Summary

Debt restructuring and good faith

1 The rise in consumer credit and debt problems

In the latter half of the twentieth century, in parallel with increasing prosperity since World War 2, credit provision in Europe and the USA has undergone considerable expansion. Research provides inconclusive evidence that the rise in the provision of credit is the reason for the rise in insolvencies, however a causal link between the two is a feasible proposition. The interest rate increases expected by the OECD represent a threat not only to those with unsecured debts but also to mortgagors (and in some credit markets to mortgagees). Debtors frequently underestimate their debt problems and imprudently take on further financial responsibilities. Legislation intended to protect consumers against excessive credit provision has failed to prevent the increase in the number of individuals requiring debt counselling. The Dutch Financial Services Act (Wet financiële dienstverlening) and the Dutch Finance Supervisory Act (Wet financieel toezicht) have not been effective in terms of preventing consumers from falling into debt situations from which they are unable to independently extricate themselves. Debt counselling is not always effective and creditors frequently refuse out-of-court debt settlements. The Dutch Act on Debt Restructuring for Natural Persons (Wet schuldsanering natuurlijke persoonen), included in the Dutch Bankruptcy Act in 1998 and generally referred to as the Wsnp, operates as a final resort for individuals experiencing serious debt problems. In 1999, one in every 2000 people in the Netherlands were either declared bankrupt or applied to undergo Wsnp debt restructuring. This number had doubled by 2005.

2 A short introduction to the three Dutch insolvency schemes including the Wsnp

2.1 The Dutch Bankruptcy Act (Faillissementswet, also referred to as the Act), in force since 1896, provides for three distinct insolvency proceedings: (i) bankruptcy, (ii) moratorium of payments, and since 1998 (iii) debt restructuring.

i Bankruptcy: Under the Act, all individuals, whether engaged in business or not, and all legal entities, may be declared bankrupt. A debtor can be declared bankrupt upon his or her own request or at the request of his or her creditors. The court appointed trustee liquidates all assets except certain personal belongings and those basic assets needed for day-to-day existence. The trustee distributes the net proceeds to the creditors according to their respective ranking. No debts are discharged either by operation of law or by the courts. If the debtor fails, as is the case in the majority of bankruptcies, to make an agreement with his creditors, the debtor remains indebted following closure of the bankruptcy proceedings.

ii Moratorium of payments: All legal entities (engaged in commercial business or not) and all individuals engaged in business or professional activities may apply for a *provisional* moratorium of payments which is perfunctorily applied by the Dutch courts. At a later stage of the proceedings, the creditors will vote on a definite moratorium of payments and a possible arrangement of debts. The debtor and the court appointed administrator cooperate to continue or transfer the business. Debts may be partially discharged by an arrangement only. Moratorium of payments proceedings are frequently unsuccessful and debtors are subsequently declared bankrupt.

iii Debt restructuring: Any individual (engaged in commercial business or not) may submit a request to the bankruptcy court to apply for admission to the debt restructuring scheme (creditors may not submit such requests). The courts *must* reject a debtor's request if (1) the debtor is not over-indebted and is able to continue paying his or her debts, or (2) 'justified fear' exists that the debtor will not comply with his or her obligations under the Wsnp scheme or that the debtor may prejudice his creditors during the application of the scheme, or (3) the scheme already applies to the debtor (to avoid secondary proceedings concerning new debts incurred during the application of the initial Wsnp scheme). In addition, the court has a discretionary power and therefore *may* reject a debtor's request if (1) the same debtor was declared bankrupt or applied for entry onto the Wsnp scheme within a ten year period prior to the (new) application, or (2) if the court finds that it is likely that the debtor has *not acted in good faith* when incurring debts or leaving them unpaid. If the court decides to allow the debtor admission to the Wsnp scheme, the scheme will, in general, operate for three years. During the application of the scheme the debtor is required to make efforts to generate income in order to pay his creditors. If insufficient income is generated to make payments to creditors (e.g. for reasons of ill-health) the period may be reduced to one year. In some cases the court may stipulate a longer period, for example five years. The application of the scheme may be terminated early if the debtor incurs excessive new debts or otherwise fails to comply with his obligations under the Wsnp scheme.

The (Dutch) Committee on Insolvency law (Commissie Insolventierecht) is currently working on a completely new Insolvency Act, suggesting uniform

insolvency proceedings for legal entities and natural persons. Details of the work in progress are not yet public. According to a letter from the Committee to the Minister of Justice the new Act will address debt restructuring. The Committee has proposed that the debtor's good faith should be tested at the end of the scheme when the decision on the discharge is to be taken rather than at the outset of the proceedings.

2.2 The main subject of this thesis is the good faith test, as applied by the Dutch courts when deciding on the admission of a debtor to the Wsnp scheme. Extensive case law and parliamentary history concerning the Wsnp has been reviewed. In addition research has been performed on a) the causes of debt problems (b) debt counselling and adjustment outside insolvency proceedings (c) the history of Dutch insolvency law (commencing with Roman law) (d) the application of the debt restructuring scheme to sole traders (e) the revised version of the Wsnp which will come into force in 2008 (f) a comparative study of the personal bankruptcy systems in the US, France, Germany, Belgium, Luxemburg, England and Wales and European initiatives. The thesis concludes with the author's view on the question of whether the debtor's good faith should or should not play a role in the court's decision on allowing the debtor entry onto a debt restructuring scheme.

