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DRAFT OF THE CROATIAN CONSUMER BANKRUPTCY ACT: LEGAL PROTECTION INSTRUMENT FOR OVER-INDEBTED CONSUMERS OR PROLONGATION OF THE STATUS QUO?*

Abstract: *In the course of enacting new acts, questions concerning which practices should be followed are constantly reemerging in former socialist countries. Should the lawmakers follow the traditional European-continental models, should they be driven by the Anglo-American principles, or should they perhaps combine the most effective aspects of both legal traditions? In this context, lawmakers should regulate the institute of consumer bankruptcy as a sub-domain of bankruptcy, given that it is the most pertinent subject of interest in both legal theory and practice. In comparative legal practice there is a large amount of compromising in temporary solutions, aimed at striking the right balance in the dispersion of risk between the debtor and the creditor. Research in consumer bankruptcy within a number of legal systems has shown that there are multiple "models" regarding the organization of consumer bankruptcy. That being said, it is a historical certainty that German insolvency legislation has had the largest impact on Croatian bankruptcy legislation. Furthermore, the Draft of the Croatian Consumer Bankruptcy Act of 2014 is based on the German consumer bankruptcy legislation envisaged in the Insolvency Statute (Insolvenzordnung). The purpose of this paper is to provide an insight into the Draft of the Croatian Consumer Bankruptcy Act and, simultaneously, to analyze whether or not the legislators used the most effective practices to achieve an optimal solution.*

Key words: *consumer bankruptcy, Draft Consumer Bankruptcy Act, Croatia.*

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1. Genesis of Consumer Bankruptcy Idea (overview)

In numerous revisions and amendments of the Bankruptcy Act, hereinafter: the BA, (OG, no. 44/96, 161/98, 29/99, 129/00, 123/03, 197/03, 187/04, 82/06, 116/10, 25/12, 133/12, and 45/13.), there are two bankruptcy law institutes that have experienced minimal changes. The first is the institute of personal bankruptcy (Garašić, 2004: 29-75) (BA Ch. VII, Art. 266-281) and the second is the institute of remaining debt relief (BA Ch. VIII, Art. 197, 198, and 282-299) (Čuveljak, 2008: 955-970). The institute of personal bankruptcy refers to the administration of bankruptcy involving a legal entity and property of an individual debtor. The institute of remaining debt relief refers exclusively to an individual debtor (individual traders and artisans). The common ground concerning the institutes of personal bankruptcy and remaining debt relief is the fact that they are rarely put to practical use, particularly in bankruptcy proceedings before the Croatian commercial courts, which is definitely not the case in the rest of the world (Germany, for example). By recognizing the institutes of personal bankruptcy and remaining debt relief, Croatia has joined a group of countries which have realized the necessity of enacting and implementing a consumer protection act. However, given the lack of possibility to follow the idea through to completion, the consumer bankruptcy act was only partially completed. One could claim that such regulations are not justified but, considering the ever-increasing number of bankruptcy subjects, a partial solution is better than none or the one exclusively regulating bankruptcy of legal entities. Therefore, in anticipation of adopting and implementing the Consumer Bankruptcy Act, the current legal solutions should be considered as transitional solutions (Bodul, 2011: 351-377).

2. Solutions for the Draft of the Consumer Bankruptcy Act

The Draft Consumer Bankruptcy Act ((hereinafter: the Draft CBA) envisages that general provisions of the Bankruptcy Act constitute law applicable in consumer bankruptcy proceedings (Draft CBA, Art. 14). The primary goal of the Draft CBA is to regulate simplified consumer bankruptcy procedure through a *lex specialis*, the Consumer Bankruptcy Act. The physiognomy of bankruptcy procedure and its basic principles are established primarily with the goal of instituting bankruptcy proceedings and achieving equal settlements for creditors as a whole. This should occur while simultaneously obtaining agreement between the consumer and the creditor regarding payment of remaining debt or liquidation of consumer property (Draft, Art. 2. p.1). The secondary goal is to provide the consumer with the possibility, upon completion of a period of verifiable attempts to reconcile with creditors, to be relieved of the remaining

debt towards rightful creditors (Draft, Art. 2, p.2). Accordingly, the subject matter of highest importance to a creditor is the Bankruptcy Estate. Consumers, as natural persons, enjoy protection from distraint (seizure) of certain parts of their property in order to secure an existential (bare) minimum. In the Draft CBA, the distraint limitation is regulated by rules governing the Bankruptcy Estate, which includes the entire property of the debtor at the outset of the bankruptcy procedures, as well as the property which the debtor acquires in the course of the consumer bankruptcy proceedings (BA Art. 67 correlated with Draft CBA, Art. 14).¹

When the consumer in debt (debtor) is concerned, the law provides that the property assets which cannot be subject to distraint shall not be entered into the Bankruptcy Estate in case where the debtor is not an individual trader or artisan (BA Art. 68 correlated with the Draft Art. 14).² Accordingly, in respect of distraint limitation, the Draft CBA (Art. 14) refers to the appropriate/relevant provisions of the BA which, in turn, suggests the adoption of the Distraint Act (BA Art. 68). Therefore, in consumer bankruptcy proceedings, the consumer has a personal and unlimited liability to perform the obligations towards creditors concerning assets which are not deducted from the Bankruptcy Estate. The treatment of real estate is a matter of special consideration within the aforementioned topic.

