

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

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Abstract: In this Article, Professor Nathalie Martin examines societal attitudes toward debt and financial failure in the context of two global trends, the liberalization of bankruptcy and insolvency laws, and the increased availability of consumer credit around the world. The Article begins with a description of the history of the U.S. economy, its risk-oriented capitalist ethos, its consumer culture, and its resulting consumer and business bankruptcy laws. The Article next briefly addresses the personal bankruptcy systems of Continental Europe, noting that in some places, U.S.-style bankruptcy systems have been enacted but not necessarily accepted. Professor Martin then discusses Japanese and Chinese cultural attitudes toward debt, and briefly discusses new laws being proposed or passed in Japan, Hong Kong, and mainland China, some of which are based in part upon U.S. laws. Based on this and other examples, she concludes that cultural attitudes play a tremendous role in the efficacy of bankruptcy and insolvency systems. She further concludes that, as more and more consumer and business credit becomes available around the world, the countries affected will need to enact effective and accepted discharge and fresh start principles, but that these systems cannot simply be transplanted from the United States. Such transplantation is likely to be ineffective and thus gradual education and changes in laws and credit availability will be needed in order to avoid the extensive social costs that could result from too much credit in systems that do not accept financial failure.

INTRODUCTION

Does culture shape law or does law shape culture? Throughout history, culture has taken the leading role by informing society of

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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 United States, which has a very different cultural attitude toward debt forgiveness.⁴ Although these 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 transplan-

¹ See Linz Audain, *Critical Cultural Law and Economics, The Culture of Deindividualization, 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 generally EUROPEAN CREDIT RESEARCH INSTITUTE, CONSUMER CREDIT IN THE EUROPEAN UNION 16–18, available at <http://www.ecri.be/pubs/ECRIen.pdf> (Feb. 2000) (last visited Oct. 22, 2004) (noting tremendous increases in credit card debt in Europe); PAUL MIZEN, CONSUMER CREDIT AND OUTSTANDING DEBT IN EUROPE 1, available at <http://www.nottingham.ac.uk/economics/ExCEM/issues/issues4.pdf> (last visited Oct. 22, 2004) (exploring regional differences in the amount of outstanding debt in Europe); Jason Booth, *KIS Investors Bet on South Korea's Rising Debt*, WALL ST. J., May 30, 2002, at C14 (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); Ian Fletcher, *Card Fraud Soars to £228M*, EVENING STANDARD, Oct. 16, 2002, at 15 (noting mounting credit card debt throughout the United Kingdom, Mexico, and Malaysia, as well as China, South Korea, and Thailand); *Growth of Credit Cards in Emerging Markets Leading to Concern Over Mounting Consumer Debt and Card Fraud*, M2 PRESSWIRE, October 15, 2002, at 2002 WL 26804947 (describing skyrocketing credit card debts in China, South Korea, Brazil, and Thailand).

³ See Rafeal Efrat, *Global Trends in Personal Bankruptcy*, 76 AM. BANKR. L.J. 81, 91–92 (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 United States for an example of a working bankruptcy system). Article 9 of the Uniform Commercial Code 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 (2001) (discussing how New Zealand, Canada, Australia, and even England, are looking to Article 9 of the U.S. Uniform Commercial Code to solve a few nagging problems with personal property security systems in their own countries' laws).

⁵ See *infra* notes 392–414 and accompanying text.

tation are likely to create the desired results of fueling a market economy and promoting economic growth and well-being.

The current U.S. bankruptcy system grew directly out of the United States' 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, and an equally forgiving business reorganization system to encourage risk taking and economic growth.⁸ Both systems are part of a larger scheme to keep economic players alive and active in the game of capitalism. U.S. bankruptcy systems are among the country's few social programs and they address many of society's ills.⁹ Thus, they are broad and form an integral part of the social system from which they sprung.¹⁰

As globalization takes place, more and more countries believe that creating a viable bankruptcy system will help fuel a market economy.¹¹

⁶ As one U.S. scholar recently noted:

[E]ach country gets the bankruptcy law it deserves. I think we deserve [C]hapter 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).

⁷ See Alan Reder, *The Yoga of Money*, YOGA J., Mar.-Apr. 2003, at 114 (discussing the importance of spending in the U.S. economy). Indeed, after September 11, 2001, President Bush's frequent pleas to consumers to spend caused one author to call this the "shop-till-Osama-drops" plan for fighting terrorism. See *id.*; see also Mark Gongloff, *When Will We Spend Again?*, MONEY.CNN.COM, at http://money.cnn.com/2001/10/26/economy/economy_consumer/ (Oct. 26, 2001) (linking consumer spending to U.S. economic recovery).

⁸ See *infra* notes 153–201 and accompanying text.

⁹ See generally Broude et al., *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 person's well-being).

¹⁰ See EDWARD J. BALLEISEN, *NAVIGATING FAILURE: BANKRUPTCY AND COMMERCIAL SOCIETY IN ANTEBELLUM AMERICA* 28 (2001). 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.

¹¹ See, e.g., Letter from Tarrin Nimmanahaeminda, Minister of Finance, & M.R. Chatu Mongol Sonakul, Governor, Bank of Thailand, to Michel Camdessus, Managing Director,

As a result, many countries have attempted to create a reorganization scheme for failing enterprises like Chapter 11 of the U.S. Bankruptcy Code (Chapter 11), in which existing management stays in place and manages the reorganizing company.¹² These systems are perhaps the most common U.S. legal exports today.¹³ Many countries are also liberalizing their consumer bankruptcy systems.¹⁴ 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.¹⁵ 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.¹⁶ 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.¹⁷

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 enterprises or indi-

IMF (Aug. 25, 1998), *available at* <http://www.imf.org/external/np/loi/082598.htm> (last visited Oct. 22, 2004) (assenting to the IMF's demand for a reorganization plan as a prerequisite to bail-out assistance for Thailand during the Asian banking crisis).

¹² See Jeffrey Davis, *Bankruptcy, Banking, Free Trade, and Canada's Refusal to Modernize Its Business Rescue Laws*, 26 TEX. INT'L L. J. 253, 253-54 (1991). 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 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 id.* Liquidation, conversely, can cause a domino of failure, unnecessarily harming everyone with whom the debtor does business. *See id.*

¹³ *See infra* notes 268-308 and accompanying text.

¹⁴ See Jason J. Kilborn, *The Innovative German Approach to Consumer Debt Relief: Revolutionary Changes in the German Law, and Surprising Lessons for the United States*, 24 N.W. J. INT'L L. & BUS. 257, 257 (2003) [hereinafter *German Approach*]; Jason J. Kilborn, *La Responsabilisation de l'Economie: What the U.S. Can Learn from the New French Law on Consumer Overindebtedness*, 26 MICH. J. INT'L L. (forthcoming) [hereinafter *French Law on Consumer Overindebtedness*]; *see also* Efrat, *supra* note 3, at 91-92. Some countries, such as Italy and Greece, still have no personal bankruptcy system at all. *See infra* notes 241-267 and accompanying text.

¹⁵ 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 system once credit has been deregulated).

¹⁶ See Nathalie Martin, *Common-Law Bankruptcy Systems: Similarities and Differences*, 11 AM. BANKR. INST. L. REV. 367, 403-10 (2003).

¹⁷ *See infra* notes 235-308 and 380-414 and accompanying text.

viduals.¹⁸ 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 upon which they are based.¹⁹ This Section also describes modern credit practices and attitudes toward debt and repayment.²⁰ It then briefly describes the U.S. bankruptcy systems that developed out of this economic history.²¹

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.²² 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 United States.²³ 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.²⁴

¹⁸ A country should 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.

¹⁹ See *infra* notes 30–106 and accompanying text.

²⁰ See *infra* notes 107–149 and accompanying text. This Section discusses empirical research regarding the types of debts that U.S. citizens have, as well as the circumstances many individual debtors face, when they file for bankruptcy. It briefly examines business or corporate debt culture in the United States as well, concluding that there is little stigma associated with business failure in the United States, given the premium U.S. citizens place on entrepreneurialism and risk taking.

²¹ See *infra* notes 150–160 and accompanying text.

²² See *infra* notes 209–228 and accompanying text. This Article does not do a true comparison of different systems, though a recent book describes many consumer systems around the world and compares some of these systems as well. See CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE (Johanna Niemi-Kiesiläinen et al., eds., 2003).

²³ See *infra* notes 209–228 and accompanying text.

²⁴ See *infra* notes 511–513 and accompanying text.

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.²⁵ 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.²⁶ This Section 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.²⁷

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

This Section outlines the history of the United States' growth economy and the unique entrepreneurial spirit that led to an equally unique bankruptcy system for both businesses and consumers.²⁸ It also discusses the development of consumer and credit culture and the laws that have developed from these unique quirks of history.²⁹

A. *The History of the U.S. Economy: The Connection Between Bankruptcy Law and Capitalism*

Relatively speaking, U.S. society can be characterized as capitalistic and consumeristic, although the extent to which the United States should embrace these two ideologies has been controversial throughout our history.³⁰ Early discussions of bankruptcy policy were divisive, in part because early bankruptcy policy helped to shape the U.S. economic identity.³¹ The expansion of capitalism and spending resulted in some failure, followed by the creation of the first U.S.

²⁵ See *infra* notes 514–523 and accompanying text.

²⁶ See *infra* notes 514–523 and accompanying text.

²⁷ See *infra* notes 514–523 and accompanying text.

²⁸ One of the goals of this Section is to explain to foreign scholars who are studying the U.S. insolvency systems how the U.S. system came into being and how it fuels U.S. capitalism and entrepreneurialism.

²⁹ See *infra* notes 107–201 and accompanying text.

³⁰ See Richard C. Sauer, *Bankruptcy Law and the Maturing of American Capitalism*, 55 OHIO ST. L.J. 291, 291–98 (1994).

³¹ See *id.* at 298.

bankruptcy system.³² This Section reviews the economic culture from which this bankruptcy system arose.³³

1. The Development of the United States' Free-Market Economy.

Alex de Tocqueville's "new model man" portrayed the American as a child of the commercial revolution that should progress quickly toward commercial and industrial maturity.³⁴ This model saw economic prosperity, technical development, education, and expanded cultural opportunities as the lynchpins of a successful society.³⁵ On the other hand, the agricultural sector of society rejected these big-business ideas as a threat to its ideal nation of small producers and laborers who earned an honest living working the soil.³⁶ The agrarian sector 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.³⁷

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

³² See *id.*

³³ This Article does not outline the history of U.S. bankruptcy laws, as this has been done well and extensively outlined by previous scholars. See Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L. J. 325, 344–69 (1991) [hereinafter Tabb, *Evolution of Discharge*]; Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 7 (1995) [hereinafter Tabb, *History of Bankruptcy*].

³⁴ Sauer, *supra* note 30, at 291–92.

³⁵ See *id.* at 292.

³⁶ See *id.* at 292–93. 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 (2001).

³⁷ Sauer, *supra* note 30, 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*, in 16 FRANKLIN PAPERS 107, 109 (William Willcox ed., 1972). Thus, Franklin's sentiments illustrate that upon this nation's formation, mercantile capitalism (with its venture capitalists) was not an idea embraced immediately. See *id.*

absolutely essential.³⁸ Conversely, the 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 1800s 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 U.S. citizens 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, U.S. citizens produced more cotton, grain, livestock, textile goods, coal, and lumber than previously thought possible.⁴³ A greater number of U.S. citizens began, at last, to have disposable income to spend on house wares, nicer homes, fancier furnishing and clothing, and unimproved land.

The expansion of the United States' 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 The United States 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

³⁸ See Sauer, *supra* note 30, at 293–94.

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 36, at 26.

⁴⁰ See Sauer, *supra* note 30, at 295. Much of this view was predicated on the intangibility of credit. See *id.* 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. See *id.* In a sense, the idea of credit as a vice to these agrarians makes perfect sense as their time-frame 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 10, at 26.

⁴² *Id.* at 26–27.

⁴³ See *id.* at 27.

⁴⁴ *Id.*

⁴⁵ See *id.*

⁴⁶ BALLEISEN, *supra* note 10, at 27.

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 shows that the use of credit was common by the mid-1800s.⁴⁹ Indeed, many merchants not only paid debts many months after 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 called “systemized credit” the one characteristic of capitalism that distinguishes it from all other economic orders and, 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

⁴⁷ See *id.* at 26–27. As Balleisen notes, this dependence on credit was based in part on the development of the United States’ post-revolution brand of market capitalism. *Id.*

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

⁴⁹ See *id.* at 27–28. 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 had succumbed to filing for bankruptcy as of the 1840s and 1850s. *Id.* at 3. He found that the availability of credit was far greater than many had anticipated. *Id.* at 27–29. One of his underlying theses is that the integration of a national credit system helped contribute to a new phase of capitalism in the United States. See *id.* at 27. The average U.S. citizen could now start up a business on credit and attempt to attain his or her dreams. Of course, the business cycle, economic blights, and large debt burdens forced many to file. See *id.* at 32–41.

⁵⁰ See *id.* at 28–32.

⁵¹ See BALLEISEN, *supra* note 10, 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*, 12 KNICKERBOCKER 190 (1838).

⁵² See Sauer, *supra* note 30, at 294–95 (discussing how the availability of credit has long been central to developing a capitalist economy); see also FOREST McDONALD & ELLEN SHAPIRO McDONALD, *REQUIEM: VARIATIONS ON EIGHTEENTH-CENTURY THEMES* 184 (1988); ADAM SMITH, *WEALTH OF NATIONS* 275–77 (Knopf 1991).

⁵³ See BALLEISEN, *supra* note 10, 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

2. The Rationale and Political Milieu of Early U.S. 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 U.S. citizens vulnerable to the shifting currents of the overall economy, and intricately tied them to the financial health of the firms with which they did business.⁵⁵ This may explain why many early market capitalists in the United States 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 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-1800s.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 1700s.⁶¹

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 CONGRESS 1098 (1822) (remarks of Rep. Wood).

⁵⁵ See BALLEISEN, *supra* note 10, at 31.

⁵⁶ See Sauer, *supra* note 30, at 295–96. But see BALLEISEN, *supra* note 10, at 26–27. Thus, the division between agrarians and capitalists, and that between bankruptcy advocates and those against it, was predicated on a recognition of the potential for failure and the need to address such failure.

⁵⁷ Sauer, *supra* note 30, at 296 & n.28.

⁵⁸ BALLEISEN, *supra* note 10, 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 et al., *Ladies in Red: Learning from America's First Female Bankrupts*, 40 AM. J. LEGAL HIST. 1, 3–4 (1996). The stories of the women told in this article prove that women of the 18th and 19th centuries 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. *Id.* at 36. They too were willing to take risks. See *id.*

A legal culture of tolerance toward non-payment developed, in order to encourage people to continue entrepreneurial pursuits.⁶² The relative lenience of U.S. 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 United States.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

⁶² See BALLEISEN, *supra* note 10, at 16. Of course, this is just one side of the story, and the rosy one at that. See BRUCE H. MANN, *REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE* 79 (2002) (chronicling the history, development, and ultimate abolition of debtors’ prisons in the United States, which originally were permitted in every state).

⁶³ See BALLEISEN, *supra* note 10, 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 30, 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 a 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 success; more commonly they led only to new accumulations of unpayable obligations. Collectively, the ventures of risk-taking former bankrupts helped to consolidate 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.”

BALLEISEN, *supra* note 10, 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 30, 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

The U.S. system also developed from the country's distinctive partisan political system, and the unique way that both debtor and creditor interests were balanced in that system, along with the early and prominent role of attorneys as the primary professionals in its development.⁶⁵ 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.⁶⁶ Because Republicans tended to favor creditor interests, and Democrats or Populists tended to favor debtor interests, the compromises that resulted were the product of the unique, U.S. two-party system.⁶⁷

Moreover, from the start, private attorneys played a very significant role in U.S. bankruptcy cases and in the reform process.⁶⁸ As the law took shape, general practitioners began to specialize in bankruptcy cases, thereby perpetuating the system.⁶⁹ As Professor Skeel recounts, "government agencies have a tendency to become self-perpetuating. 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."⁷⁰ As Skeel explains, while the bankruptcy bar is private rather than governmentally-run, it

honest and cooperative, the debtor has every incentive to be honest and helpful and not hide assets. *See id.* at 300.

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.* 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 him or her economically dormant, imprisoned, and with a family supported by the state. *See id.*

This Bankruptcy Act of 1898 was the precursor to the current U.S. system and the first systematic bankruptcy system of the nation. *See id.* The history surrounding its enactment explains in some measure how the complex U.S. bankruptcy system developed so much earlier than all other systems of its kind around the world. *See id.* at 300–01.

⁶⁵ *See* SKEEL, *supra* note 36, at 2–4.

⁶⁶ *Id.* at 2.

⁶⁷ *Id.* at 16.

⁶⁸ *See id.* at 2.

⁶⁹ *See id.* at 92.

⁷⁰ SKEEL, *supra* note 36, at 47.

has played an analogous, self-perpetuating role.⁷¹ This is one explanation for why the system changes, but never by leaps and bounds.