3 The historical development of Dutch insolvency law and the role of the debtor's good faith

3.1 Under ancient Roman law the failure by an individual to satisfy outstanding debts could have physical consequences for the individual in question ranging from imprisonment of the debtor by the creditor to capital punishment. By the pre-classic period the Romans had developed the concept of seizure of property (*missio in bona)* as an alternative to seizure of the person. A trustee, appointed by the creditors, would liquidate the estate and distribute the proceeds amongst the creditors. The debtor was given the opportunity to assign his property to his creditors in return for retaining his freedom (*cessio bonorum*). The role of the State in insolvency law was, at this time, limited.

3.2 By the middle ages insolvency law fell under the auspices of the criminal law. Habitual defaulters were publicly disgraced and subject to severe criminal punishment. At the time of the Dutch Republic (from the 16th to the 18th century) the criminal aspect of insolvency was easing into the background. Under the influence of developing trade and commerce in cities such as Antwerp and Amsterdam more significance was being assigned to the interests of the creditors. The concept of forging agreements with creditors was developing. The debtor's good faith played a prominent role under local ordinances if permission was to be granted to enter into compulsory agreements with creditors or for the debtor to

assign property to the creditors. During the course of the 19th century and the beginning of the 20th century the role of the debtor's good faith slowly became irrelevant under Dutch insolvency law.

3.3 Following the introduction of the Commercial Code in 1838 (Wetboek van Koophandel) good faith was no longer a requirement for the debtor's legal rehabilitation or for entry into a compulsory agreement with the creditors. Under the Bankruptcy Act 1896 (Faillissementswet) foreclosure and seizure of property took precedence and the behaviour of the debtor was no longer instrumental in creditors agreements. After 1935 good faith was no longer a requirement for the granting of a moratorium of payments (surseance van betaling) or for a creditors' composition during a moratorium of payments (introduced in 1935). The fresh start doctrine – with a renaissance of the good faith requirement – was first incorporated into Dutch law in 1998 (Wsnp). Judges have a discretionary power to reject a Wsnp application on the basis of the debtor's lack of good faith in respect of existing or unpaid debts. Changes to the Wsnp, coming into force on January 1st 2008, mean that the debtor will be required to demonstrate his or her good faith (see also paragraph 7 below).

3.4 The schedule below provides a schematic overview of historical research into the role of debtors' good faith (or lack of it) in connection with admission to a variety of insolvency procedures and the application of various legal concepts during such insolvency procedures, from the 18th century onwards.

	Year	Insolvency Proceedings	Good faith a requirement? Yes/No….
1	**1777**	**Amsterdam decree**	
1.1		Access to sequestration proceedings	No, transition to bankruptcy if debtor of bad faith
1.2		Access to insolvency proceedings	No
1.3		Compulsory arrangement with creditors	Yes
1.4		% of distribution passed to debtor	Yes
1.5		Personal freedom in return for assets	Yes
1.6		Legal rehabilitation	Yes

2	**1838**	**Merchants Act**	
2.1		Access to bankruptcy proceedings	No
2.2		Compulsory arrangement in bankruptcy	No
2.3		Rehabilitation at request of debtor	No, however, in certain cases no rehabilitation
2.4		Rehabilitation following compulsory arrangement with creditors	Yes
2.5		Access to moratorium of payments	Yes, access denied if debtor acts in bad faith
2.6		Personal freedom in return for assets	Yes
3	**1838**	**Civil Procedure Act**	
3.1		Access to 'status of apparent insolvency' for non-merchants	No
3.2		Compulsory arrangement with creditors	No
4	**1896**	**Bankruptcy Act**	
4.1		Access to bankruptcy proceedings	No
4.2		Compulsory arrangement in bankruptcy	No
4.3		Rehabilitation	No
4.4	1896	Access to preliminary moratorium	Yes, no moratorium for a debtor acting in bad faith
	1935	Access to preliminary moratorium	No
4.5	1935	Compulsory arrangement in moratorium	No
4.6		Termination of moratorium	Yes, due to debtor administering estate in bad faith
5	**1998**	**Wsnp, Chapter III of Bankruptcy Act**	
5.1	1998	Admission to WSNP scheme	Yes, the court *may* reject application for bad faith
5.2	2008	Access requirement for admission	Yes, the court *must* reject for bad faith, unless the cause of debts is under control'

4 Debt Restructuring for Natural Persons (Wsnp, 1998) and testing the debtor's good faith

4.1 Under the Wsnp, if it can reasonably be foreseen that an individual will not be able to continue paying his or her debts, or, if the debtor has already stopped paying his or her debts, the court will, at the request of the debtor, open debt restructuring proceedings (Wsnp). The Act includes both mandatory and discretionary grounds for refusing a debtor's request to be admitted to restructuring proceedings. The most important mandatory reason for refusal is 'justified fear' that the debtor will not adhere to the rules during the application of the scheme. If such fear is established the court *must* reject the debtor's request. If the court finds that it is likely that the debtor has not acted in good faith when incurring debts or in leaving them unpaid the court *may* reject the debtor's request. According to the 'Explanatory Memorandum to the Bill' the good faith test aims to prevent *abuse*. The parliamentary history gives examples of situations in which an application should be rejected on the basis of lack of good faith. However no definition of good faith or abuse is provided. The creditors play no role in the good faith test. It is unclear who is intended to be protected from such *abuse*.

