrast with the U.S. remains striking.

The next part of the story from England is the rate at which creditor petitions convert to orders. It is clear from the available data that a significant proportion of the petitions presented to the court do not result in orders. Our conversion data supplied by the Insolvency Service runs from April 2006 until the end of 2011. This data compares petitions and orders on the basis of a one-quarter time lag that reflects the gap between the presentation and hearing of the petition. The data shows an average conversion rate for creditor-initiated bankruptcy petitions against individuals of approximately 49.9 percent and an average conversion rate for creditor-initiated company winding-up petitions of approximately 43.8 percent.⁸¹

Thus, somewhere in the region of 50-60 percent of all creditor petitions are either voluntarily withdrawn or dismissed by the court. It is not possible to identify with any particularity the relative proportions of withdrawn and dismissed petitions, as the available data is insufficiently granular. The court may restrain or dismiss involuntary proceedings on grounds that the petition debt is genuinely disputed on substantial grounds or that the debtor has a cross-claim that exceeds the petition debt. These grounds are well settled and a properly advised creditor is unlikely to petition in the event of a dispute concerning the existence or quantum of the debt for fear of costs sanctions.⁸² The powerful inference, then, is that creditors voluntarily withdraw the vast majority of these petitions because the debtor pays all or a substantial portion of the petition debt before the hearing.

Furthermore, there is some evidence to suggest that many petitions are withdrawn quite late on in the process. Our 2011 data compiled from the London Gazette reveals that creditors advertised over 7,000 company winding-up petitions in the calendar year and yet the Insolvency Service's official statistics record less than 5,000 winding-up orders. Although these data are not time lagged,⁸³ it appears that creditors withdraw around 30 percent of the winding-up petitions that are advertised and in the public domain. Our interviewees confirmed our understanding that it is standard practice for the courts to adjourn a creditor-initiated petition for a few weeks in order to give the debtor time to pay the petition debt and avoid bankruptcy or winding-up. This is consistent with the finding based on the 2011 Gazette data and indicates that the courts have

⁸⁰ *Id.*

⁸¹ Ministry of Justice data for 2006-11 on company winding-up petitions and orders in the Chancery Division reinforces the Insolvency Service data suggesting an average annual conversion rate of around 47 percent though this data is not lagged. See Ministry of Justice, *Judicial and Court Statistics 2011*, tbl. 5.6 (2012), online at www.justice.gov.uk/statistics/courts-and-sentencing/judicial-annual-2011.

⁸² See, e.g., *Mann v. Goldstein* [1968] 1 W.L.R. 1091 (Ch); *Re A Company* (No. 006685 of 1996) [1997] B.C.L.C. 639 (Ch); *Re Bayoil SA* [1999] 1 W.L.R. 147 (CA); *Portsmouth City Football Club Ltd v. Revenue & Customs Commissioners* [2011] S.T.C. 683 (Ch); *Angel Group Ltd v. British Gas Trading Ltd* [2012] EWHC 2702 (Ch). The grounds for setting aside a statutory demand in the context of individual bankruptcy are virtually identical. See Insolvency Rules 1986, SI 1986/1925, rule 6.5(4). In English law, these grounds go to standing. The courts generally acknowledge that an involuntary proceeding is a legitimate means to enforce payment of a debt but subscribe to the theory that a petitioner whose debt is disputed or subject to a valid cross-claim is simply not a "creditor." Thus, it follows that if part of the debt is undisputed, or a cross-claim is insufficient to reduce the petition debt to the £750 threshold or below, the petitioning creditor will still have standing. Where a petition is restrained or dismissed, the petitioning creditor can expect costs sanctions as a matter of course.

⁸³ Some of the orders will relate to petitions presented in late-2010 while some of the petitions presented and advertised in late-2011 will not have resulted in orders until early 2012.

adopted institutional practices that support the use of creditor-initiated bankruptcy proceedings as a collection device.

As we observed in relation to the Netherlands, the conversion data tells us nothing about the extent to which creditors succeed in collecting by threatening debtors with bankruptcy or winding-up proceedings. Anecdotally we understand – and our interviewees confirm– that creditor usage of statutory demands is widespread. If the debtor has some ability to pay, she will pay in response to a statutory demand in order to avoid triggering a creditor petition. As a statutory demand is not a form of court process – a creditor merely has to make demand on the debtor using a form prescribed by secondary legislation – we have no way of measuring the extent to which creditors successfully employ statutory demands to leverage collection in the shadow of the formal bankruptcy system.