The Draft CBA (Art. 35) prescribes special provisions regarding the liquidation of real estate necessary for personal use. The provisions in paragraph 4 describe the obligation of the court to take into account that real estate should be proportional to the housing needs of the consumer. The court may (but is not required to) decide that real estate should be sold and that consumers should be secured with bought or leased real estate appropriate for their basic subsistence and livelihood. This rule does not apply to creditors who insured their claims. Creditors who have mortgaged or fiduciary collateral on deducted property have a theoretical possibility of forced collection, with no regard for laws of deduction.³ However, if they do not use that opportunity within 60 days of court

1 Draft proposal of the Consumer Bankruptcy Act, Ministry of Justice, Zagreb, June, 2014

2 See BA Art. 274 on cases in which the court judges rule on the opening of bankruptcy procedures, to give authority to debtors to manage possessions of the Bankruptcy Estate under a Supervising Commissioner (personal administrator). The Commissioner secures the rights of the debtor, who is required by law to sustain (including any dependents) in accordance with their prior yet modest standard of living.

3 According to the Draft, Art. 31, the creditor has an exclusively secured right to liquidate assets, provided the court has authorized enjoining of the liquidation of assets within 60 days. If the creditor fails to liquidate assets within 60 days, the right to liquidate goes to the Commissioner. In certain cases, the court can rule that assets will not be subject to liquidation if costs of liquidation would surpass the value of the asset(s) in question. In such a case, the court will produce a deadline by which the debtor has to pay the creditor the

notification, the liquidation right is passed on to the Commissioner. Following the logic of efficiency, in certain cases, the court can rule that assets will not be subject to liquidation if costs of liquidation would surpass the value of the asset(s) in question. In such a case, the court will produce a deadline by which the debtor has to pay the creditor the amount that is equal to the Bankruptcy Estate, which would be divided between creditors (Draft, Art. 31). Thus, for the purpose of maintaining an existential minimum, the lawmakers provide a possibility to consumers to obtain a prior court approval in the period following the confirmation of good behavior, and to start running their businesses as entrepreneurs or artisans (Draft, Art. 32 and 33) (Bodul, 2014: 725-739).

2.1. Parties and Participants in the Procedure

It is necessary to mention the parties in the bankruptcy procedure because they are key entities directly involved in bankruptcy proceedings. The parties of cooperative bankruptcy procedure are enlisted in Article 15 BA; they are: bankruptcy judges (BA Art. 17), the Bankruptcy Trustee (BA Art. 20-31), the Assembly of Creditors (BA Art. 38a-f), and the Creditors' Committee (BA Art. 32-38). Every entity in the bankruptcy procedure has its specific role regarding rights and obligations. They may not interfere with responsibilities of other entities. Bankruptcy procedure is the only procedure which, in addition to court bodies (bankruptcy judges), includes the assistance of other parties (Bankruptcy Trustee, Assembly of Creditors, and Creditors' Committee). However, when it comes to consumer bankruptcy, there is a significant difference in the methods.

The first party is the court. It is represented by a bankruptcy judge, whose main task is to ensure that the procedure is carried out in accordance with the law. In this context, the bankruptcy judge makes decisions on conducting

amount that is equal to the Bankruptcy Estate, which would be divided between creditors. According to Council Regulation, Art. 5 (EC) no. 1346/2000 of 29 May 2000, regarding bankruptcy insolvency procedures (OG, 160, 30.06.2000., pp. 1-18.), the opening of bankruptcy proceedings does not have an effect on real rights of creditors or third parties regarding material or nonmaterial, movable or non-movable assets, and defined assets and collections of undetermined assets as a whole, which are changing from time to time, that belong to the debtor and are on property of another state at the time of opening the procedure. The listed rights especially relate to: (a) right to disposal of assets, paying fees from assets, or incomes from assets, especially based on pledge law or mortgage; (b) exclusive right to settlement of claims or special rights connected with a claim insured by pledge law or assignment of claims based on collateral; (c) right to request assets and/or ask for compensation from the one who possesses or is in use of that particular asset, contrary to wishes of the authorized person; (d) real right to authorization use of asset. The right which is enlisted in the public register, and which is executed towards third parties, is the possibility to acquire real law or balance with real law in accordance with real law.

actions, managing procedures, and other questions when raised explicitly (BA Art. 10 and 17). According to the Draft CBA, the substantive law on consumer bankruptcy procedures falls under subject matter jurisdiction of municipal courts. In this respect, the primary decision-making privilege is on the County courts, so that previous decisions made by municipal courts may be overturned by County courts.

The second party includes creditors. Within the framework of bankruptcy procedure, the following creditor categories share a common interest: creditors with an exclusion right (BA Art. 79-80), secured creditors (BA Art. 81-84), bankruptcy creditors (BA Art. 70), and creditors of the Bankruptcy Estate (BA Art. 85-87.a). The common ground, in terms of interest, is protection of rights resulting in fulfillment of their claims. However, within the framework of similar interests, each category has a different way of fulfilling that which is required by law, as well as the legal position from which it acts. As a matter of fact, bankruptcy procedure is conducted precisely because the rights of the creditors have to be protected. According to the BA, creditors are represented within two parties: the Assembly of Creditors and the Creditors' Committee. Although these two parties are not mentioned in the Draft CBA, subsidiary application of provisions (Draft Art. 14 and BA Art. 300) gives rise to conclusion that the Assembly of Creditors is the only existing party. The Assembly of Creditors is granted the majority of rights to rule regarding the key decisions of the flow and direction of fulfillment of bankruptcy procedure.