4.2 According to the Explanatory Memorandum the principle of good faith under the Wsnp differs from the principle as laid down in other areas of Dutch law. It is not the same as that referred to in Book 3 of the Dutch Civil Code i.e. if good faith is required for a legal effect, it will be deemed as lacking not only if the person knew of the relevant facts but also if that person should have known of the relevant facts. In addition it does not equate to the principles of reasonableness and fairness as detailed in Book 6 of the Dutch Civil Code. Furthermore the principle of good faith referred to in the Wsnp does not equate to that mentioned in a particular provision (Article 54) of the Dutch Bankruptcy Act which relates to the preclusion of the setting off of claims, by an individual who happens to be both a debtor and a creditor of the bankrupt where that debtor/creditor did not act in good faith when acquiring a debt owed to, or a claim against, the bankrupt. The Dutch legislator decided to leave it to the courts to apply the good faith principle under the Wsnp, allowing the court to take into account all the circumstances of the specific situation of the debtor.

5 Interpretation and application by the courts of the good faith principle under the Wsnp; case law since 1998

5.1 The legislator clearly believed that the courts would be able to apply the good faith principle. What is not clear is whether the legislator intended the courts to explicitly lay down specific new rules for determining the debtor's good faith or whether the legislator anticipated that such rules would develop over time as a result of court decisions in individual cases. The Supreme Court has not

made any efforts to interpret the ratio of the good faith principle and has not related the good faith principle to the objectives of the Act (Wsnp). The Supreme Court is aware, from parliamentary history, that a court may, in a particular case, consider all circumstances. In several judgments the Supreme Court has quoted the following explanation given by the Minister of Justice during the passage of the legislation through parliament:

> Relevant are the nature and the amount of the debts, the moment that the debts were incurred, the extent to which the debtor could be blamed for incurring the debts or for leaving them unpaid, the debtor's efforts to pay off the debts or the debtor's actions to prevent creditors' recourse.

5.2 The Supreme Court has not contributed any further legal direction to the above quoted Explanatory Memorandum on the principle of good faith. Attempts by debtors to limit the scope of the good faith principle or to relate the principle to the objectives of the Wsnp have not been successful in the Supreme Court. Debtors who stated in court cases that not all debts or all circumstances provide justification for the rejection of a Wsnp application have also been unsuccessful. According to the Supreme Court, it is not necessary for the court to establish a causal link between culpable conduct and the incurring of debts or the non-payment of debts in order to reject a Wsnp application.[1] A debtor who has unintentionally incurred debts or left them unpaid could still be considered to have acted without good faith. Apparently the Dutch Supreme Court does not consider itself to have a role in determining the meaning or scope of the good faith principle. The Supreme Court has given the lower courts total freedom to apply the good faith principle taking into consideration all facts and circumstances of each individual case. However, if the lower courts reject Wsnp applications the Supreme Court recognises the importance of reasoned decisions being provided for such rejections. The Supreme Court is reluctant to overturn decisions rejecting Wsnp applications where such decisions are made by the lower courts providing that all relevant circumstances have been considered. However, a recent decision possibly indicates a turn around of the Supreme Court's reticent approach. In April 2007 the Supreme Court found that it was inconceivable that a lower court should reject a Wsnp application, based on criminal debts amounting to less than half a percent of total debts. Thus the lower courts were urged to take into account the fact that those debts which were incurred with a lack of good faith were only a very small portion of the total debts incurred.[2]

5.3 When deciding on Wsnp applications, the lower courts have often made a clear distinction between their *discretionary power* to reject a Wsnp application on

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1 See the decision of the Dutch Supreme Court January 10 2003, www.rechtspraak.nl LJN: AF0749 and Dutch Supreme Court June 13 2003, www.rechtspraak.nl LJN: AF7006.

2 See the decision of the Dutch Supreme Court April 20 2007, www.rechtspraak.nl LJN: BA0903.

the basis of the good faith principle and the *meaning* of the good faith principle. The majority of lower courts first answer the question of whether the debtor lacks good faith. If the court concludes that good faith was lacking it will then use its discretionary power to make the final decision on whether the debtor may be admitted to the Wsnp scheme taking into account all relevant circumstances. Until recently, unlike the lower courts, the Supreme Court had not seen fit to clearly distinguish between the meaning of the good faith principle and the discretionary power to reject an application. In the aforementioned decision dated April 2007, the Supreme Court qualified the debtor's lack of good faith as 'a circumstance' to be weighed against 'all other circumstances of the case'.

