

Individual Bankruptcy in the United States and Germany: Recommendations for Georgia

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LIST OF ABBREVIATIONS

Bankruptcy Code

U.S. Code: Title 11

InsO

German Insolvency Code (Insolvenzordnung)

U.S.

United States of America

ABSTRACT

Georgia possesses no individual bankruptcy law in its legal system notwithstanding that with the availability of affordable credit and the resulting increasing number of defaults there would be a need for it. The main research question of this thesis therefore is whether and why Georgia should introduce individual bankruptcy law and to highlight why having a modern individual bankruptcy system and giving second chance (fresh start) to individuals is advantageous. A related goal is to draw recommendations how to introduce individual bankruptcy provisions in Georgia.

The model of individual bankruptcy laws developed in the United States (U.S.) and Germany are used as an inspiration for the recommendations. While US law works successfully in practice and is the most tested system globally, the German legal system is one of the most impactful civil law systems and it has the biggest impact on Georgian legislation today. Based on the analyses of these two jurisdictions, I will give recommendations to Georgian legislator about what main policies, rules and features should be taken into consideration while implementing individual bankruptcy provisions.

The thesis uses the mix of doctrinal and policy-oriented research methods. First, it will analyze the regulatory frameworks of individual bankruptcy in U.S. and Germany by scrutinizing the statutory framework, available case law and scholarly materials. Also, an interview with Emeritus Professor Reinhard Bork about German consumer insolvency law will be used to enrich the discussion on German the consumer insolvency system and its use in practice. Based on that, the Georgian individual debt collection system will be overviewed along with recommendations related to the individual bankruptcy system Georgia is to introduce.

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1. INTRODUCTION

1.1. Why this topic?

Georgia does not have implemented individual bankruptcy system in the legislation. Individuals with financial distress cannot get discharged of their debts and therefore cannot receive a “fresh-start” either. They are registered in the Debtors’ Registry (Movaleta Reestri - მოვალეთა რეესტრი)¹ once they become the target of enforcement proceedings.² Individuals who are registered in the debtor’s register cannot dispose of their property freely or even open a bank account.³ So, indebted individuals do not have a second chance and often there is no single way out of their financial distress. Irrespective that every asset owned by them could be sold in enforcement proceedings, but still there may be debts left.

On the other hand, in the U.S.⁴ and Germany,⁵ there are individual bankruptcy laws and individuals with financial distress can get their debts discharged if they satisfy certain conditions imposed by the legislation. These individuals receive a “fresh-start” and therefore a second chance.

According to data, there were 158 422 natural persons registered in the Debtor Registry.⁶ It is more dramatic that one-fifth of the workforce in Georgia is either registered in the debtors’

¹ Debtor Registry web-page, < <https://debt.reestri.gov.ge/> > (accessed 15 June 2023).

² National Bureau of Enforcement < http://nbe.gov.ge/index.php?sec_id=367&lang_id=ENG > (accessed 15 April 2023).

³ National Bureau of Enforcement < http://nbe.gov.ge/index.php?sec_id=367&lang_id=ENG > (accessed 15 April 2023).

⁴ 11 U.S. Code § 109 (b), < <https://www.law.cornell.edu/uscode/text/11/109> > (accessed 15 April 2023).

⁵ German Insolvency Code, Section 304, < https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html > (accessed 15 April 2023).

⁶ < http://www.barristers.ge/ge/page/news_item/1388?fbclid=IwAR2moLIT0Y35U7VXBJ6IjX_1X-Lw-GEjEWtY99HYbdSIFWbuJ95TK4GzGU > (accessed 15 June 2023).

registry or on the list of bad debts in the banking sector.⁷ This shows that there is a problem that needs to be regulated by the legislation.

1.2.The Jurisdictions Covered

The thesis will cover U.S., German, and Georgian jurisdictions. The reasons why particularly above-mentioned jurisdictions were chosen is that the U.S. bankruptcy code is considered a model which works good in practice and from which other countries can take lessons.⁸ Germany is one of the most impactful jurisdictions in civil law countries aside from France.⁹ Also, the German legal system has the biggest influence on the Georgian one.¹⁰ So it will be particularly interesting to see how individual bankruptcy is regulated also in Germany, apart from the U.S.

1.3.Research Methodology

The research method will be generally doctrinal, with a mix of policy-oriented research methods. The doctrinal research method analyzes legal doctrine and the way it was developed and applied, on the other hand, policy-oriented research method aims to influence the decisions made by authorities embodied in laws and regulations. In doctrinal research method the core sources of research are existing regulations and laws, court decisions and legal doctrine (*lex lata*), but in policy-oriented research method the main thing is how norms should be formed

⁷ Jaba Gvelebiani, Alexi Kochlashvili, Nana Amisulashvili, *Feasibility Study: On the Regulation of Personal Insolvency* (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), 2021) 71.

⁸ Tibor Tajti, Bankruptcy stigma and the second chance policy: the impact of bankruptcy stigma on business restructurings in China, Europe and the United States (2017) *China-EU Law J* 1, 26.

⁹ See Uwe Kischel, *Comparative Law* (Oxford 2019) 359-60.

¹⁰ See Giorgi Rusiashvili, Place of Georgian Civil Law in European Legal Family (2015) *TSU J Law* N1 95, 105.

(lex ferenda). So with my research I will try to show what is the existing practice in U.S. and Germany (lex lata) and also give recommendations how regulations can be structured in Georgia to be complete and effective in practice.

There are some limits when it comes to German individual bankruptcy research in terms of available English language materials. There are only several recent academic articles or books about German consumer insolvency law in English and court decisions about this topic cannot be found in English language. Because of this reason, I held an interview with an Emeritus professor of Hamburg University Reinhard Bork, whose remarks and answers to my questions are incorporated into the thesis, which fills the gaps that are the result of not having enough materials in English.

1.4.The Roadmap to the thesis

The thesis is structured as follows. The first chapter of the thesis will explain what the discharge and “fresh-start” policies are and what are the theories justifying the discharge of individual debtors. It will also discuss what bankruptcy stigma is and how it influences bankruptcy laws. Terminological caveats will also be covered.

The second chapter will analyze U.S. individual bankruptcy system. Overview the history of individual bankruptcy and analyze what main resorts are available to indebted individuals. Also, discuss the main trends and discussions in the academic literature about the topic and possible future reforms.

The Third chapter will explain how the consumer insolvency system is regulated in Germany. It will overview when was consumer insolvency introduced there and who is eligible for it. Also, the main procedural details and characteristics will be discussed.

The Fourth chapter will overview the bankruptcy system of Georgia and how individual indebted debtors are treated under Georgian laws. It will try to justify why an individual bankruptcy system should be introduced in Georgia and will try to give recommendations about how to introduce an individual bankruptcy system.

2. BUILDING BLOCKS AND PHILOSOPHY OF INDIVIDUAL BANKRUPTCY

2.1. Discharge and Fresh-Start

Discharge and justification of it is widely discussed in the U.S. scholarly works, so this part of the thesis will overview the scope and justification of discharge based on the U.S. perspective, but the theoretical analyses can be applied to any jurisdiction.

Discharge can be considered as the most important feature of the Bankruptcy Code from the debtor's perspective.¹¹ As a rule, an individual in bankruptcy (unless he has violated some norm of behavior, which is specified in the bankruptcy laws) can obtain a discharge from most of the debts he had incurred before filing for bankruptcy by surrendering his existing nonexempt assets.¹² However, we should keep in mind, that certain debts cannot be discharged in bankruptcy.¹³ Discharge of debts can be seen as a trade-off, a debtor in financial struggles is relieved from the pre-petition debts but at the price of surrendering certain assets to the bankruptcy court and bankruptcy trustee.¹⁴ After discharge, the debtor is not obliged to pay the discharged debts and creditors are unable to bring any actions to collect them.¹⁵ Some view discharge 'as a form of limited liability for individuals'.¹⁶

Discharge gives the debtor a financial fresh start.¹⁷ U.S. Supreme Court in *Local Loan Co. v. Hunt* has stated that one of the main goals of the Bankruptcy Act is to 'relieve the honest debtor

¹¹ John M. Czarnetzky, 'The Individual and Failure: A Theory of the Bankruptcy Discharge' (2000) 32 Ariz St LJ 393, 394.

¹² Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* (first published 1986, Beard Books 2001) 225.

¹³ Kenneth W. Clarkson and others, *Business Law: Text and Cases* (11th edn, South-Western) 621.

¹⁴ Michael D. Sousa, 'The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge' (2010) 58 U Kan L Rev 553, 562-63.

¹⁵ Kenneth W. Clarkson and others, *Business Law: Text and Cases* (11th edn, South-Western) 621.

¹⁶ John M. Czarnetzky, 'The Individual and Failure: A Theory of the Bankruptcy Discharge' (2000) 32 Ariz St LJ 393, 396; See CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* 701 (1997).

¹⁷ Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* (first published 1986, Beard Books 2001) 225.

from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes'.¹⁸

Fresh-start is provided to "honest but unfortunate debtors".¹⁹ 'It gives a debtor "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt."' ²⁰ So, we can say that discharge in individual bankruptcy, which results in the "fresh-start" for the "honest but unfortunate" debtor, can really be helpful for an indebted individual and helping "honest but unfortunate debtors" by discharging their debts is a central policy of U.S. bankruptcy system²¹

2.2. The Justification of Discharge

Let's try to see the justifications behind individual bankruptcy discharge. First of all, we should keep in mind that bankruptcy law is not just purely economic, but it is also a social legislation.²² Many scholars have come up with theories justifying individual bankruptcy discharge, but of course no theory can gain everyone's support.²³ In this sub-section we will discuss these theories.

¹⁸ Michael D. Sousa, 'The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge' (2010) 58 U Kan L Rev 553, 566; See *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

¹⁹ Douglas G. Baird, *The Elements of Bankruptcy* (5th edn, The Foundation Press, Inc., 2010) 30; See *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

²⁰ Jonathon S. Byington, 'The Fresh Start Canon' (2017) 69 Fla L Rev 115, 116; See *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

²¹ See generally Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 949-52.

²² Todd J. Zywicki, 'Bankruptcy Law as Social Legislation' (2001) 5 Tex Rev L & Pol 393, 394.

²³ Michael D. Sousa, 'The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge' (2010) 58 U Kan L Rev 553, 614.

The debtor cooperation theory justifies discharge based on historical reasons.²⁴ It explains that discharge was introduced because it is a necessary “carrot” to make debtor participate in bankruptcy process and therefore distribute debtors’ assets to creditors.²⁵ “Carrot” here can be seen as a stimulation, which makes the debtors participate in the bankruptcy process. Debtors knowing they can receive a discharge cooperate voluntarily, which is a key to operate bankruptcy system effectively.²⁶ So, based on this theory discharge gives individuals incentives to participate in the bankruptcy process.

On the other hand, Thomas H. Jackson tried to justify bankruptcy discharge based on impulsive control of individuals.²⁷ He thinks, that impulsive persons choose to consume today, rather than plan for the future.²⁸ Because of this impulsiveness individuals can experience regret over time, that is in professor Jackson’s opinion, why legislators introduced nonwaivable discharge, which can be considered as a “paternalistic” restriction on the freedom of contract.²⁹ He claims, that nonwaivable discharge protects impulsive debtors, because it forces the creditors to monitor and control borrowing.³⁰ That is logical, creditors knowing that individual debtor can get a discharge from the debts, will try to monitor giving him credit under stricter terms and conditions and check debtors’ current financial situation (whether will he be able to repay debt) more thorough.

²⁴ *ibid*, 584; See Charles Jordan Tabb, *The Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate*, 59 GEO. WASH. L. REV. 56, 90 (1990).

²⁵ John M. Czarnetzky, *The Individual and Failure: A Theory of the Bankruptcy Discharge* (2000) 32 Ariz St LJ 393, 395; See CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* 700 (1997).

²⁶ Michael D. Sousa, *The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge* (2010) 58 U Kan L Rev 553, 585.

²⁷ See Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* (first published 1986, Beard Books 2001) 234-36.

²⁸ *ibid*, 235.

²⁹ *ibid*, 233.

³⁰ *ibid*, 236.

Professor Jackson also thinks, that due to incomplete heuristics³¹ decision makers often overestimate chances of success and underestimate risks.³² ‘They underestimate the risk their current consumption imposes on their future well-being.’³³ Also, this author suggests that if the indebted individual is not discharged of his debts, he may have no stimulation to work more in the future and may devote more time to leisure, therefor make less contribution to the society (do not pay taxes, depend on social welfare programs etc....).³⁴ So, professor Jackson justifies individual bankruptcy discharge based on impulsive control of individuals and incomplete heuristics.

Some completely disagree with Jackson³⁵ and think that the differentiation of creditors as rational and debtors as irrational (not being able to control themselves or plan for the future) is not reasonable.³⁶

Also, there is the humanitarian theory of consumer discharge which is based on forgiveness and demonstration of mercy towards individuals.³⁷ In this respect, we should agree that the society has duty to promote the values of human dignity and self-respect.³⁸ Discharge provides ‘not just humane treatment of debtors, but it increases social utility by returning the debtor to productive labors’.³⁹ Moreover, Bankruptcy process gives an indebted individual the chance to become a productive member of the society again.⁴⁰ Humanitarian theory of consumer discharge is based on a natural law theory of morality.⁴¹ I should agree with professor Flint,

³¹ Author explains that, the term ‘refers to tools that individuals employ in processing information’; *ibid*, 237.

³² *ibid*, 239.

³³ *ibid*, 239.

³⁴ *ibid*, 245.

³⁵ See David Gray Carlson, 'Philosophy in Bankruptcy' (1987) 85 Mich L Rev 1341.

³⁶ *ibid*, 1365.

³⁷ Michael D. Sousa, 'The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge' (2010) 58 U Kan L Rev 553, 587.

³⁸ Jonathon S. Byington, 'The Fresh Start Canon' (2017) 69 Fla L Rev 115, 120-21.

³⁹ John M. Czarnetzky, 'The Individual and Failure: A Theory of the Bankruptcy Discharge' (2000) 32 Ariz St LJ 393, 396; see CHARLES JORDAN TABB, THE LAW OF BANKRUPTCY 701 (1997).

⁴⁰ Michael D. Sousa, 'The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge' (2010) 58 U Kan L Rev 553, 588.

