

BANKRUPTCY OF NATURAL PERSONS: THE POLISH EXPERIENCE

1. Discharge provisions under the Bankruptcy and Rehabilitation Law of 2003

The first Polish regulation allowing for discharge of natural persons in bankruptcy proceedings was adopted in the Law of 28 February 2003 on Bankruptcy and Rehabilitation⁴¹ (BRL) and entered into force on 1 October 2003. The possibility of discharge, provided for in Articles 369-370 BRL, applied only to entrepreneurs, as non-entrepreneurs were excluded from the scope of bankruptcy proceedings. The regulation of discharge was quite rudimentary and allowed natural persons to apply for discharge of their debts on the basis of a one-off court decision, issued upon a regular conclusion of bankruptcy proceedings. This procedural solution meant that the debtor needed to cover the cost of the opening and conduct of the bankruptcy proceedings until their regular conclusion after a final distribution to creditors, as otherwise the bankruptcy request would have been dismissed (Art. 13 BRL) or, in case of subsequent lack of assets, the proceedings discontinued (Art. 361 BRL). The decision to grant discharge was only possible if the insolvency of the debtor resulted from extraordinary circumstances beyond his or her control.

Although no statistics in this regard were collected, it is believed that under those provisions decisions granting a discharge were issued only in very rare cases. The regulation of Articles 369-370 BRL was widely considered to be irrelevant in practice.

At the time of the adoption of the BRL in 2003 there was some discussion on the introduction of consumer bankruptcy, allowing for discharge of natural persons not

41 *Prawo upadłościowe i naprawcze*, Dz.U. of 2003 No. 60, item 535.

carrying out any business activity. The idea was dropped due to fears that the courts would be swamped with an avalanche of cases beyond their organisational capacities, leading to the bankruptcy court system being paralysed. It was also considered that at the time the overall degree of household indebtedness in Poland had not yet reached a level justifying the introduction of a consumer insolvency regulation⁴².

2. The initial regulation of consumer bankruptcy in 2009

Provisions allowing for consumer bankruptcy, i.e. providing for a specific subset of bankruptcy proceedings applicable to natural persons being non-entrepreneurs, were first introduced to Polish law as Art. 491¹ – 491¹² BRL by the Law of 5 December 2008⁴³, entering into force on 31 March 2009. As in case of discharge applicable to entrepreneurs, newly introduced consumer bankruptcy provisions required financing of proceedings from the debtor's assets. It led to the paradox that most debtors were too poor to afford their own bankruptcy and created a perverse incentive to hide some assets from creditors in order to be able to finance the proceedings. As in the case of entrepreneurs, discharge in consumer bankruptcy was available only if the insolvency of the debtor resulted from extraordinary circumstances beyond his or her control. Following a regular conclusion of bankruptcy proceedings, after a final distribution, a payment plan for a period of up to 5 years was to be adopted. Discharge was granted first after the payment plan period had expired and all obligations specified in the plan had been carried out. Any infringements by the debtor during this period, even minor ones, led to a compulsory annulment of the payment plan and refusal of discharge.

The above restrictive criteria resulting from conservative approach of the drafters of the 2008 law contributed to its failure in practice. During the period of application of the 2008 law from 31 March 2009 to 30 December 2014, only 121 consumer bankruptcy proceedings were opened in total (no data exist as to their success rate), which is a shockingly low number for a country of ca. 38 million

⁴² See explanatory memorandum to the draft BRL, parliamentary document no. 809 of 22.08.2002, p. 99.

⁴³ Dz.U. of 2008, No. 234, item 1572.

inhabitants. That made a clear case for a comprehensive reform.

3. Consumer bankruptcy reform of 2014⁴⁴

In 2012 a decision was taken to launch work on a fundamental reform of the Polish insolvency law, including both proceedings applicable to entrepreneurs (corporations and natural persons) and to natural persons – non-entrepreneurs. In April 2012 an expert group was formed by the Ministry of Justice, including ca. 30 persons – bankruptcy judges, bankruptcy practitioners, corporate lawyers, academics from the field of law and economic sciences and public officials⁴⁵. The composition of the group allowed to combine various perspectives while maintaining a practical approach and avoiding excessive reliance on purely academic concepts. The group produced its recommendations by December 2012⁴⁶.

During the legislative work on the insolvency law reform a political decision was taken to hasten the amendment of provisions on consumer bankruptcy. As a result, the Law of 29 August 2014⁴⁷ which entered into force on 31 December 2014, introduced new or substantially redrafted Articles 491¹ – 491²³ BRL completely overhauling consumer bankruptcy law, while the overall reform of the insolvency law had to wait until the Restructuring Law of 15 May 2015⁴⁸.

