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Novelization of the Insolvency Act 2017

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- **The novelization of the Insolvency Act**, i.e. the Act No. 64/2017 Coll., by which the Act No. 182/2008 Coll., the Insolvency Act („the **IA**"), is amended, will become effective as of **1st July 2017.**

- **The aim of this rather large novelization** is especially: (i) to reinforce the protection of businessmen against so-called bullying insolvency petitions, (ii) to realize changes in the field of the debt relief, which have turned out to be necessary due to the application practise, and (iii) to increase the transparency of the insolvency proceedings.

I. Protection against so-called bullying insolvency petitions

- The novelization embodies new institute of **the preliminary assessment of an insolvency petition submitted by a creditor** (Section 100a IA). The insolvency court will be newly obliged to assess the insolvency petition filed by a creditor immediately after its delivery, i.e. **before its publication in the Insolvency Register**. If the court will see **any doubts about the legitimacy** of such petition, it will decide that neither **the insolvency petition** nor any other accompanying documents **will be published** for a certain period of time. This procedure should **eliminate negative impacts** caused by abusing insolvency petitions, which are sometimes submitted by entrepreneurs in order to deliberately injure their business competitors by the actual fact that the opening of the insolvency proceedings is published in the Insolvency Register.

- The novelization **modifies the existing legal definition of bankruptcy in the form of insolvency** in relation to businessmen keeping accounts. The novelization introduces **new institute of so-called coverage gap**, which means the difference between the amount of due monetary debts and the amount of debtor's disposable incomes. According to the new legislation (Section 3 (3) IA) there is the presumption of non-bankruptcy, where the coverage gap reported in the statement on the state of liquidity does not exceed 10 % or where the outlook of liquidity developments certifies that the coverage gap will fall under this limit during the period for which the outlook has been drawn up.

- Higher protection against so-called bullying insolvency petitions should be also ensured by implementation of **the new obligation of the insolvency petitioner to evidence the existence of a mature claim** - and to join the submission of this claim to the insolvency petition at the same time (Section 105 IA). In the case that the debtor is a legal entity, the insolvency petitioner, who is keeping accounts or tax records according to the Income Tax Act, will be obliged to give evidence of his claim by (i) **the acknowledgement of debt with verified debtor's signature** or (ii) **the enforceable decision** or (iii) **the notarial deed with the consent to enforceability** or (iv) **the executory deed with the consent to enforceability** or (v) **the confirmation made by an auditor, a court expert witness or a tax advisor** and certifying that the creditor accounts for this claim.

- The novelization also **increases** the upper limit of **the fine**, which may be imposed upon the insolvency petitioner by the respective insolvency court, if he submits flagrant groundless insolvency petition, i.e. from existing sum of CZK 50,000 to CZK 500,000 (Section 128a (3) IA).

II. Changes of Insolvency Act in the field of Debt Relief

- In the field of the debt relief the novelization **brings the new legislation in relation to the specification of the authorised persons entitled to submit the insolvency petition, where the bankruptcy will be solved by the debt relief**. The debt relief petition can no longer be complied by the debtor itself, but it **must be made only by an attorney, a notary, a court executor, an insolvency trustee or by an accredited person** - a legal entity, which has obtained an accreditation of the Ministry of Justice for providing services in the area of the debt relief (public beneficial legal entities).

- The provision about mandatory representation of a debtor by a professional **will not be applied**, if the debtor is a natural person and has Master's Law or Economic Education or passes the exam for an insolvency trustee, or if such professional acts on behalf of a debtor, who is a legal entity.

- The novelization also **limits the amount of the remuneration** for writing up and filling the debt relief petition. The authorised professional will be entitled to ask for a remuneration in the maximum amount of CZK 4,000 without VAT and in the case of joint debt relief of a married couple in the maximum amount of CZK 6,000 without VAT (Section 390a (3) IA). The accredited persons will be allowed to provide the services free of charge only.

- These changes should help to ensure the satisfactory professionalism, when providing services connected with the institute of the debt relief, and at the same time they should lead to price reduction of these services.

