Several practical points regarding insolvency proceedings

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Monitor the insolvency register

The insolvency law provides creditors with new rights, not yet seen in this country, and from that point of view it is for sure much more “verifiable” than the preceding law about bankruptcy and reconciliation. On the other hand, however, it is rather strict, even merciless upon creditors in many aspects.

The essence of any insolvency proceedings from the point of view of the creditor is a timely applying of receivables. It must be stressed that in the regime of the Czech bankruptcy legislation a creditor need not become informed about bankruptcy of his partner or another debtor at all! In fact it is not the obligation of the insolvency court, either of a receiver to notify the creditor of commencement of the proceedings and even of declaration of bankruptcy of the debtor. The notice about commencement of insolvency proceedings is published only in the insolvency register maintained by the Ministry of Justice (isir.justice.cz).

This in itself would not mean much danger if the law, in addition to this, did not provide relatively short periods, and at the same short expiry dates for application of receivables (30 days to 2 months from the decision of the court about declaration of bankruptcy while it is up to the court which specific period to impose in a particular case – according to our experience it is most often the shortest one, it means a 30-day period). Receivables applied with a delay are not considered during the insolvency proceedings, they cannot be satisfied in the proceedings at all. In practice it means that the chances of such late applied receivable are zero although the receivable as such does not expire. It cannot be anticipated that some assets will remain after completion of the insolvency proceedings from which such “late-comers” could be satisfied.

How not to miss the period for application? In this context there is no other solution but to monitor the insolvency register. If a company has debtors whose financial position is not very good, regular monitoring of the insolvency register really pays off. For larger companies it is advisable to consider whether to invest into special software which arranges automated monitoring and warns the company about new insolvencies, relevant for the firm.

It pays off no to overdo

Regarding the application of receivables relatively strict penalties must be considered which can be imposed if you apply a receivable higher than the real amount, resp. higher than the amount in which it will be later in the insolvency proceedings defined (confirmed). If the receivable is confirmed later in an amount lower than 50% of the applied amount the whole applied receivable will not be satisfied in the insolvency proceedings. Moreover, the creditor can be ordered to pay into the basis an amount corresponding the amount in which the receivable was rejected. This obligation is guaranteed by persons who signed the application of the receivable (resp. the statutory body issuing a power of attorney for that purpose)! Similarly, with application of secured receivables the creditor is in danger of a penalty for claiming the right for satisfaction from the security (in practice in particular from a pledge) in a better priority than the real (resp. corresponding an agreement of creditors). If this happens the right for satisfaction from security would not be considered in the insolvency proceedings at all and the secured creditor would have to be satisfied together with other unsecured creditors.

From the point of view of creditors' practice it is also important to claim in time penalty interest from receivables after maturity. In compliance with the provisions of Section 170 point b) it is impossible to claim in insolvency proceedings such interest, penalty interest and penalty fee which became payable only after the decision on bankruptcy. If maturity of such interest is not provided directly by the agreement and its maturity therefore, according to generally applicable legal regulations, comes only on the date following delivery of the creditor's request for its payment it is necessary in the case of problematic debtors to claim regularly (best before the beginning of the insolvency proceedings, after their commencement immediately) relevant penalty interest so that the interest becomes payable before possible declaration of bankruptcy. If this does not happen it is not possible to cover the relevant interest in the insolvency proceedings at all.

It is a frequent mistake that creditors rely on the fact that they have an open court dispute (or arbitration proceedings) with the debtor regarding receivables against the debtor simultaneously with the bankruptcy proceedings and have often also an effective execution title. In this context it must be stressed that even such receivables must be applied in the insolvency proceedings. If this does not happen they cannot be satisfied in the insolvency proceedings through which the chances for their real payment in fact expire.

One of the most important rights of creditors of a bankrupt is the possibility to recall and appoint a new insolvency administrator according to their discretion. It must be, however, pointed out that creditors have this right only at their first meeting which follows after the review meeting. For that reason, the creditors should pay attention to the person of the insolvency administrator, who is regarding the decision making about the assets basis one of the most important persons, sufficiently in advance to arrange support of a majority of creditors for the person they trust.

