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Legal and Economic Analysis of Discharge of Debts

Disertační práce

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Prohlašuji, že jsem disertační práci na téma Legal and Economic Analysis of Discharge of Debts vypracoval samostatně a citoval jsem všechny použité zdroje.

V Olomouci dne 14. března 2017 Petr Sprinz

To Parents and Kamila

Content

Abbreviations

2017 Amendment	Act no. 64/2017 Coll., on the Modification of the Act on Insolvency and Methods of its Resolution (Insolvency Act) and Some Other Acts [in Czech: *zákon, kterým se mění zákon č. 182/2006 Sb., o úpadku a způsobech jeho řešení (insolvenční zákon), ve znění pozdějších předpisů, a některé další zákony, ve znění pozdějších předpisů*], as amended
2018 Draft Amendment	Draft bill of the Ministry of Justice of the Czech Republic proposed to the Parliament under ref. no. 1030
Bankruptcy and Composition Act	Act no. 328/1991 Coll., on Bankruptcy and Composition [in Czech: *zákon o konkursu a vyrovnání*], as amended
Commission Proposal for a Directive	European Commission Proposal for a Directive of the European Parliament and the Council on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency and Discharge Procedures and Amending Directive 2012/30/EU, COM/2016/0723 final - 2016/0359 (COD)
Czech Act on Distrait	Act no. 120/2001 Coll., on Enforcement Office Holders and Distrait and on Modification of Some Other Acts [in Czech: *zákon o soudních exekutorech a exekuční činnosti (exekuční řád) a o změně dalších zákonů*], as amended
Czech Civil Code	Act no. 89/2012 Coll., Civil Code [in Czech: *občanský zákoník*]
Czech Civil Procedural Code	Act no. 99/1963 Coll., Civil Procedure Code [in Czech: *občanský soudní řád*], as amended

Czech IA	Act no. 182/2006 Coll., on Insolvency and Methods of its Resolution (Insolvency Act) [in Czech: *zákon o úpadku a způsobech jeho řešení (insolvenční zákon)*], as amended
Hungarian LDA	Act XLIX of 1991 on Liquidation and Dissolution, as amended
Hungarian ADSP	Act CV of 2015 on Debt Settlement Procedure
Insolvency Trustees Act	Act no. 312/2006 Coll., on Insolvency Trustees [in Czech: *zákon o insolvenčních správcích*], as amended
Polish LRA	Liquidation and Reorganization Act of February 28, 2003, published in Polish Journal of Laws of 2003, no. 175, as Item 1361
Regulation (EC) No 1346/2000	Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, OJ L 160, 30. 6. 2000, pp. 1-18
Regulation (EU) 848/2015	Regulation (EU) No 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, OJ L 141, 5. 6. 2015, pp. 19-72
Regulation on Remuneration of Insolvency Trustees	Regulation no. 313/2007 Coll., on the Remuneration of Insolvency Trustee, Reimbursement of Expenses, Remuneration of Members and Replacement Members of the Creditors' Committee and Compensation of their Necessary Expenses [in Czech: *vyhláška o odměně insolvenčního správce, o náhradách jeho hotových výdajů, o odměně členů a náhradníků věřitelského výboru a o náhradách jejich nutných výdajů*], as amended

Revision Amendment	Act no. 294/2013 Coll., on the Modification of the Act on Insolvency and Methods of its Resolution (Insolvency Act) and Insolvency Trustees Act [in Czech: *zákon, kterým se mění zákon č. 182/2006 Sb., o úpadku a způsobech jeho řešení (insolvenční zákon), ve znění pozdějších předpisů, a zákon č. 312/2006 Sb., o insolvenčních správcích, ve znění pozdějších předpisů*]
Slovak LRA	Act. no. 7/2005 Coll., on Liquidation and Restructuring [in Slovak: *zákon o konkurze a reštrukturalizácii a o zmene a doplnení niektorých zákonov*], as amended
Slovak Revision Amendment	Amendment to the Slovak LRA, draft bill proposed to the Parliament under ref. no. 247 and approved in the Parliament on 29 November 2016
TFEU	Treaty on the Functioning of the European Union, Official Journal C 326, 26/10/2012 P. 0001 - 0390
US Bankruptcy Code	Title 11 Bankruptcy of the United States Code, as amended

1 Introduction

1.1 Overview

Credit or money is deemed to be at the root of the progress the Western world has made.[1] Nevertheless, money has been also framed as the source of evil.[2] Instead of achieving the so-called American dream that the credit promises, it may bring about a dream of a different sort – bankruptcy nightmare.[3]

With the occurrence of the economic crisis, not only corporations but also individuals have struggled with financial issues. In recent years, the availability of credit, the increase in consumption and the financial crisis have contributed to the rise of indebtedness of households. Statistics confirm that such indebtedness is not rare nowadays. Pursuant to these statistics, in the EU 11.4 % of the surveyed were in arrears with payments in last 12 months on their bills due to financial difficulties. [4] The situation in Bulgaria, Greece and Romania was even worse since more than three out of ten of those surveyed admitted being in arrears.[5] As a consequence of this, personal insolvency law has attracted a considerable amount of attention and in line with a different sort of the European Commission recommendations a debt relief procedure has arguably become an important feature of modern bankruptcy laws across Europe. Hence, legal provisions enabling a debt relief for individuals together with the so-called fresh-start policy have become an important tool of social policy and focus of debates among policy makers. This might be exactly the point where the possibility of a better future replaces the bankruptcy nightmare mentioned above.

In the famous wording of the US Supreme Court ruling, a discharge of debts *"relieves the honest debtor from the weight of oppressive indebtedness and permits him to start afresh*

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[1] FERGUSON, Niall. *The Cash Nexus: Money and Power in the Modern World, 1700-2000***.** New York: Basic Books, 2001, p. 1.

[2] A quote from the Bible, 1 Timothy, 6:10 speaks for itself: "*The love of money is the root of all evil.*"

[3] A paraphrase of the introductory sentence in WILLIAMS, Winton E. *Games Creditors Play: Collecting from Overextended Consumers.* Durham: Carolina Academic Press, 1998, p. vii.

[4] CIVIC CONSULTING. *The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impac*t [online]. European Commission, 2013 [cited 3 March 2017]. Available on <http://ec.europa.eu/consumers/financial_services/reference_studies_documents/docs/part_1_syndissertation_of_findings_en.pdf>.

[5] *Idem*.

free from the obligations and responsibilities consequent upon business misfortunes."[6] It essentially provides the "*honest but unfortunate debtor ... a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt*."[7] In essence, the debtor provides his tangible or other capital in the view of releasing himself from past obligations so that that unpaid debts are consequently not enforceable.

Yet, rules on individual bankruptcies are not only significant with respect to solving financial difficulties *ex post*, once a shortage of money has occurred. The availability of a debt relief brings about possible implications even before insolvency happens. One must bear in mind that outside of bankruptcy law, the underlying principle stipulates that debts ought to be paid. Since discharge of debts entails a departure from non-bankruptcy law, it needs to be well reasoned.[8] Apart from important legal implications, discharge of debts triggers a set of economic, psychological and other consequences, and raises many interesting questions such as whether the law should protect debtors or to what extent debtors should be protected. Individuals might be presumably more willing to undertake risks if they know that the bankruptcy law will help them to cope with possible negative implications. Accordingly, the bankruptcy law cannot enable debtors to escape from their obligations too easily. It is the challenge for legislature to implement the law that balances the interests of creditors and debtors as well as other stakeholders, which is certainly not an easy task.

1.2 Context and review of literature

This dissertation comprises a legal study of personal insolvency law in the Czech Republic focused on discharge of debts [in Czech: *oddlužení*] as a method of resolution of a debtor's insolvency implementing the so-called fresh-start policy from the view of law and economic analysis. In the Czech Republic,[9] the topic of personal insolvency law tends to be more and more debated issue as the number of motions for discharge of debts has arisen significantly since the adoption of the Czech IA. Whereas in 2008, only 1,693 motions

[6] The Supreme Court of the USA ruling in re *Local Loan Co. v. Hunt*, 294 U.S. 234, 244 (1934).

[7] *Idem*.

[8] See mainly chapter 2.5 *infra*.

[9] In the Czech Republic, recently there have been several initiatives discussed. See *inter alia* project of the Ministry of Justice of the Czech Republic "Sanace dluhů" or projects of Aliance proti dluhům. More information are available on <http://portal.justice.cz/Justice2/ms/ms.aspx?o=23&j=33&k=4709&d=287302> and <http://alianceprotidluhum.cz/>.

for discharge of debts were filed, in 2016 26,556 motions were filed. Nowadays, discharge of debts proceedings account for about 90 % of all insolvency proceedings in the Czech Republic.[10]

The importance of the topic is strengthened by recent legislative initiatives at the national, regional as well as the EU level. Only in the Czech Republic, one amendment addressing discharge of debts shall take into effect as of 1 July 2017 and another one is subject to legislative process whereas both of them seek to substantially reshape the framework of discharge of debts. In 2015, amendments to the Polish personal insolvency law became effective. In late 2015, Hungary finally adopted laws which allow individuals a relief from their debts. In November 2016, the Slovak Parliament adopted significant modifications to the Slovak LRA which presumes the new concept of debt relief procedure. At the EU level, in November 2016, following years-long debate, the European Commission published its proposal of the directive which among others aims at harmonization of a debt relief procedure. The mentioned recent initiatives prove that the dissertation is indeed topical.

Obviously, the issue of discharge of debts is not a new invention.[11] Debt relief procedures have been historically discussed mainly in the USA.[12] Before examining specific issues of discharge of debts, one must mention that a great deal of literature focuses on bankruptcy law. Valuable theoretical background of bankruptcy law provides *inter alia* Douglas Baird's "*The Elements of Bankruptcy*",[13] Theodore Eisenberg's "*Bankruptcy and Debtor-Creditor Law. Cases and Materials*",[14] Thomas Jackson's "*The Logic and Limits of Bankruptcy Law*",[15] Tomáš Richter's "*Insolvenční právo*",[16] Charles Tabbs' "*The Law of Bankruptcy*",[17] and James White's "*Bankruptcy and Creditors' Rights: Cases*

[10] Pursuant to the statistics of the Ministry of Justice of the Czech Republic 29,493 insolvency petitions were filed and 26,556 motions for discharge of debts were submitted in 2016. See in more details chapter 5 *infra*.

[11] Since the ideas advocated by the respective authors generally concern specific legal issues, the author refers also to specific parts of this dissertation.

[12] One of the oldest publications about justification of modern discharge of debts laws is BLACKSTONE, William. *Commentaries on the Laws of England*. Baton Rouge: Claitor's Publishing, 1976. Edited by William Carey Jones. 253 pages.

[13] BAIRD, Douglas G. *The Elements of Bankruptcy.* 5th edition. New York: Foundation Press. 2010. 270 pages.

[14] EISENBERG, Theodore. *Bankruptcy and Debtor-Creditor Law. Cases and Materials.* 4th edition. New York: Foundation Press, 2011. 833 pages.

[15] JACKSON, Thomas H. *The Logic and Limits of Bankruptcy Law*. Washington: Beard Books, 2001. 300 pages.

[16] RICHTER, Tomáš. *Insolvenční právo*. 1st edition. Prague: ASPI, 2008. 472 pages.

[17] TABB, Charles, J. *The Law of Bankruptcy*. Westbury: Foundation Press, 1997. 1050 pages.

and Materials".[18] Still, the list of literature on bankruptcy theories can be in this regard hardly exhaustive.[19]

In terms of the theory of personal insolvency law, one of the most cited papers seems to be Jackson's "*The Fresh-Start Policy in Bankruptcy Law*", which elaborates on the principles of discharge of debts and establishes several key justifications for the introduction of a debt relief.[20] However, the ideas put forward by Thomas Jackson were neither accepted by all scholars[21] nor completely inclusive. Other key papers concerning theoretical foundations of a debt relief procedure include Margaret Howard's "*A Theory of Discharge in Consumer Bankruptcy*"[22], Theodore Eisenberg's "*Bankruptcy Law in Perspective*"[23] or Steven Harris' response "*Reply to Theodore Eisenberg's Bankruptcy Law in Perspective*".[24]

Since the thesis seeks to approach the topic of discharge of debts from the perspective of the law and economics, the literature focused on the economics is of particular importance. As concerns theoretical questions the author refers particularly to Richard Posner's "*Economic Analysis of Law*",[25] which provides its readers with a fascinating economic analysis of almost all major areas of law. "*Economics and the Law. From Posner to Post-Modernism*"[26] published by Nicholas Mercuro and Steven Medema describes

[18] WHITE, James J. *Bankruptcy and Creditors' Rights: Cases and Materials*. St. Paul (Minn): West Publishing, 1985. 812 pages.

[19] See also e.g. EPSTEIN, David G., NICKLES, Steve H., WHITE, James J. *Bankruptcy*. St. Paul: West Publishing, 1992. 3 volumes; MOKAL, Jameel R. *Corporate Insolvency Law. Theory and Application*. Oxford: Oxford University Press, 2005. 380 pages; or RASMUSSEN, Robert K. *Bankruptcy Law Stories*. New York: Foundation Press, 2007. 244 pages.

[20] JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, pp. 1393-1448.

[21] See for instance a harsh criticism in the following publication: CARLSON, David G. Philosophy in Bankruptcy. *Michigan Law Review*, 1987, vol. 85, no. 5, pp. 1341-1389.

[22] HOWARD, Margaret. A Theory of Discharge in Consumer Bankruptcy. *Ohio State Law Journal*, 1987, vol. 48, no. 4, pp. 1047-1088.

[23] EISENBERG, Theodore. Bankruptcy Law in Perspective. *UCLA Law Review*, 1981, vol. 28, no. 5, pp. 953-999.

[24] HARRIS, Steven L. Reply to Theodore Eisenberg's Bankruptcy Law in Perspective. *UCLA Law Review*, 1982, vol. 30, no. 2, pp. 327-365. See also EISENBERG, Theodore. Bankruptcy Law in Perspective: A Rejoinder. *UCLA Law Review*, 1983, vol. 30, no. 3, pp. 617-636.

[25] POSNER, Richard A. *Economic Analysis of Law*. 7th edition. New York: Aspen Publishers, 2007. 816 pages. See also POSNER, Richard A. *The Economics of Justice.* Cambridge: Harvard University Press, 1981. 415 pages; and POSNER, Richard A. *Aging and Old Age*. Chicago: The University of Chicago Press, 1995. 375 pages.

[26] MERCURO, Nicholas, MEDEMA, Steven G. *Economics and the Law. From Posner to Post-Modernism.* Princeton: Princeton University Press, 1997. 235 pages

comprehensively various theories of law and economics, whereas Robert Cooter's and Thomas Ulen's theoretical publication "*Law and Economics*"[27] and Mitchell Polinsky's "*An introduction to law and economics*"[28] examines essential notions which are necessary to understand how the law might affect incentives of people. As concerns the labour market, work efforts of individuals in bankruptcy and related issues, the author considers that particularly useful is Gary Becker's "*The Economic Approach to Human behaviour*"[29], Avery Katz's "*Foundations of the economic approach to law*"[30], Kevin Lancaster's "*Modern Economics: Principles and Policy*"[31] or one of the most famous books - "*Economics*" written by Paul Samuelson and William Nordhaus.[32] Winton Williams' publication on the theory of games "*Games Creditors Play: Collecting from Overextended Consumers*" serves also as an interesting source of inspiration regarding bankruptcy law theories.[33]

In this connection, the analysis of a debt relief procedure cannot ignore that institutional creditors such as banks and other financial institutions play a crucial role in the indebtedness of households. In this context, publication "*The Economics of Consumer Credit Demand and Supply*"[34] written by a group of authors provides an important insight into consumer financing. Other authors who have focused on these issues are Lawrence Ausubel,[35] Richard Hynes, Eric Posner,[36] Cass Sunstein,[37] Reint Gropp, John Scholz and Michelle White.[38]

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[27] COOTER, Robert, ULEN, Thomas. *Law and Economics.* 4th edition. Boston: Pearson, 2004. 533 pages.

[28] POLINSKY, Mitchell A. *An introduction to law and economics*. 2nd edition. 1989, Boston: Brown. 153 pages. See also mainly GEORGAKOPOULOS, Nicholas L. *Principles and Methods of Law and Economics: Basic Tools for Normative Reasoning.* 1st edition. New York: Cambridge University Press, 2005. 378 pages.

[29] BECKER, Gary. *The Economic Approach to Human behaviour*. Chicago: University of Chicago Press, 1976. 314 pages.

[30] KATZ, Avery W. *Foundations of the economic approach to law*. New York: Oxford University Press, 1998. 399 pages.

[31] LANCASTER, Kevin. *Modern Economics: Principles and Policy*. Chicago: Rand McNally, 1973. 741 pages. See also DAU-SCHMIDT, Kenneth G., HARRIS Seth D., LOBEL, Orly. *Labor and Employment Law and Economics.* Northampton: Edward Elgar, 2009. 738 pages; or SHAPIRO, Carl, STIGLITZ, Joseph E. Equilibrium Unemployment as a Worker Discipline Device. *The American Economic Review*, 1984, vol. 74, no. 3, pp. 433-444.

[32] SAMUELSON, Paul A., NORDHAUS, William, D. *Economics.* 14th edition. New York: McGraw-Hill, 1992. 784 pages.

[33] WILLIAMS, Winton E. *Games Creditors Play: Collecting from Overextended Consumers.* Durham: Carolina Academic Press, 1998. 190 pages.

[34] BERTOLA, Giuseppe, DISNEY, Richard, GRANT, Charles (eds.). *The Economics of Consumer Credit Demand and Supply.* Cambridge: MIT Press, 2006. 378 pages.

[35] AUSUBEL, Lawrence M. Credit Card Defaults, Credit Card Profits, and Bankruptcy. *The American Bankruptcy Law Journal*, 1997, vol. 71, no. 2, pp. 249-270.

[36] HYNES, Richard M., POSNER, Eric A. The Law and Economics of Consumer Finance. *American Law and Economics Review*, 2002, vol. 4, no. 1, pp. 168-207.

Joseph Stiglitz and Andrew Weiss have also contributed to the topic of consumer financing.[39] Also, a growing number of analyses has focused on empirical issues concerning the effects of debt collection laws and debt relief procedures. Song Han and Li Wenli have focused on the implications of a debt relief on work efforts.[40] Michelle White, Scott Fay and Erik Hurst and other authors[41] have also published papers on economic implications of a debt relief procedure.

However, not only classical economics is relevant. Behavioural approach to law seems to increase in importance. Herbert Simon,[42] Daniel Kahneman and Amon Tversky[43] are

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[37] SUNSTEIN, Cass R. Boundedly Rational Borrowing. *The University of Chicago Law Review*, 2006, vol. 73, no. 1, pp. 249-270.

[38] GROPP, Reint, SCHOLZ, John K., WHITE Michelle J. Personal Bankruptcy and Credit Supply and Demand. *The Quarterly Journal of Economics*, 1997, vol. 112, no. 1, pp. 217-251.

[39] STIGLITZ, Joseph E., WEISS, Andrew. Credit Rationing in Markets with Imperfect Information. *The American Economic Review*, 1981, vol. 71, no. 3, pp. 393-410. See also LA PORTA, Rafael, LOPEZ-DE-SILANES, Florencio, SHLEIFER, Andrei, VISHNEY, Robert. Legal Determinants of External Finance. *Journal of Finance*, 1997, vol. 52, no. 3, pp. 1131-1150.

[40] See e.g. HAN, Song, WENLI, Li. Fresh Start or Head Start? The Effect of Filing for Personal Bankruptcy on Work Efforts. *Journal of Financial Services Research*, 2007, vol. 31, no. 2, pp. 123-152.

[41] See e.g. GROPP, Reint, SCHOLZ, John K., WHITE, Michelle J. Personal Bankruptcy and Credit Supply and Demand. *The Quarterly Journal of Economics*, 1997, vol. 112, no. 1, pp. 217-251; WANG, Hung-Jen, WHITE, Michelle J. An Optimal Personal Bankruptcy Procedure and Proposed Reforms. *The Journal of Legal Studies*, 2000, vol. 29, no. 1, pp. 255-286; FAN, Wei, WHITE, Michelle J. Personal Bankruptcy and the Level of Entrepreneurial Activity. *Journal of Law and Economics*, 2003, vol. 46, no. 2, pp. 543-567; WANG, Hung-Jen, WHITE, Michelle J. An Optimal Personal Bankruptcy Procedure and Proposed Reforms. *The Journal of Legal Studies*, 2000, vol. 29, no. 1, pp. 255-286; WHITE, Michelle J. Why It Pays to File for Bankruptcy: A Critical Look at the Incentives Under US Personal Bankruptcy Law and a Proposal for Change. *The University of Chicago Law Review*, 1998, vol. 65, pp. 685-732; and FAY, Scott, HURST, Erik, WHITE, Michelle J. The Household Bankruptcy Decision. *American Economic Review,* 2002, vol. 92, no. 3, pp. 706-718.

[42] SIMON, Herbert A. A Behavioral Model of Rational Choice. *The Quarterly Journal of Economics*, 1955, vol. 69, no. 1, pp. 99-118; and SIMON, Herbert A Rationality in Psychology and Economics. *The Journal of Business*, 1986, vol. 59, no. 4, pp. S209-S224.

[43] See e.g. KAHNEMAN, Daniel, TVERSKY, Amos (eds.). *Choices, Values, and Frames*. Cambridge: Cambridge University Press, 2000. 840 pages; KAHNEMAN, Daniel. *Thinking Fast and Slow*. London: Penguin Books, 2012. 499 pages; KAHNEMAN, Daniel, KNETSCH, Jack L, TVERSKY, Amos. Experimental Tests of the Endowment Effect and the Coase Theorem. *The Journal of Political Economy*, 1990, vol. 98, no. 6, pp. 1325-1348; KAHNEMAN, Daniel, TVERSKY, Amos. Subjective Probability: A Judgment of Representativeness. *Cognitive Psychology*, 1972, vol. 3, no. 3, pp. 430-454; KAHNEMAN, Daniel, TVERSKY, Amos. Availability: A Heuristic for Judging Frequency and Probability. *Cognitive Psychology*, 1973, vol. 5, no. 2, pp. 207-232; KAHNEMAN, Daniel, TVERSKY, Amos. Prospect Theory: An Analysis of Decision under Risk. *Econometrica*, 1979, vol. 47, no. 2, pp. 263-292; KAHNEMAN, Daniel, TVERSKY, Amos. Judgment Under Uncertainty: Heuristics and Biases. *Science*, 1985, vol. 185, no. 41, pp. 1124-1131; KAHNEMAN, Daniel, TVERSKY, Amos. Rational Choice and the Framing of Decisions. *The Journal of Business*, 1986, vol. 59, no. 4, pp. S251-S278; KAHNEMAN, Daniel, TVERSKY, Amos. Advances in Prospect Theory: Cumulative Representation of Uncertainty. *Journal of Risk and Uncertainty*, 1992, vol. 5, no. 4, pp. 297-323; KAHNEMAN, Daniel. Maps of Bounded Rationality: Psychology for Behavioral Economics. *The American Economic Review*, 2003, vol. 93, no. 5, pp. 1449-1475. See also JOLLS, Christine, SUNSTEIN, Cass R., THALER, Richard. Theories and Tropes: A Reply to Posner and Kelman. *Stanford Law Review*, 1998, vol. 50, no. 5, pp. 1593-1608.

certainly among those who have paved the way for such avenue. Further to findings of behavioural scientists, David Laibson, [44] Jason Kilborn,[45] Ian Ramsay[46] as well as other authors[47] have sought to apply models of behavioural law and economics to behaviour of individuals (consumers) and debt relief procedure.

Many other academics have examined the topic of a debt relief procedure from different angles. Some of them took an economic approach,[48] whereas other commentators preferred rather sociological approach or philosophical approach. Karen Gross' "*Failure and Forgiveness: Rebalancing the Bankruptcy System*",[49] Lisa McIntyre's "Sociological Perspective on Bankruptcy"[50] or "*As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America*"[51] written by Elizabeth Warren, Teresa Sullivan and Lawrence Westbrook prove that not only grounds related to economics are stressed in terms of justification of a debt relief procedure.[52] Also, several authors have focused on the role of stigma

[44] LAIBSON, David, ZECKHAUSER, Richard. Amos Tversky and the Ascent of Behavioral Economics. *Journal of Risk and Uncertainty*, 1998, vol. 16, no. 1, pp. 7-47; ANGELETOS, George-Marios, LAIBSON, David, REPETTO, Andrea, TOBACMAN, Jeremy Tobacman, WEINBERG, Stephen. The Hyperbolic Consumption Model: Calibration, Simulation, and Empirical Evaluation. *The Journal of Economic Perspectives*, 2001, vol. 15, no. 3, pp. 47-68.

[45] See e.g. KILBORN, Jason J. Mercy, Rehabilitation, and Quid Pro Quo: A Radical Reassessment of Individual Bankruptcy. *Ohio State Law Journal*, 2003, vol. 64, no. 3, pp. 855-896; KILBORN, Jason J. Behavioral Economics, Overindebtedness & Comparative Consumer Bankruptcy: Searching for Causes and Evaluating Solutions. *Emory Bankruptcy Development Journal*, 2005, vol. 22, no. 1, pp. 13-45; KILBORN, Jason J. La Responsabilisation De L'Economie: What the United States Can Learn from the New French Law on Consumer Overindebtedness. *Michigan Journal of International Law*, 2005, vol. 26, pp. 619-671.

[46] See e.g. RAMSAY, Iain. Models of Consumer Bankruptcy: Implications for Research and Policy. *Journal of Consumer Policy*, 1997, vol. 20, pp. 269-287.

[47] See e.g. NIEMI-KIESILAINEN, Johanna. Consumer Bankruptcy in Comparison: Do We Cure a Market Failure or a Social Problem? *Osgood Hall Law Journal*, 1999, vol. 37, pp. 473-503.

[48] See e.g. WEISTART, John C. The Costs of Bankruptcy. *Law and Contemporary Problems*, 1977, vol. 41, no. 4, pp. 107-122; HARRIS, Margaret. A Theory of Discharge in Consumer Bankruptcy. *Ohio State Law Journal*, 1987, vol. 48, no. 4, pp. 1047-1088; ADLER, Barry, POLAK, Ben, SCHWARTZ, Alan. Regulating Consumer Bankruptcy: A Theoretical Inquiry. *The Journal of Legal Studies*, 2000, vol. 29, no. 2, pp. 585-613.

[49] GROSS, Karen. *Failure and Forgiveness: Rebalancing the Bankruptcy System*. New Haven: Yale University Press, 1997.

[50] McINTYRE, Lisa J. Sociological Perspective on Bankruptcy. *Indiana Law Review*, 1989, vol. 65, no. 1, pp. 123-140;

[51] SULLIVAN, Teresa A., WESTBROOK, Lawrence J., WARREN, Elizabeth. *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America*. New York: Oxford University Press, 1989. 370 pages. See also e.g. FLINT, Richard E. Bankruptcy Policy: Toward a Moral Justification for Financial Rehabilitation of the Consumer Debtor. *Washington and Lee Law Review,* 1991, vol. 48, no. 2, pp. 515-578.

[52] See also WILHELMSSON, Thomas. "Social Force Majeure": A New Concept in Nordic Consumer Law. *Journal of Consumer Policy*, 1990, vol. 13, no. 1, pp. 1-14.

associated with bankruptcy[53] and there is at least one publication concerning the implementation of the fresh-start policy.[54]

The thesis also stems from a numerous comparative literature. Titles such as "*Consumer Bankruptcy in Global Perspective*",[55] "*Comparative Consumer Bankruptcy*",[56] or "*Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*" aggregate valuable thoughts on debt relief procedures from various countries as their authors discuss distinct legal regimes. Moreover, one cannot forget about historical insights presented by bankruptcy law scholars.[57]

In the Czech Republic, Petr Holešínský, Petr Strnad,[58] Bohumil Havel,[59] Petr Kavan,[60] Rostislav Krhut,[61] Lukáš Pachl,[62] Tomáš Richter,[63] Oldřich Řeháček[64] as well as other

[53] See e.g. EFRAT, Rafael. The Evolution of Bankruptcy Stigma. *Theoretical Inquiries in Law*, 2006, vol. 7, no. 2, pp. 365-393, and EFRAT, Rafael. Bankruptcy Stigma: Plausible Causes for Shifting Norms. *Emory Bankruptcy Development Journal*, 2005, vol. 22, no. 2, pp. 481-519;

[54] EFRAT, Rafael. The Fresh-Start Policy in Bankruptcy in Modern Day Israel. *American Bankruptcy Institute Law Review,* 1999, vol. 7, no. 2, pp. 555-600.

[55] NIEMI-KIESILAINEN, Johanna, RAMSAY, Iain, WHITFORD, William C. (eds.). *Consumer Bankruptcy in Global Perspective*. Oxford: Hart, 2003. 368 pages.

[56] KILLBORN, Jason J. *Comparative Consumer Bankruptcy.* Durham: Carolina Academic Press, 2007. 114 pages. See also RAMSAY, Iain. Comparative Consumer Bankruptcy. *Illinois Law Review*, 2007, no. 1, pp. 241-274.

[57] See e.g. COUNTRYMAN, Vern. Bankruptcy and the Individual Debtor - And a Modest Proposal to Return to the Seventeenth Century. *Catholic University Law Review*, 1983, vol. 32, no. 4, pp. 809-827; McCOID, John C. The Origins of Voluntary Bankruptcy. *Bankruptcy Development Journal*, 1988, vol. 5, no. 2, pp. 361-390; TABB, Charles J. Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate. *George Washington Law Review*, 1990, vol. 59, no. 1, pp. 56-113; or McCOID, John C. Discharge: The Most Important Development in Bankruptcy History. *American Bankruptcy Law Journal*, 1996, vol. 70, no. 2, pp. 163-194. See also KOZÁK, Jan. Nové úpadkové právo v České republice. *Právní zpravodaj*, 2008, vol. 9, no. 2, pp. 3-7.

[58] HOLEŠÍNSKÝ, Petr, STRNAD, Michal. Nové způsoby řešení úpadku dle insolvenčního zákona. *Právní rozhledy*, 2008, vol. 16, no. 1, pp. 7-16.

[59] HAVEL, Bohumil. Oddlužení - zbraň nebo hrozba? *Právní rozhledy*, 2007, vol. 15, no. 2, pp. 50-55.

[60] KAVAN, Petr. Malé zamyšlení a několik výkladových poznámek k institutu oddlužení. *Právní rozhledy*, 2008, vol. 16, no. 12, pp. 434-440; KAVAN, Petr. Dlužník, který není podnikatelem – peripetie výkladu jednoho sousloví. *Právní rozhledy*, 2012, vol. 20, no. 12, pp. 733-735.

[61] KRHUT, Rostislav. Poctivý záměr v oddlužení. *Bulletin advokacie*, 2012, no. 9, pp. 42-43.

[62] PACHL, Lukáš. Kdy a jak správně podat návrh na povolení oddlužení. *Právní fórum*, 2008, vol. 13, no. 5, pp. 209-213.

[63] RICHTER, Tomáš. Slovenská rekodifikace insolvenčního práva: několik lekcí pro Českou republiku (a jedna sázka na divokou kartu. *Právní rozhledy,* 2005, vol. 13, no. 13, pp. 731-741; and RICHTER, Tomáš. Insolvenční zákon: od vládního návrhu k vyhlášenému znění. *Právní rozhledy,* 2006, vol. 14, no. 14, pp. 765-774.

[64] ŘEHÁČEK, Oldřich. Osobní bankrot manželů a jeho řešení v soudní judikatuře. *Bulletin advokacie*, 2011, no. 7-8, pp. 42-44; and ŘEHÁČEK, Oldřich. Osobní bankrot v soudní praxi. *Bulletin advokacie*, 2013, no. 7-8, pp. 45-47.

authors[65] contributed to discussions regarding discharge of debts. Commentaries on the Czech IA also provide valuable remarks on discharge of debts proceedings. [66]

Nevertheless, the scholars in the Czech Republic have mostly focused on particular issues, such as the requirement of honesty,[67] eligibility for discharge of debts,[68] relation of insolvency proceedings to enforcement proceedings[69] and discharge of debts of spouses.[70] A comprehensive paper about the background of discharge of debts and theory behind that is missing, although the importance thereof has been pointed out.[71] This dissertation seeks to fill that gap.

[65] See e.g. BABUŠKOVÁ, Jana. Oddlužení manželů – aneb co v zákoně nenajdete. *Bulletin advokacie*, 2012, no. 4, pp. 32-33; GRUS, Zdeněk, CIDLINA, Václav. „Oddlužení podnikatele" nejenom v rozhodovací praxi. *Právní rozhledy*, 2013, vol. 21, no. 13, pp. 704-707; KUTNATOVÁ, Karolína. Zákonná vyživovací povinnost rodiče ve vztahu k insolvenčnímu řízení. *Bulletin advokacie*, 2015, no. 12, pp. 35-38; PAULDURA, Lukáš. Žádost o nižší splátky v průběhu oddlužení a použití § 407 insolvenčního zákona. *Bulletin advokacie*, 2016, no. 3, pp. 33-37; SIGMUND, Adam. (Ne)poctivý záměr v sanačních formách insolvenčního řízení. *Bulletin advokacie*, 2016, no. 3, pp. 35-37; ŠŮSOVÁ, Táňa. Přinesla novela účinná od 1. 1. 2014 pro společné oddlužení manželů něco nového? *Ad Notam*, 2015, no. 1, pp. 3-5.

[66] See e.g. KOTOUČOVÁ, Jiřina et al. *Zákon o úpadku a způsobech jeho řešení (insolvenční zákon) – komentář*. Prague: C. H. Beck, 2008; and KOZÁK, Jan et al. *Insolvenční zákon a předpisy související; Nařízení Rady (ES) o úpadkovém řízení: komentář.* Prague: ASPI, 2008.

[67] See e.g. KRHUT, Rostislav. Poctivý záměr v oddlužení. *Bulletin advokacie*, 2012, no. 9, pp. 42-43; and PLEVA, Vítězslav. K pojmu nepoctivý záměr v insolvenčním řízení. *Právní rozhledy*, 2014, vol. 22, no. 3, pp. 104-107.

[68] See e.g. SPRINZ, Petr. Kdo ještě je a kdo už není podnikatel aneb subjektivní přípustnost oddlužení dnes a „zítra". *Právní rozhledy*, 2013, vol. 21, no. 10, p. 361; GRUS, Zdeněk, CIDLINA, Václav. „Oddlužení podnikatele" nejenom v rozhodovací praxi. *Právní rozhledy*, 2013, vol. 21, no. 13, pp. 704-707; KAVAN, Petr. Dlužník, který není podnikatelem – peripetie výkladu jednoho sousloví. *Právní rozhledy*, 2012, vol. 20, no. 12, pp. 733-735; or KAVAN, Petr. Malé zamyšlení a několik výkladových poznámek k institutu oddlužení. *Právní rozhledy*, 2008, vol. 16, no. 12, pp. 434-440.

[69] KOCINEC, Jaroslav. Judikát Nejvyššího soudu v otázce střetu insolvence s exekucí. *Komorní listy*, 2015, vol. 1, pp. 33-39; KUBIZŇÁK, Jan. Účinky zahájení insolvenčního řízení ve vztahu k exekuci srážkami ze mzdy. *Komorní listy*, 2014, vol. 2, pp. 13-16; Neuhäuserová, Jana. Střet insolvence s exekucí. *Komorní listy*, 2016, vol. 3, pp. 26-29.

[70] ŘEHÁČEK, Oldřich. Osobní bankrot manželů a jeho řešení v soudní judikatuře. *Bulletin advokacie*, 2011, no. 7-8, pp. 42-44; BABUŠKOVÁ, Jana. Oddlužení manželů – aneb co v zákoně nenajdete. *Bulletin advokacie*, 2012, no. 4, pp. 32-33.

[71] RICHTER, Tomáš. Insolvenční zákon: od vládního návrhu k vyhlášenému znění. *Právní rozhledy,* 2006, vol. 14, no. 14, pp. 765-774. The author admits, however, that he has not reviewed SMOLÍK, Petr. *Oddlužení v českém právním řádu ČR*. Prague: C. H. Beck, 2016. 352 pages, which was published shortly before the finalization of this dissertation.

1.3 Research questions of the dissertation and its aim

This dissertation examines theories behind proceedings enabling a debt relief (debt relief procedures), identifies possible positive as well as negative aspects thereof and observes particularly the role of discharge of debts in the Czech Republic as one of debt relief procedures. More specifically, the research question is: what considerations a debt relief procedure should take into account from legal and economic perspective and to what extent Czech legislation reflects such considerations. Since this dissertation avails of law and economics, the research questions shall be assessed particularly from this perspective.[72] The outcome of the dissertation should be the analysis that might serve not only as a source of information for legal scholars or practising lawyers but also as a guideline for future legislative changes.

In this connection, the thesis sets forth particular hypotheses as follows.

- **Debt relief procedure brings about significant *ex ante* as well as *ex post* socio-economic effects.**

Both in the economic as well as social sphere, bankruptcy law theories identify a number of grounds substantiating the introduction of insolvency proceedings contemplating a sort of a debt relief. This thesis seeks to comprehensively evaluate various functions of a debt relief procedure and their *ex ante* and *ex post* effects. Moreover, this dissertation intends to examine other possible rationales behind the fresh-start policy.

- **Debt relief procedure should be available to individuals regardless of whether they are engaged in business.**

Generally, there are three basic options how to approach subjective scope of a debt relief procedure in terms of business activities of the debtor. First, insolvency laws do not distinguish between the individuals, who are engaged in business, and the individuals, who

[72] Scholars from different fields have for a long time waged a debate over the normative value of the economic analysis and validity of its conclusions. Notwithstanding the possible limits of the economic approach to law it may still be in many respects a helpful analytical tool and a source of inspiration. See for instance DWORKIN, Ronald M. Is Wealth a Value? *The Journal of Legal Studies,* 1980, vol. 9, no. 2, pp. 191-226; KRONMAN, Anthony T. Wealth maximization as a normative principle. *The Journal of Legal Studies*, 1980, vol. 9, no. 2, pp. 227-242; or POSNER, Richard A. Reply to Some Recent Criticisms of the Efficiency Theory of the Common Law. *Hofstra Law Review*, 1981, vol. 9, no. 3, pp. 775- 794. Milton Friedman argued that "*Economics should not be judged on whether the assumptions are realistic or valid, but rather on the quality of its predictions*." FRIEDMAN, Milton. *Essays in Positive Economics*. Chicago: Chicago University Press, 1953, p. 15.

are not engaged in business. Second, insolvency laws provide more favourable conditions for entrepreneurs. Third, insolvency laws prefer non-entrepreneurs to those engaged in business activities by setting more favourable conditions for discharge of debts. The latter is the case of the Czech Republic. This dissertation shall assess whether it is appropriate to distinguish between entrepreneurs and non-entrepreneurs in terms of subjective scope of discharge of debts.

- **The principle that a debt relief procedure is available for honest but unfortunate debtors is reflected in the general requirement to act honestly in discharge of debts.**

Jurisprudence has traditionally linked admissibility of a debt relief procedure to the honest but unfortunate debtor.[73] This dissertation shall focus on the question to what extent such assertion is reflected in discharge of debts proceedings under the Czech IA.

- **Rules on a debt relief procedure should motivate debtors to maximize the value for creditors on the one hand, and prevent them from abusing the debt relief on the other hand, by balancing the interests of the respective stakeholders.**

It is argued that provisions governing discharge of debts should seek to create a framework that adequately protects the interests of all stakeholders. Such protection is *inter alia* ensured by virtue of preconditions for the debt relief procedure and duties of debtors in discharge of debts proceedings. This dissertation shall assess particularly to what extent the Czech legal framework of discharge of debts fulfils its purpose. In this respect, the thesis will focus on what prerequisites the Czech legal framework relies.

- **The role of the debtor in discharge of debts is rather limited. Although the insolvency trustee plays a significant role, the court holds the role of the gatekeeper of utmost importance.**

This dissertation shall assess the roles of the respective stakeholders in discharge of debts. The author *inter alia* argues that although courts are overloaded, they are considered to be gatekeepers of legality and their role is of utmost importance.

[73] See mainly JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, pp. 1393-1420.

- **Debt relief procedure is a key feature of modern insolvency laws and therefore it is neglected neither at the EU nor at the regional level.**

This dissertation observes that a debt relief procedure has gained importance in modern bankruptcy laws. Although as of the submission of the initial thesis proposal, Poland and Slovakia did not have working legal framework of the fresh-start policy and Hungary lacked it totally, the respective legislators in the region have focused on the improvement thereof.

The purpose of this thesis is to establish a comprehensive theoretical study on discharge of debts. It should serve to academics as well as professionals to cope with various conceptual as well as practical issues. Moreover, it might be used as a source of inspiration for the purpose of amendment of the Czech IA. For the sake of completeness, since the dissertation focuses on discharge of debts from the law and economics perspective, the aim thereof is neither to provide a thorough historical background of a debt relief procedure (insolvency proceedings) [74] nor to elaborate on other resolutions of the debtor's insolvency. Moreover, this thesis does neither focus on cross-border debt relief procedures nor specifically on any foreign legal frameworks.

Initially, the dissertation intended to examine also macroeconomic data. Due to limitations of resources, scope and time, solely limited data corresponding to the hypotheses of this dissertation have been analysed. However, the author suggests that it would be useful to observe possible correlations of statistics concerning discharge of debts and the macroeconomic data such as unemployment rate and indebtedness of households in the respective regions. Also, it would be useful to undertake statistical analysis of rate of satisfaction of claims in discharge of debts of proceedings akin to analysis undertaken within the project of the University of Economics in Prague.[75] In other words, this dissertation, like any other paper, does not present all-inclusive study on discharge of debts, and the leaves additional room for further research of these topics.

[74] Historical notes are mostly limited to recent developments of Czech personal insolvency law and common-law roots of the proceedings in order to point out several key concepts and importance of the fresh-start policy.

[75] Information about the project are available on <http://vyzkuminsolvence.cz/grafy-a-fotodokumentace/nezajisteni-veritele-maji-mizive-sance-na-penize-dalsi-zavery-ze-statistickych-setreni.html>.

1.4 Structure of the dissertation

This dissertation is divided into eleven chapters including this part. Whereas first chapters are rather general and theoretical, subsequent chapters focus more on practical and more specific issues concerning the Czech legal environment of discharge of debts.

More specifically, chapter 2 deals with a number of key notions, describes the historical background of a debt relief procedure (the fresh-start policy) and outlines the fundamentals of bankruptcy law since such understandings are essential for other parts of the dissertation to which they refer. Moreover, it examines development of personal insolvency law.

Chapter 3 discusses positive effects substantiating the introduction of a debt relief procedure. The mentioned chapter also identifies other possible rationales behind a debt relief procedure and its negative impacts. Moreover, it briefly describes solutions that might mitigate drawbacks of a debt relief procedure.

Chapters 4, 5 and 6 shift focus on the Czech personal insolvency law. To be more precise, chapter 4 deals with preconditions for discharge of debts in the Czech Republic and provides information about its legislative framework. Chapter 5 describes distributive decision-making process within discharge of debts, including differences between the respective methods of discharge of debts in the Czech Republic and the corresponding duties of debtors. Also, it deals with rulings in discharge of debts proceedings and their effects on debtor's earning capacity. Chapter 6 seeks to summarize the roles that the respective stakeholders play in discharge of debts proceedings. In essence, the chapter partially reflects conclusions made on the basis of previous chapters.

The subsequent part examines a debt relief procedure from a comparative perspective. Specific attention is paid to the EU legal framework and recent legislative initiatives in this sphere. Taking into account basic principles of the fresh-start policy, chapter 7 also aims at setting forth several conclusions regarding the implementation of the fresh-start policy in Visegrad countries, and seeks to shortly identify the weaknesses and differences of particular legal systems.

Chapter 8 presents several conclusions regarding the abovementioned hypotheses. Chapter 9 lists the sources that were used in the course of the research of this dissertation. Yet, as concerns the index of court rulings, the dissertation enumerates only those rulings to which the respective parts refer. Last chapters include abstract and key words related to this thesis.

Finally, since it is required[76] that a dissertation shall consists of original parts of the author, parts published and parts to be published, the author summarizes the outcomes of previous publications as follows: chapters 2, 3 and partially also chapter 7 stems from previous publications "*Fresh-Start Policy as an Integral Part of Bankruptcy Laws and its Implementation*"[77]; chapter 4 derives mainly from the publication "*Kdo ještě je a kdo už není podnikatel aneb subjektivní přípustnost oddlužení dnes a „zítra"*"[78] and partially also from other related publications[79] whereas chapter 6 is based *inter alia* on publication "*Discharge of Debts in the Czech Republic: The Role of Respective Actors and the Reflected Data*".[80] The outcomes of the research undertaken within the preparation of the thesis were presented at various conferences and seminars, including at Academic Forum of INSOL Europe in Brussels, Istanbul or at recent INSOL Europe EECC Conference in May 2016.

1.5 Methodology of the dissertation

As the name of this dissertation suggests, the scope of the dissertation goes beyond law and interferes to a certain extent into socio-economic dimensions. Apart from legal pieces of biography, economic as well as sociological types of literature are examined. Since the topic of the dissertation has been widely analysed mainly in the USA, the vast majority of literature comes from the USA. In this connection, the author notes that a substantial amount of literature has been gathered as part of his research at the Cornell Law School.

The Czech IA, as well as other primary sources regulating the discharge of debts in the Czech Republic, is rather limited taking into account various situations which may

[76] See section 47(4) of the Act no. 111/1998 Coll., as amended.

[77] SPRINZ, Petr. Fresh-Start Policy as an Integral Part of Bankruptcy Laws and its Implementation in PARRY, Rebecca (ed.). *Designing Insolvency Systems.* Nottingham: INSOL Europe: 2016, pp. 147-157. It also stems from the paper "The Fresh-Start Policy in Visegrad Countries: Economic and Legal Analysis". SPRINZ, Petr. *The Fresh-Start Policy in Visegrad Countries: Economic and Legal Analysis* [online], CEU, 2011 [cited 3 March 2017] available on <http://www.google.cz/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0ahUKEwjxiNj26OvQAhWLbBoKHUFhBksQFggeMAA&url=http%3A%2F%2Fwww.etd.ceu.hu%2F2011%2Fsprinz_petr.pdf&usg=AFQjCNFzthcZW_vwLIPZYJ5y7q7BLdikkQ>.

[78] SPRINZ, Petr. Kdo ještě je a kdo už není podnikatel aneb subjektivní přípustnost oddlužení dnes a „zítra". *Právní rozhledy*, 2013, vol. 21, no. 10, pp. 361-367.

[79] See SPRINZ, Petr. Zřízení (soudcovského) zástavního práva po zahájení insolvenčního řízení, *Právní fórum*, 2012, vol. 8, pp. 345-349, and SPRINZ, Petr. Nelegitimní zahájení insolvenčního řízení: problémy, možnosti obrany a legislativní reakce. Obchodní právo, 2013, no. 3, pp. 90-97.

[80] SPRINZ, Petr. Discharge of Debts in the Czech Republic: The Role of Respective Actors and the Reflected Data in PARRY, Rebecca (ed.). *European Insolvency Law: Current Issues and Prospects for Reform.* Nottingham: INSOL Europe: 2014, pp. 59-68.

occur during discharge of debts proceedings. Many important questions might be only answered in court rulings. Therefore, this dissertation substantially stems from the case-law of Czech courts. This thesis benefits from the publicity of the insolvency register in the Czech Republic where all court rulings are mostly accessible online (including the rulings of the High Court in Prague and High Court in Olomouc which are not ordinarily accessible via regular search tools).[81] Nevertheless, an immense number of available Czech court rulings is also partly one of the limitations of the research since it is hardly possible to review all available decisions. Still, over 200 cases are directly cited in this dissertation. In this connection, any reference to "the Supreme Court" entails reference to the Czech Supreme Court unless otherwise specifically stated.

Since one of the aims of this dissertation is also to assess how the legal framework of discharge of debts functions in the real world and what its role is in insolvency law and the society in general, the dissertation examines also selected statistical data. Some of them are available on the webpage of the Ministry of Justice of the Czech Republic.[82] Yet, the most recent statistics as well as other selected data were provided to the author further to the request to provide information addressed to the Ministry of Justice of the Czech Republic. Limited number of data concerning discharge of debts in the Czech Republic was collected from the internal database of Havel, Holásek & Partners, attorneys-in-law. Generally speaking, since the available statistical data stem from the insolvency register, they might contain several inaccuracies. These inaccuracies might be caused *inter alia* by a simple fact that the court designates the respective document in an incorrect way.[83]

[81] Court rulings are easily accessible via a search tool Salvia available on <http://salvia2.gurkol.net/>.

[82] See <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html>. Selected data are also contained in the explanatory notes to the 2017 Amendment and the 2018 Draft Amendment. See <http://www.psp.cz/sqw/historie.sqw?o=7&T=1030>.

[83] Further reservations might be pointed out. For instance, one must bear in mind that a court might decide over a certain issue manifold if a previous decision is overruled (e.g. in one insolvency proceedings, a motion for discharge of debts might be issued and following an appeal against such order, the motion might be dismissed). Also, in certain cases, it is interesting to observe the ratio between two quantitative data – e.g. the ratio between the number of motions for discharge of debts and discharge of debts orders. Yet, since the available statistics do not specify the date of the submission of the respective motion (petition) upon which the court decides, the ration is always of indicative value [e.g. in 2016 22,287 discharge of debts orders were issued, yet it is not possible to infer how many of these orders relate to motions for discharge of debts filed in previous year(s)].

This dissertation sought to embrace the approach of law and economics. As a consequence of this, the respective areas of research were approached mainly from the perspective of economic incentives that the law provides to the respective stakeholders.[84]

Apart from the law and economics approach, this dissertation avails of a comparative legal research. Initially, this dissertation was supposed to be more comparative as the original title suggests ("*Discharge of Debts in Central Europe*"). The focus of the dissertation together with the title thereof has been changed after having found that whereas in Poland and Slovakia, the then applicable legal framework of debt relief procedure did not function well, in Hungary it was not until 2015 that the local Parliament adopted comprehensive personal insolvency law enshrining the fresh-start policy. Therefore, the cornerstone of the focus of the dissertation has been switched from comparative to more economic perspective. Yet, in order to make the dissertation more comparative, the dissertation also takes into account the framework adopted in Visegrad countries. Those countries were selected due to their geographic, economic, historical and cultural proximities. Moreover, selected recommendations of the EU and INSOL Europe are taken into account since national legislations cannot be perceived in isolation.

From historical and law and economics perspective, it appears that the fundamentals of modern theory and practice of bankruptcy law have been mostly drawn from the common law countries. Historically, the most notable was the English Act 4 & 5 Anne (1706) which introduced a debt relief and gave rise to the modern fresh-start policy.[85] Therefore, from the historical view, the dissertation focuses mainly on the development of the common-law bankruptcy law as the knowledge of the development in English bankruptcy law in the respective period is valuable for scholars engaged in personal bankruptcy law. In this context, since the dissertation in many respects refers to the US Bankruptcy Code as the benchmark for comparison,[86] the dissertation adheres to the US terms.[87]

As a part of preparation of this dissertation, in order to obtain opinions on several key issues the author prepared a questionnaire and which was circulated among insolvency

[84] See chapter 2.1 *infra*.

[85] EFRAT, Rafael. Evolution of the Fresh-Start Policy in Israeli Bankruptcy Law. *Vanderbilt Journal of Transnational Law*, 1999, vol. 32, no. 1, p. 53. Yet, it is naturally possible to assess bankruptcy law from more Continental law perspective. The selected approach also stems from the fact that vast majority of literature has been collected by the author at the Cornell Law School in the USA

[86] References to the US Bankruptcy Code are mostly in footnotes.

[87] Typically, the term "liquidation" has a different meaning in different legal systems.

trustees, judges, their assistants and court clerks [in Czech: *vyšší soudní úředník*]. Naturally, not all stakeholders replied so that gathered questionnaires and following discussion with the respective addressees might reflect only limited, albeit interesting and useful, anecdotal experience. Moreover, the anecdotal experience, to which the author refers, reflects the author's discussions with representatives of several institutional creditors and collection agencies.

As concerns the citation norm, the dissertation follows, where applicable, the Dean's directive no. 2/2010, which sets forth requirements related to qualification theses. When the dissertation refers to online sources, it employs the rule concerning repeated citations, i.e. repeated citations do not always refer to particular details of the source. As concerns citations of court rulings, the dissertation refers to case number and date of the rulings. However, due to the scope of the research of the case-law, solely the cases, which are referred to directly in the dissertation, are stated in the index of court rulings. Finally, charts and graphs are inserted in the main part of the dissertation in order to better serve the relevant parts of the text.

It remains to be said that unless otherwise mentioned, the dissertation is based on the Czech legal framework which is effective as of 28 February 2017.

1.6 Terminology of the dissertation

Since there is no unanimity in terminology, several key concepts might be explained.

For the purpose of this dissertation, a debt relief or a discharge is considered to be a legal reflection of the so-called fresh-start policy[88] in the sense that unpaid debts are no longer enforceable against a debtor.[89] There are two main legal avenues to achieve this purpose.[90]

The first is the US Chapter 7-type of procedure that entails collection of the debtor's non-exempt assets, their conversion to monetary form and subsequent distribution among creditors. Within the process, the debtor is granted a debt relief so that his human capital

[88] EPSTEIN, David G., NICKLES, Steve H., WHITE, James J. *Bankruptcy*. St. Paul: West Publishing, 1992, vol. 2, p. 312.

[89] WHITE, James J. *Bankruptcy and Creditors' Rights: Cases and Materials*. St. Paul: West Publishing, 1985, p. 63.

[90] This dissertation does not deal with procedures akin to Chapter 11 reorganizations since they are mainly aimed at continuance of business and resolving corporate bankruptcy.

is being freed.[91] This model is entitled mostly as "liquidation".[92] The second basic model is based on the US Chapter 13 "wage earner plan" or "repayment plan". In this respect, before a debt relief is granted, the debtor is required to repay debts over a specific period of time.

Although in some jurisdictions, scholars distinguish the term "insolvency law" from "bankruptcy law", the dissertation uses these terms interchangeably.[93] The terms "insolvency" and "bankruptcy" are interpreted as a state of affairs that might trigger insolvency proceedings [in Czech: *úpadek*].[94]

From the perspective of the Czech law, the Czech IA provides for four basic resolutions of insolvency: liquidation [in Czech: *konkurs*], reorganization, discharge of debts (proceedings) [in Czech: *oddlužení*] and special procedures for specifically enumerated debtors. An individual, depending on the circumstances of the case, can avail of the first three procedures. However, in practice, an individual can undertake either liquidation or discharge of debts proceedings.[95] The main difference between these methods of resolution of the debtor's insolvency is that unlike discharge of debts, the liquidation does not entail a relief from unpaid debts.

It might be noted that insolvency proceedings anticipating a discharge of debts comprises of several key phases. The insolvency proceedings commence upon the submission of an insolvency petition [in Czech: *insolvenční návrh*] to a competent court. In case of a debtor's insolvency petition, a motion for discharge of debts [in Czech: *návrh na povolení oddlužení*] should be attached if the debtor seeks discharge of debts. Otherwise,

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[91] See e.g. BERTOLA, Giuseppe, DISNEY, Richard, GRANT, Charles (eds.). *The Economics of Consumer Credit Demand and Supply.* Cambridge: MIT Press, 2006, p. 242.

[92] Liquidation is in some jurisdictions referred to as the term meaning the dissolution of a legal entity. Likewise, Chapter 7 procedure is by some authors in Europe designated as "bankruptcy".

[93] Charles Tab notes that the bankruptcy law was originally viewed to be a process to provide a relief for creditors whereas insolvency law was seen as a device for debtors' relief. TABB, Charles J. *The Law of Bankruptcy.* Westbury: Foundation Press, 1997, p. 2.

[94] ZYWICKI, Todd J. An Economic Analysis of the Consumer Bankruptcy Crisis. *Northwestern University Law Review*, 2005, vol. 99, no. 4, p. 1478.

[95] Reorganization is available only for business debtors, including individuals. Yet, stringent criteria of eligibility based on the size test apply. The turnover of a debtor in the preceding accounting year should at least reach CZK 50 million or the debtor should have at least 50 employees. Alternatively, reorganization can be approved on the basis of creditors' consent. See section 316 of the Czech IA. Since 2008 courts have approved solely one reorganization plan with respect to an individual. See also the dataset prepared by Tomáš Richter available on <http://ies.fsv.cuni.cz/default/file/download/id/14273>. See RICHTER, Tomáš. *Reorganizing Czech Businesses: A Bankruptcy Law Reform Under a Recession Stress-Test* [online]. SSRN, January 5, 2011 [cited 3 March 2017]. Available on <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1735334&>, p. 10.

a motion for discharge of debts should be filed later within a specified time. If the insolvency petition is substantiated, the court issues an insolvency order [in Czech: *rozhodnutí o úpadku*] and commonly also preliminarily approves discharge of debts by the respective decision – a discharge of debts order [in Czech: *povolení oddlužení*]. Furthermore, the court issues a confirmation of discharge of debts [in Czech: *schválení oddlužení*] whereby the court rules on a particular method of discharge of debts (repayment plan [in Czech: *plnění splátkového kalendáře*] or sale of debtor's assets – liquidation [in Czech: *zpeněžení majetkové podstaty*]). All this is undertaken in order to provide a debtor with a debt relief [in Czech: *osvobození od dluhů*] which is achieved via a debt relief order. Eventually, discharge of debts proceedings end upon the date of the legal force and effectiveness of the court's decision whereby it notes the accomplishment of discharge of debts pursuant to section 413 of the Czech IA [in Czech*: rozhodnutí o vzetí na vědomí splnění oddlužení*]. Although the Czech IA refers to the "insolvency court", the dissertation refers to the "court".

In this connection, if the dissertation refers to discharge of debts or discharge of debts proceedings, it refers to the Czech or another particular national method of resolution of debtor's insolvency. The term "debt relief procedure" is perceived more generally to be a type of insolvency procedure without a particular reference to any national legal system.

1.7 Acknowledgments

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2 Basic concepts and the role of bankruptcy law

2.1 Economic approach to law

The law and economics analysis anticipates approaching problems from an economic standpoint,[96] i.e. from the view of maximizing utility, market equilibrium and preferences.[97] Seen from this perspective, the law might be seen as a tool to modify the incentives of people.[98] In other words, legal rules have arguably an impact on the incentives of people and ultimately change the economic performance and behaviour.[99] The subject-matter of law and economics is not, however, money but rather the use of resources.[100]

In this respect, economists posit that every rational agent seeks to maximize, be it utility in case of consumers or votes in case of politicians.[101] In the real world, individuals have alternatives as to their choices what to do in the everyday life. The option that brings about the most under the set of constraints entails maximizing.[102] The overall system should lead to efficiency.[103]

As far as the bankruptcy law is concerned, it should seek to achieve two objectives.[104] First, it should be *ex post* efficient in the sense of providing an efficient post-insolvency treatment. Second, bankruptcy law should be also *ex ante* efficient in the sense that it should

[96] It must be noted that the law and economics movement is not homogenous. See MERCURO, Nicholas, MEDEMA, Steven G. *Economics and the Law. From Posner to Post-Modernism.* Princeton: Princeton University Press, 1997, p. ix.

[97] *Idem*, p. 3; see also BECKER, Gary. The Economic Approach to Human Behaviour cited in KATZ, Avery W. *Foundations of the Economic Approach to Law*. New York: Oxford University Press, 1998, p. 5.

[98] POSNER, Richard A. *The Economics of Justice.* Cambridge: Harvard University Press, 1981, p. 75.

[99] For more elaborate explanation see MERCURO, Nicholas, MEDEMA, Steven G. *Economics and the Law. From Posner to Post-Modernism.* Princeton: Princeton University Press, 1997, pp. 21-24.

[100] Richard Posner observes that the most tenacious mistake about economics is that it is concerned only about money. Richard Posner points out that money is just "a claim on resources", whereas the focus is on the "use of resources." POSNER, Richard A. *Economic Analysis of Law*. 7th edition. New York: Aspen Publishers, 2007, p. 6.

[101] The movement of law and economics is based largely on microeconomics. COOTER, Robert, ULEN, Thomas. *Law and Economics.* 4th edition. Boston: Pearson, 2004, p.15.

[102] *Idem*.

[103] Several concepts of efficiency have been developed ranging from rather illusionary *Pareto optimal* to more realistic *Kaldor-Hicks efficiency*. See e.g. MERCURO, Nicholas, MEDEMA, Steven G. *Economics and the Law. From Posner to Post-Modernism.* Princeton: Princeton University Press, 1997, pp. 14-18. See also POSNER, Richard A. The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*. Hofstra Law Review*, 1980, vol. 8, no. 2, pp. 488-489.

[104] CLAESSENS, Stijn, DJANKOV, Simeon, MODY, Ashoka. *Resolution of Financial Distress: An International Perspective on the Design of Bankruptcy Laws*. Washington: World Bank, 2001, pp. 3-7.

deliver proper incentives to the respective stakeholders and provide framework that would create an environment properly balancing the interests of debtors, creditors and other persons involved.

Bankruptcy world is the arena of competing interests. To strike a proper balance is of utmost importance. On the one hand, if the bankruptcy law is too debtor-friendly, the credit market might be crippled.[105] On the other hand, undue promotion of creditors' interests might lead to creditors' (lenders') failure to exert due diligence and other misbehaviour.[106] Overall, the bankruptcy law should lead to effective allocation of resources and balancing of interests. Obviously, such objectives concern also personal insolvency law, including rules on discharge of debts.

2.2 Credit

The word "credit" derives from Latin, in which it means "to believe".[107] Belief or trust that contractual obligations shall be honoured is indeed commonly at the heart of every given promise. Nevertheless, not all creditor-debtor relationships are based on "belief" or "trust". The nature of a debt is usually contractual and usually implies that a debtor owes money to a creditor. If the debtor repays, he can still control his assets.[108] If not, the creditor acquires rights and powers to pursue debtor's assets.[109] In the real life, people are surrounded by a jungle of different contracts.[110] What is important to note is that at the end of every string of such network, there is a particular individual.[111]

[105] *Idem*, pp. 21-22.

[106] *Idem*, p. 22.

[107] McINTYRE, Lisa J. Sociological Perspective on Bankruptcy. *Indiana Law Review*, 1989, vol. 65, no. 1, p. 136. William Meckling stresses that the word "promise" captures the essence of a credit arrangement; the credibility of a borrower is crucial. MECKLING, William H. Financial Markets, Default, and Bankruptcy: The Role of the State. *Law and Contemporary Problems*, 1977, vol. 41, no. 4, pp. 14-15. See also COLEMAN, Jules L. Markets, Morals and the Law. New York: Cambridge University Press, 1988. 393 pages.

[108] For the avoidance of doubts, any reference to "he" is to be understood as including the female gender (or legal entity, where applicable) in the text also.

[109] HART, Oliver D. *Firms, Contracts, and Financial Structure.* New York: Oxford University Press, 1995, p. 101. See also SHLEIFER, Andrei. Will the Sovereign Debt Market Survive? *The American Economic Review*, 2003, vol. 93, no. 2, p. 85.

[110] MECKLING, William H. Financial Markets, Default, and Bankruptcy: The Role of the State. *Law and Contemporary Problems*, 1977, vol. 41, no. 4, pp. 19-20.

[111] All funds must come from individuals, even though there are many intermediaries. *Idem*.

Bankruptcy law deals with insolvency which is largely associated with the repayment of debts. In theory, debts might be divided into several categories. [112] From possible *ex ante effects* of discharge of debts, it is important to consider that not all debts are created consensually. Debts might stem *inter alia* from tortious behaviour, unjust enrichment or from tax-related statutes. This distinction is crucial particularly in terms of the policy-making. Consensual creditors might take into account a possibility of bankruptcy and adjust the terms of their contracts accordingly;[113] they might ask for collateral to secure their obligations or raise a principal price or an interest rate. Obviously, non-consensual creditors do not enjoy the same level of comfort. The victim in a car crash is not given a room for any negotiation of any peculiarities of his claim beforehand.[114]

Moreover, debts can be distinguished on the basis of their source. The debtor might acquire surviving debts which are incurred by way of necessities of life (e.g. food and beverage), over-consumption debts (which are generated mostly by the use of borrowed money over a standard), compensation debts arising from over-consumption (typically due to deprivation or social exclusion), relational debts incurred on the basis of connection to others (such as marriage or death), accommodation debts (which typically results from inability to adapt to new circumstances or previous wrong expectations which do not materialize), and fraudulent debts (which are caused by wilful over-commitments).[115]

[112] This dissertation does not attempt to make a comprehensive analysis of the types of claims.

[113] As soon as in 1843 it has been noted that "*The foundation of loan is trust, wherever securities are not taken; it is confidence; it is credit-all terms which imply risk, and the possibility of failure. The risk relates to the question of solvency or insolvency when the period comes for demanding payment. This kind of property is held subject to this contingency; and the lender himself takes the risk; he is his own insurer. If his debtor fails, he loses; if not, he has his own. He charges, too, for this risk-in the shape of interest, premium, or commission. He parts with the immediate possession of his property, expecting it to come back to him, in proper time, with increase; he puts it afloat, and takes the hazards of the voyage for a consideration; if whelmed in the turbulent sea, he expects to sustain the loss.*" Report from the Congress of the USA cited in HOWARD, Margaret. A Theory of Discharge in Consumer Bankruptcy. *Ohio State Law Journal*, 1987, vol. 48, no. 4, p. 1064, ft. 134.

[114] Thomas Jackson notes that in terms of policy making, it is necessary to account for differences among various types of creditors. JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, p. 1422. Karen Gross for instance observes that not all tort victims are the same. See GROSS, Karen. *Failure and Forgiveness: Rebalancing the Bankruptcy System*. New Haven: Yale University Press, 1997, p. 170.

[115] See INSOL Europe. *Consumer Debt Report – Report of Findings and Recommendations* …, p. 4 and p. 5.

2.3 Moral hazard and risk aversion

Two prominent professors in economics state that "*Money is lubricant that facilitates exchange*."[116] If a person does not have money, he can borrow it. However, borrowing is a risky business. Particularly in credit arrangements, the creditor faces the problem of asymmetry of information. It is connected to the issue of hidden information in situations when one party knows more than the other.[117] This asymmetry creates the adverse selection problem.[118] In practice, given that players act rationally, it is assumed that, if a lender increases an interest rate, those who believe that they are the least likely to be in default will stop borrowing. Nevertheless, those who are more likely to be unable or unwilling to repay will still borrow.[119] In terms of the game theory, equilibrium might not necessarily exist.[120] With the interest rate being higher to cover the expected losses, the credit is more and more attractive for riskier borrowers. It has been argued that at a certain point, with the increase of an interest rate, the profits will gradually stop increasing and start decreasing.[121]

Economists suggest that lenders react by virtue of the credit rationing. Lenders presumably fix an interest rate lower to attract "good" borrowers.[122] Moreover, big lending institutions can partially overcome the asymmetry of information regarding the prospect of repayment by virtue of what is known as "the law of large numbers".[123] One must bear

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[116] NORDHAUS, William D., SAMUELSON, Paul A. *Economics.* 14th edition. New York: McGraw-Hill, 1992, p. 30.

[117] In comparison to what information lenders possess, borrowers have more precise information concerning their propensity to default, willingness to repay, and care of financial risks after the credit is extended. See HYNES, Richard M., POSNER, Eric A. The Law and Economics of Consumer Finance. *American Law and Economics Review*, 2002, vol. 4, no. 1, p. 173.

[118] See also the illustration concerning marketing of cars in AKERLOF, George A. The Market for "Lemons": Quality Uncertainty and the Market Mechanism. *The Quarterly Journal of Economics*, 1970, vol. 84, no. 3, pp. 492-494. In practice, it implies that less creditworthy individuals are not discouraged by higher interest rates. See explanation in BERTOLA, Giuseppe, DISNEY, Richard, GRANT, Charles (eds.). *The Economics of Consumer Credit Demand and Supply.* Cambridge: MIT Press, 2006, pp. 12-13.

[119] *Idem*, p. 13.

[120] BAIRD, Douglas, GERNTNER, Robert, PICKER, Randal. *Game Theory and the Law.* 1st edition. Cambridge: Harvard University Press, 1994, p. 153.

[121] Stitglitz and Weiss presented one of the first works on credit rationing. See STIGLITZ, Joseph E., WEISS, Andrew. Credit Rationing in Markets with Imperfect Information. *The American Economic Review*, 1981, vol. 71, no. 3, pp. 393-394.

[122] *Idem*, p. 13.

[123] This rule states that "*unpredictable events for individuals become predictable among large groups of individuals*." COOTER, Robert, ULEN, Thomas. *Law and Economics.* 4th edition. Boston: Pearson, 2004, p. 53.

in mind that creditors other than institutional creditors do not possess such options how to address the asymmetry of information.

Another problem that arises in the context of bankruptcy and the credit industry is moral hazard, which is also known as "the problem of hidden action".[124] The moral hazard implies a situation where a person systematically and rationally gets involved in risky activities because the costs thereof are borne by others, or at least the costs are not imposed proportionately in comparison to the amount of the undertaken risk.[125] In a credit arrangement, the creditor presumably assesses a risk of a particular transaction at the time prior to the conclusion thereof. Once the creditor determines the possibility of the default of his debtor and sets the interest rate, the creditor has not much leverage over the specifics of the respective credit arrangement. In this situation the debtor faces motivation to raise the riskiness of the transaction. By undertaking more risky activities the debtor in effect obtains the credit at a cheaper interest rate compared to the one that would be otherwise charged had the creditor known what would be the steps of the debtor. In other words, the debtor gets a credit at more favourable conditions, which he would otherwise do not deserve.[126]

Also, in connection with the business engagement of entrepreneurs, the approach of individuals towards risks known as "risk aversion" is worth mentioning.[127] The risk aversion entails weighting a prospect of certain amount of money higher in comparison to a prospect of uncertain equal expected monetary amount of money.[128] Such attitude stems from the fact that people generally do not like to gamble.[129] Therefore, the appropriate

[124] BAIRD, Douglas, GERNTNER, Robert, PICKER, Randal. *Game Theory and the Law.* 1st edition. Cambridge: Harvard University Press, 1994, p. 153.

[125] JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, p. 1402.

[126] JACKSON, Thomas H., KRONMAN Anthony T. Secured Financing and Priorities among Creditors. *The Yale Law Journal*, 1979, vol. 88, no. 6, p. 1149. Two primary methods have been suggested on how to deal with moral hazard problems. First, one may seek to obtain information, which might be, however, costly. The alternative is to employ "output-based incentive". See JACKSON, Howel E. et al. *Analytical Methods for Lawyers.* 2nd edition. New York: Foundation Press, 2011, pp. 52-53.

[127] Risk aversion is associated with utility function. COOTER, Robert, ULEN, Thomas. *Law and Economics.* 4th edition. Boston: Pearson, 2004, pp. 50-51.

[128] *Idem*, p. 51. One example suffices. A person is risk-averse if he prefers the certain gain of CZK 500 to the gain of CZK 1000 with fifty percent certainty.

[129] More precisely, individuals tend to prefer certainty to uncertainty. *Idem*.

allocation of risks is important for it might lead risk-averse party to get involved in socially desirable activities which would be otherwise left untouched due to their riskiness.[130]

2.4 Labour and productivity in the context of discharge of debts

Concepts related to labour are of utmost importance, particularly as concerns the debtor's insolvency and its implications on his productive activities. At the outset, it is critical to note how the notion of opportunity costs arises in the context of work efforts. It is argued that a wage paid to workers must cover *inter alia* the opportunity costs of leisure.[131] The reason is that in practice a worker can choose to either spend his time by working or by doing something else. What affects his decision is what he values more. For certain hours dedicated to work, a worker obtains earnings that he can exchange for goods. The more he works, the more he can presumably earn.[132]

In this respect, a peculiar feature regarding the labour supply is that the labour supply curve is backward-bending due to the substitution and income effect.[133] When the income increases in real monetary value, a worker enjoys a greater utility of work.[134] Consequently, the worker prefers work to leisure. Yet, the substitution effect at a certain point faces the income effect. In other words, in order to meet the given consumption the worker can afford to work less. Putting it simply, the income effect makes the worker to prefer leisure at a certain level of income stream.[135]

Moreover, what is of the interest of employees as well as the society is productivity. Productivity can be defined as the ratio between the invested input and the gained output.[136] On part of workers, the main factors are work efforts and number of hours. It is arguably in the interest of the growth of the economy that workers increase both. As it has been

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[130] SHAVELL, Steven. *The Allocation of Risk and the Theory of Insurance* in KATZ, Avery W. *Foundations of the Economic Approach to Law*. New York: Oxford University Press, 1998, p. 212. See chapter 3.1.6 *infra*.

[131] Leisure in this respect stands for any other activity than working. See LANCASTER, Kevin. *Modern Economics: Principles and Policy*. Chicago: Rand McNally, 1973, p. 321.

[132] It must be noted, however, that the implications thereof always depend on a remuneration system. When the remuneration is fixed, the wage is not higher. Still, with more work, there might be a better chance of promotion. Also, a worker may accept an additional job and earn more.

[133] NORDHAUS, William D., SAMUELSON, Paul A. *Economics.* 14th edition. New York: McGraw-Hill, 1992, p. 235. See also CAMPBEL, Thomas J. Labor Law and Economics. *Stanford Law Review*, 1986, vol. 38, no. 4, pp. 991-1064.

[134] An additional hour spent at work generating higher income means that the worker can buy more.

[135] *Idem*, p. 235. The worker can afford to stay at work less time in order to cover his needs.

[136] *Idem*, p. 112.

outlined above, the number of hours spent at work depends on wage. The lower is a wage, the higher is the probability that an individual will choose leisure to work.[137] Nevertheless, difficulties appear in case of heavily indebted workers. If the debtor (worker) cannot repay his debts, he lacks motivation for higher earnings. Everything above the non-exempt level of income is anyway garnished. Whatever his efforts are, the gains are the same.[138]

2.5 Bankruptcy law and its role

When a debtor owes a creditor a debt, the creditor is obviously interested in receiving the money back. One way of course is to contact the debtor and try to get the money back without resorting to a court or the other formal collection remedies.[139] Once these efforts prove unsuccessful, the creditor can either forget about the debt or pursue the available legal: individual or collective procedures (bankruptcy). Unlike individual collection laws that are centred on a debtor-creditor relationship, the bankruptcy law can be associated rather with a creditor-versus-creditor relationship.[140]

However, the question that must be answered in the first place is why to have the bankruptcy law.[141] The justification of the bankruptcy law lies in the shortcomings that individual enforcement remedies have.[142] Bankruptcy law is by a part of the scholarship substantiated on the basis of the theory of the "creditors' bargain"[143] which is largely

[137] POSNER, Richard A. *Aging and Old Age*. Chicago: The University of Chicago Press, 1995, p. 82.