The third party is the Commissioner. When bankruptcy procedure is conducted over a public entity, the Bankruptcy Trustee is granted management and disposal rights of certain property, as well as all rights that belonged to the former parties of the debtor of a public entity (BA Art. 24). On the other hand, the bankruptcy procedure refers only to the businesses of individual debtors within the Bankruptcy Estate, and they represent the bankruptcy debtor with the authority of a legal representative. According to the BA, in case of bankruptcy over a public entity debtor, the Bankruptcy Trustee is concurrently his representative. When opening bankruptcy proceedings over an individual debtor, the rights of the individual debtor regarding the management of property that enter the Bankruptcy Estate are passed onto the Bankruptcy Trustee (BA Art. 89). In the scenario of consumer bankruptcy, the role of Commissioner is quite similar to the role of the Bankruptcy Trustee. Being given the authority to open consumer bankruptcy proceedings, the Commissioner is granted the right to manage the property of the consumer, in his name and for his account.

In terms of the Draft of the Consumer Bankruptcy Act, the Commissioner duties are envisaged in Chapter 7 (BA 36-41). The lawmaker specifies how the

Commissioner is appointed from the list of potential agents. The lawmaker also indicates in which ways the minister in charge of legislation may advise, by enacting special by-laws, regarding the procedures of enlistment and removal from the list of Commissioners. The lawmaker indicates that the Commissioner must be exempt from a bankruptcy procedure, especially when that individual is a close relative of the judge, creditor, or debtor. Any individual who has been legally convicted of a criminal act against the system or a criminal act deeming that person unworthy of carrying out the Commissioner duties shall also be exempt. It is clear that the lawmaker considered changing the conditions for appointing Commissioners because the nature of business is not uniform as it is in case of the Bankruptcy Trustee; thus, for example, insisting upon a bankruptcy-management exam is inappropriate. Furthermore, the doctrine indicates that comparative legislation does not identify any strict (formal) criteria for the appointment of the Commissioner in bankruptcy or the Commissioner in the remaining debt relief proceedings (Lovrić, 2015). One of the most important duties of the Commissioner is to submit quarterly written reports to the judge, in which they will state the condition of the debtors' property, new circumstances which could be of significant influence regarding the fulfillment of consumer obligations, the total amount of paid funds to individual creditor(s), information regarding liquidated property, and other significant information which is potentially consequential for the course of procedure (Draft, Act. 37). The nature of the Commissioners' duties is to manage the obligations that are set upon him over the lengthy period of seven years. Personal financial obligations of relevance for bankruptcy proceedings should be taken into account. Therefore, it is essential to ensure that the Commissioner is carefully appointed, keeping in mind the former criteria. As the Commissioner is not under constant supervision, it is imperative that the person be impartial. Close ties with debtors are also undesirable because the Commissioner's task is to protect the interests of creditors over a long period of time. There are also strict rules concerning the exemption of the Bankruptcy Trustee in favour of the Commissioner. Article 39 of the Draft CBA defines the obligations of the Commissioner regarding the special transaction account. Namely, by the end of the current/following working day, the Commissioner appointed by a judge to act in a bankruptcy case is obliged to open a special transaction account⁴ with a financial institution. Via that account, the Commissioner can only accept payments from individual debtors and pay funds which are related to management and disposal of the Bankruptcy Estate. Special transaction account funds cannot be the subject of distraint conducted against the Commissioner. In case of bankruptcy or death of the Commissioner, these funds are not to enter the Bankruptcy Estate, nor the bequest. The Com-

4 See National Payment System Act, OG, no. 133/09 and 136/12, Art. 58.

missioner is obliged to hold all payments that refer to management and disposal of the Bankruptcy Estate separate from his private property. The actions of the Commissioner are supervised exclusively by the court (Draft Art. 38); the Commissioner is also entitled to receive additional income for his work, as well as compensation for overhead costs. The additional income for the Commissioners' work consists of fixed and variable parts. The court defines the additional income for the Commissioner as well as certain amounts due after every liquidation (division) of assets. The fixed amount is 500 HKR for each bankruptcy procedure, and the variable amount depends on the total of liquidated (divided) assets. Thus, the variable amount of additional income is determined according to the level of liquidated (divided) assets: 4% for the amount of up to 300.000,00 HKR; 3% for the amount ranging from 300.000,00-500.000,00 HKR, and 2% for the amount above 500.000,00 HKR. Even though it is not specifically defined, the expressed percentages are considered to be the amounts of net value, which is indicated in Article 19 of the Directive Regarding Criteria, Calculation, and Payment of Supplementary Income to Bankruptcy Trustees (OG, no. 189/03). The question that arises is what amount of additional income, defined in this way, will create incentive enough for individuals to consider becoming Commissioners? Upon the relevant compensation of the Commissioner's overhead costs, the BA provides for the payment of costs to the Bankruptcy Trustee.⁵The costs of supplementary income for Commissioners' work, as well as compensation for their overhead expenses, are costs of consumer bankruptcy procedure and have priority in the settlement.⁶

At this point, we should look into the concept of individual consumer. The Draft CBA defines the consumer as any natural person, including individual traders (Draft Art. 3). The term is often used in a narrow sense. In this scenario, one often fails to take into account the broader picture of the term "consumer" in various legal acts. Thus, there is a divergence which makes it unnecessarily difficult to ensure the application of law as well as the consistency of legal terminology. However, in this case, we should refer to the decision of the Constitutional Court of Republic of Croatia (no. U-II-6/1992 of 8 April PSP 52/52), which states that "the foundation of various consumer categories are contrary to the constitutional principle regarding the equality of all under the law..."

5 The calculation of overhead costs of the Bankruptcy Trustee is approved by the bankruptcy judge, on the basis of written, substantiated and documented reports of the Bankruptcy Trustee (BA Art. 29, p. 3).