Obligations of debtors

A debtor must be first of all warned about his legal obligation to submit an insolvency proposal without an undue delay after he became aware or should become aware with a proper care about his bankruptcy. The same obligation is of the statutory body and the liquidator of the debtor who is a legal entity in liquidation. If this obligation is not complied with, i.e. the insolvency proposal is submitted late or is not submitted at all those persons (it means also the statutory body or the liquidator of the debtor) are liable pursuant to the provision of Section 99 of the insolvency law for a damage caused to creditors. Regarding liability of statutory bodies it is important to know that creditors claiming compensation of the damage need not have to prove its amount because it is presumed by the insolvency law in Section 99 as damage or another detriment consisting in the difference between the receivable amount defined in the insolvency proceedings applied by the creditor for satisfaction and the amount received by the creditor in the insolvency proceedings for satisfaction of the receivable. The debtor, resp. his management is released from the liability for damage or another detriment only if he proves that the failure to comply with the obligation to submit the insolvency proposal did not influence the scope of amount defined for satisfaction of the receivable applied by the creditor in the insolvency proceedings or that he did not comply with this obligation due to reasons occurring outside his will and which he could not overcome even with spending of any effort which can be reasonably required from him.

Two forms of bankruptcy

The law differentiates two forms of bankruptcy, this bankruptcy due to insolvency and bankruptcy due to over indebtedness. Insolvency becomes in the case when the debtor:

1. has more creditors and
2. monetary liabilities after maturity for a period exceeding 30 days and
3. he is not able to perform the liabilities.

The law further presumes through refutable legal presumptions that the debtor is not able to perform his payable liabilities if:

1. he interrupted payments of a substantial part of his monetary liabilities, or
2. he does not perform them for a period exceeding 3 months after maturity, or
3. it is impossible to achieve satisfying of any of payable receivables against the debtor through performance of decision or execution, or
4. he has not performed the obligation to submit lists defined in Section 104 (1) imposed to him by the insolvency court.

Bankruptcy in the form of over indebtedness becomes when a debtor who is a legal entity or a physical person – entrepreneur has more creditors and the sum of his liabilities exceeds the value of his assets. In specification of the value of the debtor's assets, also further management of his assets is considered, resp. further operation of his business if it is possible, considering all circumstances, to anticipate reasonably that the debtor will be able to continue in management of his assets or operation of his business. In this context it is necessary to state that according to the amendment of the insolvency law, approved so far only by the Chamber of Representatives, probably the obligation will apply in the future to submit an insolvency proposal only in the case of bankruptcy due to insolvency not therefore due to over indebtedness.

Present bad practice – insolvency vexation

Finally, it is suitable to mention the bad practice of recent times, vexation insolvency proposals, a situation when various creditors endeavour to achieve satisfaction of their – often questionable – receivables through submission of an insolvency proposal against a debtor who is not bankrupt. Instead of claiming their title through finding proceedings and then execution; they misuse therefore insolvency proceedings the effects of which start, pursuant to the new law, already at the moment of their commencement. The debtor is then often forced rather to pay the questionable receivables to divert not only legal effects of insolvency proceedings (limitation of disposal with his assets, etc.) but in particular other consequences – loss of reputation, deterioration of credit conditions, etc. The legislation does not enable de facto any preventive protection therefore it can only be recommended to claim consistently compensation of damage against such vexation creditors (and resp. their statutory body) under the title of their responsibility pursuant to the provisions of Section 147 of the insolvency law. At the same time it is necessary to appeal the general, as well as creditors' public of such a "debtor" not to perceive commenced insolvency proceedings as a definitive confirmation of a "sentence" on his insolvency. This is and can be only the court decision on finding of his bankruptcy.

To overcome a situation that a business in the position of a debtor becomes a target of similar vexation practices and questionable receivable not to be claimed by third entities (often founded for the purpose or so called "empty" companies without assets against which the above mentioned compensation of damage can be claimed only hardly) a recommendation is advisable to check properly contractual partners and at the same time to insist in all agreements on prohibited assignment of receivables to third entities without consent in writing from the debtor.

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