A further striking aspect of practice in England concerns the pattern of “repeat player” creditor usage. As gazette notices of bankruptcy orders and advertised company winding-up petitions identify the petitioning creditor, we can discern patterns of usage from our 2011 Gazette data. This data shows that creditor-initiated bankruptcy process is a tool that is particularly favored and systematically deployed by Her Majesty’s Revenue & Customs (“HMRC”) and local authorities in relation to unpaid national and local taxes. Her Majesty’s Revenue & Customs was the petitioning creditor in 34 percent of individual bankruptcies and in 54 percent of advertised winding-up petitions in 2011.⁸⁴ Additional corroborative data from the Insolvency Service for the years 2009-2011⁸⁵ suggests that HMRC and local authorities together account for roughly 40 percent of all creditor-initiated bankruptcies and liquidations. The Gazette data reveal a number of other repeat players: around 13 percent of the bankruptcy orders were obtained by buyers of consumer debt and asset-based financiers;⁸⁶ around 2.5 percent of the bankruptcy orders and 4 percent of the advertised winding-up petitions were attributable to three well known suppliers to the construction industry.⁸⁷ But by far and away the largest user is HMRC.⁸⁸

Persistent and prevalent usage of creditor-initiated bankruptcy in England is not by any means to the exclusion of the ordinary debt collection system, which, for the most part, is operated by the county courts. Ministry of Justice data over time demonstrates that creditors continue to use traditional judgment enforcement techniques, especially warrants of execution, attachments of earnings,⁸⁹ and charging orders on real property in high volumes.⁹⁰ Moreover, creditors can file unpaid debt claims in the county courts online and there are bulk-processing services available for claimants who issue high numbers of claims, such as credit card lenders

⁸⁴ Not all advertised winding-up petitions will have resulted in orders. See *supra* note 83 and accompanying text.

⁸⁵ On file with authors.

⁸⁶ Lowell Portfolio, Lombard North Central Plc, 1st Credit (Finance) Ltd.

⁸⁷ Wolseley UK Ltd, Jewson Ltd and Travis Perkins Trading Company Ltd.

⁸⁸ It appears that local authorities have cut back on their usage in response to criticisms by the Local Government Ombudsman regarding heavy handed use of bankruptcy petitions to leverage collection of council tax arrears from vulnerable individuals. See Local Government Ombudsman, *Can't Pay? Won't Pay? Using bankruptcy for council tax debts* (2011), <http://lgo.org.uk/publications/fact-sheets/complaints-about-bankruptcy/>.

⁸⁹ “Wage garnishment” in U.S. parlance.

⁹⁰ See Ministry of Justice, *Judicial and Court Statistics 2011*, at 19-20, Tables 1.15-1.18 (2012), online at www.justice.gov.uk/statistics/courts-and-sentencing/judicial-annual-2011.

and utilities suppliers.⁹¹ This begs the question: why are some creditors seeking to collect their debts through the statutory demand and bankruptcy system rather than through the ordinary debt collection system?

What seems clear is that, for the creditors who use it, creditor-initiated bankruptcy serves at least two overlapping functions. First, it appears to function as a peculiarly draconian sorting mechanism by which the creditor can quickly determine whether the debtor has means to pay or is insolvent and unable to pay. Clearly, a solvent debtor faced with the threat of bankruptcy or winding-up is likely to pay. As we have seen, the statutory demand and petition process has very few moving parts. In contrast to ordinary debt collection, the creditor does not have to obtain a judgment as a pre-condition to enforcement. Non-payment of a statutory demand⁹² is the green light for entry into the bankruptcy system. It is therefore relatively easy for sophisticated creditors to use bankruptcy process to flush out ability to pay.

