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# **Principles of Debt Restructuring and Restrictions on Initiation of Debt Restructuring Proceedings**

The purpose of this article is to determine the basic principles of debt restructuring proceedings and the content thereof and how these are applied and to research what the basic principles should be for debt restructuring proceedings, alongside what the rules and restrictions should be on the initiation of debt restructuring proceedings. The article compares the regulations enacted in other countries pertaining to release from debt and contrasts these against the Debt Restructuring and Debt Protection Act<sup>\*1</sup> (DRDPA) in force in Estonia and current judicial practice.

## **1. The basic principles of debt restructuring—what they are and what they should be**

According to the views expressed in legal literature<sup>\*2</sup>, the basic principles of debt restructuring can be encapsulated in three tenets:

1. Debt restructuring proceedings shall provide fair and equitable, efficient and cost-effective, accessible and transparent settlement and discharge of consumer debts.
2. They shall propose some form of ‘fresh start’ for the debtor.
3. There shall be equally available options of extra-judicial and judicial proceedings.

In the case of the second and third principle, the consumer may be offered a choice between a payment schedule and immediate release. In both cases, an extended period of insolvency proceedings has no benefit for a debtor without a portion of income against which a claim for payment cannot be made or without prospects for reaching a better financial position within reasonable time. Legislators should offer consumer

<sup>1</sup> Võlgade ümberkujundamise ja võlakaitse seadus ['Debt Restructuring and Debt Protection Act'], entering into force on 5.4.2011. – RT I, 6.12.2010, 1 (in Estonian). English text available via <http://www.legaltext.ee/> (most recently accessed on 30.5.2013).

<sup>2</sup> U. Reifner, J. Niemi-Kiesiläinen, N. Huls, H. Springeneer. *Overindebtedness in European Consumer Law: Principles from 15 European States*. Norderstedt: Books on Demand GmbH 2010, pp. 34–47; INSOL International Consumer Debt Report—report on findings and recommendations (May 2001), pp. 1–31. Available at [www.insol.org/pdf/consdebt.pdf](http://www.insol.org/pdf/consdebt.pdf) (most recently accessed on 30.5.2013).

debtors a discharge of indebtedness as a tailpiece of a liquidation or rehabilitation procedure, yet this should not become an easy way out. For this purpose, some preconditions should be established, but, again for balance, these must not be so high that the debtor loses the courage to enter into the proceedings.<sup>\*3</sup> According to the model set forth by Huls, the debtor and creditors should go to their best efforts to find extra-judicial solutions for the debts and the law should be reformed accordingly to facilitate and strengthen voluntary agreements for the payment of debts, along with official court proceedings that offer a means of escalation in order to encourage extra-judicial arrangements.<sup>\*4</sup> The third principle invites legislators to encourage extra-judicial proceedings for resolution of consumers' debt problems and to support it by offering competent and independent debt-counselling services. The primary advantages of extra-judicial proceedings over court proceedings are decreased costs and duration. Indeed, costs should never prevent a debtor from resolving the debt problems through extra-judicial proceedings.<sup>\*5</sup> Exceptions to this should be established: debts from which release shall not be granted, such as alimony or child support, fines and debts arising from criminal or grossly negligent activities, and accumulation of national taxes and utility costs.<sup>\*6</sup>

According to the legal literature<sup>\*7\*8</sup>, there are three primary issues that can be resolved on the basis of the fundamental principles of debt restructuring laid out above. The first issue is that of conflicting incentives—the less a debtor foresees his solvency improving later, the less motivated he will be to look for a better job in order to earn a larger income or to engage in business and take business-related risks. The reason for this is that the income or profit gained will go to the creditors, whereas it is still unknown whether the debtor will be relieved from the unpaid debts. In this case, the debtor becomes less interested in remaining a productive member of society and may engage in illegal business in order to avoid creditors. The second issue is financial hardship—the debtor may have sufficient income to live and provide for his basic needs, but it is likely that the debtor cannot put all of his income toward paying the debt incurred. Creditors will attempt to impose various statutory measures to seize assets, including income, and this often until the debtor is impoverished. Moreover, frequent meetings between the debtor and creditors demanding the payment of debts may be psychologically oppressive and cause a significant decrease in quality of life. The third issue is financial uncertainty: In societies where the public sense of security stemming from a state of well-being has decreased, the availability of credit has become a means for replacing social insurance. However, a consumer with excessive debt has little or no chance of receiving additional credit. Unforeseen events such as illness or becoming unemployed are followed by financial hardship, and the debtor may have nowhere to turn for help. Even if an unforeseen event does not take place, the uncertainty is greater precisely because of the knowledge that an opportunity to receive additional credit does not exist, and this uncertainty decreases one's quality of life.<sup>\*9</sup>