[138] See chapters 3.1.3 and 3.1.4 *infra*.

[139] See the respective illustration in EISENBERG, Theodore. *Bankrutpcy and Debtor-Creditor Law. Cases and Materials.* 4th edition. New York: Foundation Press, 2011, p. 2ů or

[140] WARREN, Elizabeth. Bankruptcy Policy. *The University of Chicago Law Review*, 1987, vol. 54, no. 3, p. 785. Bankruptcy law is a field of law that is crucial to the development of the economy and society's wealth fare. It should be structured as to reflect social, economic and other patterns and perceptions in the society. It should provide incentives or counterbalance negative practices as much as it is feasible and at the lowest costs. STIGLITZ, Joseph E. *Bankruptcy Laws: Basic Economic Principles* in CLAESSENS, Stijn, DJANKOV, Simeon, MODY, Ashoka. *Resolution of Financial Distress: An International Perspective on the Design of Bankruptcy Laws.* Washington: World Bank, 2001, p. 23. See also ADLER, Barry, BAIRD, Douglas G., JACKSON, Thomas H. *Cases Problems and Materials on Bankruptcy*. 4th edition. New York: Foundation Press Thomson/West, 2007, p. 54. See also JACKSON, Thomas H., SCOTT, Robert E. On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain. *Virginia Law Review*, 1989, vol. 75, no. 2, pp. 155-204.

[141] Due to the limited scope of this thesis, it does not attempt to elaborate fully on the justification of bankruptcy law.

[142] See JACKSON, Thomas H. Of Liquidation, Continuation and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules. *American Bankruptcy Law Journal*, 1986, vol. 60, no. 4, pp. 401-402.

[143] JACKSON, Thomas H. Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain. *The Yale Law Journal*, 1982, vol. 91, no. 5, p. 857-907. Yet, the dissertation does not attempt to question the theory. Still, it must be noted that the theory is not at all shared by all the scholars. The theory has been criticized *inter alia*

associated with Thomas Jackson.[144] The underlying principle of the theory is that it should generally reflect the agreement which would be presumably struck by creditors *ex ante* if they were in the position to negotiate together. [145] Overall, the theory offers three advantages.[146]

The first advantage is that bankruptcy law seeks to eliminate strategic costs linked to the so-called race of diligence.[147] Obviously, one of the problems connected to bankruptcy is multiplicity of creditors. In the world without bankruptcy, creditors files individual actions, potentially before different courts, and as a result there is not only multiplicity of creditors but also multiplicity of fora and proceedings. The nature of competition among creditors is crucial to grasp the problem.[148] The principle of "first come first serve" or rather "first who files a legal action and first who grabs the assets wins" is commonly the underlying motivation of individual enforcement remedies[149] since the first person usually holds a priority position. The race of diligence begins and nobody knows who will reach the end successfully.[150] In the absence of any rules, some would happen to be lucky, whereas some will be left empty-handed. Those whose monitoring was effective would be rewarded. However, such actions and preventive measures might in effect entail the waste of resources.

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in COUNTRYMAN, Vern. The Concept of a Voidable Preference in Bankruptcy. *Vanderbilt Law Review*, vol. 38, no. 4, p. 827, or in CARLSON, David G. Philosophy in Bankruptcy. *Michigan Law Review*, 1987, vol. 85, no. 5, pp. 1341-1389. See also a thorough explanation and criticism in MOKAL, Jameel R. *Corporate Insolvency Law. Theory and Application.* Oxford: Oxford University Press, 2005, p. 33. For a more comprehensive review, see TABB, Charles J. *Bankruptcy Anthology*. Cincinnati: Anderson Publishing, 2002, pp. 51-133.

[144] At the outset, it must be noted that when Thomas Jackson developed the theory he limited its scope to legal entities. The crucial difference is that unlike a legal entity, an individual does not cede to exist when there are no assets left. Still, as Thomas Jackson admits, reasoning concerning personal bankruptcies might overlap. JACKSON, Thomas H. Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain. *The Yale Law Journal*, 1982, vol. 91, no. 5, p. 858. Peculiarities of personal insolvency law are left for subsequent discussion in chapter 2.6 *infra*.

[145] Thomas Jackson explains that no actual negotiation takes place. *Idem*, p. 860 and p. 866.

[146] *Idem*, p. 861. The theory also elaborates advantages regarding the position of secured creditors. However, the explanation goes beyond the scope of this dissertation.

[147] See TABB, Charles J. *The Law of Bankruptcy.* Westbury: Foundation Press, 1997, p. 4.

[148] Winton Williams notes that in case of insufficiency of assets, every creditor tries to persuade a debtor to pay particularly him. WILLIAMS, Winton E. *Games Creditors Play: Collecting from Overextended Consumers.* Durham: Carolina Academic Press, 1998, pp. 29-30. The principle of first in time first in right applies. This maxim expresses the fact that priorities are determined not by maturity of claims but by specific interest be it a security interest or judgment entered into against a debtor. See e.g. section 280 of the Czech Civil Procedural Code. See WILLIAMS, Winton E. *Games Creditors Play: Collecting from Overextended Consumers.* Durham: Carolina Academic Press, 1998, p. 31.

[149] See TABB, Charles, J. *The Law of Bankruptcy.* Westbury: Foundation Press, 1997, p. 4.

[150] JACKSON, Thomas H. Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain. *The Yale Law Journal*, 1982, vol. 91, no. 5, p. 858.

In this connection, individual creditors face the problem of asymmetry of information.[151] It is difficult to determine who is going to get a portion of the available pool of assets. At the outset nobody knows who will prevail. Therefore, all creditors might be induced to undertake actions towards their debtor as soon as possible.[152] The bankruptcy law arguably provides solution to such setting since the proceeds obtained in the insolvency proceedings are generally distributed according to the *pari passu* rules.[153]

The second advantage of the bankruptcy law is that it provides a solution to the "*problem of common property*".[154] During individual enforcement proceedings, assets are collected, converted to cash and distributed individually. Such process might lead not only to the waste of resources as described above, but also to the potential loss in the gained value. When assets are sold piece by piece, the value obtained might not be as high as if they are sold altogether.[155] It is particularly the case of corporations with going concerns. Nevertheless, the issue is not limited to legal entities. In this connection, the bankruptcy law precedes the non-bankruptcy procedure and substitutes less efficient method of collection by collective distribution process.[156] As a result, general creditors might be better off.[157]

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[151] KILBORN, Jason J. *Two Decades, Three Key Questions, and Evolving Answers in European Consumer Insolvency law: Responsibility, Discretion and Sacrifice*. In NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds.). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 312. See explanation in chapter 2.3 *supra.*

[152] This problem is more burning in cases of bankruptcies of legal entities because the legal entity is liquidated which means the end of the game. On the contrary, in personal bankruptcies the individual survives so there is still a chance that in some time in the future, the money shall be recovered.

[153] Moreover, by virtue of collective distribution process, the bankruptcy law also deals with the risk aversion since it decreases the risk of different proportion of distribution of the proceeds. JACKSON, Thomas H. Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain. *The Yale Law Journal*, 1982, vol. 91, no. 5, pp. 861-862. Risk-averse creditors arguably prefer the certainty of some portion to uncertainty of having either a lot or being left with nothing.

[154] WHITE, CLAESSENS, Stijn, DJANKOV, Simeon, MODY, Ashoka. *Resolution of Financial Distress: An International Perspective on the Design of Bankruptcy Laws*. Washington: World Bank, 2001, pp. 26-27.

[155] Although, it might be possible to sell assets collectively even outside bankruptcy, there might be limits such as when the amount claimed does not reach the value of assets to be sold. See e.g. limits in sections 264 or 326 of the Czech Civil Procedure Code.

[156] Lynn LoPucki refers to the so-called *in terrorem* effect, i.e. that by virtue of enforcement some production-related pieces of property might be taken away which might render the operation of the debtor's business forestalled. LoPUCKI, Lynn. A General Theory of the Dynamics of the State Remedies/Bankruptcy System. *Wisconsin Law Review*, 1982, vol. 26, no. 1, p. 317.

[157] CLAESSENS, Stijn, DJANKOV, Simeon, MODY, Ashoka. *Resolution of Financial Distress: An International Perspective on the Design of Bankruptcy Laws*. Washington: World Bank, 2001, p. 27.

Finally, the third advantage might be viewed in terms of administrative efficiency.[158] As it was illustrated by virtue of the race of diligence, once debts proved to be uncollectible, it is obvious that creditors had wasted their resources. Court and attorney fees or possibly also enforcement costs had been paid with little or no chance of recovery. However, not only private resources are wasted. Court proceedings as well as other individual enforcement proceedings impose costs on state authorities.[159] It is not only a matter of private wasting but also a matter of wasting of public resources which might have been spent otherwise (perhaps more usefully).[160] In individual proceedings, courts might investigate as to the existence of liens, inform lien holders or other interested persons and make certain steps manifold.[161] Collective remedial systems are presumably less expensive than individual proceedings.

The above mentioned problem might be also depicted in terms of the theory of games.[162] Insolvency entails a game of more players who have claims against one debtor and share common pool of assets. All of them want to maximize their profit (payoff in terms of the theory). Consequently, the players face a decision whether to pursue their claims collectively or not. Possible strategies anticipate either cooperation or coercion.[163] In the situation of multiplicity of creditors and the insufficiency of assets it might be better for creditors to cooperate to achieve collectively better result out of which all or most of the creditors would benefit. However, if it is not possible for creditors to credibly cooperate, each will rather pursue his claim individually.[164]

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[158] JACKSON, Thomas H. Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain. *The Yale Law Journal*, 1982, vol. 91, no. 5, p. 866.

[159] See KILBORN, Jason J. *Two Decades, Three Key Questions, and Evolving Answers in European Consumer Insolvency law: Responsibility, Discretion and Sacrifice.* In NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 312.

[160] Naturally, even in case of collective proceedings, the costs might happen to be spent in a wasteful way. However, the idea is that in case that there are no assets left, one collective proceedings save costs otherwise incurred in multiple individual proceedings.

[161] WEISTART, John C. The Costs of Bankruptcy. *Law and Contemporary Problems*, 1977, vol. 41, no. 4, p. 109. Although some actions might be adjoined, it is obviously not the case for all of them.

[162] As regards the application of the game theory on legal issues see BAIRD, Douglas, GERNTNER, Robert, PICKER, Randal. *Game Theory and the Law.* 1st edition. Cambridge: Harvard University Press, 1994. 330 pages.

[163] See WILLIAMS, Winton E. *Games Creditors Play: Collecting from Overextended Consumers.* Durham: Carolina Academic Press, 1998, p. 74-77.

[164] The reason is that if the creditor is inactive and does not race for money, the others might do so. Consequently, until the inactive creditor embarks on enforcement of his claims, all assets might be already distributed to more active creditors. The outlined situation has obviously the pattern of the prisoner's dilemma. See explanation and criticism in WILLIAMS, Winton E. *Games Creditors Play: Collecting from Overextended Consumers.* Durham: Carolina Academic Press, 1998, p. 77-84. Given the absence of cooperation, actions that

Yet, it might be argued that bankruptcy law helps those general creditors, who are rather less diligent in terms of monitoring and pursuing their claims. [165] In some cases, small claim holders might benefit from a collective type of procedure. In the absence of collective proceedings they would not be sufficiently persuaded about to recover their money. Bankruptcy law appears to provide equal chances to all general creditors. Distinctions between passive and prudent as well as aggressive creditors are tainted. Thus, aggressive creditors are effectively made worse off. Their efforts consisting in monitoring and their sophisticated methods of enforcement might lose benefits.[166]

One must bear in mind that the bankruptcy law is largely connected to other areas of laws.[167] In this regard, one of the critical issues in the bankruptcy law is its relationship to the non-bankruptcy law.[168] More precisely, the issue is to what extent it should honour non-bankruptcy entitlements. The prevailing approach seems to be the one advocated by the proceduralists.[169] They assert that the bankruptcy law should serve as a tool how to collect debts and that it should regulate how the right is collected and not what is the content of the right itself.[170] Accordingly, the bankruptcy law should follow the non-bankruptcy entitlements,[171] unless there is a good reason. Otherwise, departure from the non-

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are optimal for individuals are sub-optimal from a collective perspective. JACKSON, Thomas H. Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain. *The Yale Law Journal*, 1982, vol. 91, no. 5, p. 862.

[165] It must be noted that secured creditors have different stakes. Since their claim is secured they have better chance to obtain proceeds inside or outside bankruptcy more or less equally, depending on how the law treats entitlements outside and inside bankruptcy.

[166] See illustrative description in LoPUCKI, Lynn M., WARREN, Elizabeth. *Secured Credit: A Systems Approach*. 3rd edition. New York: Aspen Publishers, 2006, p. 96.

[167] BAIRD, Douglas G. *The Elements of Bankruptcy.* 5th edition. New York: Foundation Press. 2010, p. 4. In any case, it must be borne in mind that bankruptcy law cannot be viewed narrowly. It is not a closed system and is highly interlinked with other areas of laws. Bankruptcy law affects behaviour of others, including financial entities providing credit. RASMUSSEN, Robert K. *Bankruptcy Law Stories*. New York: Foundation Press, 2007, p. 2.

[168] There has been also a debate as to the goals of the bankruptcy law. Unlike Douglas Baird who argues that the bankruptcy law should enhance collection of debts, Elizabeth Warren posits that the bankruptcy law should properly distribute losses. See WARREN, Elizabeth. Bankruptcy Policy. *The University of Chicago Law Review*, 1987, vol. 54, no. 3, pp. 777-778 and pp. 811-814.

[169] Proceduralists and traditionalists differ in many respects. See BAIRD, Douglas G. Bankruptcy's Uncontested Axioms. *The Yale Law Journal*, 1998, vol. 108, no. 3, pp. 577-580 and the US Supreme court ruling *Butner v. United States* 440 U.S. 48 (1979).

[170] See BAIRD, Douglas G. Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren. *The University of Chicago Law Review*, 1987, vol. 54, no. 3, p. 818. One of the key questions seems to be to what extent rights of secured creditors should be kept. *Idem*, p. 823.

[171] This principle is commonly known in the USA as "*Butner principle*" after the US Supreme court ruling in re *Butner v. United States* 440 U.S. 48 (1979).

bankruptcy law might generate incentives for opportunistic behaviour.[172] Moreover, commercial agents play their game in a particular setting and if the setting is changed upon filing an insolvency petition, it further burdens them as "new costly planning is required".[173] In other words, the bankruptcy law should not alter substantive law unless there is a justification for it. In this context, the bankruptcy law might be seen as a more or less oblique glass through which we look at other areas of laws. The idea is pertaining to the necessity to substantiate discharge of debts as stated below.

In any case, ideal bankruptcy law does not exist. When a person or an entity is over-indebted, things turned to be unpleasant. However, bad bankruptcy regime can even worsen the situation.[174] As indicated above, bankruptcy law should have two objectives of efficiency. First of all, it should be *ex post* efficient in the sense to provide efficient post-petition treatment and perhaps also efficient discharge of debts, provided that such solution is justified. Second, the bankruptcy law should be also *ex ante* efficient in the sense to deliver proper incentives to parties and provide framework that would create good environment balancing the interests of debtors and creditors. [175] In this connection it is true that the bankruptcy law affects mainly creditors and debtors. Still, in order to make a comprehensive assessment of *ex post* and *ex ante* efficiency, it is necessary to bear in mind that other players might be involved as well. Workers, family members, potential suppliers and other groups of people also form part of the whole picture. Even though, a failure of legal entities as well as financial situation of individuals is commonly viewed in monetary terms, it brings about failures in other domains as well.[176] In this respect, the bankruptcy law creates externalities.[177]

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[172] In re *Patterson v. Shumate* 504 U.S. 753 (1992), at 764, the Supreme Court held that "*Declining to recognize any exceptions to that provision within the bankruptcy context minimizes the possibility that creditors will engage in strategic manipulation of the bankruptcy laws in order to gain access to otherwise inaccessible funds.*"

[173] EISENBERG, Theodore. Bankruptcy Law in Perspective. *UCLA Law Review*, 1981, vol. 28, no. 5, p. 957.

[174] CLAESSENS, Stijn, DJANKOV, Simeon, MODY, Ashoka. *Resolution of Financial Distress: An International Perspective on the Design of Bankruptcy Laws*. Washington: World Bank, 2001, p. xix.

[175] In brief, law should discourage imprudent behaviour. *Idem*. See also HART, Oliver D. *Firms, Contracts, and Financial Structure*. New York: Oxford University Press, 1995, p. 159. After all, bankruptcy has also ethical perspective. See BOATRIGH, John R. *Ethics in Finance.* 2nd edition. Malden: Blackwell Publishing, 2008, p. 152

[176] Karen Gross points out that bankruptcy affects the whole community. GROSS, Karen. *Failure and Forgiveness: Rebalancing the Bankruptcy System*. New Haven: Yale University Press, 1997, pp. 23 and 193-214.

[177] Joseph Stiglitz mentions that bankruptcy brings about many innocent bystanders. See STIGLITZ, Joseph E. *Bankruptcy Laws: Basic Economic Principles* in CLAESSENS, Stijn, DJANKOV, Simeon, MODY, Ashoka.

2.6 Specific features of personal bankruptcy law

"*I know how to liquidate over-committed businesses but I cannot imagine how I should liquidate an individual*."[178] This quote illustrates the fundamental difference between an individual and a legal entity when it comes to the bankruptcy law.

On the one hand, personal bankruptcy shares a lot of features with the bankruptcy of legal entities and is in many ways no different. A resolution of competing interests in a situation of a scarcity of assets to satisfy all debts poses challenges in both sorts of bankruptcies. On the other hand, there are significant differences, which not only justify, but also require, distinct approaches towards certain issues, including the standpoint towards a debt relief procedure. Bankruptcy of individuals creates a peculiar problem associated with the difference in statuses between natural persons and legal entities. Legal entity is only a juridical entity. It can be established and dissolved at any time. Although some costs are always involved, there is "*no virtue in preserving a corporate charter for its own sake*."[179] A company is basically a legal shell.[180] After bankruptcy, the legal entity generally ceases to exist unless it is reorganized. Artificial constructions do not need to be provided incentives to remain alive. They might be re-established.[181] In this regard, there is no reason to give a fresh-start to legal entities.

However, the situation of individuals in this respect substantially differs. Unlike legal entities, the debtor's existence is not dependent on bankruptcy.[182] In the absence of a debt

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Resolution of Financial Distress: An International Perspective on the Design of Bankruptcy Laws. Washington: World Bank, 2001, p. 4. See also BERTOLA, Giuseppe, DISNEY, Richard, GRANT, Charles (eds.). *The Economics of Consumer Credit Demand and Supply.* Cambridge: MIT Press, 2006, p. 242.

[178] Quote of Jobst Wellensiek cited in NIEMI-KIESILAINEN, Johanna, RAMSAY, Iain, WHITFORD, William C. (eds.). *Consumer Bankruptcy in Global Perspective*. Oxford: Hart, 2003, p. 144. See also INSOL Europe. *Consumer Debt Report – Report of Findings and Recommendations …*, p. 19: "*A legal entity conducting a business, whether large or small, may cease to exist after the termination of insolvency proceedings, together with the remainder of any unpaid debt. However, where the business is in any way identifiable with a natural person who remains responsible for the debts of the business after insolvency, the person's situation may not be different from any other consumer with debt problems*."

[179] BAIRD, Douglas G. *The Elements of Bankruptcy.* 5th edition. New York: Foundation Press, 2010, p. 59.

[180] WHITE, James J. *Bankruptcy and Creditors' Rights: Cases and Materials*. St. Paul: West Publishing, 1985, p. 361.

[181] WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. World Bank, 2014 [cited 3 March 2017]. Available on <http://documents.worldbank.org/curated/en/120771468153857674/pdf/ACS68180WP0P120Box0382094B00PUBLIC0.pdf>, p. 17.

[182] NIEMI-KIESILAINEN, Johanna, RAMSAY, Iain, WHITFORD, William C. (eds.). *Consumer Bankruptcy in Global Perspective*. Oxford: Hart, 2003, pp. 144-145.

relief procedure, unpaid debts survive. In this perspective, the creditor's claims do not practically burden only the debtor's assets but also the debtor's human capital.[183]

Be a fresh start one of the goals of bankruptcy law or not,[184] the underlying and prevailing opinion is that the bankruptcy law should not change the non-bankruptcy law unless there is a reasonable ground. The fresh-start policy together with a relief from debts entails precisely such departure from the non-bankruptcy law. In this respect, it is obvious that the advantages that are allegedly offered by the theory of the creditors' bargain apply with minor reservations.[185] Still, in case of many debtors creditors' claims are uncollectible or at least hardly collectible even in the long-term;[186] all depending on the degree of over-indebtedness. Essentially, in personal bankruptcy the same problems are encountered but with different implications. Although, unlike in bankruptcy of legal entities, there is some chance of recovery of debts, to be the first in row also matters.

2.7 Over-indebtedness

To become over-indebted is rather a process than a single event; many unfortunate and more or less conscious events might trigger over-indebtedness.[187] Some people might deliberately seek to abuse framework of discharge of debts and irresponsibly borrow, whereas others fell into over-indebtedness by reasons out of their control.[188] Intuition tells us that the applicable system should preferably distinguish among sorts of debtors and provide for some advantageous treatment for those who deserve it.[189]

In fact, various sources of indebtedness exist. The scholarship tends to divide the sources *inter alia* into two main categories.[190] The first category is connected

[183] MECKLING, William H. Financial Markets, Default, and Bankruptcy: The Role of the State. *Law and Contemporary Problems*, 1977, vol. 41, no. 4, p. 13.

[184] Charles Tabb pointed out that regardless of its appealing character, a fresh start is not the primary function of bankruptcy law. See TABB, Charles J. *The Law of Bankruptcy.* Westbury: Foundation Press, 1997, p.3.

[185] See also notes on the evolution of the English bankruptcy law that was presumably grounded on the problem of the race for the assets; the fact that some creditors were left with nothing was considered to be inequitable. TABB, Charles J. Historical Evolution of the Bankruptcy Discharge. *American Bankruptcy Law Journal*, 1991, vol. 65, no. 3, p. 328.

[186] This line of argumentation appears to be behind the 2018 Draft Amendment.

[187] NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives.* Oxford: Hart Publishing, 2009, p. 91.

[188] *Idem*, p. 357.

[189] Such distinction might be reasonable in terms of mitigation of moral hazard on part of debtors.

[190] NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds.). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 251.

with structural changes of the economy. Causes such as the rise of the availability of credit to the large public domain together with mismanagement of finances, labour market failures, unemployment and discrimination serve as examples.[191] The other category is linked to cultural factors such as rise of consumption, lack of knowledge and mismanagement in general.[192] Yet, the above mentioned cultural and structural causes of indebtedness cannot be easily separated; business environment and consumer culture are interlinked and a change in regulatory framework does not necessarily mean that there will be a change in the cultural setting.[193]

Quite expectedly, no unanimity exists on how to define over-indebtedness itself.[194] Different sort of benchmarks might be used ranging from the debt-to-income ratio, debt-to-assets ratio to debt-to-savings ratio.[195] Exact definitions arguably seem to fail to picture all complexities of the concept.[196] There can hardly be a uniform criterion since economic, social and other related conditions significantly vary.[197] Therefore, there is also a suggestion to use a subjective definition. This definition is based on what particular debtors feel about their situation. The indebtedness is defined as situation in which the debtor perceives that his debts are no longer being handled.[198]

Also, there are many variations of over-indebtedness. The debtor might be so deeply insolvent so that there is not a chance that he will recover from his debts. The debtor might be insolvent only temporarily and with some intervention he might recoup income to repay

[191] See elaborated analysis referring to many reports in BRAUCHER, Jean. Theories of Over-Indebtedness: Interaction of Structure and Culture. *Theoretical Inquiries in Law*, 2006, vol. 7, no. 2, pp. 327-327. See also KILBORN, Jason J. See also KILBORN, Jason J. La Responsabilisation De L'Economie: What the United States Can Learn from the New French Law on Consumer Overindebtedness. *Michigan Journal of International Law*, 2005 vol. 26, pp. 624-627.

[192] NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 251.

[193] BRAUCHER, Jean. Theories of Over-Indebtedness: Interaction of Structure and Culture. *Theoretical Inquiries in Law*, 2006, vol. 7, no. 2, p. 326. In the words of Jean Braucher: "*Efforts to create or recreate a culture of personal financial responsibility thus face an uphill battle against entrenched structural and cultural features of society*."

[194] NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds.). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives.* Oxford: Hart Publishing, 2009, p. 94.

[195] *Idem*, p. 253.

[196] *Idem.*

[197] *Idem*.

[198] NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds.). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives.* Oxford: Hart Publishing, 2009, pp. 353-357.

debts. In the middle of the sliding scale, the debtor might not be able to repay his debts only temporarily with a reasonable chance to repay his debts over a time.[199]

2.8 Historical background of a debt relief procedure

2.8.1 Creation of the concept of the fresh-start policy in Anglo-American world

The word "bankruptcy" comes probably from Medieval Italy where it was allegedly a custom to break benches of bankers and merchants who left without satisfying the claims of their creditors.[200] Although the history shows that the debtor's insolvency has been approached differently in distinct legal systems, one seems clear. At least in civilized countries applicable rules have secured that the treatment of debtors is incomparably more lenient.[201] Debtors are no longer deprived of their freedom and put into slavery as in the times of the Romans. What is distributed among creditors is not the debtor himself but his assets.[202]

From a historic point of view, one of the first "insolvency statutes"[203] was the English statute 34 & 35 Henry VII of 1543.[204] Quite expectedly, the act was not drafted to help "unfortunate but honest debtors".[205] The statute rather served a different purpose – to deter

[199] *Idem*, p. 357.

[200] BAIRD, Douglas G. *The Elements of Bankruptcy.* 5th edition. New York: Foundation Press, 2010, p. 4.

[201] Historic statutes must be viewed in relation to the then existing background and environment in order to understand the motives and meaning behind them. The economy in the absence of modern technology and other means was highly dependent on mutual confidence. Old materials show that the bankrupts in England were perceived more badly than ordinary thieves as they arguably not only "stole" somebody else's money but also breached the relationship of trust. KADENS, Emily. Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law. *Duke Law Journal*, 2010, vol. 59, no. 7, p. 1239.

[202] See the text of the Roman Twelve Tables translated in COUNTRYMAN, Vern. Bankruptcy and the Individual Debtor - And a Modest Proposal to Return to the Seventeenth Century. *Catholic University Law Review*, 1983, vol. 32, no. 4, pp. 809-810.

[203] Even the Roman Twelve Tables from the 5th century B.C. dealt with indebted persons. COUNTRYMAN, Vern. Bankruptcy and the Individual Debtor - And a Modest Proposal to Return to the Seventeenth Century. *Catholic University Law Review*, 1983, vol. 32, no. 4, pp. 809-810.

[204] There has been confusion regarding dating of old English statutes. It is explained that statutes were initially dated as of the date of the first respective parliamentary session. Therefore the Act 4 & 5 Anne appears dated to 1705 even though the royal assent was given in 1706 when the act was formally adopted. Apart from that until the middle of the 18th century, England used medieval dating when the beginning of the year started on March 25. See KADENS, Emily. Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law. *Duke Law Journal*, 2010, vol. 59, no. 7, pp. 1236-1237.

[205] It is commonly said that the idea behind the fresh-start policy is to protect "honest but unfortunate" debtors. See e.g. JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, pp. 1393-1448.

fraudulent behaviour.[206] At first glance, one may note that the preamble of the aforementioned "*Act Against Such Persons As Do Make Bankrupt*" criticized the behaviour of the bankrupts. They were denoted as persons who took the means of other men, consumed it for their own pleasure and delicate living, and left houses while leaving their debts unsatisfied.[207] The statute clearly reflected negative view of the society on the indebted persons. The act in question brought about several changes. In general, the introduced bankruptcy system can be characterized by the following features.[208] First, the process was fully in creditors' hands. They could initiate the procedure by virtue of a petition.[209] Debtors did not have such an option. In this connection, the ground for submission of the petition was the act of bankruptcy. The act of bankruptcy was defined in terms of the intention to defraud creditors or to hinder or delay the satisfaction of their debts. Also, creditors were to be treated as a group and the debtor's assets were to be distributed among them *pro rata* which is perhaps the most typical feature of modern bankruptcy law regimes.[210] Moreover, the debtor was virtually deprived of everything. Unlike in ordinary common law proceeding in which debtors had some guarantees, bankruptcy did not contemplate any allowances.[211] No discharge was at place and even after the distribution of all the debtor's assets, creditors were entitled to proceed individually. Obviously, there was nothing in the act that would provide any incentive to the debtor to cooperate. Finally, when the debtor was imprisoned, such imprisonment was originally considered private; thus the imprisoned debtor was not fed by the public purse. Consequently he was dependent on his friends who provided him with the necessities to survive.[212]

The Act 14 Elizabeth I from 1571 entitled "An Act Touching the Orders for Bankrupts" introduced several changes. The most important element was the explicit limitation

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[206] Charles Tabb noted that "… *relief was not for debtors but from debtors*." TABB, Charles J. History of the Bankruptcy Laws in the United States. *American Bankruptcy Institute Law Review*, 1995, vol. 3, no. 1, p. 8.

[207] See Act 34 & 35 Hen. VIII, chapter IV (1543), para 1.

[208] KADENS, Emily. Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law. *Duke Law Journal*, 2010, vol. 59, no. 7, pp. 1240-1242.

[209] Act 34 & 35 Hen. VIII, chapter IV (1543), para 1.

[210] KADENS, Emily. Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law. *Duke Law Journal*, 2010, vol. 59, no. 7, p. 1241.

[211] *Idem*.

[212] See more information and later development of the status of imprisoned debtors in COUNTRYMAN, Vern. Bankruptcy and the Individual Debtor - And a Modest Proposal to Return to the Seventeenth Century. *Catholic University Law Review*, 1983, vol. 32, no. 4, pp. 811-812.

as to the personal scope of the statute. Only merchants could commit the act of bankruptcy.[213] Moreover, the Elizabeth's Act provided for the position of commissioners who were today's equivalent of insolvency trustees.[214] On paper it may seem to create a framework within which creditors achieved what they sought to aim – satisfaction of their debts to the highest possible extent. Yet, the reality was different. The system proved to be highly inefficient.[215] It stripped debtors of everything, permitted creditors to imprison debtors and to pursue their individual remedies until debts were fully recouped whereas the debtors were given nothing in exchange.[216]

The question was how to deal with the debtor's unwillingness to cooperate. The Act 1 James I (1604) provided for the imprisonment of bankrupts who denied answering commissioners' questions.[217] Moreover, the debtor who tried to answer wrongly and intentionally deceived his creditors faced the threat to stand two hours having his ear nailed to the pillory and then cut off.[218] More cruel threat was to come in about a hundred years later.[219]

In the meantime, additional issues arose that complicated already questionable procedure. The bankrupts allegedly colluded with friends who falsely claimed more in order to later give the proceeds to the bankrupts.[220] One cannot say that the problem of uncooperative debtors went unnoticed. Several bills were proposed to deal with it.[221] The key idea was to provide some incentive to the bankrupts. Apart from that, the situation of debtors was upsetting when they wanted to cooperate and deal with their indebtedness

[213] Act 14 Elizabeth I, chapter VII (1571), para 1. The merchant meant a person who uses the trade of merchandise in gross or retail, by way of bargaining, exchange, re-change, bartering, contracting, or otherwise, or who buys and sells for living.

[214] Act 14 Elizabeth I, chapter VII (1571).

[215] Emily Kadens cites historic Manuscripts of the House of Lords from the era of 1693-1695 that mentioned that few creditors were successful with their efforts to collect debts. KADENS, Emily. Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law. *Duke Law Journal*, 2010, vol. 59, no. 7, p. 1233, ft. 17.

[216] Besides that, the statute lacked enough provisions regarding the procedural aspects of the proceedings. *Idem*, p. 1243.

[217] Act 1 James I, chapter XV (1604), para 8.

[218] Act 1 James I, chapter XV (1604), para 9. For further discussion see KADENS, Emily. Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law. *Duke Law Journal*, 2010, vol. 59, no. 7, p. 1248. The punishment was also extended to other misbehaviour.

[219] See Act 4 & 5 Anne I, chapter IV (1706), para 1.

[220] KADENS, Emily. Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law. *Duke Law Journal*, 2010, vol. 59, no. 7, p. 1250.

[221] *Idem*, pp. 1250-1252.

by virtue of composition.[222] Even if some creditors were willing to restructure their debts and thereby agree on lesser amount of repayment, genuinely consensual solution had to be agreed upon by all creditors. Given the known fact that one creditor will hardly agree to cut down his debt when others refuse to do the same,[223] consensual agreements were mostly blocked by few unwilling creditors.[224] The situation changed in 1706 by virtue of the Act of 1706 when a debt relief procedure was introduced.

Having said that, for bankruptcy lawyers, the most important development during the reign of the Queen Anne was probably not the unification of England and Scotland, but rather the adoption of the Act 4 & 5 Anne (1706). The statute introduced the provision on discharge of debts and thereby crossed the line towards more debtor-friendly environment, and marked the beginning of the modern incentive-based fresh-start policy. Yet, the history shows that the outcome was not easy to be achieved. In early years of the 18th century, London experienced a massive fraud scheme orchestrated by two merchants – Thomas Pitkin and Thomas Brerewood. These two persons intentionally planned and committed a fraudulent bankruptcy which left many creditors unpaid.[225] Since the fraud had a huge impact, it attracted attention[226] and happened to allegedly initiate the bankruptcy reform.[227] The debate ended up in the adoption of the Act 4 & 5 Anne II (1706) entitled "*An Act to Prevent Frauds Frequently Committed by Bankrupts*". The statute not only imposed harsher penalties for bankruptcy acts but became known for the introduction of discharge of debts and other pro-debtor measures.[228] Thus, it partially embraced the policy of a carrot and a stick.[229]

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[222] Composition in this context is perceived to be a type of voluntary workout when creditors agree on writing off some portion of owed debts.

[223] For the discussion on the problems associated with workouts, see WILLIAMS, Winton E. *Games Creditors Play: Collecting from Overextended Consumers.* Durham: Carolina Academic Press, 1998. 190 pages.

[224] The problem is illustrated in the Manuscripts of the House of Lords from 1693-1695, p. 360 in KADENS, Emily. Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law. *Duke Law Journal*, 2010, vol. 59, no. 7, p. 1251, ft. 99.

[225] *Idem*, pp. 1255-1260.

[226] Some of the crucial elements were the plague that spread in London in 1665 and the economic situation in general after the Civil War in England. McCOID, John C. Discharge: The Most Important Development in Bankruptcy History. *American Bankruptcy Law Journal*, 1996, vol. 70, no. 2, p. 165.

[227] The fraud contributed to the tightening of punishments for bankruptcy-related crimes.

[228] Pro-debtor measures were adopted as a reaction to the aforementioned issues that had arisen by that time.

[229] TABB, Charles J. Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate. *George Washington Law Review*, 1990, vol. 59, no. 1, p. 90.

First, the statute provided for penalties for some acts committed by bankrupts. Newly, "the stick" was a threat of the so-called felony without the benefit of clergy which meant nothing but a death penalty. [230] Capital punishment could have been imposed for intentional acts such as a failure to fully disclose all assets. However cruel it sounds, the analysis of the available data shows that only four men were hanged during the life of the statute.[231] In this respect it is asserted that a lack of numerous punishment records does not mean that the bankrupts ceased to commit frauds.[232] The statute was simply not fully enforced.

In any case, threats were not the only means that the statute employed in order to mitigate fraudulent behaviour of the bankrupts. The statute in many parts sought to grant benefits to the bankrupt who duly fulfilled his obligation to fully disclose his assets and cooperate with commissioners. Therefore there were "carrots" to countervail the "sticks." The statute enacted that the debtor who in all respects conformed to his duties was relieved from unsatisfied debts.[233] The bankrupt was supposed to approach commissioners, undertake an oath and fully disclose all his assets in a timely manner. Finally, the debtor was mandated to hand over the assets he possessed.[234] In any case, a debt relief did not automatically follow. It was granted by virtue of commissioners' certification that the bankrupt conformed to the set duties.

At the time of the adoption of the statute, creditors did not have decisive power over the question whether the debtor fulfilled his duties or not. Yet, there was a significant change in 1732 which introduced the requirement of 80 % majority of creditors. Without such approval, a debt relief could not be granted.[235] The need for consent certainly contributed to a fewer number of granted debt reliefs.

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[230] Act 4 & 5 Anne, chapter IV (1706), para 1, 19.

[231] See KADENS, Emily. Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law. *Duke Law Journal*, 2010, vol. 59, no. 7, pp. 1270-1271. It must be noted that the statute had a limited temporary duration. However, it was later extended.

[232] *Idem*, p. 1271.

[233] Act 4 & 5 Anne, chapter IV (1706), para 8.

[234] Act 4 & 5 Anne, chapter IV (1706), para 1 and 6.

[235] COUNTRYMAN, Vern. Bankruptcy and the Individual Debtor - And a Modest Proposal to Return to the Seventeenth Century. *Catholic University Law Review*, 1983, vol. 32, no. 4, p. 812.

Given the fact that the discharge of debt also served as a defence in possible proceedings, it effectively forced creditors to join the proceeding. [236] Therefore, an integrated form of collective proceeding was created.[237]

Moreover, cooperating bankrupts were allowed to keep a certain portion of the proceeds of sale of their assets if the proceeds exceeded given amount of money. If the proceeds were lower, the allowance was to be set by the commissioners as they considered fit for the purpose.[238] The purpose was arguably to leave minimum means for living of the bankrupt and leaving an incentive to disclose all the assets. The economic function of a discharge was upheld. Sir Blackstone wrote that *"... the bankrupt becomes a clear man again; and by the assistance of his allowance and his own industry may become a useful member of the commonwealth ..."*[239]

What the statute did not change was that the debtor could not still initiate the proceedings himself. It took more than a century that a debtor was permitted to commence the proceeding.[240] Nor did the statute amend the personal scope. It was still available only to the debtors involved in trade.[241] The rationale was that the bankruptcy law was enacted to facilitate trade which could not be done without undertaking debts.[242] Only traders were essentially allowed to incur debts as it was held to be unjustifiable for gentlemen other

[236] See also BLACKSTONE, William. *Commentaries on the Laws of England*. Baton Rouge: Claitor's Publishing, 1976, vol. 1, p. 1369.

[237] Interestingly, the statute sought to deal with the costs of the proceeding and thus banned reimbursement of expenses for drinking and eating on the part of commissioners. See Act 4 & 5 Anne, chapter IV (1706), para 21.

[238] Act 4 & 5 Anne, chapter IV (1706), para 8 and 9.

[239] BLACKSTONE, William. *Commentaries on the Laws of England*. Baton Rouge: Claitor's Publishing, 1976, vol. 1, p. 1369.

[240] It was in 1841 that the US Bankruptcy Act of 1841 provided for the debtor's petition. TABB, Charles J. History of the Bankruptcy Laws in the United States. *American Bankruptcy Institute Law Review*, 1995, vol. 3, no. 1, p. 17. The same option was introduced in England in 1849. McCOID, John C. The Origins of Voluntary Bankruptcy. *Bankruptcy Development Journal*, 1988, vol. 5, no. 2, p. 361.

[241] Initially, the limitation was not explicitly limited to traders in law. Yet, in practice such limitation might have existed. It firstly appeared in Act 14 Elizabeth I, chapter VII (1571), para 1. See TABB, Charles J. History of the Bankruptcy Laws in the United States. *American Bankruptcy Institute Law Review*, 1995, vol. 3, no. 1, p. 9.

[242] Sir William Blackstone noted that bankruptcy law was for the benefit of trade and founded on the principle of humanity and justice. BLACKSTONE, William. *Commentaries on the Laws of England.* Baton Rouge: Claitor's Publishing, 1976, vol. 1, pp. 1356-1357.

than merchants to encumber themselves with debts.[243] The act generally reflected the prevailing approach towards the credit.[244]

Yet, the Act 4 & 5 Anne contained important exemptions. None of the benefits available to cooperating debtors could be availed of by the gamblers who lost money exceeding a certain amount in the period preceding the commencement of the proceeding.[245] By the same token, neither a debt relief nor allowances were given to the bankrupt who had gratuitously given money to his children, unless limited conditions applied.[246] The rationale behind that is arguably that the law should neither promote gambling nor giving up money.[247]

2.8.2 Development of discharge of debts in the Czech Republic

The historic roots of insolvency law in our territory are mainly associated with the so-called Josephine Bankruptcy Code. This statute of procedural nature was adopted in 1781 and had many deficiencies which were manifested particularly by lengthy duration and costly administration of the proceedings.[248] With the aim to reform the then overly complicated rules, the Bankruptcy Procedure Act of 1868 [in Czech: *konkursní řád*] was adopted under no. 1/1869 Coll., which was subsequently followed by the regulation no. 337/1914 Coll. [in Czech: *císařské nařízení, jímž se zavádí řád konkursní, řád vyrovnávací a řád odpůrčí.*]. The mentioned regulation was incorporated into the Czechoslovak law after the creation of independent Czechoslovak Republic. However, the incorporated regulation did not survive too long. In 1931, the new Act no. 64/1931 Coll. [in Czech: *řády konkursní, vyrovnací a odpůrčí*] was adopted.

Long-lasted history of the insolvency law of the Czech Republic was interrupted by the events which occurred in the 50's. The Act no. 64/1931 Coll. was replaced by the Act no. 142/1950 Coll., Procedural Code [in Czech: *o řízení ve věcech občanskoprávních*

[243] *Idem*, pp. 1359-1360. Even the early bankruptcy act of 1800 was dedicated solely to traders. See TABB, Charles J. Historical Evolution of the Bankruptcy Discharge. *American Bankruptcy Law Journal*, 1991, vol. 65, no. 3, p. 346.

[244] *Idem*, p. 335.

[245] The statute enumerates a number of games such as bets in horse races, cock fighting, cards, dices, etc. See Act 4 & 5 Anne, chapter IV (1706), para 16.

[246] Act 4 & 5 Anne, chapter IV (1706), para 14.

[247] As regards the opposite side of Atlantic, see particularly COUNTRYMAN, Vern. From Dismemberment to Discharge And a Modest Proposal to Return to the Seventeenth Century. *Catholic University Law Review*, 1983, vol. 32, no. 4, pp. 809-827; or DUNCAN, Andrew J. From Dismemberment to Discharge: The Origins of Modern American Bankruptcy Law. *Commercial Law Journal*, 1995, vol. 100, no. 2, p. 217.

[248] KOZÁK, Jan. Nové úpadkové právo v České republice. *Právní zpravodaj*, 2008, vol. 9, no. 2, p. 3.

(občanský soudní řád)]. Yet, the Procedural Code of 1950 did not regulate proceedings of collective nature. In other words, no collective distribution mechanism existed.

It is often quoted that "*Capitalism without bankruptcy is like Christianity without hell*".[249] The insolvency law is indeed closely related to the existence of the market economy. In the era of communism, there was not a hunger for the insolvency law. Not surprisingly, it is argued that capitalism is inevitably associated with risks.[250] Along with increasing significance of the market oriented economy, higher probability of insolvency of unsuccessful entrepreneurs might be expected. Such pressure naturally leads to a larger importance of the insolvency law.[251] Until an environment conducive to capitalist behaviour was created, the bankruptcy law simply had not been needed as a prominent economic mechanism.[252]

Local legislator did not wait too long. In connection with the removal of legal barriers to the expansion of the market environment, four decade-long vacuum of bankruptcy law was finally ended. Act no. 328/1991 Coll., on Bankruptcy and Composition (the Bankruptcy and Composition Act) restored insolvency law in the Czech Republic.[253] Conceptually, the Bankruptcy and Composition Act was based on the Act no. 64/1931 Coll. which was, however, set in a completely different legal and socio-economic reality.[254] The Bankruptcy and Composition Act appeared to be highly unpredictable with many loopholes.[255] It suffices to say that legal framework which would effectively enable reorganisation of large

[249] RICHTER, Tomáš. *Insolvenční právo.* 1st edition. Prague: ASPI Wolters Kluwer, 2008, p. 19.

[250] McINTYRE, Lisa J. Sociological Perspective on Bankruptcy. *Indiana Law Review*, 1989, vol. 65, no. 1, p. 126.

[251] *Idem.*

[252] KIM, Michael. When Nonuse is Useful: Bankruptcy Law in Post-Communist Central and Eastern Europe. *Fordham Law Review*, 1996, vol. 65, no. 3, p. 1047.

[253] The EBRD survey from 2004 ranked the Bankruptcy and Composition Act as being in medium range compliance, whereas the Czech IA has gained much better score (83 %). EBRD. *EBRD Insolvency Law Assessment Project – 2009. Czech Republic* [online]. EBRD, 2009 [cited 3 March 2017]. Available on <http://www.ebrd.com/downloads/legal/insolvency/czechre_ia.pdf>; UTTAMCHANDANI, Mahesh. Insolvency Law and Practice in Europe's Transition Economies. *Butterworths Journal of International Banking and Financial Law*, 2004, vol. 19, no. 10, p. 452.

[254] See also the explanatory notes to the Czech IA which was submitted to the Parliament of the Czech Republic draft bill no.1120, available on <http://www.psp.cz/sqw/historie.sqw?o=4&T=1120>. To a certain extent, this chapter relies thereon.

[255] RICHTER, Tomáš. The New Czech Insolvency Act - New Insolvency Regime for Czech Corporate Debtors and their Creditors. *Butterworths Journal of International Banking and Financial Law*, 2006, vol. 21, no. 6, pp. 271-275.

and medium enterprises were arguably missing.[256] Together with the increase of the credit market of non-business individuals, new phenomenon begun to increase in importance – indebtedness of households, which could not be effectively tackled by the outdated Bankruptcy and Composition Act.

Eventually, in 2006 the legislature reflected the long-term calls for adoption of new law whereby the Czech IA was adopted. The basic pillars of the Czech IA include: strengthening position of the creditors, increase in transparency of insolvency proceedings and introduction of new means of resolving insolvency (including discharge of debts).[257]

Until now, the Czech IA has been subject to several modifications. As concerns discharge of debts, the first major legislative change has been introduced in the midst of the financial crisis by the Act no. 217/2009 Coll. The amendment enabled a debtor to keep some portion of his non-exempt income that would be otherwise garnished. The move sought to promote productivity and social policy.[258]

As of 10 September 2010, the Constitutional Court intervened by virtue of its ruling whereby it stroke out the presumption concerning implications of the debtor's absence at the creditors' assembly.[259] The provision used to set forth that if a debtor does not show up at creditors' assembly, it is presumed that he has withdrawn a motion for discharge of debts. In short, the Constitutional Court ruled that such fiction is not proportionate.

Furthermore, the Act no. 69/2011 Coll. in essence responded to the Constitutional Court ruling regarding rights to deny claims of creditors.[260] It has established that the debtor has a right to deny the claims of creditors whereas such denial has similar effects as the denial of the insolvency trustee. However, more systematic modification has been implemented via the Act no. 334/2012 Coll. applicable as of 1 November 2012. Initially, section 395 of the Czech IA stated that there was a presumption of dishonesty if the debtor has been convicted of a crime of economic or property-related nature in the last five years prior to the commencement of insolvency proceedings or if insolvency proceedings were held with respect to such debtor (dependent on the outcome of such proceedings) in the preceding five years. By virtue of the Act no. 334/2012 Coll., the legislature added that the presumption

[256] *Idem*.

[257] RICHTER Tomáš. Insolvenční zákon: od vládního návrhu k vyhlášenému znění. *Právní rozhledy,* 2006, no. 14, pp. 765-774.

[258] See chapter 5.4.3 *infra*.

[259] See the Constitutional Court ruling case no. Pl. ÚS 19/09 (KSOS 16 INS 4988/2008) of 27 July 2010.

[260] See the Constitutional Court ruling case no. Pl. ÚS 14/10 of 1 July 2010.

does not apply if the debtor specifically ascertains that he does not pursue dishonest intentions.

In the meantime, the Ministry of Justice of the Czech Republic embarked on a thorough discussion regarding the shape of the then insolvency proceedings. The discussion proved that there were many issues which have remained either unresolved or with dubious solutions. Hence, the Revision Amendment has been adopted. First, subjective scope of discharge of debts was supposed to be relaxed.[261] Second, the legislature decided to address discharge of debts of spouses.[262] Third, presumptions regarding dishonest intentions have been abandoned as they had seemed to be too strict and the Ministry of Justice of the Czech Republic intended to provide the court with wider discretion to determine whether a debtor has dishonest intentions or not.[263] Last but not least, the Revision Amendment clarified a relationship between enforcement and insolvency proceedings and set forth implications regarding certain dishonest measures of the debtors (including a failure to enlist an asset in a list of debtor's assets).[264] The Revision Amendment also modified the system how insolvency trustees are appointed. Until the end of 2013, insolvency trustees used to be appointed from the list of insolvency trustees whereas there was no difference between the list of insolvency trustees for liquidation and discharge of debts. Since the beginning of 2014, insolvency trustees in discharge of debts are chosen from the list whereas the list encompasses the insolvency trustees who have their seat or establishment within the area of the district court which is the general court of the debtor (i.e. in most cases it is the district court of the debtor's place of residence).[265]

2.8.3 Proposed changes concerning discharge of debts in the Czech Republic

The legal framework of discharge of debts in its current status will not last long.[266] In 2015, the Czech Ministry of Justice launched a thorough discussion on another reform

[261] Section 389 of the Czech IA.

[262] New section 394a of the Czech IA was adopted.

[263] Section 395 of the Czech IA.

[264] Sections 109 and 408(2) of the Czech IA.

[265] In case of liquidation the list encompasses trustees who have their seat or representation within the area of the competence of the respective court deciding the case in question (i.e. regional court). Section 25 of the Czech IA.

[266] Although neither the 2017 Amendment nor the 2018 Draft Amendment is yet effective as of the finalization of this thesis, since they intend to thoroughly modify rules governing the subject matter of this dissertation, this dissertation refer to particular proposed changes where applicable. More attention is, however, paid

of Czech insolvency law which has resulted in the 2017 Amendment. The 2017 Amendment was proposed to the Parliament in 2016 under publication no. 785 and on 3 March 2017, it was published in the Collection of Laws.[267] The relevant changes shall become effective as of 1 July 2017.[268]

The 2017 Amendment seeks to address mainly the following issues. First, one of the major changes is the proposed introduction of conditions as to who may submit and draft a motion for discharge of debts. Also, it limits remuneration for such services. In this connection, the legislature allegedly responds to the market practice of entities which abuse debtors' desperate financial strains and for excessive remuneration prepares (sometimes defected) motions for discharge of debts together with insolvency petitions. The 2017 Amendment sets forth that a limited scope of persons shall be eligible for drafting and submission of motions for discharge of debts (together with insolvency petitions where applicable) and limits remuneration for such services.

Second, the 2017 Amendment intends to increase transparency, decrease administrative burdens placed on courts and strengthen the use of delivery of data mail box [in Czech: *datové schránky*]. The legislature *inter alia* responds to the fact that courts lack sufficient staff and are over-loaded with cases. The aim is to transfer certain burdens to insolvency trustees and creditors. In the context of discharge of debts, one of the key changes is that courts shall be less involved in rather administrative measures in discharge of debts proceedings. The proposed change shall also touch upon the form of submission of insolvency petitions.

Third, the 2017 Amendment proposes to modify the rules on the appointment of insolvency trustees in discharge of debts. After the adoption of the Revision Amendment, many insolvency trustees established a large amount of establishments in order to be appointed in as many discharge of debts proceedings possible whereas certain establishments were even fictitious or largely abandoned. The legislature noted that such practice is not sustainable since insolvency trustees should not seek solely profits. They should also ensure that the insolvency proceedings are held in a legal and appropriate manner. The related aim

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to the 2017 Amendment since it is not clear whether the 2018 Draft Amendment will be even adopted or what the final wording will be.

[267] The explanatory notes to the 2017 Amendment are available on <http://www.psp.cz/sqw/text/tiskt.sqw?O=7&CT=785&CT1=0>.

[268] The 2017 Amendment shall take effect the first day of the fourth month following the official publication thereof. See part 5 of the 2017 Amendment.

is to strengthen supervisory role of the Ministry of Justice of the Czech Republic over functions of insolvency trustees.

Last but not least, the aim of the proposed bill is to limit the role of illegitimate insolvency proceedings.[269]

Interestingly, the 2017 Amendment is not the only legislative proposal currently being discussed. In late 2016, the government published the 2018 Draft Amendment which mainly seeks to render discharge of debts more accessible to debtors and which should presumably take effect on 1 January 2018.[270] Pursuant to the 2018 Draft Amendment, a cornerstone of the current legislative scheme anticipating the requirement to repay 30 % of all unsecured claims is to be displaced. The Ministry of Justice of the Czech Republic intends to address the issue of the over-indebtedness of households and the fact that many debtors face multiple enforcement proceedings.[271] Also, the 2018 Draft Amendment proposes modifications of the methods of discharge of debts so that one of them remains to be sale of debtor's assets whereas repayment plan will mandatorily include partial or full liquidation of debtor's assets depending on the structure and value thereof.[272]

The 2018 Draft Amendment has been subject to harsh criticism[273] and as of the time of the finalization of this dissertation, it is not known whether it will obtain approval from the Parliament.[274] Allegedly, it should become effective as of 1 January 2018.

[269] See in more details chapters 4 and 5 *infra*.

[270] The 2018 Draft Amendment, including the explanatory notes, is available on <https://apps.odok.cz/veklep-detail?pid=KORNAEGFH2IL> or on <http://www.psp.cz/sqw/historie.sqw?o=4&T=1120>.

[271] Pursuant to the explanatory notes to the 2018 Draft Amendment 4,082,203 enforcement proceedings are held by enforcement office holders [in Czech: *exekutor*] against 731,341 debtors. See the explanatory note to the 2018 Draft Amendment, pp. 49-52.

[272] See chapter 5.2.3 *infra* and mainly section 398 of the Czech IA as amended by the 2018 Draft Amendment.

[273] The 2018 Draft Amendment has been criticized by several ministries and other bodies (including the Ministry of Agriculture, vice prime minister for science, Supreme Court of the Czech Republic) which are part of the legislative process. See the respective comments available on <https://apps.odok.cz/veklep-detail?pid=KORNAEGFH2IL>.

[274] The dissertation addresses solely key aspects of the 2018 Draft Amendment since it is not clear what will be the final wording of the amendment. Since its initial presentation it has changed significantly.

3 Rationales behind a debt relief procedure and its effects

As it has been pointed out, the debtor's existence is independent of bankruptcy. What might die (vanish) in the process of bankruptcy is not the debtor but his debts.[275] A debt relief procedure seeks to achieve this aim. However, it does not suffice at all to merely claim that giving an unfortunate but unlucky debtor a fresh start provides justification for discharge of debts.[276] This chapter identifies efficiency grounds substantiating a debt relief procedure (the fresh-start policy) together with its positive effects, other possible rationales behind it as well as negative effects which a debt relief procedure might bring about.

3.1 Economic rationales and positive effects of a debt relief procedure

The introduction of a debt relief procedure might be justified on the basis of several positive effects. The effects might be viewed rather as benefits for creditors, debtors, economy or society. Nevertheless, the distinction among them is not always clear since they overlap.

3.1.1 Enhanced cooperation and maximization of the value of insolvency estate

Originally, a discharge was introduced to ensure cooperation between a debtor and his creditors.[277] Debtors were required to disclose their assets and to comply with other duties, which arguably led to maximization of the value of the debtor's insolvency estate. The underlying principle was that the debtors, who behaved in the prescribed manner and fulfilled the applicable preconditions, were rewarded by virtue of an extinguishment of their debts. On the contrary, those debtors who showed signs of misbehaviour were punished. In this perspective, a debt relief operated as the policy of a carrot and a stick.

Although the law no longer provides for harsh punishment as the original statutes used to,[278] the mentioned argument behind a debt relief procedure is still valid. Nowadays, the law

[275] NIEMI-KIESILAINEN, Johanna, RAMSAY, Iain, WHITFORD, William C. (eds.). *Consumer Bankruptcy in Global Perspective*. Oxford: Hart, 2003, pp. 144-145.

[276] BAIRD, Douglas G. A World without Bankruptcy. *Law and Contemporary Problems*, 1987, vol. 50, no. 2, p. 178.

[277] TABB, Charles J. *The Law of Bankruptcy.* Westbury: Foundation Press, 1997, p. 700. See also literature cited in chapter 2.8.1 *supra*.

[278] See chapter 2.8.1 *supra*.

sets standards of behaviour that are expected from debtors such as full disclosure of assets or good behaviour requirements during the life of a repayment plan.[279] If such duties are not fulfilled, negative consequences in the form of a denial of a debt relief or revocation of the previously granted discharge of debts confirmation follow. A discharge in this respect serves as a tool giving the bankrupts incentives to cooperate with creditors and refrain from any misbehaviour.

3.1.2 Reduction of enforcement costs

A debt relief procedure arguably leads to the reduction of enforcement costs. This economic benefit of a debt relief might be appropriately illustrated on an example of a heavily indebted person with virtually few assets and little earnings. In case of such debtors, a chance of repayment of all debts is very little, if not zero. Enforcement of such claims will be mostly wasteful. In the absence of a discharge, creditors might spend resources on monitoring and the court might deal with the case for years without any actual benefits. Given the lengthy and costly collection procedure, there can be much more to be lost than to be gained.[280] Moreover, some costs on the part of courts are not fully borne by those who benefit from them (i.e. creditors). [281]

Debt relief procedure might be an alternative solution. It has been argued that many creditors would stop chasing their debtors upon finding that their debtors are not in the position to satisfy their debts.[282] If a chance of repayment is little, creditors might not in fact suffer significant losses. In insolvency proceedings the insolvency trustee or the court seeks to locate assets, ascertain their value and determine potential earning capacity of a debtor for the benefit of all the creditors in insolvency proceedings. Thus, the availability of a debt relief procedure saves both public as well as private spending.

[279] Compare e.g. section 727(a)(2) of the US Bankruptcy Code denying a discharge to debtors who has *inter alia* concealed property.

[280] CZARNETZKY, John M. The Individual and Failure: A Theory of the Bankruptcy Discharge. *Arizona State Law Journal,* 2000, vol. 32, no. 2, p. 451.

[281] POSNER, Richard A. *Economic Analysis of Law*. 7th edition. New York: Aspen Publishers, 2007, p. 436.

[282] BAIRD, Douglas G. *The Elements of Bankruptcy.* 5th edition. New York: Foundation Press, 2010, p. 31.

3.1.3 Inclusion of debtors to the economy as productive members

One of the most cited and perhaps the most appealing[283] ground substantiating a debt relief procedure is that it enhances the inclusion of bankrupts to the economy as productive members.[284] Interestingly, even Sir William Blackstone attributed an economic function to a discharge of debts as he observed that it rendered the bankrupts clear of debts so they could join the society as full members.[285]

When a debtor has a minimum chance to meet all his obligations, he can prefer leisure to work at practically no costs.[286] If the debtor faces a decision whether to work and have his wage garnished with no prospect of repayment or whether to enjoy leisure, he might tend to prefer the latter. The reason is that in essence the debtor's creditors bear the costs of such option. Whatever the debtor gains above the exempted level of income, his creditors grab. The debtor lacks incentive to work *more* when the fruits of his work are reached by creditors.[287]

Once a debt relief has been granted, a future income stream is untouched. Substitution effect suggests that an individual will make bigger efforts because of a higher utility of work.[288] Thus, the debtor is motivated to find higher-yielding job, take an additional job or simply make more efforts in order to enjoy the benefits thereof.

3.1.4 Elimination of the shadow economy

The availability of a fresh-start brings about another advantage to the economy. In the situation when a debtor's salary is garnished, he can possibly switch to the shadow (labour) market.[289] Gained earnings would be neither taxed nor garnished. It goes without saying that both the state purse and the creditors do not benefit from such scenario.

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[283] HOWARD, Margaret. A Theory of Discharge in Consumer Bankruptcy. *Ohio State Law Journal*, 1987, vol. 48, no. 4, p. 1069 and p. 1087.

[284] TABB, Charles J. Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate. *George Washington Law Review*, 1990, vol. 59, no. 1, p. 94.

[285] Sir Blackstone wrote that *"... the bankrupt becomes a clear man again; and by the assistance of his allowance and his own industry may become a useful member of the commonwealth ...*" BLACKSTONE, William. *Commentaries on the Laws of England*. Baton Rouge: Claitor's Publishing, 1976, vol. 1, p. 1359.

[286] JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, p. 1421.

[287] See chapter 2.4 *supra* and literature cited therein.

[288] *Idem.*

[289] RICHTER, Tomáš. Slovenská rekodifikace insolvenčního práva: několik lekcí pro Českou republiku (a jedna sázka na divokou kartu. *Právní rozhledy,* 2005, vol. 13, no. 20, p. 736.

The discharge diminishes such incentives.[290] Consequently, it brings benefits to public budget as less tax evasions are arguable committed.

3.1.5 Inclusion of debtors to the society and mitigation of externalities

At the outset it might be noted that different kinds of losses emerge in bankruptcy.[291] Costs arise on part of creditors, debtors, insolvency trustees as well as state bodies. As regards creditors, bankruptcy is associated with "actual" losses in terms of a failure to recover debts owed to creditors, including opportunity costs.[292] Also, creditors incur losses with respect to enforcement of their claims. State bodies bear administrative costs regarding the procedure. Due to the multitude of proceedings, debtors incur losses for instance in terms of costs of legal proceedings and time consumed on such individual proceedings. Bankruptcy might significantly limit such costs since many steps are not undertaken manifold.[293]

Still, not all costs can be measured and valued in monetary terms or at least not directly. Bankruptcy creates many externalities.[294] Individuals might suffer psychological harm as a result of anxiety over their financial situation, e.g. due to the stigma attached to the bankrupts.[295] The whole family might be affected.[296] The debtors might be more prone

[290] Analysis of Song Han and Li Wenli points out such effect. HAN, Song, WENLI, Li. Fresh Start or Head Start? The Effect of Filing for Personal Bankruptcy on Work Efforts. *Journal of Financial Services Research*, 2007, vol. 31, no. 2, p. 150.

[291] Compare HALPERN, Paul, TREBILCOCK, Michael, TURNBULL, Stuart. An Economic Analysis of Limited Liability in Corporation Law. *The University of Toronto Law Journal*, 1980, vol. 30, no. 2, p. 131.

[292] As regards opportunity costs see analysis in NORDHAUS, William D., SAMUELSON, Paul A. *Economics.* 14th edition. New York: McGraw-Hill, 1992, p. 27.

[293] See the theory of the creditors' bargain enshrined in chapter 2.5 *supra*.

[294] Charles Tabb raises the "*fabric of society argument*" saying that a large class of hopelessly insolvent people creates political unrest and hardship for other members of the society. TABB, Charles J. Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate. *George Washington Law Review*, 1990, vol. 59, no. 1, p. 94.

[295] It is difficult to predict what the role of stigma is in the Czech society. Presumably given the high number of insolvency petitions of individuals, the role of stigma is limited. In any case, it would be interesting to see the results of any survey on this topic. Iain Ramsay posits that stigma is particularly pertaining to the bankrupts in Japan whereas in the USA or Israel the stigma attached to failure is arguably less perceptible. RAMSAY, Iain. Comparative Consumer Bankruptcy. *Illinois Law Review*, 2007, no. 1, p. 265. See also SENOR, Dan; SINGER, Saul. *Start-Up Nation. The Story of Israel's Economic Miracle*. New York: Twelve, 2011, p. 281.

[296] KILBORN, Jason J. *Two Decades, Three Key Questions, and Evolving Answers in European Consumer Insolvency law: Responsibility, Discretion and Sacrifice*. In NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 313.

to commit suicide, use drugs or commit crimes, and thereby impose additional costs on the society.[297]

A debt relief procedure arguably helps to bring debtors back to the society, decrease the likelihood of abusing drugs and engagement in other forms of bad behaviour.[298] In other words, a debt relief procedure might reduce externalities.

3.1.6 Entrepreneurship encouragement

The fact that in business environment an entrepreneur necessarily incurs debts has been recognized a long time ago.[299] Naturally, all debts imply risks and even with due diligence, a failure is sometimes inevitable due to economic aspects or other reasons. Still, the assumption of reasonable risks might be efficient for the sake of the development of the industry and society in general.

Most of people are risk-averse.[300] Individuals do not generally like running risks. In this regard, the EU barometer shows that people perceive the risk of bankruptcy to be the most significant risk of setting up a business if they were to consider whether to engage in business today.[301] In order to cope with the risk aversion of individuals and induce debtors to undertake risks, several legal devices have been developed. One of them is a limited liability company. One thing is clear - a limitation of liability does not diminish the risks of business itself. It shifts the risks to other parties (creditors)[302] whereby it fosters business engagement. By virtue of the limited liability, shareholders reduce an exposure to risks as they are insulated from liabilities of the respective entity. Likewise, by way of a discharge, [303]

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[297] See e.g. WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. …, pp. 36-37.

[298] NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 242. See e.g. the analysis regarding the impact of insolvency law in Japan see WEST, Mark D. *Dying to Get Out of Debt: Consumer Insolvency Law and Suicide in Japan. The John M. Olin Center for Law & Economics Working Paper Series 21* [online]. University of Michigan Law School, 2003 [cited 3 March 2017]. Available on <http://www.law.umich.edu/centersandprograms/lawandeconomics/abstracts/2003/Documents/west03015.pdf>.

[299] BLACKSTONE, William. *Commentaries on the Laws of England.* Baton Rouge: Claitor's Publishing, 1976, vol. 1, p. 1360.

[300] COOTER, Robert, ULEN, Thomas. *Law and Economics.* 4th edition. Boston: Pearson, 2004, p. 51.

[301] EUROPEAN COMMISSION. *Flash Eurobarometer 354. Entrepreneurship in the EU and Beyond. Summary*. [online]. European Commission, August 2012 [cited 3 March 2017]. Available on <http://ec.europa.eu/public_opinion/flash/fl_354_sum_en.pdf>, p. 72.

[302] POSNER, Richard A. *Economic Analysis of Law*. 7th edition. New York: Aspen Publishers, 2007, p. 424.

the debtor's human capital is insulated as creditors have recourse solely against present assets or limited income stream.[304] In the long run the human capital is protected.

It has been observed that the degree of risk aversion has an impact on the decision whether to become an entrepreneur or prefer to stay as an employee.[305] It is presumably less risky to be employed than to become an entrepreneur.[306] Therefore, the more is a person risk-averse, the less he is prone to engage in business.[307] Potential entrepreneurs can *ex ante* expect that if they engage in risk-taking and fulfil requirements under bankruptcy law, they will not be left in servitude of debts in case of a failure.[308]

In addition to that, providing a debtor a fresh start may arguably lead to the debtor's future success in business. Some studies claim that the debtors, who have failed once, have learned a lesson and are more successful in their future business activities.[309] Previous failure may be arguably regarded "*an opportunity for learning and improving*".[310]

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[303] See LoPUCKI, Lynn. A General Theory of the Dynamics of the State Remedies/Bankruptcy System. *Wisconsin Law Review*, 1982, vol. 26, no. 1, p. 324.

[304] In the absence of a discharge, the creditors can reach the debtor's assets and have the debtor's income garnished until the repayment. POSNER, Richard A. The Rights of Creditors of Affiliated Corporations. *The University of Chicago Law Review*, 1976, vol. 43, no. 3, p. 503; JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, p. 1400.

[305] Many people are deterred from starting their own business due to the fear of bankruptcy and its consequences. See e.g. EUROPEAN COMMISSION. *A Second Chance for Entrepreneurs: Prevention of Bankruptcy, Simplification of Bankruptcy Procedures and Support for a Fresh Start* [online]. European Commission, 2011 [cited 3 March 2017]. Available on <http://ec.europa.eu/enterprise/policies/sme/business-environment/files/second_chance_final_report_en.pdf>, p. 3 and p. 4. See EUROPEAN COMMISSION. *Flash Eurobarometer 354. Entrepreneurship in the EU and Beyond. Summary*. [online]. …, p. 13. As regards the risk aversion see chapter 2.3 *supra*.

[306] An employee faces mainly the risks of the creditworthiness of his employer and his liability is mostly limited to a certain amount unless it is caused intentionally. The employee cannot be generally held liable for debts incurred from business activities of his employer. On the contrary, an entrepreneur as an individual directly bears the risks in connection with his activities.

[307] KIHLSTROM, Richard E., LAFFONT, Jean-Jacques. A General Equilibrium Entrepreneurial Theory of Firm Formation Based on Risk Aversion. *The Journal of Political Economy*, 1979, vol. 87, no. 4, p. 719.

[308] CZARNETZKY, John M. The Individual and Failure: A Theory of the Bankruptcy Discharge. *Arizona State Law Journal,* 2000, vol. 32, no. 2, p. 414; POSNER, Richard A. *Economic Analysis of Law*. 7th edition. New York: Aspen Publishers, 2007, p. 431. It has been also noted that such protection has no externalities as the risks are internalized by virtue of a higher interest rate. POSNER, Richard A. The Rights of Creditors of Affiliated Corporations. *The University of Chicago Law Review*, 1976, vol. 43, no. 3, pp. 501-503. See also argumentation of the UK government in the ECHR ruling in re *Bäck v. Finland* (no. 37598/97, ECHR 2004-VIII), p. 8.

[309] See e.g. EUROPEAN COMMISSION. *A Second Chance for Entrepreneurs: Prevention of Bankruptcy, Simplification of Bankruptcy Procedures and Support for a Fresh Start* [online]. …, p. 3; CUMMING, Douglas J. *Bankruptcy Law and Entrepreneurship* [online]. SSRN, 2002 [cited 3 March 2017]. Available on <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=762144>, p. 18; EUROPEAN COMMISSION. *Commission Staff Working Document. Impact Assessment Accompanying the document Commission Recommendation on a New Approach to Business Failure and Insolvency. SWD(2014) 61 final* [online]. European Commission, 2014 [cited 3 March 2017]. Available

3.1.7 Wealth insurance

Above, it has been argued that since a debt relief procedure effectively limits liability of the debtor, it serves as a business enhancing mechanism. A similar rationale can be established outside the risk-encouraging entrepreneurship scenario.

A debt relief procedure serves as a form of insurance[311] protecting human capital.[312] It provides debtors with insurance against negative consumption shocks.[313] By the same token, it has been also argued that a debt relief procedure actually protects also the government since the government in return does not have to "bail out" indebted individuals.[314]

Also, a debt relief procedure effectively entails a mechanism for the allocation of losses. Inability to repay debts might be caused by events that are completely out of the debtor's control.[315] The creditors, particularly lenders, are arguably in a better position to bear such losses. They may better absorb them due to a larger number of transactions they undertake in comparison to debtors.[316]

Interestingly, it has been argued that depending on who is a superior risk-bearer, a debt relief should be either limited or expanded. It has been suggested that in order to determine

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on <http://ec.europa.eu/justice/civil/files/swd_2014_61_en.pdf>, p. 22: "*In fact there is evidence which shows that re-starters have a greater chance of success than first starters*."

[310] EUROPEAN COMMISSION. *Entrepreneurship 2020 Action Plan* [online]. European Commission, 2013 [cited 3 March 2017]. Available on <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0795:FIN:en:PDF>, p. 17.

[311] Richard Posner provides an argument on the basis of risk-aversion stating that a debt relief procedure is a sort of insurance against going bankrupt. It is seen as a useful device, particularly given the absence of such insurance in the market. POSNER, Richard A. *Economic Analysis of Law*. 7th edition. New York: Aspen Publishers, 2007, p. 436.

[312] ADLER, Barry, POLAK, Ben, SCHWARTZ, Alan. Regulating Consumer Bankruptcy: A Theoretical Inquiry. *The Journal of Legal Studies*, 2000, vol. 29, no. 2, p. 587; SCHWARTZ, Alan. Valuation of Collateral. In RASMUSSEN, Robert K. *Bankruptcy Law Stories.* New York: Foundation Press, 2007, p. 104.

[313] WHITE, Michelle J. *Bankruptcy and Consumer Behavior: Theory and U.S. Evidence*. In BERTOLA, Giuseppe, DISNEY, Richard, GRANT, Charles (eds.). *The Economics of Consumer Credit Demand and Supply.* Cambridge: MIT Press, 2006, p. 242.

[314] *Idem*, p. 260. However, it does not mean that debtors may not face financial difficulties in the years following the discharge of debts or that the debtors will achieve economic success. See e.g. PORTER, Katherine; THORNE, Deborah. The Failure of Bankruptcy's Fresh Start. *Cornell Law Review*, 2006. vol. 92, pp. 67-128.

[315] See also an interesting concept of "*social force majeur*" employed particularly in Scandinavian countries, which is explained in WILHELMSSON, Thomas. "Social Force Majeure": A New Concept in Nordic Consumer Law. *Journal of Consumer Policy*, 1990, vol. 13, no. 1, pp. 1-14.

[316] RAMSAY, Iain. Models of Consumer Bankruptcy: Implications for Research and Policy. *Journal of Consumer Policy*, 1997, vol. 20, p. 275. See also WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. …, pp. 33-35.

the superior risk-bearer two basic criteria apply.[317] First, the question is who is in a better position to prevent the risk in question from happening.[318] If it is the debtor, the risk-allocation would speak for a limited availability of a debt relief procedure. Second, one may consider who is a better insurer.[319] Again, if a better insurer is the debtor, the limitation of the discharge should be arguably justified. In this connection, the assessment turns on whether the debtor or the creditor is generally in the position to more cheaply appraise the magnitude and the probability of the risk, as well as to avoid related transaction costs. Such costs include the costs of elimination or minimization of the risk by virtue of pooling it with other uncertain events.[320]

In this respect, it might be useful to examine who the creditors are and also what are particular causes of indebtedness.[321] The available data, which are rather limited to consumers, suggest that the causes lie individually more in the hands of debtors. In the USA, three main causes of over-indebtedness include unemployment, medical costs and divorce.[322] The data from Germany, which is geographically closer to the Czech Republic, reveal that debtors attributed their debt-related issues particularly to unemployment, loss of financial overview and divorce or separation.[323] As concerns the structure of creditors, according to the survey from Germany, big corporations figure among top creditors. [324]

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[317] The test has been originally developed in the context of contractual excuses from performance. However, it has been commonly used to assess the risk-allocation. POSNER, Richard, ROSENFIELD, Andrew, Impossibility and Related Doctrines in Contract Law: An Economic Analysis. *The Journal of Legal Studies*, 1977, vol. 6, no. 1, pp. 83-118.