Second, in the hands of HMRC, it appears to function as a quasi-regulatory mechanism for extracting payment from particularly unresponsive tax debtors or, if it turns out that the debtor cannot pay, for limiting any further losses in tax revenue that would arise were the debtor to continue operating outside of the bankruptcy system. Indirectly, HMRC's approach may therefore have positive externalities insofar as it serves to protect other unsecured creditors who would otherwise suffer loss through extending further credit to the debtor and assists in ensuring that genuinely insolvent and financially nonviable debtors are channeled into the bankruptcy system where they belong. Less charitably, it was suggested to us that, on occasions, bankruptcy may operate as a convenient mechanism for HMRC to shift the administrative burden of a troublesome tax debtor over onto the official receiver, the state agency that, at least initially, handles all individual bankruptcies and creditor-initiated winding-up cases and, in practice, administers through to closure all bankruptcies and winding-up cases where there are insufficient assets to make the appointment of an insolvency practitioner from the private sector worthwhile.⁹³

At first blush, it may be thought odd that creditors would deliberately choose to risk the possibility of a meager return in insolvency proceedings given that diligent, successful use of the ordinary collection system will yield a decent return that does not have to be shared with other creditors.⁹⁴ This would seem to be *a fortiori* as regards HMRC, which has special statutory

⁹¹ *Id.* at 13-14; *see also supra* note 69.

⁹² Or, indeed, a formal written demand. It is settled law that a creditor can set up the presumption of inability to pay without necessarily having to wait 21 days to see if the debtor will pay. *See, e.g.,* *Taylor's Industrial Flooring Ltd v. M&H Plant Hire (Manchester) Ltd* (1990) BCC 44 (Court of Appeal).

⁹³ On the office and role of the official receiver, *see* Insolvency Act 1986 §§ 132, 136, 287, 289, 399-401; *Re Pantmaenog Timber Co Ltd* [2004] 1 AC 158 (HL) [43]-[46]. On the state's role in administering asset-less cases, *see* The International Association of Insolvency Regulators, *Assetless Insolvencies* (2005), online at www.insolvencyreg.org/sub_publications/docs/IAIR%20Assetless%20Insolvencies%20Report%20V103.pdf.

⁹⁴ Execution creditors who succeed in completing the execution process before the commencement of winding-up or bankruptcy are entitled to retain the fruits of execution even if the debtor subsequently enters winding-up or bankruptcy. Insolvency Act 1986 §§ 183, 346. By extension, a liquidator or trustee in bankruptcy is generally unable to recover eve-of-bankruptcy fruits of execution from an arm's length creditor as a preference because a debtor who is coerced into paying is not influenced by a desire to prefer the creditor for the purposes of Insolvency Act 1986 sections 239(5) or 340(4).

powers to distrain on debtor assets⁹⁵ at its disposal in addition to the usual array of ordinary collection remedies. However, for the sophisticated “repeat player” creditors who use it, it appears that creditor-initiated bankruptcy is a streamlined and cost-effective process. If in a run of cases more debtors pay in response to a statutory demand or a petition than end up in insolvency proceedings, the net payout over time is likely worth the risk.

Where the debtor pays after presentation of a petition, there is a technical risk that other unpaid creditors could take over the petition.⁹⁶ In these circumstances, the creditor who has successfully collected risks having to surrender the recovery as dispositions of the debtor’s property after presentation of the petition are automatically avoided once the debtor enters bankruptcy or winding-up.⁹⁷ Creditors routinely manage this risk by insisting that any payment of the debt made after presentation of a petition is paid from third party funds rather than directly from the debtor’s assets.

The story we glean from our qualitative data is that sophisticated creditors and credit managers tend to perceive ordinary county court enforcement processes as “debtor friendly” and ineffective. The proxy in this regard is the attitude of unsecured creditor groupings such as the Institute of Credit Management.⁹⁸ It seems that county courts are often inclined to extend the debtor’s time to pay on a judgment with the result that recoveries are slow, resource intensive and have to be managed out. In contrast, a statutory demand followed, if necessary by a petition, is a surgical strike that will quickly establish the debtor’s repayment capacity. What is more, the High Court has concurrent bankruptcy and winding-up jurisdiction with the county courts⁹⁹ and, while the High Court is prepared to allow a debtor some time to pay, it will not adjourn the hearing of a petition indefinitely. Another sub-theme of the qualitative data is that creditor usage is sometimes lawyer-driven (certain firms of lawyers will tend to default to this mode of collection) and sometimes client-driven (some clients like to be seen to be tough with debtors as a means of conveying a message to all those to whom they extend credit).

