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## Creditor Rights Protection, Tort Claims and Credit

JOSHUA O ANYANGAH\*

### Highlights

Editor's comments:

- The sequence in which the assumptions are introduced and discussed has been changed in order to sensibly show that screening is socially valuable.
- On the good types are creditworthy. Screening weeds out bad borrowers. Thus, the optimal contract comprises a single interest which applies only for those borrowers that pass the credit-worthiness test.
- The timing of the game is such that a credit contract is signed only after the loan applicant has been subjected to a creditworthiness.
- The program maximizes the utility of type G borrower and not the average utility of the firm based on Bayesian (expected) probability of success because it is assumed that the firm knows its type.
- The first order approach is valid because the borrower's utility function is concave, given the financial contract.
- Examples of legal systems that prioritize tort creditors can be found in Canada and the US, where maritime law has long given super-priority to certain classes of involuntary unsecured creditors, including tort victims, via an *in rem* action against a vessel or vessels.

Reviewer # 1:

- There is no empirical evidence on how senior treatment of debt affects the performance of the credit market. However, the priority status of senior debt has indeed been legislatively curbed in some jurisdictions as highlighted above.
- Adding a moral hazard problem on the part of borrowers leads to an increase in the rate of interest (and the extent to which credit is rationed), but this increase is less pronounced compared with the case of unilateral moral hazard.

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