CHANCES OF THE BUSINESS RECOVERY PRINCIPLE IN MODERN INSOLVENCY LAW

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ABSTRACT *Taking the situation in the Czech Republic as an example, the study concerns the potential of recovery procedures in dealing with business bankruptcies. Based on the analysis of statistics, it arrives at the conclusion that despite the attempts at promoting the importance of recovery principle under new legislation, there has been virtually no change in the proportion of using the recovery principle to liquidation. It becomes evident that the real obstacle in using such methods of resolving bankruptcy which enable to save a going concern and retain jobs was not the legislation existing in the Czech Republic prior to 2008, i.e. before the Insolvency Act became effective, but that the cause has been mainly economic. According to the author's conclusions, the decisive fact is that businesses enter insolvency proceedings too late, in a time when their assets are quite insufficient to satisfy the creditors, which means that the assets are equally insufficient to keep the business as a going concern.*

KEY WORDS *Insolvency, bankruptcy, reorganization, debtor, creditor, insolvency law*

INTRODUCTION

The last decade of the 20th century and the first decade of the 21st century witnessed a strong preference for the business recovery approach over the liquidation approach to insolvency resolutions. This means that the legal systems of many countries were adjusted and amended to motivate the creditors to put more effort into saving the debtor as a going concern and especially to retain the existing jobs. However, the ideology behind this pressure did not come from economists: this trend in the legislative process was, of course, triggered by political order and necessity.

As usual in similar situations, the change is considered a sign of progress designed to improve the general arrangements, with the alleged development in the situations in which businesses become insolvent mostly cited as the reason for the change. While in older and relatively recent past, a typical business going bankrupt was a small business with only a few employees, the last decades witnessed a change when bankruptcy became a more palpable threat to medium and large businesses, including financial service providers. Please note that these statements are considered self-evident, are rarely well documented and never rely on undoubted statistical data.

In reality, the current preference for the business recovery principle in insolvency law does not mean that there were and are no economic reasons for further development of insolvency law, including a potential review of our approach to the liquidation and business recovery principle, as there is no rational reason from the economic perspective why the business recovery principle should be more beneficial in terms of "public interest" or "social costs" than the liquidation principle. As was already said – the reasons behind the preference of the business recovery principle are political in general, and social on detail inspection, which of course will not stand as an argument by itself.

1. A BRIEF REVIEW ON EUROPEAN SITUATION

It is often argued that defaulted companies are less likely to survive as going concerns in creditor-friendly countries such as the UK, where secured creditors have wide discretion to sell their collateral (Hart, 2000; Acharya *et al.*, 2006). Acharya *et al.* (2006) predict that the allocation of control rights in bankruptcy should affect the firm's choice of optimal capital structure.

The explicit preference of the U.K. banks for going-concern reorganizations and the willingness of the U.K. banks to go to great lengths to turn around the ailing firm (Franks and Sussman, 2005) is consistent with the fact that they are often residual claimants in default, and therefore have strong incentives to maximize the total recovery. Franks and Sussman (2005) studies (Fanks and Sussman, 2005; Davydenko and Franks, 2008) discussed the reorganization of small firms in the UK, although the lack of country comparisons makes it more difficult for them to study the impact of bankruptcy rules on the outcome of default and bankruptcy.

Claessens and Klapper (2005) analyse how legal origins and creditor protection affect the incidence of formal bankruptcy procedures at the country level. Qian and Strahan

(2007) examine their influence on the terms and pricing of bank loans, and Bae and Goyal (2004) focus on the effect of property rights on loan spreads across countries. These papers find that difference in creditors' rights, particularly relating to the treatment of collateral, significantly influence the terms of loan contracts.

Studies of other jurisdictions include papers on bankruptcy auctions in Finland (Ravid and Sungren, 1998) and in Sweden (Stromberg, 2000; Thornburn, 2000). Data limitations usually restrict available evidence to formal bankruptcies.

