

## Moral decision-making in insolvency law

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### Introduction

This paper reflects on previous work by the author on decision theory in insolvency law,<sup>1</sup> and expands the conversation to include what consideration, if any, should be given to morality in insolvency decision-making. Broadly speaking, moral decision-making is the process in which it is determined what is proper or acceptable within a group or by an individual. Morality therefore influences rules and guidelines for behaviour and the form that this takes often aligns with one's perception of what is considered right and wrong.

The subjective nature of morality poses many interesting challenges as to its relationship with the law. There is no singular consideration since what is perceived to be right and wrong is susceptible to several individualistic (internal) and peripheral (external) influential factors. First, there is a critical distinction between what is perceived to be morally right and what is legally right. Another factor to consider is that behaviour or conduct rarely neatly fits into either a right or wrong category. What is determined to be proper involves a judgment of actions, intentions, and behaviours and these are categorised against moral standards that may be subjective to the group or the individual's cultural or philosophical beliefs. Further, there may be conflict or tension between an individual's behaviour and societal expectations since morality, or moral values, are not standardised and may evolve over time, with societal shifts and broader individual experiences influencing what is considered to be proper conduct.<sup>2</sup> How such tensions are resolved may not focus solely on social and moral obligations,<sup>3</sup> but rather financial value and where the optimal result can be reached.<sup>4</sup> The debate of what should be the

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<sup>1</sup> JM Wood, 'Decision theory and insolvency law' in Emilie Ghio, John M. Wood and Jennifer L.L. Gant, *Re-examining Insolvency Law and Theory in the 21st Century* (Edward Elgar Publishing, 2023), Ch 8.

<sup>2</sup> Broader impacts of insolvency on society and the economy continue to involve and so too must the approaches taken in relation to the debtor company, see J LL Gant, 'Using vulnerability and relative resilience to optimise fairness in insolvency and restructuring: a human perspective', (2025) 36(8) *International Company and Commercial Law Review* 405.

<sup>3</sup> Although attempts have been made to argue that insolvency goes beyond economics to include moral, political, personal and social problems, see D R Korobkin, 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1991) 91(4) *Columbia Law Review* 717, 762, others have argued that the only values to be protected are those within an insolvency distribution and the effective implementation of those values, see E Warren, 'Bankruptcy Policymaking in an Imperfect World', (1993) 92 *Mich. L. Rev.* 336.

<sup>4</sup> R Edward Freeman, Robert Phillips, and Rajendra Sisodia, "Tensions in Stakeholder Theory" (2018) 59(2) *Business & Society* 213, 217.

priority consideration remains alive and well within insolvency law, particularly because it has been argued that no specific answers can be derived from a testable set of criteria.<sup>5</sup> What has developed in place of this myriad of possibilities are arguments that aim to question the merits of what should be included as factors to be considered.

On this point, it is argued that morality is one of those factors that should be explored. How conflict between behaviour and societal expectations should be addressed in the context of morals and the law corresponds with a persistent question that was held by legal positivist such as H.L.A. Hart, who asked *how does legal obligation differ from, and how is it related to, moral obligation?* According to Hart, what the law is, he argued, and what it ought to be are two distinct questions. In his *The Concept of Law*, he argued that morality may influence the law, but laws and morals are distinct social phenomena.<sup>6</sup> It was within his 'separability thesis' that there may be agreeable indicators of what is good law, but this does not make it a moral principle. Properly understood, morality can influence the law, but it is not synonymous with the law.

This brings us to a two-part question. First, to what degree does morality influence decision-making, and secondly, if morality does influence decision-making are there any circumstances in which that decision could be classified as a moral-based decision. The general consensus is that the law cannot be used to enforce morality, even if morality had influenced the decision. Moralistic principles are broad enough to be captured in a wide variety of scenarios, but this does not make the subsequent law a law based on moral principles. If the law was influenced by morals, what criteria could be used to determine the law as good or bad? Is a bad law simply one that is devoid of morals? But bad laws can be influenced on good morals, or equally on morals that were once common but no longer reflective of society. If morals can change, and they do as societal expectations change, but the law does not, inevitably an expectations gap between the factors that influential behaviour and the law is formed. This predicament leaves two paths. Accept that morals may be present, but not a defining characteristic of the law, or to remove morality from law. Arguably, the latter is impossible since morals is associated with behaviour, which leaves the option of establishing a process that recognised that for 'social cohesion' there is no need for the law to impose a singular 'seamless web' of morality;<sup>7</sup> individuals or groups can choose their own moral systems.