Thus, a number of unique characteristics have created the U.S. 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 U.S. Consumerism

The above discussion focuses primarily on the development of business and commerce and the resulting business debt. Current U.S. attitudes toward personal or consumer bankruptcy, however, 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.⁷² Due to rationing of most consumer products, and stopped production for others, most people saved their wages.⁷³ After the war, the United States experienced a period of inflation, after which consumer demand for various household goods and services increased dramatically.⁷⁴ 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.⁷⁵

U.S. 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.”⁷⁶ This strategy apparently worked well, as Americans began purchasing to be happy, and building social experiences around the act of acquiring.⁷⁷

⁷¹ See *id.*

⁷² See John Henry Schlegel, *Law and Economic Change in the Short Twentieth Century* 15 (unpublished manuscript, on file with author).

⁷³ *Id.*

⁷⁴ See *id.* at 18.

⁷⁵ See *id.*

⁷⁶ David Ray Papke, *Discharge as Denouement: Appreciating the Storytelling of Appellate Opinions*, in *NARRATIVE AND THE LEGAL DISCOURSE* 206, 214 (Papke ed., 1991) (quoting D. MILLER & M. NOWAK, *THE FIFTIES: THE WAY WE REALLY WERE* 117 (1977)).

⁷⁷ See *id.*

As inflation subsided, the housing and auto industries expanded and the United States began exporting a huge variety of goods, including farm products. This resulted in large trade surpluses since Europe and Japan, the main U.S. trade partners, had little to export.⁷⁸ The economy grew in a strong and stable fashion in the early 1950s.⁷⁹ 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.⁸⁰

U.S. citizens 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 then, 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.⁸¹ Still, consumer credit has been rising steadily for decades.⁸² Over time the United States has learned to consume too well. While it can manufacture and produce many products and services worthy of export, the voracious U.S. desire to consume makes it unlikely that Americans will ever produce as much as they use.⁸³ As a culture, Americans 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 pro-

⁷⁸ See Schlegel, *supra* note 72, at 18.

⁷⁹ *Id.*

⁸⁰ See *id.* at 19.

⁸¹ See generally MATTHEW J. SLAUGHTER, MULTINATIONAL FIRMS AND WAGES IN A GLOBAL ECONOMY, available at <http://www.dartmouth.edu/~glm/pdf/SageMJS.pdf> (last visited Oct. 25, 2004) (noting that low-skill labor wages in the United States are much higher than similar skill labor wages elsewhere, and therefore, firms have a clear incentive to move those operations abroad which utilize low-skill labor).

⁸² See Series Title: Household Sector: Total Credit Market Debt Owed by: Credit Market Debt Outstanding: Billions of Dollars: Amounts Outstanding End of Period, NSA, at <http://www.economagic.com/em-cgi/data.exe/frbz1/f1154102005> (last visited Nov. 5, 2004).

⁸³ See BUREAU OF ECONOMIC ANALYSIS, REAL GROSS DOMESTIC PRODUCT AND RELATED MEASURES: PERCENT CHANGE FROM PRECEDING PERIOD, tbl.1(2), available at <http://www.bea.doc.gov/bea/newsrel/2003cr.xls>. (last visited Nov. 29, 2004).

gram introduced by President Roosevelt in the New Deal Legislation.⁸⁴ 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.⁸⁵ As a result of these conditions, only about 45% of the homes in the United States were owner-occupied.⁸⁶ Roosevelt sought to foster stability and security during the depression by making it much easier for the average person to buy and keep a home.⁸⁷

This was accomplished through the formation of the Home Owners Loan Corporation (HOLC), the Federal Housing Administration (FHA), and the Department of Veterans Affairs (VA). The FHA, created by the National Housing Act of 1934, did not make mortgage loans but rather insured them.⁸⁸ Because the FHA began insuring these loans, lenders were much more willing to make loans with lower down payments and at lower interest rates.⁸⁹ This made mortgage loans more available to the middle class than ever before.⁹⁰ Owning a home became a nearly universal dream for U.S. citizens after World War II.⁹¹ As late as 1940, half of all young adults between the ages of twenty and twenty-four lived with their parents.⁹² In the fifteen years following the war, home ownership shot

⁸⁴ U.S. Housing Act of 1937, ch. 896, 50 Stat. 888 (codified as amended at 42 U.S.C. § 1437(2000)).

⁸⁵ Thomas W. Hanchett, *The Other "Subsidized Housing:" Federal Aid to Suburbanization, 1940–1960s* in FROM TENANTS TO TAYLOR HOMES 165 (John I. Bauman et al. eds., 2000).

⁸⁶ *Id.*

⁸⁷ Florence Wagman Roisman, *Teaching About Inequality, Race, and Property*, 46 ST. LOUIS U. L.J. 665, 676 (2002). 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 id.*

⁸⁸ *See* National Housing Act, Pub. L. No. 73–479, 48 Stat. 1246 (1934) (codified as amended at 12 U.S.C. §§ 1701–1750 (2000)).

⁸⁹ David Dante Troutt, *Ghetts Made Easy: The Metamarket/Antimarket Dichotomy and the Legal Challenges of the Inner-City Economic Development*, 35 HARV. C.R.-C.L. REV. 427, 439 n.46 (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).

⁹⁰ *See id.* Troutt notes that between 1936 and 1941, new home owners increased from 332,000 to 619,000. *See id.*

⁹¹ *See* IN THE GOOD OLD DAYS: FACT OR FICTION ON THE NOSTALGIA TRIP, available at <http://www.agls.uidaho.edu/ccf/CCC%20Families/pdf/coontz.pdf> (last visited Dec. 5, 2004).

⁹² *The Feminine Mystique*, at http://www.columbia.edu/~rr91/3567_lectures/feminine_mystique.htm (last visited Nov. 8, 2004).

up to 62%.⁹³ No one individual was more responsible for this change than William Levitt,⁹⁴ who built new Cape Cod homes and sold them for \$7,990 in the late 1940s, with little or no money down and a 4.5% interest rate.⁹⁵

These events forever changed the face of U.S. consumerism and consumer credit. They ultimately revolutionized the home finance industry in three ways: by making 20% down payments the norm, rather than the previous 50% required;⁹⁶ by stretching home loans out over twenty-five or thirty 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.⁹⁷ As a result of these and other more recent changes, 68.6% of U.S. citizens now own their homes,⁹⁸ a percentage higher than most other coun-

⁹³ *Id.*

⁹⁴ *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 houses 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.

⁹⁵ E-mail from Polly Dwyer, President of Levittown Historical Society, to Frederick Hart, Professor Emeritus of Law, University of New Mexico School of Law (Jan. 11, 2003; 01:20:40 MST) (on file with author); see also John Cassidy, *The Next Crash: Is the Housing Market a Bubble That's About to Burst?*, THE NEW YORKER, Nov. 11, 2002, at 123 (discussing the Levittown development project).

⁹⁶ See MARC A. WEISS, *THE RISE OF THE COMMUNITY BUILDERS: THE AMERICAN REAL ESTATE INDUSTRY AND URBAN LAND PLANNING* 32 (1987).

⁹⁷ See KENNETH T. JACKSON, *CRABGRASS FRONTIER: THE SUB-URBANIZATION OF THE UNITED STATES* 204 (1985).

⁹⁸ U.S. CENSUS BUREAU, *HOUSING VACANCY SURVEY FIRST QUARTER OF 2004*, available at <http://www.census.gov/hhes/www/housing/hvs/q104tab5.html> (last visited Nov. 8, 2004); see *Coastal Business*, SUN-NEWS (Myrtle Beach, S.C.), Apr. 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% respectively but that the Pacific Coast had a rate of just 59.6%, showing a large variation across the country).

tries in the world.⁹⁹ The New Deal Legislation unquestionably led to this result and, along with the advent of private mortgage insurance, now allows U.S. citizens to buy a home with 0% down.¹⁰⁰ These conditions lead to a generally higher disposable income for U.S. citizens than most other citizens in the world.¹⁰¹

Low down payment loans in the United States have led to another uniquely U.S. 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 1991.¹⁰² These types of loans are pushed non-stop through the media in the United States, yet are virtually unheard of in Europe.¹⁰³ 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 I with far more land owned publicly and far more people owning homes and businesses on leased land.¹⁰⁴ Thus, in comparison to the United States, there are far fewer home equity loans in Europe and the rest of the world and thus less overall indebtedness.¹⁰⁵

⁹⁹ New Zealanders purportedly have the highest home ownership rate at 71.2% with Australia in second place at 70.1%. See *Australia Has World's Second Highest Home Ownership Rate*, ASIA PULSE, Feb. 11, 2002. The United States is next at 67%, see *Coastal Business*, *supra* note 98, at D1, and England is next at 66%. See Roger Bootle, *Not a Common European Home Economic Agenda*, THE SUNDAY TELEGRAPH (London), Aug. 18, 2002. Continental Europe's rate is currently 58%, but, of course, this number represents an average of a number of different rates across Europe. See *id.*

¹⁰⁰ See, e.g., "0" Down, at http://www.newloan4you.com/0_down/0d1.html (last visited Nov. 9, 2004).

¹⁰¹ In many parts of Europe, a buyer seeking a loan from a lending institution is still expected to put down 50% in order to get a home loan. See, e.g., Broich, Bayer, von Rom, *Restructuring & Turnarounds*, at <http://www.broich.de/eng/restructuring-and-turnarounds.htm> (last visited Nov. 10, 2004).

¹⁰² U.S. GENERAL ACCOUNTING OFFICE, TAX POLICY: MANY FACTORS CONTRIBUTED TO THE GROWTH IN HOME EQUITY FINANCING IN THE 1980s 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. *Id.* at 1. For a more detailed exploration of the dilemma with home equity loans, see generally Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 TUL. L. REV. 373 (1994) (discussing the federal government's promotion of home equity financing).

¹⁰³ 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.

¹⁰⁴ LORD MADOC ARUNDEL & CHRISTOPHER T.C. MILLER, THE GOVERNANCE OF REAL PROPERTY IN ENGLAND FROM HENRY I TO THE SECOND REITERATION OF MAGNA CARTA, available at http://www.pbm.com/~lindahl/articles/land_law.html (last visited Nov. 9, 2004).

¹⁰⁵ See Nicola Clark, *Frugal Europeans Hold up Recovery: Struggle Is on to Persuade Consumers to Spend Despite Economic Uncertainty*, INT'L HERALD TRIBUNE, July 22, 2004, at 1 (stating that strict banking laws make it difficult, if not impossible, to extract added value from a

Lending found its true cornucopia in the United States, however, with the introduction of the charge card in the 1960s, followed by the credit card in the 1970s and 1980s.¹⁰⁶ Since then, there has been no turning back.

B. *Current U.S. Consumer Culture: Buying Happiness*

U.S. citizens are considered profligate in their personal lives as well as their business lives, particularly in comparison to other world citizens.¹⁰⁷ While the last subsection attempts to explain how these habits developed, this subsection examines how U.S. society views debt today, and what current legal, cultural, and economic factors have led to the country's "compulsively" consumeristic behavior.¹⁰⁸ It also examines the financial and other life conditions of most individual bankruptcy debtors in the United States and discusses whether there is a different bankruptcy or debt culture for U.S. business debtors, as compared to individual consumer debtors.

1. How and Why We Spend It: Let Us Count the Ways

Consumer spending is considered one of the most important indicators of economic health in the U.S. economy.¹⁰⁹ Despite the

mortgage through a home equity loan). With this background, one can begin to understand how the U.S. bankruptcy system of debt forgiveness came into being. What is not clear is whether the countries that are importing aspects of the U.S. bankruptcy system actually need this system or will need it. Will they also become highly consumeristic because that is where globalization will take them? As stereotypes would have it; some Europeans are known for having one small closet filled with a few expensive pieces of clothing, whereas U.S. citizens 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.

¹⁰⁶ 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, Diners Club, and Carte Blanche first offered charge cards, which, as their name implies, had to be paid off each month. *See id.* The big profits occurred with the development of the credit card, and the resulting high interests rates to lenders. *See id.* These did not blossom until the 1970s and the 1980s in the United States, *see id.*, and still have not done so throughout the rest of the world. *See id.* at 1056–57. Mann attempts to explain this phenomenon by examining the banking and lending systems of the United States versus other parts of the world, particularly Japan. *See id.*

¹⁰⁷ See Jacob S. Ziegel, *The Fragile Middle Class: Americans in Debt, Discussed from a Canadian Perspective*, 79 TEX. L. REV. 1241, 1244 (2001).

¹⁰⁸ *See id.*

¹⁰⁹ 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

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.¹¹⁰ 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.¹¹¹

The advertisement goes on to tell the recipient whom to call to get a home equity loan to solve all of life's problems, demonstrating that, despite popular belief, you can buy both happiness and peace of mind.¹¹²

two-thirds of our gross domestic product, which is the broadest measure of economic health. *See* Gongloff, *supra* note 7.

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 dispensable income. If, however, they do not believe that good times lay ahead, they are more likely to save their money. THOMAS MAYER ET AL., *MONEY, BANKING, AND THE ECONOMY* 273 (1999).

¹¹⁰ One advertisement admonishes U.S. citizens to get the money they deserve by tapping into the \$30 trillion dollars in equity currently available in U.S. real estate. No mention is made of the need to pay such funds back. In a title loan company advertisement, 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 advertisement, Mr. T tells a huge, slovenly debtor that all his financial problems can be solved if he takes out a title loan. In a MasterCard advertisement, a man in a 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 U.S. citizens to go out and spend money last fall (despite high bankruptcy rates and low savings rates) in order to breath life into the flagging economy.

¹¹¹ Letter from United Pan Am Mortgage to Professor Frederick M. Hart (Sept. 30, 2002) (on file with the author).

¹¹² *See id.*

U.S. popular culture oozes with references to spending and happiness. In the tongue-in-cheek novel, *Shopaholic Ties the Knot*, 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:

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.¹¹³

As a result of relentless and unyielding admonitions to spend, as well as other cultural factors, U.S. citizens have more debt of all kinds than all persons of all other parts of the world.¹¹⁴ Consumer debt, second mortgages, foreclosures,¹¹⁵ and personal bankruptcies are all at an all-time high.¹¹⁶ The average household carries \$8,000 in credit card debt¹¹⁷ and record numbers of U.S. citizens now carry more than one mortgage.¹¹⁸ Between 1979 and 1997, personal bankruptcies in-

¹¹³ SOPHIE KINSELLA, *SHOPAHOLIC TIES THE KNOT* 8 (2002)

¹¹⁴ I respectfully disagree with Professor Ronald Mann's conclusion that neither Japanese nor U.S. consumers are encouraged to over-extend. See Mann, *supra* note 106, at 1084 n.107 (citing ROBERT D. MANNING, *CREDIT CARD NATION: THE CONSEQUENCES OF AMERICA'S ADDICTION TO CREDIT* 3 (2002)). Mann proposes that U.S. society does not venerate those who rely on credit beyond their income. See *id.* Unfortunately, I believe that Manning is just a voice in the wilderness on this point, with U.S. media having won the war against sensible credit use.

¹¹⁵ Thomas A. Fogarty, *Home Foreclosures at 30-Year High*, USA TODAY, Sept. 11, 2002, at A1, available at http://www.usatoday.com/money/perfi/housing/2002-09-09-foreclosure_x.htm (last visited Dec. 4, 2004). 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 since this data has been kept, and is up from 1% just one year ago. See *id.*

¹¹⁶ See AM. BANKR. INST., *QUARTERLY U.S. BANK STATISTICS*, at <http://abiworld.org/statistics> (last visited Dec. 4, 2004). 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. & ORG. 205 (1998).

¹¹⁷ *CardFAQs - Frequently Asked Questions*, at <http://www.cardweb.com/cardlearn/faqs/2003/ian/8.xcml> (last visited Dec. 4, 2004).

¹¹⁸ See generally Riva D. Atlas, *Home Equity Borrowing Rises to Worrisome Levels*, N.Y. TIMES, Mar. 26, 2003, at C1 (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 lending up to 100% of the home's value, despite the fact that people often have insufficient income to service such loans. *Id.*

creased by more than 400%.¹¹⁹ The upsurge in the mid-1990s was particularly shocking because this was a period of widespread economic recovery.¹²⁰ 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, and the credit industry's voracious appetite for more lending, and the statistics are not surprising.¹²¹

2. Personal Bankruptcy and Stigma in the United States

While some people insist that the stigma of bankruptcy is gone,¹²² empirical research suggests that it may not be that simple.¹²³ 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.¹²⁴ They conclude that unemployment or underemployment, illness, and divorce are the primary causes of bankruptcy in the United States, but that huge amounts of consumer debt in general, and credit card debt in particular, lower U.S. citizens' threshold for collapse when financial disasters strikes.¹²⁵

¹¹⁹ See THERESA SULLIVAN ET AL., *THE FRAGILE MIDDLE CLASS* 3 (2000). Since World War II, personal bankruptcies have steadily increased most years. "These increases accelerated during the 1980s and 1990s, frequently breaking records from quarter to quarter and year to year." *Id.*

¹²⁰ *Id.* As the authors state, financial collapse amidst all this prosperity was both mystifying and worrisome. *See id.*

¹²¹ *See id.* at 17. Department of Labor Statistics indicate that between 1995 and 1997, 8 million U.S. workers were displaced, and that by 1998, 50% were re-employed at their old salaries, 25% were earning 20% less, and the other 25% were still unemployed. *See id.*

¹²² Some bankruptcy experts and policy-makers believe an increased willingness to declare bankruptcy and a diminishment in the social stigma attached to it are largely responsible for the recent jump in filings. *See* Michelle Clark Neely, *Personal Bankruptcy: The New American Pastime?*, *THE REGIONAL ECONOMIST* (Oct. 1998), at <http://www.stlouisfed.org/publications/re/1998/d/re1998d4.html> (last visited Dec. 4, 2004). This is hardly strong proof that the stigma is gone. *See* Sherry Qualters, *Once a Stigma, Ch. 11 Seen as Management Tool*, *BOSTON BUS. J.*, July 12, 2002, at 1; Gregory E. Maggs, *Bankruptcy as a Business Tool*, 71 *TEX. L. REV.* 681, 684–87 (1993) (reviewing KEVIN J. DELANEY, *STRATEGIC BANKRUPTCY: HOW CORPORATIONS AND CREDITORS USE CHAPTER 11 TO THEIR ADVANTAGE* (1992)) (describing the development of strategic uses for Chapter 11, while reviewing a book whose name speaks for itself); American Financial Services Association, *Explaining the Escalation in Personal Bankruptcies*, Spotlight on Financial Services, at <http://www.spotlightonfinance.org/issues/march/stories/story7.htm> (last visited Dec. 15, 2004); *see also* SKEEL, *supra* note 36, at 1 (discussing the issue of stigma in general).