[318] *Idem*, p. 90.

[319] *Idem*, pp. 91-92.

[320] *Idem*, p. 91. Mostly, the latter means whether a person can self-insure for instance by the diversification of own assets.

[321] To the author's knowledge, no such analysis has been undertaken in the Czech Republic.

[322] See WARREN, Elizabeth, TYAGI, Amelia W. *The Two-income Trap*. New York: Basic Books, 2003, p. 81 cited in NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds.). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 283.

[323] The report shows that unemployment (42.8 %), loss of financial overview (37.3 %) and divorce or separation (36.4 %) and other reasons not expressly mentioned (21,4 %) were among main causes. Other causes were business failure (21 %), consumption (21 %), lack of experience with banks (20.8 %), family problems (2.5 %), decrease in income (19.6 %), lack of experience with money (18 %), low income (18 %), psychological problems (15.4 %), co-liability (12.5 %), surety (12.1 %) and own sickness (10.6 %). *Idem*, pp. 275-287. Data from other countries suggest similar results since unemployment, divorce and illness figured among top causes. It might be noted that debtors could provide more answers. See JENTZSCH, Nicola, RIESTRA, Amparo S. J. *Consumer Credit Markets in the United States and Europe*. In BERTOLA, Giuseppe, DISNEY, Richard, GRANT, Charles (eds.). *The Economics of Consumer Credit Demand and Supply.* Cambridge: MIT Press, 2006, p. 37.

[324] Researchers examined kinds of debt that led to the over-indebtedness of the surveyed debtors. Debtors could provide more answers. The outcome of the survey suggests that overdrawn bank account comes as first

In theory, there is, however, not an agreement over who is the superior risk-bearer.[325] While Theodore Eisenberg[326] leans towards arguing that it is rather the debtor who is the superior risk-bearer, Margaret Howard[327] and Thomas Jackson[328] seems to identify the creditor as the superior risk-bearer. Expectedly, there are also opinions that it cannot be determined.[329] Arguably, as indicated above, at least as far as commercial lenders are concerned, they seem to be in a better position to appraise the risks of default *inter alia* due to a high number of transactions.[330]

3.2 Alternative rationales of a debt relief procedure

3.2.1 Objections to the economic approach to law

Economists suggest that individuals behave rationally and that in the pursuit of their goals they make choices that are the most efficient. Yet, repeated behaviour shows patterns which do not correspond to the theory of maximizing benefits.[331] When an individual has

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with 53.5 %. The other kinds of debts were telephone bills (25 %), rent debts (24.7 %), cell phone bills (22.5 %) car loans (21.9 %), other loans (21.6 %), real estate debts (21.2 %), consumer credit (20.9 %) and taxes or fees (18 %). See BACKERT, Wolfram, BROCK, Ditmar, LECHNER, Gotz, MAISCHATZ, Katja. *Bankruptcy in Germany: Filing Rates and the people behind the Numbers*. In NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds.). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 284.

[325] See e.g. EISENBERG, Theodore. Bankruptcy Law in Perspective. *UCLA Law Review*, 1981, vol. 28, no. 5, pp. 981-983; HOWARD, Margaret. A Theory of Discharge in Consumer Bankruptcy. *Ohio State Law Journal*, 1987, vol. 48, no. 4, pp. 1064-1065; JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, p. 1400; or HARRIS, Steven L. Reply to Theodore Eisenberg's Bankruptcy Law in Perspective. *UCLA Law Review*, 1982, vol. 30, no. 2, p. 363.

[326] Theodore Eisenberg argues that the debtor presumably "has control" over his financial situation and controls the risk. Even though Theodore Eisenberg admits that some sophisticated creditors can assess the risk better, it could be neither the case of all nor most of them. EISENBERG, Theodore. Bankruptcy Law in Perspective. *UCLA Law Review*, 1981, vol. 28, no. 5, pp. 982-983.

[327] HOWARD, Margaret. A Theory of Discharge in Consumer Bankruptcy. *Ohio State Law Journal*, 1987, vol. 48, no. 4, pp. 1064-1065.

[328] JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, p. 1400.

[329] HARRIS, Steven L. Reply to Theodore Eisenberg's Bankruptcy Law in Perspective. *UCLA Law Review*, 1982, vol. 30, no. 2, p. 363.

[330] HOWARD, Margaret. A Theory of Discharge in Consumer Bankruptcy. *Ohio State Law Journal*, 1987, vol. 48, no. 4, pp. 1063-1064; WESTON, Fred J. Some Economic Fundamentals for an Analysis of Bankruptcy. *Law and Contemporary Problems*, 1977, vol. 41, no. 4, p. 61. There has been a disagreement, though, whether all commercial stakeholders can indeed assess the risks equally. HOWARD, Margaret. A Theory of Discharge in Consumer Bankruptcy. *Ohio State Law Journal*, 1987, vol. 48, no. 4, pp. 1063-1064.

[331] FRADE, Catarina, LOPES, Claudia, A. *Overindebtedness and Financial Stress: A Comparative Study in Europe*. In NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds.). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 256. However, as has been remarked by Richard Posner, even the so-called "conventional economists" to whom some

a choice, he tends to "*fail to employ the most efficient strategy, suggesting that the maximization of profits is not a universal criterion for human decisions*."[332] Recently, a part of the scholarship has turned to psychological science to examine these questions. Some researchers suggest that an individual is in certain situations not led solely by rational analyses, as economists posit. Accordingly, new theories helping to substantiate a debt relief procedure on the ground of paternalism have evolved.[333]

Before considering more specific findings, one qualification must be pointed out. The outlined approach obviously concerns behaviour. Nevertheless, not all bankruptcies are caused necessarily by causes which might be attributed to behaviour; other causes exist, such as severe illness, loss of job or other unpredictable or uncontrollable events. Therefore, behavioural approach cannot be extended to all cases.[334] Also, conclusions of behavioural scientists are not unanimously accepted and their findings are questioned.[335]

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behavioural economists refer do not presume completely "unsocial" or "egoistic" men and women. See POSNER, Richard A. Rational Choice, Behavioral Economics, and the Law. *Stanford Law Review*, 1998, vol. 50, no. 5, p. 1552. Also, he points out that perfect rationality is not assumed and that human cognitive limitations are taken into account. See POSNER, Richard A. *Economic Analysis of Law*. 7th edition. New York: Aspen Publishers, 2007, p. 3.

[332] FRADE, Catarina, LOPES, Claudia, A. *Overindebtedness and Financial Stress: A Comparative Study in Europe*. In NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds.). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 256. It is clear that the advocates of law and economics are aware of the assumptions and reality. It has been argued that no theory can possibly explain all the complexities of the world and human behaviour. See POSNER, Richard A. *Economic Analysis of Law*. 7th edition. New York: Aspen Publishers, 2007, p. 16. Still, acknowledgment that individuals sometimes do not maximize their utility does not necessarily make law and economics useless. As Richard Posner notes economics is concerned with tendencies rather than individuals; overall small departures from standards are compensated. *Idem*, p. 17.

[333] A paternalistic rule in the sphere of private law has been defined as the rule that "*prohibits an action on the ground that it would be contradictory to the actor's own welfare.*" KRONMAN, Anthony T. Paternalism and the Law of Contract. *The Yale Law Journal*, 1983, vol. 92, no. 5, p. 763. It is argued that anti-antipaternalism is pertinent to behavioural approach to law. See JOLLS, Christine, SUNSTEIN, Cass R., THALER, Richard. A Behavioral Approach to Law and Economics. *Stanford Law Review*, 1998, vol. 50, no. 5, p. 1541

[334] Saul Schwartz rightly notes this limitation. SCHWARTZ, Saul. *Personal Bankruptcy Law: A Behavioural Perspective*. In NIEMI-KIESILAINEN, Johanna, RAMSAY, Iain, WHITFORD, William C. (eds.). *Consumer Bankruptcy in Global Perspective*. Oxford: Hart, 2003, p. 67. Broadly speaking, this limitation is narrow as even occurrences of illness are somehow related to the underestimation of risks.

[335] See e.g. HARRIS, Adam J., HAHN, Ulrike. Optimism About Future Events: A Cautionary Note. *Psychological Review*, 2011, vol. 118, no. 1, pp. 135-154.

3.2.2 Behavioural approach to law

Advocates of behavioural law and economics do not posit hypothetical *homo economicus* but real actual people with their constraints.[336] Three bounds of economic behaviour were historically identified – bounded rationality, bounded willpower and bounded self-interest.

First, bounded rationality entails that uncertainty and incomplete information are not seen as constraints or obstacles but rather as "*limits to the reasoning process itself*".[337] In the words of Herbert Simon, an economist and cognitive scientist, a rational person "*makes his decisions in a way that is procedurally reasonable in the light of the available knowledge and means of computation*".[338] Cognitive limits of human beings are acknowledged.[339] People face computational skills and flawed memories.[340] To tackle with these limitations, individuals would have to assess all information, double-check the assessment and spend deliberation costs. [341]

People act within acquired patterns. It is argued that individuals make shortcuts and follow several rules of thumb.[342] One of such rules of thumb is for instance the so-called "availability". According to this rule people determine probability that something happens

[336] JOLLS, Christine, SUNSTEIN, Cass R., THALER, Richard. A Behavioral Approach to Law and Economics. *Stanford Law Review*, 1998, vol. 50, no. 5, p. 1476.

[337] KATZ, Avery Wiener. *Foundations of the Economic Approach to Law*. New York: Oxford University Press, 1998, p. 296. See also illustration of problem of full and incomplete specificity in ADLER, Matthew D. *Bounded Rationality and Legal Scholarship* in WHITE, Mark D (ed.). *Theoretical Foundations of Law and Economics*. Cambridge: Cambridge University Press, 2009, pp. 140-144. Matthew Adler points out how decision-making of individuals is bounded.

[338] SIMON, Herbert A Rationality in Psychology and Economics. *The Journal of Business,* 1986, vol. 59, no. 4, p. S219. In his earlier work Herbert Simon also outlined how rational choices are limited. See SIMON, Herbert A. A Behavioral Model of Rational Choice. *The Quarterly Journal of Economics*, 1955, vol. 69, no. 1, pp. 99-113.

[339] ADLER, Matthew D. *Bounded Rationality and Legal Scholarship* in WHITE, Mark D. (ed.). *Theoretical Foundations of Law and Economics*. Cambridge: Cambridge University Press, 2009, p. 137.

[340] JOLLS, Christine, SUNSTEIN, Cass R., THALER, Richard. A Behavioral Approach to Law and Economics. *Stanford Law Review*, 1998, vol. 50, no. 5, p. 1477.

[341] SCHWARTZ, Saul. *Personal Bankruptcy Law: A Behavioural Perspective*. In NIEMI-KIESILAINEN, Johanna, RAMSAY, Iain, WHITFORD, William C. (eds.). *Consumer Bankruptcy in Global Perspective*. Oxford: Hart, 2003, p. 63.

[342] JOLLS, Christine, SUNSTEIN, Cass R., THALER, Richard. A Behavioral Approach to Law and Economics. *Stanford Law Review*, 1998, vol. 50, no. 5, p. 1477. For interesting analysis about how people perceive expenses and income see e.g. THALER, Richard H. Mental Accounting Matters. *Journal of Behaviour Decision Making*, 1999, vol. 12, pp. 183-206. See also KAHNEMAN, Daniel. *Thinking Fast and Slow.* London: Penguin Books, 2012. 499 pages.

against the benchmark of how easily they recall such occurrence.[343] In this regard, Daniel Kahneman and Amos Tversky note that one can assess a frequency of a business failure by recalling difficulties he might face.[344] Such behaviour is economic in terms of saving time. Yet, such decision-making process generates choices that differ from the choices of truly rational agents posited by economics.[345]

In effect, bounded rationality might lead to the over-optimism[346] and underestimation of risks.[347] Translating the mentioned conclusion into the area of personal insolvency, individuals might underestimate risks associated with borrowings[348] or actual consumption,

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[343] See TVERSKY, Amos, KAHNEMAN, Daniel. *Judgment Under Uncertainty: Heuristics and Biases*. In CONNOLY, Terry, ARKES, Hal R., HAMMOND, Kenneth R. (eds.) *Judgment and Decision Making: an Interdisciplinary Reader.* New York: Cambridge University Press, 1986, pp. 42-44. Amos Tversky and Daniel Kahneman call such rules as "heuristics". The other heuristics are representativeness, and anchoring and adjusting. The representativeness is defined to be the degree to which the subjective probability of an event, or a sample, (i) is similar in essential characteristics to its parent population, and (ii) reflects the salient features of the process by which it is generated. KAHNEMAN, Daniel, TVERSKY, Amos. Subjective Probability: A Judgment of Representativeness. *Cognitive Psychology*, 1972, vol. 3, no. 3, p. 430. Anchoring and adjustment is used in situations where individuals estimate numbers so that they shift up or down to find out plausible answers.

[344] *Idem* p. 43. For further reading see e.g. KAHNEMAN, Daniel, TVERSKY, Amos. Subjective Probability: A Judgment of Representativeness. *Cognitive Psychology*, 1972, vol. 3, no. 3, pp. 430-454 (regarding representativeness as one of the heuristics); KAHNEMAN, Daniel, TVERSKY, Amos. Availability: A Heuristic for Judging Frequency and Probability. *Cognitive Psychology*, 1973, vol. 5, no. 2, pp. 207-232 (regarding availability); KAHNEMAN, Daniel; TVERSKY, Amos. Rational Choice and the Framing of Decisions. *The Journal of Business*, 1986, vol. 59, no. 4, part 2, pp. S251-S278 (regarding framing). See also KAHNEMAN, Daniel, KNETSCH, Jack L., TVERSKY, Amos. Experimental Tests of the Endowment Effect and the Coase Theorem. *The Journal of Political Economy*, 1990, vol. 98, no. 6, pp. 1325-1348; KAHNEMAN, Daniel. Maps of Bounded Rationality: Psychology for Behavioral Economics. *The American Economic Review*, 2003, vol. 93, no. 5, pp. 1449-1475; KAHNEMAN, Daniel. *Thinking Fast and Slow.* London: Penguin Books, 2012. 499 pages.

[345] JOLLS, Christine, SUNSTEIN, Cass R., THALER, Richard. A Behavioral Approach to Law and Economics. *Stanford Law Review*, 1998, vol. 50, no. 5, p. 1478.

[346] Many analyses show that people tend to be overoptimist and see themselves unrealistically positively. See e.g. Shelley E., BROWN, Jonathon, D. Illusion and Well-Being: A Social Psychological Perspective on Mental Health. *Psychological Bulletin*, 1988, vol. 103, no. 2, pp. 195-196; CAMERER, Colin F, LAVALLO, Dan. Overconfidence and Excess Entry: An Experimental Approach. *The American Economic Review*, 1999, vol. 89, no. 1, p. 30; RAMSAY, Iain. Comparative Consumer Bankruptcy. Illinois Law Review, 2007, no. 1, p. 9; SUNSTEIN, Cass R. Boundedly Rational Borrowing. *The University of Chicago Law Review*, 2006, vol. 73, no. 1, p. 252.

[347] " *... overoptimism leads most people to believe that their own risk of a negative outcome is far lower than the average person's. Similarly, the effect of salience may lead to substantive underestimation of certain risks encountered in everyday life*." JOLLS, Christine, SUNSTEIN, Cass R., THALER, Richard. A Behavioral Approach to Law and Economics. Stanford Law Review, 1998, vol. 50, no. 5, p. 1541. See also SUNSTEIN, Cass R. *Behavioral Analysis of Law. Chicago Working Paper in Law & Economics* [online]. University of Chicago, 1997 [cited 3 March 2017]. Available on <http://www.law.uchicago.edu/files/files/46.CRS_.Behavioral.pdf>.

[348] See exemplification in SCHWARTZ, Saul. *Personal Bankruptcy Law: A Behavioural Perspective*. In NIEMI-KIESILAINEN, Johanna, RAMSAY, Iain, WHITFORD, William C. (eds.). *Consumer Bankruptcy in Global Perspective*. Oxford: Hart, 2003, p. 65.

breakdown of relationships or future income shock.[349] Hence, people borrow in the expectation that they will not be struck by external events such as unemployment or illnesses.

Second, bounded willpower (weakness of will)[350] is linked to the assertion that people do not keep stable preferences; they tend to prefer something which they know is against their long-term interests.[351] In terms of savings and borrowings, an individual who gets a loan might in a long-term prefer to regularly set aside some portion of his earnings. Still, in some situations such person is temptated to instantaneous impulses and spends money unreasonably.[352] In short, problems with self-control lead people to undermine future well-being.[353]

Third, without actually challenging "conventional economic approach" towards pursuing self-interest, behavioural law and economics contemplates that people sometimes act even solely for the benefit of others.[354] This concept is closely connected to the idea of fairness and means presumably that people act out of motives.[355] In terms of personal bankruptcy law, people might guarantee debts of others which might eventually render them insolvent.

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[349] RAMSAY, Iain. Models of Consumer Bankruptcy: Implications for Research and Policy. *Journal of Consumer Policy*, 1997, vol. 20, p. 274.

[350] See counterarguments in POSNER, Richard A. Rational Choice, Behavioral Economics, and the Law. *Stanford Law Review*, 1998, vol. 50, no. 5, pp. 1555-1557. Yet, Richard Posner also states that conventional approach regarding discounting between present and future costs and benefits implies impartiality. In this respect, he further observes that "*discount rates are much too high for an inference of impartiality*". See POSNER, Richard A. Are We One Self or Multiple Selves?: Implications for Law and Public Policy. *Legal Theory*, 1997, vol. 3, no. 1, p. 30.

[351] See JOLLS, Christine, SUNSTEIN, Cass R., THALER, Richard. A Behavioral Approach to Law and Economics. *Stanford Law Review*, 1998, vol. 50, no. 5, p. 1479. Ian Ramsay mentions a simple example of a man who sets up his alarm clock at 6 am to have a walk before a breakfast and the next day he turned off the alarm clock to prolong his sleep. See RAMSAY, Iain. *Consumer Credit Regulation as "The third Way"* [online]. International Association of Consumer Law [cited 3 March 2017]. Available on <http://www.iaclaw.org/Research_papers/thirdway.pdf>, p. 8.

[352] This propensity is illustrated in SCHWARTZ, Saul. *Personal Bankruptcy Law: A Behavioural Perspective*. In NIEMI-KIESILAINEN, Johanna, RAMSAY, Iain, WHITFORD, William C. (eds.). *Consumer Bankruptcy in Global Perspective*. Oxford: Hart, 2003, p. 66.

[353] SUNSTEIN, Cass R. Boundedly Rational Borrowing. *The University of Chicago Law Review*, 2006, vol. 73, no. 1, p. 252. Other problems are procrastination, and "*miswanting*" that causes people to want items that do not improve their welfare and *vice versa*. *Idem*, p. 253.

[354] Richard Posner challenges these arguments in POSNER, Richard A. Rational Choice, Behavioral Economics, and the Law. *Stanford Law Review*, 1998, vol. 50, no. 5, pp. 1557-1558.

[355] See SCHWARTZ, Saul. *Personal Bankruptcy Law: A Behavioural Perspective*. In NIEMI-KIESILAINEN, Johanna, RAMSAY, Iain, WHITFORD, William C. (eds.). *Consumer Bankruptcy in Global Perspective*. Oxford: Hart, 2003, p. 67.

One of the theories that draw on the abovementioned behavioural economics is the prospect theory.[356] As a descriptive model of decision-making under uncertainty[357] it seeks to capture the framework of inconsistency in behaviour.[358] Instead of utility, the prospect theory focuses on description of behaviour in terms of losses and gains and observes several generalizations.[359] The key point seems to be that "*losses loom larger than gains*"[360] and that individuals allegedly prefer risk aversion as regards gains and risk seeking as far as losses are concerned[361] (the so called loss aversion)[362]. Loss aversion of consumers leads allegedly to several effects connected to saving behaviour which might be considered imprudent. It has been *inter alia* noted that with the prospect of the increase in wages of individuals increase their consumption whereas with the prospect of the decrease in future wages, the consumption is not adjusted.[363] Similarly, bad expenses management might be also attributed to the related notion of cumulative cost omission. This concept entails

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[356] KAHNEMAN, Daniel, TVERSKY, Amos. Prospect Theory: An Analysis of Decision under Risk. *Econometrica*, 1979, vol. 47, no. 2, pp. 263-292; KAHNEMAN, Daniel, TVERSKY, Amos. Advances in Prospect Theory: Cumulative Representation of Uncertainty. *Journal of Risk and Uncertainty*, 1992, vol. 5, no. 4, pp. 297-323. For further reading on the prospect theory and heuristics see e.g. LAIBSON, David, ZECKHAUSER, Richard. Amos Tversky and the Ascent of Behavioral Economics. *Journal of Risk and Uncertainty*, 1998, vol. 16, no. 1, pp. 8-14.

[357] THALER, Richard H. Toward a Positive Theory of Consumer Choice. *Journal of Economic Behavior and Organization*, 1980, vol. 1, no. 1, p. 40.

[358] FRADE, Catarina, LOPES, Claudia, A. *Overindebtedness and Financial Stress: A Comparative Study in Europe*. In NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 256.

[359] As Richard Thaler sums up, losses and gains are treated differently, certain outcomes are overweighed in comparison to uncertain outcomes; a value function is of S-shape depicting concave curve for gains and convex curve for losses based on the fact that "*the difference between 0 and 100 is greater than difference between 1,000 and 1,100*". Also, the curve is steeper for losses than for gains. See THALER, Richard H. Toward a Positive Theory of Consumer Choice. *Journal of Economic Behavior and Organization*, 1980, vol. 1, no. 1, pp. 42-43.

[360] KAHNEMAN, Daniel, TVERSKY, Amos. Prospect Theory: An Analysis of Decision under Risk. *Econometrica*, 1979, vol. 47, no. 2, p. 278. Due to the loss aversion of consumers, elasticity of consumer goods is greater in magnitude in case of the increase in price in comparison to the decrease thereof. Consumers who are loss averse dislike more increases than decreases. See CAMERER, Colin F. Prospect Theory in the Wild: Evidence from the Field. In KAHNEMAN, Daniel, TVERSKY, Amos (eds.). *Choices, Values, and Frames.* Cambridge: Cambridge University Press, 2000, p. 292.

[361] KAHNEMAN, Daniel, TVERSKY, Amos. Prospect Theory: An Analysis of Decision under Risk. *Econometrica*, 1979, vol. 47, no. 2, p. 269.

[362] BOWMAN, David, MINEHART, Deborah, RABIN, Matthew. Loss Aversion in a Consumption-savings Model. *Journal of Economic Behavior & Organization*, 1999, vol. 38, p. 155.

[363] Colin Camerer refers to the empirical analysis undertaken among workers with a relatively stable and predictable level of wages, i.e. teachers. See an explanation in CAMERER, Colin F. Prospect Theory in the Wild: Evidence from the Field. In KAHNEMAN, Daniel, TVERSKY, Amos (eds.). *Choices, Values, and Frames.* Cambridge: Cambridge University Press, 2000, p. 293. Consumers, who are loss-averse, dislike more increases than decreases. *Idem*, p. 292.

that people tend to neglect small number of expenses or borrowings, which in total might make a large sum of money, which would have not been incurred at once.[364] In other words, by making little purchases (on a credit card), people may get into debts that may cease to be manageable.

Also, cognitive theories have been applied to inter-temporal decisions (a decision between current and future benefits or losses) with a special focus on saving customs. In this regard, it has been noted that individual behaviour shows discrepancies between short-term and long-term preferences so that the former undermines the latter.[365] It has been also asserted that an individual when facing a decision of having current rewards or higher future rewards prefers current rewards.[366] Likewise, in situation of choice between current losses and delayed losses, a person prefers delayed losses. Applying this to patterns of borrowing, current benefits such as money borrowed seem better than delayed losses like instalments or payment of interests.[367]

Given the deficiencies in human behaviour, several authors in effect refer to the behavioural approach to law in order to support the fresh-start policy (debt relief procedure) on paternalistic grounds. Thomas Jackson asserts that a debt relief procedure is justified on the basis of incomplete heuristics and impulsiveness.[368] Similarly, Ian Ramsay argues that systemic flaws in behaviour of individuals are the basis for consumer protection

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[364] Cass Sunstein refers to works of Paul Slovic, author who is related to the prospect theory. See SUNSTEIN, Cass R. Boundedly Rational Borrowing. *The University of Chicago Law Review*, 2006, vol. 73, no. 1, p. 251.

[365] David Laibson has devoted a lot of attention to the pattern of hyperbolic discounting – the concept regarding inter-temporal decision-making. He contends that the discount function decreases more intensively in the short term than in the long term. See e.g. ANGELETOS, George-Marios, LAIBSON, David, REPETTO, Andrea, TOBACMAN, Jeremy Tobacman, WEINBERG, Stephen. The Hyperbolic Consumption Model: Calibration, Simulation, and Empirical Evaluation. *The Journal of Economic Perspectives*, 2001, vol. 15, no. 3, pp. 47-51.

[366] FRADE, Catarina, LOPES, Claudia, A. *Overindebtedness and Financial Stress: A Comparative Study in Europe*. In NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds.). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 256. The authors are referring to the work of David Laibson.

[367] *Idem*.

[368] Thomas Jackson employs the Rawlsian concept of "veil of ignorance". "*If people in the "original position" had known about the problems of incomplete heuristics and impulsive behavior, and about the difficulty of adjusting for these problems in making credit decisions, they presumably would have opted for a legal rule designed to avert those problems in advance*." JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, p. 1415. As regards the notion of the "veil of ignorance" see particularly RAWLS, John. A Theory of Justice. Cambridge: Belknap Press of Harvard University Press, 1971, pp. 136-142. However, David Carlson argues that Rawl's concept can hardly be used to substantiate a discharge from a philosophical point of view. See CARLSON, David G. Philosophy in Bankruptcy. *Michigan Law Review*, 1987, vol. 85, no. 5, pp. 1358-1361.

in the field of bankruptcy.[369] In short, individuals fail to accurately mirror their stance towards consumption and savings when they face uncertainty. Thus, people allegedly tend to "[*underestimate*] *the risks that their current consumption imposes on their future well-being.*"[370] In the end, the debtor feels regret as a result of the incurred debts. Yet, it may be too late to stop the spinning of the debt-spiral.[371] Lenders are certainly aware of individuals' weakness and many of them avail thereof. To tackle with misleading practices various acts have been adopted.[372] However, the usefulness of such strategy has been questioned.[373] In this regard, various forms of actions to tackle irrational behaviour of consumers (people) might be employed.

In terms of paternalism, one can imagine a different scale of actions that stretches from weaker forms to stronger forms of paternalism.[374] It is suggested that the law should prefer weaker forms of paternalism[375] to stronger ones.[376] The most common form of weak paternalistic approach lies in the adoption of the truth-in-lending statutes. Debiasing is also rather a weaker form of paternalism.[377] Due to the over-optimism to which people are

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[369] RAMSAY, Iain. Models of Consumer Bankruptcy: Implications for Research and Policy. *Journal of Consumer Policy*, 1997, vol. 20, p. 274.

[370] JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, p. 1412.

[371] See Antony Kronman's argumentation on the distinction between the notion of a disappointment and a regret in the context of bankruptcy. KRONMAN, Anthony T. Paternalism and the Law of Contract. *The Yale Law Journal*, 1983, vol. 92, no. 5, pp. 780-786.

[372] See e.g. the Directive 2011/83/EU of the European Parliament and the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council.

[373] The so-called truth in lending strategy is certainly not omnipotent. As Iain Ramsay notes, it is certainly an important method of consumer protection allowing consumer to do an informed choice. Still, its effectiveness in practice is questionable as it is grounded on the idea of rational behaviour. See RAMSAY, Iain. *Consumer Credit Society and Consumer Bankruptcy: Reflections on Credit Cards and Bankruptcy in the Informational Economy.* In NIEMI-KIESILAINEN, Johanna, RAMSAY, Iain, WHITFORD, William C. (eds.). *Consumer Bankruptcy in Global Perspective*. Oxford: Hart, 2003, p. 33; SUNSTEIN, Cass R. Boundedly Rational Borrowing. *The University of Chicago Law Review*, 2006, vol. 73, no. 1, pp. 260-261.

[374] SUNSTEIN, Cass R. Boundedly Rational Borrowing. *The University of Chicago Law Review*, 2006, vol. 73, no. 1, pp. 260-261.

[375] KRONMAN, Anthony T. Paternalism and the Law of Contract. *The Yale Law Journal*, 1983, vol. 92, no. 5, p. 763.

[376] SUNSTEIN, Cass R. Boundedly Rational Borrowing. *The University of Chicago Law Review*, 2006, vol. 73, no. 1, pp. 254-270. The rationale is, among others, that people should themselves decide what fit them or that legislators are (as well) subject to the same defects of irrational behaviour. Moreover, it is claimed that under the disguise of paternalism, selected solutions may serve "parochial interests" rather than the interests of those who were supposed to be protected.

[377] *Idem*, pp. 261-263. Cass Sunstein notes that public education campaigns may be undertaken to raise consciousness of people about possible implications of indebtedness. Such actions should avail of salience

arguably exhibited these weak forms as well as mere education (debt-counselling in particular) may not work to achieve the goal.[378] Although a debt relief procedure seems to be a stronger form of paternalism, it might be justified on the ground that other forms of legal responses would hardly work,[379] particularly in today's anonymous mechanisms of borrowing.[380]

3.3 Rehabilitation and other rationales of a debt relief procedure

A debt relief procedure is also justified on the ground that it is inhuman to let people live buried permanently in debts with no hope of better life.[381] Most of people, if not all, would agree that to have stable families and good emotional health are goals worth living for.[382] In this context, over-indebtedness brings about many implications associated with psychological and economic situation which hampers them. Psychological discomfort, social, financial and market exclusion are one of undesirable consequences of financial difficulties.[383] Indebted people might suffer mental and physical illnesses as a result of stress and nervousness over their desperate financial situation.[384] Moreover, in case of insolvency

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and availability in the debiasing efforts (substitution of hard questions by easier ones), e.g. by sharing stories of indebted people. *Idem*, p. 262.

[378] SUNSTEIN, Cass R. *Behavioral Analysis of Law. Chicago Working Paper in Law & Economics* [online]. …, p. 10; RAMSAY, Iain. Consumer Credit Regulation as "The third Way" [online]. …, p. 10.

[379] Debt relief procedures arguably prevent individuals from contracting out too much of their personal liberty so that they are barred from effectively mortgaging their future income stream. In other words, the fresh-start policy upholds personal integrity. See KRONMAN, Anthony T. Paternalism and the Law of Contract. *The Yale Law Journal*, 1983, vol. 92, no. 5, pp. 774-775 and pp. 785-786.

[380] Douglas Baird points out that in the world of credit cards and other technological advances the scheme of borrowing has changed substantially. BAIRD, Douglas G. Discharge, Waiver, and the Behavioral Undercurrents of Debtor-Creditor Law. *The University of Chicago Law Review*, 2006, vol. 73, no. 1, p. 31.

[381] TABB, Charles, J. *The Law of Bankruptcy.* Westbury: Foundation Press, 1997, p. 700. Even Sir Blackstone already noted that one of the foundations of bankruptcy law a discharge of debts was that it was human. See BLACKSTONE, William. *Commentaries on the Laws of England.* Baton Rouge: Claitor's Publishing, 1976, vol. 1, pp. 1356-1357.

[382] GROSS, Karen. *Failure and Forgiveness: Rebalancing the Bankruptcy System*. New Haven: Yale University Press, 1997, p. 102. It must be noted, though, that most of people will probably do not agree at what costs such stability should be achieved. Also, Karen Gross sees bankruptcy as a way how to promote responsibility. However, such responsibility is required not only from debtors but also from creditors. *Idem*, p. 118. See also SULLIVAN, Teresa A., WESTBROOK, Lawrence J., WARREN, Elizabeth. As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America. New York: Oxford University Press, 1989. 370 pages.

[383] FRADE, Catarina, LOPES, Claudia, A. *Overindebtedness and Financial Stress: A Comparative Study in Europe*. In NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds.). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 249. See also e.g. the US Supreme Court ruling in re *Everett v. Judson*, 228 U.S. 474 (1913), at 477.

[384] FRADE, Catarina, LOPES, Claudia, A. *Overindebtedness and Financial Stress: A Comparative Study in Europe*. In NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds.). *Consumer Credit, Debt*

not only the debtor's life and self-respect is at stake but also the lives of those who are in his vicinity, including his spouse and children.[385]

In this connection, it has been argued that a debt relief procedure may be justified on the natural law theory of morality as the autonomous ground separated from any economic reasoning.[386] Some scholars argue that this moralistic argumentation is completely different and inconsistent with law and economics.[387] The ability to earn and maintain living for oneself is in this connection seen as the value connected to dignity.[388]

Similarly, a debt relief procedure is also linked to the idea of forgiveness, the concept with a long religious as well as secular tradition.[389] The Bible reads that "*At the end of every seven years there is to be a general forgiveness of debt*."[390] Due to psychological and social impact of indebtedness on a debtor and on his family,[391] a debt relief procedure has certainly a big moral appeal particularly in the context of the poorest.[392] The fresh-start policy mirrors society's noneconomic values of compassion, charity and forgiveness.[393] "*It holds out*

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and Bankruptcy: Comparative and International Perspectives. Oxford: Hart Publishing, 2009, p. 249. Debtors suffer anxiety, stomach upset, sleeping disorders or express dysfunctional reactions against themselves or their families. See the researches cited in EFRAT, Rafael. The Fresh-Start Policy in Bankruptcy in Modern Day Israel. *American Bankruptcy Institute Law Review,*1999, vol. 7, no. 2, p. 561.

[385] WEISTART, John C. The Costs of Bankruptcy. *Law and Contemporary Problems*, 1977, vol. 41, no. 4, p. 116.

[386] Richard Flint states that "*The moralistic approach stresses that human dignity is of higher value than the economic benefits or costs …"* FLINT, Richard E. Bankruptcy Policy: Toward a Moral Justification for Financial Rehabilitation of the Consumer Debtor. *Washington and Lee Law Review,* 1991, vol. 48, no. 2, pp. 520-521.

[387] *Idem*, p. 525.

[388] *Idem*, p. 536.

[389] GROSS, Karen. *Failure and Forgiveness: Rebalancing the Bankruptcy System*. New Haven: Yale University Press, 1997, p. 93.

[390] Deuteronomy, 15:1.

[391] Thomas Jackson supports a fresh-start policy *inter alia* on the ground that the law needs to protect other affected persons. JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, pp. 1418-1419.

[392] One of the grounds to allow discharge of debts may be that indebtedness is often caused by external events. Most cited causes in the USA were, as Elizabeth Warren mentioned, job loss, family breakups and medical problems. RAMSAY, Iain. Comparative Consumer Bankruptcy. *Illinois Law Review*, 2007, no. 1, p. 247. See also PORTER, Katherine; THORNE, Deborah. The Failure of Bankruptcy's Fresh Start. *Cornell Law Review*, 2006. vol. 92, pp. 100-116.

[393] ZYWICKI, Todd J. An Economic Analysis of the Consumer Bankruptcy Crisis. *Northwestern University Law Review*, 2005, vol. 99, no. 4, p. 1466.

a promise to the debtor of a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."[394]

Human capital might be perhaps exploited. Yet, unlike physical capital, it is neither possible to subject it to collection nor to distribution.[395] In one of the most famous cases, the US Supreme Court states that "*The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty.*"[396] Personal bankruptcy law seeks to protect this liberty as a part of personal integrity.[397]

Yet, the law can do more than just protect personal integrity. Some authors suggest that a debt relief procedure should serve the purpose of rehabilitation of the debtor.[398] The process should arguably have an educational purpose. The law might provide optional or mandatory assistance to debtors to restore their self-worth[399]and to help them tackle financial issues.[400] In this regard, a debt relief procedure is considered to be a mechanism how to restore self-respect of the debtor and get rid of self-hatred that his future income stream has been effectively mortgaged.[401] Broadly speaking, it might be said that while the law

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[394] The dissenting opinion of Justice Steward, with whom three other justices joined, reflects a high moral appeal. The opinion reads as follows "*Yet the Court today denies that promise to those who need it most, to those who every day must live face-to-face with abject poverty -- who cannot spare even $ 1.28 a week. The Court today holds that Congress may say that some of the poor are too poor even to go bankrupt. I cannot agree*." See the US Supreme Court ruling in re *United States v. Kras* 409 U.S. 434, 457 (1973).

[395] NIEMI-KIESILAINEN, Johanna, RAMSAY, Iain, WHITFORD, William C. (eds.). *Consumer Bankruptcy in Global Perspective*. Oxford: Hart, 2003, p. 145. It seems that the way how to liquidate human capital would be to reinstate slavery. See WHITE, Michelle J. *Bankruptcy and Consumer Behavior: Theory and U.S. Evidence*. In BERTOLA, Giuseppe, DISNEY, Richard, GRANT, Charles (eds.). *The Economics of Consumer Credit Demand and Supply.* Cambridge: MIT Press, 2006, p.243.

[396] "*When a person assigns future wages, he, in effect, pledges his future earning power. The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much as, if not more than, it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern. From the viewpoint of the wage earner there is little difference between not earning at all and earning wholly for a creditor. Pauperism may be the necessary result of either*." See the US Supreme Court ruling in re *Local Loan Company v. Hunt* 292 U.S. 234, 244 (1934).

[397] In this context, a debt relief procedure might be even justified from the perspective of human rights. See e.g. ONDERSMA, Chrystin. A Human Rights Framework for Debt Relief. *University of Pennsylvania Journal of International Law*, 2014, vol. 36, no. 1, pp. 269-351.

[398] HOWARD, Margaret. A Theory of Discharge in Consumer Bankruptcy. *Ohio State Law Journal*, 1987, vol. 48, no. 4, pp. 1059-1060.

[399] TABB, Charles J. Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate. *George Washington Law Review*, 1990, vol. 59, no. 1, p. 95.

[400] HOWARD, Margaret. A Theory of Discharge in Consumer Bankruptcy. *Ohio State Law Journal*, 1987, vol. 48, no. 4, p. 1060. Niall Ferguson analysed many surveys and presented the conclusions in FERGUSON, Niall. *The Ascent of Money: A Financial History of the World*. New York: Penguin Press, 2008, pp. 11-12.

[401] KRONMAN, Anthony T. Paternalism and the Law of Contract. *The Yale Law Journal*, 1983, vol. 92, no. 5, pp. 785-786.

and economics approach seeks to justify the fresh-start policy on the basis of the debtor' inclusion to the economy, the approach based on humanity aims at the debtor's inclusion to the society as a rehabilitated person. [402] However, the fact that rehabilitation is proposed to be one of the goals of bankruptcy law does not imply that the law approves indebtedness. Unlike criminal activity which the law usually seeks to eliminate at all, the law generally does not want and cannot intend to forbid assumption of debts.[403]

It must be also borne in mind that the over-indebtedness of individuals is not only caused by irresponsible debtors who presumably uncontrollably and arbitrarily borrow with no limits.[404] The responsibility is in many cases shared together with questionable lending practices of credit providers. Arguably, such lenders must also bear their share of risk and responsibility.[405] This concept might be based on the notion of "collective responsibility" which implies a sort of generalization. However, even if it is assumed that generalization can be made and collective responsibility is appropriate one reservation should be made. Not all classes of creditors might be blamed. Distinction between consensual and non-consensual creditors is, again, of utmost importance. Moreover, huge differences might exist even among consensual creditors. There might be some aversion against consumer credit lenders or bankers. However, intuition indicate that a small trade creditor (be it a carpenter

[402] Arguably, the US Supreme Court quoted rehabilitation as one of the aims of bankruptcy law. See PORTER, Katherine; THORNE, Deborah. The Failure of Bankruptcy's Fresh Start. *Cornell Law Review*, 2006, vol. 92, p. 72 referring to the US Supreme Court ruling in re *Local Loan Co. v. Hunt*, 294 U.S. 234, 244 (1934): "*One of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes*." Margaret Howard, who has explicated multiple ways in which a debt relief procedure could rehabilitate consumer debtors, observes that rehabilitation encompasses at least three goals: consumer financial education of the debtor, emotional and psychological relief from financial failure, and renewed participation in the open-credit economy. See HOWARD, Margaret. A Theory of Discharge in Consumer Bankruptcy. *Ohio State Law Journal*, 1987, vol. 48, no. 4, p. 1060.

[403] GROSS, Karen. *Failure and Forgiveness: Rebalancing the Bankruptcy System*. New Haven: Yale University Press, 1997, p. 99.

[404] See WILHELMSSON, Thomas. "Social Force Majeure": A New Concept in Nordic Consumer Law. *Journal of Consumer Policy*, 1990, vol. 13, no. 1, p. 8.

[405] Jason Kilborn points out that lenders' practices lead to irresponsible borrowings. See KILBORN, Jason J. La Responsabilisation De L'Economie: What the United States Can Learn from the New French Law on Consumer Overindebtedness. *Michigan Journal of International Law*, 2005, vol. 26, p. 669-671. See also KILBORN, Jason J. *Two Decades, Three Key Questions, and Evolving Answers in European Consumer Insolvency law: Responsibility, Discretion and Sacrifice*. In NIEMI, Johanna, RAMSAY, Iain, WHITFORD William C. (eds.). *Consumer Credit, Debt and Bankruptcy: Comparative and International Perspectives*. Oxford: Hart Publishing, 2009, p. 311. Jason Kilborn attributes the evolution of the European consumer insolvency law to the acknowledgement of the responsibility of lenders for consumer bankruptcies.

or an accountant assisting a debtor) is innocent as concerns the over-indebtedness of individuals.[406]

Another rationale behind a debt relief procedure lies in the application of the principles of social welfare state which have been largely embodied in the public policy in Continental Europe. The idea of social safety net is based on solidarity among people. In this respect we might perceive bankruptcy law or more precisely the fresh-start policy as one of the possible substitutes of social welfare state.[407] Whereas economic rationales behind the fresh-start policy are rather linked to the liberal paradigm anticipating that the policy should serve its market function and generally enable exit from the economy, the welfare paradigm seeks to focus on the protection of citizens in connection with the risks posed by natural disasters, economic misfortunes and other causes. Debtors are protected from creditors and their burdens are relieved either after the sale of their assets or after a certain specified period of time. If their debts were not relieved, social safety net would be presumably more burdened. Due to the lack of incentives, indebted individuals would be perhaps more dependent on state support.

Some scholars suggest that a debt relief might be possibly substantiated on the ground of impossibility, impracticability, duress or similar legal concepts.[408] The mentioned notions are associated with the risk allocation and the problem of incomplete contracts.[409] In the ideal world with zero transaction costs of bargaining, contracts would contemplate every possible contingency (including allocation of risks in connection with bankruptcy). However, our world is far from being ideal and to negotiate terms about how to deal with bankruptcy is not only in most cases inefficient but also practically impossible. Accordingly, default rules serve as guidance on how to deal with different sort of situations. Before considering whether such doctrines might be applicable, one major objection should be raised. Not only contract-based creditors file their claims; non-consensual creditors such as tort victims or creditors

[406] See chapter 2.2 *supra*.

[407] See VIIMSALU, Signe. *The Over-Indebtedness Regulatory System in the Light of the Changing Economic Landscape* [online]. Juridica International [cited 3 March 2017]. Available on <http://www.juridicainternational.eu/public/pdf/ji_2010_1_217.pdf>, pp. 218-220.

[408] See e.g. JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, p. 1406 referring to COUNTRYMAN, Vern. Improvident Credit Extension: A New Legal Concept Aborning. *Maine Law Review*, 1975, vol. 27, no. 1, pp. 9 -10. See also WEISTART, John C. The Costs of Bankruptcy. *Law and Contemporary Problems*, 1977, vol. 41, no. 4, pp. 111-112. John Weistart points out that the law has been liberalizing grounds for discharge of obligations and further asks whether unpredictable events such as illness would perhaps satisfy the threshold for the discharge of obligations.

[409] See COOTER, Robert, ULEN, Thomas. *Law and Economics.* 4th edition. Boston: Pearson, 2004, p. 275.

with statutory claims, such as tax-related claims, might be affected by the bankruptcy too. In order words, impossibility or other concepts are doctrines of contract law so that it is questionable to extend them outside their reach. [410]

3.4 Negative effects of a debt relief procedure

The fresh-start policy implying a debt relief brings about potentially significant positive effects. Yet, if a debt relief procedure is to be labelled as a medicine for symptoms caused by the debtor's indebtedness, it is not the medicine without any side-effects. Legislature must certainly consider not only its advantages but also its negative effects. Main drawbacks include potentially reduced collection and satisfaction of claims, erosion of debtors' responsibility, moral hazard problem, risks of debtors' fraud and limited availability of credit. These countervailing factors cannot be separated from each other and to a certain extent overlap. Apart from examining these downsides, the dissertation also briefly outlines measures which may help to cope with the drawbacks.

3.4.1 Reduced satisfaction of claims

A debtor's failure to satisfy the creditor's claims certainly indicates that something is going wrong. Bankruptcy clearly makes these concerns well-grounded, whereas a debt relief procedure translates them into certain losses. Depending on the degree of indebtedness, it is more or less obvious at what stage the worries become legitimate. In many cases a chance of repayment is little if not null.[411] Also, sometimes the costs to pursue one's claim might be even higher than subsequent gains.[412] A debtor might be unable to work and have no assets left. One might actually think of various desperate scenarios when debts are uncollectible.[413] In such situations, the worries are legitimate even prior to a debt relief, and the fresh-start

[410] Also, it has been argued that the mentioned concepts serve as contractual defences that should be employed on the base of case-by-case analysis and could not generally operate so broadly unless some systematic weaknesses of human beings towards assessment of uncertainties are showed. JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, p. 1406. See also chapter 3.2 *supra*.

[411] BAIRD, Douglas G. *The Elements of Bankruptcy.* 5th edition. New York: Foundation Press, 2010, p. 30.

[412] See chapter 3.1.2 *supra*.

[413] See WEISTART, John C. The Costs of Bankruptcy. *Law and Contemporary Problems*, 1977, vol. 41, no. 4, p. 110.

policy does not affect the relative factual value of the creditor's claims so that the impact of a debt relief procedure is rather limited.[414]

Still, there are situations when a debtor has either a non-negligible amount of assets left, or actual as well as potential future income stream. The crucial question is whether the debtor would be able to repay debts or at least a reasonable portion thereof outside of bankruptcy.[415] If the answer is in the affirmative, a debt relief procedure generally leads to reduced satisfaction of debts. Without any doubts, such implication is perceived negatively from the creditor's points of view as the relative value of the creditor's claims is changed to his detriment.

One of the solutions to minimise the abovementioned the problem might be to distinguish between the debtors who cannot repay their debts and those who are simply unwilling to do so. The law should not protect those debtors who simply try to hide behind the false premise that the fresh-start policy should help them to avoid their liabilities.[416] However, since the law prescribes general rules which cannot address all the peculiarities of individual cases, the implementation of the fresh-start policy always brings about the negative effect implying the reduced satisfaction of debts.

3.4.2 Erosion of debtors' responsibility and moral hazard

Debts ought to be repaid. This maxim has been enshrined in laws for centuries. The law should arguably promote the idea of the solemnity of keeping promises and morality of repayment.[417] After all, breaking a promise has some ethical[418] as well as societal

[414] In this respect, it is *ex post* effect that is limited. It does not mean that *ex ante* effect is limited as well.

[415] The possibility of repayment of a significant amount of debts might be taken into account with respect to decisions regarding whether to opt for a sale of debtor's assets or repayment plan.

[416] It might be concluded that the fresh-start policy might play a role in sorting out situations when a repayment of debts is worth pursuing and when it simply does not pay off.

[417] Iain Ramsay for instance observes that the US Bankruptcy Review Commission feared that the current US Bankruptcy Code had actually encouraged defaulting. See RAMSAY, Iain. Consumer *Credit Society and Consumer Bankruptcy: Reflections on Credit Cards and Bankruptcy in the Informational Economy*. In NIEMI-KIESILAINEN, Johanna, RAMSAY, Iain, WHITFORD, William C. (eds.). *Consumer Bankruptcy in Global Perspective*. Oxford: Hart, 2003, p. 36.

[418] BOATRIGH, John R. *Ethics in Finance.* 2nd edition. Malden: Blackwell Publishing, 2008, p. 150.

dimension,[419] albeit the role has been probably minimizing. A debt relief procedure seems to undermine the solemnity of contractual obligations as it allows escaping from them.[420]

Outside of the insolvency law the debtor is not relieved from liability and is fully responsible for the repayment of his debts.[421] Once the debts have been wiped out by virtue of a discharge the debtor effectively bears fewer burdens. Therefore, it is asserted that a debt relief procedure might undermine responsibility of individuals.[422] Such claim is associated with the problem of moral hazard. In this respect, it might be reminded[423] that moral hazard implies a situation when an individual gets involved in risky activities whereas the costs thereof are not borne proportionately to the degree of the undertaken risks.[424] In practice, a debt relief procedure might theoretically encourage individuals in imprudent borrowing.[425] The same concern emerges in the context of businessmen. On the one hand, the availability of a debt relief encourages risk-taking and fosters entrepreneurship. On the other hand, the discharge might actually encourage individuals to carry out too risky activities.[426] In the absence of a possibility of having human capital freed up from liabilities, a person may tend to arrange his affairs more reasonably and prudently as to diminish the risks of indebtedness to a minimum.[427]

[419] McINTYRE, Lisa J. Sociological Perspective on Bankruptcy. *Indiana Law Review*, 1989, vol. 65, no. 1, p. 136.

[420] This negative effect is obviously linked to the ones mentioned above. Still, the purpose is to underline the principle of contract law.

[421] The Latin maxim "*pacta sunt servanda*" applies.

[422] It appears that the elimination of the moral hazard is behind the substantial revision of the US Bankruptcy Code by virtue of the so-called 2005 BAPCA that seeks to avoid the misuse of Chapter 7. See e.g. EISENBERG, Theodore. *Bankrutpcy and Debtor-Creditor Law. Cases and Materials.* 4th edition. New York: Foundation Press, 2011, p. 686.

[423] For further explanation see chapter 2.2 *supra* and the relevant literature cited therein.

[424] JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, p. 1402.

[425] WEISTART, John C. The Costs of Bankruptcy. *Law and Contemporary Problems*, 1977, vol. 41, no. 4, p. 110.

[426] CZARNETZKY, John M. The Individual and Failure: A Theory of the Bankruptcy Discharge. *Arizona State Law Journal,* 2000, vol. 32, no. 2, p. 414.

[427] BAIRD, Douglas G. A World without Bankruptcy. *Law and Contemporary Problems*, 1987, vol. 50, no. 2, p. 175.

The solution to the problem will be in greater details discussed below. At this point it suffices to say that the key to the problem arguably lies in the roots of the moral hazard – the costs. If discharge of debts is easily available, the problem is intensified and *vice versa*.[428]

3.4.3 Debtors' fraud

As mentioned above, taking into account that there is a possibility of debt relief, the debtor might be less prudent as concerns his business as well as other activities (including level of consumption). However, certain debtors might even tend to abuse the legal regime of a debt relief procedure and tend to *inter alia* conceal their assets or income, incur debts without having the intention of repaying them or get involved in other types of fraudulent conduct. Nevertheless, pursuant to the World Bank report, fraudulent behaviour is not common; some degree of risks is associated with all legal solutions and some risks should be accepted.[429]

In any case, one of the measures to mitigate the abovementioned risks is to implement proper criminal law. Also, the assessment of honest intentions of debtors might mitigate the countervailing factor.

3.4.4 Impact on the credit market

All creditors are to a certain degree affected by the bankruptcy of their debtors. With reference to the division of creditors to consensual and non-consensual, it is clear that only consensual creditors can in practice take bankruptcy of their debtors into account. Still, there seems to be differences even among consensual creditors.[430]

The class of creditors whose core business activity is to provide credit in various forms is presumably the most prone to take into account all the aspects of the applicable bankruptcy regime. Lending is their daily business and so is the possibility of defaults on their loans. Thus, lenders will be arguably more sensitive to the peculiarities of the bankruptcy law which will be in turn reflected in the availability of credit.[431] In this regard, the availability of credit

[428] Discharge of debts should be conditioned on reasonably stringent requirements. WEISTART, John C. The Costs of Bankruptcy. *Law and Contemporary Problems*, 1977, vol. 41, no. 4, p. 110.

[429] WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. …, pp. 42-43.

[430] See the discussion in EISENBERG, Theodore. Bankruptcy Law in Perspective. *UCLA Law Review*, 1981, vol. 28, no. 5, p. 983; and HOWARD, Margaret. A Theory of Discharge in Consumer Bankruptcy. *Ohio State Law Journal*, 1987, vol. 48, no. 4, p. 1064.

[431] Michelle White with other co-authors has undertaken several quantitative analyses regarding the availability of credit. One empirical study reveals e.g. that higher exemptions have an impact on the availability of credit.

might be discussed mainly in terms of its size, rate of denial of provision of credit and price in the form of an interest rate.

The overall risk assessment certainly takes into account a lot of variables.[432] It goes without saying that lenders seek to attract borrowers that are the least likely to default. Sophisticated techniques have been developed to cope with such evaluation.[433] However, to the extent that the lenders do not avoid the provision of the so-called bad debts which are not repaid, they incur losses.[434] The lenders who want to be profitable take these losses into account. Therefore, the losses will be arguably shifted to borrowers by virtue of an interest rate or other payments.[435] Given perfect market conditions, the costs of credit (i.e. mainly an interest rate) mirror the risk of default.[436]

In this connection, it must be noted that bad debts may have in its complexity inter-debtor effects. The borrowers who repay all their debts in effect bear the costs of the increased unavailability of credit since they pay all the costs (including the interest which has been presumably calculated on the basis of an average default rate).[437] Thus, good borrowers presumably subsidize bad borrowers.[438] Since a debt relief procedure possibly raises the interest rate, liberal debt relief laws lead to a sort of wealth-distribution.[439] Apart

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See GROPP, Reint, SCHOLZ, John K., WHITE, Michelle J. Personal Bankruptcy and Credit Supply and Demand. *The Quarterly Journal of Economics*, 1997, vol. 112, no. 1, p. 245. See also FAN, Wei, WHITE, Michelle J. Personal Bankruptcy and the Level of Entrepreneurial Activity. *Journal of Law and Economics*, 2003, vol. 46, no. 2, pp. 543-567.

[432] A crucial factor is whether a loan is provided on a secured or an unsecured basis. There is a great deal of literature on the function of a security interest. For instance Thomas Jackson and Antony Kronman consider security interest among others as a solution to the problem of policing. JACKSON, Thomas H., KRONMAN, Anthony T. Secured Financing and Priorities among Creditors. *The Yale Law Journal*, 1979, vol. 88, no. 6, pp. 1150-1153.

[433] See chapters 2.2 and 2.3 *supra*.

[434] MECKLING, William H. Financial Markets, Default, and Bankruptcy: The Role of the State. *Law and Contemporary Problems*, 1977, vol. 41, no. 4, pp. 23-24.

[435] Consequently, it will be reflected in the overall access to the credit. *Idem*, p. 27.

[436] HYNES, Richard M., POSNER, Eric A. The Law and Economics of Consumer Finance. *American Law and Economics Review*, 2002, vol. 4, no. 1, p. 170. See also JACKSON, Thomas H., KRONMAN, Anthony T. Secured Financing and Priorities among Creditors. *The Yale Law Journal*, 1979, vol. 88, no. 6, p. 1149.

[437] The so-called "good debtors" paid the costs in the form of the interest rate for the increased risk they have actually managed. On the contrary, debtors who defaulted actually contributed to the rise of the interest rate. See e.g. EISENBERG, Theodore. Bankruptcy Law in Perspective. *UCLA Law Review*, 1981, vol. 28, no. 5, p. 983.

[438] *Idem*. See also HOWARD, Margaret. A Theory of Discharge in Consumer Bankruptcy. *Ohio State Law Journal*, 1987, vol. 48, no. 4, p. 1066.

[439] The ground for such redistribution of wealth is curious as pointed out by Richard Posner. POSNER, Richard A. *Economic Analysis of Law*. 7th edition. New York: Aspen Publishers, 2007, p. 436.

from that, short-time redistribution from creditors to debtors can be assumed in case of unexpected changes in law.[440]

When it comes to personal bankruptcy, lenders mainly consider the availability and the scope of a debt relief. On the scale from the most lenient to the most stringent regimes of debt relief laws, the regimes that would be located at both ends of such scale would lead to the least number of debt reliefs.[441] On the one hand, if the law sets forth harsh conditions, hardly anybody would comply with them. Thus, a debt relief would be granted only exceptionally and one cannot help thinking that a debt relief procedure would become essentially meaningless. On the other hand, freely available discharge would largely contribute to the unavailability of credit.[442] Lenders would be arguably reluctant to extend credit and thus there would be fewer debts to be discharged.[443] Anyway, in case of genuine inability to fulfil a promise to repay a debt, bankruptcy procedure which allows some adjustment may provide "*valuable consumption-smoothing opportunities*."[444] The real problem occurs in the situation when the fresh-start policy is abused.

The solution to the problem lies in a reasonable and balanced implementation of discharge of debts laws. What is decisive is the overall "price" for a debt relief.[445] The price implies the burdens in a broad sense which the debtor must bear or other limitations which the debtor must face as a result of a debt relief procedure (debt relief order). In this connection, two basic "burdens" which serve as the so-called "price" of discharge of debts exist: a surrender of non-exempt assets (i.e. sale of debtor's assets) and repayment of debts over a period of time (repayment plan).[446] These methods may be used either separately

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[440] *Idem*. It follows that changes in bankruptcy law should be discussed publicly and the time should be granted to creditors to adjust their interest rates. Redistribution from creditors to debtors might occur *inter alia* in case of the adoption of the 2018 Draft Amendment since so far creditors expected at least 30 % of satisfaction of all unsecured claims in discharge of debts.

[441] See graphical illustration of the curve and explanation in MOSS, David A., JOHNSON, Gibbs A. Rise of Consumer Bankruptcy: Evolution, Revolution, or Both. *American Bankruptcy Law Journal*, 1999, vol. 73, no. 2, pp. 344-345.

[442] See also argumentation elaborated on the basis of the game theory, more particularly on extensive form game, in BAIRD, Douglas, GERNTNER, Robert, PICKER, Randal. *Game Theory and the Law.* 1st edition. Cambridge: Harvard University Press, 1994, pp. 53-58

[443] BERTOLA, Giuseppe, DISNEY, Richard, GRANT, Charles (eds.). *The Economics of Consumer Credit Demand and Supply.* Cambridge: MIT Press, 2006, p. 19.

[444] *Idem*.

[445] JACKSON, Thomas H. The Fresh-Start Policy in Bankruptcy Law. *Harvard Law Review*, 1985, vol. 98, no. 7, p. 1428.

[446] *Idem*.

or in a combination. Moreover, other aspects such as future implications of a discharge in private life such as credit rating[447] or possibility to engage in business activities also matter.

It follows that in order to diminish the effects of a debt relief procedure on the credit market the discharge should not be overly generous towards debtors. Otherwise, lenders might be less willing to extend credit and more prone to raise their interest rate. Accordingly, the credit would be less available.

[447] *Idem*.

4 Commencement of insolvency proceedings and discharge of debts

4.1 Preconditions for commencement of insolvency proceedings and insolvency petition

Under the Czech IA insolvency proceedings can be initiated either by a debtor or by any of his creditors. Therefore, insolvency proceedings cannot be initiated from the initiative of courts or other public authorities (unless such authorities have their claims towards the debtor).[448] In practice, the overwhelming majority of insolvency proceedings are initiated by debtors – this is particularly the case of insolvency proceedings when a motion for discharge of debts is filed. If statistics do not account for cases where a motion for discharge of debts is filed, the ratio of debtor's insolvency petitions has lowered from 62 % to about 39 % since 2008 until 2016.

Chart 1 – Statistics about insolvency petitions[449]

Period	IP	Debtor's IP	Debtor's IP / IP	IP excl. MDD	Debtor's IP excl. MDD	Debtor's IP excl. MDD / IP
2008	5,236	3,889	74.3 %	3,543	2,196	62.0 %
2009	9,396	7,382	78. 6%	5,663	3,649	64.4 %
2010	16,601	13,616	82. 0%	6,594	3,609	54.7 %
2011	24,466	21,549	88. 1%	6,446	3,529	54.7 %
2012	32,656	29,582	90. 6%	6,788	3,714	54.7 %
2013	37,613	33,840	90. 0%	7,287	3,514	48.2 %
2014	35,076	32,061	91. 4%	4,501	1,486	33.0 %
2015	32,334	29,864	92. 4%	3,756	1,286	34.2 %
2016	29,493	27,694	93. 9%	2,937	1,138	38.7 %
Total	**222,871**	**199,477**	**89. 5%**	**47,515**	**24,121**	**50.8 %**

*IP - insolvency petitions

**MDD - insolvency proceedings where a motion for discharge of debts is filed

[448] See section 97(5) of the Czech IA.

[449] See statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information.

Czech law neither requires debtors to undertake any proceedings prior to the commencement of insolvency proceedings, nor does it regulate such proceedings. However, it does not prevent debtors from engaging in out-of-court negotiations which are, however, rather rare. Nevertheless, it is not rare that court enforcement of decisions [in Czech: *výkon rozhodnutí*] or distrait [in Czech: *exekuce*][450] take place prior to the commencement of insolvency proceedings.[451]

Under the Czech IA two forms of insolvency exist - inability to meet one's obligations [in Czech: *platební neschopnost*] and over-indebtedness [in Czech: *předlužení*].[452] However, the latter applies solely to entrepreneurs or legal entities. In this regard, the debtor is unable to pay his debts if he has at least two creditors[453] and has (monetary) debts [in Czech: *peněžité závazky*] more than 30 days overdue which he is unable to satisfy vis-à-vis at least two such creditors.[454] Since it is generally difficult to prove that the debtor is unable to repay his debts, several revocable presumptions apply in order to facilitate the position of an insolvency petitioner. A debtor is deemed unable to pay his debts if (i) he is in default with payment of his debts for more than three months, (ii) he has suspended payments of a substantial portion of his debts,[455] (iii) it is not possible to satisfy some of creditor's claims against the debtor by means of a court enforcement of decisions, or (iv) the debtor fails to submit to the relevant court the requested lists of his assets, debts and employees.[456] From creditors' perspective, it appears that the first revocable presumption is the most relevant and the least

[450] Enforcement proceedings pursuant to the Czech Civil Procedural Code and distrait pursuant to the Act on Distrait have similar effects. Therefore, the dissertation does not specifically distinguish between these proceedings unless it is required under specific conditions of these proceedings.

[451] Please note that entrepreneurs as well as legal entities are obliged to commence insolvency proceedings if they are insolvent.

[452] Section 3 of the Czech IA. This thesis, however, does not seek to comprehensively assess the definition of insolvency under the Czech law.

[453] Both forms of insolvency share that a debtor must have at least two creditors. Since creditors used to artificially create a plurality of creditors by virtue of an assignment of claims or parts thereof, section 143(2) of the Czech IA sets forth six-month test in case of assignments of a claim. More specifically, for the purpose of the assessment of the plurality of creditors, the court shall disregard the creditor to whom an insolvency petitioner has assigned his claim or a part thereof in the last six month prior to the commencement of the insolvency proceedings or during the respective insolvency proceedings.

[454] The 2017 Amendment shall amend the definition of inability to repay debts by virtue of the notion of the liquidity gap.

[455] It may be noted that the suspension of payments does not occur in all cases of failures to pay. Pursuant to the relevant case-law, the suspension should be done intentionally whereas it is commonly associated with a declaration to this effect. See e.g. the Supreme Court ruling no. 29 NSČR 24/2013 (MSPH 76 INS 2762/2011) of 3 April 2015.

[456] See section 3(1) and section 3(2) of the Czech IA.

disputed.[457] It is, however, important to distinguish the inability to pay own debts and unwillingness to repay debts. In this regard, a debtor might prove that he simply contests the respective claim of a creditor.[458]

A debtor is over-indebted if he has at least two creditors and his total liabilities [in Czech: *závazky*] exceed the value of his assets (taking into account the administration of the debtor's assets and/or further operation of his business if he is likely that the debtor will be able to further administer his assets and/or conduct his business).[459] There is, however, no clear guidance as how to calculate the value of the debtor's assets. Therefore, it may be rather difficult to determine whether the debtor meets the criterion of over-indebtedness and the views of the debtor and his creditors may vary in this regard. As it is mentioned above, over-indebtedness as a form of insolvency applies solely in case of entrepreneurs and legal entities. Thus, it does not apply to individuals who are not considered to be entrepreneurs.

Moreover, the debtor may also file an insolvency petition in case of imminent insolvency [in Czech: *hrozící úpadek*], i.e. if it may be reasonably expected with regard to all circumstances that the debtor will not be able to perform a substantial part of his debts duly and on time.[460] Creditors may not file an insolvency petition in the case of imminent insolvency.

Insolvency petitions are to be filed to the regional court with the jurisdiction over the area of the general court of a debtor (i.e. district court of residence of a debtor or seat of a debtor).[461] Insolvency petition should be signed with authorisation[462] unless it is sent

[457] Once the presumption is established, the burden of proof that the debtor is not insolvent is upon the debtor. In this regard, the debtor must generally evidence that it can satisfy all the due debts which have been evidenced. See the Czech Supreme Court ruling no. 29 NSČR 38/2010-A-62 (MSPH 88 INS 7327/2009) of 3 January 2012 or 29 NSČR 24/2013-A-175 (MSPH 76 INS 2762/2011) of 30 April 2015.

[458] The Czech Supreme court has noted that an insolvency petition should be dismissed in case that a creditor may enforce his claims by virtue of individual means, i.e. in enforcement proceedings. See e.g. the Czech Supreme Court ruling no. 29 NSČR 113/2013-A-68 (MSPH 88 INS 4881/2012) of 12 December 2013. Such decision is, however, subject to criticism for various reasons.

[459] Section 3(3) of the Czech IA.

[460] Section 3(4) of the Czech IA.

[461] Section 7 and 7b of the Czech IA.The Czech IA does not generally prevent creditors (or a debtor, if applicable) from filing another insolvency petition once one insolvency petition has been already filed until the court has effectively decided upon the submitted insolvency petition. Such petitioner should accept the current status of the insolvency proceedings and the insolvency petition is joined to the pending insolvency proceedings. See particularly section 107 of the Czech IA. The effects of the additional insolvency petition and the position of the additional insolvency petitioner are dependent on the stage of the pending insolvency proceedings.

[462] Sections 97(2) and (3) of the Czech IA.

by e-mail with authorized electronic signature or via a data box [in Czech: *datová schránka*].[463] In case a debtor is represented, the respective power of attorney should be also signed with authorisation. If the requirement of authorised signature is not met, the insolvency petition is disregarded and the submission of the insolvency petition has no effects.[464]

Pursuant to section 103 of the Czech IA, an insolvency petition must identify the debtor, the petitioner or his representative. The insolvency petition must also include information attesting the debtor's (imminent) insolvency.[465] The petitioner should accompany his petition also with the respective documentary evidence.[466]

If an insolvency petition is filed by a debtor, the debtor is also obliged to attach to the insolvency petition several attachments, mainly a list of his assets [in Czech: *seznam majetku*] (including receivables), a list of his debts [in Czech: *seznam závazků*], and a list of his employees [in Czech: *seznam zaměstnanců*]. If the debtor does not have any employees or any debtors, the list should contain an explicit declaration to this effect. The lists must be signed by the debtor together with the confirmation that they are correct and complete. If an insolvency petition is filed by a creditor, the creditor must also attach to the insolvency petition a lodgement of his claim [in Czech: *přihláška pohledávky*].[467]

According to section 57(8) of the Act no. 549/1991 Coll., on Court Fees, as amended, the state fee for filing the insolvency petition by a creditor is CZK 2,000. The debtor's insolvency petition is not subject to any court fees. Also, pursuant to section 108 of the Czech IA, an insolvency petitioner may be required to deposit an amount of money specified

[463] Pursuant to sections 80a and 97(4) of the Czech IA as amended by the 2017 Amendment, persons who have mandatorily established a data box should avail thereof in communication with courts. Alternatively, such persons might use an e-mail with authorized electronic signature. If such requirement is not complied with, the court shall disregard the respective insolvency petition. Similarly, pursuant to section 97(5) of the Czech IA as amended by the 2017 Amendment, if an insolvency petition filed together with a motion for discharge of debts is not signed by eligible person within the meaning of Section 390a, it shall be disregarded (see chapter 4.3.2 *infra*).

[464] See e.g. the Czech Supreme Court ruling no. 29 NSČR 51/2011-B-73 (MSPH 59 INS 13320/2010) of 27 September 2011.

[465] Czech courts interpret the provisions of the Czech IA rather strictly as they require both debtors as well as creditors to state precise information about the debtor's insolvency. Thus, in case of inability to repay debts, it is necessary to identify at least two unpaid debts precisely (essentially by identification of the amount, legal basis, creditor and due date). See *inter alia* the Czech Supreme Court ruling no. 29 NSČR 14/2011-A-20 (MSPH 88 INS 14537/2010) of 21 December 2011.

[466] However, attachments are not part of the insolvency petition, which implies that in case the insolvency petition does not contain the required information, the court might reject the insolvency petition regardless of the fact that the information is contained in the attachment. See e.g. the Czech Supreme Court ruling case no. 29 NSČR 7/2008-A-16 (KSBR 31 INS 1583/2008) of 26 February 2009.

[467] Creditor's ownership of a claim is a precondition for the eligibility to file an insolvency petition.

by a court in order to cover the costs of the insolvency proceedings if the costs cannot be covered otherwise. The maximum amount of such deposit is CZK 50,000. Courts usually require such deposit if it is obvious that the debtor does not have enough money deposited in his bank account. The deposit sum may be reimbursed from the insolvency estate if paid by a creditor.[468]

Nevertheless, the court shall not require any deposit sum if the court may decide on a discharge of debts order together with the insolvency order.[469] Therefore, in the case that the debtor files a motion for discharge of debts, no deposit sum is required if the motion is to be approved. This provision has been put forth specifically in order to prevent the courts from imposing additional monetary obligations on the debtors who are already in financial difficulties.[470] However, since the moment of the discharge of debt order, the debtors are obliged to pay a deposit to cover the remuneration and lump sum costs of an insolvency trustee.[471]

It might be added that the 2017 Amendment sets forth new rules concerning the payment of deposits. A deposit shall be payable *inter alia* together with every insolvency petition of a creditor. In case of a debtor – natural persons, a deposit shall equal to CZK 10,000.[472] If the deposit is not paid together with the filing of an insolvency petition, the insolvency petition shall be rejected.[473]

[468] Section108 of the Czech IA.

[469] Initially, the Czech IA did not provide for such provision and there has been discrepancy among the courts in setting the amount of deposit.

[470] See the explanatory notes to the Revision Amendment available on <http://www.psp.cz/sqw/historie.sqw?o=6&T=929>.

[471] See section 136(4) of the Czech IA.

[472] Section 108 of the Czech IA as amended by the 2017 Amendment.

[473] Section 128a(2)(d) of the Czech IA as amended by the 2017 Amendment.

4.2 Commencement of insolvency proceedings and its effects

Insolvency proceedings are commenced upon the entitled person filing an insolvency petition to the relevant court pursuant to section 97(1) of the Czech IA. In this connection, it is important to note that the individuals who are not engaged in business have no obligation to file for bankruptcy. Solely legal entities and entrepreneurs have such obligation.[474]

Upon the submission of an insolvency petition to a court, the court shall publish information about the commencement of the insolvency proceedings in the publicly available insolvency register. The court is obliged to publish the information two hours after the submission of an insolvency petition unless it is filed less than within two hours prior to the end of working hours.[475] The insolvency register contains practically all important information about insolvency proceedings.[476] Therefore, in practice anybody can follow insolvency proceedings online which naturally might lead to an abuse of the insolvency proceedings. Although a potential of the abuse of publicity of insolvency proceedings concerns all individuals, the threat might loom larger on entrepreneurs since it might have a considerable impact on their business activities.[477]

As outlined above, due to the publicity of the insolvency proceedings in the Czech Republic, the commencement of the insolvency proceedings trigger implications of both legal as well as other nature. From a legal perspective, the most substantial effects of the commencement of insolvency proceedings in respect of a debtor are the following: (i) the debtor's creditors may not seek their claims or other rights concerning the insolvency estate by a legal action [in Czech: *žaloba*] if they can lodge their claims in the insolvency proceedings by means of a lodgement of claims; (ii) a security interest relating to the assets owned by the debtor or other assets belonging to the insolvency estate may be created or realised [in Czech: *uplatnit*] only pursuant to statutory conditions of the Czech IA;[478]

[474] Section 98(1) of the Czech IA. In case of a failure to file an insolvency petition, the debtors might be liable for damage caused by such failure. See particularly sections 99 and 100 of the Czech IA.

[475] Section 101 of the Czech IA. The 2017 Amendment substantially modifies these rules.

[476] Section 419 *et seq.* of the Czech IA.

[477] See e.g. SPRINZ, Petr. Nelegitimní zahájení insolvenčního řízení: problémy, možnosti obrany a legislativní reakce. *Obchodní právo*, 2013, no. 3, pp. 90-97.

