Czech Insolvency Law after Four Years

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Abstract: - Insolvency systems are essential characteristics of every national economy. Their performance can significantly affect the quality of the business environment and are especially important for the predictability of risk. The present study concerns the possibilities of reforming Czech insolvency law on the basis of the experience gained during the four years in which the new legislation has been in effect. After evaluating changes in the costs incurred by creditors during insolvency proceedings, the duration of insolvency proceedings and recovery rates for lenders, the following hypothesis is suggested: Further improvement of creditors' positions and in the functioning of the insolvency system as a whole are possible only if more comprehensive legislative changes are made. An analysis of the functioning of the new law and other relevant regulations from 2008 to 2012 (the first quarter) shows that the fundamental problem in the processes of solving bankruptcies of Czech companies is the fact that insolvency proceedings are commenced late, at a time when debtors possess very few assets which are quite insufficient for satisfying the creditors, especially non-secured creditors. Therefore, new legislative and systematic measures to remedy this unacceptable situation are proposed. Moreover, on the basis of international comparisons and their own research, the authors advise against new objectives being incorporated into the insolvency law such as preserving employment or maintaining the firm as a going concern. They conclude that such legal attempts lead to worse results, and jobs and production are maintained in a smaller number of cases than in an impartial insolvency system.

Key-Words: - Bankruptcy, debtor, insolvency, insolvency law, reorganisation, creditor.

1 Legislative promise

With the implementation of the new *Insolvency Act* (Act No. 182/2006 Coll. on *Bankruptcy and Ways Towards its Solution*, legally abbreviated InsA) and its coming into effect in 2008, significant hopes, among other things, were placed on the strengthening of the so-called financial rehabilitation principle in insolvency practice. In the given context of bankruptcy, we understand that it entails a more frequent utilisation of reorganisation as opposed to compensation, which was the case with the previous act (Act No. 328/1991 Coll. *on Bankruptcy and Compensation*). After more than four years of the new legal amendment's being in effect, however, the time has come to assert that these hopes have not been fulfilled and in reality, we are unable to show that, in comparison to the total amount of bankruptcies, the financial rehabilitation principle has become a more significant aspect of insolvency practice than was the case with compensation.

At the same time, it would be somewhat naive to thereby deduce that it is merely the fault of the diction of the act and its particular provisions. On the contrary, the problem is apparently deeper and arises from crucial economic relationships and habits set in the Czech economic environment.

2 Problems of insolvency proceedings in the CR

Although there was a marked improvement in the results of the insolvency system after 2008, when the new insolvency legislation took effect, the situation in the Czech Republic is still far behind

OECD countries. This assertion can be substantiated by numerous facts.

As we can see, the duration of insolvency proceedings in the Czech Republic is almost twice the average of OECD countries. If we were to use the country's largest commercial partner, i.e. Germany, as a comparison, the duration of insolvency proceedings would be practically three times as long. The situation is practically the same with costs of proceedings. Yields from investments are also considerably higher on average for creditors in OECD countries; it is true that, in comparison to Germany, the Czech economic environment is successful in this regard, but if we look at Finland, Great Britain, or the USA, then the difference in this category of comparison is literally enormous.

Table 1: Duration of insolvency proceedings, costs for proceedings and yields from proceedings (2011)

Country	Duration (years)	Costs (% of yield)	Yield (%of investment)
CR	3,2	17	56,0
OECD (average)	1,7	9	68,2
Finland	0,9	4	89,1
Germany	1,2	8	53,8
Italy	1,8	22	61,1
Poland	3,0	15	31,5
SR	4,0	18	54,3
Sweden	2,0	9	75,8
GB	1,0	8	88,9
USA	1,5	7	81,5

Source: Doing Business 2012, http://data.worldbank.org/indicator/IC.ISV.DURS?page=1 [1]

It is an indisputable fact that the length of time for insolvency or similar proceedings in the Czech Republic has significantly decreased in recent years, clearly as a result of the new insolvency act. This is, moreover, shown by Table No.2. We can observe similarly noteworthy progress where yields for debtors are concerned – the increase is truly rapid; however, as Table 1 shows, in comparison to the OECD average and, most importantly, in comparison to certain economies which can boast the highest quality environment in this sense, the improvement must still be deemed totally insufficient.