5.4 According to research by Huls and Schellekens (2001), the lower courts are often inclined to decide Wsnp applications on the basis of a general impression given by the debtor. The high number of Wsnp cases that the insolvency chambers of the courts must process also seems to bear an influence on the decisions taken. In the absence of clear statutory rules and Supreme Court guide lines, it is hardly surprising that many variations can be identified in decisions made by the lower courts concerning the good faith principle. However, it is possible to identify certain categories of debts and circumstances which will, in the majority of cases, result in a rejection of a Wsnp application by the lower courts. Where debts occur as a result of (a) social security fraud, (b) criminal offences or (c) substance addiction, the debtor is usually considered to be lacking good faith. However, even where the debtor is found to be lacking good faith the courts sometimes allow admission to the Wsnp scheme on the basis of (1) personal circumstances, such as illness or a family situation in which young children may be affected, (2) the time elapsed since the debts were incurred, or (3) a positive attitude on behalf of the debtor who is making a genuine attempt to pay off his debts. From extensive case law it can be concluded that some courts are more strict than others in terms of admitting to the scheme debtors whose good faith may be brought into question. In the absence of clear Supreme Court guidelines the emergence of such a *local legal culture* is hardly surprising. A recent statistical evaluation, *Monitor Wsnp (2006)*, concurs with the results of this thesis with regard to both the most common reasons for rejecting a Wsnp application and the varying application of the good faith principle by the lower courts. Variations between decisions concerning the good faith of the debtor exist not only between courts but also over the course of time. At the end of 2005 supervisory judges acting in Wsnp cases agreed on new guidelines concerning many aspects of the Wsnp scheme. The guidelines provide detailed rules with regard to the question of rejecting a Wsnp application on the basis of a debtor's lack of good faith. Convergence of local case law can subsequently be expected. However, the validity of the guidelines is questionable as they have not been sanctioned by either the legislator or the Supreme Court.

Finally, it is interesting to note that neither the legislator nor the lower courts nor the Supreme Court have adequately addressed the role that the creditors have

played in the over-indebtedness of a debtor who has applied for entry to the Wsnp scheme.

5.5 In April 2007 the Supreme Court took its first decision, since the introduction of the Wsnp in 1998, on the imperative ground to dismiss a Wsnp request on the basis of 'justified fear' that the debtor would not comply with his or her obligations under the Wsnp scheme or that the debtor may prejudice his creditors during the application of the scheme.[3] The Supreme Court ruled that the existence of 'justified fear' of expected non-compliance by the debtor is insufficient reason to reject an application. In order to reject an application on the grounds of 'justified fear', the court must decide whether the debtor should be considered *responsible* for the expected non-compliance.

5.6 According to the Explanatory Memorandum the debtor's good faith plays an important role not only in awarding Wsnp applications but also during the three year (or relevant term decided by the court) debt restructuring period. However, the provisions in the Bankruptcy Act with regard to obligations and prohibited acts during the restructuring period do not refer to the good faith principle (see Articles 350, 352, 354 and 358a of the Dutch Bankruptcy Act regarding decisions on the early termination of a Wsnp application and decisions concerning the fresh start to be granted by the courts). There is no reference to the good faith principle in either Supreme Court or lower court decisions on the termination of the restructuring period. It can be concluded that the good faith principle has no role in such termination decisions. One possible exception occurred where the Supreme Court decided that the debtor was obliged to provide any information to the trustee that the debtor *knew, or should have known*, to be important to the trustee during the restructuring period in order to realise an effective restructuring process.[4] This wording concurs with the subjective good faith that is mentioned in Book 3 of the Dutch Civil Code (see above).

6 Debt restructuring for the self-employed

Self employed individuals are also entitled to apply for admission to the Wsnp scheme. Although it is not stated in the Wsnp, according to parliamentary history, a self-employed individual who wishes to continue his or her business should opt for the moratorium of payments proceedings rather than applying for restructuring under the Wsnp. Even though the temporary continuation of a business is possible under the Wsnp restructuring scheme, the Wsnp does not offer adequate provisions to restructure or re-launch a business. The Wsnp assumes

3 See the decision of the Dutch Supreme Court April 13 2007, www.rechtspraak.nl LJN: AZ8174.
4 See the decision of the Dutch Supreme Court February 15 2002, *Nederlandse Jurisprudentie* 2002, 259.

that assets will be liquidated and that no new debts will be incurred. Accordingly, the courts are reluctant to admit self-employed individuals who are still running a business. It is only freelancers with no company assets and low fixed costs who may continue their businesses under the scheme.
Dutch courts also seem fairly reluctant to admit to the Wsnp scheme those who have only recently wound up a business, specific reasons for rejection of a Wsnp request in such cases being lack of good faith due to (1) the inadequacy of the administration/accounts, (2) continued loss-making business activities, and/or (3) the existence of tax debts.

7 Evaluation of the Wsnp and changes to be effected in 2008

7.1 The Wsnp has been in force since December 1st 1998. In 1999 6,500 individuals were admitted to the Wsnp scheme. By 2006 this number had more than doubled to 15,000 new cases per annum although the growth in the number of new cases has slowed over the last two years. Surprisingly, the number of personal bankruptcies has increased rather than decreased over the same period (1999-2006). This can be explained, to a certain extent, by the early termination of the Wsnp scheme for a number of individuals – resulting in 16% of all those who are admitted to the Wsnp scheme ultimately being declared bankrupt. Early termination occurs when debtors under the Wsnp scheme do not pay their current debts or demonstrate a lack of effort in generating income in order to pay pre-Wsnp creditors.