[478] In this connection, pursuant to the case-law it appears that the security interest cannot be effectively created even if the security agreement is agreed upon and the motion to register the security interest is filed to the cadastral registry prior to the commencement of the insolvency proceedings if the respective cadastral office decides upon the security interest after the commencement of the insolvency proceedings. See e.g. the Supreme Court ruling no. 29 NSČR 16/2011-P8-23 (KSPH 39 INS 4718/2009) of 30 November 2011

(iii) court enforcement of decisions that would affect the assets owned by the debtor or other assets belonging to the insolvency estate may be ordered, but may not be generally performed; and (iv) the debtor is generally prohibited from making disposals of the insolvency estate and assets which may belong to it if such disposals might substantially change structure, use or determination of such assets or if it might cause a non-negligible reduction of such assets.[479] Moreover, as concerns the disposal of the debtor' assets, the relevant court is entitled to order protective measures to secure the property of the debtor before it issues its decision on the debtor's insolvency.[480]

In case of entrepreneurs, no later than within seven days (in case of an insolvency petition filed by the debtor) or 15 days (in case of an insolvency petition filed by the debtor's creditor) following the filing of the insolvency petition, the debtor may file a petition for a moratorium with the court. However, the written consent of the majority of his creditors (counted on the basis of the amount of claims of the respective creditors) must be attached to such petition for a moratorium. The court may declare a moratorium for the duration of up to three months. The duration of the moratorium may be further prolonged by the court upon the debtor's request with the updated list of obligations and with the written consent of the majority of his creditors (counted on the basis of the amount of claims of the respective creditors) for another 30 days.[481] The court may not issue a decision declaring the debtor's insolvency during the moratorium. In practice, it appears that the filing of a petition for a moratorium is not common among the entrepreneurs.[482]

Pursuant to section 134 of the Czech IA, the court is obliged to take the steps leading to the decision on insolvency of a debtor within 10 days after the submission of the insolvency petition. In case the insolvency petition is submitted by a debtor, the court is obliged to decide on the petition 15 days after the submission thereof at the latest. In practice, however, it appears that the courts are overloaded and they do not manage to meet the deadline set forth by the Czech IA. In this regard, it is important to note that a failure

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and SPRINZ, Petr. Zřízení (soudcovského) zástavního práva po zahájení insolvenčního řízení. *Právní fórum*, 2012, no. 8, pp. 345-349.

[479] Sections 109 and 111 of the Czech IA.

[480] Section 113 of the Czech IA.

[481] See sections 115-127 of the Czech IA.

[482] On the basis of the internal database of Havel, Holásek & Partners, attorneys-in-law, in 2015 solely one petition for moratorium was filed by an individual whereas only 4 moratoria were declared (all of them with respect to legal entities).

to make the decisions within the respective periods does not mean that the courts cannot decide on the insolvency of debtors.[483]

4.3 Motion for discharge of debts

4.3.1 Current legal framework of a motion for discharge of debts

At the outset, it must be noted that the decision-making process related to discharge of debts proceedings has several stages. First, the court issues an insolvency order which it often issues together with a discharge of debts order. However, the court does not necessarily have to issue such rulings concurrently. In a discharge of debts order, the court decides as a preliminary question whether a debtor is eligible for discharge of debts (i.e. whether he fulfils all preconditions). Further to a discharge of debts order, the court finally decides whether to approve discharge of debts and which form it shall take pursuant to creditors' decision (if there is any) by virtue of a discharge of debts confirmation. Discharge of debts confirmation essentially marks the commencement of a repayment plan (if there is any) or the commencement of the distribution process in case of sale of debtor's assets.

Only a debtor is entitled to commence discharge of debts proceedings. Pursuant to section 390 of the Czech IA, if a debtor files an insolvency petition, a motion for discharge of debts must be filed simultaneously with the insolvency petition. If an insolvency petition is filed by a creditor, the debtor must file a motion for discharge of debts within 30 days from (i) the date when the creditor's insolvency petition is delivered to the debtor and concurrently (ii) the date when the debtor is informed about the possibility to file a motion for discharge of debts.[484] If a motion for discharge of debts is filed after the respective deadline, it shall be rejected by a court and the only possible method of resolution of the debtor's insolvency shall be liquidation.

Pursuant to the available data (see chart 2 below), the overwhelming majority of motions of discharge of debts are filed together with an insolvency petition. In average, only about 0.5 % of total number of motions for discharge of debts is filed after the submission of an insolvency petition. Therefore, discharge of debts (insolvency proceedings) is commenced generally upon the debtor's initiative. Although it is the debtor

[483] See e.g. the Czech Supreme Court ruling no. 29 NSČR 22/2009-A-21 (KSPL 27 INS 1784/2009) of 20 May 2010.

[484] Section 390(1) of the Czech IA. See also e.g. the Supreme Court ruling no. 29 NSČR 39/2012-B-27 (KSPL 27 INS 5504/2011) of 26 June 2012.

who triggers insolvency proceedings, it is not possible to infer whether there were any other court or enforcement proceedings against the debtor prior to the commencement of the insolvency proceedings.

Chart 2: Statistics about motions for discharge of debts[485]

Period	Total number of MDD	Number of MDD filed together with IP	Number of MDD filed after submission of IP	MDD filed together with IP / number of MDD
2008	1,693	1,687	6	99.6 %
2009	3,733	3,722	11	99.7 %
2010	10,007	9,976	31	99.7 %
2011	18,020	17,933	87	99.5 %
2012	25,868	25,785	83	99.7 %
2013	30,326	30,159	167	99.4 %
2014	30,575	30,369	206	99.3 %
2015	28,578	28,421	157	99.5 %
2016	26,556	26,442	114	99.6 %
Total	**175,356**	**174,494**	**862**	**99.5 %**

*IP - insolvency petitions

**MDD - motions for discharge of debts

If a court omits to inform the debtor about the possibility to resolve his insolvency by virtue of discharge of debts, the period to file a motion for discharge of debts does not commence to lapse. However, once the court decides on liquidation and such decision is in force, the debtor cannot any more file a motion for discharge of debts.[486] In other words, if a debtor omits to file an appeal against a liquidation order, discharge of debts is no longer possible regardless of previous court's failure to inform the debtor about his right to file a motion for discharge of debts.

Pursuant to section 391 of the Czech IA, a motion for discharge of debts should be filed in a form prescribed by the Ministry of Justice of the Czech Republic. It requires the debtor to submit a set of information such as the information about the anticipated income in the upcoming five years, income in the preceding three years and suggested method of discharge of debts (sale of debtor's assets or repayment plan). The motion for discharge

[485] Source of data: statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information.

[486] See the Supreme Court ruling no. 29 NSČR 5/2014-B-37 (MSPH 98 INS 7422/2012) of 30 January 2014.

of debts should be accompanied mainly by a list of assets and debts[487] and documents proving past income. Moreover, if any creditor consents to lesser satisfaction of his claims,[488] a written submission of such creditor shall be accompanied to a motion for discharge of debts pursuant to section 392(1)(c) of the Czech IA.

Generally, the purpose of a motion for discharge of debts (including the respective attachments) is to provide the court with the basis to assess whether the debtor is eligible for discharge of debts. Also, it should serve as the basis for creditors to assess what method of discharge of debts is more appropriate.[489] Yet, certain requirements are commonly rather unreliable. The debtor is hardly able to predict his income in the upcoming 5-year period. Anecdotal experience suggests that debtors often change their workplace or lose their jobs. Therefore, estimations of income may have the same value as forecasting future from a crystal ball.

If a motion for discharge of debts does not contain all necessary information or if it is incomprehensible or uncertain, a court cannot reject it immediately like in case of flaws of an insolvency petition.[490] In such a scenario, the court shall request the debtor to amend the motion for discharge of debts or to modify it within 7 days whereas it shall inform him what he should do to rectify the flaw of the motion. The court proceeds in the same way if the debtor does not attach all the necessary annexes or if the annexes do not fulfill all the statutory requirements.[491] If the debtor does not comply with the request to amend or otherwise modify the motion for discharge of debts and the court may not continue despite such defects, or if the annexes have not been modified pursuant to the request or if they do not contain all the statutory requirements, the court shall reject the motion for discharge of debts.[492] In practice, however, courts commonly provide debtors with a longer period, or they are rather reluctant to reject the motion immediately.[493]

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[487] As mentioned above in chapter 4.1 *supra*, the lists should include the confirmation of the debtor that they are complete and correct. The list of assets thus cannot be *inter alia* replaced by the proclamation that an enforcement office holder has liquidated all the assets of the debtor. See e.g. the Supreme Court ruling case no. 29 NSČR 13/2009-B-36 (KSPL 29 INS 252/2008) of 31 March 2011.

[488] See chapter 5.5.5 *supra*.

[489] See e.g. the Supreme Court ruling case no. 29 NSČR 16/2010-B-45 (KSUL 44 INS 411/2009) of 26 October 2010.

[490] See sections 128 and 393 of the Czech IA.

[491] See section 393(2) of the Czech IA.

[492] Section 393(3) of the Czech IA.

[493] See e.g. the Supreme Court ruling case no. 29 NSČR 16/2010-B-45 (KSUL 44 INS 411/2009) of 26 October 2010.

Nevertheless, if a debtor does not provide the court with the respective list of debts, the court cannot make any conclusions as to the question whether the debtor is eligible for discharge of debts in terms of (business-related) nature of his debts. Therefore, the court should request the debtor to submit the list prior to taking any negative decision regarding eligibility of the debtor.[494]

If a court rejects a motion for discharge of debts, the court shall issue a liquidation order which does not contemplate any debt relief. In case of a rejection of a motion for discharge of debts, solely the petitioner (i.e. the debtor) might file an appeal. If a court issues a discharge of debts order and later finds that the respective motion for discharge of debts is flawed, the court is not precluded from dismissing the motion for discharge of debts. However, it should arguably consider whether the flaw is material so that it contravenes the purpose of the motion (i.e. assessment of whether preconditions for discharge of debts are met and which method of discharge of debts is more appropriate).[495]

If neither an insolvency petition nor a motion for discharge of debts complies with requirements set forth by the Czech IA, the flaws of the insolvency petition "prevail" in the sense that they exclude the assessment of the admissibility of motion for discharge of debts. In other words, the court shall not decide on a motion for discharge of debts if an insolvency petition is flawed. It might seem to be a theoretical question, yet it has important implications for the debtor. If an insolvency petition is rejected, liquidation does not follow since the insolvency proceedings are terminated. In effect, the debtor is saved from having his assets being distributed to his creditors without any debt relief. Moreover, once a decision on rejection of an insolvency petition becomes effective and in force, the debtor might file another insolvency petition.[496]

Until a court issues a discharge of debts confirmation, a debtor may withdraw his motion for discharge of debts.[497] Later submission of a withdrawal of a motion for discharge of debts shall be disregarded.[498] Once a motion for discharge of debts is withdrawn, it cannot

[494] See the Supreme Court ruling case no. 29 NSČR 13/2009-B-36 (KSPL 29 INS 252/2008) of 31 March 2011.

[495] See e.g. the Supreme Court ruling case no. 29 NSČR 16/2010-B-45 (KSUL 44 INS 411/2009) of 26 October 2010.

[496] See e.g. the High Court in Prague ruling case no. 4 VSPH 608/2016-A-14 (KSPL 52 INS 28746/2015) of 26 April 2016.

[497] See section 394(1) of the Czech IA.

[498] Section 394(4) of the Czech IA.

be filed within the same insolvency proceedings again.[499] Thus, the court shall issue a liquidation order pursuant to section 396 of the Czech IA.

4.3.2 Proposed modifications concerning a motion for discharge of debts

One of the major changes anticipated by the 2017 Amendment is the introduction of conditions as to who may submit and draft a motion for discharge of debts on behalf of a debtor and what should be the remuneration for such services. As the respective explanatory notes set forth in more details,[500] the legislature seeks to address the abusive practices of numerous entities which propose to draft a motion for discharge of debts for excessive remuneration. The quality of such services has not always been high which has rendered some portion of motions for discharge of debts doomed to fail.

The 2017 Amendment sets forth that a limited scope of persons shall be eligible to draft and submit motions for discharge of debts (together with insolvency petitions, where applicable).[501] Such list shall include qualified attorneys, notaries, enforcement office holders [in Czech: *exekutoři*],[502] insolvency trustees[503] and legal entities which are holders of authorization granted by the Ministry of Justice of the Czech Republic.[504] A debtor himself shall be eligible to draft and submit a motion for discharge of debts if he has earned a master degree in legal or economic program or if he has passed an insolvency trustee exam, or in case of a debtor – legal entity, if a person acting on behalf of such legal entity has earned

[499] Section 394(3) of the Czech IA.

[500] The explanatory note is available on <http://www.psp.cz/sqw/text/tiskt.sqw?O=7&CT=785&CT1=0>.

[501] Such persons shall not be official representatives of debtors. Yet, they will be notified about the flaws of the respective motions. See section 393(1) of the Czech IA as amended by the 2017 Amendment.

[502] Yet, the enforcement office holder who holds proceedings against the debtor or her spouse cannot draft and submit a motion for discharge of debts on behalf of such debtor. See section 398(6) of the Czech IA as amended by the 2017 Amendment.

[503] Pursuant to sections 36b(1)(j) and 36b(4)(d) of the Insolvency Trustees Act as amended by the 2017 Amendment, an insolvency trustee may be sanctioned by a penalty in the amount up to CZK 1,000,000 if he repetitively causes that a motion for discharge of debts submitted by himself is rejected or dismissed. The author argues that insolvency trustees will not be probably motivated to draft and submit motions for discharge of debts given the disproportionate sanctions provided by law.

[504] Requirements to award such authorization are governed by section 418b *et seq.* of the Czech IA as amended by the 2017 Amendment. They *inter alia* include that a legal entity has the respective insurance contract coverage and a right to use the premises where services are to be rendered.

a master degree in legal or economic program or if he has passed an insolvency trustee exam.[505]

Moreover, the remuneration for drafting and submission of a motion for discharge of debts shall be limited to CZK 4,000 or CZK 6,000 in case of a motion of spouses (in both cases excluding VAT). Such remuneration shall also cover drafting and submission of an insolvency petition (where applicable), related services and meeting with a debtor. The corresponding claim for remuneration shall not be paid before the issuance of decision on such motion and shall have a status of a preferential claim which are on par with claims behind the insolvency estate [in Czech: *pohledávka postavená na roveň pohledávkám za majetkovou podstatou*]. However, unlike other preferential claims, such claim should be submitted within the deadline for submission of standard non-preferential claims.[506] The abovementioned remuneration cannot be claimed whatsoever by legal entities which are holders of authorization granted by the Ministry of Justice of the Czech Republic.[507]

It is true that that a non-negligible amount of debtors are probably subject to abusive conduct of different sort of providers of services. Yet, the whole concept suggested by the Ministry of Justice of the Czech Republic appears to limit the access to discharge of debts. As the available data indicate, considerable amount of insolvency petitions has been indeed rejected or dismissed (see chart 3 below). Nevertheless, the majority thereof have been successful.[508] The 2017 Amendment might discourage and/or burden debtors who would be otherwise able to file motions for discharge of debts or with the help of others.[509] Moreover, it is not clear why only legal entities (and not individuals) are entitled to obtain the authorization of the Ministry of Justice of the Czech Republic. Furthermore, the necessity to obtain the authorization and related requirements might exclude certain non-profitable organisations from the provision of services to the poorest. Overall, it remains to be seen

[505] See section 390a(1) and (2) of the Czech IA as amended by the 2017 Amendment. It is not clear how the fulfillment of the mentioned preconditions is assessed. Arguably, the respective debtor should ascertain that he is eligible to file the motion (insolvency petition) himself.

[506] Section 390a(3)-(5) of the Czech IA as amended by the 2017 Amendment.

[507] Section 390a(4) of the Czech IA as amended by the 2017 Amendment.

[508] See also chart 5 about discharge of debts orders in chapter 5.1.2 *infra* and graph 1 in chapter 4.4.2.1 *infra.*

[509] The Supreme Court commented that with reference to experience with other mandatory cases of legal representation by qualified attorneys, mandatory representation of debtors does not mean that the desired quality of services will be always achieved. See comments available on <https://apps.odok.cz/veklep-detail?p_p_id=material_WAR_odokkpl&p_p_lifecycle=0&p_p_state=normal&p_p_mode=view&p_p_col_id=column-1&p_p_col_count=3&_material_WAR_odokkpl_pid=RACK9WEJKB4S&tab=remarks>.

to what extent the 2017 Amendment shall bring about exclusionary effects, which was not the intention of the Ministry of Justice of the Czech Republic.

As regards a method of the submission of a motion for discharge of debts (and insolvency petition where applicable), pursuant to the 2017 Amendment, if it is submitted by notaries, qualified attorneys, insolvency trustees or authorized holders of licence, it should be sent by virtue of a data box or by an e-mail with authorized electronic signature.[510]

Chart 3: Statistics about decisions on debtor's insolvency petitions[511]

Period	IP	IO	IO / IP	Rejection of IP	Rejection of IP / IP	Dismissal of IP	Dismissal of IP / IP	SIP	SIP / IP
2008	3,889	1,111	28.5 %	949	24.4 %	545	14.0 %	333	8.6 %
2009	7,382	3,174	43.0 %	1,305	17.7 %	1,634	22.1 %	790	10.7 %
2010	13,616	6,883	50.6 %	2,947	21.6 %	1,661	12.2 %	1,247	9.2 %
2011	21,549	12,712	59.0 %	3,726	17.3 %	1,532	7.1 %	2,063	9.6 %
2012	29,582	19,117	64.6 %	4,187	14.2 %	1,501	5.1 %	3,160	10.7 %
2013	33,840	22,877	67.6 %	5,489	16.2 %	1,739	5.1 %	4,508	13.3 %
2014	32,061	25,609	79.8 %	5,330	16.6 %	145	0.5 %	4,977	15.5 %
2015	29,864	24,006	80.4 %	4,004	13.4 %	85	0.3 %	3,777	12.6 %
2016	27,694	22,992	83.0 %	3,035	11.0 %	66	0.2 %	3,921	14.2 %
Total	**199,477**	**138,481**	**69.4 %**	**30,972**	**15.5 %**	**8,908**	**4.5 %**	**24,776**	**12.4 %**

*IP – insolvency petitions

** IO – insolvency orders

*** SIP – stay of insolvency proceedings

If a motion for discharge of debts is not drafted and submitted by an eligible person as set forth above, it shall be rejected.[512] Yet, if an insolvency petition filed together with a motion for discharge of debts is not prepared and signed by an eligible person within

[510] The legislature proposes that all persons having mandatorily established a data box should avail thereof in communication with courts. Alternatively, such persons might use an e-mail with authorized electronic signature. See section 80a of the Czech IA as amended by the 2017 Amendment. The requirement does not have to be kept solely if reasoned.

[511] Source of data: statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information.

[512] Section 393(3) of the Czech IA as amended by the 2017 Amendment.

the meaning of section 390a of the Czech IA as amended by the 2017 Amendment, it shall be disregarded.[513] Still, until 1 July 2018, the mentioned negative implications shall not apply if a motion for discharge of debts (and insolvency petition) is filed by an ineligible legal entity.[514]

If a motion for discharge of debts does not contain all the necessary information, if it is not in the required form or method, or if it is incomprehensible or uncertain, the court shall request the person who has submitted the motion for discharge of debts to amend it or modify it within the deadline which cannot be longer than 7 days; the court shall also inform the respective petitioner how to amend it. Also, such request shall be sent to the debtor.[515]

The 2017 Amendment similarly as the current wording of the Czech IA enables a debtor to withdraw his motion for discharge of debts. However, if insolvency proceedings are commenced upon the debtor's motion, the withdrawal of a motion for discharge of debts will not automatically entail liquidation. On the contrary, such withdrawal shall lead to the termination of insolvency proceedings. Yet, if a qualified person representing the debtor asks for remuneration, the debtor shall be ordered to pay the respective amount.[516]

In contrast to the current wording of section 396 of the Czech IA, the new wording proposes that discharge of debts proceedings are converted into liquidation solely if, as the legislature puts it, "the state does not have to fund the respective liquidation".[517] Otherwise, a court shall stay [in Czech: *zastaví*] the respective insolvency proceedings and order the debtor to pay remuneration to the person who prepared an insolvency petition and/or a motion for discharge of debts (unless a decision to stay insolvency proceedings is due to such person's fault). Such amendment has certainly pro-debtor effects. Yet, it is

[513] Section 97(5) of the Czech IA as amended by the 2017 Amendment. It is not clear how the court shall find out who has drafted the respective motion for discharge for debts (insolvency petition). In any case, the fact that an insolvency petition is disregarded means that the effects of the commencement of insolvency proceedings do not apply (i.e. enforcement proceedings outside insolvency cannot be halted).

[514] See article II(2) (transitory provisions) of the 2017 Amendment. The idea is that debtors should not be punished by illegal conduct of ineligible legal entities. The respective legal entities might be severely sanctioned. See section 418j of the Czech IA as amended by the 2017 Amendment.

[515] Section 393(1) of the Czech IA as amended by the 2017 Amendment.

[516] Section 394(2) of the Czech IA as amended by the 2017 Amendment.

[517] More specifically, a liquidation order shall follow only if in principle (i) a court determines that the value of debtor's assets is not too low to satisfy creditors' claims, or (ii) the value of the debtor's assets is too low to satisfy creditors' claims, an insolvency petition is filed together with a motion for discharge of debts (i.e. debtor initiates the insolvency proceedings) and the debtor expresses his intention to resolve his insolvency by virtue of liquidation and pays the respective deposit (if it has been set forth by court). In this regard, it is not exactly clear what declaration is needed. See section 396(1) and (2) of the Czech IA as amended by the 2017 Amendment.

questionable since it might uphold moral hazard incentives on the part of debtors.[518] If a rejection or a dismissal of a motion for discharge of debts is for instance due to the debtor' negligent behavior or dishonest practice, he will no longer be automatically "punished" by liquidation. He might get away clean with his remaining assets. Further to termination of insolvency proceedings after possibly several months, certain voidable conveyances might be left untouched since it will not be possible to file an action to challenge them.[519]

Newly, however, a list of claims prepared by the insolvency trustee may serve as a legal title to enforce them. Yet, it might be used solely with respect to the claims, which were not denied by the debtor and only if the insolvency proceedings were initiated by a creditor.[520] Right to enforce such claims shall be precluded after a lapse of 10 years following the decision to stay the insolvency proceedings.

4.4 Preconditions for discharge of debts

The Czech IA anticipates essentially the following preconditions for discharge of debts: (i) eligibility of the debtor in a narrow sense, (ii) minimum repayment of creditors' claims, (iii) requirement of honesty and (iv) a lack of reckless and negligent approach of the debtor.

4.4.1 Eligibility of debtors[521]

The original proposal of the Czech IA presumed that discharge of debts shall be available to (i) persons (including legal entities) who are not entrepreneurs and (ii) individuals who as entrepreneurs have not debts based from employment relationships [in Czech: *pracovněprávní závazky*][522] and more than 20 creditors.[523] However, the legislature eventually

[518] Moreover, the 2017 Amendment does not enable creditors to pay additional deposit (if the law provided for that, the insolvency proceedings would continue at creditors' costs).

[519] Arguably, in such case a motion for discharge of debts might be dismissed on the ground of dishonest intention.

[520] Section 396(3) of the Czech IA as amended by the 2017 Amendment. Arguably, it would make sense to broaden the scope of the application of the rule so that it applies regardless of whether the insolvency proceedings were commenced on the basis of creditor's insolvency petition.

[521] In more details see e.g. SPRINZ, Petr. Kdo ještě je a kdo už není podnikatel aneb subjektivní přípustnost oddlužení dnes a „zítra". *Právní rozhledy*, 2013, vol. 21, no. 10, pp. 361-367.

[522] The legislature presumably contemplated debts of the debtor vis-a-vis his employees.

[523] See section 389 of the original proposal of the Czech IA available on <http://www.psp.cz/sqw/historie.sqw?o=4&T=1120>. In this regard, it is argued that the legal framework

enacted that discharge of debts shall be available to persons (including legal entities) who are not entrepreneurs. At the outset, it might be noted that the inclusion of legal entities seems rather odd particularly in comparison to foreign legal frameworks. As it has been already mentioned, there does not seem to be a reason why to save legal entities and provide them a debt relief.[524]

As concerns individuals, the initial wording of the Czech IA excluded businessmen from the subjective scope of discharge of debts. The principle behind that is allegedly that entrepreneurs do not deserve the benefits of discharge of debts since they voluntarily incur risks associated with business activities and such risks should not be transferred to creditors.[525] Naturally, such rationale seems to be in contravention with the underlying principle of the fresh-start policy. The exclusion of businessmen with business-related debts from the scope of discharge of debts entails that the Czech IA has clearly failed to promote entrepreneurship.[526] It seems improper that the Czech IA prefers rather consumption to the encouragement of productive risk-taking.[527]

According to the original wording of the Czech IA, as a rule of thumb the debtor was eligible if he (i) was not an entrepreneur; and (ii) had not past business debts. Initially, some courts have interpreted the provision seemingly strictly so that persons with even small business-related debts were excluded from the scope of discharge of debts.[528] However, for the sake of "the spirit of law" the Supreme Court in its ruling no. 29 NSCR 3/2009 stated[529] that the court should have always considered *inter alia*: (i) the time of creation

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of discharge of debts has not been subject to a thorough discussion. See e.g. RICHTER Tomáš. Insolvenční zákon: od vládního návrhu k vyhlášenému znění. *Právní rozhledy,* 2006, vol. 14, no. 14, pp. 765-774.

[524] See chapter 2.6 *supra.*

[525] See e.g. the Supreme Court ruling case no. 29 NSČR 20/2009-B-32 (KSPH 39 INS 4221/2008) of 31 March 2011.

[526] This is particularly accurate since legal framework of reorganization makes it effectively impossible for small businesses to undertake the procedure. It appears that only one sole proprietor has been successful in having a reorganisation plan approved. See the Regional Court in Hradec Králové ruling case no. KSHK 42 INS 1568/2009-B-21 of 15 October 2009 in re Mrs. Mala. Yet, the proceeding was later on converted into liquidation.

[527] It may be argued that sole proprietors may set up a limited liability company (and some of them really do). However, due to the uneasiness of establishing a business in the local legal environment, the legislature has missed a chance to promote business encouragement. SPRINZ, Petr. *The Fresh-Start Policy in Visegrad Countries: Economic and Legal Analysis* …, p. 32.

[528] Generally the decisions lacked reference to other criteria such as the proportion of the incurred non-business to business debts, etc. See e.g. the High Court in Prague ruling case no. 1 VSPH 524/2009-A-20 (KSUL 70 INS 3836/2009) of 15 October 2009.

[529] The Supreme Court ruling case no. 29 NSČR 3/2009-A-59 (KSOS 34 INS 625/2008) of 21 April 2009.

of a business-related debt; (ii) time of termination of business activity; (iii) number of business-related debts; (iv) amount of business-related debts in relation to non-business-related debts;[530] and (v) acknowledgement of a creditor with potential discharge of debts or consent thereof.[531] The Supreme Court held that in some cases, a discharge of business-related debts does not contravene the underlying principle enshrined in the legislation and is in line with the purpose of the law.

Courts *inter alia* noted that if business-related claims are to be fully satisfied, they do not prevent discharge of debts,[532] regardless of whether such full satisfaction of claims is due to high income stream of the debtor or a failure of creditors to lodge their claims timely.[533] Similarly, if creditors with business-related claims fail to lodge them in insolvency proceedings, such business-related claims are in effect disregarded in the assessment of eligibility of debtors.[534]

In this regard, the meaning of business-related debts is not always clear. Business-related debts are not only debts arising out of private law such as contracts concluded by the debtor as an entrepreneur. The business-related debts include also debts stemming from the public law if they are linked to business activities such as outstanding tax or social security arrears.[535] Similarly, business-related debts are also debts which are incurred by another person – entrepreneur, if assumed voluntarily by a debtor (e.g. on the basis

[530] E.g. 5 % of business-related debts were considered marginal in the High Court in Prague ruling case no. 1 VSPH 1041/2012-B-22 (KSPL 29 INS 24594/2011) of 27 August 2012. It seems that 10 % of business-related debts were still acceptable - see e.g. the High Court in Olomouc ruling case no. 2 VSOL 271/2012-A-9 (KSBR 44 INS 2949/2012) of 27 April 2012. As concerns the criterion of the amount of business-related debts vis-à-vis non-business related debts, under certain circumstances up to 37 % of business-related debts might be considered marginal. See the High Court in Prague ruling case no. 1 VSPH 425/2012-B-23 (KSPH 23 INS 19345/2011) of 23 April 2012. In such case, the court noted that presumed satisfaction of claims in discharge of debts was considerably higher than in liquidation whereas business-related debts were incurred a long time prior to the commencement of insolvency proceedings and were of penalty nature. See also see e.g. SPRINZ, Petr. Kdo ještě je a kdo už není podnikatel aneb subjektivní přípustnost oddlužení dnes a „zítra". *Právní rozhledy*, 2013, vol. 21, no. 10, pp. 361-367.

[531] It has been argued that such acknowledgement might follow from the affected creditor's failure to file an objection against a discharge. See the High Court in Prague ruling case no. 3 VSPH 12/2011-A-16 (KSLB 76 INS 12115/2010) of 15 February 2011. The Revision Amendment sought to bring about the same effect.

[532] From an economic point of view, one must note that since interest and penalty payments which arise after an insolvency order are not satisfied generally in insolvency proceedings, creditors with business-related claims might in fact be affected.

[533] See the High Court in Prague ruling case no. 2 VSPH 89/2009 (KSPH 39 INS 4221/2008) of 21 November 2011.

[534] See the Supreme Court ruling case no. 29 NSČR 11/2009-B-16 (KSUL 43 INS 2864/2008) of 31 March 2011.

[535] See the Supreme Court ruling case no. 29 NSČR 20/2009-B-32 (KSPH 39 INS 4221/2008) of 31 March 2011.

of an agreement on the sale of an enterprise).[536] Nevertheless, debts securing business-related debts such as promissory notes [in Czech: *směnka*] or guarantees are not automatically considered to be business-related debts unless they are executed by the debtor in the position of an entrepreneur.[537] Although it might be questioned, courts even do not consider such debts to be business-related in situations when the debtor is an executive director [in Czech: *jednatel*] or other member of the statutory body [in Czech: *statutární orgán*] of the company whose debts are secured by instruments such as promissory notes.[538] Also, debts which are governed by the Act no. 513/1991 Coll., Commercial Code, as amended,[539] pursuant to section 262 of thereof, are arguably not automatically business-related debts either. Simple application of the Commercial Code does not render debts to be business-related debts.

As of 1 January 2014 when the Revision Amendment took effect, provisions regarding the eligibility for discharge of debts have substantially changed. Entrepreneurs are not excluded automatically from the scope of discharge of debts. However, section 389 of the Czech IA reads that entrepreneurs should not have business-related debts. Still, section 389(2) of the Czech IA clarifies that business-related debts do not preclude debtors from discharge of debts if any of the following condition is fulfilled: (i) the respective creditor with the business-related debt agrees with discharge of debts, (ii) the debtor has undertaken liquidation which was terminated under section 308(1)(c) or (d) of the Czech IA[540] and the respective business-related debt has not been satisfied in such proceedings, or (iii) the respective business-related debt is a secured debt.

Since one cannot expect that creditors will actively provide the consent to a discharge of business-related debts, section 403(2) of the Czech IA provides for a fiction of the consent of creditors if they do not raise objections at the creditors' assembly where the creditors vote on the method of discharge of debts.[541] Concurrently, section 397(1) of the Czech IA newly

[536] By virtue of such voluntary act a debtor assumes a position of an entrepreneur. See the High Court in Prague ruling case no. 1 VSPH 3/2008-A-8 (KSPL 29 INS 252/2008) of 13 March 2008.

[537] See the Supreme Court ruling no. 29 NSČR 9/2009-A-29 (KSUL 70 INS 3940/2008) of 23 February 2011 in or the High Court in Prague ruling no. 4 VSPH 120/2016-B-44 (KSPL 29 INS 10684/2014) of 8 April 2016.

[538] See e.g. the High Court in Prague ruling no. 4 VSPH 1401/2015-B-16 (MSPH 78 INS 33393/2014) of 25 August 2015.

[539] The Commercial Code has been repealed by the Czech Civil Code.

[540] I.e. the liquidation is terminated after the distribution of the proceeds, or liquidation is terminated for the insufficiency of assets to be distributed among creditors.

[541] Since section 399(3) of the Czech IA enables the creditors to vote on the method of the discharge of debts outside the creditors' assembly by virtue of ballots, in such cases, the creditors would have to raise objections within 10 days after the publication of the results of the voting. However, such voting appears to be not used.

stipulates that in case of doubts concerning the fulfillment of conditions for the discharge of debts, the court should issue a discharge of debts order.

Yet, following the Revision Amendment, there has been a disagreement among courts whether the debtor with business-related debt should attach the consent of his creditor to a motion for discharge of debts. In short, the High Court in Prague appears to initially take rather a pro-debtor approach as it argued that debtors cannot be forced to provide the court with the consent of creditors with business-related debts together with a motion for discharge of debts. [542] In effect, the assessment of whether the debtor is eligible for discharge of debts proceedings would be shifted rather to later phases of insolvency proceedings, i.e. at creditors' assembly. Thus, it provided the debtor a higher rate of success since due to the so-called rational apathy of creditors the creditors might rationally omit to actively raise objections. The High Court in Prague *inter alia* reasoned that at the time of the submission of a motion for discharge of debts, it is not known whether creditors with business-related claims will even lodge their claims. Moreover, at that time creditors ordinarily do not possess all the information to assess whether discharge of debts is more suitable form of resolution of the debtor's insolvency.

On the opposite, the High Court in Olomouc appears to take a more stringent approach.[543] Simply said, the High Court in Olomouc requires that debtors state with respect to each business-related debts the ground on the basis of which the discharge of debts is possible (e.g. that the respective creditor consents with discharge of debts). Only in case of doubts courts may issue a discharge of debts order. Otherwise, a motion for discharge of debts should be rejected. One can imagine that the debtor simply states that the respective preconditions are fulfilled whereas he even had not sought to ensure the fulfillment thereof. Arguably, at later phases of discharge of debts proceedings, the motion for discharge of debts should be dismissed on the ground of dishonesty of the debtor.

The approach of the High Court in Prague is arguably more reasonable since it makes more room for creditors' initiatives and corresponds to the legislature's intention. Moreover, the Czech IA does neither prescribe any requirement to submit the consent of the affected creditors nor does it require that the consent must be in a written form. However, as the law

[542] See e.g. the High Court in Prague ruling no. 2 VSPH 1995/2014-A-13 (KSPA 59 INS 13797/2014) of 16 October 2014.

[543] See e.g. the High Court in Olomouc ruling no. 3 VSOL 200/2016-A-13 (KSOL 16 INS 31553/2015) of 18 April 2016 or the High Court in Olomouc ruling no. 1 VSOL 918/2015-A-18 (KSBR 29 INS 15846/2015) of 24 September 2015.

stands, the Supreme Court appears to uphold the position of the High Court in Olomouc as it approved the decision of the High Court in Olomouc no. 1 VSOL 918/2015-A-18 (KSBR 29 INS 15846/2015) of 24 September 2015 for publication.[544]

Moreover, the High Courts in Olomouc and Prague uniformly noted that after the adoption of the Revision Amendment, courts might not apply the criteria stated in the above cited Supreme Court ruling no. 29 NSCR 3/2009.[545] However, such decision does not appear to convene to the legislative intention since the explanatory notes to the Revision Amendment explicitly anticipate the application of the then case-law (including the criteria stated by the Supreme Court). Yet, it appears that the High Court in Prague has overcome the rule that the mentioned criteria did not apply. In one of its ruling, the High Court in Prague noted that the objection of the creditor against the discharge of its business-related debt might be disregarded either if the respective claim is marginal in its amount or if it is against good morals.[546] The reference to good morals might open the gate for other possible creative (dis-)interpretations. Also, the mentioned decision is not in line with the previous decision of the High Court in Prague in which the court stated that courts should not assess reasons why creditors disagreed with the discharge of their business-related debts.[547] The court *inter alia* mentioned that doing so would in effect entail creation of law.

To sum it up, current case-law does not appear to be consistent with the intention of the legislature which was enshrined in the explanatory notes to the Revision Amendment. The amendment intended to clarify and broaden the subjective scope of eligibility for discharge of debts. It arguably did neither intend to exclude debtors who would otherwise pass the "test" set forth in the abovementioned Supreme Court decision stating several criteria nor to exclude those who would otherwise repay 100 % of their business-related debts.

Eventually, it might be noted that a court cannot make any conclusion as to the question whether a debtor is eligible for discharge of debts unless the debtor submits

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[544] See e.g. the High Court in Olomouc ruling no. 3 VSOL 1331/2015-A-21 (KSBR 24 INS 17951/2015) of 21 April 2016.

[545] See e.g. the High Court in Prague ruling case no. 2 VSPH 1995/2014-A-13 (KSPA 59 INS 13797/2014) of 16 October 2014. In the High Court in Prague ruling case no. 1 VSPH 2081/2015-B-19 (KSHK 41 INS 11057/2015) of 10 November 2015 the court even noted that the disagreement of the creditor with business-related debt cannot be disregarded even in case when the business-related debt is marginal.

[546] The High Court in Prague ruling case no. 2 VSPH 2450/2014-B-22 (KSHK 41 INS 20728/2014) of 18 September 2015. See also the High Court in Prague ruling case no. 4 VSPH 826/2015-B-17 (KSPH 60 INS 27272/2014) of 12 May 2015 or 1 VSPH 598/2016-B-26 (MSPH 76 INS 20921/2015) of 11 August 2016.

[547] The High Court in Prague ruling no. 1 VSPH 139/2015-B-17 (KSHK 42 INS 17311/2014) of 14 August 2015.

the required list of his debts which is a mandatory part of an insolvency petition. In other words, if a debtor does not provide the court with the respective list of debts, the court should first request the debtor to submit the list. The court cannot simply dismiss a motion for discharge of debts.[548]

As concerns proposed changes, the 2017 Amendment shall touch upon *inter alia* the eligibility for discharge of debts as it presumes fiction of the consent of a creditor with business-related claim at earlier stage.[549] More specifically, unless the creditor together with the submission of his business-related claim does not state that he disagrees with discharge thereof, a fiction of consent shall apply. Such disagreement should be substantiated. Therefore, if creditors are passive and do not actively object at the time of the submission of their claims,[550] their consent shall be assumed.

The author argues that the 2017 Amendment in effect supersedes the current case-law preventing debtors with business-related debts to achieve discharge if they do not attach consent of creditors therewith.[551] This line of argumentation might be arguably supported by section 136(3) of the Czech IA which states that a discharge of debts order does not have to be reasoned if any creditor has not stated that he disagrees with any discharge of business-related debts. As a result of the proposed change, entrepreneurs should in theory more easily meet the criteria of eligibility which is definitely a positive move. Clearly, the legislature again missed the opportunity to ultimately resolve the disputed issue.[552]

Moreover, it is not clear whether a court shall assess reasoning of the respective creditor who submits a disagreement with a discharge of debts and what the court should do in case it does not consider the reasoning to be appropriate (i.e. whether the court might ask for a more thorough reasoning or whether such reasoning should be disregarded). Arguably, the court should review the reasoning since otherwise the requirement would be meaningless and simple submission of disagreement would suffice. In this connection, the court is

[548] See the Supreme Court ruling case no. 29 NSČR 13/2009-B-36 (KSPL 29 INS 252/2008) of 31 March 2011.

[549] Section 389(2) of the Czech IA, as amended by the 2017 Amendment.

[550] Arguably, the deadline should rather correspond to the deadline for lodgment of claims as creditors might withdraw their lodgments of claims until the deadline lapses and submit a new lodgment of claims.

[551] As mentioned above, courts nowadays require the debtor to submit the creditor's consent with the discharge of business-related debts together with a motion for discharge of debts (i.e. prior to the deadline for the lodgment of claims).

[552] Still, creditors might argue that the legislature did not intend to supersede the current case-law and that it simply had to modify the date to which the fiction relates since creditors' assembly shall not be mandatorily convened. Currently, the fiction is linked to the passivity of the creditor at the creditors' assembly.

mandated to tackle [in Czech: *vypořádat*] with creditors' objections in a decision on confirmation of discharge of debts.[553] Therefore, creditors' objections might be arguably superseded.

4.4.2 Minimum repayment of unsecured claims

4.4.2.1 Current legal framework regarding minimum repayment of unsecured claims

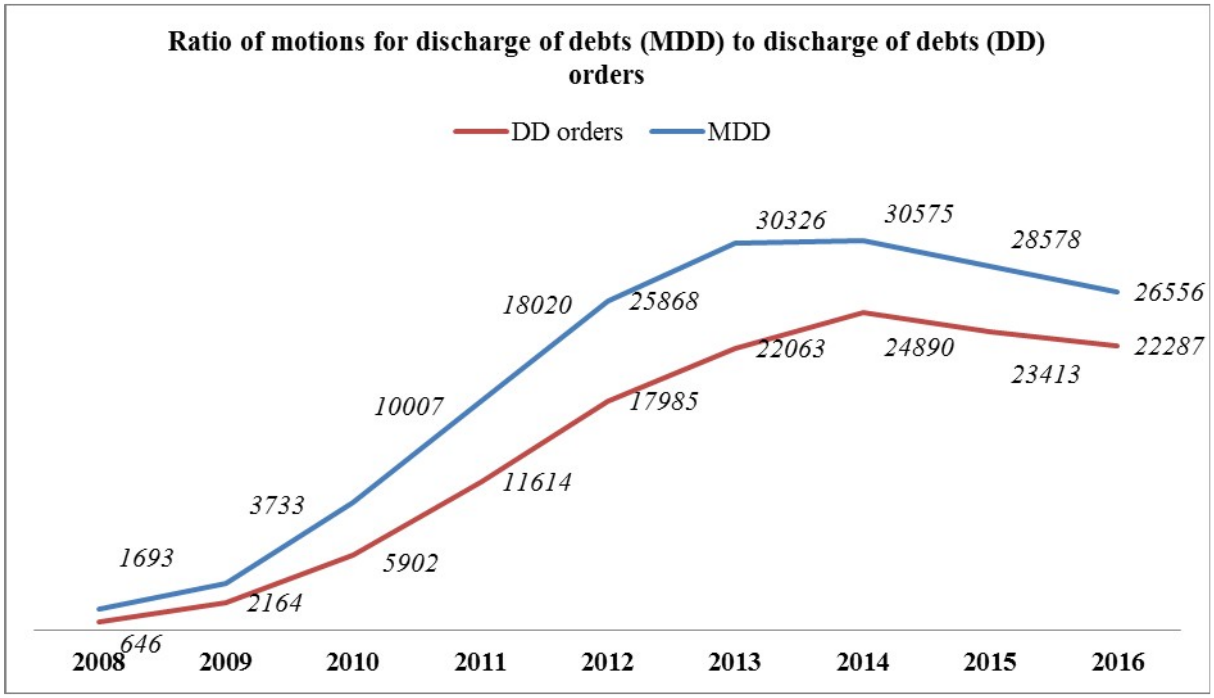
One of peculiar requirements enshrined in the legal framework of the Czech insolvency law is that section 395(1)(b) of the Czech IA law generally requires mandatory repayment of at least 30 per cent of allowed unsecured claims.[554] This requirement might *ex ante* induce debtors to deal with their insolvency earlier at the time when they can still repay the mentioned portion of their debts. Therefore, those who are unable to meet this requirement cannot reach a debt relief. However, as the data suggests, it does not seem that such restriction is prohibitive to the wide use of discharge of debts. [555]

[553] Section 397(2) of the Czech IA, as amended by the 2017 Amendment.

[554] The US Bankruptcy Code does not generally dictate any repayment threshold. However, see e.g. indirect threshold for Chapter 13 bankruptcy in section 1325(a)(4) of the US Bankruptcy Code.

[555] Nevertheless, the Ministry of Justice of the Czech Republic points out that 4,082,203 enforcement proceedings are held by enforcement office holders [in Czech: *exekutor*] against 731,341 debtors. In other words, majority of debtors face multiple proceedings. Arguably, they would otherwise file a motion for discharge of debts, had they fulfilled the respective conditions. See the explanatory note to the 2018 Draft Amendment, pp. 49-52 available on <http://www.psp.cz/sqw/historie.sqw?o=4&T=1120>.

Graph 1: Motions for discharge of debts and discharge of debts orders[556]



Naturally, as mentioned above, the requirement to repay at least 30 % of unsecured claims leaves debtors with insufficient assets and income out of the scope of the discharge of debts. Interestingly, in order to overcome the mandatory pay-out, debtors seem to avail of a donation agreement or an agreement on the provision of allowances.[557] In essence, a third party agrees to pay a certain monthly payment to a debtor to enable him to repay 30 % of his unsecured debts. Initially, some courts rejected this practice particularly in cases when the declared income of debtors was completely or mostly stemming from such agreements.[558] In other words, courts required that the debtor must be able to repay at least some amount of his debts from his own income stream (be it a salary or pension).[559] Nowadays, the courts

[556] Source of data: statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information.

[557] Interestingly, in the sample having about 1,200 cases of discharge of debts proceedings in the form of repayment plan, 16 % of debtors are expected to fully repay their debts and about 29 % of debtors are expected not to reach the mandatory payout. See the explanatory note to the 2018 Draft Amendment, p. 55.

[558] The High Court in Olomouc also held that it is up to creditors to raise objections, if they have any. See e.g. the High Court in Olomouc ruling case no. 3 VSOL 535/2012-A-19 (KSBR 40 INS 5526/2012) of 29 August 2012.

[559] See e.g. the High Court in Olomouc ruling case no. 2 VSOL 807/2012-A-18 (KSOL 16 INS 22329/2011) of 17 October 2012, 1 VSOL 406/2012-A-11 (KSBR 30 INS 4109/2012) of 10 July 2012 or 2 VSOL 282/2012-A-9 (KSOS 22 INS 4750/2012) of 9 May 2012. Mostly, courts ruled that the fact that burdens of discharge

acknowledge such practice and consider it consistent with the duty of debtors to seek to procure the maximum income possible.[560] The Revision Amendment has in effect upheld a possibility to procure such sort of external financing by virtue of the amendment to section 392 of the Czech IA. It sets forth that in case the debtor procures income from third persons, signatures on a donation agreement or agreement on the provision of allowances should be authorized.

In this connection, it is interesting to note that courts of appeal even held that courts of first instance had a duty to inform a debtor of any additional payment needed to reach the 30 % threshold. The reasoning is that the courts should ensure that a debtor has a real opportunity to secure such additional payment from third persons (i.e. external resources).[561] In accordance with the case-law, a debtor might even submit the respective agreement on the provision of allowances during appellate proceedings in case a court of first instance rules that the debtor has not sufficient income.[562] However, the provision of additional income during the proceedings before the Supreme Court is not in effect possible to overrule the decision of lower courts.[563]

Debtors might tend to terminate an agreement on the provision of allowances once they secure better paid jobs so that the allowances are not needed. Termination of the agreement might be in contravention with the duty to act honestly and the duty to seek to procure a maximum income. Still, if there are objective reasons to terminate the agreement for instance due to illness or lack of resources on the part of a counter-party, the termination or modification should not be questioned.[564]

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of debts proceedings are put on a person different from the debtor is inconsistent with the principles of discharge of debts (including the duty to act honestly). On the contrary, the High Court in Prague admitted that all payments may stem from external resources. See e.g. the High Court in Prague ruling case no. 3 VSPH 848/2012-B-20 (KSHK 45 INS 12804/2011) of 27 August 2012.

[560] See e.g. the Supreme Court ruling case no. 29 NSČR 53/2012-B-31 (KSOS 22 INS 16136/2011) of 24 July 2014.

[561] The ruling of High Court in Prague case no. 3 VSPH 478/2012-B-16 (KSUL 43 INS 20691/2011) of 13 June 2012 or 3 VSPH 723/2012-B-20 (KSHK 45 INS 14971/2011) of 26 July 2012.

[562] See e.g. the High Court in Olomouc ruling case no. 1 VSOL 198/2015-B-35 (KSBR 29 INS 20495/2014) of 31 March 2015.

[563] Section 241a(6) of the Czech Civil Procedural Code forbids the Supreme Court to take into account new facts. See also e.g. the Supreme Court ruling case no. 29 NSČR 83/2013-B-38 (KSBR 24 INS 3408/2012) of 28 November 2013.

[564] See e.g. the Supreme Court ruling case no. 29 NSČR 71/2013-B-131 (KSHK 42 INS 3097/2012) of 26 February 2014. The debtor agreed with the donor that the amount of allowances will be dependent on the sum needed to repay 30 % of unpaid unsecured claims.

In terms of the mandatory pay-out, debtors must take into account that in addition to the respective portion of unsecured claims they must be able to repay the remuneration of an insolvency trustee. When creditors are satisfied from the debtor's future disposable income, the insolvency trustee essentially gets a flat fee. In case of the sale of assets, the fee depends on the amount of distributed proceeds.[565]

In order to determine whether a debtor is able to reach the mandatory pay-out, it is important to find out what is the total amount of creditors' claims. In this context, the deadline for submission of claims gains importance.[566] As mentioned above, the Czech IA provides for rather a strict deadline for the submission of creditors' claims. In an insolvency order, the court *inter alia* calls creditors to lodge their claims within the specified period together with the warning that later submission of claims shall be disregarded. If courts issue a discharge of debts order together with an insolvency order, which is mostly the case, the period for the lodgement of claims lasts 30 days. Otherwise, the period for the lodgement of claims is two months. As a result of this, the total amount of claims lodged in insolvency proceedings might differ (and in practice differs) from the total amount of claims stated in the list of debtor's debts. In such case, the decisive amount seems to be the one corresponding to the total amount of lodged unsecured claims.[567] Secured claims are not relevant in this assessment.[568]

It may be questionable what claims should be taken into account when assessing the ability to repay at least 30 % of unsecured debts. This is particularly true in case of denied claims or other claims that have not been yet ascertained [in Czech: *zjištěné pohledávky*]. The starting point is whether the debtor acknowledges the respective claim and what is the basis of denial thereof (if applicable).[569] As a rule of thumb, if the court cannot exclude

[565] See chapters 5.3.4 and 5.4.5 *infra*.

[566] WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. …, pp. 74-75.

[567] See e.g. the High Court in Prague ruling case no. 1 VSPH 464/2010-B-11 (KSUL 70 INS 2745/2010) of 30 June 2010.

[568] See e.g. the High Court in Prague ruling case no. 1 VSPH 169/2008-A-24 (KSHK 42 INS 2002/2008) of 7 October 2008.

[569] See e.g. the Supreme Court ruling case no. 29 NSČR 6/2008-B-60 (KSBR 31 INS 156/2008) of 29 September 2010.

on the basis of a preliminary assessment that a denial of a claim will be unsuccessful, it shall disregard the denied claims.[570]

It must be mentioned that the debtor should be able to repay at least 30 % of unsecured debts from his current income stream. He cannot derive the ability to reach the mandatory pay-out from potential or otherwise fictitious income or prospects of future increase in payroll which are not certain. In this connection, the Supreme Court held that a debtor could not refer to uncertain allegations that income generally rises.[571] If the debtor relies on such type of allegations, the court should dismiss a motion for discharge of debts. Similarly, it might be argued that the appraisal of the debtor's property for the sake of discharge of debts by virtue of the sale of assets should be based on current value and not on uncertain prospects of the value of assets. In any case, a motion for discharge of debts should at least contain information that enables the court to conclude that the motion is substantiated. If the motion itself states information that precludes the confirmation of discharge of debts, the court cannot approve discharge of debts.[572]

Section 395 of the Czech IA anticipates that creditors might individually agree with lesser satisfaction.[573] Moreover, in case of repayment plan, the debtor might suggest to repay less than what he would be required under law. It is up to the court to decide on the debtor's motion. Since such decision has potentially significant impact, a court might approve a motion for lesser instalments solely if it might be presumed that the debtor will repay at least 50 % of his debts unless individual creditors agree with lesser satisfaction pursuant to section 398(4) of the Czech IA. Standpoint of the debtor's creditors is not binding. Still, the court should take into account creditors' recommendation, the alleged causes of the debtor's insolvency, total amount of his debts, current as well as prospective income stream and measures that the debtor is undertaking in order to maintain or increase his income. Yet, such motion to pay lesser monthly payments must be filed together with

[570] See e.g. the Supreme Court ruling case no. 29 NSČR 22/2012-B-18 (KSCB 27 INS 13044/2010) of 31 July 2012 and the High Court in Prague ruling case no. 1 VSPH 1304/2012-B-17 (KSHK 41 INS 5220/2012) of 8 October 2012. See section 411(2) of the Czech IA.

[571] See e.g. the Supreme Court ruling case no. 29 NSČR 6/2008-B-60 (KSBR 31 INS 156/2008) of 29 September 2010.

[572] *Idem*.

[573] If such creditors exist, a discharge of debts confirmation should also contain the identification of the respective creditors. See in particular sections 406(2)(c) and 406(3)(c) of the Czech IA. Moreover, the consent of the creditors who agree with lesser satisfaction must be provided in a written form and attached to a motion for discharge of debts; it should also mention the minimum repayment which the creditors demand. See section 392 of the Czech IA.

a motion for discharge of debts since later submission of the request is disregarded by the court.[574] Such limitation does not seem to be appropriate.[575]

Finally, it might be noted that the question whether a debtor is more or less wealthy than any of his creditors is not relevant. Thus, discharge of debts might be confirmed even if any of creditors of the debtor is in effect in worse financial situation than the debtor himself.[576]

4.4.2.2 Minimum repayment of unsecured claims pursuant to the 2018 Draft Amendment

The 2018 Draft Amendment seeks to delete one of the cornerstones of discharge of debts under the Czech IA as it proposes to dispense with requirement of the mandatory pay-out. More specifically, the duration of repayment plan should be dependent on rate of satisfaction of debtor's all unsecured claims so that the following categories of the duration of the repayment plan shall exist. First, repayment plan would end upon full satisfaction of all unsecured claims. Second, repayment plan would last three years in case of satisfaction of at least 50 % of debtor's all unsecured claims. Third, repayment plan would last five years in case of satisfaction of at least 30 % of debtor's all unsecured claims. Finally, repayment plan would last 7 years in case the debtor is not able to satisfy at least 30 % of his unsecured claims.[577]

Still, a debtor is in any case required to make for costs of insolvency proceedings (reimbursement of expenses of insolvency trustee and his remuneration, and costs associated with the administration of insolvency estate), statutory alimonies, remuneration for drafting of a motion for discharge of debts (and insolvency petition, where applicable).[578] Also, if the debtor's claims reach 1000 times more than the amount corresponding to subsistence

[574] Section 398(4) of the Czech IA.

[575] See more details in chapter 5.4.3 *infra*.

[576] See e.g. See e.g. the Supreme Court ruling case no. 29 NSČR 53/2012-B-31 (KSOS 22 INS 16136/2011) of 24 July 2014.

[577] Section 412a of the Czech IA as amended by the 2018 Draft Amendment.

[578] Section 395(1)(b) of the Czech IA as amended by the 2018 Draft Amendment. The requirement to pay statutory alimonies was added allegedly after the government meeting shortly prior to the submission of the 2018 Draft Amendment to the Parliament.

minimum, the debtor will be obliged to repay 30 % of unsecured claims. [579] However, such amount is to be rarely seen in practice.[580]

The abovementioned proposal seeks to broaden the access to discharge of debts to the poorest debtors, particularly to the debtors who face multiple of enforcement proceedings.[581] Naturally, distinctions between the respective categories limit moral hazard that the deletion of the mandatory pay-out otherwise creates. It, however, appears that such proposal is not backed by sufficient analysis and data. Clearly, it is also questionable whether one of the purposes of insolvency proceedings is the provision of a fresh-start to all individuals under such conditions.[582] The author argues that in order to cope the debtors with multiple enforcement proceedings, the legislature might have first tried to establish a duty to notify debtors about a possibility to file an insolvency petition with a motion for discharge of debts. The reason is that anecdotal experience suggests that many of the debtors who would currently meet preconditions for discharge of debts are not simply aware of such option.[583] Moreover, the limit regarding mandatory repayment (CZK 2,200,000) seems to be too low; arguably it would be more appropriate if the limit equals to about CZK 600,000.

Moreover, the 2018 Draft Amendment anticipates interruption and extension of repayment plan by virtue of a court ruling. Both types of rulings affect duration of the repayment plan and might be combined. As concerns the former, the court might interrupt discharge of debts solely further to the debtor's or insolvency trustee's motion on the basis of reasoned ground [in Czech: *z důležitých důvodů*] only once.[584] The maximum time for interruption is one year. As a consequence of the court's decision on interruption, the debtor does not have to fulfill his obligation to pay regular installments. Therefore,

[579] See the Act no. 110/2006 Coll., on Living and Subsistence Minimum, as amended, and the Government Decree no. 409/2011 Coll., on Indexation of Living Minimum and Subsistence Minimum Amounts. As of 31 December 2016 subsistence equals to CZK 2,200. Therefore, the criterion equals to CZK 2,200,000.

[580] The average amount of claims lodged in discharge of debts pursuant to the explanatory notes to the 2018 Draft Amendment equals to amount between CZK 600,000 and 800,000.

[581] See the explanatory notes to the 2018 Draft Amendment.

[582] Also, debtors might in certain situations seek to find financing (via a third person such as relatives) in order to fall into a more favorable category of duration of the repayment plan.

[583] The author has discussed this issue with several collection agencies and bank representatives which support such statement.

[584] It might be added that even without explicit framework for interruption of repayment plan, at least in one case, the court has already interrupted discharge of debts proceedings. See the Regional Court in Pilsen ruling case no. KSPL 56 INS 1722/2015-B-18 of 8 October 2015.

a debtor might in theory cope with insufficient income stream (temporary loss of job or long illness) or otherwise keep the installments for other causes (unexpected costs). Neither creditor nor anybody else might file an appeal against the affirmative decision of a court. Although some flexibility regarding duration of repayment plan is generally welcome, creditors will lose control over the process (they can neither avail of their individual rights during the interruption of the repayment plan nor they can file an appeal against decision on the interruption) whereas debtors might in theory abuse the interruption.[585]

Extension of repayment plan also seeks to provide a debtor an opportunity to fall to a more favorable category of duration of the repayment plan. The court might extend the duration of repayment plan solely further to debtor's motion on the basis of reasoned ground [in Czech: *z důležitých důvodů*] only once.[586] The maximum time for extension is 6 months. Neither creditor nor anybody else might file an appeal against the affirmative decision of a court.[587]

4.4.3 Honesty of debtors

One of the underlying preconditions for discharge of debts mandates that a debtor does not pursue dishonest intentions.[588] Requirement of honesty should arguably prevent debtors from reaching a debt relief in cases when formal preconditions are met, yet, the approval thereof would entail injustice or would be otherwise in contravention with good faith or good morals.[589]

From a general perspective, the assessment of the mentioned precondition is based on a case-by-case analysis of individual circumstances. As the Supreme Court held, the courts cannot be instructed how to assess whether the debtor acted dishonestly since it would go against the principle of discretionary evaluation of evidence as set forth in procedural laws.[590] In this respect, courts also take into account whether creditors are active and raise objections

[585] Section 412b(1)-(4) of the Czech IA as amended by the 2018 Draft Amendment.

[586] It might be added that even without explicit framework for interruption of repayment plan, at least in one case, the court has already interrupted discharge of debts procedure. See the Regional Court in Pilsen ruling case no. KSPL 56 INS 1722/2015-B-18 of 8 October 2015.

[587] Section 412b(5) of the Czech IA as amended by the 2018 Draft Amendment.

[588] Section 395 of the Czech IA.

[589] See TELEC, Ivo. Poctivost a důvěra, dobrá víra, dobré mravy, veřejná morálka a veřejný pořádek. *Právní rozhledy*, 2011, vol. 19, no. 1, pp. 1-5; or PLEVA, Vítězslav. K pojmu nepoctivý záměr v insolvenčním řízení. *Právní rozhledy*, 2014, vol. 22, no. 3, pp. 104-107.

[590] See the Supreme Court ruling case no. 29 NSČR 8/2012-B-49 (KSHK 42 INS 13386/2010) of 30 January 2014.

or not. On the basis of silence of creditors, courts infer the consent of creditors with discharge of debts.[591]

The assessment of the question whether a debtor has dishonest intentions might be undertaken from two perspectives. First, the crucial question is what exactly constitutes dishonesty. Second, the court should consider what time period is decisive for the assessment of the criterion.

As concerns the merits of the question, courts have recognised that the underlying requirement of honesty stems from a civil-law maximum "*nemo turpitudinem suam allegans auditur*" (no one should be permitted to profit from his own fraud, or take advantage of his own wrong).[592] The requirement of honesty essentially reflects the underlying principle of "good faith" in insolvency proceedings. Nevertheless, provisions on dishonesty do not provide a clear guidance what dishonesty exactly stands for. As interpreted by case-law, it is an objective criterion which should not be dependent on the perception of individual debtors.[593] Initially, the Czech IA used to provide for several presumptions of existence of dishonest intentions. Such presumptions used to cover mainly previous insolvency proceedings as well as a criminal record with respect to economic or proprietary criminal offences. The presumptions have been gradually abandoned as they seemed to be too strict. Nowadays, courts have wider discretion to determine whether a debtor has dishonest intentions or not.[594] Having analysed the relevant case-law, it appears that courts are rather flexible in the interpretation of the existence of dishonest intentions. This approach corresponds to the overall tendency of acceptance of rather lower standard of honesty since it is often difficult to evaluate the respective situation *ex post facto*.[595]

In this context, courts have noted that discharge of debts is available not only to the debtors, who are indebted due to external circumstances which they could not have caused such as illness, accident, death of a close relative or perhaps shortage of work.

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[591] See e.g. the High Court in Prague ruling case no. 1 VSPH 996/2012-B-8 (KSPL 56 INS 8680/2012) of 27 August 2012.

[592] See the Supreme Court ruling case no. 29 NSČR 8/2012-B-49 (KSHK 42 INS 13386/2010) of 30 January 2014.

[593] See e.g. the High Court in Prague ruling case no. 3 VSPH 254/2012-A-18 (MSPH 95 INS 1845/2012) of 23 August 2012.

[594] Initially, section 395 of the Czech IA *inter alia* stated that there was a presumption of dishonesty if a debtor has been convicted of a crime of economic or property-related nature. By virtue of the Act no. 334/2012 Coll., the legislature added that the presumption does not apply if the debtor specifically ascertained that he does not pursue dishonest intentions. Eventually, the Revision Amendment has eliminated presumptions.

[595] WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. …, p. 66.

The Supreme Court held that as defined under the Czech IA, the status of insolvency is of objective nature and discharge of debts should be available also to debtors who might have acted imprudently or negligently.[596] Courts mostly note that in comparison to the alternative method of resolution of debtor's insolvency – liquidation – discharge of debts brings about more benefits to creditors. Hence, previous imprudent borrowing practices, gambling or inappropriate consumption do not generally themselves exclude debtors from the subjective scope of discharge of debts. [597] Courts duly note that the cause of the debtor's insolvency is relevant in cases when the debtor seeks to decrease instalments to be paid to creditors in accordance with section 391(2) and 398(4) of the Czech IA. Otherwise, the cause of the debtor's insolvency should not be relevant.

What appear to be generally inconsistent with a duty to act honestly are criminal acts of economic or property-related nature. Yet, the fact that a debtor has been convicted does not *per se* disqualify the debtor as section 416(1) of the Czech IA explicitly contemplates that pecuniary sanctions imposed for intentional crimes cannot be discharged.[598]

Other dishonest measures include an intentional omission to enlist known foreign[599] or local creditors in the list of the debtor's debts. Undertaking new credit a short time prior to the commencement of insolvency proceedings might be another ground for a dismissal or rejection of a motion for discharge of debts. [600] This might be particularly the case when debtors sign an inaccurate statement that they have no other debts due. Yet, many courts acknowledge that creditors would provide credit to a debtor regardless knowledge of the existence of other debts.[601]

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[596] See the Supreme Court ruling case no. 29 NSČR 32/2011-B-37 (KSOS 31 INS 12026/2010) of 28 March 2012.

[597] *Idem*. It is obviously questionable whether such low standard should be generally accepted and whether it shall survive if the 2018 Draft Amendment is enacted in its version as proposed to the Parliament.

[598] See also the Supreme Court ruling case no. 29 NSČR 8/2012-B-49 (KSHK 42 INS 13386/2010) of 30 January 2014. The author argues, however, that particularly in cases of intentional crimes, all circumstances must be carefully examined.

[599] Pursuant to section 430 of the Czech IA, unlike other creditors, known foreign creditors from member states of the EU (except Denmark) are notified about an insolvency order. Thus, an omission to mention foreign creditors might lead to their harm since there is a higher probability that they will have lesser chance to get to know about the debtor's insolvency. See e.g. the Supreme Court ruling case no. 29 NSČR 45/2010-B-174 (MSPH 93 INS 1923/2008) of 30 April 2013.

[600] See e.g. the Supreme Court ruling case no. 29 NSČR 45/2010-B-174 (MSPH 93 INS 1923/2008) of 30 April 2013.

[601] See the High Court in Prague ruling case no. 2 VSPH 255/2013-A-15 (KSHK 28946/2012) of 25 February 2013 or 3 VSPH 912/2012-A-17 (KSCB 26 INS 13119/2012) of 10 September 2012. Clearly, though, a false statement has badges of fraud and dishonesty. Interestingly, claims based on false statements of a debtor are exempted from the scope of debt relief order under section 523(a)(2) of the US Bankruptcy Code.

Also, a failure to disclose assets has been considered in certain cases in contravention with the requirement of honesty.[602] Such failure might be to the detriment of creditors particularly in case of concealment assets of significant value since creditors might have otherwise voted in favour of sale of debtor's assets instead of repayment plan as a method of discharge of debts. However, section 412(1)(b) of the Czech IA, as amended by the Revision Amendment, provides that the assets not listed in a list of assets should be given to the insolvency trustee even in case of repayment plan. The proceeds from the liquidation of such assets are to be distributed among creditors. Therefore, one can raise doubts whether a failure to list any asset in the list of debtor's assets should prevent a debtor from reaching a discharge of debts since in effect the creditors are not harmed. Still, a failure to disclose assets is definitely a failure to meet the debtor's duty. As in other cases, individual circumstances must be taken into account such as whether the debtor himself later disclosed the respective assets or what motivation was behind such omission. In this connection, it is worth noting that courts generally distinguish cases when a debtor omits to state assets in the list of assets from cases of intentional concealments. Whereas the former might constitute a ground for dismissal of discharge of debts motion on the basis of reckless behavior, the latter is rather connected with honesty.[603]

Other questionable steps include transfers of valuable assets[604] prior to the commencement of insolvency proceedings or intentional preferential satisfaction of claims of creditors affiliated to the debtor.[605] Interestingly, courts of appeal in certain cases held that courts of first instance should give a debtor a reasonable time to rectify the mistake and provide him with the advice how to do that.[606] As indicated above with respect to a failure to disclose assets, in case a debtor makes preferential or other voidable conveyance, it might be argued that it is not necessary to dismiss a motion for discharge of debts. The reason is that

[602] Pursuant to section 727(a)(2) of the US Bankruptcy Code a concealment of property under Chapter 7 proceedings is a ground not to grant a debt relief order.

[603] See e.g. the Supreme Court ruling case no. 29 NSČR 47/2013-B-49 (KSBR 37 INS 13037/1012) of 17 June 2015 or 29 NSČR 33/2016-B-38 (MSPH 77 INS 5093/2014) of 29 February 2016.

[604] Not all transfers of assets are, however, considered to be dishonest. All circumstances should be taken into account. See e.g. the High Court in Olomouc ruling case no. 1 VSOL 676/2012-A-9 (KSBR 38 INS 15634/2012) of 4 Septemer 2012.

[605] Transfer of property with the intention to hinder, delay or defraud creditor or an officer of the insolvency estate is a ground for refusal to grant a debt relief order under section 727(a)(2) of the US Bankruptcy Code.

[606] See e.g. the High Court in Prague ruling case no. 1 VSPH 1377/2012-A-18 (KSUL 81 INS 18419/2012) of 16 October 2012. The debtor encumbered his flat by the easement of the use thereof in favor of a relative. The High Court in Prague noted that it had no doubts that the debtor had honest intentions and that he should have been provided with a period and advised to remove the easement.

such transfer might be in certain cases challenged pursuant to provisions on voidable conveyances; thus creditors will be put into the same position.[607] Yet, it must be born in mind that an act having the badges of dishonesty does not have to be necessarily a voidable transaction.[608] Moreover, particularly in cases when a debtor does not rectify his mistake by arranging the return of the transferred property back into his ownership, transfers that preclude the creditors to effectively choose between the sale of assets and repayment plan will typically be dishonest acts.[609]

Yet, probably one of the most interesting cases involved rather a peculiar case which clearly illustrates that courts are not ready to accept obvious abuses of discharge of debts. The debtor commented on his facebook profile "*Well, you must learn to be a bankrupt, take unpaid leave from work and eat salmon, sushi and exclusive cheese ...*" In this regard, the court noted that "*Debtor's vision of enjoying fully his life with support of his elderly grandmother while leaving his debt issues to insolvency trustee contravenes morality as well as principles and aims of discharge of debts proceedings ...*"[610]

In the context of the assessment of honesty, one of the critical questions is "how often" a debtor can file a motion for discharge of debts.[611] There used to be a disagreement among the scholarship as to whether the initial wording of section 395(2)(a) of the Czech IA should have been strictly interpreted as to preclude a debtor from effectively filing a second motion for discharge of debts anytime in his life.[612] Nowadays, the mentioned presumption no longer applies. As the law stands, it is arguably more appropriate to adhere to the opinion that previous filing or even a previously granted debt relief does not prevent the debtor from filing

[607] See particularly sections 240, 241 and 242 of the Czech IA.

[608] See e.g. the Supreme Court ruling case no. 29 NSČR 88/2013-B-29 (KSOS 22 INS 22824/2012) of 30 January 2014.

[609] See e.g. the Supreme Court ruling case no. 29 NSČR 61/2012-B-35 (KSOS 22 INS 24195/2011) of 26 February 2014 and 29 NSČR 88/2013-B-29 (KSOS 22 INS 22824/2012) of 30 January 2014.

[610] See the High Court in Prague the ruling case no. 1 VSPH 1775/2012-B-18 (MSPH 89 INS 13383/2012) of 8 January 2013.

[611] The US Bankruptcy Code distinguishes between discharge of debs under chapter 7 and chapter 13 whereas chapter 13 receives favorable treatment in order to make it more attractive to chapter 7. See mainly sections 1328(f) and 727(a) of the US Bankruptcy Code.

[612] Section 395(2)(a) of the Czech IA initially states that the court would dismiss a petition if the petition was filed by a person whose petition for a discharge of debts was considered. Some authors argued that a motion for discharge of debts could only once in a life. See KOTOUČOVÁ, Jiřina et al. *Zákon o úpadku a způsobech jeho řešení (insolvenční zákon) – komentář*. Prague: C. H. Beck, 2008, p. 953.

another motion for discharge of debts in the future.[613] In other words, the court has arguably discretion to consider whether the filing is abusive.

In this connection, the 2018 Draft Amendment excludes debtors from discharge of debts proceedings if in the last 10 years preceding the submission of an insolvency petition, they have been granted a debt relief order.[614] Similarly, the court is mandated to dismiss a motion for discharge of debts if three years prior to the submission of an insolvency petition, the debtor's motion for discharge of debts has been dismissed on the basis of dishonesty, or a discharge of debts confirmation has been revoked on the basis of dishonesty.[615] Also, one of the preconditions shall be that a motion for discharge of debts has not been withdrawn three months prior to the commencement of insolvency proceedings.[616] Pursuant to the updated explanatory notes, the intention is to prevent the abuse of filings of repeated insolvency petitions.[617] Yet, the abovementioned exclusionary barriers should not apply in cases of reasons worthy of special consideration [in Czech: *důvody zvláštního zřetele hodné*], in particular if the debtor assumed a debt on the basis of justifiable reason or if there is a significant disproportion between the amount of debt and related consideration [in Czech: *zavázal-li se dlužník z ospravedlnitelného důvodu nebo existuje-li výrazný nepoměr mezi výší dluhu a poskytnutého plnění*].[618]

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[613] Strict adherence to the text of the provision would arguably lead to the interpretation that would be too restrictive. Moreover, efficiency grounds as well as social policy enshrined in the explanatory note favour a more liberal approach. See also HAVEL, Bohumil. Oddlužení - zbraň nebo hrozba? *Právní rozhledy*, 2007, vol. 15, no. 2, pp. 52-53.

[614] Section 395(4) of the Czech IA as amended by the 2018 Draft Amendment. Initially, the 2018 Draft Amendment contemplated the period of 7 years.

[615] Section 395(5) of the Czech IA as amended by the 2018 Draft Amendment. Yet, the provision does not contemplate the case when a debt relief is revoked on the basis of fraudulent conduct pursuant to section 417(1) of the Czech IA. Such omission is probably not the intention of the legislature.

[616] Section 395(6) of the Czech IA as amended by the 2018 Draft Amendment. Yet, it appears that the wording should rather refer to a withdrawal of an insolvency petition instead of a withdrawal of motion for discharge of debts.

[617] It does not seem necessary to incorporate such preconditions since arguably even under the current wording of the Czech IA such practice would not be consistent with the requirement to act honestly. Incorporation of such preconditions might open a room for (incorrect) argumentation that the submission of an insolvency petition 3 months and one day after previous motion has been withdrawn is perfectly fine.

[618] Section 395(7) of the Czech IA as amended by the 2018 Draft Amendment. The vague wording is subject to criticism. See e.g. comments available on <https://apps.odok.cz/veklep-detail?pid=KORNAEGFH2IL>. The Ministry of Justice of the Czech Republic updated the explanatory note which seeks to provide several examples, including a case when a debtor has incurred excessive debts in relation to his illness which has threatened his life. Regardless of provision of any examples, the vague and unclear wording might lead to unpredictable interpretation.

However, as is discussed below in terms of time frame which is considered, not all steps taken by the debtor are irrevocable. Courts mainly take into account rather a short period of time which precedes the commencement of the insolvency proceedings. It appears that the most decisive point is whether as of the filing of a motion for discharge of debts, the debtor has undertaken in fact a real transformation to solve his affaires prudently.[619] Thus, as indicated above, courts even allow debtors to prove such real transformation during proceedings before a court of appeal. In other words, if a debtor has undertaken a dishonest measure prior to the filing of an insolvency petition, such as a transfer of property to a friend or a relative, he might still prove his honest intentions and real transformation by returning the respective piece of property back or by similar actions. These steps restore creditors to the same position as if the debtor had not undertaken the questionable conveyance. If it is the debtor who discloses previous missteps to creditors and the court, the disclosure might support the conclusion that the debtor has in fact undertaken the real transformation of his affairs.

