

# CONSUMER BANKRUPTCY IN COMPARISON: DO WE CURE A MARKET FAILURE OR A SOCIAL PROBLEM?<sup>©</sup>

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The Continental European and Scandinavian bankruptcy laws did not have provisions enabling the discharge of debt until quite recently. While bankruptcy law did not specifically exclude consumer debtors, in the absence of discharge, consumer bankruptcy was meaningless and rare. After the deregulation of credit markets in the 1980s, many west European countries faced a huge increase in consumer debt problems. Several countries passed consumer debt adjustment laws during the late 1980s and 1990s. Unlike the North American consumer bankruptcy laws, the European laws attach moral attributes to the access to adjustment procedures, which require a mandatory payment plan, and offer debt counselling. This article argues that the European laws reflect an understanding of overindebtedness as a social problem, rather than as a market failure.

Jusqu'à récemment, les lois de la faillite de l'Europe continentale et de la Scandinavie ne contenaient pas de clauses permettant la décharge de la dette. Tandis que la loi sur la faillite n'excluait pas des consommateurs débiteurs, en absence de décharge, la faillite de consommateurs était insignifiante et rare. Après la dérèglement des marchés de crédits dans les années 1980, plusieurs pays européens ont dû faire face à une augmentation énorme dans les problèmes de débit. Certains pays ont passé la loi de l'ajustement des débits de consommateurs vers la fin des années 1980 et 1990. Contrairement aux lois nord-américaines sur la faillite des consommateurs, les lois européennes attachent des attributs moraux à l'accès aux procédures d'ajustement, qui exige un plan de paiement obligatoire, et offre des conseils sur le débit. L'article argumente que les lois européennes reflètent une compréhension du surendettement comme un problème social plutôt que comme un problème de faillite de marché.

I. INTRODUCTION .....	474
II. TWO PARADIGMS OF CONSUMER BANKRUPTCY .....	476
A. <i>Consumer Bankruptcy in the Open Credit Economy</i> .....	476
B. <i>The Economic and Legal Background of the European Debt Adjustment System</i> .....	479
III. THE EUROPEAN CONSUMER BANKRUPTCY LAWS .....	482
A. <i>Overview</i> .....	482
B. <i>Consumer Protection and Prevention in France</i> .....	483
C. <i>The German and Austrian Laws</i> .....	485
D. <i>The Unknown Path Breaker: Danish Debt Arrangement Act of 1984</i> .....	488

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E. <i>Finnish Debt Adjustment Legislation as a Response to a Deep Debt Crisis</i> . . . . .	490
F. <i>Conflict Between the Welfare State and Insolvency Models in Norway</i> . . . . .	493
G. <i>Only Limited Access in Sweden</i> . . . . .	495
IV. DISCUSSION . . . . .	497
V. CONCLUSION . . . . .	502

## I. INTRODUCTION

Comparative research in consumer bankruptcy law, as scarce as it is, seems to be more interesting than ever before. While the European jurisdictions have been influenced by the Anglo-Saxon “fresh start” policies in their search for new approaches to consumer debt problems,<sup>1</sup> the Americans are now discussing “means testing” and mandatory counselling, both of which have recently been introduced in European jurisdictions.

In its 1997 report, the United States National Bankruptcy Review Commission launched a discussion on “means testing” in consumer bankruptcy, that is, requiring debtors with an adequate income to pay part of their debt as a condition of discharge.<sup>2</sup> Although the majority of the Commission remained faithful to the principle of an efficient “fresh start” and open access to discharge, the minority proposed means testing. Subsequent discussions and two bills in Congress in 1997-1998 have concentrated on this topic.<sup>3</sup> Neither of the

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<sup>1</sup> American consumer bankruptcy law has been the focus of much European scholarly interest during the last two decades: see, for example, H.-P. Ackmann, *Schuldbefreiung durch Konkurs?* (Schriften zum deutschen und europäischen Zivil-, Handels- und Prozessrecht 96, 1983); K. Mezinger, *Das freie Nachforderungsrecht der Konkursgläubiger, Fragwürdigkeit und Grenzen* (Schriften zum Bürgerlichen Recht 75, 1982); B. Knüllig-Dingeldey, *Nachforderungsrecht oder Schuldbefreiung* (Göttinger rechtswissenschaftliche Studien 127, 1984); and N.J.H. Huls, “Alternatives to Personal Bankruptcy” in G. Hörmann, ed., *Consumer Credit and Consumer Insolvency* (Bremen: Universität Bremen, 1986) 289. Additionally, European consumer debt adjustment bills frequently include a discussion of American consumer bankruptcy policy.

<sup>2</sup> See National Bankruptcy Review Commission, *Bankruptcy: The Next Twenty Years, Final Report* (Washington, D.C.: U.S. Government Printing Office, 1997), online: National Bankruptcy Review Commission <<http://www.nbrc.gov/reportcont.html>> (date accessed: 16 July 1999). The majority of the Commission did not fully discuss means testing.

<sup>3</sup> See *Responsible Borrower Protection Bankruptcy Act*, H.R. 2500, 105th Cong. (1997); and *Consumer Bankruptcy Reform Act of 1998*, S. 1301, 105th Cong. (1997).

bills was adopted by Congress in 1998, but the discussion is far from over.

While American consumer bankruptcy law has long been acknowledged as the most generous in the world, the European bankruptcy laws did not include any provisions for discharge at all until quite recently. However, the economic crisis at the beginning of this decade created such insurmountable economic difficulties for so many households that the European states felt forced to seek new solutions. Several European countries have enacted new consumer bankruptcy (or debt adjustment) legislation in the 1990s.

The European consumer bankruptcy laws differ from the Anglo-Saxon laws in at least three important respects.<sup>4</sup> First, European legislatures have not adopted open access to consumer bankruptcy. On the contrary, access is restricted to those debtors deemed worthy of it. Because of this attitude, there is a tendency in Europe to attach moral attributes to consumer overindebtedness and access to debt adjustment programs.

Second, and equally important, is the insistence on a mandatory payment plan for all consumer debtors. The discharge is either conditional or is not granted before the completion of the payment plan, the duration of which varies from five to seven years. No provisions exist for a straight discharge. The function of the plan is not only economic; rather, it is intended to ensure that the adjustment procedure is not an "easy way out." This is best illustrated by the fact that even poor debtors, who are not in a position to contribute to the plan, are technically put under the plan for several years.

Third, the European model puts special emphasis on debt counselling services. Counselling aims at the rehabilitation of the debtor, and economic education and lifestyle adjustments, but also at fuller repayment of the debts. The debt counselling services are an integral part of the debt adjustment procedure. How this is accomplished varies among European jurisdictions, but generally the debt adjustment laws require that, before filing for judicial consumer bankruptcy or debt adjustment, the European consumer debtor must take part in debt counselling and negotiations or mediation with creditors in order to solve his or her debt problem.

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<sup>4</sup> These distinctive characteristics can be used to construct a European model of consumer bankruptcy: see N.J.H. Huls, "Overindebtedness and Overlegalization: Consumer Bankruptcy as a Field for Alternative Dispute Resolution" (1997) 20 J. Consumer Pol'y 143; and N.J.H. Huls *et al.*, *Overindebtedness of Consumers in the EC Member States: Facts and Search for Solutions* (Bruxelles: Story Scientia, 1994) [hereinafter *Overindebtedness of Consumers in the EC*].

Compared with the American consumer bankruptcy regime, the differences are so fundamental that they justify a different terminology. In the following discussion, I refer to the Anglo-Saxon institution as “consumer bankruptcy” and to the European approach as “consumer debt adjustment.”<sup>5</sup>

Because of the current discussions about “means testing” in the United States, American consumer bankruptcy experts may have a special interest in understanding what mandatory payment plans and restricted access mean in Europe, and how these institutions work there. Therefore, Part III of this article includes a description of the European consumer bankruptcy laws, with a special emphasis on Scandinavia, where these laws have now been in operation for several years. First, however, I wish to discuss the different ideologies animating the North American and the European consumer bankruptcy regimes.

## II. TWO PARADIGMS OF CONSUMER BANKRUPTCY

### A. *Consumer Bankruptcy in the Open Credit Economy*

The fundamental philosophy supporting American bankruptcy laws was persuasively and eloquently laid down by the Bankruptcy Laws Commission in 1973.<sup>6</sup> Essentially, it is a moral regime with an emphasis on a second chance and a fresh start policy. At the same time, the Commission’s starting point was acceptance of, and adherence to, the notion of an open credit economy.<sup>7</sup> The Commission saw credit as a beneficial social institution, both from the individual’s and from society’s point of view. According to the Commission, credit furthers economic growth and increases individuals’ well-being, and both goals are better served if consumers are inclined to take risks. A basic function of bankruptcy is therefore to serve the credit markets. While access to the

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<sup>5</sup> A common translation of the European terms is “rescheduling of debts.” It is found, for example, in *European Current Law Monthly Digest* (January 1999) at 194. The translated term, however, disguises the fact that all European laws, except those in France, allow for the discharge of a substantial part of the consumer’s debts. See also J. Niemi-Kiesiläinen, “Changing Directions in Consumer Bankruptcy Law and Practice in Europe and USA” (1997) 20 *J. Consumer Pol’y* 133 at 135.

