

THE ROLE OF HISTORY AND CULTURE IN DEVELOPING BANKRUPTCY AND INSOLVENCY SYSTEMS: THE PERILS OF LEGAL TRANSPLANTATION

NATHALIE MARTIN*

I. INTRODUCTION.

Does culture shape law or does law shape culture? Throughout history, culture has taken the leading role by informing society of what laws are necessary and appropriate.¹ Today, however, global economics are rapidly changing the world, and credit - particularly consumer credit - is being offered in greater amounts and to greater numbers of people in more countries than ever before.² Commercial borrowing is also on the rise. One question raised by these increases in debt is whether there will be sufficient safety nets in place to help people and entities that are unable to pay back all this new debt.

Many governments with developing economies are aware of the need for more forgiving insolvency systems, and are implementing such systems.³ In most cases, however, these new proposed systems do not arise from existing cultural conditions. Rather, the laws are transplanted from elsewhere and the cultural views are expected to change with the laws. Many new bankruptcy laws have been transplanted from the U.S., which has a very different cultural attitude toward debt forgiveness.⁴ Although these

* Associate Professor of Law, University of New Mexico School of Law. The author thanks Karen Gross, Frederick Hart, Christian Fritz, and Antoinette Sedillo-Lopez for their helpful comments on earlier drafts of this Article, as well as Michael Plante, Richard Moran, Jennifer Breakell, Caitlin DiMotta, and Scott Jaworski, for their fine research assistance.

¹ Linz Audain, *Critical Cultural Law and Economics, The Culture of Deindividuation, The Paradox of Blackness*, 70 IND. L. J. 709, 713-14 (1995) (discussing generally how culture informs law and economics and vice versa); Naomi Mezey, *Law as Culture*, 13 YALE J.L. & HUMAN 35, 37 (2001) (describing law as culture).

² See *Growth of Credit Cards in Emerging Markets Leading to Concern Over Mounting Consumer Debt and Card Fraud*, M2 Presswire, October 15, 2002, 2002 WL 26804947 (describing skyrocketing credit card debts in China, South Korea, Brazil, and Thailand); Paul Mizen, (paper published by the Experian Centre for Economic Modeling, School of Economics, University of Nottingham), at 1, <http://nottingham.ac.uk/eco>, visited on March 3, 2003. European Credit Research Institute, *ECRI Research Report Number 1, Consumer Credit in the European Union*, at 16-18, <http://www.ecri.be/pubs/ecrien>, visited on March 2, 2003 (noting tremendous increases in credit card debt in Europe); Ian Fletcher, *Card Fraud Soars to Pounds 228M*, EVENING STANDARD, Oct. 16, 2002, 2002 WL 101323704 (noting mounting credit card debt throughout the United Kingdom, Mexico and Malaysia, as well as China, South Korea and Thailand); Jason Booth, *KIS Investors Bet on South Korea's Rising Debt*, WALL STREET JOURNAL, May 30, 2002, 2002 WL 3396232 (discussing the U.S. and South Korean levels of credit card debt and predicting a consumer-credit blowout in South Korea that could slow the entire economy).

³ See Rafeal Efrat, *Global Trends in Personal Bankruptcy*, 76 AM. BANKR. L.J. 81, 92-93 (2002).

⁴ See Julia M. Metzger & Samuel L. Bufford, *Exporting United States Bankruptcy Law: The Hungarian Experience*, 21 CAL. BANKR. J. 153, 153 (1993) (noting how other countries are looking to the U.S. for an example of a working bankruptcy system). Article 9 of the U.C.C. is also being examined by other countries. See Daniel E. Allen, *Personal Property Security Interests in Australia, A Long, Long Trail A-Winding*, 106 DICK. L. REV. 145, 147 (1991) (discussing how New Zealand, Canada, Australia and even

imported systems have been strangely out of place in other societies, the transplantation continues.⁵ This Article raises the question of whether these attempts at transplantation are likely to create the desired results of fueling a market economy and promoting economic growth and well-being.

The current American bankruptcy system grew directly out of the U.S.'s unique capitalist system,⁶ which rewards entrepreneurialism as well as extensive consumer spending.⁷ It makes sense that a society in which dollars rule would have a forgiving personal bankruptcy system in order to keep consumer spending high,⁸ and an equally forgiving business reorganization system to encourage risk taking and economic growth.⁹ Both systems are part of a larger scheme to keep economic players alive and active in the game of capitalism. American bankruptcy systems are among the country's few social programs and address many of society's ills.¹⁰ Thus, they are broad and form an integral part of the social system from which they sprung.¹¹

As globalization takes place, more and more countries believe that creating a viable bankruptcy system will help fuel a market economy.¹² As a result, many countries have attempted to create a Chapter 11-style reorganization scheme for failing enterprises, in which existing management stays in place and manages the reorganizing company.¹³

England, are looking to Article 9 of the American Uniform Commercial Code to solve a few nagging problems with personal property security systems in their own countries' laws).

⁵ See *infra* notes 409-37 and 482-511 and accompanying text.

⁶ As one American scholar recently noted:

[E]ach country gets the bankruptcy law it deserves. I think we deserve chapter 11. Bankruptcy does not exist independent of the social system that exists in each nation. The United States has little in the way of government sponsored programs to compensate people for the dislocation caused by financial failure. So every financial problem, and that is not hyperbole, I think that's almost true, every consequence of every financial problem is thrown into our bankruptcy system: environmental problems, mass tort problems, business failure problems, failure of companies properly to fund their retirement plans. Whatever the reason for financial failure, the only place we have to put it is bankruptcy.

Richard F. Broude, et al., *The Judge's Role in Insolvency Proceedings: Views From the Bench: Views from the Bar*, 10 AMER. BANKR. INST. L.REV. 511, 522 (2002) (comments of Richard Broude) (hereinafter, "*Views from the Bench*").

⁷ Spending is critical to the U.S. economy, as President Bush reminded us after 9/11. Frequent admonitions to spend caused one author to call this the "shop-till Osama-drops" plan for fighting terrorism. See Alan Reder, *The Yoga of Money*, YOGA JOURNAL, March-April 2003, at 114.

⁸ "When will we Spend Again?," October 26, 2001, www.cnn.com, visited on January 7, 2003.

⁹ See *infra* notes 157-198 and accompanying text.

¹⁰ See *supra* note 6; see also KAREN GROSS, FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM 93-98 (1997) (describing the incredible emotional benefits of bankruptcy, which in turn benefit the economy as well as the persons well being).

¹¹ In the United States, we do not draw large distinctions between our forgiving "rescue" culture for businesses on the one hand, and for individuals on the other. Philosophically, every person is a potential entrepreneur. See EDWARD J. BALLEISEN, NAVIGATING FAILURE: BANKRUPTCY AND COMMERCIAL SOCIETY IN ANTEBELLUM AMERICA 28 (N. Carolina Press 2001).

¹² The International Monetary Fund certainly believes this and made creation of a reorganization system for failing businesses a prerequisite to bail-out assistance during the Asian crisis. See *Thailand Letter of Intent*, dated August 25, 1998, <http://www.imf.org/external/np/loi/082598.htm>, visited on March 26, 2003.

¹³ The rationale is that providing for rescue opportunities creates additional benefits to society not available in a liquidation only system, such as greater return for unsecured creditors, an ability for equity holders to

These systems are perhaps the most common American legal export today.¹⁴ Many countries are also liberalizing their consumer bankruptcy systems.¹⁵ Because consumer credit has become much more available in Western Europe and Japan, as well as parts of the developing world, more forgiving bankruptcy systems are a necessity.¹⁶ They cannot be imported wholesale, however.

Insolvency systems profoundly reflect the legal, historical, political, and cultural context of the countries that have developed them. Thus, even countries that share a common legal tradition, such as the United States, England, Canada, and Australia, display marked differences in how they approach both business and personal bankruptcies.¹⁷ Countries with different legal traditions, such as those within Continental Europe and Japan, currently have even more divergent bankruptcy systems, though many are moving toward the U.S. models.¹⁸

Given the vast cultural differences around the world, and the history of each country's economy and attitudes about money and debt, there is no one-kind-fits-all bankruptcy system for either enterprises or individuals.¹⁹ New insolvency systems must instead reflect how individual nations have experienced the growth of market economies, and how, philosophically, countries have viewed debt. Bankruptcy systems are social tools. As such, they are value-laden and must be drafted with care to reflect the particular values of a culture. Yet the extensive availability of credit requires a face-saving way out of financial failure. Providing such a way out is a challenge many nations will face as credit is used more extensively in the new modern economy. This Article attempts to aid this transition in some small way, by helping inform the decisions made within developing systems.

Part II of this Article explains the symbiotic relationship between capitalism and bankruptcy laws, the theories behind these laws, and the history and political systems

retain an interest in a viable company, saving jobs, allowing suppliers to survive and allowing customers to continue receiving goods and services that may be in short supply. See Jeffrey Davis, *Bankruptcy, Banking, Free Trade, and Canada's Refusal to Modernize its Business Reorganization Laws*, 26 TEX. L. REV. L. J. 253, 253 (1991). Liquidation, conversely, can cause a domino of failure, unnecessarily harming everyone whom the debtor does business. See *id.*

¹⁴ Metzger & Bufford, *supra* note 4, at 154. Initiatives to replicate at least some of the properties of Chapter 11 can be seen in Japan, Western Europe, Eastern Europe, China, the former Soviet Union, and Mexico, among other places. See *id.*

¹⁵ See Efrat, *supra* note 3, at 92-93. Some countries, such as Italy and France, still have no personal bankruptcy system at all. See *infra* notes 347-70 and accompanying text.

¹⁶ See Rafael Efrat, *The Rise and Fall of Entrepreneurs: An Empirical Study of Individual Bankruptcy Petitioners in Israel*, 7 STAN. J.L. BUS. & FIN. 163, 165-66. (discussing the need for a forgiving bankruptcy systems once credit has been deregulated).

¹⁷ See Nathalie Martin, *Common Law Bankruptcy Systems: Similarities and Differences*, 11 AMER. BANKR. INST. L. REV. 367, 403-10 (2003).

¹⁸ See *infra* notes 262-302, and 375-411 and accompanying text.

¹⁹ One may not simply reproduce Chapter 11, with its emphasis on the enterprise, the shareholders and the creditors, in societies that place more value on employees and government debt than on payments to private creditors. Nor can one expect a society that deeply values a person's word, and his or her "honor," to readily accept the personal bankruptcy discharge, even if doing so would fuel an economy based on consumer spending.

upon which they are based.²⁰ This section also describes modern credit practices and attitudes toward debt and repayment.²¹ It then briefly describes the American bankruptcy systems that developed out of this economic history.²²

Part III discusses divergent attitudes toward debt in other parts of the world, using England, parts of continental Europe, and parts of East Asia as examples.²³ While many of these countries and regions have imported U.S.-style bankruptcy laws to some extent, all have far less forgiving cultural views toward debt and debt forgiveness than does the U.S.²⁴ Given these pronounced differences in attitude, this Section concludes that the mere import of U.S.-style reorganization and personal debt forgiveness systems is unlikely to create the desired economic effect.²⁵

Part IV describes the global trend toward credit proliferation and concludes that countries must carefully examine cultural views and attitudes before allowing credit to spin out of control in their countries.²⁶ If it is too late, and credit is already widely available despite very negative stigma toward failure, this section advocates large-scale education efforts in order to keep people from becoming indigent, or even suicidal, following mounting debt.²⁷ It ultimately concludes that while importing a more forgiving bankruptcy system may help stem these problems, without changes in cultural attitudes, these new laws may have little impact.²⁸

II. BANKRUPTCY IN THE UNITED STATES: HISTORY, ATTITUDES AND LAW

This Section outlines the history of the U.S. growth economy and the unique entrepreneurial spirit that led to an equally unique bankruptcy system for both businesses and consumers.²⁹ It also discusses the development of consumer and credit culture and the laws that have developed from these unique quirks of history.³⁰

A. The History of the American Economy: The Connection Between Bankruptcy Law and Capitalism

²⁰ See *infra* notes 31-198 and accompanying text.

²¹ See *infra* notes 118-45 and accompanying text. This section discusses recent empirical research regarding the types of debts that Americans have, as well as the circumstances many individual debtors face when they file for bankruptcy. It briefly examines business or corporate debt culture in America as well, concluding that there is little stigma associated with business failure in the United States, given the premium Americans place on entrepreneurialism and risk taking.

²² See *infra* notes 146-98 and accompanying text.

²³ See *infra* notes 199-510 and accompanying text.

²⁴ See *id.*

²⁵ See *infra* notes 507-10 and accompanying text.

²⁶ See *infra* notes 511-20 and accompanying text.

²⁷ See *id.*

²⁸ See *infra* notes 517-20 and accompanying text.

²⁹ See *infra* notes 31-65 and accompanying text. One of the goals of this section is to explain to foreign scholars who are studying the U.S. insolvency systems, as well as to American scholars, how the American system came into being and how it fuels U.S. capitalism and entrepreneurialism.

³⁰ See *infra* notes 66-71 and accompanying text.

Relatively speaking, American society can be characterized as capitalistic and consumeristic, although the extent to which America should embrace these two ideologies has been controversial throughout our history.³¹ Early discussions of bankruptcy policy were divisive, in part because early bankruptcy policy helped shape our nation's economic identity.³² The expansion of capitalism and spending resulted in some failure, followed by the creation of our first bankruptcy system.³³ This section reviews the economic culture from which this bankruptcy system arose.³⁴

1. The Development of America's Free-Market Economy.

Alex de Tocqueville's "new model man" portrayed America as a child of the commercial revolution that should progress quickly toward commercial and industrial maturity.³⁵ This model saw economic prosperity, technical development, education and expanded cultural opportunities as the lynchpins of a successful society.³⁶ On the other hand, the agricultural sector of society rejected these big-business ideas as a threat to their ideal nation of small producers and laborers who earned an honest living working the soil.³⁷ They saw the new merchant and financial capitalists as:

parasites who drop their buckets into wells dug by others.... Unbounded by any connection to honest labor, their profits could accrue to such a level as to enable the capitalist sector to upset the delicate counterpoise of interests that sustain a free and virtuous social order, and substitute a morally vacuous dynamic of market transactions and profit calculations that respects the social identity of neither person nor property.³⁸

In this context, the battle over appropriate bankruptcy laws began. The market capitalists saw the development of a credit-based economy as absolutely essential. Conversely, the

³¹ See Richard C. Sauer, *Bankruptcy Law and the Maturing American Capitalist*, 55 OHIO ST. L.J. 291, 291-97 (1994).

³² See *id.* at 298.

³³ See *id.*

³⁴ This Article does not outline the history of American bankruptcy laws, as this has been done well and extensively by previous scholars. See Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AMER. BANKR. L.J. 325, 336 (1991)(hereinafter, "Evolution of Discharge"); Charles Jordan Tabb, *The History of Bankruptcy Laws in the United States*, 3 AMER. BANKR. INST. L. J. 5, 7 (1995)(hereinafter, "History of Bankruptcy").

³⁵ See *id.* at 291-92.

³⁶ See *id.* at 292.

³⁷ See *id.* These were the Jeffersonian Republicans, who later became Democratic Republicans, and then finally, modern-day Democrats. See DAVID A. SKEEL, JR., *DEBT'S DOMINION* 26 (Princeton Univ. Press 2001).

³⁸ See *id.* at 293. As Sauer notes, this view was not limited to purely southern agrarians. For instance, Benjamin Franklin wrote, "the only honest Way; wherein Man receives a real Increase of the Seed thrown into the Ground, in a kind of continual Miracle wrought by the Hand of God ... as a reward for his innocent Life and virtuous Industry." Benjamin Franklin, *Positions to Be Examined*, Apr. 4, 1769, in 16 FRANKLIN PAPERS 107, 109 (Williams Wilcox ed., 1972). Thus, the Franklin's sentiments illustrates that upon this nation's formation, mercantile capitalism-with its venture capitalists-was not an idea embraced immediately.

agrarian sector of society saw extensive credit as a vice.³⁹ The more a person wished to create a free-market capitalist economy, the more he supported the free availability of credit, as well as a systematic means of dealing with financial failure.⁴⁰

By the early 1800's capitalist interests began to win out over agrarian interests, and a greater number of agrarians began producing food for sale rather than mere consumption.⁴¹ Artisans in turn moved away from customized markets and toward standardized goods for a larger market. More and more Americans entered business as merchants of one form or another.⁴² Burgeoning market-oriented production and surging demand for food and consumer goods fostered great economic growth. In the decades following the War of 1812, Americans produced more cotton, grain, livestock, textile goods, coal, and lumber, than previously thought possible.⁴³ A greater number of Americans began, at last, to have disposable income to spend on house wares, nicer homes, fancier furnishing and clothing and unimproved land.

The expansion of America's market economy, however, depended heavily upon "the credit system"- an intricate tangle of obligations that extended throughout the country's financing production, distribution, and consumption.⁴⁴ America saw itself as a land of great potential, and was thus taken by optimism and a willingness to build and spend far beyond its actual wealth.⁴⁵ Thus, the antebellum economy was structured as much around borrowed money and promises to pay as it was around rivers, roads and canals.⁴⁶

Few merchants could enter business without credit.⁴⁷ Entrepreneurs rarely paid rent, wages, supplies, or transportation costs in advance, nor did they demand cash from their own customers.⁴⁸ A study of the court records of debtors who filed for bankruptcy under the Bankruptcy Act of 1841 showed that the use of credit was common by the mid-1800s.⁴⁹ Thus, by the mid-1800s, many merchants not only paid debts many months after

³⁹ See *id.* at 294-95. These were the Federalists, who later became the Whigs, who then became modern-day Republicans. See Skeel, *supra* note 37, at 26.

⁴⁰ See *id.* Much of this view was predicated on the intangibility of credit. That is, as a primarily agrarian economy, where trade and commerce existed as a real exchange of goods, credit allowed one party to the transaction to "cheat" by receiving something for nothing. In a sense, the idea of credit as a vice to these agrarians makes perfect sense as their timeframe within each commercial transaction was as limited as the perishability of the items they sold. Thus, selling on credit a perishable item that could never be repossessed likely influenced this view.

⁴¹ See BALLEISEN, *supra* note 11, at 26.

⁴² See *id.* at 26-27.

⁴³ See *id.*

⁴⁴ See *id.* at 27.

⁴⁵ *Id.*

⁴⁶ *Id.* at 27-28.

⁴⁷ See *id.* at 26. As Balleisen notes, this dependence on credit was based in part on the development of America's post-revolution brand of market capitalism. *Id.*

⁴⁸ See *id.* at 28 (describing how merchants rarely expected to be paid upon delivery, for agricultural products or finished articles).

⁴⁹ See *id.* generally. Balleisen spent several years in the Northeast branch of the National Archives in Bayonne, and later when it relocated to Manhattan, examining federal bankruptcy records following the passage of the Bankruptcy Act of 1841. Balleisen found that as many as one in three businesses succumbed

they were incurred, but also allowed their own customers to pay them under even slower payment schedules.⁵⁰ Needless to say, this does not make particular business sense, but the free market economy was new and many wanted to participate.⁵¹

The availability of credit was seen as central to reaching economic potential in a capitalist system.⁵² In fact, one scholar had called “systemized credit” the one characteristic of capitalism that distinguishes it from all other economic orders. As the Albany Republican Committee noted in 1837, “the credit system has extended our commerce all over the world - peopled our wilderness - built our cities and villages - founded our colleges and built our schools. It has given us national wealth and individual prosperity.”⁵³ In short, credit was in large part what defined capitalism as well as wealth.⁵⁴

2. *The Rationale and Political Milieu of Early American Bankruptcy Law.*

While credit was seen as necessary, it also had its hazards. Where there is credit, there is also default, and the use of credit unquestionably made early Americans vulnerable to the shifting currents of the overall economy, and intricately tied to the financial health of the firms with which they did business.⁵⁵ This may explain why many early market capitalists in America favored a systematic and forgiving bankruptcy system to address the issue of default.⁵⁶ Ironically, a system of distributing a debtor’s available assets and discharging his or her remaining debts was ultimately seen as a characteristic

to filing for bankruptcy. He found that the availability of credit was far greater than many had anticipated. One of his underlying theses is that the integration of a national credit system helped contribute to a new phase of capitalism in America. The average American could now start up a business on credit and live the American dream. Of course, the business cycle, economic blights, and large debt burdens forced many to file. *See id. generally.*

⁵⁰ *See id.* at 28-32.

⁵¹ *See id.* at 53. Balleisen quotes an article from a defunct New York magazine from the time, which read “All classes became smitten with a sudden criminal passion of being rich...They thought no more of the gradual accumulation of wealth by labor, but would escape the curse imposed on Adam. A fortune must now be made in a day.” *Rural tales and sketches of Long Island: The Kushow Property*, THE KNICKERBOCKER (1835) 190.

⁵² *See Sauer, supra note 31*, at 294-95 (discussing how the availability of credit has long been central to developing a capitalist economy). *See also* FOREST & ELLEN SHAPIRO McDONALD, *REQUIM: VARIATIONS ON EIGHTEENTH CENTURY THEMES* 185 (1988); ADAM SMITH, *WEALTH OF NATIONS* 275-77 (1937).

⁵³ *See BALLEISEN, supra note 11*, at 32. The quote comes from a July 22, 1837 article in *NWR, Address of the Albany General Republican Committee* “Credit is the universal solvent of a market economy. It increases the liquidity of assets and allows extensive investment, even from geographically remote locations.

⁵⁴ “[Credit] is a kind of mercantile funding system, which enables [merchants] to enlarge their capital by anticipating the profits of their enterprises.” 38 *ANNALS OF CONG.* 1098 (1822) (remarks of Rep. Wood).

⁵⁵ *See BALLEISEN, supra note 11*, at 31.

⁵⁶ *See Sauer, supra note 31*, at 295-96; *but see supra notes 42-45*. Thus, the division between agrarians and capitalists, between bankruptcy advocates and those against it, was predicated on a recognition of the potential for failure and the need to address such failure.

of economic modernity, “the result of the complex development to which modern society has attained.”⁵⁷

People took risks and the bankruptcy system facilitated this risk by design. The drive to be self-employed, and thus to be successful in business, caused a great deal of financial failure in the mid-1800’s.⁵⁸ The economy was friendly to any capitalist effort, as the goal was to create a vibrant market economy as quickly as possible.⁵⁹ As young men tried their luck at business, many learned about success, as well as failure in the pursuit.⁶⁰ Interestingly, early bankruptcy merchants included women as well as men, indicating that women participated in the marketplace even as early as the 1700’s.⁶¹

A legal culture of tolerance toward non-payment developed, in order to encourage people to continue entrepreneurial pursuits.⁶² The relative lenience of American bankruptcy law, as compared to law on the European Continent, for example, shocked some, including Alex de Toqueville, who commented on the “strange indulgence” shown to bankrupts in the American Union.⁶³ He claimed that in this respect, “the Americans differ, not only from the nations of Europe, but from all the commercial nations of our time.”⁶⁴

⁵⁷ *Id.* at 296 (quoting R. McLean, *Bankruptcy Law*, 2 LAW NOTES 292, 292 (Albert Gibson ed., 1883); see also H.R. Rep. No. 5, 27th Cong., 1st Sess. (1841); CONG. GLOBE, 39th Cong., 1st Sess. 755 (1866) (remarks of Rep. Jenckes).

⁵⁸ See BALLEISEN, *supra* note 11, at 15. The desire to go into business, despite inexperience and limited capital, made many early entrepreneurs vulnerable to financial failure. See *id.*

⁵⁹ See *id.*

⁶⁰ See *id.* at 18.

⁶¹ See Karen Gross, Marie Stefanini Newman, and Denise Campbell, *Ladies in Red: Learning from America’s First Female Bankrupts*, 40 AM. J. LEGAL HIST. 1, 20 (1996). The stories of the women told in this article prove that women of the 18th and 19th century were indeed engaged in the commercial marketplace and the world of debt and credit. Some had children and some did not, and most were engaged in business of some sort. See *id.* at 16-18. Like the men, some failed, but in a sense this is evidence of their success. See *id.* at 36. They too were willing to take risks. See *id.*

⁶² See BALLEISEN, *supra* note 11, at 16.

⁶³ See *id.* at 13.

⁶⁴ *Id.* at 13. Tolerance toward bankruptcy debtors was seen as a significant contributor to successful capitalism, as volatility in the free market was a fact of life. See *id.* at 18; see also Sauer, *supra* note 31, at 295. As during financial panics and depressions, bankruptcy helped problems percolate slowly through the system. More importantly, endemic insolvency and the ability of bankrupts to gain legal absolution from old debts “unleashed a range of economic energies.” As Balleisen explains:

Perhaps the most important connections between antebellum bankruptcy and the release of capitalist energy manifested themselves in post-failure career strategies. Not every former bankrupt sought haven from risk after insolvency. Discharge from past obligations encouraged a number of highfliers to redouble their entrepreneurial efforts. These bankrupts typically sought to breach prevailing commercial boundaries, either by expanding the domain of market transactions, developing new products, or devising new methods of distribution. On occasion such efforts produced spectacular postfailure successes; more commonly they led only to new accumulations of unpayable obligations. Collectively, the ventures of risk-taking former bankrupts helped consolidated a business culture predicated on “creative destruction,” in which a multitude of entrepreneurs mounted ongoing assaults on prevailing forms of economic activity, at once seeking profits and envisioning, if not always realizing, a continuous process of social “improvement.

The American system also developed from the U.S.'s unique partisan political system, the unique way that both debtor and creditor interests were balanced in the system, and the early and prominent role of attorneys as the primary professionals in the developing system. In his account of the role of politics in the developing U.S. bankruptcy law, bankruptcy historian David Skeel explains that once creditor groups formed trade organizations that promoted the passage of a federal bankruptcy law, populist interests joined forces as well, forcing a compromise between debtor and creditor groups not seen in England or elsewhere. Because Republicans tended to favor creditor interests and Democrats or the populists tended to favor debtor interests, the compromises that resulted were the product of the unique, American two-party system.