⁴¹ *ibid*.

that ‘the discharge of the consumer debtor recognizes the inherent dignity of every human to be afforded an opportunity to earn a living and puts him or her back on the road to self-determination’.⁴² Therefore, “fresh-start” can really preserve social order and peace in the community.⁴³

In line of humanitarian theory of consumer discharge we should also highlight the importance of individual bankruptcy during such unforeseen and uncontrollable circumstances as it was outbreak of Covid-19 pandemic.⁴⁴ It left a lot of debtors unemployed and unable to pay their creditors without any fault on their side, we can presume that such events also justify the existence of a discharge policy.⁴⁵

John M. Czarnecky came up with a new theory - the “entrepreneur hypothesis”, claiming that bankruptcy discharge can be seen as a part of the institutional framework necessary for encouraging entrepreneurship in the market.⁴⁶ He thinks, that bankruptcy discharge assures that if an entrepreneur acts honestly but fails, ‘he will not be subject to debt servitude and the will of his creditors for some extended period of time’.⁴⁷ On the other hand, if the debtor does not act honestly, he should be deprived of the chance to have debts discharged.⁴⁸ So, professor Czarnecky thinks that bankruptcy discharge fosters entrepreneurship and that is why legislation guarantees and, we can say, should guarantee it.⁴⁹ Some also claim that the main justification for the discharge is ‘to restore the debtor to participate in the open credit

⁴² *ibid.*

⁴³ Jonathon S. Byington, 'The Fresh Start Canon' (2017) 69 Fla L Rev 115, 120.

⁴⁴ *See generally* < <https://www.justia.com/covid-19/debts-and-bankruptcy-during-the-covid-19-outbreak/> > (accessed 15 June 2023).

⁴⁵ *See generally* Jialan Wang and others, ‘Bankruptcy and the COVID-19 Crisis’, Harvard Business School, Working Paper 21-042 (September 2020) 1-5.

⁴⁶ John M. Czarnecky, 'The Individual and Failure: A Theory of the Bankruptcy Discharge' (2000) 32 Ariz St LJ 393, 399.

⁴⁷ *ibid.*

⁴⁸ *ibid.*

⁴⁹ *See ibid*, 464.

economy'.⁵⁰ So, a “fresh-start” helps individual debtors to stay economically productive and contribute to society.⁵¹

Michael D. Sousa tried to justify discharge based on the general idea of utilitarianism.⁵² Utilitarianism says that, proper laws achieve the greatest happiness to overall community or the greatest happiness for greatest number.⁵³ A theory of consumer utility combines all the existing theories about bankruptcy discharge, but also satisfies other concerns many debtors face – for example individuals with financial stress are prone to higher chances of physical and mental health problems.⁵⁴ Some argue that discharge and, therefore “fresh-start” can promote the physical and mental health of debtors.⁵⁵ We can say, that discharge can prevent different kinds of problems debtors face. So, consumer utility theory proves that bankruptcy discharge maximizes the happiness of a collective community of debtors by giving them relief from debts and a second chance.⁵⁶

Based on above-discussed justifications we can say, that bankruptcy discharge is a really important legal mechanism that gives an individual a “fresh-start” and the second chance. The necessity of this mechanism can be justified based on the above discussed theories and discussions, some of which may not be convincing to everyone. But at least some theories should convince the majority why it is necessary to have individual discharge as part of bankruptcy legislation.

⁵⁰ Michael D. Sousa, 'The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge' (2010) 58 U Kan L Rev 553, 589.

⁵¹ Jonathon S. Byington, 'The Fresh Start Canon' (2017) 69 Fla L Rev 115, 121.

⁵² See Michael D. Sousa, 'The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge' (2010) 58 U Kan L Rev 553.

⁵³ *ibid*, 593.

⁵⁴ *ibid*, 599-600.

⁵⁵ Jonathon S. Byington, 'The Fresh Start Canon' (2017) 69 Fla L Rev 115, 121.

⁵⁶ Michael D. Sousa, 'The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge' (2010) 58 U Kan L Rev 553, 602.

2.3. Bankruptcy Stigma

Christianity, Islam, Judaism and Hinduism in their moral codes all highlight the importance of debt repayment and therefore promote avoidance of bankruptcy.⁵⁷ In the past going bankrupt was almost the same as committing a crime.⁵⁸ In ancient Rome (according to the Twelve Tables) the creditor had right to imprison the debtor who could not pay and treat him like a slave, even sell him to other country or cut a proportionate share of his body.⁵⁹

England was the country where the first bankruptcy law was introduced in 1542 (which introduced collective proceedings against the individual debtors), but it took more than one-and-a-half century until the discharge of individual debtors was introduced.⁶⁰ Discharge was seen as “a carrot” to make the debtor participate in the bankruptcy process, otherwise, he would get “a stick” – death penalty.⁶¹ But we can say, that this was far from today’s understanding of discharge. The modern discharge in U.S. law appeared in 1898.⁶² This was an important development globally because the US has been at the forefront of promoting discharge and the second chance bankruptcy philosophy ever since.

Based on the abovementioned short historical overview, it should be no surprise why filing for individual bankruptcy can have stigmatizing effects. A social stigma still attaches to debtors who do not pay their creditors even in the US which is the most tolerant bankruptcy system.⁶³

Bankruptcy stigma can be explained as an injury to reputation that a person can get as a result

⁵⁷ Todd J. Zywicki, 'Bankruptcy Law as Social Legislation' (2001) 5 Tex Rev L & Pol 393, 398; See Rafael Efrat, The Moral Appeal of Personal Bankruptcy, 20 WHITTIER L. REV. 141,167 (1998).

⁵⁸ Tibor Tajti, Bankruptcy stigma and the second chance policy: the impact of bankruptcy stigma on business restructurings in China, Europe and the United States (2017) China-EU Law J 1, 12.

⁵⁹ Charles J Tabb, Ralph Brubaker, *Bankruptcy Law: Principles, Policies, Practice* (Anderson Publishing Company, 2003) 57.

⁶⁰ *ibid.*

⁶¹ *ibid.*, 58.

⁶² Michael D. Sousa, 'The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge' (2010) 58 U Kan L Rev 553, 563.

⁶³ Barry E. Adler, Douglas G. Baird, Thomas H. Jackson, *Bankruptcy: Cases, Problems and Materials* (4th edn, Foundation Press 2007), 560.

of filing for bankruptcy, some can even decide not to file for it because being afraid of this reputational loss.⁶⁴ So, stigma is associated with hard to reputation or violation of moral norms.⁶⁵

Generally, it is accepted, that bankruptcy stigma is lower in Anglo-Saxon systems (common law countries) than Continental European civil law systems.⁶⁶ U.S. should be considered a country with lowest intensity of stigma.⁶⁷ The right to bankruptcy and fresh start in the U.S. is looked upon “almost as an inalienable constitutional right”.⁶⁸ This is the reason why the U.S. bankruptcy system predominantly works properly in practice and it is considered as a model bankruptcy law by many notwithstanding the considerable number of abuses.⁶⁹

Since the 1990s the credit industry in the U.S. was claiming that individual debtors were abusing the system, many “can-pay” debtors were choosing to liquidate their assets and get discharged rather than pay from their future earnings.⁷⁰ They claimed that these debtors were able to pay their debtors out of their future earnings but were abusing the system (they stated it was the reason of the reduced bankruptcy stigma), which was the main reason for the Bankruptcy Code amendments in 2005 in the U.S.⁷¹

On the other hand, Germany is often used as a contrast to the U.S. when it comes to bankruptcy stigma, with a very high level of stigma.⁷² But according to professor Reinhard Bork in Germany nowadays consumer insolvency proceedings combined with discharge proceedings

⁶⁴ Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, 'Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings' (2006) 59 Stan L Rev 213, 233.

⁶⁵ Tibor Tajti, Bankruptcy stigma and the second chance policy: the impact of bankruptcy stigma on business restructurings in China, Europe and the United States (2017) China-EU Law J 1, 9.

⁶⁶ *ibid*, 26.

⁶⁷ *ibid*, 15.

⁶⁸ *ibid*, 16; *See also* Niall Ferguson, the ASCENT OF MONEY (Penguin Books 2009), page 60.

⁶⁹ *ibid*.

⁷⁰ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing) 48.

⁷¹ *ibid*, 47-48.

⁷² Tibor Tajti, Bankruptcy stigma and the second chance policy: the impact of bankruptcy stigma on business restructurings in China, Europe and the United States (2017) China-EU Law J 1, 15.

are perceived as a relieve rather than being stigmatize. It is understood that people go bankrupt for various reasons, many having nothing to do with dishonesty and failure.⁷³ Professor Bork believes that in Germany the intensity of bankruptcy stigma today is quite low when it comes to consumer insolvency and he justifies it by huge number of individuals filing for consumer insolvency every year.⁷⁴

The most rapid increase in bankruptcy filings in the U.S. began in 1960s along with the rise in consumer credit and general rise in the bankruptcy filings is explained by the reduced-stigma hypothesis.⁷⁵ The reduced stigma hypothesis means that individuals with the same economic distress would not have filed for bankruptcy because of stigma in the past but may file for bankruptcy these days. So, they claim that an average individual filing for bankruptcy in the U.S. feels less shame today than in the past.⁷⁶ The big reform in U.S. individual bankruptcy in 2005 was because of the enormous increase in the number of individual bankruptcy filings, and as a result they limited the accessibility to consumer bankruptcy and claimed it was due to the declining stigma associated with it.⁷⁷ The credit industry was claiming that the increased filings were the result of individuals who were abusing the bankruptcy system by pursuing to liquidate their assets and get discharged immediately rather than pay their creditors through repayment plans out of their future earnings.⁷⁸

On the contrary, based on analyses of three decades of bankruptcy filings in the U.S., some scholars suggest that the stigma has not declined but, it is even increasing.⁷⁹ They argue, that

⁷³ Interview with Reinhard Bork, Emeritus Professor, Faculty of Law, Hamburg University (Hamburg, Germany, 21 March 2023).

⁷⁴ *ibid.*

⁷⁵ Tibor Tajti, Bankruptcy stigma and the second chance policy: the impact of bankruptcy stigma on business restructurings in China, Europe and the United States (2017) *China-EU Law J* 1, 17.

⁷⁶ See Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, 'Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings' (2006) 59 *Stan L Rev* 213, 234.

⁷⁷ See *ibid.*, 214.

⁷⁸ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing) 47.

⁷⁹ Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, 'Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings' (2006) 59 *Stan L Rev* 213, 215.

the number of bankruptcy filings are rising not because of reduced stigma, but because of more financial distress of population.⁸⁰ They conclude this, based on declining fortunes of those who are willing to file for bankruptcy, significant underreporting of bankruptcy (meaning individuals who have financial problems, but do not want to file for bankruptcy) and characterization of bankruptcy by individuals as a terrible event - less terrible than death, but more serious than divorce or death of close friend.⁸¹ They make this assumptions based on The National Opinion Research Centre of University of Chicago survey in 2005.⁸² They think stigma even increases because of all the media coverage individual bankruptcy gets – some magazine articles claim that people filing for bankruptcy cost the rest of the population some costs.⁸³

Overall, it is quite hard to measure bankruptcy stigma with some kind of scale or index, as it is hardly quantifiable, there is not a mathematically founded index to measure bankruptcy stigma or it has not been created yet.⁸⁴ Also, we should keep in mind, that there is nothing wrong with ‘a healthy bit of stigma’, which will make individuals not file for bankruptcy without a legitimate reason, as an easy way out of their obligations.⁸⁵

⁸⁰ *ibid*, 242.

⁸¹ *ibid*, 246.

⁸² *See* TROUBLES IN AMERICA: A STUDY OF NEGATIVE LIFE EVENTS ACROSS TIME AND SUBGROUPS 10 (2005).

⁸³ Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, 'Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings' (2006) 59 *Stan L Rev* 213, 244.

⁸⁴ Tibor Tajti, Bankruptcy stigma and the second chance policy: the impact of bankruptcy stigma on business restructurings in China, Europe and the United States (2017) *China-EU Law J* 1, 26.

⁸⁵ *ibid*; *See also* 2013 World Bank Report, para 118, page 42.

2.4. Terminology Caveat

There are terminological differences in different systems when it comes to legal terminology. In the U.S. bankruptcy proceedings refer to all kinds of insolvency related proceedings.⁸⁶ In German Insolvency Code chapter 10 is named as ‘consumer insolvency proceedings’. In scholarly materials sometimes the terminology seems to be used interchangeably.⁸⁷ For the aims of this thesis the term individual bankruptcy will be used to refer to U.S. and Georgian systems and consumer bankruptcy – German.

⁸⁶ *ibid*, 8.

⁸⁷ *See* Frank M. Fossen, “Personal Bankruptcy Law, Wealth, and Entrepreneurship—Evidence from the Introduction of a "Fresh Start" Policy” (2014) *American Law and Economic Rev* 269, 273 – the article refers to German personal bankruptcy law.

3. INDIVIDUAL BANKRUPTCY IN THE UNITED STATES

3.1. Short Overview of the United States Bankruptcy System and History

The constitution of the U.S. states that ‘the congress shall have the power ... to establish uniform laws on the subject of bankruptcy throughout the United States’.⁸⁸ So, congress has the right to pass federal laws regarding bankruptcy. For quite a long time there was no constant federal bankruptcy law, there were federal bankruptcy acts of 1800, 1841, and 1867, but they were the result of financial disasters and each of them was in effect for a few years.⁸⁹

Since the enactment of the bankruptcy act of 1898, there is a permanent federal bankruptcy legislation in the U.S.⁹⁰ The 1898 Act was quite liberal compared to earlier laws, which also allowed for discharge but with many restrictions.⁹¹ The 1898 Act strictly limited the number of grounds for denying discharge.⁹² It was still viewed as a trader remedy and not a consumer remedy.⁹³ Notwithstanding, it is considered that ‘the 1898 Act is the foundation for modern bankruptcy law as we know it.’⁹⁴

In the 1920s and 1930s, it was a period when the U.S. bankruptcy system was converted and became more consumer-friendly and fresh-start for individuals became a leading principle.⁹⁵ This trend can clearly be seen in the 1934 Supreme Court decision *Local Loan Co. v. Hunt*, which stated that one of the main goals of the Bankruptcy Act is to ‘relieve the honest debtor

⁸⁸ Constitution of the United States, Article I, Section 8.

⁸⁹ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 37.

⁹⁰ *ibid*, 39.

⁹¹ *ibid*, 39.

⁹² *ibid*, 39.

⁹³ Iain Ramsay, *Personal Insolvency in the 21st Century* (2017, Hart Publishing), 37.

⁹⁴ David R. Jones, 'Savings: The Missing Element in Chapter 13 Bankruptcy Cases' (2018) 26 Am Bankr Inst L Rev 243, 248.