¹²³ *See* SULLIVAN ET AL., *supra* note 119, at 263.

¹²⁴ *See generally id.*

¹²⁵ *See id.* at 22. While only 10% of the consumers in the authors' 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.*

Credit card use in the United States has risen steadily every year since the cards were introduced.¹²⁶ In the fifteen years from 1980 to 1995, the amount of outstanding revolving credit jumped seven-fold.¹²⁷ 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 3.5 billion credit card solicitations were sent out thereafter in 1998, portending continuing increases.¹²⁸ 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 lending.¹²⁹ The more cardholders a company has, the more money it makes, even if this is accomplished by lowering lending standards.¹³⁰

Sub-prime lending, meaning lending specifically to people who are living on the edge, is the most profitable niche in lending.¹³¹ 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 cars early, giving away free t-shirts and requiring no income.¹³² Some 83% of undergraduate students have at least one credit card, a 24% increase since 1998, and 21% of undergraduates who have cards have high-level balances between \$3,000 and \$7,000.¹³³

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.

¹²⁶ *See id.* at 123.

¹²⁷ *See id.* By the 1990s economists speculated that U.S. citizens 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.*

¹²⁸ The bankruptcy debtors in the study carried more credit card debt than the average U.S. citizen, but most 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. *See id.*

¹²⁹ *See id.* at 135.

¹³⁰ *See id.* at 123. 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.*

¹³¹ *See id.* at 135–36.

¹³² *See id.* 137.

¹³³ NELLIE MAE, UNDERGRADUATE STUDENTS AND CREDIT CARDS: AN ANALYSIS OF USAGE RATES AND TRENDS 1, available at http://www.nelliemae.com/library/ccstudy_2001.pdf (Apr. 2002) (last visited Dec. 4, 2004).

Studies show that most people feel bad when they are unable to pay their debts,¹³⁴ despite deep societal ambivalence about consumer debt.¹³⁵ Economists recommend that increased consumption is necessary to economic growth.¹³⁶ In mainstream U.S. news media, such as the *Wall Street Journal*, consumer spending is equated consistently with happiness and health.¹³⁷ For example, in an article titled *Consumers' Attitudes Brighten*, 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."¹³⁸ The story then claims that "consumer sentiment" and "consumer attitudes" have improved, causing economists to conclude that the waning economy might be improving.¹³⁹

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

¹³⁴ See SULLIVAN ET AL., *supra* note 119, at 139–40.

¹³⁵ See *id.* at 23.

¹³⁶ See President George W. Bush, Speech to Congress, (Sept. 20, 2001), *available at* <http://www.whitehouse.gov/news/releases/2001/09/20010920-8.html> (last visited Nov. 22, 2004). Moreover, in the wake of September 11, President Bush told us that we could all fight terrorism by being good consumers. *Id.* The Federal Reserve then encouraged consumer spending by repeatedly cutting interest rates over the next few months. See *U.S. Economy Shrinks*, MONEY.CNN.COM, *at* <http://money.cnn.com/2001/10/31/economy/economy/> (Oct. 31, 2001) (last visited Nov. 22, 2004). Again, on January 7, 2003, President Bush delivered a speech in which he encouraged U.S. citizens to be good consumers in spite of the economic stand-still. See President George W. Bush, Speech to the Economic Club of Chicago (Jan. 7, 2003), *available at* <http://www.whitehouse.gov/news/releases/2003/01/20030107-5.html> (last visited Nov. 22, 2004).

¹³⁷ See, e.g., Greg Ip, *Consumers' Attitudes Brighten*, WALL ST. J., Dec. 16, 2002, at A2 (discussing the possibility of economic recovery).

¹³⁸ *Id.* This top financial newspaper often devotes an entire two-page spread to bankruptcy and consumer sentiments. For example, on Monday, December 16, 2002, the paper not only contained this story about whether consumer spending would be "bright" enough to give retailers a profitable Christmas season, but also included a comparison of Australian bankruptcy and U.S. bankruptcy, and an article about United Airlines' request to borrow \$2.4 billion from its union's pension plan to fund its Chapter 11 activities. See *id.*; Sarah McBride, *Australia's Tough-Minded Bankruptcies May Serve as Role Model*, WALL ST. J., Dec. 16, 2002, at A2; Susan Carey, *United Lobbies for More Savings from Its Unions*, WALL ST. J., Dec. 16, 2002, at A2.

¹³⁹ See Ip, *supra* note 137, at A2. 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.

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.¹⁴⁰

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.¹⁴¹ 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.¹⁴² None of this makes bankruptcy pleasant, although at least it is available.¹⁴³

¹⁴⁰ See SULLIVAN ET AL., *supra* note 119, 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 59, that debtors tend to be from the middle rather than the lower classes, *see id.* at 55, 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.* at 55, but the numbers did suggest these alternative conclusions to me.

¹⁴¹ *See id.* at 259.

¹⁴² *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 out of 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. *See id.* at 260–61. Moreover, while creditor-funded campaigns to restrict consumers' access to bankruptcy have been 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.

¹⁴³ 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* Consumer Fed'n of Am., *Credit Card Issuers Expand Marketing and Available Credit While Consumers Increasingly Say No*, at http://www.consumerfed.org/081402bankruptcy_

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.”¹⁴⁴ And, while some U.S. citizens may try to buck the trend and consume less, strong societal pressures keep most of Americans spending.¹⁴⁵

3. Business Bankruptcy and Stigma in the United States

When it comes to stigma, however, business bankruptcy in the United States is an entirely different matter.¹⁴⁶ There seems to be less stigma associated with a failing business in the United States than with a personal bankruptcy, probably due to the U.S. notion that some risk is good and necessary to a well-functioning capitalist economy. The United States considers business failure to be negative but not morally wrong. Americans rarely throw corporate officers in jail for failing at

credit_card_report_02_2.html (Aug. 15, 2002) (last visited Nov. 22, 2004). In the twelve month period ending March 31, 2002, card issuers mailed five billion solicitations, nearly fifty per household. They now make available more than \$3 trillion in unused credit, or \$30,000 per household. *Id.* Yet consumers are increasingly rejecting more of these solicitations and refusing to expand their lines of credit. *Id.* 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%. *Id.* There is some indication that British subjects are also cutting back a bit on credit. The Credit Card Research Group (CCRG) reports that total credit card spending in the United Kingdom (UK) rose to £16.8 billion in September 2002, up 6.9% from the same period the prior year. 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*, NEWS.BBC.CO.UK, at <http://news.bbc.co.uk/1/hi/business/2409655.stm> (Nov. 6, 2002) (last visited Nov. 22, 2004).

My own sense is that if means testing is implemented in the United States, 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, a banking industry representative stated the following: “The 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 Arkadi Kuhlmann, *Bankruptcy Bill Hurts Odds of Second Chance*, AM. BANKER, Mar. 5, 2004, at 11.

¹⁴⁴ See SULLIVAN ET AL., *supra* note 119, at 260.

¹⁴⁵ For help scaling back, see *Bankrate's Guide to Managing Credit*, at <http://www.bankrate.com/brm/news/credit-management/debt-home.asp> (last visited Oct. 28, 2004).

¹⁴⁶ See WHITE & CHASE LLP, BANKRUPTCY AND A FRESH START: STIGMA ON FAILURE AND LEGAL CONSEQUENCES OF BANKRUPTCY 10 (European Comm., U.S. Report, 2002), available at http://europa.eu.int/comm/enterprise/entrepreneurship/support_measures/failure_bankruptcy/stigma_study/report_usa.pdf (stating that although the stigma associated with filing for Chapter 11 has diminished substantially, “the decision to commence a Chapter 11 case is never easy.”) (last visited Oct. 28, 2004).

business. In fact, in some industries, like the high-tech or dot-com industries, going through a business failure actually can be seen as a badge of honor, proof that the entrepreneurs were willing to take the kinds of risks necessary to fuel capitalism.¹⁴⁷

In other industries, the United States seems 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, Americans do not like business failure, but they find it more acceptable than personal bankruptcy.¹⁴⁸ This distinction appears to be shared throughout most of the world. Unlike the rest of the world, however, the United States also recognizes that personal financial failure can be caused by business failure, and thus provides systems to help both failing businesses and failing individuals.¹⁴⁹

¹⁴⁷ See Theresa Forsman, *Failure as a Badge of Honor*, BUSINESSWEEK ONLINE, at http://www.businessweek.com/magazine/content/01_35/b3746632.htm (Aug. 27, 2001) (last visited Nov. 22, 2004).

¹⁴⁸ This could also be due to the uniquely U.S. 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. L. 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).

¹⁴⁹ 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. See Elizabeth Warren, *The Changing Politics of American Bankruptcy Reform*, 37 OSGOODE HALL L.J. 189, 192–93 (1999). These sentiments, though not entirely partisan, are generally thought to be Republican or conservative sentiments. See *id.* at 194. Underlying these views is a strong belief that individuals have overspent irresponsibly. *Id.* at 195; see Ame Wellman, *Relief for the Poorest of All: How the Proposed Bankruptcy Reform Would Impact Women and Children*, 6 J.L. & POL'Y 273, 274–75 (2002). Yet Republican or big-business interests, or even those interested in fueling the economy, have consistently admonished U.S. citizens 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 officials 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 United States. See Lester C. Thurow & Basler Zeitung, *Surprising 1998 American Economic Strength*, at <http://www.com/articles/html/suprising.htm> (Dec. 1998) (last visited Nov. 22, 2004) (reporting negative U.S. savings rates). 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.

C. *Thumbnail Sketch of the U.S. 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.¹⁵⁰ This choice is generally not available in other parts of the world.¹⁵¹ 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.¹⁵²

1. Personal Bankruptcy in the United States: An Overview

Personal bankruptcies in the United States take one of two general forms. One can either give up all of one's non-exempt assets¹⁵³ in ex-

See Warren, *supra* note 149, at 194 (noting that liberals have traditionally considered bankruptcy laws in the larger context of progressive social legislation). But, some of these people believe that excess spending on the part of U.S. citizens is so harmful to society that it could ultimately destroy the world and its resources. *See id.* at 195. While this would be deeply disturbing if true, the idea of not spending is almost incomprehensible to U.S. citizens. Clearly, U.S. citizens operate in a culture of consumption and spending unlike any other in the world. Kurt Richebächer, *Consumption: Recovery Leader or Potential Profit-Killer?*, GOLD DIG. (Nov. 3, 2003), at http://www.gold-eagle.com/gold_digest_03/richebacher110303.html (last visited Nov. 22, 2004).

¹⁵⁰ SKEEL *supra* note 36, at 1–2.

¹⁵¹ *See id.*

¹⁵² *See id.*

¹⁵³ In a Chapter 7 bankruptcy, an estate is created to collect and sell property to satisfy the debt of the debtor. But, 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 these 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. 5963, 6087. In the United States, a debtor filing for bankruptcy may choose between the federal or state exemptions, *see* 11 U.S.C. § 522(b) (2000), if the state in which the debtor is filing has not "opted-out" of the federal bankruptcy exemption scheme. Some examples in the federal exemption system include the following: 1) up to \$17,425 of equity in real or personal property used as a homestead, *id.* § 522(d)(1); 2) up to \$2,775 in one motor vehicle, *id.* § 522(d)(2); 3) up to \$9,300 in household furnishings, *id.* § 522(d)(3); 4) up to \$1,150 of jewelry, *id.* § 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, *id.* § 522(d)(5); 6) up to \$1,750 in professional books or tools of the trade, *id.* § 522(d)(6), and the debtor's right to receive payment for certain things such as social security, veteran benefits, and alimony, *id.* § 522(d)(10) (all the dollar figures are updated by the United States Congress periodically to reflect economic conditions; these values are current through 2003). State exemption schemes were developed not because of bankruptcy but because of collection laws. Because each state

change for an almost immediate discharge of most of one's unsecured debts,¹⁵⁴ 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 non-exempt assets as long as one pays at least the value of those non-exempt assets to creditors under the payout plan.¹⁵⁵ Again, the debtor, rather than creditors, makes this choice.¹⁵⁶ The payout-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 his or her collateral as long as the plan payments are made.¹⁵⁷ 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.¹⁵⁸

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.¹⁵⁹ In many states, the exemptions are extremely generous, sometimes allowing in-

has its own exemption legislation, there is 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. CODE ANN. tit. x, § 4902 (1974 & Supp. 2002). Delaware does not even have any type of homestead exemption. *See id.* Texas allows not only unlimited homestead exemptions, *see* TEX. PROP. CODE ANN. § 41.001 (1984 & Supp. 2004), but also exempts up to \$30,000 in personal property, which includes household furniture, tools and equipment, clothing, jewelry, firearms, and motor vehicles. *See id.* § 42.002. But Texas does not allow a checking account to be exempt like the federal exemptions. *See id.* Unlike Texas, Florida has opted out of most of the federal exemptions, *see* FLA. STAT. ANN. § 222.20 (1999 & Supp. 2002), but does allow all federal 11 U.S.C. § 522(d)(10) exemptions. FLA. STAT. ANN. § 222.201 (1999 & Supp. 2002). Florida also has an unlimited homestead exemption. FLA. CONST. art. VII, § 6(a)(1). However, Florida has a modest personal property exemption: only up to \$1000 in personal property, FLA. CONST. art. X, § 4(a)(2), and money contributed to retirement funds, FLA. STAT. ANN. § 222.21 (1999 & Supp. 2002), and college trust funds, *id.* § 222.22.

¹⁵⁴ This is considered a straight liquidation bankruptcy under Chapter 7 of the United States Bankruptcy Code. *See* 11 U.S.C. §§ 701-784.

¹⁵⁵ This is considered a restructured debt plan under Chapter 13 of the United States Bankruptcy Code. *See* 11 U.S.C. §§ 1301-1330.

¹⁵⁶ *See* SKEEL, *supra* note 36, at 2.

¹⁵⁷ *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 creditor's interest is not available under a Chapter 7 bankruptcy. *See id.* §§ 701-784.

¹⁵⁸ *See id.* § 727.

¹⁵⁹ *See* Jacob Ziegel, *Canada's Phased-in Bankruptcy Reform*, 70 AM. BANKR. L.J. 383, 404 (1996).

dividual debtors an unlimited amount of equity in a home.¹⁶⁰ Research suggests that states with higher exemptions, which 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 U.S. Business Reorganization Scheme and Its Rationale

The theory behind a Chapter 11 reorganization case in the United States is that a business enterprise¹⁶¹ is often worth more to a creditor alive than dead.¹⁶² In other words, a business may be able to pay creditors more by continuing to operate its business, 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 use the proceeds to pay creditors through what is called a liquidating Chapter 11 plan.¹⁶³ 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 goodwill was simply liquidated at the first sign of financial failure.¹⁶⁴

¹⁶⁰ See, e.g., TEX. PROP. CODE ANN. § 42.002 (2003); FLA. STAT. ANN. § 222.201 (2003) (allowing unlimited homestead exemptions in Texas and Florida, respectively).

¹⁶¹ Chapter 11 is available to corporations, partnerships, as well as individuals. 11 U.S.C. § 109(d). 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 U.S.C. § 109(e).

¹⁶² See Davis, *supra* note 12, at 253.

¹⁶³ See *id.* at 256. In fact, the debtor is permitted to sell off its assets piecemeal in a Chapter 11, even before a plan is filed, despite the fact that the formal name of this chapter of the code is Reorganization. See *id.* About 20–30% of confirmed plans are liquidation plans. *Id.*; see E. FLYNN, STATISTICAL ANALYSIS OF CHAPTER 11, at 12 (1989).

¹⁶⁴ 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 chief executive officer (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, who is also basically the Registrar of Companies, who 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 1) can accept the measures 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) can urge the CEO to file for protection under French law. See Broude et al., *supra* note 6, at 536–39.

For the benefit of stakeholders (such as 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.¹⁶⁵ While this theory is not without its critics,¹⁶⁶ the overwhelming worldview today is that some system for “rescuing” ailing businesses is a pre-condition to maintaining a vibrant, capitalist economy.¹⁶⁷

The shocking difference between U.S.-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.¹⁶⁸ The historical development of this unique

¹⁶⁵ Sometimes equity is distributed to the unsecured creditor class under the plan of reorganization. See 11 U.S.C. § 1129(b)(2)(B) (describing how equity cannot retain the stock unless unsecured creditor classes are paid in full or accept the plan).

