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Reform, Counter Reform and Transatlantic Rapprochement in the Law of Personal Bankruptcy

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Introduction

1 I am thrilled to contribute to a celebration of the work of one of the greatest international giants in the field of insolvency, Ian Fletcher. I had the singular honour of meeting Professor Fletcher and presenting with him on a panel in June 2009 at INSOL International's Eighth World Congress in Vancouver, Canada. The topic of the panel was the accelerating pace of worldwide reform of debt relief procedures for individuals, what one from an Anglo-American tradition might call "consumer bankruptcy".[1] The audience and I were treated to the most erudite and brilliantly articulate presentation by Professor Fletcher on the situation in England & Wales. Even more delightful for me was the opportunity to get to know him better at the gala reception later on. The only thing more impressive than a brilliant professor with encyclopaedic knowledge of his subject matter is such a professor who also happens to be a generous and compassionate human being, a genuinely nice person. That's Ian Fletcher in a nutshell.

2 Perhaps I admire Professor Fletcher so much because we are kindred spirits, both intensely interested in developments beyond the borders of our home jurisdictions. For example, many non-US commentators seem not to have understood the real thrust of the 2005 massive reform of the US consumer bankruptcy system,[2] but

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[1] This terminology is not used, indeed, it seems to be expressly avoided, elsewhere in Europe, where labels having something to do with "debt adjustment" or "rehabilitation" are preferred. See e.g. J. Niemi-Kiesiläinen, "Consumer Bankruptcy in Comparison: Do We Cure a Market Failure or a Social Problem?" (1999) 37 *Osgoode Hall Law Journal* 473, at 476.

[2] See e.g. J. Kilborn, "Still Chasing Chimeras But Finally Slaying Some Dragons in the Quest for Consumer Bankruptcy Reform" (2012) 25 *Loyola Consumer Law Review* 1, at 3-13.

Professor Fletcher is an exception. He perfectly encapsulated the US reform in his treatise, *The Law of Insolvency*: the US reforms, he explains:

> "have resulted in a reversal of some of the long-standing assumptions regarding the relatively more favourable treatment of insolvent debtors under the laws of the United States."[3]

3 Exactly—"some" of the assumptions, but by no means all, and "relatively more favourable treatment", though not uniformly so. While the 2005 reform scaled back what many around the world regarded as the excesses of US debt relief generosity,[4] the post-reform US consumer bankruptcy system remains open with an offer of very generous relief, relative to other worldwide regimes.

4 Professor Fletcher insightfully juxtaposes the liberalizing reforms of English individual bankruptcy law against the contemporaneous counter-reformation in the US. The Enterprise Act 2002 instituted an automatic discharge after one year for most English debtors,[5] finally putting an end to the former, more hesitant regime of relief under English bankruptcy law.[6] "By a curious paradox", Professor Fletcher observes, at the same time in the country whose liberal regime had "served as a talisman for the recasting of UK policy," a counter-reform drove US bankruptcy law in the opposite direction. Aptly described by Professor Fletcher, the so-called Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was indeed:

> "designed to reduce the possibility for debtors … to have recourse to bankruptcy,"

most notably by placing a guard at the formerly wide-open gates to relief, a test of debtors':

> "means to pay at least a proportion of their debts under a court-sanctioned payment plan."[7]

5 The practical effect of the presumptive narrowing of the gates to relief, however, has been negligible; only a fraction of one percent of US debtors have been revealed to have the presumptive "means" to pay a substantial portion of their debts and thus have been barred from a quick discharge. Though the process of seeking that relief has been made more expensive and aggravating, the end result continues

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[3] I. Fletcher, *The Law of Insolvency* (4th ed) (2009, Sweet & Maxwell, London), at paragraph 1-044.

[4] For example, in the deliberations over the new German consumer debt relief provisions, lawmakers commented that "a discharge after the Anglo-American model is out of the question." Kommission für Insolvenzrecht, *Zweiter Bericht der Kommission für Insolvenzrecht* § 6.3 (1986) (author's translation).

[5] Section 279(1), Insolvency Act 1986 (as amended, effective April 2004).

[6] For a vivid description of this former regime, see D. Boshkoff, "Limited, Conditional, and Suspended Discharges in Anglo-American Bankruptcy Proceedings" (1982) 131 *University of Pennsylvania Law Review* 69.