Access to debt restructuring proceedings should be broad, avoiding obstacles such as minimum levels that exclude the poor and strict application of the test of good faith to the debtor, which eliminates some debtors from consideration in view of subjective normative decisions about their lifestyle. If the legislation provides for termination of the debtor's obligations, there is always a risk of release from debts being too readily accessible to a debtor and of this reducing the debtor's attempts to avoid the occurrence of permanent insolvency in the first place.<sup>\*10</sup>

Western European regulations are based on the principle of attempting to preserve everyone's general moral obligation to pay his debts. It is important to honour agreements and respect the obligation to do so. The objective is to reconcile this principle with the debtor's actual capacity to pay his debts. Western European regulations on release from debt generally do not grant the debtor free access to proceedings for the release from one's debts. This is provided only for natural persons who truly deserve it. A debtor who has irresponsibly created debt is not deemed worthy of being released from that debt.<sup>\*11</sup>

<sup>3</sup> INSOL International (see Note 2), pp. 6, 18, 22–24.

<sup>4</sup> N. Huls *et al.* *Overindebtedness of Consumers in the EC Member States: Facts and Search for Solutions*. Louvain-la-Neuve: Centre de Droit de la Consommation; Diegem: E. Story-Scientia 1994, pp. 218, 224–225, 229–232, 246, 250, 258–262.

<sup>5</sup> INSOL International (see Note 2), pp. 25–27.

<sup>6</sup> N. Huls *et al.* (see Note 4), p. 229.

<sup>7</sup> *Ibid.*, pp. 220–223.

<sup>8</sup> U. Reifner, J. Niemi-Kiesiläinen, N. Huls, H. Springeneer (see Note 2); INSOL International (see Note 2).

<sup>9</sup> J. Niemi-Kiesiläinen, I. Ramsay, W.C. Whitford. *Consumer Bankruptcy in Global Perspective*. Oxford: Hart 2003, p. 4.

<sup>10</sup> *Ibid.*

<sup>11</sup> U. Reifner, J. Niemi-Kiesiläinen, N. Huls, H. Springeneer (see Note 2); INSOL International (see Note 2).

If a debtor is released from debt, the process of that release should ensure that he has learned his lesson for the whole of his life. The purpose is to educate the debtor in the course of the proceedings such that this constitutes the first and only instance of being in such a situation in his entire life. In Western Europe, normally the release from debts is either conditional or not applied before a payment schedule has been honoured in full. This is to ensure that debt restructuring proceedings do not form an easy way out for the debtor and an opportunity to avoid the obligations undertaken.<sup>\*12</sup> For example, in the Netherlands, very poor debtors, whose situation would not enable them to contribute to meeting a normal payment schedule, have been technically shown to complete the scheduled payments but just over several years. As of 2008, one of the preconditions for admission to the proceedings in the Netherlands is that the debtor prove having acted in good faith for the five years prior to filing of the application.<sup>\*13</sup> In Belgium and Luxembourg, debtors who have knowingly caused their own insolvency are excluded from proceedings for release from debt. In contrast, the laws of England, Wales, Germany, and the USA do not set forth conditions precluding the admission of a debtor's application. Since 2005, the USA has used the so-called income test in order to assess the debtor's insolvency and to determine whether the debtor may file an application for directly entering Chapter 7 proceedings under the U.S. Bankruptcy code, as a result of which he is released from debt, or instead must first go through the proceedings for release from debt arising from Chapter 13.<sup>\*14</sup>