6 See BA Art. 86, Financial Operations and Pre-Bankruptcy Settlement Act, Art. 38 (OG no. 108/12, 144/12, 81/13, and 112/13), and Regulations on the Costs of the Pre-Bankruptcy Settlement Proceedings (OG no. 5/13).

2.2. Reasons for Bankruptcy

The proposal for opening consumer liquidation procedure is considered when there is a reason for bankruptcy. Assumptions concerning the liquidation process are questioned at the time of proposal submission. Yet, many debtors will find it impossible to pursue a new (financial) beginning. In theory, liquidation is traditionally defined as a permanent impossibility to settle debts upon maturity. In the countries of the European-continental legal system, there is no unique definition of liquidity as states have different approaches to this matter. Analyzing the requirements which have to be fulfilled in order for an individual to declare consumer bankruptcy under privileged procedure, we defer to distinguished liberal systems, which envisage a smaller number of necessary requirements, ultimately resulting in a larger number of bankruptcies. On the other hand, conservative systems imposing a larger number of requirements result in opening a smaller number of procedures. This conservative model is characteristic of Croatian law.

2.2.1 Insolvency Criteria

The consumer bankruptcy procedure can be opened if the consumer cannot settle one or more mature obligations for a minimum of two months. Such obligations surpass (three times) their salary or other regular, permanent income which they receive in periods that are not longer than two months. The same rule applies if a consumer is unemployed and cannot settle obligations in amount higher than 10.000,00 HRK (Draft Art. 4). Therefore, reasons for bankruptcy (liquidation, inability for paying and indebtedness) are not explicitly defined. Considering the former logic of bankruptcy reasoning from the Bankruptcy Act, one would conclude that the most relevant questions are of illiquidity⁷ and insolvency⁸ of a consumer, while indebtedness is not a legitimate reason for

7 The debtor is illiquid if they are not able to meet their financial obligations within a specific time limit (BA Art. 4, p. 2). The debtor will be considered illiquid if they are more than 60 days late in fulfilling one or more monetary obligation, whose amount surpasses 20% of their obligations reported in the annual report for the prior year, or if they are more than 30 days late with payment of salaries (in the amount defined in the contract) and payment of related taxes and contributions which one is required to pay together with the salary (BA Art. 4, p. 3).

8 Debtors are incapable of paying if they cannot fulfill their mature monetary obligations over a long period of time. The debtor will be considered incapable of paying if he/she has recorded the unmet obligations regarding payment within a period longer than 60 days in the register of Sequence Base of Payment which is kept by the Financial Agency. Based on the valid assumptions for paying and without further consent of the debtor, these obligations should be collected from any one of the debtor's accounts (BA Art. 4, pp.6-7).

bankruptcy.⁹ In fact, indebtedness of consumers is very hard to determine because one can reasonably expect that the consumer is capable, over the course of their life, to acquire assets for payment of their mature monetary obligations. When discussing legal entities within the consumer bankruptcy procedure, it is the assumption of indebtedness, which exists as a reason for bankruptcy, which is not a suitable category. Consumers are not required to keep account books, unlike legal entities that conduct activity driven by profit, and therefore, are obliged to keep account books. These are legal entities, which, in practice, are managing account books according to the principle of unchanged records. Regarding the resulting business events and according to the balance sheet, it is easy to determine the indebtedness of the legal entity.

2.2.2. "Good Faith" Criteria

The second assumption for entrance into consumer bankruptcy procedure is the existence of "good faith" criteria. If one takes into consideration the specifics of consumer bankruptcy, which can be reflected in the opportunity of the insolvent debtor to be allowed to achieve economic recovery, the question arises of how to determine the group of people who will be given the chance to use this institution, taking into consideration numerous possible forms of abuse. At first glance, several possibilities for ominous activities of the debtor can be spotted, which constitute the abuse of law in their favor. Since there is a risk that the ease of debt relief would encourage debtors to create a debt beyond intention to pay, consumer bankruptcy legislation in certain countries is introducing terms such as "good faith". This is an important assumption in preventing abuse by unfair debtors who would like to evade their commitments. Debtors are required to act in good faith when they acquire their debts and to show the real state of their property, incomes, and expenditures in the course of consumer bankruptcy or alternative procedures. Even though the term "good faith" is not explicitly used, one can easily notice that legislators have been considering that idea. For example, providing incomplete or inaccurate data will be considered equally as reproachable as providing a false statement under oath (Draft Art. 8, p.2). Additional criteria for testing "good will" have been considered. Remaining debt relief is contingent upon debtor's successful "check

9 The bankruptcy proceedings over a legal entity will be opened in case where the legal entity is indebted. The legal entity will be considered indebted if their assets cannot cover the existing obligations. The legal entity will not be considered in debt if, according to the circumstances of the case (development programs, available sources of funding, types of property, obtained collateral), one cannot assume that, with continued extension of business, they will be able to fulfill their mature obligations in an orderly manner (BA Art. 4, p.11). A legal entity will not be considered indebted if any of its members, who are required to act in solidarity in terms of the entity liabilities, can cover the monetary obligations (BA Art. 4, p.12).