¹⁶⁶ 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, 311 (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 (1986); 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 & Michael Rosenzweig, *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 H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 VA. L. REV. 155, 160 (1989) (questioning the incentives created by the current bankruptcy system). But see GROSS, *supra* note 9, 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 had 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, Mar. 19, 2002, available at 2003 WL 16151125; see also Lucian Ayre Bechuck, *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 A2.

¹⁶⁷ See Metzger & Bufford, *supra* note 4, at 153–54.

¹⁶⁸ *Legal & Business Forms—Chapter 11 Reorganization*, at <http://www.legal-forms-kit.com/freelegaladvice/bankruptcy/8.html> (last visited Jan. 11, 2005). 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.

system derives from the first reorganizations in the railroad industry, one the first big businesses in the United States.¹⁶⁹ At the time that Munroe 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.¹⁷⁰ Because piecemeal sale of the debtor's assets would result in great financial loss to all, the court merged these two legal concepts and ordered that the lender sell the assets all at once, pursuant to a going concern sale, rather than piecemeal.¹⁷¹

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 request an injunction against creditor collection efforts.¹⁷² 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.¹⁷³ Ultimately, after many twists and turns, the current Chapter 11 system emerged from this humble start.

3. The Logistics of Chapter 11 Business Reorganization¹⁷⁴

Bankruptcy cases, of which Chapter 11 is one kind, are presided over by a specialized bankruptcy court that is part of the federal judicial scheme.¹⁷⁵ The law in place is the Federal Bankruptcy Code,¹⁷⁶ although some principles used in bankruptcy cases arise from state law.¹⁷⁷ When an enterprise is in Chapter 11, it normally operates its own business through its pre-filing management.¹⁷⁸ No trustee is or-

¹⁶⁹ SKEEL, *supra* note 36, at 57.

¹⁷⁰ *See id.*

¹⁷¹ *Id.*

¹⁷² *Id.* at 58.

¹⁷³ *Id.*

¹⁷⁴ Chapter 11 can also be used by individuals. *See* 11 U.S.C. § 109(d).

¹⁷⁵ *See generally* 28 U.S.C. § 157(a) (2000) (establishing the bankruptcy court system).

¹⁷⁶ 11 U.S.C. §§ 101-1330.

¹⁷⁷ *See, e.g.,* *Butner v. United States*, 440 U.S. 48, 55 (1979) (stating that "[u]nless a particular federal interest requires a different result, property interests are created and defined by state law").

¹⁷⁸ *But see* 11 U.S.C. § 1104(a). 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

dinarily appointed. As soon as a debtor files a voluntary Chapter 11 case,¹⁷⁹ an automatic stay goes into effect, effectively stopping all collection activity against the debtor or any of its property of any kind.¹⁸⁰ The stay is broad and powerful and even things that one would not think would be stayed are indeed stayed.¹⁸¹ For example, secured creditors are prohibited from taking any action to repossess collateral that they could repossess if not for the bankruptcy.¹⁸² Even the government is precluded from collecting on its claims.¹⁸³ Virtually all enterprises,¹⁸⁴ and even individuals,¹⁸⁵ are eligible for Chapter 11 and there is no requirement that the debtor be insolvent in anyway.¹⁸⁶

mismanagement. *See id.* This is in order to protect interests of creditors and equity holders. *See id.*; *see also In re Sharon Steel Corp.*, 871 F.2d 1217 (3rd Cir. 1989) (upholding, reluctantly, the trial court's decision to appoint a trustee, because the debtor-in-possession had been unable to turn the company around, and because the debtor had conducted questionable transfers of property, had virtually violated its fiduciary duty by not pursuing claims to recover the transferred property, and had proven to be dishonest).

¹⁷⁹ In the United States, the vast majority of cases filed under any chapter of the Bankruptcy Code are voluntary cases. *See generally* Nathalie Martin, ¿*Qué 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).

¹⁸⁰ *See* 11 U.S.C. § 362(a).

¹⁸¹ *See* Martin *supra* note 179, at 75 ("There is a very broad, automatic stay granted in favor of the debtor. This stays virtually all collection activity that is out there, including . . . employee claims, labor claims, and every other type of lawsuit.").

¹⁸² *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 grant relief only in limited circumstances. *See* 11 U.S.C. § 362(d); *see also* Martin, *supra* note 179, at 81.

¹⁸³ *See* Martin, *supra* note 179, 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, 1297 (9th Cir. 1997) (finding that the § 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."). The two tests to determine if a government action is a police and regulatory exception 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)). "In 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. If the government action is pursued solely to advance a pecuniary interest of the governmental unit, the stay will be imposed." *Id.* (citations omitted).

¹⁸⁴ *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 banks, cooperative banks, savings and loan associations, building and loan associations, and homestead associations. *Id.* § 109(b). These exclusions include both domestic and foreign entities. *Id.*

¹⁸⁵ *See* 11 U.S.C. § 109(d).

¹⁸⁶ *See* Martin *supra* note 179, at 77.

Chapter 11 can be used as a strategic measure to stop lawsuits, to stop foreclosures, or for whatever purpose the debtor chooses.¹⁸⁷ 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.¹⁸⁸

The debtor's goal in the case is to emerge from Chapter 11 with its debts restructured and also reduced in amount in most cases. 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.¹⁸⁹ 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.¹⁹⁰ If the debtor can get most creditors to vote in favor of the plan, it can be forced on the dissenting creditors who also will be bound by it.¹⁹¹ Sometimes the debtor can approve a plan, even if most creditors vote against the plan, although this is rare.¹⁹²

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.¹⁹³ Some creditors, such as taxing authorities and employee

¹⁸⁷ See Maggs, *supra* note 122, at 685–86 (discussing how Texaco filed its Chapter 11 case in order to delay collection on Pennzoil's \$10.53 billion judgment, and ultimately to gain leverage to settle the judgment for \$3 million).

¹⁸⁸ For example, US Airways recently tried to have a bankruptcy court intervene in a labor dispute on an immediate and emergency basis. See Susan Carey, *UAL Says It Must Cut Expenses by More Than \$1.1 Billion a Year*, WALL ST. J., Sept. 20, 2004, at A8 (discussing how the bankruptcy court may intervene to grant emergency relief to the company).

¹⁸⁹ See 11 U.S.C. § 1121(c)(2) (stating that the debtor has the exclusive right to file a plan for 120 days).

¹⁹⁰ See *id.* § 1129(a)(8) (discussing creditors' rights to accept or reject a plan); *id.* § 1126 (2000) (discussing how acceptance is accomplished); see also *id.* § 1121(c) (stating that any party in interest can file a plan, if certain criteria are met).

¹⁹¹ See *id.* § 1129(b)(2) (describing the process of forcing a plan on classes of secured and unsecured creditors); see also 11 U.S.C. § 1126 (describing when a class is deemed to have accepted a Chapter 11 plan).

¹⁹² See *id.* § 1129(a)(10) (discussing how a Chapter 11 plan can be forced on dissenting creditors, as long as at least one class of creditors votes yes).

¹⁹³ See *id.* § 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.

claims, are entitled to special priority¹⁹⁴ and must be paid in full in the plan.¹⁹⁵ 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.¹⁹⁶ There is no set amount of distribution that unsecured creditors must receive, but the debtor needs the unsecured creditors' votes and thus often offers as much as it can afford to pay.

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.¹⁹⁷ In a sense, creditors get to choose, through their voting rights,¹⁹⁸ whether to go along with the reorganization plan, or alternatively, to liquidate the debtor's business. In reality, however, the debtor usually retains control over the case and the plan process throughout the case, and has the exclusive right to file a plan for at least the first four months of the case and often much longer.¹⁹⁹ This leaves many creditors feeling like hostages in a debtor-friendly proceeding, but a case cannot go on forever.²⁰⁰ From this it seems clear that 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.²⁰¹

D. *Conclusions About the U.S. Scheme and Its Societal Role*

U.S. 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 U.S. society. These attitudes and conditions are unique and are not present in other countries, including those countries currently adopting U.S.-style systems. This may limit the effectiveness of 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.

Id.

¹⁹⁴ See 11 U.S.C. § 507(a).

¹⁹⁵ See *id.* § 1129(a) (9).

¹⁹⁶ See *id.* § 1141(d).

¹⁹⁷ See *id.* § 1129(b) (2) (B) (i). But, if under a plan an unsecured creditor is impaired by the plan, the court can still approve the plan if it is shown that the unsecured creditor would receive as much under a Chapter 7 liquidation plan. See *id.* § 1129(a) (7) (A) (ii).

¹⁹⁸ But see *id.* § 1129(a) (8) (stating that, if the creditor is not impaired by the plan and votes against the plan, the court can still verify the plan).

¹⁹⁹ See 11 U.S.C. § 1121(b).

²⁰⁰ See *id.* § 1129(a) (11).

²⁰¹ *Id.*

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

Around the world, people are less forgiving about debt forgiveness than they are in the United States.²⁰² In some parts of the world, not paying debts is the ultimate disgrace.²⁰³ In other parts of the world, there simply is no personal bankruptcy system,²⁰⁴ and little in the way of business reorganization either.²⁰⁵ 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.²⁰⁶ Given the unique cultural, economic, and historical development of the U.S. system, 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.-style bankruptcy 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,²⁰⁷ from which the original U.S. 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 U.S. attitudes previously discussed. The laws of these countries also are briefly examined in order to discuss the role of both transplantation, as well as local culture, in enacting such laws.²⁰⁸

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.²⁰⁹

²⁰² See *infra* notes 235–308, and 380–513 and accompanying text.

²⁰³ See *infra* notes 415–421 and accompanying text.

²⁰⁴ See *infra* notes 235–267 and accompanying text.

²⁰⁵ See *infra* notes 268–317 and accompanying text.

²⁰⁶ See *infra* notes 268–308 and accompanying text.

²⁰⁷ Martin, *supra* note 16, at 367. England, as well as Canada and Australia, have relatively lenient personal bankruptcy systems by world standards. *Id.* at 367 n.1; see Efrat, *supra* note 3, at 88–90. Other countries that have more lenient personal bankruptcy systems, besides the United States, England, Canada, and Australia, include Hong Kong, New Zealand, Taiwan, Russia, Scotland, and the Netherlands. Martin, *supra* note 16, at 367 n.1. Virtually all of these countries impose a Chapter 13-like payment plan on at least some bankruptcy debtors before granting them a discharge. *Id.*

²⁰⁸ See *infra* notes 209–513 and accompanying text.

²⁰⁹ See *England: History*, Lonely Planet World Guide, at <http://www.lonelyplanet.com/destinations/europe/england/history.htm> (last visited Nov. 9, 2004).

While, initially, U.S. and English bankruptcy laws were quite similar, by the 1800s, English law had a very different emphasis and flavor in regard to its treatment of debtors than early U.S. bankruptcy law.²¹⁰ England's first bankruptcy laws were created in 1543.²¹¹ The preamble to this law described the bankruptcy debtor as an anti-social, immoral character who regularly took advantage of others.²¹² The law itself was designed solely for the benefit of creditors and was virtually criminal in nature.²¹³ Bankruptcy was something creditors did to the debtor, an involuntary social condition to which a naughty user of credit was subjected against his will.²¹⁴ Not surprisingly, then, early English bank-

²¹⁰ See SKEEL, *supra* note 36, at 38 (stating that in the 1880s, English bankruptcy law was quite tough on debtors, who had to subject themselves to searching scrutiny and long discharge delays). 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 Tabb, *History of Bankruptcy*, *supra* note 33, at 7.

²¹¹ See Robert Weisberg, *Commercial Morality, the Merchant Character, and the History of the Voidable Preference*, 39 STAN. L. REV. 3, 20 (1986).

²¹² See *id.* The Preamble stated that

[w]here divers and soondry persones craftelye obteyning into theyre handes 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 credyte of other men, for theyre owne pleasure and delicate lyving, againste all reasone equity and good conscience.

Id.

²¹³ See *id.*

²¹⁴ See Tabb, *Evolution of Discharge*, *supra* note 33, at 336.

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.

ruptcy 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.²¹⁵ While few were actually subject to death for failing to pay their bills, debtors’ prison was common,²¹⁶ as was being shunned by society in Dickensian fashion.²¹⁷

There was no debtor discharge, though there was plenty of credit, even as early as the 1600’s.²¹⁸ The first debtor discharge was introduced in the Statute of Anne in 1705, but this provision was only in place for three years.²¹⁹ 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

Id. at 329–30. The first voluntary bankruptcy law in England was passed in 1844 and applied to traders only. *Id.* at 353. This was extended to non-merchants in 1861. *See id.* at 354.

²¹⁵ *See* Tabb, *Evolution of Discharge*, *supra* note, 33 at 336. *But see* Weisburg, *supra* note 211, at 6. 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.” *Id.* 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.

Id. 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. *See id.*

²¹⁶ *See* Tabb, *History of Bankruptcy*, *supra* note 33, at 7.

²¹⁷ For an example of England’s historical perception of bankruptcy in the nineteenth century, one should read Dickens’ *The Little Dorrit*. *See generally* CHARLES DICKENS, *THE LITTLE DORRIT* (Dodd, Mead 1951) (1857) (a story about a father and his family living and growing up in the Swansea debtors’ prison). Dickens’ tale is not unlike Defoe’s sentiment referred to *supra* in note 215. 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 debtors’ prison. The story’s main focus is on how bankruptcy impacts the family unit and how it is truly punitive in nature.

²¹⁸ *See* Tabb, *Evolution of Discharge*, *supra* note 33, at 330.

²¹⁹ *See id.* at 333. Tabb also notes that discharge was not automatic. The bankrupt needed to receive a “certificate of conformity.” To receive this, the bankrupt needed to surrender voluntarily to an examination by the court, to full disclosure, and to 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 is interesting is that creditors at the time had no power to block the bankrupt’s receipt of the certificate. *See id.* at 333–34. One could argue that this was one of the first pro-debtor bankruptcy laws, but as will be seen, the act lasted all but three years. *See id.* at 333.

and had cooperated with creditors.²²⁰ 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.²²¹ Unlike the early U.S. 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.²²² 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, English people are sensitive about financial failure.²²³ They generally consider such failure to be 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.²²⁴ Now there is more credit and more personal financial failure.

While England and Wales only had 0.47 personal bankruptcy filings for every 1000 individuals in 1997 (as compared to 5 personal bankruptcy filings for every 1000 that same year in the United States),²²⁵ these are still considered major embarrassments, even if they result from the failure of a business.²²⁶ Executives in a company that

²²⁰ See *id.* at 339. This provision is still popular in the personal bankruptcy laws of many countries today.

²²¹ See Tabb, *Evolution of Discharge*, *supra* note 33, at 335–36.

²²² See Weisberg, *supra* note 211, at 66. As Professor Weisberg notes, in the United States, bankruptcy law was seen as a “robust, economical, and scientific instrument of commercial efficiency.” See *id.* In England, credit was morally tinged and represented false wealth to many people in the traditional land-based society. See *id.* at 13.

²²³ See *id.*

²²⁴ See James A. Morone & Janice M. Goggin, *Health Policies in Europe: Welfare States in a Market Era*, 20 J. HEALTH POL., POL’Y & L. 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”).

²²⁵ See Efrat, *supra* note 3, at 100–01. English bankruptcy rates are higher than those in most other parts of Europe. See Michael Harrison, *Personal British Bankruptcies Hit 10-Year High*, THE FED. CAP. PRESS OF AUSTL., Nov. 10, 2003, at A17 (stating that high rates of bankruptcy in Britain are the result of the explosion of consumer credit).

²²⁶ 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

fails can have a very difficult time finding another job and are often shunned socially.²²⁷ Thus, despite all the new credit available, the English marketplace comes down hard on those who have gotten into financial difficulty. The attitude is “once a bankrupt, always a bankrupt.”²²⁸ 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 noted that when he wants to talk to Europe, he’s not sure whom to call.²²⁹ While this may be changing, now that the EU is working on unifying currency and laws, Europe still consists of many diverse cultures, has a huge variety of insolvency systems, and contains a host of diverging philosophies about debt.²³⁰

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.²³¹ Reorganization laws are far more varied and reflect other societal concerns.²³² European governments are attempting to reduce the negative stigma associated with business failure in order to fuel

without fraud.” Peter V. Pantaleo, *Basic Business Bankruptcy*, PRACTICING L. INST., COMMERCIAL LAW AND PRACTICE COURSE HANDBOOK SERIES 7, 11 (1992).

²²⁷ See, e.g., David Gow, *Former Alstom Chief to Return His £2.7 Million Pay-off*, GUARDIAN UNLIMITED, at <http://www.guardian.co.uk/executivepay/story/0,1204,1021483,00.html> (Aug. 19, 2003) (last visited Nov. 22, 2004) (discussing the public disdain at a corporate officer who received a golden parachute before the company failed).

²²⁸ See Lucinda Kemeny & Garth Alexander, *Blair Chases American Dream*, TIMES (London), Feb. 18, 2001, at A1 (noting mantra of “once a bankrupt, always a bankrupt”). The United States did away with the word bankrupt in the 1978 Code, replacing it with the more genteel “debtor,” exactly because bankrupt carried such negative stigma. Donald R. Price & Mark C. Rahdert, *Distributing the First Fruits: Statutory and Constitutional Implications of Tithing in Bankruptcy*, 26 U.C. DAVIS L. REV. 853, 862 n.33 (1993) (stating that the 1978 Reform Act, which created the current Bankruptcy Code, does not refer to the word “bankrupt” but uses the more euphemistic word “debtor” instead).