Because Czech commercial law can (after the coming into effect of the insolvency act) be termed a legal system on the level of significant foreign regulations which also served as an important model for the Czech legislation, the fact that the insolvency system as a whole is still relatively weak in efficacy should be probably be searched for in areas other than the diction of the insolvency act itself.

Table 2: Duration of proceedings and yield for creditors from proceedings following declaration of a debtor's bankruptcy (in the CR)

Year	Duration of an insolvency proceeding (in years)	Creditor's yield from debtor's bankruptcy (% of receivable)
2002	9,2	15,4
2003	9,2	15,4
2004	9,2	16,8
2005	9,2	17,8
2006	9,2	18,5
2007	6,5	21,3
2008	6,5	20,9
2009	6,5	20,9
2010	3,2	55,9
2011	3,2	56,0

Source: Doing Business 2012, http://www.doingbusiness.org/custom-query [2]

We can to a high degree of probability define two loci of reasons as to why the efficacy of the Czech system is lower than in the developed economies. The first reason is probably the fact that we have to deem the entire system of commercial judicature and settlement of lawsuits arising from business activities in the Czech Republic slower than similar systems in the most developed countries. Secondly, there is also the issue that Czech companies and other business subjects enter the insolvency process later than what is appropriate, especially in times when the company's problems are not merely defaults to creditors, but over-indebtedness to a much more fundamental degree, i.e. when a company's debt significantly exceeds the value of its assets.

2.1 The problem with the length of commercial lawsuits

According to World Bank statistics [2], the usual length of a commercial lawsuit in the Czech Republic is 611 days (in OECD countries the average is 518 days).

This serves to prove the relatively poor quality of the whole system of commercial judicature. Although some improvement can be observed here, we can by no means deem this sufficient or corresponding to the needs of the economy.

It thus seems that within a relatively short time it will be necessary to considerably change the situation in this regard and that the court system will generally need to become significantly more effective. This could probably be achieved through a further simplification of the court system, reducing time limits and, most importantly, excluding less important cases from this relatively complicated mechanism.

Table 3: Duration of a commercial lawsuit (days from filing to court ruling)

Year	CR	Netherlands	New Zealand	Germany
2002	663	534	232	403
2003	663	534	232	403
2004	653	534	220	394
2005	653	514	220	394
2006	653	514	220	394
2007	653	514	216	394
2008	653	514	216	394
2009	611	514	216	394
2010	611	514	216	394
2011	611	514	216	394

Source: Doing Business 2012, http://data.worldbank.org/indicator/IC.ISV.DURS?page=1 [1]

The problem with the length of commercial lawsuits has one important effect which has not been fully appreciated in the Czech environment. Conducting a lawsuit which leads to seizure of a debtor's property is a means of individual collection of the creditor's receivables. Given that this type of collection is still neither fast nor effective enough, numerous subjects do not resort to it and rather allow space to negotiate with the debtor instead. Individual collection entails expenses and, given the length of commercial lawsuits, does not allow much space for a creditor to truly succeed should he choose to consistently defend his rights in this manner. While his lawsuit proceeds, the debtor's situation is likely to deteriorate, meaning that at the end of the lawsuit, the debtor either has no assets at his disposal anymore to satisfy the creditor, or his situation develops in such a way that he has to begin insolvency proceedings. In such cases, however, any further possibilities of individual collection of receivables are curtailed and creditors are relegated to a joint approach. A responsible creditor thus outlays expenses, but his prospects for success are extremely low as it is impossible to assume that, given the significant length of a lawsuit, it is possible to achieve appropriate satisfaction by means of individual approaches.

2.2 The problem of insufficient assets

Another circumstance, however, manifests itself as more important aspect of the situation insofar as companies entering into insolvency proceedings do not have sufficient assets to appropriately satisfy creditors. This state of affairs is shown by Table 4, from which we can read the proportion between the entire number of declared bankruptcies and those cases where further court adjudication is cancelled (when it becomes evident that the bankrupt company has no assets to enable effective conducting of insolvency proceedings which could achieve its aims, i.e. satisfaction of creditors).