Although it appears that the most decisive is the time which shortly precedes the submission of a motion for discharge of debts, the Czech IA does not explicitly sets forth any ultimate historic moment at which one might look. Unless specific circumstances demand otherwise, it might be argued that one should not take into considerations facts that occurred more than 5 years prior to the commencement of insolvency proceedings.[620] Nevertheless, five-year long period might seem to be too long. In any case, this question seems to be rather theoretical as courts mostly look at a short period prior to the commencement of insolvency proceedings and the answer might be therefore important mostly in cases of previous insolvency proceedings or criminal convictions.

Moreover, the requirement to act honestly applies arguably to the whole length of the discharge of debts proceedings.[621] In this regard, pursuant to section 418 of the Czech IA, the court might *inter alia* revoke a discharge of debts confirmation and convert

[619] See e.g. the Supreme Court ruling case no. 29 NSČR 15/2013-B-48 (KSBR 40 INS 14439/2011) of 26 February 2014.

[620] The initial wording of section 395 of the Czech IA anticipated that the courts might have taken into account previous insolvency proceedings or criminal conviction 5 years prior to the insolvency proceedings.

[621] See e.g. the Supreme Court ruling case no. 29 NSČR 8/2012-B-49 (KSHK 42 INS 13386/2010) of 30 January 2014 or 29 NSČR 45/2010-B-174 (MSPH 93 INS 1923/2008) of 30 April 2013 or the High Court in Olomouc ruling case no. 1 VSOL 382/2016-A-14 (KSBR 44 INS 2582/2016) of 16 April 2016.

the proceedings into liquidation if on the basis of the circumstances of individual case, it might be reasonably concluded that a debtor pursues dishonest intentions.[622]

In this connection, it is worth mentioning that the question whether a debtor acts honestly actually might be assessed even three years following a debt relief order becomes effective. However, the court should take into account only the steps that occurred during discharge of debts proceedings.[623] Other approach would be obviously inconsistent with the principles of discharge of debts since its aim is not to motivate debtors to act honestly even after the termination of the insolvency proceedings.

The Ministry of Justice of the Czech Republic initially contemplated that the abovementioned framework concerning the requirement to act honestly would be significantly changed by virtue of the 2018 Draft Amendment. It initially suggested that courts should move from quantitative criteria to qualitative criteria. As indicated above, the 2018 Draft Amendment generally seeks to dispense with the mandatory requirement of repayment of 30 % of unsecured claims. By the same token, it intended to incorporate new precondition of discharge of debts, namely whether the actual method of living of a debtor hitherto indicates his recklessness or negligence, which after considering all circumstances might lead to a reasonable assumption that the debtor will not fulfil his obligations in insolvency proceedings [in Czech: *dosavadní způsob života dlužníka svědčí o jeho zřejmé lehkomyslnosti nebo nedbalosti, pro něž lze se zřetelem ke všem okolnostem důvodně předpokládat, že dlužník nebude plnit povinnosti v insolvenčním řízení*]. It is not exactly clear what the intention was. The explanatory notes indicated that courts should assess more the way of living of a debtor prior to the commencement of insolvency proceedings. Given the fact that the 2018 Draft Amendment seeks to dispense with the mandatory pay-out, there might be a substantial increase the number of new motions for discharge of debts which would render the assessment of previous way of debtor's living unreal. Also, the mentioned requirement would arguably overrule the current pro-debtor (favourable) approach of courts.[624] In the end, the intention of the Ministry of Justice of the Czech Republic –

[622] Prior to 1 January 2014 the Czech IA did not provide for the conversion of discharge of debts into liquidation after the issuance of a discharge of debts confirmation. Yet, since the Czech IA provided for rejection of a debt relief order on the ground of dishonesty, courts rightly concluded that discharge of debts might be converted into liquidation even during the life of repayment plan. See e.g. the Supreme Court ruling case no. 29 NSČR 71/2013-B-131 (KSHK 42 INS 3097/2012) of 26 February 2014.

[623] Section 417 of the Czech IA.

[624] See also comments of the Supreme Court on the 2018 Draft Amendment available on <https://apps.odok.cz/veklep-detail?pid=KORNAEGFH2IL>.

to render discharge of debts available to the poorest would probably miss the aim since debtors would presumably more often fail to meet the requirement. Following the criticism of the abovementioned proposal, the Ministry of Justice of the Czech Republic appears to leave the idea so that the current version of the proposal no longer contains the new criterion. Still, for unknown reasons, the explanatory notes refer to the fact that courts should move their assessment from quantitative criteria to qualitative criteria which might lead to unpredictable interpretations.[625]

4.4.4 Reckless or negligent approach

Also, a motion for discharge of debts shall be dismissed in cases when results of insolvency proceedings demonstrate that a debtor has reckless or negligent approach towards fulfilment of his duties in the insolvency proceedings [in Czech: *dosavadní výsledky řízení dokládají lehkomyslný nebo nedbalý přístup dlužníka k plnění povinností v insolvenčním řízení*].[626] The provision provides no guidelines on the interpretation thereof. What is common with the requirement of honesty is that compliance with this duty is based on a case-by-case analysis of individual circumstances. Unlike in case of the requirement to act honestly, courts assess solely facts that occur during the course of the insolvency proceedings. The principle behind that is that the requirement should ensure cooperation of the debtor in insolvency proceedings. [627] In other words, it mandates a debtor to fulfil particularly his procedural duties. A failure to meet this requirement might be a reason for dismissal of previously issued discharge of debts order.[628]

As in the case of the requirement of honesty, it appears that courts are generally reluctant to dismiss a motion for discharge of debts on the basis of minor infringements of debtor's duties and are quite sympathetic towards debtors. Judges mostly consider that debtors have not enough legal background to comprehend legal peculiarities of discharge of debts. Thus, inappropriate behavior of a debtor does not automatically mean that a motion

[625] Arguably it might be due to the fact that it seeks to strengthen the supervisory role of insolvency trustees.

[626] Section 395(2) of the Czech IA.

[627] See e.g. the High Court in Olomouc ruling case no. 3 VSOL 32/2015-B-10 (KSBR 24 INS 18592/2014) of 27 January 2015 or the High Court in Prague ruling case no. 4 VSPH 160/2015-A-37 (MSPH 93 INS 4054/2014) of 9 March 2015.

[628] See e.g. the Supreme Court ruling case no. 29 NSČR 16/2010-B-45 (KSUL 44 INS 411/2009) of 26 October 2010.

for discharge of debts shall be dismissed.[629] Also, a lack of complete documentation or individual absence at a court hearing might be excused when the debtor otherwise keeps his duties.[630] This is particularly the case when a debtor expresses regret over previous missteps[631] or when taking into account other circumstances a dismissal would appear to create a hardship.[632] Interestingly, courts also take into account debtor's steps (including rectification of previous missteps) undertaken after courts of first instance convert discharge of debts into liquidation.[633] However, repeated failures to fulfill obligations such as a failure to provide the necessary documentation,[634] to cooperate with an insolvency trustee, [635] to provide the court with the information regarding nature of debtor's debts[636] or to pay a deposit on remuneration of insolvency trustee[637] are mostly not tolerated.

4.4.5 Assessment of fulfillment of preconditions for discharge of debts

Discharge of debts proceedings essentially anticipate two main court rulings, namely a discharge of debts order and a discharge of debts confirmation. However, as indicated

[629] See e.g. the High Court in Olomouc ruling case no. 3 VSOL 418/2012-B-15 (KSBR 24 INS 23614/2011) of 12 June 2012 where a debtor left a court hearing after being angered by the fact that the insolvency trustee acknowledged that sale of debtor's assets is not possible as a method of discharge of debts. The debtor later expressed his apologies and explained his behavior in the appeal against the dismissal of his motion for discharge of debts. The High Court in Olomouc noted that the debtor should know the law but understood that presence before a court might be stressful for the debtor.

[630] See e.g. the High Court in Olomouc ruling case no. 1 VSOL 854/2012-B-34 (KSBR 30 INS 468/2012) of 31 January 2013.

[631] See e.g. the High Court in Prague ruling case no. 1 VSPH 100/2012-B-23 (MSPH 94 INS 10452/2011) of 30 January 2012 or 3 VSPH 223/2011-B-13 (KSUL 70 INS 11081/2010) of 15 April 2011. Interestingly, the court of appeal accepted the debtor's promise to improve his behavior after having used vulgar language and otherwise refused to cooperate with the insolvency trustee. See the High Court in Prague ruling case no. 4 VSPH 2197/2015-B-14 (KSCB 41 INS 17401/2015) of 28 April 2016.

[632] See e.g. the High Court in Olomouc ruling case no. 2 VSOL 556/2015-B-15 (KSBR 33 INS 33016/2014) of 18 June 2015.

[633] See e.g. the High Court in Olomouc ruling case no. 2 VSOL 454/2016-B-30 (KSOS 33 INS 24943/2012) of 23 June 2016.

[634] See e.g. the High Court in Prague ruling case no. 2 VSPH 132/2015-B-24 (KSUL 77 INS 14754/2013) of 4 September 2015 or 3 VSPH 801/2015-B-19 (KSUL 81 INS 14150/2014) of 16 November 2015.

[635] See e.g. the High Court in Prague ruling case no. 4 VSPH 2197/2015-B-14 (KSCB 41 INS 17401/2015) of 28 April 2016.

[636] The High Court in Olomouc ruling case no. 2 VSOL 373/2015-A-20 (KSBR 47 INS 34240/2014) of 22 July 2015.

[637] See e.g. the High Court in Prague ruling case no. 2 VSPH 851/2014-B-12 (MSPH 60 INS 35680/2013) of 12 September 2014 or the High Court in Olomouc ruling case no. 1 VSOL 56/2016-B-20 (KSBR 31 INS 11547/2015) of 10 February 2016. A failure to pay the respective deposit to an insolvency trustee, however, might be cured by later payment thereof during appellate proceedings. See e.g. the High Court in Prague ruling case no. 1 VSPH 2540/2014-B-20 (KSUL 44 INS 19671/2014) of 5 January 2015.

above, it does not mean that the assessment of whether a debtor fulfils all the preconditions for discharge of debts is limited until the issuance of these decisions. Conversely, compliance with debtor's duties (including an obligation to act honestly and to cooperate) is reviewed in the whole course of the insolvency proceedings.[638] This is currently explicitly enshrined in section 418 of the Czech IA,[639] which enables courts to revoke a discharge of debts confirmation and convert discharge of debts into liquidation *inter alia* if a debtor does not fulfil his substantial duties in insolvency proceedings or if on the basis of circumstances of individual case, it might be reasonably concluded that a debtor pursues dishonest intentions.[640]

[638] See e.g. the Supreme Court ruling case no. 29 NSČR 8/2012-B-49 (KSHK 42 INS 13386/2010) of 30 January 2014 or 29 NSČR 45/2010-B-174 (MSPH 93 INS 1923/2008) of 30 April 2013 or the High Court in Olomouc ruling case no. 1 VSOL 382/2016-A-14 (KSBR 44 INS 2582/2016) of 16 April 2016.

[639] As mentioned above, prior to 1 January 2014 the Czech IA did not provide for the conversion of discharge of debts after the confirmation thereof into liquidation. Yet, see e.g. the Supreme Court ruling case no. 29 NSČR 71/2013-B-131 (KSHK 42 INS 3097/2012) of 26 February 2014.

[640] From a broader perspective, the requirement of honesty is assessed even three years following a debt relief order becomes effectives since section 417 of the Czech IA anticipates a revocation of a debt relief order in cases it is ascertained that that a discharge of debts confirmation or debt relief order has been obtained fraudulently or that the debtor has provided to any of his creditors any special preference.

5 Distributive decision-making in discharge of debts

5.1 Rulings in discharge of debts proceedings and their effects

One of the aims of the Czech IA like is that claims of creditors vis-à-vis their debtors are satisfied. In discharge of debts, such procedure comprises of three essential stages. First, a court shall decide on the debtor's insolvency by virtue of an insolvency order. Second, the court issues a discharge of debts order. Finally, the court issues a discharge of debts confirmation which essentially marks the beginning of either repayment plan or liquidation of debtor's assets.

5.1.1 Insolvency order and appointment of an insolvency trustee

Insolvency order commonly marks a decisive phase of insolvency proceedings. In this decision, a court *inter alia* appoints an insolvency trustee.[641] The respective insolvency trustee is designated by a special measure taken by the president of the court. In theory, the president should have no influence over a designation of an insolvency trustee in a particular case as he should proceed pursuant to a rota system and the insolvency trustee is chosen from a list of persons in order. The president may, however, designate a different insolvency trustee on the basis of selected grounds. Such designation must be justified.[642]

Currently, insolvency trustees are chosen from a list of eligible insolvency trustees. In case of discharge of debts, the list of eligible insolvency trustees encompasses insolvency trustees who have their seat or establishment [in Czech: *provozovna*] within the area of a district court which is the so-called general court of a debtor (i.e. in most cases it is a district court determined as per the debtor's place of residence).[643] The 2017 Amendment seeks to modify the rule so that insolvency trustees are chosen from the list of insolvency trustees who have their seat or establishment within the area of a regional court of the debtor.

[641] See section 136 of the Czech IA.

[642] Rules governing the position of insolvency trustees are incorporated particularly in sections 21-40a of the Czech IA and in the Insolvency Trustees Act.

[643] In case of liquidation, the list encompasses insolvency trustees who have their seat or establishment within the area of the competence of the respective court deciding the case in question (i.e. regional court).

The legislature seeks to limit a number of establishments which have been created pursuant to current rules on the appointment of insolvency trustees.[644]

By virtue of an insolvency order, a court also calls creditors of a particular debtor to lodge their claims within the specified period together with the warning that later submission of claims shall be disregarded. If a court issues a discharge of debts order together with an insolvency order, which is mostly the case, the period for a lodgement of claims lasts 30 days. Otherwise, the period for lodgement of claims is two months.

It must be noted that creditors, unless they are seated or domiciled in the Member states of the EU except for Denmark, are not specifically notified about the commencement of insolvency proceedings or about an insolvency order.[645] Taking this into account, implications of a late submission of lodgement of claims seem to be rather harsh. The legal framework, as it stands, effectively puts a burden on creditors to monitor whether any insolvency proceedings have been instigated against their debtors, and lies on the principle of *vigilantibus iura*. In other words, creditors are in practice required to procure hardware (computer, mobile with access to internet or another device), ensure an access to internet and regularly search the insolvency register. Institutional creditors, such as financial institutions, naturally have systems that facilitate them to regularly monitor their debtors in order not to miss the deadline for the lodgement of claims. However, one may have concerns whether such requirement is fair with respect to natural persons who are not engaged in business. This is particularly due to a relatively short period applicable for the lodgement of claims.[646] Despite these concerns, at least with respect to entrepreneurs the Constitutional Court held that the provision concerning the deadline of the lodgement of claims is not unconstitutional.[647] Still, the Constitutional Court noted that amendment contemplating a notification to creditors would be appropriate.[648] Since it is always the debtor who proposes

[644] Insolvency trustees have been motivated to create as many establishments possible in order to attract a large number of cases.

[645] The creditors are generally deemed to be notified by virtue of the publicly available insolvency register. See particularly sections 71 and 136 of the Czech IA or the Supreme Court ruling case no. 29 NSČR 4/2008-P11-12 (KSBR 38 INS 735/2008) of 4 September 2008. On notification of known creditors from abroad see section 430 of the Czech IA.

[646] In practice, the creditors might lodge their claims since the commencement of insolvency proceedings. Thus, the period for the lodgment is in fact longer.

[647] See e. g. the Czech Constitutional Court ruling case no. II. ÚS 3637/14 (KSPA 48 INS 12585/2012) of 16 December 2014 or I. ÚS 2536/08 (KSBR 38 INS 735/2008) of 26 January 2009.

[648] The Slovak LRA as amended by the Slovak Revision Amendment anticipates that a debt relief applies solely to those creditors whom an insolvency trustee could notify (i.e. who were enlisted in the respective list of debtor's debts). See the Slovak Revision Amendment.

to resolve his insolvency by way of discharge of debts proceedings, the requirement to notify creditors might be shifted to the debtor who would have to prove the fulfilment of this obligation together with the submission of a motion for discharge of debts.[649] In any case, in order to balance rights and obligations of creditors and debtors, partial modification of the current legal framework would be reasonable.

Insolvency order also sets the date of the first creditors' assembly [in Czech: *schůze věřitelů*] and hearing on verification of creditors' claims [in Czech: *přezkumné jednání*]. Generally, a creditors' assembly shall be convened within three months from the issuance of an insolvency order and the hearing on verification of creditors' claims shall take place within two months from the lapse of time for the lodgement of claims, but no sooner than 7 days after such lapse.[650] If a discharge of debts order is issued together with an insolvency order, the hearing on verification of creditors' claims takes place in the period between 37 and 60 days after the issuance of an insolvency order.[651] Regularly, the first creditors' assembly takes place immediately after the hearing on verification of creditors' claims. At creditors' assembly, creditors might vote on the method of discharge of debts, choice of creditors' representative (or creditors' committee) and might vote on the removal of the appointed insolvency trustee and his replacement by another insolvency trustee.

From a statistical viewpoint, vast majority of insolvency petitions have been substantiated in the sense that courts issued an insolvency order. Interestingly, since the adoption of the Czech IA, the ratio of substantiated insolvency orders to insolvency petitions has been increasing. In 2016, 29,493 insolvency petitions were submitted and courts issued 24,146 insolvency orders. In other words, the ratio of insolvency orders to insolvency petitions equals to 81.9 %.[652]

[649] Given the fact that debtors seem not to be knowledgeable about the rules of discharge of debts, it is questionable how the requirement would be fulfilled in practice.

[650] See section 137 of the Czech IA.

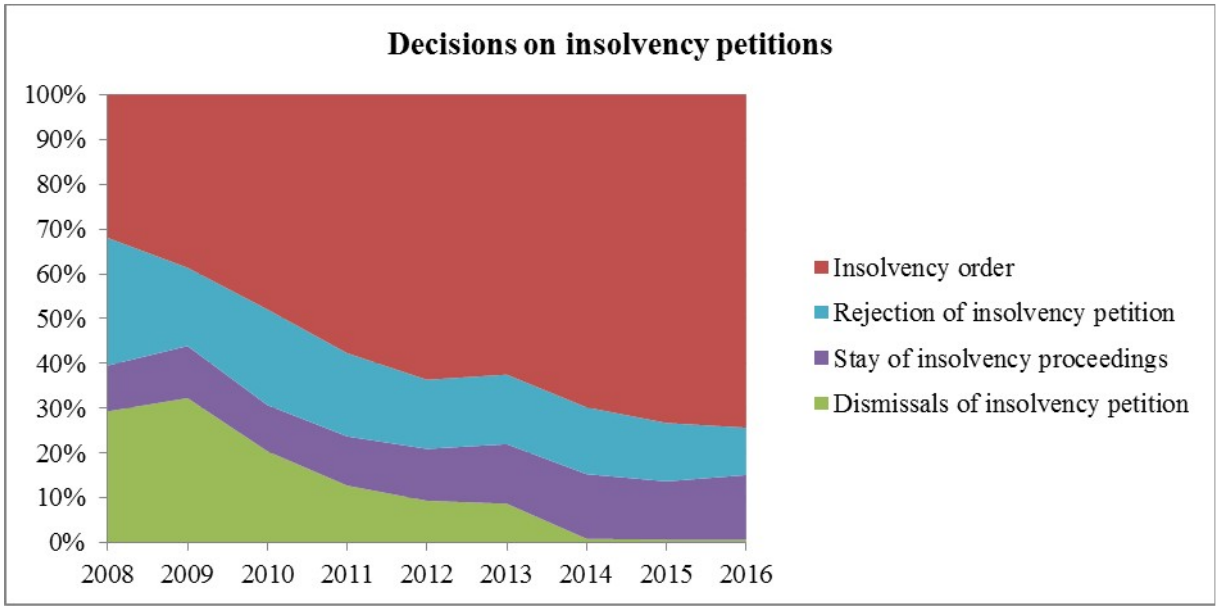
[651] See section 137(2) of the Czech IA.

[652] One must bear in mind that it takes some time to decide over an insolvency petition. Yet, it appears that overall ratio of decision whereby courts did not issue an insolvency order has decreased.

Chart 4: Statistics about insolvency orders[653]

Period	Number of insolvency petitions	Number of insolvency orders	Insolvency orders / insolvency petitions
2008	5,236	1,368	26.13 %
2009	9,396	3,941	41.94 %
2010	16,601	8,004	48.21 %
2011	24,466	14,118	57.70 %
2012	32,656	20,700	63.39 %
2013	37,613	25,044	66.58 %
2014	35,076	27,843	79,38 %
2015	32,334	25,698	79.48 %
2016	29,493	24,146	81.9 %

Graph 2: Statistics about decision on insolvency petitions[654]



In this connection, the 2017 Amendment anticipates one major set of modifications. In line with the current trend,[655] the amendment seeks to dispense with so far mandatory creditors' assembly. Creditors' assembly shall be convened only if the so-called double

[653] Source of data: statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information.

[654] Source of data: statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information. It may be observed that a number of decisions whereby courts dismissed insolvency petitions has substantially decreased since 2014. It is *inter alia* also due to the fact that since 1 January 2014 courts cannot dismiss insolvency petitions on the ground of insufficiency of debtor's assets.

[655] See e.g. WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. …, p. 56.

majority of creditors require so (majority of creditors counted as per number of creditors and concurrently as per value of claims). Given that creditors tend not to attend creditors' assembly at all, one might expect that creditors' assembly will become rare.[656]

From a critical viewpoint, on the one hand, it might be reasonable to dispense with mandatory creditors' assembly since they are rarely attended. On the other hand, the requirement of double majority to convene a creditors' assembly might be questionable since in case of other methods of resolution of debtor's insolvency, a request of two creditors having at least 10 % of total value of claims suffices. Also, the absence of creditors' assembly entails that the debtor lose face-to-face contact with the court and *vice versa*.[657] The supervisory role of the court (judges) might be, to a certain extent, limited.

If creditors would like to assume a role of a creditors' representative (member of creditors' committee), they would have to actively submit a declaration to the court.[658] Yet, it is not clear how the court shall decide if more creditors will seek to assume the position in the absence of creditors' assembly.

Moreover, the 2017 Amendment anticipates that in order to remove the appointed insolvency trustee and appoint a new one, double majority shall be needed.[659] The legislature argues that in many proceedings, institutional creditors such as financial institutions tend to appoint the very same insolvency trustee in insolvency proceedings, which is perceived negatively. Nevertheless, the sole fact that certain insolvency trustees are appointed does not mean that the choice of the newly appointed insolvency trustees is not substantiated. Arguably, if such appointed insolvency trustee is not competent enough or has a conflict

[656] Anecdotal experience suggests that in less than 10 % of cases at least one creditor takes part in creditors' assembly. Yet, no precise data exist.

[657] In this connection, it would be interesting to evaluate to what extent the absence of a face-to-face contact of debtors with courts and public hearings shall affect stigma attached to insolvency, and whether it shall affect the propensity to go bankrupt.

[658] Pursuant to section 136(2)(h) of the Czech IA as amended by the 2017 Amendment, an insolvency order issued together with a discharge of debts order shall contain a call for creditors to declare whether they are willing to assume a position in creditors' body (creditors committee or creditors' representative). However, based on general apathy of creditors hardly anybody will actively ask for such function.

[659] See section 29(1) of the Czech IA as amended by the 2017 Amendment. Moreover, pursuant to section 34(3) of the Czech IA as amended by the 2017 Amendment, if the appointed insolvency trustee is removed, he shall act as a separate insolvency trustee [in Czech: *oddělený insolvenční správce*] with his consent with respect to claims denied before the removal and assets vis-à-vis to the creditors who voted for the removal.

of interest, the law should address it differently (a court might remove an insolvency trustee).[660]

In any case, as the 2017 Amendment stands, powers of creditors shall be limited.[661] Presumably, the legislature went too far. It would arguably suffice to simply state that creditors' assembly shall not take place unless at least two creditors having at least 10 % of total value of claims requests the court to convene it.[662]

5.1.2 Discharge of debts order

Pursuant to section 397(1) of the Czech IA, the court shall issue a discharge of debts order unless the court decides on dismissal or rejection of a motion for discharge of debts or unless the debtor has withdrawn his motion for discharge of debts. Following the adoption of the Revision Amendment, it follows that in case the court has doubts on whether the debtor is eligible for discharge of debts, the court shall rule in favour of discharge of debts order.[663] Any disputed issues should be resolved at the creditors' assembly convened to decide on the confirmation of discharge of debts and its method.[664]

Since a discharge of debts order represents a ruling in favor of a debtor as a sole petitioner, there cannot be an appeal against such ruling. If creditors do not agree with discharge of debts, they might formally question discharge of debts at creditors' assembly upon which the court decides on confirmation of discharge of debts. In other words, the creditors have no formal say concerning whether the court should issue a discharge of debts order.[665]

From the available data, it follows that since 2008, a number of motions for discharge of debts submitted to courts has been gradually increasing until 2015. Year-over-year growth in 2009 reached more than 120 % and in 2010 even 168 %. The increase in the number

[660] A special relationship or even dependence might create between the respective creditor and insolvency trustee which might cast doubts upon the impartiality of the insolvency trustee. Such insolvency trustee should disclose all facts pertaining to his impartiality.

[661] Clearly, the legislature intends to save costs at the price of limitation of creditors' powers.

[662] This requirement applies generally in order to convene creditors' assembly if it is not mandatory. See section 47(1) of the Czech IA.

[663] See section 397(2) of the Czech IA.

[664] However, as stated above, it is argued that courts have interpreted the mentioned provision incorrectly as concerns the eligibility for discharge of debts and existence of business-related debts. Arguably, following the 2017 Amendment, the current case-law shall be displaced in favor of debtors. See chapter 4.4.1 *supra.*

[665] Following the 2017 Amendment, creditors might either request the court to convene creditors' assembly and/or submit written objections. Accordingly, creditors' position shall be undermined.

of submission of motions for discharge of debts from 2008 until 2016 equals to an incredible growth of about 1,588 %.

A number of issued discharge of debts orders has increased even more substantially.[666] Whereas for instance in 2009 courts issued 2,164 discharge of debts orders, in 2015 the courts ruled in favour of debtors in 23,413 instances. Obviously, discharge of debts has become a huge phenomenon. Year-over-year growth in number of issued discharge of debts order in 2009 was 235 % whereas in 2010 about 173 %. The difference in year-over-year growth between numbers of motions for discharge of debts and discharge of debts orders is mainly due to the fact that "success rate" of such motions has been gradually increasing from about 38 % in 2008 up to current 84 % in 2016.[667] Accordingly, the increase in number of issued discharge of debts from 2008 until 2016 equals to about 3,350 %.

One final comment must be made. A small decrease in the number of submissions of motions for discharge of debts in 2015 and 2016 does not have to necessarily mean that the number of debtors, with respect to which discharge of debts have been initiated, has decreased too. As of the beginning of 2014, the legislature has introduced a joint motion for discharge of debts of spouses.[668] Therefore, since that time, instead of two individual motions a single joint motion is filed.[669] In other words, since January 2014 it is not possible to infer how many individual debtors have filed for discharge of debts.

[666] As mentioned above, statistics might contain several inaccuracies – e.g. an appeal may be filed against a discharge of debts order which is then overruled and issued again. As a consequence of this procedure, more discharge of debts orders might be in theory issued in one insolvency proceedings. Given the large number of discharge of debts orders, such deficiency arguably has a limited impact.

[667] However, one must take into account that it takes courts generally a few weeks to decide over a motion for discharge of debts. Therefore, in practice many discharge of debts orders are issued further to motions for discharge of debts submitted in the preceding year.

[668] See chapter 5.8 *infra*.

[669] Similarly instead of two separate discharge of debts orders, courts issue solely one discharge of debts order.

Chart 5: Statistics about discharge of debts orders[670]

Period	MDD	MDD y-o-y	DD orders	DD y-o-y	DD orders / MDD
2008	1,693	-	646	-	38.2 %
2009	3,733	120.5 %	2,164	235.0%	58.0 %
2010	10,007	168.1 %	5,902	172.7%	59.0 %
2011	18,020	80.1 %	11,614	96.8%	64.5 %
2012	25,868	43.6 %	17,985	54.9%	69.5 %
2013	30,326	17.2 %	22,063	22.7%	72.8 %
2014	30,575	0.8 %	24,890	12.8%	81.4 %
2015	28,578	-6.5 %	23,413	-5.9%	81.9 %
2016	26,656	-7.0 %	22,287	-4.8%	83.9 %
Total	**175,356**		**130,964**		**74.7 %**

*MDD - motions for discharge of debts
**DD orders - discharge of debts orders
***y-o-y - year-over-year growth

5.1.3 Rulings in discharge of debts and their effects on the debtor's earning capacity

The Czech IA does not set forth the implications of the issuance of an insolvency order on possible entrepreneurial or other earning activities of debtors.[671] Such implications are stated in special statutes concerning different sort of activities.

From a range of the most stringent to the least stringent laws in terms of limitations on debtors' entrepreneurial or other earning activities, one might distinguish three essential categories of laws. First, an insolvency order, discharge of debts order or discharge of debts confirmation might automatically exclude debtors from earnings activities. Second, they might exclude debtors on a discretionary basis. Third, they might have no implications on debtors' activities or they might trigger some information duties.

Although this chapter does not aim to capture all sort of different professions, arguably, most of Czech statutes fall into the third category. In other words, most of earning activities might be undertaken regardless of rulings issued in discharge of debts proceedings

[670] Source of data: statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information.

[671] Apart from effects on entrepreneurial activities of debtors, an insolvency order has several additional effects such as the commencement of the lapse of time for lodgement of claims, effects on pending proceedings etc.

so that they do not in effect disqualify debtors.[672] What in essence appears to impede most of entrepreneurial activities is the issuance of a liquidation order (in Czech: *prohlášení konkursu*).

Arguably, most of entrepreneurs are engaged in business on the basis of a trade license (in Czech: *živnostenské oprávnění*).[673] Pursuant to the Act no. 455/1991 Coll., Trade Licensing Act, as amended, a person who is declared insolvent is not automatically excluded from his entrepreneurial activities and may continue in business untouched. The so-called obstacles of business operation [in Czech: *překážka provozování živnosti*], which prevent an entrepreneur from engaging in business under regulated trade licenses, are triggered in liquidation. Arguably, neither an insolvency order nor a discharge of debts order does prevent debtors from engaging in business under the Trade Licensing Act.[674]

Also, a person who is declared insolvent is not excluded from being a member of an elected body of a legal entity. However, section 153 of the Czech Civil Code triggers certain information duties. A member of an appointed body has a duty to inform the body which has appointed such person about an insolvency order. If such duty is not met, any person who has a legal interest might file a motion to a court to remove the respective person unless the body appointing the person confirms the respective person in function in the meantime. These implications expire three years after the termination of insolvency proceedings. Similarly, pursuant to section 46(2) of the Act no. 90/2012 Coll., on Corporations, a person who intends to get a position as a member of the appointed body of corporations shall inform the respective founder or corporation *inter alia* whether any insolvency proceedings were pending in the preceding three years with respect to his

[672] Pursuant to date published by the Czech Social Security Administration, as of 31 December 2015, there were 969,849 self-employed persons whereas 572,126 were undertaking entrepreneurial activities as main activity and the rest as ancillary activity. See *Summary on statistics regarding self-employed persons as of 31. 12. 2015* [online]. Czech Social Security Administration, 2016 [cited 3 March 2017]. Available on <http://www.cssz.cz/NR/rdonlyres/79262D9E-873B-4D77-B1F7-D0DCB29E4DB5/0/prehled_o_poctu_osvc_dle_ossz_a_kraju__brezen_2016.pdf>.

[673] Pursuant to the data published by the Ministry of Industry and Trade of the Czech Republic there were 1.982.757 holders of trade licenses as of 31 December 2015. See data available on <http://www.rzp.cz/statistikySbj.html>.

[674] In this regard, it might be argued that discharge of debts in the form of sale of debtor's assets constitute the so-called obstacle of business operation. The reason is that pursuant to section 408(1) of the Czech IA the sale of debtor's assets has the same effects on the debtor's assets as a liquidation order. However, section 408(1) of the Czech IA refers to the effects on the debtor's assets not on the debtor in general. Moreover, there would be an unsubstantiated discrepancy between the effects of two different methods of discharge of debts. It would not be reasonable to exclude from business the debtors, with respect to whom the sale of assets as a method of discharge of debts is confirmed, and concurrently leave the debtors in repayment plan unaffected.

property. Yet, the Act on Corporations stipulates that in case a discharge of debts confirmation is issued, general partnership is dissolved.[675]

The second category of statutes includes *inter alia* the Act no. 85/1996 Coll., on Legal Profession, as amended [in Czech: *zákon o advokacii*], or the Act no. 458/2000 Coll., Energy Act, as amended. The Energy Act does not automatically disqualify debtors from business activities regulated hereunder. However, the Energy Regulatory Office might revoke a license if an insolvency order has been issued with respect to a holder of a license.[676] Pursuant to the Act no. 85/1996 Coll., on Legal Profession, the Czech Bar Association might suspend a practice of legal profession of a lawyer if insolvency proceedings have been commenced with respect to such lawyer as a debtor.[677] A member of the Czech Bar Association is removed if a liquidation order is issued with respect to such person as a debtor. Therefore, even if the Czech Bar Association might suspend a right to exercise legal profession, the respective debtor is not automatically barred from continuance of his activities even in cases a discharge of debt order is issued. Interestingly, there are no provisions regarding particularly notaries and enforcement office holders [in Czech: *exekutor*].

On the margin between the second and the first category lies the new Act no. 134/2016 Coll., on Public Procurement. Section 74 of Act no. 134/2016 Coll., on Public Procurement, anticipates that a person with respect to whom an insolvency order has been issued does not comply with the so-called basic qualification criteria. Whereas the old Act no. 137/2006 Coll., on Public Procurement, as amended, stated that an insolvency order excluded the person from procurement for a limited period of three years following the termination of insolvency proceedings,[678] the current procurement laws do not contemplate such strict limitation. Instead, the Act on Public Procurement contemplates that the respective person might prove that it has recovered the ability to fulfill qualification criteria.[679] Thus, no strict formal criteria apply and there is some discretion on the part of the procuring entity.

The first category of statutes covers more or less specialized professions where the state arguably emphasis financial health on the side of the providers of services. First

[675] Section 113(1)(f) of the Act no. 90/2012 Coll., on Corporations.

[676] Section 10(3)(b) of the Act no. 458/2000 Coll., Energy Act, as amended.

[677] See section 9(2)(c) of the Act no. 85/1996 Coll., on Legal Profession, as amended.

[678] See section 53(1)(d) of the Act no. 137/2006, on Public Procurement, as amended.

[679] See section 76 of the Act no. 134/2016 Coll., on Public Procurement.

of all, not surprisingly, a person who is declared insolvent is not eligible to become an insolvency trustee.[680] Similarly such person cannot be a holder of a license for being an exchange officer.[681] Under section 19(1)(b) of the Act no. 38/2004 Coll., on Insurance Brokers and Loss Adjustors, as amended, a person who is declared insolvent does not comply with the requirement of credibility. Therefore, professionals such as tied insurance intermediaries subordinated insurance intermediaries, insurance agents, insurance brokers or independent loss adjustors are limited in their scope of activities. Interestingly, authorization granted under the Act no. 258/2000 Coll., on Protection of Public Health, as amended, terminates upon the issuance of an insolvency order of a holder.[682]

To sum it up, generally, an insolvency order, a discharge of debts order and a discharge of debts confirmation do not prevent debtors from being engaged in business activities that they until then were doing. With certain exceptions, what impedes continuance of entrepreneurial activities is the issuance of a liquidation order. This approach is consistent with the fresh-start principle as the person should be given a new chance which implies also continuance of his previous activities.

5.2 Discharge of debts confirmation

The Czech insolvency law anticipates that discharge of debts proceedings may be in the form of either liquidation of all non-exempt debtor's assets [in Czech: *zpeněžení majetkové podstaty*] or repayment plan [in Czech: *plněním splátkového kalendáře*].[683] In comparison to the repayment plan, the sale of debtor's assets appears to be generally faster since insolvency proceedings might be terminated within one year from the commencement of the insolvency proceedings. Thus, from an economic standpoint, if the sale of debtor's assets and repayment plan anticipates more or less the same ratio of satisfaction of creditors' claims, it might be more beneficial for creditors to prefer the sale of debtor's assets. Simply said, creditors obtain the proceeds sooner. In this connection, it must be noted that neither the interest on the claims (both contractual as well as statutory interest on delayed payments)

[680] Section 7(1)(c) of the Insolvency Trustees Act.

[681] Section 9(1)(b) of the Act no. 277/2013 Col., on Exchange Office Services, as amended.

[682] See section 83c(1)(e) of the Act no. 258/2000 Coll., on Protection of Public Health, as amended.

[683] Unlike in the USA, where a debtor is arguably even after the adoption of the 2005 BAPCA (Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. 109–8, 119 Stat. 23, enacted 20 April 2005) less constrained as to whether to choose chapter 7 or chapter 13 procedure, under the Czech IA, the debtor indicates the preference of the method in a motion for discharge of debts, yet creditors are given an opportunity to vote over it. See sections 399-402 of Czech IA.

nor contractual penalties applicable to the claims which have arisen or which have become due after the insolvency order might be satisfied in insolvency proceedings.[684] This rule does not provide many incentives to creditors to prefer repayment plan (i.e. to obtain proceeds on their claims over a period of time).

Naturally, risks associated with the respective methods of discharge of debts differ.[685] In sale of assets, the risks include that the value of assets to be liquidated will be substantially lower than anticipated or that some of the assets will not be sold at all. Also, there might be additional costs associated with the sale of the property as certain assets might be difficult to sell. Arguably, debtors in discharge of debts proceedings have rather standard types of assets which are not difficult to sell. Risks in repayment plan might be perceived to be rather higher particularly due to the fact that a repayment plan might take (and mostly indeed takes) up to five years. Most notably, debtors might lose their job, get ill, commit suicide or die. Nevertheless, there are mostly no additional costs of administration on the part of an insolvency trustee.[686]

Statistically, the sale of the debtor's assets accounts for a small minority of all discharge of debts proceedings. Taking into account the available data from 1 January 2008 until 31 December 2016, in average, less than 3 % of all discharge of debts had the form of sale of debtor's assets. The minimum ratio of sale of debtor's assets vis-à-vis total number of discharge of debts confirmation was 1.8 % in 2010 whereas the maximum reached only about 3.3 % (see chart 6 below). Arguably, at the time of the commencement of insolvency proceedings, debtors have small assets left either due to previous higher consumption, previous enforcement proceedings in which the assets were liquidated, poverty or other related causes.

[684] Section 170 of the Czech IA sets forth a number of types of claims that are not subject to satisfaction in insolvency proceedings.

[685] Obviously, in both methods of discharge of debts, there are risks associated with fraudulent behavior of debtors consisting *inter alia* of the temptation not to disclose extraordinary income during the course of the insolvency proceedings. However, creditors vote on the method of discharge of debts at creditors' assembly. Thus, they will not mostly take into account some uncertain steps such as whether a debtor will obtain any extraordinary income in the future. In other words, risks associated with fraudulent or otherwise unlawful acts of debtors will arguably not be reflected in the decision-making of the creditors.

[686] See rules on remuneration of insolvency trustees in chapter 5.4.5 *infra*.

Chart 6: Statistics about methods of discharge of debts[687]

Period	Sale of assets	Repayment plan	DDC in total	Sale of assets / DDC in total	Repayment plan / DDC in total
2008	13	464	477	2.7 %	97.3 %
2009	30	1,592	1,622	1.8 %	98.2 %
2010	82	4,584	4,666	1,8 %	98.2 %
2011	183	9,238	9,421	1.9 %	98.1 %
2012	414	14,291	14,705	2.8 %	97.2 %
2013	572	18,803	19,375	3.0 %	97.0 %
2014	778	22,759	23,537	3,3 %	96.7 %
2015	636	23,020	23,656	2.7 %	97.3 %
2016	526	21,558	22,084	2.4 %	97.6 %
Total	**3,234**	**116,309**	**119,543**	**2.7 %**	**97.3 %**

*DDC - discharge of debts confirmations

As concerns the overall number of discharge of debts, it is obvious that since 2008 it was gradually increasing until 2015 (including this year).[688] In 2008 solely 477 discharge of debts confirmation were issued whereas in 2015 23,656 of them were issued. Maintenance of growth in 2015 might be due to the fact that in 2015 more discharge of debts confirmations were issued than discharge of debts orders. This might be either caused by previous annulment of discharge of debts confirmations by courts of appeal or by higher number of issuance of discharge of debts in 2014 which were subsequently handled by courts in 2015.

In this connection, it remains to be said that the ratio between issued discharge of debts orders and discharge of debts confirmation has been in principle increasing. Arguably, one may expect that once courts issue a discharge of debts order, there is a high probability of success in terms of its later confirmation.

[687] Source of data: statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information.

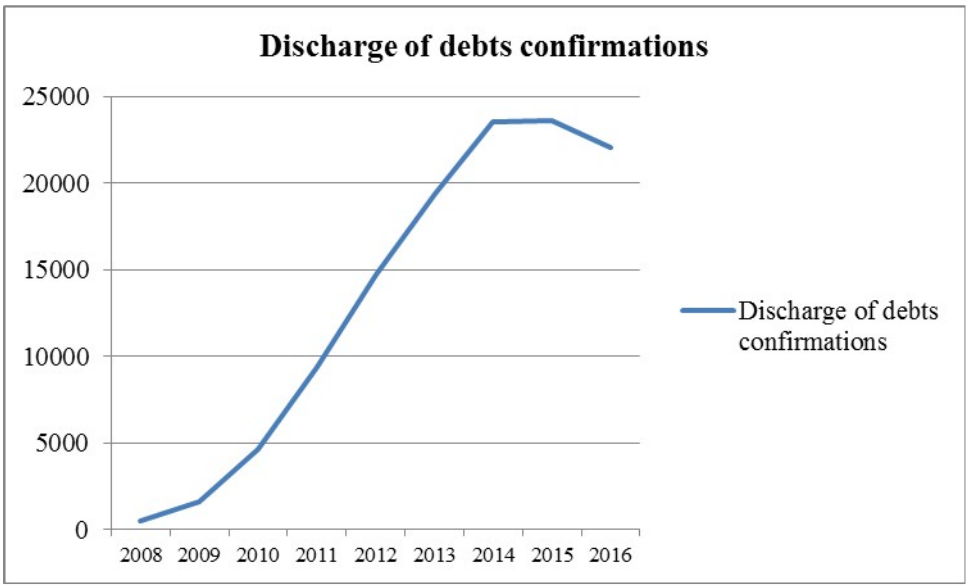
[688] As mentioned above, statistics might contain several inaccuracies – e.g. an appeal might be filed against a discharge of debts confirmation which is then overruled and issued again. As a consequence of this procedure, more discharge of debts confirmations might be in theory issued in one insolvency proceedings. Given the large number of discharge of debts confirmations, such deficiency arguably has a limited impact.

Chart 7: Statistics about discharge of debts confirmations[689]

Period	DD orders	DDC	DDC y-o-y	DD orders / DDC
2008	646	477	-	73.8 %
2009	2,164	1,622	240.0 %	75.0 %
2010	5,902	4,666	187.7 %	79.1 %
2011	11,614	9,421	101.9 %	81.1 %
2012	17,985	14,705	56.1 %	81.8 %
2013	22,063	19,375	31.8 %	87.8 %
2014	24,890	23,537	21.5 %	94.6 %
2015	23,413	23,656	0.5 %	101.0 %
2016	22,287	22.084	-6.6 %	96.7 %
Total	**130,964**	**119,543**	**-**	**91.3 %**

*DD orders - discharge of debts orders
**DDC - discharge of debts confirmations
***y-o-y - year-over-year growth

Graph 3: Statistics about discharge of debts confirmations[690]



[689] Source of data: statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information.

[690] Source of data: statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information.

5.2.1 Decision on discharge of debts confirmation

Whereas a discharge of debt order is issued by courts regardless of creditors' standpoint, as far as a discharge of debts confirmation is concerned, the viewpoint of creditors is of utmost importance. Creditors are entitled to vote on the method of discharge of debts and on the recommendation whether a court should order a debtor to pay lesser instalments in a repayment scheme (if such motion is filed by a debtor). Moreover, creditors might also raise objections against a discharge of debts confirmation.

At the outset, it must be noted that creditors generally exercise their rights at a creditors' assembly convened by the court.[691] However, the Czech IA enables creditors to vote on a method of discharge of debts outside a creditors' assembly by virtue of ballots.[692] Section 400(1) of the Czech IA even anticipates a sort of "pre-packed discharge of debts proceedings" entailing that a creditor votes on a method of discharge of debts prior to the commencement of insolvency proceedings. However, the mentioned provision mandates that the creditor has an opportunity to assess the same amount of information as contained in a motion for discharge of debts.[693] Votes casted outside creditors' assembly are counted together with votes casted at the creditors' assembly.[694] If all eligible creditors exercise their voting rights outside creditors' assembly, the court cancels the creditors' assembly.[695] In such case, the court shall publish the information about the outcome of the voting in the insolvency register.[696] No available statistics exist as to how often the creditors vote outside creditors' assembly. Yet, anecdotal experience suggests that such practice is not common.

Given the fact that rational apathy of creditors apply, the Czech IA does not state a high quorum for decision-making regarding the method of discharge of debts. Pursuant

[691] Debtors are mandated to attend creditors' assembly. However, the Constitutional Court has repealed the initial wording which provided for a fiction of a withdrawal of a motion for discharge of debts in case a debtor fails to appear at the hearing. The Constitutional Court ruled that such provision was unconstitutional since the effect did not have only procedural impact but affected also substantive rights of the debtor disproportionately. See the Constitutional Court ruling case no. Pl. ÚS 19/09 (KSOS 16 INS 4988/2008) of 27 July 2010.

[692] Section 401 of the Czech IA further sets forth formal requirement on such voting outside creditors' assembly.

[693] Similarly, it is possible to vote on recommendation whether to allow a debtor to pay lesser installments in repayment plan. Sections 400(2) and 399(1) of the Czech IA.

[694] Section 400(2) of the Czech IA.

[695] See section 399(3) of the Czech IA. If creditors' assembly is not convened yet, the court shall not order the hearing.

[696] If a creditor intends to raise objections against discharge of debts, he must file such objections to the court within 10 days from the publication of the information about the voting. See section 403(2) of the Czech IA.

to section 402(3) of the Czech IA, a simple majority of votes of unsecured creditors participating at creditors' assembly suffices whereas CZK 1 equals to 1 vote.[697] In other words, an amount of unsecured claim is decisive for voting. If creditors do not reach the required majority (mainly because no creditor takes part in the voting), the court shall decide over the method of discharge of debts. The court decides over a method of discharge of debts even in cases when no creditor lodges his claim. In such situations, after satisfaction of the costs of proceedings, insolvency proceedings are terminated.[698]

If a creditor votes for the method of discharge of debts that is eventually not approved, it might file an appeal against a discharge of debts confirmation. The mechanics of the decision-making functions as follows. First, if creditors' assembly has decided on the method of discharge of debts at least by a simple majority counted as per the value of claims, the creditors who voted for a different method of discharge of debts might file an appeal against the discharge of debts confirmation. It follows that if the creditors' assembly does not approve one of the proposed methods, the creditors vote on the other method. Second, if the creditors' assembly has not decided on any of the method of discharge of debts and the court approves one of the methods of discharge of debts, only those creditors who have voted against the approved method are entitled to file an appeal against the confirmation. In other words, those creditors who previously unsuccessfully voted for the approved method of discharge of debts are not empowered to file an appeal against the discharge of debts confirmation. Also, the creditors who abstained from voting are not entitled to file an appeal. Thus, if a creditor intends to object against discharge of debts in any case, he should vote against all methods of discharge of debts. Alternatively, he should vote for any of the methods of discharge of debts and concurrently raise objections stating that there is a reason for which a motion for discharge of debts should be dismissed or rejected.[699] For a creditor to be able to file an appeal, he does not have to raise objections at the creditors' assembly. On the opposite, it is possible and certainly more appropriate to file objections prior to the creditors' assembly.[700] However, solely unsecured creditors' objections are relevant.[701]

[697] With the exception concerning the position of secured creditors which is discussed below, general rules set forth particularly in sections 49-55 of the Czech IA apply.

[698] There is no reason why to revoke discharge of debts order or confirmation. See e.g. the High Court in Prague ruling case no. 2 VSPH 474/2009-B-15 (KSPH 39 INS 1527/2009) of 14 December 2009.

[699] The summary of the mechanics is thoroughly described in the Supreme Court ruling case no. 29 ICdo 6/2014 (KSOS 13 INS 2847/2010) of 22 December 2015. See also section 406(4) of the Czech IA.

[700] See the Supreme Court ruling case no. 29 NSČR 83/2014-B-37 (KSOS 39 INS 4961/2013) of 28 January 2016.

If the court approves the lesser installments in repayment plan, the creditor who voted against recommendation to this effect might also file an appeal. Otherwise, creditors cannot file an appeal against the discharge of debts confirmation.

According to the case-law, courts do not have to inform creditors about preconditions for a right of appeal against a discharge of debts confirmation. In other words, courts are not commanded to explain creditors that in order to file an appeal they have to take part in the voting at creditors' assembly and what steps they should undertake.[702]

Interestingly, in the past, there has been a disagreement among courts whether creditors' decision on a method of discharge of debts might be reconsidered by the courts and whether debtors have a right to appeal against the selected method of discharge of debts. Section 54(1) of the Czech IA lists the creditors' decision on a method of discharge of debts among a few of the decisions that courts cannot reassess.[703] Yet, the High Court in Prague ruled that under certain exceptional circumstances, the court might take a different decision on a method of discharge of debts.[704] The High Court in Prague argued that social considerations must be taken into account when the repayment plan and sale of debtor's assets would lead to nearly a similar pay-out. More specifically, it held that the sale of debtor's assets could not be preferred to the repayment plan particularly in situations when the sale of debtor's assets anticipates the sale of a place where the debtor and his close relatives lived. Also, the High Court in Prague reasoned that if the creditors would vote for a method of discharge of debts which would not entail the mandatory pay-out, they would necessarily make the court to convert discharge of debts into liquidation. By the same token, the High Court in Prague empowered the debtor to file an appeal against a discharge of debts

[701] See e.g. the High Court in Prague ruling case no. 1 VSPH 170/2008-B-17 (KSUL 70 INS 2162/2008) of 30 October 2008. Objections of secured creditors should be arguably taken into account since the court as a supervisor of insolvency proceedings should assess whether there is any reason to dismiss discharge of debts on its own motion.

[702] See the Supreme Court ruling case no. 29 ICdo 6/2014 (KSOS 13 INS 2847/2010) of 22 December 2015. If creditors do not take part in the voting, they might not file an appeal regardless of whether they file any objections against discharge of debts confirmation. See the Supreme Court ruling case no. 29 NSČR 83/2014-B-37 (KSOS 39 INS 4961/2013) of 28 January 2016.

[703] Pursuant to section 54(1) of the Czech IA, if a decision of creditors' assembly contravenes common interests of creditors, the court might exceptionally overrule such decision. Yet, the same provision enlists five decisions that cannot be overruled whereas the decision on a method of discharge of debts is one of them.

[704] See mainly the High Court in Prague ruling case no. 3 VSPH 1053/2011-B-31 (KSUL 70 INS 11081/2010) of 16 February 2012 or 2 VSPH 143/2013-B-20 (KSUL 71 INS 15185/2012) of 22 May 2013.

confirmation if the debtor proposes a different method of discharge of debts. The High Court in Olomouc disagreed with this approach.[705]

The Supreme Court gave an end to the interpretation pushed by the High Court in Prague[706] and ruled that courts are not entitled to confirm method of discharge of debts different from the one approved by creditors' assembly. In other words, the choice made by creditors cannot be subject to reconsideration of the court. Moreover, the Supreme Court ruled that a debtor is not entitled to file an appeal against a discharge of debts confirmation on the ground that he preferred the other form of method of discharge of debts.[707] It reasoned that upon the submission of a motion for discharge of debts, a debtor implicitly agrees with both methods of discharge of debts.[708]Nowadays, it appears that both high courts accept this line of interpretation.[709] Thus, courts should not reconsider the decision of the creditors' assembly (even if such decision essentially contemplates that a debtor will not reach the mandatory pay-out) and a debtor has no right of appeal against a discharge of debts confirmation.[710]

[705] See the High Court in Olomouc ruling case no. 2 VSOL 1001/2015-B-15 (KSOS 34 INS 16750/2014) of 14 September 2015.

[706] See the High Court in Prague ruling case no. 4 VSPH 1472/2015-B-14 (KSPA 53 INS 9280/2015) of 3 September 2015.

[707] In this connection, section 406(4) of the Czech IA sets forth that a debtor is entitled to file an appeal solely if the court does not approve lesser installments in repayment scheme.

[708] See the Supreme Court ruling case no. 29 NSČR 91/2013-B-35 (KSUL 71 INS 15185/2012) of 30 January 2014. The Supreme Court rightly noted that if creditors vote for a particular method of discharge of debts that does not entail the mandatory pay-out and if the debtor proposes the other method which would arguably lead to the mandatory pay-out, the debtor might be discharged of unpaid debts pursuant to section 415 of the Czech IA. This provision anticipates the issuance of a debt relief order in cases when the mandatory pay-out is not reached due to external circumstances. See more details in chapter 5.7.1.2 *infra*.

[709] Further to such decision, the High Court in Prague still accepted that a debtor has no right to appeal against a discharge of debts confirmation in case there was no creditors' assembly decision (i.e. that the court simply decided on a method of discharge of debts since no creditor had taken part in the hearing) - see the High Court in Prague ruling case no. 3 VSPH 540/2014-B-42 (KSPL 27 INS 19609/2013) of 19 January 2015. However, such decision is perhaps due to the time gap between the publication and issuance of the abovementioned ruling of the Supreme Court since in later decision, the High Court in Prague appears to accept that a debtor has no right of appeal. See *inter alia* the High Court in Prague ruling case no. 3 VSPH 393/2015-B-19 (KSCB 28 INS 20012/2014) of 20 November 2015, 1 VSPH 640/2015-B-20 (KSPL 20 INS 21948/2014) of 11 June 2015 or 3 VSPH 1845/2015-B-61 (MSPH 59 INS 4512/2014) of 9 March 2016.

[710] Exceptionally, courts grant creditors a right to appeal even if they do not participate in the creditors' assembly and do not vote over the method of discharge of debts. However, such right has been granted against ruling which does not concern a method of discharge of debts. In the past, courts acknowledged that creditors were entitled to appeal against the ruling which did not enlist specific claims into a distribution scheme. See e.g. the High Court in Prague ruling case no. 3 VSPH 2109/2015-B-20 (KSPA 60 INS 30371/2014) of 18 April 2016.

Eventually, unlike under the US Bankruptcy Code, it might be noted that it is not possible to later change the selected method of discharge of debts after it is in force and effective.[711] Any motion to do so shall be dismissed.[712]

As mentioned above, the 2017 Amendment will bring about many crucial changes which generally shift more tasks from courts to insolvency trustees. First of all, in line with global trend mandatory creditors' assembly shall be abandoned if courts issue an insolvency order together with a discharge of debts order.[713] Creditors' assembly shall be convened only if majority of creditors counted concurrently as per number of creditors and as per value of claims request such hearing. Given that creditors tend not to attend creditors' assembly at all, one might expect that creditors' assembly will take place rarely.[714] Hearings on verification of creditors' claims shall be dispensed totally.[715]

In order to assist creditors, insolvency trustees shall be asked by courts to submit a report on verification of claims [in Czech: *zpráva o přezkumu*] and a report for discharge of debts [in Czech: *zpráva pro oddlužení*]. Also, insolvency trustees shall prepare a list of insolvency estate. All the documents shall be submitted to a court within 30 day from lapse of period for lodgment of creditors' claims.[716]

A report on verification of claims is a formal document containing information required by law and reflecting previous verification of claims of debtor's creditors. It shall include a list of claims prepared by an insolvency trustee together with the information whether any of the claims are denied by the insolvency trustee, debtor or any of his creditors.[717] Moreover, the report shall comprise *inter alia* signed minutes from personal meeting between the debtor and the insolvency trustee[718] and document proving that

[711] See section 706(a) and 1307(a) of the US Bankruptcy Code. Since chapter 7 and chapter 13 proceedings differ, it might be reasonable for the debtor to seek to convert the case into the other type of proceedings.

[712] See e.g. the High Court in Prague ruling case no. 4 VSPH 522/2015-B-37 (KSHK 40 INS 10380/2013) of 13 August 2015.

[713] Section 47(1) of the Czech IA as amended by the 2017 Amendment.

[714] The aim is to place less administrative burdens upon the courts and transfer them to insolvency trustees.

[715] Section 190(1) of the Czech IA as amended by the 2017 Amendment.

[716] Section 136(2)(f) of the Czech IA as amended by the 2017 Amendment.

[717] Period set for creditors to deny claims of other creditors shall be shortened to 10 days after the lapse of time for lodgment of claims. Given the fact that it might take some time for courts to publish a lodgment of claims in the insolvency register, the period might be insufficient if a creditor lodges claims the very last date. See section 200(2) of the Czech IA as amended by the 2017 Amendment.

[718] Section 410(2) of the Czech IA as amended by the 2017 Amendment. Information about the date and venue of personal meeting should be communicated to the debtor at least 7 days prior to occurrence thereof.

the creditor, whose claim - which has not been adjudicated - is denied, has been informed about the denial.[719]

A report for discharge of debts shall *inter alia* contain a proposal of a method of discharge of debts and a proposed distribution scheme. It shall also state a prospected satisfaction of claims in a repayment plan. If a debtor suggests setting lesser instalments, an insolvency trustee shall also express his opinion on such proposal. If a real estate is enlisted in the debtor's insolvency estate, an expert appraisal shall be attached thereto. Moreover, if an insolvency trustee is of the opinion that a motion for discharge of debts should be rejected or dismissed, he shall state it in the report.[720]

The court shall review a report on verification of claims[721] and a report for discharge of debts and clarifies mistakes or ambiguities (if applicable), which should be undertaken in principle after a hearing with an insolvency trustee. Subsequently, the court shall inform creditors about the reports by publishing them in the insolvency register. Also, it shall notify creditors that they might file objections against the reports within 7 days from publication thereof.[722] Within the same period, the creditors may in effect request the court to convene creditors' assembly.[723]

Timing of the publication of a report for discharge of debts is of utmost importance. Since creditors' assembly shall not be convened in most cases, creditors will be entitled to vote on the method of discharge of debts outside the creditors' assembly. Creditors have to, however, vote within 7 days from the publication of a report for discharge of debts.[724] Within the same time frame, creditors might raise objections against a discharge of debts confirmation (if there is not creditors' assembly in which case the creditors should raise

[719] *Idem.*

[720] Section 403(1) of the Czech IA as amended by the 2017 Amendment.

[721] Courts might approve a report on verification of claims (if no objections are filed or if they are groundless), request amendment thereof (if any of the objections are considered to be grounded) or rejects the report (if objections raised in accordance with rules set forth in section 398a(4) of the Czech IA undermines the report as such. See section 410(3) of the Czech IA as amended by the 2017 Amendment.

[722] If any objections are filed, the court shall rule on them at the latest within a discharge of debts confirmation. An appeal is specifically excluded. See sections 398(6) and 406(4) of the Czech IA as amended by the 2017 Amendment.

[723] Section 136(2)(i) of the Czech IA as amended by the 2017 Amendment. The period seems to be rather short taking into account particularly the fact that the report for discharge of debts is published so late in the proceedings.

[724] Section 136(2)(i) and 399(1)of the Czech IA as amended by the 2017 Amendment.

objections until the end thereof).[725] The court rules on creditors' objections as a part of decision on a discharge of debts confirmation. It might (but does not have to) convene a hearing.[726]

Moreover, pursuant to the 2017 Amendment, if creditors do not require creditors' assembly and a court decides on method of discharge of debts, the decision on confirmation of discharge of debts shall also tackle with creditor's objections against discharge of business-related debts (if applicable).[727] Affected creditors might file an appeal against discharge of debts confirmation.[728] Newly, however, submission of objections, which do not concern discharge of their business-related debts (e.g. objections concerning dishonesty of debtors or mandatory repayment), does not render creditors eligible to file an appeal against a discharge of debts confirmation.[729] This seems to be rather inappropriate limitation of creditors' rights.

Although mandatory creditors' assembly shall be dispensed with, the debtor should attend a hearing with the respective insolvency trustee over verification of creditors' claims. At the meeting, the debtor shall have an opportunity to ask for lesser installments.[730]

Finally, the creditors might communicate their interest in participating in creditor's committee.[731] Given rational apathy of creditors, one cannot expect that creditors will be eager to apply for such position.

5.2.2 Combination of methods of discharge of debts

As mentioned above, section 398(1) of the Czech IA explicitly anticipates that discharge of debts might be undertaken either in the form of sale of debtor's assets or repayment plan. The combination of both methods is not contemplated in the Czech IA. However, courts accept the combination of methods of discharge of debts in case a debtor

[725] Section 403(2) of the Czech IA as amended by the 2017 Amendment.

[726] Section 403(3) of the Czech IA as amended by the 2017 Amendment.

[727] Section 397(2) of the Czech IA as amended by the 2017 Amendment. As indicated above, it is not clear to what extent the court might challenge or supersede the creditor's disagreement with the discharge of business-related debts. The author argues that the criteria of the Supreme Court ruling case no. 29 NSČR 3/2009-A-59 (KSOS 34 INS 625/2008) of 21 April 2009 should be taken into account.

[728] Section 397 of the Czech IA as amended by the 2017 Amendment.

[729] See sections 398(6) and 406(4) of the Czech IA as amended by the 2017 Amendment.

[730] Section 398(4) and 410 of the Czech IA as amended by the 2017 Amendment.

[731] Section 137(2)(h) of the Czech IA as amended by the 2017 Amendment does not set any specific deadline for such decision. Most probably, the intention of the legislature was not to limit the period for communication of any interest.

agrees therewith and when it helps the debtor.[732] This might be particularly useful in case that neither sale of assets nor repayment plan would alone lead to satisfaction of 30 % of all unsecured claims of creditors.

Nevertheless, if the court approves the combination of both methods of discharge of debts without the consent of a debtor, the debtor might successfully challenge such ruling. This appears to be an exception to the rule that debtors are not entitled to file an appeal against a discharge of debts confirmation.[733]

In case a discharge of debts confirmation anticipates both methods of discharge of debts, the court should state what assets shall be liquidated. In this regard, it is questionable whether the insolvency trustee's remuneration should equal to remuneration applicable to discharge of debts in the form of repayment plan, or combination of remuneration applicable to sale of assets and repayment plan.[734] The High Court in Prague held that the trustee is entitled to obtain remuneration solely as in the case of repayment plan so that no other fees is payable on the basis of the sale of assets.[735] However, extraordinary appellate proceedings on this issue are pending.

It remains to be said that the 2017 Amendment essentially enshrines the case-law regarding the combination of methods of discharge of debts since it specifically allows the court to combine them. As supported by the current case-law, the consent of a debtor is required. In addition to that, however, in order to avail of both methods of discharge of debts, insolvency trustee's motion to this effect is required. Moreover, it will not be necessary to liquidate all debtor's assets so that a debtor might propose to liquidate only part thereof. [736]

5.2.3 Methods of discharge of debts under the 2018 Draft Amendment

The 2018 Draft Amendment proposes to amend methods of discharge of debts so that discharge of debts shall take form of either sale of debtor's assets or repayment plan combined with the limited sale of debtor's assets.

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[732] See e.g. the High Court in Prague ruling case no. 1 VSPH 1533/2012-B-23 (KSHK 45 INS 22049/2011) of 15 November 2012 or 3 VSPH 400/2016-B-13 (KSCB 27 INS 14726/2015) of 3 March 2016.

[733] See e.g. the High Court in Prague ruling case no. 1 VSPH 1533/2012-B-23 (KSHK 45 INS 22049/2011) of 15 November 2012.

[734] See chapter 5.3.4 and 5.4.5 *infra*.

[735] The High Court in Prague ruling case no. 3 VSPH 1010/2015-B-63 (MSPH 79 INS 14449/2012) of 23 February 2016.

[736] Section 398(1) of the Czech IA as amended by the 2017 Amendment.

In other words, the repayment plan in its current wording shall cease to exist and repayment plan will be automatically accompanied with sale of debtor's assets. However, sale of assets in the latter form shall be limited. First, sale of debtor's assets shall not take place if pursuant to a report, which insolvency trustee shall prepare, sale of debtor's assets would not lead to satisfaction of creditors' claims [in Czech: *zpeněžením tohoto majetku by se nedosáhlo uspokojení věřitelů*].[737] Since the updated explanatory notes lack a thorough explanation, it is not clear whether a single Czech crown as proceeds of the sale would be enough.[738]

Moreover, debtor's residence shall not be subject to sale[739] unless the value of the residence pursuant to the insolvency trustee's report for discharge of debts exceeds the value calculated as a multiplication of the amount corresponding to housing costs in the debtor's place of residence determined pursuant to implementing regulation [in Czech: *hodnota určená podle zvláštního právního předpisu násobkem částky na zajištění bydlení v dlužníkově bydlišti*]. A short legislative history of the provision indicates that the Ministry of Justice of the Czech Republic has not much considered its proposal.[740] Since the draft proposal of the implementing legislation does not provide any more details, it appears that the Ministry of Justice of the Czech Republic was unable to propose a widely acceptable solution and postpone the final decision to future. Yet, the absence of more detailed method

[737] Initially, the Ministry of Justice of the Czech Republic suggested that no sale would take place if proceeds of the sale would not exceed CZK 100,000. Anecdotal experience suggests that debtors have rather little assets left. Therefore, following a criticism of this limitation, it has been modified.

[738] The current wording might open the gate for the interpretation that at least non-negligible proceeds should be expected. In this connection, it is questionable to what extent it makes sense to complicate the procedure. Alternatively, the legislature simply could combine mandatorily both methods of discharge of debts.

[739] Mostly, debtors will not have any residence, and if yes, such residence will serve as collateral of creditors and be subject of sale pursuant to secured creditor's instructions as it is under current regime.

[740] Original wording assumed that the debtor's residence shall not be subject to sale unless the value of the residence determined in the insolvency trustee's report for discharge of debts shall exceed 1000 times the amount of normative costs of living as per one person [in Czech: *částka normativních nákladů na bydlení pro jednu osobu*] set forth pursuant to special legal regulation (i.e. the Act no. 117/1995 Coll., on State Social Aid, as amended). Since such calculated amount in any case exceeds CZK 4 million, the requirement would hardly touch upon any debtor.

As of 31 December 2016, the amount of normative costs of living for one person equals for municipalities with up to 9,999 inhabitants amount of CZK 4,811, municipalities with 10 000 up to 49 999 inhabitants amount of CZK 4,996, municipalities with 50 000 up to 99 999 inhabitants amount of CZK 5,858, municipalities with over 100,000 inhabitants amount of CZK 6,146 and in Prague the amount of CZK 7,731. See information available on <https://portal.mpsv.cz/soc/ssp/obcane/prisp_na_bydleni> and section 398(3) and (6) of the Czech IA as amended by the 2018 Draft Amendment.

of calculation in a statute might be challenged on ground of constitutionality.[741] In any case, the proposed protection of place for living might be questionable since it prefers owners of real estate property to the debtors, who have to rent their place for living.[742]

Moreover, the 2018 Draft Amendment anticipates that repayment plan with concurrent sale of assets shall be the default method of discharge of debts. Unless creditors will explicitly vote for simple sale of debtor's assets, the court shall rule in favour of repayment plan with sale of assets.[743]

Finally, the 2018 Draft Amendment anticipates one novelty supporting the principle of rehabilitation of a debtor.[744] In case of discharge of debts in the form of repayment plan together with sale of debtor's assets, the court might mandate the debtor to undertake a gratuitous course on financial counselling in order to avoid insolvency issues in the future.[745] Yet, it is not clear why the Ministry of Justice of the Czech Republic intends to promote financial counselling solely in cases of discharge of debts in the form of repayment plan accompanied with sale of debtor's assets.

5.3 Discharge of debts in the form of sale of debtor's assets

5.3.1 Procedure

Discharge of debts in the form of sale of debtor's assets is largely akin to liquidation as one of the resolutions of debtor's insolvency. Pursuant to section 398(2) of the Czech IA, sale of assets is to be undertaken pursuant to rules on liquidation and sale of debtors' assets in discharge of debts has the same effects as sale of debtor's assets in liquidation. Also, pursuant to section 408(1) of the Czech IA, a discharge of debts confirmation in the form of sale of debtor's assets has the same effect on the debtor's assets as a liquidation order.

Discharge of debts in the form of sale of debtor's assets anticipates that all non-exempt assets that belong to the debtor's insolvency estate at the time of the discharge of debts

[741] Pursuant to article 79(3) of the Constitutional Act no. 1/1993 Coll., Constitution of the Czech Republic, as amended, ministries may issue regulations on the basis of and within the bounds of a statute. However, the bounds of the provision are not clear.

[742] Moreover, the protection might be unsubstantiated particularly in cases when the expected rate of satisfaction might be close to zero.

[743] Section 402(5) of the Czech IA as amended by the 2018 Draft Amendment.

[744] See chapter 3.3 *supra*.

[745] See section 398(7) of the Czech IA as amended by the 2018 Draft Amendment.

confirmation[746] are subject to liquidation.[747] The scope of non-exempt assets in discharge of debts is essentially[748] the same as in enforcement proceedings under the Czech Civil Procedural Code.[749] Rules governing the sale of secured assets in liquidation apply similarly in discharge of debts. Generally, debtors' assets might be liquidated by public auction,[750] by sale of assets pursuant to rules in civil enforcement proceedings[751] or by sale outside public auction.[752] A method of liquidation of debtors' assets is chosen by the insolvency trustee. However, an insolvency trustee needs to obtain consent of creditors' committee.[753] Moreover, in order to undertake a sale outside public auction, it is necessary to obtain a court's consent. Without the consent of the court and the creditor's committee, an agreement on the sale of the respective asset is not effective.[754] It may be added that a debtor, persons closely related to the debtor [in Czech: *osoby blízké*] and other enumerated persons[755] are barred from acquiring the debtor's property. However, the court may grant an exception if it is grounded.[756]

[746] Other assets are subject to liquidation if the debtor has failed to enlist them in the list of his assets. This provision has been clarified by the 2017 Amendment. See section 406(2)(b) of the Czech IA as amended by the 2017 Amendment.

[747] It is possible to sell the undertaking of the debtor who is an entrepreneur. Similarly, it is possible to sell all the debtor's assets by virtue of one agreement [in Czech: *prodej majetkové podstaty jednou smlouvou*]. Sections 290 and 291 of the Czech IA.

[748] Unlike in enforcement proceedings, debtor's assets dedicated to entrepreneurial activities are, however, always part of the debtor's insolvency estate. See section 207 of the Czech IA.

[749] Historically, a definition of non-exempt property has served social purposes. Yet, unlike discharge of debts, sole exemption of property from sale does not alone entail all the positive effects of discharge of debts proceedings as it does not *inter alia* provide incentives to debtors to become productive members of the economy. See e.g. WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. …, p. 76.

[750] See the Act no. 26/2000 Coll., on Public Auctions, as amended.

[751] See the Czech Procedural Code or BUREŠ, Jaroslav, DRÁPAL, Ljubomír et al. *Občanský soudní řád. I., II. Komentář.* 1st edition. Prague: C. H. Beck, 2009. 1600 pages.

[752] The 2017 Amendment shall enable to sell assets also by virtue of a sale by an enforcement office holder [in Czech: *exekutor*]. See section 289a of the Czech IA as amended by the 2018 Draft Amendment.

[753] Section 286(2) of the Czech IA.

[754] Section 289 of the Czech IA.

[755] Section 295 of the Czech IA. The 2017 Amendment shall broaden the list of persons.

[756] Mostly, such exceptions might be applied in case there is no other person interested in the sale of the property. See e.g. the Regional Court in Prague ruling case no. KSPH 41 INS 17187/2011-B-14 of 26 June 2012 whereby a share in a family house was subject to sale. The 2017 Amendment shall partially modify the rules. See section 295(2) and (3) of the Czech IA as amended by the 2017 Amendment.

Assets serving as collateral shall be liquidated pursuant to secured creditor's instructions.[757] In this regard, it suffices to state that generally speaking secured creditors have rather strong powers over a sale process as they are entitled to instruct an insolvency trustee as to how to administer and sell secured assets.[758] If a secured creditor decides not to proceed with liquidation, his security interest survives a debt relief order.[759] Eventually, it must be noted that an insolvency trustee does not need to obtain a secured creditor's instruction if liquidation of other assets do not suffice to satisfy all unsecured claims and the secured claim apparently does not exceed the value of collateral.[760] Thus, the provisions on liquidation of secured assets seek to respect the position of secured creditors to the maximum extent.

Following the sale process, an insolvency trustee in principle embarks on the distribution of the proceeds. An insolvency trustee prepares a final report [in Czech: *konečná zpráva*] pursuant to section 302 of the Czech IA which he presents to a court together with the calculation of his remuneration and expenses. The final report is subject to a court's review and the debtor as well as creditors might file objections against it.[761] Upon the approval of the final report, an insolvency trustee submits a proposal of an order on distribution of the proceeds [in Czech: *návrh rozvrhového usnesení*] that essentially apportions the proceeds of the sale of the debtor's assets among the respective creditors.[762] Following the review of the proposal, a court issues an order on distribution of the proceeds

[757] In case more than one secured creditor has a security interest in one particular asset, the instructions should be accompanied by the consent of secured creditors of lower priority. If such consent is not given, an insolvency trustee notifies a court which will hold a hearing on this issue. Secured creditors should submit their objections 7 days prior to such hearing; otherwise, they will be inadmissible (section 293 and 230 of the Czech IA). See also section 167 of the Czech IA.

Unlike in case of a repayment plan, if proceeds from the sale of the collateral exceed the secured claim, the difference is to be distributed among unsecured creditors. See e.g. the High Court in Prague ruling case no. 3 VSPH 1127/2012-B-15 (KSCB 25 INS 159/2012) of 22 October 2012 or 1 VSPH 175/2012-B-30 (KSPL 20 INS 3876/2010) of 28 February 2012.