The purpose of the DRDPA (as set forth in §1 (1)) is to 'facilitate the restructuring of the debts of a natural person having solvency problems (debtor), in order to overcome the solvency problems and avoid bankruptcy proceedings'. The natural person must himself propose solutions for achieving this. The proceedings may not involve a zero rate; that is, the debtor is required to have an income and actually pay the debts. According to the DRDPA's §2 (1), in debt restructuring proceedings the restructuring of the financial obligations of a debtor is made possible by way of extension of the term for performance of an obligation, by way of agreement on performance of the obligation in instalments, or by way of reduction of the obligation. The above-mentioned conditions are assessed by the creditors and the court both upon initiation of proceedings and upon release from obligations. Through adherence to such criteria, a natural person can avoid permanent insolvency in the meaning of §1 (2) of the Bankruptcy Act. The general principle of debt restructuring proceedings is that creditors should not end up in a significantly worse situation than that in which they would find themselves upon the disposal of the debtor's existing assets in the course of bankruptcy proceedings and in view of the opportunities for gains before any possible release of the debtor from the debt.<sup>\*15</sup>

The author finds that, for resolution of natural persons' debt problems, a balance is needed between the avoidance of over-indebtedness of natural persons and the rehabilitation of their financial position. One possibility for achieving this balance is the writing off of debts, which may be considered the best and most radical way of improving the situation. For this method, it is important to ensure that the release from obligations is not too easily available, since otherwise the debtor is not sufficiently motivated to avoid debt in the first place. Secondly, over-indebtedness may be addressed through education and counselling of the debtor, with the purpose being to inform the debtor of how to avoid debts and consider the limits when taking out credit. The objective must be the rehabilitation of the situation when one focuses on the strategy for handling the case-specific situation of the debtor. In the education and counselling, attention should be paid not only to financial education and improvement of the current situation of the debtor but also to considering the future. From the practice of other countries (mainly Germany and Finland), it is evident that the importance of the social objective related to debt restructuring and release from obligations lies in debt counselling, which exists as a direct legal precondition to the proceedings or a factually unavoidable requirement for them.<sup>\*16</sup> Free debt counselling and its organisation must be considered important, as it is clear that a debtor without assets does not have funds available to pay for procedural

<sup>12</sup> *Ibid.*

<sup>13</sup> A. Noordam's doctoral thesis, defended at Vrije University in Amsterdam in 2007, *Schuldsanering en goede trouw* ['Debt Restructuring and Good Faith']. Available at <http://bobwessels.nl/wordpress/wp-content/uploads/2007/11/summary.pdf> (most recently accessed on 30.5.2013).

<sup>14</sup> J.J. Kilborn. *Still Chasing Chimeras But Finally Slaying Some Dragons in the Quest for Consumer Bankruptcy Reform*. Available at <http://ssrn.com/abstract=1701212> (most recently accessed on 30.5.2013).

<sup>15</sup> Debt Restructuring and Debt Protection Act (see Note 1), p. 15.

<sup>16</sup> J.J. Kilborn. *Expert Recommendations and the Evolution of European Best Practices for the Treatment of Overindebtedness, 1984–2010*. Available at <http://ssrn.com/abstract=1663108> (most recently accessed on 30.5.2013).

expenses, pay for counselling, and/or pay legal fees. Debt restructuring and release from obligations both shall be seen as a part of practical and public social objectives. In the author's opinion, counselling for the debtor should be considered especially important if only for the purpose of supporting him in initiating extra-judicial negotiations with creditors. The debtor would come to an accurate understanding of the obligations involved and the possibilities for fulfilling these obligations within the appropriate constraints of time and place.

In the author's opinion, the objective of the proceedings should be to enable a natural person who is having solvency problems to restructure his debts in order to overcome the solvency problems and avoid bankruptcy proceedings. Access to the proceedings shall be granted to a debtor who has the resources to perform the obligations or the opportunity to earn such resources and who has the knowledge to argue credibly before the creditors that proceedings pursuant to the DRDPA<sup><sup>17</sup></sup> are the best option for both the creditors and himself. The author finds that imposing restrictions on access to debt restructuring proceedings that take place on the initiative of a debtor with the intent to avoid bankruptcy proceedings and the undesirable restrictions related thereto is justified. Imposition of restrictions to access to the proceedings is precisely what enables creditors and the court to ascertain that the natural person wanting to restructure his debt can propose a solution for performance of the obligations and consider the interests of the creditors when doing so. Given the purpose of the act, the initiation of debt restructuring proceedings should signal that the debtor has come to the right conclusions from the solvency problems that have occurred and wishes to learn to cope with the financial obligations that are going to be created in the future and learn to restore his solvency. In this regard, the author finds that pre-trial negotiations should not be imperative but the initiation of negotiations shows the debtor's real intent to find extra-judicial solutions.