Table 4: Proposals rejected on the grounds of insufficient debtor assets in comparison with other cases

Year	Proposals rejected for lack of assets	Declared bankruptcies	Approved reorganisations (compensation)
2003	627	1719	9
2004	889	1435	6
2005	1159	1230	6
2006	1536	1238	7
2007	1986	1104	11
2008	668	651	6
2009	1768	1660	14
2010	1571	1948	19
2011	1441	2229	17

Source: Ministry of Justice CR, http://www.insolvencni-zakon.cz/ [3]

In Table 4 we can see that the proportion between petitions filed and subsequently rejected by the court on the grounds of insufficient debtor assets and those which culminated in declaration of bankruptcy has changed significantly over the past ten years. In certain periods, the amount of petitions which the court refused to hear was actually higher than the amount of declared bankruptcies. This is an extremely disquieting fact, considering that in 2007, practically twice as many petitions were rejected owing to the fact that the companies had ceased to exist by the time they had been accepted for proceedings. In fact, it is fascinating: Let us imagine an economy where two out of three companies try to remain in operation so long that they expend the last remnants of their assets, at least those that are not pledged in favour of creditors and that are thus

accessible to the debtor. Such an economy is evidently full of managers who consider maintaining a company as a going concern to be their mission in life.

It could also be an economic system where certain legal regulations have been poorly set, so the legal system is unable to intervene against the kinds of managers and company owners who keep their bankruptcies secret – whatever their intentions may be. This explanation is arguably more probable, as it complies with the models we are familiar with. Bankruptcy and insolvency proceedings are a sort of period in the history of a company's existence when, from the owner's point of view, assets are destroyed with final effect – whether by becoming worthless or because they are monetised and the yield is used to remit the creditors' receivables. Also from the perspective of the management, the future is generally closed, at least within the scope of the given company insofar as the end of its existence is mostly clear, and if it is not, the future owners are not likely to take over the company with the management. As far as the impact in terms of reputation is concerned, it is often serious for the management. It is therefore not surprising that both the owners and the management exert so much effort to influence events before bankruptcy in order to open avenues for uses of assets other than those which are a natural part of insolvency proceedings.

Thus, if we were to search for reasons as to why so many companies enter into the insolvency phase of their existence in a state where they are truly devoid of property, we could name several motives besides the classical economic ones (such as inability to compete).

Primarily, it seems that the insolvency act was unable to effectively oblige responsible persons to petition for insolvency for their own companies. The new amendment prescribes this to a group of responsible persons not only in cases of evident bankruptcy; that is, in cases of inability to remit the company's liabilities within the agreed time or at least thirty days after their due date (inability to pay or default), but also in cases of latent, or hidden bankruptcy, i.e. if the company's liabilities are greater than its assets (over-indebtedness). The lawmakers' intentions, however, clearly remained unfulfilled in practice.

Evidently, the fact that over-indebtedness can occur relatively long before actual insolvency takes place was not fully appreciated. In practice, we can find many companies which are truly over-indebted, but continue in their existence; and in reality it cannot be ruled out that some of them are later saved or that prolonging their activity eventually leads to real solution of their bankruptcy – for instance, through a merger or other process outside the area of insolvency law. In reality, however, the number of these "happy endings" entailing one hundred percent or nearly one hundred percent returns for creditors is not likely to be high. A far more common consequence of prolonging the operation of an over-indebted company is that the company begins insolvency proceedings with assets insufficient in proportion to its liabilities, or even low enough to render the effective course of insolvency proceedings impossible.

This means that emphasis on property or criminal liability of managers or owners should lead to a reduced number of companies entering insolvency in a state of extreme over-indebtedness. But apparently, although we cannot take it as a proven fact, the opposite is the case, and the actual codification of criminal and property liability of managers has resulted in no substantial change in this state of affairs.

It should, moreover, be taken into account that the efficacy of pertinent provisions of the *Insolvency Act* (effective from 1 January 2008) was already stopped once during 2009 and renewed on 1 January 2012 [4]. It is therefore difficult to examine their true functionality; at least we cannot do so from a long-term perspective, which is certainly necessary for a critical assessment of the situation. However, Table 4 shows that in all probability, this amendment is insufficient at present and does not meet the aims of the legislation. The first of these was to create an environment in which there would be fewer companies whose entering the insolvency proceedings would culminate in the court discovering that the company's assets do not suffice for the proceedings to open, i.e. the assets are practically null and void. The second intention was to arrange that in the majority of cases not only secured creditors would gain higher recovery rate, but non-secured creditors too would recover at least some of their finances. At present, however, this occurs only exceptionally.