<sup>6</sup> See Bankruptcy Laws Commission, *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 93-173 (1973).

<sup>7</sup> *Ibid.* at 68.

credit market should be easy and open, open access to bankruptcy as an exit from the market is equally important.<sup>8</sup>

In addition, bankruptcy should lead to a fair and equitable distribution of assets among creditors, efficient and economic administration of estates, and the deterrence and punishment of fraud and abuse.<sup>9</sup> The last-mentioned goals are, of course, uncontroversial. From a comparative perspective, the narrow definition of deterrence is noteworthy. The practices the lawmakers wanted to discourage were defined narrowly in the enumeration of exceptions to the right of a discharge, leading either to the dismissal of the application for discharge for all debts<sup>10</sup> or only for a particular debt.<sup>11</sup> Only one exception, the abuse of the bankruptcy process,<sup>12</sup> is formulated broadly in the United States *Bankruptcy Code*, but it has not been widely used in practice.

Much consumer bankruptcy research relies on the law-and-economics paradigm, which views bankruptcy mainly as an institution for risk allocation. Since the typical risks in the consumer credit market (*i.e.*, loss of income because of lay-offs, downsizing, and illness) are unforeseeable, they should, according to the theory, be allocated to the party who is in a better position to bear the risk—the commercial lender. Even where the consumer has better information about the risk (such as the borrower's own over-commitment), some theorists would impose the loss on the institutional lender because of the lender's superior ability to diversify and calculate the risks.<sup>13</sup>

Given that the typical risks in the consumer credit market are beyond the reach of bankruptcy law, law-and-economics bankruptcy scholarship has focused on the variables in bankruptcy law that may

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<sup>8</sup> *Ibid.* at 75-76.

<sup>9</sup> *Ibid.* at 75-83.

<sup>10</sup> See especially United States Bankruptcy Code, 11 U.S.C. §§727, 707 (1998) [hereinafter *Bankruptcy Code*].

<sup>11</sup> *Ibid.* § 523(a).

<sup>12</sup> *Ibid.* § 707.

<sup>13</sup> See, for example, F. Weston, "Some Economic Fundamentals for an Analysis of Bankruptcy" (1977) 41 L. & Contemp. Probs. 47 at 56; T.H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge, Mass.: Harvard University Press, 1986) at 229; and M. Howard, "A Theory of Discharge in Consumer Bankruptcy" (1987) 48 Ohio St. L.J. 1047 at 1064. On the other hand, Theodore Eisenberg regards the debtor as a better risk bearer because he or she can avoid the risk: see T. Eisenberg, "Bankruptcy Law in Perspective" (1981) 28 UCLA L. Rev. 953 at 983.

affect the debtor's decision to file for bankruptcy, such as exemptions<sup>14</sup> and incentives to repay debt through a plan. Consequently, much of the American empirical consumer bankruptcy research has focused on the debtor's choice between a Chapter 7 and Chapter 13 filing, and on evaluating the incentives created by the law for the debtor to choose a Chapter 13 payment plan.

Another group of scholars takes a socio-legal view of consumer bankruptcy.<sup>15</sup> They maintain that what is needed is comprehensive empirical information about consumer debtors, their debt problems and reasons for filing for bankruptcy, and the operation of consumer credit markets; decisions on bankruptcy law and policy, they believe, should be based on that information.<sup>16</sup>

Both sets of scholars base their approaches on a notion of consumer bankruptcy as an institution for the regulation of the consumer credit market. The law-and-economics discipline is optimistic about the ability of bankruptcy law to modify debtors' behaviour, whereas the socio-legal school tends to be pessimistic about the remedial powers of bankruptcy law. Instead, the socio-legal school emphasizes the impact of larger economic forces, economic fluctuations, and unemployment, which cause debtors and their families financial distress and lead them to file for bankruptcy.

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<sup>14</sup> See M.J. White, "Economic Versus Sociological Approaches to Legal Research: The Case of Bankruptcy," Book Review of *As We Forgive Ours Debtors: Bankruptcy and Consumer Credit in America* by T.A. Sullivan, E. Warren, & J.L. Westbrook (1991) 25 L. & Soc'y Rev. 685 at 688. Empirical research comparing different American states does not support the popular belief that the level of exemptions affects the level of consumer bankruptcies: see L. Shepard, "Personal Failures and the Bankruptcy Reform Act of 1978" (1984) 7 J. L. & Econ. 419 at 424-25; W.J. Woodward Jr. & R.S. Woodward, "Exemptions as an Incentive to Voluntary Bankruptcy: An Empirical Study" (1983) 57 Am. Bankr. L.J. 53; T.A. Sullivan, E. Warren & J.L. Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America* (New York: Oxford University Press, 1989) at 241 [hereinafter *As We Forgive Our Debtors*]; and P. Shuchman & T.L. Rhorer, "Personal Bankruptcy Data for Opt-Out Hearings and Other Purposes" (1982) 56 Am. Bankr. L.J. 1. The severity of wage garnishment seems to affect the frequency of consumer bankruptcies: see P. Shuchman, "Social Science Research on Bankruptcy," Book Review of *As We Forgive Ours Debtors: Bankruptcy and Consumer Credit in America* by T.A. Sullivan, E. Warren & J.L. Westbrook (1990) 43 Rutgers L. Rev. 185 at 235 [hereinafter "Social Science Research on Bankruptcy"].

<sup>15</sup> About the different paradigms of consumer bankruptcy law and the controversy between them, see White, *supra* note 14, and *As We Forgive Our Debtors* *supra* note 14 at 230.

<sup>16</sup> See, for example, *As We Forgive Our Debtors* *supra* note 14. The work of Philip Shuchman has increased empirical knowledge of bankruptcy debtors and the reasons they end up in bankruptcy: see "Social Science Research on Bankruptcy" *supra* note 14.

B. *The Economic and Legal Background of the European Debt Adjustment System*

European thinking seems to come closest to the socio-legal view. Research and legislation in different European countries tend to emphasize the causes of overindebtedness, such as economic recessions, unemployment, business failures, personal misfortunes such as illness, and inability to manage one's budget. Consequently, the overindebtedness of private households is seen primarily as a social problem, not as a market failure. Recently, this view was expounded by a representative of the European Union (EU), who characterized overindebtedness as a social and health problem involving individuals, rather than implicating consumer protection policy or other market regulation.<sup>17</sup> However, this understanding of the reasons for overindebtedness, which is shared with the American socio-legal school, leads to a completely different concept of discharge that can only be understood from an historical perspective.

Nineteenth century bankruptcy laws were still in force in most European countries at the beginning of the 1980s. The continental bankruptcy laws did not contain any discharge provisions at all. Non-business bankruptcies were rare. English bankruptcy law had discharge provisions, but bankruptcy was not accessible to ordinary consumers or other non-business debtors.<sup>18</sup>

The debt problems of households were not on the political agenda either. Admittedly, some individual debtors had excessive debt loads, mostly arising out of unsuccessful businesses. How these cases were handled has never been properly examined, but creditors may have used several strategies. Credit institutions pursued their claims in due

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<sup>17</sup> See J. Ring, "What is the EU Doing to Deal with Overindebtedness?" (The European Conference on Money and Debt Advice, Guarantee Foundation, Hämeenlinna, Finland, 3-5 September 1997) in S. Helesuo, ed., *Debt Advice Networking: Ways Forward* (Helsinki: Guarantee Foundation, 1997) 10 at 12. The European Union (EU) has not taken a stand on debt adjustment law and policy, but it has funded research on the topic.

<sup>18</sup> Historically, bankruptcy and discharge were not accessible to private persons (*i.e.*, non-traders). The formal restriction was abolished in 1869, but, because of high costs, bankruptcy never became popular among English consumers. The debt administration order, a debt adjustment procedure, was created in 1883, but it never gained the same popularity as the American consumer bankruptcy. The debt administration order requires a mandatory payment plan, and plans have been very long: see U.K., *Civil Justice Review: Report of the Review Body on Civil Justice* Cmnd 394 (London: Her Majesty's Stationery Office, 1988). The debt administration procedure is regulated in the *County Courts Act of 1984* (U.K.), 1984, c. 28, ss. 112-17. It was amended in 1990 to make the order more favourable to the debtor: see *Courts and Legal Services Act 1990* (U.K.), 1990, c. 41, s. 13. The amendment is not yet in force.

order, sometimes causing formal bankruptcy of the debtor, and wrote off the debts. The legal prescription periods for private debts were long—thirty years in Germany, for example, and ten years in many other countries—and could be renewed an unlimited number of times. It is assumed, however, that many creditors wrote off the debt after recognizing that further enforcement efforts would be futile. Tax authorities and other public or semi-public creditors took the same position, but these debts usually had shorter prescription periods and were not subject to renewal.

Even less is known about what happened to the debtors. Some resumed their careers or businesses and prospered, while others left the labour force and lived on the margins of society with the help of welfare payments or through illegal activities. Some debtors took up paid work; however, that could be very frustrating for them, since salaries were easy to trace and subject to garnishment, perhaps for the rest of their lives. Nevertheless, the number of these debtors was so small that there was no political pressure to change the debt enforcement legislation before the recession at the beginning of the 1990s.