Moreover, from the start, private attorneys played a very significant role in American bankruptcy cases and in the reform process. As the law took shape, general practitioners began to specialize in bankruptcy cases. These attorneys perpetuated the system. As Professor Skeel, recounts:

...government agencies have a tendency to self-perpetuate. Once Congress establishes a new agency and creates jobs for a group of new government officials, these same officials will later serve as the primary bulwark against elimination of the agency. In a sense, the agency becomes its own political constituency.⁶⁵

As Professor Skeel explains, while the bankruptcy bar is private rather than governmentally-run, it has played an analogous, self-perpetuating role. This is one explanation for why the system changes, but never by leaps and bounds.

BALLEISEN, *supra* note 11, at 19. A lenience toward debtors helped ordinary people create a market economy in the United States, and also caused some to rethink their role in the capitalist economy and thus to engage in valuable "capitalist adaptation." *Id.* at 21.

Thus, bankruptcy's historical popularity with the commercial classes is attributable to its ability to promote and foster commercial development in several ways. First, having an involuntary bankruptcy system in place makes it more efficient to collect and distribute assets and also serves a deterrent function of causing people to pay debts rather than lose assets. *See* Sauer, *supra* note 31, at 299. Both involuntary and voluntary bankruptcy save the costs of fighting among creditors and prevents state law collection efforts from eviscerating the debtor's estate before it can be efficiently distributed. Preference laws, which require that creditors who received advantageous payments or property just prior to a bankruptcy to return it, discourage creditors from trying to gain such advantage while a debtor is insolvent. *See id.* Finally, by allowing a debtor to discharge most debts as long as he or she is honest and cooperative, the debtor has every incentive to be honest and helpful and not hide assets. *See id.*

Other more obvious financial benefits flow from a well-developed bankruptcy system as well. By limiting the financial exposure of individuals, risk-taking is encouraged and the economy can grow. *See id.* at 301. Finally, and perhaps most obviously, by allowing an individual to discharge debts that are a burden, he or she can return to economic life, hire employees or be an employee, pay taxes, buy things, and otherwise fuel the economy. Such a system can keep that person "in play", rather than leaving them economically dormant, imprisoned, and with a family supported by the state.

This Bankruptcy Act of 1898 was the precursor to our current system and the first systematic bankruptcy system of the nation. *Id.* The history surrounding its enactment explains in some measure how our complex bankruptcy system developed so much earlier than all other systems of its kind around the world. *Id.*

⁶⁵ Skeel, *supra* note 37, at 90.

Thus, a number of unique characteristics have created the United States' unique bankruptcy system. These characteristics include a strong societal desire to create a commercial economy, a resulting extensive use of credit, a desire to balance creditor and debtor interests in developing the law, a unique two-party political system that helped create this balance, as well as a highly unusual and prominent role for private attorneys in the bankruptcy process.

3. *The Rise in American Consumerism.*

The above discussion focuses primarily on the development of business and commerce and the resulting business debt. Our current attitudes toward "personal" or "consumer" bankruptcy, on the other hand, developed far more recently, under circumstances no less unique. The United States was pulled out of the great depression by World War II, which created jobs for virtually everyone who was not in the Armed forces.⁶⁶ Due to rationing of most consumer products, and stopped production for others, most people saved their wages.⁶⁷ After the war, we experienced a period of inflation, after which consumer demand for various household goods and services increased dramatically.⁶⁸ Three things fueled these increases in demand, a pent-up desire for things that were unavailable during the war, large savings accounts, and the baby boom.⁶⁹

American policy at the time promoted spending to the fullest extent possible. As one consultant announced shortly after the war," the greatest challenge facing American business was convincing consumers that the hedonistic approach to life is a moral, not an immoral one."⁷⁰ This strategy apparently worked well, as Americans began purchasing to be happy, and building social experiences around the act of acquiring.⁷¹

As inflation subsided, the housing and auto industries expanded and America began exporting a huge variety of goods, including farm products. This resulted in large trade surpluses since Europe and Japan, our main trade partners, had little to export.⁷² The economy grew strongly and stably in the early 1950s.⁷³ Capital was plentiful, and consumer goods appeared everywhere in record numbers. Chains like Sears and Montgomery Ward sold products cheaply and more and more household electronic goods were being manufactured.⁷⁴

⁶⁶ See John Henry Schlaegel, *Law and Economic Change in the Short Twentieth Century*, draft manuscript, on file with author.

⁶⁷ See *id.* at 3, 8.

⁶⁸ See *id.* at 8.

⁶⁹ See *id.*

⁷⁰ David Ray Papke, *Discharge as Denouement: Appreciating the Storytelling of Appellate Opinions*, in *NARRATIVE AND THE LEGAL DISCOURSE* 206, 214 (ed. Papke 1991).

⁷¹ See *id.*

⁷² See Schlaegel, *supra* note 66, at 9.

⁷³ See *id.* at 9.

⁷⁴ See *id.* at 3-4.

Americans with ready cash on hand began to believe that they needed these gadgets, that they were a sign of modernity and prosperity, and that buying them would fuel the economy. Thus, a consumer class was born.

Since that time, though the U.S. economy has sagged at various times, U.S. wages have made domestic production uncompetitive in many industries and thus upset trade balances.⁷⁵ Wealth per household actually decreased, yet consumer spending did not dissipate.⁷⁶ Instead, it has increased as consumer credit has been made available in record amounts to people of lower and lower economic means.⁷⁷ Over time we have learned to consume too well. While we can manufacture and produce many products and services worthy of export, our voracious desire to consume makes it unlikely that we will ever produce as much as we use.⁷⁸ As a culture, we love to spend, and are even encouraged to do so when the economy flags, despite record household credit and record low savings rates.

4. *The Effect of Low Down-Payment Home Loans on Consumer Spending Habits.*

Another historical event that drastically changed the debtor-creditor system in the United States was the home ownership program introduced by President Roosevelt in the New Deal Legislation.⁷⁹ Before 1930, home loans had short terms and were used primarily by the wealthy, because one was required to put down 50% of the purchase price in order to get a home loan. As a result of these conditions, only about 45% of the homes in American were owner occupied.⁸⁰ Roosevelt sought to foster stability and

⁷⁵ Low-skill labor wages in the U.S. are much higher than similar skill labor wages elsewhere. In these cases, firms have a clear incentive to move abroad those operations which utilize low-skill labor. Slaughter, Matthew J., *Multinational Firms and Wages in a Global Economy*, www.dartmouth.edu/~glm, visited on January 6, 2003.

⁷⁶ *Id.*

⁷⁷ See *Credit Screening: The Rest of the Story*, 49 CON L. QUARTERLY 391 (Fall 1995); see also THERESA SULLIVAN, ELIZABETH WARREN AND JAY WESTBROOK, *THE FRAGILE MIDDLE CLASS* 135 (Yale University Press 2000)(hereafter, "FRAGILE MIDDLE CLASS"). In 1910, Sears began selling goods on credit to ordinary working class people. In 1949, the Diners Club card was Fragileborn, so executives could keep track of charges and pay just one bill per month. See *id.* at 109. In 1958, American express and Carte Blanche joined and in the 1960's MasterCard and Visa set up their extensive credit card networks. In 1986, Sears entered the all-purpose card market with its Discover Card. By the end of the 1990's, Americans carried over \$500 billion in outstanding credit card debt. See *id.*

The next historical event of significance was the deregulation of consumer interest rates, which made credit card lending the more profitable than any other aspect of lending, and also made it profitable to lend to higher credit risks. See *id.* at 135.

⁷⁸ Statistics from the Bureau of Economic Analysis show that over the past few years, we have consumed more than we have produced. Table 1.2, *Real Gross Domestic Product*, www.bea.doc.gov, visited on January 8, 2003.

⁷⁹ U.S. Housing Act of 1937, ch. 896, 50 stat. 888(current version at 42 U.S.C. section 1437(2002)).

⁸⁰ See Florence Wagman Roisman, *Teaching About Inequality, Race, and Property*, 46 ST LOUIS L. J. 665, 676 (2002); Thomas W. Hanchett, *The Other "Subsidized Housing": Federal Aid to Suburbanization, 1940-1960's in FROM TENAMENTS TO TAYLOR HOMES* 163, 165 (John I. Bauman et.al. eds.. 2000)).

security during the depression by making it much easier for the average person to buy and keep a home.⁸¹

This was accomplished through the formation of the Home Owners Loan Corporation (HOLC), the FHA and the VA. The FHA, created by the National Housing Act of 1934,⁸² did not make mortgage loans but rather insured them. Because the FHA began insuring these loans, lenders were much more willing to make loans with lower down payments and at lower interest rates.⁸³ This made mortgage loans more available to the middle class than ever before.⁸⁴ Owning a home became a nearly universal American dream after World War II.⁸⁵ As late as 1940, half of all young adults between the ages of 20 and 24 lived with their parents.⁸⁶ In the fifteen years following the war, home ownership shot up to 62%.⁸⁷ No one individual was more responsible for this change than William Levitt, who built new cape cod homes and sold them for \$7,990 in the late 40's,⁸⁸ with little or no money down and a 4 1/2% interest rate.⁸⁹

⁸¹ Perhaps I should say that this legislation made it easier for the average white person to buy and keep a home. Numerous scholars have noted that at the same time that the FHA and VA reduced down payments under these programs, minorities were refused such loans and instead lived in stingy, alienating public housing projects, which hindered minority home ownership for the rest of this country's history. See Roisman, *supra* note 84, at 676.

⁸² Alice O'Connor, *Understanding Inequality in the Late Twentieth Century Metropolis: New Perspectives on the Great Racial Divide*, IN *URBAN INEQUALITY: EVIDENCE FROM FOUR CITIES* 22 (Alice O'Connor, et al. eds. 2001). See Home Owners' Loan Act of 1933, Pub. L. No. 73-43, 48 Stat. 128 (1933) (codified as amended at 12 U.S.C. §§1461-1468 (1998)); see also National Housing Act, Pub. L. No. 73-479, 48 Stat. 1246(1934) (codified as amended at 12 U.S.C. §1716 (1988)).

⁸³ David Dante Troutt, *Ghettos Made Easy: The Metamarket/Antimarket Dichotomy and the Legal Challenges of the Inner-City Economic Development*, 35 HARV. C.R.-C.L. REV. 427, 507 n. 146 (2002) (stating that the FHA's new lending model allowed for smaller down payments, lower interest rates, longer repayment periods, and full loan amortization, making it easier for many homeowners to buy rather than rent).

⁸⁴ See *id.* Troutt notes that between 1936 and 1941, new home owners increased from 332,000 to 619,000. See *id.*

⁸⁵ See http://www.columbia.edu/~rr91/3082_lectures/feminine_mistique.htm, visited on January 11, 2003.

⁸⁶ See *id.*

⁸⁷ See *id.*

⁸⁸ See *id.* William Levitt became:

the Henry Ford of home building by applying methods of mass production to housing. In the late forties, William Levitt embarked on the biggest private housing project in American history. Buying up 4,000 acres of potato fields in Hempstead, Long island, about 25 miles east of new York City, he started work on 17,500 homes in what was to be known as Levittown. To minimize costs, he broke down construction into 26 steps. Teams of workers executed specific tasks: bulldozing the land, paving the roads, pouring foundations, [planting trees, joining the walls and roof, installing the plumbing and electricity, and painting. Every house was identical, one story high, covering 25 by 32 feet, with a living room, kitchen, two bedrooms and a bathroom.

Those cape cod homes became the single most powerful symbol of the dream of upward mobility and home ownership for American families. With no down payment, a 30-year mortgage, and a tax deduction for interest payments, it was cheaper to buy a house in Levittown, where mortgage costs ran \$56 per month, than to rent an apartment in New York, where apartment rentals averaged \$93 per month.

Id.

⁸⁹ Electronic interview between Frederick Hart and Polly Dwyer, President of Levittown Historical Society, on January 11, 2003. The rate was 4 ½% if there was no down payment and 4% if the purchaser put down

These events forever changed the face of American consumerism and consumer credit. They ultimately revolutionized the home finance industry, by making 20% down payments the norm, rather than the previous 50% required,⁹⁰ and by stretching home loans out 25 or 30 years, as compared to the three years at which commercial banks were lending, and finally, by amortizing the loans rather than having them end with balloon payments.⁹¹ As a result of these and other more recent changes, 68% of Americans now own their homes,⁹² a percentage higher than most other countries in the world.⁹³ The New Deal Legislation unquestionably led to this result, and, along with the advent of private mortgage insurance, now allows Americans to buy a home with only 5% down.⁹⁴ These conditions lead to more disposable income for Americans than any other group of citizens in the world.⁹⁵

Low down-payment loans in the United States have led to another uniquely American phenomenon, the home equity loan. Home equity loan indebtedness has substantially increased in a short period of time, from \$60 billion in 1981 to \$357 billion in 1991⁹⁶. These types of loans are pushed non-stop through the media in the U.S., yet

\$990. *See id*; *see also The Next Crash: Is the Housing Market a Bubble that's About to Burst?*, THE NEW YORKER, November 11, 2002, at 123 (discussing the Levittown development project).

⁹⁰ *See* MARC A., WEISS, RISE OF THE COMMUNITY BUILDERS: THE AMERICAN REAL ESTATE INDUSTRY AND URBAN PLANNING 32 (1987). Weiss states that the FHA began making 80% loans for 20 years when the previous norm for commercial banks was 50% loans for three years. Twenty years later, the FHA began making 90% loans for 25 years. *See id*.

⁹¹ *See* KENNETH T. JACKSON, CRABGRASS FRONTIER: THE SUB-URBANIZATION OF THE UNITED STATES 204 (1985).

⁹² *See Local & The Carolinas Coastal Business*, SUN-NEWS (Myrtle Beach, S.C.), April 6, 2002, at D1 (reporting a 67.8% home ownership rate in April of 2002, and noting that the Great plains and the Great Lakes region had a rate of 73.9% and 72.7% percent respectively but that the Pacific Coast had a rate of just 59.6%, showing a large variation across the country); *see also* REALTY TIMES, October 22, 1998, <http://realtymtimes.com/news/rtpages/19981022-hmownership.htm>, visited on February 23, 2004 (reporting a 66.8% home ownership rate in October of 1998); *see also* U.S. CENSUS BUREAU, <http://www.census.gov/hhes/www/housing/hvs/ann01ind.html>, visited on January 17, 2003.

⁹³ New Zealanders purportedly have the highest home ownership rate at 72% with Australia in second place at 70.1%. *See Australia Has World's Second Highest Home Ownership Rate*, ASIA PULSE, February 11, 2002. The U.S. is next at 67%, *see Local & The Carolinas Coastal Business*, *supra* note 96, at D1, and Britain is next at 66%. *See Not a Common European Home Economic Agenda*, THE SUNDAY TELEGRAPH (LONDON), August 18, 2002. Continental Europe's rate is currently 59%, but of course, this number represents an average of a number of different rates across Europe. *See id*.

⁹⁴ Anyone who watches late night television knows that if you buy from the owner or the builder you can often buy a home with no money down in the United States.

⁹⁵ In Europe, a buyer seeking a loan from a lending institution is still expected to put down 50% in order to get a home loan. <http://www.remx-oa.com/resource/BuyersGuide/Arranging/Default.asp>, visited on March 2, 2004. Even in Canada, 25% is a typical down payment. *See id*. Moreover, in many countries, homes can only be purchased with cash. *See id*.

⁹⁶ U.S. GENERAL ACCOUNTING OFFICE, TAX POLICY: MANY FACTORS CONTRIBUTED TO THE GROWTH IN HOME EQUITY FINANCING IN THE 1980'S 3, 12-14 (1993). While home equity loans grew at a rate of 20% per year between 1981-1991, other consumer debt increased by just 4% per year *supra* at 1. For a more detailed exploration of the dilemma with home equity loans *See* Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Government's Promotion of Home Equity Financing*, 69 TUL.L.REV. 373, 373 (1994).

are virtually unheard of in Europe.⁹⁷ In fact, European concepts of land ownership are completely different from U.S. concepts. The ownership of land and tenant rights in England had their origin in the feudal system imposed by William I⁹⁸ with far more land owned publicly and far more people owning homes and businesses on leased land. Thus, there are far fewer home equity loans in Europe and the rest of the world and thus less overall indebtedness.⁹⁹

Lending found its true cornucopia in America, however, with the introduction of the charge card in the 1960's, followed by the credit card in the 1970's and 1980's.¹⁰⁰ Since then, there has been no turning back.

B. American Consumer Culture: Buying Happiness

Americans are considered profligate in their personal lives as well as their business lives, particularly in comparison to other world citizens.¹⁰¹ While the last sub-section attempts to explain how these habits developed, this sub-section examines how our society views debt today, and what current legal, cultural, and economic factors have led to our “compulsively consumeristic” behavior.¹⁰² It also examines the financial and other life conditions of most individual bankruptcy debtors in American, and discusses whether there is a different bankruptcy or debt culture for American business debtors, as compared to individual consumer debtors.¹⁰³

1. How and Why We Spend it: Let us Count the Ways

⁹⁷ A recent radio advertisement asks “Did you know that there currently is available over \$30 billion in equity in American real estate?”, it then admonishes listeners not to let this money waste and to call an 800 number immediately to get the cash they deserve out of their home.

⁹⁸ Lord Madoc Arundel and Christopher T.C. Miller, *The Governance of Real Property in England from Henry I to the Second Reiteration of Magna Carta*, http://www.pbm.com/~lindahl/articles/land_law.html, visited on Nov. 5, 2003.

⁹⁹ With this background, we can begin to understand how our bankruptcy system of debt forgiveness came into being. What is not clear is whether the countries that are importing aspects of our bankruptcy system actually need this system or will need it. Will they also become highly consumeristic because that is where globalization will take them? Some Europeans, for example, are known for having one small closet filled with a few expensive pieces of clothing whereas Americans prefer a huge closet full of moderately priced items, a reflection of differing consumer cultures. Not all Europeans are cut from the same spending mold, however. The Italians love beautiful things while northern Europeans would consider high-ticket fashion items to be highly unnecessary.

¹⁰⁰ See Ronald J. Mann, *Credit Cards and Debit Cards in the United States and Japan*, 55 VAND. L. REV. 1055, 1064 (2002). As Mann explains, American Express, Diner's Club, and Carte Blanche first offered charge cards, which, as their name implies, had to be paid off each month. The big profits occurred with the development of the credit card, and the resulting high interests rates to lenders. These did not blossom until the 1970's and the 1980's in the United States and still have not done so throughout the rest of the world. See *id.* Mann attempts to explain this phenomenon by examining the banking and lending systems of the U.S. versus other parts of the worlds, particularly Japan. See *id.* at 1061-64.

¹⁰¹ Jacob S. Ziegel, *The Fragile Middle Class: Americans in Debt, Discussed from a Canadian Perspective*, 79 TEX. L. REV. 1241, 1244 (2001).

¹⁰² See *id.*

¹⁰³ See THE FRAGILE MIDDLE CLASS, *supra* note 77, at 2 (discussing how increased volatility in the job market, exploding amounts of available consumer credit, and privatized health care, all helped lead to record bankruptcy numbers in recent years).

Consumer spending is considered one of the most important indicators of economic health in the American economy.¹⁰⁴ Despite the credit industry's claims that consumers are abusing credit, credit industry advertising encourages people to use as much credit as they can get, for every use imaginable or no particular use at all.¹⁰⁵ Some advertisers rely on nostalgia to get people to borrow as much money as possible. For example, in a mailer for a home equity loan, United Pan Am Mortgage writes:

[r]emember the days when dad worked, mom managed the home, and there was still enough money for a house, cars, vacations ...even college? It's sure not like that anymore. Today, with single parents or even with both parents working, it's hard to make ends meet, let alone have some of the good things life offers. We think you deserve more and we can help. ...A friendly phone call will get the ball rolling on putting a lump sum in your pocket. That's right –have the extra cash to make those home improvements you've been putting off, take that vacation you've been dreaming about, give yourself peace of mind, knowing your son or daughter's tuition is covered.¹⁰⁶

The ad goes on to tell the recipient who to call to get a home equity loan and solve all of life's problems, demonstrating that despite popular belief, you can buy both happiness and peace of mind.¹⁰⁷

American popular culture oozes with references of spending and happiness. In the tongue-in-cheek novel, *Shopaholic Ties the Knot*,¹⁰⁸ Becky Bloomwood notes how her whole life will change when she and her beau own the vintage cocktail cabinet she spots in an antique shop:

¹⁰⁴ Consumer spending is one of the major indicators by which the government and economists measure the strength of our economy. Consumer spending makes up about two-thirds of our gross domestic product, which is the broadest measure of economic health. *When will we Spend Again?*, *supra* note 8.

Consumer spending is widely believed to be a measure of overall consumer confidence. When a household is deciding what it can afford, it will look at probable future income as well as current income. If consumers are optimistic about the future economy, they will be inclined to spend their dispensible income. If, however, they do not believe that good times lay ahead, they are more likely to save their money. THOMAS MAYER, JAMES S. DUESENBERY & ROBERT ALIBER, *MONEY, BANKING, AND THE ECONOMY* 273 (Norton & Co. 1999).

¹⁰⁵ One advertisement admonishes Americans to get the money they deserve by tapping into the \$30 trillion dollars in equity currently available in American real estate. No mention is made of the need to pay such funds back. In a title loan company add, a woman finds that as long as she takes out a title loan, she has the money to go out to dinner after all. In another add, Mr. T tells a huge, slovenly debtor that all his financial problems can be solved if he takes out a title loan. *See* Appendix, Case Study #4. In a MasterCard advertisement, a man in cubicle becomes ecstatic beyond words when he wins a trip to Hawaii from his benevolent credit card company. Businesses advertising on every network offer free credit for 6-12 months, as long as you spend a certain dollar amount, and even the government told Americans to go out and spend money last fall (despite high bankruptcy rates and low savings rates) in order to breath life into out flagging economy.

¹⁰⁶ Sent to Professor Frederick M. Hart on September 30, 2002, on file with the author.

¹⁰⁷ *See id.*

¹⁰⁸ SOPHIE KINSELLA, *SHOPAHOLIC TIES THE KNOT* 8 (Delta 2002).

Just think, if we had one of these in the apartment it would change our lives. Every night Luke and I would mix martinis, and dance to old-fashioned songs, and watch the sun go down. It'd be so atmospheric! We'd have to buy one of those old-fashioned record players with the big horns, and start collecting 78s, and I'd start wearing gorgeous, vintage tea dresses.¹⁰⁹

As a result of relentless and unyielding admonitions to spend, as well as other cultural factors, Americans have more debt of all kinds than all persons of all other parts of the world.¹¹⁰ Consumer debt, second mortgages, foreclosures,¹¹¹ and personal bankruptcies are all at an all-time high.¹¹² The average household carries \$8,000¹¹³ in credit card debt and record numbers of Americans now carry more than one mortgage.¹¹⁴ Between 1979 and 1997, personal bankruptcies increased by more than 400%.¹¹⁵ The upsurge in the mid-nineties was particularly shocking because this was a period of widespread economic recovery.¹¹⁶ History partially explains why this debt picture looks so different from that of the rest of the world. Add a volatile economy and job market,

¹⁰⁹ *Id.*

¹¹⁰ I respectfully disagree with Professor Ronald Mann's conclusion that neither Japanese nor American consumers are encouraged to over-extend. See Mann, *supra* note 100, at 1108 n. 107 (citing Robert D. Manning, CREDIT CARD NATION: THE CONSEQUENCES OF AMERICA'S ADDICTION TO CREDIT 3 (2002). Mann cites Robert Manning's Credit Card Nation for the proposition that American society does not venerate those who rely on credit beyond their income. See *id.* Unfortunately, I believe that Manning just a voice in the wilderness on this point, American media having won the war against sensible credit use.

Personally, I find it impossible to spend a quiet evening at home without being barraged by credit card and home refinancing options. New on the scene are those irritating and relentless "non-profit" credit consolidation companies, who call as many as four times per week, insisting they can lower our huge monthly payments, even though we do not carry a balance at all.

We also have found it next to impossible to cancel a credit card, being recently offered a waiver of the monthly fee, and finally, a free airline ticket, if we would just not cancel.

¹¹¹ Thomas A Fogarty, *A record Number of U.S. Homeowners are Facing Foreclosure, and Many More Are Falling Behind*, September 11, 2002, <http://www.survivalforum.com/modules.php?name=News&new-topic=23>, visited on January 13, 2003. Fogarty reports that during April, May and June of 2002, 1.23% of all mortgages- or 640,000 - were in foreclosure. See *id.* This is the highest rate recorded in the 30 years in which this data has been kept, and is up from 1% just one year ago. See *id.*

¹¹² See <http://abiworld.org/statistics>, visited on December 4, 2003. Yet at least one scholar has wondered why more U.S. households do not file for bankruptcy, concluding that as of 1998, only about 1% of households file but 15% could benefit from such a filing. See Michelle J. White, *Why Don't More Households File for Bankruptcy?*, 14 J.L.ECON. 205-31 (1998).

¹¹³ See <http://www.cardweb.com/cardlearn/faqs/2003/jan/8.xcml>, visited on March 26, 2003.