This brings us to the focus of this paper. Insolvency law may adopt its own moral system, or in other words, it may determine what is right and wrong, according to the philosophical approach it follows.

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<sup>5</sup> Vanessa Finch, "The Measures of Insolvency Law" (1997) 17(2) *Oxford Journal of Legal Studies* 227, 241.

<sup>6</sup> HLA Hart, *The Concept of Law* (Oxford University Press 1957), 202.

<sup>7</sup> HLA Hart, *Law, Liberty and Morality* (Stanford University Press, 1963), at 51.

For some time, in the UK this would have been the principles and objectives amplified in the Cork Report which tended to favour the creditors.<sup>8</sup> More recently, with the introduction of the Corporate Governance and Insolvency Act 2020, there has been a more favourable shift to the debtors.<sup>9</sup> Arguable the change was not based on moral principles, but commercial pragmatism to aid financial distressed companies. So, while morals may evolve, it is also true that the law may evolve separately to moral principles.

It is also true that while morals and the law is separate, the law can nevertheless present many moral dilemmas. While insolvency has extensively evolved over the years,<sup>10</sup> from its punitive approach to debtors,<sup>11</sup> to an industry that is now geared towards rehabilitation and rescue,<sup>12</sup> what is morally right entirely depends on the perspective taken – the creditors, the company, the directors, the employees, or the insolvency practitioner.

### **Relevance of decision theory in insolvency**

Decision theory principally consists of two categories: descriptive and normative. Descriptive decision theory provides an explanation for, and prediction of, the choices that are made by individuals and groups facing choices such as those evident within an insolvent company. The normative decision theory, which is the focus of this paper, addresses the question of what decisions should be made and how they should be made. Such considerations concern how creditors, directors and insolvency practitioners should evaluate their options, how to assess any alternatives that may be presented, what criteria, legal or moralistic, they should employ in making those decisions, and what factors have or may influence those decisions.

Applied to insolvency, the theory does pose some challenges as some actors, such as directors and insolvency practitioners are afforded wide discretion to make commercial decisions, and this can lead to systematic deviations from what is perceived as the normative approach. Reasons for deviations can be explained by the presence of biases – reasons why certain decisions are preferred. Biases are expected since human judgment is influenced by behaviour, and as such if they are not found, it should

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<sup>8</sup> See JM Wood, *The Interpretation and Value of Corporate Rescue*, (Edward Elgar 2022), Ch 2.

<sup>9</sup> See JM Wood, 'Creative Destruction and the post COVID-19 economy: a critique of the (un)creative rescue value contained within the permanent CIGA 2020 reforms' (2023) 3 *Journal of Business Law* 197; JM. Wood, 'Corporate Rescue Reanimated' (2025) 1 *Journal of Business Law* 1.

<sup>10</sup> See JM Wood, 'Assessing the Effectiveness of the UK's Insolvency Regulatory Framework at Deterring Insolvency Practitioners' Opportunistic Behaviour' (2019) 19(2) *Journal of Corporate Law Studies* 333.

<sup>11</sup> For an overview of this development, see V Finch and D Milman, *Corporate Insolvency Law: Perspectives and Principles* (Cambridge University Press, 2017), p.9-18.

<sup>12</sup> See generally the Corporate Insolvency and Governance Act 2020.

be attempted to explain why this is the case. The nature of the bias should be examined to determine if there is a need to correct the bias. As this would require a review of the influence on the behaviour, this does include morality-based decisions. Such action could improve the judgments and align them more readily to the normative standards.

### **Morality in decision-making**

In an insolvent company, or a company that is in the vicinity of insolvency, the initial priority is to determine if the value within the company can be rescued or rehabilitated. If rescue is not possible then the optimal outcome for creditors is pursued. Decision-making in either of these contexts, whether by the directors (as directors in possession) or by insolvency practitioners, can be said to follow a rational model that attempts to achieve the most advantageous outcome given the circumstances. The relevance of morality in insolvency decision-making is more apparent when applied to decision theory within insolvency, as they explore how insolvency influences behaviour and human judgment,<sup>13</sup> which is in turn often informed by the end results.<sup>14</sup> On the influence here, the law is not troubled with the enforcement of an existing utilitarian morality that tells people what to do; instead, it strives to provide a mechanism that generates normative guidelines where they do not exist.<sup>15</sup>

Insolvency legislation is comprehensive, and with the extensive case law, specific practice statements and a code of ethics, the guidelines that explain the level of decision-making that different agents can have in the respective insolvency regimes is largely well defined. Yet, within the scope of some of these decisions there lies broad discretion, particularly in companies that have sought early intervention. A choice of procedures and outcomes may exist, but beyond economical pragmatism it is human judgment that may lead to preferences in the decision-making. The question here is whether morality forms part that judgment.