[758] Generally, an insolvency trustee is bound by the instructions of a secured creditor. However, if the insolvency trustee reasonably considers any instruction of the secured creditor to be inappropriate, he may refuse to follow the instruction. In such a case, he should file a petition to a court to decide over the challenged instruction and further steps. Moreover, a secured creditor may also give instructions to an insolvency trustee as regards the administration of the collateral. Such instructions are also generally binding (section 230 of the Czech IA). As in the case of instructions to liquidate particular collateral, if the insolvency trustee considers the instruction of the secured creditor to be inappropriate, it may reject to follow the instruction. In such case, he should apply to a court to decide over such instruction and further steps. See *inter alia section* 230(2)-(5) of the Czech IA and section 293 of the Czech IA.

[759] See section 414(4) of the Czech IA and chapter 5.7 *infra*.

[760] See section 408(3) of the Czech IA.

[761] See particularly section 304(1) of the Czech IA.

[762] Section 306(1) of the Czech IA.

[in Czech: *rozvrhové usnesení*].[763] The creditors whose claims are touched upon, the debtor as well as an insolvency trustee might file an appeal against the ruling.[764] Claims should be satisfied by an insolvency trustee as set forth in an order on distribution of the proceeds, at the latest within two months from the date when the order becomes effective and in legal force.[765] However, before the satisfaction of ordinary claims, preferential claims are satisfied.[766]

The discharge of debts proceedings are terminated upon the legal force and effectiveness of a court's order issued pursuant to section 413 of the Czech IA. By the same decision, a court formally decides on the remuneration of an insolvency trustee and releases him from his function.

5.3.2 Debtor's duties

The Czech IA does not place upon the debtor any specific duties in discharge of debts in the form of sale of debtor's assets. However, the debtor has a number of duties stemming from general provisions such as a duty to cooperate with the insolvency trustee in connection with determination of insolvency estate,[767] duty to enable an insolvency trustee to access the debtor's property,[768] duty to state his opinion on lodged claims,[769] and a duty to administer the debtor's insolvency estate.[770]

5.3.3 Disposal of debtor's property and effects of discharge of debts confirmation on debtor's assets

In case of sale of debtor's assets, a debtor has a right to freely dispose of his property which he acquired after a discharge of debts confirmation took effect. However, a debtor acquires such right only after a discharge of debts confirmation is in legal force and effective [in Czech: *pravomocné*]. The reason is that if a discharge of debts confirmation is later dismissed on the basis of the decision of a court of appeal, the debtor could irreversibly

[763] Section 306(2) of the Czech IA.

[764] Section 307(1) of the Czech IA.

[765] Section 307(2) of the Czech IA.

[766] See section 305 and section 168 and 169 of the Czech IA.

[767] Section 210 of the Czech IA.

[768] Section 212 of the Czech IA.

[769] The debtor is mandated to state whether he denies any of his claims. See section 188(1) of the Czech IA.

[770] See e.g. sections 229 and 230 of the Czech IA.

dispose of his property to the detriment of his creditors. In any case, assets in debtor's disposition cannot be subject to enforcement proceedings held for the claims which are or should have been lodged in the insolvency proceedings or which have arisen prior to the moment when a discharge of debts confirmation took effect.[771]

An insolvency trustee has disposal rights with respect to the property (including collateral) that had been acquired prior to the moment when a discharge of debts confirmation took effects.[772] Thus, for instance the insolvency trustee is entitled to enforce claims that fall into the debtor's insolvency estate.[773] Naturally, the debtor has a right to freely dispose of the assets that do not fall into the insolvency estate.[774]

Debtors' measures consisting of disposal of debtor's assets with respect to which the insolvency trustee is entitled to dispose of are ineffective by operation of law.[775] In this connection, after a discharge of debts confirmation, a debtor cannot deny inheritance or donation unless an insolvency trustee consents therewith. Without the insolvency trustee's consent, such denial is pursuant to section 246(4) of the Czech IA invalid. The same applies to the conclusion of an agreement on the settlement of inheritance on the basis of which a debtor obtains less than his statutory share.

Discharge of debts confirmation entails several effects on the debtor's assets and his rights in general. First of all, security interests created with respect to debtor's assets after a discharge of debts confirmation in contravention with the Czech IA are ineffective.[776] Second, real encumbrances created under obviously inappropriate conditions after

[771] Pursuant to section 408(2) of the Czech IA, the assets in the disposition of a debtor might be subject to enforcement proceedings solely for claims which cannot be satisfied in discharge of debts and which have arisen only after a discharge of debts confirmation takes effect. In this regard, Lukáš Pachl argues that the effects set forth in section 109(1)(c) of the Czech IA still apply. However, it appears more appropriate not to refer to such provision since the limitations are separately regulated in section 408 of the Czech IA. See KOZÁK, Jan et al. *Insolvenční zákon - komentář*. Prague: ASPI, 2016, p. 756.

[772] There might be doubts whether a debtor or an insolvency trustee has disposal rights with respect to the property acquired after a discharge of debts confirmation took effect but before such confirmation becomes in legal force and effective. Presumably, it is the insolvency trustee, who should not, however, arguably dispose of this property to the detriment of the debtor.

[773] See e.g. section 294 of the Czech IA.

[774] Section 207 of the Czech IA.

[775] This represents an exemption to the general rule that an insolvency trustee should file an action to determine that certain acts are ineffective. See sections 235(2) and 246(2) of the Czech IA.

[776] Section 248(2) of the Czech IA. Interestingly, the ineffectiveness does not apply solely with respect to creditors within the insolvency proceedings but also outside the insolvency proceedings. See e.g. the Supreme Court ruling case no. 29 NSČR 16/2011-P8-23 (KSPH 39 INS 4718/2009) of 30 November 2011.

the commencement of insolvency proceedings took effects are to be considered ineffective.[777] Third, creditors' claims which are not yet due are deemed to be due. However, this implication does not apply to debtor's claim vis-à-vis his creditors. Last but not least, specific rules apply with respect to leased property. It *inter alia* follows that the lessor is not entitled to terminate a lease agreement on the ground of a failure to pay payments which became due prior to an insolvency order or on the basis of the worsening of financial situation of the debtor.[778]

However, the operation of debtor's undertaking does not come to an end simply because of the issuance of a discharge of debts confirmation. The operation of the debtor's undertaking is terminated solely upon the sale of the undertaking as a whole or upon a court's ruling issued upon a motion of an insolvency trustee. [779]

5.3.4 Remuneration of insolvency trustees

Insolvency trustee has a right to receive remuneration for the performance of his duties. In the case of discharge of debts in the form of sale of debtor's assets, the remuneration is calculated on the basis of the number of claims verified in the insolvency proceedings and the value of the assets liquidated by the insolvency trustee.

The remuneration is different with respect to the proceeds to be distributed to secured and unsecured creditors (see chart 8 below). However, the minimum remuneration is CZK 45,000.

If an insolvency trustee is a value added tax payer, value added tax shall be added to the remuneration of the insolvency trustee.

Remuneration and reimbursement of expenses are paid from the insolvency estate (deposit amount). If the insolvency estate (deposit amount) does not suffice, the remuneration and the deposit amount are paid by the state. However the maximum limit paid by the state is CZK 50,000 for the remuneration and the same amount for the reimbursement of the insolvency trustee's expenses.

[777] See section 248(2) of the Czech IA. Arguably, such real encumbrances would have to be challenged by an action of an insolvency trustee. See section 235(2) of the Czech IA.

[778] Section 257 of the Czech IA.

[779] See section 261 of the Czech IA. If creditors' committee has been already constituted, a court shall also take into account its recommendation.

Chart 8: Remuneration of insolvency trustees – sale of debtors' assets

Value of proceeds, CZK	Remuneration of insolvency trustee - unsecured creditors, CZK	Remuneration of insolvency trustee - secured creditors, CZK
up to 500,000	25 %	9 %
500,001-1,000,000	125,000 and 20 % from amount exceeding 500,000	
1,000,001-5,000,000	225,000 and 15 % from amount exceeding 1,000,000	90,000 and 4 % from amount exceeding 1,000,000
5,000,001-10,000,000	825,000 and 13 % from amount exceeding 5,000,000	
10,000,001-50,000,000	1,475,000 and 10 % from amount exceeding 10,000,000	450,000 and 3 % from amount exceeding 10,000,000
50,000,001-100,000,000	5,475,000 and 5 % from amount exceeding 50,000,000	1,650,000 and 2% from amount exceeding 50,000,000
100,000,001-250,000,000	7,975,000 and 1 % from amount exceeding 100,000,000	
250,000,001 - 500,000,000	9,475,000 and 0,5 % from amount exceeding 250,000,000	
500,000,001 and more		10,650,000 and 1 % from amount exceeding 500,000,000

5.4 Discharge of debts in the form of repayment plan

5.4.1 Procedure

Statistically, the most common method of discharge of debts takes form of repayment plan. During the life of such plan, all non-exempt income is in principle distributed to creditors.[780] Distribution works as follows. Employers or other entities that pay income to debtors are mandated to pay non-exempted parts of the debtor's income to an insolvency trustee.[781] In case of income stemming from entrepreneurial activities, a debtor shall transfer such income directly to an insolvency trustee himself. Similarly, if a debtor obtains any extraordinary income, which is subject to distribution scheme, the debtor shall transfer such extraordinary income to the insolvency trustee.

The repayment plan lasts five years at maximum with no flexibility given as to the extension of the time period.[782] From a comparative viewpoint, the time period is not that relaxed as in Latvia (3 years), yet, not that strict as in Finland (10 years) or France (8 years).[783] The length of the period is rather long in comparison to the recommendation of the European Commission which generally promotes three-year period.[784] If one of the goals of insolvency law is to maximize the value for creditors, the longer the repayment plan lasts, the better for creditors. Yet, maximization of value is not the only aim of discharge of debts. In practice, there seems to be generally an inverse relationship between a length of a repayment plan and success thereof.[785] Also, imposition of long repayment periods

[780] Determination of non-exempt income is governed by the Czech Civil Procedural Code. Generally, it is defined with reference *inter alia* to a minimum wage. Therefore, any increase in the minimum wage might also determine whether a person will be eligible for discharge of debts. Not all monetary payments obtained by the debtor constitute income within the meaning of the Czech IA. Alimonies paid to a debtor's child are not to be distributed among the creditors since such amounts are not owned by the debtor. See the High Court in Olomouc ruling case no. 2 VSOL 138/2009-A-27 (KSOS 38 INS 2766/2008) of 28 May 2009.

[781] Currently, the distribution scheme is a part of a discharge of debts confirmation. See section 406(3)(a) of the Czech IA. Pursuant to section 406(3)(a) of the Czech IA as amended by the 2017 Amendment, the distribution scheme shall be contained in the report for discharge of debts.

[782] See mainly section 398(3) of the Czech IA.

[783] McCORMACK, Gerard et al. *Study on a new approach to business failure and insolvency* [online]. European Commission, 2016 [cited 3 March 2017]. Available on <http://ec.europa.eu/justice/civil/files/insolvency/insolvency_study_2016_final_en.pdd>, p. 360.

[784] Chapter 7.1.2 *infra*.

[785] WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. …, pp. 86-88.

on debtors who can hardly repay anything beyond the costs of the proceedings does not seem to be economically reasonable.[786]

As confirmed by the Supreme Court, the period starts from the first instalment and is limited to 5 years.[787] Thus, if the first instalment is due as of September 1, year T, the last instalment shall be due on September 1, year T + 5.[788] During the repayment period, a debtor is naturally obliged to make reasonable effort at work or search for a job if he becomes unemployed. If a debtor repays all his unsecured allowed debts, the repayment plan is fulfilled and discharge of debts shall be terminated earlier than expected. This may happen since not all creditors might lodge their claims in insolvency proceedings and the total amount of debts owed to creditors is usually much less than the actual amount of debts.[789] In any case, the provision does not seem to provide debtors with many incentives to increase their efforts in employment during these five years.[790]

5.4.2 Debtor's duties

Apart from general duties imposed upon any debtors in insolvency proceedings,[791] the debtor in repayment plan has numerous specific duties. Systematically, they might be classified into the following categories – debtor's earning duties; debtor's duty to cooperate; and debtor's fairness duties.

[786] *Idem*.

[787] See the Supreme Court ruling case no. 29 NSČR 12/2013-B-54 (KSUL 45 INS 3212/2009) of 28 February 2013.

[788] See the Supreme Court ruling case no. 29 NSČR 45/2010-B-174 (MSPH 93 INS 1923/2008) of 30 April 2013.

[789] Anecdotal experience suggests that debtors benefit from the fact that the Czech IA anticipates strictly formal preclusive time period for a lodgment of claims. Thus, many creditors simply omit to submit their claims in the insolvency proceedings thereby enabling debtors to reach a debt relief (sooner).

[790] Two arguments may be raised. The first is that the mandatory repayment requirement constitutes an incentive to make more work efforts because if the threshold is not met, a motion for discharge of debts is either dismissed or discharge of debts is converted into liquidation with no debt relief according to sections 395 and 418(1)(b) of the Czech IA respectively. Second, under certain circumstances, a court has discretion to grant a debt relief even if the repayment threshold has not been met. Not surprisingly, the lack of the debtor's fault in respect of the cause of insolvency is one of the factors.

[791] See chapter 5.3.2 *supra.*

5.4.2.1 Debtor's earning duties

In case of repayment plan, pursuant to discharge of debts confirmation, a debtor's regular as well as irregular non-exempt income (i.e. gifts or inheritance) is distributed to his creditors by virtue of an insolvency trustee. Thus, the most critical duty of debtors in repayment plan is naturally to pay income to an insolvency trustee. In practice, if a debtor is employed, an employer transfers non-exempt parts of the debtor's income to an insolvency trustee who in turn distribute the proceeds to creditors.

In conformity with that, a debtor is mandated to undertake appropriate [in Czech: *přiměřenou*] income activities. Also, the debtor must not reject to seize a feasible opportunity to procure income.[792] The law does not explain what these terms stand for. The wording does not indicate that debtors should take more jobs than they would otherwise do. Arguably, debtors should at least undertake such activities as they would normally do being out of insolvency proceedings. Nevertheless, the assumption of additional activities might be taken into consideration in terms of the assessment of whether to set lesser installments[793] or whether to grant the debtor a debt relief despite the fact that he has not reached the limit of the mandatory repayment.[794] Still, if debtors have an opportunity to accept higher-earning job and if they are in principle physically and psychically able to assume such position, they should arguably do so.

If a debtor is unemployed, he is required to seek to find a job. It might be questionable whether a debtor should accept any available job offer which the debtor might adequately undertake or whether the debtor might deny acceptance of selected jobs on the basis that such jobs are low-paying or below the debtor's level of expertise etc. The High Court in Prague effectively ruled in favor of the latter.[795]

By the same token, a loss of job and corresponding loss of income stream does not *per se* entail that discharge of debts is automatically transformed into liquidation. In this connection it might be pointed out that a discharge of debts confirmation in case of repayment plan is in fact a type of decision that is subject to the change of circumstances and thus its binding effect is somehow limited. Pursuant to section 407(3) of the Czech IA, a court shall

[792] See section 412(1)(a) of the Czech IA.

[793] See chapter 5.4.3 *infra.*

[794] See chapter 5.7.1.2 *infra*.

[795] The High Court in Prague ruling case no. 3 VSPH 607/2010-B-35 (KSPH 55 INS 1199/2009) of 29 September 2010. Arguably, debtors should follow the rules on social system.

even without any motion change a discharge of debts confirmation if the criteria decisive for the amount of installments have substantially changed. However, the court shall terminate discharge of debts proceedings if it follows that a debtor shall not be able to fulfill a substantial part of repayment plan pursuant to section 418(1)(c) of the Czech IA.[796]

Debtor is also required to transfer to an insolvency trustee his extraordinary income.[797] Extraordinary income entails income of rather irregular nature such as the proceeds from a sale of publications, proceeds from lotteries, tax bonuses to be paid to debtors,[798] insurance proceeds based on the insured event of death of a relative,[799] payments arising from a short term additional employment or extra income from entrepreneurial activities. If an income is of regular nature, the court should arguably modify the repayment plan andmandate the payer thereof to transfer the income to an insolvency trustee.[800] In this context it might be added that an extraordinary income to be distributed to creditors is not subject to rules on the calculation of exempted and non-exempted income. In other words, the whole amount of extraordinary income is to be transferred to the insolvency trustee.[801]

Not surprisingly, it is often difficult to distinguish the extraordinary income to be distributed among creditors from the income that belongs to debtors. Courts on certain occasions held that the proceeds from a sale of assets by a debtor in case of repayment plan constitute an extraordinary income.[802] Strictly speaking, the proceeds from a sale of assets are indeed income. However, such line of argumentation would not be consistent with the differences between discharge of debts in the form of repayment plan and sale of assets. The debtor, however, might choose to use the proceeds as an extraordinary installment. This opinion is supported by the case-law stating that in case of a sale of collateral, the proceeds that exceed the secured claim shall be distributed to a debtor.

[796] See chapter 5.6.2 *infra*.

[797] Section 412(1)(b) of the Czech IA.

[798] See the High Court in Prague ruling case no. 1 VSPH 241/2013-B-50 (MSPH 93 INS 19653/2011) of 18 March 2013 and 1 VSPH 2243/2015-B-18 (KSPH 61 INS 28780/2014) of 16 September 2016 or High Court in Olomouc ruling case no. 2 VSOL 454/2016-B-30 (KSOS 33 INS 24943/2012) of 23 June 2016 or 1 VSOL 218/2014-A-14 (KSBR 29 INS 34939/2013) of 25 March 2014.

[799] See e.g. the High Court in Prague ruling case no. 3 VSPH 829/2013-B-63 (KSHK 41 INS 5343/2010) of 8 November 2013.

[800] See section 407(3) of the Czech IA and HÁSOVÁ, Jiřina. et al. *Insolvenční zákon. Komentář*. 2nd edition. Prague: C. H. Beck, 2014, pp. 1392-1393.

[801] See e.g. the High Court in Olomouc ruling case no. 1 VSOL 218/2014-A-14 (KSBR 29 INS 34939/2013) of 25 March 2014.

[802] See e.g. the High Court in Olomouc ruling case no. 1 VSPH 241/2013-B-50 (MSPH 93 INS 19653/2011) of 18 March 2013 or the Supreme Court ruling case no. 21 Cdo 4599/2014 of 18 March 2015.

In other words, the proceeds from the sale of collateral after a deduction of all costs and interests belong to debtors.[803] Similarly, proceeds gained from the agreement on the settlement of joint property of spouses belong to a debtor and do not constitute an extraordinary income.[804]

After the adoption of the Revision Amendment, inherited assets, gifts and assets acquired on the basis of voidable transactions [in Czech: *neúčinné úkony*] and assets not listed in the debtor's list of assets[805] should be given to the insolvency trustee for the liquidation thereof; the proceeds shall be distributed among the debtor's creditors. It applies regardless of the fact whether a debtor is simply reckless or whether he intentionally seeks to hide certain assets.[806]

In case of doubts whether the respective asset forms a part of insolvency estate or whether the proceeds thereof should be distributed to creditors, the courts should issue a ruling to this effect. Such ruling is issued within the powers under section 11 of the Czech IA. Thus, there is no right of appeal.[807] If the debtor does not agree with the enlistment of the debtor's property to the insolvency estate, he might file a motion to exclude the respective asset pursuant to section 226 of the Czech IA.[808]

5.4.2.2 Debtor's duties to cooperate

Pursuant to section 412(1)(c), (d) and (e) of the Czech IA, debtors have certain duties having the nature of information duties. First and foremost, the debtor shall without undue delay inform a court, insolvency trustee and creditors' committee about any change in his address, seat or employment. Naturally, any changes include also the loss of employment without finding a new one. The debtor shall also submit to the court, insolvency trustee and creditors' committee a summary of his income for the preceding six calendar months on 15 March and 15 September each year unless the court states a different period

[803] See e.g. the High Court in Olomouc ruling case no. 1 VSOL 19/2014-B-40 (KSBR 32 INS 13039/2011) of 23 April 2014 and decision cited therein.

[804] See the High Court in Prague ruling case no. 4 VSPH 942/2015-B-27 (KSPH 40 INS 5908/2012) of 25 May 2015.

[805] The debtor should list all his property regardless of whether he needs it himself or not. See the Supreme Court ruling case no. 29 NSČR 33/2016-B-38 (MSPH 77 INS 5093/2014) of 29 February 2016.

[806] *Idem.*

[807] Section 91 of the Czech IA. See also e.g. the High Court in Prague ruling case no. 3 VSPH 829/2013-B-63 (KSHK 41 INS 5343/2010) of 8 November 2013.

[808] See e.g. the Supreme Court ruling case no. 29 NSČR 33/2016-B-38 (MSPH 77 INS 5093/2014) of 29 February 2016.

for submissions. Upon the request of a court, insolvency trustee or creditors' committee the debtor is mandated to present his financial reports for inspection.

Information duties must be met specifically to all the respective stakeholders individually. As regards the creditors' committee, the debtor shall provide the necessary information to the hands of the presiding member of the committee.

The nature of the abovementioned duties indicates that they relate to the course of the insolvency proceedings. A failure to meet the duties might entail conversion of discharge of debts into liquidation on the ground of a reckless or negligent approach of the debtor towards fulfilment of his duties.[809]

5.4.2.3 Debtor's duties of fairness and economic rationality

Finally, the debtors have other duties that might be covered under the aegis of fairness and economic rationality.

Pursuant to section 412(1)(e) of the Czech IA, the debtor shall not disguise any of his income. This duty reflects and corresponds to the duty to provide regular and extraordinary income to an insolvency trustee for redistribution to creditors under section 412(1)(a) and (b) of the Czech IA. Naturally, some debtors simply succumb to the temptation that it is better to keep their income stream untouched by creditors.[810] Nevertheless, if the debtors, who have failed to fulfil their duties, promise to repay the previously disguised income, courts are sometimes willing to provide them with a second chance.[811]

Moreover, pursuant to section 412(1)(f) of the Czech IA, the debtor shall not provide to any of his creditors any special consideration or advantage. The underlying principle is that creditors should be treated equally according to their position as also enshrined in the essential principles set forth in section 5 of the Czech IA.[812] Obviously, the provision of advantage to the debtor's creditors does not necessarily have to be concurrently considered to be a criminal act. The provision of a special consideration might be of lesser criminal gravity. The provision of specific consideration to the debtor's creditors is also one

[809] As noted above, courts are generally ready to provide the debtor an opportunity to rectify his omission or failure.

[810] See e.g. the High Court in Olomouc ruling case no. 1 VSOL 1296/2014-B-70 (KSOL 16 INS 701/2009) of 6 May 2015.

[811] See e.g. the High Court in Olomouc ruling case no. 3 VSOL 659/2011-B-31 (KSOS 34 INS 8770/2009) of 6 November 2011 or the High Court in Prague ruling case no. 1 VSPH 1506/2014-B-42 (KSPH 36 INS 11043/2012) of 22 January 2015.

of the limited grounds of the revocation of a discharge of debts relief as stated in section 417(1) of the Czech IA.

Finally, as concerns debtor's financial affairs diligently, pursuant to section 412(1)(g) of the Czech IA, the debtor shall not accept new undertakings which he will not be able to repay in due course. The principle behind the provision is that the debtor should approach his affairs with due care so that he will handle his financial issues. The interpretation of the provision might, however, lead to apparently unjust effects when for instance a debtor might incur debts in connection with regular services such as rent which he is unable to repay.[813] In this connection, the High Court in Olomouc held that the inability to repay debts stemming from non-contractual relationships (more specifically arising out of municipal regulation) does not fall within the category failures under section 412(1)(g) of the Czech IA.[814]

It is not clear whether a failure to meet the duty enshrined in section 412(1)(g) of the Czech IA should lead to revocation of discharge of debts as the case-law suggests. The reason is that section 409(2) of the Czech IA presumes that with respect to the property that does not belong to the insolvency estate (e.g. assets acquired after a discharge of debts confirmation takes effect), enforcement proceedings might be realized solely for claims which are not subject to discharge of debts and which have concurrently arisen after a discharge of debts confirmation takes effect.

5.4.3 Lesser instalments

During the life of a repayment plan, all non-exempt income is to be distributed via an insolvency trustee.[815] However, if a debtor is reasonably expected to repay at least 50 % of his allowed unsecured claims, he may, pursuant to section 398(4) of the Czech IA, request a court to set lesser installments so that the debtor keeps the difference for himself. However, such a request must be filed as part of an insolvency petition (i.e. at the filing of a motion for discharge of debts). In this regard, it does not seem reasonable to limit the application for lesser installments to the time of the submission of a motion for discharge of debts. There

[813] See e.g. the High Court in Olomouc ruling case no. 1 VSOL 315/2016-B-41 (KSOS 39 INS 3163/2010) of 13 April 2016. The debtor repaid her debts during the course of appellate proceedings. Thus, the High Court of Olomouc as a court of appeal overruled the previous decision.

[814] See e.g. the High Court in Olomouc ruling case no. 1 VSOL 814/2016-B-39 (KSOS 34 INS 12709/2010) of 21 July 2016. The court dealt *inter alia* with unpaid fees for cleaning of garbage.

[815] See e.g. section 406(5) of the Czech IA.

is no reason to prevent the debtor from submissions of a motion at least as of the first creditors' assembly where creditors have an opportunity to express their standpoint. The High Court in Prague as well as High Court in Olomouc overcame the statutory wording and mandated a court of first instance to allow lesser installments even in the case when the respective motion had been filed after the issuance of a discharge of debts confirmation. The High Court in Prague reasoned that it is more important to provide a debtor with an opportunity to maintain his social status than to insist on strict compliance with the unsubstantiated wording of the law.[816] The High Court in Olomouc stated that whereas allowing lesser installment prior to a discharge of debts confirmation is covered by section 398(4) of the Czech IA, allowing lesser installments afterwards should be regulated by section 407(3) of the Czech IA concerning a change of circumstances.[817] In other words, the High Court in Olomouc instructed the court to assess whether there are any new circumstances which would substantiate lesser installments (change of the previously issued discharge of debts confirmation).

It is the court that decides whether to approve a motion to allow lesser installments. In this regard, the court is not strictly bound by a debtor's motion since a court may require the debtor to pay more than proposed. [818] However, since a court cannot decide on the lesser installments without a debtor's motion, it cannot set forth lesser installments than the debtor proposes. In other words, the court should issue the ruling within the bounds of the debtor's motion.

In terms of the assessment whether to allow the debtor to repay less, the court shall consider grounds for insolvency, overall amount of debts due to creditors, current and prospected income, measures taken and to be taken by the debtor to minimize the amount of the debts owed to creditors and the creditors' recommendations.[819] Creditors adopt such recommendation at creditors' assembly or outside creditors' assembly by virtue of ballots as set forth in section 400(1) of the Czech IA. In any case, the law does not require that

[816] See the High Court in Prague ruling case no. 3 VSPH 321/2013-B-17 (KSUL 81 INS 16496/2012) of 28 June 2013.

[817] The High Court in Olomouc ruling case no. 1 VSOL 12/2016-B-31 (KSBR 32 INS 19139/2013) of 12 April 2016 or 1 VSOL 691/2016-B-70 (KSBR 28 INS 15129/2010) of 21 September 2016.

[818] See section 398(3) of the Czech IA.

[819] See section 398(4) of the Czech IA.

the debtor satisfy the whole amount of claims.[820] Nevertheless, the fact that the debtor is able to repay 100 % of all unsecured claims does not automatically entail that the debtor should be allowed to repay lesser installments.[821] Moreover, the Czech IA does not make clear whether any other considerations should be taken into account. In several instances, courts took into account other aspects.[822]

The ruling on the lesser installments is part of a discharge of debts confirmation. Naturally, the ruling on installments should be reasoned as well as other rulings.[823] Courts are mandated to assess whether the respective grounds for approval of a motion have been fulfilled.[824] The burden to state and prove the respective aspects, however, lies primarily on the debtor.[825] One of preconditions for successful assessment of the petition is that the debtor states that he is able to repay at least 50 % of all unsecured claims.[826] If the court does not approve the debtor's motion, the debtor might file an appeal.[827] This appears to be another ground for an appeal on the part of the debtors against a discharge of debts confirmations. Since a discharge of debts confirmation is subject to change of circumstances, if there is any change, the court might also change the ruling on the lesser installments.[828]

The purpose of the provision which allows debtors to pay less is to assist mainly those debtors who would otherwise have to solve their insolvency by liquidation. The threshold should not be met solely by those who have above-standard wages or other income stream but

[820] See e.g. the High Court in Prague ruling case no. 3 VSPH 923/2013-B-14 (KSPA 59 INS 29609/2012) of 16 September 2013.

[821] See e.g. the High Court in Olomouc ruling case no. 2 VSOL 1290/2014-B-9 (KSOS 31 INS 9338/2014) of 9 December 2014.

[822] The High Court in Prague in the assessment whether to allow lesser instalments in repayment plan stressed that a court should *inter alia* take into account whether creditors attended creditors' assembly (in that case they were passive). See e.g. the High Court in Prague ruling case no. 3 VSPH 2354/2015-B-10 (KSPL 51 INS 5301/2015) of 18 December 2015.

[823] See e.g. the High Court in Prague ruling case no. 3 VSPH 2354/2015-B-10 (KSPL 51 INS 5301/2015) of 18 December 2015.

[824] The High Court in Prague ruling case no. 3 VSPH 1360/2013-B-22 (KSPL 29 INS 2549/2013) of 24 November 2014.

[825] See e.g. the High Court in Prague ruling case no. 3 VSPH 1588/2012-B-16 (KSCB 25 INS 10428/2012) of 18 January 2013.

[826] See e.g. the Supreme Court ruling case no. 29 NSČR 53/2012-B-31 (KSOS 22 INS 16136/2011) of 24 July 2014.

[827] Section 406(4) of the Czech IA.

[828] Section 407(3) of the Czech IA. See also e.g. the High Court in Prague ruling case no. 3 VSPH 1588/2012-B-16 (KSCB 25 INS 10428/2012) of 18 January 2013.

those who would otherwise suffer in material need [in Czech: *hmotná nouze*].[829] In the past, a court *inter alia* allowed lesser payments if the debtor had to take care of his child.[830]

Interestingly, the law does not explicitly govern situation what happens if a debtor loses fully or partially income stream and in the end pays more than 30 % but less than 50 % of all unsecured claims. Certainly, the court might set a different payment scheme so that allowance of lesser payments is cancelled. However, if nobody notices until the end of repayment plan, formally, the debtor is granted a debt relief since he fulfills the precondition of repayment of 30 % of all unsecured claims. The 2017 Amendment intends to touch upon this issue.[831]

The 2017 Amendment also responds to the criticism regarding the necessary timing for submission of a debtor's proposal to allow lesser installments. The debtor shall have an opportunity to request lesser installments also at the meeting with insolvency trustee organized mainly for the purpose of verification of claims pursuant to section 410 of the Czech IA as amended by the 2017 Amendment.

5.4.4 Disposal of debtor's property

Unlike in case of sale of debtor's assets, in repayment plan, a debtor has a right to freely dispose of his property (excluding, however, collateral), unless exceptions apply.[832] Nevertheless, similarly as in the case of sale of debtor's assets, a debtor acquires such right only after a discharge of debts confirmation is in legal force and effective.

In this connection, it must be noted that the Revision Amendment clarified that a debtor obtains a right to dispose of property with respect to which the limitations under enforcement proceedings have so far applied.[833] In other words, if any assets have been sold

[829] The High Court in Prague ruling case no. 3 VSPH 1360/2013-B-22 (KSPL 29 INS 2549/2013) of 24 November 2014, the High Court in Olomouc ruling case no. 2 VSOL 218/2013-B-10 (KSOS 33 INS 12929/2012) of 20 March 2013 or 1 VSOL 713/2016-B-19 (KSOS 33 INS 2955/2014) of 13 September 2016. In the latter, the court noted that only upon extraordinary circumstances, the court might allow lesser instalments.

[830] The High Court in Prague ruling case no. 3 VSPH 1241/2011-B-12 (KSUL 77 INS 2422/2011) of 23 January 2012.

[831] See chapter 5.7.1.2 *infra*.

[832] Section 409(2) of the Czech IA. As it is discussed in chapter 5.5.4 *infra*, secured creditors might request the insolvency trustee to liquidate the respective collateral. Also, the debtor cannot naturally provide any favorable treatment to any of his creditors (i.e. provide any special benefit for his creditors). Such behavior would be in contravention with the duty to act honestly.

[833] Prior to the adoption of the Revision Amendment, the High Court in Prague ruled that a debtor had indeed a right to dispose of the proceeds held in enforcement proceedings, however, such proceeds were to be distributed to creditors. The court reasoned that the debtor should seek to achieve the highest possible

in enforcement proceedings, yet the proceeds from the sale of such assets have not been distributed to creditors, the debtor should obtain such proceeds. Thus, an insolvency petition might be strategically used in case the proceeds from enforcement proceedings have not been distributed.[834]

A debtor does not possess disposition rights with respect to the property which serves as collateral. Although the Czech IA does not state it explicitly, it should be an insolvency trustee who holds right of disposition with respect to collateral. However, the insolvency trustee is to a large extent bound by the instructions of secured creditors.[835] The collateral might be liquidated only if the secured creditor instructs the insolvency trustee to do so. However, an insolvency trustee might proceed with the liquidation of such property only after the respective secured claim is ascertained in the insolvency proceedings.[836] If a secured creditor decides not to proceed with liquidation, his security interest survives a debts relief order.[837] Interestingly, the difference between the proceeds from a sale of collateral and the respective payment on a secured claim belongs to a debtor.[838]

Moreover, inherited assets, gifts and assets acquired on the basis of voidable transactions and assets not listed in the debtor's list of assets are in the disposition of the insolvency trustee.[839] Inclusion of assets not disclosed in the debtor's list of assets as well as assets acquired on the basis of voidable transactions reflects the principle of honesty required from debtors which seeks to eliminate incentives on the part of debtors to hide their property.

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satisfaction of the creditors' claims. See the High Court in Prague ruling case no. 3 VSPH 450/2012-B-24 (KSPH 39 INS 14325/2011) of 5 November 2012.

[834] See chapter 5.9 *infra*. As stated therein, it has been disputed whether a claim of a enforcement office holder for expenses and remuneration should be lodged in insolvency proceedings as any other unsecured claim or whether it might be directly satisfied from the proceeds (if not yet settled from the sale of assets). See e.g. the Supreme Court ruling case no. 21 Cdo 3182/2014 of 23 October 2014 or 26 Cdo 3759/2015 of 18 November 2015 and the Constitutional Court ruling case no. IV. ÚS 378/16 of 12 September 2016.

[835] See particularly sections 230, 409(3) and 293 of the Czech IA and chapters 5.3.1 and 5.3.3 *supra*.

[836] See section 409(3) of the Czech IA. As concerns the ascertainment of the claims, see particularly section 201 of the Czech IA.

[837] See section 414(3) of the Czech IA and chapter 5.7.

[838] See e.g. the High Court in Prague case no. 3 VSPH 1127/2012-B-15 of 22 October 2012, 1 VSPH 175/2012-B-30 (KSPL 20 INS 3876/2010) of 28 February 2012 or High Court in Olomouc case no. 3 VSOL 186/2015-B-34 (KSOS 34 INS 14745/2013) of 29 June 2015.

[839] Section 412(1)(b) of the Czech IA. See also KOZÁK, Jan et al. *Insolvenční zákon - komentář*. Prague: ASPI, 2016, p. 785.

5.4.5 Remuneration of insolvency trustees

In the case of repayment plan, the remuneration of an insolvency trustee equals to a monthly payment of CZK 750, or CZK 1,125 in the case of joint proceedings of spouses. If the secured creditor requests the liquidation of assets that serve as collateral, remuneration of an insolvency trustee is increased by the amount corresponding to the abovementioned amounts regarding remuneration calculated from the proceeds to be distributed to secured creditors.[840]

The Regulation on Remuneration of Insolvency Trustees also sets forth the amount of monthly expenses which equals to CZK 150, or in case of joint proceedings of spouses to CZK 225.

Pursuant to section 38(1) of the Czech IA as amended by the 2017 Amendment, since 1 July 2017 an insolvency trustee shall newly obtain CZK 250 for a review of every lodgment of claims.

It follows, however, that insolvency trustees are not sufficiently motivated to maximize the value for creditors, to supervise debtors or to inform the court about any possible infringements of debtors.[841] The remuneration for insolvency trustees is fixed. Therefore, the longer the repayment plan lasts the higher is remuneration for insolvency trustees. The author argues that the current scheme of remuneration should be modified.[842]

5.5 Claims subject to satisfaction in discharge of debts

Generally, only claims which are lodged in insolvency proceedings might be satisfied either from the proceeds of the sale of assets or under the respective repayment plan. Therefore, creditors as well as those who solely hold a security interest in the property belonging to the debtor's insolvency estate should lodge their claims and /or security interest within the time limits set forth by the Czech IA.[843] In any case, creditors' claims should be

[840] The author argues that the system of remuneration does not provide insolvency trustees with enough incentives to take an active role. It should contain arguably some elements of success fee. The current system motivates insolvency trustees to uphold discharge of debts proceedings as long as the debtor pays them a monthly fee. Moreover, the insolvency trustee is not incentivized to file an action to challenge voidable transfers. Overall, thorough revision would be needed.

[841] However, the 2017 Amendment anticipates that higher sanctions might be imposed upon insolvency trustees for failures to meet their duties. See part IV of the 2017 Amendment.

[842] Arguably, remuneration might be more dependent on the value that creditors obtain (rate of satisfaction).

[843] The creditors might lodge their claims in insolvency proceedings from the commencement of the insolvency proceedings. Creditors with preferential claims do not lodge their claims in insolvency proceedings; they might apply them in a different way. See particularly section 165 *et seq.* of the Czech IA.

lodged regardless of whether they are due, subject to enforcement or civil proceedings, subject to conditions or secured.

5.5.1 Claims which are not due

First of all, it might be noted that one of the effects of a liquidation order is that the claims which are not yet due are considered to be due.[844] Although it is not clear from the wording of section 408(1) of the Czech IA, it might be concluded that a discharge of debts order in the form of sale of assets should have the same effect so that such claims are subject to satisfaction.[845]

Unlike rules on liquidation, none of the provisions governing discharge of debts addresses whether the claims which are not yet due are subject to satisfaction in discharge of debts. As mentioned above,[846] underlying principle of insolvency law is that it should not modify the status of rights (claims) unless it is needed.[847] Therefore, the question is whether there is any reason why undue claims should be satisfied sooner.

One of the strongest reasons supporting the conclusion that undue claims should be satisfied in discharge of debts is that it would be unjust for creditors with such claims since their claims are also subject to a debt relief order.[848] The case-law has upheld this line of argumentation, and therefore, claims which are not yet due are subject to satisfaction in discharge of debts in both of its forms.[849]

5.5.2 Denied claims

As indicated above, claims of creditors are subject to review procedure (verification of claims) and they might be denied. Until the claims are finally ascertained, creditors shall not obtain any proceeds on them. However, the related question is how such denied claims are treated in distribution scheme, particularly in case of a repayment plan.

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[844] See section 250 of the Czech IA.

[845] See also the High Court in Prague ruling case no. 4 VSPH 77/2015-B-15 (MSPH 79 INS 11648/2014) of 7 April 2015.

[846] See in more details chapter 2.5 *supra.*

[847] As mentioned above, this principle is commonly known in the USA as *Butner principle* after the US Supreme court ruling in re *Butner v. United States* 440 U.S. 48 (1979).

[848] Section 416 of the Czech IA lists exclusively which claims are not subject to a debt relief order.

[849] See e.g. the High Court in Prague ruling case no. 1 VSPH 1808/2014-B-13 (KSUL 71 INS 7422/2014) of 22 September 2014, 3 VSPH 1321/2012-B-16 (KSPL 20 INS 5856/2012) of 2 February 2014, 1 VSPH 1808/2014-B-13 (KSUL 71 INS 7422/2014) of 22 September 2014 or 4 VSPH 1889/2015-B-32 (KSPL 20 INS 13246/2012) of 18 November 2015.

First, the insolvency trustee might not include denied claims in the respective distribution scheme. In case the creditor happens to be successful in the verification process of his claim, he will be incorporated in the distribution scheme and will obtain an extraordinary payment so that the creditor is put in the position had the claim been ascertained since the commencement of insolvency proceedings. Alternatively, the insolvency trustee might set aside a portion of the proceeds corresponding to the repayment of a denied claim. If the creditor is successful in insolvency proceedings, the insolvency trustee will include the denied claim into distribution scheme and the creditor will obtain an extraordinary instalment corresponding to the proceeds which were set aside. If the denied claim is not established, the proceeds which were set aside are distributed among other creditors as extraordinary payments.

Naturally, the latter seems to be the preferred option. [850] However, if a debtor is not able to repay 30 % of all his unsecured debts (i.e. including denied claims), the former might be the only viable solution. If the creditor is successful and his previously denied claim is ascertained, the repayment plan might simply come to an end pursuant to section 418 of the Czech IA since the debtor will not be in the position to repay 30 % of his unsecured debts.

5.5.3 Claims subject to conditions

First of all, similarly as the Czech Civil Code, the Czech IA distinguishes between conditions precedent and suspensive conditions. Rules on discharge of debts are, however, silent on the treatment of claims that are subject to conditions.

However, the case-law rightly holds that section 306(6) of the Czech IA which relate to liquidation should apply per analogy.[851] Accordingly, claims subject to conditions precedent shall not be listed in the respective distribution scheme until the condition precedent is fulfilled. After such condition is fulfilled, a discharge of debts confirmation is to be changed pursuant to section 407(3) of the Czech IA so that it newly anticipates also satisfaction of the previously conditioned claims.

[850] This approach is supported by the wording of section 411(2) of the Czech IA.

[851] See e.g. the High Court in Prague ruling case no. 1 VSPH 464/2010-B-11 (KSUL 70 INS 2745/2010) of 22 June 2010. Section 306(6) of the Czech IA states that the inclusion of claims subject to conditions to the distribution scheme in liquidation is dependent on whether they are conditioned as of the issuance of an order on distribution of the proceeds.

5.5.4 Secured claims

Secured creditors have a specific position in discharge of debts. The legislature anticipates that secured creditors stand rather outside of discharge of debts.[852] Their role is to quite a large extent suppressed and neglected. As mentioned above, solely unsecured claims are part of distribution scheme and the criterion of mandatory pay-out relates exclusively to unsecured claims.[853] Secured creditors neither vote over a method of discharge of debts nor do they participate in the voting on recommendation whether to allow lesser installments. The reason is that in they are to be satisfied solely from their collateral.

Generally, pursuant to section 167(3) of the Czech IA, in insolvency proceedings the creditor is secured only to the extent of an expert's appraisal prepared following the issuance of an insolvency order and the rest of the claim is considered to be unsecured. Yet, section 402(1) of the Czech IA does not allow bifurcation of claims as it states that in discharge of debts, secured creditors do not vote to the extent their claims are not considered to be secured. This provision leads to the argumentation that the creditor has to lodge his claim either as secured or unsecured. Such conclusion might be rather unfair as the creditor with a security interest has to decide what would be more beneficial for him without knowing all the information (including whether the collateral even exists or in what conditions it exists). If a creditor is not fully secured, it may make economic sense to register his claim as unsecured provided that a debtor will be able to repay more than the value of the collateral during the life of repayment plan. However, if the debtor's income decreases the creditor may obtain less than expected at the time of the lodgment of his (otherwise secured) claim. Moreover, discharge of debts might be converted into liquidation and the creditor will lose his position as a secured creditor since it is not generally possible to lodge one's security interest after the lapse of time for the lodgment of claims.

What is striking is that creditors should decide whether to lodge their claims as secured or unsecured prior to the decision on a discharge of debts confirmation (i.e. prior to the decision on a method of discharge of debts). As of the lodgments of claims, creditors do not possess all the information to fully assess all the aspects regarding their position. In the past courts even ruled that the creditor who files his claim as secured cannot be satisfied in discharge of debts proceedings as unsecured creditors even if his security interest is not

[852] See *inter alia* the explanatory notes to the Revision Amendment, chapter 3.2.(v) thereof. The explanatory notes are available on <http://www.psp.cz/sqw/historie.sqw?o=6&T=929>.

[853] See mainly sections 402(1), 395(1)(b) and 398(3) of the Czech IA.

ascertained.[854] Thus, a lodgment of claims may be under certain circumstances akin to gambling. This was the reason why the respective provisions governing status of secured creditors were challenged as unconstitutional. Although the Constitutional Court indicated that the respective rules are not optimal, it held that the legislature had a large discretion in the area of insolvency law and that the regulation was in line with constitutional law.[855]

There is a tendency among creditors to get around the mentioned provision and the creditors sometimes seek to artificially lodge one claim as two claims – part as secured to the extent of the anticipated value of the collateral and the remaining part as unsecured. The practice has been challenged by the courts and it is not certain whether such practice is in line with the wording of Czech IA, particularly in case of repayment plan which specifically state that secured creditors are to be satisfied solely from the collateral.[856] Also, another practice lies in partial withdrawal of a security interest after the lapse of the period for the lodgment of claims which has not been also addressed uniformly.[857]

There are obviously methods how to evade the provision. Once of the solution is to *ex ante* provide a credit to a person different from the person who grants a security interest. Another solution is to simply *ex post* assign a part of a claim as secured and keep the remaining part of the claim as unsecured.[858] Given the fact that there are ways how to escape from the application of the abovementioned criticized rule, bifurcation of claims should be arguably allowed.

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[854] See e.g. the High Court in Prague ruling case no. 3 VSPH 154/2013-B-33 (KSHK 45 INS 1677/2012) of 2 April 2013.

[855] See the Constitutional Court ruling case no. I. ÚS 3271/13 (KSUL 74 INS 69/2013) of 6 February 2014.

[856] There is a substantial number of cases regarding artificial bifurcation of claims. High Courts have approved such practice e.g. in the High Court in Prague rulings case no. 104 VSPH 126/2014 (KSLB 82 INS 16257/2012) of 14 October 2014 or 3 VSPH 2109/2015-B-20 (KSPA 60 INS 30371/2014) of 18 April 2016. Yet, the same court ruled in the opposite direction in its ruling case no. 2 VSPH 405/2014-P4-9 (KSHK 42 INS 295595/2013) of 29 July 2015.

[857] The High Court in Olomouc has challenged this approach in its ruling case no. 3 VSOL 319/2015-B-12 (KSOS 31 INS 16848/2014) of 30 June 2015 and approved in its ruling case no.2 VSOL 959/2013-P8-6 (KSBR 29 INS 12814/2013) of 6 December 2013. The High Court in Prague stated in its ruling case no. 3 VSPH 154/2013-B-33 (KSHK 45 INS 1677/2012) of 2 April 2013 that once the claim is filed as secured it cannot be modified.

[858] See also the High Court in Prague ruling case no. 3 VSPH 2109/2015-B-20 (KSPA 60 INS 30371/2014) of 18 April 2016 - the court acknowledged that since a creditor may generally assign part of his claim as unsecured it does not make sense not to allow bifurcation of the claim.

5.5.5 Claims of creditors who agreed with lesser satisfaction

One of the preconditions of discharge of debts is that a debtor is able to pay generally 30 % of unsecured creditors' claims. Yet, an individual creditor might agree with lesser satisfaction of his claim. In such scenario, it is important that he specifies how his claim should be treated in case the debtor repays 30 % of all other unsecured claims. Essentially, there are two options – either a creditor might not ask for anything beyond the agreed level of satisfaction of his claims or alternatively he might ask for more. If the latter applies, two possibilities might follow.

First, if a creditor agrees with satisfaction equalling to 10 % of the value of his claim, his claim might be further satisfied in a ratio of 1:3 (i.e. the ratio of agreed 10 % of satisfaction of the claim to the mandatory repayment of 30 % of unsecured claims). In other words, the creditor receives only a third of all the amounts that would be otherwise payable on his claim. Second approach entails that once claims of all other creditors are satisfied up to 30 % of their value, the claim of the creditor who agreed with lesser satisfaction will be subject to satisfaction up to the remaining amount corresponding to 30 % of his claim. Afterwards, all claims shall be subject to equal satisfaction.

There is no unity on how to proceed. The first approach seems to be more substantiated from the perspective of other creditors. Yet, the second approach might be more attractive for creditors to agree with lower level of satisfaction of their claims.

5.6 Revocation of discharge of debts confirmation

Pursuant to section 418(1) and (2) of the Czech IA, a court might revoke a discharge of debts confirmation under the following circumstances: (i) a debtor does not fulfil substantial duties in the insolvency proceedings as per the respective method of discharge of debts, (ii) a substantial part of repayment plan will expectedly not be fulfilled, (iii) due to culpable [in Czech: *zaviněné*] debtor's conduct a debt more than 30 days overdue arose after a discharge of debts confirmation, (iv) a debtor files a motion to revoke the discharge of debts confirmation, or (v) on the basis of the circumstances of individual case, it might be reasonably concluded that a debtor pursues dishonest intentions.[859]

[859] As concerns chapter 13 proceedings, grounds for conversion into chapter 7 proceedings are mentioned in section 1307 of the US Bankruptcy Code and include *inter alia*: unreasonable delay by the debtor that is prejudicial to creditors (equaling roughly to negligent conduct under the Czech IA), nonpayment of any fees and charges, failure to file a plan timely, material default by the debtor with respect to a term of a confirmed plan.

If a court revokes a discharge of debts confirmation, it shall also convert the case into liquidation which does not anticipate a debt relief. From the perspective of time, the court might revoke a discharge of debts confirmation only until the issuance of the court's decision whereby it notes the accomplishment of discharge of debts pursuant to section 413 of the Czech IA. However, the court shall decide only after a hearing to which it convenes a debtor, insolvency trustee, creditors' committee and the creditors who file a motion to revoke a discharge of debts confirmation. Only the mentioned persons might file an appeal against the respective court's decision.

The court shall assess whether there is any ground for revocation of discharge of debts confirmation on its own motion. There is in principle no need for creditors to intervene as a court undertakes a role of a watch dog of creditors' interests.[860] Preferably, the court should regularly monitor debtor's performance of his duties. Accordingly, in practice, if it finds out that a debtor does not fulfil any of his obligations, it should notify the debtor with possibilities how to cure the respective failures in order to ensure due course of discharge of debts proceedings.[861] In practice, it appears that courts are rather reluctant to convert discharge of debts into liquidation automatically so that infringements of debtor's duties do not always lead to a liquidation order

[860] See e.g. the High Court in Prague ruling case no. 3 VSPH 535/2010-B-34 (KSHK 45 INS 8999/2009) of 24 August 2010 or 3 VSPH 640/2010-B-35 (KSUL 77 INS 7671/2009) of 22 February 2011.

[861] See e.g. the High Court in Prague ruling case no. 2 VSPH 9/2016-B-44 (KSLB 87 INS 21405/2011) of 14 January 2016.

Chart 9: Statistics about revocations of discharge of debts confirmations[862]

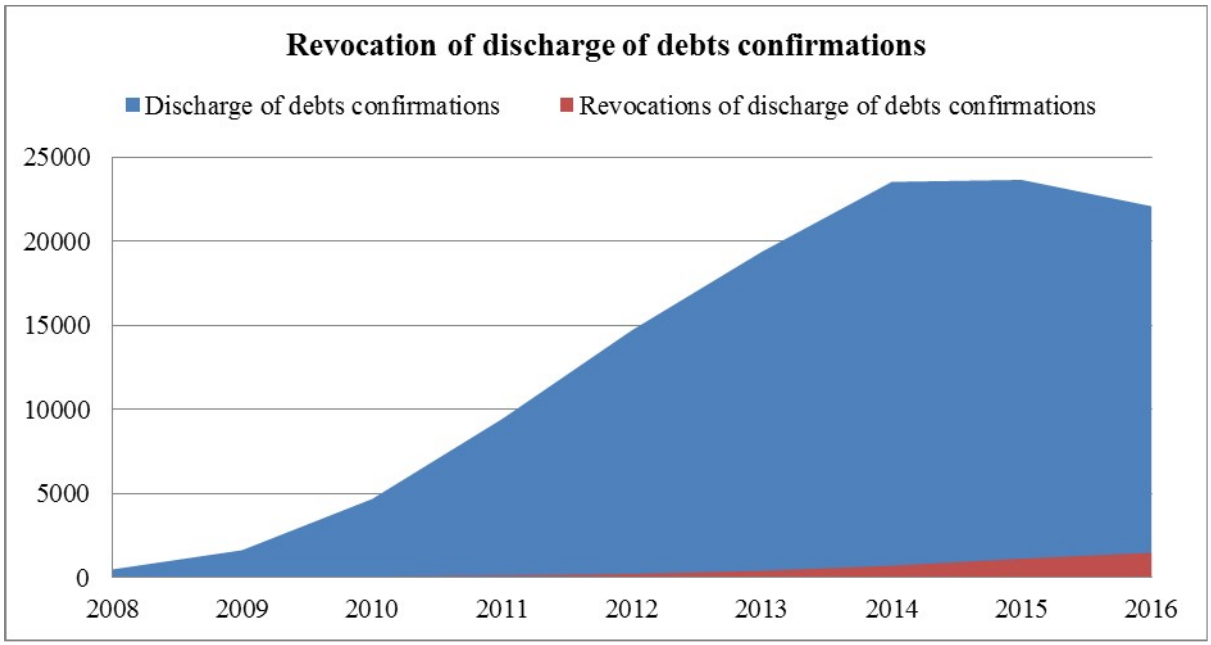
Period	Discharge of debts confirmations	Revocations of discharge of debts confirmations	Revocations of discharge of debts confirmations / discharge of debts confirmations
2008	477	8	1.7 %
2009	1,622	30	1.8 %
2010	4,666	56	1.2 %
2011	9,421	109	1.2 %
2012	14,705	211	1.4 %
2013	19,375	398	2.1 %
2014	23,537	700	3.0 %
2015	23,656	1,116	4.7 %
2016	22,084	1,476	6.7 %
Total	**119,543**	**4,104**	**3.4 %**

From the available data, it follows that a number of cases where courts revoked a discharge of debts confirmations has been naturally increasing since 2008 hand in hand with the total number of discharge of debts confirmations. Also, it appears that the ratio of the number of revocations of discharge of debts confirmations to the number of discharge of debts has been increasing. It does not mean that gradually the debtors tend to fail to fulfil their duties more often. Arguably, the figure can be explained by the growing number of pending cases.[863]

[862] Source of data: statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information.

[863] As explained above, the overwhelming majority of discharge of debts is in the form of repayment plan which lasts up to 5 years. Therefore, the number of pending discharge of debts proceedings in 2016 might be in theory over 95,000.

Graph 4: Ratio of revocations of discharge of debts confirmations to discharge of debts confirmations[864]



Although there are not comprehensive statistics about grounds on the basis of which discharge of debts confirmation have been revoked, pursuant to the analysis of the Ministry of Justice of the Czech Republic, the most applicable ground for revocation of discharge of debts confirmations was a failure to fulfill substantial duties on the part of debtors.[865] Mostly, it was accompanied by a failure to fulfil a substantial part of repayment plan. In less than 10 % latter was the sole ground for a revocation of a discharge f debts confirmation.[866] In slightly more than 10 % of cases, courts revoked discharge of debts confirmation as due the debtor's conduct a debt more than 30 days overdue arose after a discharge of debts confirmation. Interestingly, in few cases, the reason behind revocation was debtor's dishonesty.[867]

[864] Source of data: statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information.

[865] The ministry has evaluated 104 selected cases from 2008 until 2013. The mentioned ground stands for 80 % of all revocations. See the explanatory notes to the 2018 Draft Amendment, pp. 45-46.

[866] Only in 10 out of 104 cases, the sole reason to revoke a discharge of debts confirmations was that a substantial part of repayment plan will expectedly not be fulfilled. It appears that the Ministry of Justice of the Czech Republic did not distinguish properly between first two grounds. *Idem.*

[867] Dishonesty ground was applied solely in five cases. *Idem.*

Similarly to the rejection and dismissal of a motion for discharge of debts, the 2017 Amendment does no longer state that if a discharge of debts confirmation is revoked, liquidation order follows. Unlike the current wording of 418 of the Czech IA, the new wording proposes that the case is converted into liquidation solely if a motion for discharge of debts is filed together with insolvency proceedings, a debtor requests that a liquidation is a form of resolution of debtor's insolvency and the debtor paid a deposit (if required by court).[868] Otherwise, the court shall stay the respective insolvency proceedings and order the debtor to pay remuneration to a person who prepared an insolvency petition and/or a motion for discharge of debts. As mentioned above, it is questionable whether the exclusion of mandatory conversion of discharge of debts into liquidation is reasonable.[869]

5.6.1 Failure to fulfil substantial duties

One of the grounds for revocation of discharge of debts consists of the debtor's failure to meet his substantial duties as per the respective method of discharge of debts. The rationale behind that lies mainly in the principle of a carrot and a stick. Simply said, the legislature seeks to ensure fulfilment of the debtor's duties in discharge of debts proceedings.

First of all, the basis for revocation relates to the debtor's failures that occur only after the issuance of a discharge of debts confirmation. Any failure to meet the debtor's duties prior to the issuance of a discharge of debts confirmation should be generally addressed prior to such court's decision.[870] Thus, the mentioned ground essentially corresponds to the pre-condition of the discharge of debts confirmation – absence of reckless and negligent behaviour of debtors. [871]

Second, the debtor should not be punished for any breaches of his obligations. Solely qualified failures should trigger revocation of a discharge of debts confirmation. However, a court should not assess whether the debtor is in fault or not.[872] Arguably,

[868] See section 418(4) of the Czech IA as amended by the 2017 Amendment.

[869] See chapter 4.3.2 *supra*.

[870] Alternatively, such failures might be addressed on the ground of debtor's dishonest intentions. See chapter 5.6.5 *infra.*

[871] As mentioned above, one of the preconditions for discharge of debts proceedings is that current results of the proceedings demonstrate that the debtor has reckless of negligent approach towards his duties in insolvency proceedings (section 395(2) of the Czech IA).

[872] See the Supreme Court ruling case no. 29 NSČR 45/2010-B-174 (MSPH 93 INS 1923/2008) of 30 April 2013.

until the revocation of a discharge of debts confirmation becomes effective, the debtor might seek to rectify his failures (if it is possible).[873]

The mentioned ground for revocation of discharge of debts confirmation does not apply to the obligation to repay at least 30 % of unsecured debts as such failure constitutes another basis for revocation of a discharge of debts confirmation.[874] However, the related earning obligations might be touched upon (e.g. the obligation to seek to procure job or to undertake appropriate income activities).

Prior to the adoption of the Revision Amendment, the Supreme Court noted that the mentioned ground covered also a failure to act in good faith.[875] Currently, such line of argumentation is no longer applicable since the debtor's failure to act honestly constitutes a separate basis for revocation of discharge of debts confirmation.[876]

5.6.2 Failure to fulfil substantial part of repayment plan

If a substantial part of repayment plan will expectedly not be fulfilled, a court shall revoke a discharge of debts confirmation. In terms of earning duties of a debtor, the risk of revocation of discharge of debts confirmation should incentivize the debtor to secure sufficient income stream.

If it appears that the debtor will not be able to reach the mandatory pay-out due to events that occur after the issuance of a discharge of debts confirmation, it does not make sense to wait until the end of a repayment plan. Generally speaking, if a debtor does not satisfy 30 % of unsecured claims, he shall not obtain a debt relief order. However, the provision on revocation of a discharge of debts confirmation should be interpreted in line with section 415 of the Czech IA.[877] Pursuant to the mentioned provision, a debtor might be granted a debt relief order notwithstanding a failure to pay 30 % of unsecured claims if *inter alia* the mandatory pay-out is not reached due to circumstances not pertinent to the debtor's fault [in Czech: *okolnost, kterou nezavinil*] and the actual satisfaction of unsecured claims is

[873] See e.g. the Supreme Court ruling case no. 29 NSČR 61/2012-B-35 (KSOS 22 INS 24195/2011) of 26 February 2014 and 29 NSČR 88/2013-B-29 (KSOS 22 INS 22824/2012) of 30 January 2014.

[874] See the Supreme Court ruling case no. 29 NSČR 12/2013-B-54 (KSUL 45 INS 3212/2009) of 28 February 2013.

[875] See the Supreme Court ruling case no. 29 NSČR 45/2010-B-174 (MSPH 93 INS 1923/2008) of 30 April 2013.

[876] Section 418(3) of the Czech IA.

[877] See the Supreme Court ruling case no. 29 NSČR 12/2013-B-54 (KSUL 45 INS 3212/2009) of 28 February 2013.

not lesser than the expected satisfaction of claims in liquidation had it been the method of resolution of the debtor's insolvency.

Anecdotal experience suggests that courts are generally reluctant to revoke a discharge of debts confirmations if debtors cease to repay their claims. There is not a strict line how to interpret the provision and the court should undertake a case-by-case analysis of individual circumstances.[878] In any case, a temporary impairment of income stream of a debtor which does not allow the debtor to pay regular instalments covering the mandatory pay-out does not substantiate a revocation of a discharge of debts confirmation.[879] The court shall revoke a discharge of debts confirmation only when it becomes clear that within the timeframe of repayment plan, the debtor will not be able or willing to overcome the current unpleasant development, or if within a reasonable timeframe the debtor fails to achieve required income stream, which he assumed, and there is no real hope for change.[880] In this regard, it suffices to say that the question whether the change of income stream is attributable to the debtor's behaviour or not or whether the debtor is accountable for such change is irrelevant. Assessment of whether the ground for a revocation of a discharge of debts confirmation is fulfilled is of objective nature.[881]

In any case, courts generally also take into account what would be the satisfaction of creditors' claims in liquidation. Thereby they provide debtors with an opportunity

[878] The Supreme Court supported the revocation of discharge of debts confirmation in the situation when the debtor paid 8 out of 38 installment [the Supreme Court ruling case no. 29 NSČR 12/2013-B-54 (KSUL 45 INS 3212/2009) of 28 February 2013]. The High Court in Prague also supported the revocation of a discharge of debts confirmation in case the debtor in 51 months satisfied less than 15 % of his unsecured claims and the prospected satisfaction after the end of the repayment plan would equal to 15 %; see the High Court in Prague ruling case no. 3 VSPH 632/2015-B-44 (KSLB 87 INS 6062/201) of 19 May 2015. Similarly see also the decision of the High Court in Olomouc case no. 3 VSOL 111/2016-B-50 (KSBR 31 INS 18911/2012) of 1 March 2016. The High Court in Olomouc in its ruling case no. 1 VSOL 750/2016-B-29 (KSOS 22 INS 2651/2011) of 30 August 2016 upheld the revocation of a discharge of debts confirmation when the debtor's prospected rate of satisfaction fell to about 29 % since the debtor did not have any job for quite a long period of time.

[879] The 2018 Draft Amendment adds that a discharge of debts confirmation shall be revoked if the debtor will not be able to pay in full reimbursement of expenses of insolvency trustee and his remuneration, costs associated with the administration of insolvency estate, statutory alimonies which arose after the insolvency order due to circumstances for which he is culpable [in Czech: *dlužník není v důsledku okolností, které zavinil, po dobu delší než 3 měsíce schopen splácet v plné výši ani pohledávky podle § 395 odst. 1 písm. b), jestliže vznikly po rozhodnutí o úpadku*]. See section 418(1)(d) of the Czech IA as amended by the 2018 Draft Amendment.

[880] See e.g. the High Court in Prague ruling case no. 3 VSPH 535/2010-B-34 (KSHK 45 INS 8999/2009) of 24 August 2010 or 3 VSPH 640/2010-B-35 (KSUL 77 INS 7671/2009) of 22 February 2011.

[881] See e.g. the Supreme Court ruling case no. 29 NSČR 83/2013-B-38 (KSBR 24 INS 3408/2012) of 28 November 2013 or 29 NSČR 12/2013-B-54 (KSUL 45 INS 3212/2009) of 28 February 2013 or the High Court in Olomouc ruling case no. 1 VSOL 750/2016-B-29 (KSOS 22 INS 2651/2011) of 30 August 2016.

to overcome a lack of sufficient income stream.[882] Also, courts of appeal take into consideration the changes that occur in appellate proceedings. As a consequence of this, if the debtor procures additional income stream to achieve the prospected pay-out, he might successfully appeal against the previously substantiated decision of the court of first instance.[883]

As mentioned above, if discharge of debts is confirmed notwithstanding the fact that a debtor is not able to repay all unsecured claims, including the claims which are not yet ascertained, later decision ascertaining the denied claims might lead to revocation of the discharge of debts confirmation pursuant to section 418(1)(b) of the Czech IA.[884]

5.6.3 Failure to pay a new debt

The court shall revoke a discharge of debts confirmation also upon the occurrence of the following circumstances: (i) assumption of a new debt (monetary obligation) after a discharge of debts confirmation, (ii) a failure to pay such debt more than 30 days after its due date and (iii) culpable debtor's conduct which gives rise to the debt.[885] In this connection, the issuance of an enforcement order entails a rebuttable presumption that the debtor is culpable for the assumption of the debt.[886]

It is not clear what principle is exactly behind the rule that a discharge of debts confirmation might be revoked if a debt more than 30 days overdue arises after the discharge of debts confirmation due to debtor's culpable conduct. One might argue that debtors who do not manage their financial affairs do not deserve a relief from debts. Arguably pending insolvency proceedings should not bar enforcement of newly incurred debts.[887]

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[882] See e.g. the High Court in Prague ruling case no. 4 VSPH 460/2015-B-42 (KSPH 39 INS 3702/2012) of 25 May 2015.

[883] See e.g. the High Court in Olomouc ruling case no. 2 VSOL 193/2015-B-21 (KSOS 33 INS 6672/2012) of 21 May 2015.

[884] See e.g. the Supreme Court ruling case no. 29 NSČR 22/2012-B-18 (KSCB 27 INS 13044/2010) of 31 July 2012

[885] See the Supreme Court ruling case no. 29 NSČR 110/2015-B-37 (KSOS 8 INS 27373/2015) of 30 November 2015.

[886] Section 418(2) of the Czech IA. See also e.g. the High Court in Olomouc ruling case no. 3 VSOL 323/2011-B-99 (KSBR 44 (40) INS 1670/2008) of 18 August 2011.

[887] Pending insolvency proceedings bar the commencement of new insolvency proceedings. It does not generally prevent the commencement of enforcement proceedings for newly incurred debts, yet debtors in discharge of debts proceedings presumably have not income stream or sufficient assets to satisfy claims of the creditors who are not listed in distribution schemes. See also chapter 5.9 *infra.*

In any case, the presumption concerning the commencement of enforcement proceedings does not appear substantiated. The commencement of such proceedings has nothing to do with the debtor's conduct or his culpability as it is solely up to creditors whether they file such motion. The commencement of enforcement proceedings might only support the conclusion that the respective claim is substantiated.

Courts might provide a debtor with an opportunity (i.e. time) to pay his newly incurred debts.[888] In any case, if a court revokes discharge of debts confirmation and convert the case into liquidation, newly incurred debts, which serve as a basis for revocation, are not satisfied in liquidation.

5.6.4 Debtor's motion

One of the principles behind discharge of debts is that a debtor voluntarily assumes duties associated with this method of resolution of the debtor's insolvency. A discharge of debts order might be issued solely upon a debtor's motion and proceedings are in this regard in the debtor's hand. If a debtor intends to stay the proceedings, the court revokes the previously issued confirmation.

5.6.5 Debtor's dishonest intention

The court shall also revoke a discharge of debts confirmation if on the basis of the circumstances of individual case, it might be reasonably concluded that the debtor pursues dishonest intentions. The mentioned ground for revocation of a discharge of debts confirmation has been added by the Revision Amendment and is applicable since 1 January 2014. However, the Revision Amendment has only confirmed the conclusions supported already by the case-law of the Supreme Court. The Supreme Court held that the principle to act honestly is applicable to (and should be assessed during) the whole course of the proceedings.[889] Typically, a debtor might act dishonestly if he *inter alia* as a statutory

[888] The High Court in Olomouc ruling case no. 2 VSOL 369/2011-B-46 (KSOS 8 INS 7872/2009) of 31August 2011. The debtor incurred new debts on the basis of a rental agreement. The court did not accept difficult financial situation of the debtor who allegedly had to take care of his child.

[889] See e.g. the Supreme Court ruling case no. 29 NSČR 45/2010-B-174 (MSPH 93 INS 1923/2008) of 30 April 2013. In the cited case, a debtor failed to mention foreign creditors in the list of his debts.

representative of a legal entity, to which the debtor owes money, omits to lodge a claim against himself.[890]

As concerns the assessment of whether the conditions for revocation are fulfilled, the test is the same as in the assessment of preconditions for discharge of debts. Simply said, courts should take into considerations all circumstances of the case, on a case-by-case analysis and consider *inter alia* whether a debtor has undertaken a real transformation during the insolvency proceedings.[891]

5.7 Relief from debts

Debt relief is a specific feature of insolvency pertaining to discharge of debts whereby all remaining debts that are eligible for discharge will be wiped out. Different legal regimes address conditions for the issuance of a debt relief order, scope thereof as well as possibilities to revoke the debt relief order differently.

5.7.1 Conditions for the issuance of a debt relief order

5.7.1.1 General conditions for the issuance of a debt relief order

Relief from debts should serve as "a carrot" which motivates the debtor to fulfil his duties in discharge of debts proceedings. Accordingly, section 414 of the Czech IA provides that a debtor might be granted a debt relief only if he fulfils all his duties as per the respective method of discharge of debts in a timely manner.

However, the requirement to fulfil "all" duties "in a timely manner" might be slightly misleading.[892] Naturally, the aim is that the debtor fully cooperates and otherwise does what he is expected to do. In practice, courts take into consideration that debtors are humans who make mistakes and in effect the courts tolerate the debtors' misdemeanours once they are

[890] See the High Court in Olomouc ruling case no. 2 VSOL 560/2016-B-36 (KSOS 14 INS 8464/2012) of 21 September 2016. Needless to say that the debtor should have undertaken steps in order to avoid the necessary conflict of interest.

[891] See chapter 4.4.3 *supra*. See also *inter alia* the High Court in Prague ruling case no. 3 VSPH 2107/2013-B-22 (KSUL 81 INS 474/2013 of 29 January 2014 or High Court in Olomouc ruling case no. 1 VSOL 1126/2016-B-24 (KSOS 34 INS 17675/2015) of 15 September 2016.

[892] Also, it is not clear whether some failures constitute a ground for rejection to issue a debt relief order or a ground for revocation of a discharge of debts confirmation. For instance, the High Court in Olomouc ruled that the inability to repay newly incurred debts is a ground for revocation of a discharge of debts confirmation but not a ground for rejection of the issuance of a debt relief order in its ruling case no. 1 VSOL 814/2016-B-39 (KSOS 34 INS 12709/2010) of 21 July 2016. The same court, however, ruled in the contrary in its ruling case no. 3 VSOL 1294/2015-B-40 (KSOS 25 INS 4488/2010) of 31 March 2016.

cured or minor.[893] Still, the court will be reluctant to issue a debt relief order if it concludes that the debtor acts in contravention with the principle of honesty even if such conclusion is found at the stage of the issuance of a debt relief order.[894]

One of the main and most pertinent requirements applicable in discharge of debts is to repay at least 30 % of debtor's unsecured debts.[895] In fact, anecdotal experience suggests that rationales of debt relief orders are more or less limited to the statement that the debtor repaid more than 30 % of unsecured claims and that the debtor filed the respective motion for the issuance of the order, which is also one of the preconditions for the issuance of a debt relief order.

As stated above, apart from the fulfilment of debtor's duties as per the respective method of discharge of debts, the debtor should also file a motion for a debt relief order as set forth in section 414(1) of the Czech IA. Thus, a debt relief order is not granted automatically. Section 414 of the Czech IA does not provide any specific requirements in terms of its form or content. Thus, the debtor might simply state that he requests the court to grant him a debt relief order.

From the perspective of time, it is not clear when the debtor should file such motion. No specific time limit applies. In practice the court might issue a debt relief order either together with the ruling whereby they note accomplishment of discharge of debts pursuant to section 413 of the Czech IA or separately in a specific ruling. In any case, the court shall issue a debt relief order only after all the steps leading to the implementation and realisation of the respective method of discharge of debts proceedings are undertaken.[896]

Pursuant to section 414(1) of the Czech IA as modified by the 2017 Amendment, the court shall grant a debt relief order even without a debtor's specific motion which is certainly a good pro-debtor move. Therefore, the 2017 Amendment dispenses with the otherwise useless requirement to ask for a grant of debt relief.

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[893] The standpoint of courts is essentially the same as in terms of the assessment of (i) honesty of debtors, (ii) lack of negligent and reckless approach, and (iii) fulfillment of conditions for revocation of a discharge of debts confirmation.

[894] See the High Court in Olomouc ruling case no. 3 VSOL 1176/2015-B-46 (KSOS 14 INS 6028/2009) of 24 March 2016. The court found that the debtor had presented a fictitious donation agreement on the basis of which a third party should have paid a monthly remuneration to the debtor.

[895] Naturally, if a creditor agrees to obtain lower satisfaction on his claim, the agreed rate of satisfaction applies.

[896] In case of sale of debtors' assets, it includes *inter alia* also distribution of the proceeds from the sale to creditors. See the High Court in Olomouc ruling case no. 3 VSOL 119/2013-B-30 (KSOS 22 INS 5888/2010) of 22 March 2013.

5.7.1.2 Issuance of a debt relief order regardless of the mandatory pay-out

The debtor might be granted a debt relief order notwithstanding a failure to pay 30 % of unsecured claims if *inter alia* the mandatory pay-out is not reached due to circumstances not attributable to the debtor and the actual satisfaction of unsecured claims is not lesser than the expected satisfaction of claims in liquidation had it been the method of resolution of the debtor's insolvency.[897] The provision seeks to address hardships that might occur during the course of the proceedings and balance the injustice that would otherwise happen due to strict application of the mandatory repayment.[898]

The debtor shall be granted a debt relief regardless of the rate of satisfaction of unsecured claims generally if the mandatory pay-out is not achieved due to the method of discharge of debts chosen by creditors. It applies, however, only if the debtor proposed the other method which would arguably meet the criterion of the mandatory pay-out.[899] However, if the debtor makes the court or creditors believe that one of the methods of discharge of debts is better and such method leads to insufficient satisfaction of unsecured creditors, the debtor will be presumably denied a debt relief order.[900]

It is questionable whether in order to reach a debt relief the debtor should at least partially satisfy his unsecured claims or whether zero rate of satisfaction is irrelevant. Although the law does not mandate such requirement, the High Court in Olomouc denied the issuance of a debt relief order to the debtor who had not satisfied the unsecured claims of his creditors at all.[901] Such view arguably cannot be generally accepted. The High Court in Prague indeed ruled that section 415 of the Czech IA does not exclude issuance of a debt relief order when the rate of satisfaction of unsecured creditors equals to zero.[902] In practice,

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[897] See the Supreme Court ruling case no. 29 NSČR 12/2013-B-54 (KSUL 45 INS 3212/2009) of 28 February 2013. Similarly, pursuant to section 1328(b) of the US Bankruptcy Code, the court may also grant a debt relief regardless of fulfillment of the confirmed plan whereas one of the factors is also that the debtor's failure is due to circumstances for which the debtor should not be held accountable.