[7] Fletcher, above note 3, at paragraph 1-044.

to be that hundreds of thousands of US debtors obtain immediate and unconditional discharge relief each year, very much like before the reform.[8]

6 The "curious paradox" extends far beyond Anglo-American comparison. Just as the US has taken a step away from its historically open and unconditional extension of relief to over indebted individuals, country after country in Europe and beyond have done as England did and begun to move in the opposite direction, embracing the idea of broader, more timely relief on less inhibited terms. A transatlantic *rapprochement* in consumer debt relief policy is observable along the lines identified by Professor Fletcher, though on a wider scale. Drawing inspiration from Professor Fletcher's observation, this essay will explore a number of other ways in which European personal insolvency policy has been veering toward the historically open US position, just as US policy has shifted (in theory) toward the historically more restrictive European approach.

The Bellwether: Denmark

7 For a variety of reasons, the best place to begin is Denmark. The first mover in continental Europe, Denmark adopted a debt relief regime specifically for non-merchant individuals in 1984, well before England liberalized the rules for automatic discharge in 1986. The impetus for Denmark's ground-breaking move is largely consistent with Professor Fletcher's account of the philosophical foundations of English bankruptcy law:

> "the interests of the individual debtor, and also those of society at large, are ultimately best served by … reliev[ing] the debtor from the cumulative burden of debts which he has no realistic prospect of repaying."[9]

8 The law reform process began in earnest in Denmark when a barrister named Frederick Bang Olsen complained of the senseless inability of courts to reduce judgments against debtors who were manifestly unable to pay, as well as the consequent waste of value when the debtor's meagre assets were sold at a value that scarcely covered administrative costs.[10] Bang Olsen had been struck by the very real and very deleterious effects of such financial struggles on debtors' health,[11] proving Professor Fletcher's point that:

> "the human consequences of such pressures can be extremely serious."[12]

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[8] See Kilborn, above note 2, at 8-9.
[9] Fletcher, above note 3, at paragraph 3-002.
[10] F. Bang Olsen, "Social-retspleje" (1972) 1 *Advokatbladet* 4, at 5.
[11] Ibid., at 4-5.
[12] Fletcher, above note 3, at paragraph 3-003.

9 On the other hand, Danish reformers took a contrasting perspective on another of Professor Fletcher's observations about bankruptcy philosophy. Professor Fletcher sums up the function of a personal insolvency procedure as "a mechanism of redistribution", spreading an individual debtor's burden such that:

> "[a] wider constituency of persons … are obliged to absorb the debts"

as society bears the consequent burden of unpaid tax claims and the bad debt tax write-offs of unpaid creditors.[13] While Professor Fletcher here identifies a socialization of loss as an *effect* of insolvency relief, Danish reformers envisioned a *purpose* of insolvency relief in avoiding an even larger socialization of loss. In a country that provides for the medical care of its residents, the negative effects of over indebtedness on debtors' health soon become a public responsibility. Bang Olsen argued against the counterproductive cycle in which courts and public collection authorities cause debtors to suffer health problems due to the pressure of largely fruitless enforcement actions, and social support authorities are consequently burdened with relieving those health problems at great cost to the state and society.[14] Rather than regarding the insolvency procedure as externalizing debtors' burdens, Danish reformers sought to use the insolvency procedure to prevent a continuing externalization of loss by creditors and enforcement authorities onto debtors and ultimately onto society.

10 Breaking from a long tradition of holding individual debtors to their bargains, Denmark proceeded very hesitantly in extending relief only to the most heavily and hopelessly encumbered.[15] To stave off opportunistic debtors who might seek to abuse this new opportunity for debt forgiveness, the Danish regime stands behind a double gateway: First, only debtors who suffer from demonstrable "qualified insolvency" may gain admission. This concept implies a complete impossibility to economize and live more frugally so as to satisfy one's debts in the foreseeable future. A second, subjective entry restriction requires the debtor to convince the court that his or her case is an appropriate one for extending the extraordinary relief of a discharge of debt that cannot be paid pursuant to a reasonable payment plan. This judgment is influenced in particular by the degree to which the debtor has endeavoured to manage his or her debts responsibly, as well as the types of debts that have rendered the debtor insolvent (fines, penalties, and "irresponsible" debts for such things as luxury consumption weight against extending relief).

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[13] Ibid., at paragraph 3-002; Kilborn, above note 2.

[14] Bang Olsen, above note 10, at 6. For a more recent example of this debt-healthcare cycle problem, see "Frelsens Hær fjærner fattiges gæld" (*Jyllands Posten*, 4 July 2008), reporting on a single mother who avoided eviction only when the Salvation Army paid her DKK 12,000 debt, avoiding the state's being "shot in the knee" with substantial expenses for her care in a crisis centre).