of good behavior,” which includes fulfillment of debt payment plan as well as the debtor’s duty to find a suitable job, for example (Draft Art.49). Legislators had envisaged the possibility of denying the remaining debt relief, which will occur if the consumer refuses to adhere to their obligations or, in any other way, tries to manipulate his creditors (Draft Art. 50).¹⁰ If the consumer has filed a proposal for out-of-court settlement, along with the proposal he is obliged to deliver to the counselor the list of assets, creditors and creditors’ claims, as well as statements that all the submitted information is accurate and complete. The list will be submitted in a form established by the competent Minister in charge of business activities, regulated by a special rulebook. For providing incomplete or inaccurate information, consumers’ actions will be considered equally as reproachable as providing a false statement under oath (Draft Art. 8, p.2). If the proposal has been filed by a creditor, alongside with the proposal he is obliged to submit proof of validity of his claims. It will be considered that the creditor has proved validity of his claims if their existence is based on a distraint certificate or credible document (Draft Art. 8, p.3). If the debtor in the stated phase of the procedure cannot agree with creditors regarding the method for settling existent claims, the procedure would be handled before supervisory municipal courts. Also, there is a pre-assumption that an attempt to achieve an out-of-court agreement has failed if a creditor, after the beginning of negotiation with a goal of concluding agreement on regulating the consumer commitments, opens distraint procedure or explicitly and unequivocally declares that they are not in agreement with out-of-court positions (Draft Art. 10 p.1).

2.3. The Course of Out-of-Court Procedure

The logic that legislators used when defining the course of out-of-court procedure can also be seen within the German Consumer Insolvency Procedure. The procedure is carried out in three separate stages, as will be shown in the following text.

2.3.1. First Out-of-Court Stage

With the purpose of preemptively reducing the large number of expected court proceedings, legislators have predicted the debtors’ duty to try to achieve settlements with their creditors in out-of-court proceedings during the period of 60

10 The author holds that legislators should specify that the proposal will be dismissed if the debtor deliberately or, negligently provides inaccurate or incomplete information about the current financial standing, i.e. if he/she does not act in good faith. Other positive practice and possible improvements can be observed in the example of the Slovenian legislator (in Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act, Art. 399, p.1, OG. / . RS, no.13-14).

or 90 days, respectively (Draft Art. 9), before filing the proposal for opening consumer bankruptcy procedures with the municipal court in charge (Draft Art. 5-12). The counselor is expected to assist the consumer in finding the best possible option for restructuring their debts due to creditors, and also to help them draw up a plan for debt settlement. Simultaneously, they should point out to the debtor the possibility of filing a proposal for remaining debt relief (Draft Art. 8). One should keep in mind that the problems that the debtors are encountering are very complex because, in most cases, the problems are arising from many interconnected domains (legal, psychological, and socioeconomic). However, it is assumed that the counselor will help the debtor come up with a reasonable and economically sustainable proposal regarding regulation of debt, and fulfillment of other necessary preconditions for achieving an out-of-court agreement. The out-of-court agreement achieved between the consumer and the creditor has the effect of an out-of-court settlement and it represents a plan of settling debt, as well as a distraint document (Draft Art.11, p.1). According to the Ministry of Justice of the Republic of Croatia (the promoter of the Draft), out-of-court procedures are performed in front of counsel chambers (associations, centers, legal clinics, and counsel facilities which are trained for professional counseling of consumers regarding ways of regulating their obligations (FINA-Financial Agency) (Draft Art. 7, p.2)); they are considered to be a type of formal procedure with a purpose beyond mediation between the participants in the procedure. The secondary purpose of the formal procedure is to collect all relevant information regarding creditors' claims and debtors' assets. In achieving these services, counselors act in "quasi-legal" capacity toward debtor. The counselor is mandated to consider reasons behind debtors' financial problems throughout the structural analyses of incomes and expenditures, ways of allocating resources, and possibilities of enlarging incomes and downsizing expenditures. Also, counselors suggest solutions which would avoid the aforementioned negative practices in the future. Counselor are expected to be highly familiar with other social solutions and, if necessary, to direct the debtor towards those solutions. In addition, the counselor must have financial knowledge through which they would inform debtors about the repayment of debts. The American, English, German, French, and Slovenian models of debt relief require the debtor to abide by a payment plan. The debtor is obliged to reimburse the maximum possible without endangering his fundamental existence. A goal of counseling is to help consumers adjust their lifestyle accordingly. Introducing licensed counselors in out-of-court procedures can develop broader and more flexible methods of addressing problems. The out-of-court model includes the possibility of solving legal and non-legal (socio-economic) issues. As court procedures are not always adequate for resolving issues raised in cases of insolvent individuals, there is a

question whether out-of-court or in-court procedure may be put into practice without professional help.

2.3.1.1. Active Legitimacy for Filing Proposal

Proposals for opening consumer bankruptcy procedures can be filed by either creditor or debtor. If the proposal is filed by debtor, as stated in paragraph one of this Article, they are obliged to provide to counsel chambers a list of property and creditors, a list of claims which creditors have towards them, and a statement that all the provided information is accurate and complete. Determining and defining official forms for court actions and submissions, through which parties are communicating with the bankruptcy court, will substantially contribute to a procedure simplified in this way (Draft Art. 8, p.2). Thus, besides the instructive role, the files will contribute to higher efficiency in solving tens of thousands of proposals, which are anticipated to be filed. If the proposal is filed by the creditor, they are obliged to make plausible existence of their claim and provide at least one reason for bankruptcy. It will be considered that the creditor made plausible existence of their claims if the actuality of the claim is based on distraint or a credible certificate.

2.3.2. The Second Out-of-Court Stage

The court procedure also bears elements of “good will” as it gives the consumer a new possibility of making agreements with creditors before the court concerning the court settlement (Draft Art. 12-24). The proposal is filed with the local municipal court of the debtor’s residence (Draft Art. 13). It should be noted that this second stage is considered unnecessary in German practices; therefore, the question of need for its termination arises.

