Consumer Bankruptcy - the Direction of Legislative Changes

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Abstract: The proposed changes in relation to consumer bankruptcy may constitute a revolutionary legislative change in relation to debtors. Liberalization of regulations in this area will lead to increased amounts of announced consumer bankruptcies. It seems, however, that the proposed changes disturb the balance between the need to protect the interests of creditors and support the legal protection of the debtor. The key is to determine whether State's task is to protect creditors against insolvent debtors or to support unreliable debtors. Too loose the introduction of legislative changes can significantly reduce social morale and encourage citizens to take unfair actions. The author undertakes an attempt to critically evaluate the proposed changes, referring both to its positive aspects and negative aspects. At the same time, he points out those legal solutions that may have negative consequences for legal transactions, as well as may be subject to negative public perception.

Keywords: bankruptcy, consumer law, law reform

Introduction

The bankruptcy of a natural person not conducting business activity was introduced into the Polish legal order on March 31, 2009, enjoying the variable popularity among debtors. "Consumer bankruptcy", as this legal institution in Poland was adopted under that name, in the first assumption it was to be a privilege for a reliable debtor (Adamus, Witosz, Witosz, 2009, p. 23). The legislator imposed on the debtor applying for the declaration of bankruptcy an obligation to prove before the bankruptcy court that this exceptional and independent from the debtor's circumstances led him to a state of insolvency, which was then to be the basis for the bankruptcy court to decide on the declaration of bankruptcy. The privilege for a debtor who obtained the status of a bankrupt was that after the bankruptcy proceedings had been closed, his unfulfilled liabilities in the course of the bankruptcy proceedings were being canceled, and thus the debtor was given a chance for a "new start" in life. In practice, however, "consumer bankruptcy" in the indicated formula was not successful, because in most cases the bankruptcy court dismissed the application for the declaration of the bankruptcy of the debtor due to the fact that the debtor did not present the reasons for its announcement. In the last year of the regulation, regarding the "consumer bankruptcy" in its original word in Poland, 31 bankruptcy of natural persons not conducting business activity (2014) were announced for 300 submitted applications[1].

[1] Justification to the draft bill dated 18 April 2018 „o zmianie ustawy – Prawo upadłościowe oraz niektórych innych ustaw", number from the list UD357, retrieved from http://legislacja.rcl.gov.pl.

The year 2015 brought a fundamental change to the regulations regarding consumer bankruptcy. The legislator has decided to introduce a different model of conditions determining the declaration of bankruptcy. Positive premises were omitted, such as the necessity of the debtor demonstrating that the insolvency situation was caused by exceptional circumstances beyond his control, and the principle that consumer bankruptcy is always announced in relation to the debtor, unless negative premises were found, conditional on dismissal application for bankruptcy. Therefore, consumer bankruptcy ceased to be a privilege for the debtor and became the rule. The legislator imposed on the bankruptcy court an obligation to dismiss the application for bankruptcy only in a situation where the debtor led to his insolvency or significantly increased its degree intentionally or as a result of gross negligence. The introduced amendment significantly increased the number of declared bankruptcies and "consumer bankruptcy" has become a more and more popular way to indemnify debtors. And so, already in the first full year of application of the Act in a modified form in Poland (in 2015), 5.616 applications for bankruptcy were submitted to courts, of which 2.220 cases ended with the declaration of bankruptcy[2].

Currently, therefore, "consumer bankruptcy" is very popular, and the fact that since 2016 there has also been a change in the rules that insolvency proceedings under the provisions on consumer bankruptcy can be carried out against former entrepreneurs within one year of deleting them from the relevant register or ceasing to run their business activity, contributed to an even greater increase in the declared bankruptcy towards consumers. Commercial departments for bankruptcy and restructuring issues flooded the wave of applications for the declaration of bankruptcy of consumers, with a relatively small number of bankruptcy cases for entrepreneurs.

Recently, however, efforts have been made to liberalize the provisions of law regulating consumer debt default, which, in the opinion of the Ministry of Justice, is justified by the need to improve the conduct of the proceedings. In the justification to the draft bill, it was pointed out that the regulations on consumer bankruptcy are characterized by some weaknesses, including the time when the court is forced to examine the negative conditions for bankruptcy, and in particular to investigate whether the debtor led to his insolvency or significantly increased it intentionally or as a result of gross negligence[3]. Therefore, in the view of the project promoter, these activities significantly affect the length of the course of proceedings preceding the bankruptcy court's decision on the declaration of bankruptcy, the so-called proceedings regarding the application for bankruptcy, which should result in a significant legislative change. In practice, however, the recognition of the application for the declaration of consumer bankruptcy is limited to determining by the bankruptcy court one date of the hearing, after which the judgment is issued by the court resulting in the declaration of bankruptcy of the debtor or dismissal of the application, and cases where the court is forced to postpone the hearing, taking further steps to establish negative premises for the bankruptcy of the debtor, are marginal.