¹¹⁴ See Riva D. Atlas, *Home Equity Borrowing Rises to Worrisome Levels*, N.Y. TIMES, March 26, 2003 (stating that home equity loan levels have reached such a high level that consumer groups think many people will be unable to service these loans and will end up homeless). Some lenders, including Wells Fargo Bank, are even ending up to 100% of the home's value, despite that people often have insufficient income to service such loans. *Id.*

¹¹⁵ See FRAGILE MIDDLE CLASS, *supra* note 77, at 3. Since World War II, personal bankruptcies have steadily increased most years. These increases accelerated during the 1980's and 1990's, frequently breaking records from quarter to quarter and year to year. See *id.*

¹¹⁶ See *id.* As the authors state, financial collapse amidst all this prosperity was both mystifying and worrisome. See *id.*

and the credit industry's voracious appetite for more lending and the statistics are not surprising.¹¹⁷

2. *Personal Bankruptcy and Stigma in The United States*

While some people insist that the stigma of bankruptcy is gone,¹¹⁸ empirical research suggests that it may not be that simple.¹¹⁹ In their empirical Study, *The Fragile Middle Class*, scholars and empiricists Sullivan, Warren and Westbrook, conclude that bankruptcy is a treatment of a financial problem but is not itself the disease.¹²⁰ They conclude that unemployment or underemployment, illness and divorce are the primary causes of bankruptcy in American, but that huge amounts of consumer debt in general and credit card debt in particular, lower Americans' threshold for collapse when financial disasters strikes.¹²¹

Credit card use in the United States has risen steadily every year since the cards were introduced.¹²² In the fifteen years from 1980 to 1995, the amount of outstanding revolving credit jumped sevenfold.¹²³ Credit card debt doubled in just four years, from \$211 billion in 1993 to \$422 billion in 1997. Both the number of cards and the balances increased dramatically in this time period, yet three and a half billion credit card solicitations were sent out thereafter in 1998, portending continuing increases.¹²⁴ One historical event explains the rise in credit card debt, namely deregulation of consumer interest rates, which has made credit card lending more profitable than any other form of

¹¹⁷ Department of Labor Statistics indicate that between 1995 and 1997, eight million American workers were displaced, and that by 1998, 50% were reemployed at their old salaries, 25% were earning 20% less, and the other 25% were still unemployed. See FRAGILE MIDDLE CLASS, *supra* note 77, at 17.

¹¹⁸ This is a constant claim of the credit industry, though one credit card company's own web page states that "While not definitive, the research appears to confirm the suspicion that bankruptcy no longer carries the serious social stigma it once did. While many of the debtors expressed remorse over having to file for bankruptcy, many appeared to take a more relaxed attitude." See <http://www.abiworld.org/stats/visa/97qualitative.html>, visited on March 2, 2004. This is hardly strong proof that stigma is gone. See *Once a stigma, Ch. 11 Seen as Management Tool*, BOSTON BUSINESS JOURNAL, July 12, 2002, at B1; Gregory E. Maggs, *Book Review: Bankruptcy as a Business Tool*, 71 TEX. L. REV. 681, 684-87 (describing the development of strategic uses for Chapter 11, while reviewing a book who's name speaks for itself); *Bankruptcy Boom*, www.abcnews.com, August 15, 2002, visited on January 8, 2003; *Explaining the Escalation in Personal Bankruptcies*, www.spotlightonfinance.org, visited on January 8, 2003.

¹¹⁹ See THE FRAGILE MIDDLE CLASS, *supra* note 77, at 263.

¹²⁰ See *id.*

¹²¹ See *id.* at 22. While only 10% of the consumers in their empirical study reported that consumer or credit card debt as the actual cause of their bankruptcy, in most cases, the debtor could have withstood the layoff, illness or family breakup, if not for their crushing amounts of consumer debts. See *id.*

¹²² See *id.* at 123.

¹²³ By the 1990's economists speculated that Americans could tolerate no more credit card debt. Since 1993, however, growth in credit card debt has been greater than any other type of consumer loan. See *id.*

¹²⁴ The bankruptcy debtors in the study carried more credit card debt than the average American, but most Americans are now carrying more than they can afford to repay. This is because there is virtually no limit to the amount of credit a person can obtain through credit cards. See *id.*

The credit card industry did not grow to its current size by being cautious about distributing cards. See *id.* at 135. It grew because it distributed cards freely, and solicited new customers relentlessly, at a cost of \$100 in solicitation for every new card member acquired in 1994.

lending.¹²⁵ The more cardholders a company has, the more money it makes, even if this is accomplished by lowering lending standards.¹²⁶

Sub-prime lending, meaning lending specifically to people who are living on the edge, is the most profitable niche in lending.¹²⁷ Yet traditional banking has declined in profitability, making it necessary for lenders to make ends meet in other ways. A popular long-term strategy is to get college students hooked on credit cards early, giving away free t-shirts and requiring no income.¹²⁸ Sixty nine-percent of students in 1999 had a credit card and 20% had four or more.¹²⁹

The existence of all this consumer credit does not mean that people do not feel guilty when they fail to keep up with their payments. Studies show that most people feel badly when they are unable to pay their debts,¹³⁰ despite deep societal ambivalence about consumer debt.¹³¹ Economists recommend that people save more to increase capital investment and productivity while at the same time warning that increased consumption is necessary to economic growth.¹³² In mainstream American news media, such as the Wall Street Journal, consumer spending is consistently equated with happiness and health.¹³³ For example, in an Article titled *Consumers Give Brighter Outlook*, the author claims that “[c]onsumers’ spirits picked up a bit in early December, an encouraging sign for retailers hoping for a strong holiday season.”¹³⁴ The story then claims that “consumer

¹²⁵ See *id.*

¹²⁶ Interest rates drive profitability and interest payments account for more than 80% of the profits of credit card companies. The enormous profits available from people who charge up to the limit and pay only the minimum monthly payment make delinquent cardholders the most valued customers in the business. See *id.*

¹²⁷ See *id.* at 135-36.

¹²⁸ See *id.* 137.

¹²⁹ See *id.* In fact, some state legislatures have attempted to stem this tide by placing additional legal guidelines and restrictions on credit card issuers who issue cards to minors. Unfortunately, these efforts have not been very successful. See <http://www.cardtrak/1999/march1.html>, visited on January 13, 2002, (reporting that on March 26, 1999, the Oklahoma state legislature declined to pass a law restricting offerings to citizens under the age of 21).

¹³⁰ See THE FRAGILE MIDDLE CLASS, *supra* note 77, at 139-40. We are, however, an immediate gratification society with little willpower, a fact also demonstrated by our national obsession with food and weight loss, and our well-documented obesity problems.

¹³¹ See *id.* at 23.

¹³² See *Bankruptcy Blues Generate Consumer Blahs*, <http://today.uci.edu/releases/95releases/079ky95.html>. Moreover, in the wake of September 11th, President Bush told us that we could all fight terrorism by being good consumers. George W. Bush, Speech to Congress, (Washington D.C., September 20, 2001) (accessed from ABCNEWS.com, visited on January 6, 2003). The Federal Reserve then encouraged consumer spending by repeatedly cutting interest rates over the next few months. *U.S. Economy Shrinks*, October 31, 2001, www.cnn.com, visited on January 7, 2003. Again on January 7, 2003, President Bush delivered a speech in which he encouraged Americans to be good consumers in spite of the economic stand-still. George W. Bush, *Speech to Economic Club of Chicago*, (Chicago, Illinois, January 7, 2003).

¹³³ WALL STREET JOURNAL, Dec. 16, 2002, at A2.

¹³⁴ See *id.* This top financial newspaper often devotes an entire two-page spread to bankruptcy and consumer sentiments every singly day. For example, on Monday, December 16, 2002, a fairly typical day, the feature story contained a comparison of Australian bankruptcy and U.S. bankruptcy, the sideline was about United Airlines’ request to borrow \$2.4 billion from its union’s pension plan to fund its Chapter 11, along with this story about whether consumer spending would be “bright” enough to give retailers a profitable Christmas season.

sentiment” and “consumer attitudes” have improved, causing economists to conclude that the waning economy might be improving.¹³⁵

The nature of the U.S. economic system, however, makes some financial failure a certainty. The dynamics of capitalism, combined with a thin social safety net, guarantee that some families will fail:

[w]ithout universal health insurance to protect every family from the financial ravages of illness and without higher levels of unemployment compensation to cushion the effects of a layoff, each day, in good times and in bad, some families will fall over the financial edge. And in a market that provides virtually unlimited amounts of consumer credit, some people will accumulate a debt load that eventually takes on a life of its own – swelling on compound interest, default rates, and penalty payments until it consumes every available dollar of income and still demands more. Just as the poor will always be with us, so will the bankrupt middle class.¹³⁶

A more protective consumer bankruptcy system seems to be directly related to the size of the social safety net and the availability of consumer credit.¹³⁷ The United States admittedly offers more families sanctuary in bankruptcy while at the same time offering a wide open consumer credit economy with no limit on lending or interest rates, and few protections from the economic consequences of other problems such as job loss, illness, accidents and family breakdowns.¹³⁸ None of this makes bankruptcy pleasant, although

¹³⁵ News stories of this kind equate good “moods” or “spirits” with high consumer spending, even though more personal financial failures occur after the holidays than at any other time of year. It is not surprising that we have as much debt as we do, when we are told that spending on consumer goods is critical to keeping our economy viable. *See id.*

¹³⁶ FRAGILE MIDDLE CLASS, *supra* note 77, at 3. Sullivan, Warren and Westbrook uncover a few surprising facts about bankruptcy debtors in this study, including that bankruptcy rates are very similar across racial and ethnic lines, *see id.* at 41-47, that bankruptcy debtors come from a cross-section of occupations, *see id.* at 55-58, that debtors tend to be from the middle rather than the lower classes, *see id.* at 59, and that bankruptcy debtors are more likely to have attended college than the average citizen, *see id.* at 51-55. This last statistic can be read several different ways. What the study actually showed was that bankruptcy debtors were more likely to have attended college than the general population but less likely than average to have graduated from college. Thus, more went to college but few graduated. Is it possible that the study actually showed that bankruptcy debtors were more likely to try new things but less likely to stick with them? These are not the conclusions drawn by the authors, *see id.*, but the numbers did suggest these alternative conclusions to me.

¹³⁷ *See id.* at 259.

¹³⁸ *See id.* Whether these high levels of consumer bankruptcies are seen as a societal problem or not, it is clear that consumer bankruptcy is the ultimate free-market solution to bad debt. It forces individual creditors who have made voluntary decisions to lend to recoup the losses from bad loans, from the profits of the good ones. And recoup they have, earning the highest profits in lending history despite all the defaults. Bankruptcy is the market-driven choice to deal with privatized rather than socialized risk. Moreover, while creditor-funded campaigns to restrict consumers’ access to bankruptcy have both popular and successful in Congress, there have been no campaigns to restrict access to credit. That type of legislation would be seen as anti-capitalist and paternalistic. Many would say that individuals should be allowed to make their own choices about credit, and should be responsible for their own decision-making and the resulting consequences. *See id.*

at least it is available.¹³⁹ While there may be more people filing for personal bankruptcy in the United States than ever before, the “sting of failure is still sharply felt by those who must publicly declare that they are bankrupt.”¹⁴⁰ And, while some Americans may try to buck the trend and consume less, strong societal pressures keep most of us spending.¹⁴¹

3. *Business Bankruptcy and Stigma in the United States.*

When it comes to stigma, however, business bankruptcy in America is an entirely different matter.¹⁴² There seems to be less stigma associated with a failing business in America than with a personal bankruptcy, probably due to our capitalist notion that some risk is good and necessary to a well-functioning capitalist economy. We consider business failure to be negative but not morally wrong. We rarely throw corporate officers in jail for failing at business. In fact, in some industries, like the high-tech or dot.com industries, going through a business failure can actually be seen as a badge of honor, proof that the entrepreneurs were willing to take the kinds of risks necessary to fuel capitalism.¹⁴³

¹³⁹ Data collected by the Consumer Federation of America suggests that despite the constant barrage of solicitations, acceptance of new cards has finally stemmed to some extent. *See* <http://www.consumerfed.org/backpage/081402>, visited on August 26, 2002. In the 12-month period ending March 3, 2002, card issuers mailed five billion solicitations, nearly 50 per household. They now make available more than \$3 billion in unused credit, or \$30,000 per household. Yet consumers are increasingly rejecting more of these solicitations and refusing to expand their lines of credit. During the first three months of 2002, revolving consumer debt declined by 29 billion, bringing the ratio of credit used to a low of 22.1. *See id.* There is some indication that Brits are also cutting back a bit on credit. The Credit Card research group (CCRG) reports that total credit card spending in the U.K. rose to 16.8 billion pounds, up 6.9% from the prior period. This rate of growth, while high, is lower than the increase for the same period last year, which was 10%. *See Credit Card Spending Eases*, BBC News, November 6, 2002, <http://news.bbc.co.uk/1/hi/business/2409655.stm>, visited on January 2, 2003.

My own sense is that if means testing is implemented in the U.S., this may eventually backfire on the credit industry and cause at least the educated middle-class consumers to use less credit, thus reducing the industry's profit margins. If this happens, the industry may respond by granting more credit to less educated and poorer consumers, increasing the gap between the haves and the have-nots. **No doubt, the credit industry is already recognizing that the new bill might not be good for business. In one article, the banking industry itself stated that “[t]he one-sided provisions of this bill are bad news for consumers. But they are also bad news for our industry. Consumers are our customers. By creating a form of debt imprisonment, this bill will hobble the most important player in the world economy -- the American consumer.”** *See Bankruptcy Bill Hurts Odds of Second Chance*, <http://moneycentral.msn.com/content/invest/extra/P76658.asp>, visited on March 4, 2004.

¹⁴⁰ *See id.* at 260.

¹⁴¹ For help scaling back, see *Bankrate's Guide to Managing Credit*, <http://www.bankrate.com/news/credit-management>, visited on March 2, 2004; NoDebtNoStress, <http://home.quixnet/~meirich>, visited on March 2, 2004.

¹⁴² Stephanie Gruner, *Seeking a Second Chance: Is Failure Still a Dirty Word?* Wall Street Journal, June 21, 1999, at A1; *see also Bankruptcy and a Fresh Start: Stigma on Failure and Legal Consequences of Bankruptcy*, http://europa.eu.int/comm/enterprise/entrepreneurship/support_measures/failu.../bankruptcy.ht (report of U.S.), visited on March 17, 2003 (stating that although the stigma associated with filing for Chapter 11 has diminished substantially, “the decision to file for Chapter 11 is never an easy one.”).

¹⁴³ *See* Gruner, *supra* note 142, at A1 (stating that while it is sometimes considered a positive thing when a U.S. entrepreneur fails in business, the same cannot be said in Europe, where considerable stigma still exists).

In other industries, we seem to recognize as a society that one-time events can cause business failure or that sometimes a change in market conditions cannot be predicted and is better softened by Chapter 11 if the company is at stake. In any case, we do not like business failure but we find it more acceptable than personal bankruptcy.¹⁴⁴ This distinction appears to be shared throughout most of the world. Unlike the rest of the world, however, we also recognize that personal financial failure can be caused by business failure, and thus provide systems to help both failing businesses and failing individuals.¹⁴⁵

C. Thumbnail sketch of the American Systems: Debt Forgiveness for both Individuals and Business

The bankruptcy systems that have resulted from the history, politics, and culture discussed above are also unique. First and foremost, they allow each bankruptcy debtor a choice about whether to attempt to pay back creditors or to just give up and walk away from debt.¹⁴⁶ This choice is generally not available in other parts of the world.¹⁴⁷ Moreover, as discussed below, businesses that are reorganizing can continue to operate through a Chapter 11 reorganization proceeding that is not overseen by a court-appointed administrator.¹⁴⁸

1. Personal Bankruptcy in America: An Overview

¹⁴⁴ This could also be due to the uniquely American corporate concepts of limited liability, given that we tend to see businesses as entities separate and apart from their owners and managers. See Joseph A. McCahery, *Comparative Perspectives on the Evolution of the Unincorporated Firm: An Introduction*, 26 J. CORP. LAW, 803, 807 (2001) (discussing how some European scholars believe, for example, that extending limited liability to small firms will cause moral hazard and that as such, the costs of extending limited liability to such firms would outweigh the benefits to society of doing so).

¹⁴⁵ Bi-partisan politics continue to play an important role in the development of bankruptcy laws, though in some respects these politics are counter-intuitive. The credit industry, particularly the consumer credit industry, has pushed tremendously in recent years for stricter bankruptcy laws for consumers, that require larger paybacks on old debts. These sentiments, though not entirely partisan, are generally thought to be Republican or conservative sentiments. Underlying these views is a strong belief that individuals have irresponsibly overspent. Yet Republican or big-business interests, or even those interested in fueling the economy, have consistently admonished Americans to do the right thing and spend even more, for the sake of economic growth. This seems inconsistent with the bankruptcy crack-down, given that the government official who have admonished us to spend, as a group, know full well that most people now have more debt than they can repay and that savings rates are now negative in the U.S. Spending without going into debt is not an economic reality, yet we are still encouraged to do it. Moreover, the much-decried bankruptcy crack-down is most likely to hurt consumer credit interests rather than help them, when people reduce spending in reaction to the bankruptcy crack-down.

On the other side of this political coin, it is no less ironic. Very liberal persons, though certainly not all democrats, favor debtor-oriented bankruptcy laws like the ones in place now. However, some of these people believe that excess spending on the part of Americans is so harmful to society that it could ultimately destroy the world and its resources. While this would be deeply disturbing if true, the idea of not spending is almost un-American. Clearly, Americans operate in a culture of consumption and spending unlike any other in the world.

¹⁴⁶ SKEEL *supra* note 37, at 1-2.

¹⁴⁷ See *id.*

¹⁴⁸ See *id.*

Personal bankruptcies in the United States take one of two general forms. One can either give up all of one's non-exempt assets,¹⁴⁹ in exchange for an almost immediate discharge of most of one's unsecured debts,¹⁵⁰ or one can choose to pay off creditors, either in whole or in part over a period of three to five years, in which case one does not need to give up his or her non-exempt assets as long as he or she pays at least the value of those non-exempt assets to creditors under the payout plan.¹⁵¹ Again, the debtor, rather than creditors, makes this choice.¹⁵² The pay-out style bankruptcy also allows one to cure, stretch out and sometimes reduce, secured debt that has gone into default, thereby forcing new payment terms on the secured creditor, who is precluded from repossessing its

¹⁴⁹ In a Chapter 7 bankruptcy an estate is created to collect and sell property to satisfy the debt of the debtor. However, a debtor can claim certain assets exempt from the bankruptcy estate not to be sold for the benefit of the creditors. "The historical purpose of exemption laws has been to protect a debtor from his creditors, to provide him with the basic necessities of life so that even if his creditors levy on all of his nonexempt property, the debtor will not be left destitute and a public charge." H.R. Rep. No. 95-595, at 126 (1977), *reprinted in* 1978 U.S.C.C.A.N. at 6087. In the United States a debtor filing bankruptcy may choose between the federal or state exemptions, See 11 U.S.C. § 522 (b) if the state the debtor is filing has not "opted-out" of the federal bankruptcy exemption scheme. Some examples in the federal exemption system are: 1) up to \$17,425 of equity in real or personal property used as a homestead (11 USCA § 522 (d) (1)), 2) up to \$2,775 in one motor vehicle (§ 522 (d) (2)), (3) up to \$9,300 in household furnishings (§ 522 (d) (3)), (4) up to \$1,150 of jewelry (§ 522 (d) (4)), 5) \$925 in any property (usually checking accounts) and if the debtor did not use the homestead exemption up to an additional \$8,725 (§ 522 (d) (5)), 6) up to \$1,750 in professional books or tools of the trade (§ 522 (d) (6)), and the debtors right to receive payment for certain things such as social security, veteran benefits, and alimony (§ 522 (d) (10)) (all the dollar figures are updated by the United States Congress periodically to reflect economic conditions). State exemption schemes were developed not because of bankruptcy but because collection laws. Because each state has their own exemption legislation there is a quite a bit of difference between states. A person filing in Delaware, which has opted-out of the federal scheme, can only choose the Delaware exemptions which are not generous. For example a debtor can only exempt books, clothing, a seat or a pew in church, sewing machines, tools of the trade (limited to a certain amount in some counties, and pianos (*See* 10 Del. C. §4902). Delaware does not even have any type of homestead exemption. Texas allows not only unlimited homestead exemptions (*see* Tex. Prop. Code§40.01), but also up to \$30,000 in personal property which includes household furniture, tool and equipment, clothing, jewelry, firearms, and motor vehicles (*see* Tex. Prop. Code§42.002). But Texas does not allow a checking account to be exempt like the federal exemptions. Unlike Texas, Florida has opted out of most of the federal exemptions (*see* Fla. Stat. § 222.20 (2002)) (Florida allows all federal §522 (d) (10) exemptions). Florida also has an unlimited homestead exemption (Fla. Const. Art. I, § 4(a)(1) (2002)). However, Florida has modest personal property exemption. Only up to \$1,000 in personal property (Fla. Const. Art. I, § 4(a)(2) (2002)) (Fla. Stat. § 222.25 (2002)) and money contributed to retirement funds (§222.21) and college trust funds (§222.22).

¹⁵⁰ This is considered a straight liquidation bankruptcy under Chapter 7 of the United States Bankruptcy Code. *See* 11 U.S.C. § 701 et. seq.

¹⁵¹ This is considered a restructured debt plan under Chapter 13 of the United States Bankruptcy Code. *See* 11 U.S.C. § 1301 et. seq.

¹⁵² *See* SKEEL, *supra* note 37, at 2.

collateral as long as the plan payments are made.¹⁵³ Additionally, Chapter 7 bankruptcy is almost entirely non-interventionist because, assuming there is no objection from a creditor to a debtor's discharge, the debtor is granted a discharge automatically.¹⁵⁴

The U.S. personal bankruptcy system is unquestionably the most forgiving in the world, and strongly encourages persons who have failed financially to get back into the economy and try again.¹⁵⁵ In many states, the exemptions are extremely generous, sometimes allowing individual debtors to an unlimited amount of equity in a home.¹⁵⁶ Research suggests that states with higher exemptions, and that thus allow an individual debtor to keep more assets free from creditor claims, have the highest levels of entrepreneurship in the country, again establishing the connection between business activity and an incentive to take risks.

2. *The American Business Reorganization Scheme and Its Rationale.*

The theory behind a Chapter 11 reorganization case in the United States is that a business enterprise¹⁵⁷ is often worth more to creditor alive than dead.¹⁵⁸ In other words, a business may be able to pay creditors more by continuing to operate its business and paying creditors a distribution over time from its future profits, rather than simply liquidating its assets and paying creditors from the liquidation proceeds. Alternatively, a debtor can sell its business as a going concern while in Chapter 11, leaving enough time to sell property so that a good price can be realized for the business enterprise, and then using the proceeds to pay creditors through what is called a liquidating Chapter 11 plan.¹⁵⁹ In either case, the business is operated for a time while in Chapter 11, in order to avoid the waste that could occur if a business with accumulated good will was simply liquidated at the first sign of financial failure.¹⁶⁰ For the benefit of stakeholders such as

¹⁵³ See 11 U.S.C. § 1322 (b)(2) allowing for the modification of secured claims except secured claims on real property. This option of modifying a secured creditors interest is not available under a Chapter 7 bankruptcy.

¹⁵⁴ See 11 U.S.C §727.

¹⁵⁵ Jacob Ziegel, *Canada's Phased-in Bankruptcy Reform*, 70 AM. BANKR. L.J. 383, 395 (1006).

¹⁵⁶ See Tex. Prop. Code§42.002; Fla. Stat. § 222.20 (both allowing unlimited homestead exemptions).

¹⁵⁷ Chapter 11 is available to corporations, partnerships, as well as individuals. Because it is complicated and expensive in terms of legal fees, an individual normally will file a Chapter 13 instead, if his or her debts fall within the debt limitations, namely the debtor has noncontingent, liquidated, unsecured debts of less than \$290,525 and noncontingent, liquidated, secured debts of less than \$871,550. See 11 US.C § 109 (e).

¹⁵⁸ See Davis, *supra* note 13, at 253.

¹⁵⁹ In fact, the debtor is permitted to sell off its assets piece-meal in a Chapter 11, even before a plan is filed, despite that the formal name of this chapter of the code is reorganization. See Davis; *supra* note 13, at 256, about 20-30% of confirmed plans are liquidation plans. See *id*; see also E. Flynn, *Statistical Analysis of Chapter 11, 12* (Administrative Office of US Courts, Bankruptcy Division 1989).

¹⁶⁰ The French commercial system takes actual steps to prevent companies from getting into too much financial trouble. Judges of the Commercial courts have the power to summon the CEO of any company that appears to be in financial trouble. Once summoned an informal hearing is held to discuss the information gathered by the court (the information is collected by the Clerk of the Court which is also basically the Registrar of Companies, which has filed information, such as liens, mortgages, and preferences, on each company in the territory). The CEO is allowed to inform the judge of the types of measures the company is taking to right itself. After the hearing the judge can 1) accept the measures

creditors, equity holders or owners, and employees, it is sometimes more efficient and less wasteful to allow the business to reorganize its affairs, either through restructuring its debt, by obtaining new equity owners or both.¹⁶¹ While this theory is not without its critics,¹⁶² the overwhelming worldview today is that some system for “rescuing” ailing businesses is a pre-condition to maintaining a vibrant, capitalist economy.¹⁶³

The shocking difference between American-style reorganization and most others around the world is that current management of the failing company normally stays in place with no administrator directly overseeing the system.¹⁶⁴ The historical development of this unique system derives from the first railroad reorganizations, which were among the first big businesses in America.¹⁶⁵ At the time that Monroe Railroad and Banking, Co. defaulted on its obligations to its lenders, there was no mechanism in place to address this failure other than the lender’s right to foreclose and the court’s equitable right to appoint a receiver to take over the debtor’s assets.¹⁶⁶ Because piece-meal sale of the debtor’s assets would result in great financial loss to all, the court merged these two

discussed by the CEO, 2) gather more information concerning the company from many sources, 3) the CEO can file for a court agent to oversee the company, and 4) urge the CEO to file for protection under French law. *See Views From the Bench, supra* note 6, at 536-39.

¹⁶¹ Sometimes equity is distributed to the unsecured creditor class under the plan of reorganization. *See* 11 U.S.C. § 1129.