7.2 In 70% of Wsnp cases all debts are discharged and the debtor obtains a clean slate. Only 10% of those obtaining a fresh start incur new debts within one or two years. Considering the primary objective of the Wsnp, to prevent those in hopeless debt situations from remaining in such situations for the rest of their lives, it may be concluded from these figures that the Wsnp is relatively successful. However, the large number of cases and the intensive involvement of the courts during the process have created a heavy workload for the insolvency courts. In order to reduce the number of early terminations and the workload generated, the legislator has produced more stringent rules for the courts to apply when deciding whether debtors should be allowed admission to the scheme. The new rules have been accepted by parliament and come into force on January 1st 2008. The new rules aim to (i) admit only those debtors who are prepared to comply with all obligations imposed under the scheme (ii) support amicable arrangements with creditors (iii) simplify the Wsnp scheme and (iv) reduce the involvement of the courts during the process. Whatever the merits of the new rules a significant disadvantage is that the debtors who are excluded from the Wsnp scheme will never obtain a fresh start.

7.3 When applying for admission to the Wsnp scheme the debtor has a statutory obligation to provide certain information concerning debts, assets and income. Under the current Wsnp rules the debtor is not required to provide evidence of his good faith. It is up to the court to apply the good faith test at its discretion. In order to obtain further information to assist in the decision on the matter of good faith the court may require the debtor, and the creditors, to attend a hearing. The court may also provisionally admit the debtor to the Wsnp scheme. During the provisional period the court appointed administrator, or a separately appointed financial expert, may provide the courts with further information to decide on the debtor's good faith. The Minister of Justice has designed new statutory rules in order to improve the selection of debtors applying for admission to the Wsnp scheme by shifting the onus of proof to the debtor. As of January 2008 debtors applying for the Wsnp scheme will need to demonstrate that they have acted in good faith when incurring debts and leaving debts unpaid. The new rules limit the scope, in time, of the good faith test to debts incurred within the last five years but still fail to provide a definition of 'good faith'. From the parliamentary history (2004 -2007) on the new rules it can be inferred that the courts may continue to allow all the circumstances of the specific situation of the debtor to be taken into account. The original statutory Bill excluded from the Wsnp scheme, without exception, debtors who failed to demonstrate good faith and debtors with debts which were incurred as a result of criminal offences. According to the original proposals the courts' discretionary power was removed and it was no longer possible to admit debtors who failed to prove their good faith. Furthermore, debtors with debts less than five years old, resulting from criminal offences, were not allowed admission to the Wsnp. If such debts were older than five years the court maintained the discretionary power to admit the debtor concerned. Debts resulting from minor offences would not preclude entry onto the Wsnp scheme. Such debts, however, would not be discharged under the scheme. Parliament opposed these strict new rules on admitting debtors. Under pressure from parliament the Minister of Justice introduced a new rule (article 288 section 3 of the Bankruptcy Act) mitigating the strict rules. The additional new rule allows the courts to 'repair' the debtor's lack of good faith and also allows the court to admit debtors with debts arising from criminal offences, but only if the causes of the debt problems are 'under control'. Following three years of parliamentary discussion it can be concluded that (i) it is doubtful whether the new rules are actually more strict in terms of allowing admission to the Wsnp scheme and (ii) the new rules do not simplify the courts' decision process which, it can be argued, is more convoluted than previously.

7.4 As of 2008, under the new rules, provisional admission to the Wsnp scheme will be abolished. However, two new measures have been put in place to support the out-of-court debt-counselling process. Firstly, in order to support amicable arrangements with creditors, the new rules enable the bankruptcy courts to impose a debt settlement arrangement on creditors who are reluctant to accept an arrange-

ment proposed by the debtor. Secondly, the debtor may request the court to freeze redress actions taken by certain creditors (i.e. (i) the debtor's landlord (ii) utilities suppliers (iii) health insurance providers) for a six month period. The debtor's request for such preliminary measures needs to be accompanied by an alternative Wsnp request providing the courts with detailed information on the debt situation. Although the new statutory rules do not require the debtor to be of good faith for such measures to be taken, in his comments on the Bill, the Minister of Justice has confirmed that courts may reject implementation of such preliminary measures due to the debtor's lack of good faith.

8 Comparison with other legal systems

8.1 US, French, German, Belgian, Luxembourg, and English bankruptcy and debt discharge systems have been examined and compared with the system operating in the Netherlands. The comparative study also considers the UNCITRAL Legislative Guide on Insolvency Law, several European surveys and various recent European initiatives to regulate consumer bankruptcy.

