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Infoservis – Insolvency Act effective 1st January 2008

On January 1, 2008, the new act regulating insolvency – Act No. 182/2006 Coll., ***on Bankruptcy and Its Settlement Methods – the Insolvency Act*** (and related Act on Insolvency Administrators), will take effect. The Insolvency Act will replace Act No. 328/1991 Coll., *on Bankruptcy and Composition*, as subsequently amended. In this edition of information service we would like to inform you on the most important changes introduced by the new Insolvency Act.

In general

The Insolvency Act (hereinafter referred to as the „***IA***“) implements new institutes in the area of insolvency law of the Czech Republic. IA newly constitutes approach to settlement of debtor's bankruptcy (or threatening bankruptcy as the case may be). The essential change concerns the conception of insolvency proceedings, creditors´ standing and the way in which they can affect the course of settlement of the debtor's bankruptcy.

The insolvency proceedings are, according to the new regulation, divided in several phases. In the first phase it is decided whether the bankruptcy exists and if affirmative, how to settle it. After the decision on bankruptcy is made, the proceedings are differentiated so for each method of settlement of bankruptcy different procedure is chosen. However, some of the common principles persist and there is no barrier line between the individual methods of bankruptcy settlement. In case some of the manners of bankruptcy settlements appear unsuccessful, they may turn into *bankruptcy* (in Czech "*konkurz*"), which remains one of the main methods of bankruptcy settlements.

On the other hand, IA introduces new, so called rescuing bankruptcy settlements (i.e. non-liquidating bankruptcy settlements). So called *restructuring* is an entirely new institute, which means a gradual satisfaction of creditors´ claims while preserving the debtor's business in running, secured by measures aimed at stabilizing the business economy under the reconstruction plan approved by court, with periodical inspection of its fulfillment by the creditors (reconstruction can be made e.g. by waiver of a part of debtor's debts or by suspension of their due dates or by sale of debtor's business, by debtor's merger, etc.).

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Another entirely new bankruptcy settlement is so called *discharge of debts* – this settlement is only available to debtors who are not entrepreneurs (this anticipates two forms which are discharge of debts by realization of assets and discharge of debts in a form of an installment calendar).

Another new institute is so called *moratorium* which offers the debtor a possibility to overcome its crisis situation out of the insolvency proceedings, however only upon assumption, that the debtor will cooperate with the creditors.

IA also stipulates for the institute of *insolvency register*, i.e. an information system through which some of the deeds will be published; considering that IA presumes entering of decisions of the insolvency court and all filings, through the register it will be possible to get acquainted with a court file practically immediately. The insolvency register should also contain a list of debtors and a list of insolvency administrators.

Further, the IA newly regulates *creditors´* standing. The creditors will have immediate influence on the choice of settlement of debtor's bankruptcy. The creditors will directly influence the choice of the insolvency administrator and the control function of creditors´ bodies will be strengthened. Concurrently, the members and alternate members of the creditors´ committee are obliged to act with due diligence while exercising of their office, and they are liable for damage or other detriment they cause by unprofessional exercising of their office (they are also liable for their employees and other persons, through whom they performed or should have performed their duties).

How to find out that insolvency proceedings have been commenced?

The insolvency court is obliged to notify a commencement of the insolvency proceedings by means of a notice, which has to be published (on the official notice board and in the insolvency register as well) within 2 hours of the receipt of the insolvency petition at the latest. Such a notice has to be delivered to the parties to the insolvency proceedings (to the debtor and creditors).

* Note: On September 27, 2007 the Chamber of Deputies ratified amendment to the Insolvency Act, which was already reviewed by the Senate and currently is about to be reviewed by the President. The amendment modifies the aforesaid situation so the insolvency petition should be - because of protection against abuse in competition –

provided with certified signature or secured electronic signature. In the course of the next year, the insolvency courts should declare insolvency proceedings during working hours. Companies facing the insolvency petition should be excluded from tenders only when the court recognizes the petition justified.

Commencement of the insolvency proceedings – Insolvency petition

The insolvency proceedings can be commenced only upon a petition. It has to be commenced on the date when such an insolvency petition was received by the competent court. An insolvency petition can be lodged by the debtor or his/her creditor; in the event of a threatening bankruptcy, the insolvency petition can be lodged by the debtor only.

