

The IP Lottery: The Role of Noise in Balancing Creditor and Stakeholder Interests in Insolvency Proceedings

An empirical tale from the Netherlands

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Abstract

Insolvency practitioners (IPs) manage and liquidate bankrupt estates. While their primary responsibility lies in prioritizing the interests of the collective creditors, they must also consider various other (societal) interests in their decision making. The law typically grants IPs discretion in balancing these interests, but this flexibility leads to variability in bankruptcy proceedings, resulting in legal uncertainty and inequality. This paper aims to introduce the reader to the psychological concept of *noise* (variability in judgments or decisions that ought to be identical) and to highlight the considerable level of variability in IPs' decisions when balancing interests. More specifically, using examples from empirical studies we conducted in the Netherlands, the paper demonstrates how stakeholders in bankruptcy proceedings are at the mercy of IPs' subjective judgements and that there is very little uniformity in their judgments. To reduce the level of legal uncertainty and inequality, this paper proposes further clarification on how IPs should navigate and balance interests in insolvency proceedings.

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Keywords: Dinoise, insolvency practitioner, stakeholders, sustainability, societal interests, empirical research

1. Introduction

1. The role of insolvency practitioners (IPs) is evolving. The context in which bankrupt estates have to be managed, has drastically changed in recent years. Traditionally, the primary purpose of bankruptcy proceedings has been, and remains, to maximize returns for creditors.⁷ This focus on creditors could deter IPs from considering broader societal interests, if doing so impedes value maximization. In recent years, however, there has been a worldwide shift towards a more stakeholder-friendly insolvency law, broadening the perspective on the goals and interests that insolvency proceedings should serve.⁸ In addition, IPs are increasingly confronted with obligations that do not focus on merely maximizing value for creditors but also on promoting other, societal interests, such as cleaning up hazardous waste sites or combatting fraud.⁹ With this shift, the interests of a more diverse group of stakeholders have gained ground in bankruptcy proceedings.¹⁰ In some jurisdictions for example, IPs are increasingly expected to take into account the interests of employees and in other jurisdictions, such as France, Italy, and Spain, the protection of employment has long been a primary concern, with French law even placing it on equal footing with

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- 7 A Keay, 'Insolvency Law: A Matter of Public Interest?' (2000) 51 Northern Ireland Legal Quarterly 509; K Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (Yale University Press 1997) 23, 137, 193.
 - 8 A Keay, 'Insolvency Law: A Matter of Public Interest?' (2000) 51 Northern Ireland Legal Quarterly 509; K Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (Yale University Press 1997); T Linna, 'Insolvency Proceedings from a Sustainability Perspective' (2021) 28 *International Insolvency Review* 210; JMW Pool, 'Rethinking the Goal of Bankruptcy Proceedings: Maximizing Value Versus Sustainable Liquidation' (2023) 16 *Erasmus Law Review* 114-123. See also Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, amending Directive (EU) 2017/1132 (Directive on Restructuring and Insolvency), art 19 (directors' duties); B Wessels, 'Performance of Insolvency Administrator Activities in EU Member States: A Dutch View' (2022) 19/6 *International Corporate Rescue* 314.
 - 9 JMW Pool, 'Rethinking the Goal of Bankruptcy Proceedings: Maximizing Value Versus Sustainable Liquidation' (2023) 16 *Erasmus Law Review* 114-123; B Wessels, 'Performance of Insolvency Administrator Activities in EU Member States: A Dutch View' (2022) 19/6 *International Corporate Rescue* 314.
 - 10 JMW Pool, 'Rethinking the Goal of Bankruptcy Proceedings: Maximizing Value Versus Sustainable Liquidation' (2023) 16 *Erasmus Law Review* 114-123.

creditors' interests.¹¹ In addition, they are being confronted with obligations to comply with rules that aim to protect societal interests, such as environmental and privacy legislation. The main goal of bankruptcy proceedings, however, has remained unchanged.

2. The varied interests that IPs must consider can be conflicting, presenting a challenge in determining the appropriate course of action. The course of action for IPs in situations where conflicting interests arise is ambiguous as the law gives little guidance considering the openness of the applicable norms; IPs possess a significant degree of discretion in executing their duties, particularly when confronted with the need to balance competing stakeholder interests. They have the authority to determine, on a case-by-case basis, whether and how to consider (conflicting) interests of stakeholders. Due to the limited guidance provided by the law and the broad nature of the applicable norms, IPs have substantial discretion, which could result in significant variability in their decisions.
3. In psychology, this variability in judgments is termed 'noise.' Noise refers to unwanted fluctuations in judgments and decisions that should ideally be consistent.¹² When noise occurs in the way IPs handle societal interests, it can lead to different approaches to bankruptcy cases, meaning that individuals and stakeholders involved may experience inconsistent outcomes depending on the IP handling their case. This introduces the risk of arbitrariness, potentially resulting in legal uncertainty and inequality, as those affected by insolvency proceedings are subject to varying decisions based on the subjective judgment of each IP. For instance, in a going concern sale of a company, one IP might choose to sell to the highest bidder, while another might prioritize a bidder committed to retaining the most employees, even if it means creditors incur a 10% haircut. Similarly, in cases of suspected fraud, one IP might consistently pursue investigations, potentially at the expense of creditors, whereas another IP might abstain from such actions, considering them beyond their responsibility.
4. In this paper, our aim is to demonstrate the significant variability in IPs' decisions through the psychological concept of noise. More specifically, the paper

11 Art. L631-1 Code de Commerce de Redressement judiciaire procedure. See also T Linna, 'Insolvency Proceedings from a Sustainability Perspective' (2019) 28 *International Insolvency Review* 210, 224-225; Hilpert et al, 'Looking Ahead: How ESG May Affect Investing, Refinancing and Restructuring' (2022) 31(5) *Norton Journal of Bankruptcy Law* 660.

12 D Kahneman, O Sibony & C R Sunstein, *Noise: A Flaw in Human Judgment* (Little, Brown Spark 2021).

demonstrates how stakeholders are subject to the IP's subjective judgement, and why this is a problem for both stakeholders and the insolvency system. First, we explore the global emergence of societal interests in insolvency proceedings and explain how this trend may worsen the amount of noise in decision-making processes of IPs, with a focus on the Netherlands as a case study (par. 2). We then discuss the phenomenon of 'noise' and discuss empirical findings regarding noise in legal decision-making (paragraph 3). Subsequently, using the Dutch system as a case study as it is a jurisdiction in which IPs are granted considerable leeway to deal with an insolvent company as they see fit, we demonstrate that Dutch IPs show a significant level of noise in their decisions (par. 4). In par. 5 we discuss the implications of the level of noise among IPs and propose further clarification on how IPs should navigate and balance interests in insolvency proceedings.