## **2. Restrictions on initiating debt restructuring proceedings**

If one is to explain and assess the need for restrictions on initiation of debt restructuring proceedings, it is necessary to be guided by the basic principles of debt restructuring. The legislator has established specification of conditions upon the existence of which it is not permissible to be admitted to debt restructuring proceedings. These restrictions have been set forth in §17 (1) and 17 (2) of the DRDPA. The provisions specified in §17 (1) 1–4) of the DRDPA prohibit the court from accepting the application to be admitted to proceedings on the basis of the circumstances set forth in said provisions. Additionally, the court has been granted a right of discretion pursuant to §17 (2) of the DRDPA (additional grounds for restriction of admission). Pursuant to §10 (1) of the DRDPA, before submitting an application for debt restructuring to a court, a debtor shall take active steps to achieve extra-judicial restructuring of the debt. The debtor is obliged to do everything in his power to come to an extra-judicial agreement with the creditors before submitting an application to the court. As the court has the opportunity to refuse to admit the application for proceedings (pursuant to §17 (2) 2) of the DRDPA) if this provision is not fulfilled, both of these sections shall be discussed jointly in the next part of the article.

### **2.1. Debt counselling and pre-trial negotiations as a restriction on the initiation of proceedings**

Although the debtor has an obligation to do everything in his power to reach extra-judicial agreements with creditors before filing the application, the law does not define the point at which the debtor is deemed to have gone to sufficient efforts to make such agreements, nor does it specify the form for the negotiations or what constitutes 'reasonable time' for attempting to reach agreements with creditors. Uncertainty as to the extent of fulfilment of the provision is evident in judicial practice also. Even if debtors have taken part in (unsuccessful) negotiations prior to filing of the application, their applications have not been admitted

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<sup>17</sup> Debt Restructuring and Debt Protection Act, §§2, 8, 10.

for proceedings. The reasons stated in the court decisions<sup>\*18</sup> have indicated that, in reality, the sending of a few ambiguous e-mail messages or holding a few meetings is not enough and the debtor must present to the creditors all argument on the basis of which the creditor should agree with the debtor's proposal to enter into an agreement for extra-judicially restructuring the debt.

When establishing the prerequisite of pre-trial negotiations, the legislator has considered Western European practice, wherein the emphasis is on the debt-counselling service. The purpose of counselling is the economic education of the debtor, including advisory assistance in discharging the debts, adjusting one's lifestyle, and ensuring rehabilitation of the debtor. Ways of achieving this vary in Western European countries, but generally it is required that the debtor participate in debt counselling and in negotiations with creditors to attempt to resolve the problems extra-judicially before being permitted to file the application. There are various opinions as to the necessity of the stage of negotiations and debt counselling. In Scandinavia, the debt-counselling service is organised by the state or the local government; in Germany, however, this is done by the private sector, receiving support from the state<sup>\*19</sup>. In Estonia, a not-for-profit organisation (Eesti Võlanõustajate Liit, the Estonian Association of Debt Counsellors) has been established to this end, but there is no information as to the success of its activities, so it is impossible to provide an assessment of the functioning of the debt-counselling system. In the author's opinion, the current system is not transparent and its effectiveness cannot be assessed. The author finds that debt counselling should be a social service ensured by the state, in order that effective extra-judicial agreements can be concluded between debtor and creditor.<sup>\*20</sup> In a parallel to the Finnish practice, debt counselling could be organised at the local government level either by creating the respective positions or by outsourcing the service.<sup>\*21</sup>

The debt restructuring regulation is meant to rehabilitate natural persons who are fighting debts and to offer reasonable and realistic reductions of claims to the creditors, not for facilitating the achievement of consensual solutions. The absence of a counselling and negotiation requirement in Denmark is also related to the fact that there is no debt-counselling system with extensive state support in place and no support to facilitate negotiations. Also, J.J. Kilborn has admitted to negative development of counselling and negotiations in the case of the USA, stating that the counselling and negotiations have become pointless.<sup>\*22</sup> In Germany, the attempts at reaching extra-judicial settlements are criticised and called a farce, as debt counselling fails to provide the required help, on account of excessive work loads.<sup>\*23</sup> A court-approved agreement provides a sense of security to the creditor, as enforcement proceedings can be initiated under a court decision if the debtor does not perform his obligation.