The approach taken during the work on consumer bankruptcy reform was to identify existing obstacles to the practical application of consumer bankruptcy and access to discharge and try to remove them, while striving to maintain balance with legitimate interest of creditors and avoid encouraging reckless or fraudulent behaviour⁴⁹.

The following main obstacles were identified and rectified by the 2014 reform:

44 For a comprehensive description of the Polish consumer bankruptcy law following the 2014-2015 reforms as compared to other European jurisdictions and Russia see M. Porzycki, A. Rachwał, *Poland*, in: T. Kadner Graziano, J. Bojars, V. Sajadova (eds.), *A Guide to Consumer Insolvency Proceedings in Europe*. Edward Elgar 2019, pp. 762-801.

45 Disclosure: the author took part both in the expert group and in the narrower drafting panel which worked on the exact wording of the reform laws.

46 *Rekomendacje Zespołu Ministra Sprawiedliwości ds. nowelizacji Prawa upadłościowego i naprawczego*, Warsaw 10.12.2012, available on the archived website of the Ministry of Justice, <https://www.arch.ms.gov.pl/pl/restrukturyzacja-i-upadlosc/>

47 Law amending the BRL, Dz.U. of 2014 item 1306.

48 Dz.U. of 2015, item 978.

49 See explanatory memorandum to the draft law, parliamentary document no. 2265 of 7.2.2014, p. 15.

1) the financing. A requirement to cover the costs of proceedings from the debtor's assets was lifted as a condition for the opening of proceedings. Correspondingly, temporary State financing of proceedings with no assets was introduced, modelled similarly to the German regulation⁵⁰. The State financing should be subsequently recovered, if possible, from the bankruptcy estate or repaid by the debtor under the payment plan. In many cases however the State ends up covering the costs of proceedings as the bankruptcy estate is not sufficient and the debtor not able to repay those costs. Such situation does not exclude discharge of the debtor.

At the same time some attention was also given to reduction of unnecessary costs during the proceedings. A requirement to publish official announcements in newspapers was dropped due to excessive cost and replaced by a temporary rule in view of a later introduction of an on-line insolvency register (after significant delays now planned for 2020). Limits were introduced for the remuneration of the bankruptcy practitioner which is to be set by the court in the range between one-quarter and double of the average monthly wage (approx. between 1000 PLN and 8000 PLN at the time of entry into force; approx. between 1300 PLN and 10.400 PLN at the time of writing), up to four times (currently ca. 20.800 PLN) in exceptionally complex and cumbersome cases. It needs to be observed however that the remuneration around the lower limit of the above range is considered inadequate by most practitioners.

2) access criteria. A previous limitation to debtors whose insolvency results from extraordinary circumstances beyond their control was dropped in favour of a much more lenient set of negative criteria precluding access to discharge. After the 2014 reform a general negative criterion applies of insolvency having been caused intentionally or in a grossly negligent way. Simple recklessness of the debtor does not exclude him or her from discharge. The assessment, whether behaviour of a specific debtor should be qualified as reckless or grossly negligent, is made taking into account his or her specific level of awareness, education, social status, even

50 §§ 4a-4d of the German Insolvency Code (*Insolvenzordnung*).

psychological situation.

A set of further negative criteria relates to the period of previous ten years before the bankruptcy application. A debtor is to be excluded from consumer bankruptcy if during the previous ten years he or she has infringed against his or her obligations in previous bankruptcy proceedings, has failed to file for bankruptcy (as an entrepreneur or board member of a corporation) despite being obliged to do so, or his or her legal act has been declared detrimental to creditors. Those criteria have a built-in flexibility mechanism allowing for disregarding them and opening consumer bankruptcy proceedings if justified by humanitarian or equitable grounds.

Finally, an additional restriction applies during the period of ten years since a previous discharge in bankruptcy proceedings. A new discharge is only allowed if the debtor has acted in a diligent way, with even simple recklessness precluding the opening of proceedings.

3) „safety valves” of humanitarian and/or equitable grounds. To avoid undue rigidity of the previous regulation and take into account the fact that applicants are often affected by social exclusion and have a very low level of legal awareness, the 2014 reform introduced general clauses of humanitarian and/or equitable grounds allowing for the continuation of proceedings and granting of discharge whenever under general circumstances the discharge should be refused due to some infringement by the debtor. The power to apply those clauses is vested with the bankruptcy court.

4. The structure of consumer bankruptcy proceedings introduced by the 2014 reform.

Consumer bankruptcy proceedings as introduced by the 2014 reform has two phases.