2. Societal interests in bankruptcy proceedings: a source of noise

2.1 The emergence of societal interests in insolvency proceedings around the globe

5. The field of sustainability is becoming increasingly prominent in law, particularly due to the convergence of societal, environmental, and economic crises the world is facing. In company law, a critical issue is balancing the interests of shareholders, who prioritize maximizing profits, with those of other stakeholders, such as employees, customers and the environment, to promote sustainability.¹³ Recent legislative efforts on the EU-level, such as the recently approved Corporate Sustainability Due Diligence Directive¹⁴ and the Corporate Sustainability Reporting Directive¹⁵, aim to "foster sustainable and responsible corporate behaviour in companies".¹⁶ These initiatives encourage companies to identify and address the adverse human rights and environmental impacts

13 See JC Dembach et al, 'The Growing Importance of Sustainability to Lawyers and the ABA' (2013) *ABA Trends* 21, 24.

14 See Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937.

15 Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.

16 See the website of the European Commission about the corporate sustainability due diligence directive https://commission.europa.eu/business-economy-euro/doing-business-eu/corporate-sustainability-due-diligence_en.

of their actions both within and outside Europe.¹⁷ In essence, companies are now expected to shift their focus from solely making profits to also embracing corporate social responsibility.

6. Following recent developments in company law, there are several insolvency-related EU-initiatives aimed at minimizing the negative effects of unnecessary liquidations. For instance, the Restructuring Directive seeks to provide early support for entrepreneurs and businesses facing financial difficulties, enabling them to continue operations.¹⁸ This directive offers a flexible and efficient restructuring framework to help businesses recover and get back on track. The goal is to prevent the insolvency and liquidation of viable businesses, thereby preserving jobs and maintaining business continuity. This continuation not only benefits employees but also is supposed to have positive impact on the community and consumers.
7. However, these initiatives do not specifically aim to foster sustainable and responsible corporate behaviour like the CSDDD and the CSRD. There are no legislative rules to ensure that companies continue to identify and address the adverse human rights and environmental impacts of their actions during insolvency proceedings. The recently published proposal for a directive harmonizing certain aspects of insolvency law (Insolvency III Directive), despite its goal of ensuring “the predictable and fair distribution of recovered value among creditors,” does not include specific provisions for handling societal interests during insolvency proceedings.¹⁹
8. Nevertheless, some national initiatives have begun addressing this gap, either through specific provisions or by allowing IPs the flexibility to consider interests beyond those of creditors. An example of a jurisdiction without specific provisions is the Netherlands, where the Supreme Court has ruled that Dutch insolvency practitioners should take societal interests into account during insolvency proceedings.²⁰ In the following paragraph, we will examine the

17 Idem.

18 Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

19 Proposal for a Directive of the European Parliament and of the Council harmonising certain aspects of insolvency law (COM/2022/702 final).

20 Dutch Supreme Court 24 February 1995, ECLI:NL:HR:1995:ZC1643, r.o. 3.5, *NJ 1996/472 (Sigmacon II)*. See also Dutch Supreme Court 19 April 1996, ECLI:NL:HR:1996:ZC2047, r.o. 3.5.2, *NJ 1996/727 (Maclou)*,

Dutch legal framework as a case study, exploring how these broad and open-ended norms may contribute to variability in judgments.

2.2 The Dutch case: the open norm of considering societal interests

9. Dutch IPs are tasked with the settlement of bankruptcies.²¹ They perform their duties in the interests of the collective creditors. This task is rooted in the objective of bankruptcy, which is to maximize the realization of the debtor's assets to satisfy the creditors as much as possible according to their priority. In carrying out their duties, IPs primarily focus on advocating for the interests of the collective creditors, striving to maximize the estate's value.²² Historically, IPs have not been explicitly assigned a duty to also consider societal interests.²³ In recent decades, the role of the IP has evolved with changing societal norms, and therefore there is a growing emphasis on societal responsibility. This evolved role now encompasses, among other things, addressing irregularities such as apparent misconduct and fraud, as mandated by a revision of the Dutch Bankruptcy Act in 2017 to strengthen the position of the IP.²⁴ Additionally, IPs are required to adhere to statutes and regulations safeguarding societal interests, such as environmental and privacy laws. While the interests of the collective creditors remain paramount²⁵, IPs are increasingly recognized as custodians of societal concerns.²⁶ Consequently, it is established legal doctrine that IPs must take into account societal interests in their decision-making.²⁷
10. However, it remains unclear how IPs should navigate between creditors' interests and societal interests or what their precise obligations entail in scenarios where those interests collide. In the Netherlands, IPs possess considerable

21 Article 68 Dutch Bankruptcy Act (DBA).

22 RD Vriesendorp, *Insolventierecht* (Wolters Kluwer 2021) nr. 162; FMJ Verstijlen, *De Faillissementscurator* (W.E.J. Tjeenk Willink 1998) 155.

23 FMJ Verstijlen, *De Faillissementscurator* (W.E.J. Tjeenk Willink 1998) 149. See also Van der Feltz II, explanation to article 68 DBA.

24 *Stb.* 2017, 176. *Kamerstukken* 34253.

25 Dutch Supreme Court 16 December 2011, *NJ* 2012/515 (Prakke/Gips). See also FMJ Verstijlen, *De Faillissementscurator* (W.E.J. Tjeenk Willink 1998) 155; Dutch Supreme Court 19 December 2003, *NJ* 2004/293 (Mobell/Interplan).

26 Dutch Supreme Court 24 February 1995, ECLI:NL:HR:1995:ZC1643, r.o. 3.5, *NJ* 1996/472 (*Sigmacon II*). See also JMW Pool, 'Maatschappelijk Verantwoord Vereffenen: Belangenpluralisme bij de Maatschappelijke Taakuitoefening van de Curator' (2022) *Tvl* 20; A van Hees, 'Maatschappelijk Verantwoord Vereffenen' (2015) *Tvl* 1.

27 HR 24 februari 1995, ECLI:NL:HR:1995:ZC1643, r.o. 3.5, *NJ* 1996/472 (*Sigmacon II*). Zie ook HR 19 april 1996, ECLI:NL:HR:1996:ZC2047, r.o. 3.5.2

discretion in balancing the interests of creditors and those of other stakeholders. They have broad discretionary powers, especially when weighing conflicting interests. IPs can decide on a case-by-case basis whether and how to consider the interests of stakeholders beyond creditors. While the interests of these stakeholders have gained recognition in bankruptcy proceedings, it ultimately falls upon the specific IP handling the bankruptcy to determine the extent to which these interests are taken into consideration.