To understand the background of the new laws properly, I must briefly describe the economic situation at the beginning of the 1990s, and the welfare state structure of European countries. The economic cycle before consumer debt adjustment laws were enacted was essentially similar in each country. The consumer credit markets were strictly regulated until the 1980s. Because of careful screening of credit applicants and the fact that demand for credit exceeded supply, default was rare. The credit markets were rapidly deregulated during the 1980s, which led to an increased supply of credit to consumers. Because unsatisfied demand had accumulated during the regulatory period, the credit market expanded rapidly. It is estimated that in several European countries, the total outstanding volume of consumer credit doubled during the 1980s.<sup>19</sup>

When the recession started at the turn of the decade, the rise in unemployment affected already heavily indebted households. Home mortgages played a big role in countries that favour private homeownership such as France, Great Britain, Norway, and Finland. Real estate values rose in the 1980s and fell in the 1990s. Also, many well-educated middle-class individuals were “downsized” or lost their small businesses. Often family members, wives, and cohabitees had given

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<sup>19</sup> In southern European countries, the same development is taking place ten years later: see, for example, S.M. Pereira, “Debt in Portugal” in Helesuo, ed., *supra* note 17, 35; and M. Mousouraki, “Overindebtedness in Greece,” in Helesuo, ed., *supra* note 17, 39.

personal guarantees for business loans and were sucked into the economic crisis. Business debts and mortgages played a substantial part in the private debt crisis. Even if credit card liabilities and purchase money debts are present in most cases of overindebtedness, consumer credit in the strict sense did not play a decisive role in the debt crisis of the 1990s.

The new middle-class debtors, unlike the poor, could pursue their grievances effectively and created political pressure for measures to alleviate the burden of excessive debt. Legislators saw the unexpected loss of income because of unemployment or similar reasons as the main cause for overindebtedness. This assumption was supported by research that showed that consumer debt problems were related to unemployment, loss of income because of illness, and low-income families with many children<sup>20</sup> (although this research did not completely reflect the new debtors' reality). The new debtors were unemployed, true, but they were not necessarily in lower social or income groups, and had often been self-employed or had a self-employed family member.<sup>21</sup>

To understand the background of the new debt adjustment laws, one must also appreciate the welfare and security expectations in European societies of the late 1980s. There was a common expectation that well-developed welfare societies protect people in the event of illness or unemployment. However, the traditional unemployment benefits were both insufficient and inadequate to help people with excessive debt loads, and new measures were called for. Therefore, the debt adjustment laws were seen as part of the welfare state protection.

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<sup>20</sup> See, for example, K. Holzschek *et al.*, *Praxis des Konsumentenkredits—eine empirische Untersuchung zur Rechtssoziologie und Ökonomie des Konsumentenkredits* (Köln: Bundesanzeiger, 1982) at 338; G. Parker, *Getting and Spending, Credit and Debt in Britain* (Avebury: Gower, 1990) at 157; R. Berthoud & E. Kempson, *Credit and Debt: The PSI Report* (London: Policy Studies Institute, 1992) at 110; P. Conaty, "The Need for Money Advice Centres" in Hörmann, ed., *supra* note 1, 321; M. Adler, "The Economic and Social Situation of Consumer Debtors in Great Britain" in Hörmann, ed., *supra* note 1, 37; and J. Leskinen, *Use of Consumer Credit in the Context of the Consumer's Way of Life and Personal Situation* (Helsinki: University of Helsinki, 1990).

<sup>21</sup> According to the empirical studies, the debt adjustment debtors are often unemployed, have large total debts, have been self-employed or have a family member who has been self-employed, and have large business debts: for Sweden, see *Utvärdering av skuldsaneringslagen, Konsumentverket* 1995/96:31, 16; for France, see J.-J. Hyst & P. Loridant, *Commission des lois et Commission des Finances, Rapport d'information n° 60—Surendettement Prévenir et Guérir* (1997/1998), online: [http://www.senat.fr/rap/r97-060/r97-060\\_mono.html](http://www.senat.fr/rap/r97-060/r97-060_mono.html) (date accessed: 23 August 1999) [hereinafter *Rapport d'information*]; and, for Finland, see J. Tala *et al.*, *Velkajärjestelyt tuomioistuimissa* (Helsinki: National Research Institute of Legal Policy, 1994); and V. Muttillainen & J. Tala, *Kuka vapautuu veloistaan* (Helsinki: National Research Institute of Legal Policy, 1998).

How does this description help us to understand the European model of debt adjustment? First, it was natural to restrict access to debt adjustments to those debtors who were hit by social risks similar to those from which the welfare state ordinarily protects its citizens: that is, unemployment, illness, and unexpected disability. Second, the idea of economic rehabilitation was not tied to the goal of a quick economic recovery and re-entry to the credit market. Participation in the credit market was not deemed necessary, and was perhaps not even desirable. On the contrary, economic recovery was intended to secure partial repayment of old debt through the payment plan. Third, debt adjustment was perceived as a remedy to the problems that led to the overindebtedness. Through counselling, the welfare state is given a chance to help.

The relationship between the debt adjustment law and the credit market is defined in several European bills. According to them, the new law should interfere with the functioning of the credit market as little as possible, if at all. For example, the Swedish bill for Debt Adjustment Law indicates, both in words and spirit, that a basic function of the law is to uphold the obligation to pay one's debts.<sup>22</sup> Some bills emphasize that the aim is only to discharge such debts as the debtor would never be able to repay.<sup>23</sup> All European bills emphasize that the law must not undermine the general moral imperative of paying one's debts.

### III. THE EUROPEAN CONSUMER BANKRUPTCY LAWS

#### A. Overview

The first European country to introduce a specific procedure for consumer debt adjustments and debt discharge was Denmark, in 1984. The Danish law was an important example for the other Scandinavian countries when they drafted their laws. Laws on judicial debt adjustment for consumers entered into force in Finland and Norway in 1993, and in Sweden in 1994.

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<sup>22</sup> See *Regeringens proposition 1993/1994:123 Skuldsaneringslag*<sup>6</sup> [hereinafter *Reg. Prop. 1993/1994:123*].

<sup>23</sup> See *Bet 957/1982, Betænkning om gældssanering*<sup>7</sup><sup>6</sup> (the Danish bill for debt adjustment) [hereinafter *Bet 957/1982*]; and *Regeringens proposition 183/1993, Hallituksen esitys laiksi yksityishenkilön velkajärjestelystä*<sup>22</sup> (Finnish bill for the Judicial Debt Adjustment Act) [hereinafter *Reg. Prop. 183/1993*].

The French law on prevention and regulation of individual and household overindebtedness was enacted in 1989, but its provisions on discharge are limited. The British Debt Administration Order, available to consumers, was substantially reformed and modernized in 1990. In Austria, legislation was adopted in 1994, and in the Netherlands in 1997.<sup>24</sup> The German insolvency reform Act was amended during its passage in the German Parliament to include a chapter on consumer insolvency. Although adopted in 1994, this Act did not come into force until 1999.

### B. *Consumer Protection and Prevention in France*

Unlike other continental European countries, France first introduced bankruptcy discharge in business bankruptcy law as a part of a comprehensive insolvency law reform in 1985. Thus, when the French Act to prevent and regulate overindebtedness of individuals and families, known as *Loi Neierz*<sup>25</sup> was enacted in 1989, the problem of overindebted households was seen in the context of consumer protection. *Loi Neierz* does not, however, contain a discharge provision that comes anywhere near the Anglo-Saxon concept of discharge. Instead, the law provides a framework for rescheduling the payment of debts, and its discharge provisions apply only after a grace period.

Institutionally, the law created administrative commissions to administer the rescheduling of debts. The commissions consist of representatives of the Banque de France, local banks, consumer groups, and local governments. The debtor files a rescheduling application with the commission, which then makes extensive inquiries into the debtor's affairs, facilitates negotiations with the creditors, and sets up a plan for acceptance by the parties (*plan conventionnel*). The commission's aim is to win the creditors' support and to avoid court proceedings.<sup>26</sup> If the plan is not accepted, the debtor may go to court. In that case, the commission

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<sup>24</sup> The Dutch law was consolidated to the bankruptcy law in 1988; *Bankruptcy Act 1998* (June 25) Stb 445; and *Bankruptcy of Natural Persons (Procedure) Act 1998* (June 25) Stb 447.

<sup>25</sup> See *Loi 89-1010 relative à la prévention et au règlement des difficultés liées au surendettement des particuliers et des familles*, in force 1 March 1990. In 1993, the provisions were incorporated in the Consumer Protection Act as articles L.331-1–L.333-8.

<sup>26</sup> The success of the rescheduling is measured as a proportion of the filings that led to acceptance of the *plan conventionnel*. The acceptance rate increased from 45 per cent in 1990 to nearly 70 per cent in 1996: see *Rapport d'information* *supra* note 21 at 9, 44.

proposes a plan to the court.<sup>27</sup> At any point in the proceedings, if the commission's negotiations are hampered by a creditor's execution measures, the court may order a stay.