It has been ascertained in Western European countries' practice of release from obligations that creditors prefer to act under the supervision of the court, which is why the creditor ends up refusing the debtor's proposals: primarily because the debtor cannot offer them sufficient credibly on conditions favourable to the creditor. In 2007, Sweden abolished the requirement for negotiation, thus following the example of Denmark, because it only protracted the admission to proceedings for release from debt and was a useless waste of labour, one that even the representatives of creditors considered 'almost pointless'<sup>\*24</sup>. Extra-judicial processes may save time and money in cases wherein the creditor can be convinced to accept the compromise, but, as the vast majority of cases reach court in the end, the delays and expenses of the required stage of negotiations are not only useless but also harmful. The purpose should be to reach a solution wherein it would be possible to hold extra-judicial negotiations in cases in which it is suitable and to include

<sup>18</sup> Regulation of the Tartu County Court (TCCr) 7.11.2011, 2-11-51962; regulation of the Harju County Court (HCCr) 5.1.2012, 2-11-63782; TCCr 21.9.2011, 2-11-38724; HCCr 30.8.2011, 2-11-32099; TCCr 10.6.2011, 2-11-21804.

<sup>19</sup> J. Niemi-Kiesiläinen, A.-S. Henrikson. Report on Legal Solutions to Debt Problems in Credit Societies. Strasbourg 11.10.2005. Available at [http://www.coe.int/t/dghl/standardsetting/cdcj/2005/CDCJ-BU%20\\_2005\\_%2011EREV.pdf](http://www.coe.int/t/dghl/standardsetting/cdcj/2005/CDCJ-BU%20_2005_%2011EREV.pdf) (most recently accessed on 30.5.2013).

<sup>20</sup> P. Gottwald et al. *Insolvenzrechts-Handbuch* ['Handbook of Insolvency Law']. Fourth edition. Munich: C.H. Beck 2010, p. 1241.

<sup>21</sup> R. Koulu, E. Havansi, E. Korkea-Aho, H. Lindfors, J. Niemi. *Insolvenssioikeus* ['Insolvency Law']. Third edition. Helsinki: WSOYpro 2009, p. 869.

<sup>22</sup> J.J. Kilborn. *Comparative Consumer Bankruptcy*. Durham, North Carolina: Carolina Academic Press 2007, pp. 20–48; J.J. Kilborn. Twenty-five years of consumer bankruptcy in continental Europe: Internalizing negative externalities and humanizing justice in Denmark. – *International Insolvency Review* 2009/18, pp. 155–186.

<sup>23</sup> P. Gottwald et al. (see Note 20).

<sup>24</sup> J.J. Kilborn (see Note 16).

a counsellor in such cases who would assist the parties in reaching an extra-judicial agreement. In the course of debt restructuring proceedings, existence of a commensurate body should be ensured for debt counselling so that the debtor could receive assistance in resolving the current issues before proceedings commence and also during the proceedings.<sup>\*25</sup> The first obligatory stage in Sweden had been one-on-one negotiations with creditors in co-operation with a counsellor, a system quite similar to that under Dutch regulations. In the second stage, once the negotiations had failed, in the name of co-operating with creditors and finding individual solutions, the creditors applied to the national Executive Office (*Kronofogdemyndigheten*, or KFM) for official release. In this stage, the KFM was also responsible for preparing a payment schedule, which was submitted to the creditors for a vote. Normally, the creditors refused the schedule, which is why in the third stage the Executive Office included the court, to review the schedule and to confirm the debtor's binding payment schedule with the creditors. This is why the compulsory stage of seeking a consensual compromise with the creditors (Stage 1) that applied in Sweden was abolished. Also, the court stage (Stage 3) was removed from the system. The KFM schedules prepared in the second stage were in most cases approved by the court, which made the engagement of the court to approve the schedule a mere formality. The elimination of the court's review obligation has definitely made the system more efficient.<sup>\*26</sup>