11. The open norm governing how IPs balance creditors' interests with societal concerns can lead to significant variability in decision-making, resulting in a noisy system. In the following paragraphs, we will explain what noise is, outline the different types of noise, and illustrate how these broad and open-ended norms contribute to inconsistency in IPs' decisions.

3. Noise: a psychological perspective on variability

3.1 Noise in a legal context

12. In legal literature, we mainly speak of the risk of arbitrariness when the use of (open) norms can lead to widely differing interpretations, while in behavioural sciences, the term 'noise' is used.²⁸ Both phenomena, arbitrariness and noise, refer to the same issue, namely the unwanted variability in judgments and decisions that should ideally be uniform. It is important to note that noise is not the same as *bias*, a psychological phenomenon that is also receiving increasing attention within the legal domain.²⁹ While biases refer to unconscious prejudices or cognitive errors in judgment and decision-making that often result in a certain systematic deviation in a particular direction – think for example of prejudices leading to ingroup bias (favourable judgments towards one's own

28 D Kahneman, O Sibony & C R Sunstein, *Noise: A Flaw in Human Judgment* (Little, Brown Spark 2021). See also N Strohmaier & JMW Pool, 'Ruis bij Open Normen: Een Onderschat Risico voor Rechtszekerheid en Rechtsgelijkheid', in LC Groen & SJ Reinders (eds), *Empirisch Onderbouwde Wetgeving* (Boom Juridisch 2024), on which paragraph 2 is based.

29 See also C Guthrie, JJ Rachlinski & AJ Wistrich, 'Inside the Judicial Mind' (2000) 86 *Cornell Law Review* 777; C Guthrie, JJ Rachlinski & AJ Wistrich, 'Blinking on the Bench: How Judges Decide Cases' (2007) 93 *Cornell Law Review* 1; D Teichman, E Zamir & I Ritov, 'Biases in Legal Decision-Making: Comparing Prosecutors, Defense Attorneys, Law Students, and Laypersons' (2023) 20(4) *Journal of Empirical Legal Studies* 852-894; N Strohmaier et al, 'Hindsight Bias and Outcome Bias in Judging Directors' Liability and the Role of Free Will Beliefs' (2021) 51(3) *Journal of Applied Social Psychology* 141-158; N Strohmaier, *Making Sense of Business Failure: A Social Psychological Perspective on Financial and Legal Judgments in the Context of Insolvency* (Doctoral dissertation, Leiden University 2020).

group) –, noise refers to variability without any systematic pattern; judgments that can go in any direction. The distinction between bias and noise is further illustrated in Figure 1. Here, it can be seen that bias involves a systematic deviation from the ideal (the bullseye), while this systematicity is absent in noise. In legal judgments, there is often no such thing as an ‘accurate’ or ideal judgment. However, this does not make the problem of noise any less significant. Even without the possibility of an accurate judgment or a correct decision, a high degree of variability poses a problem as it leads to legal uncertainty and inequality. As a final note on the distinction between bias and noise, it is important to realize that biases among decision makers can lead to noise. Because people have their own biases following from their own unique traits and characteristics, one person may in a particular case be biased in a certain direction, whereas another person would lean towards the opposition direction due to their unique biases, thus creating noise. A single judgment or decision can be biased but not noisy, as noise refers to variability in a larger set of judgments and there is no variability in a single judgment. However, the sum of people’s biases in specific instances can create a noisy system. As we will see, noise can result from many things, biases being just one of them.

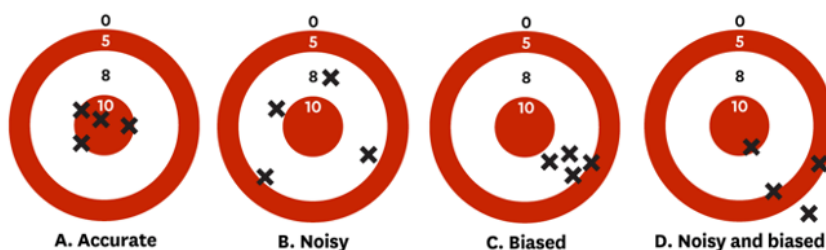


Figure 1. Visualization of the difference between bias and noise.³⁰

13. The issue of noise within the legal domain and its consequential challenges has been a topic of discussion for decades. For example, it was American federal judge Marvin Frankel who drew attention to the topic already in the seventies of the previous century. Based on his own observations, Frankel strongly believed that the outcome of a case primarily depends on the judge assigned to it, rather than the facts of the case. To test his intuition, he commissioned

³⁰ D Kahneman, J Rosenfield, R Gandhi & A Blaser, ‘Noise: How to Overcome the High, Hidden Cost of Inconsistent Decision Making’ (2016) <https://hbr.org/2016/10/noise> accessed 20 September 2024.

a study in 1974, the conclusion of which was: “absence of consensus is the norm”.³¹ In one of the cases presented to participants in that study involving a robbery, the participating judges’ verdicts ranged from 30 days to 5 years imprisonment. The presence of noise in legal judgments and its problematic extent will become even clearer in the subsequent paragraphs. But before we delve into further empirical evidence, we first address the definition of noise and where it originates from. How is it possible for those tasked with interpreting and applying legal norms, to differ so significantly in their judgments while having access to the same information? The following sections address this question.

3.2 Sources of noise

14. The total amount of noise in a particular system (also known as system noise), such as the total noise in the interpretation of a specific open norm, can be divided into noise *between* assessors (level noise) and noise *within* assessors (pattern noise). The latter can then be further divided into ‘stable pattern noise’ and ‘situational pattern noise’. The relationship between these different sources of noise is visually depicted in Figure 2.

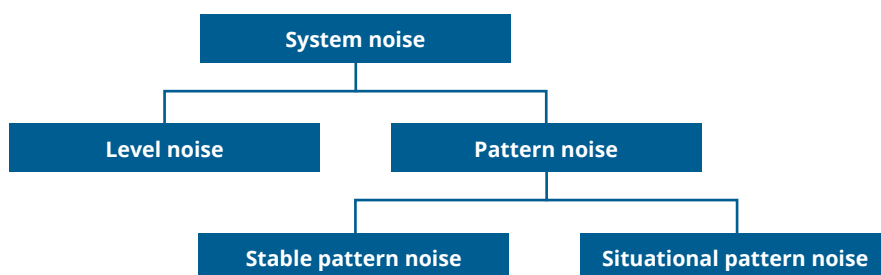


Figure 2. Visualization of the different components of system noise.