¹⁶² Some scholars feel that Chapter 11 is not worth its astronomical costs, or its drag on the economy, particularly given the relatively low success rate for reorganizing companies. *See* Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 312-13 (1993); Douglas G. Baird, *Loss Distribution, Forum Shopping and Bankruptcy A Reply to Warren*, 54 U. CHI. L. REV. 815, 827-28 (1987) (stating that bankruptcy creates benefits to bankrupt companies that are not available to others, creating perverse incentives to file and giving some companies an unfair advantage); Douglas G. Baird, *The Uneasy Case for Chapter 11 Corporate Reorganization*, 15 J. LEGAL STUD. 127, 128 (1996); James W. Bowers, *Wither What Hits the Fan? Murphy’s Law, Bankruptcy Theory, and the Elementary Economics of Loss Distribution*, 26 GA. L. REV. 27 (1991) (arguing that Chapter 11 offers little to justify its existence); Michael Bradley and Michael Rosensweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1049-50 (1992) (arguing that because equity holders rarely recover anything in Chapter 11, Chapter 11 should be repealed); Thomas Jackson and Robert Scott, *On the Nature of Bankruptcy: An Essay and Bankruptcy Sharing and the Creditor’s Bargain*, 75 VA. L. REV. 155, 160 (1981) (questioning the incentives created by the current bankruptcy system). *but see* Gross, *supra* note 10, at 5 (claiming that 20%, one of the estimates of success rates in Chapter 11, is a respectable rate, and evidence of the system’s success).

It is true that Chapter 11 fees are notoriously expensive. Enron attorneys have spent over \$331 million dollars as of March 2003, and the company was still nowhere near confirming a plan at that time. *See* Kristen Hays, *Enron Proposes New Pipeline Business*, ASSOCIATED PRESS, March 19, 2002, 2003 WL 16151125; *see also* Lucian Ayre Bebchuck, *A New Approach to Corporate Reorganization*, 101 HARV. L. REV. 775, 780-81 (1988) (describing the numerous costs and inefficiencies in the current Chapter 11 scheme). Also, in highly regulated industries, with large infrastructures, critics have argued that the Chapter 11 of one player in a closed industry can be unfair and harmful to the other firms in the industry, and even weaken the other firms, by allowing the company in bankruptcy to externalize pre-petition debts and undercut market prices, therefore recovering a greater market share. *See* Sarah McBride, *Australia’s Tough-Minded Bankruptcies May Serve as Role Model*, WALL. ST. J., Dec. 16, 2002, at A1.

¹⁶³ *See* Metzger & Bufford, *supra* note 4, at 153-54.

¹⁶⁴ While scholars have regularly noted that old management is often replaced with new management as the case proceeds, this is often because old management wishes to resign.

¹⁶⁵ Skeel, *supra* note 37, at 57.

¹⁶⁶ *See id.*

legal concepts and ordered that the lender sell the assets all at once, pursuant to a going concern sale, rather than piece-meal.¹⁶⁷

Amazingly, this tiny innovation in foreclosure practice, which took place in the narrow context of failing U.S. railroads, led to a new way of looking at reorganization and value. Lenders continued to threaten foreclosure, but did not always follow through. Moreover, courts began appointing a receiver in each case, who would watch over and protect the debtor's property and to request an injunction against creditor collection efforts.¹⁶⁸ This process was known as equity receivership and allowed the business to continue in operation while the parties attempted to negotiate a favorable resolution of the debt.¹⁶⁹ Ultimately, after many twists and turns, the current Chapter 11 system emerged from this humble start.

3. *The Logistics of Chapter 11 Business Reorganization.*¹⁷⁰

Bankruptcy cases, of which Chapter 11 is one kind, are presided over by a specialized bankruptcy court, that is part of the federal judicial scheme¹⁷¹. The law in place is the Federal Bankruptcy Code,¹⁷² although some principles used in bankruptcy cases arise from state law¹⁷³. When an enterprise is in Chapter 11, it normally operates its own business through its pre-filing management.¹⁷⁴ No trustee is ordinarily appointed. As soon as a debtor files a voluntary¹⁷⁵ Chapter 11 case, an automatic stay goes into effect, effectively stopping all collection activity against the debtor or any of its property of any kind.¹⁷⁶ The stay is broad and powerful and even things that one would not think would be stay are indeed stayed.¹⁷⁷ For example, secured creditors are prohibited from taking any action to repossess collateral that they could repossess if not for the

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

¹⁶⁹ *Id.* at 58.

¹⁷⁰ Chapter 11 can also be used by individuals. *See* 11 U.S.C. § 109(d).

¹⁷¹ *See* 28 U.S.C. § 157(a).

¹⁷² 11 U.S.C. §§101, et. seq.

¹⁷³ For example property exempt from judicial proceedings, *see* note 146, and concepts of property ("Unless a particular federal interest requires a different result, property interests are created and defined by state law." *Butner v. United States*, 440 U.S. 48, 55 (1979).

¹⁷⁴ Although it is unusual, a party in interest may seek the removal of the debtor and have a trustee appointed by showing cause, such as fraud or mismanagement. This is in order to protect interests of creditors equity hold. *See* 11 U.S.C. § 1104 (a); *but see In re Sharon Steel Corp.*, 871 F.2d 1217 (3rd Cir. 1989), (in which appellate court reluctantly upheld trial courts decision to appoint a trustee because the debtor in possession had been unable to turn company around, debtor had conducted questionable transfers of property, virtually violated its fiduciary duty by not pursuing claims to recover such transferred property, and where the debtor itself had proven to be dishonest).

¹⁷⁵ In the United States, the vast majority of cases filed under any chapter of the Bankruptcy Code are voluntary cases. *See* Nathalie Martin, *Que Es La Diferencia?: A Comparison Of The First Days Of A Business Reorganization Case In Mexico And The United States*, 10 U.S.-MEX. L.J. 73, 75 (2002).

¹⁷⁶ *See* 11 U.S.C. §362.

¹⁷⁷ *See* Martin *supra* note 175, at 75. "[T]here is a very broad, automatic stay granted in favor of the debtor. This stays virtually all collection activity that is out there,employee claims, labor claims, every lawsuit that is out there."

bankruptcy.¹⁷⁸ Even the government is precluded from collecting on its claims.¹⁷⁹ Virtually all enterprises,¹⁸⁰ and even individuals,¹⁸¹ are eligible for Chapter 11 and there is no requirement that the debtor be insolvent in anyway.¹⁸² Chapter 11 can be used as a strategic measure, to stop lawsuits, to stop foreclosures, or for whatever purpose the debtor chooses.¹⁸³ Practically speaking, one of the most beneficial features of Chapter 11 is the captive audience that the debtor-in-possession has in its bankruptcy judge, who is available in record time to hear any emergency that could affect the debtor's chances at rehabilitation.¹⁸⁴

The debtor's goal in the case is to emerge from Chapter 11 with its debts restructured and also reduced in amount in most case. This goal is achieved by obtaining approval of a Chapter 11 plan outlining how, to what extent and over what time period debts will be repaid.¹⁸⁵ Creditors are allowed to vote on the debt restructuring plan, thus allowing them to choose whether to go along with the debtor's plan, propose their own plan, or choose to liquidate the debtor's business.¹⁸⁶ If the debtor can get most creditors to vote in favor of the plan, it can be forced on the dissenting creditors who will also be bound by it.¹⁸⁷ Sometimes the debtor can approve a plan even if most creditors vote against the plan, although this is rare.¹⁸⁸

¹⁷⁸ See 11 U.S.C. § 362 (a) (3). For a secured creditor, any party in interest for that matter, must ask the court for permission to lift the stay in order to proceed for repossession. The court will only grant relief for limited circumstances, see 11 U.S.C. § 362 (d); see also Martin, *supra* note 167, at 81.

¹⁷⁹ See Martin, *supra* note 175, at 79, citing 11 U.S.C. § 362 (stating that even government entities must stop all collection efforts, and can only maintain lawsuits against entities in bankruptcy if the issue affects health and public safety, which is interpreted very narrowly); see also *In re Universal Life Church, Inc.*, 128 F.3d 1294 (9th Cir. 1997), cert. denied, 524 U.S. 952 (1998) (finding that the Section 362 (b)(4) police and regulatory exceptions to an automatic stay "refers to the enforcement of laws affecting health, welfare, morals and safety, but not regulatory laws that directly conflict with the control of the *res* or property by the bankruptcy court."). *Id.* at 1297. The two tests to determine if a government action is police and regulatory in nature are the "pecuniary purpose" test and the "public policy" test, *id.* citing *NLRB v. Continental Hagen Corp.*, 932 F.2d 828, 833 (9th Cir. 1991). "Under the pecuniary purpose test, the court determines whether the government action relates primarily to the protection of the government's pecuniary interest in the debtor's property or to matters of public safety and welfare. [NLRB]. If the government action is pursued solely to advance a pecuniary interest of the governmental unit, the stay will be imposed." *Id.*, citing *In re Thomassen*, 15 B.R. 907, 909 (9th Cir. BAP 1981)

¹⁸⁰ See 11 U.S.C. § 109 (d), defining who can be a debtor under Chapter 11. Some examples of entities excluded from Chapter 11 are insurance companies, banks, savings bank, cooperative bank, savings and loan association, building and loan association, and homestead association. These exclusions include both domestic and foreign entities.

¹⁸¹ See 11 U.S.C. § 109(d).

¹⁸² See Martin *supra* note 175, at 77.

¹⁸³ See Maggs, *supra* note 119, at 686 (discussing how Texaco filed its Chapter 11 case in order to delay collection on Penzoil's \$10 million judgment, and ultimately to gain leverage to settle the judgment for \$3 million).

¹⁸⁴ For example, United Airlines just discovered that the IRS owes a \$360 million tax refund, and because United is in bankruptcy, this money will be forthcoming far more quickly than usual. See *IRS Owes United \$360M Refund: But a Federal Investigation Puts Money on Hold*, USA TODAY, March 24, 2003, at B1 (discussing how the bankruptcy court is involved and how settlement may be forthcoming immediately).

¹⁸⁵ Debtor has the exclusive right to file a plan for 120 days, see 11 U.S.C. § 1121(c)(2).

¹⁸⁶ See 11 U.S.C. § 1129(b)(1)

¹⁸⁷ See *id.*

¹⁸⁸ See *id.*

Secured creditors are normally paid in full with interest, up to the lesser of the amount of the loan or the value of the collateral. If the debt is undersecured, all the deficiency claims become unsecured claims.¹⁸⁹ Some creditors, such as taxing authorities and employee claims, are entitled to special priority¹⁹⁰ and must be paid in full in the plan.¹⁹¹ Unsecured creditors are often paid a distribution over time, and are very rarely paid in full. The amounts not paid are discharged at the end of the case and never paid.¹⁹² There is no set amount of distribution that unsecured creditors must receive, but the debtor needs unsecured creditors' votes and thus often offers as much as it can afford to pay.¹⁹³

Existing equity can retain their ownership of the debtor firm, but only if the unsecured creditors agree or if unsecured creditors are paid in full.¹⁹⁴ In a sense, creditors get to choose, through the voting rights¹⁹⁵, whether to go along with the reorganization plan or alternatively, to liquidate the debtor's business. In reality, however, the debtor retains control over the case and the plan process throughout the case in most instances, and has the exclusive right to file a plan for at least the first four months of the case and often much longer.¹⁹⁶ This leaves many creditors feeling like hostages in a debtor-friendly proceeding. A case cannot go on forever, however.¹⁹⁷ A business that is losing money will be liquidated almost immediately because the case is not likely to succeed at reorganization and any delay will hurt creditors.¹⁹⁸

D. Conclusions about the American Scheme and its Societal Role.

American bankruptcy systems did not emerge randomly or in a vacuum, but through conscious modern and historical decisions about the role of credit and money in American society. These attitudes and conditions are unique and are not present in other countries, including those countries currently adopting our systems. This may limit the effectiveness of the imported systems, and should lead countries that are adopting new systems to study other systems as well, and to consider local culture when enacting new laws.

¹⁸⁹ See 11 U.S.C. § 506 (a). "An allowed claim of a creditor secured by a lien on property in which the estate has an interest... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an *unsecured* claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim." This is commonly referred to as bifurcation.

¹⁹⁰ See 11 U.S.C. § 507 (a)

¹⁹¹ See 11 U.S.C. § 1129 (a) (9)

¹⁹² See 11 U.S.C. § 1141 (d)

¹⁹³ A 30% distribution has always struck me as acceptable, though it depends on the case.

¹⁹⁴ See 11 U.S.C. § 1129 (a) (8). However, if under a plan a unsecured creditor is impaired by the plan the court can still approve the plan if it is shown that the unsecured creditor would have received as much under a Chapter 7 liquidation plan, See 11 U.S.C. § 1129 (a) (7) (A) (ii).

¹⁹⁵ However, if the creditor if the creditor is not impaired by the plan and votes against the plan the Court can still verify the plan. See *id.*

¹⁹⁶ See 11 U.S.C. § 1121.

¹⁹⁷ See 11 U.S.C. § 1129 (a) (11).

¹⁹⁸ *Id.*

III. CROSS-CULTURAL ATTITUDES TOWARD DEBT: UNRIPE GROUND FOR TRANSPLANTATION

Around the world, people are less forgiving about debt forgiveness than they are in the U.S.¹⁹⁹ In some parts of the world, not paying debts is the ultimate disgrace.²⁰⁰ In other parts of the world, there simply is no personal bankruptcy system,²⁰¹ and little in the way of business reorganization either.²⁰² Despite this, many countries are starting to move toward a U.S. bankruptcy reorganization model for businesses and some are also replicating forgiving personal bankruptcy laws.²⁰³ Given the unique cultural, economic and historical development of the U.S. systems, however, this may be impractical. This Section describes cultural attitudes toward debt in a few other parts of the world, that are currently in the process of importing U.S. bankruptcy-style laws. It suggests that history cannot be the sole driving factor in determining which bankruptcy system and philosophy a country develops, by describing the very different system and attitudes of England,²⁰⁴ from which our original bankruptcy system arose. By way of further example, it then describes attitudes toward debt and bankruptcy in parts of continental Europe, as well as Japan, as a contrast to the American attitudes previously discussed. The laws of these countries are also briefly examined, in order to discuss the role of both transplantation as well as local culture, in enacting such laws.²⁰⁵

A. *Historical Bankruptcy Perspectives Outside the U.S.: England as an Example*

Because of its long history of commerce, England never had to sprint to catch up or otherwise create a quick market economy.²⁰⁶ Thus, from its inception, English bankruptcy had a very different emphasis and flavor than early American bankruptcy law.²⁰⁷ England's first bankruptcy laws were created in 1543.²⁰⁸ The preamble to this law described the bankruptcy debtor as an anti-social, immoral, character who regularly

¹⁹⁹ See *infra* notes 206-61 and accompanying text.

²⁰⁰ See *infra* notes 480-90 and accompanying text.

²⁰¹ See *infra* notes 238-45 and accompanying text.

²⁰² See *infra* notes 262-70 and accompanying text.

²⁰³ See *infra* notes 375-86 and accompanying text.

²⁰⁴ England, as well as Canada and Australia, have relatively lenient personal bankruptcy systems by world standards. See Efrat, *supra* note 3, at 88-90. Other countries that have more lenient personal bankruptcy systems, besides the U.S., England, Canada and Australia, include Hong Kong, New Zealand, Taiwan, Russia, Scotland and the Netherlands. Virtually all of these countries impose a Chapter 13-like payment plan on at least some bankruptcy debtors before granting them a discharge. See *id.*

²⁰⁵ See *infra* notes 233-302, 375-411, 423-443, and 498-507 and accompanying text.

²⁰⁶ Like many other European nations, it developed its commercial economy over a long period of time, with typical ebbs and flows but continued growth from 1805, at the early beginnings of the industrial revolution, to the present.

²⁰⁷ See Tabb, *History of Bankruptcy* *supra* note 34, at 7 (1995)(noting that early English bankruptcy law was harsh). Professor Tabb notes, however, that English law was hardly unique at the time in its tough treatment of bankruptcy debtors. Common punishments around the world included forfeiture of all property, relinquishment of the consortium of a spouse, imprisonment and death. Early stories claim that in Rome, creditors were permitted to carve up the body of a debtor. See *id.*

²⁰⁸ See Robert Weisberg, *Commercial Mortality, The Merchant Character, and the History of the Voidable Preference*, 39 STAN. L. REV. 3, 20 (1986).

took advantage of others.²⁰⁹ The law itself was designed solely for the benefit of creditors and was virtually criminal in nature.²¹⁰ Bankruptcy was something creditors “did” to the debtor, an involuntary social condition to which a naughty use of credit was subjected against his will.²¹¹ Not surprisingly, then, early English bankruptcy laws were filled with numerous penalties and punishments for non-payment, the most well known of which was to “suffer as a felon, without the benefit of clergy,” a polite phrase for the death penalty.²¹² While few were actually subject to death for failing to pay ones bills, debtors’ prison was common,²¹³ as was being shunned by society in Dickensian fashion.²¹⁴

There was no debtor discharge, though there was plenty of credit, even as early as the 1600’s.²¹⁵ The first debtor discharge was introduced in the Statute of Anne in 1705,

²⁰⁹ See *id.* The Preamble stated that “Where divers and soondry persones craftelye obteyning into theyre hands greate substaunce of other mennes goods doo sodenlie flee to partes unknowne or kepe theyre houses, not mynding to paie or restore to any of theyre creditours theyre debtes and dueties, but at theyre owne willes and pleasures consume the substaunce obteyned by credyde of other men, for theyre owne pleasure and delicate lyving, againste all reasone equity and good conscience . . .”

²¹⁰ See *id.* at 3.

²¹¹ See Tabb, *Evolution of Discharge*, *supra* note 34, at, 336 (1991) (stating that in 1542 Parliament enacted the first English bankruptcy law, 34 & 35 Henry 8, chapter 4, entitled “An act against such persons as do make bankrupts.” As the title indicates, the act was not passed with any heed for the interests of the debtor. Instead, it was intended to give creditors another collection remedy. The new remedy lay against all fraudulent and absconding debtors (but not merely unfortunate debtors), referred to throughout the act as “offenders.” This act, along with all of the early bankruptcy laws, was quasi-criminal in nature, and provided for the imprisonment of the offender if necessary. A British commentator notes that “the law seems at that time to have been administered with considerable severity.” *Id.* Under this act (and for almost three centuries hence) bankruptcy was purely involuntary as to the debtor. The right to commence a bankruptcy proceeding rested solely in the hands of the creditors of the debtor. This limitation was perfectly consistent with the rationale of the act, which was to protect creditors and thus facilitate commerce. Upon notice the various assets of the debtor were seized, appraised, and sold, and the proceeds were distributed pro rata to all creditors proving just claims.

The first voluntary bankruptcy in England was passed in 1844 and applied to traders only. See *id.* at 353-54. This was extended to non-merchants in 1861. See *id.*

²¹² See Tabb, *Evolution of Discharge* *supra* note 34 at 327; but see Weisburg *supra* note 208, at 4.

Weisburg looks at a 1697 treatise by Daniel Defoe, vocal commentator on bankruptcy law and its impact on society. In his “Essay on Projects”, Defoe sets out that the laws of England are, “generally good, and above all things are temper’d with Mercy, Lenity, and Freedom. But bankruptcy law has something in it of Barbarity; it gives loose to the Malice and Revenge of the Creditor, as well as a Power to right himself, while it leaves the Debtor no way to show himself honest: it contrives all the ways possible to drive the debtor to despair, encourages no new Industry, for it makes him perfectly incapable of anything but starving.” Sentiments such as Defoe’s clearly show that society, as a whole, was conscious of the ill effect the law had on the average bankrupt. *Id.*

²¹³ See Tabb, *History of Bankruptcy*, *supra* note 34, at 7.

²¹⁴ For an example of Britain’s historical perception of bankruptcy in the nineteenth century, one should read Dickens’ “Little Dorrit.” The story is about a father and his family living and growing up in a debtor’s prison (Swansea). Dickens’ tale is not unlike Defoe’s sentiment in *supra* note 6. Essentially, the bankrupt was treated like a leper, and the prison was like a leper colony Mr. Dorrit, finally gets out of prison, after receiving a windfall in inheritance, spends it all, and then dies before being forced to return to debtor’s prison. The story’s main focus is on how bankruptcy impacts the family unit, and how it is truly punitive in nature.

²¹⁵ See Tabb, *Evolution of Discharge*, *supra* note 34 at 330.

but this provision was only in place for three years.²¹⁶ The debtor discharge later became part of the permanent law, but was granted upon application only, rather than automatically, after the debtor proved that he had been honest and had cooperated with creditors.²¹⁷ Until 1705, a bankruptcy discharge was only available to merchants, as credit was seen as unnecessary and even a fraud if obtained outside the commercial context.²¹⁸ Unlike the early American economic climate, in which every man was seen as a potential merchant who could help grow the economy, early English society accepted credit only as a necessary evil.²¹⁹ While laws themselves became more lenient over time, this attitude toward debt and credit never really changed.

B. Attitudes Toward Debt in England Today.

Even today, Brits are sensitive about financial failure.²²⁰ They generally consider such failure a failure of character and consider it extremely negative if a person, or even a business, fails financially. Strictly personal bankruptcies, resulting from too much credit card debt or the loss of a job or good health, have been rare in the past because there was little consumer credit, and government programs helped people if they lost employment or needed health care.²²¹ Now there is more credit and more personal financial failure.

While the UK certainly has more bankruptcies than the rest of the EU,²²² these are still considered major embarrassments, even if they result from the failure of a business.²²³ Executives in a company that fails can have a very difficult time finding another job, and are often shunned socially.²²⁴ Thus, despite all the new credit available, the British marketplace comes down hard on those who have gotten into financial difficulty. The

²¹⁶ See *id.* Tabb also notes that discharge was not automatic. The bankrupt needed to receive a “certificate of conformity.” To receive this, the bankrupt needed to voluntarily surrender to an examination by the court, full disclosure, and delivery of all the bankrupt’s assets to the court. The court maintained the power to deny the certificate, but this discretion was seldom used. What’s interesting is that creditors at the time had no power to block the bankrupt’s receipt of the certificate. One could argue that this was one of the first pro-debtor bankruptcy law, but as will be seen the act lasted all but three years.

²¹⁷ See *id.* This provision is still popular in the personal bankruptcy laws of many countries today. See *infra* notes 347-70 and accompanying text.

²¹⁸ See Tabb, *Evolution of Discharge*, *supra* note 34, at 331.

²¹⁹ See Weisberg, *supra* note 208, at 66. As Professor Weisberg notes, in the U.S., bankruptcy law was seen as a “robust, economical, and scientific instrument of commercial efficiency, in England credit was morally-tinged and represented false wealth to many people in traditional land-based society. See *id.*

²²⁰ See *infra* notes 204-07 and accompanying text.

²²¹ See James A. Morone and Janice M. Goggin, *Health Policies in Europe: Welfare States in a Market Era*, 20 J. HEALTH POLITICS, POLICY AND LAW 557, 558, 563 (1995) (noting that England currently has a state-run health care system but that it and other similar European systems may soon be “Americanized”).

²²² See Efrat, *supra* note 3, at 100-01.

²²³ As an example of how harsh the “bankrupt” was treated by the early British code, consider that a nonconforming bankrupt was subject to the death penalty and that to obtain a discharge the bankrupt had “to (i) secure a certificate of conformity from a majority of “bankruptcy commissioners,” (ii) obtain such a certificate from four-fifths of creditors, in value and number, and (iii) swear that the creditor certificates “were obtained fairly and without fraud.” Peter V. Pantaleo *Basic Business Bankruptcy*, 614 PLI/Comm 7 April-May, 1992

²²⁴ See *id.*

attitude is “once a bankrupt, always a bankrupt”.²²⁵ The British government now wants to change these attitude in order to encourage people who have failed to go back into business and help fuel Britain’s flagging economy.²²⁶ Yet it is unclear that one can change attitudes by changing laws. The government is likely to be unable to tell people how to think or whom to invite to parties, even through drastic legal change.

C. Attitudes Toward Debt in Continental Europe: Do the Laws Reflect Them?

Henry Kissinger once said, “when I want to talk to Europe, I don’t know who to call.”²²⁷ While this may be changing, now that the European Union is working on unifying currency and laws, Europe still consists of many diverse cultures, has a huge variety of insolvency systems, and a host of diverging philosophies about debt.²²⁸ As a rule, financial failure on the continent carries significantly more stigma than in the common law countries, and the personal bankruptcy laws are less forgiving than those in the common law countries.²²⁹ Reorganization laws are far more varied and reflect other societal concerns.²³⁰ European governments are attempting to reduce the negative stigma associated with business failure in order to fuel entrepreneurial spirit.²³¹ Many countries, as well as lawmakers of the newly formed European Union, are looking to the U.S. for ideas.²³²

1. Continental Credit Use and Personal Bankruptcy Systems

Personal bankruptcy systems on the continent vary significantly, but have become far more forgiving in the past decade, following the deregulation of consumer credit. While credit, particularly consumer credit, is on the rise on the continent, it is still light years behind that in the U.S. and England.²³³ Savings rates on the continent are declining as well.²³⁴ Socially-minded European governments have expressed concern over both the increase in credit use and the reduction in savings rates.²³⁵ As a result, some have simply

²²⁵ The U.S. did away with the word “bankrupt” in the 1978 Code, replacing it with the more genteel “debtor,” exactly because “bankrupt” carried such negative stigma. See 11 U.S.C. § 101. This was done to attempt to stop citizens from being prejudiced toward bankruptcy debtors.

²²⁶

²²⁷ Steven Pearson, *Successful Restructuring Requires Sensitivity*, THE FINANCIAL NEWS, December 1, 2002, 2002 WL 24141004.

²²⁸ See *infra* notes 233-311 and accompanying text.