All regulations in European practice thus far (except in Denmark and in Sweden as of 2007) demand that the debtors proceed through the negotiations phase with a significant right of discretion. The right of discretion is applied in the proceedings only by the debtor and creditors. Extra-judicial agreements concluded through the assistance of debt counselling are preferred, since the purpose of this approach is to find simpler, faster, and less expensive solutions and to avoid placing a greater burden on the courts.<sup>\*27</sup> The legislators of most European countries have shared the experts' opinion that assistance in getting out of debt should commence at the first opportunity, when moderate intervention and financial counselling may be sufficient for directing the debtor back to the right path. Most European counties offer debt counselling to debtors even though the sources of funding and the possibilities may vary from one country to another. In Southern and Eastern Europe, debt-counselling networks are either non-existent or less developed.<sup>\*28</sup>

The author is of the opinion that a debtor should have access to counselling and that this should not be selective. The debtor should be obliged to include a counsellor who would help the debtor and creditors to focus on finding solutions and direct the parties toward practical solutions, in order to avoid excessive emotions. The same position has been expressed by Kilborn, who finds that this also justifies the debtor bearing the costs related to professional debt counselling, which would help to save the parties' time and eliminate the possibility of later court disputes related to the costs. The counsellor must encourage the debtor and creditors to find solutions also in more complicated cases and this especially for the purpose of the debt counsellor engaged in assessing the case at hand not being hindered by restrictions arising from the law in offering solutions that could result in the court refusing to satisfy the application.<sup>\*29</sup>

The author sees two significant problems. Firstly, too much attention is paid to legal issues in the course of negotiation, while the economic possibilities are neglected. Secondly, the author considers it unreasonable to force debtors into emotional compulsory negotiations, since extra-judicial negotiation should also fulfil procedural purposes—i.e., direct the parties toward extra-judicial agreements. On the other hand, the negotiations may be difficult for the debtor, as the attitudes of one party to another may become an obstacle to finding positive solutions. Accordingly, establishing negotiations as an absolute obligation is not purposeful and the focus should be rather more on the debtor's debt counselling.

<sup>25</sup> *Ibid.*

<sup>26</sup> J.J. Kilborn (see Note 14).

<sup>27</sup> Council of Europe Committee of Ministers. Recommendation CM/Rec(2007)8 of the Committee of Ministers to member states on legal solutions to debt problems. Explanatory Memorandum. Available at <https://wcd.coe.int/ViewDoc.jsp?id=1155927> (most recently accessed on 30.5.2013).

<sup>28</sup> Johannes Gutenberg University. *Debt Advice in Europe*. Available at <http://www.srz.uni-mainz.de/2626.php> (most recently accessed on 30.5.2013).

<sup>29</sup> J.J. Kilborn (see Note 16).

## **2.2. Grounds for refusal to initiate court proceedings as additional restrictions on initiating proceedings**

Subsection 17 (2) of the DRDPA provides seven additional grounds on which the court may refuse to initiate debt restructuring proceedings. In addition, there is another restriction to admission to these proceedings: failure to pay the state fee (DRDPA, §17 (1) 4)). Each of these seven supplementary grounds in itself constitutes sufficient reason for restriction to admission to debt restructuring proceedings; that is, the failure to meet even one of the conditions for admission provides the court with a legal basis for refusing to admit the application. In judicial practice, the supplementary restrictions (DRDPA, §17 (2) 1 and 2)) have become the primary grounds for not initiating proceedings.

The court may refuse to admit an application for proceedings pursuant to §17 (2) 1) of the DRDPA if the approval or implementation of the debt restructuring plan offered by the debtor is unlikely in view of, among other factors, the debtor's solvency status over a period of three years preceding the submission of the debt restructuring application and the debtor's ability to engage in reasonably profitable activity during the term of validity of the debt restructuring plan, in consideration of the debtor's age, profession, and education. In this case, a person requesting admission to proceedings must convince the court that he is suitable for it. This means the debtor making efforts to resolve the debt problems and putting his debts in order (there are no fines, the debtor has not undertaken new obligations irresponsibly, there are no obligations arising from profligate consumption, the debtor does not gamble, etc.).<sup>\*30</sup>