31 A. Partridge & W.B. Eldridge, ‘The Second Circuit sentencing study: A report to the judges of the Second Circuit’ (1974) *Federal Judicial Center* nr. 74-4. A group of fifty judges was presented with a series of case files and asked to individually render judgments. For example, one of the cases involved a heroin dealer, for whom the sentences ranged from 1 to 10 years of imprisonment. In another case concerning extortion, the penalties ranged from a fine of \$65,000 to a prison sentence of twenty years. See also K. Clancy, J. Bartolomeo, D. Richardson & C. Wellford, ‘Sentence decisionmaking: The logic of sentence decisions and the extent and sources of sentence disparity’ (1981) *J. crim. L. & criminology* 72, 524; P. J. Van Koppen & J. Ten Kate, ‘Individual differences in judicial behavior: Personal characteristics and private law decision-making’ (1984) *Law & Society Review* 18(2), 225-247.

3.2.1 Level noise

15. When averaging a number of decisions or judgments by a range of different assessors, one assessor will on average judge or decide differently than the next. This is essentially what constitutes level noise: variation between assessors when looking at their judgments and decision in the aggregate.
16. In the context of legal decision making, the existence of level noise among judges has been convincingly demonstrated. For example, a study that analysed 2,200 court decisions showed that in the United States, Republican judges on average handed out seven months longer prison sentences than Democratic judges, meaning that one source of level noise may be found in differences between assessors in political orientation.³²
17. Another example of level noise concerns research on asylum application decisions in the US. This comprehensive study analysed more than 400,000 decisions and for example demonstrated that Colombian asylum applicants in the US federal immigration court had a 5% chance of success with one judge versus an 85% chance with another.³³ The same study also looked at the role of the judge's gender and found that female judges showed a significantly higher acceptance rate of asylum applications than male judges. Other research further shows that female judges seem more likely to push (and successfully so) for settlement in personal injury cases than their male colleagues.³⁴ The scant research that has been done on the influence of age on judicial judgments shows that in criminal cases, older judges are more likely to rule in favour of the victim than younger judges.³⁵

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- 32 M.M. Schanzenbach & E.H. Tiller, 'Reviewing the sentencing guidelines: Judicial politics, empirical evidence, and reform' (2008) *The University of Chicago Law Review* 75(2), p. 715-760; see also A. Arora, 'Too tough on crime? The impact of prosecutor politics on incarceration' (2008) *American Economic Association*; A. Cohen & C.S. Yang, 'Judicial politics and sentencing decisions' (2019) *American Economic Journal: Economic Policy*, volume 11, nr. 1, p. 160-191; L. Epstein & J. Knight, 'Reconsidering judicial preferences' (2013) *Annual Review of Political Science*, volume 16, p. 11-31; For a study on the influence of political preferences and other factors in jury decision making see for example A. Shamena & B. Patrick, 'Politics in the Courtroom: Political Ideology and Jury Decision Making' (2015) *Journal of the European Economic Association*.
 - 33 J Ramji-Nogales, Al Schoenholtz & PG Schrag, 'Refugee Roulette: Disparities in Asylum Adjudication' (2007) 60 *Stanford Law Review* 295.
 - 34 C.L. Boyd, 'She'll settle it?' (2013) *Journal of Law and Courts*, volume 1, nr. 2, p. 193-219.
 - 35 R. Fox & R. van Sickle, 'Gender dynamics and judicial behavior in trial courts: an exploratory study' (2000) *Justice System Journal*, volume 21, nr, 3, p. 261-280.

18. The most recent and perhaps the most comprehensive study on the topic, using machine learning, analysed six million decisions by immigration judges in the US. This study concluded that 58.5% of the variation in rulings can be explained by extra-legal factors, such as personal characteristics of the judge.³⁶ Indeed, the reason for the existence of level noise (i.e., why people judge differently in the aggregate) can largely be found in differences between assessors in terms of personal backgrounds, political views, personalities, norms and values, prejudices, et cetera.

3.2.2 *Pattern noise*

19. Besides noise arising from differences between assessors, noise can also arise from factors within assessors because they themselves are not always consistent. This form of noise, called pattern noise, refers to the fact that an assessor may judge differently as a result of (conscious or unconscious) personal preferences and biases and properties of what is being judged (and especially the interaction between them), or by irrelevant situational factors. Pattern noise can arise from two different sub-forms of this form of noise: stable pattern noise and situational pattern noise.
20. By stable pattern noise, one should think of a certain stable pattern of biases. For example, again in the context of judicial decision making, a generally very lenient judge may be much more strict in particular type of cases. One can also think of a judge who, because of his more socialist background, is extra strict in tax fraud cases, or a judge who is particularly harsh on those who commit theft or violence towards elderly. Or a judge who is more lenient towards parties who are similar to the judge in terms of physical similarities or socio-economic or geographical background (i.e., similarity bias). One can also think of favouring or disadvantaging specific population groups, as research indeed shows that there is a difference in the extent to which judges are susceptible to racial bias (i.e. more negative assessment of defendants of a different race).³⁷ Further, research showed that female judges were more likely to approve the request for protection of (female) victims of domestic violence than male judges, and this effect was particularly visible among older female judges and primarily

36 V Raman, C Vera & CJ Manna, 'Bias, Consistency, and Partisanship in US Asylum Cases: A Machine Learning Analysis of Extraneous Factors in Immigration Court Decisions' in *Proceedings of the 2nd ACM Conference on Equity and Access in Algorithms, Mechanisms, and Optimization* (2022) 1-14.

37 D.S. Abrams, M. Bertrand & S. Mullainathan, 'Do judges vary in their treatment of race?' (2012) *The Journal of Legal Studies*, volume 41, nr. 2, p. 347-383; see also B. Depew, O. Eren & N. Mocan, 'Judges, juveniles, and in-group bias' (2017) *The Journal of Law and Economics*, volume 60, nr. 2, p. 209-239.

when their workload was high.³⁸ Also, research from the US shows that female judges are more likely to rule in favor of the plaintiff in gender-discrimination cases.³⁹ Research on the role of age in legal decision making found that younger judges seem less inclined than their older colleagues to rule in favour of the plaintiff in age discrimination cases.⁴⁰ In short, because of the idiosyncrasies of judges, they do not judge uniformly in every case and the pattern of judgments is also different for each judge. Note that the majority of the examples given thus far pertain to the US context. For our purposes it is not relevant whether the same effects can be observed in other parts of the world. The goal for now is merely to introduce the concept of noise and demonstrate the different types of noise and their potential causes. It may very well be the case that different sources of noise can be found in different parts of the world.