8.2 The research determined that it is only France and the Netherlands that have a good faith requirement for admission to a debt discharge scheme. However, French case law indicates that creditors need to actively oppose the admission of the debtor if not to demonstrate the debtor's bad faith whereas, under present Dutch law, Dutch courts examine the debtor's good faith *ex officio*. As of 2008 it will be the debtor's responsibility to demonstrate that he or she acted in good faith during five years prior to the Wsnp application. Belgium and Luxemburg exclude debtors who *knowingly* brought about their own insolvency situation. The bankruptcy rules in England and Wales, Germany and the US give no subjective grounds to reject a debtor's application to a debt restructuring scheme. Since October 2005 however, an income test is applied in the US to avoid abuse of the swift liquidation proceedings of Chapter 7, in favour of the restructuring proceedings under Chapter 13 including a savings plan. In comparison with the six foreign legal systems which were reviewed, the Dutch system comprises a relatively large number of reasons for rejecting an application to a debt discharge scheme. Unique to the Dutch system is the ground allowing an application to be rejected on the basis of 'justified fear' that (a) the debtor will not comply with his or her obligations under the Wsnp scheme or (b) will prejudice his or her creditors during the operation of the scheme.

8.3 From a creditor's point of view it may, of course, be argued that the infringement of claims pursuant to statutory debt restructuring schemes cannot be justified. A Finnish creditor complained that the Finnish debt restructuring act violated his rights of ownership under Article 1 of Protocol No. 1 of the European Con-

vention on Human Rights. From the ECHR's decision in this case dated July 20th 2004 the following general conclusions can be drawn.[5]

1 The debt-adjustment legislation clearly serves legitimate social and economic policies and is not therefore, ipso facto, an infringement of Article 1 of Protocol No. 1.
2 The fact that in the case of bankruptcy the creditor's claims would have remained legally valid and enforceable at a later stage does not change the fact that by entering into an agreement with a debtor a creditor takes upon himself a risk of financial loss.
3 The European Court would not exclude the possibility that a court-ordered irrevocable extinction of a debt, as opposed to the scheduling of payments of a debt over a longer period of time or the bankruptcy of a private individual, could in some circumstances result in the placing of an excessive burden on a creditor.
4 The question of whether such a burden was placed on the applicant also depends on whether the procedure applied provided him with a fair possibility of defending his interests as one of some seventy creditors.

8.4 A '*Group of Specialists seeking Legal Solutions to Debt Problems (CJ-S-Debt)'* drafted a Recommendation of the Committee of Ministers to member states of the European Union with the following objectives (1) to prevent over-indebtedness of individuals and families (2) to take appropriate measures to alleviate the effects of the recovery of debts (3) to introduce mechanisms necessary to facilitate rehabilitation of over-indebted individuals and families and their reintegration into society. The group decided that "the Recommendation should remain strictly a legal instrument and therefore decided not to make a distinction between 'good' or 'bad' debtors or include the idea of 'good faith'".[6] The CJ-S-Debt recognised that total or partial discharge of debt can be a useful solution in cases of over-indebtedness but "such a solution should only be sought when all other available means of settling the debt have been ineffective as the possibility of abuse is inherent should such a solution be applied systematically, as it gives the impression that a debtor could escape his/her obligations." In addition, the Group advised member states to "bear in mind that this measure would only make sense if causes for recidivism have been dealt with".

8.5 The statutory regulations in the US, England and Wales and the Netherlands make no distinction between sole traders and other individuals. The debt restructuring schemes of Germany, Belgium and Luxemburg are not open to sole traders with an ongoing business. Under the French system sole traders are excluded from entry into a debt restructuring scheme under the *Code de la Consommation*. The UNCITRAL Legislative Guide addresses corporate bank-

5 ECHR, *Case of Bäck v.Finland, Application no. 37598/97*, see http:/www.echr.coe.int/echr.
6 Final Activity Report, CJ-S-DEBT, November 29 2006, p. 6, para 33 and 34.

ruptcy as well as bankruptcy of sole traders. The Legislative Guide recommends criteria to facilitate early and easy access to restructuring.

8.6 All of the legal systems examined for the purposes of this thesis provide for the possibility of debt discharge. However, all systems make exceptions for certain debts. In accordance with the general characteristics of bankruptcy law, secured debts are excluded from the discharge in all systems. Furthermore, debts that are excluded from the discharge in several countries include (a) maintenance payments (b) obligations to pay compensation for injury caused by the debtor or for a crime committed by the debtor and (c) fines and other debts relating to criminal offences. Almost 20 different exceptions to the discharge exist under the US bankruptcy system. Belgium has only 3 such exceptions. In the German system debts can only be excepted from discharge upon the request of creditors and merely on grounds specified in statutory rules. The present Dutch Wsnp only excludes one category of debts from the discharge – student loans owed to the Dutch state. From the research carried out it can be concluded that, in comparison to other law systems the Dutch Wsnp provides for many subjective grounds on which a Wsnp application may be rejected (Article 288 of the Act). The Dutch courts appear to apply the subjective criteria stringently, the Dutch system also provides for several grounds on which the scheme may be terminated early. However, as mentioned, the number of exceptions to the discharge is, under Dutch law, relatively small. Thus, it can be argued that, once the debtor has been admitted to the scheme, provided he or she complies with all obligations under the scheme, a discharge of almost all debts is inevitable. The situation in the US and the UK is very different as there are no subjective grounds for rejecting admission to a debt discharge scheme but there are many exceptions to the debts which will be discharged.

The schedule below summarizes the exceptions to the discharge found in the seven legal systems examined.