A creditor – petitioner is, besides other duties, obliged to bring evidence that he/she has a due and payable claim towards the debtor and he/she is obliged to attach its registration to the insolvency petition.

Prior to the decision on the insolvency petition, the insolvency court can order the insolvency petitioner to pay within a set out period of time an advance for the costs of the insolvency proceedings, such an advance can the court order in the amount up to CZK 50,000 (should the number of the petitioners be more than one, they are obliged to pay such an advance jointly and severally). The court has to refuse the insolvency petition provided there was no evidence brought to prove, that the insolvency petitioner and at least one other person had a due claim towards the debtor.

What threatens in case the court dismisses or rejects the lodged petition or discontinuous the proceedings?

In case the insolvency petition proceedings was discontinued or the insolvency petition was dismissed or rejected by default on the part of the insolvency petitioner, the debtor (or other debtor's creditor) has a right to compensation of damage or any other detriment, she/he suffered from commencement of the insolvency proceedings and from measures taken in the course of the proceedings. As to the liability to the debtor, in the event of a doubt it is taken for granted that the insolvency petitioner is responsible for the discontinuation of the insolvency proceedings or refusal of the insolvency petition – i.e. if he/she wants to be released from such liability to pay damages to the debtor, he has to prove the contrary.

Should the insolvency petitioner be a legal entity, the members of its statutory body guarantee the payment of the compensation of damage or other detriment jointly and severally, unless they have proven, that without undue delay after filing of insolvency

petition, they informed the insolvency court on the fact that the insolvency petition was lodged without grounds or that another condition set out by the law for the granting of the decision on bankruptcy was not met.

The debtor has to file the action within 3 months of the day when he/she was delivered the decision by which the insolvency petition proceedings are terminated, at the latest; another debtor's creditor has to file such action within 3 months of the publication of this decision in the insolvency register at the latest (however, the court should not decide on such an action prior to the legal effect of the decision on termination of the insolvency petition proceeding).

Ineffectiveness of legal acts of the debtor

Ineffective legal acts are those, by which the debtor shortens the possibility to satisfy creditors or prefers some creditors to the prejudice of the others. The insolvency court decides on ineffectiveness upon a petition of the insolvency administrator. Persons in whose favour the ineffective legal act was performed or who had benefited from it are obliged to deliver the debtor's fulfilment into the estate.

The following may be considered such legal acts:

a) A legal act without adequate counter-fulfilment (i.e. a legal act by which the debtor undertook to provide the fulfilment free of charge or for counter-fulfilment whose price is significantly lower than the usual price) - it is possible to object to such a legal act without the adequate counter-fulfilment if it was performed within the previous 3 years before the commencement of the insolvency proceedings in favour of a person close to the debtor or subject forming with the debtor concern or within 1 year before the commencement of insolvency proceedings in favour of another person. In case of a legal act performed in favour of another person, additional condition has to be fulfilled under which it should be an act performed when the debtor was already in bankruptcy or an act which led to the bankruptcy of the debtor.

b) Discriminative legal acts (i.e. a legal act in whose consequence a creditor will receive higher satisfaction to the prejudice of the other creditors than it was stated in the bankruptcy – e.g. the debtor paid the debt before it became due) - it is possible to object to such a legal act provided, that it was performed within the previous 3 years of the commencement of the insolvency proceedings in favour of a person close to the debtor or subject forming with the debtor concern or within 1 year before the commencement of insolvency proceedings in favour of another person. Also in this case additional condition has to be fulfilled, under which, in case of a legal act performed in favour of another person, it should be an act performed when the debtor is in bankruptcy or an act which could lead to the bankruptcy of the debtor.

c) Intentionally shortened legal acts - it is possible to object also to a legal act by which the debtor intentionally shortened the satisfaction of the creditor if this intention was known to the second party or must have been known to this party due to all circumstances (in case of legal acts performed in favour of a person close to the debtor or a subject forming with the debtor concern, the debtor's intention is presumed). It is possible to object to such a legal act if it was performed within the last 5 years before the commencement of the insolvency proceedings.

Insolvency Administrator

The insolvency administrator is appointed by an insolvency court. The court appoints a person determined by a presiding judge of an insolvency court. Under the new regulation, at the meeting of creditors, which immediately follows the review proceedings, creditors can decide on revocation of the insolvency administrator appointed by the insolvency court and on appointing of a new one. The respective decision of the meeting of creditors is approved by the insolvency court.