In Estonia, one obstacle for debtors has been the fact that their income, including income that might be earned in the future, is insufficient to satisfy the creditors' claims in an extent that would be satisfactory for them. The debtors' proposals thus far have mostly been unacceptable to the creditors (especially pledgees). Debtors have made proposals under which they would perform their obligations in such a small extent that this would constitute not restructuring of the debts but, in essence, writing off of the debts. The other extreme is debtors filing application according to the data of which they wish to give the whole of their income to satisfy the creditors' claims while not considering their day-to-day expenses.<sup>\*31</sup> Applications of the latter sort indicate that the debtor is incapable of evaluating his income and possibly available resources that could be used for making payments to creditors. Therefore, it would be unreasonable to process debt restructuring applications that are clearly going to fail. The debtor must consider that the payment schedules submitted should ensure that the payment amounts and the duration of the timetable do not eliminate the ability of the debtor and his family, if any, to cater for their basic needs in a manner showing respect for human dignity.<sup>\*32</sup> Finding a solution to the problem comes down to debt counselling that would give the debtor a clear idea of his capacity to perform certain obligations and enable him to judge which proceedings are most suitable for the debtor and creditors for reaching the objectives. In the course of this, it can be determined whether debt restructuring, bankruptcy proceedings, and the subsequent proceedings for release from obligations are suitable or if it is instead possible for the debtor to reach an extra-judicial agreement with the creditors and thus overcome the solvency problems. The author's position is supported by the practice in Finland, where it was clear already in the process of drafting of the debt restructuring act that debtors need competent assistance both with court proceedings and with determining, improving, and planning their financial position in a broader sense and in finding and implementing other solutions than debt restructuring.

Clause §17 (2) 2) of the DRDPA sets forth the obligation of the debtor to hold negotiations with creditors. In the author's opinion, the imperativeness of these negotiations should be lifted at least somewhat and this requirement must not become an obstacle to admission to proceedings. It is difficult to determine when sufficient negotiations have taken place between the debtor and creditor; sometimes a single e-mail message is enough, while in other cases several meetings take place. A study by INSOL International has noted that a debtor who is a natural person must have easy access to the proceedings for release from debts

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<sup>30</sup> J.J. Kilborn (see Note 14).

<sup>31</sup> HCCr 5.1.2012, 2-11-63782; Regulation of the Viru County Court 26.11.2011, 2-11-38844; HCCr 21.6.2011, 2-11-27890; HCCr 11.5.2011, 2-11-18767.

<sup>32</sup> Council of Europe Committee of Ministers. Final Activity Report of the Group of Specialist [sic] for Legal Solutions to Debt Problems (CJ-S-DEBT). Available at [http://www.coe.int/t/dghl/standardsetting/cdcj/CJSDEBT/CJ-S-DEBT%20\\_2006\\_%20Final%20-%20web%20version.pdf](http://www.coe.int/t/dghl/standardsetting/cdcj/CJSDEBT/CJ-S-DEBT%20_2006_%20Final%20-%20web%20version.pdf) (most recently accessed on 30.5.2013).

without numerous or complicated formalities.<sup>\*33</sup> The above-mentioned problem could again be resolved by means of professional and continuous debt counselling. The debtor should be able to obtain assistance from a counsellor, who could also advise the debtor before and during the proceedings in order to achieve the best result for both the debtor and the creditors. Similarly to what is enshrined in the legislation in force in Finland, the debt counsellor's duties should extend beyond the scope of court proceedings. In Finland, a debt counsellor's tasks also include general guidance in managing and handling debt and attempts have been made to emphasise and improve precisely this aspect.<sup>\*34</sup>

A third obstacle to admission to proceedings is the distribution of costs (DRDPA, §17 (1) 4)). According to the INSOL International study, the costs should not hinder access to the proceedings for release from debt. Kilborn also confirms the existence of a problem related to the costs, noting that they have been a direct problem in some Eastern European systems, as these laws generally demand that the debtors pay the costs or prove that they will be able to bear the court expenses and/or fees out of their future income. If this is not the case, the proceedings will be terminated immediately.<sup>\*35</sup> The laws of most Western European countries, however, do not require a debtor to pay fees upon filing the application for being released from debt. In some of the Scandinavian countries, France, Belgium, and Luxembourg, general procedural costs are considered to be a part of the general system of social benefits that shall be borne from the budgets of social services and the relevant court. In Germany, the insolvency act in its first form prescribed an obligation to refuse application to debtors who lacked sufficient assets or had no income from which to pay the court expenses.<sup>\*36</sup> The law reform of 2001 made the conditions more favourable for the debtor by providing an opportunity to postpone the court expenses for the entire duration of the proceedings.<sup>\*37</sup>