3 Possibilities of reforming the insolvency system

This discovery opens the need for discussion regarding further reforms of the insolvency system in the Czech Republic, including reforms in the commercial law.

As regards the field of insolvency law, there is room for a quite radical, but arguably effective solution to the discussion which relates to the

problem of over-indebtedness of companies. In the given context, over-indebtedness is defined as follows in section 3(3) of the *Insolvency Act*: "Over-indebtedness occurs when a debtor has several creditors and the debts payable exceed the value of his assets. When fixing the value of the debtor's assets, further administration of his assets, or further operation of his business is also taken into consideration if, in view of all circumstances, it can reasonably be assumed that the debtor can continue in the administration of his assets or the operation of his business" [5].

Logically, a provision thus defined is completely ineffective because it always enables authorised parties to claim that they had expected further administration of property and subsequently a significant improvement in the company's financial situation which would lead to its bankruptcy being brought under control. This wording could largely be dismissed as an example of passing the buck from the perspective of legislative activity: On the one hand, the lawmakers make it clear that an over-indebted company should not partake in future economic relationships, and that it should be prevented from transferring its financial situation to other subjects – most importantly, its suppliers (creditors from business contact, mostly non-secured creditors from the logic of things). On the other hand, however, the lawmakers define such "gentle" criteria for assessing over-indebtedness (i.e. hidden bankruptcy), against which the creditors have no effective defence that, with the exception of completely unambiguous cases, we basically cannot assert that responsible persons could not, "in view of all circumstances", assume future business enabling an improvement in its financial situation.

However, the issue of a strictly defined obligation to propose that one's own company file for bankruptcy is decisive for increasing the returns from insolvency proceedings for creditors – both secured and non-secured (who face a far more fundamental problem). The present solution thus needs to undergo critical analysis of its functionality – both on the basis of real, known cases and with the aid of modelled situations.

For the time being, however, it can be asserted that one possible solution would be to define "over-indebtedness" differently than is presently the case. There can be no doubt that this would entail a fundamental intervention into the very concept of insolvency law and even into the philosophy of this law.

This can be conceived on two levels. The first would involve the removal of relative conditions from the formulation of section 3(3) of the *Insolvency Act*. This means that bankruptcy would be defined as a state when a company's debts exceed its assets, without further circumstances, i.e. strictly. Naturally, the question remains how to define assets as for their real value, that is, as collateral that creditors will receive money for when it is sold. This accounting problem is fundamental; nevertheless it can be considered technical in the sense that a difficulty with correct definition is in question. However, it is obvious that the real amount of cash is detectable only after the assets have been sold; any estimate of value carried out even with the best of intentions is merely theoretical [6].

Even this intervention would clearly evoke a significant reaction in the behaviour of debtors, as it involves a restriction on their approaches and forces them to be far more cautious, if we now simplify the issue of debtors to the locus of responsible persons from the legal perspective.

One can go still further and define over-indebtedness more strictly than as liabilities exceeding 100% of the company's assets. This thought may immediately seem absurd for several reasons – for instance, in view of the volatility of asset value and other influences [7] which companies are subjected to. Still, even these are in fact merely technical complications and are no different from those which we are presently dealing with in similar regards. In any event, such measures would entail a meaningful strengthening of creditor security.

Such a solution would use a logical concept as a departure point insofar as the assets of a company is an unknown value given as we do not know its potential when turned into cash. The rules of caution in such cases dictate that it is not possible to accept a debt to the amount of 100% of the potential collateral; on the contrary, it is necessary to index the value of the collateral downwards to also cover risks. This would, however entail defining over-indebtedness not as a state in which debts payable exceed one hundred percent of the company's asset value, but rather when they reach eighty, ninety or perhaps even seventy percent.

4 Advantages and risks of reform

The aim of similar reforms of law and the insolvency system should not be a situation in which creditors receive one hundred percent of their receivables. Such a state would evoke inappropriate reactions on the side of lenders: it would lead to their laxity and the growth of risks taken on their part in a way that would be unwise economically.