III. Higher transparency of insolvency proceedings

- Among important measures serving to this aim belongs also the establishment of **the ban on the voting right of a creditor who constitutes a business group with a debtor** or who is a close person to a debtor (Section 53 (1) IA). Such a creditor will not be allowed to vote on the meeting of creditors, unless explicitly provided by the Insolvency Act. The main motivation for implementation of this ban is the fact that the above stated creditors are usually in a conflict of interest and on the meeting of creditors they often protect the interests of debtors instead of supporting their interests from the position of creditors.

- The existing **ban on the voting right of a creditor regarding „his own issue“** remains still in the Insolvency Act (Section 53 (2) IA). However, the novelization replaces the term „his own issue“ by the list of specific cases, when the creditor is not allowed to vote. Pursuant to the new legislation the creditor cannot vote in cases, in which he is active or is or should be a party to, such as (i) an acquisition of property or another fulfilment from the insolvency assets, (ii) a legal acts regarding the right that is or can be the part of the insolvency assets, (iii) an incidental dispute, or (iv) a decision about the voting right.

- **The creditors of assigned claims** are newly obliged to **reveal their beneficial owners** (Section 177 (2) IA). The new obligation relates to the creditors who have acquired their claims via assignment or another similar procedure after the commencement of the insolvency proceedings or in the period of six-month prior to its commencement. These creditors will have to add to the submission of their claims a sworn affidavit, in which they have to reveal, who is their beneficial owner according to the AML Act, i.e. the Act No. 253/2008 Coll., on the prevention of money laundering and terrorist financing, and give the reason, and why this person should be considered as the beneficial owner; (claims not exceeding the value of EUR 10,000 will be exempt).

- The novelization furthermore establishes a measure against a possible manipulation with the local jurisdiction of insolvency proceedings – **so-called fixation of the local jurisdiction** (Section 7b (1) IA). The relevant court will be the court, in whose territory the debtor - the businessmen registered in the Commercial Register - has his registered seat on the day preceding 6 months prior to the commencement of the insolvency proceedings. The aim of this rule is to eliminate the calculated change of debtor's seat, which may lead to difficulties when performing creditor's rights (e.g. creditors will have to travel to the court proceedings) and to the factual infringement of the Rule of the lawful judge.

- At the same time **the court has to continue in the insolvency proceedings** and take urgent actions before making decision about the local jurisdiction (Section 7b (5) IA). It is an exception from the rule that only the relevant court with local jurisdiction is entitled to make decisions in the pro-

ceedings. According to the new legislation, the court will be obliged to decide e.g. about the appointment of the preliminary creditor committee, the appointment of preliminary insolvency trustee, the fact that the insolvency petition will not be published in the Insolvency Register, the refusal of the insolvency petition or its refusal due to its flagrant groundlessness.

- The novelization emphasizes **the delivery** of documents **to data boxes** of the court and embodies **mandatory use of electronic forms** (Section 80a IA). For example the inventory of the insolvency assets, the list of registered claims, the final report and the report about the performance of the reorganization plan must be submitted by the insolvency trustee only via electronic forms.

- **Certain competences of the insolvency courts** in insolvency proceedings, where the bankruptcy will be solved by debt relief, **will be transferred from courts to insolvency trustees**. This should ease the administrative burden of courts and allow the courts to focus on more complicated bankruptcy proceedings and reorganisation.

- Great impact in practise will represent **the change in system of distribution of insolvency cases to insolvency trustees in the field of debt relief**. The novelization cancels the district principle, i.e. distribution of insolvency cases to insolvency trustees according to district courts (the debtor's general court), and installs the application of **the principle of region courts** (Section 25 (2) (b) IA). This means that the list of insolvency trustees who are specialized on solving the bankruptcy by the debt relief will be newly kept pursuant to the territory of region courts. Insolvency trustees will not need to

have their registered seat or establishment in every particular district, but it will be sufficient to have one in the region. It is expected that this change will lead to the decrease in number of establishments (often fictional) by big insolvency trustees in order to increase the number of newly distributed insolvency issues and to the more evenly distribution of insolvency cases among all insolvency trustees.

- Finally, the new legislation **brings the reinforcement of the general supervision of the Ministry of Justice over the performance of the function of an insolvency trustee** (the Ministry of Justice will gain the right to cancel the authorization of an insolvency trustee, if he breaks his duties seriously or repeatedly).

We hope the above summary will ease your orientation in the new legislation. We are available for any of your additional requests or information or legal assistance in the area.

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