Because of the above-mentioned restrictions to entry into debt restructuring, the circle of persons for whom debt restructuring proceedings are a way out is limited. Proper efficiency of access to such proceedings means not only that such proceedings should be free (or at least low-cost) and impartial but also that they should be easily accessible on a practical level.<sup>\*38</sup> Debt restructuring must be seen as part of the set of communal and public social objectives. Debt restructuring proceedings do not exist to raise creditors' risk-awareness; they are meant for debtors who have encountered solvency problems largely for reasons independent of their own actions (illness, accidents, disasters, and other such social circumstances).

The author must take the position that the proceedings for release from debt are meant for debtors who acknowledge their debt problems and try to find solutions to them, who have sufficient knowledge and financial resources to cover expenses related to the proceedings, and who are able to make payments to creditors for the full duration of the payment timetable. In the author's opinion, the debtor should be afforded procedural assistance, primarily with the payment of procedural expenses and state fees to be paid upon initiation of proceedings, which would ease the debtor's burden of payment in the initial phase of the proceedings and would enable the making of payments to creditors already in the early stages of the proceedings.

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<sup>33</sup> U. Reifner, J. Niemi-Kiesiläinen, N. Huls, H. Springeneer (see Note 2); INSOL International (see Note 2).

<sup>34</sup> R. Koulu, E. Havansi, E. Korkea-Aho, H. Lindfors, J. Niemi (see Note 21), p. 869.

<sup>35</sup> J.J. Kilborn (see Note 16).

<sup>36</sup> J.J. Kilborn. The innovative German approach to consumer debt relief: Revolutionary changes in German law, and surprising lessons for the U.S. – *Northwestern Journal of International Law & Business* 2004/24, pp. 257–298. Available at <http://scholarlycommons.law.northwestern.edu/njilb/vol24/iss2/13> (most recently accessed on 30.5.2013).

<sup>37</sup> Insolvenzordnung ['Insolvency Statute'], §§4a–4d, 26 (1), 298, 305.

<sup>38</sup> Council of Europe Committee of Ministers (see Note 32).

### 3. Conclusions

Restrictions on initiation of debt restructuring proceedings shall be guided by the basic principles of debt restructuring. Under those basic principles, firstly, the debt restructuring proceedings shall provide fair and equitable, efficient and cost-effective, accessible and transparent settlement and discharge of consumer debts; secondly, they shall propose some form of 'fresh start' for the debtor; and, thirdly, there shall be equally available options of extra-judicial and judicial proceedings. Establishing restrictions to admission to debt restructuring proceedings, with the assistance of creditors and the court, filters debtors who have a realistic chance of restructuring their debts from those who do not. On the other hand, the restrictions must not become an impediment that no-one can overcome. Establishing an immutable obligation (such as the negotiation obligation) does not achieve that purpose, for it creates a psychological barrier between the debtor and the creditor and results in failure to meet the debt-restructuring-related preconditions that are set for initiation of proceedings. Therefore, the debtor's opportunity to restructure his debt is inherently precluded. Instead of negotiation, the primary focus should be on debt counselling, and the legislator should make significant contributions to establishing and developing a state debt-counselling system or a debt-counselling system operating in the private sector with state guarantees. Inclusion of a debt counsellor prior to court proceedings could ensure the successful admission of a greater proportion of applications to proceedings and approval of the payment schedules. The role of the counsellor is no less important during the court proceedings. If the debtor has not included a debt counsellor prior to the proceedings, the court should do this, similarly to appointing a reorganisation adviser pursuant to the Reorganisation Act. Restrictions on admission to proceedings must not become too burdensome for the debtor, mentally or financially. The aim of the proceedings is to overcome the solvency problems in order to avoid bankruptcy proceedings while considering the creditors' justified interests.