However, increasing safety for investors and for lenders can bring about an improved situation on the money market, increase trust in the whole economic system and also make leeway for reducing prices – both of money and supplies. If participants in economic relations were not forced to calculate risks in such volumes they have had to until now, new avenues would be opened for a general reduction of risk margins.

From the economic point of view, the matters described above have been clearly proven and it is thus unnecessary to prove this potential. The volume, or the extent of changes to which these measures could lead to in the long term perspective cannot be estimated.

A highly probable result of this would be that, if numerous companies entered into insolvency proceedings when they were still capable of further operation, strengthening them by the financial rehabilitation principle (reorganisation) would be a solution. In view of the fact that debtors would be forced to entrust further decisions regarding their company to their creditors much sooner than is the case at present, there would be a better chance to save the company in the sense of its continued existence. This would have the effect of fulfilling one of the goals which the new legislation passed in 2008 intended to achieve. At the time, the new act aimed towards fewer companies ending their existence during insolvency proceedings in liquidation and bankruptcy. On the contrary, the number of companies which would undergo reorganisation and be preserved as independent units and, most importantly, as employers, was meant to increase.

The Czech business environment is no oddity in this sense, given that political pressure in developed economies aims primarily to prevent insolvency from becoming a cause of further unemployment. In several countries, the perception of settling insolvency has evolved to such extent that the courts themselves are legally bound to seek possibilities for preserving employment when a debtor is declared bankrupt, which forces them into an insoluble dilemma with a further obligation – making maximum profits for the creditor [8]. A solution which would involve a reform of the insolvency system and changes in the definition of over-indebtedness would probably move in the direction of achieving this goal in an economically cleaner fashion which could not be dismissed as an invasion into the nature of the economy.

Naturally, changing the definition of over-indebtedness would carry considerable risks which cannot be taken lightly. One of these is the danger that hasty implementation of similar regulations (especially in the sense of implementing a new definition of over-indebtedness) would evoke a reaction in the business field, where the legal definition of bankruptcy would be applicable to too many companies. Prior to the implementation of this measure, a transitional period would have to be defined, during which companies would get some time to adapt to the new legislation – three years is an appropriate period in the event that the limit for bankruptcy would be liabilities amounting to 90% of the company's assets, or five years if the limit amounted to 80 percent. In the first phase, it would also be appropriate to remove the passage following the actual definition of bankruptcy from the effective law which relates to circumstances for assessing a company's assets in relation to its further existence and annual turnover. Any future amendment would have to be stricter than the present variant – it would have to cease considering exceptions and strictly fix a level of debt against assets to make it impossible to manoeuvre within the legal prescription and thereby destroy the entire provision.

Of course, it is quite likely that new regulations, especially the removal of manoeuvring space making it possible to rely on a company's future results, would result in bankruptcies even in the cases of companies which were not dead economically and were only going through temporary difficulty. One can even conceive that in quite exceptional cases sustainable projects would disappear from the economy. This, however, is more a question of the abilities of the owners and their negotiations with their creditors – if they were able to prove that the future management of the company would be more effective, they would probably implement reorganisation as a means of solving bankruptcy problems. This is despite the fact that the current insolvency act gives the debtor substantial room to propose reorganisation as a means of solving bankruptcy problems, propose a reorganisation plan and, if he cooperates with the court in an appropriate manner, to receive approval for the plan. Such approval could be gained although certain groups of creditors may disapprove and (if the plan is compiled in a certain way) even despite the disapproval of the majority of creditors.

5 Macroeconomic and financial contexts of the insolvency system

In numerous countries, there is a dominant opinion which is relatively difficult to understand insofar as

it pushes the entire insolvency system (and, most importantly, the issue of insolvency legislation) out of the field of national economic considerations and from the province of economy (in the sense of a scientific field) and shifts this problem into the province of legal sciences. This is an absurd error: It can be considered a many-times proven fact that the whole setting of insolvency law, the definition of its preferences and its approach to both debtors and creditors, leads to the formulation of the entire economic environment of a country in an absolutely fundamental way.