²²⁹ Martin, *supra* note 175, at 408.

²³⁰ See *infra* notes 262-302 and accompanying text.

²³¹ Paul Mizen, (paper published by the Experian Centre for Economic Modeling, School of Economics, University of Nottingham), at <http://nottingham.ac.uk/eco>, visited on March 3, 2004. European Credit Research Institute, *ECRI Research Report Number 1, Consumer Credit in the European Union*, at 16-18, <http://www.ecri.be/pubs/ECRIen>, visited on March 2, 2004.

²³² Metzger & Bufford, *supra* note 4, at 153.

²³³ See Mizen, *supra* note 231, at 16.

²³⁴ See *id.* France’s savings rate increased a bit to 15.6%, while all other countries’ rates dropped, and with one country, Denmark, dropping even to U.S. levels. See *id.* at 2.

²³⁵ Proceedings of the 3rd European Conference on Consumer Debt, hosted by National Social Service Board (NSSB) Ireland and European Consumer DebtNet (CDN) Dublin, Ireland, Sept., 1998, *Consumer Debt Problems In Changing Europe*, at 9, <http://news.bbcco.uk/2/hi/business>, visited on February 24, 2003. In the Keynote Conference Speech, Minister of Social, Community and Family Affairs, Dermot Ahern, stated that:

stepped up efforts to educate the public about the hazards of credit use.²³⁶ Others have liberalized bankruptcy and discharge laws, in order to ensure that social problems aren't exacerbated by the increases in credit.²³⁷

Not all European countries have forgiving bankruptcy systems, however, and some have no systems for consumers at all.²³⁸ For example, in the bankruptcy-restrictive countries of Italy, France²³⁹ and Greece,²⁴⁰ individuals are not eligible for bankruptcy protection unless they are engaged in business.²⁴¹ In other words, there simply is no

Here in Ireland, with our booming economy, and our young, vibrant population, the conditions are ripe for an expansion of consumerism, in addition to the already 'normal' levels of personal borrowing that exist in the population. This, in point of fact, is not an undesirable prospect as consumer demand has, and will continue to, drive economic and employment growth. It will underpin employment in the service sector and allow large sections of the population to expand and develop their lifestyles.

However, with all this emphasis on the booming economy, we must remember that the economy is just a means to an end and not an end in itself. What really matters is the welfare of our people. Here we must ensure that massive growth in consumer credit does not lead to an equal growth in consumer debt. People who are living on the margins of poverty must not be the ones to pay for our consumer boom.

As crises on a global scale are beyond our capacity to resolve, we have to concentrate our energies on national, local, and personal debt management strategies.

Id. at 9.

²³⁶ *Id.* at 35. The Swedish keynote speaker at the same conference noted that as family debt increases it is imperative to educate children about debt. *See id.* at 35 (remarks of Hans Naslund). As the speaker explained: [b]y strengthening children and young people in their role as consumers, the basis can be laid for a strong consumer role in adult life with lifestyles that are in harmony with their income." *Id.* This certainly differs from the American model of the "strong consumer." *See supra* notes 104-45 and accompanying text.

²³⁷ *See* Efrat, *supra* note 16, at 165-66. Professor Efrat hypothesizes that the need for a fresh start policy is greater in societies where the government does not regulate credit rates or availability, where the government actively promotes entrepreneurship, where the welfare programs are small, and where private financial institutions have relatively lax standards for granting credit. *See id.* He argues that the U.S. fresh start policy is very justified in this context, and also that more countries should enact more lenient systems of debt forgiveness as they move toward the U.S. regarding these factors. *See id.* at 167-68.

²³⁸ *See* Efrat, *supra* note 3, at 109 n. 16. Under one scholar's characterization of Continental systems, the most restrictive or "conservative" camp is comprised of systems that provide no debt forgiveness to consumers at all. The "moderate" camp is comprised of nations that offer debt forgiveness to financially distressed consumers, but not as a matter of course, and the least restrictive or "liberal" camp, headed by the United States, consists of countries that provide a relatively prompt bankruptcy discharge as a matter of course. *See id.* at 82-83.

²³⁹ Oddly, under French law, which is fairly liberal for business debtors, individuals can be discharged only from mortgage deficiency claims. *See* Efrat, *supra* note 3, at 86 (quoting Françoise Domont-Naert, *Legal Response to Problems of Consumer Indebtedness in Europe*, in CONSUMER LAW IN THE GLOBAL ECONOMY-NATIONAL AND INTERNATIONAL DIMENSIONS 285, 288 (Iain Ramsay ed., 1997)). Conceptually, I have always considered France to fall into the most "conservative" or "restrictive" group because there is no personal bankruptcy discharge at all, except for mortgage deficiency debt (emphasis added) *See id.*

²⁴⁰ Remarkably, the Greeks use little credit. *Greek households are not Overdebted*, ATHENS NEWS, March 13, 2003, 2003 WL 2677459.

²⁴¹ *See id.* at 81; *see also* Metzger & Bufford, *supra* note 4, at 154 (1993); Richard L. Bohanon & William C. Plouffe, Jr., *Mongolian Bankruptcy Law: A Comparative Analysis with the American Bankruptcy*

bankruptcy system for consumers.²⁴² Even for individuals engaged in business, a discharge is not granted until many years after bankruptcy is declared, and in a handful of the most restrictive places, no discharge is granted unless creditors are ultimately paid in full.²⁴³ This is certainly an unusual interpretation of a discharge, at least from an American perspective.²⁴⁴ The underlying theme of bankruptcy in these jurisdictions is that bankruptcy is a creditor-oriented mechanism and is not designed to serve the interests of financially distressed consumers.²⁴⁵

The lack of such a system could have grave societal implications in the face of consumer credit deregulation. In the past, countries without a personal bankruptcy system generally did not have access to consumer credit. This equilibrium is now out of balance. Where there is an economy with consumer credit, such as in Italy or France, there is simply no way out.²⁴⁶ If one gets in trouble with consumer debt, one remains in trouble, perhaps indefinitely.

Other European countries are more forgiving, providing some form of discharge. In Norway, Sweden, Denmark, Finland, Austria, Germany, France, Spain and Portugal,²⁴⁷ the judge has the discretion to decide whether a discharge is justified.²⁴⁸ While the particular standard for granting a discharge varies from place to place, the burden is on the debtor to prove that the discharge is justified in moderate camp jurisdictions.²⁴⁹ In

System, 7 TULSA J. COMP. & INT'L L. 1, 6 (1999); Kevin P. Block, *Ukrainian Bankruptcy Law*, 20 LOY. L.A. INT'L & COMP. L.J. 97, 99 (1997)

²⁴² In a few of these places, such as Brazil and Venezuela, an individual is *only* eligible for bankruptcy if he or she engaged in business activity as a merchant. In many of these places there also is little consumer debt available. Perhaps these laws make sense in their context. See Antonio Mendes, *The New Latin American Debt Regime-A Brief Incursion into Bankruptcy and the Enforcement of Creditor's Rights in Brazil*, 16 J. INT'L L. BUS. 107, 108 (1995). See Efrat, *supra* note 3, at 84. In the Czech Republic, the debtor must enter into a settlement agreement with her creditors. See Helmut Gerlach, *Bankruptcy in the Czech Republic, Hungary, and Poland and Section 304 of the United States Bankruptcy Code, Proceedings Ancillary to Foreign Bankruptcy Proceedings*, 22 MD. J. INT'L L. & TRADE 81 (1998). Conversely, Chile and Egypt offer the debtor no discharge at the conclusion of the proceedings. See also Ricardo Sandoval, *Chilean Legislation and Cross-Border Insolvency*, 33 TEXAS INT'L L. J. 557, 577 (1998).

²⁴³ See Efrat, *supra* note 3, at 84-85. Professor Efrat notes that in these conservative nations, bankruptcy is a creditor-biased mechanism, more akin to a debt-collection proceeding than a debt-forgiveness framework. Thus, there is no need to discharge the debt. See *id.* In Italy, for example, discharge is for merchants only and it takes 5 years to get a discharge, while it takes 10 years in Greece. See also *Bankruptcy and a Fresh Start: Stigma on Failure and Legal Consequences of Bankruptcy*, *supra* note 143, at 335.

²⁴⁴ The U.S. Bankruptcy Code of 1978 allows certain debts to be wholly or partially discharged.

²⁴⁵ See *id.* For example, one source claims that the purpose of Italian bankruptcy law is to "satisfy the creditors rights and remove the insolvency (sic) company from the market." See web page of Avvocato Giorgio Cherbuni, Giorgio.cherbuni@stdiopirola.com, visited on March 17, 2003.

²⁴⁶ Efrat, *supra* note 3, at 86.

²⁴⁷ See *id.* at 85. This category also includes the Asian countries of India, Pakistan, Japan, Singapore, and the Philippines, as well as Israel, South Africa, Kenya and Uganda. See *id.*

²⁴⁸ See *id.* at 87. This attribute has fundamental impact on debtors seeking relief, as they have the burden of convincing the judge to grant relief. Efrat reports that there are three basic reasons why debtors in this strata choose not to file for bankruptcy: social stigma, ignorance of debt forgiveness outcome, and the high costs and unpredictable results associated with convincing a judge. This is an attribute of Indian law as well as the law of the Philippines, Singapore and Japan, and the African nations listed above. See *id.*

²⁴⁹ See *id.*

many places, the judge may grant a bankruptcy discharge only if the person is unable to pay the debts.²⁵⁰ For example, in Denmark, the debtor must be hopelessly indebted and the circumstances must justify granting a discharge.²⁵¹ In Norway, a debtor must be permanently unable to pay.²⁵² In Sweden, in order to get a full or partial discharge, the debtor must affirmatively prove that “the debtor has no hopes of paying his or her debts in the foreseeable future.”²⁵³

Other European laws have other themes. In Austria and Germany, a discharge is only granted if the debtor abides by a repayment plan over a period of years, similar in some respects to Chapter 13 under American law.²⁵⁴ In Germany, the debtor must make an effort to increase his or her income for the benefit of creditors and also must pay over all seizable income to creditors for seven years.²⁵⁵ Moreover, creditors are only kept at bay so long as the debtor does not exceed a certain income or asset level,²⁵⁶ a provision that arguably creates the wrong incentives.

In all the systems discussed in this section, there has been movement toward liberalizing the laws, though none are as forgiving as that of the U.S., England and the other common law systems.²⁵⁷ Until recently, it was not clear that the continent needed forgiving bankruptcy systems, given extensive social systems and fairly rigid requirements for borrowing.²⁵⁸ Extensive growth in consumer credit, makes such debt forgiveness necessary, however, particularly in light of existing stigma about financial failure.²⁵⁹ Fortunately, as a whole European governments seem interested in making sound public policy and protecting citizens not merely fueling economies for their own sake.²⁶⁰ Hopefully these concerns will keep credit from proliferating beyond the respective systems’ ability to address failure in a constructive way. Some countries, such as Italy and France, have not yet balanced these concerns and may face social problems as a result.²⁶¹

2. European Reorganization Schemes: France and Germany as Examples.

²⁵⁰ See *id.* at 86.

²⁵¹ See *id.* at 103. See also Hans Petter Graver, *Consumer Bankruptcy: A Right or a Privilege? The Role of the Courts in Establishing Moral Standards of Economic Conduct*, 20 J. CONSUMER POL’Y 161, 170 (1997).

²⁵² See *id.*

²⁵³ See *id.* See also IAN RAMSEY, *CONSUMER LAW IN THE GLOBAL ECONOMY: NATIONAL AND INTERNATIONAL DIMENSIONS* 287 (1997)

²⁵⁴ See Efrat, *supra* note 3, at 109. See also Christoph G. Paulus, *The New German Insolvency Code*, 33 TEX. INT’L L. J. 141, 143-44 (1998)

²⁵⁵ See *id.* (“The Gesamtvollstreckungsordnung includes a discharge rule--not the Anglo-American rule but the Swiss rule: It keeps the creditors away only as long as the debtor does not achieve a certain income and wealth level After the closing of the [bankruptcy] procedure, the debtor will have to earn as much as possible for seven years and hand over this income to a trustee, who will divide it among creditors.”).

²⁵⁶ *Id.*

²⁵⁷ Martin, *supra* note 175, at 75.

²⁵⁸ See Efrat, *supra* note 3, at 94-95.

²⁵⁹ Mizen, *supra* note, 231, at 16-18.

²⁶⁰ *Id.*

²⁶¹ Efrat, *supra* note 3, at 85.

As with personal bankruptcy systems, not all continental countries have reorganization schemes. In fact, until recently, most countries did not have such a scheme.²⁶² With the fall of communism and Europe's desire to create a more competitive market economy, however, reorganization laws have become popular new legislation. Most of these systems are still very different from the U.S. Chapter 11 model.²⁶³ In most places, there is no "automatic stay" that protects the debtor and its assets upon the filing.²⁶⁴ Additionally, in most places the debtor must be insolvent in order to apply for reorganization and also must have some likely chance of success at reorganizing.²⁶⁵ The stay, if there is one at all, normally kicks in after the court sorts out all these problems and issues an order declaring the company in bankruptcy or reorganization.²⁶⁶

Under most schemes, the debtor's management is replaced with the trustee, a neutral third party who will run the company while it is attempting to restructure, and who will control the case and the plan proposal process.²⁶⁷ In some reorganization schemes, secured creditors are not precluded or stayed from gaining possession of their collateral, and thus can thwart the reorganization process if they wish.²⁶⁸ For example, in the new European Union Council Regulation of Insolvency Proceedings, the secured party retains the right to dispose of assets and obtain satisfaction from the proceeds of

²⁶² See Martin, *supra* note 167, at 78.

²⁶³ *Id.*

²⁶⁴ *Id.*

²⁶⁵ *Id.*

²⁶⁶ See *id.* at 82.

²⁶⁷ See, e.g., *supra* notes 282-315 and *infra* notes 408-36 and accompanying text.

²⁶⁸ Because of this, some scholars consider these composition systems rather than reorganization systems. Two economists recently completed a study of bankruptcy and insolvency laws and infrastructures around the world. Clas Wihlborg & Shubhashis Gangopadhyay, *Infrastructure Requirements in the Area of Bankruptcy Law*, Brookings-Wharton Papers on Financial Services, 281, 281 (2001) (hereafter, "WSG"). Positing that strong creditor remedies, as well as strong rehabilitation systems, should save more firms, they compared countries on several considerations, starting with whether a country's laws could be considered more debtor friendly or more creditor friendly. See *id.* at 291. Their study actually purports to be much broader, studying the economic role of insolvency procedures and their affect on efficient allocation of resources, economic growth, and the depth and duration of financial strain. See *id.* at 284. They defined a creditor orientation as one that recognizes the claims of creditors to a great extent in insolvency (see *id.* at 295), and a debtor orientation as one that allows debtors to retain a stake or control in insolvency, (see *id.* at 293), although no equity is left in the firm. See *id.* at 291. They also rated each country or region's attitudes toward security, particularly floating liens that create a security interest in all cash flow generated by a business, and examined the scope of security interests under various countries' laws. See *id.* at 294-95. They argued that countries that allow floating liens or charges and that position the secured creditor's interests over unsecured claims of labor and the government, for example, should create more certainty for lenders and thus promote lending and growth. See *id.* at 295, 307. The authors note that in Latin America, labor claimants are highly favored, which could explain why there is little lending in Latin America. On the other hand, the authors acknowledge that the same favoritism toward labor is present in France, see *id.* at 301, but there is no dearth of lending there.

Countries found to be very sympathetic to creditor interests in these ways were all the English common-law countries, including the United States, and Scandinavia. See *id.* at 296-97. Sympathetic countries include Germany, Japan, Netherlands, Switzerland, Scotland and South Africa. Countries hostile to security on these factors include Belgium, Luxemburg, Greece, Spain, and most of Latin America, See *id.* at 300.

those assets.²⁶⁹ In some countries, labor claims are so strong that they also are not stayed and can also veto any plan the debtor proposes.²⁷⁰

Many schemes, like the U.S. scheme, provide that creditors can vote on the plan of reorganization and thus decide if it should be allowed to reorganize or should instead be liquidated.²⁷¹ Many, though not all, countries' laws also allow the majority to bind the dissenting minority to the terms of the plan.²⁷² In some places, big institutional creditors, such as lenders and banks, control the case and essentially decide the business's fate.²⁷³ In most places, secured creditor claims are not changed in either amount or payment terms, causing one scholar to conclude that these are not really Chapter 11-style reorganization scheme but rather "composition" plans.²⁷⁴

Compared to American bankruptcy laws, many countries' laws read like penal codes. Fraud and criminal activities are discussed at length, leaving one to believe that there is almost a presumption of criminal activity or fraud when a business fails to pay its debts.²⁷⁵ Other provisions suggest that limited liability is not as "limited" as it is in the United States; thus more debts pass through to parents, owners and even managers.²⁷⁶ Finally, in some countries, if the managers let the company run for longer than is reasonable without seeking rehabilitation assistance or closing down, the managers can be imprisoned for wasting creditors' assets.²⁷⁷

French reorganization law, at one end of the continuum, is considered the most "rescue" oriented in the world, even more so than Chapter 11 of the U.S. Code.²⁷⁸ The goal of the French system is not merely to facilitate reorganization, but to encourage it, through early interventionist mechanisms that force or strongly encourage businesses to

²⁶⁹ *Id.*

²⁷⁰ See Dr. Wolfgang Lueke, *The New European Law on International Insolvencies: A German Perspective*, 17 BANKR. DEV. J. 369, 369 n.1 (2001)(stating that, with respect to secured interest, in cases opened under the IPR, the IPR provides that "[s]uch a right will not be affected by the opening of the proceeding." *Id.* at 386-87.

²⁷¹ See Martin, *supra* note 175, at 80.

²⁷² See *id.* at 82.

²⁷³ Curtis J. Milhaupt, *On the (Fleeting) Existence of the Main Bank System and Other Japanese Economic Systems*, 27 L. & SOC. INQUIRY 425, 430-33 (2002).

²⁷⁴ Martin, *supra* note 175, at 81.

²⁷⁵ See *id.*

²⁷⁶ See Paulus, *supra* note 254, at 145.

²⁷⁷ See Paulus, *supra* note 254, at 147.

²⁷⁸ See WSG *supra* note 268, at 293. Part of the reason it is considered more debtor friendly than American law is because of the very strong rights of secured creditors under U.S. law, which are balanced by Chapter 11 and Chapter 7 bankruptcies. Secured creditors do not have these strong rights in France. *Id.* at 296. In fact French bankruptcy laws could be considered hostile.

These laws are far different from those of Germany. See Paulus, *supra* note 254, at 145. In May of 2000, the European Union adopted the European Union Council regulation of Insolvency Proceedings (the "IPR"), which is an effort to create a binding common legal regime for cross-border insolvencies between member nations.²⁷⁸ The task proved daunting because France had a strong rehabilitation goal and culture, whereas Germany favored liquidation over rehabilitation and gave secured creditors the right to control business bankruptcy cases.

seek rehabilitation early enough so businesses and jobs are not lost.²⁷⁹ France has a strong history of state intervention into corporate affairs, which has carried over into modern reorganization laws.²⁸⁰ The process favors saving job-generating enterprises at almost any cost.²⁸¹

German reorganization law, lies at the other end of the spectrum in some respects. It now allows for but certainly does not favor the use of a debtor-in-possession. In 1999, Germany enacted “rescue” legislation, with the stated purpose of promoting reorganization over liquidation.²⁸² Prior to this time, the only insolvency law used in Germany was a liquidation statute, the Konkursordnung.²⁸³ While another prior law, the Vergleichsordnung, allowed rehabilitation,²⁸⁴ the concept of reorganizing rather than liquidating a troubled business had never really been accepted in German culture and thus the Vergleichsordnung was never used.²⁸⁵ Thus, prior to the adoption of the New German Insolvency Code (the “InsO”), all businesses were simply liquidated.²⁸⁶ The presumption in favor of liquidation was so strong that when a team of researchers

²⁷⁹ See Richard L. Koral & Marie-Christine Sordino, *The New Bankruptcy Reorganization Law in France: Ten Years Later*, 70 AM. BANKR. L.J. 437, 437-40 (1996). The laws require greater financial reporting so that companies in distress are identified early, and the companies themselves recognize when they are in need of assistance. All financial reports are filed with the clerk of the Commerce Tribunal who, using computer programs designed to identify signs of weakness in a company, brings defaults to the attention of the president of the Commercial Tribunal. If the company does not address the defaults the president of the Commerce Tribunal has the power to call the company’s President into chambers for a “frank personal discussion”. I can imagine that companies would prefer to avoid this discussion. Courts in the United States do not have the oversight ability given to the courts in France, and hence no early intervention. See *id.* at 457. The court can also arrange for mediation between the company and its creditors before judicial remedies are needed. *Id.* at 446.

²⁸⁰ *Id.* at 444. France has historically protected the rights of workers, which explains the involvement of the court in reorganization plans. Dating back to 1673 with the “Ordinance de Colbert” and the original Commercial Code of 1807, France has had an attraction for state intervention. The courts play a role much more inclined to protect the economic function of society, rather than a means for creditors to regain their debt.

²⁸¹ See *id.*

²⁸² Section 1, InsO states explicitly that one of the Code’s objectives is the “reorganization of insolvent debtors.” *Insolvenzordnung* [Insolvency Act], v. 5.10.1994 (BGB1. I S.2866) (hereinafter, the “InsO”), Section 1; see also Christoph Paulus, *Germany: Lessons to Learn from the Implementation of a New Insolvency Code*, 17 CONN. J. INT’L L. 89, 90 (2001); see Paulus, *supra* note 254, at 142.

Before we get too excited about this significant change, we should recognize that this does not mean reorganization in the American sense of staying in business. Section 156(1) of the InsO states that “[a]t the report meeting the insolvency administrator shall report on the economic situation of the debtor and its causes. He shall assess any prospect of maintaining the debtor’s enterprise as a whole or in part, indicate any possibility of drawing up an insolvency plan and describe the effects of each solution on the satisfaction of the creditors.” InsO, Section 156(1). Section 157, however, states that “[a]t the report meeting the creditors’ assembly shall decide whether the debtor’s enterprise should be closed down or temporarily continued.” InsO, Section 157. Thus, a reorganization that leaves the debtors operations intact over the long haul seems outside the contemplation of this new law.

²⁸³ *Konkursordnung* (InsO) [Bankruptcy Act], v. 10.2.1877 (RGI. S.351).

²⁸⁴ *Verordnung uber die Gesamtvollstrecknung* (Gesamtvollstreckungsverordnung) [Collective Enforcement Act], v. 6.6.1990 (GBI DDR I S.285).

²⁸⁵ Paulus, *supra* note 254, at 141-42.

²⁸⁶ See *id.*

collected data on the effectiveness of rehabilitation systems around the world, no rehabilitation statistics were available for Germany.²⁸⁷

German lawmakers, if not German society in general, now believe that liquidation is not the best solution to some industry or business problems.²⁸⁸ The enactment of the InsO was motivated by recessions and general problems with the economy, as well as the need to help acclimate and protect Eastern European individuals and businesses, who have been “overwhelmed by Western consumer standards.”²⁸⁹ Unlike most parts of the world, German insolvency cases are presided over by a specialized bankruptcy court.²⁹⁰ In most cases brought under the InsO, a trustee, called an administrator, operates the debtor’s business, although at least in theory, a debtor-in-possession is possible.²⁹¹

Reality may operate quite differently, however. Whatever the new Code actually says about the plan’s possible affect on creditors, creditors - particularly secured creditors - always have and still do control insolvency proceedings.²⁹² In fact, although the new Code states that the administrator appointed in each case shall be independent and thus not biased toward any particular party in the case, prior to the enactment of InsO,²⁹³ it was common for the administrator to be chosen by the lead or primary secured lender in the case.²⁹⁴ This has not changed under the InsO.²⁹⁵ Thus, despite the technical requirement of an independent administrator, the main or lead bank can often choose an administrator who is friendly to its interests.

Additionally, despite clear language in the InsO stating that one purpose of the InsO is to “reorganize insolvent debtors,” this concept is far from universally accepted. One scholar wrote *after* the enactment of the InsO that German insolvency law does not

²⁸⁷ See WSG, *supra* note 268, at 302.

²⁸⁸ See InsO, Section 1.

²⁸⁹ See Paulus, *supra* note 254, at 142. Professor Paulus explains in another article that “once the wall came down, an enormous and politically significant number of East German households had become insolvent- to a high degree due to common Western sales practices to which former GDR inhabitants had never been exposed before. Thus, the German legislature was bound to do something for the needs of these families.” Paulus, *supra* note 282, at 90.

²⁹⁰ See *View from the Bench*, *supra* note 6, at 518-19. In fact, many of the important decisions made by the German Bankruptcy courts are actually delegated to a graduated law clerk who is paid less and presumably has far less experience than the judges themselves. See *id.* at 533-34.

²⁹¹ See Paulus, *supra* note 254, at 146-47 (stating that a trustee that is independent of the interests of either the debtor or the creditors, is usually appointed in an InsO case for the purpose of running the debtor’s business, but that if the creditors still trust the debtor, “they may agree to the personal management of the debtor.”).

²⁹² WSG, *supra* note 268 at 300.

²⁹³ InsO, Section 56(1).

²⁹⁴ See WSG, *supra* note 268, at 301.

²⁹⁵ Professor Paulus notes that the largest creditors have the right to appoint an administrator that they choose and know and trust. See Paulus, *supra* note 282, at 93. As he explains, there is no particular reason why these big creditors should not have the right to work with someone whom they know and trust, given that they are the ones paying most for the debtor’s insolvency and thus have the most to lose. However, “this historical picture gets distorted when these creditors start to act irresponsibly, responsibility meaning here that they should keep in mind that they are given all of these rights and powers in order to increase the efficiency of the new law, and not in order to achieve some windfall advantage.” See *id.*

favor rehabilitation over liquidation, and leaves that decision squarely in the hands of creditors.²⁹⁶ Even the explicitly provided for “reorganization” contemplated by the InsO is *not* what an American lawyer might picture; this is not a reorganization in which the business restructures its debts and continues in operation over the long haul. Section 157 of the InsO states that “[a]t the report meeting the creditors’ assembly shall decide whether the debtor’s enterprise should be closed down or *temporarily* continued.”²⁹⁷ Thus, a reorganization that leaves a debtor operational on a long-term basis appears outside the contemplation of this new law.