2. SPECIFIC SITUATION OF THE CZECH ECONOMY

The Czech Republic after 1990 was in an entirely extraordinary situation that allows us, to a considerable degree, to weight the true effects of various legal resolutions at a time of significant economic instability, at a time when moral standards are absent or weak, and the economic shocks are strong. As a post-communist reform state, the Czech Republic underwent a series of fundamental changes from 1990 to 2012, including, without limitation, the resumption of insolvency law in the country when Act No. 328/1991 Coll., on Bankruptcy and Composition, was adopted.

The communist economic system controlled by the government did not need to address businesses exiting the economy: these exits could have only been triggered by the planners, not by the company's economic failures. The socialist law only needed elementary provisions for liquidation (Sections 352 through 354 of Act No. 99/1963 Coll., the Code of Civil Procedure); the rest was redundant – also because all standard businesses were owned by the government (only a few business activities remained private, mostly through cooperatives or similar forms of ownership). After the communist regime fell in late 1989, a quick transformation of the entire Czech economy to the market system was launched, which inevitably entailed the reinstitution of bankruptcy law as one of the essential components of the entire legal system.

The Act on Bankruptcy and Composition enters into force on 1 October 1991. It was undoubtedly an ambitious attempt to introduce a legal standard that followed up on the 1931 Act but was inspired by the newest foreign legislations in many aspects. However, everyday practice showed that the Act on Bankruptcy and Composition was incapable of proper operation due to the generally loose standards, the overloaded courts, the fact that judges had absolutely no knowledge of economic issues, and the development of other legislation that provided for relationships between economic entities, including, without limitation, the Commercial Code. By 2006 the Act was amended more than twenty time, including amendments by means of judgments of the Constitutional Court. The Act was constantly criticized for lengthy procedures, no general concept and impracticability, while in reality this criticism was targeted at the general environment rather than the legislation itself (Paseková *et al.*, 2011). One of the reasons why the Act on Bankruptcy and Composition was rejected was the fact that composition (as a recovery method, i.e. a method that retains the debtor as a going concern and saves at least some jobs) was hardly ever used in practice. Traditionally, the Act was put to blame for that deficiency.

> In reality only 48 compositions were permitted in more than fifteen years of operation of the Act on Bankruptcy and Composition, which is hardly

anything – in addition, we no statistics are available to show whether these attempts to adopt the recovery approach were successful.

The year 2008 saw the introduction of the Insolvency Act (Act No. 182/2006 Coll.), which was adopted with hopes that it would help the recovery approach to gain much more ground than in the past. However, looking back at the first four years of its operation, we cannot see (although some experts observe an apparent shift – e. g. Richter (2011)) the Insolvency Act helping to rescue businesses, and by extension jobs, to any larger extent.

What we can say instead is that despite all the awareness and the opportunity to draw inspiration from the newest foreign legislation when the Insolvency Act was drafted, the number of rescue operations in businesses that became bankrupt has not in reality witnessed any rise whatsoever.

Of course, we must prove this assertion by specific numbers. Just consider that from 1993 until and including 2007, the total of 48 compositions were approved. From 2008 to and including 2011 (i.e. in the first four years of operation of the Insolvency Act), about fifty reorganizations took place under the Insolvency Act. Therefore, we could say that this development clearly proves that more rescue works in businesses were undertaken in these four years than from 1993 to (and including) 2007. However, that assertion would be oversimplified.

Table 1. **Use of different forms of the business recovery principle pro rata the liquidation approach**

Year	Permitted compositions/reorganizations*	% recoveries of total	Declared bankruptcies**
2003	9	0.52	1 719
2004	6	0.42	1 435
2005	6	0.49	1 230
2006	7	0.56	1 238
2007	11	0.99	1 104
2008	6	0.91	651
2009	14	0.84	1 660
2010	19	0.97	1 948
2011	17	0.76	2 229

* Including compositions under the Act on Bankruptcy and Composition until 2007, and under the Insolvency Act in later years

** Businesses only

Note: Surprisingly, data on declared bankruptcies in the Czech Republic tend to differ from source to source, although they are all derived from the official statistics of the Justice Ministry. Still, they may differ – slightly, not by much – from the data shown in Richter (2010).