The prepared amendment to the Act introduces three fundamental solutions. In particular, it is proposed to drop the examination by the bankruptcy court whether the debtor led to its insolvency or substantially increased its degree intentionally or due to gross negligence, which should be considered the main objective of the amendment, as well as consumer bankruptcy may also be carried out against an entrepreneur who did not submit an application for declaration of bankruptcy, running a business, and was legally obliged to do so, except of course the situation when the court ruled against him against art. 373 of the Bankruptcy Act[4]. As a result, the

[2] Justification to the draft bill dated 18 April 2018 „o zmianie ustawy – Prawo upadłościowe oraz niektórych innych ustaw", number from the list UD357, retrieved from http://legislacja.rcl.gov.pl.

[3] Justification to the draft bill dated 18 April 2018 „o zmianie ustawy – Prawo upadłościowe oraz niektórych innych ustaw", number from the list UD357, retrieved from http://legislacja.rcl.gov.pl.

[4] Act of February 28, 2003 „Prawo upadłościowe", Dz.U.2017.2344 j.t.

proposed changes to the provisions also provide for the possibility of concluding a debtor with the creditors outside the bankruptcy proceeding, which arrangement would only be subject to approval by the bankruptcy court. The proposed assumptions of the project promoter should be assessed partly negatively.

It should be noted that while the possibility of entering into an arrangement with creditors may significantly accelerate the course of bankruptcy proceedings, it is difficult to conclude that depriving the bankruptcy court of the need to investigate whether the debtor's gross actions led him to a state of insolvency finds rational justification. It is necessary to answer the key question whether the legal provisions are to provide legal protection to an unreliable debtor, or rather to protect the creditors against unreliable debtors (Gurgul, 2016, p. 954). There is no doubt that the announced change in the provisions of the bankruptcy law may lead to granting legal protection also to those debtors who consciously undertook actions aimed at achieving their insolvency, i.e. being in an insolvency state incurring further liabilities.

The analysis of the project leads to the conclusion that its authors assumed that grossing the debtor's state of insolvency may result in a plan for the repayment of liabilities for a longer period, but it does not mean that the debtor will be deprived of the possibility of their redemption at all, thus the unreliable debtor will take advantage of the privilege of remitting its obligations. Consumer bankruptcy, in the proposed model, can also be a signal for citizens that the state protects those who behave in a dishonest and reckless way by incurring new obligations, while being aware of the fact that they do not intend to repay them. The argument that should determine the direction of the proposed changes are financial issues, i.e. the principles of financing the bankruptcy process in the course of consumer bankruptcy. It should be noted that consumer bankruptcy is announced against debtors who, as a rule, no longer have any assets. As a result, it means that the costs of bankruptcy proceedings pursuant to art. 491^7 par. 1 of the Bankruptcy Act are covered by the State Treasury (Zimmerman, 2016, p. 953). In the proposed model of changes in consumer bankruptcy, there is likely to be a significant increase in the number of consumer bankruptcies announced and, as a result, significant expenditure on the State Treasury (Gurgul, 2016, p. 943). Despite the fundamental change in the regulations concerning a non-commercial natural person, which is the adoption of the principle that consumer bankruptcy is to be announced in relation to each debtor who submits such an application, it is worth paying attention to other proposals for legislative changes to be verified. In practice, they can also raise doubts.

In particular, the legislator in the proposed model, providing for the possibility of requesting the bankruptcy of the debtor by the creditor, imposes on the creditor, who is the initiator in this respect, an advance payment for the costs of bankruptcy proceedings pursuant to art. 22a of the Bankruptcy Act. This change should be assessed positively, in the context of the above-mentioned arguments about excessive encumbrance of the State Treasury with expenses related to the bankruptcy proceedings. Creditors interested in declaring the debtor's bankruptcy would be, however, only in the beginning, to finance it. Thus, it would significantly limit the expenditure of the State Treasury.