21. Situational pattern noise should be thought of as irrelevant situational (and thus temporal) factors that affect the judgment of assessors. In the context of judicial decision making, one might think of a judge's mood on a particular day, the weather, a defendant's birthday, et cetera. These examples may seem somewhat ridiculous, but there is empirical evidence that such factors can in fact influence judicial judgments. For instance, a study of 4.8 million legal judgments in France over a 12-year period found that judgments were less harsh when it was the defendant's birthday.⁴¹ Other research found that when judges in the US were in a bad mood because their local football team had unexpectedly lost over the weekend, they ruled more harshly (manifesting in longer sentences) on the Monday after the weekend and that effect also trickled down into the following days.⁴² For a win or an already anticipated loss, this relationship was not found. Whereas the latter study had examined 'only' a thousand court judgments, another study that analysed one and a half million judgments

38 J.J. Vallbé & C. Ramírez-Folch, 'The effect of judges' gender on decisions regarding intimate-partner violence' (2023) *Journal of Empirical Legal Studies*.

39 C.L. Boyd, 'Representation on the courts? The effects of trial judges' sex and race' (2016) *Political Research Quarterly*, volume 69, nr. 4, p. 788-799..

40 K.L. Manning, B.A. Carroll & R.A. Carp, 'Does age matter? Judicial decision making in age discrimination cases' (2004) *Social Science Quarterly*, volume 85, nr. 1, p. 1-18..

41 D.L. Chen & A. Philippe, 'Clash of norms judicial leniency on defendant birthdays' (2023) *Journal of Economic Behavior & Organization*, volume 211, p. 324-344.

42 O. Eren & N. Mocan, 'Emotional judges and unlucky juveniles' (2018) *American Economic Journal: Applied Economics*, volume 10, nr. 3, p. 171-205.

on asylum applications over a period of three decades came to the same conclusion: harsher judgments followed the loss of the local football club.⁴³

22. A frequently cited study in the context of irrelevant factors that may influence judicial judgments is the 'hungry judges' study. This study seemed to show that parole decisions are influenced by judges' hunger levels. The percentage of approved applications dropped from 65% to practically 0% as the morning progressed and jumped back to 65% after the lunch break. However, the study has been subject to strong criticism, both on methodological grounds⁴⁴, particularly because the allocation and treatment of cases during the day was not random as was assumed by the researchers, and on statistical grounds.⁴⁵ It may be possible that hunger and 'decision fatigue' affect judicial decisions, but the study in question probably did not provide any supportive evidence.
23. A more recent study does seem to have found a link between eating patterns and judicial verdicts, but in the opposite direction to the earlier study on hungry judges. Half a million verdicts in criminal cases of ten thousand judges from India and Pakistan over a span of half a century were examined to see if there is a link between fasting during Ramadan and verdicts in criminal cases.⁴⁶ The analyses show that as the intensity of fasting increases, judges increasingly acquit the accused. Whether these results can be explained by hunger, or the practice of a religious ritual (or something else) is not yet clear.

3.3 The illusion of objectivity

24. Before concluding this section on the different sources of noise, it is important to note that the judges in the studies that have been discussed are acting in good faith and are merely using the discretionary space, in good conscience, given to them by the legislature. Therefore, the undesirable influence of personal characteristics, biases, and irrelevance situational factors mainly stem from automatic and unconscious processes. Kunda spoke of the 'illusion

43 D. L. Chen & M. Loecher, 'Mood and the Malleability of Moral Reasoning: The Impact of Irrelevant Factors on Judicial Decisions' (2022) *HAL* 03864854.

44 K. Weinshall-Margel & J. Shapard, 'Overlooked factors in the analysis of parole decisions' (2011) *Proceedings of the National Academy of Sciences*, volume 108, nr. 42; see also A. Glöckner, 'The irrational hungry judge effect revisited: Simulations reveal that the magnitude of the effect is overestimated' (2016) *Judgment and Decision Making*, volume 11, nr. 6, p. 601-610.

45 D Lakens, 'The 20% Statistician: Impossible Hungry Judges' (3 July 2017) <https://daniellakens.blogspot.com/2017/07/impossibly-hungry-judges.html>.

46 S. Mehmood, A. Seror & D.L. Chen, 'Ramadan fasting increases leniency in judges from Pakistan and India' (2023) *Nature Human Behaviour*, volume 7, p. 874-880.

of objectivity' as people unconsciously reason towards a desired conclusion and, in the process, interpret and construct both the facts and the law in such a way as to justify the desired conclusion on seemingly rational and objective grounds.⁴⁷ Kunda phrased it as follows:

25. *"People do not realise that the process is biased by their goals, that they are accessing only a subset of their relevant knowledge, that they would probably access different beliefs and rules in the presence of different directional goals, and that they might even be capable of justifying opposite conclusions on different occasions."*
26. This process is also known as 'motivated cognition' or 'motivated reasoning'.⁴⁸ The fact that people often do not realise that they are unconsciously influenced by irrelevant factors is partly due to the idea that people believe they experience and perceive the world as it objectively is and that those who have different views are ill-informed or biased. This idea is called 'naive realism' and is closely related to bias blindspot, which means people are willing to acknowledge the influence of biases in others but deny that they too may be biased.

3.4 Interim conclusion regarding noise

27. This section has explained that the total amount of noise – system noise – when using an open norm arises from level noise (one assessor is not the other), stable pattern noise (idiosyncratic patterns of an assessor, including personal biases) and situational pattern noise (irrelevant factors of temporary nature). The empirical evidence on these sources of noise is substantial. Political preferences, biases, mood, weather, suspects' birthdays, and many other factors can influence judgments, and the literature reviewed so far is far from exhaustive. The sum of the various sources of noise means that once there is some room for discretion on the part of the assessor, the degree of noise in the system can be severe.
28. The studies reviewed in this section mainly focus on judicial decisions. The question can therefore be raised to what extent noise in judicial judgments

47 Z. Kunda, 'The case for motivated reasoning' (1990) *Psychological Bulletin*, volume 108, nr. 3, p. 480-498.

48 For an overview on motivated reasoning in the legal domain, zie A. M. Sood, 'Motivated cognition in legal judgments—An analytic review' (2013) *Annual Review of Law and Social Science*, 9(1), 307-325; N. Strohmaier & S. de Jong, 'Moral Character Judgments and Motivated Cognition in Legal Reasoning' (2023) *Legal Reasoning and Cognitive Science: Topics and Perspectives*, p. 1-22.

can be translated to noise among IPs. However, given that at its core judges and IPs have very similar tasks in the sense that both need to form judgments and make decisions based on complex information while being granted some degree of discretionary power, we consider it to be a safe assumption that the research on noise among judges can be extrapolated to the context of IPs. We provide evidence for that assumption in the next paragraph.