[15] For a detailed description of the history and development of the Danish regime, see J. Kilborn, "Twenty-Five Years of Consumer Bankruptcy in Continental Europe: Internalizing Negative Externalities and Humanizing Justice in Denmark" (2009) 18 *International Insolvency Review* 155.

11 Denmark experienced a similar "curious paradox" of liberalizing personal insolvency reform at exactly the same time as the US counter-reform. In October 2005, just as the gateway to US relief was placed under guard for the first time, the restrictive entry requirements for Danish relief were softened.[16] Just as Professor Fletcher observed of the US system, however, the Danish reform simply:

> "resulted in a reversal of some of the long-standing assumptions regarding the relatively [less] favourable treatment of insolvent debtors"

in Denmark. Debtors still must clear substantial hurdles in order to gain admission to the Danish personal insolvency procedure, but as of October 2005, a "long-standing assumption" against relief has been reversed. While under the original law, courts were to presume that relief was not appropriate, the revised law now directs courts to admit individuals seeking relief unless the circumstances mentioned above speak decisively against.[17]

12 Just as the US reform had little actual effect in restricting access to relief, the Danish reform seems to have had less effect than desired in broadening access. In the year immediately following the reform, the rate of admission of debtor applications rose from just over 40% to just over 50%. In the following year, however, while applications remained fairly steady at about 5000 per year, the acceptance rate immediately began a slow decline back to below 40% within five years before rebounding back above 50% only in the first half of 2014.[18]

13 A more impactful reform affected the terms of eventual relief. A discharge under Danish law must be earned by dedicating all disposable income to debt payment over a standard five-year payment plan. The types and amounts of living expenses that debtors could subtract from their income to reveal "disposable" income was originally left to court discretion. The major thrust of the Danish reform of 2005 was to charge the Justice Ministry with unifying basic allowances. A positive side effect of this was a significant lightening of the burden on debtors, setting aside state transfer payments for children exclusively for the benefit of debtors' children, and raising the basic budget allowances nearly 20% over the amounts granted up to that point by most courts.[19] Thus, the same juxtaposition of opposing transatlantic reform and counter-reform in mid-2000s England and the United States is even more evident in the Danish and US amendments of October 2005.

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[16] See Law no. 365 of 24 May 2005 (effective 1 October 2005).
[17] Section 197, *Konkurslov*.
[18] Historical statistics are on file with the author, and recent statistics for newly undertaken debt adjustment cases (*Modtagne insolvensskifter mv.*) are available online at: <http://www.domstol.dk/om/talogfakta/statistik/Pages/skiftesager.aspx>.
[19] See Konkursrådet, *Betænkning om gældssanering* nr. 1449/2004, at 24, 139-40, 144, 170, 185-89, 480.

Reducing Burdens: Germany

14 Another salient example of breaking with longstanding tradition and broadening access to relief is Germany. As in Denmark, the personal discharge provisions of the German Insolvency Act (*InsO*, effective in 1999) originally limited access to relief and expropriated debtors' disposable income during a seven-year "good behaviour period" as a *quid pro quo* for that relief.[20] The access restriction stemmed from a long tradition in German insolvency law of dismissing cases in which available asset value was insufficient to cover the administrative costs of the proceedings.[21] Not surprisingly, the overwhelming majority of consumer insolvency cases were pursued by debtors with very little asset value and little to no disposable income with which to pay the required administrative expenses. Around 90% of individual debtors' cases were dismissed on this basis before Germany joined the post-2000 transatlantic-reform-and-counter-reform party.

15 A seemingly insignificant modification to the treatment of expected fees revolutionized the effects of German personal insolvency law. After 2001, individual debtors no longer face immediate dismissal of their cases for inability to cover administrative expenses. Rather, those expenses are deferred. Indeed, they can be indefinitely deferred (in part or in total) if the debtor is never in a financial position to pay them, in which case they simply count as an unaddressed expense of the federal or state administrative budget.[22] As a result of this deferral policy, the numbers of German debtors allowed into the relief system skyrocketed. Applications flooded in, with 40-60% year-over-year growth rates from 2002 through 2005.[23] Consumer debt relief applications topped 100,000 for the first time in 2007 and have only fallen back to the 90,000-range in the past few years. The German expense-deferral reform of 2001 has had perhaps the greatest impact of any consumer insolvency reform in any country to that point or since.

16 The German reform of 2001 softened not only demands with respect to debtors' covering administrative expenses, but also with respect to covering their debts as a condition of relief. The original seven-year "good behaviour" payment period was reduced to six years, and more importantly, the amount of income reserved for the support of debtors and their families was increased substantially. The German insolvency law accounts for debtors' reasonable expenses by applying the general,

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[20] For a discussion of the background and detail of the German personal insolvency system and its series of reforms, see J. Kilborn, "The Innovative German Approach to Consumer Debt Relief: Revolutionary Changes in German Law, and Surprising Lessons for the United States" (2004) 24 *Northwestern Journal of International Law & Business* 257.