A considerable amount of proof has been furnished. For instance, reference [9] asserts: "Using a sample of small firms that defaulted on their bank debt in France, Germany, and the United Kingdom, we find that large differences in creditors' rights across countries lead banks to adjust their lending and reorganization practices to mitigate costly aspects of bankruptcy law. In particular, French banks respond to a creditor-unfriendly code by requiring more collateral than lenders elsewhere, and by relying on collateral forms that minimize the statutory dilution of their claims in bankruptcy. Despite such adjustments, bank recovery rates in default remain sharply different across the three countries, reflecting very different levels of creditor protection." (page 565)

In reality, it is precisely insolvency law that affects the economic environment of a given country far more substantially than one is willing to admit. Considerations on this theme usually conclude with a primary statement that lower recovery rate, thus higher risk for investors, lead to lenders requiring more collateral, and possible loans (or other forms of loan capital) are more costly for creditors. But differences in price are considered to be the cost of risk. In reality, however, it can be seen that the impact of regulating insolvency law and the entire insolvency system is more distinct.

On the basis of sufficiently comprehensive analysis of specific examples and substantiating information, the same study [9] adds: "First, we find that banks significantly adjust their lending and reorganization practices in response to the country's bankruptcy code. In particular, collateral requirements at loan origination directly reflect the bank's ability to realize assets upon default. Thus, because the proceeds from collateral sales are lower in France, at loan origination French banks demand higher levels of collateral per dollar of debt. Moreover, the composition of different types of collateral reflects their expected value in default. While real estate collateral is the most important source of banks' recovery in Germany and the United Kingdom, it is far less valuable in France, both because sales proceeds there are diluted by preferential creditors such as employee wages and bankruptcy fees, and because French bankruptcy courts tend to sell assets below their potential market prices in order to preserve employment. By contrast, accounts receivable and personal guarantees can be realized by French banks directly, and the proceeds are not subject to dilution by preferential creditors. As a result, these collateral types are used more often than real estate at loan origination in France." (pages 566–567)

These are by no means all of the conclusions drawn by the authors – among others, they also found that the French court is legally bound to salvage a debtor's company in the event of a bankruptcy and to preserve employment to the highest possible degree; in reality, however, a smaller percentage of bankrupt companies are salvaged than is the case in Germany, and most importantly, than in Great Britain.

But the cited study arrives at a truly shocking conclusion on the issue of insolvency proceedings returns for lenders. Davydenko and Franks discovered that in Britain, median undiscounted recovery rates amount to 92 percent, in Germany 67 percent, and in France 56 percent. We must also realize that the differences would probably be larger if the creditors, i.e. primarily the banks, proceeded unaware of the risks awaiting them in the event of a debtor's default and did not take certain measures against these risks. The basic question which remains, then, is why such significant differences emerge in countries which (in all three cases) we would generally consider to be market economies with a high-quality legal system. (In this regard, we might add that the same authors reached a further conclusion: The recovery rate in the event of restructuring is very similar in all three countries: We can therefore deem the general environment to be reasonably comparable, differing mainly in the general regulation of insolvency law and setting of creditors' rights on the one hand, and debtors' on the other, as two antagonistic groups within the context of insolvency proceedings).

The answer to the question of where the differences in recoveries are found is clear according to the authors of the study and, based on experiences from the Czech Republic, it can only be confirmed. The way the regulation of insolvency

law is set is decisive in terms of how the bankruptcy process of companies affects the economic system and the extent to which it is a devastating process within its framework. Quite naturally, the course of insolvency proceedings is understood as a risky process from the perspective of investors. Its quality towards creditors is consequently a significant attribute of financial enterprise as a whole.

During our research in the Czech Republic, we arrived at the view that not even the new insolvency act enables creditors to rely on the collection of receivables. Most importantly, creditors cannot lose sight of the fact that it can in no way be certain that a debtor has any assets whatsoever at his disposal (when his bankruptcy becomes evident) to cover creditors' receivables. In the given period, roughly 4.5 years after the new legislation took effect, there are no relevant case studies in the Czech environment to support these assumptions on the basis of more comprehensive surveys. Such studies are being undertaken in 2012 and their results will be made public later.

Nevertheless, the authors of this text use as their departure point their preliminary research of numerous closed cases of insolvency proceedings which began after 1 January 2008, and which were thus conducted according to the new legislation. From these experiences it follows that the return on investments for creditors is still very low in cases of insolvency proceedings. This casts doubt upon statistical data contained in the sources cited above [1], [2] – according to them, a marked improvement in insolvency proceedings results in the Czech Republic should have been observed after 2010. But until the above-mentioned research is concluded, we cannot make any bolder statements on the state of insolvency law in the Czech Republic.