Finally, the debtor-in-possession provisions in the InsO are also likely to get little play. The concept of a debtor-in-possession has been criticized and mistrusted by most of German society for such a long time that it may never be unearthed regardless of what the law says.²⁹⁸ Professor Paulus tells an amazing story about the Holzman Construction Company bankruptcy, in which Holzman had the most experienced and well thought-of insolvency attorney appointed to the board of the company, so that they could go forward under the best of circumstances with the very first debtor-in possession case under the new law.²⁹⁹ The government was so opposed to the concept of a debtor-in possession that they found a way to bail Holzman out completely so that there would be no bankruptcy and thus no debtor-in-possession.³⁰⁰

Again, history and culture may be more important in determining how cases are handled than the actual law. As one scholar notes, people who were accustomed to the old law are likely to stick to what they have become accustomed to, and act as they always have, regardless of which law is on the books.³⁰¹ Thus, two years after the InsO went into effect, the new law is still widely objected to, if not entirely ignored.³⁰²

²⁹⁶ *Id.* at 91-92.

²⁹⁷ InsO, Section 157 (emphasis added).

²⁹⁸ Paulus, *supra* note 282, at 91.

²⁹⁹ *See id.* at 91-92.

³⁰⁰ *See id.*

³⁰¹ *See id.* at 90. As Paulus notes, in addition to ignoring concepts such as debtor-in possession, and presumptions of rehabilitation over liquidation, courts and creditors interpret the new laws as narrowly as one possibly could, and as consistently as possible with the law replaced. *See id.*

³⁰² *See id.*

3. Conclusions About European Bankruptcy Laws and Culture

While one might predict that personal bankruptcy would carry more stigma than business bankruptcy in most of continental Europe, particularly since some countries do not permit a discharge for people who are just consumers, the line between individual financial failures and business ones is blurred on the continent. Failure is failure pure and simple and the stigma is significant.³⁰³

Until recently, there was little consumer credit, and thus little need for a consumer bankruptcy system. This is all about to change as consumer credit becomes widely available to a huge percentage of the population over the next decade. This could leave many societies with excessive debt and no way to discharge it. Even if discharge systems are enacted, societal views about debt may keep them from being used. In many failed businesses throughout Europe, including The U.K., the stigma is so pronounced that executives and even employees and suppliers often disappear entirely.³⁰⁴

On the business side, European governments are already doing all that they can to enact rescue-style reorganization systems, in order to allow more failing businesses to survive in troubled times.³⁰⁵ As an official European Union source stated:

Europe must re-examine its attitudes toward risk, reward and failure. Thus, enterprise policy must encourage policy initiatives that reward those who take risks. Europe is often reluctant to give a second chance to those entrepreneurs who failed. Enterprise policy will examine the conditions under which failure

³⁰³ When Ioncia P.L.C., a wireless telephone company, failed recently in the Netherlands, all employees lost their jobs, stockholders lost their equity and suppliers found new work or failed themselves. Five executives of the company tried to start a new company but no one wanted to do business with them. Europeans are expected to work at the same job for life and starting several different companies or careers is rare. Entrepreneurial spirit is also uncommon although many European governments would like to increase this element in society. Similarly in France, it is considered a mortal sin to apply for bankruptcy. A person who does so is morally stained in society's eyes. Debtors from many countries report that after failing financially, all social relationships often disappear.

Similarly, one embarrassed citizen in Italy recently told me that when he became \$3.00 overdrawn on his checking account, his entire economic life was halted. A car loan was called and his account was shut down. Apparently the society is simply not set up to "float" cash to average citizens.

³⁰⁴ Gruner, *supra* note 142, at A1. This makes more sense than one might think. In some countries, executives can be imprisoned for failing to stop operating a failing company as soon as it is clear that it is failing. In Germany, for example, one can be sent to jail for deliberately and recklessly keeping a company in operation once it is losing money. *See id.* at A3. In other countries there is personal liability to directors and officers of a company that is allowed to operate while it is losing money. Needless to say, laws like these do not encourage risk taking.

Tough attitudes toward financial failure make great sense in more socialist societies. The government protects people by at least providing the basic necessities of life. These basics are provided by taxing private industry enough to keep most people in the middle classes. None of this encourages entrepreneurialism nor necessitates a strong debt forgiveness system, though it does provide more safety nets than the American system. As the E.U. embraces a more market-based economy, it will be interesting to see if attitudes change. It will be interesting to see if in fact average citizens become more forgiving both socially and in business, in order to support and create a more market-based economy.

³⁰⁵ *See Bankruptcy and A Fresh Start, supra* note 143, at 31.

could acquire a less negative connotation and it could be acceptable to try again. It will encourage member states to review bankruptcy legislation to encourage risk-taking.³⁰⁶

A recent European Union (“EU”) study examined stigma and financial failure in the fifteen EU member states as well as the United States to determine how to reduce stigma about financial failure, for the benefit of the overall EU economy.³⁰⁷ Given the extent of the negative stigma, the study concluded that even if domestic legislators adopt laws that promote a fresh start, “there is a need to introduce a European cultural campaign promoting the fresh start....”³⁰⁸

Yet Europeans appear conflicted on whether to actually promote a fresh start. This study, as well as numerous other sources, focuses extensively on separating the fraudulent from the non-fraudulent debtors, and providing rehabilitation rights only for the worthy.³⁰⁹ There is no indication, however, that fraud will be a problem.³¹⁰ While the goals of the E.U. in modernizing and liberalizing the insolvency laws of member countries seem sensible, it is unclear whether this will work. Long held and strong cultural values may stand in the way, despite the best intentions of lawmakers. This has clearly been an impediment in Germany where rescue culture has not been accepted in society. In France, by comparison, where rescue culture is entirely consistent with long-held beliefs about the importance of saving jobs, rescue culture and business reorganization has been well accepted and frequently utilized.³¹¹

E. East Asian Bankruptcy Law and Culture: A Different World

³⁰⁶ See *id.*

³⁰⁷ See *id.* According to this study, most EU member states have legal procedures aimed at rehabilitation, but they appear to be unsuccessful or unpopular with the business community, due to negative complex and expensive procedures, a lack of awareness of the options, as well as slow adaptation to new systems. See *id.* at 356.

³⁰⁸ See *id.* at 354. The study went on to say that “[i]n Latin countries, the word “faillite” (“fallimento”, “quiebra”...) holds a very negative connotation. It seems that these cultural elements would also require a sound reflection in order to involve these three communities.”

³⁰⁹ See *id.* at 356; see also Bethany Blow, *The Economics of Insolvency, Conference Summary*, Financial Stability report, 153, 154 (Dec. 2002), available at <http://www.bankofengland.co.uk/conferences/conf0209>, visited on March 17, 2003 (reciting the remarks of Paolo di Martino, an Italian attorney, stating that bankruptcy law must “be able to select between good and fraudulent debtors”).

³¹⁰ The implication is that fraud in bankruptcy is a major issue, although there is no reason to believe that this is the case. Given the extremely small number of fraudulent debtors that are present even in the lenient U.S. system, this goal seems oddly misplaced. It continues to focus on the negative rather than promoting forgiveness and future economic activity. These goals seem particularly misplaced when compared to American metaphors about the fresh start. For example in the famous case of *Local Loan v. Hunt*, the U.S. Supreme Court described the Bankruptcy Act as: “a sturdy bridge over financially troubled waters.... We refuse to make it a treacherous tightrope on which the slightest misstep spells disaster and over which only the most accomplished acrobat can successfully pass.” 292 U.S. 234, 238 (1934). Commentators playing on Hunt’s metaphors have claimed that bankruptcy provides “the opportunity to free a family from living hell, permitting it to attain a new and brighter world, no longer oppressed by the clouds of fear, degradation, and discouragement...” Papke, *supra* note 70, at 212.

³¹¹ See *supra* notes 278-81 and accompanying text.

Of all of the East Asian countries, Japan has borrowed the most from American bankruptcy systems and also has developed the most complex bankruptcy systems.³¹² Its systems are thus discussed below in some detail. To a large extent, Japan's attempted transplantations have failed to overcome strong cultural attitudes against bankruptcy.³¹³ Hong Kong is less traditional and could probably accept modern bankruptcy laws much more readily.³¹⁴ Ironically, it has not modernized its business bankruptcy laws, due to its own unique cultural concerns.³¹⁵ China's proposed bankruptcy laws also borrow significantly from American systems.³¹⁶ These laws are far more lenient about business failure than existing Chinese laws.³¹⁷ Given China's traditionally communist economy, it faces unique challenges as it attempts to adopt bankruptcy laws that will promote a market-based economy.³¹⁸ Given strong cultural beliefs that bankruptcy is bad luck and will follow a family forever,³¹⁹ China may face problems similar to those of Japan in gaining acceptance of more lenient bankruptcy laws.

1. Japanese Bankruptcy Law and Culture.

In the past few years, Japanese spending habits, as well as Japanese bankruptcy and insolvency laws, have gradually become more similar to their U.S. counterparts.³²⁰ Drastic measures have been taken to promote business rehabilitation in order to aid Japan's ailing economy.³²¹ Personal bankruptcy has also become more accessible.³²² These are necessary developments, given that credit has recently become more available to the Japanese, which has in turn increased borrowing.³²³ Yet the Japanese avoid using these initiatives for cultural reasons.³²⁴

A. Law and Japanese Culture

Western legal notions are unfamiliar to the Japanese mind, heart, and soul. Traditional Japanese culture emphasizes the group over the individual, similarity over difference.³²⁵ Thus, the Japanese feel that it is embarrassing and shameful to need to

³¹² See *infra* notes 375-411 and accompanying text.

³¹³ See *infra* notes 412-18 and accompanying text.

³¹⁴ See *infra* notes 458-61 and accompanying text.

³¹⁵ See *infra* notes 423-38 and accompanying text.

³¹⁶ See *infra* notes 498-507 and accompanying text.

³¹⁷ Actually, under Chapters 16 and 19 of China's Civil Procedure Law, private enterprises may reorganize but state-owned enterprises need government approval in order to file for liquidation or reorganization. Douglass G. Boshkoff and Youxin Song, *China's New Bankruptcy Law: A Translation and Introduction*, 61 AMER. BANKR. L. J. 359, 359 (2001); Xianchu Zhang and Charles D. Booth, *Chinese Bankruptcy Law in an Emerging Market Economy: The Shenzhen Experience*, 15 COLUM. J. ASIAN L. 1, 12 (2001).

³¹⁸ See *infra* notes 480-90 and accompanying text.

³¹⁹ See Pauline Ma, *A New Chinese Bankruptcy System: Made for Business or for the State?*, 11 AUSTRALIAN J. CORP. L. 192, 205(2000).

³²⁰ See *infra* notes 353-411 and accompanying text.

³²¹ See *infra* notes 387-411 and accompanying text.

³²² See *infra* notes 375-86 and accompanying text.

³²³ See *infra* notes 366-74 and accompanying text.

³²⁴ See *infra* notes 412-13 and accompanying text.

³²⁵ Yosiyuki Noda, *The Character of the Japanese People and their Conception of Law* in H. TANAKA, THE JAPANESE LEGAL SYSTEM 301-10 (University of Tokyo Press, 1976).

resort to the law.³²⁶ In fact, the Japanese believe that everyone would be better off if there was no law, and no need for the law.³²⁷ Naturally, then, use of the court system is viewed as a last resort. Informal mediation and negotiation is encouraged and used primarily for dispute resolution.³²⁸ If these tactics fail and formal proceedings are necessary, it is assumed that both parties will neither win nor lose.³²⁹ The objective of the court system is not to declare a winner or loser, but rather to construct a harmonious compromise for both parties.³³⁰

Japanese culture has often been referred to as a culture of shame.³³¹ This characterization encompasses everything from the adverse attitude toward the need for laws to suicide over debts and economic failure.³³² In the 1990's, a new element was added into the mix of Japanese culture. The government and aristocracy began a campaign of *kokusaika*, meaning the internationalization of Japanese style and culture.³³³ This trend introduced more foreign influences into Japan than ever before.³³⁴ Yet cultural trends of other countries are never fully integrated into the cultural fabric of Japan.³³⁵ Instead, they maintain their "foreignness" and are even thought of as elite, exotic and cosmopolitan.³³⁶

With the modern trend of globalizing culture and business, Japan began in early 2001 to reform its bankruptcy laws. In the past, bankruptcy proceedings in Japan have taken place only after an extensive and informal process of confidential discussions with the court as to reorganization without insolvency.³³⁷ This included informal contact with creditors.³³⁸ The emphasis of these informal discussions was on rescue, not through any "formal legal process . . . [or] the application of an insolvency law."³³⁹ Unfortunately for the individual or individuals at the head of a financially troubled business, the culture of shame that pervades Japan makes bankruptcy a personal failure, not a business failure.³⁴⁰ This characterization of bankruptcy in Japan often leads to tragedy for the individual, be

³²⁶ *Id.* at 302.

³²⁷ *Id.*

³²⁸ *Id.* at 303.

³²⁹ *Id.*

³³⁰ Noda, *supra* note 325, at 303.

³³¹ *Id.* at 310.

³³² Associated Press, *Japanese Ponder Shame Culture that Leads to Suicides Over Debt*, <http://www.charleston.net>, visited on Feb. 7, 2004.

³³³ Halldor Stefansson *Media Stories of Bliss and Mixed Blessings in D.P. MARTINEZ, THE WORLDS OF JAPANESE POPULAR CULTURE* 160-65 (Cambridge University Press, 1998).

³³⁴ *Id.*

³³⁵ D.P. MARTINEZ, *THE WORLDS OF JAPANESE POPULAR CULTURE* 5 (Cambridge University Press, 1998).

³³⁶ *Id.*

³³⁷ Ron W. Harmer, *Comparison of Trends in National Law: the Pacific Rim*, 23 *BROOK. J. INT'L L.* 139, 157 (1997).

³³⁸ *Id.*

³³⁹ *Id.*

³⁴⁰ Brooke Schumm III, *Comparison of Japanese and American Bankruptcy Law*, 9 *MICHIGAN YEARBOOK OF INTERNATIONAL LEGAL STUDIES*, 291-331 (1998).

it suicide or isolation from family and community.³⁴¹ Bankruptcy is a type of devastation not unlike “sickness, shipwrecks, fires, painful childbirth, and other vicissitudes.”³⁴²

The reluctance of the Japanese to use the new formal insolvency law and their propensity for the more informal discussion is firmly rooted in the negative Japanese attitude towards law.³⁴³ As law and ethics are inseparable to the Japanese, a contract breach or a formal bankruptcy proceeding are as personal as character flaws.³⁴⁴ Rather than a legal system of rights and duties, the Japanese follow the concept of *giri*.³⁴⁵ *Giri* is loosely translated to mean “a duty or the state of a person who is bound to behave in a prescribed way toward a certain other person.”³⁴⁶ Obligation of fulfillment of *giri* is not legally enforced, but socially and culturally enforced as part of personal honor.³⁴⁷ Again, the idea of shame or guilt attached to behaving in a way that is contrary to *giri* builds the foundation of law and society in Japan.³⁴⁸ The well-known Japanese notion of “losing or saving face” also flows from the concept of *giri*.³⁴⁹ Following *giri* is thought to be intuitive, not learned, and therefore formal rules of law are resisted by the Japanese as counter-intuitive.³⁵⁰ Lawyers themselves appear to play a different role in Japan than in the West, as the word lawyer in Japanese, *bengoshi*, translates loosely as mediator rather than litigator.³⁵¹ The law itself is analogized to a sacred sword – it is displayed but preferably never used.³⁵²

B. Japan's Economy and Spending Habits

While some Americans stereotype the Japanese as profligate spenders,³⁵³ in reality the Japanese are among the biggest savers in the world.³⁵⁴ Japan's economy, the

³⁴¹ Associated Press, *Japanese Ponder Shame Culture that Leads to Suicides Over Debt*, <http://www.charleston.net>, visited on Feb. 7, 2004.

³⁴² Omamori-Good Luck Charms, <http://www.oren.jp>, visited on Feb. 7, 2004. Perhaps while it is acceptable to the Japanese to transplant foreign popular cultural trends into their society, it is not, however, appropriate to transplant foreign systems of law into Japanese society. The new Japanese bankruptcy laws are based on the UNCITRAL (United Nations Commission on International Trade Law) model law. Kazuhiko Yamamoto, *New Japanese Legislation on Cross-border Insolvency as Compared with the UNCITRAL Model Law. (United Nations Commission on International Trade Law)*, 11 INT. INSOL. REV. 67, 69 (2002). The traditional foundation of Japanese aversion to law and the omni-present culture of shame may prevent the new system of law from ever being used by the Japanese in a way that is comparable to other countries. *Id.*

³⁴³ Harmer, *supra* note 337, at 154.

³⁴⁴ Noda, *supra* note 325, at 310.

³⁴⁵ Ken Minami, *Japanese Thought and Western Law: A Tangential View of the Japanese Bengoshi and the Japanese American Attorney*, 8 LOYOLA L. S. INT'L & COMP. L. J. 301, 306-7 (1986), *citing* Y. NODA, INTRODUCTION TO JAPANESE LAW 174 (1976).

³⁴⁶ *Id.*

³⁴⁷ *Id.*

³⁴⁸ *Id.*

³⁴⁹ *Id.*

³⁵⁰ *Id.*

³⁵¹ *Id.* at 314.

³⁵² *Id.*

³⁵³ See Arnold Redman and N.S. Gullet, *An Empirical Study of the Impact of Foreign Ownership on the Values of U.S. Commercial Properties*, 11 J. FIN. STRAT. DECS. 53, 53 (1998).

second largest in the world, began to fail in the early nineties because of overall business failure that in turn threatened the entire banking system.³⁵⁵ This was caused in large part because the Japanese traditionally prefer saving over spending and have refused to buy commensurate with Japan's growing economy.³⁵⁶ The Japanese government begged citizens to spend money to fuel their crashing economy.³⁵⁷ Unlike Americans, who were too happy to oblige when asked to do the same after September 11, the Japanese refused. As a group, they are less willing to spend, particularly in tough economic times marked by industry failures and job loss.³⁵⁸

Like the American spending habits discussed previously, these habits were created through historical events.³⁵⁹ After World War II, Japan built its economy on standardized mass production.³⁶⁰ This was wildly successful, creating a large trade surplus with the United States, the world's largest consumer, and creating a large middle class.³⁶¹ Japan's success in this area caused it to enter the stock or "value" market very late, and probably to enter this area too quickly, without public understanding or support of the financial industries upon which the value market is based.³⁶² This created a

This perception is likely the result of widespread Japanese real estate investments in the 1980's. For instance, in 1985, Japanese investment in U.S. real estate was \$1.8 billion. Within one year, this number climbed to \$5.0 billion. By 1988, Japanese investment totaled \$16.5 billion. *See id.*

³⁵⁴ *See* Mann, *supra* note 100, at 1084 n. 103 (noting that American household savings rates now hover between zero and one percent, but that the Japanese rates are around 13%). Other sources suggest that Japan's savings rate is now around 11.2%, lower but still among the highest in the world, along with France at 15.6% and Belgium at 13.9%. *See* Paul Mizen, *supra* note 231.

³⁵⁵ *Id.*

³⁵⁶ *Id.*

³⁵⁷ Wayne Angell, *How to Save Japan from Over-saving*, Wall St. J., June 20, 1998.

³⁵⁸ Q&A: *Reviving the Japanese Economy*,

http://news.bbc.co.uk/1/hi/english/news_id_1229000/1229930.stm, visited on March 26, 2003. Banks even started lending at virtually no interest to try to get people to spend money and borrow money but to no avail. This is just too foreign for the Japanese who like to buy with cash but only if they feel comfortable with the amount they have saved. Because the economy was so soft as it was this refusal to spend at all because of the failing firms made the economy screech to a halt. *But see* Mann, *supra* note 103, at 1086 (noting that despite these unquestionably high savings rates, Japan does have a great deal of consumer debt in its economy).

³⁵⁹ During the Tokugawa period (1603- 1868), feudal lords exploited tenant's surpluses and left tenants with very low standards of living. *See* Shin-Ichi Yonekawa, *Recent Writing on Japanese Economic and Social History*, ECON. HIST. REV. 107-23 (1985). Japan also engaged in non-agricultural endeavors in this period, including rice marketing and financing, land transport, and coastal shipping. *Id.* (quoting Shinbo, H. and Y. Yasuba. *Kindai Ikoki no Nippon Keizai (Japanese Economy in the Transition to Modern Times)*, 1979. During the Meiji period that followed (1868-1912), Japan attempted to nurture a modern industrial economy. This movement was drastically behind similar movements in the U.S. and Europe, however. It also had a different flavor, resulting from Marxist influences, that retained militaristic influences on industry. Although the resulting government-run businesses were not successful, this left valuable lessons for the more capitalist systems that followed. *See* Yonekawa, *supra*, at 122.

³⁶⁰ Speech given by Taichi Sakaiya at the American Enterprise Institute, Washington D.C., March 29, 2001. Sakaiya was minister of state for economic planning from July, 1998 until December, 2000, as well as a former senior official of the Ministry of International Trade and Industry.

³⁶¹ *See* Sakaiya, *supra* note 360.

³⁶² *See id.* Sakaiya also suggests that another reason for Japan's deflationary period was caused by a reluctance to diversify from a purely mass-production economy to an information technology economy. As

“bubble economy”³⁶³ which burst in the nineties, and the effects of which are still felt today.³⁶⁴ In 2001, Japan announced that it was in its first deflationary economy in history.³⁶⁵

This trend may be changing however, particularly in the area of credit card use. The Japanese currently carry much more cash than Americans and do not use credit cards nearly as extensively.³⁶⁶ Additionally, while about half of all Americans carry a balance on their credit cards, only about 10% of the Japanese do so.³⁶⁷ This is in part because most Japanese cards are not set up for this type of use. In most cases, the Japanese are required to decide at the checkout counter if they want to pay off the item in one billing cycle or carry the debt for a longer period.³⁶⁸ Recently, a new product was made available to the Japanese that did not require this up-front decision and disclosure, and thus allowed the customer to decide later if he or she wanted to pay off the item or carry it as a balance.³⁶⁹ This financial product has been very successful for the issuers because a shocking 90% of the items purchased on these cards have not been paid off in a cycle but instead carried as revolving credit.³⁷⁰ At least one scholar predicts that the use of revolving credit is likely to increase drastically as a result of the availability of this product.³⁷¹

Despite the past unwillingness of individuals to spend, Japanese businesses spent and borrowed extensively. Due to the lack of profits, and extremely lax banking regulations and borrowing requirements, many businesses are failing. After a record

companies like Microsoft, Intel, and Cisco Systems were developing new ways to store information and exchange data, Japanese businesses remained focused on producing consumer goods.

³⁶³ See *id.* A clear example of a bubble economy comes from the dot.com mid-1990s, where the natural price of a company’s stock and the artificial selling price differed significantly. Thus, in this short time, a large spike or bubble would occur, until it ultimately burst based on the artificial valuations which had previously propped it up. Japan suffered from various bubbles. Its investors were buying up stocks at inflated prices not because they expected a solid dividend return but because they expected further gains in the value, not unlike the American investing public who funneled millions to companies who could never provide investors with dividends, but whose stock was valued based on speculation. What’s more, Japan’s real estate prices were so out of line that at one time the land beneath the Emperor’s Palace in Tokyo was considered more valuable than all of California. Finally, Japan imposed a monetary policy that forced the rate of interest to deviate from a natural rate generated by the supply and demand for saving. Jennifer McNulty, <http://www.ucsc.edu/oncampus/currents/97-10-13/hutchison.htm>, visited on March 2, 2004.

³⁶⁴ See McNulty, *supra* note 363.

³⁶⁵ See *id.* Many businesses continue to fail because of this stagnant economy. The most common reason for this continuing problem seems to be the public’s relentless unwillingness to spend. Even at interest rates of less than one percent, the Japanese people do not want to borrow money. They continue to over-save and under-spend which stops growth and investment in private industry. See Angell, *supra* note 357. This has also caused the yen to fall as against the dollar as people prefer to save in the stable dollar, further exacerbating the problem. *Id.*

³⁶⁶ See Mann, *supra* note 100, at 1056.

³⁶⁷ See *id.* at 1057.

³⁶⁸ See *id.* at 1074. Carrying a balance involves telling the sales clerk that the item will not be paid for immediately, a step many Japanese are unwilling to take for smaller purchase and even many larger purchases. See *id.* In reality, then, most Japanese credit cards have been used like an American debit card.

³⁶⁹ See *id.*

³⁷⁰ See *id.* at 1080.

³⁷¹ See *id.*

number of corporate bankruptcies,³⁷² in 1996, the government embraced rescue culture with a vengeance, starting a rapid initiative to revamp business reorganization laws to make it easier to reorganize and keep a company from folding.³⁷³ The government planned to unfold a new reorganization law for smaller businesses in 2001, but as the economy continued to flag, it stepped up efforts and actually finalized and passed the new reorganization law ahead of schedule.³⁷⁴

B. Personal Bankruptcy in Japan

As in many other parts of the world, bankruptcy was not initially available to individuals in Japan but only to merchants.³⁷⁵ Eventually, a personal bankruptcy system was enacted, that could be used by any natural person, whether a merchant or not.³⁷⁶ From the beginning, creditors in Japan had the right to decide whether to allow a merchant to stay in business or to liquidate his business.³⁷⁷ Today individuals are able to obtain a discharge fairly routinely, causing at least one scholar to conclude that Japanese personal bankruptcy law is not drastically different than in the U.S.³⁷⁸ In many ways, however, Japanese bankruptcy law is stricter than American law. A bankruptcy case can be maintained only if the debtor is unable to pay debts as they become due.³⁷⁹ Moreover the discharge is not automatic but must be applied for.³⁸⁰ In addition, it takes ten full

³⁷² Angell, *supra* note 357.