Access to the rescheduling proceedings was originally intended to be open to all consumer debtors. However, fraud, the provision of incorrect information to creditors or the commission, and conduct prejudicial to the creditor's interests all exclude debtors from participating in the proceedings. The French Parliament also added a good faith test (*de bonne foi*). The interpretation of "good faith" was left to the commissions and the courts, and has been a major ground for the dismissal of applications.<sup>28</sup> Most applications, however, have been held admissible.<sup>29</sup>

The law enumerates the options that the commissions and the courts have at their disposal. The most important limitation on the court's power is that the capital of the debt may not be reduced. The only exception to this principle is that the court may, after a forced sale of a family home, discharge the remaining part of the debt.<sup>30</sup> With respect to other debts, the court has the power to grant an extension of time, adjust the interest rate, and order payments to be credited to capital before being credited to interest. Also, payment of a debt may be rescheduled for up to one-and-one-half times the original repayment period, or a maximum of five years. The average length of the plans has been nearly ten years.<sup>31</sup>

These provisions are not sufficient to help debtors who have no, or very little, capacity to pay. Several studies show that 25–40 per cent of debtors fall into this category.<sup>32</sup> Lack of payment capacity does not make a filing inadmissible, and so the Commissions have established the

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<sup>27</sup> The procedures were slightly modified toward a three stage procedure by *Loi 95-125* (8 February 1995). If the Commission does not agree to present a plan, but recommends the dismissal of the application, the debtor may appeal to the court.

<sup>28</sup> Regarding the interpretation of *de bonne foi* see G. Paisant, "Chroniques de législation et de jurisprudence françaises, Surendettement des particuliers" (1991) *Rev. trim. dr. com.* 446; and D. Desurville, *Histoire de la banqueroute et faillite contemporaine* (Paris: L'Harmattan, 1992) at 169-70.

<sup>29</sup> About 90 per cent of the filings were found admissible: see *Rapport d'information supra* note 21 at 35.

<sup>30</sup> About one-half of the cases had home mortgage debts, but the debt was reduced in only 10 per cent of the cases: see *ibid.* at 18, 38.

<sup>31</sup> The *plan conventionnel* accepted in the first stage of the procedure, has had an average duration of more than ten years (123 months). The plans confirmed by the court have been shorter (ninety months, or seven-and-one-half years): see *ibid.* at 39.

<sup>32</sup> See *ibid.* at 42.

practice of granting consecutive grace periods to indigent debtors.<sup>33</sup> Since their situation rarely changes during the moratorium period, cases kept coming back to the Commissions. As a result of the amendment of 1998,<sup>34</sup> a discharge is possible after a three year grace period for debtors with no payment capacity.

*Loi Neierz* is considered a success, and the number of filings reached 90,000 during the first ten months after it came into force in 1990. In the period between 1991 and 1994, filings levelled off at the rate of 68,000 per year.<sup>35</sup> The subsequent rise to 95,700 in 1997 is attributed to the practice of granting moratoria, which led to repeated applications by the same debtors.

### C. *The German and Austrian Laws*

Debate over revision of the German bankruptcy law of 1877 went on for decades.<sup>36</sup> The discharge of debt was not a central theme in the reform discussions. The Insolvency Law Review Commission (1986) had business failures in mind when it proposed that composition agreements by insolvent debtors should be made easier.<sup>37</sup> Before the proposal went forward, restrictions on post-bankruptcy enforcement of pre-bankruptcy debts were adopted in an East German law enacted only six months before the unification in 1989.<sup>38</sup>

The final bill for the new Insolvency Law (*Insolvenzgesetz*), adopted by the unified Germany in 1991, included a detailed regulation

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<sup>33</sup> The commissions granted a moratorium in 28 per cent of the cases; the courts did likewise in more than one-half of the cases: see *ibid.* at 44.

<sup>34</sup> See *Loi n. 98-657* (29 July 1998).

<sup>35</sup> See *Rapport d'informationsupra* note 21 at 15.

<sup>36</sup> *Konkursgesetz von 1877* was replaced by *Insolvenzordnung* 5.10.1994, which came into force 1 January 1999. For a discussion of this reform, see W. Uhlenbruck, ed., *Einhundert Jahre Konkursordnung 1877-1977* (Köln: Heyman, 1977).

<sup>37</sup> The reform discussions were concerned about the drastically decreased number of compositions. Compositions, both in and outside bankruptcy, were regulated by the *Vergleichsverordnung* of 1932, and were almost nonexistent in bankruptcy in the 1980s: see C. Doehring, "Das Insolvenzgeschehen in der Bundesrepublik Deutschland mit neueren statistischen Ergebnissen" (1989) 50 KTS 825 at 827. The Insolvency Law Review Commission tried to make composition-type agreements feasible as part of a bankruptcy proceeding: see *Kommission für Insolvenzrecht, Bundesministerium Justiz* Erster Bericht 134-136 (1985); and Zweiter Bericht 150-163 (1986).

<sup>38</sup> This law, *Gesamtvollstreckungsordnung* 6.6.1990, was in force until 1999 in the territory of former East Germany: see G.-A. Lübchen & H.-G. Landfermann, "Das neue Insolvenzrecht der DDR" (1990) ZIP 829 at 837-38.

of discharge and payment plan, but only for insolvent businesses.<sup>39</sup> Until then, the reform discussions had paid little attention to debt counselling practised by consumer and charitable organizations, churches, and unions. These organizations had been trying to persuade the politicians to allocate more funding for counselling, and to establish a separate debt rescheduling procedure for consumers.<sup>40</sup> During the parliamentary hearings on the Insolvency Act, the opposition Social Democratic Party made a proposal along these lines. The basic elements of that proposal were then incorporated in the Insolvency Act.

Consequently, the new Insolvency Act,<sup>41</sup> adopted in 1994, has a two-track discharge procedure. One track, the small debtor adjustment, is designed for consumers and individuals operating a small business. The other track is available to bankrupts as a means to end bankruptcy proceedings. The conditions of discharge are quite different in each proceeding.

The small debtor's primary obligation is to negotiate with his or her creditors before and during the proceedings. The first stage of the proceedings is called the "small process" (*Kleinverfahren*). The debt counsellors' new responsibility will be to guide these negotiations and report about them to the courts. The debtor is likely to need assistance, because he or she is required to attach a complete payment proposal to the application. The court confirms the plan if it is accepted by a majority of the creditors or if there is no creditor opposition.

The bankruptcy track (*Restschuldbefreiung*) follows different principles. Creditors' acceptance of the plan is not necessary. The discharge proceedings follow the normal bankruptcy course. Discharge may be denied because of economic crime, other fraud, or conduct injurious to creditors' interests. Access to the proceedings, however, only confers the right to start a payment plan. The duration of the payment plan is seven years, and there are no exceptions. The payment obligations under the plan correspond to the garnishment provisions, and leave the debtor with only enough money to live at a basic subsistence level. During the three last years of the plan the payment

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<sup>39</sup> See *Diskussionsentwurf. Gesetz zur Reform des Insolvenzrechts. Allgemeine Begründung* 27 (1988) [hereinafter *Diskussionsentwurf*]; and *Regierungsentwurf einer neuen Insolvenzordnung vom 21.11.1991* (Deutscher Bundestag Drucksache 1262443, 15.4.1992) at 81 (the German bill to revise the insolvency law) [hereinafter *Regierungsentwurf*].

<sup>40</sup> See *Institut für Finanzdienstleistungen und Verbraucherschutz im Auftrag der Bundesarbeitsgemeinschaft der Freien Wohlfahrtspflege e. V. und der Arbeitsgemeinschaft der Verbraucherverbände e. V., Gutachten zum Entwurf des Verbraucherkonkordanzgesetzes (1990)* [hereinafter *Gutachten*].

<sup>41</sup> See *Insolvenzordnung* 5.10.1994, Bundesgesetzblatt Teil I, 2866. In force 1 January 1999.

obligations are reduced. The debtor is under the surveillance of the trustee and creditors during the plan, not only regarding his or her repayment behaviour, but also with respect to his or her obligation to find employment and to keep working. In the discharge hearing upon the completion of the plan creditors can still oppose the discharge if the debtor has not fulfilled the plan obligations.

Critics objected that the bankruptcy track was too harsh.<sup>42</sup> The creation of separate proceedings for small debtors provides a partial answer to this critique. These proceedings, however, leave the small debtor at the mercy of creditors. If the creditors do not accept the proposal, the debtor may file for bankruptcy. It is unlikely that the creditors would accept a more lenient plan than the bankruptcy option provides for.

In Austria, a consumer debt adjustment regime was introduced in 1993 with an amendment to the bankruptcy law.<sup>43</sup> As a result, the provisions for a composition in bankruptcy were relaxed for private debtors and a five-year plan with a minimum requirement of 30 per cent repayment becomes binding if it is accepted by a three-quarters majority of creditors.

A specific debt adjustment procedure was also introduced.<sup>44</sup> The debtor may file for a debt adjustment at the same time as the bankruptcy filing, but the adjustment proceeding only starts after the composition plan that the debtor presented has been rejected. Pre-bankruptcy negotiations are not strictly mandatory, but, to obtain a waiver of the bankruptcy fee, the debtor must present a certificate that pre-bankruptcy negotiations have taken place with the creditors.