The wide development of ICT solutions should also result in introducing changes to increase the effectiveness of actions taken by the bankruptcy court and the judge-commissioner. Therefore, the proposed change should be positively assessed by introducing the possibility of an "official" procedural law, contact with the debtor and then the bankrupt, with the court by e-mail or by telephone. This can significantly accelerate the course of bankruptcy proceedings, the essence of which is often the need to take urgent and efficient actions.

Actions to speed up the bankruptcy proceedings, while respecting the need to protect the interests of creditors, include the proposed change, referred to above, regarding the possibility for the court to approve the arrangement with creditors in a situation where the arrangement has already been concluded before bankruptcy. The bankruptcy court would therefore only legally sanction the creditors' arrangements with the debtor. Thus, the settlement of a debtor's dispute with creditors is usually the best legal solution, because it

takes into account mutual compromises between parties and because of achieving a level of satisfaction for each party is a guarantee that this state of affairs will allow for a successful conduct of bankruptcy proceedings. However, it is necessary to ensure that the actions undertaken in this area bring measurable real results.

The legislator in the regulations governing the bankruptcy of a natural person who does not conduct business activities, also provided for the possibility of the court appointing a temporary court supervisor. This institution has so far been known in the proceedings regarding the declaration of bankruptcy in relation to the entrepreneur. The introduced legal solution may therefore contribute to obtaining by the court of bankruptcy credible information related to the financial situation and, in a sense, the life candidate for the bankrupt. However, the condition for the establishment of a temporary court supervisor will be filing for bankruptcy by the creditor or debtor, who will make it probable that he has no assets.

The adoption of the proposed legislative changes and their entry into force certainly, in particular in the first years of the validity of the law, will lead to an enormous increase in the number of cases that will result in the declaration of the debtor's bankruptcy. Therefore, assuming an increase in the number of bankruptcy proceedings, the legislator also provided for the possibility of appointing a judge-commissioner of the court registrar (rechtspfleger) to perform the duties of a judge. However, the competence of the court registrar (rechtspfleger) in this respect has been limited by the legislature. The court registrar (rechtspfleger) acting as judge-commissioner has been excluded from the possibility of applying coercive measures to the bankrupt, the right to proceed with the division plan and the list of claims will be denied. Indicated activities will still belong to the judge-commissioner, whose function in this area in the given proceedings is still to be performed by a professional judge. Therefore, the tasks of the court registrar (rechtspfleger) as a judge-commissioner are marginal, although in effect he will supervise the entire bankruptcy proceeding, and he was therefore able to act efficiently in its course. Nevertheless, it is mainly the course of bankruptcy proceedings that is determined by the actions taken by the trustee. Exercising supervision over a trustee in a situation where the appointed judge-commissioner cannot use coercive measures against him seems to be ineffective. In fact, it should be remembered that the judicial system can in principle be exercised in Poland by judges, whereas the court registrar (rechtspfleger) is authorized only to take actions in the scope of non-judicial legal protection (Article 2 (2) of the Law on the system of common courts)[5]. Hence the need to strictly and lawfully define its competence in bankruptcy proceedings, which the project promoter does not do enough.

The project promoter also proposes a legal solution, according to which the debtor's obligations may be remitted on the date of the announcement of his bankruptcy without the obligation to set a repayment plan (Zimmerman, 2016, p. 1004). The condition for the declaration of bankruptcy along with the waiver of liabilities will be the necessity to prove that the bankrupt has no assets. From the practical point of view, it will mean that in fact bankruptcy proceedings will end with the dismissal of the bankrupt's obligations already on the date of declaration of bankruptcy. Undoubtedly, this will affect the speed of the bankruptcy proceedings, essentially causing that they will not be carried out at all, but it will also mean affirming the attitudes of unreliable debtors.

Another proposed legislative amendment requiring a comment are legal solutions regarding the advance granted to the receiver against the costs of bankruptcy proceedings. At present, such an advance payment may be granted to the receiver only in particularly justified cases. After the assumed changes, the receiver will receive such an advance always after the bankruptcy. This will undoubtedly affect the costs of the State Treasury's bankruptcy proceedings, while at the same time it should be noted that in the majority of cases these advances may be unrecoverable due to the debtor's lack of property to cover the costs of bankruptcy proceedings. However, the announced legislative change is part of the planner's assumption that bankruptcy

[5] Act of July 27, 2001 r. „Prawo o ustroju sądów powszechnych", Dz.U.2018.23 j.t.

proceedings conducted in relation to natural persons who do not conduct business activity are to be financed by the State Treasury in the event of lack of debtor's assets to carry them out.