The first phase is winding-up of the debtor's assets in bankruptcy proceedings with some specific features. The proceedings can only be initiated on request of the debtor. During the proceedings a specific arrangement applies to protect housing needs of the debtor if he or she owns an apartment or a house used for personal housing purposes. In such case the real estate in question is still sold during the

proceedings but an amount from the proceeds of the sale is set aside to finance rent for an alternative lodging for the debtor for the period of up to two years.

After the debtor's estate has been fully wound-up and the proceeds distributed among creditors, the court adopts a payment plan for the debtor, specifying payments for up to three years. The payment plan needs to take into regard the debtor's earning capacity and the need to cover living expenses for him or her and his or her dependents, including their housing needs. Once the payment plan has been carried out, discharge is granted with the remaining unsatisfied part of the claims against the debtor being extinguished.

Certain debts, including those resulting from alimony claims, criminal or administrative penalties and damages resulting from crimes and misdemeanours, are excluded from the scope of the payment plan and the discharge.

The above structure has specific arrangements for cases with no assets or with the debtor manifestly unable to carry out a payment plan, as well as built-in flexibilities for subsequent changes in the debtor's situation. If the debtor has no assets, no distribution is made and the payment plan is adopted straight after the establishment of the list of creditors. If the debtor is unable to carry out any payments under the plan (e.g. due to illness or disability), discharge can be granted immediately upon the conclusion of the first phase, without a payment plan being adopted. In case of changes of the debtor's situation during the realisation of the plan payments can be adjusted in both directions or the duration of the plan can be extended by up to 18 months.

The 2014 reform also introduced a possibility to conclude an arrangement between the debtor and the creditors, allowing for a more amicable solution, e.g. to let the debtor retain some assets (for example an apartment) in return for a longer period of payments. This possibility has not been used in practice however, therefore this attempt to bring some more conciliatory spirit into consumer bankruptcy can be regarded as failed.

Last but not least, the 2014 reform did not bring any changes to court competence and/or organisation in regard to consumer bankruptcy cases. Expecting a large

overload of consumer bankruptcy cases, the expert group recommended in its initial report of 2012⁵¹ to shift the competence in consumer bankruptcy cases from insolvency divisions of district courts (currently numbering ca. 40 of them countrywide) to much more numerous and better accessible civil law divisions (above 300). This recommendation was not implemented however due to lack of approval by the government.

5. Bankruptcy and restructuring law reforms in 2015

The second and main stage of the insolvency law reform initiated in 2012 was enacted on 15 May 2015⁵² and entered into force on 1 January 2016. As consumer bankruptcy had already been reformed in 2014, the Restructuring Law did not bring any major changes to consumer bankruptcy except adaptations to the changed structure of general insolvency proceedings⁵³. Specific rules were introduced for former entrepreneurs, within a year following the cessation of their business activity. A more substantial change concerned natural persons – entrepreneurs, as the 2015 reform aligned rules applicable to them to those applicable in consumer bankruptcy. According to substantially amended and partly newly introduced Articles 369-370f BL⁵⁴ discharge of natural persons – entrepreneurs depends on the same criteria and follows a similar two-phase procedure like consumer bankruptcy. The most important difference is that the requirement to cover the costs of proceedings from the assets of the debtor still applies to entrepreneurs. In case of natural persons-entrepreneurs without sufficient assets the practical solution is to end the business activity and apply for consumer bankruptcy as a non-entrepreneur, in order to avail of the State financing of proceedings.

A standard form of request for consumer bankruptcy was also introduced following the 2015 reform, facilitating the task both for applicants and for the bankruptcy courts.

51 *Rekomendacje...*, p. 261 (see footnote 6 above).

52 Restructuring Law (*Prawo restrukturyzacyjne*), see footnote 8 above.

53 The reform introduced separate bankruptcy and restructuring proceedings instead of previously existing bankruptcy proceedings with winding-up or arrangement options.

54 The BRL (see footnote 1) has been renamed as Bankruptcy Law (*Prawo upadłościowe*), hereinafter 'BL'. Latest consolidated version Dz.U. of 2019 item 498.

6. Practical experience with the reformed consumer bankruptcy laws

The 2014-15 reform has brought a watershed change, as the consumer bankruptcy has finally started to be applied in practice and gained some actual impact on the socioeconomic reality in Poland. The number of cases has gradually reached above 6000 per year (see table below).

Year	Number of cases
Under old provisions:	
2009-2014	121 in total
Under reformed provisions:	
2015	2112
2016	4434
2017	5535
2018	6570
2019 (Jan-Sep)	5640

Source: Centralny Ośrodek Informacji Gospodarczej (a private sector commercial data provider), <https://www.coig.com.pl/lista-upadlosci-firm.php> (seen on 7.10.2019).