After the debtor has negotiated twice with the creditors, the court determines the special conditions of the adjustment. The debtor cannot make use of the adjustment regime in cases of fraud or other conduct injurious to the creditors, where an adjustment procedure occurred within the last twenty years, or where the debtor incurred unreasonable debts during the last three years.

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<sup>42</sup> See a comment by a group of bankruptcy lawyers, Gravenbrucher Kreis, "Grosse Insolvenzrechtsreform gescheitert" (1990) ZIP 476 at 478; see also *Gutachten, supra* note 40 at 82; U. Reifner, "Grundsätze zur Bewertung des Verbraucherkonkurses" in *Verbraucher und Recht* (1990) 132; and, from a banking perspective, F.J. Scholz, "Insolvenzverfahren für Verbraucher aus der Sicht des Bankenfachverbandes (BKG)" in *Insolvenzverfahren für Verbraucher - mit oder ohne Restschuldbefreiung* (BKG ed. 1988) 23 at 27.

<sup>43</sup> See *Konkursordnungsnovelle* 1993 (BGBl 974). In force 1 January 1995.

<sup>44</sup> See *Abschöpfungsverfahren mit Restschuldbefreiung, Konkursordnung* § 199-216.

The plan runs for seven years and is equivalent to a wage garnishment. The debtor may apply for a discharge after three years have elapsed and if 50 per cent of the total debt has been paid; after seven years with a 10 per cent minimum repayment; or on the basis of special hardship after ten years.<sup>45</sup> Payments are administered by a trustee, and the debtor is under the surveillance of the trustee and the creditors regarding his or her employment, domicile, and other circumstances.

D. *The Unknown Path Breaker: Danish Debt Arrangement Act of 1984*

The Danish bankruptcy law was amended in 1984 to include debt adjustments for consumers.<sup>46</sup> The Debt Arrangement Act was endorsed by all parties in the Danish legislature, and still enjoys great popularity. Unfortunately, no extensive empirical research about it exists.<sup>47</sup> Even the Act itself was not widely known outside the country before the beginning of the 1990s, when delegations from other Scandinavian countries started to tour Denmark.

The Danish preparatory committee discussed the meagre prospects of an overindebted debtor and examined the collection efforts by the creditors.<sup>48</sup> Its conclusion was that the discharge of “hopeless” debts would cause no remarkable loss to any party. In the committee’s view, society would benefit from a discharge in various ways. In addition to the advantages to the debtor and his or her family, the debtor’s economic recovery and increased motivation to work could benefit society through savings in social security and increase in tax flow. Even creditors might save futile enforcement costs and would benefit from their share of the payment plan.

The crucial question, then, was how to spot the “hopeless” debt for discharge. The Danish Act leaves the discretion largely to the courts. The preconditions of the arrangement, according to the Act, are the debtor’s insolvency and overall circumstances. The insolvency requirement is usually met if the debtor has total debts of at least

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<sup>45</sup> See F. Mohr, *Das Privatkonkurs* (Wein: Manz, 1994) at 65-69.

<sup>46</sup> The amendment of the Danish Bankruptcy Code, *Konkurslov* (part IV, *Gældsanering* S. 197-237) came into force 1 July 1984 [hereinafter *Konkurslov*].

<sup>47</sup> For an overview in English, see P. Møgelvang-Hansen, “Adjustment of Hopeless Debt” (Third European Conference on Overindebtedness, Birmingham, 4-5 December 1992) in *Consumer Debt in Europe—The Birmingham Declaration* (Birmingham: Birmingham Settlement, 1993) at 85.

<sup>48</sup> See *Bet 957/1982*, *supra* note 23.

250,000 Danish crowns (US\$40,000) if employed, or 100,000 crowns (US\$15,000) if unemployed or retired. Also, the court has to take into consideration

whether the overall circumstances of the debtor speak in favour of the arrangement, such as the debtor's interest in the arrangement, the age of the debts, the origin of the debts, the debtor's circumstances when the debts were incurred, the repayment history of the debts, and the debtor's circumstances while the application is pending.<sup>49</sup>

These general terms have been elaborated in court practice to reflect Danish public policy goals. In court practice, the debt adjustment is denied if the debtor is likely to incur new debts; if he or she is expecting to inherit money in the near future; if the debts are of recent origin or derive from criminal acts, speculative businesses, or extravagant consumption; or if the debtor has systematically neglected to pay taxes or to pay alimony. The discharge is to be denied if the debtor does not honestly disclose his or her affairs and does not comply with other orders of the court.<sup>50</sup>

The debtor takes the initiative in proposing a payment plan. If the debtor is unemployed or retired, a straight discharge is possible. The Danish legislature envisaged that a zero-payment plan would be exceptional, but the practice has been more liberal. The duration of the plan is usually five years, and longer for student loans. All unsecured creditors are on the same footing. The few priorities acknowledged in the Danish bankruptcy law do not apply to consumer debt arrangements.

The debtor is required to pay the debts from that part of his or her income that exceeds the necessary costs of living for the debtor's family. The essential living costs are determined on the same basis as the minimum social security payable by the state. Secured debts are outside the adjustment. The debtor is sometimes allowed to keep the family home and to make the mortgage payments during the plan, but the payments may not exceed reasonable alternative housing costs.

Even though the debt arrangement is regulated in Danish bankruptcy law, the debt adjustment is a separate procedure. The debtor files in the court of first instance. The judge examines the debtor's application and personal circumstances in detail before deciding on the admissibility of the application. Because most applications are turned down at this stage (between 1986 and 1989, nearly 80 per cent of the

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<sup>49</sup> *Konkurslov*, *supra* note 46, s. 199.

<sup>50</sup> The appellate court practice is described in detail in L. Hindborg, *Gældsanering* (Copenhagen: Jurist-og Økonomforbundet, 1991); and G.D. Jensen, *Gældssanering* (Copenhagen: Jurist-og Økonomforbundet, 1993).

applications were denied in the first instance court of Copenhagen), this is also the most important step in the process.

If a case is declared admissible, it is administered by a trustee who is a private attorney. The costs are paid by the state. The trustee's obligations include a detailed investigation of the debtor's circumstances and the preparation of the plan. The creditors are heard, but the court is not bound by their opinion. The plan confirmed by the court discharges any part of the debt that is not included in the plan.

It was estimated that 10,000 applications would be filed each year, but less than half this number were filed in the 1980s. However, the filings increased in the 1990s and reached 8,000 in 1991. Filings have fluctuated between 6,000 and 8,000 during the 1990s.<sup>51</sup> The success rate of applications was remarkably low in the 1980s, only about 25 per cent. The rate has since risen, but the majority of applications are still dismissed. Looking at the appellate court practice, the applications of seriously overindebted individuals are dismissed in some circumstances, such as unemployment or other severe economic hardship.<sup>52</sup> Also, serious debt problems remain outside the ambit of the adjustment program.<sup>53</sup>

E. *Finnish Debt Adjustment Legislation  
as a Response to a Deep Debt Crisis*

In Finland, the deregulation of the credit market took place more quickly than in many other West European countries. Also, the recession in the early 1990s was deepened by the decline in trade after the collapse of the Soviet Union. The recession led to a larger increase in unemployment and bankruptcy filings than in many other countries. The drafting and enactment of the consumer debt adjustment legislation can be seen as part of a national crisis management effort. The legislation was drafted quickly because the Finnish Parliament was convinced of the need for it, and the law was passed unanimously. The need for the law was questioned only once, most dramatically by the

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<sup>51</sup> See *Statistiske efterretninger: Social Sikring og Tersvæsen 1995:8, 1998:11*

<sup>52</sup> See J. Niemi-Kiesiläinen, *Luonnollisen henkilön velkavastuu insolvenssioikeudessa* (Helsinki: Finnish Lawyers' Association, 1995) (Liability for Debt in Insolvency Law) at 509 [hereinafter *Luonnollisen henkilön*].

<sup>53</sup> Some critical opinions about the high dismissal rate have been voiced: see H.H.H. Andrup & J. Meyhof, "Gaeldssanering pa afveje" (1986) *Ugeskrift for Retsvæsen* 215; M. Munch, *Konkursloven af 1977 med kommentare* (1988) 771; and Møgelvang-Hansen, *supra* note 47 at 90-91.

president of the Finnish Republic. He delayed signing the law by a couple of weeks while considering its necessity. The Law on Consumer Debt Adjustment<sup>54</sup> came into effect on 8 February 1993.

The Finnish law provides for a traditional judicial bankruptcy procedure in the court of first instance; written and oral submissions from creditors; a judge charged with making decisions in response to motions from both sides; a trustee to administer the procedure; and finally the confirmation of a plan.

The law requires the debtor to propose a voluntary payment agreement to the creditors before making an application to the court. State funding for counselling has been available as an employment program for “downsized” bank clerks and social workers. Four-fifths of debtors receive counselling before they file in court.<sup>55</sup> In practice, the counsellor helps the debtor to negotiate with the creditors and to prepare documents for court filing. Little time is devoted to economic planning and the development of budgeting skills.