Nevertheless, while we research the impact of the quality of insolvency proceedings on the Czech economic environment, we must assert that the acceptance of the new insolvency act has not made any marked effect which we could define by means of statistics. This is naturally caused by the reality of the deep and lengthy crisis which struck the Czech economy at the end of 2008 and affected 2009, and also 2010 to some extent, whereas new problems arrived in 2012 after a brief revival in 2011. It is therefore very difficult to judge the effect of the insolvency act, which is without doubt a regulation of higher quality than the preceding act on bankruptcy and compensation.

As we can observe from the data on the amount of insolvency petitions per thousand registered companies, the whole system is being increasingly burdened and this trend will continue in 2012 also, if we consider that the data for the first nine months of 2012 show a significant increase in submitted proposals. Consequently, it is logical that the impact of insolvency law will exert an increased influence on the entire system of settling the bankruptcy of companies and physical entities listed in the commercial register. The result of this is a deepening of problems which cause difficulties when asserting the rights of creditors. The cited study by Davidenko and Franks [9] shows that a supervised attempt to maintain a company as a going concern and to preserve employment results in the opposite. If the aim of the legislator is to fulfill a similar task, the best way forward is to provide as much space as possible for the creditors to decide according to their wills and about the approach towards a debtor's assets. As we have proven in the preceding sections, however, the problem in the Czech economy is much deeper, as creditors have been given considerable room by the new legislation (effective as of January 2008) for supervising and correcting the insolvency process; but in reality this had relatively little influence on the actual results of insolvency proceedings. When companies are bankrupt, only a small number of them possess sufficient assets for insolvency proceedings (as an act of collective enforcement of receivables) to make any sense.

This assertion brings us back to the question of the extent to which insolvency proceedings are an effective means of settling bankruptcy and to what extent its use (which in a sense is forced by the law) is effective from the angle of the use of assets as a whole.

It is frequently forgotten that, in numerous situations, laws force creditors to undergo insolvency proceedings as this is more advantageous to them from the perspective of tax regulations [14]. A vicious circle emerges as a result. On the one hand, even after the improvement of the Czech insolvency law, we have a situation which is relatively benevolent towards debtors, and although creditors' rights have been strengthened, this still does not suffice. Besides this, some economists have assessed the situation with considerable foresight in their analyses of the insolvency act at the time of its genesis [15]: "In the beginning we emphasized that when designing a bankruptcy law, it is important to decide what goals the law shall

achieve. Shall the goal be to maximize the economic performance by shutting down inefficient firms and freeing their resources for a more efficient use? Or is maintaining employment in the short run also important? Or are other goals relevant? A benevolent social planner would choose a law whose only goal is to maximize overall, long-term benefits. Such a law would promote stable and high economic growth and high level of employment in the long run. In the short run, however, it could cause some painful situations connected with the failure of large firms employing many people. Because political economy factors are important in reality, the bankruptcy laws usually differ from those that would be chosen by a benevolent social planner. The politicians operate in a short time horizon and goals of long-term efficiency are often out of their sight."

The Czech Republic is no exception in this sense. All the competing versions of the prepared bankruptcy reform are rather soft laws, with the emphasis on preserving employment. Although we do not want to make a general judgement that tough law is better for the long-run efficiency (such a judgement would not be justified given the current state of research in this topic), the conditions prevailing in the Czech Republic speak rather in favor of a tough law. The heavy dependence of the Czech economy on debt rather than equity financing makes the problem of credit rationing stemming from ex-ante inefficiency more severe. Maybe even more strikingly, the state of the Czech judiciary gives rise to doubts of how the judges will use the discretion awarded to them by the proposed law.