[21] See section 26(1), *InsO*.

[22] Sections 4a-4d, 26(1), *InsO*.

[23] Historical filing data is on file with the author, and recent filing statistics are available online at: <https://www.destatis.de/DE/ZahlenFakten/GesamtwirtschaftUmwelt/UnternehmenHandwerk/Insolvenzen/Insolvenzen.html>.

standard income exemptions of ordinary enforcement law.[24] These figures had not been indexed for inflation in years, but beginning 1 January 2002, the minimum exemption jumped nearly 50% for the majority of German households, and the exemptions are recalibrated biennially to keep pace with inflation.[25] As a result of these enhanced income protections and the limited resources available to many over indebted German households, a consistently estimated 80% of all consumer insolvency cases in Germany today produce no dividend to creditors at all. Living on subsistence income for six years is no holiday, but the availability of relief is vastly greater in Germany after 2001, again in contrast to the US counter-reformation.

Going All the Way: France

17 No European country—and perhaps no country in the world—has gone as far as France toward the "relatively more favourable treatment of insolvent debtors under the laws of the United States." The relief available under the French law on "individual over indebtedness" (*surendettement des particuliers*) has expanded over the years to the point that the original purpose of the law has faded into the background, and the impact of this law now rivals its US counterpart.

18 France started down the path to treating the ills of personal insolvency even more hesitantly than Denmark. The *Loi Neiertz*,[26] adopted on the last day of 1989, did not provide immediate legal relief to debt-plagued consumers. Instead, it set up an impressive national framework for facilitating compromises between consumers and their creditors, administered by a nationwide network of over 100 commissions headed by the Banque de France.[27] For the first decade of its existence, this new infrastructure was limited to supporting consumers in their efforts to strike amicable compromise arrangements with creditors. While reasonable compromises could be imposed on creditors by court order upon the recommendation of the relevant commission, discharge of debt was essentially unavailable as a form of relief.[28] Moreover, many commissions had rather outsized expectations of debtors' wherewithal to maintain a dignified standard of living while paying down their

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[24] Section 287(2), *InsO*.

[25] See Beschlussempfehlung und Bericht des Rechtsausschusses (6. Ausschuss), BT-Dr. 14/7478, at 4-5 (14 November 2001).

[26] Law no. 89-1010 of 31 December 1989, J.O. 2 January 1990, at 18. The individual over indebtedness law is codified in Title III of the Consumer Code, the *Code de la consommation*.

[27] For a more detailed discussion of the development and operation of the various personal insolvency options in France, see J. Kilborn, "*La Responsabilisation de l'Economie:* What the United States Can Learn From the New French Law on Consumer Overindebtedness" (2005) 26 *Michigan Journal of International Law* 619.

[28] For the one narrow exception related to a deficiency remaining after sale of a principal residence, see Article L.331-7-1, *Code de la consommation*.

debts. The amounts budgeted to debtors for household expenses were in many cases scandalously miserly.

19 Both of these problems captured the attention of the legislature, which responded with the first of three major reforms in 1999. As to the budgeting practices of the commissions, the legislature lightened the weight of sacrifice expected of debtors by directing that, as in Germany, at least the amount of income protected by law from seizure in ordinary enforcement actions be reserved for the support of debtors and their families.[29] As to the relief available, finally in 1999 France joined with Denmark, England, and Germany in moving toward US-style discharge relief. This first move remained hesitant. The commissions first were given the power to recommend the court-imposed "extraordinary" measure of a global deferral of all debts for three years (in 2004, reduced to two years). Upon re-evaluation of the debtors' situation at the end of this period, if the commission concluded that the debtor was still irretrievably insolvent, the commission could recommend a court-imposed discharge of whatever debt could not be paid off in an ordinary payment plan.

20 At the defining moment of European reform and US counter-reform in the mid-2000s, France made a pair of particularly bold moves, extending US-style immediate discharge relief to a far greater number of debtors just as the US was attempting to limit the availability of such relief. When studies revealed that the commissions were unable or unwilling to extend effective relief to debtors who most desperately needed it, the legislature introduced the most aggressive "fresh start" procedure in Europe (for which the French designed their own term, of course, calling it a *nouveau départ*, or "new beginning"). As of 2004, for debtors in an "irremediably compromised" situation of hopeless insolvency, the commissions were empowered to recommend a court-supervised inventory and liquidation of non-exempt assets and an *immediate* discharge of unpaid debt. This so-called "personal recovery procedure" is all but indistinguishable from a US Chapter 7 liquidation consumer bankruptcy process, with no waiting periods and no "good behaviour" payment plans.