		USCh7	USCh13	Fra	Ger	Belg	Lux*	Eng	Neth	Neth
	Exceptions to the discharge									**2008**
1	Student loans	**yes**	**yes**					**yes**	**yes**	**yes**
2	Maintenance Payments	**yes**	**yes**	**yes**		**	**yes**	**yes**		
3	Other divorce debts	**yes**								
4	Compensation payments for causing personal injury	**yes** ***	**yes** ***					**yes**		
5	Compensation payments to victims of crime	**yes**	**yes**	**yes**		**yes**				**yes**
6	Fines for minor criminal Offences	**yes**		**yes**	**yes**			**yes**		**yes**

		USCh7	USCh13	Fra	Ger	Belg	Lux*	Eng	Neth	Neth
	Exceptions to the discharge									**2008**
7	Fines for serious criminal offences	**yes**	**yes**							**yes**
8	Damages arising from tortious actions	**yes**			**yes**					
9	Debts arising from fraud	**yes**						**yes**		
10	Debts with finance companies						**yes**			
11	Tax debts	**yes**					**yes**			
12	Business debts remaining following company bankruptcy					**yes**				
13	Court fees	**yes**								
14	Loans for payment of costs for discharge proceedings				**yes**					
15	Debts to guarantors or co-debtors who have paid debts on behalf of the debtor			**yes**						
16	Debts arising from acting in a fiduciary capacity	**yes**								
17	Consumer debts incurred Up to 60 days prior to bankruptcy	**yes**								
	Total exceptions	12	5	4	3	2	3	5	1	4
	Total exceptions US	19****								

* The scope of the discharge under Luxembourg law is limited to fines and certain costs.
** Belgian law excludes maintenance payments which had not yet fallen due on the date that the court ordered restructuring plan (gerechtelijke aanzuiveringsregeling) was established.
*** In the US, debts for causing personal injury whilst operating a motor vehicle are only excluded if such operation was unlawful because the debtor was intoxicated due to alcohol or drug use.
**** Under the US Chapter 7 proceedings, in total, 19 categories of debts are excluded (not only the 12 listed above). Some of these exceptions will only apply to a very specific group of debtors, such as those acting in a fiduciary capacity.

9 Objectives of the Wsnp *versus* the ratio of the good faith test

9.1 According to the 'Explanatory Memorandum to the Bill' for the Wsnp (issued by the Minister of Justice), the primary objective of the Wsnp was to prevent debtors who are in hopeless debt situations from remaining in such situations for the rest of their lives. Secondly, the government wished to stimulate creditors

to accept consensual agreements prior to the commencement of an insolvency procedure and thirdly, to reduce the number of personal bankruptcies. In my opinion testing the debtor's good faith when deciding on an application for admission to the Wsnp scheme is incompatible with these three Wsnp objectives. Rejection of an application for admission to the scheme on subjective, non-financial grounds can result in debtors remaining in hopeless debt situations for the rest of their lives. Additionally, such rejection does not serve to reduce the number of bankruptcies. Furthermore, rejection of Wsnp applications does not stimulate creditors to accept consensual agreements prior to the start of an insolvency procedure; the creditors are, as it were, kept in a *prisoner's dilemma* collectively making disproportionate costs in comparison to the amount that may actually be recovered.

9.2 Under the Dutch Wsnp system debtors do not receive a discharge of debts without providing something in return. According to parliamentary history and case law, the debtor is obliged to generate maximum income and any excess income will be distributed by the administrator to the creditors. Accordingly, the Wsnp could be considered as a statutory and compulsory arrangement between creditors and debtors, where no consensual arrangements can be made. Creditors who may receive nothing, or almost nothing in bankruptcy (merely the proceeds of the liquidation of assets) are better off under the Wsnp scheme (receiving the proceeds of the liquidation of assets plus the debtors excess income). Indeed, statistical studies show that the average creditors' recovery rate in Wsnp-proceedings amounts to 20%, a much higher rate than the bankruptcy recovery rates (between 1,5% for ordinary creditors and 8% for the tax authorities).

9.3 It is not only creditors who suffer as a result of the over-indebtedness of their debtors. Debtors in a hopeless debt situation also create costs for society. Consequently the Wsnp scheme serves not only the interests of insolvent debtors but also the interests of creditors and the interests of society as a whole. It can be argued that the societal interests justify government intervention in legal relationships between debtors and creditors, even more so if the authorities pay most of the costs of debt restructuring. It is my view that the good faith test does not reduce the inclination to take on loans or leave debts unpaid. I believe that the good faith test, as a criterion for deciding whether a debtor should be admitted to debt restructuring proceedings (Article 288 section 2 under (b) of the Act), provides no benefit to creditors or society and is therefore unnecessary.

9.4 Before the debtor is able to pay off any debts it is of paramount importance that the debtor brings his expenses in line with his income and creates no new debts. Only the debtor who improves his financial situation, aided by debt counselling and budget control, is able to successfully complete the Wsnp debt restructuring scheme. Therefore the debtor needs to be prepared to do so before even embark-

ing on the demanding Wsnp scheme. Accordingly I am in favour of maintaining the additional subjective test for entry onto the scheme ensuring that if it can be foreseen that a debtor will not comply with their obligations under the scheme the court may refuse that debtor admission to the scheme (Article 288 section 1 under (b) of the Act). I also believe that the debtor's main obligation to generate maximum income and assets during the application of the Wsnp scheme deserves to be specified in the Dutch Wsnp, rather then being left to the discretion of the courts.