³⁷³ The theory of changing the law was that if these companies could pay back their debts, rather than just ceasing operations, this might save the failing banks and the entire system.

³⁷⁴ See *infra* notes 482-511 and accompanying text.

³⁷⁵ Matthew Bender, *Doing Business in Japan*, 5-XIV-7-DBJAPAN § 7.01 (2001)(hereinafter “*Doing Business in Japan*”). The system that was in place was simply a private agreement (*kashi bunsan*) between the obligor and his creditors. The obligor was a social outcast, and not worthy of the usual social considerations due to a member of society. Private agreements began in the 1600’s and continued until 1867.

³⁷⁶ *Doing Business in Japan*, *supra* note 375, at §7.02, (2001); Bankruptcy Act, Arts. 5, 12, 31, 33,34, 42-44, 80-82.

³⁷⁷ *Id.*

³⁷⁸ See Mann, *supra* note 10o, at 1084-85.

³⁷⁹ See *Doing Business in Japan*, *supra* note 375, at §7.02.

³⁷⁹ Japanese law focuses on the civil law approach of accentuating the debtor’s insolvency to justify bankruptcy proceedings. Currently Japanese law recognizes three bankruptcy causes: *shiharai-funC* (Insolvency), *shiharai-teishi* (suspension of payments), and *saimu-chCka* (liabilities exceed assets). When the petition is filed with the clerk the court does not confirm that there is in fact a “cause” that would support the petition. The obligor can rebut each type of “cause” if they do not want the bankruptcy adjudicated. For a more in depth overview of how Japanese Bankruptcy law operates and treats adjudication of Bankruptcy status see *Insolvency Overview-Japan: The World Bank*, <http://Gild%20G%20User:password@wbln0018.worldbank.org/legal/gild/Home/Japan.nsf/lates>, last visited May 30, 2003; see also Shinchiro Abe, *Recent Developments of Insolvency Laws and Cross-Border Practices in the United States and Japan*, 10 AM. BANKR. INST. L. REV. 47, 49-51 (2002). As in the United States, a trustee is appointed to take over all non-exempt assets. *Id.* As in the United States, a trustee is appointed to take over all non-exempt assets. See Civil Execution Act, (*Minhi ShikkC HC*, Law No. 4, 1979), Arts. 131. 132. 152., 153., cited in *Doing Business in Japan*, *supra* note 375, at § 7.06[1]. As in the United States, a trustee is appointed to take over all non-exempt assets. *Id.*

³⁸⁰ See Efrat, *supra* note 3, at 102. It will be granted, in the judge’s discretion, only if the judge finds that the debtor is honest and unable to pay his or her debts. See *id.*; see also *Report on Bankruptcy Law and the Trend of Consumer Bankruptcy in Japan from Takashi Yoshida*, *Primus Financial Services, Japan*, to

years to get the discharge, during which time the debtor is forbidden from many business activities, including being a director of a corporation or a *kabushiki kaishi*.³⁸¹

Personal bankruptcy is rare in Japan, with just .7 filings per 1,000 residents in 2000, compared to 5.2 filings per 1,000 residents in the U.S.³⁸² This is not surprising, given the spending habits of the Japanese,³⁸³ as well as the societal stigma assigned to such behavior. The social implications arising out of the *bunsan*, or customary law of insolvency, are clear from the expression *chawah hitotsu ni hashi ichizen*, which literally means “one rice bowl and one pair of chopsticks.”³⁸⁴ The phrase refers to the full exemptions to which a debtor was entitled under customary law,³⁸⁵ and suggests that a person who has filed for bankruptcy is entitled to virtually nothing, and is “a disgraced person no longer worthy of the usual social consideration due a member of society.”³⁸⁶

C. Japanese Reorganization Laws

Japan has a number of reorganization systems, and they are not mutually exclusive.³⁸⁷ This complex system includes the prior Composition Act,³⁸⁸ the Corporate Reorganization Act,³⁸⁹ and the recently enacted Civil Rehabilitation Act (the “CRA”).³⁹⁰ Japan’s Commercial Code also provides for an out-of-court workout procedure known as a “Corporate Arrangement.”³⁹¹ While the Corporate Reorganization Act was designed for large publicly traded companies, and while the Composition Act is roughly the predecessor for the new CRA for small business reorganizations,³⁹² a company needn’t

Elizabeth Bobenmoyer, FORD FINANCIAL 1, Nov. 27, 2001. Grounds for denial of a discharge include fraudulent conveyances prior to the case, making false statements to the court. See CRA art. 366-69.

³⁸¹ See *Doing Business in Japan*, *supra* note 375, at § 7.08 n. 14.

³⁸² Efrat, *supra* note 3, at 100.

³⁸³ See *infra* notes 353-74 and accompanying text.

³⁸⁴ See *Doing Business in Japan*, *supra* note 375, at § 7.08.

³⁸⁵ See *id.*

³⁸⁶ See *id.*

³⁸⁷ See Shinichiro Abe, *The Japanese Corporate Reorganization Reform Law of 2002*, 22 AMER. BANKR. INST. J. 36, 36 (2003); Kent Anderson, *Small Business Reorganizations: An Examination of Japan’s Civil Rehabilitation Act Considering U.S. Policy Implications and Foreign Creditors’ Practical Interests*, 75 AMER. BANKR. L.J. 355, 360 (2001).

³⁸⁸ See *id.* at n. 6, citing Wagi ho (the “Composition Act”). This was the reorganization law most often used before the recent enactment of the Civil Rehabilitation Act, Law No. 225, Dec. 14, 1999 (the CRA”). For the statistical figures, see Anderson, *supra* note 387, at 360, citing 1 Saiko Saibansho Jimu Somukyoku [Supreme Court General Secretariat], SHIHO TOKEI NENPO, Minji hen (Annual Report of judicial statistics, Civil and administrative cases volume) (1990-1999).

³⁸⁹ See Kaisha kosei ho (the “Corporate reorganization Act”). The Corporate Reorganization Act has been described as a rigid and unforgiving process designed for the rehabilitation of large publicly-held corporations. See Theodore Eisenberg & Shoichi Tagashira, *Should We Abolish Chapter 11: The Evidence From Japan*, 23 J. LEGAL STUD. 111, 114 (1994).

³⁹⁰ See Minji saisei ho (the “Civil Rehabilitation Act) (the “CRA”), Law No. 225, Dec. 14, 1999.

³⁹¹ See Shinichiro, *supra* note 387, at 36. This is essentially an out-of-court, private work-out arrangement. Because it requires the approval of all creditors to the proposed work-out plan, it has not been used much. *Id.*

³⁹² See Anderson, *supra* note 387, at 360-61 (stating that the CRA is best seen as an extension or revision of the Composition Act).

be large to use the Corporate Rehabilitation Act, nor small to use the CRA.³⁹³ In fact, Japan's massive Sogo Department Store recently filed a case under the CRA, probably because it is simply more debtor friendly and easier to use than the Corporate Rehabilitation Act.³⁹⁴

Compared to both the Composition Act and the Corporate Reorganization Act, the CRA was a radical departure from existing law.³⁹⁵ It was the first debtor-in-possession system in Japan and was far less rigid than other existing systems.³⁹⁶ Unlike virtually all other schemes in existence at the time, outside the U.S.,³⁹⁷ the CRA does not contain an insolvency requirement.³⁹⁸ Like most other systems, a case will only be accepted if there is a chance of reorganization.³⁹⁹

In theory, the business is run by a debtor-in-possession under the CRA.⁴⁰⁰ The extent to which the company is actually run by a debtor-in-possession, however, varies from district to district.⁴⁰¹ In the Osaka and Sapporo districts, courts usually follow an American-style reorganization scheme, leaving the debtor-in-possession in place and appointing no overseers.⁴⁰² In Tokyo, however, the courts generally follow the old Composition system and appoint a supervisor in every case.⁴⁰³ In Nagoya, the courts seem to follow the English system and appoint examiners, including business

³⁹³ See Anderson, *supra* note 387, at 363-64.

³⁹⁴ See *id.* The Corporate Reorganization Act had yet to be modernized when the CRA was enacted, making the CRA as the most recent policy statement about business reorganization policy in Japan.

³⁹⁵ See *id.*

³⁹⁶ See *id.* Unlike the Composition Act, the CRA allows a business to file its petition for reorganization before a plan is submitted. CRA, art. 21(2).

³⁹⁷ France also has no insolvency requirement. See *Views from the Bench*, *supra* note 6, at 560.

³⁹⁸ See CRA, art. 21. Now a mere apprehension of either balance sheet or equitable insolvency is sufficient to allow one to file a successful petition. See *id.* The reason for the change was that the drafters wanted to avoid an insolvency requirement that could make it too late to rehabilitate. See Anderson, *supra* note 387, at 364.

³⁹⁹ See CRA, art. 33, 21(1). There must be a chance that the plan will actually be approved and a showing of good faith. See *id.* There is a time limit for filing a plan but it is not a rigid one. See Anderson, *supra* note 480, at 391. Unlike the Composition Act, which requires a plan at filing, "the regulations accompanying the CRA provide that, unless special circumstances exist otherwise, a plan *should* be filed within two months of the deadline for submissions of proof of claim, that claims deadline generally being between two and four weeks after commencement. CRA art. 84, 18(1), (emphasis added). Furthermore, it is the court that determines the time frame for submitting a plan. "Debtor shall prepare and submit to the court a draft rehabilitation plan within the period stipulated by the court" see Anderson, *supra* note 387, at 391, *citing* CRA, art. 163 (1).

⁴⁰⁰ The court, however, has the discretion to appoint a dizzying variety of professionals in a case, including supervisors, examiners, trustees, receivers, representative officers, and creditors' committees. See Anderson, *supra* note 387, at 373-79 (describing the role of each of these professionals in detail).

⁴⁰¹ See *id.* at 373.

⁴⁰² See *id.*

⁴⁰³ See *id.* The court can appoint a supervisor to monitor the debtor. The statute is vague in terms of the powers of the supervisor, other than a supervisor will oversee the debtor and make sure the debtor does not do specific acts, as determined by the court, without the consent of the supervisor, CRA art. 54. The supervisor has two affirmative powers: 1) the court can grant a supervisor a right of avoidance to challenge fraudulent and refilling transfers (CRA art. 56), and 2) the supervisor has a subpoena-like right to demand reports directly from the debtor and its officers and managers (CRA art. 59).

professionals such as accountants to run the company in every case.⁴⁰⁴ Needless to say, there is still ambivalence in Japan about the concept of a debtor-in-possession, but this was a tremendous step toward embracing the debtor-in-possession concept.

Not long after the CRA was passed, the Corporate Reorganization Act was amended to make *it* more user-friendly as well.⁴⁰⁵ The most radical thing about the new Corporate Reorganization Act is that it binds both secured and unsecured creditors.⁴⁰⁶ Because of a strong belief in *betsujo ken*, or the right of separation for secured creditors, no prior Japanese bankruptcy or insolvency law ever affected the rights of secured parties.⁴⁰⁷ Even the new CRA does not affect the rights of secured creditors,⁴⁰⁸ though it does allow debtors to reduce the debt owed on property by essentially paying its value into the court and thus wiping out the secured party's security interest in that particular item.⁴⁰⁹

The passage of the CRA, as well as the recent amendments to the Corporate Reorganization Act, appear to be a successful attempt at liberalizing the laws in order to promote rehabilitation. Having said that, one would assume that Japanese society now

⁴⁰⁴ *See id.* The powers of the examiner is not as far reaching as the supervisor in that the examiner does not have the subpoena and avoidance powers. However, the examiner is capable of examining the debtor (*CRA art. 62*). The major duty of the examiner is to provide a report to the court in a stipulated time (*CRA art. 62*).

⁴⁰⁵ *See* Shinichiro, *supra* note 387, at 36. The amendments to the Corporate Reorganization Act went into effect on April 1, 2003. *Id.*

⁴⁰⁶ *Id.*

⁴⁰⁷ *See* CRA, art. 51; Tasuka Matsue, Bankruptcy and Corporate Reorganization, in *Doing Business in Japan*, *supra* note 375, at §§ 7.22 through 7.24 (Zentaro Kitagara rev.ed. 1999), *cited in* Anderson, *supra* note 387, at 380. However, the CRA does provide that a court can temporarily limit a secured creditor's right to sell a debtor's property at judicial sale, if the debtor applies for such an order, pays the creditors potential costs up front, proves that the delay will not hurt the creditor, and also proves that the stay of such action is in the best interests of creditors. CRA art. 31(1)(2).

⁴⁰⁸ The debtor has the burden of proving all of these things, unlike under Section 362 of the U.S. Bankruptcy Code, in which the debtor gets an automatic stay and the creditor must prove a host of facts in order to get the stay lifted. *See* 11 U.S.C. § 362(d)(1)&(2). The narrowness of this exception demonstrates the powers of secured creditors in reorganization cases generally, including cases instituted under the CRA.
⁴⁰⁹ CRA, art. 148(1). This essentially amounts to a redemption under American bankruptcy law, *see* 11 U.S.C. § 722, and is always permitted in a Chapter 11 as well as a Chapter 7. Unfortunately, most American debtors, and, I suspect, Japanese debtors, do not have the cash to actually buy out the secured party's interest in such collateral in most cases. While this is not a drastic displacement of the secured party's rights by American standards, and probably of little use to a cash-poor debtor, it is the first example in Japanese history of reducing a secured party's claim in a bankruptcy case. *See* Anderson, *supra* note 480, at 384. This provision could be useful in Japan's current deflationary and stagnant economy, where many types of collateral have not held their value. If nothing else, the provision may provide leverage - for the first time - against the secured party within a bankruptcy case. *See id.*

The amendments to the Corporate Reorganization Act made the process far simpler overall than it once was. *See* Shinichiro, *supra* note 387, at 36 (stating that it was used between 4 and 57 times per year during the past 20 years). The bankruptcy court need not find that a company has a prospect of reorganization under the new Corporate Reorganization, which is more favorable to debtors than the CRA, and which may facilitate earlier filings. The Corporate Reorganization Act also gives better protection for post-petition claims, thus promoting post-petition financing. *See id.* at 37. Finally, while the Corporate Reorganization Act is not a debtor-in-possession system *per se*, it does allow the court to appoint members of the debtor's management as the trustee.

accepts business failure as part of life in Japan. This does not appear to be the case. Bankruptcy of any kind is still a major embarrassment. The government has recently gone so far as to promote the use of the CRA in a prime-time television show describing its many positive uses and attributes,⁴¹⁰ which itself demonstrates society's resistance to this idea.

D. When Law and Culture Clash: Debt and Suicide.

At a time when the Japanese government is doing everything it can to reduce the stigma associated with financial failure, Japanese consumers finally appear to be loosening up and spending more. The use of revolving consumer credit appears to be on the rise, which may help fuel the economy. It also may result in more financial failure for consumers, which could actually cause more social problems.

Despite more consumer credit in the system, the Japanese have not relaxed their views on financial failure, for either businesses or consumers. Despite the huge amount of debt companies have taken out recently, stigma over a failed business is higher in Japan than virtually anywhere else in the world. Executives of failed companies in Japan often do more than disappear. Financial failure is the ultimate societal disgrace and suicide is a common way out.⁴¹¹ As higher consumer debt levels become more common, failures will increase and so may suicide rates. It is unclear whether merely liberalizing laws can stem this tide.⁴¹²

Japanese culture is complicated with many unspoken rules and hierarchies.⁴¹³ People have the expectation of being in the same job for life and cannot face job loss without losing face.⁴¹⁴ Yet saving face is the ultimate societal necessity. Neither law nor

⁴¹⁰ Anderson, *supra* note 387, at 363. It is hard to imagine the U.S. government doing such a show to promote the use of Chapter 11, but the Japanese economy is in deep trouble.

There also may be different cultural views on what makes for good advertising. I remember a government campaign in Singapore, designed to stem the negative population growth in that country. The government took out full-sized billboards all over town, proclaiming that "life without children is dull."

⁴¹¹ See Françoise Kadri, *Millions of Ordinary Japanese on Brink of Financial Ruin as Debts Mount*, AGENCE FRANCE-PRESS, March 24, 2002, 2002 WL 2369590. Suicide is tied directly to financial failure, and few people know that they can file for bankruptcy instead. See also Gautaman Bhaskaran, *Suicide State*, THE HINDU, May 12, 2002, 2002 WL 20190290. There are scores of newspaper articles reporting on this problem, although this story is among the most poignant. It ties the high suicide rates directly to the economic slump and outlines the government's attempts to alleviate the problem through education. The article reports on Japan's well-known tradition of life-time employment and company loyalty, as well as the trend toward suicide when job loss occurs. Japan's suicide rate is the highest in the industrial world, over 80 per day. This source attributes a large portion of such deaths to financial problems, a phenomenon unknown to America society. See *id.*

⁴¹² Stigma can be explained by looking at psychological literature, that claims that the more a society values independence, the less worried it is likely to be about contract breaches in general, and failures to pay specifically. Cultures that highly value dependence over independence are more likely to want to keep one's word at all costs, as a way of saving face. Davangshu Datta, *Uncertain Times*, THE BS WEEKEND, October 26, 2002, 2002 WL 100052313.

⁴¹³ Milhaupt, *supra* note 273, at 434-35.

⁴¹⁴ See Curtis J. Milhaupt, *A Relational Theory of Japanese Corporate Governance: Contract, Culture, and the Law*, 37 HARV. INT'L. L. J. 3, 4 (1996).

propaganda may be capable of changing these views. In most parts of Asia, including Japan, informal agreements are as enforceable as formal ones, if not more so.⁴¹⁵ Explicit insolvency laws, like explicit contract laws, and explicit corporate and securities law, play a far smaller role than in the Western world than they do in Japan.⁴¹⁶ Informal insolvency procedures are often preferred to formal systems because the formal rules often conflict with the value systems of the society.⁴¹⁷ Thus, simply changing the laws will not necessarily change financial and legal practices, or attitudes toward financial failure.

2. *Lesson from Hong Kong and China*

Neither Hong Kong nor China has developed bankruptcy systems as elaborate as the Japanese bankruptcy laws.⁴¹⁸ Hong Kong has a modern individual bankruptcy law, but does not have a business reorganization system.⁴¹⁹ China has no personal bankruptcy system but is developing a rescue system for ailing businesses.⁴²⁰ As is the case in Japan, cultural issues may keep the Chinese from using these new laws.⁴²¹

1. *Hong Kong Bankruptcy Law and Culture*

As one would expect from an English colony, Hong Kong's Insolvency Laws have always looked somewhat similar to those of the United Kingdom.⁴²² What is harder to anticipate is that Hong Kong still has no corporate reorganization process, and has taken few steps to modernize its business bankruptcy laws. Hong Kong's current insolvency laws are based loosely on law from the United Kingdom that dates back to 1929.⁴²³ Not surprisingly, these laws are archaic, harsh and pro-creditor.⁴²⁴

⁴¹⁵ See *id.*

⁴¹⁶ See *id.*

⁴¹⁷ See WSG, *supra* note 268, at 305. For example in Indonesia and Thailand, new restructuring laws and procedures were implemented after the Asian crisis. See *id.* at 306. These new changes have had virtually no effect in assisting viable companies to restructure or in closing down nonviable firms, because there is a deep-rooted belief that creditors should not be able to take over firms that owner-managers have built up over time. *Id.* This obviously creates no incentives for firms to attempt to improve their businesses as there is no way for a creditor to effectively foreclose on assets and no threat of take-over.

⁴¹⁸ See *infra* notes 422-506 and accompanying text. Thus, there is much less to say about the bankruptcy laws of Hong Kong and Japan. See also Roman Tomasic, Peter Little, Angus Francis, Kam Kamarul, and Kui Hua Wang, *Insolvency Law Administration and Culture in Six Asian Legal Systems*, 6 AUSTRALIAN J. CORP. L. 248, 248 (1996) (noting that the laws in place are old and their purpose is to kill the company, not revive it).

⁴¹⁹ Leslie Burton, *An Overview of Insolvency Proceedings in Asia*, 6 ANN. SURV. INT'L & COMP. L. 113, 114 (2000).

⁴²⁰ See Tomasic, Little, Francis, Kamarul, and Wang, *supra* note 418, at 252 (stating that China has no personal bankruptcy system). China is developing a consumer culture, however, The Associated Press ran a recent story about Mercedes dealerships and Gucci stores popping up all over China. Ellen Knickmeyer, *China: Asia's New Money Machine*, ALBUQUERQUE JOURNAL, Feb. 15, 2004, at B8.

⁴²¹ See *infra* note 479-89 and accompanying text.

⁴²² Burton, *supra* note 419, at 114.

⁴²³ Tomasic, Little, Francis, Kamarul, and Wang, *supra* note 418, at 255.

⁴²⁴ Burton, *supra* note 419, at 114.

Proposed changes to the Hong Kong Insolvency laws, dealing with corporate or business reorganization, have failed to pass.⁴²⁵ Liquidation, which is referred to as “insolvency,” is the only option for corporations.⁴²⁶ For almost a decade, scholars and legislators have been attempting to pass corporate rescue regime in Hong Kong, to no avail.⁴²⁷ The scheme, named “provisional supervision,” was originally drafted to operate much like an English “Administration.” Under a provisional supervision, a specialist or trustee runs the company and proposes a voluntary arrangement, which creditors vote upon within six months.⁴²⁸ As in an English Administration, creditors control the proceeding.⁴²⁹ None of the drafts of the yet-to-be-passed provision supervision contemplate a debtor-in-possession system.⁴³⁰

The first drafts of the new procedure were vehemently opposed by labor groups, who currently receive the first dollars out of a liquidating company under the liquidation procedure set out in section 166 of the Companies Ordinance.⁴³¹ These groups feared that the new provision supervision would be less favorable to their interest and thus opposed the bill.⁴³² Thereafter, in order to appease these interests, the draft law was changed to require any company in provisional supervision to pay off in full, in advance, all wage claims and severance payments for all workers laid off in the past, or to be laid off in the future, in the context of the reorganization.⁴³³ Many scholars and legislators see this requirement, which is still contained in the current proposed draft bill, as a major obstacle to successful rehabilitation, or even attempted rehabilitation.⁴³⁴

Another sticking point in the current legislation has been the treatment of secured creditors. In earlier drafts, secured creditors voted with all other creditors on the arrangement and thus could be forced to accept a plan they did not like, and could lose

⁴²⁵ *Id.*; Philip Smart and Charles D. Booth, *Corporate Rescue: Hong Kong Developments*, 10 AM. BANKR. INST. L. REV. 41, 42 (2002).

⁴²⁶ *Id.*

⁴²⁷ *Id.*

⁴²⁸ Interestingly, the bill provided that provisional supervision be available to both insolvent and solvent companies. See Charles D. Booth, *Hong Kong Corporate Rescue: Recent Developments*, 15 AM. BANKR. INST. J. 3 (Nov. 2000).

⁴²⁹ *Id.*

⁴³⁰ *Id.*

⁴³¹ The Companies (Corporate Rescue) Bill 2001, available at <http://law.hku.hk/staff/psm>, cited in Smart and Booth, *supra* note 425, at 45 n. 1.

⁴³² *Id.*

⁴³³ The law actually requires such companies to “pay off in full (or set up a trust account with a licensed bank containing sufficient funds to pay off in full): (a) all wage claims owed to its employees; and (b) all entitlements arising under the Employee Ordinance (e.g. severance payments) owed to its former employees. Smart and Booth, *supra* note 425, at 43. Because the words “former employees” are interpreted narrowly, this required companies to not only set aside the funds for those already laid off but also to calculate and pay in advance the same amounts for workers that will be laid off in the restructuring effort. *Id.*

⁴³⁴ *Id.* A compromise that would cap the amount of money that a firm would have to pre-pay is under consideration, but has not been passed. Given labor’s strong views, passing the law with such a cap could prove difficult. Moreover, passing it without such a cap could make the law ineffective or leave it unused despite passage. *Id.*

the benefit of their superior position in their collateral.⁴³⁵ While the current draft no longer contains these disadvantageous provisions, the pendulum may now have shifted too far in the secured creditor's favor.⁴³⁶ Secured creditors holding a security interest in all or substantially all of a debtor's assets now have veto power over the provisional supervision and can, for 4-7 working days following a petition, terminate the provisional supervision completely.⁴³⁷ None of this has become law, however, so all provisions are still up for grabs. Moreover, Hong Kong has a long history of handling insolvency and financial distress through informal means, such as out-of-court workouts, and this trend is likely to continue whether the provisional supervision passes or not.

While business bankruptcy law in Hong Kong has not been modernized, the bankruptcy process for individual debtors, which is called "bankruptcy," has been relaxed and modernized.⁴³⁸ In the past, due to the discretionary discharge provisions, many debtors received no discharge and the quickest one could obtain a discharge was eight years.⁴³⁹ For example, for the ten-year period from 1983 through 1992, 2,400 people filed for personal bankruptcy in Hong Kong and only 25 received a bankruptcy discharge.⁴⁴⁰ In effect, the discretionary discharge made bankruptcy a life sentence for most.⁴⁴¹ During the post-filing period and before a discharge, a debtor cannot obtain additional credit. Effective April 1, 1998, many if not most individual debtors can obtain a discharge within four years.⁴⁴²

Unlike some parts of East Asia, Hong Kong citizens have not been afraid to exercise their bankruptcy rights.⁴⁴³ In November of 2003, there were 939 bankruptcies in the City of Hong Kong.⁴⁴⁴ There were 1,417 during October of the same year.⁴⁴⁵ These numbers show that filings were down from the prior year, when there were 2,441 in November of 2002, and 3,193 in January of 2003.⁴⁴⁶ These numbers are astronomical compared to the ten years prior to this time, showing an increase in filings of over 1,000%.⁴⁴⁷ While some of this increase can be attributed to liberalization of the individual bankruptcy discharge, increases in consumer credit, particularly credit cards,

⁴³⁵ *Id.* at 44.