²²⁹ Steven Pearson, *Successful Restructuring Requires Sensitivity*, THE FINANCIAL NEWS, Dec. 1, 2002, available at 2002 WL 24141004.

²³⁰ See *infra* notes 230–307 and accompanying text.

²³¹ See Efrat, *supra* note 3, at 100–101.

²³² See *infra* notes 259–308 and accompanying text.

entrepreneurial spirit.²³³ Many countries, as well as lawmakers of the newly formed EU, are looking to the United States for ideas.²³⁴

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.²³⁵ Consumer credit usage varies widely on the continent, with consumers in some countries such as Sweden using it heavily, while Italian and Greek consumers use it much less frequently.²³⁶ Overall, though, credit use is rising and savings rates on the continent are declining.²³⁷ European banking and economic officials have expressed concern over this trend.²³⁸ As a result, some have simply stepped up efforts to educate the public about the hazards of credit use.²³⁹ Others have liberalized bankruptcy and discharge laws, in order to ensure that social problems are not exacerbated by the increases in credit.²⁴⁰

²³³ Cf. Philip Cullum et al., *Entrepreneurship Around the Globe: Adapting to Different National Environments*, OUTLOOK POINT OF VIEW (May 2002), at http://www.accenture.com/xdoc/en/ideas/outlook/pov/A4_Global_entrepreneurial_models_PoV2.pdf (last visited Nov. 22, 2004) (stating that the most important aspect for entrepreneurial executives is the particular country's attitude toward the possibility of failure).

²³⁴ Metzger & Bufford, *supra* note 4, at 153.

²³⁵ See Kilborn, *German Approach* *supra* note 14, at 257; *French Law on Consumer Overindebtedness*, *supra* note 14, at 5–9.

²³⁶ EUR. CREDIT RESEARCH INST., CONSUMER CREDIT IN THE EUROPEAN UNION (Feb. 2000), available at <http://www.ciaonet.org/wps/gun01/gun01.pdf> (last visited Dec. 4, 2004). "The weight of consumer credit is far higher in the U.S. economy than in the EU countries, including the UK." *Id.* Because of large differences in the use of consumer credit observed across EU countries, however, it is hard to generalize about a European consumer credit use. *Id.*

²³⁷ See ORG. FOR ECON. COOPERATION & DEV., *Household Saving Rates - Statistical Data Included*, ECONOMIC OUTLOOK, June 2001, at Annex, tbl.26, available at http://www.findarticles.com/p/articles/mi_m4456/is_2001_June/ai_78133182 (last visited Dec. 10, 2004). As of 2000, France's national saving rate was 16.1% while Britain's was 4.7%. *Id.* The savings rates overall appear to be trending down over the long term.

²³⁸ See Heather Stewart et al., *Hawkish King Fears High Debt Could Tip UK into Crash*, GUARDIAN UNLIMITED, at <http://www.guardian.co.uk/business/story/0%2C3604%2C1063043%2C00.html> (Oct. 15, 2003) (last visited Dec. 4, 2004).

²³⁹ *OFT Issues Consumer Debt Warning*, NEWS.BBC.CO.UK, at <http://news.bbc.co.uk/1/hi/business/3281871.stm> (Nov. 19, 2003) (last visited Dec. 10, 2004).

²⁴⁰ See Efrat, *supra* note 15, at 166. 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.* at 165–66. He argues that the U.S. fresh start policy is very justified in this context, and also that more countries should enact more lenient sys-

Not all European countries have forgiving bankruptcy systems, however, and some have no systems for consumers at all.²⁴¹ For example, in the bankruptcy-restrictive countries of Italy and Greece,²⁴² individuals generally are not eligible for bankruptcy protection unless they are engaged in business.²⁴³ In other words, there is simply no bankruptcy system for consumers.²⁴⁴ 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.²⁴⁵ This is certainly an unusual interpretation of a discharge, at least from a U.S. perspective.²⁴⁶ The underlying theme of bankruptcy in these jurisdic-

tems of debt forgiveness as they move toward the United States regarding these factors. See *id.* at 167–68.

²⁴¹ See Efrat, *supra* note 3, at 82–83 (describing how, in Italy and Greece, bankruptcy is available only to merchants or businesses). 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. *Id.* 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 84–87.

²⁴² Remarkably, the Greeks use little credit. *Greek Economy-Weekly Review*, ATHENS NEWS AGENCY, Mar. 15, 2003, available at <http://www.hri.org/news/greek/ana/2003/03-03-15.ana.html> (last visited Dec. 10, 2004).

²⁴³ See Efrat, *supra* note 3, at 82–83; see also Metzger & Bufford, *supra* note 4, at 154; Hon. Richard L. Bohanon & William C. Plouffe, Jr., *Mongolian Bankruptcy Law: A Comparative Analysis with the American Bankruptcy 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).

²⁴⁴ In a few of these places, such as Brazil and Venezuela, an individual is *only* eligible for bankruptcy if he or she is engaged in business activity as a merchant. In many of these places there is also little consumer debt available. Perhaps these laws make sense in their context. See Antonio Mendes, *A Brief Incursion into Bankruptcy and the Enforcement of Creditor's Rights in Brazil*, 16 NW. J. INT'L L. & BUS. 107, 111 (1995); 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, 93 (1998). Conversely, Chile and Egypt offer the debtor no discharge at the conclusion of the proceedings. See Ricardo Sandoval, *Chilean Legislation and Cross-Border Insolvency*, 33 TEX. INT'L L. J. 575, 577 (1998).

²⁴⁵ 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.* at 84. In Italy, for example, discharge is for merchants only and it takes five years to get a discharge, while it takes ten years in Greece. See also WHITE & CHASE LLP, *supra* note 146, at 335.

²⁴⁶ The U.S. Bankruptcy Code of 1978 allows certain debts to be wholly or partially discharged.

tions is that bankruptcy is a creditor-oriented mechanism and is not designed to serve the interests of financially distressed consumers.²⁴⁷

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, there is simply no way out.²⁴⁸ If one gets in trouble with consumer debt, one remains in trouble, perhaps indefinitely.

Other European countries are more forgiving and provide some form of discharge. In Norway, Sweden, Denmark, Finland, Austria, Germany, France, Spain, and Portugal,²⁴⁹ the judge has the discretion to decide whether a discharge is justified.²⁵⁰ 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.²⁵¹ In many places, the judge may grant a bankruptcy discharge only if the person is unable to pay the debts.²⁵² For example, in Denmark, the debtor must be hopelessly indebted and the circumstances must justify granting a discharge.²⁵³ In Norway, a debtor must be permanently unable to pay.²⁵⁴ In Sweden, in order to get a full or partial

²⁴⁷ See Efrat, *supra* note 3, at 82–83. For example, one source claims that the purpose of Italian bankruptcy law is to satisfy the creditors' rights and remove the insolvency company from the market. See GIORGIO CHERUBINI, RECOGNITION OF AN INSOLVENCY SCHEME OF ARRANGEMENT IN ITALY 41, available at http://www.insol-europe.org/publications/cva_italy.pdf (last visited Dec. 4, 2004).

²⁴⁸ See Efrat, *supra* note 3, at 81.

²⁴⁹ See *id.* at 85–86. 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.*

²⁵⁰ See *id.* at 84. This attribute has a 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. *Id.* at 86–87. 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.* at 85–86.

²⁵¹ See *id.* at 84.

²⁵² See *id.* at 86.

²⁵³ See Efrat, *supra* note 3, at 85; 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).

²⁵⁴ See Efrat, *supra* note 3, at 85.

discharge, the debtor must affirmatively prove that “the debtor has no hopes of paying his or her debts in the foreseeable future.”²⁵⁵

Most European laws grant a discharge of indebtedness only after a repayment plan, similar in some respects to Chapter 13 under U.S. law.²⁵⁶ In Germany, for example, the debtor must make an effort to increase his or her income for the benefit of creditors,²⁵⁷ and also must pay over all seizable income to creditors for six years.²⁵⁸ Moreover, creditors receive all of the debtor’s income over a certain amount, a provision that arguably creates the wrong incentives.²⁵⁹

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 United States, England, and the other common law systems.²⁶⁰ Until recently, it was not clear that the continent needed forgiving bankruptcy systems, given its extensive social systems and fairly rigid requirements for borrowing.²⁶¹ But, extensive growth in consumer credit makes such debt forgiveness necessary, particularly in light of existing stigma about financial failure.²⁶² Fortunately, as a whole, European governments seem interested in making sound public policy to protect citizens, and not merely to fuel economies for their own sake.²⁶³

²⁵⁵ See Graver, *supra* note 253, at 170; see generally CONSUMER LAW IN THE GLOBAL ECONOMY: NATIONAL AND INTERNATIONAL DIMENSIONS 287 (Iain Ramsey ed., 1997) (presenting essays on bankruptcy law in foreign states).

²⁵⁶ See Efrat, *supra* note 3, at 88; see also Christoph G. Paulus, *The New German Insolvency Code*, 33 TEX. INT’L L. J. 141, 143–44 (1998). *Contra* Kilborn, *German Approach*, *supra* note 14, at 279.

²⁵⁷ See Kilborn, *German Approach*, *supra* note 14, at 280–81 (noting that a debtor cannot turn down employment and must work in a job outside the person’s field if that is all that is available).

²⁵⁸ See Paulus, *supra* note 256, at 144.

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.

Id. at 143–44.

²⁵⁹ The debtor can keep 100% of the first \$17,000 in income. See Kilborn, *German Approach*, *supra* note 14, at 286. After that, income is shared but the debtor can never keep more than about \$27,500 per year. *Id.*

²⁶⁰ Martin, *supra* note 16, at 75.

²⁶¹ See Efrat, *supra* note 3, at 96.

²⁶² See Kilborn, *German Approach*, *supra* note 14, at 260–61; See Kilborn, *French Law on Consumer Overindebtedness*, *supra* note 14, at 5–9.

²⁶³ See Kilborn, *German Approach*, *supra* note 14, at 260–61; See Kilborn, *French Law on Consumer Overindebtedness*, *supra* note 14, at 5–9.

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, have not yet balanced these concerns and may face social problems as a result.²⁶⁴

Scholar Jason Kilborn, who has studied and translated the new personal bankruptcy systems of France and Germany, has noted the deep resentment and distrust held by French and German citizens toward lenient consumer bankruptcy laws.²⁶⁵ While these attitudes will surely change over time, they reflect long-standing notions of immorality and personal responsibility,²⁶⁶ as well as different credit practices, both of which bear heavily on the acceptance of, and need for, consumer bankruptcy.²⁶⁷

2. European Reorganization Schemes: France and Germany as Examples

As with personal bankruptcy systems, not all continental countries have reorganization schemes. In fact, until recently, most countries did not have such a scheme.²⁶⁸ 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.²⁶⁹ In most places, there is no "automatic stay" that protects the

²⁶⁴ See Efrat, *supra* note 3, at 82–83.

²⁶⁵ See Kilborn, *German Approach*, *supra* note 14, at 269. In a 1986 report regarding personal indebtedness, legislators acknowledged the need for a consumer bankruptcy discharge, but concluded that "a discharge after the Anglo-American model is out of the question." *Id.* In discussing French attitudes, Professor Kilborn notes that the French word for business bankruptcy comes from the French word—*faillite* or the Latin word—*fallere*, which mean to cheat, deceive, or trick. Kilborn, *French Law on Consumer Overindebtedness*, *supra* note 14, at 1. The even more distrusted *consumer* bankruptcy process, a recent enactment in any event, was called a *deconfiture*, meaning to "diminish by boiling down, or to squander." *Id.*

²⁶⁶ When I say "personal responsibility," I do not mean the notion that is floating around in the U.S. Congress today, namely that bankruptcy is a moral issue and that people should not take on more debt than they can afford to repay. See Todd J. Zywicki, *The Past, Present, and Future of Bankruptcy Law in America*, 101 MICH. L. REV. 2016, 2025–27 (2003). Rather, I refer to the notion of whether society is already meeting one's needs, through national health care, good benefits for the poor and unemployed, and so on.

²⁶⁷ Kilborn, *French Law on Consumer Overindebtedness*, *supra* note 14, at 5–9; Kilborn, *German Approach*, *supra* note 14, at 260–61. In each of these articles, Professor Kilborn chronicles the rise in consumer credit, as well as the resulting need for better personal bankruptcy protection.

²⁶⁸ See Martin, *supra* note 179, at 78.

²⁶⁹ See *id.*

debtor and its assets upon the filing.²⁷⁰ 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.²⁷¹ The stay, if there is one at all, normally kicks in after the court sorts out all of these problems and issues an order declaring the company in bankruptcy or reorganization.²⁷²

Under most schemes, the debtor's management is replaced with a neutral third party trustee, who will run the company while it is attempting to restructure and control the case and plan proposal process.²⁷³ 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.²⁷⁴ For example, in the new EU Council Regulation of Insolvency Proceedings (IPR), the secured party retains the right to dispose of assets and obtain satisfac-

²⁷⁰ See *id.*

²⁷¹ See *id.*

²⁷² See *id.* at 82.

²⁷³ See, e.g., *infra* notes 277–308 and *infra* notes 402–430 and accompanying text.

²⁷⁴ 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. See Clas Wihlborg & Shubhashis Gangopadhyay, *Infrastructure Requirements in the Area of Bankruptcy Law*, in BROOKINGS-WHARTON PAPERS ON FINANCIAL SERVICES 281 (Robert E. Litan & Richard Herring eds., 2001). 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.

tion from the proceeds of those assets.²⁷⁵ Indeed, in some countries, labor claims are so strong that they also are not stayed and can veto any plan the debtor proposes as well.²⁷⁶

Many schemes, like the U.S. scheme, provide that creditors can vote on the plan of reorganization and thus decide if the business should be allowed to reorganize or should instead be liquidated.²⁷⁷ Many, though not all, countries' laws also allow the majority to bind the dissenting minority to the terms of the plan.²⁷⁸ In some places, big institutional creditors, such as lenders and banks, control the case and essentially decide the business's fate.²⁷⁹ 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 schemes, but rather "composition" plans.²⁸⁰

Compared to U.S. 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.²⁸¹ 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.²⁸² 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.²⁸³

French reorganization law, at one end of the continuum, is considered the most rescue-oriented in the world, even more so than Chapter 11.²⁸⁴ The goal of the French system is not merely to facilitate

²⁷⁵ See Dr. Wolfgang Lueke, *The New European Law on International Insolvencies: A German Perspective*, 17 BANKR. DEV. J. 369, 369 n.1 (2001).

²⁷⁶ See *id.* Lueke states 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.

²⁷⁷ See Martin, *supra* note 179, at 80.

²⁷⁸ See *id.* at 82.

²⁷⁹ See Curtis J. Milhaupt, *On the (Fleeting) Existence of the Main Bank System and Other Japanese Economic Institutions*, 27 LAW & SOC. INQUIRY 425, 431–33 (2002).

²⁸⁰ See Martin, *supra* note 179, at 81.

²⁸¹ See *id.*

²⁸² See Paulus, *supra* note 256, at 145.

²⁸³ See *id.* at 147.

²⁸⁴ See Wihlborg & Gangopadhyay, *supra* note 274, at 293. Part of the reason it is considered more debtor friendly than U.S. 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 to secured creditors.

reorganization, but to encourage it, through early interventionist mechanisms that force or strongly encourage businesses to seek rehabilitation early enough that businesses and jobs are not lost.²⁸⁵ France has a strong history of state intervention into corporate affairs, which has carried over into modern reorganization laws.²⁸⁶ This process favors saving job-generating enterprises at almost any cost.²⁸⁷

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.²⁸⁸ Prior to this time, the only insolvency law used in Ger-

²⁸⁵ See Richard L. Koral & Marie-Christine Sordino, *The New Bankruptcy Reorganization Law in France: Ten Years Later*, 70 AM. BANKR. L.J. 437 (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 446. The court can also arrange for mediation between the company and its creditors before judicial remedies are needed. See *id.*

²⁸⁶ See *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 "Ordonnance 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.

²⁸⁷ See *id.*

²⁸⁸ The new German Insolvency Code explicitly states, in section 1, that one of the Code's objectives is the reorganization of insolvent debtors. See Christoph G. Paulus, *Germany: Lessons to Learn from the Implementation of a New Insolvency Code*, 17 CONN. J. INT'L L. 89, 89-91 (citing the Insolvenzordnung [Insolvency Act], v. 5.10.1994 (BGB1. I S.2866), Section 1 [hereinafter "InsO"]) (2001).

Before we get too excited about this significant change, we should recognize that this does not mean reorganization in the U.S. 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." See Paulus, *supra* note 256, at 148 n.49 (citing 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." See *id.* at 148 n.50 (citing InsO, Section 157). Thus, a reorganization that leaves the debtors operations intact over the long haul seems outside the contemplation of this new law.

many was a liquidation statute, the *Konkursordnung*.²⁸⁹ While another prior law, the *Vergleichsordnung*, allowed rehabilitation,²⁹⁰ 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.²⁹¹ Thus, prior to the adoption of the new German Insolvency Code (InsO), all businesses were simply liquidated.²⁹²

German lawmakers, if not German society in general, now believe that liquidation is not the best solution to some industry or business problems.²⁹³ 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 had been “overwhelmed by Western consumer standards.”²⁹⁴ Unlike most parts of the world, German insolvency cases are presided over by a specialized bankruptcy court.²⁹⁵ 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.²⁹⁶

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.²⁹⁷ 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

²⁸⁹ See Paulus, *supra* note 256, at 142 (citing *Konkursordnung* [Bankruptcy Act], v. 10.2.1877 (RGBl. S.351)).