(Source: Czech Ministry of Justice, www.insolvencni-zakon.cz)

As Table 1 indicates, despite the expectations, we cannot see any real development, and reorganizations as a recovery-based approach to bankruptcy resolutions have not brought about substantial departure from the composition under the legislation valid before 2008. Expressed as a percentage proportion, the number of reorganizations

compared to the total number of business bankruptcies declared and addressed throughout the years was the same and the number of compositions compared to the bankruptcies under the Act on Bankruptcy and Composition. The share of the cases resolved using a recovery-based approach has remained under one percent of all the insolvency cases, and there is truly no indication that this trend is about to change in the short or medium-term future. In light of this development, we can say that the legislator's intention to create pace for a much more frequent use of the business recovery principle in insolvencies in businesses has failed to materialize.

If we wanted to continue to analyze the results of recovery efforts event further, we would found out that the situation is actually worse than Table 1 would seem to indicate – many reorganizations announced in 2010 and 2011 actually ended as bankruptcies after the plan of reorganization either was not adopted, or indeed was adopted, but its implementation later revealed that its completion was thwarted by unsuitable economic conditions.

Table 2. **Reorganizations transformed to bankruptcies in the course of the proceedings**

Year	**2008**	**2009**	**2010**	**2011**
Number	0	0	4	7*

* Of which four bankruptcies were declared after reorganization was approved as the bankruptcy resolution method, and three after the reorganization plan was approved

(Source: Czech Ministry of Justice, www.insolvencni-zakon.cz)

Keeping that in mind, if we looked at 2011 with regard to the cases that started off as reorganizations but finished as bankruptcies, the share of reorganizations would drop below one half of a percentage point of all insolvency cases, i.e. to the statistics in 2003 through 2006. What is interesting is that the number of cases that start as reorganizations and end up as the inevitable bankruptcy has been on the rise. A more detailed analysis of the specific events would be required to explain this phenomenon, but two basic explanations are most likely. Firstly, the fact that some reorganizations are transformed to bankruptcies in the course of the proceedings can be understood as a natural part of the reorganization plan: after some steps are completed, the completion of the reorganization by means of bankruptcy seems to be the logical step. However, we should then expect that these bankruptcies to be subsequently cancelled for lack of the debtor's assets. The second explanation explains reorganizations cancelled before the adoption of the reorganization plan: a group of creditors probably formed among all the creditors, which was not willing to adopt the reorganization plan, and although the court permitted the reorganization, the creditors did not find consensus on its implementation.

However, given the total number of insolvency cases, the number of these cases has been nothing but marginal so far.

3. INTENTION AND REALITY

Therefore, the crucial question for any further considerations of insolvency, or bankruptcy, law is why the proportion in which creditors opt for liquidation

mechanisms and recovery mechanisms does not witness a more substantial and palpable change.

According to available sources, up to ten percent of bankruptcies are resolved through reorganization in the United Kingdom, and even more in the United States.

An answer to the aforementioned questions will give us a specific idea whether it makes any real sense to respond to the current situation by means of further amendments to the insolvency laws, and whether the entire preference of the business recovery principle is a mere wish of the political representation rather than a real need of the economic public.

Therefore, we must find out why creditors make no use of recovery mechanisms and still prefer rapid liquidation of enterprises, the sale of their assets, and the ensuing partial satisfaction of their claims.

However, there are multiple reasons for the foregoing: some will be found in the area of economic relations while other reasons are related to the general quality of the judiciary, the legal protection enjoyed by the creditors, and the general quality of the legislation.