The access to debt adjustment was designed to take into account the structural reasons for a debt crisis. An insolvent debtor should show an acceptable reason for his or her insolvency, such as unemployment, illness, layoff, or business bankruptcy. Filings that are contrary to the moral imperative to pay debts are excluded, such as filings by debtors convicted or suspected of economic crimes, those who have participated in a speculative business, acted against the interests of the creditors, or worsened their economic position by voidable transactions. For example, a number of debtors who invested borrowed money in land and securities in the late 1980s had their cases dismissed because of the exclusion of speculative business debts from the law.<sup>56</sup> There is also a bar to a second adjustment. Unlike the American six-year bar, this bar has no limitation. All exclusion clauses, including the bar to repeat debtors, are subject to review by the court.

The most important exclusion concerns reckless borrowing or “reasonable grounds to believe that the debtor has run into debt in an irresponsible way or with a debt arrangement procedure in mind.”<sup>57</sup> More specifically, the debtor’s borrowing is judged by his or her

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<sup>54</sup> *Laki yksityishenkilön velkajärjestelystä* (Consumer Debt Adjustment) (25.1.1993/57).

<sup>55</sup> See V. Muttilainen, *Velkajärjestelyn kustannukset* (Helsinki: National Research Institute of Legal Policy, 1995).

<sup>56</sup> See Supreme Court KKO 1995:22. The appellate court practice was unequivocal: see *Luonnollisen henkilön*, *supra* note 52 at 194.

<sup>57</sup> See *Laki yksityishenkilön velkajärjestelystä*, *supra* note 54, s. 10 para. 7.

prudence in handling finances, the source of the debts, and the circumstances under which they were incurred. A considerable amount of case law has evolved around this provision. The bulk of the case law concerns consumer households with heavy credit card debt, or which have guaranteed another person's loan. The case law has developed a *bona fide* test looking to see whether the debtor knew or should have known that he or she would not be able to pay debts when they became due. If the test were applied strictly, a substantial number of debtors who guaranteed business or housing debts of their family members or significant others would be excluded. However, the Finnish Supreme Court changed the practice in a decision giving weight to the relationship between the primary debtor and the guarantor, the purpose of the debt, and other circumstances of the case.<sup>58</sup> Cases involving a large volume of debts or numerous credit card debts have been dismissed.

The plan is drafted by a trustee appointed by the court and paid for by the state. The creditors are then heard, but the court is not bound by the creditors' acceptance of the plan. The maximum duration of the plan is five years. The plan may exceed five years if the debtor is allowed to keep a privately-owned home and to pay off the mortgage debt during the plan. The mortgage debt payments<sup>59</sup> may be extended for a period longer than five years and the interest rate may be modified.

The Finnish law was part of a national strategy of recovery from the economic misfortunes at the beginning of the 1990s, and has been quite successful. During the four-year period between 1993 and 1996, 33,000 plans were confirmed, and only 15 per cent of the filings were dismissed. The law has been criticized on two grounds. Creditors have complained that the plans yielded payments that were too low. The administrators complained that too many plans had to be changed because of changes in the debtor's circumstances. The law was reformed in early 1997 to exclude temporarily unemployed debtors.<sup>60</sup>

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<sup>58</sup> See Supreme Court KKO 1995:158. The guarantee was given by parents on their children's business and housing loans, all of them being in the work force at the time: see, further, J. Niemi-Kiesiläinen, "Kvinnoperspektiv på skuldsanering" (1996) 75 *Retfærd* 35 [hereinafter "Kvinnoperspektiv på skuldsanering"].

<sup>59</sup> The debt is considered secured up to the value of the security when the procedure is initiated.

<sup>60</sup> See Law 22.2.1997/63. *Regeringens proposition 180/1996, Hallituksen esitys laiksi yksityishenkilön velkajärjestelystä annetun lain muuttamisesta* (Bill for the Amendment of the Judicial Debt Adjustment Act).

F. *Conflict Between the Welfare State and Insolvency Models in Norway*

The Norwegian legislative drafting process represents a shift from a welfare state model of debt adjustment to an insolvency model. These two concepts were defined in the report of the preparatory committee, which presented two drafts of a consumer debt adjustment law in 1991.<sup>61</sup> The majority presented what they described as a welfare state model. They emphasized that the law should prevent serious debt problems, especially in cases of illness and unemployment, and that mortgage liabilities should be included in the debt adjustment. They therefore proposed open access to adjustment, a grace period, and institutional negotiations between the debtor and the creditors before an application could be made to the court.

The minority member of the committee, who was a private attorney, presented a proposal that resembled the Danish Debt Arrangement Act, and called it an insolvency model. The government compromised between the two proposals. The grace period and the open access to debt adjustment were deleted, but the pre-trial procedure was maintained. The Law on Voluntary and Compulsory Debt Adjustment for Individuals was enacted on 17 July 1992, and became effective 1 January 1993.<sup>62</sup>

Access to debt adjustment is regulated broadly. The debtor has to be permanently insolvent. An overall evaluation of the debtor's situation takes place, but is guided only vaguely by the law. The adjustment may not be accepted if it is *støtande*, that is, against the general moral obligation to pay one's debts. Experience to date suggests that this bar will be interpreted narrowly.

The debtor files with the enforcement official who is responsible for compiling the information about debtors. The enforcement official forwards the application to the court, which will order a stay of proceedings against the debtor. During the three-month stay, the debtor is expected to present a plan, the enforcement official meets with the creditors and, if none of them objects, confirms the plan. The enforcement official may appoint an advisor to the debtor. Several new

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<sup>61</sup> See NOU 1991:16 *Gjeldsordning for personer med betalingsvansker*

<sup>62</sup> Lov av 17. July 1992 om frivillig og tvungen gjeldsordning for privatpersoner (*Gjeldsordningloven*)

jobs were created in the consumer advice offices when the law came into force.<sup>63</sup>

The number of uncontested debt settlements has been disappointingly small. Because the creditors objected, most cases had to be heard by a judge,<sup>64</sup> who can confirm a plan despite the creditors' objections. The plan's duration is five years, but it may be extended by the court.

Because four-fifths of Norwegians live in their own homes, and housing loans are an important reason for overindebtedness, mortgages are included in the debt adjustment. According to the law, the debtor is obliged to sell his or her home only if it is in the best interest of the creditors *and* the house exceeds the reasonable needs of the debtor's household.<sup>65</sup> Consequently, most debtors can keep their homes in adjustment proceedings.<sup>66</sup> The interest of the secured creditor is protected by requiring the debtor to pay the secured debt up to the value of the house plus 10 per cent in full. The secured creditor must, however, contend with interest payments during the plan. Down payments on the principal of secured debt start when the plan is over.

The number of debt adjustments has been modest. During the first four years, an average of fewer than 1,500 plans a year were confirmed.<sup>67</sup> The enforcement officials did an effective pre-screening job. During the first year of operation (1993), more than 22,000 debtors contacted the enforcement officials, either personally, by phone, or in writing, but only 4,400 filed for debt adjustment with the enforcement official. During the first six months, 44 per cent of registered contacts resulted in dismissal by the authority, withdrawal of the petition by the debtor, or a decision by the debtor not to file at all.<sup>68</sup>

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<sup>63</sup> *Ot. prp. nr. 81 (1991-92), Om lov om frivillig og tvungen gjeldsordning for privatpersoner (gjeldsordningsloven)* at 18 (the Norwegian bill for the Debt Adjustment Law) [hereinafter *Ot. prp. nr. 81 (1991-92)*].

<sup>64</sup> See E. Rokhaug, "Insolvency Legislation: National Experiences" in Helesuo, ed., *supra* note 17, 105 at 107.

<sup>65</sup> During the Parliamentary hearings, the minimum needs were replaced by reasonable needs: see *Ot. prp. nr. 81 (1991-92)*, *supra* note 63 at 63, 135.

<sup>66</sup> It is reported that up to 90 per cent of applicants are allowed to keep their homes: see Rokhaug, *supra* note 64 at 107; and H.P. Graver, *Gjeldsordningsloven med kommentare* (Oslo: Tano A.S., 1996) at 115-16.

<sup>67</sup> Up to March 1998, 8,000 plans were confirmed: Minister Svarstad Haugland 19 March 1998, in answering a parliamentary question.

<sup>68</sup> See C. Poppe, *Gjeldsordningslovens første leveår, En evaluering av lovens konsekvenser for namsmenn, kreditorer og skyldner* (Statens institutt for forbruksforskning Rep. no. 1, 1994) at 109-10, 240-41.

G. *Only Limited Access in Sweden*

Surprisingly, Sweden was the last Scandinavian country to introduce debt adjustment legislation. This may have been because Sweden had a conservative government (but so did Finland) or is more prosperous than other countries (although Norway is more prosperous). Another explanation may be that Sweden had a more active employment policy and a stronger social security cushion.

The Swedes started the preparatory work well in advance and the committee's report was published in 1990.<sup>69</sup> However, the law was only given legislative approval in 1994 and came into force 1 July 1994.<sup>70</sup> The delay was due to the opposition within the government. The Minister of Justice herself opposed the bill, but political pressures finally forced her to bring it forward.