10 An alternative for the Dutch Wsnp

10.1 The Wsnp is effectively a savings scheme. The saved balance is distributed to the creditors by a court appointed administrator. As an alternative, I propose a debt restructuring regulation based on credit. Such credit creates the possibility to settle the accounts with creditors at a very early stage thus simplifying the proceedings and reducing costs. Dutch municipal money-lending institutions would play a pivotal role in the proposed system. The system would not be a court-controlled insolvency regime under the Bankruptcy Act but an administrative system subject to the Dutch General Administrative Law Act (Algemene wet bestuursrecht). The courts' involvement would be reduced to a minimum. The amount of credit issued by municipal money-lending institutions would be equal to the calculated present value of the debtor's income excess to be generated during the period of debt restructuring plus the proceeds of any assets that the debtor may have. It is my suggestion that the statutory debt restructuring period should be two years. If the debtor fails to generate the calculated income excess, then the municipal money-lending institutions could prolong the pay-off period for up to a maximum of three years. It is proposed that the pay-off period for consensual arrangements should be three years and should be confirmed in statutory rules. The difference between the consensual scheme (three years) and the statutory scheme (two years) can be justified by the high costs of applying statutory measures, which costs are borne by the government serving creditors' interests. Although under the consensual scheme the debtor faces a longer pay-off period, advantages for the debtor may be that (a) there is no public record of the proceedings (b) no administrator will be appointed (c) there will be no redirection of the debtor's post and (d) liquidation of assets will not necessarily be part of consensual arrangements.

10.2 The application for the new statutory scheme would be submitted to the municipal money-lending institutions via the internet. The financial insolvency criterion would remain unchanged (see the criterion in Article 284 of the Bankruptcy Act). There would be no need to test the debtor's good faith. 'Justified fear' that the debtor may not comply with his or her obligations under the Wsnp scheme or may prejudice his creditors during the application of the scheme would remain

a ground to reject an application but should only be based on evidence gained during debt counselling. Effectively debt counselling would have to confirm the expectation that the debtor would be able to adhere to the proposed scheme. As of the moment that an application was filed over the internet the municipal money-lending institutions would control the debtor's budget. Claims of creditors would be verified via the internet. The verification process and the payment to creditors, funded by the credit referred to above, would be completed at a very early stage of the new scheme. The institutions would also have a role in the coordination of the social services and any counselling needed to reintegrate the debtor into society.

11 Final conclusions

The following conclusions can be drawn:

1 Under the Dutch Act on Debt Restructuring (Wsnp), any over-indebted individual (whether engaged in commercial business or not) may submit a request to the bankruptcy court to apply for admission to the debt restructuring scheme. Under the current Wsnp (effective since 1998) the court may reject admission to the scheme if the court finds that it is likely that the debtor has *not acted in good faith* when incurring debts or leaving them unpaid. As of 2008 the debtor will be required to demonstrate that he or she has acted in good faith (with regard to incurring debts or leaving them unpaid) for a period of five years prior to his or her application for admission to the Wsnp scheme. Parliamentary history and Dutch case law give no satisfactory explanation of the meaning or the role of this good faith test. The Supreme Court refers to the inconclusive parliamentary history and has, until 2007, not made any efforts to interpret the ratio of the good faith principle or the lower courts' discretionary power to apply the principle. Accordingly, many variations can be identified in decisions made by the lower courts. However, it is possible to identify certain categories of debts and circumstances which will, in the majority of cases, result in a rejection of a Wsnp application. Where debts occur as a result of (a) social security fraud, (b) criminal offences or (c) substance addiction, the debtor is usually considered to be lacking good faith. Reasons to reject applications of individuals engaged in business are lack of good faith due to (i) the inadequacy of the administration/accounts, (ii) continued loss-making business activities, and/or (iii) the existence of tax debts. However, even where the debtor is found to be lacking good faith the courts have, in certain cases, used their discretionary power to allow admission to the Wsnp scheme on the basis of (1) personal circumstances, such as illness or a family situation in which young children may be affected, (2) the time elapsed since the debts were incurred, or (3) a positive attitude on behalf of the debtor who is making a genuine attempt to pay off his debts.

2 Our welfare and economic growth relies on the provision of credit. Debt restructuring offers a form of social insurance for over-indebted individuals which is indispensable to a modern credit society. To be admitted to a debt restructuring scheme I believe it is necessary and sufficient that the debtor is prepared (a) to balance income and outlay and (b) to make the maximum effort to acquire an income surplus to pay off his creditors.

3 In my opinion, the good faith test is neither in line with the historical development of Dutch insolvency law nor is it in line with the legal systems of our neighbouring countries or the US system. It is contrary to the three objectives of the Wsnp. Furthermore the ambiguous test undermines legal certainty for both insolvent debtors and their creditors and affects the equal rights and ranking of creditors. The test adversely affects the realization of consensual debt arrangements and provides no benefit to the creditors. Thus it is my conclusion that the good faith test unnecessarily impairs debt restructuring. Consequently, the good faith test should be excised from the Dutch rules on debt restructuring.