²⁹⁰ See *id.* (citing *Verordnung über die Gesamtvollstreckung* (Gesamtvollstreckungsverordnung) [Collective Enforcement Act], v. 6.6.1990 (GBl.DDR I S.285)).

²⁹¹ See *id.* at 141–42.

²⁹² See *id.*

²⁹³ See Paulus, *supra* note 256, at 149 n.13 (citing InsO, Section 1).

²⁹⁴ See *id.*, at 142. Professor Paulus explains in another article that “a few years after 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 288, at 90.

²⁹⁵ See Broude et al., *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 534–35.

²⁹⁶ See Paulus, *supra* note 256, 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.”).

²⁹⁷ Wihlborg & Gangopadhyay, *supra* note 274, at 300.

enactment of InsO,²⁹⁸ it was common for the administrator to be chosen by the lead or primary secured lender in the case.²⁹⁹ This has not changed under the InsO.³⁰⁰ 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 favor rehabilitation over liquidation, and leaves that decision squarely in the hands of creditors.³⁰¹ Even the explicitly provided-for reorganization contemplated by the InsO is not what a U.S. 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.”³⁰² 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.³⁰³ 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

²⁹⁸ See Paulus, *supra* note 256, at 146 (citing InsO, Section 56(1)).

²⁹⁹ See Wihlborg & Gangopadhyay, *supra* note 274, at 301.

³⁰⁰ See Paulus, *supra* note 288, at 93 (noting that the largest creditors have the right to appoint an administrator that they choose and know and trust). As Professor Paulus 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. But:

this theoretical picture gets distorted when these creditors start to act irresponsibly, responsibility meaning here that they should keep in mind that they are given all 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.

³⁰¹ *Id.* at 91–92.

³⁰² See Paulus, *supra* note 256, at 148 n.50 (citing InsO, Section 157).

³⁰³ See Paulus, *supra* note 288, at 91.

law.³⁰⁴ 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.³⁰⁵ After this initial stage of rejecting the debtor-in-possession model, German companies (including Holzman itself) began to use the debtor-in-possession model, but it is still the very rare exception to the rule.³⁰⁶

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.³⁰⁷ Thus, two years after the InsO went in to effect, the new law is still widely objected to, if not ignored.³⁰⁸

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.³⁰⁹

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 England, the stigma is so pronounced that executives, and even employees and suppliers, often disappear entirely.³¹⁰

³⁰⁴ See *id.* at 91–92.

³⁰⁵ See *id.*

³⁰⁶ See Broich, Bayer, von Rom, *supra* note 101 (noting that debtors-in-possession are rare in Germany, though the law allows them).

³⁰⁷ See Paulus, *supra* note 288, 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, and as consistently, as possible with the law replaced. See *id.*

³⁰⁸ See *id.*

³⁰⁹ See Cullum et al., *supra* note 233.

³¹⁰ Stephanie Gruner, *Seeking a Second Chance: Is Failure Still a Dirty Word?*, WALL ST. J., June 21, 1999, 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

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.³¹¹ As an official EU 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 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.³¹²

A recent EU study examined stigma and financial failure in the then 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.³¹³ 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”³¹⁴

Yet Europeans appear conflicted on whether to actually promote a fresh start. This study, as well as numerous other sources, focuses exten-

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. *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 U.S. system. As the EU embraces a more market-based economy, it will be interesting to see if attitudes change. It also will be interesting to see if average citizens become more forgiving, both in society and in business, in order to support and create a more market-based economy.

³¹¹ See WHITE & CHASE LLP, *supra* note 146, at 31.

³¹² *Id.*

³¹³ 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. *Id.* at 356.

³¹⁴ *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.” *Id.*

sively on separating the fraudulent from the non-fraudulent debtors, and providing rehabilitation rights only for the worthy.³¹⁵ There is no indication, however, that fraud will be a problem.³¹⁶ While the goals of the EU 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.³¹⁷

D. *East Asian Bankruptcy Law and Culture: A Different World*

Of all of the East Asian countries, Japan has borrowed the most from U.S. bankruptcy systems and also has developed the most complex bankruptcy systems.³¹⁸ 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.³¹⁹ Hong Kong is less traditional and could probably accept modern bankruptcy laws much more readily.³²⁰ Ironically, it has not modernized its business bankruptcy laws due to its own unique cultural concerns.³²¹ China's proposed bankruptcy laws also borrow sig-

³¹⁵ See *id.* at 356; see also Bethany Blowers, *The Economics of Insolvency Law: Conference Summary*, FIN. STABILITY REV. 153, 153 (Dec. 2002), available at <http://bankofengland.co.uk/conferences/fsr/fsr13.htm> (last visited Nov. 22, 2004) (reciting the remarks of Paolo di Martino, an Italian attorney, stating that bankruptcy law must "be able to select between good and fraudulent debtors").

³¹⁶ 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 U.S. 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 new opportunity in life and a clear field for future effort unhampered by the pressure and discouragement of preexisting debt." 292 U.S. 234, 244 (1934). Commentators 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 76, at 212.

³¹⁷ See *supra* notes 284–287 and accompanying text.

³¹⁸ See *infra* notes 380–414 and accompanying text.

³¹⁹ See *infra* notes 415–421 and accompanying text.

³²⁰ See *infra* notes 426–464 and accompanying text.

³²¹ See *infra* notes 453–463 and accompanying text.

nificantly from U.S. systems.³²² These laws are far more lenient about business failure than existing Chinese laws.³²³ Given China's traditionally communist economy, it faces unique challenges as it attempts to adopt bankruptcy laws that will promote a market-based economy.³²⁴ Given strong cultural beliefs that bankruptcy is bad luck and will follow a family forever,³²⁵ 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.³²⁶ Drastic measures have been taken to promote business rehabilitation in order to aid Japan's ailing economy.³²⁷ Personal bankruptcy has also become more accessible.³²⁸ These are necessary developments, given that credit has recently become more available to the Japanese, which has in turn increased borrowing.³²⁹ Yet the Japanese avoid using these initiatives for cultural reasons.³³⁰

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.³³¹ Thus, the Japanese feel that it is embarrassing and shameful to need to resort to the law.³³² In fact, the Japanese believe that everyone would be better off if there was no

³²² See *infra* notes 465–510 and accompanying text.

³²³ Douglas G. Boshkoff & Yongxin Song, *China's New Bankruptcy Law: A Translation and Introduction*, 61 AM. BANKR. L.J. 359, 359–60 (2001). Under China's Civil Procedure Law, private enterprises may reorganize, but state-owned enterprises need government approval in order to file for liquidation or reorganization. See *id.* at 361; see also Xianchu Zhang & Charles D. Booth, *Chinese Bankruptcy Law in an Emerging Market Economy: The Shenzhen Experience*, 15 COLUM. J. ASIAN L. 1, 12 (2001).

³²⁴ See *infra* notes 464–509 and accompanying text.

³²⁵ See Pauline Ma, *A New Chinese Bankruptcy System: Made for Business or for the State?*, 11 AUSTL. J. CORP. L. 192, 205 (2000).

³²⁶ See *infra* notes 380–414 and accompanying text.

³²⁷ See *infra* notes 392–414 and accompanying text.

³²⁸ See *infra* notes 380–391 and accompanying text.

³²⁹ See *infra* notes 359–379 and accompanying text.

³³⁰ See *infra* notes 359–379 and accompanying text.

³³¹ See Ken R. Minami, Comment, *Japanese Thought and Western Law: A Tangential View of the Japanese Bengoshi and the Japanese American Attorney*, 8 LOY. L. A. INT'L & COMP. L. J. 301, 302 (1985).

³³² See *id.* at 307.

law, and no need for the law.³³³ 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.³³⁴ If these tactics fail and formal proceedings are necessary, it is assumed that both parties will neither win nor lose.³³⁵ The objective of the court system is not to declare a winner or loser, but rather to construct a harmonious compromise for both parties.³³⁶

Japanese culture has often been referred to as a culture of shame.³³⁷ This characterization encompasses everything from the adverse attitude toward the need for laws, to suicide over debts, and economic failure.³³⁸ In the 1990s, 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.³³⁹ This trend introduced more foreign influences into Japan than ever before.³⁴⁰ Yet cultural trends of other countries are never fully integrated into the cultural fabric of Japan.³⁴¹ Instead, they maintain their foreignness and are even thought of as elite, exotic, and cosmopolitan.³⁴²

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.³⁴³ This included informal contact with creditors.³⁴⁴ The emphasis of these informal discussions was on rescue, not through any "formal legal process . . . [or] the application of an insolvency law."³⁴⁵ Unfortunately for the individual or individuals

³³³ See Yosiyuki Noda, *The Character of the Japanese People and their Conception of Law*, in THE JAPANESE LEGAL SYSTEM 302 (Hideo Tanaka ed., 1976).

³³⁴ See Minami, *supra* note 331, at 305.

³³⁵ See Noda, *supra* note 333, at 303.

³³⁶ See *id.*

³³⁷ Associated Press, *Japanese Ponder Shame Culture That Leads to Suicides over Debt*, POST AND COURIER (Charleston, S.C.), at http://www.charleston.net/stories/030703/wor_07japan.shtml (Mar. 3, 2003) (last visited Nov. 22, 2004).

³³⁸ See *id.*

³³⁹ See Halldór Stefánsson, *Media Stories of Bliss and Mixed Blessings*, in THE WORLDS OF JAPANESE POPULAR CULTURE 165 (D. P. Martínez ed., 1998).

³⁴⁰ See *id.*

³⁴¹ *Id.*

³⁴² *Id.*

³⁴³ Ron W. Harmer, *Comparison of Trends in National Law: The Pacific Rim*, 23 BROOK. J. INT'L L. 139, 157 (1997).

³⁴⁴ *Id.*

³⁴⁵ *Id.* at 158.

at the head of a financially troubled business, the culture of shame that pervades Japan makes bankruptcy a personal failure, not a business failure.³⁴⁶ This characterization of bankruptcy in Japan often leads to tragedy for the individual, be it suicide or isolation from family and community.³⁴⁷ Bankruptcy is a type of devastation not unlike “sickness, shipwrecks, fires, painful childbirth, and other vicissitudes.”³⁴⁸

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 toward law.³⁴⁹ As law and ethics are inseparable to the Japanese, a contract breach or a formal bankruptcy proceeding are as personal as character flaws.³⁵⁰ Rather than a legal system of rights and duties, the Japanese follow the concept of *giri*.³⁵¹ *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.”³⁵² *Giri* is not legally enforced, but socially and culturally enforced as part of personal honor.³⁵³ 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.³⁵⁴ The well-known Japanese notion of “losing or saving face” also flows from the concept of *giri*.³⁵⁵ Following *giri* is thought to be intuitive, not learned, and therefore, formal rules of law are resisted by the Japanese as counter-intuitive.³⁵⁶ Lawyers themselves appear to play a different role in Japan than in the West, as the word lawyer in Japanese, *bengoshi*, translates loosely as

³⁴⁶ Brooke Schumm III, *Comparison of Japanese and American Bankruptcy Law*, 9 MICH. Y.B. INT'L LEGAL STUD. 291, 291 (1988).

³⁴⁷ See Associated Press, *supra* note 337.

³⁴⁸ See *Omamori-Good Luck Charms*, at http://www.oren.jp/japan_22.htm (last visited Nov. 5, 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 United Nations Commission on International Trade Law (UNCITRAL) model law. Kazuhiko Yamamoto, *New Japanese Legislation on Cross-border Insolvency as Compared with the UNCITRAL Model 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.

³⁴⁹ See Noda, *supra* note 333, at 302.

³⁵⁰ See *id.* at 309.

³⁵¹ Minami, *supra* note 331, at 306.

³⁵² *Id.*

³⁵³ *Id.*

³⁵⁴ *Id.*

³⁵⁵ *Id.* at 306–07.

³⁵⁶ Minami, *supra* note 331, at 307.

mediator rather than litigator.³⁵⁷ The law itself is analogized to a sacred sword—it is displayed but preferably never used.³⁵⁸

b. *Japan's Economy and Spending Habits*

While some U.S. citizens stereotype the Japanese as profligate spenders,³⁵⁹ in reality the Japanese are among the biggest savers in the world.³⁶⁰ Japan's economy, the second largest in the world, began to fail in the early 1990s because of overall business failure that in turn threatened the entire banking system.³⁶¹ 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.³⁶² The Japanese government begged citizens to spend money to fuel their crashing economy.³⁶³ Unlike U.S. citizens, who were too happy to oblige when asked to do the same after September 11, 2001, the Japanese refused. As a group, they are less willing to spend, particularly in tough economic times marked by industry failures and job loss.³⁶⁴

Like U.S. spending habits discussed previously, these habits were created through historical events.³⁶⁵ After World War II, Japan built its

³⁵⁷ *Id.* at 314 n.93.

³⁵⁸ See Noda, *supra* note 333, at 302–03.

³⁵⁹ See Arnold L. Redman & 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). Perhaps this perception is the result of widespread Japanese real estate investments in the 1980s. For instance, in 1985, Japanese investment in U.S. real estate was \$1.8 billion. Within one year, this number climbed to \$5.7 billion. By 1988, Japanese investment totaled \$16.5 billion.

³⁶⁰ See Mann, *supra* note 106, at 1084 n.103 (noting that U.S. household savings rates now hover between 0% and 1%, but that the Japanese rates are around 28.5%). 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 MIZEN, *supra* note 2, at 2.

³⁶¹ See Sungwoo Kim & Steven Morrison, *A Fallacy of Composition: Saving Is Good for an Individual, Yet Very Harmful for a National Economy*, EXPLORING ECONOMICS, at <http://www.economics.neu.edu/exploring/index.php?pid=8&cid=77> (last visited Nov. 19, 2004).

³⁶² See *id.*

³⁶³ See *id.*

³⁶⁴ See, e.g., *Japan Economy on Track for Another Grim Year*, HONOLULU ADVERTISER, at <http://www.honoluluadvertiser.com/specials/outlook2002/japan.shtml> (Jan. 20, 2002) (noting the frugality of Japanese tourists in Hawai'i due to the economic downturn in Japan). 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, this refusal to spend at all made the economy screech to a halt. *But see* Mann, *supra* note 106, at 1086 (noting that despite these unquestionably high savings rates, Japan does have a great deal of consumer debt in its economy).

³⁶⁵ 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*

economy on standardized mass production.³⁶⁶ This was wildly successful, creating a large trade surplus with the United States, the world's largest consumer, and creating a large middle class.³⁶⁷ 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.³⁶⁸ This created a bubble economy³⁶⁹ which burst in the 1990s, and the effects of which are still felt today.³⁷⁰

This trend may be changing, however, particularly in the area of credit card use. The Japanese currently carry much more cash than U.S. citizens and do not use credit cards nearly as extensively.³⁷¹ Additionally, while about half of all U.S. citizens carry a balance on their credit cards, only about 10% of the Japanese do so.³⁷² 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.³⁷³ 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

Japanese Economic and Social History, in ECON. HIST. REV. 107, 108 (1985). Japan also engaged in non-agricultural endeavors in this period, including rice marketing and financing, land transport, and coastal shipping. *Id.* at 109. During the Meiji period that followed (1868–1912), Japan attempted to nurture a modern industrial economy. *Id.* at 110. This movement was drastically behind similar movements in the United States and Europe, however. *Id.* It also had a different flavor, resulting from Marxist influences, that retained militaristic influences on industry. *Id.* Although the resulting government-run businesses were not successful, this left valuable lessons for the more capitalist systems that followed. *Id.* at 111.

³⁶⁶ See *Post-Occupied Japan—After WWII*, at http://www.japan-101.com/history/history_post_occupied_japan.htm (last visited Nov. 6, 2004).

³⁶⁷ See *id.*

³⁶⁸ See *id.*

³⁶⁹ Mark Thornton, *The Japanese Bubble Economy*, at <http://www.lewrockwell.com/thornton/thornton24.html> (May 23, 2004) (last visited Nov. 6, 2004). 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. See *Economy: Japan's Economy Enters an Era of Globalization*, at <http://www.se.emb-japan.go.jp/JapanAccess/economy.htm> (last visited Nov. 29, 2004).

³⁷⁰ See Thornton, *supra* note 369.

³⁷¹ See Mann, *supra* note 106, at 1057.

³⁷² See *id.*

³⁷³ 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 purchases and even many larger purchases. In reality, then, most Japanese credit cards have been used like a U.S.-style debit card. See *id.* at 1074–75.

she wanted to pay off the item or carry it as a balance.³⁷⁴ 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.³⁷⁵ 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.³⁷⁶

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 number of corporate bankruptcies,³⁷⁷ 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.³⁷⁸ 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.³⁷⁹

E. *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.³⁸⁰ Eventually, a personal bankruptcy system was enacted that could be used by any natural person, whether a merchant or not.³⁸¹ 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.³⁸² Today, individuals are able to obtain a discharge fairly routinely, causing at least

³⁷⁴ See *id.* at 1080.