The first of the reasons is likely to be the structure of bankruptcy creditors common in the Czech Republic. Without relying on thorough statistics that are unavailable anyway, we can easily claim that the largest creditors, and even the decisive creditors, in all the more substantial bankruptcies in which insolvency proceedings have been launched and a decision on the resolution method adopted are banks and other creditors that hold liens and pledges, including, without limitation, the state and its agents (social security authorities, health insurers or finance offices). In each insolvency case, these creditors enjoy preferential titles to proceeds from the debtor's eligible assets, which quite logically reduces their willingness to go through the uncertain and complex path of recovery procedures, as we can usually assume that even in case of a very successful reorganization, the creditors will not receive benefits that will guarantee a much higher satisfaction of their claims than a simple and relatively quick liquidation. Therefore, the recovery method lacks the most fundamental element that tends to be the biggest economic driver – interest of economic parties based on at least some benefit that the given procedure may potentially bring.

Therefore, the likelihood that the business recovery principle will be used rises wherever the creditor's share in the assets used to secure loans does not reach and is substantially lower than 100%. However, we see no reason why the entity in the given case should be bankrupt when it can probably address its poor financial standing by another loan or by selling assets. Nevertheless, we can admit that regardless of the unlikelihood of that development, the entity's bankruptcy may have been caused by a coincidence of certain circumstances.

However, there is another situation where even secured creditors may be willing to opt for reorganization: the approval of a plan of reorganization does not necessarily mean that the recovery method will be fulfilled, as continued operation of the enterprise's core business is not the fundamental condition for the reorganization.

Although this fact has been ignored and neglected in specialist literature, reorganization has some advantages over bankruptcy for the key investors when the price of assets is low. While approving bankruptcy means that the insolvency trustee will relatively quickly proceed to sell assets on certain terms regardless of the situation on the assets market, e.g. the real estate market, damping down an enterprise while keeping it formally a going concern gives the creditors the option to wait with the sale for as long as they agree in the reorganization plan (Bonaci and Strouhal, 2011; Strouhal, 2009). This gives the key creditors who enjoy sufficient support in all the creditor groups or who can find a consensus with other creditor groups the opportunity to set up the reorganization plan so as to protect and secure the assets at acceptable financial costs until they are liquidate in some more profitable future. This approach is likely especially when the debtor's assets have been pledged but their potential value may be substantially higher (on a rising market) than their current value at the time of the bankruptcy.

But as we can see, reorganization is "misused" here for a purpose not intended by the legislator, i.e. to liquidate the enterprise at a later time after the bankruptcy. Reorganization will then give the creditors vast opportunities to take care of the debtor's assets in the meantime and protect it from alienation or devaluation. However, the debtor's recovery is missing in this picture.

> Of course, we can imagine the opposite situation, i.e. a bankruptcy resulting in the company's recovery, in which the business remains a going concern and the debtor may even retain all its employees. The Czech insolvency practice has seen cases where the debtor's business was sold in its entirety, or, more precisely, its core portion that forms a logical business unit was sold. 2011 saw the bankruptcy of Sazka, a lottery operator, whose core business was sold as a whole, with the bankruptcy trustee later addressing the sales of the remaining assets excluded from the assets sold as part of the core business.

The creditors' need to give some preference to the liquidation approach when they resolve the debtor's bankruptcy is also motivated by the crucial issue of risks (Sieber and Hnilica, 2011). We can generally accept the idea that risk is always and from any perspective higher when assets are liquidated in a future that we cannot correctly foresee, let alone know with any certainty. This issue can also be expressed in terms of a price of money in time (Schönfeld, 2011, pp. 146-149). Money is more valuable at present than in the future, and a creditor must have a very strong reason to rely on future proceeds in preference over present proceeds, as exemplified by the popular saying "A bird in the hand is worth two in the bush." The legislator may be surprised to see creditors following this folk wisdom, but the economist should accept this fact with understanding: in essence, this saying is very accurate in capturing the investor's view of the nature of risks associated with insolvency proceedings.