⁹⁵ Iain Ramsay, *Personal Insolvency in the 21st Century* (2017, Hart Publishing), 41-42.

from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes'.⁹⁶

The most important amendment of the 1898 Act was the Chandelier Act of 1938, which allowed debtors to use their future income to pay debts over time.⁹⁷ In 1970 Congress amended the 1898 Act and made 'the discharge self-executing, rather than just an affirmative defense', and bankruptcy courts gained exclusive jurisdiction over the dischargeability litigation.⁹⁸

The Bankruptcy Reform Act of 1978 was the first complex reform of the federal bankruptcy law in decades, it replaced the 1898 Act.⁹⁹ The 1978 Act created the Bankruptcy Code that is in effect in the U.S. today, with some amendments.¹⁰⁰ The Bankruptcy Code replaced the term "bankrupt" with "debtor", which is more neutral and we can say it is associated with less stigma than the term "bankrupt".¹⁰¹ The 1978 Code also offered "super-discharge" to individual debtors if they filed under Chapter 13 (meaning that, this chapter allowed them to discharge more debts than Chapter 7).¹⁰²

The Bankruptcy Code is located in title 11 of the U.S. Code.¹⁰³ And it has nine chapters.¹⁰⁴ Generally the majority of individuals file bankruptcy petitions under Chapter 7 or Chapter

⁹⁶ *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934), < <https://supreme.justia.com/cases/federal/us/292/234/> > (accessed 2 June 2023).

⁹⁷ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 39; Jason J. Kilborn, *Comparative Consumer Bankruptcy* (Carolina Academic Press, 2007), 53.

⁹⁸ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 39.

⁹⁹ *ibid*, 41.

¹⁰⁰ *ibid*, 41.

¹⁰¹ Charles J. Tabb, 'The Top Twenty Issues in the History of Consumer Bankruptcy' (2007) 2007 U Ill L Rev 9, 29.

¹⁰² *ibid*, 22.

¹⁰³ United States Code, < <https://uscode.house.gov/browse/prelim@title11&edition=prelim> > (accessed 2 June 2023).

¹⁰⁴ The chapters of the Bankruptcy Code are: Chapter 1 – General Provisions; Chapter 3 – Case Administration; Chapter 5 – Creditors, The Debtors and The Estate; Chapter 7 – Liquidation; Chapter 9 – Adjustment of the Debts of Municipality; Chapter 11 – Reorganization; Chapter 12 – Adjustment of Debts of A Family Farmer Or Fisherman With Regular Annual Income; Chapter 13 – Adjustment of Debts of An Individual With Regular Income; Chapter 15 – Ancillary and Other Cross-Border Cases.

Chapters 1, 5, and 5 apply to all kinds of bankruptcy cases, and the other chapters deal with specific types of debtors and reliefs.

13.¹⁰⁵ Under Chapter 7 the debtor's assets are liquidated and the creditors are paid on the pro-rata basis and the debtor is discharged.¹⁰⁶ On the other hand, in Chapter 13 individual debtors pay to their creditors through court-confirmed prepayment plans and receive discharge only after completion of the plan.¹⁰⁷

3.2. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

BAPCPA was one of the most comprehensive amendments of the Bankruptcy Code since 1978.¹⁰⁸ Professor Charles J. Tabb states that much of BAPCPA was written by two lobbyists – the credit industry and the auto industry.¹⁰⁹ On the other hand, bankruptcy professionals, like judges, professors, and attorneys – who were actively involved in other bankruptcy law amendments were ignored by Congress.¹¹⁰ Professor Tabb also alleges that the interested industries spent millions of dollars on campaign contributions that funded President Bush and key members of Congress.¹¹¹ This resulted that, there are some provisions in BAPCPA that professor Tabb considers anti-debtor provision, which worsened the rights of debtors.¹¹²

One of the primary goals of BAPCPA was to force debtors to stay away from Chapter 7 (liquidation) and go towards Chapter 13 (adjustment of debts for individual debtors), the reasoning was that, they should pay as much as they can in order to receive discharge of the

¹⁰⁵ Julie Aberasturi, 'Trouble with BAPCPA: A Call for Statutory Reform regarding Retirement Contributions in Chapter 13 Bankruptcy Plans' (2022) 30 Am Bankr Inst L Rev 279, 280.

¹⁰⁶ See generally Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 88-92.

¹⁰⁷ See generally *ibid*, 98-103.

¹⁰⁸ Iain Ramsay, 'U.S. Exceptionalism, Historical Institutionalism, and the Comparative Study of Consumer Bankruptcy Law' (2015) 87 Temp L Rev 947, 969.

¹⁰⁹ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 50.

¹¹⁰ *ibid*.

¹¹¹ *ibid*.

¹¹² *ibid*, 47.

debts.¹¹³ The justification behind BAPCPA was that many debtors were abusing bankruptcy laws and there were many serial filers.¹¹⁴ Despite much data suggesting otherwise, the credit industry convinced Congress, that there was widespread abuse of the bankruptcy system from the side of individual debtors.¹¹⁵ BAPCPA went into effect on 17 November 2005.¹¹⁶

Among other changes, BAPCPA added a compulsory credit counseling requirement for individual debtors.¹¹⁷ The counseling should be acquired by an approved nonprofit budget and credit counseling agency, which will give some recommendations to the debtor and also tell them what options they have in bankruptcy.¹¹⁸ The counseling should be done by the debtor within 180 day period before filing for bankruptcy.¹¹⁹

Overall, the 2005 Act was not friendly to individual debtors and enacted changes in legislation that made it harder for individuals to get a “fresh start”.¹²⁰ In order to force debtors into Chapter 13 proceedings instead of Chapter 7, BAPCPA introduced the “means test” to determine their alternatives in bankruptcy.¹²¹ “Means test’s” aim is to stop so-called “can-pay” debtors to file for bankruptcy under Chapter 7.¹²²

¹¹³ David R. Jones, 'Savings: The Missing Element in Chapter 13 Bankruptcy Cases' (2018) 26 Am Bankr Inst L Rev 243, 244.

¹¹⁴ Sara Sternberg Greene, 'The Failed Reform: Congressional Crackdown on Repeat Chapter 13 Bankruptcy Filers' (2015) 89 Am Bankr LJ 241, 242.

¹¹⁵ Michael D. Sousa, 'The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge' (2010) 58 U Kan L Rev 553, 594.

¹¹⁶ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 50.

¹¹⁷ *ibid.*, 128.

¹¹⁸ *ibid.*

¹¹⁹ *ibid.*

¹²⁰ Geoffrey K. McDonald, 'Homelessness in the COVID Era: Utilizing the Bankruptcy Solution' (2022) 41 Yale L & Pol'y Rev 122, 150.

¹²¹ David R. Jones, 'Savings: The Missing Element in Chapter 13 Bankruptcy Cases' (2018) 26 Am Bankr Inst L Rev 243, 244.

¹²² Charles Jordan Tabb, 'The Death of Consumer Bankruptcy in the United States' (2001) 18 Bankr Dev J 1, 10.

3.3. Chapter 7- Liquidation

Chapter 7 cases are sometimes called “straight liquidation” cases.¹²³ A debtor under Chapter 7 can be an individual, partnership or corporation.¹²⁴ Mostly, individual debtors file under Chapter 7 in order to be discharged of their debts.¹²⁵ Basically, the debtors surrender their nonexempt assets to a trustee, which sells them and distributes the proceedings to the creditors, whereas the debtor keeps exempt assets and is discharged from pre-bankruptcy claims.¹²⁶

Individual Chapter 7 cases can be “voluntary” – meaning filed by the debtor or involuntary – filed by the creditors.¹²⁷ In case of involuntary filing, the creditors must prove one of the statutorily determined grounds, from which, the most common is not paying debts when they become due.¹²⁸ Filing the case invokes automatic stay, which is one of the most important features of bankruptcy.¹²⁹ The automatic stay has the effect equivalent to an injunction, it automatically restrains the creditors to take any further actions to collect their debts or enforce their liens.¹³⁰ It is believed, that automatic stay preserves the status quo.¹³¹ We can say, that automatic stay at least gives a guarantee to the debtor that creditors cannot take away from him the chance of discharge in bankruptcy by trying to take some legal actions or enforce liens to collect their debts.

Automatic stay terminates when the particular property is no longer property of the bankruptcy estate or when the bankruptcy case is closed.¹³² The 2005 amendments added two new grounds

¹²³ Terrence L. Michael, 'There's a Storm a Brewin': The Ethics and Realities of Paying Debtors' Counsel in Consumer Chapter 7 Bankruptcy Cases and the Need for Reform' (2020) 94 Am Bankr LJ 387, 389.

¹²⁴ Kenneth W. Clarkson and others, *Business Law: Text and Cases* (11th edn, South-Western) 612.

¹²⁵ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 91.

¹²⁶ *ibid*, 88.

¹²⁷ *ibid*.

¹²⁸ *ibid*.

¹²⁹ Stephen L. Sepinuck, Gregory M. Duhl, *Problems and Materials on Bankruptcy Law and Practice* (3rd edn., 2017, West Academic Publishing), 28.

¹³⁰ *ibid*, 45.

¹³¹ *ibid*, 28.

¹³² David G. Epstein, *Bankruptcy and Related Laws in a Nutshell* (9th edn., 2017, West Academic Publishing), 49-50.

for the termination of automatic stay: when the debtor has filed a bankruptcy case, which was dismissed within one year of filing the present case automatic stay terminates 30 days after the filing unless good faith of the debtor is shown.¹³³ The second ground for termination of the automatic stay is when the debtor had two or more bankruptcy cases filed in the past year.¹³⁴

3.4. Property of the Estate and Exempt Property

After the filing of the case bankruptcy estate is formed, it includes all the debtor's property and forms the property of the estate.¹³⁵ The trustee should liquidate (dispose of) the property, which is nonexempt by the legislation and pays from this money to the creditors.¹³⁶ It is important to highlight, that Chapter 7 bankruptcy estate does not include any future income of the debtor after the filing for bankruptcy.¹³⁷ It is also of utmost relevance that empirical data suggests, that there are a lot of "no-asset" cases in individual Chapter 7 cases.¹³⁸

The justification behind the statutorily protected exempt property is that the debtors need some property to stay active members of society, to continue their professional work, also some properties can have no value to creditors and finally, there are some exempt properties also with value, but which can have a specific sentimental attachment to the debtor.¹³⁹ By exemption, we mean property that is exempt from the bankruptcy estate. 'All states have

¹³³ *ibid.*

¹³⁴ *ibid.*

¹³⁵ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 88.

¹³⁶ *ibid.*, 89.

¹³⁷ Stephen L. Sepinuck, Gregory M. Duhl, *Problems and Materials on Bankruptcy Law and Practice* (3rd edn., 2017, West Academic Publishing), 30.

¹³⁸ 'Only 7% (169) of the 2,500 individual Chapter 7 cases examined were asset cases.'; Dalie Jimenez, 'The Distribution of Assets in Consumer Chapter 7 Bankruptcy Cases' (2009) 83 Am Bankr LJ 795, 800.

¹³⁹ Stephen L. Sepinuck, Gregory M. Duhl, *Problems and Materials on Bankruptcy Law and Practice* (3rd edn., 2017, West Academic Publishing), 137.

exemption laws that operate outside of bankruptcy, which shield certain assets of individual debtors from creditor collection efforts.¹⁴⁰

Exemptions can be used by debtors in Chapter 7 and Chapter 13, each state has its own exemptions but there are also federal exemption rules.¹⁴¹ In some states, debtors can choose between federal and state exemptions, but they should take into account that once they choose a set of exemptions they cannot apply some exceptions from the other set.¹⁴² The most important for individuals is a “homestead” exemption.¹⁴³ We can say, that the “homestead” exemption gives individuals the opportunity not to stay homeless and retain a “fresh start”.

Example of federal exemptions is: “homestead” - 27 900 \$; jewelry – 1 875 \$; household goods – 14 875 \$ (per item up to 700 \$); motor vehicle – 4 450 \$.¹⁴⁴

3.5. Dismissal of Chapter 7 Case and “Means Test”

A Chapter 7 liquidation case may be dismissed for “cause” as the Bankruptcy Code states.¹⁴⁵ The term “cause” is not defined by the code, but statutorily given examples show that a case can be dismissed because of the lack of debtor’s cooperation to support the filing.¹⁴⁶ If it will be defined holistically, looking at the whole code and its history then it can be said that the case cannot be dismissed for cause because of the debtor’s ability to pay creditors out of future

¹⁴⁰ Charles J. Tabb, 'The Top Twenty Issues in the History of Consumer Bankruptcy' (2007) 2007 U Ill L Rev 9, 14.

¹⁴¹ < <https://www.justia.com/bankruptcy/exemptions/> > (accessed 3 June 2023).

¹⁴² < <https://www.justia.com/bankruptcy/exemptions/> > (accessed 3 June 2023).

¹⁴³ David G. Epstein and others, *Bankruptcy: Dealing with Financial Failure for Individuals and Businesses* (4th edn., 2015, West Academic), 165.

¹⁴⁴ ‘These values are current as of 2022. Federal bankruptcy exemption values adjust every three years.’, < <https://www.justia.com/bankruptcy/exemptions/federal-bankruptcy-exemptions/> > (accessed 3 June 2023).

¹⁴⁵ U.S. Bankruptcy Code, paragraph 707 (a); *See generally* Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 167.

¹⁴⁶ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 168.

earnings.¹⁴⁷ The 1978 Code's intent was to permit debtors to choose under which Chapter to proceed not looking at the future income and ability to pay the creditors out of it.¹⁴⁸

Since 1984 the courts could dismiss Chapter 7 cases if they found "substantial abuse" and there was a presumption in favor of granting relief to the debtors.¹⁴⁹ In 2005, with the enactment of BAPCPA, the test changed to simple "abuse", also the presumption in favor of the debtor was eliminated and individual debtors now have to go through the "means test" in order to decide whether their case should be dismissed as abusive or not.¹⁵⁰

In order to establish abuse with means tests, the debts should be primarily consumer debts.¹⁵¹ There are 2 stages of the means test: firstly, the debtor's monthly income is compared to the median monthly income in the state, where the debtor resides depending on the household size (adjusted to it); if it is below the median the presumption of abuse does not arise and the debtor can proceed in Chapter 7.¹⁵² If the debtor's income is more than the median income 'The court calculates the debtor's disposable income by reducing the debtor's "current monthly income" by certain specified deductions for living expenses.'¹⁵³ Then it is calculated what repayment capacity the debtor has over the next 5 years period.¹⁵⁴ If the debtor can repay 25% of his unsecured claims or 6 000 \$ (whichever is greater); or 10 000\$ there is an abuse.¹⁵⁵ It means, that if disposable income in the next 60 months is less than 6 000 \$, the presumption of abuse

¹⁴⁷ *ibid*, 169.

¹⁴⁸ *Ibid*.