³⁷⁵ See *id.* at 1081.

³⁷⁶ See Mann, *supra* note 106, at 1081.

³⁷⁷ See Arthur J. Alexander, *Business Failures Rising in Japan as New Bankruptcy Law Takes Effect*, 22 JAPAN ECON. INST. REP. (June 9, 2000), at <http://www.jei.org/Archive/JEIR00/0022w5.html> (last visited Nov. 9, 2004).

³⁷⁸ See *id.* The theory behind 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. See *id.*

³⁷⁹ See *id.*

³⁸⁰ DOING BUSINESS IN JAPAN § 7.01 (Zentaro Kitagawa ed., 2001). The system that was in place was simply a private agreement (*kashi bunsan*) between the obligor and his creditors. See *id.* The obligor was a social outcast, and not worthy of the usual social considerations due to a member of society. See *id.* Private agreements began in the 1600s and continued until 1867. See *id.*

³⁸¹ *Id.* § 7.01[3] (2001); Bankruptcy Act, arts. 5, 12, 31, 33, 34, 42–44, 80–82.

³⁸² DOING BUSINESS IN JAPAN, *supra* note 380, § 7.01[2]

one scholar to conclude that Japanese personal bankruptcy law is not drastically different than personal bankruptcy law in the United States.³⁸³ But, in many ways, Japanese bankruptcy law is stricter than U.S. bankruptcy law. A bankruptcy case can be maintained only if the debtor is unable to pay debts as they become due.³⁸⁴ Moreover, the discharge is not automatic, but must be applied for.³⁸⁵ In addition, it takes ten full 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*.³⁸⁶

Personal bankruptcy is rare in Japan, with just 0.7 filings per 1,000 residents in 2000, compared to 5.2 filings per 1,000 residents in the United States.³⁸⁷ This is not surprising, given the spending habits of the Japanese,³⁸⁸ 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.”³⁸⁹ The phrase refers to the full exemptions to which a debtor was entitled under customary law.³⁹⁰ The phrase suggests that a person who has filed for bankruptcy is entitled to virtually nothing, and is

³⁸³ See Mann, *supra* note 106, at 1084–85.

³⁸⁴ See DOING BUSINESS IN JAPAN, *supra* note 380, § 7.02.

³⁸⁴ 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-junC* (insolvency), *shiharai-teishi* (suspension of payments), and *saimu-chCka* (liabilities exceed assets). When a 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 Asian Development Bank, *Insolvency Law Reforms—Report on Japan*, at http://www.insolvencyasia.com/insolvency_law_regimes/japan/index.html (last visited Nov. 22, 2004); 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. See Minhi shikkC HC [Civil Execution Act], Law No. 4 of 1979). arts. 131, 132, 152, 153, *cited in* DOING BUSINESS IN JAPAN, *supra* note 380, § 7.06[1].

³⁸⁵ 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.* Grounds for denial of a discharge include fraudulent conveyances prior to the case and making false statements to the court. See Minji saisei ho [Civil Rehabilitation Act], Law No. 225 of 1999, arts. 366–69.

³⁸⁶ See DOING BUSINESS IN JAPAN, *supra* note 380, § 7.08[3] n.14.

³⁸⁷ Efrat, *supra* note 3, at 100–01.

³⁸⁸ See Mann, *supra* note 106, at 1084.

³⁸⁹ See DOING BUSINESS IN JAPAN, *supra* note 380, § 7.01[2].

³⁹⁰ See *id.*

"a disgraced person no longer worthy of the usual social consideration due a member of society."³⁹¹

F. Japanese Reorganization Laws

Japan has a number of reorganization systems, and they are not mutually exclusive.³⁹² This complex system includes the prior Composition Act,³⁹³ the Corporate Reorganization Act,³⁹⁴ and the recently enacted Civil Rehabilitation Act (CRA).³⁹⁵ Japan's Commercial Code also provides for an out-of-court workout procedure known as a "Corporate Arrangement."³⁹⁶ While the Corporate Reorganization Act was designed for large publicly traded companies, and while the Composition Act technically is the predecessor for the new CRA for small business reorganizations,³⁹⁷ a company need not be large to use the Corporate Reorganization Act, nor small to use the CRA.³⁹⁸ 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 Reorganization Act.³⁹⁹

³⁹¹ See *id.*

³⁹² 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).

³⁹³ See Abe, *supra* note 392, at 36 n.6 (citing Wagi ho [Composition Act], Law No. 72 of 1922 [hereinafter Composition Act]). This was the reorganization law most often used before the recent enactment of the Civil Rehabilitation Act on Dec. 14, 1999. See Minji saisei ho [Civil Rehabilitation Act], Law No. 225 of 1999 [hereinafter Civil Rehabilitation Act]. For the statistical figures, see Anderson, *supra* note 392, at 360 (citing 1 Saiko Saibansho Jimu Somukyoku [Supreme Court General Secretariat], SHIHO TOKEI NENPO, Minji gyosei hen (Annual Report of Judicial Statistics, Civil and Administrative Cases Volume)) (1990–1999).

³⁹⁴ See Kaisha kosei ho [Corporate Reorganization Act], Law No. 172 of 1952 [hereinafter 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, 113–14 (1994).

³⁹⁵ See Civil Rehabilitation Act, *supra* note 393.

³⁹⁶ See Abe, *supra* note 392, at 36. This is essentially an out-of-court, private workout arrangement. Because it requires the approval of all creditors to the proposed workout plan, it is not used much. *Id.*

³⁹⁷ See Anderson, *supra* note 392, at 360–61 (stating that the CRA is best seen as an extension or revision of the Composition Act).

³⁹⁸ See *id.*

³⁹⁹ See *id.* at 363–64. The Corporate Reorganization Act had yet to be modernized when the CRA was enacted, making the CRA the most recent policy statement about business reorganization policy in Japan. See *id.*

Compared to both the Composition Act and the Corporate Reorganization Act, the CRA was a radical departure from existing law.⁴⁰⁰ Unlike virtually all other schemes in existence at the time outside the United States,⁴⁰¹ the CRA does not contain an insolvency requirement.⁴⁰² Like most other systems, a case will only be accepted if there is a chance of reorganization.⁴⁰³

In theory, the business is run by a debtor-in-possession under the CRA.⁴⁰⁴ The extent to which the company is actually run by a debtor-in-possession, however, varies from district to district.⁴⁰⁵ In the Osaka and Sapporo districts, courts usually follow a U.S.-style reorganization scheme, leaving the debtor-in-possession in place and appointing overseers only as an exception.⁴⁰⁶ In Tokyo, however, courts generally follow the old Composition system and appoint a supervisor in every case.⁴⁰⁷ In Nagoya, courts seem to follow the English system and appoint examiners, including business professionals, such as accountants, to run the

⁴⁰⁰ See *id.* at 363.

⁴⁰¹ See, e.g., Broude, et al., *supra* note 6, at 560 (stating that France also has no insolvency requirement).

⁴⁰² See Civil Rehabilitation Act, 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 392, at 367.

⁴⁰³ See Civil Rehabilitation Act, arts. 21(1), 33. 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 392, 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." Civil Rehabilitation Act, arts. 18(1), 84 (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." Anderson, *supra* note 392, at 391 (citing Civil Rehabilitation Act, art. 163(1)).

⁴⁰⁴ 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 392, at 373–79 (describing the role of each of these professionals in detail).

⁴⁰⁵ See *id.* at 373.

⁴⁰⁶ See *id.*

⁴⁰⁷ 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 that a supervisor will oversee the debtor and make sure the debtor does not undertake specific acts, as determined by the court, without the consent of the supervisor. Civil Rehabilitation Act, art. 54. The supervisor has two affirmative powers: 1) the court can grant the supervisor a right of avoidance to challenge fraudulent and refilling transfers, *id.*, art. 56, and 2) the supervisor has a subpoena-like right to demand reports directly from the debtor and its officers and managers. *Id.*, art. 59.

company in every case.⁴⁰⁸ 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.⁴⁰⁹ The most radical thing about the new Corporate Reorganization Act is that it binds both secured and unsecured creditors.⁴¹⁰ Because of a strong belief in *betsujo ken*, or the right of separation for secured creditors, no prior Japanese bankruptcy or insolvency law had ever affected the rights of secured parties.⁴¹¹ Even the new CRA does not affect the rights of secured creditors,⁴¹² though it does allow debtors to reduce the debt owed on property by essentially paying its value into the court, thus wiping out the secured party's security interest in that particular item.⁴¹³

⁴⁰⁸ See *id.* The powers of the examiner are not as far reaching as those of the supervisor in that the examiner does not have the subpoena and avoidance powers. But, the examiner is capable of examining the debtor. *Id.*, art. 62). The major duty of the examiner is to provide a report to the court in a stipulated time. *Id.*

⁴⁰⁹ See Abe, *supra* note 392, at 36. The amendments to the Corporate Reorganization Act went into effect on April 1, 2003. *Id.*

⁴¹⁰ *Id.*

⁴¹¹ See Civil Rehabilitation Act, art. 51; Anderson, *supra* note 392, at 380 n.148. But, the CRA does provide that a court can temporarily limit a secured creditor's right to sell a debtor's property at a 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. Civil Rehabilitation Act, art. 31(1)(2).

⁴¹² The debtor has the burden of proving that the creditor is not entitled to the asset or the stay, 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), 362(d)(2). The narrowness of this exception demonstrates the powers of secured creditors in reorganization cases generally, including cases instituted under the CRA.

⁴¹³ Civil Rehabilitation Act, art. 148(1). This essentially amounts to a redemption under U.S. bankruptcy law, see 11 U.S.C. § 722, and is always permitted in a Chapter 11 as well as a Chapter 7. Unfortunately, most U.S. 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 U.S. 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 392, 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 Abe, *supra* note 392, at 36 (stating that it was used between four and fifty-seven times per year during the past twenty years). The bankruptcy court

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 law in order to promote rehabilitation. Having said that, one would assume that Japanese society now 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,⁴¹⁴ which itself demonstrates society's resistance to this idea.

G. *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 failures 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.⁴¹⁵ As higher consumer debt

need not find that a company has a prospect of reorganization under the new Corporate Reorganization Act, 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 in lieu of a trustee, meaning the debtor chief executive officer, its chief financial officer, etc. *See id.*

⁴¹⁴ Anderson, *supra* note 392, 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.

⁴¹⁵ MARK WEST, DYING TO GET OUT OF DEBT: CONSUMER INSOLVENCY LAW AND SUICIDE IN JAPAN 14–15 (2003), available at <http://www.law.umich.edu/centersandprograms/olin/abstracts/discussionpapers/2003/west03015.pdf> (last visited Nov. 22, 2004); *see* Francoise Kadri, *Millions of Ordinary Japanese on Brink of Financial Ruin as Debts Mount*, AGENCY FR.-PRESS, Mar. 24, 2002, available at 2002 WL 2369590; Yuri Kageyama, *Debt, Loan Sharks and Culture of Shame a Recipe for Suicide*, JAPAN TIMES, Mar. 13, 2003, at 15; Marina Kamimura, *As Japan's Economy Stumbles, Suicides Near Record Levels*, CNN.COM, <http://www.cnn.com/WORLD/asiapcf/9809/13/japan.suicides> (Sept. 13, 1998). Suicide is tied directly to financial failure, and few people know that they can file for bankruptcy instead. *See* Gautaman Bhaskaran, *Suicide State*, THE HINDU, May 12, 2002, available at 2002 WL

levels become more common, failures will increase and so may suicide rates. It is unclear whether merely liberalizing laws can stem this tide.⁴¹⁶

Japanese culture is complicated, with many unspoken rules and hierarchies.⁴¹⁷ People have the expectation of being in the same job for life and cannot face job loss without losing face.⁴¹⁸ Yet, saving face is the ultimate societal necessity. Neither law nor 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.⁴¹⁹ Explicit insolvency laws, like explicit contract laws, and explicit corporate and securities laws, play a far smaller role than those in the Western world.⁴²⁰ Informal insolvency procedures are often preferred to formal systems because the formal rules often conflict with the value systems of the society.⁴²¹ Thus, simply changing the laws will not necessarily change financial and legal practices, or attitudes toward financial failure.

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 U.S. society. *See id.*

⁴¹⁶ 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 their word at all costs as a way of saving face. Davangshu Datta, *Uncertain Times*, THE BS WEEKEND, October 26, 2002, *available at* 2002 WL 100052313.

⁴¹⁷ Milhaupt, *supra* note 279, at 434–35.

⁴¹⁸ *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).

⁴¹⁹ *See id.*

⁴²⁰ *See id.*

⁴²¹ *See* Wihlborg & Gangopadhyay, *supra* note 274, 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.

1. Lesson from Hong Kong and China

Neither Hong Kong nor China has developed bankruptcy systems as elaborate as the Japanese bankruptcy laws.⁴²² Hong Kong has a modern individual bankruptcy law, but does not have a business reorganization system.⁴²³ China has no personal bankruptcy system, but is developing a rescue system for ailing businesses.⁴²⁴ As is the case in Japan, cultural issues may keep the Chinese from using these new laws.⁴²⁵

a. *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 England.⁴²⁶ 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 England that dates back to 1929.⁴²⁷ Not surprisingly, these laws are archaic, harsh, and pro-creditor.⁴²⁸

Proposed changes to the Hong Kong insolvency laws dealing with corporate or business reorganization have failed to pass.⁴²⁹ Liquidation, which is referred to as "insolvency," is the only option for corporations.⁴³⁰ For almost a decade, scholars and legislators have been attempting to pass a corporate rescue regime in Hong Kong, but to no avail.⁴³¹ The scheme, named "provisional supervision," was originally drafted to operate much like an English "Administration." Under a

⁴²² See *infra* notes 423–510 and accompanying text. Thus, there is much less to say about the bankruptcy laws of Hong Kong and China; see also Roman Tomasic et al., *Insolvency Law Administration and Culture in Six Asian Legal Systems*, 6 AUSTL. J. CORP. L. 248, 248 (1996) (noting that the Hong Kong and Chinese laws in place are old and their purpose is to kill the company, not revive it).

⁴²³ Leslie Burton, *An Overview of Insolvency Proceedings in Asia*, 6 ANN. SURV. INT'L & COMP. L. 113, 114–15 (2000).

⁴²⁴ See Tomasic et al., *supra* note 422, at 252 (stating that China has no personal bankruptcy system). China is also developing a consumer culture. The Knight Ridder news service ran a recent story about Mercedes dealerships and Gucci stores popping up all over China. Tim Johnson, *China: Asia's New Money Machine*, ALBUQUERQUE, J., Feb. 15, 2004, at B8.

⁴²⁵ See *infra* note 484–493 and accompanying text.

⁴²⁶ See Burton, *supra* note 423, at 114.

⁴²⁷ Tomasic et al., *supra* note 422, at 255.

⁴²⁸ Burton, *supra* note 423, at 114.

⁴²⁹ *Id.* at 115; See Philip Smart & Charles D. Booth, *Corporate Rescue: Hong Kong Developments*, 10 AM. BANKR. INST. L. REV. 41, 42 (2002).

⁴³⁰ See Burton, *supra* note 423, at 114–15.

⁴³¹ See *id.* at 115.

provisional supervision, a specialist or trustee runs the company and proposes a voluntary arrangement, that creditors vote upon within six months.⁴³² As in an English Administration, creditors control the proceeding.⁴³³ None of the drafts of the yet-to-be-passed provisional supervision contemplate a debtor-in-possession system.⁴³⁴

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.⁴³⁵ These groups feared that the new provisional supervision would be less favorable to their interest and thus opposed the bill.⁴³⁶ 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.⁴³⁷ 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.⁴³⁸

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

⁴³² Charles D. Booth, *Hong Kong Corporate Rescue: Recent Developments*, 15 AM. BANKR. INST. L. REV. 24, 24 (Nov. 2000). Interestingly, the bill provided that provisional supervision be available to both insolvent and solvent companies. *Id.*

⁴³³ *See id.*

⁴³⁴ *See id.*

⁴³⁵ *See* Philip Smart & Charles D. Booth, *Provisional Supervision and Workers' Wages: An Alternative Proposal*, 31 HKLJ 188, 188 (2001).

⁴³⁶ *Id.*

⁴³⁷ Smart & Booth, *supra* note 429, at 43. 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.'" *Id.* Because the words "former employees" are interpreted narrowly, this requires 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.*

⁴³⁸ Electronic Interview with Charles D. Booth, Associate Dean, University of Hong Kong (Dec. 2, 2004). In compulsory liquidations, the workers' main protection comes from what is called the "protection of wages on insolvency fund." A possible solution to the current impasse, proposed by the Secretary for Financial Services and the Treasury in September of 2002, is to require that in a provisional supervision, companies be required to pay up front (or deposit in a trust account) an amount equivalent to the amount that would be payable by this fund in a compulsory liquidation, rather than to pay the entire amount of all entitlements in full. *Id.*

to accept a plan they did not like, and could lose the benefit of their superior position in their collateral.⁴³⁹ While the current draft no longer contains these disadvantageous provisions, the pendulum may now have shifted too far in the secured creditor's favor.⁴⁴⁰ 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 four to seven working days following a petition, terminate the provisional supervision completely.⁴⁴¹ 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.⁴⁴² In the past, due to the discretionary discharge provisions, many debtors received no discharge and the shortest time in which one could obtain a discharge was eight years.⁴⁴³ For example, for the ten-year period from 1983 through 1992, roughly 2,400 people filed for personal bankruptcy in Hong Kong and only twenty-five received a bankruptcy discharge.⁴⁴⁴ In effect, the discretionary discharge made bankruptcy a life sentence for most.⁴⁴⁵ 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.⁴⁴⁶

Unlike in some parts of East Asia, Hong Kong citizens have not been afraid to exercise their bankruptcy rights.⁴⁴⁷ In November of 2003, there were 939 bankruptcies in the City of Hong Kong.⁴⁴⁸ There

⁴³⁹ *Id.* at 42–43.