Of course, creditors (investors) see the risks exactly as they are created by the system and established rules, principles and usual results of insolvency proceedings. Therefore, investors in countries where the proceeds from insolvency proceedings are substantial and where attempts to revitalize businesses are successful will be less likely to assess the associated risks as unacceptable and will be more willing to discuss recovery procedures with the debtor.

It is worth noting that in many legal systems, the legislator did not see it fit to leave the decision on the risks the investor would be voluntarily undergoing on the investor alone. Even under Czech law – although this institute is much stronger in some other legal systems – the debtor may ask the court for repeated protection against creditors, which allows the debtor to negotiate with new investors within a certain time, and thus to address its imminent bankruptcy without actually initiating insolvency proceedings, or, when insolvency proceedings have been initiated, to suspend them during the protection period. In some cases, it is even possible to force certain debt repayment terms upon the creditors under a court decision, e.g. delayed repayments or changed repayment schedule. In that case, we can say that the preference for the business recovery principle has been extended to a degree that encroaches the rights of the creditors and that allows the debtor to fundamentally control the negotiations of its own future even when the debtor is actually bankrupt. On the other hand, similar protection can be afforded only to debtors that are able to generate cash-flow and that own assets free of encumbrances, in other words to debtors that is assumed to be a going concern.

Looking back at the issue or risks and risk assessment by the creditors in relation to insolvency proceedings and to the willingness to take the potential risk of reorganization, it is clearly vital that the general business public does not trust the judicial system in general, and the insolvency courts in particular, very much. The past years saw several cases in which insolvency judges cooperated with business groups and influenced insolvency proceedings to grant unjustified benefit to one group of creditors over others. Each case of this nature substantially reduces the credibility of the entire system, which in turn leads to exaggeration of the potential risks, including, without limitation, the risks associated with the courts' decision-making processes.

However, the single most important factor that essentially rules out any hope for a significant use of the business recovery principle within insolvency proceedings is the fact that Czech debtors enter bankruptcy not only insolvent in terms of their inability to pay their debts in full and when due but primarily in terms of "over-indebtedness", i.e. when the value of their business is negative, and the "negative value" is overwhelming. The number of insolvency petitions that are rejected for lack of the debtor's assets in the Czech Republic is simply breath-taking.

Table 3. **Bankruptcies rejected for lack of debtor's assets**

Year	Bankruptcies rejected for lack of debtor's assets	Bankruptcies declared	Reorganisations admitted
2003	627	1 719	9
2004	889	1 435	6
2005	1 159	1 230	6
2006	1 536	1 238	7
2007	1 986	1 104	11
2008	668	651	6
2009	1 568	1 660	14
2010	1 571	1 948	19
2011	1 441	2 229	17

(Source: Czech Ministry of Justice, www.insolvencni-zakon.cz)

Please note for instance that in 2006 through 2008, the number of bankruptcies rejected for lack of the debtor's assets exceeds the number of declared bankruptcies, and the proportion between the proposed bankruptcies rejected for lack of assets and the bankruptcies truly declared does not begin to rise until 2010.

Of course, the fact that many Czech business enter insolvency proceedings only after their bankruptcy has become so deep that they hold no true property and their assets have been consumed in their totality and essentially without any remains cannot be used alone to make any fundamental conclusions or judgments; it does not necessarily mean that all the companies whose bankruptcy has been published and who are facing a application for the initiation of bankruptcy proceedings must have inevitably been "consumed" in that sense of the work.

> We must not forget that non-existence of corresponding assets in a bankrupt company does not necessarily mean that these assets were consumed within the efforts to rescue the business – cases in which assets were taken out of the business well before its apparent bankruptcy so that the owners do not lose control over these assets and so that the assets are not liquidated in favour of the creditors are much more frequent. In the Czech Republic, the term "tunnelling" has entered general parlance to denote this process of asset stripping.