Further presumptions of permissibility are: the jurisdiction of the municipal court in terms of the debtor’s place of residence (Draft Art. 13), existence of confirmation concerning failed attempts at achieving an out-of-court agreement (Draft Art. 17, p.2), and coverage of procedure costs. Otherwise, the proposal would be dismissed (Draft Art. 17, p.4). Regardless of who has filed the proposal for opening the consumer bankruptcy procedure, the Draft CBA envisages that it necessary to cover fees and advanced payment for foreseeable costs which can emerge from the opening of bankruptcy procedure. Costs must be covered even if it is determined that the debtor’s property, which is part of the Bankruptcy Estate, is insufficient for covering debt procedure costs or if the assets are of insignificant value (Draft Art. 18).

The Draft contains special provisions about costs of procedure (Art. 18) and costs of supplementary income granted to the Commissioner (Art.41).The consumer bankruptcy costs are borne by the promoter (consumer or creditor) in lump sums which are determined by the court and cannot be lower than 1.000,00 HRK. However, if the consumer is unable to cover the procedure costs (but has some property), the court can decide that costs are to be paid from the Bankruptcy Estate in advance,¹¹ and the said costs will be settled with priority from the liquidated properties of the consumer. If the consumer bankruptcy procedure is opened, the advanced amount is added to procedure costs (in comparison with BA Art. 41). In case the promoter does not pay the lump sum within a 15-day period, the court will dismiss the proposal. The rule is that every creditor bears its own procedure costs (in comparison with BA Art. 14 and AFMPS Art. 86).

2.3.2.1. Preliminary Hearing

Before opening the consumer bankruptcy procedure concerning debt settlement, the court will schedule a preliminary hearing where a debt settlement plan, attached to a proposal for opening the procedure, will be considered (Draft Art. 20). The summons for a preliminary hearing is announced via the official website (e-portal) of the courts, together with a debt settlement plan and a list of claims and creditors. Given their legal interest in the debt settlement plan, the creditors are obliged to make their position known within the period of 30 days after the summons for preliminary hearings has been published on the official website. The creditors whose claims are not included on the debtor's list, nor taken into account in the course of preparing the debt settlement plan, may ask for their settlement only if they submit a request for amending and supplementing the debtor's list within a period of 30 days after the summons for preliminary hearings has been published.

If it is determined during the preliminary hearing that the consumer's property which constitutes the Bankruptcy Estate is insufficient for settling the procedure

¹¹ Here, it is worth focusing on the experience in pre-bankruptcy settlements. Namely, the procedure of pre-bankruptcy settlements has been used by many debtors as a cheaper way of entering into bankruptcy since, in case of unsuccessful conclusion of the procedure, the financial agency (FINA) files the proposal for opening the bankruptcy procedure, by means of which they are freed from payment of fees and costs connected with the opening of bankruptcy procedure. As a result of applying of the AFMPS (Act of Financial Management and Pre-Bankruptcy Settlement- orig. ZFPPN), the practice holds that between 4.000 and 6.000 bankruptcy procedures could be opened before the Commercial Court upon FINA proposal. Multiple millions will be necessary for costs of publishing announcements, with the burden falling on the creditors or state budget, and more than tens of millions will be needed for bankruptcy managers, whose compensation is being taken from Fund Assets, which are nonexistent at the moment.

costs or the assets are of insignificant value, the court will make a decision on the opening and closing of consumer bankruptcy procedure. Simultaneously, the court will name a Commissioner and make a decision on remaining debt relief, if such a request is filed. In that case, the provisions of the Remaining Debt Relief Act apply (Draft Art. 26, p.1).

In a preliminary hearing, every creditor has the right to request a review of the entire content included in the list of claims and creditors. "Request of a review" means the right of creditors to have their declarations asserted in a timely manner regarding all claims and all creditors from the list because, in this type of hearing, the plan is either accepted in full or dismissed (compare with BA Art. 175).

2.3.2.2. Acceptance of Plan

The debt settlement plan is accepted in the following circumstances: 1.) The creditor has not responded or declared his position on the the debt settlement plan, within a period of 30 days following the publication of the summons for preliminary hearings on the official website of the courts, is considered to have accepted the plan; and 2.) If none of the creditors have opposed the plan, it is deemed to be accepted. Furthermore, the plan will be accepted in case where the judge rules so. Namely, if creditors are in disagreement about the plan, the court's decision can replace explicit consent of a certain creditor if both of the following assumptions are fulfilled: 1.) if the total number of creditors whose claims account for more than half of the total debt have given their approval, and 2.) if the creditor who has not given his/her consent is not placed in a worse position than the one he would be in if the plan were nonexistent (Draft Art. 23). In the BA, the first assumption is defined as *necessary majority* (BA Art. 240), while the second assumption is defined as *ban of obstruction* (see BA Art. 241).

Finally, if the debt settlement plan is accepted, the proposal for opening consumer bankruptcy procedure, as well as the proposal for remaining debt relief, will be considered withdrawn. The accepted plan has the effect of a court settlement.

2.3.3. The Third Out-of-Court Stage

If the creditors have not accepted the plan for regulating the debtors' obligations within the frame of court procedure, the third stage of urgent out-of-court settlement follows. This implies that simplified court insolvency procedures will be opened. This means that the procedure may be delayed because the settlement of claims can diminish in value over the time in which bankruptcy procedure is underway (Draft Art. 15, p.3).

2.3.3.1. *Opening of Consumer Bankruptcy Proceedings*

Following the close of the attempted procedure for achieving out-of-court agreement, the consumer bankruptcy procedure is opened upon a proposal filed by a consumer or creditor. The person who filed the proposal delivers confirmation that the procedure has been conducted, that an out-of-court agreement has not been achieved, and that the debt settlement plan has not been accepted in the preliminary hearing (Draft Art. 25, p.1). The opening of simplified bankruptcy procedures requires an established and admissible proposal for bankruptcy. The court appoints the Commissioner and orders that the decision on this rescript be entered in the land property register (Draft Art. 25).