⁴⁴⁰ *See id.*

⁴⁴¹ *Id.* Though 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.

⁴⁴² *See* Charles D. Booth & Philip St. J. Smart, *Retroactive or Prospective?: Determining the Scope of Hong Kong's New Insolvency Law*, 8 INT'L INSOL. REV. 27, 32 (1999).

⁴⁴³ *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. *See id.*

⁴⁴⁴ *Id.* at 32 n.24.

⁴⁴⁵ *Id.* at 32.

⁴⁴⁶ *See Id.*

⁴⁴⁷ *See* Kelvin Chan & Chow Chung-yan, *Bankruptcies Fall to Their Lowest Level in Two Years*, S. CHINA MORNING POST, Dec. 20, 2003, at 3.

⁴⁴⁸ *Id.*

were 1,417 during October of the same year.⁴⁴⁹ 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 2003.⁴⁵⁰ These numbers are astronomical compared to the ten years prior to this time, showing an increase in filings of over 1,000%.⁴⁵¹ While some of this increase can be attributed to liberalization of the individual bankruptcy discharge, increases in consumer credit, particularly credit cards, may also explain these increases.⁴⁵² As of March of 2002, there were nearly 7 million residents of Hong Kong, and 9.38 million credit cards in circulation.⁴⁵³

Culture appears to play a much smaller role in Hong Kong's attitudes towards bankruptcy, especially compared to China.⁴⁵⁴ Because Hong Kong laws are based on English law, the law lacks local culture elements unique to Hong Kong.⁴⁵⁵ 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.⁴⁵⁶ 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.⁴⁵⁷

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 tran-

⁴⁴⁹ *Id.*

⁴⁵⁰ *Id.*

⁴⁵¹ *Id.* 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. *Id.*

⁴⁵² *Hong Kong Bankruptcies and Jobless Rates Hit Record*, THE ASIAN BANKER J., Sept. 20, 2002, at 4.

⁴⁵³ *Id.* The authors note that this amounts to 1.34 credit cards per person. *Id.*

⁴⁵⁴ Tomasic et al., *supra* note 422, at 282–83.

⁴⁵⁵ *Id.* at 283.

⁴⁵⁶ *Id.*

⁴⁵⁷ *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.

sient.⁴⁵⁸ Some large bankruptcies in the 1980s made the idea more common, and therefore more acceptable.⁴⁵⁹ Among the traditional Chinese people who live in Hong Kong, the stigma is still present, and bankruptcies from Chinese owned business are rare.⁴⁶⁰

Like the mainland Chinese, Hong Kong citizens would rather avoid courts, preferring to work things out on their own.⁴⁶¹ The robust Hong Kong economy also has made bankruptcy reform less of a necessity.⁴⁶² 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.⁴⁶³ Moreover, Hong Kong citizens are more likely to embrace and to use modern bankruptcy laws than the citizens of either China or Japan. Confucianism and other traditional forces play a smaller role in modern, long-colonized, market-based Hong Kong.⁴⁶⁴

b. *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.⁴⁶⁵ 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 1,298,847,624.⁴⁶⁶ 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.⁴⁶⁷ In fact, well over half of all China's busi-

⁴⁵⁸ Burton, *supra* note 423, at 117.

⁴⁵⁹ *Id.*

⁴⁶⁰ *Id.* The relationship between Hong Kong and China concerning bankruptcy is complicated. *See id.* at 120. At the moment, China does not recognize Hong Kong bankruptcies. *See id.* 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.* at 116.

⁴⁶¹ Tomasic et al., *supra* note 422, at 255–56.

⁴⁶² Andrew Duncan, *A Brief Overview of Insolvencies in Hong Kong*, 30 BCD NEWS & COMMENT 21 (1997).

⁴⁶³ Tomasic et al., *supra* note 422, at 256.

⁴⁶⁴ *Id.* at 282.

⁴⁶⁵ *See The World Fact Book Website—China*, <http://www.cia.gov/cia/publications/factbook/geos/ch.html> (last visited Dec. 14, 2004). This is particularly striking when compared to U.S. history reaching back only to 1776 A.D.

⁴⁶⁶ *Id.* (providing a July 2004 estimate).

⁴⁶⁷ *See* ASIAN DEV. BANK, *THE DEVELOPMENT OF PRIVATE ENTERPRISE IN THE PEOPLE'S REPUBLIC OF CHINA* 63–65, available at http://www.adb.org/documents/studies/PRC_Private_Enterprise_Development/prc_private_enterprise.pdf (Mar. 5, 2003) (discussing five types of private entities and how “private” is defined in China both by the state and by economists).

nesses are now privately owned.⁴⁶⁸ Moreover, China is working hard to encourage foreign investment in its businesses.⁴⁶⁹

In the past, the communist government of China has fought to limit any capitalist influence in the economy.⁴⁷⁰ Now, due to a growing realization that capitalism may produce more efficiently in many sectors than the regime's State Owned Enterprises (SOEs), the Communist Party of China is accepting and even encouraging capitalism.⁴⁷¹

This acceptance of private enterprise did not occur suddenly. Through the assumption of power of the Communist Party until the 1980s, the authorities actively crushed capitalist enclaves.⁴⁷² In 1982, the government "rehabilitated" capitalist entrepreneurs in an effort to increase economic activity.⁴⁷³ "At the 16th party congress, not only were the 'red capitalists' invited to join the Communist Party, some private entrepreneurs were even made delegates."⁴⁷⁴ The Communist Party also vowed to "promote the healthy development of the non-public sector" and to "better safeguard private property."⁴⁷⁵

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.⁴⁷⁶ 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 1996.⁴⁷⁷ Moreover, China's large state banks have written off US\$15.3 billion in non-performing loans to SOEs.⁴⁷⁸

⁴⁶⁸ See *id.*

⁴⁶⁹ See, e.g., Stephen H. Diamond, *The PetroChina Syndrome: Regulating Capital Markets in the Anti-Globalization Era*, 29 J. CORP. L. 39, 47 (2003) (describing the PetroChina initial public offering).

⁴⁷⁰ See Allan Zhang, *Hidden Dragon: Unleashing China's Private Sector*, at <http://www.pwcglobal.com/extweb/newcolth.nsf/docid/3D15C57A6D220BB985256CF6007B9607>, (last visited Nov. 22, 2004). It is important to note that this data is provided by PricewaterhouseCoopers. The firm may have a pecuniary interest in portraying the investment climate in China as being better than it is in reality.

⁴⁷¹ See *id.*

⁴⁷² See *id.*

⁴⁷³ *Id.*

⁴⁷⁴ *Id.*

⁴⁷⁵ See Zhang, *supra* note 470.

⁴⁷⁶ CHRISTOPHER A. McNALLY, CHINA'S STATE-OWNED ENTERPRISES: THRIVING OR CRUMBLING? 1 (2002).

⁴⁷⁷ See *id.* at 1.

⁴⁷⁸ *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. See A \$45 Billion Shot In The Arm,

Private enterprise is developing rapidly despite a difficult regulatory environment and continuing government discrimination.⁴⁷⁹ 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.⁴⁸⁰ The private sector is producing eight out of ten new jobs.⁴⁸¹ China's overall economy is growing by 8% and this rate is expected to continue into 2005.⁴⁸² 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.⁴⁸³

Culture plays a substantial role in Chinese laws, especially its bankruptcy laws.⁴⁸⁴ Considering its population, China has a low level of reported commercial bankruptcies.⁴⁸⁵ In Chinese society the notion of bankruptcy has long been condemned as "bad luck," meaning "broken fortune."⁴⁸⁶ 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.⁴⁸⁷

THE ECONOMIST GLOBAL AGENDA, at http://www.economist.com/agenda/displayStory.cfm?story_id=2328008 (Jan. 6, 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. *See id.*

⁴⁷⁹ *See* Zhang, *supra* note 470.

⁴⁸⁰ *Id.*

⁴⁸¹ *Id.*

⁴⁸² A \$45 Billion Shot In The Arm, *supra* note 484.

⁴⁸³ *See* Zhang, *supra* note 470. China will continue to depend on SOEs for a large part of its economic productivity. *See id.* But, 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. *See id.*

⁴⁸⁴ *See* Ma, *supra* note 325, at 205.

⁴⁸⁵ *See* Feng Chen, *Chinese Bankruptcy Law: Milestones and Challenges*, 31 ST. MARY'S L.J. 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: (1) immense pressure on government leaders, (2) strong opposition to bankruptcy from banks, and (3) an entrenched 'reliance' psychology in society." *Id.* Chen describes reliance as a phenomenon where the working class is considered the "leading class" by society, and is thus entitled to be taken care of by the government, especially workers in SOEs. *See id.*

⁴⁸⁶ Ma, *supra* note 325, at 205.

⁴⁸⁷ *Id.*

The Chinese historically have a low regard or disbelief in judicial power.⁴⁸⁸ Creditors focus on *guanxi* (relationships) as opposed to their entitlements to payment.⁴⁸⁹ As is further discussed below, bankruptcy cases in China have been controlled by the government, not by independent courts, causing citizens to distrust the system.⁴⁹⁰ Confucianism also continues to have great influence on commercial activities. 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, etc.”; *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”.⁴⁹¹ Confucianism “encourages balance and harmony.”⁴⁹² “Unless there is no other choice, people should keep their friendships and relationships intact,” rather than pursue court intervention; under Confucianism, it is also “anti-moral” to *force* a debtor into involuntary bankruptcy.⁴⁹³

Socialism and communism also have a great affect on attitudes and culture in China and the resulting bankruptcy laws.⁴⁹⁴ The most developed and most significant Chinese Bankruptcy laws focus on

⁴⁸⁸ *Id.* at 206.

⁴⁸⁹ *Id.*

⁴⁹⁰ *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. 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.” 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 courts’ direction.

Id.

⁴⁹¹ B.A. Robinson, *Confucianism: Founded by K'ung Fu Tzu*, Ontario Consultants on Religious Tolerance, at <http://www.religioustolerance.org/confuciu.htm>, (July 12, 1995).

⁴⁹² Ma, *supra* note 325, at 206.

⁴⁹³ *Id.* at 207. 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.*

⁴⁹⁴ *See id.*

SOEs.⁴⁹⁵ It is very difficult to place an SOE into bankruptcy and government permission is needed.⁴⁹⁶ SOEs are property of the state, and bankruptcy is viewed as a leadership failure, a loss of face for the government.⁴⁹⁷ Yet, scores of SOEs operate at a loss.⁴⁹⁸ Naturally, if a large 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.⁴⁹⁹ If SOEs are given free access to bankruptcy, a domino effect is also feared because many SOEs are deeply indebted to one another.⁵⁰⁰

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.⁵⁰¹ If the case is accepted by the court, then a stay of collection efforts goes into effect.⁵⁰² While all cases begin as liquidations, a case can proceed, through the actions of a Creditors Assembly, so that creditors can vote on a reorganization plan that will be approved if it is accepted by two-thirds of all unsecured creditors.⁵⁰³ Priority treatment is given to wage claims first, and then to taxes.⁵⁰⁴

In 1986, China passed a controversial law that permitted the bankruptcy of SOEs.⁵⁰⁵ These cases all start as liquidations, but can then become reorganization cases.⁵⁰⁶ The goals in enacting this new law were

⁴⁹⁵ Immanuel Gebhardt & Kerstin Olbrich, *New Developments in the Reform of Chinese Bankruptcy Law*, 12 AUSTL. J. CORP. L. 109, 109 (2000) (stating that this law contains China's most detailed stipulations on bankruptcy).

⁴⁹⁶ Ma, *supra* note 325, at 208.

⁴⁹⁷ *Id.* at 207.

⁴⁹⁸ Chen, *supra* note 485, at 60.

⁴⁹⁹ Ma, *supra* note 325, at 208. Chinese workers are considered the leaders of the country. Chen, *supra* note 474, 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.*; see Zhang & Booth, *supra* note 323, at 13 (describing SOEs as more like municipalities than private companies, where their workers are concerned).

⁵⁰⁰ Ma, *supra* note 325, at 208–09.

⁵⁰¹ Gebhardt & Olbrich, *supra* note 495, at 109. In the Shenzhen District, the debtor is eligible for bankruptcy if it has suffered serious losses or has been unable to pay its debts as they come due. Zhang & Booth, *supra* note 323, at 7.

⁵⁰² Zhang & Booth, *supra* note 323, at 9.

⁵⁰³ *Id.* at 7.

⁵⁰⁴ *Id.*

⁵⁰⁵ See Ta-kuang Chang, *The Making of the Chinese Bankruptcy Law: A Study in the Chinese Legislative Process*, 28 HARV. INT'L L.J. 333, 333–34 (1987) (describing the entire legislative process in detail); Gebhardt & Olbrich, *supra* note 495, at 152 (describing the intense pressure Prime Minister Zhao received to pass this law for economic reasons); Zhang & Booth, *supra* note 326, at 2.

⁵⁰⁶ Boshkoff & Song, *supra* note 323, at 360.

to encourage more efficient management of SOEs and to liquidate unprofitable businesses.⁵⁰⁷ 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.⁵⁰⁸ Courts are still not independent, and the community continues to have a lack of trust for judicial bodies.⁵⁰⁹ 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.⁵¹⁰ Clearly, the desire to compete in a global capital market cannot overcome ancient cultural and societal beliefs.

2. 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 passage of its new Civil Rehabilitation Law, one of the few debtor-in-possession systems in 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.⁵¹¹ 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.⁵¹² 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.

⁵⁰⁷ See Zhang & Booth, *supra* note 323, at 2.

⁵⁰⁸ See Boshkoff & Song, *supra* note 323, at 361; Ma, *supra* note 325, at 206; *see also* Gebhardt & Olbrich, *supra* note 495, at 109–10 (discussing the need for reform); Zhang & Booth, *supra* note 323, at 2–3 (same).

⁵⁰⁹ Ma, *supra* note 325, at 206.

⁵¹⁰ See *id.* at 207. Issues surrounding how fired employees will be taken care of also remain as stumbling blocks. Unlike U.S. 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 & Song, *supra* note 323, at 361. The Chinese law allows criminal sanctions for poorly-managed enterprises. *Id.*

⁵¹¹ See Associated Press, *supra* note 337. 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. *Id.*

⁵¹² *Id.* One of the most shameful things one can do is not pay one's debts. See WEST, *supra* note 415. Suicide is often preferred to bankruptcy, even when the law is favorable to management and to business. Japan has one of the highest per capita suicide rates in the world. See *id.* at 9–10.

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 one's debts, a misfortune that would follow one for the rest of his or her life.⁵¹³ Culturally, like the Japanese, the Chinese are taught to value relationships over money and self-promotion.

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.

CONCLUSION

As the above discussion of U.S. policy demonstrates, bankruptcy's fresh start, as well as the reorganization through a debtor-in-possession, grew from the roots of U.S. capitalism.⁵¹⁴ First came the creation of an entrepreneurial economy, followed by an active consumer economy.⁵¹⁵ 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.⁵¹⁶ At the same time, citizens of the world are also being exposed

⁵¹³ See, e.g., Pamela Pun, *Top Bank "Names and Shames" Debtors in Adverts*, THE STANDARD (Hong Kong), at http://www.thestandard.com.hk/news_detail_frame.cfm?articleid=51898&intcatid=2 (Nov. 3, 2004).

⁵¹⁴ See *supra* notes 30–83 and accompanying text.

⁵¹⁵ See *supra* notes 34–83 and accompanying text.

⁵¹⁶ Metzger & Bufford, *supra* note 4, at 153 (noting that when a country attempts to create a market economy, bankruptcy laws are among the first capitalist laws to be enacted).

to more and more credit—often more than they can back.⁵¹⁷ 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.⁵¹⁸

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 United States 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 on to blank cultural slates, such as the U.S. economy and social system of the 1700s and early 1800s. 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 not try 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 unaware of the debt forgiveness now allowed by law. Others still refuse to use these laws because doing so is dishonorable.⁵¹⁹ Education efforts should continue in an effort to destigmatize, as well as avoid isolation, voluntary exile, and suicide from over-indebtedness.

⁵¹⁷ See *supra* note 2.

⁵¹⁸ See Efrat, *supra* note 3, at 92–94.

⁵¹⁹ See *Business Suicides: Japan's Death Trap*, BUS. WEEK ONLINE, at http://www.businessweek.com/print/magazine/content/02_22/b3785141.htm (June 3, 2002).

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,⁵²⁰ and Thailand,⁵²¹ 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.⁵²² 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 import any systems wholesale, countries should attempt to borrow from many systems and ensure that the new law reflects both the economic needs of the society, as well as the unique cultural components of the society.⁵²³

⁵²⁰ See Wihlborg & Gangopadhyay, *supra* note 274, at 306.

⁵²¹ See *id.*

⁵²² 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.

⁵²³ Examples of such cultural components 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, as well as many other rich areas of discussion.