The content of the project also implies that the only sanction for deliberately leading the debtor to his insolvency or gross negligence will be the extension of the duration of the repayment plan by the debtor. So far, the above circumstances have been a negative condition for the bankruptcy of the debtor. The content of the project shows that the duration of the repayment plan in such a case cannot be shorter than 48 months (4 years) and longer than 84 months (7 years). In the current legal status there is only one lower limit of 36 months (3 years). Comparison of the number of months 36 and 48 as a way of differentiating the attitude of a reliable debtor and an unreliable debtor seems to be a less educational activity. The project promoter thus assumes that the period of one year of repayment of liabilities is to be a "punishment" for the debtor for causing his insolvency intentionally or as a result of gross negligence. It is difficult to conclude that such legal solutions will discourage debtors from taking unreliable actions aimed at increasing their state of insolvency, because regardless of the attitude presented in the economic turnover, the situation of an unreliable debtor will not be significantly worse than the situation of a reliable debtor. He will still be able to count on the declaration of bankruptcy and the remission of his obligations.

Finally, at the end, it is worth signaling the proposed legal solution consisting in introducing the possibility of conditional remission of the debtor's obligations without fixing a repayment plan in a situation where none of the creditors submits within 7 years from the day when the conditional clause of the application for setting a repayment plan becomes final, as a result of which court will revoke the conditional termination of the liabilities without fixing the repayment plan and establish the repayment plan. The indicated legal solution for conditional redemption of liabilities may take place when the inability to make any repayments under the plan of repayment of creditors resulting from the personal situation of the bankrupt is not permanent. Thus, improvement of the debtor's life situation will result in the court being able to "withdraw" its decision on conditional remission of the debtor's obligations without fixing the repayment and order the debtor to implement the repayment plan. The proposed change should therefore be assessed positively in the context of the need to increase the protection of creditors' rights and to the extent to which the decision of the bankruptcy court is of a reversible nature. The institution of conditional cancellation of obligations is, however, debatable due to concerns about the assessment of the financial situation of the debtor by the creditors themselves, as well as about the chances that they will recover their liabilities. Doubts may also apply to the assessment of the situation by the debtor, who will not be sure about the prospects of his economic situation in the future, and which in turn will be able to determine his further decisions.

The final assessment of the proposed legislative changes concerning consumer bankruptcy leads to the conclusion that the intention of the project promoter is to undermine the fundamental objective of the bankruptcy proceeding and breach of its previous concept. Bankruptcy proceedings in relation to consumers are not to be carried out already in order to satisfy claims of the bankrupt's claim, and its sole purpose is to enable the bankrupt's obligations not fulfilled in bankruptcy proceedings to be canceled (Article 2 of the Bankruptcy Act) (Witosz, 2016, p. 1280). The main assumptions of the bankruptcy proceedings that have been guiding since the beginning of this proceeding are that bankruptcy proceedings are to constitute an alternative way for claimants to pursue claims, which is to be expressed through a single, group, fair manner of their "enforcement" from the debtor. It seems, however, that the path chosen by the promoter is aimed at protecting unreliable debtors while, unfortunately, harming the rights of creditors. In the new consumer bankruptcy model, creditors will have a real chance of satisfying their claims in a marginal manner, since consumer bankruptcy and the related debt cancellation will be a rule for debtors regardless of the measurable effects on the creditors.

Of course, one can agree with the statement that in some cases creditors contribute to the insolvency of debtors, for instance by "hasty" granting loans to debtors without reliable prior verification of their financial capacity to pay their debts. Nevertheless, the proposed legal changes by the project promoter are too far-reaching and can affirm negative attitudes in society, giving a clear signal to unreliable debtors to allow you to take such actions. Undoubtedly, the implementation of the proposed change project will provide an opportunity for debtors to return to function in society, take up employment without fear of losing part of the remuneration, and thus will be a kind of motivation for further actions in life. Do not forget, however, that the source of financing for new legal solutions will take place in the State Treasury budget. Each of us will indirectly cover the costs of the bankruptcy proceedings of an unreliable debtor, because in such a situation these costs will also be financed from the State Treasury. Therefore, the proposed legal changes will undermine the legitimate interests of all citizens, in particular citizens who are diligently and sensibly functioning in society.

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