To address this question, it would require a review of how different agents act in specific circumstances. For example, the directors' conduct when a company is trading in administration, or when a company voluntary arrangement is in place, or when a standalone moratorium is in effect. For

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<sup>13</sup> Human judgment and the influences that may impact such decisions in an insolvency context are examined in J Wood, 'Assessing the Effectiveness of the UK's Insolvency Regulatory Framework at Deterring Insolvency Practitioners' Opportunistic Behaviour' (2019) 19(2) *Journal of Corporate Law Studies* 333.

<sup>14</sup> J Bentham, *Introduction to the Principles of Morals and Legislation* (J H Burns and H L A Hart (eds), Oxford University Press 1996) 34, 38; J Bentham, *Constitutional Code Rationale. In First Principles Preparatory to Constitutional Code* (P Schofield (ed) Clarendon Press 1989) 232.

<sup>15</sup> D Priel, 'Bentham's Public Utilitarianism and Its Jurisprudential Significance' (2021) 34(4) *Ration Juris* 415, 415.

the practitioner, were the choices made based purely on the circumstances, or was there influence from the firm when undertaking insolvency work.<sup>16</sup> Many of these type of decisions may be approached or critiqued as moral-based questions, but this is often due to the wording of the insolvency legislation or dictum in case law since the focus is on processes and procedures that tend to dictate for who's benefit should the decision be made. For most part it is the secured creditors of the company who are likely to have priority in such decisions.<sup>17</sup>

But this does not mean all other interests should be readily dismissed; nor does the law require this in all circumstances. It is within this discussion that morality may arise. For example, the broader rescue objective covers an array of interests that go beyond merely the secured creditors. Good social norms or moral decisions that benefit stakeholders, such as unsecured creditors, should be applied where possible but only within a particular 'community',<sup>18</sup> not universally,<sup>19</sup> to ensure the objective of rescue is not diluted to the point that it does not well serve any interest. What morality should do is offer improvement to outcomes, where the law falls short. How this 'improvement' should be implemented and to whom should this benefit is mostly provided for in the legislation, but some discretion is afforded to the directors or insolvency practitioners if they can justify their decisions within the parameters that are permitted.<sup>20</sup>

## Conclusion

Morality, whether it is from the perspective of an individual or a group, may influence insolvency law, but it is not synonymous with it. Insolvency law is largely concerned with how a debtor is to be treated, and the impact of debt on creditors. As a mechanism of commercial pragmatism, the treatment of debtors has evolved from one that was creditor-centric, to one increasingly focused on debtor rehabilitation and company rescue. This evolution, however, appears to be driven by commercial necessity rather than explicit moral principles, highlighting how law can change independently of shifting societal morals.

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<sup>16</sup> The recent consultation by the Insolvency Service, *The Future of Insolvency Regulation* (21 March 2022) highlights the tension between the commercial interests of the firm and the statutory responsibilities of the practitioner, see Part B.

<sup>17</sup> The protection of creditors' interests is well noted, see *Liquidator v West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30, [1988] BCLC 250. More recently, this 'creditor duty' was confirmed in *BTI 2014 LLC v Sequana SA* [2022] UKSC 25.

<sup>18</sup> J Bentham, *The Works of Jeremy Bentham* (J Bowring (ed) William Tait 1841) 2:537-8; J R Dinwiddy, *Radicalism and Reform in Britain, 1780–1850* (Hambledon Press 1992) 317-8, 335-7.

<sup>19</sup> D Priel, 'Bentham's Public Utilitarianism and Its Jurisprudential Significance' (2021) 34(4) *Ration Juris* 415, 431.

<sup>20</sup> See J M. Wood, 'Insolvency office-holder discretion and judicial control' (2020) 6 *Journal of Business Law* 451.

Yet, as the discussion on normative decision theory illustrates, the human judgment remains unavoidable. Actors in insolvency are afforded considerable discretion, and their judgments—while aiming for the ‘optimal result’—are susceptible to biases and individualistic influences, which may be rooted in personal or professional moral beliefs. The core question, therefore, is not whether insolvency law can enforce a singular morality, but rather to what degree morality acts as an unseen variable in descriptive decision-making, and whether it *should* be intentionally incorporated into normative insolvency guidelines. The answer to this question, quite ironically, is likely to be influenced by one’s own sense of morality.



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