Before ruling on the opening of consumer bankruptcy procedure, the court may, upon the proposal of the consumer or creditor, call for a halt of procedure for a period of minimum one and maximum three months. This can only occur under specific circumstances when, given the extension of negotiation in the case, it is found that the consumer could achieve a settlement with the creditors (Draft Art. 19, p.1). If agreement is not to be achieved, the procedure will be carried on *ex officio* (Draft Art. 19, p.2).

The report on the opening of consumer bankruptcy procedure is published on the official website (e-portal) and in the Croatian official gazette, *NarodneNovine* (Draft Art. 25). One can file an objection against the report regarding the opening of consumer bankruptcy procedure, but only in relation to the goal of settling debt. A higher court is required to accept or reject the objection within a period of two weeks (Draft Art. 25).

2.3.3.2. *Legal Consequences of Opening Consumer Bankruptcy Proceedings*

The legal consequences take effect from the moment when the report regarding the opening of consumer bankruptcy procedure is published on the official website, (Draft Art. 27). Therefore, after the opening of consumer bankruptcy procedure, consumers' disposal of objects from the Bankruptcy Estate is without legal effect. This does not apply to Estates that fall under general rules regarding protection of trust in public books. Consideration will be returned from the Bankruptcy Estate to the other side if the value of the Bankruptcy Estate is increased by consideration (Draft Art. 28). If the consumer performs an obligations in a period after the opening of consumer bankruptcy procedure, even though such obligation should have been fulfilled for the benefit of the Bankruptcy Estate prior to publishing the statement on the opening of procedure, such performance will relieve the consumer from obligations if he/she proves that, at the time of performance, the consumer was not aware that the consumer bankruptcy procedure was opened (Draft Art. 29). However, if the consumer

has gained legacy or record before opening or in the course of the consumer bankruptcy procedure, the property gained on these grounds would be entered into the Bankruptcy Estate. On the other hand, if the consumer renounces his legacy after the opening of consumer bankruptcy procedure or in the period of three years before opening of the procedure, the court will, after hearing from both creditors and debtors, evaluate the reasons of the renunciation and review the impact of said renunciation on the decision on remaining debt relief (Draft Art. 30). The most important consequence of the character of legal procedure is the cease of distraint procedures (Draft Art. 31, p.7).

2.3.3.3. Remaining Debt Relief Procedure

The consumer-debtor is obliged to clarify, while filing the proposal for opening the insolvency procedure, whether they will use the institute of remaining debt relief. In case the creditors or the Commissioner do not point out the existence of a reason for withholding that institute, the court will decide to relieve the debtor from the performance of remaining obligations. The court decision is preceded by the so-called period of verification of good behavior. During this period, the debtor's responsibility is to see the obligations¹² through and to ensure that the circumstances for denial of the institute¹³ do not occur. However, German case law points out that the majority of individuals are not capable of paying even a small portion of these claims; given the fact that a vast majority of debtors are on the verge of financial extinction, the question arises whether the period of verifying good behavior makes sense. Upon completion of the assignment, the bankruptcy judge will schedule a hearing in order to examine the proposal for relieving the debtor of remaining liabilities. After he hears the Commissioner of the debtor and the bankruptcy creditors, the bankruptcy judge will decide

12 In the period of verification of good behavior, consumer-debtors are obliged to engage in a suitable profession; they may not refuse employment, activity or seasonal work if they are qualified for such work; they are required to report to the Commissioner the inherited property, which is entered into the Bankruptcy Estate; they are obliged to report to the Commissioner, without delay, every change of residency or workplace; they cannot omit any property or any single amount covered in the declaration of assignment. Upon the request of the court and the Commissioner, they are obliged to provide information about their work or attempt to find such, their sources of income and property. If consumer-debtors adhere to all stated obligations in the period of verification of good behavior, the court will relieve them from remaining obligations after the conclusion of the verification of good behavior (Draft Art. 49).

13 These circumstances include as follows: if the consumer, during the period of verification of good behavior, is found guilty of criminal activity against the market, or other criminal activity which would indicate malpractice on their part in terms of fulfillment of their duties and obligations; if the consumer has violated in any other way their duties or prevented the settlement of their creditors (Draft Art. 50).

on the remaining debt relief. Withholding the decision on remaining debt relief upon the end of the assignment period is a very infrequently implemented measure. Regarding that measure, the court can decide only through suggestion of an active, legitimate proposal promoter and base their decisions on specifically defined reasoning. The decision on remaining debt relief is the expected outcome of long consumer bankruptcy proceedings. In case there is a lack of a legitimate proposal for the release from remaining debt, or if the proposal has been denied in the preliminary proceedings, the courts will (after hearing from the Commissioner, debtors, and creditors) release the debtors from remaining liabilities (Draft Art. 51).

3. In lieu of Conclusion: Why did the Croatian legislator adhere to the German legal solutions?

The German Insolvency Act (German: *Insolvenzordnung*, *Bundesgesetzblatt* 1994., I, p. 2866, last change BGB1, 2010., I, p. 1885; hereinafter: the InsO) entered into force in 1999 (Paulus, C. G., 2001: 89). According to rules of consumer insolvency procedure (InsO §§ 304-314), the goal of the consumer debtor is to release themselves from remaining debts by liquidating seizable property through a proportionate settlement of creditors. Special insolvency regulations provide consumers with the right to be released of debt in three stages (Backert, W., *et al.*, 2009: 285).