[898] See e.g. the High Court in Prague ruling case no. 4 VSPH 1658/2015-B-39 (MSPH 89 INS 28031/2013) of 11 December 2015.

[899] See the Supreme Court ruling case no. 29 NSČR 91/2013-B-35 (KSUL 71 INS 15185/2012) of 30 January 2014.

[900] See e.g. the High Court in Prague case no. 2 VSPH 2470/2014-B-46 (KSPH 37 INS 21604/2011) of 29 March 2016.

[901] See the High Court in Olomouc ruling case no. 3 VSOL 119/2013-B-30 (KSOS 22 INS 5888/2010) of 22 March 2013. See also the High Court in Prague case no. 2 VSPH 2470/2014-B-46 (KSPH 37 INS 21604/2011) of 29 March 2016.

[902] See the High Court in Prague ruling case no. 1 VSPH 2161/2014-B-74 (KSLB 76 INS 8091/2009) of 21 January 2015. In such situation the debtor presented an expert opinion that the only valuable asset reached the value which would suffice for the satisfaction of secured as well as unsecured creditors. Yet, the asset was

such situation might happen particularly in case of liquidation of debtor's assets when the assets are of no market value or if they serve as collateral and the proceeds from the sale thereof do not reach the secured claim.[903]

Yet, if any of the unsecured claims is unsatisfied due to measures undertaken by court or insolvency trustee and the debtor fulfilled all his duties, he shall not be refused a debt relief order. In other words, if a failure to satisfy any of the unsecured claims occurs outside of the debtor's conduct, such failures cannot prevent him from achievement a debt relief.[904]

In this connection, the 2017 Amendment newly requires that in case a debtor is allowed to pay lesser installments, he shall generally repay 50 % of all unsecured claims.[905] Otherwise he shall not be granted a debt relief order, unless *inter alia* the mandatory pay-out is not reached due to circumstances not pertinent to the debtor's fault [in Czech: *okolnosti, které nezavinil*] and the actual satisfaction of unsecured claims is not lesser than the expected satisfaction of claims in liquidation had it been the method of resolution of the debtor's insolvency.

From a procedural view, it is the debtor who bears the burden of proof to support preconditions that a debt relief order might be issued.[906] In any case, the court's decision shall be well reasoned and based on the assessment of all relevant circumstances.[907]

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finally sold with difficulties after 4 years whereas only one secured creditor was partially satisfied. The court ruled that the debtor could not affect the expert's opinion and since he had zero non-exempt income, satisfaction in liquidation would not be higher. See also the High Court in Prague ruling case no. 4 VSPH 508/2015-B-17 (KSPH 61 INS 8528/2014) of 16 April 2015.

[903] In such situation, however, the debtor should generally have not any available income stream in order to meet the other precondition that the satisfaction of claims in liquidation would not be higher. In liquidation, the debtors' non-exempt income would fall into the insolvency estate. Therefore, if the debtor has any non-exempt income, it might be impossible for him to reach a debt relief unless he transfers such amount to the insolvency trustee as an extraordinary payment. See e.g. the High Court in Olomouc ruling case no. 2 VSOL 560/2016-B-36 (KSOS 14 INS 8464/2012) of 21 September 2016.

[904] See the High Court in Olomouc ruling case no. 2 VSOL 933/2015-B-52 (KSOS 36 INS 4643/2009) of 8 January 2016. In the mentioned case, the court of first instance failed to notify a foreign known creditor in a timely manner and due to subsequent denial of the respective claim, the unsecured claim of such creditor was not subject to satisfaction since 5-year long repayment plan lapsed in the meantime.

[905] Section 415 of the Czech IA as amended by the 2017 Amendment.

[906] Section 415 of the Czech IA.

[907] See e.g. the High Court in Prague ruling case no. 4 VSPH 1658/2015-B-39 (MSPH 89 INS 28031/2013) of 11 December 2015. As regards specific situations, the courts *inter alia* held that the debtor is accountable for a failure to repay 30 % of his unsecured debts if he was unable to secure job due to chronic alcoholism and gambling. See the High Court in Olomouc ruling case no. 3 VSOL 879/2015-B-49 (KSOS 31 INS 7941/2009) of 22 January 2016. The court ruled that the debtor should have commenced hospitalization earlier.

5.7.2 Scope of a debt relief order and its effect

A debt relief may be granted to a debtor by virtue of a court ruling in order to release him from claims which were not satisfied during the discharge of debts proceedings. The scope of the discharge is rather broad and unlike the US Bankruptcy Code, the Czech IA contains only two exceptions.[908]

The list of excluded claims is exhaustive.[909] Pursuant to section 416(1) of the Czech IA, the debtor shall not be released from (i) pecuniary or other proprietary sanctions that were imposed upon the debtor in criminal proceedings[910] and (ii) claims to compensate damage caused intentionally by the debtor in breach of a legal duty [in Czech: *náhrada škody způsobené úmyslným porušením právní povinnosti*].[911] Typically, they include the claims for damages caused by a criminal act.[912] Also, unlike under the US Bankruptcy Code, the court does not have any discretion over decision-making on the scope of a debt relief.[913]

The debt relief order relates both to the claims that have been partly satisfied as lodged claims in the insolvency proceedings as well as to the claims that should have been lodged.[914] Yet, the release of the debtor from his unpaid debts does not release the person, who bears joint liability with the debtor, from the performance of his obligations. If the person, who

[908] See generally section 523 of the US Bankruptcy Code. The Czech IA enacts a single set of exemptions to the discharge. The US Bankruptcy Code provides two sets of exceptions, one being broader for Chapter 13 cases in order to make Chapter 13 more attractive to debtors. Section 523 of the US Bankruptcy Code *inter alia* include: tax claims, fines imposed under federal election law, domestic support obligations, under certain circumstances student loans or claims not listed in the required schedule of claims.

[909] See e.g. the High Court in Prague ruling case no. 1 VSPH 1808/2014-B-13 (KSUL 71 INS 7422/2014) of 22 September 2014.

[910] It appears that criminal courts interpret section 140a of the Czech IA and other provisions of the Czech IA in the way that insolvency proceedings does not preclude the harmed party to enforce their claims for damages caused by the debtor in criminal proceedings. See the Supreme Court ruling case no. 4 Tdo 624/2015 of 15 July 2015.

[911] The wording might imply that damages caused by breaches of a legal duty include also damages caused by breaches of contractual duties. However, since breaches of contractual obligations might cover nearly all unsecured claims, they should not be arguably excluded from the scope of discharge of debts. Also, exceptions to the mentioned rules should be arguably interpreted rather narrowly.

[912] Obviously, unlike the exception enacted in the US Bankruptcy Code, the Czech IA does not require malicious conduct. Intentional behaviour suffices. See section 523(a)(6) and 1328(a)(4) of the US Bankruptcy Code and section 416(1) of the Czech IA. See e.g. the US Supreme Court ruling in re *Kawaauhau v. Greiger* 523 U.S. 57 (1998).

[913] Section 523 of the US Bankruptcy Code contains several presumptions and generally allows the court to take into account individual circumstances of the case.

[914] See section 414(2) of the Czech IA. See also the Supreme Court ruling case no. 29 Cdo 2756/2013 of 29 October 2015 or 29 NSČR 6/2008-B-60 (KSBR 31 INS 156/2008) of 29 September 2010.

bears joint liability with the debtor, performs his obligation, he shall not have a right of recourse against the debtor if the debtor has obtained a debt relief order.[915]

Also, a release from debts does not affect the secured creditor's right with respect to the collateral.[916] However, the secured creditor may not obtain claims that are otherwise excluded from satisfaction in insolvency proceedings (mainly interests accrued after an insolvency order).[917]

The Czech IA does not specifically state whether the release from the debtor's obligations implies the termination of debts or their unenforceability. The case-law, however, supports the view that the unpaid claims subject to a debt relief order do not cease to exist; they are simply not enforceable. This means that if the debtor pays the remaining debts, the repayment shall not be considered unjust enrichment of the creditor. In court or other proceedings, the court should however dismiss the motion to request the debtor to pay the respective claim. In enforcement proceedings, such claims have the same status as the claims which are time barred.[918] Therefore, the enforcement proceedings should be stayed.[919]

Since a debt relief order essentially entails that a portion of debts shall not be enforceable, the issuance thereof infringes the creditor's right to own property as fundamental right protected *inter alia* under article 11 of the Constitutional Act no. 2/1993 Coll., Charter of Fundamental Rights and Freedom, as amended, or article 1 of the Protocol 1 to the Convention for the Protection of Human Rights and Fundamental Freedoms. However, the Constitutional Court did not consider the legal framework to be unconstitutional.[920] For the sake of completeness, it might be noted that a debt relief procedure having similar features as the Czech legal regime has been also tested by the European Court of Human Rights in *Bäck v. Finland*. The court stated that the Finish debt adjustment procedure interfered with the right to own property, yet such procedure was not in contravention

[915] Section 414(3) of the Czech IA.

[916] This applies only if the secured creditor lodged his secured claim in the insolvency proceedings.

[917] Section 414(4) of the Czech IA.

[918] See e.g. the Supreme Court ruling case no. 29 Cdo 3509/2010 of 24 November 2010 and 29 Cdo 2756/2013 of 29 October 2015.

[919] See section 268 of Czech Civil Procedural Code.

[920] See *inter alia* the Constitutional Court ruling case no. I. ÚS 3271/13 of 6 February 2014 or the High Court in Olomouc ruling case no. 1 VSOL 178/2015-B-40 (KSBR 27 INS 18247/2014) of 21 October 2015. The Constitutional Court reasoned that the legislature enjoys a significant degree of discretion.

with the Protocol 1 to the Convention for the Protection of Human Rights and Fundamental Freedoms as it was legitimate.[921]

Finally, it might be noted that the Czech IA does not specifically address the question of appropriate waiting period before two debt relief orders.[922] The Czech IA does not state that a debt relief order is once in a lifetime opportunity. Yet, previously granted debt relief shall be one of the considerations taken into account in terms of admissibility for discharge of debts within the meaning of the criterion to act honestly.[923]

5.7.3 Procedural aspects of the issuance of a debt relief order

As mentioned above, the court shall issue a debt relief order only after all the steps leading to the implementation and realisation of the respective method of discharge of debts proceedings have been undertaken.[924] Such decision is taken either together with the ruling pursuant to section 413 of the Czech IA or later.

If the court issues a debt relief order, solely a creditor whose claim has not been satisfied fully in discharge of debts proceedings might appeal against the decision. Neither the creditors who fail to lodge their claims nor can co-debtors (guarantors) of discharged claims challenge the ruling. Even secured creditors who are satisfied solely from collateral cannot file an appeal.[925] In appeal, it is possible to only claim that the preconditions for the issuance of a debt relief order are not met.[926] Nevertheless, if the court rejects to issue a debt relief order, solely a debtor might file an appeal against such decision.

It remains to be said that a debt relief order is to be delivered to a debtor, insolvency trustee and creditors' committee as set forth in section 416 of the Czech IA.

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[921] See the ruling of European Court of Human Rights case no. *Bäck v. Finland* (no. 37598/97, ECHR 2004-VIII). The court ruled that the debt adjustment procedure might be, however, in contravention with the Protocol 1. In the specific case, the court ruled that the creditor (applicant) was able to defend his rights and that the decision of the Finish court was not arbitrary.

[922] As regards waiting period, see INSOL Europe. *Consumer Debt Report – Report of Findings and Recommendations* …, p. 23.

[923] See chapter 4.4.3 *supra*, including changes anticipated under the 2018 Draft Amendment.

[924] See the High Court in Olomouc ruling case no. 3 VSOL 119/2013-B-30 (KSOS 22 INS 5888/2010) of 22 March 2013.

[925] See the High Court in Prague ruling case no. 4 VSPH 822/2016-B-38 (KSPA 56 INS 25264/2012) of 16 September 2016 or 4 VSPH 1346/2015-B-50 (KSLB 57 INS 332/2010) of 1 September 2015.

[926] Section 416(2) of the Czech IA.

5.7.4 Revocation of debt relief order and its termination

Since the principle of honesty is the underlying principle behind the legal framework of discharge of debts, section 417 of the Czech IA provides for revocation and termination of a debt relief order under circumstances which involve batches of misbehaviour. The difference between revocation and termination of a debt relief order is that the former anticipates a specific motion of creditors.

5.7.4.1 Revocation of a debt relief order

Pursuant to section 417(1) of the Czech IA, the court shall revoke a debt relief order if within three years from the legal force thereof it is found that a discharge of debts confirmation or debt relief order has been obtained fraudulently, or the debtor has provided a special preference (consideration – e.g. side payments or other non-pecuniary benefits) to any of his creditors.[927] Although, the provision does not state it explicitly, it follows that such fraudulent behaviour should occur in connection with a debt relief order or a discharge of debts confirmation.

The court shall revoke a debt relief order solely upon a motion of any "affected debtor's creditor". Since a motion to revoke a debt relief cannot be filed if the creditor could raise objections prior to the issuance of a debt relief order, arguably solely the creditors who were entitled to file an appeal against the debt relief order can file the motion.[928] In other words, creditors who failed to lodge their claims in insolvency proceedings are not entitled to officially file a motion to revoke a debt relief order.[929]

Revocation of a debt relief order is not effective with respect to the creditors who were involved either in fraudulent dealings with the debtor or in the provision of specific consideration. This stems from a civil-law maxim "*nemo turpitudinem suam allegans auditur*" (no one should be permitted to profit by his own fraud, or take advantage of his own wrong).[930]

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[927] Under the US Bankruptcy Code, a debt relief order may be revoked generally within one year after an award thereof. See section 727(e) and 1328(e) of the US Bankruptcy Code. A debtor's fraud serves as a ground for revocation of a debt relief order.

[928] Since creditors cannot raise arguments which could have been raised prior to the issuance of a debt relief order, the creditors should react promptly and should not wait and challenge issued decisions later. See e.g. the High Court in Olomouc ruling case no. 1 VSOL 344/2015-B-61 (KSOL 16 INS 13759/2012) of 30 September 2015.

[929] Pursuant to section 14(1) of the Czech IA, solely creditors who apply their rights in insolvency proceedings are participants of the insolvency proceedings.

[930] If there is such creditor, the court shall mention it in its ruling. See section 417(3) of the Czech IA.

The court decision shall be delivered to the debtor and the creditor to whom the revocation relates. Only these persons might file an appeal. Yet, it appears that revocation of a debt relief is issued very rarely.[931]

5.7.4.2 Termination of a debt relief order

Debt relief order terminates if within three years from the legal force of a debt relief order the debtor is sentenced for any crime committed intentionally whereby the debtor substantially impacted discharge of debts confirmation, its realisation or issuance of a debt relief order or whereby the debtor otherwise harmed his creditors.[932]

Termination of a debt relief order is not effective with respect to the creditors who were involved in fraudulent dealings with the debtor.[933] The court decision shall be delivered to the debtor and the creditor to whom the revocation relates. Only these persons might file an appeal. In any case, it appears that so far there has been no termination of debt relief order.[934]

5.8 Discharge of debts of spouses

The original wording of the Czech IA did not anticipate common discharge of debts of spouses.[935] Such omission gave rise to many unregulated issues such as whether separate insolvency proceedings of spouses might be adjoined,[936] how creditors should lodge their claims, whether a debt relief order might also relate to the other spouse, or what should be remuneration of an insolvency trustee dealing with both spouses.[937]

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[931] On the basis of the analysis of the database of Havel, Holásek & Partners, attorneys-in-law, it appears that solely one decision has been issued so far. See the Regional Court in Ostrava ruling case no. KSOS 13 INS 4241/2008 of 24 September 2014.

[932] Section 417(2) of the Czech IA.

[933] If there is such creditor, the court shall mention it in its ruling. See section 417(3) of the Czech IA.

[934] The conclusion is based on the analysis of the database of Havel, Holásek & Partners, attorneys-in-law.

[935] Section 392(3) of the Czech IA provided for a mandatory signature of a spouse together with a consent with a motion for discharge of debts of the other spouse, unless discharge of debts could not affect unsettled joint property of spouses, the extent of the debtor's maintenance obligation towards his (her) spouse and dependent children or a scope of maintenance obligations of the debtor's spouse.

[936] Joinder of insolvency proceedings is not specifically addressed by the Czech IA. However, the Supreme Court ruled that a joinder is possible under section 112 of the Czech Civil Procedural Code. See the Supreme Court ruling case no. 29 NSČR 39/2011-P10-1 (MSPH 88 INS 4025/2011) of 31 August 2011 which concerned the publication of documents in the insolvency register in case of joined insolvency proceedings.

[937] It appears that courts eventually unanimously held that in repayment plan, remuneration equal to one proceedings shall be paid. See e.g. the High Court in Prague ruling case no. 3 VSPH 514/2010-A-13 (KSUL 77 INS 5859/2010) of 20 January 2011 or 3 VSPH 1518/2015-B-28 (KSLB 87 INS 2361/2013)

Historically, several approaches developed with more or less significant differences and subcategories.[938] First, courts held two separate proceedings with respect to individual spouses. Second, courts adjoined two separate proceedings into one insolvency proceedings, based on the signature of the other spouse who had to sign the respective motion for discharge of debts. Third, the courts held two separate proceedings whereas they were coordinated so that all unsecured creditors obtained 30 % of their claims.

One of the pivotal decisions was the High Court in Prague ruling Case no. 1 VSPH 669/2009-A-21 (KSPL 54 INS 4966/2009) of 15 December 2009.[939] The court ruled that a debtor's spouse gave consent to the insolvency proceedings by signing the respective motion for discharge of debts. Also, it *inter alia* ruled that both income streams should be considered together and that there is a reason to replace an insolvency trustee so that one insolvency trustee is appointed with respect to both debtors. One of the preconditions, however, seems to be that both spouses share the same debts and property.[940] The fact that the spouses do not live together does not entail that common proceedings are not possible.[941] In practice, the joinder of proceedings entail that spouses can simply pay 30 % of their debts (not 60 % thereof). [942]

The absence of thorough regulation of discharge of debts of the spouses has been eventually addressed by the adoption of the Revision Amendment which has introduced *inter alia* new section 394a of the Czech IA. Thus, since 1 January 2014, the legislation has specifically provided for a joint motion for discharge of debts of spouses.[943]

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of 16 September 2015. See also ŠIMÁK, Pavel. *Společné oddlužení manželů* [online]. epravo, 2011 [cited 3 March 2017]. Available on <http://www.epravo.cz/top/clanky/spolecne-oddluzeni-manzelu-74667.html>.

[938] See e.g. ŘEHÁČEK, Oldřich. Osobní bankrot manželů a jeho řešení v soudní judikatuře. *Bulletin advokacie*, 2011, no. 7-8, pp. 42-44 or BABUŠKOVÁ, Jana. Oddlužení manželů – aneb co v zákoně nenajdete. *Bulletin advokacie*, 2012, no. 4, pp. 32-33.

[939] The decision has not been unequivocally accepted. See e.g. KOZÁK, Jan. *Poradna konkursních novin* [online]. Konkursní noviny, 17 February 2010 [cited 3 March 2017]. Available on <http://www.kn.cz/clanek/poradna-konkursnich-novin-140>.

[940] See also e.g. the High Court in Olomouc ruling case no. 1 VSOL 640/2013-A-10 (KSOS 34 INS 10422/2013) of 23 August 2013 or 3 VSOL 726/2013-A-15 (KSOS 38 INS 733/2013) of 12 September 2013.

[941] See the High Court in Olomouc ruling case no. 2 VSOL 91/2012-A-13 (KSBR 38 INS 14779/2011) of 29 February 2013.

[942] *Idem*.

[943] By the same token, the legislature has generally prohibited a joinder of insolvency proceedings, unless specifically provided for. See section 83a of the Czech IA. Interestingly, courts rightly held that separate motions filed prior to the Revision Amendment should be joined notwithstanding the fact that the Revision Amendment applied to such motions. See the High Court in Prague ruling case no. 1 VSPH 966/2014-B-15 (KSPL 27 INS 19201/2013) of 6 June 2014.

Joint discharge of debts proceedings are built on the concept of legal fiction of a single debtor. Unless otherwise provided, general rules on discharge of debts apply.[944] Therefore, a motion should be submitted together with an insolvency petition or in case of creditors' insolvency petition, within 30 days from the receipt of the information about the commencement of insolvency proceedings. If a creditor initiates insolvency proceedings solely vis-à-vis one of the spouses,[945] the spouse in insolvency proceedings should file solely a motion for discharge of debts proceedings whereas the other spouse should file an insolvency petition together with a motion for discharge of debts.[946]

The main precondition for submission of a joint motion is that each of the spouses is eligible for discharge of debts. This, however, does not mean that both spouses should be insolvent within the meaning of the Czech IA. In other words, conditions are also assessed cumulatively.[947] Therefore, if one of the spouses is formally insolvent, a joint motion might be filed. Still, if one of the spouses is not eligible for discharge of debts (e.g. due to the existence of business-related debts), a joint motion shall be rejected.[948]

A joint motion for discharge of debts shall contain an express declaration of both spouses that they agree that for the sake of sale of their assets, all their property is to be considered community property as set forth in section 394a(2) of the Czech IA. If debtors fail to submit such declaration, they should be requested to submit it by a court.[949]

Statutory fiction of a single debtor means that if there is a ground for revocation of a discharge of debts confirmation on part of one of the spouses, it is generally not possible

[944] Joint motion for discharge of debts is not mandatory and the spouses are allowed to submit individual motions if they wish so.

[945] A creditor cannot file an insolvency motion against both spouses. See the High Court in Prague ruling case no. 3 VSPH 38/2015-A-17 (KSPL 20 INS 28364/2014) of 12 January 2015.

[946] See e.g. HÁSOVÁ, Jiřina. et al. *Insolvenční zákon. Komentář*. 2nd edition. Prague: C. H. Beck, 2014, p. 1253.

[947] See e.g. the High Court in Prague ruling case no. 4 VSPH 673/2014-A-16 (KSPH 60 INS 4489/2014) of 28 July 2014 or 3 VSPH 831/2014-A-13 (KSPH 60 INS 8224/2014) of 15 September 2014. It follows that it is not necessary to distinguish who is a contractual obligor and who is jointly and severally liable on the basis of common property principles set forth in the Czech Civil Code. As mentioned below, the spouses shall be treated as a single debtor.

[948] See e.g. the High Court in Olomouc ruling case no. 1 VSOL 548/2014-A-15 (KSBR 45 INS 11019/2014) of 27 June 2014 or 1 VSOL 124/2015-A-10 (KSBR 47 INS 31183/2014) of 24 February 2015.

[949] If such declaration is not contained in a joint motion, the court shall not reject an insolvency petition since such declaration is a mandatory part of a joint motion. Therefore, the court should request the debtors to submit the respective declaration to rectify the defect of a joint motion. See the High Court in Prague ruling case no. 1 VSPH 882/2014-A-15 (KSPH 68 INS 6828/2014) of 19 May 2014

to revoke a discharge of debts confirmation with respect to one of the spouses.[950] Similarly, it is not possible to issue a discharge of debts order or discharge of debts confirmation solely with respect to one of the spouses. Also, if one of the spouses denies a creditor's claim, such creditor shall file an action to ascertain his claim against both debtors.[951]

Nevertheless, the legal fiction of one debtor does not entail that debts, which were originally owed to one of the spouses, fall into inheritance in case of the death of the other spouse. Such claims shall continue to be part of distribution scheme which is not affected by the death of one of the spouses. The insolvency proceedings are stayed with respect to such late spouse.[952] Also, the fiction of one debtor works arguably only one-way so that creditors cannot file one insolvency petition against both spouses in order to adjoin two proceedings into one. Such petition would be rejected.[953]

Preconditions for discharge of debts are assessed as of the time of the submission of a motion to the respective court. A divorce of the spouses in a later phase of insolvency proceedings should not *per se* hinder joint insolvency proceedings. This is confirmed by the wording of section 394a(3) of the Czech IA which states that the spouses, who file a joint motion for discharge of debts, shall be during discharge of debts proceedings considered to be a single debtor. Nevertheless, once discharge of debts is converted into liquidation, the debtors will no longer be treated as a single debtor.[954]

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[950] See the High Court in Prague ruling case no. 1 VSPH 309/2016-B-39 (MSPH 95 INS 872/2016) of 31 March 2016. On the contrary, previous unregulated legal framework enabled separation of insolvency proceedings. See e.g. the High Court in Prague ruling case no. 3 VSPH 1687/2013-B-41 (KSUL 71 INS 15708/2011) of 2 December 2013.

[951] See the High Court in Prague ruling case no. 101 VSPH 211/2016-146 (KSPH 66 INS 14604/2014) of 25 August 2016.

[952] See the High Court in Olomouc ruling case no. 2 VSOL 54/2016-B-19 (KSBR 31 INS 15847/2014) of 28 April 2016.

[953] See the High Court in Prague ruling case no. 3 VSPH 38/2015-A-17 (KSPL 20 INS 28364/2014) of 12 January 2015. In theory, one petition against two debtors might be considered as petition which triggers two insolvency proceedings which might be later adjoined pursuant to section 112 of the Czech Civil Procedural Code [see the High Court in Prague ruling case no. 3 VSPH 1198/2011-A-14 (MSPH 88 INS 16288/2011) of 17 October 2011]. Yet, following the adoption of the Revision Amendment, it is no longer possible to adjoin the proceedings unless specifically provided for.

[954] See the High Court in Prague ruling case no. 2 VSPH 2257/2013-B-31 (KSUL 71 INS 1378/2013) of 20 March 2014 or High Court in Olomouc ruling case no. 1 VSOL 273/2015-B-15 (KSOL 16 INS 13605/2014) of 17 April 2015.

5.9 Relation of discharge of debts to enforcement proceedings

From debtors' view, enforcement proceedings are perceived to be similar to insolvency proceedings as they share several features. In both proceedings, claims are enforced against debtors. Insolvency proceedings, however, aggregate all creditors (debts) into one forum together with debtor's assets.

When it comes to discharge of debts, several important distinctions arise. First and foremost, unlike enforcement proceedings, discharge of debts anticipates a debt relief.[955] Second, in enforcement proceedings, both debtor's current and future assets as well as income stream are touched upon. In discharge of debts, unless a debtor agrees otherwise, solely debtor's property or income stream are generally subject to distribution among creditors. Last but not least, whereas enforcement proceedings are not generally limited in time and might last years, discharge of debts is generally more or less limited to 5 years.

In practice, it does not seem rare that a debtor is a participant of one or more enforcement proceedings when he or another creditor initiates insolvency proceedings. Therefore, the relation of insolvency to enforcement proceedings is crucial. Pursuant to section 109(1)(c) of the Czech IA, the commencement of insolvency proceedings does not prevent initiation and order of enforcement proceedings.[956] Nevertheless, it precludes realization of such proceedings. Section 109(2) of the Czech IA clarifies that realization does not encompass measures undertaken to secure the debtor's property for the sake of future enforcement of claims against such property. The borderline between the realization of enforcement proceedings and other measures is not always clear.[957] Decisions or measures undertaken in contravention with the aforementioned ban shall be, however, disregarded

[955] As the law stands, discharge of debts does not bring about only a relief from debts. One must bear in mind that several types of claims are not satisfied (including interest accrued after an insolvency order, legal representation in insolvency proceedings or fees which would be otherwise paid in case of submission of new legal actions in order to enforce claims) and due to strict deadlines for lodgment of claims, it is possible that certain claims will not be enforced.

[956] Pursuant to section 411(1) of the Czech IA, enforcement proceedings ordered with respect to the property of the debtor has no effect on the debtor's duty to dispose of his income in repayment plan.

[957] This is particularly true about enforcement proceedings by way of deductions of wage or other income. See e.g. KUBIZŇÁK, Jan. Účinky zahájení insolvenčního řízení ve vztahu k exekuci srážkami ze mzdy. *Komorní listy*, 2014, vol. 2, pp. 13-16. See also NEUHÄUSEROVÁ, Jana. Střet insolvence s exekucí. *Komorní listy*, 2016, vol. 3, pp. 26-29.

in insolvency proceedings.[958] Following the issuance of an insolvency order, it is not possible to commence or order enforcement proceedings.[959]

In practice, due to the effects of the commencement of insolvency proceedings, many debtors initiate illegitimate insolvency proceedings with the sole aim to prevent a public auction ordered in enforcement proceedings from occurring.[960] Anecdotal experience suggests that some debtors initiated plenty of such insolvency proceedings to avoid enforcement of claims outside insolvency. The legislature responded by the enactment of express possibility of the court to issue a preliminary ruling to exclude the mentioned effect of the commencement of insolvency proceedings.[961] In practice, courts are rather reluctant to issue such preliminary rulings. Yet, courts do not hesitate to issue preliminary injunctions particularly in case of repeated (ab-)use of insolvency petitions.[962]

The commencement of insolvency proceedings does not affect disposition rights with respect to the proceeds of enforcement proceedings. Thus, even though a debtor has generally disposition rights with respect to his assets, he cannot effectively claim the proceeds of enforcement proceedings.[963] Yet, once a court confirms repayment plan, the debtor arguably regains disposition right with respect to the assets restricted under previously issued enforcement orders.[964] In other words, the debtor arguably *inter alia* obtains the amount

[958] Section 109(6) of the Czech IA. Once insolvency proceedings are finished, such decisions and measures are fully effective. The court might also *inter alia* decide on the postponement of legal force of decisions or measures undertaken in enforcement proceedings. It might also instruct the respective authority not to take any further decision or measure.

[959] Section 140e(1) of the Czech IA. Section 109(6) of the Czech IA applies similarly. The ban does not apply to the commencement or order of enforcement proceedings applicable pursuant to section 203(5) of the Czech IA. The mentioned provision concerns satisfaction of preferential claims.

[960] In this connection, the 2017 Amendment seeks to minimize the commencement of illegitimate insolvency proceedings. More specifically, it incorporates preliminary assessment of insolvency petitions filed by creditors. See section 100a of the Czech IA as amended by the 2017 Amendment. However, as indicated, it will not touch upon the debtor's insolvency filings.

[961] See section 82(2)(b) of the Czech IA.

[962] See e.g. the High Court in Prague ruling case no. VSPH 241/2014-A-18 (KSPH 41 INS 37067/2013) of 10 February 2014.

[963] It may be added that under the rules of enforcement proceedings, the debtor might be to a large extent limited as concerns his rights to dispose of his property.

[964] Section 409(2) of the Czech IA. See also section 44(6) of the Act on Distrait which states that if an enforcement office holder detains any proceeds, he shall transfer it to an insolvency trustee following a separate ruling and after deduction of his costs. Deduction of costs itself has been a disputed issue for several years. See e.g. the Constitutional Court ruling case no. IV. ÚS 378/16 of 12 September 2016.

corresponding to deductions of wage or other income so far detained by the payer of such income pursuant to enforcement orders.[965]

In discharge of debts proceedings, it is possible to commence, order and realize enforcement proceedings with respect to the property which does not fall into the debtor's insolvency estate. Yet, such proceedings might be undertaken solely with respect to the claims which are not to be satisfied in distribution scheme in discharge of debts and concurrently which arise following a discharge of debts confirmation becomes effective.[966]

[965] See also KOZÁK, Jan et al. *Insolvenční zákon - komentář*. Prague: ASPI, 2016, commentary to section 409. Prior to the adoption of the Revision Amendment, courts ruled otherwise. See e.g. 2 VSPH 2169/2013-A-11 (MSPH 90 INS 33097/2013) of 26 February 2014, 4 VSPH 241/2014-A-18 (KSPH 41 INS 37067/2013) of 10 February 2014, 1 VSPH 1262/2013-A-14 (KSCB 25 INS 12826/2013) of 19 August 2013 or 3 VSPH 450/2012-B-24 (KSPH 39 INS 14325/2011) of 5 November 2012.

[966] Sections 408(2) and 409(2) of the Czech IA.

6 Role of key stakeholders in discharge of debts

As the title suggests, this chapter focuses on the assessment of the role of debtors, creditors, insolvency trustees and courts, how do they avail of their roles, and how they affect the outcome and the course of the proceedings in the Czech Republic.[967]

6.1 Role of debtors

As mentioned above, the Czech IA reflects the policy of a carrot and a stick. A relief from debts may be granted only upon the debtor's compliance with all his duties. The debtor has a general duty to act honestly throughout the course of the proceedings.[968] In addition to that, if a repayment plan is adopted, the debtor has a number of other duties.[969] The long and short of it, on the one hand, the carrot is a release from unpaid debts; on the other hand, the stick is conversion of the case to liquidation, which does not contemplate any release from unpaid obligations.[970]

In this regard, it is notable that immense number of cases shows how debtors have failed to meet their duties. Although no thorough study has been undertaken in the Czech Republic, from the available data and anecdotal experience it may be inferred that debtors are usually not competent to deal with all the peculiarities and requirements related to discharge of debts. Accordingly, the debtors are in many respects rather passive observers.

Such passivity and failure to meet all the debtor's duties may imply that debtors act recklessly or with insufficient care. However, courts have recognized that infringements in the course of discharge of debts proceedings are not mostly attributable to debtor's dishonest or otherwise malicious intentions; they are often implications of the debtor's lack of understanding. Having considered that, it seems that the courts have adopted a pro-debtor

[967] This chapter is largely based on paper SPRINZ, Petr. Discharge of Debts in the Czech Republic: The Role of Respective Actors and the Reflected Data in PARRY, Rebecca (ed). *European Insolvency Law: Current Issues and Prospects for Reform.* Nottingham: INSOL Europe: 2014, pp. 59-68. It is also based on a project within which questionnaires have been sent to insolvency trustees and courts (judges as well as their assistants and court clerks [in Czech: *vyšší soudní úředník*]).

[968] See sections 395(1)(1), 417 and 418(3) of the Czech IA.

[969] See particularly chapter 5.4.2 *supra.*

[970] However, the 2017 Amendment seeks to remove the automatic conversion of discharge of debts into liquidation. See chapter 4.3.2 *supra*. Therefore, the stick shall be the stay of the proceedings without any debt relief.

attitude. In practice, the court often provides the debtor an opportunity to rectify his missteps, thereby giving the debtor a "second chance."[971]

Coming more specifically to the debtor's role, only the debtor may file a motion for discharge of debts, despite the fact that any creditor may initiate insolvency proceedings.[972] However, this is where the debtor's predominant activities often end.

The Czech IA does not require any specific activity such as undertaking a course on financial affairs, previous attempt to agree with debtors out-of-court or preparation of a distribution scheme. The role of the debtors in discharge of debts is limited which might make it attractive for them. In any case, anecdotal experience suggests that the debtors would not be able to assume responsibility for preparation of more sophisticated submissions.

The 2017 Amendment shall affect the role of debtors as it will generally deprive them of the right to draft and submit a motion for discharge of debts (and an insolvency petition) without any assistance of a third person. Presumably, the quality of motions shall increase. Still, the author has doubts whether the prevailing effects thereof will be positive. In any case, given this sort of professionalization, the author argues that debtors should be required to notify their creditors prior to the submission of insolvency petition so that they have a reasonable opportunity to lodge their claims.[973]

6.2 Role of creditors

Unlike the Bankruptcy and Composition Act, the current Czech IA embodies a creditor-oriented approach.[974] Depending on a method of resolution of the debtor's insolvency, creditors who submitted their claims in insolvency proceedings have a set of rights and powers to influence the course of the insolvency proceedings. This is effectuated mainly via creditors' bodies: (a) creditors' assembly [in Czech: *schůze věřitelů*]; and (b) the creditors' committee [in Czech: *věřitelský výbor*] or creditors' representative [in Czech: *zástupce věřitelů*].

[971] See *inter alia* chapters 4.4.3, 4.4.4 and 5.7 *supra*.

[972] Following the adoption of the 2017 Amendment, the debtor would need in principle the assistance of a qualified third person. See chapter 4.3.2 *supra*.

[973] Arguably, such requirement should at least relate to the creditors who are not entrepreneurs.

[974] RICHTER, Tomáš. Chapter 7: National Report for the Czech Republic, Chapter 7. In FABER, Dennis, VERMUNT, Niels, KILLBORN, Jason, RICHTER, Tomáš (eds.). *Commencement of Insolvency Proceedings*. Oxford: Oxford University Press, 2012, p. 195.

Creditors' assembly generally comprises all the creditors who submitted their claims in the insolvency proceedings. The competence of creditors' assembly includes, among other things, replacement of the court-appointed insolvency trustee with an insolvency trustee chosen by creditors, election of the creditors' committee (creditors' representative) and decision on a method of resolution of the debtor's insolvency. Furthermore, the creditors' assembly may in principle reserve for itself any matter that falls within the competence of the creditors' committee (creditor's representative).

It is the court that conclusively approves discharge of debts. Yet, creditors may generally vote whether they wish to be satisfied from repayment plan or sale of debtor's assets. Although the court as a watchdog of discharge of debts should examine whether all preconditions for discharge of debts are fulfilled (e.g. the requirement to act honestly),[975] one of the key rights of creditors in discharge of debts is that they may raise objections against discharge of debts and challenge other decisions in the course of discharge of debts proceedings. As a consequence of this, creditors might supervise the debtor and seek to minimize moral hazard together with possibilities of fraudulent behaviour on his part.[976] In this connection, however, one of the preconditions for successful challenge of key decisions is previous active involvement of the creditor in the proceedings. In other words, in order to preserve his rights, the creditor should mostly assume an active role and raise objections in time and in a prescribed manner.[977]

Yet, anecdotal evidence from practice indicates that creditors commonly neither attend creditors' assembly nor do they otherwise take an active role.[978] The rationale behind that is that, given relatively small amounts at stake, rational apathy prevails.[979] Put differently, from creditors' view, it is mostly not worth spending time (and money) to seek to influence discharge of debts proceedings.[980] Creditors arguably participate solely if such participation is

[975] The Supreme Court ruling case no. 29 NSČR 71/2013-B-131 (KSHK 42 INS 3097/2012) of 26 February 2014. Yet, objections as to the existence of business-related debts are indeed disregarded if not filed in time.

[976] See WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. …, p. 68.

[977] This principle will apply also after the 2017 Amendment takes effect.

[978] The author's discussion with several institutional creditors (mostly banks and collection agencies) indicates that creditors generally do not require their representatives to attend creditors' assembly. Mostly, they tend to limit their activities to lodgment of claims.

[979] See analogically RICHTER, Tomáš. *Insolvenční právo.* 1st edition. Prague: ASPI Wolters Kluwer, 2008, p. 143.

[980] Yet, there might not be much to be influenced. While creditors may vote over the method of the satisfaction, there will be usually only one possibility.

beneficial for them, which is hardly the case due to low expected satisfaction of their claims.[981]

It is notable that passivity of creditors may ultimately undermine their positions in discharge of debts proceedings. In a few occasions courts referred to the passivity of creditors in dismissing objections regarding discharge of business-related debts, allegations of dishonesty by creditors[982] or allowance of lesser payments.[983]

In line with the tendency of developed insolvency systems,[984] due to low participation of creditors at creditors' assemblies, the 2017 Amendment anticipates scraping creditors' assemblies unless creditors generally request such meetings. Moreover, stricter rules will apply on the replacement of court appointed insolvency trustees. A single creditor will not be generally able to have a decisive role on the replacement as double majority will be required (majority of creditors counted as per number of creditors and as per value of claims).[985] Therefore, institutional creditors like financial institutions or other major creditors shall no longer be able to replace the appointed insolvency trustees themselves.

Overall, the 2017 Amendment recognises the rational apathy of creditors and hand in hand with that seeks to limit creditors' rights. Creditors, in order to safeguard their rights, shall have to be more actively involved and will have to form coalitions with other creditors. In any case, the 2017 Amendment shall undermine position of creditors which might be questionable as it goes contrary to the underlying principle of the Czech IA. By the same token, one may reasonable expect that more emphasis shall be put particularly on the role of insolvency trustees. The question is whether insolvency trustees have sufficient motivation to undertake such role diligently.

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[981] See WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. …, p. 70.

[982] See e.g. High Court of Prague ruling case no. 1 VSPH 883/2011-B-36 (KSPH 37 INS 6276/2009) of 29 July 2011 or 1 VSPH 996/2012-B-8 (KSPL 56 INS 8680/2012) of 27 August 2012, 1 VSPH 874/2012-B-15 (KSHK 45 INS 12557/2011) of 27 August 2012 or 3 VSPH 12/2011-A-16 (KSLB 76 INS 12115/2010) of 15 February 2011. The High Court in Olomouc ruled that it is also up to creditors to express their opinion on whether they agree that the debtor's income stream is based to a high extent on external resources, i.e. on donations (see e.g. ruling case no. 3 VSOL 535/2012-A-19 (KSBR 40 INS 5526/2012) of 29 August 2012).

[983] See e.g. the High Court in Prague ruling case no. 3 VSPH 2354/2015-B-10 (KSPL 51 INS 5301/2015) of 18 December 2015. The High Court in Prague in the assessment whether to allow lesser instalments in repayment plan stressed that the court should *inter alia* take into account whether creditors attended the creditors' assembly (in that case they were passive).

[984] WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. …, p. 56 and p. 70.

[985] See Section 29(2) of the Czech IA as amended by the 2017 Amendment.

6.3 Role of insolvency trustees

Insolvency trustees, appointed generally by courts, have a number of duties. First and foremost, they have to act diligently and with professional care.[986] Furthermore, they shall, *inter alia*, use all efforts to achieve the highest-possible satisfaction of creditors' claims.[987]

Although it is the court that conclusively decides upon a method of the resolution of the debtor's insolvency further to a motion for a discharge of debts, the insolvency trustee plays a crucial role. Upon an insolvency order, the insolvency trustee prepares a list of creditors' claims, collects assets and assesses the debtor's position. Documents prepared by the insolvency trustee are essential for further process.[988]

With respect to debtors, the insolvency trustee's key role is to supervise them. There is supposedly a close link between the debtor and the insolvency trustee. The insolvency trustee is usually the first one who finds out any infringement of the debtor's duties in discharge of debts proceedings or who knows about debtor's difficulties.[989] In this respect, it may be expected that he will provide the debtor with necessary guidance in case the debtor needs it.

As concerns the insolvency trustee's supervisory position, he is obliged to share any information that might lead to rejection or dismissal of a motion for discharge of debts.[990] Also, the insolvency trustee should, unless otherwise required by the court in the insolvency proceedings, submit to the court and creditors' committee a report about the status of the insolvency proceedings.[991] In this connection, the insolvency trustee should regularly enquire about the debtor and in repayment plan, the insolvency trustee should supervise the debtor.[992] However, the decision-making power stays with the court.

Insolvency trustee is remunerated for rendering his professional services. As rational actors, the way that the insolvency trustees are remunerated might have an impact on their

[986] Section 36(1) of the Czech IA.

[987] *Idem.*

[988] This assertion is strengthened by the 2017 Amendment.

[989] See e.g. High Court in Olomouc ruling case no. 3 VSOL 568/2011-B-44 (KSOS 34 INS 1208/2010) of 3 November 2011. In case of repayment plan, an insolvency trustee collects the debtor's income and distribute it among the creditors. Thus, e.g. in case of the debtor that becomes unemployed, the insolvency trustee learns about such change.

[990] See particularly section 403(1) of the Czech IA.

[991] Section 36(2) of the Czech IA.

[992] See particularly section 412 of the Czech IA.

behaviour and efforts. Different rules apply for repayment plans and sales of assets.[993] There are critical views (not surprisingly, mainly from insolvency trustees) that remuneration is not high enough. The relevant question may still be whether the work of an insolvency trustee is not too expensive, given the amount at stake.

Without questioning the integrity of insolvency trustees, one might have justifiable doubts as to whether the current remuneration system gives insolvency trustees incentives to take an active role. When it comes to the repayment plan, if the insolvency trustee files an action to avoid certain transactions, there is no direct reward. One may claim that the prospect of professional liability will hold him up to keep his duties.[994] Indeed, in big cases, an insolvency trustee is under the scrutiny of creditors. However, in discharge of debts, due to the prevailing passivity of creditors, creditors do not effectively supervise the fulfilment of the insolvency trustee's role. The author suggests that the remuneration system should be changed so that it is, at least partially, dependent on the proceeds that creditors obtain.

The anecdotal experience suggests that insolvency trustees are rather passive and lack motivation to actively investigate whether the debtor fulfils all his duties in discharge of debts proceedings.[995] Particularly in case of repayment plan, the insolvency trustee apparently lacks motivation to actively raise objections that debtors do not fulfil their obligations since the insolvency trustee obtains remuneration on a monthly basis.[996] It will be interesting to see to what extent the strengthening of the supervisory position of the Ministry of Justice of the Czech Republic might affect the practice of insolvency trustees.[997]

Although it might be questioned whether insolvency trustees have sufficient incentives to be actively involved in discharge of debts cases, the 2017 Amendment seeks to strengthen their role. The 2017 Amendment contemplates that creditors' assembly shall not take place unless specifically required by creditors. Insolvency trustee shall prepare a report on verification of claims and report for discharge of debts which will be

[993] See chapters 5.3.4 and 5.4.5 *supra*.

[994] The insolvency trustee is not, strictly speaking, the agent of creditors. Yet, he holds personal liability for damage caused by the breach of his duties. See section 37 of the Czech IA.

[995] The necessity to motivate insolvency trustees and to strengthen their role will be particularly important if the 2018 Draft Amendment is adopted.

[996] See chapter 5.4.5 *supra.*

[997] See part V of the 2017 Amendment.

published in the insolvency register.[998] Therefore, verification of claims and creditors' assembly shall be dispensed with whereby insolvency trustees might be arguably under less intensive scrutiny from creditors. Also, court appointed insolvency trustees shall presumably be more certain about their positions since their replacement will hardly be possible without forming a coalition of creditors.

6.4 Role of courts

Although, courts are mentioned lastly, they play a crucial and indispensable role in discharge of debts. They hold decision-making as well as supervisory powers.

First and foremost, the court decides whether a debtor is insolvent, or is threatened with insolvency in the first place. Also, the court rules on whether the debtor is eligible for discharge of debts, whether to allow lesser instalments, whether to issue a debt relief order or whether discharge of debts is to be converted into liquidation in the further course of the proceedings. Also, the court convenes the respective hearings and judges preside over them. In many instances, creditors might file motions or vote over a specific issue. However, it is always the court that has the last word.[999]

As concerns the supervisory role of courts, they control whether debtors as well as insolvency trustees fulfil their obligations with respect to courts (including submission of relevant reports etc.). Keeping that in mind, courts noted that they are the "gatekeepers of legality" of discharge of debts proceedings.[1000] Since discharge of debts may be approved without the consent of creditors and this method of resolution of the debtor's insolvency may be literally imposed upon them, the courts generally acknowledged that they should properly examine whether all preconditions for discharge of debts have been fulfilled. Similarly, the courts should be vigilant about the compliance of debtor with his duties during the course of the proceedings. Thereby, they should minimize moral hazard on part of debtors in insolvency proceedings.

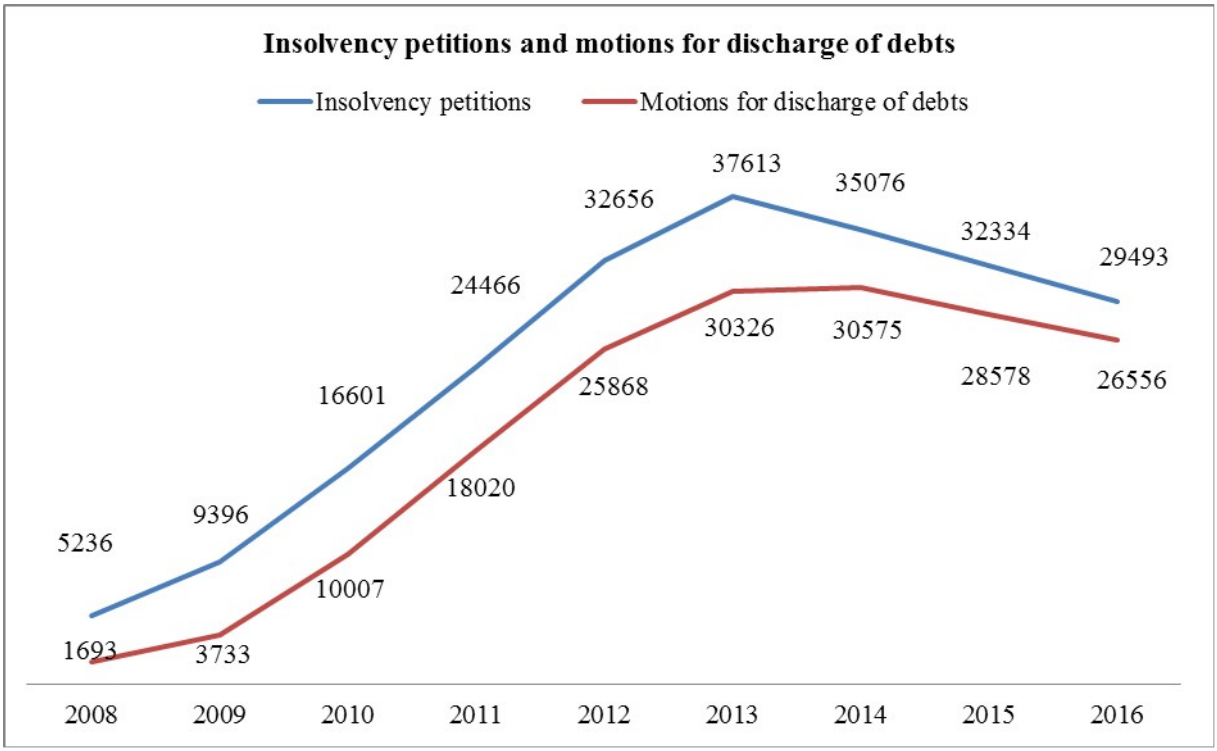
[998] See chapter 5.2.1 *supra*.

[999] In this connection, creditors might e.g. vote over a method of discharge of debts, file objections against discharge of debts or challenge debt relief orders. Nevertheless, it is up to the court to decide over contentious issues.

[1000] See e.g. the High Court in Prague ruling case no. 3 VSPH 463/2010-B-113 (MSPH 93 INS 1923/2008) of 5 August 2010.

Yet, one thing is clear. If one looks at the data, for a long time there was a continuous increase in the number of insolvency petitions (not only insolvency cases of individuals; see graph 5 below).[1001]

Graph 5: Statistics about insolvency petitions and motions for discharge of debts [1002]

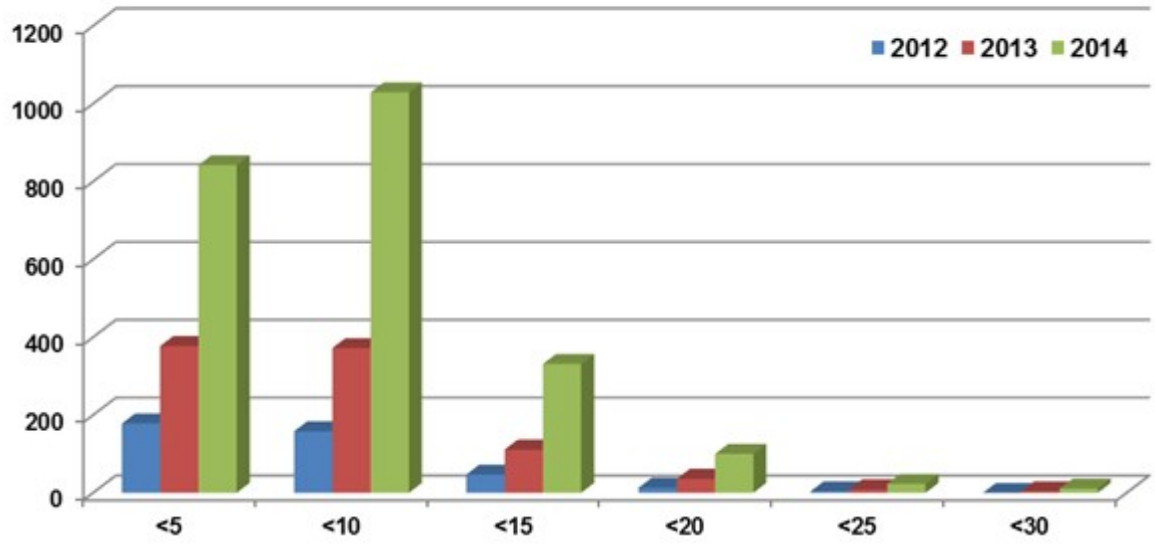


Moreover, pursuant to the available data, the average number of lodgements of claims filed in discharge of debts proceedings has been increasing. In 2012, mostly between 1 and 5 lodgements of claims were filed. Two years later, in 2014, between 1 and 10 lodgements were mostly filed (see graph 6 below). Accordingly, not only that the number of discharge of debts proceedings (insolvency proceedings) has increased substantially since 2008, the proceedings have become arguably more time-consuming and demanding.

[1001] See also chart 1 depicting statistics about insolvency petitions in chapter 4.1 *supra* and chart 2 about motions for discharge of debts in chapter 4.3.1 *supra.*

[1002] Source of data: statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information.

Graph 6: Statistics about lodgements of claims in discharge of debts [1003]



Given the fact that the number of judges allegedly has not increased proportionately, the courts have been quite overloaded.[1004] Pursuant to the available data, there were about 101 insolvency judges dealing with insolvency proceedings in 2014.[1005] Taking into account the overall number of insolvency petitions, every judge in average had to deal with about 347 insolvency cases per year.[1006] Still, eventually, they are the stakeholders who have to handle the cases.

Furthermore, the courts play a vital role via the interpretation of the law whereby they serve as final arbiters of law. Examples of such influence relate *inter alia* to the development of common insolvency proceedings of spouses, eligibility of debtors in terms of the existence of business-related debts or interpretation of honesty which opens the gate of discharge of debts for many debtors.

[1003] Source of data: statistics in the explanatory notes to the 2017 Amendment, p. 55.

[1004] The Ministry of Justice of the Czech Republic further to the request to provide information stated that it does not have any statistics regarding the number of judges who have dealt with insolvency cases since 2007 until now. Yet, pursuant to the provided data – there were generally 338 judges dealing with commercial agenda in 2008 at regional courts; in 2016 there were 331 judges.

[1005] See the explanatory note to the 2017 Amendment, pp. 106-107.

[1006] It must be noted that although some insolvency petitions are rejected, dismissed or withdrawn, the majority of them are substantiated in the sense that an insolvency order is issued. Therefore, many steps are to be undertaken with respect to every case, including creditors' assembly or verification hearing or the so-called incidental disputes as proceedings related to insolvency proceedings [in Czech: *incidenční spory*]. Allegedly, there were 4,557 incidental disputes in 2014. See the explanatory note to the 2017 Amendment, pp. 106-107.

As it has been mentioned, courts have arguably recognized the complexity of the debtor's situation and his general lack of financial and legal literacy.[1007] Accordingly, the courts have, in certain respects, manifested a tendency to take rather a pro-debtor approach. First, as indicated above, apart from initially more flexible interpretation of eligibility rules,[1008] the courts admitted a combination of both repayment plan and sale of assets provided that it helps the debtor.[1009] Second, upper courts directed first-instance courts to inform the debtor about a possibility to obtain another source of income in order to reach a mandatory pay-out.[1010] Third, courts have applied a more lenient approach in the assessment of the debtor's compliance with his duties as concerns decision-making whether to issue a discharge of debts order, discharge of debts confirmation, its revocation as well as the issuance of a debt relief.[1011] In this regard, courts *inter alia* mostly provide debtors an opportunity to rectify their missteps.

In this respect, it is notable that courts dealing with the question whether to approve discharge of debts or convert the case into liquidation take into account what the creditors' satisfaction would be in liquidation as the alternative to discharge of debts. The courts in many instances noted that liquidation would be mostly against the underlying principles of the Czech IA.[1012] The reason is that the debtors generally do not have many assets left so that there would be little to distribute among the creditors.[1013] The courts argue that in such situations, discharge of debts is better both for the debtor and the creditors and hence they overlook minor failures on the part of debtors. In the end, the debtors may be released from debts whereas the creditors can achieve higher satisfaction of their claims.

The 2017 Amendment contemplates that creditors' assembly will take place solely if creditors require so. Due to the required majority to convene meetings, one cannot expect that creditors' assembly will occur often. This will presumably save time on the part of courts.

[1007] See e.g. High Court in Prague ruling case no. 3 VSPH 912/2012-A-17 (KSCB 26 INS 13119/2012) of 10 September 2012 or 3 VSPH 4/2012-B-27 (KSCB 25 INS 4957/2011) of 1 March 2012. See generally also the Supreme Court ruling case no. 29 NSČR 32/2011-B-37 (KSOS 31 INS 12026/2010) of 28 March 2012.

[1008] See chapter 4.4.1 *supra*.

[1009] See chapter 5.2.2 *supra*.

[1010] See chapter 4.4.2.1 *supra*.

[1011] See particularly chapters 4.4.3, 4.4.4 and 5.6 *supra*.

[1012] See e.g. the High Court in Prague ruling case no. 1 VSPH 1069/2012-B-23 (KSHK 45 INS 11567/2011) of 27 August 2012.

[1013] Courts properly reflect the principle set forth in section 5 letter a) of the Czech IA stating that insolvency proceeding must be held so that none of the participants shall be unfairly harmed or illegally advantaged and that the highest possible satisfaction of creditors shall be achieved swiftly and efficiently.

Hand in hand with that, the 2017 Amendment seeks to shift more burdens from courts to insolvency trustees so that the insolvency trustee should prepare documents in advance for the courts.[1014] Moreover, electronic communication and submission of relevant documents might also help the courts to deal with their workload.

Nevertheless, courts might not benefit from the novelties of the 2017 Amendment for too long. Upon the adoption of the 2018 Draft Amendment, the courts might experience another wave of new submissions of motions for discharge of debts since the amendment aims to resolve indebtedness of those who are currently unable to meet the requirement to repay at least 30 % of all unsecured debts. In this connection, as mentioned above, there is a risk that the legislature seeks to move from quantitative to qualitative assessment of individual cases which might be hardly expected in practice, given the annual average number of filed motions for discharge of debts.[1015]

[1014] Possibly, given an absence of face-to-face meetings, mistakes might occur in theory more often due to misunderstandings.

[1015] See chapter 4.4.2.2 *supra*.

7 EU and comparative aspects of a debt relief procedure

Discharge of debts is not a specific feature of the Czech insolvency law. Different legislators have adopted distinct approaches and paradigms. The main purpose of this chapter is to briefly note how a debt relief procedure is addressed in the EU and in other Visegrad countries.[1016]

7.1 Debt relief procedure from the EU perspective

7.1.1 Need for the EU regulation and the EU legal framework

The vast majority of the EU Member States have enacted rules on the over-indebtedness of individuals. The majority of them also provides for some sort of debt reliefs. Naturally, the fresh-start policy has been gaining an increasing amount of attention in the EU. Yet, so far, the EU by way of its formal legislative actions - Regulation (EC) No 1346/2000 and Regulation (EU) 848/2015 - has been mostly concerned with conflicts of laws; substantive laws have been mostly set aside. In other words, rules on a debt relief procedure have not been harmonized.[1017]

Significant differences between legal regimes on debt relief schemes in the EU Member States provide incentives for the so-called forum-shopping. Pursuant to the study of the European Commission only few Member States do not contemplate the insolvency proceedings for individuals and self-employed persons.[1018] The period of repayment plan allegedly varied from one year in England to over 5 years. As a consequence of this, the debtors burdened with payments in arrears might seek to relocate themselves to search

[1016] Discharge of debts has become a global topic as well. In this connection, one of the recent key papers on discharge of debts proceedings is Report on the Treatment of the Insolvency of Natural Persons commissioned under the auspices of the World Bank in 2014. The report should serve as guidance on an effective insolvency regime for natural persons and on the opportunities and challenges encountered in the development of such a regime. See WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. …

[1017] The absence of substantive law regulation of discharge of debts proceedings does not mean that the EU law cannot be relevant. See e.g. the Court of Justice of the European Union ruling C-461/11 in re *Ulf Kazimierz Radziejewski v Kronofogdemyndigheten i Stockholm* of 8 November 2012: "*Article 45 TFEU must be interpreted as precluding national legislation, such as that at issue in the main proceedings, which makes the grant of debt relief subject to a condition of residence in the Member State concerned*."

[1018] HESS, Burkhard et al. *External Evaluation of Regulation no. 1346/2000/EC on Insolvency Proceedings* [online]. European Commission, 2014 [cited 3 March 2017]. Available on <http://ec.europa.eu/justice/civil/files/evaluation_insolvency_en.pdf>, p. 42.

for more favourable states in order to obtain a debt relief.[1019] Naturally, barriers for individuals might be difficult in terms of costs and benefits. This is where the Regulation (EC) No 1346/2000 and Regulation (EU) 848/2015 come into play with the key notion of the so-called COMI – centre of main interests of the debtor. The COMI determines where the insolvency proceedings should be primarily located and which rules should apply accordingly.

The Regulation (EC) No 1346/2000 does not set forth the definition of the COMI of individuals. The study regarding the Regulation (EC) No 1346/2000 found that some national courts presumed the COMI of individuals to be at the debtor's domicile. This conception was not, however, adopted by all courts across the EU as some of them applied national concepts to COMI.[1020] It is recommended that the COMI of an individual should be placed at his habitual residence. However, the study suggests not setting forth the presumption as individuals may move their habitual residence without significant burdens. The COMI of individuals should be evaluated individually.[1021] In this respect the COMI of a professional should be arguably located at its place of business.[1022]

Pursuant to article 3(1) of the Regulation (EU) 848/2015, the COMI shall be generally the place where the debtor conducts the administration of his interests on a regular basis and which is ascertainable by third parties. Further, it specifies that in the case of an individual exercising an independent business or professional activity, the COMI shall be presumed to be that individual's principal place of business in the absence of proof to the contrary. That presumption shall only apply if the individual's principal place of business has not been moved to another EU Member State within the 3-month period prior to the request for the opening of insolvency proceedings. Nevertheless, in the case of any other individual, the COMI shall be presumed to be the place of the individual's habitual residence in the absence of a proof to the contrary. This presumption shall only apply if the habitual residence has not been moved to another Member State within the 6-month

[1019] *Idem*, p. 81.

[1020] *Idem*, p. 17.

[1021] *Idem*.

[1022] *Idem*.

period prior to the request for the opening of insolvency proceedings. Therefore, the test period is longer.[1023]

In any case, the EU is limited in terms of its actions by provisions of the TFEU. In terms of legislation regarding a debt relief procedure, the legal basis of EU actions might be particularly article 114 or 292 of the TFEU. Whereas the former anticipates the use of directive of the European Parliament and of the Council, the latter implies the European Commission recommendation.

For quite a long time, the European Commission has been actively involved in the preparation of various recommendations. It has long seemed improbable that the EU adopts any directive pursuant to article 114 of the TFEU. However, on 22 November 2016, the European Commission adopted its legislative proposal of the directive on preventive restructuring, insolvency and second chance. In this connection, the European Commission underlines the need to urge modernisation of the framework of insolvency proceedings.

The substantiation for any moves include improvement of functioning of the internal market since great discrepancies between legal regimes of discharge of debts procedures entails obstacles to the free movement of capital, goods and services in the internal market. In effect, such discrepancies might lead to "*create high costs for cross-border creditors, incentives for the relocation of the debtors and obstacles to the restructuring of cross-border groups of companies*" whereas the "*creditors located in one Member State suffer losses (e.g. sub-optimal recovery of debts) due to the insufficient procedures in another Member State*."[1024]

[1023] See also recital 30 of Regulation (EU) 848/2015: "*In the case of an individual not exercising an independent business or professional activity, it should be possible to rebut this presumption, for example where the major part of the debtor's assets is located outside the Member State of the debtor's habitual residence, or where it can be established that the principal reason for moving was to file for insolvency proceedings in the new jurisdiction and where such filing would materially impair the interests of creditors whose dealings with the debtor took place prior to the relocation.*"

[1024] EUROPEAN COMMISSION. *Commission Staff Working Document. Impact Assessment Accompanying the document Commission Recommendation on a New Approach to Business Failure and Insolvency. SWD(2014) 61 final* [online]. …, p. 24.

7.1.2 Selected EU initiatives

At the EU level, it has been recognized that the provision of a second chance to a debtor plays an import role for the economy in a narrower as well as a wider perspective. In the narrower perspective, it promotes the inclusion of the debtor as a productive member and helps him to start anew. In the wider scope, the fresh-start policy leads to the elimination or mitigation of stigma attached to failure that may discourage would-be entrepreneurs.[1025] In this respect, polls have been undertaken to identify the causes and barriers to entrepreneurship. The barometer shows that people perceive the risk of bankruptcy as the most significant risk of setting up a business if they were to consider whether to engage in business.[1026] Slightly more than four out of ten respondents would perceive the risk of going bust as a major threat whereas 37 % percent of respondents say that the risk of losing their home make them worried about setting up their business. Obviously, the latter risk is also connected to bankruptcy.[1027]

One of the first significant initiatives addressing the fresh-start policy was the 2007 Commission communication "*Overcoming the stigma of business failure – for a second chance policy; implementing the Lisbon Partnership for Growth and Jobs*".[1028] This communication among others underlines the need to promote "*a second chance to those who have previously failed*".[1029] Following this, the European Commission has been concerned about the fact that Europeans are less enthusiastic about entrepreneurship than the US respondents. In order to change the environment the European Commission adopted the so-called "Small Business Act" which represents an agenda for small and medium-sized enterprises setting forth several principles. The Small Business Act dated to 2008 is one of the most pertinent initiatives in the area of a debt relief procedure. One of the principles enshrined therein includes the following: "*The Member States should ensure that honest*

[1025] See e.g. EUROPEAN COMMISSION. *A Second Chance for Entrepreneurs: Prevention of Bankruptcy, Simplification of Bankruptcy Procedures and Support for a Fresh Start* [online]. …, pp. 10-11.

[1026] EUROPEAN COMMISSION. *Flash Eurobarometer 354. Entrepreneurship in the EU and Beyond. Summary*. [online]. …, p. 72.

[1027] *Idem*.

[1028] EUROPEAN COMMISSION. *Overcoming the stigma of business failure – for a second chance policy; implementing the Lisbon Partnership for Growth and Jobs*. [online]. European Commission, 2007 [cited 3 March 2017]. Available on <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0584:FIN:EN:PDF>.

[1029] *Idem*, p. 4 and p. 11.

entrepreneurs who have faced bankruptcy quickly get a second chance.[1030] In this respect, the task of the European Commission should be to promote the fresh-start policy by facilitating the best practice among Member States whereas the Member States were *inter alia* invited to promote a positive attitude in society towards giving entrepreneurs a fresh start, for example through public information campaigns, and ensure that re-starters are treated on an equal footing with new start-ups.[1031]

Building on the abovementioned aspects, the European Commission carried out a project which resulted in the paper called "*A Second Chance for Entrepreneurs: Prevention of Bankruptcy, Simplification of Bankruptcy Procedures and Support for a Fresh Start*".[1032] The paper seeks to summarize main conclusions and recommendations regarding bankruptcy and the idea of a second chance. One of the recommendations is that repayment plan should last three years at most for honest entrepreneurs.[1033] Also, the paper emphasises a distinction between fraudulent and non-fraudulent bankrupts while pointing out that the latter constitutes only a minority of bankruptcies.[1034] In any case, it must be noted that, it addresses issues of entrepreneurs and not all individuals.

Further to its previous initiatives, on 9 January 2013 the European Commission adopted the Entrepreneurship 2020 Action Plan.[1035] The idea behind the new policy was to foster entrepreneurial activities which are regarded as a positive driving force in the creation of competitiveness and innovation. One of the policy ideas became to turn

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[1030] EUROPEAN COMMISSION. *Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions - "Think Small First" - A "Small Business Act" for Europe {SEC(2008) 2101} {SEC(2008) 2102}* [online]. European Commission, 2008 [cited 3 March 2017]. Available on <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52008DC0394>.

[1031] *Idem*, p. 7.

[1032] EUROPEAN COMMISSION. *A Second Chance for Entrepreneurs: Prevention of Bankruptcy, Simplification of Bankruptcy Procedures and Support for a Fresh Start* [online]. … However, the paper does not constitute an official document of the European Commission.

[1033] See 2nd recommendation: "*Discharge is key for second chance: a 3 year discharge and debt settlement period should be a reasonable upper limit for an honest entrepreneur and as automatic as possible. It is fundamental to send a message that entrepreneurship may not end up as a "life sentence" in case things go wrong. Otherwise it acts as an effective deterrent to entrepreneurship*". *Idem*, p. 12.

[1034] See 3rd recommendation: "*Decisive actions must be taken for a greater differentiation of honest and dishonest bankruptcies. It is best to assume in principle that all are honest and then identify those that are dishonest and prosecute/penalise them. Insolvency regimes should differentiate between debtors who have acted honestly in their conduct or business giving rise to the indebtedness, and those who have acted dishonestly in that regard and contain provision that wilful non-compliance with legal obligations by a debtor be subject to civil sanction and, where appropriate, criminal liability.*". *Idem*, p. 12.

[1035] EUROPEAN COMMISSION. *Entrepreneurship 2020 Action Plan* [online]. …

failure into success by promoting second chances for honest bankrupts.[1036] The failed bankrupts (so-called second starters) have an arguably higher success-rate and survive longer than average start-ups. This leads the European Commission to state that a previous failure should be seen as "*an opportunity for learning and improving*".[1037] The document set forth that the European Commission should launch a public consultation to discover opinions from numerous stakeholders. By the same token, the European Commission invited Member States to *inter alia* shorten, when possible, the discharge time and debt settlement for honest entrepreneurs after bankruptcy to a maximum of three years by 2013 as requested by the conclusions from 2011 Competitiveness Council, to offer support services to businesses for early restructuring, advice to prevent bankruptcies and support for small and medium enterprises to restructure and re-launch, and provide advisory services to bankrupt entrepreneurs to manage debt and to facilitate economic and social inclusion.[1038]

On 12 March 2014 the European Commission formally approved the Recommendation on a new approach to business failure and insolvency.[1039] One of the objectives of the recommendation is to facilitate and promote the fresh-start policy in order to foster entrepreneurial activities, investment, employment and improvement of internal market.[1040] The recommendation sets forth the minimum standard for discharge of debts of insolvent entrepreneurs. Part IV thereof headed as Second chance for entrepreneurs recommends certain features described below. The European Commission recommends that: the "*entrepreneurs should be fully discharged of their debts which were*

[1036] *Idem*, p. 17.

[1037] *Idem*.

[1038] *Idem*, pp. 17-18.

[1039] EUROPEAN COMMISSION. *Commission Recommendation on a New Approach to Business Failure and Insolvency.* [online]. European Commission, 2014 [cited 3 March 2017]. Available on <http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf>.

[1040] See particularly recital 1 ("*... The Recommendation also aims at giving honest bankrupt entrepreneurs a second chance across the Union*") 3 ("*Similarly, national rules giving entrepreneurs a second chance, in particular by granting them discharge from the debts they have incurred in the course of their business vary as regards the length of the discharge period and the conditions under which discharge can be granted*."), recital 4 ("*The discrepancies between the national restructuring frameworks, and between the national rules giving honest entrepreneurs a second chance lead to increased costs and uncertainty in assessing the risks of investing in another Member State, fragment conditions for access to credit and result in different recovery rates for creditors.*") and recital 20 ("*The effects of bankruptcy, in particular the social stigma, legal consequences and the on-going inability to pay off debts constitute important disincentives for entrepreneurs seeking to set up a business or have a second chance, even if evidence shows that entrepreneurs who have gone bankrupt have more chance to be successful the second time. Steps should therefore be taken to reduce the negative effects of bankruptcy on entrepreneurs, by making provisions for a full discharge of debts after a maximum period of time*"). *Idem*, p. 3 and p. 5.

subject of a bankruptcy after no later than three years starting from: (a) in the case of a procedure ending with the liquidation of the debtor's assets, the date on which the court decided on the application to open bankruptcy proceedings; (b) in the case of a procedure which includes a repayment plan, the date on which implementation of the repayment plan started."[1041] It appears that honesty is a key criterion of the measure.[1042] Moreover, in article 31 thereof, the European Commission recommends that the discharge should be automatic so that the debtors should not be obliged to re-apply to court for any measure. By the same token, the European Commission recognized that there cannot be one-size-fits-all approach. Member States should be left with an option to apply stricter provisions in order to provide discentives to the entrepreneurs who acted dishonestly or in bad faith, deter the entrepreneurs who do not fulfil their obligations, or protect the livelihood of the entrepreneurs and their families by allowing the entrepreneur to keep certain assets. Finally, the recommendation anticipates that the Member States might exclude specific categories of claims from a debt relief.[1043]

Further to the Recommendation on a new approach to business failure and insolvency, the European Commission has evaluated the progress made in the respective area.[1044] Therein, the European Commission noted that in Germany, Ireland, Latvia, Finland, France, Netherlands, Slovakia and UK repayment periods are largely complying with the benchmark. However, it also stated that Bulgaria and Hungary did not provide for any debt adjustment procedures and Croatia, Luxemburg and Poland had not determined fixed repayment periods since they were decided upon by the judge. Repayment periods were allegedly too long in Czech Republic, Estonia, Lithuania, Portugal, Ireland and Sweden where the repayment

[1041] *Idem*, p. 9.

[1042] The recommendation acknowledges that reduction of stigma attached to bankruptcy is connected with the distinction between honest and dishonest entrepreneurs and a reduction of the discharge period for the honest bankrupts, whether they have the means to pay their creditors under a payment plan or not. In this connection, honesty should encompass in essence fraudulent conduct, whereas Member States may also cover bad faith either before or after the opening of bankruptcy procedures. See also EUROPEAN COMMISSION. *Commission Staff Working Document. Impact Assessment Accompanying the document Commission Recommendation on a New Approach to Business Failure and Insolvency. SWD(2014) 61 final* [online]. …, p. 39.