¹⁴⁹ Stephen J. Spurr & Kevin M. Ball, 'The Effects of a Statute (BAPCPA) Designed to Make It More Difficult for People to File for Bankruptcy' (2013) 87 Am Bankr LJ 27, 30.

¹⁵⁰ *ibid*.

¹⁵¹ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 172.

¹⁵² Stephen J. Spurr & Kevin M. Ball, 'The Effects of a Statute (BAPCPA) Designed to Make It More Difficult for People to File for Bankruptcy' (2013) 87 Am Bankr LJ 27, 30.

¹⁵³ *ibid*, 30-31.

¹⁵⁴ Bankruptcy Code, paragraph 707(b) (2)(A)(i), <
<https://uscode.house.gov/view.xhtml?hl=false&edition=2021&req=granuleid%3AUSC-prelim-title11-section707&num=0> > (accessed 3 June 2023).

¹⁵⁵ Bankruptcy Code, paragraph 707(b) (2)(A)(i), <
<https://uscode.house.gov/view.xhtml?hl=false&edition=2021&req=granuleid%3AUSC-prelim-title11-section707&num=0> > (accessed 3 June 2023).

does not arise, but if it is more than 10 000 \$ the presumption arises.¹⁵⁶ And if the disposable income for the next 60 months is between 6 000 \$ and 10 000 \$ if it is sufficient to at least pay 25 % of the debtor's nonpriority, unsecured claims, then there is a presumption of abuse.¹⁵⁷ In case of presumption of abuse, the case can be dismissed, or with the debtor's consent, it can be converted to Chapter 13 or Chapter 11 case.¹⁵⁸

The presumption of abuse can be rebutted, the courts may consider the totality of the circumstances and the good faith of the debtor.¹⁵⁹ 'Even if the presumption of abuse does not arise or is rebutted, the court may dismiss the chapter 7 case if the "totality of the circumstances" demonstrates abuse or the debtor filed the petition "in bad faith."'¹⁶⁰

3.6. Exceptions from Discharge

Even when the debtor receives the discharge, it does not free him from all the obligations.¹⁶¹ Firstly, we should keep in mind that bankruptcy discharges obligations and that the obligation should fit in the code's definition of "debt", but since this definition is quite broad almost all obligations can fit in it.¹⁶² Also, it is necessary that the debt should have arisen before the bankruptcy.¹⁶³ But it is evident, that not all debts can be discharged – paragraph 523 of the

¹⁵⁶ Numbers are adjusted based on the current Bankruptcy Code; See Stephen L. Sepinuck, Gregory M. Duhl, *Problems and Materials on Bankruptcy Law and Practice* (3rd edn., 2017, West Academic Publishing), 46.

¹⁵⁷ Stephen L. Sepinuck, Gregory M. Duhl, *Problems and Materials on Bankruptcy Law and Practice* (3rd edn., 2017, West Academic Publishing), 46.

¹⁵⁸ Bankruptcy Code, paragraph 707(b) (1), < <https://uscode.house.gov/view.xhtml?hl=false&edition=2021&req=granuleid%3AUSC-prelim-title11-section707&num=0> > (accessed 4 June 2023).

¹⁵⁹ Stephen L. Sepinuck, Gregory M. Duhl, *Problems and Materials on Bankruptcy Law and Practice* (3rd edn., 2017, West Academic Publishing), 45.

¹⁶⁰ Stephen J. Spurr & Kevin M. Ball, 'The Effects of a Statute (BAPCPA) Designed to Make It More Difficult for People to File for Bankruptcy' (2013) 87 Am Bankr LJ 27, 31.

¹⁶¹ David G. Epstein, *Bankruptcy and Related Laws in a Nutshell* (9th edn., 2017, West Academic Publishing), 243.

¹⁶² *ibid.*

¹⁶³ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 946.

Bankruptcy Code sets out detailed rules about obligations which are exceptions to discharge. It is no surprise, that certain taxes are non-dischargeable because of their public nature,¹⁶⁴ even if a debtor incurs credit card debt in order to pay non-dischargeable taxes, the portion of the debt which was used to pay them will be excepted from discharge.¹⁶⁵ Also, debts based on fraud are excepted from discharge, in order to protect innocent parties.¹⁶⁶ The debtor has to schedule a debt in order for the court to inform the creditors, unscheduled debts are not discharged.¹⁶⁷

Debts incurred for ‘fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny’ are not dischargeable.¹⁶⁸ Debts arising from ‘willful or malicious injury’ are also exempt from discharge.¹⁶⁹ Governmental fines and penalties, criminal restitutions, and educational loans are nondischargeable.¹⁷⁰ It is clear that Congress keeps adding exceptions, there are nineteen exceptions in paragraph 523 and several more exclusions in the other parts of the code.¹⁷¹ We should also mention, that discharge does not protect co-debtors and has no effect on liens.¹⁷²

¹⁶⁴ See generally *ibid*, 967.

¹⁶⁵ David G. Epstein, *Bankruptcy and Related Laws in a Nutshell* (9th edn., 2017, West Academic Publishing), 246.

¹⁶⁶ See generally Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 970.

¹⁶⁷ See generally *ibid*, 979.

¹⁶⁸ U.S. Bankruptcy Code, paragraph 523 (a) (4), < <https://uscode.house.gov/view.xhtml?req=granuleid:USC-prelim-title11-section523&num=0&edition=prelim> > (accessed 5 June 2023).

¹⁶⁹ See generally Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 985.

¹⁷⁰ See generally *ibid*, 990-992.

¹⁷¹ *ibid*, 999; See also < <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/discharge-bankruptcy-bankruptcy-basics> > (accessed 5 June 2023).

¹⁷² David G. Epstein, *Bankruptcy and Related Laws in a Nutshell* (9th edn., 2017, West Academic Publishing), 255-56.

3.7. Chapter 13 – Adjustment of Debts of an Individual with Regular Income

Chapter 13 is intended as a rehabilitation for individual consumer debtors.¹⁷³ It permits the debtor to retain the property and repay the creditors according to the plan approved by the court over three to five years.¹⁷⁴ Before the enactment of the means test, it was generally used by those, who would lose assets in Chapter 7 liquidation proceedings.¹⁷⁵ So, the debtors were using it mainly to retain their assets, but after the enactment of the means test many debtors are imposed to proceed under Chapter 13.¹⁷⁶ An individual is eligible for the Chapter 13 if his combined total debts (secured and unsecured) are less than 2 750 000 \$.¹⁷⁷

Chapter 13 was often referred to as the “wage earners” plan, but now any individual with regular income can file for bankruptcy under Chapter 13.¹⁷⁸ It is important to highlight, that unlike Chapter 7, Chapter 13 can be only voluntary, but the debtor can be forced to go under the given chapter if his liquidation case is dismissed or if it is converted to Chapter 11 reorganization.¹⁷⁹

The main feature of the given chapter is that the property remains in possession of the debtor even though it becomes the property of the estate.¹⁸⁰ Also, a trustee mainly has an administrative function – to pay the creditors the money paid by the debtors according to the court-approved plan.¹⁸¹

¹⁷³ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 1208.

¹⁷⁴ *ibid*, 1208.

¹⁷⁵ JONATHAN D. FISHER, ‘Who Files for Personal Bankruptcy in the United States?’, *Journal of Consumer Affairs* Vol53, N4, 2003, 2005.

¹⁷⁶ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 99.

¹⁷⁷ 11 U.S.C. § 109(e).

¹⁷⁸ David G. Epstein and others, *Bankruptcy: Dealing with Financial Failure for Individuals and Businesses* (4th edn., 2015, West Academic), 237.

¹⁷⁹ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 1219.

¹⁸⁰ *ibid*, 100.

¹⁸¹ *ibid*, 1221.

Under Chapter 13 the creditor voluntarily files for relief with the repayment plan and the court has the authority to confirm it.¹⁸² The court examines the plan according to the “best interests test”, which requires debtors to pay the creditors no less than what they would receive in Chapter 7.¹⁸³ While calculating this the court deducts all the costs that would be incurred in Chapter 7, like costs of administration and professionals the trustee will hire in case of liquidation.¹⁸⁴

Unlike in Chapter 7, here debtor bears the cost of the statutory commission towards the trustee, which is limited to the maximum of 10% of the distributions to be made under the plan.¹⁸⁵ Also, inflation should be taken into account, because 100 \$ now is not equal to 100 \$ after three or five years.¹⁸⁶ The courts are very inconsistent with calculating interest over the amount that would have been distributed under liquidation, some apply market rate, others contract rate or interest that applies to judgments.¹⁸⁷

There is a risk that during the period of the plan the debtor’s financial situation, particularly income may change or debtors may have some unexpected expenses, what may affect the whole plan.¹⁸⁸ The abovementioned is the reason why many plans fail.¹⁸⁹ ‘In recognition of this reality, the bankruptcy court for the Southern District of Texas undertook a coordinated effort to find a solution consistent with the Bankruptcy Code that would increase the success

¹⁸² *ibid*, 1228-29.

¹⁸³ David G. Epstein and others, *Bankruptcy: Dealing with Financial Failure for Individuals and Businesses* (4th edn., 2015, West Academic), 243.

¹⁸⁴ *ibid*, 243.

¹⁸⁵ David R. Jones, 'Savings: The Missing Element in Chapter 13 Bankruptcy Cases' (2018) 26 Am Bankr Inst L Rev 243, 250.

¹⁸⁶ David G. Epstein and others, *Bankruptcy: Dealing with Financial Failure for Individuals and Businesses* (4th edn., 2015, West Academic), 243.

¹⁸⁷ *ibid*.

¹⁸⁸ David R. Jones, 'Savings: The Missing Element in Chapter 13 Bankruptcy Cases' (2018) 26 Am Bankr Inst L Rev 243, 245-46.

¹⁸⁹ *See ibid*, 253.

of Chapter 13 plans.’¹⁹⁰ They started the a related savings program on January 1, 2015.¹⁹¹ Participating in that savings program is voluntary and the debtor can allocate these savings to the trustee, the savings do not have to be the same amount and consistent and they are returned to the debtors after the conclusion of the plan.¹⁹² These savings are used to pay the creditors in case the debtors fail to comply with the plan due to some reason.¹⁹³ It is clear that this saving plan is a creative invention for the benefit of the debtors.

Discharge under Chapter 13 is granted after the debtor completes the payments according to the plan.¹⁹⁴ 1978 Code offered the debtors in Chapter 13 “super-discharge”, meaning discharging debts not dischargeable in Chapter 7, in order to give incentives for them to file under the given chapter.¹⁹⁵ Almost all debts not dischargeable under Chapter 7 are also nondischargeable under Chapter 13, the only important difference is that in Chapter 13 a non-fraudulent tax claim is dischargeable.¹⁹⁶

The debtor may receive a “hardship” discharge in case he cannot complete the payments under the plan and it is due to the circumstances he should not be held accountable for.¹⁹⁷ Also, the creditors should have received as much as they would under Chapter 7 liquidation.¹⁹⁸ Under the “hardship” discharge only the debts dischargeable under Chapter 7 are discharged.¹⁹⁹

¹⁹⁰ David R. Jones, 'Savings: The Missing Element in Chapter 13 Bankruptcy Cases' (2018) 26 Am Bankr Inst L Rev 243, 253.

¹⁹¹ *ibid*, 256.

¹⁹² *ibid*, 253-55.

¹⁹³ *ibid*, 253.

¹⁹⁴ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 102.

¹⁹⁵ Charles J. Tabb, 'The Top Twenty Issues in the History of Consumer Bankruptcy' (2007) 2007 U Ill L Rev 9, 22.

¹⁹⁶ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 102.

¹⁹⁷ *ibid*, 1027.

¹⁹⁸ *ibid*.

¹⁹⁹ U.S. Bankruptcy Code, paragraph 1328(b)(2), < <https://uscode.house.gov/view.xhtml?req=granuleid:USC-prelim-title11-section1328&num=0&edition=prelim> > (accessed 7 June 2023).

Generally, in a Chapter 13 plan debtor can propose modifications about the secured claim, but the holders of the claim should agree to these modifications in order the plan to be confirmed.²⁰⁰ Although, the court can confirm the plan even if the creditor of the secured claim does not agree with it as long as the amount to be paid to him is equal to the collateral which is used as a security.²⁰¹ With the help of “cram down” debtor does not have to obtain secured creditors’ consent and the court can confirm the plan without their consent.²⁰²

The court can “cram down”²⁰³ or particularly “strip down”²⁰⁴ the amount ‘to be paid to the holder of secured debt to the value of its collateral.’²⁰⁵ The court cannot do this if the collateral is the automobile of personal use or if there is a home mortgage.²⁰⁶ Also, the debtor would have to pay interest on the value of the collateral, because of the inflation.²⁰⁷ It is interesting how this rate is calculated. In the case *Till v. SCS Credit Corp.* the court of appeals stated, that the appropriate interest rate for “cram down” in Chapter 13 should be calculated with a specific “formula”, which should be based on the national prime rate²⁰⁸ and it should be adjusted by the risk of nonpayment by the debtors.²⁰⁹

²⁰⁰ David G. Epstein, *Bankruptcy and Related Laws in a Nutshell* (9th edn., 2017, West Academic Publishing), 273.

²⁰¹ *ibid*, 274-75.

²⁰² Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 1263.

²⁰³ Bankruptcy lawyers, judges and professors use this term to describe court approval of the plan that affects the changes in the claim without the approval of the claim holder, *See David G. Epstein*, *Bankruptcy and Related Laws in a Nutshell* (9th edn., 2017, West Academic Publishing), 274.

²⁰⁴ “Strip down” is one form of the “cream down”, *David G. Epstein*, *Bankruptcy and Related Laws in a Nutshell* (9th edn., 2017, West Academic Publishing), 275.

²⁰⁵ David G. Epstein, *Bankruptcy and Related Laws in a Nutshell* (9th edn., 2017, West Academic Publishing), 274-75.

²⁰⁶ *ibid*, 277.

²⁰⁷ *ibid*, 276.

²⁰⁸ Prime rate is the interest that banks charge to creditworthy commercial clients.

²⁰⁹ *Till v. SCS Credit Corp.* - 541 U.S. 465, 124 S. Ct. 1951 (2004).

3.8. Chapter 11 – Reorganization

Chapter 11 is generally referred to as the business reorganization chapter.²¹⁰ But Chapter 11 is not only limited to business debtors, the U.S. Supreme Court in *Toibb v. Radloff* stated that individuals who are not engaged in business can file for bankruptcy under Chapter 11.²¹¹ Generally, individual Chapter 11 case looks like Chapter 13, but there are some major differences in procedure.²¹² Some even refer to it as “big Chapter 13”, but it is an oversimplification.²¹³

We can say that for the debtors who are not eligible either in Chapter 7 or Chapter 13, reorganization is the only way to go. It is accepted that most individual debtors file under Chapter 11 because in Chapter 13 the debt limit is the barrier for them.²¹⁴ In Chapter 11, unlike Chapter 13 creditors enjoy the right to vote for the plan, so influence the plan quite a lot.²¹⁵ Also, Chapter 11 can be voluntary and involuntary, unlike Chapter 13.

