

Bankruptcy law shows best effort

EXPERT FILE

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It has been 15 years now since bankruptcy law was reinstated in the Czech Republic, yet the process of closing a business and resolving bankruptcies in the Czech Republic takes on average 9.2 years and costs 14 percent of the estate value, according to the World Bank's latest "Doing Business" report. No wonder there have been loud calls in recent years to reform Czech bankruptcy law.

The bankruptcy law has in fact been changed several times since the early '90s, but now both businessmen and others resident in the Czech Republic may look forward to seeing a brand-new law coming into practice. The modern concept of bankruptcy for both natural and legal persons in the form of the new Insolvency Act will become effective July 1, 2007.

The new concept attempts to achieve a few goals simultaneously: its first task, certainly, is to fix the worst aspects of the former bankruptcy proceedings, that is, to shorten the proceedings and make them much more transparent, give a more influential or stronger position to creditors and render the entire process more efficient. To this end, the new law has been given a more extensive and more accurate structure, the terms it uses have been made more exact, deadlines have been implemented and a number of crucial decisions have been passed directly to creditors.

The new — and to some degree revolutionary — law, however, has a higher ambition: it offers a modern way of resolving insolvency by allowing the insolvent or the excessively indebted to conclude an agreement with their creditors on the method of debt settlement by the process of a so-called reorganization, meaning that the assets of such a company do not necessarily have to be sold out and its enterprise liquidated.

One of the purposes of this approach is to force debtors to adopt a much more active approach during

the entire bankruptcy process, motivate them to not procrastinate regarding their own declaration of bankruptcy as they ordinarily have done, leaving a motion for the adjudication of bankruptcy to be the "last resort."

It's naturally the creditors who are supposed to benefit from this new attitude of the debtors, making it thus more feasible for them to recover a part of their receivables, even if only to a small degree.

The new bankruptcy law also brings a new chance for natural (non-corporate) persons to resolve their outstanding debts. Individuals will now have the opportunity to resolve their insolvency not only by selling their property but also by means of a so-called debt clearance. To those who aren't entrepreneurs, or to those who in their business didn't exceed the amount of Kč 2 million (€ 70,700) in turnover in the previous accounting period, the so-called "minor bankruptcy" shall apply. However, these special simplified proceedings may not apply where a debtor has more than 50 creditors.

The relief consists in the fact that in order to take certain steps in

the bankruptcy proceedings (such as the requirement for an agreement on the mutual settlement of the common property of spouses to take effect), the consent of the court or the creditors will no longer be necessary.

Getting reorganized

It's beyond any doubt that the new insolvency law will improve the position of creditors in many respects. On one hand, the so-called "secured" creditors may rejoice. These are, in the main, banks and other financial institutions that have secured their claims against the risk of a debtors' nonpayment in various ways, such as real estate or securities collateral. These "secured" creditors shall continue to belong in the category of so-called "separate" creditors, meaning that their claims are to be satisfied exclusively from the sale (realization) of property whereby such claims are secured under bankruptcy. However, under the new bankruptcy law, they will see their claims satisfied from the proceeds of the sale of the pledged (securing) property in full (100 percent) and not merely to 70 percent as is the case under the current legislation.

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On the other hand, under the new bankruptcy law “nonsecured” creditors will gain a stronger position and more powers than they have thus far had. As a case in point, the new bankruptcy law gives them the key word in deciding how the bankruptcy of a particular debtor should be resolved. It also puts in these creditors’ hands an entire host of procedural tools giving them more control over the actions of the insolvency trustee in the course of bankruptcy proceedings. If the creditors aren’t satisfied with the actions of the insolvency trustee, they will now have the power to remove the trustee practically at any time and propose that the court appoint a new insolvency trustee.

Therefore, it will now be primarily creditors who have the power to decide on the form of their debtors’ bankruptcy.

There will be the option of a gradual satisfaction of the creditors’ claims by a “reorganization plan,” as approved by the creditors and the court, while keeping the debtor’s enterprise in operation.

Reorganization will be possible with a debtor who is an entrepreneur whose turnover in the last accounting period exceeds Kč 100 million and who employs more than 100 people. If both the secured and non-secured creditors give their consent, the court may approve reorganization as a solution even if the bankrupt doesn’t fall within the above-described parameters. If reorganization is approved after it has been consented to by the creditors, it shall be carried out according to a so-called “reorganization plan,” which is again subject to the approval of the creditors and the court before it is put into practice. Once the obligations of the debtor are fulfilled and the aims of the reorganization plan achieved, and the debtor’s claims have been settled in the manner and to the extent as agreed, the bankruptcy proceedings are terminated and the debtor’s enterprise can carry on with its ordinary activities as it did before the reorganization.

In the case of natural persons, the analogy for the reorganization is a so-called debt clearance. Upon a debtor’s motion, and following the preliminary consent of the creditors, the insolvency court will decide whether or not a debtor is to be allowed to settle its debts by debt clearance. The debt clearance may either be executed by a single sale of the debtor’s property or by the debtor’s adherence to a pre-agreed schedule of payments.

When a debtor applies to the court for approval for debt clearance, the debtor is obliged to present to the court an estimate of its total income

for the next five years and a statement of its total income for the past three years. Should the return of a debtor’s obligation be lower than 30 percent of the debt claimed — as long as the debtor is allowed to repay gradually by installments — the debtor needs to acquire nonsecured creditors’ consent with the settlement before it may be approved by the court.

Best of the recent laws

The final sections of the new bankruptcy law are dedicated to special bankruptcy proceedings for banks, savings banks, insurance companies and credit cooperatives.

The wording of the new insolvency law is certainly among the best stock of Czech legislation in recent years. The law gives the feel of a solid, logical and perfected piece, showing relatively few indefinite or unintelligible concepts or terms. Dare it be said that when it comes into effect in the middle of next year and after it has had a chance to be practice, the new bankruptcy law will bring a positive change in the field of excessive indebtedness and insolvency resolution.

However, a downright reform of the pathetic condition of Czech justice including the parts that han-

dle bankruptcy cannot be expected since no law alone may succeed in this. That would require a fundamental change in those who participate in this environment and, in fact, create it. However, the basic conceptual deformation of what is honest, moral and ethical in the minds of Czech businessmen and the Czech judiciary, bankruptcy trustees or other bankruptcy players cannot be straightened out overnight by even the most genial law under the sun. ■

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