4 Empirical evidence for noise among IPs in considering societal interests – examples from the Netherlands

4.1 Introduction

29. As mentioned above, in the Netherlands, IPs have traditionally prioritized maximizing the estate's value for the collective creditors. However, their role has expanded in recent decades to encompass broader societal responsibilities, including addressing fraud, misconduct, and compliance with environmental and privacy laws. Despite this evolution, there is limited clarity on how IPs should balance the interests of creditors with societal concerns, leaving them with considerable discretion (see para. 2.2). This discretion can lead to varying decisions among IPs, potentially introducing significant variability and noise into the decision-making process. In this paragraph, we will discuss empirical studies we conducted among Dutch IPs which reveal significant noise in their decisions on balancing creditors' interests with societal concerns (par. 4.2), ultimately concluding that a lack of consensus among IPs is the norm (par. 4.3).

4.2 Empirical evidence from the Netherlands

30. In recent years, we have conducted several empirical studies into how Dutch IPs take into account societal interests. These studies provide some insight into the differences in decision-making among IPs. For example, we investigated how IPs perceive their responsibilities in settling the bankrupt estate using surveys and interviews. The results of these studies showed that for most Dutch IPs, safeguarding creditors' interests is perceived to be central to their role.⁴⁹ Additionally, it appears that the majority of Dutch IPs consider

49 Pool 2022, para 4.5.3 6.5.4; JMW Pool, 'Rethinking the Goal of Bankruptcy Proceedings: Maximizing Value Versus Sustainable Liquidation' (2023) 16 *Erasmus Law Review* 114-123; M van Eekelen-Atema, 'De Faillissementscurator en Maatschappelijke Belangen', in E Enneking et al (eds), *Publiek Privaatrecht. Over Publieke Doelen en Belangen in Privaatrechtelijke Verhoudingen* (Boom Juridisch 2021) par. 2.4.

taking into account societal interests to be part of their job to some extent.⁵⁰ However, the extent and manner in which they do so vary significantly. Some IPs believe they should only consider societal interests when these interests align with creditors' interests, while others are willing to prioritize societal interests even at the expense of creditors.⁵¹ Furthermore, a 2023 survey of 217 Dutch IPs revealed that 70% believe that IPs cannot subordinate creditors' interests to other interests. This means that 30% believe IPs can let other interests prevail over creditors' interests, despite Dutch law suggesting otherwise.⁵² These results indicate that there is substantial variability in how IPs balance creditors' interests with societal interests.

31. Additional studies confirm this variability, highlighting the diverse approaches IPs take in fulfilling their roles. In one study, we presented Dutch IPs with three different scenarios involving bankrupt companies and asked a range of questions on how they would deal with the situation.⁵³ The first scenario relates to the prevention and combatting of bankruptcy fraud. Dutch IPs have the duty to investigate and redress possible irregularities that caused the bankruptcy or has made the deficit in bankruptcy bigger. Not all IPs are happy about this task, because they find this obligation incongruent with their primary responsibility to creditors.⁵⁴ In the scenario, IPs were confronted with a bankrupt company suspected of fraudulent activities. The case presented clear indications of financial misconduct, raising the question of whether IPs should allocate resources to further investigate the potential misconduct, despite thereby potentially reducing creditors' payouts. The investigation involved significant costs and time, with uncertain returns for creditors. An overwhelming 98% of the 84 respondents chose to proceed with the investigation, indicating a strong consensus among IPs on the necessity of pursuing fraud prevention measures (see figure 3). Hence, when it comes to combatting fraud as a responsibility for IPs, there appears to be little noise.

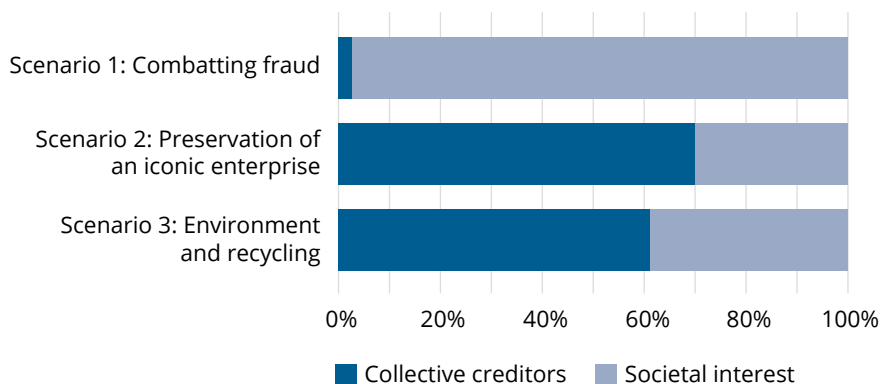
50 Idem.

51 Pool 2022, par. 7.3 en 8.4; JMW Pool, 'Rethinking the Goal of Bankruptcy Proceedings: Maximizing Value Versus Sustainable Liquidation' (2023) 16 *Erasmus Law Review* 114-123

52 JMW Pool, H Pluut & RD Vriesendorp, 'Wanneer prevaleren maatschappelijke belangen boven de belangen van de gezamenlijke schuldeisers? Een experimenteel onderzoek naar belangenafwegingen van curatoren' (2023) 2023(6) *Tijdschrift voor Insolventierecht* 274-292.

53 Idem.

54 Pool 2022.



* For scenario 1, $n = 84$; for scenario 2, $n = 70$; and for scenario 3, $n = 75$.

Figure 3. Balancing of interests in three scenarios*

32. Scenarios 2 and 3, however, paint a different picture. In scenario 2 respondents were asked to decide as an IP tasked with managing the bankruptcy of a well-established Dutch company with a significant cultural and historical footprint.⁵⁵ Two potential buyers emerged: an American private equity firm proposing a complete overhaul versus a Dutch investor aiming to preserve the company's legacy. IPs had to choose between these buyers based on their proposed plans, knowing that the choice could impact creditor payouts. The American firm promised a higher recovery rate for creditors, albeit with a more drastic transformation of the company. In contrast, the Dutch investor offered a plan that retained the company's identity but offered a lower return to creditors. Of the respondents, 70% favored collaborating with the American private equity firm. This decision reflected a prioritization of creditors' financial interests over the cultural and societal value associated with preserving the company's identity. However, 30% opted for the Dutch investor, indicating a consideration of both financial and societal implications in bankruptcy proceedings (see figure 3). Thus, whether or not cultural and social value is prioritized over creditor claims depends largely on the IP, as no clear consensus seems to exist concerning this point.
33. In the third scenario, respondents were asked to decide as an IP overseeing the bankruptcy of a company specializing in recycling household items, known