As dedicated creditors’ lawyers are fond of saying, creditor-initiated bankruptcy is just another tool in the debt collector’s armory. If the creditor can collect on a statutory demand or a petition, well and good. If it turns out the debtor cannot pay, the costs of using ordinary collection mechanisms to obtain judgment and then to try and identify assets that could be seized in satisfaction of the debt are averted. In careful hands, the process can quickly sort out the collectible debts from the write-offs. Meanwhile, the state in the guise of HMRC takes advantage of these streamlined features of bankruptcy process to further its statutory duty to collect as much tax owing as it can and to close down the genuinely insolvent with a view to capping its losses.

⁹⁵ See Taxes Management Act 1970 § 61; Social Security Administration Act 1992 § 121A; Finance Act 1997 § 51.

⁹⁶ Insolvency Rules 1986, SI 1986/1925, rules 4.19, 6.31.

⁹⁷ Insolvency Act 1986 §§ 127, 284. In cases where the petition is withdrawn altogether rather than being taken over by other unpaid creditors, the same practice eliminates any preference risk should the same debtor enter bankruptcy proceedings within the time periods stipulated in Insolvency Act 1986 §§ 239, 340.

⁹⁸ <http://www.icm.org.uk/>.

⁹⁹ Insolvency Act 1986 §§ 117, 373.

III. POLICY PRESCRIPTIONS, ESPECIALLY FOR DEVELOPING SYSTEMS

Closer, comparative examination of creditor-initiated bankruptcy reveals a compelling answer to the practical conundrum, but it raises thorny normative challenges. Not surprisingly, creditors use bankruptcy as a collection technique because it works, though not in the way one might expect. If bankruptcy is “just another tool in the debt collector’s armory,” it remains to be seen whether creditors are using that tool in a way that is not only effective, but appropriate. A revolver is also doubtless an effective collection tool, probably much more effective than dunning letters and court proceedings. But policymakers have decided that the drawbacks of using revolvers as private debt collection tools outweigh the practical advantages.

While it is admittedly a bit hyperbolic to compare creditor-initiated bankruptcy to a revolver, it should not be taken for granted that the former is an appropriate collection technique while the latter is not. Modern English policymakers do not appear to have reconsidered the appropriate contexts for creditor-initiated bankruptcy, and lawmakers in developing systems should not follow the English example without a careful re-evaluation of its strengths and weaknesses. Our examination of creditor-initiated bankruptcy in action has revealed that the advantages to individual creditors are largely unjustified by bankruptcy theory, and empirical evidence demonstrates at least the potential for, if not the realized presence of, abuse. This abuse has the troubling potential to produce at least three main groups of negative effects that are both objectively detrimental and counterproductive to the goals of modern insolvency policy.

A. Three Potential Detriments of Involuntary Bankruptcy As Debt Collection

First and foremost, using the threat of bankruptcy as a collection mechanism harms other creditors. If the process were fully administered in every case, this problem would largely disappear, as whatever value the debtor had would be distributed among all creditors. This is the paradigm envisioned by bankruptcy theory; indeed, the notion of ratable distribution of the debtor’s available assets among all creditors was the *fons et origo* of the bedrock statutory *pari passu* rule in English insolvency law since its inception in the sixteenth century.¹⁰⁰ As the empirical examination above reveals, however, the most common outcome of a creditor bankruptcy petition is *not* full administration, but rather either voluntary abandonment by the creditor or dismissal by the court. Creditors engage the bankruptcy process not to see it through to its statutorily envisaged conclusion, but to ramp up their leverage over debtors terrified by the stigma of examination and branding as a bankrupt.

In the case of perfectly solvent but recalcitrant debtors it may be objected that liberal access to creditor-initiated bankruptcy does more good than harm. These debtors can afford to pay everyone and so, it can be argued, creditors are within their rights if they use the shock treatment of an involuntary to overcome debtor obstinacy. However, in the great many cases where the petitioning creditor abandons the case after extracting payment from the debtor, this will disadvantage other creditors. They now have a smaller body of value from which to seek payment. Moreover, for debtors engaged in business, a bankruptcy petition often has negative impacts on the value of the debtor’s business prospects, further depressing the value of existing

¹⁰⁰ See the 1542 Act referred to above, text accompanying notes 23-27, *supra*, which provided that the bankrupt’s assets should be sold to pay creditors “a portion, rate and rate alike, according to the quantity of their debts.”

assets and making it more likely that the debtor will default on obligations to other creditors. An insolvent debtor who pays off a petition or the threat of a petition may limp on for a while only to end up in a bankruptcy proceeding anyway. The English practice of creditors seeking payment out of third party funds attests at the very least to the likely presence of this kind of insolvent debtor in the overall debtor population. Similarly, many cases – especially cases involving debtors who are individuals – are asset-less cases.¹⁰¹ Creditors who use the leverage of an involuntary to collect in these cases are effectively being allowed to squeeze the final drop of blood from a stone.

