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New regulation of the insolvency law

The Act on Bankruptcy and Settlements

Although Act No. 328/1991 Coll., on bankruptcy and settlements (the "Act on Bankruptcy and Settlements") has gone through a number of both partial and more extensive amendments throughout its existence, its current wording preserves essentially the original concept, which does not take into consideration the actual trends in the insolvency law. This obsolete concept is reflected in mutual relationships between the bankruptcy creditors, the court and the receiver (administrator of bankruptcy assets) which is characterised in particular by the insufficient powers of creditors and the creditors' committee, by unsuitable regulation of the position of the trustee in bankruptcy, by the excessive powers of the court in the bankruptcy proceedings, by a lack of regulation as to the position of the so-called non-bankruptcy related creditors and to the satisfaction of their claims or receivables, and finally also by lacking any provisions ruling the re-organisation of the debtor and providing for non-liquidation forms to solve bankruptcies in general.

As the aforementioned deficiencies could not be overcome in the past despite numerous amendments and extensive changes in legislation, the Czech Republic elected to perform a re-codification of the Act on Bankruptcy and Settlements. The re-codification process later culminated in the adoption of an entirely new law, Act No. 182/2006 Coll. on bankruptcy and its solutions (the "Insolvency Law"), which will become effective on 1 January 2008, and which represents a substantial change to the existing concept of the bankruptcy law.

Insolvency proceedings

The new legislation aims to increase the respective efficiency of the bankruptcy proceedings. Therefore it enables some institutes to take steps immediately after the commencement of the insolvency proceedings (e.g. the applications for receivables could be filed in advance, the court can appoint a preliminary administrator or trustee). The commencement of the proceedings has also an important impact on the debtor in the disposing of his assets, and makes it possible to take the necessary steps to establish the bankruptcy assets immediately after the motion for instituting the insolvency proceedings has been filed. This stage ends with a decision on whether there is bankruptcy on the part of the debtor and how to deal with such situation. As opposed to the regulation in the Act on Bankruptcy and Settlements, the new law can solve not only the bankruptcy of the debtor, but also an impending bankruptcy.

Ways of dealing with bankruptcy

Apart from the traditional bankruptcy proceedings (which can still be considered in respect to both entrepreneurial as well as non-entrepreneurial entities), there is a new way of dealing with bankruptcy, namely the reorganisation process, which is intended to strengthen the rehabilitation (stabilization without liquidation) function of the insolvency proceedings, and whose purpose is to maintain and preserve the operations of the debtor's business/enterprise. Reorganisation is not a general procedure applicable to any case of bankruptcy. An entrepreneur can enter into reorganisation only if his total turnover for the last accounting period preceding the insolvency proposal reached at least CZK 100,000,000, or if he has at least 100 employees in full-time jobs. The whole reorganisation process is based upon a reorganisation plan approved by the court; this plan is to observe whether the operation of the debtor's enterprise has been preserved through measures to recover his business while continuously monitoring the plan by the creditors. The purpose of the reorganisation is also the arrangement of the debtor's relationships with its creditors, which consists in the gradual satisfaction of their receivables.

The bankruptcy can also be solved in another, also essentially rehabilitative, manner of dealing with bankruptcy, namely by the so-called discharge from debts. This can only be used for non-entrepreneurial entities (both natural and legal persons). The discharge from debts will be applied in particular to those debtors who are not able to repay their mortgage, consumer loan or similar debts, and this form of dealing with bankruptcy will thus enable them to avoid execution imposed on their assets. According to the insolvency law, those who are bankrupt will have two options. The first variant consists in an arrangement with creditors and with the bankruptcy court for repayment of debts in instalments; repayment can be spread over up to five years, for which period the debtors will only retain subsistence

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money from their income. However, in this option they will retain their assets. The second possibility consists of the debtor will retain his income, but his/her assets will be liquidated. In any case, an insolvency court will decide on the possibility of discharging debts. The court has to consider whether the creditors without security will obtain at least 30% of their receivables, as well as whether an unfair intention is being pursued through this form of settlement. After fulfilling due conditions for the discharge from debts, the court will relieve the debtor of his/her remaining payables in the proportion in which they have not yet been satisfied.

The insolvency law provides for a specific proceedings in the case of a so-called negligible /in Czech "nepatrný"/ bankruptcy, which can be determined by the court if the debtor is an individual – a natural person – who is not an entrepreneur running a business, or if the total turnover of the debtor for the last accounting period preceding bankruptcy did not exceed CZK 2,000,000 and if the debtor has not more than 50 creditors. Such bankruptcy proceedings then follow the decision of a meeting of creditors, or, as the case may be, simplified rules provided by the insolvency law. If not contradictory to the decision of the meeting of creditors, the insolvency court may set further departures for the course of the negligible bankruptcy.