‘With BAPCPA, Congress made significant changes to the Code's treatment of Chapter 11 debtors.’²¹⁶ In many respects individual Chapter 11 case procedures are modified to look much like Chapter 13, the discharge is granted only after the completion of the plan.²¹⁷ Before BAPCA discharge was typically granted at the time of confirmation of the plan.²¹⁸ The specific treatment of individuals under Chapter 11 makes some think, that the only difference between

²¹⁰ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 92.

²¹¹ *Toibb v. Radloff*, 501 U.S. 157 (1991).

²¹² David G. Epstein, *Bankruptcy and Related Laws in a Nutshell* (9th edn., 2017, West Academic Publishing), 348-49.

²¹³ Anne Lawton, 'The Individual Chapter 11 Debtor Pre- and Post-BAPCPA' (2015) 89 Am Bankr LJ 455, 476.

²¹⁴ *ibid*, 468.

²¹⁵ Charles Jordan Tabb, *Law of Bankruptcy* (fifth edition, 2020, West Academic Publishing), 1216.

²¹⁶ Anne Lawton, 'The Individual Chapter 11 Debtor Pre- and Post-BAPCPA' (2015) 89 Am Bankr LJ 455, 462.

²¹⁷ Eugene R. Wedoff, 'Major Consumer Bankruptcy Effects of BAPCPA' (2007) 2007 U Ill L Rev 31, 65.

²¹⁸ Robert J. Landry II., 'Individual Chapter 11 Reorganizations: Big Problems with the New Big Chapter 13' (2007) 29 UALR L Rev 251, 273.

it and Chapter 13 is debt limitations, however, it is not true.²¹⁹ For example, in Chapter 13 debtors should receive a course of financial education in order to receive a discharge, no such requirement applies in reorganization.²²⁰

Surprisingly, individuals make 30% of all Chapter 11 filings.²²¹ Almost half of the individual debtors in 2013 had liabilities below Chapter 13 limits, but still chose to file under Chapter 11, maybe because they thought rules governing individual reorganizations would be a better fit for their cases.²²² Individuals in Chapter 11 seem more likely to operate businesses, have a higher debt-to-income ratio, and have much more household income, but on the other hand, also have much more expenses.²²³ That shows that their cases seem more complicated, therefore they do not want to comply with Chapter 13 tight deadlines, they have substantial real estate and home mortgages, so maybe they want to extend plans beyond five years.²²⁴

3.9. Student Loans

The 1978 Bankruptcy Code stated that educational loans²²⁵ were nondischargeable unless “undue hardship” was proved.²²⁶ Student loans are not dischargeable under any chapter up until today. Both private and federal student loans are protected with nondischargeability.²²⁷ The

²¹⁹ Bruce A. Markell, 'The Sub Rosa Subchapter: Individual Debtors in Chapter 11 after BAPCPA' (2007) 2007 U Ill L Rev 67, 79.

²²⁰ *ibid*, 81.

²²¹ Richard M. Hynes, Anne Lawton & Margaret Howard, 'National Study of Individual Chapter 11 Bankruptcies' (2017) 25 Am Bankr Inst L Rev 61, 65.

²²² *ibid*, 164.

²²³ *ibid*, 66.

²²⁴ *ibid*, 164.

²²⁵ The terms “student loans” and “educational loans” are used interchangeably in legal literature, the code uses term “educational”.

²²⁶ Colin A. Keith, 'A Forced Crisis: Why Student Loan Debt Should Be Separately Classified under Chapter 13 Bankruptcy Plans' (2020) 44 Del J Corp L 249, 253.

²²⁷ Aaron N. Taylor & Daniel J. Sheffner, 'Oh, What a Relief It (Sometimes) Is: An Analysis of Chapter 7 Bankruptcy Petitions to Discharge Student Loans' (2016) 27 Stan L & Pol'y Rev 295, 303.

court of appeals set the requirements that are needed to establish “undue hardship” in order to discharge student loans in *Brunner v. New York State Higher Educ. Servs. Corp.*²²⁸ ‘While this standard does not require the debtor to live in poverty, it subsequently does not allow for luxury expenses, and once the debtor had paid all necessary expenses, excess financial resources should be used to satisfy student loan debt.’²²⁹

In the court of appeals case *In Re Mosley*, the debtor got injured in the U.S. Army Reserve mission, and after that, he was living with his mother, his only income was disability benefits from the Veterans’ Administration, also he had to take antidepressant medications and was unable to work where lifting heavy things were required (which were basically the majority of jobs available to him).²³⁰ He was discharged from debts under Chapter 7, but still had to repay student loans and required the “hardship discharge”.²³¹ The court stated, that to establish “hardship discharge” it should be shown that: 1. ‘The debtor cannot maintain, based on current income and expenses a “minimal” standard of living.’; 2. ‘The additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans’ and 3. ‘that the debtor has made good faith efforts to repay the loans.’²³² The court of appeals affirmed the lower court’s discharge of student loans and so, the debtor was discharged of student loans based on “hardship”.

²²⁸ *Brunner v. N.Y. State Higher Educ. Servs. Corp.* - 831 F.2d 395 (2d Cir. 1987); Colin A. Keith, 'A Forced Crisis: Why Student Loan Debt Should Be Separately Classified under Chapter 13 Bankruptcy Plans' (2020) 44 Del J Corp L 249, 254.

²²⁹ Colin A. Keith, 'A Forced Crisis: Why Student Loan Debt Should Be Separately Classified under Chapter 13 Bankruptcy Plans' (2020) 44 Del J Corp L 249, 255.

²³⁰ *In re Mosley*, 494 F.3d 1320 (11th Cir. 2007).

²³¹ *ibid.*

²³² *ibid.*

3.10. Retirement Contributions

Retirement contribution plans, referred to as 401(k) plans are very popular in the U.S.²³³ The problem that arises in bankruptcy is whether these voluntary retirement contributions should be excluded from disposable income.²³⁴ This disposable income is used to calculate how much can you pay to your debtors in Chapter 13.²³⁵

There are 3 approaches the courts use: 1. All post-petition contributions are included in disposable income; 2. Only the amount contributed before filing the case is permitted to be contributed again and so not be considered in disposable income; and 3. Both post and pre-petition contributions are excluded from projected disposable income as long as the debtor's "good faith" is seen.²³⁶

Some think, that the approach taken by the court of appeals in *Davis v. Helbling* that 'voluntary retirement contributions, only in the amount made before filing, are excluded from disposable income' is the approach that should be followed.²³⁷ There is logic in this approach because a person who was making retirement contributions in order to have savings when he is retired should have the right to do it even under bankruptcy, but of course, it can be limited by bankruptcy legislation to reasonable extents. Overall, it is clear that statutory reform is needed to regulate the abovementioned issues, otherwise, courts should follow one approach-preferably the one taken in *Davis v. Helbling*.²³⁸

²³³ Julie Aberasturi, 'Trouble with BAPCPA: A Call for Statutory Reform regarding Retirement Contributions in Chapter 13 Bankruptcy Plans' (2022) 30 Am Bankr Inst L Rev 279, 280.

²³⁴ *ibid*, 282.

²³⁵ See definition of disposable income - U.S. Bankruptcy Code, paragraph 1325(2).

²³⁶ Julie Aberasturi, 'Trouble with BAPCPA: A Call for Statutory Reform regarding Retirement Contributions in Chapter 13 Bankruptcy Plans' (2022) 30 Am Bankr Inst L Rev 279, 282.

²³⁷ *ibid*, 286; *See Davis v. Helbling* (In re Davis), 960 F.3d 346, 355 (6th Cir. 2020).

²³⁸ *ibid*, 293.

Whether a debtor can exclude voluntary contributions to a retirement plan under Chapter 7 when calculating the income is also an actual question.²³⁹ Whether the exclusion of such contributions constitutes substantial abuse needs the review of the debtor's circumstances.²⁴⁰ In the court of appeals case *Hebbring v. U.S. Trustee* the debtor who filed under Chapter 7 excluded pre-tax deduction for 401(k) plan and after-tax deduction for retirement savings bond.²⁴¹ She was thirty-three years old and had accumulated 6 289 \$ in retirement savings, the court had to decide whether to count this money as necessary expenses when determining if the debtor could pay creditors under Chapter 13.²⁴² The code does not specify which expenses are considered reasonably necessary, so the courts take a case-by-case approach examining each debtor's specific circumstances and deciding if the expense is necessary for the maintenance or support of the debtor.²⁴³ The court of appeals stated, that bankruptcy courts have the discretion in determining whether retirement contributions are reasonably necessary expenses and in doing so, they should take into account: the age and income of the debtor; expected date of retirement; the amount of contributions; overall savings and any other relevant factor.²⁴⁴ It is essential for the debtor to have a chance of a "fresh start".²⁴⁵

Overall, the court found that the retirement contributions made by the debtor were not reasonably necessary expenses because of her age and specific financial circumstances.²⁴⁶ We can say, that the decision is in line with the Code's aim to give debtors a "fresh start", but not to let "can-pay" debtors use bankruptcy and not repay their creditors.

²³⁹ Kenneth W. Clarkson and others, *Business Law: Text and Cases* (11th edn, South-Western) 614.

²⁴⁰ *Ibid.*, 614.

²⁴¹ *Hebbring v. Trustee*, 463 F.3d 902 (9th Cir. 2006).

²⁴² *ibid.*

²⁴³ *ibid.*

²⁴⁴ *ibid.*

²⁴⁵ *ibid.*

²⁴⁶ *ibid.*

3.11. Future Developments

We have already mentioned above, that bankruptcy is an economic and social legislation, so it is no surprise that bankruptcy legislation is often amended with the change in economic and social realities. Last year, The Consumer Bankruptcy Reform Act of 2022 was introduced in congress, which is aiming to make quite big changes in individual bankruptcy in the U.S.²⁴⁷ The most important change is that the bill is set to eliminate multiple forms of consumer bankruptcy and replace them with new Chapter 10.²⁴⁸ The authors of the bill suggest that it will be easier for debtors to go to one chapter than to choose between several chapters.²⁴⁹ Consumers with debts under 7.5 million US dollars will go into two paths under the new chapter, some will get discharged of their debts, and others – with above 135 % of the median income will have to repay partially their creditors.²⁵⁰ Overall, we can say, it will be a modification of Chapters 7 and 13 in one chapter. But there will also be some other changes, student loans and some other no dischargeable debts will be discharged easier.²⁵¹ ‘The bill also would ease debtors’ ability to keep their homes and cars.’²⁵² The bill also removed the requirement of credit counseling and create the Consumer Financial Protection Bureau which would operate like a special ombudsman, taking bankruptcy complaints.²⁵³

Let’s see if the bill will be enacted by Congress and becomes effective legislation, but we should for sure look forward to some amendments in the individual bankruptcy legislation because economic and social situations change very fast and the legislation needs to answer the contemporary needs of the society.

²⁴⁷ < <https://www.congress.gov/bill/117th-congress/senate-bill/4980?s=1&r=96> > (accessed 9 June 2023).

²⁴⁸ < <https://www.kelleylawoffice.com/consumer-bankruptcy-reform-act-of-2022-what-to-know/> > (accessed 9 June 2023).

²⁴⁹ < <https://news.bloomberglaw.com/bankruptcy-law/consumer-bankruptcy-overhaul-envisioned-in-new-bill-explained-1> > (accessed 9 June 2023).

²⁵⁰ *ibid.*

²⁵¹ *ibid.*

²⁵² *ibid.*

²⁵³ *ibid.*

4. CONSUMER INSOLVENCY IN GERMANY

4.1. Short Overview of the German Consumer Insolvency History

Insolvency proceedings in Germany are regulated by the Insolvency Code (InsO) which was enacted in 1994 and went into force on 1 January 1999.²⁵⁴ The last amendment was made on 7 May 2022.²⁵⁵ There are two kinds of insolvency proceedings in InsO: regular insolvency proceedings and consumer insolvency proceedings.²⁵⁶

By the end of the 20th century, household debt was rising and it resulted in the enactment of personal bankruptcy laws in European countries.²⁵⁷ In Germany, they introduced consumer insolvency proceedings in 1999.²⁵⁸ As we see, German consumer insolvency is quite a new phenomenon compared to U.S. individual bankruptcy, which has a history of more than a century.

4.2. Overview and Eligibility for Consumer Insolvency Proceedings

Consumer insolvency proceedings in Germany are divided into three stages: out-of-court debt settlement proceedings, in-court debt settlement proceedings, and consumer insolvency proceedings.²⁵⁹ It is clear, that in consumer insolvency proceedings in Germany, attempting a consensual solution by out-of-court and in-court settlement attempts is mandatory.²⁶⁰

²⁵⁴ See Official English Translation of InsO, < https://www.gesetze-im-internet.de/englisch_inso/englisch_inso.html > (accessed 9 June 2023).

²⁵⁵ *ibid.*

²⁵⁶ Susanne Braun, 'German Insolvency Act: Special Provisions of Consumer Insolvency Proceedings and the Discharge of Residual Debts' (2006) 7 German LJ 59, 61.

²⁵⁷ Mevliyar Er, 'The German Consumer Bankruptcy Law and Moral Hazard – The Case of Indebted Immigrants' (2020) J Financial Regulation and Compliance Vol.28 No.2 161,161.

²⁵⁸ *ibid.*, 162.

²⁵⁹ Braun/Buck, *German Insolvency Code: Article-by-Article Commentary* (2nd edn., 2019, C.H. Beck) 793.

²⁶⁰ Reinhard Bork, *Corporate Insolvency Law: A Comparative Textbook* (2020, Intersentia) 207.