Access to the debt adjustment program is very narrow. The Swedish law resembles the Danish law in the narrowness of access and resembles the Norwegian law in its bureaucratic framework. The bill emphasized that debt adjustment was to be seen as a benefit and not as a legal right. For example, the bill avoided the judicial review of debt adjustment by stating that since the debtor does not have a legal claim to adjustment, he or she therefore does not risk having a right infringed upon if the adjustment is denied.<sup>71</sup> Also, a broad formulation of the preconditions to access was justified by the uniqueness of each case,<sup>72</sup> requiring a wide discretion by those applying the law.

The policy of granting a discharge only in extremely difficult situations is evident in practice. Some enforcement agencies have set a minimum requirement of at least 200,000 Swedish crowns (US\$25,000) in total debts.<sup>73</sup> The courts consider the total debt picture, the age of the debts, the debtor's age, income, and how the debts were incurred. The

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<sup>69</sup> See SOU 1990:74. *Skuldsaneringslag*

<sup>70</sup> See *Skuldsaneringslagen* 1994:334.

<sup>71</sup> See *Reg. Prop. 1993/1994:123 supra* note 22 at 154. Whether this view is consistent with the procedural safeguards provided by Article 6 of the *European Convention for the Protection of Human Rights and Fundamental Freedoms*, 4 November 1950, 213 U.N.T.S. 221, to which Sweden, like other Scandinavian countries, is a party, is questionable. According to the debt adjustment law, however, the debtor may bring a claim before the district court if the filing is dismissed by the debt enforcement agency. Therefore, the regulation as such satisfies the requirements of Article 6 of the Convention.

<sup>72</sup> See *Reg. Prop. 1993/1994:123 supra* note 22 at 95.

<sup>73</sup> See *Utvärdering av skuldsaneringslagen, Konsumentverkå* 95/1996:34 at 18 [hereinafter *Utvärdering 1995/1996:34*].

discretionary, non-legal nature of debt adjustment is best illustrated by cases concerning the debtor's diligence in paying the debts. If the debtor has recent debts, is young and unemployed, has not actively and diligently tried to reach a voluntary payment plan with the creditors, and has not sold property such as a house, condominium, or car,<sup>74</sup> the case will be dismissed.<sup>75</sup>

More than anything, the debtor's conformity with the rules is tested by the cumbersome proceedings. The procedure has three tiers consisting of debt counselling, filing and plan negotiations under the supervision of the debt enforcement official, and the court hearing. The debt counselling is not mandatory, but the debtor is required to submit a voluntary payment plan to his or her creditors before filing. In practice, most debtors need the advice of debt counsellors. The formal application is filed with the enforcement official, who helps the debtor to prepare the plan, submits it to creditors for consideration, and, if it is unopposed, confirms the plan. Either the debtor or a creditor can submit the enforcement official's decision to the court.

The layered proceeding has functioned as an effective gatekeeper. During 1995, the first complete year the law was in operation, 38,000 households contacted the debt counselling services.<sup>76</sup> Only 8,000 of them were classified as debt adjustment clients.<sup>77</sup> Nearly one-half of them (3,800) reached a voluntary agreement with their creditors.<sup>78</sup> The number of filings for debt adjustment with the enforcement agencies was 4,400 in 1995; 5,200 in 1996; and 3,600 in 1997.<sup>79</sup> In 1995, the debt enforcement officials dismissed more than one-half of the applications, and confirmed less than 300 final plans in

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<sup>74</sup> The mortgage debt cannot be adjusted. The law is unclear as to when the debtor may keep a privately-owned home in debt adjustment. Because Sweden, unlike Norway and Finland, has not promoted home-owning, only a few debtors owned their homes: see *ibid.* at 17.

<sup>75</sup> The first Supreme Court case (HD 1996-05-23) illustrates the argument. The debtor was male, 29 years old, single and employed. His debts, totalling 700,000 Swedish crowns (US\$90,000), derived from a business he had run for between three and five years before the law came into force. In affirming the appellate court's decision, the Supreme Court held that the insolvency was qualified, the debts were old enough considering that they were business related, and that the debtor had tried to reach a plan with the creditors, both before the proceedings and with the enforcement agency. The discharge was granted. The debtor's failure to submit a brief in the appellate court was not considered a breach of his obligation to cooperate in the arrangement.

<sup>76</sup> See *Utvärdering 1995/1996:34* *supra* note 73 at 18.

<sup>77</sup> *Ibid.*

<sup>78</sup> *Ibid.* at 32.

<sup>79</sup> See *Riksskatteverkets statistik 1998*

1995,<sup>80</sup> and 670 in 1997. About 1,000 cases per year have been submitted to the court, where the dismissal rate has been less than 20 per cent.<sup>81</sup>

The cumbersome and slow proceedings have been criticized and the need for two pre-court stages has been questioned,<sup>82</sup> but the policy of restricted access is generally accepted as sound.

#### IV. DISCUSSION

While we can distinguish the European model of debt adjustment from the Anglo-Saxon concept of consumer bankruptcy, it is clear that no harmonization of debt adjustment laws has so far taken place in Europe. The laws differ on such fundamental aspects as how the access to the adjustment is regulated, which institution handles the cases, what agency helps the debtors, and whether home mortgage debts are included in the plan. They are consistent in requiring prior negotiations with the creditors involving the debt counselling services, providing a two-tiered formal procedure, restricting access to the proceedings, and in insisting on a lengthy payment plan.

Udo Reifner has classified the consumer bankruptcy and debt adjustment laws based on three criteria, namely (1) the right to a fresh start as opposed to gradual reintegration to financial self-management; (2) whether the procedure includes a moral judgement on the debtor's behaviour as a precondition for discharge; and (3) how the administrative responsibility for the rehabilitation of the debtor and fulfilment of the plan is arranged.<sup>83</sup> Based on these criteria, Reifner constructs four models of consumer bankruptcy and debt adjustment that he also links to political ideologies.

In Reifner's classification, the *fresh start model* corresponds to the American bankruptcy model, and reflects the underlying policy of the small-business insolvency legislation in the United Kingdom. The *re-educational model* is painted by Reifner as a reflection of conservative

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<sup>80</sup> See *Utvärdering 1995/1996:34 supra* note 73 at 36; *Utvärdering av skuldsaneringslagen, Konsumentverket 1995/1996:3* at 9; and *Riksskatterverkets statistik 1998*

<sup>81</sup> See *Utvärdering, 1995/1996:34 supra* note 73 at 64; Larsson, *Utvärdering av skuldsaneringslagen* 1995/1996:32 at 95; and *Riksskatterverkets statistik 1998*

<sup>82</sup> See *Riksdagens revisorers förslag angående tillämpningen av skuldsaneringslagen. Förslag till riksdagen 1995/1996:RR* at 16 (Parliamentary revision); and *Lagutskottets betänkande 116/1997:LU6 Tillämpningen av skuldsaneringslagen* at 11-12 (Parliamentary committee).

<sup>83</sup> See U. Reifner, in *Overindebtedness of Consumers in the E*, *Supra* note 4 at 116-20.

Christian values with a social flavour.<sup>84</sup> Reifner identifies the debtor according to this model as a “personal and moral failure.” The *administrative help model* as presented in the French legislation, offers state administrative machinery to facilitate agreements between the debtor and creditors, and, in so doing, invokes governmental pressure on the banks. The *social protection model* is concerned with the needs and situation of the debtor. It is based on the empirical notion that the consumer debtor’s overindebtedness is often due to unemployment, illness, divorce, and other breakdowns in the family.

Because all European debt adjustment laws emphasize overindebtedness as a social problem, the need for consumer re-education and reaffirmation of payment morality, and because they involve a bureaucratic structure, these aspects are more useful in distinguishing the European regimes from the Anglo-Saxon bankruptcy philosophy than in distinguishing the European laws from each other. The same criticism may be directed at Iain Ramsay, who distinguishes between three models of consumer bankruptcy based on whether the law emphasizes the debtor’s deviant behaviour, debt enforcement, or the consumer protection function of bankruptcy.<sup>85</sup> In the new European debt adjustment laws, all three elements are present. They share the same goals of debtor rehabilitation, consumer education, and upholding the general debt payment morality. What is significant is that they seem to prefer somewhat different tools to achieve these goals.

The Scandinavian laws use sometimes cumbersome procedures and detailed disclosure requirements as educational tools, and rely on restricted access to the adjustment machinery as a means of upholding payment morality. The continental laws, on the other hand, emphasize the importance of debt repayment through a plan, both as a means of behaviour modification and as a deterrence against “loose” payment morals. The central importance of the payment plan in the continental laws is obvious while they, unlike other adjustment laws, give weight to the creditors’ acceptance of the plan, impose minimum payment requirements, and require longer plans.

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<sup>84</sup> The model corresponds to the German law proposal before the German Parliament at the time. The proposal was accepted in 1994, but a new chapter on voluntary debt adjustment and payment plans was added, thus changing the nature of the law.

<sup>85</sup> See I.D.C. Ramsay, “Models of Consumer Bankruptcy: Implications for Research and Policy” (1997) 20 J. Consumer Pol’y 269.