Moratorium

The moratorium institute is intended to replace the existing legal regulation on a protective time limit, which has not proved particularly effective in practice and which represents a continuation of a different construction of bankruptcy, and of a definition of impending bankruptcy in the new insolvency law. The moratorium aims to ensure the protection of the debtor – a businessman in the insolvency proceedings – namely for a period of three months. In the course of this period, the debtor has to use his own proceeds to prevent bankruptcy or impending bankruptcy. A proposal for moratorium may be filed before or after commencement of the insolvency proceedings. The moratorium institute cannot be applied to a debtor who is no longer running any business (a legal entity in liquidation).

The standing of creditors and the debtor

The new insolvency law substantially reinforces the standing of creditors. Whereas under existing regulation creditors can only be more active in later stages of any pending bankruptcy proceedings, the new legislation provides for their participation from the very start. In particular, creditors will have direct influence on the selection of the insolvency administrator, i.e. trustee in insolvency; at the first meeting of creditors after the examination negotiation, they can remove the insolvency administrator appointed by the court (specifically by the chairman of the insolvency court) and decide on a new administrator. The standing of the so-called secured creditors has also been reinforced: their receivables shall be satisfied from liquidation law, receivable or other assets securing their receivable. As opposed to the existing legislation, their satisfaction is not limited to 70% of the proceeds obtained by liquidating assets (sale) - a thing or another asset, which was the subject of security. When realizing them, the insolvency administrator is also obliged to follow the instructions of the secured creditor/s.

The insolvency law affects not only the position of creditors, but it also essentially modifies the legal standing of the debtor: when some effects currently related to the bankruptcy order (declaration of bankruptcy) are now connected with filing a motion for the bankruptcy order (by publishing the resolution on the commencement of insolvency proceedings in the insolvency register). From that moment, the debtor is obliged to refrain from any disposal of his assets, if such disposal consisted in substantial changes of the assets, in the use of such assets or their significant reduction; whereas this limitation does not relate to acts necessary to operate an enterprise to avoid and prevent impending damage, to meet statutory subsistence duty, or to satisfy procedural sanctions.

Insolvency administrator

A special law now deals with the persons of administrators, namely Act No. 312/2006 Coll. on insolvency administrators, which comes into effect on 1 July 2007. Any natural person, public company/partnership, a foreign trading company or a foreign association can become an insolvency administrator, who, under the new regulation, is more than an assistant to the court but a representative of the creditors, as is the case now. The persons authorised to be active as insolvency administrators are registered in the list of insolvency

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administrators in the insolvency register. As a condition to execute the functions of the insolvency proceedings, the insolvency administrator must pass an examination, or, as the case may be, pass a different examination in some professions (lawyers, tax advisors, auditors or notaries). The law on insolvency administrators sets a general obligation for the insolvency administrators to get continuous (lifetime) education and deepen their expertise for the orderly execution of the tasks of the insolvency administrator.

In addition to the standing of the insolvency administrator, the new regulation also provides the new position of the preliminary administrator, who can be appointed by the court even before the decision on the bankruptcy of the debtor has been made. After issuing the decision on bankruptcy, the preliminary administrator becomes the insolvency administrator with full powers, except that when the court provides otherwise in the said decision. The court may also appoint a separate insolvency administrator, who is appointed only to make such specified acts in the insolvency proceedings which cannot be made by the primarily determined insolvency administrator due to his relationship to some of the debtor's creditors or some of the representatives of the debtor's creditors. The court shall appoint a special insolvency administrator when, within the framework of the insolvency proceedings, special problems requiring special expertise have to be resolved.

Insolvency Register

The insolvency law introduces the entirely new institute of Insolvency Register, which represents one of the fundamental changes in the new bankruptcy legislation. This is a public administration electronic system available to the public and operated by the Ministry of Justice. Through the Insolvency Register, written documents set by the insolvency law are published. In addition, all filings and deeds made within the framework of the insolvency proceedings shall be put in the Register; thus it is possible to learn the content of a bankruptcy file through the Register. The Register also includes a list of debtors and a list of insolvency administrators.

Conclusion

The adoption of the Act on Bankruptcy and Settlement and on the methods of solutions thereof (the insolvency law) represents the culmination of the long journey the Czech Republic set out on several years ago. As early as 2001, the Government had approved the material intention of such law in connection with the building and development of a unified model of the bankruptcy law within the EU. The Act also takes into consideration respective comparative studies of similar regulations in other countries, in particular in the US and Germany, and it should also meet requirements on the regulation of the bankruptcy laws in other European countries, and at the same time correspond to specific demands in respect to the legal and economic environment in the Czech Republic. The new legislation essentially changes an approach not only to issues connected with the bankruptcy of both business and non-business entities, but it should in particular be more motivating for debtors to overcome their bankruptcy.

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