Consumer insolvency proceedings can be opened only if a certificate by a suitable person or agency proves that the debtor attempted to reach an agreement with creditors but failed to do so.²⁶¹ After that, the debtor can file for insolvency proceedings, he should include a plan for the settlement of debts with the application about opening insolvency proceedings.²⁶² Creditors have access to that plan and can object to it.²⁶³ Here, the court tries to mediate, but the debtors generally offer nothing so cannot agree with creditors, because under insolvency proceedings the debtors would have to work for three years and try to pay the creditors that way.²⁶⁴ The creditors afterward vote on the plan like it is in restructuring proceedings, but without having a formal meeting.²⁶⁵

The court opens insolvency proceedings only if both, out-of-court and in-court debt settlement proceedings have failed.²⁶⁶ So, these consumer proceedings are aimed at making the parties reach an agreement.²⁶⁷ ‘Around 1 400 publicly acknowledged and financed credit counseling centers or debtor advisory offices were set up across Germany’ for the purpose of helping debtors find amicable solutions with creditors.²⁶⁸ Their main purpose is to help debtors reach an agreement with creditors in the out-of-court phase.²⁶⁹

In order to qualify for consumer insolvency, the individual debtor should satisfy the code’s requirements set out in InsO.²⁷⁰ Consumer insolvency proceedings apply only to natural

²⁶¹ *ibid*, 207.

²⁶² *ibid*, 207.

²⁶³ *ibid*, 207.

²⁶⁴ Interview with Reinhard Bork, Emeritus Professor, Faculty of Law, Hamburg University (Hamburg, Germany, 21 March 2023).

²⁶⁵ *Ibid*.

²⁶⁶ Braun/Buck, *German Insolvency Code: Article-by-Article Commentary* (2nd edn., 2019, C.H. Beck) 793.

²⁶⁷ Interview with Reinhard Bork, Emeritus Professor, Faculty of Law, Hamburg University (Hamburg, Germany, 21 March 2023), *See also* InsO, Section 287 (2).

²⁶⁸ Mevliyar Er, ‘The German Consumer Bankruptcy Law and Moral Hazard – The Case of Indebted Immigrants’ (2020) *J Financial Regulation and Compliance* Vol.28 No.2 161,167.

²⁶⁹ *ibid*, 167.

²⁷⁰ InsO, Section 304: ‘(1) If the debtor is a natural person who is not self-employed, the general provisions apply to the proceedings, unless otherwise provided under this Part. If the debtor was self-employed, sentence 1 applies if his or her assets are manageable and no claims exist against him or her from the employment.

(2) Assets are manageable within the meaning of subsection (1) sentence 2 only if the debtor has fewer than 20 creditors at the time the request is made to open insolvency proceedings.’

persons who do not pursue self-employed economic activity.²⁷¹ Also, the person should not have pursued self-employed economic activity in the past, meaning entrepreneurs who closed down business shortly before filing for insolvency proceedings.²⁷² On the other hand, InsO lets the debtor who pursued self-employed economic activity file under consumer insolvency proceedings if the debtor has fewer than twenty creditors and there are no employment claims against him.²⁷³ If you meet the requirements of being a consumer you qualify for consumer insolvency proceedings and it does not matter how much income you have.²⁷⁴

Consumer insolvency proceedings are simplified proceedings, they are generally in writing.²⁷⁵ In practice, as a rule, the request for starting the proceedings is filed by the consumers, it is hard to find a creditor who applies for insolvency proceedings against a consumer debtor, because they have no assets and it does not make sense for the creditor to initiate the proceedings.²⁷⁶

4.3. The Procedural Details of Consumer Insolvency

The procedure of consumer insolvency is not as easy as it seems to be, especially because once the debtor is declared bankrupt the trustee is appointed for a period of three years, which supervises the financial affairs of the debtor.²⁷⁷ Even though the proceedings are simplified,

²⁷¹ Braun/Buck, *German Insolvency Code: Article-by-Article Commentary* (2nd edn., 2019, C.H. Beck) 793.

²⁷² Reinhard Bork, *Corporate Insolvency Law: A Comparative Textbook* (2020, Intersentia) 204.

²⁷³ *ibid*, 204.

²⁷⁴ Interview with Reinhard Bork, Emeritus Professor, Faculty of Law, Hamburg University (Hamburg, Germany, 21 March 2023).

²⁷⁵ Braun/Buck, *German Insolvency Code: Article-by-Article Commentary* (2nd edn., 2019, C.H. Beck) 793.

²⁷⁶ Interview with Reinhard Bork, Emeritus Professor, Faculty of Law, Hamburg University (Hamburg, Germany, 21 March 2023).

²⁷⁷ Mevliyar Er, 'The German Consumer Bankruptcy Law and Moral Hazard – The Case of Indebted Immigrants' (2020) *J Financial Regulation and Compliance* Vol.28 No.2 161,166.

standard insolvency proceeding rules apply to consumer insolvency proceedings too, where InsO does not state differently.²⁷⁸

Debtors' assets are sold by the trustee to satisfy the creditors.²⁷⁹ The exempt property that cannot be liquidated is defined by Section 36 of InsO, which also refers to the Code of Civil Procedure.²⁸⁰ Also, if the debtor lives in a rented house or he has rented out his own house the trustee has two choices. Either to continue the rent for the estate or to leave the tenancy agreement to the debtor.²⁸¹ However, in this case, the debtor is obliged to pay the current rent (as opposed to the outstanding rent).²⁸² Otherwise, he or she will be evicted.

In Germany, natural persons who apply for discharge can also apply for the postponement to pay the costs of the proceeding until the discharge is awarded if the debtor's assets are not sufficient to cover the costs.²⁸³ Also, we should mention that debtor faces some disadvantages after the insolvency proceedings, it will be hard for him to enter the general credit protection

²⁷⁸ Braun/Buck, *German Insolvency Code: Article-by-Article Commentary* (2nd edn., 2019, C.H. Beck) 793.

²⁷⁹ Interview with Reinhard Bork, Emeritus Professor, Faculty of Law, Hamburg University (Hamburg, Germany, 21 March 2023).

²⁸⁰ InsO, Section 36: Objects not subject to attachment

(1) Objects not subject to execution do not form part of the insolvency estate. Sections 850, 850a, 850c, 850e, 850f (1), sections 850g to 850l, 851c, 851d, 899 to 904, 905 sentence 1 and 3, and section 906 (2) to (4) of the Code of Civil Procedure apply accordingly. Disposals by debtors of credit on an account which, under the provisions of the Code of Civil Procedure concerning the effects of an account exempt from attachment, is not covered by the attachment, do not necessitate the credit being released by the insolvency administrator in order to be effective.

(2) However, the insolvency estate encompasses

1. the debtor's business records; any legal obligation governing storage of such documents remains unaffected;
2. in the event of the debtor being self-employed, the objects referred to in section 811 (1) no. 1 (b) and the animals referred to in section 811 (1) no. 8 (b) of the Code of Civil Procedure; objects which are needed in order to continue such self-employment which exists to provide personal services are exempt therefrom.

(3) Objects forming part of the debtor's usual household and used in the debtor's household do not form part of the insolvency estate if their disposal would obviously yield no more than proceeds largely disproportionate to their value.

(4) The insolvency court has jurisdiction in respect of rulings as to whether an object is subject to compulsory enforcement in accordance with the provisions specified in subsection (1) sentence 2. Instead of a creditor, the insolvency administrator is entitled to make a request. Sentences 1 and 2 apply accordingly in respect of the opening proceedings.

²⁸¹ InsO, Section 109.

²⁸² *ibid.*

²⁸³ InsO, Section 4a(1); Reinhard Bork, *Corporate Insolvency Law: A Comparative Textbook* (2020, Intersentia) 205.

agency, known as SCHUFA for three years.²⁸⁴ He also will not be permitted to be an executive manager or managing director for some time.²⁸⁵

4.4. Discharge

In Germany, discharge proceedings are connected to insolvency proceedings, and only natural persons are entitled to discharge.²⁸⁶ Unlike the U.S., discharge proceedings in Germany the debtor should apply separately for the discharge.²⁸⁷ Debtor should apply for the discharge simultaneously with the application of insolvency proceedings.²⁸⁸ Even if the creditors have applied for insolvency proceedings, the debtor has to apply for discharge.²⁸⁹ The debtor should apply for discharge within two weeks after being notified about the application of insolvency proceedings against him.²⁹⁰

All debtors can request the discharge of residual debts, even those whose creditors did not receive anything during the insolvency proceedings.²⁹¹ Residual debts are the unsatisfied part of the claims owed by the debtors after the termination of insolvency proceedings.²⁹² Discharge application is not permitted for the debtors if they have been granted a discharge in the past eleven years or if they have been denied a discharge in the past three or five years, depending on what the refusal was based on (sec. 287a (2) InsO).²⁹³

²⁸⁴ Mevliyar Er, 'The German Consumer Bankruptcy Law and Moral Hazard – The Case of Indebted Immigrants' (2020) J Financial Regulation and Compliance Vol.28 No.2 161,167.

²⁸⁵ *ibid*, 167.

²⁸⁶ Reinhard Bork, *Corporate Insolvency Law: A Comparative Textbook* (2020, Intersentia) 194-95.

²⁸⁷ Braun/Pehl, *German Insolvency Code: Article-by-Article Commentary* (2nd edn., 2019, C.H. Beck) 779-80.

²⁸⁸ InsO, Section 287(1).

²⁸⁹ Interview with Reinhard Bork, Emeritus Professor, Faculty of Law, Hamburg University (Hamburg, Germany, 21 March 2023).

²⁹⁰ InsO, Section 287(1).

²⁹¹ Braun/Pehl, *German Insolvency Code: Article-by-Article Commentary* (2nd edn., 2019, C.H. Beck) 779.

²⁹² See Reinhard Bork, *Corporate Insolvency Law: A Comparative Textbook* (2020, Intersentia) 191.

²⁹³ *Ibid*, 196.

After filing for insolvency, there is a compliance period that starts with the opening of insolvency proceedings and runs for three years.²⁹⁴ During this period debtor must cooperate with the trustee and engage or at least try to get engaged in employment activities.²⁹⁵ The part of the income (the legislation defines the sum below which cannot be taken from the debtor) is given to the trustee, which distributes the money among the creditors according to the schedule of the claims.²⁹⁶ If the debtors do not comply with the abovementioned rules the discharge can be denied based on the ordinary creditor's application for a rejection.²⁹⁷ The debtor should only be granted a discharge of residual debt if he fulfilled the requirement and made the necessary sacrifices.²⁹⁸

Discharge in Germany only affects the pre-commencement claims, as it is in the U.S. and other impactful jurisdictions like England and France.²⁹⁹ InsO provides an exhaustive list of claims which are not discharged in Section 302.³⁰⁰ Examples of non-dischargeable claims are fines and damages arising from intentional tort.³⁰¹ Also, third parties are not affected by the discharge.³⁰²

The discharge proceedings in Germany can be seen as a two-part process: firstly, the court decides ex officio whether there is ground to refuse the debtor admissibility to the application

²⁹⁴ *ibid*, 197.

²⁹⁵ *ibid*, 198.

²⁹⁶ *ibid*, 198.

²⁹⁷ *ibid*, 198.

²⁹⁸ Braun/Pehl, *German Insolvency Code: Article-by-Article Commentary* (2nd edn., 2019, C.H. Beck) 780.

²⁹⁹ Reinhard Bork, *Corporate Insolvency Law: A Comparative Textbook* (2020, Intersentia) 200.

³⁰⁰ InsO, Section 302: "The grant of discharge of residual debt leaves the following unaffected:

1. obligations incumbent on the debtor under a tort committed by wanton act, outstanding statutory maintenance arrears which the debtor has intentionally not paid contrary to his or her obligation or tax obligations, insofar as the debtor has been issued with a final sentence in connection therewith for a tax offence under section 370, 373 or 374 of the Fiscal Code; the creditor is to file the corresponding claim in accordance with section 174 (2), stating this legal reason;

2. the debtor's fines and obligations equal to such fines under section 39 (1) no. 3;

3. obligations from interest-free loans granted to the debtor to pay the costs of the insolvency proceedings."

³⁰¹ Braun/Pehl, *German Insolvency Code: Article-by-Article Commentary* (2nd edn., 2019, C.H. Beck) 780.

³⁰² Reinhard Bork, *Corporate Insolvency Law: A Comparative Textbook* (2020, Intersentia) 201.

of discharge and then the actual discharge proceedings begin, with the “period of good conduct”, when the debtor is required to make effort to fulfill the liabilities.³⁰³

Dishonest individuals do not get discharged of their residual debts, they can go through insolvency proceedings and get their assets sold, but the creditors who were not paid from the liquidation of the assets will still have claims against the debtor.³⁰⁴ So, we can say, that it does not make sense for dishonest individuals to file for consumer insolvency. InsO³⁰⁵ gives the detailed grounds for the refusal of discharge and which are generally situations where the debtor is not acting or has not acted in good faith.³⁰⁶ The examples are if the debtor has received a final verdict from an insolvency-related criminal offense or has given false or incomplete information regarding their economic condition in writing to get a loan or grant from the public fund or to avoid payments to them.³⁰⁷ InsO³⁰⁸ also sets out debtors’ obligations during the period of “good conduct” in order to get discharged, because for purposes of discharge debtor’s conduct matters a lot.³⁰⁹

4.5. General Remarks

Some scholars believe that consumer insolvency in Germany is not associated with substantial moral hazard or stigma.³¹⁰ Professor Reinhard Bork agrees with them and states, that it is

³⁰³ Baun/Pehl, *German Insolvency Code: Article-by-Article Commentary* (2nd edn., 2019, C.H. Beck) 779-81.

³⁰⁴ Interview with Reinhard Bork, Emeritus Professor, Faculty of Law, Hamburg University (Hamburg, Germany, 21 March 2023).

³⁰⁵ InsO, Section 290.

³⁰⁶ See Baun/Pehl, *German Insolvency Code: Article-by-Article Commentary* (2nd edn., 2019, C.H. Beck) 783.

³⁰⁷ Reinhard Bork, *Corporate Insolvency Law: A Comparative Textbook* (2020, Intersentia) 196.

³⁰⁸ InsO, Section 295.

³⁰⁹ Baun/Pehl, *German Insolvency Code: Article-by-Article Commentary* (2nd edn., 2019, C.H. Beck) 785.

³¹⁰ Mevliyar Er, ‘The German Consumer Bankruptcy Law and Moral Hazard – The Case of Indebted Immigrants’ (2020) J Financial Regulation and Compliance Vol.28 No.2 161,177.

perceived more as a relief for unfortunate indebted individuals, than a stigma.³¹¹ Numbers also show this trend, in 1999 7 562 consumers filed for bankruptcy; in 2005 – 99 711; in 2010 – 139 110.³¹² Afterward, it began to gradually decrease to 115 269 in 2014.³¹³ In 2018 there were 67 597 individual insolvency cases compared to 19 302 business insolvencies.³¹⁴

Overall we can say that the specific characteristic of German individual insolvency is that it first tries to find an agreement between creditors and the debtor with out-of-court and in-court settlements. It also has strict discharge rules and 3 years discharge period, which was longer - 6 years until 2021.³¹⁵ Also, consumer insolvency and discharge are separate proceedings, which are quite different from the U.S. approach.