**TABLE 1**  
**FOUR MODELS OF CONSUMER BANKRUPTCY**

	<i>Scandinavian</i>	<i>Continental</i>	<i>No Discharge (France)</i>	<i>American</i>
Primary Aim	rehabilitation	repayment	prevention	efficiency
Nature of Law	debt adjustment law	bankruptcy law	consumer protection law	bankruptcy law
Mandatory Counselling	yes	yes	no	no
Filing to	enforcement agency	court	commission	court
Access	restricted	through bankruptcy	broad	open
Exceptions to Availability	broad	creditor acceptance	broad	fraud
Duration of Plan	5 years	7 years	moratorium	3 years
Administering Party	debtor	trustee	debtor	trustee
Bearer of Costs	state	debtor (waiver)	state	debtor
Home Mortgage	Finland and Norway yes; Sweden and Denmark no	no	no	yes
Bar to Subsequent Filing	forever	10/20 years	no	6 years

Table 1, above, presents the consumer debt adjustment and bankruptcy laws, which are reduced to four models in this comparison. The Scandinavian bills emphasize the rehabilitation of the debtor,<sup>86</sup> and reflect what I have called the social approach to consumer bankruptcy.<sup>87</sup> The Continental model is based on the German and Austrian laws. While it shares the concerns of the Scandinavian model, it clearly puts more emphasis on repayment of the consumer's debts. Control of the debtor focuses on plan fulfilment, not on how the debts were incurred.

The fundamental difference between Anglo-Saxon consumer bankruptcy laws and European concerns the notion of the fresh start. The explicit aim of the European debt adjustment laws, contradictory as it may seem, is to rehabilitate the debtor and to promote payment of debts. It is believed that discharge at the end of a five- or seven-year plan gives the debtor an incentive to disclose his or her affairs, cooperate with the cumbersome proceedings, and to complete the plan.<sup>88</sup> This belief may be accurate if the alternative is lifelong indebtedness. It is also true that the debtor has no economic incentive to improve his or her lot during the lifetime of the plan. The incentive problem, though not expressed in these terms, emerged when the European countries had to decide what to do with unemployed debtors. It is often argued that forgiving a debtor's debts, after a moratorium of five years, when the debtor has not paid his or her debts, is immoral.<sup>89</sup> On the other hand, it can equally be argued that whether a debtor is employed at the moment of filing for debt adjustment is only arbitrarily related to whether the debtor is "deserving" or not. Discharge is often hard to get for a young, unemployed debtor who may need it most, because of the courts'

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<sup>86</sup> See *Reg. Prop. 1993/1994:123 supra* note 22 at 36, and *Reg. Prop. 183/1993 supra* note 23 at 22.

<sup>87</sup> The Scandinavian model is based on the Swedish and Norwegian laws, and does not reflect the Danish and Finnish laws accurately. The rehabilitative aim of the law is, however, even more efficiently realized by the latter laws, since they have bureaucratic layers and less restricted access.

<sup>88</sup> The German bill and discussions about it were quite explicit about this. The possibility of discharge was seen as an incentive to timely filing for bankruptcy, to ensure the debtor's cooperation in bankruptcy, and to reach more assets in the bankruptcy estate. See *Diskussionsentwurf supra* note 39 at 28-29; *Regierungsentwurf supra* note 39 at 82, 86; F. Wenzel, "Restschuldbefreiung bei Insolvenzen von Verbrauchern" (1990) *Verbraucher und Recht* 21; and M. Balz, "Aufgaben und Struktur des künftigen einheitlichen Insolvenzverfahrens" (1988) *ZIP* 273 at 292.

<sup>89</sup> For example, creditors interviewed by the Swedish consumer authority expressed this concern: see *Utvärdering av skuldsaneringslagen, Konsumentverket* 1995/1996:30.

reluctance to accept zero-payment plans,<sup>90</sup> or because access to debt adjustment is restricted by law.

The uneasy marriage of morality and economic efficiency is also evident when considering the results of plans. The average proceeds of the plans seem to be less than 15 per cent of total debt, and many debtors are not able to contribute at all.<sup>91</sup> It is questionable whether this low rate of repayment is worth the delay in the debtors' economic recovery and the loss of economic efficiency it causes. However, it needs to be emphasized that the rationale of the payment plans is not only economic but also moral.

The morality that the European countries are trying to foster goes further than the traditional bankruptcy morality of "the honest but unfortunate debtor" of *Local Loan Co. v. Hunt*.<sup>92</sup> All of the European laws exclude fraudulent debtors, but they also exclude debtors who have accumulated excessive debts, worsened their economic position in other ways, and have made no serious attempts to repay the debts. The European laws attempt to police the conduct of debtors in a credit society. Not only fraud but also reckless behaviour is punished. The educational approach also emphasizes the need for prudent conduct in the credit market, and counselling is perceived as a necessary tool to achieve this new morality.

The problems with this approach, especially if applied broadly as it is in Scandinavia, concern both economic efficiency and fairness. Case law shows that many debtors with very serious debt problems are left without a remedy. These debtors are still excluded from the credit society and their economic efficiency is impaired. When much judicial discretion is left to the pre-screening authorities, consistency and fairness become a concern. Even the criteria are suspect. Sheer inability to handle credit leads debtors in trouble without any malicious intent. Because these debtors have caused the problem themselves by using an unreasonable amount of credit, their filings are often dismissed. However, one is entitled to ask whether the inability to handle credit really shows that debtors are less deserving than others.

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<sup>90</sup> See *Utvärdering 1995/1996:34* *supra* note 73 at 19.

<sup>91</sup> For example, in Sweden the plans confirmed by the enforcement officials generated 13 per cent of the debts and 40 per cent of debtors did not make any payments. In the court proceedings, the numbers were 4 per cent of the debts, and 75 per cent of the debtors with no payments: see *Utvärdering 1995/1996:34* *supra* note 73 at 36. In Finland, a study found an average payment of 14 per cent: see Tala *et al.*, *supra* note 21 at 57; and Muttilainen & Tala, *supra* note 21 at 40.

<sup>92</sup> 292 U.S. 234 at 244 (1934).

Consider the following examples. In Sweden, a couple with a total debt of 478,000 Swedish crowns (US\$80,000) was denied debt adjustment. They had not suffered a loss of income and they had used the money to buy household items and a car. They had no income above the subsistence level. The court reasoned that it would be against payment morality if they were allowed to go unpunished. Considering that the couple had seven children, one wonders if a discharge granted to debtors like them would be likely to undermine the general payment morality. In Finland, a debtor who had co-signed the consumer loans of two other persons was denied debt adjustment because he had signed a loan while unemployed, and should have known that he would not be able to repay.<sup>93</sup> The morality of co-signing a loan often involves factors beyond the economic rationales the debt adjustment laws are trying to pursue. Frequently, loans are co-signed by family members, friends, and even employees, who may consider it a moral obligation.<sup>94</sup>

## V. CONCLUSION

The European debt adjustment laws were more often than not introduced by conservative governments. Politically, they are part of a movement towards a more rigorous market economy in Western Europe. Simultaneously, the laws were introduced to alleviate the economic crisis caused by the recession at the beginning of the decade. In a way, they reflect a new market-oriented social policy. Because of the recession, the need for such laws was so obvious that the laws met hardly any opposition at all.

In the bankruptcy context, the laws have been part of a broader effort to reform the bankruptcy laws to address the needs of a more liberal market economy. One aspect of this reform policy has been the reduction of many debt repayment priorities in bankruptcy. Some countries have abolished practically all priorities, including priorities for

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<sup>93</sup> See Supreme Court KKO 1995:17. See also "Kvinnoperspektiv på skuldsanering," *supra* note 58.

<sup>94</sup> Criticism has been voiced about the broad discretion exercised by the offices in Scandinavia, but so far it has not led to changes in law. In 1998, a Parliamentary question in Norway, and the Minister's answer to it, expressed the government's intention to define access to the adjustment process more accurately than was there the case. For Denmark, see references cited in note 53, *supra*.

taxes, retirement fund payments, and spousal obligations.<sup>95</sup> If these two reforms are combined, the creditors face a trade-off between discharge of debts and the abolition of priorities for public claims.

Consequently, the fresh start of the European debtor is delayed by the payment plan; however, when the debtor finally receives it, it really is a fresh start. All debts are discharged with the exception of child support obligations.<sup>96</sup>

The European experience casts light on some topics in the American reform discussion. In the European assessment, the mandatory payment plans work well. However, making a plan work is neither easy nor free. The design of, and compliance with, mandatory payment plans usually requires support from professional counsellors. Most plans do not survive for five years and have to be revised. Often this requires a whole new procedure, including counselling, consultation with creditors, and the drafting of a new plan. In Europe, adjustment plans are considered a good investment, and on completion of the plan the debtor obtains a fresh start, even if it is delayed.

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<sup>95</sup> Austria and Denmark had already abolished most priorities before the debt adjustment laws were introduced. In Finland, these two reforms were explicitly bundled together. In Sweden, the public claim priorities are still strong, but they are not applied in debt adjustment proceedings.

<sup>96</sup> In the United States, it has been argued that the “fresh start” in bankruptcy is not so fresh anymore: see W.C. Whitford, “Changing Definitions of Fresh Start in U.S. Bankruptcy Law” (1997) 20 *J. Consumer Pol’y* 179 at 191. Many preferential debts, most importantly taxes and alimony payments, are excepted from discharge. Also, the debtor may make an affirmation agreement with one of his or her creditors to pay the debt despite bankruptcy, a widely-used practice.