⁴³⁶ *Id.*

⁴³⁷ While some commentators have noted that exercising this veto power might cause the bank in question to suffer bad publicity, the current draft does allow a primary secured creditor to prevent a provisional supervision from happening. *Id.* at 44-45.

⁴³⁸ Charles D. Booth and Philip St. J. Smart, *Retroactive or Prospective: Determining the Scope of Hong Kong's New Insolvency Laws*, 8 INT'L INSOL. REV. 27, 32 (1999).

⁴³⁹ *Id.* The bill also provided that all bankrupts who were adjudicated bankrupt prior to April 1, 1998 would be discharged from bankruptcy on April 1, 1999.

⁴⁴⁰ *Id.* n. 24.

⁴⁴¹ *Id.* at 35.

⁴⁴² *Id.* This is true so long as the debtor has not filed for bankruptcy before.

⁴⁴³ Kelvin Chan and Chow Chung-yan, *Bankruptcies Fall to their Lowest Level in Two Years: Latest Figures Indicate City's Economy is Recovering More Strongly than Expected*, SOUTH CHINA MORNING POST, at 3, Dec. 20, 2003.

⁴⁴⁴ *Id.*

⁴⁴⁵ *Id.*

⁴⁴⁶ *Id.*

⁴⁴⁷ As in the United States, there is some indication that filings increased after the discharge rules were liberalized in 1998, though the entire increase is unlikely to be attributable to this fact.

may also explain these increases.⁴⁴⁸ As of September of 2002, there were nearly 7 million residents of Hong Kong, and 9.38 million credit cards in circulation.⁴⁴⁹

Culture appears to play a much smaller role in Hong Kong's attitudes towards bankruptcy, especially compared to China.⁴⁵⁰ Because Hong Kong laws are based on English law, the law lacks local culture elements unique to Hong Kong.⁴⁵¹ Although there are remnants of Chinese ideals in Hong Kong, such as the desire to pay creditors out of moral obligation, these Chinese traditions are diminishing due to the transient nature of Hong Kong's population.⁴⁵² Moreover, most bankruptcies in Hong Kong involve foreign companies rather than purely Chinese ones. Assets in Hong Kong tend to be people rather than large capital assets, and money goes in and out of Hong Kong quickly, requiring quick court action in bankruptcy cases.⁴⁵³

Not surprisingly, then, filing for bankruptcy in Hong Kong does not carry as much stigma as in many other Asian countries, in part because Hong Kong's community is internationally-oriented and transient.⁴⁵⁴ Some large bankruptcies in the 1980's made the idea more common, and therefore more acceptable.⁴⁵⁵ Among the traditional Chinese people who live in Hong Kong, the stigma is still present, and bankruptcies from Chinese owned business are rare.⁴⁵⁶

Like the mainland Chinese, Hong Kong citizens would rather avoid courts, preferring to work things out on their own.⁴⁵⁷ The robust Hong Kong economy also has made bankruptcy reform less of a necessity.⁴⁵⁸ When businesses do fail, the banks have been willing to bail many out. Many people believe, however, that reform is badly needed in Hong Kong.⁴⁵⁹ Moreover, Hong Kong citizens are more likely to embrace and use modern bankruptcy laws than the citizens of either China or Japan. Confucianism

⁴⁴⁸ *Hong Kong Bankruptcies and Jobless Rates Hit Record*, THE ASIAN BANKER, Sept. 20, 2002.

⁴⁴⁹ *Id.* The authors note that this amounts to 1.34 credit cards per person. *Id.*

⁴⁵⁰ Tomasic, Little, Francis, Kamarul, and Wang, *supra* note 418, at 282-83.

⁴⁵¹ *Id.* at 283.

⁴⁵² *Id.*

⁴⁵³ *Id.* Often, the purpose of a bankruptcy in Hong Kong is to provide access to compensation for employees, following a business closure, from a wage insolvency fund. *Id.* at 282. Workers in Hong Kong tend to fall into two attitudinal categories, based on their age. Those over 50 tend to be tied into Chinese culture and beliefs, and think of business relationships as long term commitments. Younger workers are often more influenced by Western culture, and rarely view business in this long-term way. They are not afraid to use the legal system if they think it will help them. Thus, the Confucian tradition is dwindling. Chinese influence is limited because most insolvency practitioners are trained in the British common law tradition. *Id.* at 283.

⁴⁵⁴ Burton, *supra* note 419, at 117.

⁴⁵⁵ *Id.*

⁴⁵⁶ *Id.* The relationship between Hong Kong and China concerning bankruptcy is complicated and is also explored in this article. *Id.* At the moment, China does not recognize Hong Kong bankruptcies. China is now the biggest investor in Hong Kong, and as a result there is a large amount of money owed to Hong Kong from Chinese businesses. *Id.*

⁴⁵⁷ Tomasic, Little, Francis, Kamarul, and Wang, *supra* note 418, at 255-56.

⁴⁵⁸ Andrew Duncan, *A Brief Overview of Insolvencies in Hong Kong*, 30 BCD NEWS & COMMENT 21 (1997).

⁴⁵⁹ Tomasic, Little, Francis, Kamarul, and Wang, *supra* note 418, at 256.

and other traditional forces play a smaller role in modern, long-colonized, market-based Hong Kong.⁴⁶⁰

3. *Chinese Economics, Bankruptcy Law and Culture*

Unlike colonized Hong Kong, mainland China has a long history of economic and social isolation, and a history reaching as far back as 221 B.C., the year it gained its independence.⁴⁶¹ China is also one of the world's largest countries by land mass, and is the world's most populated country with a population of 1,286,975,468.⁴⁶² In recent years, China has undergone a surprising shift from a state controlled economy, to an economy where a growing percentage of enterprises are privately controlled.⁴⁶³ In fact, well over half of all China's businesses are now privately owned.⁴⁶⁴

In the past, the communist government of China has fought to limit any capitalist influence in the economy.⁴⁶⁵ Now due to a growing realization that capitalism may more efficiently produce in many sectors than many of the regime's State Owned Enterprises ("SOEs"), the Communist Party of China is accepting and even encouraging capitalism.⁴⁶⁶

This acceptance of private enterprise did not occur suddenly. Through the assumption of power of the Communist Party until the 1980's, the authorities actively crushed capitalist enclaves.⁴⁶⁷ In 1982 the government "rehabilitated" capitalist entrepreneurs in an effort to increase economic activity."⁴⁶⁸ At the 16th party congress, not only were the "red capitalists" invited to join the Communist Party, some private entrepreneurs were even made delegates.⁴⁶⁹ The party also vowed to "promote the healthy development of the non-public sector" and "better safeguard private property."⁴⁷⁰

⁴⁶⁰ *Id.* at 282.

⁴⁶¹ *The World Fact Book Website – China*, <http://www.cia.gov/cia/publications/factbook/geos/ch.html>, visited on February 2, 2004. This is particularly striking when compared to U.S history reaching back only to 1776 A.D.

⁴⁶² *Id.* (providing a July 2003 estimate).

⁴⁶³ See *The Development of Private Enterprise in the People's Republic of China*, Asian Development Bank, 63-65,

http://www.adb.org/documents/studies/PRC_Private_Enterprise_Development/prc_private_enterprise.pdf visited on March 5, 2004 (discussing five types of private entities and how "private" is defined in China both by the state and by economists).

⁴⁶⁴ *Id.*

⁴⁶⁵ See Allan, Zhang, *Hidden Dragon: Unleashing China's Private Sector*, <http://www.pwcglobal.com/extweb/newcolth.nsf/docid/3D15C57A6D220BB985256CF6007B9607>, visited on February 29, 2004. It is important to note that this data is provided by Price Waterhouse Coopers brokerage. The firm may have a pecuniary interest in portraying the investment climate in China as being better than it is in reality.

⁴⁶⁶ *Id.*

⁴⁶⁷ *Id.*

⁴⁶⁸ *Id.*

⁴⁶⁹ *Id.*

⁴⁷⁰ *Id.*

China's SOEs are concentrated in heavy industrial operations and have incurred large debt loads. These industries have been restructured with massive layoffs and corporate restructuring in an attempt to increase efficiency.⁴⁷¹ Restructuring efforts are yielding limited results. Even with the Chinese government's doubtful official statistics, the SOEs losses exceeded profits for the first time in 1996.⁴⁷² Moreover, China's state banks have written off US\$15.3 billion in non-performing loans to SOEs.⁴⁷³

Private enterprise is developing rapidly despite a difficult regulatory environment and continuing government discrimination.⁴⁷⁴ By 2002, the private sector generated around 60% of China's output while using only 20% of the country's resources. The SOEs produced only 40% of output while consuming 80% of resources.⁴⁷⁵ The private sector is producing eight out of ten new jobs.⁴⁷⁶ China's overall economy is growing by 8% and this rate is expected to continue into 2005.⁴⁷⁷ The Chinese Communist Party is committed to maintaining this growth over the next two decades and the private sector will have to play an integral part in this growth.⁴⁷⁸

Culture plays a substantial role in Chinese laws, especially its bankruptcy laws.⁴⁷⁹ Considering its population, China has a low level of reported commercial bankruptcies.⁴⁸⁰ In Chinese society the notion of bankruptcy has long been condemned as "bad luck"

⁴⁷¹ Christopher McNally, *China's State-Owned Enterprises: Thriving or Crumbling?*, 59 ASIA PACIFIC ISSUES 1 (2002).

⁴⁷² See *id.* at 1. China does not possess the level of corporate transparency that is often associated with the free market system. The Communist Party officials and government functionaries who run China's SOEs have on occasion reported favorable statistics to their superiors and the public. For an example of this See <http://fpeng.peopledaily.com.cn/special/soe/1999122400S102.html>, visited on March 5, 2004.

⁴⁷³ See *id.* at 5. This write off is a very small amount of the US\$422 billion total non-performing loans that burden China's state owned banks. *A \$45 Billion Shot In The Arm*, The Economist.com, http://www.economist.com/agenda/PrinterFriendly.cfm?Story_ID=2328008, visited on February 10, 2004. These loans are a product of the banks' lending strategy that was driven by the need to prop up the bankrupt SOEs and the workers who depend on them.

⁴⁷⁴ Allan, Zhang, *Hidden Dragon: Unleashing China's Private Sector*, <http://www.pwcglobal.com/extweb/newcolth.nsf/docid/3D15C57A6D220BB985256CF6007B9607>, visited on February 29, 2004.

⁴⁷⁵ *Id.*

⁴⁷⁶ *Id.*

⁴⁷⁷ *A \$45 Billion Shot In The Arm*, The Economist.com, http://www.economist.com/agenda/PrinterFriendly.cfm?Story_ID=2328008, visited on February 10, 2004.

⁴⁷⁸ Allan, Zhang, *Hidden Dragon: Unleashing China's Private Sector*, <http://www.pwcglobal.com/extweb/newcolth.nsf/docid/3D15C57A6D220BB985256CF6007B9607>, visited on February 29, 2004. China will continue to depend on SOEs for a large part of its economic productivity. However, private enterprise is an increasingly important part of the economy. China's leaders are cognizant of the necessary role that these private businesses will have to play to maintain the country's growth.

⁴⁷⁹ Ma *supra* note 319, at 205.

⁴⁸⁰ Feng Chen, *Chinese Bankruptcy Law: Milestones and Challenges*, 31 ST. MARY'S LAW JOURNAL 49, 60 (1999). Bankruptcy law should play an important role in adjusting social structure, but bankruptcy cases are rarely in court in China. *Id.* The first bankruptcy case was heard in 1987. *Id.* In the first six months there were 98 cases at the national level. *Id.* Overall, 16,632 cases were heard by the court between 1986 and 1999. *Id.* Most of these cases involved privately-owned enterprises, collectively owned enterprises, and joint-venture enterprises. *Id.* A great disparity exists between failing enterprises and the number of bankruptcy cases filed. *Id.* This disproportion may be attributed to three main factors: First, immense

meaning “broken fortune.”⁴⁸¹ If a father owes a debt, his sons or grandsons would be responsible for it; bankruptcy implies a life of burden for generations to come.⁴⁸²

The Chinese historically have a low regard or disbelief in judicial power.⁴⁸³ Creditors focus on “guanxi” (relationships) as opposed to their entitlements to payment.⁴⁸⁴ As is further discussed below, bankruptcy cases in China have been controlled by the government not by independent courts, causing citizens to distrust of the system.⁴⁸⁵ Confucianism also continues to have great influence on commercial activities.⁴⁸⁶ Confucian ethical teachings include the following values which are held in high respect by the average Chinese person and are visible in Chinese business practices, and their use of law: “Li,” includes ritual, propriety, etiquette; “Hsiao,” love within the family, love of parents for their children and of children for their parents; “Yi,” righteousness; “Xin,” honesty and trustworthiness, “Jen,” benevolence, humaneness towards others, the highest Confucian virtue; and “Chung,” loyalty to the state.⁴⁸⁷ Confucianism encourages balance and harmony.⁴⁸⁸ Unless there is no other choice, people should keep their friendships and relationships intact, rather than pursuing court intervention. Under Confucianism it is also “anti-moral” to *force* a debtor into involuntary bankruptcy.⁴⁸⁹

Socialism and communism also have a great affect on attitudes and culture in China, and the resulting bankruptcy laws.⁴⁹⁰ The most developed and most significant Chinese Bankruptcy laws focuses on state owned enterprises (“SOE”).⁴⁹¹ It is very difficult to place a SOE into bankruptcy and government permission is needed.⁴⁹² SOE’s are property of the state and bankruptcy is viewed as a leadership failure, a loss of face, for the government.⁴⁹³ Yet, scores of SOEs operate at a loss.⁴⁹⁴ Naturally, if a large

pressure on government leaders, second, strong opposition to bankruptcy from banks, and third, an entrenched “reliance” psychology in society. *Id.*

⁴⁸¹ Ma, *supra* note 319, at 205.

⁴⁸² *Id.*

⁴⁸³ *Id.* at 206.

⁴⁸⁴ *Id.*

⁴⁸⁵ *Id.* Chinese government policy is very conservative and will not allow significant SOEs to go bankrupt and judges can’t make bankruptcy decisions without government approval. *Id.* In addition, many practitioners agree that the legal system is “too raw” and that judges do not understand the bankruptcy law due to their lack of specialization and experience. *Id.* Perceiving that courts are ill-equipped to deal with bankruptcy disputes, creditors suspecting or knowing that an enterprise is insolvent will therefore attempt to act without the courts’ direction. *Id.*

⁴⁸⁶ *CONFUCIANISM: Founded by K'ung Fu Tzu*, <http://www.religioustolerance.org/confuciu.htm>, visited on February 29, 2004.

⁴⁸⁷ *Id.*

⁴⁸⁸ Ma, *supra* note 319, at 207.

⁴⁸⁹ *Id.* A challenge faced in drafting bankruptcy law in China is convincing creditors that even though preserving harmonious relationships has been important, their economic interests might be better served if they resort to legal mechanisms of bankruptcy. *Id.*

⁴⁹⁰ *Id.*

⁴⁹¹ *Id.*

⁴⁹² *Id.*

⁴⁹³ *Id.*

⁴⁹⁴ Chen, *supra* note 480, at 60.

number of SOEs were to be closed down at one time, many people could simultaneously lose their jobs, and no national provision has yet been enacted to address this problem.⁴⁹⁵ If SOEs are given free access to bankruptcy, a domino effect is also feared because many SOEs are deeply indebted to one another.⁴⁹⁶

Private enterprises are permitted to file a liquidation case, which can later become a reorganization case, under Chapters 16 and 19 of China's Civil Procedure Law.⁴⁹⁷ If the case is accepted by the court, then a stay of collection efforts goes into effect.⁴⁹⁸ While all cases begin as liquidations, the case can proceed, through the actions of a Creditors Assembly, the creditors can vote on a reorganization plan, that will be approved if it is approved by two thirds of all unsecured creditors.⁴⁹⁹ Priority treatment is given to wage claims first, and then to taxes.⁵⁰⁰

In 1986, China passed a controversial law that permitted the bankruptcy of SOEs.⁵⁰¹ These cases all start as liquidations but can then become reorganization cases.⁵⁰² The goal in enacting this new law was to encourage more efficient management of SOEs and to liquidate unprofitable businesses.⁵⁰³ Lawmakers continue to call for reform of this law, however, because it leaves the decision about whether a company can file for bankruptcy in the hands of the government rather than courts or creditors.⁵⁰⁴ Courts are still not independent, and the community continues to have a lack of trust for judicial bodies.⁵⁰⁵ Moreover, despite the clear purpose of the new law, the government still views it as a loss of face if an SOE fails, and thus limits access to the new system.⁵⁰⁶ Clearly, the desire to compete in a global capital market cannot overcome ancient cultural and societal beliefs.

3. *Conclusions About East Asian Bankruptcy Policies and Culture*

As many traditional societies are learning, changing the law and getting people to use the new law, are two very different things. Japan, for example, pushed for early

⁴⁹⁵ Ma, *supra* note 319, at 208 Chinese workers are considered the leaders of the country. Chen, *supra* note 480, at 59. Workers sacrifice higher earnings for years believing that they will receive 90% of their wage per year upon retirement. *Id.* If the SOE goes bankrupt, workers could lose everything. *Id.*

⁴⁹⁶ *Id.*

⁴⁹⁷ Ma, *supra* note 319, at 194-95. In the Shenzhen District, the debtor is eligible for bankruptcy if it has suffered serious losses or been unable to pay its debts as they come due. Zhang and Booth, *supra* note 317, at 7. These cases can be instituted by either the debtor or creditors. *Id.*

⁴⁹⁸ *Id.* at 9.

⁴⁹⁹ *Id.* at 7.

⁵⁰⁰ *Id.*

⁵⁰¹ *Id.* at 2.

⁵⁰² *Id.*

⁵⁰³ *Id.* at 13-14.

⁵⁰⁴ Ma, *supra* note 319, at 206.

⁵⁰⁵ Zhang and Booth, *supra* note 317, at 13.

⁵⁰⁶ Ma, *supra* note 319, at 208. Issues surrounding how fired employees will be taken care of also remain as stumbling blocks. Unlike American bankruptcy law, which is non-judgmental about business bankruptcy, Chinese bankruptcy law attempts to lay blame for a business failure, or at least assess responsibility. Boshkoff & Yongxin, *supra* note 318, at 361. The Chinese law allows criminal sanctions for poorly-managed enterprises. *Id.*

passage of its new Civil Rehabilitation Law, one of the few debtor-in-possession systems on the world. It was enacted ahead of schedule, to try to help breathe life into Japan's floundering economy. While it has been used to some extent, the government would like to see it used much more.⁵⁰⁷ Shame over debt is still prevalent. With more debt in the system, a recessionary economy and more business failures, debt-related suicides have been on the rise.⁵⁰⁸ While Japan's Economy Minister has called for a change in both laws and attitudes about debt repayment, it is far easier to change the laws than the attitudes.

As China prepares to approve and unfold its reorganization scheme, it may be faced with similar problems. The Chinese also consider it a shameful thing to not pay ones debts, a misfortune that would follow one for the rest of his or her life.⁵⁰⁹ Culturally, like the Japanese, the Chinese are taught to value relationships over money and self-promotion.⁵¹⁰

None of the Asian countries discussed have high corporate bankruptcy rates. The reasons are both cultural and opportunity-driven. Sometimes the law is not helpful. Much of the time, cultural factors make bankruptcy taboo. In China, businesses can continue to hide behind state ownership even if they are not profitable. No one loses face. Where this is unavailable, such as in Japan's capitalist market, then suicide is one way out; for some it is preferable to using the new laws. Japan and other countries with a strong culture of shame must find a way to balance economic goals, such as fueling the economy through more and more credit, with the serious ramifications of over-indebtedness. In the end, bankruptcy systems must be drafted to meet a country's cultural as well as economic needs. Merely transplanting bankruptcy systems from other parts of the world, particularly culturally dissimilar places, is ineffective. The resulting laws are misunderstood, distrusted and underutilized.

⁵⁰⁷ In fact, Japanese businessmen are being strongly encouraged by the Japanese government to use this new law, both on television as well as on the web. It would be extremely hard to imagine the U.S. government promoting chapter 11, yet there are cultural factors at work in Japan that make "selling" the new bankruptcy law necessary. The traditional Japanese shame culture prevails.

⁵⁰⁸ One of the most shameful things one can do is not pay one's debts. Suicide is often preferred to bankruptcy, even when the law is favorable to management and to business. Japan has a per capita suicide rate of twice that of the United States.

⁵⁰⁹ Nor is there a developed concept of limited liability for businesses. If a person runs a business, then he or she is responsible for its debts. Numerous other cultural factors make it difficult for Chinese businessmen to accept the idea of a court-supervised liquidation or rehabilitation. People do not trust courts as neutral tribunals.

⁵¹⁰ Economics also have played a part in the Chinese bankruptcy experience. While bankruptcy has been more or less available to privately-owned businesses in China, which now account for about 59% of all businesses, state-owned enterprises ("SOEs") have not been able to file for bankruptcy without government approval. One of the reasons for this, though not the only reason, is that the bankruptcy of an SOE is seen as a failure of the state, and causes the state to lose face. These are surprising ideas for Americans, who not only expect government to fail, but expect to be able to complain openly about it.

VI. CONCLUSION

As the above discussion of U.S. policy demonstrates, the “fresh start,” as well as the reorganization through a debtor-in-possession, grew from the ground up from the roots of American capitalism.⁵¹¹ First came the creation of an entrepreneurial economy,⁵¹² followed by an active consumer economy. The conditions for such a system were present from the beginning of the economy and the bankruptcy systems grew directly from them.

Today other countries are attempting to create more vibrant market-based economies, in part by developing new insolvency systems.⁵¹³ At the same time, citizens of the world are also being exposed to more and more credit, often more than they can back.⁵¹⁴ One fairly obvious way to reduce the pain and suffering that could result from this new credit economy is to enact lenient discharge and reorganization laws to address the financial failure that will inevitably occur. This is certainly the global trend.⁵¹⁵

This Article suggests that creating more forgiving insolvency systems may make economic and social sense but still may not be accepted in some societies. On the other hand, attitudes toward bankruptcy in the U.S. changed once bankruptcy became more common, so perhaps long-held cultural views around the world will change as well. Only time will tell. In the meantime, governments and lawmakers must realize that imported bankruptcy systems are not being implanted onto blank cultural slates, such as the U.S. economy and social system of the 1700's and early 1800's. Many existing cultures are far more complicated. To those governments, I suggest the following cautious approach to developing new insolvency systems.

First, recognizing that new bankruptcy systems take some time to be accepted, governments and lawmakers should think very carefully and cautiously about how and when to deregulate credit systems. They should try to limit available credit to that which citizens can handle on their incomes, and try not to assume that extensive credit and purchasing power necessarily represents the good life. For a society that does not accept debt forgiveness, even if it is legally permissible, this could be a dangerous trap. The social consequences could include losing the family home, other possessions, and even family members themselves.

Second, assuming that it may be too late to carefully consider how credit is regulated, because it already has been extended in amounts higher than many can pay, governments and lawmakers should try to educate the public about responsible credit use, as well as the debt forgiveness benefits that the law provides. Such education is being attempted in both Europe and Japan, although many consumers report that they are

⁵¹¹ See *infra* notes 31-78 and accompanying text.

⁵¹² See *infra* notes 31-65 and accompanying text.

⁵¹³ Metzger & Bufford, *supra* note 4, at 154 (noting that when a country attempts to create a market economy, bankruptcy laws are among the first capitalist laws to be enacted).

⁵¹⁴ See *supra* note 2.

⁵¹⁵ Efrat, *supra* note 3, at 92-93.

unaware of the debt forgiveness now allowed by law. Others still refuse to use these laws because doing so is dishonorable.⁵¹⁶ Education efforts should continue, in an effort to destigmatize, as well as to avoid isolation, voluntary exile and suicide from over-indebtedness.

Finally, governments that are working on new bankruptcy systems should avoid the wholesale transplantation of any system, but in particular, should avoid transplanting U.S. systems without giving thought to the individual components of such laws. U.S. debt culture appears to be different from that of most of the rest of the world, and more moderate approaches may transplant with greater success. Transplanted aspects of U.S. bankruptcy law have been ignored in practice in Germany, Japan, Eastern Europe, Indonesia,⁵¹⁷ and Thailand,⁵¹⁸ as well as other parts of the world. They are simply too confusing, contextual, and complicated to make sense in their new homes, and also are based on social and cultural assumptions that the new host countries do not share.⁵¹⁹ This causes more problems than it solves by suggesting that the social problems caused by over-indebtedness have been solved when they have not. Rather than importing any systems wholesale, countries should attempt to borrow from many systems, and should ensure that the new law reflects both the economic needs of the society, as well as the unique cultural components of the society.⁵²⁰

⁵¹⁶ See *Doing Business in Japan*, *supra* note 375, at §7.02.

⁵¹⁷ See WSG, *supra* note 262, at 306.

⁵¹⁸ See *id.*

⁵¹⁹ Good examples include the debtor-in-possession model now in place in Japan, Germany and Mexico, but not widely accepted in any of these places.

⁵²⁰ Examples include jobs in France, honor and saving face in Japan, and efficiency in Germany and Australia. Ripe areas for development, based on cultural concerns, include the breadth of the discharge, the breadth of the automatic stay, the priority scheme, and whether a repayment plan is required.