Nevertheless, the actual results of insolvency proceedings show that even businesses and enterprises that have been declared bankrupt tend to be in a much deeper state of insolvency, and it is clear that they were operated much longer than an economically rational thought would indicate. Therefore, many businesses keep assuming liabilities even when there is no doubt that continued business activity will only deepen their bankruptcy, and thus devaluate their assets and reduce the future proceedings from the creditor's receivables.

Whether this is due to some generally exaggerated optimism plaguing most of the managers of Czech businesses in distress or whether the extended existence of businesses is misused to steer away some assets from the businesses is a question that cannot be answered in this paper. In this context, we can only assume that procrastination aimed to gain time for asset operations seems more likely. Several legislative attempts were made in the past to force managements of businesses to proceed in a way that is responsible vis-à-vis the creditors and to file for bankruptcy themselves. Nevertheless, the known management loyalty problem has always played a strong role in this regard, and we are yet to create a situation in which a company would admit to its bankruptcy at a time the company really becomes bankrupt.

Nevertheless, the most important fact in terms of the future development of the Czech insolvency system will be the setup of the rules that will govern the conduct of business managements and the definition of their liability for timely reporting of bankruptcy.

4. FUTURE OF THE BUSINESS RECOVERY PRINCIPLE IN THE CZECH REPUBLIC

However, we can hardly expect at this time any substantial change in the short or medium term in the Czech Republic that will open the space for fulfilling the hopes put into the recovery approach of addressing a debtor's bankruptcy. The fact is that some legislative and other steps aiming to improve the situation have already been taken, while other steps can still be taken and their implementation does not necessarily have to be difficult.

A significant section of the insolvency act became effective on 1 January 2012 – for some time, the management was required to file an insolvency petition against its business once it became apparently bankrupt, i.e. insolvent. In the Czech Republic, that means that the business cannot pay its payables within thirty days of their due dates, and under the renewed wording of the act, insolvency petition must be also filed when the company enters non-apparent or concealed bankruptcy, i.e. when the value of its liabilities exceeds the value of its assets (Matis *et al.*, 2009; Strouhal, 2010). This asymmetry between the duties in case of apparent and concealed bankruptcy was introduced in the law by an "anti-crisis" amendment that allowed managements to legally ignore excessive indebtedness and not respond thereto by filing an insolvency petition. It will be interesting to observe the effects of this amendment on the number of petitions filed – so far, debtors have always filed numerous insolvency petitions, but these petitions filed by debtors have formed the majority of the petitions rejected by the court for lack of assets.

We should note that the temporary solution designed to prevent "excessive strictness at a time of economic crisis" had no impact on the development of businesses, and it is in essence very easy to see why. We can observe that in the long run, managers have not respected the law to the degree of fearing punishment if they failed to file an insolvency petition in respect of their own company. Available sources show that managers faces the court for this reason in the rarest of cases – which can be hard to understand in a country where the proceedings to secured creditors in insolvency proceedings hardly exceeds sixty percent of the value of their receivables, and ranges from three to five percent for unsecured creditors.

In reality, however, the temporary anti-crisis solution followed no clear logic. It was to apply solely to enterprises that "held sufficient cash flow" and whose situation was thus "remediable" according to the petitioner. But if the legislator believes that this business may use its assets despite the fact that its liabilities exceeds its assets, it permits, from the accounting perspective, a "forced loan from creditors", as this wait has any meaning only if the business does not enter insolvency in the meantime, since that would mean an insolvency petition. Therefore, it is necessary to use the liquidated assets to repay overdue payables so as to avoid insolvency. The "forced loan" thus reduces the potential proceeds of some creditors, as the assets are liquidated and used to repay payables – which is nothing more than granting preference to the creditors who could be the first to be informed of the insolvency by not having their receivables repaid within thirty days of their due dates.