No statistics exist for discharge of natural persons-entrepreneurs following regular bankruptcy proceedings but the numbers are obviously much lower.

The rise in number of consumer cases has led to the paradox that insolvency divisions in courts, despite formally being commercial courts, deal mainly with consumer cases. The combined number of non-consumer bankruptcy and restructuring cases in Poland does not exceed 1000 in most years. As already predicted by the expert group in 2012, the increased load of consumer cases has led to stretched capacities and delays in insolvency courts. It needs to be observed, as a very rough estimate, that the number of consumer cases in Poland still has plentiful

room for growth, if compared with other EU Member States (for example ca. 100.000 consumer insolvencies in Germany).

7. Amendments to discharge laws in 2019

In 2017 work has started on yet another amendment of the bankruptcy law, concentrated on the regulation of discharge of natural persons, both consumers and entrepreneurs. The initial plan was to correct and clarify issues noted during first years of the application of provisions adopted during the 2014-15 reform, in particular streamlining procedures wherever possible. However, at one point the Justice Ministry took a controversial decision to further liberalise access criteria to discharge, reducing the examination of the causes of insolvency and honesty of the debtor to bare minimum.

The resulting Law of 30 August 2019 amending the Bankruptcy Law⁵⁵ introduces a number of changes to consumer bankruptcy as well as discharge of entrepreneurs with effect from 24 March 2020. The first phase, i.e. bankruptcy involving winding up of the debtor's assets will be opened also on request of creditors. Correspondingly, no negative criteria will apply at this stage beyond general opening grounds for bankruptcy proceedings (insolvency of the debtor). The verification of discharge criteria has been shifted to the moment of the adoption of the payment plan, following the conclusion of the winding-up and distribution. At this stage the court will receive a draft payment plan submitted by the bankruptcy practitioner. The court will refuse to adopt a payment plan (and grant discharge) only if the insolvency of the debtor results from his or her intentional actions or if the debtor has applied again within ten years after a previous discharge. In both cases an exception of humanitarian or equitable grounds will apply. In other cases the duration of the payment plan will vary. If the debtor has caused his or her insolvency by gross negligence, the payment plan will be adopted for a period of 3-7 years. In other cases the duration of the payment plan will be left unchanged at up to 3 years, except shorter payment plans if at least 70% or 50% of debts are to be paid (respectively up to 1 and 2 years). A new option is introduced for cases of temporary

⁵⁵ Dz.U. of 2019 item 1802.

inability of the debtor to carry out a payment plan. In such case a suspended discharge is to be granted for the period of 5 years, during which any creditor could apply for the adoption of a payment plan, if it is demonstrated that the inability to carry out a payment plan has ceased.

In addition to those substantial changes there are many detailed amendments aiming in general to: 1) streamline the proceedings, 2) increase the role of bankruptcy practitioners and reduce the workload of the courts (but no increase of the practitioners' remuneration is provided for) and 3) further simplify cases with no assets or manifest inability of the debtor to carry out any payments. As there are no changes to court competence and no additional resources are allocated for bankruptcy courts, a further increase of case overload and corresponding delays is to be expected due to the liberalisation of the access criteria.

A much more detailed regulation of voluntary arrangement between the debtor and the creditors in consumer bankruptcy (new Articles 491²⁵-491³⁸ BL) has replaced the hitherto brief provision. It remains doubtful however whether it will lead to increased attractiveness of the arrangement for the stakeholders.

8. Future: implementation of the EU Restructuring Directive

It needs to be noted that Polish insolvency law will soon be affected by the requirement to implement the Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132⁵⁶ (hereinafter 'the Restructuring Directive'). The implementation deadline set in the Directive is 17 July 2021. Although the Restructuring Directive does not apply directly to consumer insolvency, it covers discharge procedures applicable to natural persons-entrepreneurs and it leaves to the discretion of Member States whether to extend the application of those procedures to insolvent natural persons who are not entrepreneurs (Art. 1(4) of the Restructuring Directive). In those Member States that, as Poland, provide for identical or similar

⁵⁶ OJ L 172, 26.6.2019, p. 18–55.

discharge procedures for all natural persons, entrepreneurs and consumers, it is to be expected that the implementation of the Restructuring Directive will be extended also to consumer insolvency.

As the structure of Polish discharge regulations broadly corresponds to the requirements of the Restructuring Directive, no fundamental changes will be needed to implement it. Some adjustments will be doubtlessly introduced. Some issues remain doubtful at this stage – as an example, will it be acceptable for the Member States to extend the maximum duration of the payment plan beyond the 3 years provided for by the Restructuring Directive, if the extension is requested by the debtor and given exclusively for his or her benefit?