The first stage involves an attempt of the consumer to achieve an out-of-court agreement concerning the debtor's settlement of the creditors' claims. The condition for opening insolvency procedure is the attempt (rather than achievement) of an out-of-court agreement concerning settlement of debt.

What follows in the second stage of procedure is another attempt to come to agreement on debt settlement within the insolvency procedure. If creditors, at this point, refuse to accept the debt settlement plan, what follows is liquidation of debtors' seizable property within court procedure, which is subject to simplified rules of procedure. Depending on the debtor's proposal, remaining debt relief can occur throughout the six-year period of verification of good behavior.

The German legislators have enabled unvarying options for all insolvent consumers. Once the debtor's insolvency is established, every debtor is obliged to make predictable sacrifices. Thus, throughout the six-year period of good behavior, the debtor will cede any seizable property to creditors. When debt relief is clear and predetermined, as in German law, the path for receiving debt relief can be standardized with little room for deviation. Therefore, one must impose reasonable standards. The German experience, with all its disadvanta-

ges, provides an example of how such a process can develop within European consumer bankruptcy systems. Consequently, it is undisputed that the German model represents a model of “fairness”. The German system seems to be fairest and most consistent from the consumer’s standpoint and the legitimate sources of social education. Furthermore, the clear orientation of Croatian legislation concerning the already existent German insolvency model for consumers is meaningful because such situations allow the use of foreign court practices and foreign literature as auxiliary assets in solving problems, which will appear within applications of the “new” CBA act. Explanations and discussions from these sources are very rarely connected with isolated paragraphs. They are related to the basic principles of an appropriate act, specific solutions envisaged in that act, similar cases, and so on.

However, reforms are necessary since debt settlement plans cause problems for consumers who cannot fulfill them. In reality, one out of every 12 German households cannot settle monetary obligations which they owe (Schuldenreport, 2006: 13). From 1999 until 2005, the number of proposals for opening insolvency procedure for consumer has been increased from 3.357 to 68.898.¹⁴ After the USA which has the highest indebtedness rate (12,7%) within the international framework, Germany comes second with 8.1% rate of indebtedness. In Germany, only 6% of indebted households benefitted from being released of remaining debt liabilities (Schuldenreport, 2006: 13). In the midst of an ever greater number of indebted individuals, counselors for debtors and Consumer Protection Offices call for changing the consumers’ insolvency procedure and the remaining debt relief procedure, which would provide simplified debt relief proceedings to insolvent consumers. In the center of critique is the fact that, in cases of inconsistencies in the Bankruptcy Estate, the consumers’ insolvency procedure and the remaining debt relief procedure are too demanding and do not contribute to the settlement of creditors, which is the ultimate goal of insolvency procedure. The magnitude of the problem can be seen if one takes into consideration the data from the Federal Ministry of Justice, which states that debtors cannot settle their obligations from the Bankruptcy Estate in more than 80% of all cases. In the 1980s, the German legislator clearly stated that debt relief modeled upon the liberal American model was not, and is still not, a possibility. The current state of indebtedness of German consumers and the economically irrational positive law solutions point towards necessary changes. The former had been attempted, with numerous inconsistencies, in the Draft Act (German *Entwurf eines Gesetzes zur Entschuldung völlig mittelloser Personen und zur Änderung des Verbraucherinsolvenzverfahrens*).

14 See Statistisches Bundesamt 2006. *Press releases from 03.03.2006*, available at <http://www.destatis.de> (17.12.2014).

De lege ferenda, the author considers that it will be hard to come to a solution which would be ideal and acceptable for all parties in the consumer bankruptcy procedure. However, the legal regulation of consumer bankruptcy in positive law should rely on the continental German legal tradition, provided that certain institutes be revised without radical changes of the fundamental postulates.

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**НАЦРТ ЗАКОНА О СТЕЧАЈУ ПОТРОШАЧА РЕПУБЛИКЕ
ХРВАТСКЕ: ИНСТРУМЕНТ ПРАВНЕ ЗАШТИТЕ ЗА ПРЕЗАДУЖЕНЕ
ПОТРОШАЧЕ ИЛИ ПРОДУЖЕЊЕ STATUS QUO?**

Резиме

С обзиром на стварање нових аката у бившим социјалистичким земљама, стално се поставља питање коју врсту праксе треба следити. Да ли законодавци треба да следе традиционалане моделе у оквиру европско-континенталног система, или треба да се руководе начелима англо-америчког система, или би можда требало комбиновати најефикасније аспекте оба система? У том контексту, законодавци би требало да у област стечајног права уведу институт стечаја потрошача, који је предмет великог интересовања у правној теорији и пракси. У компаративноправној пракси се прибегава огромним компромисима приликом доношења привремених решења, у циљу проналажења равнотеже у дисперзији ризика између дужника и повериоца. Истраживање о стечају потрошача унутар правних система показало је да постоји више организационих модела стечаја потрошача. Историјски гледано, немачко стечајно законодавство је засигурно имало највећи утицај на хрватско стечајно право. Осим тога, решење о стечају потрошача преузето из немачког Закона о неликвидности (*Insolvenzordnung*) послужило је као основица за Нацрт закона о стечају потрошача Републике Хрватске из 2014. године. Сврха овог рада је да пружи увид у Нацрт хрватског закона од стечају потрошача и, истовремено, да анализира да ли је законодавац користио најефикасније примере добре праксе за постизање оптималних решења.

Кључне речи: стечај потрошача, Нацрт закона о стечају потрошача, Хрватска.