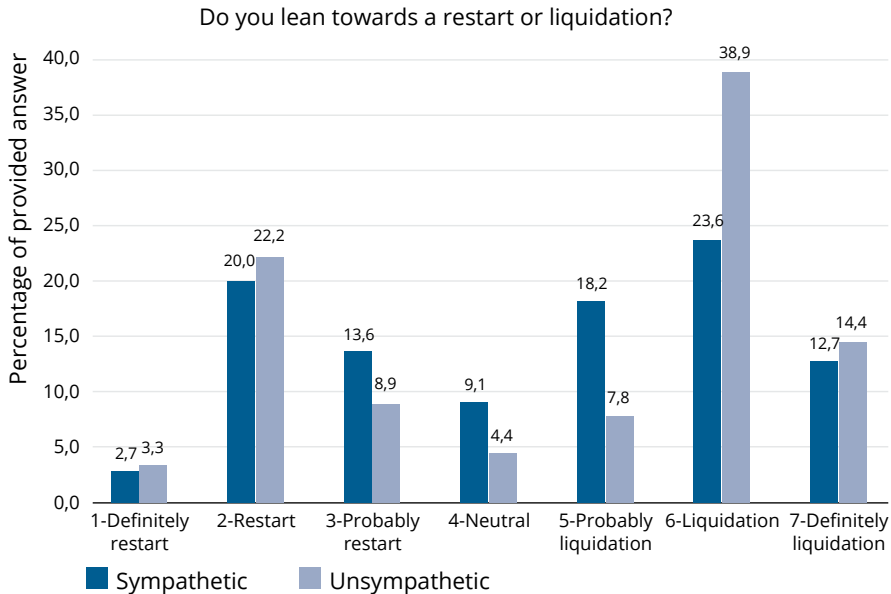
55 JMW Pool, H Pluut & RD Vriesendorp, 'Wanneer prevaleren maatschappelijke belangen boven de belangen van de gezamenlijke schuldeisers? Een experimenteel onderzoek naar belangenafwegingen van curatoren' (2023) 2023(6) *Tijdschrift voor Insolventierecht* 274-292.

for its environmental contributions.⁵⁶ The key decision revolved around the disposal of remaining inventory post-bankruptcy: either regular disposal or more costly recycling. IPs needed to decide whether to incur additional costs to recycle the items, knowing it would reduce creditors' payouts compared to standard disposal methods. Of the 75 respondents, 61.3% chose regular disposal over recycling, emphasizing financial arguments and maximizing creditor returns. A notable 38.7% opted for recycling, reflecting a concern among IPs for environmental responsibility despite its cost implications (see figure 3). This scenario highlights the challenge of balancing environmental considerations against creditors' financial interests in bankruptcy proceedings and again shows that it largely depends on the particular IP how the situation will be dealt with, creating a noisy and thus unpredictable system.

34. As a final demonstration of noise among IPs, in a recent study we presented IPs with a case concerning the bankruptcy of a family-owned business with 50 employees.⁵⁷ The IPs faced a choice between approving a restart plan, which promised to retain all employees but offered creditors only 25% of their claims, or liquidation, which would provide creditors with 40% but result in job losses. In other words, IPs had to decide between supporting the restart plan and thus prioritizing employee retention and the company's survival, or opting for liquidation to maximize creditor payouts. Respondents indicated their likelihood of choosing each option on a seven-point scale. Importantly, the study used two different versions of the case and each IP was presented with only one of the two variants: one portraying the company as sympathetic (a family-run recreational park with a good reputation) and the other as unsympathetic (a family-owned adhesive manufacturer with a bad reputation). In the sympathetic scenario, 54.5% of IPs leaned towards liquidation, while in the unsympathetic scenario, 61.1% favoured liquidation (see figure 4). More important than the impact of the sympathy of the company on the IPs decision making is the observation that there was a high degree of variability among the IPs in terms of their approach to the case, with some leaning towards restarting the company and others towards liquidation. This study therefore further underscores the inherent noise in IP decision-making when balancing societal and creditor interests.

56 Idem

57 JAA Adriaanse, N Strohmaier, JMW Pool & MJR Broekema, 'De Maatschappelijke Taak van de Curator in Sociaalpsychologisch Perspectief: Een Empirisch Onderzoek naar "Ruis" bij Belangenafwegingen in Faillissementen', in EJ Oppedijk van Veen et al (eds), *De Taak van de Curator: Insolad Jaarboek 2023* (Wolters Kluwer 2023) 3-27.



* For the sympathetic case, $n = 84$; for the unsympathetic, $n = 70$.

Figure 4. Results of the noise audit among IPs

3.4 Concluding

35. These studies illustrate the variability in decisions made by IPs when handling bankruptcies, reflecting varying priorities and ethical judgments. While fraud prevention was considered to be a justification to prioritize societal interests over creditors' interests for most IPs, the preservation of cultural icons, employment and environmental responsibilities lacked similar consensus. IPs generally leaned towards maximizing creditor returns, yet a substantial group expressed willingness to prioritize societal interests across different scenarios. This variability suggests IPs do not uniformly agree on when and how to integrate societal considerations into their decisions. In conclusion, Frankel's observation that "absence of consensus is the norm" accurately describes the decision-making of Dutch IPs.

4. Discussion

4.1 Limitations

36. Before turning to the implications of the studies discussed in this paper, addressing a few limitations of these studies is in order. First, the empirical studies relied largely on self-reported data, which may not fully capture the complexity of IPs' actual decision-making processes in practice. To overcome this, future research could include direct observations of IPs in action or conduct in-depth case studies to better understand how they navigate competing interests in real-world insolvency proceedings. This would provide more accurate insights into their judgment and decision-making behaviour.
37. Additionally, the focus on the Dutch insolvency system potentially limits the applicability of the findings to other jurisdictions. Comparative studies involving countries with different legal frameworks, such as France, where some societal interests are more integrated into insolvency law, could offer valuable cross-jurisdictional perspectives.
38. Finally, even though the presented studies clearly demonstrated the existence of noise in IPs judgments and perceptions, the drivers behind the observed noise could not be isolated. Future research could therefore focus on identifying specific components of noise, such as pattern or level noise. Understanding these components is important because they show where inconsistencies occur—whether in the way cases are interpreted or in the general tendency to favour certain outcomes. This insight would help develop more targeted strategies to reduce variability and improve fairness in insolvency proceedings.

4.2 Implications

39. The variability in decision-making among Dutch IPs has significant implications, particularly regarding the fair treatment of similar stakeholder groups. Firstly, stakeholders and creditors may experience unequal treatment depending on which IP handles their case, as IPs prioritize societal interests inconsistently, leading to a noisy system. For example, level noise may occur when some IPs consistently prioritize creditors' interests over societal concerns due to differing views about their role. This could result in one IP systematically focusing on maximizing creditor returns, while another gives greater weight to societal interests, such as job retention or environmental concerns.