When compared to the U.S., we can say that German insolvency has a one-window principle, offering one set of procedures with different steps to everyone satisfying the definition of “consumer” given by InsO, while in the U.S. generally individual debtors are applying to 2 different chapters with a completely different procedure. Also, unlike Germany, in the U.S., there is a homestead exemption so the debtor retains a place to live in order to have a “fresh start”. With all these differences shown we should agree with Professor Reinhard Bork who thinks, that generally, U.S. legal system is more debtor-friendly and German – creditor-friendly.

³¹¹ Interview with Reinhard Bork, Emeritus Professor, Faculty of Law, Hamburg University (Hamburg, Germany, 21 March 2023).

³¹² Mevliyar Er, ‘The German Consumer Bankruptcy Law and Moral Hazard – The Case of Indebted Immigrants’ (2020) J Financial Regulation and Compliance Vol.28 No.2 161,163.

³¹³ *ibid*,163.

³¹⁴ Reinhard Bork, *Corporate Insolvency Law: A Comparative Textbook* (2020, Intersentia) 201.

³¹⁵ Interview with Reinhard Bork, Emeritus Professor, Faculty of Law, Hamburg University (Hamburg, Germany, 21 March 2023).

5. INSOLVENCY SYSTEM IN GEORGIA AND RECOMMENDATIONS FOR THE INTRODUCTION OF AN INDIVIDUAL BANKRUPTCY SYSTEM

5.1. Overview of the Georgian Bankruptcy System³¹⁶

The first piece of legislation on bankruptcy law in Georgia was the 1996 Law of Georgia on Bankruptcy Proceedings.³¹⁷ Then in 2007, it was replaced by the Law of Georgia On Insolvency Proceedings.³¹⁸ The 1996 law stated that bankruptcy proceedings could be opened on an individual person's property or part of his property.³¹⁹ Despite this, there are no cases about it or any scholarly material discussing individual bankruptcy in Georgia, so we can consider it a "dead norm".

The 2007 law stated that it did not regulate insolvency issues of natural persons, except for individual entrepreneurs.³²⁰ The law also required that these individual entrepreneurs should have been established under The Law of Georgia on Entrepreneurs.³²¹ Though, the representatives of the National Bureau of Enforcement have stated that individuals whose obligations had not arisen from entrepreneurial activities have tried to register as individual entrepreneurs and to use insolvency proceedings of the individual entrepreneur in order to stop the enforcement process'.³²² So, some individuals were attempting to misuse the availability of insolvency proceedings for individual entrepreneurs.

There were some other gaps in the 2007 law, according to the Tbilisi city court judge Ketevan Meskhishvili it was especially problematic that the system was balanced in favor of secured

³¹⁶ For the purposes of this thesis U.S. nomenclature will be used, so the term bankruptcy will be used to describe and refer to Georgian system

³¹⁷ See Law of Georgia on Bankruptcy Proceedings, < <https://matsne.gov.ge/document/view/652?publication=8> > (accessed 13 June 2023), (in Georgian).

³¹⁸ See Law of Georgia on Insolvency Proceedings, < <https://matsne.gov.ge/en/document/view/23572?publication=19> > (accessed 13 June 2023).

³¹⁹ Law of Georgia on Bankruptcy Proceedings, Article 2(1).

³²⁰ Law of Georgia on Insolvency Proceedings, Article 2(2)(a).

³²¹ Law of Georgia on Insolvency Proceedings, Article 2(1).

³²² Jaba Gvelebiani, Alexi Kochlashvili, Nana Amisulashvili, Feasibility Study: On the Regulation of Personal Insolvency (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), 2021) 38.

creditors, giving much more protection to them.³²³ In 2018-2020, there was active work on the new bill, that would replace the 2007 law.³²⁴ The main goal was to eliminate the errors and gaps that were in the 2007 law and therefore in practice.³²⁵

On 18 September 2020 Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims was enacted by the Parliament of Georgia and it went into force on 1 April 2021.³²⁶ We can say that the new law aims to be in line with the EU DIRECTIVE 2019/1023.³²⁷ The new law aims to encourage rehabilitation proceedings, also to ensure recognition to all stakeholders' rights and legal interests, as well as to encourage the timely request to open bankruptcy proceedings in courts.³²⁸ With the encouragement of rehabilitation proceedings, more companies should survive and it should influence the overall economy of the country positively.³²⁹

According to current law, it regulates insolvencies of business entities 'established in accordance with the Law of Georgia on Entrepreneurs, except for an individual entrepreneur'.³³⁰ It also states that it "shall not apply to the insolvency of a natural person".³³¹ So, today Georgian legislation does not regulate the insolvency procedures of natural persons, even individual entrepreneurs were taken out of the scope of the new law.³³² Even though the

³²³ Ketevan Meskhishvili and others, 'Basics of Insolvency Proceedings According to the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims' (GIZ, 2021) 12, (in Georgian).

³²⁴ *ibid*, 13.

³²⁵ *ibid*, 13.

³²⁶ *ibid*, 13; See Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims, < <https://matsne.gov.ge/document/view/4993950?publication=0> > (accessed 13 June 2023).

³²⁷ Ketevan Meskhishvili and others, 'Basics of Insolvency Proceedings According to the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims' (GIZ, 2021) 10, (in Georgian).

³²⁸ *ibid*, 13.

³²⁹ *ibid*, 13.

³³⁰ Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims, Article 4(1)(a), < <https://matsne.gov.ge/document/view/4993950?publication=0> > (accessed 13 June 2023).

³³¹ Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims, Article 4(2)(a).

³³² Ketevan Meskhishvili and others, 'Basics of Insolvency Proceedings According to the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims' (GIZ, 2021) 27, (in Georgian)

deputy minister of justice of Georgia confirmed in 2017 that they were considering regulating the insolvency process of natural persons to this day there is not such a regulation.³³³

5.2. The Debtor Registry³³⁴

The Debtor Registry is a systemized electronic database.³³⁵ Its aim is to secure the enforcement of monetary claims, natural and legal persons are registered in that registry right away after they become the target of enforcement proceedings.³³⁶ Debtors against whom the enforcement began after 1 January 2010 are registered in that registry by the National Bureau of Enforcement of Georgia (NBE), and those against whom the enforcement began before that date can be registered by the initiative of NBE.³³⁷ The Debtor Registry is administered by NBE.³³⁸

The debtor is restricted to dispose of the property that he has registered under his name after being registered in the Debtor Registry.³³⁹ The debtor can dispose of the property with the approval of the creditor.³⁴⁰ The debtor's bank accounts are also seized, so this causes a lot of problems, they practically cannot participate in everyday economic activities.³⁴¹ Some argue,

³³³ Business Media Georgia, < <https://bm.ge/en/article/gadaxdisuunaroba-shesadzloa-fizikur-pirebzece-gavrceldes/15059> > (accessed 13 June 2023).

³³⁴ The webpage of the registry, < https://nbe.gov.ge/index.php?sec_id=367&lang_id=ENG > (accessed 13 June 2023).

³³⁵ Law of Georgia on Enforcement Proceedings, Article 19¹(1).

³³⁶ *ibid.*

³³⁷ *ibid.*, Articles 19¹(1) and 19¹(1¹).

³³⁸ *ibid.*, Article 19¹(2).

³³⁹ *ibid.*, Article 19³.

³⁴⁰ *ibid.*, Article 19⁴(3).

³⁴¹ *ibid.*, Article 19²(3).

that it causes debtors to be reluctant to seek employment, thinking that their entire wage will be deducted to repay the debts.³⁴²

The identity of the debtors in the register is public and everyone can access it.³⁴³ We can say, that it is perceived as a bankruptcy stigma to be listed on the Debtor Registry. The debtor can be registered there for 10 years.³⁴⁴ If after 2 years the claim is not enforced because there is no asset from which it can be paid, enforcement will be stopped.³⁴⁵ Although, the creditor can pay every year 200 Georgian Lari and extend the timeframe of enforcement up to a maximum of 10 years.³⁴⁶

So, for 10 years, almost 1/7 of a person's life, the creditors can seek to enforce their claims, and the debtor can be deprived of the will to participate in economic activity or be employed.³⁴⁷ This causes a lot of problems for individuals, apart from the stigma associated with it. As a rule, the indebted individuals are supported by friends, relatives, and neighbors.³⁴⁸ So, we can say, that a quite long enforcement period and debtors' lack of seeking employment cause burdens for the whole society.

³⁴² Jaba Gvelebiani, Alexi Kochlashvili, Nana Amisulashvili, *Feasibility Study: On the Regulation of Personal Insolvency* (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), 2021) 46.

³⁴³ Law of Georgia on Enforcement Proceedings, Article 19¹(4); See the website of Debtors Registry < <http://www.nbe.gov.ge/> > (accessed 13 June 2023).

³⁴⁴ Law of Georgia on Enforcement Proceedings, Article 34(1).

³⁴⁵ *ibid*, Article 35(1¹).

³⁴⁶ *ibid*, Article 35(1²).

³⁴⁷ According to World Health Organization the average life expectancy in 2019 in Georgia was 73,3 years, < <https://data.who.int/countries/268> > (accessed 13 June 2023).

³⁴⁸ Jaba Gvelebiani, Alexi Kochlashvili, Nana Amisulashvili, *Feasibility Study: On the Regulation of Personal Insolvency* (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), 2021) 76.

5.3. Possible Justifications in Support of Introducing Individual Bankruptcy in Georgia

Today in Georgia there is a crisis of credit.³⁴⁹ Natural persons take credits due to different reasons and then to repay them take other credits on worse terms.³⁵⁰ It is stated, that in 2019 there were 158 422 natural persons registered in the Debtor Registry.³⁵¹ It is more dramatic that one-fifth of the workforce in Georgia is either registered in the debtors' registry or on the list of bad debts in the banking sector.³⁵² It is clear that all this impacts the overall economic stability of the country and can have a drastically negative effect over the time. We can also consider that indebted individuals not having possibility to get discharged of their debts and not willing to seek employment thinking that all their income will be used to satisfy the claims against them for a long time may promote the migration of them. Migration of young people is a problem in Georgia.³⁵³ I have an initial hypothesis that not having individual bankruptcy only promotes the migration of young individuals because they seek employment in foreign countries, trying to save their income from Georgian enforcement authorities.

The Constitution of Georgia states, that 'Georgia is a social state'.³⁵⁴ It gives the state responsibility to strengthen social justice and take care that natural persons have 'the

³⁴⁹ Ketevan Meskhishvili and others, 'Basics of Insolvency Proceedings According to the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims' (GIZ, 2021) 27, (in Georgian)

³⁵⁰ *ibid.*

³⁵¹ < http://www.barristers.ge/ge/page/news_item/1388?fbclid=IwAR2moLIT0Y35U7VXBJ6IjX_1X-Lw-GEjEWtY99HYbdSIFWbuJ95TK4GzGU > (accessed 15 June 2023).

³⁵² Jaba Gvelebiani, Alexi Kochlashvili, Nana Amisulashvili, Feasibility Study: On the Regulation of Personal Insolvency (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), 2021) 71.

³⁵³ < <https://www.geostat.ge/en/modules/categories/322/migration> >, the positive migration rate in 2022 can be explained by Russian and Ukrainian emigrants after the war (accessed 15 June 2023).

³⁵⁴ Constitution of Georgia, Article 5: "1. Georgia is a social state.

2. The State shall take care of strengthening the principles of social justice, social equality and social solidarity within society.

3. The State shall take care of the equitable socio-economic and demographic development in the entire territory of the country. Special conditions for the development of high mountain regions shall be determined by law.

4. The State shall take care of human health care and social protection, ensuring the subsistence minimum and decent housing, and protecting the welfare of the family. The State shall promote the employment of citizens. Conditions for providing the subsistence minimum shall be determined by law.

5. The State shall take care of environmental protection and the rational use of natural resources.

6. The State shall take care of the protection of national values, identity and cultural heritage, and of the development of education, science and culture.

subsistence minimum and decent housing’.³⁵⁵ There is no answer in the constitution on how to achieve the goal of the declared social state.³⁵⁶ The state has discretion on how to achieve the abovementioned goals and what to do.³⁵⁷ Constitutional court judges Besarion Zoidze and Ketevan Eremadze think, that the state is obliged to declare social rights by legislation and in case of poverty, providing him with basic means of subsistence.³⁵⁸ Not doing so means that the state does not comply with its declared obligation to be a social state.³⁵⁹

‘Bankruptcy law is social and moral legislation as much as it is economic legislation.’³⁶⁰ We should presume, that having introduced individual bankruptcy in the legislation is part of countries duty taken by declaring in the constitution that it is a social state, and takes care of natural persons’ social rights.

We can also argue, that not having individual bankruptcy provisions can breach Article 9 of the Constitution, which guarantees the protection of human dignity.³⁶¹

According to the modern standards and experience of other countries, it is essential to have the insolvency of natural persons regulated by legislation.³⁶² Also, some think that giving individuals a “fresh-start” incentivizes them to remain economically productive and therefore contribute to the whole society.³⁶³ Introducing individual bankruptcy will have a positive effect

7. The State shall take care of the development of sports, establishing a healthy lifestyle, and engaging children and youth in physical education and sports.

8. The State shall take care of maintaining and developing connections with the homeland for Georgian compatriots residing abroad.”

³⁵⁵ Constitution of Georgia, Article 5(2)and(4).

³⁵⁶ Dissenting opinion of Ketevan Eremadze and Besarion Zoidze on Constitutional Court Case N1/2/434(27 August 2009) (paragraph 9). < <https://constcourt.ge/ka/judicial-acts?legal=1998&fbclid=IwAR1TZPdUdb3Kk7hLWPg50XZuIAfoH4ZQHamU9Zw7Msj-vQjTsyjZJ85krac> > (accessed 14 June 2023).

³⁵⁷ *ibid.*

³⁵⁸ *ibid.*

³⁵⁹ *ibid.*

³⁶⁰ Todd J. Zywicki, 'Bankruptcy Law as Social Legislation' (2001) 5 Tex Rev L & Pol 393, 429.

³⁶¹ Constitution of Georgia, Article 9.

³⁶² Ketevan Meskhishvili and others, '*Basics of Insolvency Proceedings According to the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors' Claims*' (GIZ, 2021) 27, (in Georgian)

³⁶³ Jonathon S. Byington, 'The Fresh Start Canon' (2017) 69 Fla L Rev 115, 121.

on Georgia's economy as a whole if it is regulated properly according to the needs of Georgian social-economic reality.³⁶⁴ All the above mentioned justifies why Georgia should introduce an individual bankruptcy system in the legislation.