The creditors will be aware of a debtor's apparent bankruptcy in the form of insolvency because the debtor fails to repay its payable within thirty days of its due date. In reality, this leads to information asymmetry: some creditors will become aware of the insolvency earlier and some later; some may thus begin to enforce their receivables alone and pursue execution against the debtor's assets before the other

creditors become aware that the business is bankrupt – perhaps just because their receivables are yet to fall due.

From 1 January 2012, the act thus again forces the managers to file the insolvency petition once the company enters apparent or concealed bankruptcy. The reinstated inclusion of the concealed bankruptcy in the category of "mandatory" filings is designed to prevent companies from consuming their assets to continue their business, and if they do so, to ensure that their managers are hold to account both in terms of their property and in terms of their criminal liability for these actions.

Table 4. **Insolvency petitions filed by debtors and creditors**

Year	Petitions by debtors in total	Petitions by debtors - individuals	Other petitions by debtors	Total petitions by creditors
2008	3 899	1 687	2 212	959
2009	7 382	3 722	3 660	1 966
2010	13 616	9 976	3 640	2 439
2011	21 549	17 933	3 616	2 882

(Source: Czech Ministry of Justice, www.insolvencni-zakon.cz)

Table 4 seems to indicate that the number of insolvency petitions filed by debtors remains unaffected by the applicability or suspension of the provision of the Insolvency Act obliging the management to file the insolvency petition. In the third column, we can see the number of petition filed by debtors, save for petitions relating to individuals. The "anti-crisis amendment" to the Insolvency Act that suspended some provisions of the Act until 31 December 2011 does not seem to have a significant impact on the number of these filings. Therefore, 2012 and the lowing years, i.e. the first ears of renewed application of the aforementioned provision, cannot be expected to see a dramatic rise in the number of insolvency petitions filed by the management.

Nevertheless, we can anticipate some development: although the practice of enforcing unpaid liabilities assumed during concealed bankruptcy is not common, and the practice of seeking criminal liability of the managers in charge is even rarer, managers in general are beginning to face added pressure and they are being held liable both to the business owners and to investors - creditors with increasing frequency.

Therefore, if we were to see substantially more cases of managements of businesses being forced to file insolvency petitions truly when the businesses enter bankruptcy somewhere in the future, we would be likely to see these managements making efforts to create conditions for protection against creditors (moratorium) and to negotiate with the creditors with the aim to resolve the situation on the basis of the business recovery principle, i.e. to persuade the creditors to cooperate with the business in order to reach a reorganization agreement. However, the Czech legal environment is far from reaching that situation at the present time – although in addition to civil liability, case law has been passed providing for criminal liability, too.

CONCLUSIONS

Apart from the possibility of businesses entering insolvency proceedings much earlier that they do now, once cannot imagine another significant moment that would strengthen the business recovery principle in the bankruptcy law and especially in the bankruptcies of legal entities in the Czech legal environment.

The structure of key groups of creditors of businesses that are declared and subsequently become bankrupt is not likely to witness any significant change – banks will remain the crucial creditors of most businesses, and secured creditors at that. In that aspect, we cannot expect any new stimuli: the relatively complex and uncertain process of reorganization will remain an uninteresting option for these creditors (at least in most cases), with liquidation of assets in a bankruptcy entailing much less risk.

In terms of legislation, we can hardly expect changes that would truly promote the business recovery principle at the expense of the liquidation approach. The Insolvency Act is hardly a perfect piece of legislation that would offer definite resolutions to reorganization issues; actually, it would benefit from a simplification of some of its provisions. However, even if it had been drafted perfectly, it would not help promote the business recovery principle. Reorganization as a method of resolving bankruptcies will be more successful only if the general situation offers a real and a relatively risk-free opportunity for the creditors to gain substantially higher proceeds from their receivables in the reorganization than in a simple sale within the bankruptcy proceedings.

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