40. In contrast, pattern noise may manifest in more specific, subjective decisions. For instance, an IP with a particular interest in a certain industry may go to great lengths to save a company from liquidation, working towards a restart even if it compromises creditor returns. Another IP, indifferent to that industry or company, might take a more detached approach and allow liquidation, leading to drastically different outcomes for stakeholders in similar situations. This stable, personal preference creates pattern noise across cases that involve different IPs.
41. Additionally, situational pattern noise can occur in more immediate, ad hoc decisions, such as when an IP must decide whether to approve a reward for an employee's 25-year anniversary with the company. An IP's mood on a given day or external pressures might influence their judgment. For instance, if the IP is experiencing a stressful day, they might view the reward as less justified and decide against it, even if it is a long-standing company tradition. These fleeting factors introduce inconsistency, resulting in different outcomes for similar situations based on momentary influences.
42. These types of noise create significant variability in how IPs handle insolvency proceedings, with far-reaching effects on stakeholders. For instance, an IP focused on societal interests may implement actions that benefit employees or the environment but result in lower creditor returns. Conversely, an IP focused on maximizing creditor returns might liquidate a business quickly, leading to job losses but yielding higher payouts. The impact extends to company directors as well; an IP committed to thorough investigations might hold directors accountable for mismanagement, while another IP more focused on efficient proceedings may overlook such issues, resulting in fewer legal repercussions. Overall, this variability in decision-making underscores the potential for unequal treatment among similarly situated groups and highlights the need for more consistent guidelines to reduce noise.⁵⁸
43. Second, the open norms allowing IPs to consider societal interests often fall short in practice. The variability in how IPs interpret and apply these norms leads to inconsistent outcomes, undermining the intended balance between societal and creditor interests. Without clear guidelines, broad discretion can result in decisions influenced by personal biases or differing ethical judgments rather than a coherent, standardized policy and thus create noise. This

58 See also Pool 2022, para 8.4.

variability reduces the effectiveness of encouraging IPs to integrate societal considerations into their decisions. The current Dutch approach, with its open norms⁵⁹, does not achieve the intended results, highlighting the need for more specific legislation to guide IPs in consistently incorporating societal interests into their decision-making processes.

44. Supervision by the supervisory judge can play a crucial role in mitigating variability in insolvency proceedings by providing a layer of oversight and ensuring adherence to legal standards.⁶⁰ This supervision helps ensure that IPs follow procedural norms and address key issues, thereby reducing some forms of noise, such as blatant deviations from established practices. However, the effectiveness of this supervision is limited by the absence of clear, detailed guidelines for balancing creditors' interests with societal concerns. Without precise directives, the supervisory judge may not be able to address all forms of noise, particularly those arising from subjective judgment or personal preferences of IPs. For instance, while judges can oversee the procedural fairness of decisions, they may not fully resolve inconsistencies stemming from how different IPs interpret and weigh societal interests versus creditor returns. As a result, while supervision is beneficial, it alone cannot eliminate the inherent variability in decision-making that arises from broader interpretative discretion.

5. Towards more guidance for IPs in balancing creditor interests with societal interests

45. If the variability and inconsistency in decision-making by IPs are deemed unacceptable, several strategies can be employed to reduce the amount of noise. First, drawing from the literature on noise, judgment guidelines can serve as a decision hygiene tool. By establishing clear and detailed criteria, such guidelines can help promote more uniform and fair decision-making across similar cases, thereby improving consistency and reducing variability.⁶¹ Similar to how structured judgment guidelines have been shown to benefit doctors

59 Dutch Supreme Court 24 February 1995, ECLI:NL:HR:1995:ZC1643, r.o. 3.5, *NJ 1996/472 (Sigmacon II)*. See also Dutch Supreme Court 19 April 1996, ECLI:NL:HR:1996:ZC2047, r.o. 3.5.2, *NJ 1996/727 (Maclou)*.

60 Article 64 DBA. See for example R Hollemans and G van Dijck, "'Come and Talk': The Insolvency Judge as De-escalator" (2020) *International Insolvency Review* 1-19.

61 D Kahneman, O Sibony & C R Sunstein, *Noise: A Flaw in Human Judgment* (Little, Brown Spark 2021), chapter 22.

by reducing diagnostic variability⁶², clear and detailed criteria can aid IPs by providing a consistent framework for evaluating and balancing interests in insolvency proceedings.

46. To achieve the desired noise reduction, guidelines should provide greater clarity regarding the interests that IPs should take into account, and how they should decide when these interests collide. Clarifying the expectations for balancing these interests is crucial for several reasons. First, it helps to establish a common understanding of what constitutes appropriate and fair consideration of societal factors. Second, clear guidelines would reduce the scope for subjective judgment and personal discretion, reducing the noise in the decision-making process. By defining the criteria and priorities for incorporating societal interests, the guidelines would help ensure that all IPs operate within a consistent and predictable framework, thereby reducing inconsistencies and improving fairness in insolvency proceedings. This step is essential for aligning the decision-making process with the intended balance between creditor and societal interests, ultimately leading to more equitable outcomes and a more reliable insolvency system.
47. When discussing guidelines, it is important to distinguish between rules and standards. Rules are designed to eliminate discretion by providing specific, detailed instructions that must be followed, leaving little room for interpretation. In contrast, standards are intended to grant discretion, offering broader principles and criteria that guide decision-making while allowing for some degree of judgment based on the specifics of each case. Both approaches have their merits, but rules might be better fitted to reduce noise.⁶³
48. Based on the results of the empirical studies discussed, which revealed that granting IPs discretion in balancing interests in insolvency proceedings can lead to significant variability, we suggest implementing clear rules specifying which interests IPs should consider and how they should balance creditor and other interests. To allow for discretion in specific cases while maintaining consistency, a “comply or explain” principle could be introduced.⁶⁴ This approach would require IPs to either adhere to the established rules or provide a

62 Idem.

63 D Kahneman, O Sibony & C R Sunstein, *Noise: A Flaw in Human Judgment* (Little, Brown Spark 2021), chapter 23.

64 See about the comply or explain principle: A Keay, ‘Comply or Explain in Corporate Governance Codes: In Need of Greater Regulatory Oversight?’ (2014) 34(2) *Legal Studies* 279-304.

transparent explanation for any deviations. This added layer of transparency would make it easier for stakeholders and supervisory judges to identify and address noise in decision-making processes.

6. Conclusion

49. In this paper, we demonstrated the significant level of variability in IPs decisions between creditors' interests and societal interests, based on the psychological concept of noise. We have shown that stakeholders are often subject to the subjective judgments of IPs, resulting in a lack of uniformity in decisions. To address this issue, we propose implementing clearer guidelines for IPs to navigate and balance these conflicting interests, drawing on insights from noise literature. The content of those guidelines, to be determined in a broad coalition of relevant stakeholders, should aim to reduce legal uncertainty and promote more equitable outcomes in insolvency proceedings. Ultimately, if reducing variability in decision-making is a goal, legislative intervention may be necessary to provide more structured guidance to IPs.