We contend, then, that it is counterproductive to basic bankruptcy policy to allow one aggressive creditor to use the powerful leverage of a bankruptcy case to extort full payment while externalizing losses—indeed, in some cases *creating* losses—for other creditors. Especially in light of the discovery that major repeat players are present among involuntary bankruptcy filers, it is arguably unfair to allow these sophisticated actors to derive advantages for themselves at the expense of other, less sophisticated creditors. The repeat player benefits over the run of cases if his net payout exceeds his costs. But if by playing the game in this way, the repeat player sometimes causes bankruptcies where workouts would be a better solution and other times collects in full from insolvent debtors, precisely the outcome that bankruptcy is designed to avoid, other creditors are bound to suffer.

The negative effects on creditors are especially objectionable today in light of the emphasis that modern policy makers now put on cooperative, amicable solutions to debt distress.¹⁰² This modern policy is undermined when one aggressive, uncooperative creditor is allowed to press a bankruptcy case individually for the sole purpose of collecting on a debt, especially if the process is not allowed to run its course, and the single uncooperative creditor extracts full payment to the detriment of the cooperative creditors seeking amicable, collective solutions.

Second, using the threat of bankruptcy as a collection mechanism deprives debtors of whatever protections the ordinary enforcement system might extend to them. The examination of the English system above reveals that one reason why creditors use the bankruptcy system to collect debts is their perception that ordinary enforcement courts are “debtor friendly,” offering extended payment plans and other tactics for achieving compromise solutions to situations of debt distress. In systems like the English one that expect enforcement judges to use judicious discretion to achieve more just and effective solutions, these “safety valve” goals are rendered ineffective when certain creditors evade this discretion by pursuing the alternative of bankruptcy. Once again, it is particularly troubling when, as revealed above, a subset of repeat players takes advantage of a back-door strategy while many other creditors abide by the give-and-take of compromise solutions in the ordinary enforcement process.

Third and finally, the involuntary bankruptcy strategies revealed above disrupt and burden the administration of justice. When creditors initiate cases that are either abandoned or dismissed, this clogs the bankruptcy system, which is already groaning under the weight of more and more legitimate petitions each year. Whether or not the direct expenses of creditor usage of

¹⁰¹ See, e.g., The International Association of Insolvency Regulators, *supra* note 93.

¹⁰² See, e.g., Kilborn et al., World Bank, *supra* note 14, at 44.

the bankruptcy system are paid for by those petitioning creditors, the costs in terms of time and finite personnel resources remain uncompensated. Dismissed cases produce a dead-weight loss of resources that are desperately needed elsewhere. Time spent on the majority of petitions that are not administered to completion is time that cannot be allocated to petitions that merit and need proper administration. Moreover, for the great many cases that are abandoned after the petitioning creditor collects a side payment from the debtor, the burdens of the bankruptcy process are not counterbalanced by the collective benefits to other creditors and society that the bankruptcy system is designed to achieve.¹⁰³

Bankruptcy in England arose in part due to medieval limitations on ordinary collections, but those limitations are not present today. If other limitations continue to make the ordinary enforcement system unattractive to creditors, perhaps that system is in need of reform, but the solution does not lie in allowing creditors to engage the bankruptcy process under the false pretense of seeking a collective remedy. It is disruptive and needlessly burdensome to allow creditors to use the bankruptcy process to discover whether the debtor has any asset value to spare.

Whatever burdens creditors must face in enforcing their claims, these burdens should be properly allocated within the machinery of justice. Neither private nor public creditors should be allowed to displace the burden of an ordinary collection case away from the ordinary justice organs and onto those responsible for insolvency administration. If these two systems are to continue to exist in parallel, they should be charged only with cases properly within their area of concern. Misallocation of cases undermines both the administration of the tasks assigned to each system and the planning by governments for proper distribution of funding and other scarce resources.