Table 5: Number of insolvencies and number of insolvencies per thousand registered commercial companies according to individual regions in the Czech Republic, degree of unemployment on 31. 12. 2011 (in percentages of able-bodied inhabitants)

Region	2009		2010		2011		
	amount	Ind.	amount	Ind.	amount	Ind.	Not reg.
Moravia-Silesia	456	1.87	603	2.39	986	3.81	11.2
Olomouc	190	1.40	270	1.92	411	2.88	11.4
S-Moravian	642	2.30	717	2.45	792	2.65	9.8
Usti	248	1.40	203	1.10	458	2.44	12.9
Zlín	226	1.66	242	1.72	322	2.27	9.4
Pardubice	157	1.41	176	1.52	247	2.10	8.4
Hr. Králové	177	1.34	231	1.68	287	2.08	7.5
Prague	1171	2.43	1119	2.20	1083	2.02	3.9
South-Bohemian	301	1.95	247	1.53	313	1.91	7.5
Liberec	160	1.37	183	1.52	209	1.71	9.5
Vysočina	153	1.46	139	1.28	171	1.55	9.4
Plzeň	191	1.38	265	1.81	181	1.20	7.0
Karlovy Vary	66	0.81	95	1.12	95	1.09	9.8
Central Bohemian	288	0.97	298	0.95	322	0.99	7.1

Source: Creditreform: Development of insolvencies in the Czech Republic in 2011 [10], Creditreform: The development of company insolvencies in the Czech Republic in 2010 [11], Ministry of work and social affairs [12]. The table is taken from: [13]

Definitely, more research – both theoretical and empirical – is needed, so that we can make clear conclusions. While in international literature the research in this field has grown rapidly during the last decade, the Czech Republic is still waiting for serious research in bankruptcy to come.

But this problem cannot realistically be restricted only to the issue of the insolvency proceeding in itself, nor to the potential bankruptcy of the debtor. As other studies [16] show, the question of regulating the whole system of potential demises of economic subjects from the market environment influences not only loan conditions and other areas of financial economy, but also many realities in regular economic life. Understandably, it applies that the greater the risk of a potential default presented by a debtor, the more adversely other realities are affected.

During recent crises, several of these realities became manifest when financial distress drastically affected many companies which were not ailing from the perspective of the usual definitions. Companies which would quite certainly have withstood criticism based on classic works [17] found themselves in problems difficult to solve and were forced to bear the enormous costs of their customers' financial distress, which led to their being weakened over a long term [18].

6 Conclusion

If such a reform of insolvency law (as we have outlined) and its related regulations proceeded powerfully enough, it could bring about a general reduction in the duration of commercial lawsuits on the one hand. Furthermore, it could lead to strengthening individual enforcement of receivables given a reduction in time needed to conduct commercial lawsuits in court. This would benefit the economic environment in general – debtors would lose manoeuvring space when facing creditors, who would thus be in a stronger position. At the same time, if the changes (in the insolvency act) that we mentioned and stricter definitions for over-indebtedness were implemented, companies would not enter bankruptcy proceedings without the necessary assets and creditors would be satisfied to a much higher degree than is presently the case.

All these movements of the economic environment would primarily have the effect of lowering the general extent of risks and strengthening mutual trust among economic subjects. This in turn would lead to significantly decreased creditor costs, both on a general level, and during actual insolvency proceedings.

In reality, a concept is at issue, one that could be applicable not only in the Czech Republic and in the context of the Czech insolvency system, but in all developed economies. Let us grant that settlement of a debtor's default is the responsibility of the creditor. He has information on the debtor's default at his disposal, and can thus react at his discretion. While it is true that there are several reasons why numerous creditors hesitate to take measures to collect receivables, the main one is nevertheless a definite decision taken by the creditor, who quite frequently acts knowingly and remains reserved of his own free will in the hope that such an approach will bring him better fulfillment of receivables than an attempt to enforce his rights by means of either individual or collective enforcement.

In the event of a real bankruptcy, that is, when the company is over-indebted and liabilities exceed its assets, the situation is different – the creditor is not necessarily aware of all the circumstances and in fact practically never knows them. Therefore, regulation moving towards the timely entry of a company into insolvency proceedings would certainly bring forward a range of macroeconomic improvements, as it would lead to a reduction of risks on the creditors' sides and thereby enable improved allocation of resources under generally more favorable conditions.

Acknowledgment

The article was written as an output for the research project *"The development of transaction costs among Czech economic subjects in insolvency proceedings, the possibilities of their reduction to a level standard in the EU with the aid of improved legislation, the possibilities of improving insolvency proceeding statistics and creating a household financial fragility model"*, registered at the Technological Agency of the Czech Republic (TA CR) under registration number GT309022.

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