21 A few years later, French and US consumer bankruptcy practice were drawn into even closer alignment. While US law technically calls for an inventory and liquidation of the debtor's non-exempt assets in any Chapter 7 case, significant assets are available in very few such cases (on the order of 5% of all Chapter 7 consumer bankruptcies). Indeed, creditors are asked not to submit proofs of claim unless and until the trustee discovers that assets of some value will produce a distribution to creditors.[30] Unsurprisingly, a similar phenomenon manifested itself

[29] Article L.331-2, *Code de la consommation*.

[30] Official form B9A, announcing the commencement of an individual Chapter 7 case, requests that creditors *not* file proofs of claim, as "[t]here does not appear to be any property available to the trustee

in France, and the legislature once again reacted. As of the end of 2010, the commissions can recommend a personal recovery procedure *without liquidation* of assets in cases where the debtor possesses only necessary household items and other movable things of a value "manifestly disproportionate" to the costs of a sale.[31]

22 As a result of these incremental reforms, the French *surendettement* regime has begun to produce results increasingly along the lines of the US Chapter 7 personal bankruptcy procedure.[32] Because the French regime still represents a one-stop shop, combining ordinary debt counselling with the possibility of more aggressive insolvency relief, the French process still concludes with a compromise payment plan in many cases, though far less frequently than in years past. While creditors were convinced to accept the commissions' proffered compositions in two-thirds of administered cases in the early 2000s, by 2010, that proportion had dropped below 50%, plummeting to below 35% by 2013 and continuing to decline in 2014.[33] The proportion of imposed commission recommendations has remained fairly steady at about 20-30% (about half of which anticipating a possible discharge after the two-year "extraordinary" waiting period). The proportionate decline of consensual arrangements has thus been mostly met with a concomitant rise in personal recovery procedures. Commissions have routed increasing percentages of cases to the liquidation-and-immediate-discharge proceeding every year since its inception in 2004. While only 12-13% of cases were so directed in 2004 and 2005, nearly one-quarter of cases proceeded with a personal recovery proceeding in 2009 and 2010, rising to 30% in 2011 and then 35% in 2013 (holding steady in the first ten months of 2014). And since the commissions and courts were allowed in late 2010 to dispose with the formality of a liquidation in "no-asset" cases, a steady 98% of all personal recovery procedures have involved no liquidation of assets at all, very much in line with US Chapter 7 practice.

23 Before the transatlantic *rapprochement* of French and US consumer debt relief law in 2005, most of the 150,000 French consumers who obtained over indebtedness relief each year had to make do with a compromise payment arrangement with their creditors. Today, the French regime doles out relief to nearly 200,000 French consumers each year, and more and more of them are

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to pay creditors." The form is available online at: <http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK_Forms_Current/B_009A.pdf>.

[31] Articles 330-1(1), *Code de la consommation*.

[32] In contrast to US practice, the French law allows the commissions (or courts) to dismiss cases of debtors who are not "over indebted," who have significant debt arising from the pursuit of a liberal profession, or who are not acting in "good faith," Articles L.330-1, L.331-3, *Code de la consommation*, but the dismissal rate has remained low and fairly steady for many years in the 6-7% range (and this mostly for debtors whose financial difficulties are insufficiently severe).

[33] Historical data is on file with the author, and recent statistical releases on case administration and other information on the over indebtedness procedure are available online from the Banque de France at: <https://www.banque-france.fr/la-banque-de-france/missions/protection-du-consommateur/surendettement.html>.

receiving US-style discharges. The "curious paradox" of opposing European and US personal insolvency reform is nowhere so stark as in the case of France.

Conclusion

24 A transition in US personal bankruptcy practice toward more restrictive European approaches is not a welcome development. But as Professor Fletcher points out, this is only a reversal of "some of the long-standing assumptions" of generous and unconditional US bankruptcy relief. The basic contours of the US system remain intact, and a marked uptake in acceptance in Europe of what Professor Fletcher calls the "beneficent purposes"[34] of personal insolvency policy is heartening. Most gratifying is the opportunity presented to comparative researchers by the coming together of US and European law—I now have even more reason to engage in transatlantic dialogue with really wonderful people like Professor Fletcher. For that, I am most grateful.

[34] Fletcher, above note 3, at paragraph 3-002.