B. Three Potential Approaches To Reform

To avoid or at least minimize these problems with involuntary bankruptcies, we suggest three possible approaches to reform. First, at the very least, lawmakers should restrict the “triggers” that permit creditors to initiate involuntary bankruptcy. While we do not suggest scrapping involuntary bankruptcy altogether, such cases should be founded on indicia of collective distress, not individual default. That is, involuntary bankruptcy based solely upon the debtor’s failure to pay a single debt (no matter how substantial) to a single creditor, as in the “statutory demand” process, should be eliminated in systems where it exists, and avoided in developing systems.

Especially in a business context, involuntary bankruptcy may have a proper, collective purpose beyond simple enforcement of one creditor’s claim. For example, it is quite justifiable for creditors to use involuntary bankruptcy to prevent the deterioration of the debtor’s assets due to continued mismanagement, waste, or intentional squandering of value by the debtor. Along these lines, it seems justified for HMRC to pursue a strategy, as revealed above, of using involuntary bankruptcy to deal decisively with insolvent “zombie debtors” and prevent them from further harming unsuspecting present and future creditors. Further, if one creditor discovers that others are attempting to denude the debtor of available asset value, either by

¹⁰³ *Id.* at 19-39.

compulsion in the ordinary enforcement process, or by suasion in seeking preferential treatment from the debtor, an involuntary bankruptcy petition may well be justified to halt this redistribution of value.¹⁰⁴

In other cases, the proper remedy for an individual creditor is not a collective bankruptcy, but the ordinary claims enforcement system. As a theoretical matter, bankruptcy is a collective remedy, and using it as an individual debt collection device is misuse. As a practical matter, even in cases where the debtor is insolvent and a collective remedy is appropriate, the empirical examination above reveals that creditors most often use the early stages of the involuntary bankruptcy process as a means of securing individual payment before abandoning the charade of a collective remedy. This should not be allowed to continue. Lawmakers should eliminate the perverse incentives for empty threats of involuntary bankruptcy that not only benefit no one but the threatening creditor, but produce negative results for other creditors, debtors and organs of government. The statutory demand process improperly uses a cannon to kill a flea if individual enforcement mechanisms are sound. If the individual enforcement system does not work, it should be reformed or eliminated, but if it does work, creditors should be confined to choosing the appropriate tool for the task.

Second, while the preceding proposal focuses on the *trigger* for bankruptcy, lawmakers might also, or alternatively, focus on the *result* of an involuntary bankruptcy case. The law might be amended to allow creditors to initiate a bankruptcy case only if there is some hope that bankruptcy can solve the collective problem; that is, value is available for ratable distribution among creditors. Especially in systems like that in the Netherlands, where cases are routinely dismissed for insufficient value, a front-end requirement of a showing of value would prevent massive waste and distraction from ill-advised creditor bankruptcy petitions. This reform would eliminate the vast majority of the most problematic involuntary bankruptcy cases—those against consumers with no business activity and very few available assets or income.¹⁰⁵ The modern paradigm of bankruptcy for consumers is not a collection mechanism for creditors, but a path to relief for consumer-debtors. Voluntary bankruptcy sought by debtor petition is and should be the modern norm, with involuntary cases limited to the narrow range of instances where such a case actually benefits the creditor collective.¹⁰⁶

¹⁰⁴ Many systems permit creditors to initiate provisional or interim bankruptcy proceedings on a showing that the debtor's assets are in jeopardy. For example, in England, see Insolvency Act 1986 §§ 135, 286.

¹⁰⁵ There is evidence that other regulatory and policy tools from outside bankruptcy law are being deployed to combat the use of involuntary bankruptcy in this type of case, *e.g.*, administrative law in the case of local government tax creditors, *see supra* note 88, and consumer regulation in the case of consumer lenders. In 2009, the Office of Fair Trading imposed conditions on the consumer credit license of 1st Credit, a creditor that we identified as a repeat user of involuntary bankruptcy against individual debtors, *see supra* note 86, requiring it to refrain from issuing statutory demands where bankruptcy proceedings are unlikely to follow. *See* Office of Fair Trading press releases, online at www.offt.gov.uk/news-and-updates/press/2009/20-09#.UR6tFVpeukV. We are grateful to Professor Iain Ramsay for drawing this information about 1st Credit to our attention. Our claim is that abuses could be better and more directly handled within bankruptcy law through the introduction of legislative restrictions on creditor access to involuntary bankruptcy.