5.4. Recommendations to the Georgian Legislator About Key Issues of Individual Bankruptcy

Professor Reinhard Bork states that countries that are about to introduce individual bankruptcy systems should not make it very complicated, on the contrary, they should make it as easy as possible.³⁶⁵ He justifies it by saying that, the individual insolvent debtor's affairs generally are not very complicated, the debtor does not have many assets if anything at all.³⁶⁶ Professor Bork recommends finding an easy discharge solution, which will be fair for the creditors too.³⁶⁷

According to Georgian law on Rehabilitation and the Collective Satisfaction of Creditors' Claims, it does not apply to natural persons and individual entrepreneurs.³⁶⁸ So these individuals' bankruptcy is left without any regulation. There are two options for how to regulate individual bankruptcies: it can be regulated with the general insolvency regulations – as it is in the U.S. and Germany, or a special legal act should be enacted that would regulate individual

³⁶⁴ Jaba Gvelebiani, Alexi Kochlashvili, Nana Amisulashvili, Feasibility Study: On the Regulation of Personal Insolvency (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), 2021) 33, 55.

³⁶⁵ Interview with Reinhard Bork, Emeritus Professor, Faculty of Law, Hamburg University (Hamburg, Germany, 21 March 2023).

³⁶⁶ *ibid.*

³⁶⁷ *ibid.*

³⁶⁸ Georgian Law on Rehabilitation and the Collective Satisfaction of Creditors' Claims, Article 4.

bankruptcies – this approach is taken by Lithuania.³⁶⁹ In Lithuania, individual entrepreneurs registered by the law are also regulated by the same act as legal entities.³⁷⁰

Georgian legislators can consider combining individual bankruptcy provisions in the current law on Rehabilitation and the Collective Satisfaction of Creditors' Claims or enacting a separate legislative act. According to the deputy minister of Justice of Georgia in 2017 they were considering introducing an individual bankruptcy system through separate legal act.³⁷¹ We can say, that since individual bankruptcy is a new phenomenon in Georgian society, it can be regulated by a separate legal act, but it should be strongly in line with the insolvency regime established by the 2020 law. Also, if individual bankruptcy is regulated by separate legal acts individual entrepreneurs should be still regulated with general insolvency regulation. So the new special regulations subjects should be consumer debtors.

The Georgian legislator should also decide whether to introduce one window principle as it is in Germany, where the same provisions apply to all consumer debtor or separate rules should apply to different debtors according to their income, as it is in the U.S. Feasibility Study on the regulation of personal insolvency in Georgia states, that it is better to deal with bankruptcy by rehabilitation and selling assets and discharging debts should be the last resort.³⁷² We can say, that in principle both U.S. and German legislation try to incentivize parties to participate in repayment plans by different means.

³⁶⁹ See generally Lithuanian model on individual insolvency, Jaba Gvelebiani, Alexi Kochlashvili, Nana Amisulashvili, *Feasibility Study: On the Regulation of Personal Insolvency* (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), 2021) 15-20.

³⁷⁰ Jaba Gvelebiani, Alexi Kochlashvili, Nana Amisulashvili, *Feasibility Study: On the Regulation of Personal Insolvency* (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), 2021) 15.

³⁷¹ Business Media Georgia, < <https://bm.ge/en/article/gadaxdisuunaroba-shesadzloa-fizikur-pirebzec-gavrceldes/15059> > (accessed 13 June 2023).

³⁷² Jaba Gvelebiani, Alexi Kochlashvili, Nana Amisulashvili, *Feasibility Study: On the Regulation of Personal Insolvency* (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), 2021) 40.

As we have already stated, the system of individual insolvency should not be very complicated, the legislation can provide for some income threshold according to which the court will decide whether the debtor can repay creditors through a repayment plan, and the natural persons who are above that income threshold should be guided to the provisions that would regulate repayment plan, the others – below that threshold – should be guided to the provisions that would liquidate their assets and distribute the money to creditors on pro-rata basis. So, Georgian legislator can take U.S. approach (see subchapters 3.3. and 3.8.).

The debtor's repayment plan should be denied, if creditors do not get more than they would have gotten in case the debtor's assets were liquidated, as it is in U.S. Chapter 13. It would help to ab initio prevent some abuses by the debtors, which is crucial.

The legislation should provide who is eligible for individual bankruptcy like in Germany InsO provides the definition of consumers (see subchapter 4.2.). Georgian legislators can take the eligibility criteria from InsO. The new law should state that debtor is eligible if he does or did not pursue the self-employed activity. The law can make some exclusions for self-employed persons, whose income is not above some threshold (meaning self-employed individuals with low income).

Discharge of debts for natural persons should be introduced in order to give them a “fresh-start”. The preamble of the new law can state that goal and state that honest but unfortunate debtors should be given a second chance and “fresh-start”. Discharge should be given after individuals complete the repayment plan, like in U.S. Chapter 13, or after the liquidation of their assets. Also, the legislation can give debtors a period of up to three years, like it is in Germany, during which debtors should seek employment in order to at least partially repay their debts. In the Georgian legal community, some believe that introducing an individual bankruptcy system can give irresponsible debtors incentives to take credit without much

thinking and responsibility, thinking that they can use the bankruptcy system opportunistically afterward.³⁷³ Such a “cooling off” period will ensure that such cases are eliminated to a minimum.

Also, it is essential for the government to fund some kind of advertisements – TV and Radio commercials and other means of informational campaign to educate the individual debtors about their rights under the new individual bankruptcy system. They should make sure to highlight that the new system is offered to “honest but unfortunate debtors” and it will not give dishonest individuals an easy way to not fulfill their obligations. Banks and microfinance organizations will start to check credit history and repayment chances more strictly, but the legislators should make sure that there is a balance between creditors and debtors interests and the bank’s requirements are that not overly strict, resulting that no individual is able to take the credit.

In Georgia the courts should have the jurisdiction to grant discharge and filing for the bankruptcy case should automatically turn into discharge proceedings when it is needed. The courts should have jurisdiction over whole individual bankruptcy proceedings. Enacting individual bankruptcy system may result in the large number of cases, that already loaded first instance courts will have to hear. In the U.S. there are special bankruptcy courts, Georgian legislators can also consider establishing special first instance courts for bankruptcy cases or just city courts can hear individual bankruptcy cases too.

There is always some exempt property that is non-dischargeable, Georgian Law on Enforcement Proceedings states such property too and of course it should be taken into account when regulating exempt property of individuals in bankruptcy.³⁷⁴ It states that necessary

³⁷³ Ketevan Meskhishvili and others, *‘Basics of Insolvency Proceedings According to the Law of Georgia on Rehabilitation and the Collective Satisfaction of Creditors’ Claims’* (GIZ, 2021) 27, (in Georgian)

³⁷⁴ Georgian Law on Enforcement Proceedings, Article 45- **“Assets not subject to levy**
1. The following shall be exempted from attachment:

personal and household items, for individuals engaged in agriculture – equipment and tools, the amount of minimum subsistence among others are exempt property, which cannot be taken or liquidated. The subsistence minimum in the April of 2023 in Georgia was 251,8 Georgian Lari.³⁷⁵ We can say, that it is proof of the above-given hypotheses that insolvent individuals in Georgia have no incentives to seek employment, they would not want to work full-time and be left with a subsistence minimum, which will not cover their expenses.³⁷⁶ We can presume, that all the above-mentioned can also give incentives to individuals to seek employment in such jobs, where they can work unofficially, without being registered with the tax authorities and paying taxes, so in the end the country's budget incurs a loss.

New individual bankruptcy legislation should create a little more generous exempt property, and individuals who will be able to participate in repayment plans should be given a chance to use a reasonable part of their income for expenses. The system should not leave individuals to live in poverty, but also it should not necessarily give them the possibility to live in luxury.³⁷⁷

a) personal effects and household items necessary for the debtor's professional activity, personal life and household;

b) four weeks' of food, fuel, and light for the debtor, his/her family and persons living with him/her or the money needed to buy them if there is no such supply for this period of time or they cannot be bought otherwise;

c) small livestock of limited quantity, also one milk cow or the debtor's choice of two pigs, sheep, or goats, if they are necessary to feed the debtor, his/her family and persons living with him; also, three months' supply of forage and dry grass or the money needed to buy them if there is no such supply and it cannot presently be bought otherwise;

d) for persons engaged in agriculture – agricultural equipment and tools, cattle, fertilizers, and agrarian products insofar as they are needed to maintain the debtor, his/her family, and hired workers, or the same and/or similar products until the next crops are harvested from subsequent farming;

e) for persons earning revenues from their physical or mental labour or other activity – the items needed for such activity;

f) special allowances granted by the State;

g) the assets of a family member filed in the integrated database of socially vulnerable families (other than the assets used as security for claims) whose social-economic indicator is lower than the level fixed by the Government of Georgia.

2. The amount of minimum subsistence necessary for a person's daily needs shall be determined as provided by the legislation of Georgia.

3. Discharge from attachment on the grounds indicated above shall apply to revenues below the minimum subsistence.

4. Any dispute concerning the discharge of assets shall be heard judicially.“

³⁷⁵ < <https://www.geostat.ge/en/modules/categories/791/subsistence-minimum> > (accessed 14 June 2023).

³⁷⁶ See Jaba Gvelebiani, Alexi Kochlashvili, Nana Amisulashvili, *Feasibility Study: On the Regulation of Personal Insolvency* (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), 2021) 46.

³⁷⁷ Colin A. Keith, 'A Forced Crisis: Why Student Loan Debt Should Be Separately Classified under Chapter 13 Bankruptcy Plans' (2020) 44 Del J Corp L 249, 255.

In the U.S. there is also homestead exemption³⁷⁸ (see subchapter 3.4.), which can also be considered by Georgian legislators not to leave insolvent debtors without place to live.

The proceedings costs should be also reasonable and in case the debtor gets discharged the proceeding costs should also be discharged as it is in Germany. Also the law may set necessary mediation requirement for the debtors and creditors.

It is important that the legislators come up with a regulation that will keep dishonest debtors from the bankruptcy proceedings. The legislators can take that from German InsO, and keep debtors who are not acted or have not acted with good faith out of bankruptcy proceedings.³⁷⁹

The legislators should also regulate non-dischargeable property exhaustively. They can take into accounts paragraph 523 of the U.S. bankruptcy code or German InsO Section 302, which we have discussed above in detail. Also, the legislator should take into account exempt property declared by the Georgian Law on Enforcement Proceedings.

We can say, that Georgian legislators can also establish some official authority that will be responsible for administrating and managing the individual bankruptcy proceedings as the official authorities do it in the U.S. and Germany. This authorities main function among others should be the liquidation of the debtor's assets or paying the creditors based on the debtors repayment plans. Some argued that the private enforcers or private insolvency practitioners can be more effective and fast solution for administering individual bankruptcy case, but we should keep in mind that many cases are no-asset cases and they will not have financial incentives to manage the cases.³⁸⁰

³⁷⁸ In the U.S. there is a federal homestead exemption of 27 900 \$, it means that debtors house up to this value is exempted and even if it is liquidated the debtors will receive that amount. In case it was used as a collateral than first the secured creditor is payed and then the debtor.

³⁷⁹ German InsO, Section 290.

³⁸⁰ See Jaba Gvelebiani, Alexi Kochlashvili, Nana Amisulashvili, *Feasibility Study: On the Regulation of Personal Insolvency* (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), 2021) 41.

CONCLUSION

The main aim of this thesis was to analyze individual bankruptcy systems in the U.S. and Germany and give recommendations to Georgian legislators about how can Georgia introduce an individual bankruptcy system. Also, to discuss the justifications behind the discharge of individual debtors.

The discharge of individuals is justified by the debtor cooperation theory, also by the impulsive control of individuals, forgiveness and demonstration of mercy toward them, the entrepreneur hypothesis, and the general idea of utilitarianism (see subchapters 2.1 and 2.2.). We also stated, that there is a bankruptcy stigma (see subchapter 2.3.), which is there in every country with different strengths.

In the U.S. individual debtors can file for bankruptcy under Chapters 7, 11, and 13. Generally, individuals file under Chapter 7 – liquidation (see subchapter 3.3), where their assets are sold and creditors are paid from it, or under Chapter 13 – Adjustment of Debt of an Individual with Regular Income (see subchapter 3.7.), where the debtor represents a repayment plan and the court assesses and confirms it, then the debtor pays to the creditors according to the plan for 3 or 5 years. In Chapter 7 the debtor goes through the “means test” (see subchapter 3.5.) which examines, whether he is eligible for Chapter 7. The “Means test” examines debtors by the median monthly income, comparing their income to the state’s median income and disposable income.

In Germany, consumer debtors are offered the possibility to get a discharge of their residual debts (see subchapters 4.2. and 4.4.). The debtors are forced to try to settle with the creditors during the out-of-court and in-court settlement proceedings before the court hears the case. Afterward, the debtor is given 3 years compliance period to seek employment and repay the

creditors. Then if the debtor cannot repay the creditors during that three years his assets are liquidated and the creditors receive the money out of it. The debtor gets discharged but needs to file an application for discharge.

As we have already stated, there is a crisis of credit in Georgia, with 158 422 natural persons registered in the Debtors Registry. In Georgia potentially the creditors can seek enforcement of their claims for 10 years, which is almost 1/7 of an average person's life. Therefore, it is essential to introduce an individual bankruptcy system that will give honest but unfortunate debtors a "fresh start". It will impact the overall economy of Georgia positively and give indebted individuals the incentives to seek employment and become economically active members of society again. It will help not only the indebted individuals but the whole country's economy. Also, we should highlight that the Constitution of Georgia guarantees the social rights of natural persons and social rights include that there is an individual bankruptcy system available (see subchapter 5.3.).

Georgian legislators can create a separate legal act that will regulate the individual bankruptcy system close in line with the insolvency regime of legal entities. We discussed that the two-window principle can be implemented, meaning that debtors with income above some threshold can be imposed to participate in repayment plans, and other assets can be liquidated and distributed to creditors on pro-rata bases. Georgian legislators should pay close attention to how this is regulated in the U.S. – because it's the most tested system and in Germany – because it's one of the most influential civil law legal systems.

The new law should provide an explicit definition of who is eligible for individual bankruptcy proceedings, it should also offer honest debtors discharge of their debts, but keep dishonest debtors away from it. They should also declare non-dischargeable and exempt property and try to keep the balance between the satisfaction of creditors and the basic needs of debtors. The

new law should also establish an authority that will administer and manage individual bankruptcy cases (see subchapter 5.4.).

In addition, it is interesting to see when the individual bankruptcy system will be enacted in Georgia and how it will be regulated. Hopefully, the recommendations of this thesis will be useful for Georgian legislative practice and doctrine and not only for Georgian one.

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