[1043] Article 33 of the Commission Recommendation on a New Approach to Business Failure and Insolvency. EUROPEAN COMMISSION. *Commission Recommendation on a New Approach to Business Failure and Insolvency.* [online] …

[1044] EUROPEAN COMMISSION. *Evaluation of the Implementation of the Commission Recommendation of 12. 3. 2014 on a New Approach to Business Failure and Insolvency* [online]. European Commission, 30 September 2015 [cited 3 March 2017]. Available on <http://ec.europa.eu/justice/civil/files/insolvency/02_evaluation_insolvency_recommendation_en.pdf>.

period lasted 5 years, and in Austria and Belgium where it lasted 7 years and in Greece where it corresponded up to 10 years.[1045]

Eventually, on 22 November 2016 the European Commission published a proposal for a directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU (the Commission Proposal for a Directive). It lies on three pillars, which include the introduction of restructuring frameworks, debt relief procedure and measures to increase the effectiveness of the procedures.

As concerns a debt relief procedure, the Commission Proposal for a Directive applies essentially to the entrepreneurs. Yet, the European Commission invites the Member States to extend the scope of its application to other individuals.[1046] The respective proposal derives mainly from previous recommendation whereas it mandates the Members States to ensure that over-indebted entrepreneurs may be fully discharged of their debts. If a full discharge of debt is conditional on a partial repayment of debts by the entrepreneur, as in the case of the Czech IA, the related repayment obligation should be based on the individual situation of the entrepreneur and be proportionate to his disposable income over the repayment period.[1047] The entrepreneurs may be fully discharged from their debts no longer than three years starting from: (a) the date on which the judicial or administrative authority ruled on motion to commence such a procedure, in the case of a procedure ending with the liquidation of assets; or (b) the date on which implementation of the repayment plan started, in the case of a procedure which includes a repayment plan.[1048] A discharge should be granted without a need to turn to a judicial or other authority.

The Commission Proposal for a Directive anticipates that Member States shall ensure that, where an over-indebted entrepreneur obtains a debt relief, any disqualifications from taking up or pursuing a trade, business, craft or profession which is connected

[1045] *Idem*, p. 4.

[1046] See mainly article 18 of the Commission Proposal for a Directive. However, even personal debts of entrepreneurs should be preferably treated in a single procedure. Alternatively, if they are treated in separate procedures, such procedures should be coordinated so that the debtors are granted a discharge. See article 23 of the Commission Proposal for a Directive.

[1047] Article 19 of the Commission Proposal for a Directive.

[1048] Article 20 of the Commission Proposal for a Directive.

with the entrepreneur's over-indebtedness shall cease automatically to have effect at the latest at the end of the discharge period.[1049]

In any case, the Member States may avail of a set of exceptions. More particularly, Member States should be able to maintain or introduce provisions restricting access to a debt relief procedure or laying down longer periods for obtaining a full debt relief or longer disqualification periods in certain well-defined circumstances and where such limitations are justified by a general interest, in particular where: the entrepreneur acted dishonestly or in bad faith towards the creditors when becoming indebted or during the collection of the debts; the entrepreneur does not adhere to a repayment plan or to any other legal obligation aimed at safeguarding the interests of creditors; in case of abusive access to debt relief procedure; in case of repeated access to debt relief procedure within a certain period of time. Also, the scope of a debt relief does not have to be without limits as specific categories of debt, such as secured debts or debts arising out of criminal penalties or tortious liability might be excluded, where such exclusions or longer periods are justified by a general interest.[1050]

Currently, the European Commission has been negotiating the Proposal for a Directive with other stakeholders. It remains to be seen to what extent the European Commission will gain support for its main initiative. If yes, the Czech legislative framework will certainly have to undertake another change.

7.2 INSOL Europe recommendations on a debt relief procedure

The fresh-start policy has not stood aside attention of one of the most eminent organisations focused on insolvency law – INSOL Europe. INSOL Europe has set forth several principles and recommendations concerning consumer bankruptcies, which may be arguably extended also to bankruptcies of entrepreneurs.[1051]

One of the recommendations reads that legislators should enact laws to provide for a fair and equitable, efficient and cost-effective, accessible and transparent settlement and discharge of consumer and small business debts. Aspects of fairness and equitability imply that the law should not focus simply on maximization of values for the creditors so that balanced approach of allocation of risks should enable debtors a second chance.

[1049] Article 21 of the Commission Proposal for a Directive.

[1050] Article 22 of the Commission Proposal for a Directive. Due to a number of exceptions, the actual underlying principles might be undermined.

[1051] See INSOL Europe. *Consumer Debt Report – Report of Findings and Recommendations* …, pp. 4-5.

The insolvency trustee should be able to challenge voidable transfers. The report acknowledges that debtors mostly do not have sizeable insolvency estates so complicated and lengthy proceedings should be avoided. By the same token, debtors should be able to maintain a standard of living which also affects what assets should be exempted. In case of repayment plan, the duration should not be over-extended. Yet, it accepts up to seven or eight years. As regards other aspects, accessibility means that legislators should avoid unnecessary formalities and costs barriers. Transparency anticipates that debtors and creditors are able to monitor the proceedings and exercise their rights so that public has confidence in the process.[1052]

With reference to distinctions among different sorts of debts,[1053] INSOL Europe argues that a debtor with survival debts who has not any prospects of improvement of his financial capacity should be treated differently from the debtors with accommodation debts. Whereas it does not make any sense to prolong the proceedings for the former, the latter might actually provide their creditors re-scheduled or pro-rata payments.[1054]

Moreover, INSOL Europe states that provision of a fresh-start is in the society's interest as a result of the distinction between punishment of yesteryear and the economic situation of nowadays. Debtors should be able to obtain a debt relief. The scope of such debt relief should be broad whereas solely reasonable exceptions should apply. In order to provide the debtors with an opportunity to start anew free from their past financial obligations, debtors should not be excessively restricted in their activities following a grant of a debt relief. Also, well-defined and predictable rules should apply to refusal of a debt relief.[1055]

Last but not least, according to the INSOL Europe extra-judicial proceedings should be preferred to judicial proceedings.[1056] This includes court approvals of arrangements negotiated out-of-court in case of dissenting creditors. In this connection, INSOL Europe recommends

[1052] *Idem*, pp. 14-17.

[1053] See chapter 2.2 *supra*.

[1054] *Idem*, pp. 18-19.

[1055] *Idem*, pp. 22-24.

[1056] The World Bank also acknowledges that informal systems should be integrated together with formal insolvency procedures. Mostly, informal proceedings are less costly and more flexible, the debtors may avoid stigma better and provide creditors with a more valuable offer. However, the World Bank notes the rate of success of informal proceedings is limited since there are many related factors which make them complicated, including possible veto power of few creditors. See WORLD BANK. *Report on the Treatment of the Insolvency of Natural Persons* [online]. …, pp. 45-50.

that governments, quasi-governmental or private organisations should ensure the availability of sufficient competent and independent debt counselling.[1057]

7.3 Debt relief procedures in Visegrad countries

7.3.1 Debt relief procedure in Hungary

The assessment of the Hungarian personal insolvency law has been for long time far from being optimal.[1058] Bankruptcy law used to be regulated mainly by the Hungarian LDA - Act XLIX of 1991 on Liquidation and Dissolution which did not provide for bankruptcies of individual.[1059] It was not until 1 September 2015 when new Act CV of 2015 on debt settlement procedure – the Hungarian ADSP became effective. The Act has been adopted by the Hungarian Parliament[1060] in response to problems of households which were in huge financial strains. Thus a new legal framework for personal insolvencies has been set up.

New insolvency regime provides for one out-of-court as well as two types of possible court procedures whereas the former is preferred.[1061] Out-of-court procedure is initiated by the debtor who submits a defined statement to a main creditor. Main creditors are specifically enumerated entities involved in essence in financial markets (particularly banks).[1062] The main creditor is a key stakeholder in out-of-court negotiations who should seek to reach a debt settlement agreement. If there is not any main creditor, debtor files his

[1057] INSOL Europe. *Consumer Debt Report – Report of Findings and Recommendations* …, pp. 25-27.

[1058] EBRD. *EBRD Insolvency Law Assessment Project – 2009. Hungary* [online]. EBRD, 2009 [cited 3 March 2017]. Available on <http://www.ebrd.com/downloads/legal/insolvency/hungary_ia.pdf>.

[1059] Then laws were criticised since no proper mechanism to deal with individual's indebtedness existed. See e.g. CZOKE, Andrea. *Hungary – Insolvency Law and Practice* [online]. Konferencja Szablon, 2009 [cited 3 March 2017]. Available on <http://konferencja.szablon.pl/web_documents/csoke_hungary_insolvency_law_and_practice_konspekt.pdf?PHPSESSID=64e995676479ce5bf5789493cce5a67b>.

[1060] See e.g. *The new personal insolvency law of Hungary* [online]. Családi Csődvédelmi, 2015 [cited September 3, 2016]. Available on <http http://www.csodvedelem.gov.hu/en>. See also WORLD BANK. *Doing Business 2017. Hungary. Country Profile* [online]. Doing Business, 2016 [cited December 15, 2016]. Available on <http://www.doingbusiness.org/data/exploreeconomies/hungary/>, pursuant to which Hungary ranked 63 out of 190 countries in resolving insolvency.

[1061] The mentioned rule reflects that out-of-court procedure is less costly and has more limited impact on social status of the debtors.

[1062] NAGY-KOPPANY, Kornalia. *The Hungarian Personal Bankruptcy Act* [online]. Lawyerissue, 2015 [cited 3 March 2017]. Available on <http://www.lawyerissue.com/the-hungarian-personal-bankruptcy-act/#_ftn3>.

motion to a court so that out-of-court procedure is not commenced.[1063] Submission of a motion triggers a sort of automatic stay which suspends certain creditors' rights vis-à-vis their debtor. Therefore, they are also published in the special register. It must be noted that a debt settlement agreement is effective only if it is approved by all stakeholders, including all relevant creditors.[1064]

If an out-of-court procedure fails or cannot be realized or if the debtor does not manage to fulfil the respective debt settlement agreement, the first type of judicial proceedings follows. In principle, a special insolvency administrator seeks to strike a debt settlement agreement. However, any debt settlement agreement is subject to debtor's and creditors' approval (including the main creditor, if there is any, and majority of some other creditors). If a settlement agreement is concluded, a special insolvency administrator supervises the debtor.[1065]

If a settlement agreement cannot be reached voluntarily, the debtor fails to fulfil the agreement, or if any amendment should be made and it is not agreed upon voluntarily, court enforced proceedings follow; in such proceedings the court might impose a debt adjustment plan upon creditors itself in accordance with strict rules.[1066] The court enforced resolution anticipates sale of debtor's assets together with a repayment plan. The repayment plan lasts generally five years and might be extended for additional two years. The remaining unpaid debts are to be discharged.[1067]

The statute provides for complicated criteria regarding eligibility.[1068] However, it also addresses problems of persons having joint and severally liability with a debtor and persons

[1063] The main creditor is mandated to assume the position only if all debts are owed to the main creditor or to another entities within the same group. Otherwise, it may refuse to coordinate the respective proceedings. See e.g. *The new personal insolvency law of Hungary* [online]. …

[1064] NAGY-KOPPANY, Kornalia. *The Hungarian Personal Bankruptcy Act* [online]. ….

[1065] See e.g. *The new personal insolvency law of Hungary* [online]. ….

[1066] NAGY-KOPPANY, Kornalia. *The Hungarian Personal Bankruptcy Act* [online]. …

[1067] *Idem.*

[1068] Conditions upon which debtors might file for insolvencies are rather complicated so that not all debtors might reach the proceedings. The requirements for submission of a debt settlement proceeding include that overall creditors' claims must be in the range between HUF 2,000,000 and HUF 60,000,000; overall creditors' claims must exceed the value of the debtor's assets and income projected in the upcoming 5 years but may not exceed two times of that amount; one of the creditors' claims must be at least HUF 500,000 and due for at least ninety days; one of the debts must be from a consumer loan agreement or an agreement financing the debtor's private business. See *Idem.*

living in the same household as the debtor. The Hungarian ADSP anticipates that such persons might enjoy the same benefits and share the same obligations.[1069]

The Hungarian ADSP entrenches the policy of a carrot and a stick since a court may terminate debt relief proceedings upon the debtor's failure to comply with his duties.[1070] Also, it appears that the Hungarian ADSP seeks to ensure the cooperation and involvement of debtors together with his creditors by preference of out-of-court debt settlement agreements. Yet, it anticipates also the involvement of insolvency administrators whose role in out-of-court proceedings is limited. Yet, in court proceedings, they are more involved.[1071] Interestingly, in none of the three types of procedures a debtor is expected to lead negotiation.

7.3.2 Debt relief procedure in Poland[1072]

The Polish insolvency law used to be regulated solely by Polish LRA enacted on 28 February 2003.[1073] It replaced two old acts dating back to 1934.[1074] The Polish LRA was significantly amended in 2009. One of the crucial changes was that non-business individuals were allowed to go bankrupt.[1075] Yet, the framework of personal insolvency in Poland has recently experienced two major modifications. First, as of 1 January 2015 substantial changes took effect with regard particularly to debt relief procedure of individuals not engaged in business.[1076] Second, since 1 January 2016, a completely new statute took effect which provides for four types of reorganisation proceedings (arrangement approval

[1069] NAGY-KOPPANY, Kornalia. *The Hungarian Personal Bankruptcy Act* [online]. …

[1070] *Idem*.

[1071] *Idem.* See also PAPP, Erika, SOPTEI, Szabina. *Hungary has introduced a new regime for personal insolvency* [online]. CMS, 2015 [cited 3 March 2017]. Available on <http://www.cms-lawnow.com/ealerts/2015/07/hungary-has-introduced-a-new-regime-for-personal-insolvency>.

[1072] This chapter has been discussed with Jakub Brzeski, Dr. Anna Rachwał and Dr. Marek Porzycki, to whom the author is grateful for comments on the update of Polish personal insolvency laws. For general overview see also PORZYCKI, Marek, RACHWAL, Anna. *Consumer Insolvency Proceedings in Poland* [online]. Allerhand, 2015 [cited 3 March 2017]. Available on <http://www.allerhand.pl/images/IA%20WP%202015_12%20Porzycki%20Rachwal%20fin.pdf>.

[1073] The compliance score of the Polish was 73 %. However, it seems that it did not consider the latest amendment. EBRD. *EBRD Insolvency Law Assessment Project – 2009*. *Poland* [online]. EBRD, 2009 [cited 3 March 2017]. Available on <http://www.ebrd.com/downloads/legal/insolvency/poland_ia.pdf>.

[1074] BINKOWSKA, Maja, NIEMIRSKA-FIDO, Karolina, WALAWENDER, Richard A. *The Bankruptcy and Reorganization Law*. 2nd ed. Warsaw: C.H.Beck, 2010, p. X.

[1075] *Idem*, p. XI.

[1076] The legislature aimed to provide debtors with a real opportunity of a fresh-start since the then applicable laws were not much availed of due to restrictive preconditions. As a consequence – the number of non-business insolvency procedures is now higher than earlier. Till the end of 2014 there were allegedly about 15-30 non-business insolvencies a year whereas currently about 3000-4000 cases are opened per year.

proceedings, accelerated arrangement proceedings, standard arrangement proceedings and remedial proceedings) for business persons (including individuals engaged in business).[1077]

As concerns the Polish LRA, it used to provide for strict rules which granted a debt relief truly to honest but unfortunate debtors. The courts could provide a debt relief only if the insolvency has been caused by extraordinary events that were out of the debtor's control. Yet, the interpretation of the preconditions was modified so that currently the rules are more relaxed; the debtor generally passes the text unless he was in gross negligence with respect to his bankruptcy or his behaviour intentionally led to bankruptcy.[1078] The Polish LRA further sets additional conditions which include that the debtor has complied with his duties in the course of liquidation.[1079]

The liquidation of the debtor's non-exempt assets does not suffice to grant him a debt relief. Unlike the Czech and US insolvency laws that provide a discharge for the price of either giving up all the non-exempt assets or non-exempt income stream for a specified period of time, the Polish law automatically combines both methods.

The court embarks on consideration of the proposed repayment plan only after the residence has been sold out and a debtor has left the premises.[1080] In this respect, the court has quite a strong position since it has the last word on the content of the plan. The repayment plan lasts up to three years and generally sets the portion of debts that are to be repaid.[1081] The court is instructed to take the debtor's earning capacity into account. What is important to note from a comparative perspective is that upon the approval of the plan, the insolvency trustee's role expires.[1082]

[1077] Act of 15 May 2015, published in Journal of Laws of 2015, item 978, taking effect as of 1 January 2016. See NAMIOTKIEWICZ, Gryegorz et al. *Reform of Polish Insolvency Law* [online]. Clifford Chance, 2016 [cited 3 March 2017]. Available on <https://www.cliffordchance.com/briefings/2016/06/reform_of_polishinsolvencylaw.html>. Since the thesis does not deal with reorganisation-type of proceedings, particular details are omitted. See also WIATER, Krzysztof. *Pro-business reform of Polish Bankruptcy Law – January 2016* [online]. DLA Piper, 2015 [cited 3 March 2017]. Available on <https://www.dlapiper.com/en/us/insights/publications/2015/12/global-insight-16/pro-business-reform-of-polish-bankruptcy-law/>

[1078] Section 369 of the Polish LRA. Due to the strict assessment of the cause of failure, it was questionable to what extent the Polish LRA meaningfully fostered the entrepreneurship encouragement.

[1079] Section 369 of the Polish LRA.

[1080] Section 491^{10}(2) of the Polish LRA attempts to ensure the debtor's cooperation and avoid subsequent eviction proceedings.

[1081] Section 370a of the Polish LRA.

[1082] See section 491 of the Polish LRA. Unlike in Poland, in the Czech Republic and Slovakia, the role of the insolvency trustee is not extinguished. The most significant role of the administrator is perhaps

Obviously, good and bad things might happen during the life of the plan and the Polish LRA thus contemplates the possibility of changes. In case of temporary events that negatively affects the debtor's ability to work, the courts are empowered to reduce the amount of money payable to creditors or may extend the repayment period by additional 18 months.[1083] Still, if the debtor does not meet his obligations arising out of the repayment plan, he might lose the chance to benefit from the bankruptcy procedure as the court might revoke the plan upon the creditor's motion.

Also, if the debtor's overall situation improves, the creditors might petition the court to direct the debtor to pay more on account of his debts. However, the Polish legislature refrained from allowing higher payments solely because the debtor has achieved higher remuneration thank to his own efforts.[1084] This arguably provides debtors with an incentive to join the economy as productive members during the time of the repayment of debts.[1085]

Finally, the discharge is granted upon the completion of the repayment plan. In some cases, when special conditions occur (i.e. when the debtor is unable to perform any repayment plan), the debts of the debtors not engaged in business may be discharged without the issuance of repayment plan. It must be said that the debtor cannot avail of a discharge more than once in ten years.[1086]

7.3.3 Debt relief procedure in Slovakia

The Slovak insolvency law is mainly governed by the Slovak LRA and provides debtors with three main avenues – liquidation, reorganization and discharge of debts. The latter implements the fresh-start policy. At the outset, it must be mentioned that in November 2016, the Parliament adopted the Slovak Revision Amendment. Since the Slovak Revision

in the Czech Republic, where he monthly collects and distributes the income in case of repayment plan procedure and regularly supervises the debtor.

[1083] See section 491^{10} of the Polish LRA. Unlike the Czech IA, the Polish IA seems to be more flexible as it allows possible extension of the plan for additional time. Therefore, the law favours to provide a discharge of debts and avoid its denial in exchange for the additional "price" of up to two years of repayment plan.

[1084] Generally, the provision applies if the improvement of debtor's situation is due to external events (e.g. donation or inheritance).

[1085] See section 491^{19}(3) of the Polish LRA in case of non-entrepreneurs and section 390d(2) of the Polish LRA in case of entrepreneurs.

[1086] Section 491^{4}(3) of the Polish LRA contains other barriers to a discharge procedure.

Amendment took effective as concerns parts addressing discharge of debts as of 1 March 2017 the dissertation also describes these changes. [1087]

Although the explanatory notes to the Slovak LRA do not reveal any information about specific goals[1088] that the government sought to achieve, it discloses its intention to generally move towards a pro-creditor regime.[1089] The aforementioned policy of giving creditors meaningful protection seems to be enshrined in the very first section on discharge of debts.[1090] Prior to the Slovak Revision Amendment, the Slovak LRA did not provide for two separate methods like the Czech IA. Slovak discharge of debts virtually combined both of them and was in this respect akin to the Polish LRA. In other words, the commencement of discharge of debts was preconditioned on the completion of liquidation during which a debtor could propose the commencement of discharge of debts. One of other conditions, however, was that during liquidation, at least preferential claims [in Slovak: *pohľadávky proti podstate*] were repaid.[1091] In order to protect debtors' interests, the court was directed to advise them about a right to file such motion. The prerequisite of the commencement of the case was that the debtor had duly fulfilled his duties during liquidation. Since one of the most crucial duties was the obligation to provide assistance to an insolvency trustee,[1092] the Slovak LRA had embraced the policy of a carrot and a stick.[1093] The carrot was a debt relief whereas the stick of the Slovak fresh-start policy was *inter alia* section 171 of the Slovak LRA empowering the court to dismiss the case upon repeated or serious failure to fulfil debtor's duties.

[1087] Since the Slovak discharge of debts has found little use among Slovak debtors it seems to be useful to describe also current wording of the Slovak LRA.

[1088] However, the guidelines published on behalf of the Ministry of Justice of the Slovak Republic states that the aim was to make the position of individuals equal to the position of legal entities whose debts are extinguished by virtue of the end of their existence. It seems that the authors might have argued more persuasively rather on the basis of the fresh-start policy which is not mentioned in the document. DURICA, Milan, HUSÁR, Ján. *Sprievodca konkurzným právom* [online]. Ministry of Justice of the Slovak Republic, 2008 [cited 3 March 2017]. Available on <http://www.justice.gov.sk/dwn/r0/sprievodca/SprievodcaKonkurznymPravom.pdf>, p. 63.

[1089] The explanatory notes to the Slovak LRA mention that the previous regime did not work and the statute sought to rectify it. The explanatory note is available on <http://www.nrsr.sk/Default.aspx?sid=zakony/zakon&ZakZborID=13&CisObdobia=3&CPT=835>.

[1090] Section 166 of the Slovak LRA.

[1091] Section 166 of Slovak LRA. Preferential claims are defined in section 87 of Slovak LRA and include mainly reimbursement of costs of insolvency trustee and his remuneration, taxes and alimonies due as of the month of the issuance of liquidation order and afterwards.

[1092] See e.g. section 73 of Slovak LRA enacting the duty to cooperate backed even by possible pecuniary penalties.

[1093] See chapter 3.1.1 *supra*.

The Slovak LRA also seemed to promote the inclusion of the debtor to the economy as a productive member even during the mandatory three-year "*probation period*" of discharge of debts. The law did not set any threshold for mandatory repayment of debts except for previous repayment of preferential claims in liquidation. Yet, the debtor was required to transfer certain fixed amount at the end of each year which was set by a court. In fixing the amount, courts had certain degree of discretion as the limit is 70 % of the total generated income of that year be it wage or another income.[1094] The debtor had arguably an incentive to make more work efforts since he can keep the remaining 30 % of his income. By the same token, the debtor was presumably less prone to get involved in the shadow market. Although, up to 70 % of the fruits of his labour were transferred for the benefit of the creditors, the more income the debtor generated, the greater his portion equalling to 30 % would be in total.

Nevertheless, the absence of the mandatory percentage of repayment could motivate debtors not to care that much about the income or the previously incurred debts. Section 168(2) of the Slovak LRA sought to address any possible misbehaviour by setting an obligation to make adequate efforts to find a job or otherwise generate income. Moreover, in order to have the case open the debtor should have transferred at least EUR 332 (plus VAT if applicable)[1095] annually to an insolvency trustee. This entailed that the debtor had to save at least the mentioned amount from his income and set it aside. The lump sum corresponded to less than a half of the average monthly nominal wage.[1096] Debtors who did not generate this amount per year had their case dismissed. The period of three years could be in effect too long to lose motivation and shrink. In fact, the period started from the termination of liquidation proceedings. Therefore, in practice, the whole proceedings were rather long since the liquidation could take two years in general.[1097]

As regards eligibility, unlike in the neighbouring Czech Republic, the discharge was available to business as well as non-business individual debtors without making any difference. By the inclusion of entrepreneurs, the Slovak implementation of the discharge

[1094] Section 168(1) of the Slovak LRA.

[1095] The amount corresponded to the least minimum equal to the remuneration of an insolvency trustee. See MICHALIČOVÁ, Zuzana. *Oddlženie - spôsob ako sa zbaviť svojich dlhov* [online]. e-pravo.sk, 2009 [cited 3 March 2017]. Available on <http://www.e-pravo.sk/articles/view/82/oddlzenie-sposob-ako-sa-zbavit-svojich-dlhov> and section 24(1) of Slovak regulation no. 665/2005 Coll.

[1096] The average nominal wage in 2015 was EUR 883. The data are available on <http://slovakstatistics.sk>.

[1097] See the explanatory notes to the Slovak Revision Amendment.

policy sought to encourage not only consumption but also entrepreneurship. In comparison to the Czech IA, the Slovak LRA did not distinguish between businessmen and non-businessmen.

However, this was not to say that every indebted individual could reach a fresh-start. As it has been pointed out, discharge procedure was preconditioned on the previously accomplished liquidation. In order to have the liquidation commenced the debtor had to pay fees in the amount of EUR 1,600[1098] and his non-exempt assets had to reach at least the value of about EUR 1,600. Therefore, the poorest debtors with little assets were excluded from the regime.[1099]

Furthermore, it might be remarked that the discharge rendered the claims that had not been satisfied in the process of liquidation and during the probation period unenforceable. The court ruled on the discharge on its own motion. The scope of the discharge was not limited and in comparison to the Czech IA or US Bankruptcy Code the discharge was much broader.

The Slovak LRA did not specifically address the question when a second discharge of debts proceedings could be initiated. It seems that courts could determine the possibility of further filings within the confines of the requirement of good faith.[1100]

While ensuring the maximization of the collection of debts, the Slovak LRA provided the debtor with a chance to discharge his debts. The price for the fresh-start was not low[1101] and given the monetary thresholds relating to fees and minimum value of the insolvency estate, the discharge was out of the reach of a considerable number of people. The problem seems to be that only a few debtors had availed of the discharge provision in practice.[1102] Small number of pending cases suggests that the system did not work properly. Yet, it has

[1098] See section 8(1) of Slovak regulation no. 665/2005 Coll. Moreover, proceeds from the sale of insolvency estate should fully cover certain priority claims such as administrative expenses, certain post-petition tax claims, etc. See sections 87 and 102 of Slovak LRA. Otherwise, the discharge procedure cannot follow.

[1099] It appears that the legislature wanted to provide a discharge solely to the debtors who can afford to pay at least part of the costs of the procedure.

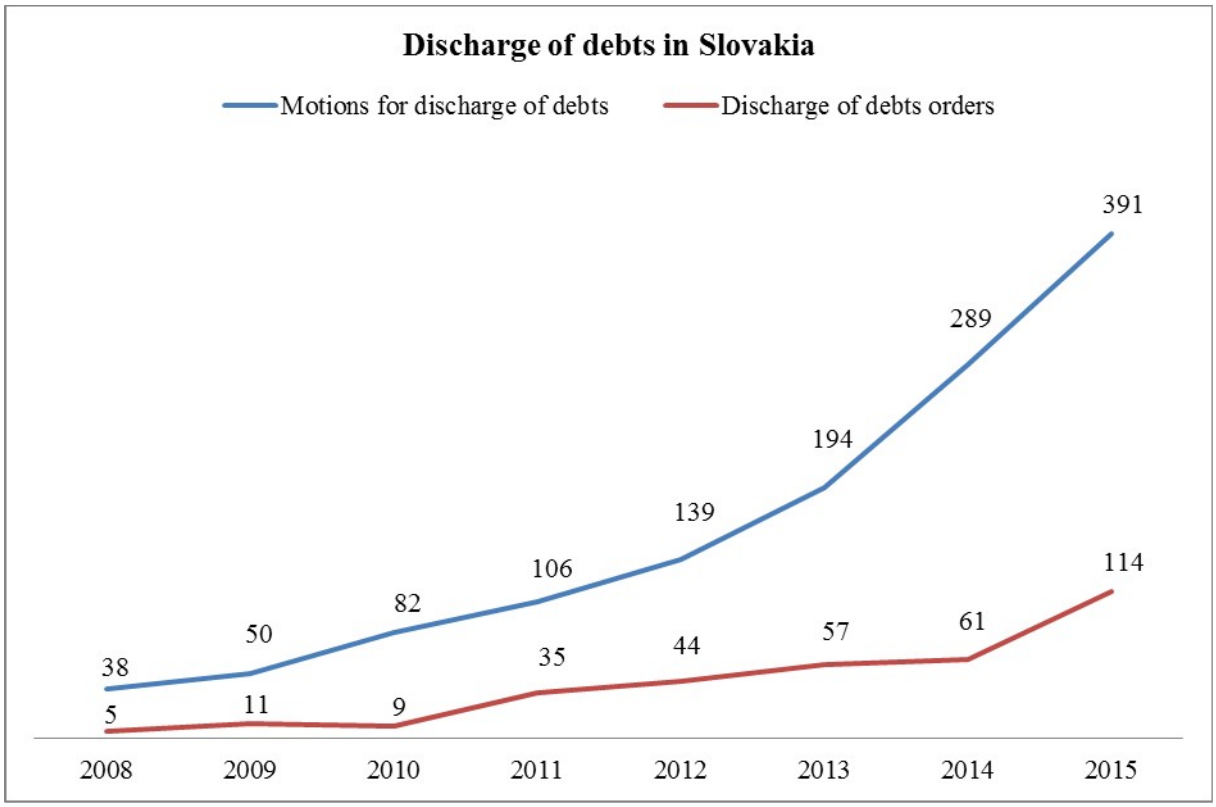
[1100] See section 167(1) of the Slovak LRA.

[1101] See RICHTER, Tomáš. Slovenská rekodifikace insolvenčního práva: několik lekcí pro Českou republiku (a jedna sázka na divokou kartu. *Právní rozhledy,* 2005, vol. 13, no. 20, p. 739.

[1102] See graph 7 *infra.*

been observed that debtors were not well-informed, face the mentioned pecuniary barriers and considered the system to be too complex.[1103]

Graph 7: Statistics about discharge of debts in Slovakia[1104]



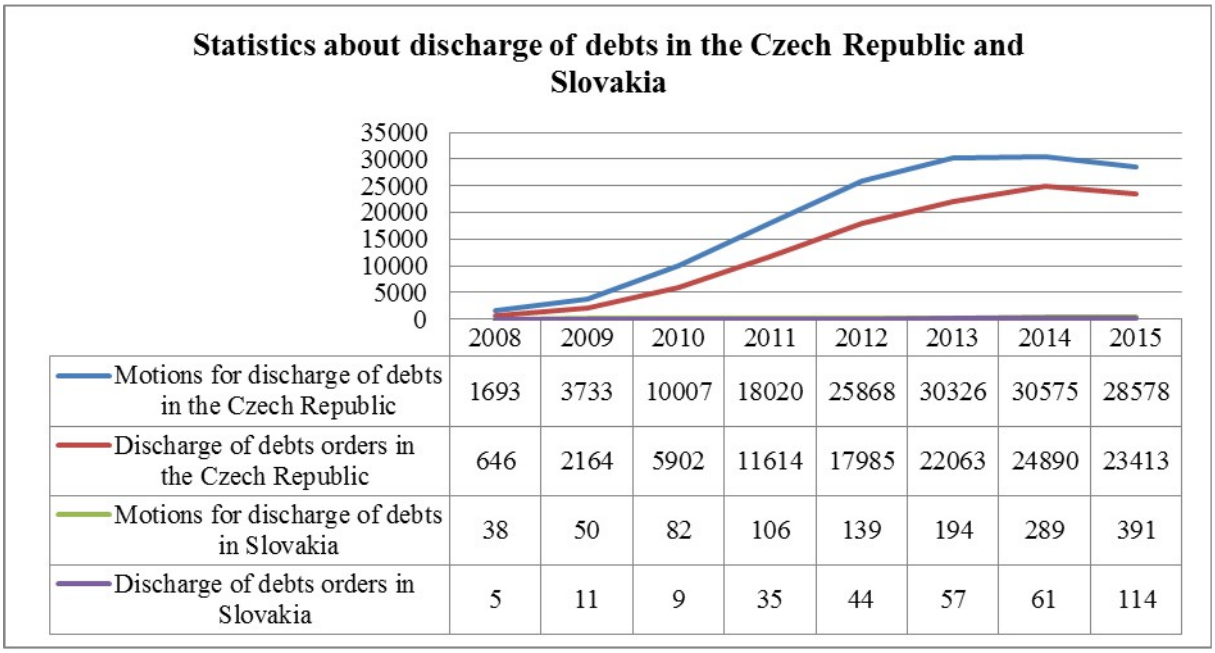
Although the number of motions for discharge of debts has increased since 2008, it was still very low in comparison to the Czech Republic (see graph 8 below).

Further to the deficiencies described above, the Slovak Revision Amendment has been adopted, which will dramatically change the framework of discharge of debts in Slovakia. The intention was to make discharge of debts more available procedure to Slovak debtors so that debtors are provided a fresh start.

[1103] HOJČUŠOVÁ, Miriam. *Osobný bankrot môžete vyhlásiť, len ak máte majetok. Záujem je nízky* [online]. SME, 2010 [cited 3 March 2017]. Available on <http://nitra.sme.sk/c/5251323/osobny-bankrot-mozete-vyhlasit-len-ak-mate-majetok-zaujem-je-nizky.html>.

[1104] Source of data: statistics available on <https://www.justice.gov.sk/Stranky/Informacie/Statistika-konkurznych-konani-OS.aspx>.

Graph 8: Statistics about discharge of debts in the Czech Republic[1105] and Slovakia[1106]



	2008	2009	2010	2011	2012	2013	2014	2015
Motions for discharge of debts in the Czech Republic	1693	3733	10007	18020	25868	30326	30575	28578
Discharge of debts orders in the Czech Republic	646	2164	5902	11614	17985	22063	24890	23413
Motions for discharge of debts in Slovakia	38	50	82	106	139	194	289	391
Discharge of debts orders in Slovakia	5	11	9	35	44	57	61	114

Debtors remain eligible for discharge of debts proceedings regardless of whether they are entrepreneurs[1107] or whether they have any business-related debts. Therefore, the Slovak Revision Amendment upholds the principle of business encouragement and wealth insurance. It clarifies, however, that in order to be eligible, enforcement proceedings must be held against the debtor and that the debtor must be insolvent in the form of illiquidity.[1108] Debtors are not eligible to file for discharge of debts sooner than 10 years from the previous issuance of a debt relief order.[1109] Interestingly, the debtor shall be mandatorily represented

[1105] Source of data: statistics available on <http://insolvencni-zakon.justice.cz/expertni-skupina-s22/statistiky.html> and the data provided by the Ministry of Justice of the Czech Republic on the basis of a request to provide information.

[1106] Source of data: statistics available on <https://www.justice.gov.sk/Stranky/Informacie/Statistika-konkurznych-konani-OS.aspx>.

[1107] However, the fact that the debtor has experience as an entrepreneur is one of the aggravating circumstances in case the court assess whether the debtor pursues dishonest intention within the meaning of section 166f(3) of the Slovak LRA as amended by the Slovak Revision Amendment. Similarly, it contains also several examples of mitigating circumstances such as old age.

[1108] In other words, if a debtor is "only" over-indebted he cannot file for discharge of debts. See section 166 of the Slovak LRA as amended by the Slovak Revision Amendment. This requirement does not seem to be substantiated.

[1109] Section 166(2) of the Slovak LRA as amended by the Slovak Revision Amendment. It must be noted, however, that a discharge of debts order is granted at the beginning of the procedure. Therefore, in comparison to the 2018 Draft Amendment, a debt relief might be in effect granted more often (sooner). Still, if the debtor fails during the repayment plan, he is barred from the submission of another motion. Under the Czech law, he is not generally barred from the submission of another insolvency petition and motion for discharge of debts unless

by the Centre for Legal Aid [in Slovak: *Centrum právnej pomoci*][1110] or a qualified attorney designated thereby.[1111]

One of the most significant modifications is that the Slovak Revision Amendment dispense with the combination of liquidation and repayment plan so that two separate methods of discharge of debts exist – liquidation of all non-exempted debtor's assets or 5-year long repayment plan. In this regard, one of the most innovative modifications includes the provision of a debt relief by virtue of a liquidation order [in Slovak: *vyhlásenia konkurzu*] or ruling on determination of repayment plan [in Slovak: *určenia splátkového kalendára*] which are issued at an initial stage of the proceedings.[1112] Yet, the provision of a fresh-start at an early phase of the procedure does not mean that the Slovak LRA departs from the adherence to the principle of a carrot and a stick. In order to motivate debtors to fulfil their duties, the Slovak Revision Amendment sets forth that a debt relief might be revoked.[1113]

Unlike under the Czech IA where the primary choice as to a method of discharge of debts is up to creditors, the Slovak Revision amendment leaves the choice to debtors.[1114]

As concerns repayment plan, the Slovak Revision Amendment puts much emphasis on the insolvency trustee who drafts a repayment plan with respect to individual debtors.[1115] The repayment plan should reflect particularly the following criteria: relation between the total amount of claims and value of the debtor's insolvency estate, causes of the debtor's

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the debtor failed due to dishonesty. See section 395(4) of the Czech IA as amended by the 2018 Draft Amendment.

[1110] The Centre for Legal Aid is a state budgetary organisation established pursuant to the Act No. 327/2005 Coll. on the Provision of Legal Aid for People in Material Need, as amended, as a state budgetary organization under the Ministry of Justice of the Slovak Republic. Information about the Centre for Legal Aid is available on <http://www.centrumpravnejpomoci.sk/>.

[1111] Section 166k of the Slovak LRA as amended by the Slovak Revision Amendment.

[1112] Section 166e of the Slovak LRA as amended by the Slovak Revision Amendment.

[1113] Section 166f of the Slovak LRA as amended by the Slovak Revision Amendment.

[1114] See particularly section 166(1) the Slovak LRA as amended by the Slovak Revision Amendment with limitations in section 168c of the Slovak LRA as amended by the Slovak Revision Amendment.

[1115] The Slovak Revision Amendment anticipates several stages which might be summarized as follows. Further to the debtor's respective petition which must include *inter alia* the debtor's list of assets and prospective income, the court essentially briefly assess it, appoint an insolvency trustee and issues a ruling on automatic stay. The debtor is requested to pay a deposit. Within 45 days from the payment of a deposit, the insolvency trustee prepares the repayment plan which is published in the official Commercial Gazette. Subsequently, creditors have 90 days to submit objections against prepared repayment plan; objections filed later are to be disregarded. The court finally decides on possible objections (if applicable) and approves the repayment plan by a ruling on determination of repayment plan. See particularly sections 168c-168e of the Slovak LRA as amended by the Slovak Revision Amendment.

insolvency, prospective rate of satisfaction of debtor's debts, previous debtor's endeavour to satisfy his debts, debtor's income stream, living, family, social conditions, age and education of the debtor.[1116] The length of repayment plan is five years[1117] and the repayment plan should be in any case feasible.[1118] Similarly as in the Czech Republic, no extension is possible. More importantly, however, the mandatory repayment of 30 % of all unsecured claims applies; also, repayment plan is only available solely if it provides creditors 10 % higher satisfaction of claims then in liquidation.[1119]

Liquidation does not anticipate any mandatory repayment. Therefore, liquidation might be more popular or, sadly so, the only method of discharge of debts for majority of debtors, particularly for the debtors having little or no assets left. Nevertheless, repayment plan might be preferred by those who intend to keep their valuable assets.[1120]

In this connection, the Slovak Revision Amendment seeks to promote also social policy by the protection of debtors' dwelling in discharge of debts in the form of liquidation. A dwelling may only be sold if proceeds from the sale thereof would be sufficient to partially cover at least creditors' claims after a deduction of (i) the costs of the sale and (ii) non-exempted amount corresponding to dwelling costs. If the dwelling is sold, the amount corresponding to the non-exempted part is deposited at a bank account whereas such proceeds are not distributed to creditors and the debtor can benefit from them (i.e. use them) under specific rules.[1121] Moreover, certain persons affiliated with the debtor have a priority right to buy debtor's assets for a fair price with the debtor's consent.[1122]

Interestingly, the Slovak Revision Amendment substantially touches upon the non-bankruptcy law as it seeks to exclude certain claims from satisfaction. Such claims shall include in principle amounts corresponding to the accrued interest which exceeds 5 % of the principle amount every year, claims from bill of exchanges [in Slovak: *zmenka*], contractual penalties, other private law sanctions as well as public law pecuniary sanctions

[1116] Section 168c(2) of the Slovak LRA as amended by the Slovak Revision Amendment.

[1117] Section 168c4) of the Slovak LRA as amended by the Slovak Revision Amendment.

[1118] Section 168c(6) of the Slovak LRA as amended by the Slovak Revision Amendment.

[1119] See particularly section 168c(4) and (5) of the Slovak LRA as amended by the Slovak Revision Amendment.

[1120] Given the fact that currently even payment of a deposit is allegedly a real barrier to discharge of debts, one cannot expect that number of motions for repayment plan will be large.

[1121] Section 167o of the Slovak LRA as amended by the Slovak Revision Amendment.

[1122] Section 167r of the Slovak LRA as amended by the Slovak Revision Amendment.

and pecuniary claims of persons affiliated with debtors.[1123] This might help debtors to reach the respective mandatory pay-out. Yet, such exclusion diverts so extensively from the non-bankruptcy law that it might create improper incentives to initiate insolvency proceedings.[1124]

The Slovak Revision Amendment builds upon the requirement of honesty and demonstrates what might be in contravention with the duty to act honestly. Such missteps shall include a failure to state all creditors (whereas petty [in Slovak: *drobné*] creditors might be arguably disregarded) or complete list of assets, provision of incorrect or incomplete piece of information, a failure to pay instalments under repayment plan, or conduct of a debtor from which it might be concluded that (i) in assumption of debts, debtor relied that he shall resolve them by virtue of liquidation or repayment plan, (ii) debtor sought to provide preferential treatment to any of his creditors, or (iii) debtor intentionally caused his insolvency.[1125] Along with the incorporation of requirement of honesty, position of creditors is strengthened as mostly creditors might file objections against a debt relief order within 6 years from the award thereof. As indicated above, on the basis of such objections, a debt relief order might be revoked so that it becomes ineffective.[1126]

The legislature noted that an obligation to pay deposit before the submission of insolvency petition and a requirement to have assets of certain value constitute obstacles to discharge of debts. As a result of this, in order to render discharge of debts more accessible,[1127] the amount of deposit payable together with the submission of motion for discharge of debts is to be decreased to EUR 500. Under certain conditions, debtors might be even provided with a credit from state funds to pay the respective deposit amount.

The legislature has acknowledged that the costs of insolvency proceedings are rather high whereas benefits in case of individuals are low. Therefore, discharge of debts contemplates several departures from general rules. The legislature has probably taken

[1123] See more details in section 166b of the Slovak LRA as amended by the Slovak Revision Amendment. In principle, solely the so-called "old debts" are excluded. See the definition of the decisive date [in Slovak: *rozhodujúci deň*] in section 166a.

[1124] See chapter 2.5 *supra.* The legislature should arguably use other means how to tackle the respective issues (e.g. it might limit the interest rate with respect to consumers etc.).

[1125] See section 166f of the Slovak LRA as amended by the Slovak Revision Amendment.

[1126] The Slovak Revision Amendment *inter alia* state that due date and enforceability is redeemed and that such claims shall not become statutorily barred sooner than 10 years after the decision on revocation of debt relief order. See section 166f(4) of the Slovak LRA as amended by the Slovak Revision Amendment.

[1127] See section 8(1) of Slovak regulation no. 665/2005 Coll. as amended by proposed changes. Minimum value of assets in case of liquidation of entrepreneurs is to be set to EUR 1,660; there shall be no minimum amount in case of individuals not being engaged in business. See also explanatory note to the Slovak Revision Amendment.

into account that remuneration of the insolvency trustee is not sufficient so that that the insolvency trustee is not obligated to undertake thorough investigation as to the whereabouts of the debtor. The insolvency trustee is mandated to undertake a thorough examination only upon the creditor's motion and payment of costs.[1128] Similarly, the insolvency trustee is not empowered to deny claims of creditors in discharge of debts in its liquidation form.[1129]

To sum it up, the Slovak Revision Amendment as a response to deficiencies of current framework seeks to render discharge of debts more accessible. It sets forth rather complicated and not very clear rules. The legislature seems to rely heavily on creditors' role to supervise and monitor the debtor since the insolvency trustee does not appear to have sufficient incentives to do so. Given the fact that even before the application of the Slovak Revision Amendment, discharge of debts procedure in Slovakia did not attract too many debtors, one may expect that since repayment plan requires mandatory pay-out, liquidation will be the preferred or the only available solution for most of Slovak debtors. It remains to be seen whether the "price" for a debt relief is not too low to handle moral hazard problems.

[1128] See section 166i of the Slovak LRA as amended by the Slovak Revision Amendment.

[1129] Section 167l(5) of the Slovak LRA as amended by the Slovak Revision Amendment.

8 Conclusions

This dissertation represents a legal study of discharge of debts as one of the methods of resolution of the debtor's insolvency implementing the fresh-start policy. It seeks to examine not only the rationales behind a debt relief procedure, possible aspects thereof, but also the implementation of the principles of the fresh-start policy particularly from the view of law and economic analysis. More precisely, the research question is: what considerations should discharge of debs procedure take into account from the legal and economic perspective and to what extent Czech legislation reflects such considerations. In this connection, the dissertation has posited several more detailed hypotheses which are discussed below.

8.1 *Ex ante* and *ex post* effects of a debt relief procedure

The author argues that the fundamental purpose of discharge of debts is to protect the borrower's equity in the form of future labour and to provide the debtor a fresh start. Since a debt relief procedure entails a clear departure from the non-bankruptcy law, it should be justified. Chapter 3 in conjunction with chapter 2 identifies a number of grounds substantiating a debt relief procedure.

Historically, perhaps the most pertinent principle behind a debt relief procedure is that an award of a debt relief enhances cooperation of debtors with authorities involved in the procedure with the aim to increase the value of the debtor's insolvency estate in favour of creditors. However, positive effects of a debt relief procedure are not limited to creditors. The whole society as well as the economy might benefit from a debt relief procedure. Even Sir Blackstone in 18th century noted that due to discharge of debts "... *the bankrupt becomes a clear man again; and by the assistance of his allowance and his own industry may become a useful member of the commonwealth ...*"[1130]

Similarly, in the tax-related context, a debt relief procedure might diminish incentives of debtors to engage in the shadow economy. In the absence of discharge of debts, debtors would have no incentives to admit their income as it would be garnished. In line with the argument that a debt relief brings debtors back to the economy, it also serves as a tool to encourage entrepreneurship and a sort of wealth insurance. Potential entrepreneurs can

[1130] W. Blackstone, Commentaries on the Laws of England (1976, Baton Rouge, Claitor's Publishing), vol. 1, p. 1359.

ex ante expect that if they engage in risk-taking and fulfil requirements under the bankruptcy law, they will not be left in the servitude of debts if they do not succeed. A fresh start may arguably lead to the debtor's future success in business as studies claim that the debtors who have failed once have learned a lesson and are more successful in their future business activities.

Moreover, a debt relief procedure might reduce some direct costs associated with indebtedness since it eliminates private costs incurred for instance by the necessity to monitor debtors, once discharge of debts has been granted, as well as well as public costs incurred by having long-lasting enforcement or insolvency proceedings pending. Yet, not all costs might be measured and there are many externalities such as anxiety over financial situation which might trigger psychological and other problems. Discharge of debts mitigates such externalities by bringing back debtors not only to the economy but also to the society.

The list of potential justification is definitely not complete. Modern behavioural approach to law gives rise to justification on the ground of paternalistic protection. Similarly, a debt relief procedure might be defended on the basis of rehabilitation and other principles.

If discharge of debts is to be labelled as medicine for symptoms caused by the debtor's indebtedness, like any other medicine, it is not the medicine without any side-effects. Law makers must certainly take into considerations not only the advantages of a debt relief procedure but also the disadvantages that the fresh-start policy might bring about. More specifically, if the debtor is unable to repay his debts even in the long-term perspective, there is not much loss involved on the part of his creditors as a result of discharge of debts. The crucial question is whether the debtor would be able to repay debts or at least a reasonable portion thereof outside of bankruptcy. If the answer is positive, the fresh-start policy generally leads to reduced satisfaction of debts. Also, the availability of discharge of debts might encourage individuals in imprudent borrowing and in carrying out more risky activities. Apart from that, debtors might tend to abuse the framework of a debt relief procedure and be tempted to commit different types of fraud.[1131] Last but not least, a debt relief procedure might also affect both the primary as well as the secondary credit market. Obviously, freely available discharge would potentially limit the availability of credit and lead to subsidization of credit by those who are able to repay them.

In order to mitigate the negative effects of a debt relief procedure two main considerations should be taken into account. Debt relief procedure has substantial negative

[1131] See chapter 3.4.3 *supra*.

impact particularly in situations when debts would be otherwise collectible outside bankruptcy. Second, a debt relief should not be freely available. To address the former, the law should in certain respects distinguish between the debtors who cannot repay their debts and those who are simply trying to avoid incurred debts. As regards the second, the legislature needs to carefully consider the preconditions for discharge of debts. A debtor must pay some "price" for a debt relief (burdens on part of creditors).

Finally, in connection with the 2018 Draft Amendment, the author would like to point out that short-time redistribution from creditors to debtors can be assumed in case of unexpected changes in law. Since the 2018 Draft Amendment contemplates more freely available discharge of debts, the author would recommend that in case it is adopted, it should apply since 1 January 2019 (not since 1 January 2018).

8.2 Availability of discharge of debts for entrepreneurs

Chapter 4 in conjunction with chapter 2 and 3 seeks to prove the second hypothesis that a debt relief procedure should be eligible to individuals regardless of their involvement in entrepreneurial activities. It is sometimes asserted that business activities are risky and by voluntary assumption of such risks, the entrepreneur should bear the implications thereof and should not shift such risks to third persons via a debt relief procedure. The dissertation argues that due to historic as well as economic reasons, such line of argumentation is flawed.

First, the alleged riskiness of business has been historically the reason why a debt relief was available solely for debtors who were engaged in business. As Sir Blackstone noted the traders are "*the only persons liable to accidental losses, and to an inability of paying their debts, without any fault of their own*". Simply said, mutual provision of credit in trade was not perceived to be not only justifiable but necessary whereas the assumption of credit in other situations was considered dishonest.[1132] This is not to say that discharge should not be available to non-entrepreneurs. Nowadays, provision of credit is part of the economy and a failure to repay debts might be unpleasant but anticipated event.

[1132] "*If persons in other situations of life run in debt without power of payment, they must take the consequences of their own indiscretion, even though they meet with sudden incidents that may reduce their fortunes: for the law holds it to be an unjustifiable practice, for any person but a trader to encumber himself with debts of any considerable value*." See BLACKSTONE, William. *Commentaries on the Laws of England*. Baton Rouge: Claitor's Publishing, 1976, vol. 1, pp. 1359-1360.

Also, from the economic perspective, one of the rationales behind a debt relief procedure is that it fosters engagement in entrepreneurial activities. If concepts of limited liability are accepted in the society it does not seem justifiable to deny discharge of debts to the entrepreneurs who do not establish legal entities to shield themselves from debts.

One final general note might be made. Rules on the eligibility for discharge of debts should be clear so that they do not open room for any ambiguities. Uncertainties concerning whether a person is eligible for a debt relief procedure might lead to inefficiencies.[1133]

In the context of the abovementioned principles, the Czech IA has failed on both accounts. First, as indicated above, the initial wording defining the subjective scope of discharge of debts has been subject to disputes. Uncertainties have been for some time at least partially clarified by the Supreme Court ruling, which defined who is considered to be an entrepreneur within the meaning of the Czech IA. Yet, further questions concerning the interpretation of eligibility have arisen following the effectiveness of the Revision Amendment.

What is, however, more striking is that the Czech IA obviously prefers discharge of debts of non-entrepreneurs to entrepreneurs. Although nowadays, entrepreneurs might reach discharge of debts, it is more cumbersome. The legislature sought to broaden the scope of discharge of debts of the entrepreneurs by virtue of the Revision Amendment. However, the courts apparently took a different course of action as they effectively require statement that the respective creditors with business-related claims consent with the discharge thereby rendering discharge of debts more burdensome to debtors. In this context, the author argues that currently courts misinterpret provision on eligibility of debtors with business-related debts. First, courts should not require the debtors to procure the consent of creditors with business-related claims at the time of the submission of a motion for discharge of debts. Second, regardless of the disagreement of affected creditors with business-related claims, courts should take into account other factors such as the amount thereof or date of creation of such claims. Hopefully, further to the 2017 Amendment courts will revise their case-law on these issues.

To sum it up, although in the end the entrepreneurs or debtors with business-related debts might reach discharge of debts by undertaking liquidation, it is much more complicated

[1133] Simply said, if it later appears that debtors are not eligible, discharge of debts procedure has been useless together with all side-costs it brought about (costs for legal representative, time spent by insolvency trustees or courts officials).

for the debtors engaged in business than for those who have not business-related debts. By partially excluding businessmen from the scope of discharge of debts, the Czech IA has clearly failed to encourage entrepreneurship.

8.3 Honesty of debtors

The dissertation has also focused on the question whether the principle of honesty is enshrined in the conception of the fresh-start policy and to what extent the requirement of the debtor's honesty is enshrined in the framework of discharge of debts proceedings.[1134] The dissertation argues that the requirement of the debtor's honesty is tenaciously linked with a debt relief procedure not in regional legislations but also in various recommendations (including World Bank, INSOL Europe as well as the European Commission initiatives). The dissertation argues that a grant of a debt relief would not be fair if the debtor did not act honestly.

Nevertheless, the interpretation on what is and what is not consistent with the principle of honesty differs. Having undertaken a thorough research, it is perhaps the most interesting topic of discharge of debts. The assessment of the compliance with the requirement of honesty might encompass and indeed has in practice encompassed various behaviour ranging from "external financing" of debtors in order to reach the mandatory pay-out, criminal conduct prior to the commencement of insolvency proceedings, fulfilment of duties in the insolvency proceedings, transfer of property prior to the commencement of insolvency proceedings or life style of debtors.

Many steps undertaken by debtors might be considered immoral or inappropriate. Gambling or imprudent borrowing when the credit is used for leisure activities at the costs of creditors seem to be at the odds with morality. However, the Supreme Court has clearly embraced a pro-debtor approach when it has ruled that discharge of debts is available also to the debtors who might have acted imprudently or negligently. In other words, in line with the case-law, discharge of debts is available not only to the debtors who are indebted due to external circumstances which they could not have caused such as illness, accident, death of a close relative or perhaps shortage of work. What seems to be decisive is that the debtor intends to undertake "real transformation" so that he starts to care about his affairs prudently. In this connection, courts have gone so far that they even provide debtors with a possibility

[1134] See particularly chapters 4, 5 and 7 *supra.*

to rectify their missteps even during appellate proceedings. Arguably, from the creditors' perspective, the case-law is too relaxed and flexible. Interestingly, from the view of law and economics, courts take into account that liquidation, which is the alternative to discharge of debts, would mostly not bring about any benefits to creditors.

However, the perception of what is commonly accepted might be changed sooner or later. The 2018 Draft Amendment contemplates that the requirement of repayment of 30 % of unsecured claims shall be deleted. The initial wording of the explanatory note, however, explained that courts should shift from quantitative assessment to qualitative assessment. Although the Ministry of Justice of the Czech Republic has apparently abandoned the idea of the incorporation of the criterion "*whether actual method of living of debtor hitherto indicates his recklessness or negligence, which considering all circumstances might lead to reasonable assumption that the debtor will not fulfil his obligations in insolvency proceedings*", the message in the explanatory note might lead to various interpretation. Since the 2018 Draft Amendment anticipates dispensing with the mandatory repayment of 30 % of allowed unsecured claims, it might need to add another element to countervail possible moral hazard on the part of debtors. The Slovak LRA might serve as a source of inspiration as it contains several aggravating and mitigating circumstances as concerns the assessment of honesty.

8.4 Discharge of debts in the Czech Republic

One of the hypotheses of this dissertation is that rules on a debt relief procedure should on the one hand motivate debtors to maximize the value for creditors, and prevent them from abusing a debt relief on the other hand, by balancing the interests of the respective stakeholders. The dissertation argues that although the legal framework of discharge of debts in the Czech Republic is not thorough enough as different peculiarities arise during the course of the discharge of debts proceedings, the courts have mostly approached the issues correctly.[1135]

As indicated above, in order to minimize negative effects of a discharge of debts, the debtors must pay some "price", be it surrender of non-exempt assets or repayment of debts over a period of time, combination thereof or imposition of other conditions. However, while too generous regime intensifies occurrence of drawbacks of discharge of debts, too stringent

[1135] See particularly chapters 4 and 5 *supra*.

requirements render the system practically useless.[1136] However, there seems to be no one-size-fits-all system suitable to all the countries. The fresh-start policy must be seen in the context.

As the law stands, a debt relief under Czech law might be achieved either by virtue of sale of debtor's non-exempt assets or by virtue of a repayment plan. Unlike the US Bankruptcy Code, the Czech IA does not seem to prefer any of the methods. In order to mitigate possible abuses of discharge of debts, the legislature might consider combination of both methods and possible shortening of the repayment period with possible prolongation thereof under well-defined conditions.

What is common to both variations is that the law generally requires mandatory repayment of at least 30 per cent of unsecured claims. Thereby, the legislature seeks to countervail the risk of moral hazard. Obviously, such generally applicable requirement precludes some debtors from reaching a fresh-start. The statistics, however, indicate that the requirement does not seem to be an overly inhibitory factor. Interestingly, anecdotal experience suggests that the debtors avail of "external financing" as they conclude different sort of donation agreement or agreements on the provision of allowances to debtors. Also, the mandatory repayment might *ex ante* induce debtors to deal with their insolvency or expected insolvency earlier at the time when they can still repay the mentioned portion of their debts.

The repayment plan lasts 5 years with no flexibility given as to the extension of the time frame. At first glance such provision seems not to provide debtors with many incentives to make bigger work efforts during these five years. The legislature should consider enacting some reward mechanism in order to induce debtors to make greater work efforts during the repayment period. A possible suggestion is to allow debtors to keep certain amount from instalments.

Also, the Czech IA anticipates a possibility to enable the debtor to keep some portion of his non-exempt income that would be otherwise garnished if a debtor files the respective motion together with the submission of the motion for discharge of debts. It would be more appropriate to set forth that a motion to allow lesser payments might be filed at any time during the course of the proceedings. The 2017 Amendment partially addresses this deficiency.

[1136] See e.g. chapters 7.3.2 and 7.3.3 *supra* regarding previous Polish and Slovak legal frameworks of debt relief procedure which were not in practice used.

The Czech legislature relies *also* on the requirement to act honestly and on the absence of reckless or negligent approach towards debtor's duties in insolvency proceedings. Although some courts initially took a strict approach, currently, the courts are rather flexible and mostly provide debtors with a real chance to rectify their mistakes. Such stance provides debtors with a real opportunity to start anew.

The Czech IA seeks to ensure the cooperation between the debtor, his creditors and other participants in order to maximize the value of the debtor's insolvency estate. The law commands the debtor to *inter alia* reveal all income. Failure to comply with the duties might trigger revocation of a discharge of debts confirmation and automatic conversion into liquidation with no possibility of a fresh start. The contemplated deletion of the automatic conversion of discharge of debts into liquidation pursuant to the 2017 Amendment is, however, a questionable move.

Also, the subjective scope of application of a discharge of debts, which covers also non-business legal entities, seems to be in contravention with the general principles of discharge of debts. The inclusion of legal entities seems to be inconsistent with the fundamentals of the fresh-start policy. In this regard, as mentioned above, the Czech approach towards eligibility of individuals with business-related debts is not reasonable and should be changed.

Unlike under US Bankruptcy Code, a debt relief order is not granted automatically so that a debtor must file the respective motion. Since the ultimate purpose of discharge of debts proceedings is a bankruptcy relief, it does not make sense to require any motion. Therefore, the modification anticipated in the 2017 Amendment is certainly a positive move.

In any case, the scope of a debt relief is rather broad and does not encompass too many exceptions. Similarly, in comparison with effects of liquidation order, neither discharge of debts confirmation nor discharge of debts order implies too many restrictions on possible entrepreneurial activities. Since debtors are not in ordinary situations disqualified from their earning activities, they are indeed provided a meaningful fresh-start.

It is argued that the Czech legislature should also consider clarifications concerning position of secured creditors. It is argued that formal prohibition of bifurcation of claims (i.e. separation of claims to partially secured and partially unsecured) might lead to unreasonable injustice particularly in situations when it is possible to assign a claim without a security interest.

To conclude, as any other legal system, the Czech legal framework of discharge of debts is far from being perfect. It seeks to balance the interests of both the creditors and debtors

as well as to serve justice and other legitimate aims. However, not all the expectations were fulfilled. There are issues to be resolved. Some of the shortcomings of Czech IA have been mitigated by the recently enacted amendment of the Czech IA. One can only hope that the remaining issues will be addressed soon as well.

Yet, the author is afraid that the 2018 Draft Amendment shall undermine the current working framework of discharge of debts. Under the auspices of the assistance to the poorest, the legislature in a rather prompt manner skipped through the standard legislative procedure and seeks to substantially modify rules on a debt relief without undertaking a sensitive and thorough analysis. The 2018 Draft Amendment might open the gate for moral hazard on the part of debtors since the generally applicable countervailing factor shall be dispensed with.

The author argues that in order to cope with the problem of multiple enforcement proceedings pending the legislature might have considered that in case of several enforcement proceedings in favor of more creditors, either insolvency proceedings would be automatically initiated or the debtor would have to be notified about the possibility to file a motion for discharge of debts together with the information how to proceed. Thereby, debtors with several creditors would better deal with their financial strains. Possibly, courts might obtain discretion whether to allow discharge of debts without any mandatory payment under specific circumstances.

If the 2018 Draft Amendment is to be accepted, the legislature should consider at least some of the following changes. First, from creditors' view, it does not make sense to complicate procedure and distinguish between the sale of debtor's assets and repayment plan with the sale of debtor's assets. Second, the limit of debts when mandatory repayment is applicable should be decreased. Third, remuneration system of insolvency trustees should be modified and their role should be strengthened. Fourth, Ministry of Justice of the Czech Republic should ensure that courts have enough personnel so that they are not overloaded; alternatively out-of-court system should be used.

8.5 Role of stakeholders in discharge of debts

The dissertation also examines the roles of stakeholders in discharge of debts in order to confirm the hypothesis concerning positions of debtors, creditors, insolvency trustees and courts.

It may be observed that debtors initiate discharge of debts by filing the respective motion for discharge of debts. Yet, arguably due to the lack of competence and knowledge about peculiarities of the procedure, the debtors stay rather passive observers in the further course of discharge of debts proceedings. The 2017 Amendment deprived debtors of the right to file a motion for discharge of debts without any assistance. The author argues that debtors should be at least required to inform certain classes of creditors about the intention to commence discharge of debts.

Nor do the creditors ordinarily take an active position since they in essence have little at stake. Their activity is predominantly determined by the rational apathy as it does not pay off to be actively involved. However, the passivity of creditors might undermine their position. In order to successfully challenge certain decisions, previous objections (i.e. procedural activity) are mostly needed. This will also apply under the 2017 Amendment.

Insolvency trustees are more active. They supervise debtors and provide them with a necessary guidance. However, their work is effectively not under creditors' scrutiny, which might have an impact on their activities. Indeed it appears that majority of tasks of insolvency trustees are undertaken by paralegals or assistance with limited knowledge of law. Unfortunately, the system of their remuneration does not provide many incentives to the insolvency trustees to dedicate additional efforts to discharge of debts proceedings. The author argues that the remuneration system should be amended so that the insolvency trustee's remuneration is more linked to his activities and amount of the proceeds to be distributed to creditors. The need for change is strengthened by the limitation of rights of creditors under the 2017 Amendment and modifications anticipated under the 2018 Draft Amendment.

The courts, however overloaded, are eventually the stakeholders which have to handle the case. Anecdotal experience indicates that the courts are unable to dedicate sufficient time to more complicated issues due to the fact that their agenda has increased substantially. In their decision-making practice, they balance two considerations. On the one hand, as gatekeepers of legality, they have to check whether all the preconditions are fulfilled. On the other hand, having recognized the complexity of the debtor's situation, and in many

respects, they have adopted rather a pro-debtor approach. The pro-debtor approach of the courts is reflected *inter alia* in the assessment of the requirement of honesty and absence of negligent and reckless behaviour of debtors towards fulfilment of their duties in insolvency proceedings.

It remains to be said that the 2017 Amendment seeks to shift more burdens from the courts to insolvency trustees. Strengthened use of electronic communication and submission of relevant documents might also help the courts to handle large amount of cases. Yet, the courts might not benefit from the novelties of the 2017 Amendment for too long. If the 2018 Draft Amendment is adopted, the courts might experience another increase in submission of new cases hand in hand with the deletion of the requirement of mandatory repayment of unsecured debts.

8.6 Debt relief procedure as integral part of modern insolvency laws

The dissertation argues that a debt relief procedure has become an integral part of modern insolvency laws. Chapter 7 together with chapters 1 and 2 elaborates on the increase of importance of the fresh-start policy not only in the Czech Republic but also in Visegrad countries as well as at the EU level.

As of the submission of a thesis proposal, Poland and Slovakia did not have working legal framework of the fresh-start policy and Hungary lacked any framework. The respective legislators of Visegrad countries have since then focused on the improvement thereof. Currently, Hungary has newly provided for a debt relief procedure further to financial crisis of households. In 2015 new legislation took effect in Poland in order to cope with insufficient use of debt relief procedure. Similarly, in Slovakia new rules are applicable as of 1 March 2017. Needless to say, recently one amendment has been approved in the legislative process (2017 Amendment) and another is currently discussed (the 2018 Draft Amendment).

Obviously, a debt relief procedure has gained a lot of attention not only in Visegrad countries but also across the EU. In most of the EU member states, the law provides for some sort of a debt relief. Yet, the preconditions and impacts differ, as was illustrated *inter alia* by the comparison of the Czech and Slovak data. There will certainly be a debate over harmonisation of the conditions for discharge of debts. However, the debate will not be easy and we will see whether it will bring about any specific legally binding instruments as the European Commission has recently proposed.

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256. Regional Court in Hradec Kralove ruling case no. KSHK 42 INS 1568/2009-B-21 of 15 October 2009
257. Regional Court in Prague ruling case no. KSPH 41 INS 17187/2011-B-14 of 26 June 2012
258. Regional Court in Ostrava ruling case no. KSOS 13 INS 4241/2008 of 24 September 2014
259. Regional Court in Pilsen ruling case no. KSPL 56 INS 1722/2015-B-18 of 8 October 2015

Other courts rulings

260. Court of Justice of the European Union ruling *Ulf Kazimierz Radziejewski v Kronofogdemyndigheten i Stockholm* of 8 November 2012)
261. European Court of Human Rights ruling. *Bäck v. Finland* (no. 37598/97, ECHR 2004-VIII
262. US Supreme Court ruling in re *Klein Everett v. Judson*, 228 U.S. 474 (1913)
263. US Supreme Court ruling in re *Local Loan Co. v. Hunt*, 294 U.S. 234 (1934).
264. US Supreme Court ruling in re *United States v. Kras* 409 U.S. 434 (1973)
265. US Supreme Court ruling in re *Butner v. United States* 440 U.S. 48 (1979)
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10 Abstract and key words

Title: Legal and Economic Analysis of Discharge of Debts

Key words: discharge of debts, fresh-start policy, insolvency proceedings, motion for discharge of debts, honesty, debt relief, law and economics

Abstract:

A discharge of debts provides a debtor with a promise to start anew unhampered by the pressure and discouragement of pre-existing debts. Since a discharge of debts entails a clear departure from the non-bankruptcy law, where the underlying principle dictates that debts ought to be paid, it should be justified. The objective of the dissertation is to identify what considerations should a debt relief procedure in general take into account from legal and economic perspective and to what extent the Czech legal framework reflects such considerations.

Apart from the introduction and conclusions, the main part of the thesis is divided into six chapters. The first two chapters approach the topic from a general perspective and examine key notions, fundamentals of bankruptcy law, and rationales behind a debt relief procedure together with its drawbacks. The author argues that a debt relief procedure brings about several economic advantages on the basis of which it may be justified. Other unrelated rationales exist as well. Yet, the legislature must certainly consider also its negative implications. Apart from examining these downsides, the dissertation also outlines measures which may help to cope with the drawbacks. In short, in order to obtain a relief from debts debtors must pay the respective price - be it a sale of their assets or a duty to repay their debts during the repayment plan together with other constraints.

Subsequent parts of the dissertation shift focus on how the abovementioned aspects have been implemented in the Czech Republic. More specifically, chapter 4 deals with preconditions for discharge of debts (including the eligibility of entrepreneurs, requirement of honesty and mandatory repayment of unsecured debts). The thesis observes how the respective preconditions are interpreted, what deficiencies they entail and how the Czech legal framework balances the interests of the respective stakeholders.

Chapter 5 examines the process of distributive decision-making within discharge of debts, thereby capturing the avenue from the submission of an insolvency motion, via

rulings on motion for discharge of debts to a relief from debts, together with debtor's duties in the proceedings. In this connection, the dissertation particularly analyses how discharge of debts in the Czech Republic motivates debtors to maximize the value for creditors and prevent them from abusing discharge of debts.

Chapter 6 answers the question what roles the respective stakeholders play in discharge of debts. Having considered findings in previous chapters, the author argues that the role of the debtor in discharge of debts is rather limited whereas the court holds the role of the gatekeeper of utmost importance. Also, it observes that with the upcoming changes, more burdens will be shifted to the insolvency trustees.

Finally, the dissertation also addresses the topic of a debt relief procedure from a comparative perspective. In this connection, the dissertation focuses on what aspects the EU and INSOL Europe upholds, and argues that a debt relief procedure has become an integral part of modern bankruptcy laws. Also, the thesis briefly observes how the fresh-start policy implying a debt relief has been implemented in other Visegrad countries.

Statistical data about the thesis:[1137]

Number of pages:	231
Number of words:	63,342 (102,702)
Number of characters with spaces:	397,288 (647,641)
Number of footnotes:	1,138
Number of cited sources:	485

[1137] Only the text of chapters 1 to 8, in brackets amounts with the footnotes.

11 Shrnutí a klíčová slova

Název: Právní a ekonomická analýza oddlužení

Klíčová slova: oddlužení, politika nového začátku, insolvenční řízení, návrh na povolení oddlužení, poctivost, osvobození od dluhů, právo a ekonomie

Shrnutí:

Oddlužení poskytuje dlužníkům vidinu začít znovu, aniž by byli zatíženi stávajícími dluhy. Vzhledem k tomu, že oddlužení předjímá zjevný odklon od neinsolvenčního práva, kde platí, že dluhy mají být splněny, musí mít své opodstatnění.

Cílem disertační práce je analyzovat otázku, jaké aspekty by mělo řízení umožňující dosažení osvobození fyzické osoby od části dluhů zohlednit, a jak těmto požadavkům odpovídá česká právní úprava *de lege lata*.

Text disertační práce je strukturou členěn (kromě úvodu a části shrnující závěry) do šesti kapitol. První dvě kapitoly se tématu oddlužení věnují z teoretického pohledu a rozsáhle analyzují východiska pro uchopení dalších částí textu, účel insolvenčního práva, jakož i důvody pro i proti zavedení oddlužení. Autor argumentuje, že oddlužení přináší řadu pozitivních aspektů, přičemž jej lze odůvodnit i na základě jiných než ekonomických důvodů. Zákonodárce nicméně nesmí opomenout i stinné stránky oddlužení. Vedle popisu negativních dopadů disertační práce navrhuje, jakým způsobem by se s nimi mohl zákonodárce vypořádat. Klíčem přitom, zjednodušeně řečeno, je, že dlužník musí za osvobození od dluhů nést odpovídající břímě, jako je rozprodej majetku nebo plnění splátkového kalendáře společně s dalšími omezeními, které řízení přináší.

Další kapitoly disertační práce se zaměřují na problematiku, jak se teoretická východiska promítla do českého právního řádu. Čtvrtá kapitola se konkrétně zaměřuje na předpoklady oddlužení (včetně podmínek přípustnosti oddlužení u podnikatelů, požadavku poctivosti a povinného uspokojení nezajištěných pohledávek). Disertační práce v tomto ohledu zkoumá, jak jsou podmínky oddlužení vykládány soudní praxí, jaké slabiny předjímají a jak právní úprava v České republice vyvažuje zájmy jednotlivých aktérů.

Pátá kapitola se věnuje rozhodovacímu procesu v rámci oddlužení směřujícímu k uspokojení pohledávek věřitelů, přičemž popisuje řízení od podání insolvenčního návrhu,

přes rozhodování o návrhu na povolení oddlužení až po konečné osvobození od dluhů, a to společně s jednotlivými povinnostmi dlužníka v řízení. V tomto ohledu disertační práce zejména zkoumá, jak právní úprava oddlužení motivuje dlužníka k maximalizaci uspokojení věřitelů na jedné straně, a jak zabraňuje zneužití oddlužení ze strany dlužníků na straně druhé.

Šestá kapitola popisuje, jakou roli jednotliví aktéři mají v procesu oddlužení. Vycházeje ze závěrů předchozích částí autor argumentuje, že role dlužníků je v oddlužení spíše omezená. Rozhodující úlohu hrají dosud znatelně přetížené soudy jakožto strážci zákonnosti řízení. S přijatými změnami lze nicméně očekávat, že by soudy měly být částečně odbřemeněny na úkor insolvenčních správců.

Disertační práce se nakonec zabývá tématem oddlužení i z komparativního hlediska. Kapitola sedm poukazuje na aspekty, které podle dokumentů EU a INSOL Europe jsou pro oddlužení stěžejní, a potvrzuje, že oddlužení se stalo součástí moderního insolvenčního práva. Disertační práce přitom poukazuje i na právní úpravu jiných zemí Visegrádské čtyřky.

Statistické údaje o práci:[1138]

Počet stran:	225
Počet slov:	63.342 (102.702)
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[1138] Jen čistý text kapitol 1 až 8, v závorce údaj včetně poznámek pod čarou.