¹⁰⁶ We do not mean to endorse the approach taken in South African law, where a voluntary petition by the debtor can only be admitted upon a showing of likely creditor benefit. *See* van der Linde, *supra* note 63, at 534-36. This approach conflates the purposes of voluntary and involuntary petitions in an unnecessary and unconstructive way.

If an effective, confidential mechanism for early asset investigation could be developed, creditors would likely welcome such a reform. Our examination of English creditor motivations revealed that a particularly salient purpose of an involuntary bankruptcy petition is a simple and effective means of sorting “asset” debtors from “no-asset” debtors. Placing the onus on creditors to engage a discovery process of some kind in advance would alleviate the unnecessary formalities and burdens of a full-blown bankruptcy case if asset discovery is a creditor’s primary purpose. It would also alleviate the many detrimental effects of allowing creditors to coerce debtors into paying them with protected (exempt) assets or seeking otherwise unavailable third-party value.

Indeed, this proposal implicitly acknowledges a weakness in the ordinary claims enforcement process. If potential plaintiff-creditors could be convinced that their debtors lacked assets, they would likely pursue neither bankruptcy nor even ordinary enforcement, but there is no effective mechanism in many civil enforcement systems to investigate asset value before judgment. If pre-judgment asset discovery were made more widely available—subject, of course, to appropriate restrictions to prevent abuse—this would likely alleviate the losses and burdens occasioned by pursuit of practically unenforceable claims both in the civil collections systems and in the bankruptcy system.¹⁰⁷ The contours of such a system are beyond the scope of this article, but our investigation reveals the potential positive effects of such an approach.

Finally, to preserve the intended benefits of creditor-initiated bankruptcy, and to prevent its most obvious abuses, creditors should be prohibited from abandoning a case once it has begun. There is no proper justification for allowing a creditor to initiate a bankruptcy process simply to abandon it once the creditor receives what in many cases may turn out to be a preferential payment. If value is available, bankruptcy policy from England and elsewhere calls for that value to be distributed ratably among all creditors. If it turns out that the debtor has no value to distribute, the case should be closed only after a disinterested official is allowed to make such a determination and assure that the petitioning creditor has not taken unfair advantage. Indeed, an aggressive sanctions mechanism might well be put in place to prevent creditors from imposing undue burdens on the administrative process in lodging bankruptcy cases against patently impecunious debtors. This mild reform will not prevent abusive threats of an *imminent* bankruptcy filing, but it likely would reduce the numbers of fruitless *actual* cases clogging the system especially in places like the Netherlands.

IV. CONCLUSION

As a single-creditor response to simple default, creditor-initiated bankruptcy is an anachronism that cries out for reform. An instance of English exceptionalism that has spread to other areas influenced by English legal thought, involuntary bankruptcy used as an ordinary collection method is a path-dependent historical anomaly that is subject to understandable but troubling misuse. Even in other systems that more carefully restrict creditor-initiated bankruptcy, this tactic produces serious detrimental effects on other creditors, debtors and

¹⁰⁷ The U.S. has taken a small step in this process by requiring defendants to reveal information concerning the existence and level of their insurance coverage at the beginning of a civil case. See Fed. R. Civ. P. 26(a)(1)(A)(iv). See also Scott Dodson, *Persuit Discovery in a Comparative Context*, 6 J. COMP. L. 51 (2011).

administrative organs. The time has come for a careful reconsideration of involuntary bankruptcy in the light of very different modern insolvency policies and practices.

If creditors are to be allowed to continue to push debtors into bankruptcy, this remedy should be admitted only where it is an effective tool for treating a collective problem with a productive solution. Bi-lateral debt disputes should be addressed in the ordinary enforcement system, and no-asset debtors should be either encouraged to produce value in an appropriate context, if possible, or simply left alone. No one benefits from wasted effort to squeeze blood from stones. Developing an effective mechanism for sorting stones from productive payers presents serious challenges, but involuntary bankruptcy is not an appropriate mechanism for performing the sorting function, much less coercing payment from “can’t pay” debtors with an all but empty threat of stigmatization.